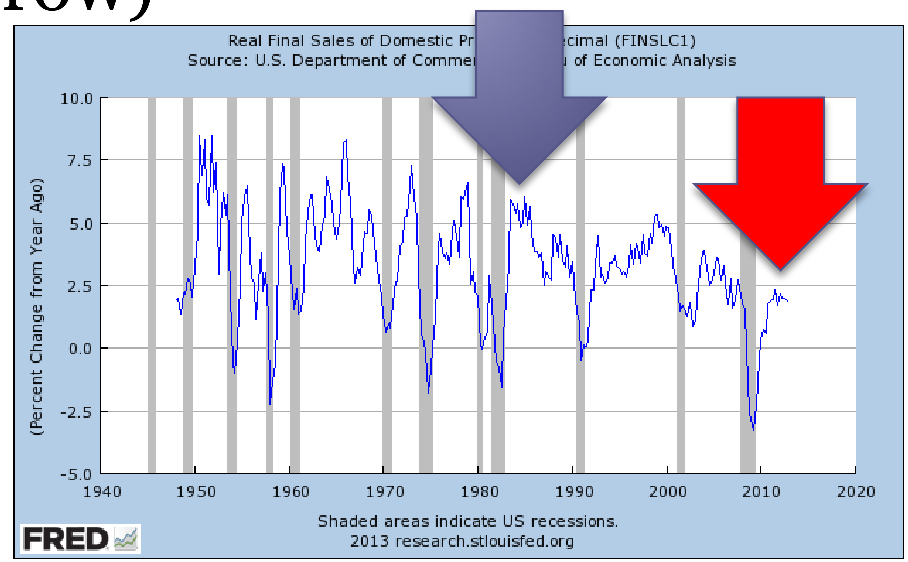
The Outlook for the U.S. Economy

Thomas D. Simpson, Ph.D.
Department of Economics and Finance
UNCW
March 4, 2013

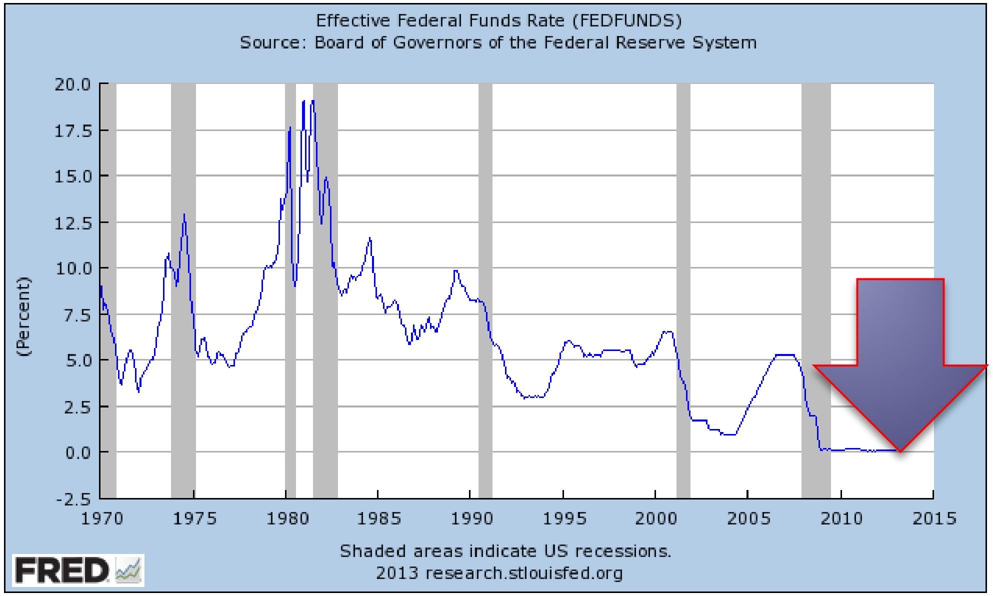
Growth Remains Sluggish

- Growth in aggregate demand in this recovery (red arrow) has been the most tepid
- Notably weak in relation to the 1982 recovery (blue arrow)



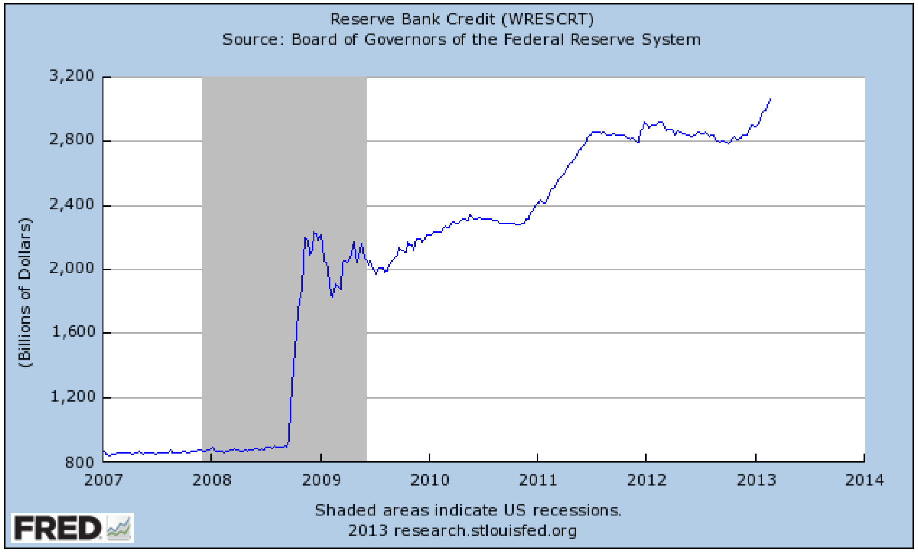
Despite Unprecedented Monetary Stimulus

- Target for the policy interest (federal funds) rate has been at zero since December 2008



Augmented by Massive Asset Purchases

- Fed assets soared from $800 billion to more than $3 trillion and are growing at a $1 trillion rate



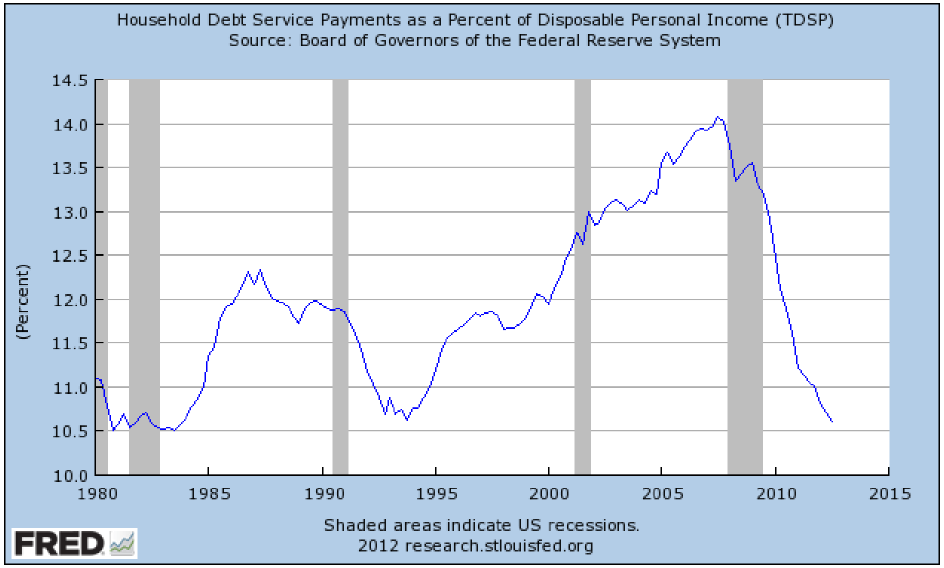
- Been accompanied by forward guidance

Headwinds

- Households had been overextended with debt
- Huge losses at key financial institutions precipitated a severe credit crunch
- Led to a vicious interaction between the credit mechanism and the economy
- Difficulties in Europe—southern rim
- State and local governments forced into major cutbacks

Households Have Repaired Balance Sheets

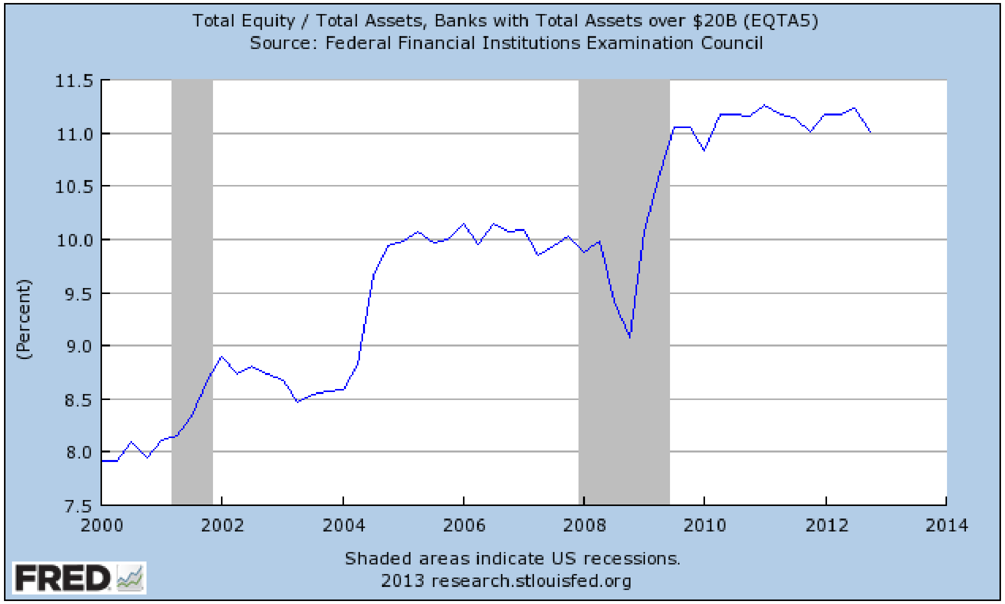
- Debt service strains have eased considerably



- Achieved largely through more saving

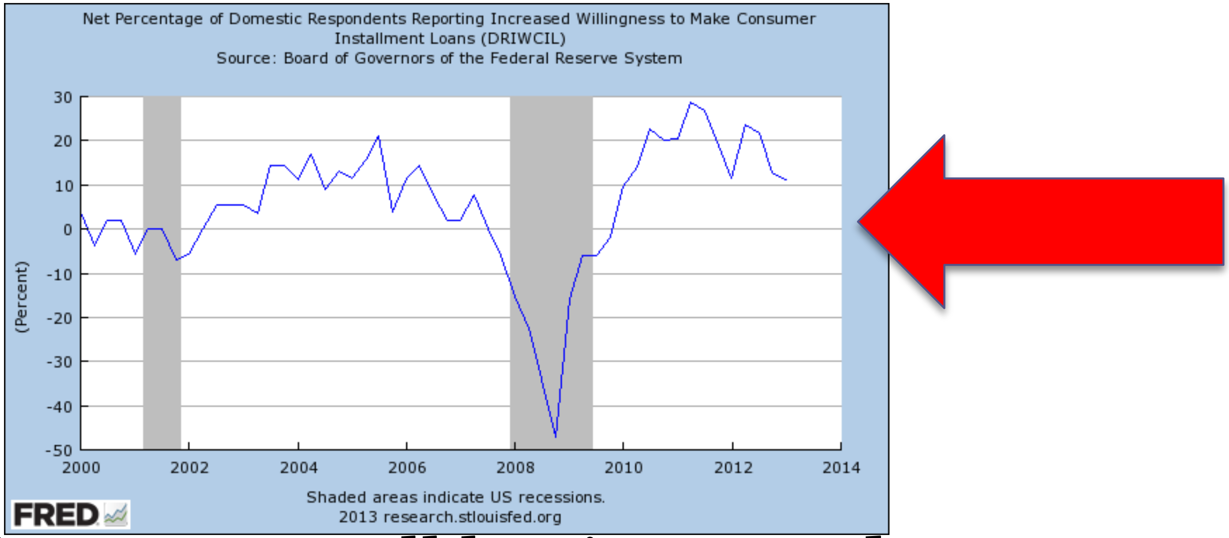
Banks Have Rebuilt Capital Positions

- Net worth, which influences the amount banks can lend, has been restored—and then some



Greater Bank Willingness to Lend

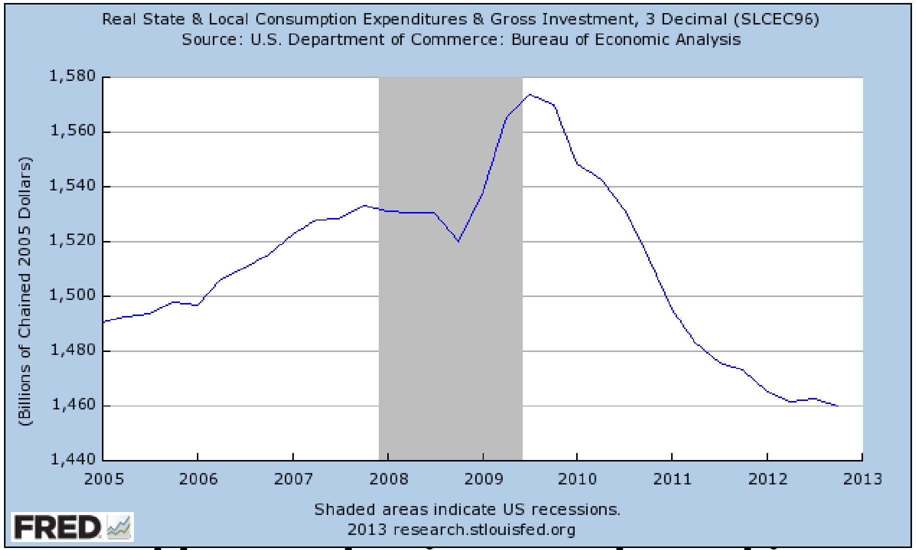
- Willingness to make consumer loans continues to improve (arrow at zero)



- Exceptions are small business and mortgage loans

Other Headwinds Mixed

- State and local budget strains easing and outlays have flattened



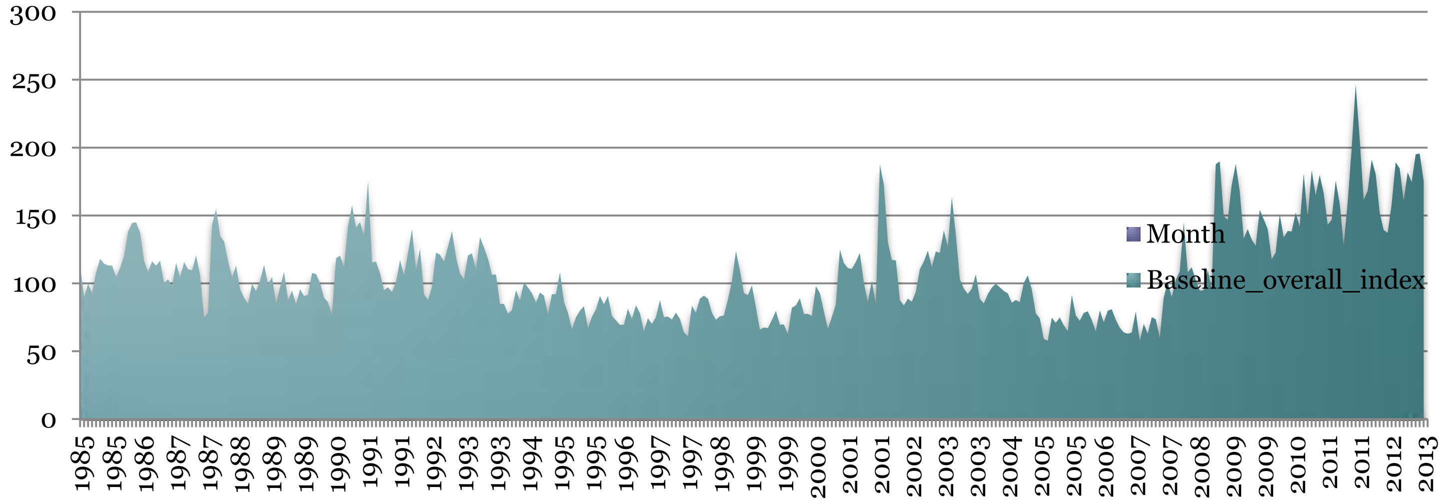
- Europe, though, is contracting and more belt-tightening is needed

Federal Fiscal Stance Has Swung to Restraint

- In contrast to the massive fiscal stimulus early in the recovery, federal fiscal policy is restrictive
- End of the temporary payroll tax reduction and boost to tax rates on higher incomes
- Sequestered spending cuts on March 1
- Trimming roughly 1-1/2 percentage points off growth this year

Political Uncertainty High

- Tensions holding index of uncertainty high



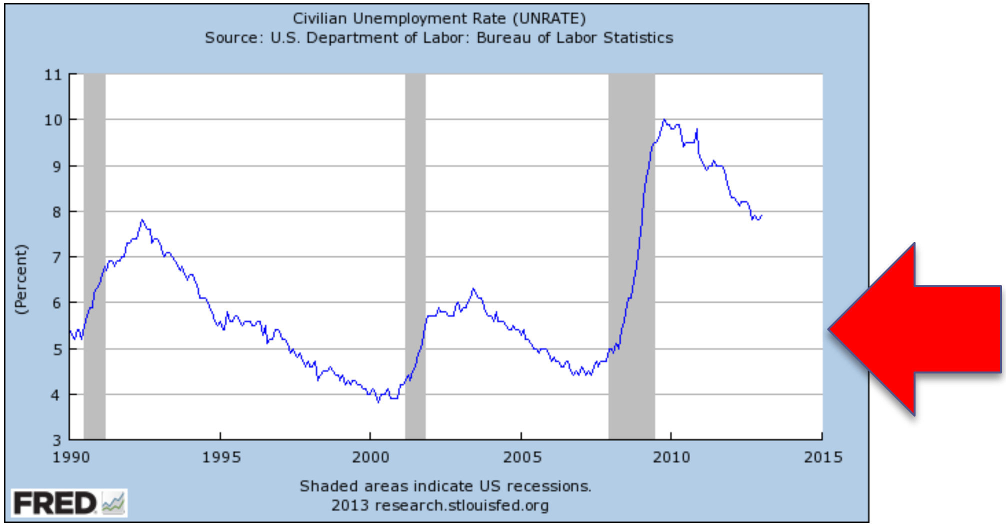
- Owes to concerns about budget and regulatory policies—and no consensus regarding solutions

Prospects for the Economy

- Despite improvements in balance sheets and credit availability, fiscal drag dominates the near term
- Real GDP is projected to grow this year around the 1-3/4 percent pace of 2012
- This falls short of the capacity of the economy to grow

Unemployment Unlikely to Drop

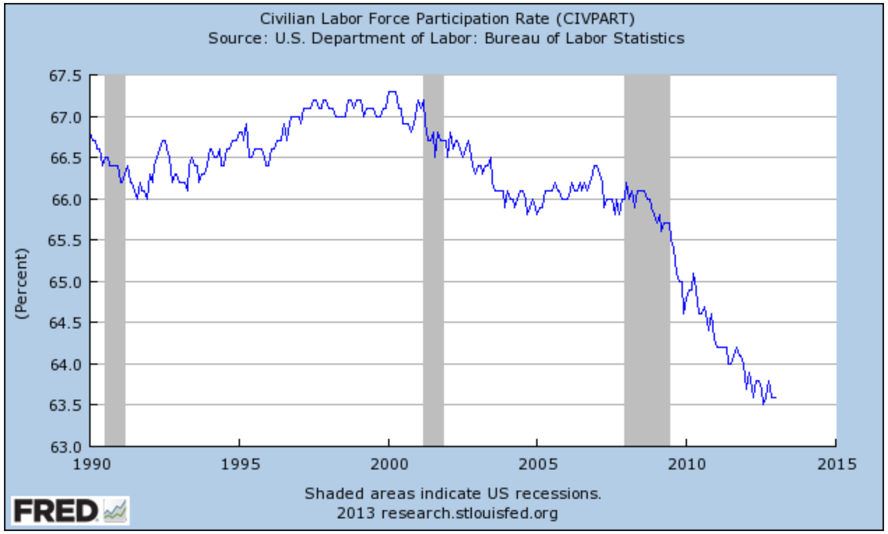
- With subpar growth, unemployment will be stubborn to decline



- Will stay well above the 5-1/2 percent rate consistent with normal conditions (arrow)

Participation Will Hold Up the Unemployment Rate

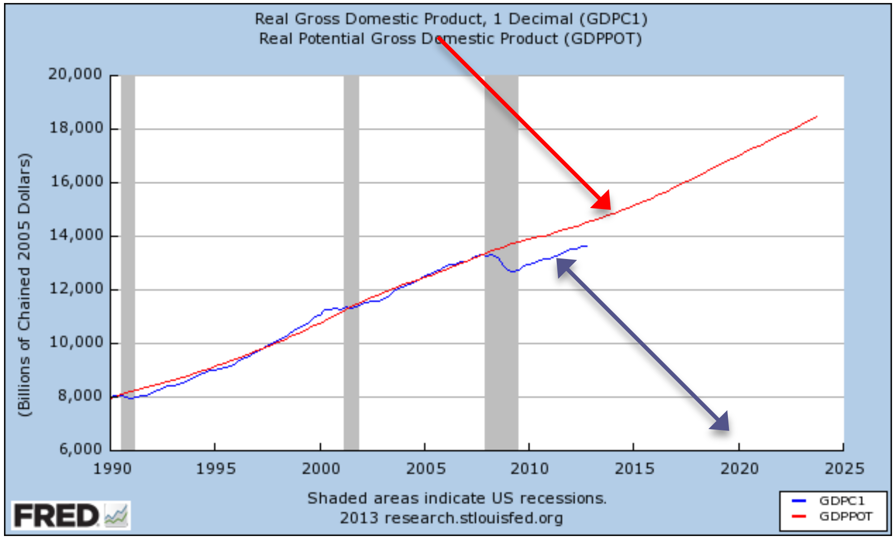
- Participation is at a very low level



- As discouraged workers return to the labor force, measured unemployment will be held up

Beyond 2013

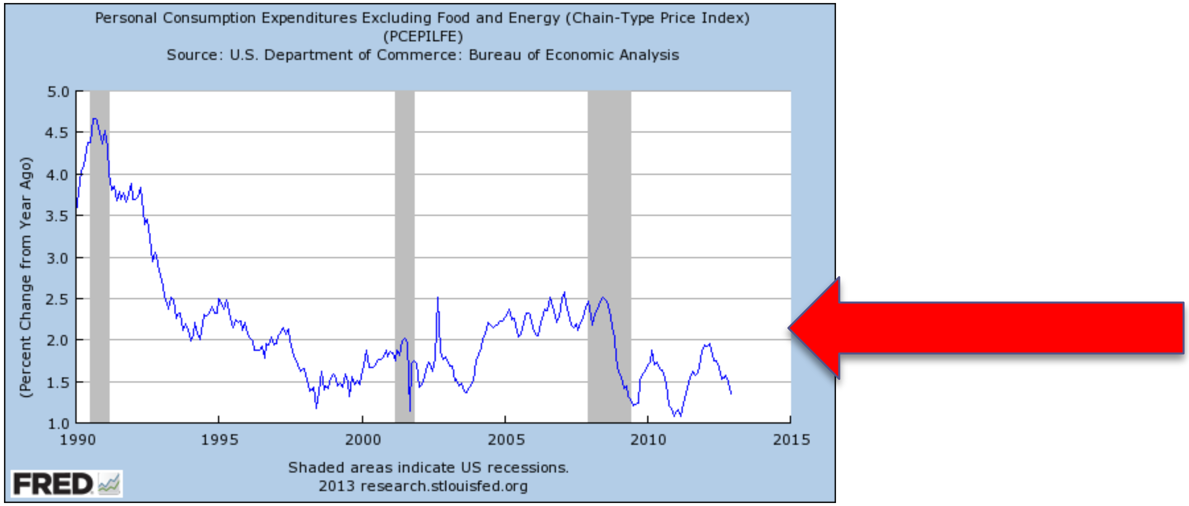
- Output growth should strengthen, but only to 3 percent or so—not enough to trim much slack



- Huge gap between actual (blue) and potential output (red) will close only gradually

Inflation Will Remain Subdued

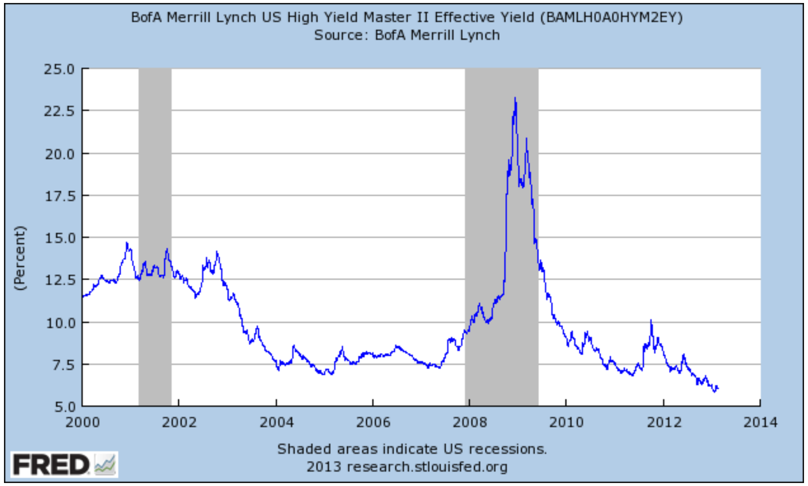
- Slack will keep inflation below the Fed's 2 percent target (red arrow)



- Even as the dollar is likely to drift down

Frictions to Watch: Monetary Policy

- Within the Fed, divisions over aggressive accommodation are sharpening



- Growing talk of fostering the next bubble, illustrated by extremely low junk bond yields

Budget Policy

- Beyond the March 1 sequester, authorization for federal programs ends on March 27
- Could be another unsettling battle and potentially a shutdown
- In addition, debt-ceiling suspension ends on May 18, inviting still another brawl
- Given major differences, little in the way of permanent solutions can be expected--implying more downgrades

Bottom Line

- Conditions in the private sector are favorable for solid expansion
- However, worries over public policies—both budget and monetary—are likely to be a damper
- The economy will continue to disappoint