

# State of the Economy: Panel Session

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## The U.S. Economic Outlook

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Not an official Document



# Outline of Talk

- Current Conditions (are we past the soft patch?)
- The Consensus Forecast
- Risks to the Consensus Forecast

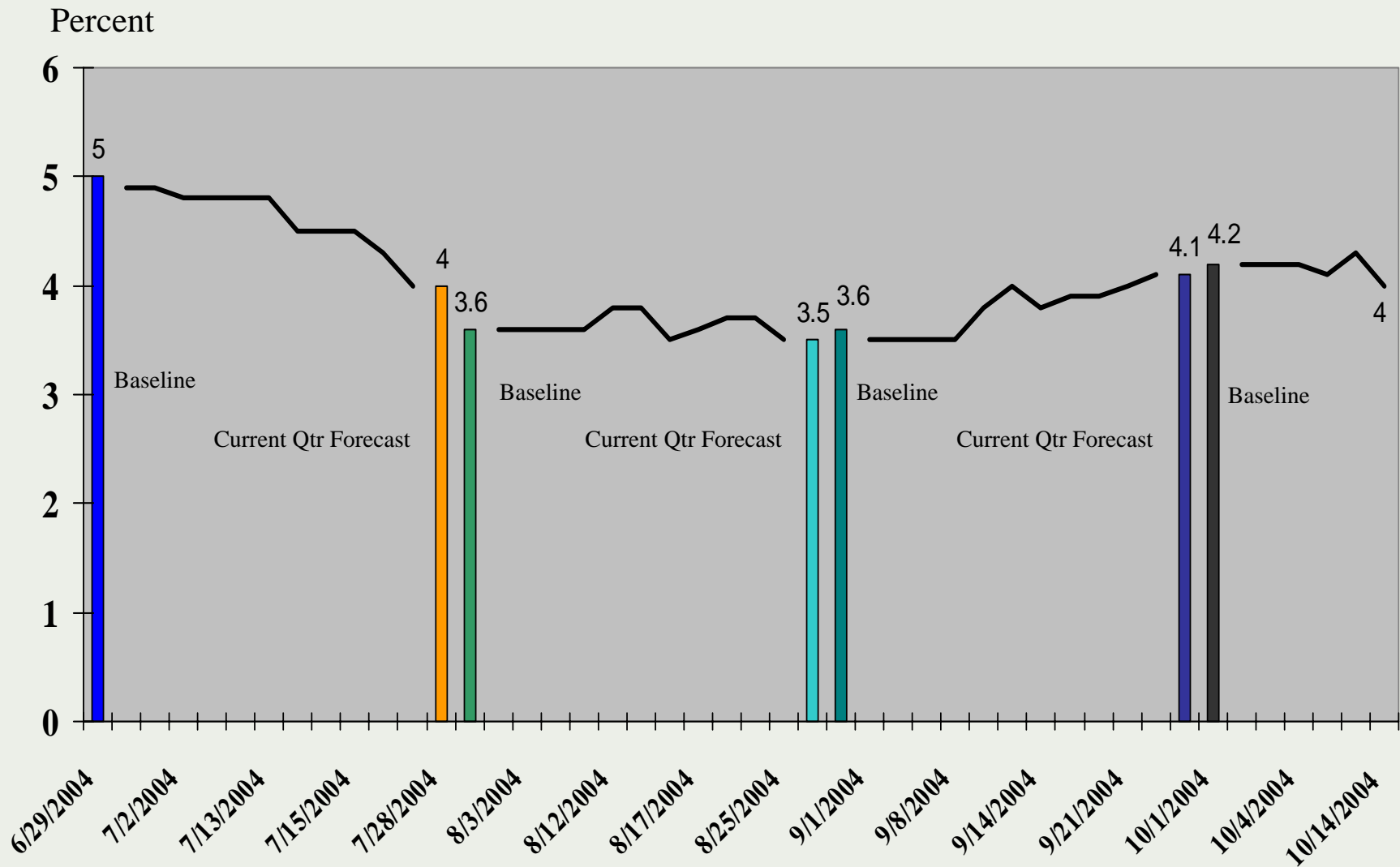


# Current Conditions

- Economic conditions firm in the third quarter, following the second-quarter “soft patch”



# “Tracking” Forecast: 2004/Q3 Real GDP Growth



Source: Macroeconomic Advisers



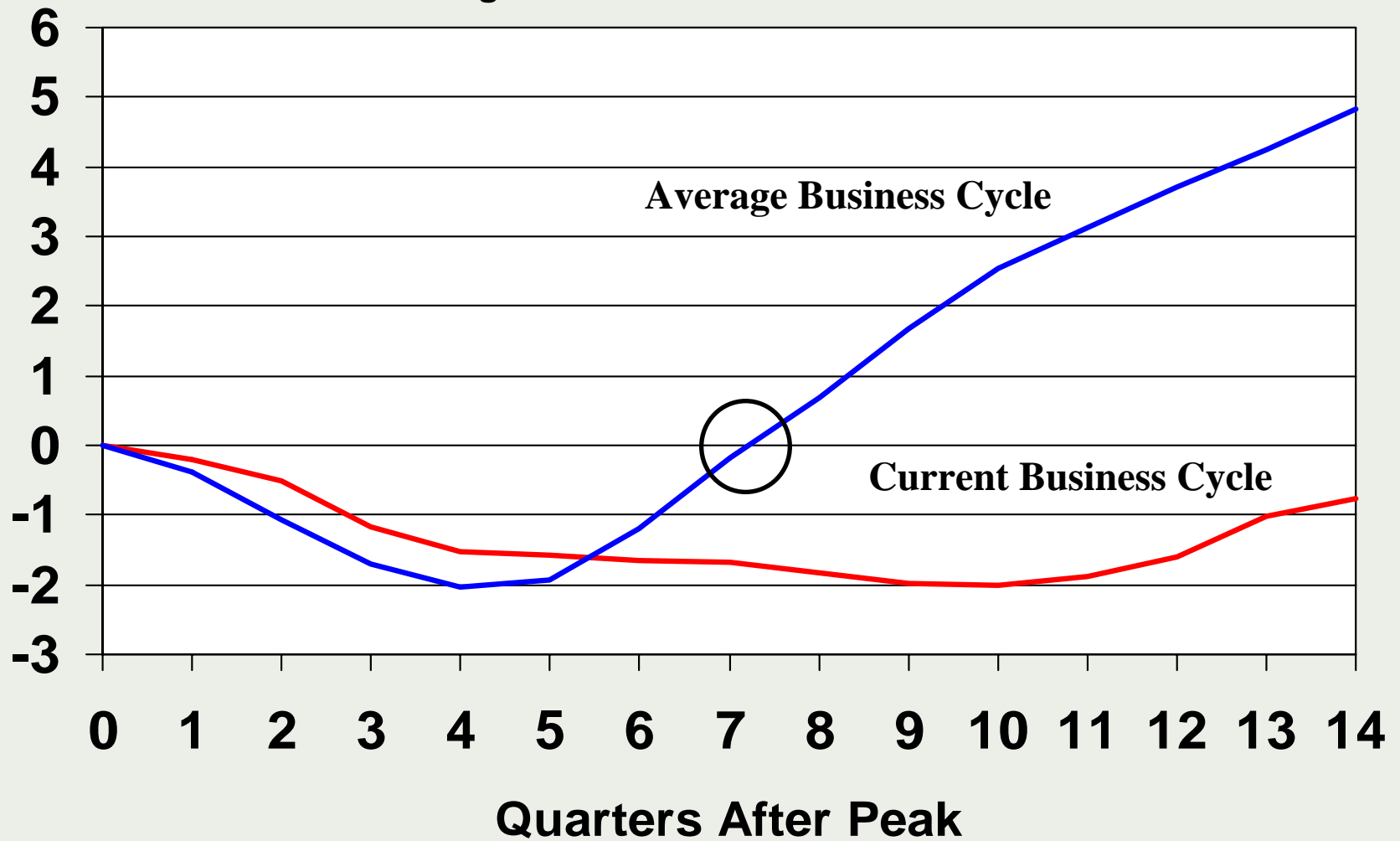
# Current Conditions

- Economic conditions firm in the third quarter, following the second-quarter “soft patch”
- Payroll employment growth remains relatively weak, but hours growth accelerates



# Payroll Employment During the Current & Average Business Cycle

Percentage Difference from Peak Value



**NOTE:** Average excludes the 1980 peak; post-WW II period.

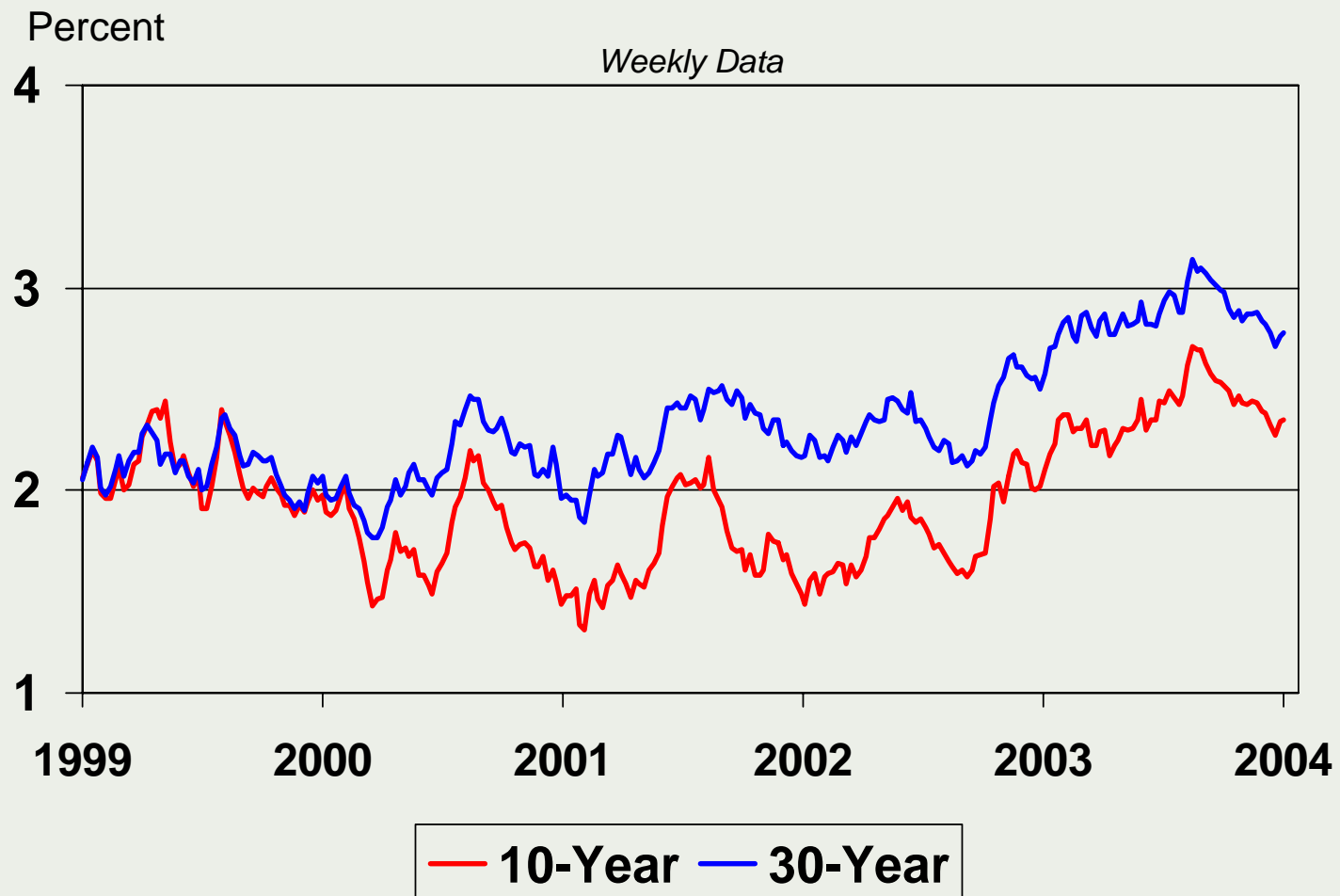


# Current Conditions

- Economic conditions firm in the third quarter, following the second-quarter “soft patch”
- Payroll employment growth remains relatively weak, but hours growth accelerates
- Monetary policy remains accommodative; FOMC moving in a “measured” pace toward neutrality
- Oil prices move past \$50/bbl, but inflation expectations remain stable



# Financial Market Inflation Expectations



**NOTE:** Yield spreads between nominal and inflation-indexed U.S. Treasury securities.



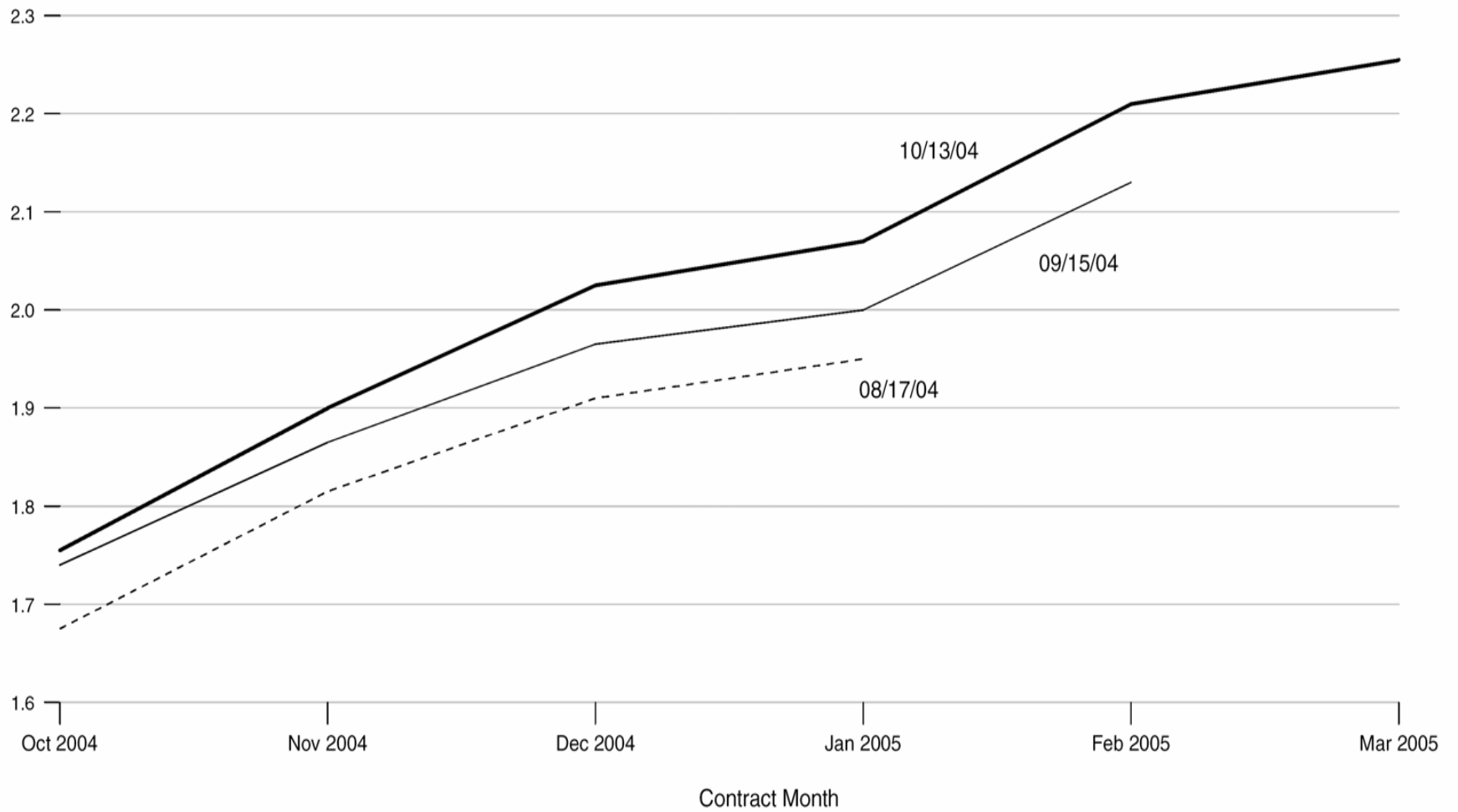
# Consensus Forecast

- Key assumptions

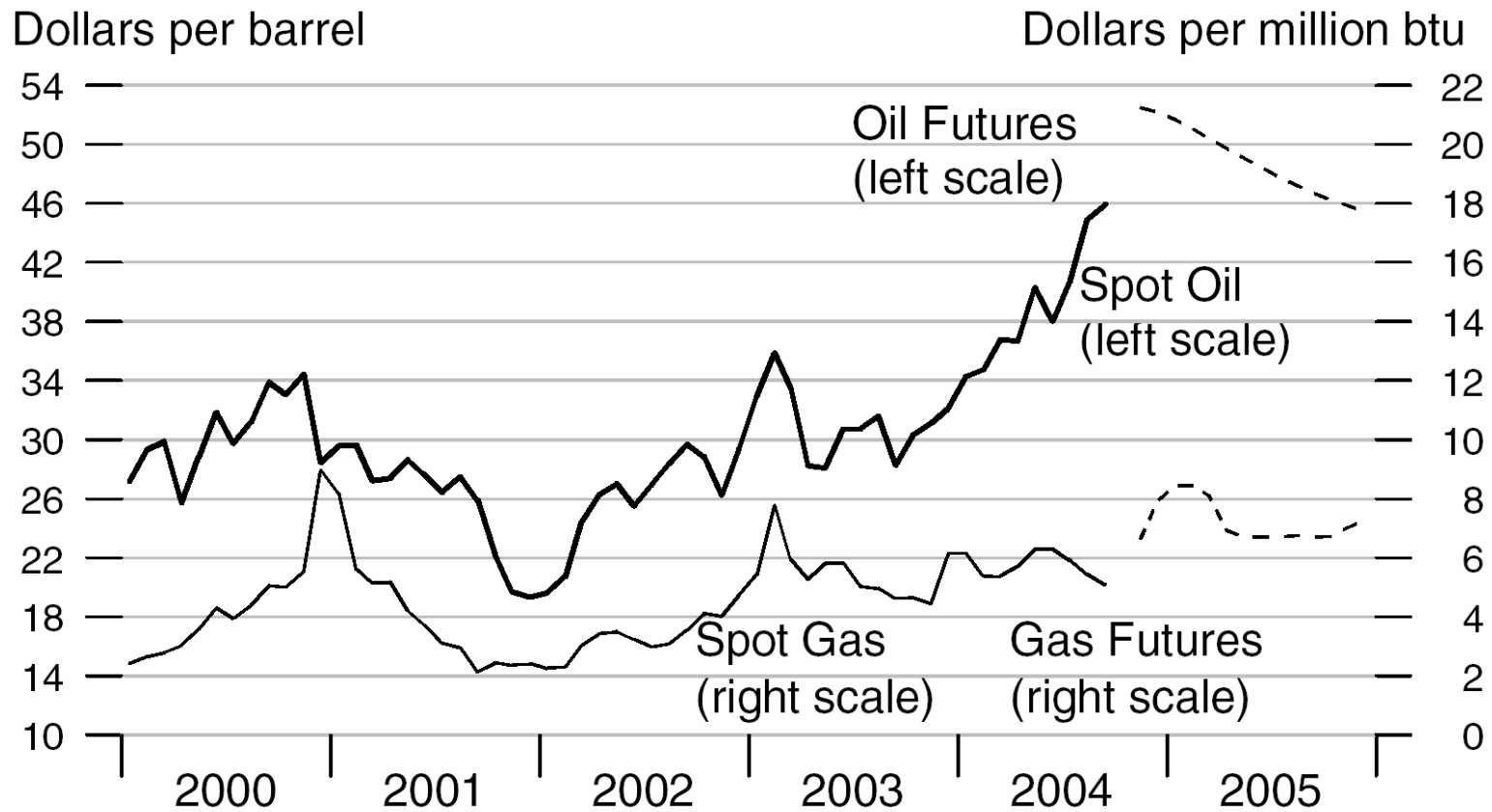


## Rates on Federal Funds Futures on Selected Dates

Percent



# Oil & Natural Gas Prices: Spot & Futures



Note: Futures prices as of 10/12/2004.

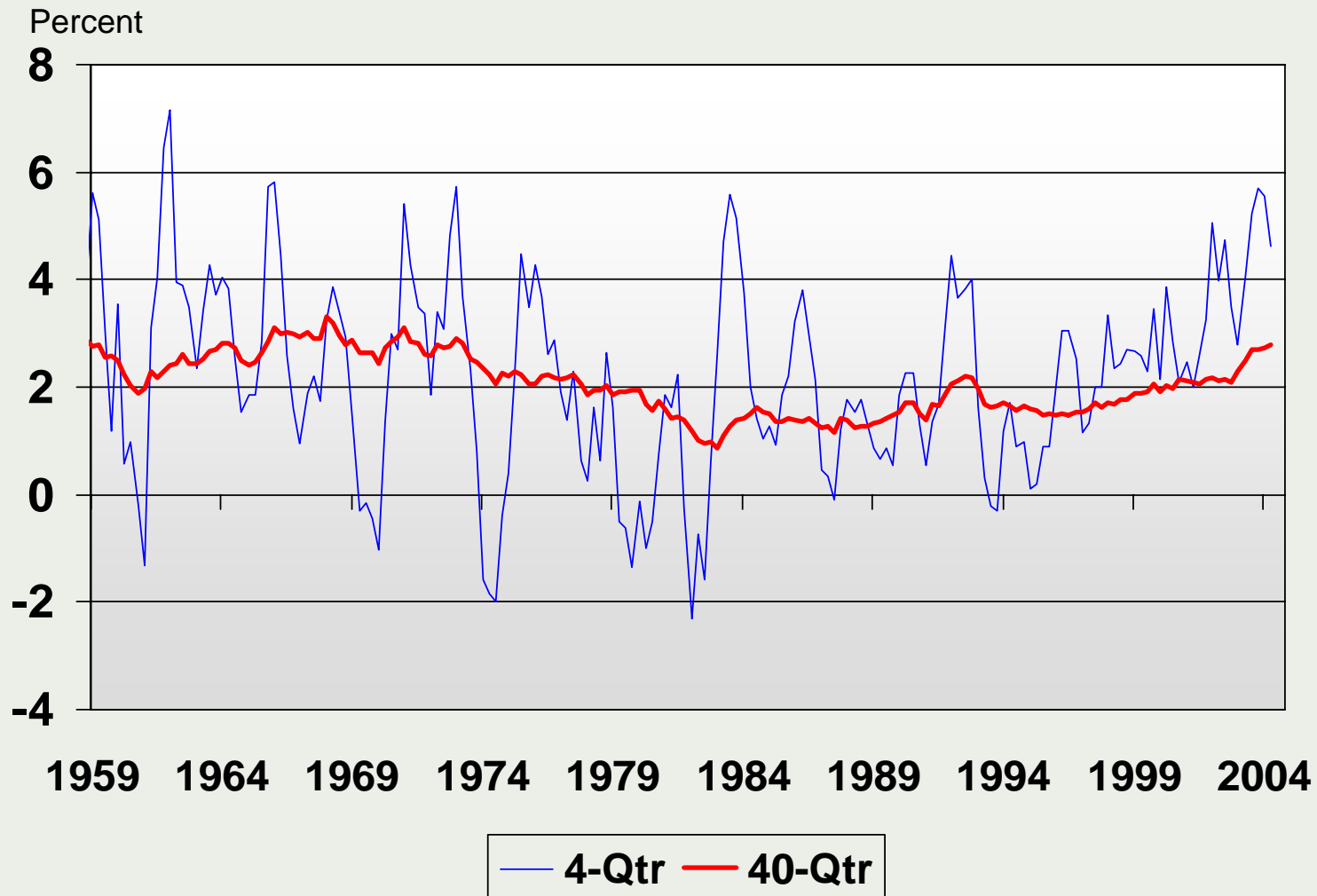


# Consensus Forecast

- Key assumptions
- Continued strong structural productivity growth boosts real incomes, spending, and holds down growth of unit labor costs and prices



# Four- and 40-Quarter Growth Rates of Nonfarm Labor Productivity

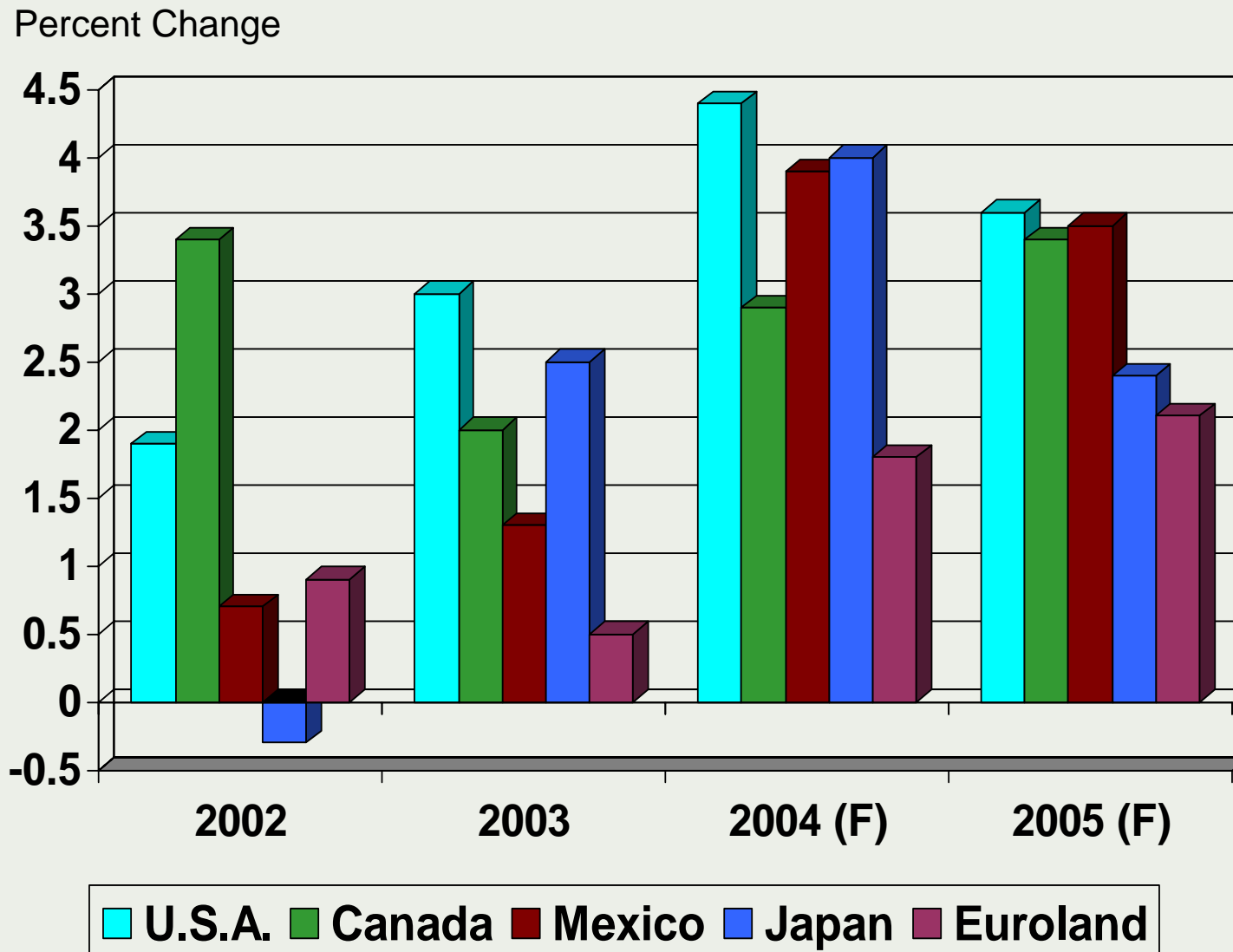


# Consensus Forecast

- Key assumptions
- Continued strong structural productivity growth boosts real incomes, spending, and holds down growth of unit labor costs and prices
- Robust profits, low cost of capital keeps business capital spending growing briskly
- Weaker foreign growth in 2005



# U.S. & Foreign Economic Growth Rates



## Forecasts for 2004 and 2005

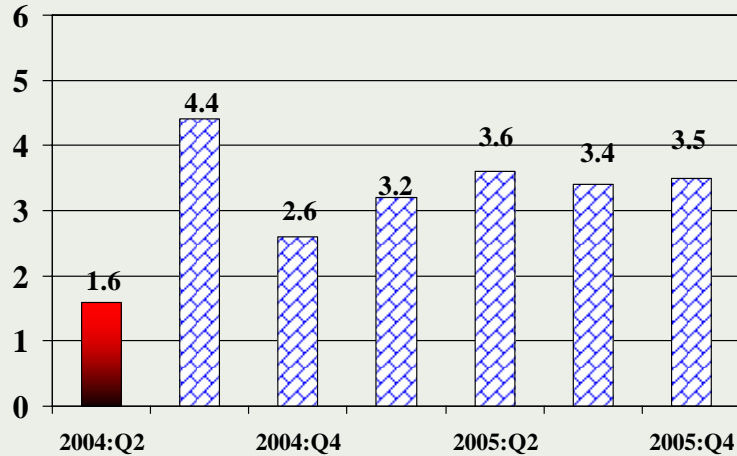
	Real GDP Growth		Core Inflation		Unemployment Rate	
	<u>2004</u>	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004:Q4</u>	<u>2005:Q4</u>
<b>Blue Chip Consensus (Oct.)</b>	3.8	3.5	2.2*	2.2*	5.4	5.2
<b>Macroeconomic Advisers</b>	3.9	4.1	1.9*	2.0*	5.3	5.1
<b>FOMC (July, central tendency)</b>	4.5 - 4.75	3.5 - 4.0	1.75 - 2.0**	1.5 - 2.0**	5.25 - 5.50	5.0 - 5.25
<b>Business Council (Sept.)</b>	N/A	2.1 - 3.5	N/A	1.1 - 2.0*	N/A	5.0 - 5.3

\*Core CPI  
\*\*Core PCE

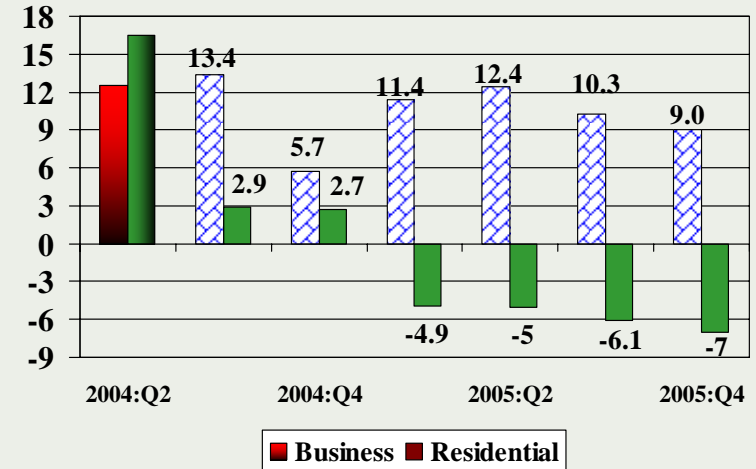


# Forecasts of Major GDP Components

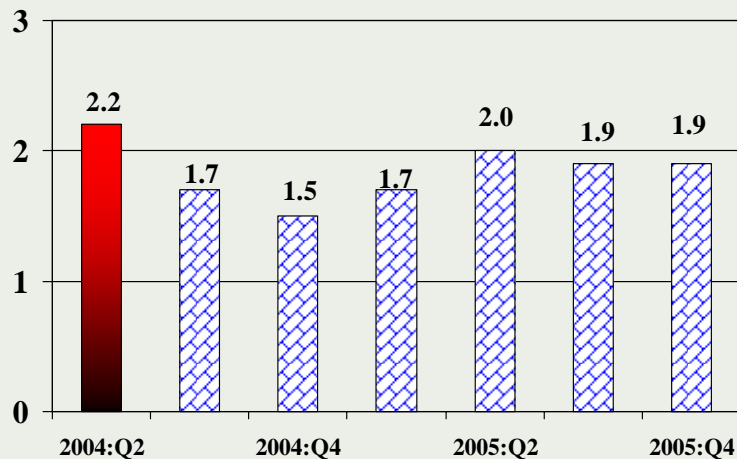
## Consumer Spending



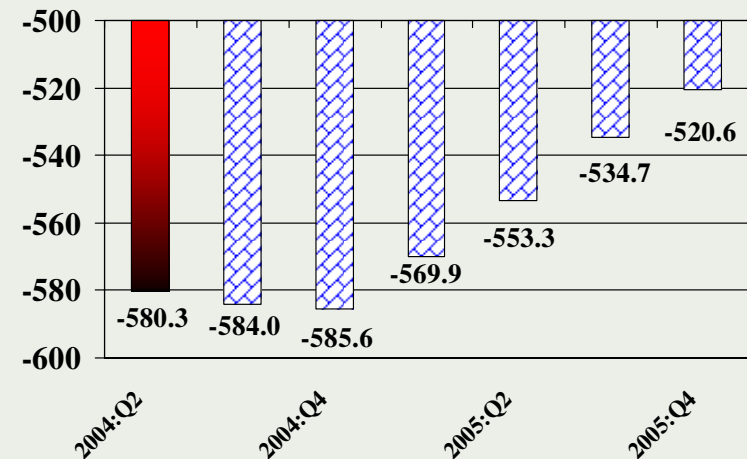
## Fixed Investment



## Govt. Spending



## Net Exports



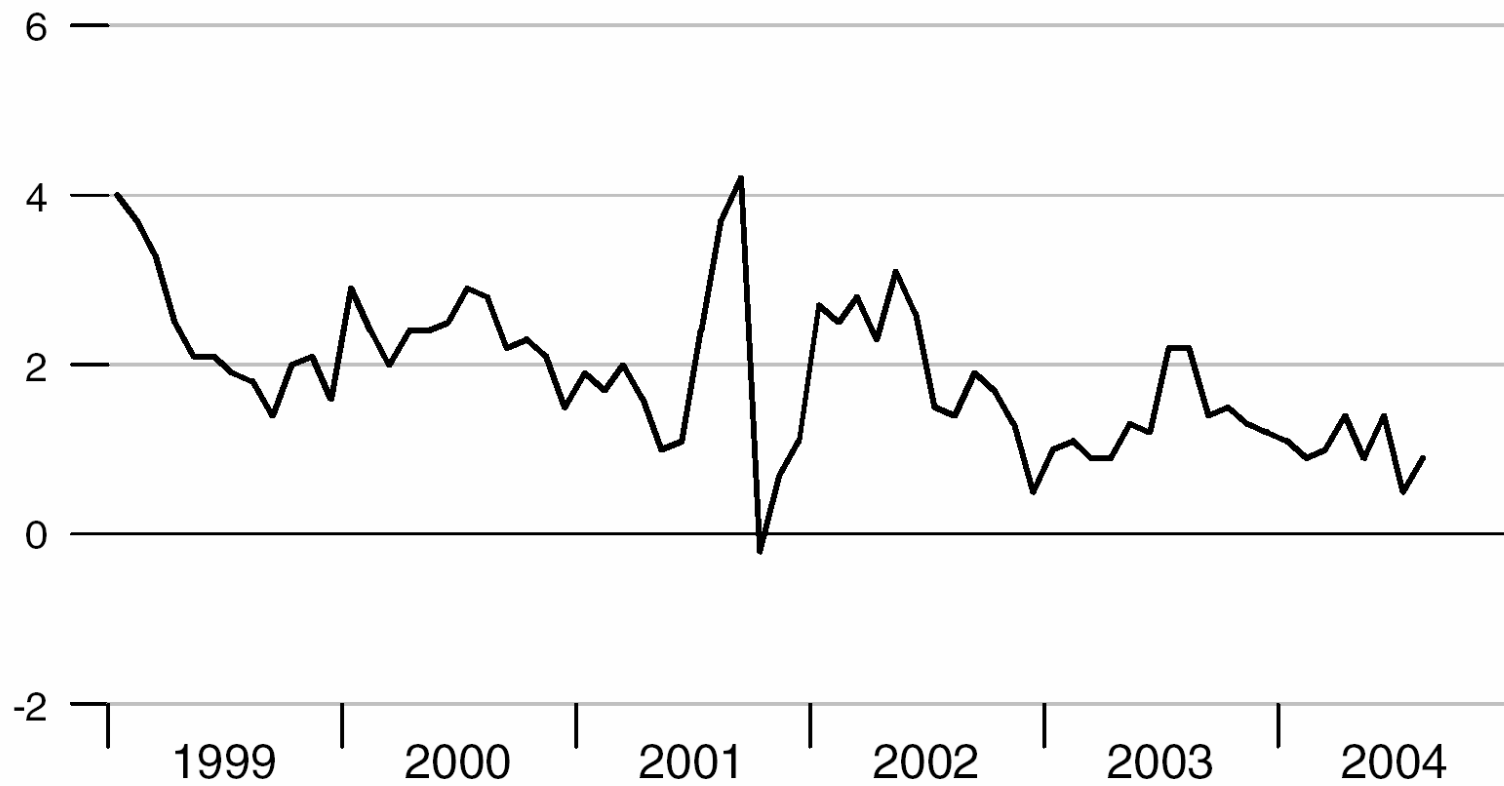
# Risks to the Forecast

- Oil prices continue to rise, weakening consumer spending and heightening business uncertainty
- Personal saving rate increases by more than expected



# Personal Saving Rate

Percent

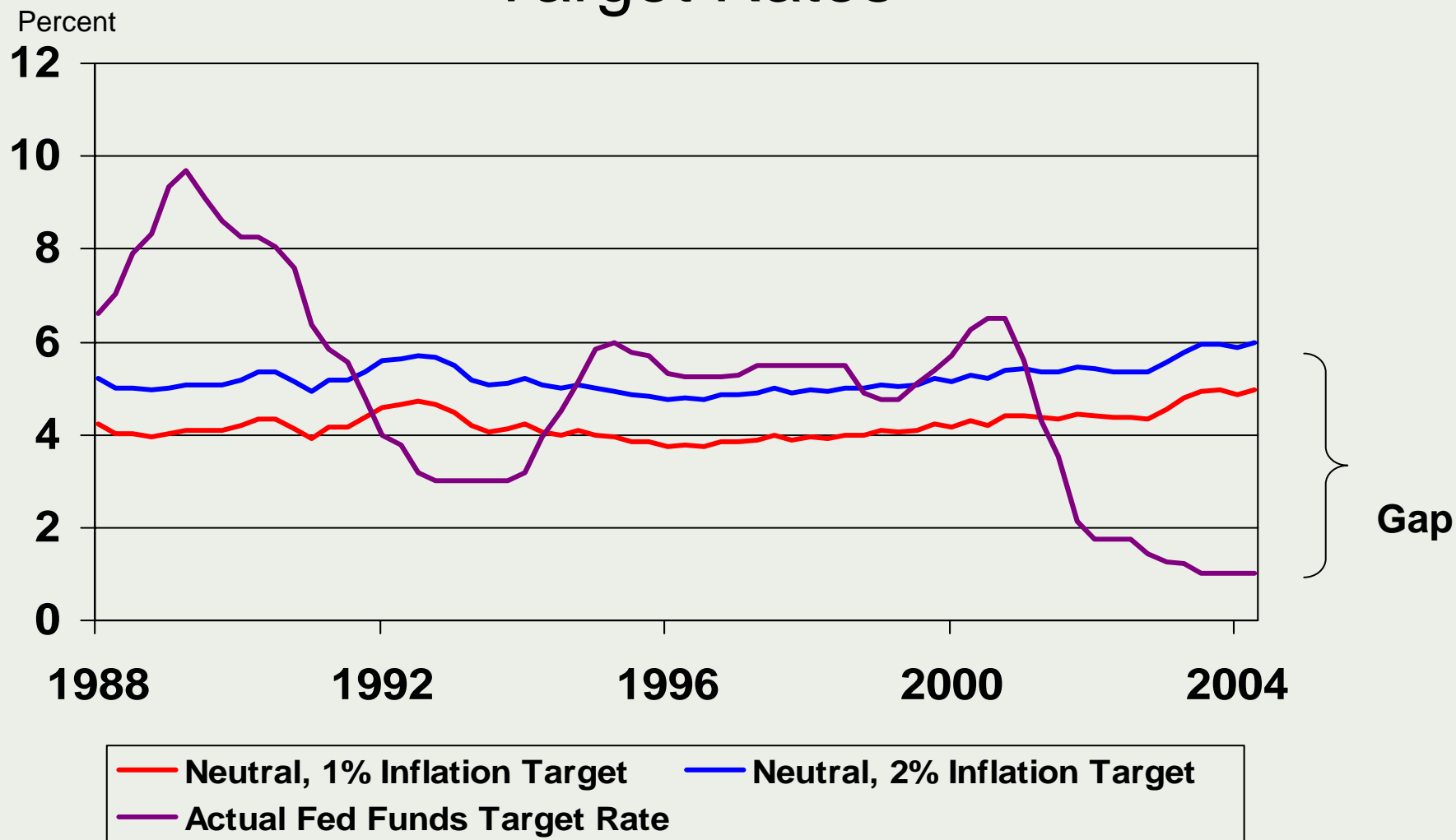


# Risks to the Forecast

- Oil prices continue to rise, weakening consumer spending and heightening business uncertainty
- Personal saving rate increases by more than expected
- Low real interest rates cause demand growth to increase faster than expected—inflationary effects from tighter labor and product markets offset
- Output gap not as large as consensus forecast suggests; in actuality monetary policy too accommodative



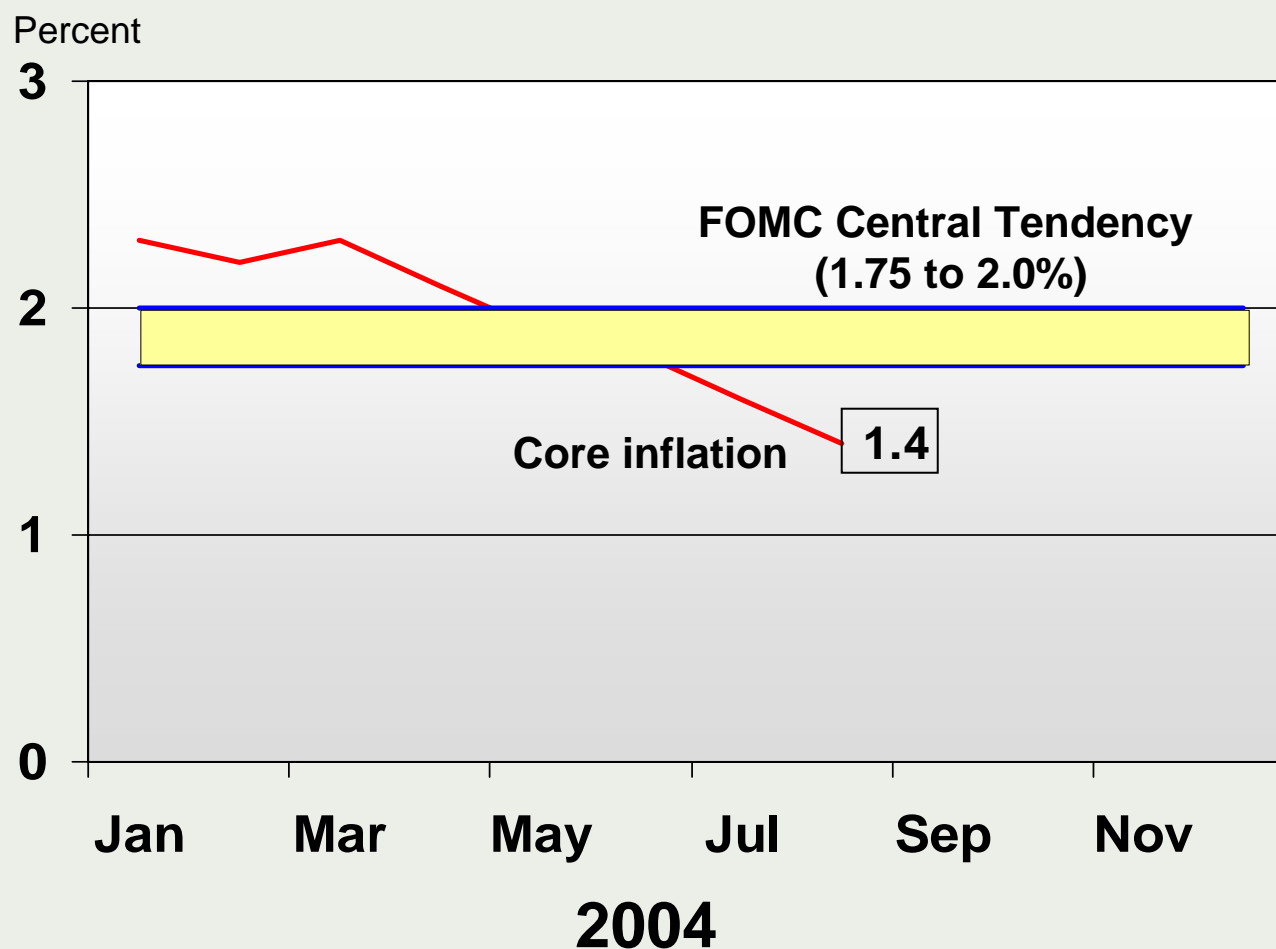
# Hypothetical Neutral Federal Funds Target Rates



**NOTE:** Hypothetical fed funds target rate is the sum of the 40-quarter annualized growth rates of labor productivity and labor force growth, plus an assumed inflation target of either 1 or 2 percent.



# Year-to-date Core PCE inflation rate and the FOMC's inflation projection for 2004 made in July 2004



**Questions?**

