

GOLDMAN'S JAN HATZIUS ON FED POLICY AND THE PRODUCTIVITY PARADOX

Jeremy Schwartz — Global Chief Investment Officer
06/24/2015

Last week, Professor Jeremy Siegel and I chatted with Jan Hatzius, Chief Economist at Goldman Sachs, to discuss his thoughts on the state of the U.S. economy, Fed policy action and long-term growth forecasts. **Highlights from the Fed Policy Meeting** The [Federal Reserve \(Fed\)](#) conducted its policy meeting last week and held a press conference shortly after. Both Professor Siegel and Hatzius noted that the members of the [Federal Open Market Committee \(FOMC\)](#) brought down their estimates for what the most appropriate [monetary policy](#) rates should be—commonly known as the “dot plots.” They both believe these downgrades were particularly meaningful. Hatzius noted that in March 2015 three people penciled in zero or one hike this year, and that number has now increased to seven. Hatzius believes—somewhat speculatively but also critically—that one of these seven was Fed chairman Janet Yellen. As a result, Hatzius’ team at Goldman pushed back its call for the first Fed rate hike to December 2015 (from September). Siegel pointed out that Hatzius’ forecast is counter to the majority of the committee. Yes, there were seven dots indicating one hike as most appropriate policy—up from three dots in March—but there were also 10 members indicating two to three rate hikes as the appropriate policy. **Position on the Long Run, New Neutral 2% Not 4%?** While the Fed prescribes a long-run tendency for a neutral [Federal Funds Rate](#) to be closer to 4%, a number of analysts, including Bill Gross, expect a new neutral Fed Funds Rate to be 2%. The lower neutral policy rate coincides with slower growth potential in the economy. Hatzius disagrees with the new normal theory and sides with the Fed in having higher expectations for the neutral target rate. While slower population and productivity growth can lead to generally lower economic growth, Hatzius does not believe it should slash 1.5% off of nominal growth figures. He expects longer-term growth to be closer to historical averages, disagreeing with predictions for growth of just 2%. **Productivity Paradox and Potential Growth** Within the last decade, we have experienced a disappointing productivity environment—similar to that witnessed in both the mid-1970s and mid-’90s, when the measure of productivity growth trended around 1.5%. Hatzius believes the current environment does not look like one where productivity has slowed as much as the [gross domestic product \(GDP\)](#) numbers imply. He has difficulty believing that “true” productivity has slowed materially considering that profit margins, [inflation](#), equity [valuations](#) and the performance of the Information Technology sector have all been stellar. Instead, poor productivity growth may just be a function of mismeasuring productivity and other economic numbers. It has become increasingly difficult to quantify technological progress. For perspective, in late the ’90s, the center of gravity for productivity growth was faster processors and greater memory capacity in computer hardware. Statisticians translated that into large quality adjustments through widespread price declines and thus large increases in technology output. The tech sector, including both hardware and software sectors, experienced a price drop of 7% to 8% in both the late ’80s and ’90s. In contrast, today, it is much tougher to measure software and digital output, and the price declines have barely budged, despite likely increases in the quality of software. **Tech Price Declines’ Impact on Productivity** Price declines that were apparent in the tech sector in the late ’80s through ’90s would have added 0.3% to 0.4% back to productivity growth. The questions today remain: How do you value free applications? How does that value find its way into national income accounts? Siegel adds that the productivity slowdown in the ’70s was partly due to a spike in oil prices, but today’s low oil prices only deepen this productivity puzzle. **Looking Ahead: U.S. GDP Growth and Euro at Parity with U.S. Dollar** According to Hatzius, Goldman expects GDP growth in the second quarter of 2015 to hit 3.1%. This comes on the heels of dismal growth in the first quarter of -0.7%. In this coming week, there is a possibility that GDP in the first quarter of 2015 might be revised up to -0.1%. Hatzius believes that the U.S. dollar thus far has trimmed 0.5% from GDP growth in 2015. In the first quarter alone, trade contribution was adversely impacted by -1.9%. Considering how volatile trade data is, he believes the drag on overall GDP later this year might not be as significant. But Hatzius thinks the stage

is set for continued U.S. dollar appreciation. [Interest rates](#) in the U.S. are still higher compared to Europe, and his team believes the euro is apt to fall to parity and potentially below. *Read the Conversations with Professor Siegel Series [here](#).*

Important Risks Related to this Article

WisdomTree and Foreside Fund Services, LLC, are not affiliated with Goldman Sachs.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our [Economic & Market Outlook](#)

View the online version of this article [here](#).

IMPORTANT INFORMATION

U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Federal Open Market Committee (FOMC) : The branch of the Federal Reserve Board that determines the direction of monetary policy.

Monetary easing policies : Actions undertaken by a central bank with the ultimate desired effect of lowering interest rates and stimulating the economy.

Dot Plot : a chart based on the economic projections of the Federal Reserve board members that illustrates their views on the appropriate pace of policy firming and provides a target range or target level for the federal funds rate.

Federal Funds Rate : The rate that banks that are members of the Federal Reserve system charge on overnight loans to one another. The Federal Open Market Committee sets this rate. Also referred to as the “policy rate” of the U.S. Federal Reserve.

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.

Inflation : Characterized by rising price levels.

Interest rates : The rate at which interest is paid by a borrower for the use of money.