Matthew Fienup
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In January 2017, the CERF team made a bold proclamation about the outlook under the new Presidential administration: "We assume that Donald Trump will not succeed in changing many of the policies which are primary drivers of the country's poor economic performance."

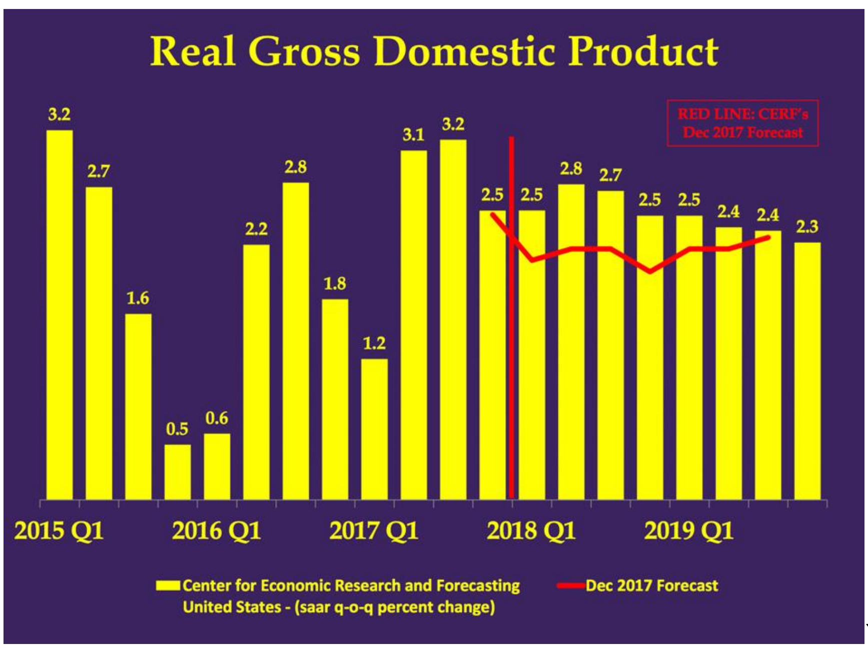
As forecasters, there are some predictions that we are happy to get wrong.

On December 20, 2017, Congress passed, and the President later signed, historic reforms to the U.S. corporate tax system. Corporate tax reform includes three noteworthy elements: a reduction in corporate tax rates, movement to a territorial tax system, and the one-time repatriation of foreign earnings.

For a full dissection of the elements of corporate tax reform and their implications, please refer to our December 2017 U.S. Economy Essay.

There are significant consequences of the reforms passed in December. First, they proved us wrong. The reform package signed into law is fundamental change of the very type that we thought impossible. It is also fundamental change of the type that will impact economic growth going forward. You see, we were not only wrong about the ability of Congress and the President to pass needed reform, by being wrong about the probability of reform, we were also wrong about the economic outlook for the country. It is now necessary for us to revise our forecast upward.

In our December 2017 forecast, we called for average growth of 2.1 percent over the following 4 quarters. Now, the average growth rate is forecasted to be 2.6 percent over the next 4 quarters.



As discussed in detail in the nearby U.S. Highlights essay, the reason for the upward revision is that we view corporate tax reform as unambiguously positive for the economy. In fact, we already see evidence of the benefits of tax reform. Many hundreds of thousands of employees at Comcast, Bank of America, AT&T, Lowe's, and Walmart received $1,000 bonus checks which company executives claim are the direct result of tax reform. Apple Computer gave all 120,000 of its employees a bonus of $2,500, redistributing over $300 million in all. Comerica Bank, Discover Financial Services, Fifth Third Bank, SunTrust Bank, JP Morgan Chase, PNC Financial Services, Regions Financial, the Travelers Companies, U.S. Bancorp, Wells Fargo, and Humana all increased their corporate minimum wage to $15 an hour. Once again, we are told by executives that the increases in pay flow directly from tax reform.

More evidence of the benefits of tax reform is provided by announcements from major U.S. corporations regarding the status of foreign earnings. Thousand Oaks based Amgen plans to repatriate $39 billion currently held overseas. Apple Computer plans to repatriate $260 billion. These many billions will finally come home from what had seemed like a permanent exile created by the old corporate tax system. The old system penalized U.S. companies for bringing foreign earnings back to our shores. Repatriated dollars will now fuel increased investment here at home. Even to the extent that these funds result in stock buy-backs rather than direct increases in domestic investment by the companies doing the repatriation, investment will increase and the effects for the economy are unambiguously good. Total economic activity and jobs will increase as a result of corporate tax reform.

Holding all else equal, we actually believe that the increase in average growth of 0.5 percentage points is a lower bound on the possible benefits of corporate tax reform. This begs the question, why then is our forecast of economic growth not even higher? In particular, why doesn't the historic tax reform package portend a return to the 3.5 percent average growth rate that was typical of the post-World War II era?

If only the corporate tax system had been the sole constraint on economic growth.

In order for the economy to break out and to begin growing at a rate closer to the historical norm, fundamental change is still required in a number of areas. Extraordinary monetary policy practiced since the Financial Crisis is perhaps the single largest constraint on economic growth. For a full discussion of monetary policy, please read the June 2017 U.S. Economy essay. Government regulation continues to thwart innovation and expansion in the private economy, and we don't believe that executive actions are sufficient to turn the regulatory tide; legislation is required, including legislative changes to the Affordable Care Act and Dodd Frank. Massive deficit spending is an increasingly large concern—the U.S. is on track to return to serial trillion-dollar deficits, this time during the expansion phase of the business cycle! And then there is the President's foray into trade protectionism.

For a detailed discussion of International Trade and the implications of tariffs and other trade restrictions, please read the nearby U.S. Economy essay.

Given the constraints mentioned above and, in particular the damage already being done by the President's trade policies, the risks to our forecast are not symmetric. Risks are weighted heavily to the down side. This is a change from the previous forecast, during which the possibility of tax reform posed a significant positive risk.

United States				
Gross Domestic Product (Real SAAR Growth)				
Quarter	CERF Forecast	WSJ Forecast	NABE Forecast	Actual (1st Est.)
2016 Q1	1.5	2.1	2.0	0.5
2016 Q2	1.5	2.4	2.3	1.2
2016 Q3	2.0	2.9	2.8	2.9
2016 Q4	1.8	2.3	2.1	1.9
2017 Q1	1.7	1.9	2.0	0.7
2017 Q2	2.2	2.9	3.1	2.6
2017 Q3	2.2	2.7	2.8	3.0
2017 Q4	2.5	2.8	2.7	2.6
2018 Q1	2.5	2.5		-
2018 Q2	2.8	3.2		-
2018 Q3	2.7	3.1		-
2018 Q4	2.5	2.9		-
2019 Q1	2.5	2.6		-
Average	1.93	2.50	2.48	1.93
Average Bias	**0.00**	**0.58**	**0.55**	**-**
Sources: US Bureau of Economic Analysis, Wall Street Journal, NABE, and CERF				

Our current forecast is still pessimistic relative to the "consensus," although the gap between the CERF forecast and both the Wall Street Journal (WSJ) and the National Association of Business Economists (NABE) consensus forecasts has shrunk. The difference in average growth between the CERF forecast and both the WSJ and NABE consensus forecasts has been about 0.5 percentage points over the previous two years. That is to say, the consensus has been 0.5 percentage points more optimistic than we have been. Over the next 5 quarters, the difference between the CERF forecast and the WSJ consensus is only half as much, just 0.26 percentage points. We're still pessimistic, but apparently no longer so foreboding.

There are two possible explanations for convergence of these forecasts. One is that the consensus among forecasters assigned greater probability to tax reform and had already embedded potential gains from reform into the forecast. We needed to actually see a credible reform package signed before we were willing to adjust the forecast. Alternately, and perhaps more interestingly, it may be the case that we assign greater benefit to tax reform than other forecasters.

In either case, we feel good about our track record up to this point. The average bias of the CERF forecast over the previous 2 years is a pleasingly round 0.00. We fully realize that this is fleeting, but we will still enjoy the apparent lack of bias until that moment on April 27 when the Q1 GDP number is released. Then, we'll be wrong again. Most importantly for this analysis, we note that the average bias of the two consensus forecasts has been positive. By comparison, the CERF forecast has been closer to so-called reality. Over the past two years, as in the previous eight, it has paid to be pessimistic.

But things are looking up.

Forecast Charts