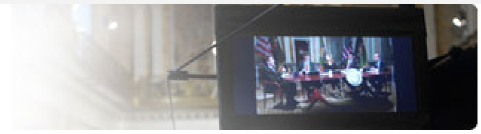

Statement of Assistant Secretary for Economic Policy Karen Dynan for the TBAC of the SIFMA

2/2/2015

STATEMENT OF ASSISTANT SECRETARY FOR ECONOMIC POLICY KAREN DYNAN FOR THE TREASURY BORROWING ADVISORY COMMITTEE OF THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION

WASHINGTON - The U.S. economy continues to strengthen. Real GDP growth has been well above trend in recent quarters, job growth has picked up sharply, and the unemployment rate has fallen to the lowest rate since 2008. Inflation remains low, caused partly by the recent steep drop in energy prices. Core inflation, which excludes both energy and food prices, is also subdued. Against the backdrop of a strengthening economy, the federal fiscal position has improved considerably and in FY 2014 the budget deficit declined to a seven-year low as a share of the economy. The Administration’s FY 2016 Budget, which was released earlier today, would build on recent fiscal progress, lowering the deficit to a sustainable level and putting debt held by the public as a share of the economy on a declining path. The President’s Budget also proposes policies that will foster durable economic growth and broadly-shared prosperity over the longer run.

Last week, the Commerce Department reported that real GDP increased at an annual rate of 2.6 percent in the fourth quarter following very strong gains of 4.6 percent and 5.0 percent in the second and third quarters, respectively. Private domestic final purchases, which exclude the volatile inventory investment, net export, and government spending categories, were up 3.9 percent, roughly in line with the robust 4.1 percent pace in the third quarter. Consumer spending rose at an annual rate of 4.3 percent, accelerating from the previous quarter’s 3.2 percent pace and marking the largest quarterly gain since early 2006. Growth of residential investment picked up, and businesses stepped up the pace of inventory accumulation, adding notably to GDP. However, following a strong gain in the third quarter, growth of business fixed investment slowed, and net exports were a large drag on GDP growth as imports rose faster than exports. Declining federal government outlays also weighed on economic activity in late 2014, but state and local expenditures rose for the third straight quarter.

Labor market conditions improved notably during 2014. Job growth picked up significantly over the course of the year and by the fourth quarter the economy was generating 289,000 jobs per month on average, roughly 100,000 more per month than in the first quarter. Nearly 3 million workers were added to nonfarm payrolls in 2014, the strongest year of employment growth since 1999. The unemployment rate fell 1.1 percentage points last year to 5.6 percent in December, the lowest level since mid-2008.

Roughly two-thirds of the improvement was due to declining long-term unemployment, although, at 1.8 percent, the unemployment rate for those without jobs for 27 weeks or more remains almost double its pre-recession average. Involuntary part-time unemployment has also been normalizing. The labor force participation rate is down sharply from its pre-recession level reflecting both fallout from the recession and retiring baby boomers, but it has been about stable at just below 63 percent over the past year. The employment report for January 2015 will be released at the end of this week.

The recovery in the housing sector continues to be mixed. Multi-family construction has bounced back to its pre-crisis range, but single-family building activity remains subdued. Meanwhile, sales of existing single-family homes have rebounded from their slump in 2013. The considerable recovery in home prices over the past few years has eroded affordability, but low mortgage interest rates have kept affordability above its historical average. Over the past year, the benchmark 30-year fixed rate on a conventional mortgage has fallen by close to ¾ percentage point and currently stands at a low 3.66 percent. The favorable level of affordability, along with the stepped-up pace of improvement in labor markets, is expected to bolster housing demand going forward.

Energy prices have fallen sharply since mid-2014. The one-month futures price of West Texas Intermediate crude oil is currently trading around $49 per barrel, down nearly $60 from a recent peak in June. Retail gasoline prices have followed crude prices lower; the U.S. average retail price of regular gas currently stands at $2.04 per gallon, down $1.65 from its June average of $3.69. Lower energy prices should provide a meaningful boost to U.S. economic growth this year because consumers will have more income to spend on other things and businesses will see reduced production costs. However, the boost to growth will be offset in part by lower profits and investment in the U.S. oil-producing sector, which has grown considerably in recent years.

Exports have been an important source of growth for the United States during the current recovery, contributing close to ¾ percentage point per year on average to real GDP growth from 2010 through 2014. Although foreign growth prospects have deteriorated recently, which should weigh on demand for our exports, we have seen only a modest slowing of real export growth to date. U.S. manufacturing activity has remained strong, with factory output rising at an annual rate of 5.2 percent in the fourth quarter.

Falling fuel prices have contributed to a pronounced moderation in headline inflation. During the year that ended in December, the consumer price index rose just 0.8 percent. Core consumer prices rose 1.6 percent over this period. Core services price inflation has been running at a moderate pace, while core goods price inflation remains quite subdued. Compensation costs appear to be putting little pressure on prices, with growth having been held in check for some time now by broader labor market slack. Over the year ending in December, growth in the Employment Cost Index for private-industry workers was 2.3 percent, well below the average pace of around 3½ percent in the decade prior to the recession.

The combination of stronger economic growth and fiscal retrenchment over the past several years has brought about considerable and rapid improvement in the federal government's fiscal position. During the fiscal year ended September 2014, the budget deficit fell to 2.8 percent of GDP, its lowest share since FY 2007. The Administration's FY 2016 Budget would trim the deficit slightly further on net, with the deficit stabilizing at 2.5 percent of GDP over the latter half of the 10-year budget period—well below the 40-year average of 3.2 percent of GDP. Under the Budget, debt held by the public as a share of GDP is projected to be 75.1 percent in the current fiscal year and decline steadily through FY 2025. The primary deficit—the deficit excluding interest payments on the federal debt—is projected to become a primary surplus in FY 2022, at which point it will no longer be adding to federal debt.

The U.S. economy is poised to continue growing at a solid pace. The improvement in labor market conditions along with the recent sharp decline in energy prices have been a boon for consumers, helping to lift consumer confidence to its highest level since the mid-2000s. Household wealth has risen considerably over the past year and credit conditions are continuing to improve. Fiscal policy (at all levels of government) is expected to support economic activity in 2015 after several years of being a drag. While developments abroad are weighing on U.S. economic performance, most forecasters continue to predict strong U.S. economic growth in 2015. The Administration's current economic forecast shows real GDP growth picking up to 3.0 percent over the four quarters of 2015, roughly in line with the private consensus forecast for 2.9 percent growth.

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