The Economic Outlook, October 2010

Larry DeBoer
Purdue University
October 26, 2010

Real GDP Growth
Real Consumption Spending Growth

Household Savings Rate
Real Business Investment Spending Growth

[Graph showing real gross private domestic investment growth]

Residential Building Permits

[Graph showing new private housing units authorized by building permits]

Source: U.S. Department of Commerce: Bureau of Economic Analysis
Source: U.S. Department of Commerce: Census Bureau
Unemployment Rate

Civilian Unemployment Rate (UNRATE)

Shaded areas indicate US recessions.
2010 research.stlouisfed.org

Okun's Law: Real GDP Growth and Change in Unemployment Rate, 1987-2009

GDPGro = -1.59 x ChUnempRate + 2.83
R² = 0.7764
CPI Inflation, All Items and Core

Phillips Curve: Change in Core Inflation and Unemployment Rate, 1987-2009

\[ \text{ChngInflaRate} = -0.22 \times \text{UnempRate} + 1.13 \]

\[ R^2 = 0.3298 \]
Federal Funds Interest Rate

Effective Federal Funds Rate (FEDFUNDS)
Source: Board of Governors of the Federal Reserve System

Corporate Bond Interest Rates

Moody’s Seasoned Baa Corporate Bond Yield (BAA)
Moody’s Seasoned Aaa Corporate Bond Yield (AAA)

BAA: higher risk
AAA: lower risk
Fed Will Hold Interest Rates Down

Economic conditions “are likely to warrant exceptionally low levels for the federal funds rate for an extended period.”

(September 21, 2010)

Ben Bernanke, Fed Chair
Fed Will Attempt to Prevent Inflation

“By carefully monitoring our balance sheet and developing tools to drain bank reserves as needed, we will ensure that policy accommodation can be reversed at the appropriate time to avoid risks of future inflation.” (Feb. 2009)

Ben Bernanke, Fed Chair
Federal Budget Balance as Percent of GDP

Shaded areas indicate US recessions. 2010 research.stlouisfed.org

Federal Budget Balance as Percent of GDP and Unemployment Rate, 1987-2009

\[ \text{BudBalPct} = -1.99 \times \text{UnempRate} + 8.91 \]
\[ R^2 = 0.8298 \]
Federal Government Debt as Percent of GDP

Why might debt be a problem?

- If Federal government borrowing “crowds out” private investment
  - Corporate bond interest rates would rise
- If the Federal Reserve “monetizes” the debt by printing money
  - Inflation would increase
- If international investors decide not to buy or hold U.S. Treasury bonds
  - Demand for the dollar would drop, supply would increase, value of the dollar would fall
Real Export and Import Spending Growth

Trade Balance, Percent of GDP
Summary

- GDP growth above 3% per year, if we’re lucky
- So unemployment will fall at most 1% per year, remains above 5% through the middle of the decade
- Inflation is not a threat now, but the Federal Reserve will have to withdraw a lot of money eventually
- The Fed will not raise interest rates in the near future, and is likely to look for ways to stimulate the economy
- The budget deficit and national debt are not problems now—they’re probably necessary—but they’re a danger once the economy recovers

Sources for Data and Graphs

- St. Louis Federal Reserve, Federal Reserve Economic Data (FRED)
- http://research.stlouisfed.org/fred2/