


Economic Forecast Conference

2010

with the Federal Reserve Bank of San Francisco

Tuesday, May 4, 2010 8:00 AM



E R Nevada County
C F Economic Resource Council
Foundation



FEDERAL
RESERVE
BANK

SAN
FRANCISCO

Federal Reserve Bank of San Francisco
Gary C. Zimmerman, Senior Economist

Economic Overview

Current situation – recovery begins:

- **Signs of improvement**
 - Industrial production, housing, consumer spending, credit conditions, global outlook, payroll jobs
- **Yet areas of weakness remain**
 - Labor market, commercial real estate, loan delinquencies, household balance sheet

Stance of Monetary Policy

- **Tools (conventional and new)**
- **Recent readings from the FOMC**

FRBSF national economic forecast

CURRENT SITUATION: SIGNS OF IMPROVEMENT

National Beige Book Survey Summary, April 14, 2010



- **Economic activity increased somewhat**
- **Increases in retail sales and vehicle sales**
- **Service sector reports—mixed**
- **Manufacturing activity increased**
- **Increased activity in housing markets from a low level**
- **Energy production increased**
- **Wage pressures—minimal**

Financial Markets Are Returning to More Normal Levels of Volatility

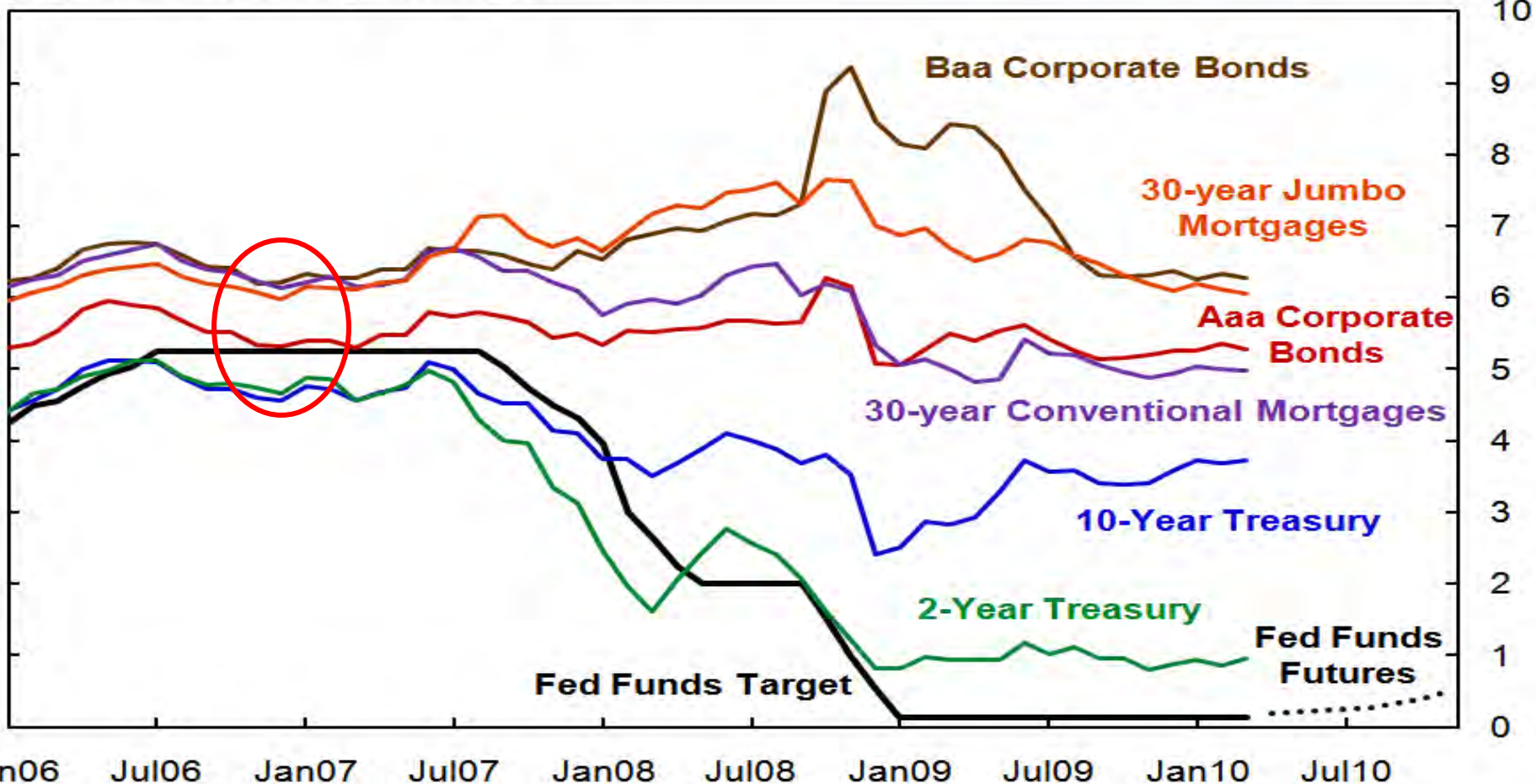
Implied Volatility on S&P 500 (VIX)



Credit Risk Spreads Narrow as Risk Subsides (Yet They Remain Above Pre-Crisis Levels)

Selected Interest Rates and Bond Yields

In percent; monthly averages

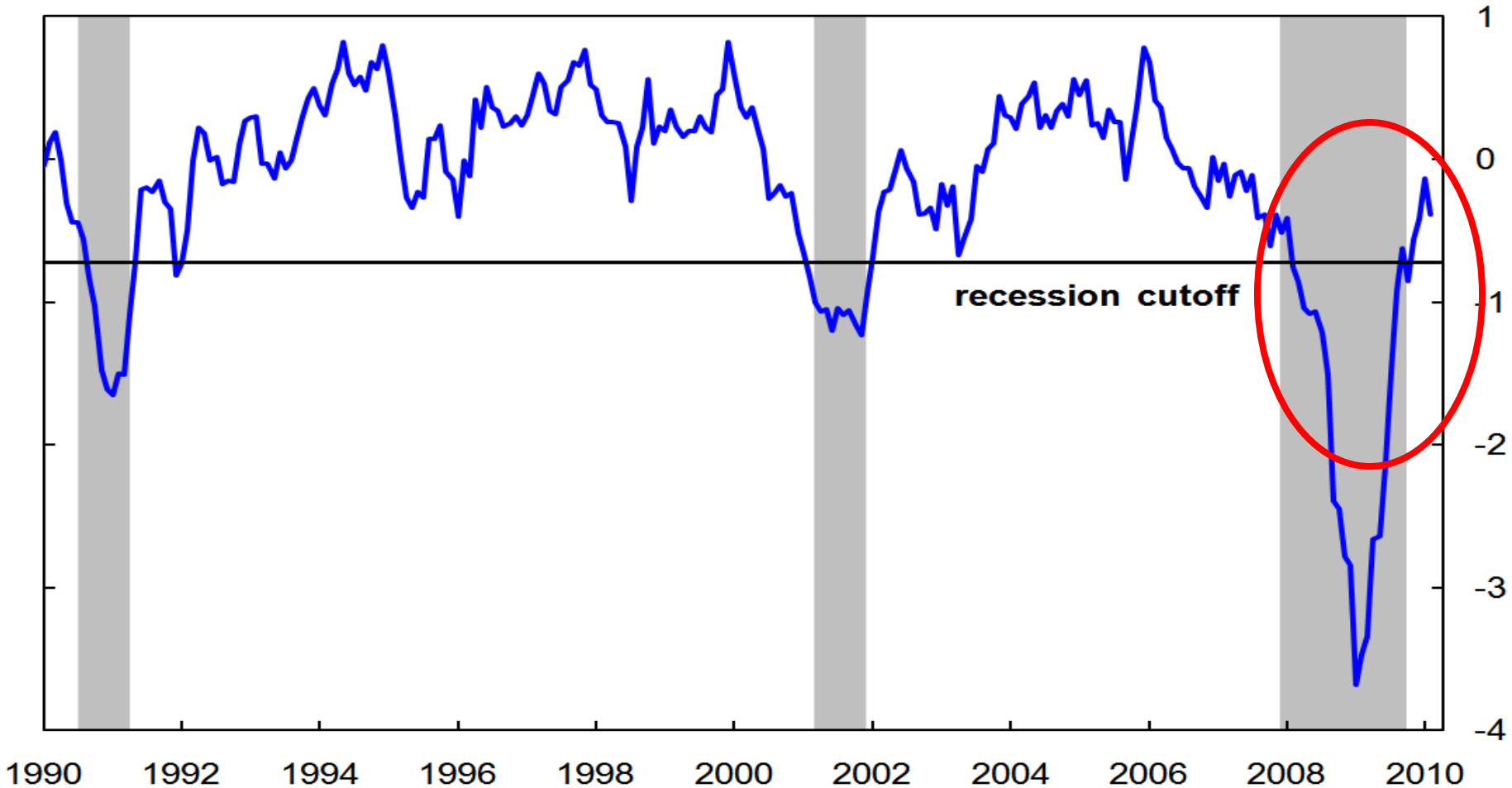


Source: Federal Reserve Board, Moody's, CBOT, WSJ, Haver

The Economy Appears to be in Moderate Recovery – Although the NBER Declined to Set a Date for the End of the Recession

FRB Chicago National Activity Index

Three month moving average

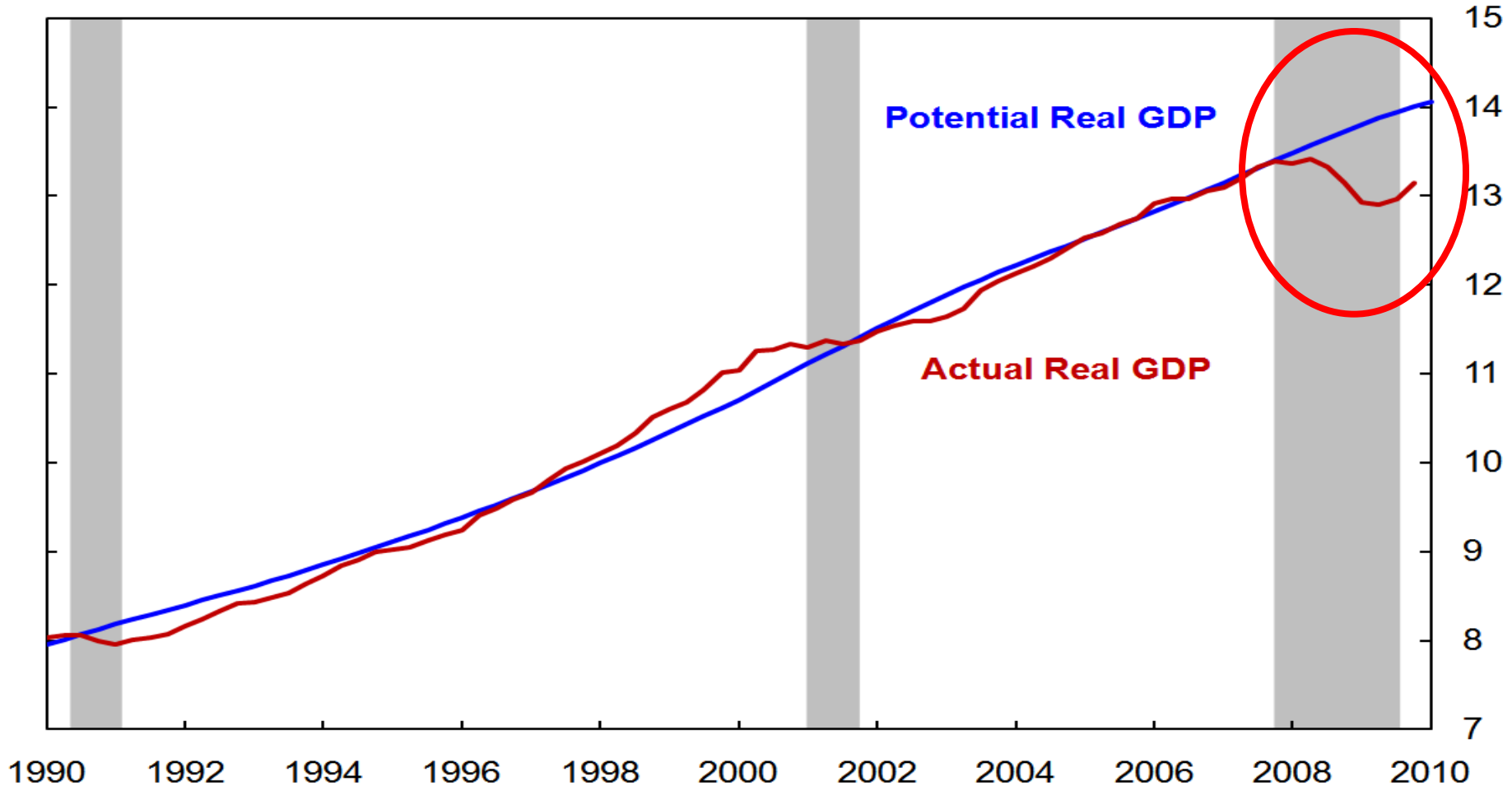


Source: Federal Reserve Bank of Chicago

The Output Gap Remains Sizeable

Actual Real GDP versus Potential Real GDP

Trillions of chained 2005\$; SAAR



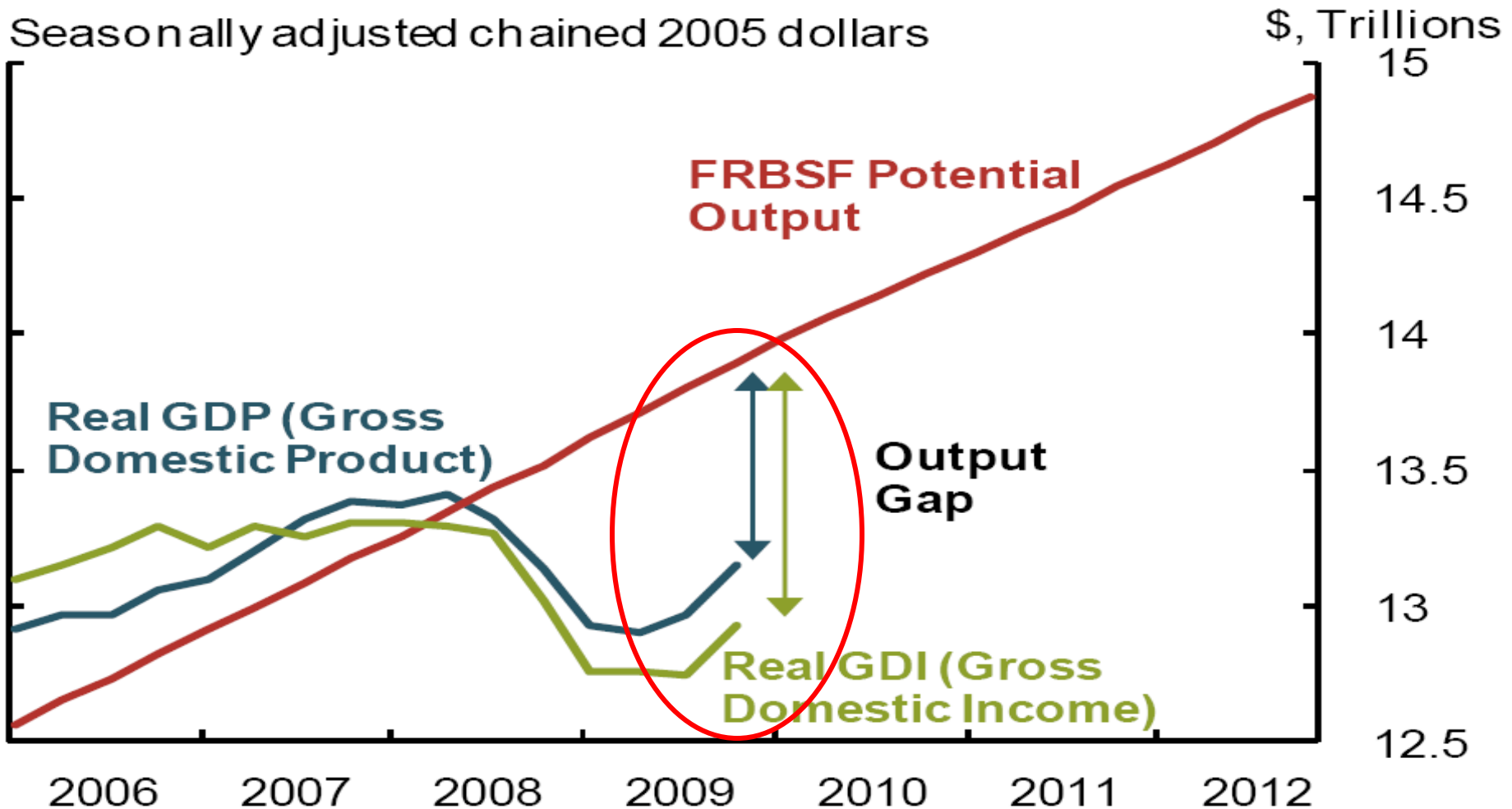
Source: Bureau of Economic Analysis, Congressional Budget Office



Moreover, there Is Uncertainty about the Size of the “Output Gap”

Real GDP and GDI

Seasonally adjusted chained 2005 dollars

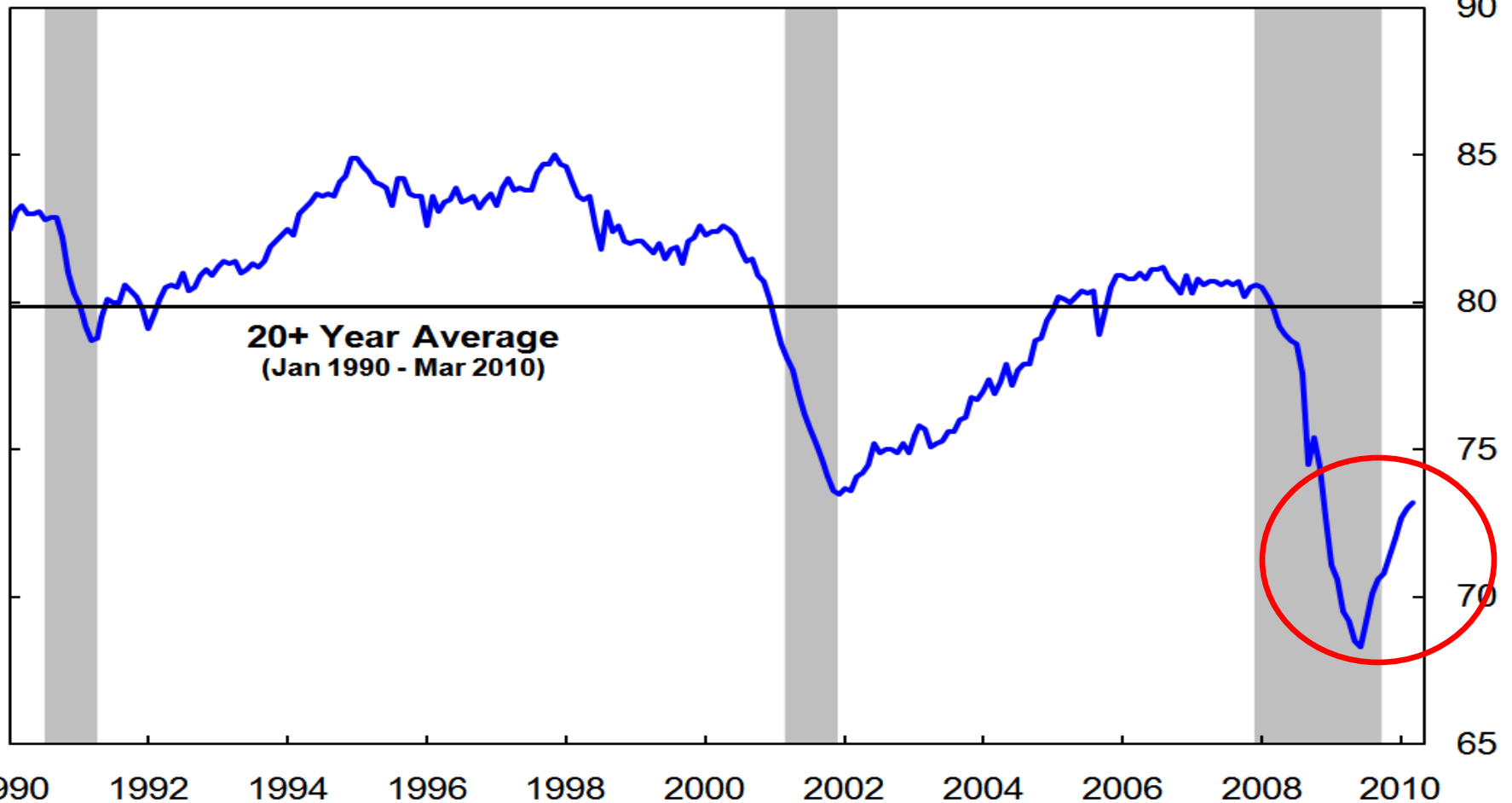


The Large "Output Gap" Is Reflected in a Low Level of Industrial Capacity Utilization

Capacity Utilization

Percent of capacity; seasonally adjusted

Percent



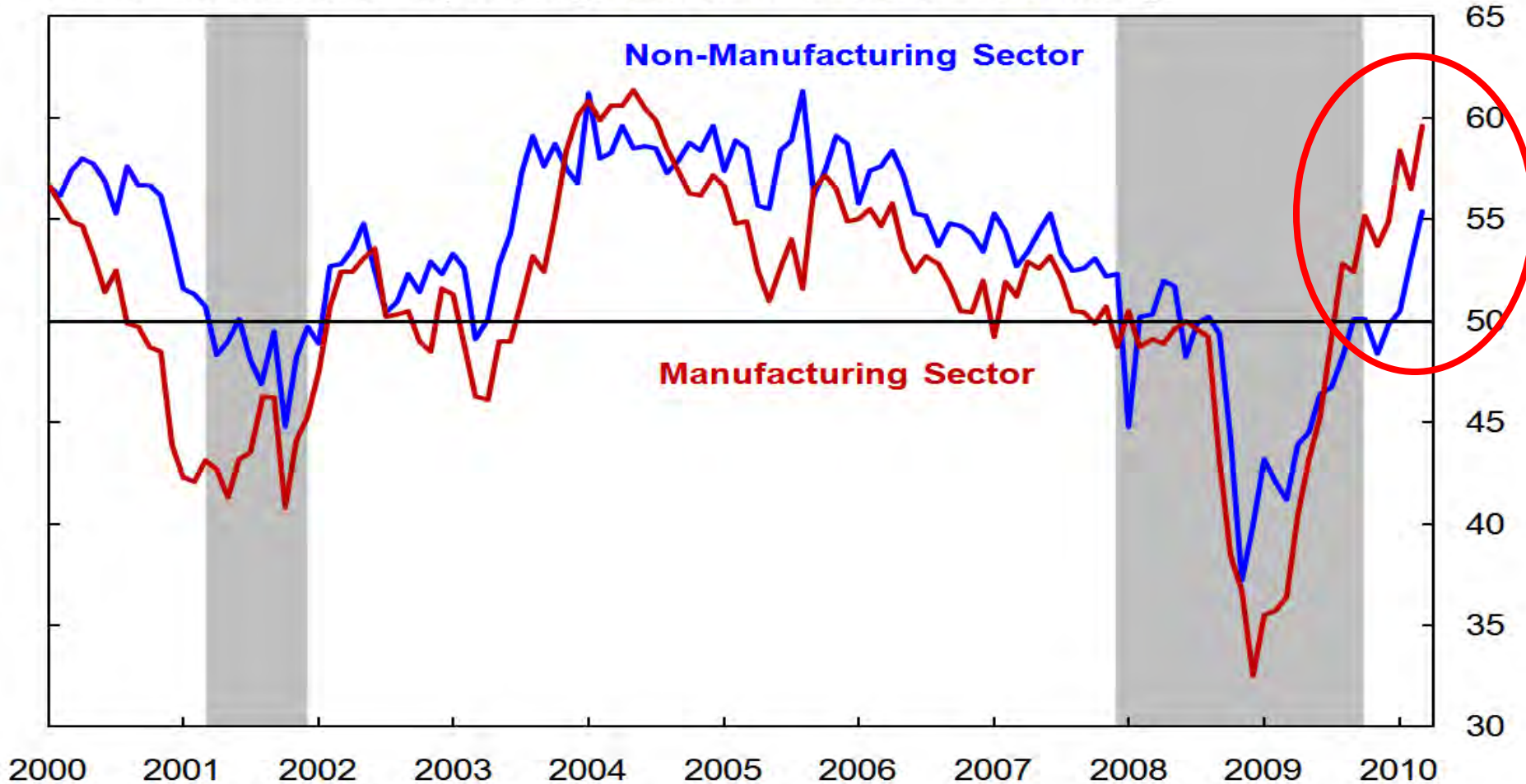
Source: Federal Reserve Board

4/30/2010

Manufacturing and Non-Manufacturing (Services) Both Rebound

ISM Composite Indices

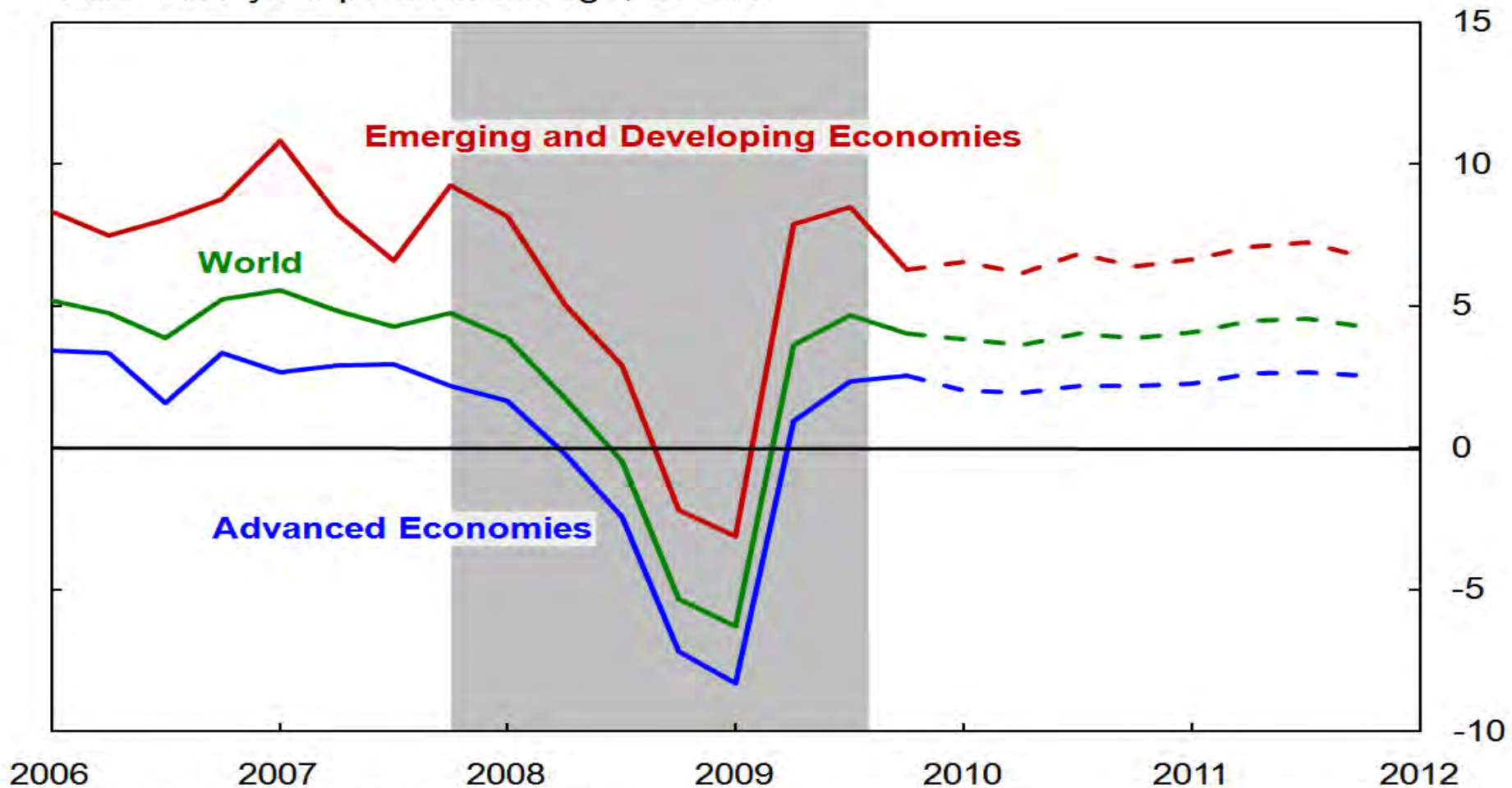
Above 50 sector is expanding; below 50 sector is contracting



Global Economic Growth: Will Boost U.S. Production and Exports

Real GDP Growth Forecasts

Year-over-year percent change; SAAR

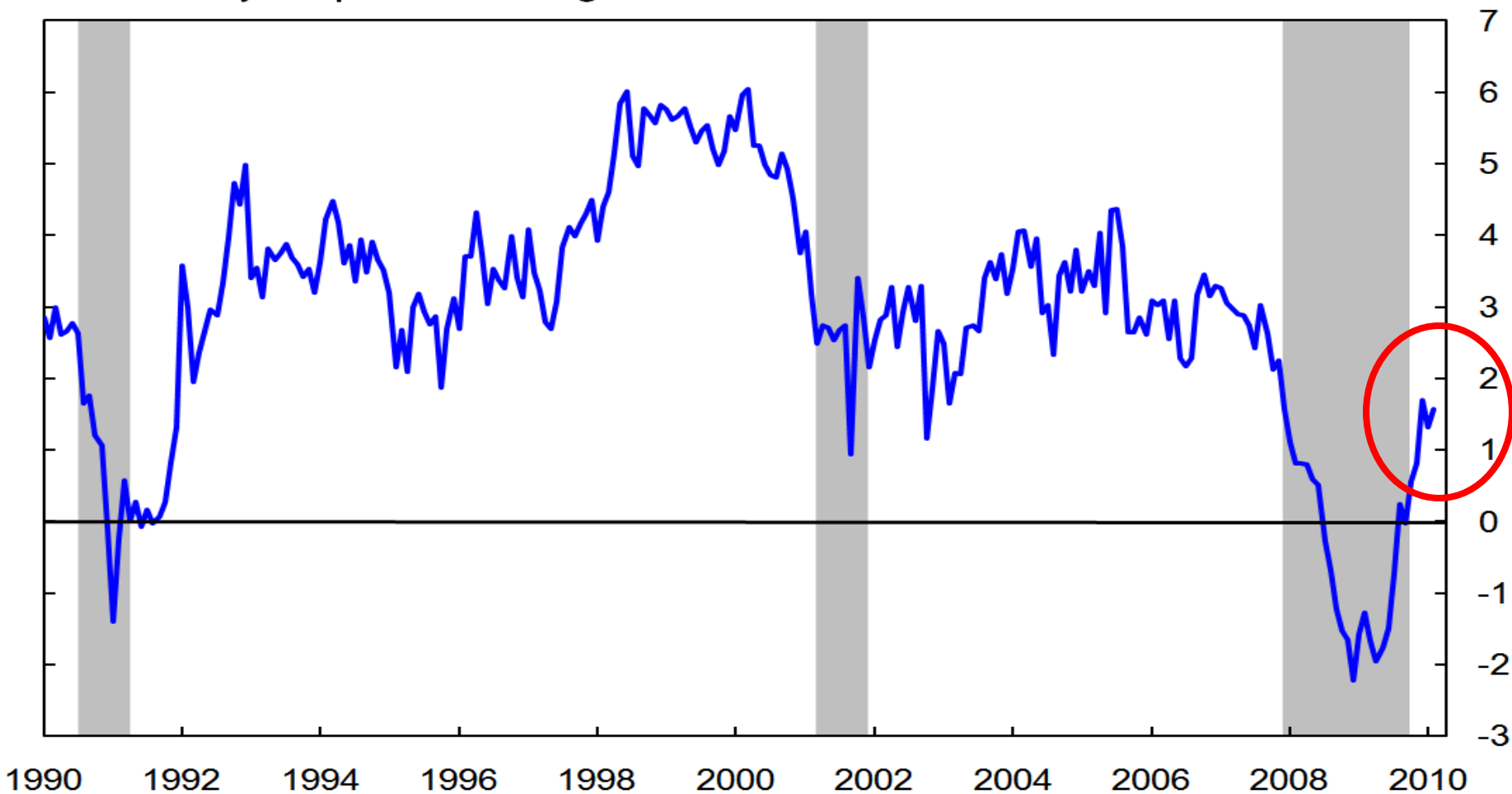


Source: International Monetary Fund (January, 2010)

Consumption Spending Growth Rate Turns Positive Again

Real Personal Consumption Expenditures

Year-over-year percent change; SAAR

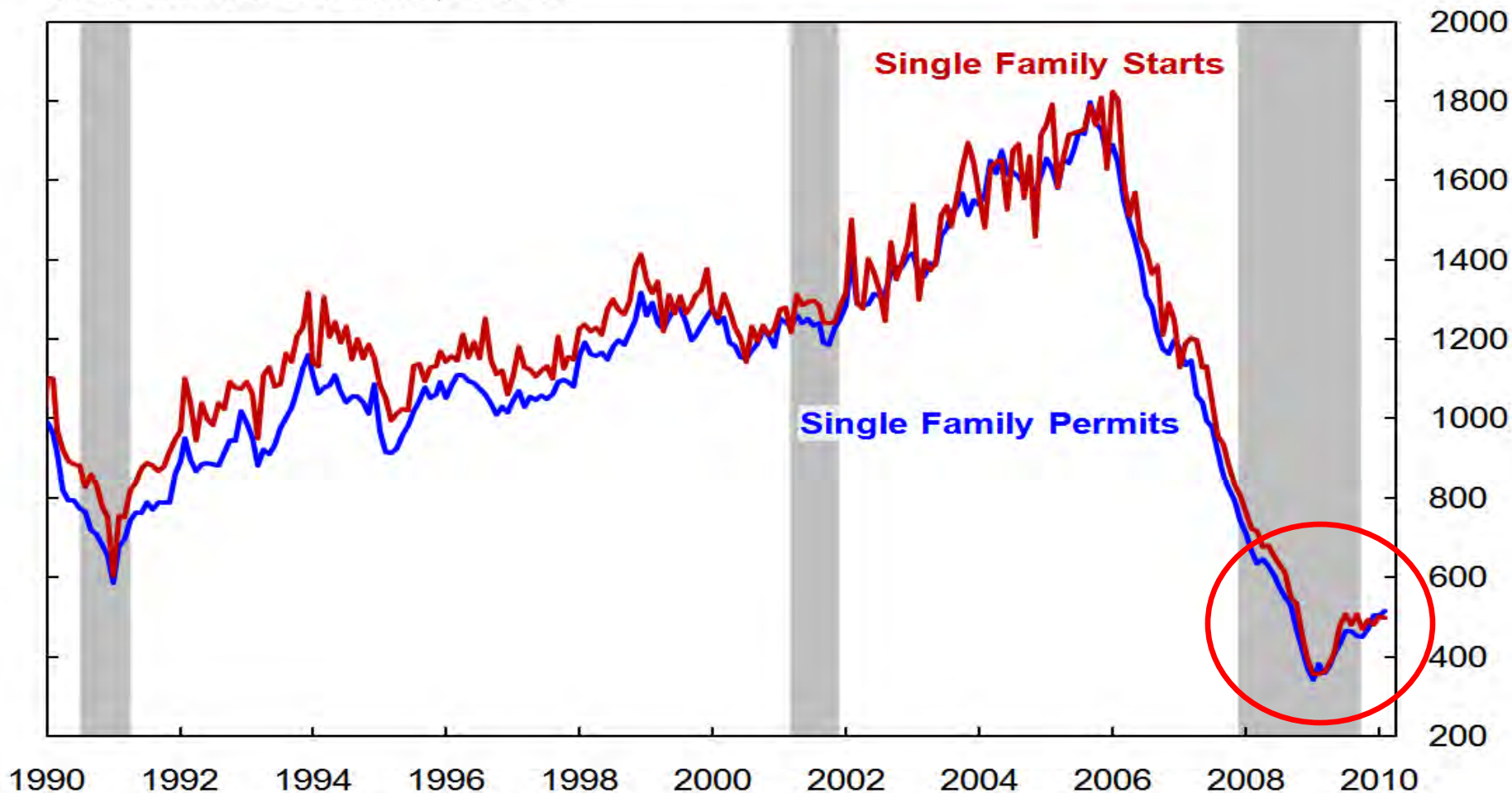


Source: Bureau of Economic Analysis

New Residential Construction Activity Hits Bottom: No Longer Subtracting from Growth

New Single Family Housing Units

In thousands of units; SAAR

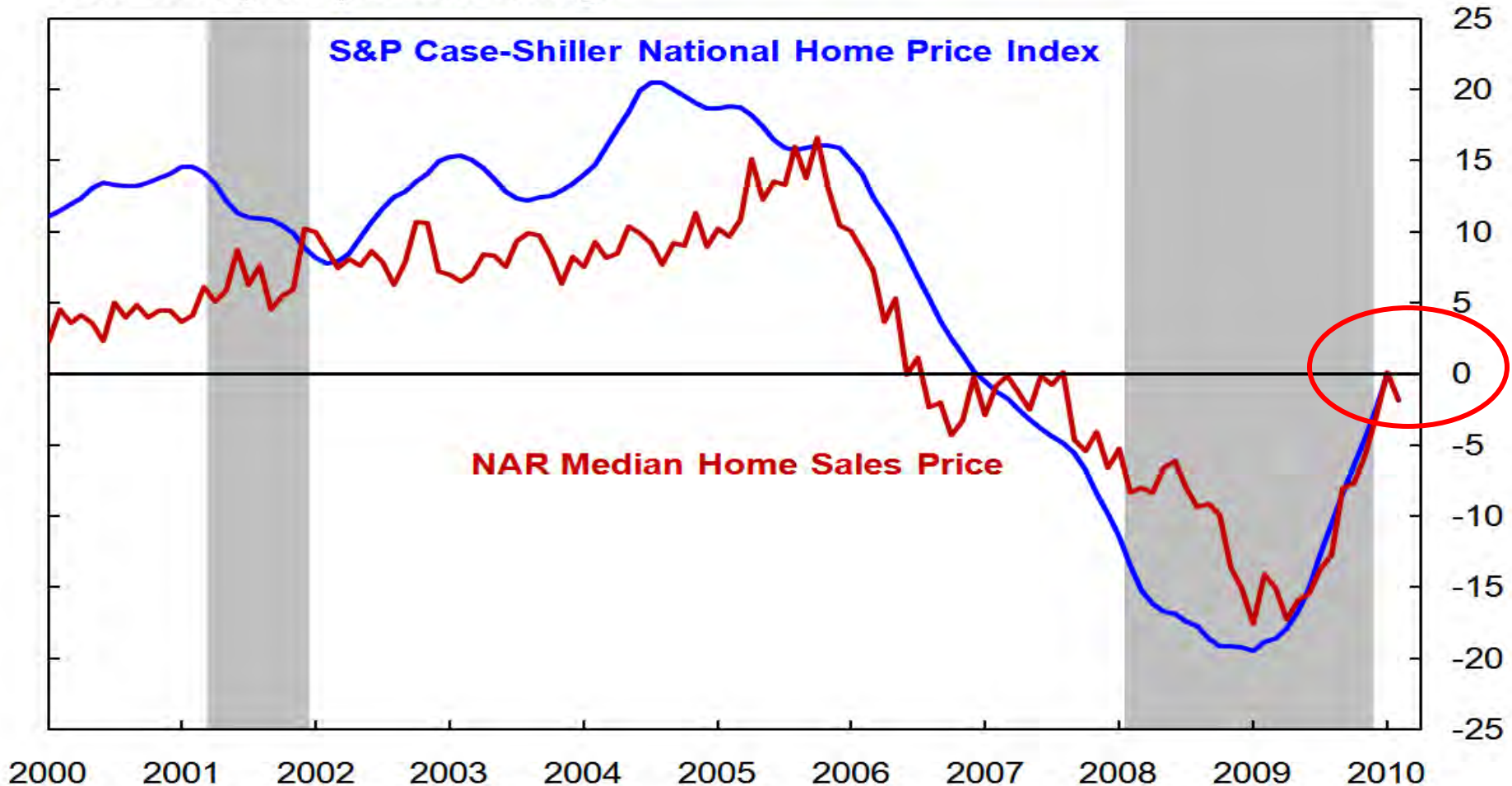


Source: Bureau of the Census

National House Prices Show Signs of Stabilization: Only Small Changes from a Year Ago

House Price Changes

Year-over-year percent change

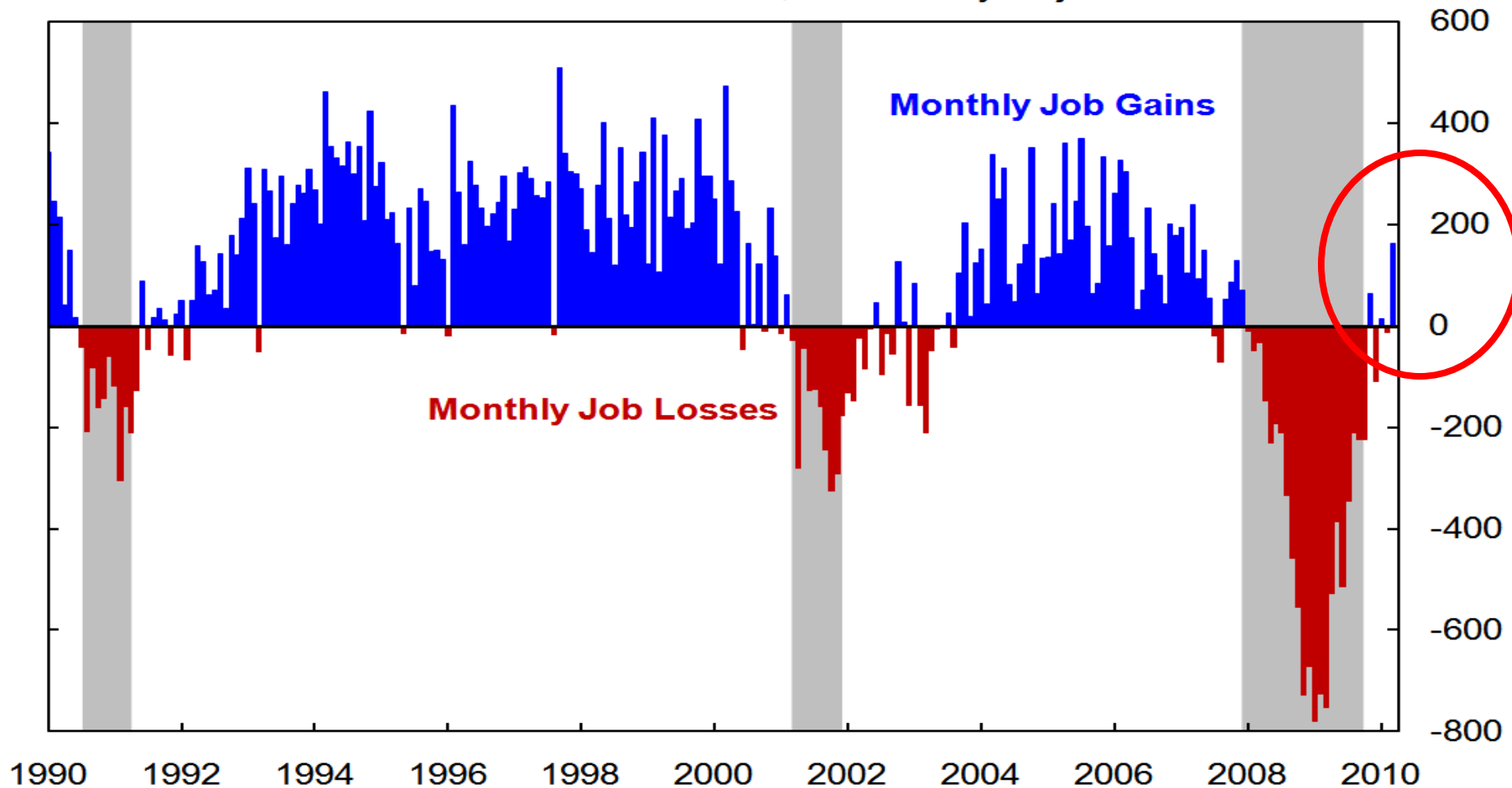


Source: Standard & Poor's, National Association of Realtors

Payrolls Add 162,000 Jobs in March – More than 8.2 Million Jobs Lost Since December 2007

Nonfarm Payroll Employment

Month-to-month difference in thousands; seasonally adjusted



Source: Bureau of Labor Statistics

CURRENT SITUATION: SIGNS OF WEAKNESS

National Beige Book Survey Summary, April 14, 2010

- **Increased activity in housing markets from a low level**
- **Commercial real estate—very weak**
- **Banking and finance sector—mixed, as loan volumes and credit quality fell**
- **Agriculture mixed**
- **Labor markets generally weak**



Joblessness is Increasingly Concentrated Among the Long-Term Unemployed (6 months or longer)

Long Term Unemployed versus Total Unemployed



Workers Unemployed 27+ Weeks as a Percentage of Total Unemployed

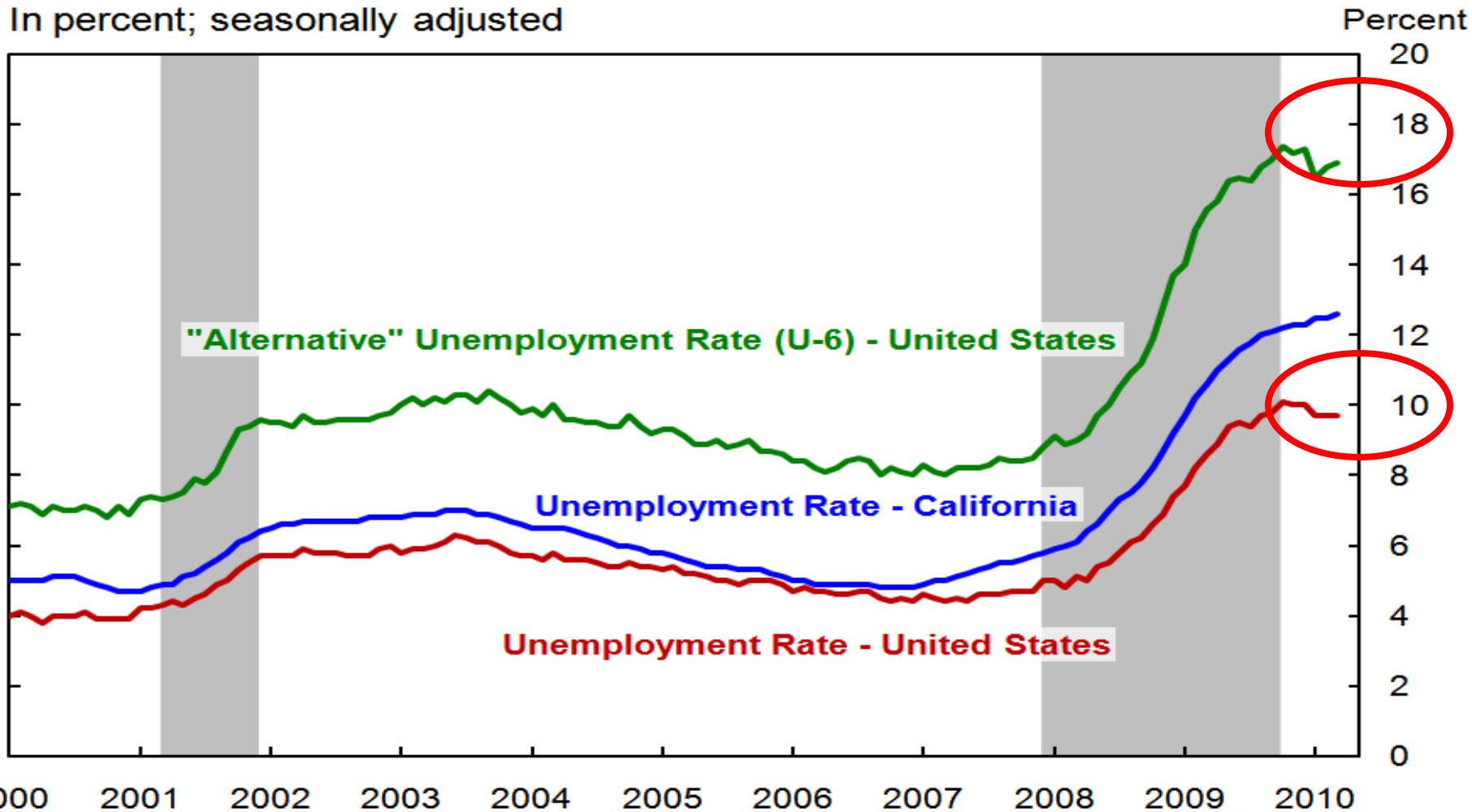
1950 1955 1960 1965 1970 1975 1980 1985 1990 1995 2000 2005 2010

Source: Bureau of Labor Statistics

Unemployment Rates Show the Extent of Labor Market Weakness

Unemployment Rate Comparison

In percent; seasonally adjusted



Source: Bureau of Labor Statistics

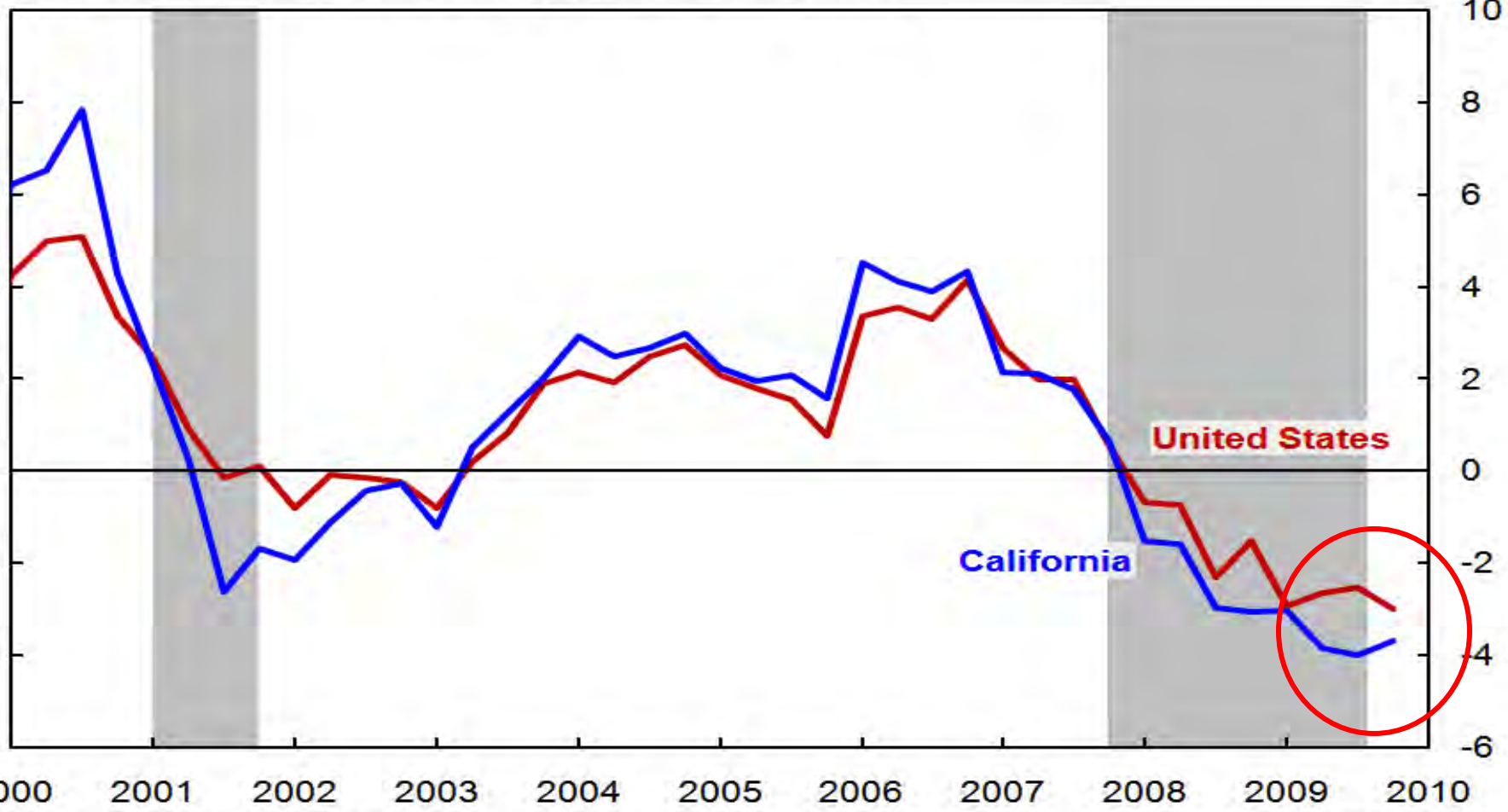
4/30/2010

Per-Capita Real Personal Income Declines in California Exceed those for the U.S.

Real Per-Capita Personal Income Growth

Year-over-year percent change; chained 2005\$

Percent

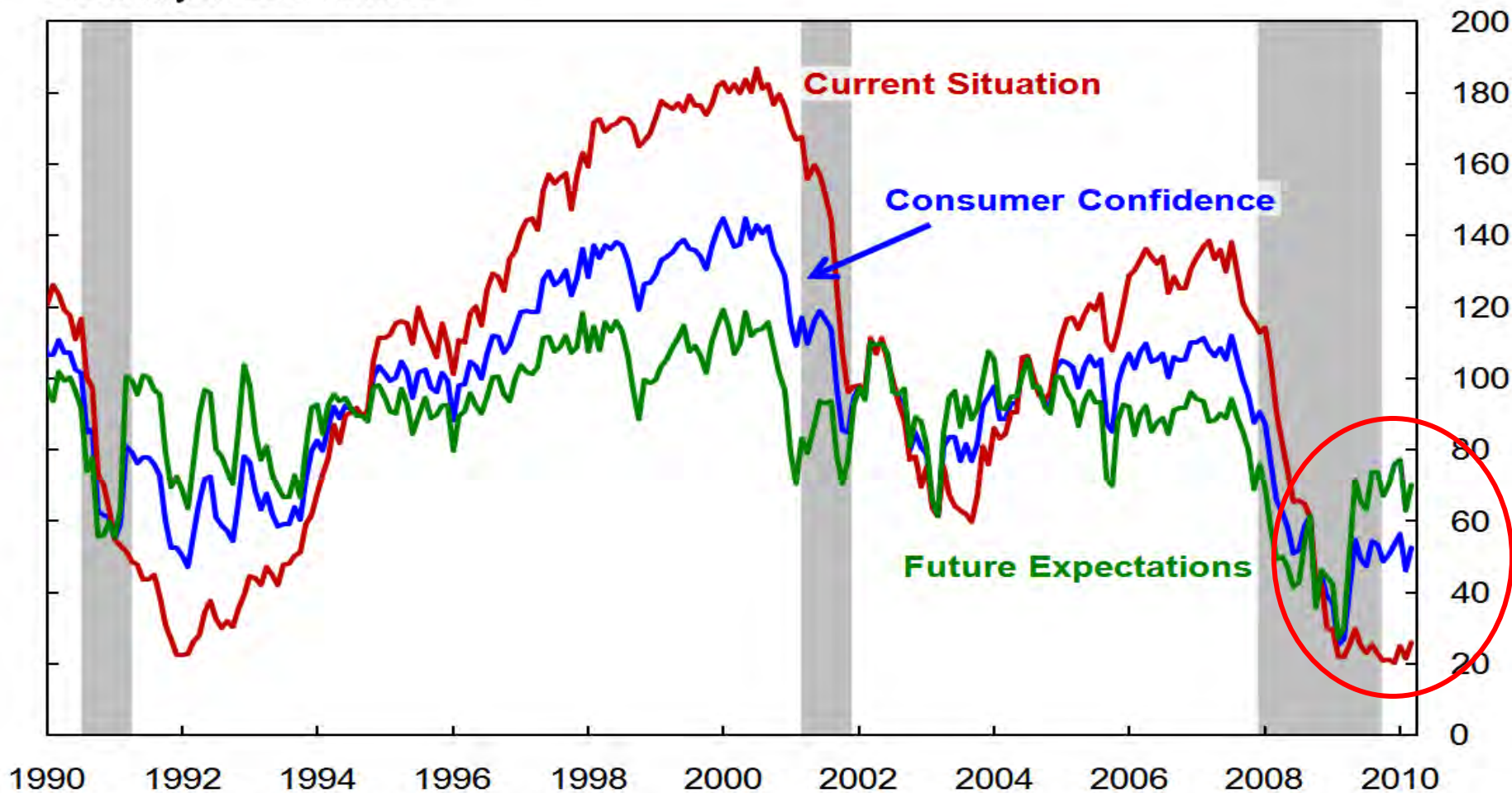


Source: Bureau of Economic Analysis

Although Expectations Have Improved from Mid-Recession, U.S. Consumers Remain Cautious

Consumer Confidence Index and Components

Monthly index values

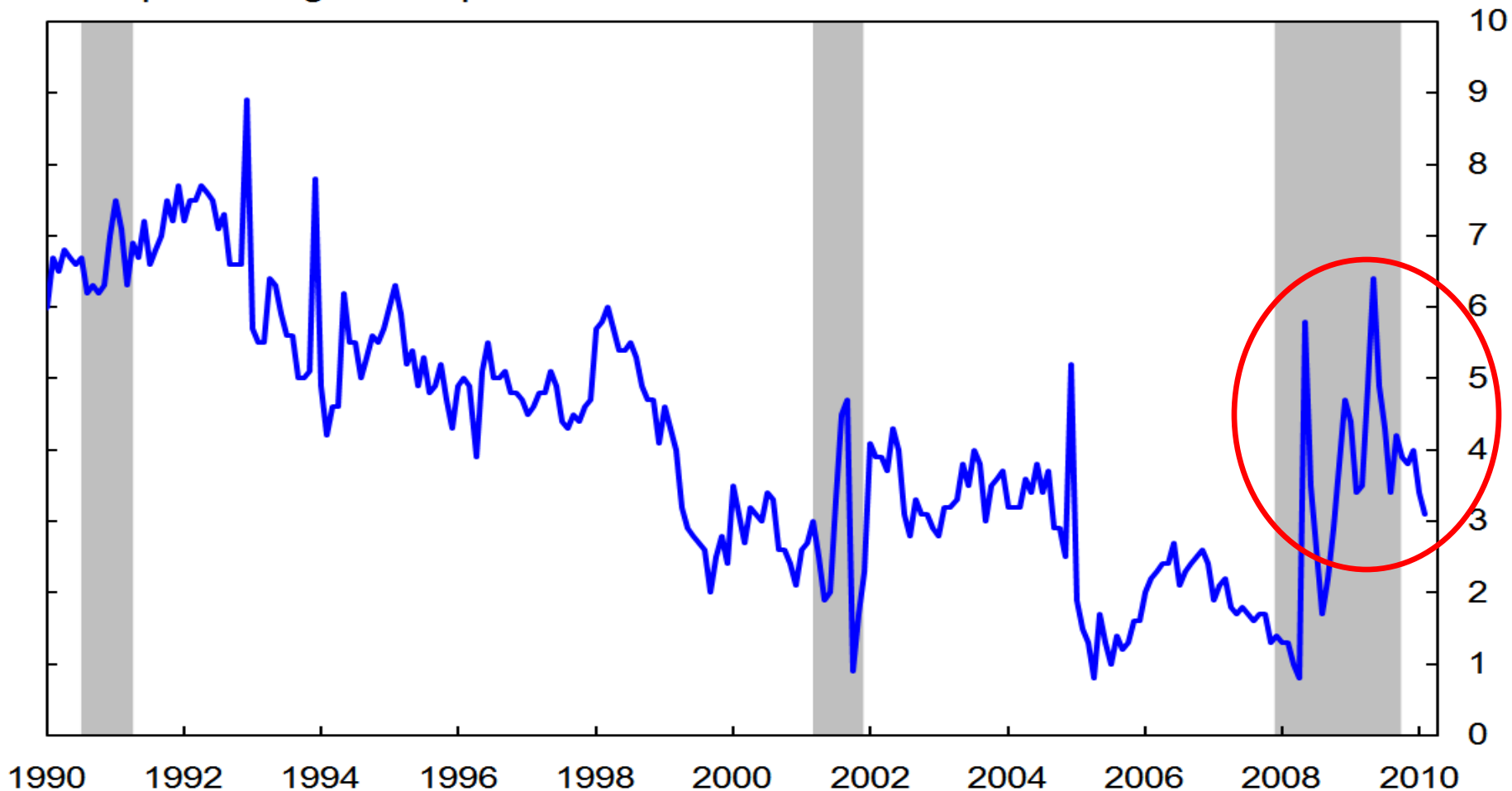


Source: The Conference Board

Declines in Wealth, Jobs, Income, and Confidence Pushed Up Household Saving

Personal Saving Rate

As a percentage of disposable income

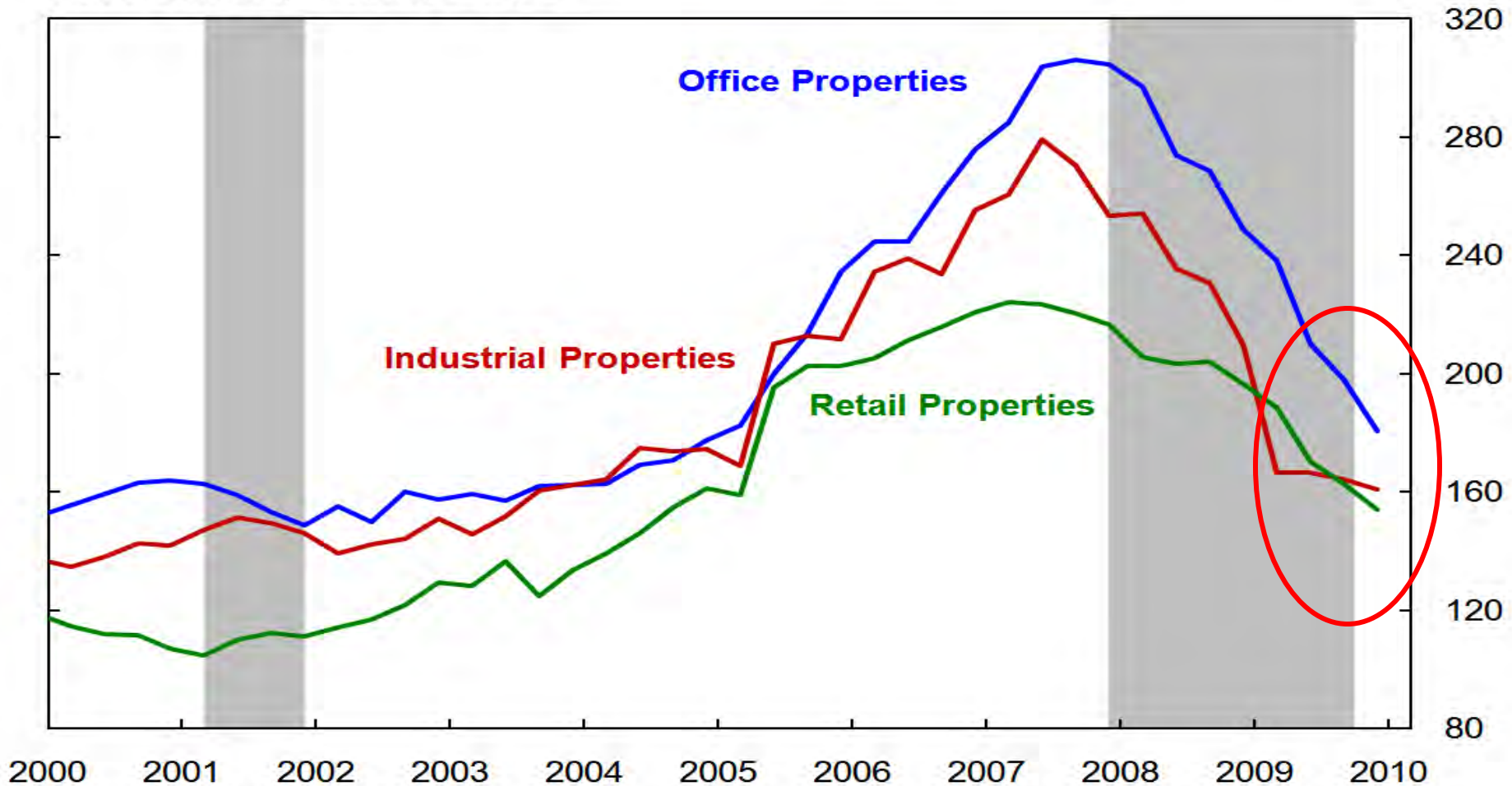


Source: Bureau of Economic Analysis

Commercial Real Estate Prices Are Falling; Few Signs this Trend Is Reversing

Commercial Real Estate Prices by Property Type

Index values; 1994Q1=100

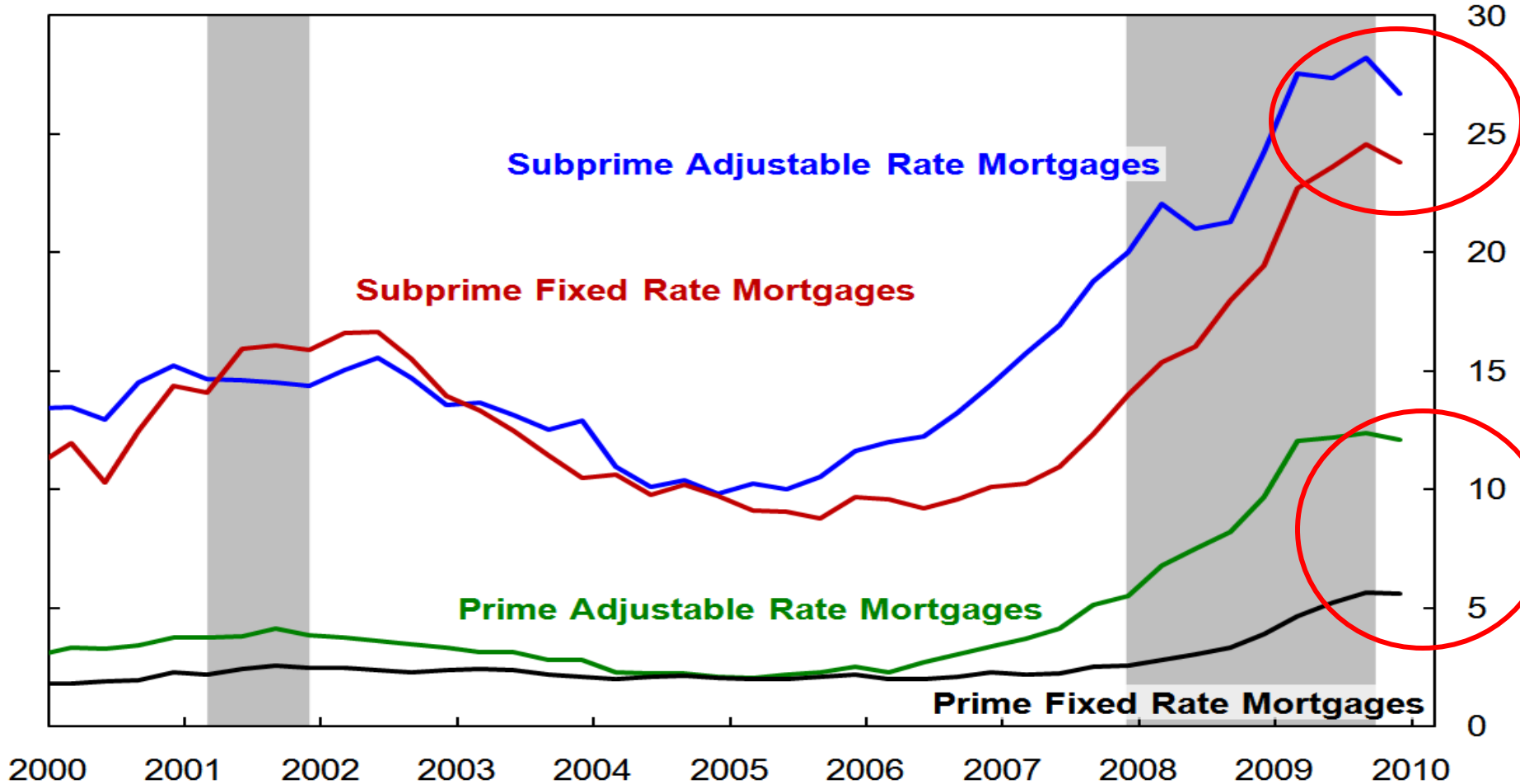


Source: MIT Center for Real Estate

No Sign of Let-Up in Loan Mortgage Delinquencies

Conventional Mortgages Past Due by Loan Type

In percent; seasonally adjusted

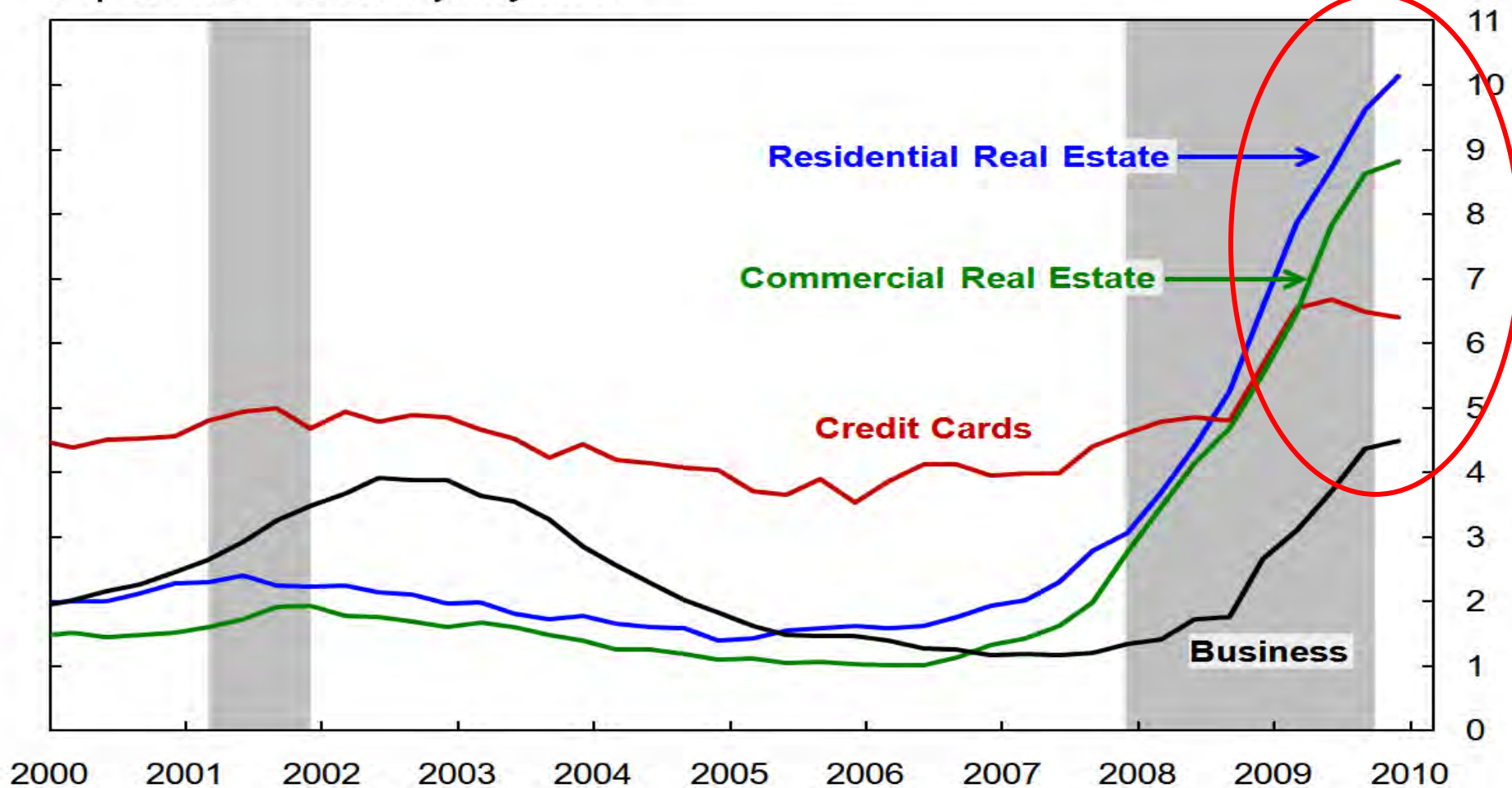


Source: Mortgage Bankers Association

Surge in Loan Delinquencies is Not Limited to Residential Real Estate

Bank Loan Delinquency Rates by Asset Type

In percent; seasonally adjusted



Source: Federal Reserve Board

STANCE OF MONETARY POLICY



Monetary Policy

- **Conducting monetary policy**

Dual goals: (1) maximum sustainable output and employment and (2) price stability

- **Tools**

- Conventional tool: federal funds rate

- “Zero bound”

- Nonconventional tools: Fed balance sheet

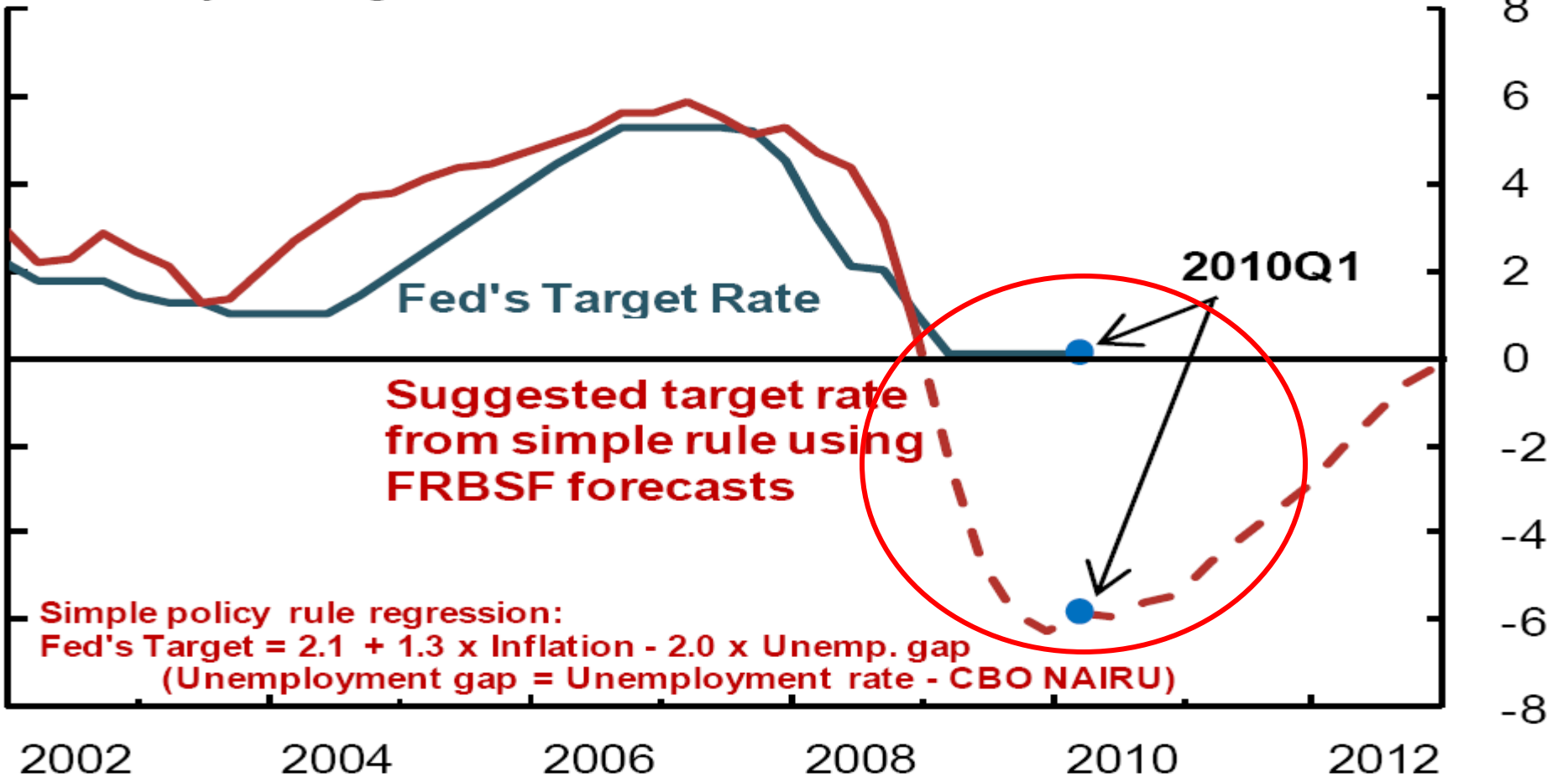
- Size has been relatively steady over the past year, but the composition has changed dramatically

Monetary Policy Stimulus is Still Needed

Federal Funds Rate

Quarterly average

Percent



Fed's Target Rate

Suggested target rate from simple rule using FRBSF forecasts

Simple policy rule regression:

$$\text{Fed's Target} = 2.1 + 1.3 \times \text{Inflation} - 2.0 \times \text{Unemp. gap}$$
 (Unemployment gap = Unemployment rate - CBO NAIRU)

Recent Statement from the FOMC on Monetary Policy Regarding Conventional Tools

“The Committee will maintain the target range for the federal funds rate at 0 to 1/4 percent and continues to anticipate that **economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations**, are likely to **warrant** exceptionally low levels of the federal funds rate for an extended period.”

FOMC Statement of April 28, 2010

<http://www.federalreserve.gov/monetarypolicy/fomccalendars.htm>

Recent Monetary Policy Actions: Unconventional Policy Tools

Unconventional Tools (Fed Balance Sheet)

- Emergency short-term lending facilities
- Purchases of longer-term securities
 - U.S. Treasuries (longer term); \$300 billion
 - Agency debt (Fannie & Freddie); \$175 billion
 - Agency mortgage-backed securities (MBS); \$1.25 trillion

Exit Strategy

- Terminating lending facilities, concluded purchases
- Making policy with a large balance sheet

Recent Readings on Monetary Policy Regarding Unconventional Tools

Fed Exit Strategy Update:

Decline in shorter-term liquidity and credit

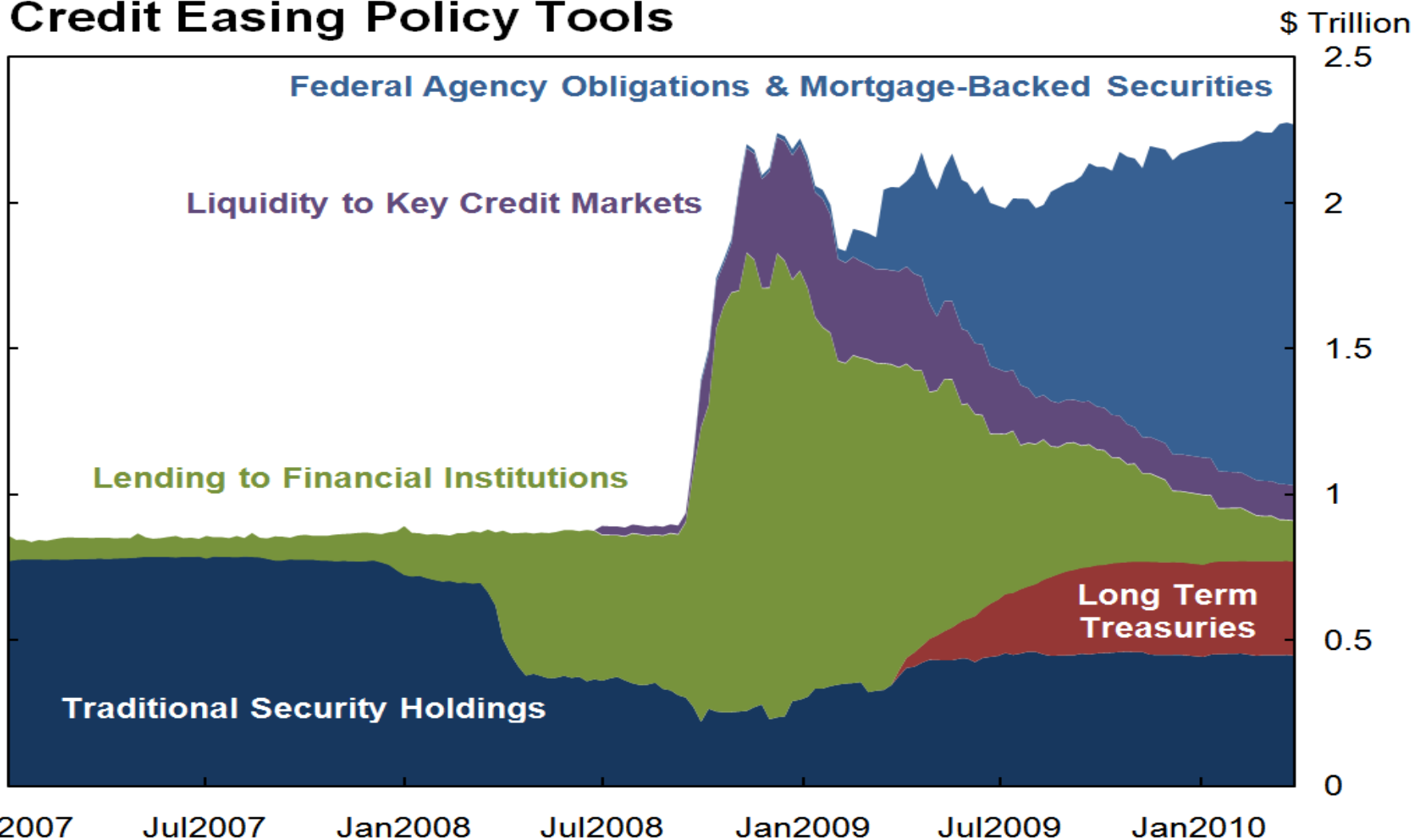
- With one exception (TALF (CMBS) until June 2010), all have been terminated

Longer-term credit and asset purchases programs have been completed

- Treasury securities purchases completed (Oct. 2009)
- Agency debt / MBS purchases completed (Mar. 2010)

Dramatic Change in Size and Composition of the Federal Reserve's Assets

Credit Easing Policy Tools

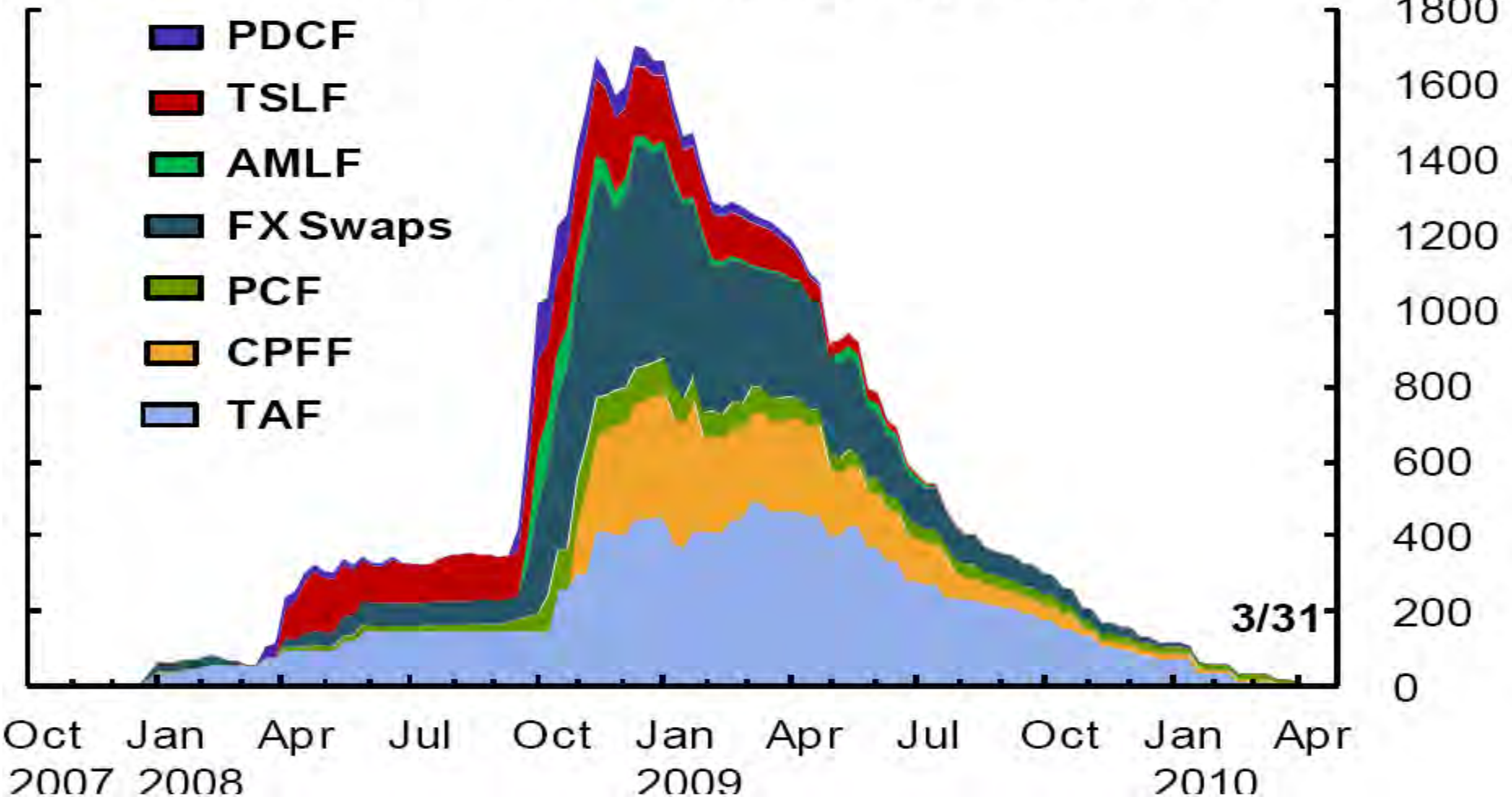


Source: Federal Reserve Board and Federal Reserve Bank of Cleveland

Direct Lending Programs: Extraordinary Lending Support Has Ended

Federal Reserve Short-Term Liquidity Facilities

\$, Billions



3/31

FOMC: Measuring the Policy Stance

Unconventional Policy:

- Difficult to measure the impacts of unconventional actions
- No history to guide policy
- No single indicator (like the funds rate) to accurately measure policy
- Size of the Fed's balance sheet may not be a useful indicator



FEDVIEWS

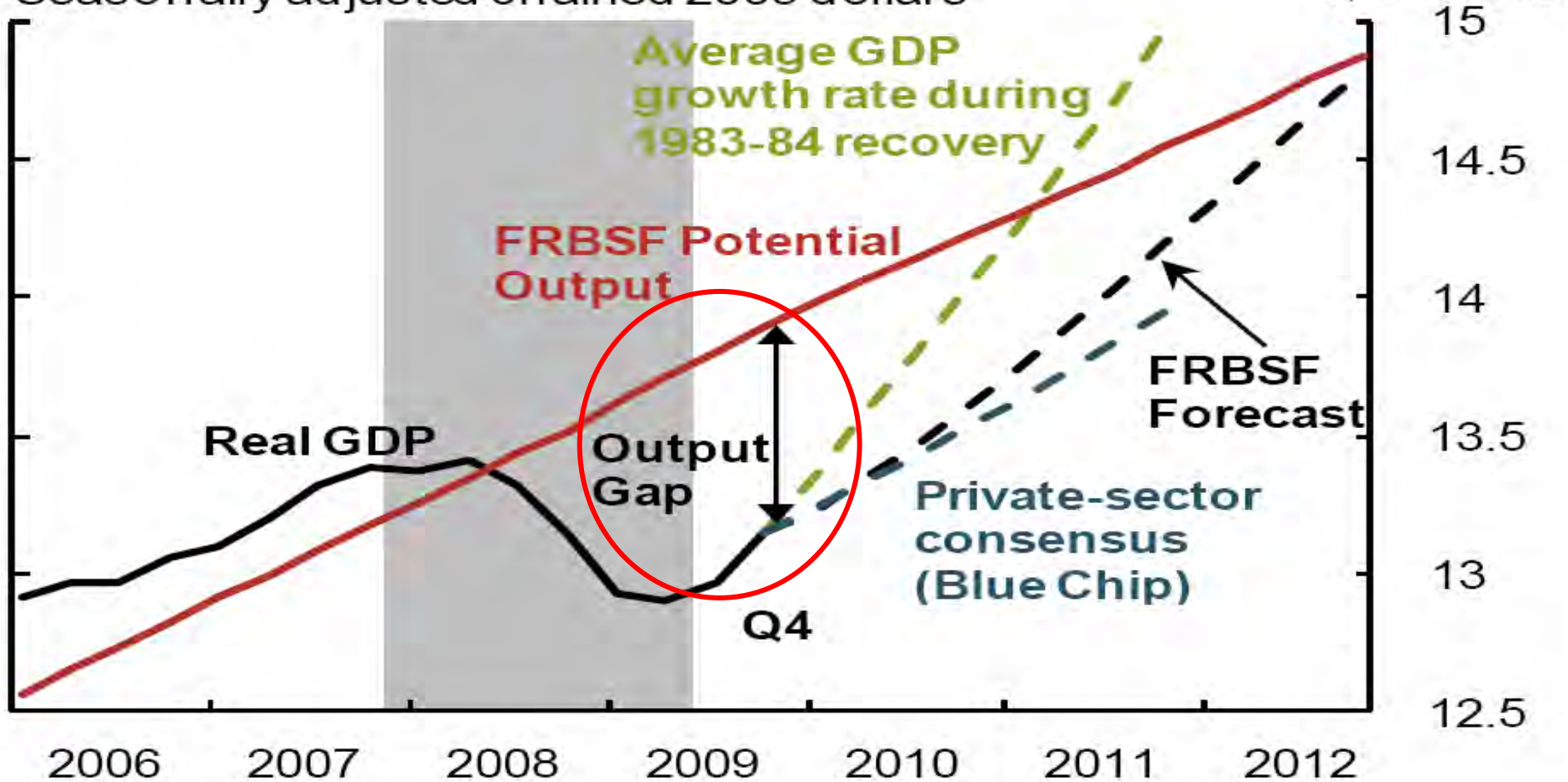
FRBSF NATIONAL ECONOMIC FORECAST

Large GDP Output Gap Likely to Persist

Real GDP

Seasonally adjusted chained 2005 dollars

\$, Trillions

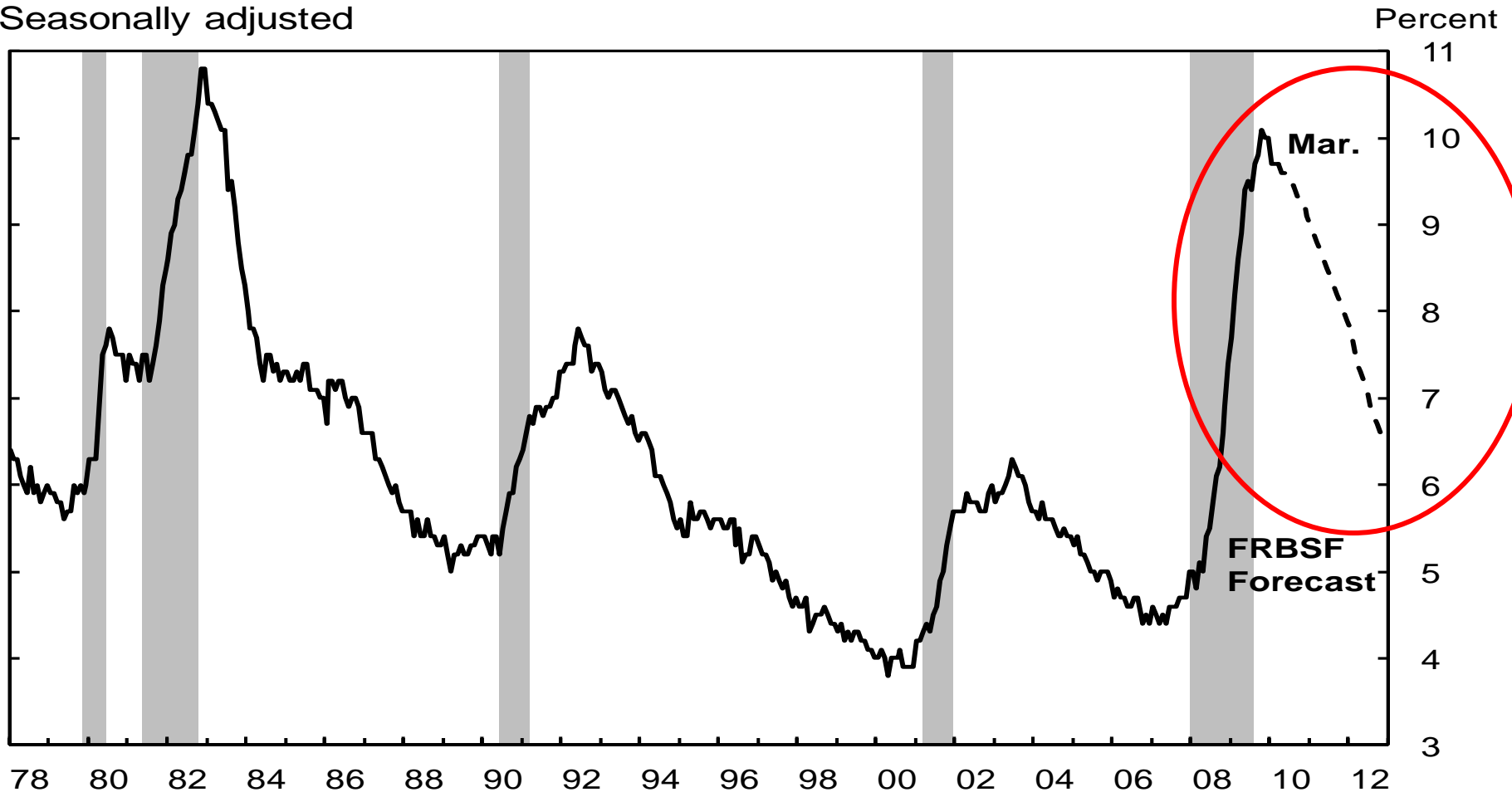


National Unemployment Rate

Forecasts Remain Elevated

Unemployment Rate

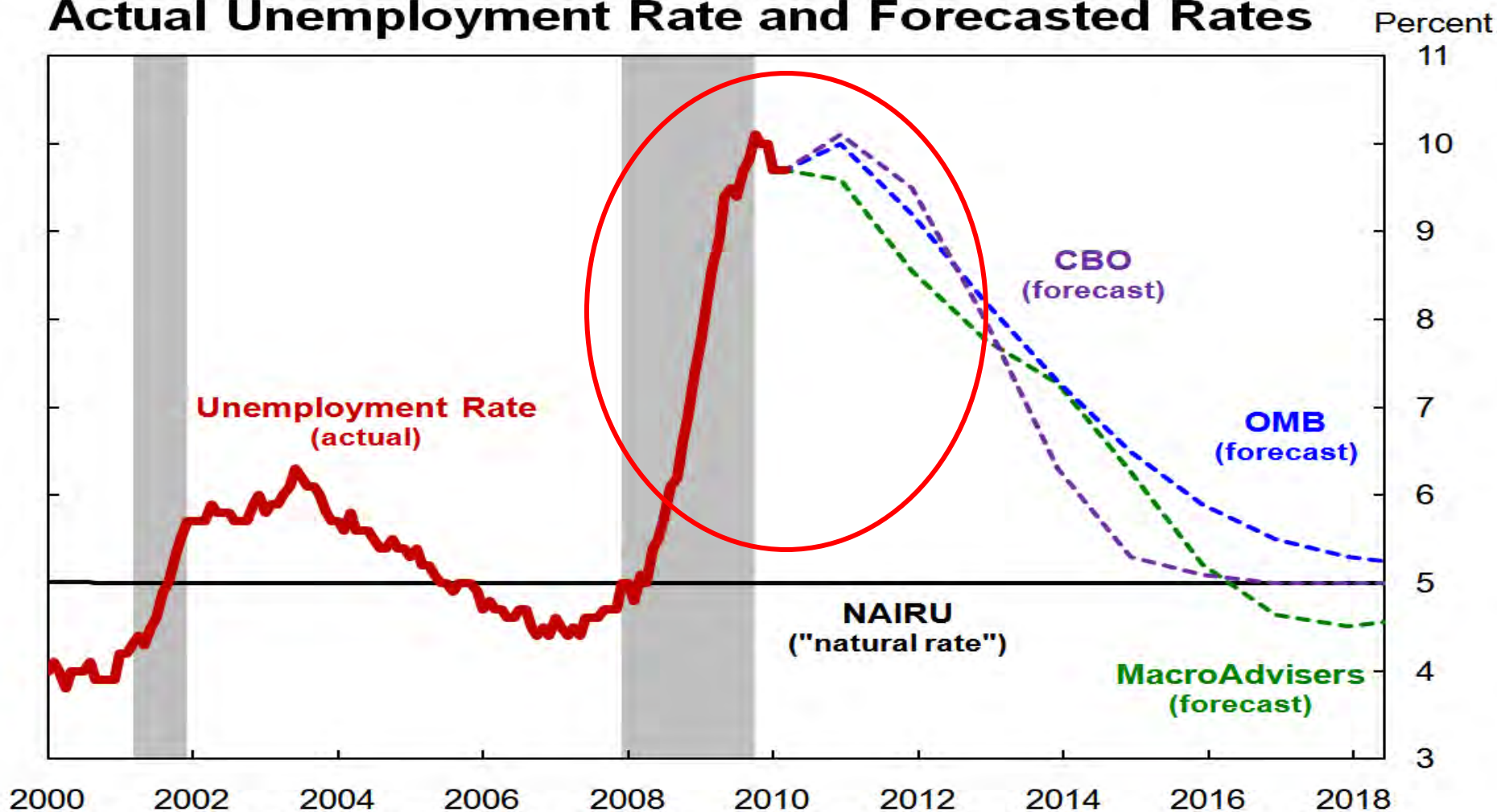
Seasonally adjusted



Source: FRBSF, April 2010.

National Unemployment Rate Forecasts Remain Elevated

Actual Unemployment Rate and Forecasted Rates



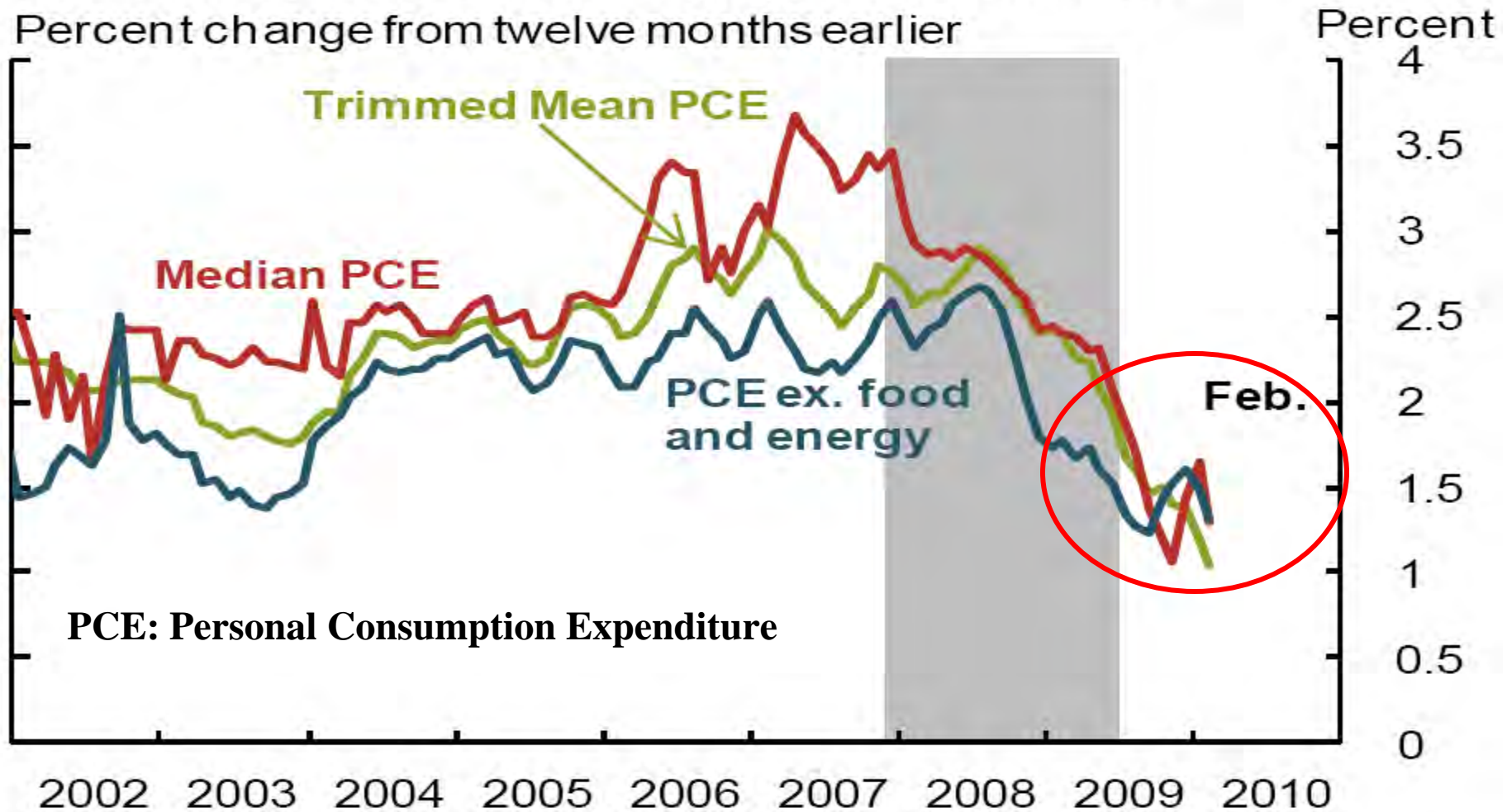
Source: BLS, CBO, OMB, Macroeconomic Advisers

Forecast dates: Congressional Budget Office (CBO) and Office of Management and Budget (OMB)-Jan. 2010. MacroAdvisers-Dec. 2009.

Current Readings Show that Inflation Is Trending Down

Three Measures of Underlying Price Inflation

Percent change from twelve months earlier



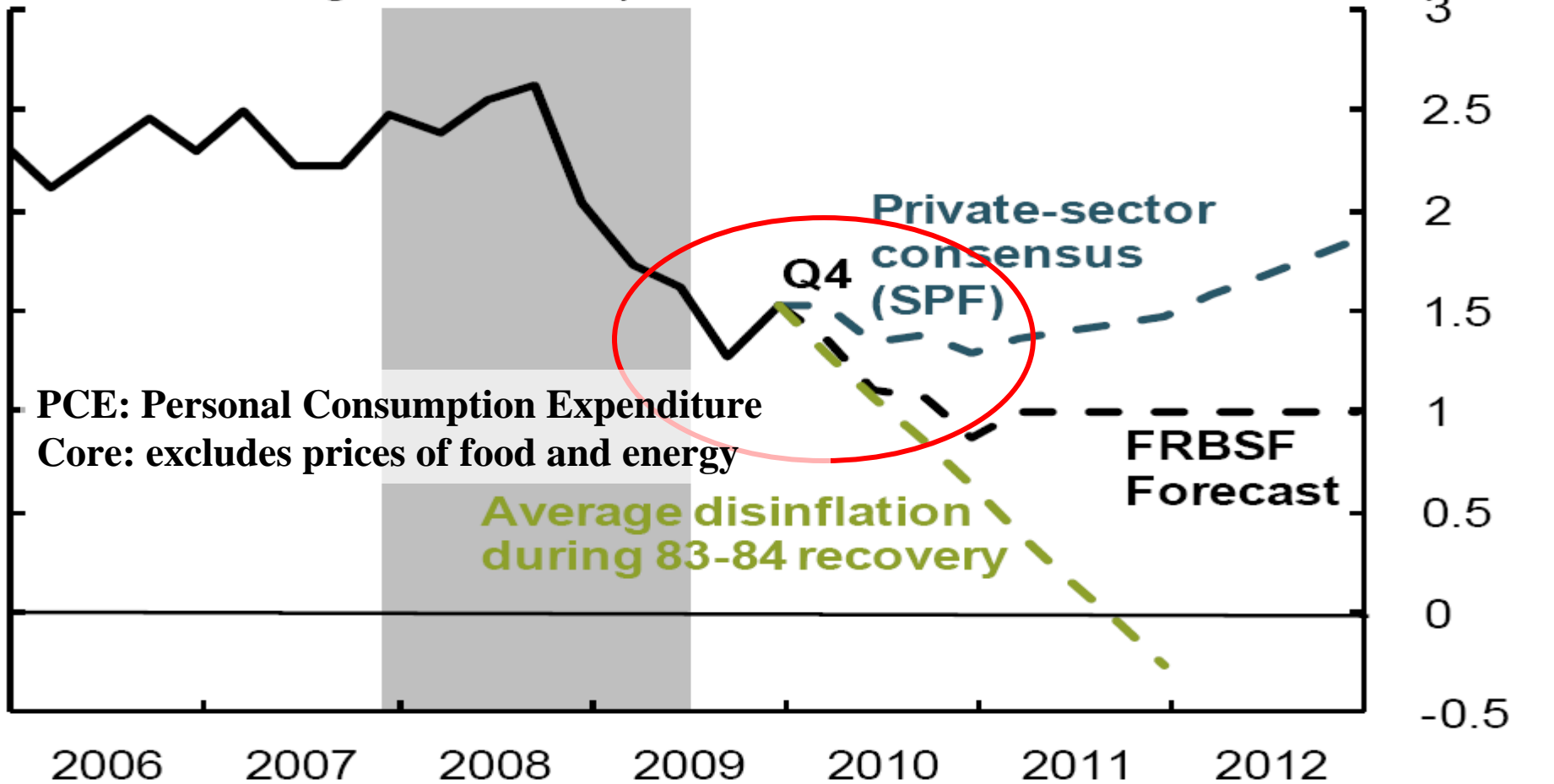
PCE: Personal Consumption Expenditure

Lower Inflation is Expected in Near Term

Core PCE Price Inflation

Percent change from four quarters earlier

Percent



Summary Points

- **Financial crisis effects likely will result in a relatively slow recovery.**
- **Moderate recovery has begun, but underutilized capacity and a high unemployment rate are expected to persist for some time.**
- **Inflation appears to be trending lower as slack restrains cost pressures and inflation expectations.**
- **Fed's unconventional lending facilities and asset purchases have been completed.**

Questions?

**Gary Zimmerman, Senior Economist
Federal Reserve Bank of San Francisco**

Gary.Zimmerman@sf.frb.org

www.frbsf.org

FRBSF Resources

www.frbsf.org/economics/



FRBSF Resources

THE ECONOMY
CRISIS & RESPONSE

WWW.FRBSF.ORG

Financial Crisis



Fed's Response



Road Ahead



FRBSF Resources

Follow the SF Fed on Facebook & Twitter

The screenshot shows the website for the Federal Reserve Bank of San Francisco. At the top, the logo and name "FEDERAL RESERVE BANK OF SAN FRANCISCO" are visible, along with links for "Careers | Fed Links | Subscriptions". A navigation bar contains several menu items: "About the Fed", "News and Events", "Economic Research and Data", "Educational Resources", "Community Development", "Consumer Information", "Banking Information", and "Services for Financial Institutions". Below this is a secondary navigation bar with links: "Home | Speeches | Events | Federal Open Market Committee (FOMC) | News Releases | Current Perspectives | Contacts".

The "NEWS AND EVENTS" section is highlighted with a red circle. It features a "Highlights" sub-section with two news items:

- The Outlook for the Economy and Inflation, and the Case for Federal Reserve Independence**
Presentation to Town Hall Los Angeles
Los Angeles, CA
March 23, 2010
- Richard C. Blum Joins San Francisco Fed Economic Advisory Council**
Richard C. Blum, chairman and founder of San Francisco-based Blum Capital Partners, has joined the Federal Reserve Bank of San Francisco's Economic Advisory Council for a three-year term ending December 31, 2012. (learn more)

The "TOOL BOX" section is also highlighted with a red circle. It contains the following links:

- Twitter
- Facebook
- RSS
- FAQ
- Fed Links
- Glossary
- Subscriptions
- Site Map
- Publications
- Careers
- Search
- Email Us
- Research Pubs

At the bottom of the Tool Box is a search bar with the text "Search:" and a search button.

Balance Sheet Management Tools

1. Inducement for depositories to hold excess reserves

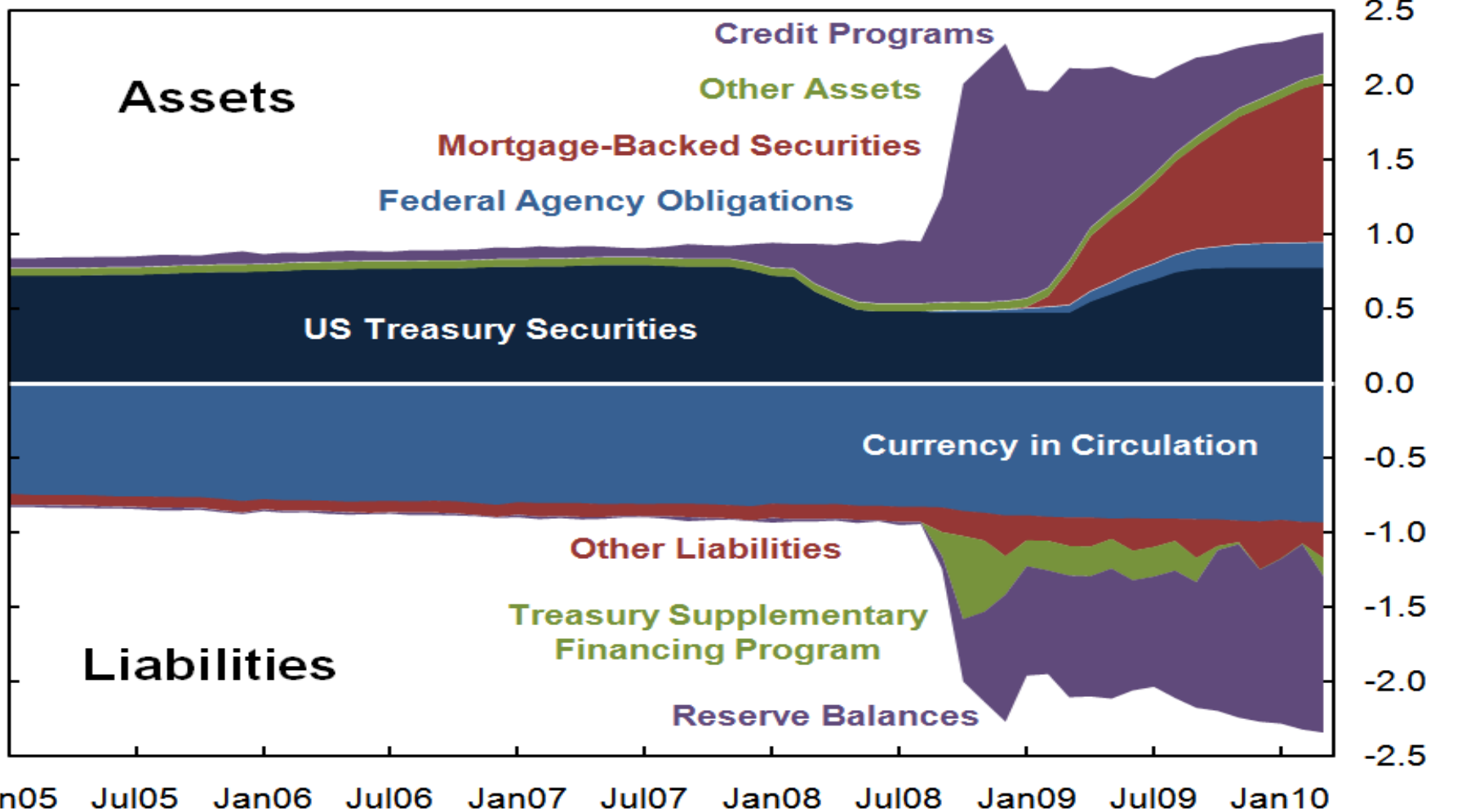
- **Paying interest on excess reserve balances (IOER)**
 - IOER has allowed the Fed to expand its balance sheet through the unconventional tools even with a target fed funds rate in the zero to 25 basis point range
 - When the Fed needs to remove monetary accommodation, raising the IOER rate will allow the fed funds rate (and other short-term interest rates) to rise even with unusually high levels of excess reserves

2. Tools for reducing the excess reserves

- **Large scale Reverse Repurchase Agreements (RRPs)**
 - Replaces excess reserves held by depositories with RRP liabilities of the Fed, without reducing the size of the Fed's balance sheet
- **Term Deposit Facility (TDF) at the Federal Reserve**
 - Replaces excess reserves held by depositories with term deposits held by depository at the Fed, without reducing the size of the Fed's balance sheet
- **Asset Sales**
 - Reduces excess reserves by shrinking the Fed's balance sheet

Dramatic Change in Size and Composition of the Federal Reserve's Balance Sheet

Assets and Liabilities of the Federal Reserve



Source: Federal Reserve Board



The Fed's Balance Sheet Expansion Has Not Caused Similar Growth in the Money Supply: New Tools to Control Bank Reserves

Monetary Base, Money Supply, and Bank Loans

Seasonally adjusted; 1/3/2007 = 100

