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Economic Outlook Symposium: Summary of 2014 results and 2015 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 a pace slightly above average in 2015, with inflation ticking lower and the unemployment rate edging down.

The Federal Reserve Bank of Chicago held its 28th annual Economic Outlook Symposium (EOS) on December 5, 2014. More than 100 economists and analysts from business, academia, and government attended the conference. This *Chicago Fed Letter* reviews the forecasts for 2014 from the previous EOS, and then analyzes the forecasts for 2015 (see figure 1) and summarizes the presentations from the most recent EOS.[1]

1. Median forecast of GDP and related items

	2013 (Actual)	2014 (Forecast)	2015 (Forecast)
Real gross domestic product[a]	3.1	**2.1**	**2.7**
Real personal consumption expenditures[a]	2.8	**2.0**	**2.6**
Real business fixed investment[a]	4.7	**5.2**	**4.2**
Real residential investment[a]	6.9	**2.4**	**7.5**
Change in private inventories[b]	81.8	**65.0**	**50.0**
Net exports of goods and services[b]	–384.0	**–415.0**	**–432.9**
Real government consumption expenditures and gross investment[a]	–1.9	**1.2**	**0.9**
Industrial production[a]	3.3	**4.1**	**3.0**
Car and light truck sales (millions of units)	15.5	**16.4**	**16.8**
Housing starts (millions of units)	0.93	**1.00**	**1.14**
Unemployment rate[c]	7.0	**5.8**	**5.6**
Consumer Price Index[a]	1.2	**1.8**	**1.7**
One-year Treasury rate (constant maturity)[c]	0.12	**0.11**	**0.47**
Ten-year Treasury rate (constant maturity)[c]	2.75	**2.36**	**3.00**
J. P. Morgan trade-weighted dollar index[a]	3.5	**2.3**	**0.5**
Oil price (dollars per barrel of West Texas Intermediate)[c]	97.39	**80.00**	**83.84**

[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 2014.
Sources: Actual data from authors' calculations and Haver Analytics; median forecast from Economic Outlook Symposium participants.

The U.S. economy entered the sixth year of its expansion in the third quarter of 2014. 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 21 quarters following the second quarter of 2009, the annualized rate of real GDP growth was 2.3%—roughly in line with the long-term historical rate of growth for the U.S. economy.

Economic growth was quite volatile during much of 2014. At 3.5% in the fourth quarter of 2013, the annualized rate of real GDP growth fell to –2.1% in the first quarter of 2014; then it rose to 4.6% in the second quarter and 5.0% in the third quarter. The fluctuation in growth rates during 2014 was due in large part to two temporary factors—extreme winter weather and a downward inventory correction. However, over the first three quarters of 2014 combined, the annualized rate of real GDP growth was a moderate 2.4%—close to the annualized growth rate during the first 21 quarters of the current expansion.

The economy continued to increase employment in 2014, with more than 2.9 million jobs added. By May 2014, the more than 8.7 million jobs lost over the period February 2008 through February 2010 had finally been recovered. Moreover, in the final quarter of 2014, the unemployment rate stood at 5.7%. The working-age population (16 and older) had increased substantially since early 2008, leading to a drop in the labor force participation rate (i.e., the proportion of the working-age population that is employed or jobless and actively seeking work). According to the U.S. Bureau of Labor Statistics (BLS), between February 2008 and December 2014, just under 2.5 million individuals joined the labor force, translating to an annualized gain of 0.2%. However, the working-age population increased by more than 16.2 million people over the same period, which translates to an annualized increase of 1.0%. As a result, the slack in the labor market remains quite large despite the job gains of last year. In addition, significant labor market slack is indicated by the still outsized number of part-time workers who desire full-time employment. Finally, some workers may not have obtained jobs that utilize their specific skills—another factor contributing to labor market slack.

In 2015, the growth rate of real GDP is expected to be 2.7%—an improvement from the projected 2.1% rate for 2014.

The year-over-year rate of inflation, as measured by the Consumer Price Index (CPI), was 1.3% in November 2014—a tad higher than the 1.2% inflation rate of 2013. Inflation remained low in 2014, in part because of the collapse in the price of oil. For instance, the price of West Texas Intermediate oil fell from roughly $97 per barrel in the fourth quarter of 2013 to about $73 per barrel in the final quarter of 2014. Developments like this in the energy sector—along with the slack in production, the labor market, and other parts of the economy—have continued to keep inflationary pressures low.

For the first 11 months of 2014, industrial production grew at an annualized rate of 5.8%—nearly double its historical growth rate. Light vehicle sales (car and light truck sales) rose to 15.5 million units in 2013—an 8% increase over the previous year's sales of 14.4 million units. In 2014, light vehicle sales increased to 16.4 million units, registering a 6% improvement from 2013.

The housing sector contributed little to the economic expansion through the third quarter of 2014. Over the 21 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 2.3%. Housing starts rose to 0.93 million units in 2013—a gain of 19% from 2012. Housing starts increased further in 2014: The annualized rate of housing starts was 0.99 million for the first 11 months of 2014—up 7% relative to the same period in 2013.

Results versus forecasts

According to the consensus forecast from the most recent EOS, the growth rate of real GDP in the fourth quarter of 2014 relative to the fourth quarter of 2013 is estimated to be 2.1%—lower than the 2.7% 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 2014 from the most recent EOS.) While real personal consumption expenditures were somewhat lower than forecasted, real business fixed investment came in much stronger than expected. Real residential investment improved at a much slower rate than anticipated. The unemployment rate was actually 5.7% in the fourth quarter of 2014—just over a percentage point lower than the 6.8% rate forecasted for the final quarter of 2014. Inflation, as measured by the CPI, is now expected to be 1.8% in 2014—nearly identical to the previously predicted rate of 1.7% for the year. Oil's actual average price in the fourth quarter of 2014 was $73.15 per barrel—significantly lower than its predicted average price of $96 per barrel. Light vehicle sales came in at 16.4 million units for 2014—higher than the 16.0 million units forecasted. The annualized rate of housing starts rose to 0.99 million units for the first 11 months of 2014; so, total housing starts in 2014 are expected to fall short of the 1.07 million units previously predicted. The one-year Treasury rate ticked up to 0.15% in the fourth quarter of 2014—a bit below the 0.20% forecasted. The ten-year Treasury rate in fact decreased to 2.28% by the end of 2014 instead of increasing to the predicted rate of 3.03%.

Economic outlook for 2015

The forecast for 2015 is for the pace of economic growth to be somewhat above the historical average. In 2015, the growth rate of real GDP is expected to be 2.7%—an improvement from the projected 2.1% rate for 2014. The quarterly pattern reveals a fairly solid performance for real GDP growth throughout 2015; the annualized rate is predicted to edge higher over the year. Given that the economic growth rate is forecasted to be only somewhat above its historical average, the unemployment rate is expected to only edge lower to 5.6% in the final quarter of 2015. Inflation, as measured by the CPI, is predicted to tick lower from an estimated 1.8% in 2014 to 1.7% in 2015. Oil prices are anticipated to remain low; they are predicted to average almost $84 per barrel in the final quarter of 2015. Real personal consumption expenditures are forecasted to expand at a rate of 2.6% in 2015. Light vehicle sales are expected to rise to 16.8 million units this year; this increase is roughly in line with the growth in overall consumer spending. Real business fixed investment growth is anticipated to slow to a still solid growth rate of 4.2% in 2015. Industrial production is forecasted to see its growth rate moderate to 3.0% this year—close to its historical average.

The housing sector is predicted to continue its fairly slow march toward normalization in 2015. Real residential investment is forecasted to improve to a growth rate of 7.5% in 2015. Housing starts are anticipated to rise to 1.14 million units in 2015—well below their 20-year annual average of roughly 1.35 million.

The one-year Treasury rate is expected to rise to 0.47% in 2015, and the ten-year Treasury rate is forecasted to increase to 3.00%. 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 2015.

Financial and consumer outlook

Carl Tannenbaum (Northern Trust) presented his outlook for consumers and the banking sector. Strong retail and auto sales of the past few years indicate improving U.S. consumption—which Tannenbaum argued was being supported by growth in household net worth and debt reduction. In particular, rising equity markets have increased wealth and helped spur additional spending even as wage growth has remained flat. The absence of wage growth is somewhat puzzling, Tannenbaum noted, since the unemployment rate has fallen sharply in the past two years. One explanation is that the unemployment rate is not accurately measuring labor market slack. Other labor market measures—such as the ratio of part-time to full-time employment and the percentage of individuals reporting they would like a job even though they are not actively looking—remain above their pre-recessionary levels, suggesting excess capacity still exists in labor markets. Another explanation is that wage growth is being held down by demographic factors: Workers tend to get larger raises when they move to new jobs, but as many approach retirement (as the baby boomers are), they are less willing to make that transition. One concern for Tannenbaum was that the economic gains of recent years have occurred only near the top of the income distribution. The Federal Reserve Board's *Survey of Consumer Finances* (SCF)[2] shows that between 2010 and 2013 net worth grew modestly in the top half of the income distribution, but fell substantially in the bottom half. For the bottom 20% of earners, net worth declined by about 30%. On the whole, not only has actual income growth slowed, but households' expectations of future income have also declined, he said. The latter is particularly concerning because economic theory suggests that income expectations are the key driver of long-run consumption. Tannenbaum also said he was worried that many households are unprepared for retirement. Not enough households have retirement accounts, and even among those that do, the value of their accounts are too low, he contended. Moreover, because many state pension plans face large funding gaps, several public sector employees may not be able to count on receiving the retirement benefits they were promised, he said.

Turning to the financial sector, Tannenbaum argued bank asset positions and performance are sound. Loan quality is excellent, business lending has picked up, and bank assets are producing healthy returns. Most importantly, new capital standards and Federal Reserve stress testing[3] for large financial institutions have led to more capital being brought onto their balance sheets, making them less susceptible to bank runs, Tannenbaum contended. Moreover, new accounting rules have made large firms' holdings more transparent. Also, he argued, regulators have a much better understanding of the interconnectedness among firms—which will help agencies better detect and address systemic risks. Tannenbaum warned that cybersecurity and leveraged lending[4] were sources of risk, but overall, he said he was optimistic about the future of U.S banking.

Automotive outlook

Haig Stoddard (WardsAuto) said U.S. light vehicle sales are expected to reach 17 million by the end of 2015. Stoddard contended that pent-up demand created by the Great Recession would continue to drive sales for the next few years as the economy steadily improves. Many vehicles have been on the road for over ten years, so consumers are soon likely to upgrade to new vehicles with better technology. He said strong prices for used vehicles would help support new vehicle sales via trade-ins. Stoddard also argued that favorable demographic trends would spur sales: He said that millennials would buy new vehicles as they begin to form households and that seniors would live and drive longer than ever before. Although some analysts have expressed concern that fuel efficiency mandates from the federal government would increase costs and dampen sales, Stoddard noted he was confident that the price impact of these regulations would be modest. Fuel efficiency for trucks and sport utility vehicles has improved dramatically in recent years, so many of the changes needed to meet the mandates have already been priced in. With regard to vehicle classes, Stoddard shared his prediction that the market share of crossover utility vehicles would continue to increase in 2015, while those of small and mid-size sedans would continue to decline. This shift would benefit auto manufacturers such as General Motors and Fiat Chrysler, which have strong product lines in the crossover utility category, he noted.

Steel outlook

Robert DiCianni (ArcelorMittal USA) said 2014 was a good year for the steel industry, as steel-intensive sectors outperformed the rest of the U.S. economy. According to DiCianni, domestic steel consumption is projected to grow by 2% in 2015, to reach 115 million tons. Nonresidential construction—the largest final market for steel—has experienced stable but modest growth since 2010; DiCianni said this pattern is expected to continue into 2015 as the economy expands. Record automotive production and solid growth in residential construction are anticipated for 2015, he said, which should be a boon to steel sales. Heavy-duty truck sales are also predicted to help drive up steel consumption in 2015 and beyond; the trucking industry faces capacity constraints and will have to grow in the coming years. Moreover, heavy-duty truck sales are forecasted to

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spike up ahead of stricter fuel efficiency standards that go into effect in 2020. Costs associated with meeting these regulations are expected to make new trucks more expensive. Machinery and public infrastructure are projected to be the two weakest final markets for steel in 2015, he said.

Global steel consumption is projected to grow by 2% in 2015, to a record level of 1.59 billion metric tons, said DiCianni. Steel consumption in Europe is expected to go up by 2.9% in 2015, as monetary stimulus from the European Central Bank (ECB) and pent-up demand for durable goods support a gradual recovery. In contrast, weakness in China's real estate market and industrial production is expected to lead the country's steel consumption to tick up by only 0.8% in 2015.

Heavy machinery outlook

Nicolas Clerc (Caterpillar) said his forecast for world GDP growth was 2.9% in 2015—enough to support modest sales growth for the heavy machine industry. Additionally, Clerc argued that leading indicators, including bond prices, vehicle sales, and freight movements, suggest the U.S. economy is not at risk of falling back into recession in the near future. He said that in the U.S., low interest rates would continue to promote new residential and nonresidential construction, which would help heavy machinery sales. That said, one weak spot for the machinery market continues to be public infrastructure spending. Although there has been some pickup in infrastructure spending in recent months, the lack of highway funding makes long-term planning difficult—and delays heavy machinery purchases. Another weak spot for the machinery market is mining, as demand for raw materials remains low. Clerc said the sales outlook for heavy machinery was weaker in less developed economies. For instance, the Chinese government responded to the financial crisis with aggressive fiscal stimulus that led to a sharp increase in machine industry activity in 2010–11; however, as it shifts to fighting inflation and reforming the banking sector, financing for construction spending is becoming scarce. In other developing countries, declines in business confidence have led to falling demand for heavy machinery, said Clerc.

Global economic assessment

Manuel Balmaseda (CEMEX) presented his outlook on the global economy. He noted that although economic growth in the U.S. has been disappointing in recent years, it has significantly outperformed growth in other developed economies. In fact, in the International Monetary Fund's October 2014 *World Economic Outlook*,[5] the U.S. was the only major economy whose growth forecast was revised up significantly. Meanwhile, declining business confidence and growth threaten to push Europe back into recession, he noted. Balmaseda said that as inflation expectations continue to fall, the ECB would inject more monetary stimulus. The ECB's balance sheet has expanded at a slower rate than those of other major central banks, and has substantial room to grow. He argued that the most recent European crisis was primarily political in nature; countries will have to integrate and give up sovereignty before the continent can recover economically, he contended. Balmaseda also expressed concern about slow growth and high inflation in Brazil and the effect of rapidly falling oil prices in Russia. Although some analysts worry that China's growing shadow banking sector[6] could lead to financial instability, Balmaseda argued that because shadow banks are isolated from the formal banking sector there, they do not pose the same risks as their Western counterparts. Overall, he said that the global economy is expected to continue to grow, but at a pace that is too slow for comfort.

Conclusion

In 2014, the U.S. economy expanded at a pace roughly in line with the historical average. The economy in 2015 is forecasted to grow at a slightly faster rate than it did in 2014. The housing sector is predicted to continue to improve in 2015, as are light vehicle sales. The unemployment rate is expected to edge lower by the end of 2015, and inflation is predicted to remain low.

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[1] Also see https://www.chicagofed.org/events/2014/economic-outlook-symposium.

[2] www.federalreserve.gov/econresdata/scf/scfindex.htm.

[3] For more on Fed stress testing, see www.federalreserve.gov/bankinforeg/stress-tests-capital-planning.htm.

[4] Leveraged loans are loans with high interest rates extended to firms or individuals that already have large amounts of debt.

[5] www.imf.org/external/pubs/ft/weo/2014/02/.

[6] For more details, see http://lexicon.ft.com/Term?term=shadow-banking.