

# **THE US ECONOMIC OUTLOOK:**

## **DATA REVISIONS AND ECONOMIC UNCERTAINTY**

Martin Neil Baily

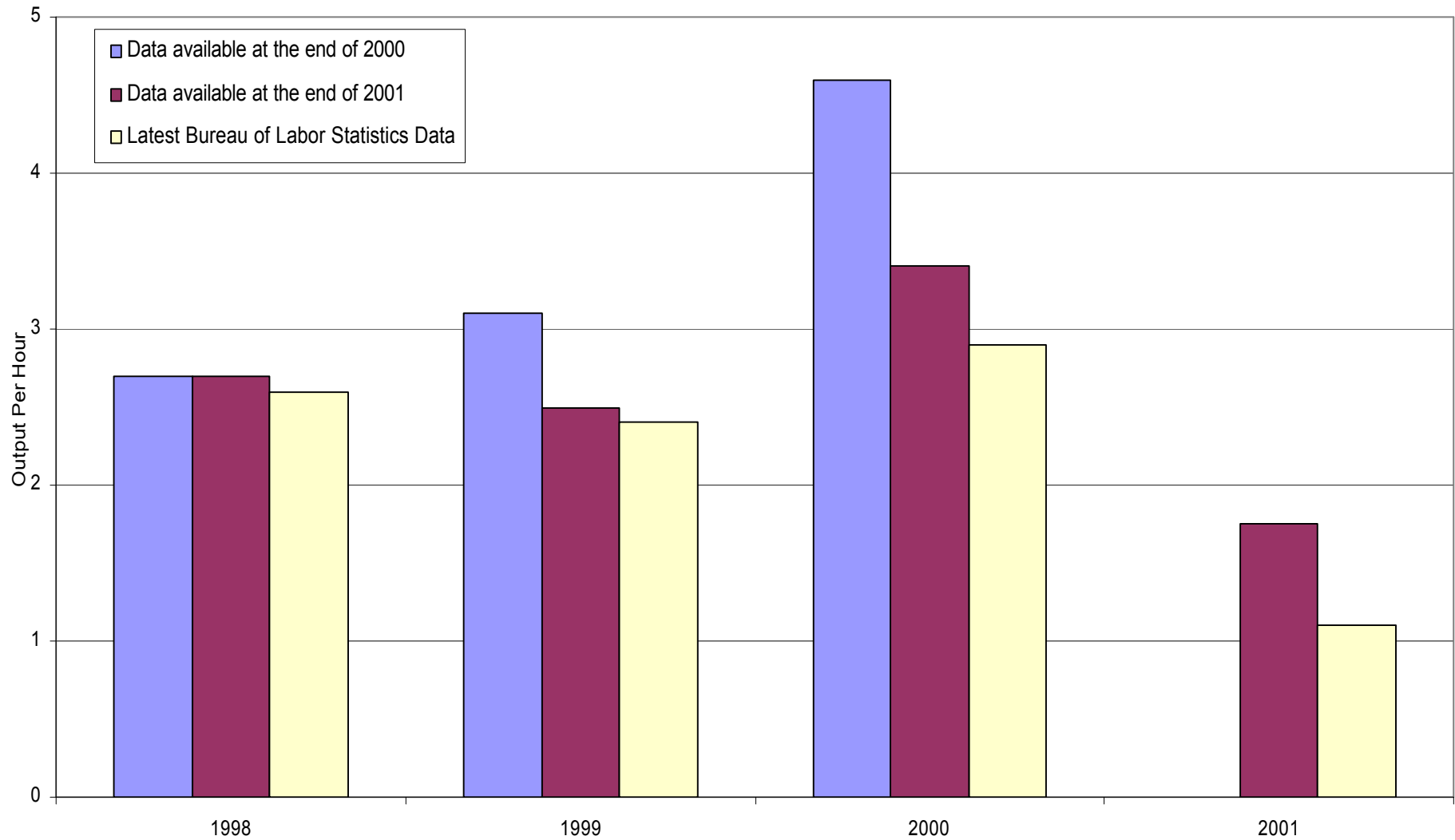
Institute for International Economics

September 18, 2002

# Successive Data Revisions Now Show a Smaller Boom and Deeper Recession than Originally Thought

## Productivity Growth Estimates Have Also Been Lowered

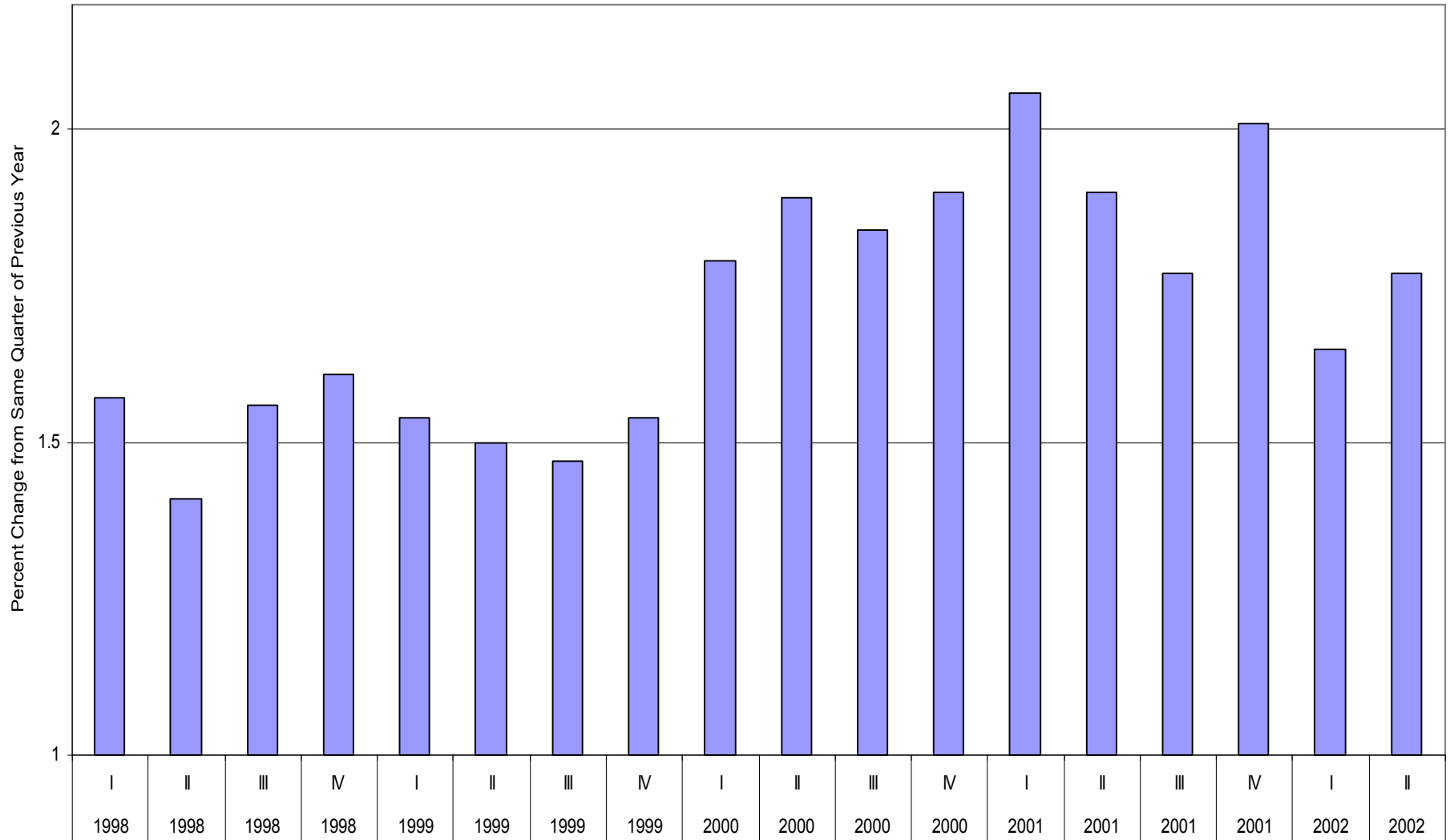
Annual Percentage Change in Output per Hour Nonfarm Business



Source: Economic Report of the President, Bureau of Labor Statistics

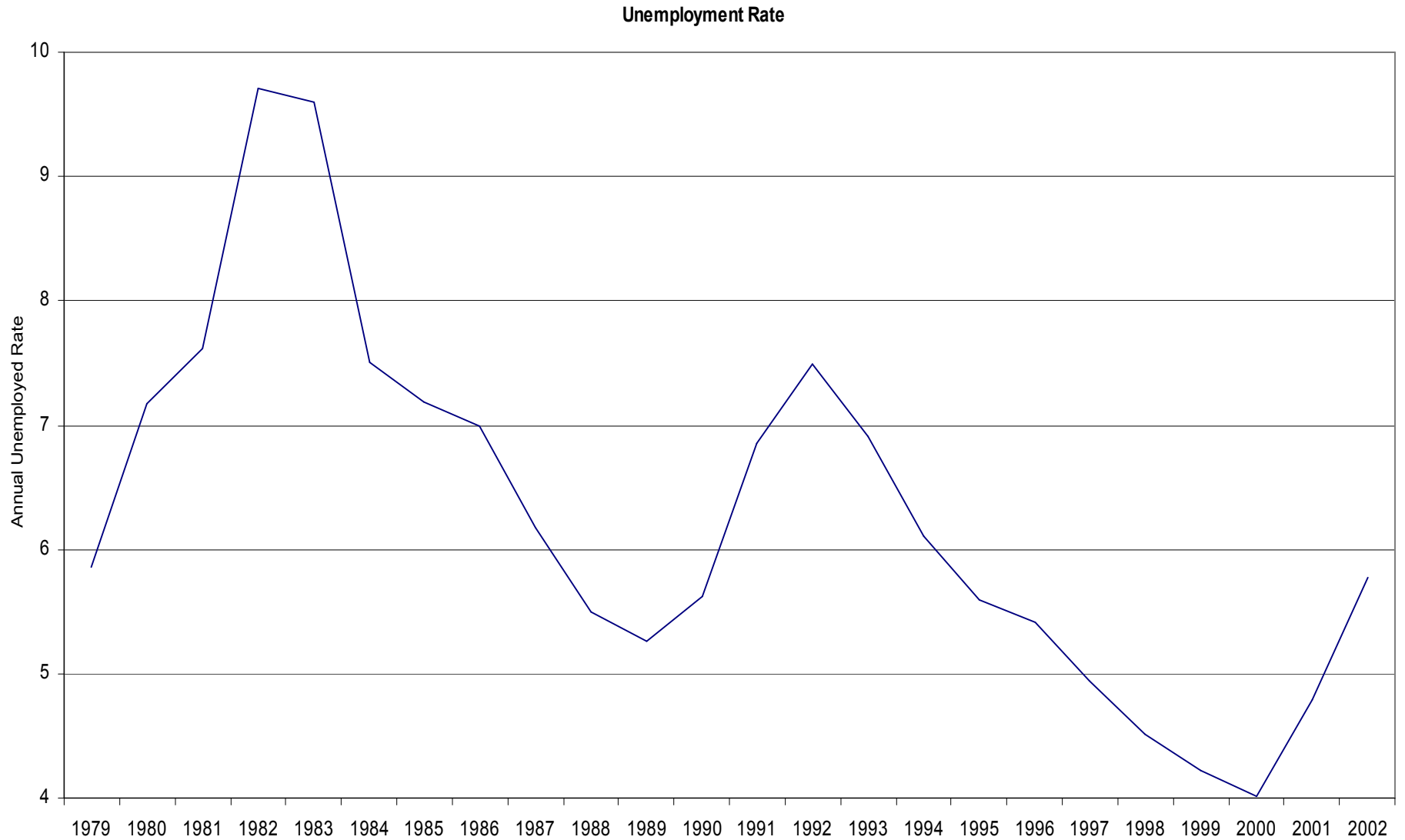
# Nevertheless, the fundamentals still look good: Inflation is low

Seasonally Adjusted Price Index for Personal Consumption Expenditure Excluding Food and Energy



Source: Bureau of Economic Analysis, [www.bea.gov](http://www.bea.gov), Table 7.4.

# Unemployment remains moderate by historical standards



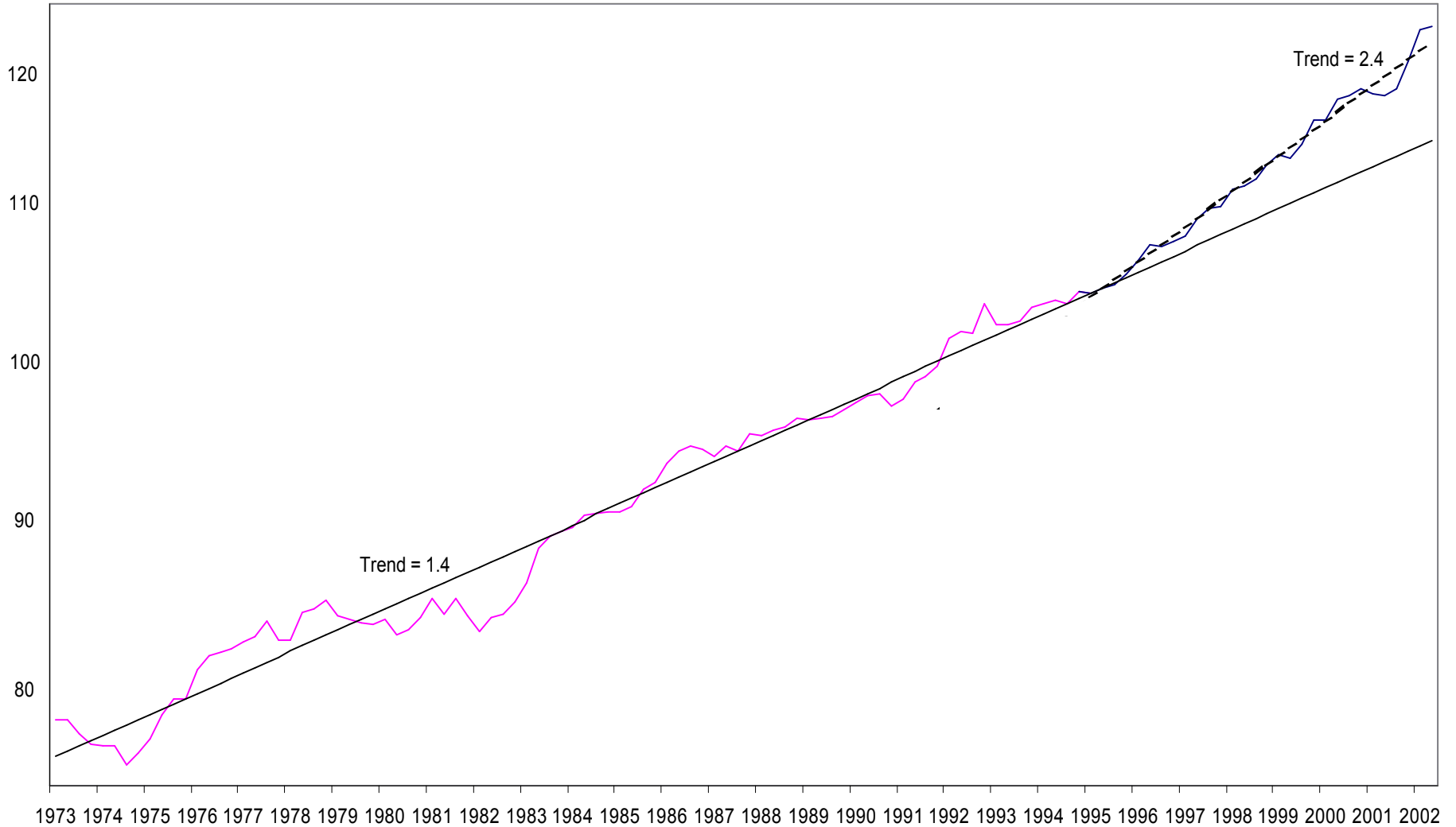
Source: Bureau of Labor Statistics

Note: Data for 2002 January through July only

# The Productivity Acceleration Remains Important

Index 1992 = 100

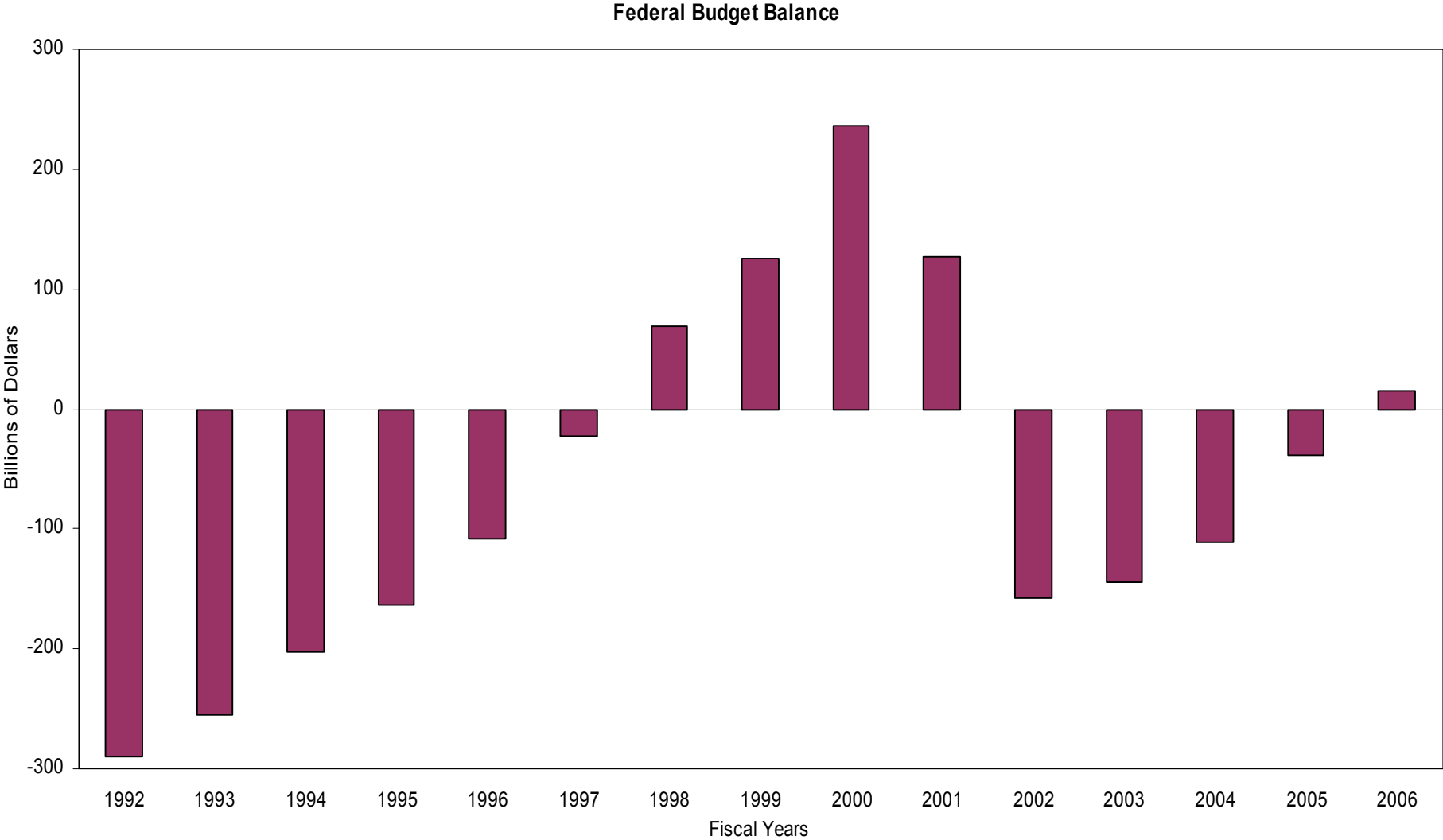
Nonfarm Business Productivity



Source: Bureau of Labor Statistics. Index on logarithmic scale.

**Current Productivity Trend Suggests Potential GDP Growth of 3 to 3.5 percent a year.**

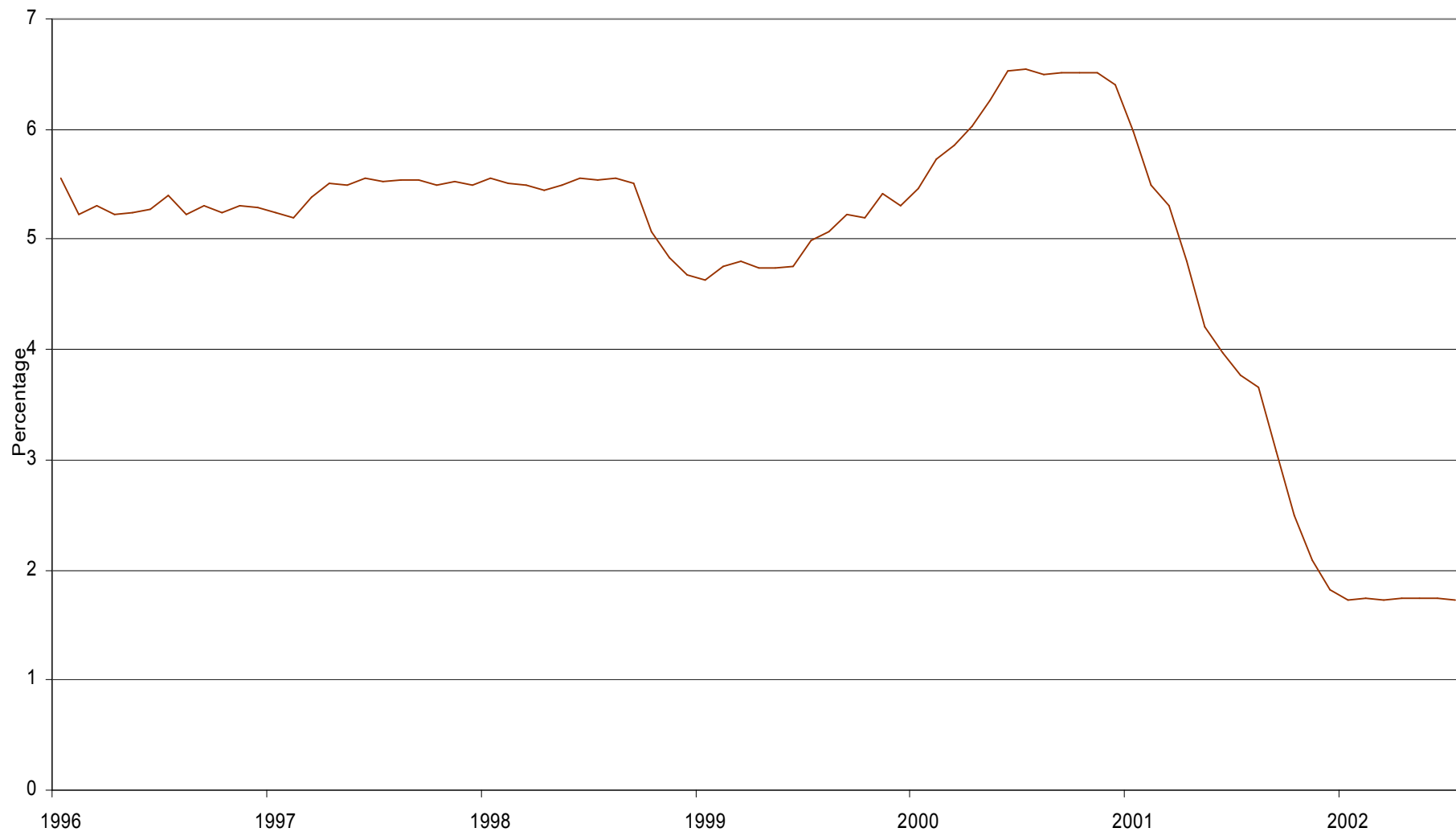
# Budget Deficits are Sustaining Demand Now: But the threat of future deficits could raise long interest rates



Source: Congressional Budget Office. Projections released August 27, 2002. They exclude proposed tax cuts and spending increases.

# Monetary Policy Remains Expansionary too

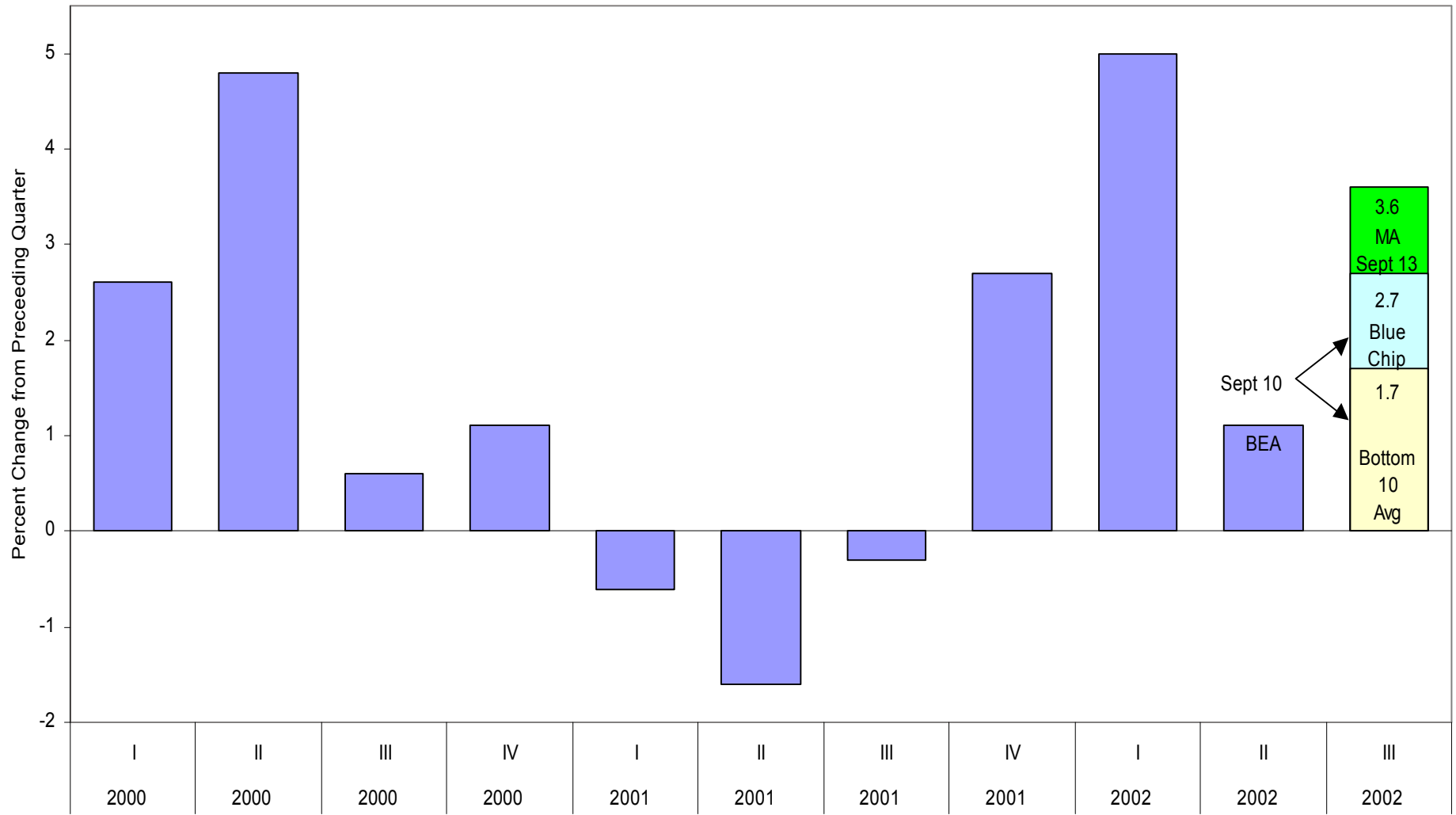
Federal Funds Rate



Source: Federal Reserve

# The Economy Bounced Back From Recession: But the strength of the recovery is uncertain

Seasonally Adjusted GDP Growth

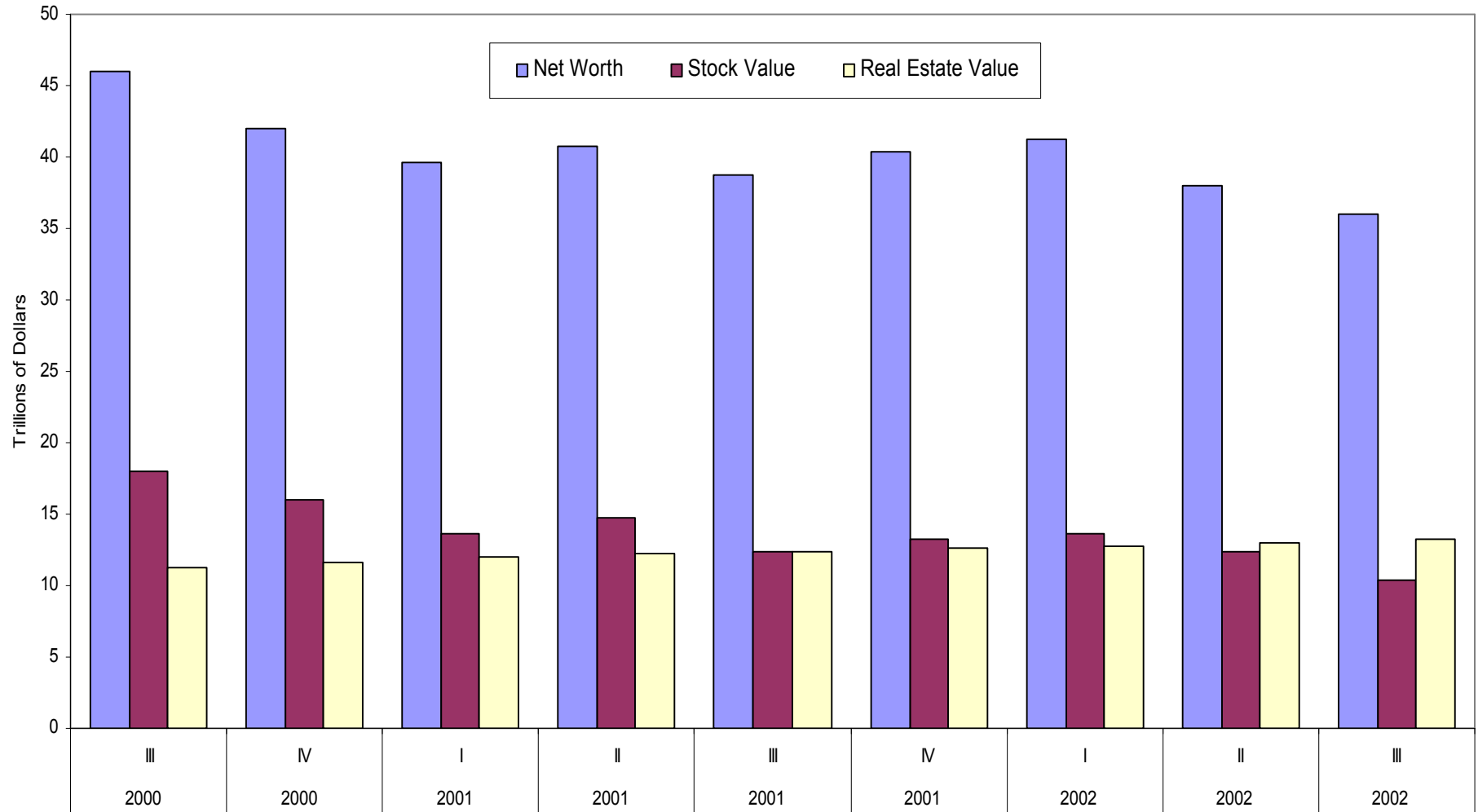


Source: Bureau of Economic Analysis, Macroeconomic Advisers, Blue Chip Indicators



# The Main Reason for Mid-Year Weakness Was the Soft Equity Market

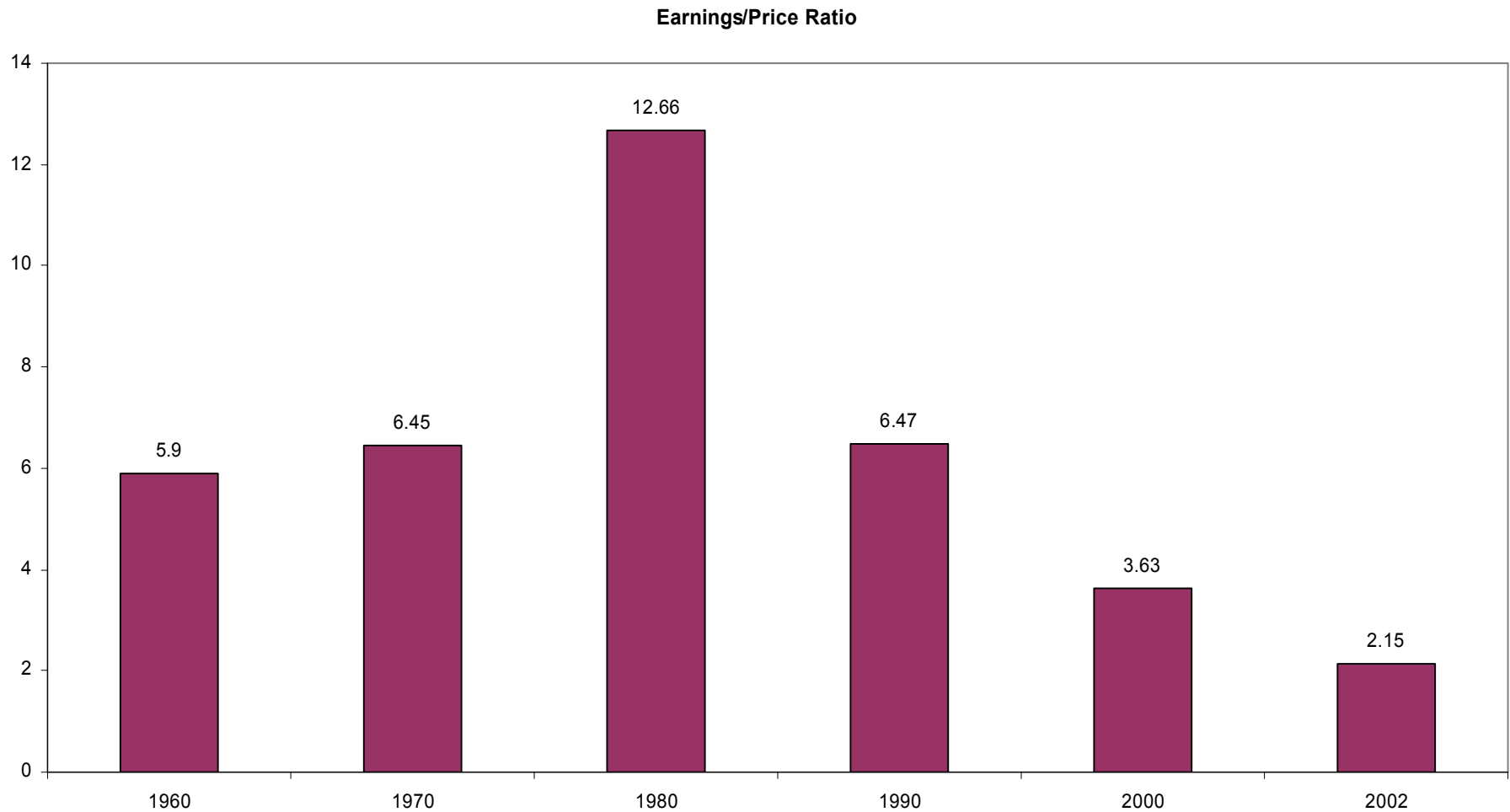
Household Net Worth, Stock Value, and Real Estate Value



Source: Federal Reserve, New York Times Analysis

# Why Did the Equity Market Decline?

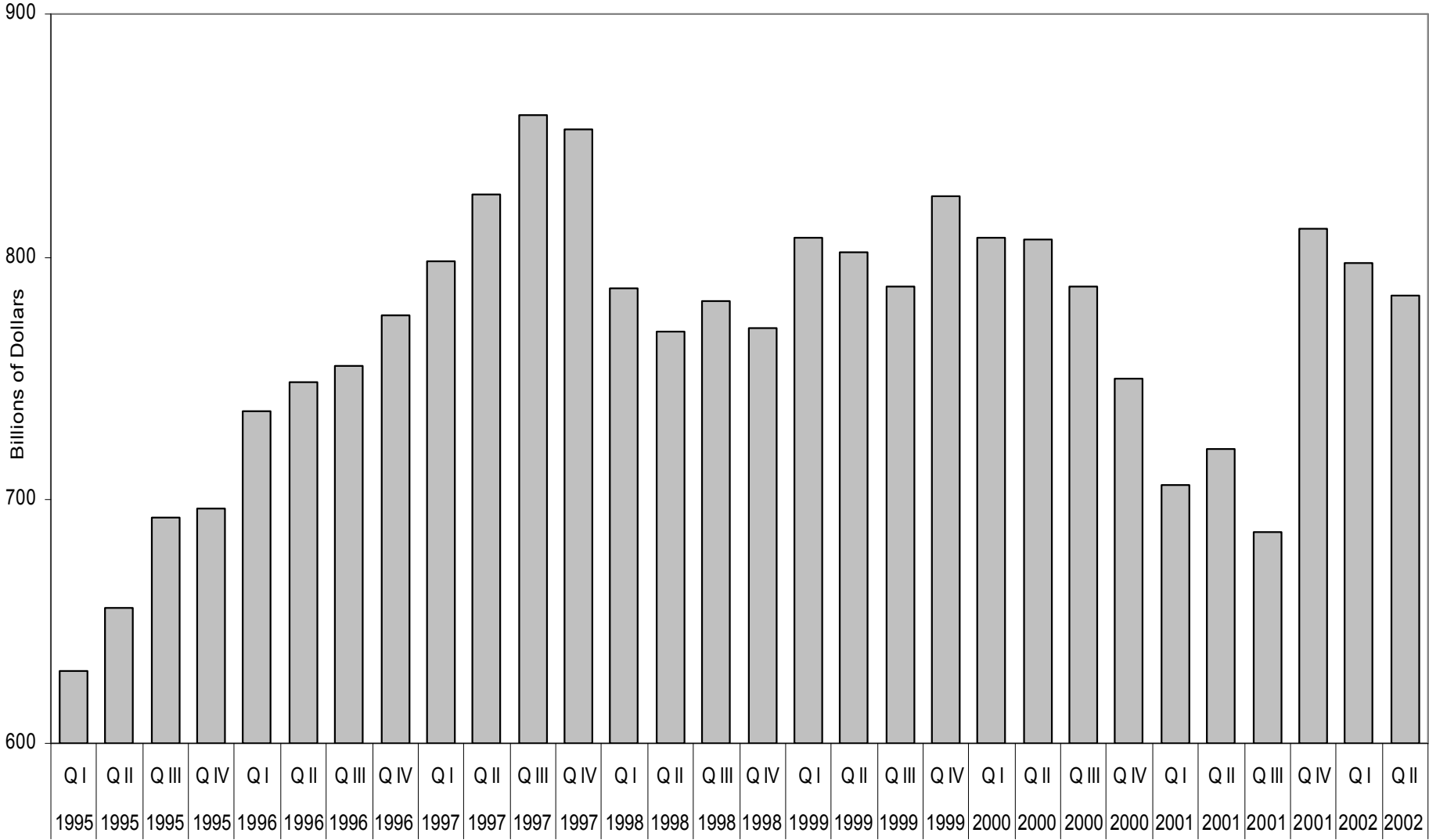
The Economic Downturn and Phony Accounting Caused a Reality Check in a Market That Went from Undervalued in 1980 to Overvalued in 2000



Source: Standard and Poor's 500

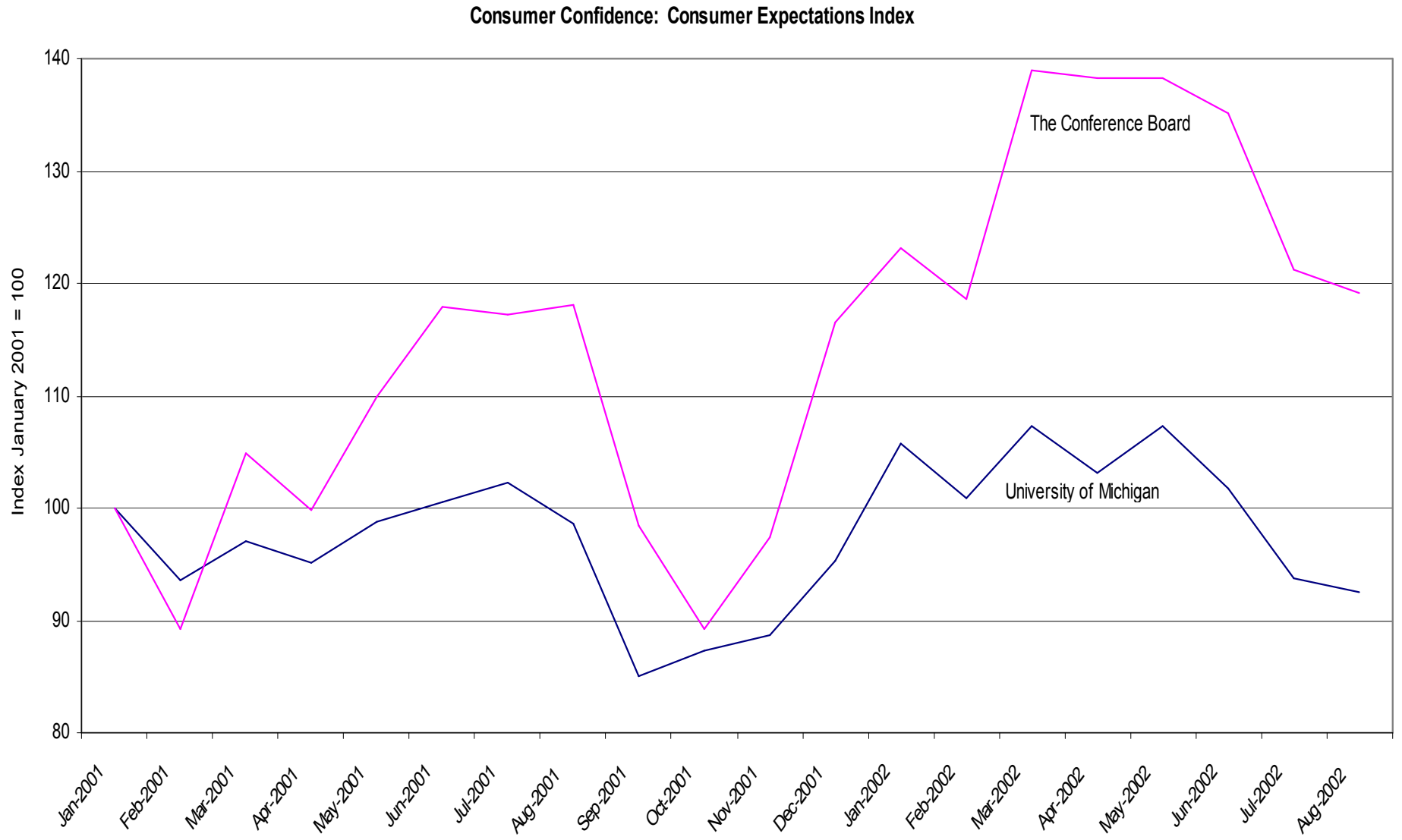
# Corporate Profits Look Disappointing: Revised NIPA Data

Corporate Profits with Inventory Valuation and Capital Consumption Adjustments



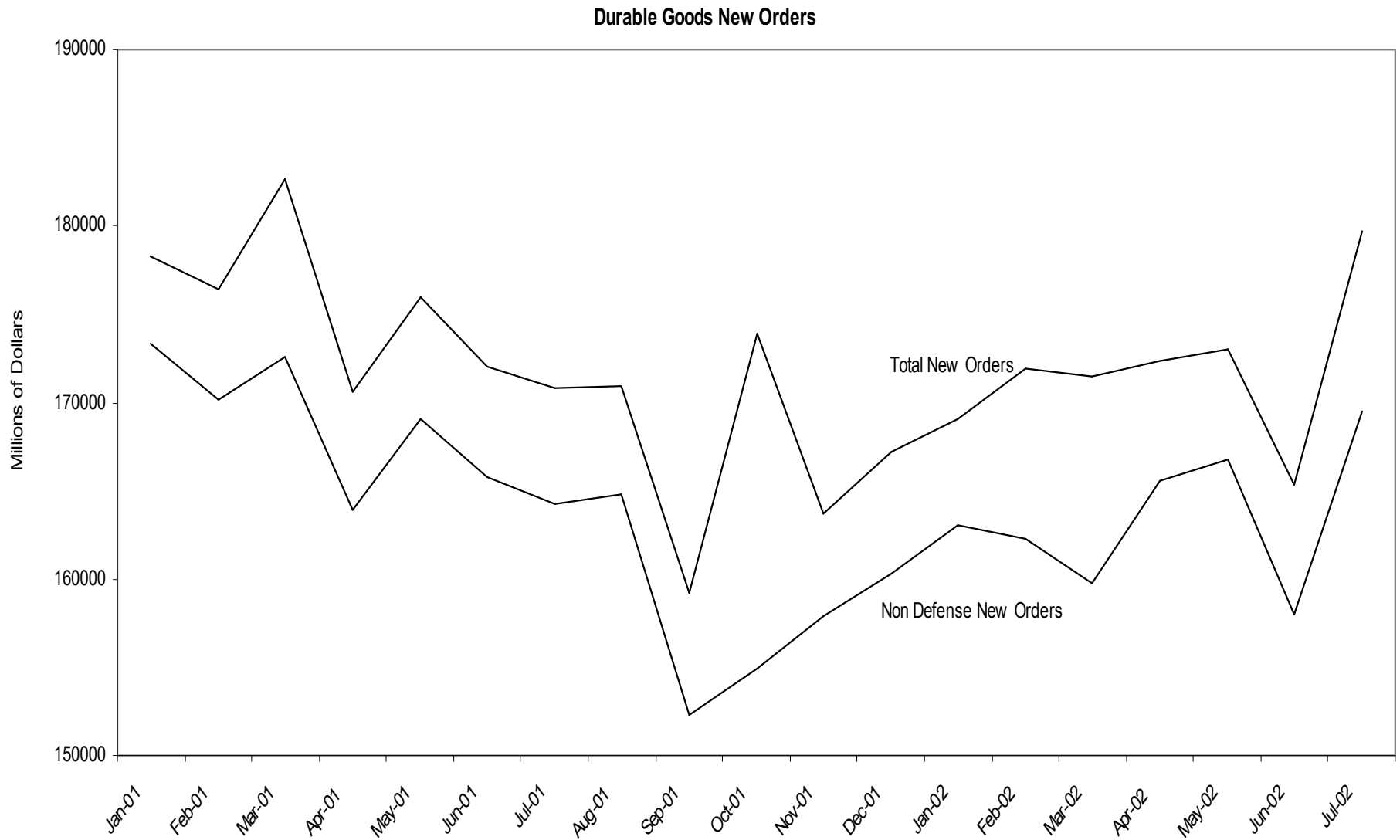
Source: Bureau of Economic Analysis, [www.bea.gov](http://www.bea.gov), Table 6.16c.

# The Economy is Currently Giving Mixed Signals: Consumer Confidence is Falling Again



Source: University of Michigan, The Conference Board

# But New Orders are Up, Suggesting a Recovery in Investment

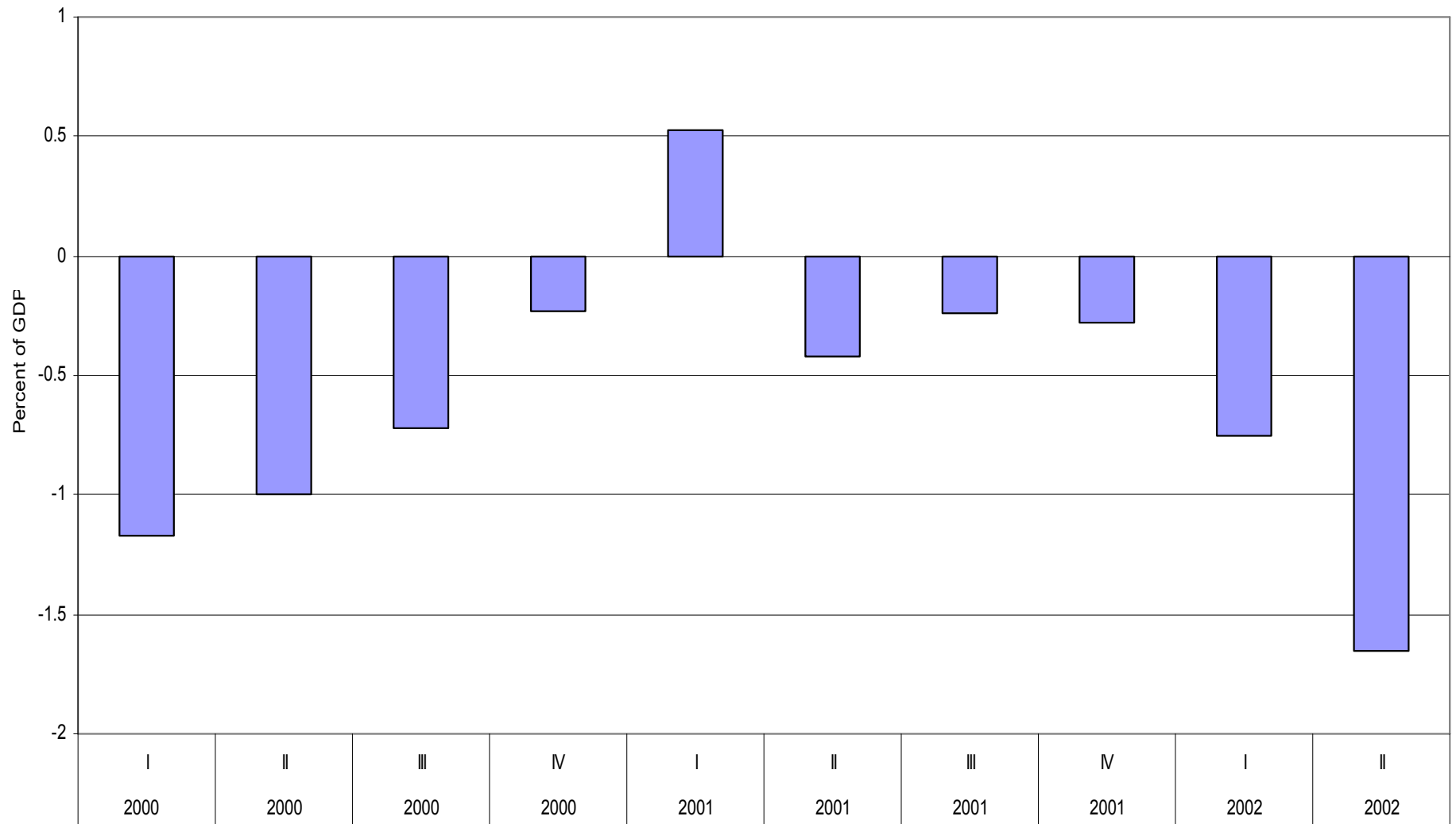


Source: US Census Bureau. Manufacturing, Mining, and Construction Statistics

Note: Seasonally Adjusted

**Foreign trade usually mitigates slumps and helps recoveries. But in this recovery, a strong dollar and a weak world economy are dragging down US growth.**

Contribution of Net Exports to GDP Growth



Source: Bureau of Economic Analysis, [www.bea.gov](http://www.bea.gov), Table S.2.

**The current consensus is for 2.5 to 3 percent growth in the second half of 2002 and around 3.5 percent in 2003, based on several positive factors:**

- Autos and housing remain strong**
- Stock market may be coming back**
- Equipment investment and industrial production are rising**
- Policy is expansionary**
- Inflation is low**
- Productivity growth remains good with the trend at 2% to 2.5%**

## **But this is a time of political and economic uncertainty**

- **War with Iraq now seems probable**

- **will boost federal spending over the next 12 months - from \$50 billion (Pentagon estimate) to \$100-200 billion (Lawrence Lindsay). This could help recovery.**

- **a short successful war is unlikely to boost oil prices much beyond current levels around \$30, up from around \$20 last year.**

- **a wider or longer conflict could result in much higher prices (up to \$100). Verleger estimates this as a 5% probability.**

- **each \$10 increase in the price of oil costs US consumers \$120 billion and hurts oil consuming industries (4% profit decline)**

- **Strategic petroleum reserve will very likely be used if prices go up from current levels**



## **Other economic uncertainties include:**

- Overall business spending is still weak – office vacancy rates are high.**
- Renewed weakness in the stock market, consumer spending or business spending could produce mutually reinforcing downward pressure on the economy.**
- In the short run, strong productivity means weak employment growth. Unemployment may rise again.**
- Sustained weakness in the Rest of the World, together with a still strong dollar, may be a drag on US Growth.**

**On balance, the chances of a “double-dip” are roughly twenty percent. The chances of a recovery that is significantly weaker than the consensus is 30 to 40 percent.**