

National and District Overview

NEW MILLENNIUM: SAME VIBRANT ECONOMY?

With few exceptions, U.S. economic performance remains exceptional at the turn of this millennium. As evident by the upbeat tone of recent beige books, this would also be an apt characterization of economic conditions in the Eighth Federal Reserve District. To get a sense of just where the District economy might be headed in 2000, it's helpful to gauge the likely strength of the national economy next year, as well as the outlook for inflation.

CENTURY CLOSES WITH A BOOM

CPI inflation through the first 11 months of 1999 ran about a percentage point above 1998's 1.6 percent rate. The bulk of this acceleration reflects the doubling of crude oil prices between February and November. Once the direct effects of higher energy prices are removed from the calculation, however, CPI inflation is actually running a bit lower (2 percent) over this period than it did in 1998 (2.4 percent). On the output side, real GDP increased at a 3.7 percent annual rate through the first three quarters of 1999. Although this is appreciably slower than 1998's 4.6 percent rate, output growth has been strong enough to pare the civilian unemployment rate to 4.1 percent in November—its lowest level in nearly 30 years.

Evidence from statistical reports available through December suggests that real GDP could expand rapidly during the final three months of 1999. In particular, fairly strong retail sales figures in October, November and—according to anecdotal reports from retailers—December, suggest that real consumer spending was quite brisk during the fourth quarter. Despite rising mortgage interest rates, which have put a damper on construction activity



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recently, the number of new and existing houses sold in 1999 will likely be the highest on record. Optimism abounds in the manufacturing sector as well, as business spending on capital goods remains quite strong. In particular, new orders and shipments of computers and office equipment advanced at their second-strongest pace in about 3½ years in October. U.S. manufacturers may see further gains if the widespread predictions of faster worldwide growth ring true.

WILL FORECASTERS BE ON THE MONEY IN 2000?

For the past few years, most forecasters have regularly underpredicted the strength of real GDP and overpredicted the rate of CPI inflation. One of the main surprises that has tripped up forecasters is the faster-than-expected growth of labor productivity (output per hour), which now appears to be growing about a percentage point faster than the 1 to 1.5 percent that most had assumed. In short, many forecasters now

assume that the economy's potential rate of real GDP growth—that is, the economy's noninflationary rate of growth—is around 3.5 percent. This also happens to be its average for the current expansion.

What about the prospects for 2000? Well, assuming next year's growth of labor input (a combination of employment growth and hours worked) and labor

productivity in the *private, nonfarm* business sector will match their average rates for this expansion—roughly 2 percent growth of each factor—nonfarm business output should grow by about 4 percent in 2000. Adding back in the government and farming sectors (to get total GDP) suggests real GDP growth of around 3.5 percent. Basically, the economy is expected to grow at its potential until some unforeseen shock causes a significant change in aggregate demand or supply. Given the poor record of forecasters stated earlier, however, the possibility of another year of above-trend growth should not be discounted.

In terms of the inflation outlook, most forecasters anticipate a modest deceleration in CPI growth in 2000, perhaps to around 2½ percent. This forecast depends significantly on a lower trajectory of oil prices—an expectation also apparent in crude oil futures prices. Continued strong productivity gains, which will temper product price pressures, as well as moderating rates of money growth, also factor into the equation. In any case, forecasters generally agree that if aggregate demand continues to expand at a rate that exceeds growth of aggregate supply, it would not be surprising to see somewhat faster price inflation.

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