

Jim Caron on CNBC: Kick Starting a U.S. Business Cycle

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Removing the shackles of central bank dependencies for economic activity will most likely kick start a U.S. business cycle.

- Policies from the new administration may kick start a business cycle through the fiscal channel: tax and regulatory reform.
- This would move markets away from a reliance on monetary policy to one driven by economic fundamentals. This is very significant because it releases the shackles of dependency on the central bank to manage growth.
- The way this may work is through creating a dynamic that encourages business investment and capital expenditures (cap-ex). These elements have been sorely lacking in the post crisis environment of 'managed growth'. It is also one of the main reasons why U.S. GDP has had difficulty sustaining levels above 2%.
- Additionally, fiscal stimulus may be coming at a time when the output gap is closed and we may be at full employment. This could create a higher inflation impulse, which brings into question how the Federal Reserve (Fed) may respond.
- However, the establishment survey of the unemployment rate (the U3 rate), which is currently at 4.7%, can be a misleading measure of the health of the labor market. This is because the U3 is a narrow measure of the unemployment rate. The broader measure of the unemployment rate (the U6 rate) may be more appropriate if the business cycle gets a kick start because it accounts for longer term unemployed people reentering the labor force as conditions improve. This rate currently stands at 9.2%. As a result, this may suggest we are not yet at full employment and the Fed may respond more slowly than in previous cycles.
- The potential benefit of a reemergence of a business cycle is that, at long last, it increases the possibility of GDP growth well above 2%. The downside is that it also may create excesses that pull forward the risk of a recession. But this is normal pre crisis business cycle behavior and to be expected as the U.S. economy is weaned off of its reliance on central banks managed growth policies.

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