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

2018 Alabama Economic Outlook

Montgomery, AL
January 11, 2018
“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.”

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.”

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.

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

Decision Maker Survey - (November 13-24)

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

- 65% decrease capital expenditures by 10% or more
- 15% decrease capital expenditures by less than 10%
- 18% no material change to capital expenditures
- 1% increase capital expenditures by less than 10%
- 1% increase capital expenditures by 10% or more

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.

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?

By Firm Size

- Small Firms (0-99 employees)
  - Decrease capital expenditures by 10% or more: 22%
  - Decrease capital expenditures by less than 10%: 20%
  - No material change to capital expenditures: 54%
  - Increase capital expenditures by less than 10%: 3%
  - Increase capital expenditures by 10% or more: 3%

- Midsize Firms (100-499 employees)
  - Decrease capital expenditures by 10% or more: 16%
  - Decrease capital expenditures by less than 10%: 9%
  - No material change to capital expenditures: 73%
  - Increase capital expenditures by less than 10%: 4%
  - Increase capital expenditures by 10% or more: 4%

- Large Firms (500 or more employees)
  - Decrease capital expenditures by 10% or more: 12%
  - Decrease capital expenditures by less than 10%: 21%
  - No material change to capital expenditures: 65%
  - Increase capital expenditures by less than 10%: 3%
  - Increase capital expenditures by 10% or more: 3%

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?

<table>
<thead>
<tr>
<th>By Sector</th>
<th>Decrease by 10% or more</th>
<th>Decrease by less than 10%</th>
<th>No Material Change</th>
<th>Increase by less than 10%</th>
<th>Increase by 10% or more</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction</td>
<td>5%</td>
<td>36%</td>
<td>18%</td>
<td>41%</td>
<td>14%</td>
</tr>
<tr>
<td>Finance and Insurance</td>
<td>65%</td>
<td>22%</td>
<td>14%</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>Healthcare and Social Assistance</td>
<td>10%</td>
<td>81%</td>
<td>9%</td>
<td>18%</td>
<td>14%</td>
</tr>
<tr>
<td>Leisure and Hospitality</td>
<td>9%</td>
<td>73%</td>
<td>17%</td>
<td>18%</td>
<td>14%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>61%</td>
<td>17%</td>
<td>14%</td>
<td>10%</td>
<td>17%</td>
</tr>
<tr>
<td>Mining and Utilities</td>
<td>3%</td>
<td>73%</td>
<td>8%</td>
<td>19%</td>
<td>14%</td>
</tr>
<tr>
<td>Professional and Business Services</td>
<td>3%</td>
<td>73%</td>
<td>8%</td>
<td>19%</td>
<td>14%</td>
</tr>
<tr>
<td>Retail and Wholesale Trade</td>
<td>61%</td>
<td>19%</td>
<td>17%</td>
<td>19%</td>
<td>17%</td>
</tr>
<tr>
<td>Transportation and Warehousing</td>
<td>50%</td>
<td>33%</td>
<td>17%</td>
<td>19%</td>
<td>14%</td>
</tr>
</tbody>
</table>

*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
What about tax reform and hiring plans

**Expected impact of Tax Cuts and Jobs Act on Hiring Plans**
(by firm size)

- **Small firms (<=100)**
  - Decrease significantly: 0.0%
  - Decrease somewhat: 1.1%
  - No change: 51.1%
  - Increase somewhat: 37.8%
  - Increase significantly: 10.0%

- **Larger firms (>100)**
  - Decrease significantly: 68.9%
  - Decrease somewhat: 23.0%
  - No change: 5.4%

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

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

TCJA Effects on Average Annual Growth Relative to Current Policy
Percentage point change

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

TCJA Effects on Average Annual Growth Relative to Current Policy

Percentage point change

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


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.

“High pressure” periods, where the unemployment rate falls below its natural rate.

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.
Another relevant picture? The term structure of interest rates

10 Year / 2 year Treasury Note Spread
percent

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.

PCE Price Index
year-over-year percent change, monthly

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.
A concern: If the inflation goal was 1.75 percent, the inflation rate of the past 5 years would look just about right.
Our survey indicates many businesses believe the Fed is most worried about inflation rising above 2%.

**Firms' Perception of Federal Reserve's Tolerance for Inflation Above/Below its Inflation Target**

- **More likely to accept inflation above its inflation target**: 22%
- **More likely to accept inflation below its inflation target**: 38%
- **Equally likely to accept inflation above or below its inflation target**: 25%
- **Unsure**: 15%

Percentage of responses

*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.

Real GDP Growth
Percent, Q4/Q4

Actual  Projected

2% Longer-Run Objective

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

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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