Recession Looms:
Can “Trumponomics” Extend the Recovery?

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April 3, 2017
Global Outlook

- **IMF** has warned of a period of slow growth that makes the global economy more vulnerable to stagnation.
- Jan 2017 forecast unchanged at **3.4%** this year, **3.6%** in 2018.
- **EU** growth rate was **1.6%** in 2016 (slowest in 5 yrs).
- **UK** growth lowest in 3 years at **2%**.
- **US** growth rate **2%** in 2016, bringing average during last 8 years to 1.7% with Core PCE 1.3%.
- Slower growth + Lower inflation ("Slowth")
Who You Calling Slow?

WELL YOU'RE LOOKING RATHER SLUGGISH YOURSELF.

CHINA 6.5%
EUROPE 1.5%
U.S.
“While expansions do not die of old age, history shows that they are at greater risk when spare capacity is exhausted, as it probably is now. So it is especially important to monitor whether growth may be running out of steam.”

–Goldman Sachs, December 30, 2016

Recession Risk
2016Q4-2018Q3
23%
An Aging Recovery

Need the current expansion to continue for another 2 1/2 years to break the all-time record.

<table>
<thead>
<tr>
<th>Recessions</th>
<th>Duration (Months)</th>
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<td>2008-09</td>
<td>18</td>
<td>2009-?</td>
<td>93 So Far</td>
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Averages:

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<td>1919-45</td>
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<tr>
<td>1945-2009</td>
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<td>1945-2009</td>
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Longest on record, with **3.6%** average growth

Fourth longest since 1850, with just **2.1%** average growth
What Does the Fed See?

- Yellen

- Business investment remains soft esp energy

- Job growth **209k** per mo for last 3 months

- Core inflation running ~**1.8% YoY**

- Expects to hit 2% target over next 2-3 years

- Over next three years median unemployment ~**4.5%**

- Absent new risks, tightening cycle continues
Dual Mandate Celebration?
MAKE AMERICA GREAT AGAIN!
“Since the trough of the recession in early 2009...essentially all of the convergence in the economy’s level of output and its potential has been achieved not through the economy’s growth, but through downward revisions in its potential.”

~ Larry Summers, 2014
In 2014, actual GDP remained ten percent below its 2007 forecast. Half of that was accommodated into a reduction of potential. The rest remained an estimate of the GDP "gap."
“In other words, through this recovery, we have made no progress in restoring GDP to its potential.”

~Larry Summers, 2014
Almost There: The Economy Closes In on Potential

U.S. economic activity is (finally) nearing what economists believe to be full capacity.

Gross domestic product

2007 Potential G.D.P.

Shaded area indicates recession
Sources: Congressional Budget Office; Bureau of Economic Analysis
“The economy has a little more room to run than might have previously been thought. That’s good news.”

~Yellen, Sept. 21, 2016
What's the Bad News?
Does Recession Loom?

- Always a question of **when** (not if)
- Real GDP growth **revised up** to 2.1% in **Q4**
- **Atlanta Fed** GDPNow 0.9%
- FOMC expects 2.1% this year, followed by 2.1% in 2018 then slowing to 1.9% in 2019
- Always a question of headwinds vs. tailwinds
What Does the Fed See?

- Yellen

- Business investment remains soft esp energy

- ~190k per mo for last 4 months (job creation)

- Core inflation running ~ 1.7%

- Expects to hit 2% target over next 2-3 years

- Over next three years median unemployment ~4.5%

- Absent new risks, tightening cycle continues
Do They Have A Paddle?

- **Conventional Policy**
  - Changing a single interest rate

- **Unconventional Policy**
  - QE
  - Forward Guidance
  - ZIRP

Out of monetary space?
Reduction in Federal Funds Rate During Previous Recessions

- Max. FFR near start of recession
- Min. FFR near end of recession
“Future policymakers might choose to consider some additional tools that have been employed by other central banks.”

–Janet Yellen, Jackson Hole, 2016
How Low Can You Go?

- **One-third** of global government bond market is trading at negative rates
- BOJ, ECB, Sweden, Switzerland, Denmark
- Purpose of government bonds is to provide safe, **fixed income**, not fixed losses
How do negative interest rates work?

Badly.
Inflation Targeting?

- Target NGDP growth
- Goal is really to raise inflation expectations
- BOJ has raised its inflation target
- Some called on Fed to do the same (Bernanke)
Jackson Hole

- Increasingly hawkish
- Recession unlikely before tightening cycle
- If it comes sooner, we have paddles
- May need to consider broader range of assets in event we need QE4
“If we could come up with better fiscal policy...then that takes the pressure off of us to try to come up with other ways to do it, like through a large balance sheet. It also means we don't have to turn to quantitative easing and other policies as much.”

– John Williams (SFO Fed)
‘Trumponomics’ to the Rescue?

- Policies are *gradually* taking shape
- Still a *moving target*
- A micro dealing-making approach to macro policy
- Depending on who you ask, 'Trumponomics' offers the promising *prospect for growth* or the greatest potential source of *downside risk*
- Let's focus on the *economic debate*
“Enormous Uncertainty”

“This is probably the largest transition ideologically and in terms of substantive policy that we’ve seen in the U.S. in the last three quarters of a century.”

~Larry Summers, 2017
What Is “Trumponomics”? 

- Broad program of policies that will impact the economy:
  - Tax policies
  - Spending programs
  - Trade agreements
  - Immigration
  - Federal regulation
  - Health Care
  - Federal Reserve (appointments)
A Big Stimulus?
“It’s called priming the pump,” Mr. Trump said. “Sometimes you have to do that a little bit to get things going. We have no choice — otherwise, we are going to die on the vine.”

He added: “The economy would be crushed under Hillary. But no matter who it is, the debt is going up.”
Warning: Debt Ahead

- Trumponomics “runs the risk it could lead to an explosion of public debt and ultimately cause a serious loss of confidence and a deep recession.” (Edmund Phelps)

- Trump's deficits "won't do much to boost growth because rates will rise and there will be lots of crowding out." (Paul Krugman)

- “The willingness of foreigners to see buying US government securities can’t be taken for granted.” (Roger Myerson)
The Stated Goal: 3.5-4.0% Growth

- To get to lower (upper) end of target, Trump needs an extra 1.8% (2.1%) from growth of labor force and/or productivity
- Navarro-Ross paper
- “So far out of the mainstream of any kind of responsible economic thinking that they are the economic equivalent of creationism.” (L. Summers)

<table>
<thead>
<tr>
<th>Period</th>
<th>Average Annual Change in GDP</th>
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<tbody>
<tr>
<td>Q4 1949-Q2 1953</td>
<td>7.6%</td>
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<tr>
<td>Q2 1954-Q3 1957</td>
<td>4.0%</td>
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<tr>
<td>Q2 1958-Q2 1960</td>
<td>5.6%</td>
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<tr>
<td>Q1 1961-Q4 1969</td>
<td>4.9%</td>
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<tr>
<td>Q4 1970-Q4 1973</td>
<td>5.1%</td>
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<tr>
<td>Q1 1975-Q1 1980</td>
<td>4.3%</td>
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<tr>
<td>Q3 1980-Q3 1981</td>
<td>4.4%</td>
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<tr>
<td>Q4 1982-Q3 1990</td>
<td>4.3%</td>
</tr>
<tr>
<td>Q1 1991-Q1 2001</td>
<td>3.6%</td>
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<tr>
<td>Q4 2001-Q4 2007</td>
<td>2.8%</td>
</tr>
<tr>
<td>Q2 2009-Q4 2016</td>
<td>2.1%</td>
</tr>
</tbody>
</table>
Can He Get Tax Reform?

- Tax Foundation says Trump’s tax plan would cost $10T over 10 years

- Compare this stimulus against the reported $10.5T in spending cuts we’re now hearing about

- Then add back any increased spending on infrastructure, military, wall, etc

- Paul Ryan insists any tax reform has to be revenue neutral, maintaining the current revenue stream (with dynamic scoring)

- Dems likely to oppose any tax reform skewed to rich so R’s looking at fast-track tool that will let them get it done on party-line vote

- In order to use reconciliation, GOP has to avoid adding to the deficit over the long term
“There is a broad consensus that the kind of policies that [President Trump] has proposed are among the policies that will not work.”

–Joseph Stiglitz, January 6, 2017
So what we’re really looking at is a combination of tax cuts and spending cuts. Overall, this will surely increase budget deficits. But the tax cuts will go to the wealthy, who won’t spend much of their windfall, while the spending cuts will fall on the poor and struggling workers, who will be forced into sharp cutbacks in spending. The overall effect on demand is therefore likely to be negative, not positive.

—Paul Krugman, 2016
Moody’s Outlook

- **Scenario 1: Full Monty Trump**
  - Whole agenda espoused in speeches/interviews/tweets/website
  - Real GDP *below* 2017 level with unemployment above 7%

- **Scenario 2: Trump Lite**
  - Basic agenda adopted on smaller scale
  - Smaller tax cuts with “only” 6 million immigrants expelled and no trade war

- **Scenario 3: Washington Reality Trump**
  - Agenda Congress could actually go along with
  - Assumes fiscal must be deficit neutral
  - No recession but average growth is just 1.7% over 10 years
Goldman, though, is growing concerned. Indeed, when you put the bank’s assumptions about Trump’s plans into the Federal Reserve’s economic forecasting model, the conclusion is that the policies will actually be a negative for growth relative to the status quo by the end of his term.

Small stimulus in 2017 (0.33pp) and 2018 (0.55pp) followed by slower growth thereafter.
“Beware of pundits who believe Trump will bring economic catastrophe.”

–Kenneth Rogoff, December 7, 2016
Rogoff

- Even if you oppose Trump’s policies, you’ve got to admit they are staunchly pro-business (except trade)

- Rogoff predicts that “higher inflation is a near certainty” as Trump’s policies juice an economy already near Yf and trade policies drive up the price of import-competing goods

- Output growth could reach 4%, at least temporarily (Rogoff)
Sugar High or Higher Potential?

“A combination of across-the-board tariffs, corporate tax reform and lower tax rates, and infrastructure spending—the whole package could boost growth,” said Michael Gapen, chief U.S. economist at Barclays. “The real question is, does that turn out to be a short-term boost or does it improve productivity growth and rates of potential. He said the economy’s underlying growth rate is likely in the range of 1.5% to 2%, and it’s “not totally impossible” to raise that trend.
Kocherlakota

- Labor market slack only part of the question
- How much labor market hysteresis is reversible?
- Other question is whether policy can raise forecast path of what is viewed as potential
- With nearly a decade of constrained AD, low capital investment/innovation, can 'Trumponomics' help reverse declines in productivity growth?
- Upside potential may be substantial
Williams

• “What we need is really better policies and investments in the long-term health of the economy.” (John Williams, SFO President)

• Infrastructure, R&D, education, etc.

• Raise the level of future GDP

• Policies that increase the level or growth rate of productivity or induce greater LFP
Too Many Unknowns

- Trump will probably get tax cuts and some additional spending
- But will it be expansionary?
- What about offsets?
- Likely that tax cuts will overwhelmingly favor top earners with low MPC
- Likely that infrastructure involves private money and will boost less
- What about trade war if tariffs are imposed?
- And how will the Fed respond?
Key Questions

- Exactly how much will “Trumponomics” boost output and inflation?
- Depends — how close is the US economy to Yf?
- Can added demand induce additional supply?
- What about productivity? Is it really going to remain low for the foreseeable future?
- If resources are truly (significantly) underutilized, then “Trumponomics” could be far more stimulative
- Business investment (long depressed) is key. If it ramps way up, output and productivity could rise sharply
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Thank You!