

*Nevada County Economic Resource Council
Grass Valley Chamber of Commerce
Citizens Bank of Nevada County*



Grass Valley/Nevada County
Chamber of Commerce



Fed in Brief
Grass Valley, CA
June 13, 2007

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Federal Reserve Bank of San Francisco

Overview

I. Monetary policy overview

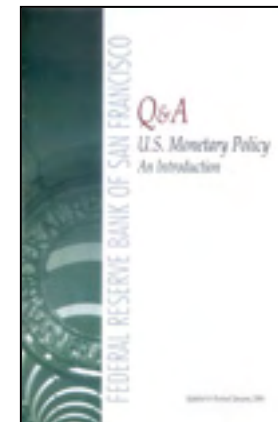
II. National economy

III. FRBSF national forecast

IV. Potential risks to the forecast

I. U.S. Monetary Policy: Two Goals

- **Monetary Policy Goals**
 - “to promote ‘**maximum**’ **sustainable output** and **employment** and to promote ‘**stable**’ prices.”



U.S. Monetary Policy: An Introduction. (2004) Federal Reserve Bank of San Francisco, page 5.

The FOMC Statement: **A Second Policy Instrument**

- **The FOMC Statement has become a second policy instrument**—wording of the statement:
 - Affects expectations about future fed funds rates
 - Influences long-term interest rates
 - Articulates balance of risks
- Released at 2:15 p.m. (Eastern) after meeting
- *Next meeting: June 27-28, 2007*

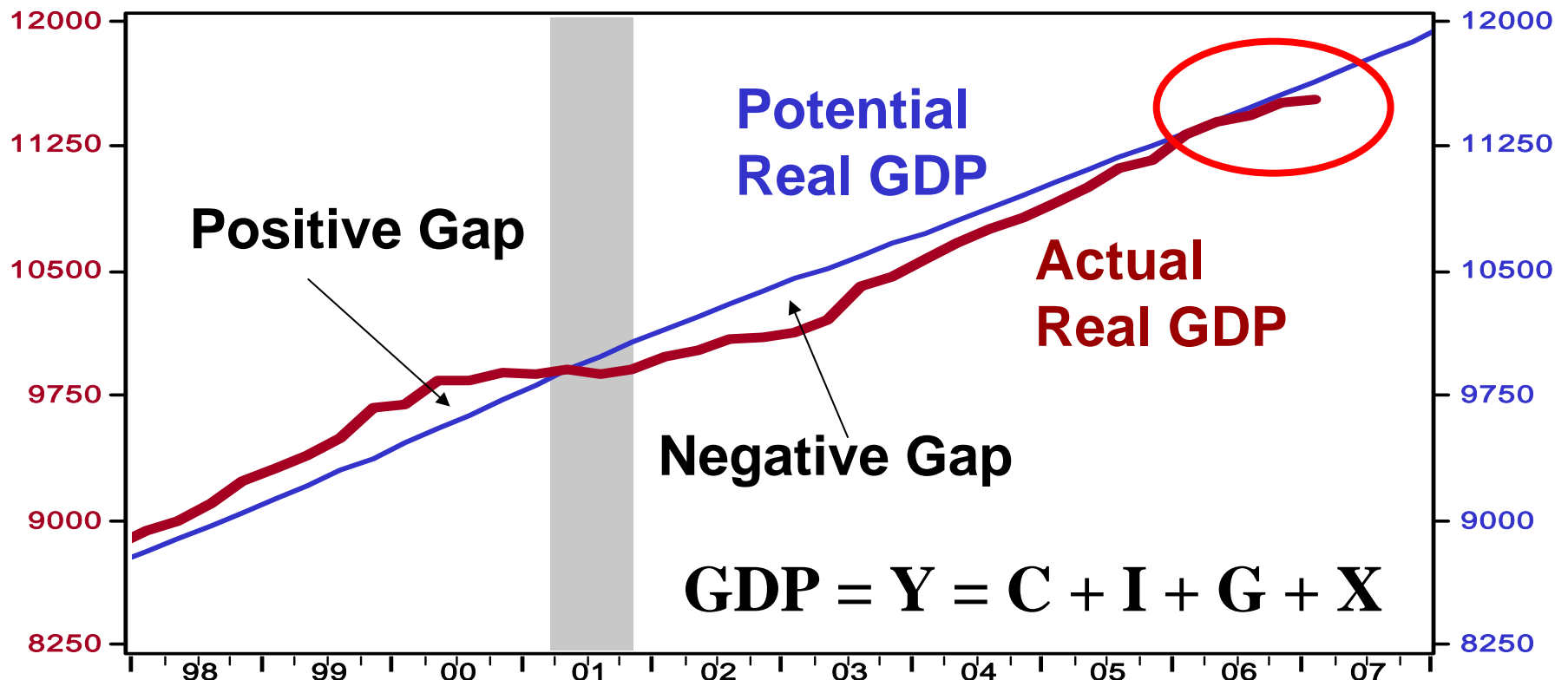
II. Big Picture: Bimodal Economy

- ***Real Gross Domestic Product (Output)***
 - Real GDP growth rate slow to a 0.6% annual rate in 2007:Q1 (preliminary estimate)
 - Reduced growth from housing, inventories, and imports
 - Most of the economy remains on track
- ***Labor market (Jobs)***
 - Still tight, but signs of softening emerge
 - Added 157,000 jobs in May
 - Monthly average of 133,000 in first 5 months of 2007
 - Compared to a monthly average of nearly 190,000 for all of 2006
 - Unemployment rate held at 4.5% in May

U.S. Economic Output: Real GDP Is Close to Estimated Potential (with core inflation above 'comfort zone')

Real Gross Domestic Product
SAAR, Bil. Chn. 2000\$

Real Potential Gross Domestic Product {CBO} Billions 2000\$
Bil. Chn. 2000\$



$$\text{GDP} = \text{Y} = \text{C} + \text{I} + \text{G} + \text{X}$$

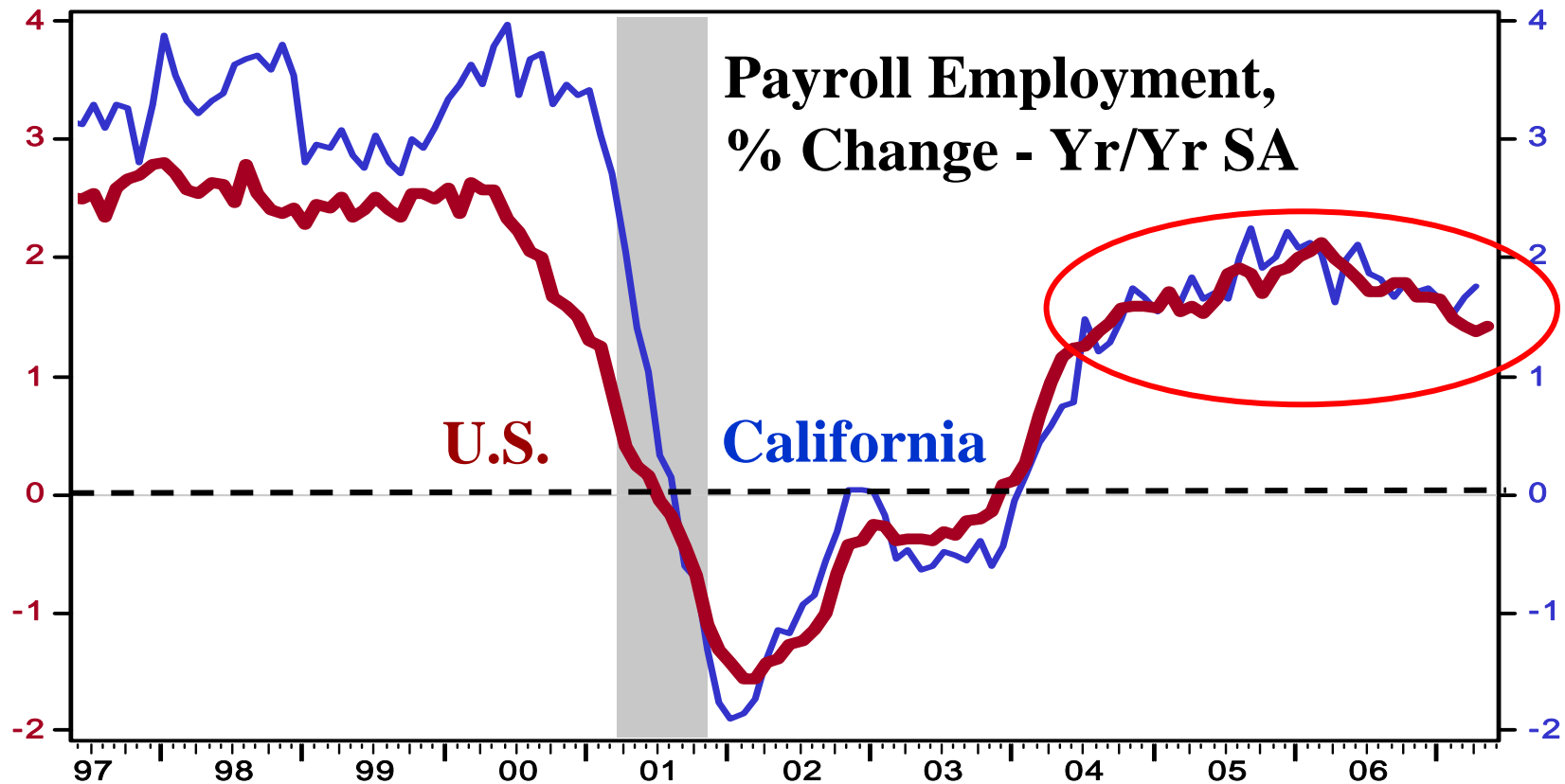
Sources: BEA, CBO /Haver

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Payroll Employment Growth Rate: California Is Mostly on Pace with the Nation

All Employees: Total Nonfarm
% Change - Year to Year SA, Thous

All Employees: Total Nonfarm, California
% Change - Year to Year SA, Thous



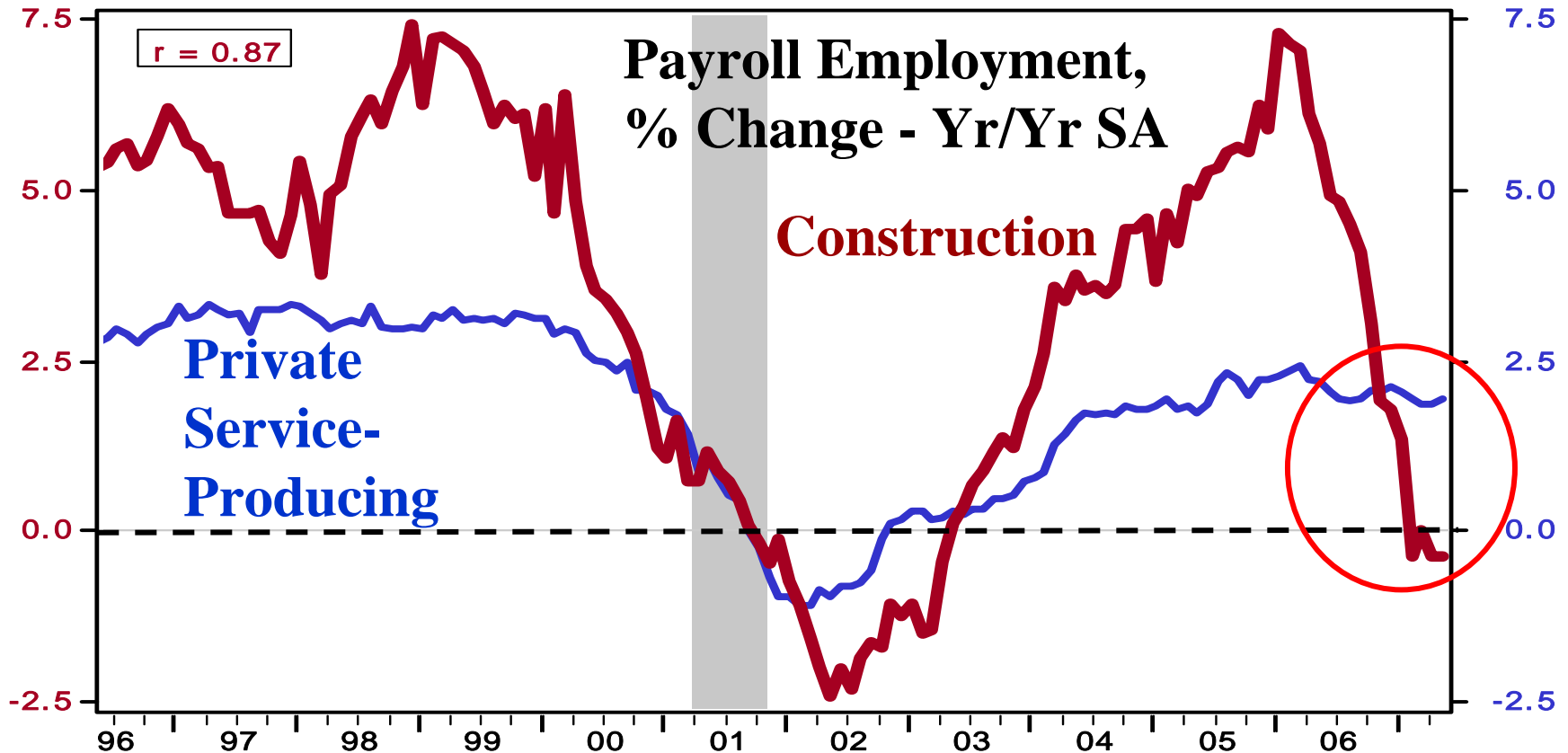
Sources: BLS, BLSCAEDD /Haver

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Payroll Employment Growth Rate: Losses in Construction; Services Strong

All Employees: Construction
% Change - Year to Year SA, Thous

All Employees: Private Service-Producing
% Change - Year to Year SA, Thous



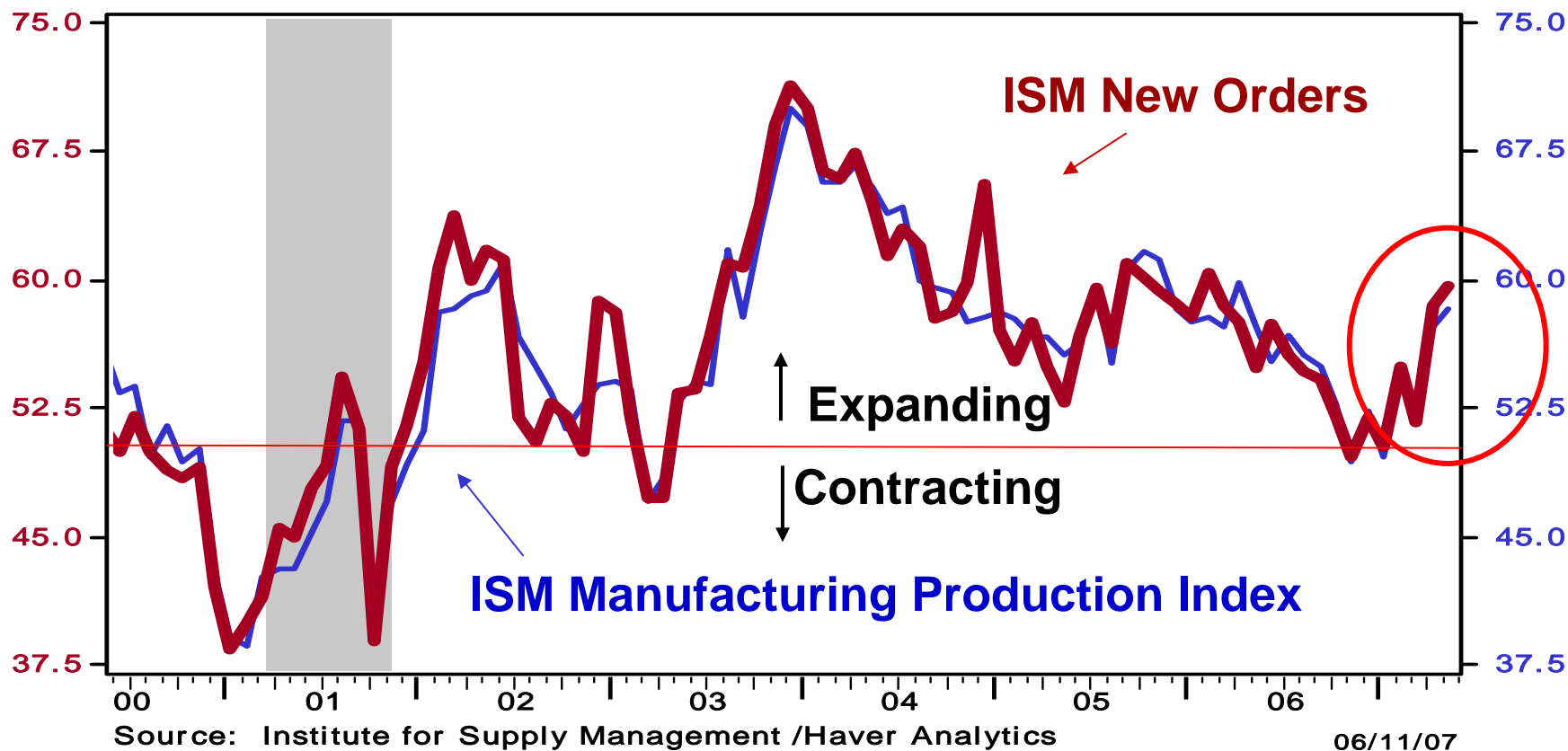
Source: Bureau of Labor Statistics /Haver Analytics

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Manufacturing Production — Both New Orders and Production Edge Upward

ISM Mfg: New Orders Index
SA, 50+ = Econ Expand

ISM Mfg: Production Index
SA, 50+ = Econ Expand



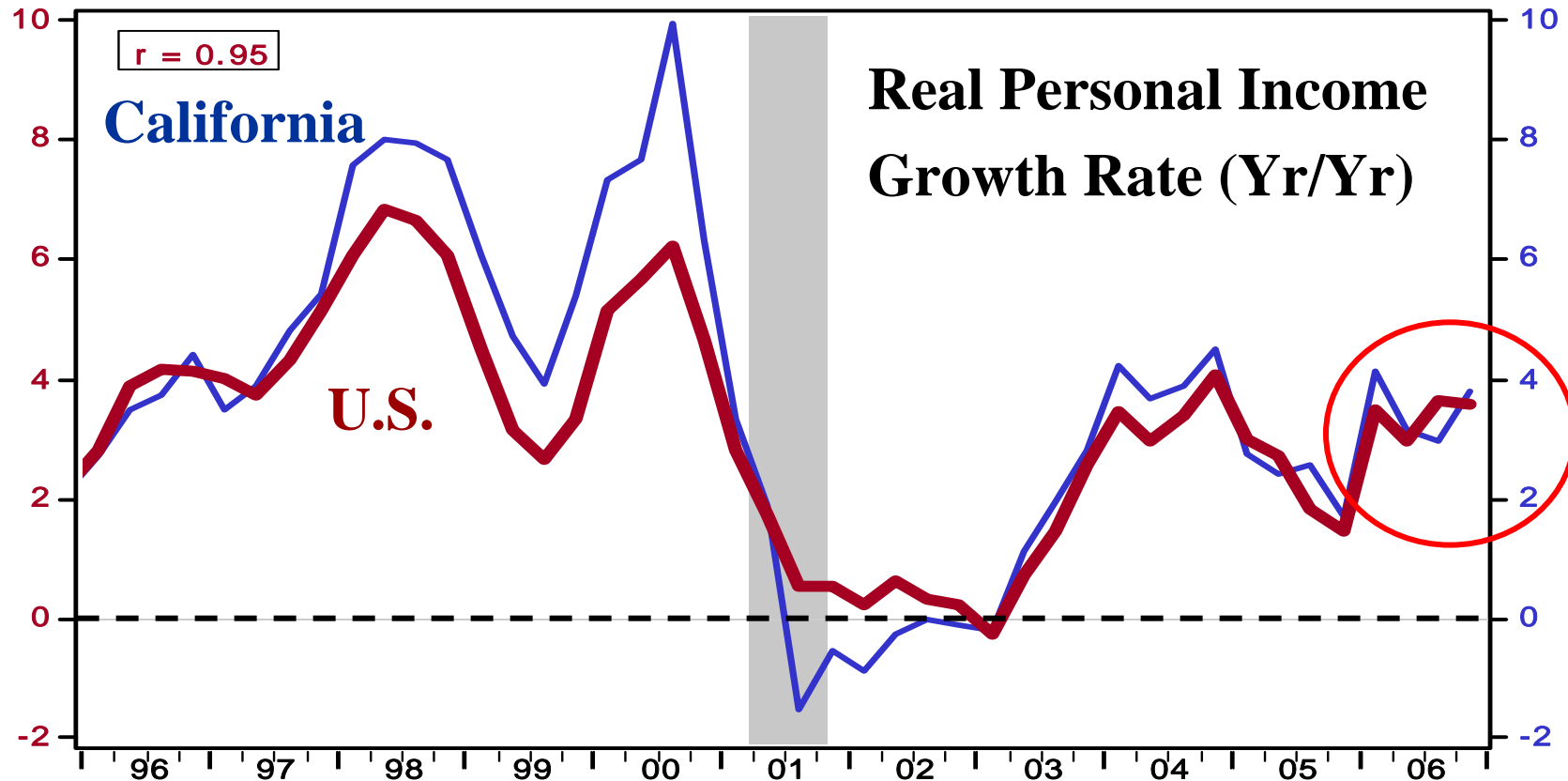
Consumer Sector: **Spending Remains Strong**

- **Consumption growth – main source of GDP growth in 2007:Q1. Fueled by:**
 - Gains in real incomes
 - Low interest rates
 - Past gains in housing wealth
- **Going forward, growth might be limited by:**
 - Higher energy costs
 - Softening in the housing market

Personal Income Growth : California Compares Well with the Nation

Personal Income, United States
% Change - Year to Year Mil.Chn.2000\$

Personal Income, California
% Change - Year to Year Mil.Chn.2000\$



Source: Bureau of Economic Analysis/Haver Analytics

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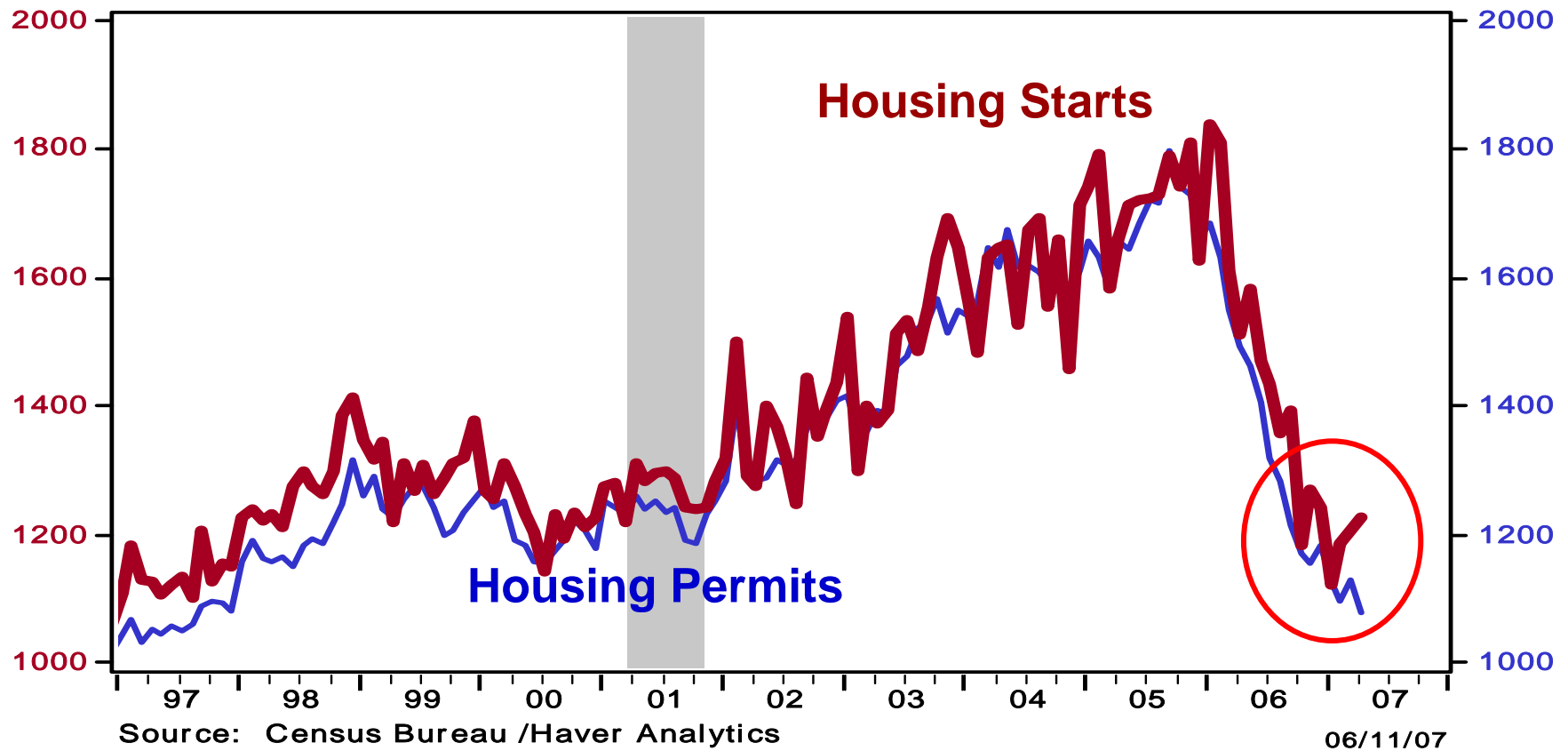
Investment Spending: **Housing Continues to Dampen Growth**

- **Residential fixed investment remains weak**
 - Contracted by 15.4% at annual rate in 2007:Q1
 - Knocked off 0.9 percentage point from annualized GDP growth for the quarter
- **Business fixed investment growth was revised upwards to 2.9%**

Housing Market: New Permits Fall, but Starts Rise

Housing Starts: 1 Unit
SAAR, Thous. Units

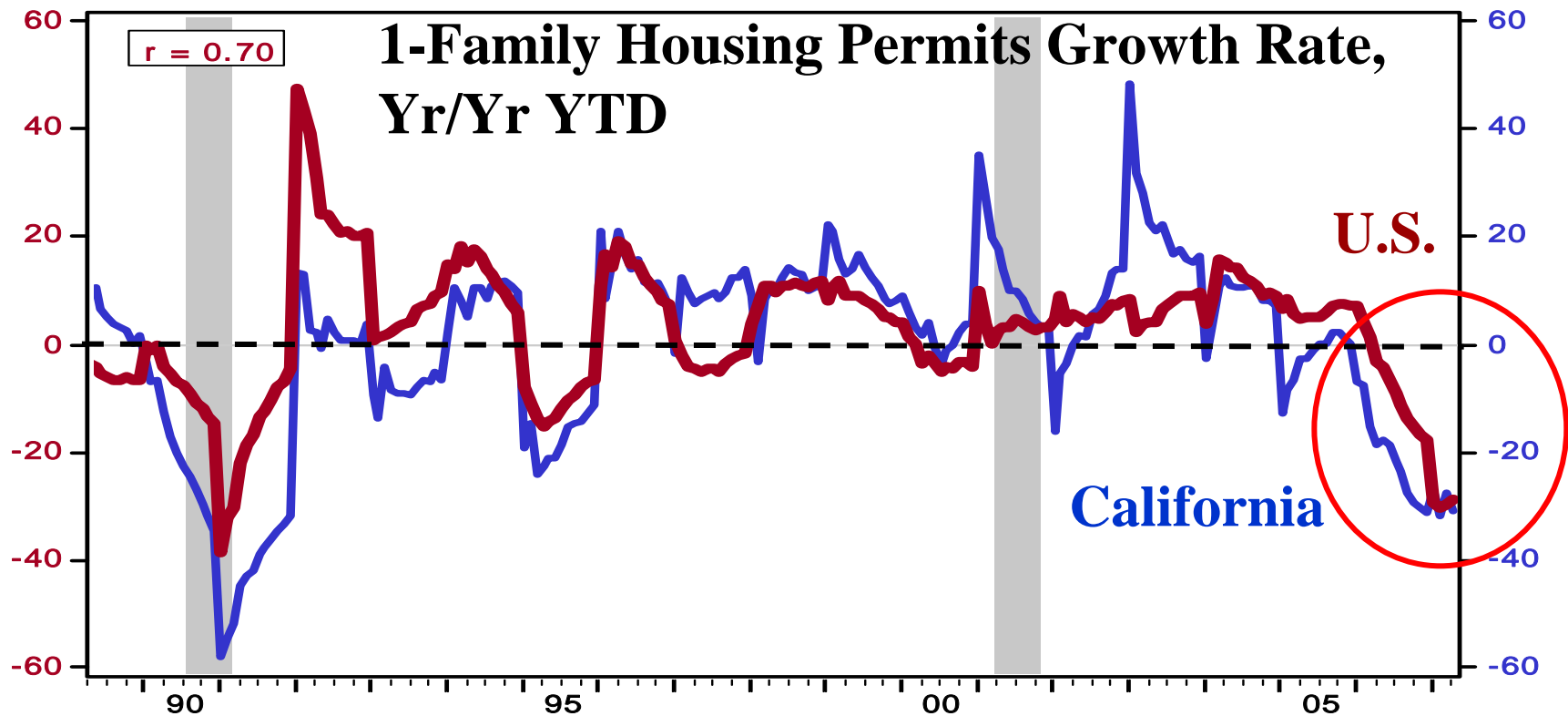
Housing Units Authorized: 1-Unit Structures
SAAR, Thous. Units



New Housing Activity: U.S. and California Record Similar Declines

Permits: 1-Family Homes, U. S.
% Change - Year to Year YTD Units

Permits: 1-Family Homes, California
% Change - Year to Year YTD Units



Source: Bureau of the Census /Haver Analytics

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III. Forecasts for the National Economy

Outlook for 2007 and 2008

- **FRBSF FedViews**

Forecast:

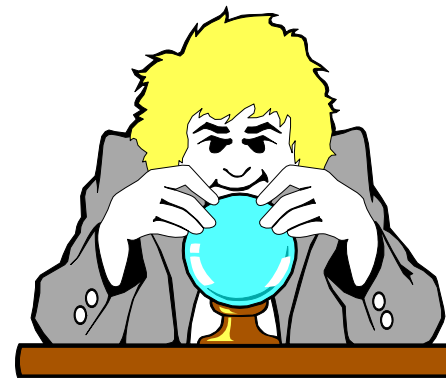
- Available at www.frbsf.org



- **Blue Chip Consensus**

Forecast comparison:

- Survey of 50 forecasters





U.S. Output Forecast: Projected Moderate Real GDP Growth

FedViews: Below trend real GDP growth expected

- Expected real GDP growth is about 2.5% annual rate for 2007:H2 and 2008
- Growth outlook has more uncertainty.

Blue Chip Forecast

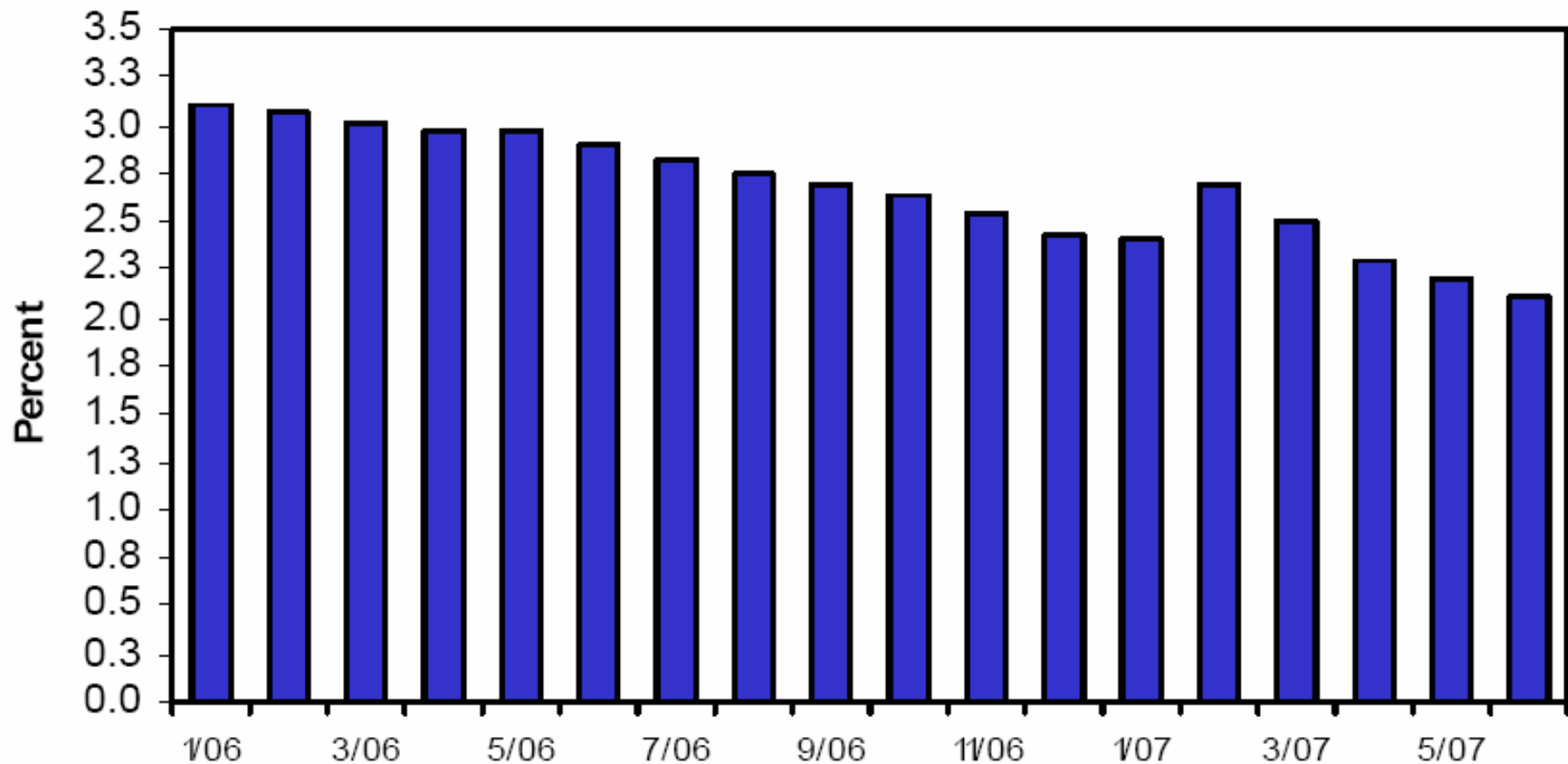
- 2007 forecast slips to 2.1% (from 2.2% in May)
- 2008 forecast at 2.9% (unchanged from May)

From May 14, 2007, FedViews & June 10, 2007 Blue Chip Financial Forecasts

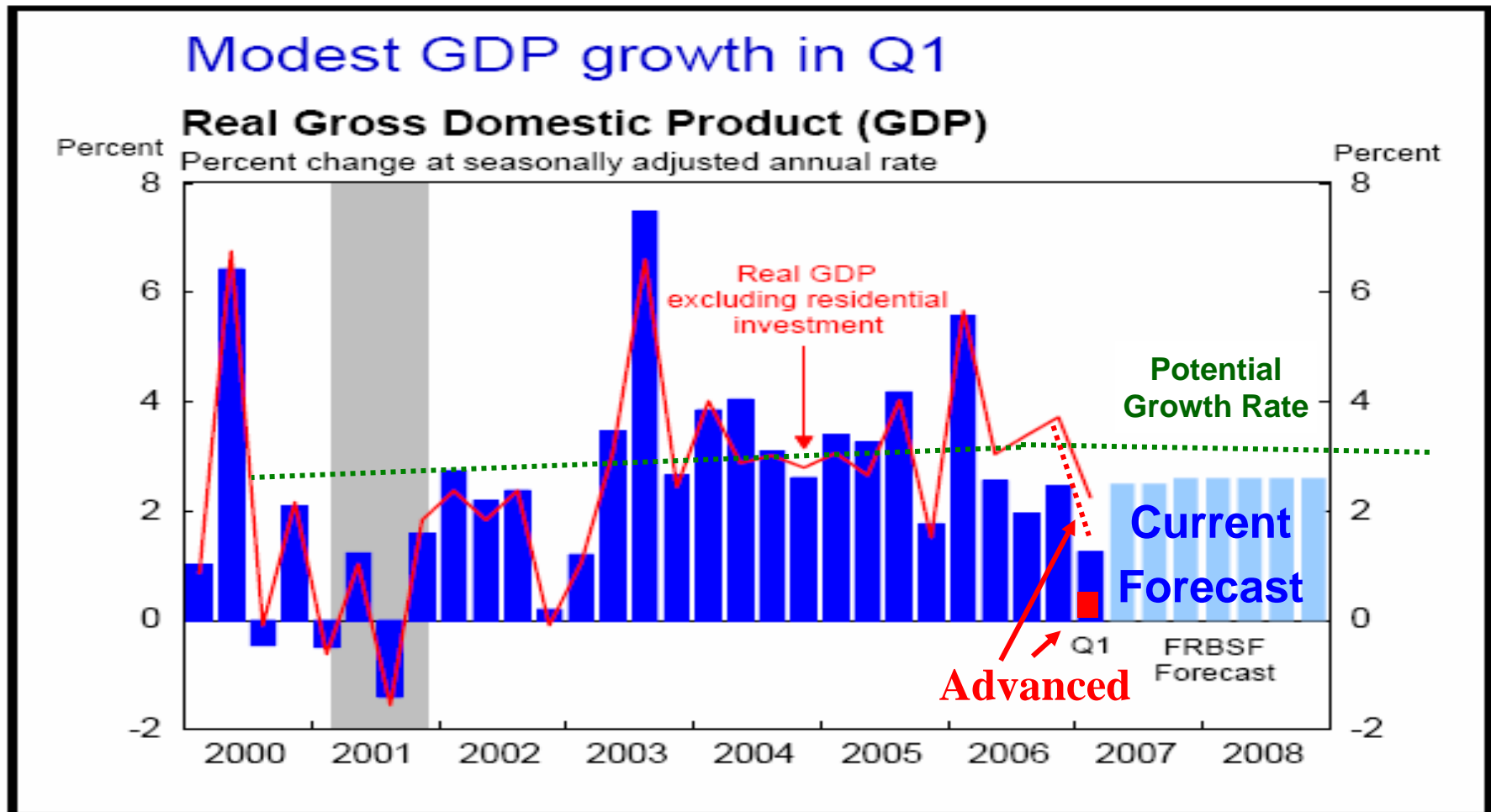
www.frbsf.org/publications/economics/fedviews/

Blue Chip Real GDP Forecasts Over Time: 2007 Growth Forecast Keeps Falling

**Consensus Forecasts Of Y/Y % Change In
Real GDP In 2007**



FRBSF Forecast: Real GDP is Slightly Below Average Growth for 2007





U.S. Inflation Forecast: **Core Inflation Expected to Ease**

FedViews:

- Core PCE should moderate, falling close to the 2% mark by the end of 2008
- Previously, forecasted core PCE was expected to fall below the 2.0% mark by the end of 2008

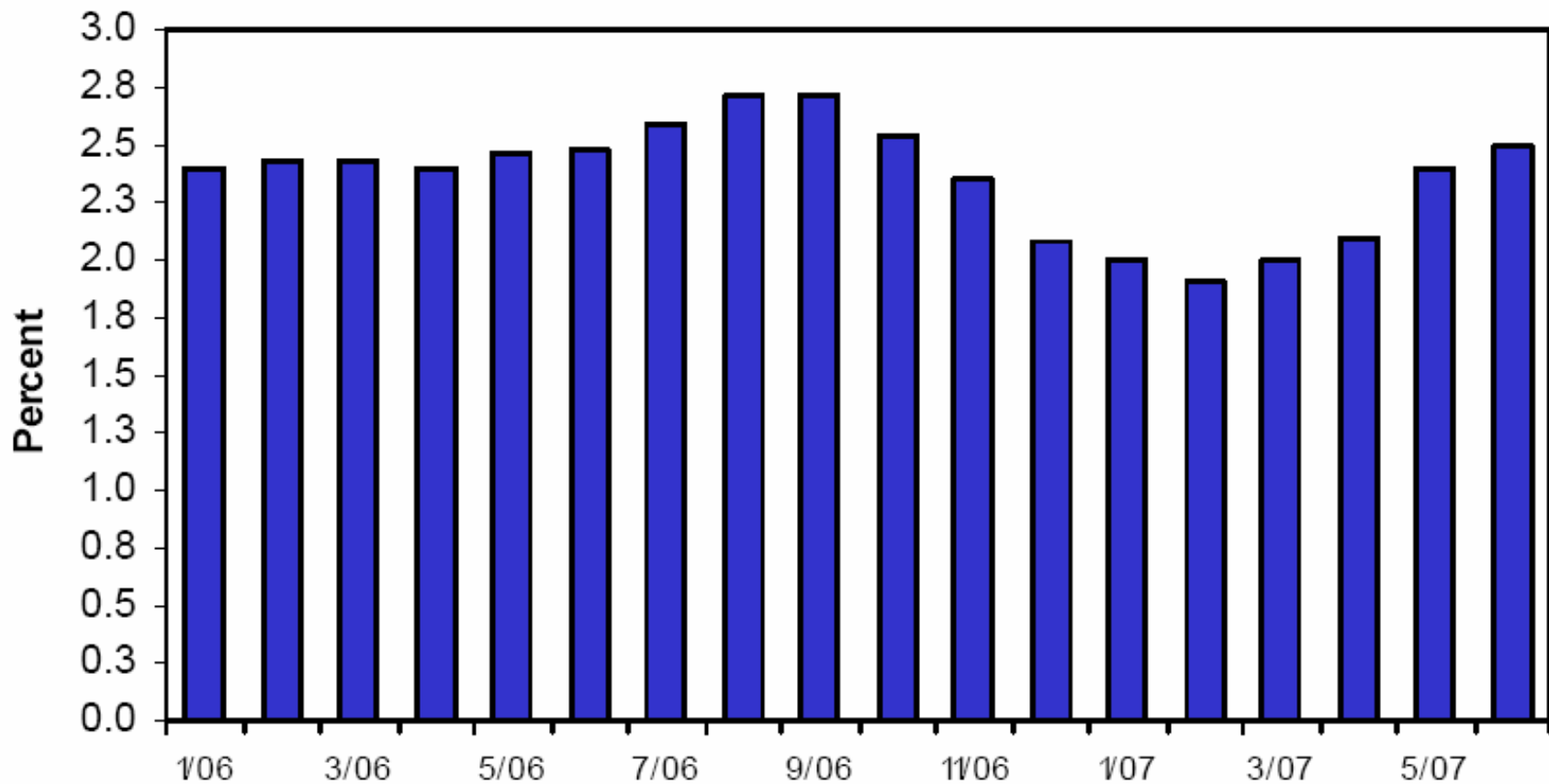
Blue Chip:

- Overall CPI for 2007 expected to increase by 2.5% (up from 2.4% in May)
- Overall CPI for 2008 expected to increase by 2.5%
- (up from 2.4% in May)

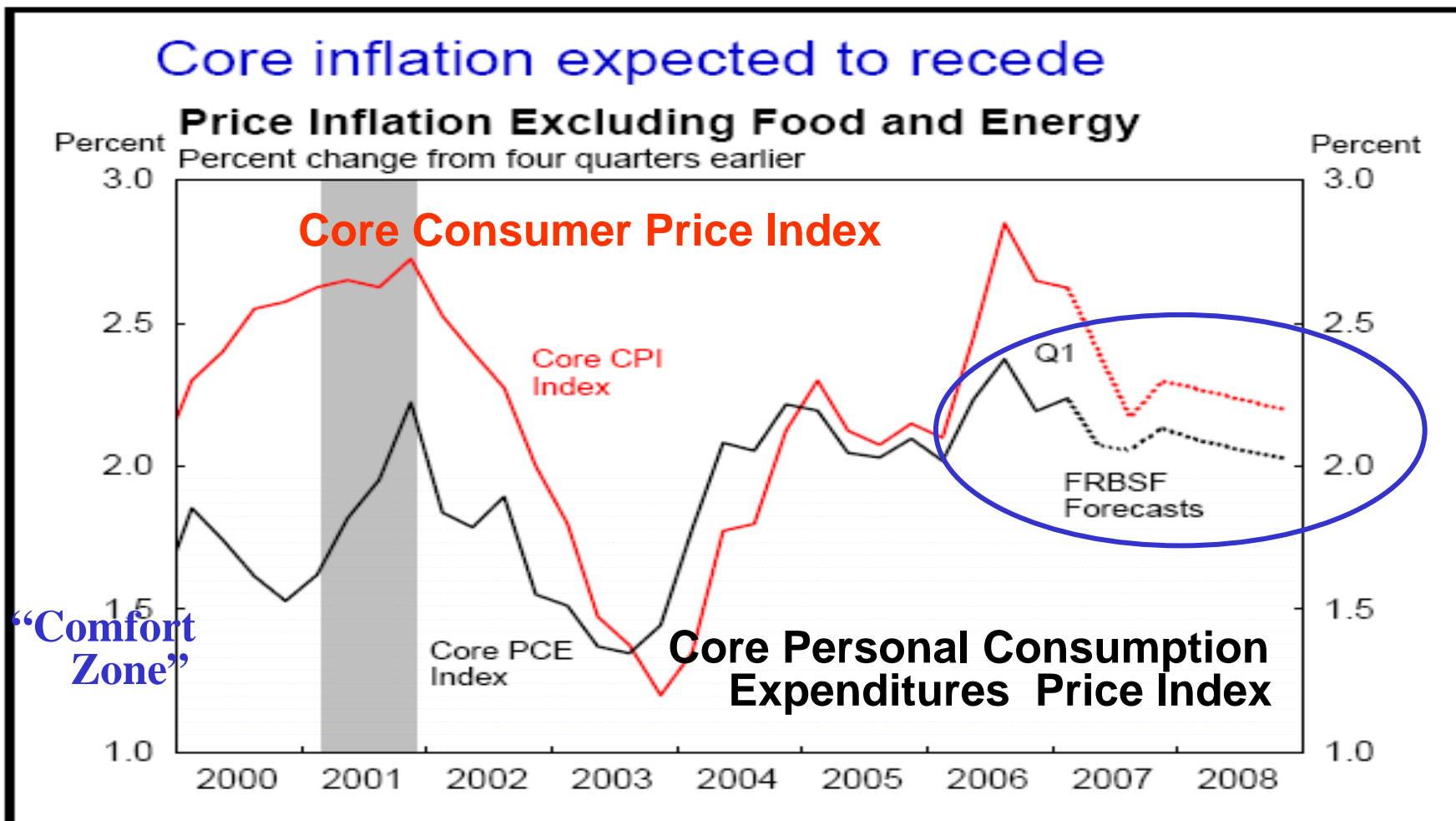
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www.frbsf.org/publications/economics/fedviews/

Blue Chip CPI Forecasts Over Time: **Recent Upward Revisions to 2007 Forecast**

**Consensus Forecasts Of Y/Y % Change In
Consumer Price Index In 2007**




FRBSF Forecast: Core Inflation to Fall as Growth Moderates



FedViews of May 14, 2007

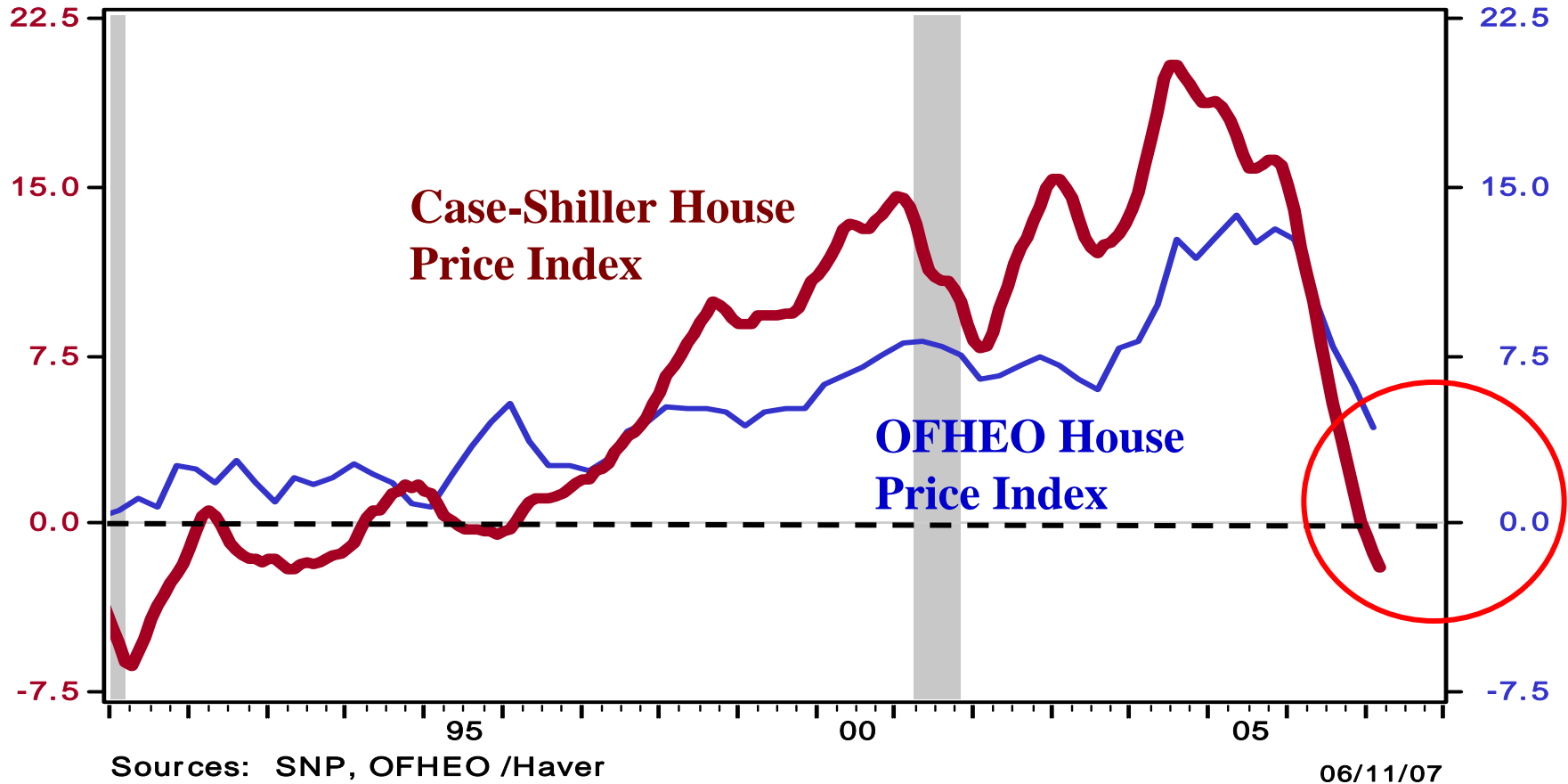
IV. Potential Risks to the Forecast

- *Housing?*
 - *Investment?*
 - *Productivity?*
 - *Oil and natural gas?*
 - *Deficits?*
 - *Dollar?*
 - *Supply of foreign capital?*
 - *SHoCKS ???*
- 

National House Price Appreciation: Some Measures Turn Negative in 2007:Q1

S&P/Case-Shiller Home Price Index: Composite
% Change - Year to Year NSA, Jan-00=100

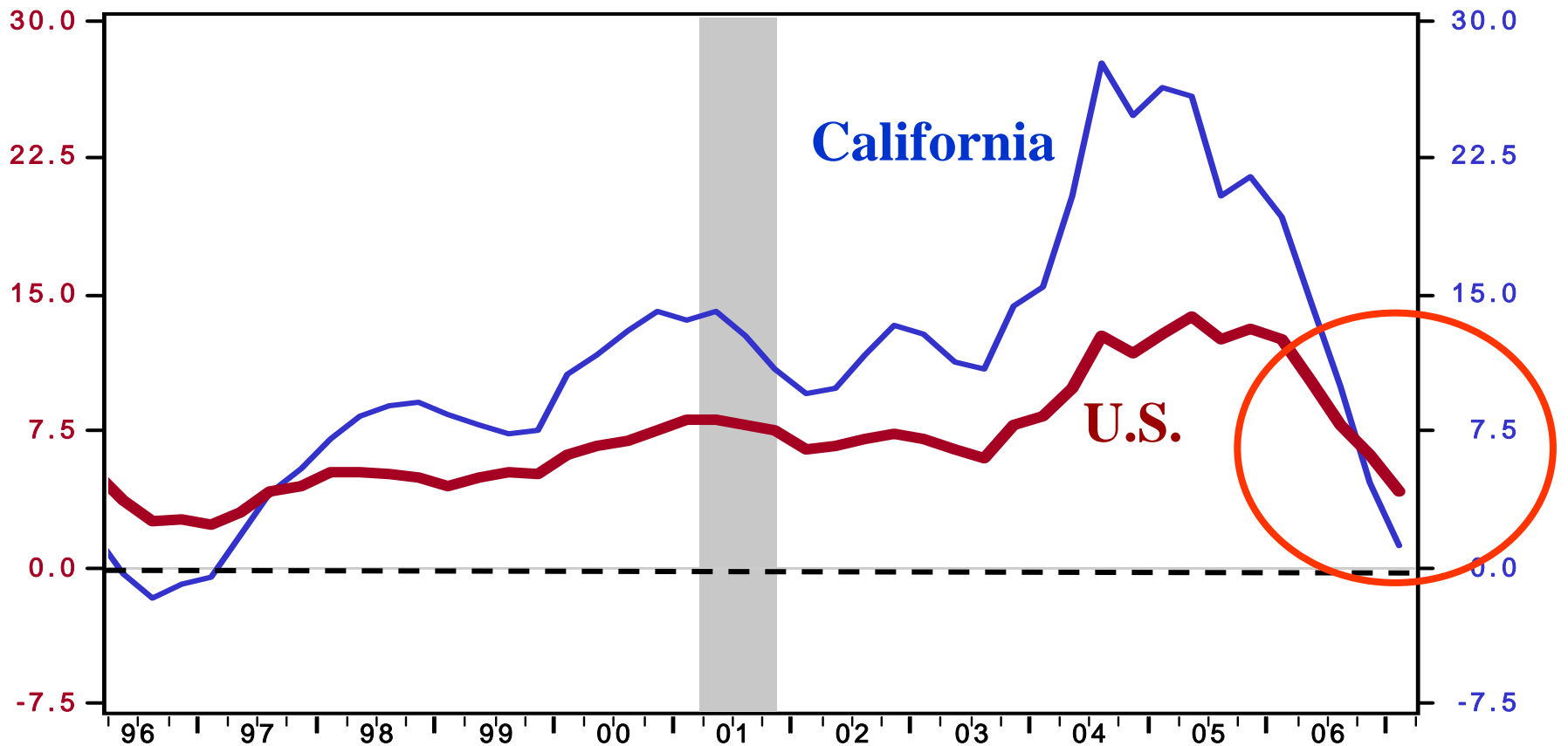
House Price Index, United States
% Change - Year to Year NSA, Q1-80=100



House Price Appreciation: California's Appreciation Rate Falls Below Nation's

House Price Index, United States
% Change - Year to Year NSA, Q1-80=100

House Price Index, California
% Change - Year to Year 1980 Q1=100



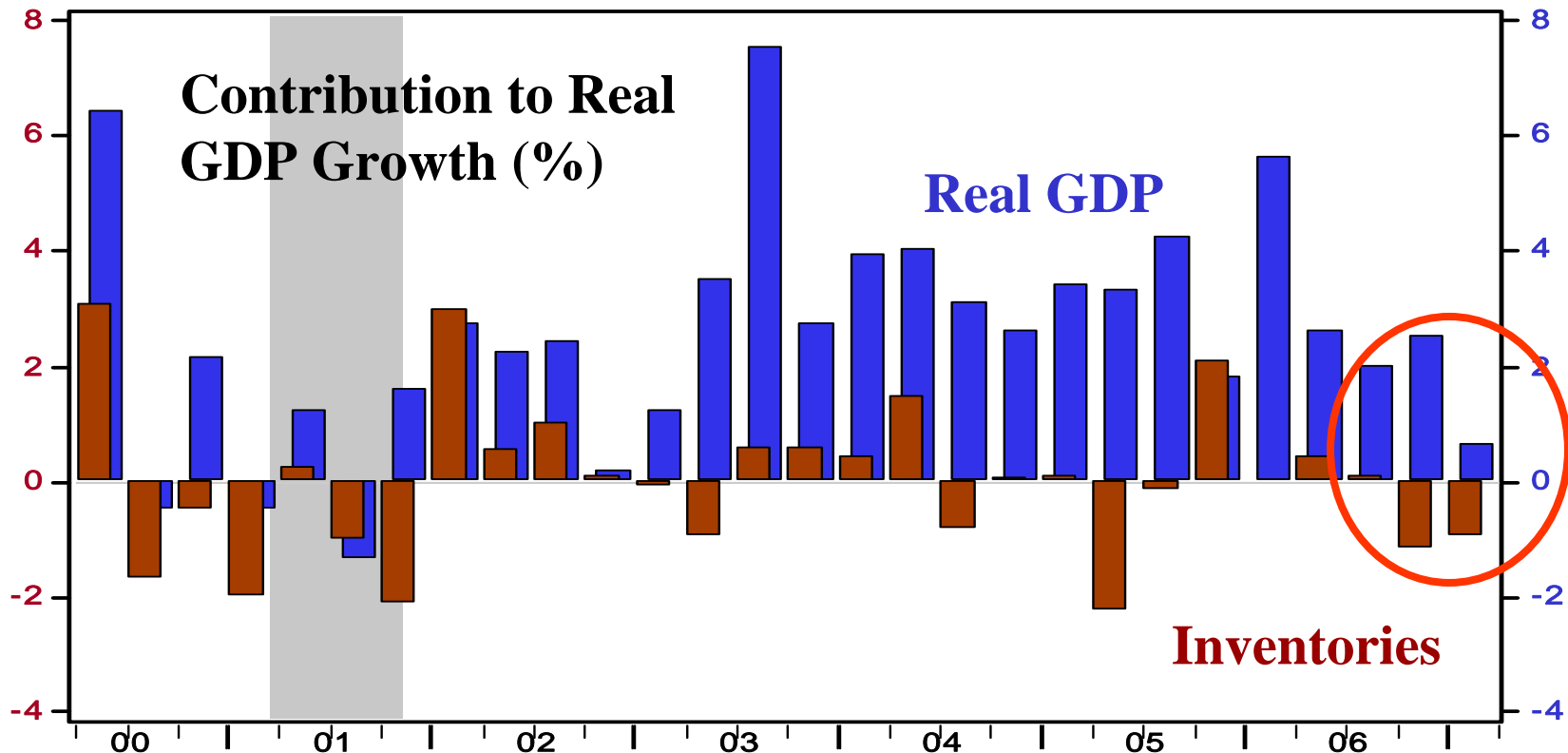
Source: OFHEO /Haver

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Inventory Adjustment: Contributing to Slower Output Growth

Real Change in Private Inventories: Contrib to Real GDP Change
SAAR, %

Real Gross Domestic Product
SAAR, %Chg



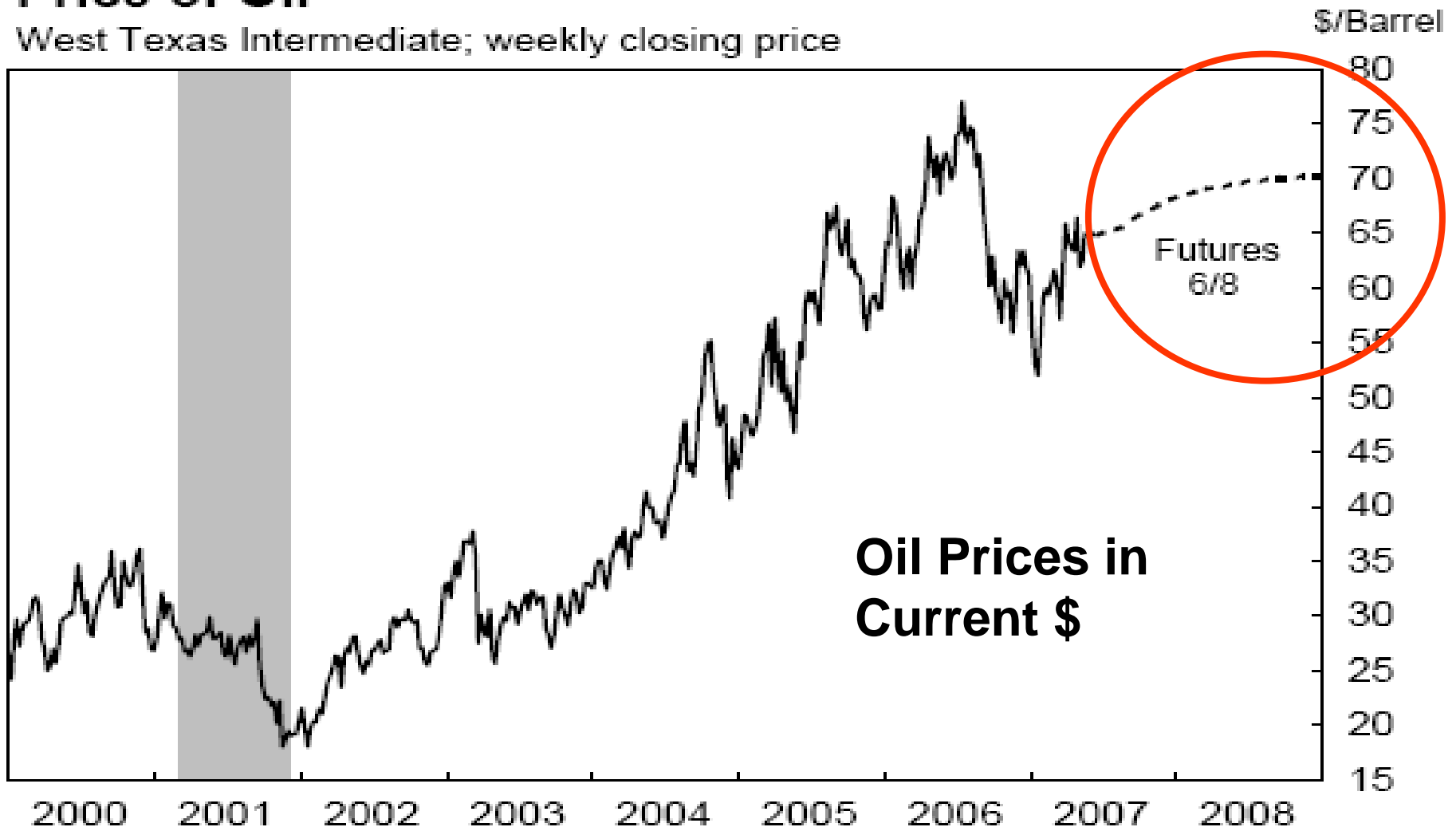
Source: Bureau of Economic Analysis /Haver Analytics

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Energy Price Concerns: Futures Predict High Prices to Continue

Price of Oil

West Texas Intermediate; weekly closing price

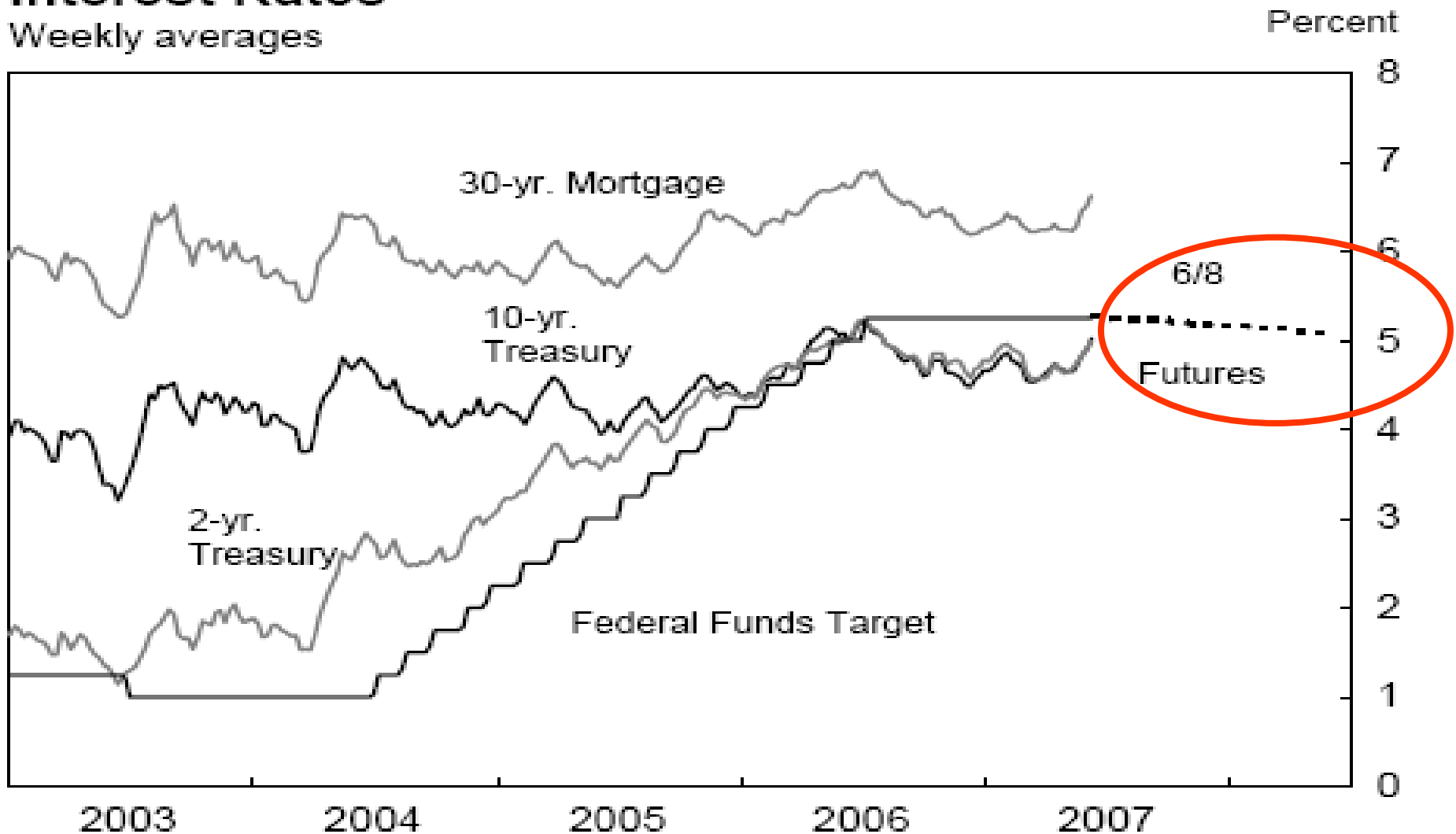


**Oil Prices in
Current \$**

Market's Fed Funds Expectations: Lower Probability of Easing

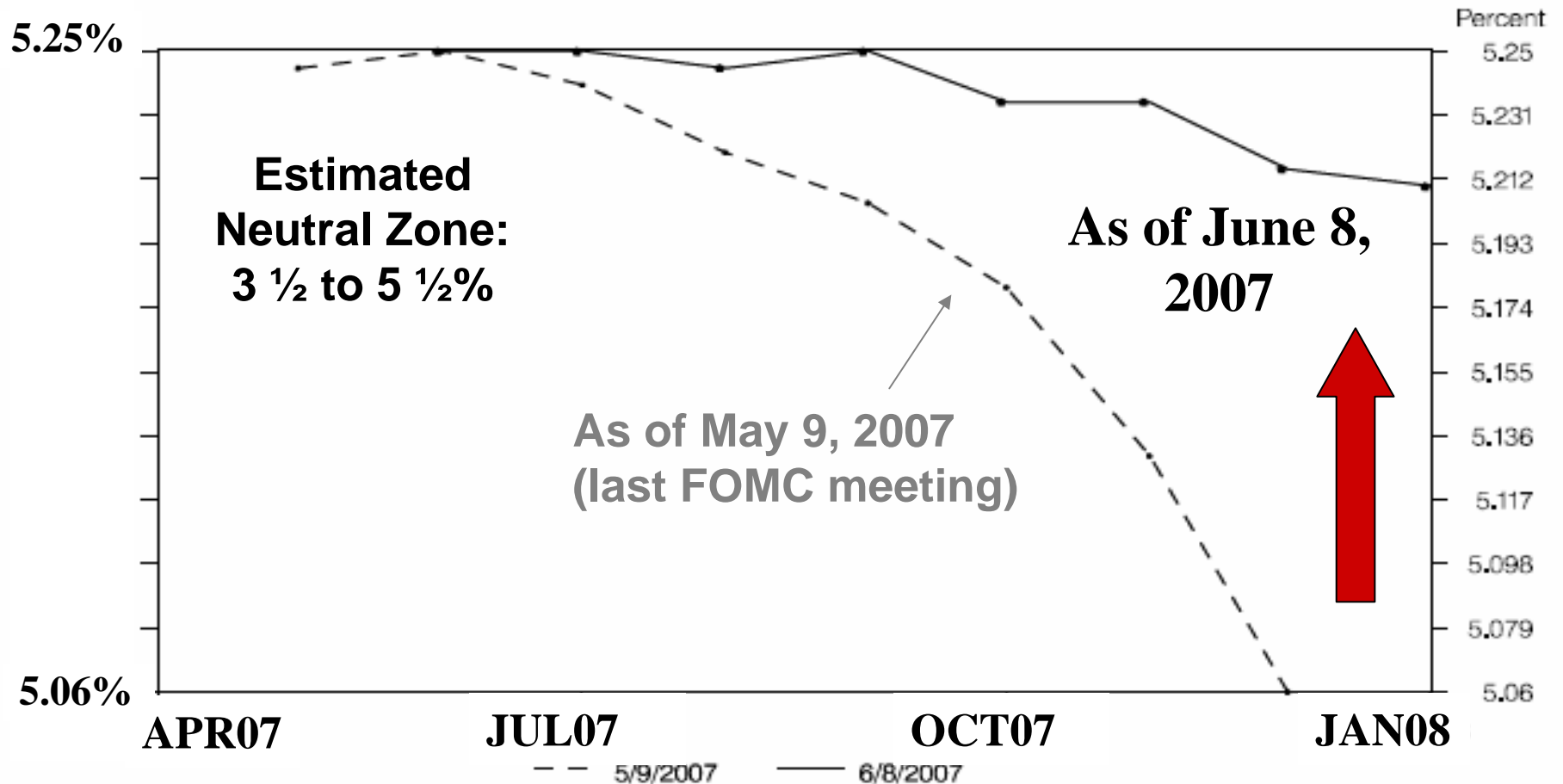
Interest Rates

Weekly averages



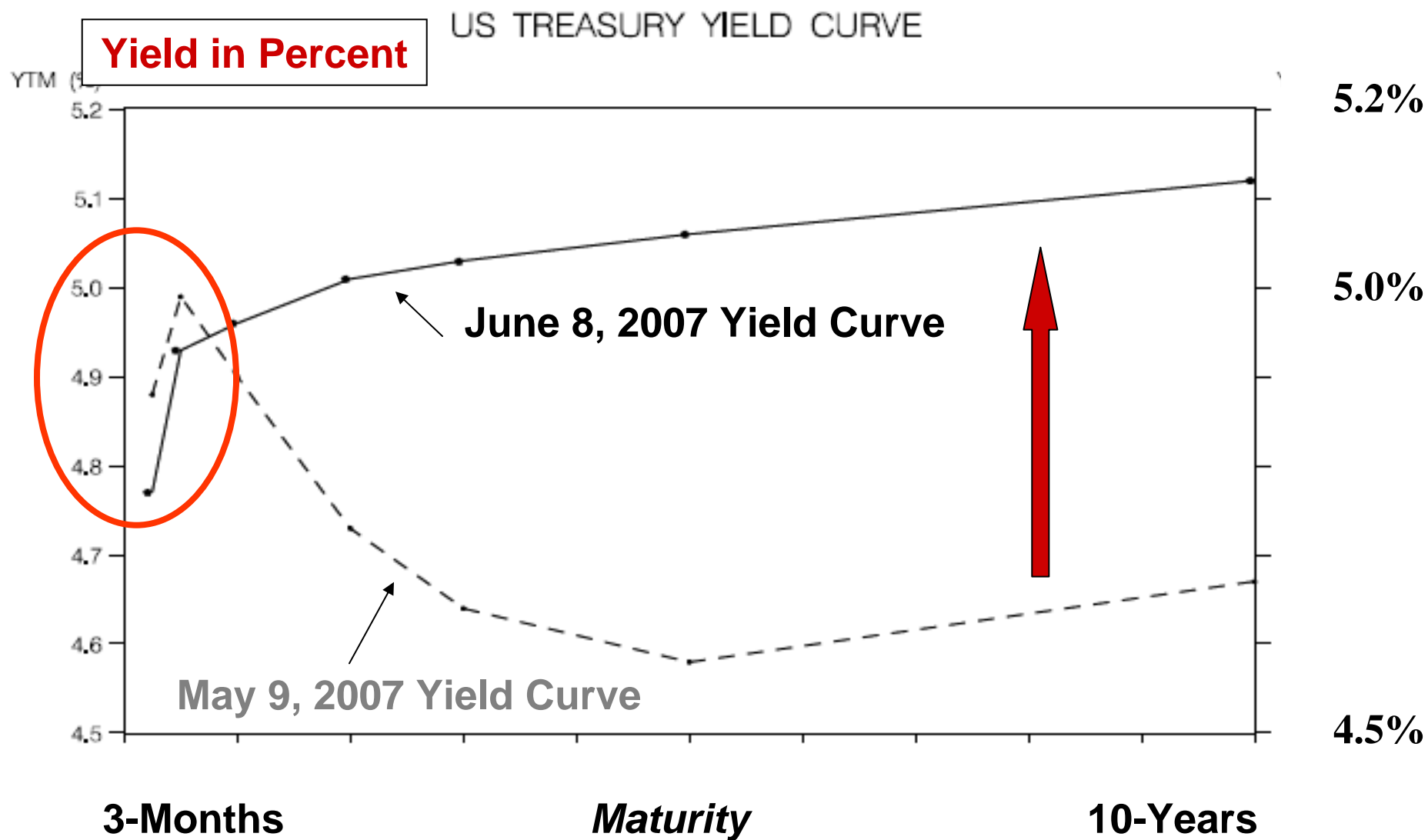
Fed Funds Futures Path: Upward Shift Since Last Meeting

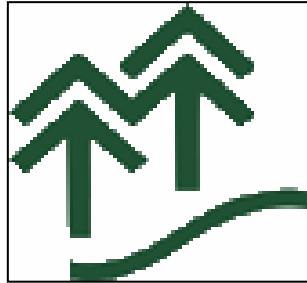
FORWARD FED FUNDS RATE IMPLIED FROM FED FUNDS FUTURES



Note: Based on Federal Funds Futures after adjusting for a one basis point per month term premium

U.S. Treasury Yield Curve: No Longer Inverted – Are Inflation Expectations Changing?





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Questions?

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