



The U.S. Economic and Interest Rate Outlook:

Close to the Breaking Point

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Main Points

- **The Investment Boom Goes Bust**
- **Market Slide Turns Wealth Effect Negative**
- **Subverting the Fed's Easing**
- **Growth to Remain Anemic**
- **Interest Rates to Fall Further**

Key Numbers in the U.S. Business Outlook

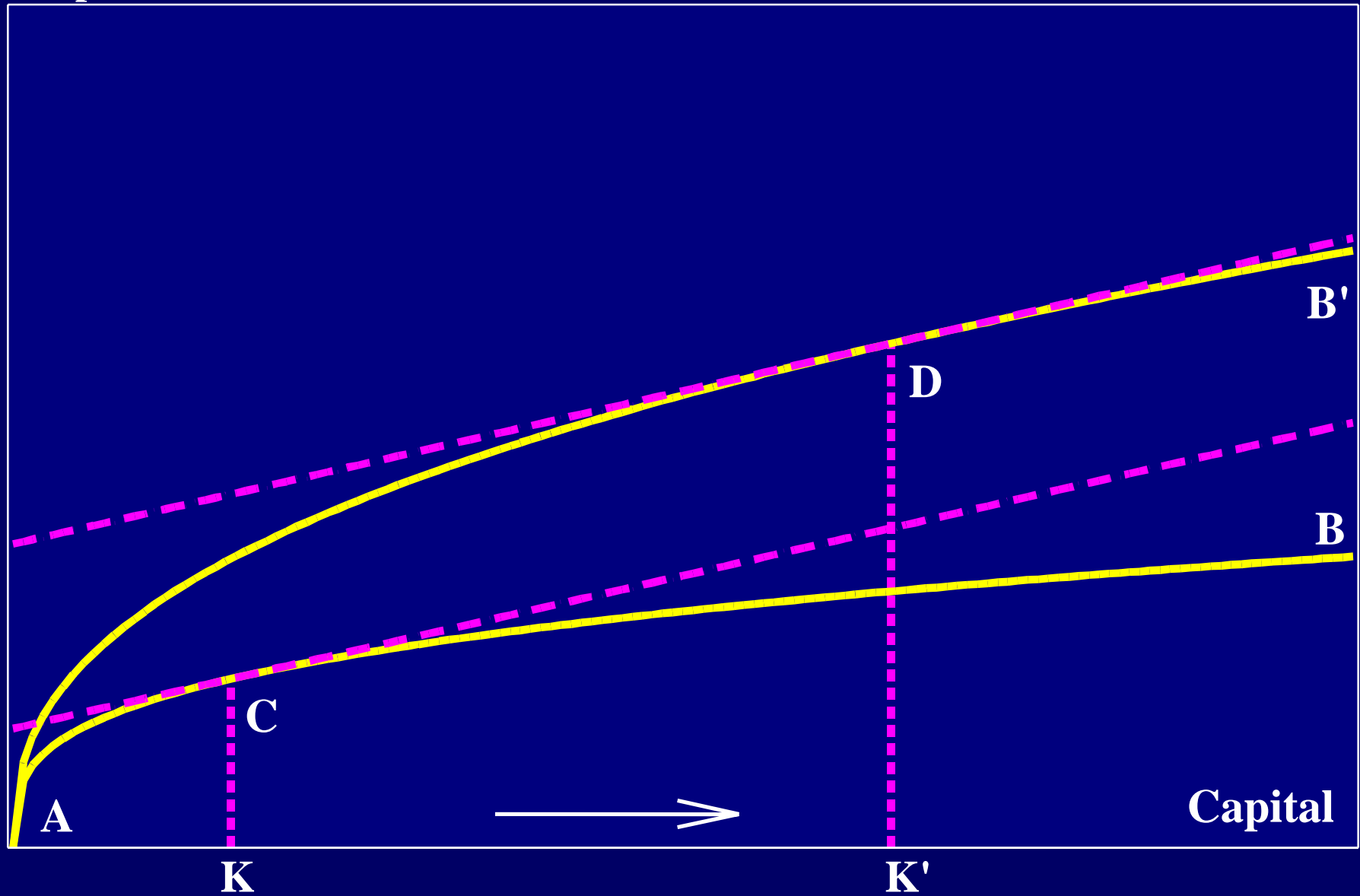
	<u>00Q4</u>	<u>01Q1E</u>	<u>01Q2E</u>	<u>01Q3E</u>	<u>01Q4E</u>	<u>2000E</u>	<u>2001E</u>
Real GDP	1.0 %	0.8 %	1.0 %	1.0 %	2.0 %	5.0 %	1.5 %
Unemployment rate	4.0	4.2	4.4	4.8	4.9	4.0	4.6
Consumer price index	2.9	4.0	2.0	1.7	2.0	3.4	2.9
After-tax adjusted profits (a)	4.0E	-1.5	-3.0	-4.0	-2.0	9.9	-2.5
Federal funds rate (b)	6.40	5.30	4.00	3.50	3.50	6.40	3.50
10-year Treasury yield (b)	5.24	4.80	4.40	4.50	4.60	5.24	4.60
Dollar/Yen (b)	113	122	124	115	113	113	113
Euro/\$ (b)	0.90	0.92	0.98	1.05	1.13	0.90	1.13

(a) Percentage change from year-earlier period.

(b) End month of period.

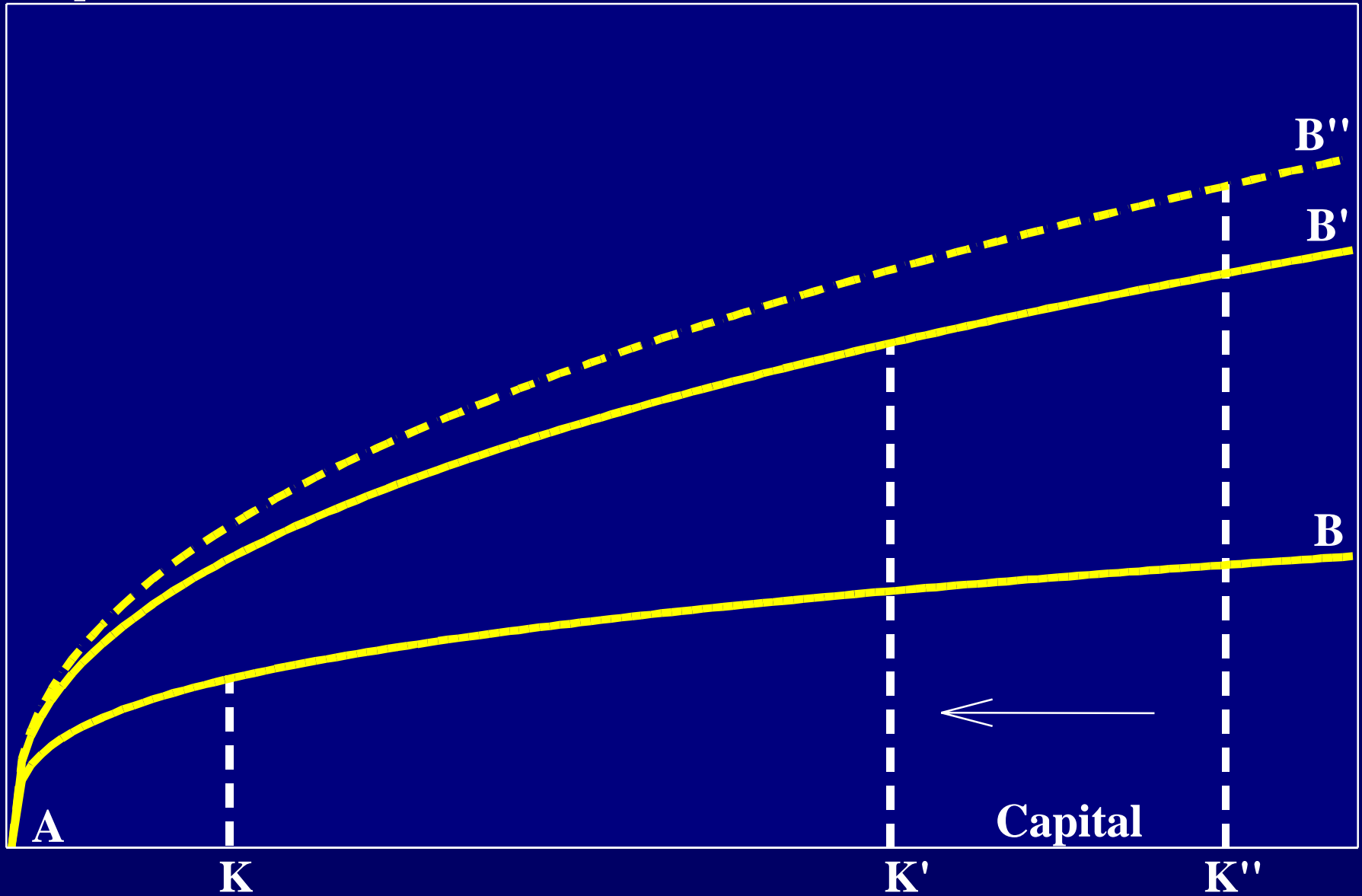
Expected Return and the Impact on Investment

Output



How Investment Spending Can Overshoot

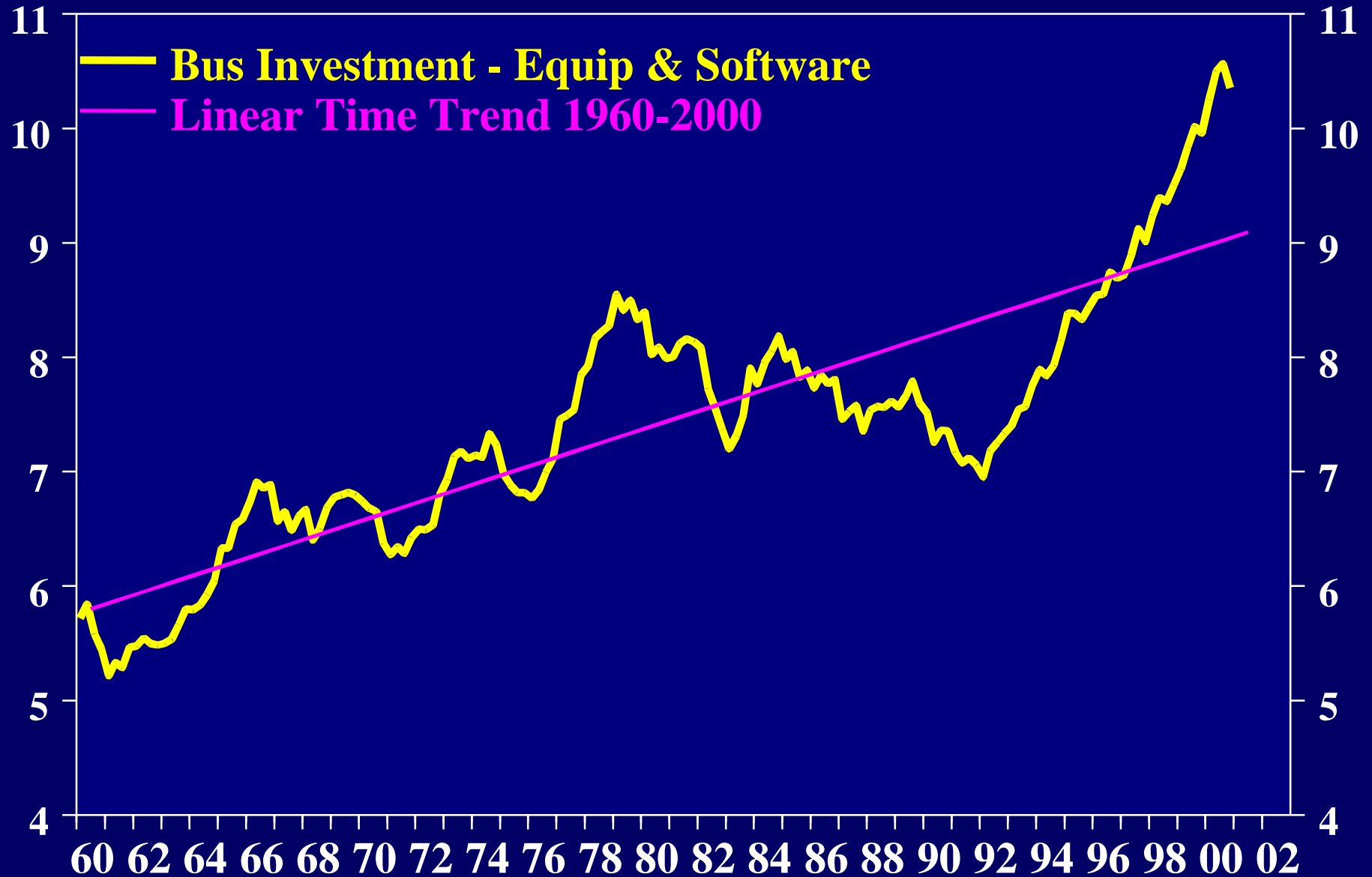
Output



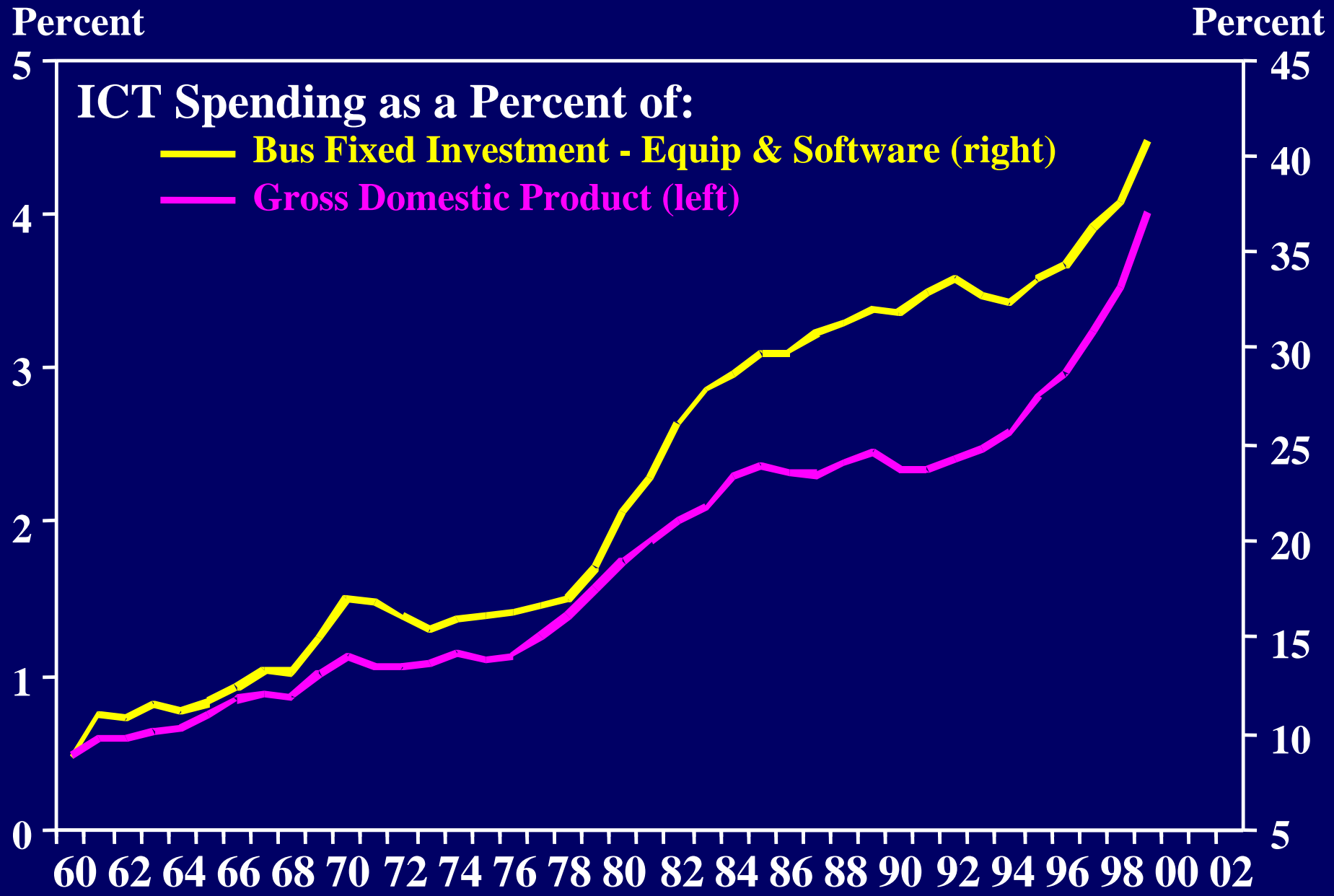
Business Investment Soars

Percent of GDP

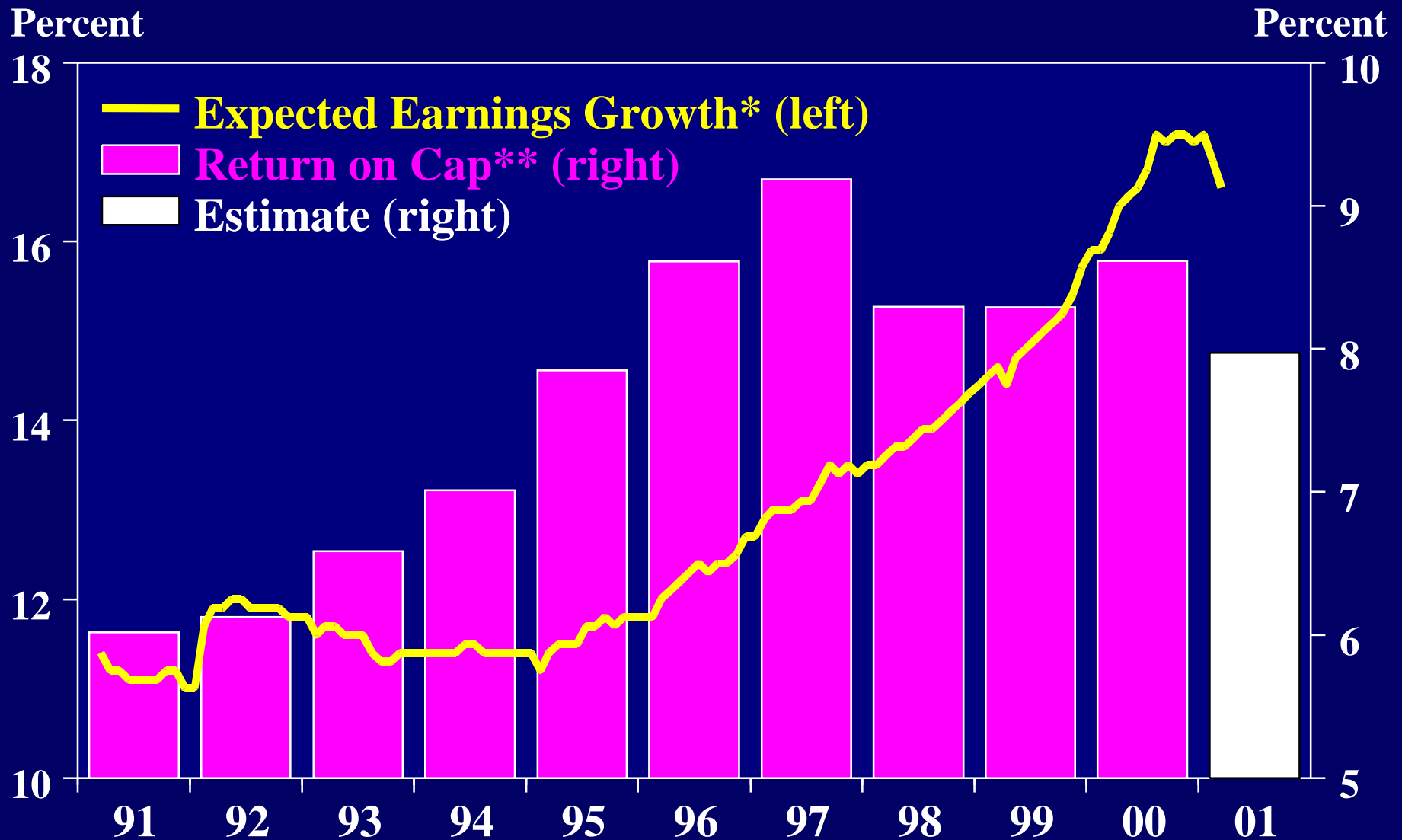
Percent of GDP



Technology Outlays Dominate



Profit Expectations...



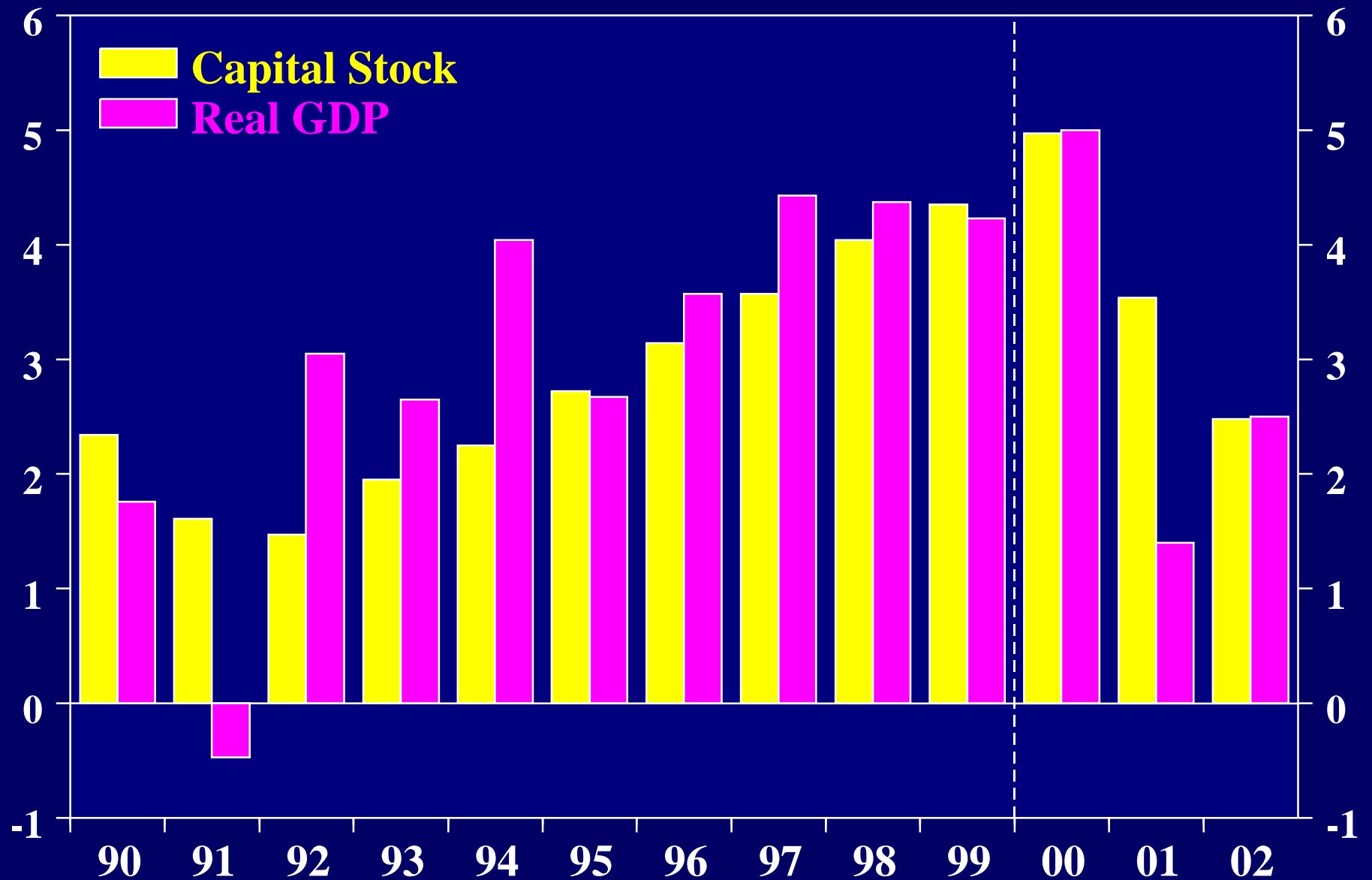
* Long-term earnings growth exp. by S&P 500 equity analysts.

** Adj. corporate profits div. by corporate capital stock.

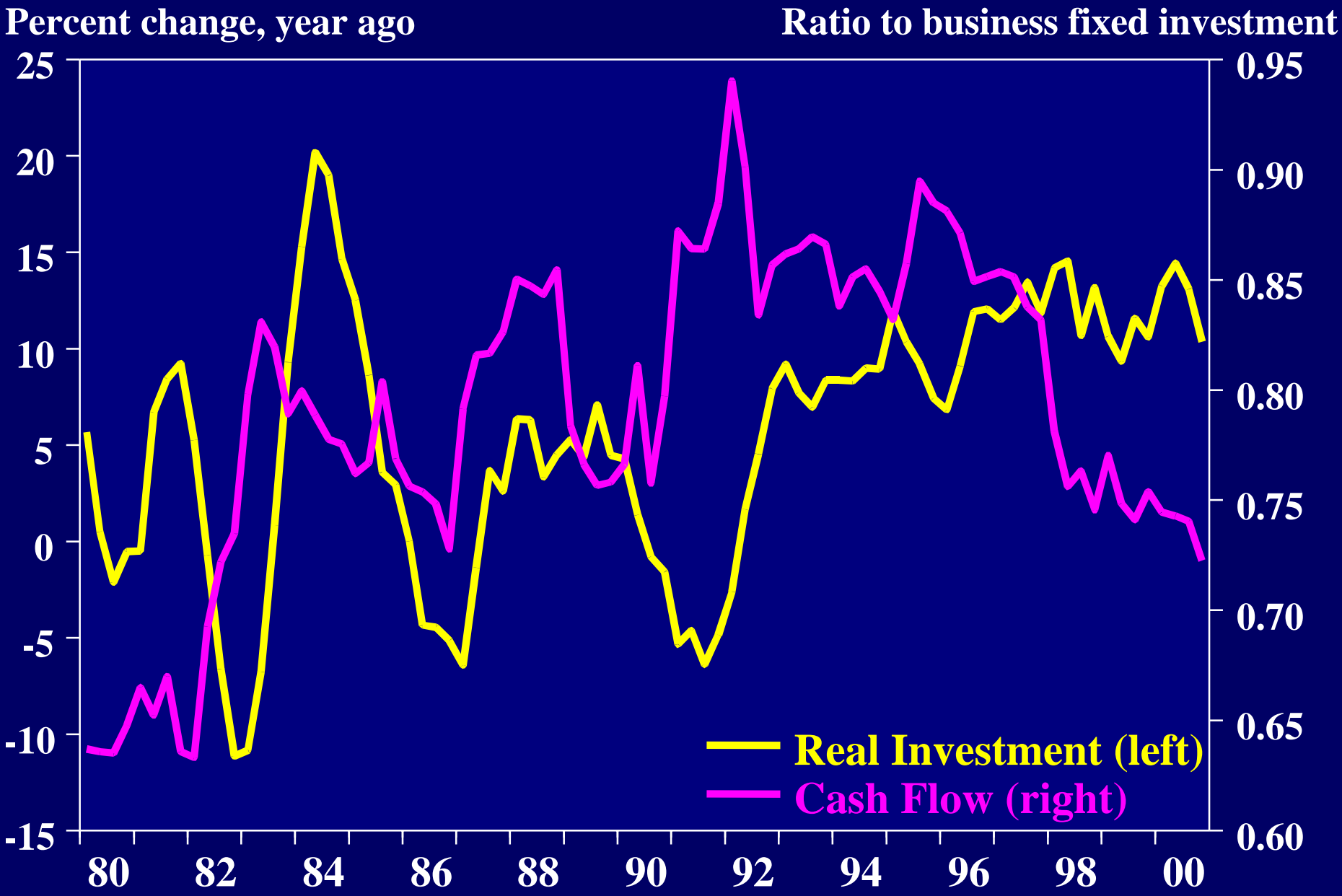
Capital Stock Growing Faster than GDP

Percent change, year ago

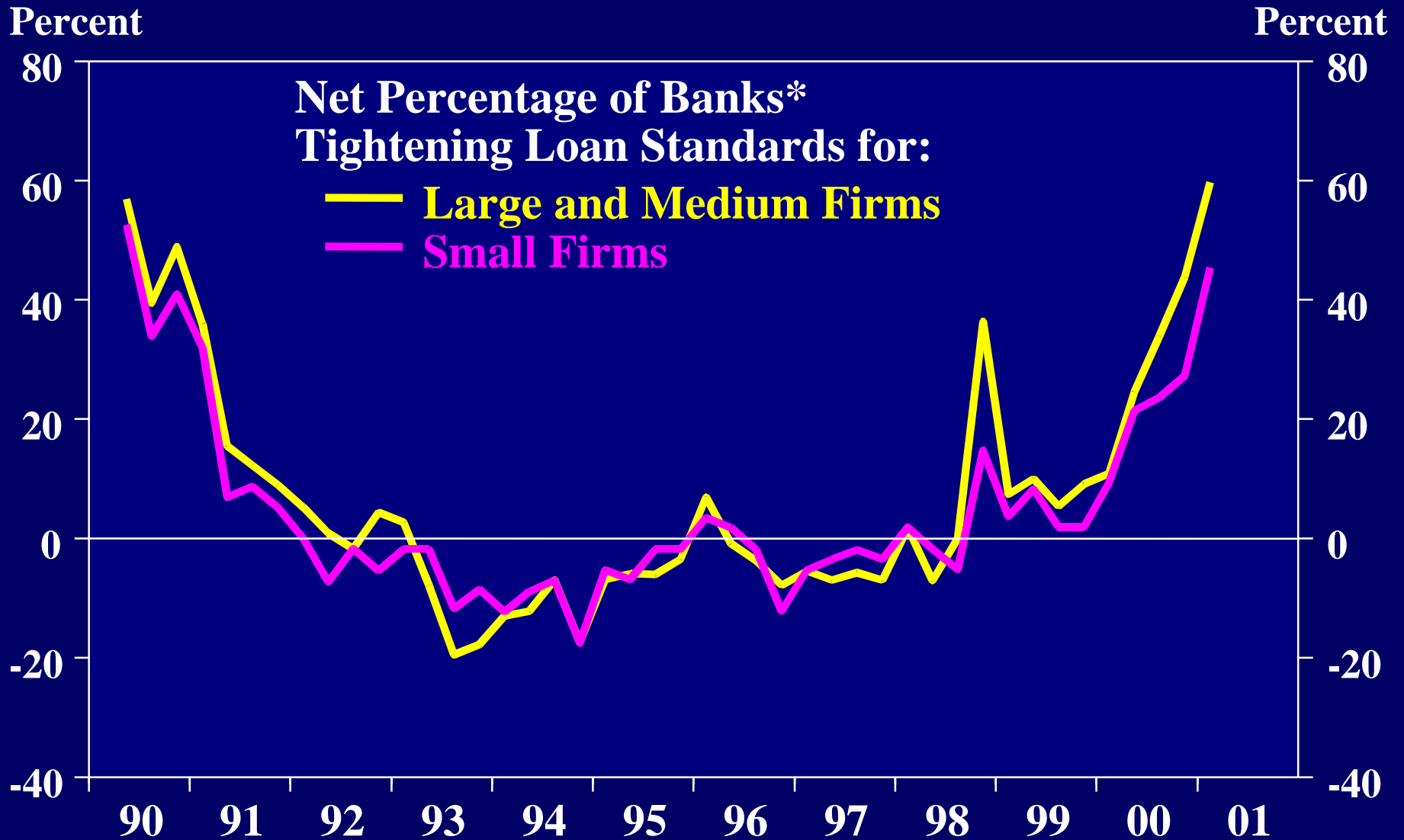
Percent change, year ago



Financing Gap Widens

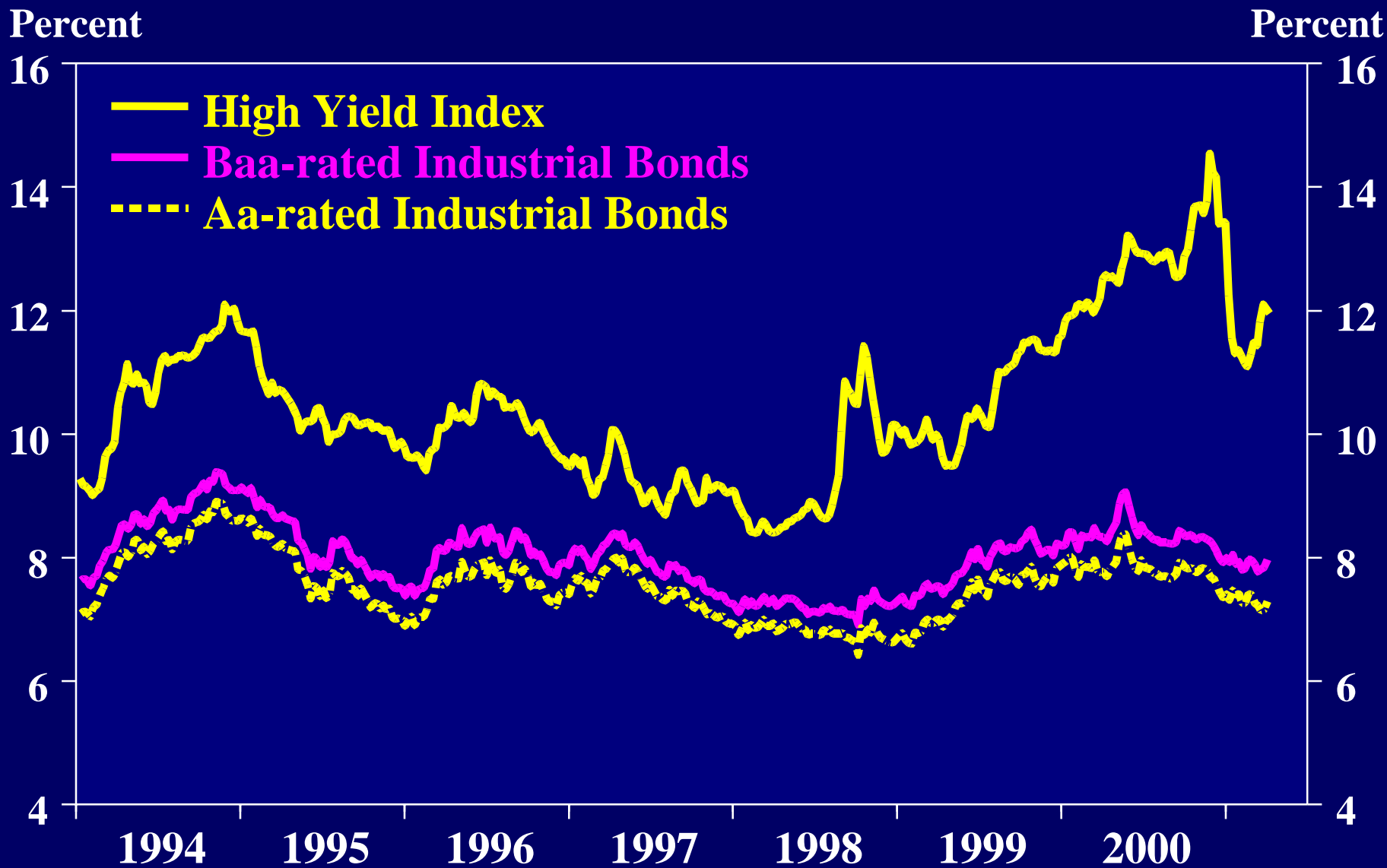


Banks Have Tightened Lending Standards



*Difference between percentage raising standards and percentage lowering standards.

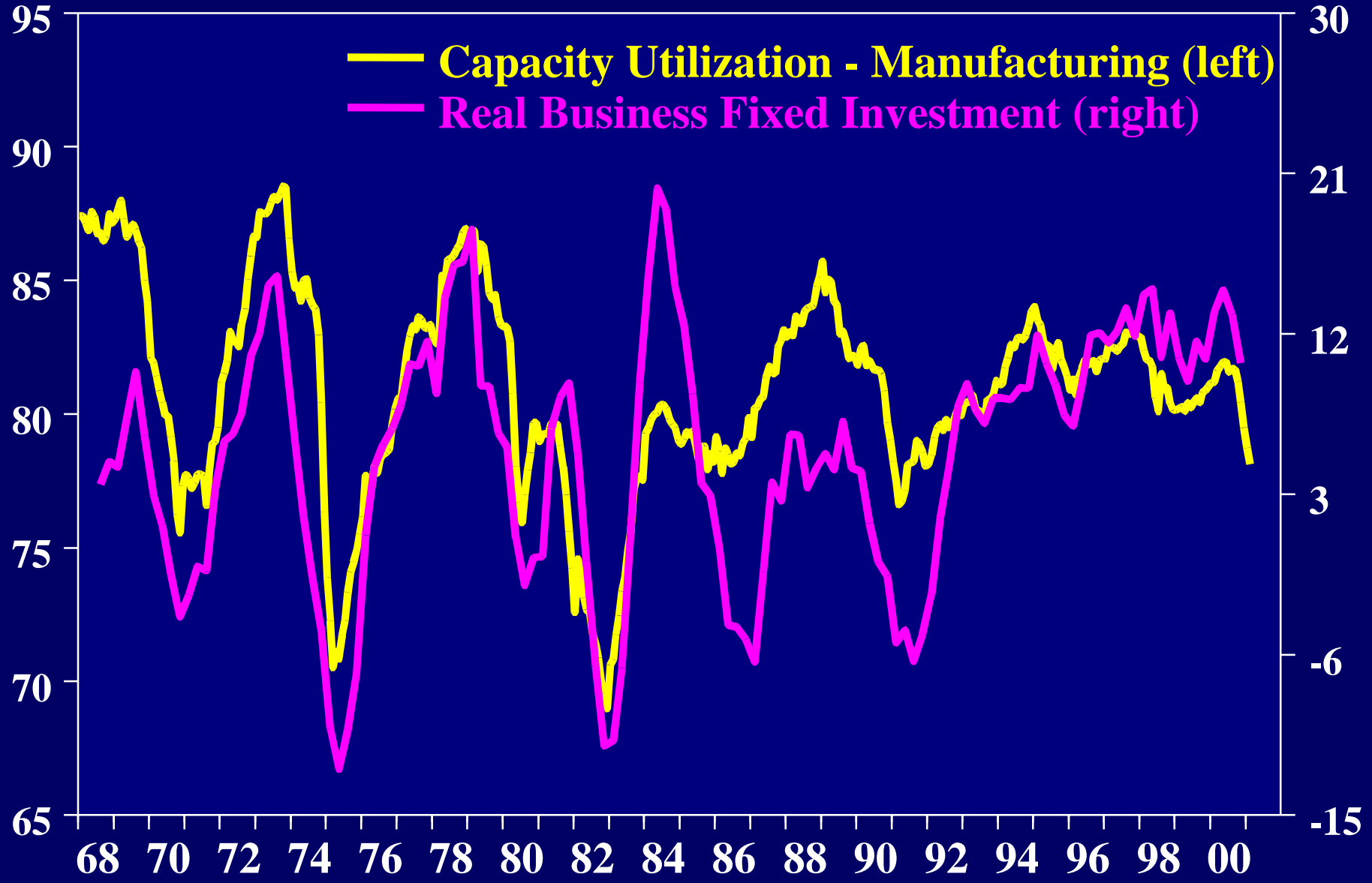
Costs of Borrowing Surge for Non-Investment Grade Borrowers



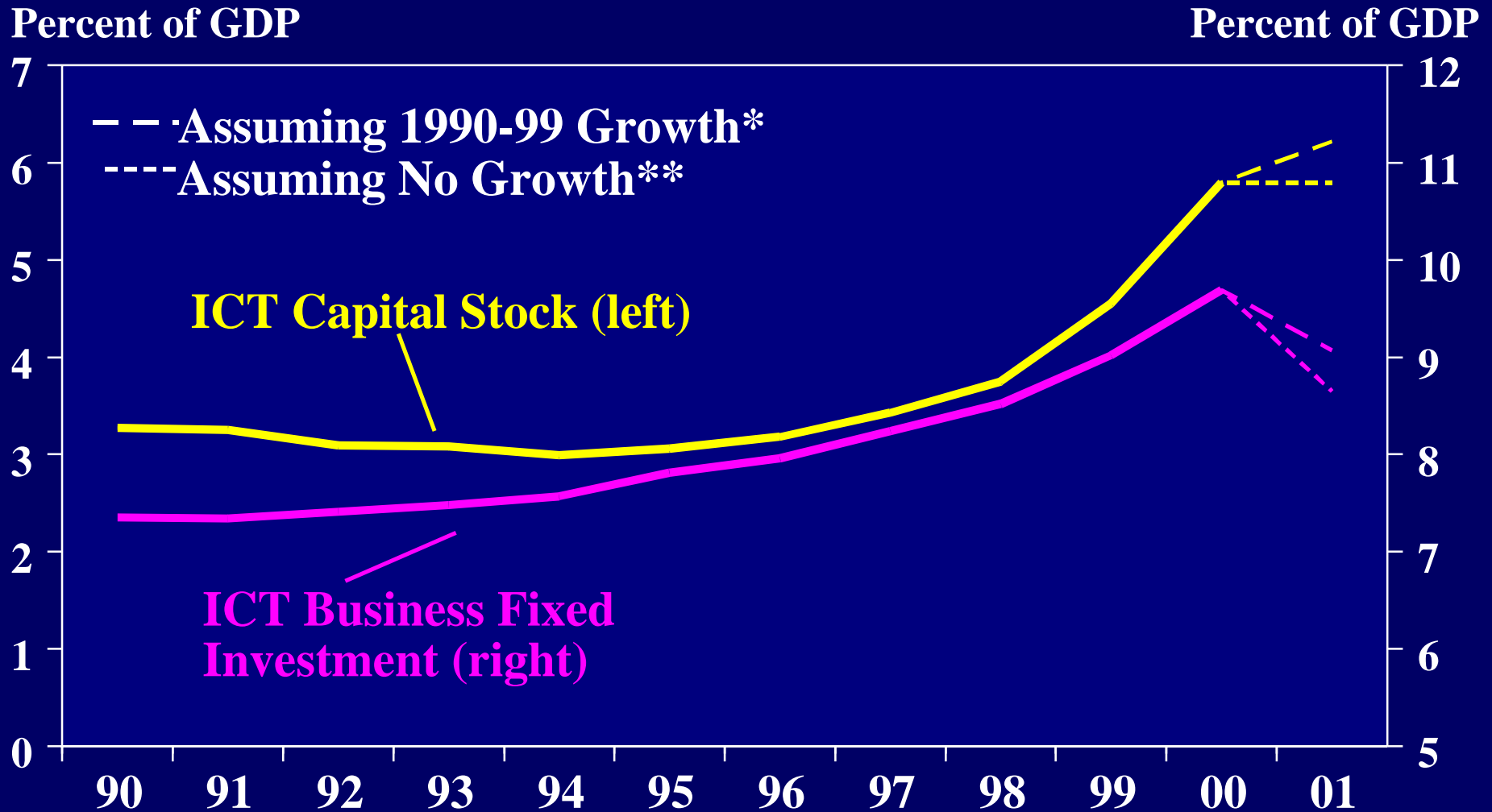
Investment and Capacity Utilization

Percent

Percent change, year ago



A Stable Capital Stock Share = Collapse in ICT Investment



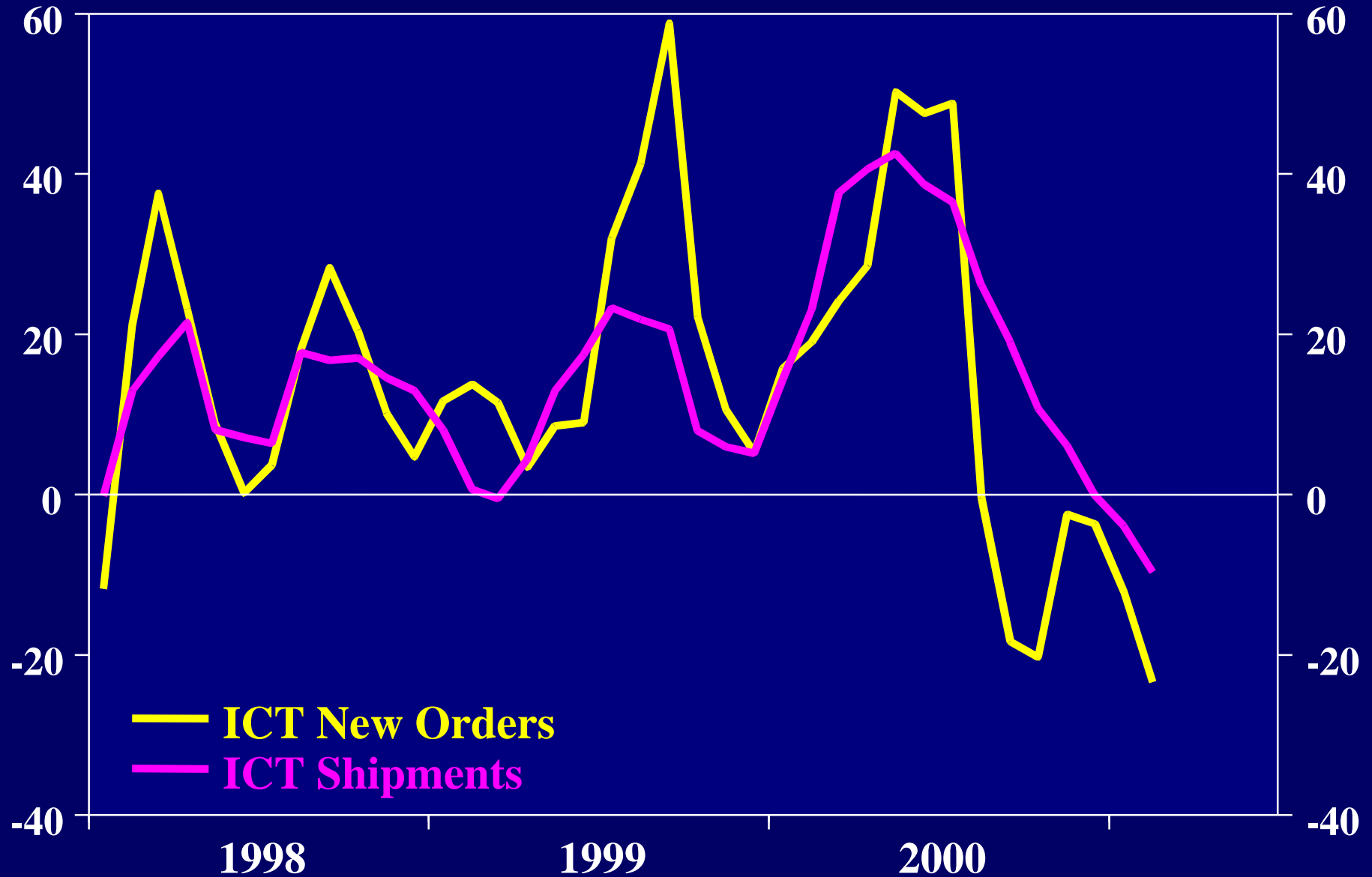
*Capital Stock to GDP ratio grows at 1990-99 average rate.

**Capital stock to GDP ratio stays constant at 2000 est.

ICT Orders and Shipments Plunging

Percent change, annual rate

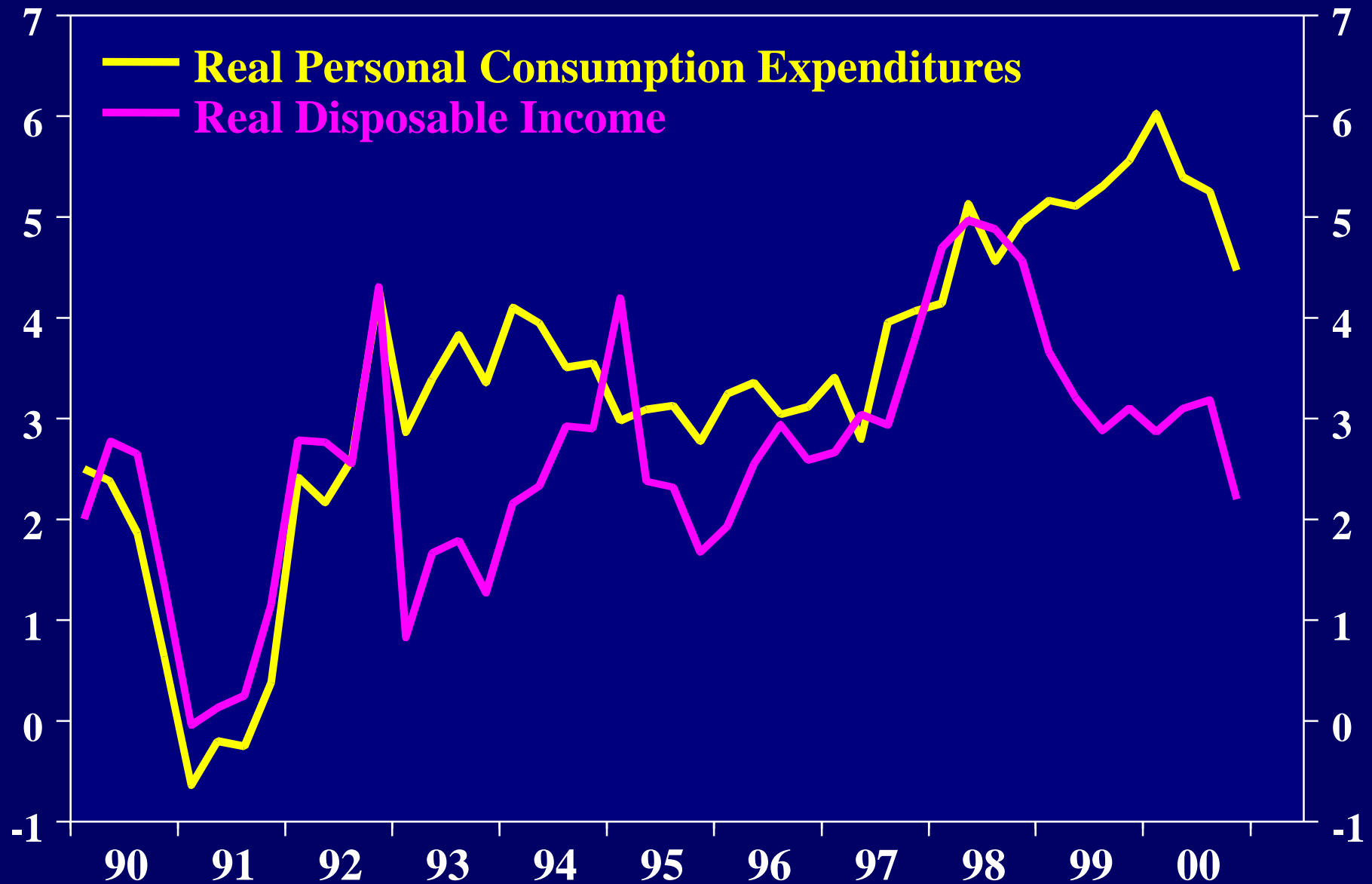
Percent change, annual rate



Gap Between Consumption and Income Growth Widens

Percent change, year ago

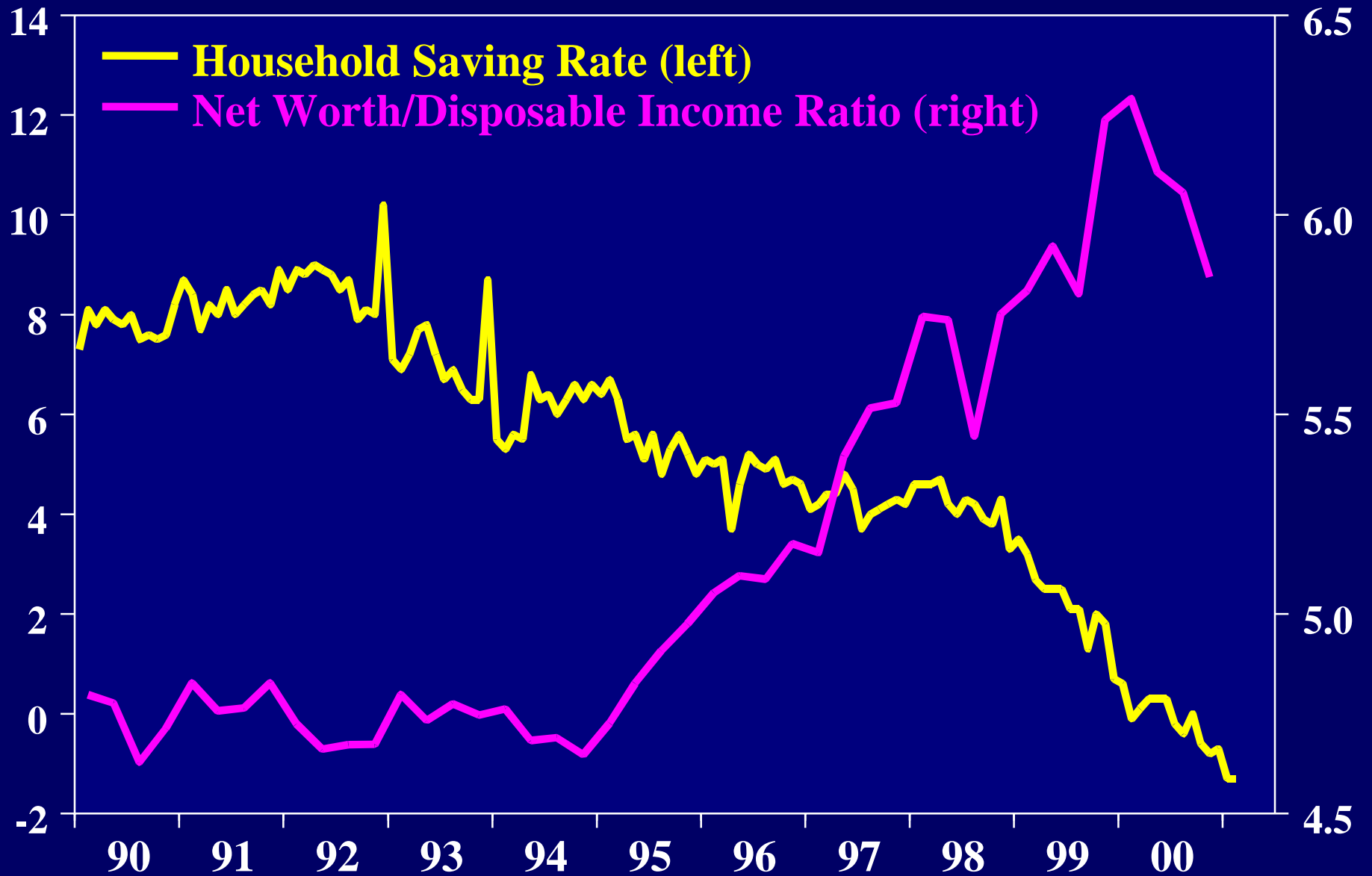
Percent change, year ago



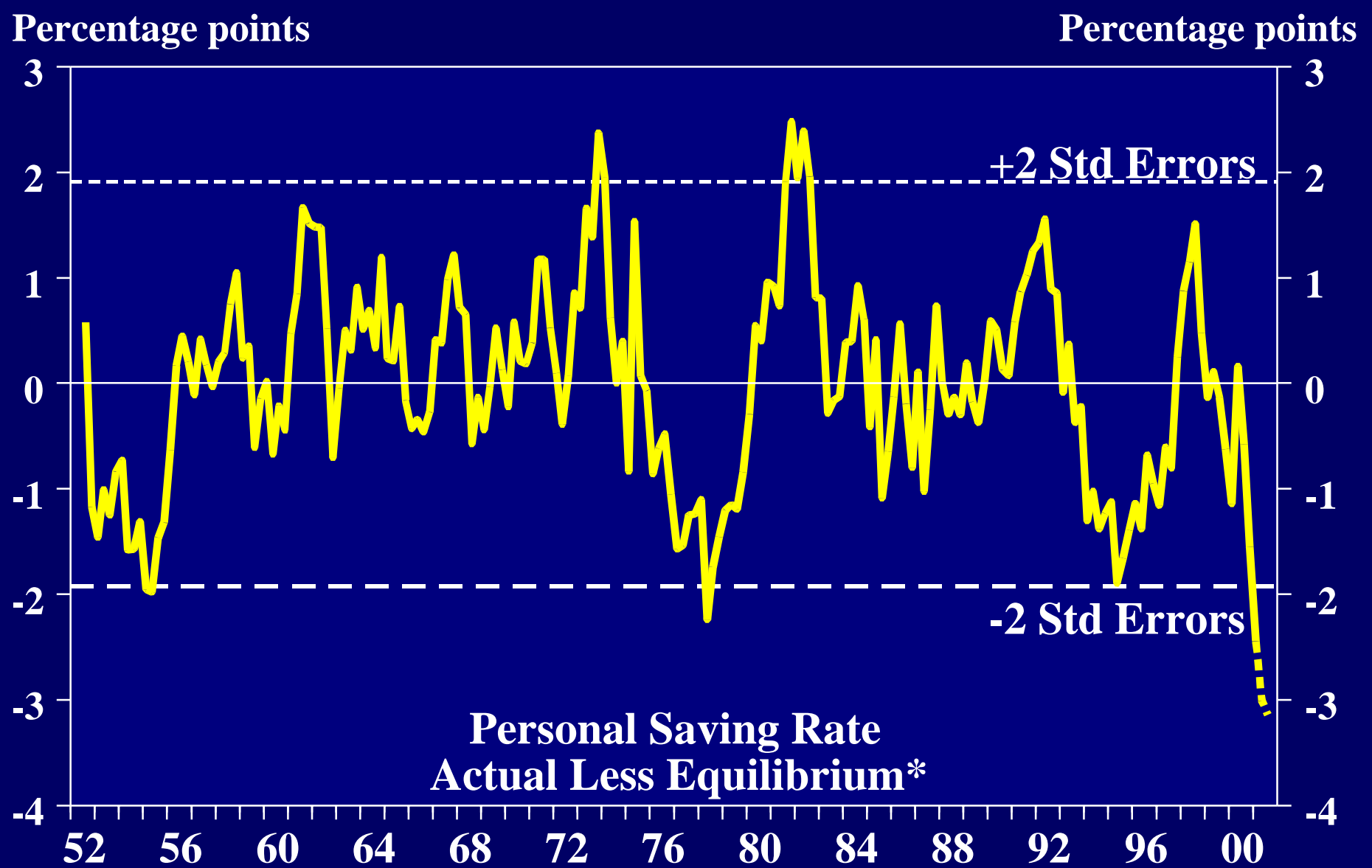
Saving Rate Hits Record Low

Percent

Ratio

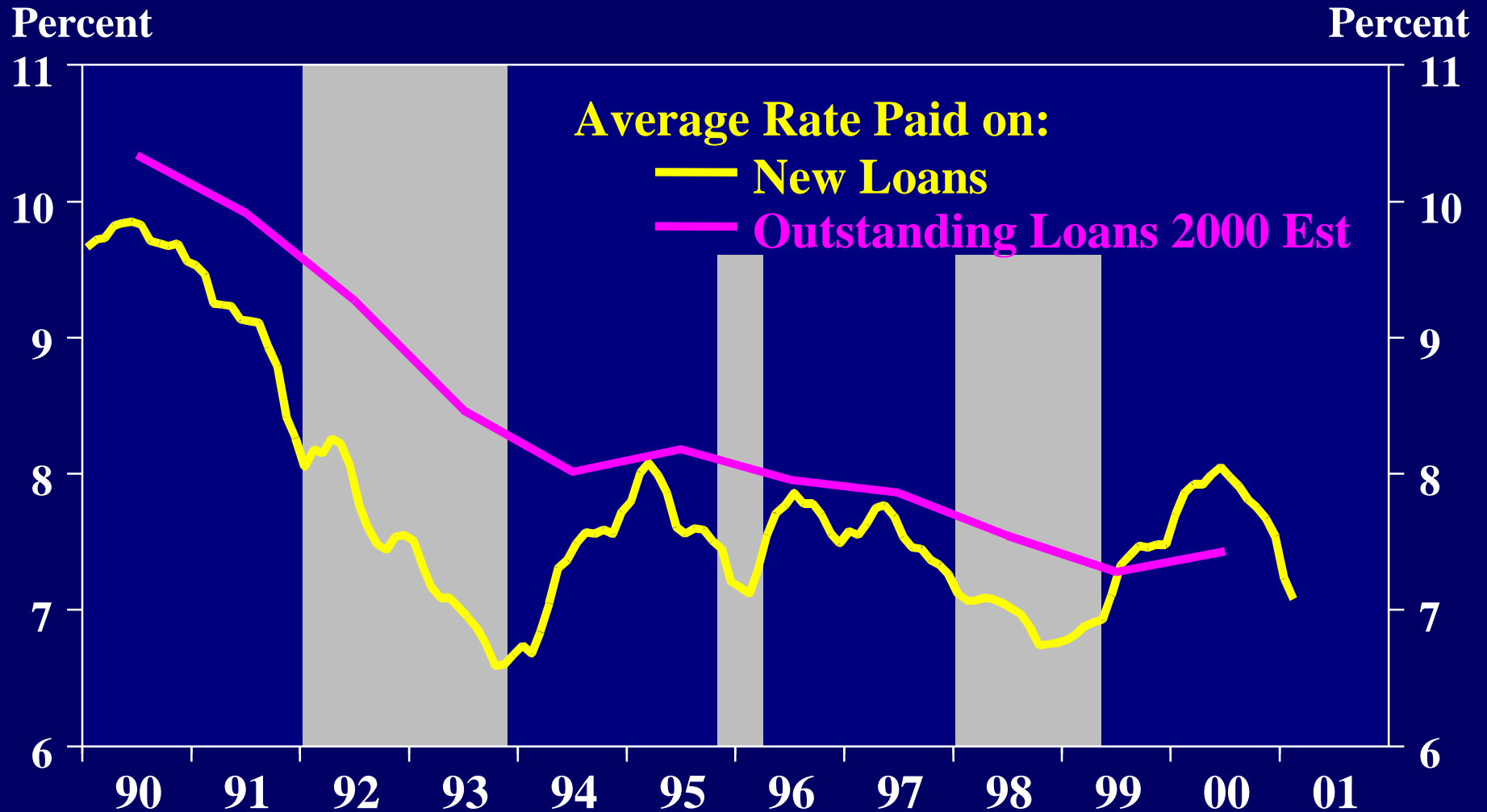


A Record Saving Gap



* Dotted line shows gap implied by current equity prices.

A Small Drop in Outstanding Mortgage Rates

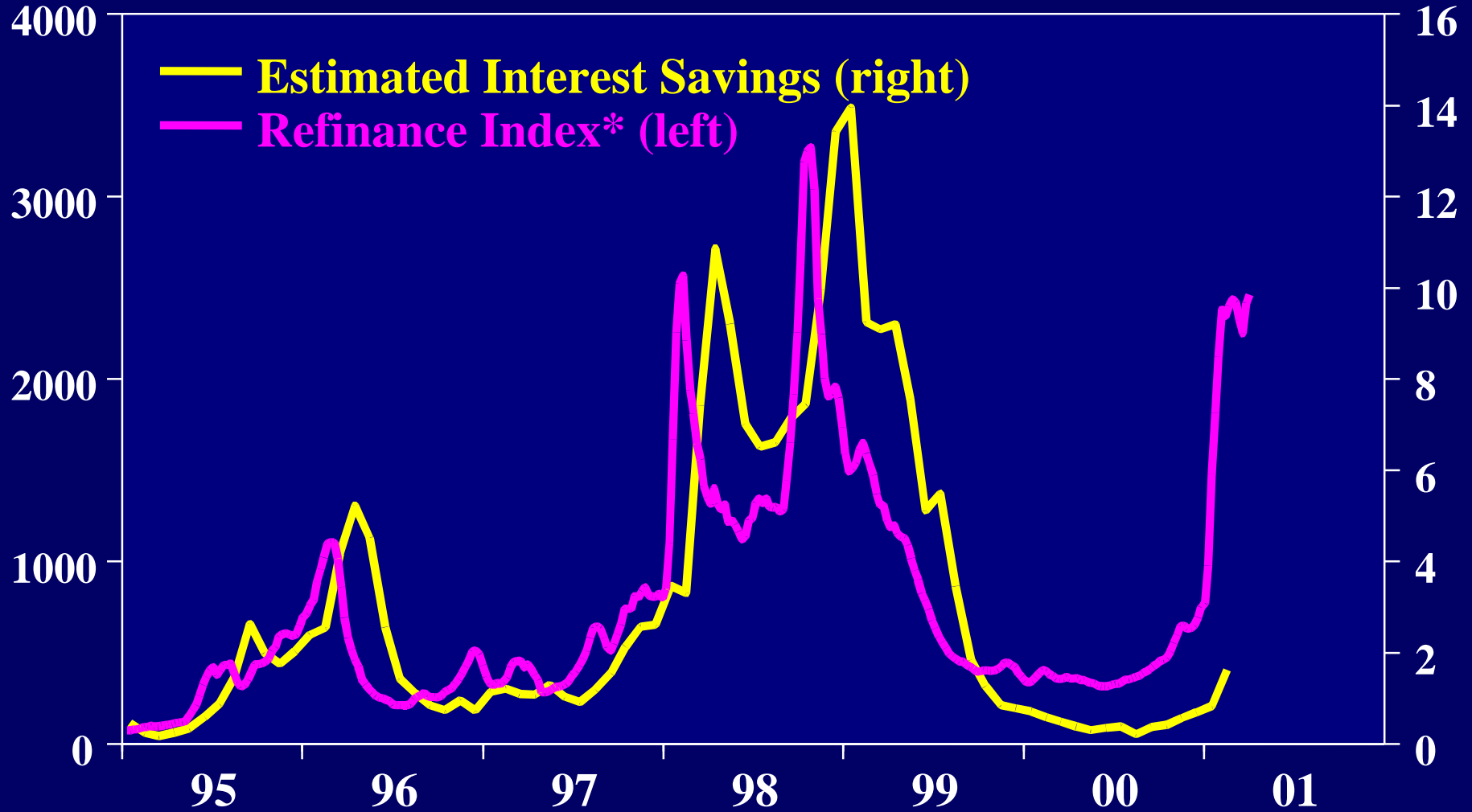


* Areas shaded when refinance index is generally above 1000 for 1992-1993 and 1998 and above 500 for 1995-1996.

Refinancing Activity Generates Modest Savings

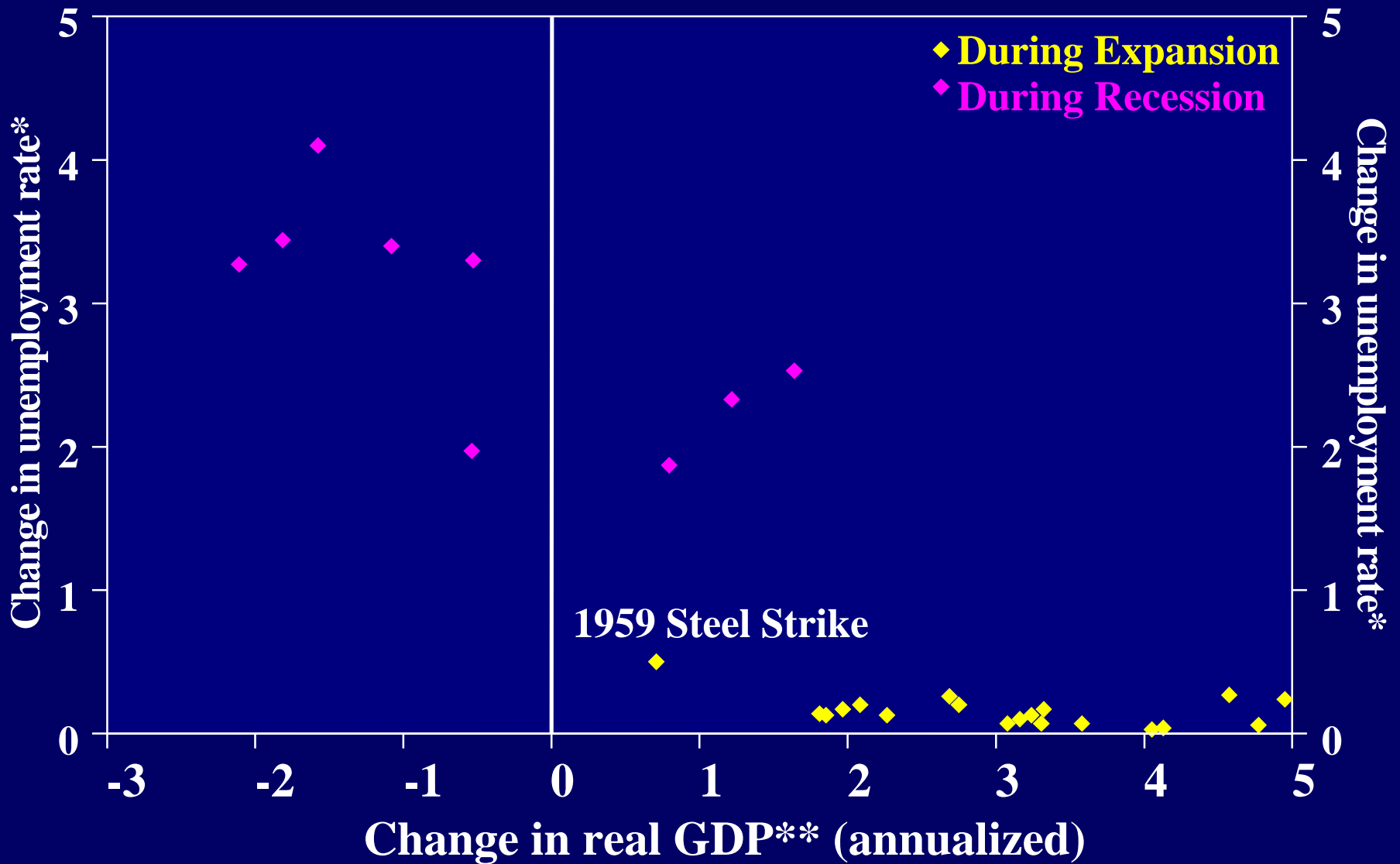
Index 3/16/90=100

Billions of dollars, annual rate



* Four-week moving average.

Unemployment Tends to Move Up a Little or a Lot



* Change from trough to peak of quarterly average of unemployment rate.

**Change in real GDP during change in unemployment rate.

Increases in U.S. Unemployment-- Either Trivial or Huge

Trough in Unemployment Rate		Month When Rate Was Up	Business Cycle	Ultimate Peak in Unemployment Rate	
Month	Level	By 1/3%	Peak	Level	Increase
Jul-48	3.57	Jan-49	Nov-48	7.10	3.53
Jul-53	2.53	Oct-53	Jul-53	5.97	3.43
Apr-57	3.83	Jul-57	Aug-57	7.40	3.57
Jul-59	5.07	Oct-59	Apr-60	7.00	1.93
May-69	3.40	Feb-70	Dec-69	6.03	2.63
Nov-73	4.73	Mar-74	Nov-73	8.87	4.13
Jul-79	5.67	Jan-80	Jan-80	7.70	2.03
Apr-81	7.33	Nov-81	Jul-81	10.67	3.33
May-89	5.13	Sep-90	Jul-90	7.70	2.57

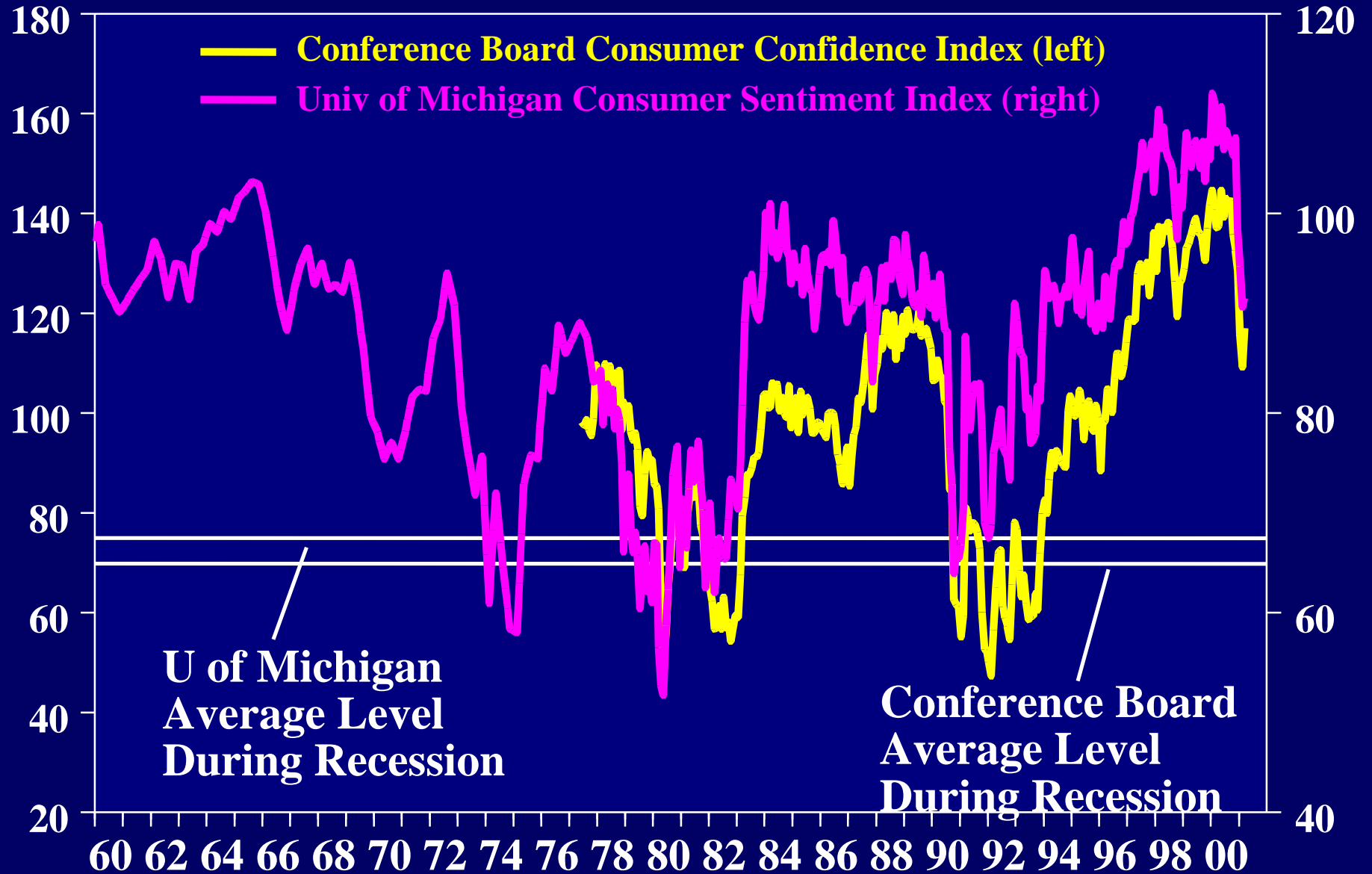
Note: All entries and calculations based on three-month trailing averages.

Source: Department of Labor. National Bureau of Economic Research.

Consumer Confidence Plunges

Index, 1985=100

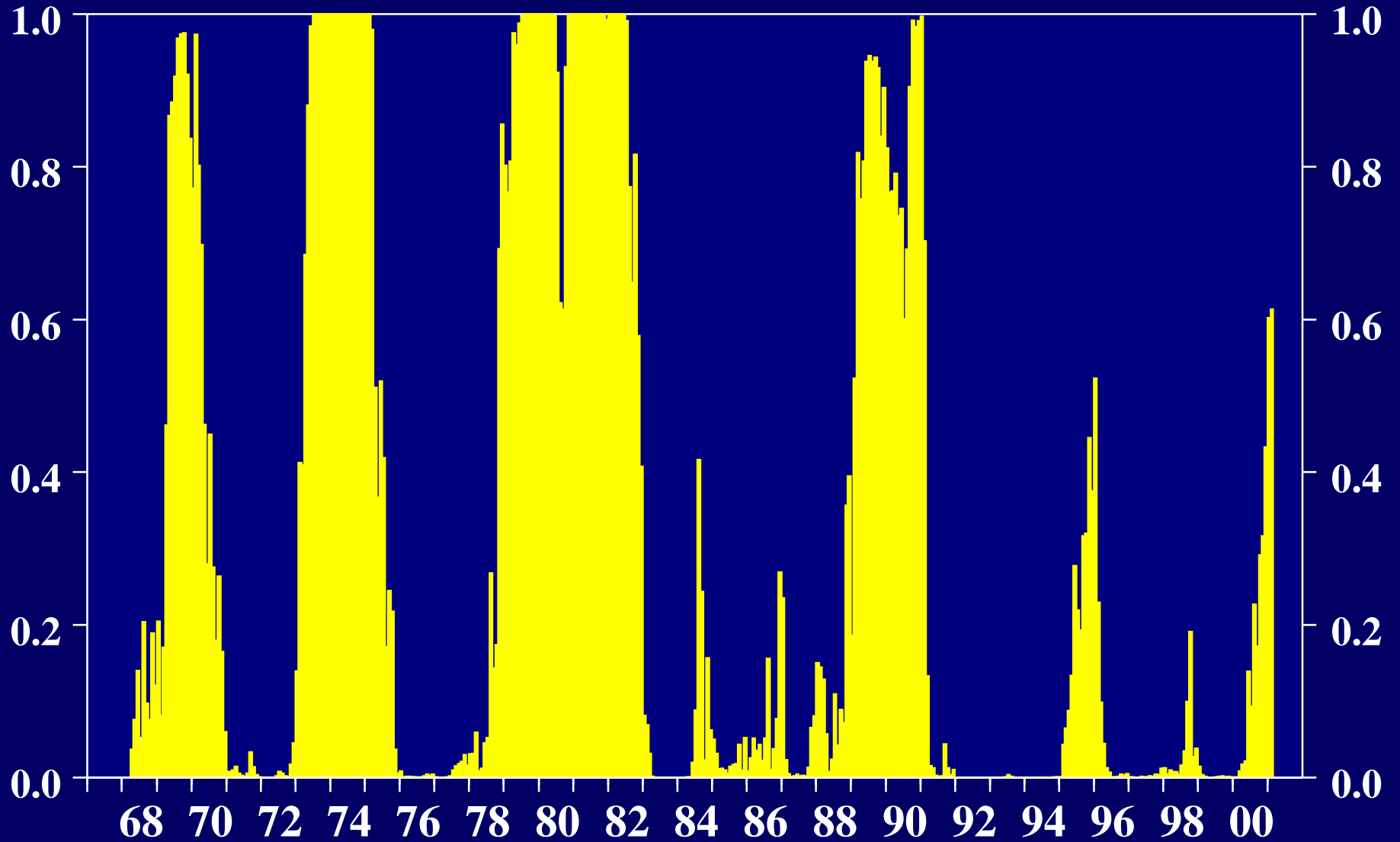
Index, 1966=100



Probability of Recession Has Climbed

Probability of recession*

Probability of recession*



* Probability of recession starting within the following 12 months.

Fed Keeps Easing

- **4% Federal Funds Rate by Mid-Year, 3 1/2% by Year-end.**
- **Bond Yields To Fall Further.**

U.S. Interest Rate Outlook

	2000				2001E			
	Q1A	Q2A	Q3A	Q4E	Q1	Q2	Q3	Q4
Federal Funds	5.85	6.53	6.52	6.40	5.30	4.00	3.50	3.50
3-Month LIBOR	6.20	6.79	6.67	6.55	5.00	4.00	3.60	3.70
2-Year Note	6.53	6.48	6.08	5.35	4.30	3.90	3.80	3.90
10-Year Note	6.26	6.10	5.80	5.24	4.80	4.40	4.50	4.60
30-Year Bond	6.05	5.93	5.83	5.49	5.25	5.00	4.90	5.00

Broad Money Growth Climbs Sharply

Percent change, annual rate

Percent change, annual rate



* Three-month percent change, annualized.

Contributions of Different Components to M3 Growth

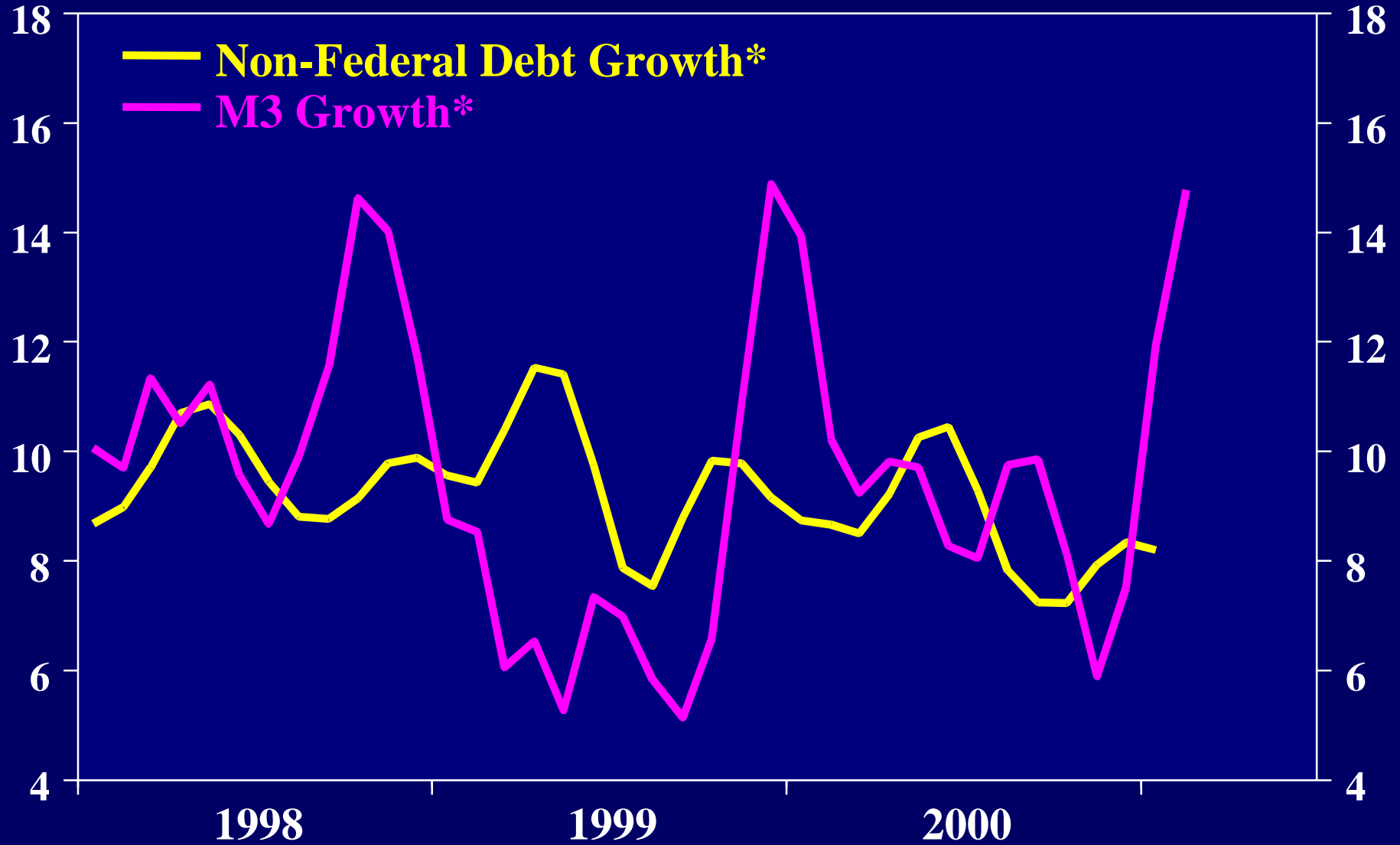
	Share	Contribution*
M2		
M1	21.8%	1.0%
Savings Deposits	38.2	5.9
Retail MM Mutual Funds	19.1	3.2
All Other	20.9	1.0
M3		
M2	69.5	7.9
Institutional MM Mutual Funds	11.8	6.3
All Other	18.7	0.2

* Contribution to annualized percent change from Nov '00 to Feb '01.
 Source: Federal Reserve Board. Our calculations.

Credit Growth Little Changed

Percent change, annual rate

Percent change, annual rate

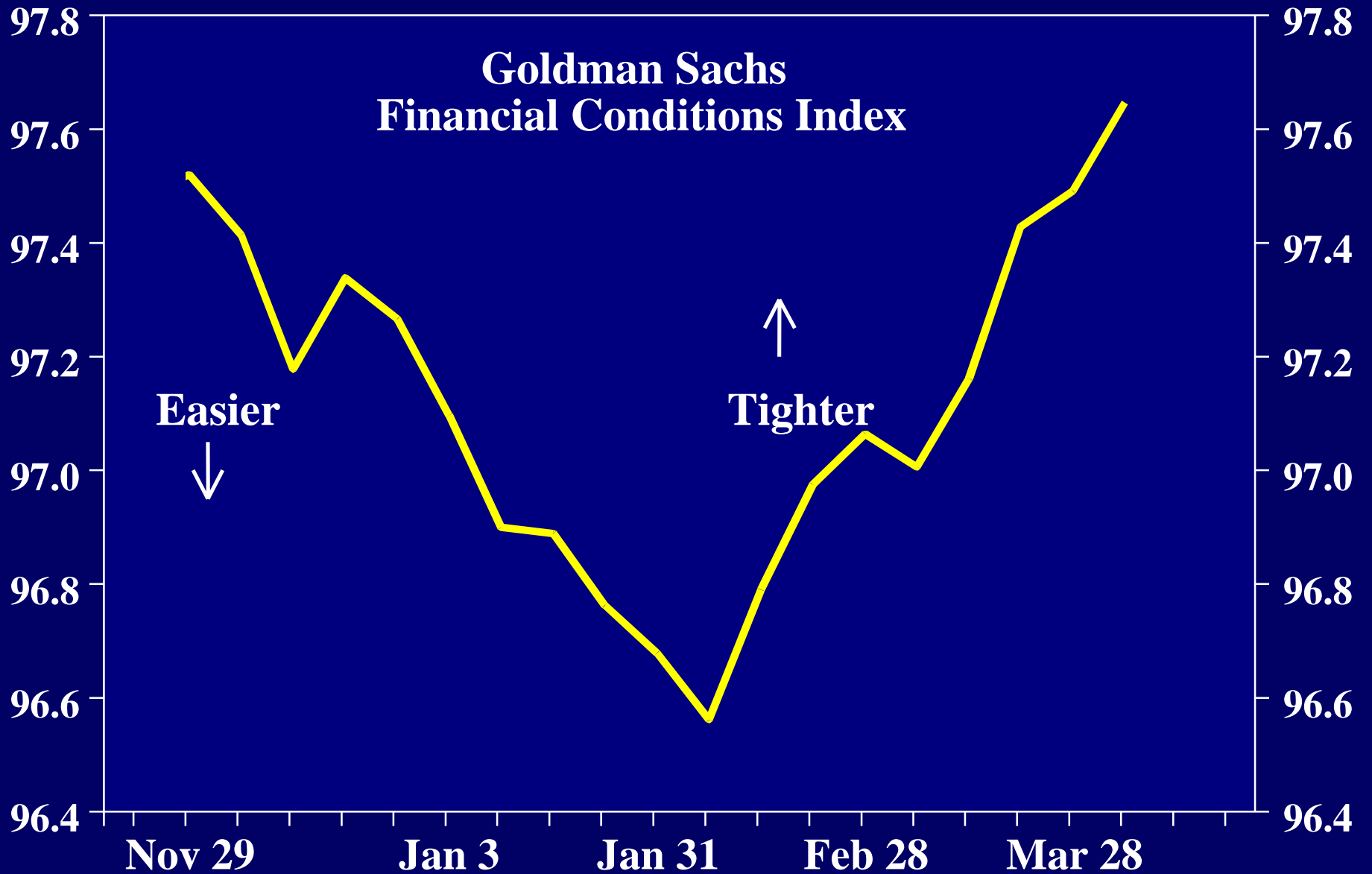


* Three-month percent change, annualized.

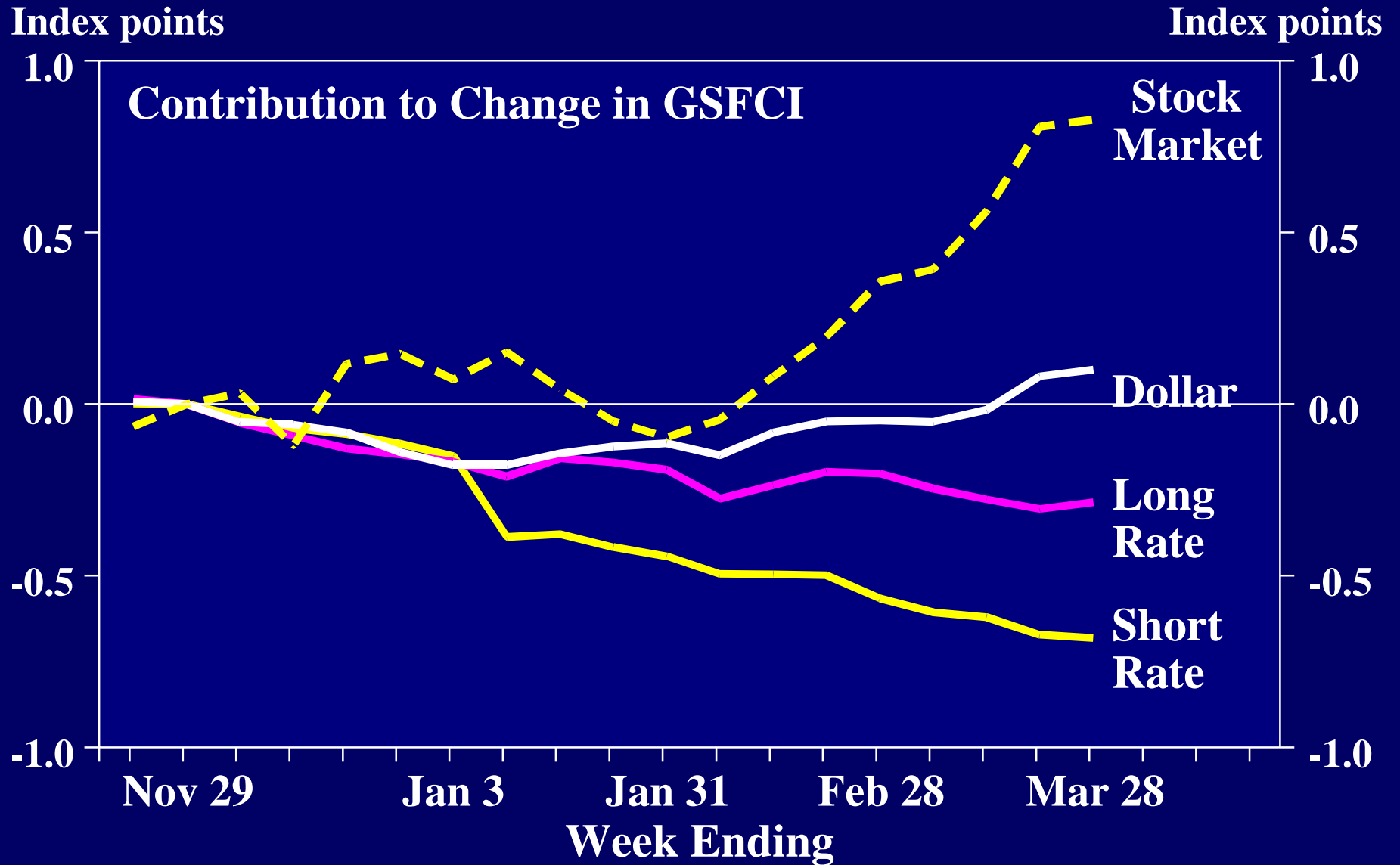
Financial Conditions Have Not Eased...

Index, 1987-1995=100

Index, 1987-1995=100



...Stock Weakness and Dollar Strength Offset Rate Declines

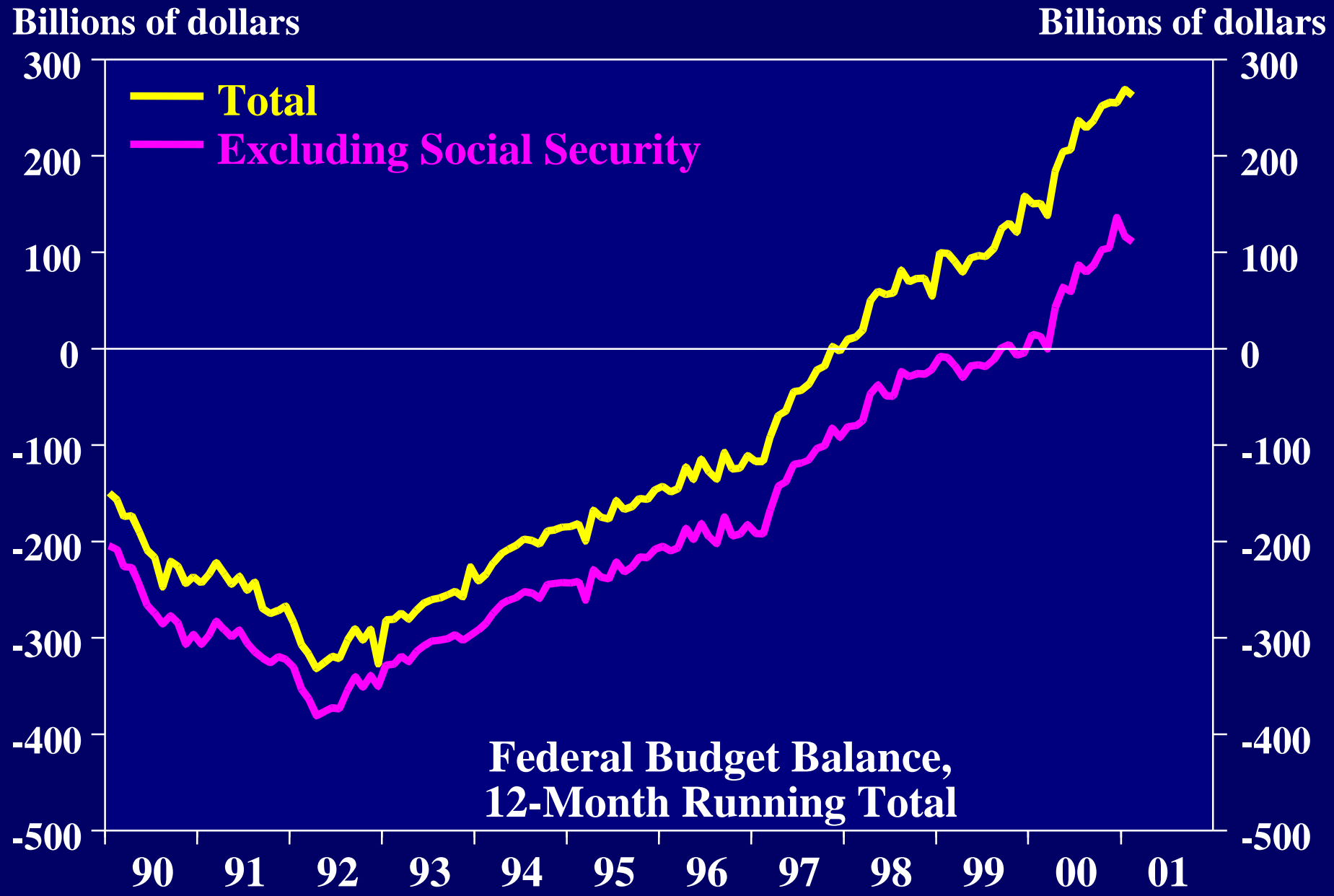


How Much Does the Fed Ease?

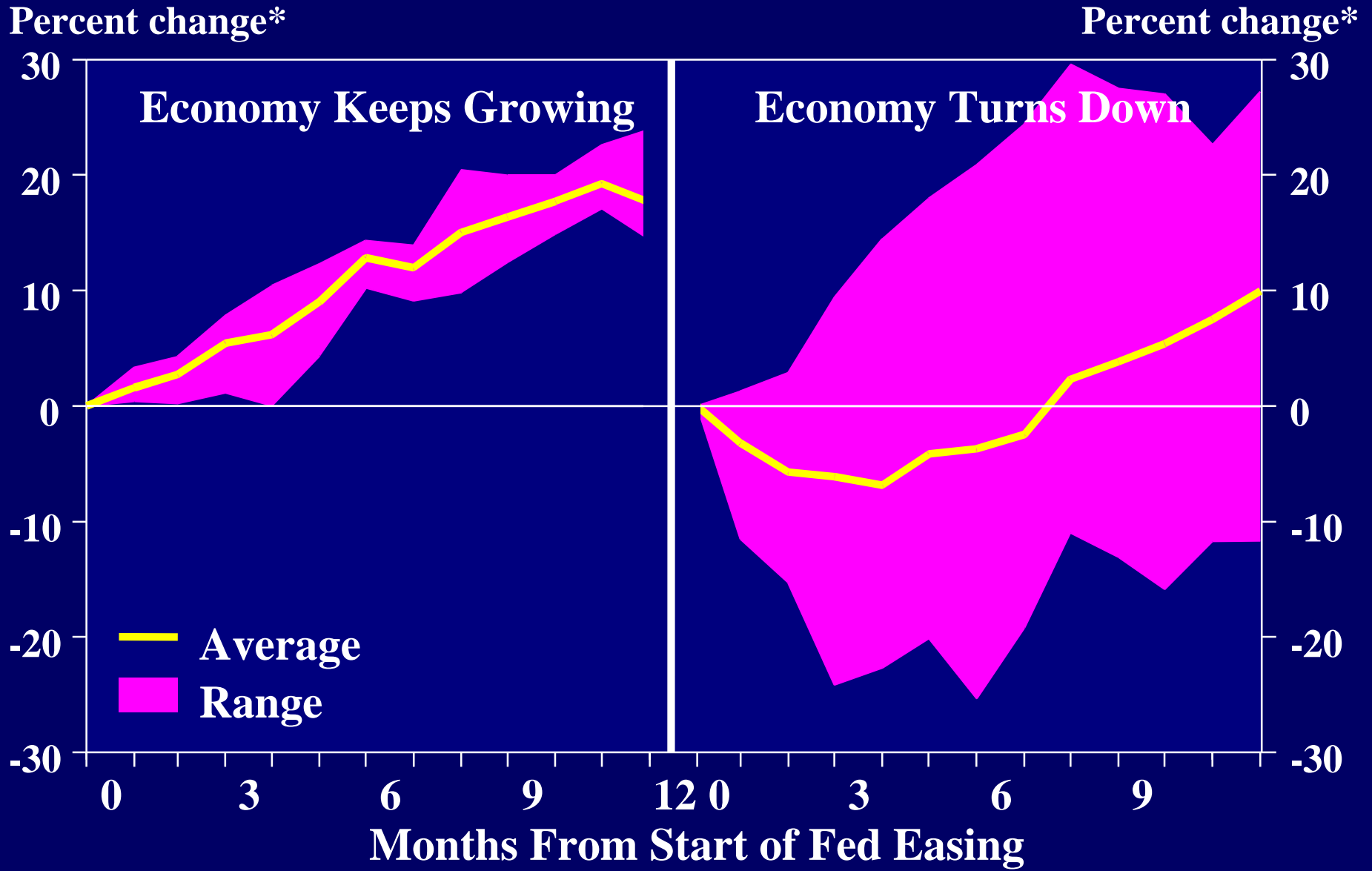
	Period	Federal Funds Rate		Change (bps)
		Beg.	End.	
Case 1:				
Financial Market	10/87-2/88	7.25	6.5	75
Turbulence	9/98-11/98	5.5	4.75	75
<i>Average:</i>				75
Case 2:				
Easing During Early	7/76-11/76	5.5	4.75	75
Stages of Recovery	4/92-9/92	4	3	100
<i>Average:</i>				87.5
Case 3:				
Economic Weakness:	12/66-7/67	5.75	4	175
Recession Averted	9/84-4/86	11.5	6.75	475
	7/95-1/96	6	5.25	75
<i>Average:</i>				241.7
Case 4:				
Economic Weakness:	4/60-1/61	4	1.5	250
Recession Not Averted	5/70-2/71	8	3.5	450
	7/74-1/76	13	4.75	825
	4/80-6/80	20	9.5	1050
	6/81-12/82	20	8.5	1150
	7/90-12/91	8.25	4	425
<i>Average:</i>				691.7

Source: Federal Reserve Bank of New York. Our estimates.

Tax Cuts Are On The Way



Stock Prices and Fed Easing



* S&P Performance from month of first easing.

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