Chicago Booth economists contend economic growth likely in 2011

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Home prices will remain near their current levels for the next few years, but the United States economy could grow faster in 2011 than the consensus forecast shows, according to predictions made Tuesday, Nov. 30 at the annual business and economic forecast luncheon of the University of Chicago Booth School of Business.

Unemployment is expected to stay high for the next few years, the forecasters agreed.

“We will not see a recovery in housing prices in the near term, nor do I expect home prices to drop further,” said Erik Hurst, a professor of economics at Chicago Booth and one of the speakers at the event at the Sheraton Chicago. “That is my take–it–to–the–bank prediction for 2011,” he said, citing the excess supply of houses on the market and continued weak demand from homebuyers.

Economic growth in the U.S. next year, as measured by the percent change in GDP, could reach 3.4 percent and exceed the consensus of economic forecasters, according to Randall Kroszner, a professor of economics at Booth who served as a governor of the Federal Reserve System from 2006–09. “I don’t agree with those who say we are in an extended period of low growth,” said Kroszner, “but we are unlikely to have a powerful recovery either.

He said that consumers are spending, although not “as robustly as hoped for,” adding that the personal savings rate is not expected to increase

significantly. “The productive engine of our economy is not broken,” said Kroszner, noting that business productivity growth has been high and firms have continued to invest in equipment and software.

The Fed’s recent quantitative easing will serve as insurance against downside risks to the economy, Kroszner said. “Monetary policy can produce the necessary conditions for job growth, but only the choices of business people can create jobs.”

Job growth will remain sluggish in 2011 due to uncertainty over the government’s policy and the current budget trajectory, Kroszner contended. “Tremendous uncertainty about what taxes will be on investment by both large and small firms, combined with uncertainty about future health care costs, has so far made businesses reluctant to hire workers on a permanent basis.”

Hurst believes consumption growth during the recovery and, as a result, economic activity as whole will be slower than previous recessions because households will try to build up savings and wealth rather than focus on spending. “During the boom years, people misallocated their earnings toward consumption and are now beginning the process of deleveraging their balance sheets,” he said.

Hurst believes unemployment will still be above 8.5 percent a year from now; the

current rate is 9.6 percent. “Some of the unemployment we are seeing is because people switched to jobs in the finance and construction sector during the late 1990s and early to mid–2000s, when times were better,” Hurst said.

During the first part of this decade “we built too many houses and saved too little,” he said. “This misallocation needs to undo itself before the

economy can return to normal growth. We need to work through the inventory of extra houses, accumulate additional saving, and reallocate workers and capital from the housing and finance sectors to other sectors. This process just takes time."

A silver lining to the current situation in the U.S. is that it is hard for weak sectors — housing, for example — to dip further, according to Raghuram Rajan, a professor of finance at Booth.

In the U.S., the recovery varies by geography and income, with sales growth strongest at stores catering to the affluent, Rajan noted. Emerging market countries, especially poorer ones, will stabilize and grow faster than developed countries, according to Rajan, a former chief economist for the International Monetary Fund. Is there growth after the fiscal stimulus and inventory rebound in developed markets, he asked.

"Yes, but slower," said Rajan, who predicted an "unspectacular recovery in the U.S., with some risks on both sides in the coming months."

Provided by University of Chicago

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