FEDERAL RESERVE BANK of ATLANTA

The Economy: A View from the (Atlanta) Fed (Staff)

2018 Alabama Economic Outlook

Montgomery, AL

January 11, 2018

The new supply-side economics?

“In their discussion of monetary policy, participants saw the outlook for economic activity and the labor market as having remained strong or having strengthened since their previous meeting, in part reflecting a modest boost from the expected passage of the tax legislation under consideration.”

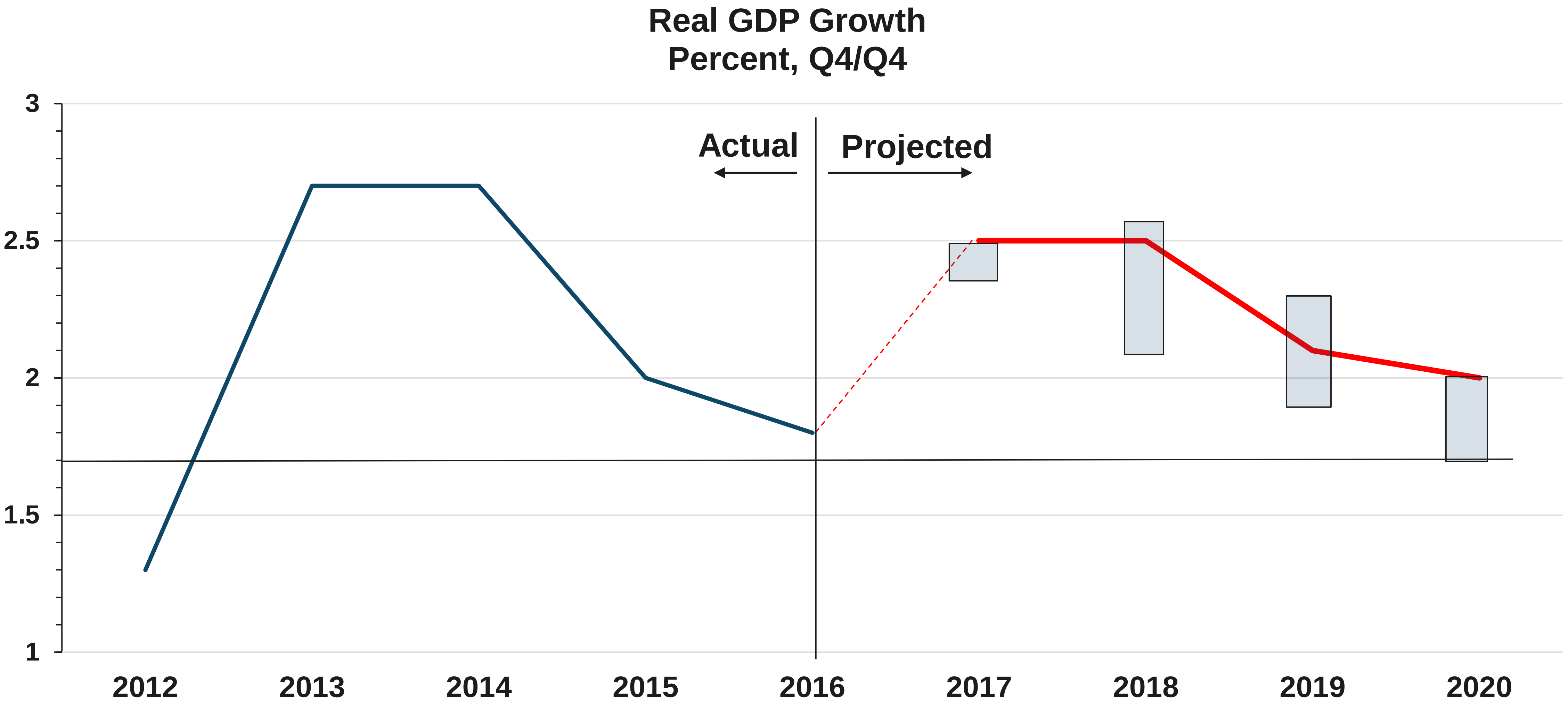
Source: Minutes of the Federal Open Market Committee, December 12-13, 2017

Will the tax cuts continue to matter? Yes, probably… but how much?

“Most participants pointed to changes in tax policy as likely to provide some boost to real GDP growth over the forecast period.”

Source: Minutes of the Federal Open Market Committee, December 12-13, 2017

The view from the FOMC: Growth holding up – then slowing to a relatively slow longer-run pace.

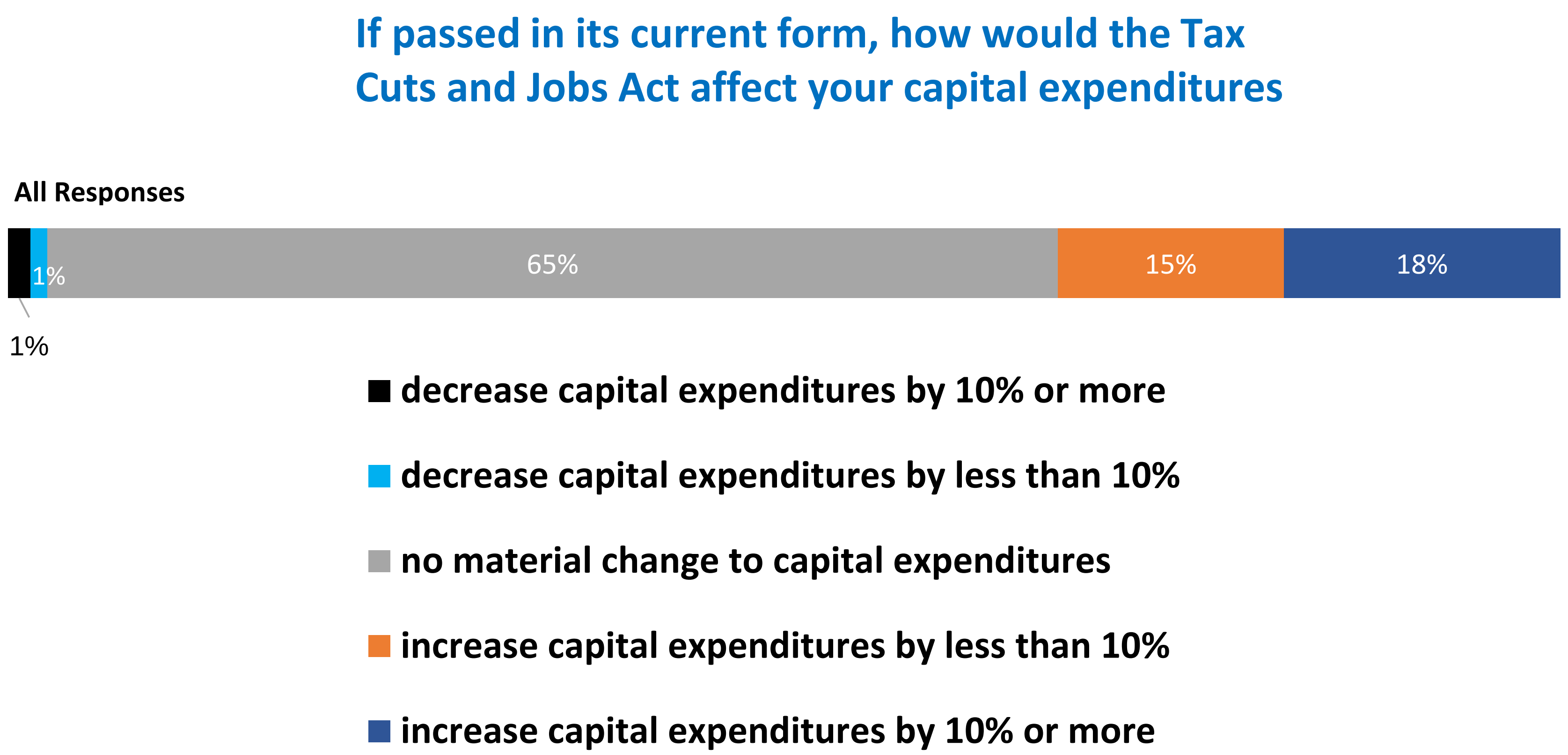


Note: The red line is the median projection; shaded bars represent the "central tendency" range of projections.

Source: FOMC *Summary of Economic Projections*, December 2017, Bureau of Economic Analysis, FRED database

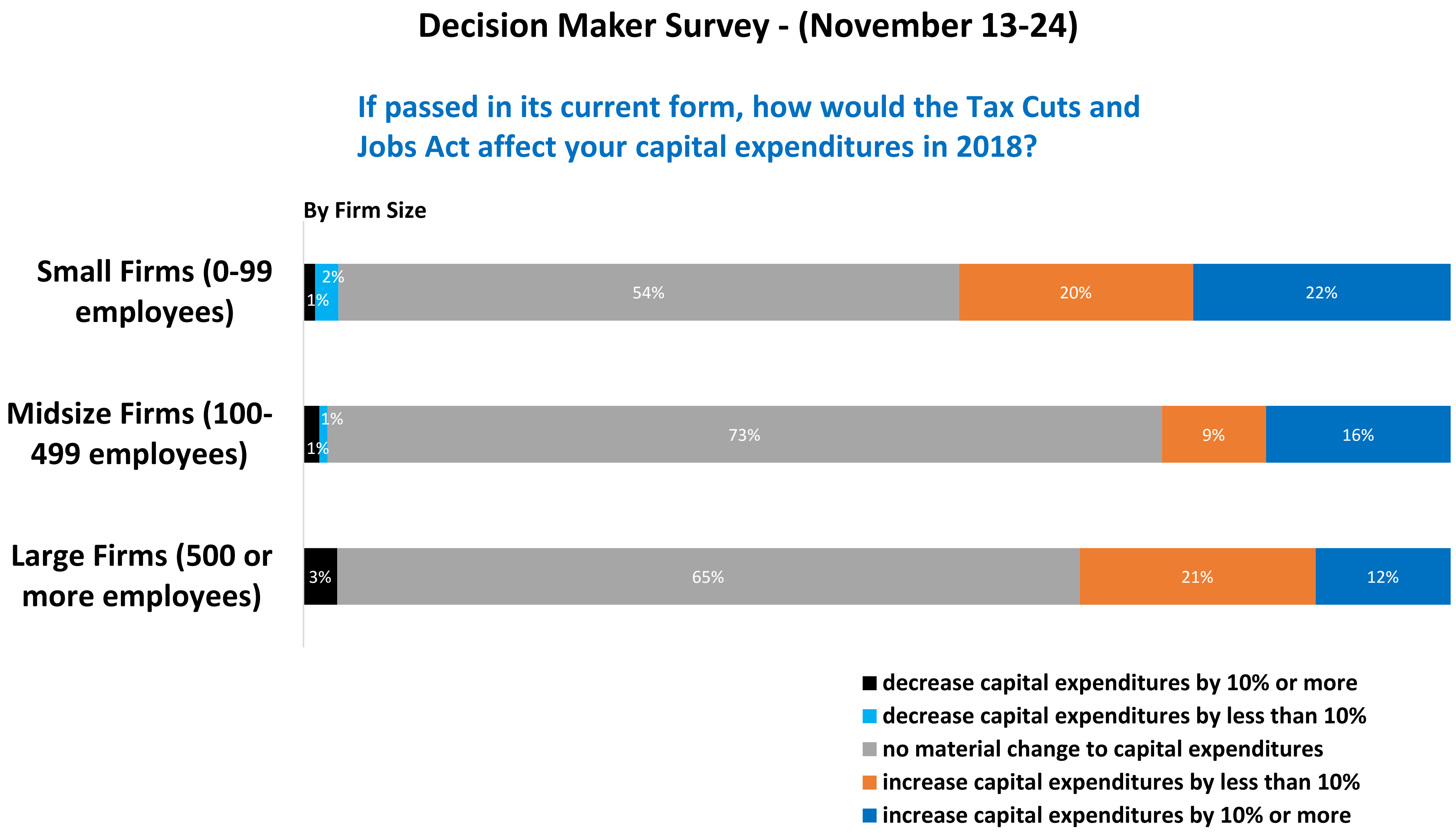
Will the tax cuts matter?
Survey says: Results from the Business Decision Maker Survey.

Decision Maker Survey - (November 13-24)



Source: Decision Makers Survey; Federal Reserve Bank of Atlanta, Stanford University, and University of Chicago

The Business Decision Maker Survey indicates that small business are somewhat more likely to increase capital expenditures as a result of tax reform.



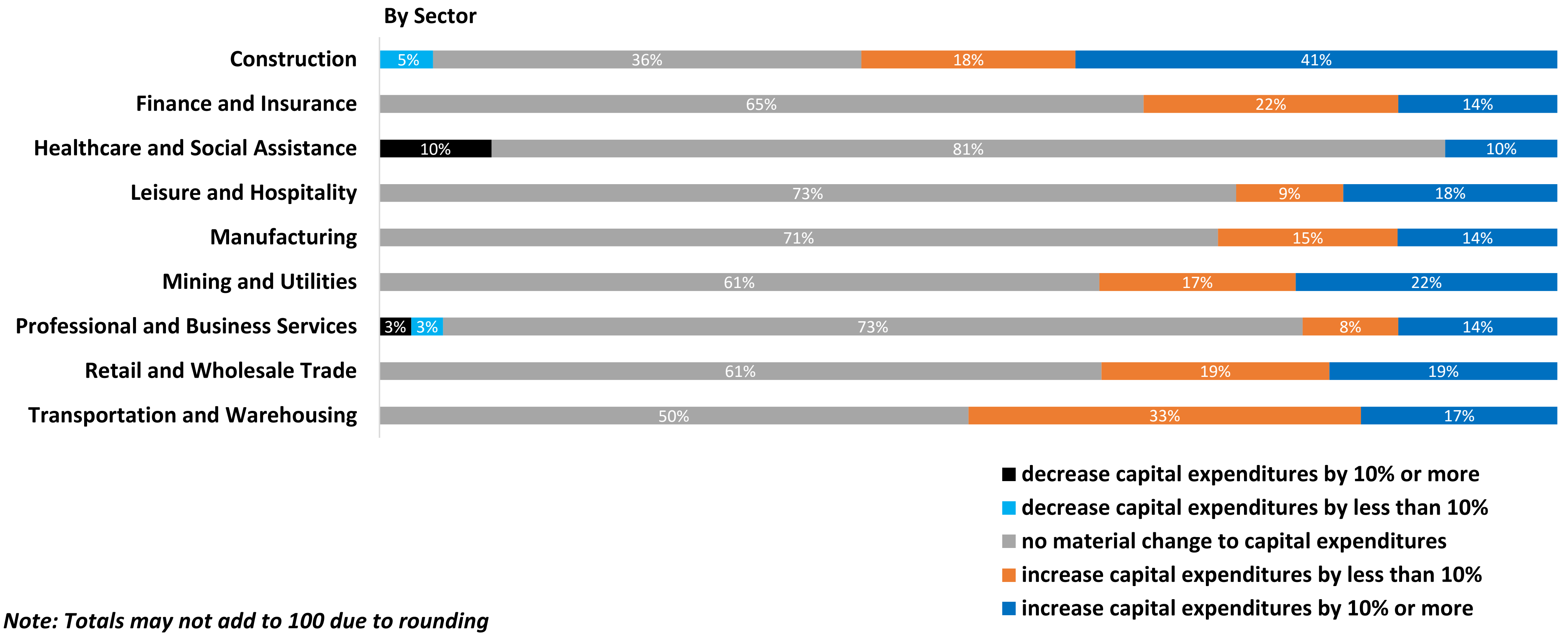
Note: Totals may not add to 100 due to rounding

Source: Decision Makers Survey; Federal Reserve Bank of Atlanta, Stanford University, and University of Chicago

Across sectors, construction was the only area suggesting significant changes in planned capital expenditures.

Decision Maker Survey - (November 13-24)

If passed in its current form, how would the Tax Cuts and Jobs Act affect your capital expenditures in 2018?



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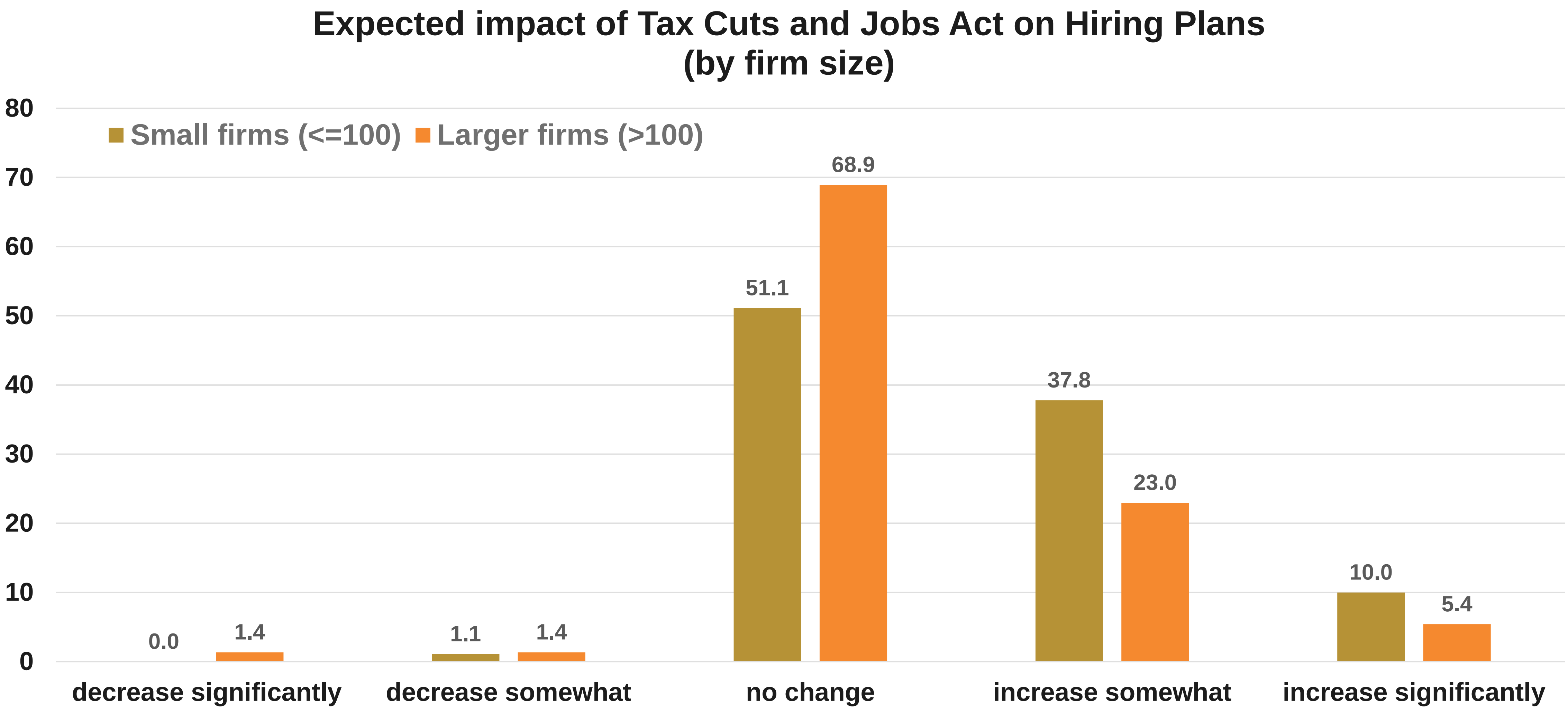
What about tax reform and hiring plans



Source: FRB Atlanta, Business Inflation Expectations Survey, Nov. 2017

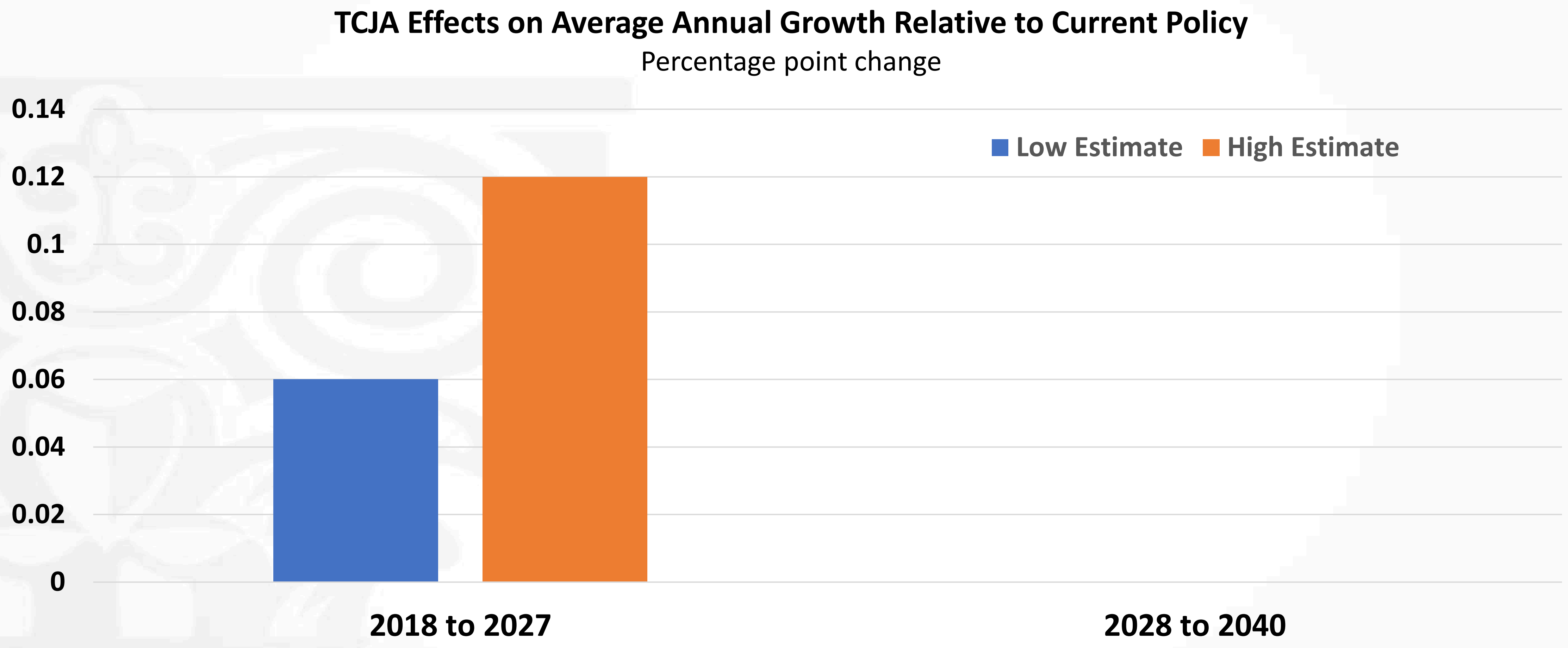
The new supply-side economics?

“The [supply-side] theory of the 1980s focused mainly on individuals, and lowering the tax rates they faced on labor income and capital gains...

The idea today is that the real power of mobilization comes through corporate associations. Assuming the tax bill passes, that theory is about to get a major test.”

Source: Tyler Cowen, “Trump’s Economic Revolution is All About Investment,” *Bloomberg View*, December 4, 2017

The growth effects of the Tax Cuts and Jobs Act (according to the Penn Wharton Budget Model).



Source: "The Tax Cuts and Job Acts, as Reported by Conference Committee (12/15/17): Static and Dynamic Effects on the

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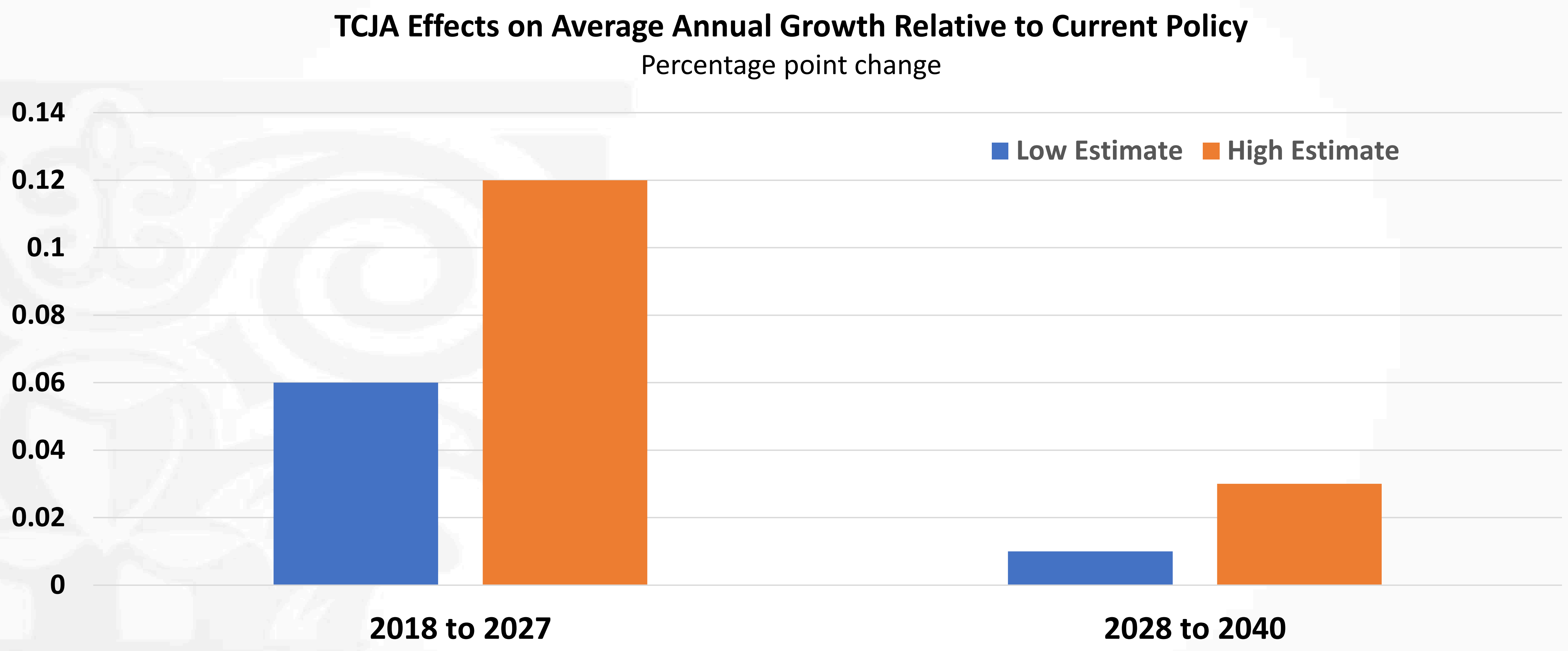
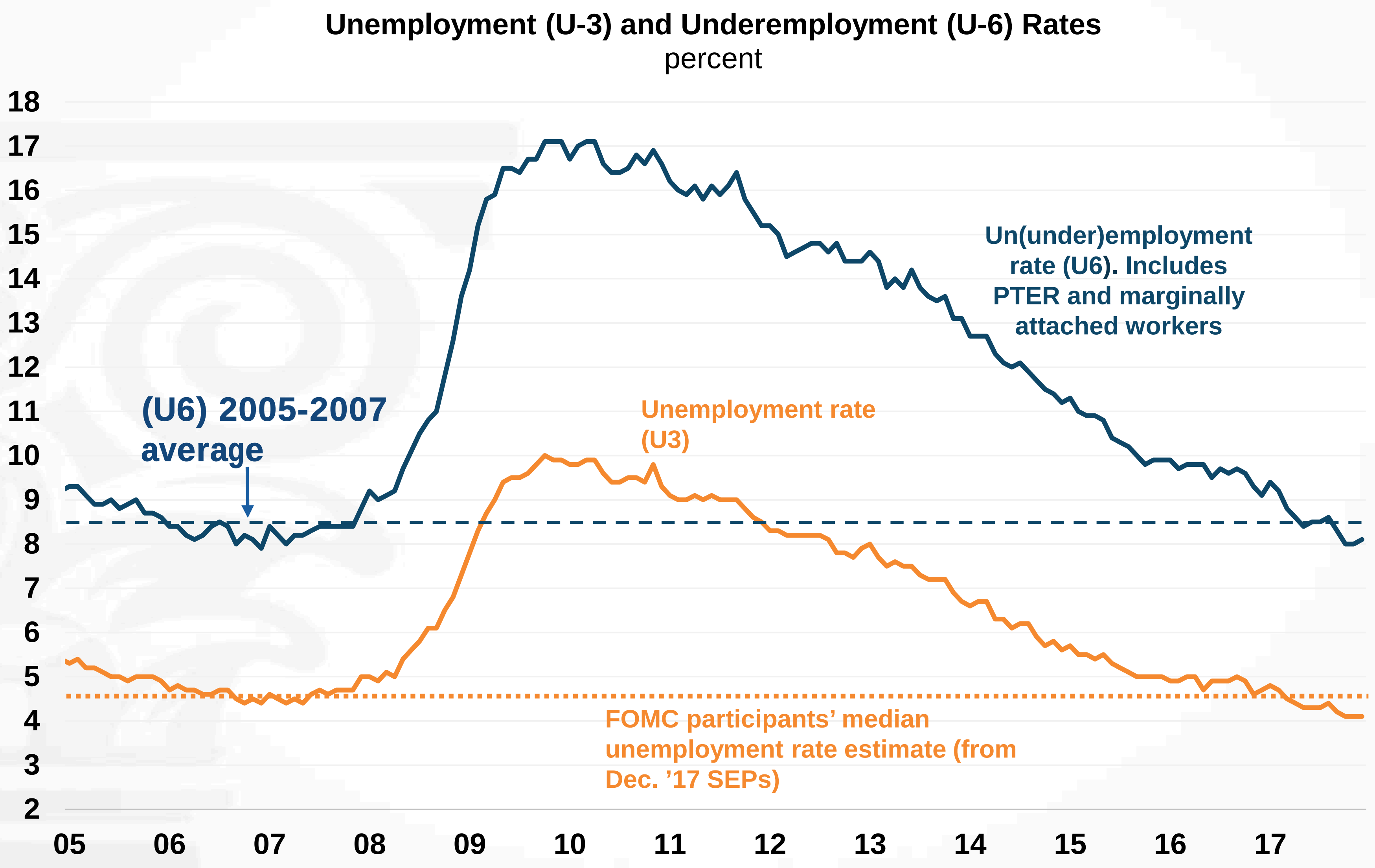


Source: “The Tax Cuts and Job Acts, as Reported by Conference Committee (12/15/17): Static and Dynamic Effects on the

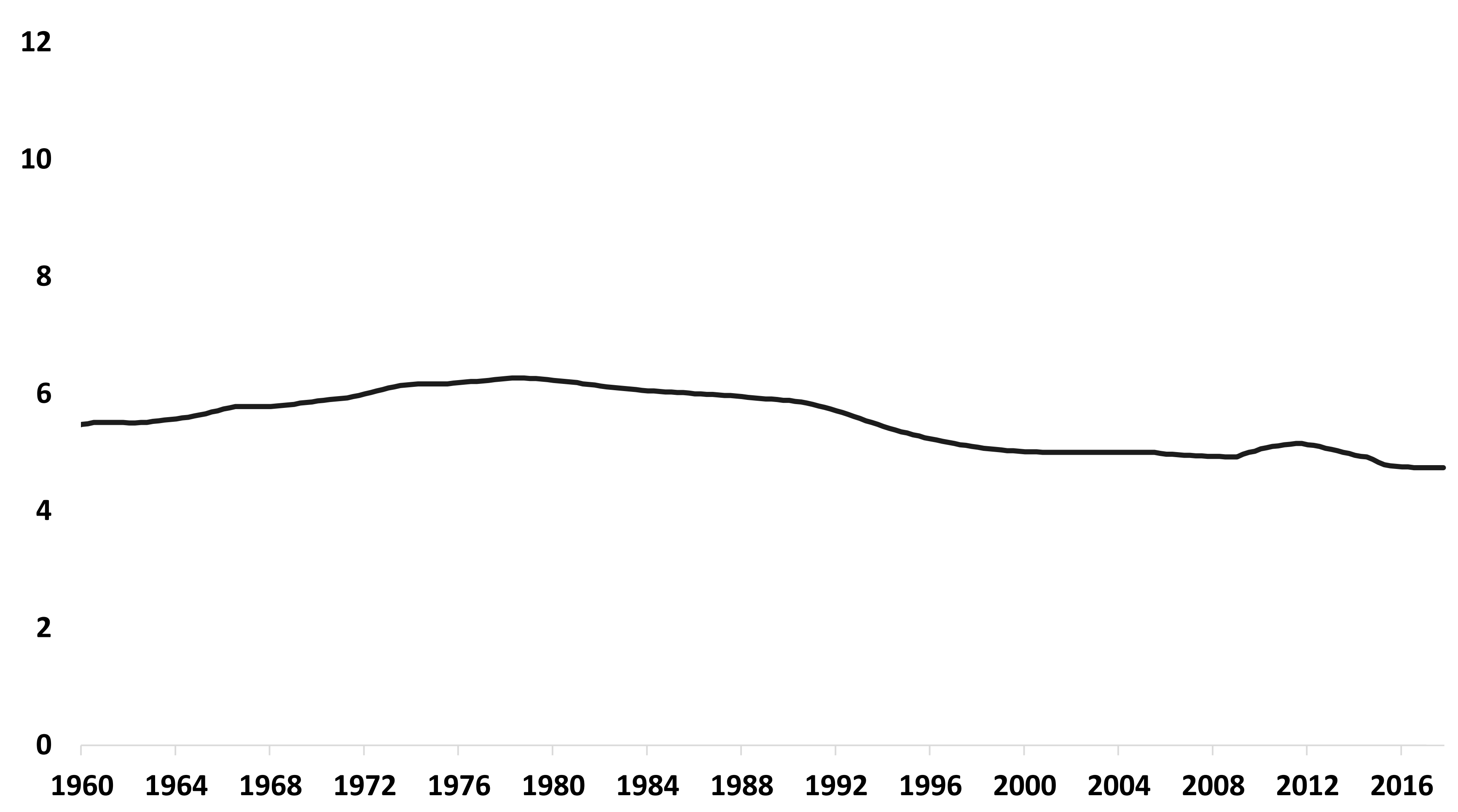
Both the narrow (U3) unemployment rate and the broader (U6) underemployment rate suggest that labor utilization is about "normal"…



Sources: Bureau of Labor Statistics; FOMC, Dec. 2017 *Summary Economic Projections*; Haver Analytics

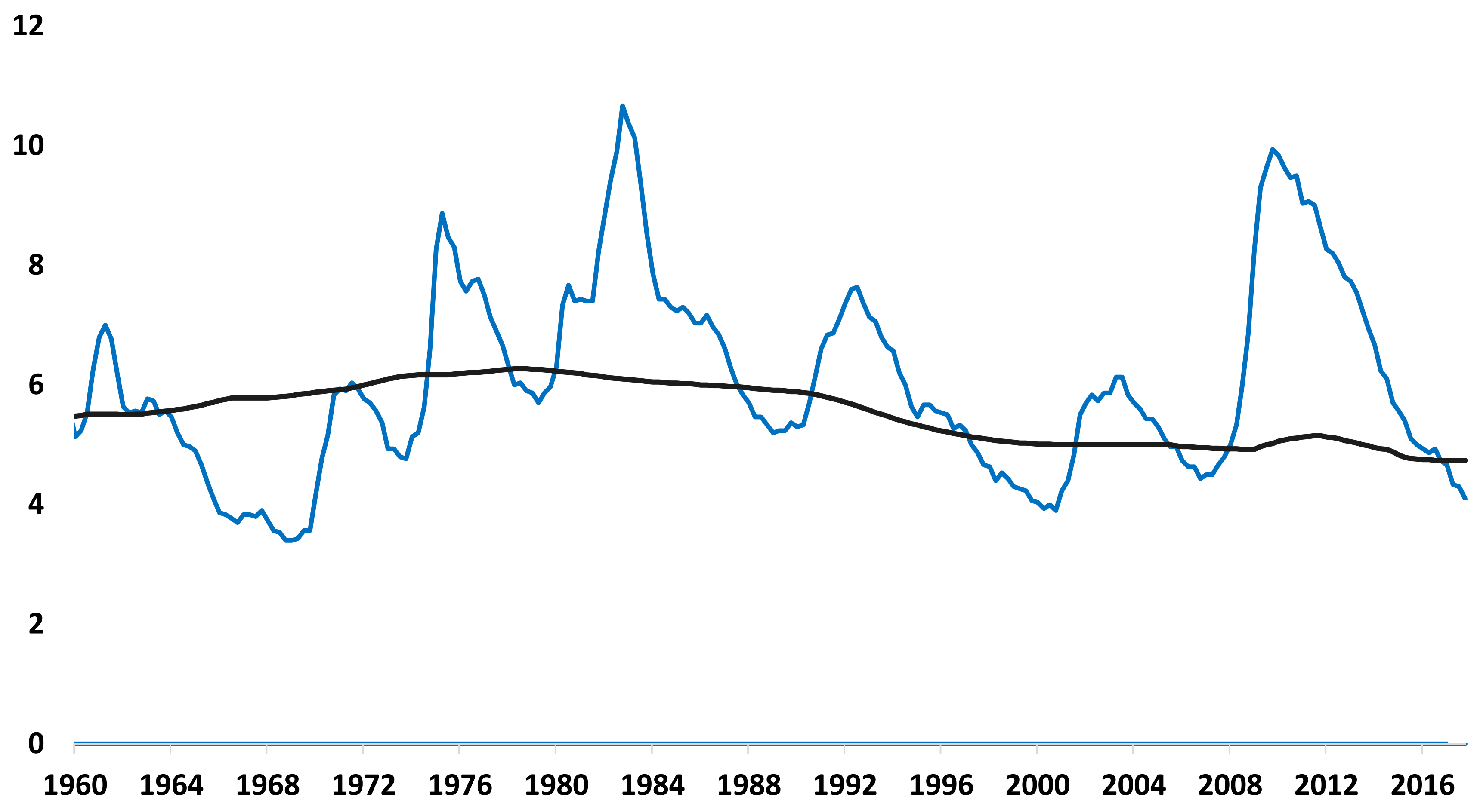
data through December 2017

Historical estimates of “normal” unemployment, from the Congressional Budget Office.



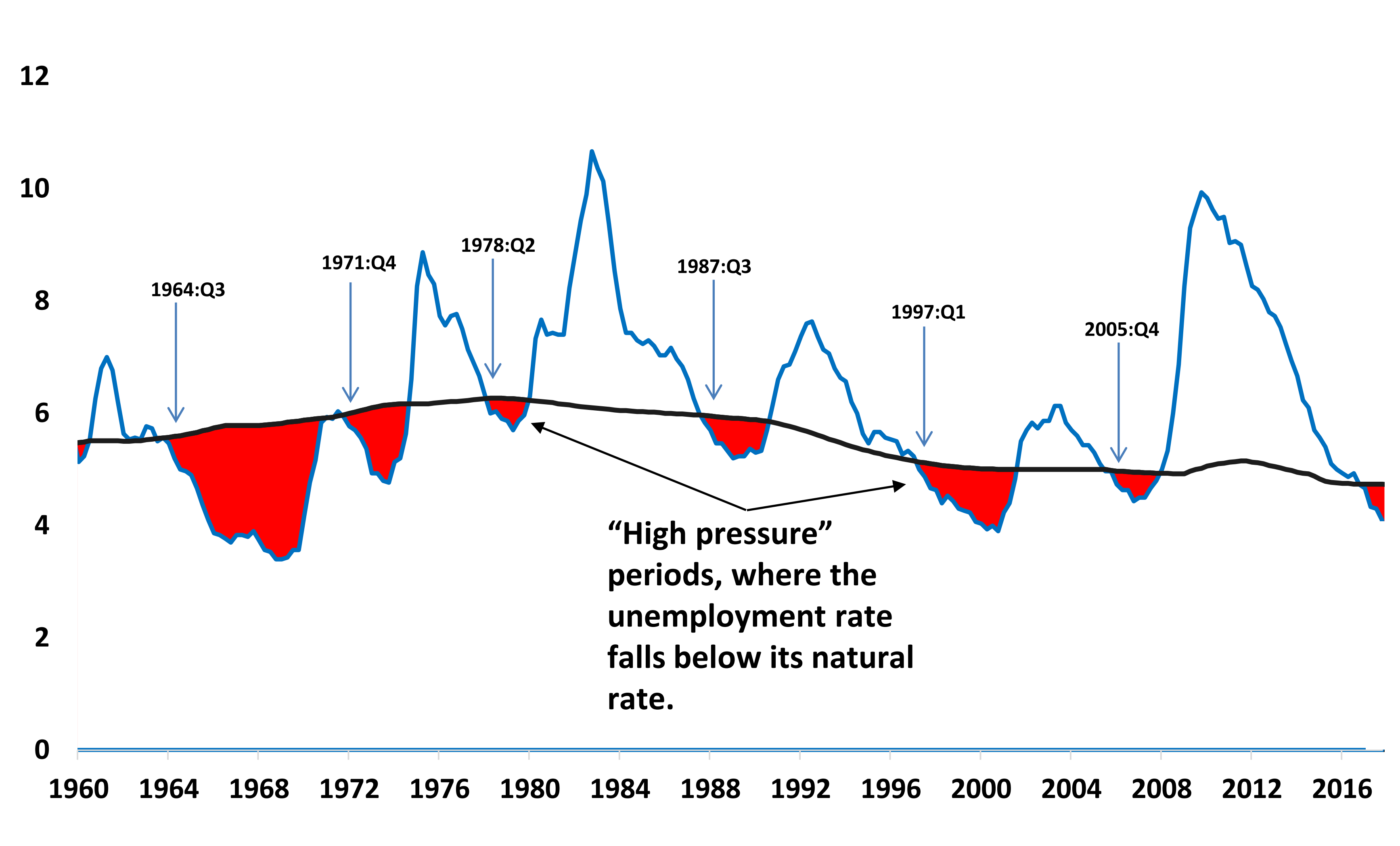
Sources: Bureau of Labor Statistics; Congressional Budget Office (CBO); BEA; Federal Reserve Board; Haver Analytics through Q4 2017

“Normal” unemployment rates are not really all that normal…



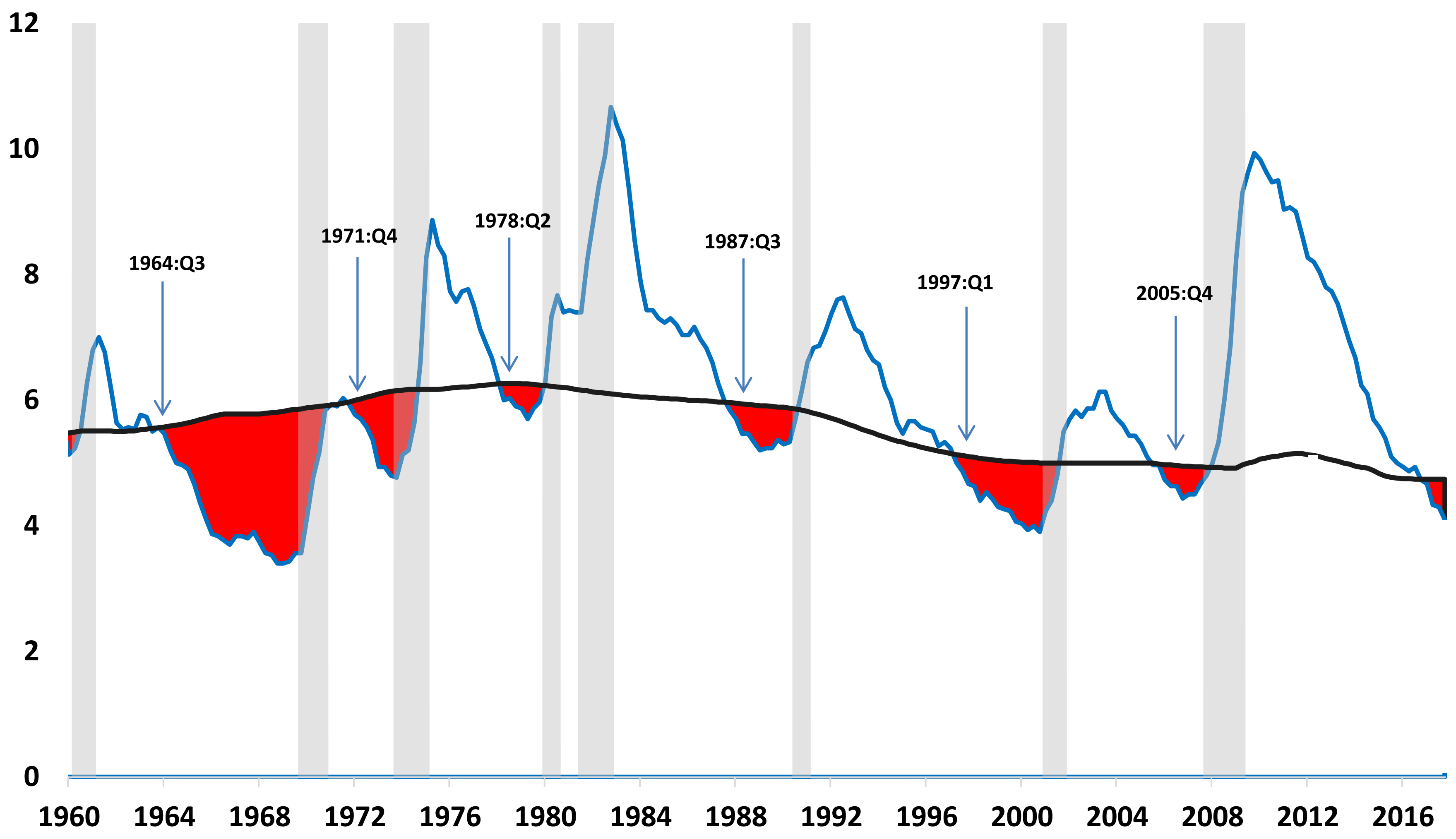
Sources: Bureau of Labor Statistics; Congressional Budget Office (CBO); BEA; Federal Reserve Board; Haver Analytics through Q4 2017

… but there have been relatively few "high pressure" episodes in recent history.



Sources: Bureau of Labor Statistics; Congressional Budget Office (CBO); BEA; Federal Reserve Board; Haver Analytics through Q4 2017

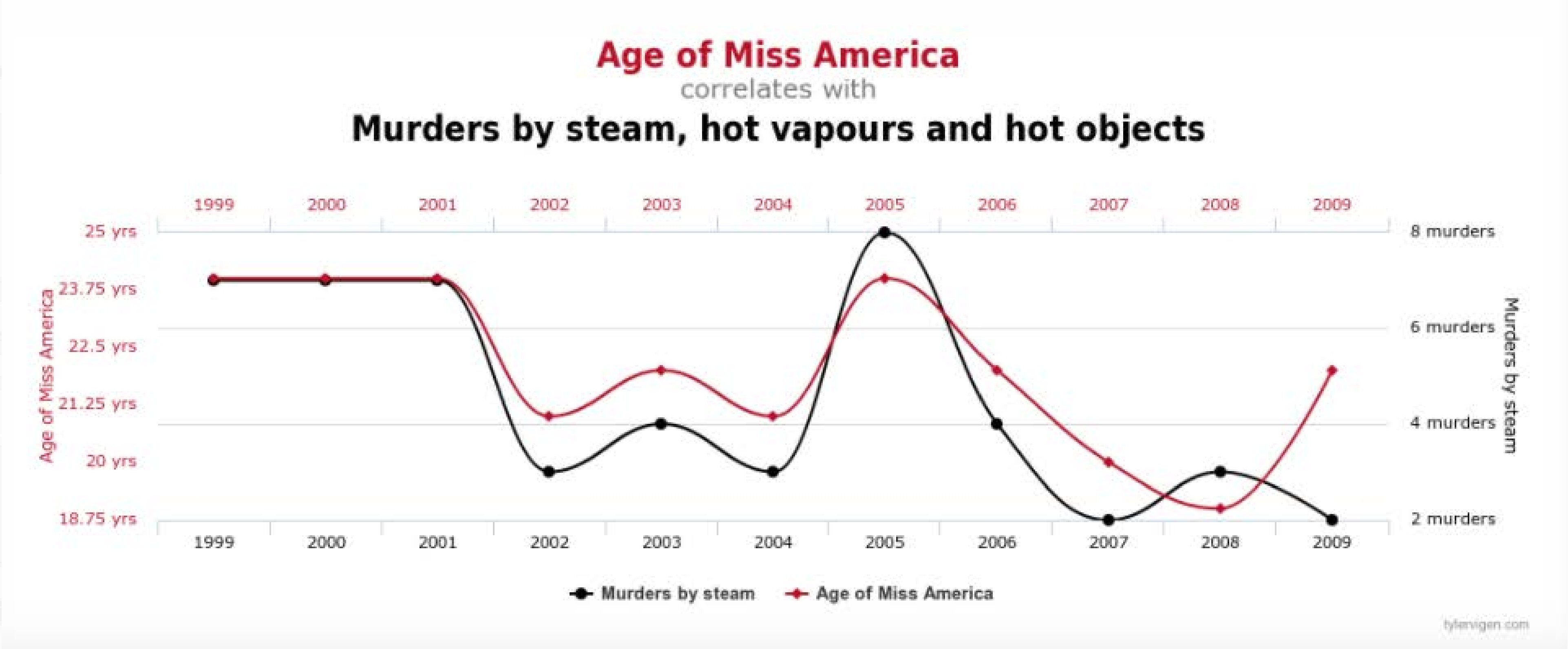
Historically, “high pressure” periods have not ended well.



Sources: Bureau of Labor Statistics; Congressional Budget Office (CBO); BEA; Federal Reserve Board; Haver Analytics

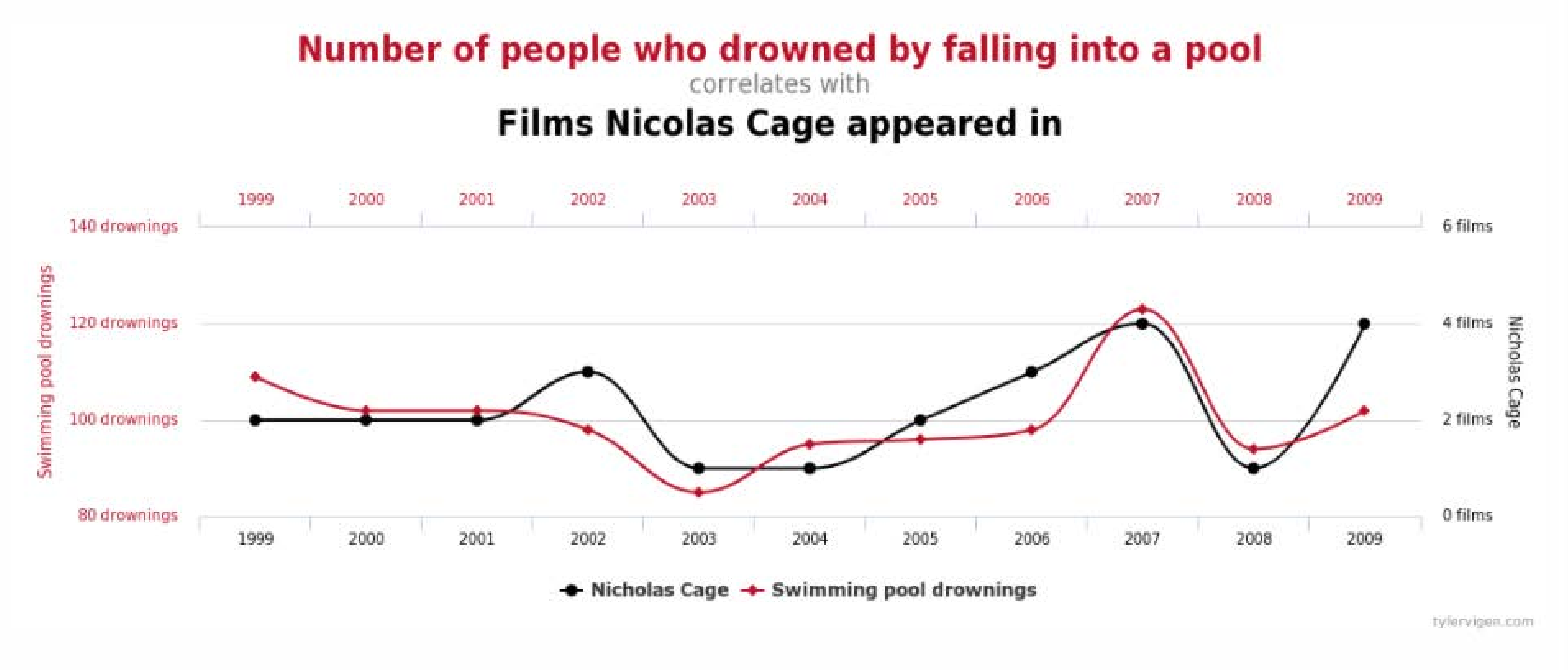
through Q4 2017

Beware the spurious correlation: Case study 1



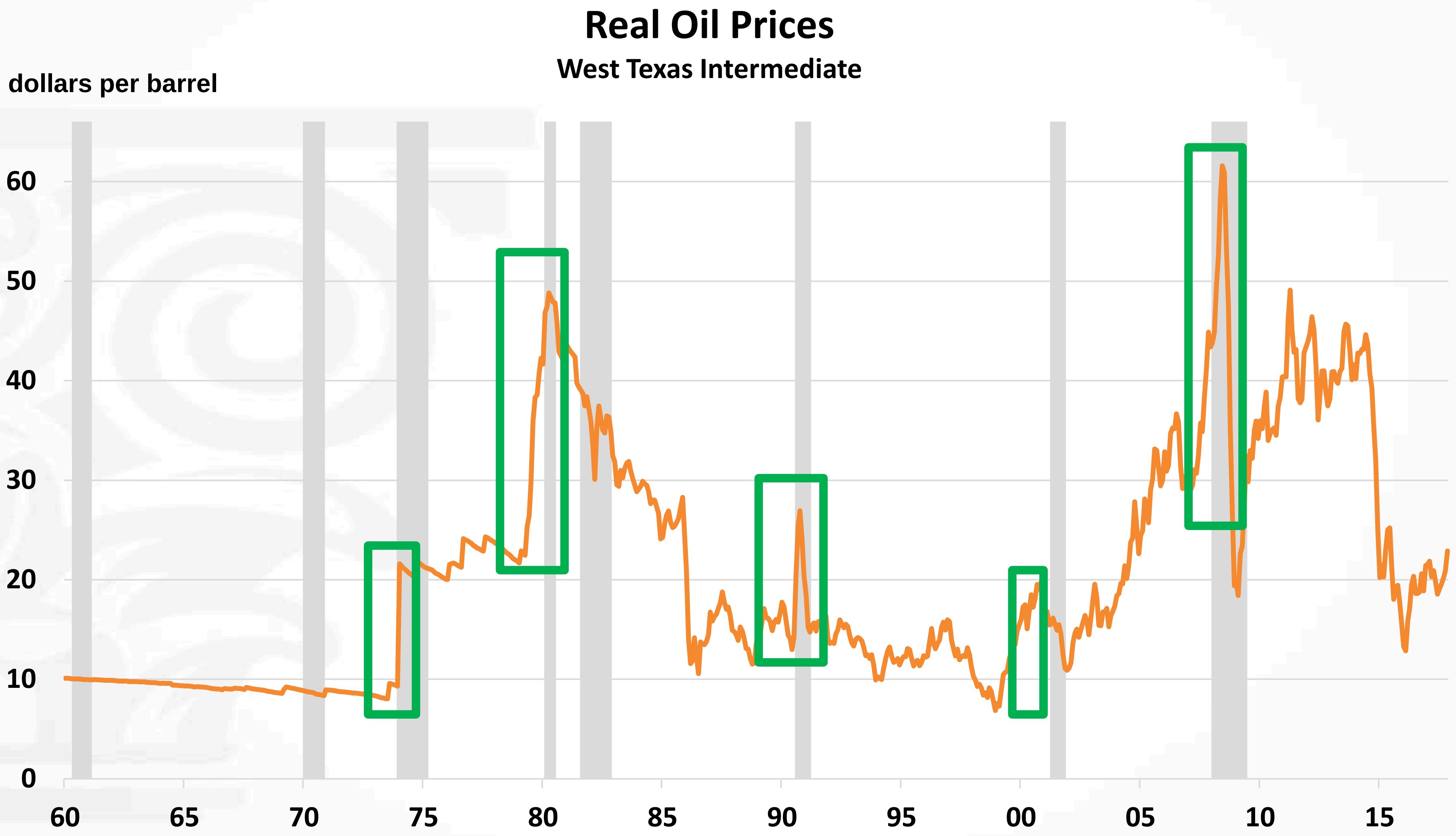
Source: http://www.tylervigen.com/spurious-correlations

Beware the spurious correlation: Case study 2



Source: http://www.tylervigen.com/spurious-correlations

Worth noting: Historically, expansions have also ended (and inflation has risen) when oil prices spike.

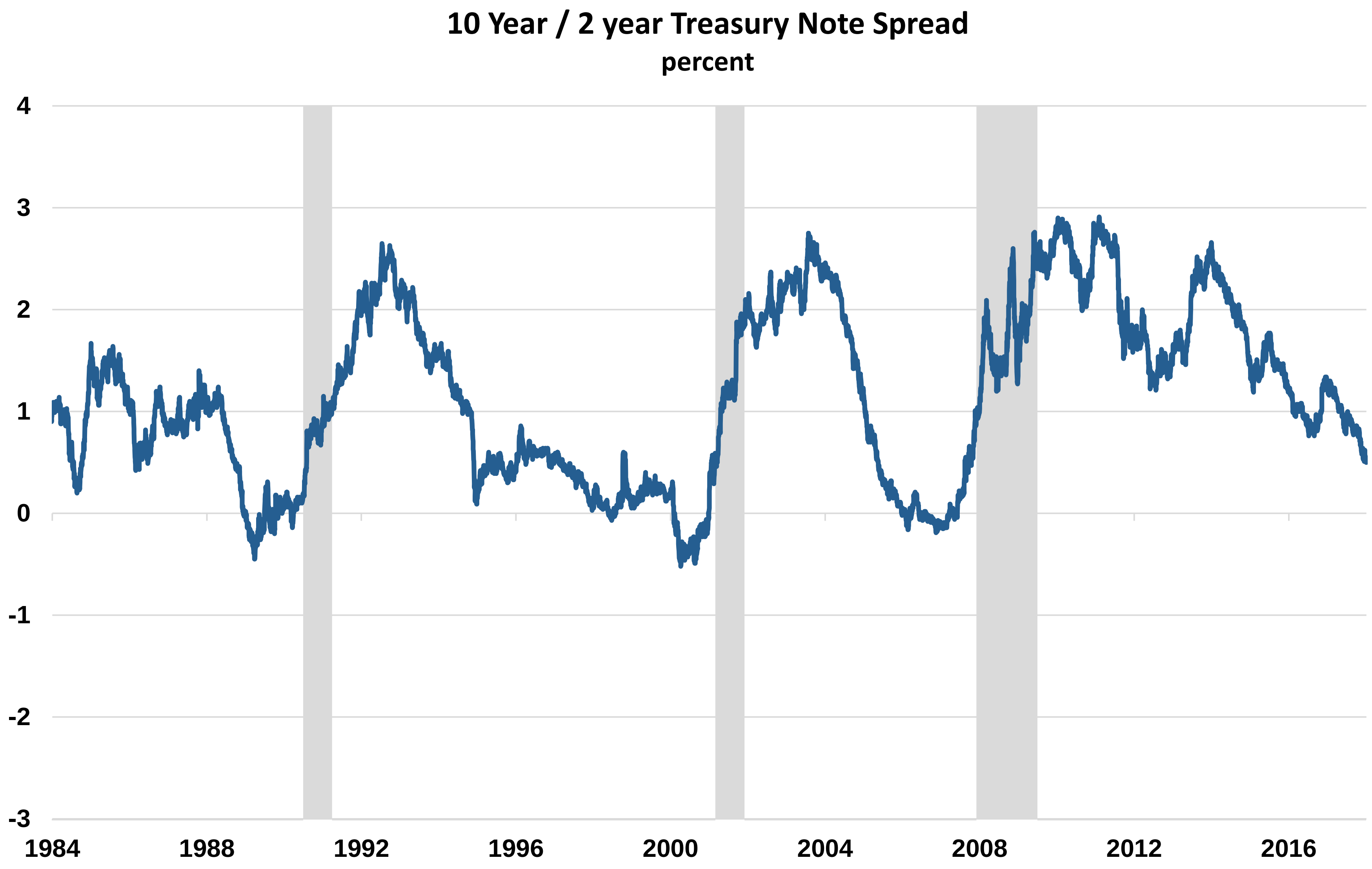


Note: Real oil prices calculated in 1982-1984 dollars using the consumer price index

Source: Bureau of Labor Statistics; Energy Information Administration; Haver Analytics

through November 2017

Another relevant picture? The term structure of interest rates



Source: Federal Reserve Board; Haver Analytics   data through January 3, 2018

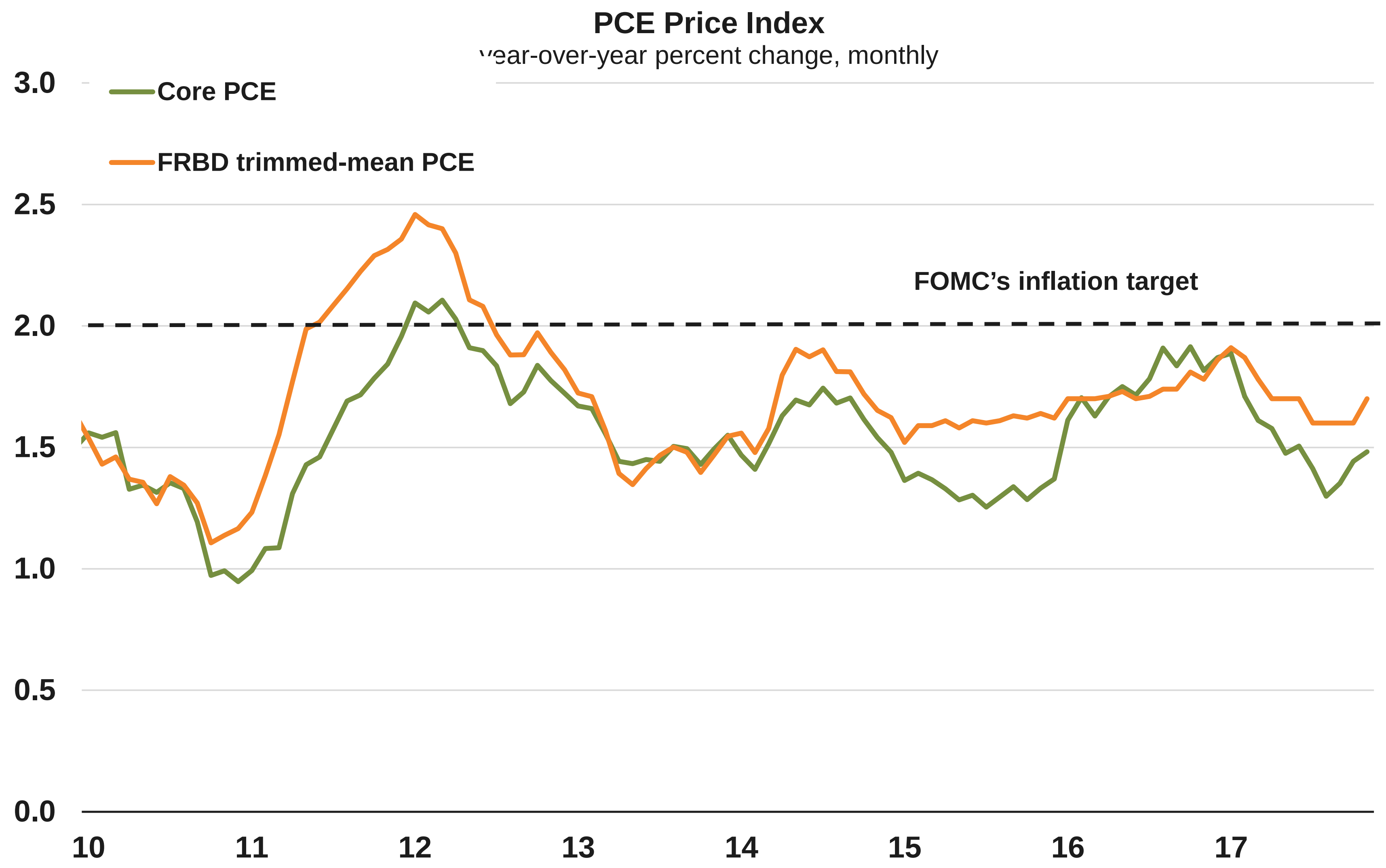
Could monetary policy overdo it?

Meeting participants also discussed the recent narrowing of the gap between the yields on long- and short-maturity nominal Treasury securities, which had resulted in a flatter profile of the term structure of interest rates…

Some expressed concern that a possible future inversion of the yield curve, with short-term yields rising above those on longer-term Treasury securities, could portend an economic slowdown…

Source: Minutes of the Federal Open Market Committee, December 12-13, 2017

Trend measures of inflation are still running soft relative to the FOMC's 2% longer-run target.

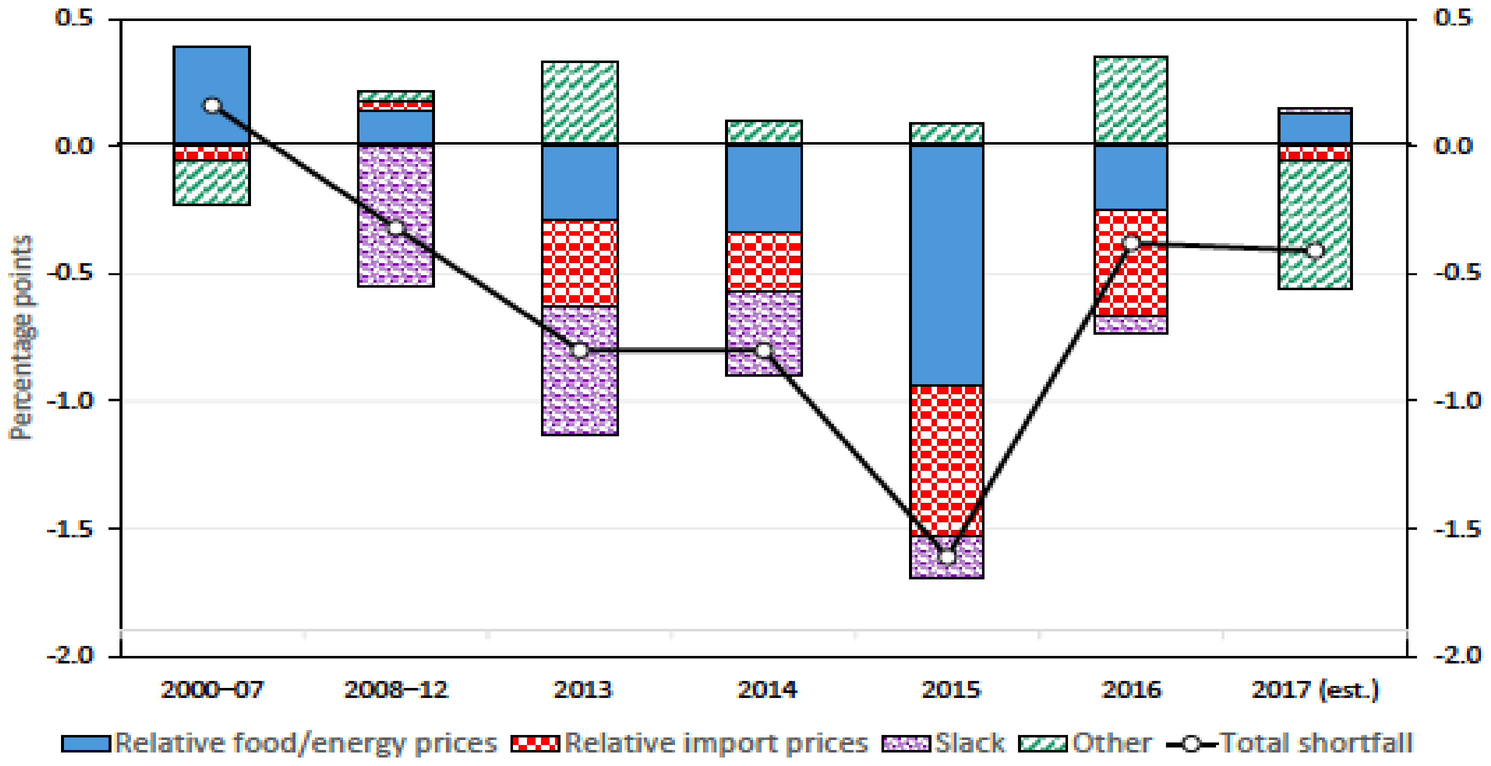


Sources: Bureau of Economic Analysis; Dallas Fed; Haver Analytics

data through November 2017

Our explanation for low inflation: Stuff happens

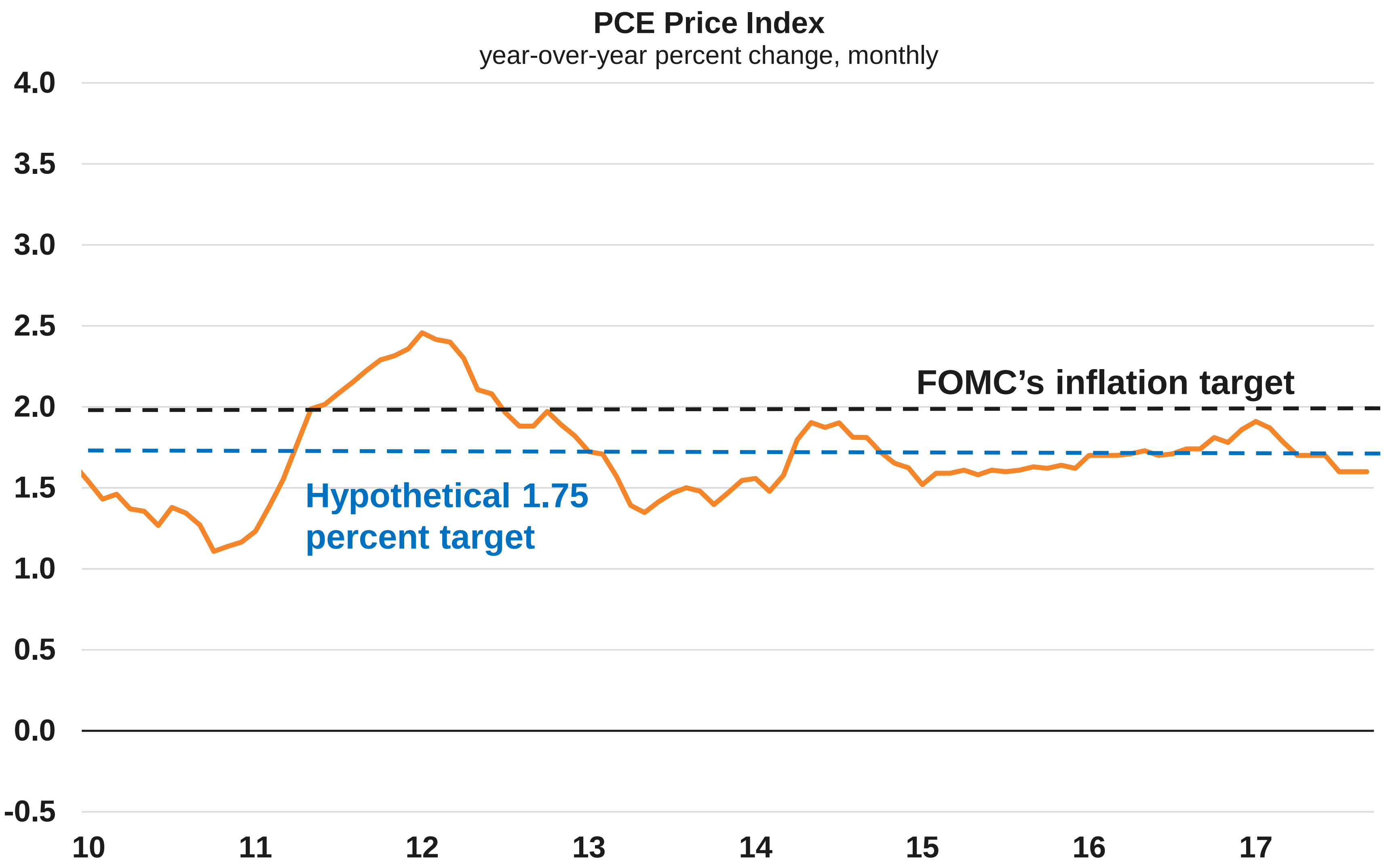
Figure 3
Why Has PCE Inflation Been Running below 2 Percent?



Note: Deviation of PCE inflation (4th quarter to 4th quarter) from 2 percent, total and portion attributable to specific factors.
Source: Federal Reserve Board calculations using data from the BEA, BLS, CBO and SPF. See the appendix for further details.

Source: Janet Yellen, "Inflation, Uncertainty, and Monetary Policy" Speech to the Annual Meeting of the National Association of Business Economists,

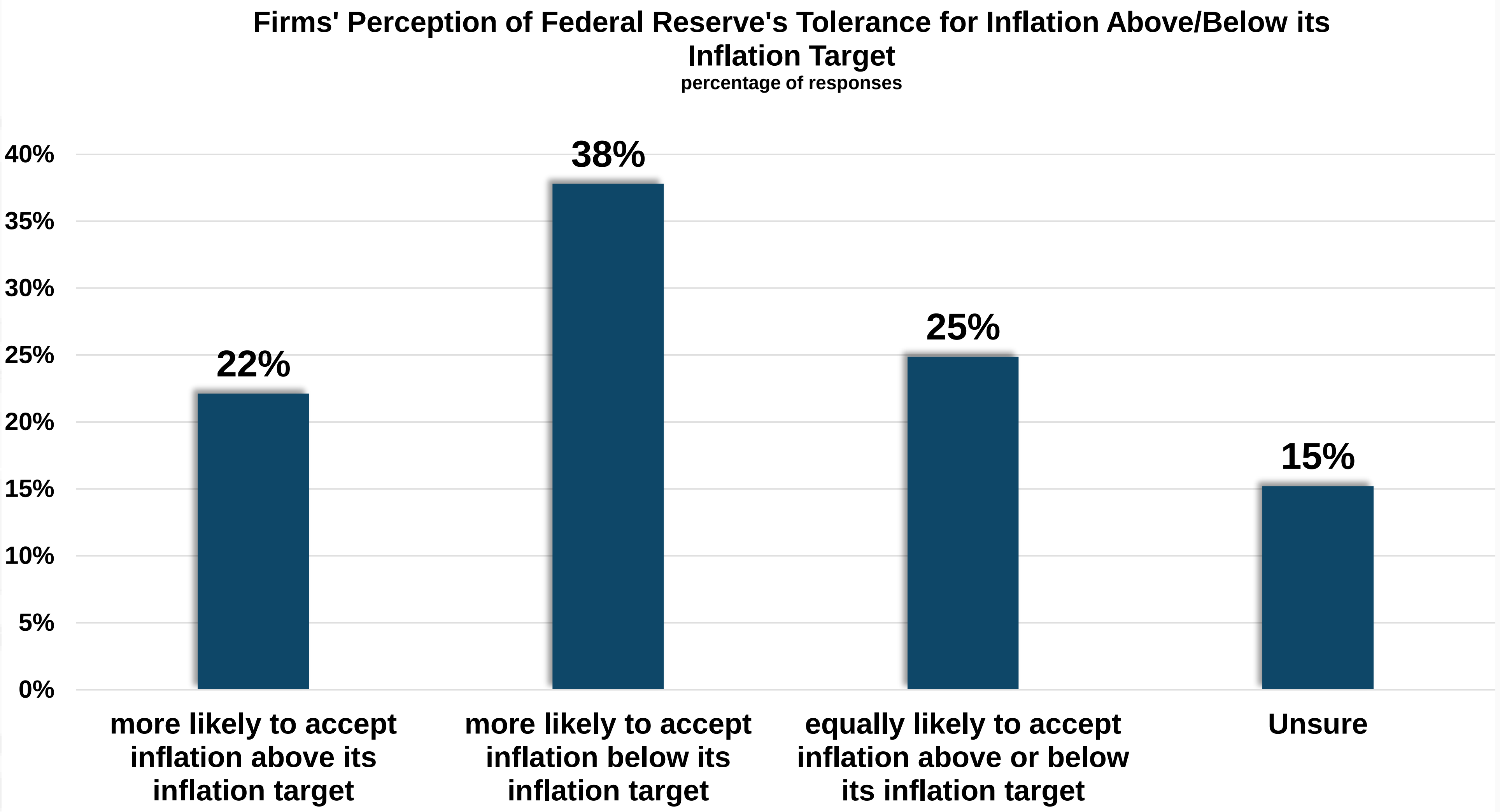
A concern: If the inflation goal was 1.75 percent, the inflation rate of the past 5 years would look just about right.



Sources: Bureau of Economic Analysis; FRB Dallas; Haver Analytics

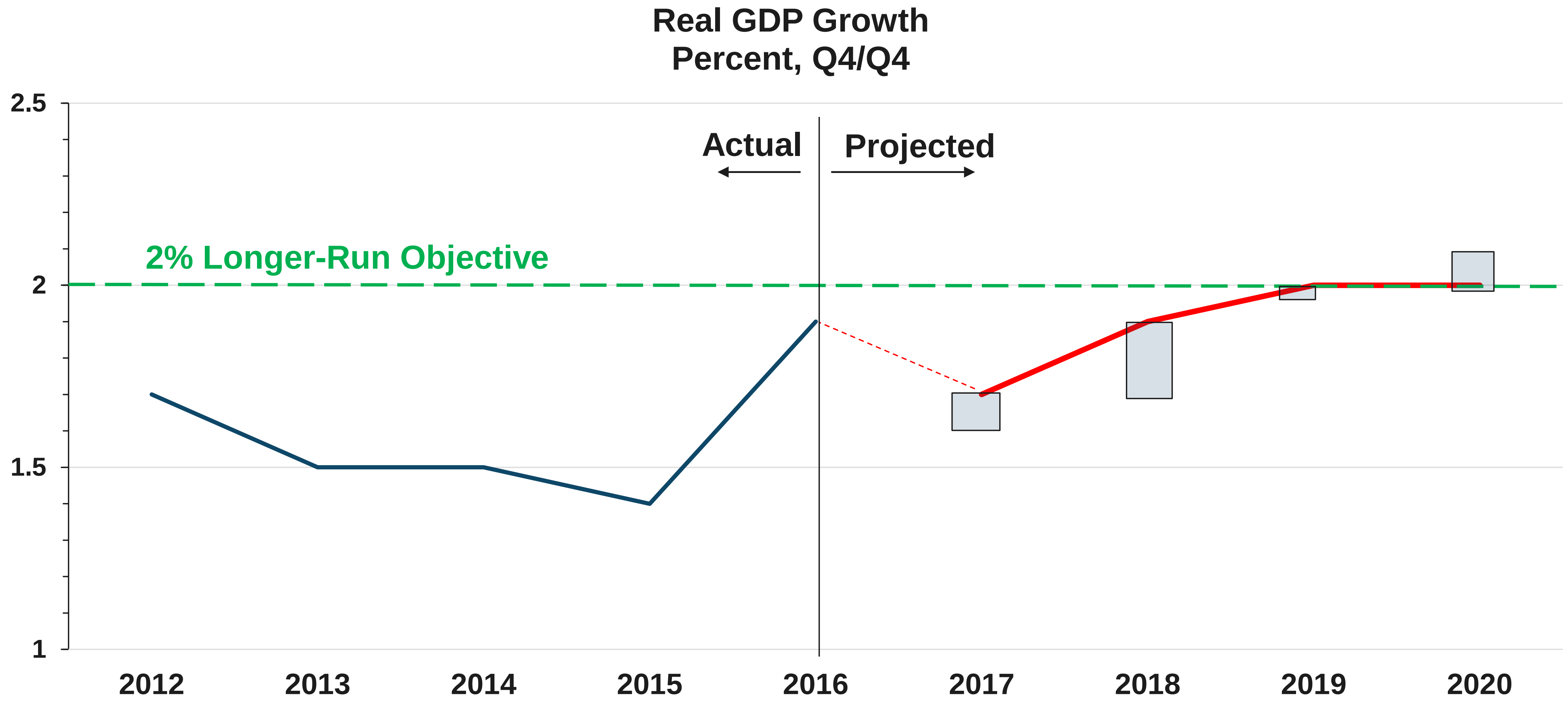
Data through September 2017

Our survey indicates many businesses believe the Fed is most worried about inflation rising above 2%.



Source: Atlanta Fed Business Inflation Expectations (BIE) Survey, April 2017

You gotta have faith – The SEP projections bring us to the inflation target by 2019.



Note: The red line is the median projection; shaded bars represent the "central tendency" range of projections.

Source: FOMC *Summary of Economic Projections*, December 2017, Bureau of Economic Analysis, FRED database

The watch list

- **Will the tax reform stimulus be bigger than we think?**
- **Will longer-term interest rates stall – or take off?**
- **Will inflation be too cold, too hot, or just right?**

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