

Economic Outlook

BEA Nevada Conference – Reno



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September 28, 2009

Federal Reserve Bank of San Francisco
Yelena Takhtamanova, Economist

Overview

- 1. U.S. monetary policy:**
 - Goals
 - Tools (conventional and new)
- 2. Current situation – challenging:**
 - Financial and banking challenges
 - Significant job losses
 - Signs of improvement
- 3. FRBSF national economic forecast**
- 4. Risks to the forecast**

These remarks represent my views and not necessarily those of my colleagues in the Federal Reserve System.

1. U.S. Monetary Policy Goals

Federal Reserve's goals:

- Ensure the functioning of the financial system
- Conduct monetary policy to:
 - Achieve maximum sustainable employment/output
 - Maintain low and stable price inflation

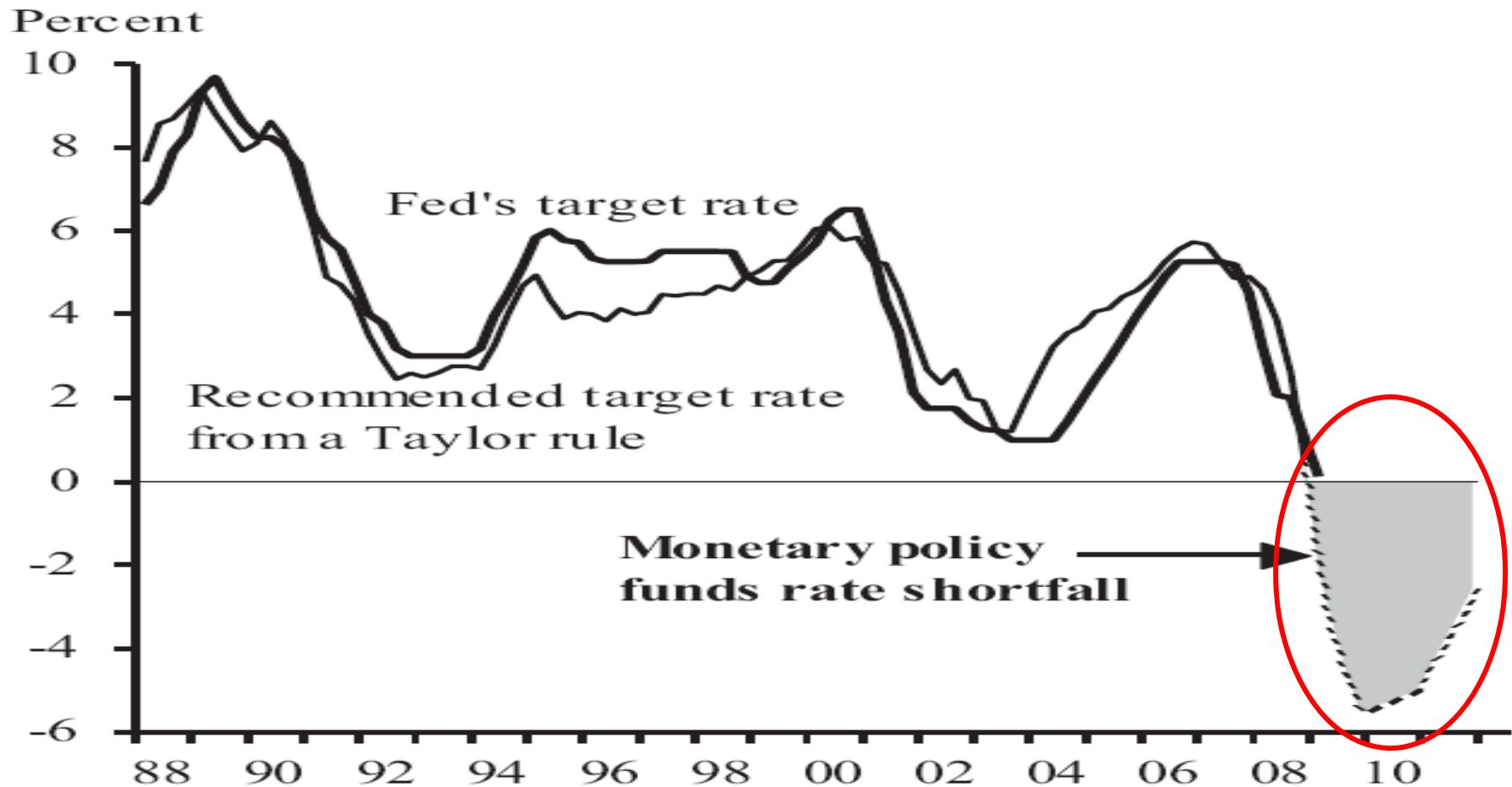
Each of these goals is currently being threatened.

Therefore, the Federal Reserve has taken action to:

- Maintain liquidity in financial markets
- Provide aid to systemically-important firms
- Lower borrowing costs for consumers and businesses
- Increase the availability of credit

Monetary Policy in Perspective: Conventional Policy Instrument Shortfall (Because of Zero Bound)

Fed Funds Target Rate and Funds Rate Shortfall



Source: Rudebusch (2009), FRBSF Economic Letter

<http://www.frbsf.org/publications/economics/letter/2009/el2009-17.pdf>

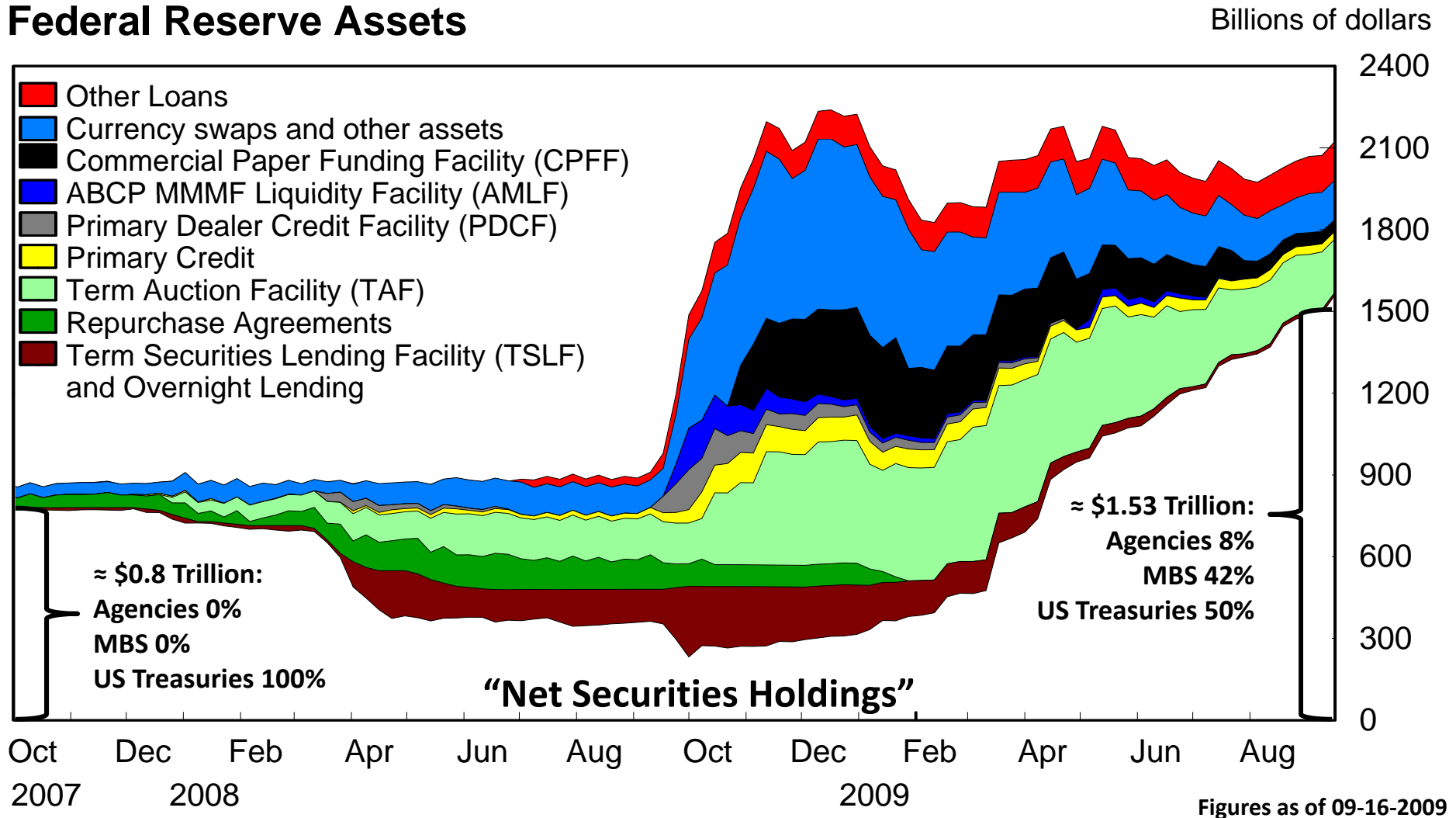
“Zero Bound” Problem: What Can Monetary Policy Do When Interest Rates Approach Zero?

Monetary Policy at Near-Zero Interest Rates – Three Strategies for Stimulating the Economy:

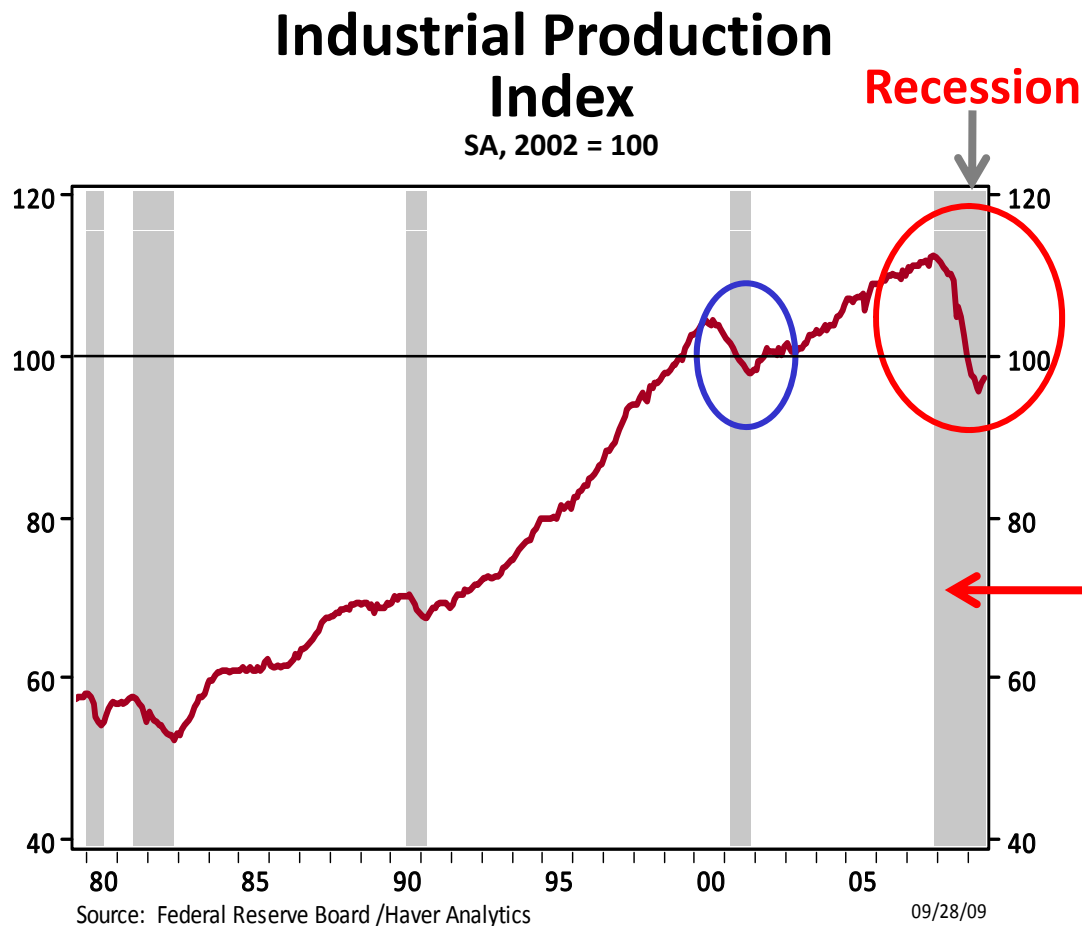
- 1. Provide a commitment to keep the funds rate low**
 - **Unconditional: “maintained for a considerable period”**
 - **Conditional: “until financial conditions stabilize”**
- 2. Alter composition of Fed’s balance sheet**
 - **Sell Treasuries, buy commercial paper, agencies, and Mortgage-backed Securities (MBS)**
- 3. Increase size of Fed’s balance sheet**
 - **“Quantitative easing”: boosting the amount of bank reserves in the economy**

Unconventional Monetary Policy Actions: Shifts and Increases in Fed's Balance Sheet

Federal Reserve Assets



2. *Current Situation:* Recession Is the Longest and Deepest Since the 1940s



***The U.S. economy
officially
peaked in and
the recession
began in
December 2007.***

National Bureau of
Economic Research

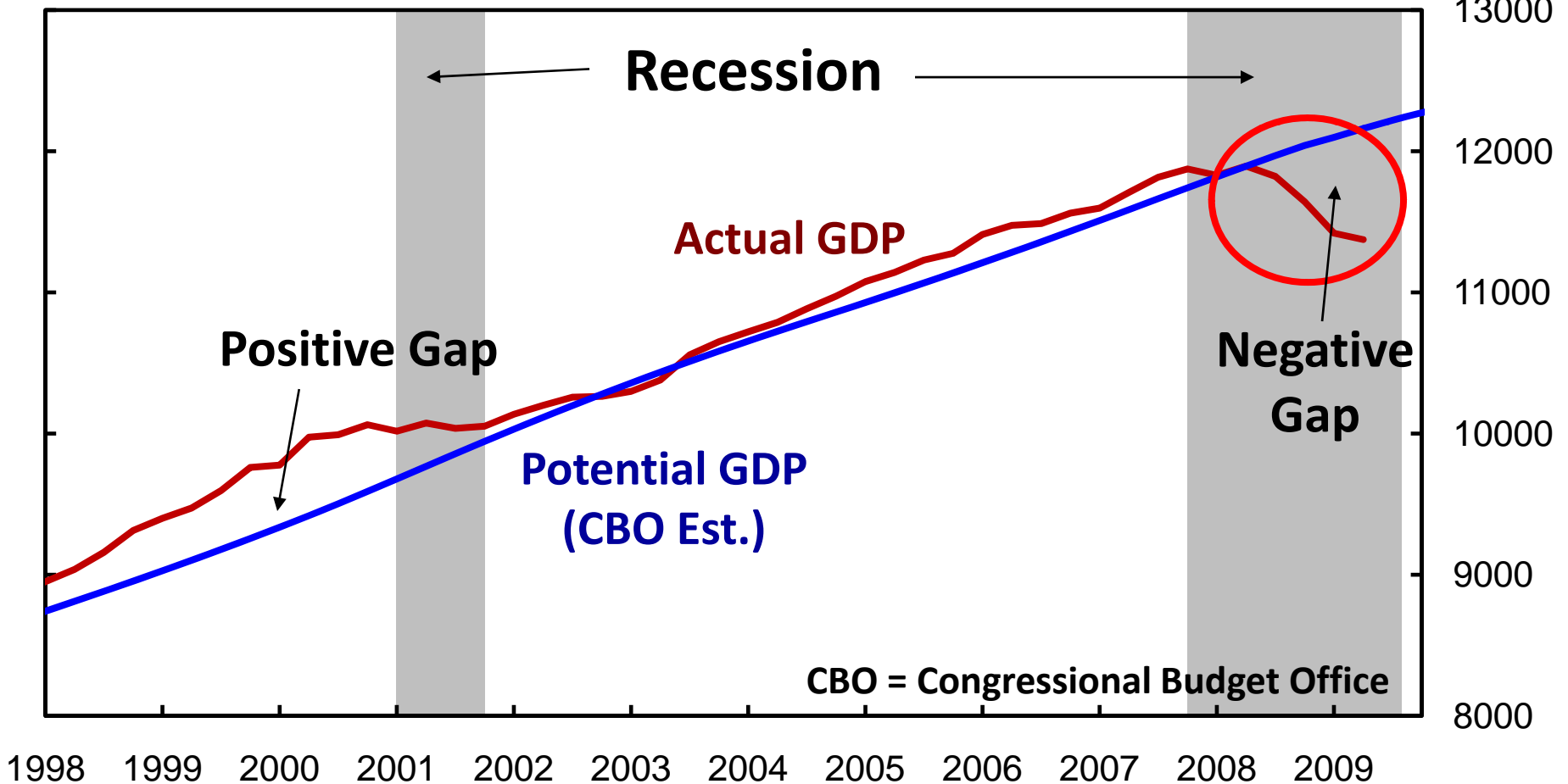
***NBER Business Cycle Dating
Committee, 11-28-2008.***

U.S. Economic Output Gap: Real Gross Domestic Product (GDP) Falls Well Below Potential

Economic Output Gap

Widening Gap Between Actual and Potential Real GDP

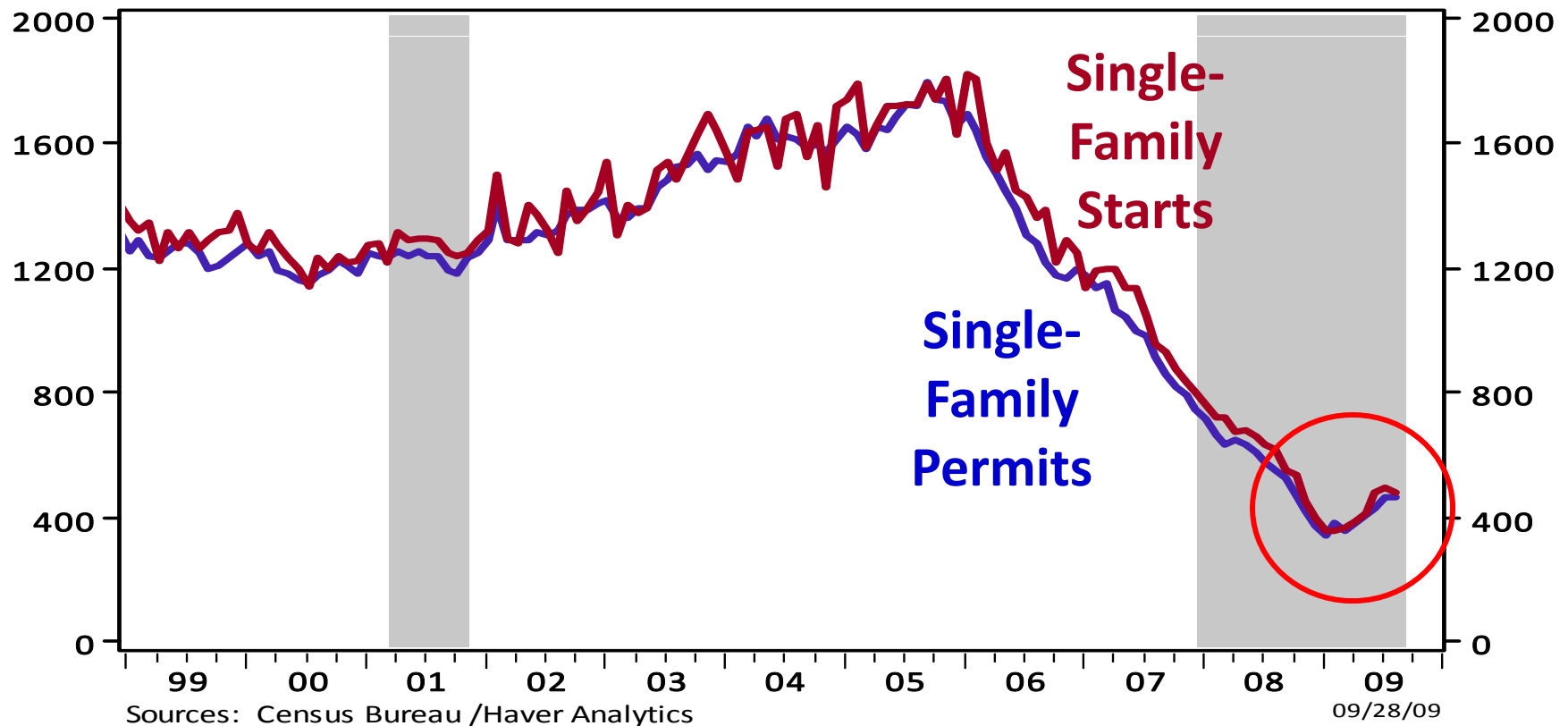
\$ Billion (2000 chained)



Source: BEA, CBO, Haver

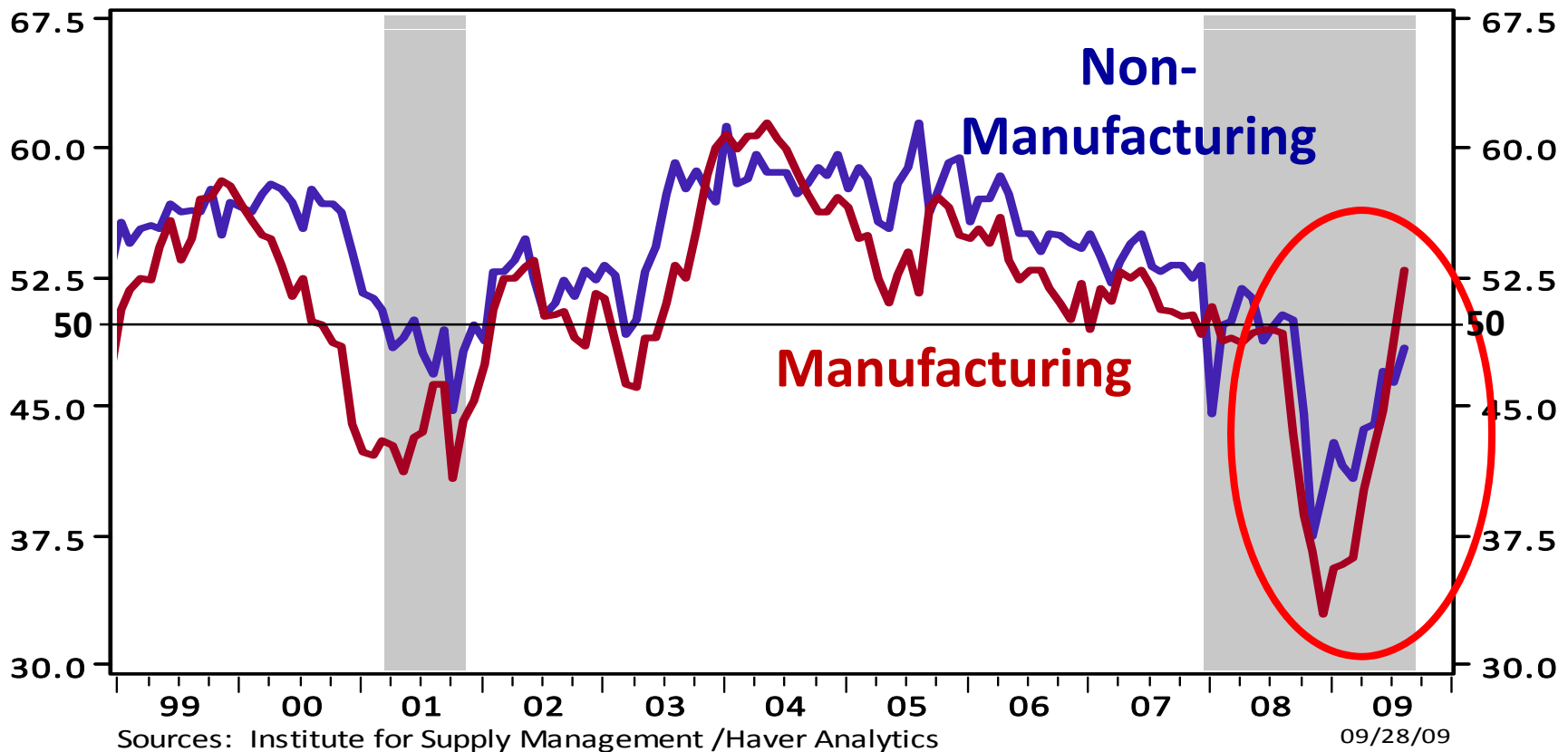
Housing Market Indicators: New Construction Activity May Have Reached the Bottom

Single-Family Housing Permits and Starts (thousands of units)



Measures of Business Activity: Both Manufacturing and Non-Manufacturing (Services) Sectors Rebounding

ISM Composite Indices: Manufacturing vs. Non-Manufacturing (Above 50 Sector is Expanding; Below 50 Sector is Contracting)

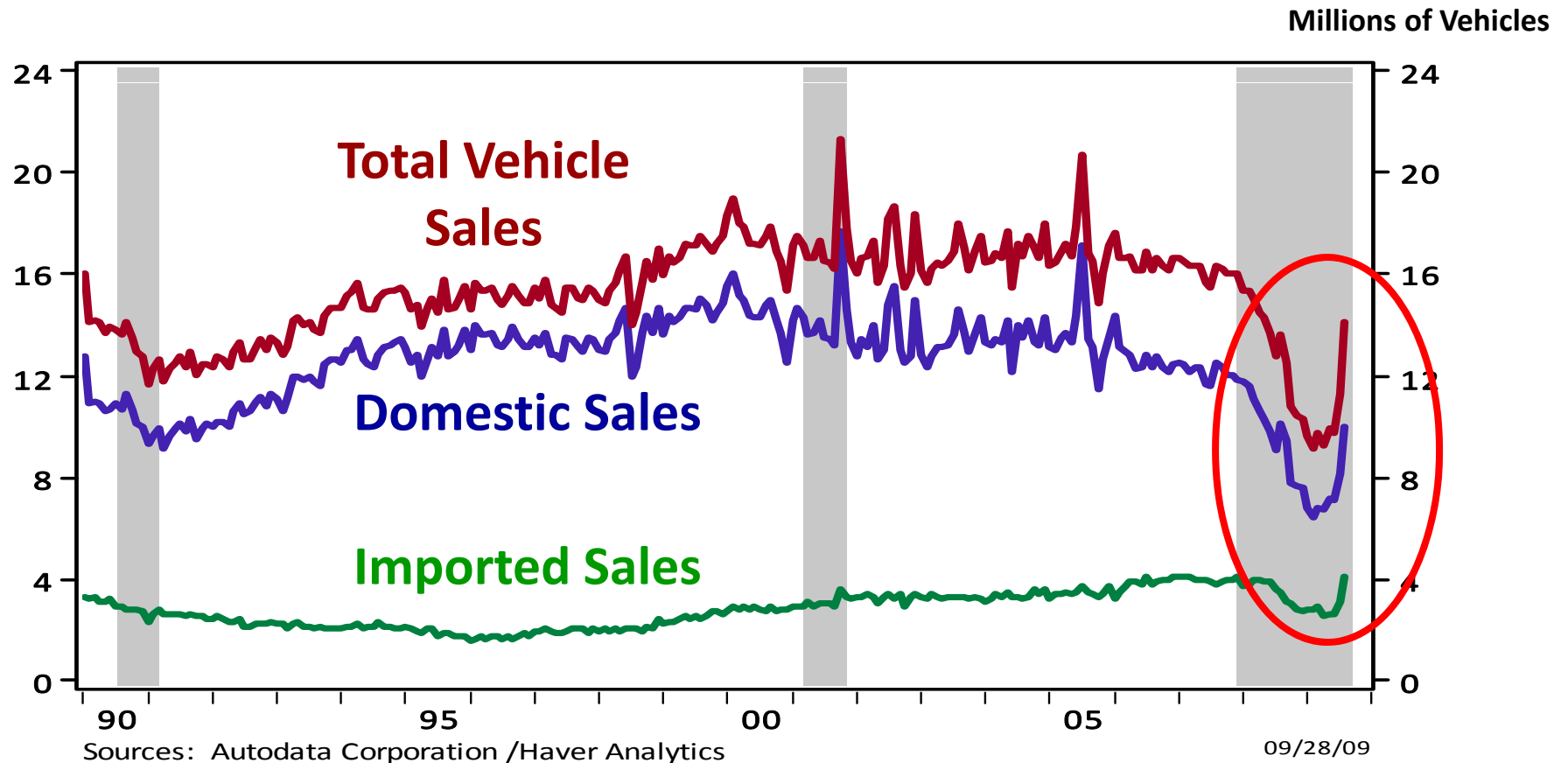


U.S. Light Vehicle Sales: “Cash-for-Clunkers” Drove Auto Sales Upward

Total Light Vehicle Retail Sales {Imported+Domestic} (SAAR, Mil. Units)

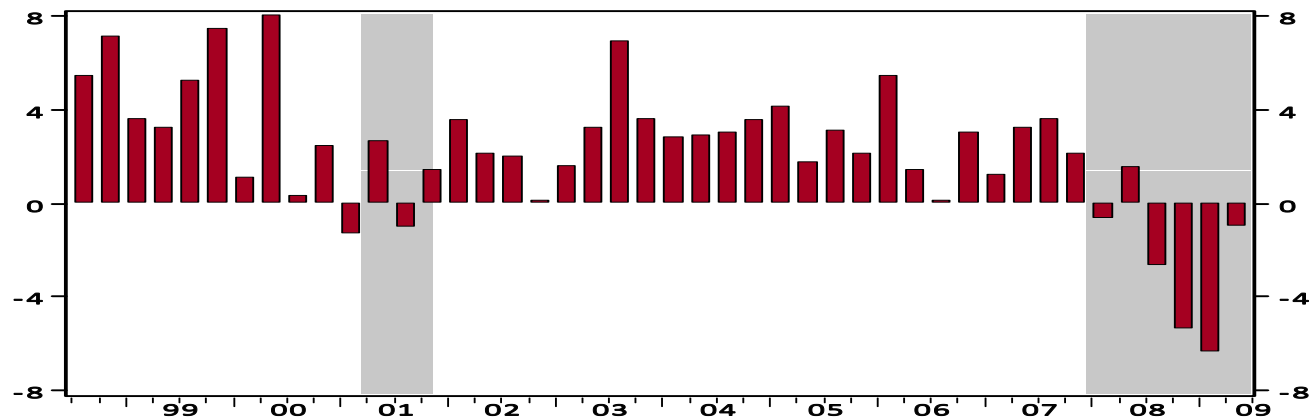
Total Domestic Light Vehicle Retail Sales (SAAR, Mil Units)

Total Imported Light Vehicle Retail Sales (SAAR, Mil. Units)

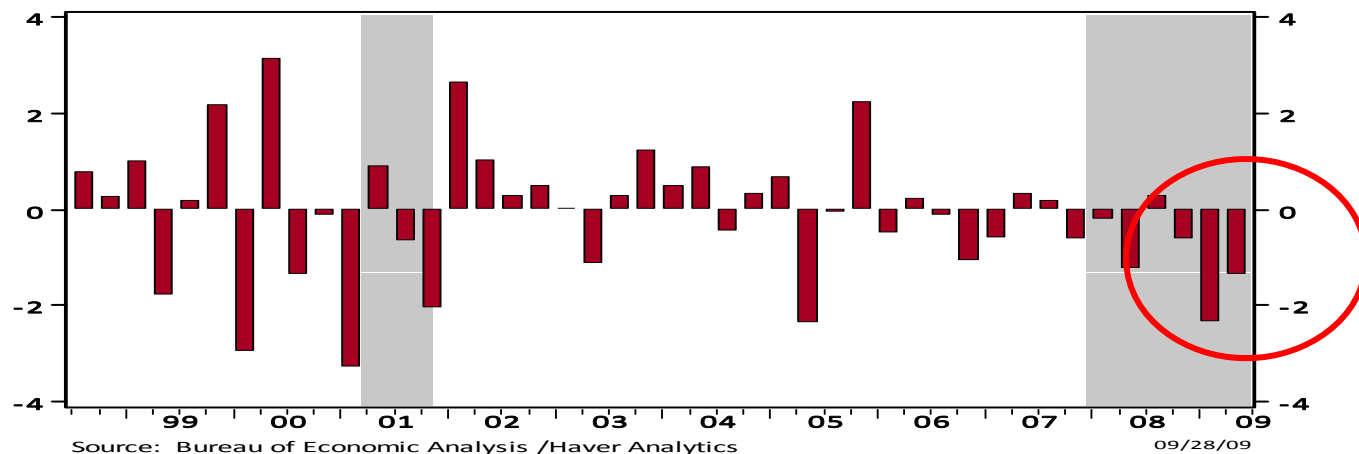


Contributions to Growth: Large Inventory Decline Reduced Current Growth, Should Help in Future

Real Gross Domestic Product
(SAAR, % chg.)



Real Change in Private Inventories: Contribution to Real GDP Change
(SAAR, % chg.)

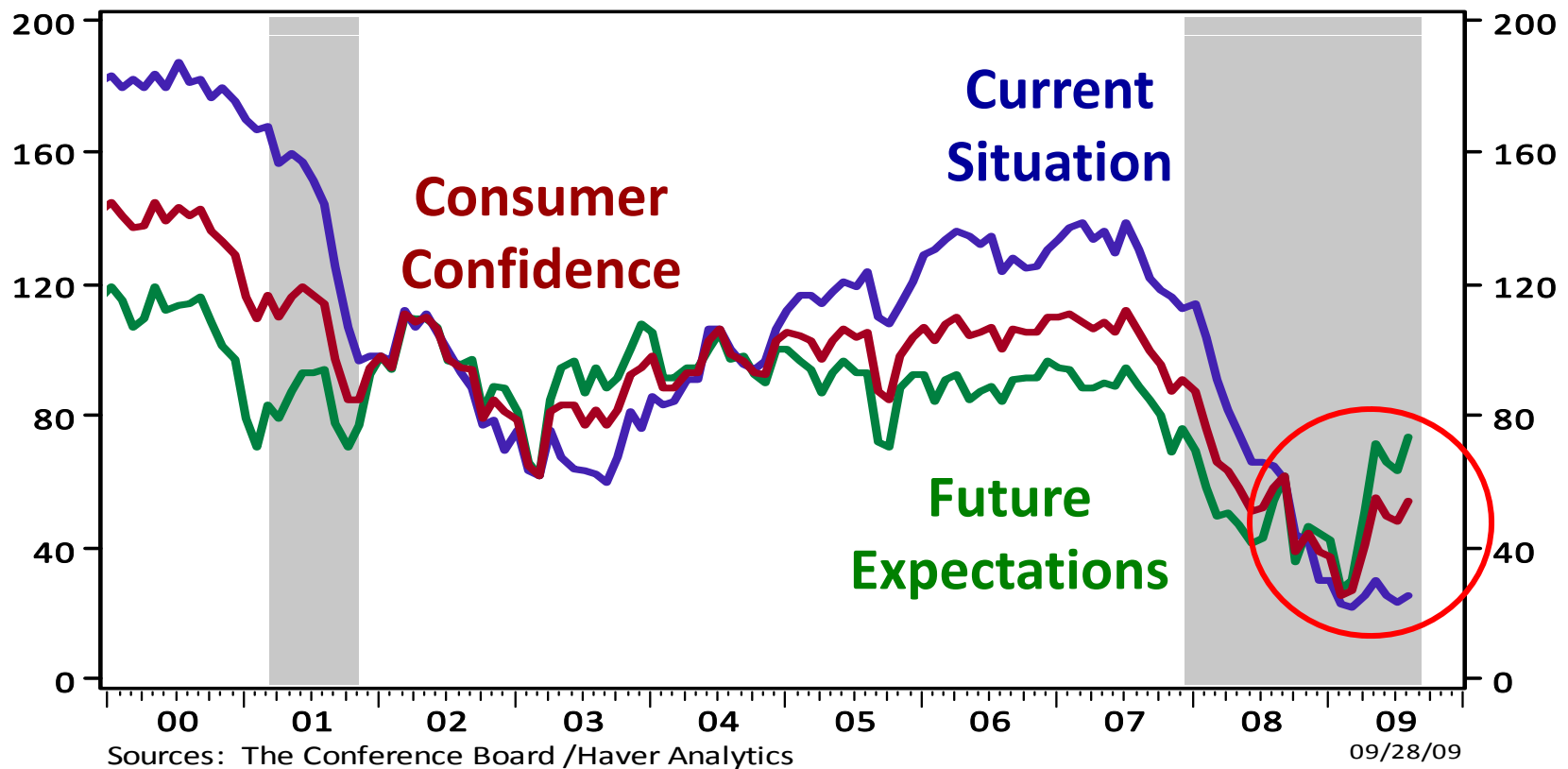


Source: Bureau of Economic Analysis /Haver Analytics

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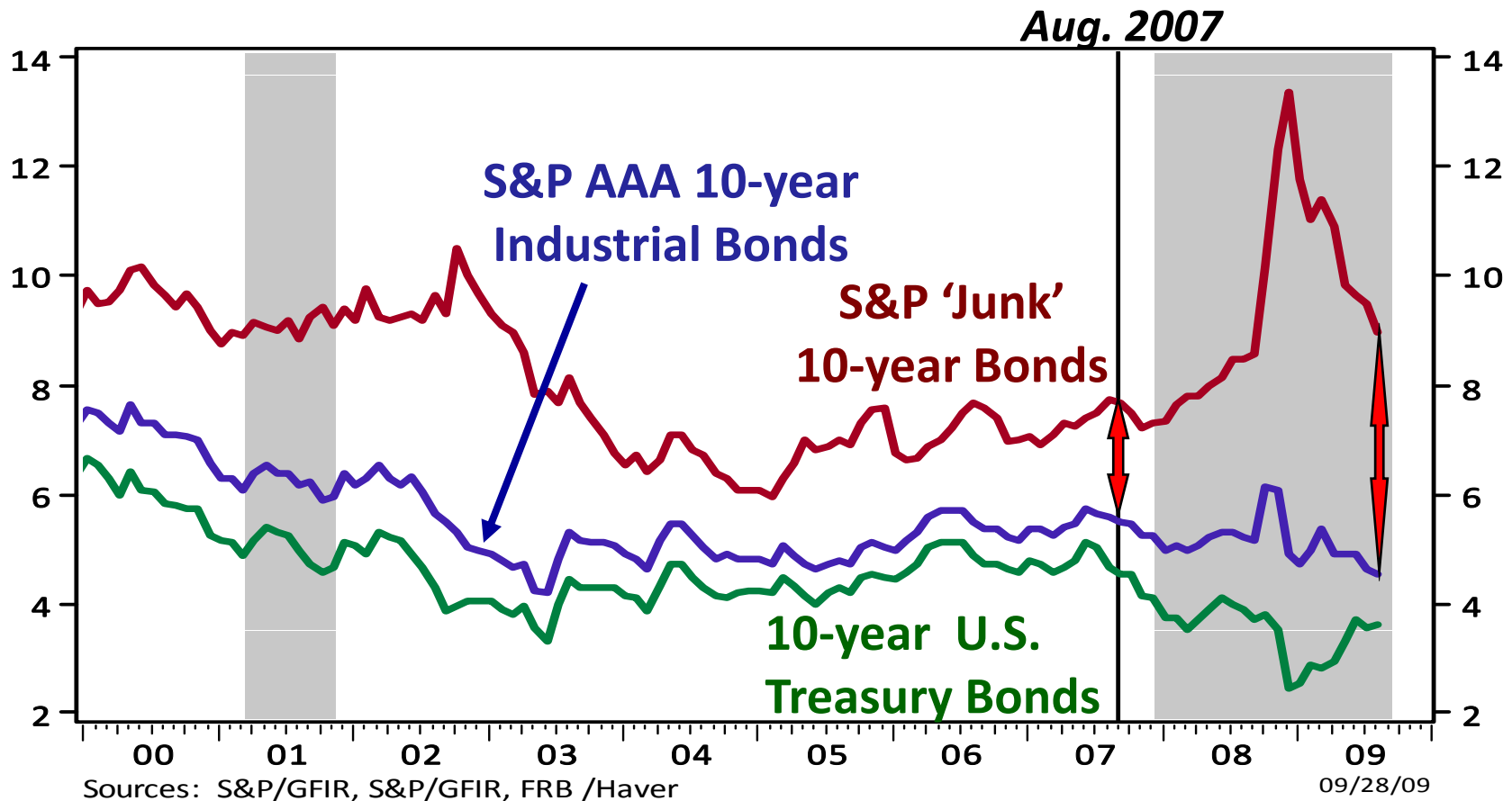
U.S. Consumer Attitudes: After Record Deterioration in Confidence – Expectations Are Improving Some

Consumer Confidence Index and Components (Index Numbers)



Signs that Unconventional Monetary Policy May be Working: Credit Risk Spread Has Narrowed Some

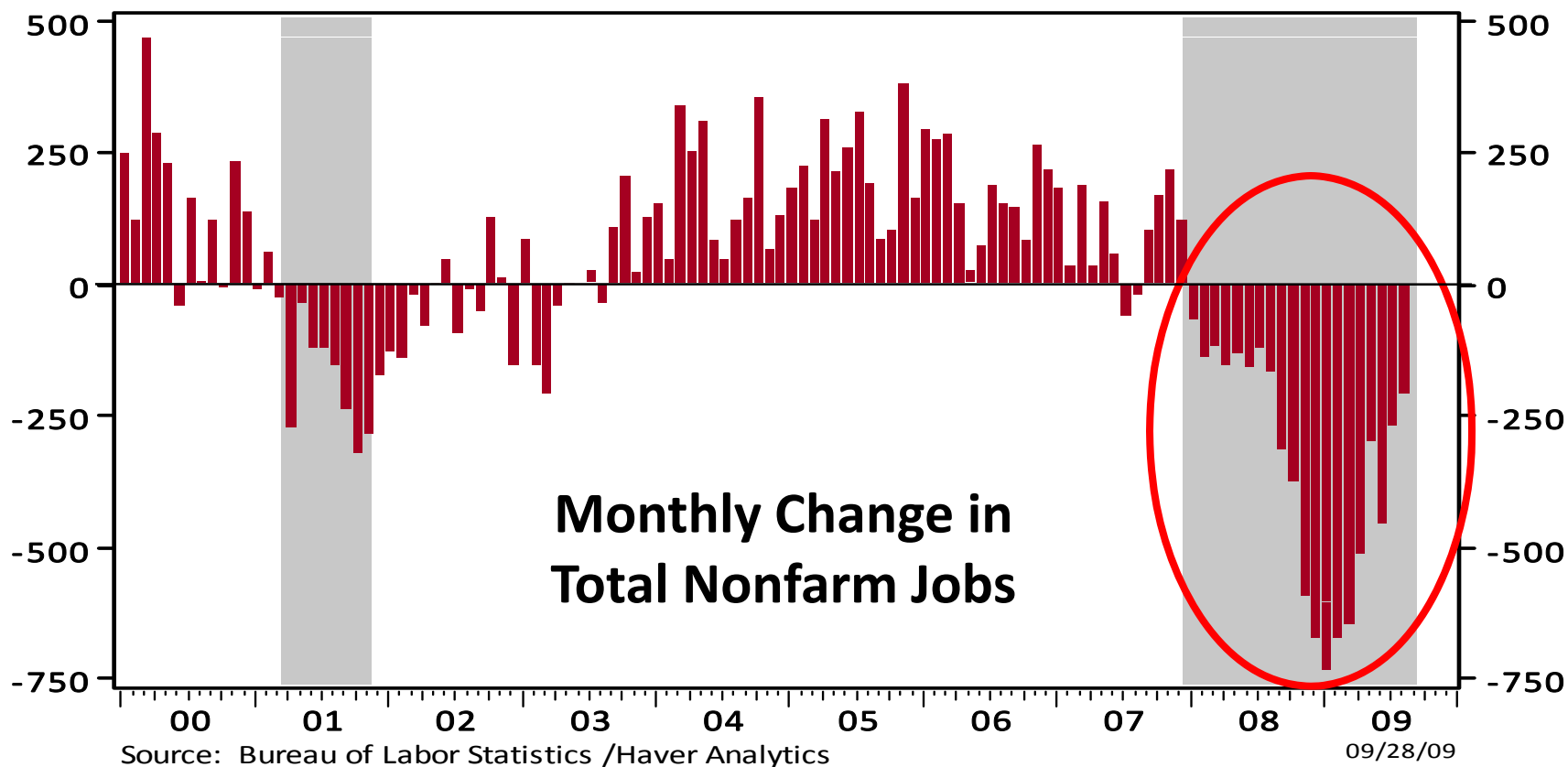
Corporate and Treasury Bond Yields (in Percent)



Employment: Total U.S. Nonfarm Employment Has Fallen Every Month Since the Beginning of 2008

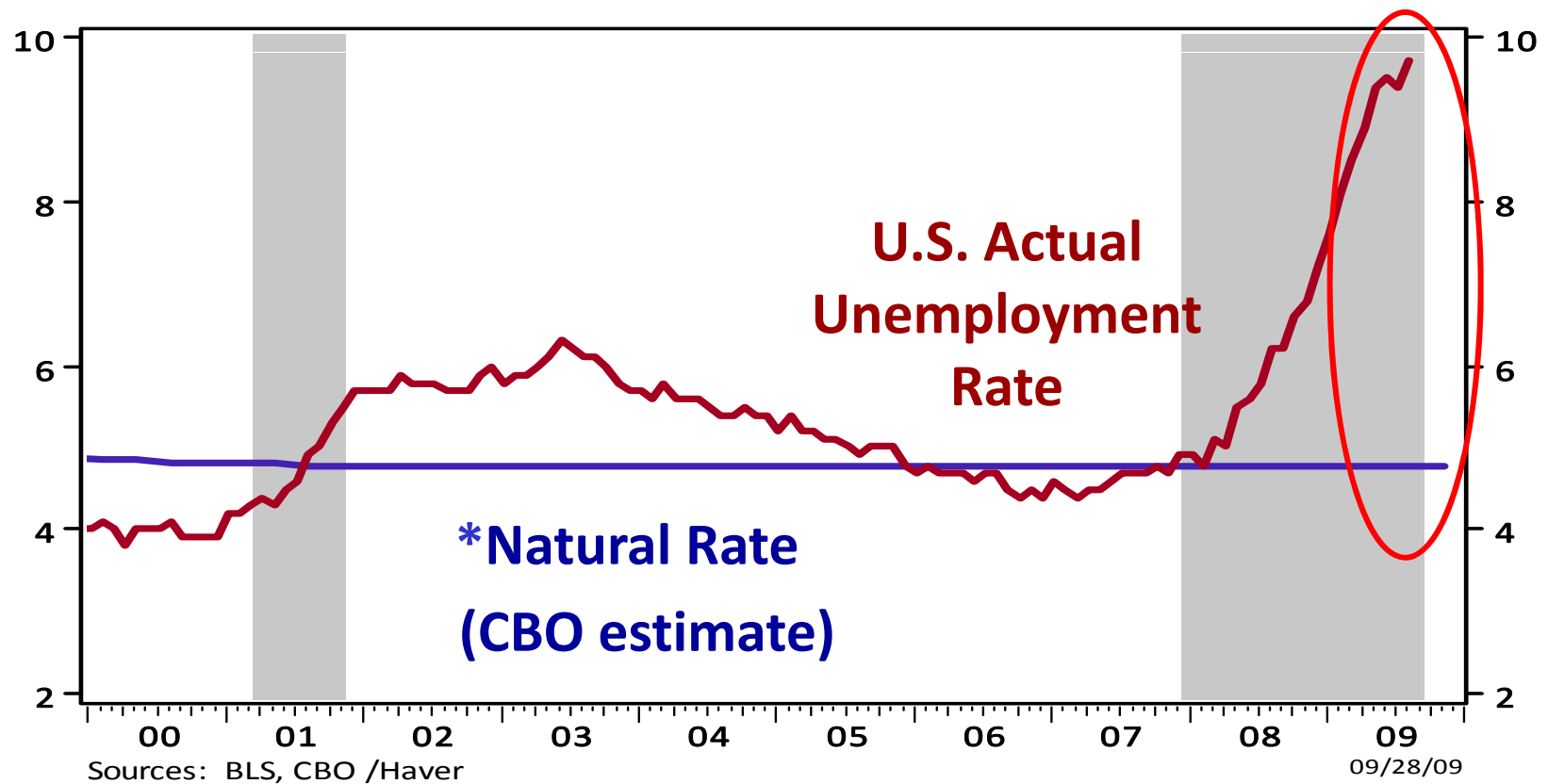
Monthly Change in Payroll Jobs (Thousands)

Job Loss Since Dec. 2007 = Over 6.9 Million



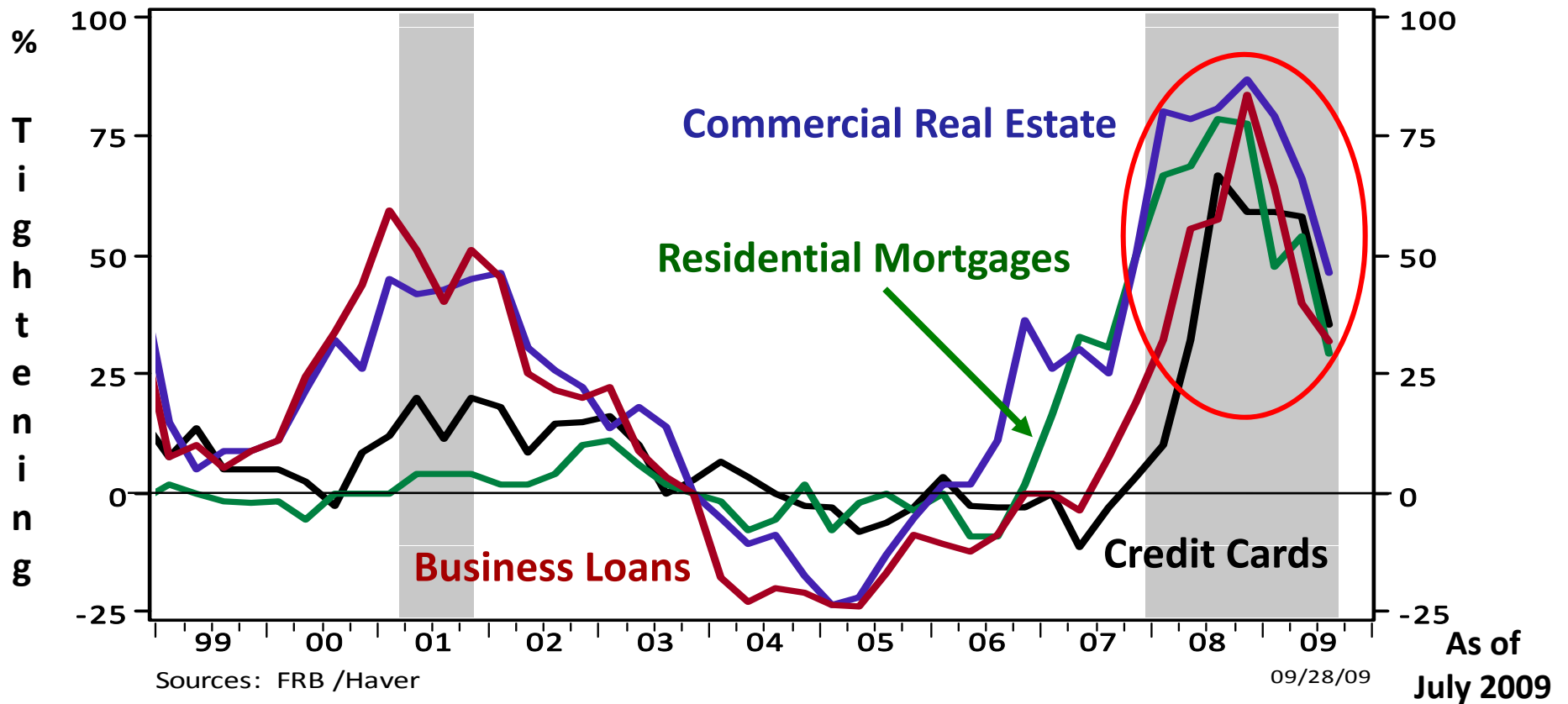
National Unemployment Rate: Has Climbed Far Above the Natural Rate

U.S. Unemployment Rate (in percent)
(CBO = Congressional Budget Office)



Lending Practices: U.S. Bank Lending Standards – Some Easing, but Still Remain Tight

Federal Reserve Senior Loan Officer Survey
Net Percentage of Banks Tightening Lending Standards
(greater than 0 % = tightening standards)

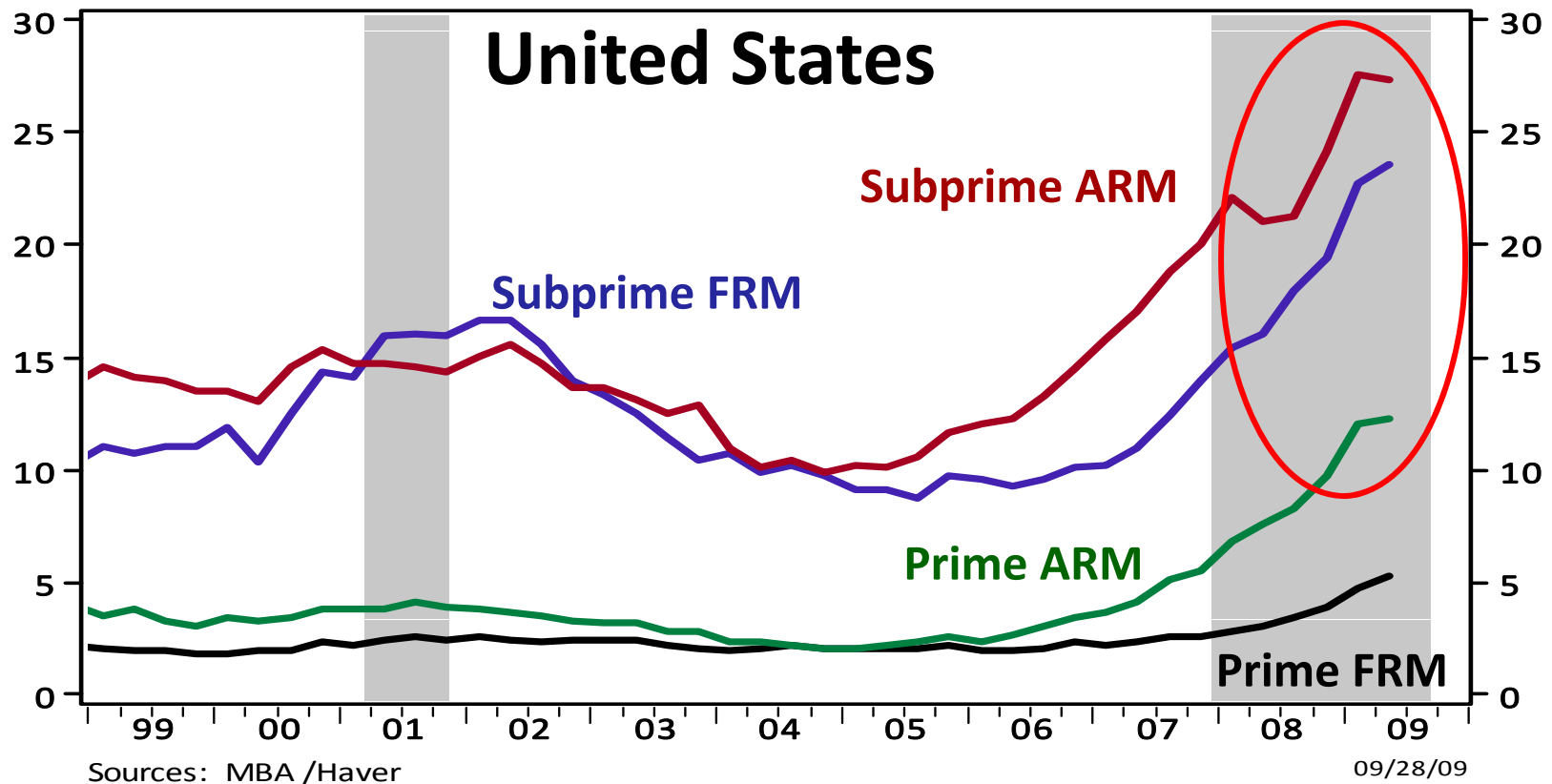


U.S. Mortgage Delinquency Rates: Increases Spreading to Prime ARM Mortgages (Sea. Adj.)

Conventional Mortgages Past Due (in Percent) by Loan Type

FRM = Fixed Rate Mortgage

ARM = Adjustable Rate Mortgage





3. *Going Forward: Weakness Expected (September Forecasts)*

Recession nearing end:

- ***FedViews***: On balance, it's probable that the economy has reached bottom and begun its slow recovery. The course going forward surely won't be smooth or painless, and clear risks remain. Despite the risks, we still expect the return to positive output growth to begin in the current quarter. We expect the recovery will gradually pick up steam over the next year or two.
- ***Blue Chip***: Consensus 2009 Real GDP growth forecast in September was for a decline of 2.6 percent (unchanged from August). The 2010 forecast calls for positive growth of 2.4 percent (revised up from 2.3 percent in August).

From September 10, 2009 *FedViews*, & September 10, 2009 *Blue Chip Economic Indicators*
See *FedViews* @ www.frbsf.org/publications/economics/fedviews/

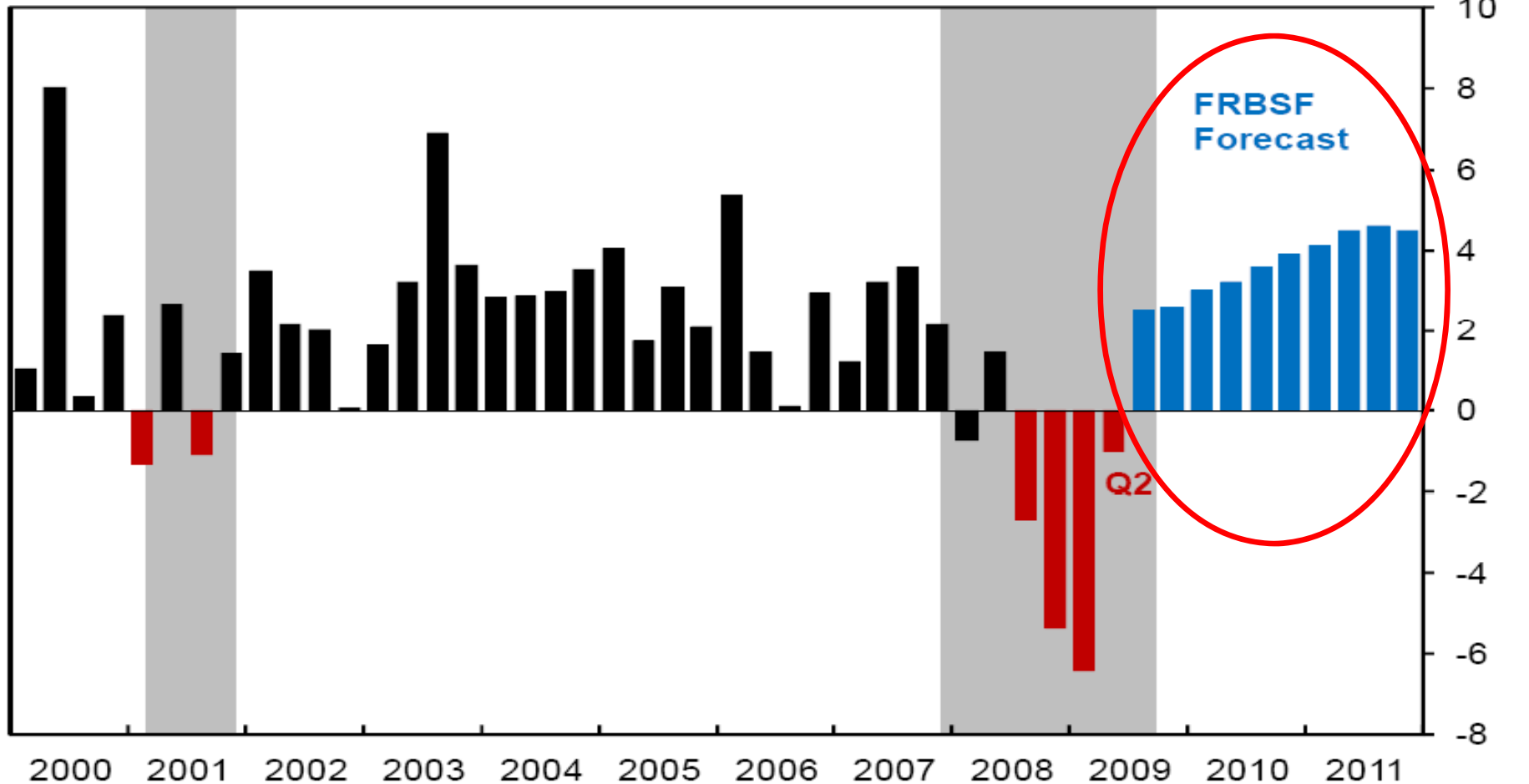


FRBSF Real GDP Forecast: Contraction in 2008:Q3-2009:Q2, Growth Starts in 2009:Q3

Real GDP

Percent change at seasonally adjusted annual rate

Percent



FedViews of September 10, 2009

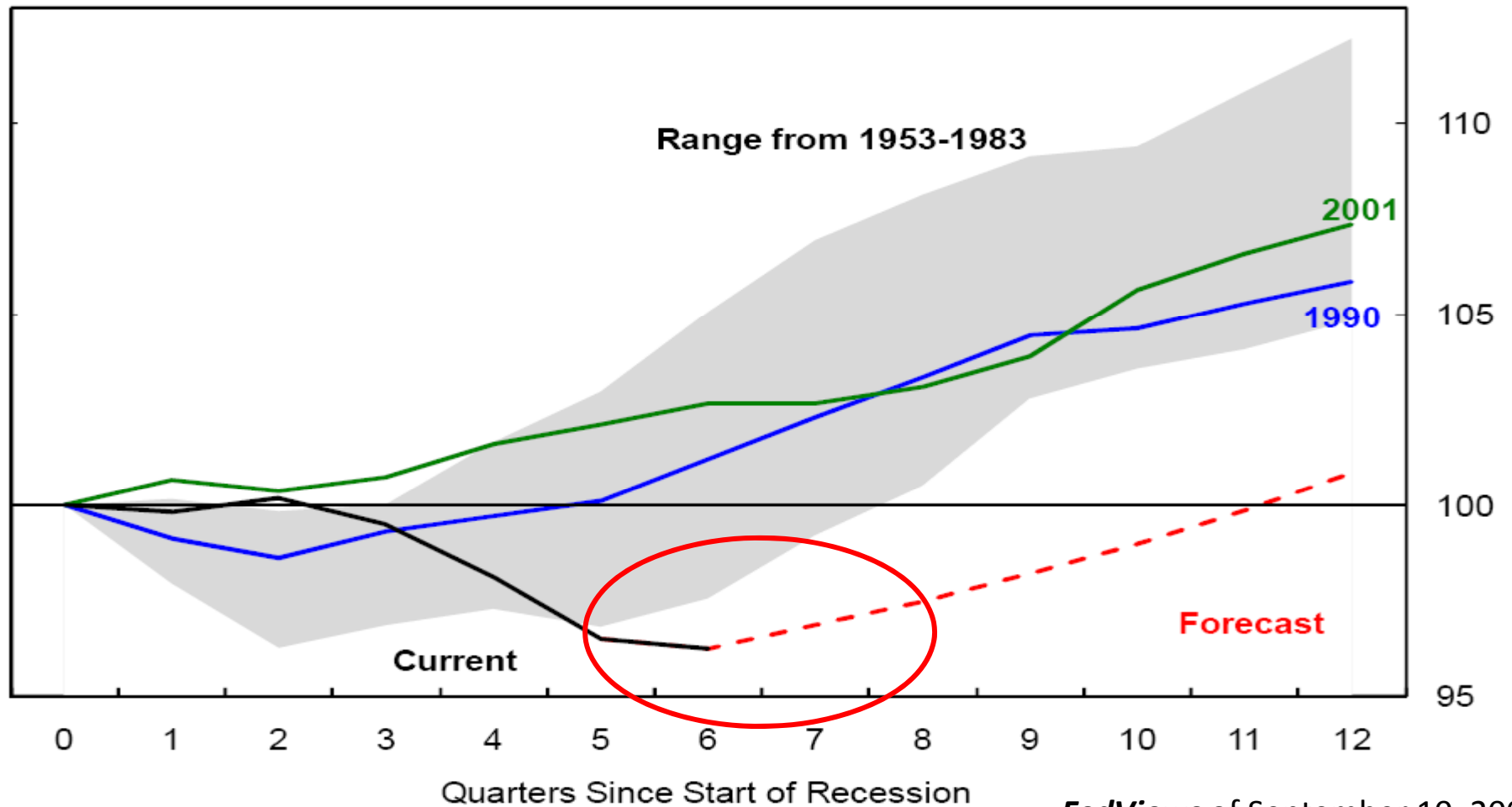


U-Shaped or V-Shaped Recovery: Slower than Normal Recovery Expected

Gross Domestic Product

Series indexed to 100 at start of recession

Percent





Going Forward: Inflation Moderation Expected (September Forecasts)

Both headline and core inflation should moderate:

- ***FedViews***: Cost pressures remain low. With the weakness in wage growth and the overall high degree of slack in the economy, little inflation pressure is evident in the near term. We expect the high degree of slack to cause core inflation to moderate even more in the near term. Overall inflation will rise somewhat more in the next few quarters.
- ***Blue Chip***: Total CPI (including food and energy) is expected to decline 0.5 percent in 2009 (unchanged from August). For 2010 the forecast is for 1.8 percent inflation (revised down from 1.9 percent in August).

PCE = Personal Consumption Expenditures, CPI = Consumer Price Index

Core Inflation = All items less food and energy

From September 10, 2009 *FedViews*, & September 10, 2008 *Blue Chip Economic Indicators*

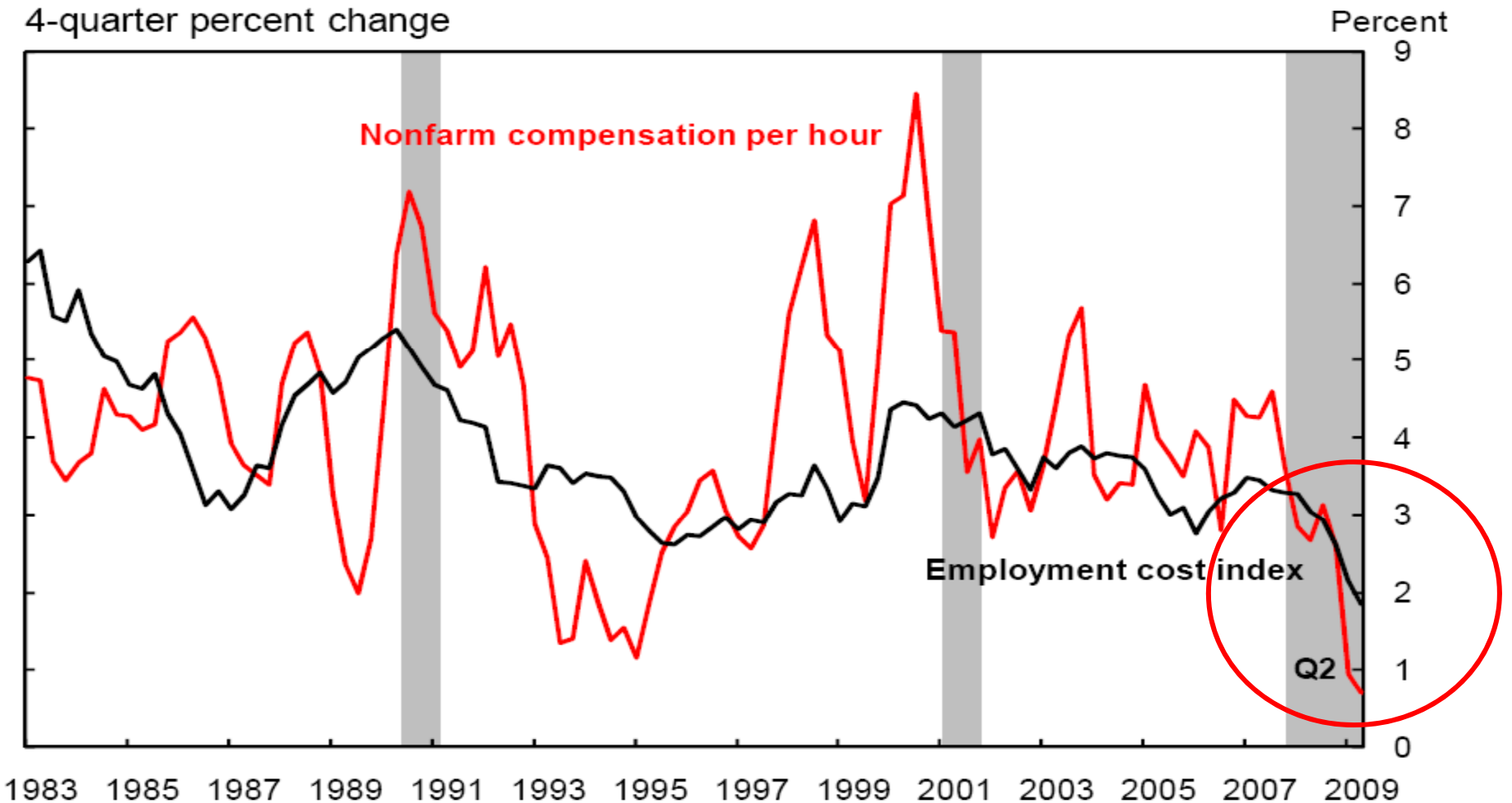
www.frbsf.org/publications/economics/fedviews/



Labor Market Outlook: Wages Are Barely Growing

Labor Compensation

4-quarter percent change



FedViews of September 10, 2009

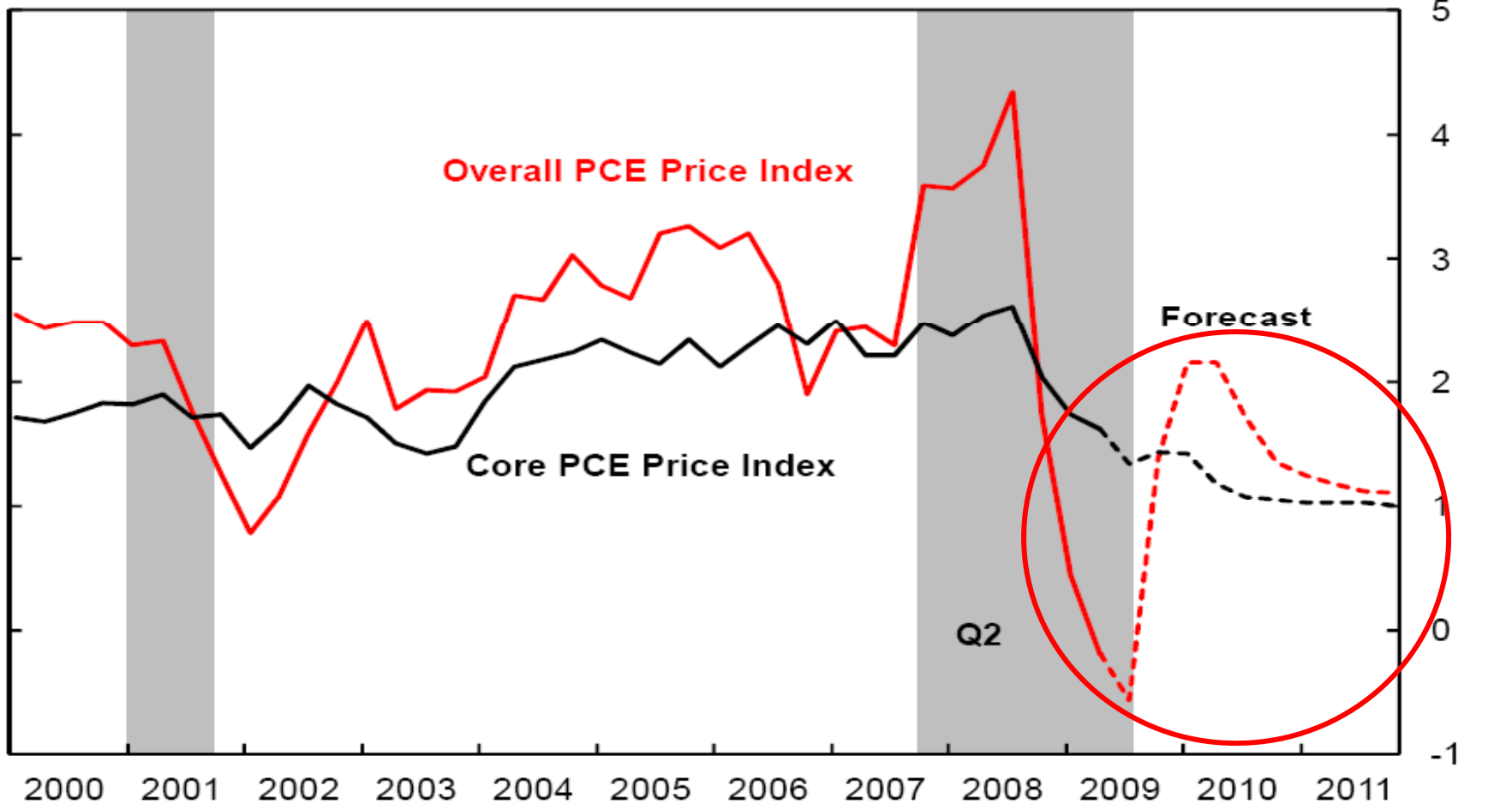


Price Level Forecasts: FRBSF Expects Inflation to Remain Low

PCE Price Inflation

Percent change from four quarters earlier

Percent



FedViews of September 10, 2009

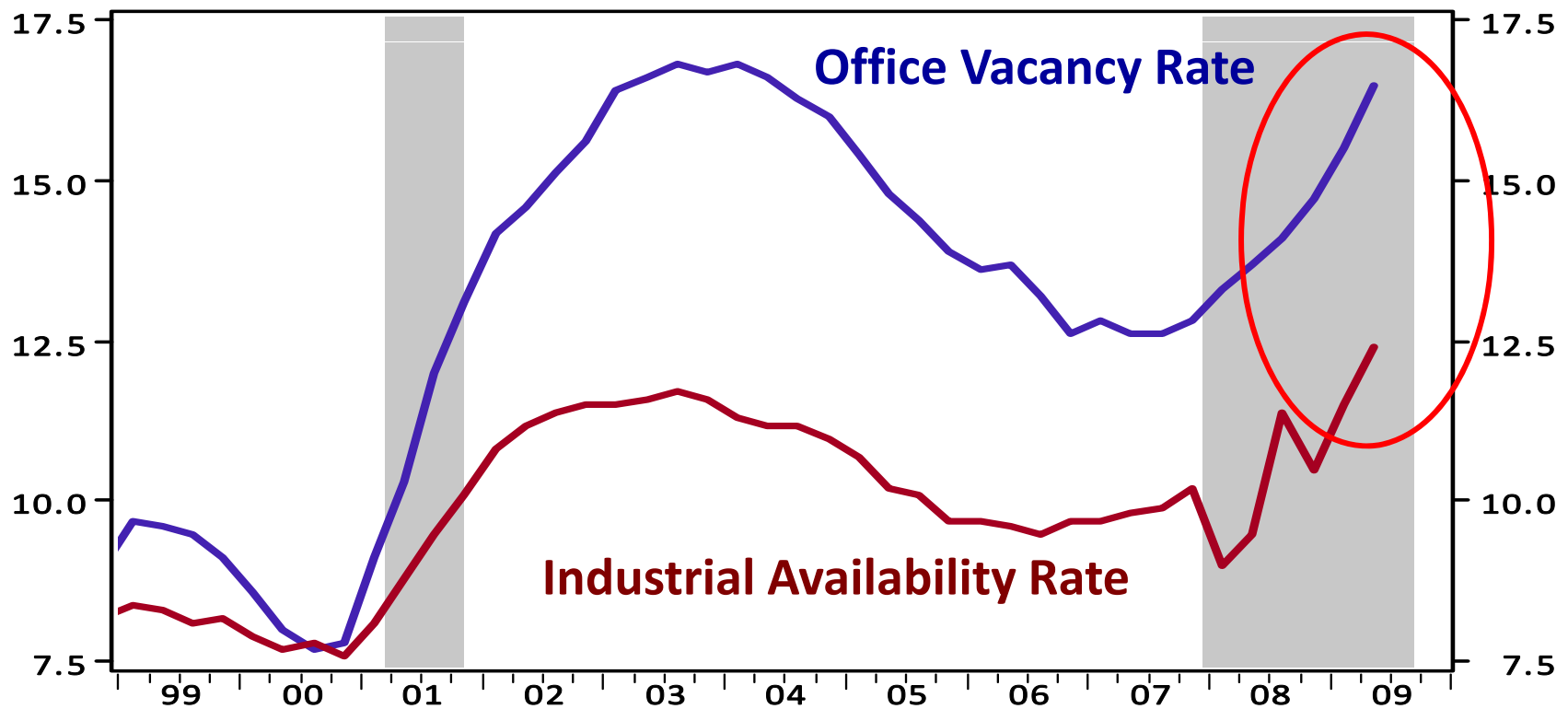
4. *Risks*: Many on the Downside — Rebound Should Be Relatively Modest

Overall risks:

- Deterioration in commercial real estate
- Housing sector is still fragile
- Depths of the global recession
- Conditions in the banking sector
- Consumer saving and spending
- The impact of the fiscal stimulus and Federal Reserve actions

Commercial Real Estate: Job Losses and Weak Economy Contribute to Softening In CRE

National Office Vacancy and Industrial Availability Rates (in percent)

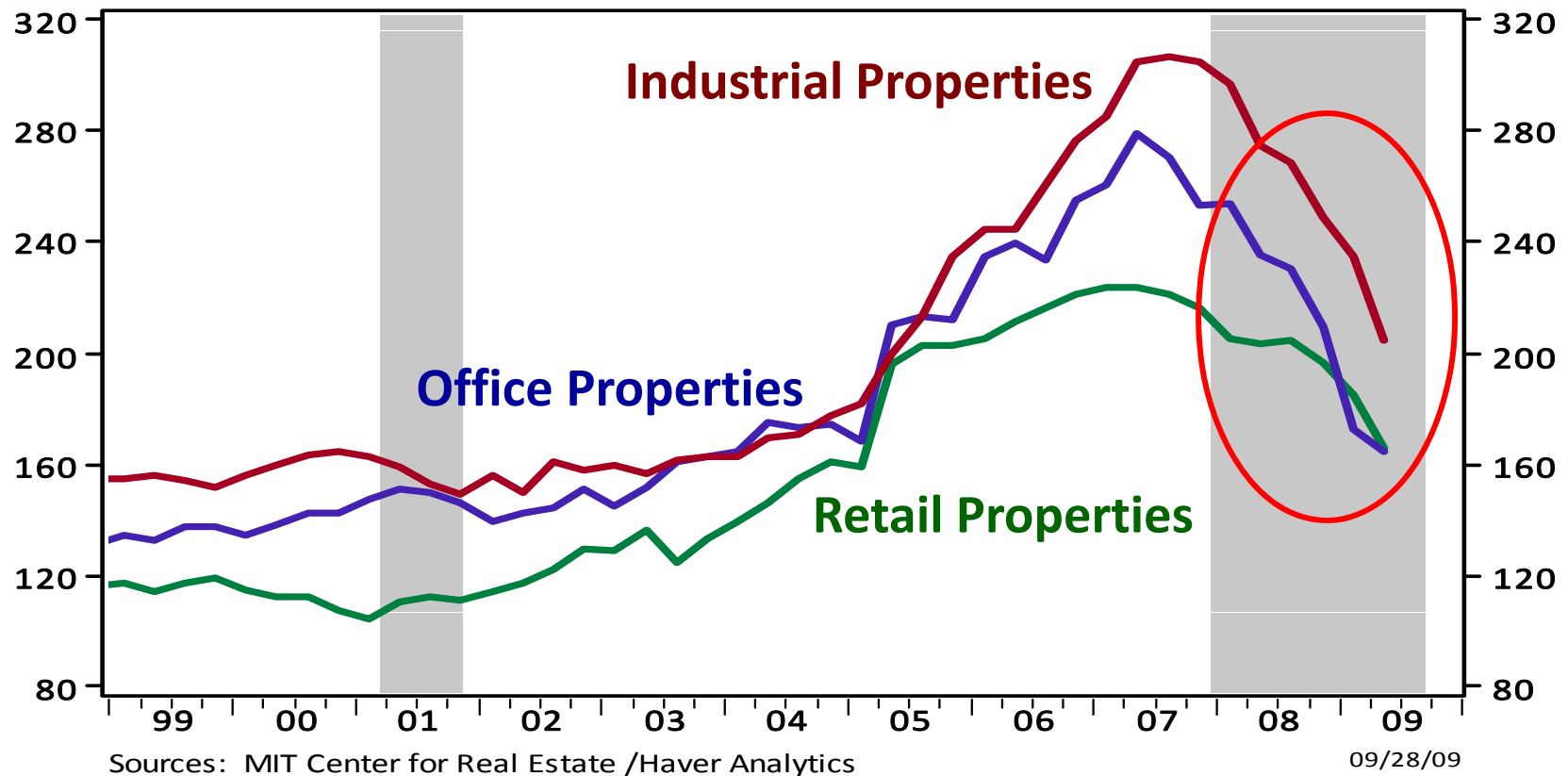


Sources: CB Richard Ellis /Haver Analytics

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Commercial Real Estate: Index Measures of Commercial Real Estate Prices Are Falling

TBI Commercial Real Estate Index by Property Type (Q1 1994 = 100)

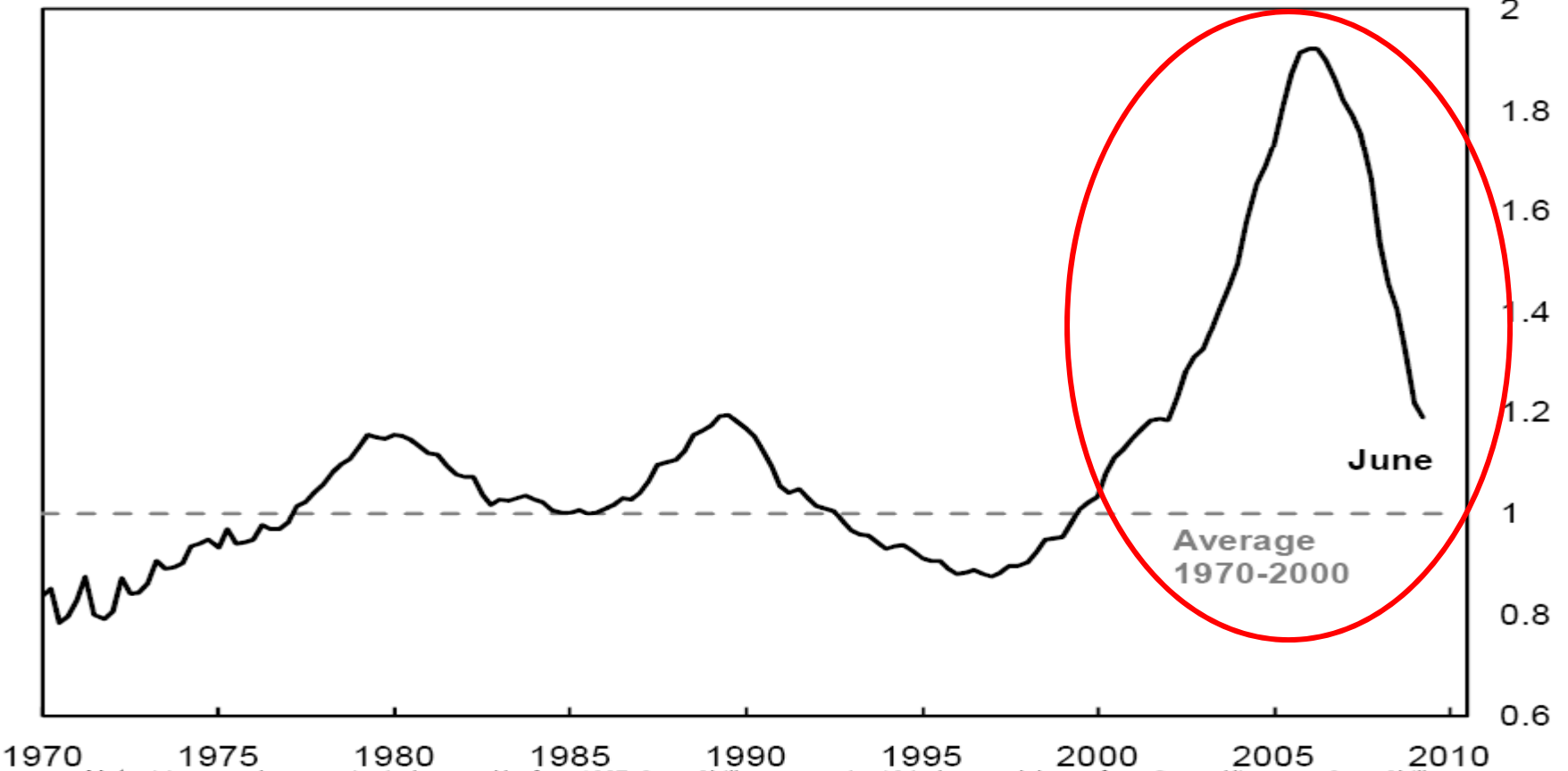




Housing Market Indicators: Continuing Price Declines but Closing in on “Normal” Level

Case-Shiller Home Price Index Relative to Rent Index

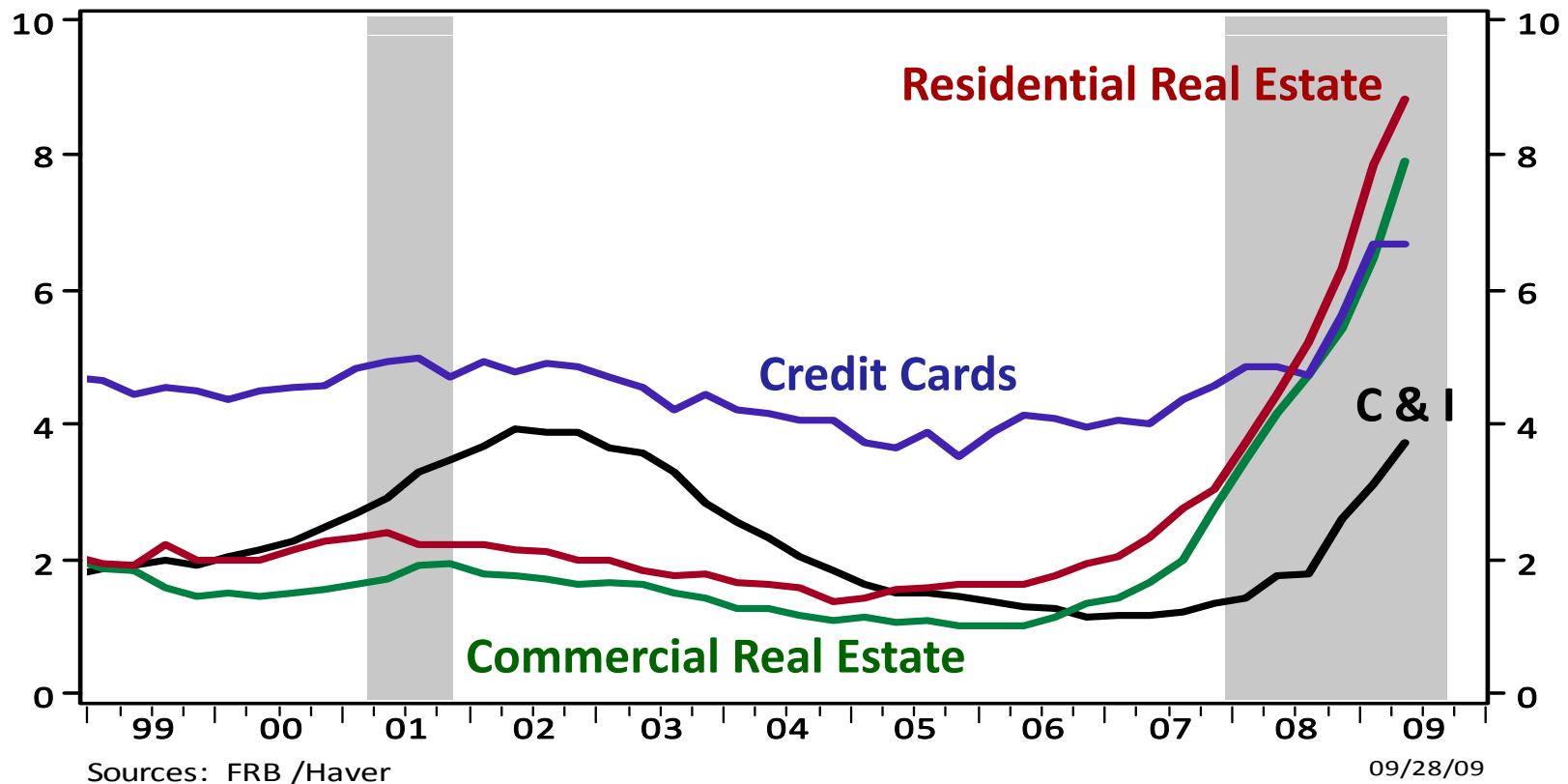
Ratio



Note: Mortgage home-price index used before 1987, Case-Shiller composite 10 index used thereafter. Dotted line uses Case-Shiller futures to project home prices. Rent Index is owners' equivalent rent.

Bank Asset Quality: Increases in Loan Delinquencies Across Key Loan Types

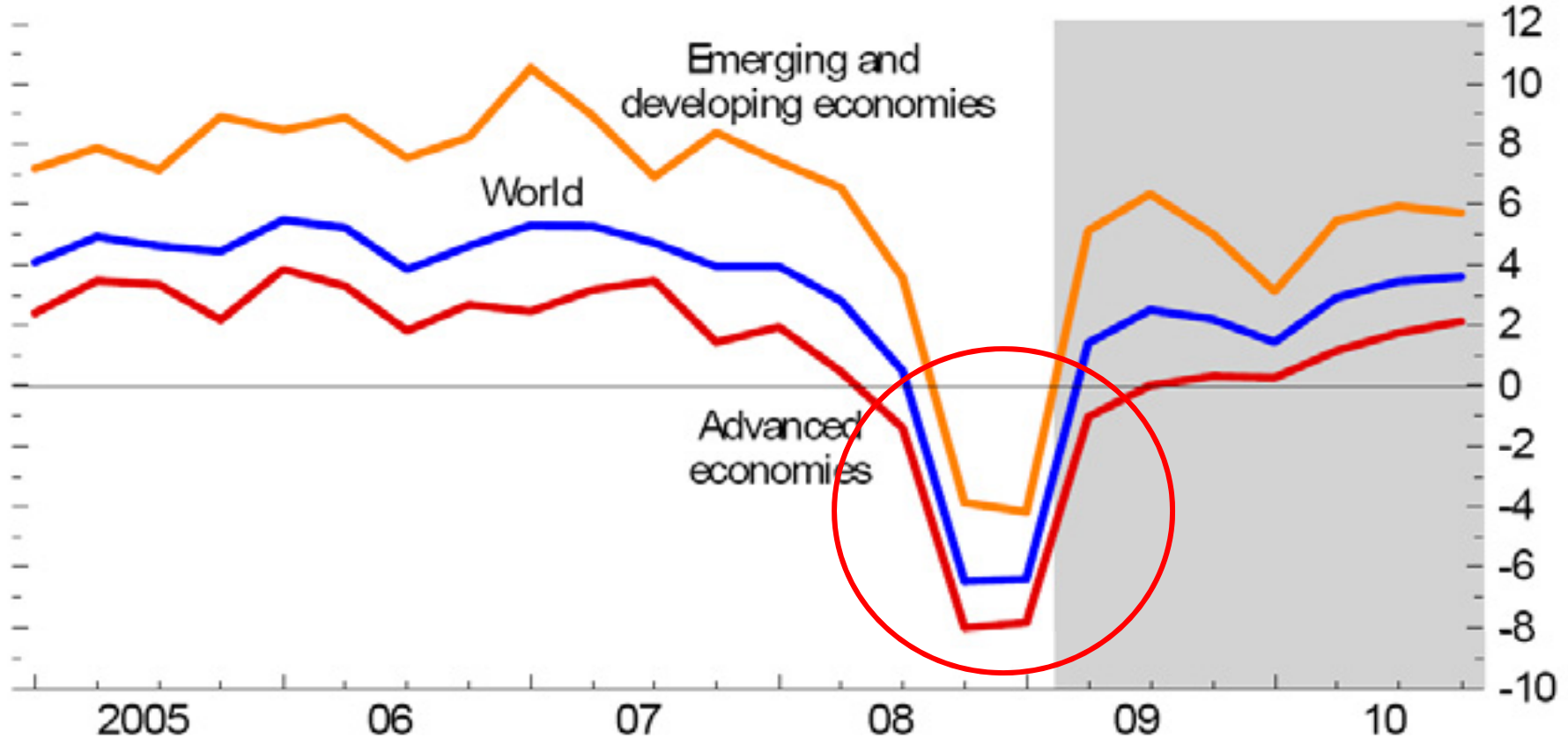
Loan Delinquency Rates in the United States by Asset Type (%)



Global Forecasts: Real GDP in the Advanced Economies Will Rebound at a Slower Pace

Real GDP Growth

(% change year over year, annualized)



Source: IMF World Economic Outlook (Update): July 9, 2009

<http://www.imf.org/external/pubs/ft/weo/2009/update/02/pdf/0709.pdf>



Labor Market Outlook: Unemployment And Under-Employment Both Rising

Alternative measures of labor utilization

Percent of labor force



FedViews of July 9, 2009

Household Spending & Saving: As Wealth, Jobs, and Confidence Fell – Saving Increased (Consumption Fell)

Personal Saving Rate (as Percentage of Disposable Income)



Summary Points

- **Current situation — challenging**
- **National forecast — slow recovery**
- **Risks to the forecast — many:**
 - Financial system stability
 - Shape of global recovery
 - Strength of consumer spending
 - Shape of the projected recovery



Questions?

**Yelena Takhtamanova, Economist
Federal Reserve Bank of San Francisco
Yelena.Takhtamanova@sf.frb.org
www.frbsf.org**