Economic Outlook for 2014

As the end of 2013 draws near, the U.S. economy appears very much like an ocean liner, finding it very difficult to change either speed or direction. As the table illustrates, overall GDP growth rates, employment growth and consumption have all been stuck in a very narrow range for the last three years.

Morningstar economists expect little change in the overall GDP growth rate for 2014, although the composition of that growth is likely to be somewhat different. Inventories should be a much smaller contributor to growth, net exports are likely to be a larger subtraction from GDP as imports grow, and government spending should be a much smaller negative in 2014.

Consumption, housing and business investments (excluding inventories) are likely to change little from their 2013 growth rates. Other forecasts may be more bullish on overall GDP growth, but Morningstar economists suspect growth rates in autos will decelerate, existing home sales will likely be flat, and government spending will still be a drag, albeit smaller than the rather large subtraction in 2013.

With little change in the 2% GDP growth rate, employment growth may not change that much, either. Slow growth, a wide output gap (a fancy capacity utilization measure) and a bumper farm crop should all keep inflation in check in 2014, though medical costs may rise faster than in 2013, bringing up the overall rate of inflation. With the Fed now officially tapering bond purchases, 10-year Treasury bond rates should move up to reflect the inflation rate plus a spread. Auto sales should continue to do well in 2014 with continued employment growth, new models, and an aging fleet. Unfortunately, auto sales are now approaching previous highs and the law of large numbers is beginning to set in, with year-over-year growth rates likely to slow. An acceleration in housing starts may still occur, as it has taken home builders some time to gear up for increased demand (zoning, land acquisition, etc.). However, existing homes will be hard pressed to grow much with higher rates, more competition from new homes, tight inventories, and lower affordability.

Probably the biggest news in the fourth quarter was that the Fed would begin tapering its large $85 billion bond purchase program. This program was a truly extraordinary measure; never before has the Fed reacted so boldly and so beyond its sphere of short-term interest rates. Given extraordinarily tight fiscal measures and a slow-growth economy, the program was both helpful and necessary. With the economy at least a little better and an easing of the fiscal tensions, however, it was probably time for it to end. Markets had already anticipated the tapering last spring, and interest rates had previously made their move up. Further rate increases are possible, but the worst may be behind us.

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	2011	2012	2013E	2014E
GDP	2.0%	2.0%	2.3%	2%–2.5%
Inflation	3.0%	1.8%	1.3%	1.5%–1.8%
Employment Growth (mo. avg.)	202,000	189,000	190,000	190,000
Unemployment Rate	8.5%	7.8%	7.1%	6.2%–6.5%
10-year Treasury	1.9%	1.8%	2.9%	3.5%–4.0%
Auto Sales (millions)	12.8	14.5	15.7	16–16.5
Housing Starts (thousands)	624	830	925	1,050–1,100
Existing Home Sales (millions)	4.3	4.7	5.1	5.1

Source: St. Louis Federal Reserve. Numbers for 2013 and 2014 are estimates. These estimates are based on Morningstar calculations and economic analysis. They (and the opinions expressed in this article) are not intended to be used or interpreted as investment or financial advice. Please consult with a financial professional for advice specific to your situation.