United States Economic Performance

Barry Bosworth
Brookings Institution
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Economic Recovery Perceived As Complete

• Resource utilization near full-employment levels
  – Unemployment at 5.6% and projected lower
  – Capacity utilization at historical norm
  – GDP growth projected at 3-3½% for 2015
• However, most of adjustment is on the supply-side.
  – Smaller labor force and capital stock
  – Reduced estimates of potential GDP
Actual and Potential GDP
trillions of dollars

Sources of Optimism

- Budget battles and fiscal drag largely over
- High consumer optimism with consumption increases in line with income growth
- Energy price collapse provides a strong boost to domestic demand
- Business investment has returned to pre-crisis rate.
- Core-inflation is well-below target of 2%.
- External deficit (3% of GDP) is well-below pre-crisis level.
Sources of Concern

- Weak global economy
  - Can the United States sustain growth as an outlier
  - Major divergence of monetary policies
  - Very large exchange rate appreciation will drag down trade performance.

- Weak recovery of housing market
- Poor productivity performance is limiting real wage growth.
Trade-Weighted Real Exchange Rate: China and the United States

Year/Quarter

Index


Trade-Weighted Real Exchange Rate: Euro Area and Japan

Year/Quarter

Index

Normalization of Monetary Policy

- FRB intention to begin raising federal funds rate in 2015
  - Timing is dependent on growth
  - Growth above 3% suggests increase at midyear
  - Less than 3% implies delay into the fall
  - Substantial increase already factored into bond rates.
  - Optimistic growth projections, such as IMF, suggest a funds rate of 1-2% in 2016.

Ten-year Bond Rates

![Graph showing ten-year bond rates for the United States, Germany, and Japan from 2005:1 to 2014:1.](image-url)
Supply-side Revisions

- Large decline in labor force participation
  - Not foreseen in earlier projections.
  - Largely demographically induced - aging of population of labor force age.
  - Discouraged worker component fades at very gradual rate.
- Cyclically-induced fall in capital accumulation
- Lower anticipated growth in TFP

Actual and Demographically-Adjusted Labor Force Participation, 2000-2022
Employment-Population (16+) Ratio

CBO Revisions to Potential GDP Growth
annual percentage change

<table>
<thead>
<tr>
<th></th>
<th>2007 projections</th>
<th>2014 projections</th>
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</thead>
<tbody>
<tr>
<td>Potential Output</td>
<td>2.6</td>
<td>2.5</td>
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<tr>
<td>Total Economy</td>
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<td></td>
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<tr>
<td>Potential Labor</td>
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<td>0.5</td>
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<tr>
<td>Force</td>
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<td>Potential Labor</td>
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<td>2.0</td>
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<td>Force Productivity</td>
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Nonfarm Business Sector:

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<tr>
<th>Contribution from:</th>
<th>2007 projections</th>
<th>2014 projections</th>
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<tbody>
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<td>Potential Hours</td>
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<tr>
<td>Capital Services</td>
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<td>Potential TFP</td>
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<tr>
<td>Total</td>
<td>3.1</td>
<td>2.9</td>
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Source: CBO, An Update to the Budget and Economic Outlook: 2014 to 2024.

Real Wage Growth

- Recovery of overall economy not matched by greater growth in real wages.
  - Slow productivity growth (return to 1972-95 pattern)
  - Significant decline in labor’s share
  - Small effect from terms of trade
  - Slower growth in fringe benefit costs provides a small improvement.

- Problem is intensified by continued increase in income inequality.
Changes in Productivity and Real Wages, 1947-2014

<table>
<thead>
<tr>
<th>Period</th>
<th>Output per hour</th>
<th>Hourly Compensation (Output Price)</th>
<th>Hourly Compensation (Consumption Price)</th>
<th>Hourly Wage (Consumption Price)</th>
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<tbody>
<tr>
<td>1947-72</td>
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<td>2005-2014</td>
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