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Economic Outlook Symposium: Summary of 2013 results and 2014 forecasts

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According to participants in the Chicago Fed's annual Economic Outlook Symposium, the U.S. economy is forecasted to grow at its fastest pace in three years in 2014, with inflation remaining low and the unemployment rate edging down.

The Federal Reserve Bank of Chicago held its 27th annual Economic Outlook Symposium (EOS) on December 6, 2013. More than 100 economists and analysts from business, academia, and government attended the conference. This *Chicago Fed Letter* reviews the forecasts for 2013 from the previous EOS, and then analyzes the forecasts for 2014 (see figure 1) and summarizes the presentations from the most recent EOS.[1]

1. Median forecast of GDP and related items

	2012 (Actual)	2013 (Forecast)	2014 (Forecast)
Real gross domestic product[a]	2.0	**2.0**	**2.7**
Real personal consumption expenditures[a]	2.0	**2.0**	**2.5**
Real business fixed investment[a]	5.0	**1.3**	**3.7**
Real residential investment[a]	15.5	**12.1**	**13.8**
Change in private inventories[b]	7.3	**–28.5**	**0.0**
Net exports of goods and services[b]	–412.1	**–408.7**	**–416.7**
Real government consumption expenditures and gross investment[a]	–1.1	**–1.5**	**0.0**
Industrial production[a]	2.8	**2.5**	**2.7**
Car and light truck sales (millions of units)	14.4	**15.5**	**16.0**
Housing starts (millions of units)	0.78	**0.91**	**1.07**
Unemployment rate[c]	7.8	**7.2**	**6.8**
Consumer Price Index[a]	1.9	**1.5**	**1.7**
One-year Treasury rate (constant maturity)[c]	0.17	**0.13**	**0.20**
Ten-year Treasury rate (constant maturity)[c]	1.71	**2.67**	**3.03**
J. P. Morgan trade-weighted dollar index[a]	–0.5	**1.5**	**1.0**
Oil price (dollars per barrel of West Texas Intermediate)[c]	88.16	**97.60**	**96.00**

[a]Percent change, fourth quarter over fourth quarter.
[b]Billions of chained (2009) dollars in the fourth quarter at a seasonally adjusted annual rate.
[c]Fourth quarter average.
Note: These values reflect forecasts made in November 2013.
Sources: Actual data from authors' calculations and Haver Analytics; median forecast from Economic Outlook Symposium participants.

The U.S. economy is in the expansion phase of the business cycle; and while the nation's real gross domestic product (GDP) is at its highest level in history, the rate of economic growth since the end of the Great Recession in mid-2009 has been very restrained. During the 17 quarters following the second quarter of 2009, the annualized rate of real GDP growth was 2.3%—roughly in line with what is considered the long-term historical rate of growth for the U.S. economy.

The economy progressed slowly in 2013, as in previous years since the Great Recession. For the first quarter of 2013, the annualized rate of real GDP growth was a very slow 1.1%. Economic activity improved over the next two quarters of 2013: The annualized rate of real GDP growth increased to 2.5% in the second quarter and then to 4.1% in the third quarter. However, the year-over-year rate of real GDP growth was just 2% in the third quarter of 2013. Indeed, significant uncertainty in both the political and economic spheres may have been restricting economic growth over the past several years.

The economy continued to add jobs, but the number of jobs added from March 2010 through December 2013 was just under 7.6 million—around 87% of the more than 8.7 million jobs lost from February 2008 through February 2010. In addition to making up for these lost jobs, the U.S. economy needs to generate jobs to accommodate the new entrants into the labor force. According to the U.S. Bureau of Labor Statistics, the labor force expanded very little between February 2008 and December 2013: On net, just under 1.3 million individuals joined the labor force during this span. However, the population aged 16 and older increased by more than 13.9 million people over the same period. These demographics are reflected in the labor force participation rate (i.e., the proportion of the working-age population that is employed or jobless and actively seeking work) falling 3.2 percentage points from 66.0% in February 2008 to 62.8% in December 2013. Each percentage point drop in participation represents nearly 2.5 million fewer workers in the labor force. The challenging labor market is also illustrated by the high unemployment rate for the United States: The unemployment rate edged down from 7.8% in the fourth quarter of 2012 to a still quite high 7.0% in the final quarter of 2013.

> In 2014, the growth rate of real GDP is expected to be 2.7%—an improvement from the projected 2.0% rate for 2013.

Inflation eased in 2013, even though the price of oil (for West Texas Intermediate) rose from roughly $88 per barrel in the fourth quarter of 2012 to about $97 per barrel in the final quarter of 2013. Inflation, as measured by the Consumer Price Index (CPI), was 1.9% in 2012; the year-over-year rate of inflation moderated to 1.6% in the third quarter of 2013. Outside of the oil sector, the slack in production, the labor market, and other parts of the economy has kept inflationary pressures low.

For the first seven months of 2013, industrial production grew at an annualized rate of 1.4%—less than half of its historical growth rate. However, industrial activity picked up in the latter part of the year: Industrial output expanded at an annualized rate of 7.1% over the August through November period of 2013.

Light vehicle sales (car and light truck sales) rose to 14.4 million units in 2012—a 13% increase over the previous year's sales of 12.7 million units. In 2013, light vehicle sales increased to 15.5 million units, registering an 8% improvement from 2012.

The housing sector contributed little to the economic recovery through the second quarter of 2012. Over the 12 quarters following the end of the Great Recession in mid-2009, residential investment contributed just 0.1 percentage points toward the overall economy's annualized growth rate of 2.5%. However, from the middle of 2012 through the third quarter of 2013, residential investment contributed 0.4 percentage points toward the economy's annualized growth rate of 2.0%. Housing starts rose to 0.78 million units in 2012—a gain of 28% from 2011. Housing starts increased further in 2013: The annualized rate of housing starts was 0.92 million for the first 11 months of 2013—up 20% relative to the same period in 2012.

Results versus forecasts

According to the consensus forecast from the most recent EOS, the growth rate of real GDP in the fourth quarter of 2013 relative to the fourth quarter of 2012 is estimated to be 2.0%—slightly lower than the 2.3% rate predicted at the previous EOS. (For the remaining comparisons of GDP components, annual values are calculated based on the consensus estimates for the fourth quarter of 2013 from the most recent EOS.) Real personal consumption expenditures were slightly lower than forecasted, and real business fixed investment came in much weaker than expected. In contrast, real residential investment experienced a more significant improvement than anticipated. The unemployment rate was actually 7.0% in the fourth quarter of 2013—lower than the 7.6% rate forecasted for the final quarter of 2013. Inflation, as measured by the CPI, is now expected to be 1.5% in 2013—lower than the previously predicted rate of 2.1% for the year. This gap is anticipated even though oil's actual average price of $97.39 per barrel during the fourth quarter of 2013 was higher than its predicted average price of $93.75 per barrel for that quarter. Light vehicle sales came in at 15.5 million units for 2013—higher than the 15.0 million units forecasted. The annualized rate of housing starts rose to 0.92 million units for the first 11 months of 2013; so, total housing starts in 2013 are expected to fall short of the 0.95 million units previously predicted. The one-year Treasury rate actually declined to 0.12% in the fourth quarter of 2013 instead of rising to 0.20% as forecasted. The ten-year Treasury rate in fact increased to 2.75% by the end of 2013, surpassing the predicted rate of 2.02%.

Economic outlook for 2014

The forecast for 2014 is for the pace of economic growth to be somewhat above the historical average. In 2014, the growth rate of real GDP is expected to be 2.7%—an improvement from the projected 2.0% rate for 2013 and the fastest pace in three years. The quarterly pattern reveals a fairly solid performance for real GDP growth throughout 2014; its annualized rate is forecasted to edge higher over the year. Given that the economic growth rate is predicted to be only somewhat above its long-term historical average, the unemployment rate is expected to remain quite high, moving down to 6.8% in the final quarter of 2014. Inflation, as measured by the CPI, is predicted to tick higher from an estimated 1.5% in 2013 to a still low 1.7% in 2014. Oil prices are anticipated to fall somewhat; they are predicted to average $96 per barrel in the final quarter of 2014. Real personal consumption expenditures are forecasted to expand at a rate of 2.5% in 2014. Light vehicle sales are expected to rise to 16.0 million units this year; if this prediction turns out to be accurate, 2014 would be the best year for car and light truck sales since 2008, when the Great Recession began. Real business fixed investment is anticipated to record a solid growth rate of 3.7% in 2014. Industrial production is forecasted to see its growth rate improve to 2.7% this year.

The housing sector is predicted to continue to improve in 2014. Real residential investment is forecasted to increase at a rate of 13.8% in 2014. Housing starts are anticipated to rise—from the predicted 0.91 million units in 2013 to 1.07 million units in 2014. While better than the previous year, the anticipated 2014 level for housing starts would be less than 80% of the 20-year annual average of 1.37 million units.

The one-year Treasury rate is expected to tick up 7 basis points to 0.20% in

2014, and the ten-year Treasury rate is forecasted to increase 36 basis points to 3.03%. Both the trade-weighted U.S. dollar and the nation's trade deficit (net exports of goods and services) are predicted to be largely unchanged in 2014.

Financial and consumer outlook

Adolfo L. Laurenti, Mesirow Financial, highlighted some trends in recent labor and income data that may pose risks to the ongoing expansion. Since 2009, the unemployment rate has, more or less, continued to fall, reaching 7.2% in October 2013, he said. On the surface, this pattern appears to bode well for the economy. But the unemployment rate does not account for those out of the labor force (jobless individuals of working age who are not actively seeking work). Notably, the labor force participation rate has also dropped since 2009. The retirements of baby boomers were anticipated to reduce this rate, yet they alone do not explain the entire decrease, Laurenti said. He presented the results of an exercise in which he adjusted for changes in the size and age distribution of the U.S. population between 2005 and 2013 while holding constant the labor force participation rates of three age groups (16–24, 25–54, and 55 and older) from 2005. In his exercise, overall labor force participation in 2013 would have been somewhat higher, but so would unemployment: By his calculations, the unemployment rate in October 2013 would have been above 8%, largely because there would have been about 4.5 million more labor force participants aged 16–54, most likely without jobs. Additionally, Laurenti remarked that while short-term unemployment has returned to its prerecessionary levels, long-term unemployment (i.e., 27 weeks or longer) remains stubbornly high. This is particularly worrisome, since long-term unemployed workers' skills erode over time, further reducing their chances of being hired.

The quality of jobs being created is also a source for concern for the ongoing expansion, observed Laurenti. Net job creation since January 2009 has been more heavily concentrated in low-wage sectors, such as leisure and hospitality. Moreover, job growth in high-wage sectors, such as finance and manufacturing, has been flat or negative. In addition, data from various government surveys (on average weekly earnings, disposable income, and median household income) show that income growth has been weak throughout most of the recovery and expansion. A final source of concern for Laurenti was the condition of household balance sheets. While there's been a quick rebound in the stock market, this has only helped households near the top of the income distribution. Home equity—a factor affecting a much broader segment of the population—has been much slower to improve. While the economy on the whole is expected to improve in 2014, the disaggregated financial and consumer data suggest many downside risks remain: Laurenti cautioned that the recovery will continue to be disappointing for most until economic growth is more evenly distributed.

Automotive outlook

Michael Robinet, IHS Automotive Consulting, said global sales of new light vehicles were strong in 2013 and they are projected to grow at an annual rate of 3.9% through the end of this decade. The majority of this automotive sales growth is expected to come from the emerging economies of Brazil, Russia, India, and China. Additionally, global light vehicle production is forecasted to rise from about 85 million units in 2014 to about 105 million units in 2020; China, Mexico, India, Poland, and Iran are anticipated to account for 70% of the cumulative production growth in the period 2014–20. Focusing on North America, Robinet said that the region's new light vehicle sales are anticipated to rise to around 20 million in 2017 and then taper off slightly. Similarly, North American light vehicle production is forecasted to grow from 16.2 million units in 2013 to 18.0 million units in 2017 and remain flat through 2020. While Robinet's auto forecasts were generally favorable, he warned that in the coming years, auto producers with North American operations are expected to be challenged by their own factories' productive capacities (most are already near their limits), as well as parts suppliers' production constraints. Moreover, these producers will have to make further adjustments to satisfy the demands of regulators and consumers for smaller, more fuel-efficient vehicles.

Steel outlook

Robert DiCianni, ArcelorMittal USA, said moderate growth in domestic demand for steel over the next several months is expected, so U.S. steel consumption is projected to grow 3% in 2014, to reach 110 million tons. Growth in nonresidential construction—the largest final market for steel—was modest in 2013, and it is expected to improve slowly as the economic recovery gains traction. Autos were the best domestic market for steel in 2013, since consumers began to replace old vehicles last year; the average age of vehicles in the United States is now over 11 years, so the release of pent-up demand for new cars is expected to continue through 2014. Another bright spot in 2013 was new household appliance shipments, which were driven higher by increases in housing starts and remodeling activity last year; appliance shipments are expected rise in 2014, as are housing starts. Public infrastructure and defense are projected to be the two weakest markets for steel in 2014.

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Global steel consumption is projected to grow 3% in 2014, to a record level of 1.52 billion metric tons, said DiCianni. Steel consumption in Europe is expected to go up by 2.1% in 2014, as industrial production and construction both begin to grow again following the region's second recession in recent years. China's steel consumption is predicted to rise by 3% in 2014 after increasing by an anticipated 6% in 2013; its auto sector is expected to remain strong, but its housing sector is likely to slow in 2014.

Heavy machinery outlook

Frank Manfredi, of Manfredi & Associates, said that the heavy machinery industry is expected to experience moderate sales growth in 2014, as it did last year. The outlook for agricultural equipment markets is steady. Farmers have strong balance sheets, and farm commodity prices, while down from 2012, remain fairly high; however, "direct payments" (federal government subsidies made regardless of market conditions or farm yields) have started to come down. To save on equipment-related costs, farmers have shifted toward lower horsepower tractors in the past few years; this trend is expected to continue in 2014. Total tractor sales are forecasted to increase by only 1% in 2014.

Manfredi said his sales outlook for construction and mining machinery is strong, mainly because residential and nonresidential construction continues to recover from record lows. Total construction machinery sales are forecasted to increase 7.4% in 2014—an improvement over the anticipated gain of 4.0% in 2013. Manfredi observed that heavy machinery is increasingly being rented rather than bought, mostly because of concerns that it will soon become out of compliance with more-restrictive U.S. emissions standards.

Illinois's fiscal challenges

William Testa, Federal Reserve Bank of Chicago, explained the fiscal issues facing Illinois. He said that Illinois's aggregate state and local tax rate (i.e., tax revenues as a share of gross state product, or GSP) has historically been somewhat below the national average and competitive with those of adjacent states. Yet, Illinois's tax structure has not produced enough revenues to cover its spending. To address this gap, the state government has been borrowing against its future by deferring liabilities (e.g., by underfunding public pensions). Testa gave his projection of what future tax revenues might have to be in order to meet these liabilities. According to Testa's estimation using data produced from the Fiscal Futures Model,[2] Illinois's annual budget gap in the coming years would be about 1.9% of its fiscal year (FY) 2010 GSP. Moreover, if the unfunded pension liabilities of all units of local government (e.g., for public schools, mass transit, and water) within Chicago were accounted for, city residents would face an additional gap equivalent to 1.1% of Chicago's FY2010 GDP, said Testa. Thus, in this scenario, the tax burden of Chicago's residents would have to grow substantially to fill these gaps. Testa concluded that when coupled with cross-border competition for business investment, the tax increases needed to pay for Illinois's and Chicago's projected liabilities would have a significant negative impact on the state's economic growth.

Conclusion

In 2013, the U.S. economy expanded at a pace in line with the historical average. The economy in 2014 is forecasted to grow at a faster rate than it did in 2013, but this pace is not expected to be strong enough to substantially reduce the economic slack built up during the Great Recession. The housing sector is predicted to continue to improve in 2014, as are light vehicle sales. The unemployment rate is expected to edge lower by the end of 2014 but remain high by historical standards, and inflation is predicted to remain low.

1 Also see www.chicagofed.org/webpages/events/2013/economic_outlook_symposium.cfm.

2 For details, see http://igpa.uillinois.edu/fiscalfutures/about.