

Economic Outlook and Current Monetary Policy

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The opinions expressed are my own and not necessarily those of the Federal Reserve Bank of Saint Louis or the Federal Reserve System.

I thank Brett Fawley for his able assistance in constructing this presentation.



Who Am I?

- ❖ I am delighted to speak to your group today.
- ❖ My father was once president of the PICPA.
- ❖ I am a research economist, not a forecaster, not a business economist.
 - My research is primarily on exchange rates.
- ❖ Economists are much better on why the past happened.
 - Economic events should be difficult to forecast for the same reason that financial markets are hard to forecast.

Today's Topics

❖ The Current Outlook

- GDP, employment, housing, credit markets, Fed policy & quantitative easing, inflation, financial markets
- Risks to the outlook



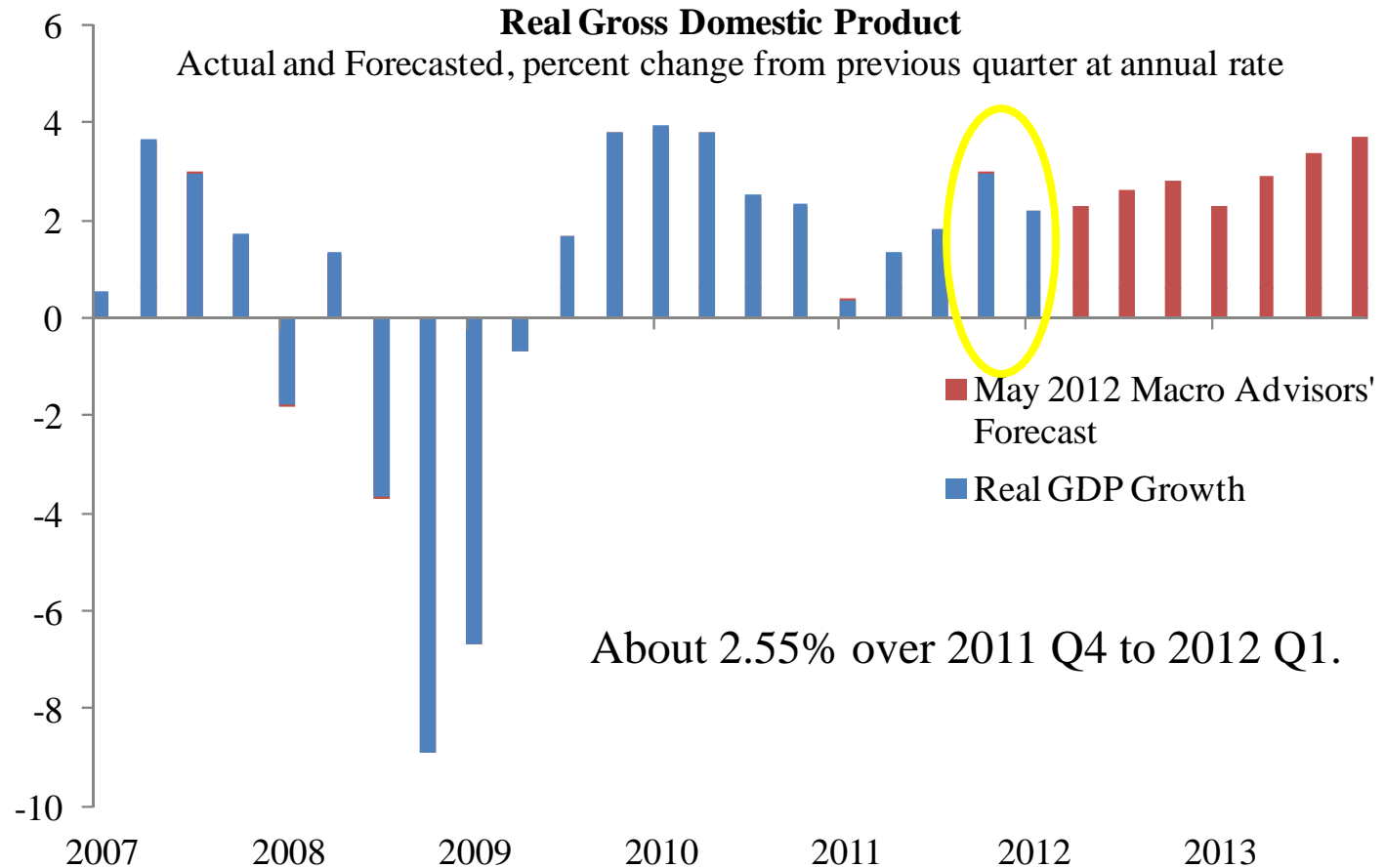
The Current Outlook

- ❖ GDP: Mixed signals, modest growth
 - Manufacturing is a relative strength.
- ❖ The Labor market: Unemployment falling slowly
 - Prolonged unemployment will have costs.
- ❖ Housing / construction
 - Market prices seem to have bottomed out; little new construction.
- ❖ Credit markets
 - Still high delinquency rates in mortgages and real estates.
- ❖ Monetary policy is very accommodative & will remain so.
- ❖ Inflation has been volatile but near-target, on average.
 - Inflation expectations remain anchored.
- ❖ Financial markets are consistent with modest growth.
- ❖ Serious risks remain for the global economy.

The Current Outlook: Real Activity

- ❖ GDP: Mixed signals, modest growth
- ❖ IP growth is stagnating. (Special factors?)
- ❖ New orders and capacity look OK.
- ❖ Vehicle sales have more-or-less recovered but no overshoot.
- ❖ Growth forecasts look for a speedup in 2013.

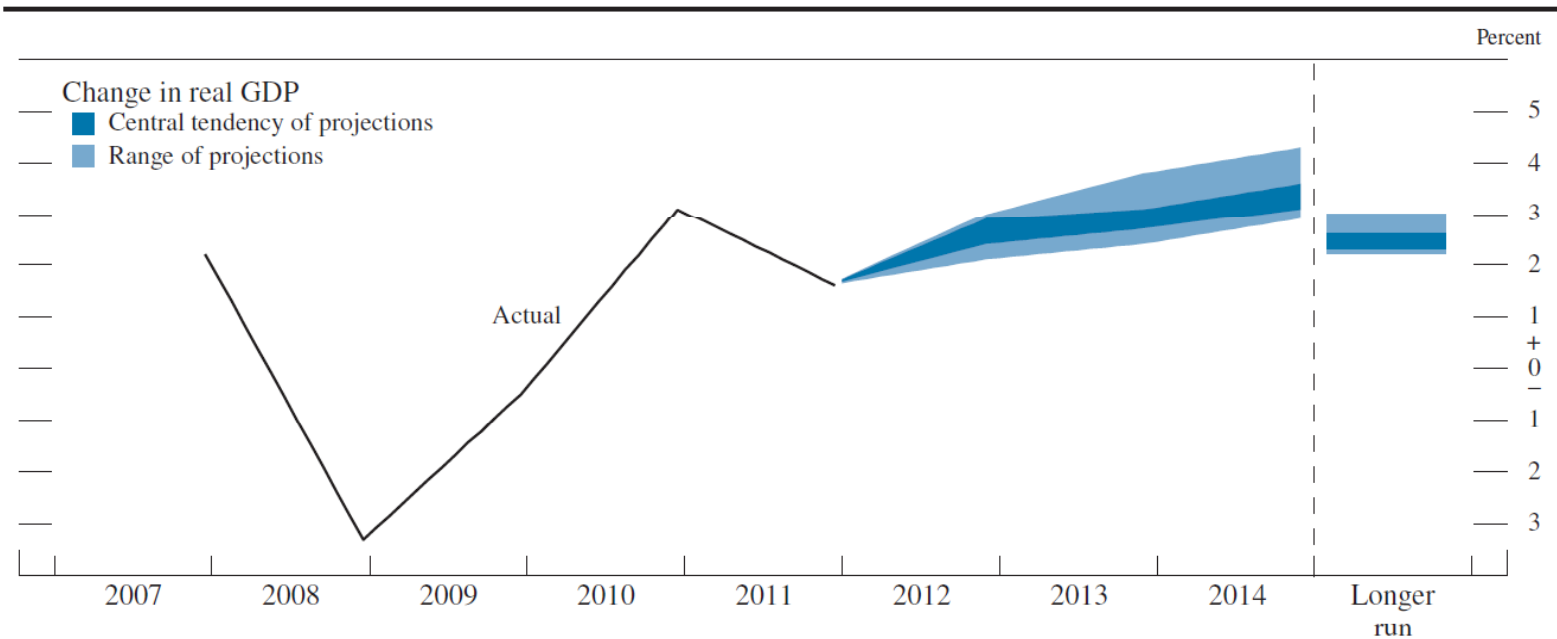
The Current Outlook: GDP



Source: Bureau of Economic Analysis/Macroeconomic Advisers

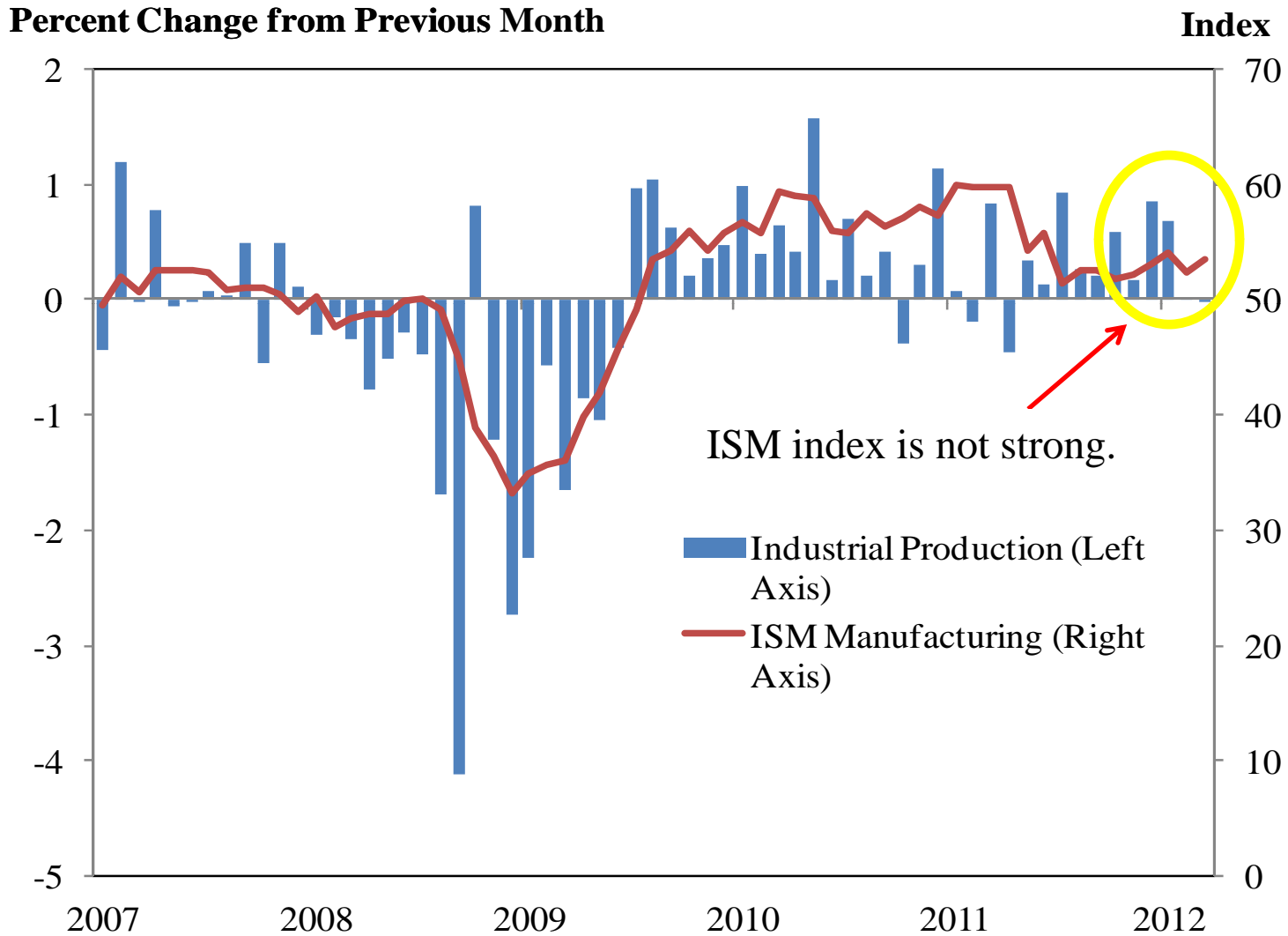
The Current Outlook: Real GDP Forecasts

Figure 1. Central tendencies and ranges of economic projections, 2012–14 and over the longer run



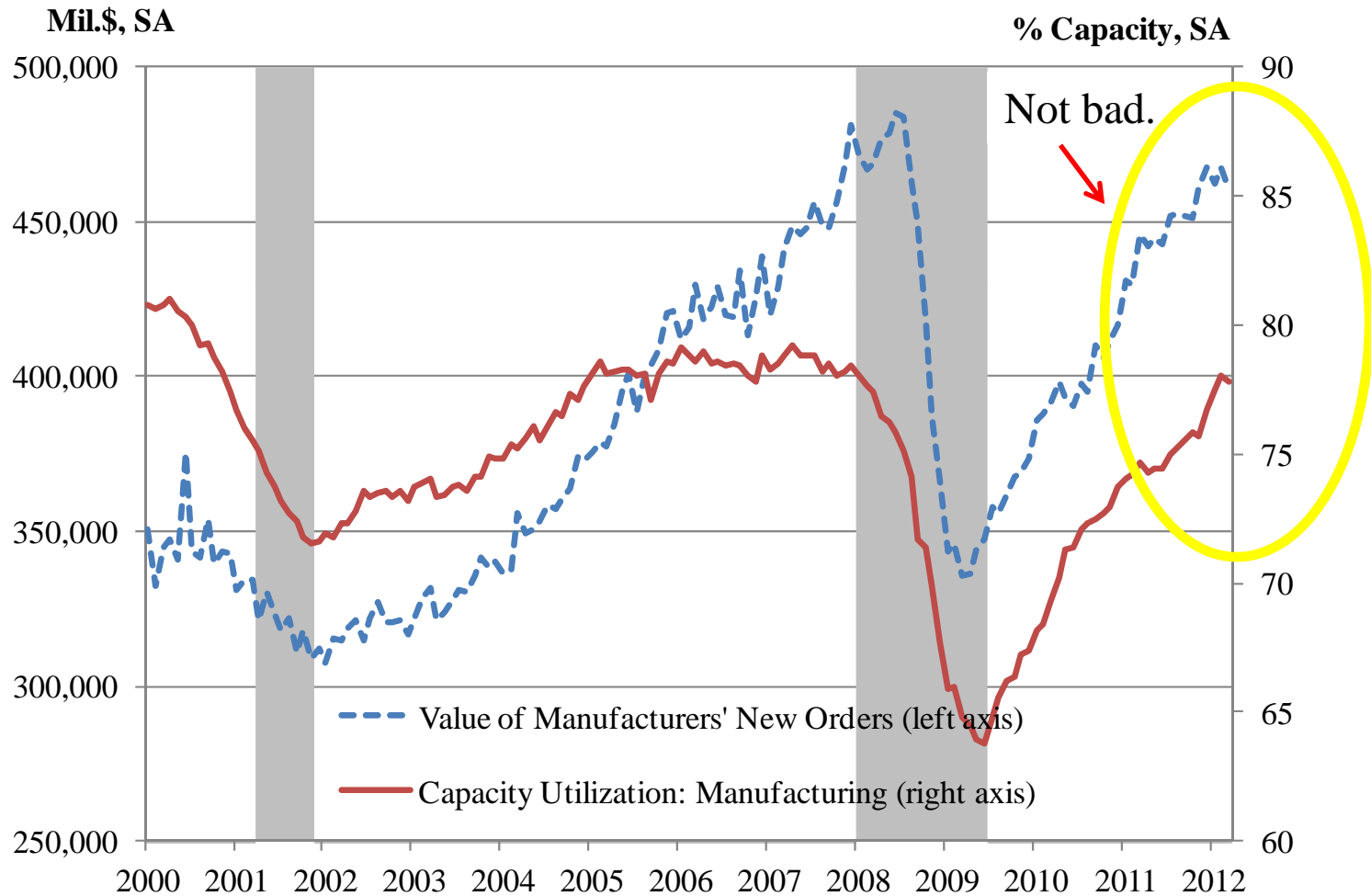
FOMC Economic projections from the April 2012
Monetary Policy Report to Congress

The Current Outlook: Industrial Production



Source: Federal Reserve Board/Institute of Supply Management

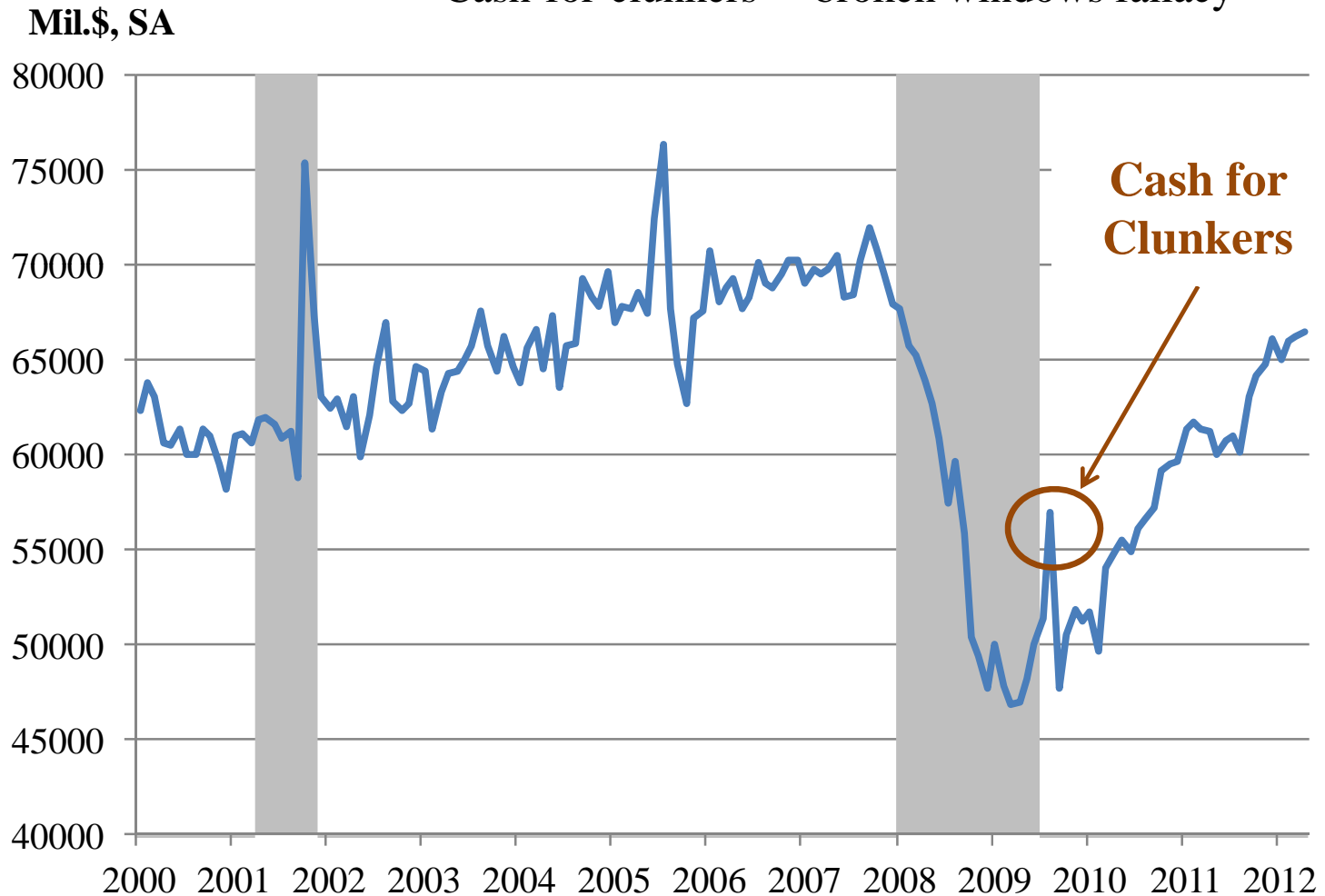
The Current Outlook: Capacity Utilization and New Orders



Source: Federal Reserve Board and Census Bureau

The Current Outlook: Vehicle Sales

Cash-for-clunkers = broken windows fallacy



Source: Census Bureau

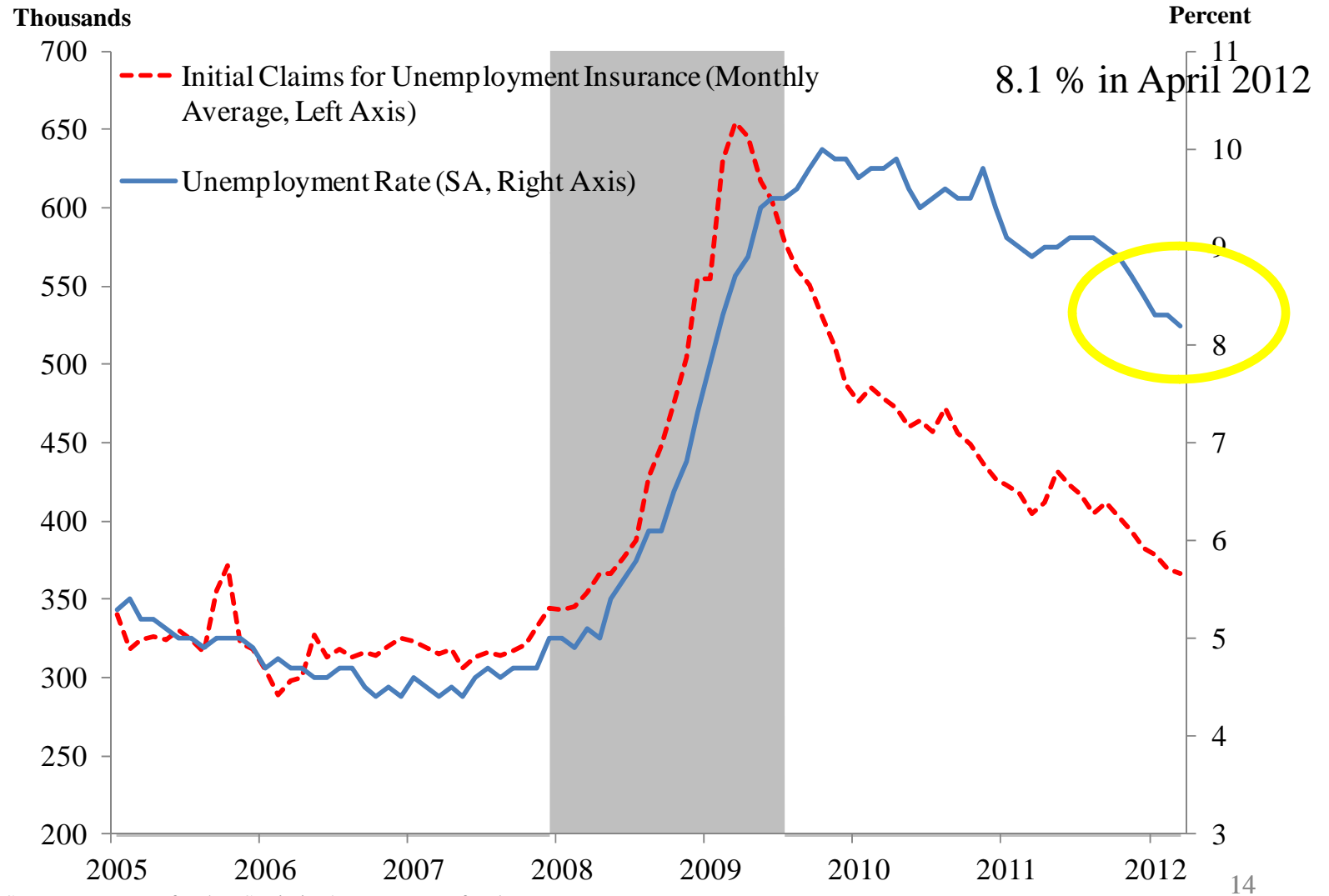
The Current Outlook: Forecasts of Real Activity

- ❖ GDP has increased very modestly – at about 2.55% per annum– from 2011Q4 to 2012Q1.
- ❖ Macro Advisors forecasts 2.5% growth in 2012 and 3.1% in 2013.
- ❖ FOMC forecasts call for strengthening GDP growth in the next 3 years, ranging from 2% to 4%.

Unemployment

- ❖ Falling slowly. Still at nearly record levels.
 - Initial claims are now less than 400K.
- ❖ Recent weakness in NFP due to overshoot from mild winter with strong gains.
- ❖ Unemployment is much worse for men, the less educated and minorities.

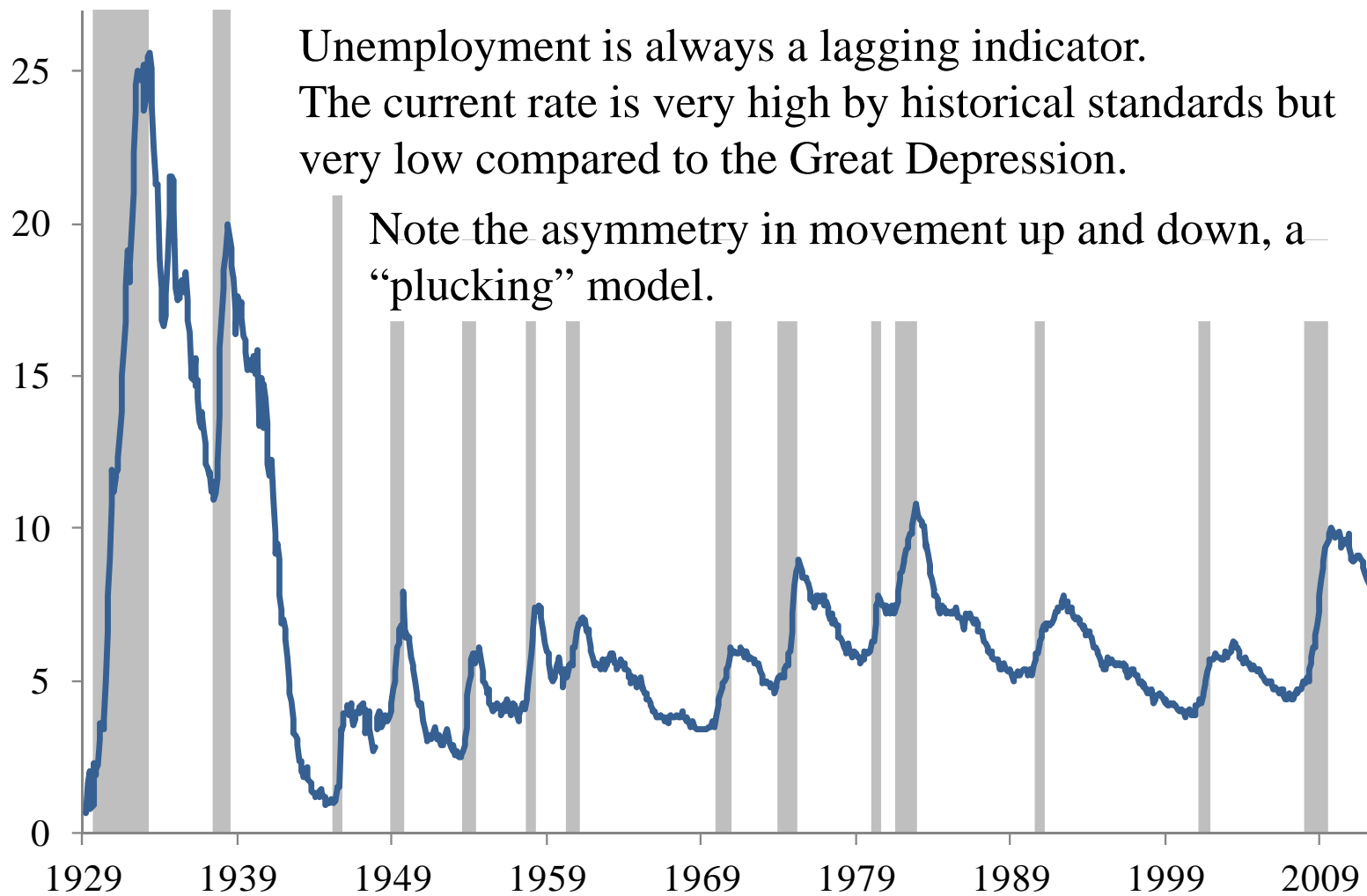
The Current Outlook: Civilian Unemployment



Source: Bureau of Labor Statistics/Department of Labor

The Current Outlook: Long-term Unemployment

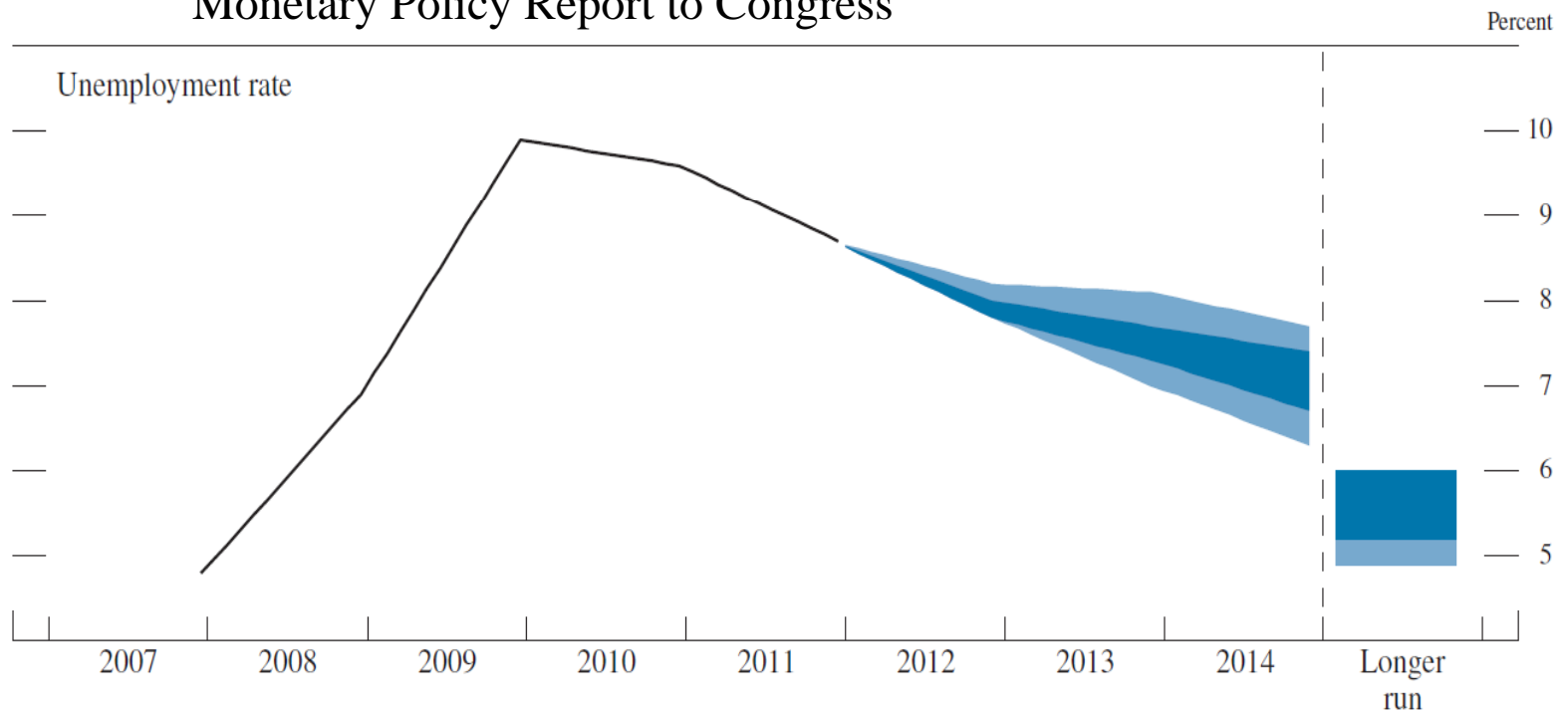
Percent



Source: Bureau of Economic Analysis

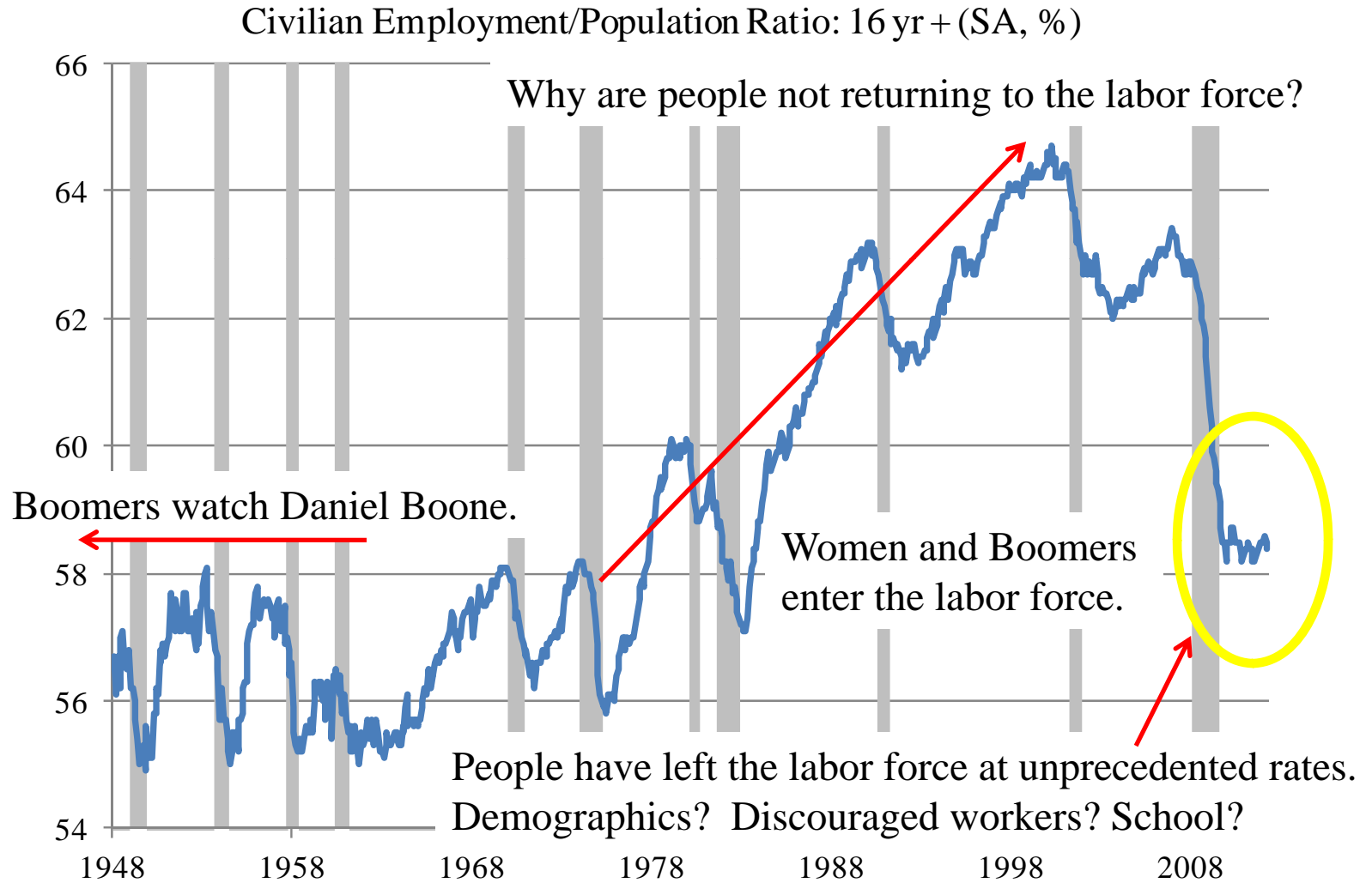
The Current Outlook: Unemployment Forecasts

FOMC Economic projections from the April 2012
Monetary Policy Report to Congress



Unemployment has usually fallen slowly, between $\frac{1}{2}$ and 1 percentage point per year, in recoveries.

The Current Outlook: Employment/Population Ratio



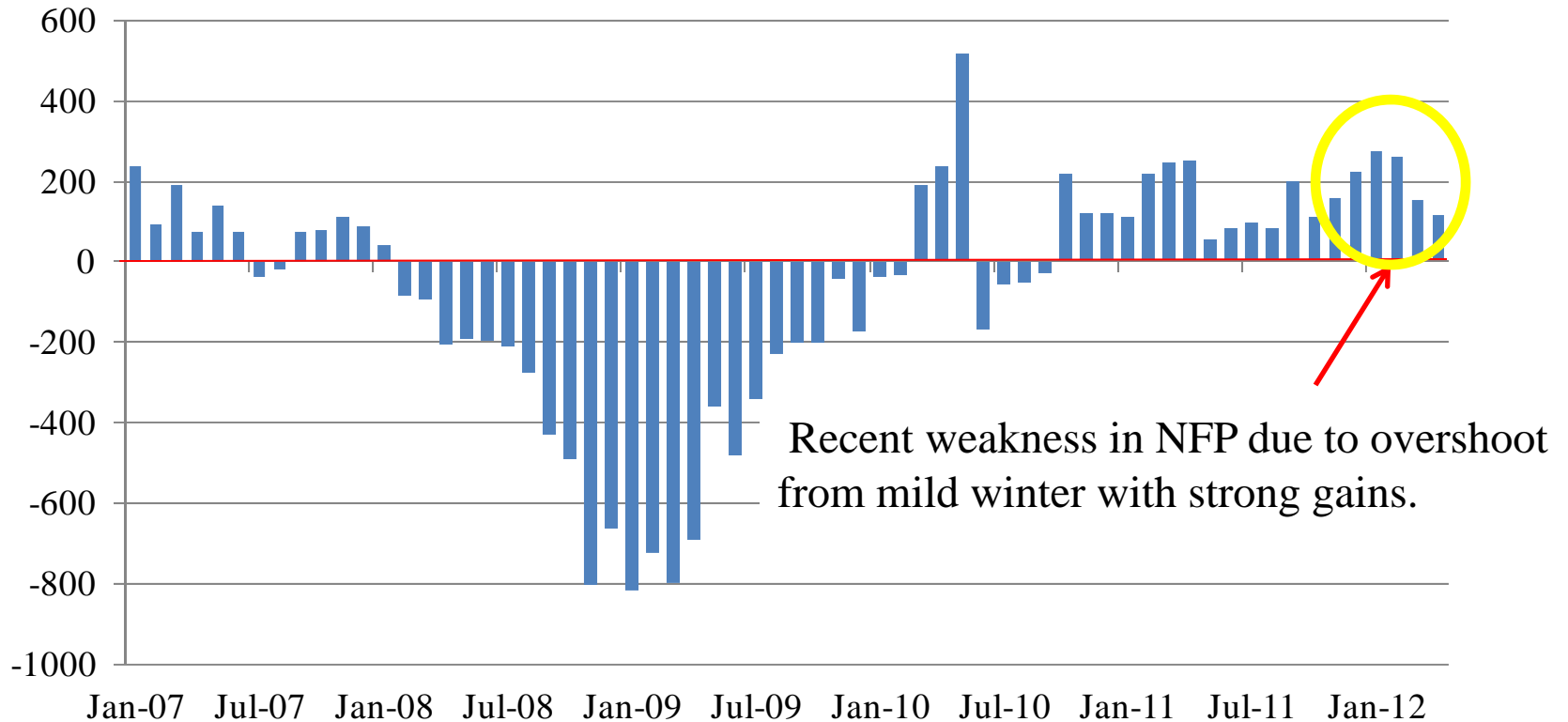
Source: Bureau of Labor Statistics

The Current Outlook: NFP Employment

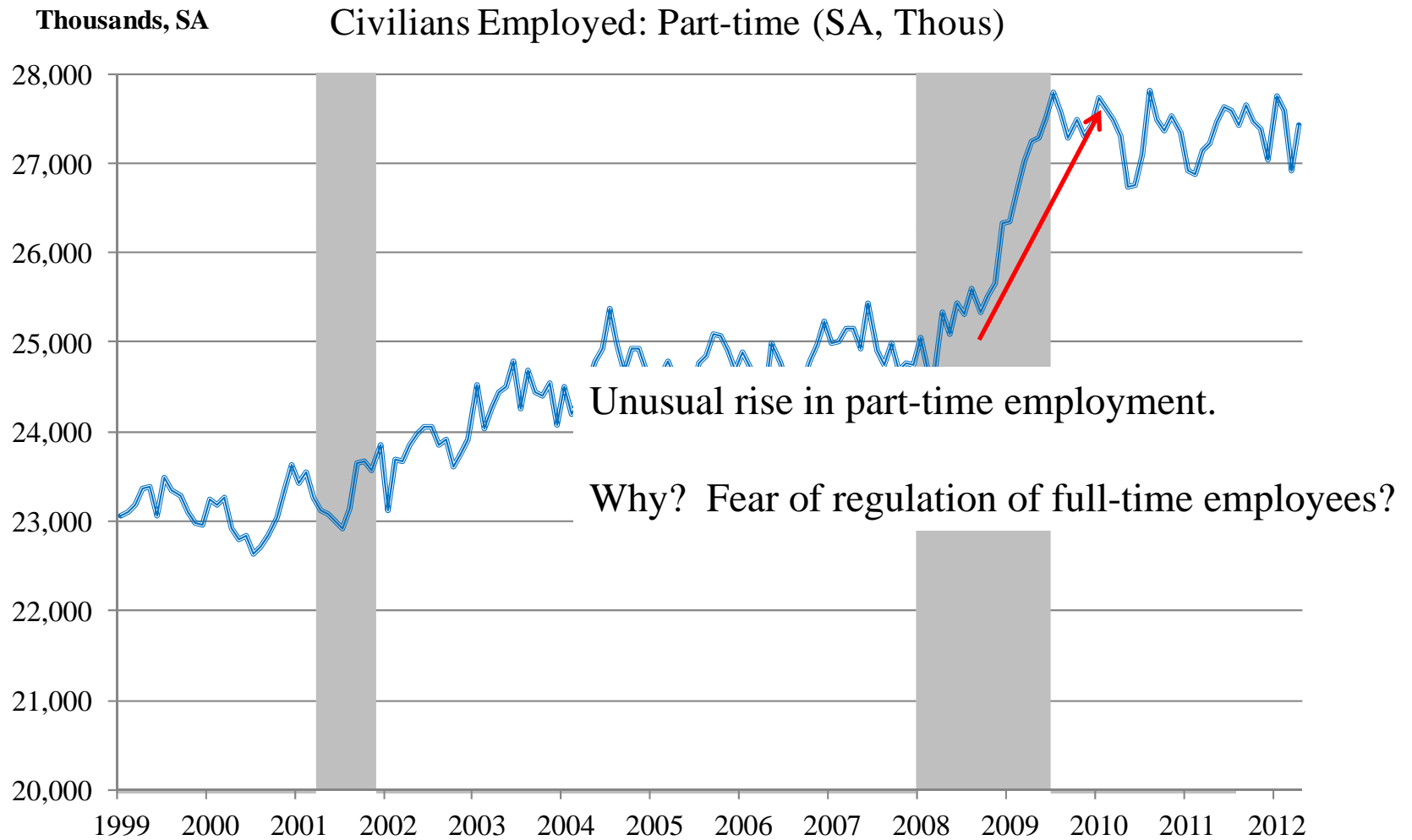
Only 115K jobs gained in April, somewhat weaker than expected (170K).

Weak growth a rebound from strong growth during a mild winter.

Thousands (Change from Previous Month)

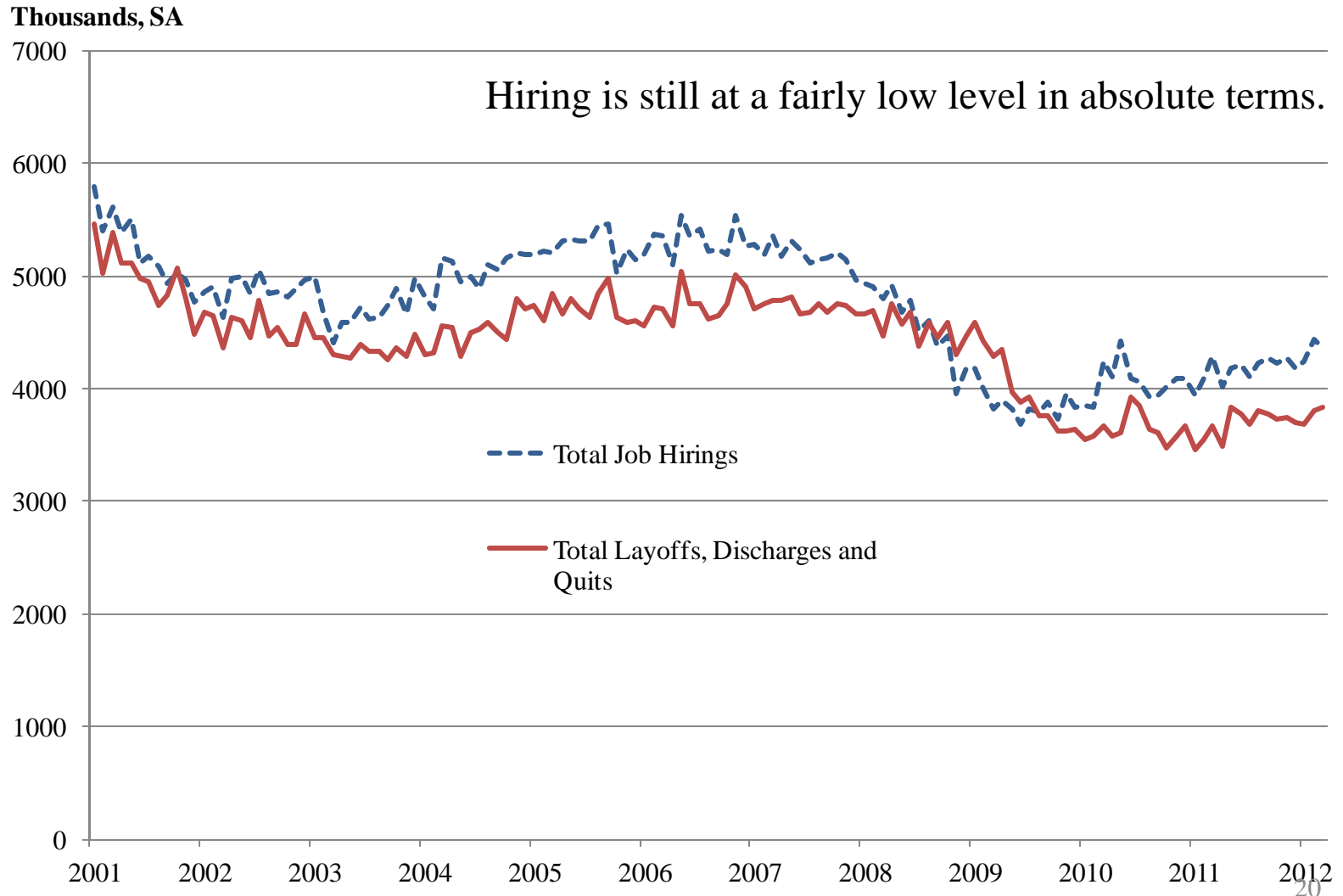


The Current Outlook: Part-time Employees



Source: Bureau of Labor Statistics

The Current Outlook: Creation vs. Layoffs



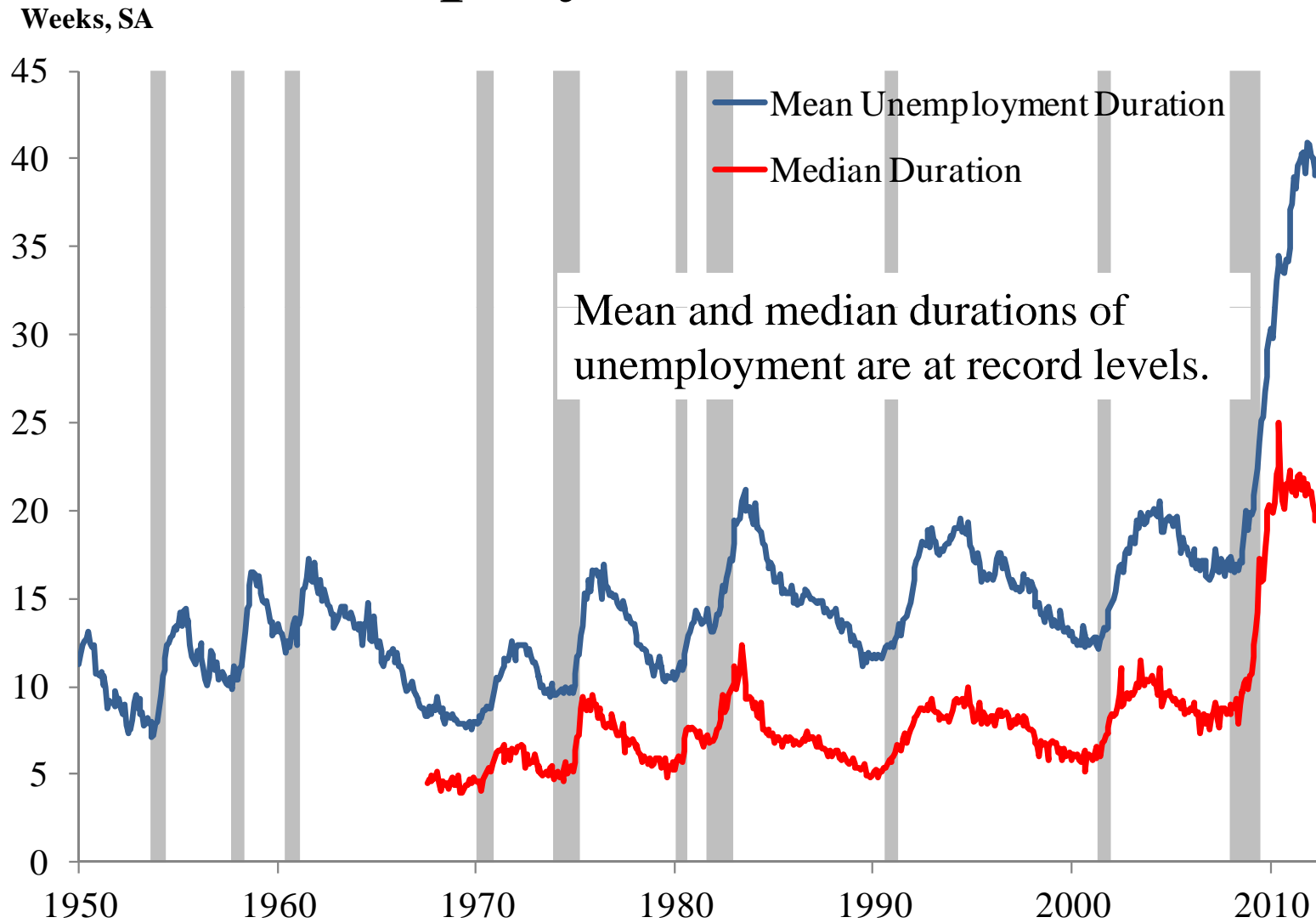
Source: Bureau of Labor Statistics

The Current Outlook: Unemployment Duration

- ❖ Unemployment has been of extraordinarily long duration.
 - Unusual extension of unemployment benefits might add 1 percent to the measured rate.
 - Extended unemployment benefits will gradually be cut back starting in June 2012.

- ❖ Long-term unemployment has costs.
 - Reduced attachment to the labor force
 - Loss of skills
 - Lower GDP growth in the future

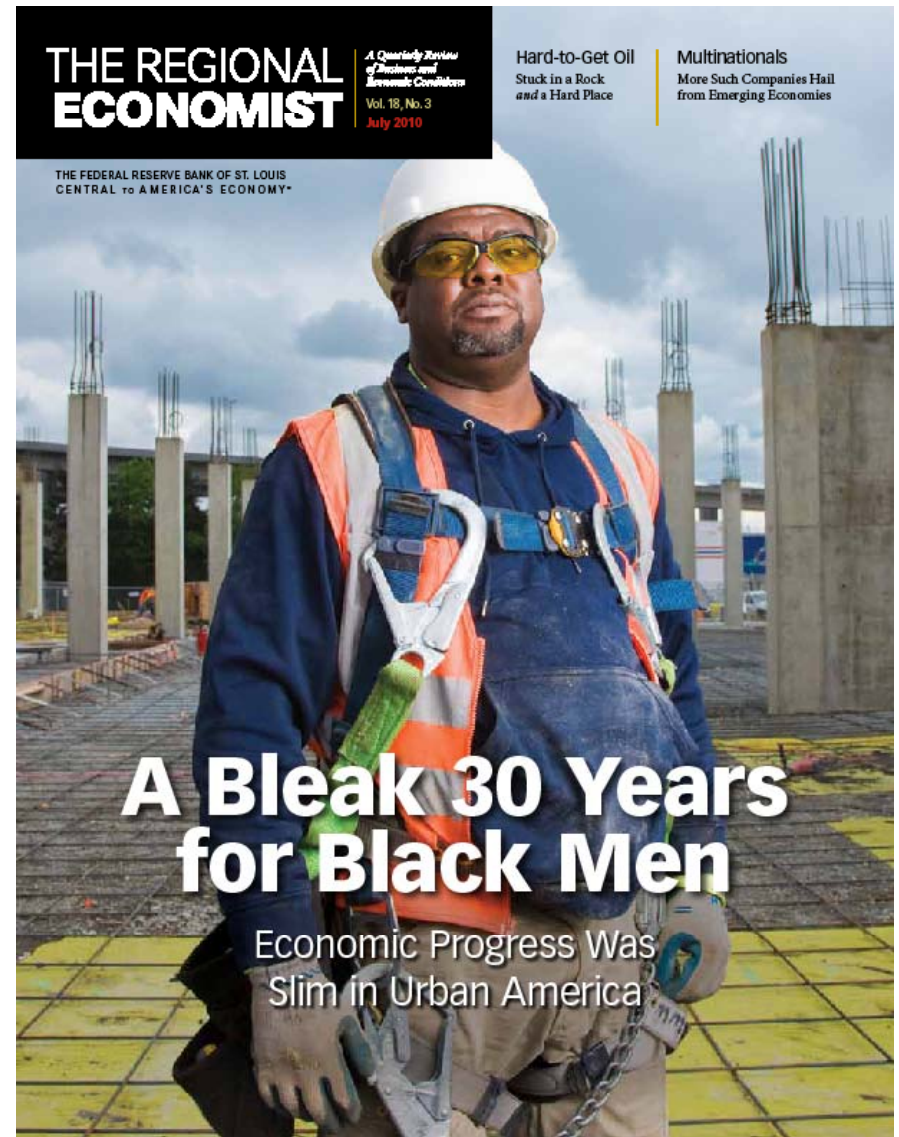
The Current Outlook: Unemployment Duration



Source: Bureau of Labor Statistics

The Current Outlook: Unemployment

- ❖ Who has been affected most by unemployment?
 - Minorities
 - The less educated
 - Men



The Current Outlook: Labor Market

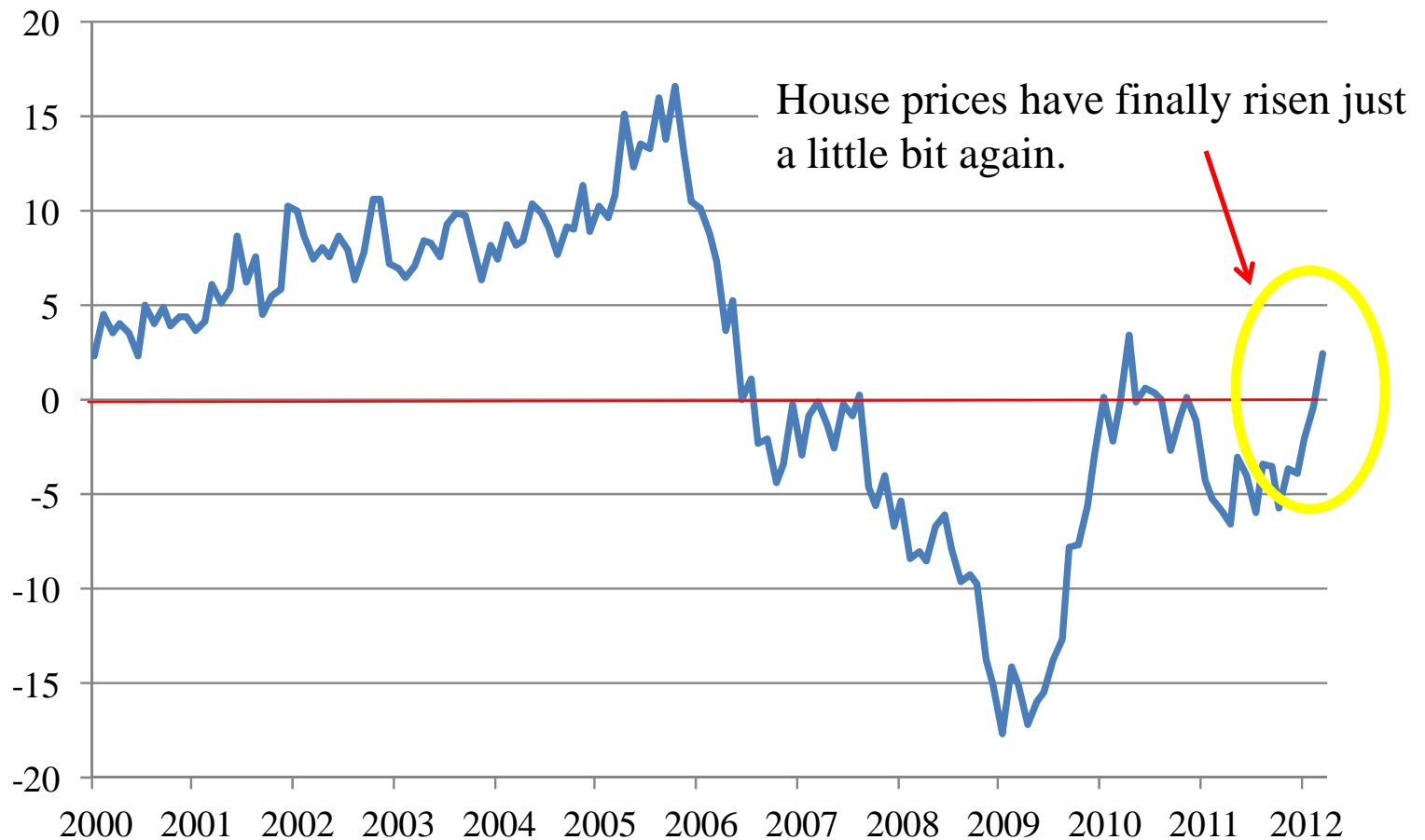
- ❖ Unemployment remains stubbornly high.
 - Usual patterns of unemployment by ethnicity and education remain.
 - Unemployment is higher for men than women, as it has been in recessions since the 1970s.
- ❖ Surprisingly, hypotheses about skill mismatches or immobility due to housing prices do not hold up well in the data.

The Current Outlook: Housing

- ❖ The house price boom was accompanied by construction of too many new houses.
- ❖ There is a large stock of vacant houses.
- ❖ New home sales are still very weak.
- ❖ House prices have just bottomed out (seemingly).
- ❖ It will probably take years for construction to return to “normal” levels.

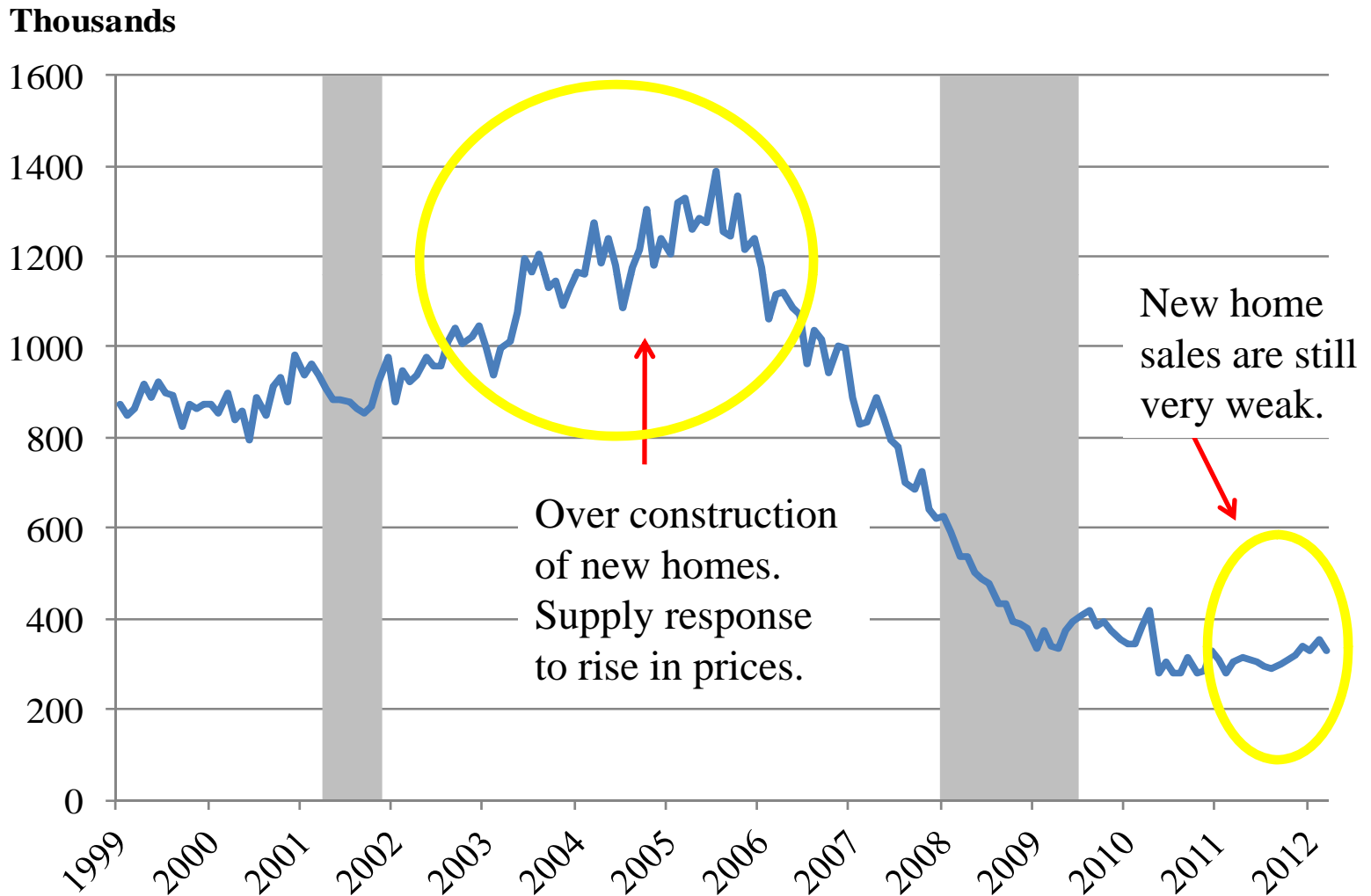
The Current Outlook: Existing Home Sales Price

% Change, Year over Year



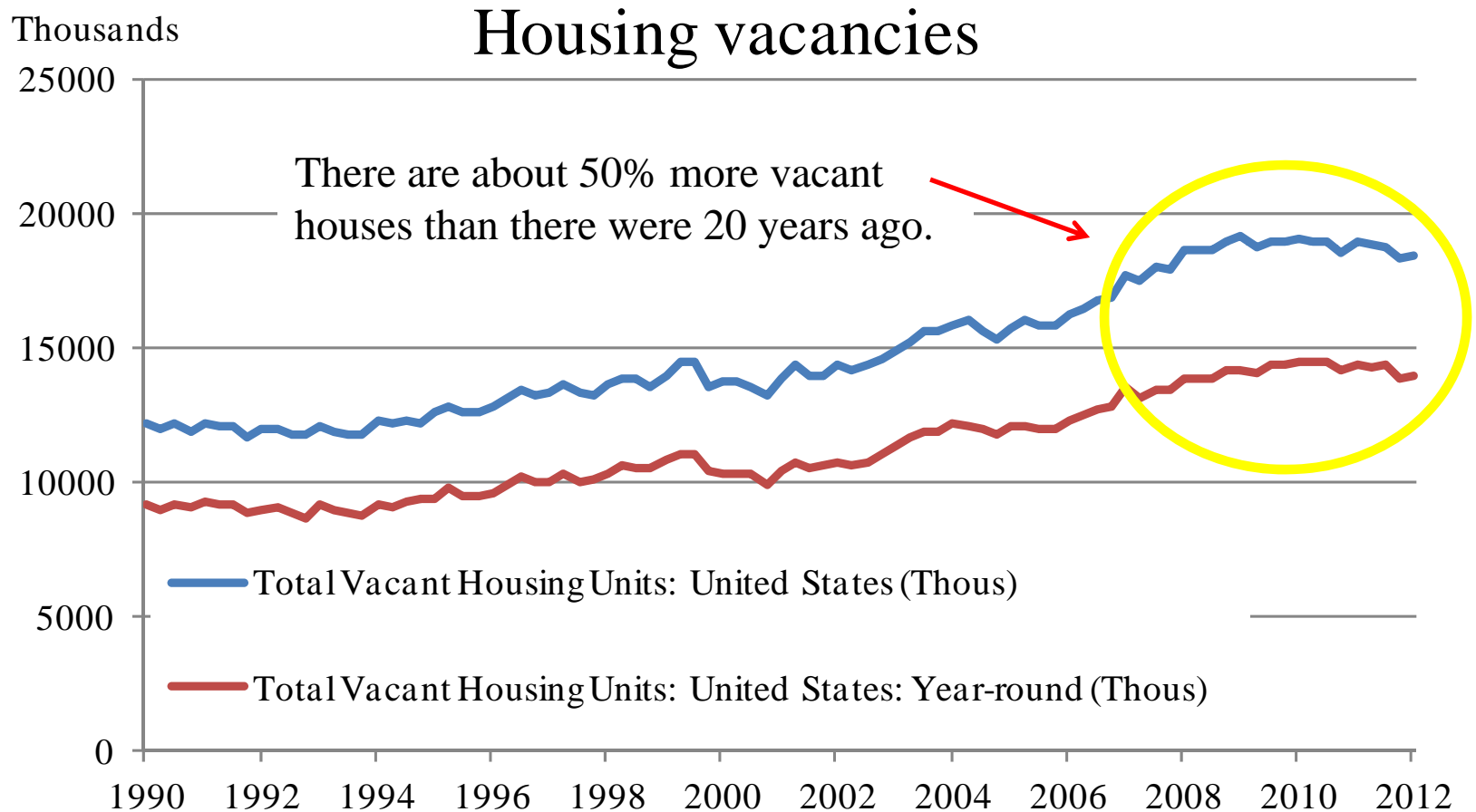
Source: National Association of Realtors

The Current Outlook: New Home Sales



Source: National Association of Realtors

The Current Outlook: Vacancies



Source: Census Bureau

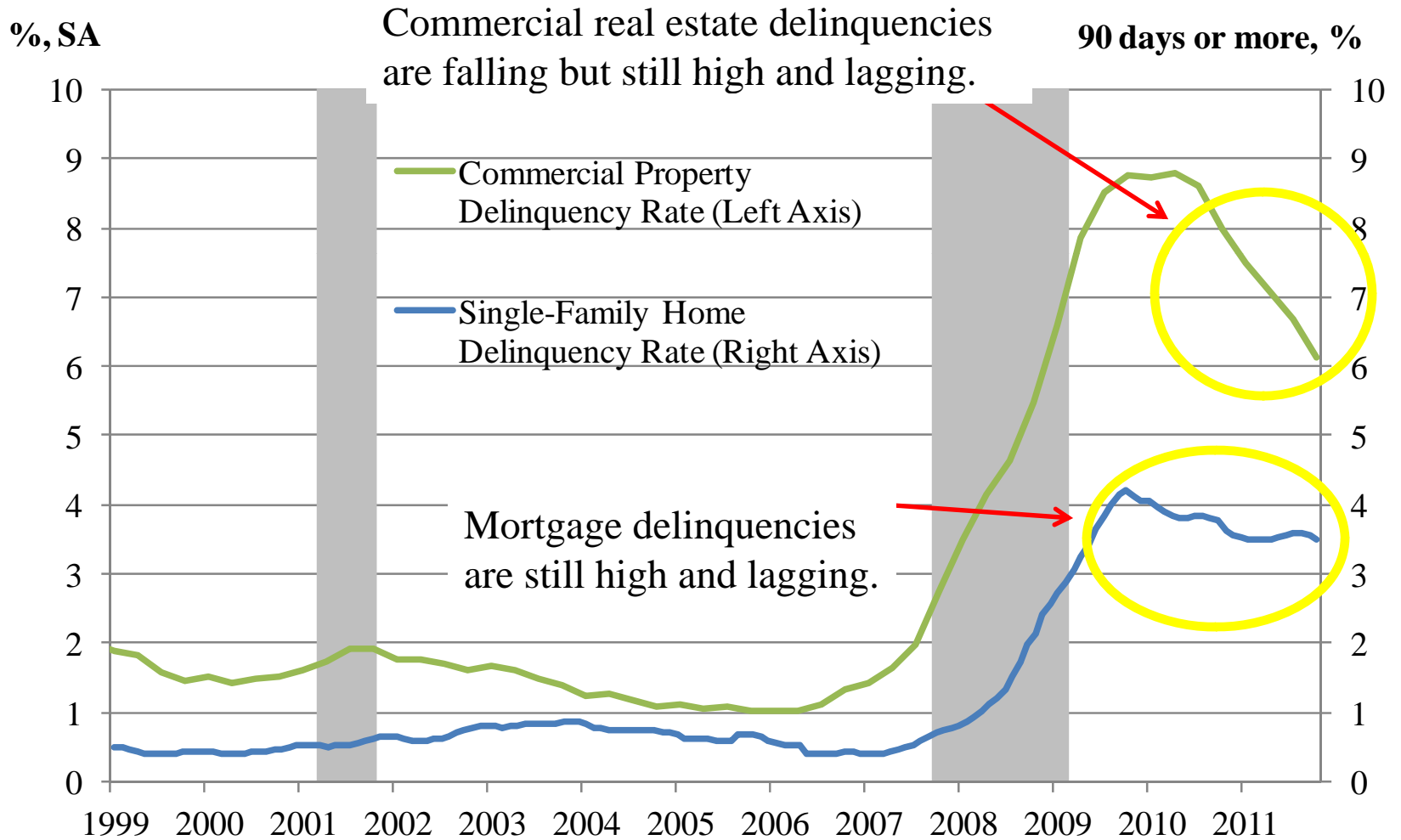
The Current Outlook: Credit Markets

- Mortgage/real estate delinquencies are still high but declining.
- Other delinquencies are more-or-less normal.
- C&I and consumption loans are growing again.

“Neither a borrower nor
a lender be.”

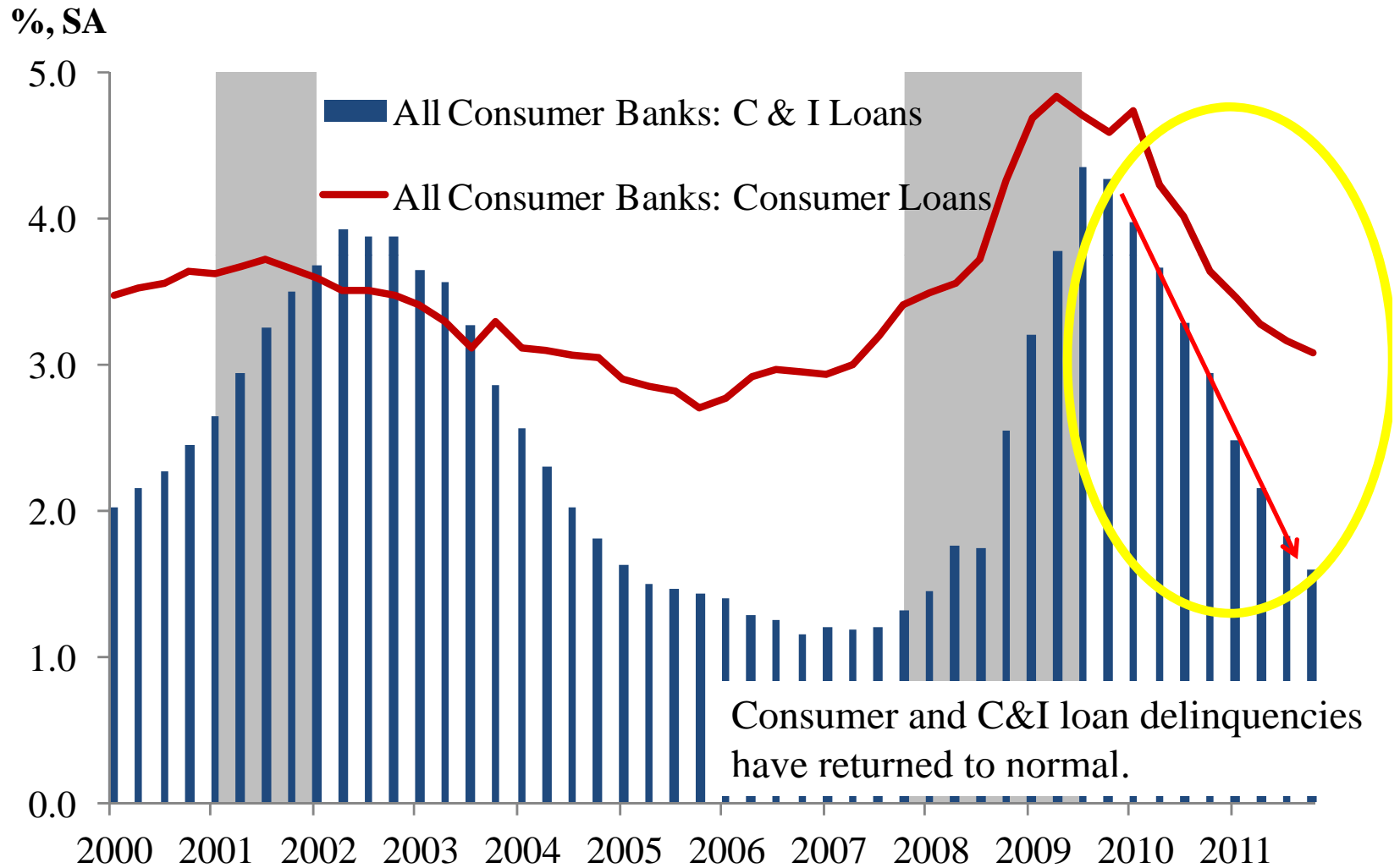
– Ben Franklin

The Current Outlook: Mortgage Delinquencies



Source: Federal Home Loan Mortgage Corporation

The Current Outlook: Loan Delinquency Rates

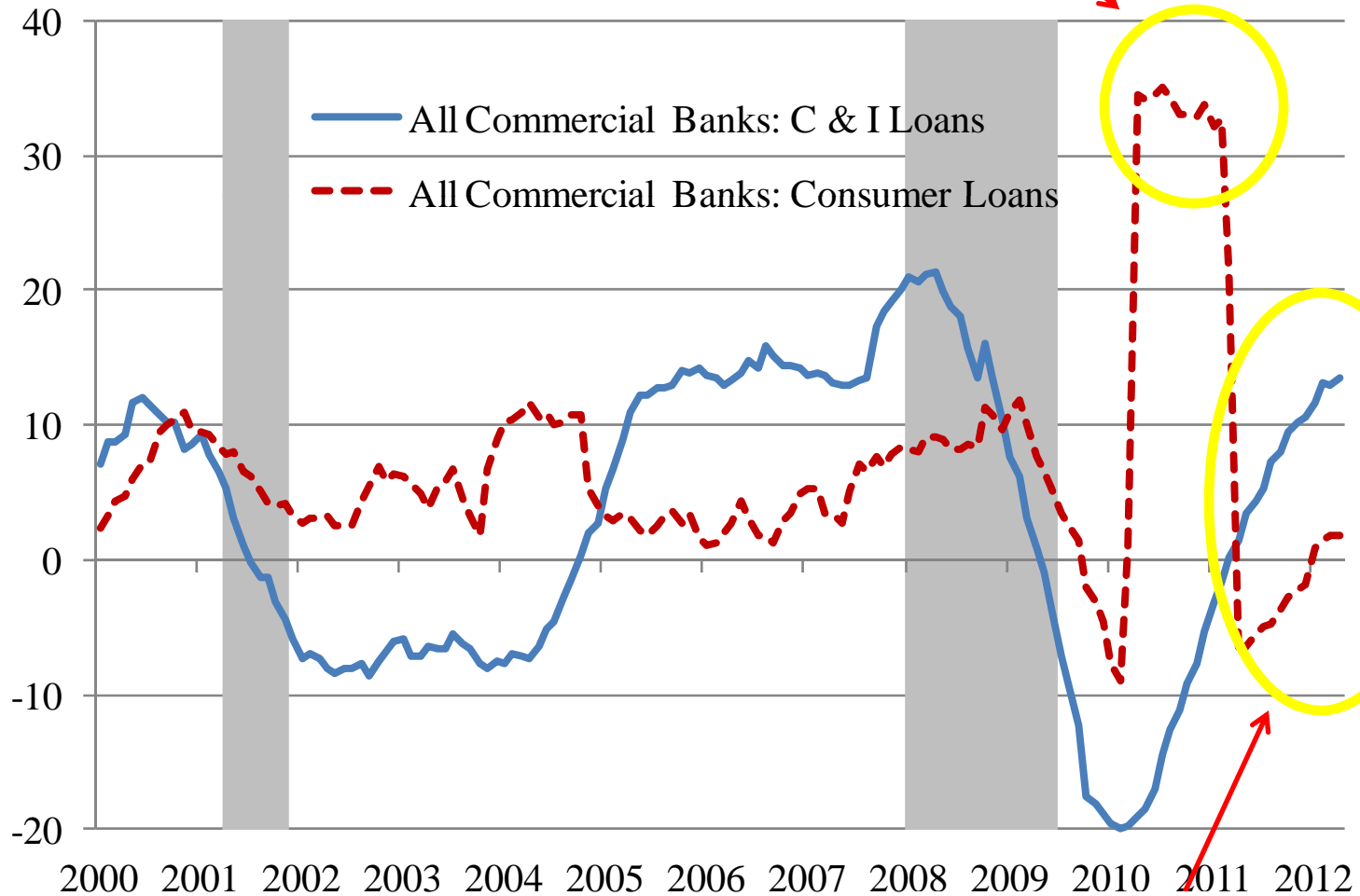


Source: Federal Reserve Board

The Current Outlook: Bank Credit

FAS 166 and 167 require banks to take securitized consumer loans back on their books in 2010Q1.

% Change, Year over Year, SA



Source: Federal Reserve Board

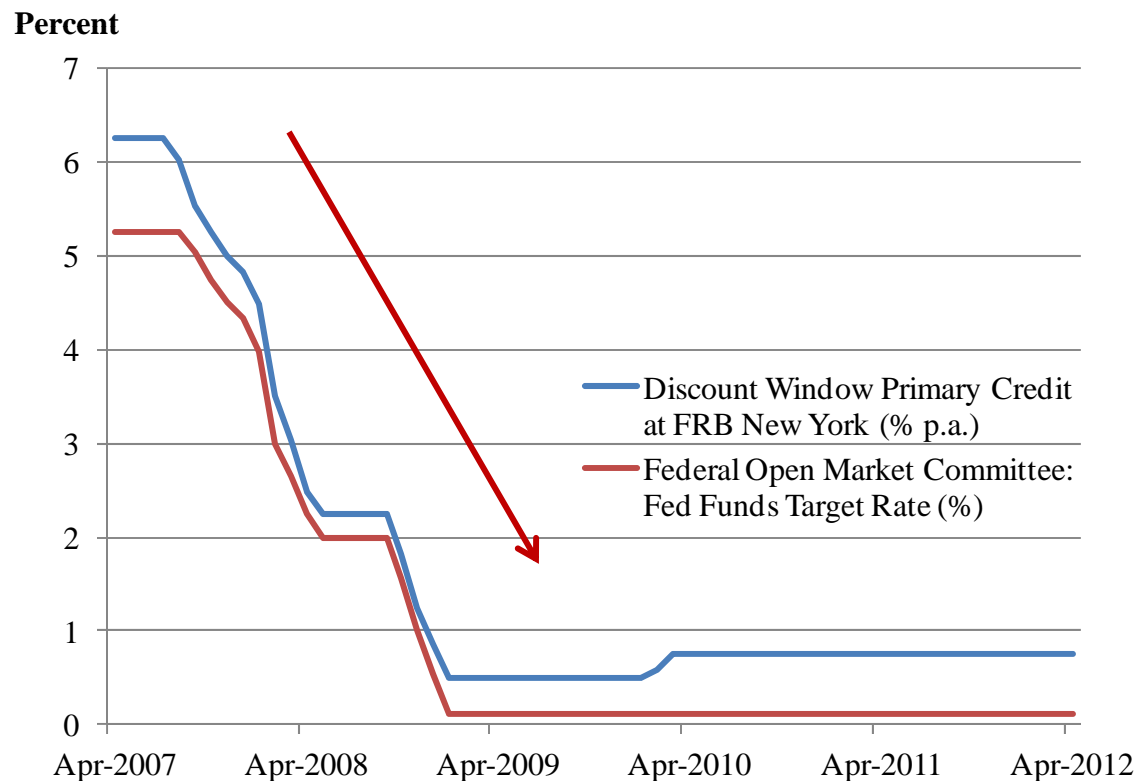
C&I loans recover.

The Current Outlook: Monetary Policy

- What is the goal of policy?
 - “Consistent with its statutory mandate, the Committee seeks to foster **maximum employment and price stability.**”
-- FOMC press release, April 25, 2012
- Monetary policy is very accommodative by any ordinary measure.
 - Short rates are very low and will be until 2014.
 - QE has reduced long-term interest rates.
 - QE injections are held as reserves, they have not spilled over to the broader aggregates.

Monetary Policy: Short Rates

“To support a stronger economic recovery and to help ensure that inflation, over time, is at the rate most consistent with its dual mandate ...the Committee decided today to keep the target range for the federal funds rate at 0 to 1/4 percent and currently anticipates that economic conditions--including low rates of resource utilization and **a subdued outlook for inflation over the medium run--are likely to warrant exceptionally low levels for the federal funds rate at least through late 2014.**” – FOMC press release, April 25, 2012

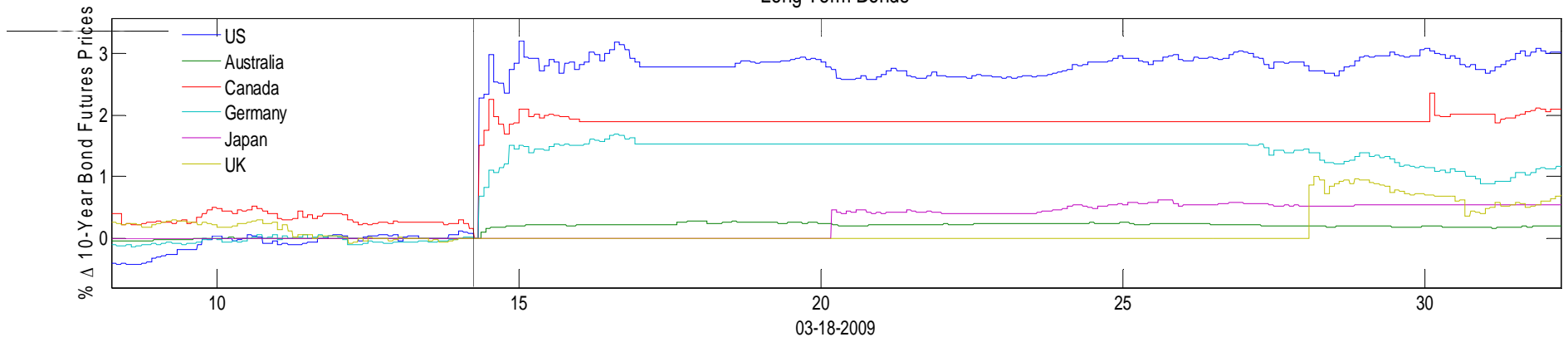


Source: Federal Reserve Board

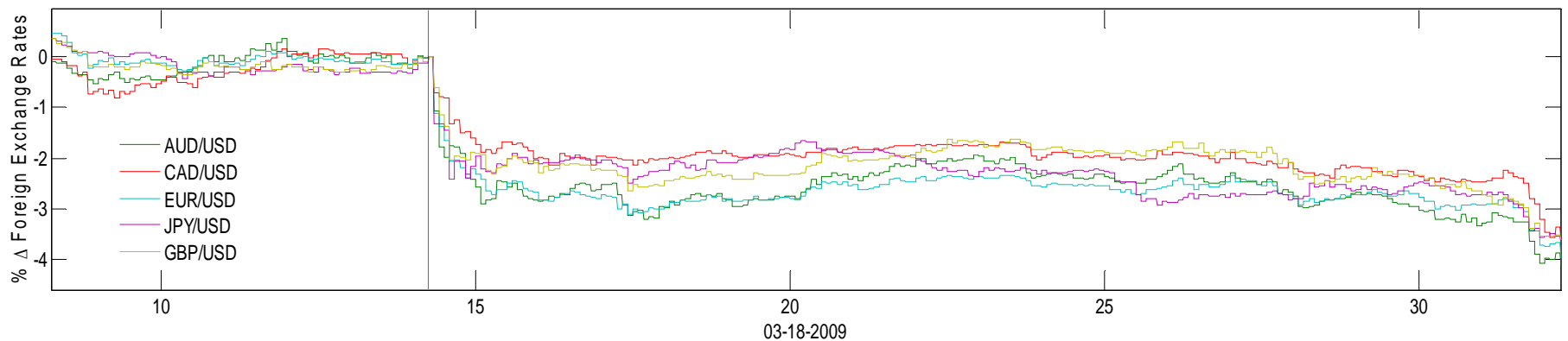
Monetary Policy: QE/Twist

“The Committee also decided to continue its program to extend the average maturity of its holdings of securities as announced in September.” – FOMC press release, May 25, 2012

Long Term Bonds

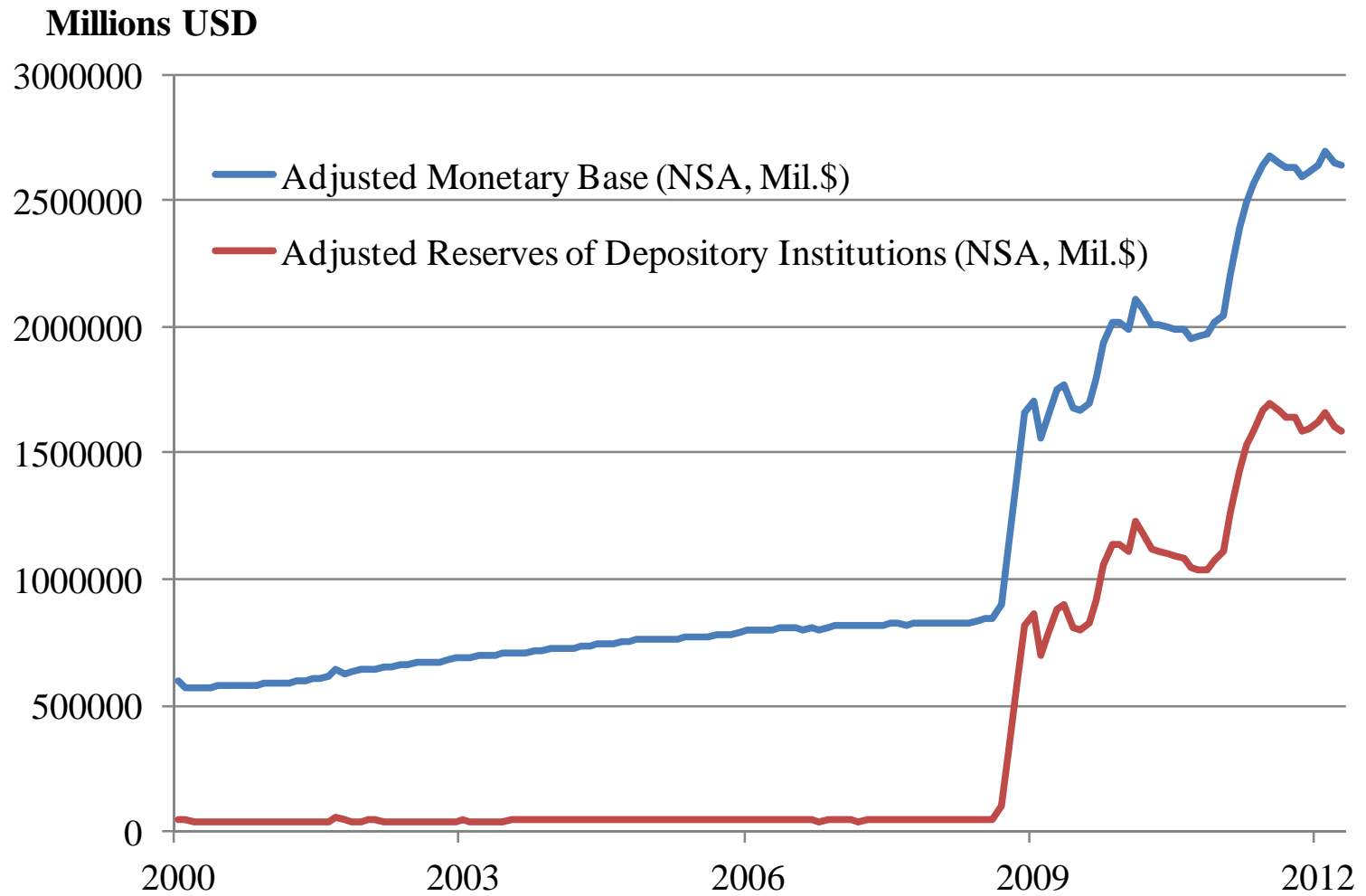


Foreign Exchange Rates



Monetary Policy: QE

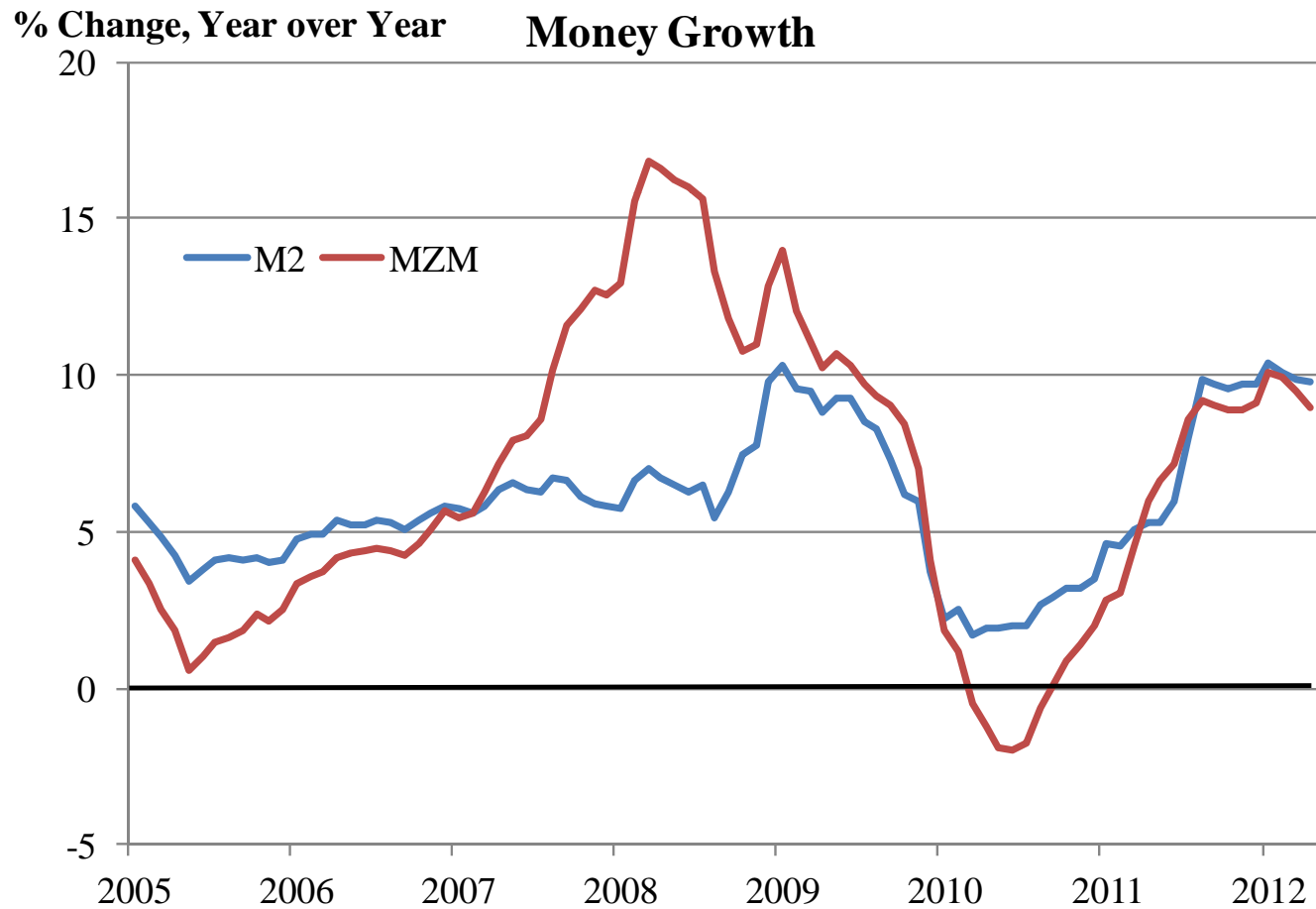
- Banks hold the QE injections as reserves with the Fed.



Source: Bureau of Economic Analysis

Monetary Policy: QE

- QE has not spilled over (much) to the broader aggregates.



Source: Federal Reserve Board

The Current Outlook: Inflation

“Stop worrying and learn to love inflation.”– Paul Krugman
< <http://www.pkarchive.org/theory/LoveInflation.htm> >

“The expansion of money, given an increase in the monetary base, is inevitable, and will ultimately result in higher inflation and interest rates. In shorter time frames, the expansion of money can also result in higher stock prices, a weaker currency, and increases in commodity prices such as oil and gold.”–Arthur Laffer, June 11, 2009
< <http://online.wsj.com/article/SB124458888993599879.html> >



The Current Outlook: Inflation

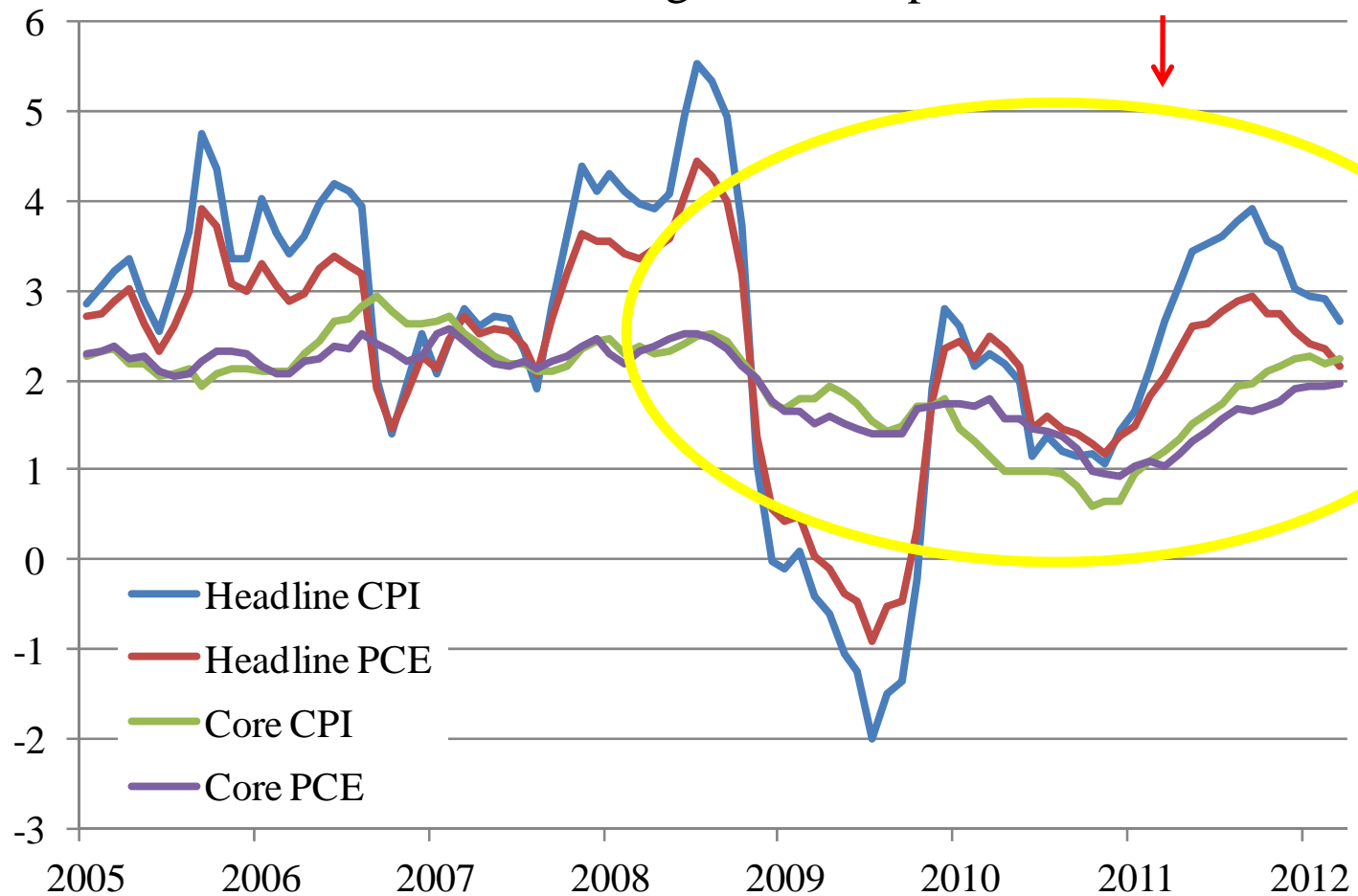
- Inflation has been volatile but near target, on average, since the start of the financial crisis.
- Inflation expectations remain anchored.



The Current Outlook: Inflation

Inflation has been volatile but about 1.6%,
on average, since September 2008.

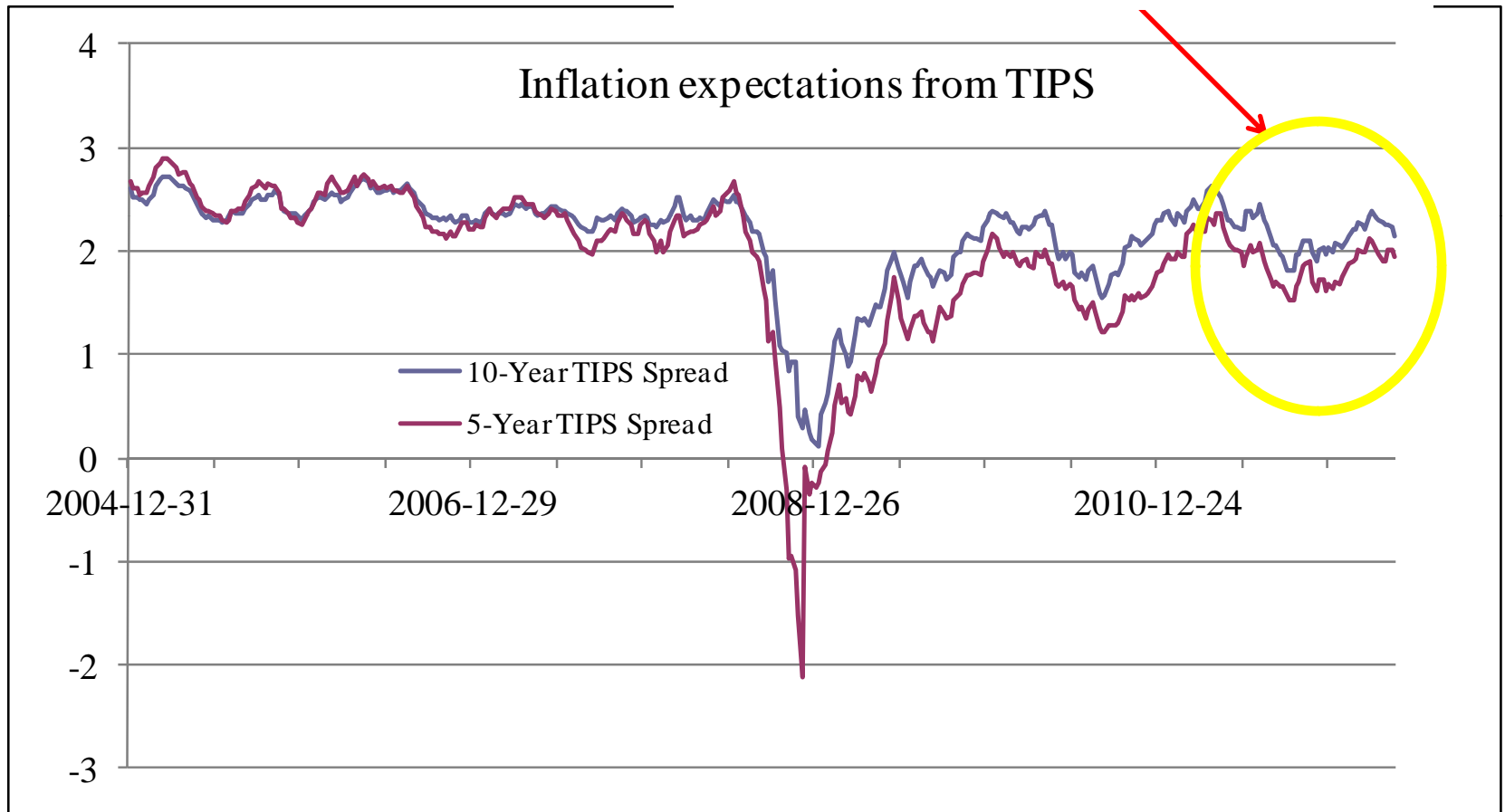
% Change, Year over Year



Source: Bureau of Economic Analysis/Bureau of Labor Statistics

The Current Outlook: Inflation

Market-based inflation expectations appear to be anchored, for now.

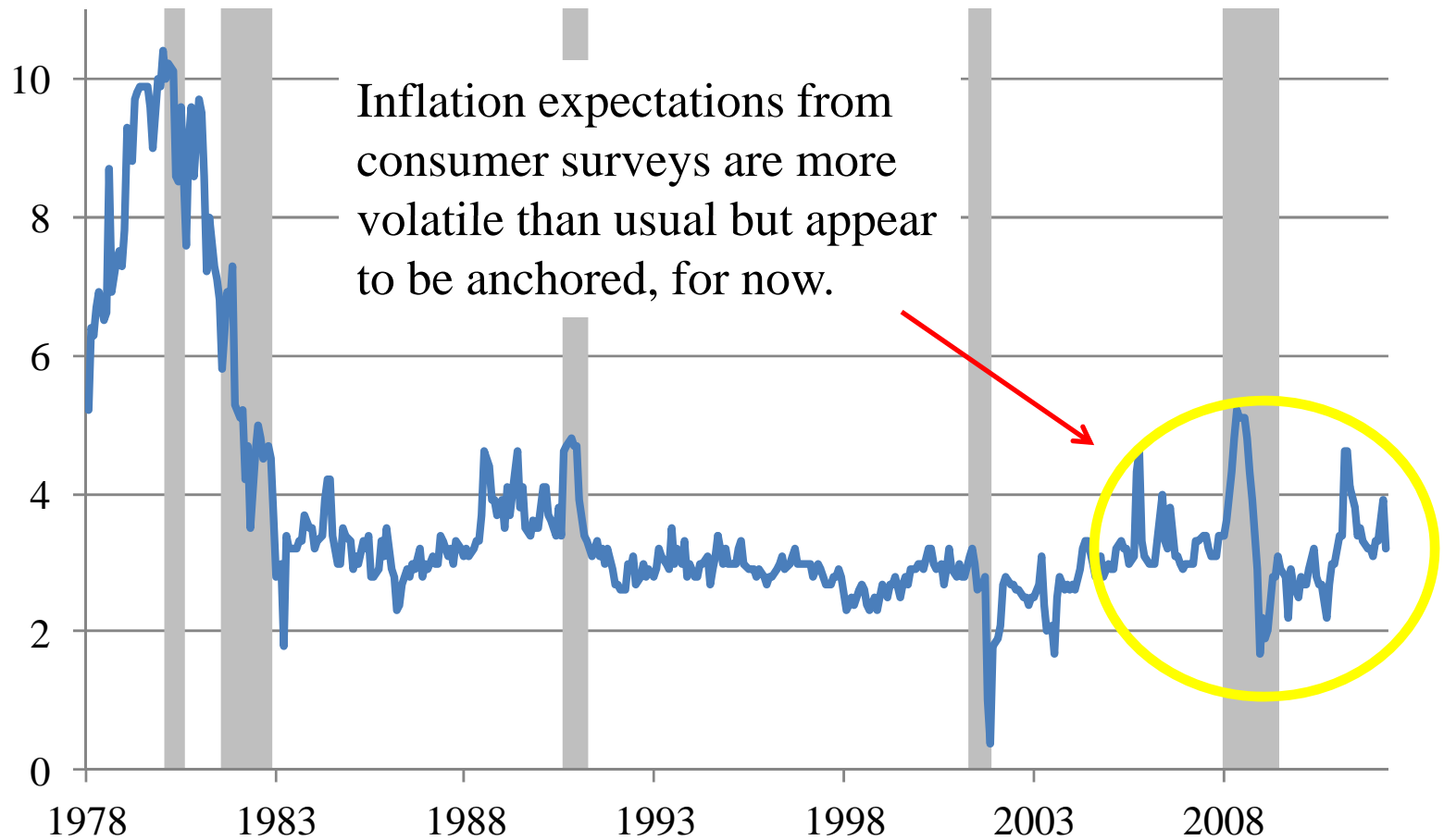


Source: U.S. Treasury

The Current Outlook: Inflation

University of Michigan Inflation Expectations

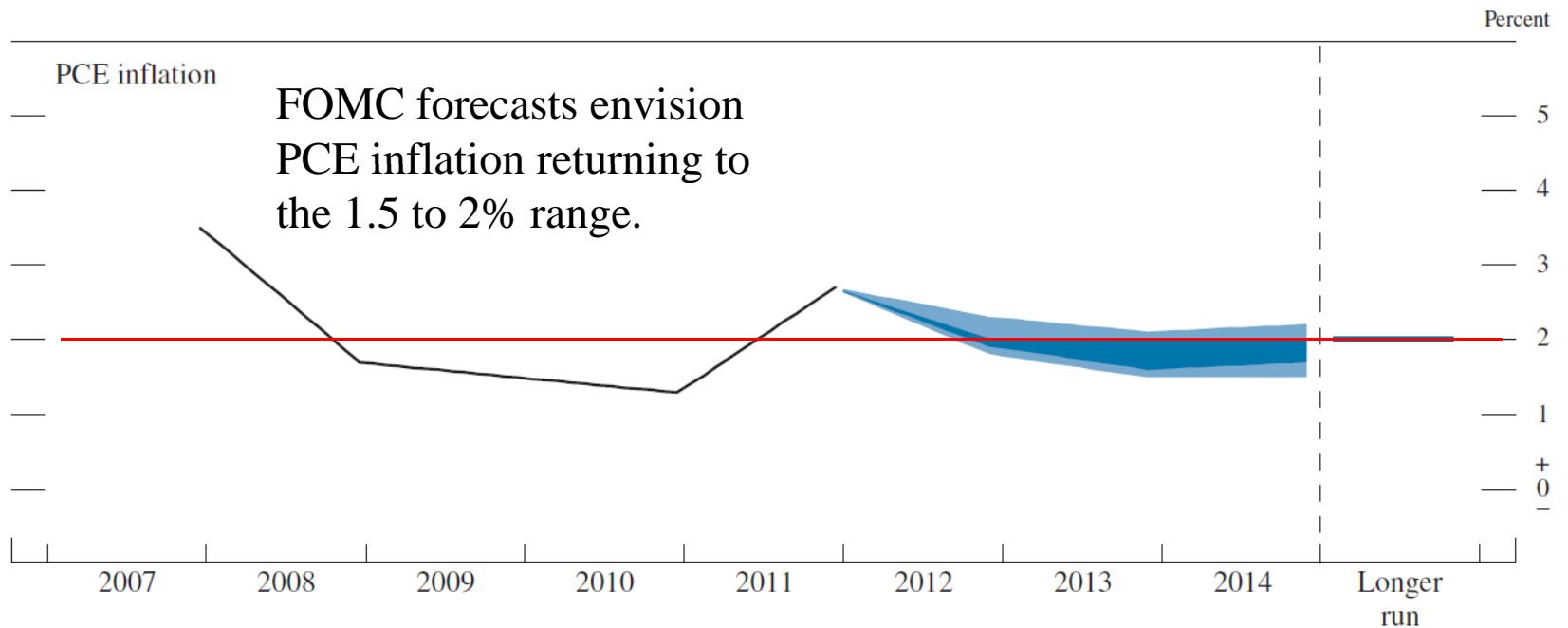
Percent



Source: Thomson Reuters/University of Michigan

The Current Outlook: Inflation forecasts

FOMC Economic projections from the April 2012
Monetary Policy Report to Congress



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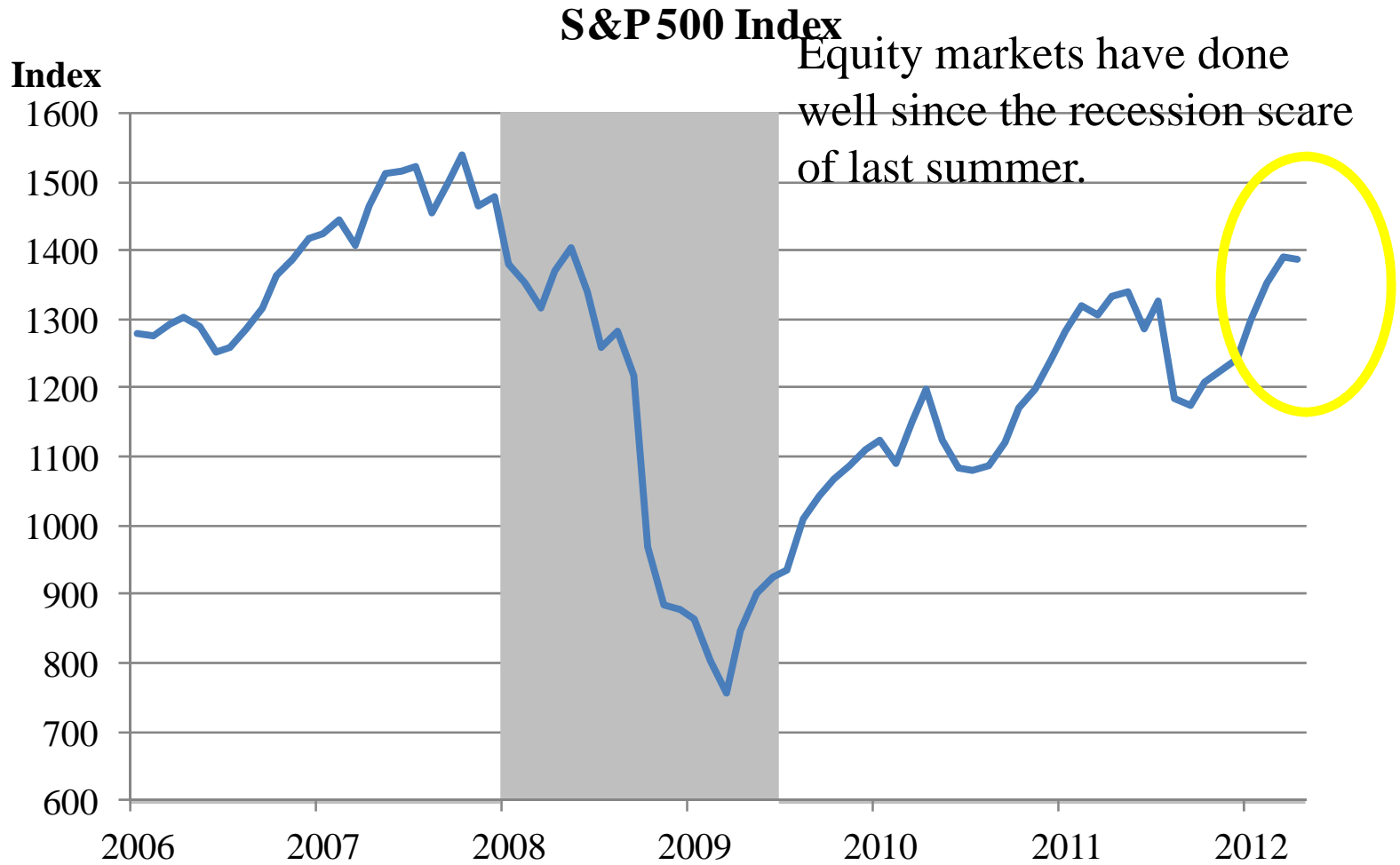
The Current Outlook: Financial Markets

The Current Outlook: Financial Markets

- Stocks are up over the medium term.
- Long-term Treasury yields are at record lows.
- The USD is up over the past year or so.
- Financial market stress is at “normal” levels after a recent recession scare.



The Current Outlook: Financial Markets

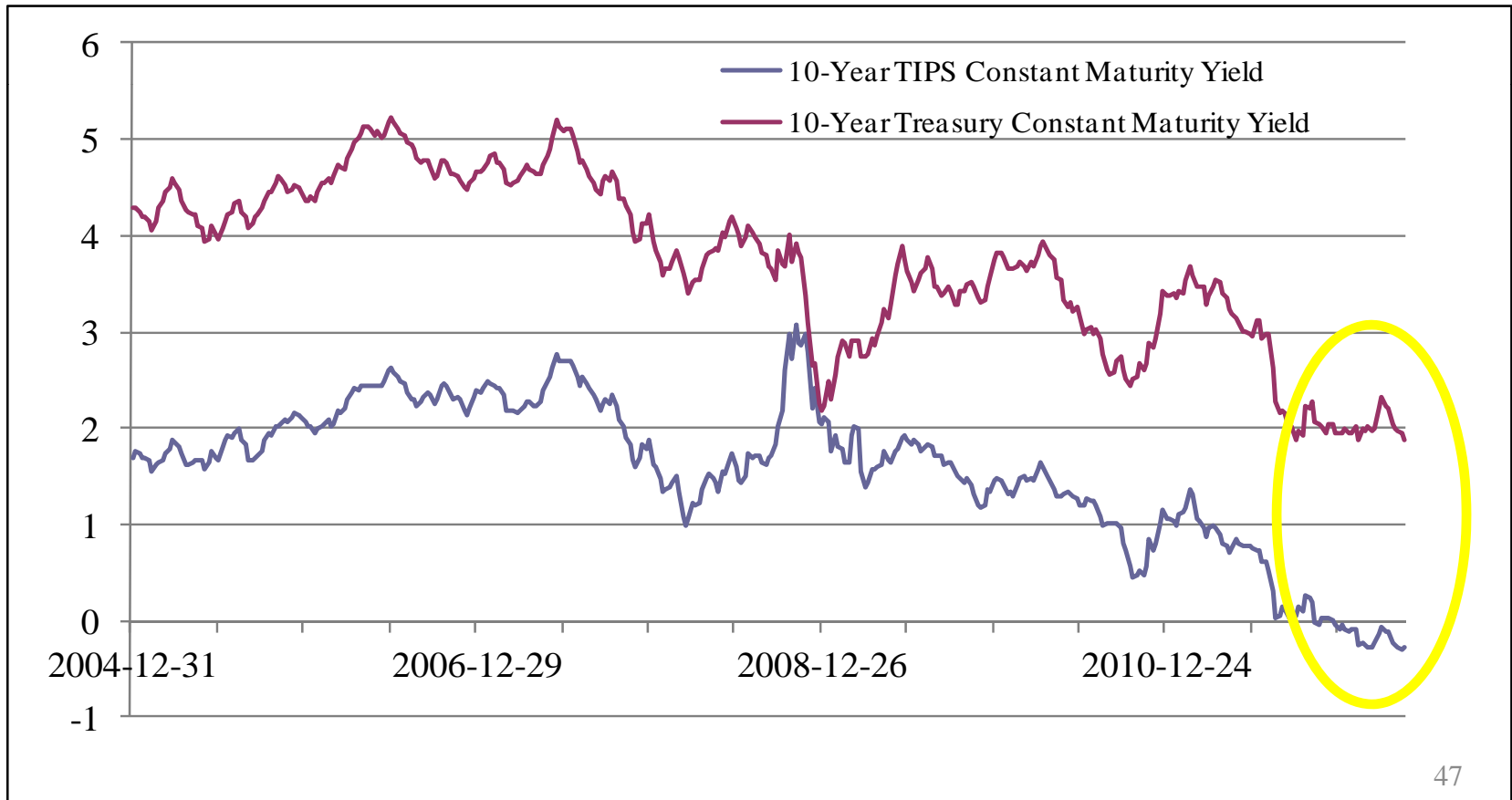


Source: Wall Street Journal

The Current Outlook: Financial Markets

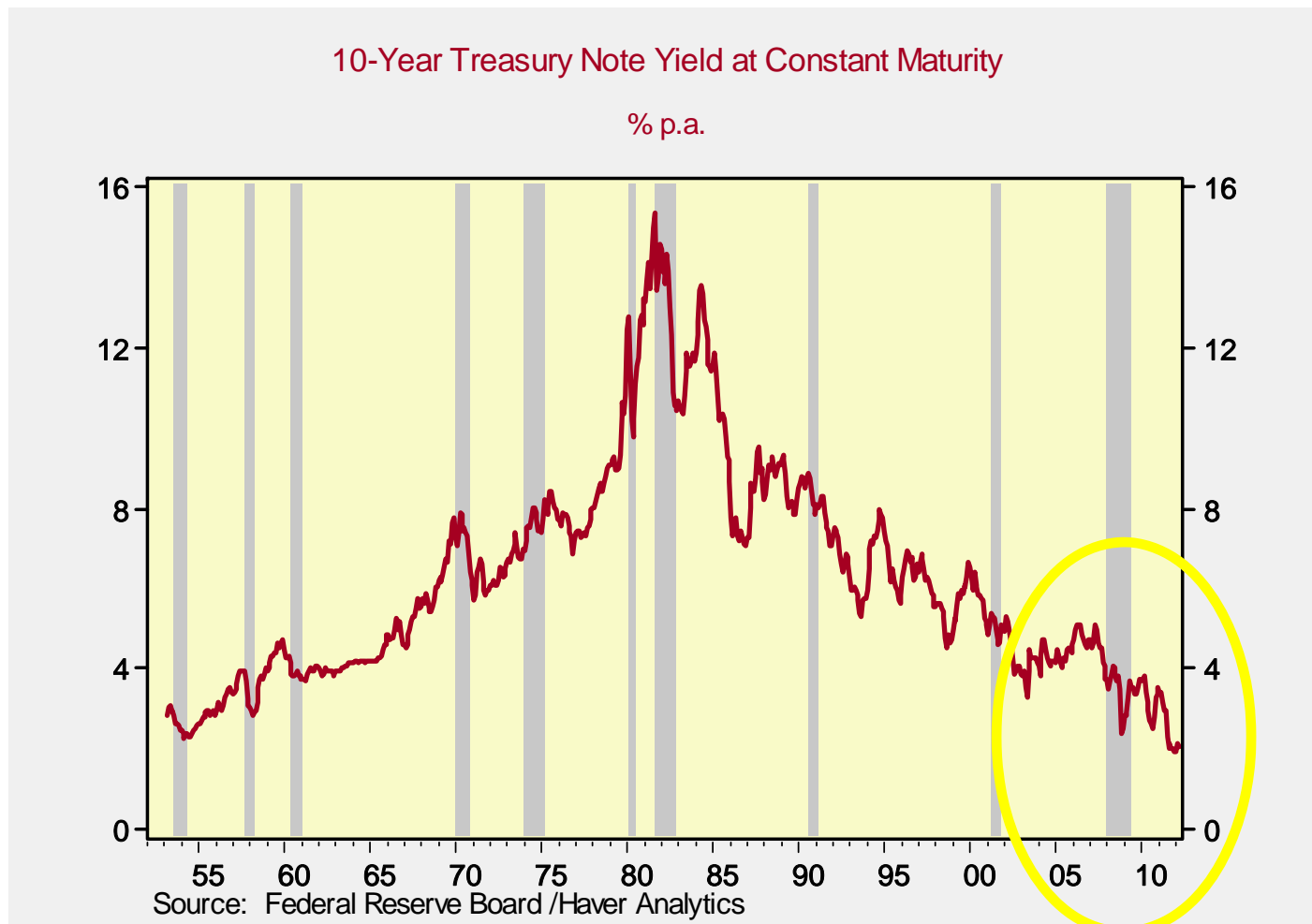
10-year Treasuries are at record lows, at least since the 1940s.

QE, weak expected growth and euro debt problems have lowered yields.

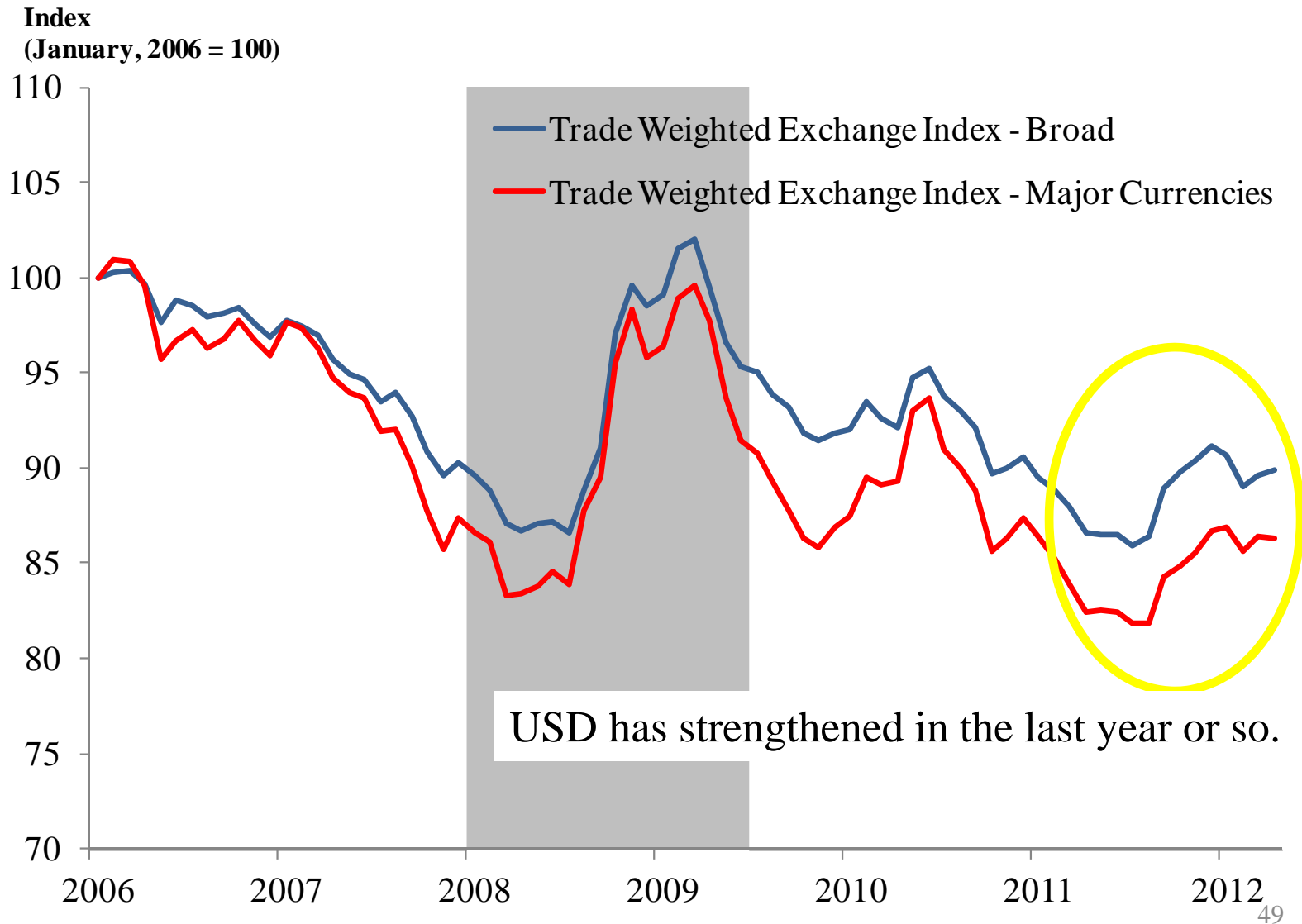


The Current Outlook: Financial Markets

10-year Treasuries are at record lows, at least since the 1940s.
QE, weak expected growth and euro debt problems have lowered yields.



The Current Outlook: Financial Markets



Source: Federal Reserve Board

The Current Outlook: Financial Markets

<http://research.stlouisfed.org/publications/net/NETJan2010Appendix.pdf>



Source: Federal Reserve Board

The Current Outlook: Financial Markets

- ❖ Equities are up fairly strongly in the last year.
- ❖ 10-year Treasuries are at record low yields.
- ❖ The St. Louis Fed's "Financial Stress Index" has come back down after a recession scare in 2011.
- ❖ The European fiscal/debt situation creates a lot of uncertainty.

Risks to the Outlook

- The security situation in the Middle East
 - Could affect us through world oil/gas prices or other channels
- The European fiscal situation
 - This is a slow motion train wreck.
- The U.S. fiscal situation
 - Looks like we are right behind the Europeans.
- U.S. commercial real estate
- Chinese banking balance sheets

The Current Outlook: A Summary

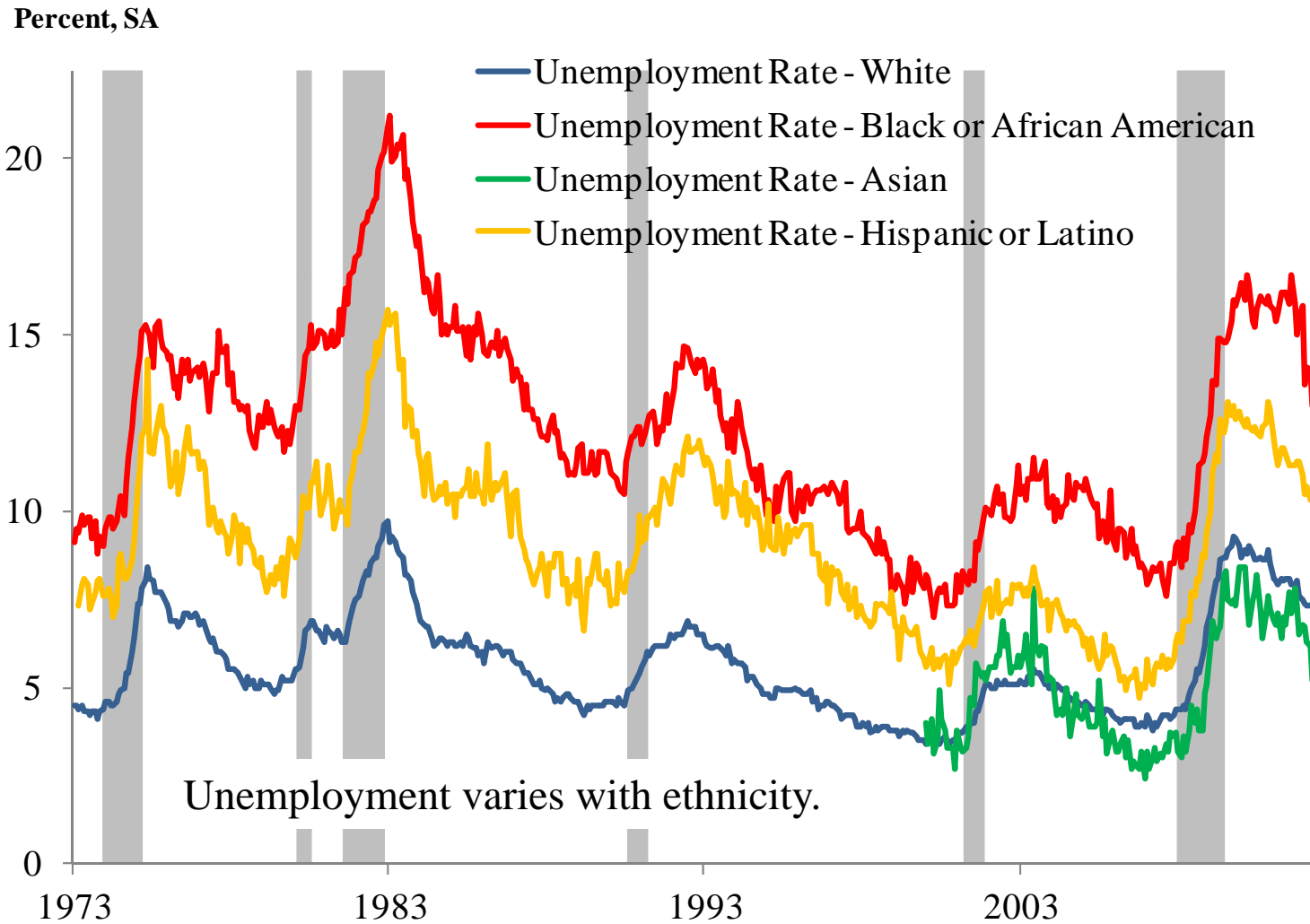
- ❖ GDP: Modest growth forecast
- ❖ Employment: Lagging
- ❖ Construction/housing: Weakness
- ❖ Credit/delinquency: Lagging but slowly returning to normal levels
- ❖ Monetary policy: Very accommodative
- ❖ Inflation: Recent volatility but expectations anchored
- ❖ Financial markets: A lot of volatility last summer/fall from a recession scare.

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The End



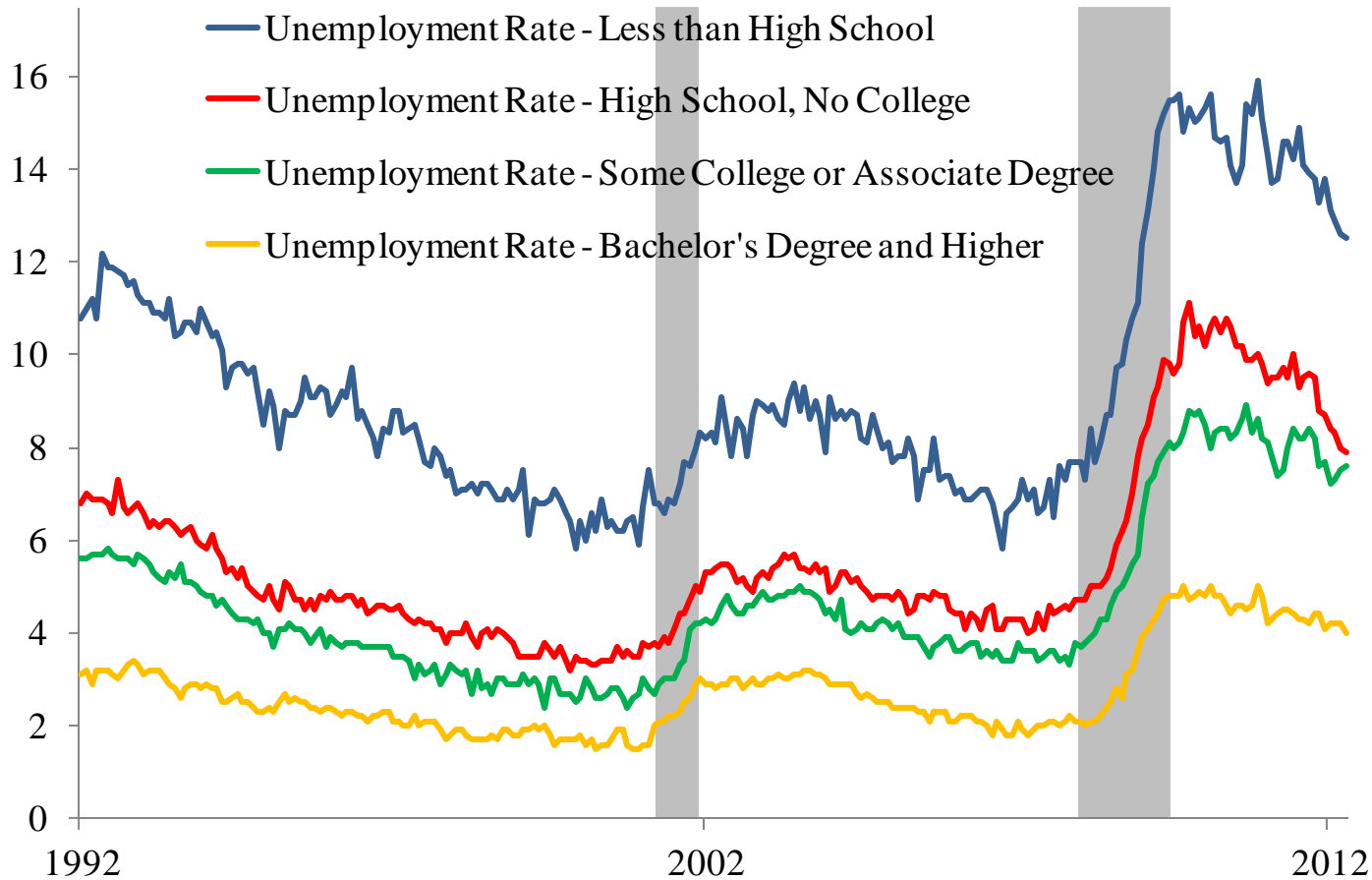
The Current Outlook: Unemployment by Ethnicity



Source: Bureau of Labor Statistics

The Current Outlook: Unemployment by Education

Percent, SA



Source: Bureau of Labor Statistics

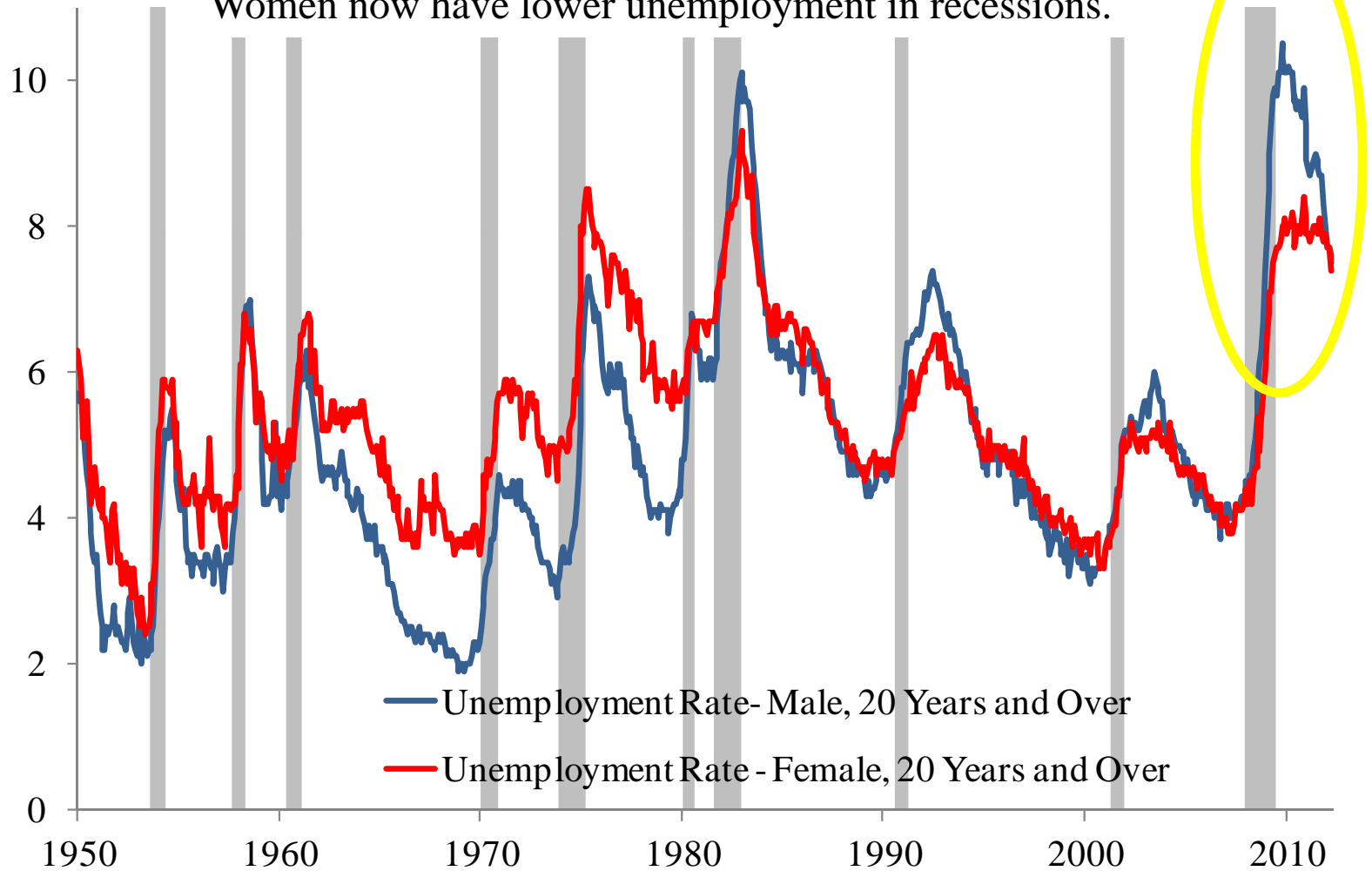
Unemployment is
always worse for the
less educated.

The Current Outlook: Unemployment by Sex

Percent, SA

Unemployment varies by sex.

Women now have lower unemployment in recessions.



Source: Bureau of Labor Statistics