Osher Lifelong Learning Institute, Winter 2020

What Economists Know About Important Policy Issues

Lecture 1: The U.S. Economy

January 22, 2020

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National Economic Education Delegation

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National Economic Education Delegation

- **Vision**
  - One day, the public discussion of policy issues will be grounded in an accurate perception of the underlying economic principles and data.
- **Mission**
  - NEED unites the skills and knowledge of a vast network of professional economists to promote understanding of the economics of policy issues in the United States.
- **NEED Presentations**
  - Are **nonpartisan** and intended to reflect the consensus of the economics profession.

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Who Are We?

- **Honorary Board: 46 members**
  - 2 Fed Chairs: Janet Yellen, Ben Bernanke
  - 6 Chairs Council of Economic Advisers
    - Furman (D), Rosen (R), Bernanke (R), Yellen (D), Tyson (D), Goolsbee (D)
  - 3 Nobel Prize Winners
    - Akerlof, Smith, Maskin
- **Delegates: 484 members**
  - At all levels of academia and some in government service
  - All have a Ph.D. in economics
  - Crowdsource slide decks
  - Give presentations
- **Global Partners: 45 Ph.D. Economists**
  - Aid in slide deck development

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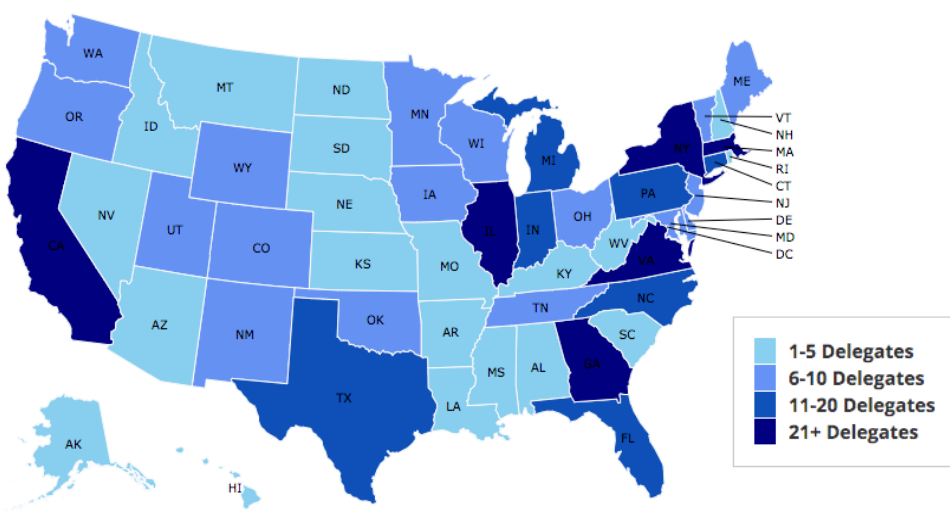
Where Are We?



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Credits and Disclaimer

- **This slide deck was authored by:**
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- **Disclaimer**
  - NEED presentations are designed to be nonpartisan.
  - It is, however, inevitable that the presenter will be asked for and will provide their own views.
  - Such views are those of the presenter and not necessarily those of the National Economic Education Delegation (NEED).

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Course Outline

- **What Economists Know About Important Policy Issues**
  - Week 1 (1/22): US Economic Update
  - Week 2 (1/29): Government Budgets
  - Week 3 (2/5): Climate Change
  - Week 4 (2/12): Income Inequality
  - Week 5 (2/19): Trade and Globalization
  - Week 6 (2/26): Housing Policy

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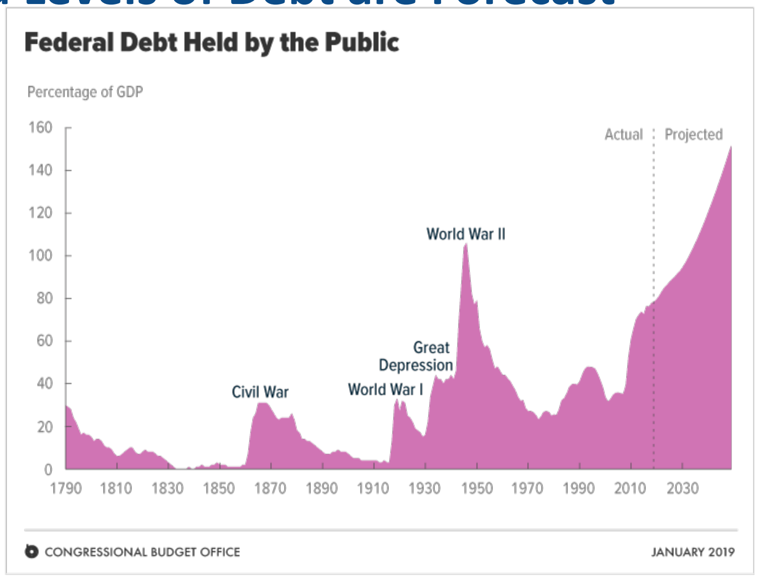
Record Levels of Debt are Forecast



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Source: Congressional Budget Office, The Budget and Economic Outlook: 2019 to 2029

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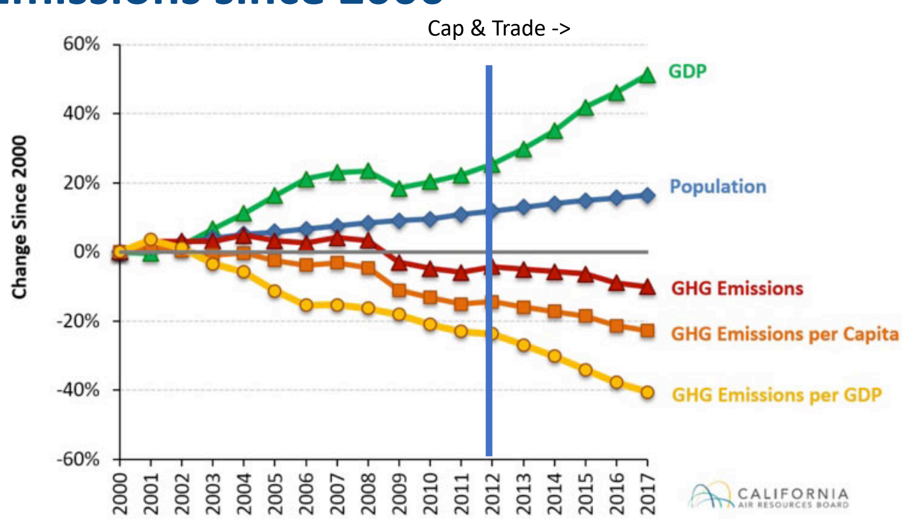
Change in California GDP, Population, and GHG Emissions since 2000



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National Income Inequality: Share of Top 10%

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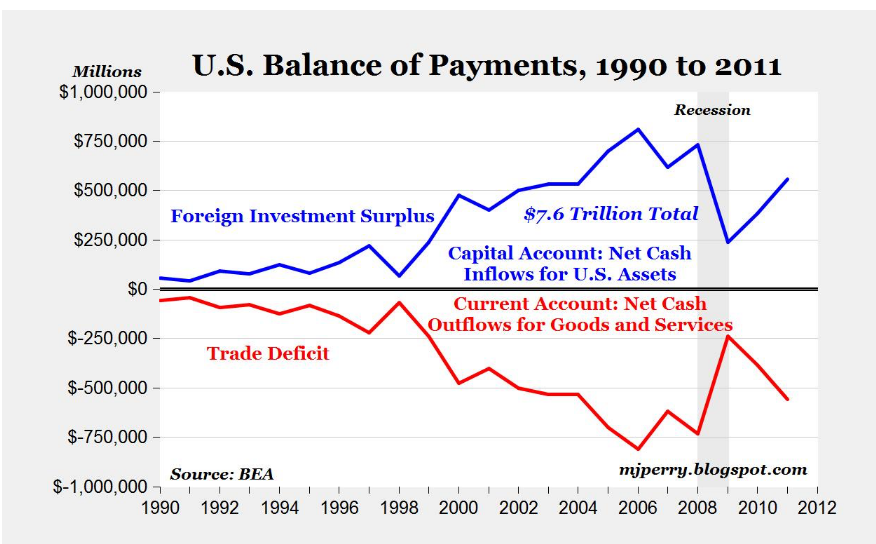
I Don't Care About the Trade Deficit



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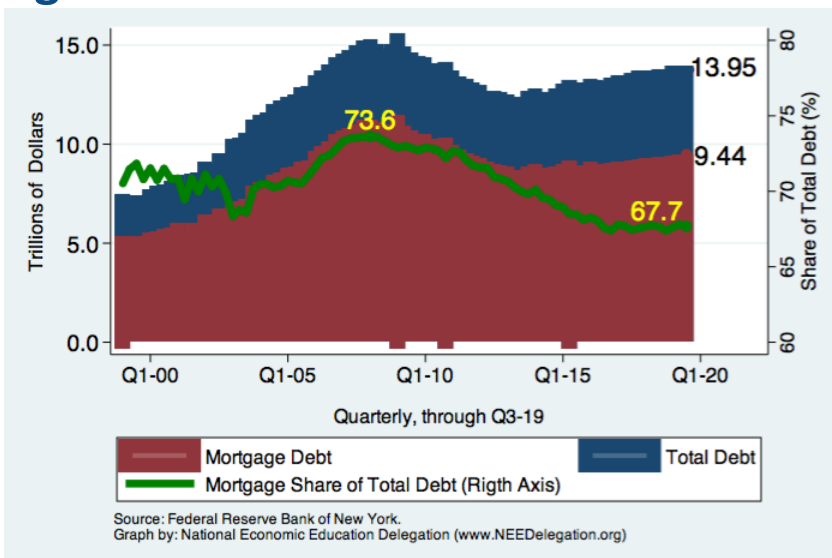
Housing Debt



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Outline – U.S. Economic Outlook

- Behavior of GDP
- Labor Market
- Monetary Policy/Interest Rates
- Other Indicators
- Summary

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Behavior of GDP

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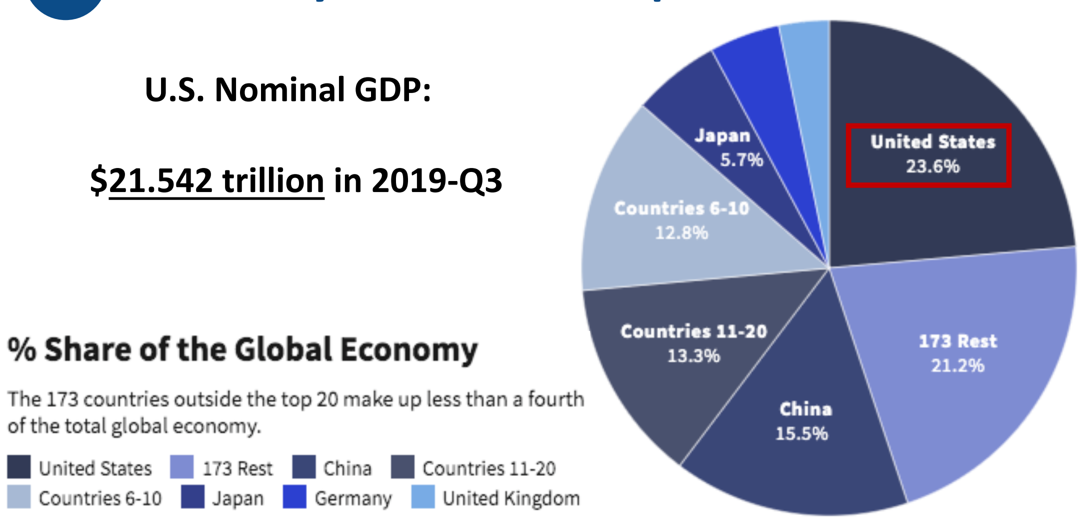
U.S. Economy in Global Perspective

U.S. Nominal GDP:

$<u>21.542 trillion</u> in 2019-Q3



Source: IMF

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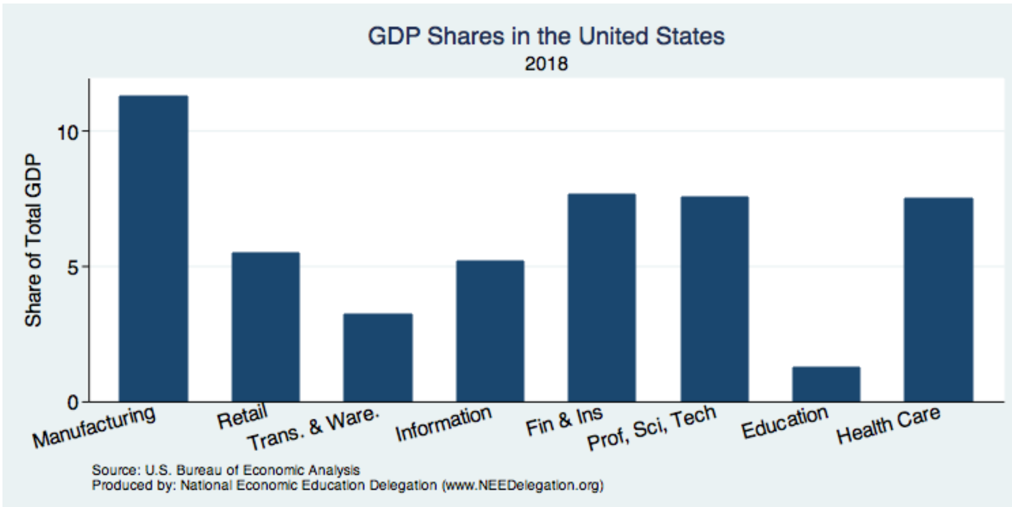
Composition of the U.S. Economy: 2018



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GDP During the Recovery

- ***Real GDP*** **is a standard measure of production used by economists to assess the size, health, and well-being of an economy.**
- ***Potential GDP*** **is the level of production in an economy operating at full employment.**
- **We use potential GDP to get a sense of what production should be in an economy.**

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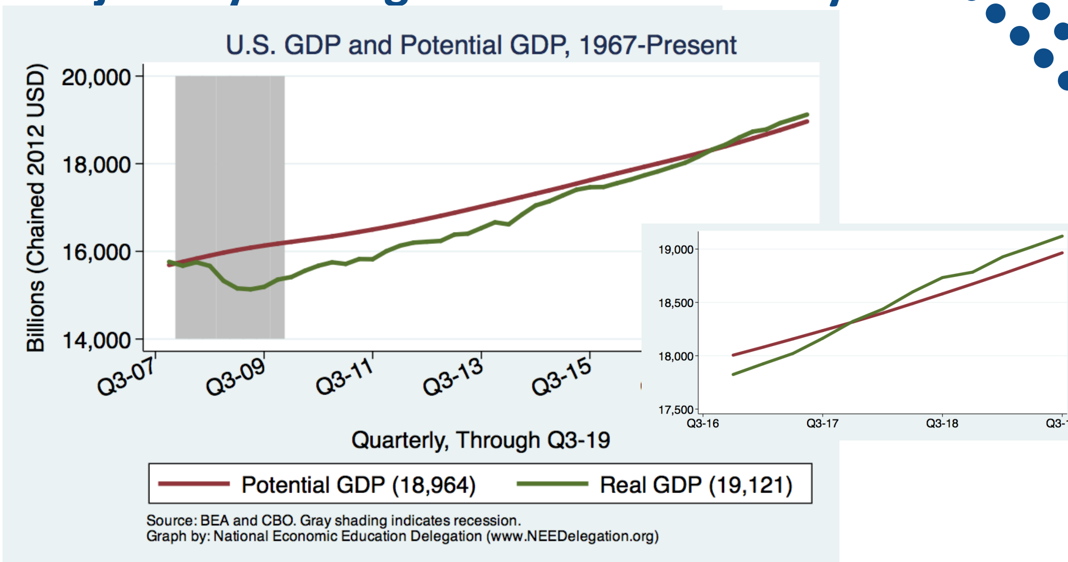
GDP Trajectory During Economic Recovery



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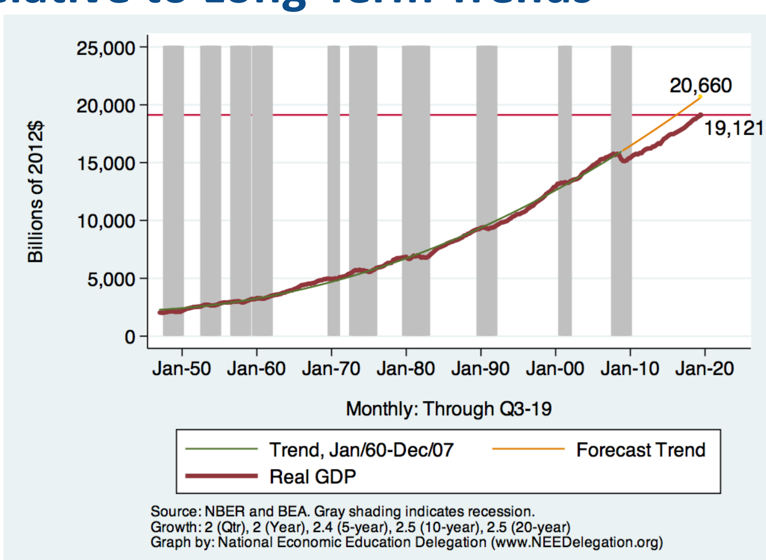
GDP Relative to Long-Term Trends



$1.5 Trillion
Below Trend

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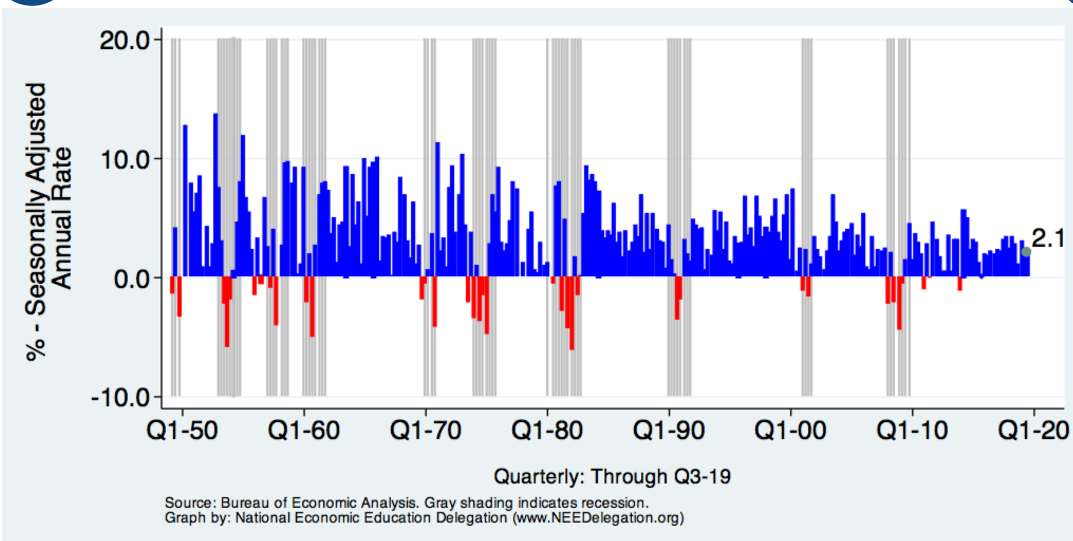
GDP Growth During Economic Recovery



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What Is "Accounting" for the Slow Recovery?

- **Expenditures drive GDP growth.**
  - GDP is the sum of four categories of spending:
    - Consumption
    - Investment
    - Government spending
    - Net Exports: Exports – Imports
      - Exports add to GDP
      - Imports are subtracted because they are included in the other categories

GDP = C + I + G + X - M

- **Production also matters and supports GDP growth.**
  - Employment
  - Productivity

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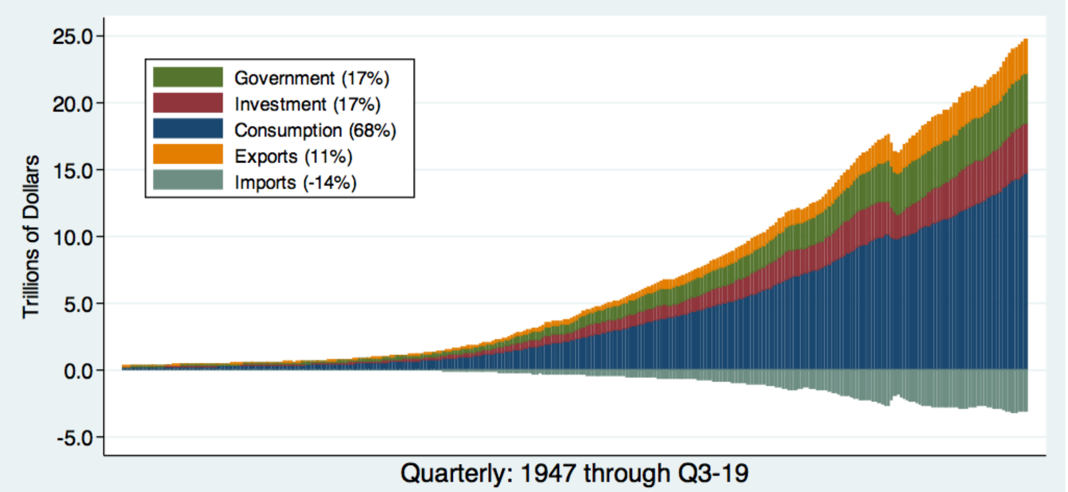
Composition of GDP



Source: U.S. Bureau of Economic Analysis

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Composition of GDP

- Slow growth in any of these categories will slow overall GDP growth.
- How does each component contribute to GDP growth pre- vs. post-recession?
- What explains current trends in each component?

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Understanding Contributions to GDP Growth

- **GDP Growth is a combination of the growth in its components:**
  - Consumption, Investment, Government, and Net Exports
  - It's a weighted average of these components
- **For example: Consumption**
  - If consumption accounts for **2/3** of the economy,
  - If consumption grew by **3%,**
  - It would cause GDP growth to be **2 percentage points** higher than it would otherwise be

$$2\% = 2/3 * 3\%$$

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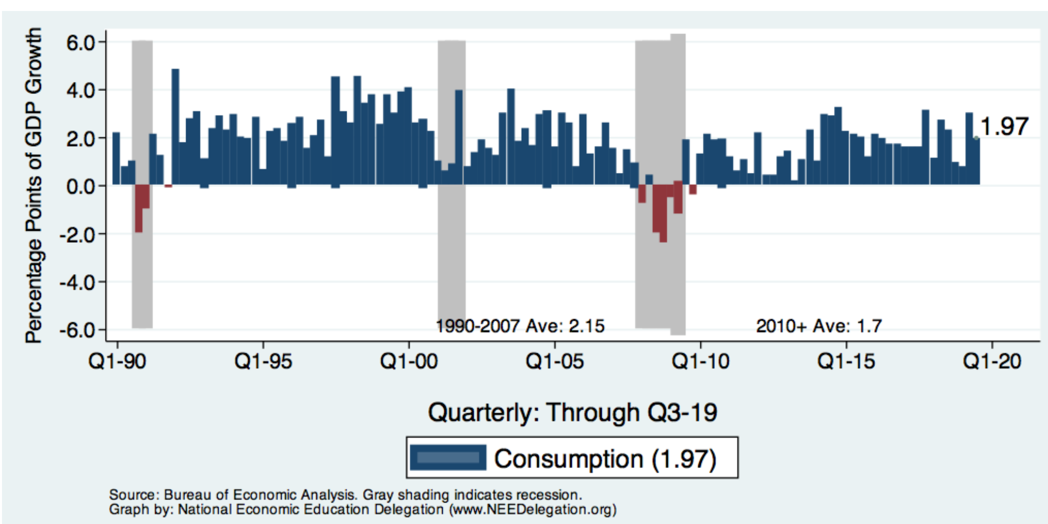
Contribution to GDP Growth: Consumption



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Personal Consumption Expenditures

- **Consumption has been slow to recover.**
  - Pre-crisis average contribution of consumption expenditures was 2.15 percentage points.
  - Post-crisis contribution is 1.6 percentage points.
- **In other words, its contribution to GDP growth is down 21%.**
  - Let's explore why

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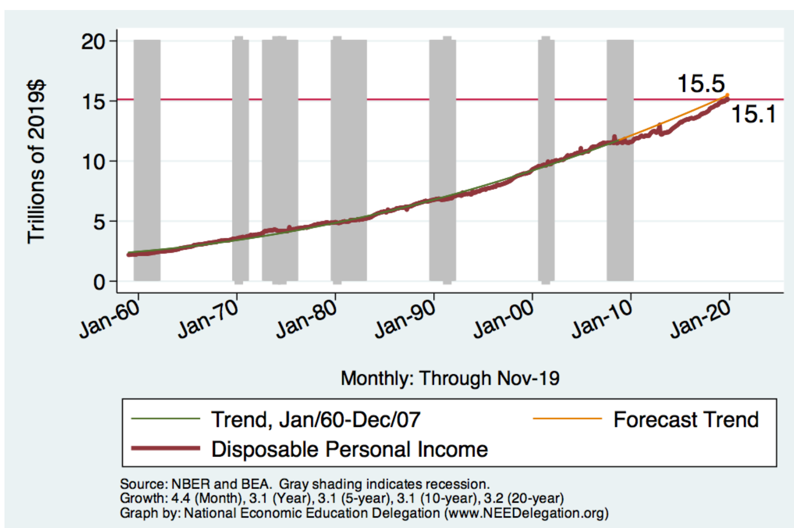
Real Disposable Personal Income



$0.4 Trillion Below Trend

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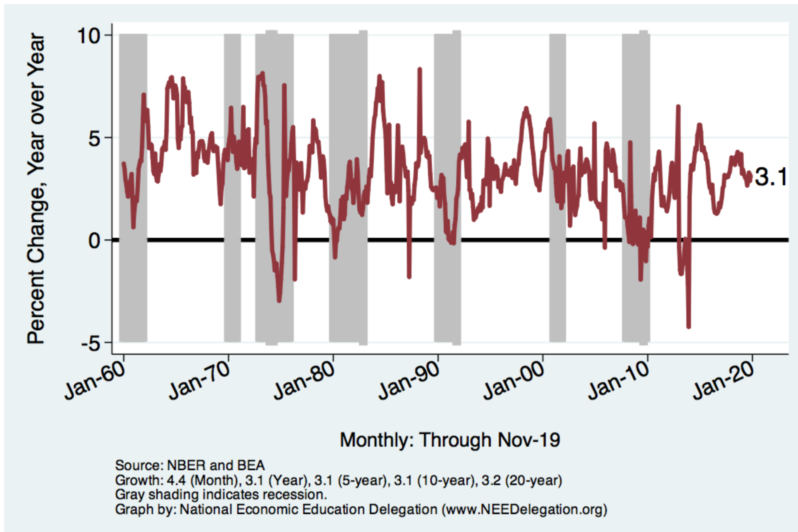
Real Disposable Personal Income - Growth



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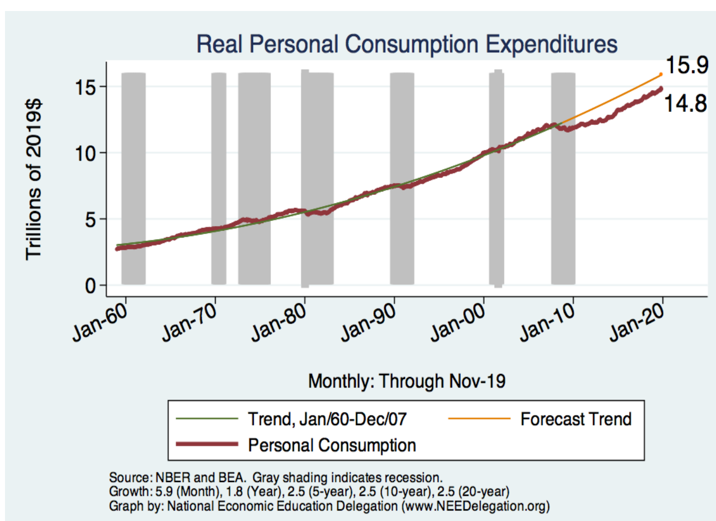
Personal Consumption Expenditures



$1.1 Trillion
Below Trend

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Explaining Consumption Expenditures

- Retail sales, household debt, and personal savings help explain changes in consumption expenditures.
- ***Lower*** levels of retail sales and household debt and ***higher*** savings should be correlated with ***lower*** levels of consumption expenditure.

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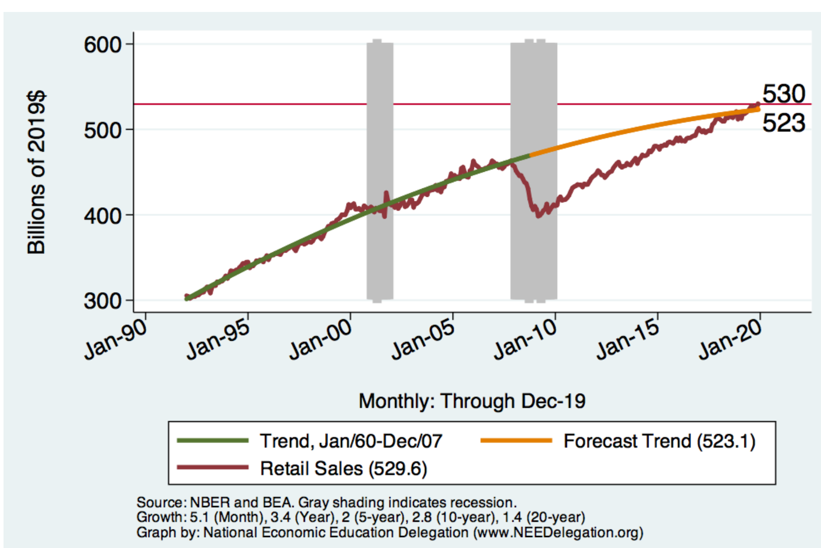
Retail Sales



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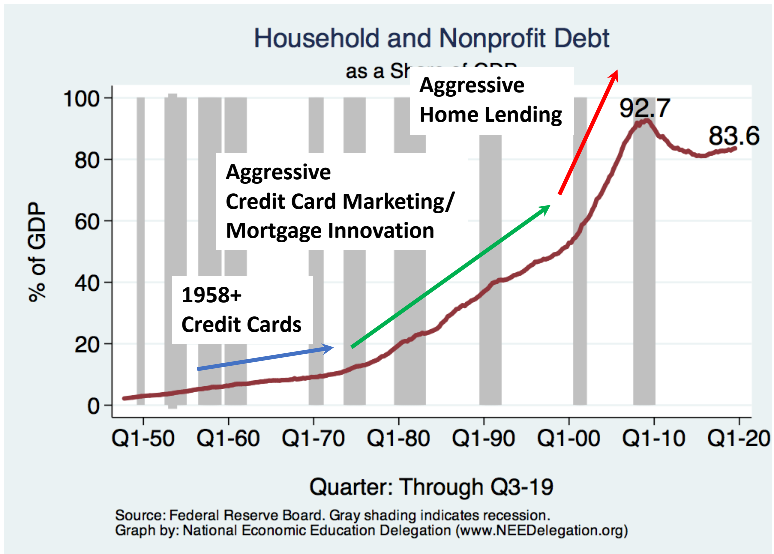
Household Debt as a Share of GDP



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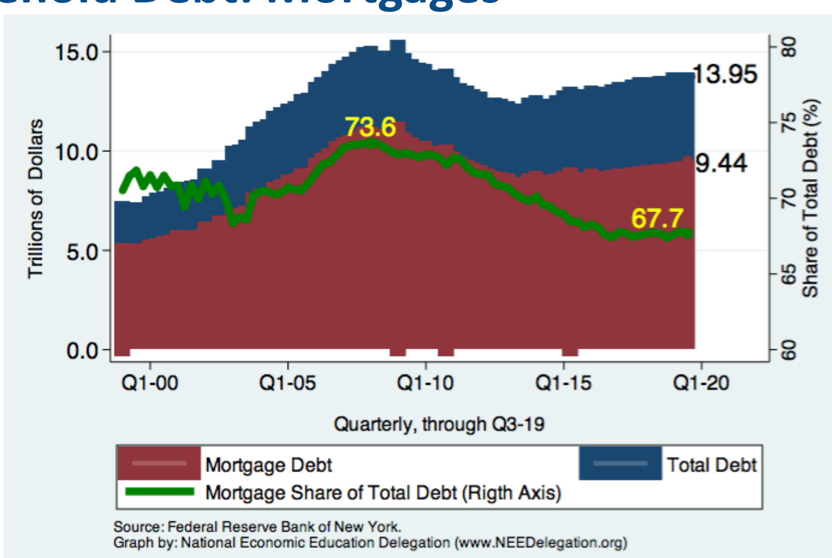
Household Debt: Mortgages



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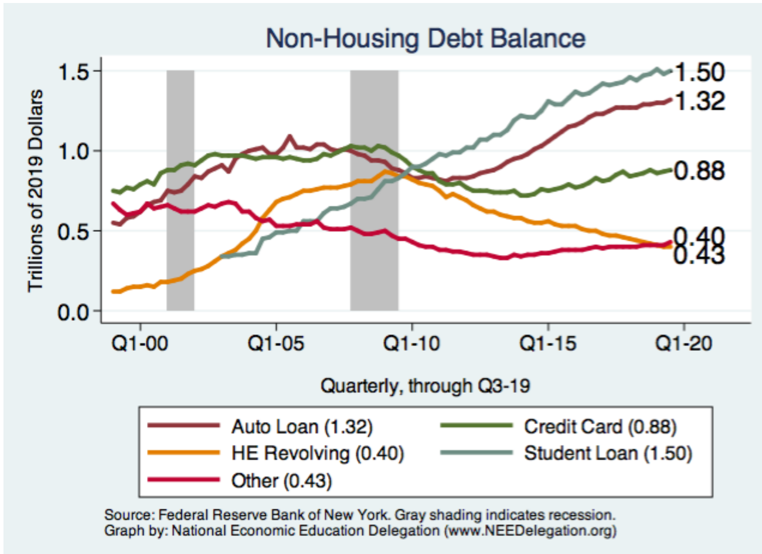
Household Debt: Other Sources



Student Loans
Car Loans

Credit Cards

HE & Other

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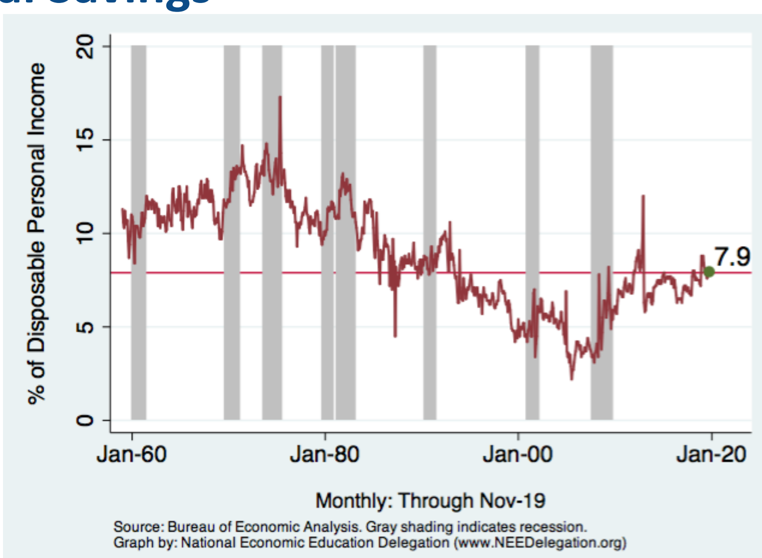
Personal Savings



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Investment Expenditures

- Investment expenditures are composed of residential and non-residential spending.
- Residential spending refers to home construction, including remodeling.
- Non-residential spending refers to capital purchases and new inventory accumulation.
  - Tools, machinery, new factories, commercial real estate.

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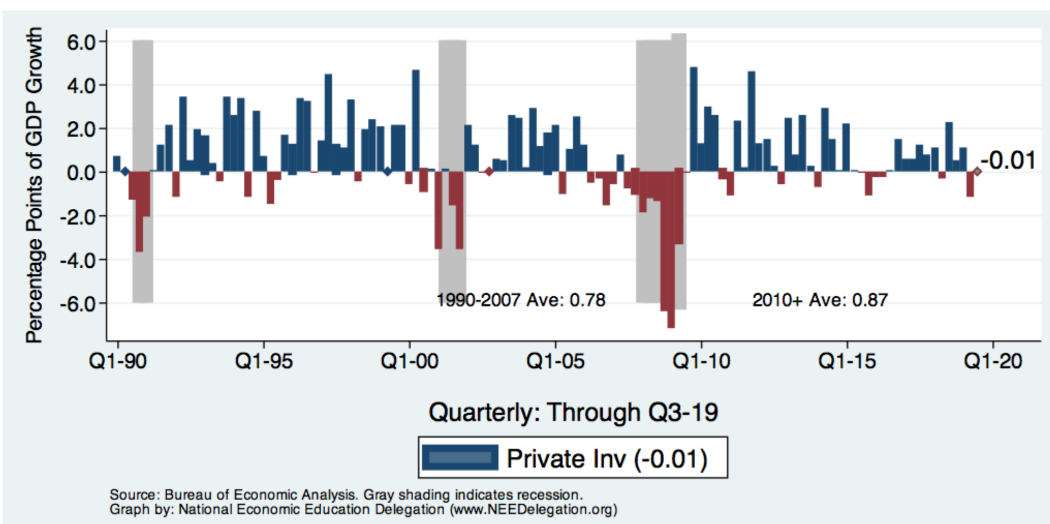
Contributions to GDP: Private Investment



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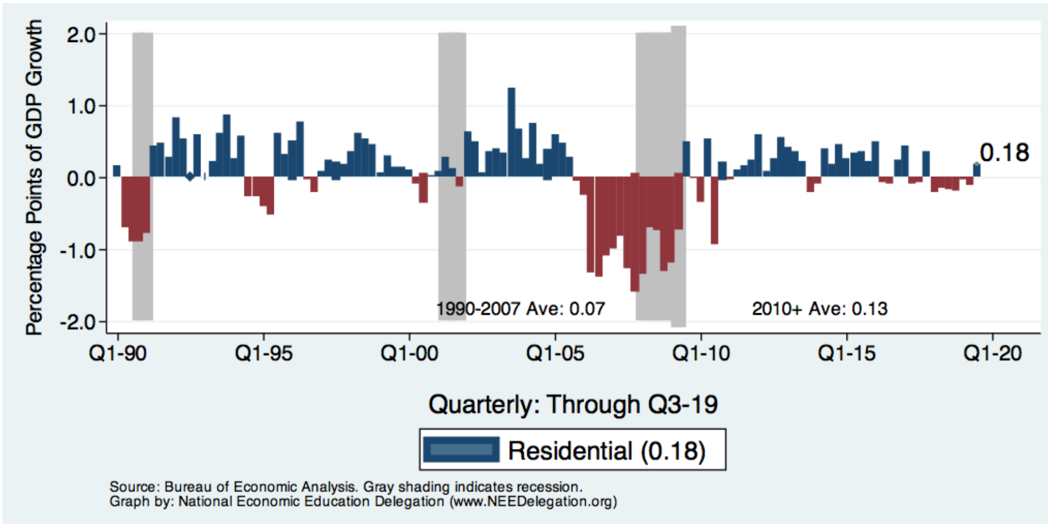
Contributions to GDP: Residential Investment



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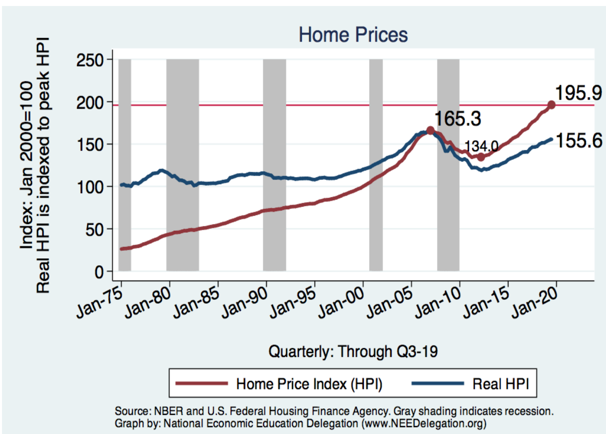
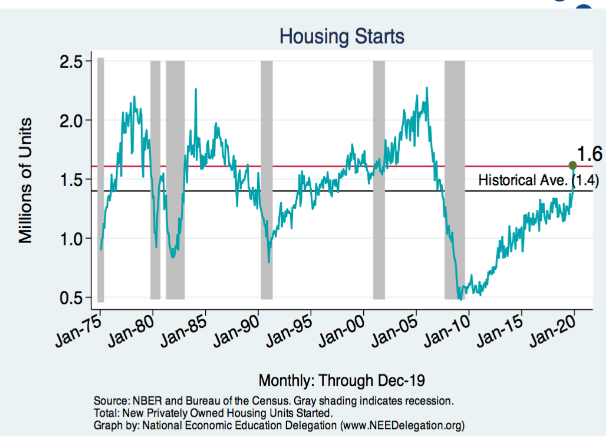
Home Prices and Housing Starts





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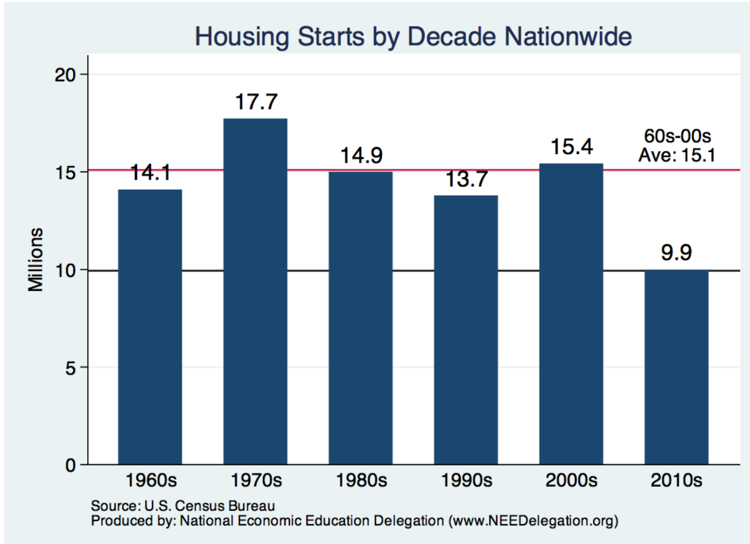
Recent Housing Growth Has Been Slow



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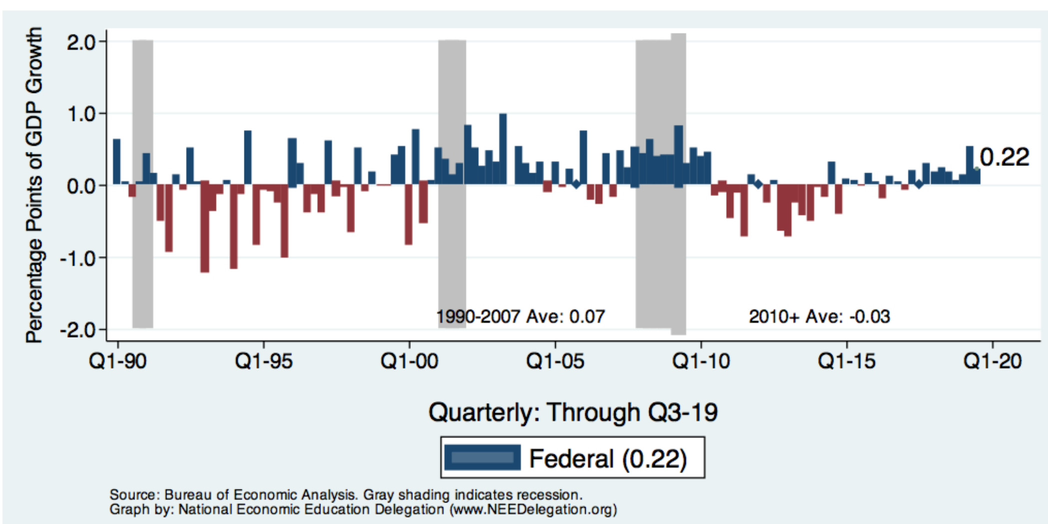
Contributions to GDP: Government



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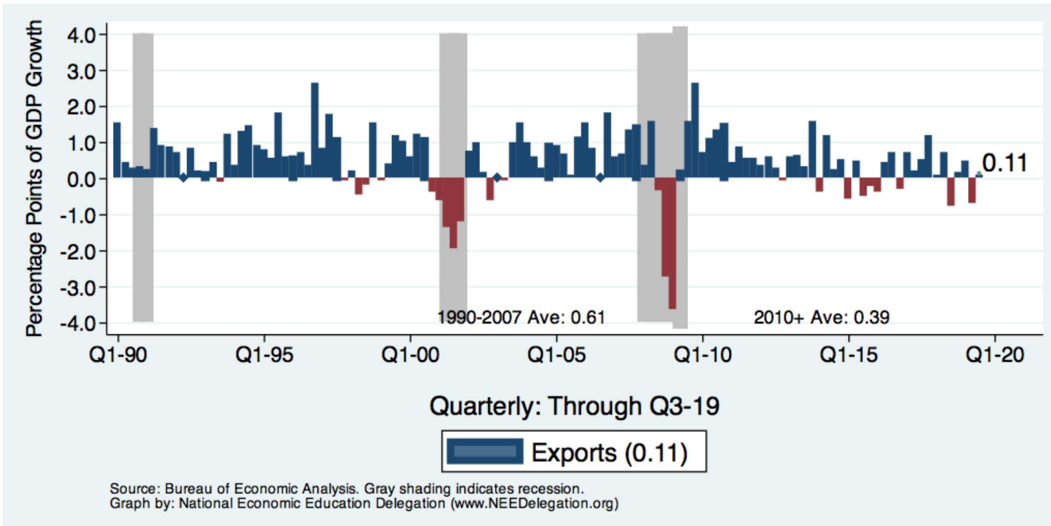
Trade's Contribution to GDP: Exports



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Expenditure Summary

- **Post-recession consumption is down:**
  - Retail sales have returning to trend;
  - Household debt down, but climbing;
  - Personal savings is up.
- **Investment expenditures are contributing more to GDP growth.**
  - But have recently slowed:
- **Post-recession government spending is down:**
  - But starting to pick up.
- **Net exports are relatively unchanged.**

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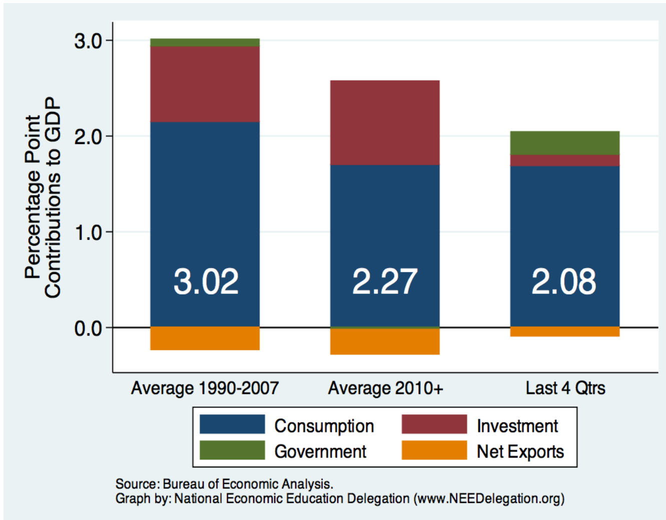
Expenditure Summary



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Labor Market

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Productivity and Employment

- **The labor market is an important indicator of the health of the U.S. economy.**
- **We'll focus on employment and productivity.**
  - Trends in employment and labor force participation.
  - Trends in labor productivity.

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Labor Market Conditions

- **Unemployment rate is low, 3.5%, a level not seen since the 1960s.**
- **Natural rate of unemployment is estimated to be 4.5% - 5.5%.**
- **Monthly employment gains have averaged 189,000 jobs over the last six months.**
  - This measure has been declining throughout 2019.
- **Recent Labor Market Concerns:**
  - Low employment-to-population ratio
  - Falling labor force participation
  - Slow wage growth

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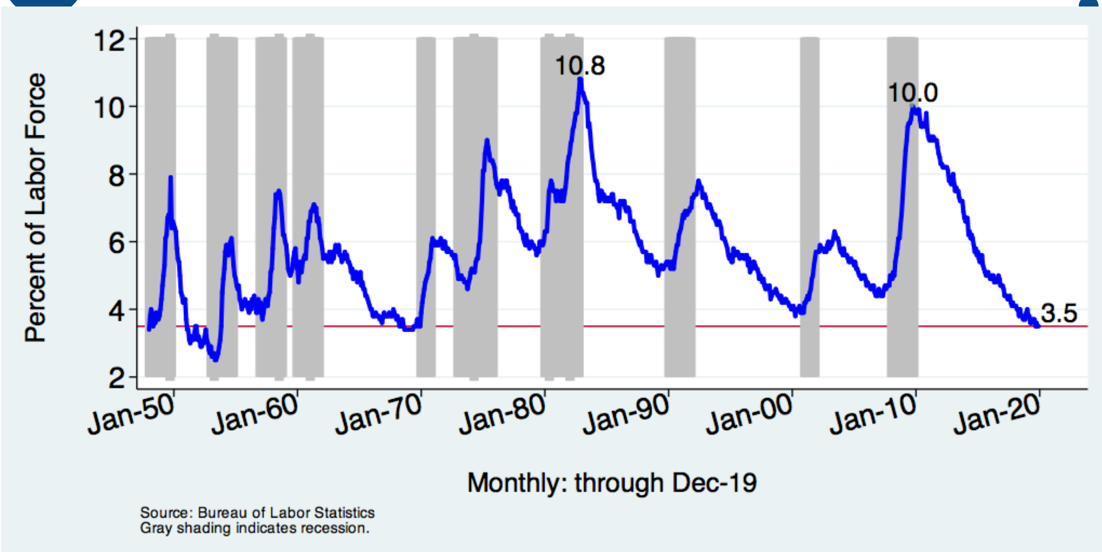
Unemployment Rate



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How is the Unemployment Rate Calculated?

- It is not a simple thing:

$$UR = \frac{\#\ Unemployed}{Labor\ Force} * 100$$

- Why is that not simple?
  - Because it can go up or down for a variety of reasons:
    - If employment shrinks – UR goes up
    - If the labor force grows – UR could go up
  - Not all employment is created equally.
- Not a good indicator of the overall well being of the US economy

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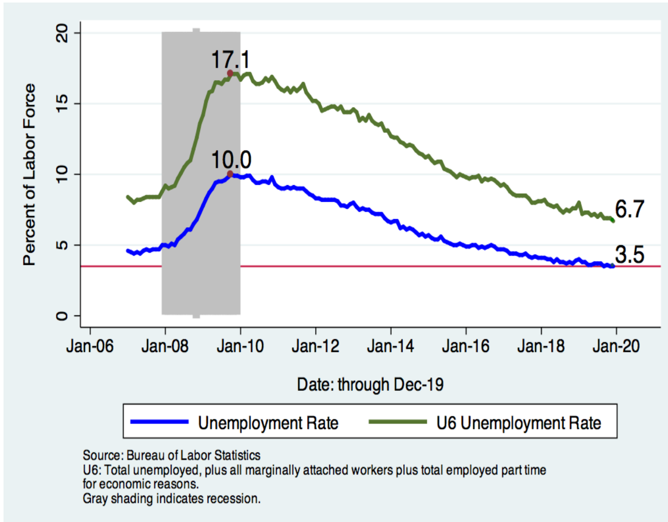
Unemployment Rate



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Low Unemployment: But Jobs Don't Pay

More than 53 million people—44% of all workers aged 18-64—are low-wage workers by our criteria. They earn median hourly wages of $10.22 and median annual earnings of $17,950.

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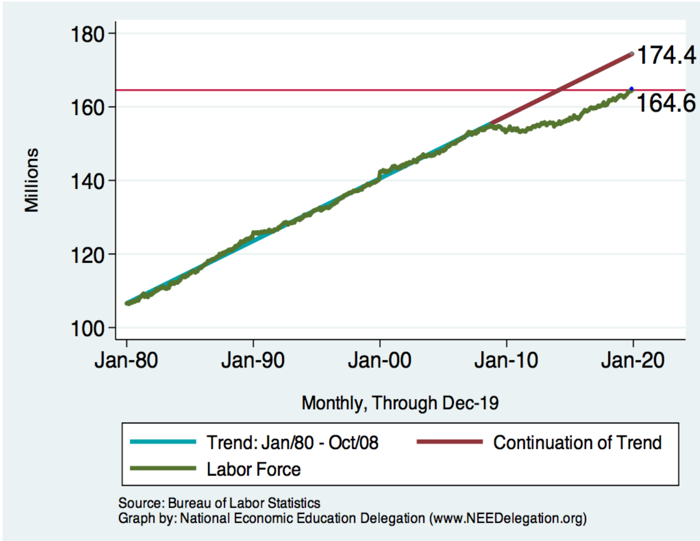
Labor Force Participation - Below Trend



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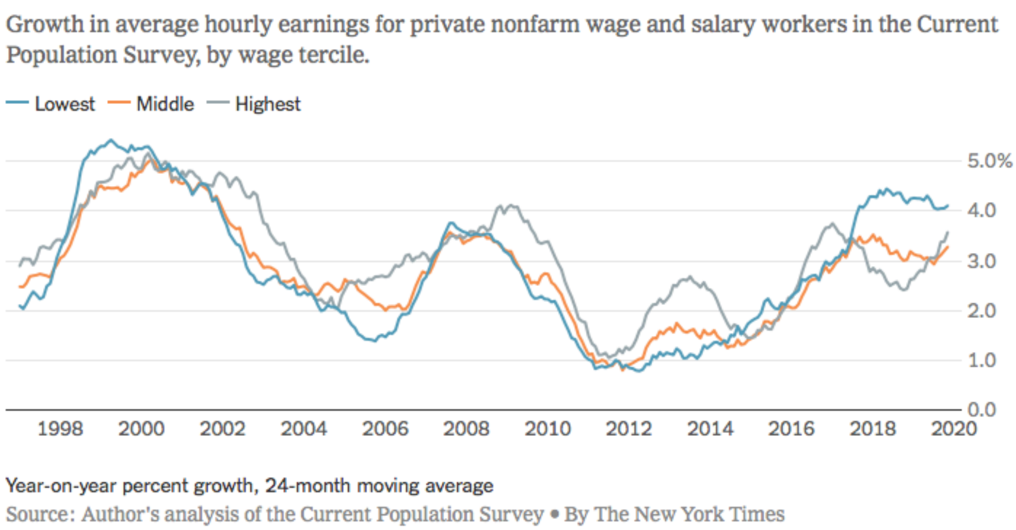
But That is Starting to Change



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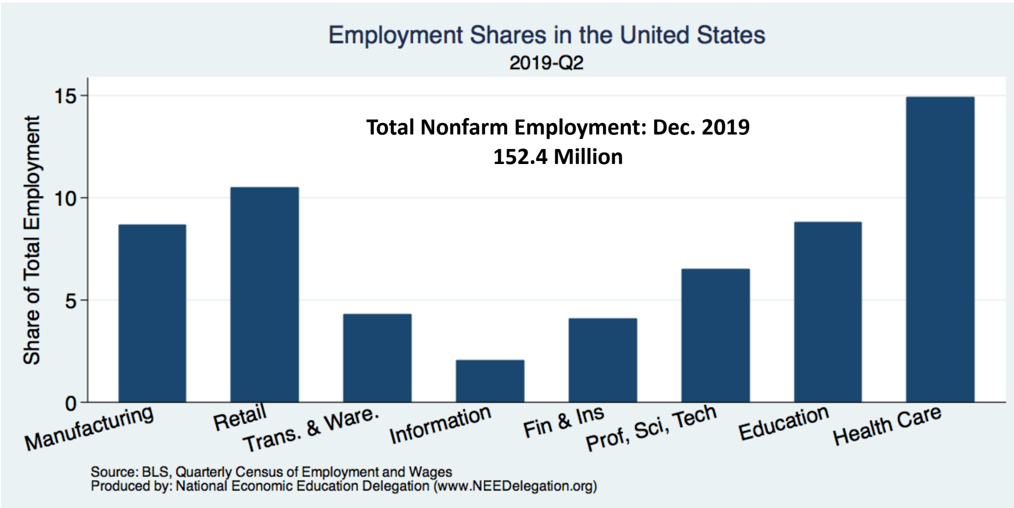
U.S. Employment



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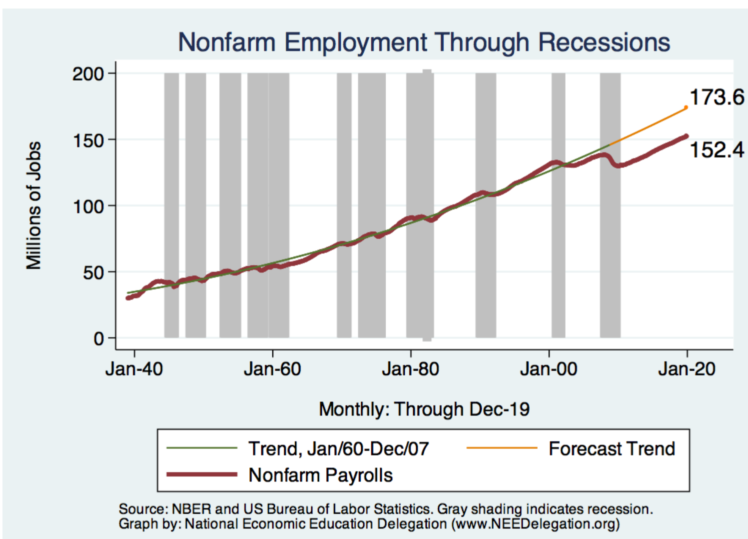
Employment Growth



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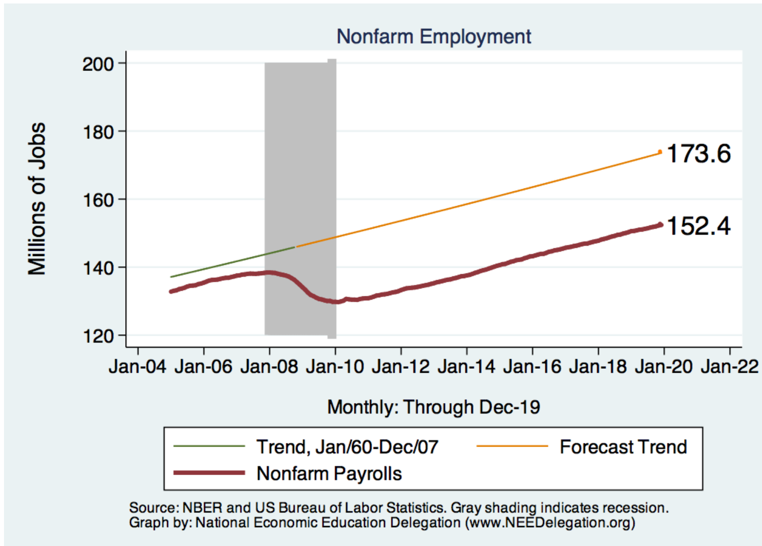
Employment Gap: Up Close



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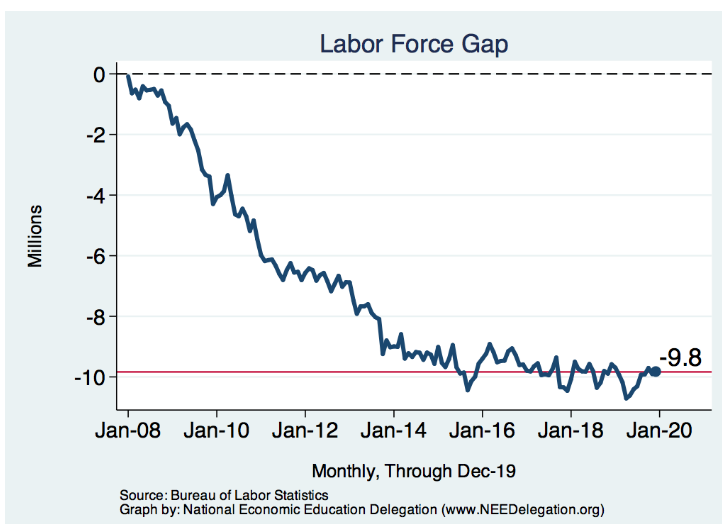
There is a Persistent Labor Force Gap



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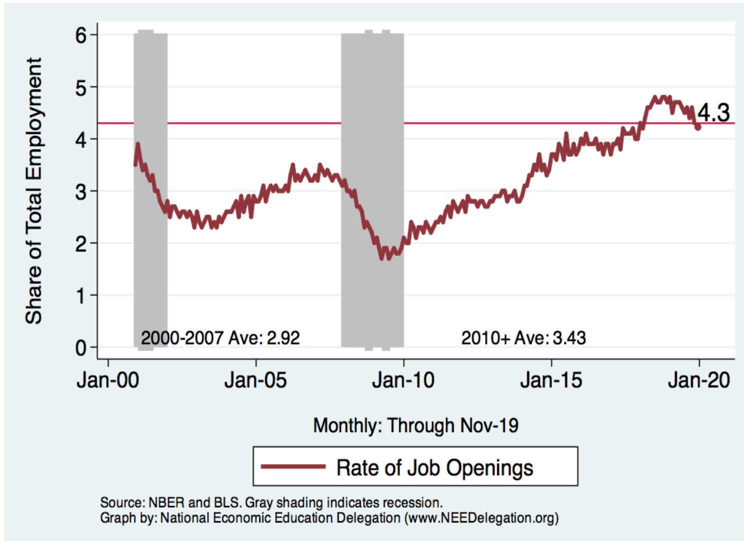
Job Openings: Share of Total Employment



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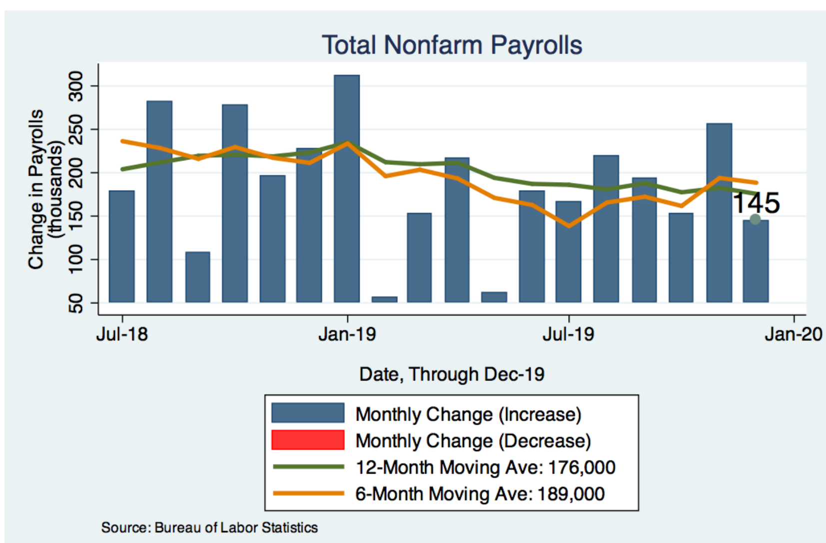
Monthly Changes in Nonfarm Employment



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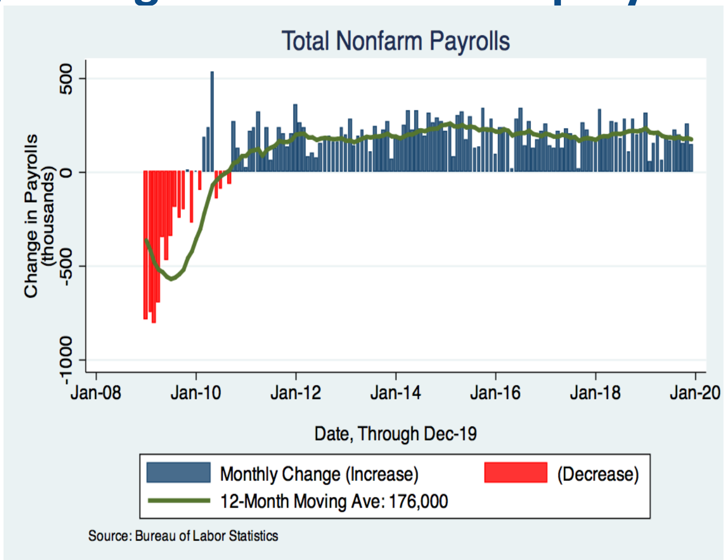
Monthly Changes in Nonfarm Employment



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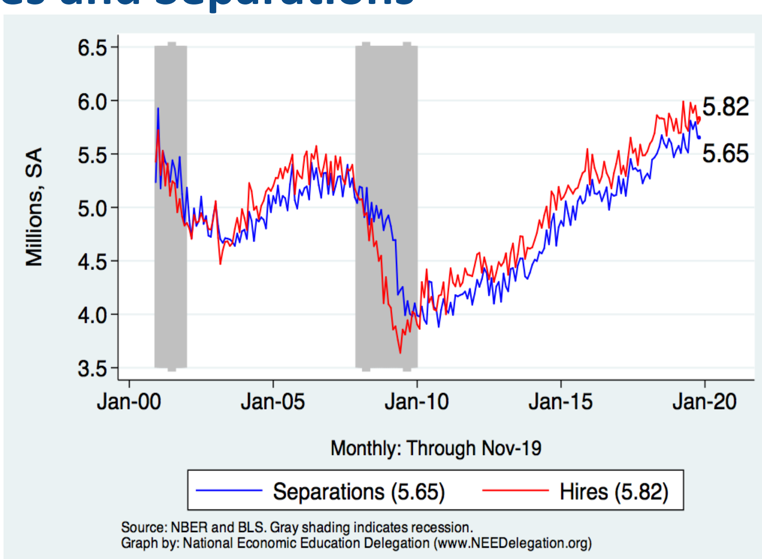
Job Hires and Separations



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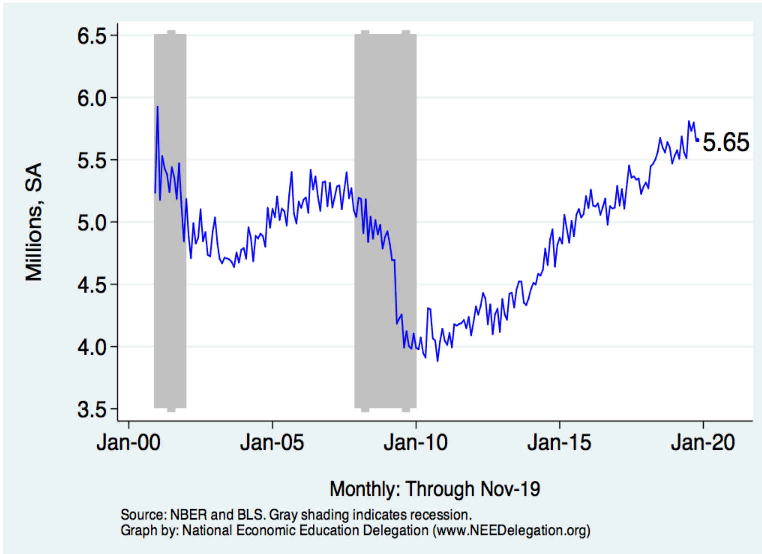
Job Separations



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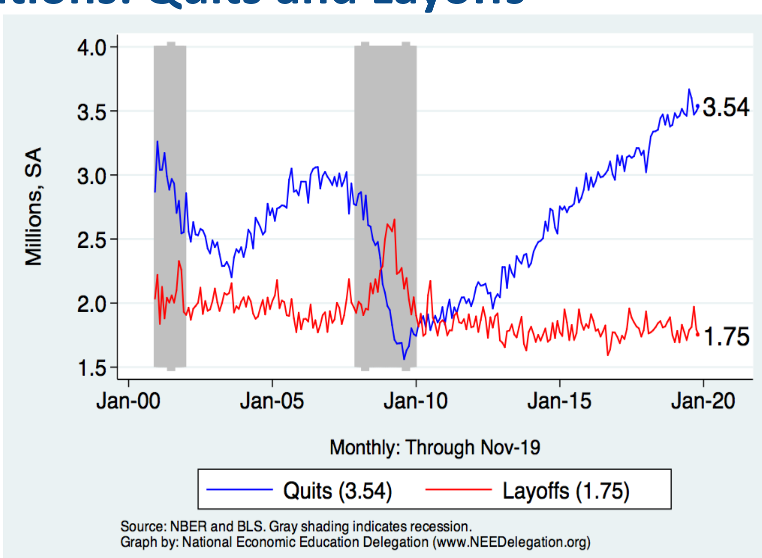
Separations: Quits and Layoffs



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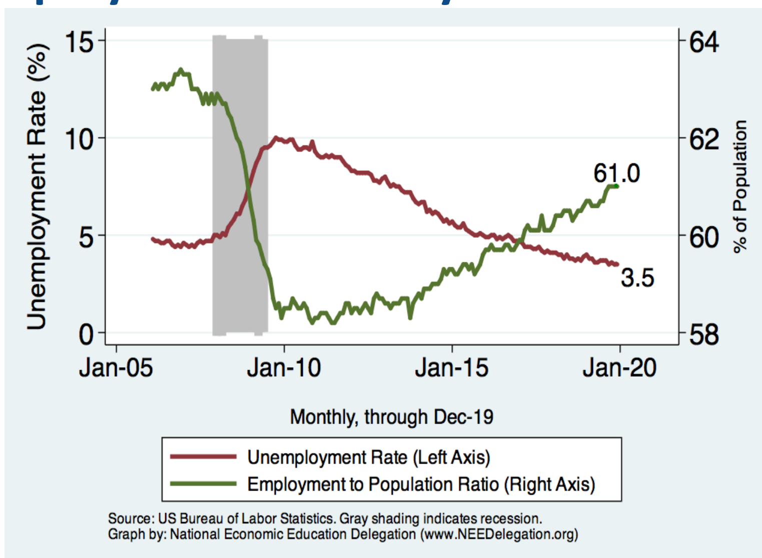
Slow Employment Recovery



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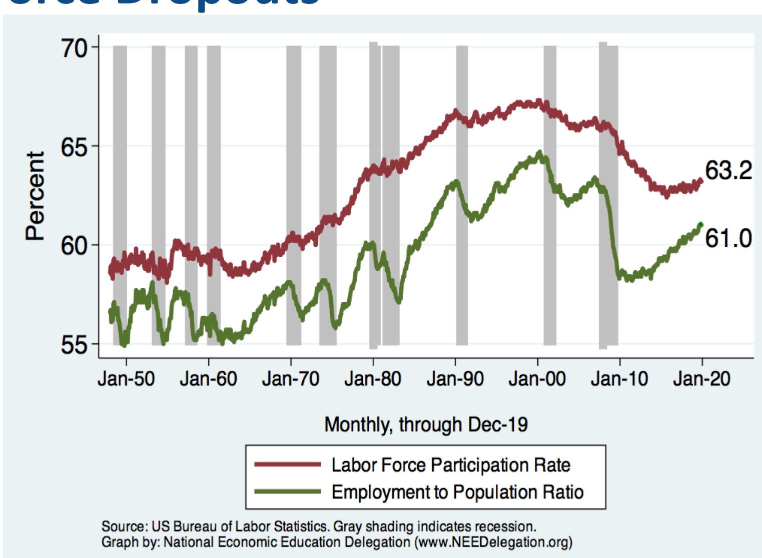
Labor Force Dropouts



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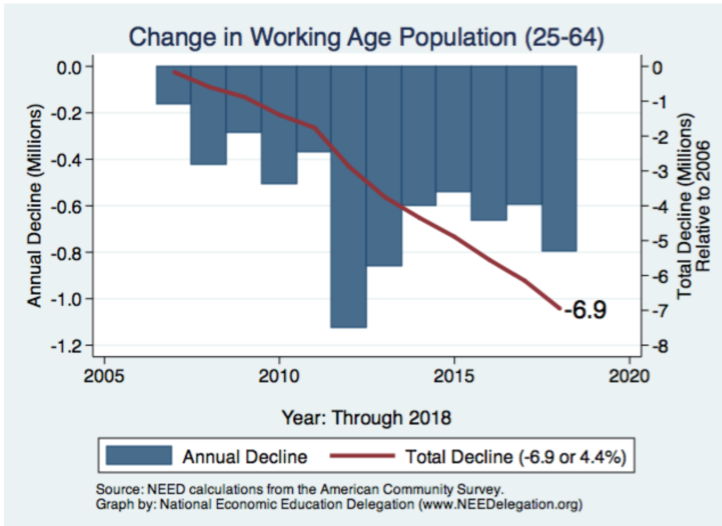
Baby Boomers Are Retiring!



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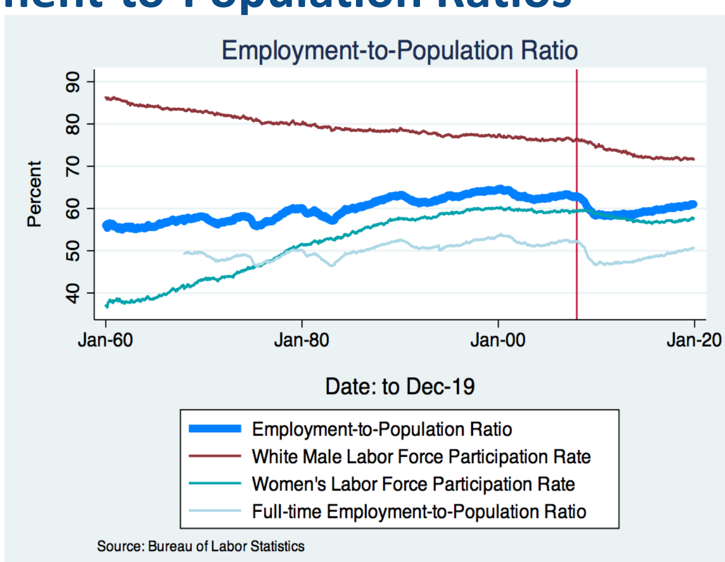
Employment-to-Population Ratios



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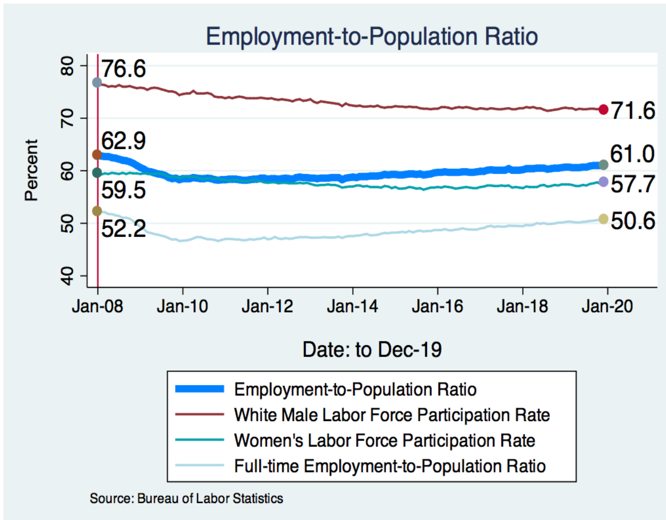
Employment to Population Ratios – Recent



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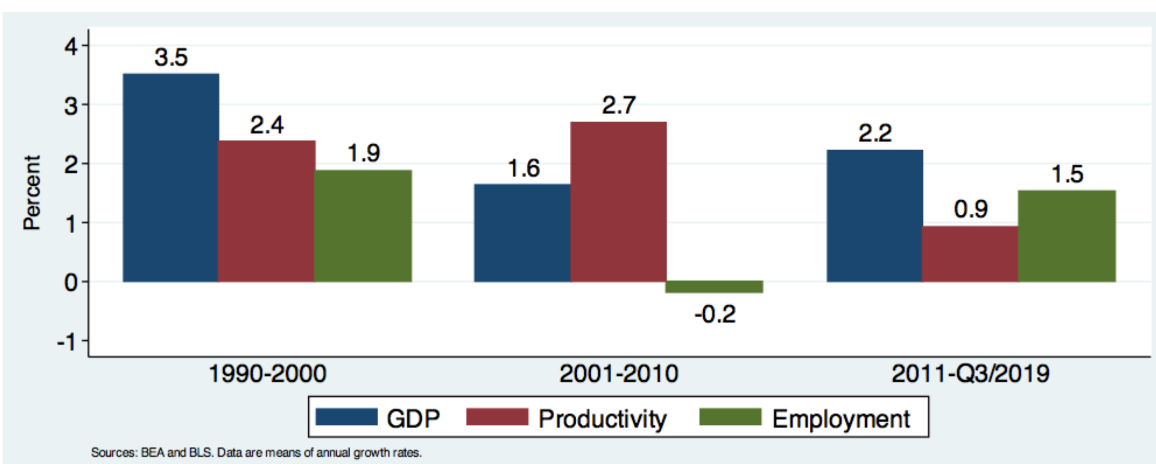
GDP Growth, Productivity, and Employment



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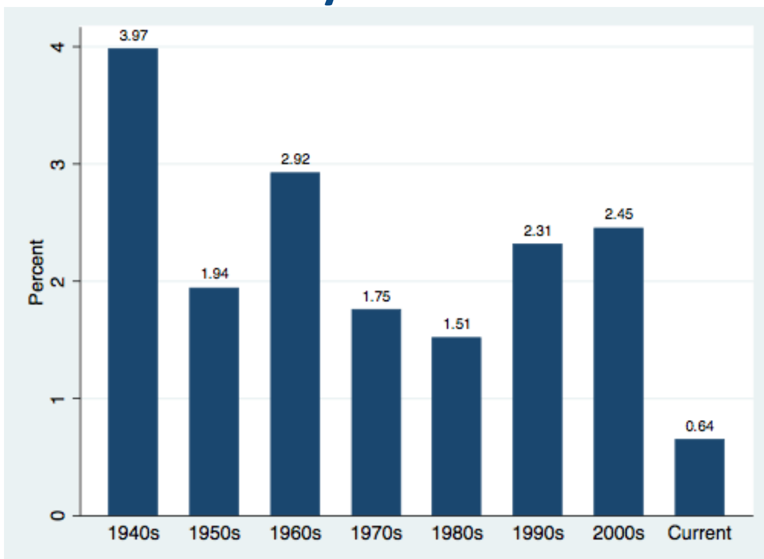
History of Productivity Growth



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Summary

- **GDP growth is primarily fueled by increases in demand for output.**
- **This growth is supported by growth in employment and productivity of the labor force.**
- **Recent years have seen relatively tepid increases in demand for output.**
  - In particular, consumption and government spending have been slow relative to other periods.
- **This tepid growth has lead to slow increases in employment.**
  - As labor markets have tightened, wages have started to grow.
- **Productivity growth has played little role in growing GDP.**
  - Why this is so is not immediately clear.

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Monetary Policy

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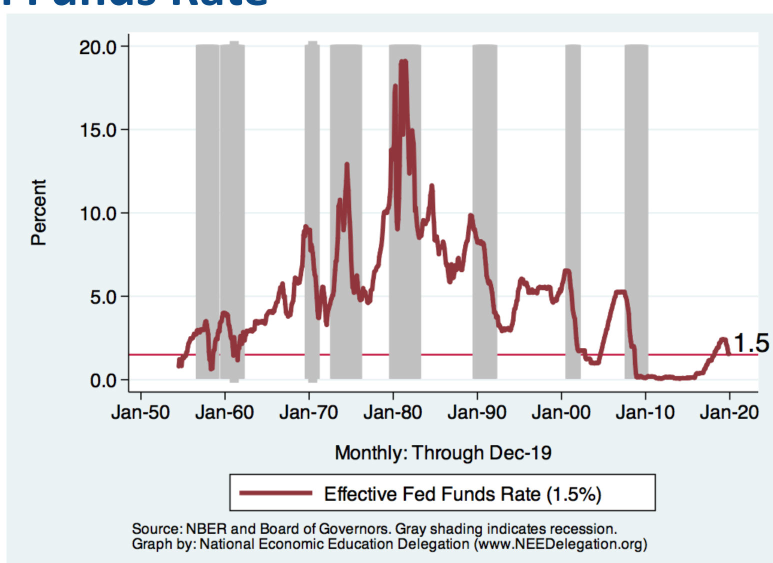
Federal Funds Rate



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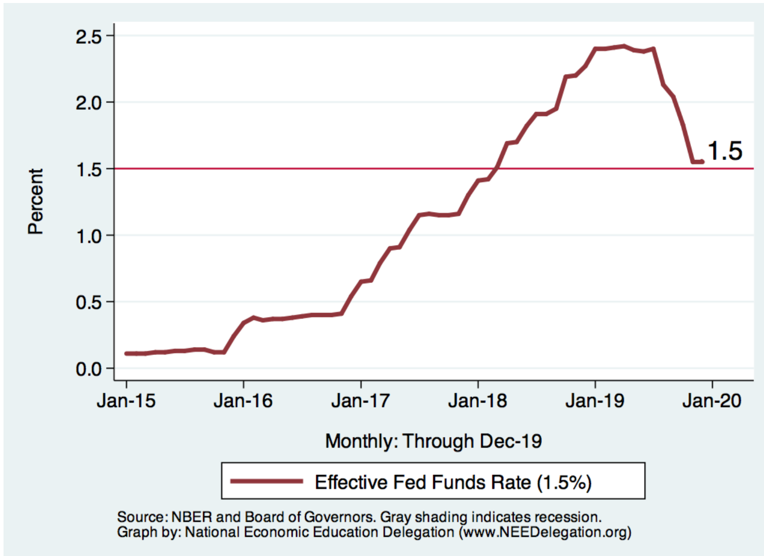
Federal Funds Rate – Last 5 Years



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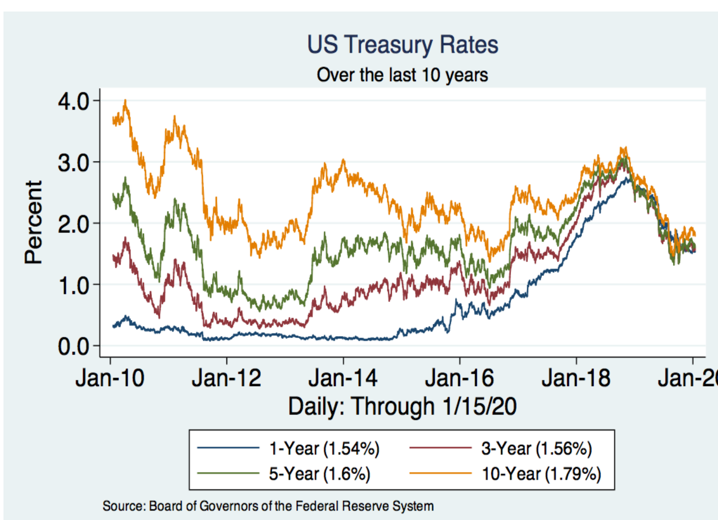
Treasuries



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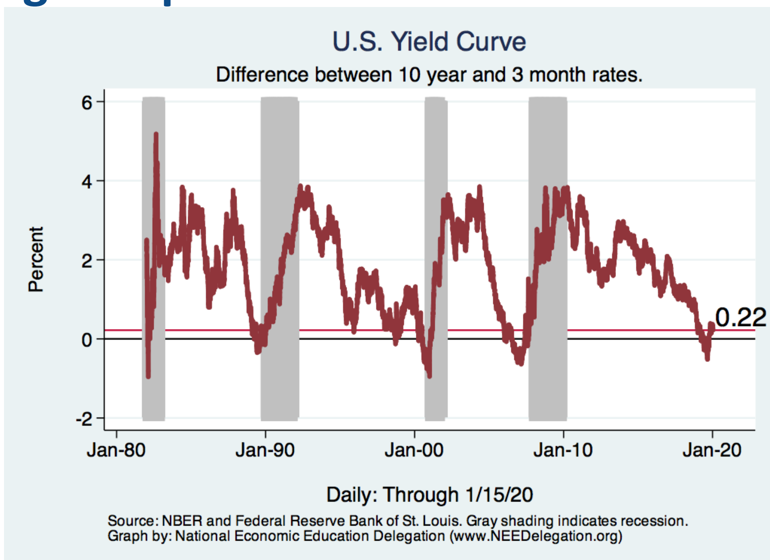
Alarming Compression of Interest Rates



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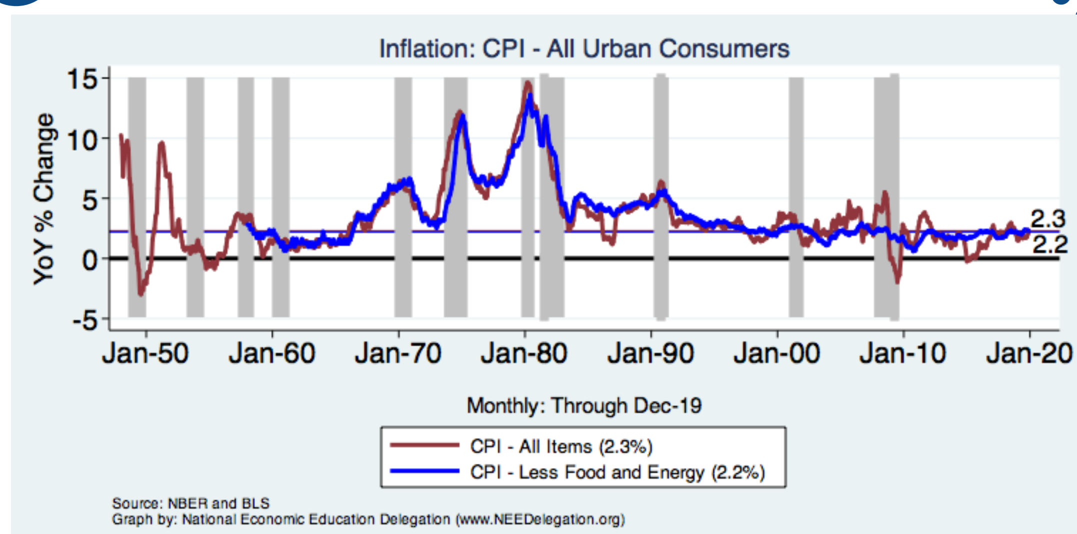
Inflation



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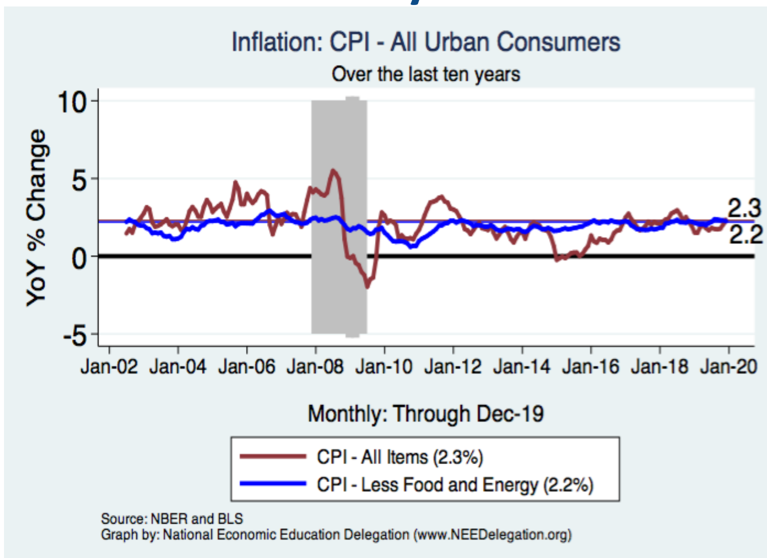
Inflation – Recent Stability



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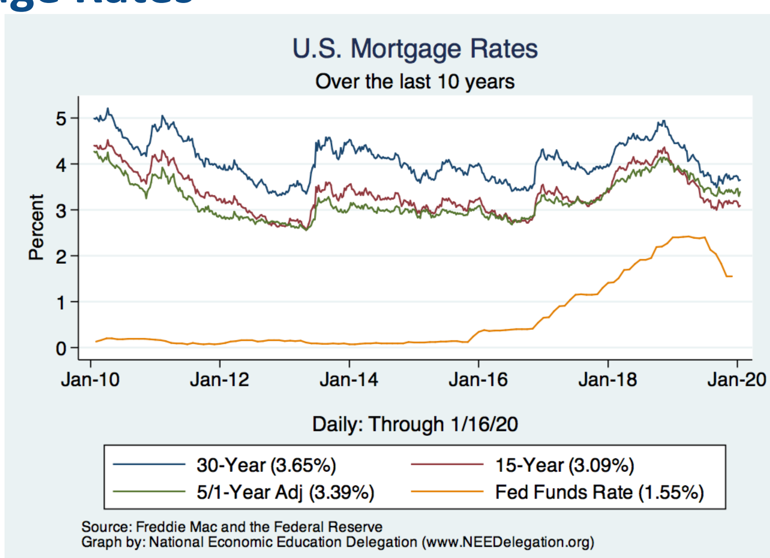
Mortgage Rates



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Other Indicators

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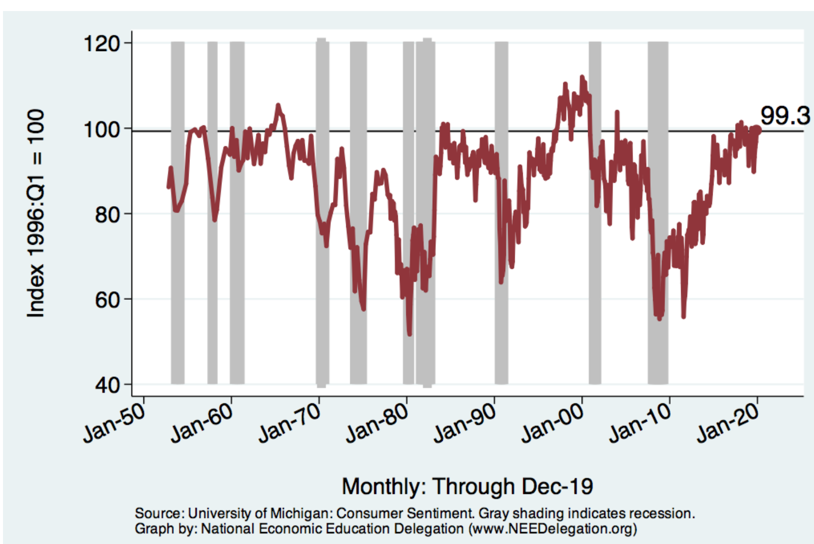
Consumer Confidence: Waning?



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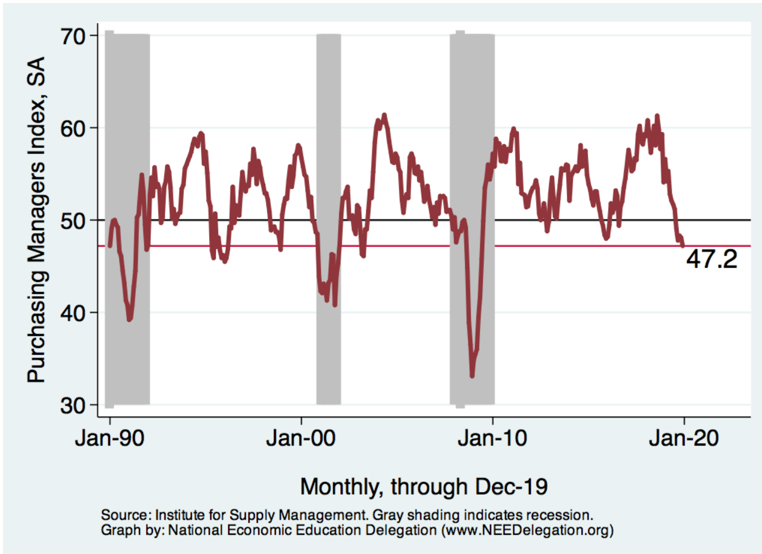
Producer Confidence: Not What it Used to be!



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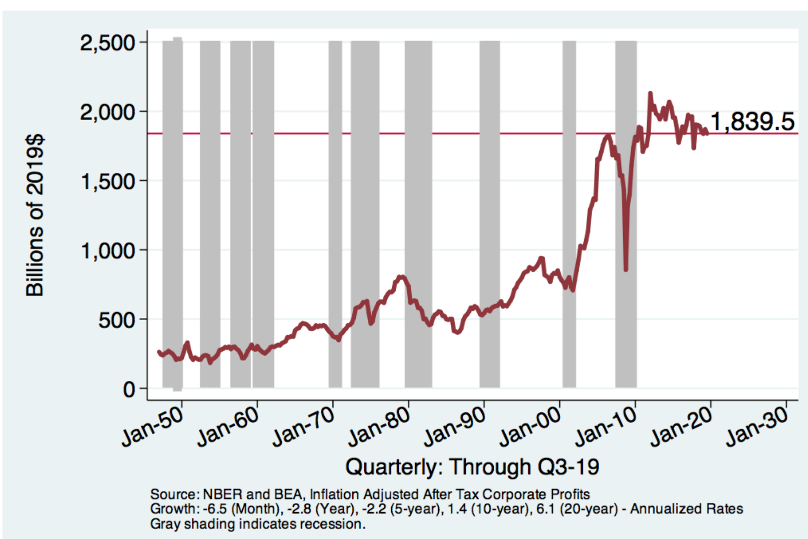
Corporate Profits – Inflation Adjusted



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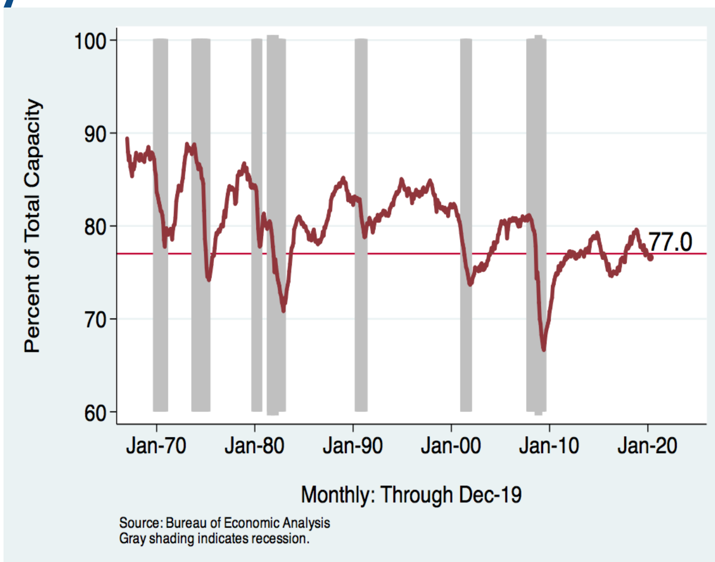
Capacity Utilization



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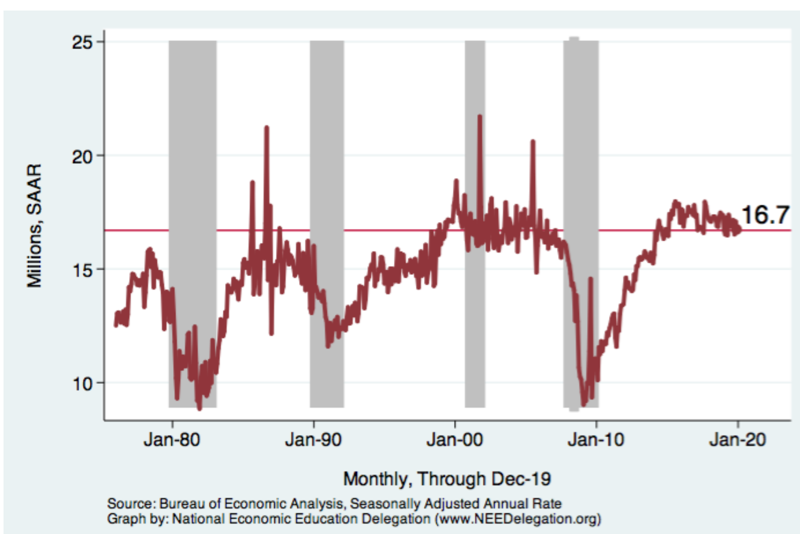
Automobile and Light Truck Sales



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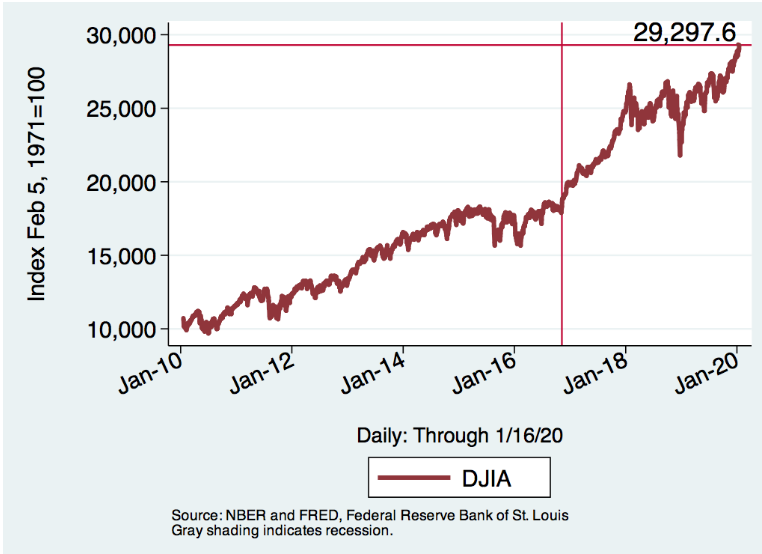
Summary of GDP, Labor Markets and Monetary Policy

- **Behavior of GDP**
  - Behavior of expenditure components matter.
  - On average, post-recession consumption, government, and export. expenditures are contributing less to GDP therefore slowing the recovery.
  - In contrast, investment expenditures are contributing more.
- **Labor Market**
  - Unemployment is low, labor force participation is stagnant
  - Real wages may be starting to grow.
- **Monetary Policy**
  - Interest rates are rising.
  - Policy normalization is underway.

Things to Be Worried About

- **Stock Markets**
- **Yield Curve**
- **Government Debt**
- **Declining Labor Force**
- **Income and Wealth Inequality**
- **Policy Uncertainty**
  - Trade and immigration policy, especially
- **Lack of ammunition to fight a recession**

Dow Jones



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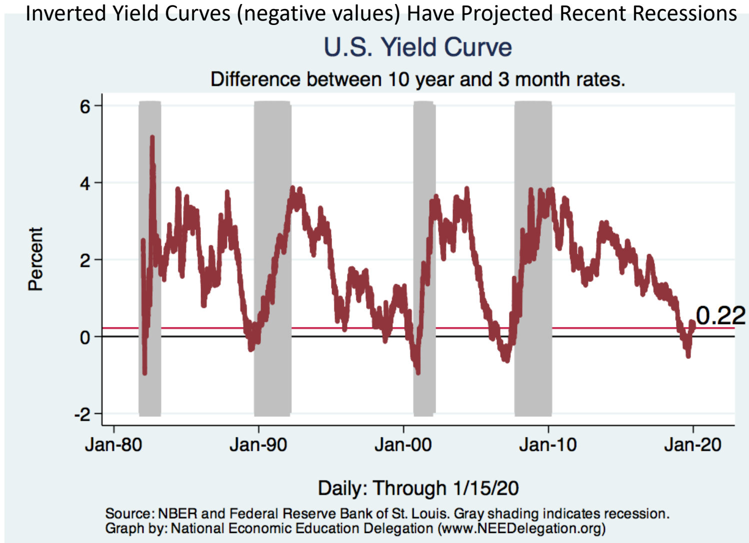
Alarming Compression of Interest Rates

Inverted Yield Curves (negative values) Have Projected Recent Recessions



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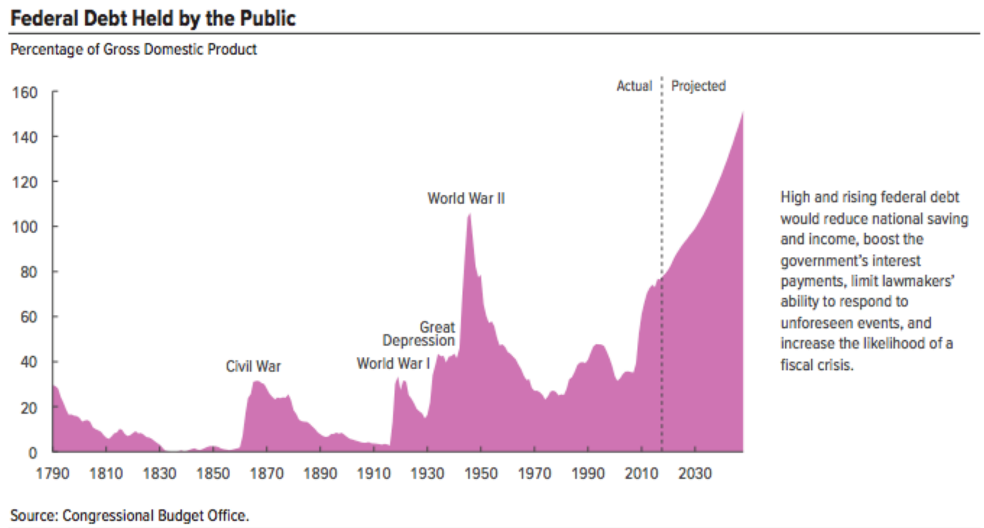
Federal Government Debt Projections



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Overall Summary

- **Tailwinds and headwinds both exist**
  - Economic forecasts for near term are favorable.
  - Later 2020 and 2021 forecasts are less sanguine.
- **There remains room for the economy to grow**
  - Labor force growth is available.
  - Consumption has room to grow, but there is evidence of slowing.
  - Business investment may be slowing.
  - Return to productivity growth? But how? What's the next big idea?
- **Long term concerns unaddressed**
  - Demographics, climate change
  - Federal government debt
  - International trade policy

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Teasers: Upcoming Lectures

- Government Budgets
- Climate Change
- Income Inequality
- Trade and Globalization
- Housing Policy

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Thank you!

Any Questions?

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Jon Haveman, Ph.D.
Jon@NEEDelegation.org

Contact NEED: info@needelegation.org

Submit a testimonial: www.NEEDelegation.org/testimonials.php

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The Local Economy

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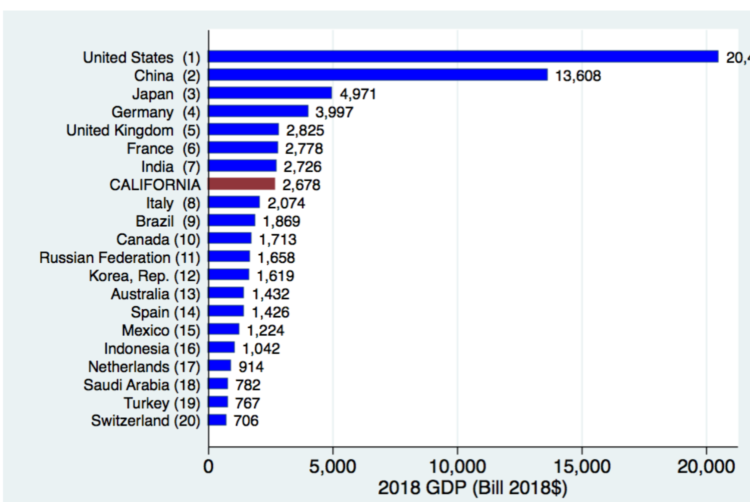
If California Were A Country…



Source: U.S. BEA and World Bank; Calculations by Marin Economic Consulting
The # in parentheses is the ranking out of 188 geographies.

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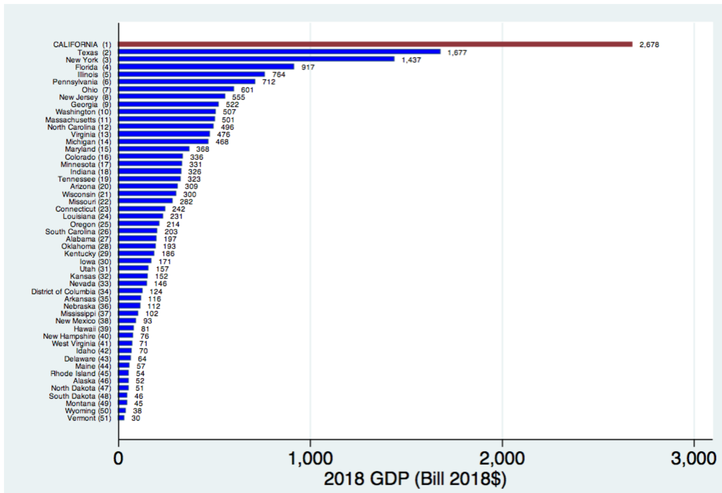
CA is the Largest State, by Far



Source: Bureau of Economic Analysis, Calculations by Marin Economic Consulting

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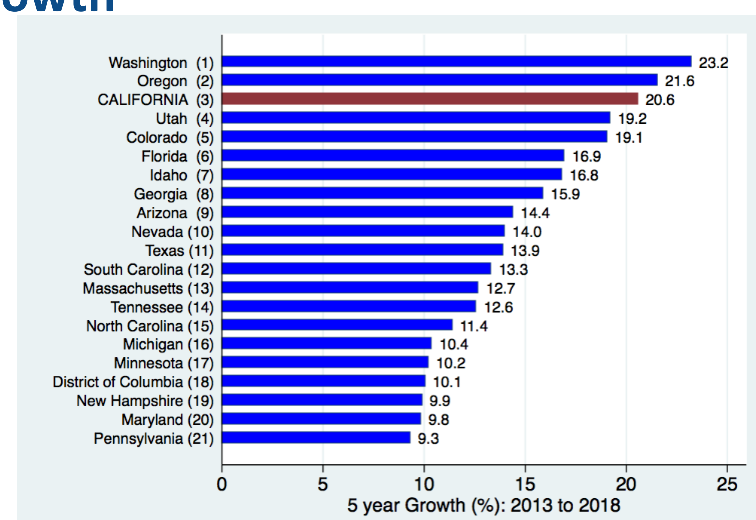
GSP Growth



Source: U.S. BEA; Calculations by Marin Economic Consulting

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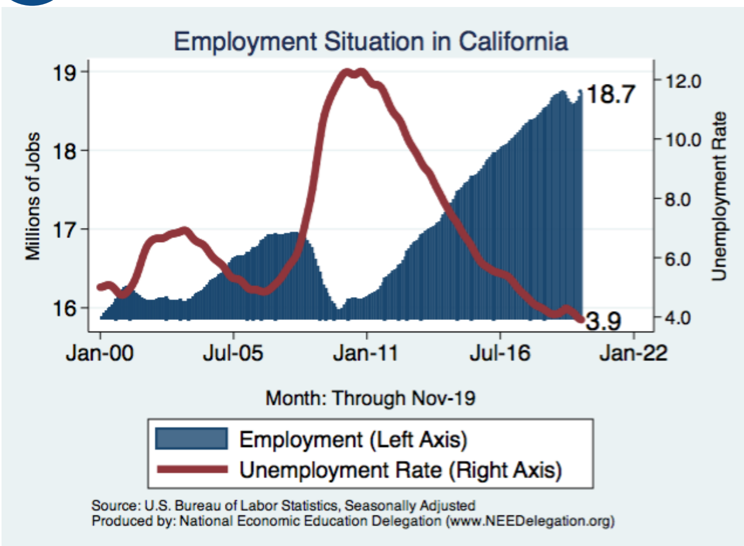
CA Employment Growth is Slowing



Growth Rate:

Last Month: 0.2%

Last Year: 1.4%

Last 3 Years: 2.0%

Last 5 Years: 2.5%

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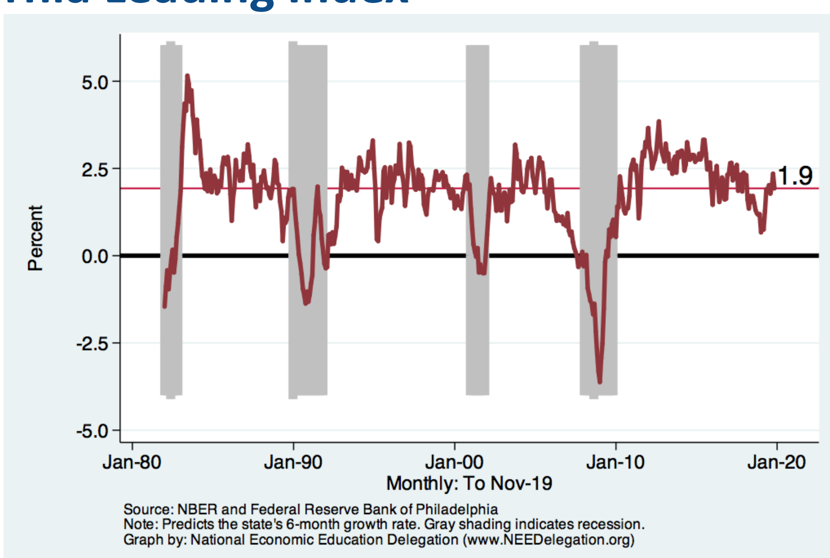
California Leading Index



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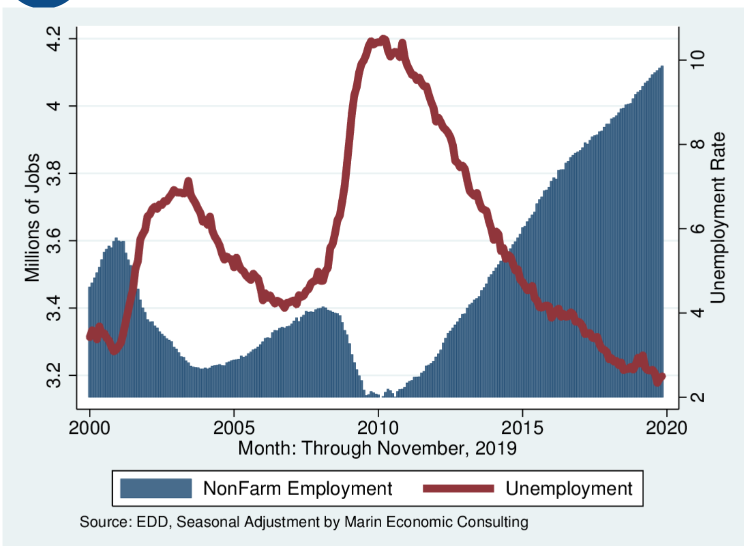
Bay Area is Growing Well: Employment



Growth Rate:

Last Month: 1.9%

Last Year: 2.4%

Last 3 Years: 2.2%

Last 5 Years: 2.8%

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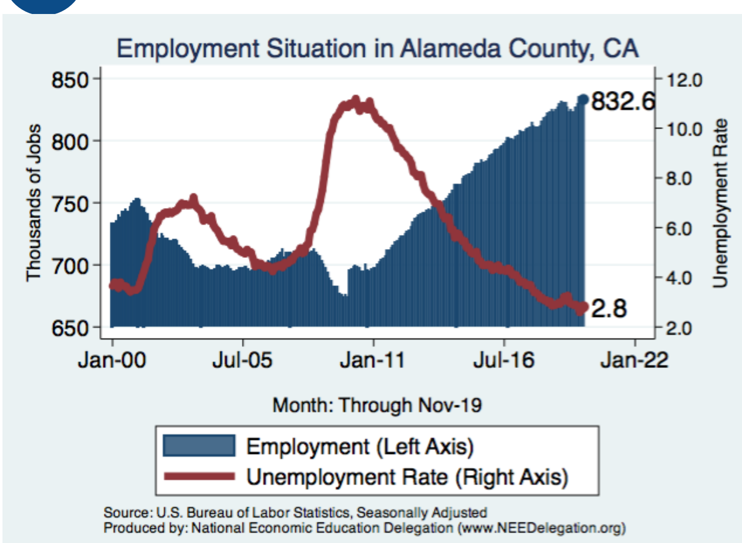
Employment Situation: Alameda County



Growth Rate:

Last Month: 0.4%

Last Year: 1.6%

Last 3 Years: 2.0%

Last 5 Years: 2.6%

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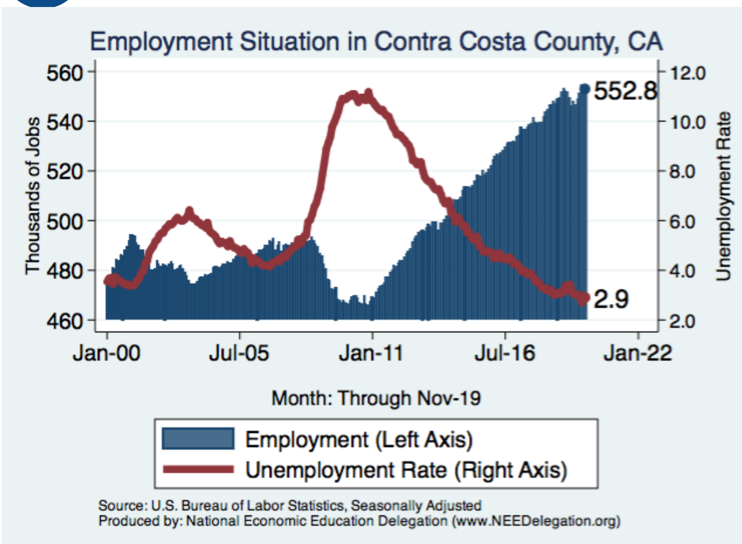
Employment Situation: Contra Costa County



Growth Rate:

Last Month: 0.4%

Last Year: 1.7%

Last 3 Years: 1.2%

Last 5 Years: 2.1%

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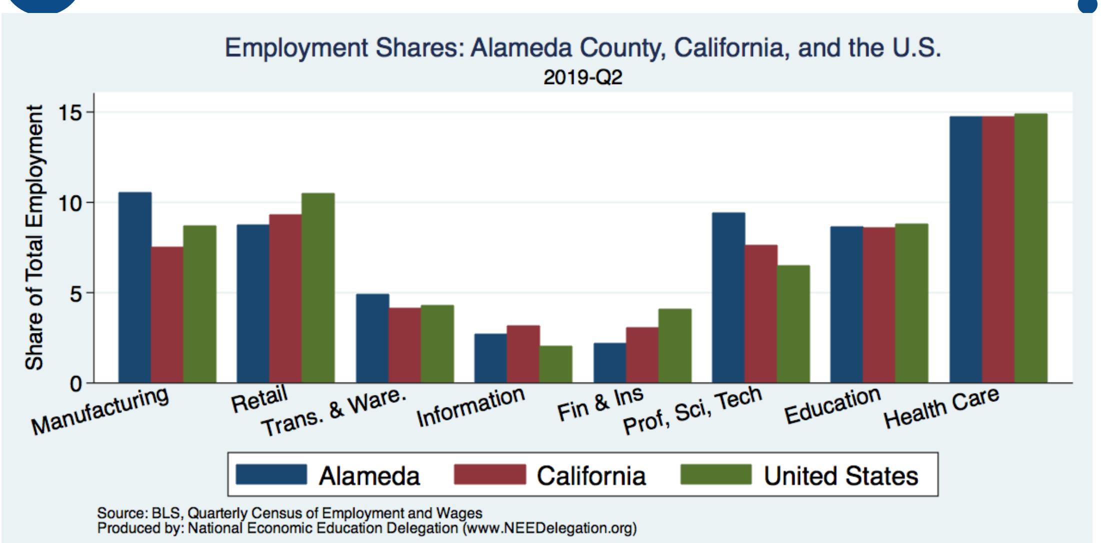
Alameda Employment Shares



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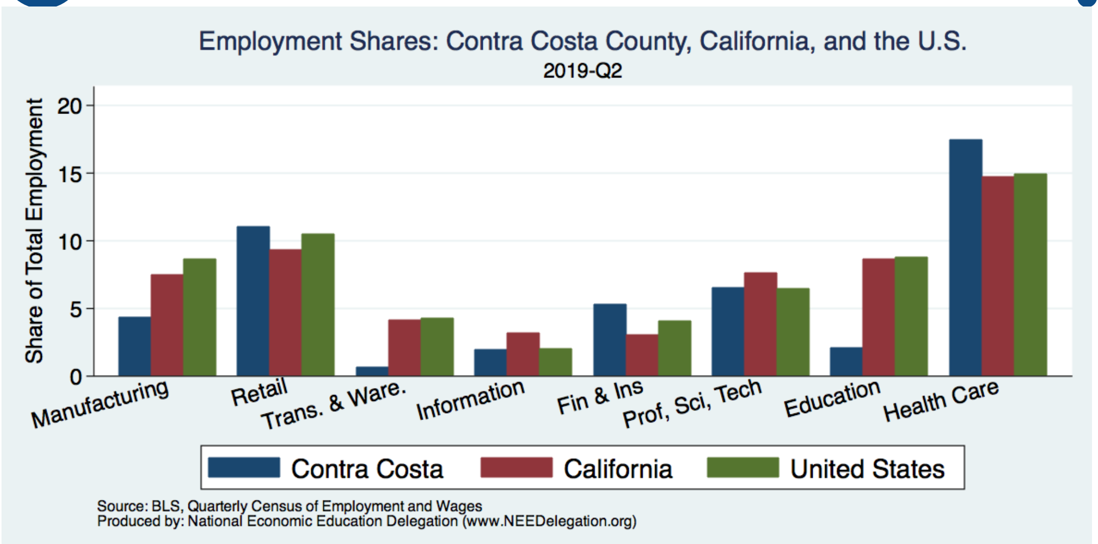
Contra Costa Employment Shares



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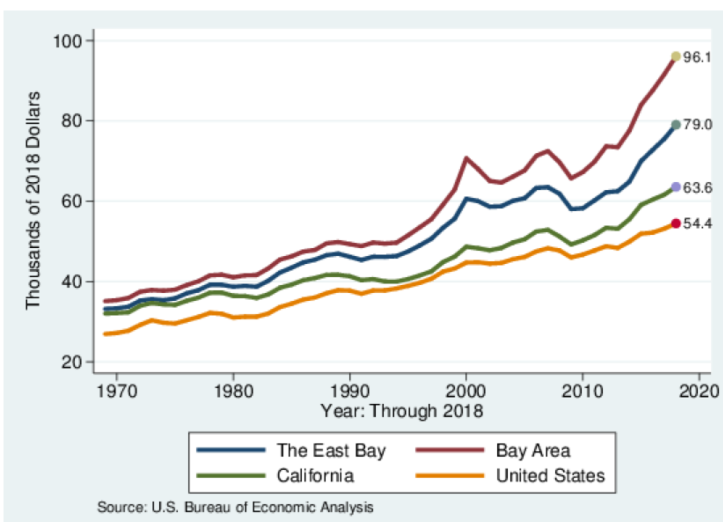
East Bay Per Capita Income



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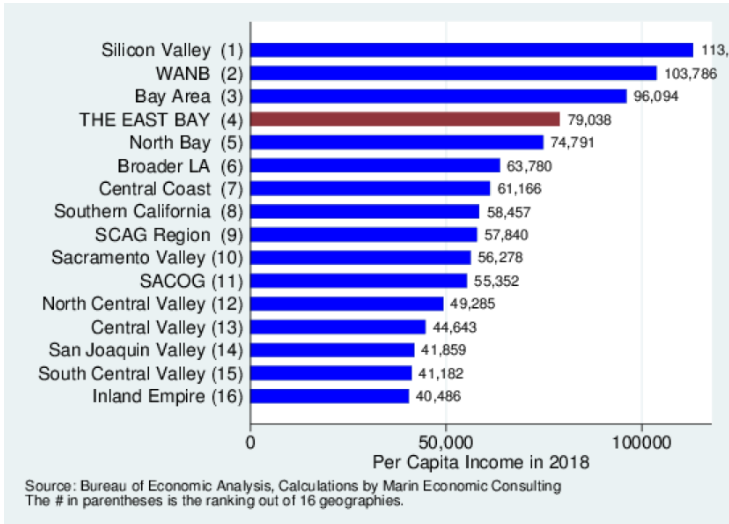
East Bay in Statewide Perspective



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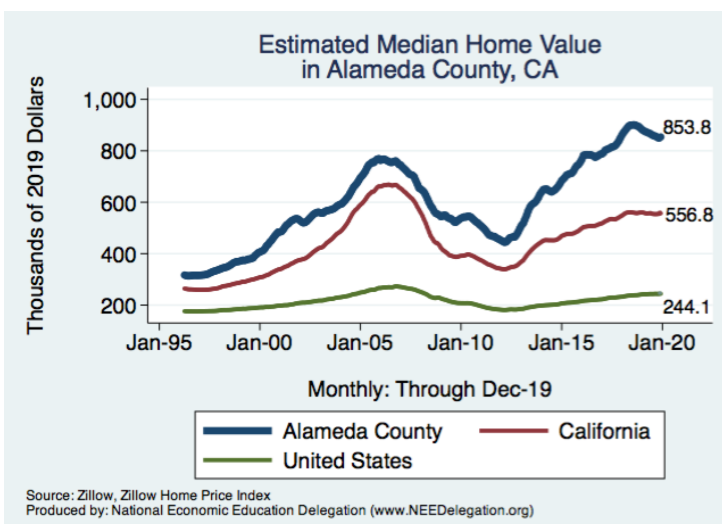
Alameda Home Prices



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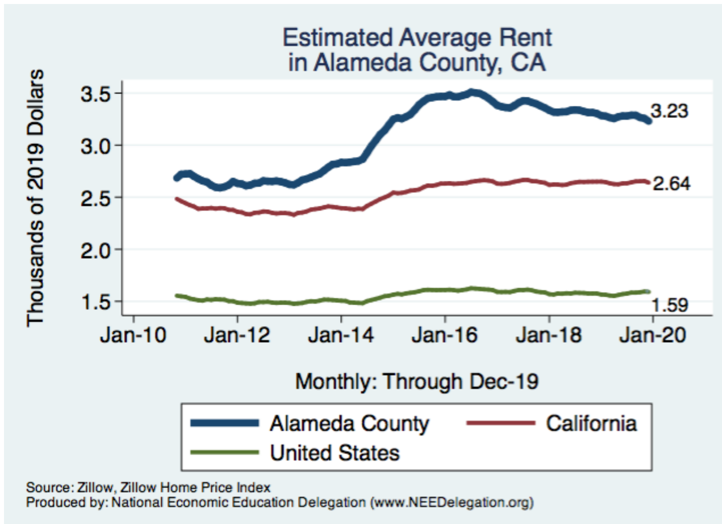
Alameda Rents



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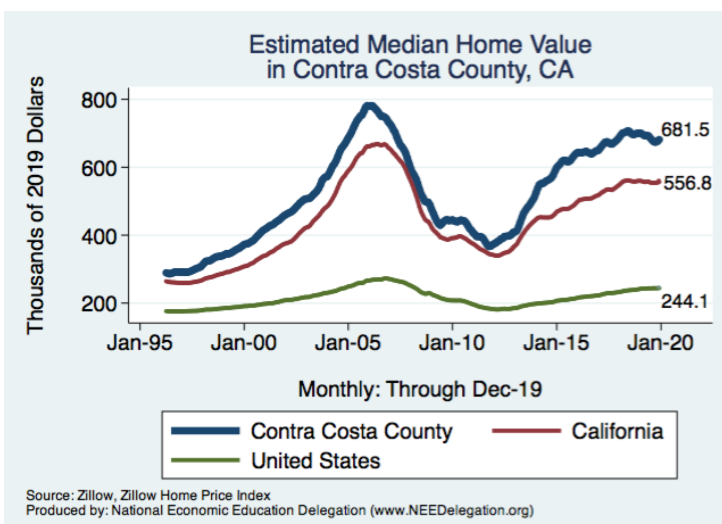
Contra Costa County Home Prices



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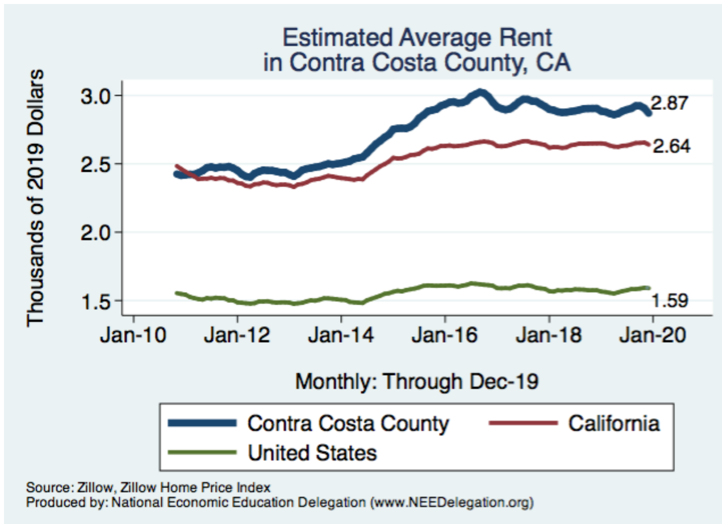
Contra Costa County Rents



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