

MARKETS			
Indices	Index January 17, 2018	% change on December 30 th , 2016	
		In local currency	In \$ terms
United States (DJIA)	26,115.7	+32.1	+32.1
United States (S&P 500)	2,802.6	+25.2	+25.2
China (SSEA)	3,607.8	+11.0	+20.0
Japan (Nikkei 225)	23,868.3	+24.9	+31.5
Britain (FTSE 100)	7,725.4	+8.2	+21.1
Euro area (FTSE Euro 100)	1,251.3	+12.5	+30.6
France (CAC 40)	5,494.0	+13.0	+31.1
Germany (DAX)	13,184.0	+14.8	+33.3
Hong Kong (Hang Seng)	31,983.4	+45.4	+44.2
South Korea (KOSPI)	2,515.4	+24.1	+40.2
World, all (MSCI)	537.1	+27.3	+27.3

Source: The Economist magazine, Jan. 18, 2018

The Wealth Effect and the U.S. Economy

by Richard W. Rahn

How rapidly will the U.S. economy grow in 2018? How about the world economy? There is a growing consensus that the world economy might grow a little more than 3.5 percent and the U.S. economy a little less than that, which would be a great improvement over recent years.

You might notice that most of the major economic forecasters — government agencies, big banks, etc. — make forecasts that are not widely different from each other.

The reason for the herd mentality is that any given forecast is almost certain to be wrong; but next year at this time when the financial writers look back as to who got it right and who got it wrong, a forecaster does not want to be listed as the one who got it much more wrong than his or her competitors.

Back in the 1980s, I was the chief economist for the U.S. Chamber of Commerce. Part of my job description was to make economic forecasts — and I was well aware of how poor our tools were for making such forecasts. The members of our team were

big supporters of President Reagan’s tax rate reductions, and we believed that they would have a more powerful positive effect than was the consensus at the time.

In our forecast for 1984, we projected an approximate 4.5 percent economic growth rate, which was considerably above the average. Shortly after we had come out with our projection, a well-known economist, who was several decades older, berated me in a public forum for being irresponsible with such an optimistic forecast.

Much to the surprise of the economic community, the following year when the numbers were in, it turned out that real economic growth for 1984 was 7.6 percent. No major forecaster had been even close to that number. Even though our team had been less wrong than almost all of the others, we still had been wide off the mark.

Thirty plus years later, we may be seeing a replay of the economic establishment, again missing the positive fundamental changes that are taking place under President Trump. Keynesian economists, like The New York Times’ Paul Krugman, whose brains still seem locked in a static view of the world, totally missed the run-up in the stock market.

Massive deregulation is taking place, which most understand to be economically beneficial, yet there are few tools available to give reliable measures of the magnitude of the positive change.

Groups like the Tax Foundation have developed dynamic models to better estimate the positive changes of the tax bill, but much of the economic establishment is still using largely static models not much different than they used three decades ago.

Do you spend more if the value of your stocks or real estate increases? Economists generally agree that people do tend to spend more as their wealth increases, even though they disagree about the magnitude of the effect and the relative effects of increases in real estate values as contrasted with increases coming from a rise in common stocks.

Over the past year, the Dow Jones Index has risen by almost a third, and the S&P index has risen by a quarter, so that most Americans who hold stock funds or common stocks directly are very happy. This rise in the stock market will cause the demand for goods and services to increase, putting more people to work and encouraging businesses to increase their level of investment.



As can be seen in the accompanying table, it is not only stock markets in the U.S. that have been rising, but equal increases have been occurring in most other countries around the world. (This is after adjusting for the rise in most local currencies against the dollar in the last year.) None of us know how rapidly the U.S. and world economy will grow in 2018. There are always too many unknowns — wars, policy mistakes by major central bankers, etc.

But if I was forced to bet, 4-plus percent seems likely, and even 5 percent would not surprise me. If I turn out to be right, you can be sure that I will remind my readers of that fact a year from now. And if I am wrong, I will be writing about something else, like why economists are endangered species.

Richard W. Rahn is chairman of Improbable Success Productions and on the board of the American Council for Capital Formation

<https://www.washingtontimes.com/news/2018/jan/22/no-one-knows-how-the-economy-will-grow-but-anythin/>

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