

US Outlook
Economic Forum
Boston Chamber of Commerce

Jeff Fuhrer
*Executive Vice President and
Director of Research*

Federal Reserve Bank of Boston

Charts prepared by Adam Shapiro



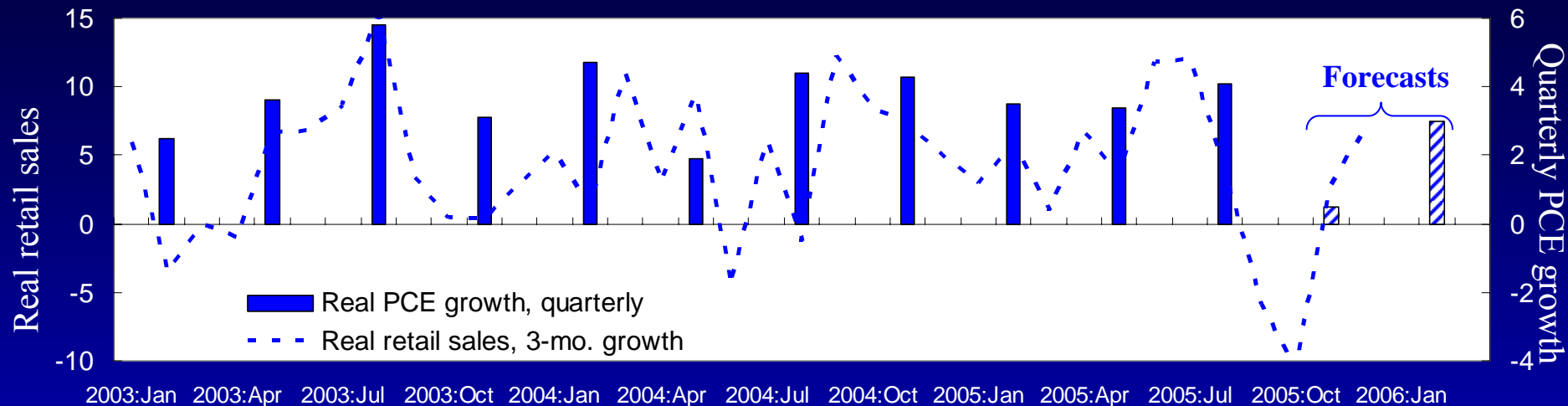
Summary of Outlook

- Growth near potential for 2006
 - We'll discuss the risks
- Economy operating roughly at full employment
- Inflation stabilizing in the neighborhood of 2% on core basis
 - Looks like a good balancing act
- But some risks

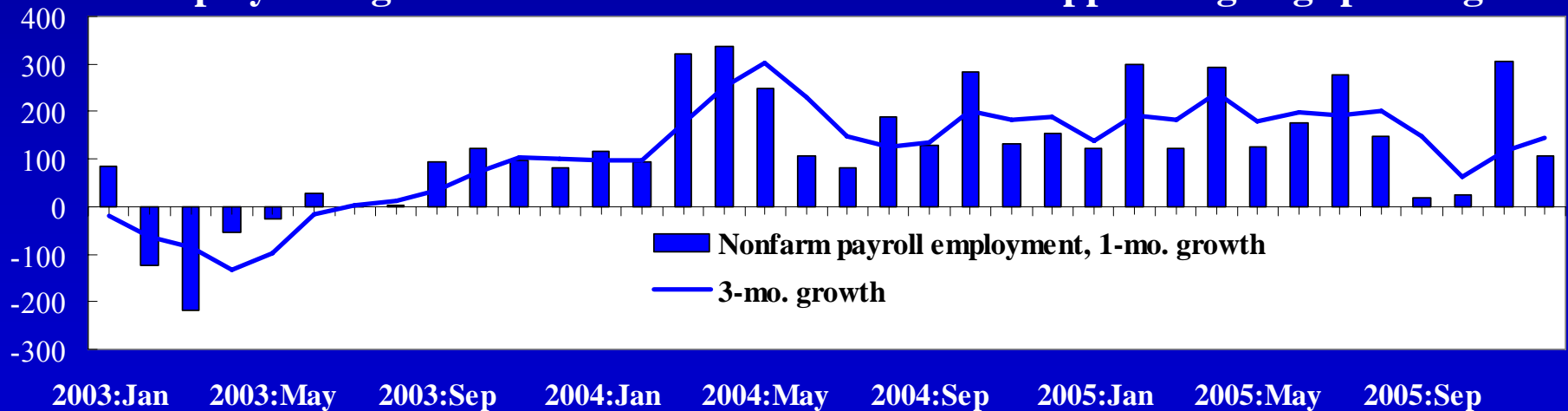
So how do we get to potential in '06?

- A combination of:
 - Reasonably solid consumption growth
 - Solid growth in equipment and software spending
 - A variety of smaller plusses and minuses
 - Small and declining drag from net exports
 - Flat to declining residential investment
 - Modest positive contributions from federal, S&L government spending

Consumer spending: Growing, but less of a force in '06



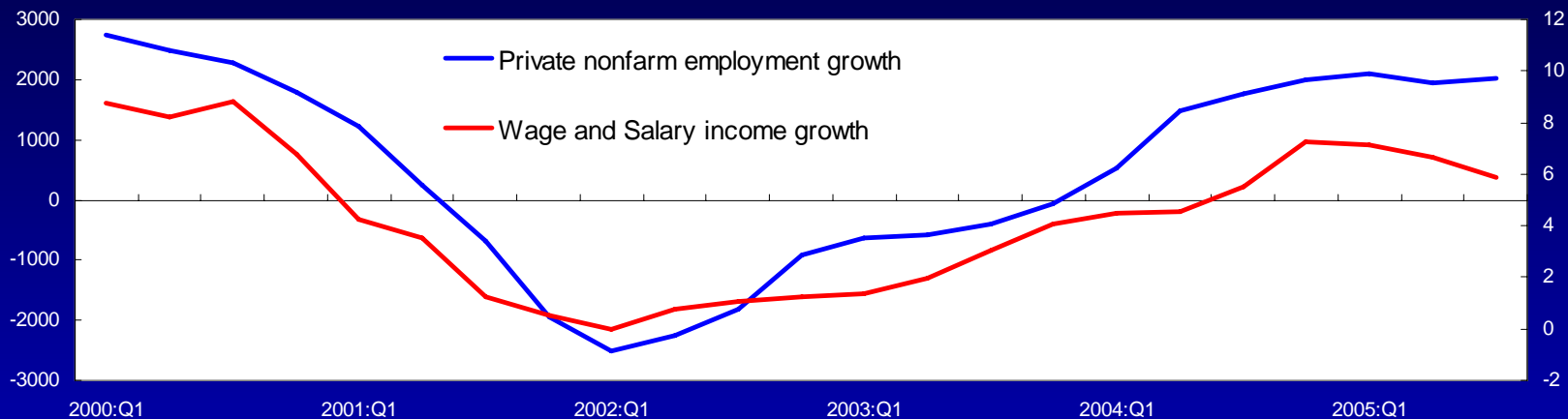
Employment growth to date has been sufficient to support ongoing spending...



...and to match entrants to the labor force, implying sustained full employment

Sustained employment growth is key to the GDP outlook ...

...because virtually all income growth has come from employment gains...



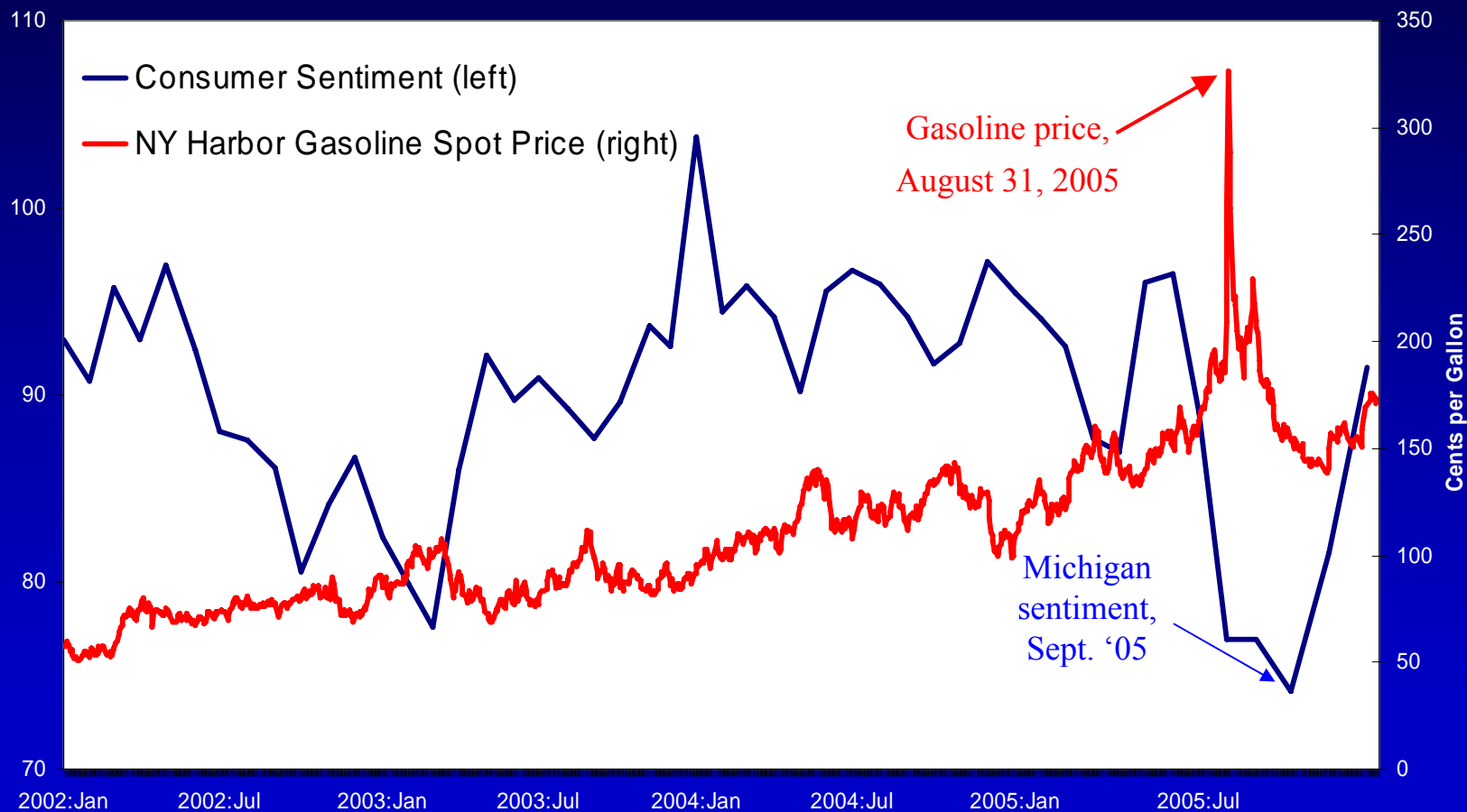
...not from increasing wage rates...



...so employment growth is likely to be the key source of household income growth, especially as the housing market cools.

Consumer confidence

Buffeted by hurricanes and gasoline prices, but now recovered



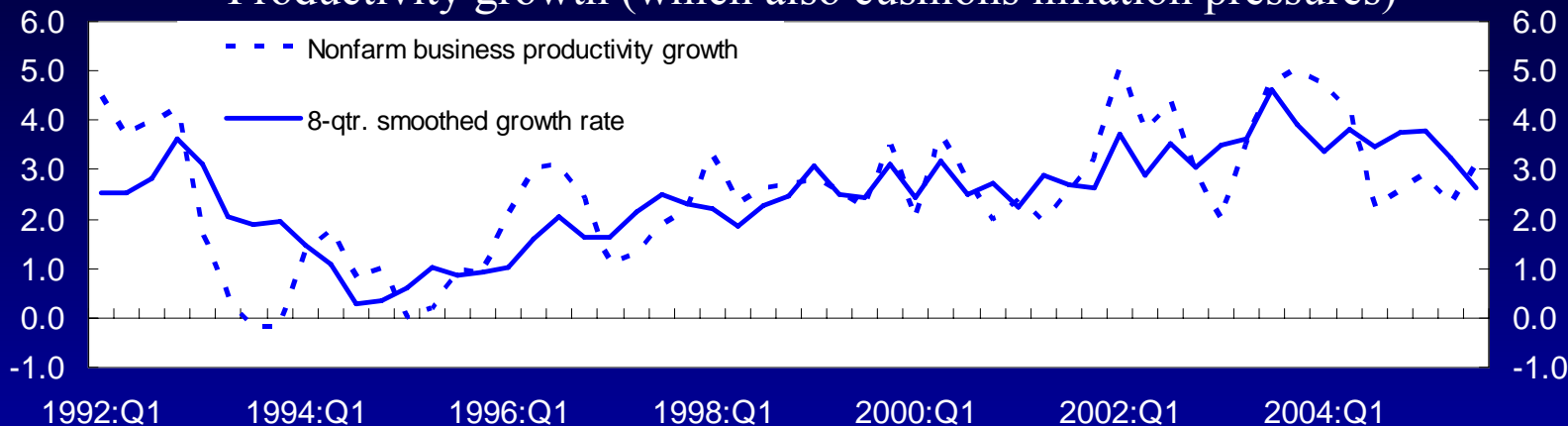
Confidence is now back in the range it occupied in early 2005—
no obvious effect of fuel oil and natural gas prices

Investment spending should be an important contributor to 2006 growth

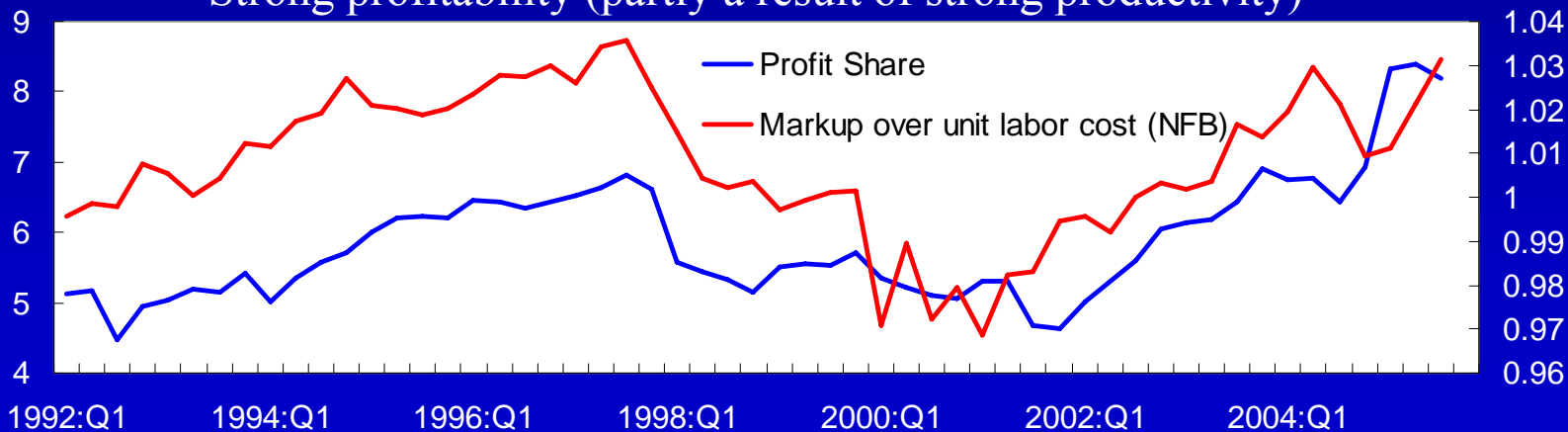
- Supports to investment spending:
 - Productivity growth—stronger than expected
 - Implies additional benefits still accruing from improving process, adopting new technology
 - Profitability still very good (related)
 - Latest data look reasonably good

Supports to investment spending:

Productivity growth (which also cushions inflation pressures)

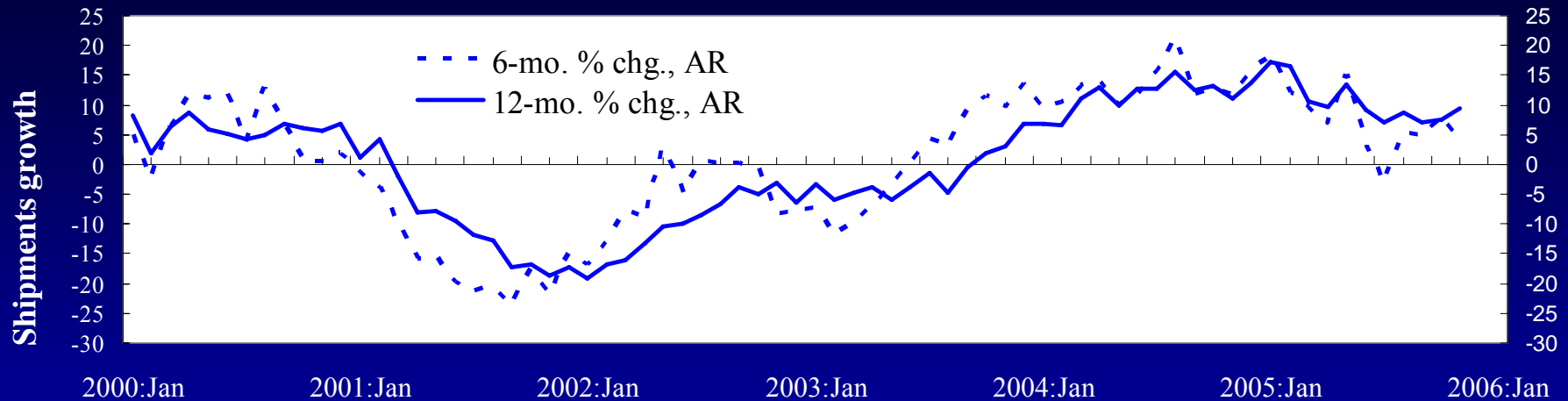


Strong profitability (partly a result of strong productivity)

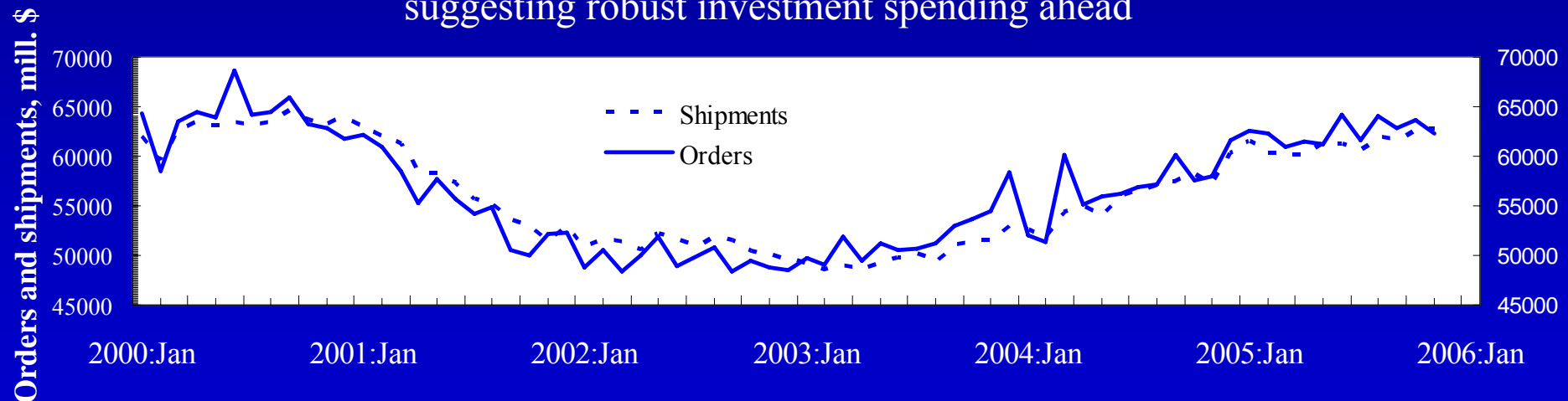


Near-term Investment Indicators

Shipments suggest that investment spending will boost growth early this year



Forward-looking orders are running ahead of shipments, suggesting robust investment spending ahead

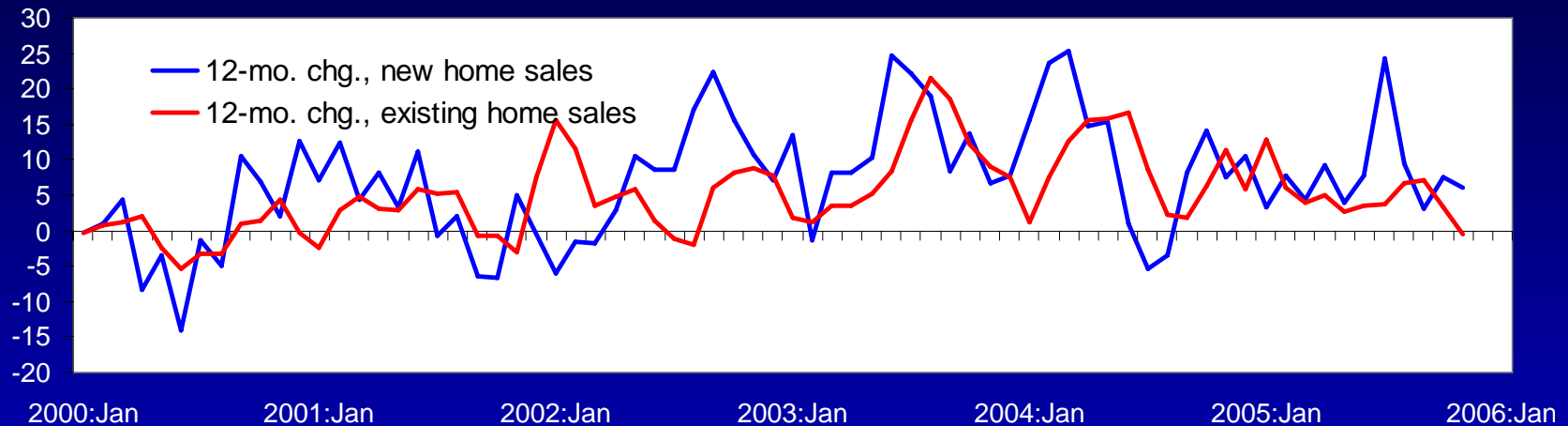


Source: Manufacturers' Shipments and New Orders of Nondefense Capital Goods ex Aircraft (SA): Census Bureau.

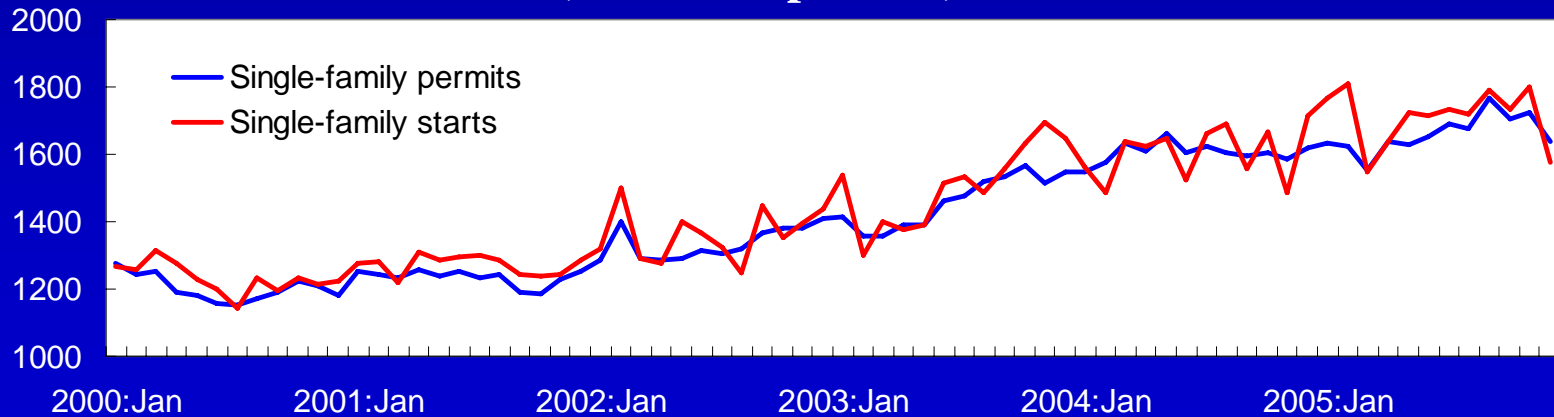
Housing

Signs of cooling?

New and existing home sales have slowed ...



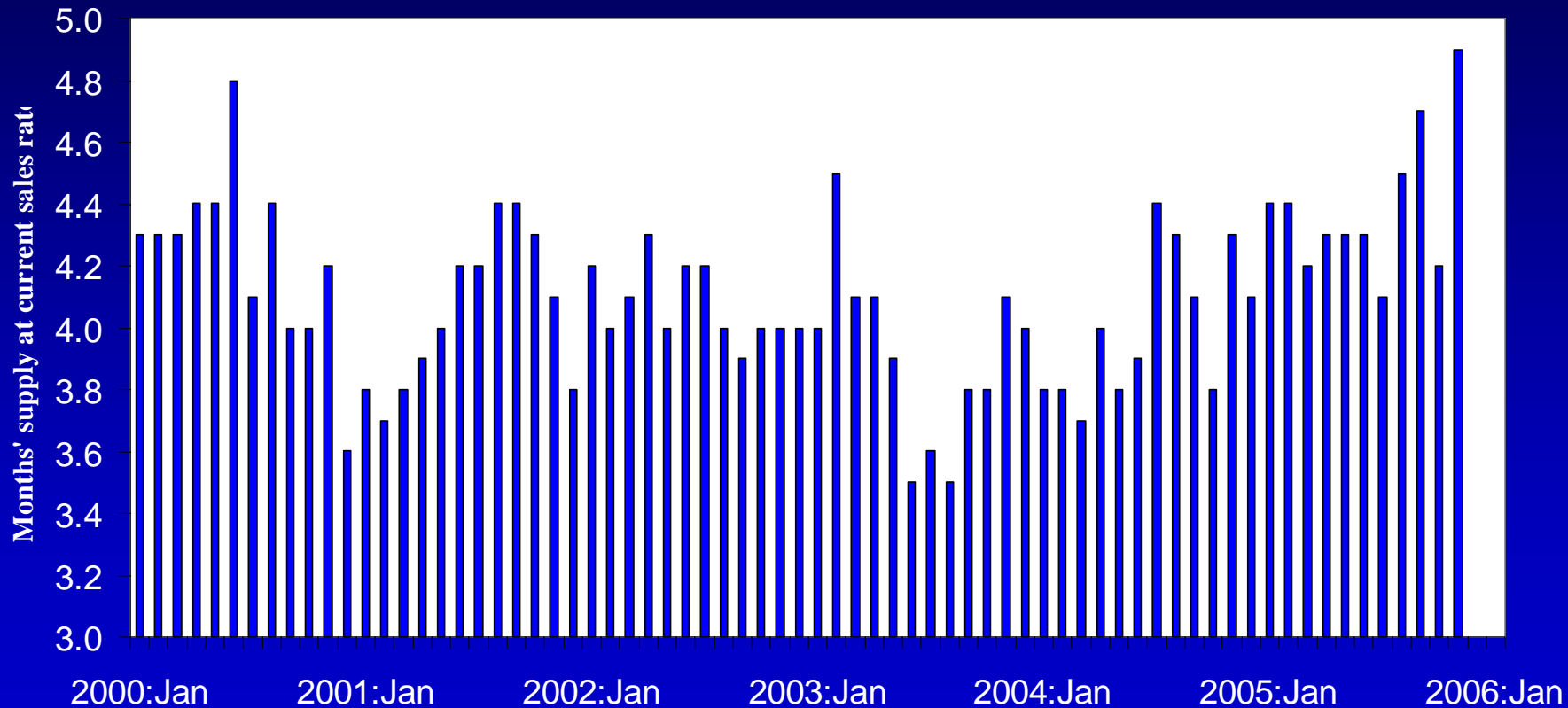
... construction (starts and permits) has not slowed as much



Housing

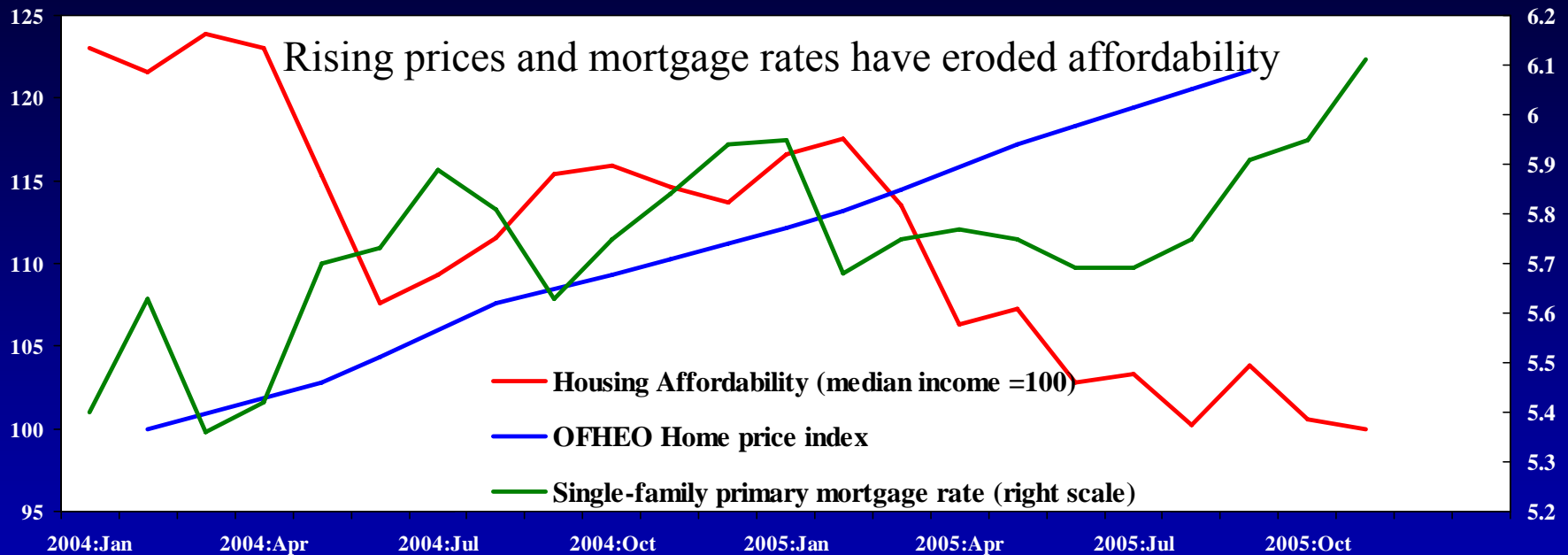
Signs of cooling?

Leading to an elevated months' supply of new homes
at current sales rates



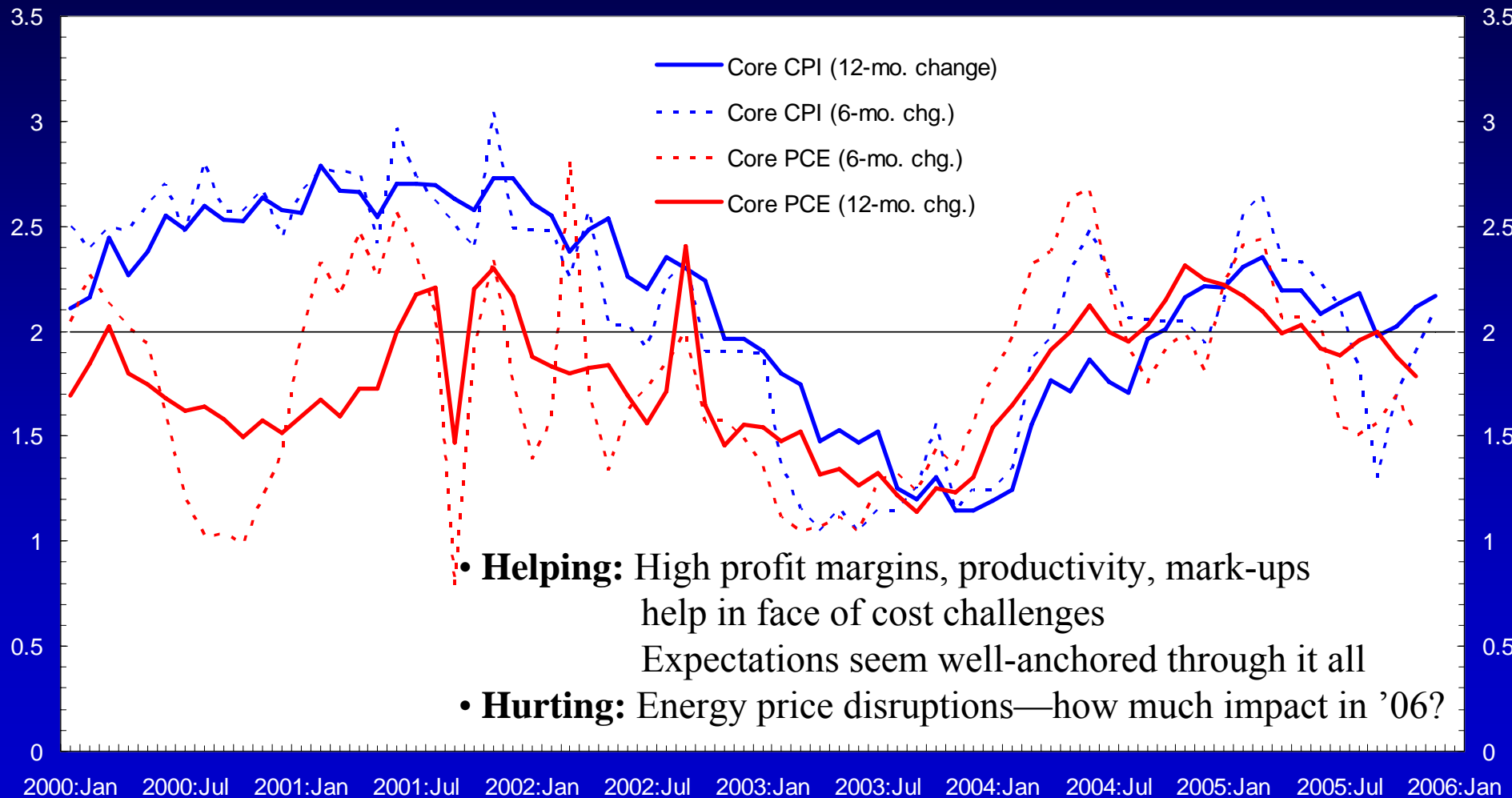
Housing

Signs of cooling?



- Overall read on housing:
 - Probably cooling—flattening production, slowing sales
 - Expect small decline in quantities, gradual flattening of prices
 - Will restrain consumer spending compared to 2004-2005, but not dramatically (modest wealth effect)

Recent inflation news is consistent with moderating inflation



Source: Consumer price index, all items excluding food and energy, Bureau of Labor Statistics; Chain-weighted price index for personal consumption expenditures, all items excluding food and energy, Bureau of Economic Analysis.

Summary of Risks to Outlook

- Consumer spending
 - Rise in savings rate? Larger housing effect?
- Capital spending
 - Continued “risk aversion” by firms? Or spending boom to work off cash flow/benefit from technology?
- Housing
 - Could continue to grow. Or could have an absolute price decline.
- Inflation
 - Risks on both sides—could rise more significantly, or could continue recent modest downward trend
- Long-run risks
 - Investment-savings imbalance (fiscal deficit, CA deficit, low savings): will it equilibrate? When? How?