Economic Outlook

Lessons from the Past and Worries for the Future

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Scary Headlines

- Eurozone debt problems threaten stability.
- China and U.S. trade frictions multiply.
- Japan growth negative.
- Currency war draws blood.
- U.S. unemployment claims too high for job growth.
- Probability of double-dip recession rises.
- No shortage of jobs for economists.
Outline

- Where are we now?
  - Current statistics are not bad, but not good, either.
- What about the future?
  - Current forecasts
  - Some lessons from forecast history
- Why should we be concerned?
- Why should we be encouraged?
The Current Economy

Good News and Less than Good News
Real GDP is Growing . . .

Chained 2005 Dollars

Annualized percent change

Source: US Department of Commerce, Bureau of Economic Analysis
But Not By Enough

Employment, millions

Investment Shows Improvement

*Business Fixed Investment*

Trillions of Chained 2005 Dollars

Source: US Department of Commerce, Bureau of Economic Analysis
But Remains Low

Business Fixed Investment

Percent of GDP

Source: US Department of Commerce, Bureau of Economic Analysis
Trade Continues to Shine

Trillion 2005 Chained Dollars

Source: US Department of Commerce, Bureau of Economic Analysis
Consumption Has Come Back

Source: US Department of Commerce, Bureau of Economic Analysis
But Housing Continues Its Collapse

Housing Starts, Million

Source: US Department of Commerce, Bureau of Economic Analysis
While Manufacturing Rebounds

Manufacturing Production, 2007=100

Source: Federal Reserve Board of Governors
Labor Productivity Continues to Rise

Output per hour, 2005=100

Unit Labor Costs Decline

Inflation is Under Control

Consumer prices, percent change from previous year

Short-term Forecasts

Less than Robust
## Average of Economists’ Forecasts

Or are economists just below average?

<table>
<thead>
<tr>
<th></th>
<th>GDP</th>
<th>CPI</th>
<th>Unemployment rate</th>
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<tbody>
<tr>
<td>Forecast issued:</td>
<td>2.4</td>
<td>2.5</td>
<td>2.8</td>
</tr>
<tr>
<td>Sept 2010</td>
<td>3.0</td>
<td>3.0</td>
<td>3.2</td>
</tr>
<tr>
<td>June 2010</td>
<td>3.0</td>
<td>3.0</td>
<td>3.2</td>
</tr>
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*Wall Street Journal Economic Survey, September 2010*
Longer-term forecasts

United States – Slightly Dimmed
World – Improved
China and Asia – Better
Brazil – Much Stronger
United States

**GDP growth and forecasts**

Annual rate of change

Source: International Monetary Fund
World

GDP growth and forecasts

Annual rate of change

Source: International Monetary Fund
EU-27

GDP growth and forecasts

Annual rate of change

Source: International Monetary Fund
Japan

GDP growth and forecasts

Annual rate of change

Source: International Monetary Fund
China

GDP growth and forecasts

Annual rate of change

Source: International Monetary Fund
Newly Industrialized Asia

GDP growth and forecasts

Annual rate of change

Source: International Monetary Fund
Brazil

GDP growth and forecasts

Annual rate of change

Source: International Monetary Fund
Some Worries

Trade Protection
Inflation
Debt
Financial and Commodity Market Volatility
Trade protection

- Beneficial in the short run.
  - Output shifts from foreign to domestic firms.
- Deadly in the long run.
  - Imports pay for exports.
  - Real income declines.
- The problem: stopping the train once it starts.
U.S. 1920 – 1940 tariffs

Average percent of dutiable imports

Source: Historical Statistics of the United States
U.S. 1920 – 1940 unemployment

Source: Historical Statistics of the United States
U.S. 1920 – 1940 exports and imports

Billion dollars

Source: Historical Statistics of the United States
U.S. 1920 – 1940 real GDP growth

Annual rate of change

Source: Historical Statistics of the United States
Trade Under Threat – Yuan

- Tough talk:
  - In a poll of Wall Street Journal readers, 69.5 percent said they would be willing to risk a trade war to force China to revalue.
  - The U.S. House of Representatives voted 348-79 for a bill that would allow the U.S. to take into account currency undervaluation to calculate duties.
  - The Chinese ambassador to the United States said that if it becomes law, there will be a U.S.-China trade war.
  - German Economy Minister Rainer Brueederle encouraged China to more fairly align its currency with those of its trading partners, warning that a trade war could result.
Other US trade problems

- China
  - Specialty steel, credit cards, coated paper, poultry, tires, rare earth export monopoly, intellectual property

- Elsewhere
  - Australia biofuels, Canada lumber, Russia poultry

- Currency wars and exchange rate volatility.

- No longer a majority support for free trade
Inflation

☐ Beneficial in the short run.
  ■ Wages tend to rise more slowly than prices, so employment increases.

☐ Deadly in the long run.
  ■ Wages rise more rapidly than prices, and employment slows or declines.

☐ The problem: stopping the train once it starts.
Inflation and Unemployment

Annual rate of change in consumer prices

Unemployment rate

Government Debt

- Beneficial in the short run.
  - Raises aggregate demand, helps raise employment.
- Eventually crowds out investment and consumption.
  - Savings finance debt.
  - Higher taxes lower consumption.
- The problem: stopping the train once it starts.
Government Deficit and Investment

Source: US Department of Commerce, Bureau of Economic Analysis
Government Debt and Consumption

Source: Historical Statistics of the United States
Financial Market Volatility

- Most obviously reflects uncertainty
  - Rates of return
  - Policy

- Repercussions on short- and long-term issues
  - Commodity prices
  - Investment decisions
  - Pensions – public and private
Financial Market Volatility

Exchange rates and equities

Coefficient of variation (dollar) vs. Coefficient of variation (S&P 500)

Source: Thomson Reuters Datastream, 30-day coefficient of variation, weekly average
Some Final Words

Reasons to be Encouraged
But Let’s Not Get Carried Away
Reasons to be encouraged

- Asia
  - Strong growth, led by China.
- Brazil and Latin America.
- Labor productivity
  - Continues to rise despite economic slowdown.
- Trade is still open and still strong.
- Inflation is under control, and plenty of tools can keep it that way.
- Government debt should begin to slow its increase.
We are not falling off a cliff, but there is no reason to be Pollyanna, either.

- Growth is solid in much of the world, but the persistently sluggish U.S. recovery is a concern.
- Unemployment will remain high.
- Potential problems of debt, inflation, and trade protection are manageable, but that does not mean we will return to the 1990’s.
- Financial markets will become more stable, once policies are more predictable.