

Economic Outlook

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Presented to

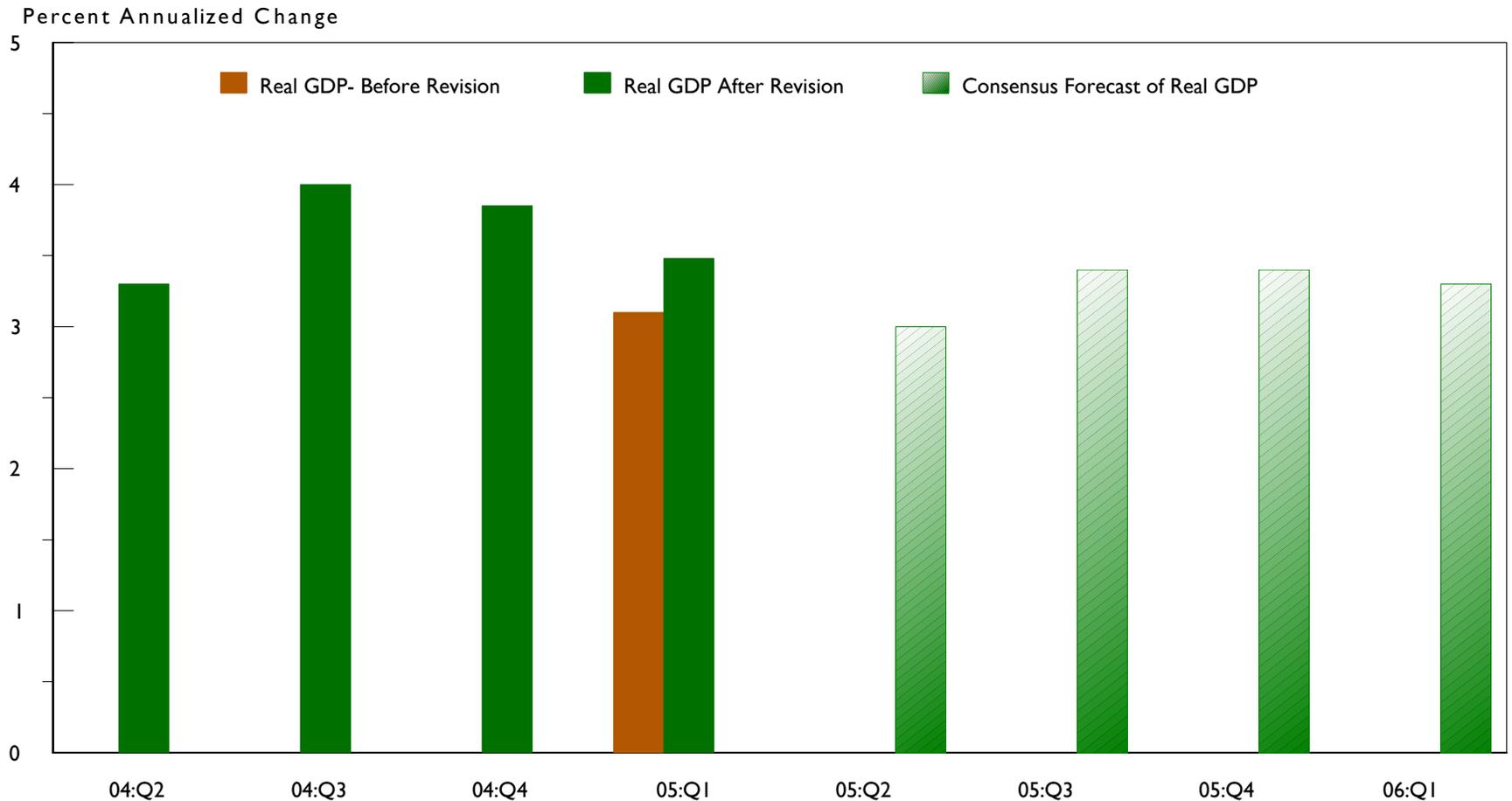
Regional and Community Bankers

June 7, 2005

Overview of the US Economy

- Over the near-term, the expansion appears to be on a solid footing
- Risks on the downside:
 - Will businesses and consumers stay the course?
 - Is there a housing bubble?
- Inflation risks:
 - The effect of oil and other input price increases are likely to moderate.
- New England continues to grow along with the nation
- In the longer run, national savings needs to increase.

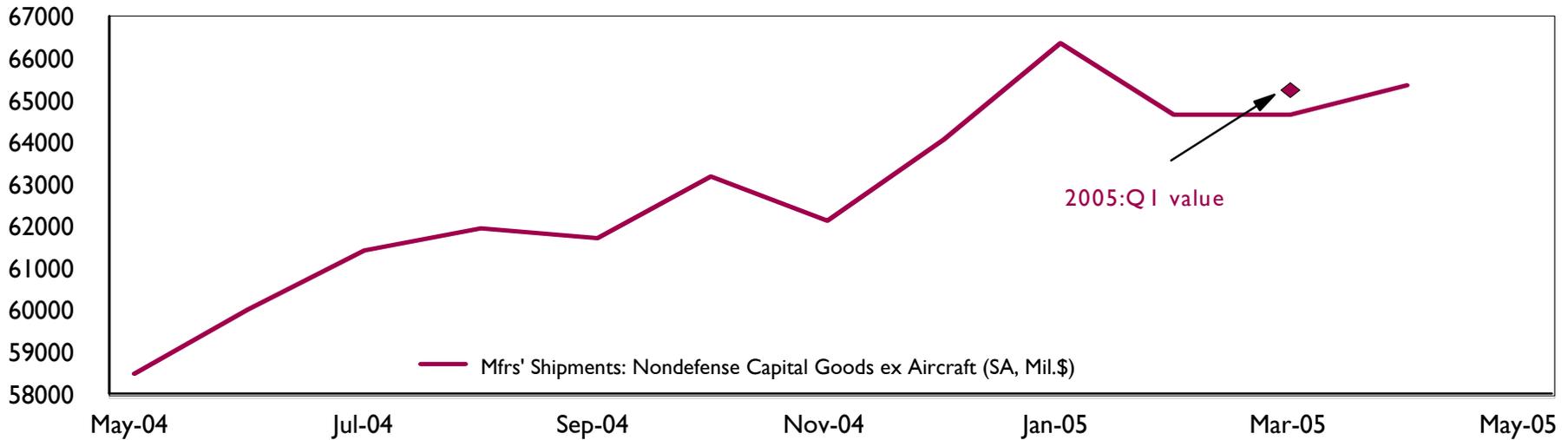
Much of the recent “Soft Patch” was revised away



Source: Bureau of Economic Analysis.
Consensus Forecast.

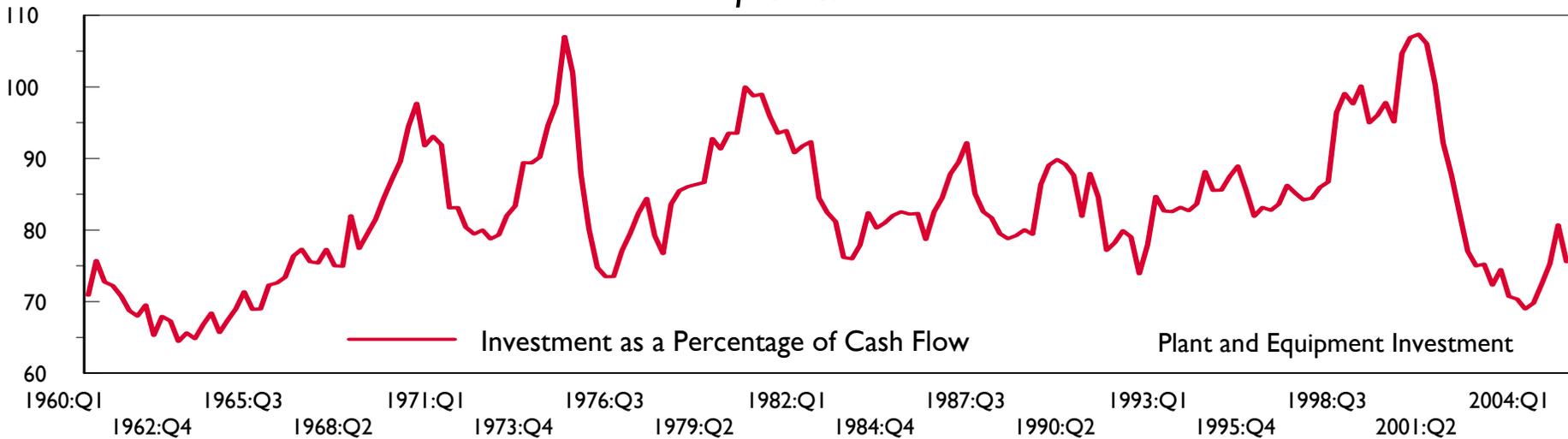
Looking forward, businesses and consumers will be the key to the continued expansion

Firms' demand for capital equipment rebounded in April after two months of weak numbers,



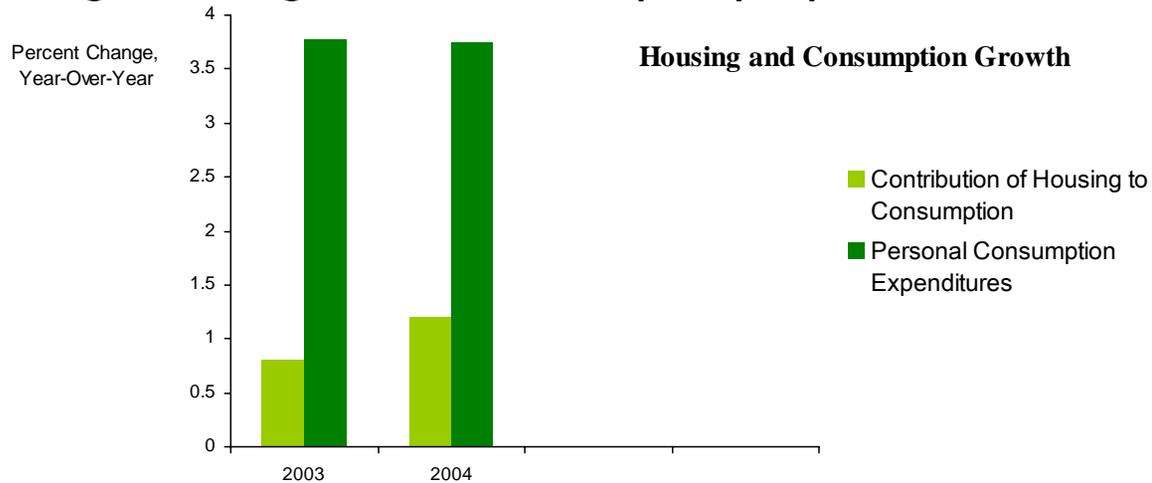
Source: Census Bureau.

but the expansion of profits and the buildup of cash should support investment in the future.



Source: Bureau of Economic Analysis.

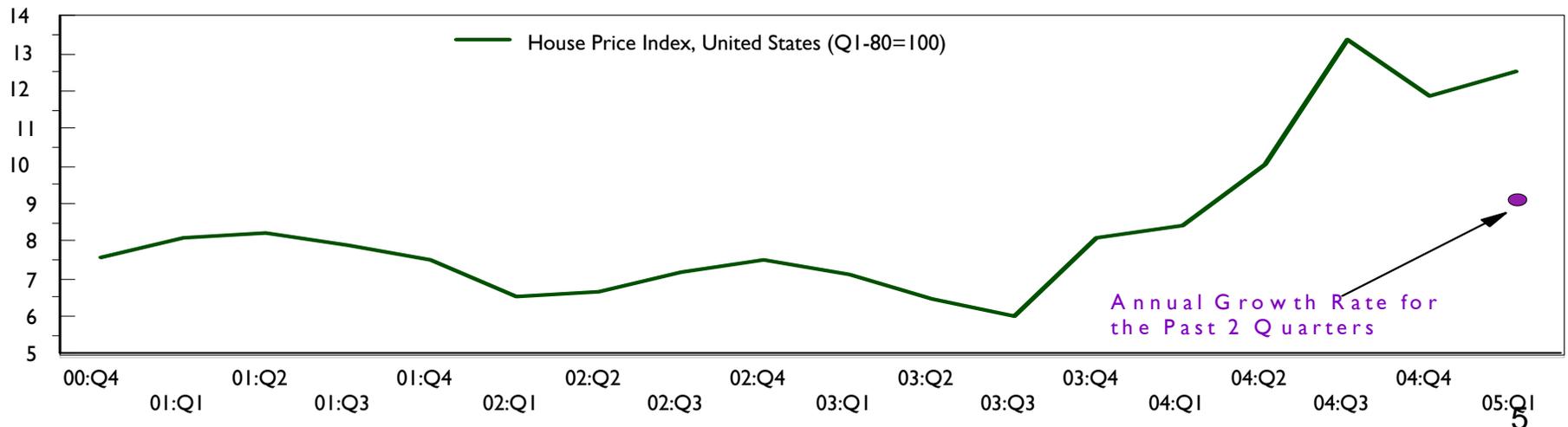
Increasing housing wealth has helped propel the consumer



Source: OFHEO, Bureau of Economic Analysis and author's calculations

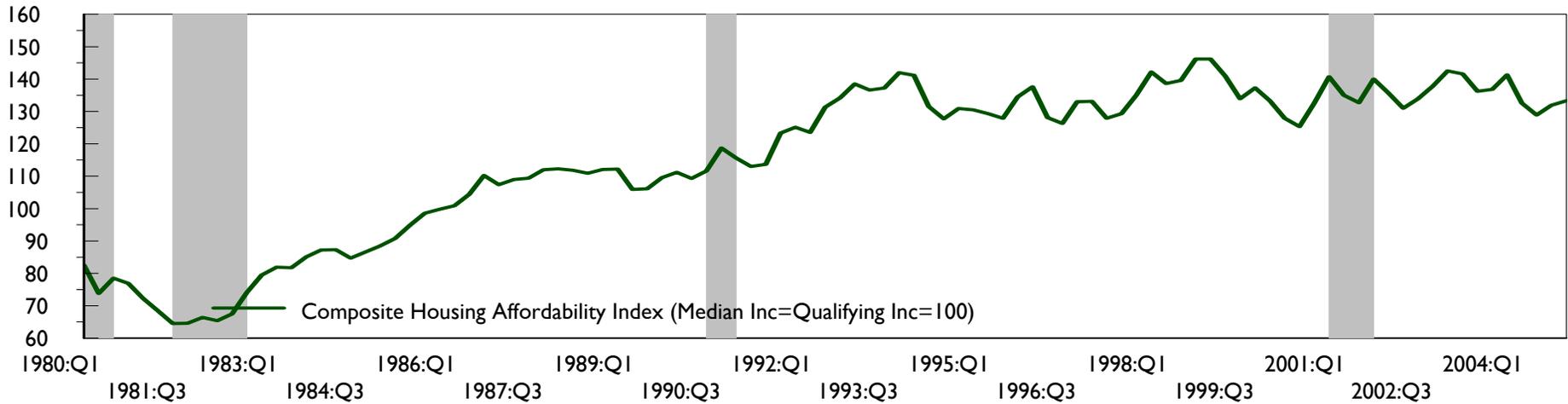
driven, in part, by rising housing prices

Percent Change, Year-Over-Year



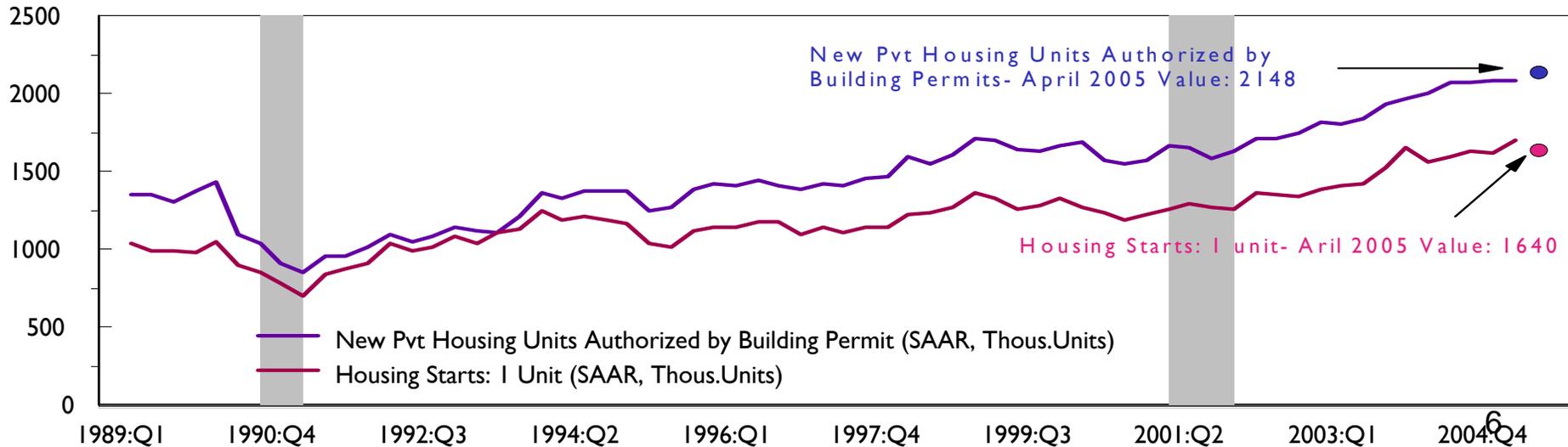
Source: Office of Federal Housing Enterprise Oversight.

Rising real estate prices have decreased affordability, but low interest rates and strong employment growth have left overall affordability high.



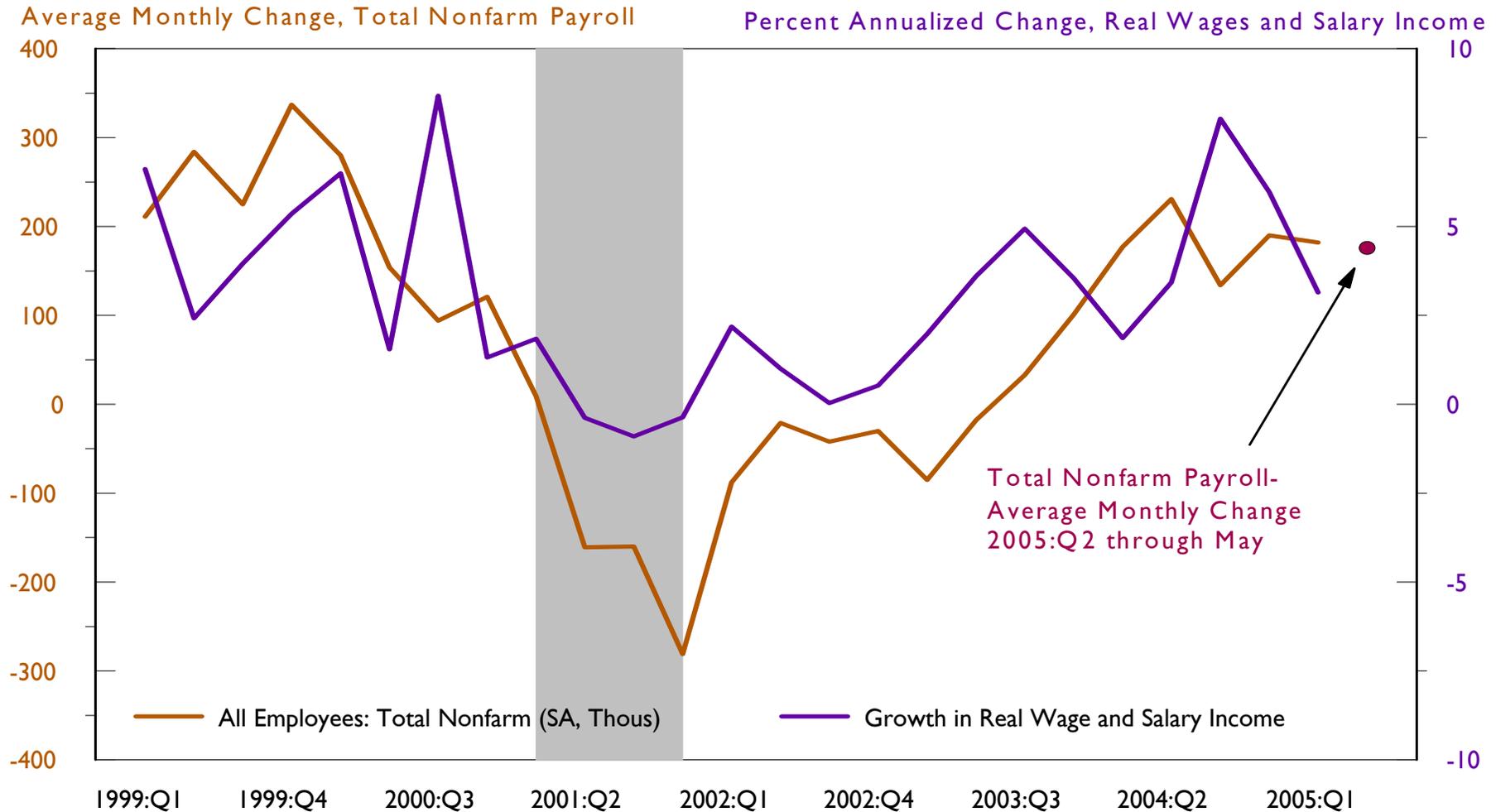
Which explains the continued strength in the housing market

Thousands of Units



Source: Census Bureau.

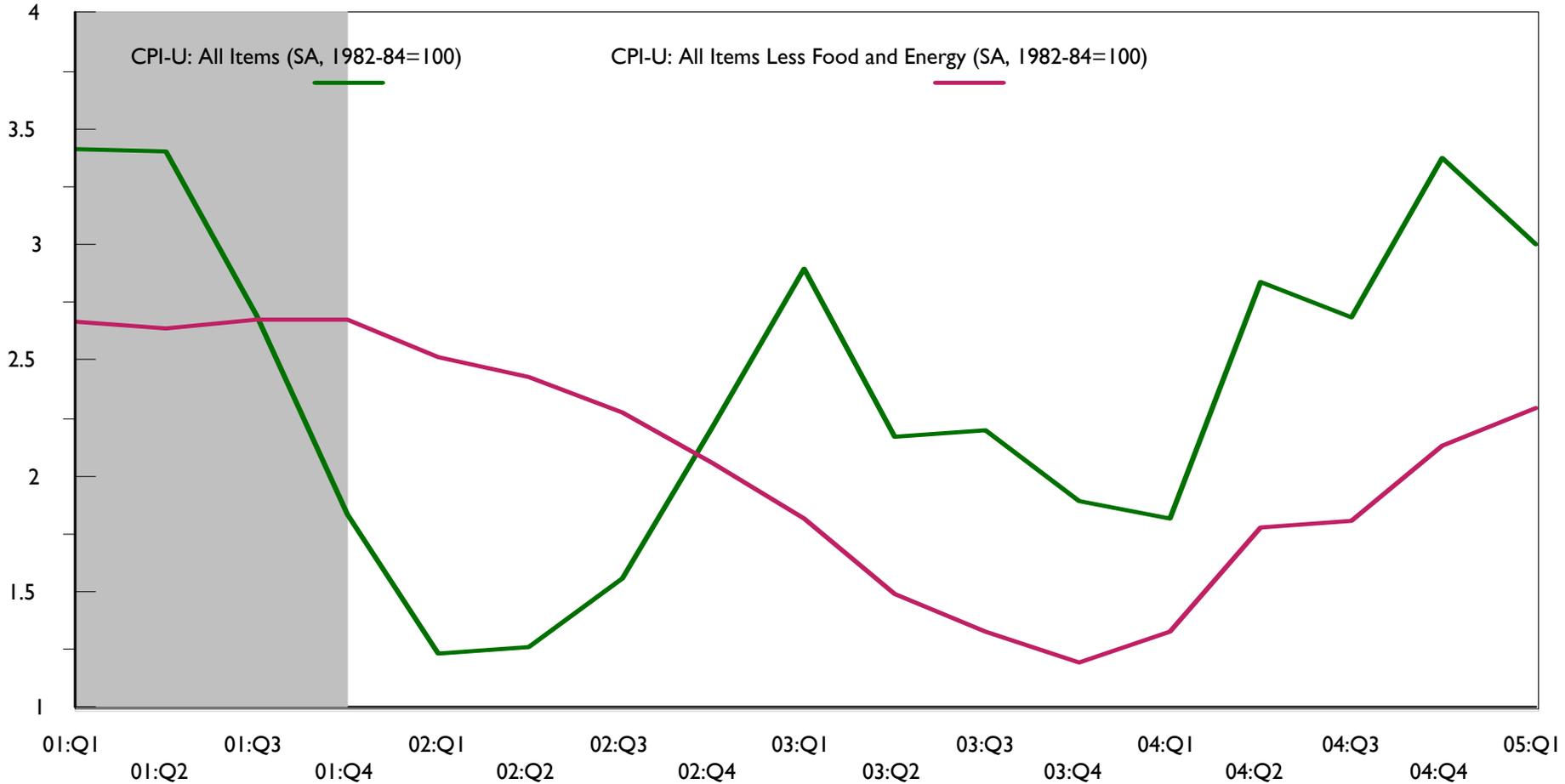
Improving employment and wage and salary growth should drive consumption



Source: Bureau of Labor Statistics .
Bureau of Economic Analysis.

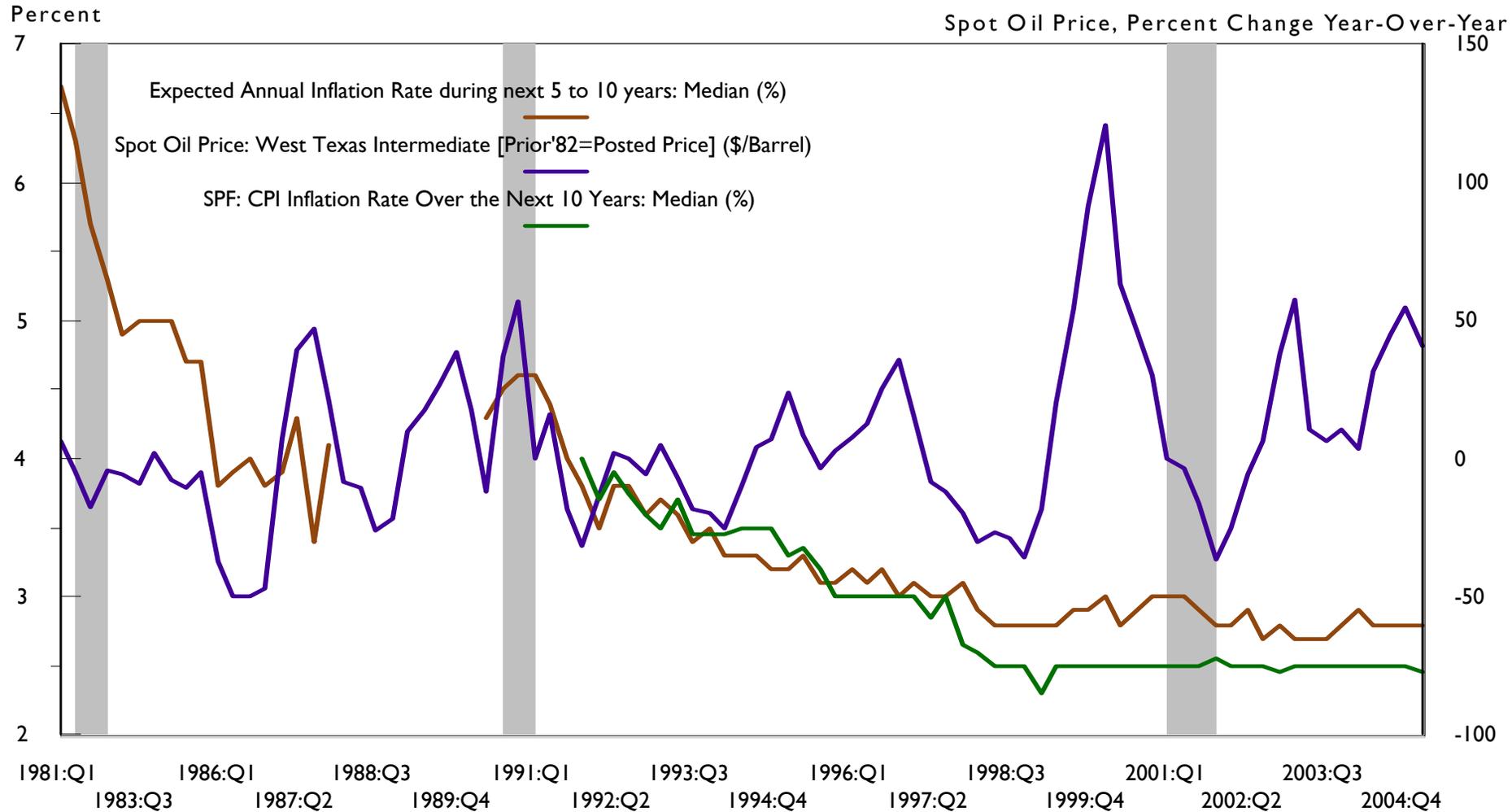
Inflation risks have risen along with oil prices

Percent Change, Year-Over-Year



Source: Bureau of Labor Statistics.

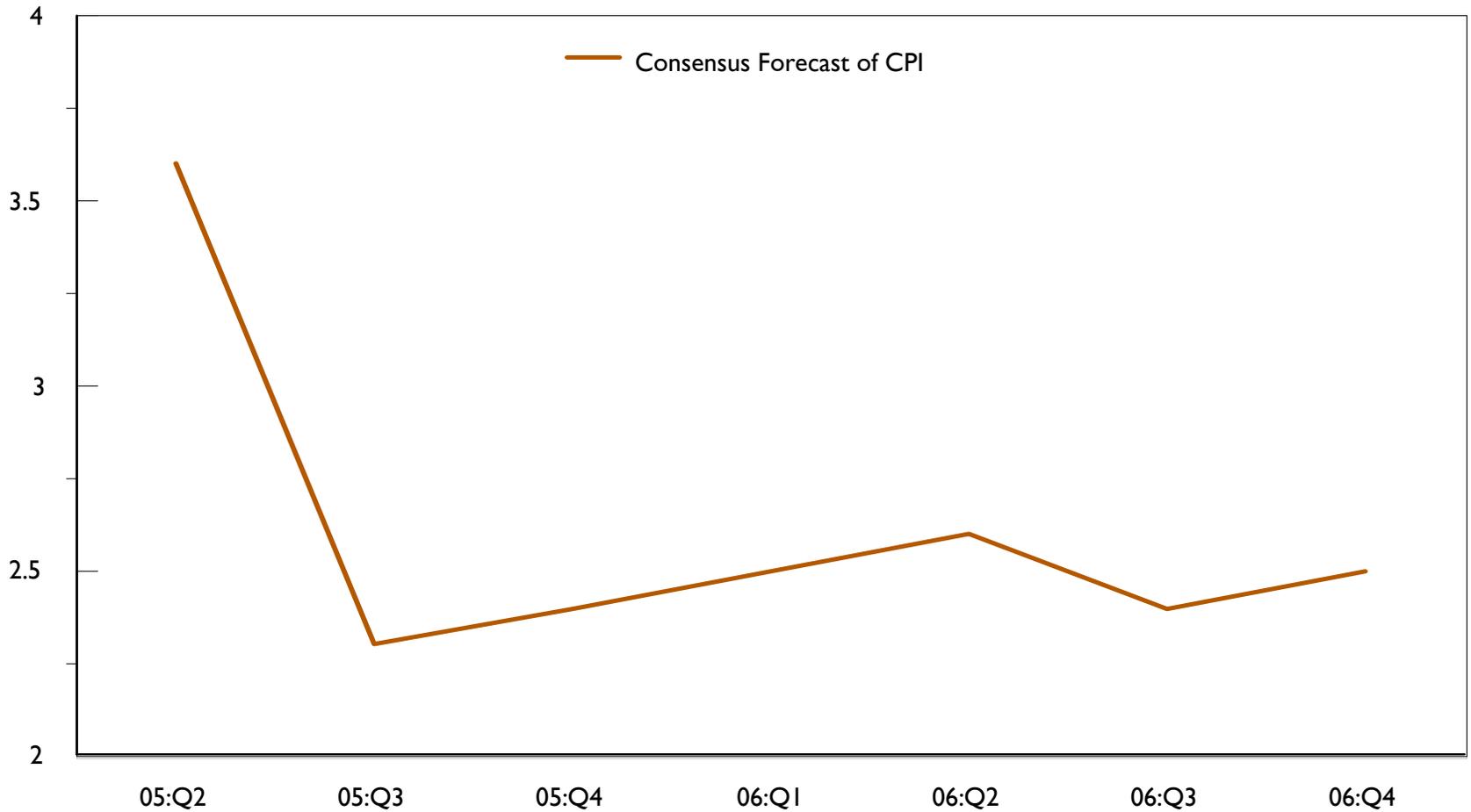
Yet oil price increases have not had a lasting effect on survey expectations of inflation.



Source: Survey of Consumers (University of Michigan).
 SPF: FRB Philadelphia.
 Wall Street Journal.

As most forecasters anticipate moderation in inflation

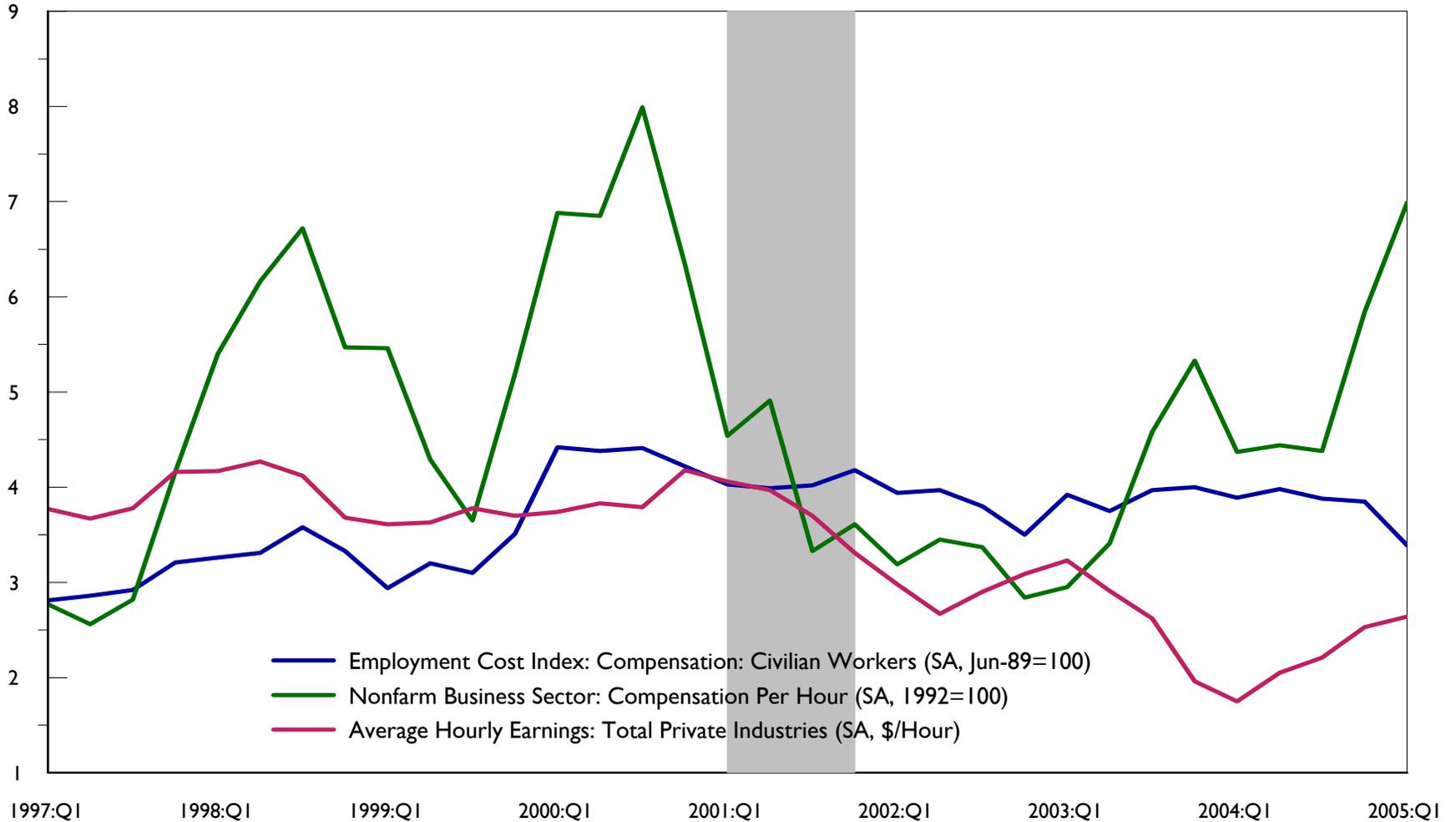
Percent Annualized Change



Source: Consensus Forecast.

And most measures of labor costs have yet to accelerate.

Percent Change, Year-Over-Year



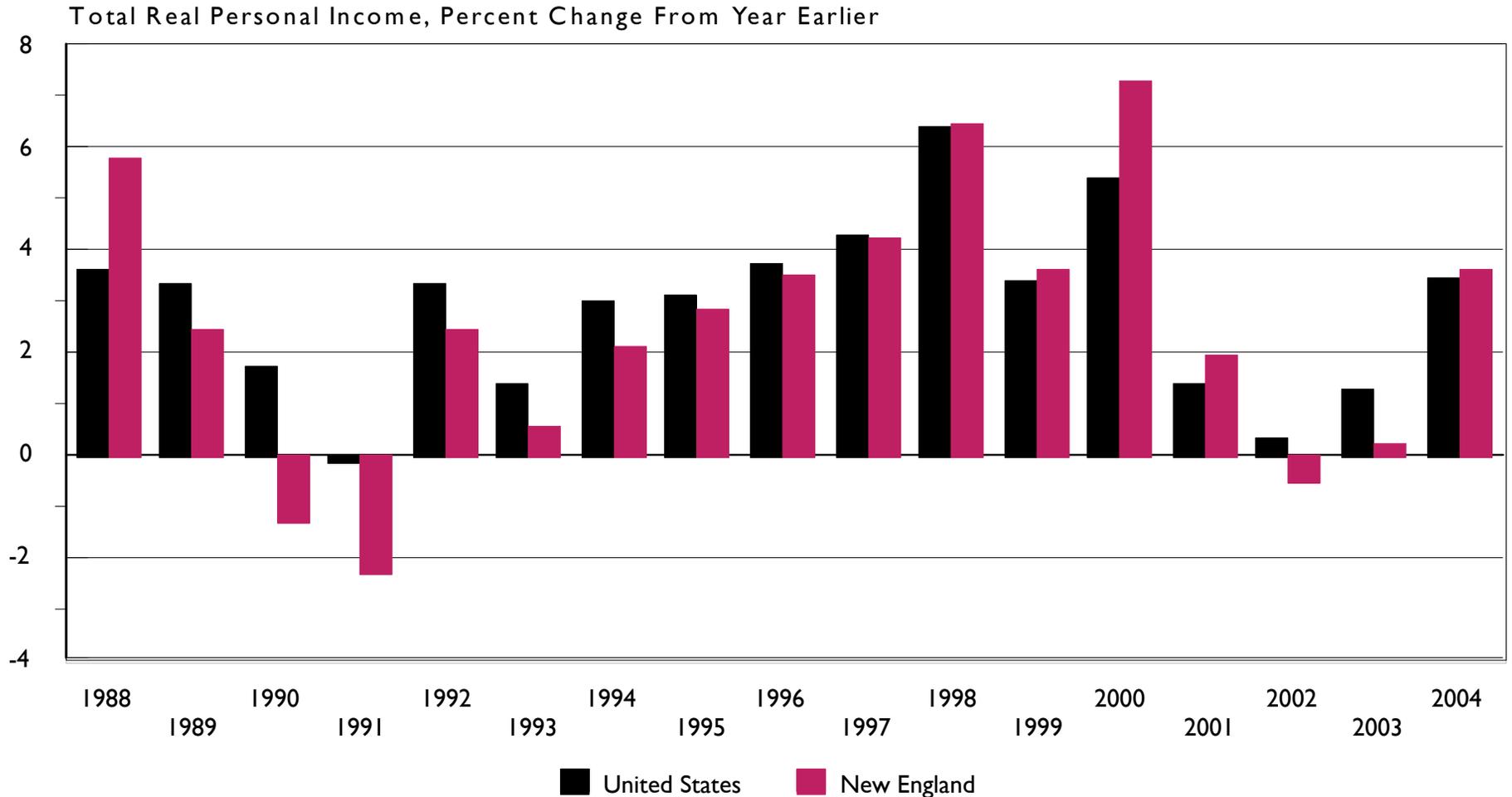
Source: Bureau of Labor Statistics.

New England Economy

Business Cycle Update

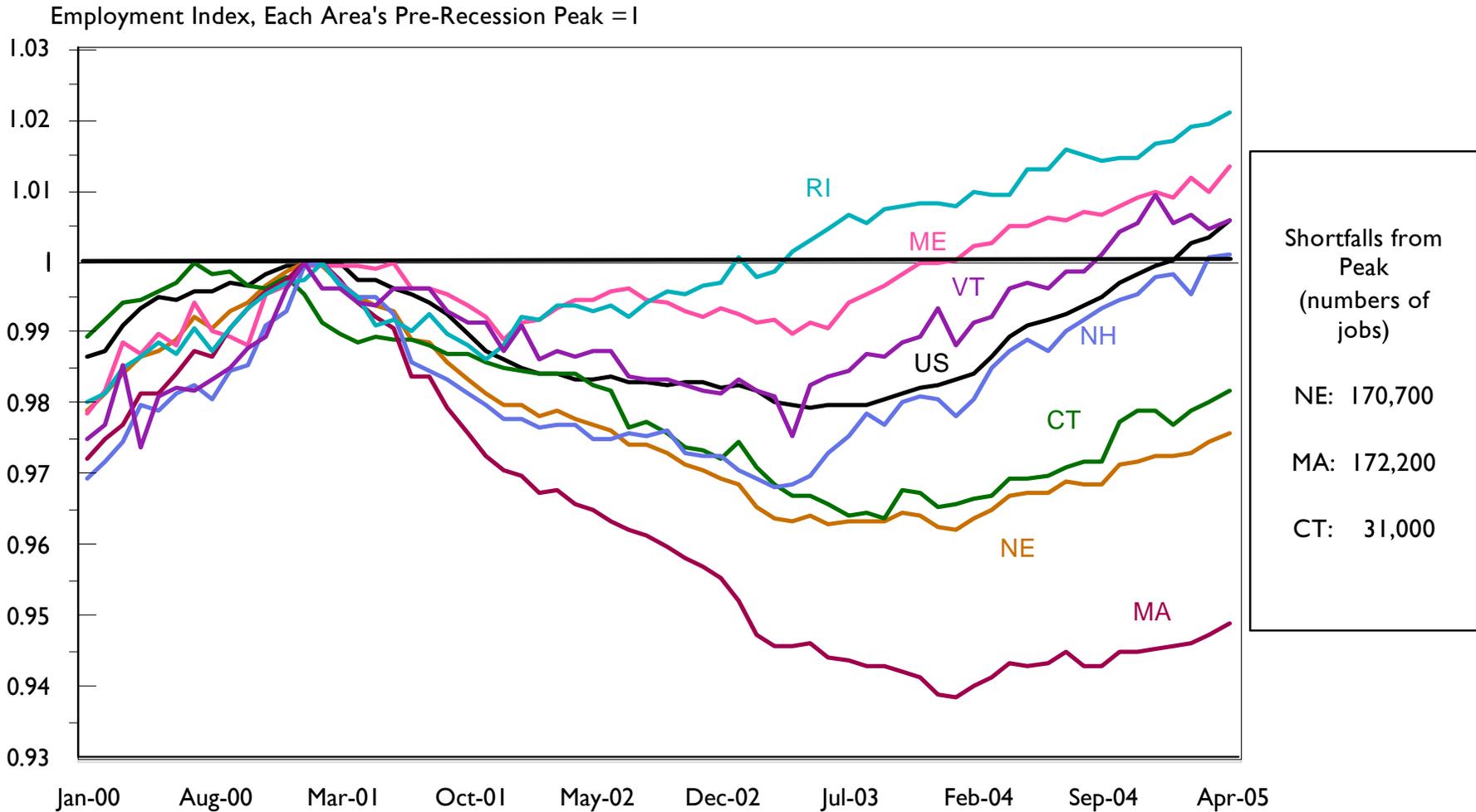
- New England's economic growth caught up with the nation's in 2004.
- Job counts remain below peak in the two largest New England states, Massachusetts and Connecticut.
- Indicators for early 2005 signal continued expansion.
- ... and their homes appreciate more moderately than those in certain other regions of the country.

After a slow pickup, the New England economy grew at the same rate as the nation in 2004.



Source: Bureau of Economic Analysis.

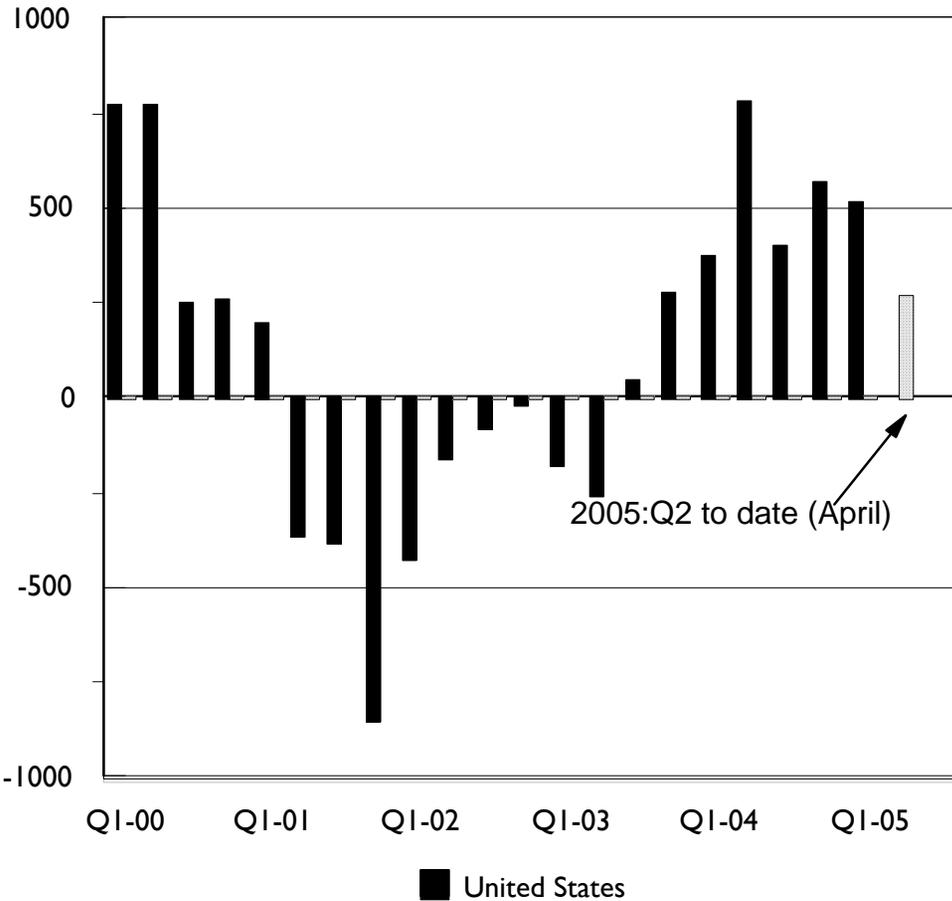
The regional job count remains below its pre-recession peak.



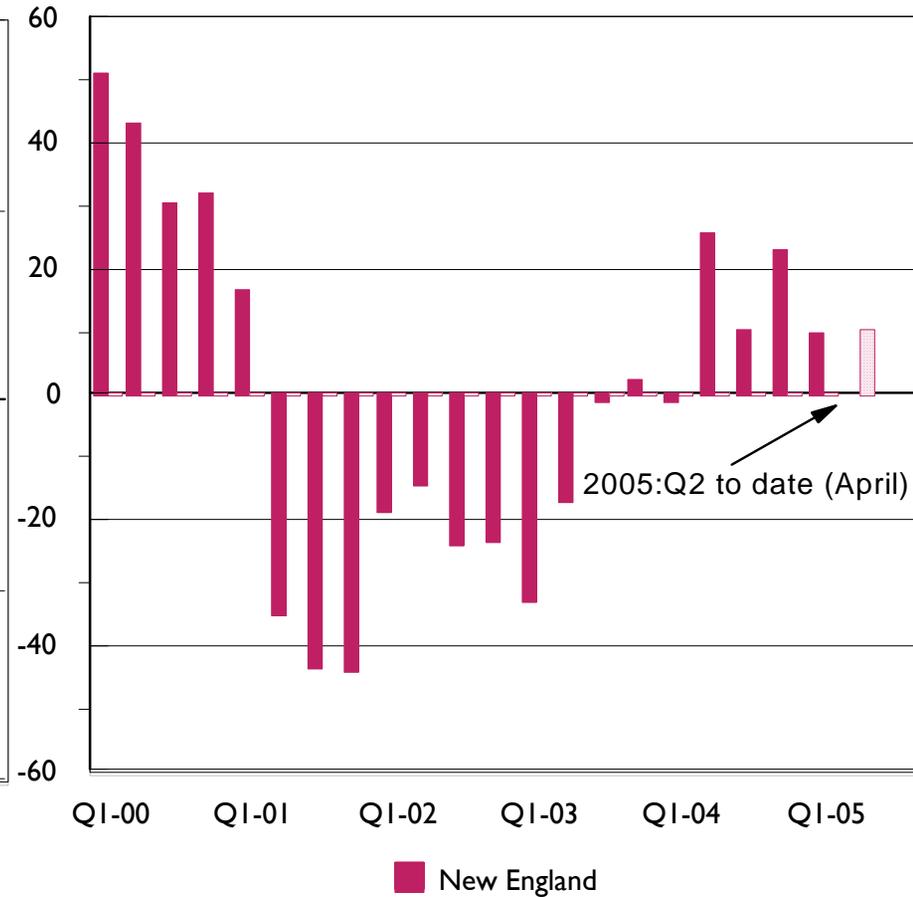
Source: Bureau of Labor Statistics.

The New England economy is continuing to grow; job gains strengthened in April.

Number of Net New Payroll Jobs, Quarterly (Thousands)



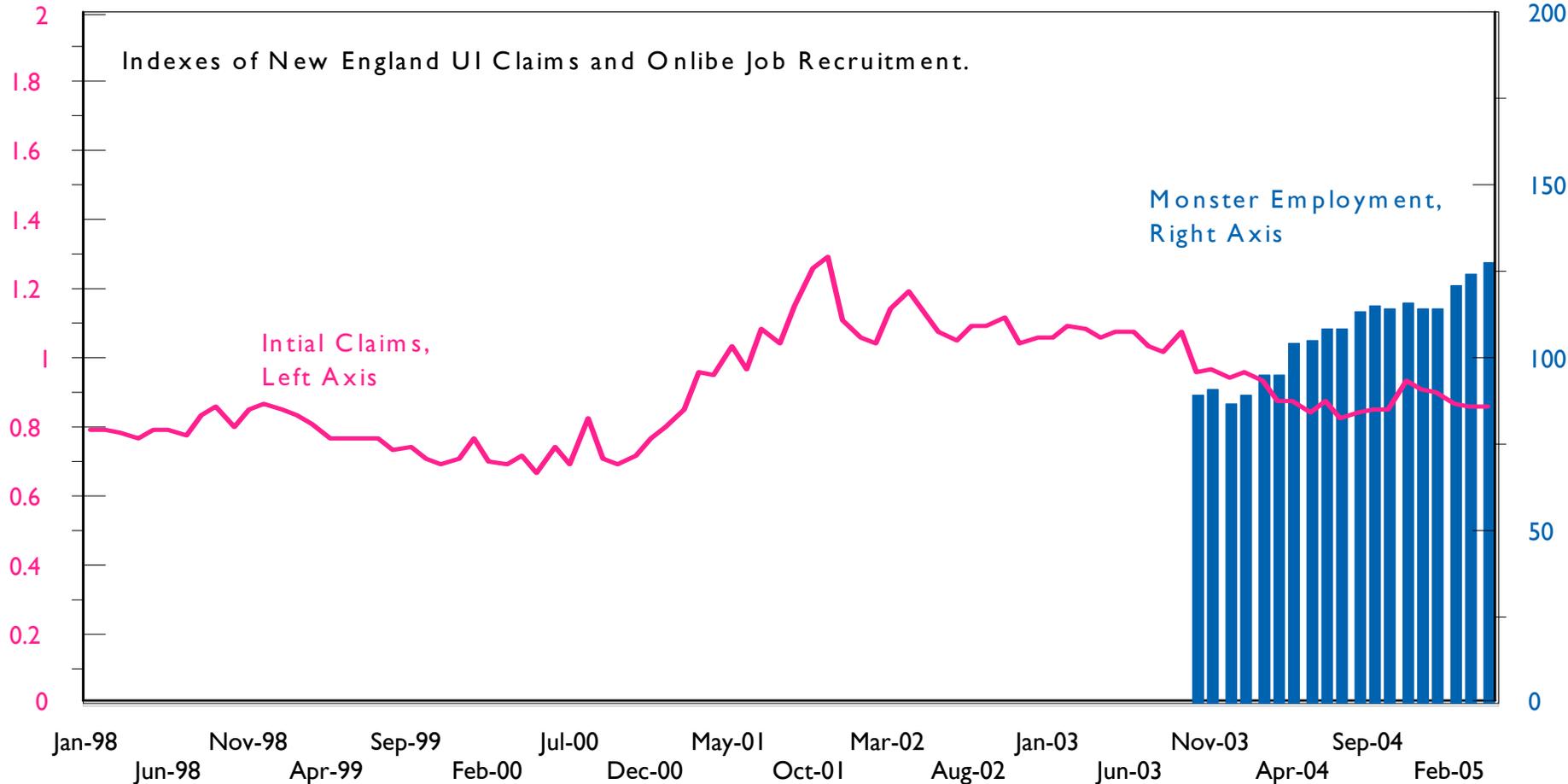
Number of Net New Payroll Jobs, Quarterly (Thousands)



Most forward-looking regional economic indicators continue to look positive.

Initial Claims for Unemployment Insurance,
Index, 1995=1

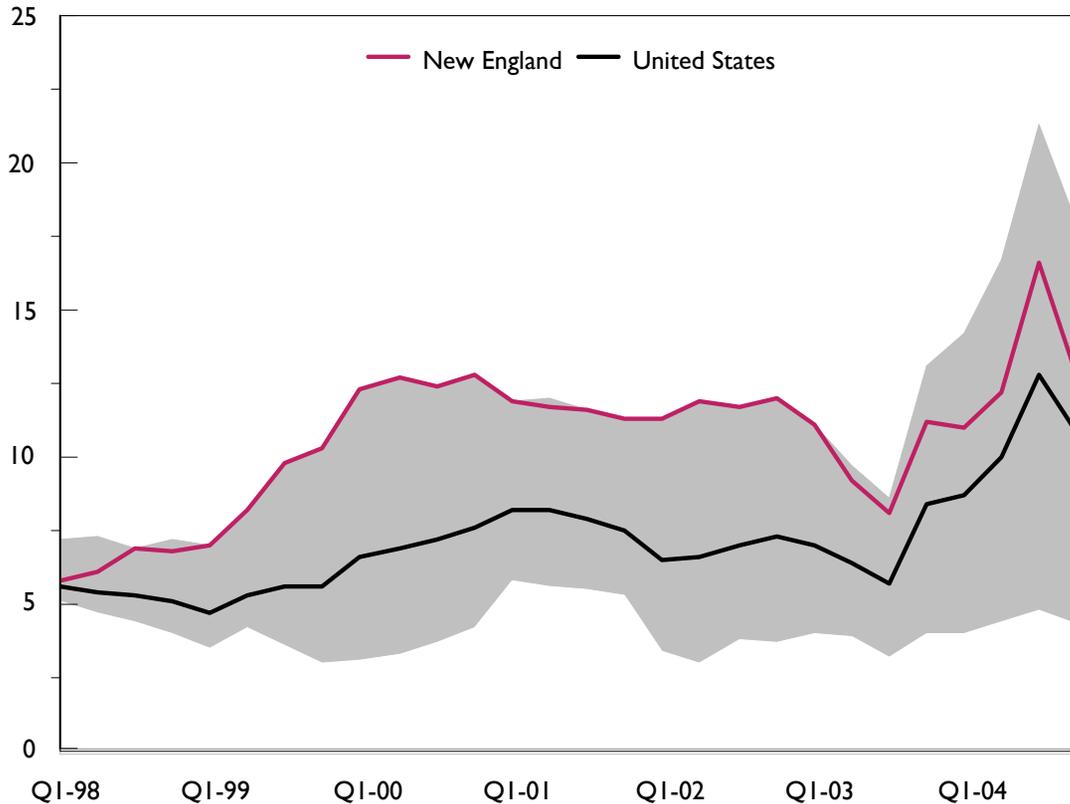
Monster Employment Index,
October 2003 - September 2004 = 100



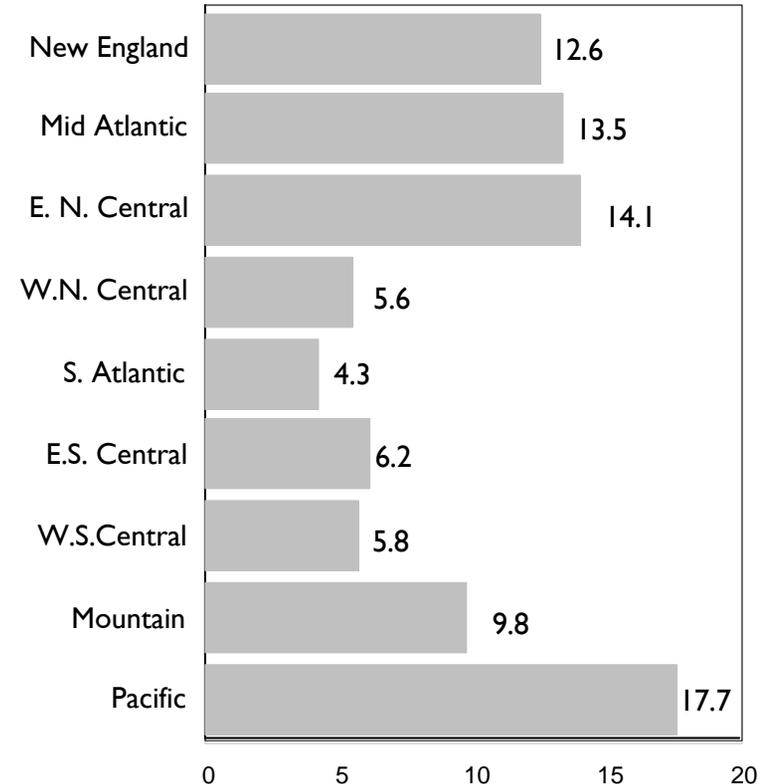
Source: U.S. Bureau of Labor Statistics and Federal Reserve Bank of Boston; Monster Worldwide.

New England homeowners continue to see their properties increase in value, but several other regions are now experiencing greater rates of home price appreciation.

Conventional Mortgage Home Price Index, Percent Change From Year Earlier



Percent Change, 2003 Q4 – 2004 Q4

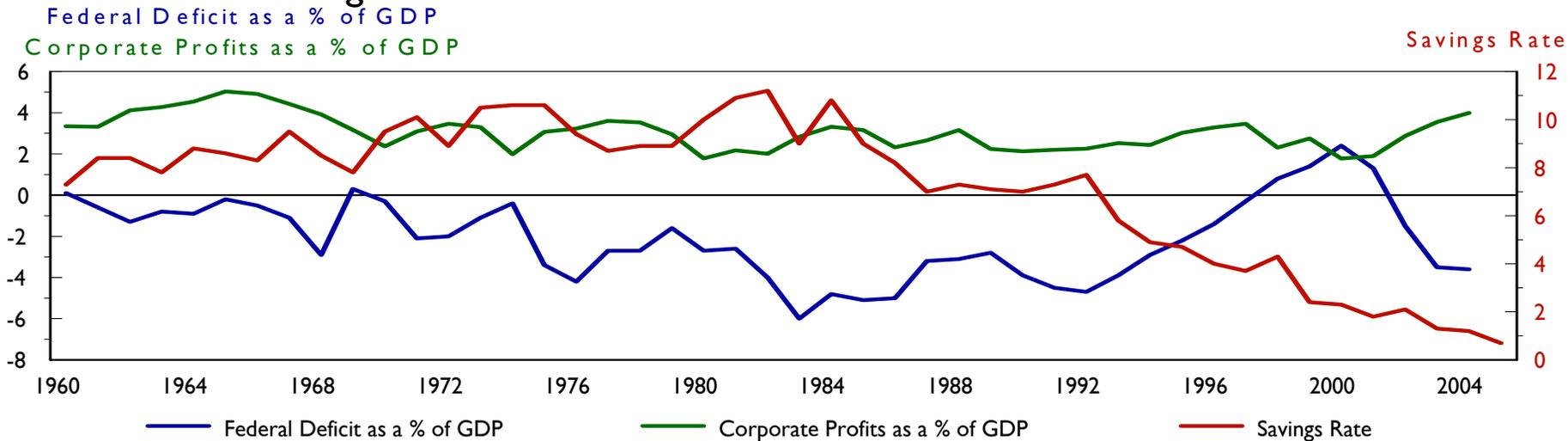


Note: Shaded area indicates range of values among the nine U.S. Census divisions.

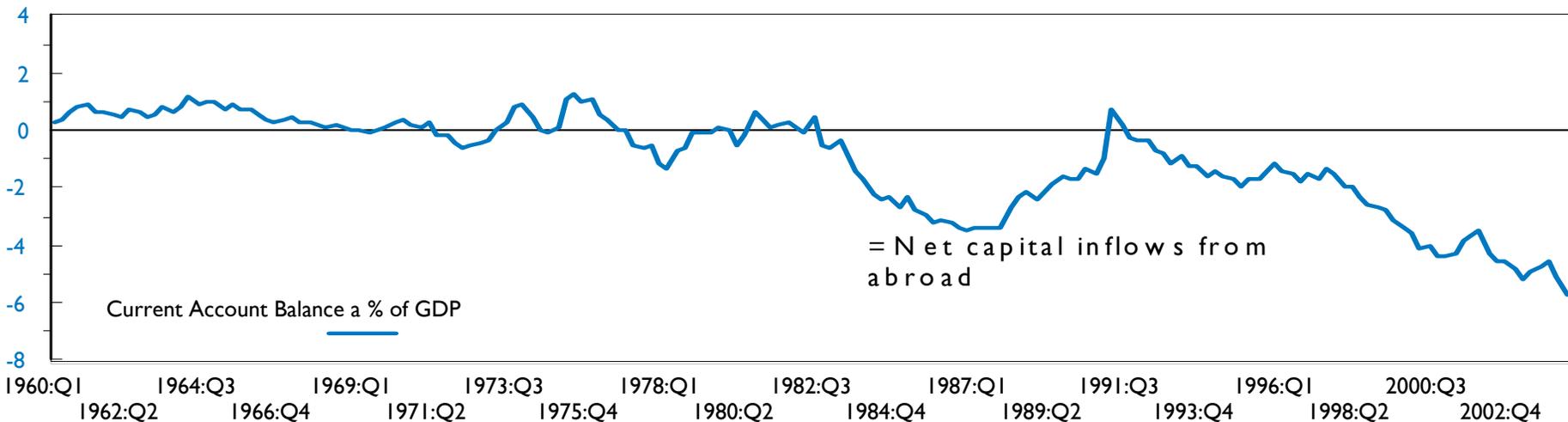
Source: Freddie Mac.

Longer-run Concerns

National savings has deteriorated...



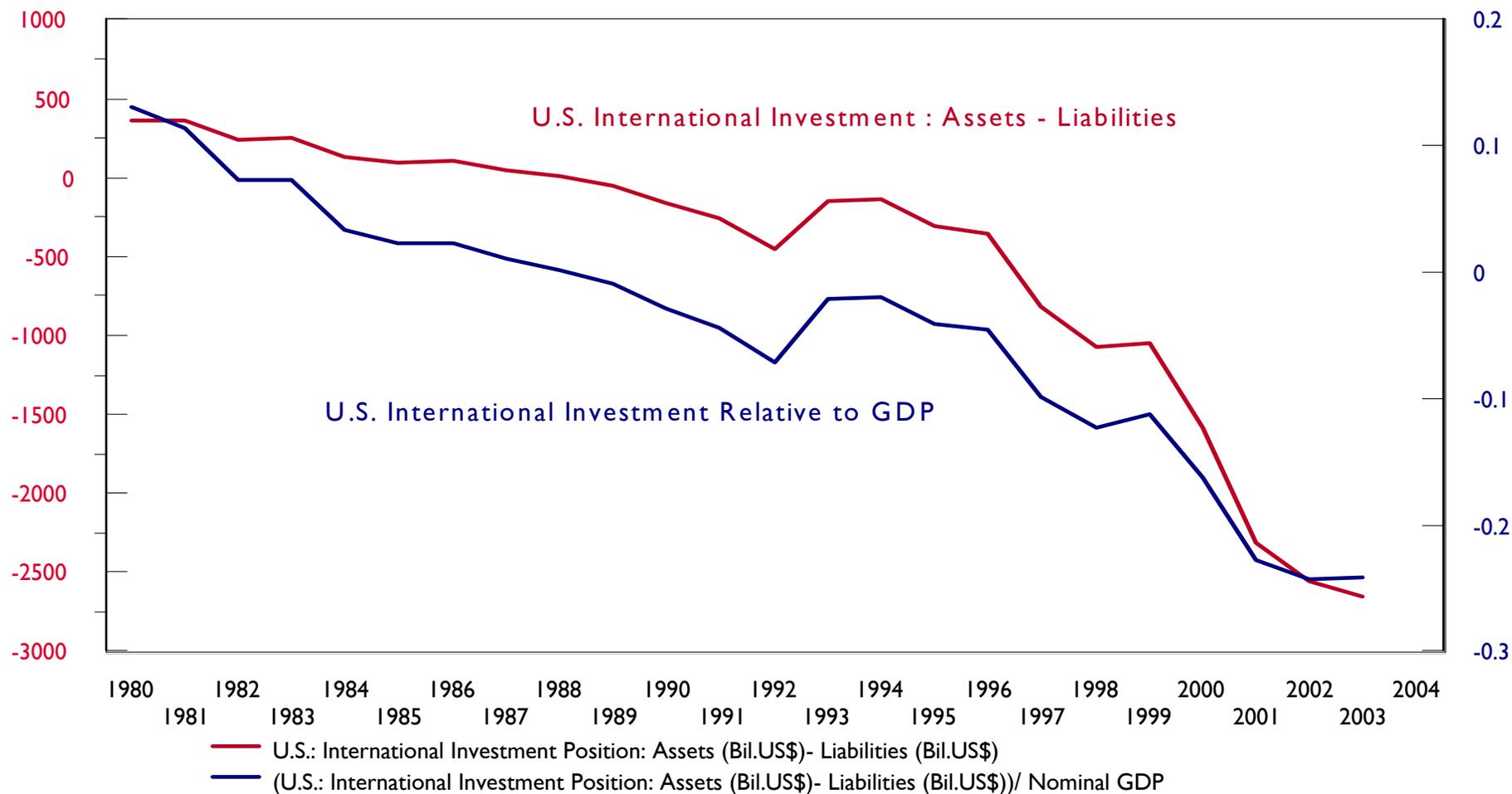
Which requires that we import savings from abroad



Source: Federal Surplus/Deficit as a % of GDP (FY): Office of Management and Budget. Personal Savings as a % of Disposable Personal Income, Balance on Current Account as a % of GDP (SAAR): Bureau of Economic Analysis. Corporate Profits as % of GDP: Bureau of Economic Analysis.

And our indebtedness relative to the rest of the world limits how long this can continue.

Billions of Dollars



Source: International Monetary Fund/ Haver Analytics.

Investment/Savings Imbalances

- How to re-balance?
 - Depreciating currency, which could result in rising interest rates and financial market instability
 - Increased government or private savings
- Problems with those solutions:
 - We may not like it in the short run
 - Increased govt. savings means less stimulus
 - Weakens recovery in short run
 - Does not yield 1-for-1 decline in trade deficit
 - The rest of the world might not like it
 - Depreciating currency makes *their* goods more expensive
 - If we save more (spend less), the “engine of world growth” slows down—so do they
- Economic logic says deficits can’t grow indefinitely.