US Economic Overview
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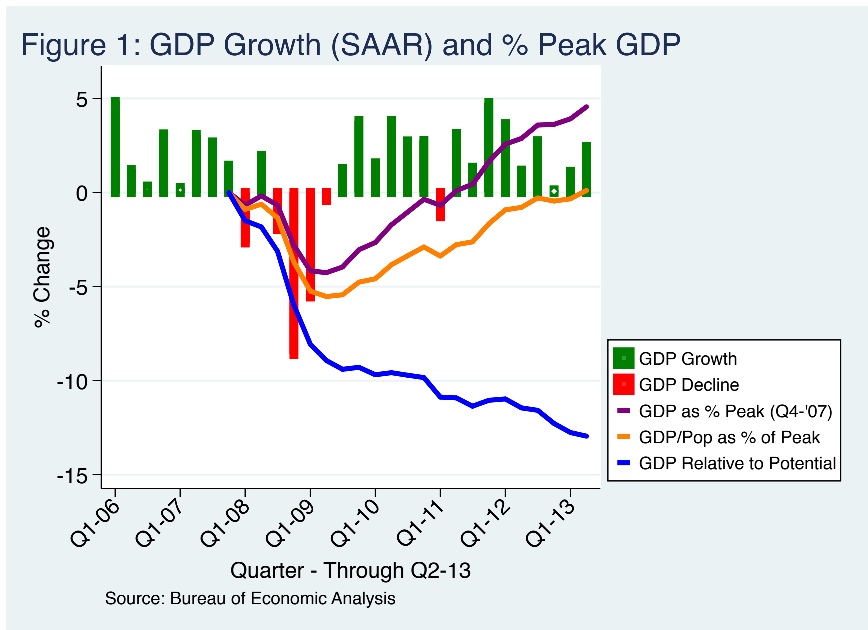
Key Findings

- Economic recovery continues. Although overall GDP is now higher than in the years before the Great Recession, GDP per person has only just recovered.
- While the unemployment rate is declining, this paints a poor picture of the labor markets. Including the under-employed and those marginally attached to the labor force, the unemployment rate is in excess of 13%.
- Job creation has been relatively steady, but jobs are being created in primarily low wage sectors.
- The overall recovery has been extremely inequitable, with the vast majority of the wage gains going to the richest among us. Corporate profits are also growing very rapidly.
- The influence of foreign economies on the recovery remains significant, but the tide is turning with gradual improvement in Europe and a "soft-landing" in China.
- The future of the recovery is squarely in the hands of policymakers in Washington, DC. A shutdown of the Federal government is inconvenient from the perspective of the economy, but a default would likely mean renewed recession.

US Economic Overview

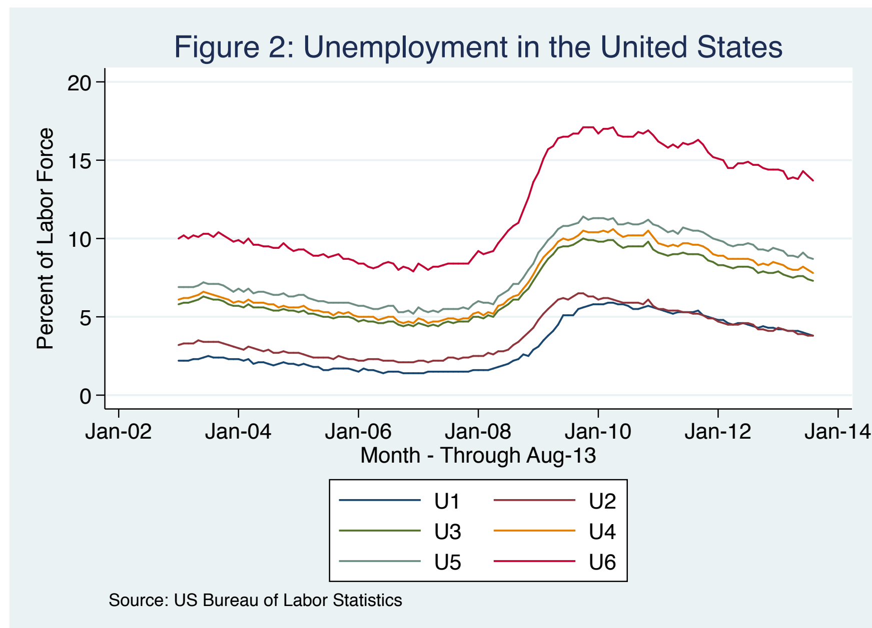
Economic recovery in the United States is proceeding, though not at a brisk pace. Growth in quarterly Gross Domestic Product (GDP) is generally below long-run trends, while employment has yet to recover its pre-recession levels. We are now five years and nine months beyond the recession start (December 2007) and four years beyond its official end (July 2009). Although overall real GDP recovered its pre-recession levels by mid-2011, population growth has slowed the recovery of overall well-being in the United States. Real GDP per capita in the United States has only recently recovered its pre-recession levels. Furthermore, current GDP is perhaps as much as 14% less than potential GDP—what might have developed in the absence of the recession. Therefore, although only about 5% of GDP was lost during the Great Recession, the slow pace of recovery has resulted in yet greater losses relative to potential.



Perhaps the most significant concern is the pace at which employment is recovering. Despite the creation of more than 169,000 jobs in August of 2013—plus an average of 183,000 created per month during the last year—overall employment levels remain nearly 2% below pre-recession levels. Although 6.8 million jobs have been created since early 2010, nearly 8.7 million jobs were lost during the recession.

Recent Periods of Job Gains/Losses by Industry			
Industry	**Jan-03 to Dec-07**	**Dec-07 to Dec-09**	**Dec-09 to Present**
Total	7,662	-8,669	6,760
Education/Health	2,116	799	1,385
Leisure/Hospitality	1,377	-616	1,278
Admin Support	701	-1,144	1,213
Retail Trade	614	-1,237	909
Prof/Sci/Tech	1,201	-374	715
Manufacturing	-1,123	-2,275	492
Transport/Warehouse	339	-374	290
Construction	786	-1,840	148
Finance/Insurance	140	-343	127
Real Estate	118	-196	33
Information	-240	-283	-58
Federal Gov't	-33	71	-88
State Gov't	105	12	-143
Local Gov't	678	21	-418

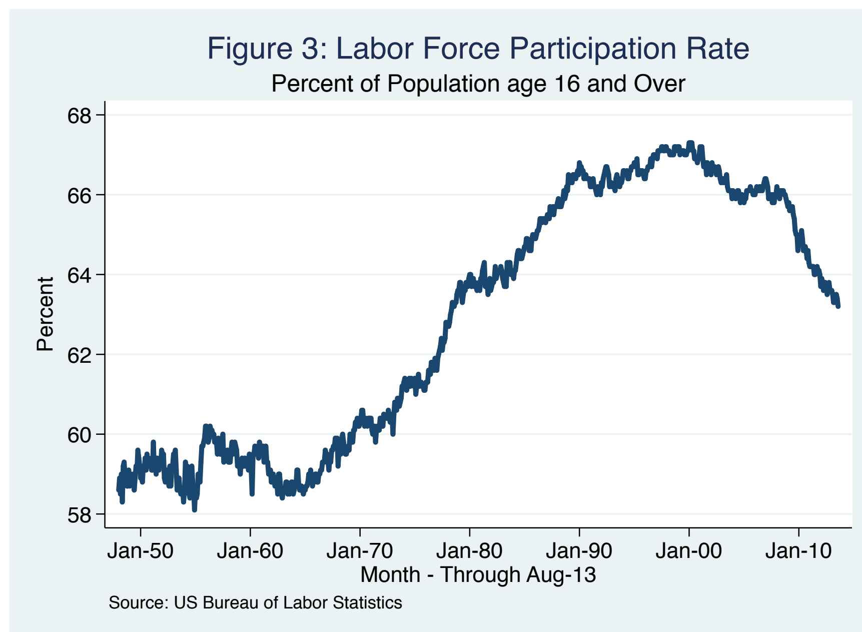
Employment recovery is also relatively concentrated in a small number of service-oriented sectors. While manufacturing has recovered nearly 500,000 jobs, these jobs are just that—recovery from losses during the recession. Few expect this trend to continue. Another aspect of the employment recovery is the continued losses of government jobs at all levels. Government employment declines have slowed employment recovery by more than 600,000 jobs.



Along with job creation, the unemployment rate has been slow in falling, with a drop of just 0.8 percentage points between August 2012 and August 2013. Un-

employment now stands at 7.3% (Figure 2, series U3). Series U1-U6 in Figure 2 represent different calculations of unemployment. U3 is the standard definition, while U6 is the most comprehensive, including those who are marginally attached to the labor force and those who are working part time for economic reasons—that is, those who are underemployed. This latter category currently indicates an underemployment rate of 13.7%.

At the same time, much of the decline in the unemployment rate is a result of workers exiting the labor force—deciding to stop looking for work. Currently, just 63.2% of the working age population in the United States is working or actively looking for work (Figure 3). This is a level that has not been seen since August of 1978, some 35 years ago.



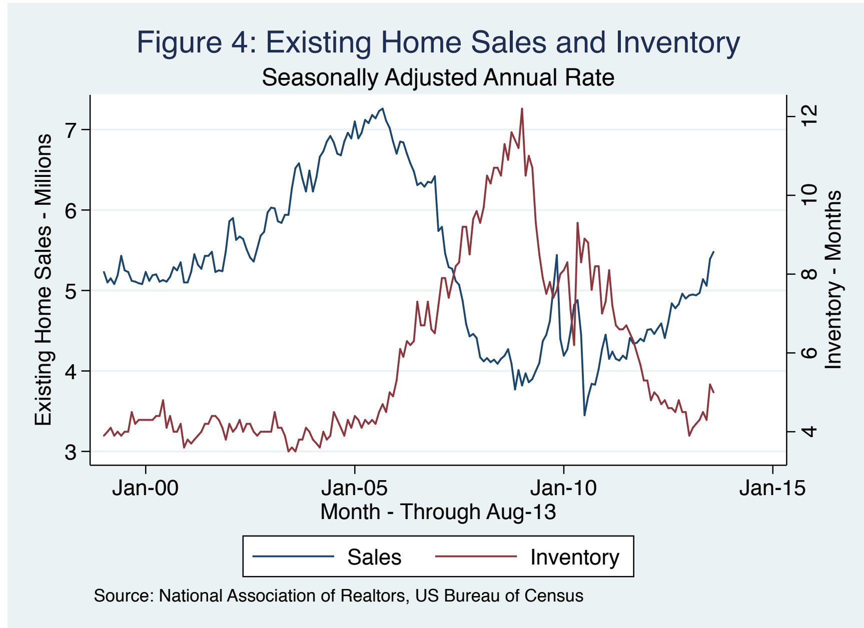
The decline in labor force participation has been underway since the turn of the century, but has been greatly exacerbated by the labor market effects of the Great Recession. To some extent, this reflects a difficult labor market, with otherwise productive workers deciding not to look for work. The longer term trend reflects the end of the demographic dividend brought about by the Baby Boom. As the Baby Boomers age, a larger percentage will be over the age of 65 and generally less likely to work. As this happens, economic growth relies on a smaller and smaller proportion of the labor force and becomes more difficult to accomplish.

Housing Market Recovery

Housing markets have been performing well lately. With interest rates at or near historic lows, able buyers have rushed in. Indexes of home prices indicate

increases. Sales are at post-recession highs—outside of some policy induced spikes (Figure 4). Inventories are also quite low.

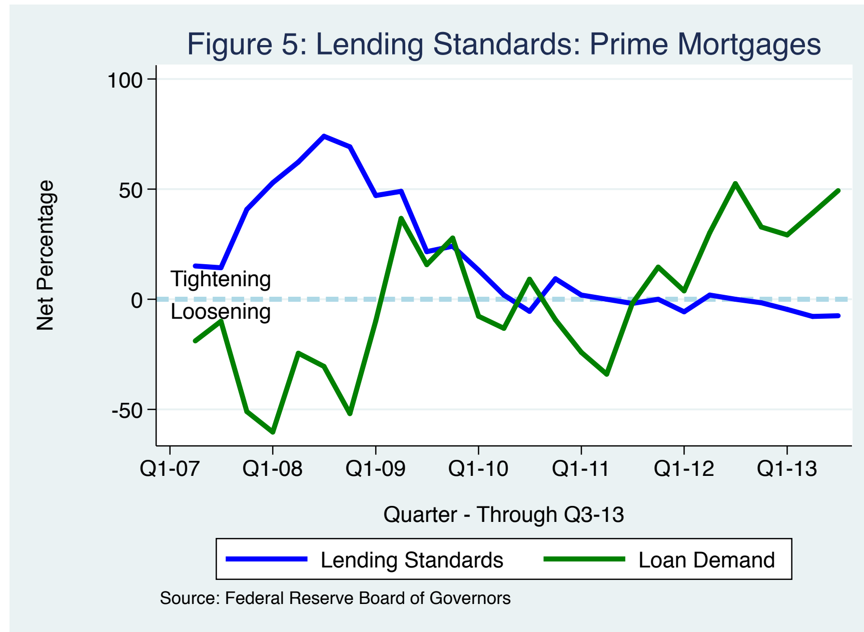
A robust and active housing market is important for economic recovery. Rising prices are a signal to home builders that demand will be there should they undertake new housing projects. Indeed, permits for new housing construction nationwide were up 33% between 2011 and 2012. They have increased by 22% thus far in 2013 relative to 2012. A robust housing construction sector has been an important contributor to economic growth over the last two years.



All is not rosy in the housing market, however. Nearly a quarter of all households in the United States with a mortgage owe more in principal than the value of their home[1]. These mortgages are said to be underwater. It is also true that some 56% of potential homeowners have credit scores that currently are categorized as sub-prime. These homeowners could not qualify for a prime mortgage.

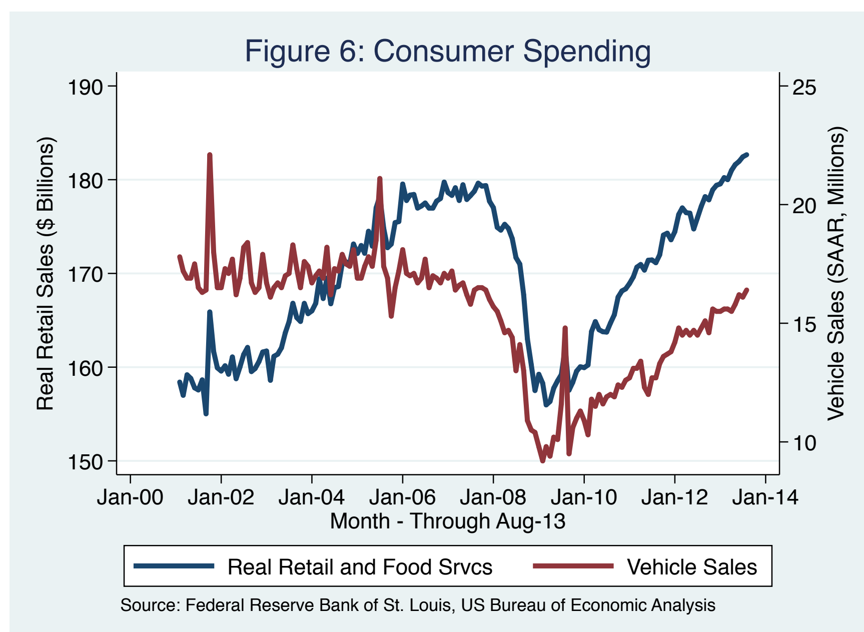
Despite the low credit rating of many potential buyers, the demand for prime mortgages has been steadily increasing since the third quarter of 2011 (Figure 5). Loosening of lending standards had not occurred with any consistency until late 2012. Loosening—the relaxing of standards that potential borrowers must meet— happened on net at less than 10% of all US banks and even then during only the last two quarters.

[1] The figure is 23.8% according to the Zillow Q2 2013 Negative Equity Report.



Retail Sales

The US economy is driven by sales of final consumption goods. In recent decades, consumption has accounted for more than 70% of GDP. During the Great Recession, retail sales and purchases of automobiles declined significantly. Retail sales fell by more than 13% from their pre-recession peak to its trough in March of 2009. Since that time, retail sales have recovered the ground lost and are now at their highest recorded level—one of the very few economic statistics for which this is true.

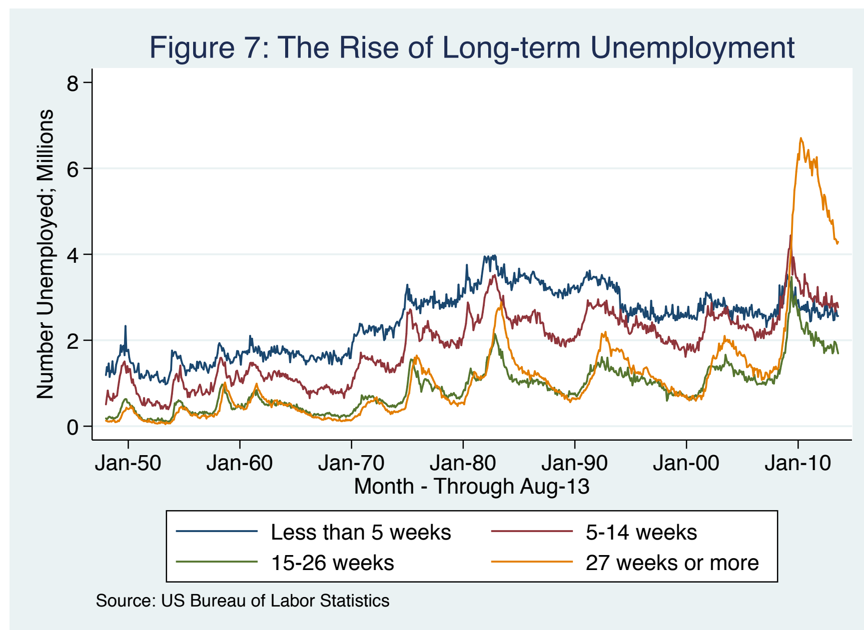


Similarly, vehicle sales fell from a reasonably steady rate of 17 million per year to just over 9 million per year—a decline of nearly 50% from peak to trough. Cash for Clunkers lead to a spike early in the recovery, but the level quickly dropped once the program ended. Through the rest of the recovery, vehicle sales have continued to increase, but are not yet back to their pre-recession levels.

Retail sales, including of automobiles, have played a significant role in the recovery. It is anticipated that this role will continue into 2014, but the extent to which consumers can continue providing this stimulus has to be called into question. Through this recovery—as in the several decades before the recession—income and wealth is becoming increasingly concentrated in the hands of fewer and fewer households. This concentration has the potential to constrain consumption as a driving force for the U.S. economy.

An Inequitable Recovery

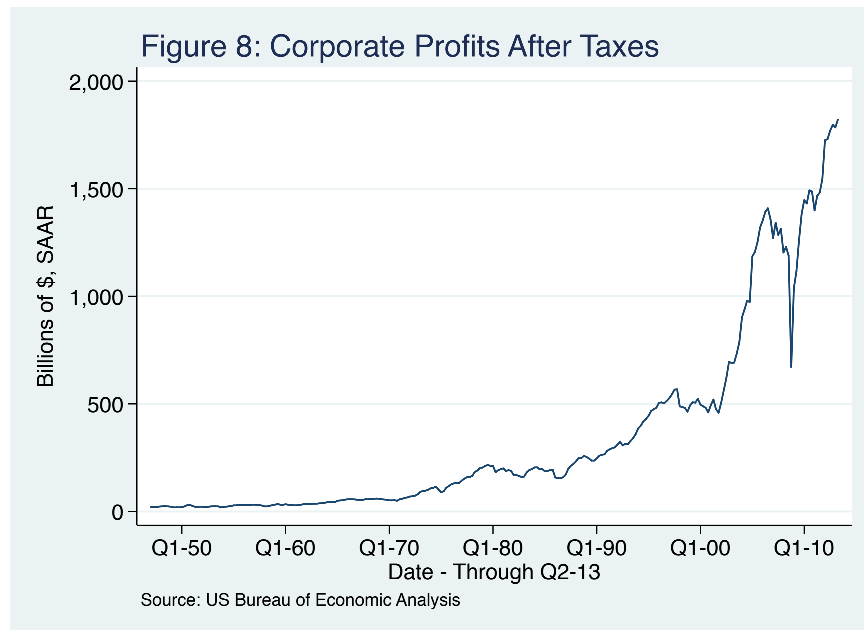
The recovery has been difficult for many workers. The number of workers unemployed for 27 weeks or more rose to levels unheard of in the last 40 years and remains highly elevated. In excess of 4.5 million workers remain classified as long term unemployed.



At the same time, corporate profits continue to grow rapidly and are significantly above their pre-recession levels. This is not necessarily a bad thing, but it is arguably only possible because many companies have used the recession to shed labor that is no longer necessary because of the influence of computerization or the introduction of other technologies into the workplace.

Of the job creation that has taken place, it has been primarily in lower wage occupations. The majority of job losses during the recession were in mid-wage occupations (60%) while the majority of jobs gained are among the lower-wage (58%). Higher-wage occupations have been created in roughly the same proportion in which they were lost, at a rate of about 1 in 5 jobs.

This pattern of job creation is largely consistent with the patterns indicated in the table on page 5. Sectors of the economy that are creating jobs are generally those that employ relatively low wage workers. Government also plays a role here, having generally been a source of well paying stable employment, but these jobs are becoming harder to come by.



The inequity in the recovery is unlikely to change unless something is done to speed up the pace at which job recovery takes place. With so many American's out of work, employers feel no need to raise salaries, comfortable in the knowledge that there is always somebody willing to do a particular job for less money. Until unemployment and underemployment are effectively dealt with, the top 1% will continue to reap 95% of any national income gains going forward as they have throughout the recovery.

Further Head Winds

Overall, the economy continues to recover, though slowly. There are many positive signs that the recovery will continue, but many headwinds remain. As a result, growth, positive though it may be, will be slower than otherwise might occur.

Policy Uncertainty

During the last several years, the Federal Government has engaged in negotiations and threats that with some frequency have created an environment of great uncertainty with regard to government policy. In 2011 it was uncertainty over the debt ceiling, with a default narrowly avoided. Toward the end of 2012 it was the Fiscal Cliff. Recently, the government was closed for 16 days before policymakers came to an agreement at the 11th hour allowing it to reopen and pay its debt obligations.

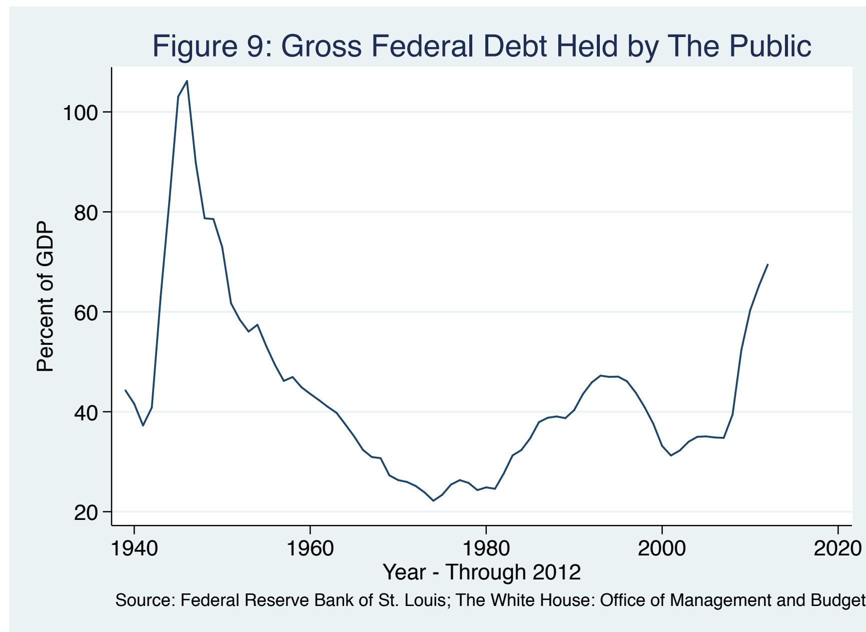
It is reasonably clear that this type of policy uncertainty can have a real impact on the economy. Although many other forces were at work, real GDP growth in the third quarter of 2011 was less than half of the preceding quarter and one-third that of the following quarter, suggesting that much economic activity was delayed. This happened again in the fourth quarter of 2012, followed by a much smaller rebound in early 2013. The smaller rebound was a result of significant budget cuts—the so-called sequestration—plus tax increases resulting from policy negotiations. Economic actors are likely to postpone investments until the future becomes clear.

We remain in a period of policy uncertainty as proper budget negotiations and discussion concerning disagreement about the debt ceiling have merely been postponed into early 2014. When that time comes, the discussion will again center on the debt ceiling—whether or not the Federal Government will continue to make good on debts it has already incurred. A repeat of government closure—an extremely poor reflection on our government's capacity to govern—would have economic implications. Turning the conversation back to defaulting on government debt would generate immensely important economic influences, with huge potential costs in terms of the debt itself. Interest rates on what the government must pay on its debt would likely rise substantially. This cost would reverberate throughout the economy with serious consequences.

Budget Deficits

Perhaps the fundamental driver behind policy uncertainty is the size of the US Federal Government's annual deficit. While this may be a scapegoat used to promote other policy objectives, the government's deficit is significant. As a percent of GDP, the annual budget deficit appears to have peaked in 2009 at 10.5%. In 2011, the situation was significantly improved at 9.3%. For 2012, the picture appears to be much improved, with a smaller deficit more likely than at any time during the previous five years.

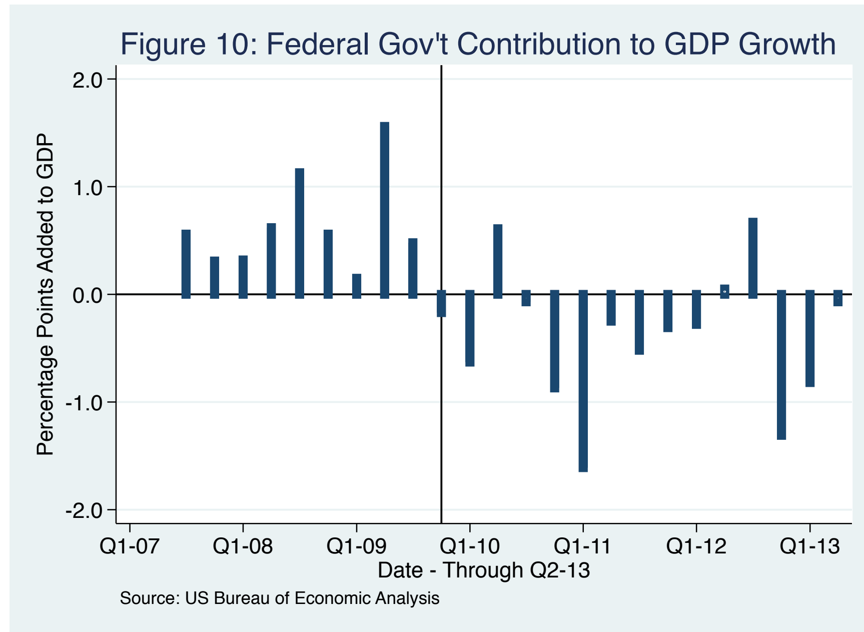
Contributing to the concern over the deficit is the overall level of indebtedness of the nation. At the end of 2012, the gross amount of federal debt held by the public was nearly $11.3 billion, or just over 72% of GDP. Much has been made about this percent of GDP and how we are reaching unsustainable levels with the possibility of a Greek-style financial crises in the United States.



Such fears are largely unfounded. First, the United States is the most attractive location for investment dollars, with US treasuries being among the most secure, despite recent downgrades. Second, Japan has had levels of indebtedness significantly in excess of those in the United States with apparently little in the way of ill effects. There are significant differences between the United States and Japan, but Japan remains an important counter argument to those who would suggest the US budget deficit is of paramount importance among policy issues.

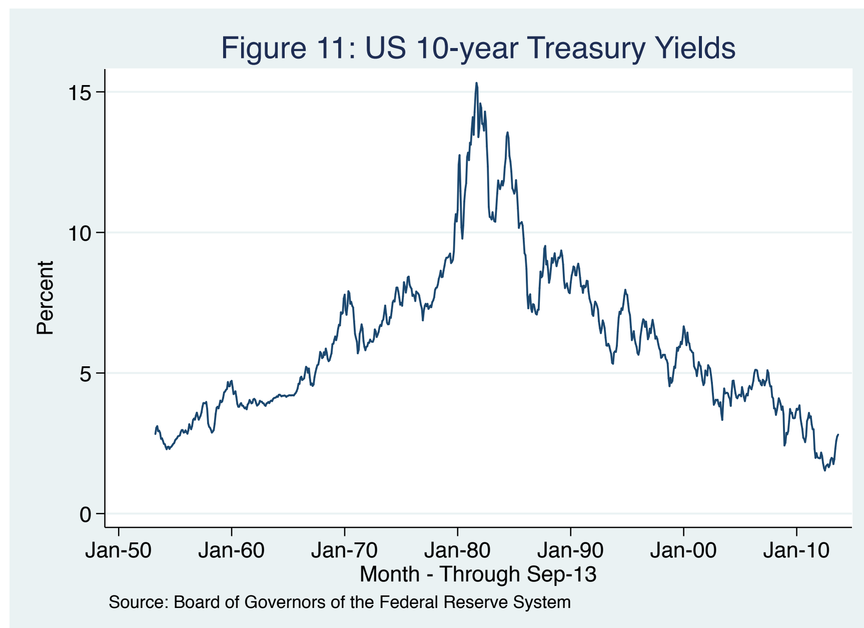
At the same time, it is frequently argued that cutting the budget—and hence the deficit—now is dangerous. These statements are made based on the notion that cutting budgets is tantamount to a policy of austerity. Those arguing that austerity is a path to prosperity in the middle of a recession or nascent recovery have been largely proven wrong by recent events in Europe and Japan. Austerity in both places has resulted in little other than severe economic hardship, at least in the short run.

Expenditures by the Federal Government have contained elements of austerity during the last several years. In fact, in only three of the 15 quarters since the recession officially ended have government expenditures contributed positively to growth in GDP (Figure 10). This is tantamount to a policy of austerity, though mild, and is a significant contributor to the slowness of the recovery. In four of the last 15 quarters, Federal Government expenditures have lowered overall GDP by more than three-quarters of a percentage point.



Interest Rates

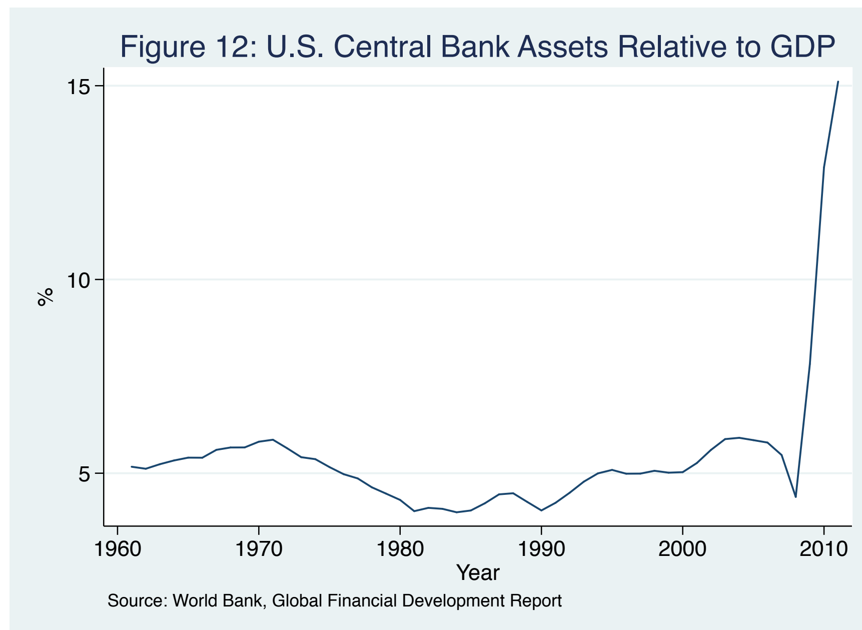
Interest rates in the United States have been at historical lows during the recovery. This is fueled in no small part by the Central Bank activities discussed below. In particular, the interest rates associated with 10-year US Treasury Bonds are lower than at any time in the last 60 years (Figure 11). These rates have stayed low despite a downgrading of the US Government credit rating, a higher than normal level of overall government indebtedness, and rising rates for many government bonds of other countries.



These interest rates have increased in recent months and it is likely that they will continue to increase through 2014. By how much depends largely on the skillfulness of our politicians in navigating the debt waters that are currently washing in. Significant increases are possible, but a more optimistic and, indeed, more likely scenario has interest rates exceeding 4% by 2015. Mortgage interest rates are also likely to creep up, but will remain historically low for some time to come. A significant overheating of the US economy would be required to change either of these forecasts. There is no hint of such a problem in the near term.

Central Bank Activities

Throughout the course of the recovery, the Federal Reserve has played a huge role in facilitating the growth of the US economy. Successive quantitative-easing programs launched by the Bank have been enormous, with some debate as to their effectiveness. Whether or not they have been effective, they have transferred a large volume of assets onto the Federal Reserve's books. As of the end of 2011, these assets amounted to just under 15% of the value of US GDP, a level significantly elevated from a historical norm of roughly 5% (Figure 12).

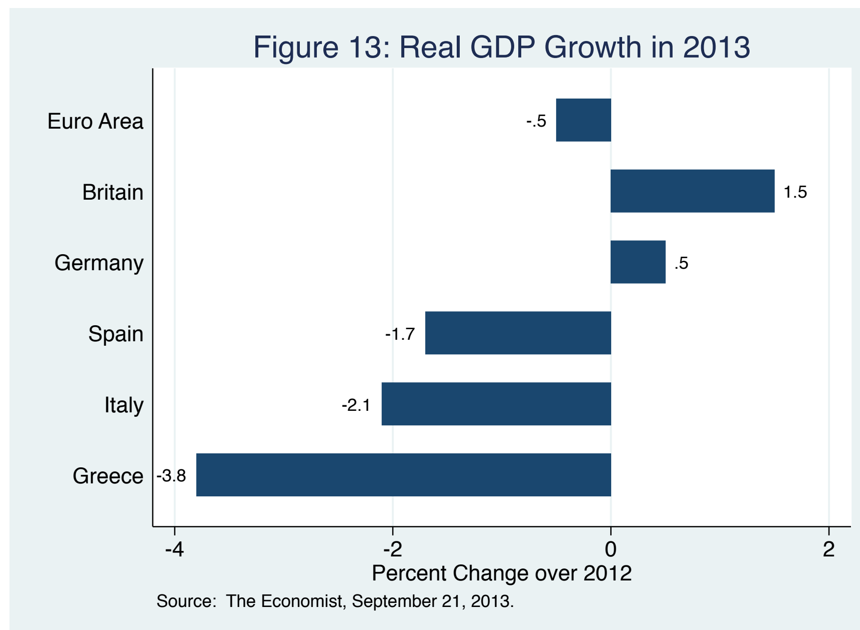


In the years to come, these assets will surely be taken off of the Bank's books, with the effect being tantamount to quantitative tightening. This process will require skillful handling by Janet Yellen, nominated by President Obama to take over the Bank's helm following the departure of Ben Bernanke, current Fed Chief and architect of the Bank's post-recession policies.

Regardless of the next Fed Chairman's identity, unraveling this massive increase in assets will be high on the list of priorities. Doing so in a way that does not significantly increase interest rates will be the key.

Foreign Economies

The United States relies to a significant degree on the health of its trading partners. These trading partners are primarily in Europe and Asia. For the last several years, much of Europe has been mired in recession, with austerity policies hampering recovery from the Great Recession (Figure 13).



China has also been experiencing reduced rates of growth during the last several years, with growth peaking in 2010 and declining into both 2011 and 2012. A soft landing has likely been engineered with many forecasters suggesting stronger Chinese growth in 2013 than in 2012.

Into 2014

The most likely scenario for the US economy is more of the same. This depends, of course, on policymakers making some of the right choices. If they make all of the right choices, growth could be better than we have experienced during the recovery. Given the current climate in Washington DC, additional government spending, or stimulus, seems unlikely. A default on US debt would not be among the right choices and could have dramatic consequences for the US economy in the form of significantly higher interest rates and greater policy uncertainty going forward.

A rebound in foreign economies could also trigger faster growth, but this is likely to be slow in coming. Though things are improving in Europe, the pace of improvement is very slow.

Slightly higher interest rates, modestly accelerating job growth, and gradual increases in GDP growth are likely in store for much of 2014. Consumers and housing markets will continue to drive growth, but they are not sufficient to bring out the true potential of the US economy.