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*The U.S. Economy
Does the Recovery Have Legs?*

Prepared for:

Federation of Tax Administrators
Revenue Estimation and Tax Research Conference
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Why Was the Recession So Mild?

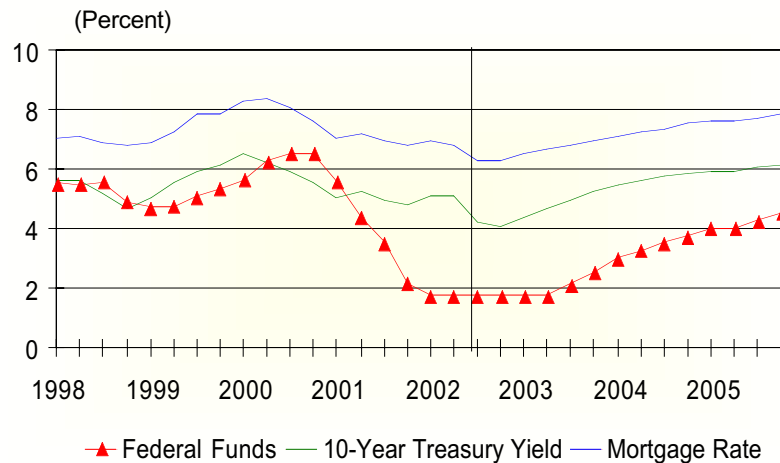
- ◆ Consumers, aided by tax cuts and aggressive price discounting, kept spending.
- ◆ Monetary and fiscal policy turned highly stimulative.
- ◆ The housing market remained buoyant.
- ◆ Productivity growth held up.
- ◆ We exported some of the high-tech bust, mostly to Asia.



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The Federal Reserve Will Delay Interest Rate Hikes to the Summer of 2003

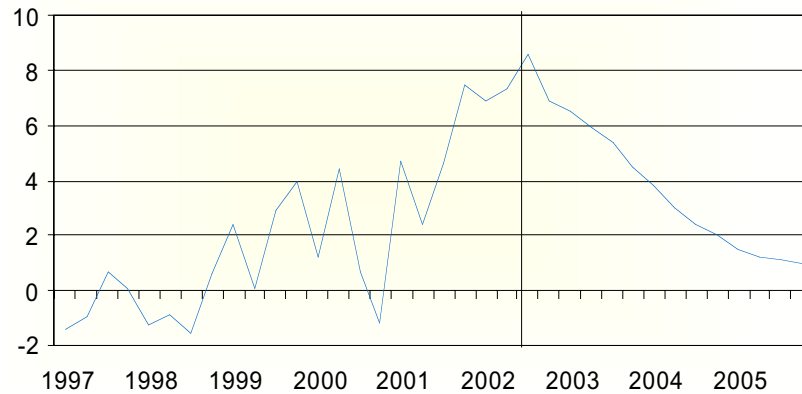


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Real Federal Spending on Goods and Services Surged After September 11

(Year-over-year percent change)



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Why Is the Recovery So Anemic?

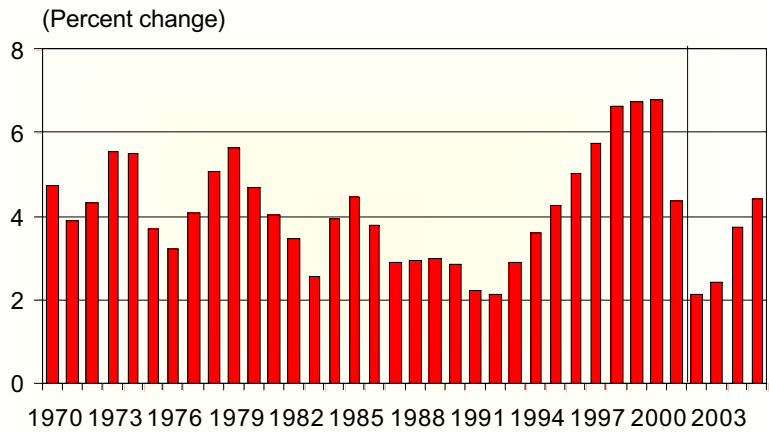
- ◆ **Excess capacity abounds.**
 - ➔ Pricing power is nil.
 - ➔ Flat top lines lead to aggressive cost-cutting.
- ◆ **Growth is even weaker outside the U.S.**
 - ➔ Poor economic policies prevail.
 - ➔ Worse growth elsewhere keeps the dollar strong.
- ◆ **State and local governments are cutting back.**



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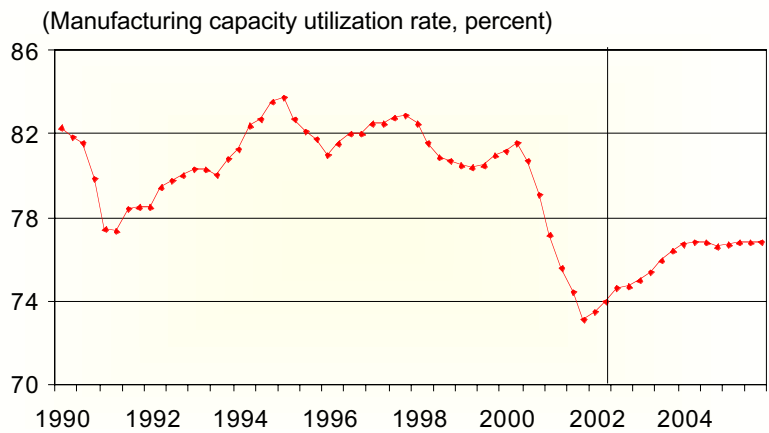
The Capital Stock Surged in the Boom Years



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Factories Could Produce a Lot More

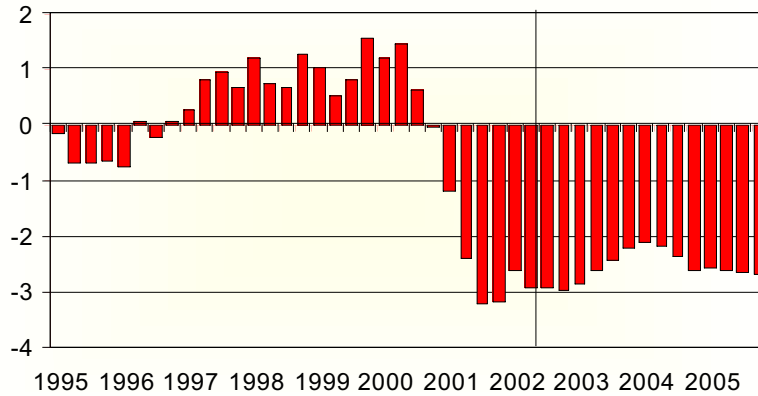


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So Could Most of the Rest of the Economy

(Actual less potential real GDP as a percent of potential)

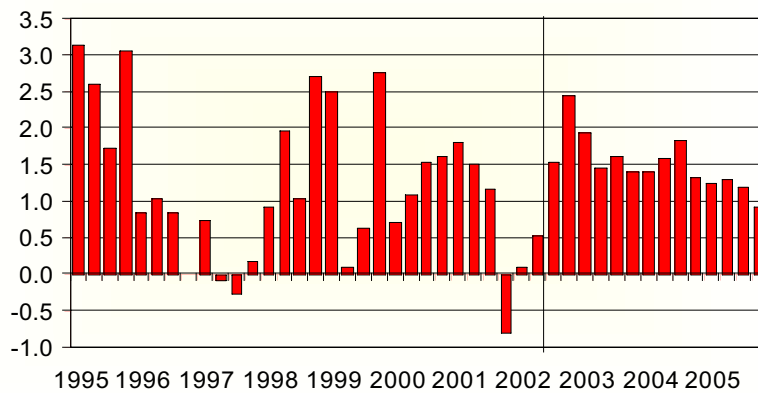


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Inflation Is Not a Worry, But Neither Is Deflation

(Producer prices for finished goods less food and energy, percent change, annual rate)

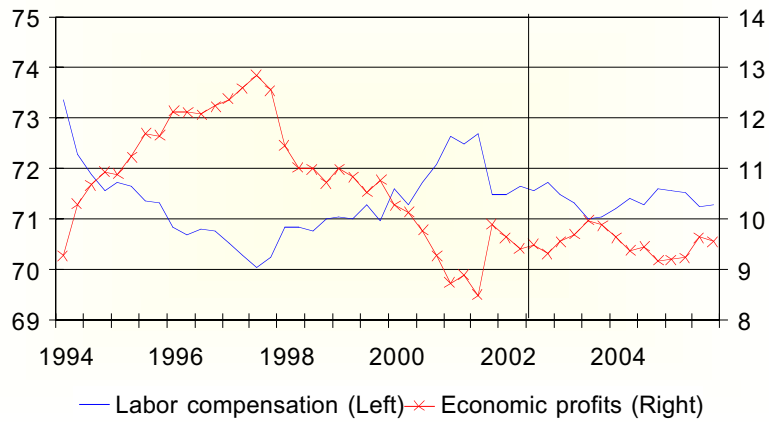


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Corporate Profits Had a Five-Year Slump

(Percent of national income)

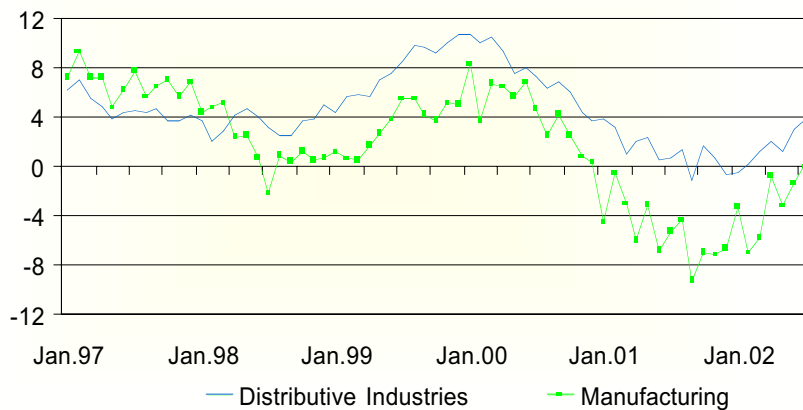


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Sales Are Beginning to Improve

(Sales, percent change from a year earlier)

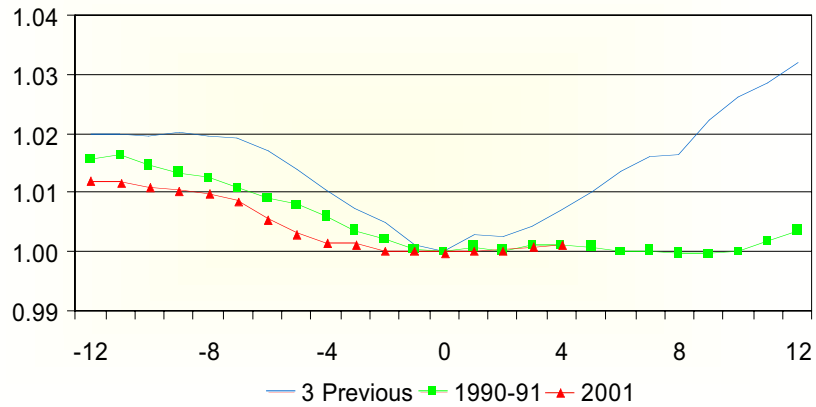


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Another “Jobless” Recovery

(Payroll employment indexed to employment trough)

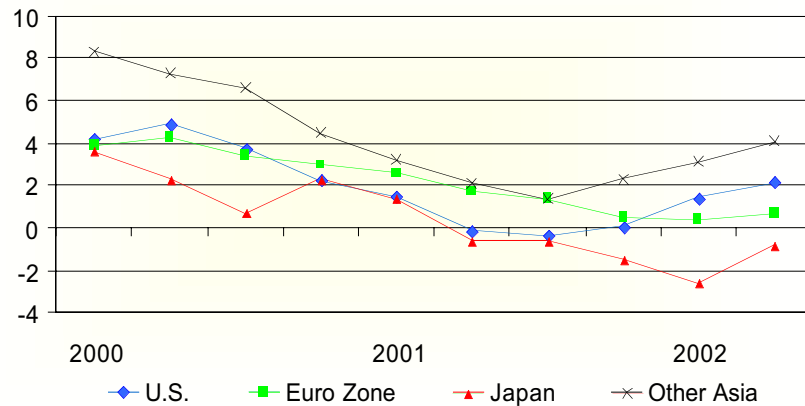


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The Situation Is Not Much Better Elsewhere

(Real GDP growth, percent change from a year earlier)

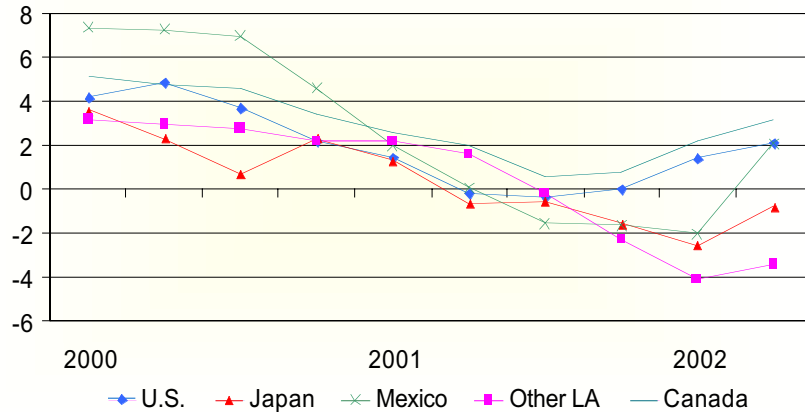


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The Situation Is Not Much Better Elsewhere

(Real GDP growth, percent change, annual rate)

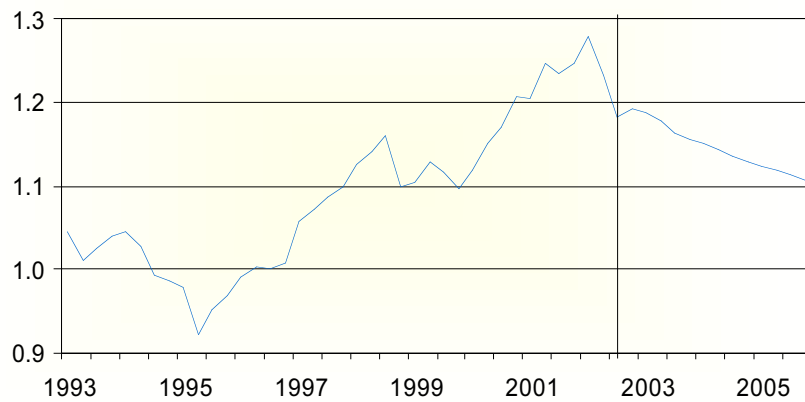


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The Dollar Has Weakened, But Not Enough

(Trade-weighted dollar exchange rate, industrial countries)

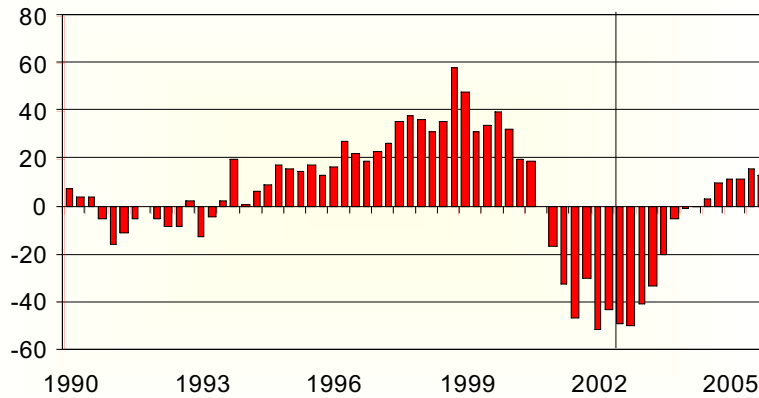


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State & Local Government Budgets Are In Dire Shape

(State and local operating surplus, billions of dollars)



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Threats from the Consumer

- ◆ Consumers are over-extended.
- ◆ Foreclosures are on the rise.
- ◆ Credit card delinquencies are at a record high.
- ◆ House prices have outpaced incomes.
- ◆ Retirement portfolios have been savaged.
- ◆ Consumers are consuming their homes.

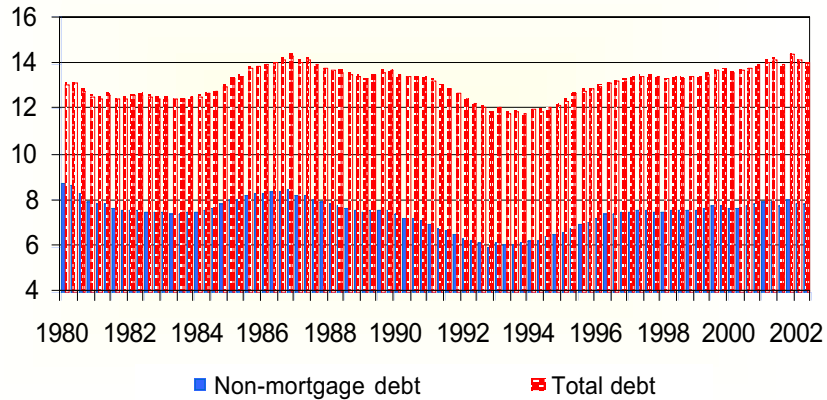


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Debt Service Claims a Record Share of Income

(Interest and principal as a percent of disposable income)

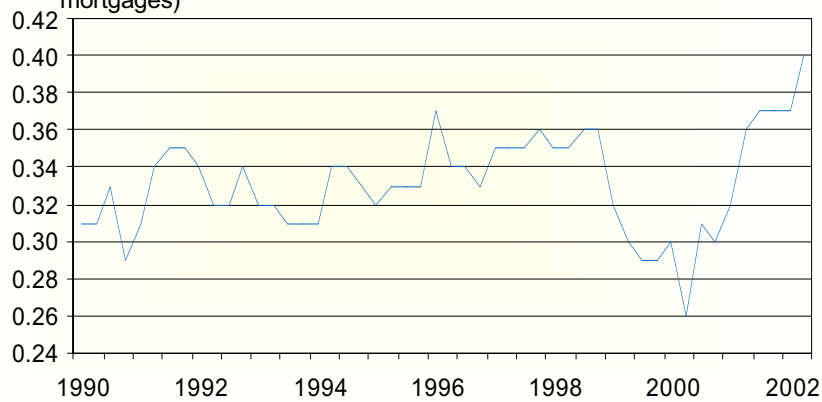


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Trouble Ahead? Foreclosures Are At a Record High

(Foreclosures started during quarter, percent of outstanding mortgages)

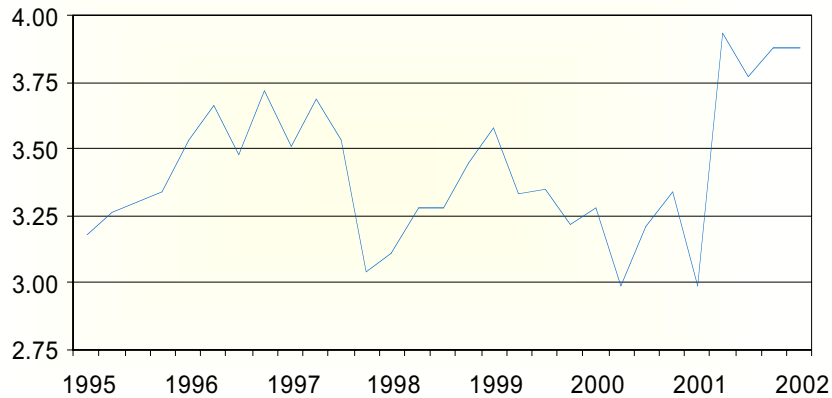


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Credit Card Delinquencies Soar

(Credit card accounts past due 30 days or more, percent of total)

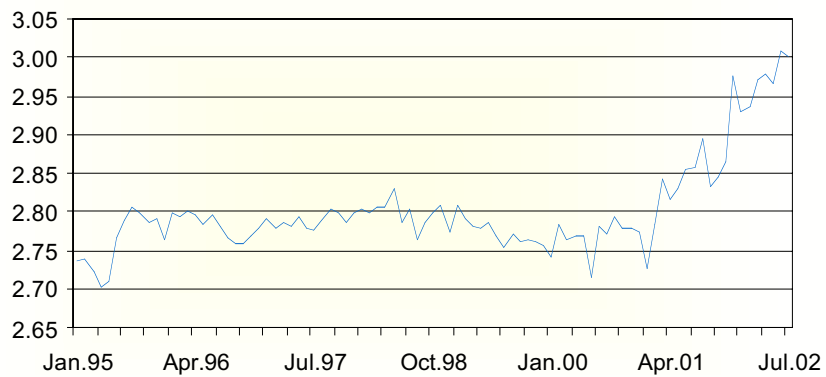


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Is There a Housing Bubble?

(Ratio of median price of existing home to median family income)

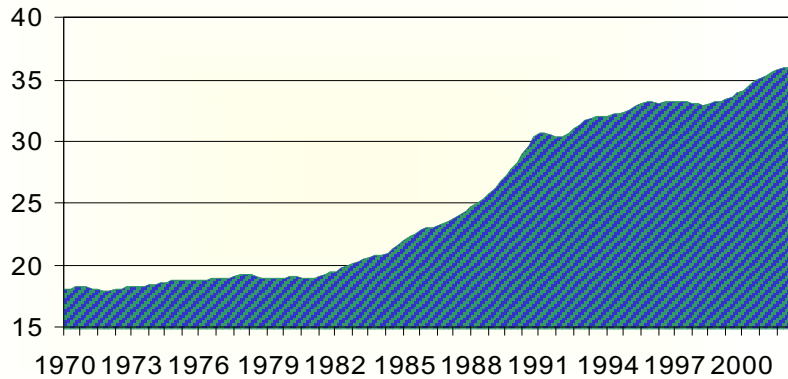


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Homeowners Have Less and Less Equity in Their Houses

(Home mortgage debt as a percent of market value)

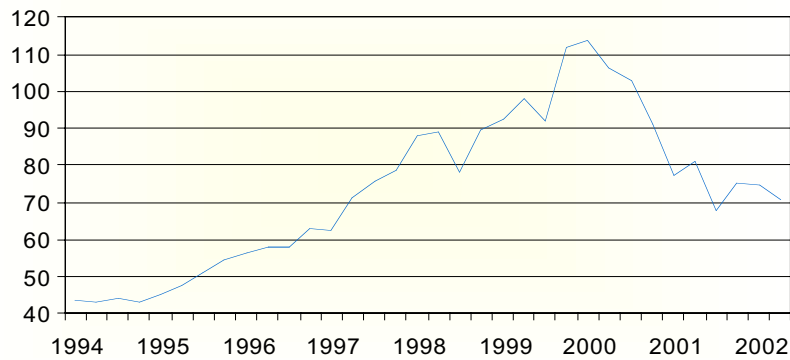


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The Market Collapse Has Wreaked Havoc With Retirement Plans

(Real equity holdings per household, thousands of dollars)

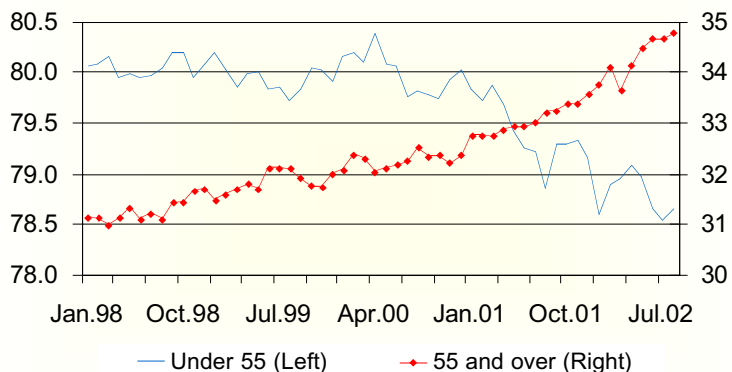


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Young Folks Leave; Old Folks Join Up

(Labor force participation rates, percent of population)

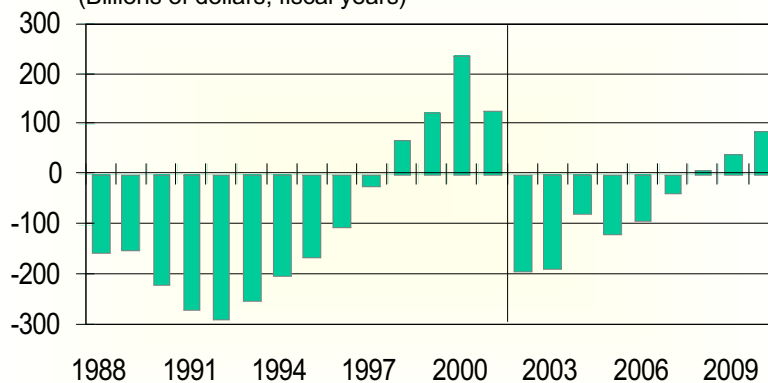


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The Federal Budget Surplus Has Disappeared

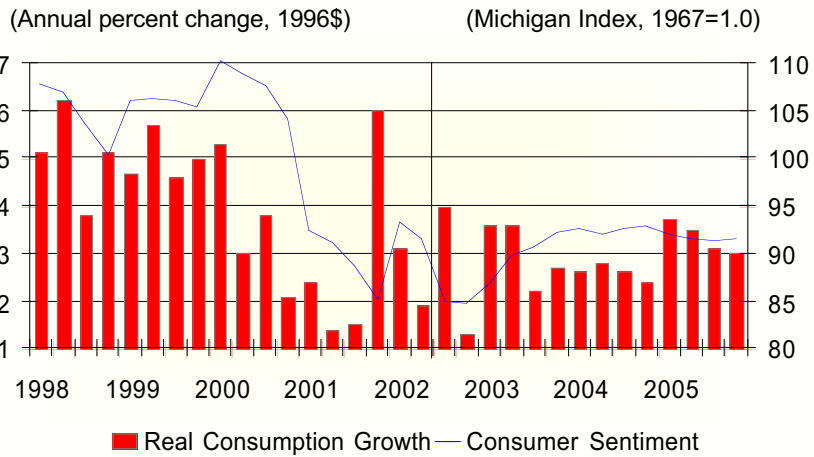
(Billions of dollars, fiscal years)



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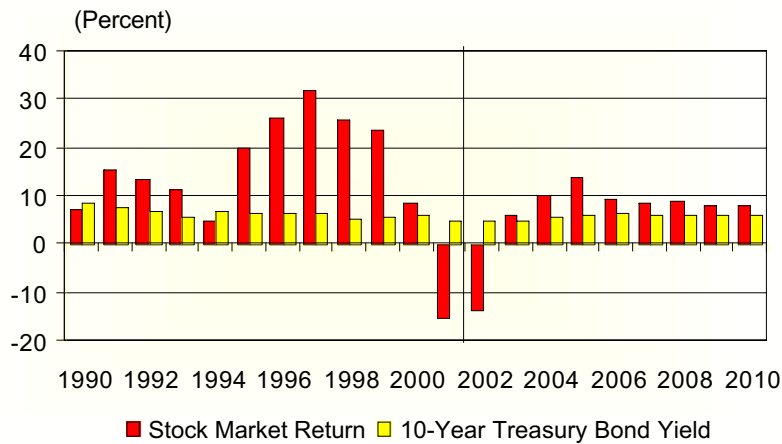
Real Consumer Spending Seldom Falls



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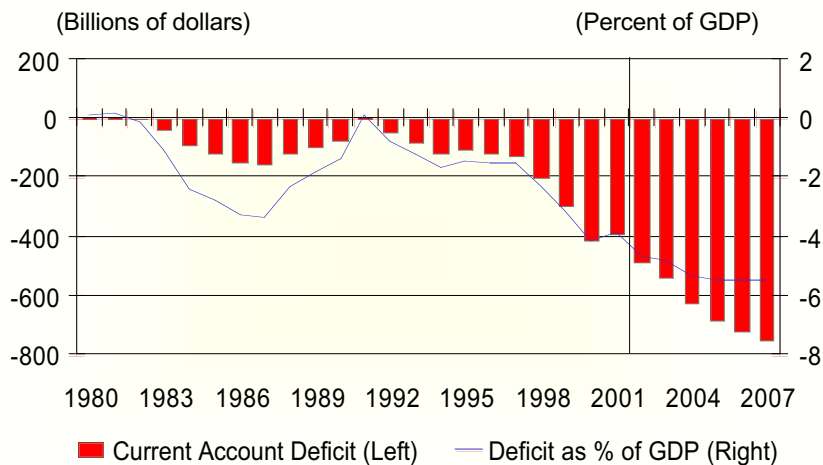
Stock Performance Will Disappoint: Returns on S&P 500 Stocks and Treasury Bonds



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The Widening U.S. Current Account Deficit



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Perspectives on Current Account Deficit

- ◆ The U.S. needs \$1.4 billion per day in net inflows of foreign capital—a rising share of global portfolios.
- ◆ Net foreign liabilities are already 20% of GDP and could reach 60% by 2010.
- ◆ European perspective: The problem is internal U.S. imbalances—low saving and high debt.
- ◆ U.S. perspective: The problem is lopsided world growth and the use of the dollar as a reserve currency.
- ◆ Result: A persistently strong dollar.

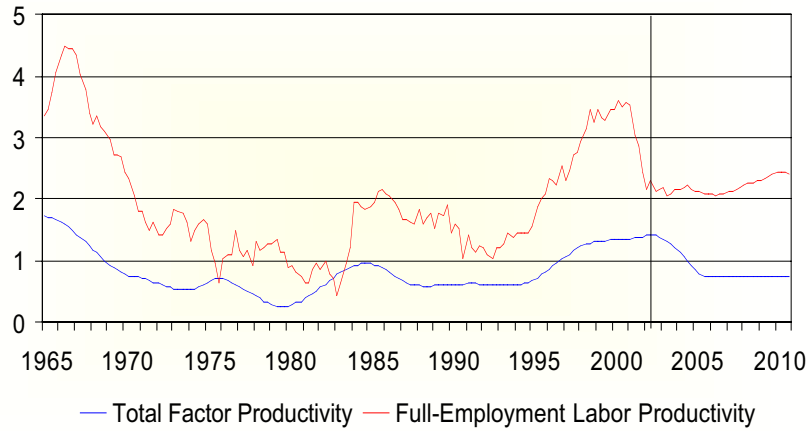


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Productivity Growth Accelerated in the Late 1990s

(Year-over-year percent change)



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