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
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

Percent


4-Qtr 40-Qtr
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

Percent Change

-0.5 - 4.5

2002 2003 2004 (F) 2005 (F)

U.S.A. Canada Mexico Japan Euroland
Forecasts for 2004 and 2005

<table>
<thead>
<tr>
<th></th>
<th>Real GDP Growth</th>
<th>Core Inflation</th>
<th>Unemployment Rate</th>
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</thead>
<tbody>
<tr>
<td>Blue Chip Consensus (Oct.)</td>
<td>3.8</td>
<td>3.5</td>
<td>2.2*</td>
</tr>
<tr>
<td>Macroeconomic Advisers</td>
<td>3.9</td>
<td>4.1</td>
<td>1.9*</td>
</tr>
<tr>
<td>FOMC (July, central tendency)</td>
<td>4.5 - 4.75</td>
<td>3.5 - 4.0</td>
<td>1.75 - 2.0**</td>
</tr>
<tr>
<td>Business Council (Sept.)</td>
<td>N/A</td>
<td>2.1 - 3.5</td>
<td>N/A</td>
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</tbody>
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*Core CPI  
**Core PCE
Forecasts of Major GDP Components

**Consumer Spending**
- 2004:Q2: 1.6%
- 2004:Q4: 3.4%
- 2005:Q2: 3.5%
- 2005:Q4: 3.6%

**Fixed Investment**
- 2004:Q2: 13.4%
- 2004:Q4: -4.9%
- 2005:Q2: -5%
- 2005:Q4: -6.1%

**Govt. Spending**
- 2004:Q2: 2.2%
- 2004:Q4: 1.7%
- 2005:Q2: 1.9%
- 2005:Q4: 1.9%

**Net Exports**
- 2004:Q2: -580.3
- 2004:Q4: -584.0
- 2005:Q2: -569.9
- 2005:Q4: -534.7

Source: Macroeconomic Advisers
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

6

4

2

0

-2

1999  2000  2001  2002  2003  2004
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

- Core inflation: 1.4%
- FOMC Central Tendency: (1.75 to 2.0%)
Questions?