GDP - Govt. PCE cap x good profits data · Look fwd to conversation after

The Domestic Economic Outlook

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Joint Center for Housing Studies

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Preface

Overview

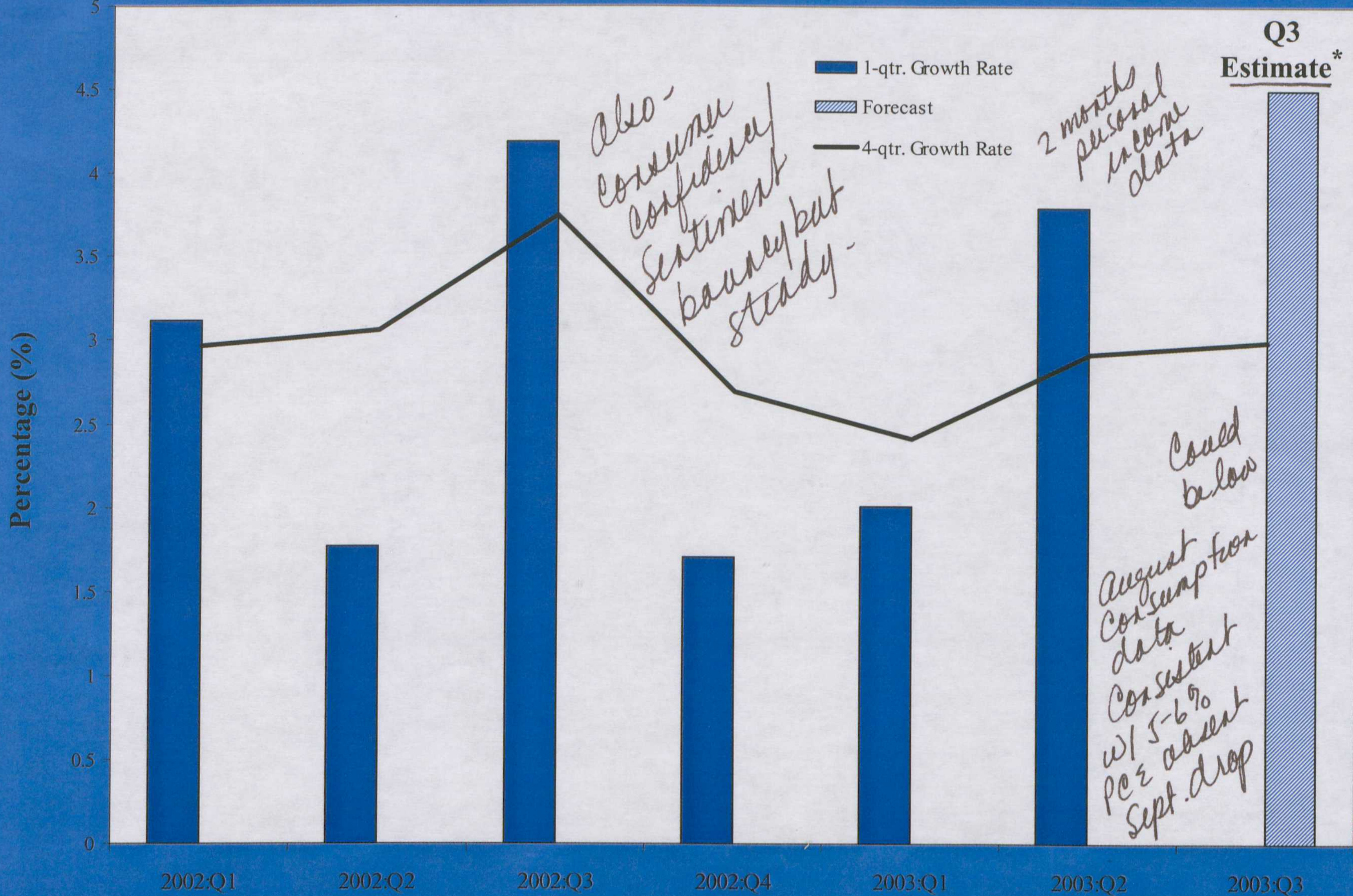
- **GDP growth in Q3 will be quite strong**
  - Consumption data robust in July and August
  - Industrial production and investment seem to be recovering

- **How much staying power in recent momentum?**
  - What are the effects of tax policy, defense spending, interest rates?
  - If strong growth persists, when will it stimulate hiring?

- **Full recovery awaits improvement in labor markets**
  - Firms continue to be reluctant to increase employment
  - Concerns remain about sustainability of growth

- **Macroeconomic outlook favorable**
  - But significant reductions in unemployment and excess capacity hinge on forecasts of relatively robust growth
  - Inflation quite low and unlikely to rise soon

Consumption growth has improved of late



* Estimate based on monthly retail sales and personal consumption data.
Source: Personal Consumption Expenditures (SAAR, Chained 1996$): Bureau of Economic Analysis.

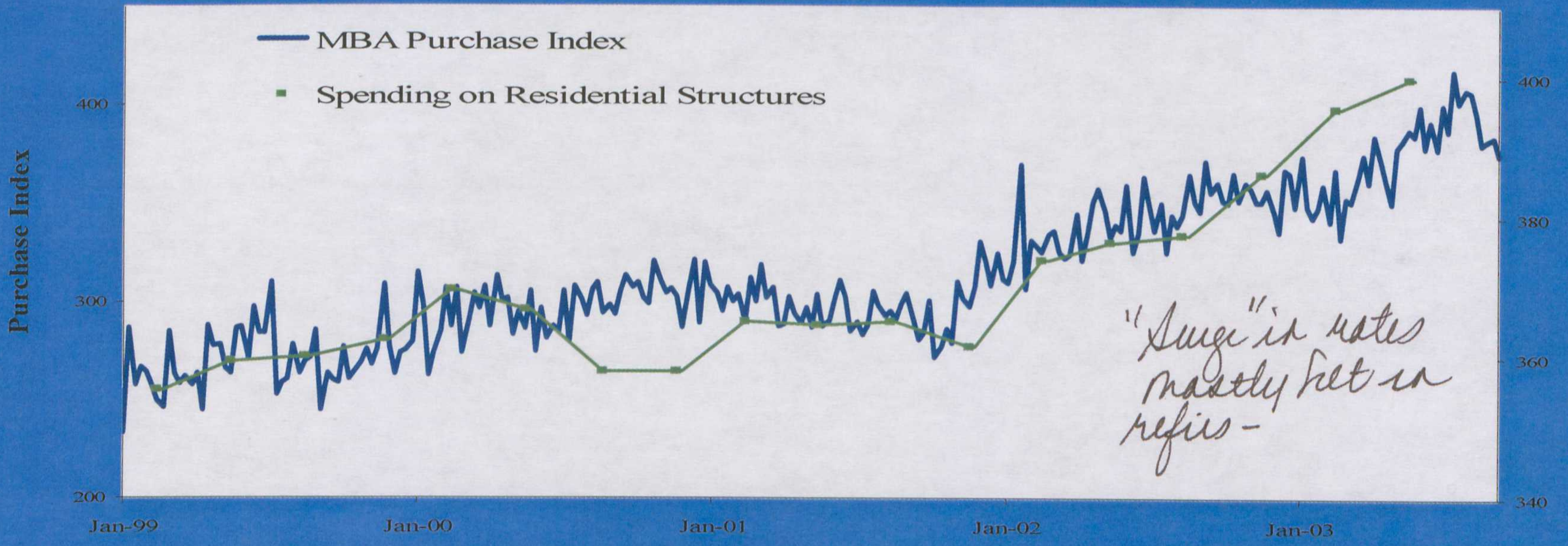
Led By Auto Sales

Total light-weight vehicle sales have surged recently

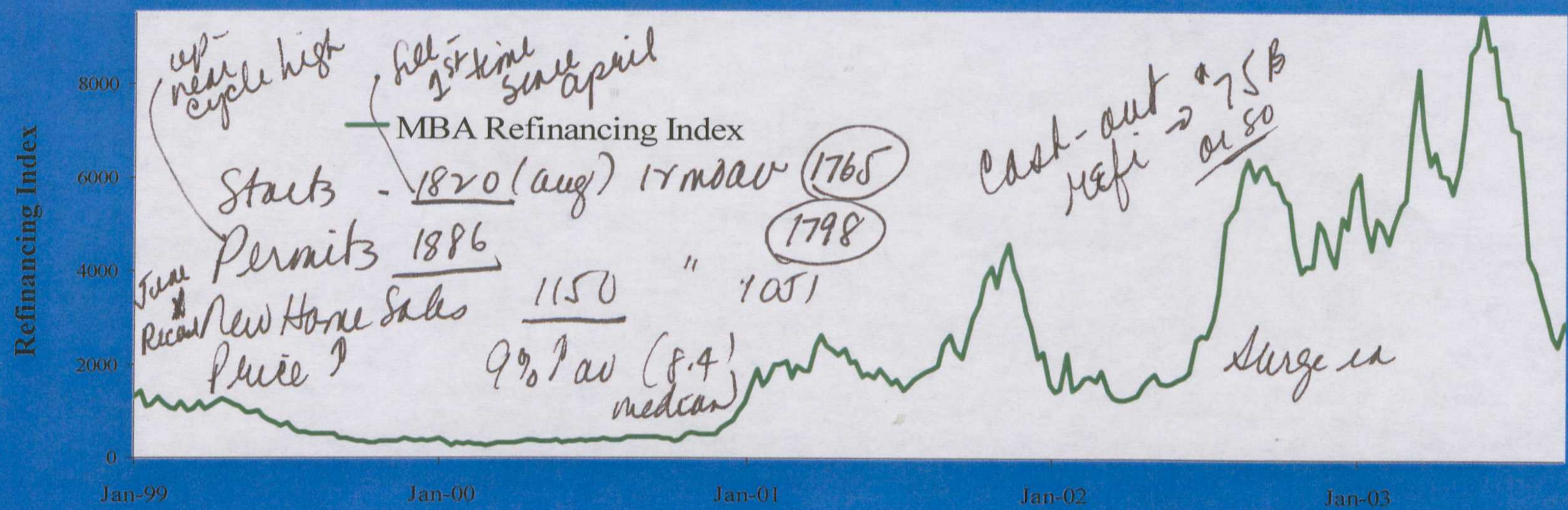
Source: Light-Weight Vehicle Sales (SAAR, Autos & Light Trucks, Millions of Units): Bureau of Economic Analysis.

And Residential Construction is Strong

Although recent mortgage-origination data suggest a slowing

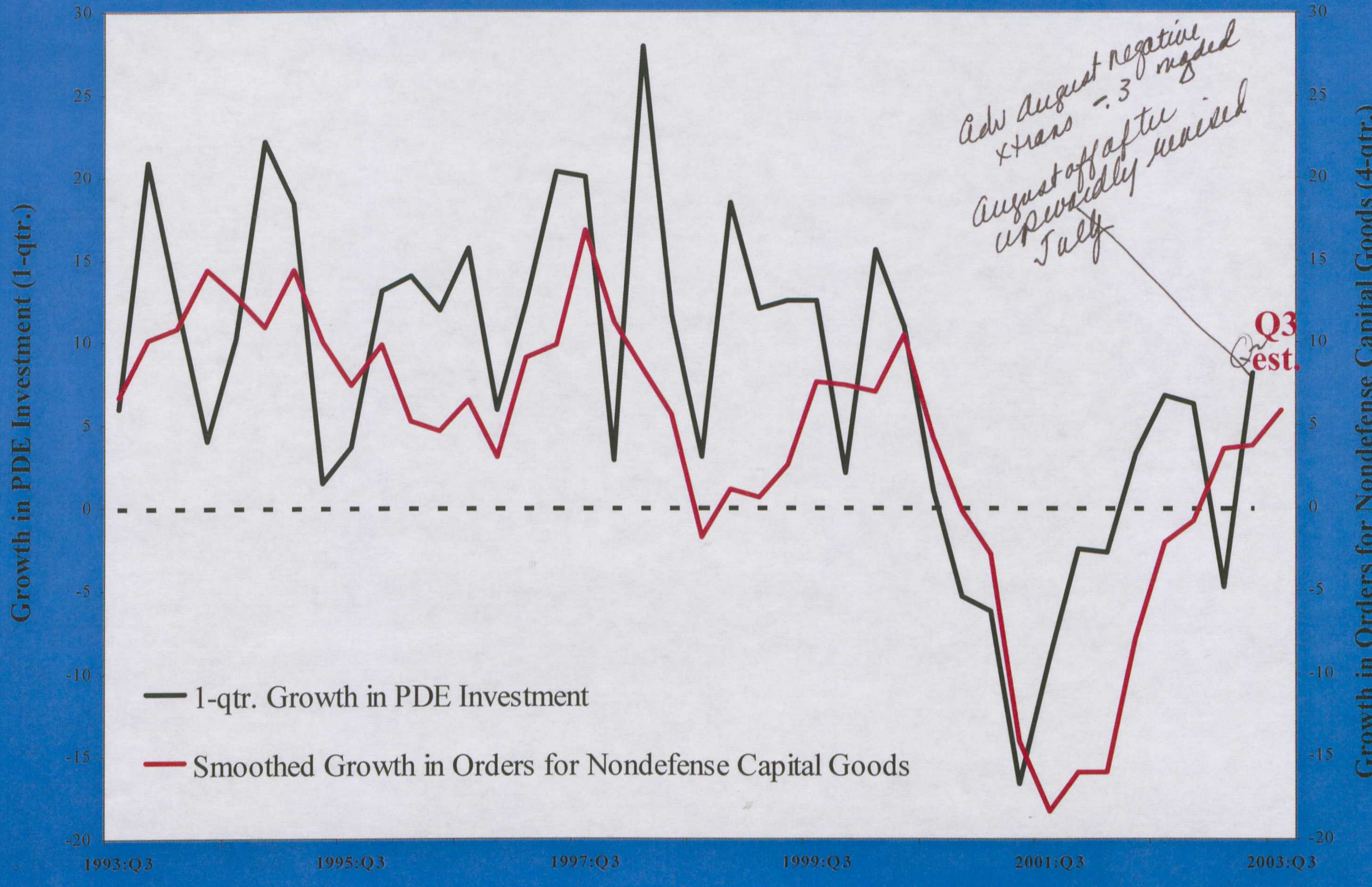


With a smaller contribution to consumption from cash-out refinancing



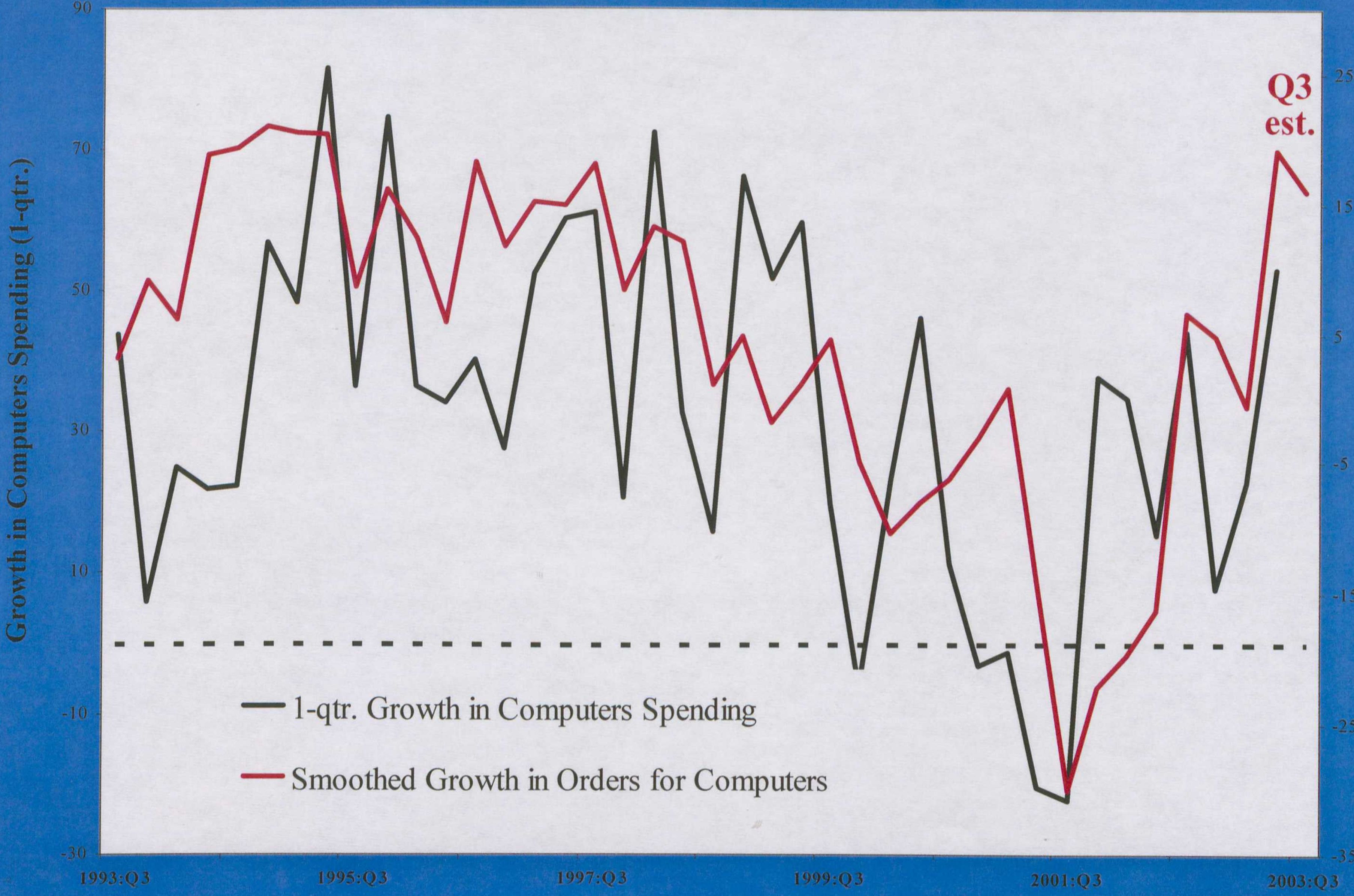
Sources: Mortgage Bankers' Association Purchase and Refinancing Indexes (SA); Federal Reserve Board. Residential Fixed Investment in Structures (SAAR, Billions Chained 1996$); Bureau of Economic Analysis.

Recent orders growth is consistent with real PDE growth that may reach double digits this quarter ...



Sources: Gross Private Domestic Investment in Nonresidential Equipment and Software (SAAR): Bureau of Economic Analysis. Manufacturers' New Orders for Nondefense Capital Goods excluding Aircraft (SA): Bureau of the Census.

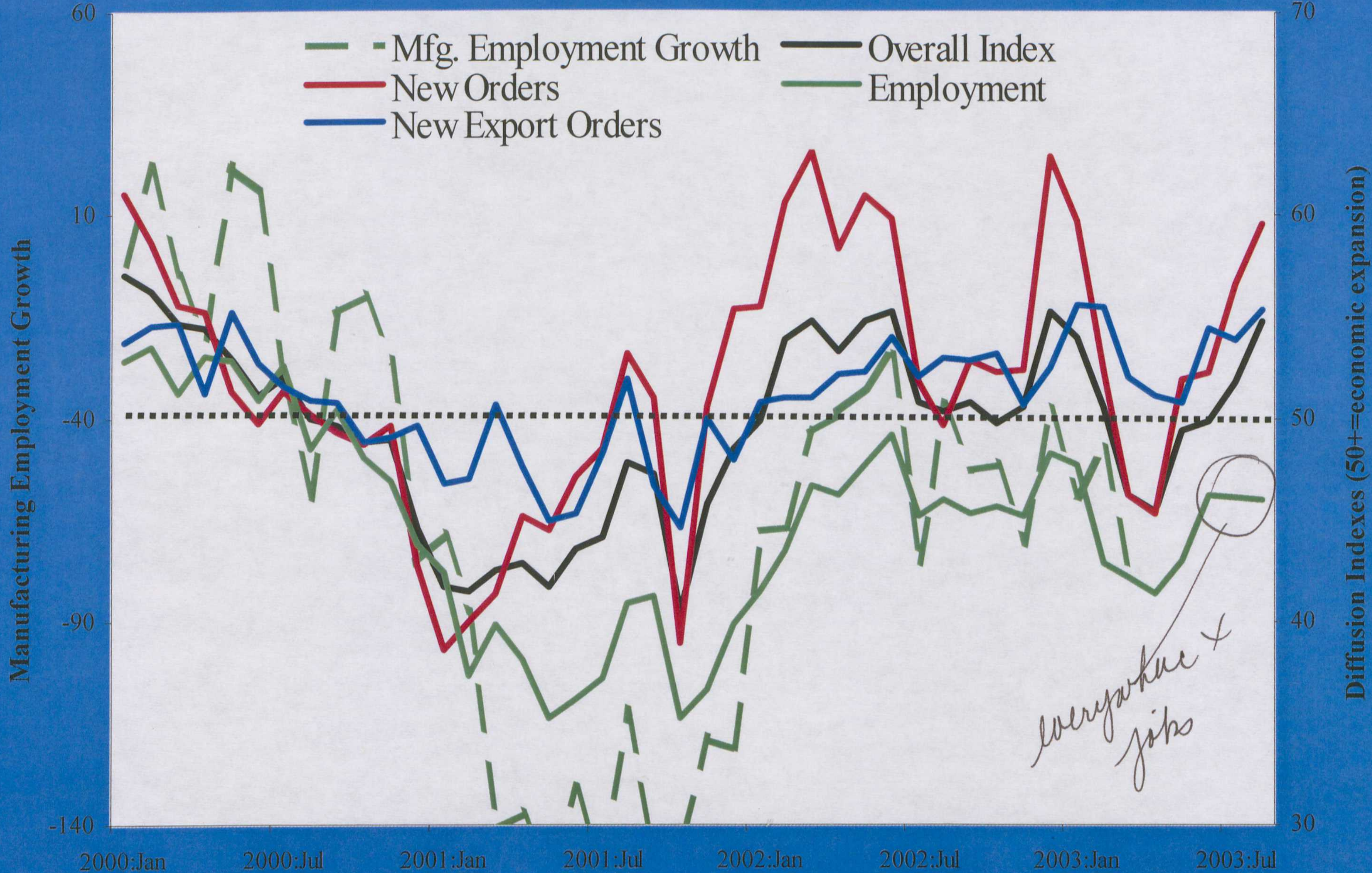
Orders data suggest continued strong growth in computer spending



Sources: Gross Private Domestic Investment in Computers & Peripheral Equipment (SAAR): Bureau of Economic Analysis. Manufacturers' New Orders for Computers & Related Products (SA): Bureau of the Census.

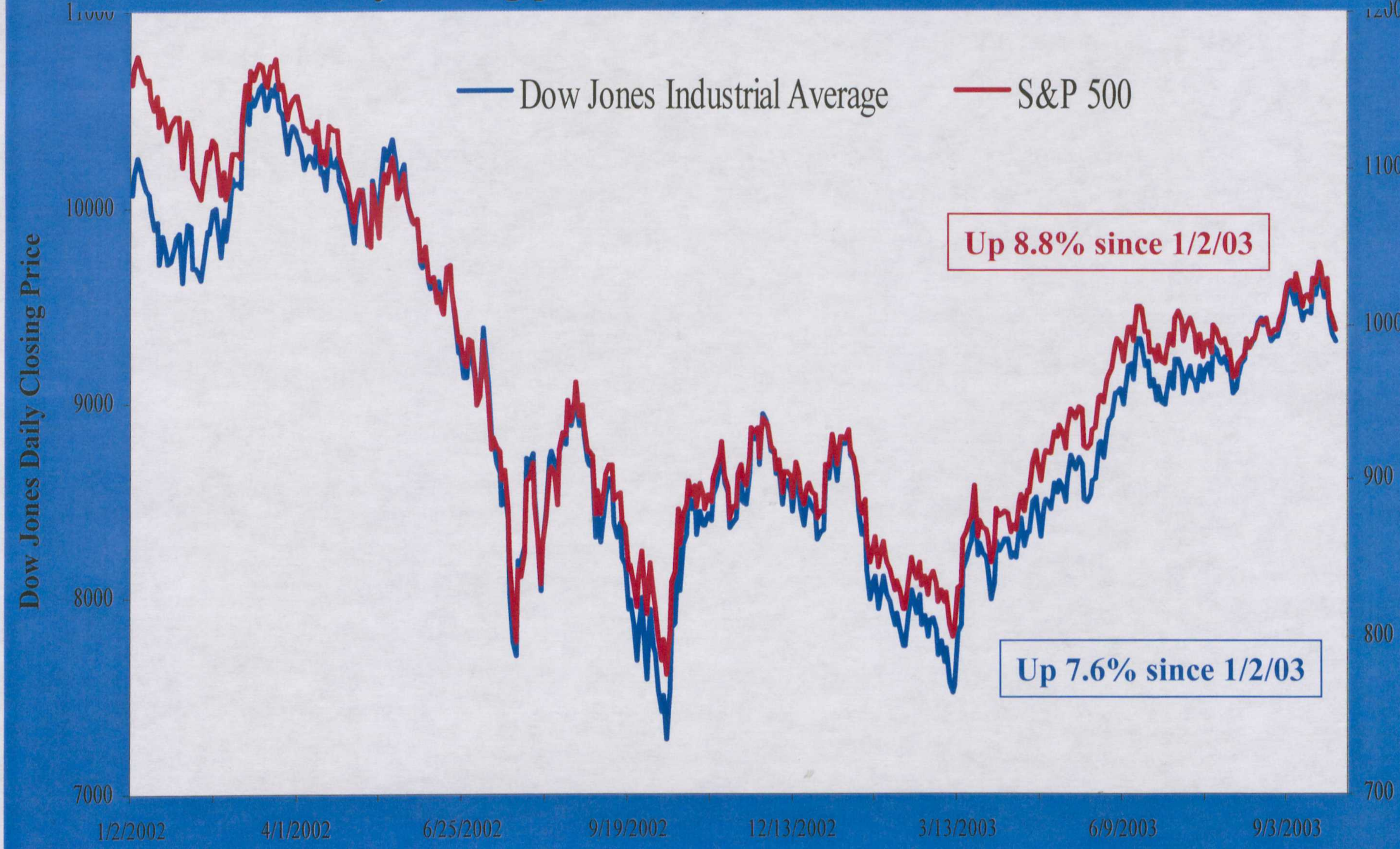
Manufacturing is showing glimmers of hope

ISM Diffusion Indexes



Sources: ISM Manufacturing: PMI Composite Index, New Orders Index, Employment Index, and New Export Orders Index (SA, 50+=economic expansion): Institute for Supply Management. Manufacturing Employment (SA, Thousands): Bureau of Labor Statistics.

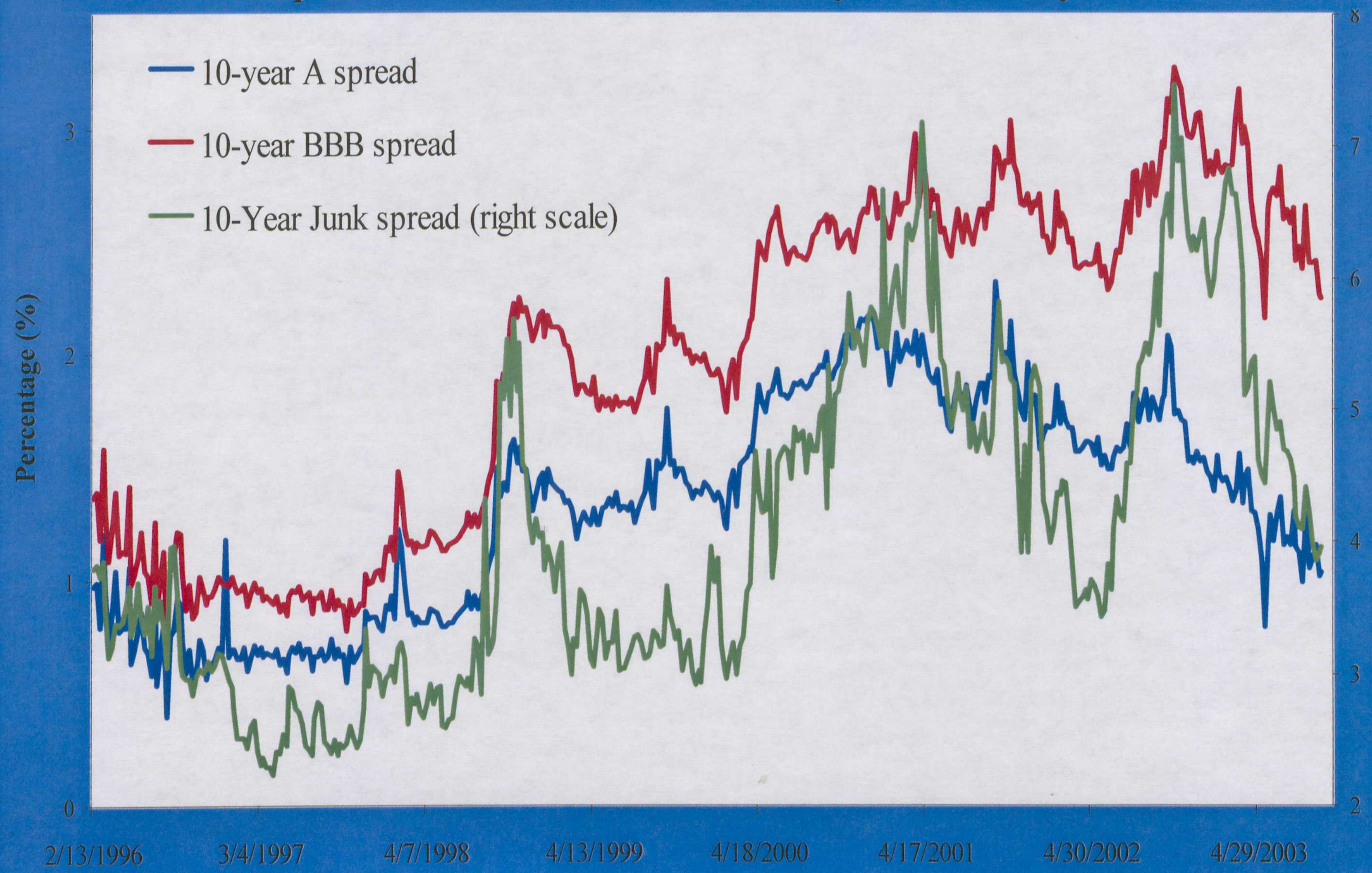
What is Supporting Growth?
Financial Market performance
Daily closing prices for the DJIA and the S&P 500



Source: S&P 500 Composite Index, Wilshire 5000 Stock Index, Dow Jones Industrial Average (Daily Closing Price): Bloomberg.

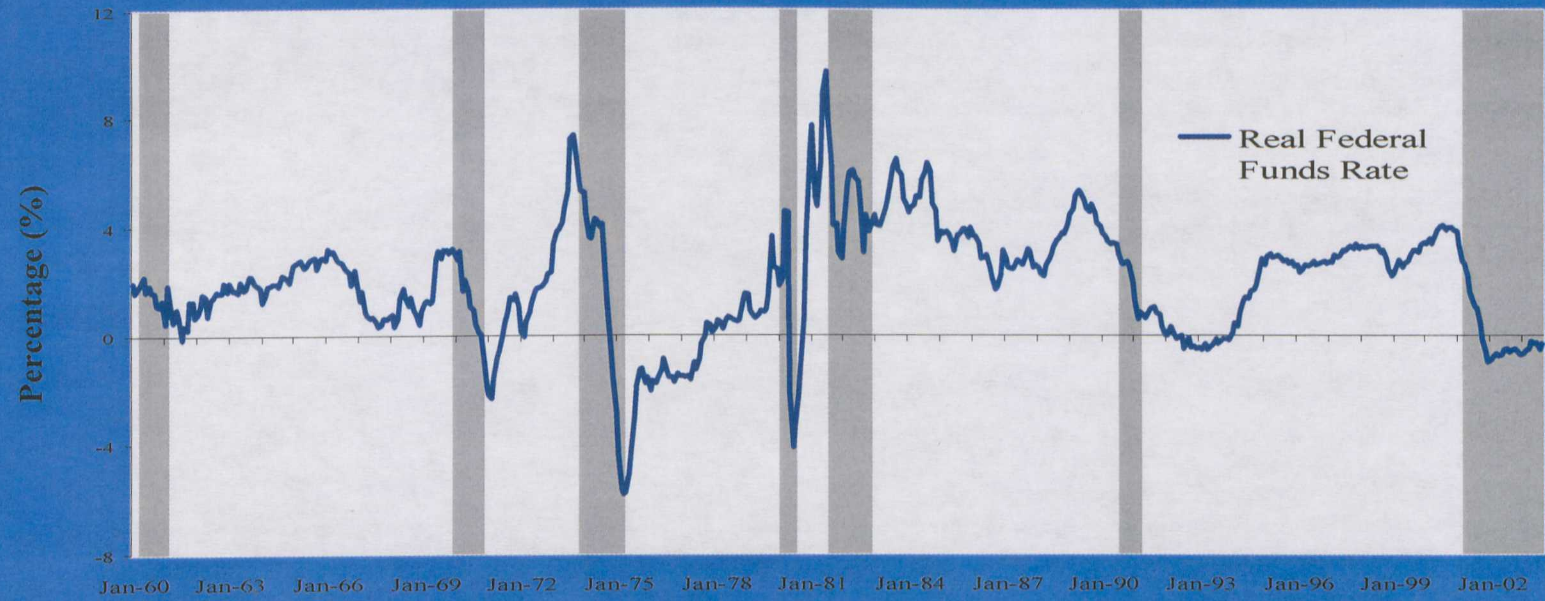
What is Supporting Growth? Financial Market performance

Spread of indicated rate over 10-year Treasury rate

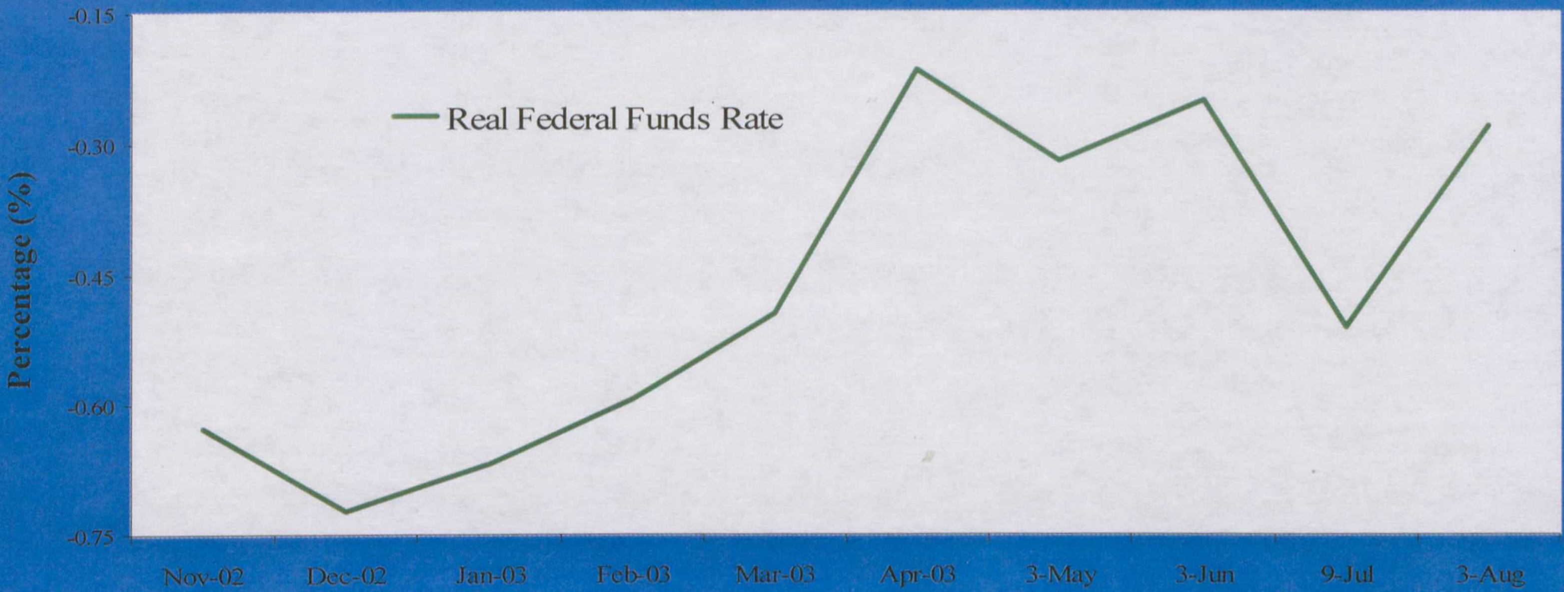


Sources: 10-year Treasury Bond Yield at Constant Maturity: Federal Reserve Board. 10-year Industrial Corporate Bond Yields: Standard & Poor's.

Stimulative monetary policy ...

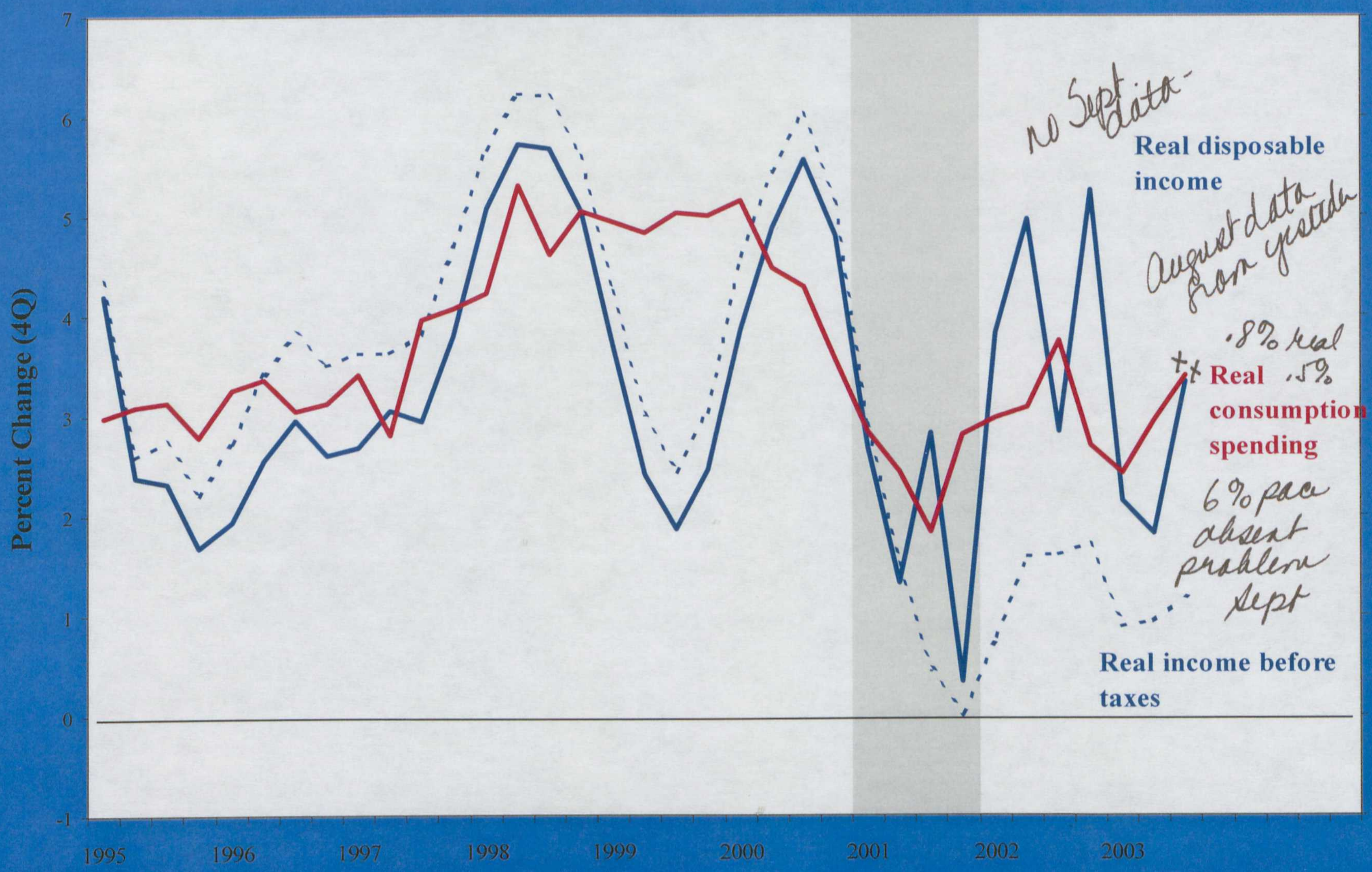


... although with falling inflation, it has become less so recently



Sources: Effective Federal Funds Rate (% p.a.): Federal Reserve Board. CPI-U, All Items Less Food & Energy (SA, 1982-84=100): Bureau of Labor Statistics.

And Stimulative Fiscal Policy
through tax cuts



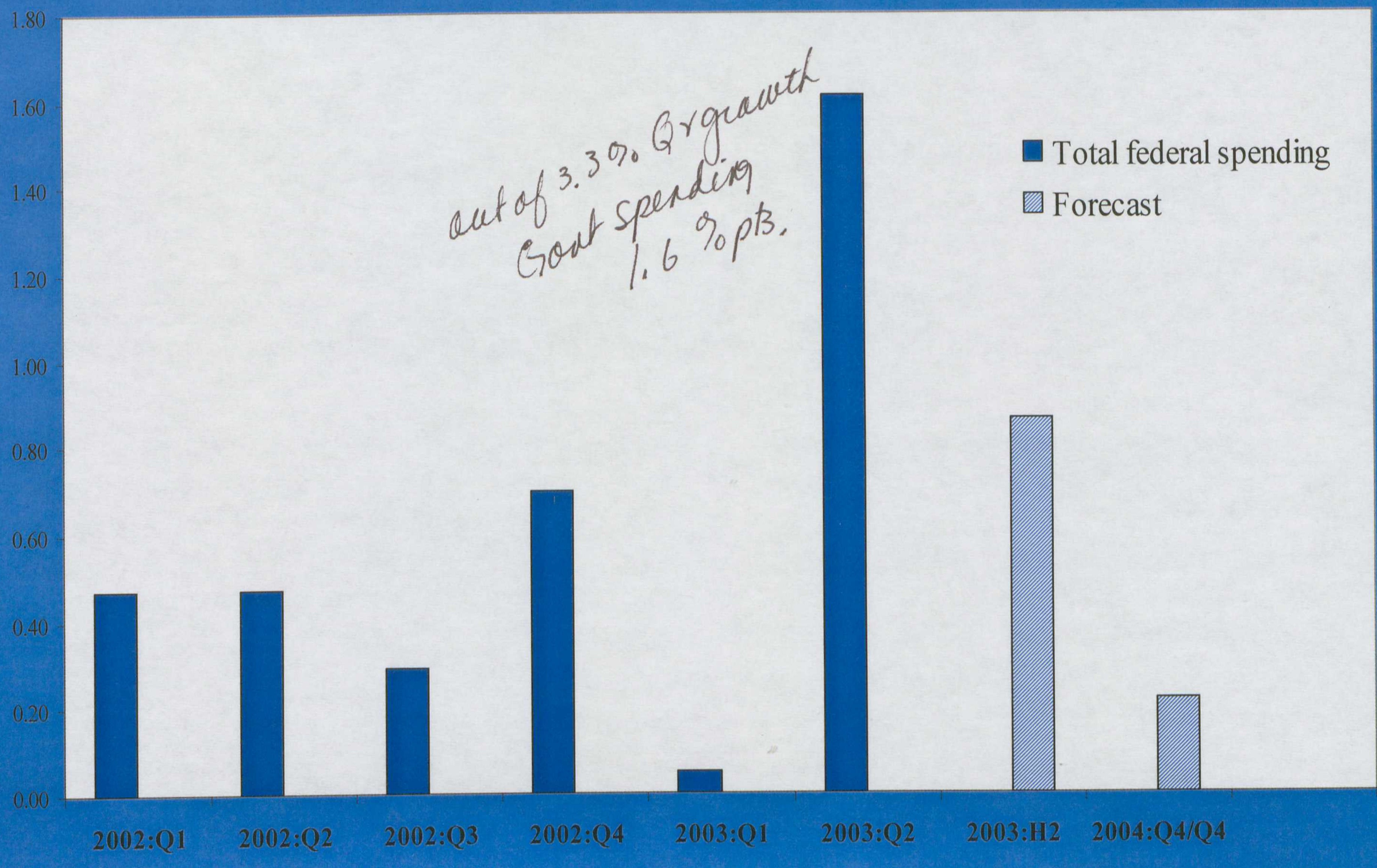
Source: Haver Analytics

Note: 2003 Q3 data equals the average of July and August.

And Stimulative Fiscal Policy

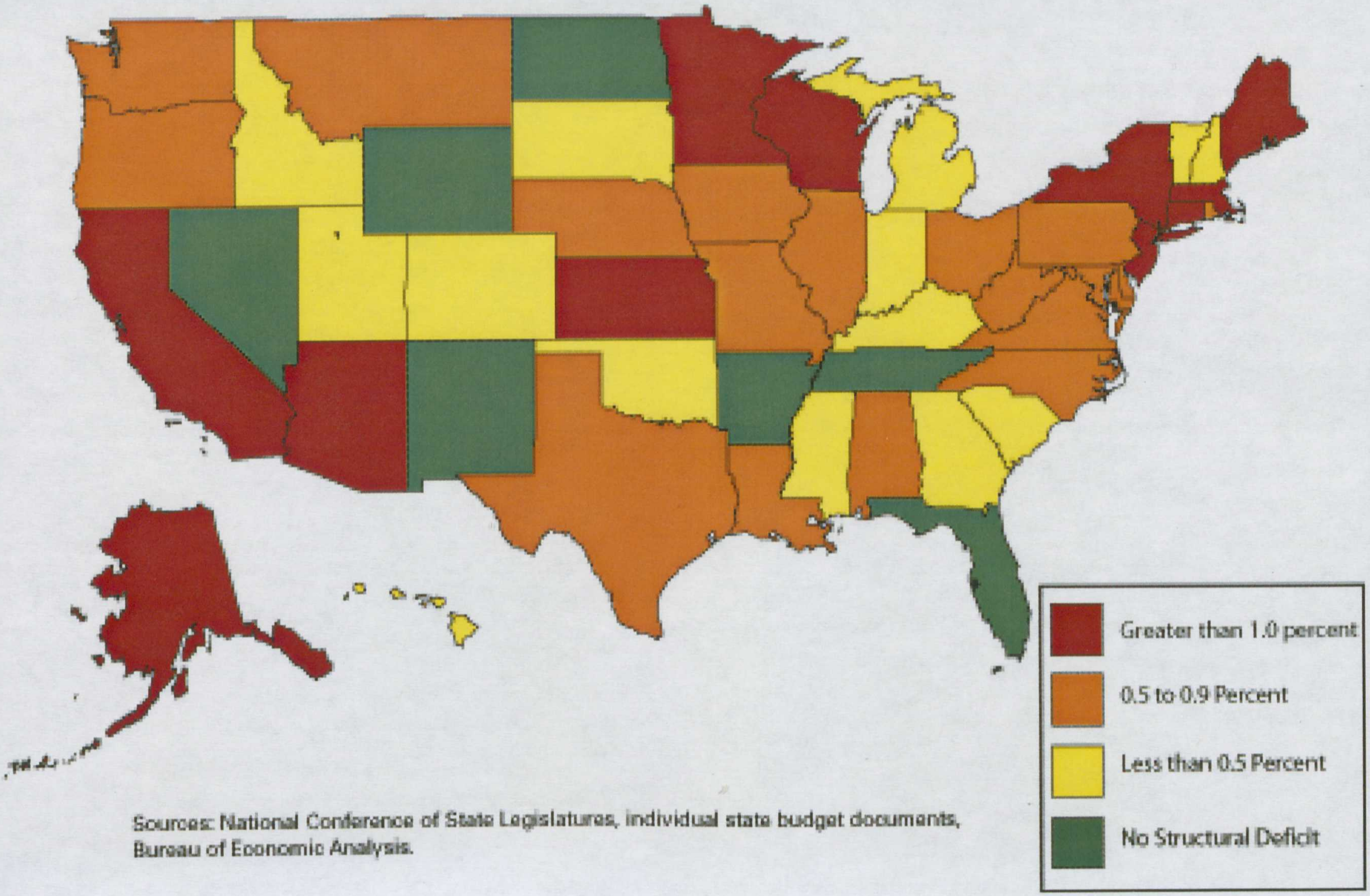
and through spending increases

Contribution of federal spending to real GDP growth



Although Weakness at State and Local Governments will partly offset federal stimulus

Projected FY2004 Structural Deficits as a Percentage of 2000 GSP



Sources: National Conference of State Legislatures, individual state budget documents, Bureau of Economic Analysis.

And Not Much Help From Abroad

Projected Real GDP Growth, U.S. versus Foreign

Source: Blue Chip Economic Indicators.

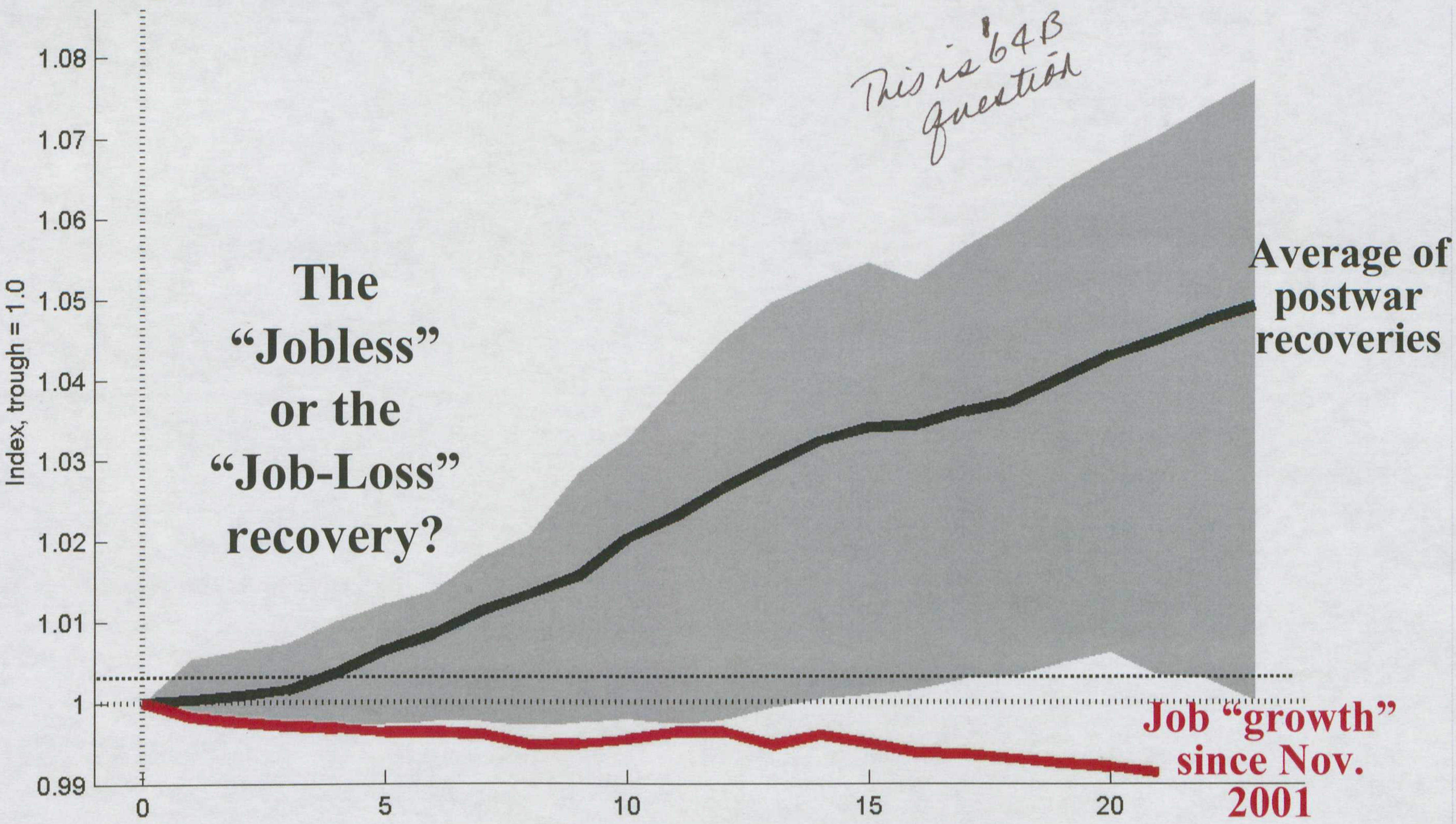
Except From the Recent Declines in the Value of the Dollar

Real Trade-weighted Broad exchange rate index

Source: Federal Reserve Board.

Is This Near-Term Growth Sustainable?

Employment continues to decline during this recovery



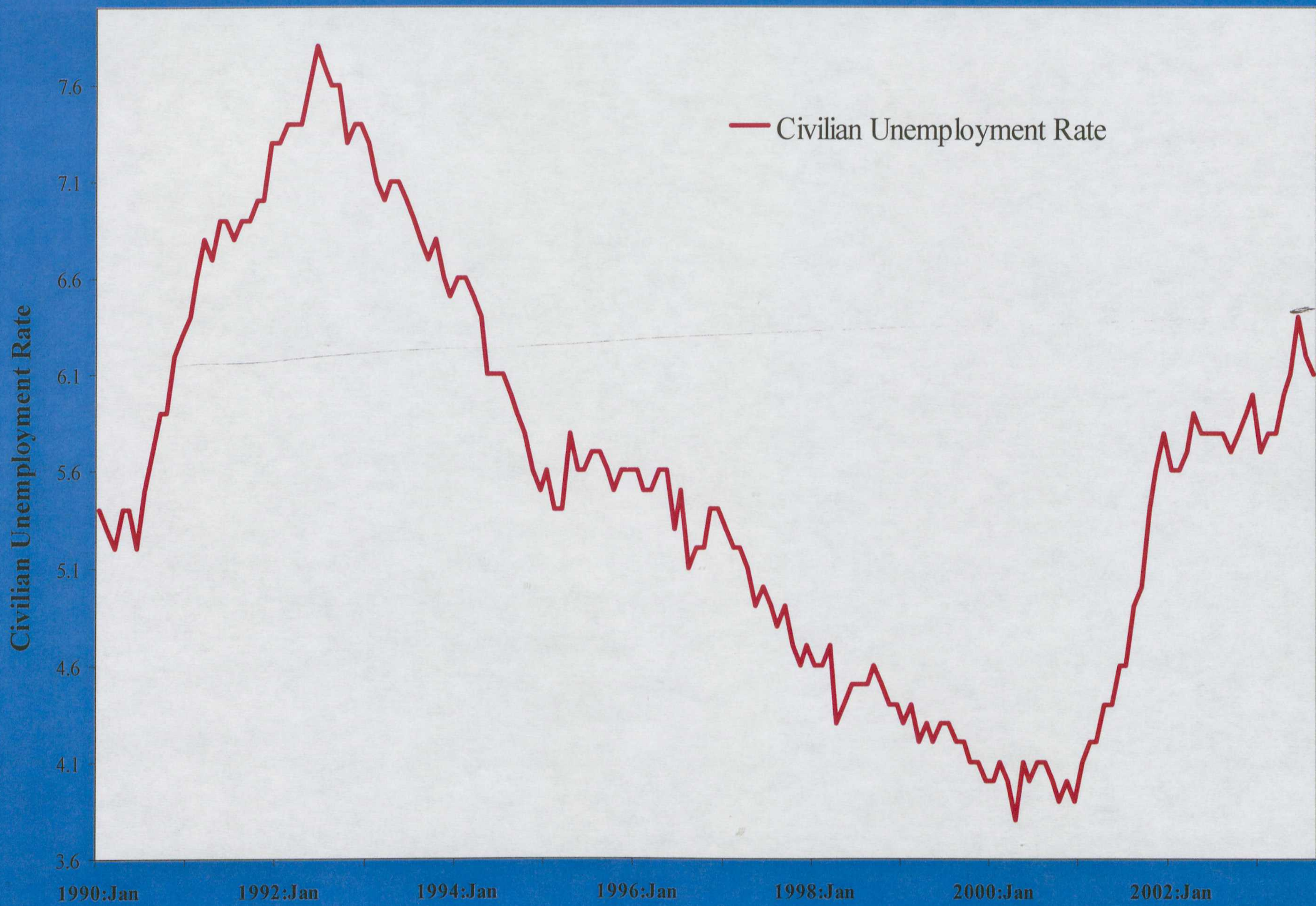
Nonfarm payroll employment, indexed to beginning of recovery

Heavy black line represents average of recessions

Heavy red line represents current experience

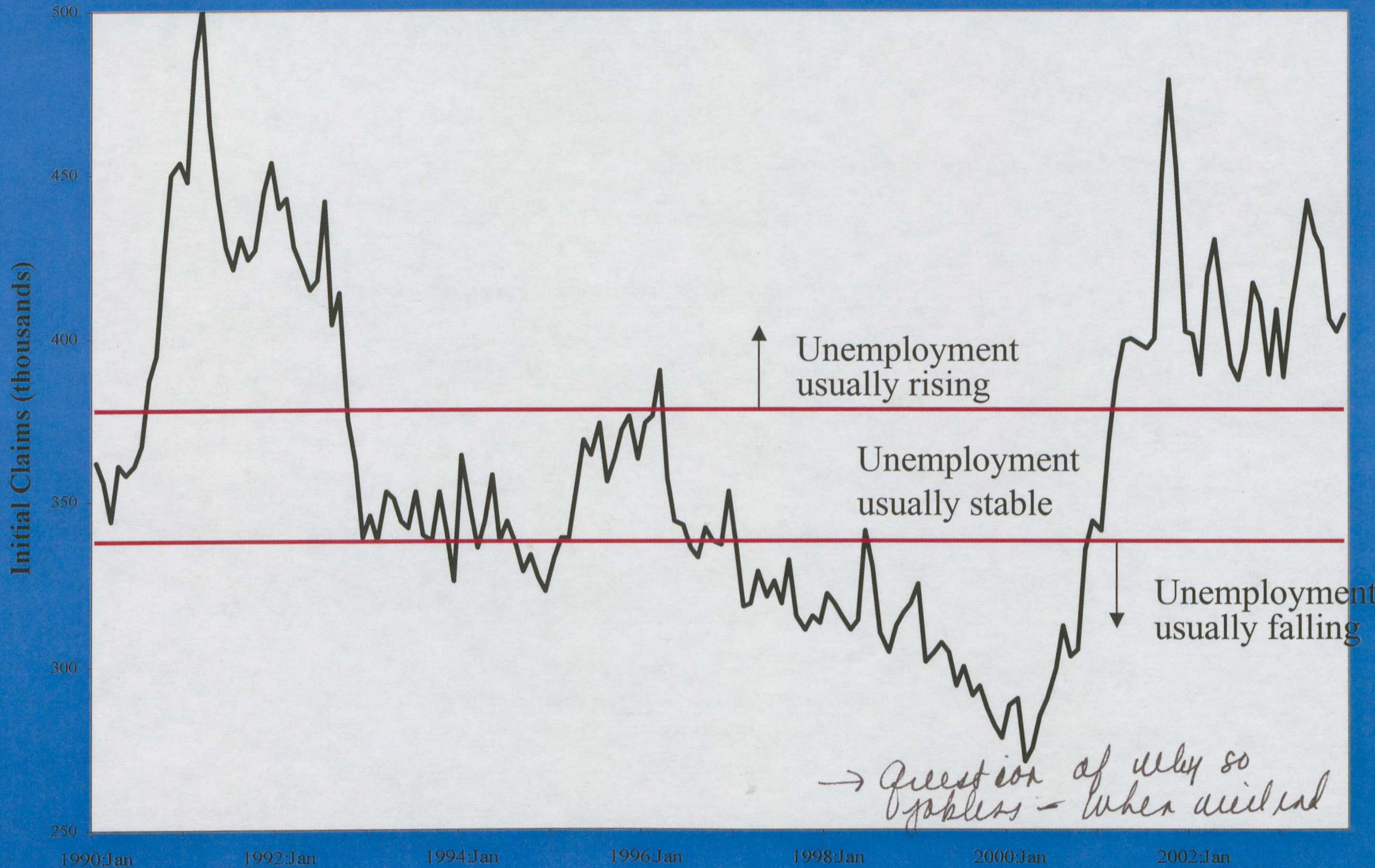
Shaded area shows range of outcomes across all business cycles

Unemployment Remains Elevated



Sources: Civilian Unemployment Rate, 16yr. + (SA): Bureau of Labor Statistics. Personal Savings Rate (SAAR): Bureau of Economic Analysis.

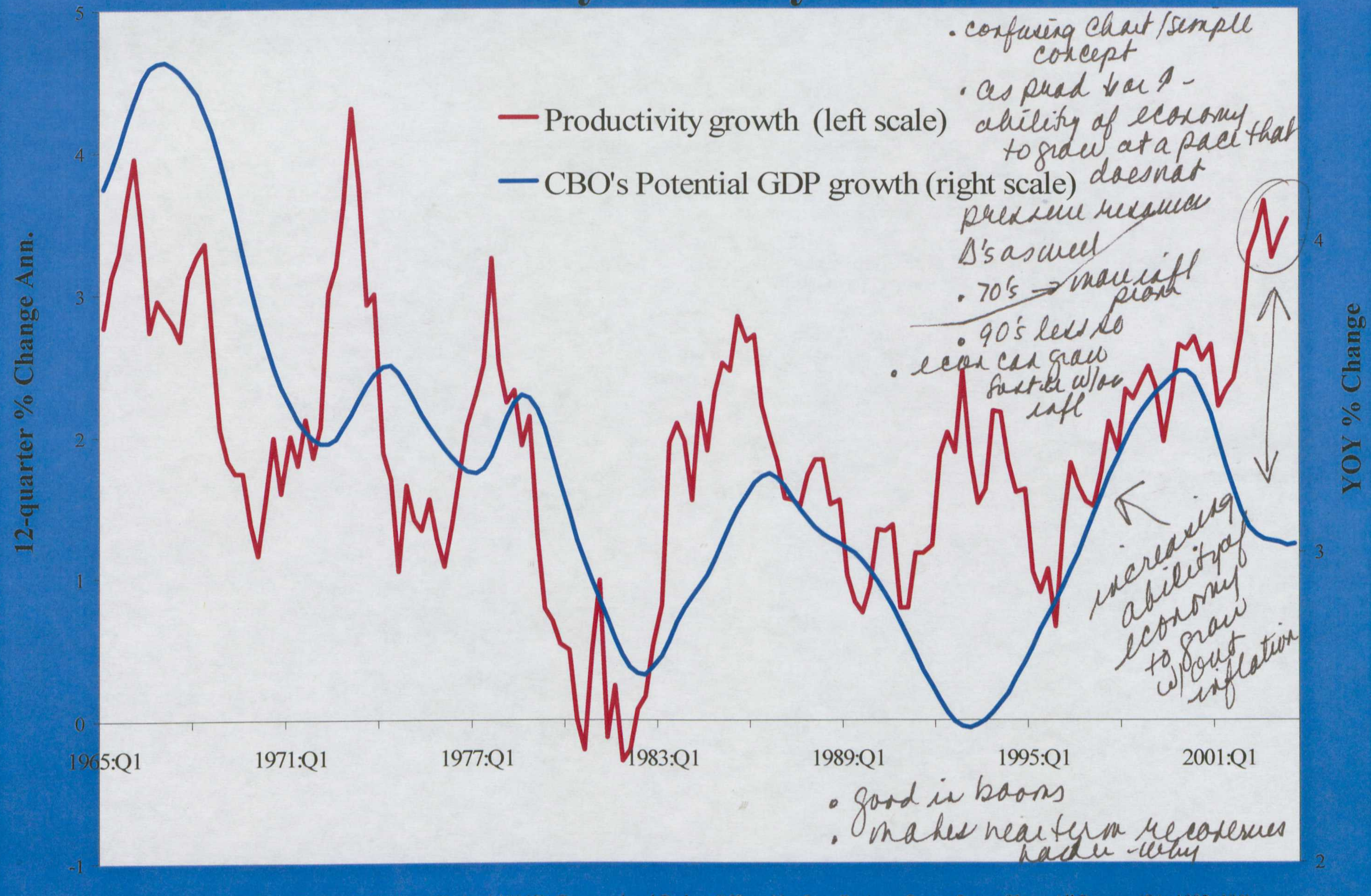
And forward-looking labor market indicators do not indicate improvement



→ question of why so jobless – when [illegible]

Source: Initial Claims for Unemployment Insurance, State Programs, Weekly Average (SA, Thousands): Department of Labor.

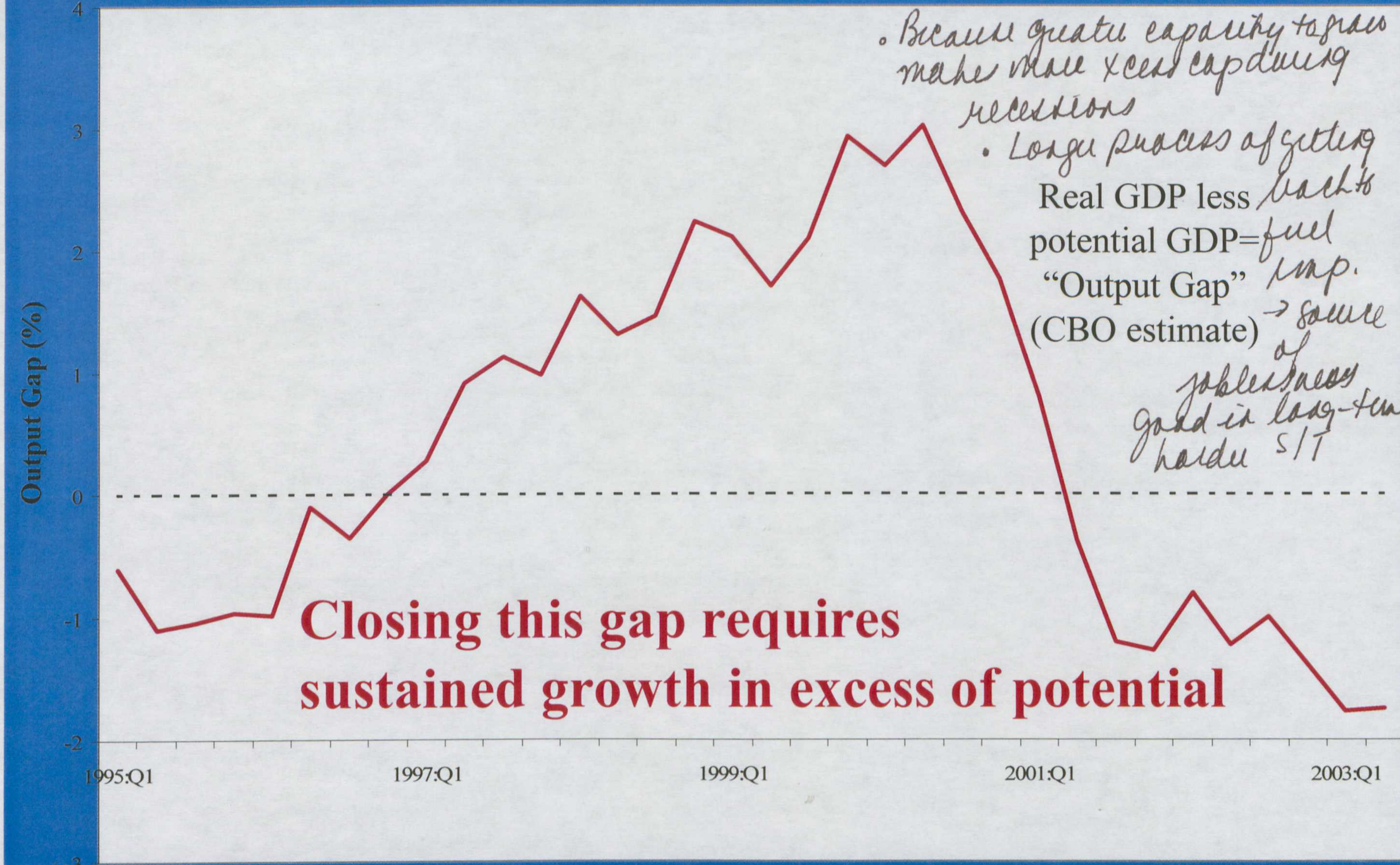
Strong Productivity Growth Has Improved the Economy's Ability to Grow



Sources: Real Potential Gross Domestic Product (Chained 1996$): Congressional Budget Office. Nonfarm Business Sector Output/Hour, All Persons (SA, 1992=100): Bureau of Labor Statistics.

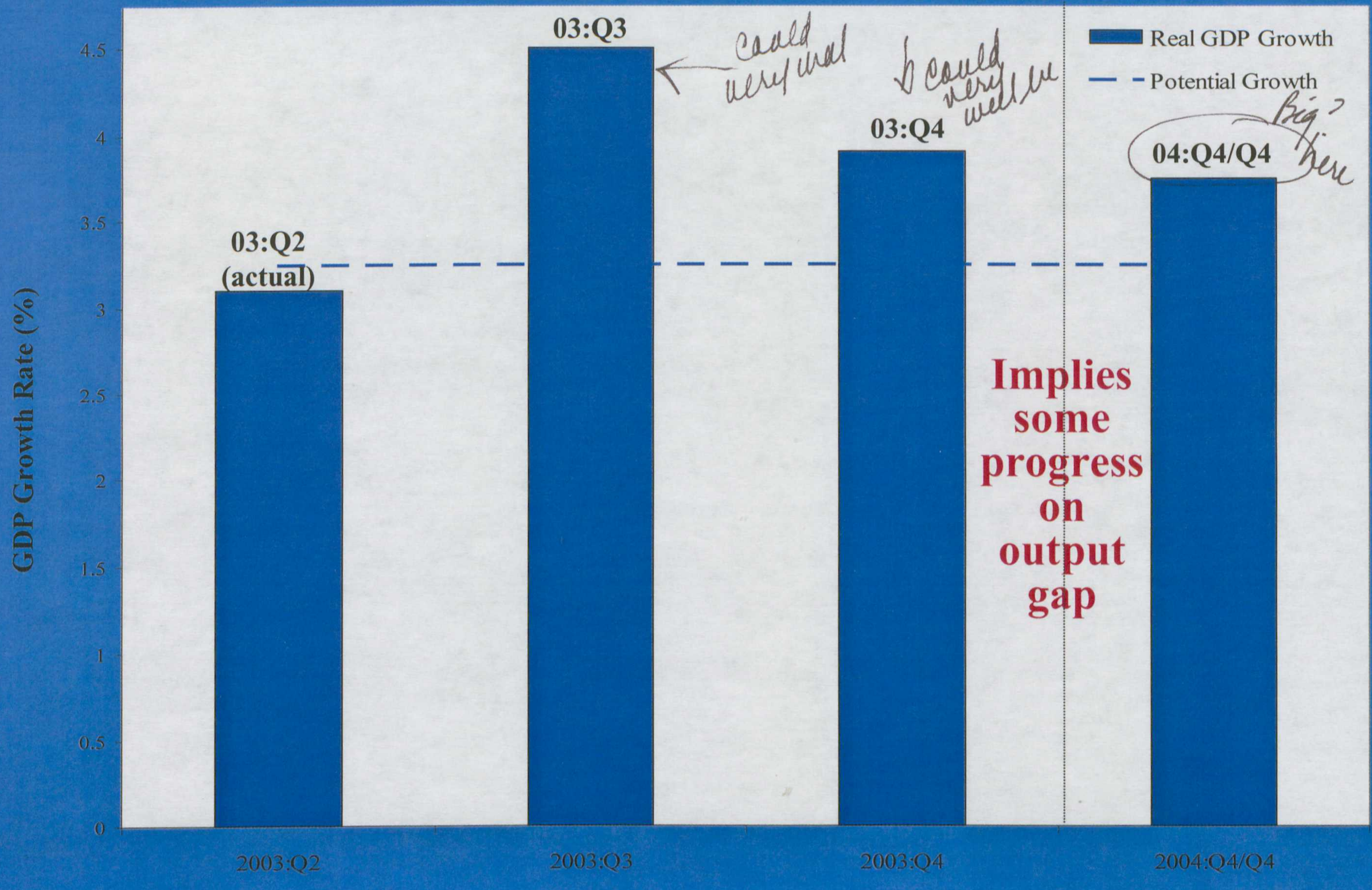
Significant excess capacity/slack remains

We are producing below our full-employment potential



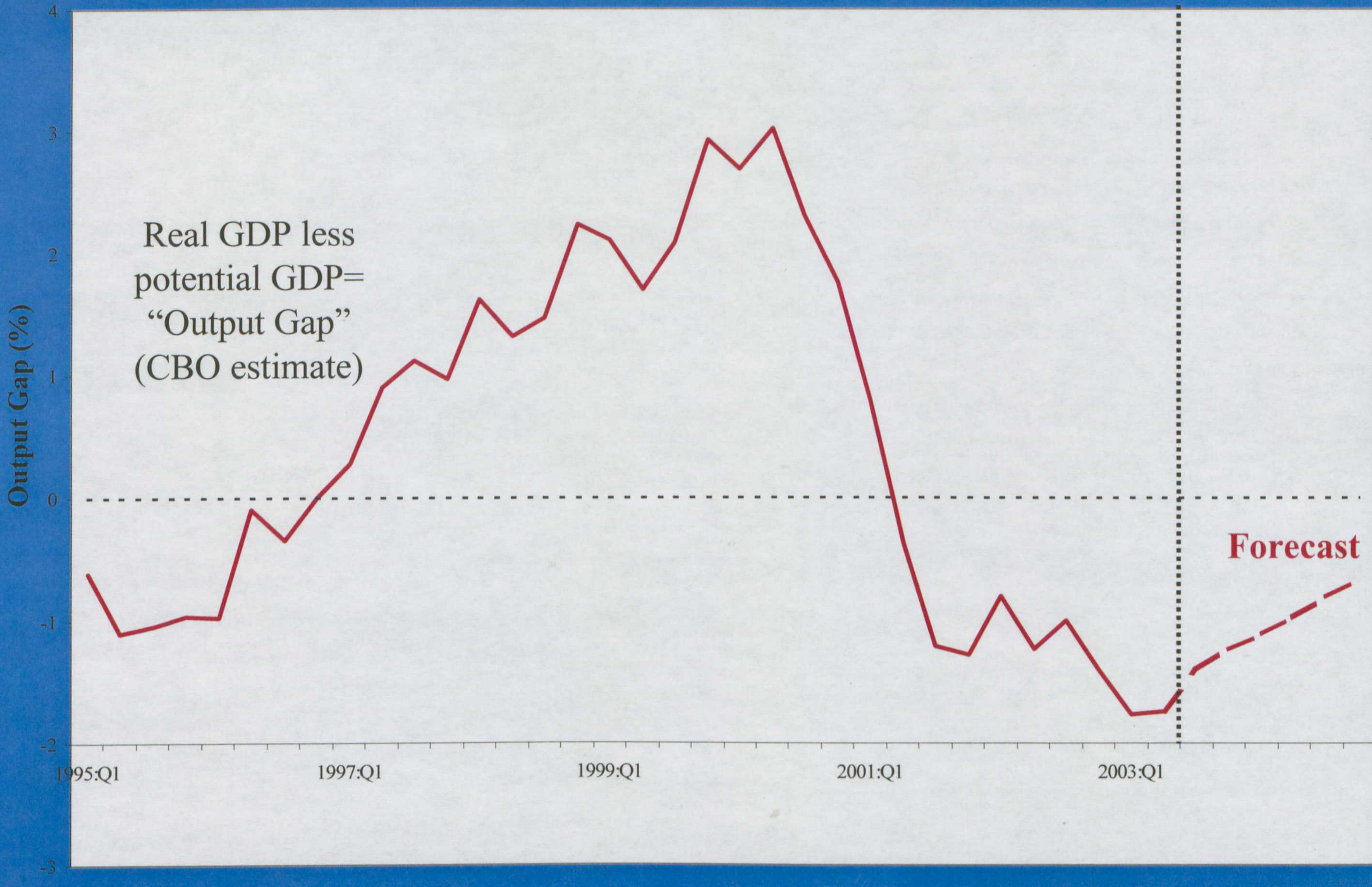
Sources: Real Gross Domestic Product (SAAR, Chained 1996$): Bureau of Economic Analysis. Real Potential Gross Domestic Product, (Chained 1996$): Congressional Budget Office.

Is Sufficient Growth in the Cards?
Blue Chip Economic Indicators Consensus Forecast



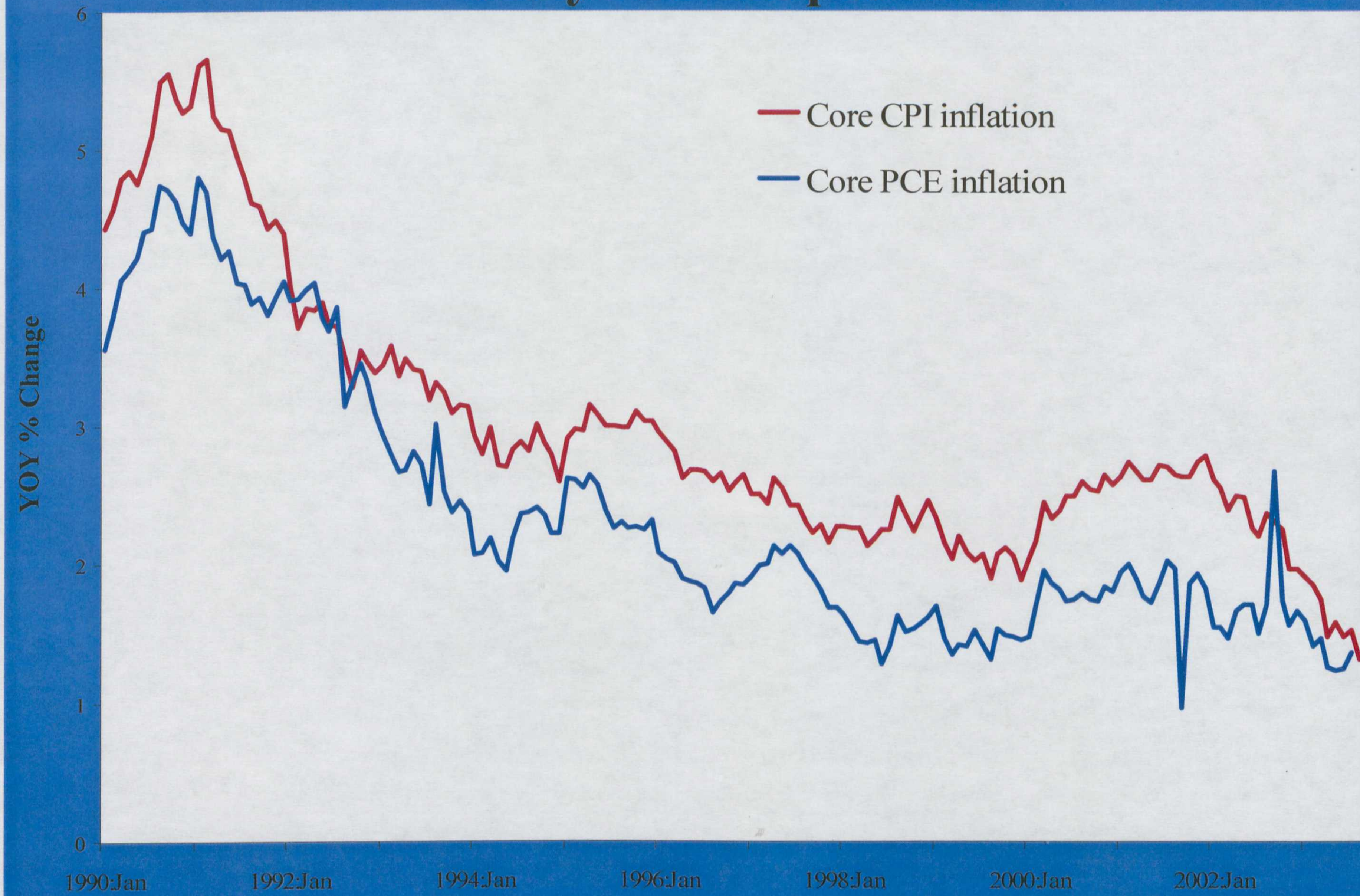
Source: Forecasts from September 10 Blue Chip Economic Indicators.

This expected growth rate will likely leave excess capacity late next year



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

Which is why inflation is trending down, and will likely remain quiescent



Sources: CPI-U, All Items Less Food and Energy (SA, 1982-84=100): Bureau of Labor Statistics. PCE Less Food and Energy, Chain Price Index (SA, 1996=100): Bureau of Economic Analysis.

Summary

- **<u>Good news</u>:**
  - Signs of more sustained and vigorous recovery
  - Fiscal stimulus, both spending and tax cuts
  - Ongoing monetary policy stimulus
- **<u>Risks</u>:**
  - Employment still falling (bad for consumers, signal of weak business confidence)
  - Capital spending may not last
  - State and local sector will offset a part of federal stimulus
  - Risks to inflation are on downside