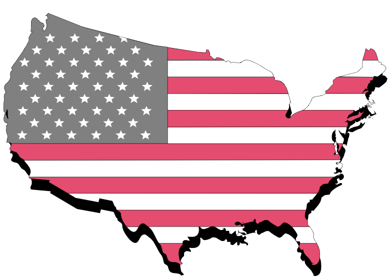
Another Try at Comfortable Deceleration

Lawrence S. Davidson

Professor of Business Economics and Public Policy and Director, Global Business Information Network, Kelley School of Business, Indiana University, Bloomington



You move into the passing lane, push the accelerator a little harder, make your pass, and then return to a comfortable, sustainable speed. The pass may have been necessary or exciting but it is good to be traveling at the right speed again. With the United States economy growing at more than 4 percent per year for four years, the forecasting community is once again predicting a deceleration of economic growth under the belief that conditions dictate a more sustainable rate of change for Gross Domestic Product (GDP) in the year 2001.

Strong growth above 4 percent has been very important to the U.S. The unemployment rate dipped below 4 percent in more than one month in 2000. With the increased employment have come higher incomes and reductions in crime and poverty. The 10-year national economic expansion has benefited consumers, armed firms with newer and better technology, and facilitated an expansion in spending on Medicare and other social programs. Clearly, gains have been widespread and significant for most groups.

But traveling so fast sets off alarms. This year saw wages and prices start to accelerate. The Federal Reserve (the Fed) raised interest rates to try to cool the economy. Spending on housing and durable goods slowed. The U.S. trade deficit soared to over $400 billion as the dollar strengthened against the new euro. Consumers reached deep into pockets to sustain spending on both imported and domestically produced goods. Equities markets drifted lower and have not recovered as of the end of the year.

As we move into the New Year the expected slowdown scenario is complicated by an energy imbalance. World economic recovery increased the demand for petroleum products. Supply was not forthcoming and prices spiked. The gray hairs remember the 1970s but they are not sure how what we learned will come into play in 2001. Perhaps energy prices are relative prices and should not be the concern of the Fed. If the economy slows, the Fed might allow interest rates to fall to prevent a deceleration from turning into a decline. But if inflation spikes, the Fed might, instead, worry about inflationary expectations. In that case, they might try to raise interest rates to prevent a temporary surge of prices from turning into a sustained cycle of rising wages and prices.

In the new year, we have concerns about a bear market, the impacts of the oil crisis, the large trade deficit's impact on the value of the dollar, and the onset of other seemingly negative events. But these ruminations should not overshadow what looks like another year of excellent sustained economic growth. Some of the highlights of our 2001 forecast include:

- GDP growth of 3.5 percent in the 11th year of the economy expansion
- CPI inflation of 3.3 percent
- Unemployment rate of 4.3 percent
- Stable short- and long-term interest rates
- Housing starts of 1.5 million units
- A trade deficit of approximately 4 percent of GDP
- A declining value of the dollar
- 20,000 new jobs for Hoosiers
- Return to double-digit growth of Indiana exports to the world

The U.S. Economy

R. Jeffrey Green

Associate Dean, Research and Operations, Kelley School of Business, Indiana University, Bloomington

Willard E. Witte

Associate Proffessor of Economics, Indiana University, Bloomington

There is some controversy whether 2000 is the last year of the 20th century or the first year of the 21st. In economic terms, if it is the former, the century ended with a bang. If it is the latter, it set a standard that will be very hard to match. Figures 1 and 2 illustrate why. **Figure 1** shows the broad economic situation as indicated by output growth and