Meet the New Boss, Same as the Old Boss?

An Economic Outlook for 2007

C. Tannenbaum
Chief Economist
Paradise Lost: The US Economy in 1975

- Initial Energy Shocks Challenge U.S. Industry
- High Inflation and High Interest Rates
- High Unemployment
- A Void in Economic Leadership
The “Maestro”

- Council of Economic Advisors
- Social Security Commission
- Fed Chairman
Settling Down

![Graph showing CPI and 10 Year UST trends from 1975 to 2000.](image-url)
More Boom Than Bust

Longest Expansions Since 1900, Months

- 1991-2001: 120 months
- 1961-1969: 106 months
- 1982-1990: 92 months
- 1938-1945: 80 months
- 2001-Present: 59 months
- 1975-1980: 58 months
- 1933-1937: 50 months

Source: NBER
Welcome, Mr. Bernanke

- Well regarded in US economic community
- Three years as a governor of the Federal Reserve System
- Chair of the President’s Council of Economic Advisors
- Less well-known on Wall Street
A Pretty Nice Expansion

Quarterly Change in US GDP, Annualized

“Potential”
Office Vacancy Rates

- **National**
- **Denver**

![Graph showing Office Vacancy Rates from 1990 to 2006 with data points for annual and quarterly observations.](image-url)
The Honeymoon is Over: The Key Economic Questions of the Day

- Is the housing industry correcting or crashing?
Home Sales

• Stabilizing?
• Norms vs. Records?
Putting the Hammer Down

- Building Permits (Right Scale)
- Inventory of Homes for Sale (Left Scale)
Existing Home Prices
Year-over-Year Increase in Existing Homes Median Price

Source: Department of Commerce
Share of non-conforming mortgage originations

Source: LoanPerformance
Employment Trends

Change in Payrolls (Left Scale)  Unemployment Rate (Right Scale)

(Thousands)

Jan-02  Jan-03  Jan-04  Jan-05  Jan-06

3.5%  4.0%  4.5%  5.0%  5.5%  6.0%  6.5%

-300  -200  -100  0  100  200  300  400

LaSalle Bank
ABN AMRO
Income and Hourly Earnings
Year-Over-Year Percent Change

- Total Income (left)
- Hourly Earnings (right)

Key events:
- Microsoft Dividend
- Katrina
Stocks: A Nice Recovery

Dow Jones Industrial Average

2000 2001 2002 2003 2004 2005 2006
Other Reasons to be Cheerful

- Fixed mortgage rates are falling
- Job relocations will continue to prompt home sales
- There is still $10 trillion in untapped home equity on American balance sheets
- Technology is helping to speed up the necessary adjustments
The Honeymoon is Over: The Key Economic Questions of the Day

- Is the housing industry correcting or crashing?
- Will elevated energy prices damage the economy?
National Average: Regular Gasoline

Per Gallon

Jan-03  Jul-03  Jan-04  Jul-04  Jan-05  Jul-05  Jan-06  Jul-06
Why Haven’t Energy Prices Been More Harmful?

- Employment and incomes are rising in compensation
- Gasoline costs are a small fraction of household expenditures
- Shift to services, greater energy efficiency
- Believe it or not, there are many who have benefited
The Honeymoon is Over: The Key Economic Questions of the Day

- Is the housing industry correcting or crashing?
- Will elevated energy prices damage the economy?
- How will the world cope with retiring baby boomers?
The Aging Population

Percent of Citizens Over Age 65

France  USA  China  India  Japan

0%  10%  20%  30%

1960  1985  2010
Aging and Economic Growth

An older population is likely to:

- Lower their labor supply, thinning the talent pool
- Save and invest less, increasing interest rates
- Be somewhat less dynamic and entrepreneurial
- Collect retirement benefits, as opposed to supporting them
A Cautionary Tale: The Auto Industry

![Market Capitalization Chart](chart.png)
The Honeymoon is Over: The Key Economic Questions of the Day

■ Is the housing industry correcting or crashing?
■ Will elevated energy prices damage the economy?
■ How will the world cope with retiring baby boomers?
■ Is China’s economic rise a blessing or a curse?
Manufacturing Trends: The Gap Between Output and Employment

- Industrial Production
- Manufacturing Employment
- Real GDP

1950 = 100
Trade Balance with China

<table>
<thead>
<tr>
<th>Year</th>
<th>$ million</th>
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<tbody>
<tr>
<td>Mar-95</td>
<td>-24000</td>
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<tr>
<td>Mar-97</td>
<td>-20000</td>
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<tr>
<td>Mar-99</td>
<td>-16000</td>
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<td>Mar-01</td>
<td>-12000</td>
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<tr>
<td>Mar-03</td>
<td>-8000</td>
</tr>
<tr>
<td>Mar-05</td>
<td>-4000</td>
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</tbody>
</table>

The chart shows the trade balance with China from March 1995 to March 2005, with a steady decrease in the deficit from $24,000 million to $4,000 million over this period.
Chinese Holdings of U.S. Treasury Securities

- Currently 12% of all Treasury Debt
Other Issues Before the New Congress

- Immigration Reform
- Relief from SOX
- Higher Minimum Wage
- Extend Tax Cuts? Reform AMT?
# The Scorecard

<table>
<thead>
<tr>
<th>Category</th>
<th>2005</th>
<th>2006E</th>
<th>2007E</th>
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</thead>
<tbody>
<tr>
<td>Real GDP Growth (Q4/Q4)</td>
<td>3.1%</td>
<td>2.9%</td>
<td>2.7%</td>
</tr>
<tr>
<td>Core Inflation (CPI)</td>
<td>2.2%</td>
<td>2.5%</td>
<td>2.2%</td>
</tr>
<tr>
<td>Unemployment</td>
<td>5.1%</td>
<td>4.6%</td>
<td>4.9%</td>
</tr>
<tr>
<td>Year-End Fed Rate</td>
<td>4.25%</td>
<td>5.25%</td>
<td>5.25%</td>
</tr>
</tbody>
</table>
Our Outlook

- 2007 looks like a solid year, but the mix of economic growth may change
- Downside risks: energy prices, housing moderation
- Our dedication to free trade may again be tested
- The Federal Reserve is probably done
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