The U.S. Economic Outlook

Giovanni Olivei
Vice President and Economist

Federal Reserve Bank of Boston

October 1, 2009
Outline

1. Review of current economic conditions.

2. The outlook in the near and medium term.

1. The economy is emerging from a severe recession, with employment declining less and less rapidly.
1. There is progress in the housing market…
1. … as inventories are now back to more manageable levels and sales are stabilizing.
1. Recent investment data give some reasons for hope …
1. … but commercial real estate is still a serious concern ..
1. … as property values are falling rapidly.
1. Retail sales are showing some improvement …
1. … and so are consumer attitudes …
1. ... as equity markets have responded favorably of late ...
1. … and housing prices have stopped falling.
1. Still, despite the equity rally and the stabilization in housing prices, households’ net worth remains well down.
2. In the near term, activity will be supported by favorable inventory dynamics.
2. The fiscal stimulus is also of significant help …
2. … and without the stimulus the fall in consumption could have been much larger.
2. Some boost to activity may come from pent-up demand for durable goods, but low net worth will be a constraint.
2. There is also pent-up demand for capital goods …
2. … in an environment in which profit margins are still healthy.
2. But the recovery will have to be well in train before firms will start to add significantly to the capital stock.
2. Concerns about the strength of the recovery remain. Credit availability is one potential issue.
2. Another important concern is the elevated level of the unemployment rate.
2. The high rate of unemployment is putting downward pressure on wages.
2. Moreover, older workers when laid off usually have to take a significant pay cut when they find a new job.
2. There is the possibility that households’ balance sheet repair will have to go further.
3. In the longer term, fiscal rebalancing will have to occur.
3. The U.S. external position remains problematic, too. There has been some improvement lately …
3. … but the improvement has come from a decline in investment and not from an increase in savings.
Summary

• The economy is likely to recover slowly.

• Some underlying fundamentals are still challenging.
  – Households’ net worth is way down.
  – Employment growth remains weak.

• The recovery should be gradual, with elevated unemployment for quite some time.

• In the long term, a rebalancing of the U.S. fiscal and external positions is needed.
  – The way in which the rebalancing occurs may have important implications for growth.