The U.S. Economy
Does the Recovery Have Legs?

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Economic Outlook Overview and Issues

- After a mild recession, the stage is set for recovery:
  - Monetary and fiscal policy are stimulative
  - Inflation is low and productivity still on the rise
  - The dollar has depreciated—a bit
- Consumer spending is providing basic support.
- Federal purchases are providing insurance.
- The recovery in capital investment is yet to come.
  - Excess capacity abounds.
  - Lenders are wary.
- Investors are skittish; retirement portfolios have been pummeled.

The U.S. Economic Expansion Will Continue

(Graph showing real GDP growth and unemployment rate from 1998 to 2005)
Why Was the Recession So Mild?

- Consumers, aided by tax cuts and aggressive price discounting, kept spending.
- Monetary and fiscal policy turned highly stimulative.
- The housing market remained buoyant.
- Productivity growth held up.
- We exported some of the high-tech bust, mostly to Asia.

The Federal Reserve Will Delay Interest Rate Hikes to the Summer of 2003

(Percent)
Real Federal Spending on Goods and Services Surged After September 11

(Year-over-year percent change)

Why Is the Recovery So Anemic?

◆ Excess capacity abounds.
  ➤ Pricing power is nil.
  ➤ Flat top lines lead to aggressive cost-cutting.
◆ Growth is even weaker outside the U.S.
  ➤ Poor economic policies prevail.
  ➤ Worse growth elsewhere keeps the dollar strong.
◆ State and local governments are cutting back.
The Capital Stock Surged in the Boom Years

Factories Could Produce a Lot More
So Could Most of the Rest of the Economy

(Actual less potential real GDP as a percent of potential)

Inflation Is Not a Worry, But Neither Is Deflation

(Producer prices for finished goods less food and energy, percent change, annual rate)
Corporate Profits Had a Five-Year Slump

(Percent of national income)

Labor compensation (Left)  Economic profits (Right)

Sales Are Beginning to Improve

(Sales, percent change from a year earlier)
Another “Jobless” Recovery
(Payroll employment indexed to employment trough)

The Situation Is Not Much Better Elsewhere
(Real GDP growth, percent change from a year earlier)
The Situation Is Not Much Better Elsewhere

(Real GDP growth, percent change, annual rate)

The Dollar Has Weakened, But Not Enough

(Trade-weighted dollar exchange rate, industrial countries)
State & Local Government Budgets Are In Dire Shape

(State and local operating surplus, billions of dollars)

 Threats from the Consumer

- Consumers are over-extended.
- Foreclosures are on the rise.
- Credit card delinquencies are at a record high.
- House prices have outpaced incomes.
- Retirement portfolios have been savaged.
- Consumers are consuming their homes.
Debt Service Claims a Record Share of Income

(Interest and principal as a percent of disposable income)

Trouble Ahead? Foreclosures Are At a Record High

(Foreclosures started during quarter, percent of outstanding mortgages)
Credit Card Delinquencies Soar

(Credit card accounts past due 30 days or more, percent of total)

Is There a Housing Bubble?

(Ratio of median price of existing home to median family income)
Homeowners Have Less and Less Equity in Their Houses
(Home mortgage debt as a percent of market value)

The Market Collapse Has Wrecked Havoc With Retirement Plans
(Real equity holdings per household, thousands of dollars)
Young Folks Leave; Old Folks Join Up

(Labor force participation rates, percent of population)

The Federal Budget Surplus Has Disappeared

(Billions of dollars, fiscal years)
Real Consumer Spending Seldom Falls

- Real Consumption Growth
- Consumer Sentiment

Stock Performance Will Disappoint: Returns on S&P 500 Stocks and Treasury Bonds

- Stock Market Return
- 10-Year Treasury Bond Yield
Perspectives on Current Account Deficit

- The U.S. needs $1.4 billion per day in net inflows of foreign capital—a rising share of global portfolios.
- Net foreign liabilities are already 20% of GDP and could reach 60% by 2010.
- European perspective: The problem is internal U.S. imbalances—low saving and high debt.
- U.S. perspective: The problem is lopsided world growth and the use of the dollar as a reserve currency.
- Result: A persistently strong dollar.
Productivity Growth Accelerated in the Late 1990s

(Year-over-year percent change)

- Total Factor Productivity
- Full-Employment Labor Productivity