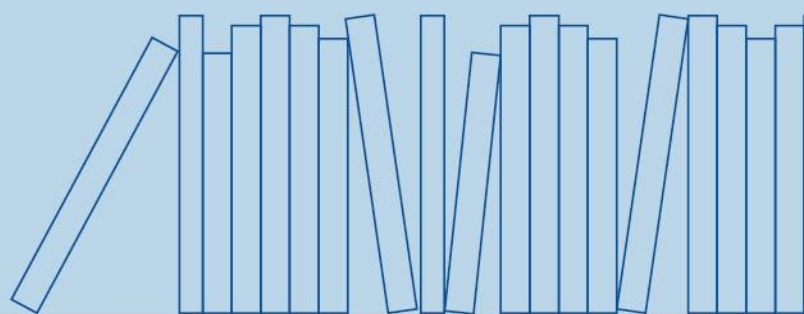


Economic Commission for Latin America and the Caribbean
ECLAC OFFICE IN WASHINGTON, D.C.



U.S. Economic Outlook

Seven years of steady but tepid growth



UNITED NATIONS



Washington, D.C., 7 April 2017

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Overview

Robust consumer spending, an uptick in factory production and firming inflation supported a healthy start for the U.S. economy in 2017 and another interest rate increase by the Federal Reserve on March 15. This healthy start follows an economic expansion that has passed the seven-year mark, supported by solid consumer spending growth. However, the pace of growth is also the weakest of the post-World War II era, as demographic trends – including aging and slow population growth – have weighed on the economy.

Since its post-crisis nadir in early 2010 the U.S. economy has created 16 million jobs. The U.S. labor market is tight and is expected to return to full employment in 2017. However, productivity has risen less than 1% for six consecutive years. Sluggish productivity has implications for wage growth, which has been low by historical standards during this economic recovery. Wage growth seems to be already picking up, though, as the economy continues to advance. Average hourly earnings for private-sector workers rose 2.9% in December 2016 from a year earlier. That was the strongest growth of the current expansion.

Inflation has been low for the past four years. However, as the expansion advances, unemployment recedes and wage growth begins to accelerate, a four-year stretch of historically low inflation could be coming to an end.

A cautious and highly accommodative monetary policy has supported the current economic expansion, but tightening is already under way. The Federal Reserve has increased interest rates by 25 basis points three times in this expansion: in December of 2015, December of 2016, and March 2017. The pace of future increases in interest rates remains uncertain, but the Federal Reserve projects two more increases until the end of the year.

Fiscal conditions were tight for most of the expansion. Federal fiscal policy shifted towards austerity in 2013, when caps on discretionary federal spending went into effect (a result of the Budget Control Act of 2011) and some tax cuts expired, while state and local spending and hiring have been slow over the entire period.

A bull market in stocks turned eight years old at the beginning of March. At the same time, the yields for Treasury securities were on a downward trend from 2007 to 2016, meaning investors were

also embracing the relative safety of U.S. government debt. The slow pace of growth, fear and uncertainty about the global economy, and the Federal Reserve's asset purchase programs, may explain this apparently inconsistent behavior.¹ Yields have started to rise since July of last year, however, reflecting higher confidence on the strength of the U.S. economy.

Trade deficits have been below 3% of GDP for the past four years, while the U.S. dollar has been gradually gaining strength.

Forecasts are largely optimistic about growth prospects in 2017. Last year the U.S. economy grew 1.6%, and growth is now expected to accelerate to more than 2% this year (table 1). U.S. consumer price inflation was 1.3% last year, but according to market projections, the CPI is expected to increase at a 2.5% rate on average in 2017, which would be the highest rate since 2011. However, forecasts cannot capture the increasing uncertainty surrounding the U.S. economic policy and legislative landscape. What the U.S. economic policy-mix will be is not yet clear, as well as what its domestic and global repercussions may be.

¹ Stock markets and bond markets usually go in opposite directions. During a bond market rally, the stock market drops. The higher the price paid for a bond, the lower its yield – so in a bond market rally, yields drop. It is unusual that both stock and bond markets rally at the same time.

TABLE 1:
ANNUAL FORECASTS FOR U.S. ECONOMIC GROWTH

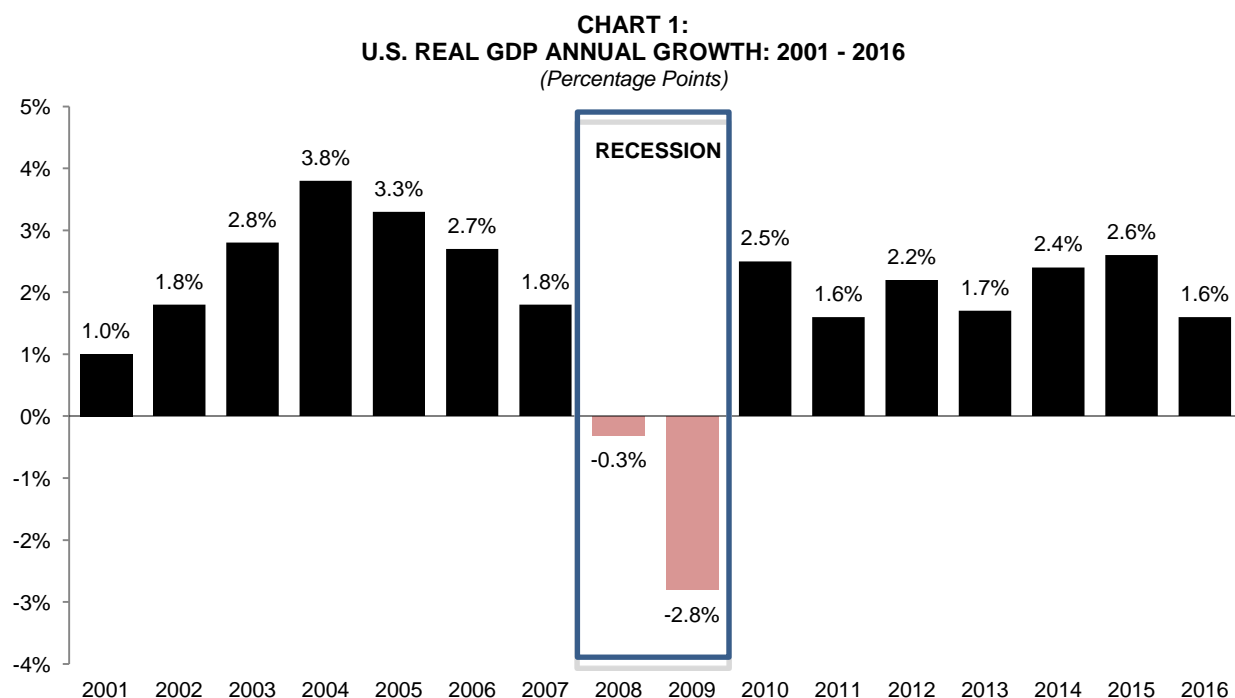
		Real GDP (% change, y/y)		CPI (% change, y/y)		Unemployment Rate (%)		FED Funds Rate (%)		Date of Forecast
		2017	2018	2017	2018	2017	2018	2017	2018	
A. What Government Agencies Say										
	FED	2.1%	2.0%	1.8%*	2.0%*	4.6%	4.5%	1.9%	3.0%	Mar-17
	CBO	2.3%	1.9%	2.3%	2.3%	4.5%	4.4%	na	na	Jan-17
B. What Markets Say										
	Bank of America/Merrill Lynch	2.1%	2.5%	2.3%	1.9%	4.6%	4.3%	1.4%	2.1%	Mar-17
	Credit Suisse	2.2%	2.2%	2.3%	2.1%	na	na	na	na	Mar-17
	JPMorgan	2.0%	1.8%	2.6%	2.4%	4.6%	4.4%	1.3%	na	Mar-17
	Moody's Economy.com	2.4%	2.9%	2.8%	2.5%	4.6%	4.4%	1.0%	1.9%	Mar-17
	Mortgage Bankers Association	2.1%	1.9%	2.4%	2.4%	4.5%	4.3%	1.4%	2.7%	Mar-17
	National Association of Realtors	2.4%	2.2%	2.6%	2.4%	4.6%	4.5%	1.0%	1.8%	Mar-17
	National Bank of Canada	2.2%	2.4%	2.2%	2.2%	4.8%	4.7%	1.3%	2.0%	Mar-17
	TD Bank Financial Group	2.2%	2.1%	2.6%	2.3%	4.7%	4.5%	1.3%	2.1%	Mar-17
	The Economist Intelligence Unit	2.3%	2.1%	2.5%	2.1%	4.5%	4.3%	na	na	Mar-17
	Wells Fargo/Wachovia	2.2%	2.4%	2.5%	2.6%	4.7%	4.5%	1.0%	1.6%	Mar-17
	Market Average	2.2%	2.3%	2.5%	2.3%	4.6%	4.4%	1.2%	2.0%	
C. What International Organizations Say										
	United Nations DESA (Baseline)	1.9%	1.2%	2.3%	2.4%	4.8%	4.8%	na	na	Jan-17
	World Bank	2.2%	2.1%	na	na	na	na	na	na	Jan-17
	OECD	2.3%	3.0%	1.8%	2.2%	4.7%	4.5%	na	na	Mar-17
	IMF	2.3%	2.5%	0.8%	1.2%	4.9%	4.8%	na	na	Jan-17

Source: ECLAC on the basis of official and market sources.

Note: *FED forecast for PCE inflation, the FED's preferred measure.

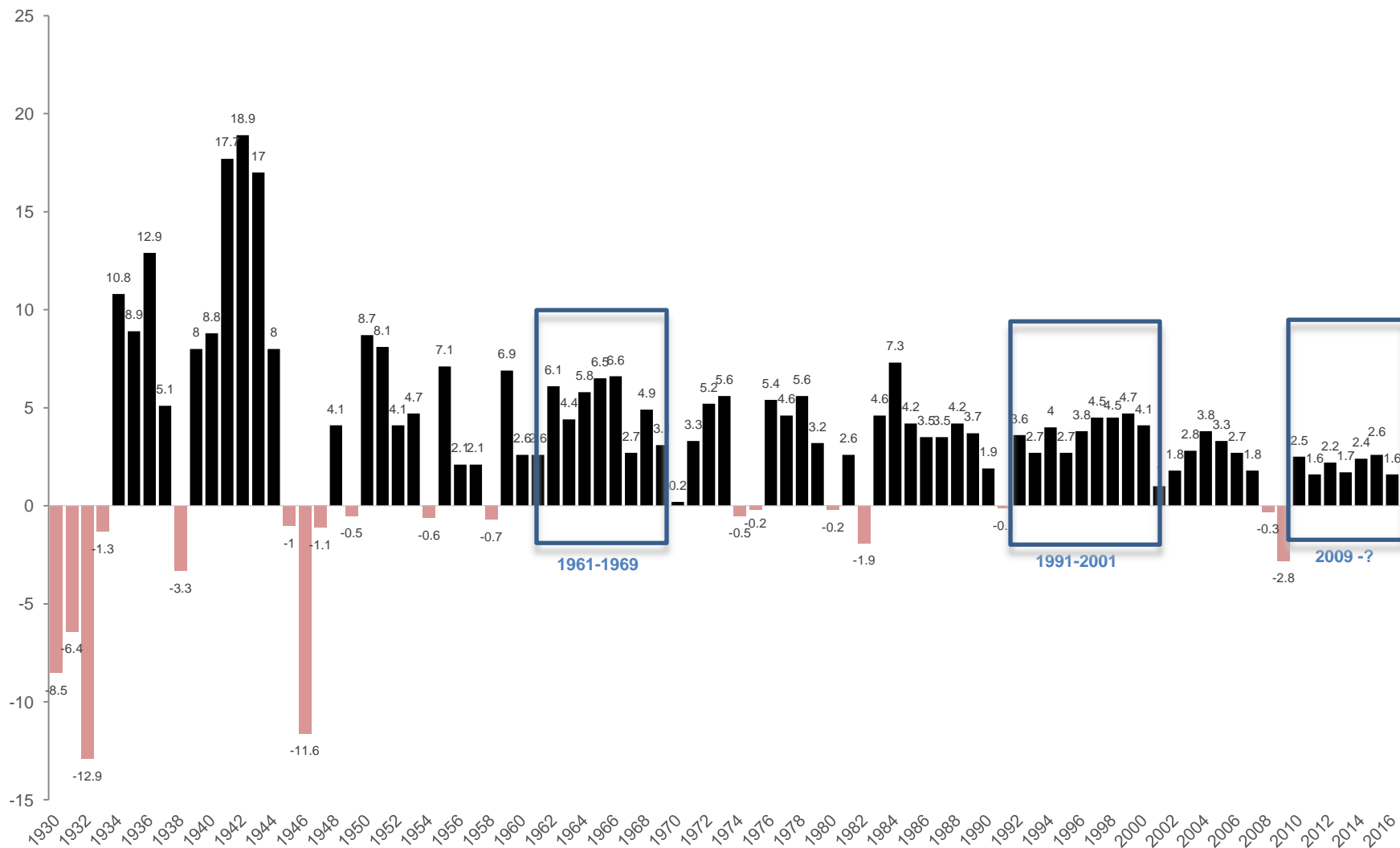
I. Seven years of sustained but slow growth

The U.S. economy expanded at a 1.6% rate in 2016, the weakest annual rate in five years (chart 1). This was, however, the seventh consecutive year of economic growth and as of end-February 2017, the third longest expansion in the country's history so far (chart 2). Yet the pace of growth is also the weakest of the post-World War II era.



Source: ECLAC, on the basis of data from the Bureau of Economic Analysis, U.S. Department of Commerce.

CHART 2:
U.S. REAL GDP ANNUAL GROWTH: 1930 - 2016
(Percentage points)



Source: ECLAC, on the basis of data from the Bureau of Economic Analysis, U.S. Department of Commerce.

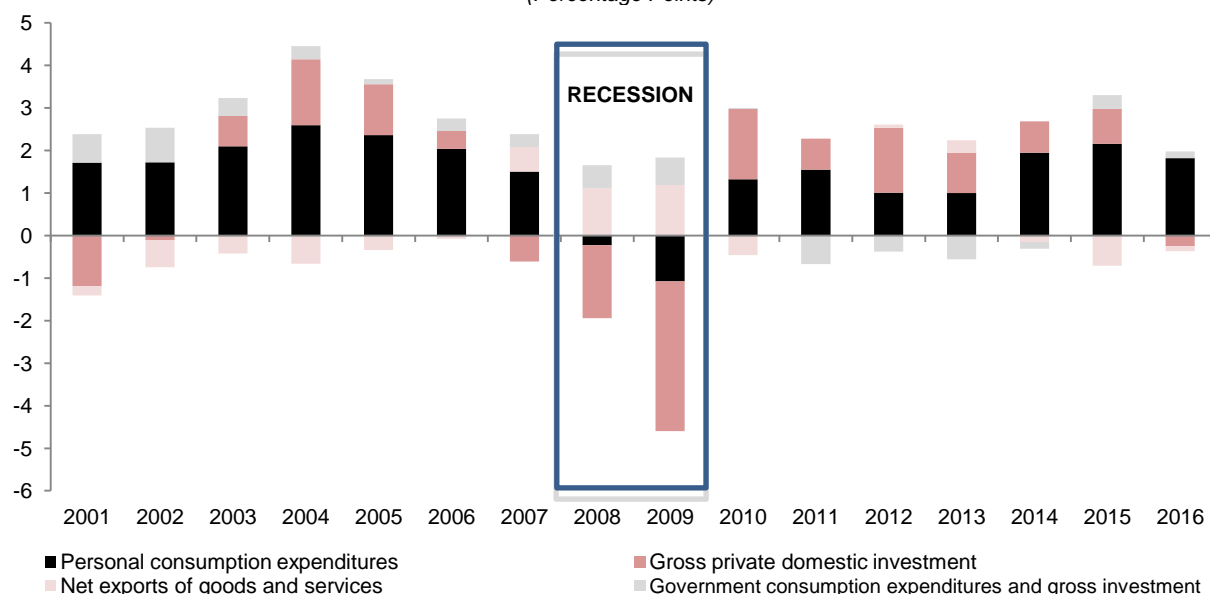
The current economic expansion began in mid-2009 and February 2017 marked the 92nd month of recovery (table 2). This expansion can break an all-time record of 120 months (the 10-year internet-fueled expansion in the 1990s is the longest thus far) if the economy continues to chug along until June 2019. Despite the length of the current expansion, odds of a recession are low, since the economy is not overheating (that is, the economy is not operating beyond full employment), leverage is low, and there seems to be no asset bubbles.²

**TABLE 2:
U.S. ECONOMIC EXPANSIONS**

U.S. Expansions	Duration (Months)
1945-1948	37
1949-1953	45
1954-1957	39
1958-1960	24
1961-1969	106
1970-1973	36
1975-1980	58
1980-1981	12
1982-1990	92
1991-2001	120
2001-2007	73
2009-?	92 as of Feb 2016

Source: ECLAC, with data from the National Bureau of Economic Research (NBER)
<http://www.nber.org/cycles.html>

**CHART 3:
CONTRIBUTIONS TO U.S. REAL GDP GROWTH**
(Percentage Points)



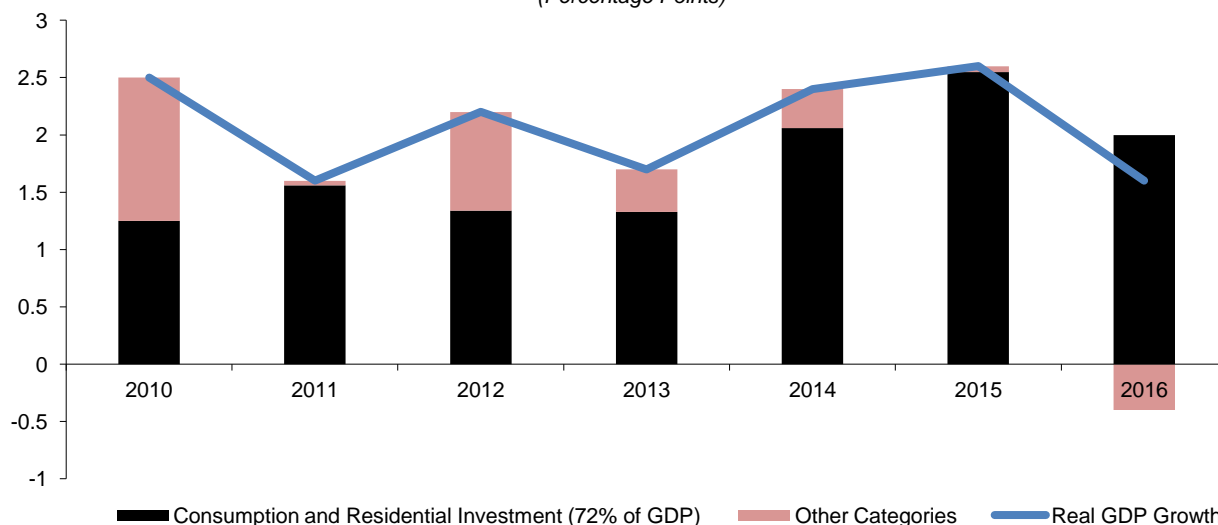
Source: ECLAC, on the basis of data from the Bureau of Economic Analysis, U.S. Department of Commerce.
 Note: Contributions to growth are measured at seasonally adjusted annual rates.

² The housing bubble was at the epicenter of the Great Recession, the technology bubble in the Y2K recession, and commercial real estate and the savings and loan industry in the early 1990's downturn.

The largest component of GDP, real personal consumption expenditures, grew 2.7% in 2016, following an increase of 3.2% in 2015. Consumer spending, the usual engine of a strong economic recovery, has again been a driver of growth during this expansion. In 2016, it contributed 1.84% to annual growth, and in five of the seven years of expansion it made the biggest contribution to growth (chart 3). Stronger and higher-quality job growth in recent years, low borrowing costs, record low debt service burdens, rebounding housing prices, and lower oil prices have supported consumer spending. The fact that U.S. consumers have been able to spend without dipping into their savings is a positive sign. The saving rate has remained above 5% during the economic recovery.

Consumption and residential investment represent 72% of U.S. GDP and have been the core of the U.S. economy. In 2016, they added 2% to annual growth. They have shown resilience throughout this expansion, with consumption being the major strength (chart 4). Investment in business equipment and structures, as well as imports, subtracted from growth in 2016.

CHART 4:
CONSUMPTION AND RESIDENTIAL INVESTMENT'S CONTRIBUTIONS TO U.S. REAL GDP GROWTH
(Percentage Points)



Source: ECLAC, on the basis of data from the Bureau of Economic Analysis, U.S. Department of Commerce.

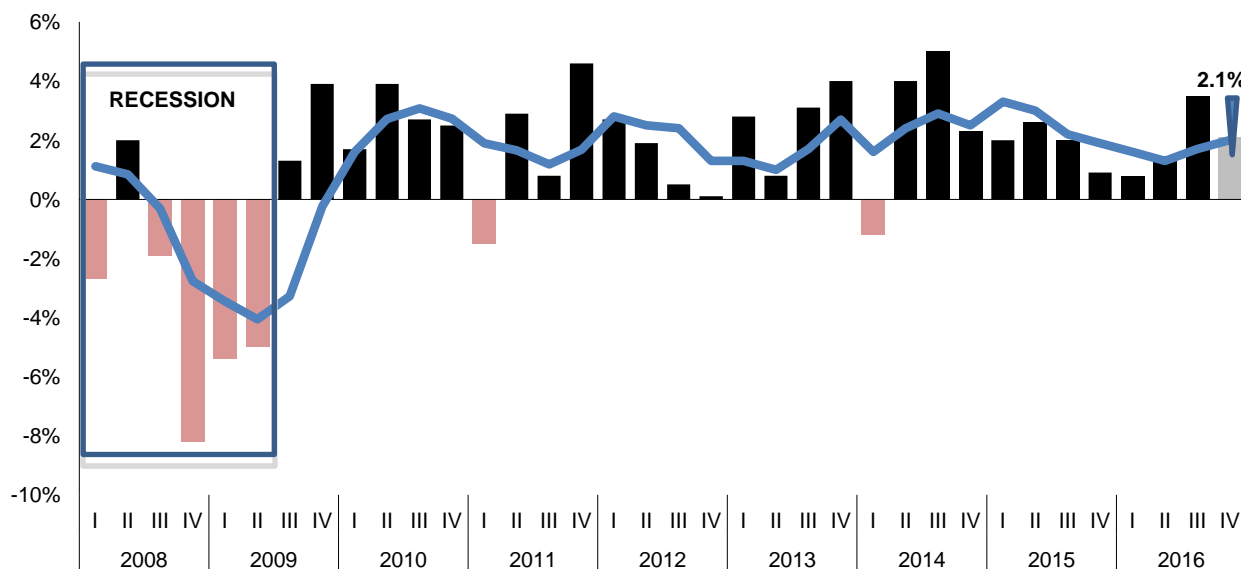
Note: Contributions to growth are measured at seasonally adjusted annual rates.

On a quarterly basis, there were only two quarters during this expansion – the first quarter of 2011 and the first quarter of 2014 – that showed negative growth. The U.S. economy expanded 1.9% in the fourth quarter of 2016, just below the average growth of 2.1% since the beginning of 2010 (chart 5).

Although an average growth of about 2% seems to be low, the U.S. growth rate since 2011 has been higher than the OECD countries' average. By the end of 2016, the U.S. economy was 12% bigger than its pre-crisis peak according to its annual real GDP in 2009 chained dollars, while real GDP per capita was 5% above the pre-crisis peak. Demographic trends may partly explain why U.S. GDP growth has been low during the current recovery.³

³ Other reasons for the slow U.S. GDP growth during the current recovery include: the slow growth of exports given weak international demand; unusually slow growth in government expenditures (at the federal level, the timing of this fiscal drag aligns with the unwinding of the Recovery Act (ARRA)'s expenditures and the 2013 introduction of the sequester, while state and local spending and hiring were slow over the entire recovery); and measurement problems, especially (but not restricted to) the IT sector's contribution to growth. See James Stock and Mark Watson (2016), *Why Has GDP Growth Been So Slow to Recover?* <https://www.bostonfed.org/-/media/Documents/economic/conf/great-recovery-2016/james-h-stock.pdf>

CHART 5:
U.S. REAL GDP: QUARTERLY GROWTH
(Percentage Points)

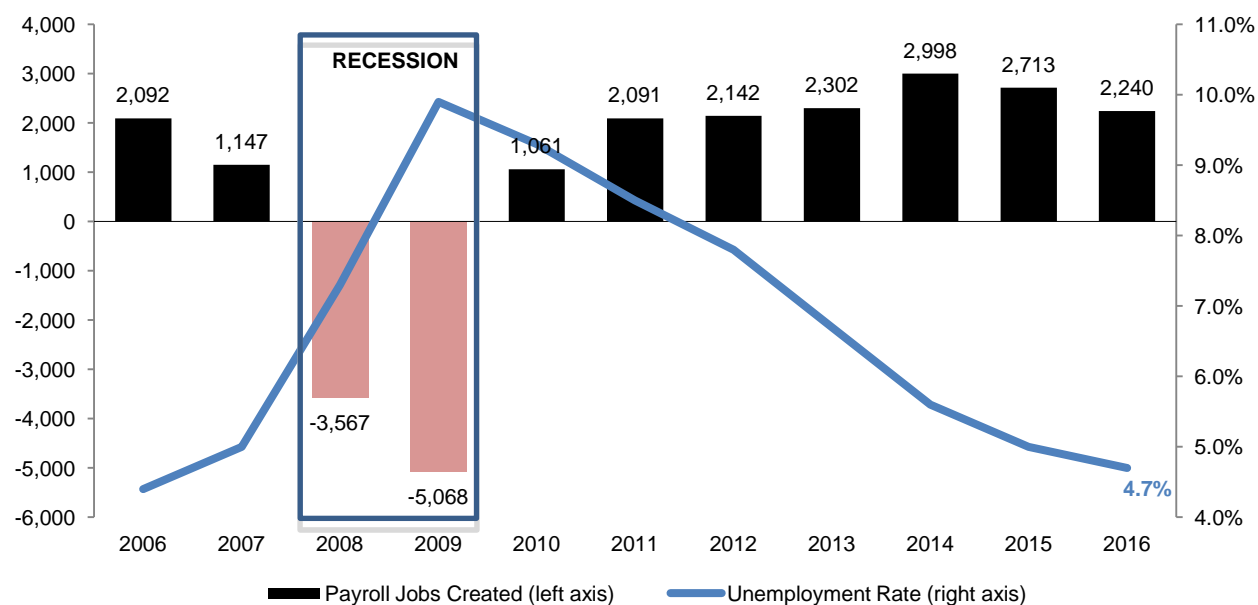


Source: ECLAC, on the basis of data from the Bureau of Economic Analysis, U.S. Department of Commerce.

A. Seven consecutive years of job gains

The U.S. economy created 2.24 million jobs in 2016, the lowest total since 2012, but still a healthy pace in view of an unprecedented seven consecutive full years of job creation. From 2010 to 2016, 15.6 million jobs were created (chart 6).

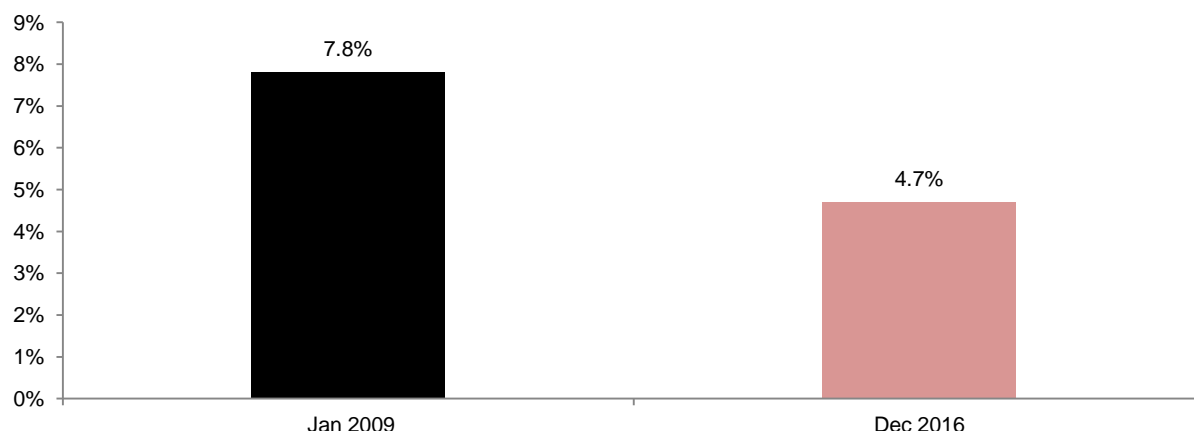
CHART 6:
THE U.S. LABOR MARKET
(Average Monthly Job Growth, thousands (left axis); Percentage Points (right axis))



Source: ECLAC, on the basis of data from the U.S. Bureau of Labor Statistics.

The progress in the U.S. labor market is also reflected in the reduction of the unemployment rate during this period. In January 2009, the unemployment rate was at 7.8% and in October 2009 it reached a peak of 10%. In December of 2016 it was at 4.7% (chart 7).

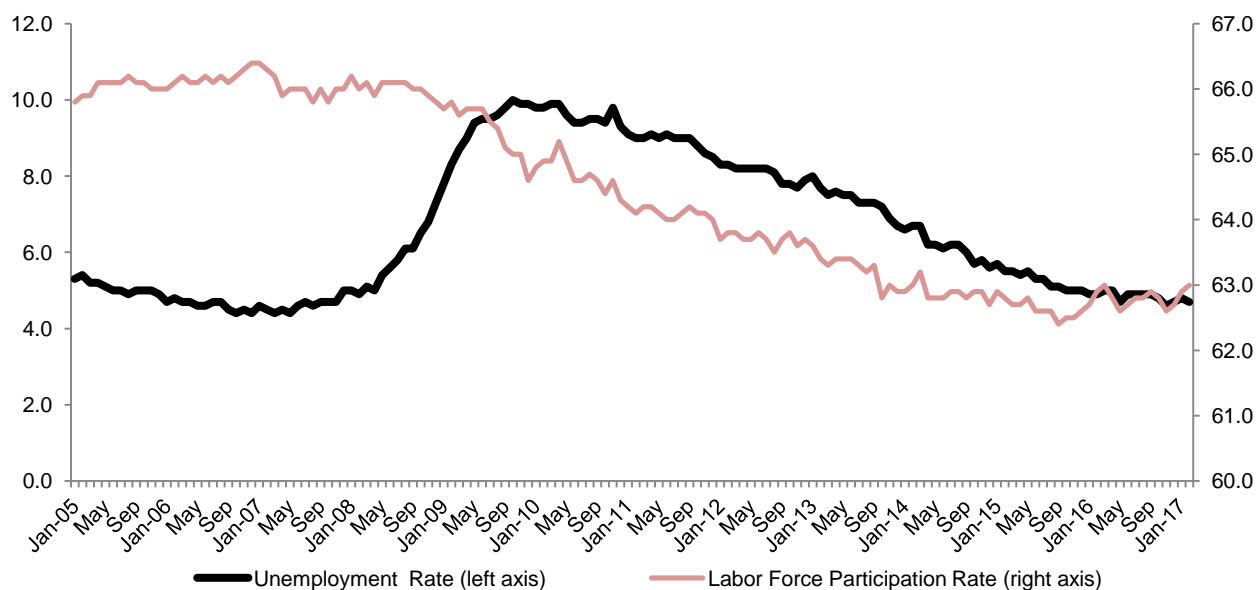
CHART 7:
U.S. UNEMPLOYMENT: THEN AND NOW
(Percentage Points)



Source: ECLAC, on the basis of data from the U.S. Bureau of Labor Statistics.

After reaching 4.6% in November 2016, its lowest level since August 2007, the unemployment rate edged higher in December because more workers joined the labor force, although the labor force participation rate, at 62.7%, ended the year no higher than at the end of 2015. In February 2017, the unemployment rate was at 4.7% and the labor force participation rate at 63%, the highest participation rate since February 2014 (chart 8).

CHART 8:
U.S. UNEMPLOYMENT RATE AND LABOR FORCE PARTICIPATION
(Percentage Points)



Source: ECLAC, on the basis of data from the U.S. Bureau of Labor Statistics.

The U.S. economy is expected to return to full employment in 2017, about a decade since the last time it reached that level. Layoffs are at a record low and weekly unemployment claims are currently at less than 250,000 (weekly claims under 300,000 signal a very strong labor market, and as of March 17, jobless claims had remained below that mark for just over 100 weeks).

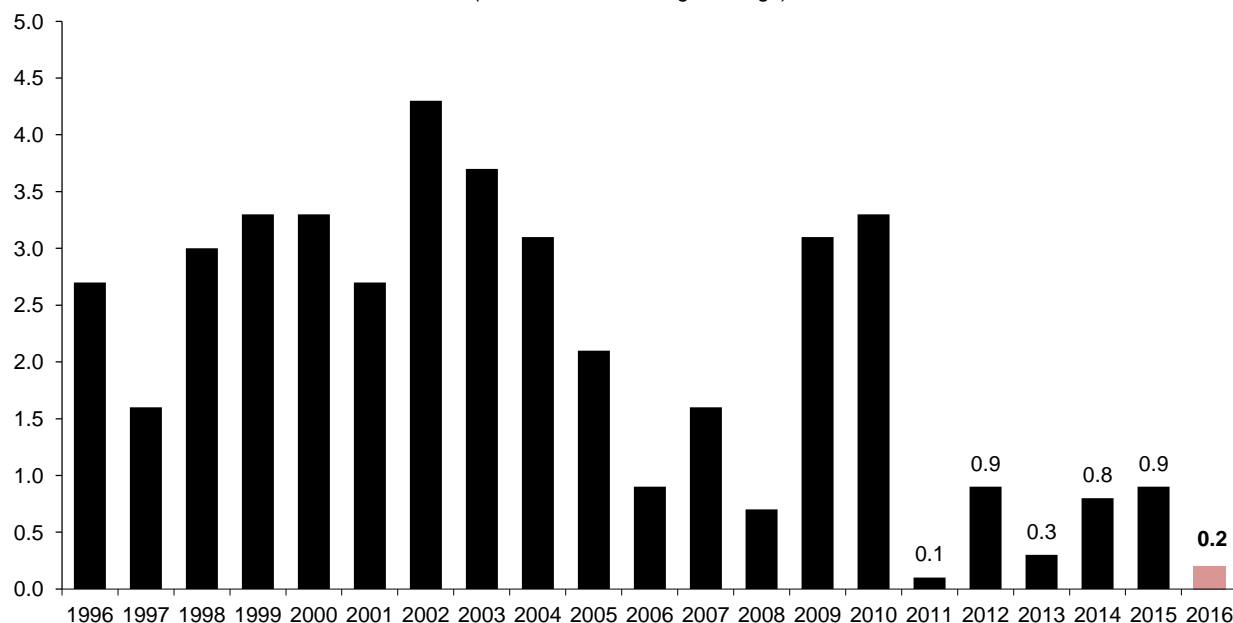
There is room for improvement in terms of job quality (i.e. creation of more full-time jobs). About 3.5% of U.S. workers are employed part-time involuntarily, compared to an average of 2.8% in the years leading up to the recession. Part-time positions come with few benefits. The number of workers employed part-time who would rather work full time declined to a post-recession low in December 2016, however. Another measure of job quality is job creation by wage tier. Since the recovery started, 46% of new jobs have been in low-wage industries while 33% have been in industries that provide mid-wage jobs, according to Moody's.⁴

Only recently, with the economy nearing full employment has wage growth started to pick up. An underlying trend influencing wage growth is the aging of the population, as many baby boomers are retiring at higher wages and being replaced by younger workers at lower wages.

B. Sluggish productivity and low wage growth

The U.S. economy has been growing, but labor productivity has not been as strong. Productivity rose only 0.2% in 2016, following a 0.9% gain in 2015. Productivity has risen less than 1% for six consecutive years (chart 9). Some industries have been doing well. For instance, the wireless telecommunication carrier industry has had annual labor productivity growth of over 15% since the beginning of the Great Recession.

CHART 9:
U.S. NONFARM BUSINESS SECTOR: ANNUAL LABOR PRODUCTIVITY
(Annualized Percentage Change)



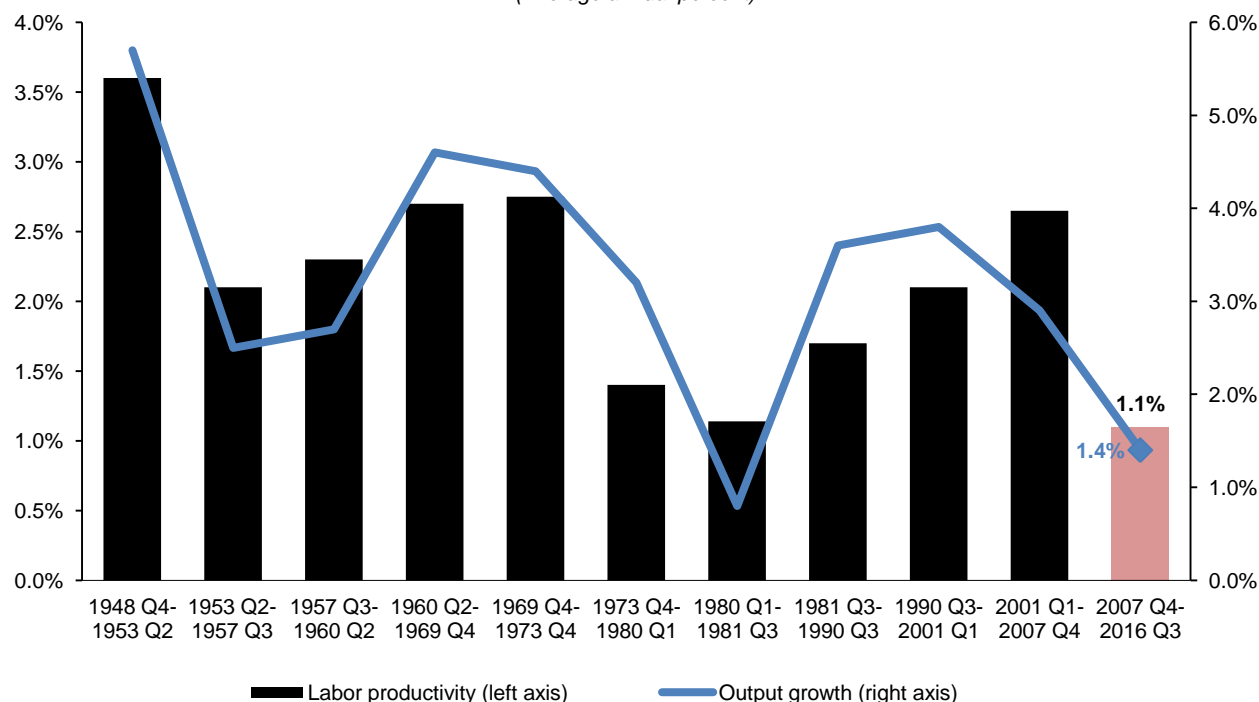
Source: ECLAC, on the basis of data from the U.S. Bureau of Labor Statistics.

⁴ Moody's, *U.S. Employment Outlook: Seven Full Years of Job Gains*, Analysis by Sophia Koropecjy, 19 January 2017.

Since the Great Recession began in the fourth quarter of 2007, labor productivity has grown just 1.1% per year (chart 10), according to the U.S. Bureau of Labor Statistics (BLS). That is less than half the long-term average rate of 2.3% since 1947. A marked slowdown in productivity gains since the IT-fueled boom of the 1990s and early 2000s, plus the deceleration in labor-force growth as the baby boom generation begins to retire and workforce participation declines, help explain the recent tepid growth trend. Productivity growth rate for the current business cycle is the lowest of the previous ten business cycles (each business cycle begins at the start of a recession, as determined by the National Bureau of Economic Research), sharing this distinction with a brief six-quarter cycle in the early 1980s, which also had 1.1% growth.

Labor productivity is defined as real output per hour of labor, and it grows when output increases faster than hours worked. Labor productivity growth can thus be estimated from the difference in growth rates between the two variables. Both hours worked and output grew at below-average rates during this business cycle, according to BLS data. However, output grew particularly slower than its historical average, and it is the main explanation for the historically low labor productivity growth rate. The average-cycle rate for output growth in the current cycle is 1.4% (chart 10), and it is the second lowest output growth rate of the previous ten cycles. It is 2% below the average-cycle output growth of 3.4%. The growth rate of hours worked during the current business cycle is 0.8% below its average-cycle rate of 1.1%.⁵

CHART 10:
CHANGE IN LABOR PRODUCTIVITY IN THE NONFARM BUSINESS SECTOR DURING BUSINESS CYCLES
(Average annual percent)



Source: U.S. Bureau of Labor Statistics, "Below trend: the U.S. productivity slowdown since the Great Recession" by Shawn Sprague, *Beyond the Numbers*, January 2017| Vol.6 / No. 2.

⁵ See U.S. Bureau of Labor Statistics, "Below trend: the U.S. productivity slowdown since the Great Recession" by Shawn Sprague, *Beyond the Numbers*, January 2017| Vol.6 / No. 2.

Output growth in the current business cycle is low because of both phases of the cycle: the Great Recession and the subsequent recovery. According to the BLS, the decline in output during the Great Recession was the largest of any recession in the post-World War II era, while output growth during the recovery has been the weakest of any recovery since 1947 (see chart 2, page 10). A key aspect of this recovery so far is that not only output growth has been well below historical trend, but it is even further behind the growth rates necessary to overcome the effect of the sharp decline in output during the Great Recession (box 1).

BOX 1: LOW OUTPUT GROWTH AND THE POSSIBILITY OF SECULAR STAGNATION

The current economic recovery has fallen short of the initial predictions that the unusually deep recession that started in the fourth quarter of 2007 would be followed by a rapid recovery, with output and employment returning to trend levels relatively quickly. In 2009, most observers did not expect that U.S. interest rates would stay near zero for seven years and economic growth would still be tepid.

A year ago, Lawrence Summers warned that the key to understanding the lukewarm recovery laid on the concept of *secular stagnation*, first put forward by the economist Alvin Hansen in the 1930s. Hansen thought a slowing of both population growth and technological progress would reduce opportunities for investment. Savings would then pile up unused, he reasoned, and growth would slump unless governments borrowed and spent to prop up demand.⁶ According to Summers, the economies of the industrial world, in this view, “suffer from an imbalance resulting from an increasing propensity to save and a decreasing propensity to invest. The result is that excessive saving acts as a drag on demand, reducing growth and inflation, and the imbalance between savings and investment pulls down real interest rates.”⁷

There are different explanations in the literature – other than the secular stagnation hypothesis – for the combination of historically low growth and low interest rates that has pervaded the current U.S. economic recovery.

Building on the work on the history of financial crises he wrote with Carmen Reinhart, for example, Rogoff attributes the slow output growth to excessive debt buildups and subsequent deleveraging. Robert Gordon, on the other hand, has pointed to the fundamental decline in the rate of productivity growth relative to its golden age from 1870 to 1970. And Ben Bernanke has emphasized the notion of a “savings glut” in the world economy.

A neutral real interest rate that is too low is the core problem of secular stagnation, according to Larry Summers. “This rate, however, cannot be increased through monetary policy. Indeed, to the extent that easy money works by accelerating investments and pulling forward demand, it will actually reduce neutral real rates later on. That is why primary responsibility for addressing secular stagnation should rest with fiscal policy. An expansionary fiscal policy can reduce national savings, raise neutral real interest rates, and stimulate growth.”

More recently, the President of the Federal Reserve of San Francisco, John Williams, released a paper on the decline in the equilibrium real interest rate in the U.S., the concept at the heart of the secular stagnation debate. He concluded that the low equilibrium real interest rate is a global phenomenon, likely to be very persistent and not confined only to safe assets. This means that even a cyclical recovery in demand – as seems to be taking place more recently – especially if confined mainly to the U.S., is unlikely to stop the debate about secular stagnation.

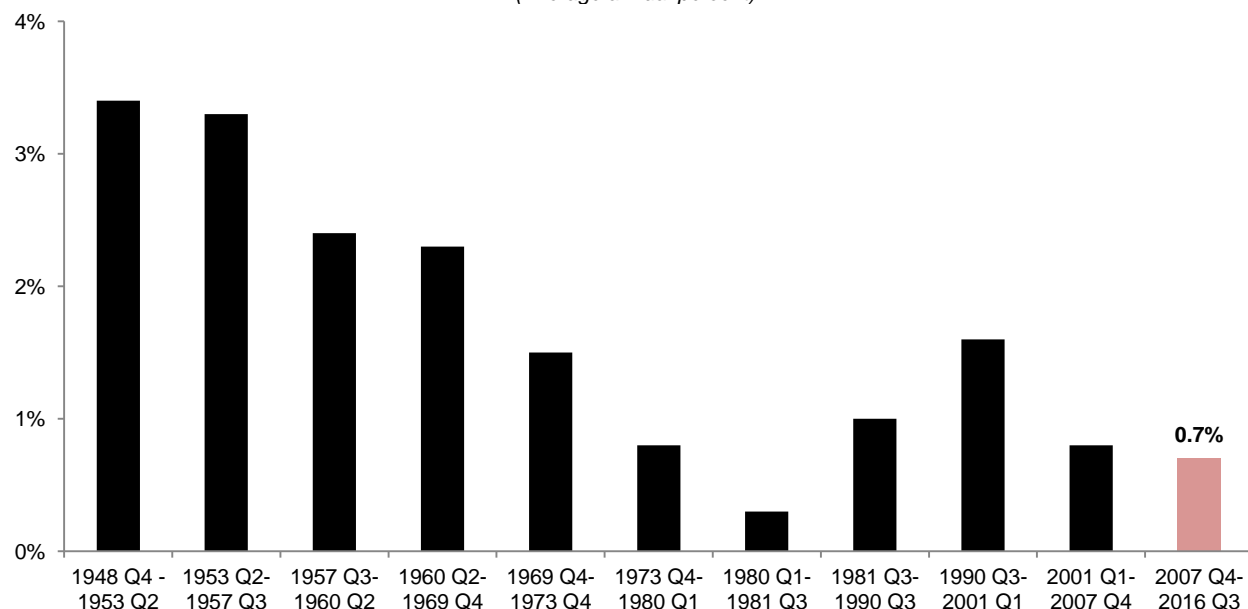
Source: ECLAC with data from several sources.

Sluggish productivity growth has implications for wage growth. Since real hourly compensation growth depends on gains in labor productivity, low labor productivity growth can limit potential gains for workers. During the current business cycle, real hourly compensation has increased 0.7%, which is low by historical standards. The rate is lower than the average-cycle real hourly compensation growth rate of 1.7%, and it is also below the rates of all previous cycles, except for the brief six-quarter cycle in the early 1980s (chart 11). Low wage growth is not constrained to the U.S. economy, however. Wages in 22 advanced economies grew by an average 3.7% a year between 1995 and 2007, but by less than 2% a year between 2008 and 2016, according to Oxford Economics.

⁶ “Secular stagnation” in graphics: Doom and gloom | *The Economist*, by the data team, 20 November 2014, <http://www.economist.com/blogs/graphicdetail/2014/11/secular-stagnation-graphics>

⁷ Lawrence H. Summers (2016), “The Age of Secular Stagnation: What It Is and What to Do About It,” *Foreign Affairs*, 15 February 2016, <http://larrysummers.com/2016/02/17/the-age-of-secular-stagnation/>

CHART 11:
REAL HOURLY COMPENSATION IN THE NONFARM BUSINESS SECTOR DURING BUSINESS CYCLES
(Average annual percent)

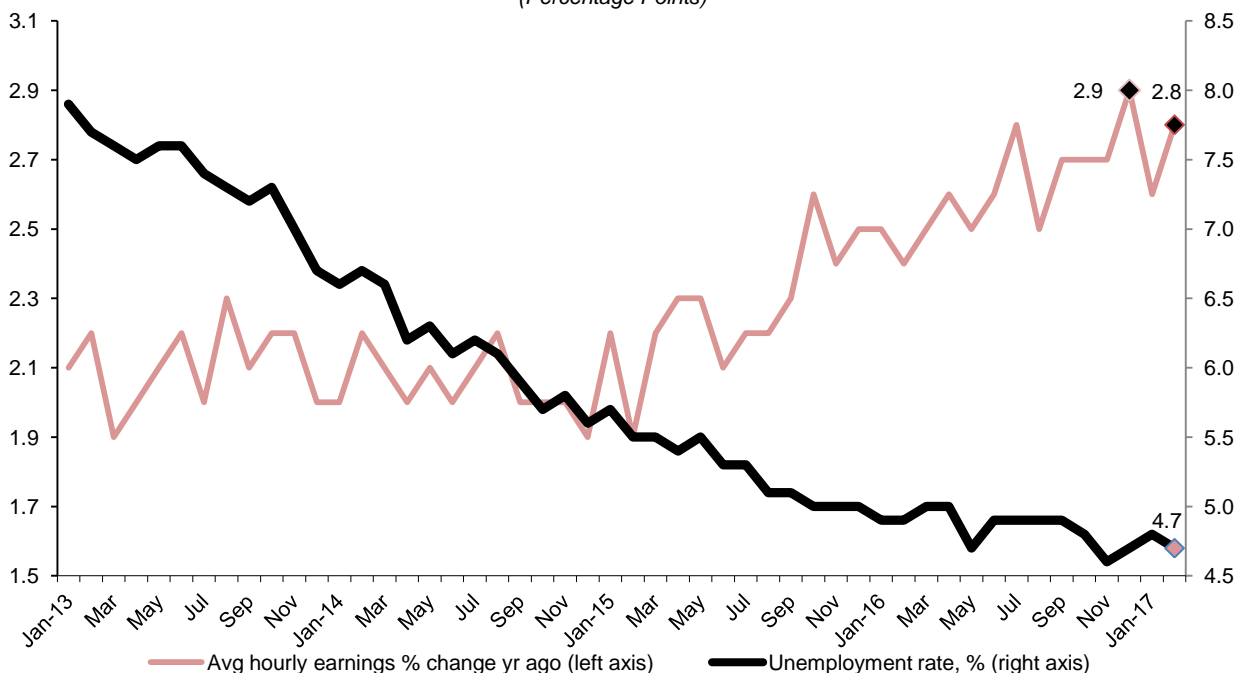


Source: U.S. Bureau of Labor Statistics.

A range of possible explanations have been suggested for why wages are growing at a slower pace. First, the types of jobs that have been created since the crisis are not the same as those lost during the crisis. While jobs were lost primarily in the construction and manufacturing sectors, new jobs have been created in the services sectors. Service-sector jobs such as in trade, transport and business services, the argument goes, tend to not pay as well. Second, the bargaining power of workers may have been eroded due to general economic uncertainty and intensifying global competition from China and elsewhere. Workers have also been changing jobs less frequently, which has been associated with weaker wage growth. Third, some firms may not have been able to cut labor costs as much as they wanted after the crisis, and therefore dragged the adjustment out over time. Public-sector pay has also been squeezed as governments reduced spending, pressuring down average wages and maybe weighing on private-sector pay by proxy.

Finally, the makeup of the labor force may provide another explanation, according to researchers at the Federal Reserve Bank of San Francisco. Low-wage workers were disproportionately fired and firms slowed new hires, what contributed to artificially hold average wages up. As the economy has strengthened, lower-wage workers have been re-entering the workforce, while highly-paid baby boomers have started to retire, putting downward pressure on wages. A better measure of wage growth, the Fed researches suggest, is the pay of workers continuously in full-time work, ignoring those entering and leaving the labor force. That indicator is tracked by the Federal Reserve Bank of Atlanta (the Wage Growth Tracker (WGT)), and it suggests wage growth has been about 1% per year higher since 2014 than is indicated by average hourly earnings. Despite pointing to slower wage growth than the WGT, the steady acceleration in the growth of average hourly earnings seems to confirm that the labor market is slowly approaching full employment (chart 12).

CHART 12:
U.S. LABOR MARKET: SLOWLY APPROACHING FULL EMPLOYMENT
(Percentage Points)



Source: ECLAC, on the basis of data from the U.S. Bureau of Labor Statistics.

C. Four years of historically low inflation

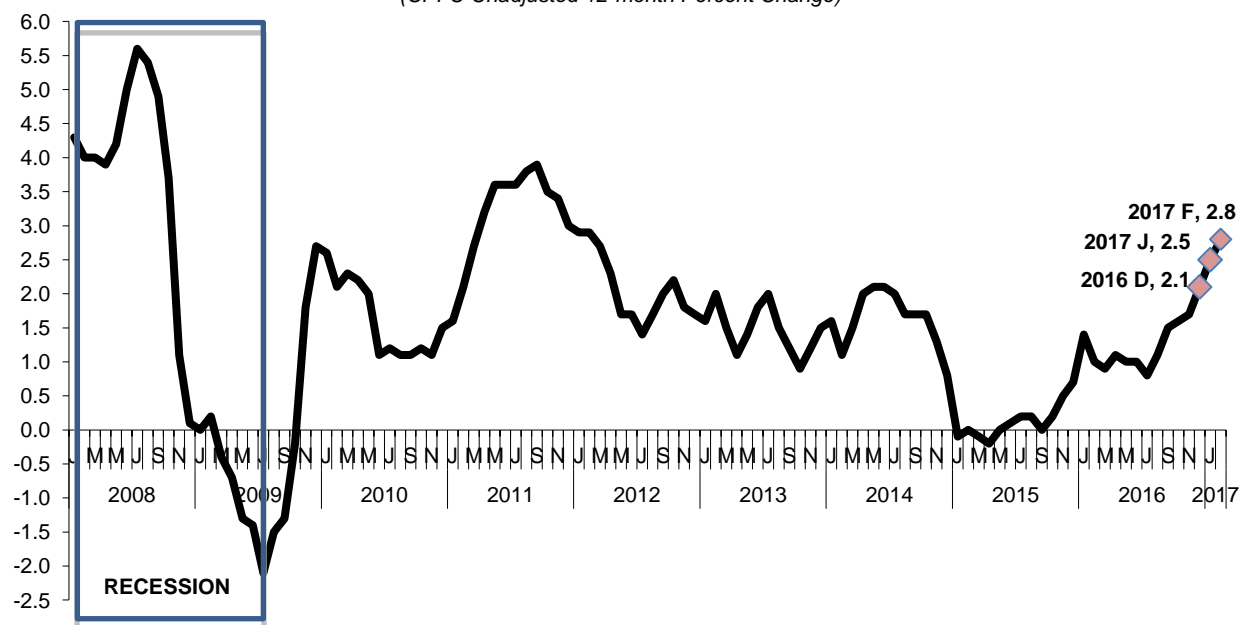
Inflation has been subdued for years amid a stretch of low energy prices and lackluster economic growth. The stunning fall in oil prices, from a peak of US\$ 115 per barrel in June 2014 to under US\$ 35 at the end of February 2016, was a most significant global macroeconomic development. However, after years of fighting against deflationary pressures, the U.S. economy has seen glimmerings of life in consumer prices and wages, suggesting that an era of historically low inflation may be receding. A broad gauge of U.S. wage and benefit costs, the employment-cost index (ECI), rose 2.2% in 2016, according to the Labor Department. The pace of compensation growth stepped up modestly from its average annual growth of 2% since 2010. A separate U.S. measure, average hourly earnings for private-sector workers, as seen in chart 12, rose 2.9% in December from a year earlier. That was the strongest growth of the current expansion.⁸

In a sign of diminished economic slack, the Consumer Price Index for All Urban Consumers (CPI-U) increased 2.8% from a year earlier in February 2017, the largest year-over-year rise since February 2012 and the seventh consecutive monthly increase (chart 13).

As gasoline prices recover from a steep decline, the pace of overall inflation, as measured by the change in the Commerce Department's personal-consumption expenditures price (PCE) index is also rising, despite remaining short of the Federal Reserve's 2% target. It has undershot the central bank's threshold for the past 4½ years. As measured by the PCE index, U.S. inflation gained 1.6% from a year earlier in December 2016, the largest gain since July 2014 (chart 14).

⁸ In January 2017, however, average hourly earnings rose at a year-on-year rate of 2.5% (a slowdown from the 2.9% in December, and below estimates of 2.7%), but edged higher again in February 2017, to 2.8% (chart 12).

CHART 13:
U.S. DOMESTIC PRICES: MONTHLY EVOLUTION
(CPI-U Unadjusted 12-month Percent Change)



Source: ECLAC, on the basis of data from the U.S. Bureau of Labor Statistics.

CHART 14:
U.S. DOMESTIC PRICES: ANNUAL EVOLUTION
(Percentage change in the 12-month period ended in December)



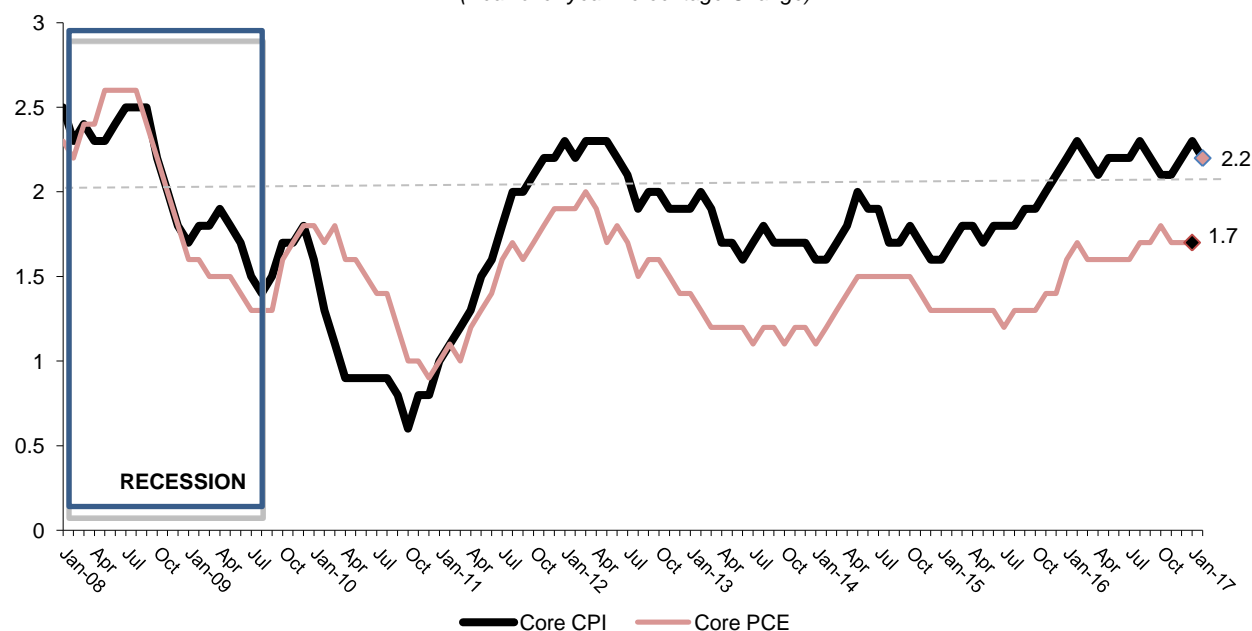
Source: ECLAC, on the basis of data from the U.S. Bureau of Labor Statistics.

The CPI index is used to adjust social security payments and is also the reference rate for some financial contracts, such as Treasury Inflation Protected Securities (TIPS) and inflation swaps. The Federal Reserve, however, states its goal for inflation in terms of the PCE.

The CPI and PCE indexes frequently diverge because they are constructed differently. While the weights in the CPI basket change only every few years, the PCE's change each month, better capturing consumers' tendency to shift from more expensive commodities and outlets to cheaper ones. The CPI is based on a survey of what households are buying; the PCE is based on surveys of what businesses are selling. The CPI's weights are determined by what consumers say they spend, whereas the PCE index is based on what they actually spend, or what is spent on their behalf, such as the employer's portion of health insurance, and what the federal government spends on Medicare. As a result the CPI assigns much more weight to rent and housing and much less to health care, and when housing prices are rising, the CPI reading is higher than the PCE reading. PCE inflation over time typically runs about 0.3% below CPI inflation.⁹

Excluding food and energy, the CPI rose 2.2% from a year earlier in February 2017, the fifteenth consecutive month that annual core inflation exceeded 2%. The most closely watched measure by the Federal Reserve – the Personal Consumption Expenditure (PCE) core price index – increased at an annualized 1.7% in January 2017, the latest data available. January marked the 57th consecutive month in which prices as measured by the core PCE index have fallen short of the Fed's 2% annual target (chart 15), but Fed officials forecast that core inflation is set to be 1.9% in 2017 and 2% in the two following years. Like the headline measures, core CPI tends to show higher inflation than core PCE.

CHART 15:
U.S. CORE CONSUMER PRICE INDICES
(Year-over-year Percentage Change)



Source: ECLAC, on the basis of data from the U.S. Bureau of Labor Statistics (BLS) and the Bureau of Economic Analysis (BEA).

⁹ See U.S. Bureau of Labor Statistics, "Differences between the Consumer Price Index and the Personal Consumption Expenditures Price Index" *Focus on Prices and Spending. Consumer Price Index: First Quarter 2011*, May 2011, Volume 2, Number 3 <https://www.bls.gov/opub/btn/archive/differences-between-the-consumer-price-index-and-the-personal-consumption-expenditures-price-index.pdf> and "The divergence between CPI and PCE prices" by G.I., *The Economist*, 29 March 2015 <http://www.economist.com/blogs/freeexchange/2013/03/divergence-between-cpi-and-pce-prices>

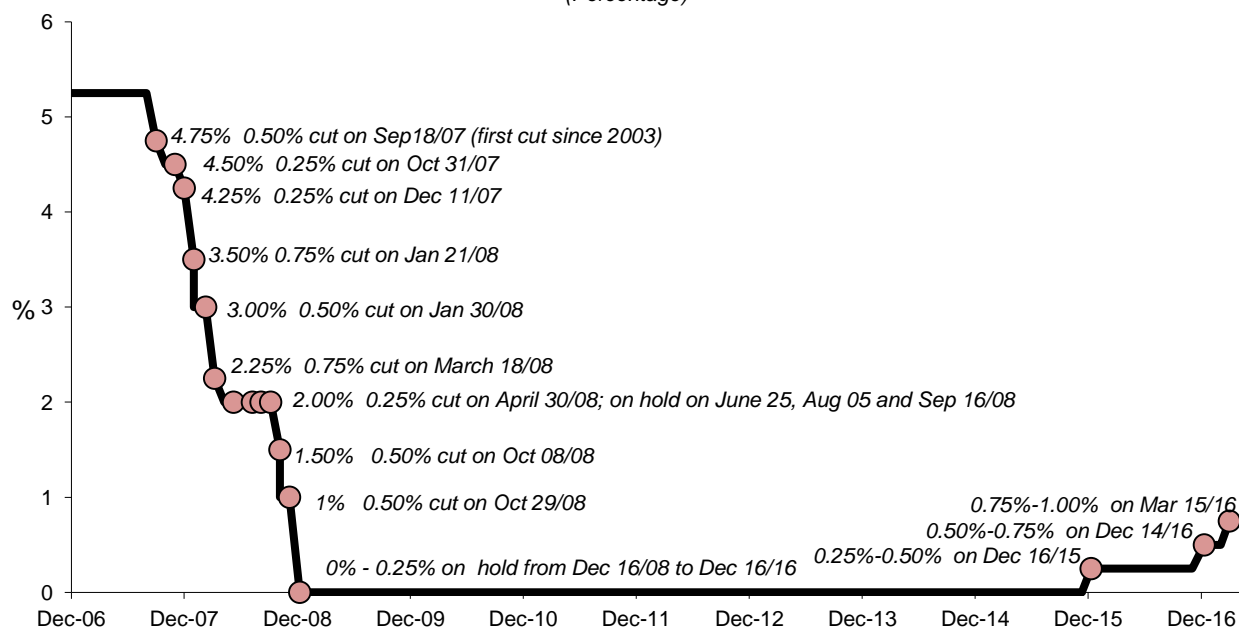
D. An accommodative monetary policy

The current U.S. expansion has been supported by a cautious and highly accommodative Federal Reserve, which included three rounds of asset-purchase programs, known as quantitative easing. In the late summer of 2013, serious discussions began within the Fed about the "tapering" of quantitative easing so that the exit from this policy could be incremental and, it was hoped, not disrupt the banking system. The tapering of Federal Reserve security purchases began in February 2014 and ceased at the end of October 2014. The balance sheet of the Fed in October 2014 totaled about US\$ 4.5 trillion, and the "excess reserves" in the banking system amounted to about US\$ 2.8 trillion.

Following the end of tapering, officials at the Fed changed their focus to the need to get interest rates back to more "normal" levels. The Fed held the federal funds rate target range at 0% to 0.25% for seven years, from December 2008 to December 2015. In December 2015 the Fed increased interest rates by 25-basis points, the first increase since the crisis. It increased interest rates by other 25-basis points one year later, in December 2016, and in March 2017 it increased interest rates for a third time (chart 16).

The Federal Open Market Committee (FOMC) raised the federal funds rate target range by a quarter-point to 0.75%-1.00% in its March 14-15 2017 meeting. The Committee delivered the widely expected increase and said the domestic economy remained on a path of slow and steady growth. In its post-meeting statement, the Fed signaled it was getting more confident about inflation, noting that headline PCE has moved close to its 2% objective (it was at 1.9% in January), even if its favored measure of core inflation remains lower. Inflation as measured by the personal consumption expenditures price index excluding food and fuel was at 1.7% in January, not too far from the Fed's 2% target. Fed officials also highlighted solid job gains. February's 4.7% unemployment rate is below the Fed policymakers' median estimate of its long-run rate. Besides employment and inflation data that are approaching the Fed's targets, other factors that are supporting Fed officials' confidence include a perceived reduction in risks overseas, at least for the time being, and a cheerful mood in stock markets.

CHART 16:
U.S. FEDERAL FUNDS TARGET RATE
(Percentage)



Source: ECLAC, on the basis of data from the U.S. Federal Reserve.

The FOMC said it will keep lifting short-term interest rates later this year (policymakers forecast two more quarter-point rate increases in 2017), signaling it is moving into a new phase in which it will more aggressively withdraw easy money from the financial system as the economy improves. The country's largest borrower, the federal government, will feel the pinch of higher rates. Federal interest payments, measured as a share of the economy, are expected to double over the next decade, according to the Congressional Budget Office.

E. Fiscal policy during the expansion

In early 2009 the U.S. Congress, at the request of then President Obama, approved a large temporary stimulus package – the American Recovery and Reinvestment Act of 2009 (ARRA) – to end in 2011. Fueled by the 2009 federal stimulus package, discretionary fiscal policy was expansionary in 2009-10, adding to growth during the first year of the recovery at roughly the same pace that fiscal policy had achieved in previous recoveries.

In response to concerns that the recovery was faltering, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 was passed by Congress and signed by the President. It included an extension for two years of the previous administration's tax cuts, a 2% cut in the payroll tax during 2011, a 13-month extension of unemployment benefits, and allowance for more rapid expensing of business investment in 2011. However, a major counterforce to the federal stimulus policies was the contraction of spending by state and local governments.

In 2013, federal fiscal policy reversed course and shifted towards austerity. The fiscal tightening resulted from automatic spending cuts (the sequester),¹⁰ enacted by the Budget Control Act of 2011, and the expiration of the 2% cut in payroll taxes at the end of 2012, as well as of tax cuts for incomes above certain thresholds. Caps on discretionary federal spending and increases in taxes contributed to a tightening in federal fiscal policy since then.

BOX 2: FISCAL POLICY DURING THE CURRENT EXPANSION IN HISTORICAL CONTEXT

Since the Great Recession total government spending has behaved unusually both in its greater volatility and in its slow growth, according to Bognanni and Millington (2015), who have looked at the recent U.S. fiscal trends in historical context.

Between 1957 and 2006 real government spending increased by an average of 3.81% per year with a standard deviation of the growth rates of government spending (a measure of variability) at 1.92%, and there was never a single year in which real government spending declined.

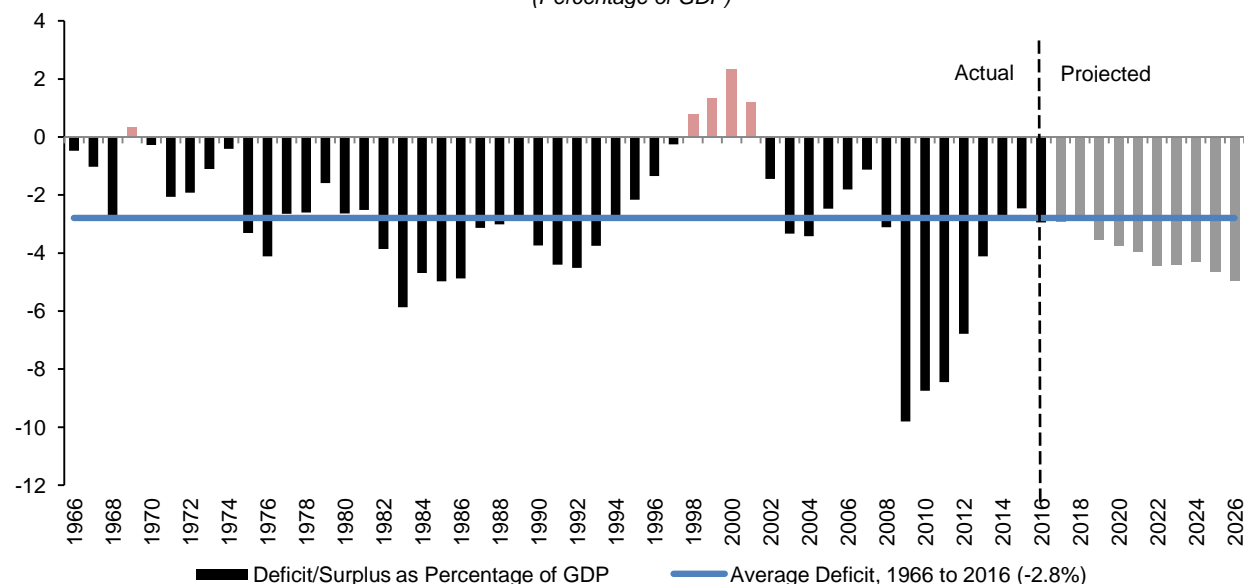
From 2007 onwards, in contrast, real government spending has increased by an average of only 1.94% per year. The standard deviation of the rates of change increased to 2.80%, and declines occurred in three out of eight years, although they followed an increase of 6.15% from 2008 to 2009, which was the largest single year increase since 1966-67, according to the authors.

Source: Mark Bognanni and Sara Millington, "US Fiscal Policy: Recent Trends in Historical Context," *Economic Trends*, Federal Reserve Bank of Cleveland, 14 July 2015.

The federal budget deficit has had seven years of declines, but has been projected to swell again, adding nearly US\$ 10 trillion to the federal debt over the next ten years, according to projections from the nonpartisan Congressional Budget Office (CBO). Deficits as a percentage of GDP are projected to exceed their 50-year average (chart 17).

¹⁰ The budget sequestration in 2013 refers to the automatic cuts to United States federal government spending that were initially set to begin on 1 January 2013 as a result of the Budget Control Act of 2011 (BCA), and were postponed by two months by the American Taxpayer Relief Act of 2012 until 1 March 2013, when this law went into effect.

CHART 17:
U.S. DEFICITS AND SURPLUSES
(Percentage of GDP)

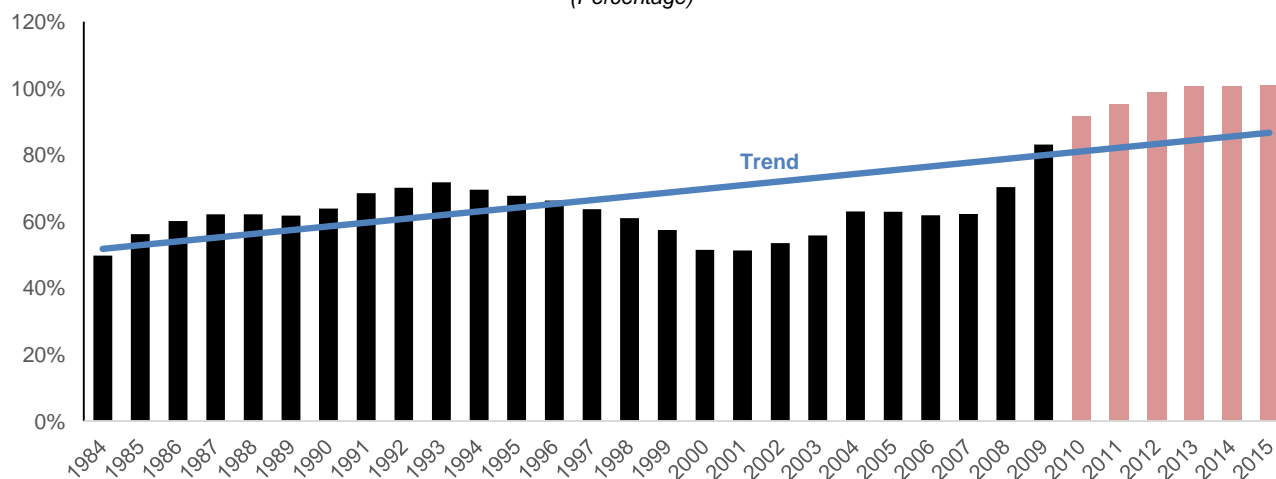


Source: Congressional Budget Office, "The Budget and Economic Outlook: 2017 to 2027."

Three factors are to be the main drivers of the higher federal deficit: an aging population that is expected to increase spending on Social Security and Medicare; the rising cost of providing healthcare, which will raise the program costs of Medicare and Medicaid; and a normalization of monetary policy, which should boost net interest payments.

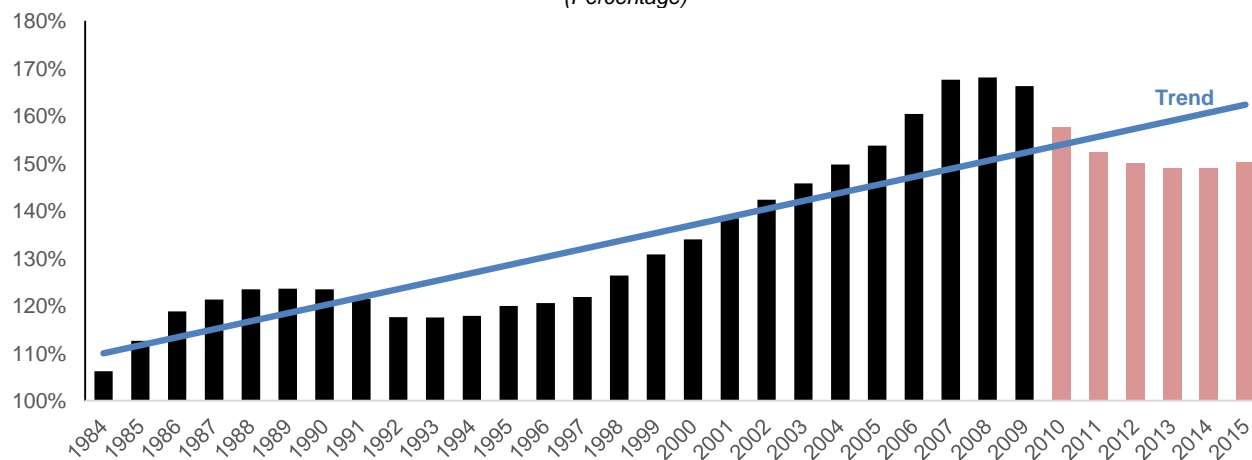
Although the economic recovery has brought increased tax revenues and stabilized deficits, government debt remains elevated and its debt-to-GDP ratio has been above-trend (chart 18). The domestic private sector debt-to-GDP ratio, on the other hand, is below-trend, suggesting that thus far there are no immediate threats arising from real excesses/unbalances in the economy (chart 19).

CHART 18:
U.S. GOVERNMENT DEBT AS A SHARE OF GDP, 1984-2015
(Percentage)



Source: ECLAC with data from the Federal Reserve Board of Governors Z1 D.3 Outstanding Debt by Sector (government debt comprised by federal, state and local debt).

CHART 19:
U.S. DOMESTIC PRIVATE SECTOR DEBT AS A SHARE OF GDP, 1984-2015
(Percentage)

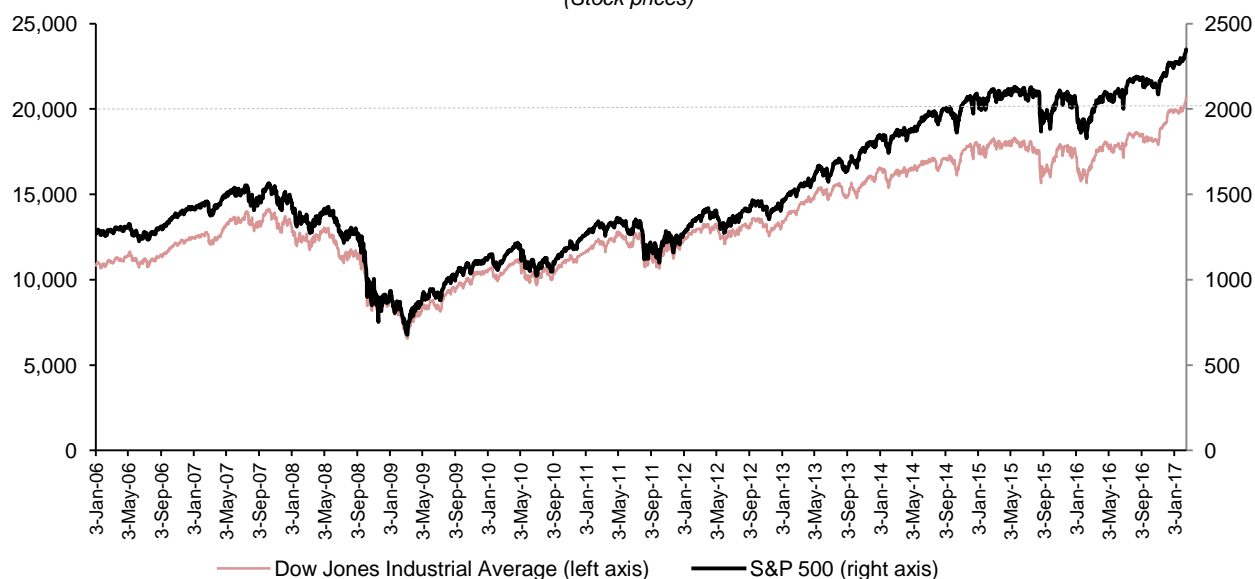


Source: ECLAC with data from the Federal Reserve Board of Governors Z1 D.3 Outstanding Debt by Sector (domestic nonfinancial private sector total).

F. Buoyant markets

The U.S. economic expansion has been supported by buoyant financial markets. In March 2017 the bull market in stocks officially turned eight years old.¹¹ The current bull market is the third-longest since World War II. The 1987 to 2000 bull market during the dot-com era lasted 12 years and four months. The 1949 to 1957 post-World War II bull market lasted eight years, one month. The S&P 500 has more than tripled since its low point on 9 March 2009. The surge reflects the U.S. recovery from the Great Recession (chart 20).

CHART 20:
DOW JONES INDUSTRIAL AVERAGE AND S&P 500 DAILY CLOSING PRICES, 2006-2017
(Stock prices)



Source: ECLAC with data from Dow Jones & Company, Inc., and Standard & Poor's.

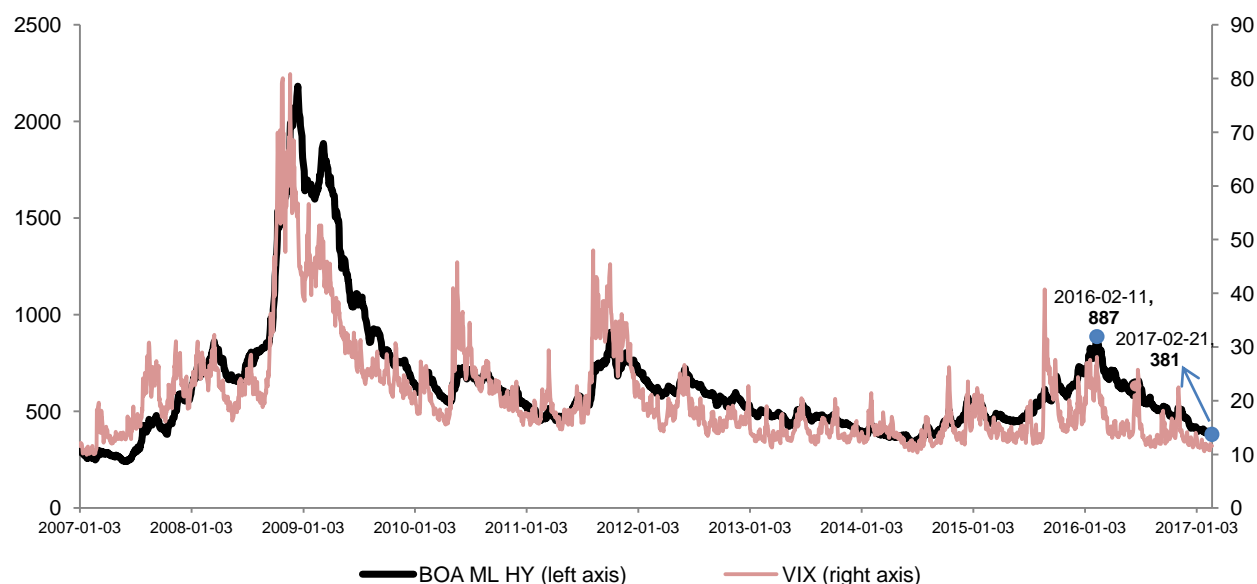
¹¹ A bull market is commonly defined as a 20% rise in the S&P 500 after a 20% decline. A bull market ends with another 20% decline.

The results of the U.S. elections in November ignited a steep rally in financial markets, pushing up equities, longer-term interest rates, and the dollar. The S&P 500 financials sector got a strong boost from the election amid expectations of a loosening in regulations, faster economic growth and reduced taxes. Those factors are bullish for banks because of their sensitivity to the overall economy, and have also led to anticipation that interest rates may begin to rise more quickly, which would be a boon to the bottom lines of banks, insurers and other groups in the financial sector. On 9 February 2017, the S&P 500 powered through the 2,300 level for the first time in history.

On 25 January 2017 the Dow Jones Industrial Average hit 20,000 for the first time, another milestone in the U.S. stock market's postelection rally. The Dow industrials have surged, buoyed by investors' bets that policies that could improve the outlook for U.S. companies will be pursued.

Investors in both the bond and stock markets are diving in at prices that are near multiyear highs. U.S. corporate bonds yields are the thinnest in more than two years, offering investors little cushion from losses. Inflows into riskier junk bonds have been substantial, and spreads have been declining. A year ago, after crude-oil prices plunged to 12-year lows and weakened the credit of energy-sector bond issuers, junk-bond investors demanded 8.9% more in yield over comparable Treasury notes, more than double the current spread (chart 21).

CHART 21:
BOFA-MERRILL LYNCH U.S. HIGH YIELD OPTION-ADJUSTED SPREAD
(Basis Points)

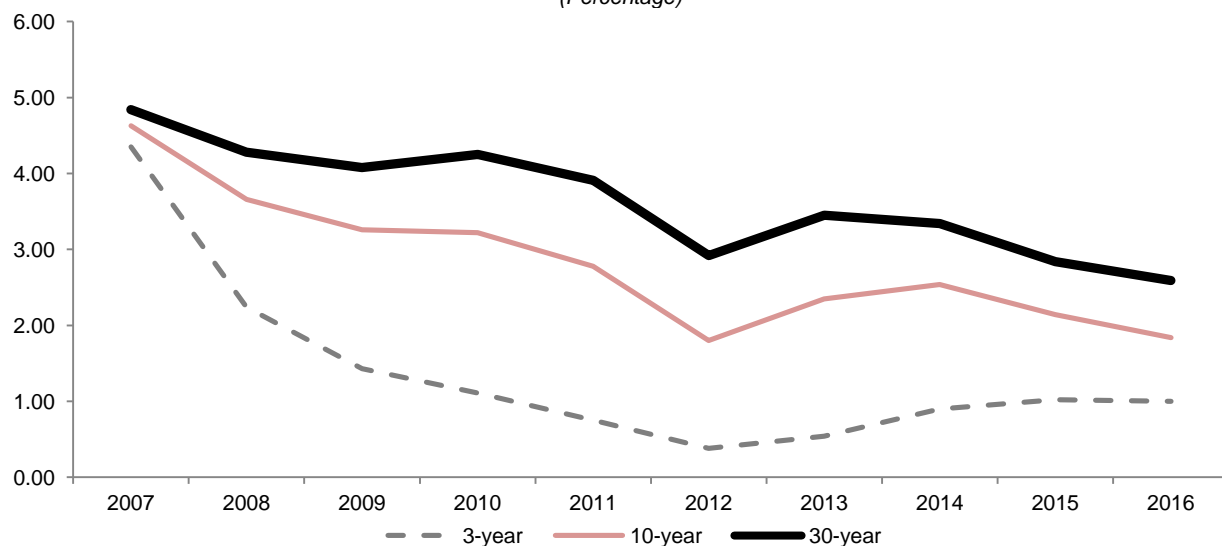


Source: ECLAC with data from St. Louis Federal Reserve FRED Economic Data and the Chicago Board Options Exchange.

Junk bond spreads have had a strong relationship with stock volatility, as measured by the Chicago Board Options Exchange (CBOE) Volatility Index (VIX), over the past 20 years, and both junk-bond spreads and VIX readings are at multiyear lows. Investors say recent demand for risky assets, including equities and corporate bonds, reflects a brightening outlook for the U.S. economy and the reality that Treasury bonds seem acutely vulnerable to rising interest rates.

In general, Treasury securities are seen as the safe alternative to risky investments. Fear and uncertainty about the global economy led investors to embrace the relative safety of U.S. government debt for most of the U.S. expansion, bringing Treasury yields to record lows. From 2007 to 2016 the yield for the 3, 10 and 30-year Treasury securities declined by 77%, 60% and 46%, respectively (chart 22).

CHART 22:
3, 10 AND 30-YEAR ANNUAL TREASURY SECURITY YIELDS
(Percentage)

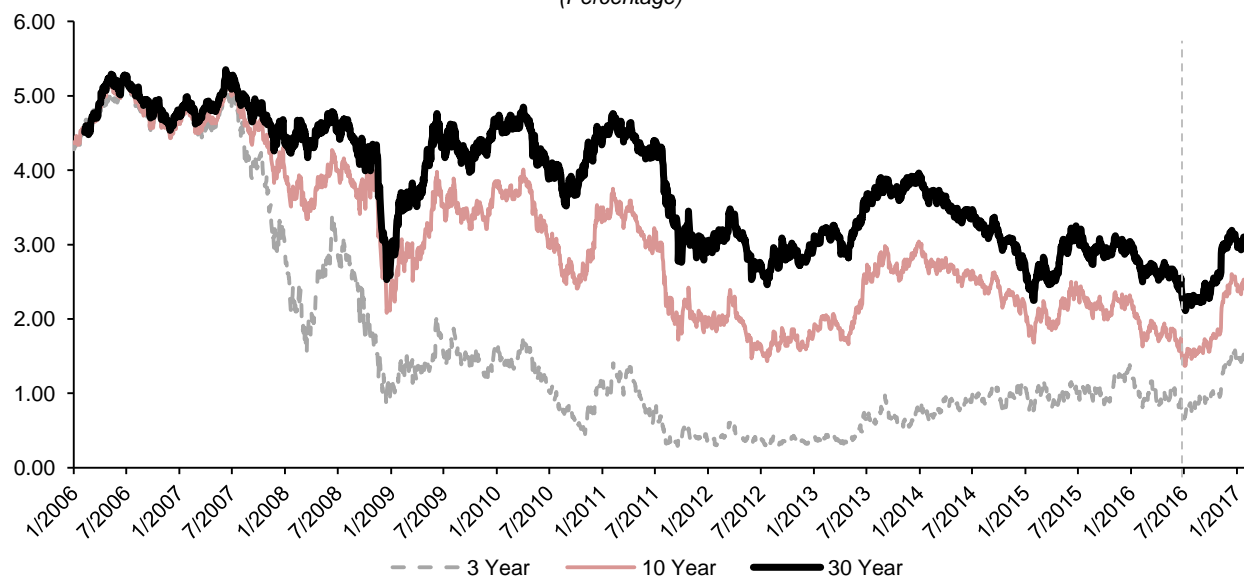


Source: U.S. Treasury Department.

Investors in Treasury bonds include pensions, foreign banks, private banks, and individuals. As with any market, supply and demand are the forces at work. The higher the demand for government debt, the higher the price and the lower the yield. The Federal Reserve also influences yields by buying and selling Treasury securities (what it did through its asset purchases programs), not to mention by influencing inflation expectations.

Since July of last year, however, U.S. Treasury security yields have been rising, reflecting optimism about the U.S. economy. After reaching a high of 2.9% in mid-December, the Treasury securities' market has stabilized, with the 10-year benchmark easing to around 2.4% (chart 23, table 4).

CHART 23:
3, 10 AND 30-YEAR DAILY TREASURY SECURITY YIELDS
(Percentage)



Source: U.S. Treasury Department.

**TABLE 3:
U.S. STOCK PRICES AND TREASURY SECURITY YIELDS**

STOCK PRICES				U.S. TREASURY SECURITY YIELDS			
Monthly Stock Prices				Monthly Yields			
	Dow Jones	S&P 500	Nasdaq		3-year	10-year	30-year
2015				2015			
January	17,542.26	2,028.18	4,673.70	January	0.90	1.88	2.46
February	17,945.41	2,082.20	4,854.26	February	0.99	1.98	2.57
March	17,931.75	2,079.99	4,938.01	March	1.02	2.04	2.63
April	17,970.51	2,094.86	4,985.95	April	0.87	1.94	2.59
May	18,124.71	2,111.94	5,029.94	May	0.98	2.20	2.96
June	17,927.22	2,099.28	5,073.04	June	1.07	2.36	3.11
July	17,795.02	2,094.14	5,082.14	July	1.03	2.32	3.07
August	17,061.59	2,039.87	4,934.62	August	1.03	2.17	2.86
September	16,339.95	1,944.40	4,748.00	September	1.01	2.17	2.95
October	17,182.28	2,024.81	4,879.04	October	0.93	2.07	2.89
November	17,723.77	2,080.62	5,082.51	November	1.20	2.26	3.03
December	17,542.86	2,054.08	5,040.54	December	1.28	2.24	2.97
2016				2016			
January	16,305.25	1,918.60	4,610.71	January	1.14	2.09	2.86
February	16,299.90	1,904.42	4,463.21	February	0.90	1.78	2.62
March	17,302.14	2,021.95	4,754.48	March	1.04	1.89	2.68
April	17,844.37	2,075.54	4,892.17	April	0.92	1.81	2.62
May	17,692.32	2,065.55	4,788.24	May	0.97	1.81	2.63
June	17,754.87	2,083.89	4,856.23	June	0.86	1.64	2.45
July	18,341.18	2,148.90	5,023.99	July	0.79	1.50	2.23
August	18,495.19	2,177.48	5,217.04	August	0.85	1.56	2.26
September	18,267.40	2,157.69	5,254.15	September	0.90	1.63	2.35
October	18,184.55	2,143.02	5,255.99	October	0.99	1.76	2.50
November	18,697.33	2,164.99	5,260.57	November	1.22	2.14	2.86
December	19,712.42	2,246.63	5,413.12	December	1.49	2.49	3.11
2017				2017			
January	19,908.15	2,275.12	5,561.42	January	1.48	2.43	3.02

Source: Economic Indicators, U.S. Government

G. Trade gaps and a strengthening dollar

The interplay between trade, growth and employment is complex. The U.S. has run trade deficits for decades, during periods of expansion and low unemployment, like now, as well as during recessions and high unemployment (chart 24).

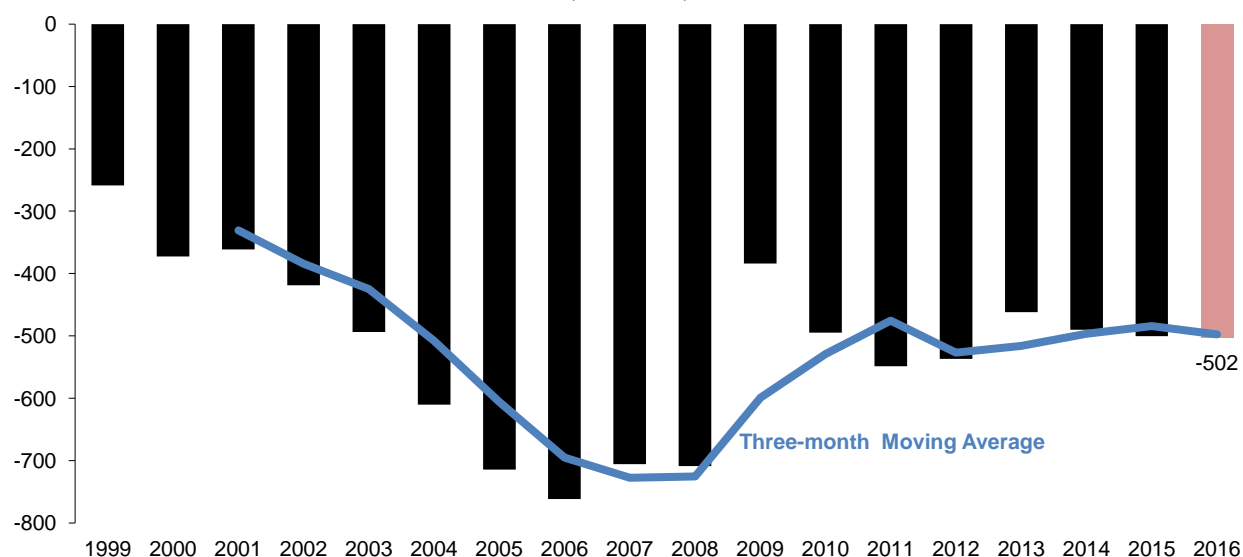
In 2016, the U.S. trade deficit rose modestly from the prior year to US\$ 502 billion, its highest dollar level since 2012. But it shrank slightly to 2.7% as a share of GDP, after reaching 2.8% in 2013 through 2015 (chart 25).

The slight increase in the trade deficit in 2016 came in the face of a stronger U.S. dollar. The US Dollar Index (USDXY, DXY) is an index (or measure) of the value of the United States dollar relative to a basket of foreign currencies. The USDXY goes up when the U.S. dollar gains "strength" (value) when compared to other currencies.

The U.S. dollar has been strengthening since 2014 (chart 26) and as of the beginning of February 2017 had appreciated 23% since July 2014 according to Federal Reserve data. The Fed's tightening of monetary policy should strengthen the dollar, with a differential impact on exports and imports, as

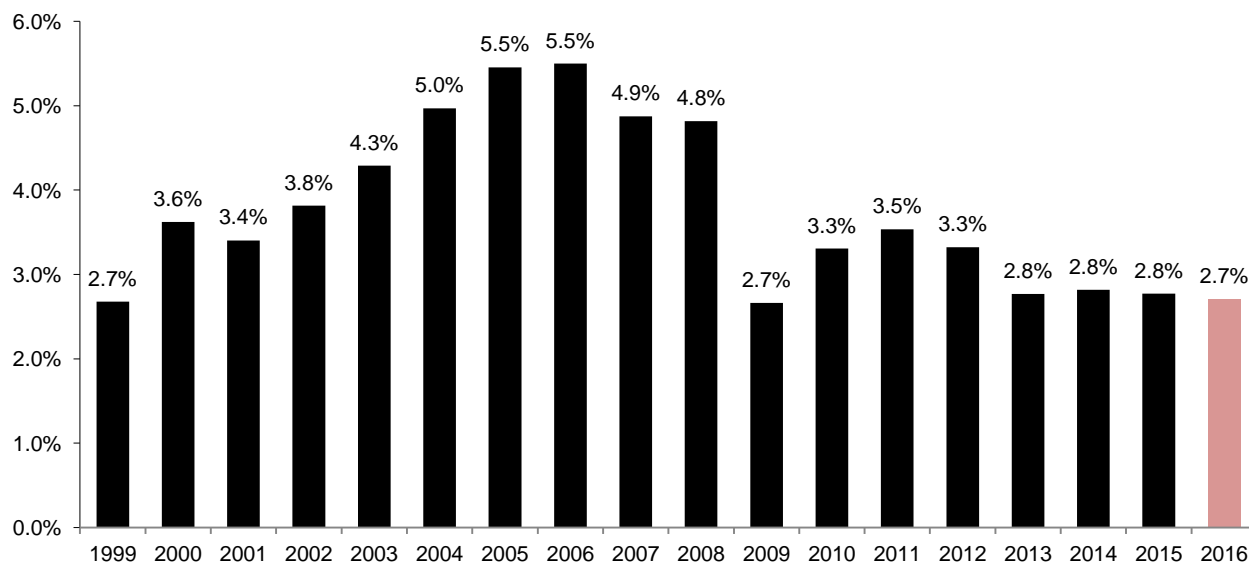
imported goods become relatively cheaper in the domestic market. The stronger dollar also lowers the value of repatriated assets from overseas investments. It may also encourage transfer payments abroad as remittances based in U.S. dollars gain in value.

CHART 24:
ANNUAL U.S. BALANCE ON GOODS AND SERVICES TRADE
(US\$ Million)



Source: ECLAC, on the basis of data from the Bureau of Economic Analysis, U.S. Commerce Department.

CHART 25:
ANNUAL U.S. BALANCE ON GOODS AND SERVICES TRADE AS A SHARE OF GDP
(Percentage)



Source: ECLAC, on the basis of data from the Bureau of Economic Analysis, U.S. Commerce Department.

CHART 26:
U.S. DOLLAR INDEX
(USD_{DX})

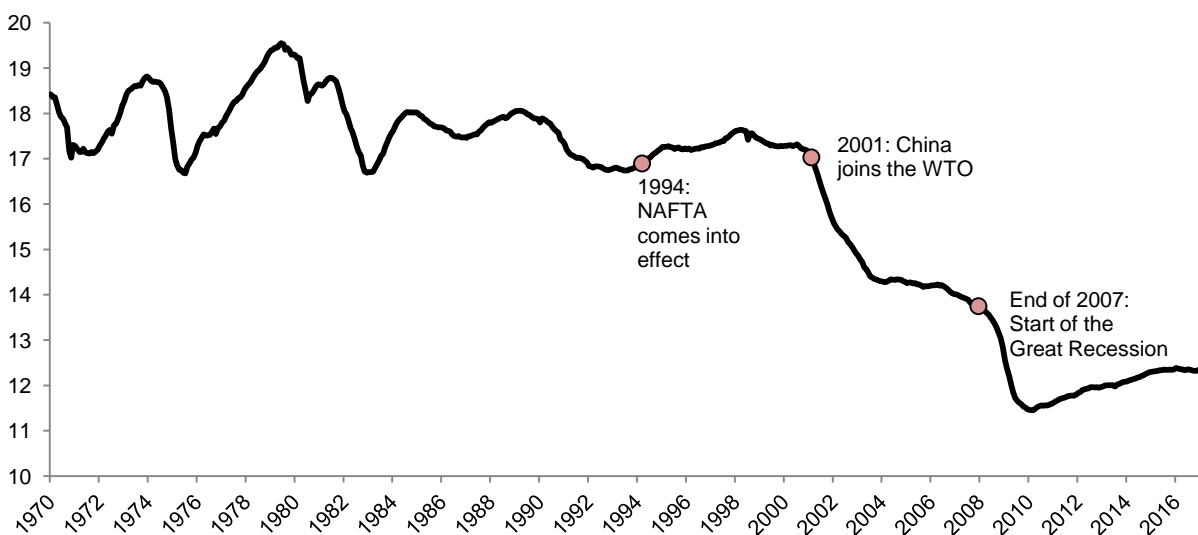


Source: ECLAC, on the basis of data from Investing.com, <https://www.investing.com/quotes/us-dollar-index-historical-data>

H. U.S. manufacturing: output is up, but not employment

The U.S. economy has lost some 5 million manufacturing jobs since 2000, a decline of nearly 30%, to 12.4 million jobs. There has been a substantial recovery since the depths of the Great Recession, but nothing on a scale that could reverse the preceding decades' losses (chart 27).

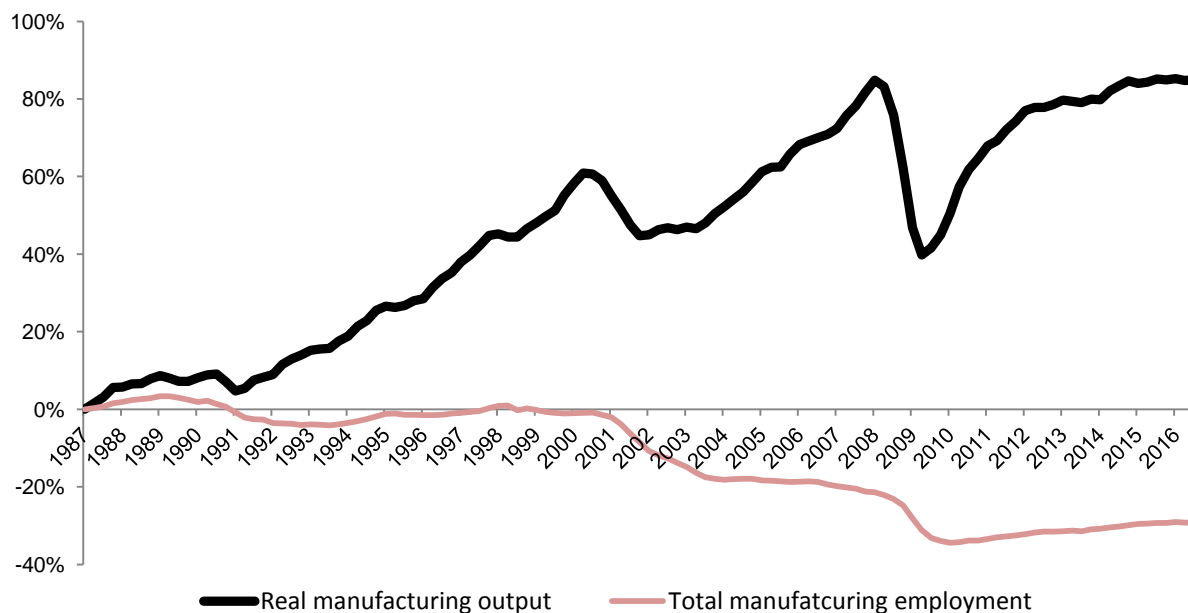
CHART 27:
U.S. MANUFACTURING EMPLOYMENT
(Millions of persons)



Source: ECLAC, on the basis of U.S. Bureau of Labor Statistics (BLS) via Federal Reserve Economic Data | FRED | St. Louis Fed <https://fred.stlouisfed.org/> and Business Insider ("There is a huge hole in Trump's promise to bring back US manufacturing jobs" by Pedro Nicolaci da Costa, 18 March 2017).

U.S. manufacturing employment has been declining since a 1970 peak, a drop that accelerated after China's entry into the World Trade Organization, but not after the U.S. entered the North American Free Trade Agreement with Mexico and Canada in 1994. That fits a nationwide pattern of manufacturing output hitting record highs in recent years, even as manufacturing employment continues its steady decline (chart 28).

CHART 28:
U.S. MANUFACTURING: OUTPUT VS EMPLOYMENT
(Percent change from Q1 1987)



Source: ECLAC, on the basis of U.S. Bureau of Labor Statistics (BLS) via Federal Reserve Economic Data | FRED | St. Louis Fed <https://fred.stlouisfed.org/> and Business Insider "There is a huge hole in Trump's promise to bring back US manufacturing jobs" by Pedro Nicolaci da Costa, 18 March 2017

There has been a vigorous debate in recent years regarding the reasons for the job losses in manufacturing. Those losses have been attributable, among other factors, to the role of automation, outsourcing and trade competition (particularly the rise in import competition from China over the period 1999 to 2011), although there is not yet an agreement on the main culprit.

II. The prospect of a shift in U.S. monetary policy and what it means for EMs

The current U.S. economic expansion has been supported by very low interest rates and loose monetary policy, which together with the accommodative stance of other advanced economies' central banks, has made yields in emerging markets attractive to investors. However, U.S. monetary policy is already turning a corner, as the March rate increase attests.

As mentioned earlier, interest rates have been increased by 25 basis points three times since the end of 2015. While the Fed waited a year between the first rate increase during this expansion (in December 2015) and the second (in December 2016), the third increase (in March 2017) came at a faster pace. The key question regarding U.S. monetary policy is what the pace of future rate increases will be.

The latest Fed projections, made in March 2017, suggest two more quarter-point increases in interest rates this year. The median interest rate projection for the end of 2017 was centered at 1.375% and at 2.125% in 2018, unchanged from the December's projections, implying three more quarter-point increases next year. Projections for rate increases edge up slightly after that, with median expectation showing rates at 3% by the end of 2019, a little higher than before. The median projection for the long-term equilibrium fed funds rate remained at 3%.

The Federal Reserve's projections signal the central bank is moving into a new phase in which it will more aggressively withdraw easy money from the financial system as the economy improves. This new stage of monetary policy is being driven by a Federal Reserve more focused than it has been in the past on the probability that the economy will outperform its forecasts, more confident that the economy has neared its goals of low unemployment and price stability.

This new phase for the Fed could pose hard new questions, including when the Federal Reserve will start to trim its balance sheet. Federal Reserve officials agreed at their March policy meeting they would likely begin shrinking their portfolio of Treasury and mortgage securities later this year, according to the minutes of the meeting. While the Fed ended its bond buying in 2014, it has been reinvesting cash from maturing debt via Treasury debt auctions. The Fed's holdings of Treasury securities stood at US\$ 2.5 trillion for the week of January 25, 2017, more than five times its level at the end of 2008, according to data from the Federal Reserve. The Fed also had agency mortgage-backed securities worth US\$ 1.7 trillion.

The average maturity of the Federal Reserve's US\$ 4 trillion-plus bond portfolio is falling, however, a process that, over the course of 2017, may have the same impact on benchmark bond yields as two short-term rate increases of 25 basis points, according to Fed Chair Janet Yellen.¹² The average duration of the Fed's portfolio, excluding mortgage-backed securities, fell to just over six years at the end of January 2017 from 7.5 years at the end of 2013, according to Deutsche Bank, a result of debt getting closer to maturity and the way matured debt has been reinvested. This suggests monetary policy is tightening, while the currently negative real fed-funds rate (the policy rate minus realized inflation) suggests it is still accommodative.

Changes in the federal funds rate affect the U.S. dollar and thus have an impact on the global economy and emerging markets. When the Federal Reserve increases the federal funds rate, it normally reduces inflationary pressure and works to appreciate the dollar. The U.S. dollar has been gradually gaining strength for years, and has surged strongly since November, prompted by the prospect of a shift in the economic-policy mix in the United States.

When the dollar rises, so does the cost of servicing dollar debts. Emerging market countries and corporations have increased their dollar debt for more than a decade and now may face a spike in servicing costs and elevated debt burdens. According to the Bank for International Settlements (BIS), 10% of dollar-denominated corporate debt in emerging markets is set to mature this year.

The impact of a stronger dollar may stretch beyond its direct effect on dollar borrowers, since low cost external borrowing has in many cases led to an increase in the supply of local credit as well. Capital inflows push up local asset prices, encouraging further borrowing. As the dollar strengthens, capital starts to flow out and asset prices to fall.

So far, credit and equity market reactions in emerging market economies have been more muted than during the taper tantrum of 2013. Latin America and the Caribbean's new debt issuance in cross-border markets, for example, reached a historic peak of US\$ 24.2 billion in January 2017, breaking the previous monthly record of US\$ 23.6 billion in January 2014, according to ECLAC estimates on the basis of data from LatinFinance. In the first quarter of 2017, total cross-border issuance reached US\$ 45.4 billion, the region's second highest quarterly issuance ever, lower only than the US\$ 45.7 billion issued in the second quarter of 2016, when Argentina came back to international markets with a jumbo issuance after a 15-year hiatus.

¹² Chair Janet L. Yellen At the Stanford Institute for Economic Policy Research, Stanford University, Stanford, California, *The Economic Outlook and the Conduct of Monetary Policy*, January 19, 2017, footnote #17, <https://www.federalreserve.gov/newsevents/speech/yellen20170119a.htm>



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