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# U.S. Macro Outlook: The Global Standout

BY MARK ZANDI — MAY 9, 2016
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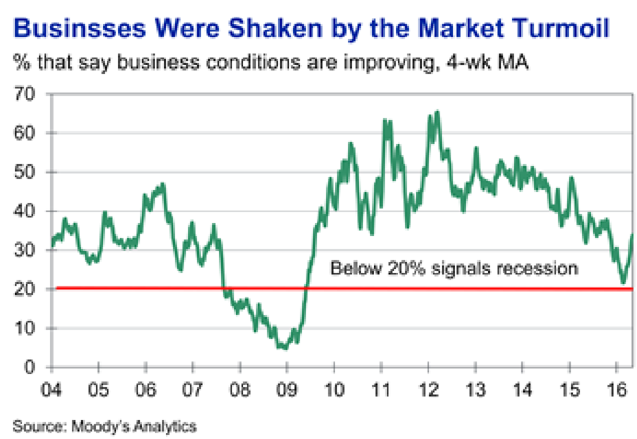
- We are now in the fourth longest expansion in the nation's economic history, and recession worries are overdone.
- The financial market turmoil has done some economic damage.
- However, markets have almost fully recovered as investors have been heartened by the fading of potential existential tail risks.
- The expansion's longevity is just one of the economic successes of President Obama's administration.

The U.S. economic recovery is approaching its seventh birthday. This is a significant achievement; the average expansion since World War II didn't even turn five. We are now in the fourth longest expansion in the nation's economic history.

Worries over an impending recession, which hit a high when global financial markets were at their lows earlier in the year, are way overdone. A recession would be incongruous with the steadfastly strong job market. Job growth is robust, supported by nearly record low layoffs and record high job openings. The recent pickup in labor force participation and the number of those quitting their jobs are also clear signs of a healthy expansion.

Even so, the financial market turmoil has done some economic damage. High-end retailing looks soft, probably because of the negative wealth effects of the punk stock market. Business investment has also stalled, even outside of the energy sector, as corporate leaders were seemingly shaken by the market volatility.




However, markets have almost fully recovered as investors have been heartened by the fading of potential existential tail risks. Concern that oil and other commodity prices will sink further, undermining already teetering emerging economies, has abated. Fears that China would precipitate a currency war to support its foundering growth have also been largely dashed.

The U.S. expansion thus seems set to persist for the foreseeable future, perhaps even rivaling the decade-long expansion of the 1990s, the longest in economic history.

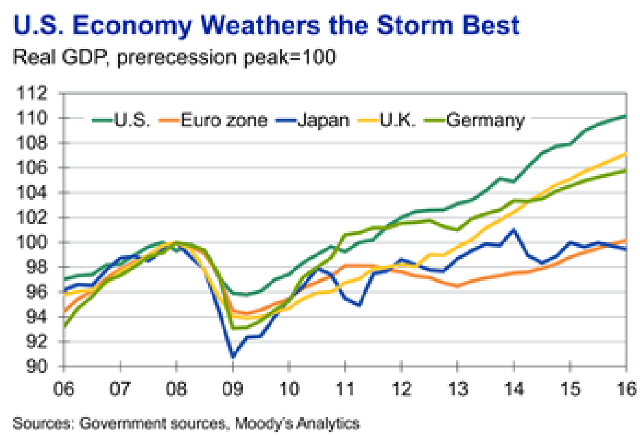
**Obama's economic legacy**

The expansion's longevity is just one of the economic successes of President Obama's administration. It is no exaggeration that Obama inherited an economy in free fall. In January 2009, the month he took office, the economy shed an astounding 800,000 jobs, and unemployment was surging. When the economic carnage ended just over a year later, almost 9 million jobs had vanished and unemployment hit 10%.

Since then, the job market has been on a tear. The economy has created more than 14 million jobs, with the longest string of monthly job gains ever. Job creation has come across occupations of all pay scales and regions of the country. Unemployment is back to 5%. And all signs point to continued strong gains in the job market, with the economy finally returning to full employment, broadly defined, later this year.

**Global standout**

The U.S. economy has performed much better than any other major developed economy since the financial crisis. U.S. real GDP is more than 10% above its prerecession peak, while in the euro zone and Japan real GDP has only now recovered what it lost in the downturn. Even the stronger U.K. and German economies have lagged well behind the U.S.




While there are likely many reasons for the standout performance of the U.S., probably most important was the aggressive policy response to the crisis by the Federal Reserve, the Obama administration and Congress. The bank stress tests and the much-maligned bank bailout, in which taxpayers provided capital to many of the nation's largest financial institutions, was vital to stabilizing the financial system and re-starting the flow of credit.

The Federal Reserve's emergency liquidity provisions, zero interest rate policy, and quantitative easing were also instrumental in ending the financial panic and facilitating the deleveraging process. The policies also supported stock prices, home values, and other asset prices, further supporting stressed balanced sheets. Worries that these policies would ignite runaway inflation or asset bubbles never materialized, at least so far.

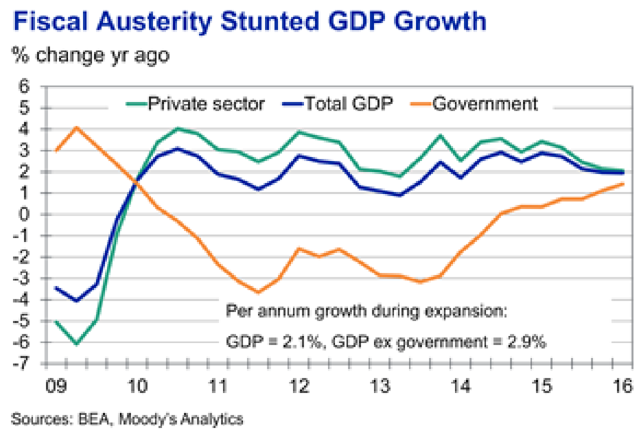
Fiscal policy was also critical to ending the recession and jump-starting a recovery. Most notable was the massive fiscal stimulus package passed into law just weeks after Obama took office. This included a plethora of temporary tax cuts and government spending increases. Combined, these helped pull the economy out of recession by summer 2009. Just one year after Obama took office, job growth resumed.

The policy response elsewhere in the developed world was much more tepid, in comparison. The European Central Bank actually increased interest rates early in the recovery, just prior to the euro zone's debt crisis. Europe's banks weren't recapitalized in earnest until very recently. The Japanese policy response to the crisis was also muddled and confused, alternating between policy stimulus and restraint.

**Lagging past expansions**

While the U.S. economy has outshined most other developed economies since the crisis, it has lagged past U.S. expansions, particularly with respect to real GDP. This expansion's just over 2% per annum GDP gain is less than half the average experienced in expansions since World War II.

Part of the shortfall in GDP growth can be explained by the severe fiscal austerity policymakers pursued after the early stimulus. This was the result of the fierce budget battles that resulted in a federal government shutdown, the sequester, and a near default on Treasury debt. Private sector GDP—GDP excluding government spending—has increased by nearly 3% per annum. That's closer but still short of growth in most past expansions.




The recent GDP (and productivity) numbers are also likely plagued by measurement problems. The Bureau of Economic Analysis is surely having trouble keeping up with the rapid adoption of e-commerce, social media and other information technologies, and the gig economy.

It is also important to account for the economy's growth potential—its long-run sustainable rate of growth—when comparing expansions. Potential growth is much slower today than in times past given that female participation has maxed out and the large baby boom cohort is retiring. The resulting slowing in labor force growth in recent years has reduced potential growth by no less than half a percentage point per annum.

All this notwithstanding, real GDP growth in this expansion has been disappointing. The culprit is slumping productivity growth. Nonfarm business productivity has averaged a paltry 1% per annum since the recession, and only about half that more recently. This hasn't been much of an issue to date, as weak productivity means more jobs and getting back to full employment more quickly—a critical priority. But with full employment at hand, unless productivity growth revives soon, the economy will not deliver the GDP, income, profits, tax revenue and asset returns everyone is counting on.

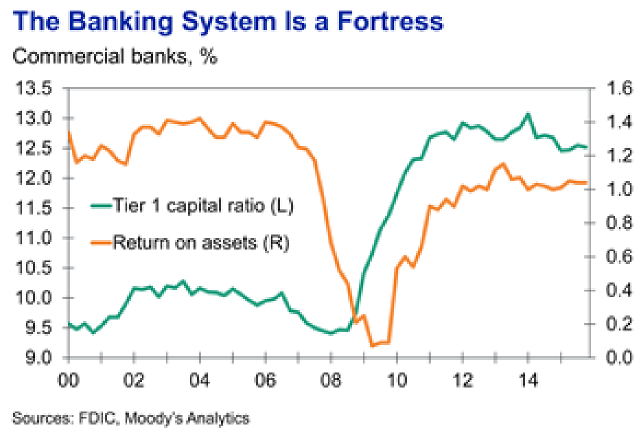
**Obamacare and Dodd-Frank**

It would be unfair to pin the productivity slump on the Obama economic agenda. Many forces are at work. The recession hammered labor mobility and business formation, both of which are vital sources of productivity gains. Cheap labor probably incented businesses to invest less, as did hard-to-shake fears regarding the durability of the expansion given the nightmare of the recession. Even the previous energy boom may have played a role, as investment was diverted to exploiting energy resources and away from productivity-enhancing technologies.

However, the wrenching changes wrought by healthcare and financial regulatory reform, both of which became law early on in the expansion, likely also weighed on productivity. Healthcare is the economy's largest industry, and the credit provided by the financial system is vital to all industries. Obamacare and Dodd-Frank required an overhaul in the ways of doing business in these key parts of the economy. It is hard to imagine there wouldn't be significant adjustment pains manifested in lower productivity growth, at least during the transition.

The political costs of getting these highly controversial reforms through Congress also added to the acid political environment that has characterized much of the Obama administration. This ostensibly raised the bar too high for getting immigration reform, tax reform, or more infrastructure spending. All of which are essential to promoting future productivity growth.

This isn't a commentary on the merits of Obamacare and Dodd-Frank per se. There is plenty to like and dislike in both reforms. However, insuring most of those without health insurance and roughly paying for it is a monumental achievement, and President Obama's legacy may very well be determined as much by this as by anything else he has done. And requiring the banking system to hold much more capital and liquidity is also a laudable accomplishment.




The banks, which were undercapitalized prior to the crisis, are now veritable fortresses. It is all but impossible to construct a scenario in which they will require taxpayers' help ever again.

**Sound ground**

President Obama is leaving an economy that is on sound ground. Full employment is at hand, inflation is low, stock and housing value are near record highs, and household and corporate debt loads are about as light as they have ever been. To be sure, many problems remain. But Obama has done his part to ensure that the next president will take office in a good place to tackle them.

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Moody's Analytics added the economic forecasting firm Economy.com to its portfolio in 2005. This unit is based in West Chester PA, a suburb of Philadelphia, with offices in London, Prague and Sydney. More information is available at www.economy.com.

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