

## A Balancing Act

*Equilibrium: Any condition in which all acting influences are canceled by others, resulting in a stable, balanced or unchanging system. (American Heritage Dictionary)*

Robert Van Order is Freddie Mac's chief economist.

Is the economy in equilibrium?

Maybe.

Over the past five years, the country has become used to an economy that offers few surprises. The economy grew each year at a steady, moderate pace of around 2.5 percent. A subdued rate of inflation hovered near the 3-percent mark. Unemployment likewise ranged in a narrow, low band of 5 percent to 5.5 percent. No upward pressure on wages surfaced.

The bond market is happy; thus, interest rates have fallen. Bond traders liked the election results, so they are no longer afraid that federal budget deficits will get worse. With each month that wages and prices stay in line, their fear lessens that today's low unemployment rate will inevitably lead to higher inflation. Consequently, high bond rates have pushed mortgage interest rates down to 7.5 percent.

Most economic forecasters envision a similar economic order over the next few years. A consensus is emerging that neither a big recession nor a big run-up in inflation is in the cards. Likewise, most prognosticators expect the Gross Domestic Product (GDP) to grow at a sustainable 2.5 percent annually.

Is that good?

Perhaps.

Achieving equilibrium does not solve everyone's economic problems. While some, especially skilled workers, have done well in the past few years, others have not. That the good and the bad are canceling each other out is a mixed blessing. To some, equilibrium is disruptive; it often leads to higher unemployment. It also makes planning by

EXHIBIT 1: Major Economic Indicators

	Average for Year						
	1994	1995	1996	1997	1998	1999	2000
Real GDP (Growth)	3.5%	1.4%	2.8%	2.2%	2.5%	2.5%	1.0%
Consumer Prices (Growth)	2.6	2.6	3.2	3.0	3.0	3.0	2.0
Unemployment Rate	6.1	5.6	5.4	5.6	5.6	5.6	6.5
30-Year Fixed Mortgage Rate	8.4	7.9	7.8	7.7	7.8	7.8	7.0

Note: Data for 1996 are estimated; data for 1997 through 2000 are forecasted.  
Source: Freddie Mac

both households and businesses more difficult. From a macroeconomic policy view, however, equilibrium is the best we can do. Moreover, it allows us to focus more directly on other problems.

Will it last?

Probably not.

Economic expansions, like Grateful Dead keyboard players, seldom last more than a few years. Some, though, do last longer than others.

Right now, however, there are no obvious macroeconomic problems that require big changes in either monetary or fiscal policy. Indeed, expansion has proven so steady that articles appearing in the popular press are suggesting that perhaps the basic rhythm of the business cycle has disappeared.

Media speculation notwithstanding, few economists believe in regular, inevitable business cycles, but most do subscribe to the notion that the overall economy reacts to shocks like the oil-price spikes in the 1970s. When the shocks to one particular market are big enough, the adverse effects spill over into other economic areas and lead to recessions. Sometimes the shocks are predictable, such as when the Fed reined in the economy in 1979, but more often they are not.

Like most economists, I do not think that our economy is immune to shocks. I do not know what the next big one will look like, but I am convinced it will not rumble through any time soon. That said, the table above lays out my economic outlook for the next couple of years. It's not Nirvana, but it's not Lawrence Welk either.