

**Tufts Economics Society  
Distinguished Speakers Series**

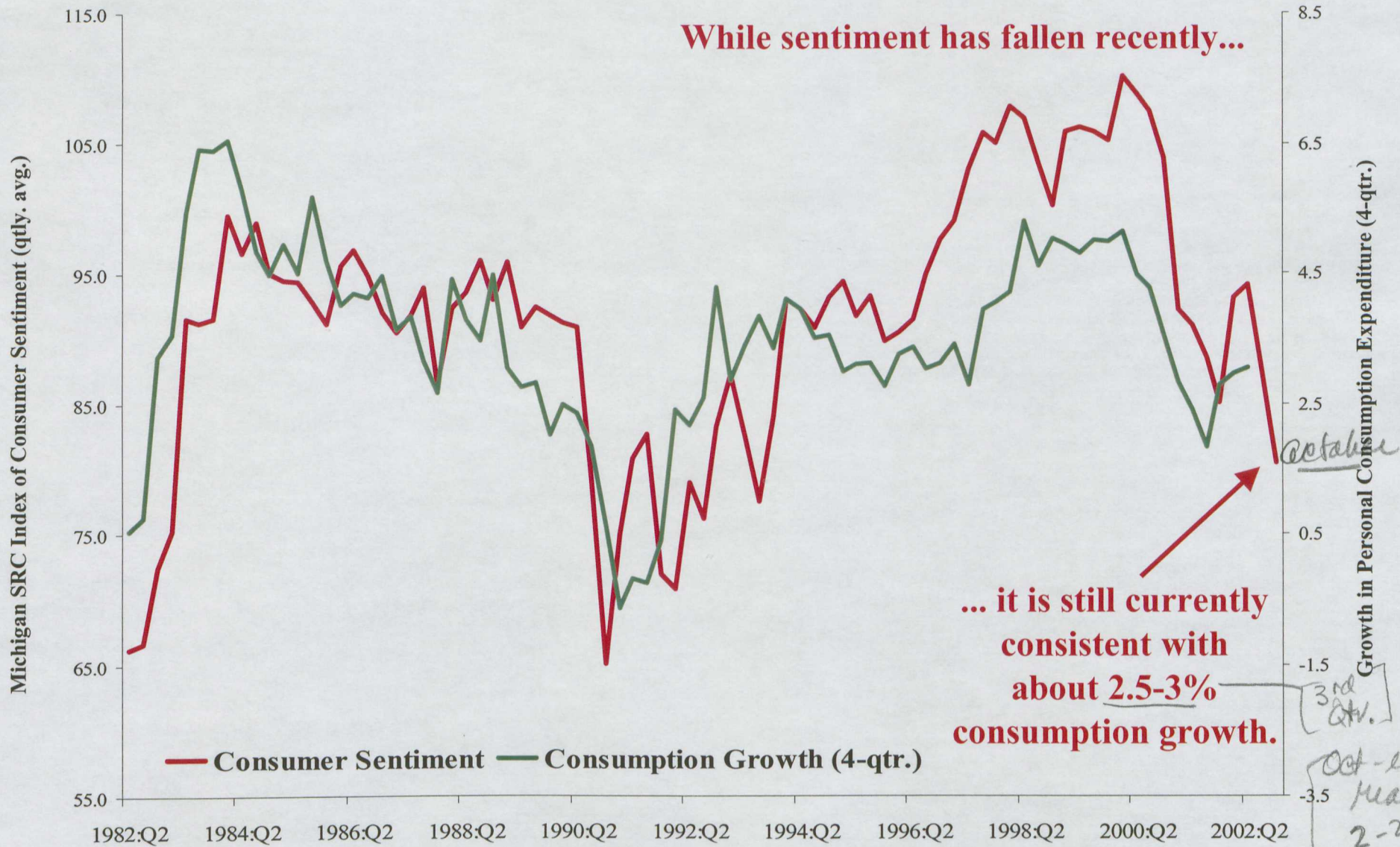
**Cathy E. Minehan, President  
Federal Reserve Bank of Boston**

**October 22, 2002**

# A Delicate Balance

- Consumer confidence has held up
  - Both by conventional measures
  - And as revealed through spending behavior
    - Spending on autos
    - Spending on houses
- Business confidence has been shaky
  - As a result, hiring has been anemic
    - Posing a risk for consumer spending
  - Investment is still largely a twinkle in firms' eyes
- This <sup>delicate</sup> balance has kept us growing modestly
  - But left us with unused capacity
  - And with risks distinctly tilted to the downside

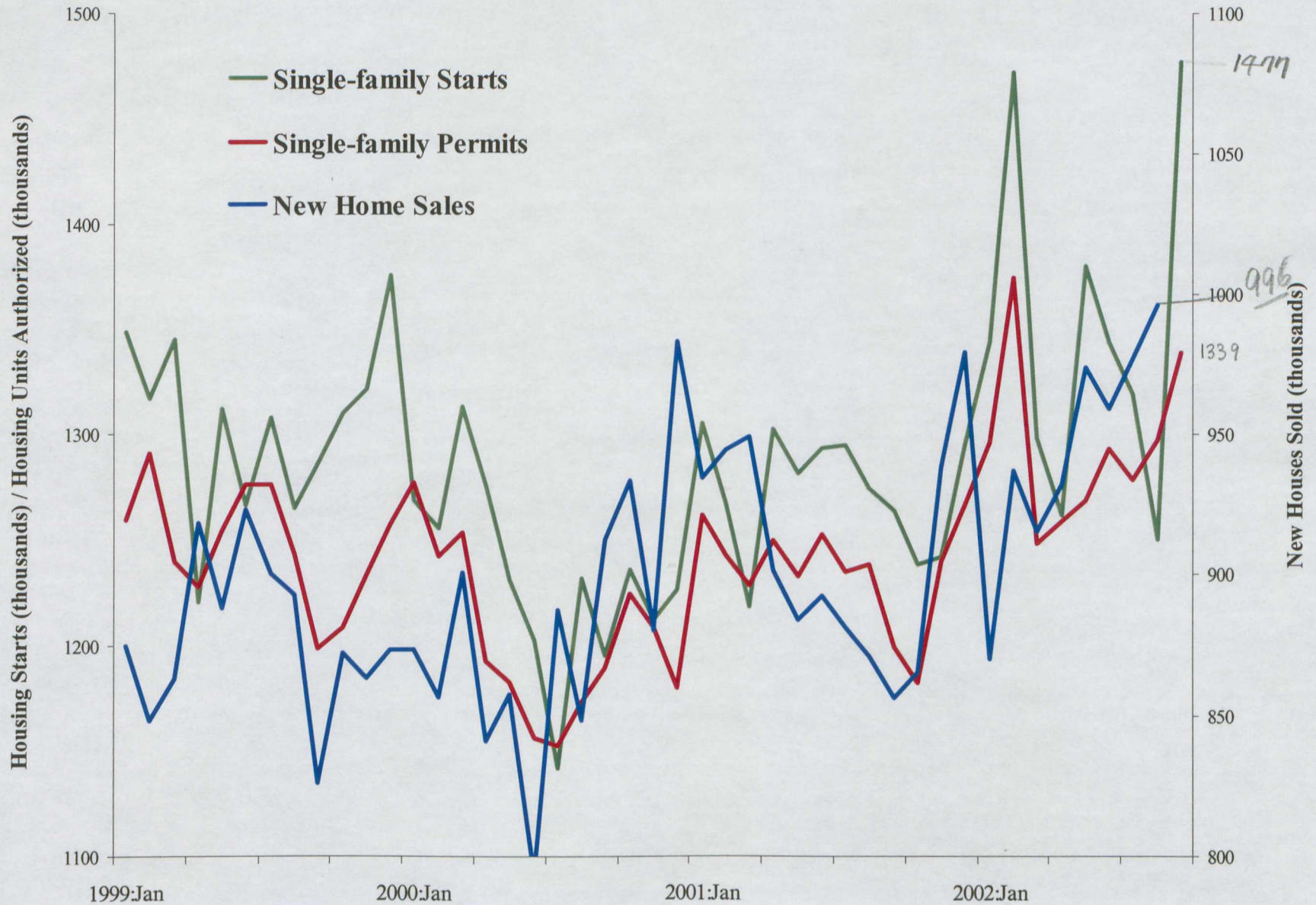
# Consumer confidence: Consumer spending has been a source of strength



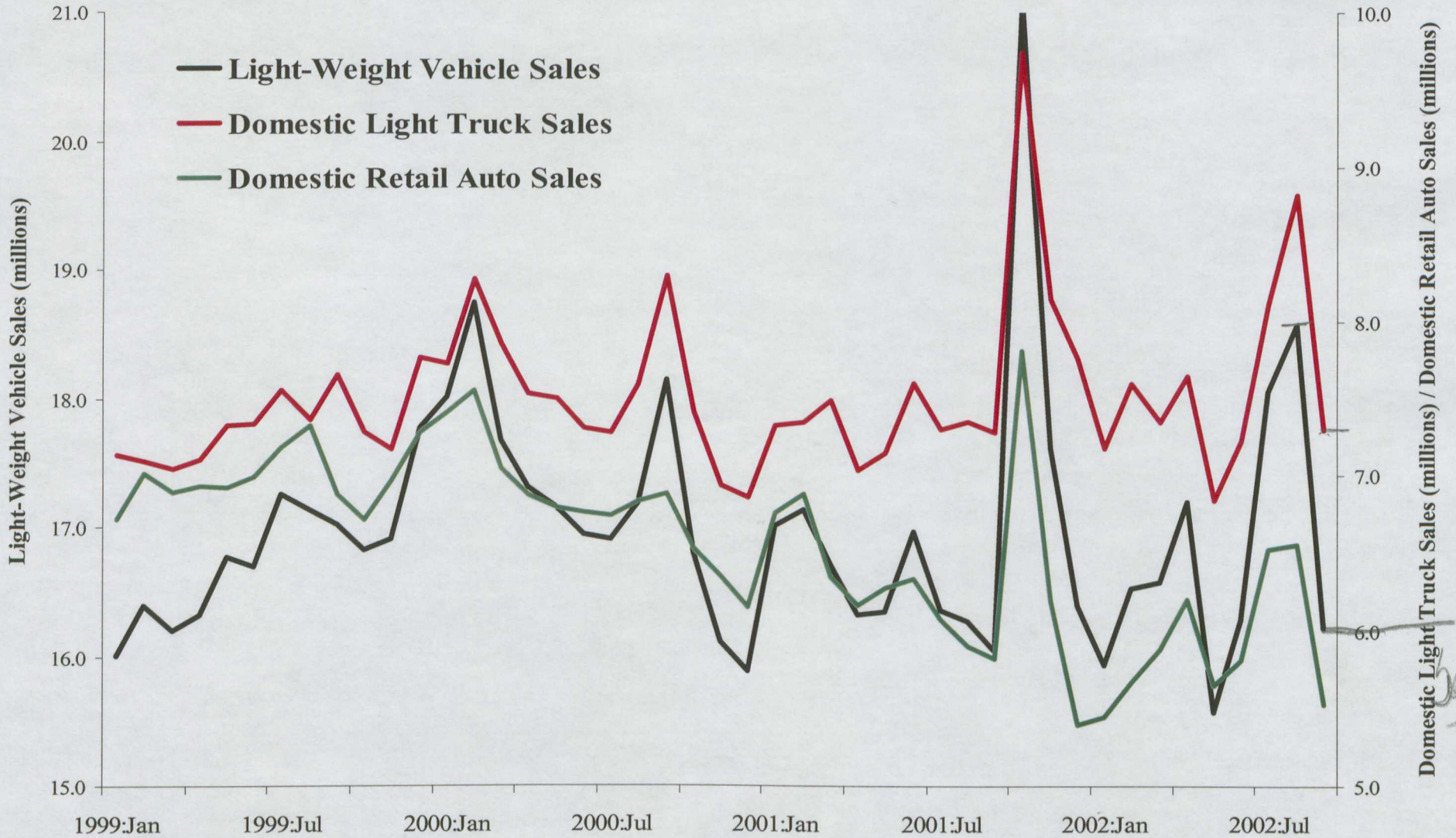
Sources: Consumer Sentiment (NSA, 1966:Q1 = 100): University of Michigan. Personal Consumption Expenditures (SAAR, Chained 1996\$): Bureau of Economic Analysis.

Note: Consumer Sentiment 2002:Q4 represents October only.

# Consumer confidence as revealed through spending: Housing activity remains robust

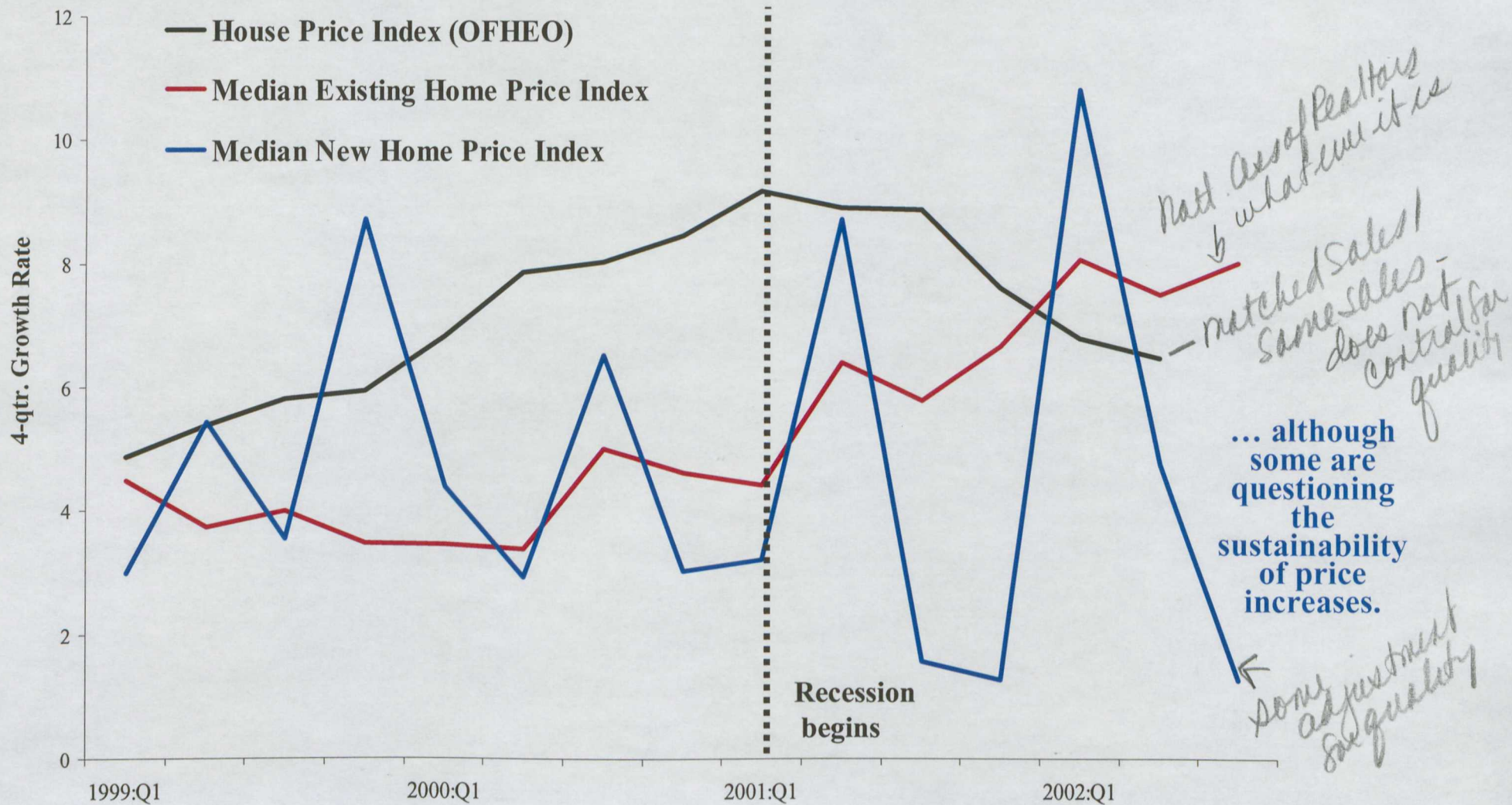


# Consumer confidence as revealed through spending: Auto sales continue at high levels



Source: Light-Weight Vehicle Sales (US Purchases of Autos and Light Trucks), Domestic Truck Sales (US Purchases of Light Trucks Assembled in North America, 0-10,000 Lbs. GVW) and Domestic Retail Auto Sales (US Purchases of Autos Assembled in North America, SAAR, Millions): Bureau of Economic Analysis.

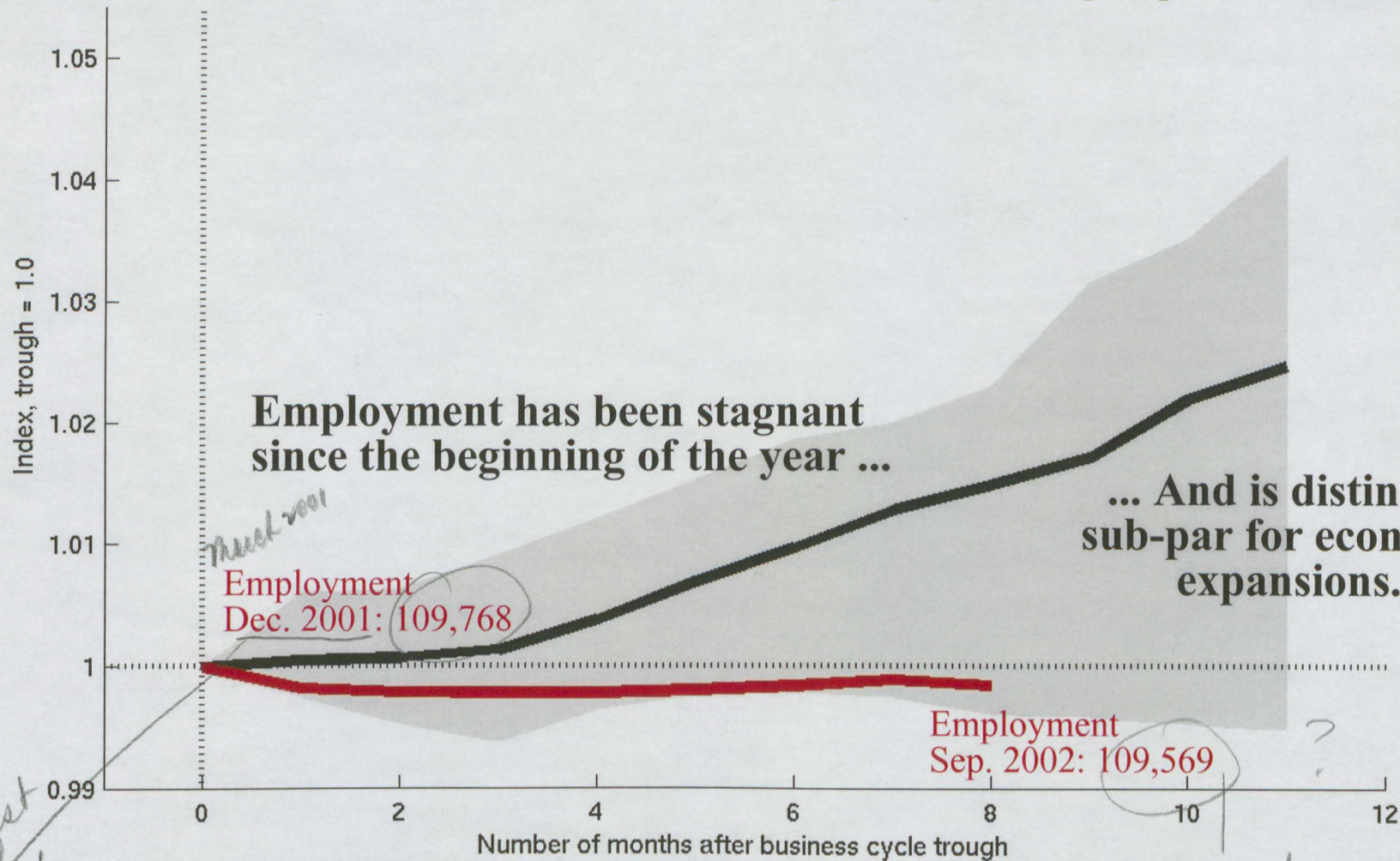
# Another support for consumer spending: Housing prices continue to grow, Reflecting strong demand and providing a source of strength



Sources: House Price Index (1980:Q1 = 100): Office of Federal Housing Enterprise Oversight. Existing 1-Family Homes, Median Sales Price (NSA): National Association of Realtors. New 1-Family Homes, Median Sales Price (NSA): Bureau of the Census.

# But business confidence has been much weaker, leading to another "jobless recovery"

Year-to-date cumulative private employment growth vs. cumulative employment growth from beginning of average expansion:



Employment has been stagnant since the beginning of the year ...

... And is distinctly sub-par for economic expansions.

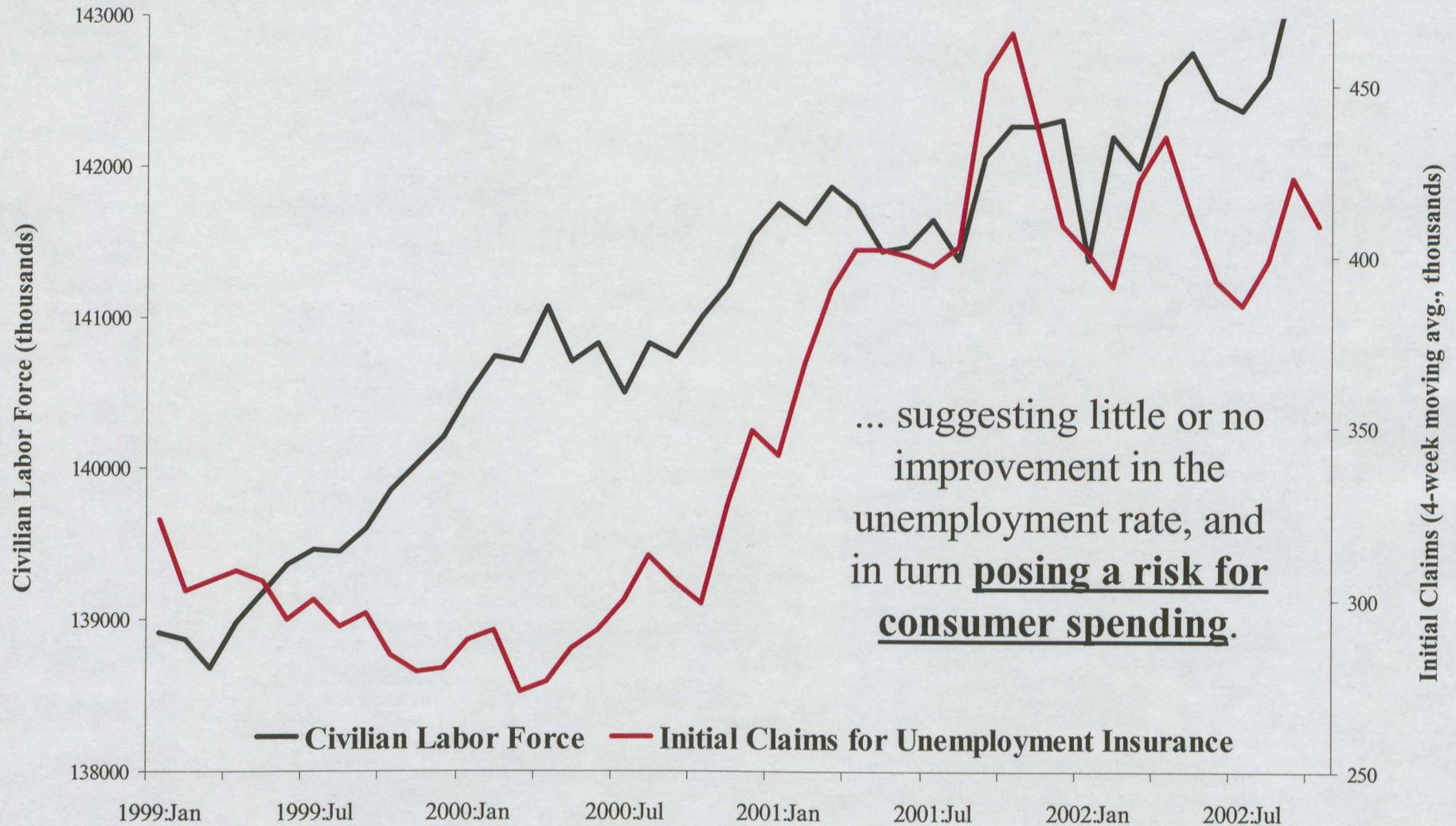
*Hardest trough*

Heavy black line represents average of recessions  
 Heavy red line represents current experience  
 Shaded area shows range of outcomes across all business cycles

Source: Employment at private non-farm establishments (SA); Bureau of Labor Statistics.

*total-down ~ 200 ms*

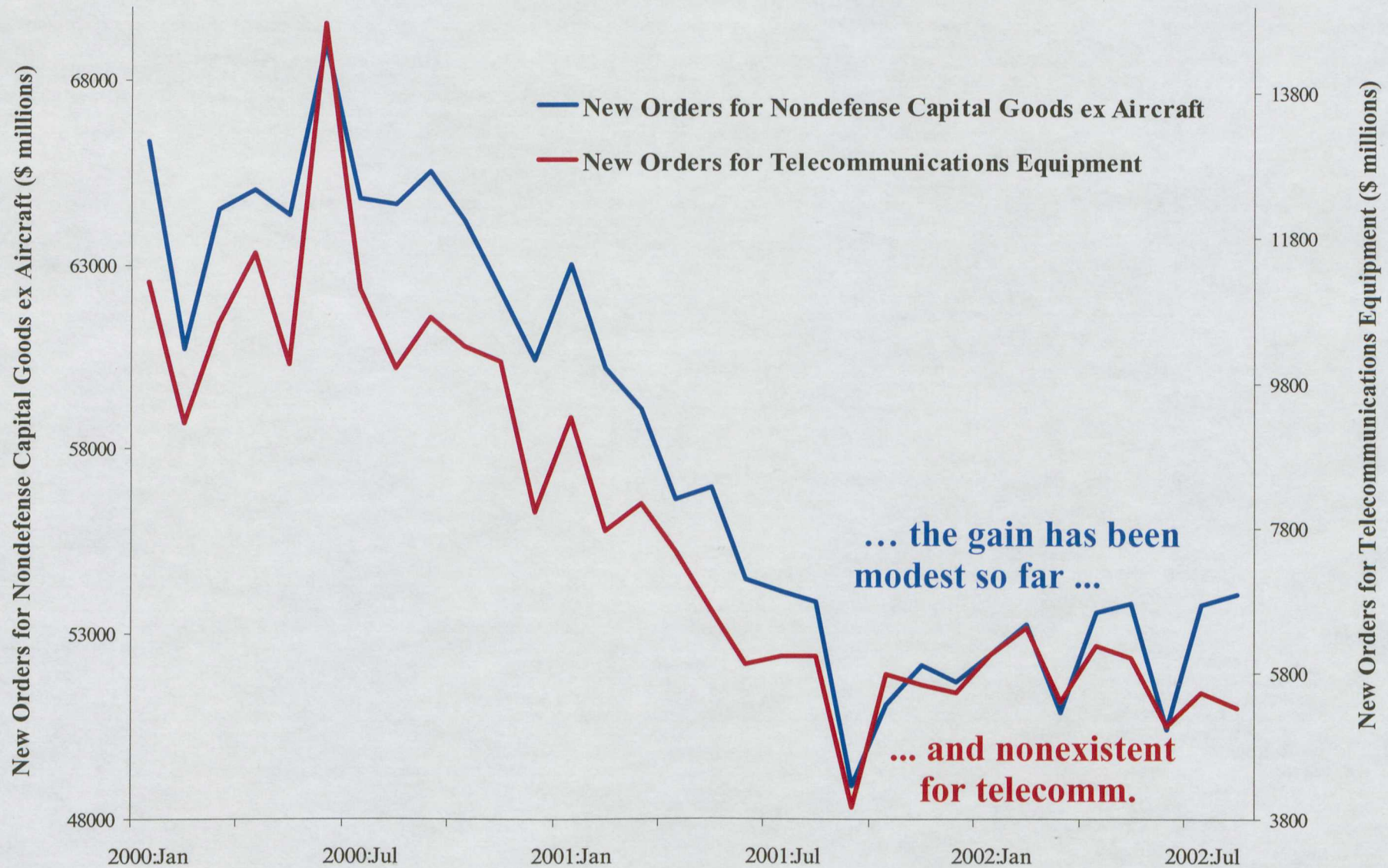
## As employment stagnates, the labor force continues to grow, and initial unemployment claims remain elevated ...



Sources: Civilian Labor Force, 16yr. + (SA, Thousands): Bureau of Labor Statistics. Initial Claims for Unemployment Insurance, State Programs (Weekly Average, SA, Thousands): Department of Labor.

Note: October Initial Claims represent claims through the week ending October 12.

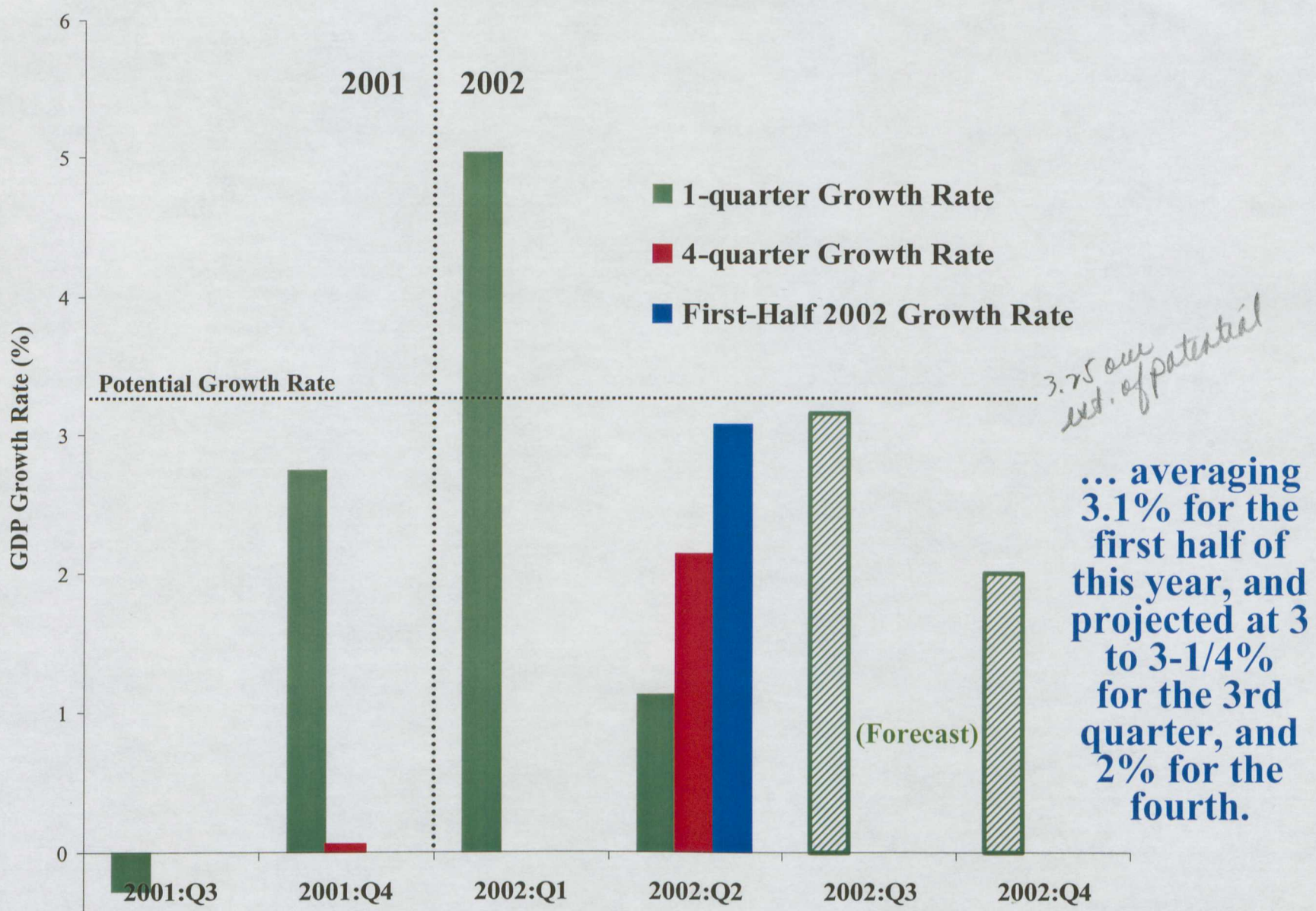
# While we have seen *some* improvement in the outlook for capital investment ...



Source: Manufacturers' New Orders for Nondefense Capital Goods excluding Aircraft and for Communication Equipment (SA, \$ Millions): Bureau of the Census.

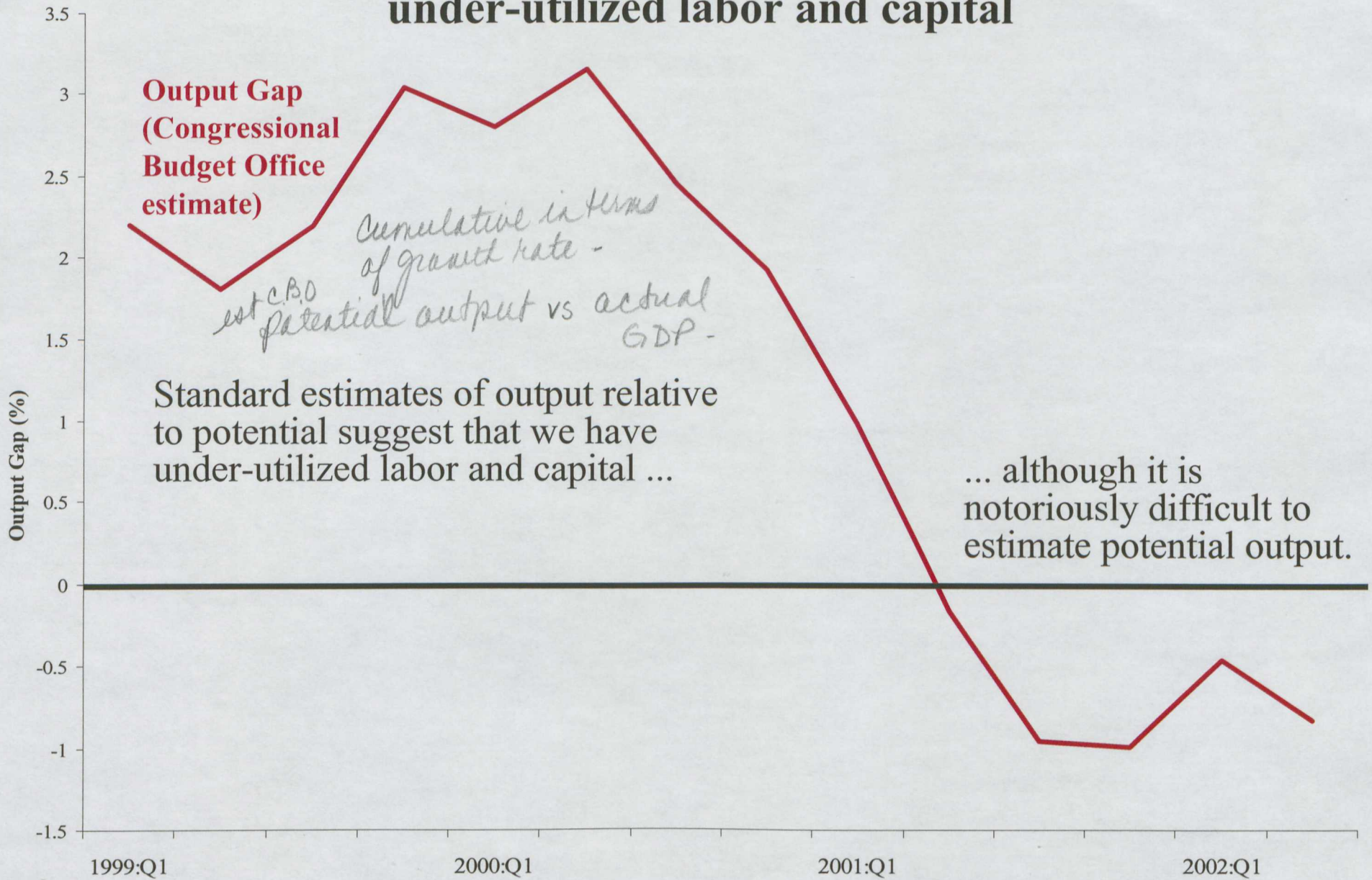
*nothing new here*

# This balance has afforded us modest growth of late ...



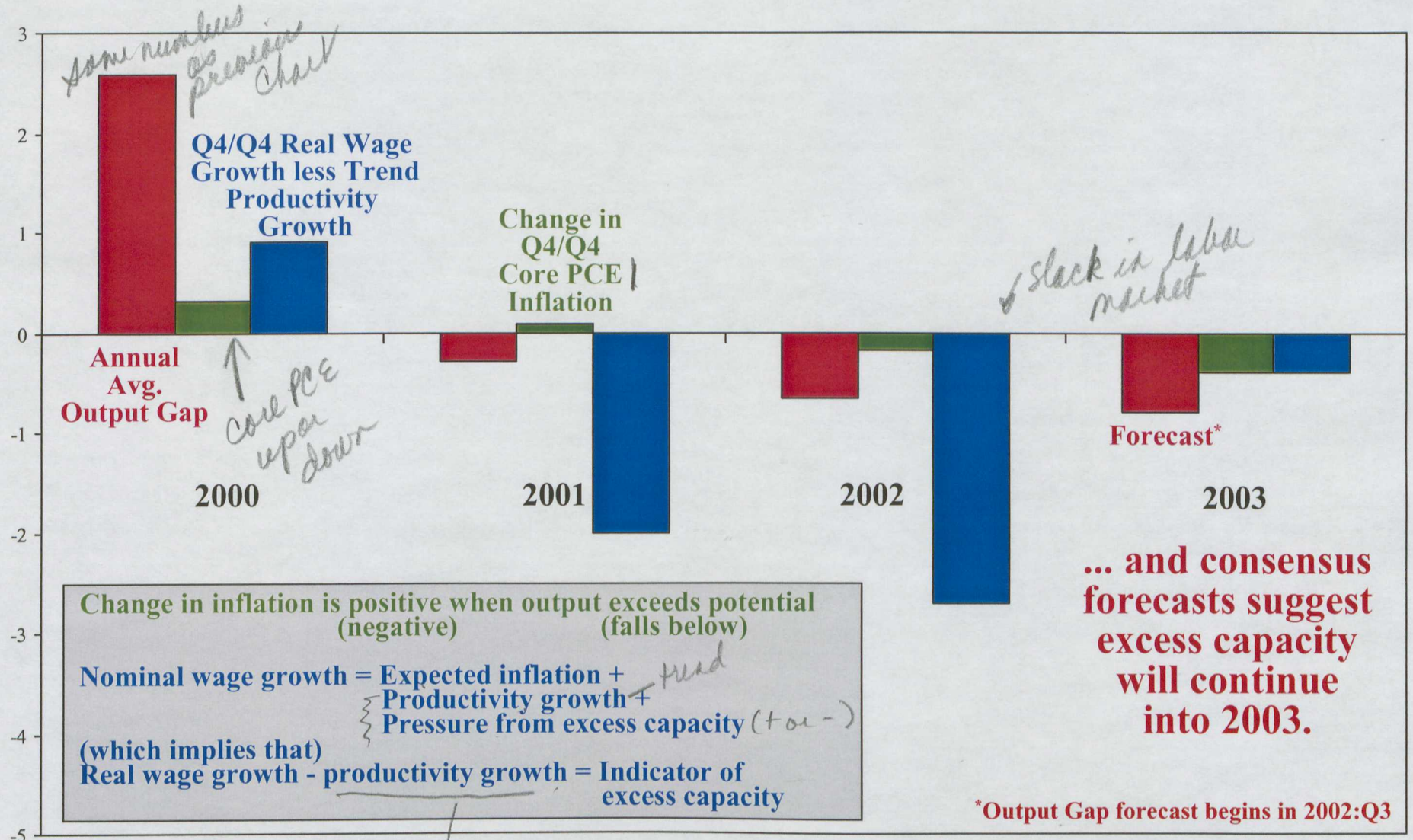
-1 Source: Real Gross Domestic Product (SAAR, Chained 1996\$): Bureau of Economic Analysis.

# Modest growth has yielded little progress in absorbing under-utilized labor and capital



Sources: Real Gross Domestic Product (SAAR, Chained 1996\$): Bureau of Economic Analysis. Real Potential Gross Domestic Product, (Chained 1996\$): Congressional Budget Office.

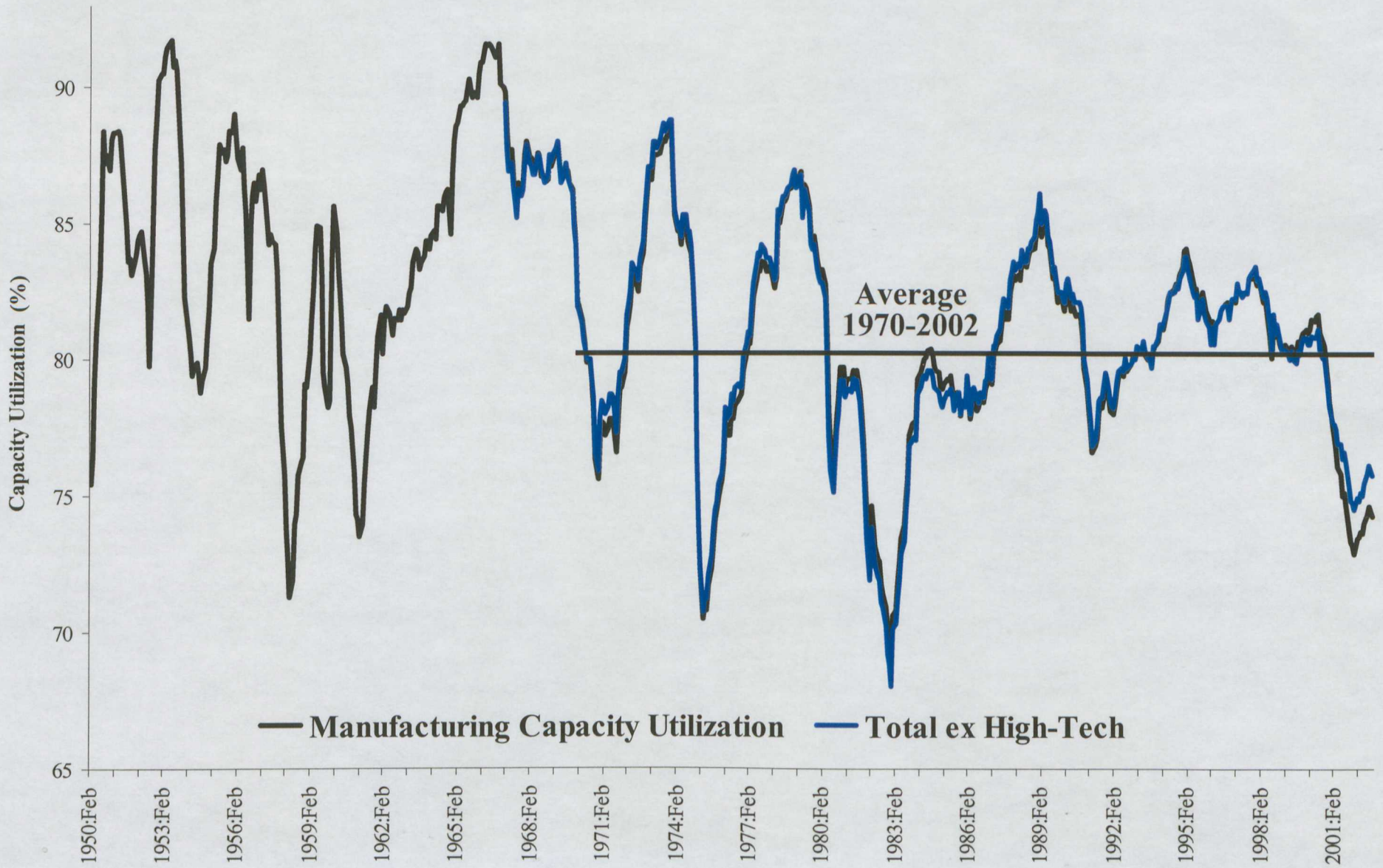
# The downward trend in wage and price inflation confirms the conventional estimates of excess capacity ...



Sources: Real Gross Domestic Product (SAAR, Chained 1996\$), PCE Less Food & Energy, Chain Price Index (SA, 1996=100): Bureau of Economic Analysis. Real Potential Gross Domestic Product (Chained 1996\$): Congressional Budget Office. Nonfarm Business Sector: Real Compensation Per Hour (SA, 1992=100), Output Per Hour, All Persons (SA, 1992=100): Bureau of Labor Statistics. Trend productivity is computed from the BLS nonfarm labor productivity series using a statistical filter.

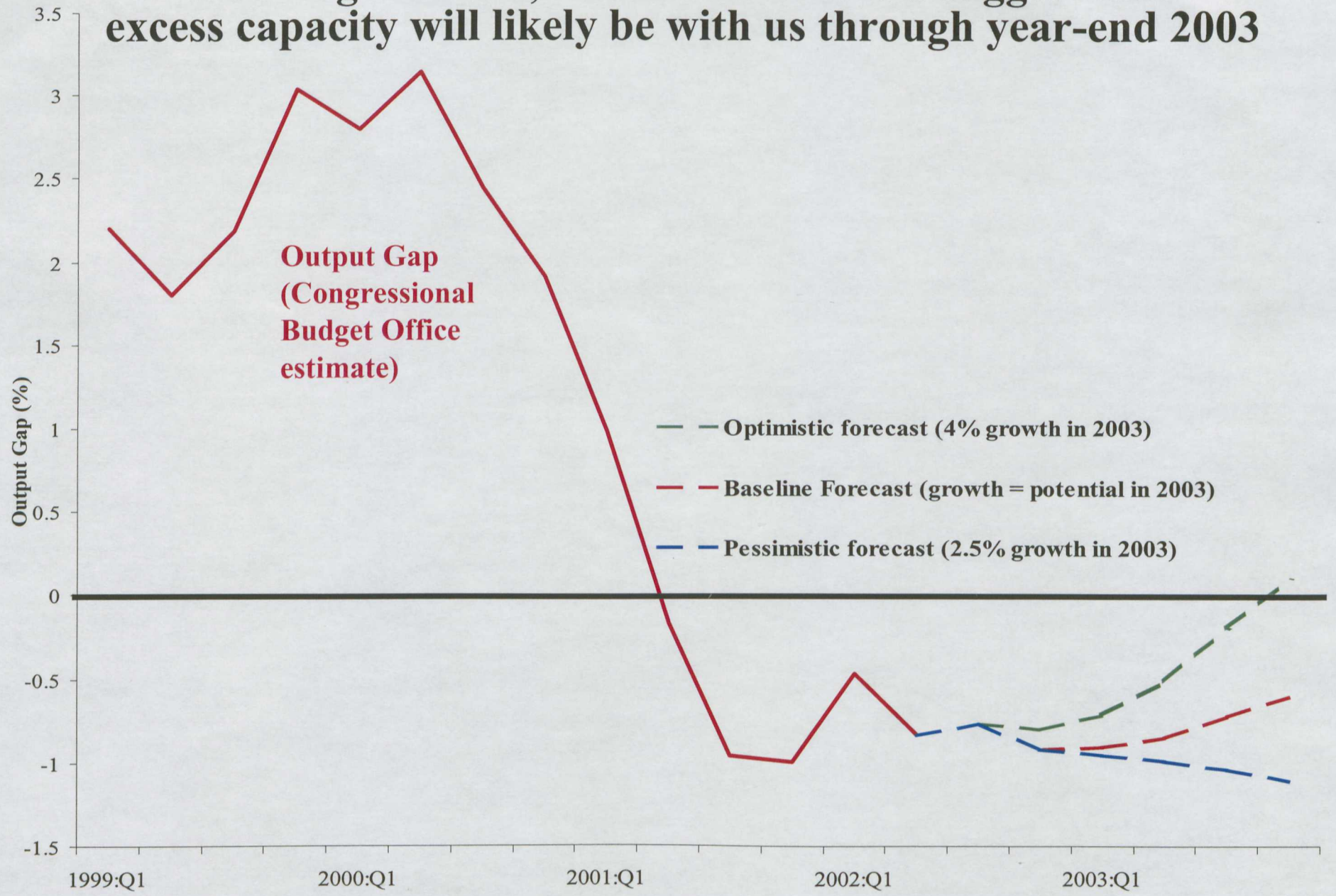
*non farm compensation - law three's 1.25 - 2.75*

# In manufacturing, without question we continue to have excess capacity, both overall and excluding high-tech sectors



Sources: Capacity Utilization Percentage: Manufacturing and Manufacturing excluding Computers, Communication Equipment, and Semiconductors (SA): Federal Reserve Board.

# Looking forward, consensus forecasts suggest that excess capacity will likely be with us through year-end 2003



Sources: Real Gross Domestic Product (SAAR, Chained 1996\$): Bureau of Economic Analysis. Real Potential Gross Domestic Product (Chained 1996\$): Congressional Budget Office.

# Risks to Outlook

- Positive side:

- Stimulative effects of war spending - *oil prices lower today*
- Extended effects of home refinancing/cash-out - *100 Billion*

- Negative side:

- Additional profits surprises (further corporate governance/accounting issues, oil price hikes?)

→ further declines/volatility in equity prices ←

*Leading Indicators - 4 straight declines - but really flat - echoing wall Street*

*Mfg very gloomy*

- Stagnant employment/rising unemployment

*Trade deficit 38.5 - August low in July (strike worries) → imports b → gloom & doom in mfg.*

- Geopolitical risks (war, terrorism, oil prices)

- Refinancing waves end as mortgage rates stabilize (FNMA increasing points for cash-out)

- Weaker than expected investment demand

(forecasts optimistic; business contacts less so)

*uncertain re economy - \$ remains strong x parts off - sitting on hands*

*Industrial Prod - fell Aug & Sept July last 9 factory output*

*- no desire to make new investments*

# Policy Considerations

- Inflation appears quiescent for now
  - Edging down a bit?
  - Possible temporary effect of oil prices.
- We've attained a balance between consumers and firms to date
- The current outlook has us growing near potential next year
  - But the risks to maintaining that balance appear to be on the downside, as the FOMC suggested at its last meeting.
  - Implying that excess capacity will remain, and possibly deteriorate further.