

• Welcome again to FRBB

• Last time I spoke 11/02

• until last month or so - could have given same speech - consumer spending business

The Domestic Economic Outlook

Shahy
strong past growth
no jobs

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Presented to

Boston Security Analysts Society

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Overview

- **GDP growth in Q3 was quite strong**
 - Led by strong consumption, especially autos and durable goods
 - Business and residential investment strong
- **This can't last**
 - Strength driven by tax cuts, low mortgage rates, auto incentives
 - “Sugar High?”
 - Fourth quarter growth will be slower

- **What about 2004?**

- Depends on business spending and hiring
- Q3 encouraging on this front
- Profits, productivity will support ongoing strength

*employment 25 A
125 S
126 O
U.R 6.0%*

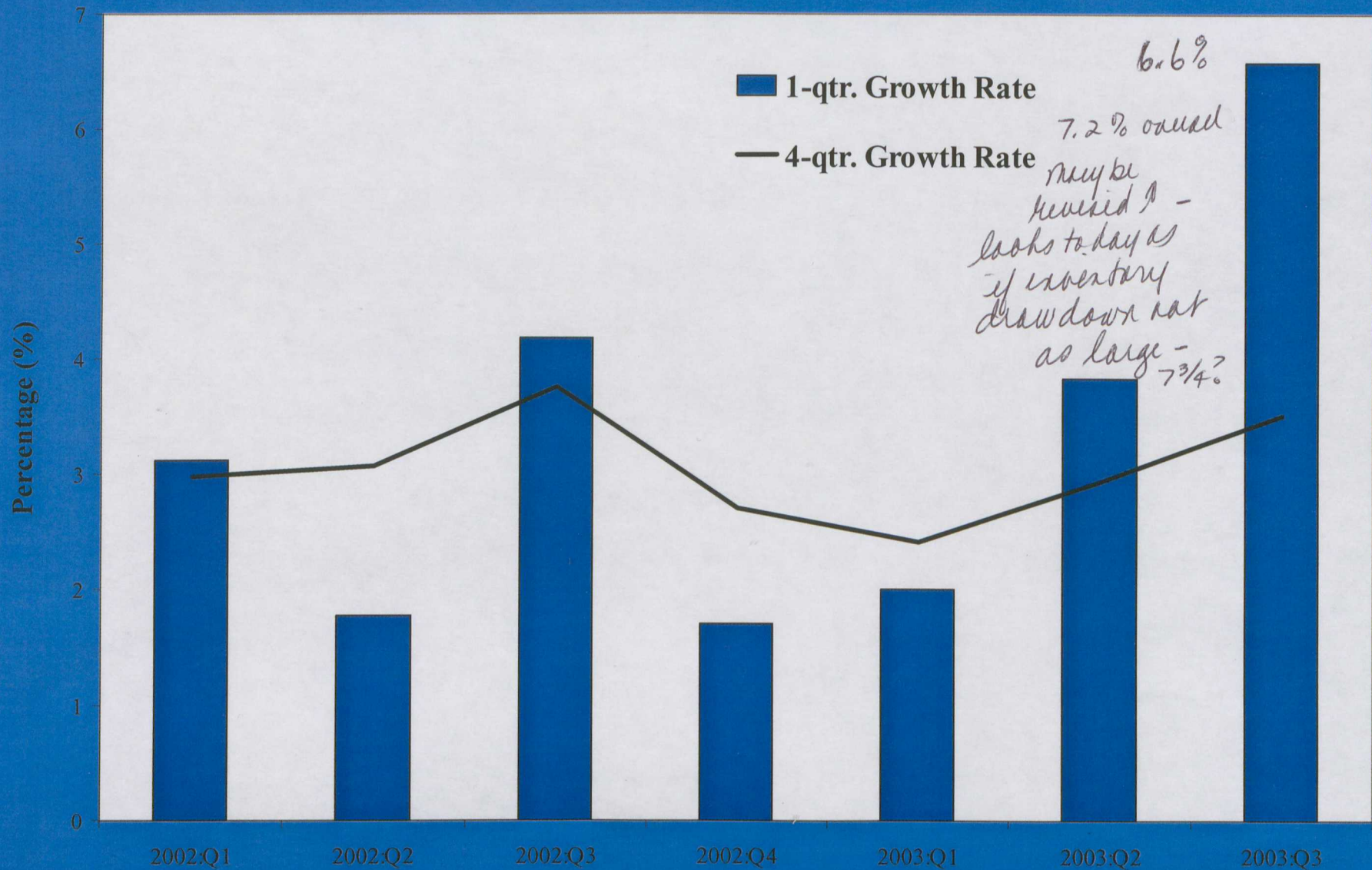
- **The Jobless Recovery: Is It Turning Around?**

- Higher productivity hurts in short run
- 2004 should see more vigorous job growth

// Really good news in labor markets today

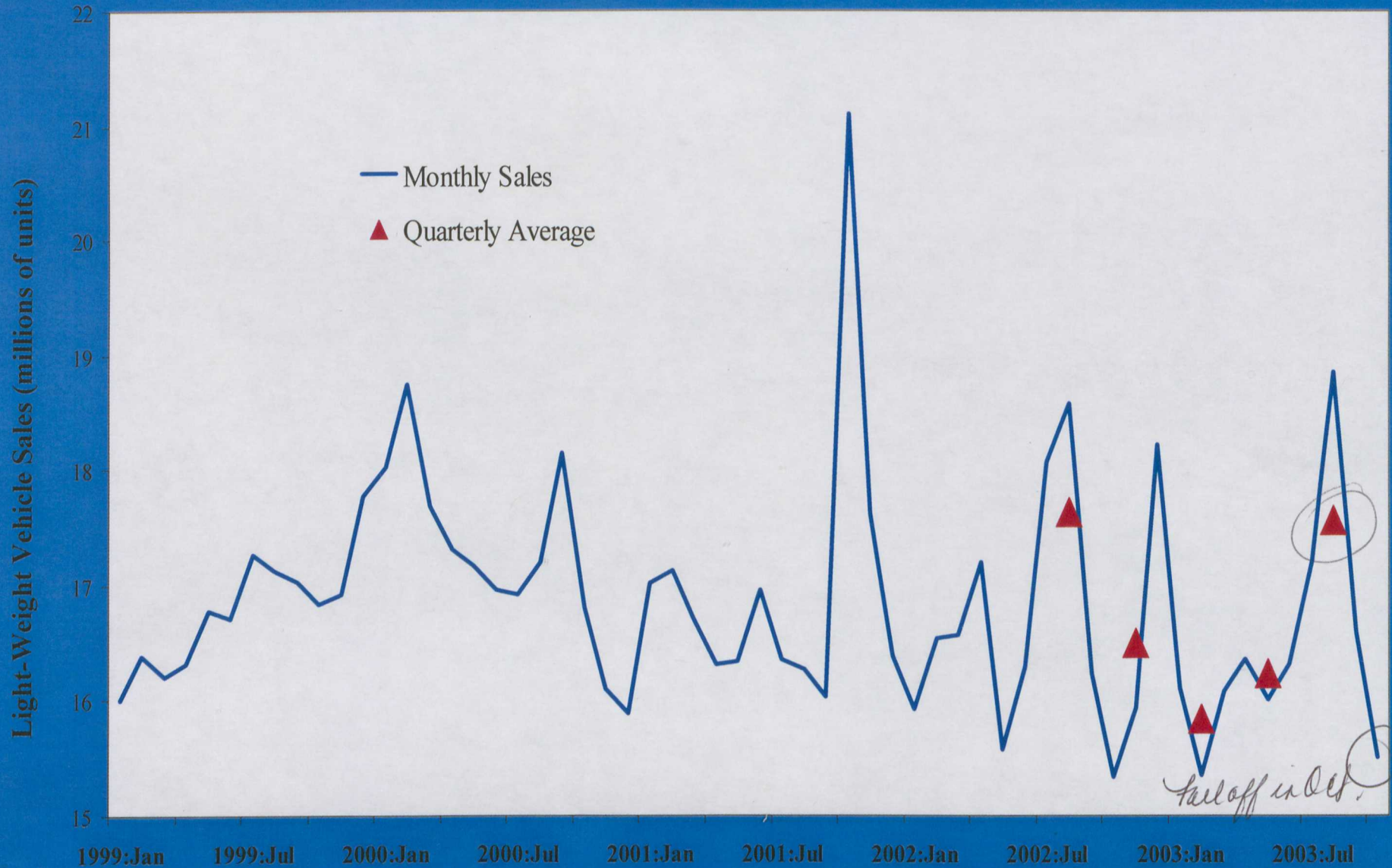
work hours ↑ Oct 1st time 3 months

Consumer spending was STRONG in Q3



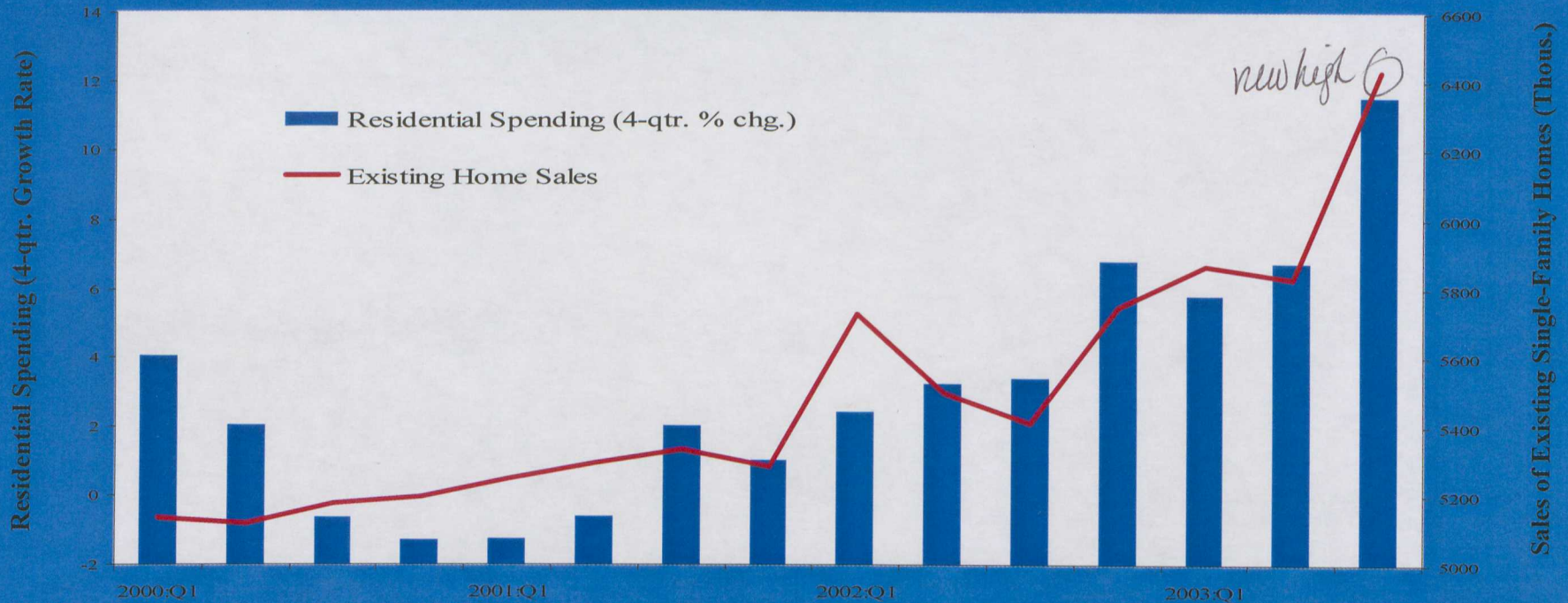
Source: Personal Consumption Expenditures (SAAR, Chained 1996\$): Bureau of Economic Analysis.

Led By Auto Sales



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

And A Burst of Residential Activity

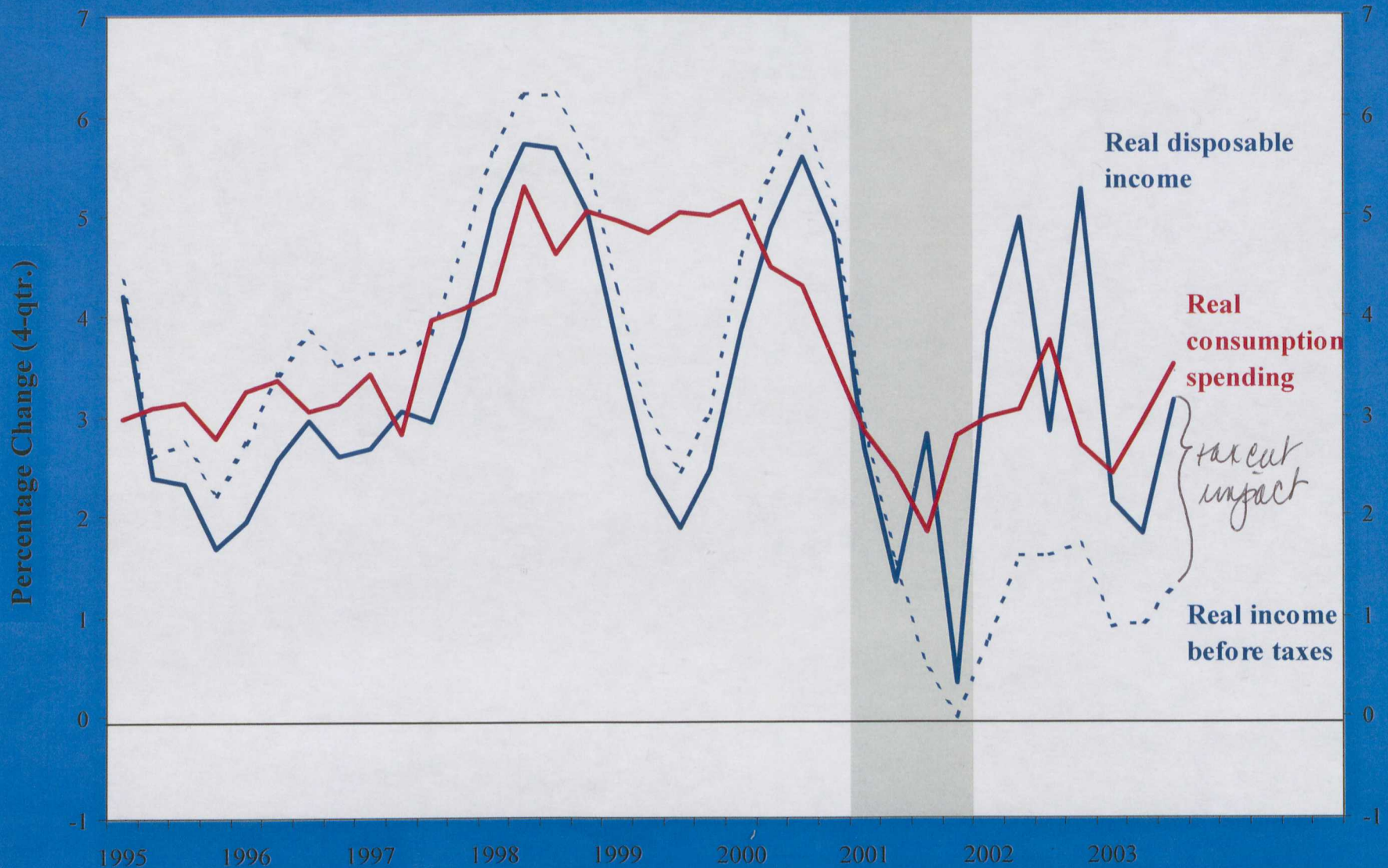


Although the refinancing boom appears to have come to a close



Sources: Fixed Private Residential Investment in Structures (SAAR); Bureau of Economic Analysis. Existing 1-Family Home Sales (SAAR, Thousands); National Association of Realtors. Mortgage Bankers' Association Purchase and Refinancing Indexes (SA); Federal Reserve Board.

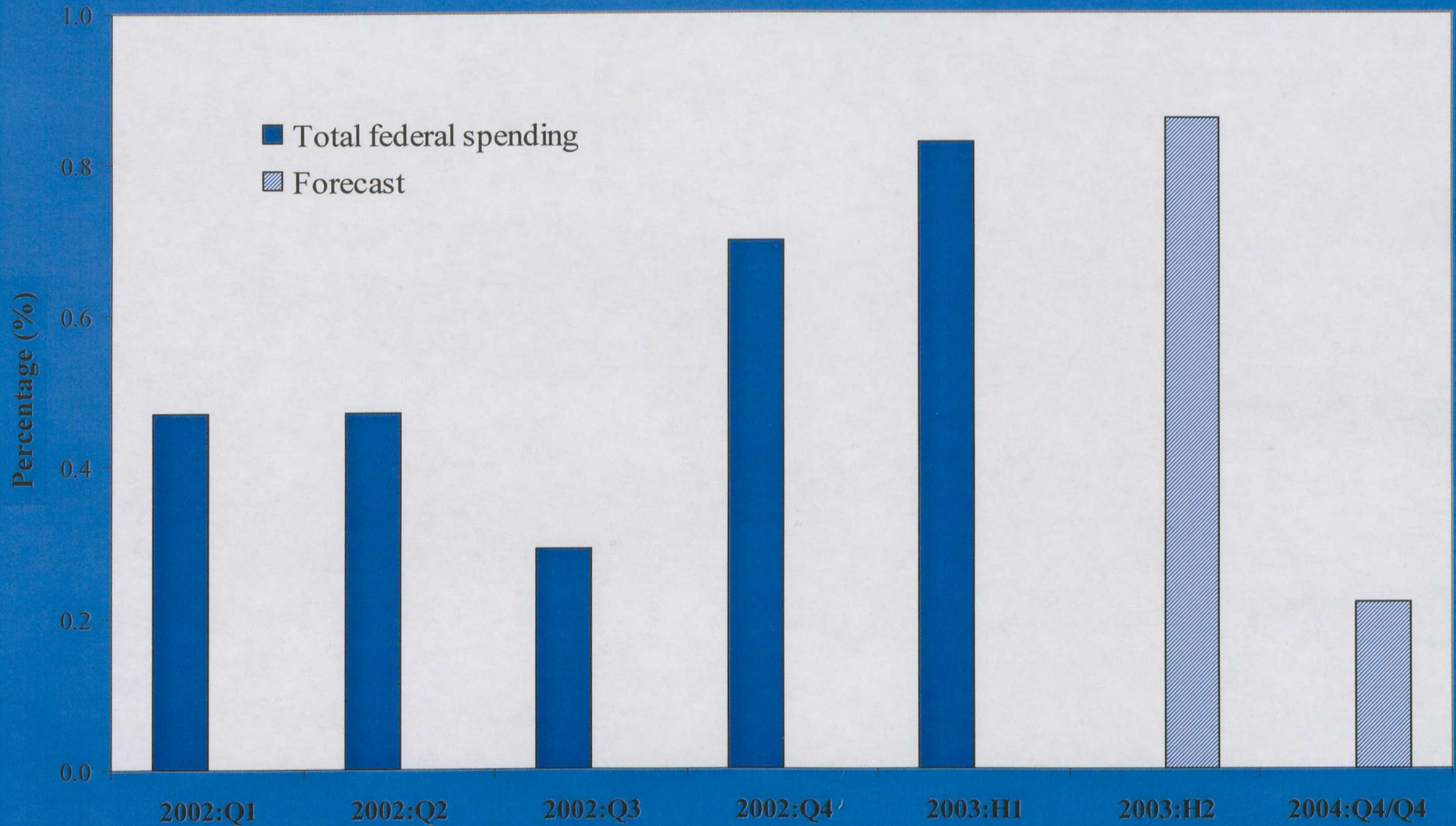
Third-quarter Consumer Strength Can't Last It was driven by tax cuts (a "sugar high")



Source: Real Disposable Personal Income, Real Personal Income, and Personal Consumption Expenditures (SAAR, Chained 1996\$): Bureau of Economic Analysis.

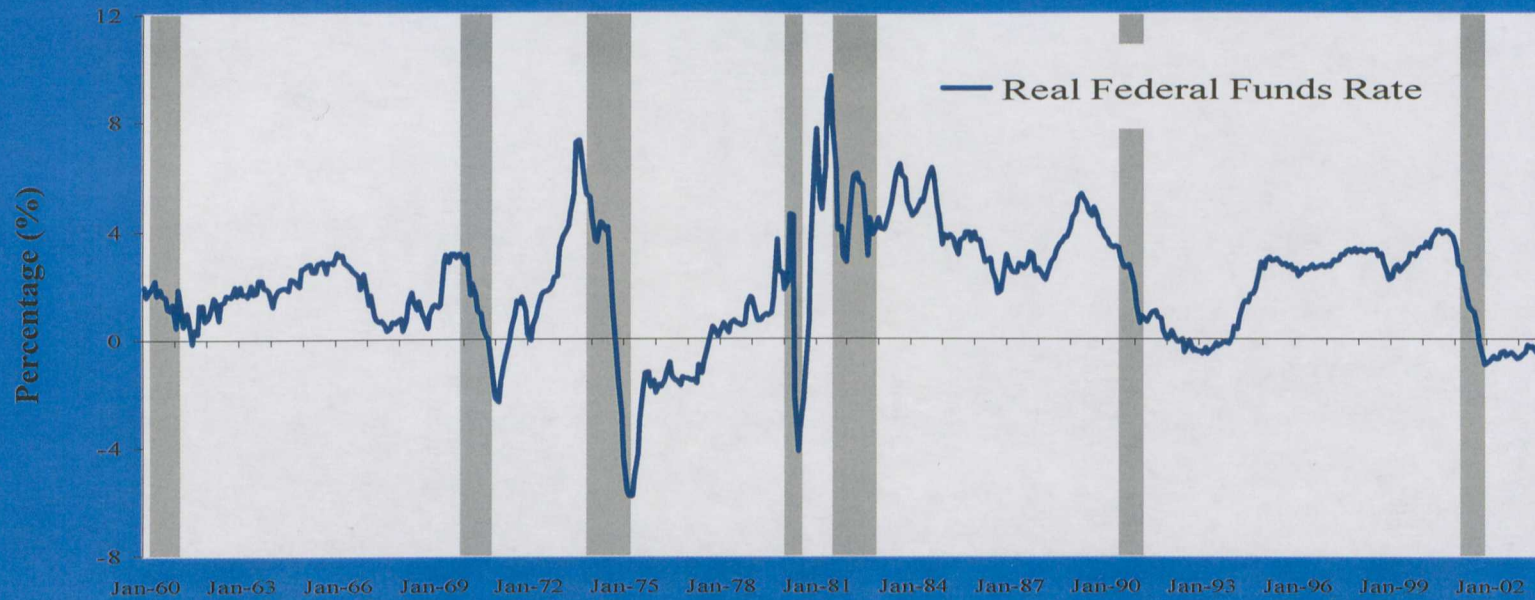
And Federal Spending

Contribution of federal spending to real GDP growth

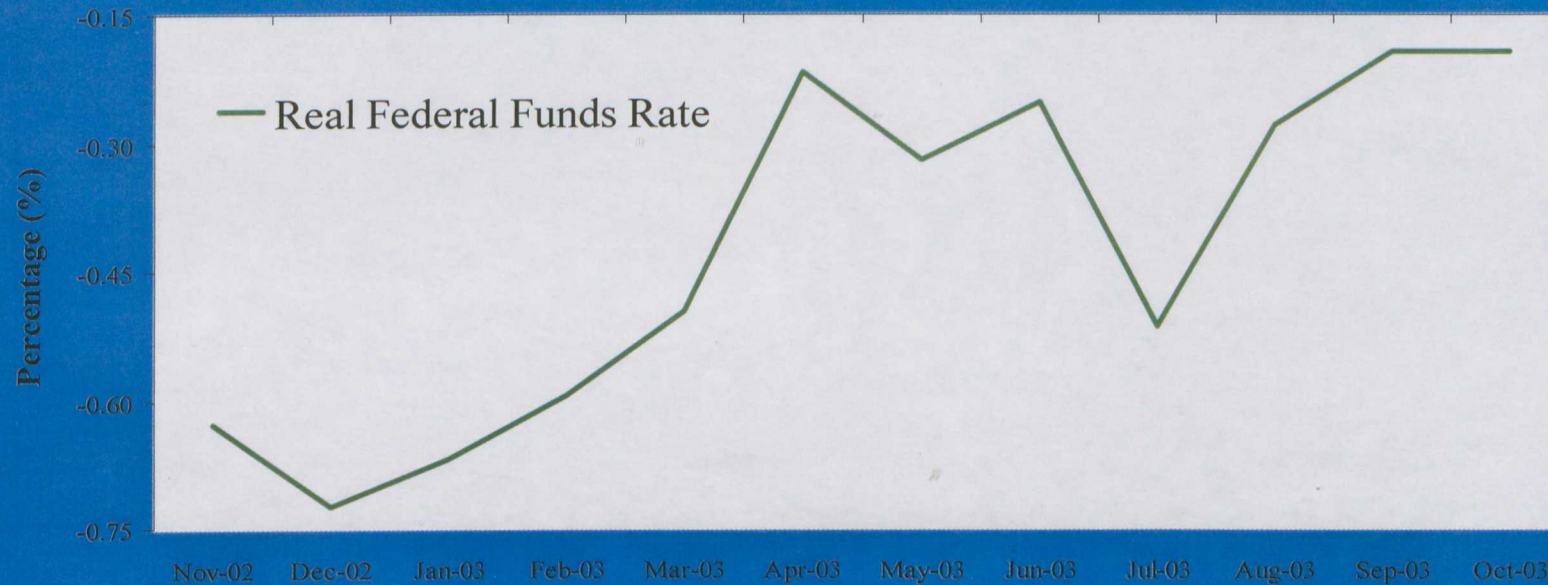


Source: Real Federal Contribution to Real GDP Change (SAAR, %): Bureau of Economic Analysis.

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 Low Mortgage Rates

Spending may have been spurred by fears rates would increase

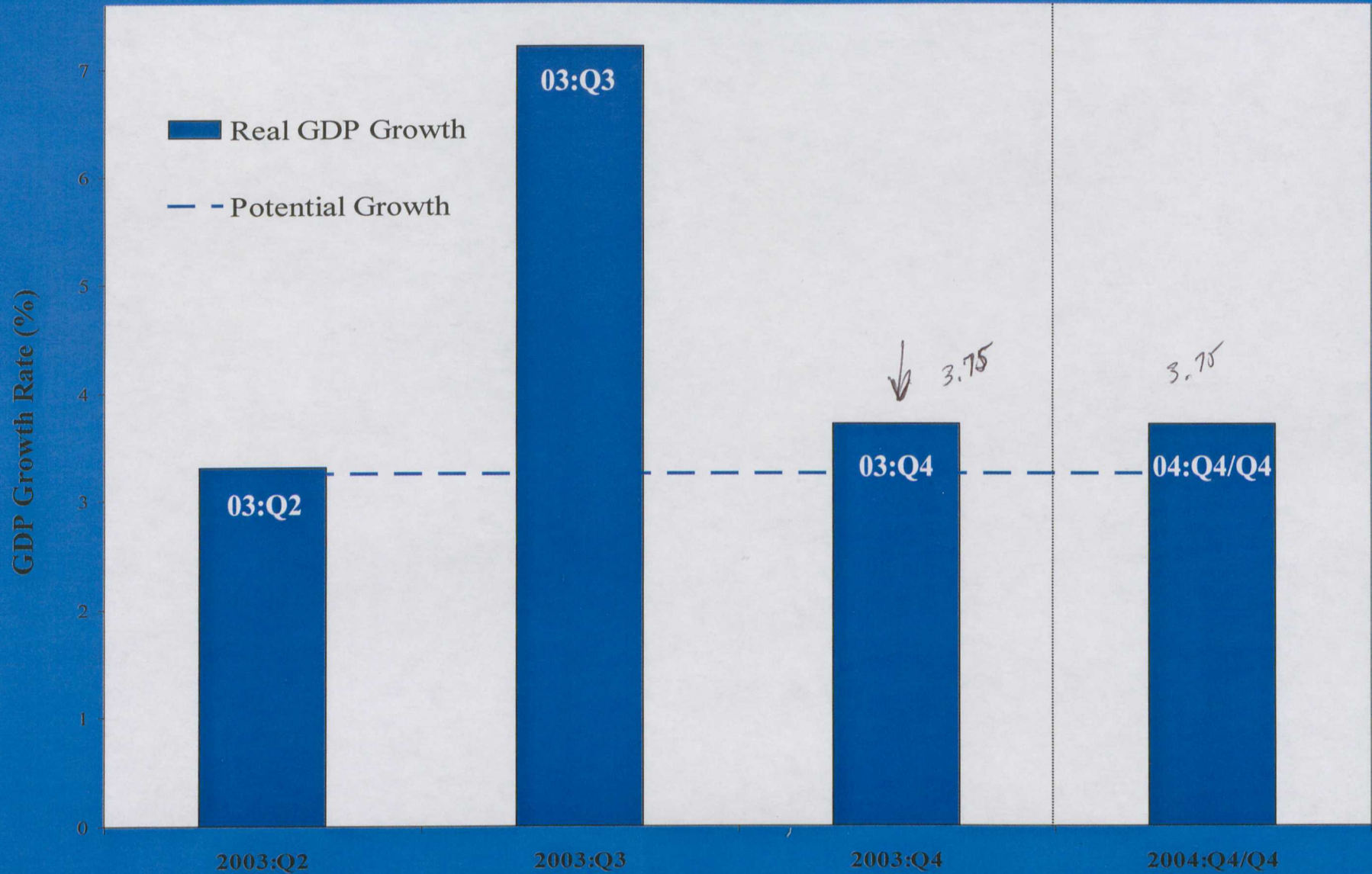


Conventional 30-year Contract Rate

Source: Contract Rates on Commitments for Conventional 30-yr Fixed-rate Mortgages; Federal Reserve Board.

Fourth-Quarter Growth Will Slow

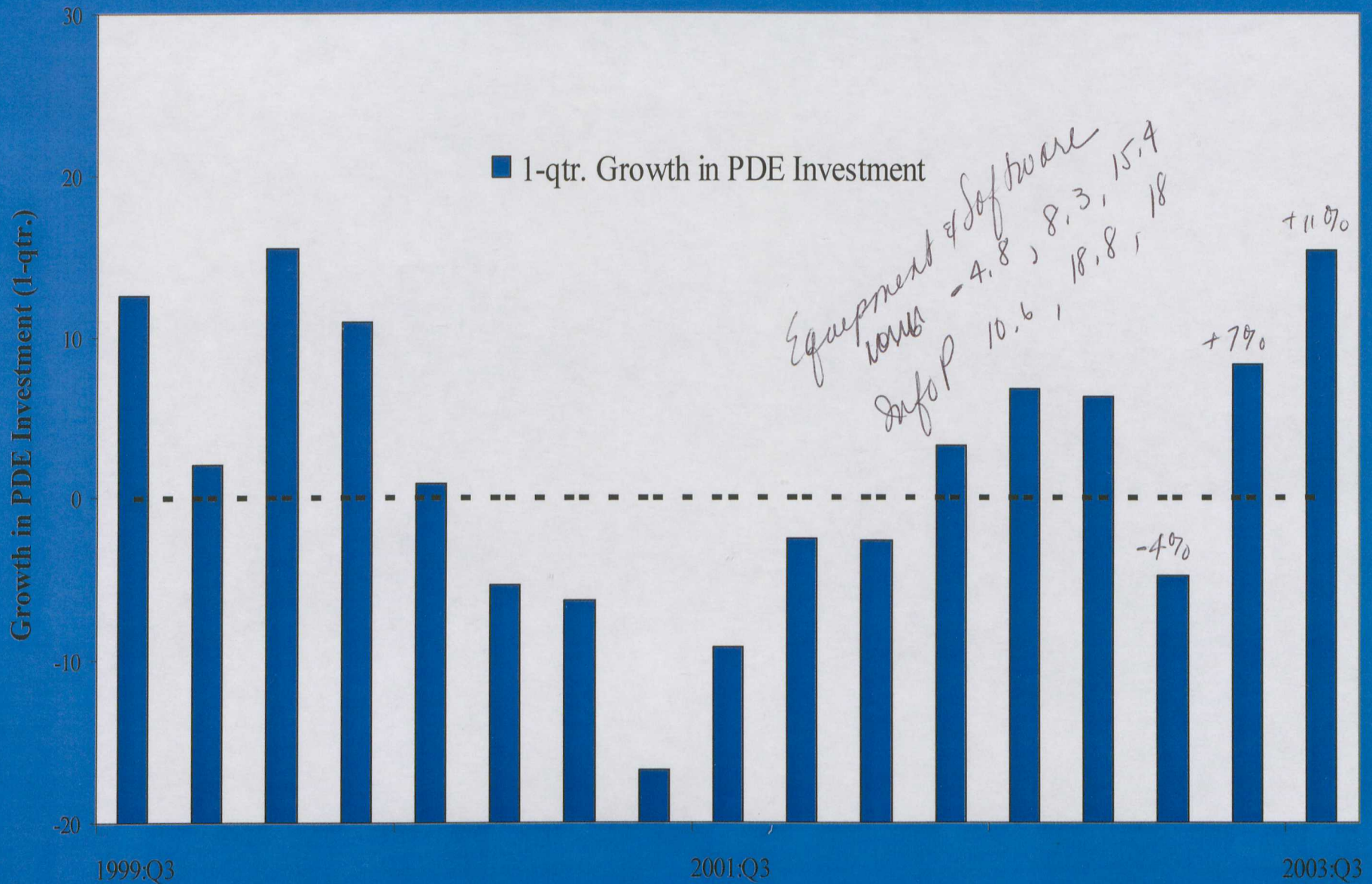
Blue Chip Economic Indicators Consensus Forecast



Source: Forecasts from October 10 Blue Chip Economic Indicators.

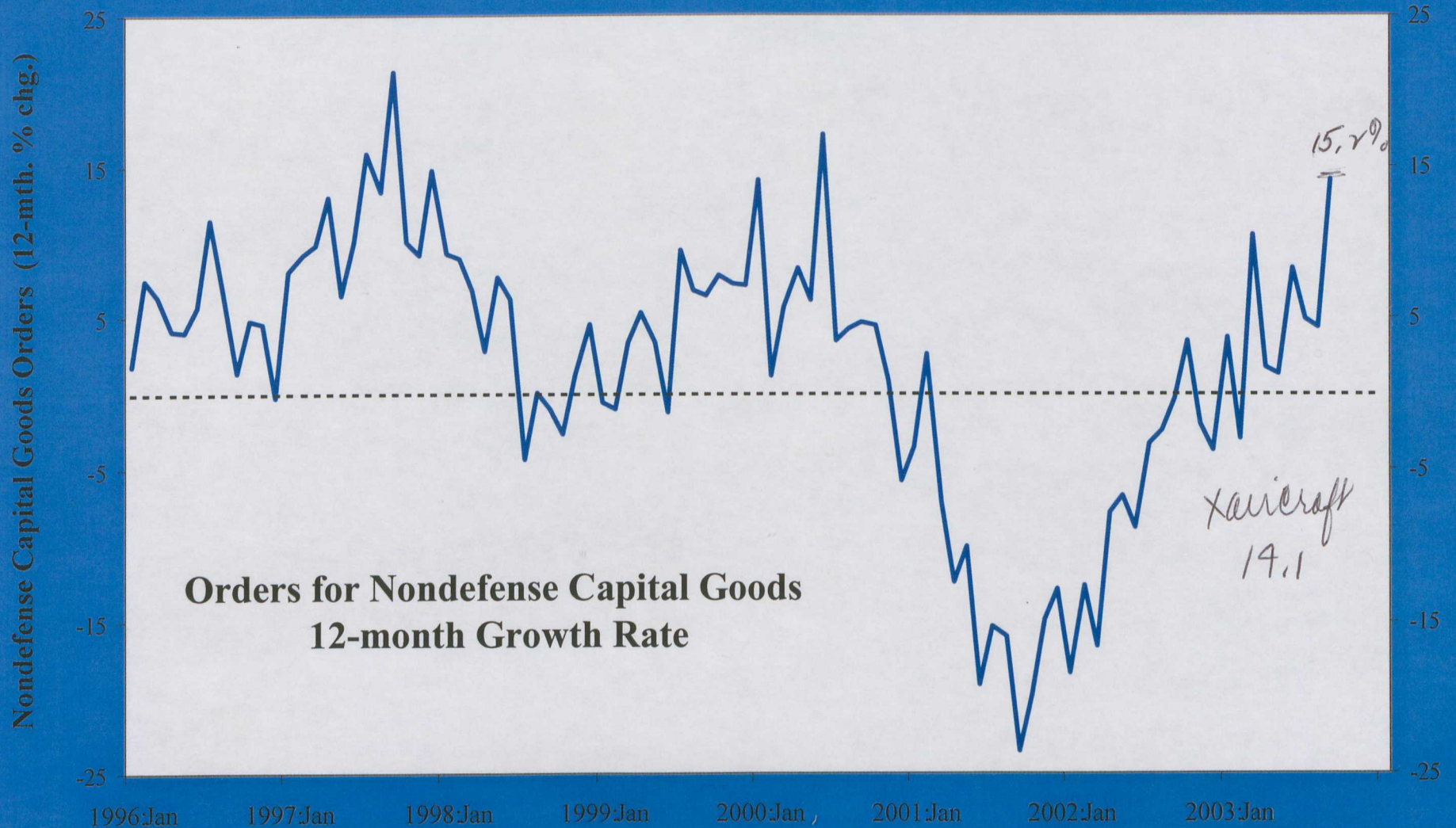
How Sustainable is Growth into 2004?

Some Good News in Q3



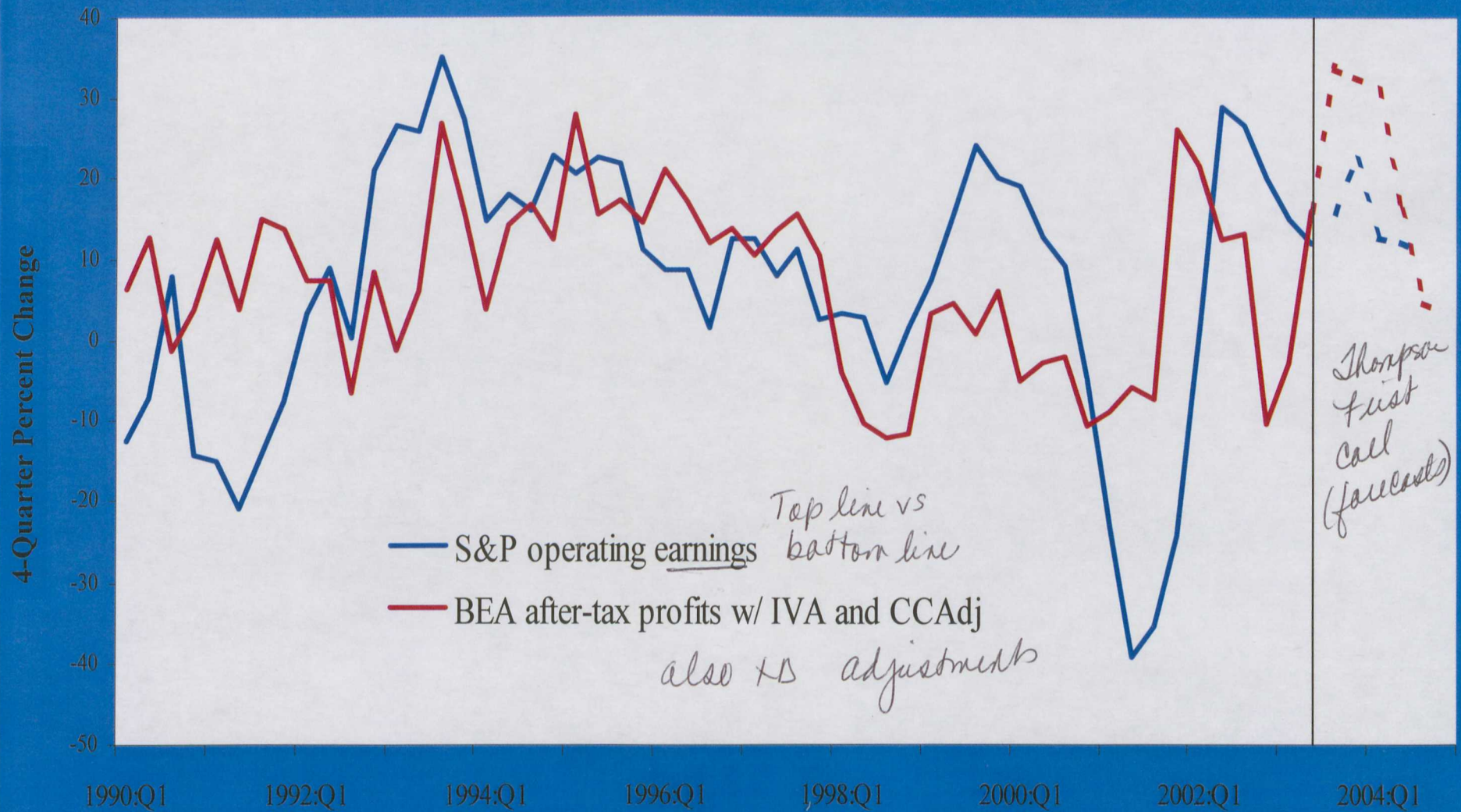
Source: Gross Private Domestic Investment in Nonresidential Equipment and Software (SAAR); Bureau of Economic Analysis.

And Recent Orders Data Suggest Continued Near-Term Strength in Investment Spending



Sources: Manufacturers' New Orders for Nondefense Capital Goods excluding Aircraft (SA); Bureau of the Census.

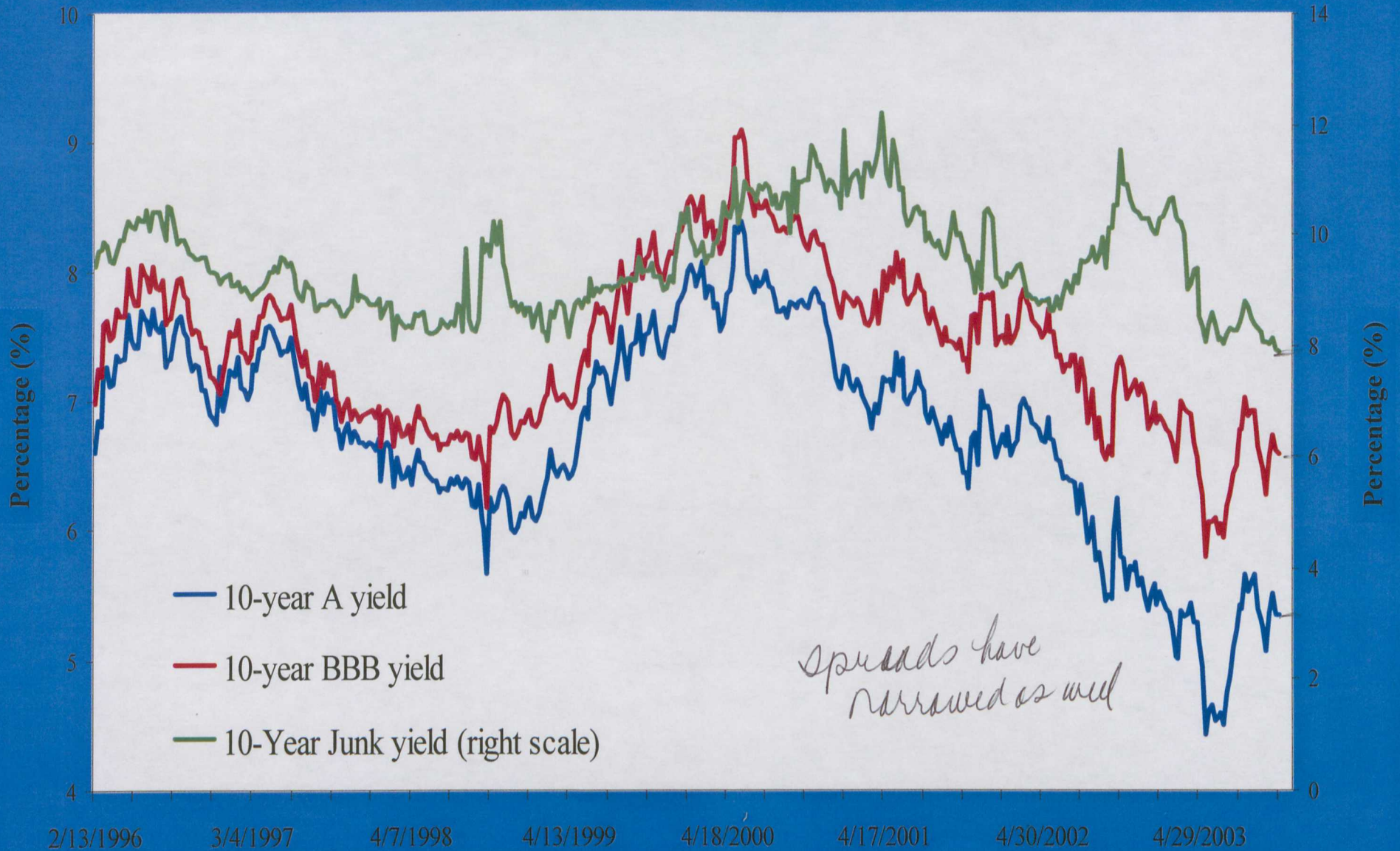
BFI Will Likely Get Support in 2004 from Corporate Earnings



Sources: Bureau of Economic Analysis, Standard and Poor's, Haver Analytics, Global Insight, Thomson Financial/First Call (Forecasts).

Financial Markets are Supportive

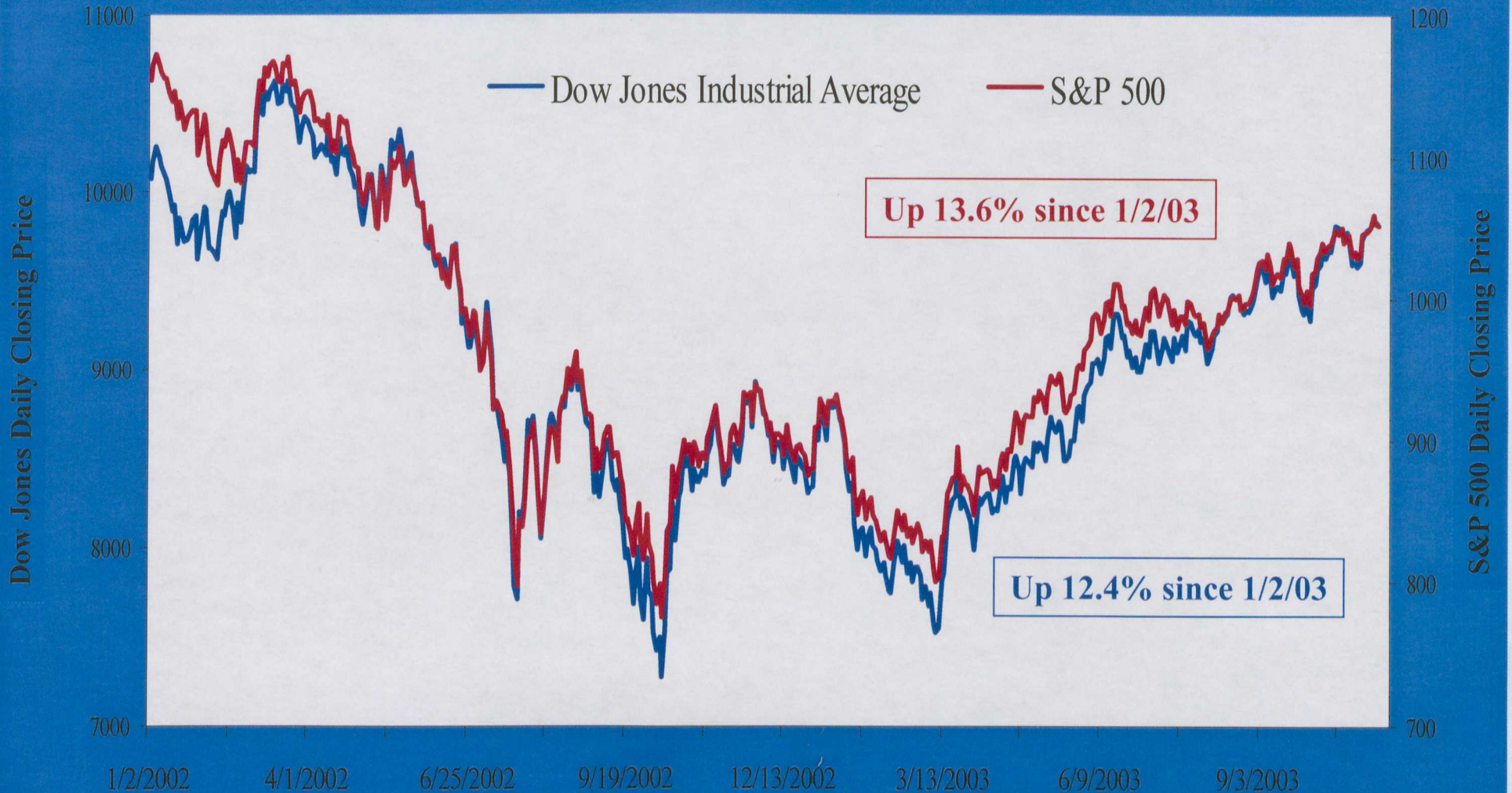
Corporate Bond Yields



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

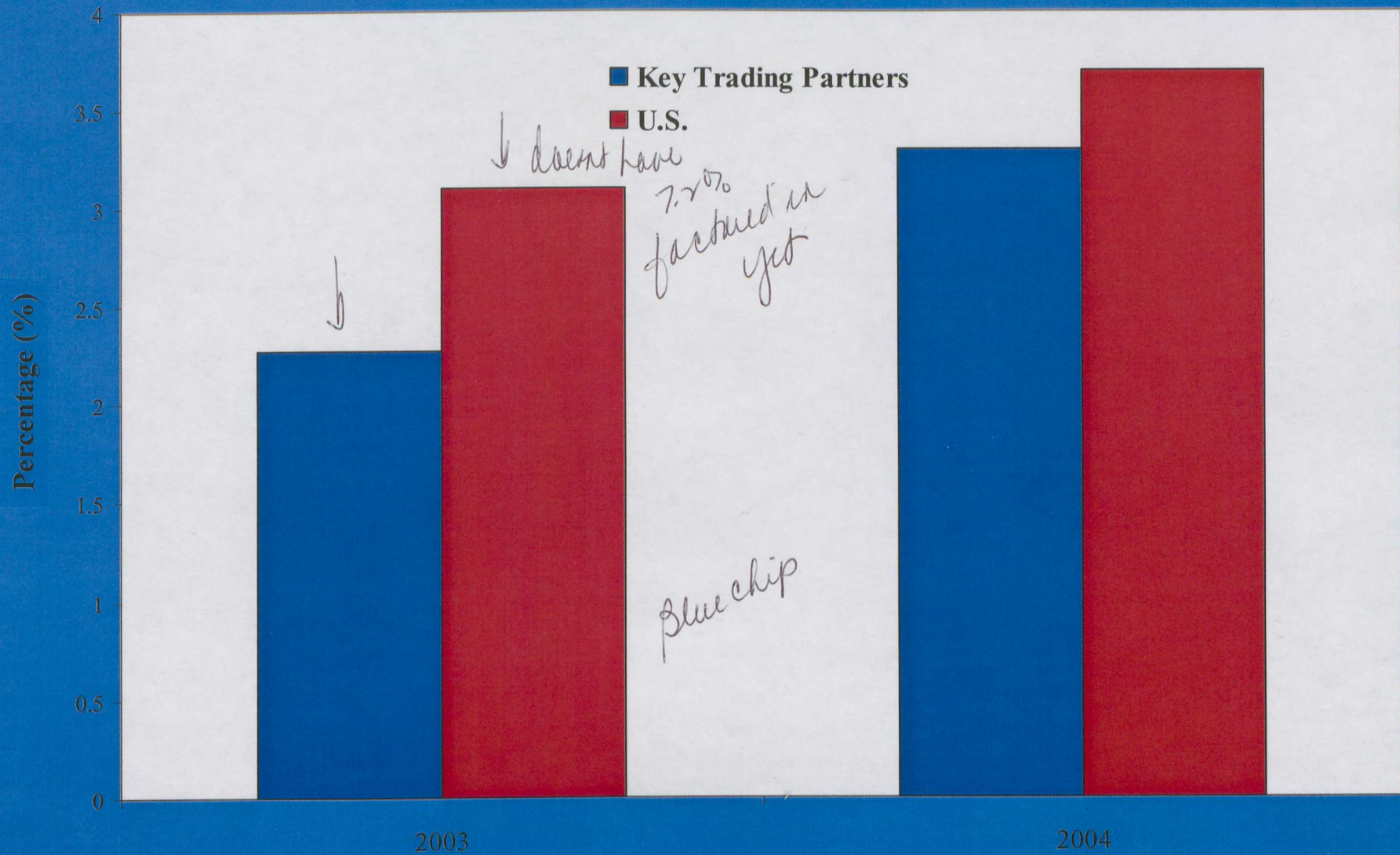
Equity Markets Are Supportive

Daily closing prices for the DJIA and the S&P 500



We Don't Expect Much Help From Abroad ...

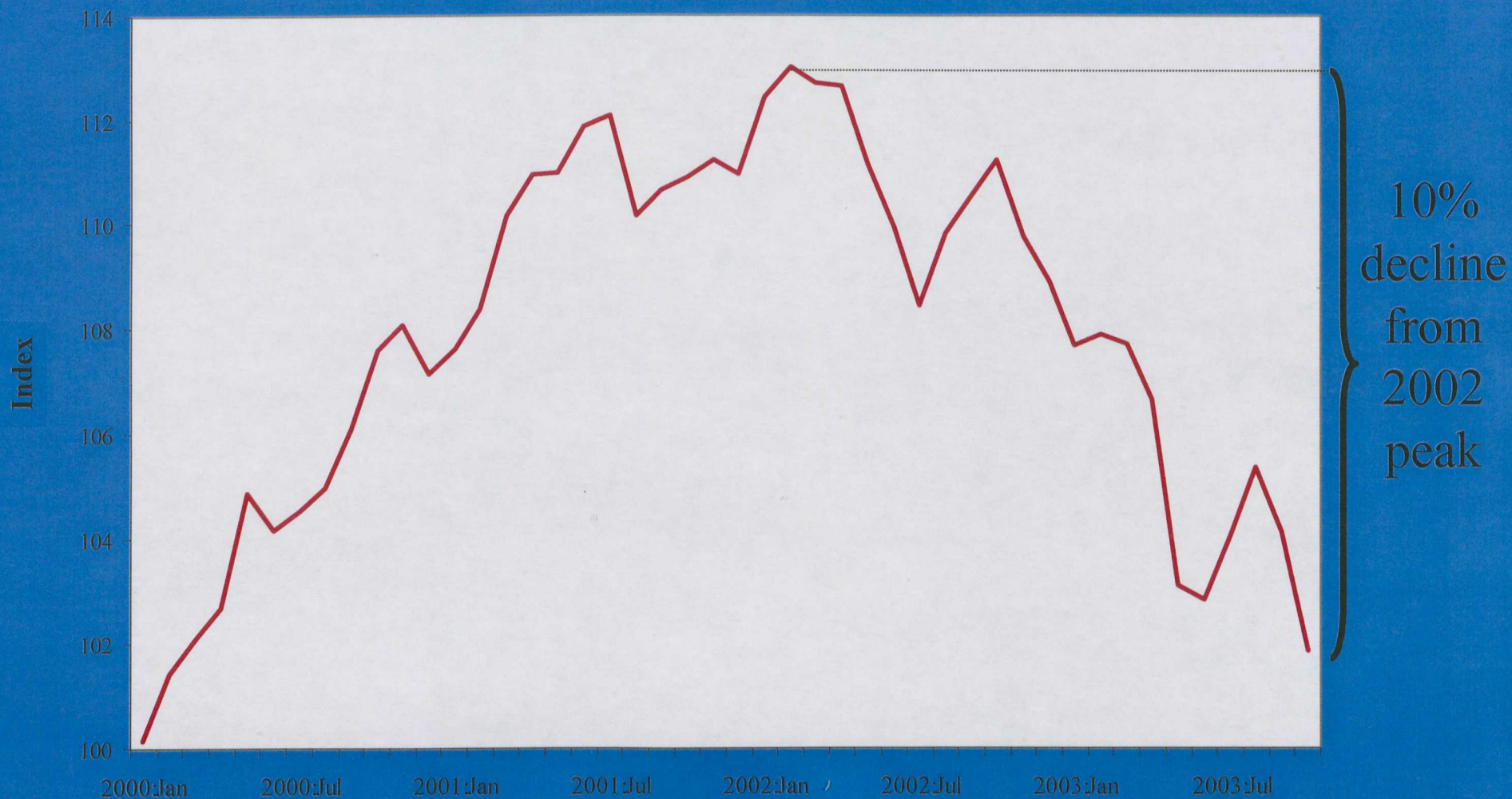
Projected Real GDP Growth, U.S. versus Foreign



Source: Blue Chip Economic Indicators.

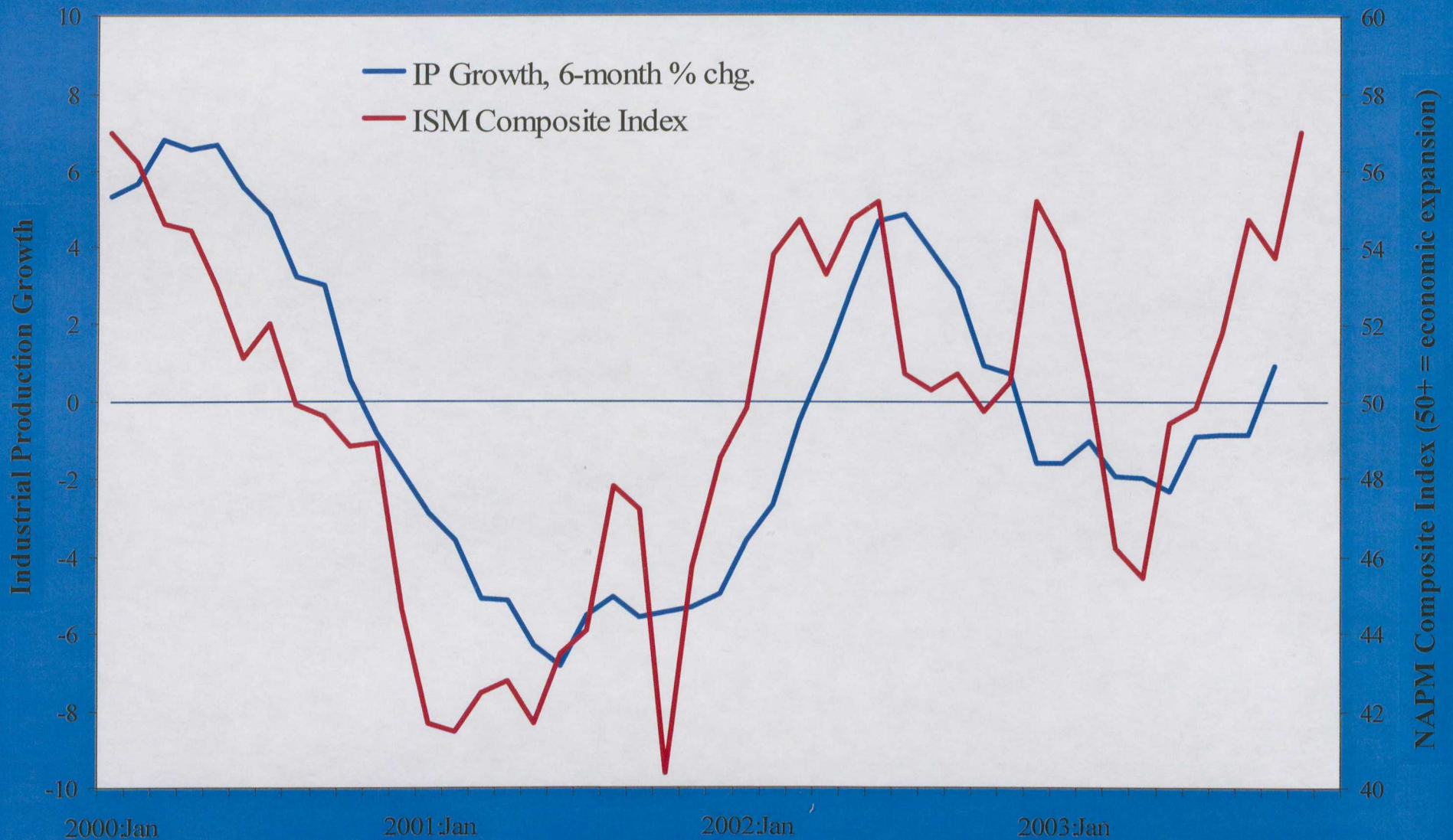
... Except From the Recent Declines in the Value of the Dollar...

Real Trade-weighted Broad exchange rate index



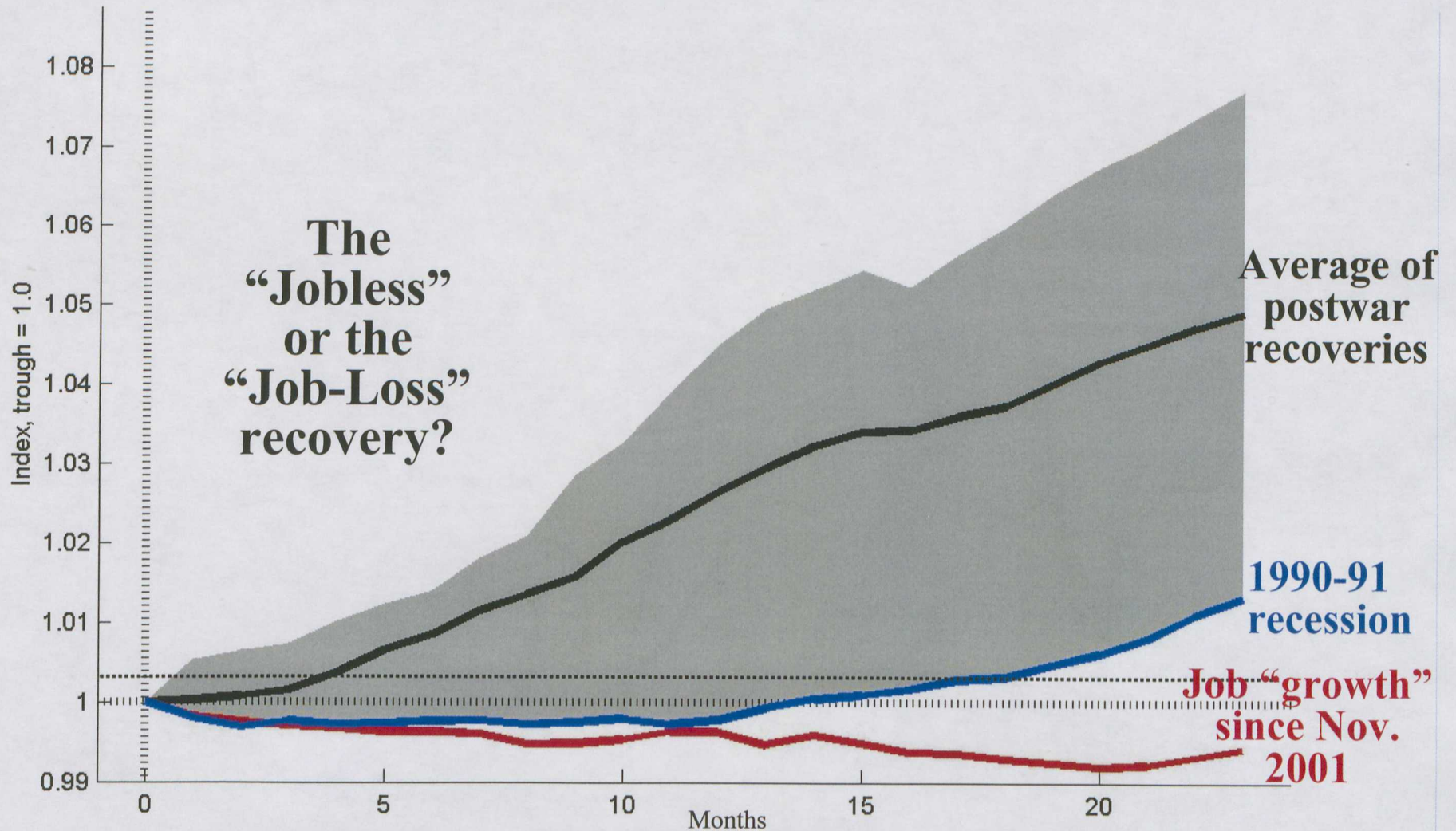
Source: Price-adjusted Broad Dollar Index (Jan. 1980 = 100); Federal Reserve Board.

... Which Have Likely Helped Manufacturing



Sources: Total Industrial Production Index (SA, 1997 = 100): Federal Reserve Board. ISM Manufacturing PMI Composite Index (SA, 50+ = Economic expansion): Institute for Supply Management.

But Employment Continues to Be an Issue Although We Have Had Three Months of Growth Now!



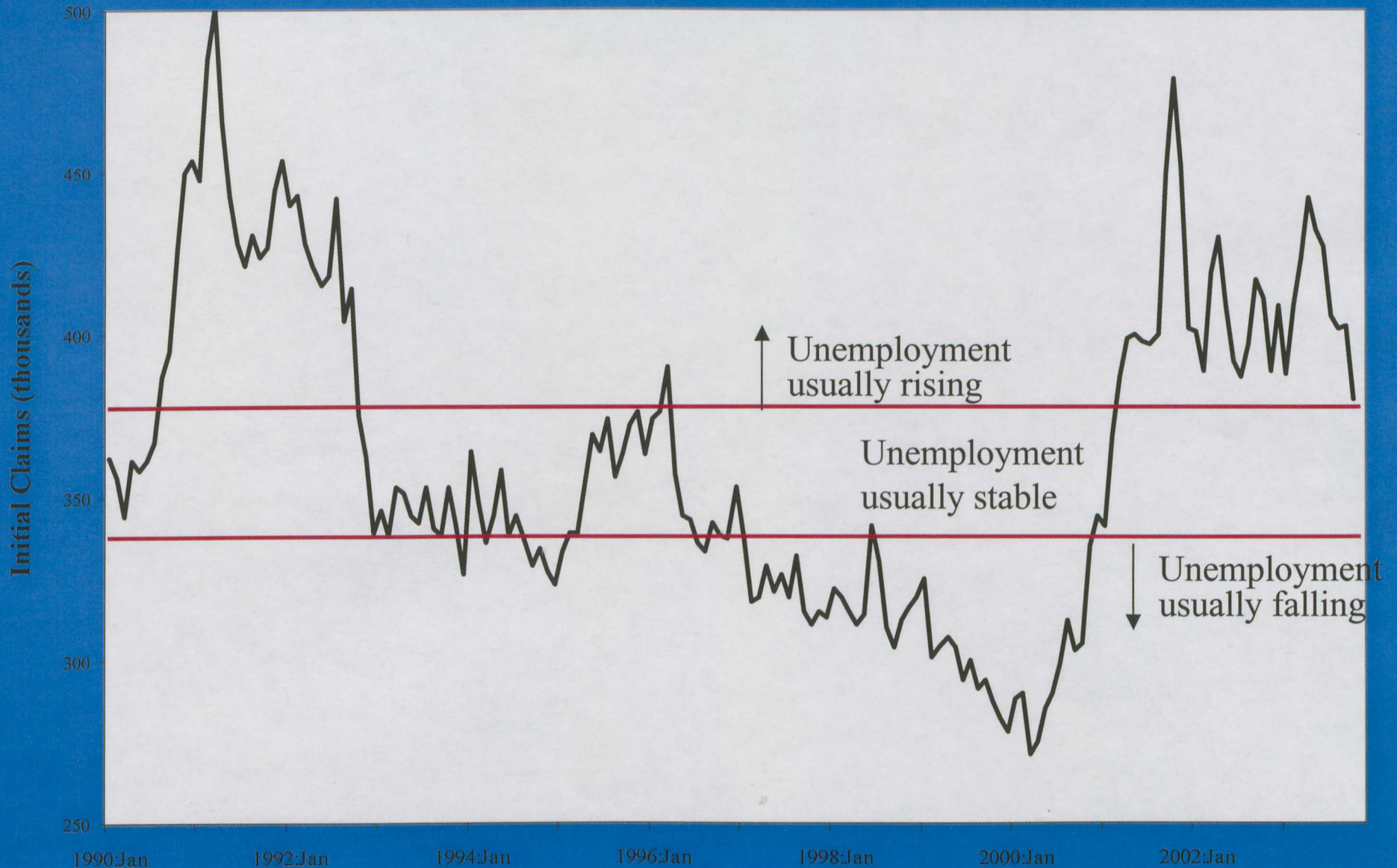
Nonfarm payroll employment, indexed to beginning of recovery

Heavy black line represents average of postwar recessions

Heavy red line represents current experience

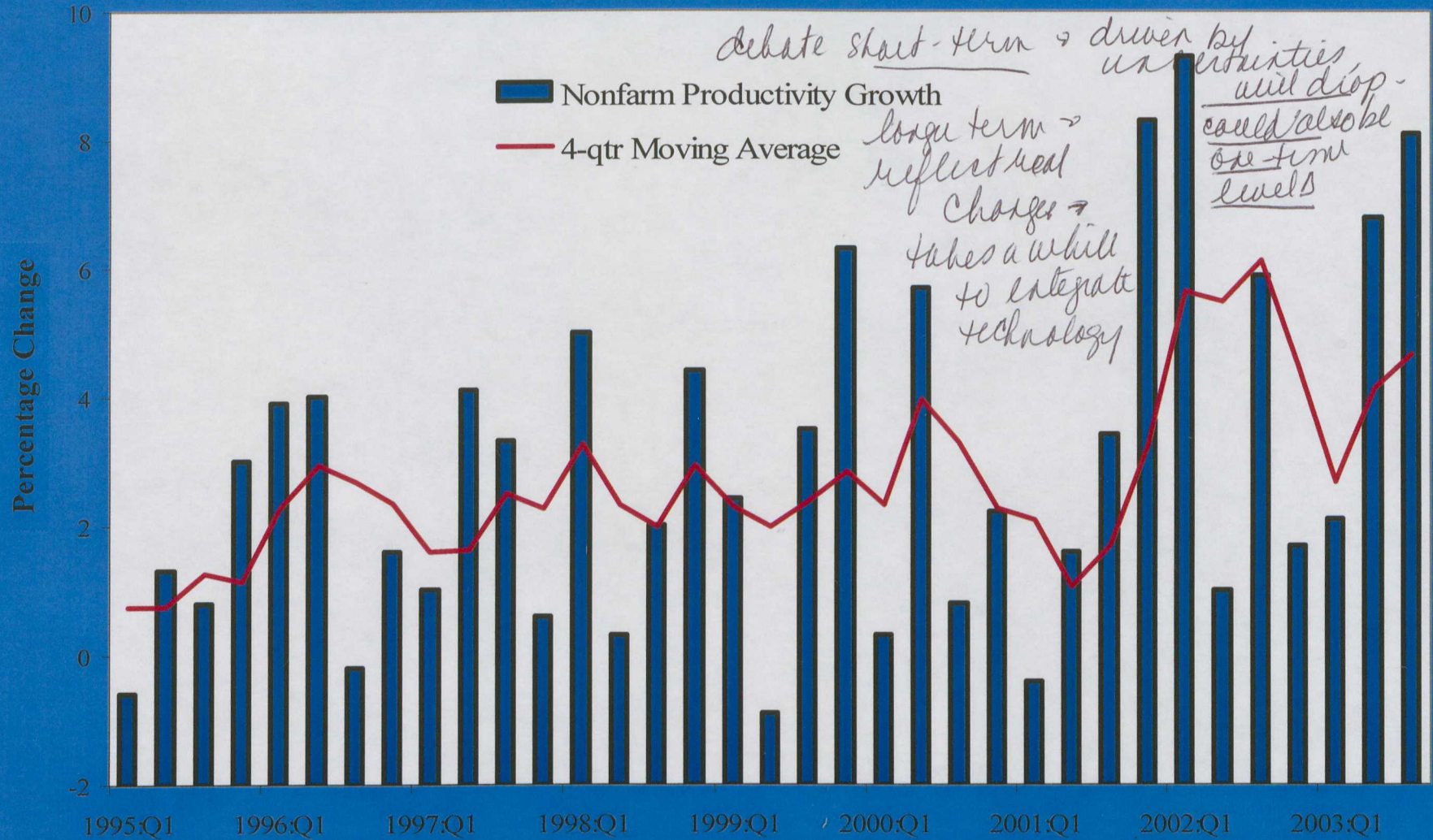
Shaded area shows range of outcomes across all postwar business cycles

Forward-looking indicators suggest labor markets remain weak, but are stabilizing



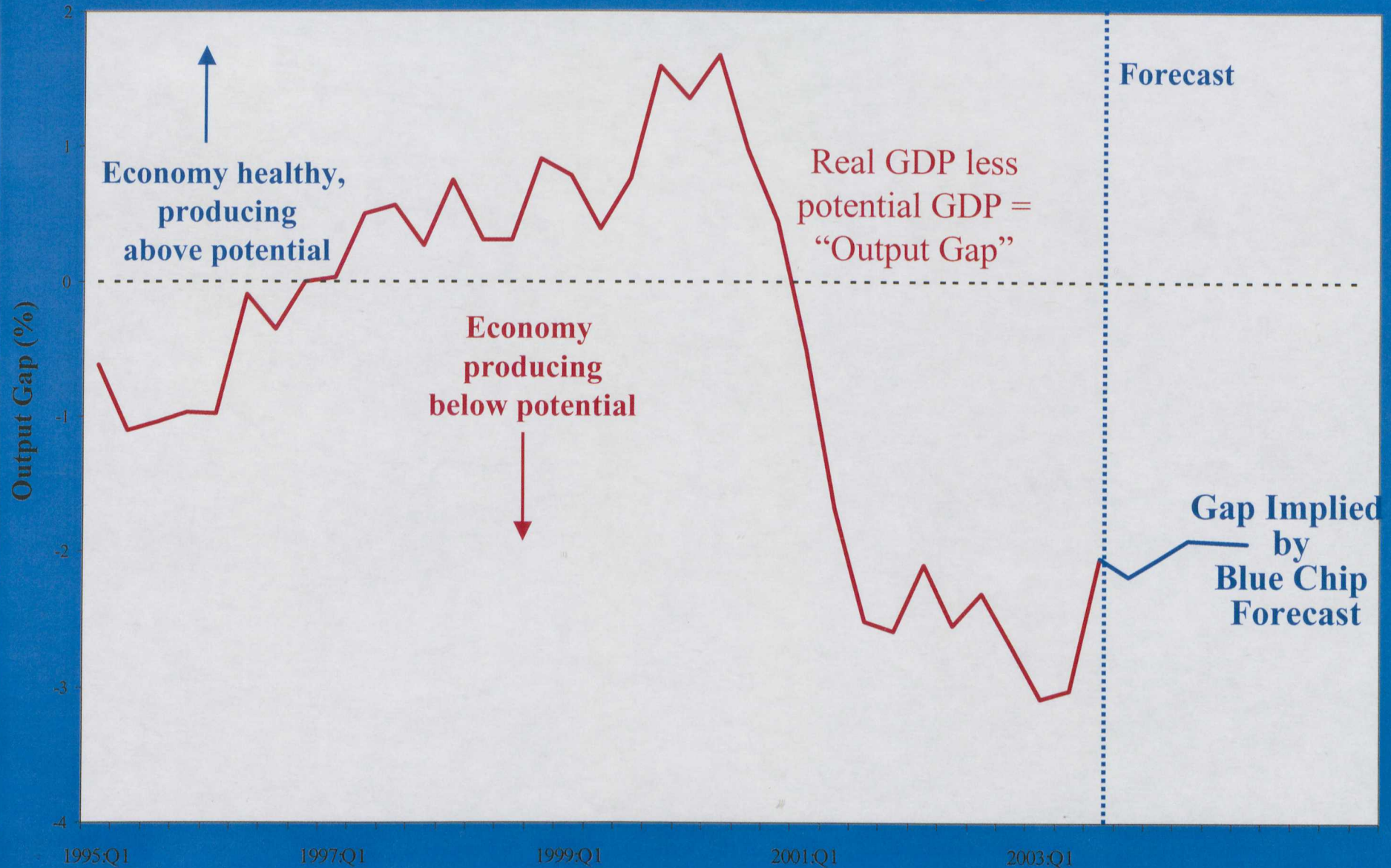
Source: Initial Claims for Unemployment Insurance, State Programs, Weekly Average (SA, Thousands); Department of Labor.

Productivity Growth



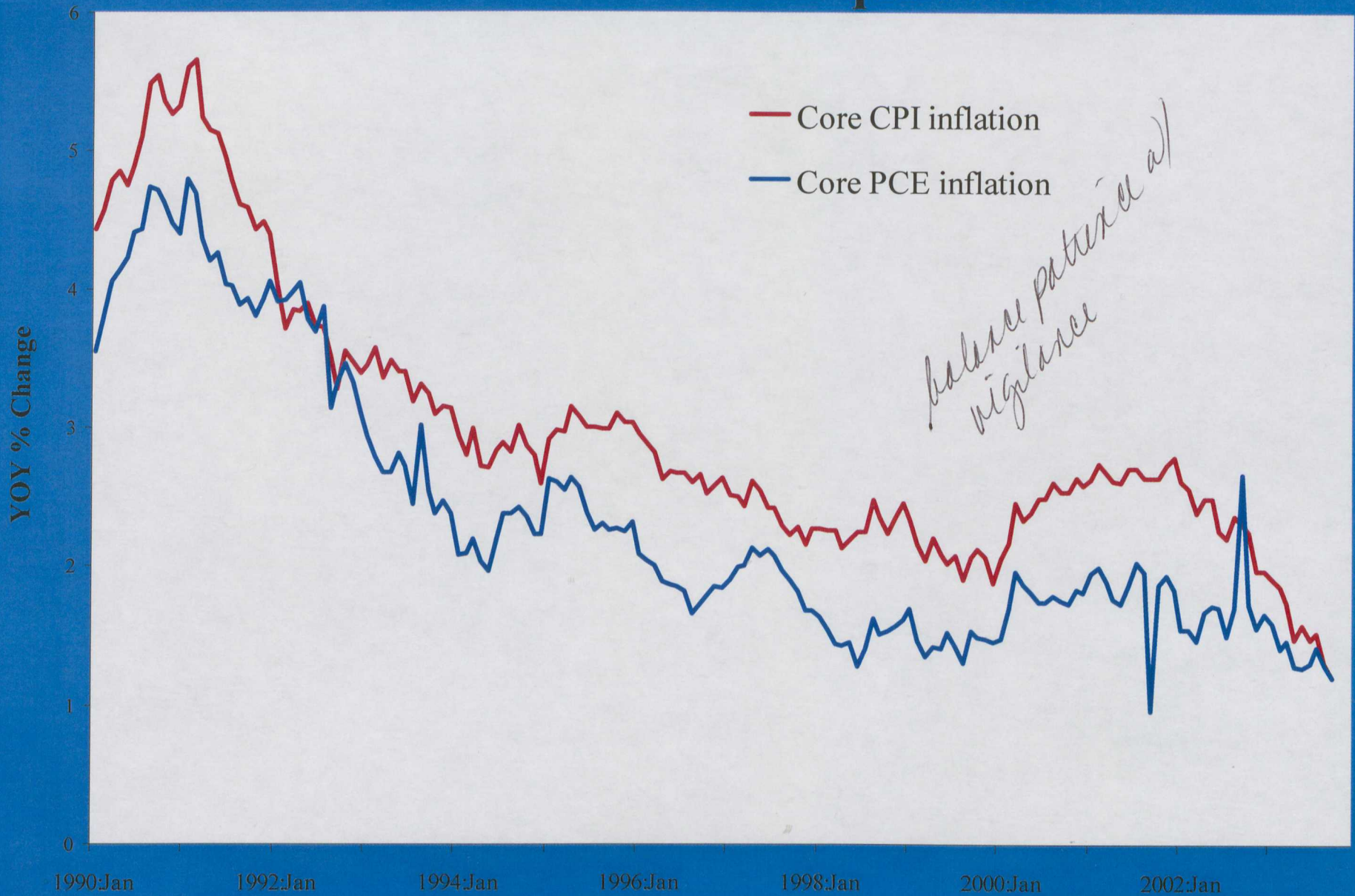
Source: Nonfarm Business Sector, Output per Hour of All Persons (SAAR, % Change); Bureau of Labor Statistics.

The consensus forecast implies excess capacity will persist into 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. Forecast: October 10 Blue Chip Economic Indicators.

Which is why inflation has been trending down, and should 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

- Good news:

- Signs of more sustained and vigorous recovery
- Fiscal stimulus in place - tax cuts/spending
- Ongoing monetary policy stimulus - remember WPCAR
in accommodation at
rate about 1%

- Looking Forward:

- Supports for capital spending are in place
- Autos, residential construction less likely to grow as strongly
- Employment now growing (but we need more)
- Productivity strong
- Which should help investment, hiring, and inflation