

“The Economic Outlook”

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Good afternoon. Thank you for inviting me here today to speak on the prospects for the American economy in the coming year. I will address three topics that will hopefully feed into the upcoming panel discussion. One is the Administration’s economic forecast for 2006, which foresees continued strong performance on many dimensions. The second is the essential role that productivity growth is playing in this strong performance. And the third is potential risks facing the American economy.

First, let me summarize the Administration’s economic forecast for 2006. The U.S. economy starts off this new year having weathered the hurricanes and volatile energy prices of 2005 with impressive resilience. For 2006, the Administration forecast is that the ongoing economic expansion will continue with healthy job creation and contained inflation.

Real gross domestic product is forecast to grow at 3.4 percent, only slightly slower than the likely rate from 2005. Payroll employment growth during 2006 is projected to average 176,000 jobs per month, a pace which is projected to keep the unemployment rate at a low 5 percent. And CPI inflation is forecast to fall to 2.4 percent from well above 3 percent in 2005. I will also point out that overall, this Administration forecast is quite similar to the consensus of professional economic forecasters.

So on the key metrics of output, employment, and price inflation, American businesses should enjoy a strong U.S. economic environment in 2006. This strength is even more impressive when measured against other major economies of the world. For example, in 2004 the value of U.S. GDP exceeded that of France, Germany, Japan, and the United Kingdom combined. Among advanced economies, the United States is forecast by the IMF to enjoy the fastest growth in 2006.

What accounts for the recent strength of the U.S. economy? The answer to this question is the second topic I would like to address: the astonishingly strong productivity performance of American companies.

To gauge the standard of living for any country, the single most important metric is productivity: the average value of output a country produces per worker. Here in the United States, our benchmark productivity measure is output per worker hour in the non-farm business sector. From 1973 to 1995, this benchmark measure grew at about 1.4 percent per year. Then in 1995, U.S. productivity growth began to accelerate. From 1995 to 2000, productivity grew at an average annual rate of 2.5 percent. And even more remarkably, since the end of 2000 productivity growth has accelerated even further, to about 3.4 percent per year.

The importance of this productivity acceleration is difficult to overstate. At the previous generation’s growth rate of 1.4 percent, average living standards required 50 years to double. At the current growth rate of 3.4 percent, average living standards need just 20 years to double. This difference of 30 years spans an entire generation, and so carries profound implications for the well-being of all Americans.

What accounts for this productivity acceleration? Your companies. It is the stakeholders in American business—workers, managers, owners—that have combined efforts to deliver innovations and ever-greater economic output. The data show the breadth of industries involved in this productivity acceleration. Much of the initial acceleration after 1995 was related to information technology—both faster productivity growth by IT companies themselves and faster IT capital investment throughout the economy. More recently, productivity gains have been delivered by many other sectors including financial services and retail trade.

Here, too, the international perspective is of value. The sluggish growth performance of many other advanced economies reflects their sluggish productivity performance. There is substantial evidence that the greater flexibility of labor, capital, and product markets in the United States has supported the ability of your companies to deliver productivity gains by allocating people, capital, and other resources to ever-shifting profit opportunities.

Let me close with my third and final topic: potential risks facing the American economy. If we look beyond 2006 we can see a number of challenges, such as the demographic shift of an aging population and the need to best educate our children in the face of rising income inequality across educational groups. These long-term challenges will require careful, constructive policies to help ensure rising standards of living for both ourselves and future generations of Americans.

If we focus on the coming 12 months, one risk I will highlight is the international arena. Here I will emphasize two issues: global imbalances and trade protectionism.

First, the rising U.S. current-account deficit. This deficit is an important part of our overall global position, and merits careful analysis for causes, consequences, and possible transitions. It is now well established that at least some of the causes of this trade deficit are the underlying strengths of the U.S. economy. In particular is the fact that the United States has been growing much more rapidly than have the economies of our biggest trade partners. Our faster growth has meant that our demand for their exports has been growing faster than their demand for our exports. At the same time, some of the other underlying causes of the trade deficit are more worrisome. Here I include the long-standing decline in savings rates by American households. The trade deficit is a matter of concern, and will merit close attention throughout 2006.

The second international concern is the risk of trade protectionism. There are many here in Washington and elsewhere who are calling for more barriers to international commerce. These calls for protectionism are at odds with the evidence that decades of trade liberalization have played an important role in helping raise average U.S. living standards. American companies that are globally engaged—through exporting, importing, and foreign direct investment—tend to be the most-productive, highest-paying companies in the United States.

Trade liberalization today is at a critical juncture. The current Doha Development Round of the WTO is in real danger of paralysis. Yet the potential economic gains to the world from further trade liberalization are enormous. Again, your companies see this very clearly. Today, the United States is home to only about 5 percent of the world's population, so 95 percent of your potential customers lie beyond our borders. It is essential that support for trade liberalization continues.

So let me summarize. Though not without risks, the U.S. economy in 2006 is expected to deliver another solid year, thanks in large part to ongoing productivity strength. Thank you again for the opportunity to present these views, and I welcome any questions you may have.