

- good to be back  
- what a difference a yr. makes  
- last year - uncertainty palpable  
- war on the horizon  
- tax cuts just being thought of  
- thought 2003 would increase strength by 2nd half - that has certainly happened but w/out usual job growth

# The Domestic Economic Outlook

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Federal Reserve Bank of Boston

Presented to

**Massachusetts Software Council**

January 13, 2004



26  
148  
24  
37

# Overview

Q - 2.0%      Q4 - 4.5%  
Q2 - 3.1%  
Q3 - 8.7%

- **We Have a Recovery**

- Our confidence in the recovery is stronger now than earlier
- We still have concerns about job growth - *last 12 mos -6* *last 3 mos +37* *+40*

- **GDP growth in 2003:H2 was quite strong**

- Led by strong consumption, especially autos and durable goods
- Business and residential investment strong
  - The keystone to the recovery - *Business spending*

- **Strength should continue into 2004**

- Depends on business spending and hiring ✓
- 2003:H2 encouraging with regard to business spending ✓
- Profits, productivity will support ongoing strength ✓

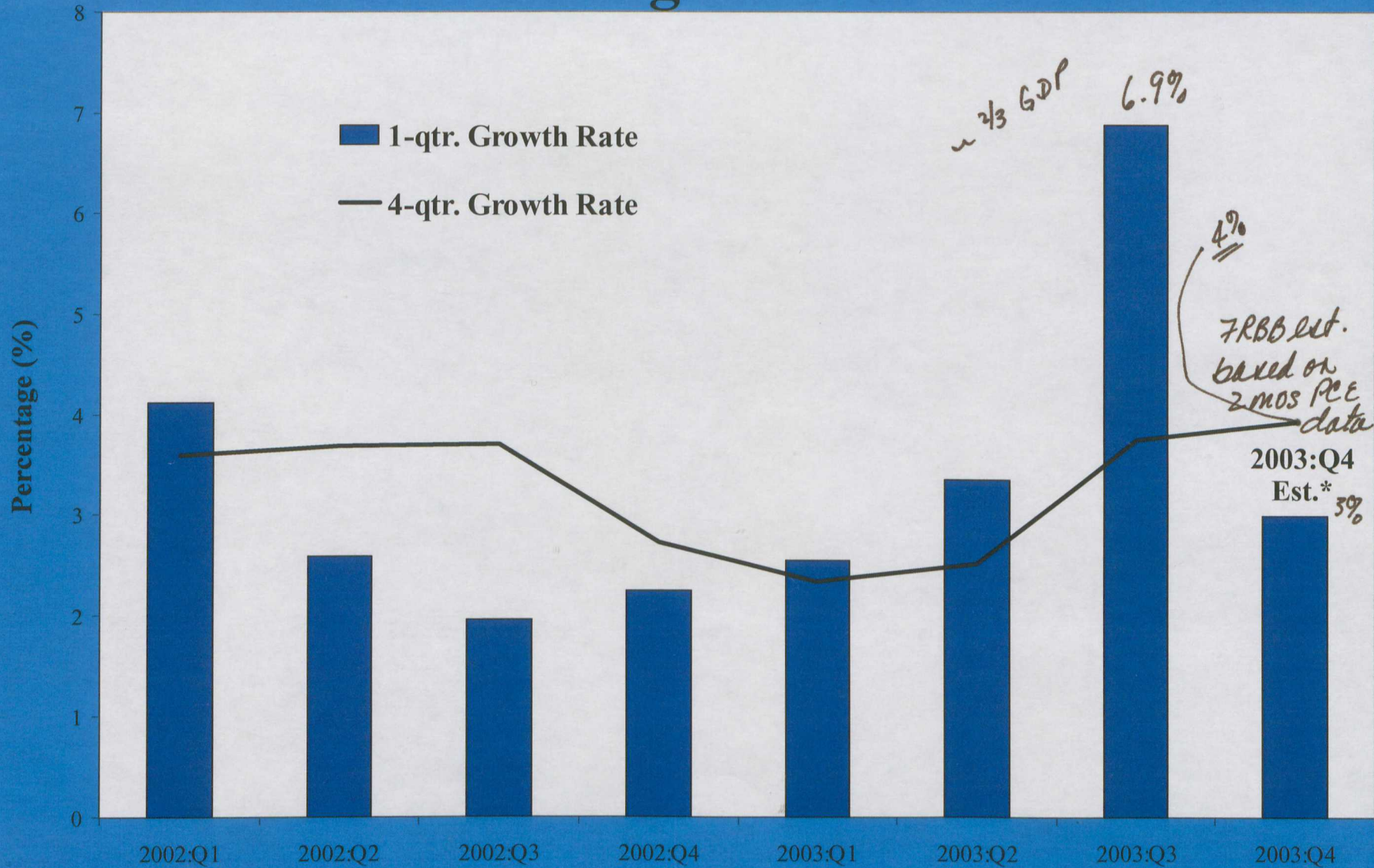
- **Jobs Still a Concern**

- Higher productivity has hurt in short run
- But we expect 2004 to show more vigorous job growth

*now lets look at data*



# Consumer spending continued strong through 2003:H2



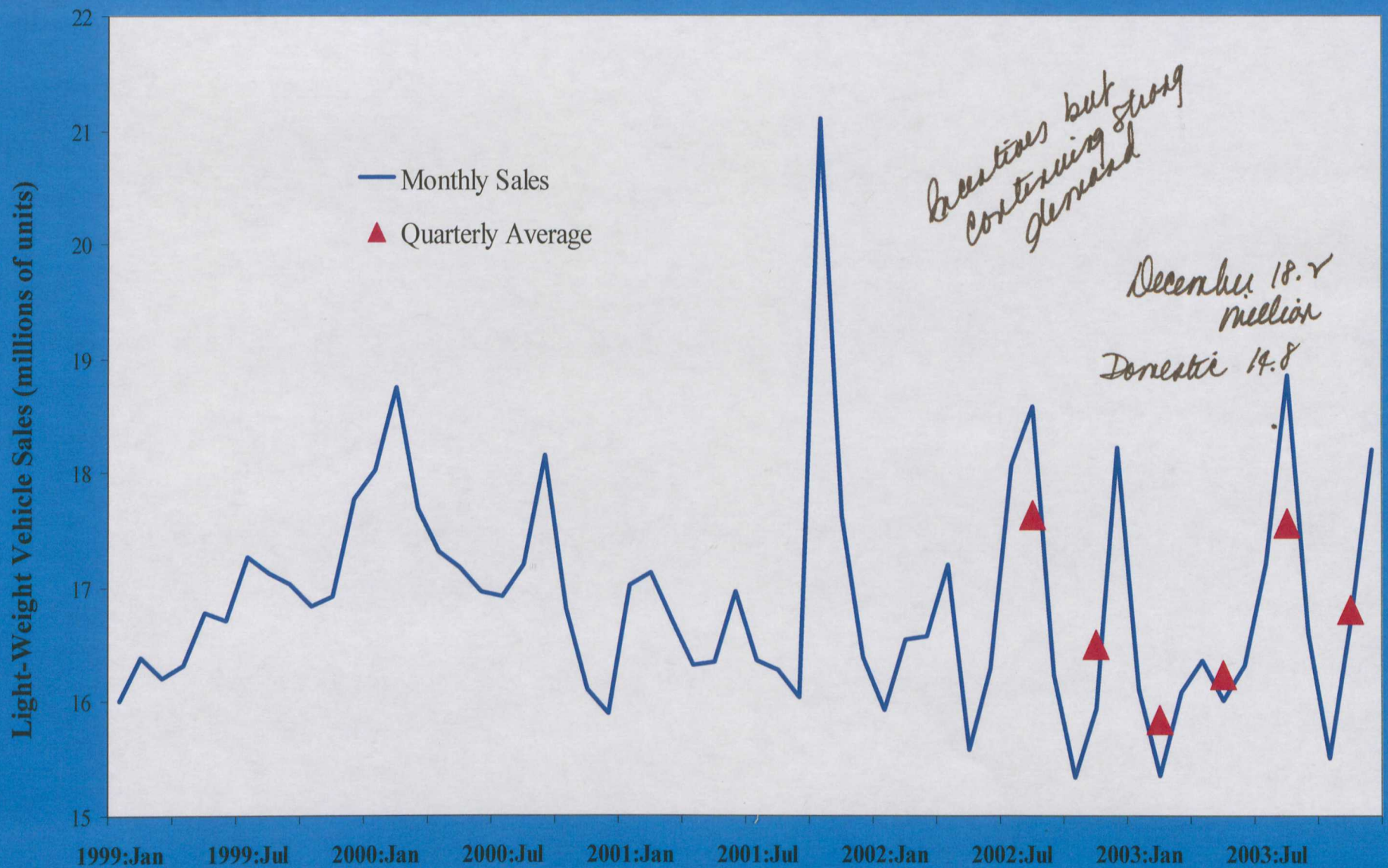
Source: Personal Consumption Expenditures (SAAR, Chained 2000\$): Bureau of Economic Analysis.

\* 2003:Q4 estimates based upon October and November data.

*what were consumers spending on?*



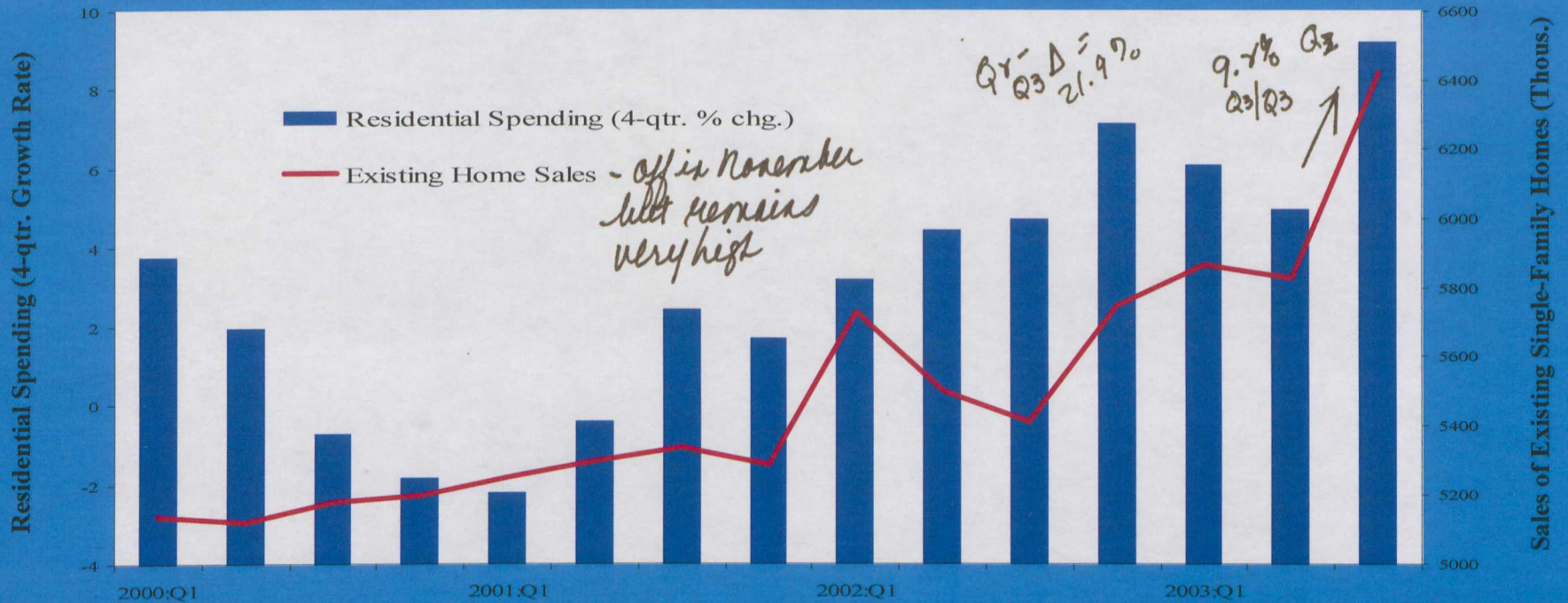
# Led By Strong Auto Sales



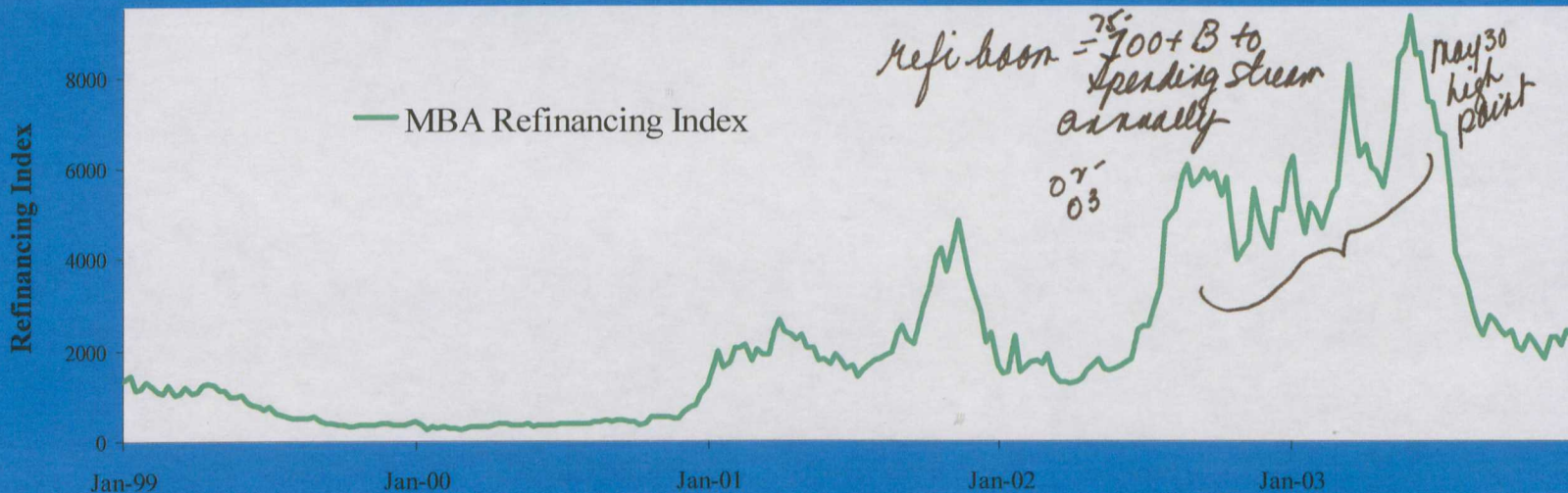


Consumers still buying homes

# Residential Investment Continues its Surge



## Although the refinancing boom appears to have come to a close



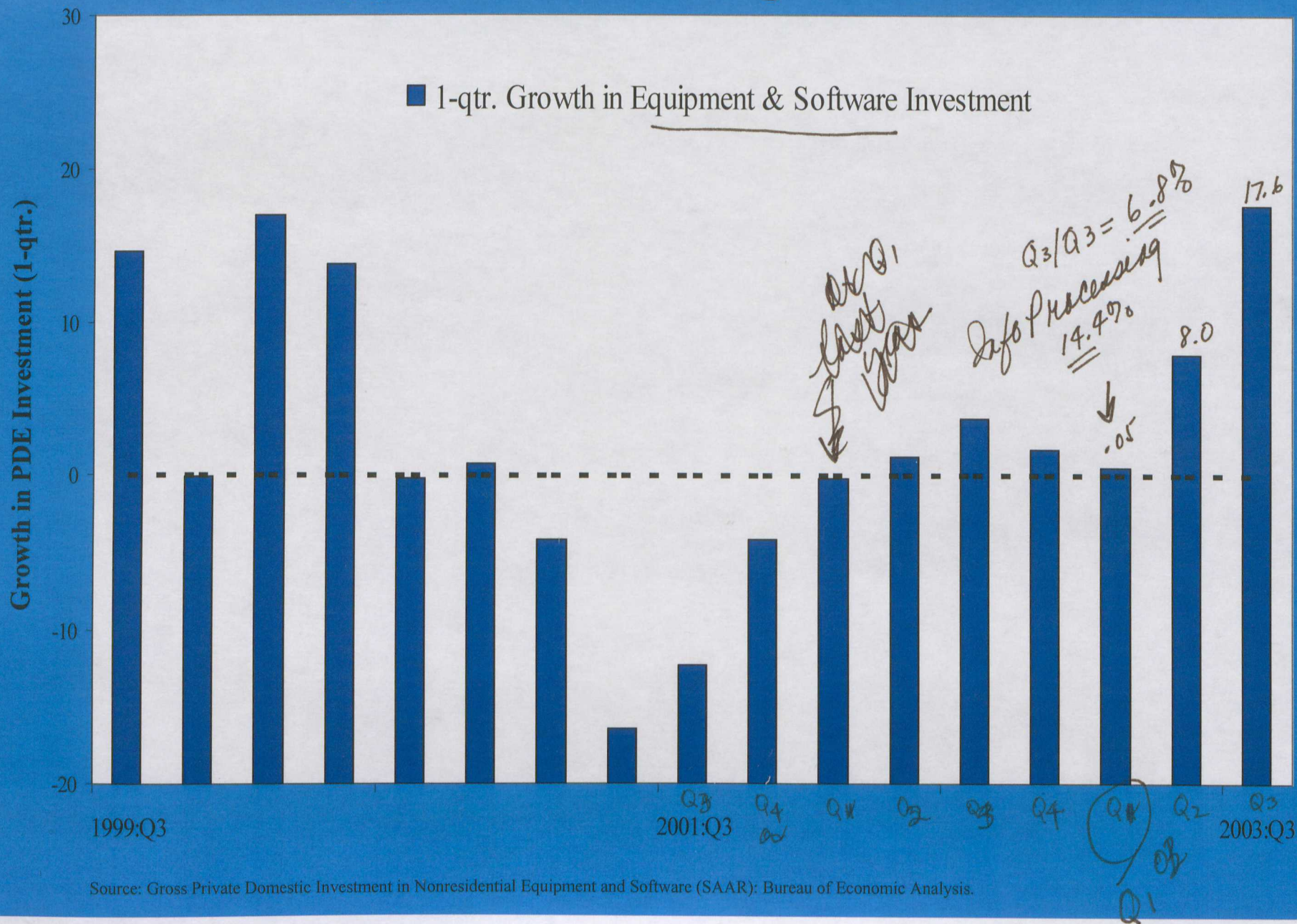
Sources: Fixed Private Residential Investment (SAAR): Bureau of Economic Analysis. Existing 1-Family Home Sales (SAAR, Thousands): National Association of Realtors. Mortgage Bankers' Association Purchase and Refinancing Indexes (SA): Federal Reserve Board.

But consumers have been the strength all along - NEW NEEDS



*Most importantly*

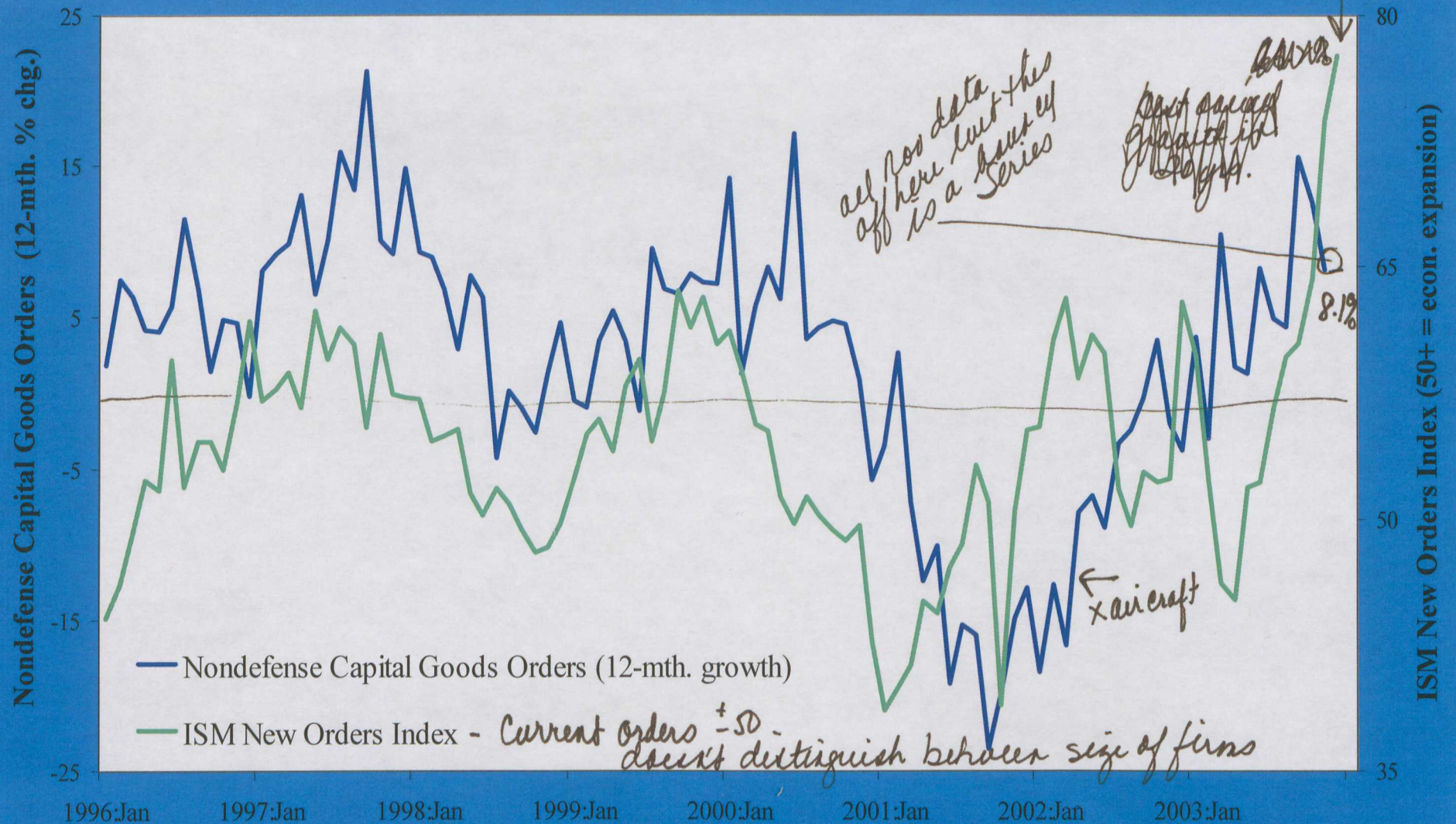
# The Long-Awaited Recovery in Capital Spending Appears to Have Begun in Earnest



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



# And Recent Indicators Suggest That This Momentum Will Continue in 2004

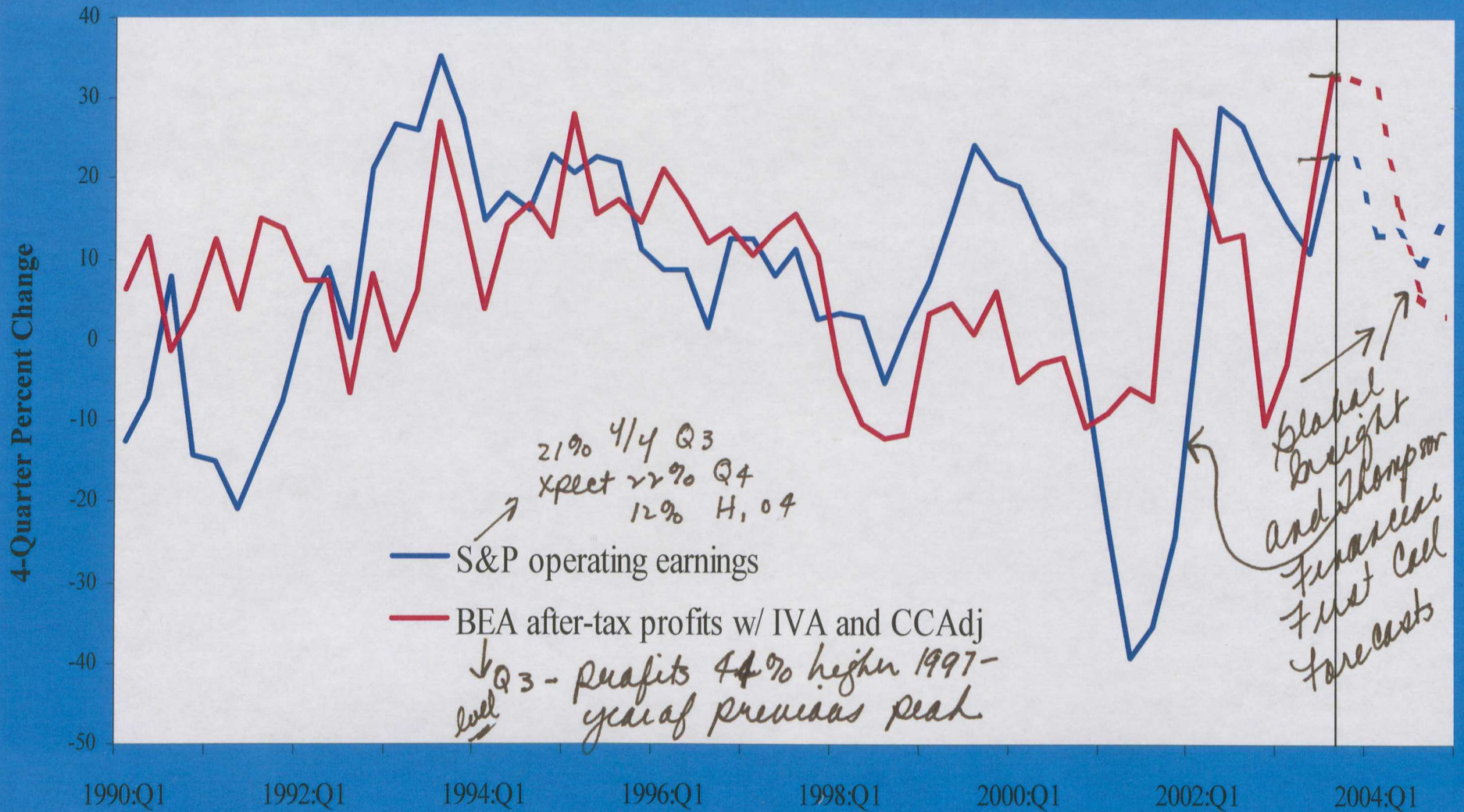


Sources: Manufacturers' New Orders for Nondefense Capital Goods excluding Aircraft (SA); Bureau of the Census. ISM Manufacturing New Orders Index (SA, 50+ = Economic expansion); Institute for Supply Management.

*Underlying this is improvement in fundamentals*



# Significant Earnings Growth Will Also Give Capital Spending a Lift in 2004

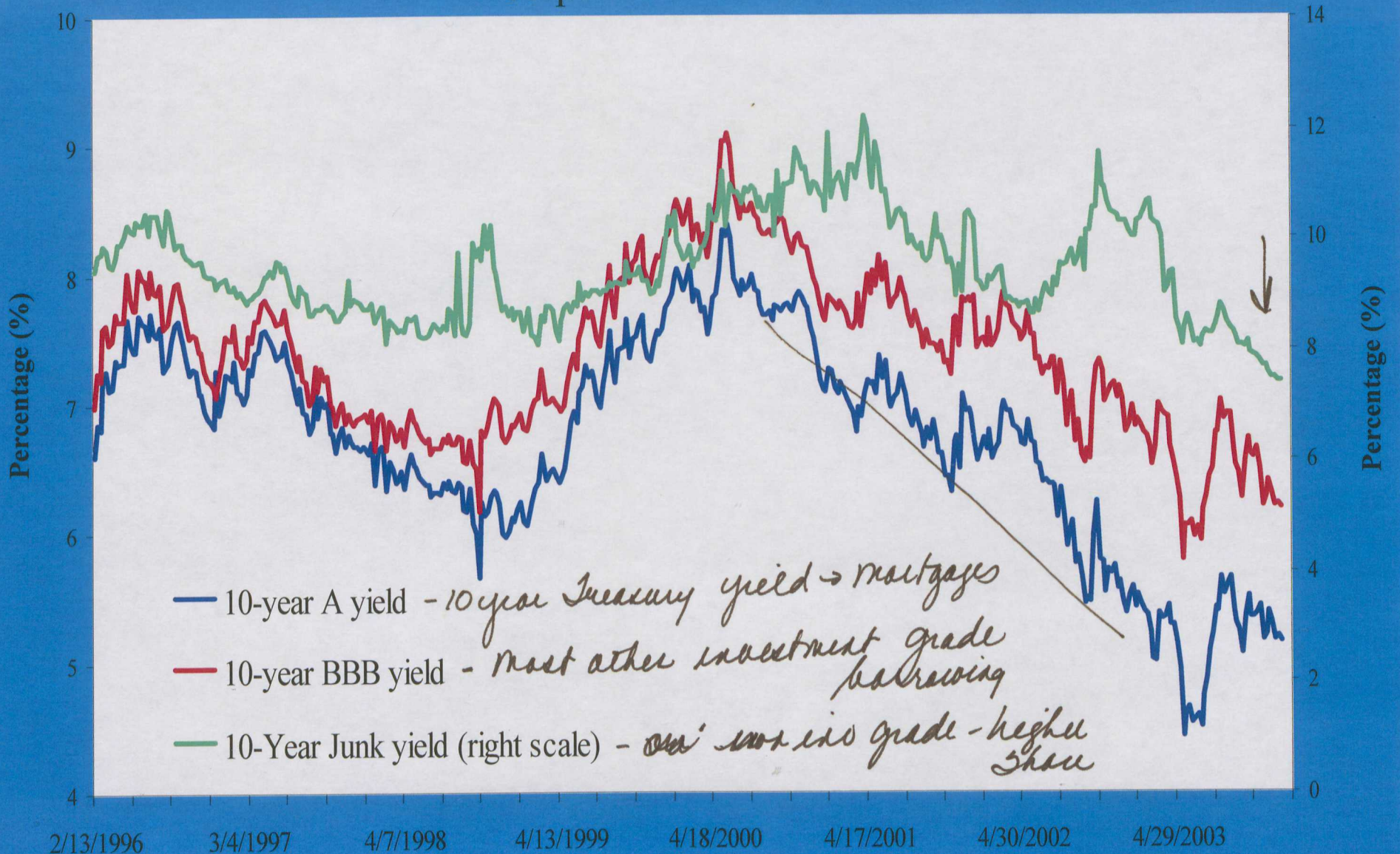


Sources: Bureau of Economic Analysis, Standard and Poor's, Haver Analytics, Global Insight, Thomson Financial/First Call (Forecasts).



# In contrast to 2001/2002, bond markets will support consumer and business spending in 2004

## Corporate Bond Yields

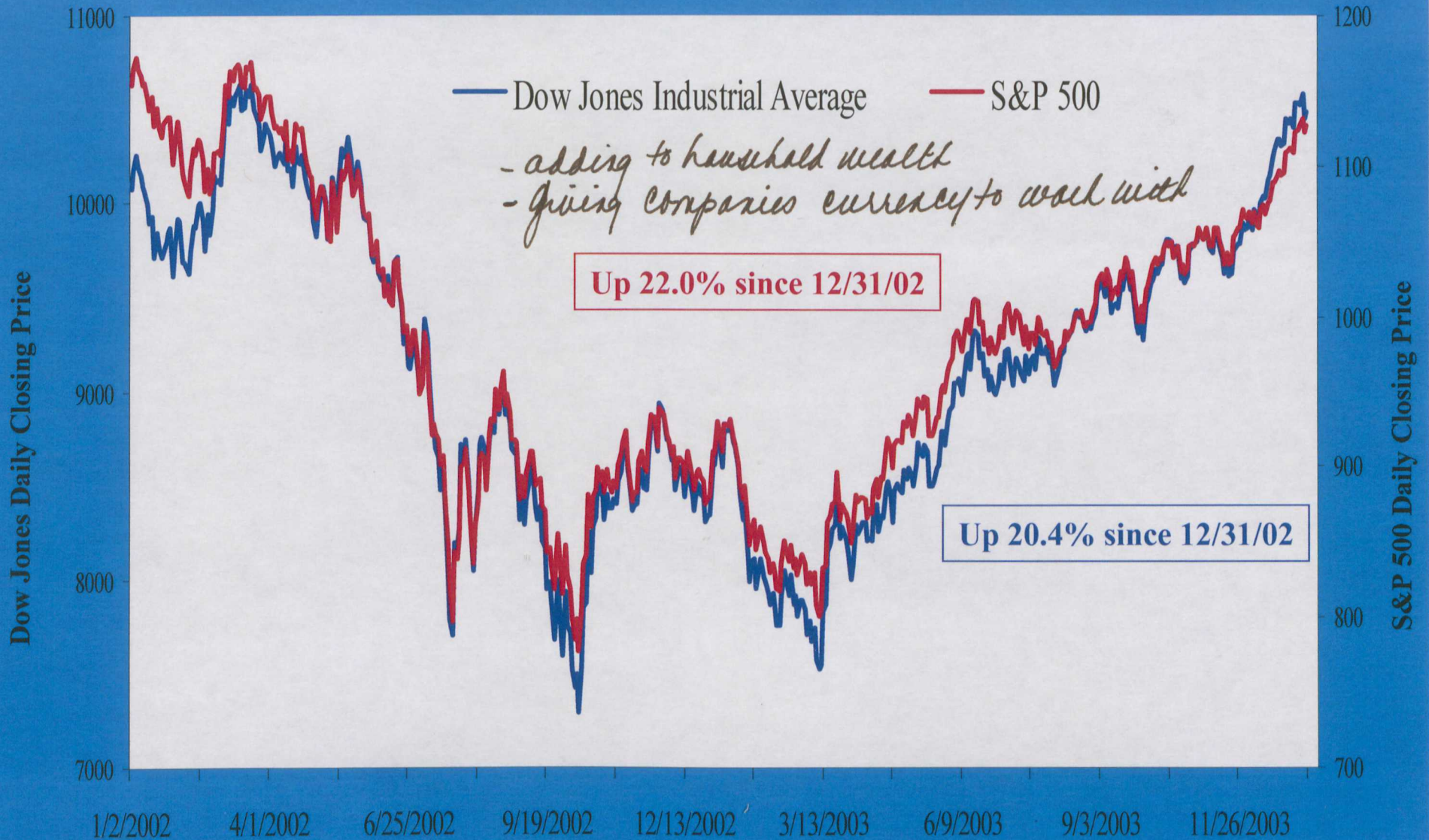


Sources: 10-year Treasury Bond Yield at Constant Maturity: Federal Reserve Board. 10-year Industrial Corporate Bond Yields: Standard & Poor's.



# As Will Equity Markets

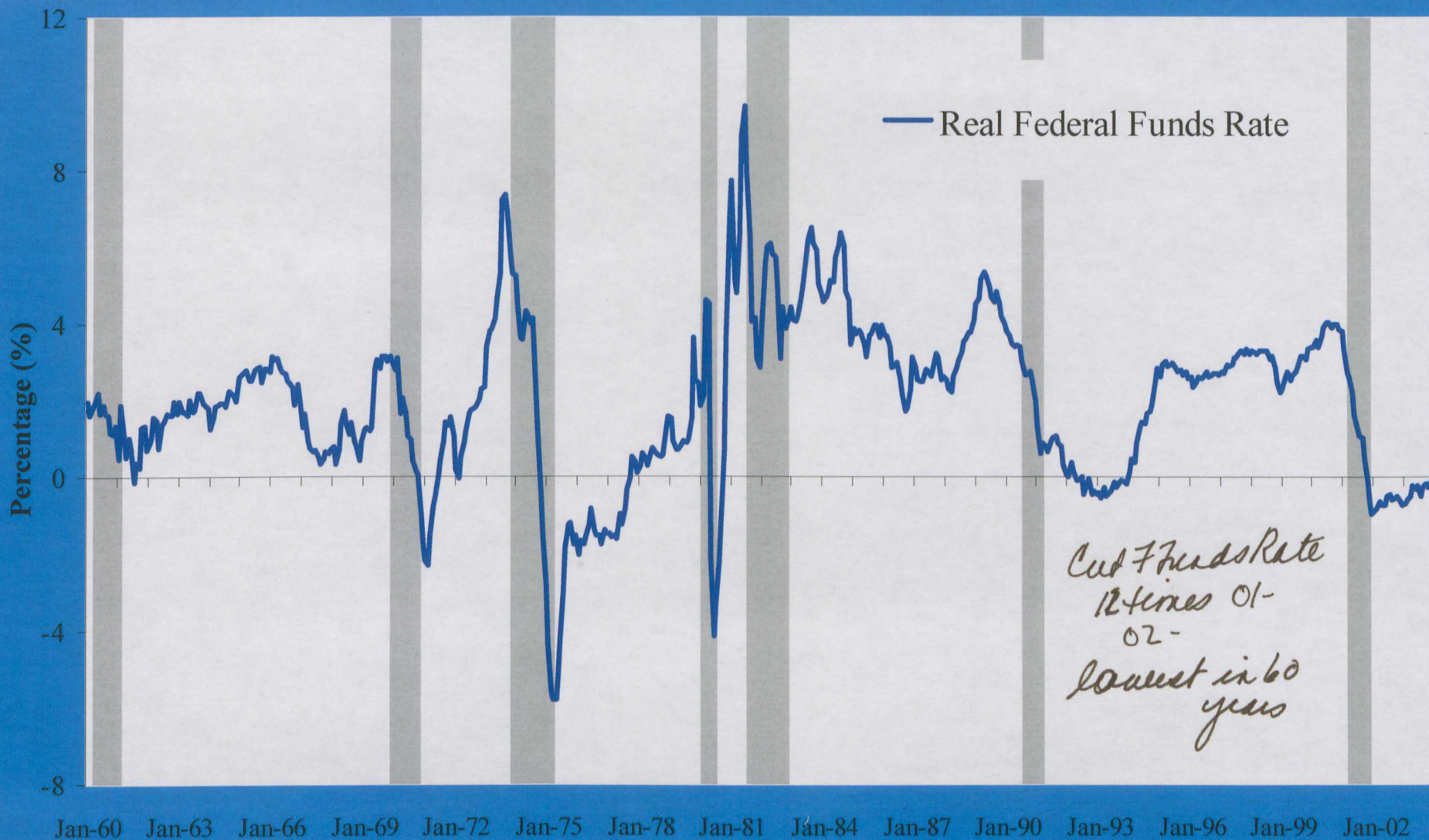
## Daily closing prices for the DJIA and the S&P 500





*Of course*

## Stimulative Monetary Policy Has Helped ...

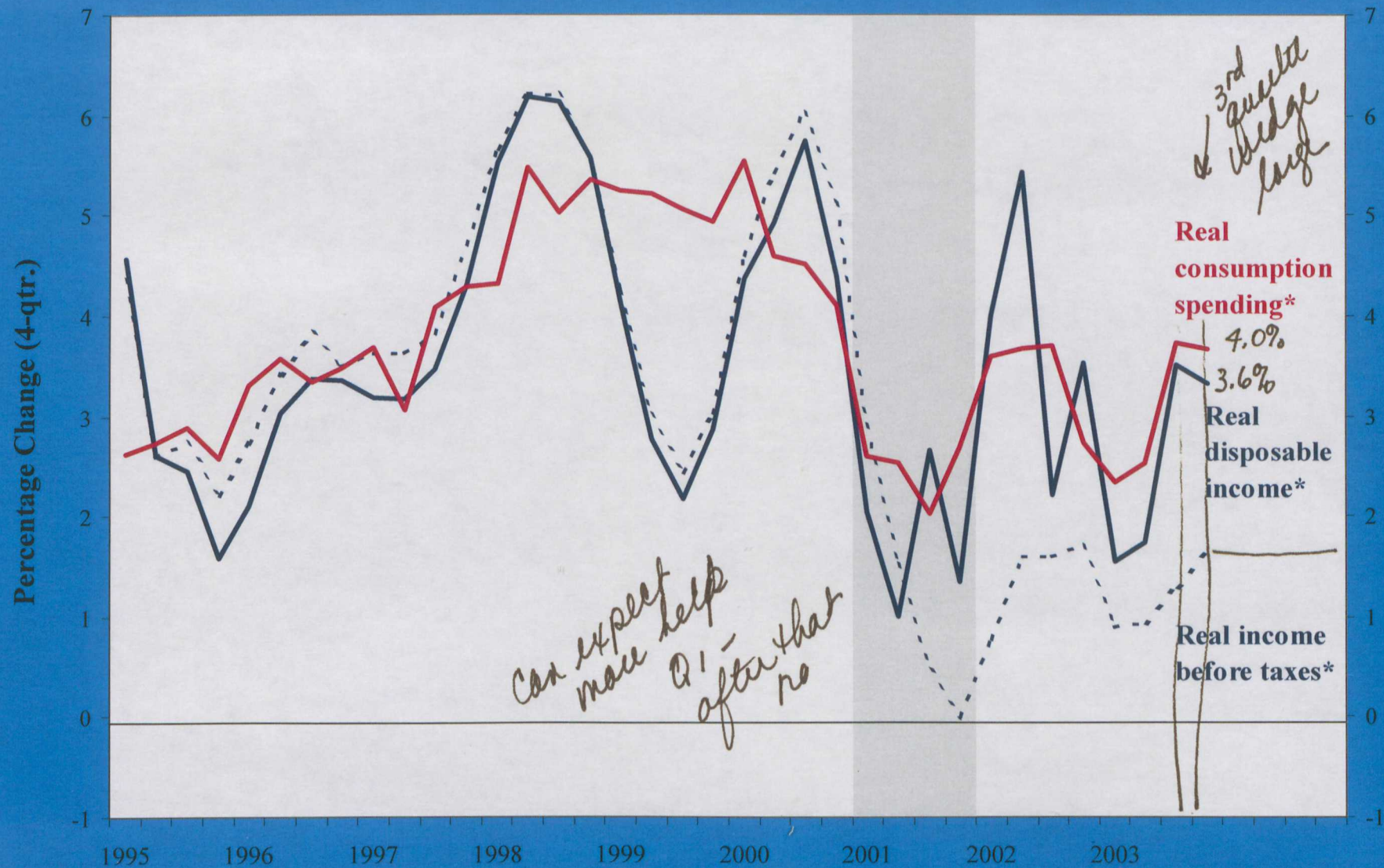


Sources: Effective Federal Funds Rate (% p.a.): Federal Reserve Board. CPI-U, All Items Less Food & Energy (SA, 1982-84=100): Bureau of Labor Statistics.



# As Has a Combination of Federal Tax Cuts...

## Consumption has tracked after-tax income



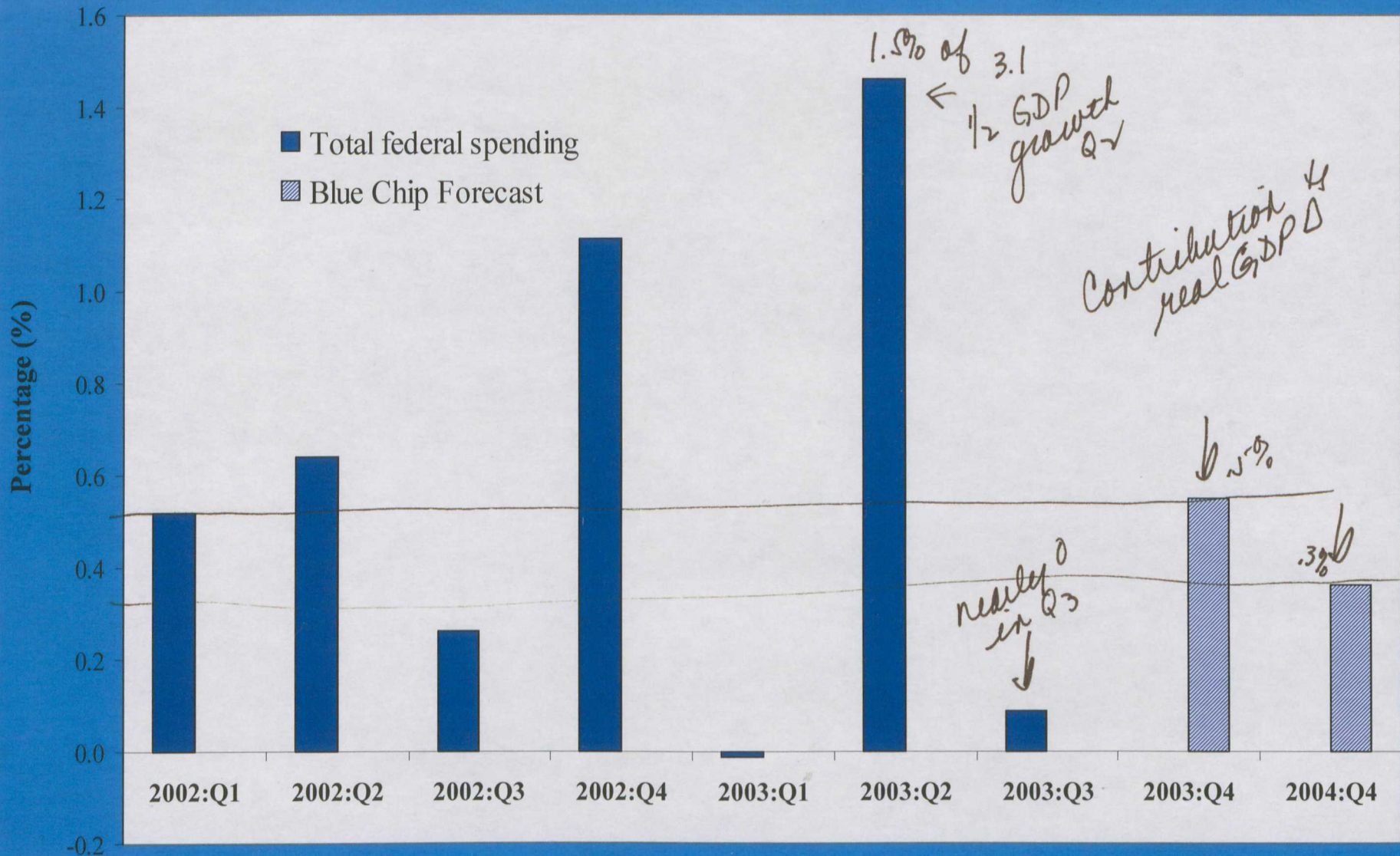
Source: Real Disposable Personal Income, Real Personal Income, and Personal Consumption Expenditures (SAAR, Chained 2000\$): Bureau of Economic Analysis.

\* 2003:Q4 estimates based upon monthly data.



# ...And Defense-Related Spending

## Contribution of federal spending to real GDP growth



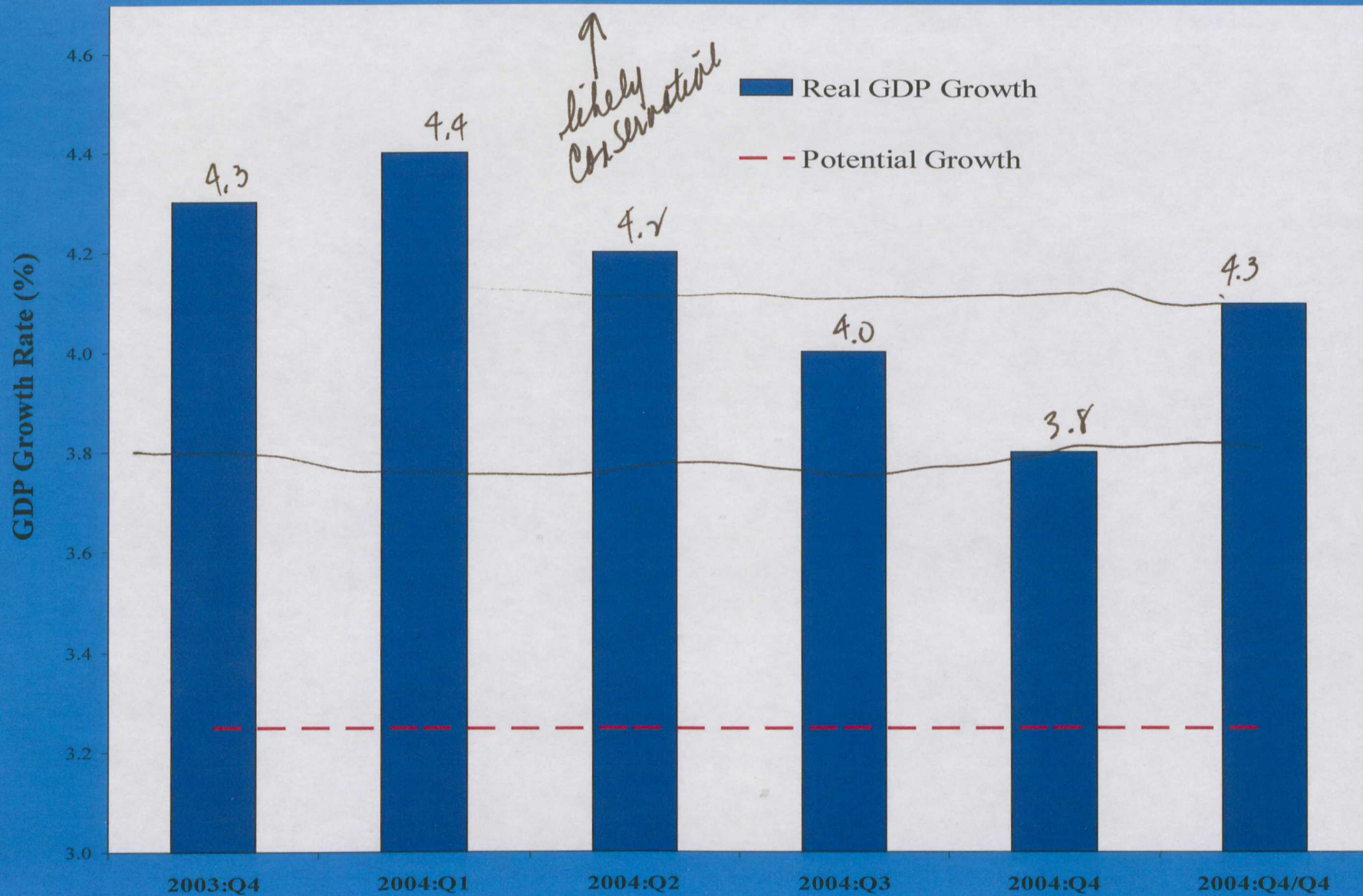
Source: Federal Consumption/Investment Contribution to Real GDP Change (SAAR); Bureau of Economic Analysis.



*Notwithstanding → Pumphas been primed*

# But Consensus Forecasts Expect a Self-Sustaining, Privately-Driven Recovery in 2004

## Blue Chip Economic Indicators Consensus Forecast



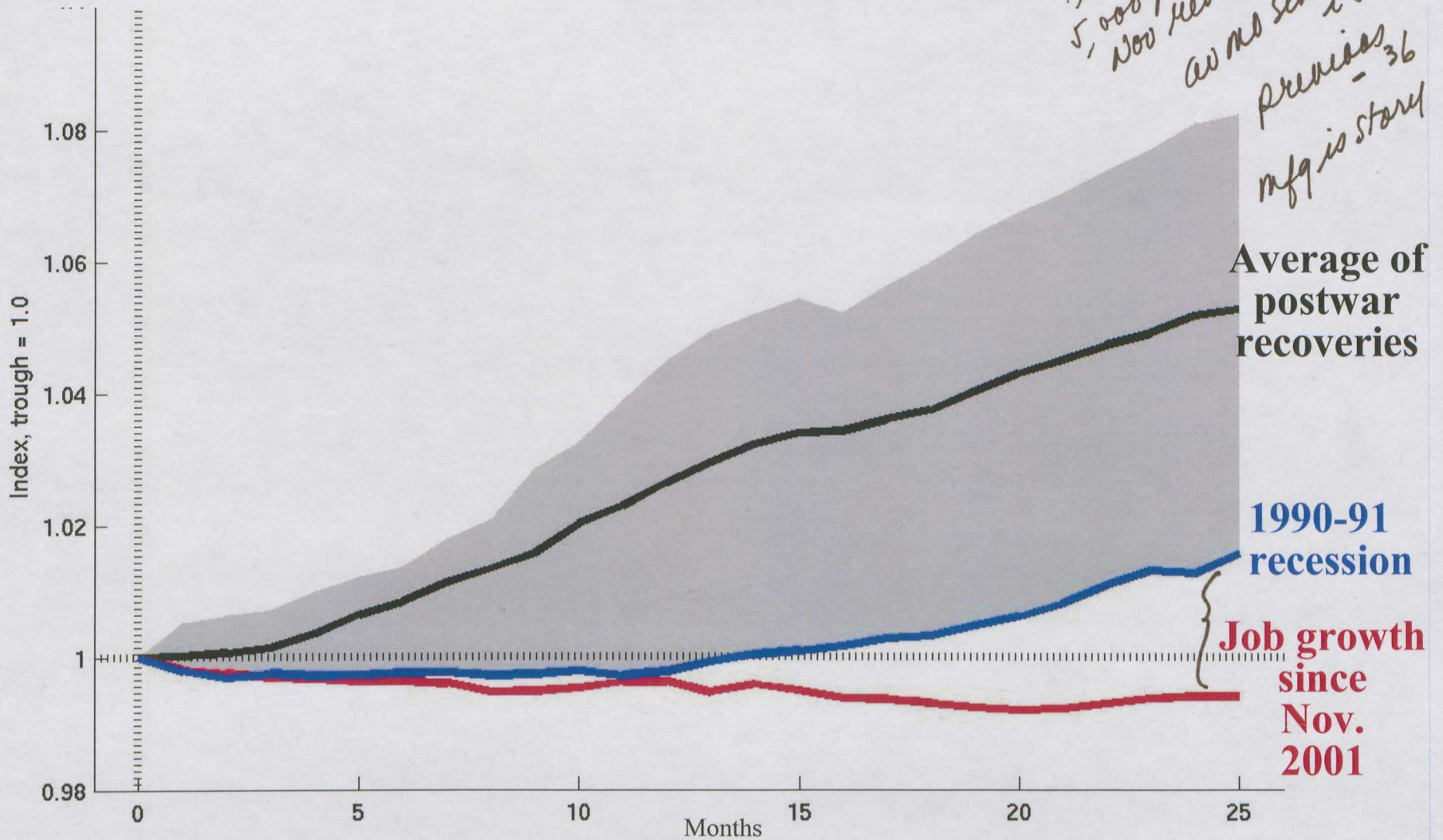
Source: Forecasts from January 10th Blue Chip Economic Indicators.



# A Remaining Issue: Employment Growth

Friday's report was disappointing

*-1,000 private nonfarm  
5,000 removed to  
1200 removed to  
as no since Italy  
previous 2754  
-36  
mfg is story*



Nonfarm payroll employment, indexed to beginning of recovery

Heavy black line represents average of postwar recessions

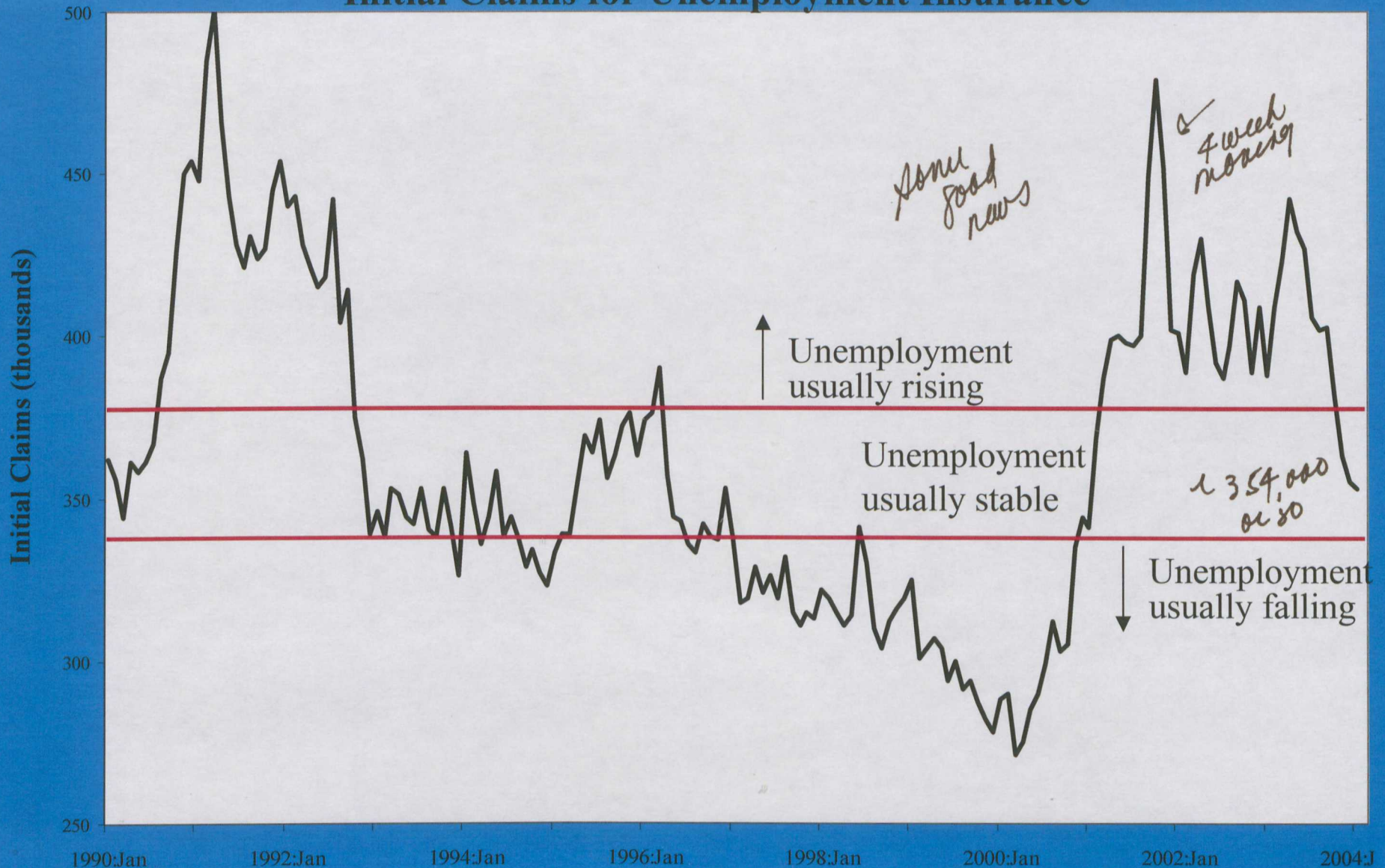
Heavy red line represents current experience

Shaded area shows range of outcomes across all postwar business cycles



# Forward-looking indicators suggest labor markets are now in more stable territory

## Initial Claims for Unemployment Insurance



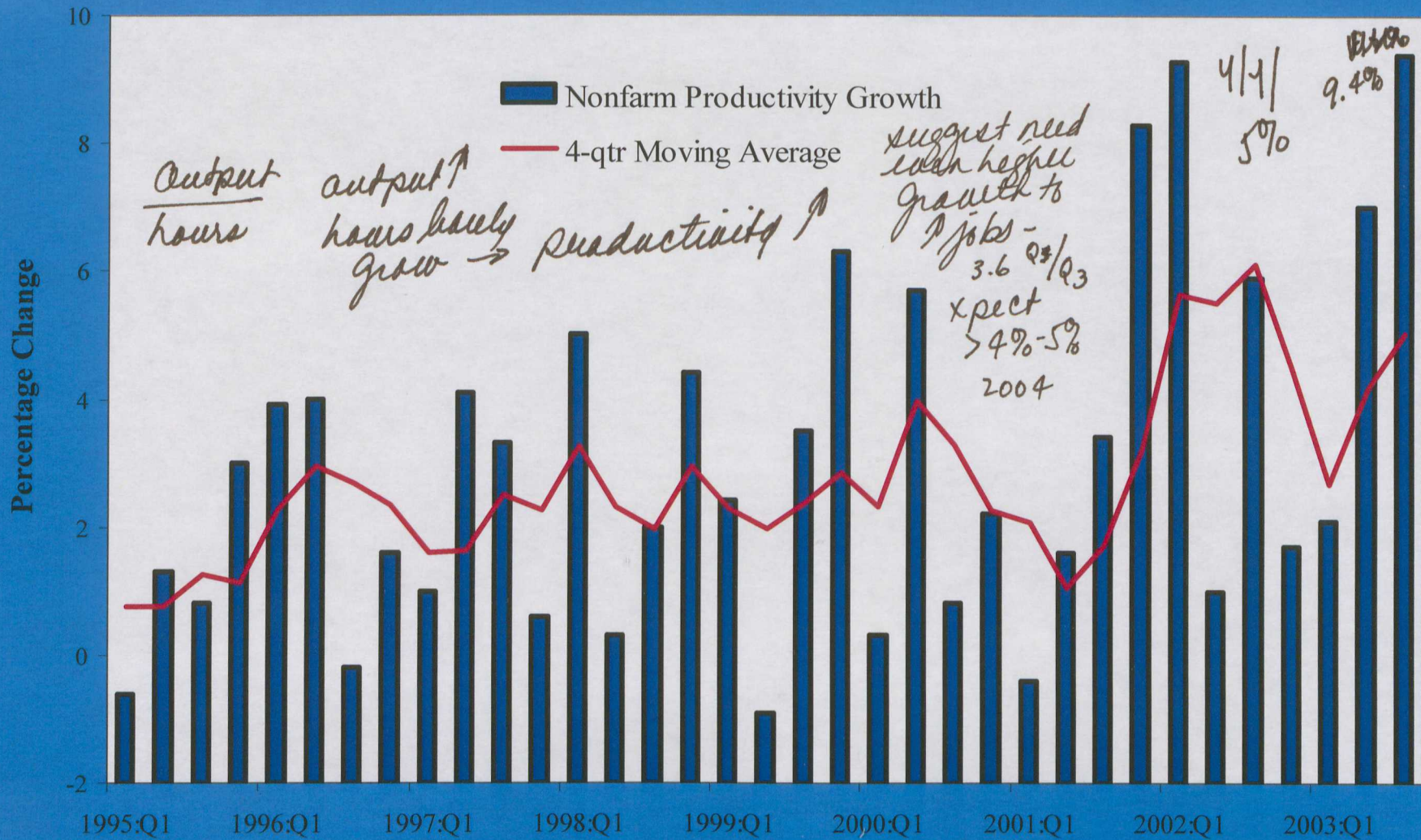
Source: Initial Claims for Unemployment Insurance, State Programs, Weekly Average (SA, Thousands): Department of Labor.

Note: January 2004 number represents claims through the week ending January 3rd.



# Productivity Growth Has Been Very Strong

## Helps Investment; A Substitute for Job Growth?



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

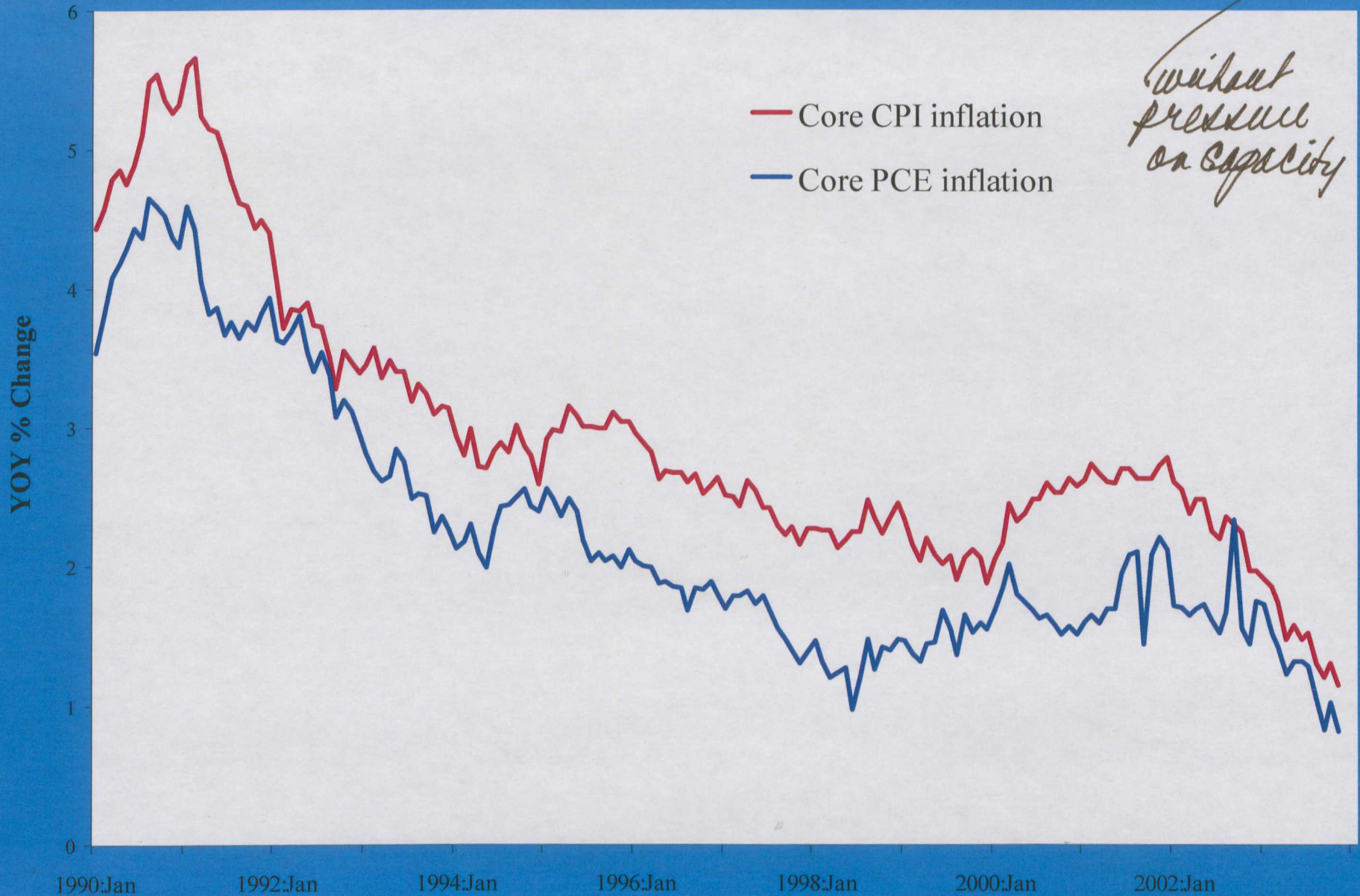
*- new tech  
 - uncertainty  
 - labor more expensive*

*} all don't know*



*But growing demand suggests existing resources can produce more*

## Which is one reason why inflation has been trending down, and should remain benign

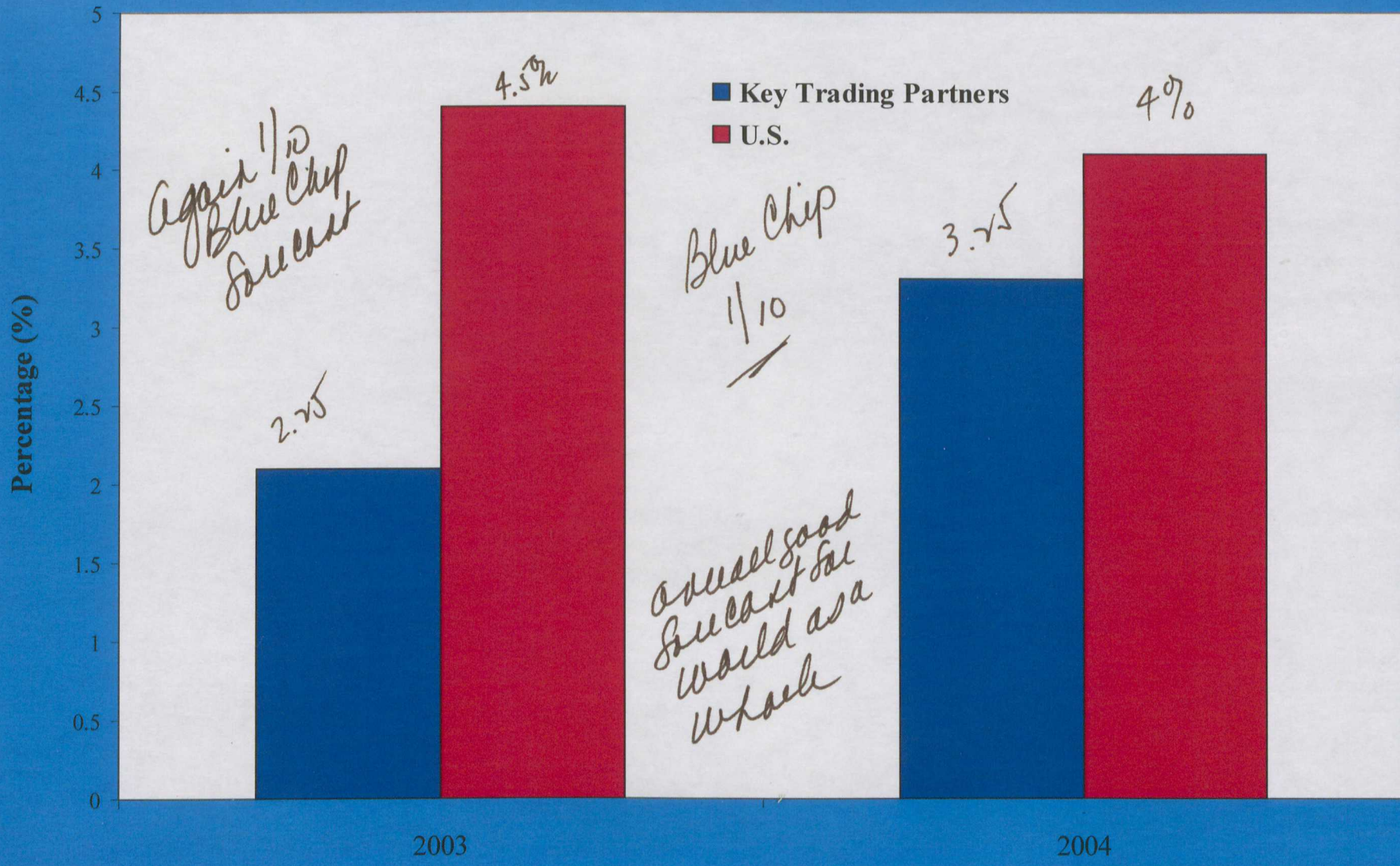


Sources: CPI-U, All Items Less Food and Energy (SA, 1982-84=100): Bureau of Labor Statistics. PCE Less Food and Energy, Chain Price Index (SA, 2000=100): Bureau of Economic Analysis.



*Pictures would not be complete w/out Herat side*

## We Don't Expect Much Help From Abroad ... Projected Real GDP Growth, U.S. versus Foreign

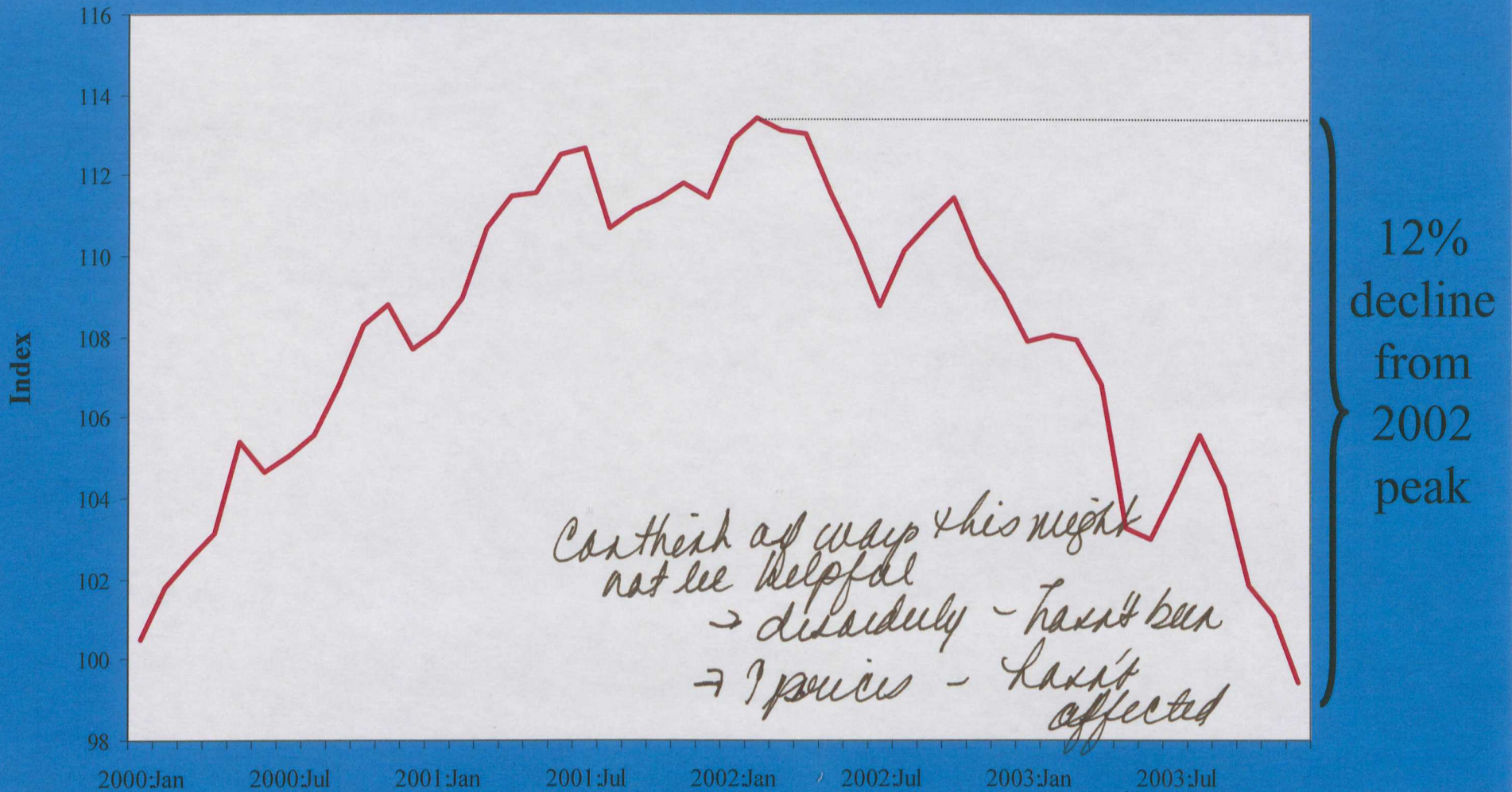


Source: January 10th Blue Chip Economic Indicators.



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

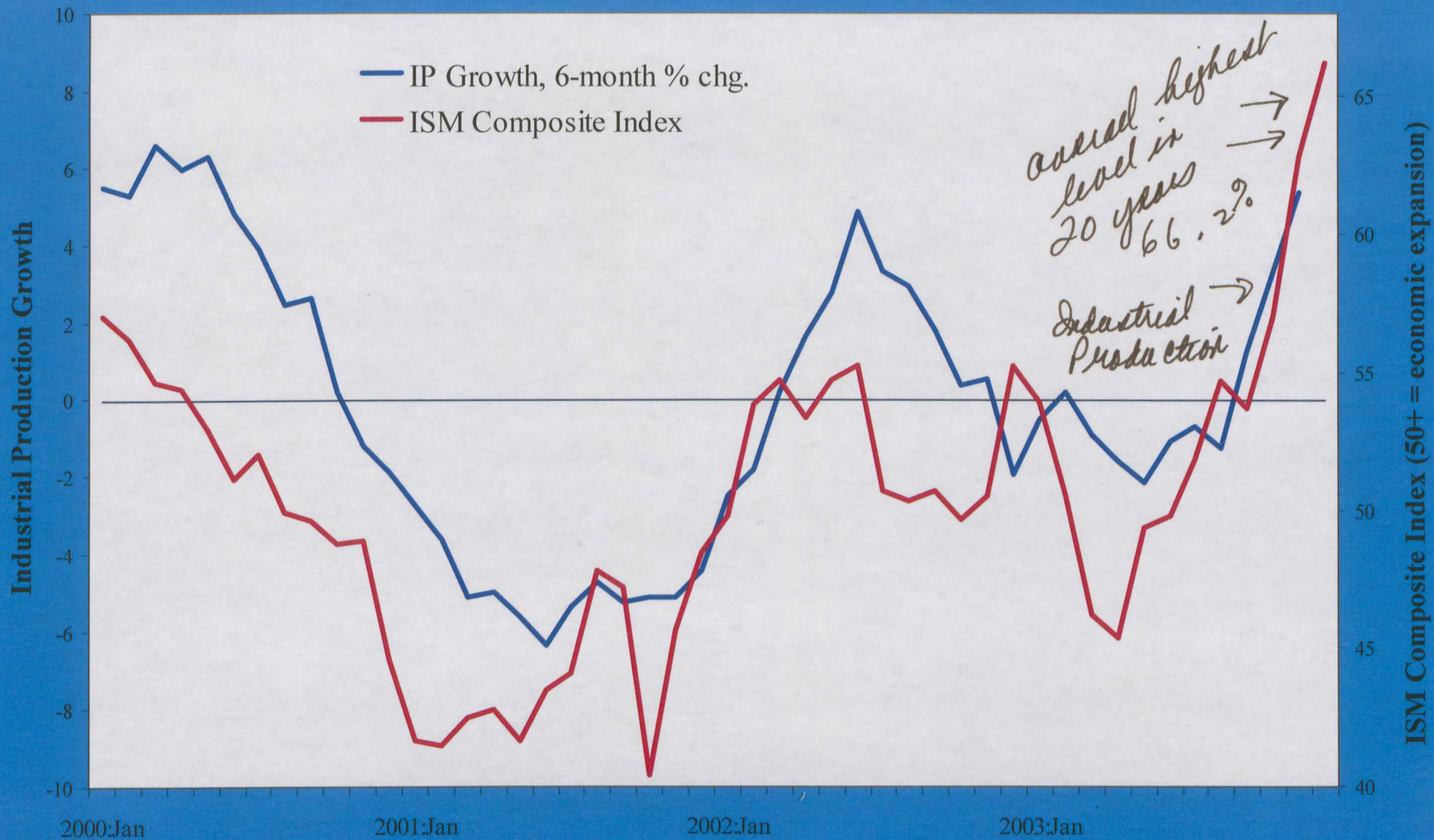
## Real Trade-weighted Broad exchange rate index





*But one way its likely been good is effect on mfg.*

## ... 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.



# Summary

## Self-sustaining private recovery in train

- Capital spending is recovering
  - Relatively good news for tech sector
- Consumer spending, housing continue to support
- Employment growth still meager; we need more