Prosperity in a Challenging Global Economy

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Any opinions expressed here are my own and do not necessarily reflect those of the Federal Reserve Bank of Saint Louis or the Federal Reserve System.
Disclaimer

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- I thank Marcela Williams and President Bullard for providing many of the figures in this presentation.
Today’s topics

- The current outlook: Green shoots vs. pitfalls.
- Solutions to current slowdown.
- The benefits of international trade.
- The limits of international influences: We control our own fate.
The Current Outlook: Green Shoots

- Forecasters expect positive GDP growth in 2009:Q3 and Q4.
- Vehicle sales have bottomed out.
- New home sales have bottomed out.
- Employment is still falling, but at a slower rate.
- Financial markets are still stressed, but much more stable.
Forecasters expect positive U.S. GDP growth in the latter half of 2009.

GDP growth is not great.

2 to 3% GDP growth is not great.
Vehicle Sales: Domestic and Imported

Millions of Units

Domestic (Right Scale)

Imported (Left Scale)

Cash-for-clunkers?
Existing Home Sales
(Monthly Data. Last Observation: July 2009)

The decline in home sales has bottomed out.
Payrolls are still falling, but at a decreasing rate.
KCFSI: Financial Stress Index
(Monthly data, last observation: July 2009)

Financial stress is lower but still higher-than-normal.
The Current Outlook: Potential Pitfalls

- Financial crises can have prolonged effects.
  - Commercial real estate could still create large losses.
- Macroeconomic policy is in uncharted territory.
  - There is unusual uncertainty about future inflation.
- The recession is widespread internationally.
- Global imbalances still exist.
  - E.g., the U.S. current account deficit.
    - U.S. consumers need to save more and consume less.
    - It would be helpful if other consumers do the opposite.
The recession is widespread.

Source: Barclays Capital Global Economic Weekly.
Inflation Measures

(Seasonally adjusted, Year-over-Year Percent change)

Inflation forecasts contain unusual uncertainty.

Sources: Bureau of Economic Analysis and Bureau of Labor Statistics.
Solutions?

Potential sources of demand for output.

- Consumption
- Investment
- Government spending
- Net exports
Consumption?

- U.S. consumers are already highly indebted.

**Personal Consumption Expenditures as a % of Disposable Personal Income**

![Graph showing trend of personal consumption expenditures](image-url)
Investment has 2 major components

- Residential fixed (houses)
  - Housing is overbuilt.
- Non-residential fixed (capital goods)
  - Forward looking, based on expectations.
Investment?

- Housing is overbuilt.

Many houses are vacant and off the market.
“The Administration recently submitted a proposed budget that projects the federal deficit to reach about $1.8 trillion this fiscal year before declining to $1.3 trillion in 2010 and roughly $900 billion in 2011. As a consequence of this elevated level of borrowing, the ratio of federal debt held by the public to nominal GDP is likely to move up from about 40 percent before the onset of the financial crisis to about 70 percent in 2011. These developments would leave the debt-to-GDP ratio at its highest level since the early 1950s, the years following the massive debt buildup during World War II.”

— Chairman Ben S. Bernanke

Current economic and financial conditions and the federal budget
Testimony before the Committee on the Budget, U.S. House of Representatives, June 3, 2009
Net exports?

The United States has a very large current account deficit.

- The U.S. imports much less than it exports.
- Low U.S. savings create this CA deficit.
Solutions?

- Consumption is not likely to bounce back quickly.
- Housing is overbuilt.
- Government spending is limited.
- Net exports is a real possibility.
  - Diversified demand is a benefit of trade.
Benefits of Trade

- One can trade in goods and assets.

Goods
- Greater variety, lower prices, more competition.

Assets
- Greater return, diversification, employment from direct investment.
The limits of international influences

- Competition is a bad metaphor for international economics.

- Companies and individuals compete.
  - E.g., Boeing vs. Airbus

- Countries don’t compete.
  - If other countries become wealthier, it does not harm us economically.
The limits of international influences

- Sometimes people blame international trade for trends that it has little to do with.
- Manufacturing output and employment has been declining.
  - Can we blame international trade?
The limits of international influences

- Manufacturing output has been declining as a share of GDP.
Manufacturing employment has been declining as a share of employment.
The limits of international influences

- Manufacturing employment has been declining?
  - Change in relative demand for goods/services probably plays a role.
  - Faster productivity growth in manufacturing explains some of the declines.
  - International trade might also play a role.
The limits of international influences

What role do changing demands for goods and services play?

Shares of Consumption

<table>
<thead>
<tr>
<th>Year</th>
<th>Services (%)</th>
<th>Goods (%)</th>
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<tbody>
<tr>
<td>1947</td>
<td>20</td>
<td>80</td>
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<td>1987</td>
<td>90</td>
<td>10</td>
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<tr>
<td>1997</td>
<td>95</td>
<td>5</td>
</tr>
<tr>
<td>2007</td>
<td>100</td>
<td>0</td>
</tr>
</tbody>
</table>
The limits of international influences

- Health care and education policies should reflect domestic priorities.
  - This does not endorse or oppose any particular proposal.
The limits of international influences

- We make decisions everyday…
  - Education
  - Work/leisure
  - Consumption/savings

- These decisions are far more important to our economy than anything that happens abroad.
The End

Federal Reserve Bank of St. Louis
stlouisfed.org

Federal Reserve Economic Data (FRED)
research.stlouisfed.org/fred2/

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http://research.stlouisfed.org/econ/cneely/
Initial jobless claims seem to have peaked.
Real Personal Consumption Expenditures

U.S. consumption flattens out.

Billions of Chained 2005$
CDS on Large Financial Firms

Default risk is lower but still higher-than-normal.
Tracking the Global Recession

Inflation forecasts contain unusual uncertainty.

Source: Federal Reserve.
Government Net Debt for Canada, Japan, United Kingdom, and United States
Percent of GDP, annual data