Outlook for the Economy in the Coming Year
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0. The Usual Disclaimers About My Crystal Ball

I. Grading Predictions from One Year Ago

Overall, I think I did pretty well this past year – I was even right about Greece and was mostly right about everything else. SO - I give myself an A !!!! My flying guesses turned out to be pretty accurate!!!!

II. Business cycle indicators of where we are now

- Coincident Indicators Looking OK

- Employment – Now at around 5.0% - down from 5.8% last year

- Industrial Production and Capacity Utilization – still hanging below 80%

- Households

  - Wages flat

  - Retail sales continue to grow but at decreasing rate

  - Household Debt Ratios - Still at historically low levels.

- Inflation – Still not a problem

III. Current Policy Stance

A. Fed just increased interest rates by ¼% in the most clearly foreshadowed rate change ever. Rates are still very low and Fed announcement emphasize the word “gradual”

B. Fiscal Policy – New agreement through 10/16. Changes around the margins with a sizeable tax cut thrown in. No changes big enough to affect macro balance next year.
IV. The Situation in Crazytown ……

A. Yet more debt ceiling and/or budget brinksmanship next October?

B. The Economy Depends on Politics (I keep saying this)

C. I have to repeat the last several years’ advice because they didn’t take it

V. Europe and China are Still Making Me Nervous

A. Europe is a good example of economics as political power games

B. China’s underground economy includes an underground financial system

VI. Where are We Going Now?

The US continues to be the brightest spot in the world economic outlook. But we need to reduce the drag caused by fiscal policy while avoiding a premature tightening of monetary policy

GDP - 2.0 – lower if rates go up more than once. Biggest caveats are overseas and likely will keep a lid on our upside

Unemployment – 5%

Inflation – Not a worry. Fed has all the tools it needs to combat any inflation (but there isn’t even a shred of evidence of it at this point.)

Interest Rates - 1% or less (probably less) this time next year though long rates may creep up. They “should” only raise rates if there starts to be excessive wage inflation

Fiscal Policy – Always the big uncertainty. Lets hope for a bit of willingness to spend since we need it. But in an election year insanity is always close to the surface in DC

Europe – No hope for relief as their political establishment remains wedded to austerity – They are fortunate Mario Draghi is in charge of the ECB. He will try to save them from themselves