

A LOOK BACK AT 2016
A LOOK FORWARD AT 2017
AND
WHAT COULD POSSIBLY GO WRONG?

NH Fiscal Policy Institute

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Looking back on 2016: A Time Line

Dec. 2015:
Fed raises rates
for first time
since pre-
recession

Feb.-Mar. 2016:
Oil prices up,
stock market
uncertain; Fed
on hold

September 2016:
We're not quite
sure; Fed on
hold

Dec. 2016:
Fed raises rates
for second time
since recession

"The Committee ...decided, for the time being,
to wait for further evidence of continued
progress toward its objectives."

"The Committee
is closely
monitoring global
economic and
financial
developments and
is assessing their
implications for
the labor market
and inflation..."

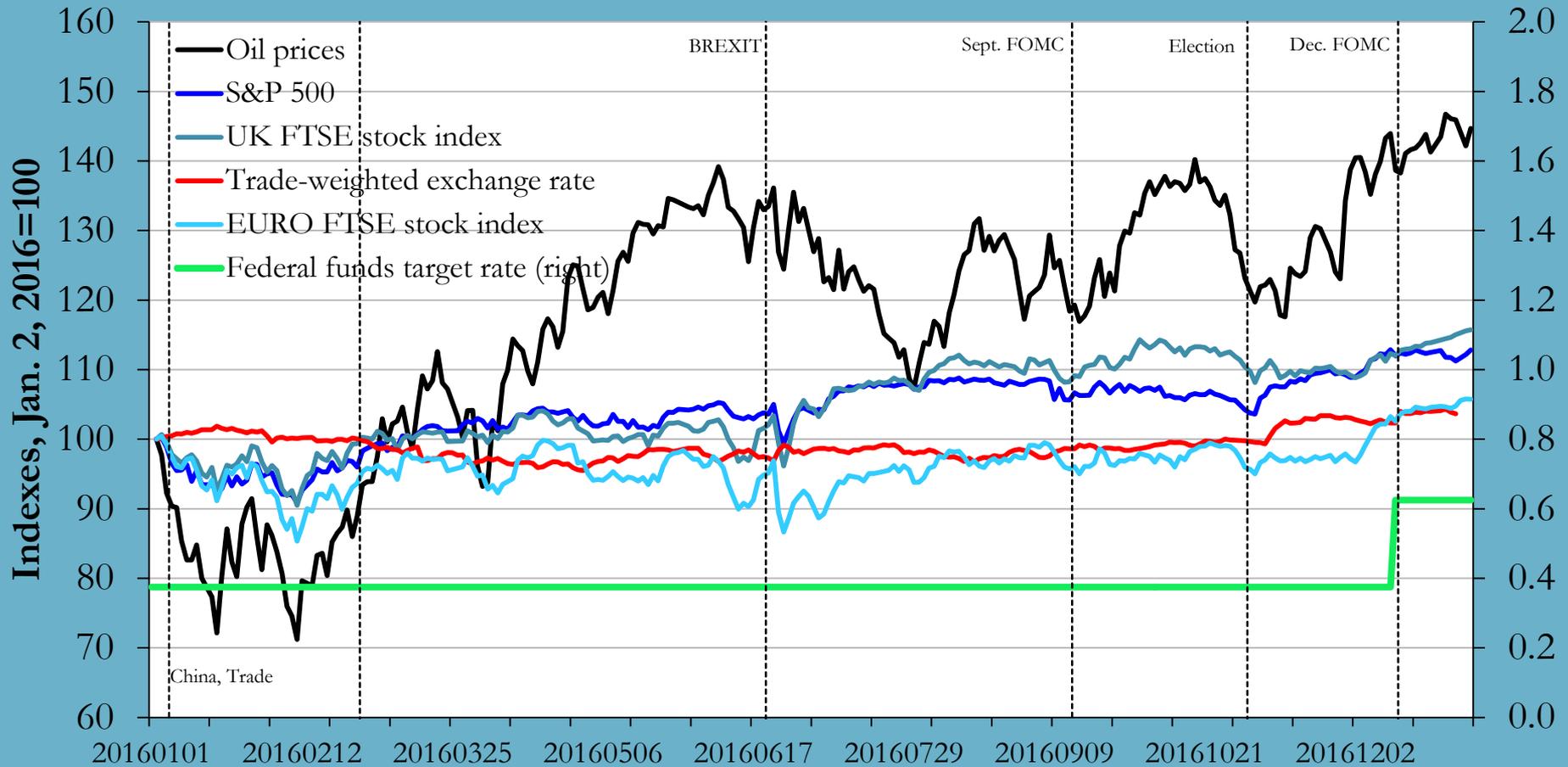
Jan. 2016:
Trade, China
threaten
recovery; oil
prices, global
stocks fall; Fed
on hold

June 2016:
stocks
recovered, but
BREXIT!!!
Fed on hold

November 2016:
Not quite ready
yet...

"The Committee judges that the case for an increase in the
federal funds rate has continued to strengthen but
decided... to wait for some further evidence of continued
progress toward its objectives."

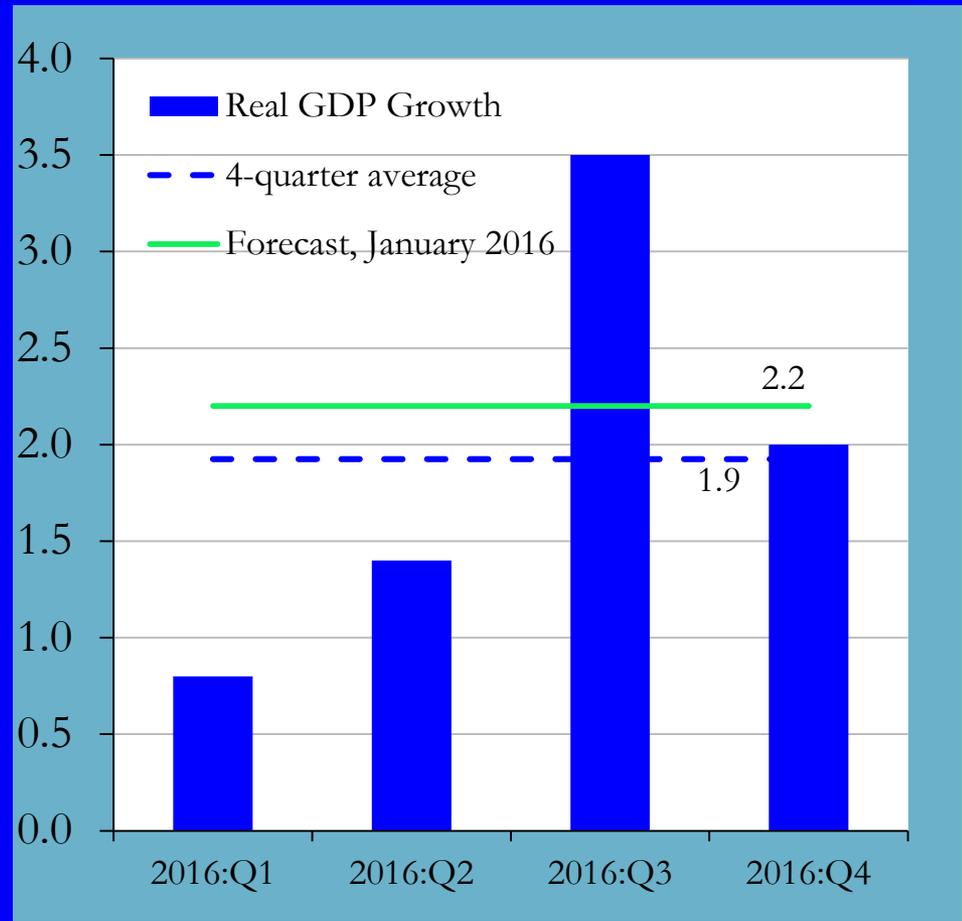
Another look at the time line



Sources: Wall Street Journal (oil prices), Financial Times (Euro and UK stock indexes), Standard and Poor's/NY Times (S&P 500), Federal Reserve Board H.10 (exchange rate), Board of Governors of the Federal Reserve System (federal funds rate), Haver Analytics

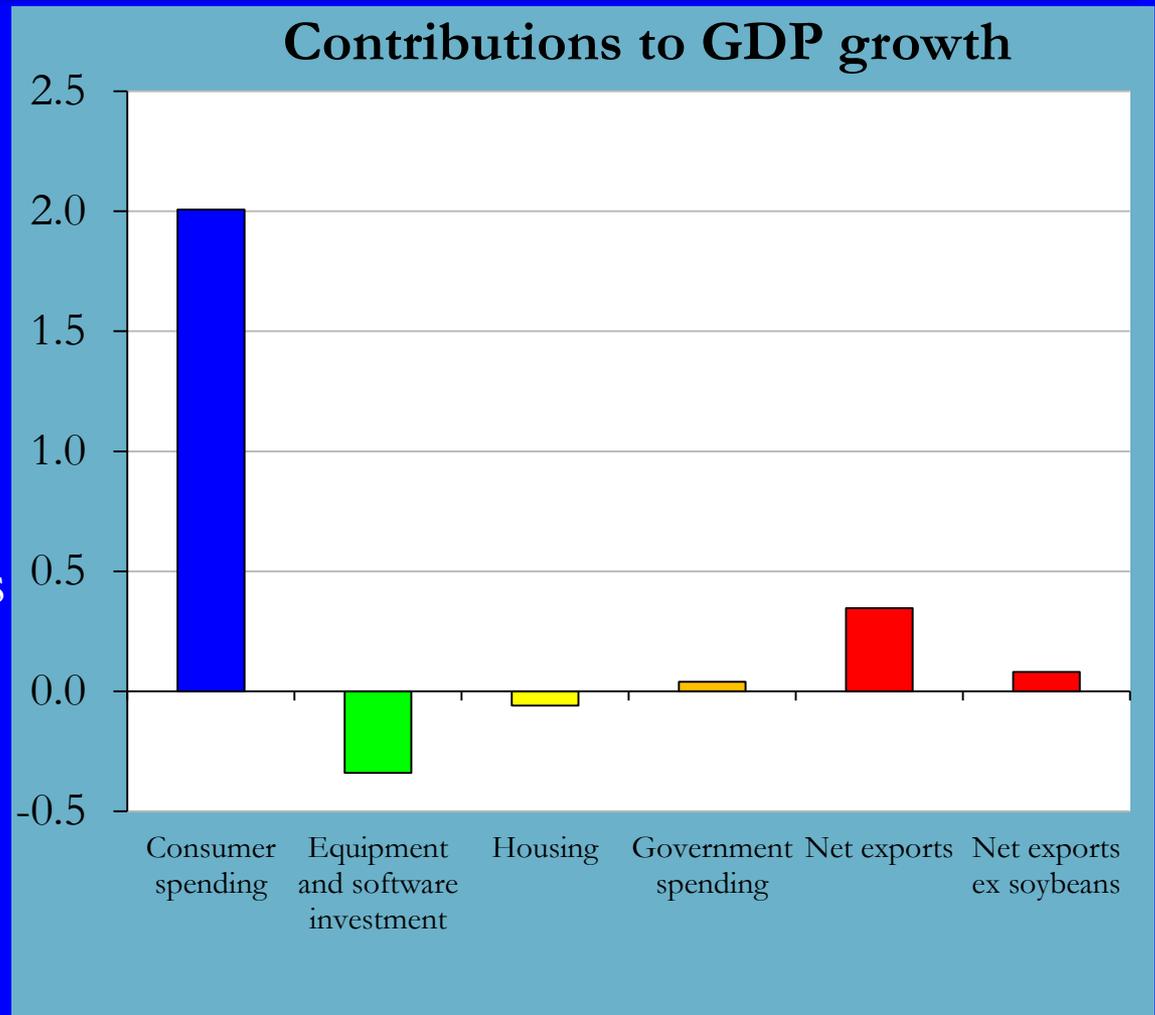
Looking back on 2016: GDP growth

- ▣ We don't know the Q4 number yet
- ▣ Probably around 2%
- ▣ But let's not focus *too much* on the quarterly numbers
- ▣ The average for the year: about 1.9% growth
- ▣ Our forecast at this time last year: 2.2% growth
- ▣ Why so slow? We'll come back to this

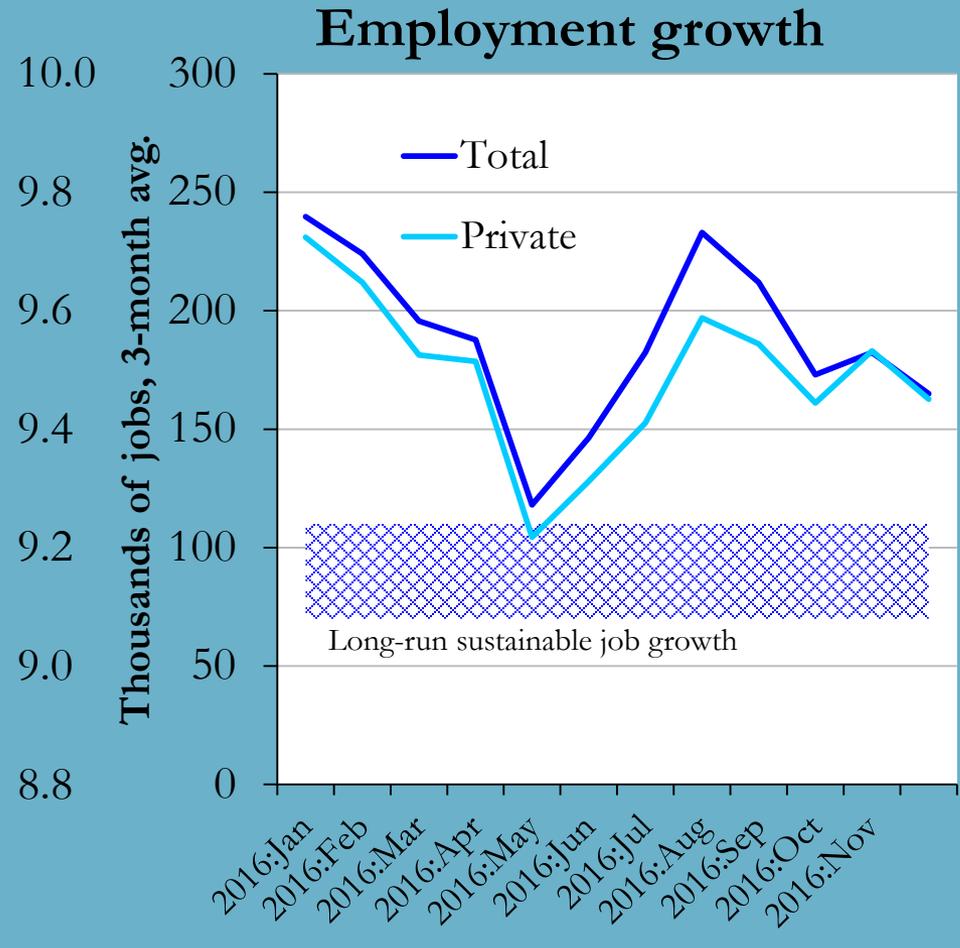
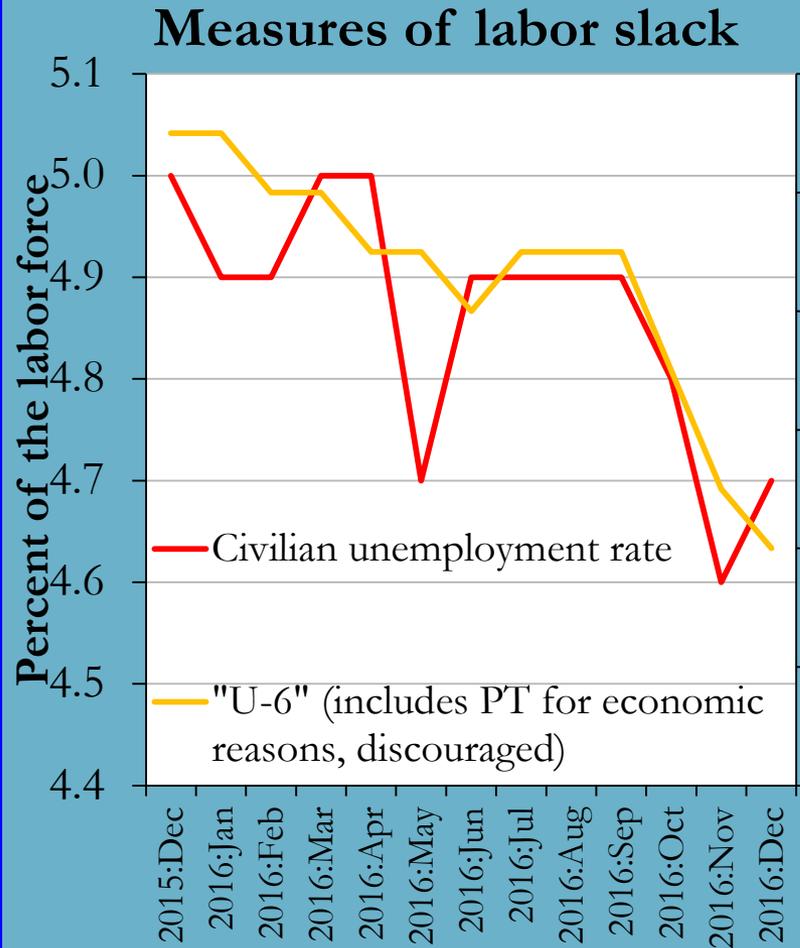


The main sources of support in 2016

- ▣ Consumer spending!
- ▣ Net exports?
 - Not really—artificially boosted by soybean exports in Q3



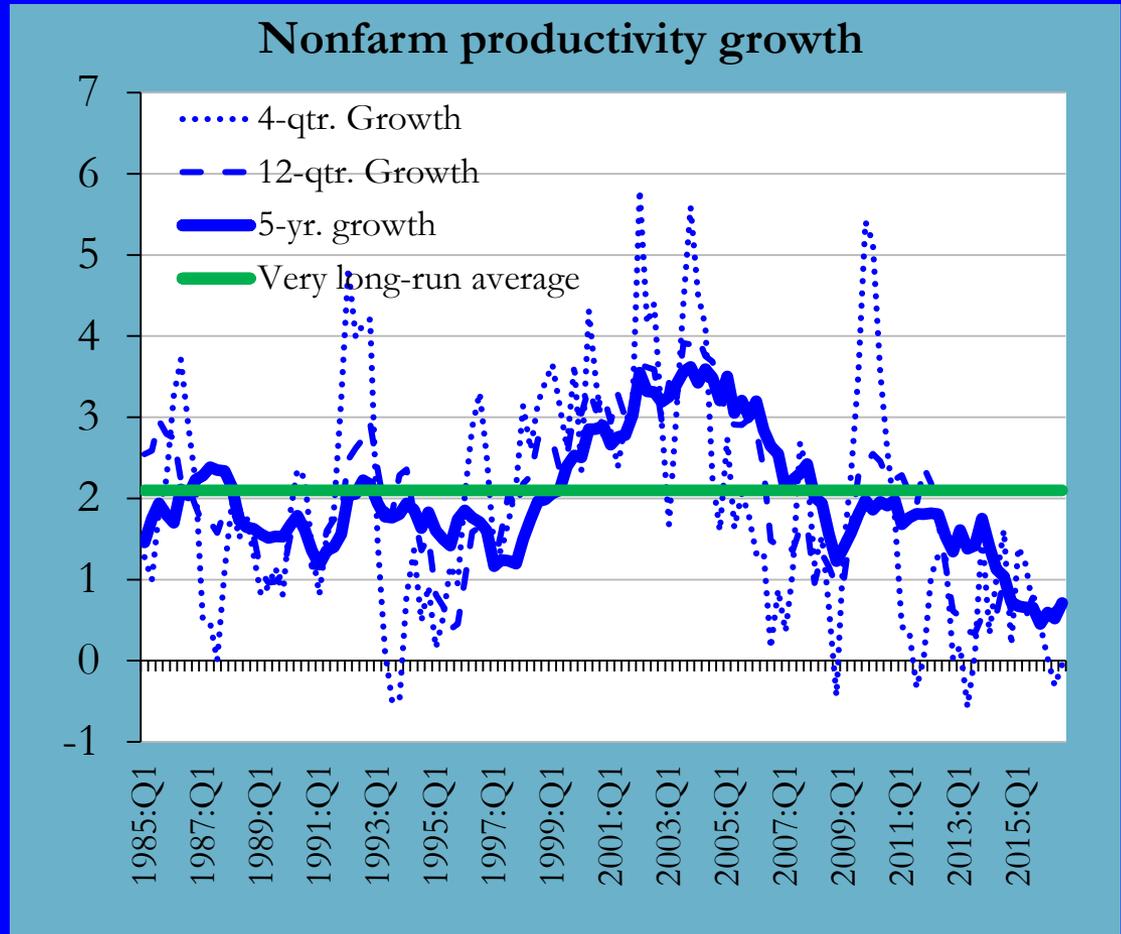
Looking back on 2016: Labor market progress



Why has growth been slow?

Longer-run factors

- ▣ Slower productivity growth
 - Long-run average is about 2%
 - Recently, 0.5%
- ▣ How persistent?
 - We don't know
 - Long-run history suggests a rebound
 - Depends on pace of investment, innovation and implementation of new ideas



Why has growth been slow?

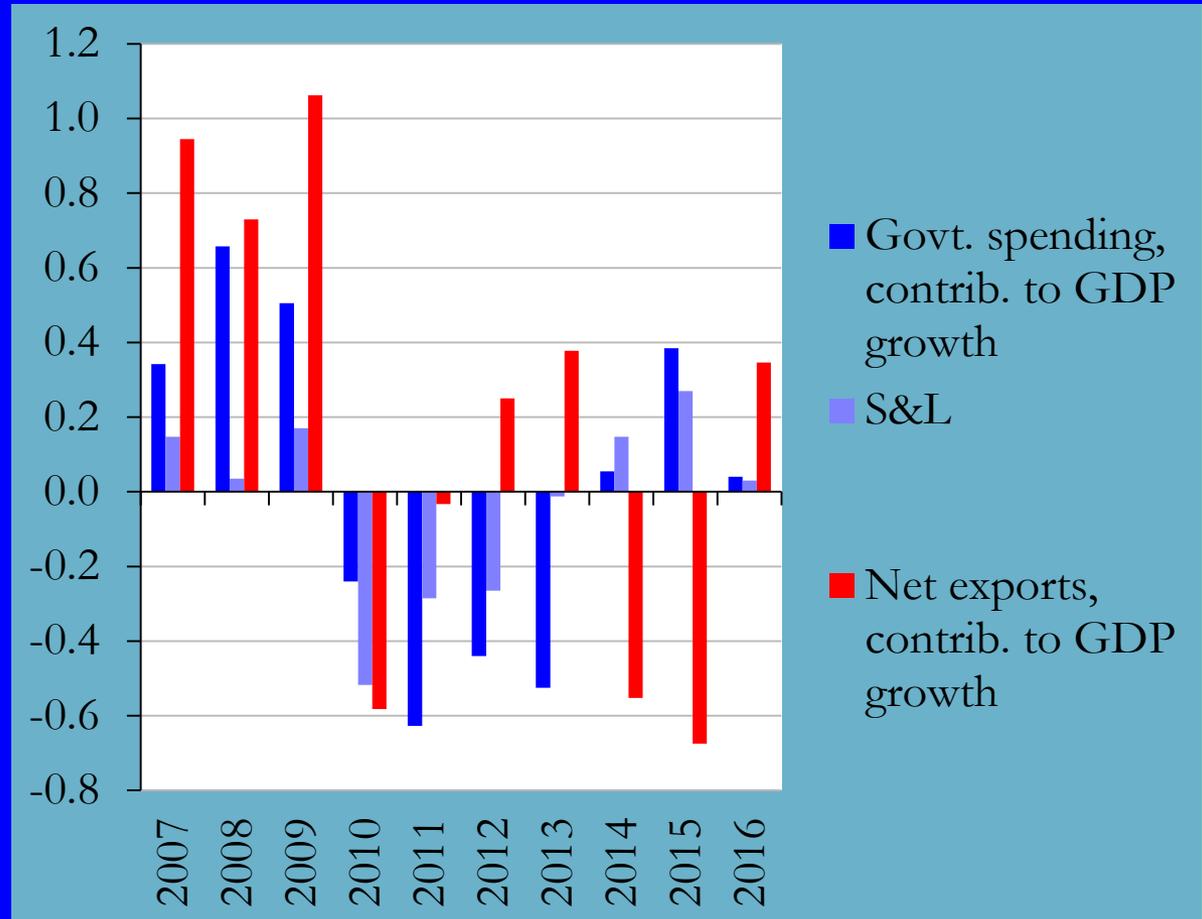
A few temporary factors

▣ Government spending

- Supported at first, but then not so much
- Both federal and state and local

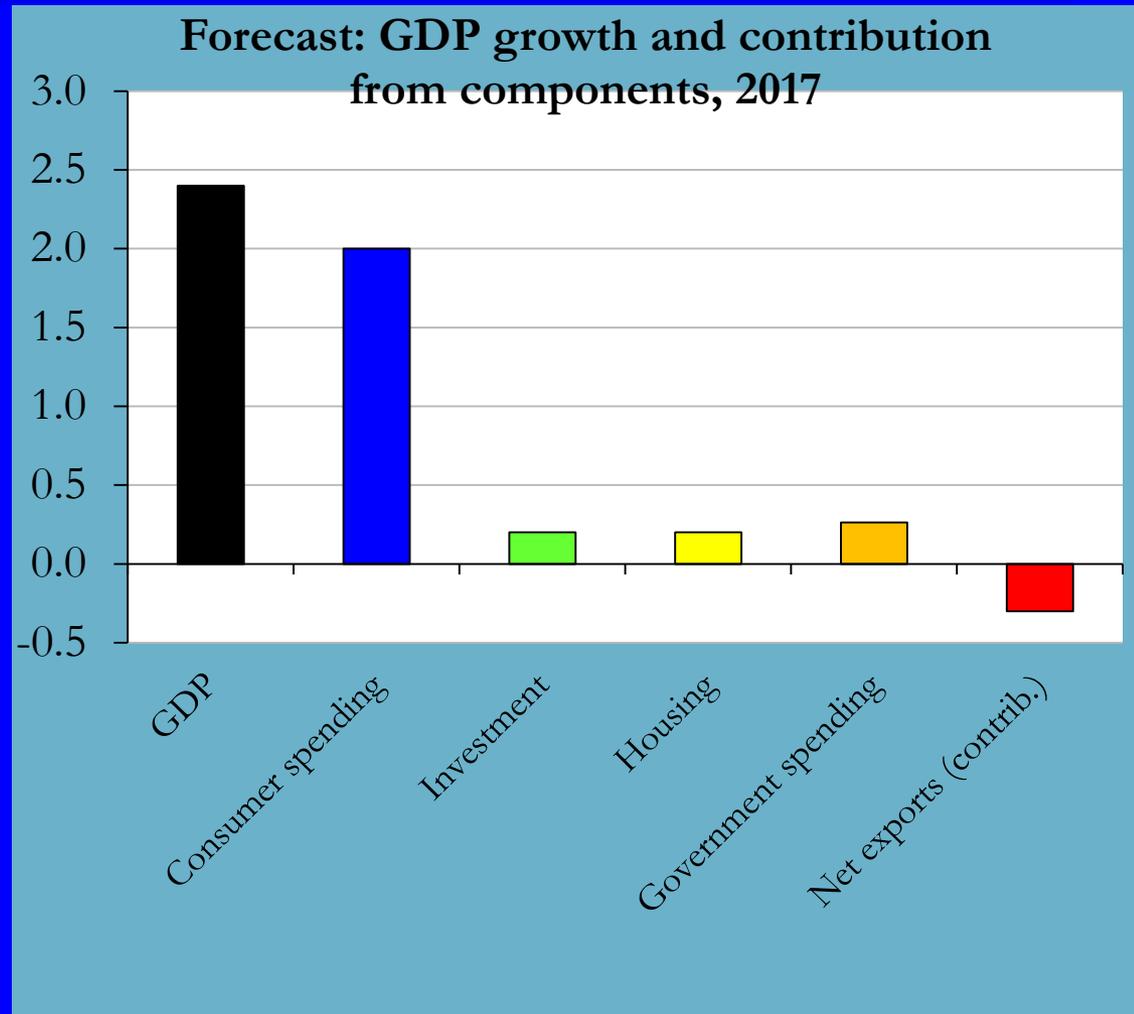
▣ Trade

- Foreign growth weak
- Dollar appreciation



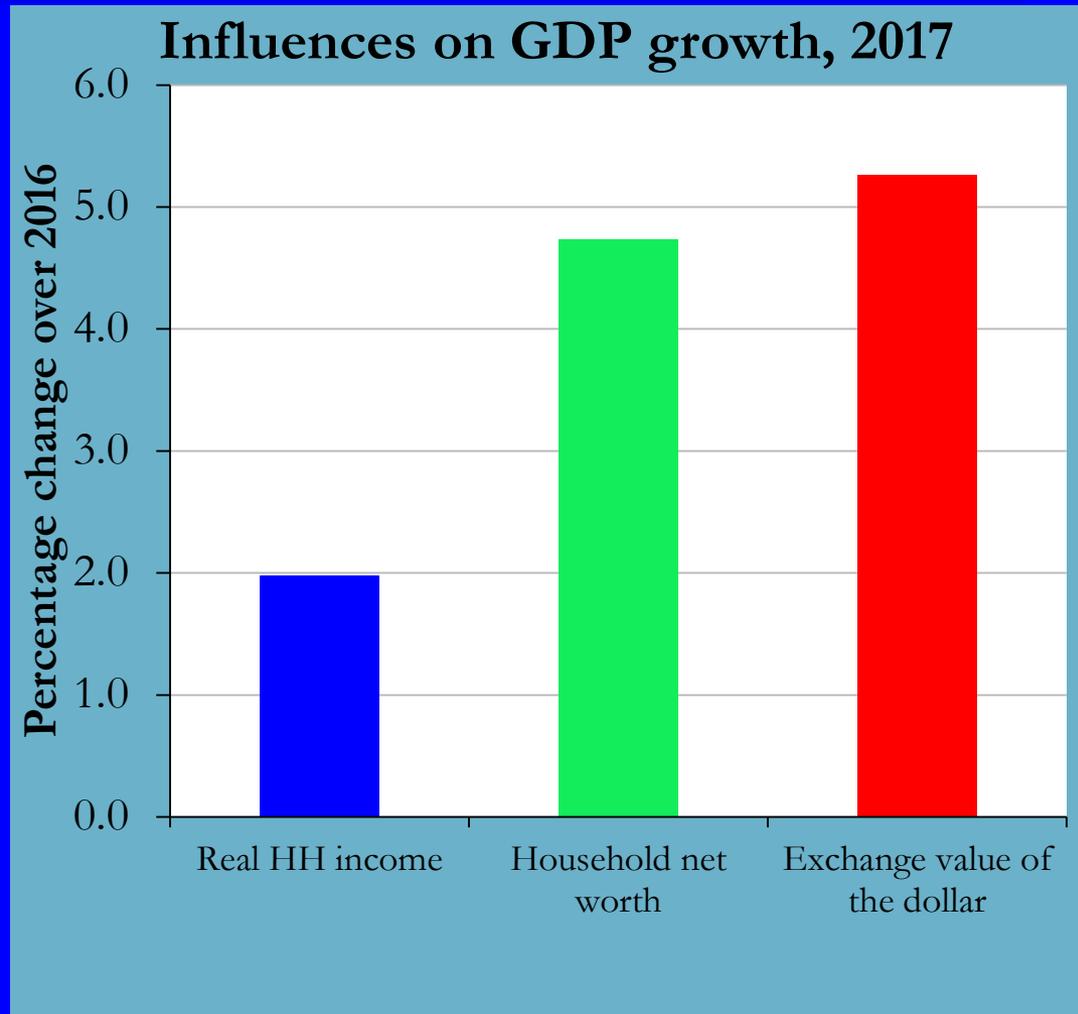
What to expect in 2017 (and beyond)...

- ❑ Consumer spending likely to hold up
- ❑ Small support from business, housing investment
- ❑ Uncertain support from federal government
- ❑ Drag from net exports



...and why

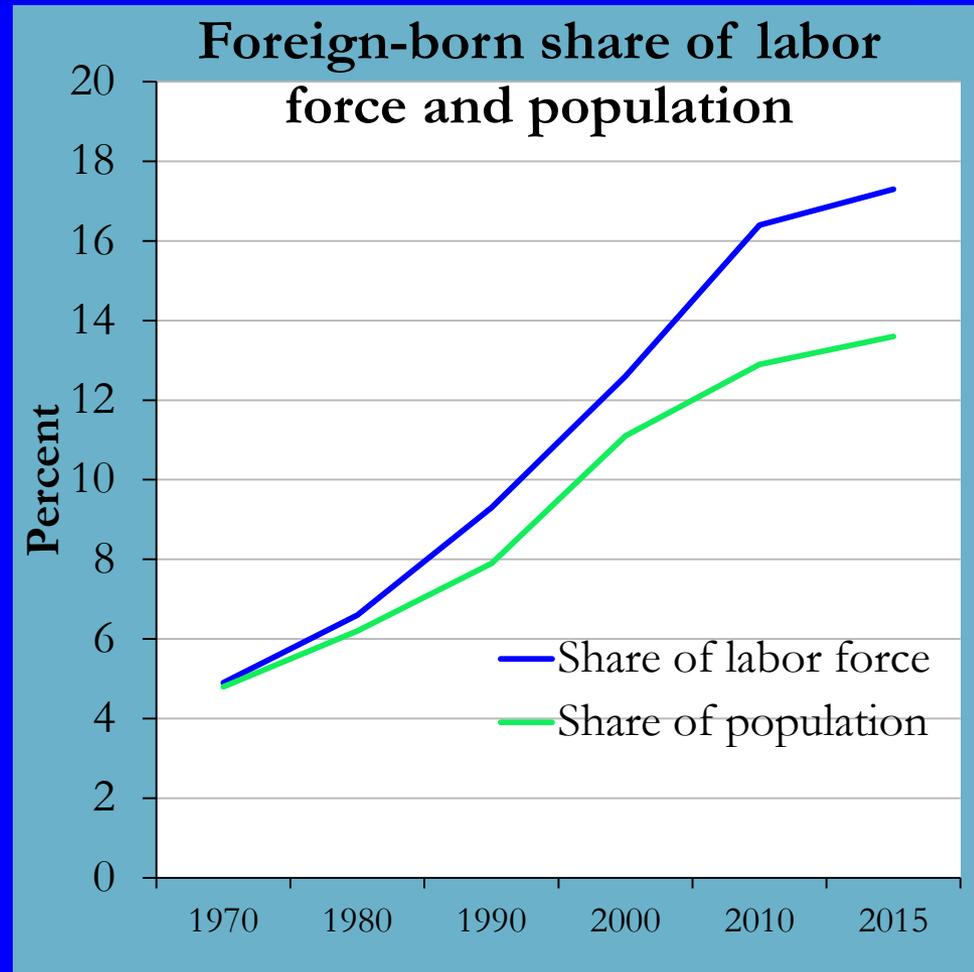
- ▣ Strong income and wealth growth boosts consumption
- ▣ Strong dollar and relatively weak foreign growth depress net exports



Sources: Bureau of Economic Analysis (HH income), Flow of Funds accounts (HH wealth), Board of Governors of the FRS (exchange rate), Haver Analytics

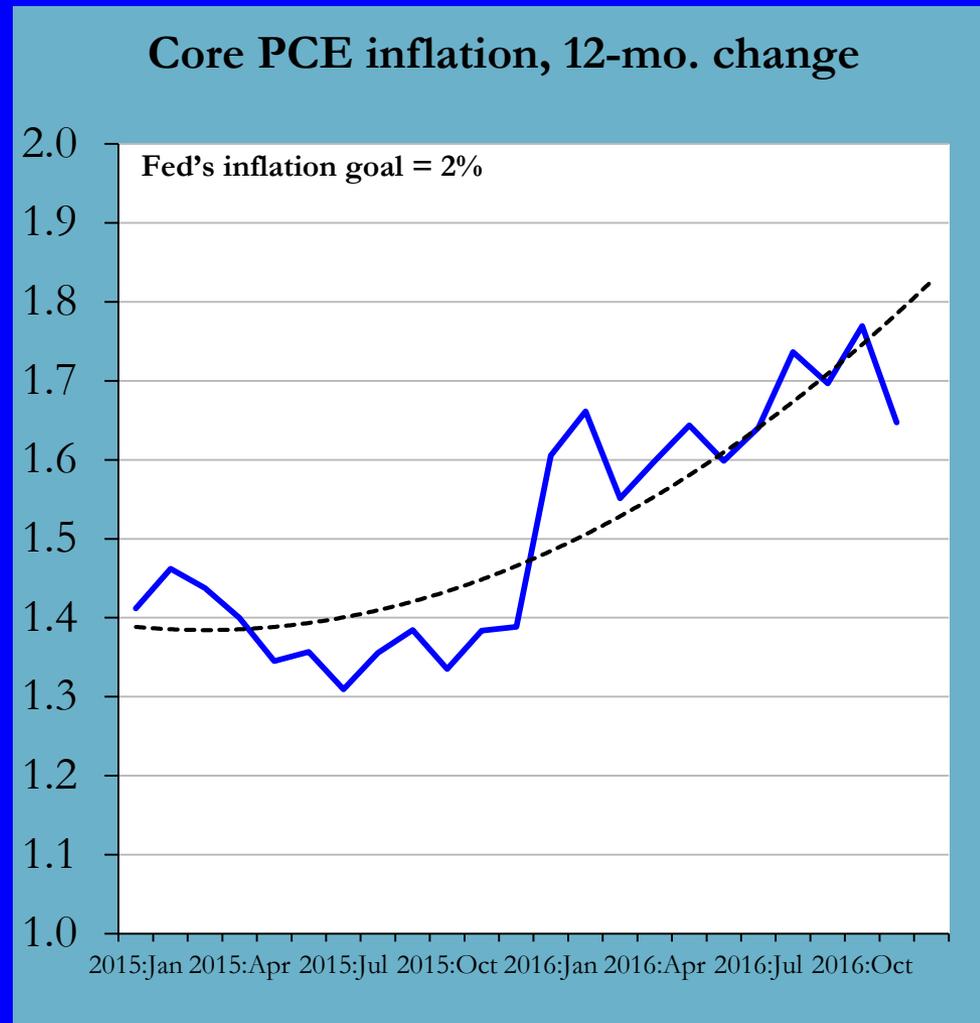
What could possibly go wrong with this outlook?

- ▣ Fiscal stimulus could be stronger than our baseline
 - Adds to GDP, lowers unemployment, raises inflation
- ▣ Trade restrictions could weaken growth
 - Effects in 2017?
- ▣ Immigration restrictions could weaken growth of the labor force



And now for a brief word on inflation...

- ▣ Inflation had been stubbornly low
- ▣ But it has risen gradually of late
- ▣ Some earlier restraining factors—declining oil prices, declining import prices—are now rising modestly
- ▣ Expect inflation to be at 2% in the next year or two

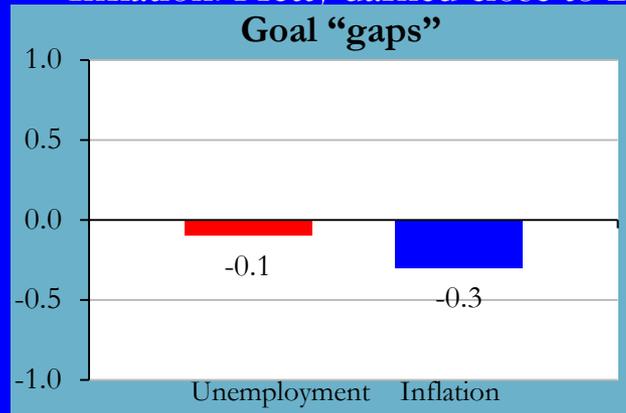


So why the heck are we tightening?

- ▣ Many ask us this question
- ▣ GDP growth has been weak, by historical standards
 - Averaging just over 2% for the past 7 years
- ▣ Job growth is slowing down
 - Was over 200k per month last year; now 165k per month
- ▣ This highlights an over-emphasis on growth in the economy versus the level of economic activity and employment
- ▣ The Fed's goals are properly expressed in terms of levels—Full employment, potential output, and 2% inflation
- ▣ When we attain those goals, we can expect
 - GDP growth a bit under 2%
 - Employment growth about 100k per month

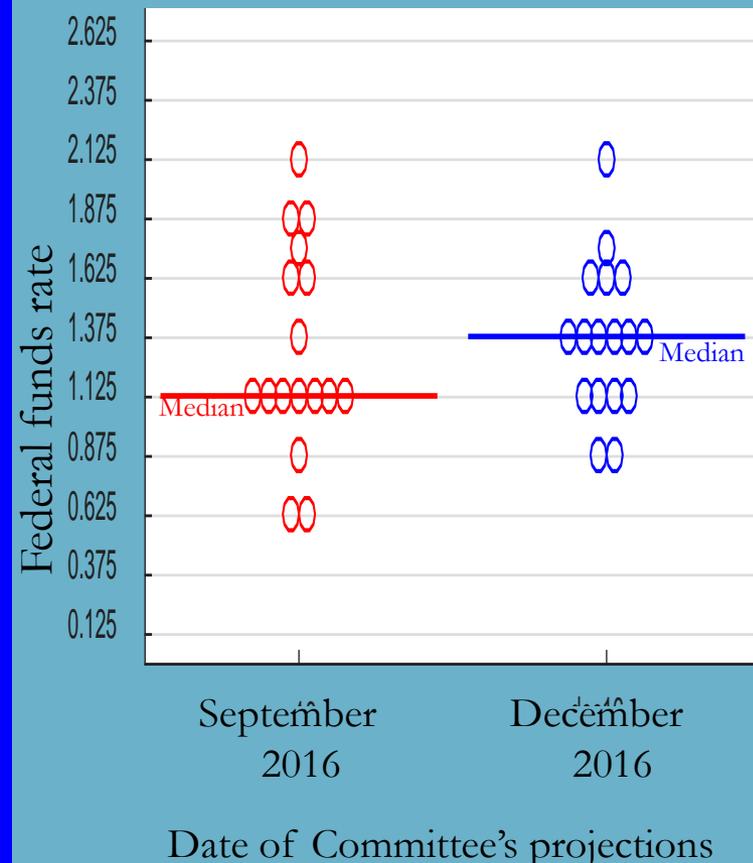
So why the heck are we tightening?

- Where are we with respect to these (levels) goals?
 - ✓ Employment: At or below the natural rate of unemployment
 - ✓ Inflation: Pretty darned close to 2%



- Committee expects a gradual increase or “normalization” in rates over the next year
 - Three ¼-point increases is the median projection for 2017

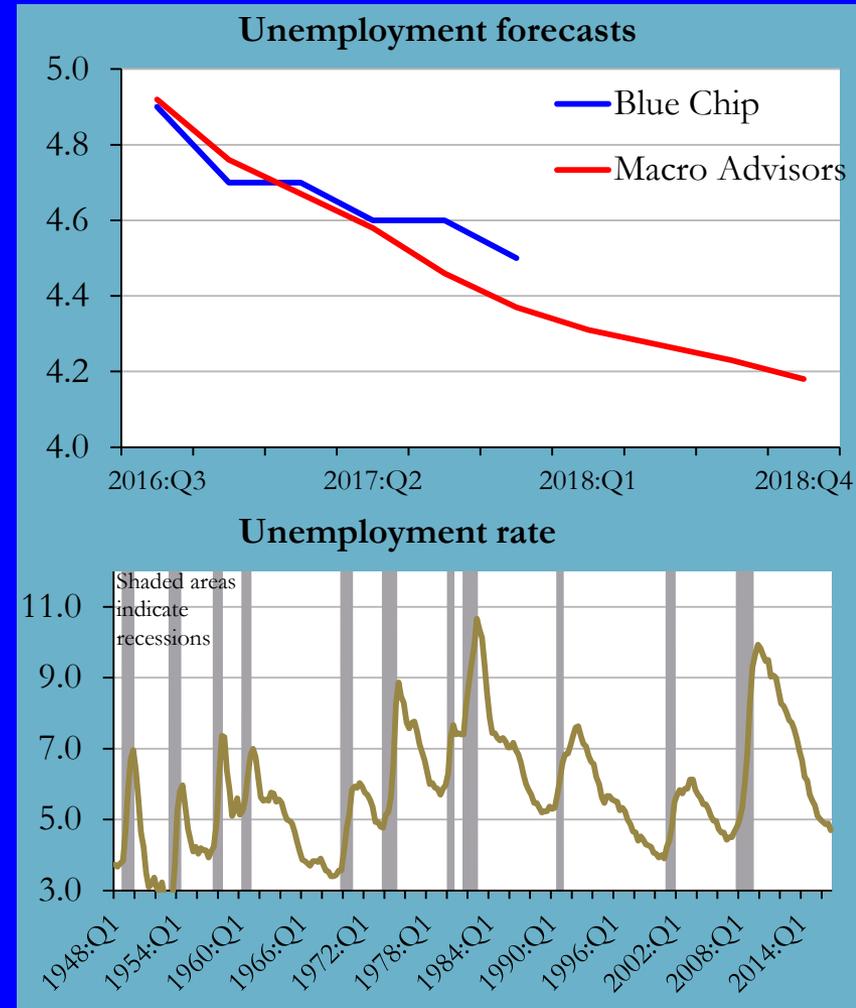
FOMC’s assessment of appropriate policy for 2017



Source: author's calculations, Board of Governors (SEP funds rate projections)

OK to let the economy run “hot” for a while?

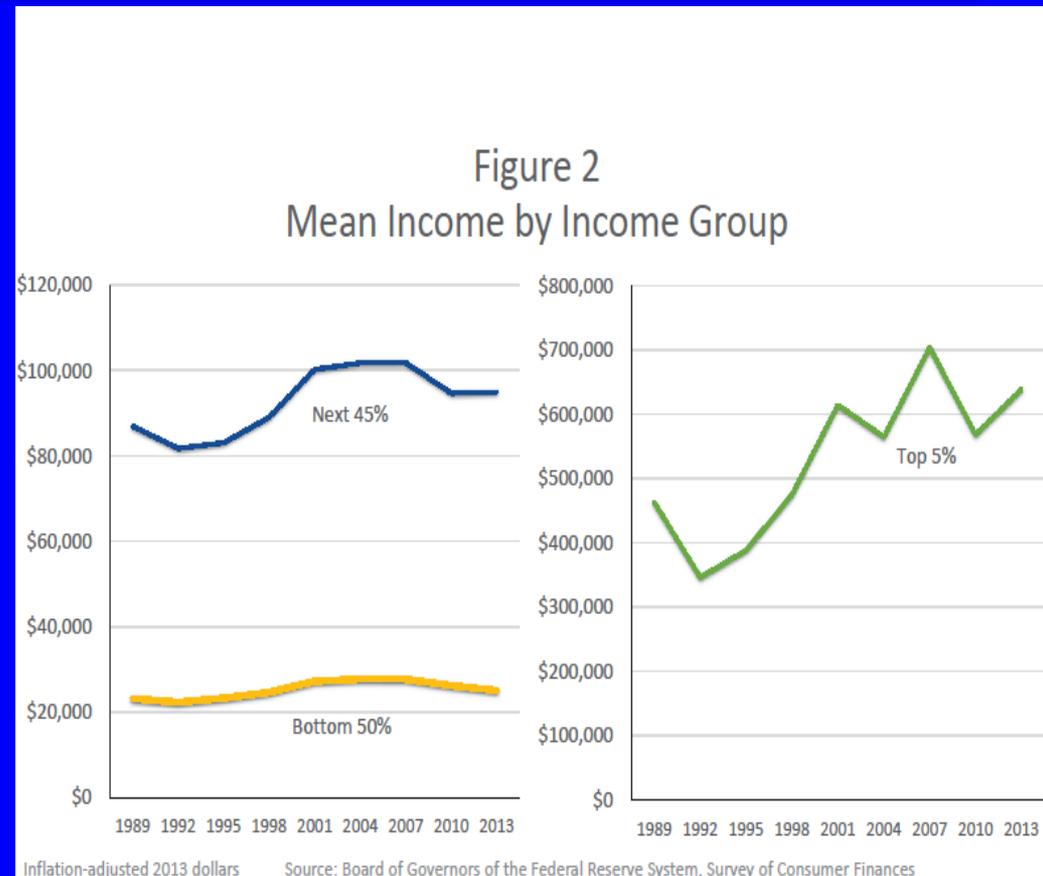
- ▣ Probably, but not for too long...
- ▣ Most forecasters expect additional decline in the unemployment rate
- ▣ Monetary policy will remain quite stimulative for some time
- ▣ But long periods of stretching the economy’s capacity usually don’t end well...



Sources: Blue Chip Economic Indicators, Macroeconomic Advisors, Bureau of Labor Statistics (unemployment rate), Haver Analytics

Does this mean everything is just fine?

- ❑ No.
- ❑ We still have many households struggling to make ends meet
 - Equality of opportunity?
- ❑ We still have longer-run budget issues (espec. Medicare)
- ❑ We still haven't solved all the medical care issues, Obamacare/repeal aside
- ❑ We have interesting upcoming debates on climate, trade, immigration
- ❑ But those aren't the province of monetary policy



Source: Janet Yellen, "Perspectives on Inequality and Opportunity from the Survey of Consumer Finances," Federal Reserve Bank of Boston annual economic conference, 10/17/14

Challenges in NH

- ▣ Mirror some national challenges
 - Overall statistics good: unemployment 2.7%, 15k new jobs last 12 months, LFP high
 - But pockets of chronic poverty, unemployment, drug abuse
- ▣ How to address?
 - We can talk about Fed's and other efforts

Poverty rates by city, NH, 2015

