

THE US ECONOMIC OUTLOOK

US economy has been growing strongly
but will slow (perhaps sharply).

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Growth Prospects

- Growth had been expected to accelerate in the second half of 2005. Katrina will cut growth in this period to around 3.5 percent.
- Katrina effects will dissipate or reverse by 2006.
- But Fed tightening, weakness in housing, plus high energy prices, will slow growth to around 2.5 percent in 2006.

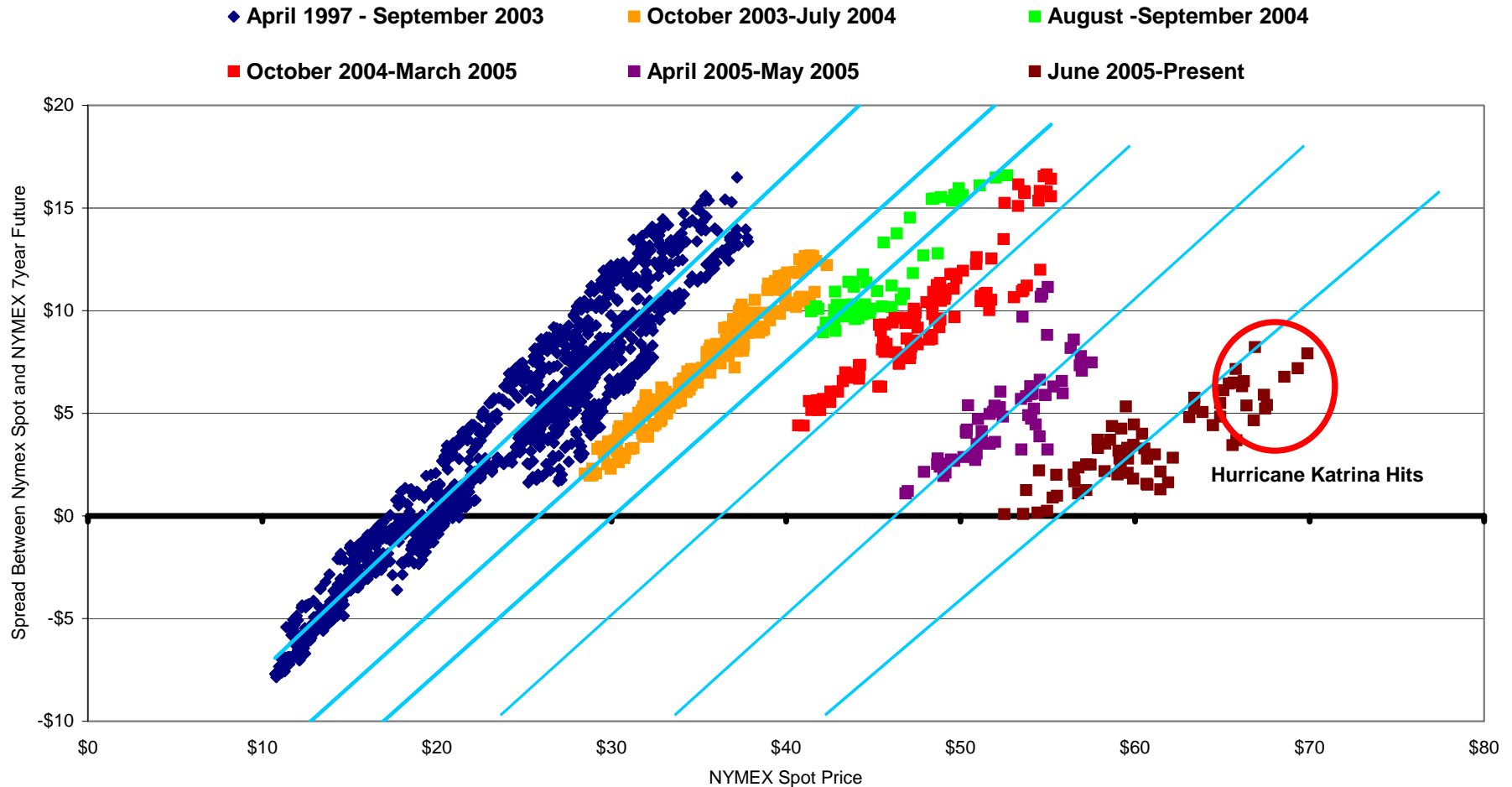
Katrina Effects on the Economy

- Louisiana and Mississippi produce about 2 percent of US GDP. About an eighth of this could be lost for three months.
- Employment effects look to be 200–300 thousand in the short term.
- Privately insured losses are estimated at about \$40–\$60 billion. Federal flood insurance will be additional.
- Congress has approved \$60 billion in emergency assistance with outlays occurring in FY2006.
- Overall, Katrina will reduce GDP growth by about 0.4 percent in the second half of 2005.

Katrina Effects on Energy

- High uncertainty: Daniel Yergin suggests Katrina may be the biggest shock ever to oil supply. Phil Verleger foresees gas lines and severe economic impacts.
- On oil: The biggest immediate problem is refining capacity, not crude. Katrina has knocked out 8 refineries, 10 percent of capacity. About half should be back quickly, the remainder may take several months.
- However, there has been a fall in gasoline consumption—5 percent—high prices are “working” (EIA estimates).
- With energy markets already tight, Katrina is likely to mean high gasoline and heating costs persist into the winter—\$2–3 per gallon of gas and natural gas prices at around \$12 mm btu.
- Over a 5-year or longer horizon, oil prices will fall back to the \$30–40 range.

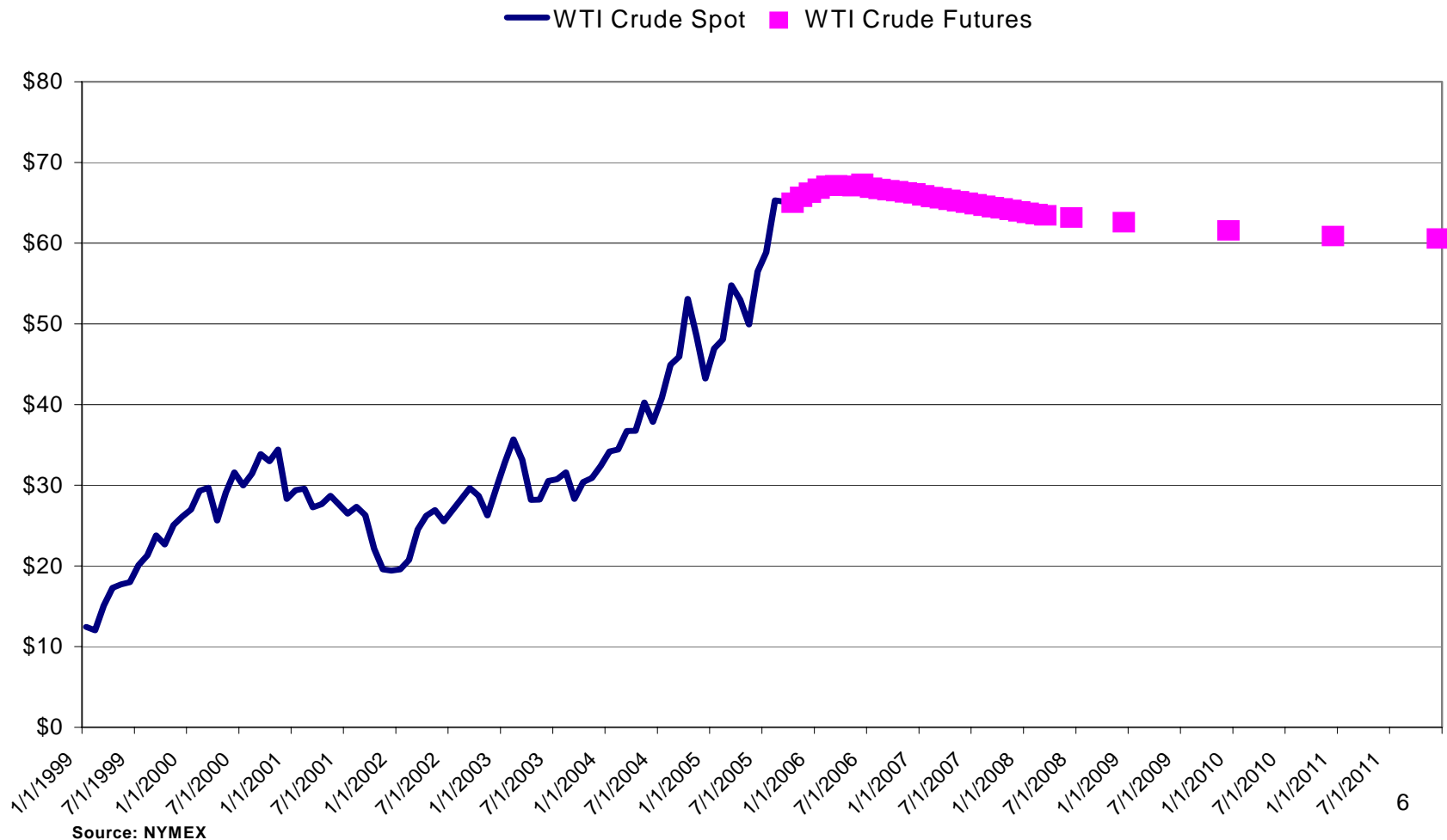
Oil: In the Past, High Spot Prices Did Not Pull Up Futures Prices; A Different Situation Today.



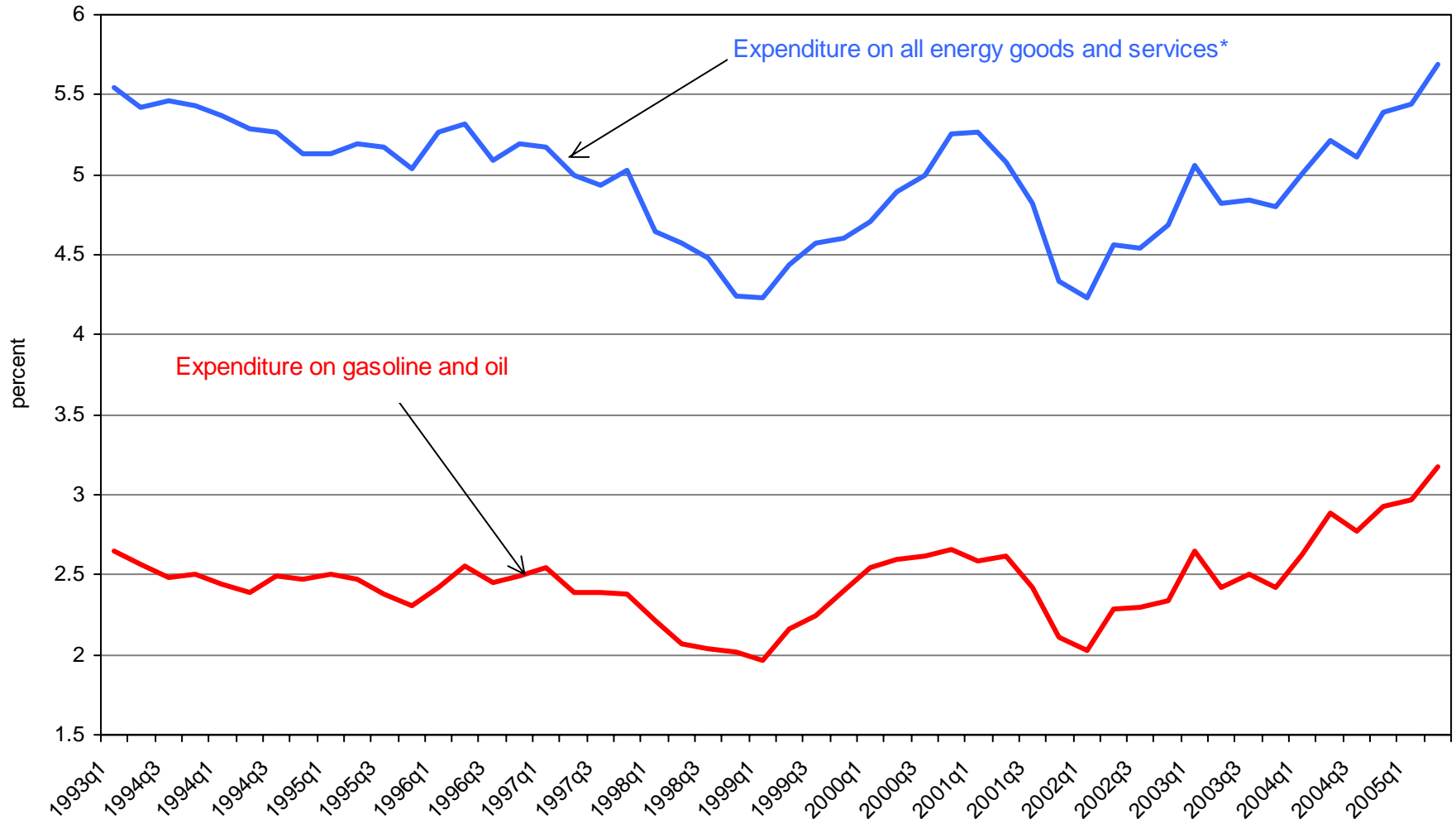
Source: NYMEX

Oil: Futures Prices are Very High Indeed—Too High in the Long Run

WTI Crude Oil Prices and Futures 1999-2011



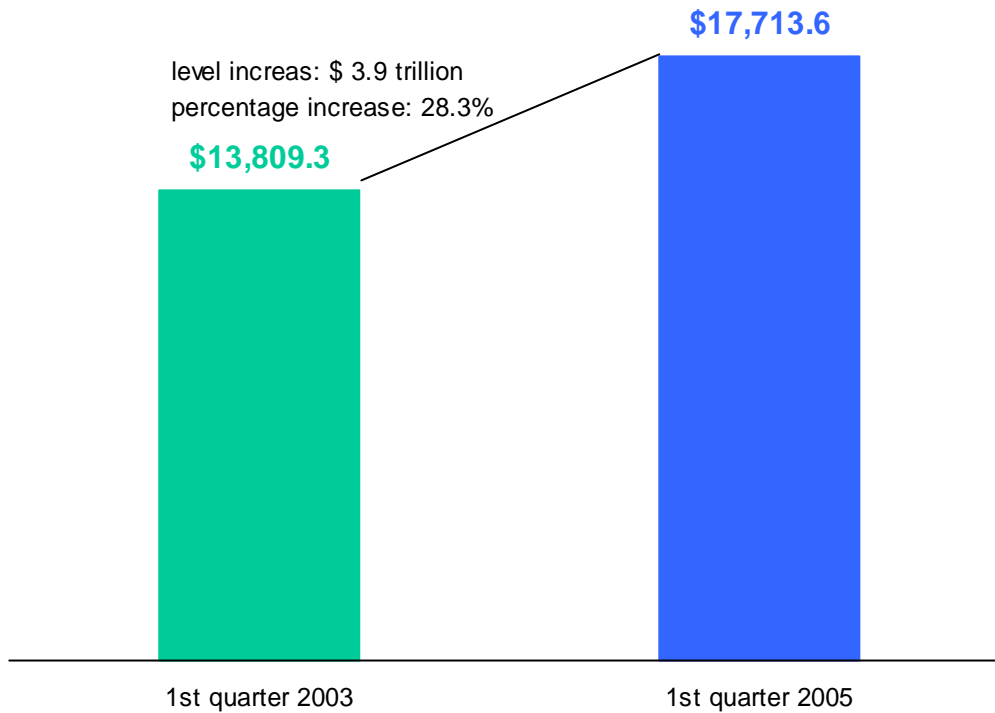
Expenditure on Energy as a Share of Total Personal Consumption Expenditure



Source: Bureau of Economic Analysis, NIPA Tables. *Consists of gasoline, fuel oil, and other energy goods and of electricity.

Housing: The Impact of Housing Wealth on Consumption

Value of households' owner-occupied housing (\$ billions)



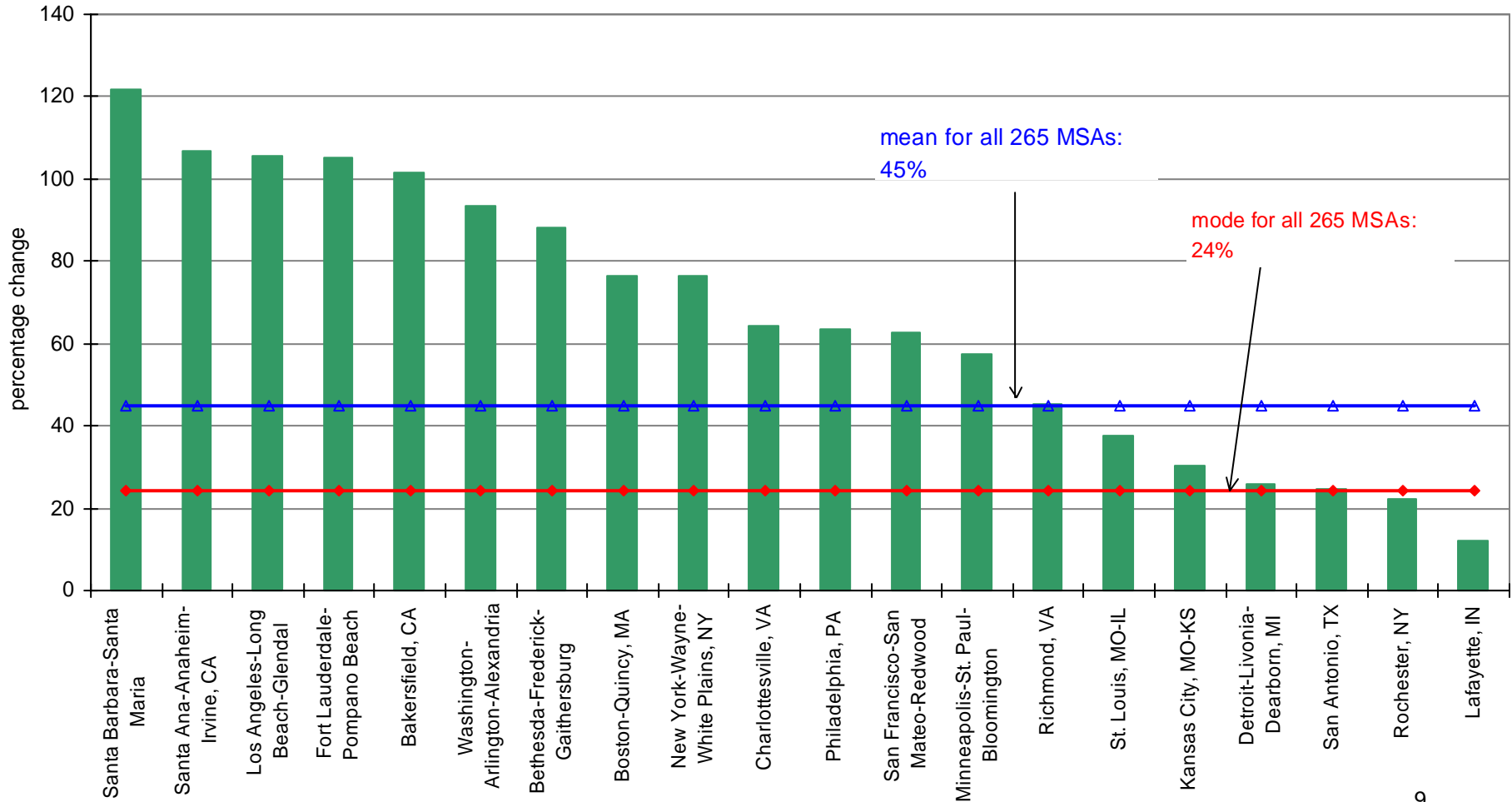
Change in wealth
multiplied by 0.05

= \$200 billion in
additional consumption

= 2.3 percent of
personal consumption
expenditures

House Prices Have Risen Sharply—Possible Bubble in some Regions

5-year percentage increase in house prices in selected metropolitan statistical areas (MSAs)



Source: Office of Federal Housing Enterprise Oversight.

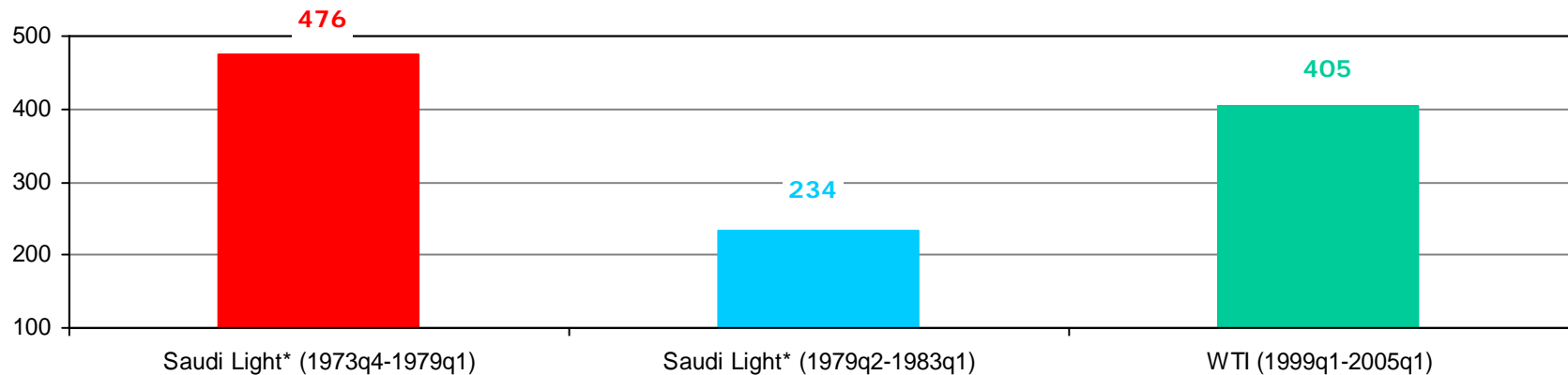
Bubble or Not, House Prices will Soften

- Real housing prices fell after the 1970s boom and after the 1980s boom.
- Prices today have moved way above trend.
- House price increases are outpacing income growth.
- Nominal price declines are likely in some regions. A large drop in overall housing wealth is unlikely.

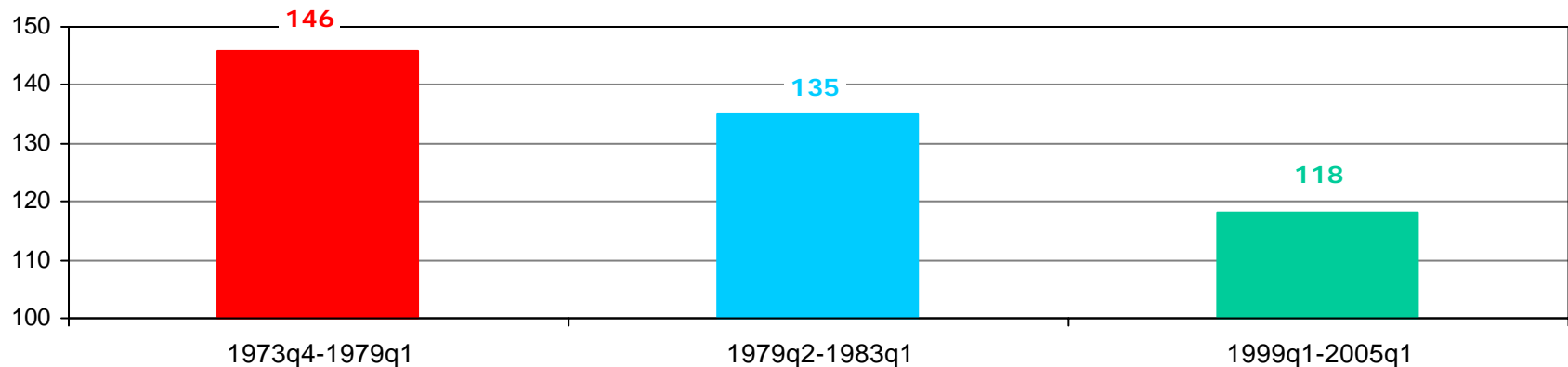
Inflation Concerns are Affecting Fed Policy

So Far the Inflation Impact of Oil Prices Has Been Moderate

Crude Oil Price, index number equal to 100 prior to shock



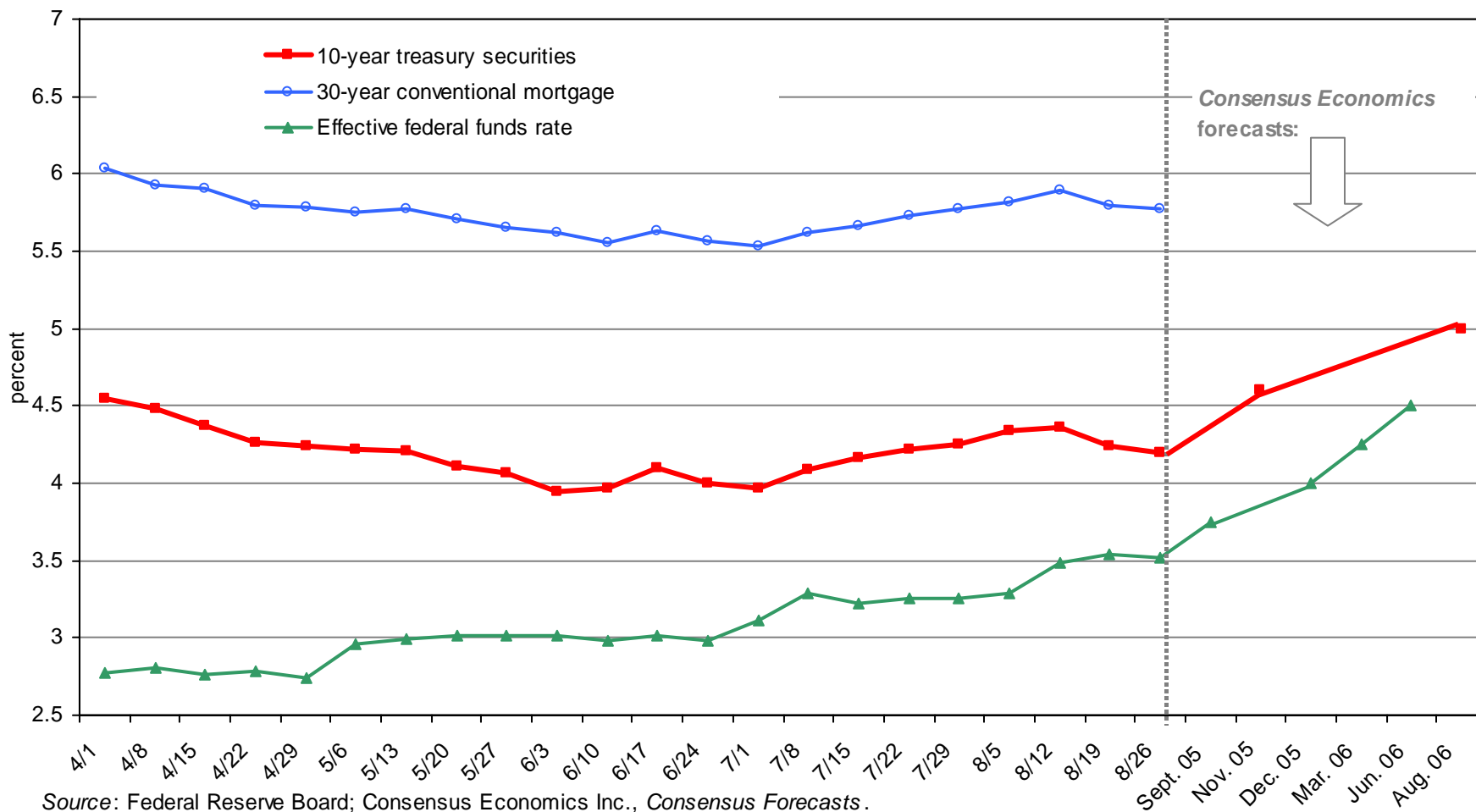
US Consumer Price Index, index number equal to 100 prior to shock



Source: [Oil Economists' Handbook](#) (5th ed., Vol.1); Datastream; OECD Main Economic Indicators.

*Note: Saudi Light – Official Government Prices.

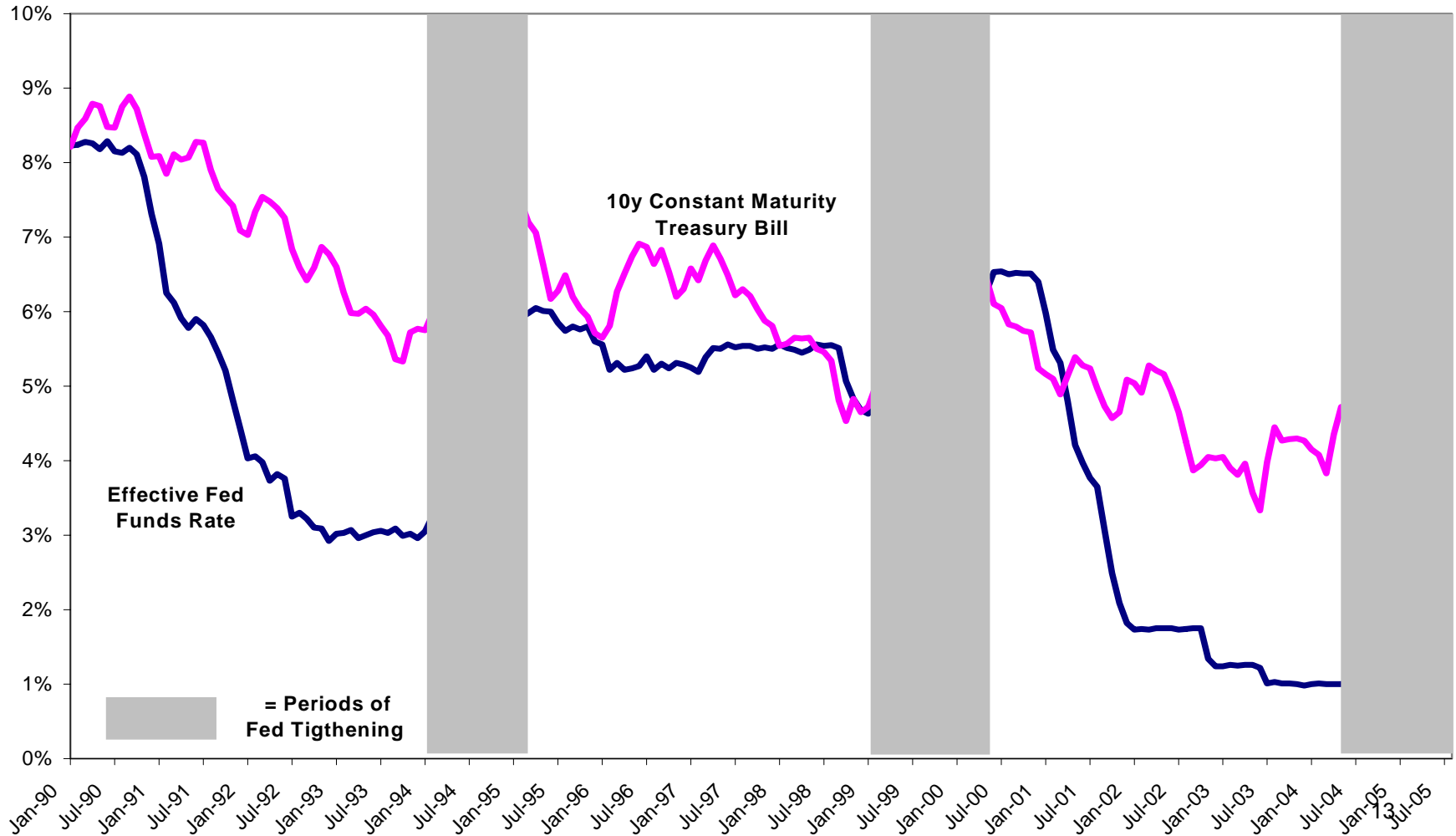
Fed Tightening: Long Rates Have Remained Low but Are Expected to Rise



Source: Federal Reserve Board; Consensus Economics Inc., *Consensus Forecasts*.

If the Fed Keeps Tightening, Long Rates will Rise. Short Rates Affect Demand Independently of Long Rates

US Short- and Long-term Interest Rates 1990-August 2005



Source: Federal Reserve

Summary and Conclusion

Why the US economy will slow down:

- Energy prices going through the roof
- Fed tightening and inflation worries
- Softer housing market
- Not much help from international trade

Why there should not be a recession:

- Long rates remain low. Fed will ease if growth falters seriously. Inflation effects are moderate so far.
- Strong momentum with low unemployment
- Housing collapse unlikely
- Federal spending on Iraq and hurricane relief