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Òscar Jordà, research advisor at the Federal Reserve Bank of San Francisco, states his views on the current economy and the outlook.

- We expect the economy to grow at a moderate pace this year and next year as consumer demand and the dynamics of recovery gain momentum. Our current forecast is that GDP will grow 2.4% in 2013 and 3.2% in 2014, up from 1.6% in 2012.
- However, uncertainty about federal fiscal policy complicates the forecast. At the beginning of March, sequestration cuts in federal spending took effect. Sequestration will reduce overall spending authority for fiscal year 2013 by about \$85 billion. Since some government contracts spill over to fiscal 2014, the effective cuts for calendar year 2013 are closer to \$60 billion.
- Meanwhile, two additional fiscal deadlines are looming. First, current federal spending authorization expires at the end of March. Congress and the White House must reach an agreement on a continuing resolution to prevent a government shutdown. Second, the statutory debt ceiling goes into effect in mid-May. In practical terms, the debt ceiling would not be expected to block federal outlays until later in the summer.
- We assume that Congress and the Obama administration will reach an agreement addressing the debt ceiling and preventing a government shutdown. Such an agreement may also reverse some of the sequestration cuts. Altogether, we have trimmed our forecast for 2013 GDP growth by nearly 0.4 percentage point because of these budgetary issues, largely reflecting our estimates of the effects of the sequestration cuts. We don't expect sequestration to have a material effect on GDP growth in 2014.
- The nation's economy added 246,000 private-sector jobs outside the farm sector in February, a solid rate of job creation. On the other hand, 10,000 jobs were lost in federal, state, and local government. Government employment has been declining steadily and is now about 2% lower than when the 2007-09 recession began. This drop contrasts with previous recoveries, when the government sector contributed to job growth. Sequestration cuts are expected to further reduce government jobs and slow private-sector hiring, reducing the projected decline in the unemployment rate this year.
- Even if some of the sequestration cuts are reversed, the expected lower rate of 2013 GDP growth will mean that the unemployment rate is likely to be about 0.2 percentage point higher than it otherwise would be. Fed policymakers have stated they don't expect to begin raising the policy interest rate at least until the unemployment rate has fallen to 6.5% and certain other conditions are met. We expect that the unemployment rate will be 7.6% at the end of 2013 and will not cross the FOMC's 6.5% threshold until mid-2015.

- Labor force participation has remained lower than expected. In addition, the proportion of part-time employees who would prefer a full-time job continues to be elevated. Long-term unemployed workers, that is, those without a job for 27 weeks or more, represent about 40% of the unemployed. Their share has been stuck at that level since 2010.
- As job market conditions improve, we would expect participation to rise, and involuntary part-time employment and long-term unemployment to fall. Specifically, a more favorable labor market is likely to push up labor force participation as more workers actively seek jobs. The larger pool of jobseekers associated with this higher participation rate could slow the drop in the unemployment rate at a given pace of job creation.
- Inflation remains in check. Lower commodity prices, slow wage growth reflecting considerable slack in the labor market, and an appreciation of the dollar against currencies of primary trading partners have kept inflation quite subdued. We expect that 2013 core personal consumption expenditures price index inflation will come in at 1.5% and roughly the same level in 2014, below the Fed's 2% target. Favorable medium-term trends in oil prices should push down headline inflation even a bit lower.
- Since consumption is a very large component of GDP, small changes in consumer spending can have a big effect on measured GDP growth. So far through February, disagreements about fiscal policy, including last year's fiscal cliff showdown and this year's sequestration cuts, do not appear to have dented consumer sentiment much. The Dow Jones industrial average recently reached values last seen in 2007, before the Great Recession began. House prices have also moved higher over the past year. As a result, household net worth expressed as a multiple of disposable income is now at levels last seen in the late 1990s. This increase has helped households in the ongoing process of repairing their finances and should provide significant support for consumer demand.

