

# THE U.S. ECONOMY IN 2020

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The Economic Miracle that Wasn't

Long-Term Prospects for the U.S. Economy: The  
Secular Stagnation Hypothesis

Evidence of Secular Stagnation

Short-Term Prospects for the U.S. Economy

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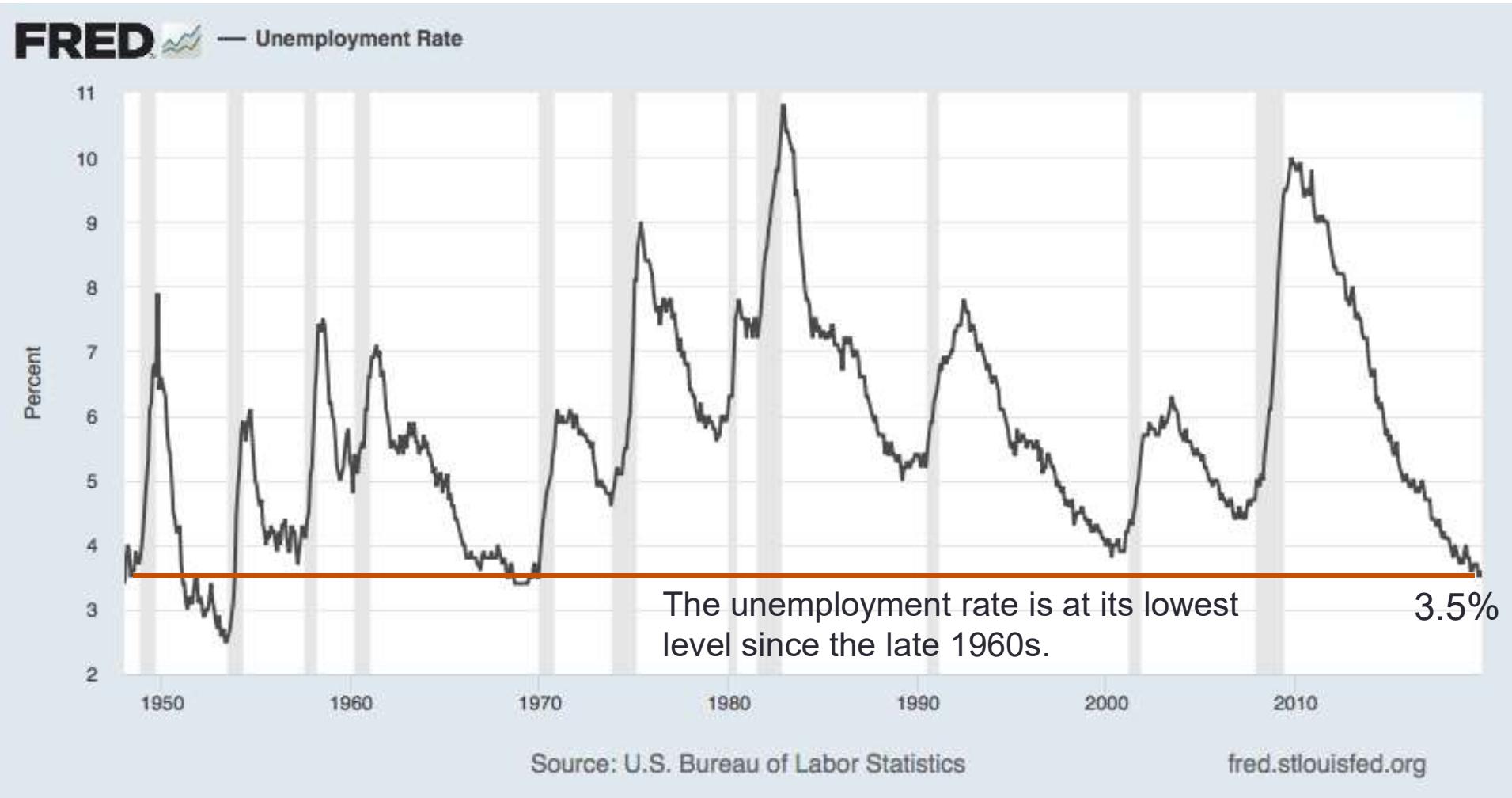
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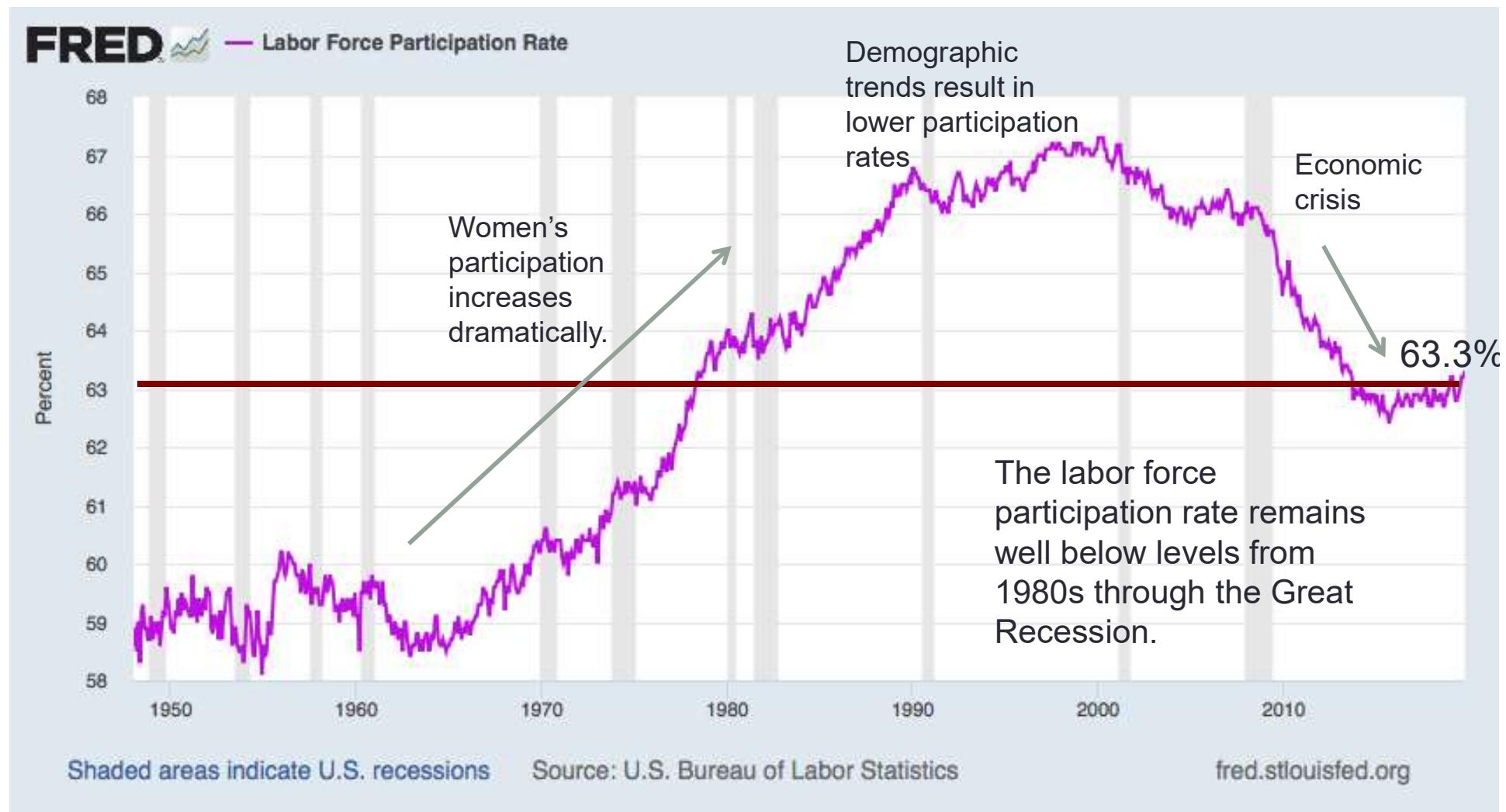
# The U.S. Unemployment Rate

1949 - 2019



# The U.S. Labor Force Participation Rate

1948 - 2019

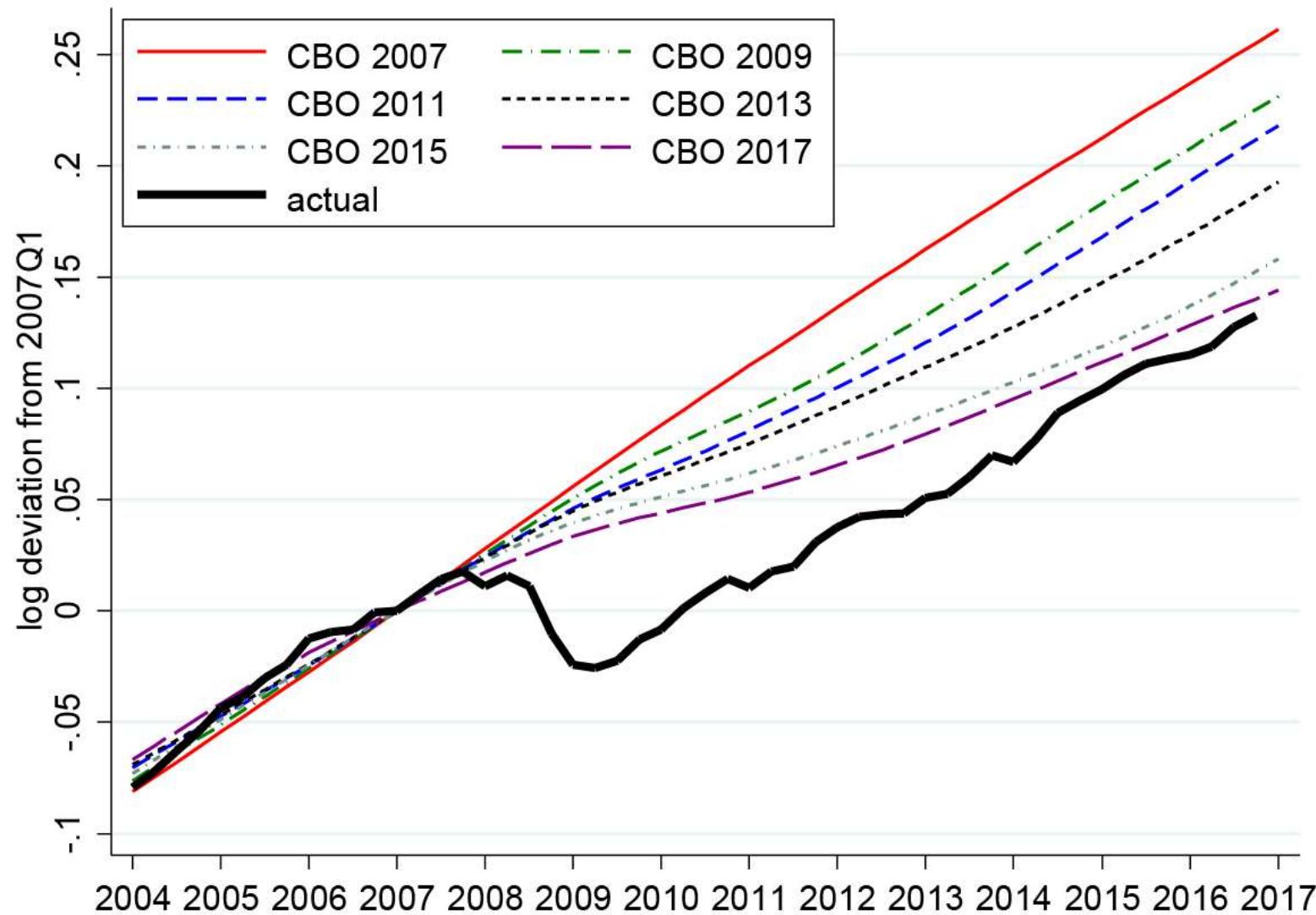


# Unemployment is Low Because Participation is Low

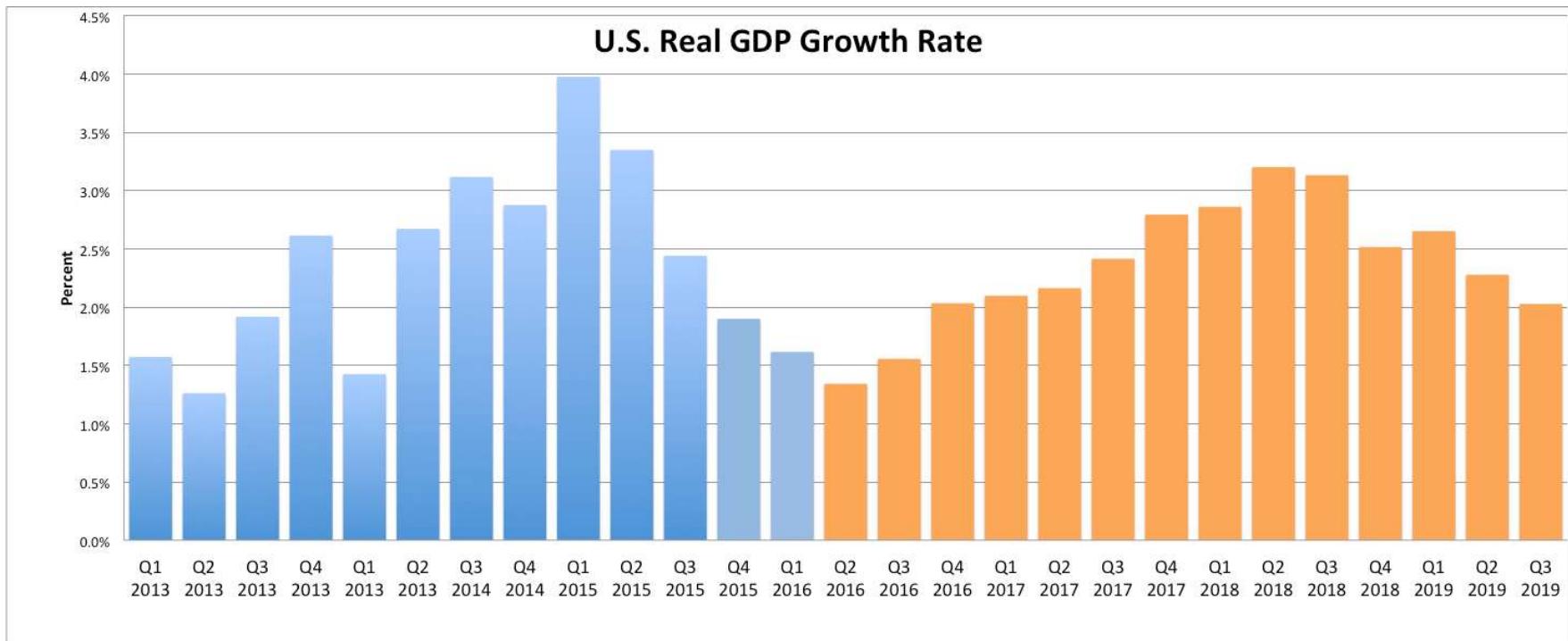
## *BLS Reported*   *What If?*

|                    |         |             |
|--------------------|---------|-------------|
| Adult Population   | 260,181 | 260,181     |
| Participation Rate | 63.2    | 67.3        |
| Labor Force        | 164,556 | 175,102     |
| Employed           | 158,803 | 158,803     |
| Unemployed         | 5,753   | 16,299      |
| Unemployment Rate  | 3.5%    | <b>9.3%</b> |

# Post-Crisis Revisions to Potential GDP Forecast



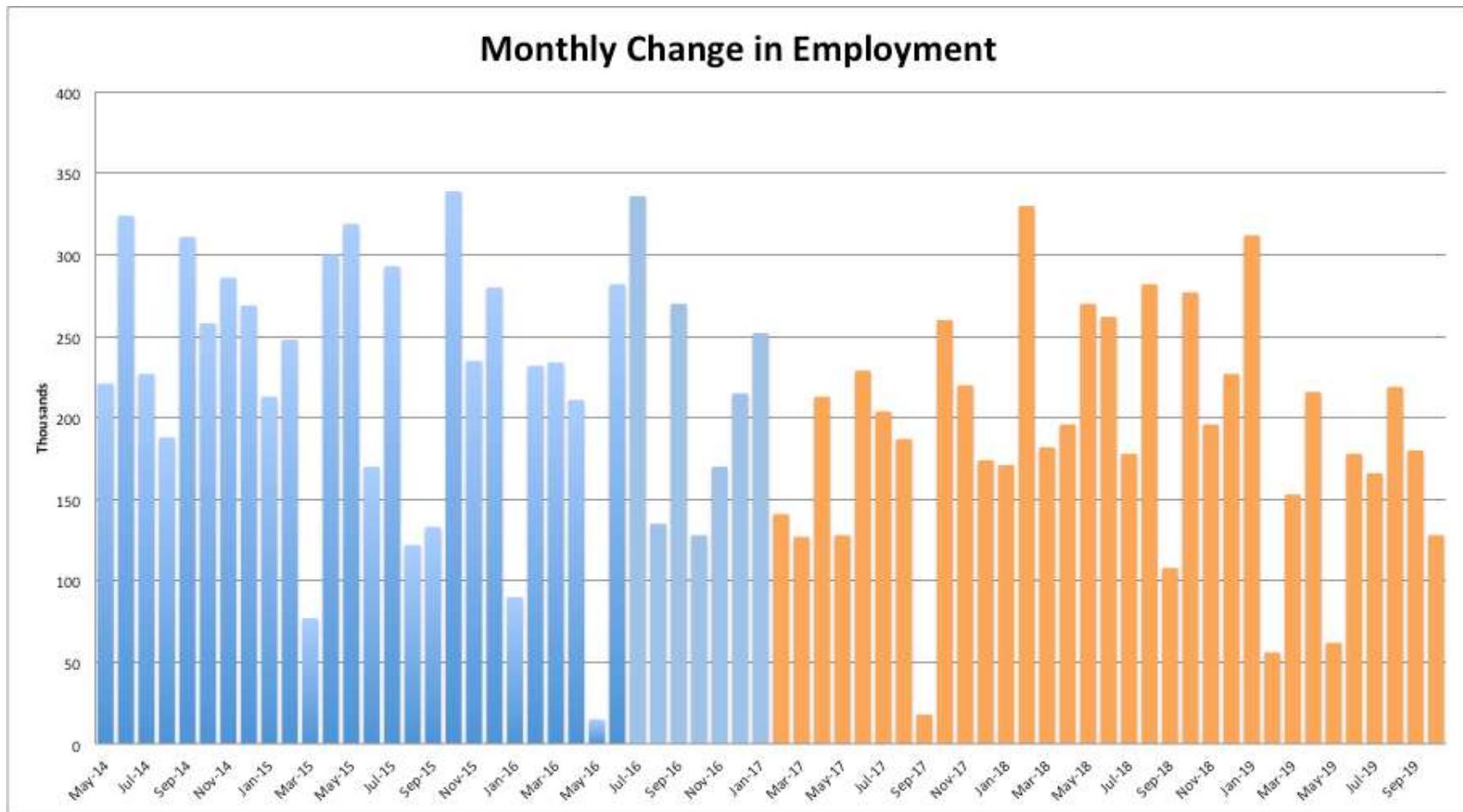
# U.S. Real GDP Growth Rate



Last 12 quarters of Obama  
Administration. Average growth  
rate = 2.6%

First 12 quarters of Trump  
“Economic Miracle”. Average  
growth rate = 2.9%

# U.S. Job Growth



Last 26 months of Obama Administration. Average monthly job growth = 224,000

First 26 months of Trump “Economic Miracle”. Average monthly job growth = 189,000

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# Secular Stagnation

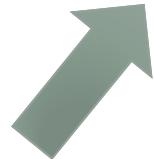
- The Secular Stagnation Hypothesis emphasizes the decline in the return to capital due to the slowdown in productivity.
  - *It's not just bond yields that have fallen. Returns to capital investment have also declined substantially.*
- Declining returns to capital investment are due to insufficient aggregate demand. Not enough people are buying the fruits of capital investment.
  - Insufficient AD was also part of GSG story.
  - But in SS theory, this also results in a productivity slowdown, as firms limit investment in newer capital equipment, embodying newer technologies.
- *An economy suffering from secular stagnation malaise, without outright stimulus policies, expansions are propagated using unsustainable policies or events that stimulate aggregate demand.*
  - *Real GDP may be growing at normal rates, but only due to “bubbles” in asset or other markets that “artificially” boost economic growth.*

# Secular Stagnation

- Demographic transitions
- Increasing inequality
- Surplus countries



- Declining global demand



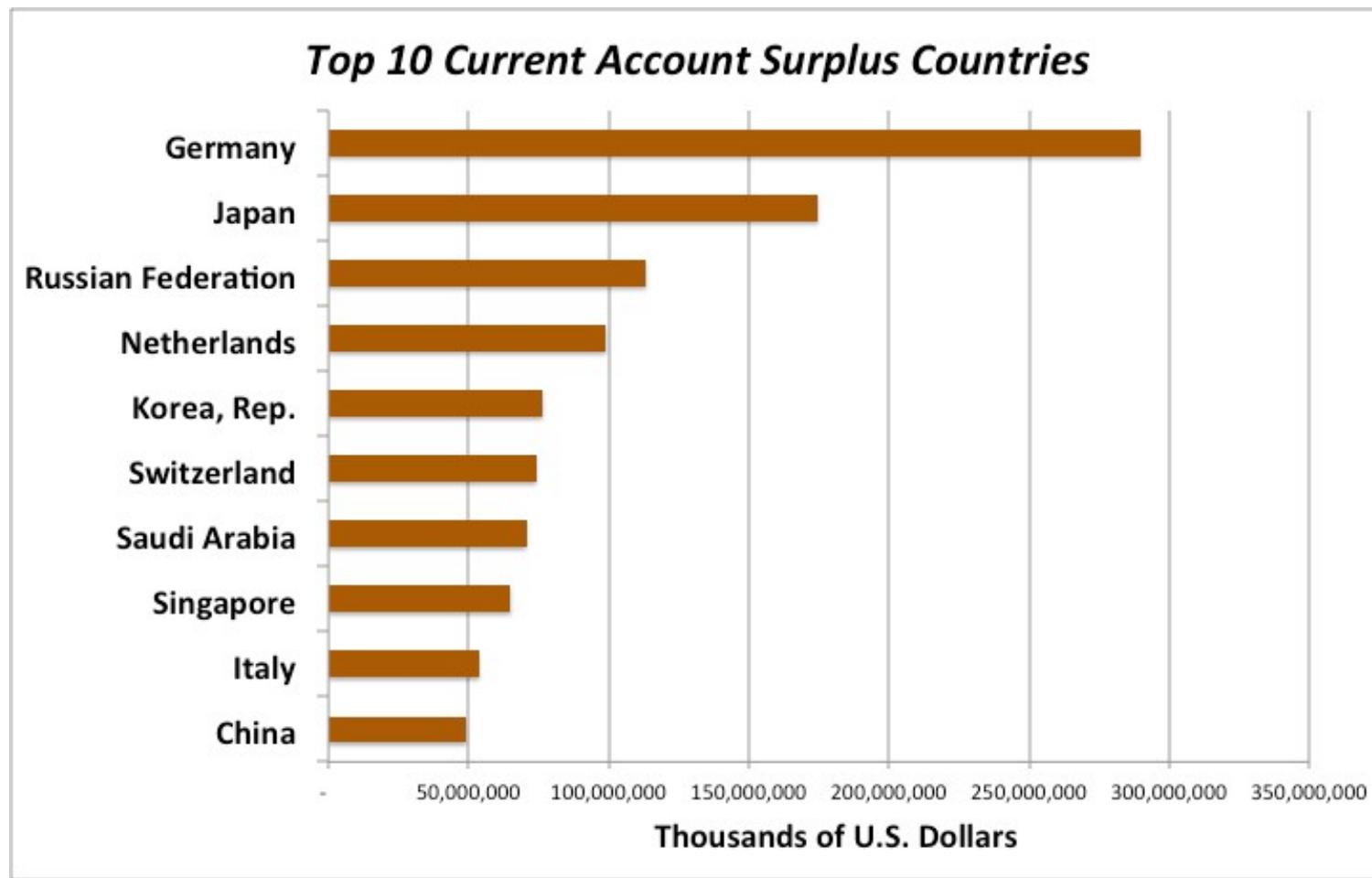
- Reduced capital investment



- Low productivity
- Low return on capital investment



# Current Account Surpluses



Source: IMF

- *The current account for a country is essentially the same thing as the trade balance with the rest of the world.*

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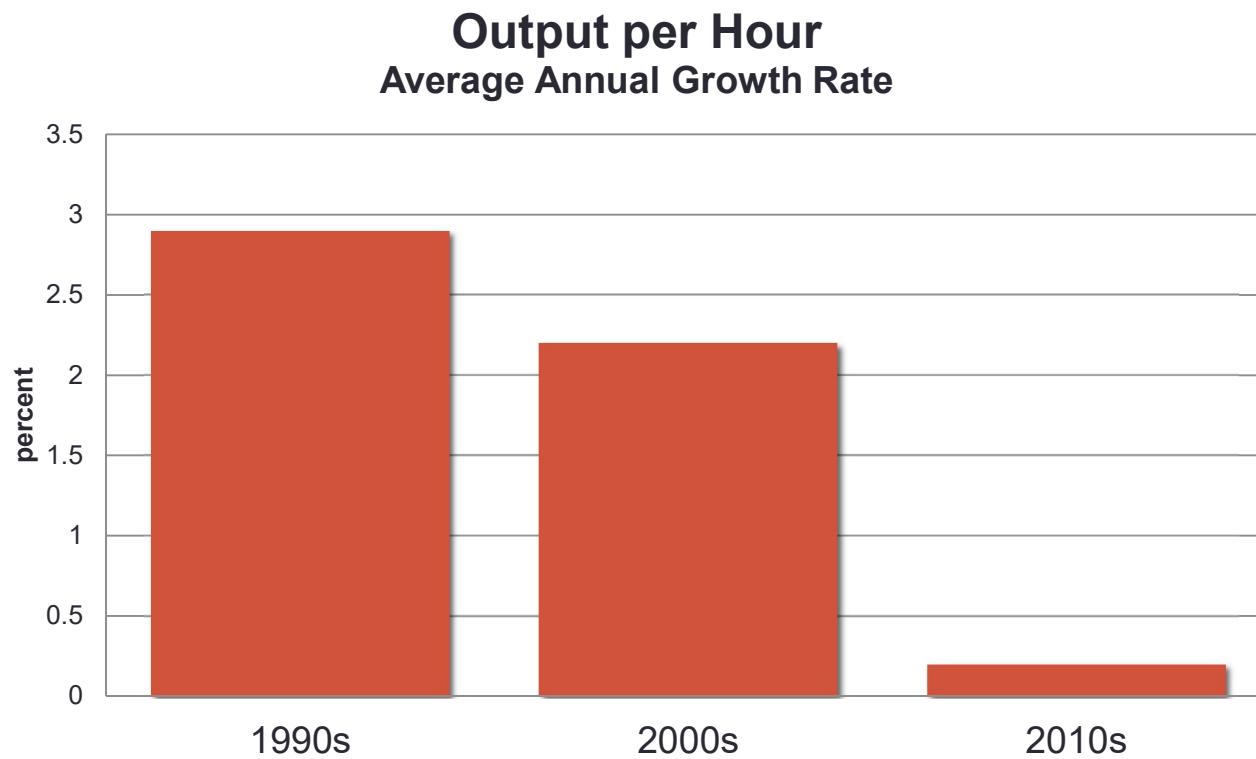
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# Implications of Secular Stagnation

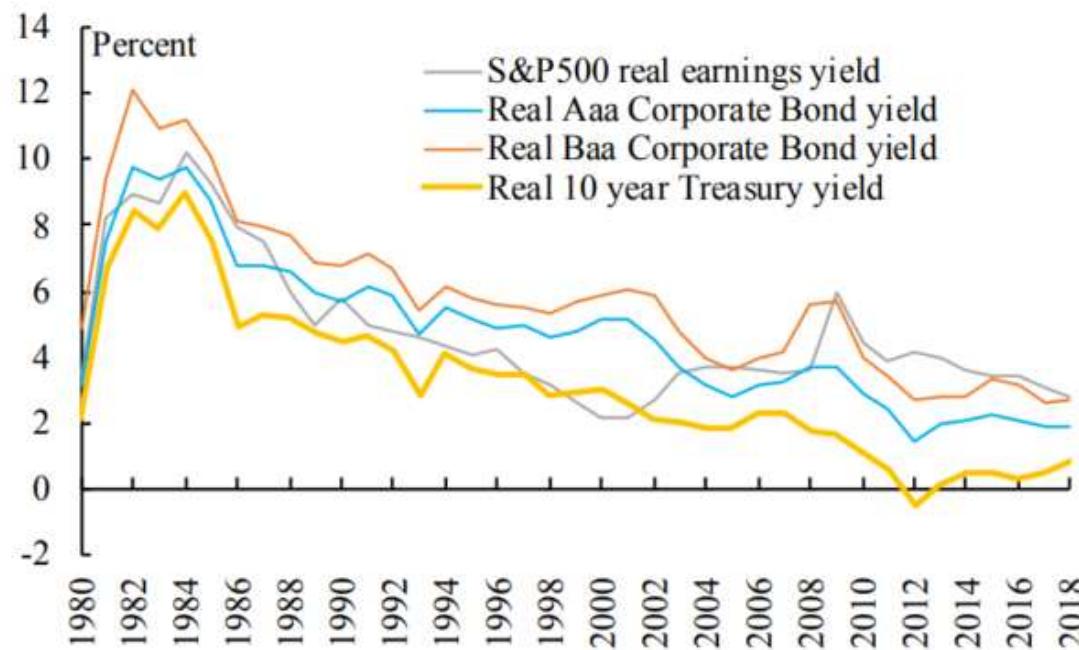
1. Low productivity and low return on capital investment
2. Slow economic growth (growth rate of real GDP)
3. Low inflation/low expected inflation
4. Continued low interest rates

# The Productivity Slowdown



- Economic growth depends on two factors:
  1. Growth in the labor force
  2. Increasing labor productivity
- Labor force participation has stagnated, meaning labor productivity must make up the difference.
  - This is not good news!

# Secular Stagnation

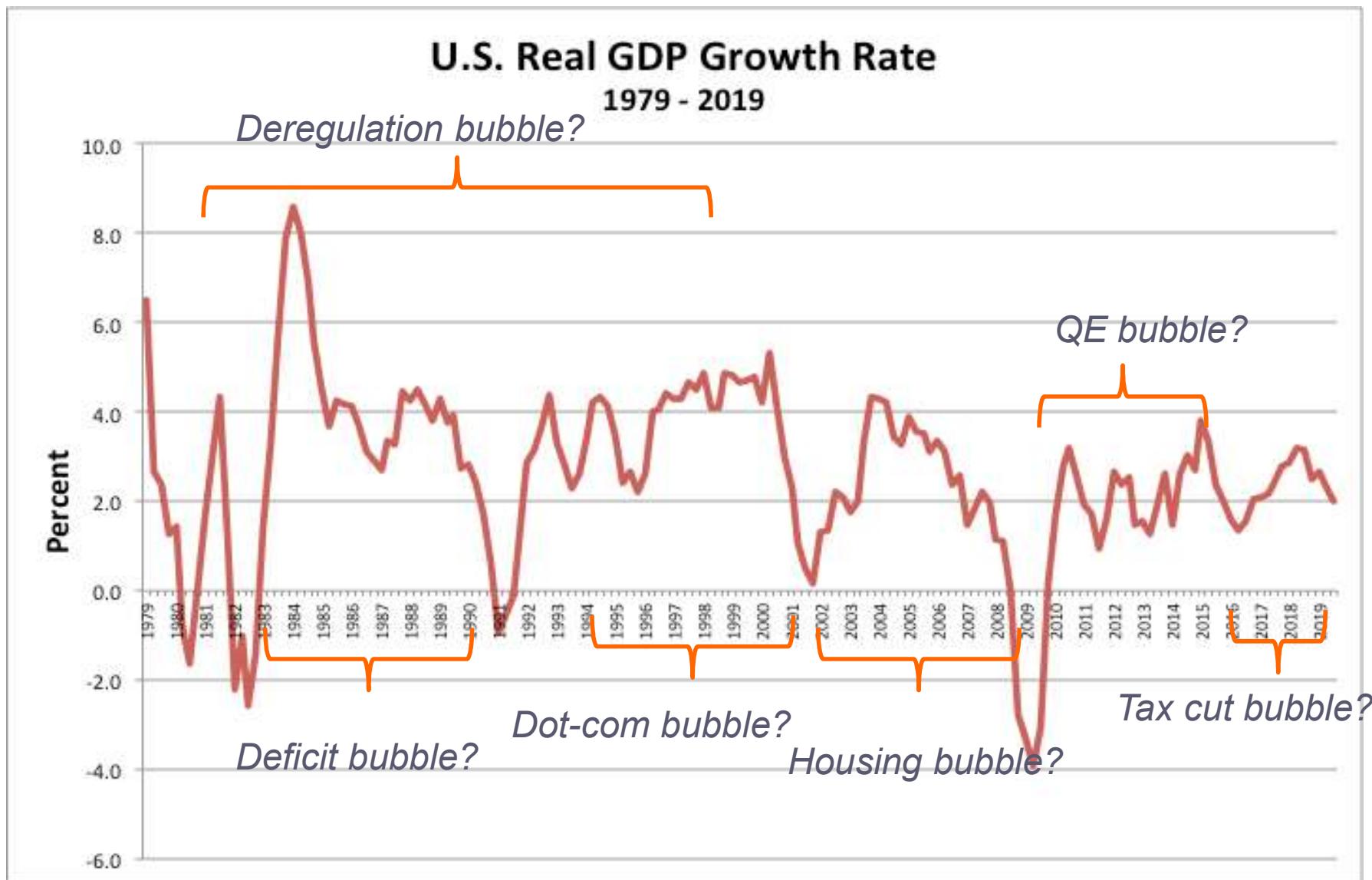


Larry Summers' description of the "core secular stagnation argument": "Normal' policy settings of real interest rates in the 2 percent range, balanced primary budgets and stable financial markets are a prescription for stagnation and underemployment. Such economic success as the industrial world has enjoyed in recent decades has reflected a combination of very low real rates, big budget deficits, private leveraging up and asset bubbles."

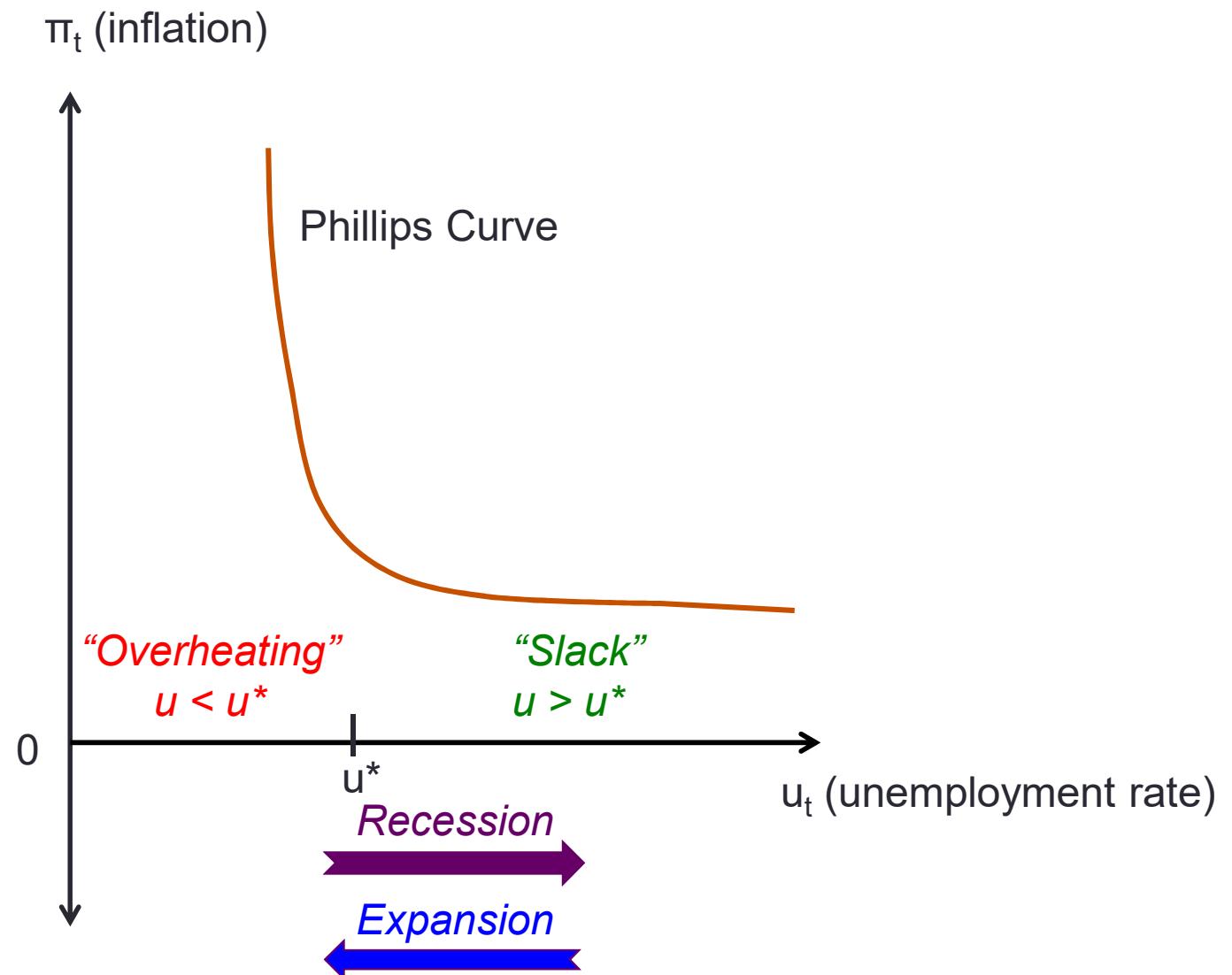
No one from whom I have heard doubts the key conclusion that a combination of meaningfully positive real interest rates and balanced budgets would likely be a prescription for sustained recession if not depression in the industrial world."

Source: Larry Summers' blog (March 20, 2019)

# Secular Stagnation?



# The Modern Phillips Curve



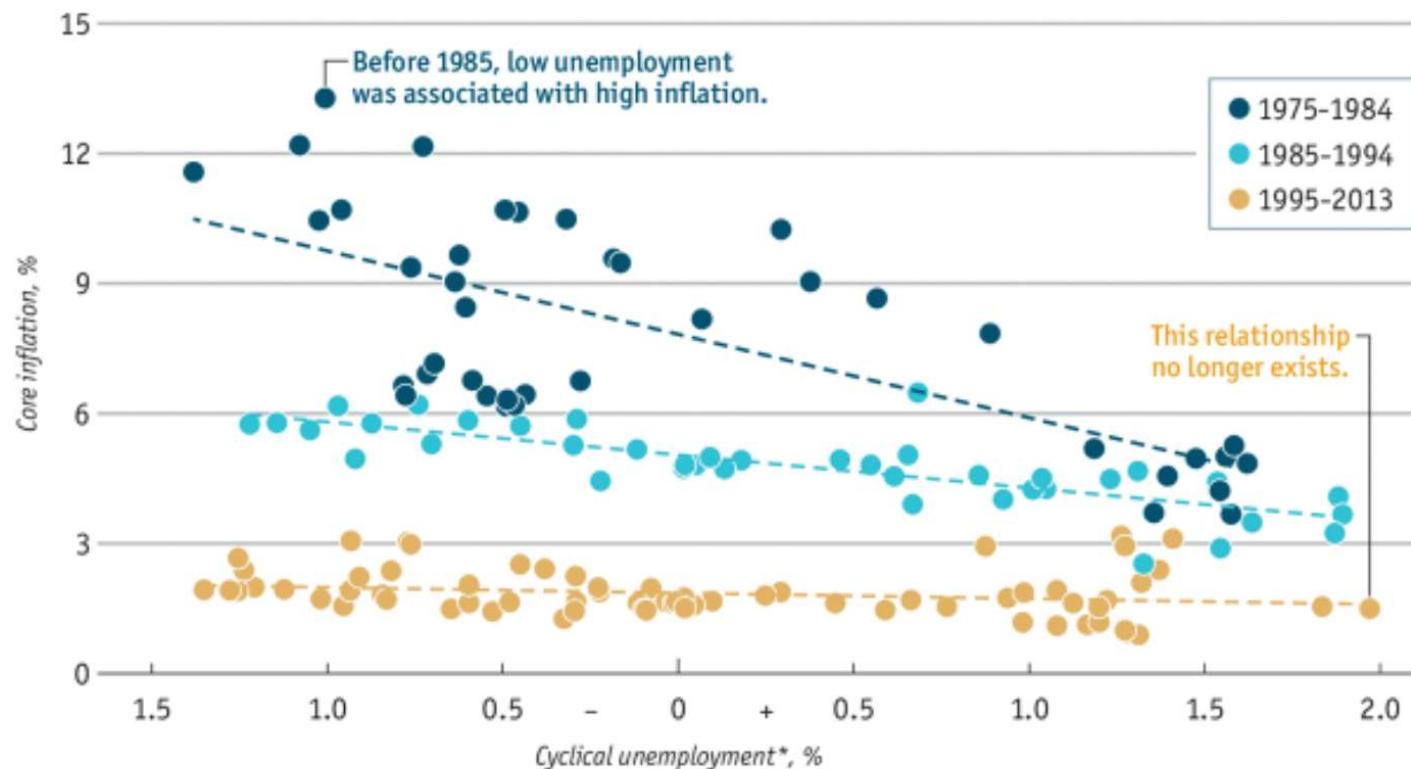
# The “Missing Inflation Puzzle”

The Phillips curve may be broken for good

*Central bankers insist that the underlying theory remains valid*

## Flatlining

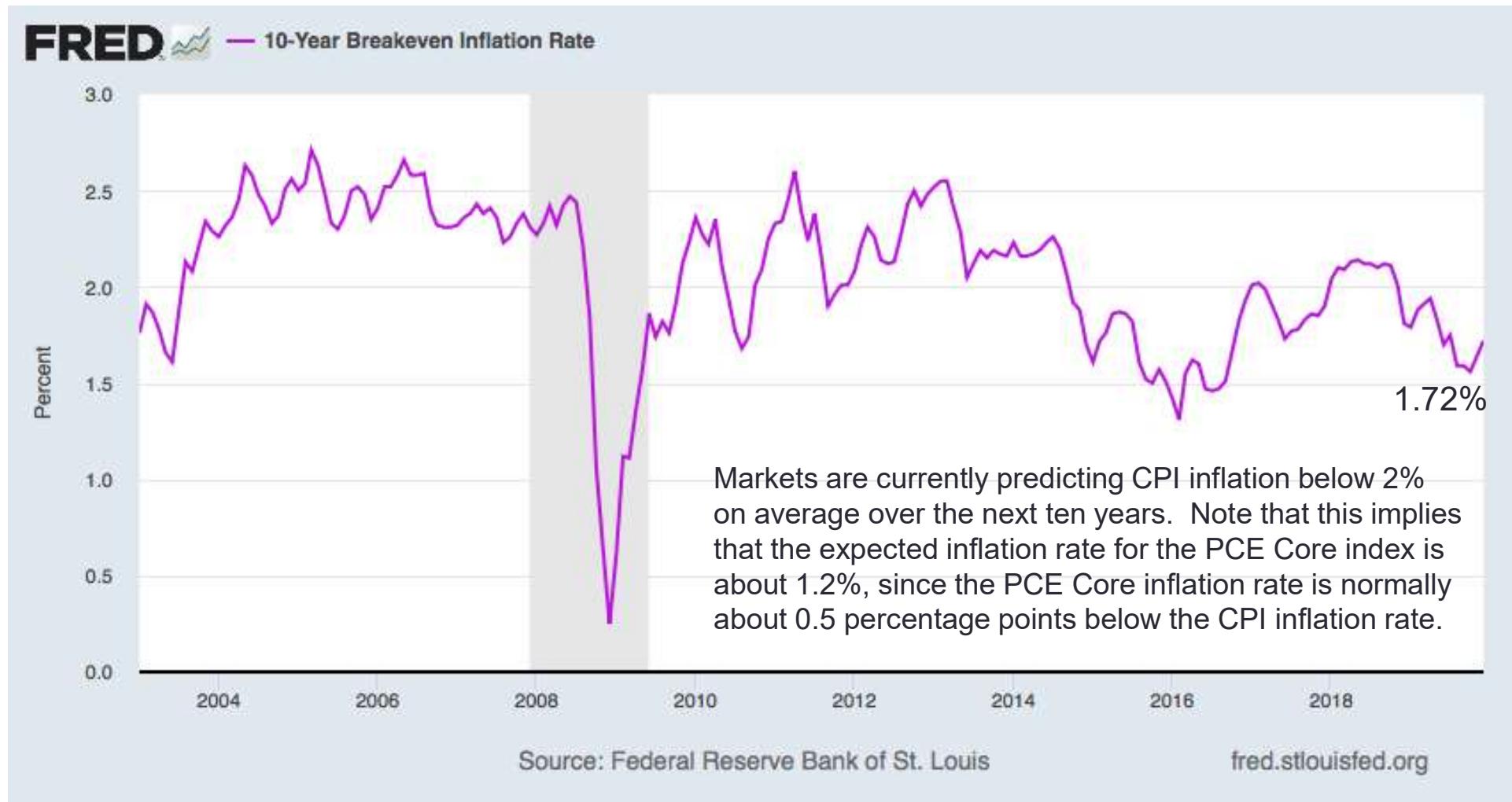
Inflation and cyclical unemployment, average across advanced economies, quarterly



Sources: OECD; IMF

# Expected Inflation

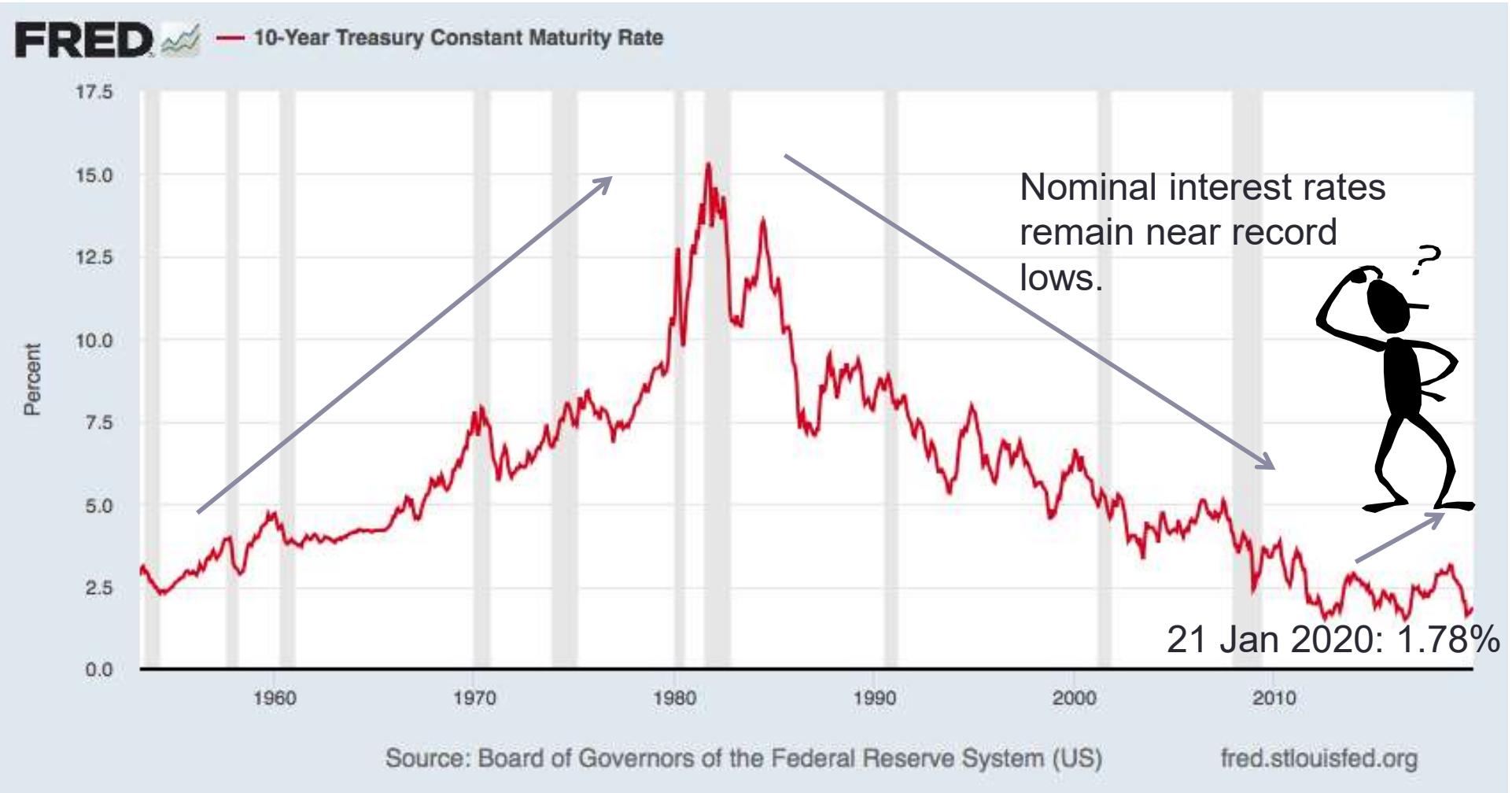
## 10-Year Breakeven Inflation 2003 - 2019



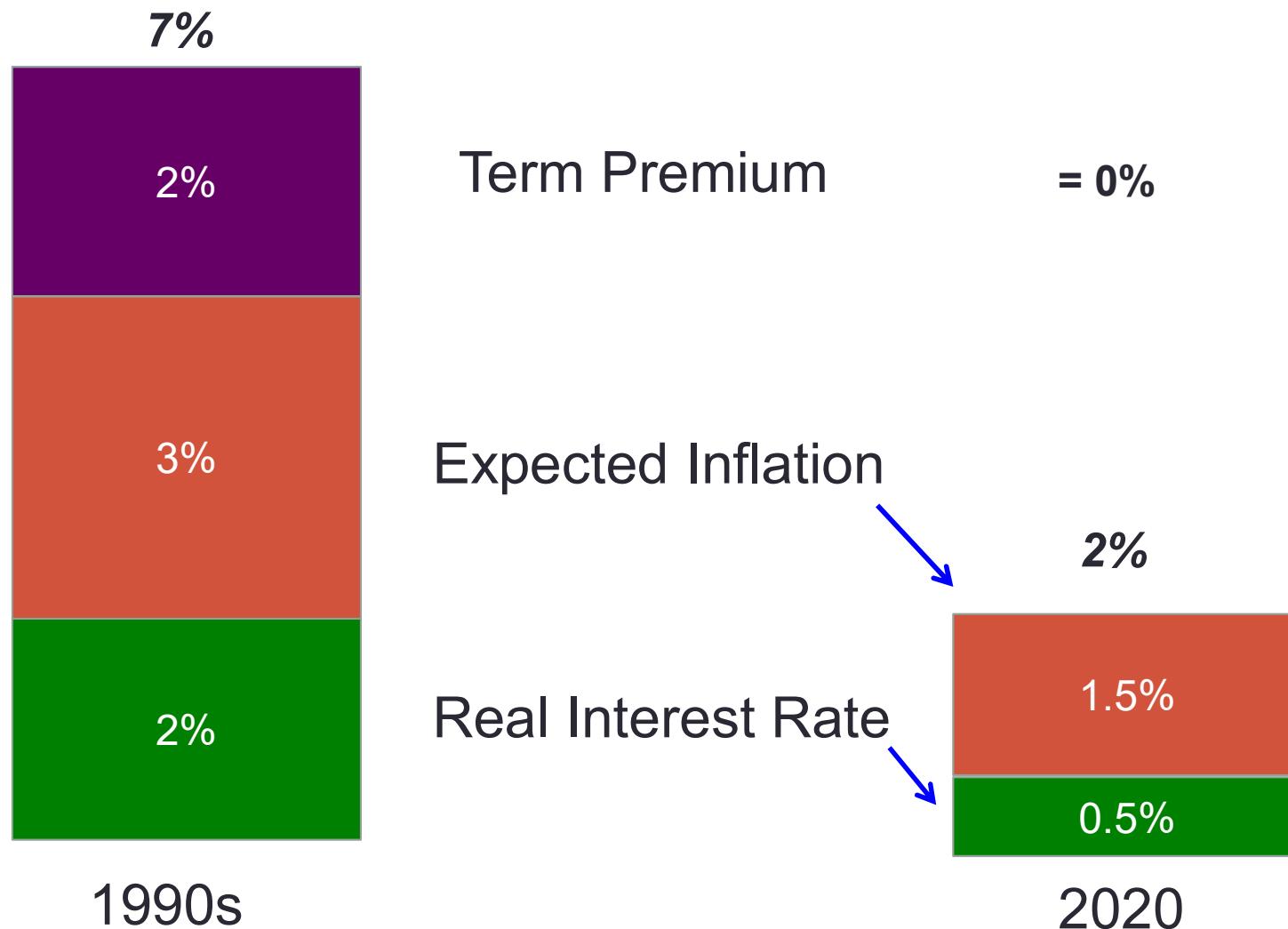
The 10-Year Breakeven Inflation Rate is the difference in yield between the 10-Year Treasury yield and the 10-Year TIPS yield. It gives the market's expectation of the average annual inflation rate over the next ten years.

# 10-Year Treasury Nominal Yield

10-Year Treasury Yield  
1953 - 2019

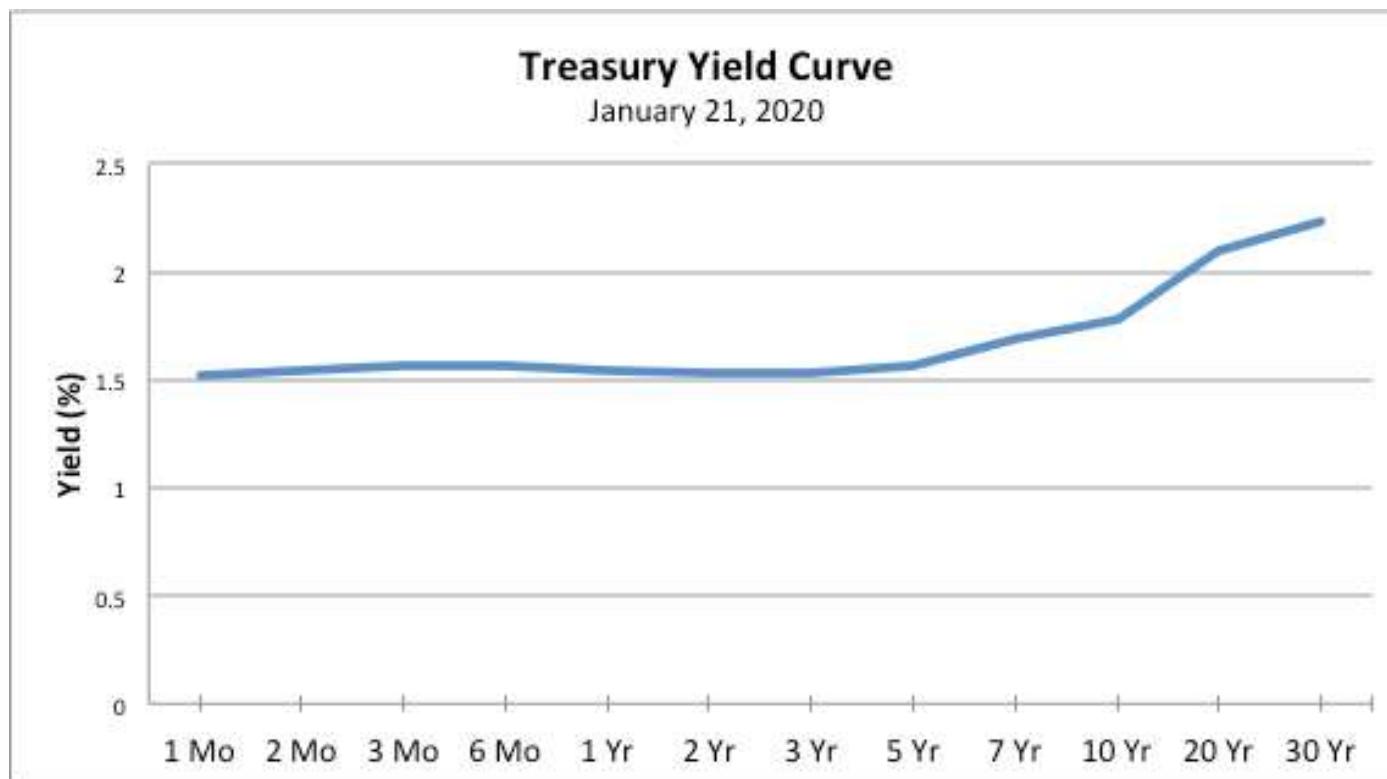


# Determinants of the 10-year Yield



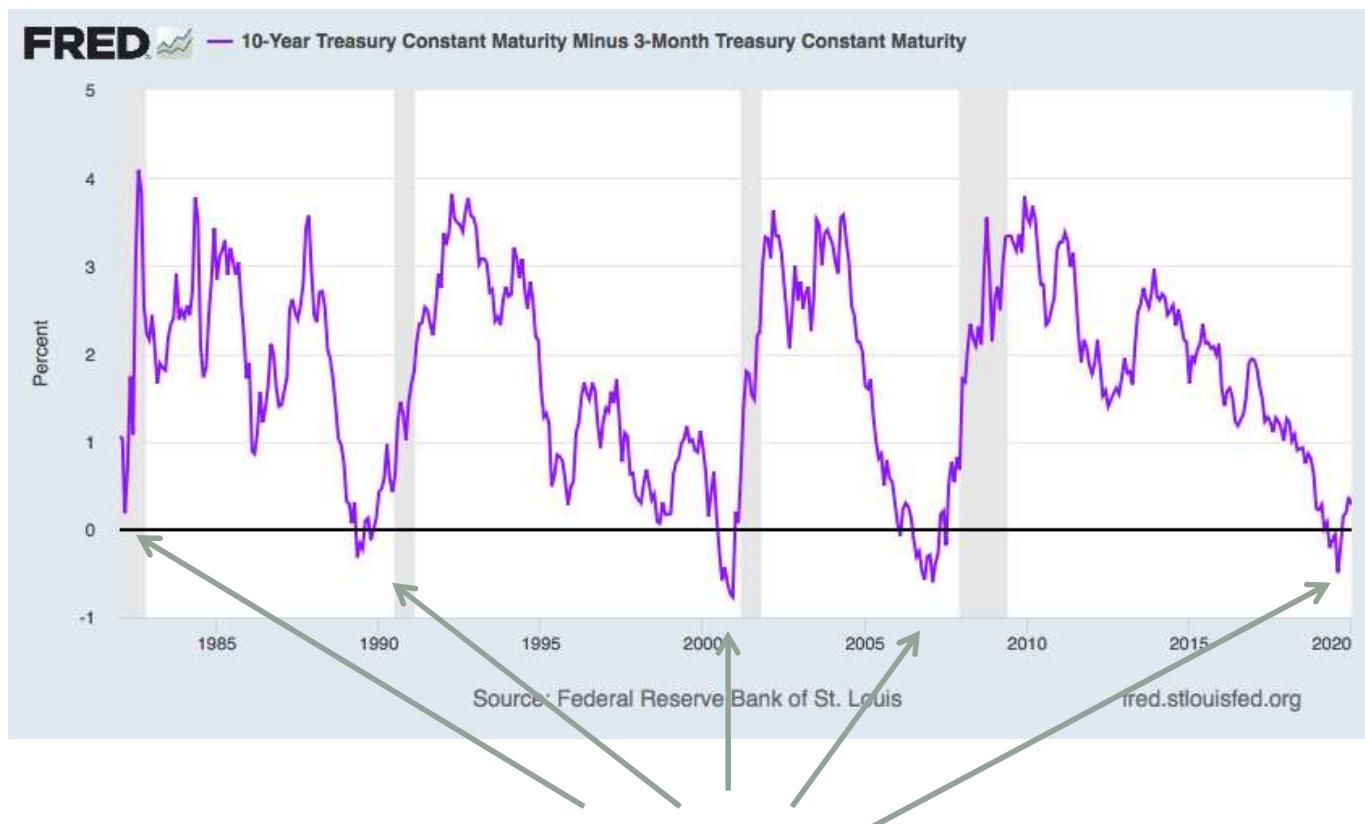
# The Yield Curve

- The Term Structure of Interest Rates
  - Whatever type of debt, longer maturities typically (but not always) pay a higher yield than shorter maturities.
  - That is, the ***Yield Curve*** is normally upward sloping.



# The Yield Curve Slope

10-Year Treasury Yield Minus 3-Month Treasury Yield  
1982 - 2019



- Inverted Yield Curve
  - This is the difference between the 10 year and the 3-month Treasury yield.
  - It summarizes the slope of the yield curve in a convenient way.
  - Historically, yield curve “inversions” have predicted subsequent recessions.

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# Short-Term Prospects

- One word characterizes our current global situation:  
***uncertainty.***
- Except for labor markets, a look-back at history would determine that our current era is one of least productive and prosperous.
  - The evidence indicates that this is true! Things are generally bad right now from a financial perspective.
- But ... we look good compared to most other parts of the world
  - Our demographic issues are not as serious as other countries
  - Our asset markets continue to attract capital from investors all of the world, who are effectively registering their confidence in the U.S. economy as they “search for yield.”
  - The U.S. is a horrible place to invest right now ... ***except for all the others!***

# Takeaways

- The U.S. economy is not performing up to its historical standards, despite some good news from labor markets.
  - Neither is anyone else.
- According to the Secular Stagnation Hypothesis, policy-makers need to provide substantial stimulus to economies globally in order to get back on the previous trajectory.
- Absolute financial returns will not be as high as they have been historically, but relative to other countries, the U.S. will continue to excel. We are still the engine of opportunity for the global economy, and current low returns partially reflect this dynamism.