Louisiana Corporate Credit Union

ECONOMIC & FINANCIAL DIGEST

3500 N. Causeway, Suite 1510 • Metairie, Louisiana 70002 • (800) 421-7030 • www.lacorp.com

Volume 25 May 2017

Slowing With Age

The economy hit another speed bump in the first quarter, something that has become a regular pattern in recent years. Perhaps it's the familiarity or just complacency, but the slowdown hardly caused a ripple on the anxiety scale. Few, if any, respected economists or policy officials think that the slippage represents the start of something ominous. True, the euphoria buoying the financial markets since the election has fizzled a bit. Stock prices, which fell in March for the first time since last October, continued to languish through the third week in April. Bond yields have declined from their nearby peak in mid-March and the almighty dollar has wobbled erratically lower in recent months. But these time-honored signs of a weakening economy have not registered with households and businesses, nor are they derailing monetary officials from their planned course of gradually lifting interest rates in coming months.

Odds are, the markets are reassessing the outlook for the economy, downgrading near-term growth prospects because of the reduced likelihood that fiscal stimulus will be forthcoming anytime soon. The failure of Republicans to push through health care reform exposed deep rifts within the party, and the G.O.P appears to be just as split over how to overhaul the tax code. Something will probably be cobbled together at some point this year, but the package of tax cuts and spending increases is not likely to be as potent as president Trump promised – or as market participants expected following his election. The main growth-boost from fiscal stimulus will not be felt until 2018 and beyond.

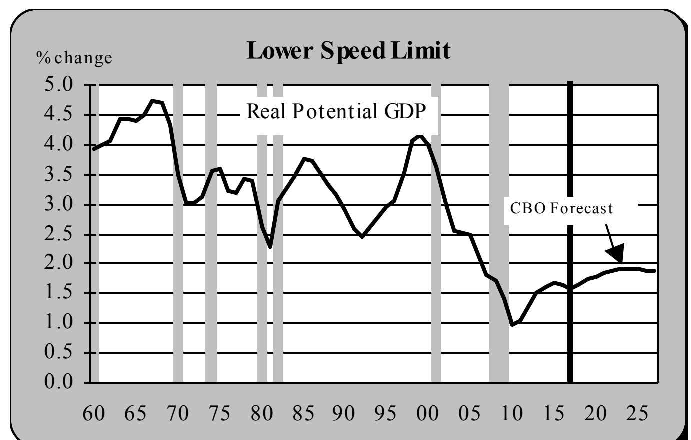
In light of the first-quarter slowdown, the economy's growth performance for the year will look very much like the 2 percent average seen since the Great Recession ended in mid-2009. When – and if – fiscal stimulus does kick in, the growth engine will crank up, perhaps accelerating to 2.5 percent in 2018. But it will be difficult to sustain that pace, much less upgrade the economy's speed limit to 4 percent as Trump promised during the campaign. Indeed, given the structural restraints on the economy's output potential, should growth for some reason accelerate much beyond 2 percent for a period of time, inflation would spike and spur the Fed into an aggressive rate-hiking process that would send the economy into a recession. The future may not always be hitched to a 2 percent growth rate, but raising the bar will require some profound changes in the fundamentals that determine the economy's noninflationary speed limit.

Lower Potential

Economists and policy makers have long debated a central question about the U.S. economy: How fast can it grow when labor and capital resources are being used to their fullest capacity? A higher potential growth rate results in more prosperity for the American people and enhances the nation's ability to meet the ever-expanding medical and retirement needs of an aging population. For policy makers, knowledge of the potential growth rate is crucial, as they need to cool the economy down when it exceeds the speed limit and stoke the engine when activity is lagging. Their objective is to bring the economy up to and then sustain growth at its potential cruising speed, i.e., achieving a state of maximum employment in a stable inflation environment.

The good news is that the economy may already be operating at that pace. The bad news is that current estimate of the potential growth rate is far below what it used to be. Throughout most of the postwar period, real potential GDP grew within a range of 2.5-4.0 percent a year, averaging 3.5 percent until the mid-2000s. However, by 2006 the trend line broke under 2.5 percent for the first time and, after the Great Recession, the downshift accelerated. Since 2007, potential growth has averaged less than 2 percent and, according to the Congressional Budget office projections, it will remain under that threshold at least until 2027.

The difference between 2 and 3.5 percent in terms of lost income and output is huge. If the economy had the capacity to grow at 3.5 percent since 2006 and actual growth lived up to potential, it would be generating $4 trillion or about 25 percent more goods and services by now, boosting real incomes of Americans by nearly a corresponding amount. In all likelihood, the national discourse would not be focused on the inadequate nest-eggs of the millions of boomers nearing retirement or fretting over the deepening hole that Social Security and Medicare will carve



out in the Federal budget in coming years, as tax revenues would be more than adequate to meet these obligations. Of course, there is no guarantee that the economy's actual performance would have lived up to its greater potential. That said, the first order of business is to raise the speed limit so that policy makers can concentrate on the more familiar challenge of revving up the growth engine.

Irreversible Restraints

President Trump may or may not fulfill his campaign promise to "Make America Great Again", but he can't make America young again. And therein lies one of the problems with boosting the nation's growth potential. Simply put, growth in the working age population – those between 16 and 64 years old – is slowing dramatically. From 1960 through 2007, population growth averaged 1.4 percent a year, but over the past 10 years, the annual growth rate plummeted to 0.5 percent. Nor is the pipeline of younger people destined to help; according to the Census Bureau's latest forecast, the 16-64 year-old age cohort is set to slow even further, to about 0.3 percent a year through 2025.

With fewer people eligible to take a job, the long decline in labor force growth is set to continue. Since the end of the Great Recession, the workforce has increased at an annual rate of 0.4 percent, one-quarter of the 1.6 percent average from 1948 to 2007. Needless to say, the more workers there are to generate output, the greater is the potential growth rate of the U.S. economy. In this case, sadly, the opposite is true. The slowdown in population growth is one of the two major constraints suppressing the economy's growth potential.

The other drag is coming from productivity – the amount of output per hour that each worker can generate. Like the labor force, productivity gains have also slowed dramatically. Since the end of the recession, worker productivity outside of farms has increased by 1.0 percent a year, well below the post-war average of 2.1 percent and that of any postwar recovery. Worse, the trend is going in the wrong direction, averaging 0.6 percent over the last six years. Since the combination of labor force growth and productivity gains constitutes the nation's output capacity, it is easy to see why the Congressional Budget Office has reduced its estimate of the economy's potential growth rate to below 2 percent.

Some Possible Tweaks

Unfortunately, government policies can do little to arrest the slowdown in population growth. What's more, the wave of retirements among aging baby boomers will put even more downward pressure on the labor force. According to the Census Bureau projections, the share of 16-64 year olds in the overall population will decline by more than one percent in each of the next five years through 2030. Simply put, irreversible demographic forces account for most of the slowdown in the nation's potential growth rate.

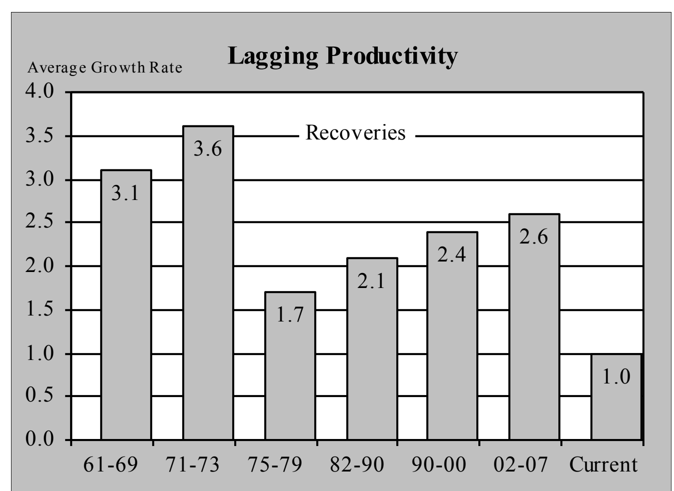
That said, some measures could be taken to mitigate the impact of these forces. While the aging population will continue to flood the pool of nonworkers with retirees, it is possible to draw some others in that pool back to the labor force. Making day care more accessible and affordable, for example, might encourage stay-at-home moms to take jobs. Likewise, expanding the earned income tax credit has been shown to be effective in attracting low-wage earners back to the workforce. Perhaps the surest way to increase the labor force participation rate would be to upgrade the skills of workers who have been sidelined by technology through expanded training programs. The widening skills gap in the nation is highlighted time and again by a litany of companies reporting they cannot find qualified workers to fill job openings.

Still, those measures would only marginally offset the relentless drag on the labor force coming from an aging population. The most powerful way to boost the economy's potential growth rate would be through boosting productivity. Indeed, if productivity growth continues at its recent 1.0 percent pace, the nation's potential GDP growth rate would more likely track 1.5 percent than 2 percent. Unfortunately, the prospect of ramping up productivity to its historical 2 percent average is not very promising, given the general weakness in capital spending since the recession. Hence, a sustained 2 percent growth rate is about the best we can hope for in the foreseeable future, unless advances in artificial intelligence, including robotics, provide an earlier and greater boost to productivity growth than expected.

Still Room For Faster Growth

Although the economy's potential growth rate is lower than in the past, it can – and hopefully will – exceed its 2 percent speed limit at least over the balance of the year. That's because there is still some ground to make up before bottlenecks and cost pressures threaten to ignite worrisome inflation. The labor market still has some slack, with too many workers on the sidelines and too many in part-time jobs that would prefer full-time positions. Inflation has been below the Federal Reserve's 2 percent target for four years and is only now within striking distance of that threshold. What's more, inflationary expectations remain quite low among households and in the financial markets.

The best-case scenario is that faster growth in coming quarters would spur more investment spending, thus sowing the seeds of stronger productivity gains down the road. Following the first-quarter slowdown, there is clearly more room to run faster for a while before the economy bumps up against its capacity limits. Of course, the traffic cops, in the guise of the Federal Reserve, will control the pace, putting rate-hiking speed bumps along the path to assure that growth does not accelerate past the noninflationary speed limit for long. Until a productivity boost lifts the economy's growth potential, the Fed's difficult task will be to keep the economy's heart beating while preventing the activity level of an aging recovery and an aging population from getting too feisty.



KEY ECONOMIC AND FINANCIAL INDICATORS

*FINANCIAL INDICATORS**

	March	February	January	December	November	October	September	12-Month Range High	Low
Prime Rate	3.88	3.75	3.75	3.64	3.50	3.50	3.50	3.88	3.50
3-Month Treasury Bill Rate	0.74	0.52	0.51	0.51	0.45	0.33	0.29	0.74	0.23
5-Year Treasury Note Rate	2.01	1.90	1.92	1.96	1.60	1.27	1.18	2.01	1.07
10-Year Treasury Note Rate	2.48	2.42	2.43	2.49	2.14	1.76	1.63	2.49	1.50
30-Year Treasury Bond Rate	3.08	3.03	3.02	3.11	2.86	2.50	2.35	3.11	2.23
Tax-Exempt Bond Yield	3.95	3.91	3.80	3.82	3.59	3.27	2.93	3.95	2.83
Corporate Bond Yield (AAA)	4.01	3.95	3.92	4.06	3.86	3.51	3.41	4.06	3.28
Conventional 30-Year Mortgage Rate	4.20	4.17	4.15	4.20	3.77	3.47	3.46	4.20	3.44
Dow Jones Industrial average	20823	20424	19908	19712	18697	18185	18267	20823	17302
S&P 500 Index	2367	2330	2275	2247	2165	2143	2158	2367	2022
Dividend Yield (S&P)	2.01	2.01	2.06	2.09	2.11	2.17	2.12	2.18	2.01
P/E Ratio (S&P)	21.7	21.8	20.9	20.6	20.5	19.9	20.4	21.8	19.1
Dollar Exchange Rate (vs. Major Currencies)	94.5	94.0	94.7	95.4	93.7	91.9	90.1	95.4	89.4

** Monthly Averages*

ECONOMIC INDICATORS

	March	February	January	December	November	October	September	12-Month Range High	Low
Housing Starts (In Thousands)	1215	1303	1241	1275	1149	1320	1052	1320	1052
New Home Sales (Thousands of Units)		592	558	530	573	568	568	622	530
New Home Prices (Thousands of Dollars)		296	308	330	318	302	234	330	234
Retail Sales (% Change Year Ago)	5.2	5.1	5.9	4.4	3.9	4.2	3.3	5.9	1.7
Industrial Production (% Change Year Ago)	1.5	0.3	0.0	0.8	-0.4	-0.8	-1.2	1.5	-1.7
Operating Rate (% of Capacity)	76.1	75.7	75.7	76.0	75.5	75.7	75.3	76.1	74.9
Inventory Sales Ratio (Months)		1.35	1.35	1.35	1.37	1.37	1.38	1.41	1.35
Real Gross Domestic Product (Annual % Change)				2.1			3.5	3.5	0.8
Unemployment Rate (Percent)	4.5	4.7	4.8	4.7	4.6	4.8	4.9	5.0	4.5
Payroll Employment (Change in Thousands)	98	219	216	155	164	124	249	297	43
Hourly Earnings (% Change Year Ago)	2.7	2.8	2.6	2.9	2.7	2.7	2.7	2.9	2.5
Personal Income (% Change Year Ago)		4.6	4.1	3.6	3.7	3.7	3.7	4.6	3.4
Savings Rate (Percent of Disposable Income)		5.6	5.4	5.2	5.5	5.6	5.7	6.2	5.2
Consumer Credit (Change in Mil. Of Dollars)		15207	10865	13932	25516	21470	17969	25516	10865
Consumer Prices (% Change Year Ago)	2.4	2.7	2.5	2.1	1.7	1.6	1.5	2.7	0.8
CPI Less Food & Energy (% Change Year Ago)	2.0	2.2	2.3	2.2	2.1	2.1	2.2	2.3	2.0
Wholesale Prices (% Change Year Ago)	2.3	2.2	1.6	1.6	1.3	0.8	0.7	2.3	-0.2

OWNED BY CREDIT UNIONS. SERVING CREDIT UNIONS.

Need Funds?

Issuing with SimpliCD

Join the 990+ credit unions that have discovered SimpliCD Issuance.

Have Funds to Invest?

Investing with SimpliCD

A variety of CD products, no safekeeping fees, and consolidated monthly statements.

It's fast. It's easy. It's SimpliCD

Contact your representative at Louisiana Corporate for details at 800-421-7030.