World Leadership Forum 2011:
Global Economic Outlook
October 19th, 2011

Featuring:

Abby Joseph Cohen, Partner and Chief U.S. Investment Strategist, Goldman, Sachs & Co.

ABBY JOSEPH COHEN: Let me extend my apologies for being late. I had quite the adventure getting here this evening, but I don't need to bore you with the details. I am very sorry. It was my intention to be here early, not late. That puts a little bit of pressure on me, right? I have to tell you what I think, and I have to tell it to you very efficiently, which is what I will do. Let me begin if I may where Larry ended, and that is to say that we would agree that the situation in Europe is perhaps the most vexing one that we all need to worry about at this time.

Europe combined GDP is the same size as the United States. We're talking about the two largest economies in the world. Our belief is that over the coming months and quarters, global economic growth will be more moderate than it otherwise would have been, because we think there's a very good chance that several of these nations in Europe will go into recession. Not necessarily the major economies of Germany and France, but they're not going to look particularly robust either. If you have a group of economies that together represent about a quarter of global GDP, and they're not looking all that vigorous, that does have an impact on the rest of the world. It has an impact on the U.S. forecast as well, because outside of Canada—our friendly and very close by neighbor where we do a lot of trade back and forth across the border—other than Canada, Europe is our largest trade customer.

Let's talk about this for a moment. They are our largest trade customer other than Canada. Why is that important? Over the last decade and over the last two to three years following the end of the credit crisis, the fastest growing sector of the

U.S. economy has been exports. This is something that most people don't think about, but exports have done well over the last many years, in periods when the dollar was strong, periods when the dollar was weak. When we think about what is important when you prepare a forecast for the U.S., you need to look at the economy sector by sector. Let me give you a very quick survey.

The fastest growing sector has been exports, and it is the one that would be most exposed to ongoing weakness in Europe. By the way, we think global GDP in 2012 will still be a plus 3.5%. We are not forecasting a global recession. We are very concerned however about Europe. Second fastest growth in the U.S. economy in the last decade and also since the end of the financial crisis has been business investment in equipment, technology equipment, communications equipment, investment in software, services, applications, and so on. This has been a very robust area of economic growth. By the way, it is also the group of categories that accounts for our strong exports.

As we go through other elements of the economy, keep in mind the GDP is consumption plus investment plus government spending plus net exports. I've told you net exports have been very strong. Investment in equipment has been very strong. Consumption is now improving. Retail sales over the last few months are up 4 to 5%. It always surprises people and they say with an unemployment rate of 9.1%, how can it be that consumption is increasing? This is what happens in every economic recovery. The people that do have jobs and whose incomes are growing kind of step up and they start to spend more. We believe that the retail sales numbers which have been quite good over the last three months or so have been spurred by things like promotions, i.e. sales, back to school savings, and so on. That reflects on the profit margins of the retailers, but it still means that consumption is moving ahead.

There are however two areas that are weakening in the U.S. economy, business construction. Business investment in equipment looks good, but business investment in new buildings is dead as a door nail. From the peak of the last cycle to where we are now, it's down 35%. By the way, residential construction is down 50% from its previous peak, but we're not really seeing much aggregate improvement in business investment in building. That's not true. There are some places where there's a lot of building going on, the city of New York for example and other places, but on a nationwide basis, this is not a source of economic energy.

There's one other category I need to mention, which is now a decrement to economic growth in the United States, and that is government spending. The federal government is spending less, and state and local governments are also spending much less because they are now—that is the state and local governments—are now dealing in a deferred way with the credit crisis and the severe recession which followed. If you think back to the Obama stimulus plan that was implemented, one of the major beneficiaries was state and local governments. Unlike the federal government which we all know can run and budget deficit for year and years and years, state and local governments cannot. Under the laws in most localities, most municipalities and states, what you find is that they must be in balance within the budget cycle. You get to the end of the fiscal year and they're running out of cash. They start firing people and they cut back on construction programs. One of the important aspects of the initial federal stimulus plan was all the money that went from the federal government to the state and local government, but the stimulus plan ended this past summer. That is why you're now hearing even more about state and local governments in greater difficulty than they were a year or two or three ago.

What are we concerned about? I told you about the sectors that look robust—exports, but we're watching Europe, business investments in equipment looks good. We are watching very carefully what is happening at the state and local level and also in employment. Let me spend just a few minutes on that. We all know that the unemployment rate is uncomfortably high. The average is 9.1%. In recent months, jobs have been created. From peak to trough, the nation lost 6% of its jobs and we're now back to about a 5% deficit, 4.5% deficit, but we still have fewer jobs today than we did before the credit crisis.

The important thing to look at is where the jobs are still being lost and where they're being created. We see that the private sector is now creating jobs, not as quickly as we might like, and the government sector is where we are losing jobs. This is something that I think has important policy implications. The other thing to keep in mind is that we have a deficit out there that we don't like to talk about very much, and I'm not talking about the budget numbers. I'm talking about the educational deficit. Even before the credit crisis, median family incomes in the United States had declined about 4% relative to inflation in the preceding decade. It's the only time we have seen that over the last many, many decades. The Great Depression was one exception. Why is that happening? Let me tell you a little bit more about the unemployment data and then we can back into it.

The average unemployment rate is 9.1%, but there is a huge spread in the employment picture based upon level of educational attainment. For those individuals who have college degrees or better, the unemployment rate has moved up to about 4%. For those who have a high school diploma, the unemployment rate is in the mid-teens. When we think about where the proximate pain is in terms of employment and also income, we see that there's a very close connection to education. We have not been doing the sort of job we need to be doing in this category. For example, ever since the data have been available worldwide going back several decades, the United States has always been number one in terms of percentage of adult population with a four year college degree. We've always been number one. Depending upon what data set you use, we're now either number 12 or number 8. It's not a picture that we're happy about.

In addition, there is a gender difference that has developed. On college campuses today, about 54% of the undergrads are women. I'm very proud of that improvement because a generation ago it was dramatically less than 50%, but that means that young men today are less likely to be studying for a college degree than they might have been a decade ago. By the way, I don't want you to think that everyone should be getting a college degree. There are many people who are better served by focusing in on vocational studies and so on, but what we see is that there is this gender gap that has developed. Today there's a higher unemployment rate for men than for women. It was as much as two percentage points higher, that is average unemployment for women 8%, average unemployment about men above 10%. Some of this is related to industry. So many of the jobs that were lost were in construction and manufacturing, and the employment there tends to be male dominated. We also have to think on a long term basis, that some of this gender difference is also related to the fact that young men about 10 to 12 years ago stopped reaching for education, and young women were reaching even more aggressively than they had before.

Let me sum this up because I'm conscious of the time, and again I apologize for getting here late. I would basically say that we can have a conversation about the short-term economic outlook or the long-term economic outlook. On a short-term basis, GDP right now has accelerated. We're growing about 2.5%. Our concern is that it might decelerate again because of what's happening in Europe, the impact on global trade, and so on. The much more interesting dilemma we all face as citizens is what we're going to do to make sure than on a long-term basis this nation returns to its potential growth rate, a potential growth rate that is probably 3% of GDP or better. We think this will require an attention once again to education, as mentioned before, a refocusing on basic research and development, and any number of other factors that have led us to be the most innovative nation on the planet.

One final comment before I sit down. I'm very proud to serve on something called the Innovation Advisory Board that is looking at innovation, national competitiveness, and job creation. This is a group which was created out of a mandate from Congress. A bill passed several months ago, and we have to report back to the Congress on the various factors that we think will help reestablish the vibrancy of the U.S. economy. Let's be very clear. The U.S. is still the world's largest economy measured by GDP or income per capita, with the exception of places like Lichtenstein and others that are probably exceptions. Number two, our workers are still the most productive workers on the planet. Number three, we still have on average the best educated workforce on the planet.

What is happening is other nations are picking up the pace of their own improvement. Some of the data I cited before suggests that on an absolute basis when we compare ourselves to where we might have been 10 years ago, we're not exactly where we'd like to be. The rest of the world is not maintaining the status quo. They are following policies in many nations to really emphasize education, particularly in stem. Do people know what STEM is? This is the acronym of the year, it's science, technology, engineering, and math. You cannot have an innovative economy if you don't have scientists and engineers and people who are not just literate but numerate, that is understand math and understand science. Other nations are focusing on that.

Other nations are also focusing on industrial policies to enhance their competitiveness and how they do in trade. As a nation, we've not been as aggressive as some others. I for one was delighted to see the bipartisan support for the trade pacts that were passed by the Congress a week or so ago. What we have to recognize is that the world has changed. Economic growth is increasingly coming from other nations, South Asia, East Asia, and Latin America. They are doing extremely well. They're picking up the pace. The balance is shifting away from some of the older economies like Europe that are not keeping up with some of these changes.

The United States is in many ways in a very unique position. When we contrast ourselves to the other major industrial economies, we have a younger workforce. We have a better educated workforce. We have a higher potential growth rate than many of these other nations. We can benefit from what we're doing and also by building we believe the trade relationships with some of the newer emerging economies. I don't want to give you a pessimistic view, but rather say here are our challenges. Let's identify them and let's figure out what we need to be doing about them. I'm going to stop right there.