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Hassett Bets on 3% U.S. Growth That Summers Sees in Fairyland

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The U.S. economy is poised to deliver a third straight quarter of at least 3 percent growth, the longest such streak since 2005 and a pace that could be sustained into next year if Congress passes a tax overhaul, White House chief economist Kevin Hassett said.

Hassett, in an interview with Bloomberg News in Washington Thursday, said a rise in capital spending, given even more momentum by the Republican tax-cutting plan which would allow for immediate expensing of investment, could provide the positive growth shock the economy needs to break out of the ho-hum expansion of the past eight years.

Economists such as Harvard University’s Lawrence Summers have argued that the pattern of low interest rates, slow growth and low inflation are tied to persistent structural problems, a malaise he calls “secular stagnation,” borrowing a term from the American economist Alvin Hansen from the 1930s.

“The whole secular stagnation hypothesis is looking a lot more tenuous just because of what happened since President Trump” won the election, Hassett said. “What is it that changed most this year? It’s that capital spending is really starting to move in the right direction.”

When significant tax legislation is approved, “it’s hard to come back to a story where you come back to 1.8 percent or whatever the CBO says is potential GDP growth,” he said, referring to the Congressional Budget Office. The CBO forecasts the U.S. growth potential at just less than 2 percent through at least 2027.

Hassett said he prefers the Federal Reserve Bank of Atlanta’s model, called GDPNow, for tracking gross domestic product. It currently estimates fourth-quarter growth at a 3.2 percent annualized pace.

“If you asked me what the best guess is for Q4, my back-of-the-envelope is just to say GDPNow,” said Hassett, the chairman of President Donald Trump’s Council of Economic Advisers. “That is as good of a guess as there is. That would give you 3 percent going into next year for three quarters in a row.”

Summers, in a blog post in May, has called such lofty forecasts “fair enough, if you believe in tooth fairies and ludicrous supply-side economics.”

The world’s largest economy grew at a 3 percent pace from July through September following a 3.1 percent advance in the previous three months, capping the strongest six months of growth since 2014. The previous stretch of at least 3 percent GDP gains lasted from the second quarter of 2004 through the first quarter of 2005.

Hassett said deregulation may already be influencing capital spending on structures, equipment and intellectual property, which expanded at a 3.9 percent annualized pace in the third quarter after gains of 6.7 percent and 7.2 percent in prior quarters, capping the strongest performance since 2014.

Hassett said the design of the tax plan should be beneficial to labor if more companies locate investments here, especially in manufacturing. Better capital should boost productivity and eventually that will lead to bigger paychecks, he said.

Just how companies respond to the tax package is a big question for the Federal Reserve next year, said Torsten Slok, chief international economist for Deutsche Bank. The House bill passed Thursday suggests some increase in the U.S. capital stock is possible, he said.

The more critical question is about inflation and “what will the Fed’s reaction to all this be?” he added. Currently, Fed officials have been waiting for the passage of the legislation before pronouncing on its implications for Fed policy. They have forecast three more hikes next year, while financial markets have priced in a high probability of another hike next month. The policy rate is currently in a range of 1 percent to 1.25 percent. The gradual pace has been dictated in part because inflation has remained low, rising just 1.6 percent for the year ending September.

Forecasts about the effect of the tax plan hinge on whether companies respond more to demand for their products or to fiscal incentives about what to do with their cash.

“Anyone who wants to expand can expand right now -- they are awash in capital,” said Ike Brannon, a visiting fellow at the Cato Institute in Washington. Immediate expensing of investment will front-load corporate decisions into the present, he said. “Whether we are going to have more long-term investment growth because of it, I am not 100 percent sure.”