

Domestic Economic Outlook

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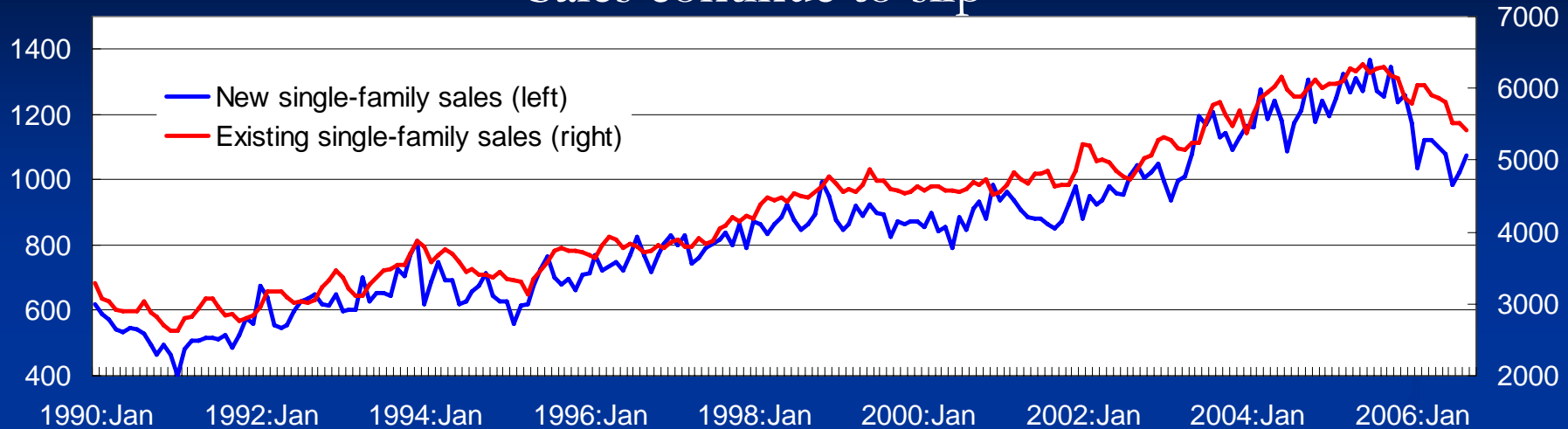
Jeff Fuhrer
Director of Research
November 7, 2006

Outlook summary

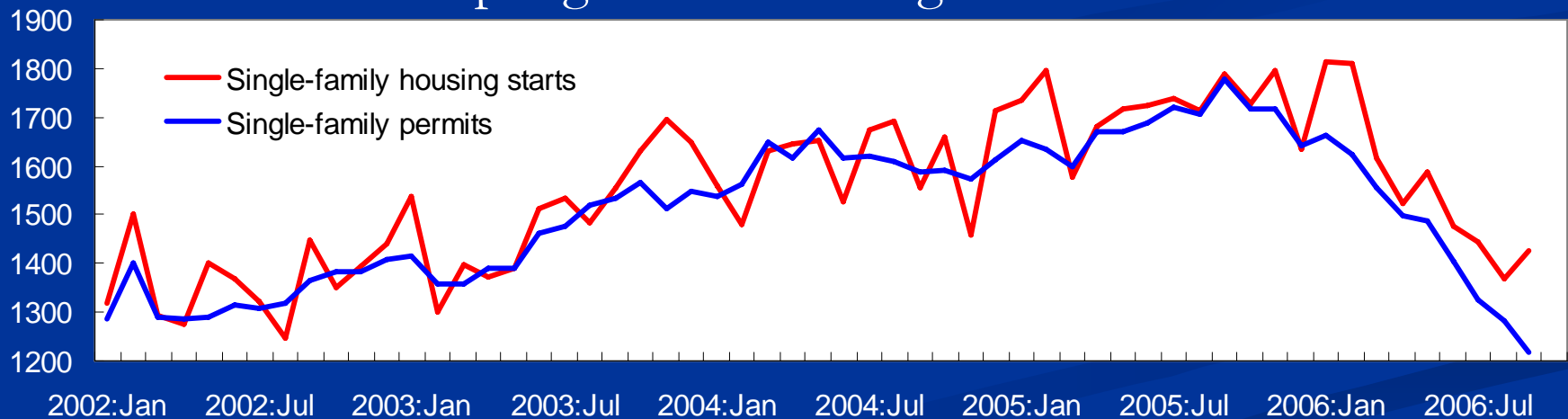
- Housing
 - Declining, but in “controlled” fashion
- Energy prices
 - Recent declines help spending and inflation
- Employment
 - Recent improvements are heartening
- Inflation
 - Some upside risk here, although recent news good
- Risks to outlook?

Housing news

Sales continue to slip



Prompting further slowing in construction



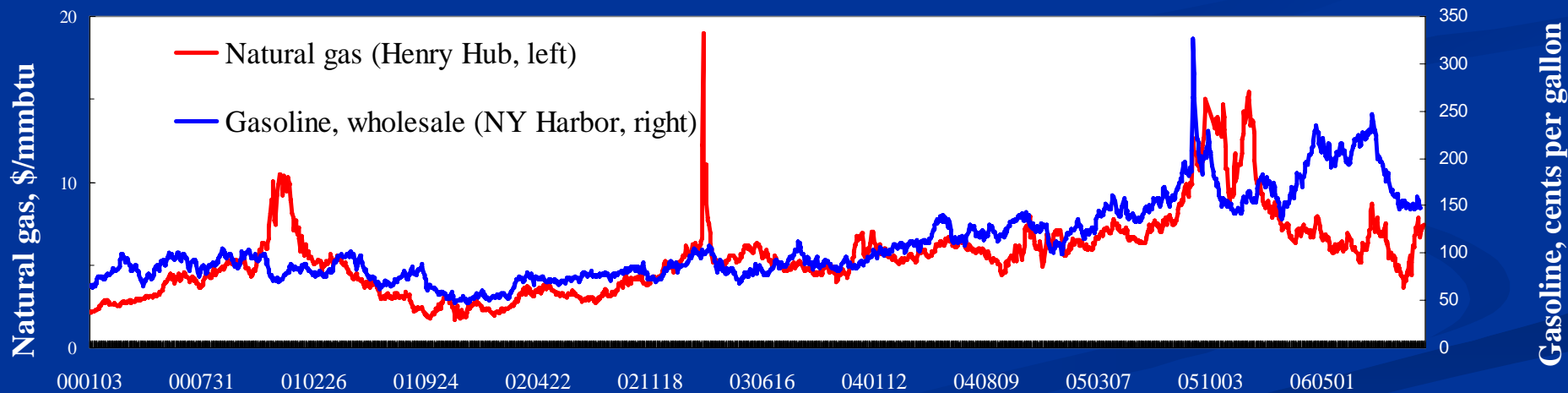
A key risk, but limited spillovers, and no landslide in national home prices so far

Energy price developments

Crude oil is off 22% from its July peak



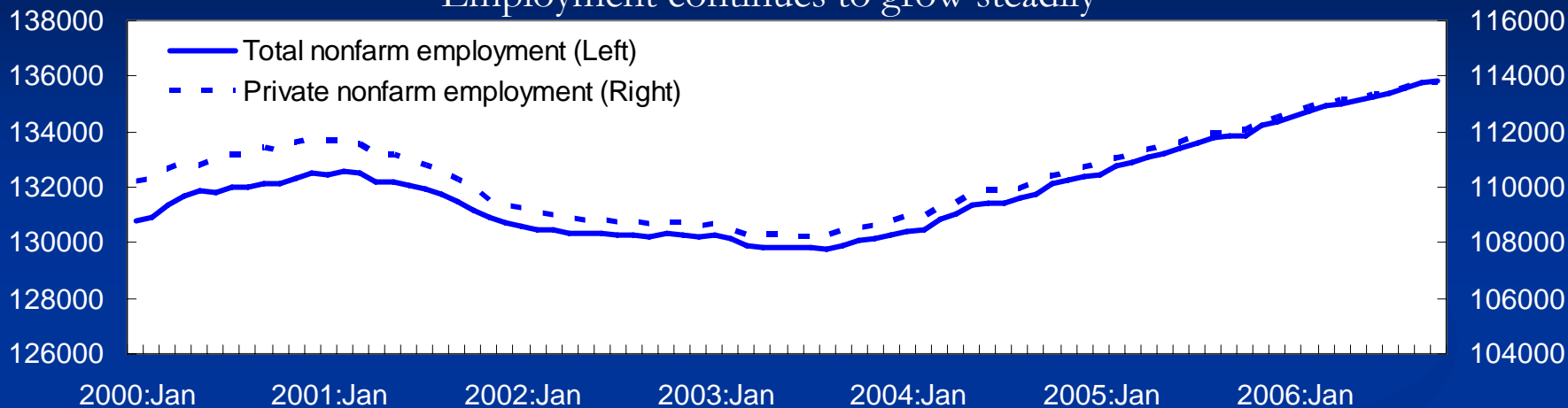
As importantly, natural gas and gasoline prices are well off their peaks



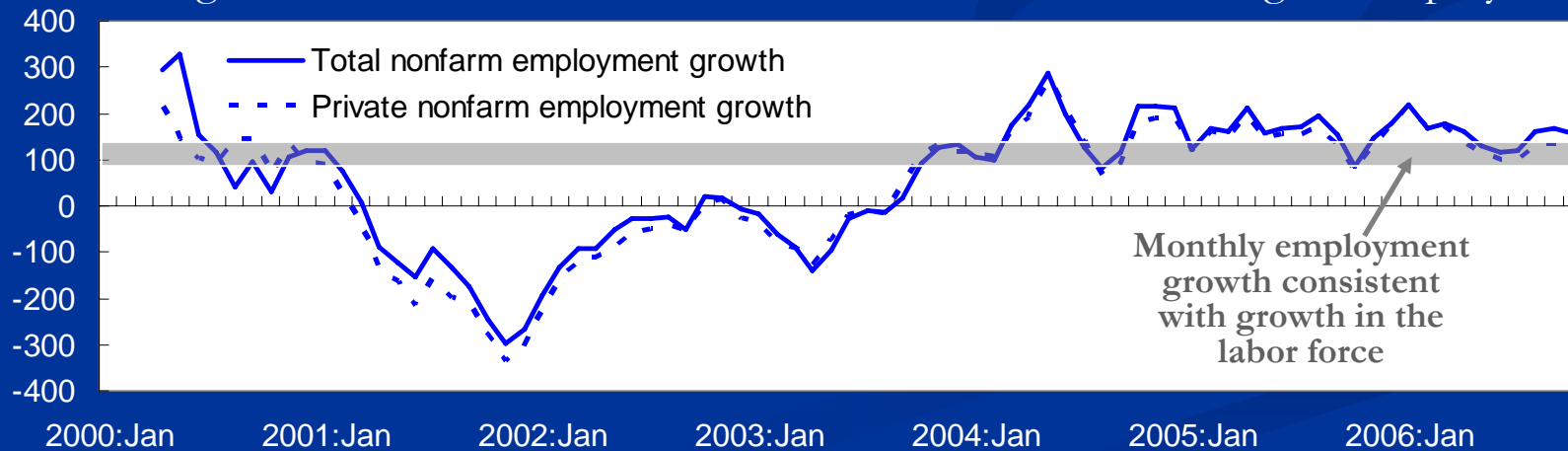
If these prices persist, they will have salutary effects on both inflation and real growth

Employment

Employment continues to grow steadily



Recent growth has been above the rate consistent with maintaining full employment

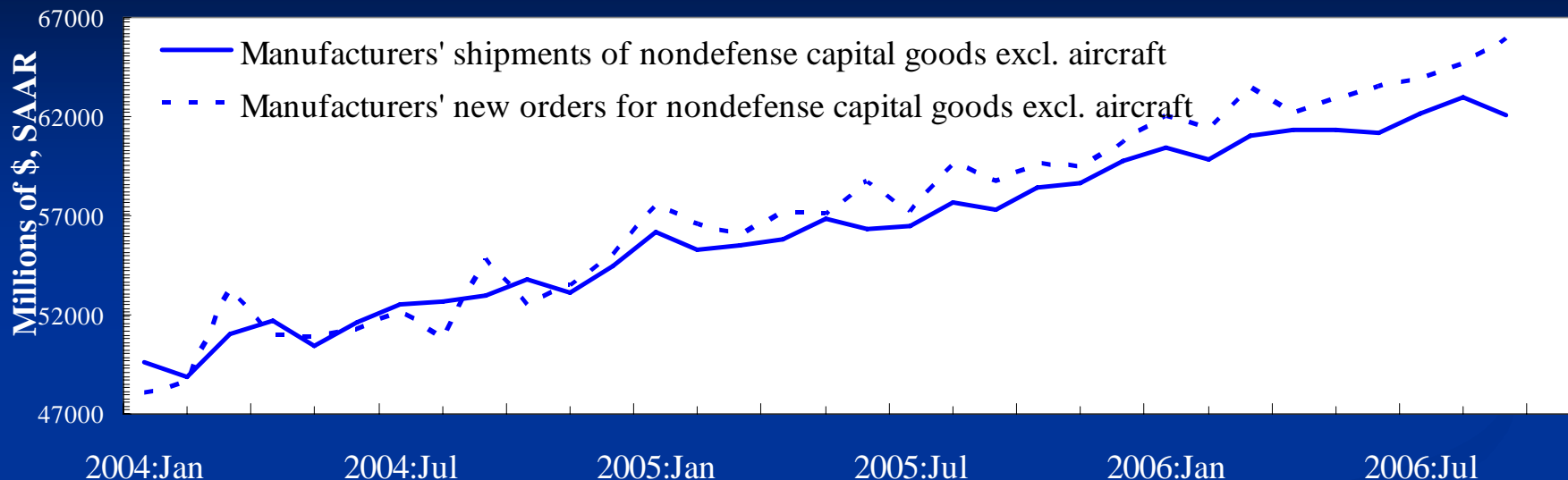


Monthly employment growth consistent with growth in the labor force

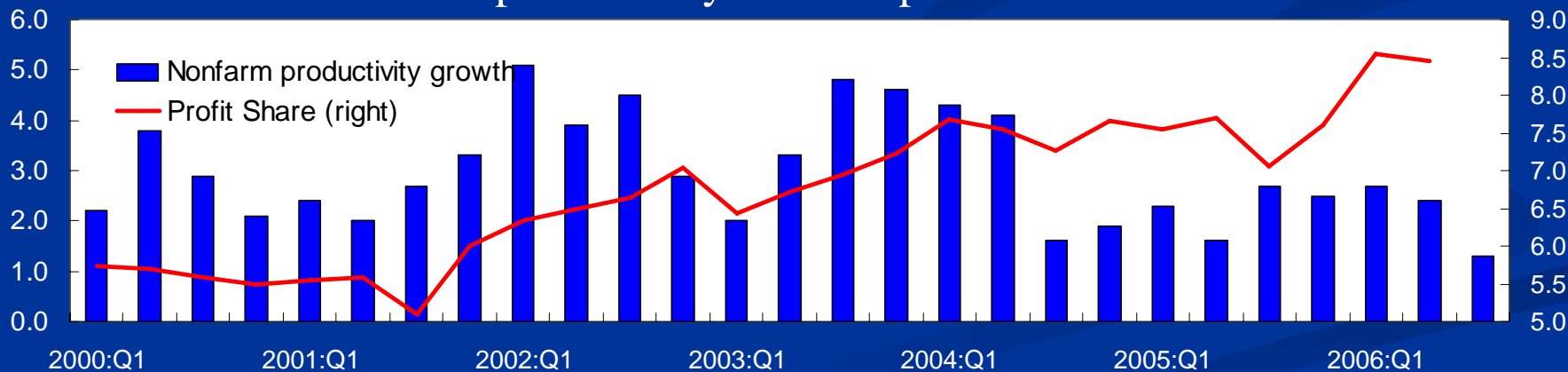
Sources: Total and private non-farm employment, establishment survey (SA): Bureau of Labor Statistics

Investment fundamentals remain solid

Orders are running about 6% ahead of shipments, suggesting further investment growth

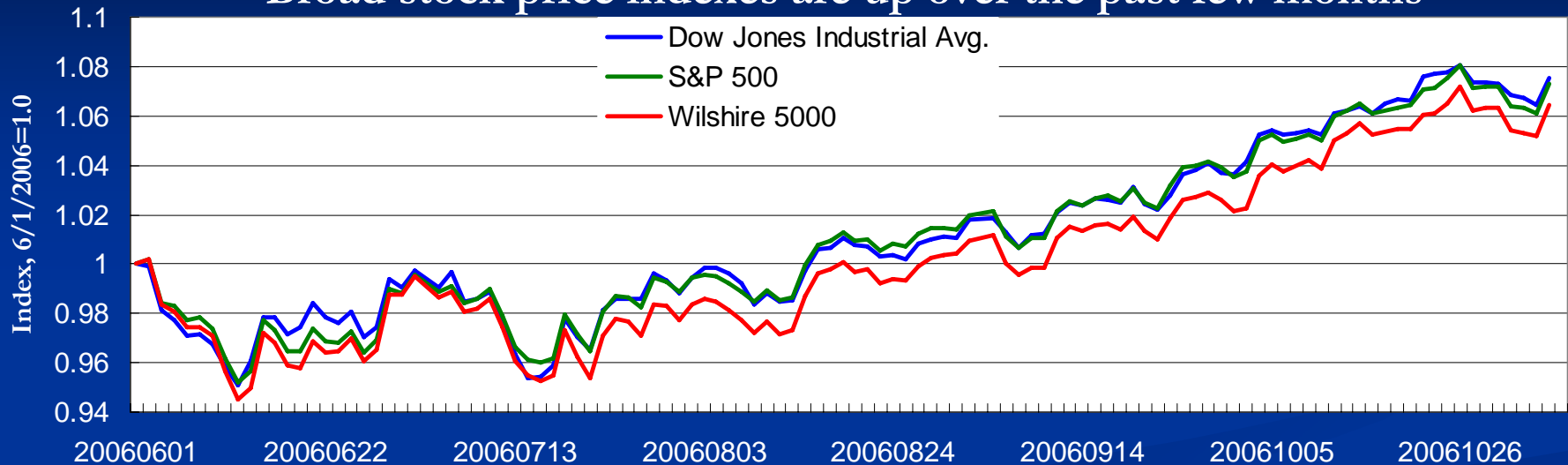


Profits and productivity remain spurs for investment

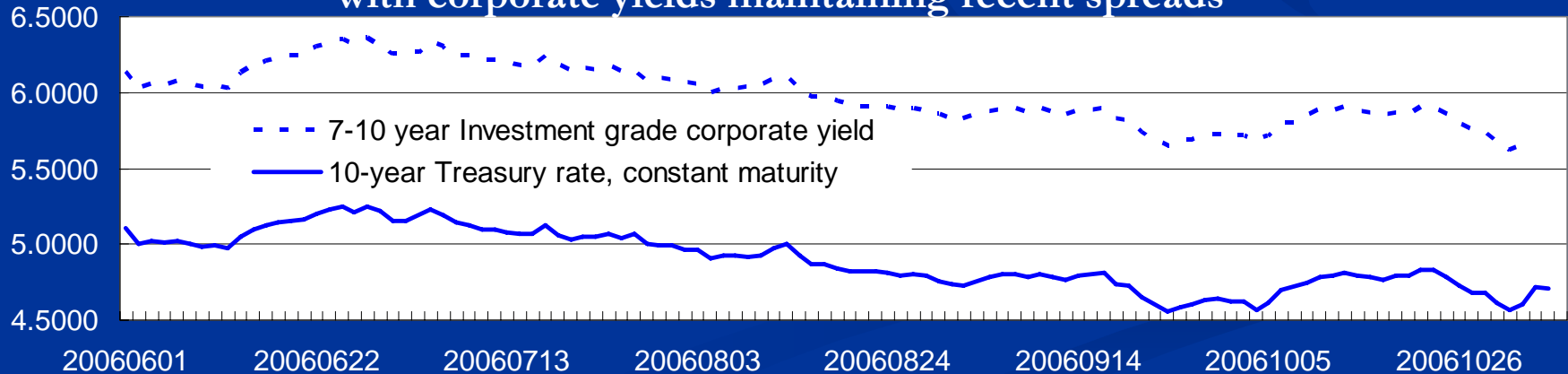


Financial conditions remain supportive

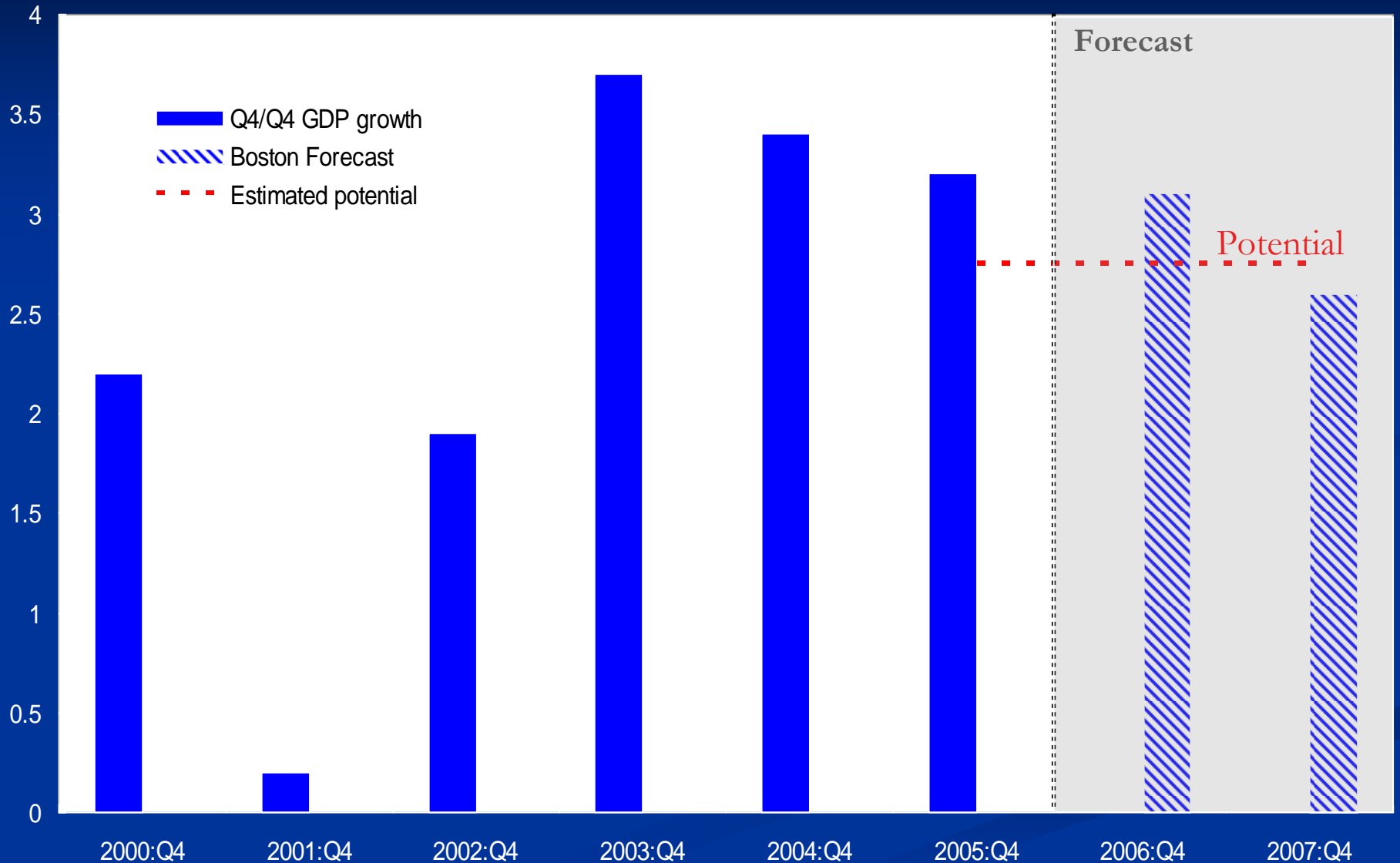
Broad stock price indexes are up over the past few months



And the 10-year Treasury remains below 5%,
with corporate yields maintaining recent spreads

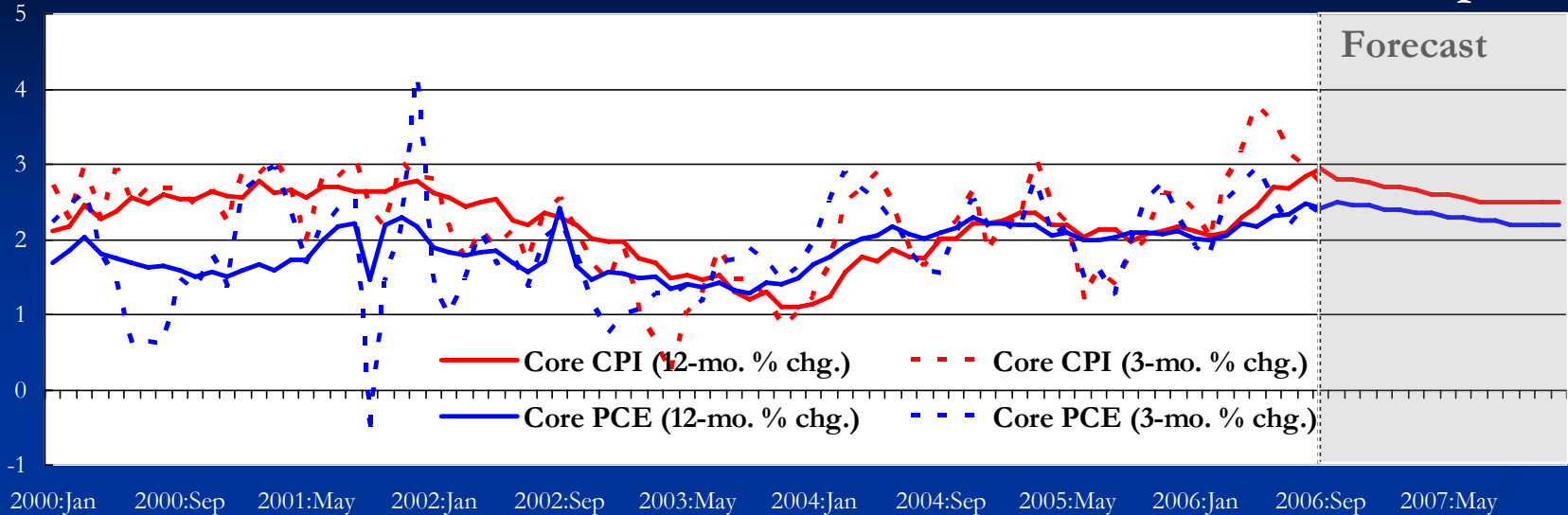


Outlook for GDP growth

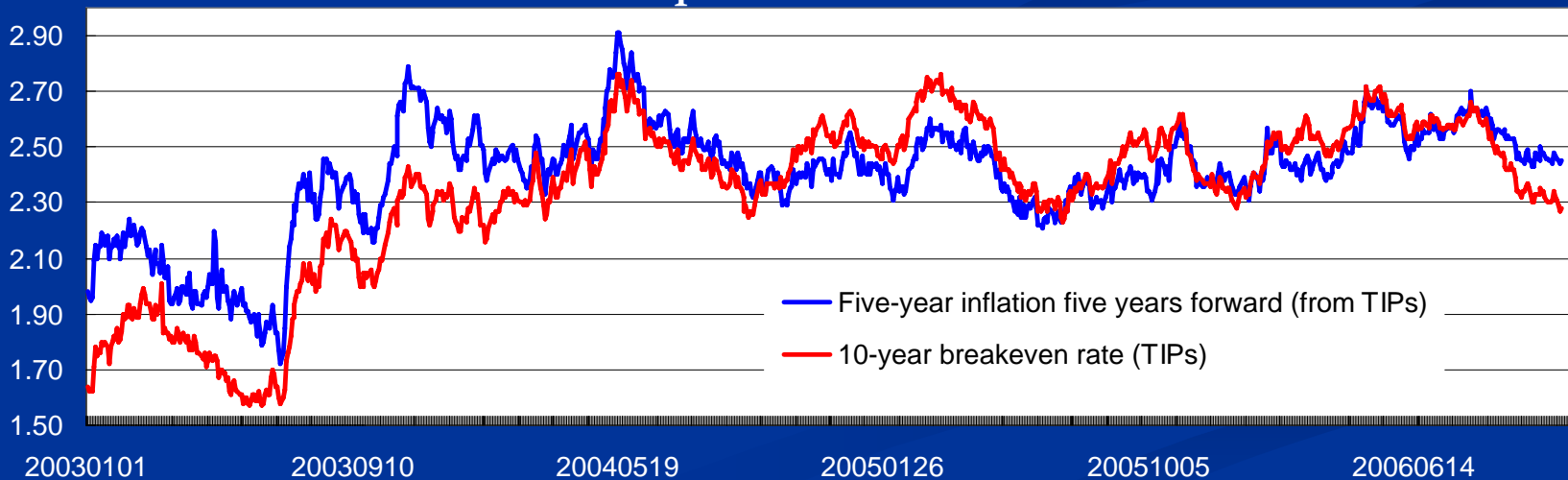


Inflation: Still a risk, but some good news

Last two months' numbers are somewhat better, and about as we expected



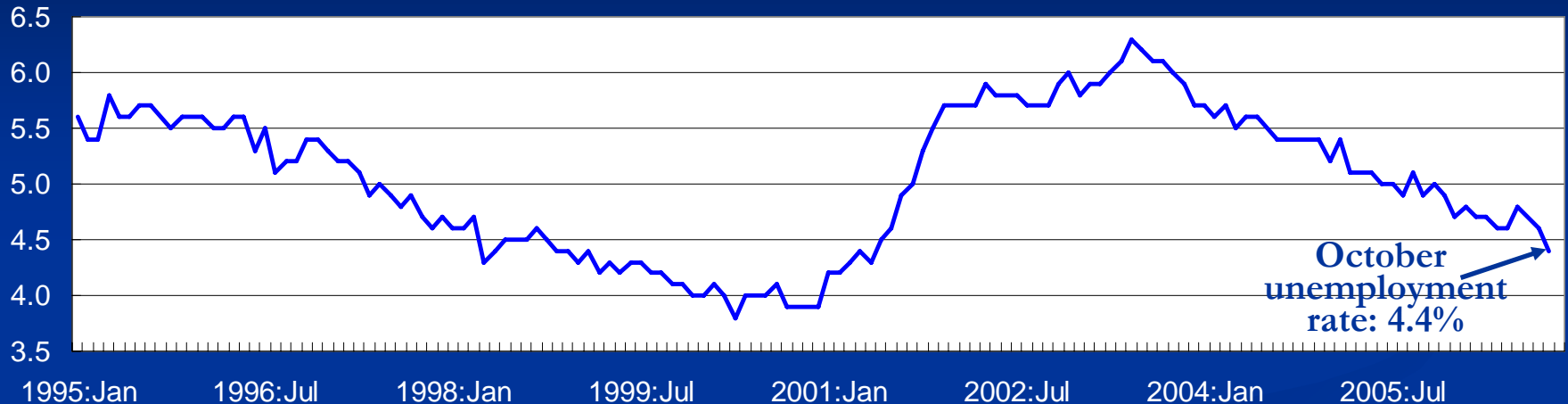
Inflation expectations remain well-anchored



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.

Resource utilization is fairly tight

Low unemployment rates are consistent with approximately full employment



- Suggests some upside risk to inflation
- Business contacts suggest some categories of workers are in short supply—some wage pressures arising
- But good to be at full employment!

Summary

- Economy progressing well, balancing risks to growth and inflation
 - Energy prices to date—if sustained—will help curtail inflation and boost growth
 - Financial conditions, employment growth, profits and productivity are supportive of moderate growth
 - Housing continues to slow in controlled fashion
 - Remains a key downside risk to growth
 - Inflation has improved, but still some upside risk
 - High resource utilization