Economic Outlook for 2013: Beyond the Fiscal Cliff

Loyola University
Chicago, IL
December 3, 2012

William Strauss
Senior Economist and Economic Advisor
Federal Reserve Bank of Chicago
The “Great Recession” ended in June 2009, and the economy expanded by 2.5% over the past year.
The liabilities side of the Fed’s balance sheet shows large amount of excess reserves.
GDP is forecast to grow slightly below trend in 2012 and slightly above trend in 2013.

Real gross domestic product

<table>
<thead>
<tr>
<th>Year</th>
<th>Actual</th>
<th>Forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>2.0</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>1.7</td>
<td>2.3</td>
</tr>
<tr>
<td>2013</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Quarterly change (saar) from a year earlier

Percent change from a year earlier

Q3-2012
The FOMC expects GDP to grow somewhat above trend over the next three years.
The forecast path of the current recovery is relatively muted compared with past deep recession recovery cycles.

![Business cycle recovery path diagram](image)

- **1974-75**: Average annualized growth: 5.3% (Blue Chip forecast recovery path)
- **1981-82**: Average annualized growth: 5.4%
- **2008-09**: Average annualized growth: 2.1%
Employment fell by over 8.7 million jobs between December 2007 and February 2010, but began to rise and has added just over 1.9 million jobs over the past 12 months.
After peaking in October 2009, the unemployment rate has fallen by 2.1 percentage points
Okun’s Law: for every percentage point that GDP growth deviates from its trend – leads to a half percentage change in the unemployment rate in the opposite direction.
The unemployment rate is forecast to edge lower.
The FOMC forecasts that the unemployment rate will remain above the natural rate through the end of 2015.

Unemployment rate

percent

FOMC Central Tendency (September 2012)

- 2012: 8.0 – 8.2
- 2013: 7.6 – 7.9
- 2014: 6.7 – 7.3
- 2015: 6.0 – 6.8

Longer run: 5.2 – 6.0

FOMC
Inflation has moderated

Personal consumption expenditure - chain price index
percent change from a year earlier

![Graph showing personal consumption expenditure - chain price index from 1990 to 2012, indicating a moderation in inflation over time.]
In large part due to the movement of oil prices. Adjusted for inflation, current oil prices are below the levels that existed thirty years ago.
Natural gas prices remain low

Real natural gas price

dollars per mmbtu (2011 dollars)
Removing the volatile food and energy components from the PCE, “core” inflation remains low.
Inflation is anticipated to rise 2.0% this year and next year.
The FOMC anticipates that PCE inflation will remain below two percent through 2015.
The FOMC anticipates that “core” PCE inflation will also remain below two percent through 2015.
The forecast calls for a very gradual recovery in housing.
Industrial output in manufacturing is 2.1% higher than a year earlier, however since February 2012 output has fallen by 2.0% (saar)
Industrial production is forecast to rise at a trend pace.
Credit spreads between Corporate High Yield securities and Corporate Aaa securities had been edging lower.
Monetary policy has been very aggressive, keeping the Fed Funds near zero since December 2008.
The Federal Funds Rate is anticipated to remain very low over the forecast horizon.
The asset side of the Fed’s balance sheet has expanded in size and in composition.
The money supply (M2) is nearly 4 times bigger than the monetary base.
The Fed’s expansion of the monetary base has allowed the money supply to continue rising, compared with what took place during the 1930s.
Summary

• The outlook is for the U.S. economy to expand at a pace below trend this year and slightly above trend in 2013.

• Employment is expected to rise moderately with the unemployment rate edging lower.

• Slackness in the economy will lead to a relatively contained inflation rate.
www.chicagofed.org
www.federalreserve.gov