FEDERAL RESERVE BANK of ATLANTA

The Economy in 2017: A View from the Atlanta Fed

2017 Alabama Economic Outlook

Montgomery, AL

January 12, 2017

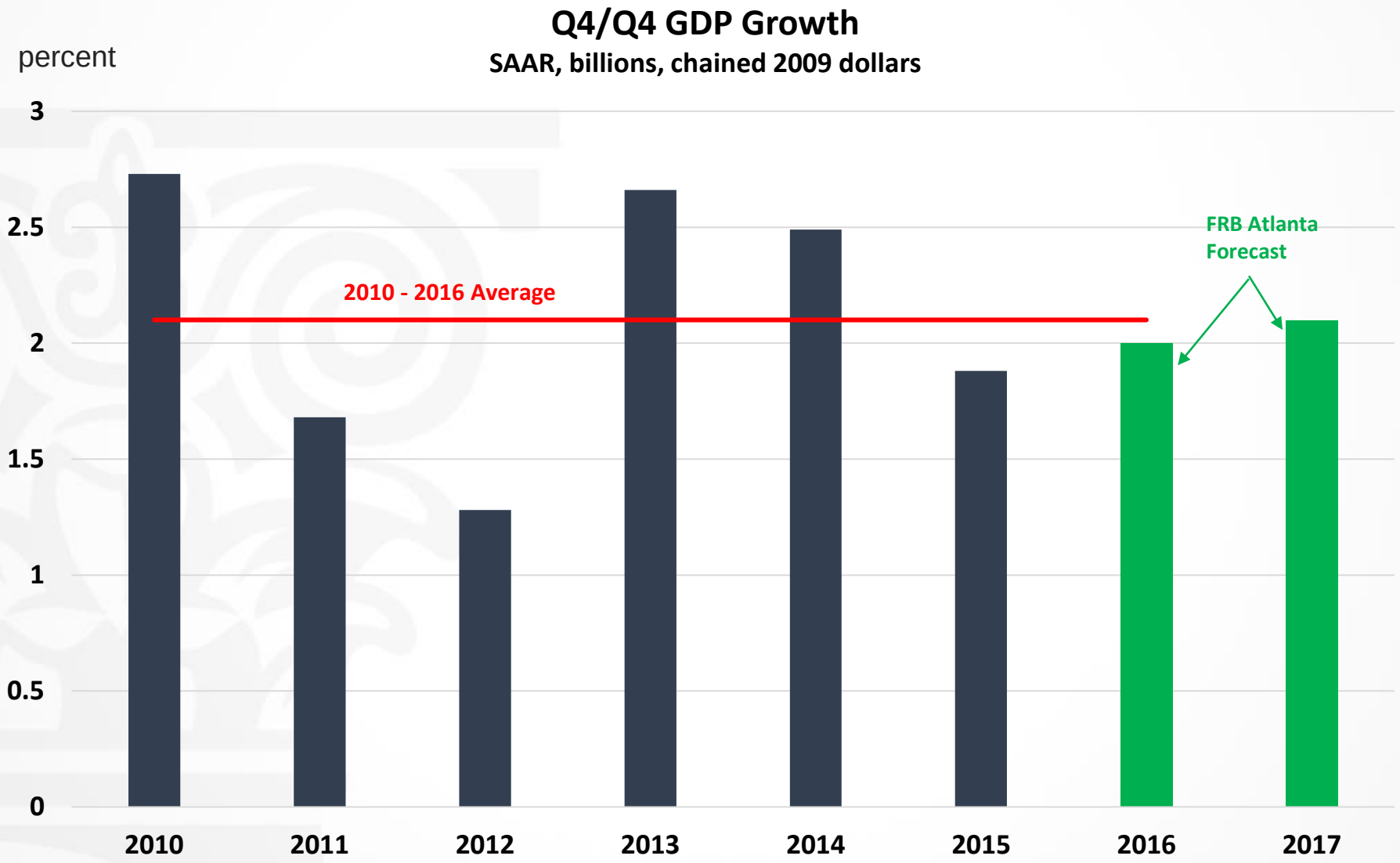
The bottom line: As of now we are projecting GDP growth this year to look a lot like last year.

Atlanta Staff Real GDP Forecasts		
	2016*	2017
Annualized GDP Growth (Q4 over Q4)	2.0	2.1

** Assumes 2.1 percent annualized growth in the fourth quarter.*

Sources: Bureau of Economic Analysis, FRBA

In other words, our current growth forecast is the recovery average.



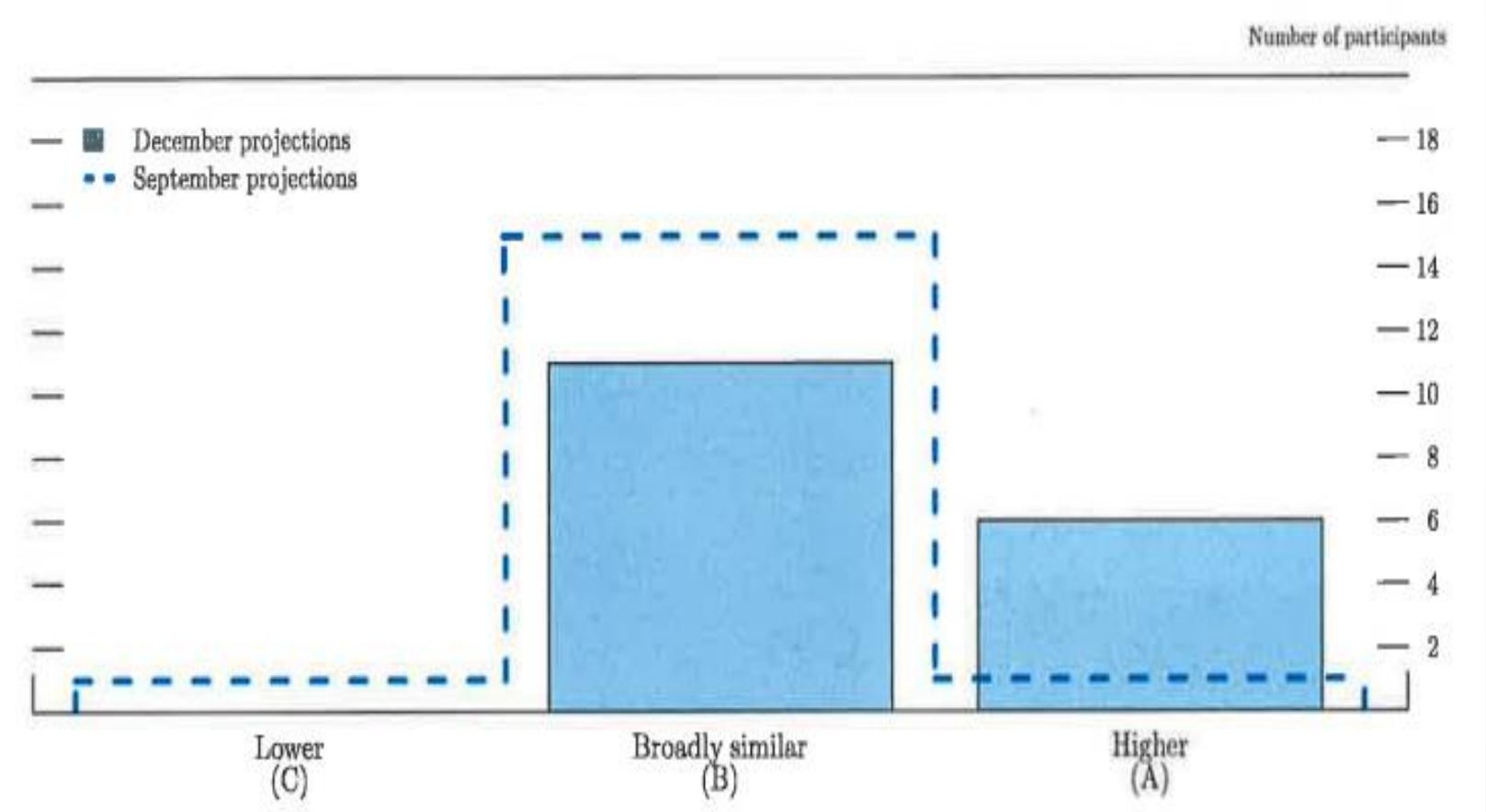
Source: Bureau of Economic Analysis; FRB Atlanta

actual data through Q4 2015

The word from the FOMC: Uncertainty around projections are higher than average.

Real GDP Projections

Level of uncertainty relative to the past 20 years



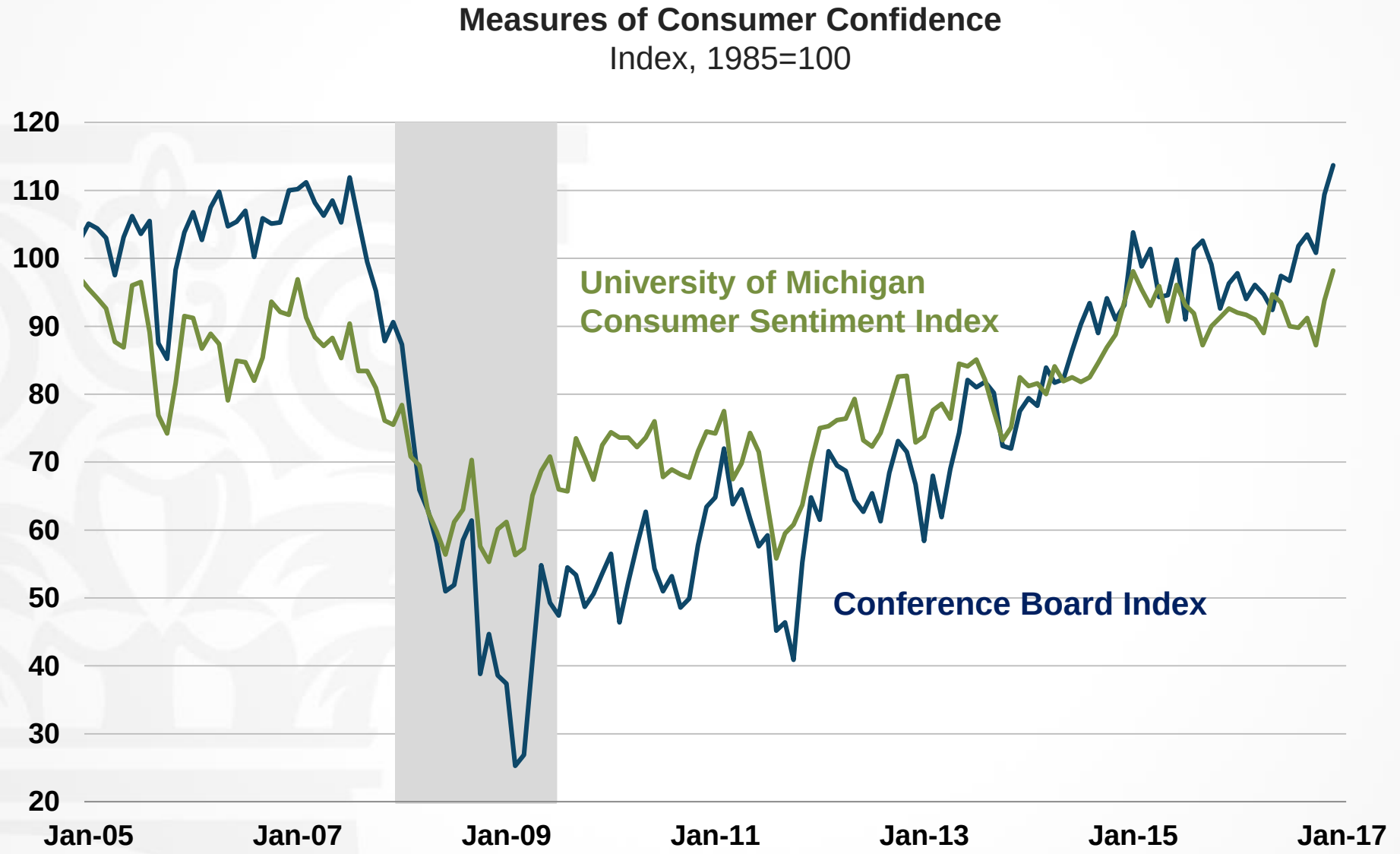
Source: Federal Open Market Committee Meeting Minutes: Summary of Economic Projections, released January 4 2017.

Our approach to dealing with prospective fiscal policy, rising optimism, and post-election developments in general.

Part 1:

The consumer, B.E. and A.E.

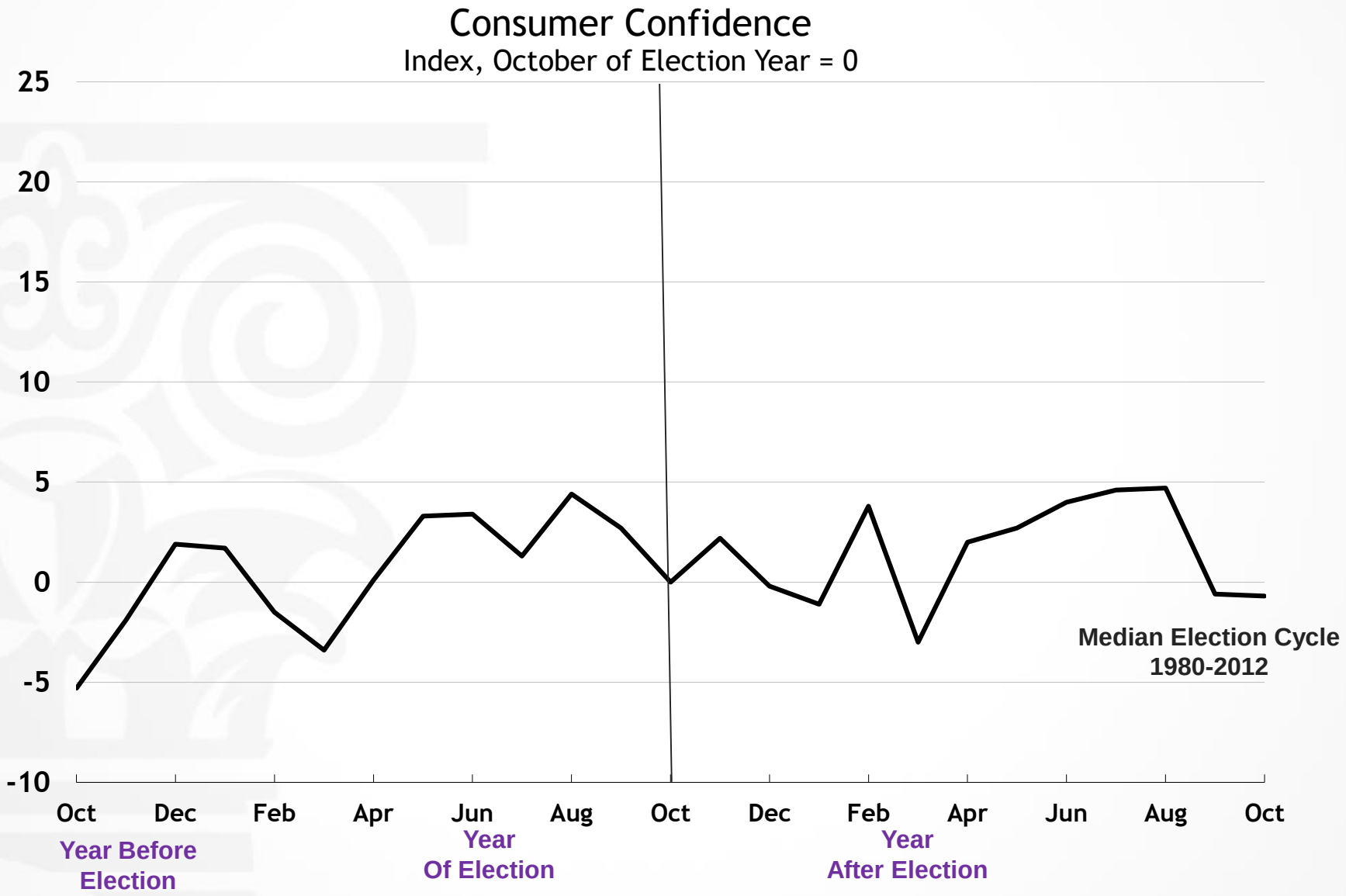
Consumer confidence measures are back to pre-recession levels.



Source: Conference Board; University of Michigan

through December 2016

Typically, elections don't have much affect on consumer confidence. They have this time…



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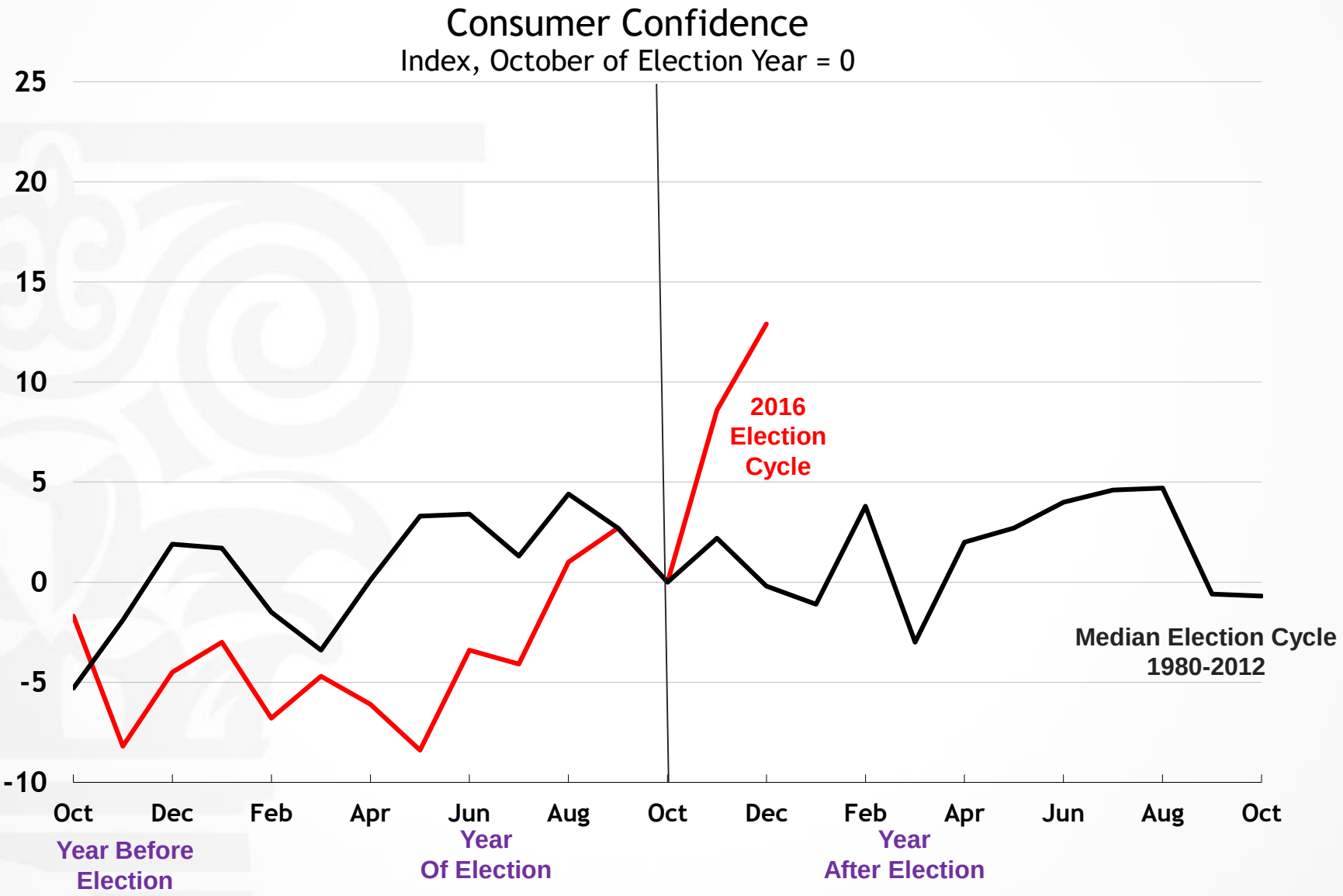
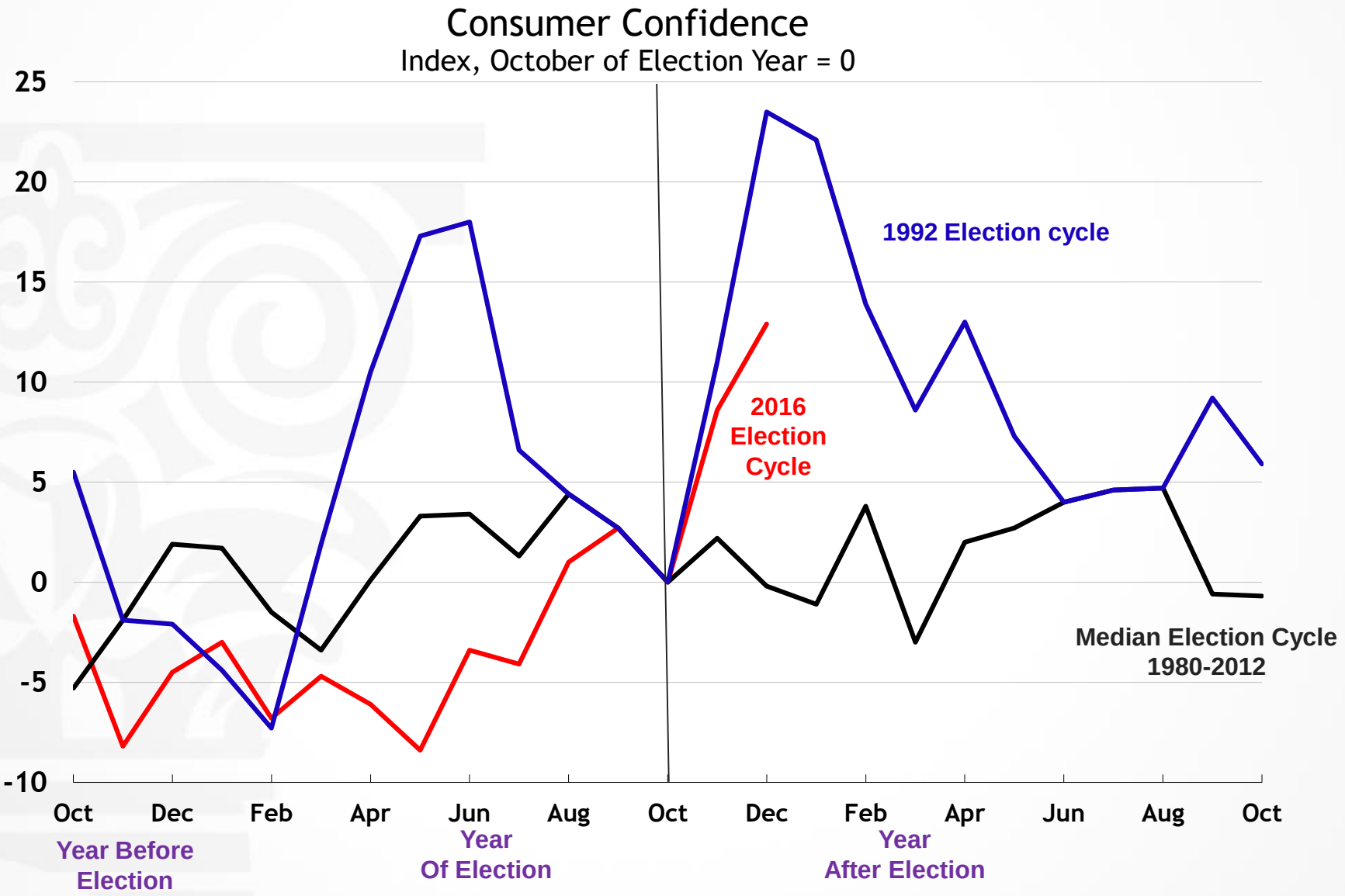


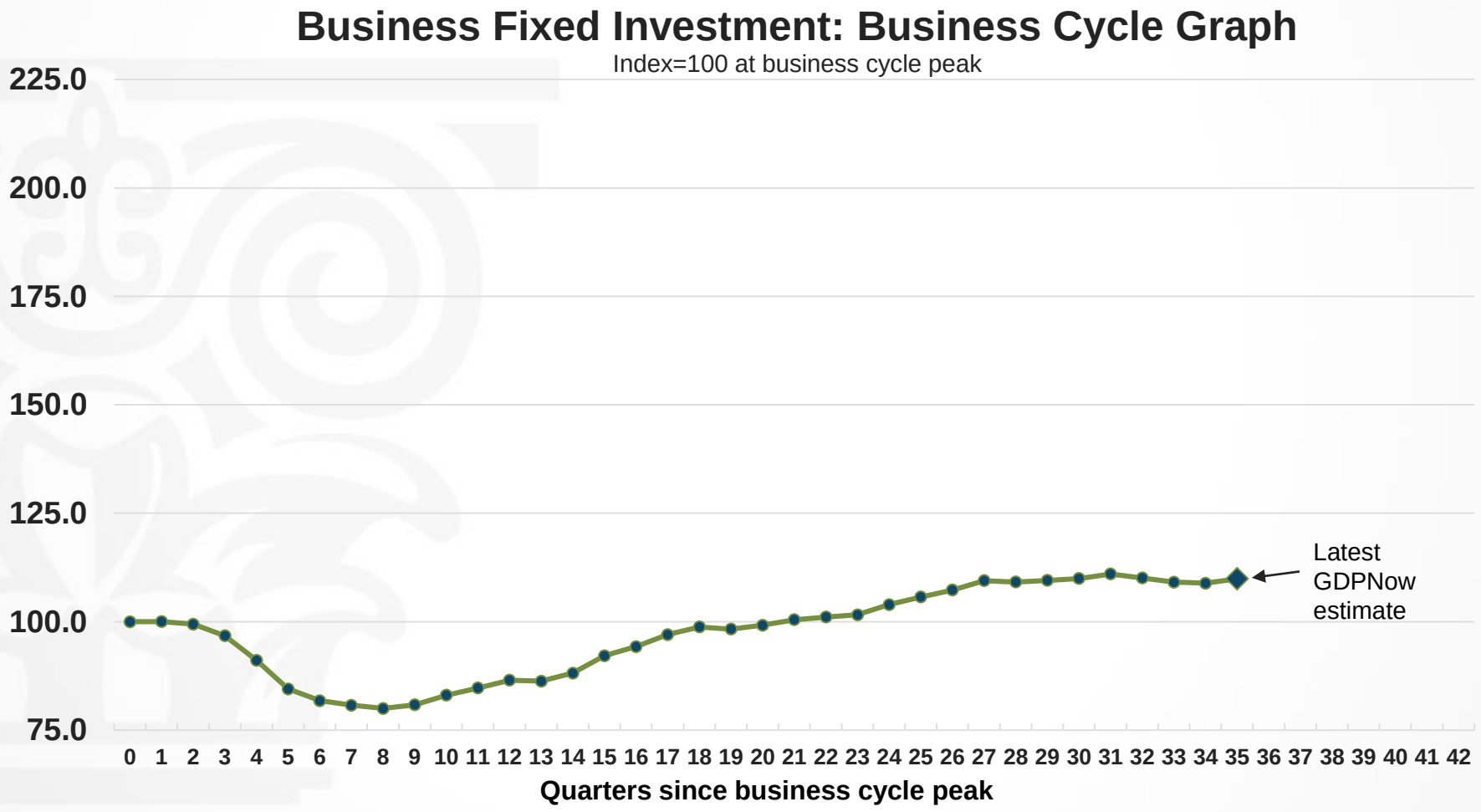
… though this isn't unprecedented (and honeymoons don't necessarily last forever).



Part 2:

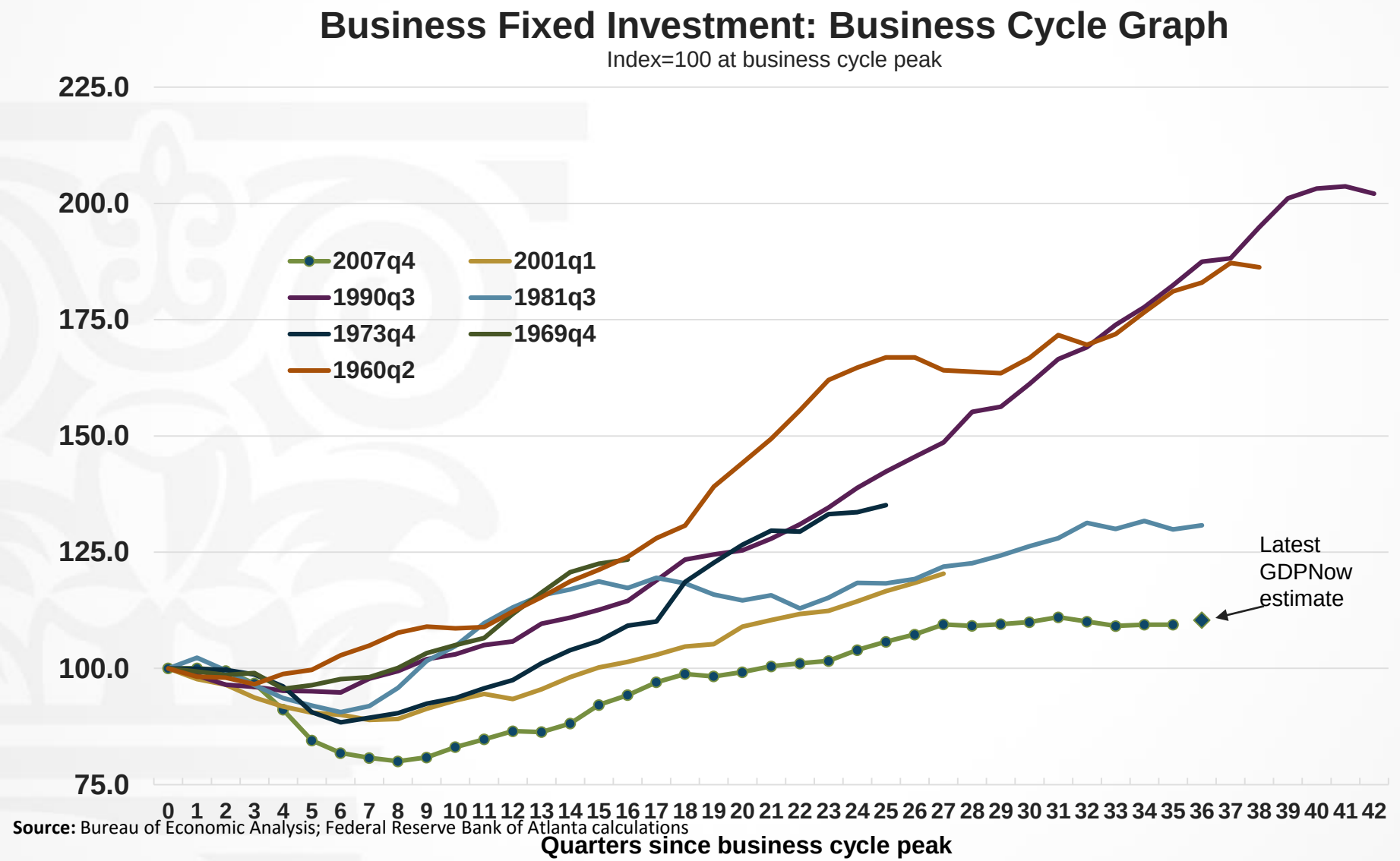
Business investment, B.E. and A.E.

Capital expansion over the course of the recovery has been extraordinarily weak…



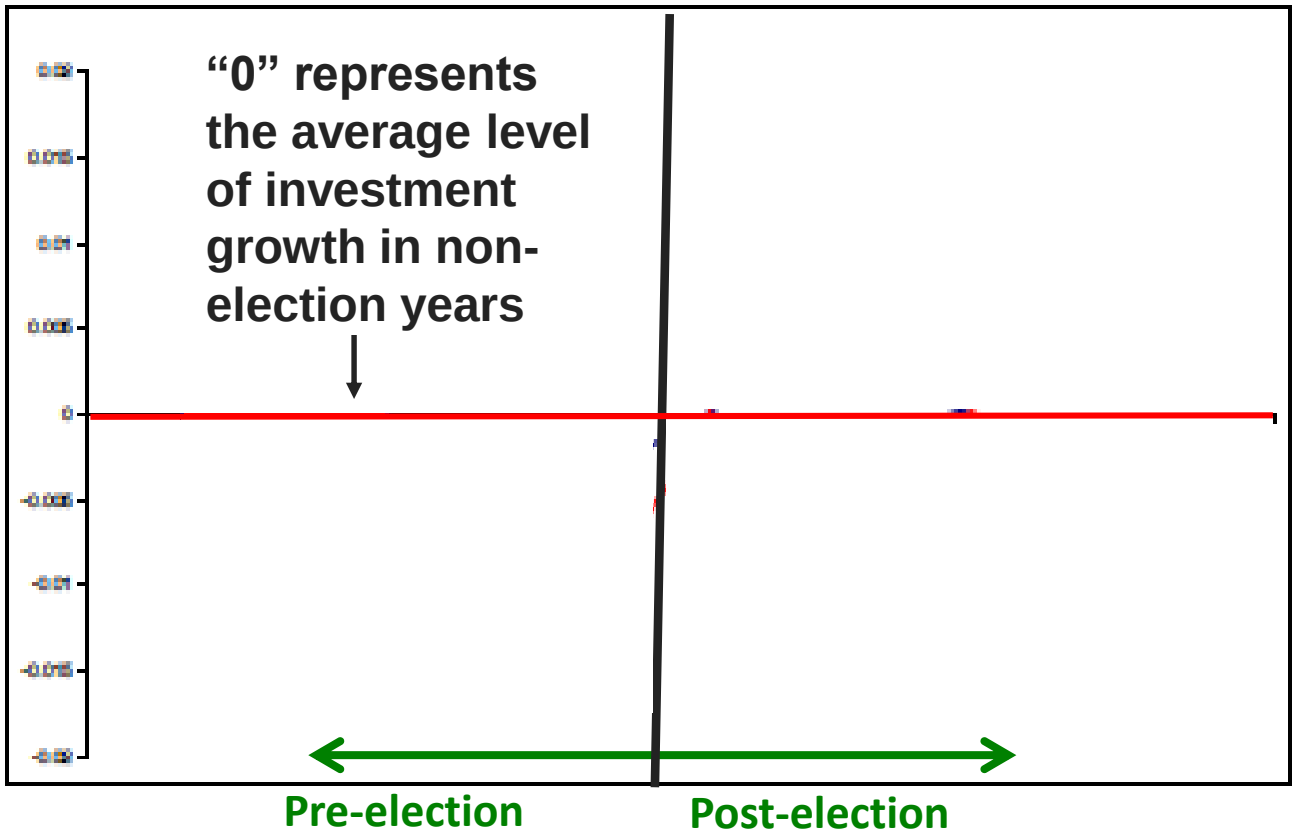
Source: Bureau of Economic Analysis; Federal Reserve Bank of Atlanta calculations

… which remains well off the pace relative to past U.S. recessions.



Source: Bureau of Economic Analysis; Federal Reserve Bank of Atlanta calculations

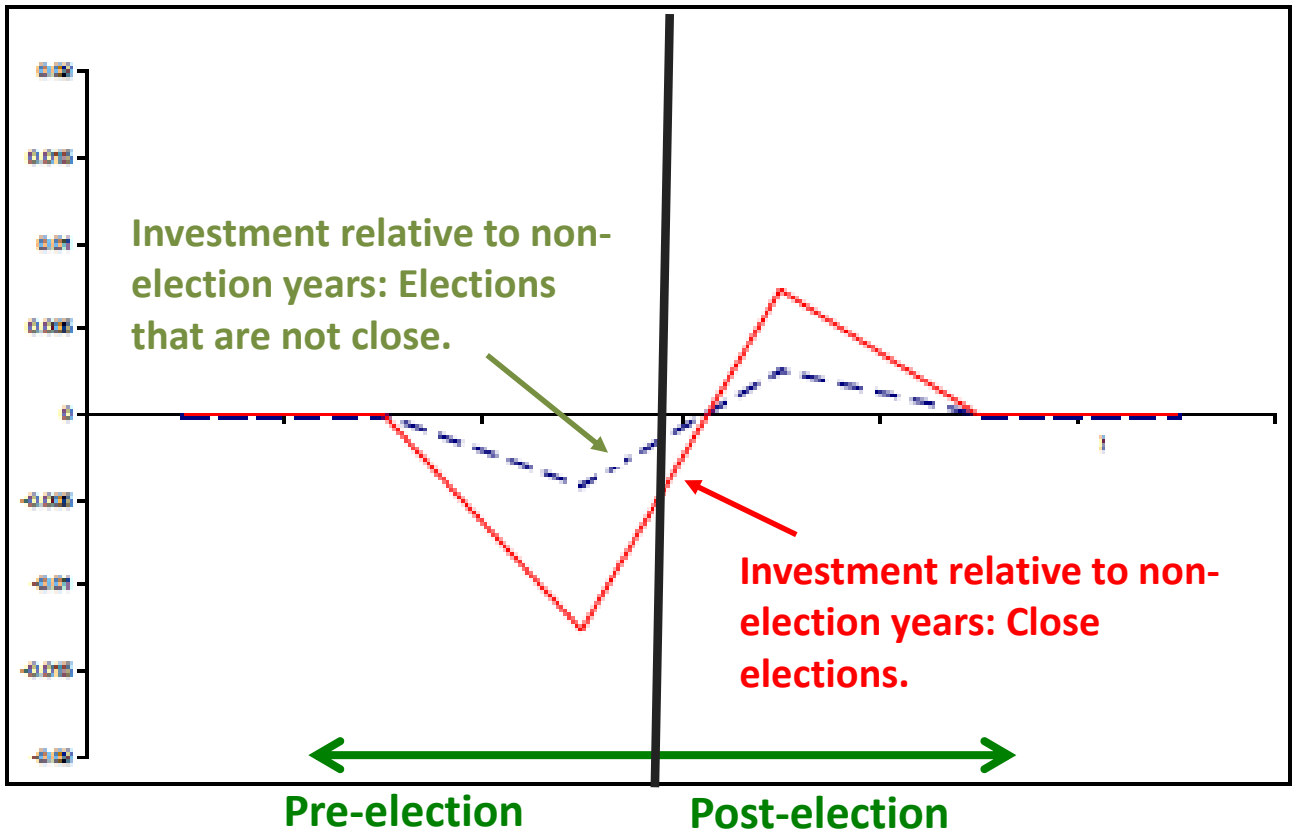
What tends to happen to investment in election years?



Note: The value "0" represents the level of average investment growth in non-election years.

Source: "Political Uncertainty and Corporate Investment Cycles," Brandon Julio and Youngsuk Yook, 2010

In election years, investment is typically weaker than average before the election, and stronger after.



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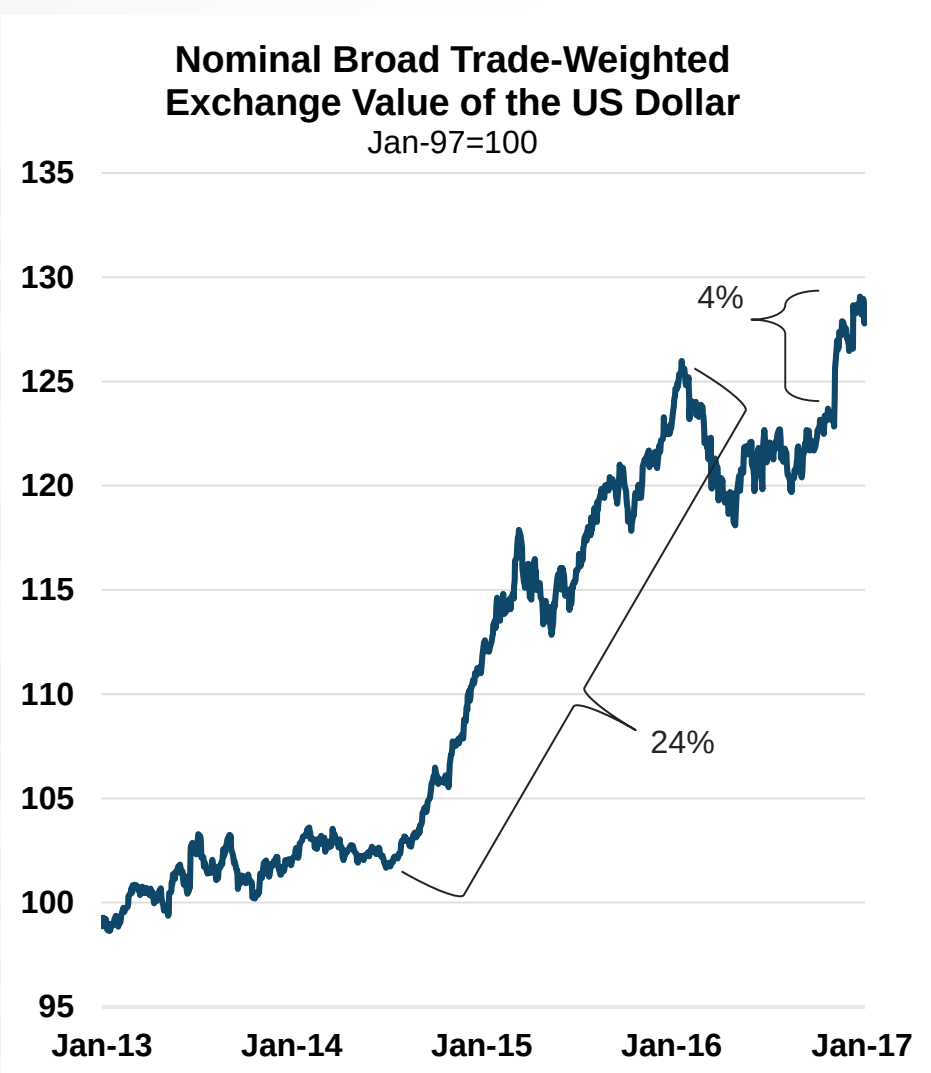
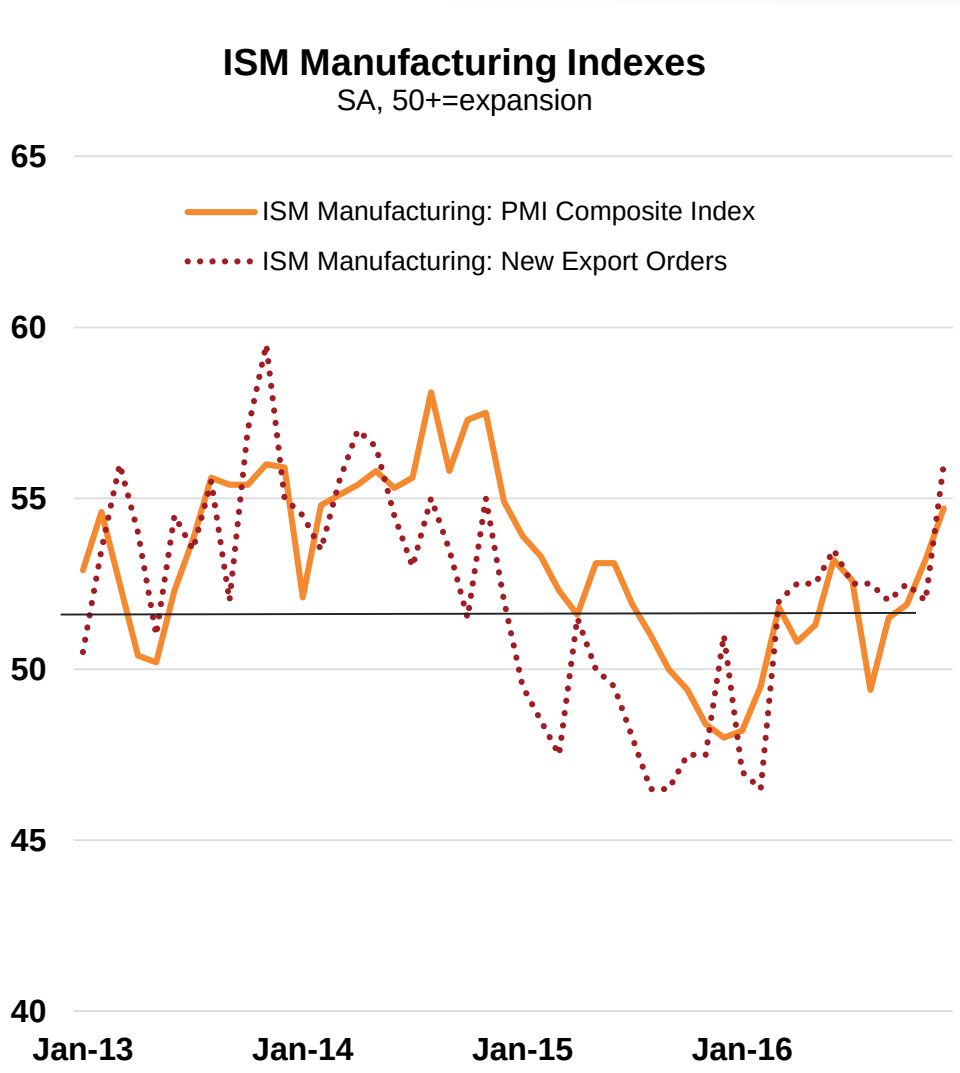
There are downside risks: Dollar appreciation could negatively impact manufacturing (again), for example.

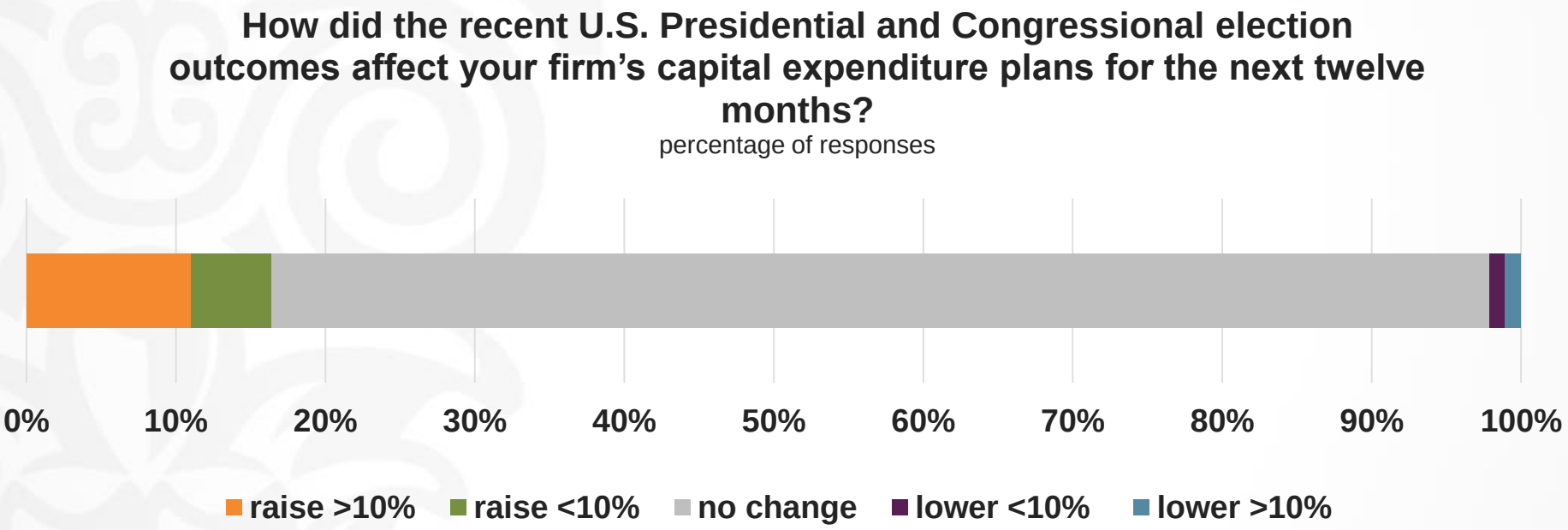




Source: Federal Reserve Board; Institute for Supply Management

Exchange rate data through Jan. 6, 2017, ISM data through December 2016

… but our Decision Maker survey from mid-December suggests a pick up in investment spending intentions.



Source: Atlanta Fed-University of Chicago-Stanford University Decision Maker Survey

Part 3:

Fiscal policy – the great unknown

Estimates of the impacts of fiscal policy vary widely by study and the policy specifics.

The "policy multiplier": The effect of a $1 change in spending or a $1 change in tax revenue on the level of GDP.

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Type of policy	Range of estimated policy multipliers
Tax Policy[a]	First year: 0.7 to 1.2 Maximum effect: less than 1 to 3.0

a: Estimates are taken from *Fiscal Multipliers: Size, Determinants and Use in Macroeconomic Forecasts,* Nicoletta Batini, Luc Eyraud, Lorenzo Forni, and Anke Weber, International Monetary Fund, September 2014. 2012.

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Defense Spending[a]	0.2 to 1.2
Transfers to state and local governments for infrastructure[b]	0.4 to 2.2

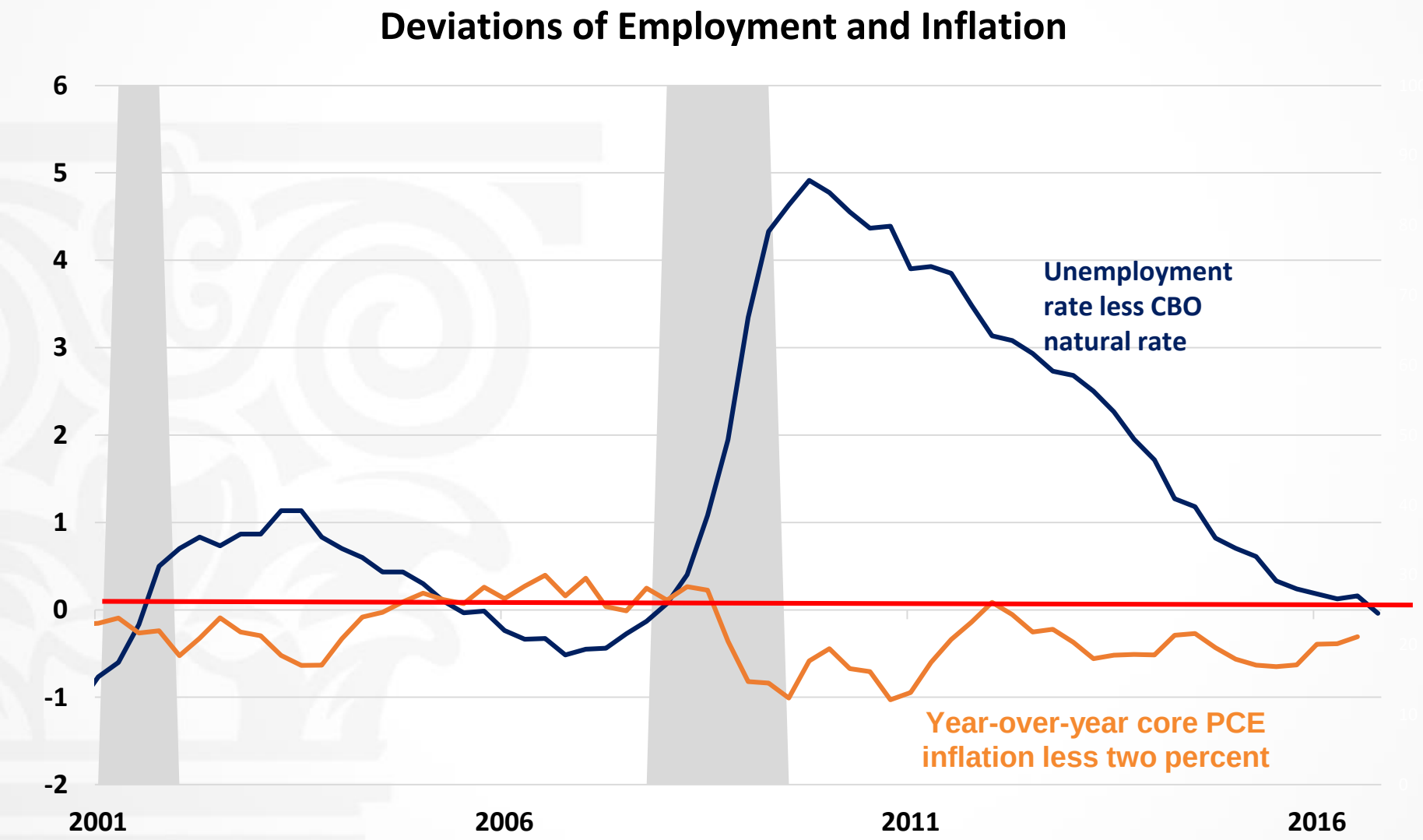
a: Estimates are taken from *Fiscal Multipliers: Size, Determinants and Use in Macroeconomic Forecasts,* Nicoletta Batini, Luc Eyraud, Lorenzo Forni, and Anke Weber, International Monetary Fund, September 2014. 2012.

b: Estimates are taken from *Estimated Impact of the American Recovery and Reinvestment Act,* Congressional Budget Office, February 2012.

Part 4:

The “consolidated” policy challenge

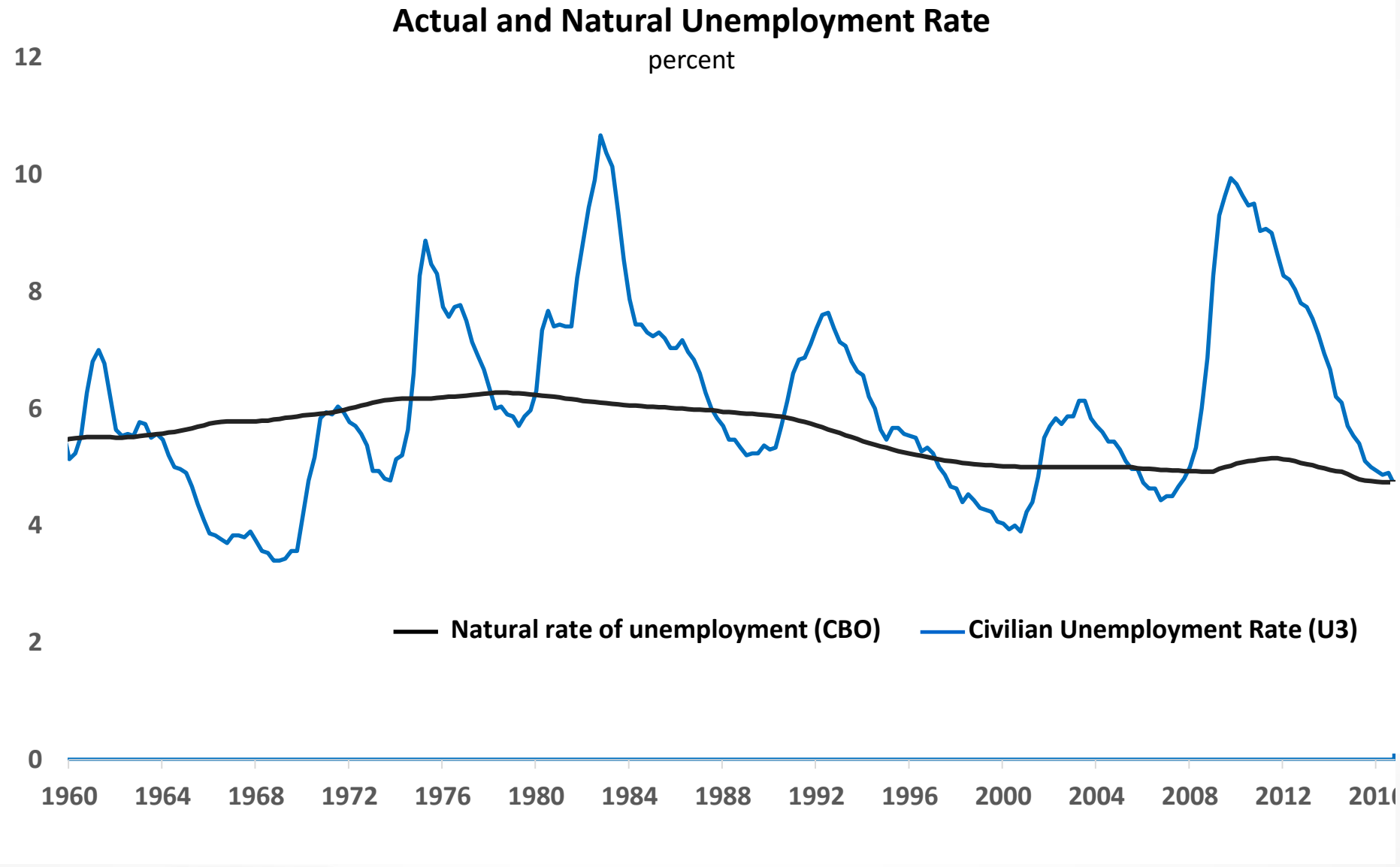
Unemployment is (arguably) at its "full employment" level and inflation is approaching the FOMC's target.



Source: Bureau of Labor Statistics; Bureau of Economic Analysis; Congressional Budget Office

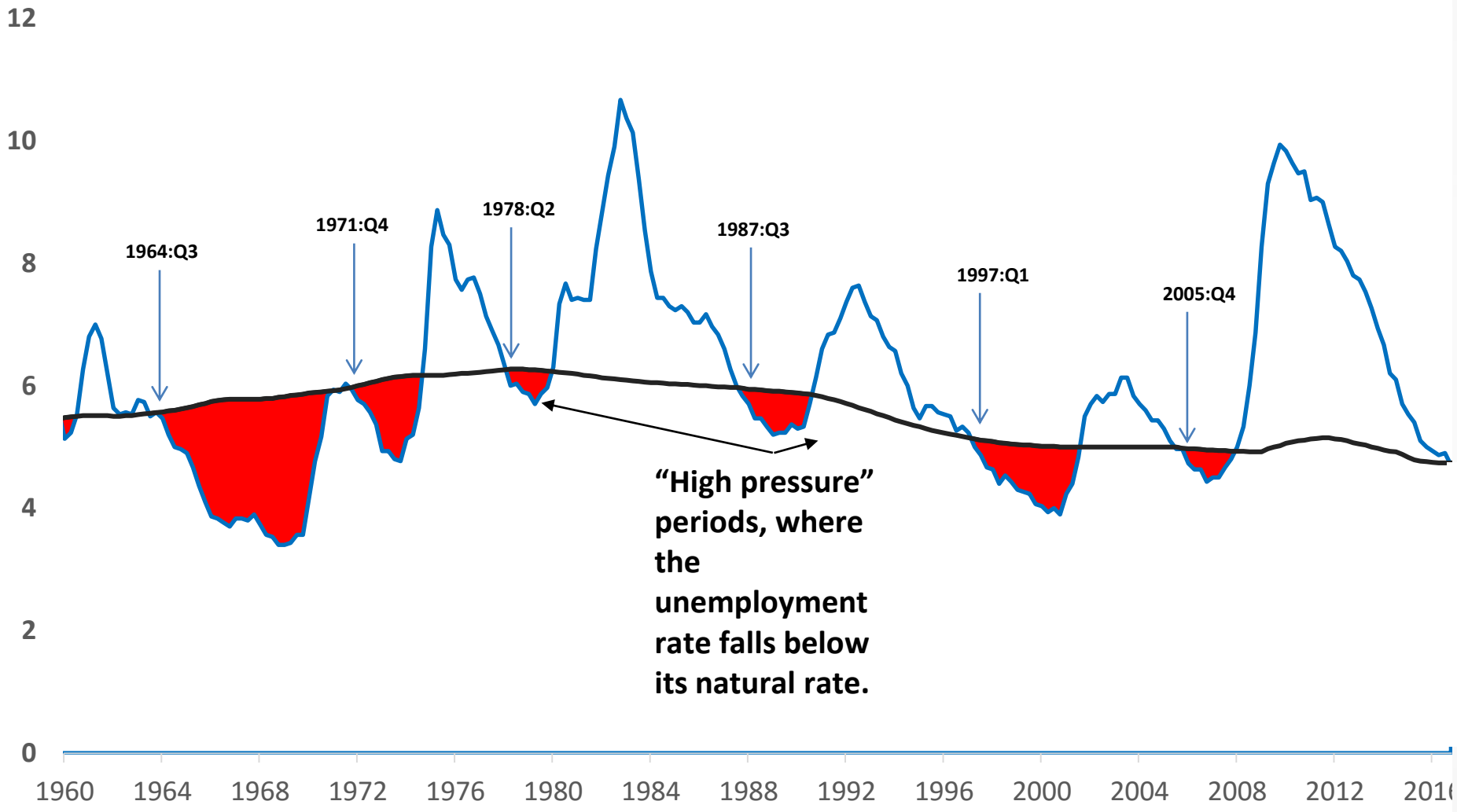
U3 data through Q4 2016; PCE data through Q3 2016

Gaps between the unemployment rate and its "natural" level are the rule, not the exception.



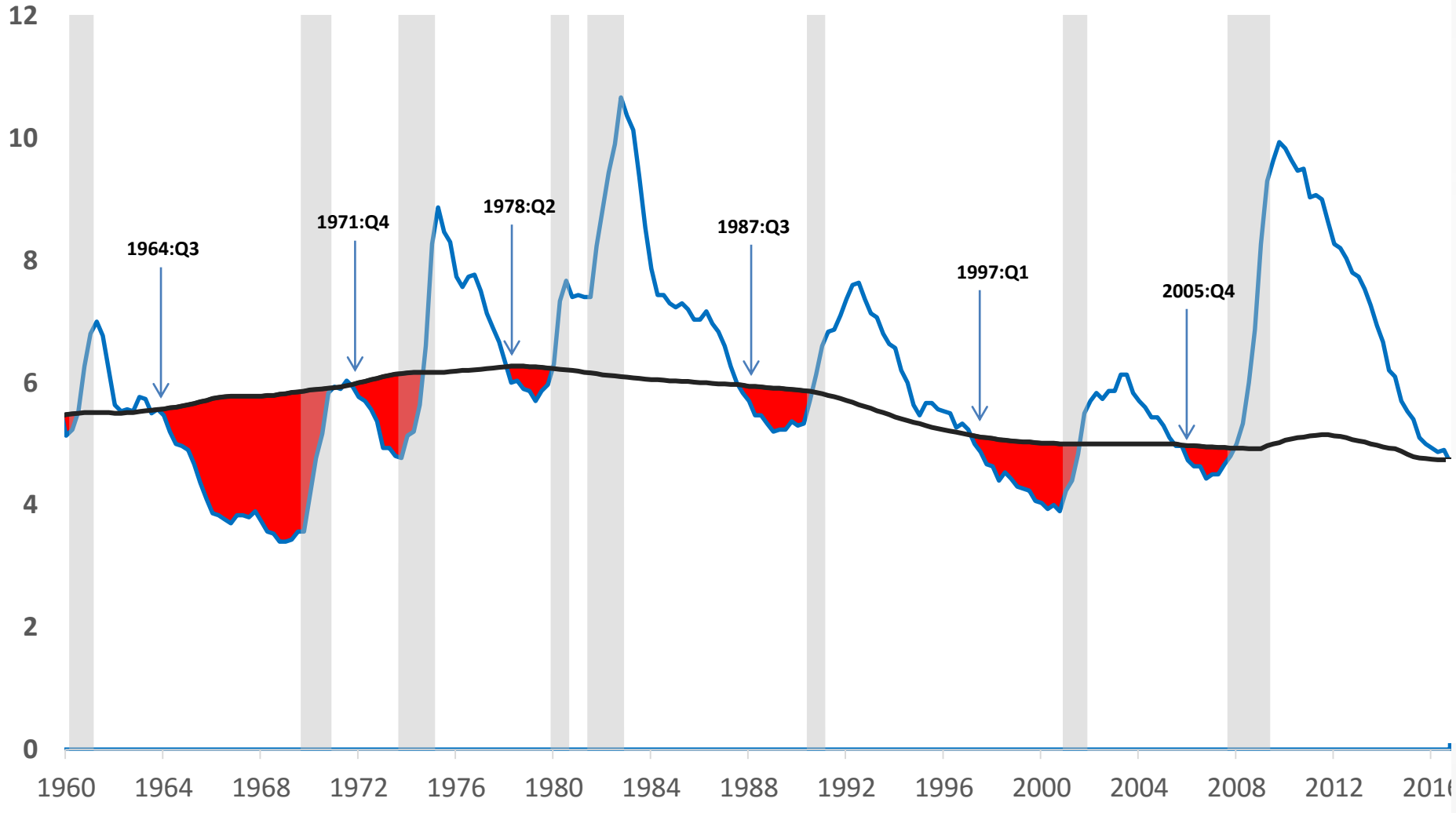
Sources: Bureau of Labor Statistics; Congressional Budget Office (CBO); BEA; Federal Reserve Board

Periods of “undershooting” the natural unemployment rate have been episodic.



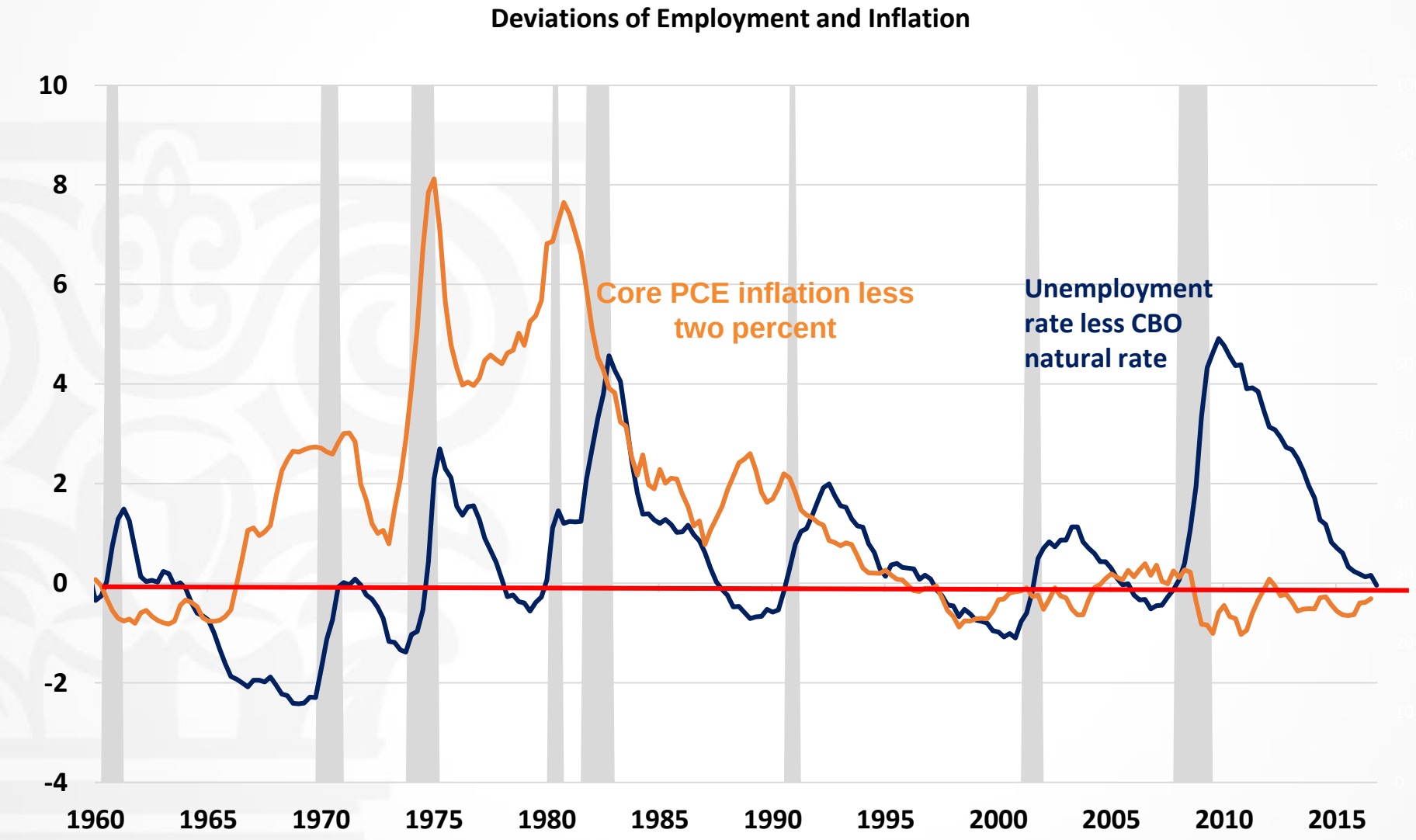
Sources: Bureau of Labor Statistics; Congressional Budget Office (CBO); BEA; Federal Reserve Board

Historically, “high pressure” periods have ended in recessions…



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

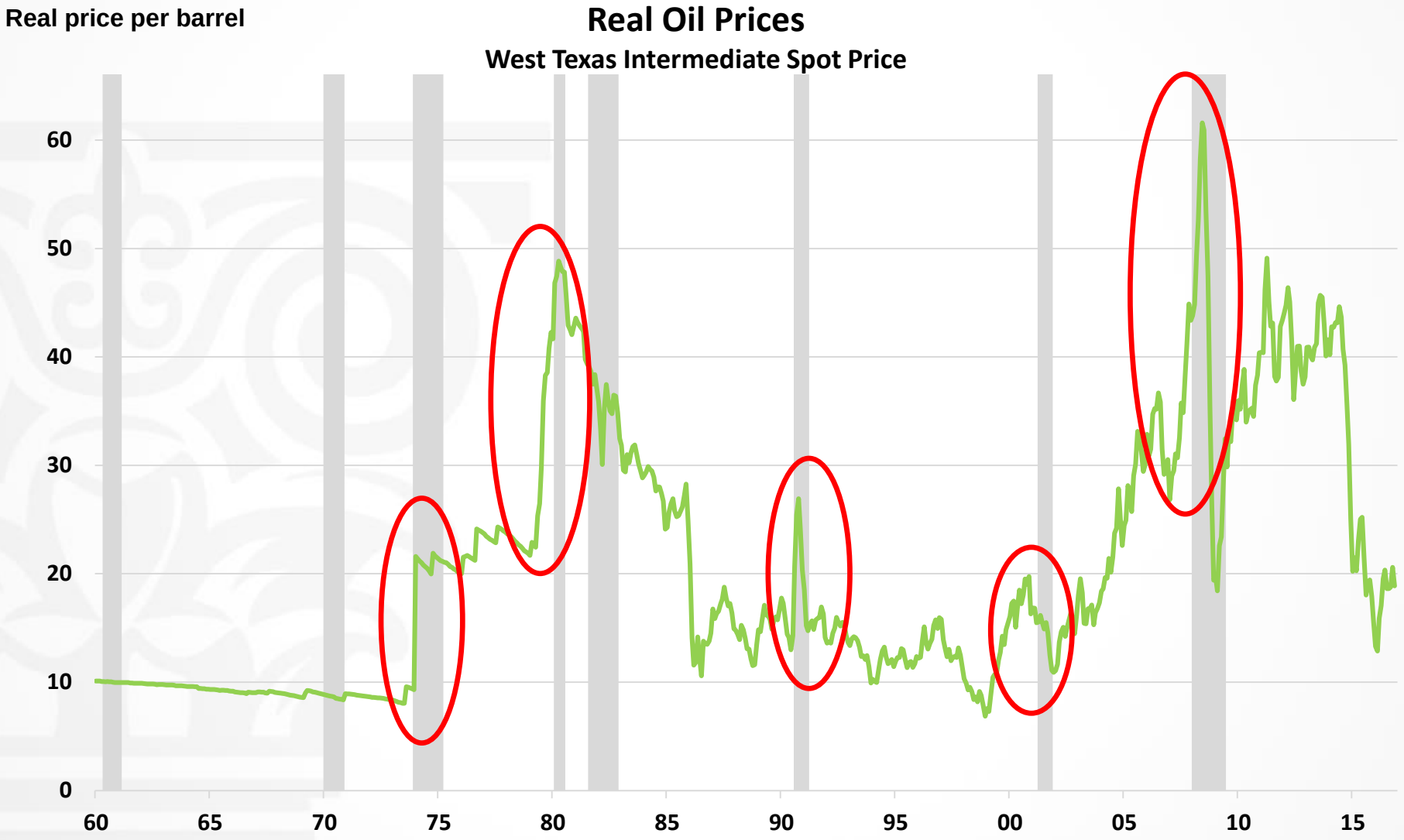
… and have been (eventually) associated with rising inflation.



Source: Bureau of Labor Statistics; Bureau of Economic Analysis; Congressional Budget Office

U3 data through Q4 2016; PCE data through Q3 2016

But, the end of recessions (and high pressure periods) have historically been associated with oil price shocks..



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

Source: Bureau of Labor Statistics; Energy Information Administration

Part 5:

An observation about structural tax reform

Alan Auerbach, Laurence Kotlikoff, and Darryl Koehler:

Calculate *net* remaining lifetime tax rates taking into account "all major federal and state tax and transfer programs, including the federal personal income tax, the FICA payroll tax, state income taxes, state sales taxes, the federal corporate income tax, the federal estate tax, TANF welfare benefits, Food Stamps, Supplemental Security Income , Social Security retirement and auxiliary… benefits, Social Security disability benefits, Medicaid benefits, Medicare benefits, and Medicare Part B premiums."

Source: "U.S. Inequality, Fiscal Progressivity, and Work Disincentives," NBER Working Paper 22032, , Feb. 2016:
http://www.ncpa.org/pdfs/U.S.%20Inequality,%20Fiscal%20Progressivity,%20and%20Marginal%20Taxation%203-14-16_NBER%20version.pdf

From the vantage point of average tax rates, the U.S. tax and transfer system looks quite progressive…

Dispersion in Current-Year Net Marginal Tax Rates, Ages 40-49

	Average Current Year Net Tax Rate
Lowest Quintile	-26.1%
Second Quintile	17.0%
Third Quintile	24.2%
Fourth Quintile	27.9%
Highest Quintile	37.4%

Source: "U.S. Inequality, Fiscal Progressivity, and Work Disincentives," NBER Working Paper 22032, , Feb. 2016:
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Current-period net marginal tax rates for 40-49 year olds, broadly defined, show little progressivity.

Dispersion in Current-Year Net Marginal Tax Rates, Ages 40-49

	Median Marginal Current Year Net Tax Rate
Lowest Quintile	33.3%
Second Quintile	31.4%
Third Quintile	32.3%
Fourth Quintile	40.0%
Highest Quintile	38.2%

Source: "U.S. Inequality, Fiscal Progressivity, and Work Disincentives," NBER Working Paper 22032, , Feb. 2016:
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When thinking about tax reform, we should probably want to consider the *dispersion* of rates for like individuals.

Dispersion in Current-Year Net Marginal Tax Rates, Ages 40-49

	Median Marginal Current Year Net Tax Rate	Minimum Marginal Current Year Net Tax Rate	Maximum Marginal Current Year Net Tax Rate
Lowest Quintile	33.3%		
Second Quintile	31.4%		
Third Quintile	32.3%		
Fourth Quintile	40.0%		
Highest Quintile	38.2%		

Source: "U.S. Inequality, Fiscal Progressivity, and Work Disincentives," NBER Working Paper 22032, , Feb. 2016:
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Net tax rates at the individual level show enormous dispersion, and are prohibitive at the high end.

Dispersion in Current-Year Net Marginal Tax Rates, Ages 40-49

	Median Marginal Current Year Net Tax Rate	Minimum Marginal Current Year Net Tax Rate	Maximum Marginal Current Year Net Tax Rate
Lowest Quintile	33.3%	-22.6%	934.6%
Second Quintile	31.4%	2.8%	506.9%
Third Quintile	32.3%		
Fourth Quintile	40.0%		
Highest Quintile	38.2%		

Source: "U.S. Inequality, Fiscal Progressivity, and Work Disincentives," NBER Working Paper 22032, , Feb. 2016:
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Dispersion in net tax rates is most dramatic for the least wealthy.

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	Median Marginal Current Year Net Tax Rate	Minimum Marginal Current Year Net Tax Rate	Maximum Marginal Current Year Net Tax Rate
Lowest Quintile	33.3%	-22.6%	934.6%
Second Quintile	31.4%	2.8%	506.9%
Third Quintile	32.3%	-37.6%	46.2%
Fourth Quintile	40.0%	16.6%	55.1%
Highest Quintile	38.2%	3.0%	69.0%

Source: "U.S. Inequality, Fiscal Progressivity, and Work Disincentives," NBER Working Paper 22032, , Feb. 2016:
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