The Outlook for the U.S. Economy: Slowly Gathering Strength

David J. Stockton

Senior Fellow
Peterson Institute for International Economics

Senior Adviser
Macroeconomic Advisers, LLC

April 1, 2013
Modest Pickup in Activity with Inflation Below Target

<table>
<thead>
<tr>
<th>Forecast</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP Growth (Q4/Q4)</td>
<td>1.7</td>
<td>2.3</td>
<td>3.1</td>
<td>3.3</td>
</tr>
<tr>
<td>Unemployment (Q4)</td>
<td>7.8</td>
<td>7.6</td>
<td>7.1</td>
<td>6.4</td>
</tr>
<tr>
<td>PCE Price Inflation (Q4/Q4)</td>
<td>1.6</td>
<td>1.6</td>
<td>1.7</td>
<td>1.8</td>
</tr>
<tr>
<td>Core PCE Price Inflation (Q4/Q4)</td>
<td>1.5</td>
<td>1.6</td>
<td>1.8</td>
<td>1.9</td>
</tr>
</tbody>
</table>

Note: Gray-shaded areas represent 70% confidence bands.

April 1, 2013
Foreign Activity Assumptions

- **Euro Area:** Flat activity, on net, for the year as a whole. Only slight improvement thereafter, with growth of about ½ percent in 2014 and about 1 percent in 2015.

- **UK:** Meager growth this year of around ½ percent, followed by modest acceleration to 1½ percent in 2014 and 2 percent in 2015.

- **Japan:** After a small upward blip this year, growth of real output runs around 1 percent in 2014 and 2015.

- **China:** Growth in the range of 8 to 8½ percent.

- **Other Emerging and Developing Economies:** A mixed bag, but generally solid if unspectacular growth.

- **Bottom Line:** External sector is a neutral for U.S. growth in 2013 and a small positive in both 2014 and 2015.
Household Financial Conditions Will Continue to Improve

Households Reduce Financial Obligations

*The ratio of debt-service payments to disposable personal income. Debt-service includes estimated required payments on outstanding mortgage and consumer debt, plus auto lease payments, rental payments on tenant-occupied property, homeowners' insurance, and property tax payments.

**Nonaccrual loans and loans past due 30 days or more and still accruing interest.

Source: Federal Reserve Board; Last data plotted for household financial obligation ratio is Q4-2012 for consumer loan delinquency rate is Q4-2012.

April 1, 2013
Housing Recovery: More In Train

House Prices

3-month annualized percent change

- Case-Shiller Composite 20
- CL-HPI

Private Housing Starts

Thous. Units, SAAR

Source: Haver Analytics.

April 1, 2013
Production Indicators

No *Clear* Breakout Yet, and None for a While

*Estimate; assumes nonfarm payroll increase of 175,000 in March.*

Source: Haver Analytics.
From Fiscal Stimulus to Fiscal Drag

Change in high-employment deficit / previous-year potential GDP

Note: Budget deficit without automatic stabilizers. Source: Congressional Budget Office.
Monetary Policy: Looser for Longer

Federal Funds Rate

- FOMC thresholds for a rate hike.
  - Unemployment rate crosses 6.5 percent.
  - Inflation one to two years ahead is projected to cross 2.5 percent.
- In this forecast, unemployment does not cross 6.5 percent until late 2015, and inflation does not approach the threshold.

Asset Purchases

- Asset purchases will continue until “outlook for labor market improves substantially.”
- Or, unless costs are judged to exceed benefits.
- This forecast assumes that QE3 continues until mid-2014, with QE3 purchases totaling $1.5 trillion.
Labor Market Slack Will Remain Sizable

Source: Peterson Institute, Macroeconomic Advisers, Haver Analytics.
No Inflation Problem

Source: Haver Analytics.
Little Inflation Risk from Declining Slack

Change in Core PCE Inflation (percentage points)

Year-Average Unemployment Rate (%)

Source: Macroeconomic Advisers and Haver Analytics.
Stable Inflation Expectations: Help Keep Fed on Hold

* Five-year-five-year forward breakeven inflation rates derived from yields on nominal Treasury securities and Treasury Inflation-Protected Securities (TIPS).

** Median forecast of PCE inflation over the next 10 years as reported in the Federal Reserve Bank of Philadelphia’s Survey of Professional Forecasters.

Modest Pickup in Activity with Inflation Below Target

### Forecast

<table>
<thead>
<tr>
<th>Forecast</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP Growth (Q4/Q4)</td>
<td>1.7</td>
<td>2.3</td>
<td>3.1</td>
<td>3.3</td>
</tr>
<tr>
<td>Unemployment (Q4)</td>
<td>7.8</td>
<td>7.6</td>
<td>7.1</td>
<td>6.4</td>
</tr>
<tr>
<td>PCE Price Inflation (Q4/Q4)</td>
<td>1.6</td>
<td>1.6</td>
<td>1.7</td>
<td>1.8</td>
</tr>
<tr>
<td>Core PCE Price Inflation (Q4/Q4)</td>
<td>1.5</td>
<td>1.6</td>
<td>1.8</td>
<td>1.9</td>
</tr>
</tbody>
</table>

Note: Gray-shaded areas represent 70% confidence bands.

April 1, 2013