

# **Economic Developments**

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**SRC All-Staff Conference**

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The views expressed in this presentation are those of the author and do not necessarily represent the views of the Federal Reserve Bank of Philadelphia, the Federal Reserve System, or the Federal Open Market Committee.



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# In November, the FOMC announced it would continue “operation twist,” reinvesting in MBS, and forward guidance

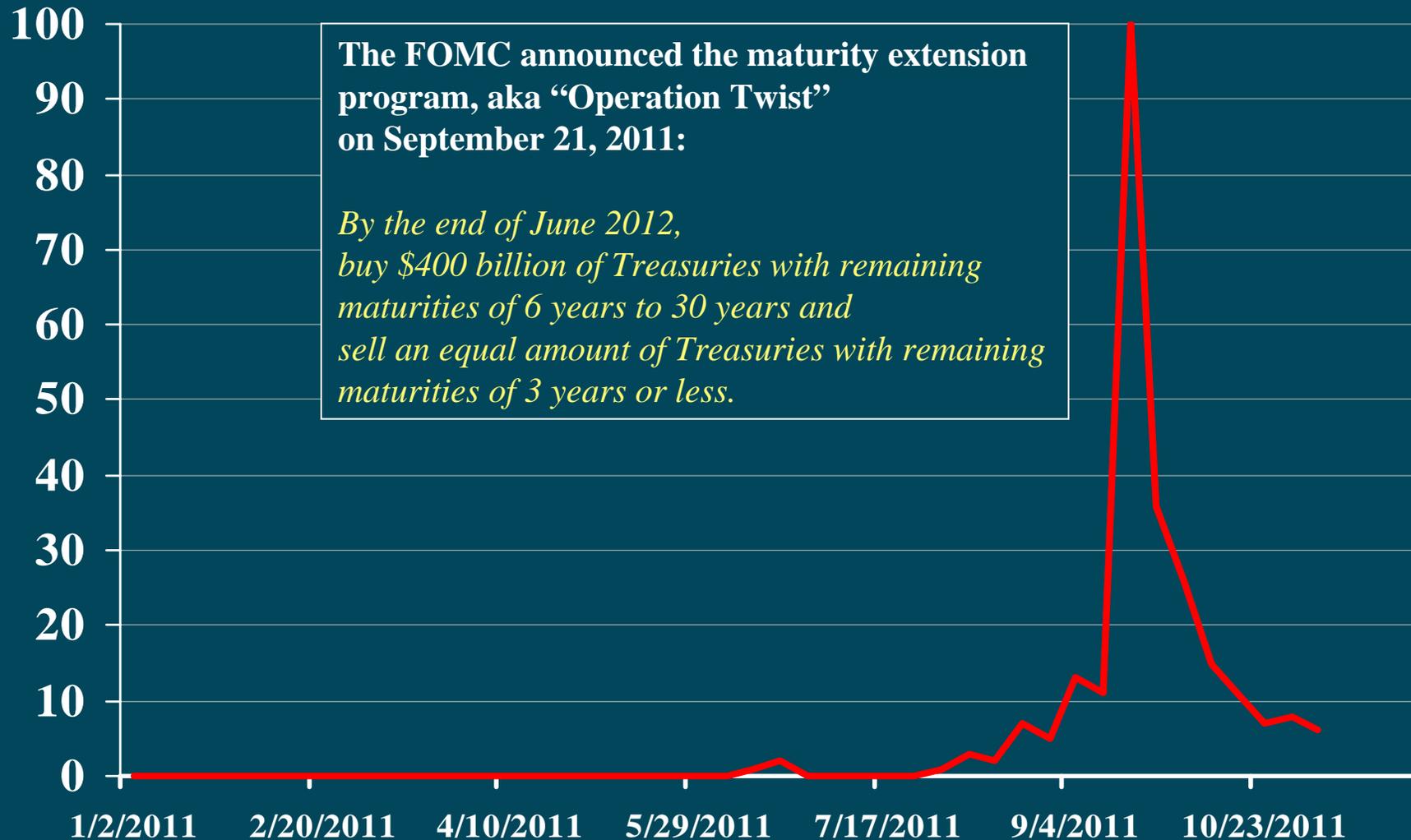
## *November 2, 2011 FOMC Statement:*

- To promote a stronger pace of economic recovery and to help ensure that inflation, over time, is at levels consistent with the dual mandate ... the Committee decided today to continue its program to extend the average maturity of its securities...
- The Committee is ... reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities.
- The Committee will maintain 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 for at least through mid-2013.



# “Operation Twist” became a popular search term on Google

Web search interest



Source: Google Insights for Search

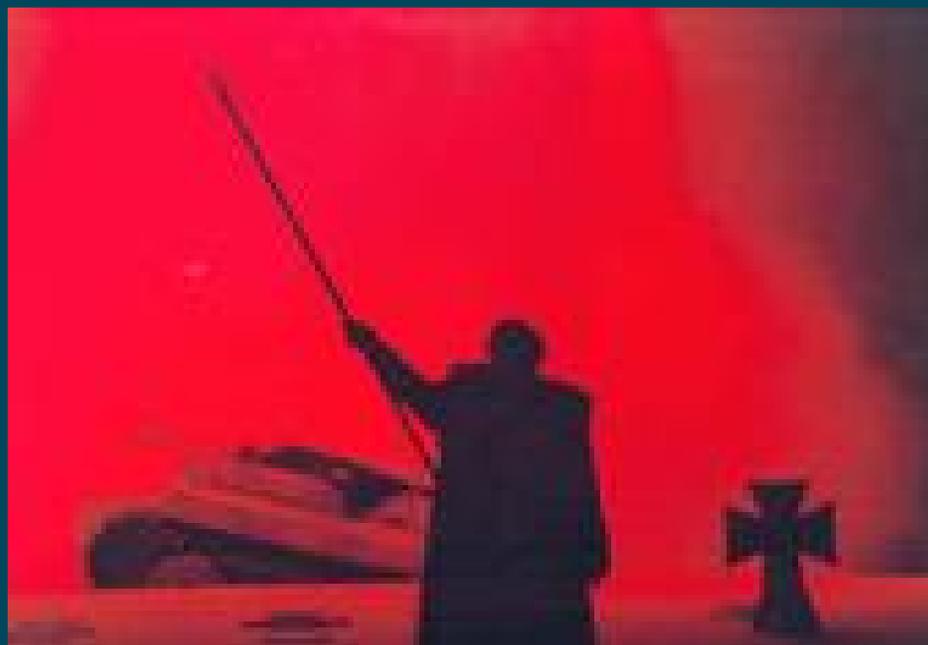


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*“Whereas deeds never done before  
are what occupy my mind.”*

Wotan

*Die Walküre, Act Two, Scene One*



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**During and after the crisis, the Fed has taken unprecedented policy actions to ease short-term funding pressures, contain systemic fallout, and support economic recovery**

Standing Facilities

- Longer maturity Discount Window loans
- Primary Dealer Credit Facility

Term Lending Facilities

- Term Auction Facility (TAF)
- FX Swaps with other central banks

Targeted Credit Facilities

- Asset-Backed Commercial Paper Money Market Mutual Fund Lending Facility (AMLF)
- Commercial Paper Funding Facility (CPFF)
- Money Market Investor Funding Facility (MMIFF)
- Term Asset-Backed Securities Loan Facility (TALF)

Programs to Individual Firms to Contain Systemic Fallout

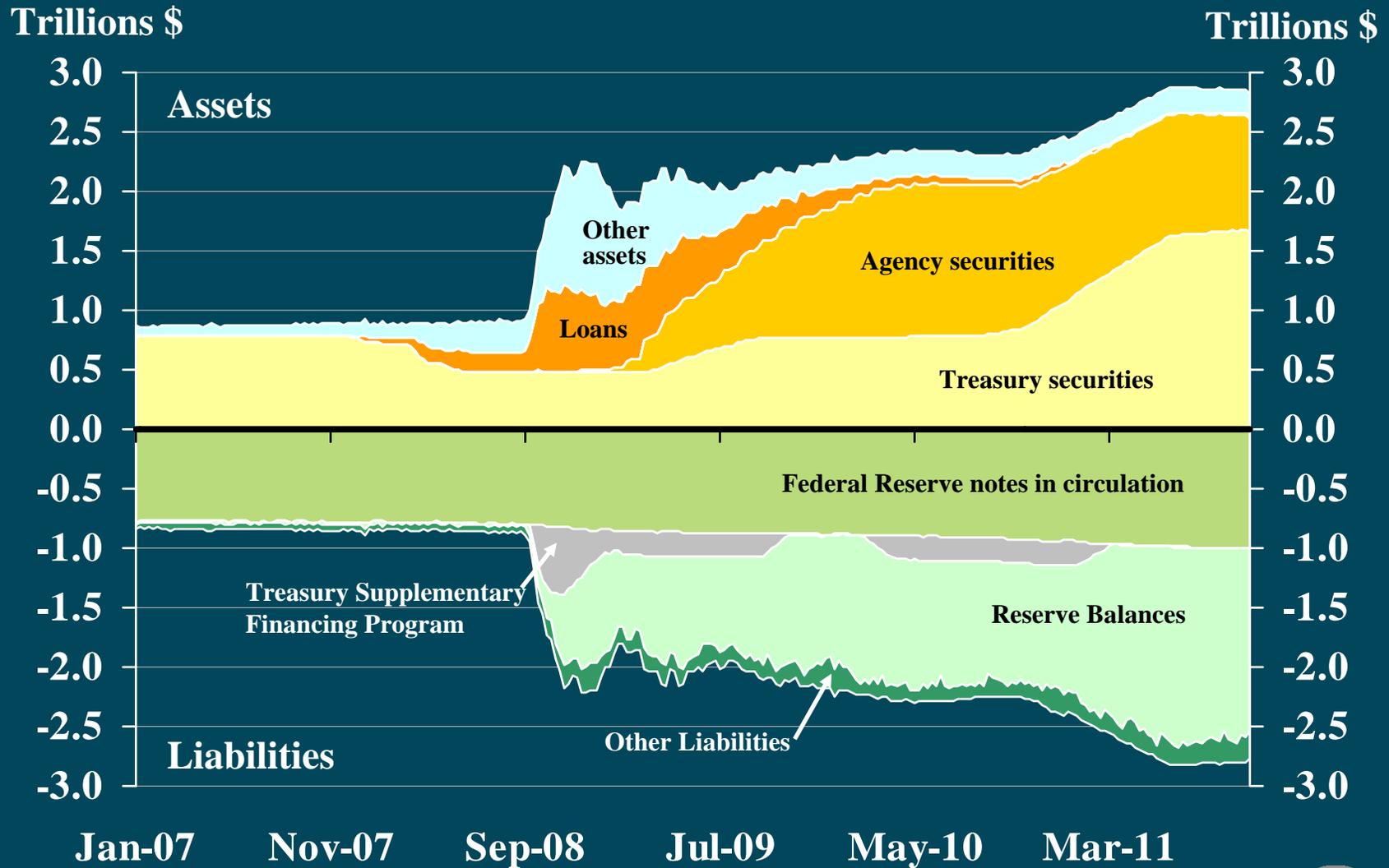
- Bear Stearns, AIG, Citigroup

Programs Focused on Longer-Term Asset Prices

- Purchases of the direct obligations of and MBS guaranteed by the housing-related GSEs
- Purchases of longer-term Treasury securities
- Maturity extension program = “Operation Twist”
- Forward guidance



# The asset purchases have tripled the size of the Fed's balance sheet



Weekly data: Last point plotted is November 2, 2011



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## Traditional monetary policy focuses on the overnight rate of interest

- Fed targets the overnight fed funds rate
- Enforces the target by buying and selling securities via open market operations:
  - Fed buys Treasury bills
    - Bank reserves rise
    - Short-term interest rates fall
    - Downward pressure on long-term interest rates, since ...
      - Long-term interest rates =  
Average of current and expected future short-term interest rates  
+ Term premium
- Consumer and business spending increases



## Nonconventional monetary policy works on expectations and the term premium

*Long-term interest rate = Average of current and expected future short-term interest rate + Term premium*

*Real rate = Nominal rate – Expected inflation*

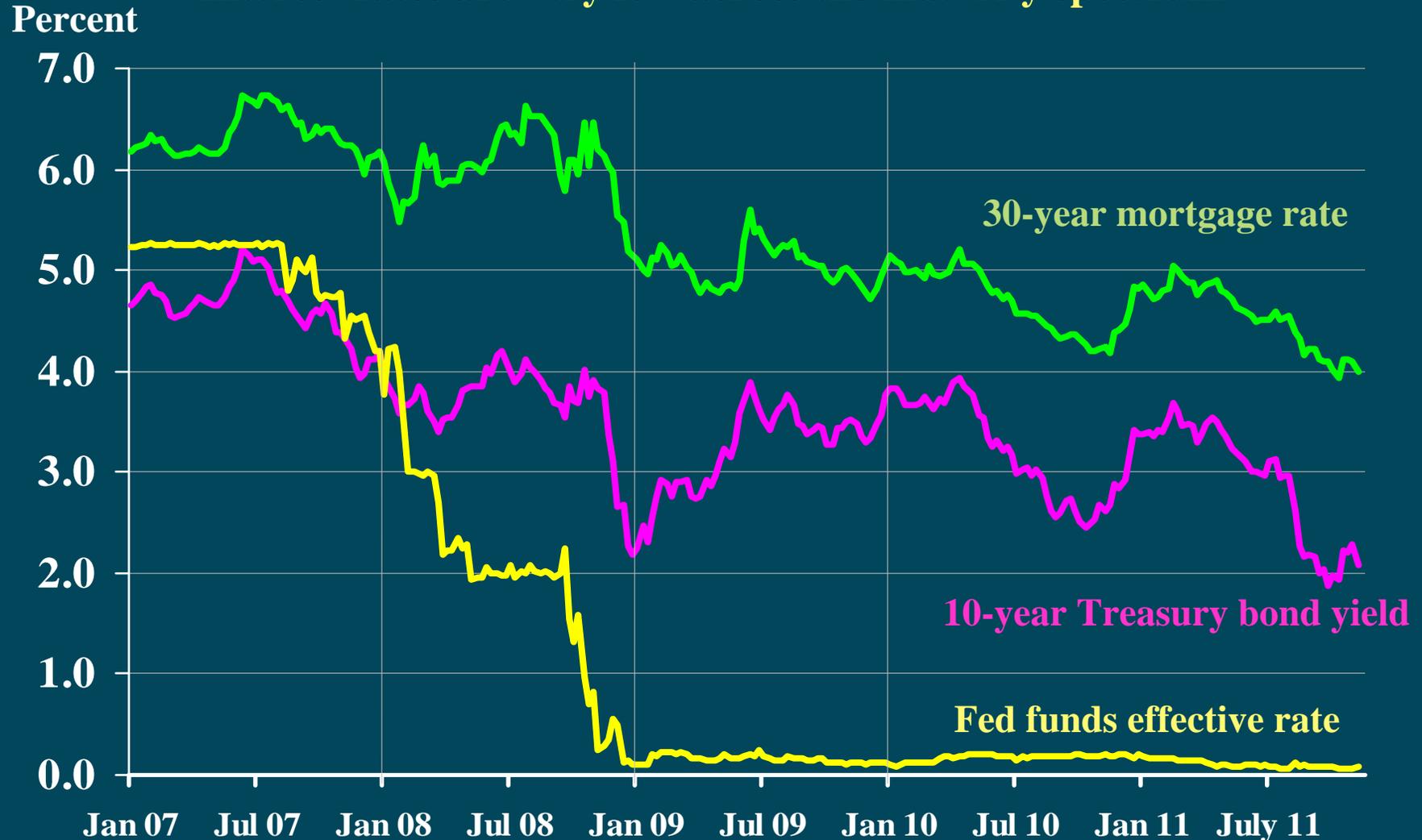
### Nonconventional monetary policy at zero bound

To lower real borrowing rates:

- Lower expected future short-term rates
- Lower the term premium on long rates
- Increase inflation expectations if too low



**For almost three years, the Fed has kept the fed funds rate at essentially zero and it expects the funds rate to remain there at least through mid-2013. Interest rates are very low across the maturity spectrum.**



Weekly data: Last point plotted is November 4, 2011



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**With the fed funds rate at zero, the Fed will need to consider other tools if it wants to ease policy further**

*Long-term interest rate = Average of current and expected future short-term interest rate + Term premium*

*Real rate = Nominal rate – Expected inflation*

**(1) Forward guidance: Communication and commitment**

- Announce commitment to keep rates low for specified period of time or until specified event occurs

**(2) Quantitative easing**

- Add more reserves to the banking system than needed to keep ff rate = 0 by buying assets
- Use composition of the Fed's balance sheet to target borrowing rates in particular markets (e.g., mortgages)

**(3) “Operation twist”: Buy longer-term Treasury securities and sell shorter-term Treasuries**

- Direct effect on long rates; might put downward pressure on term premium by increasing total demand for long-term issues, and reducing supply available to the public

**(4) Target inflation at a higher level**

**(5) Lower the rate that the Fed is paying banks on their reserves**



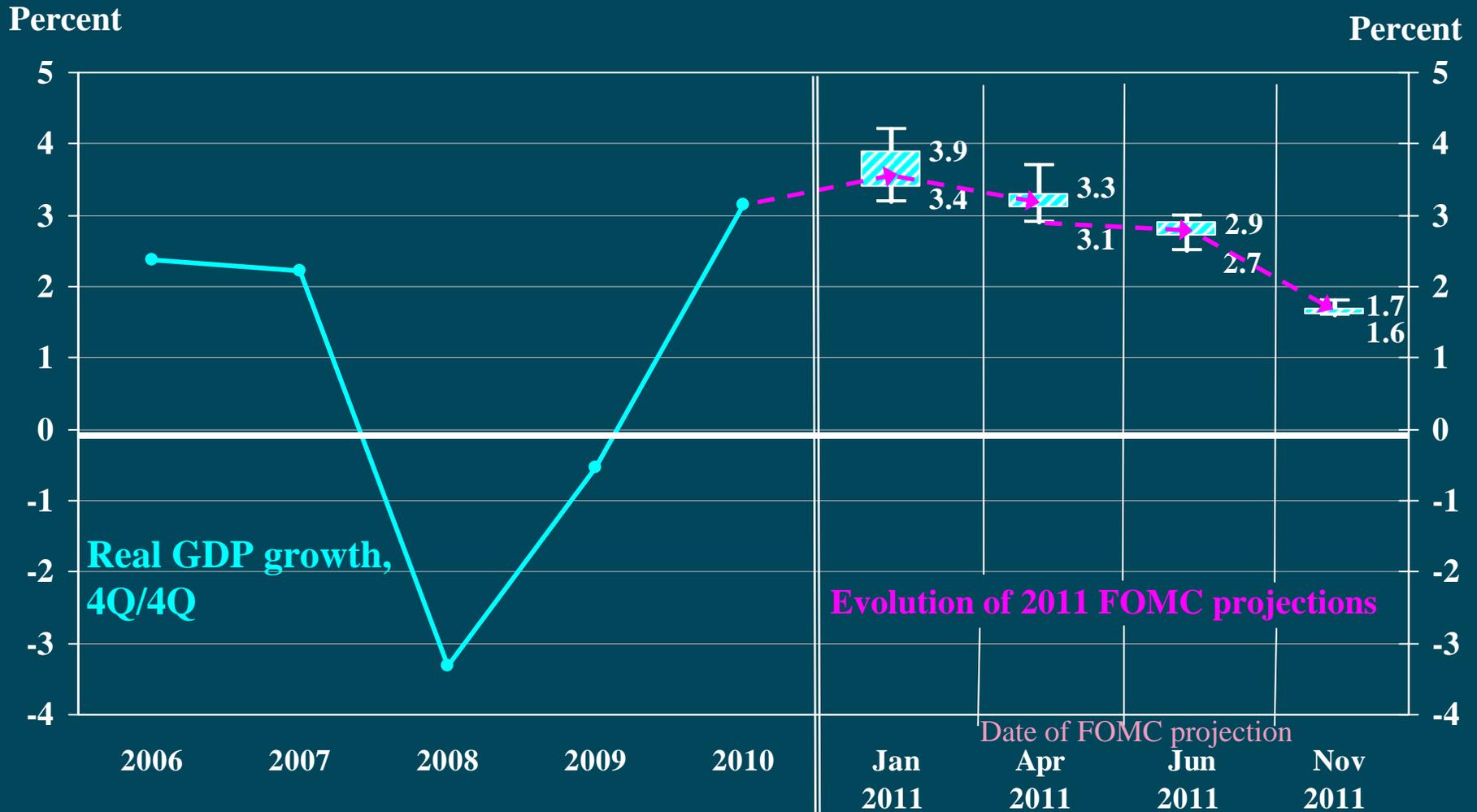
# FOMC forecasters expect moderate growth and slow declines in unemployment

## Central tendency of Fed Governors and Presidents November 2011 Forecasts

	<u>2011</u>	<u>2012</u>	<u>2013</u>
Real GDP Growth (Q4/Q4 growth)	1.6 to 1.7%	2.5 to 2.9%	3.0 to 3.5%
Unemployment Rate (Q4)	9.0 to 9.1%	8.5 to 8.7%	7.8 to 8.2%
PCE Inflation (Q4/Q4 growth)	2.7 to 2.9%	1.4 to 2.0%	1.5 to 2.0%



# The FOMC has been revising down the 2011 forecast throughout the year



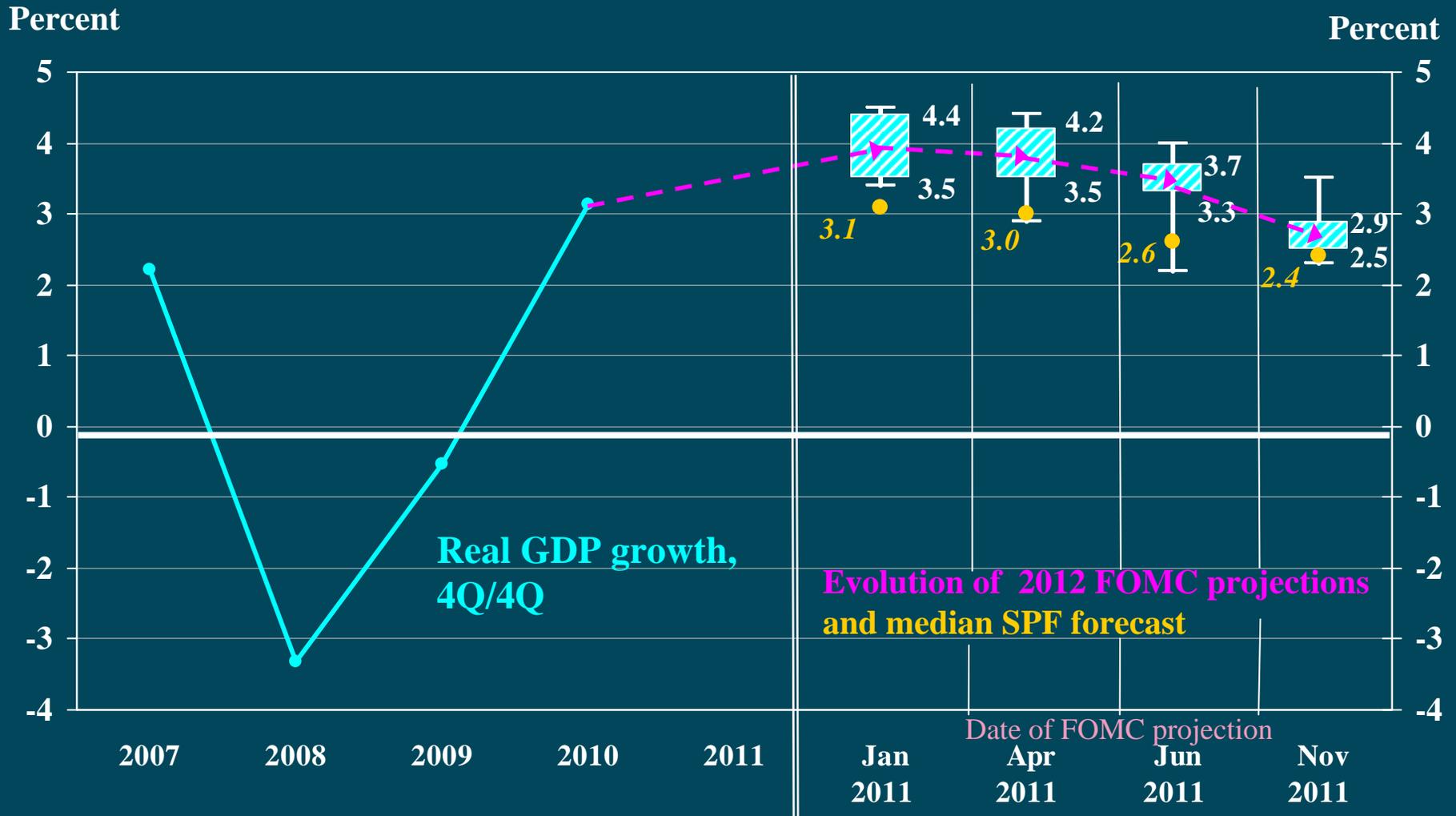
Source: FOMC Minutes and Press Conference

Projections for 2011



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# The FOMC continues to expect growth to strengthen in 2012 but it will be weaker than in earlier projections



Sources: FOMC Minutes and Press Conference, and Philadelphia Fed Survey of Professional Forecasters (SPF).  
 Note, survey dates for SPF are: Feb, May, Aug, Nov.

Projections for 2012

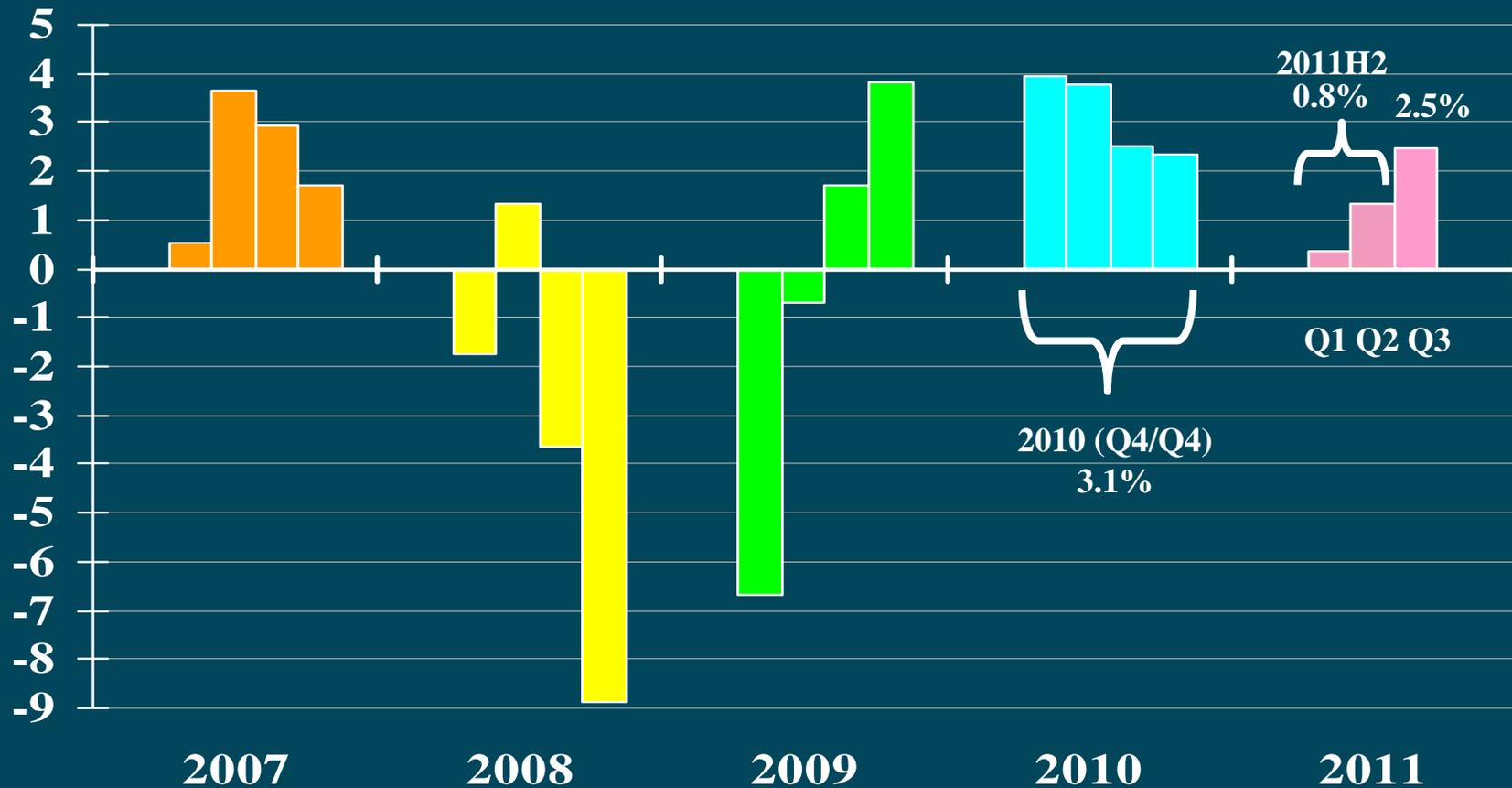


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# Growth picked up in the third quarter as temporary factors restraining growth in the first half began to recede

Percent

## Real GDP Growth, SAAR

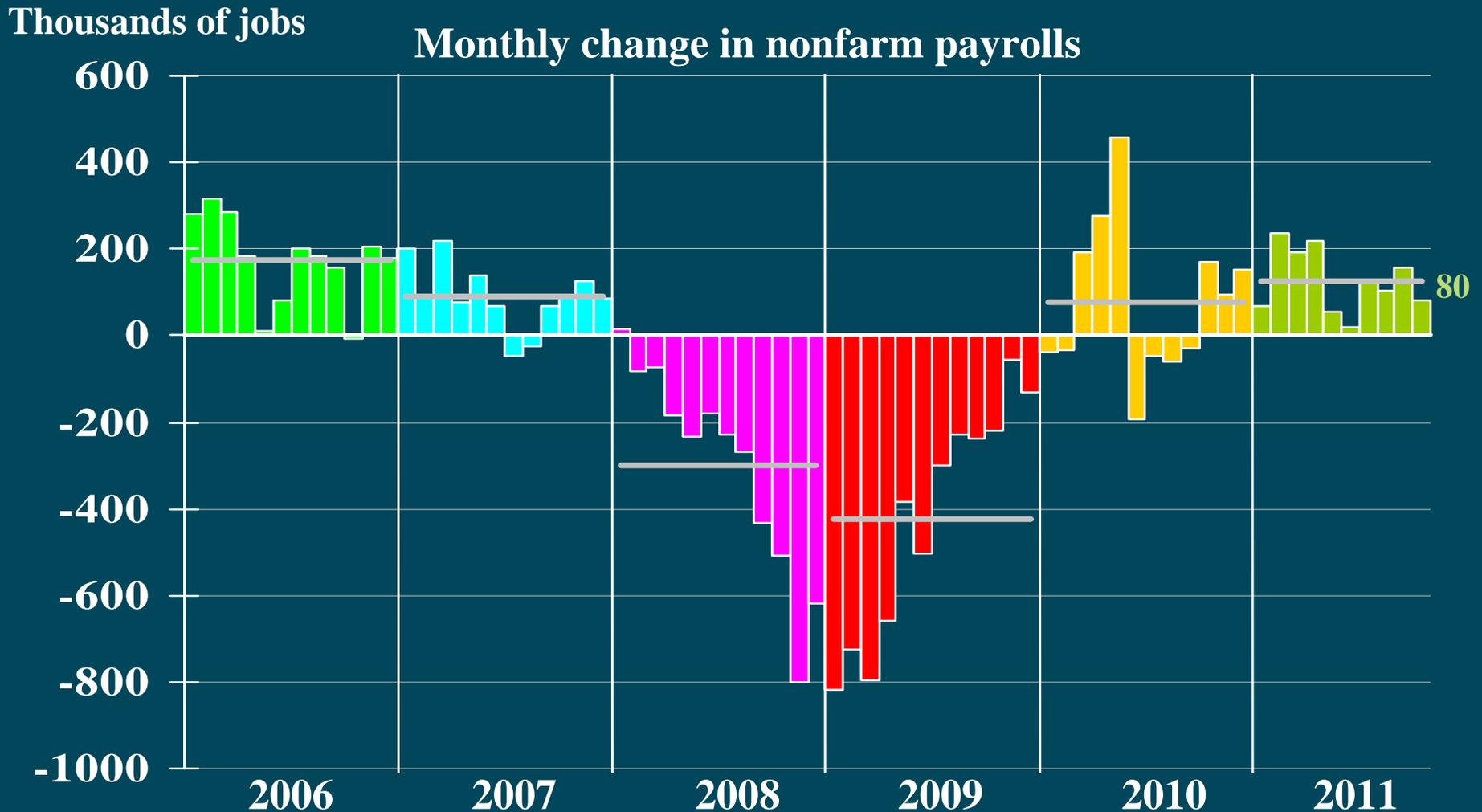


Quarterly data: Last point plotted is 2011Q3



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# Although labor markets are still weak, recent employment reports have been a bit better



Last month plotted is October 2011

Average monthly gains for each year are indicated by the grey lines

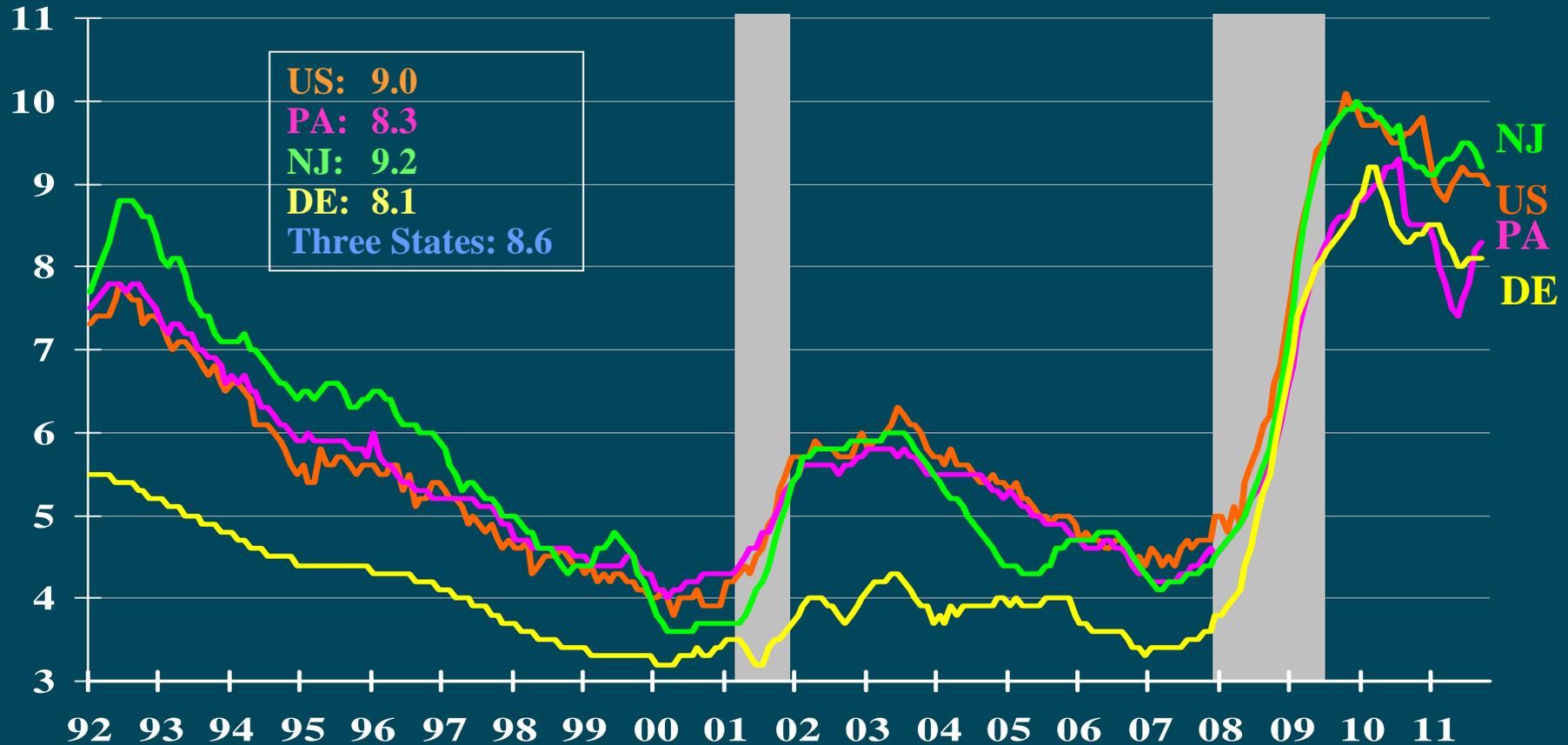


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# Unemployment rates are high

Percent

## Civilian unemployment rate

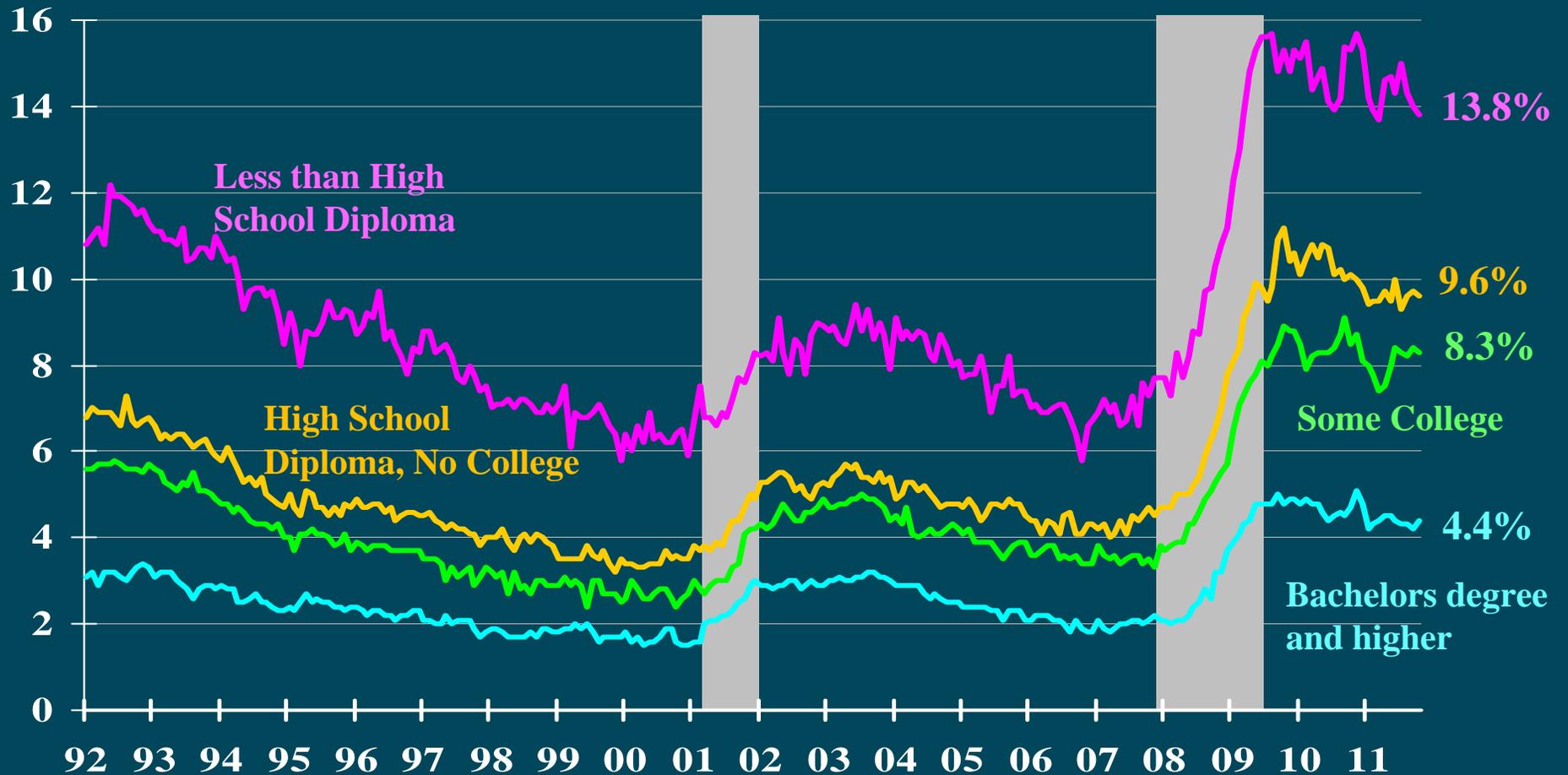


Monthly data: Last point plotted is October 2011 for U.S. and September 2011 for the states

# Tell your kids to stay in school!

Percent

## Civilian unemployment rate by educational attainment



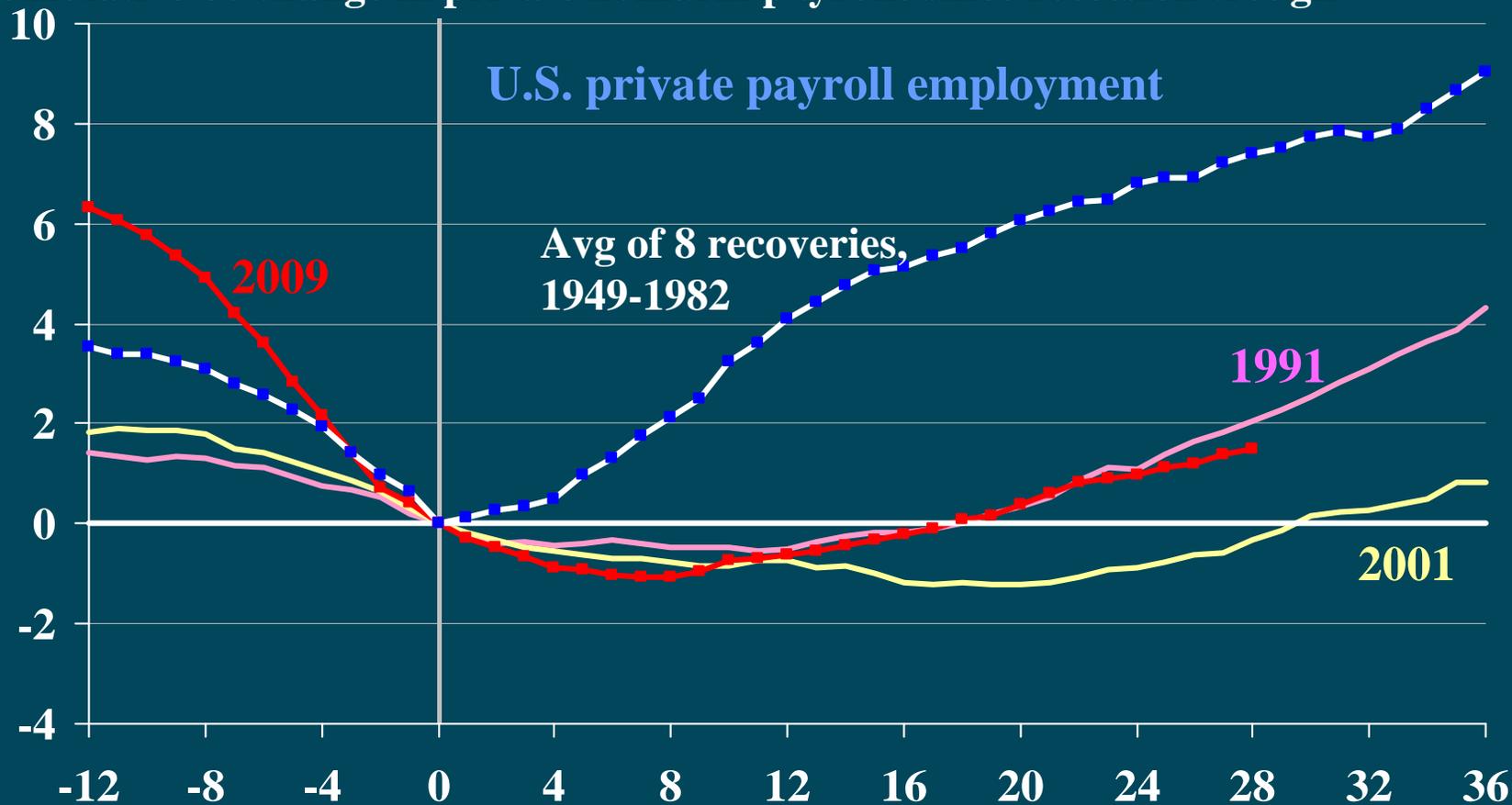
Monthly data: Last point plotted is October 2011



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**Private sector job growth in the U.S. is tracking with the 1991 “jobless” recovery. But this recession was much sharper.**

Cumulative % change in private nonfarm payrolls since recession trough



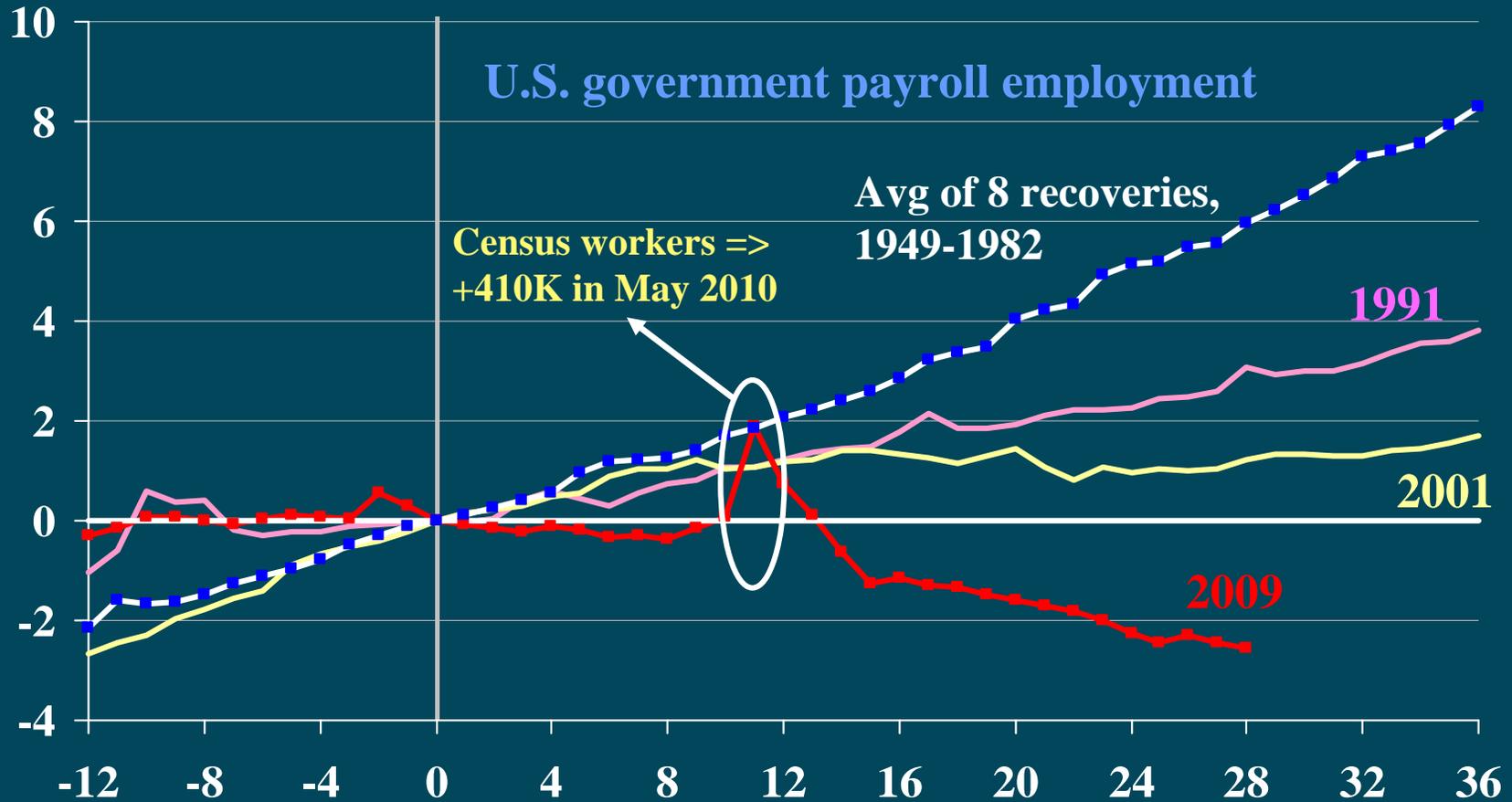
↑  
Trough  
Mar 1991  
Nov 2001  
Jun 2009

Months Since Recovery Began



# Unlike prior recessions, government jobs are being cut

Cumulative % change in government nonfarm payrolls since recession trough

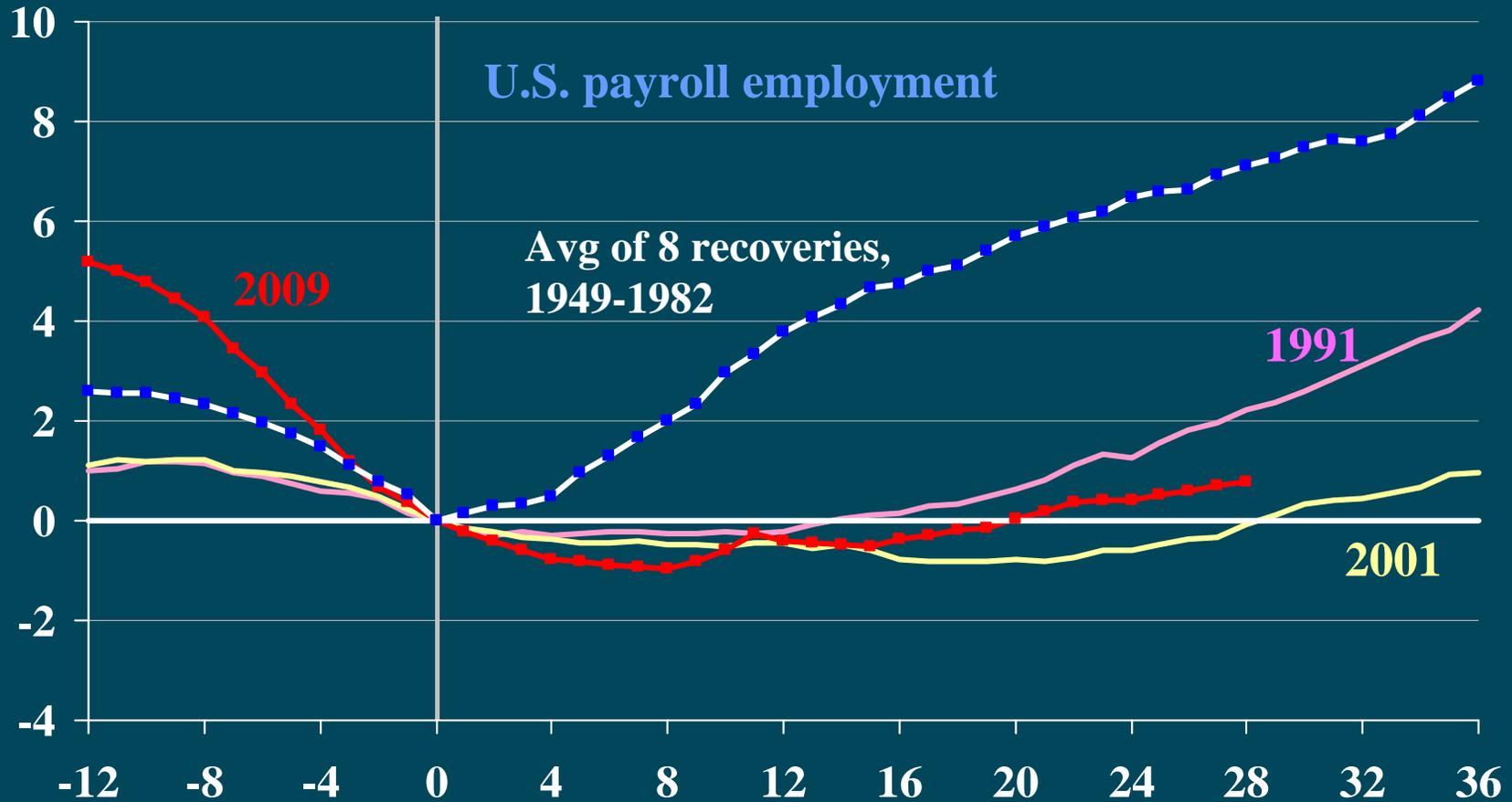


Trough  
Mar 1991  
Nov 2001  
Jun 2009

Months Since Recovery Began

# Total employment growth in the nation is weaker than in the 1991 recovery

Cumulative % change in nonfarm payrolls since recession trough

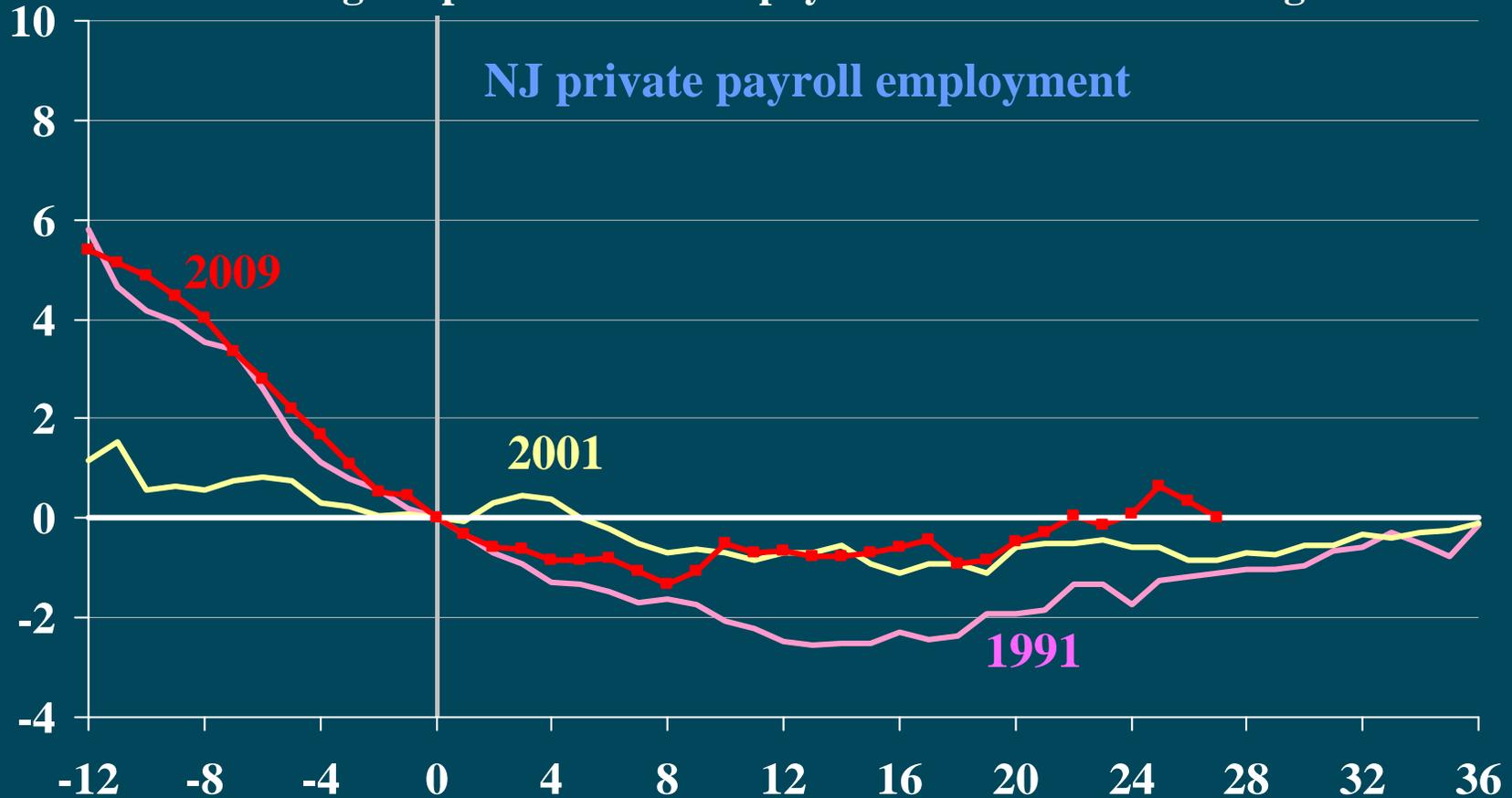


Trough  
Mar 1991  
Nov 2001  
Jun 2009

Months Since Recovery Began

# Private sector jobs in New Jersey are no higher than at the start of the recovery – but this is better performance than in the past two jobless recoveries

Cumulative % change in private nonfarm payrolls since recession trough



↑  
Trough  
Mar 1991  
Nov 2001  
Jun 2009

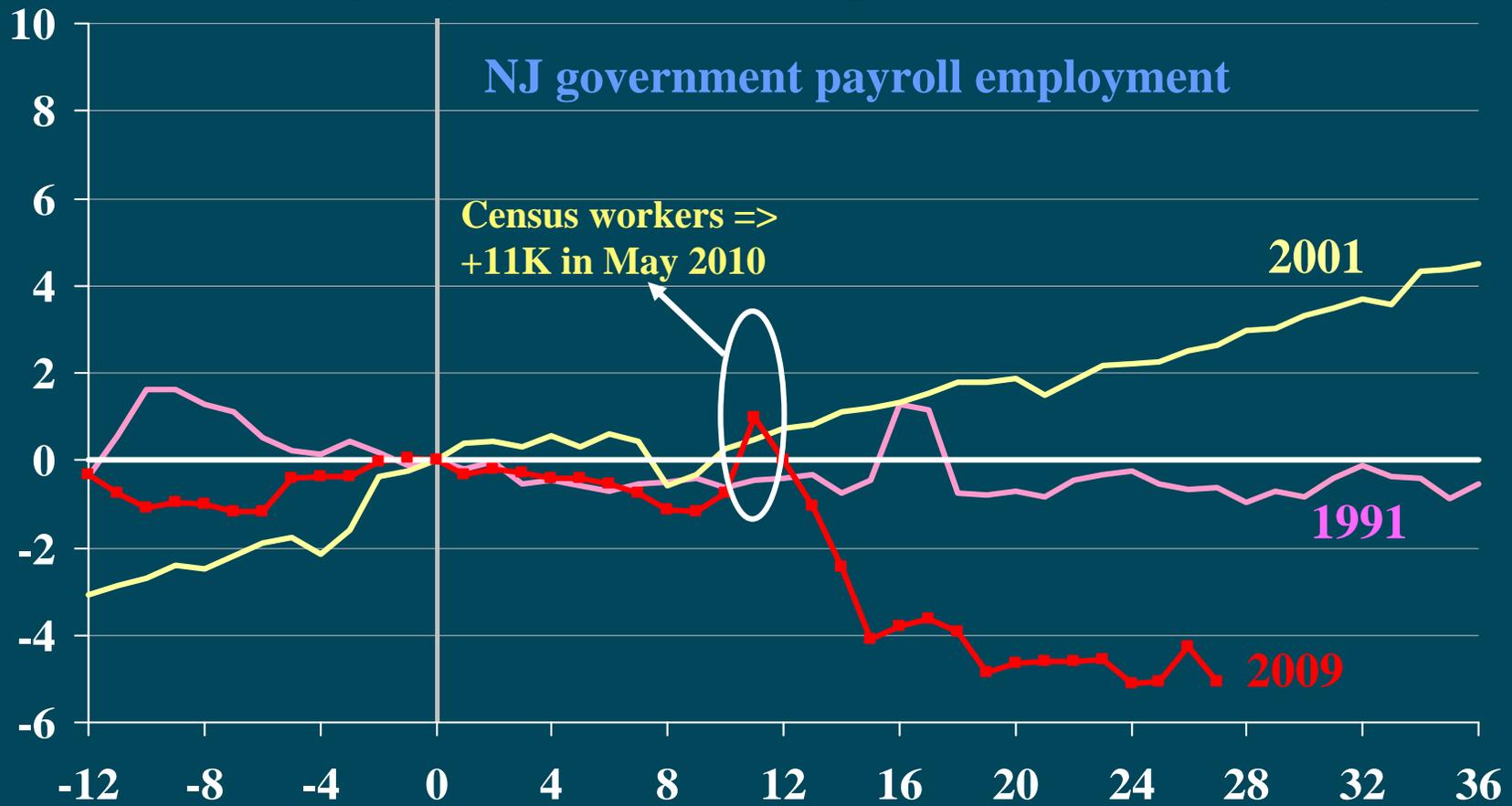
Months Since Recovery Began



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# Government job cuts are significant in New Jersey

Cumulative % change in government nonfarm payrolls since recession trough

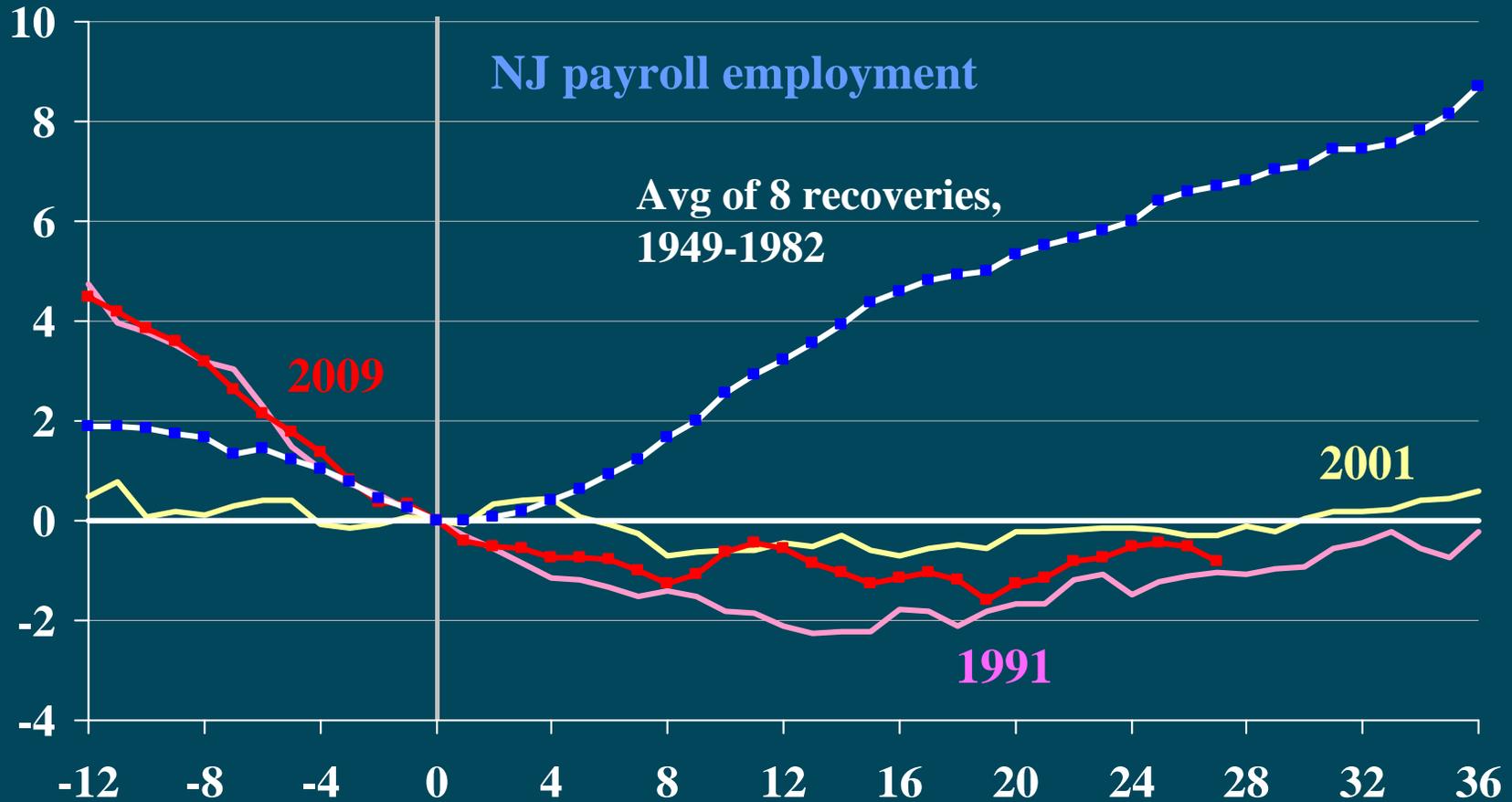


Trough  
Mar 1991  
Nov 2001  
Jun 2009

Months Since Recovery Began

# Total employment in New Jersey is below its level at the start of the recovery

Cumulative % change in nonfarm payrolls since recession trough

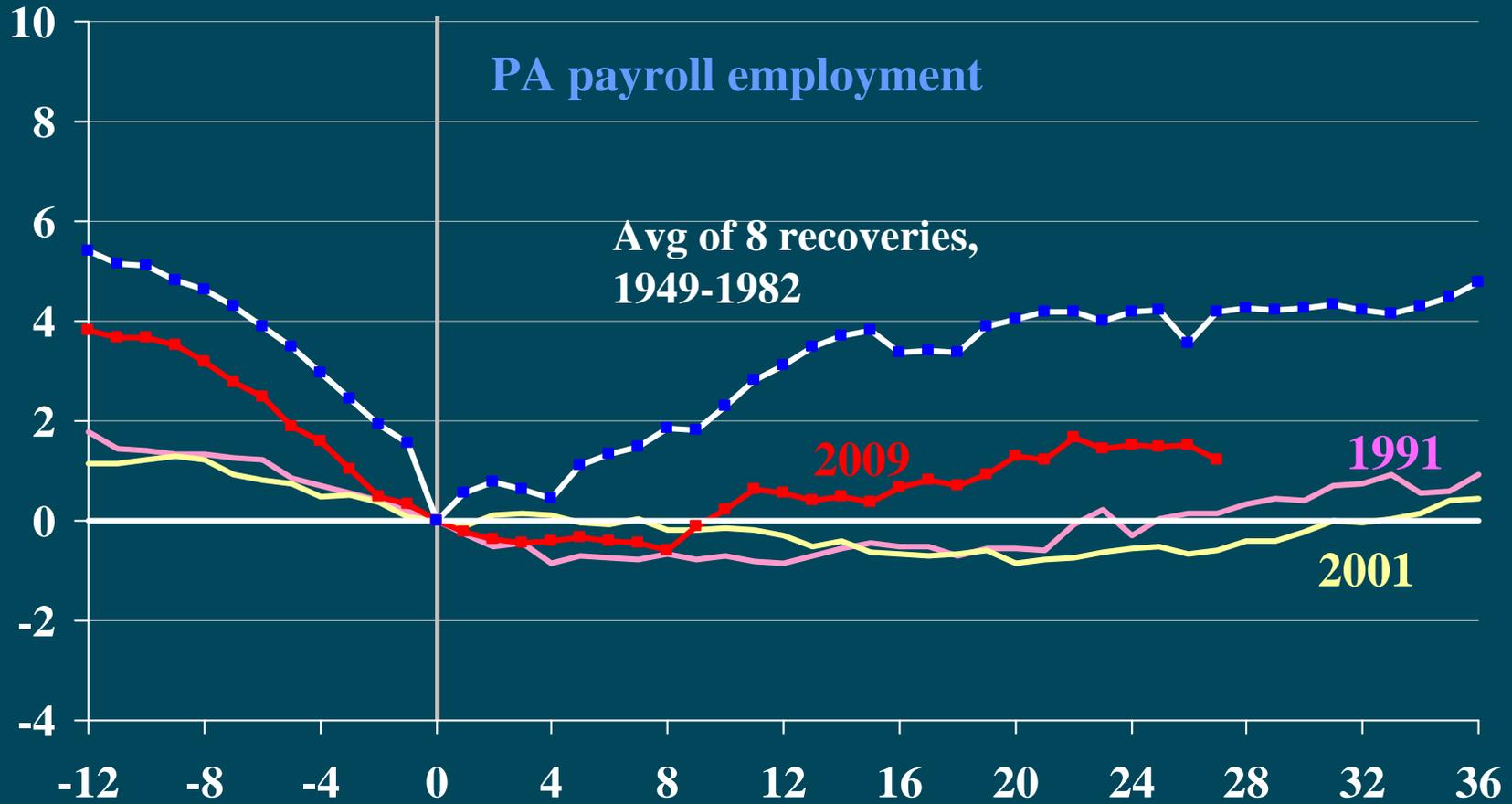


Trough  
Mar 1991  
Nov 2001  
Jun 2009

Months Since Recovery Began

# Payroll employment growth in Pennsylvania is performing better than at the same stage in the last two recoveries.

Cumulative % change in nonfarm payrolls since recession trough



Trough  
Mar 1991  
Nov 2001  
Jun 2009

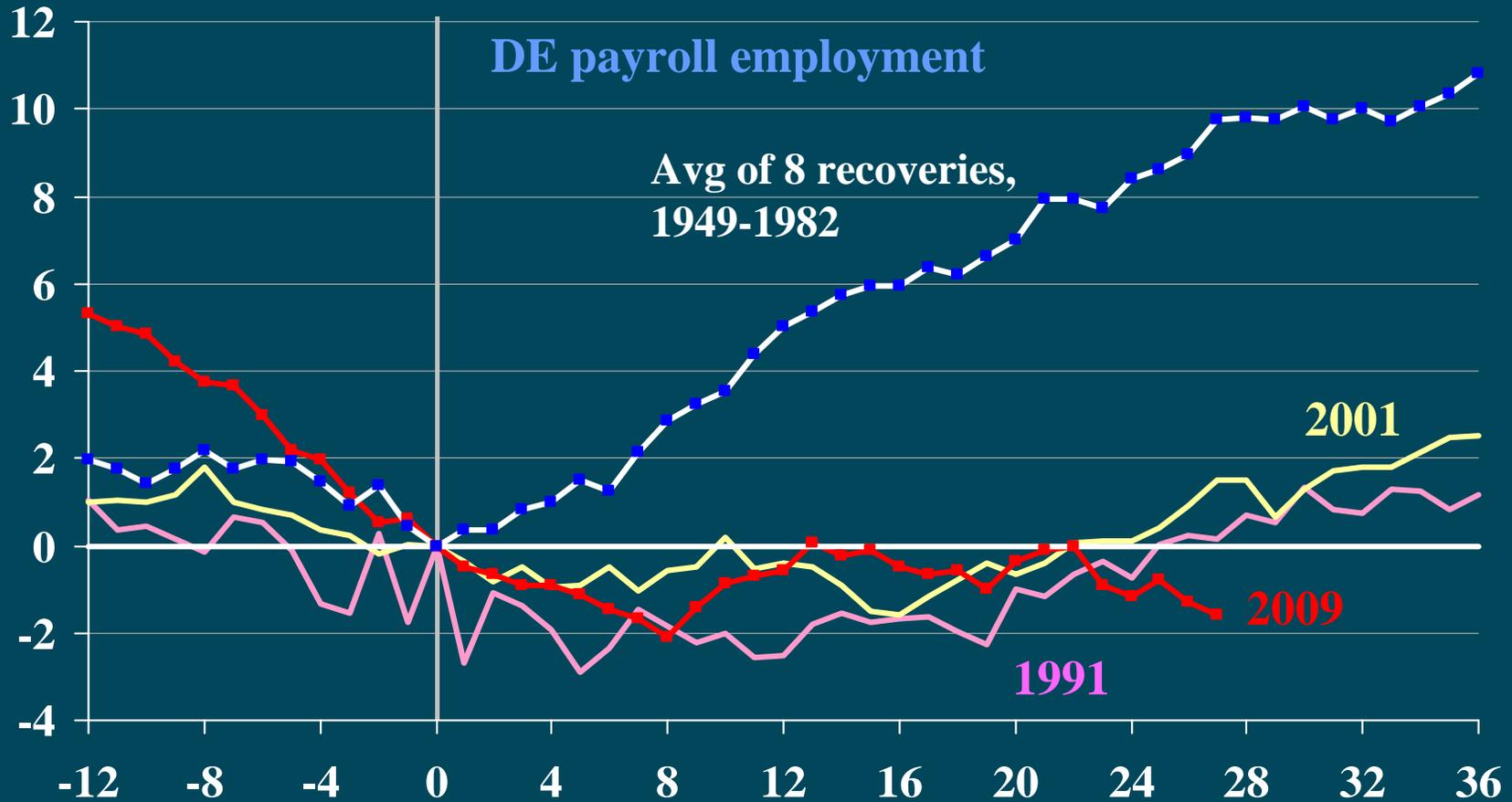
Months Since Recovery Began



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# In Delaware, job growth is underperforming compared to the same stage in the past two recoveries

Cumulative % change in nonfarm payrolls since recession trough



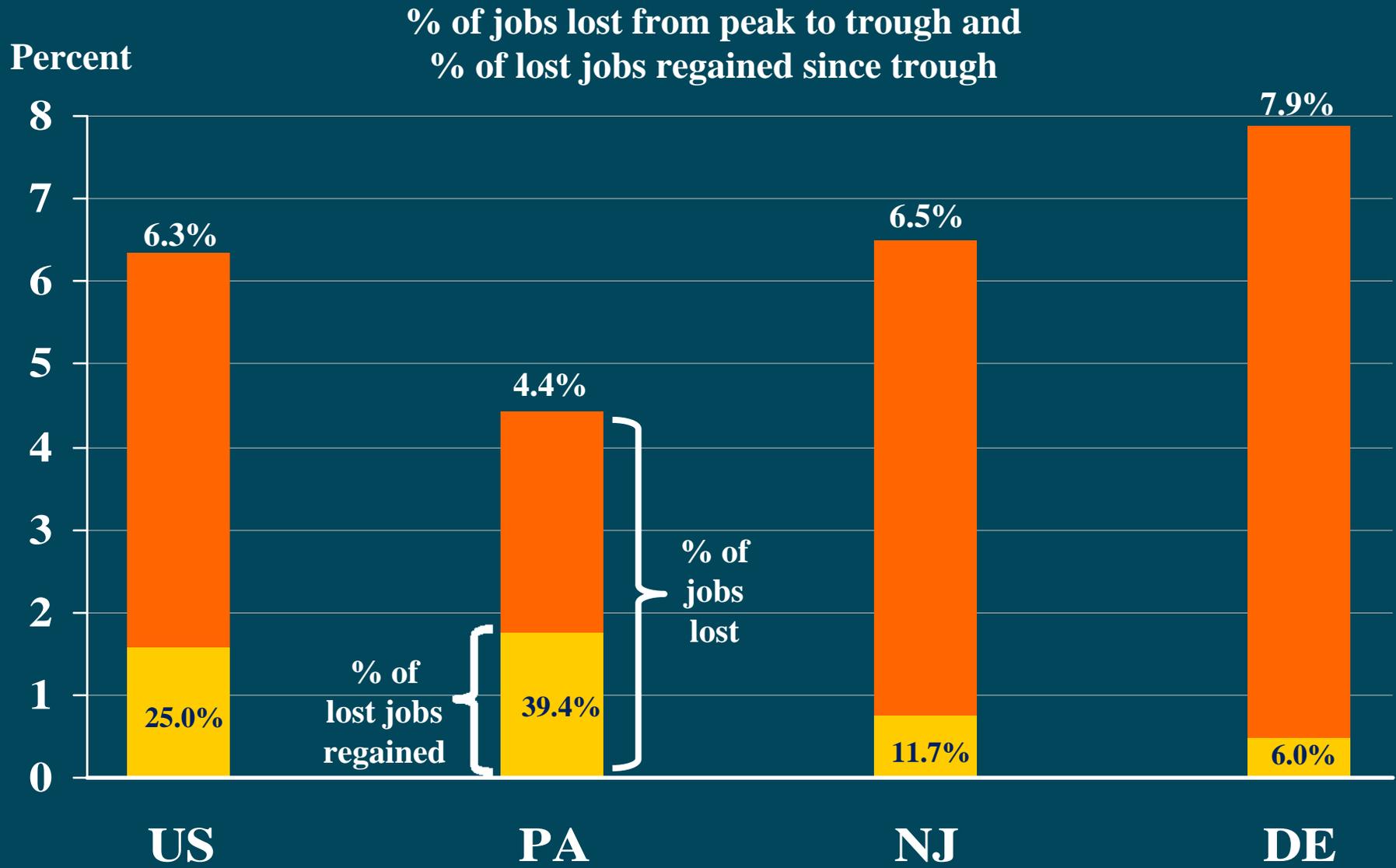
Trough  
Mar 1991  
Nov 2001  
Jun 2009

Months Since Recovery Began



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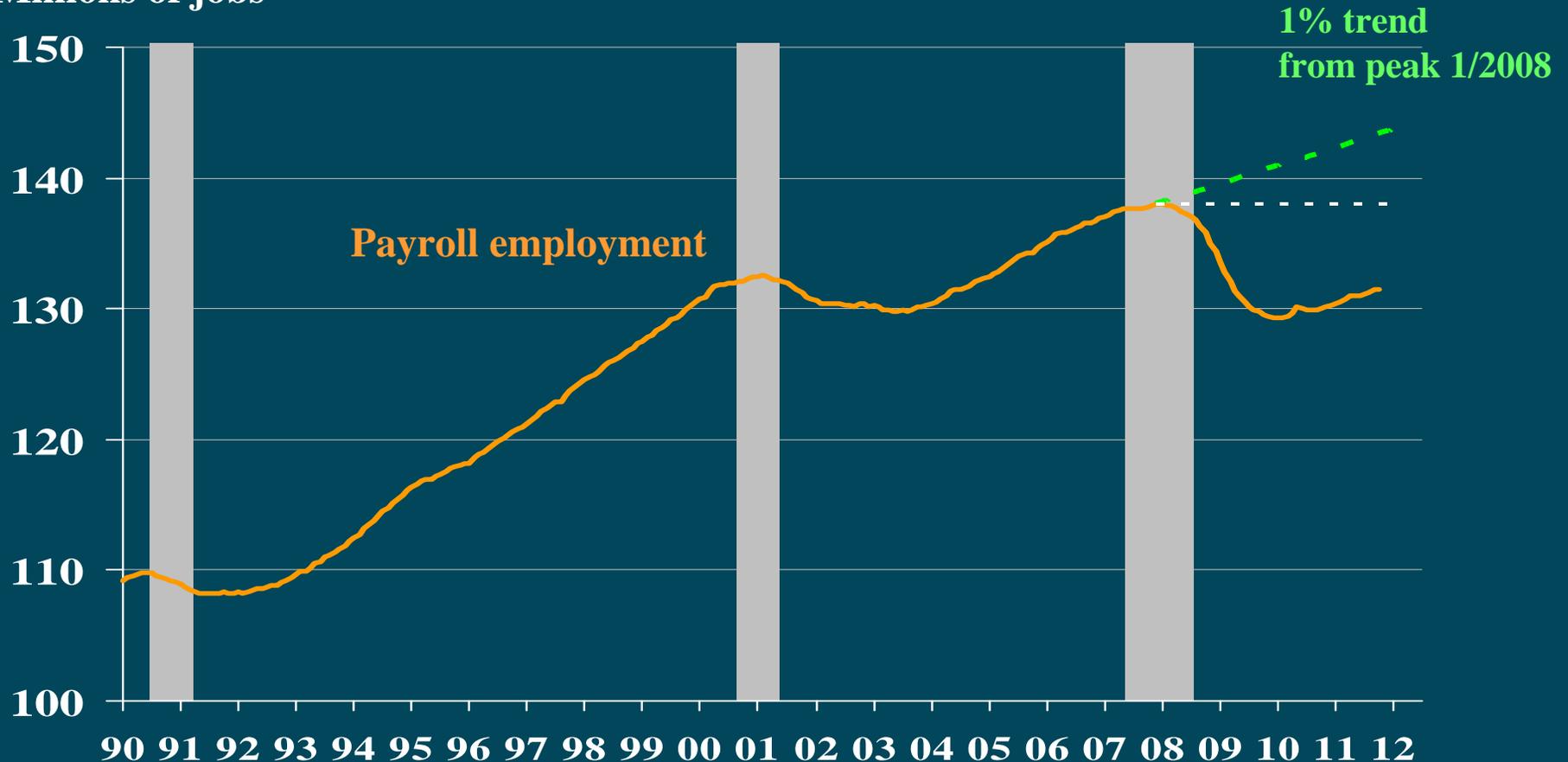
# Pennsylvania is doing better than the nation, New Jersey, and Delaware in terms of recovering lost jobs



Incorporates September 2011 data

**Payrolls are nearly 5 percent below their peak, a net loss of over 6 million jobs.  
At the current pace of job creation it will take 4 years to make up those losses.  
If job creation speeds up to what it was earlier this year, it will take 2-1/2 years.**

Millions of jobs



Monthly data: Last data point plotted is October 2011

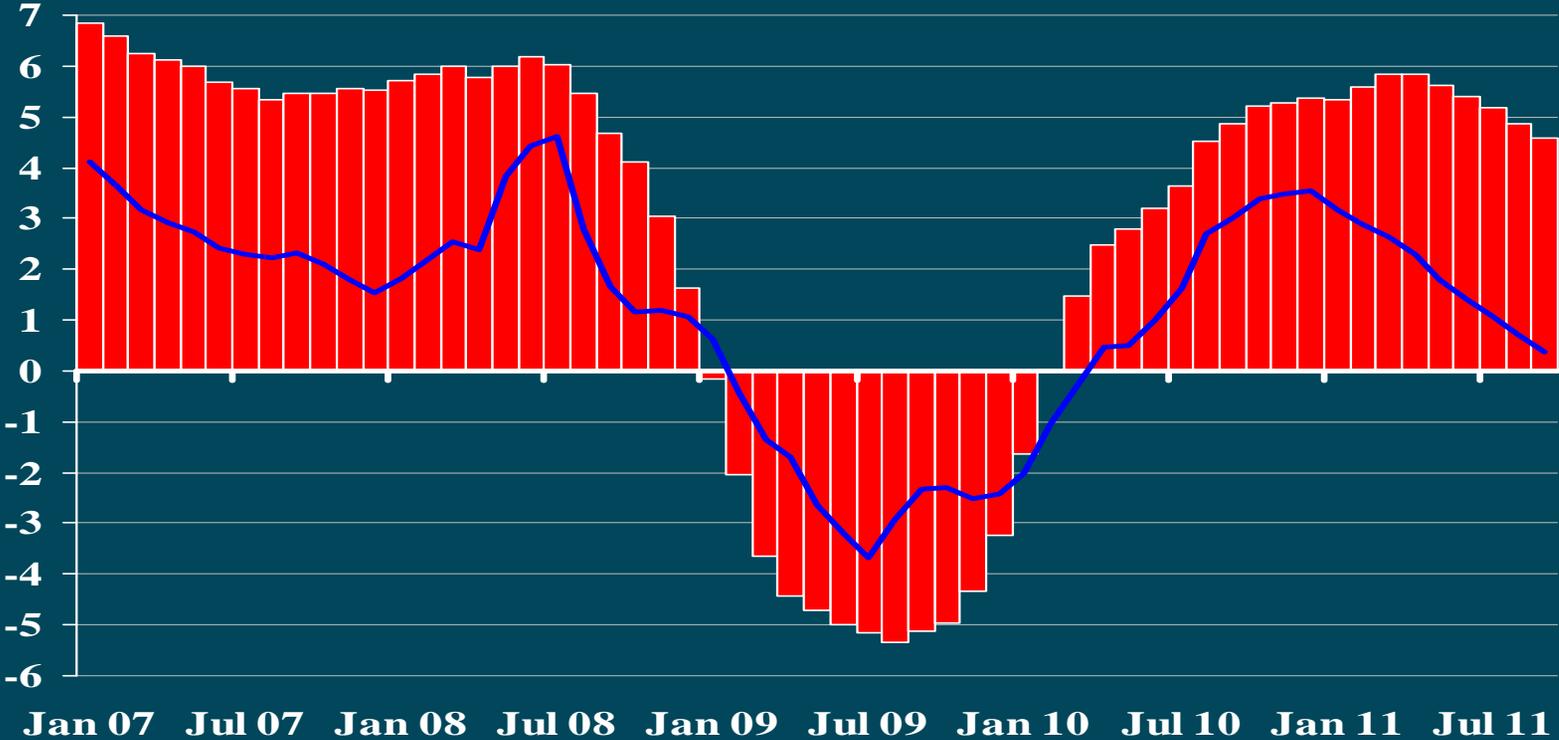


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# Personal income growth has weakened over the past three months

Year over year growth in  
**personal income** and **real disposable income**  
(3-month moving average)

Percent



Monthly data: Last point plotted is September 2011



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# Retail sales have held up, despite weak income growth and low consumer confidence

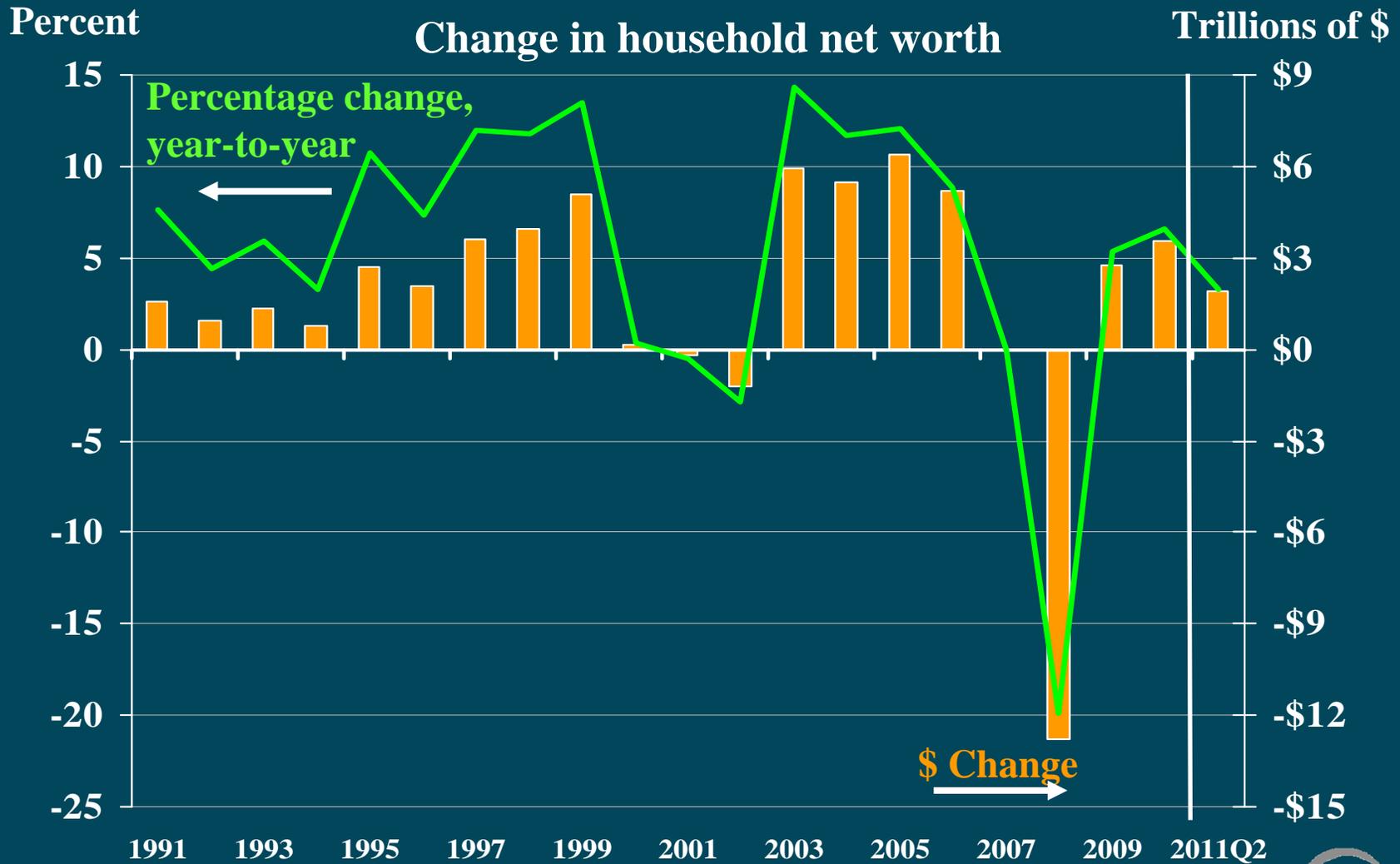


Monthly data: Last point plotted is October for retail sales  
and September for sales excl. autos, gas, and building materials



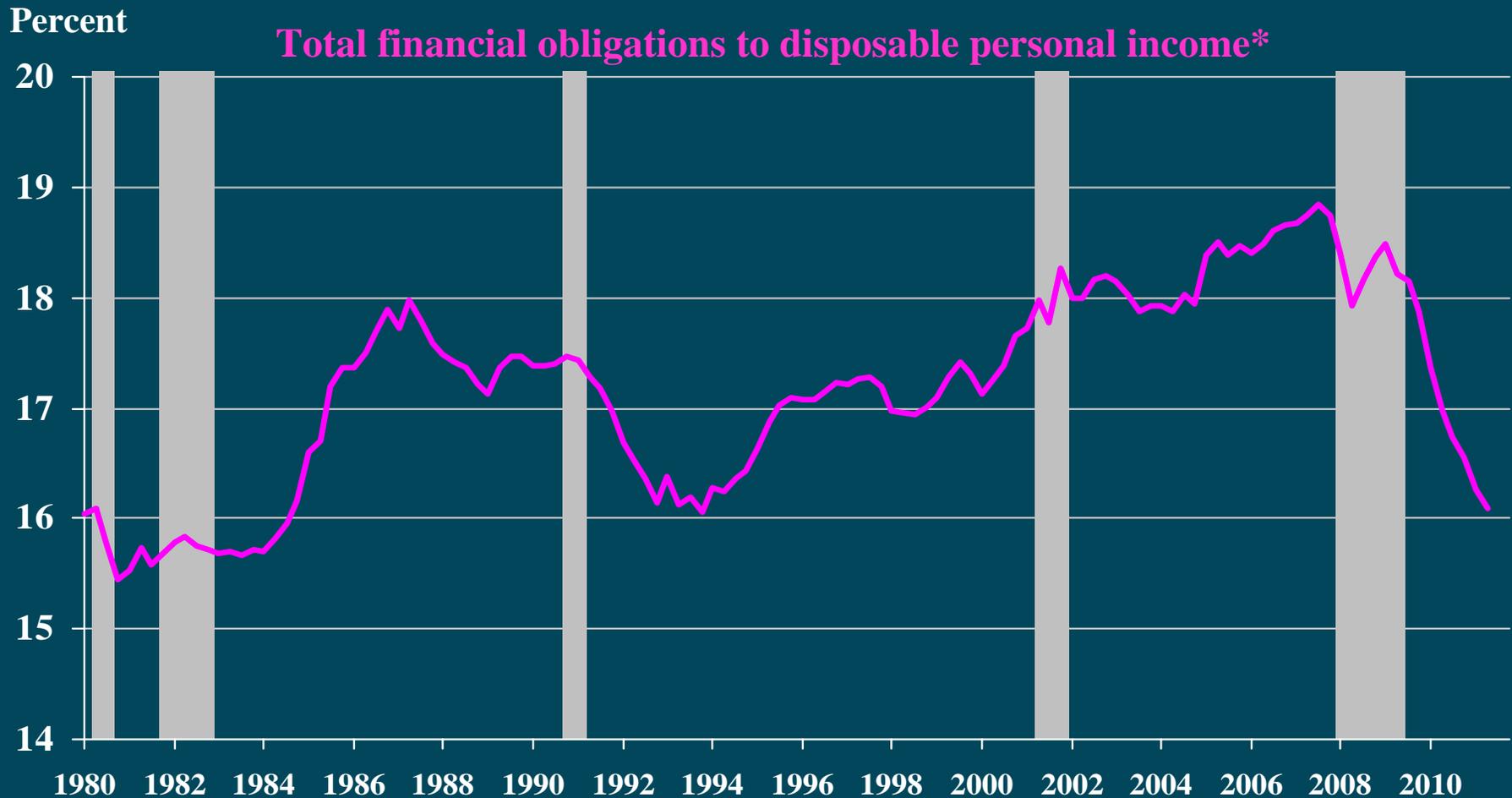
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# Household net worth continues to recover after the sharp contraction in 2008



Source: FRB Flow of Funds, annual data for 1990-2010; 2011Q2 is year-to-date, annualized

## Households' debt service burdens continue to fall. This partly reflects low interest rates.



Quarterly data: Last point plotted is 2011 Q2  
Source: Federal Reserve Board

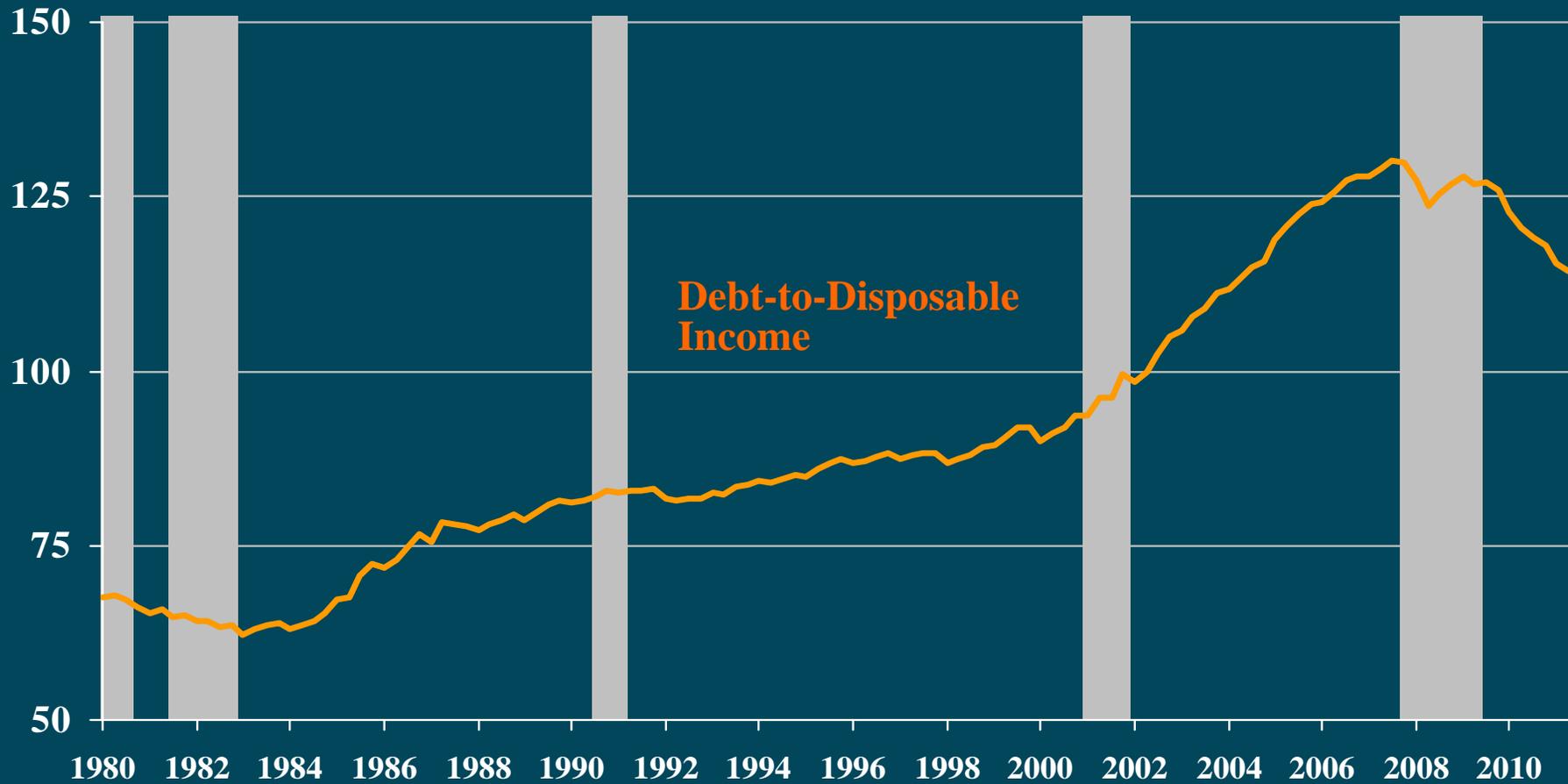
\*Includes payments on mortgage debt, consumer debt, auto leases, rental properties, homeowners insurance, and property taxes.



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## Household debt-to-disposable income is falling

Percent



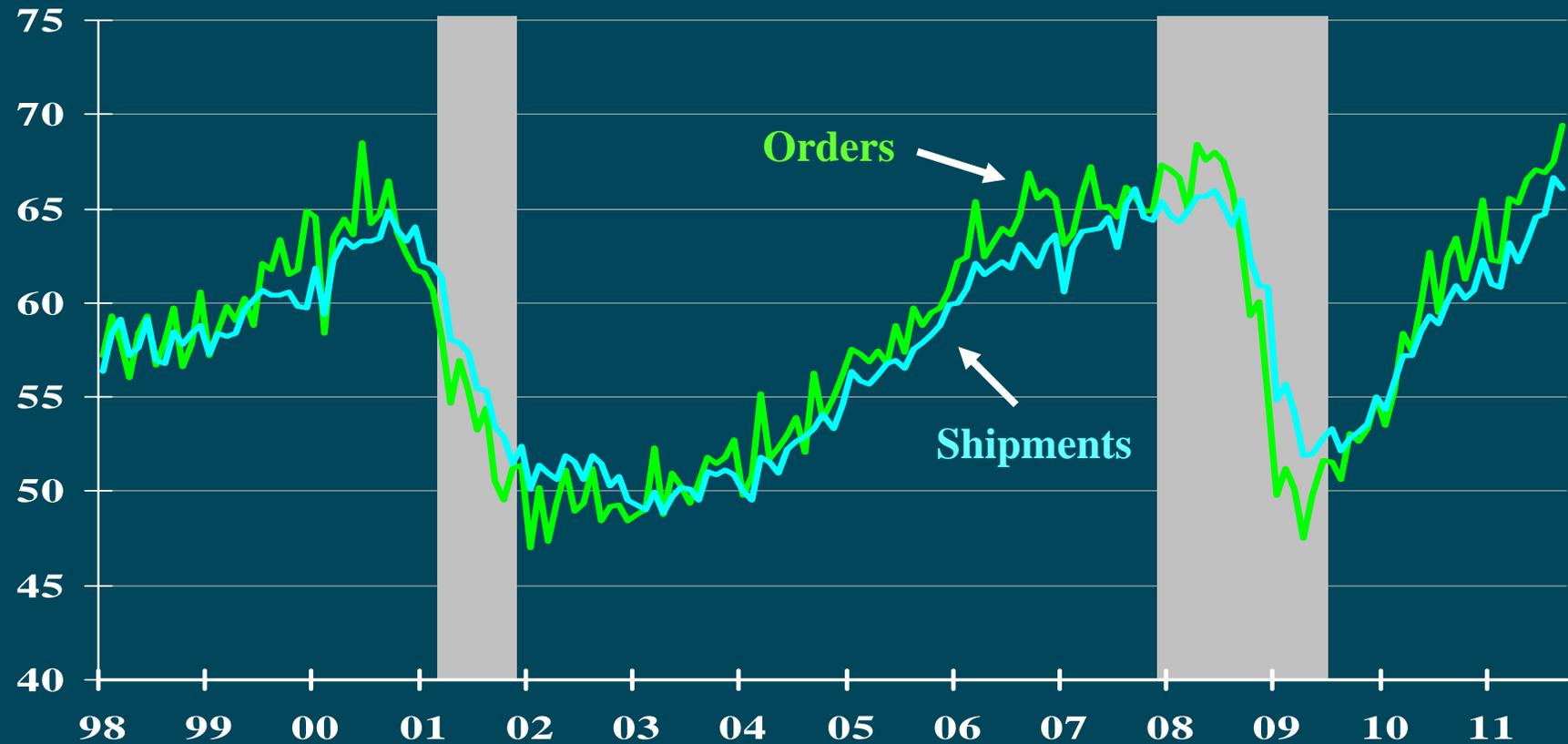
Quarterly data: Last point plotted is 2011 Q2



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## Business investment in equipment and software has been one of the economy's bright spots

Billions of \$



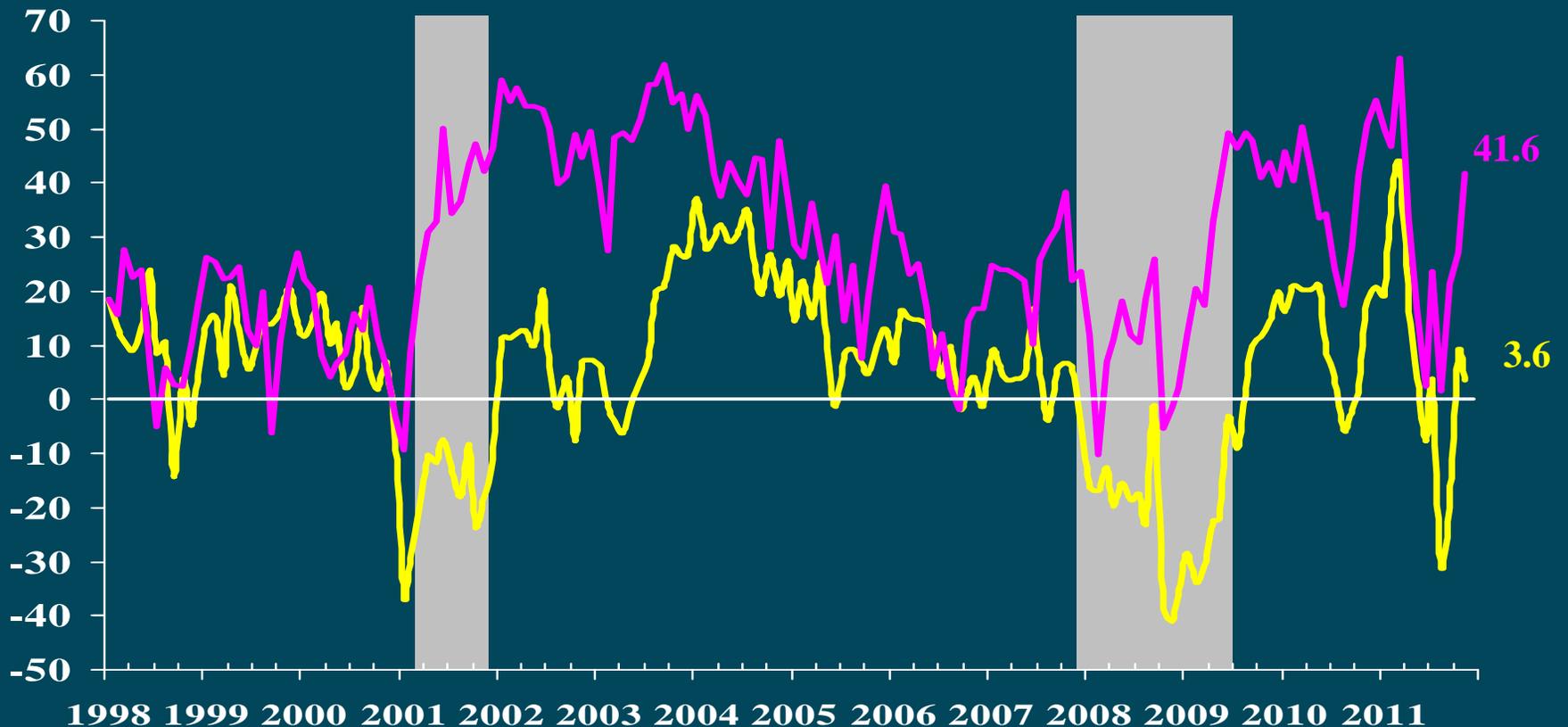
Monthly data: Last point plotted is September 2011



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# Regional manufacturing activity expanded at a modest pace in November and expectations noticeably improved

## Business Outlook Survey: **General Activity Index** **Future General Activity Index**



Index represents percentage of respondents reporting an increase minus percentage reporting a decrease.

Monthly data: Last point plotted is November 2011

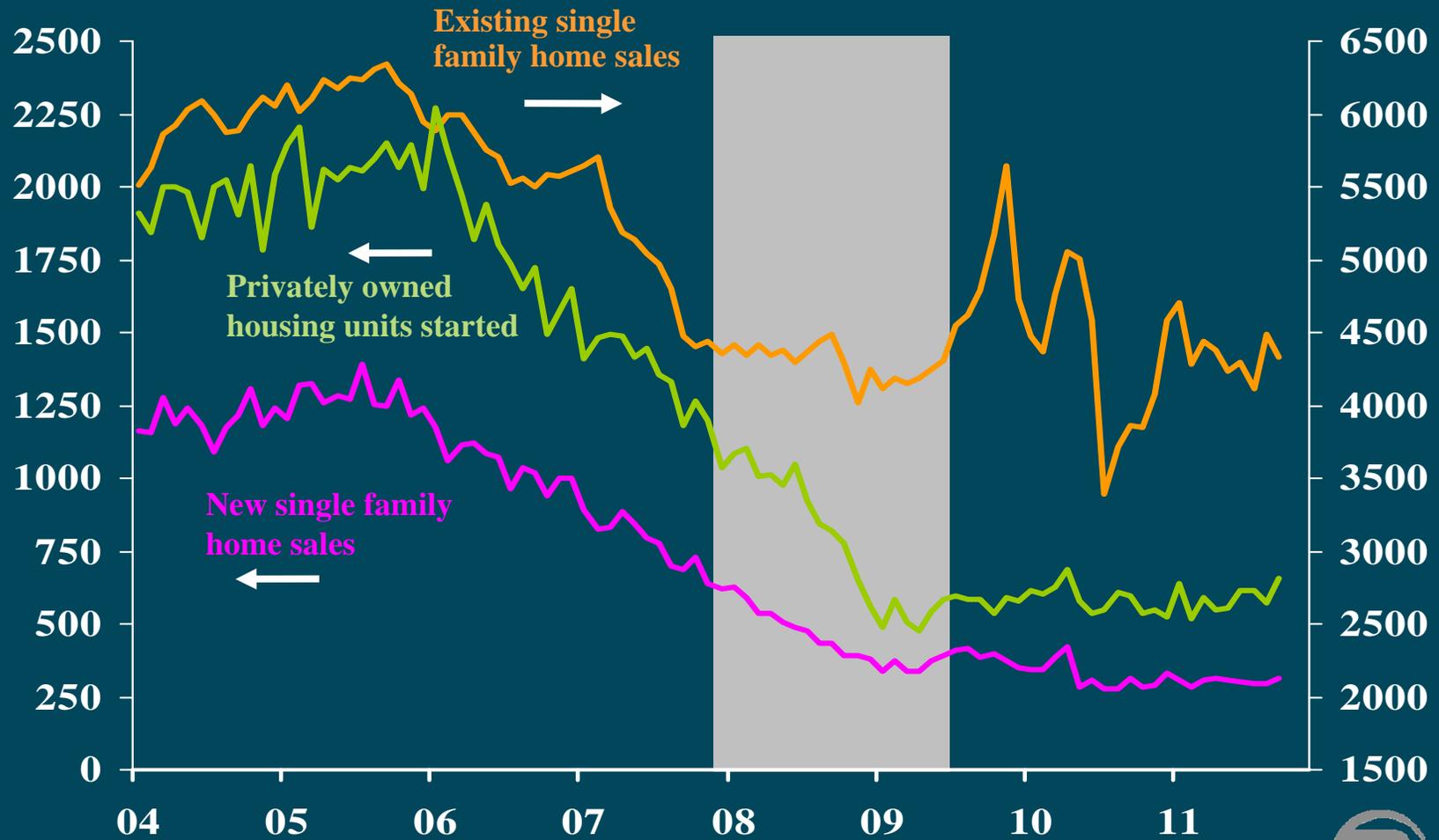


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# The housing sector remains weak but has stabilized

Thousands of units

Thousands of units



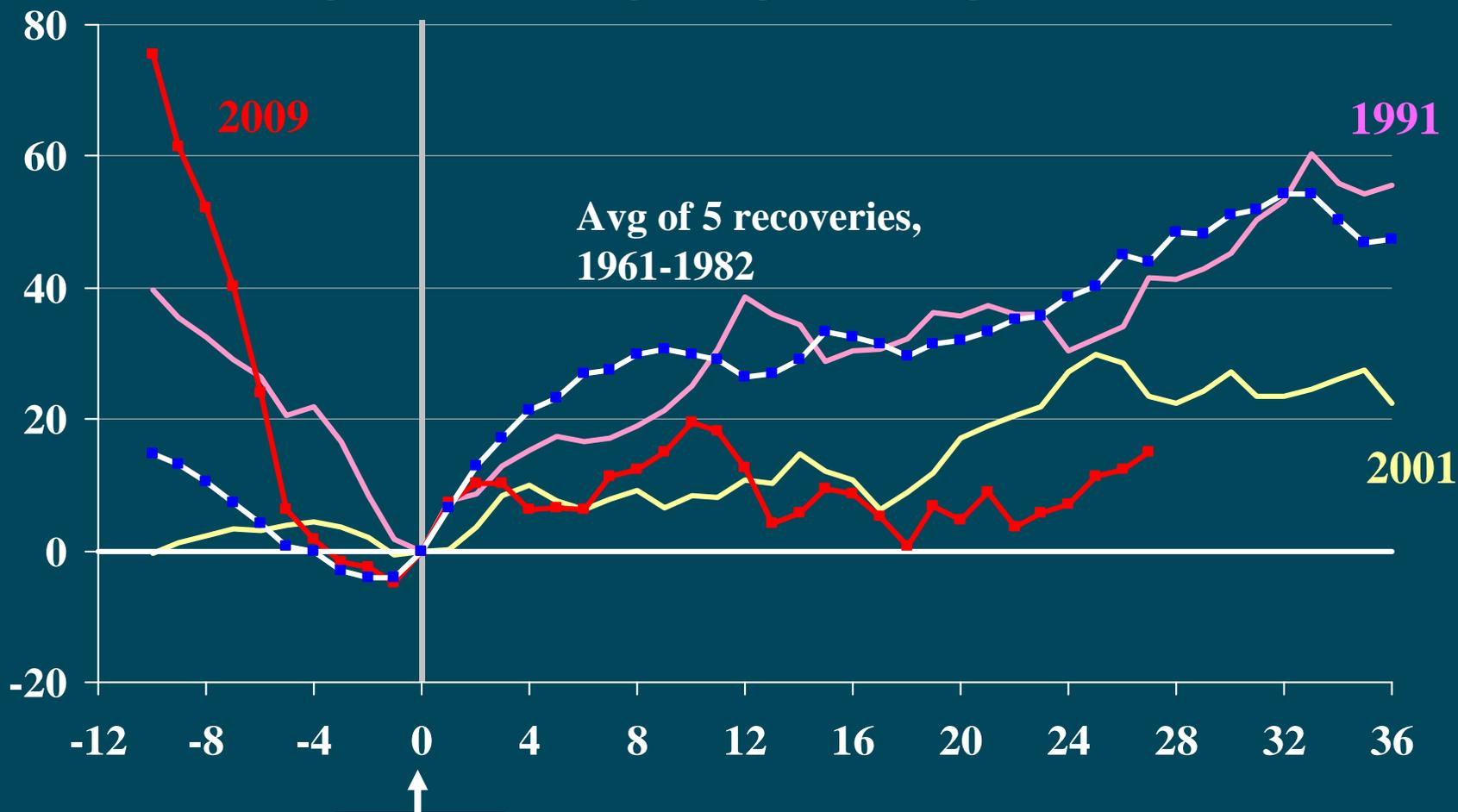
Monthly data: Last point plotted is September 2011



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# Housing is considerably weaker in this recovery than in earlier ones

Cumulative % change in 3-mo moving average of housing starts since start of recovery



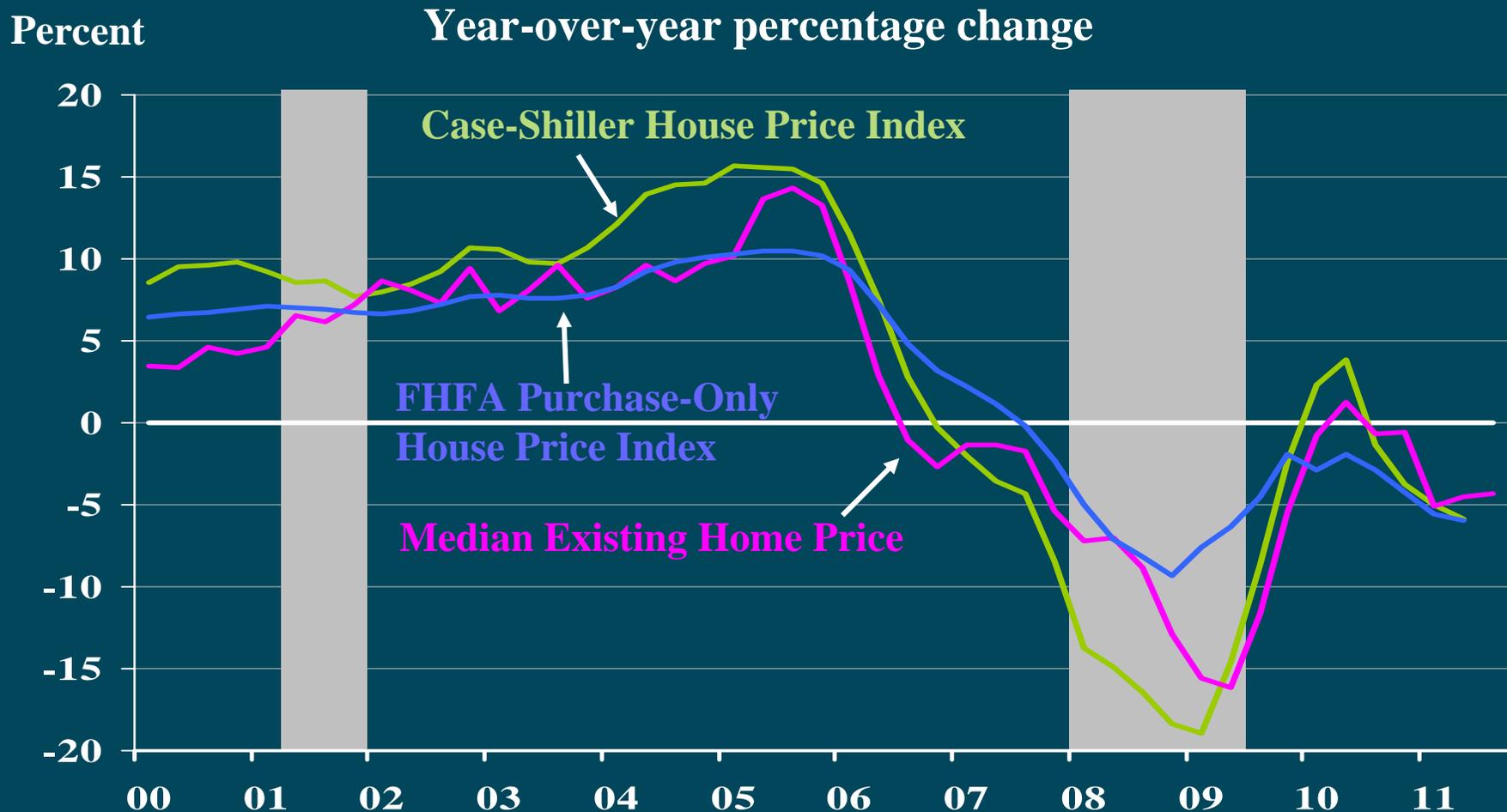
↑  
Trough  
Mar 1991  
Nov 2001  
Jun 2009

Months Since Recovery Began



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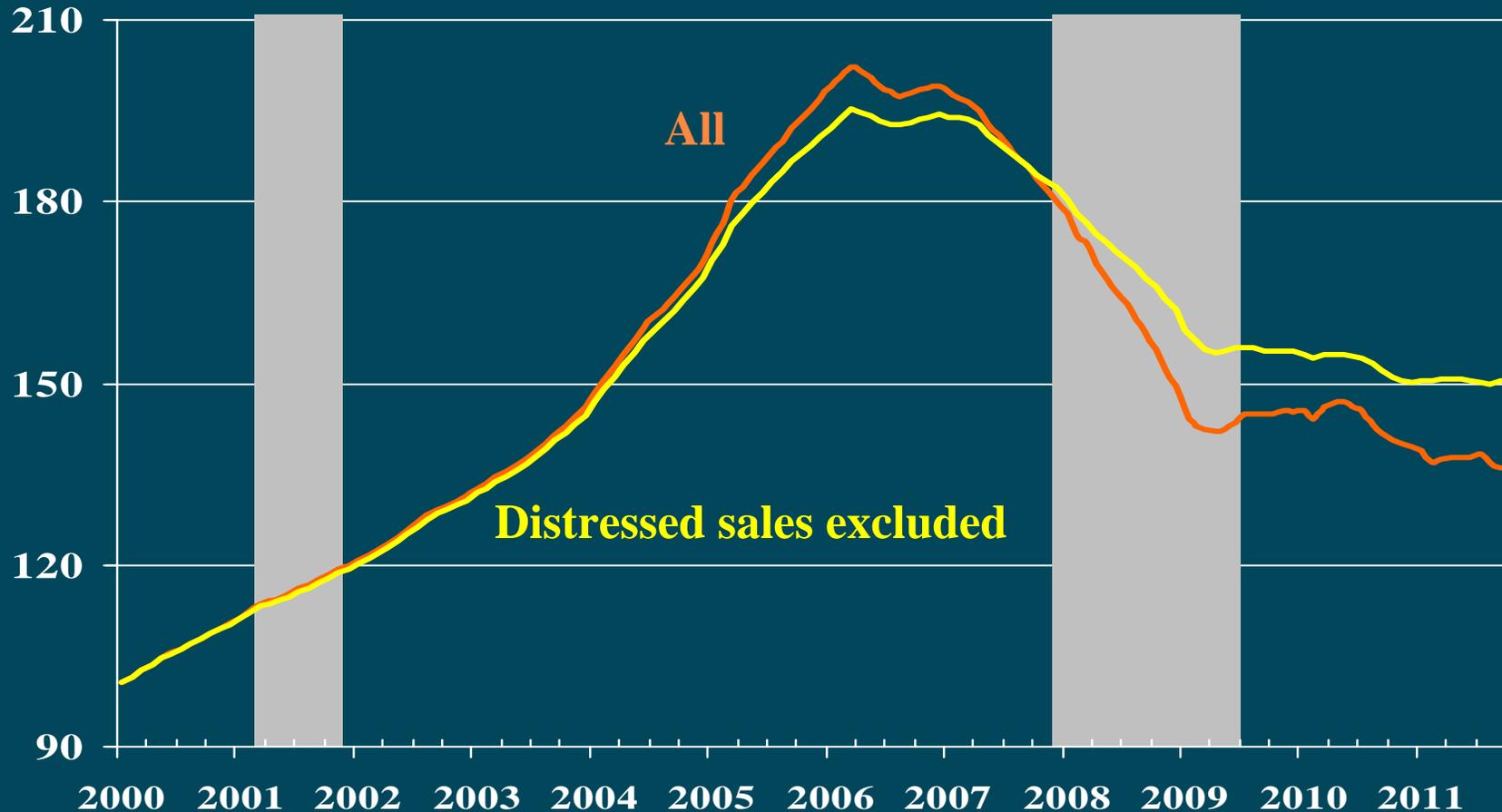
**After stabilizing last year, house prices are falling.  
They are expected to show little or no increase over the year**



Quarterly data: Last point plotted is 2011Q3 for Median Existing and 2011Q2 for Case-Shiller and FHFA

# The recent decline in house prices reflects sales of distressed properties

Index (Jan 2000=100)



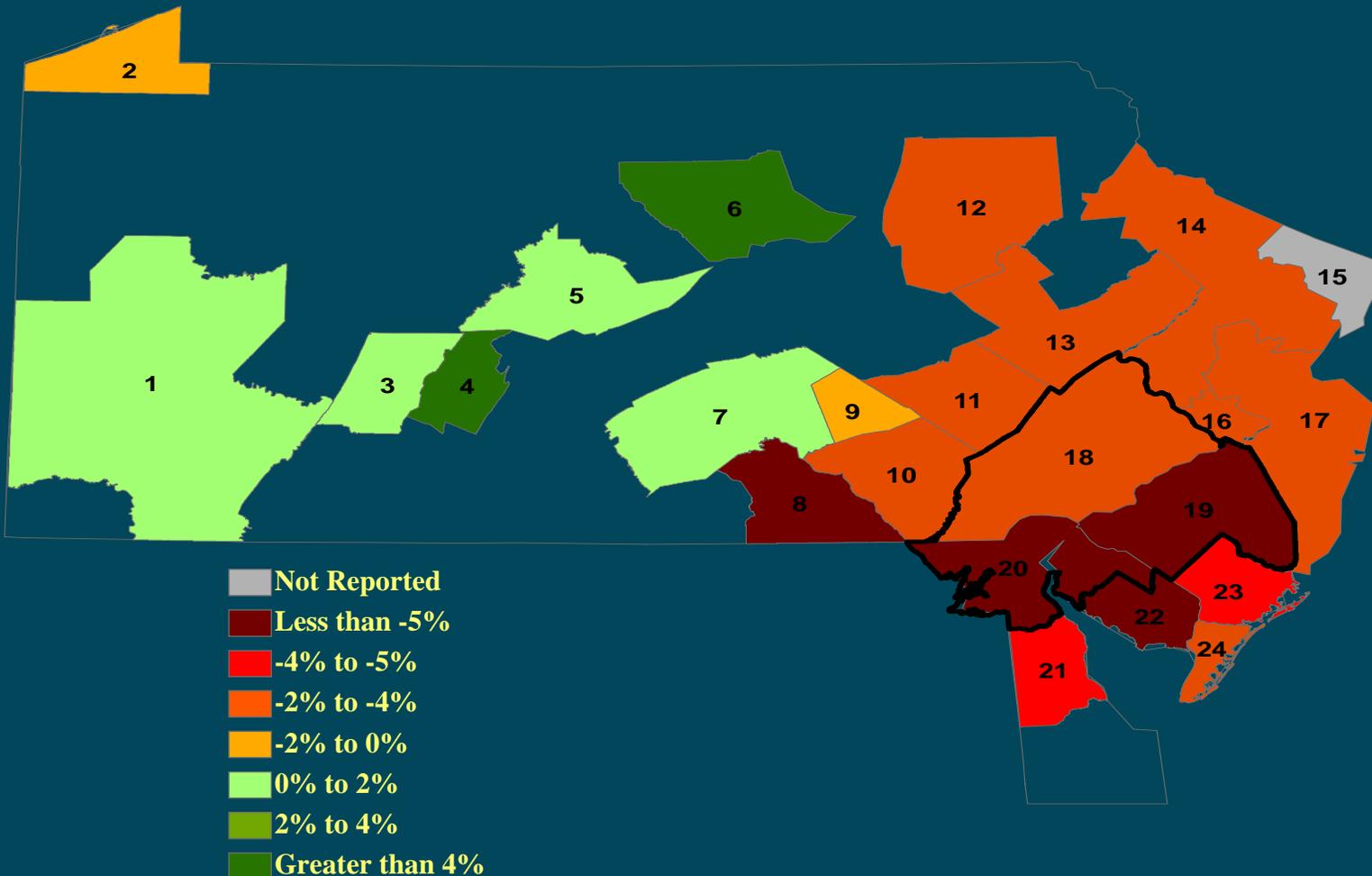
Source: CoreLogic/Haver  
Last point plotted: September 2011



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## House prices are firming in the western and central portions of Pennsylvania but continue to fall elsewhere in the district

One-Year Change in FHFA House Price Index For Metro Areas (as of 2011 Q2)

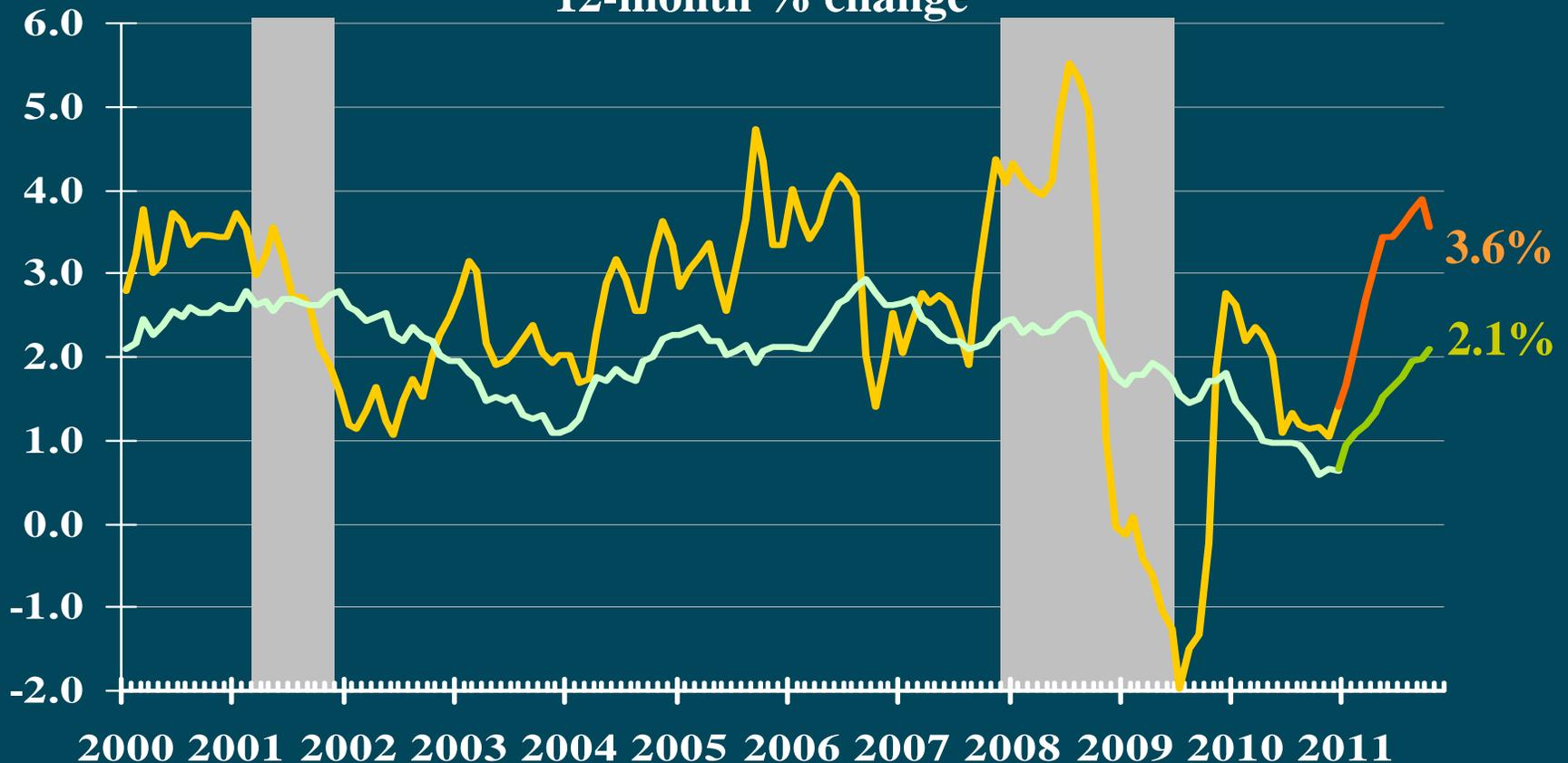


1- Pittsburgh, 2- Erie, 3- Johnstown, 4- Altoona, 5- State College, 6- Williamsport, 7- Harrisburg-Carlisle, 8- York-Hanover, 9- Lebanon, 10- Lancaster, 11- Reading, 12- Scranton-Wilkes-Barre, 13- Allentown-Bethlehem-Easton, 14- Newark-Union, 15- Bergen-Passaic-Hudson, 16- Trenton-Ewing, 17- Edison, 18- Philadelphia, 19- Camden, 20- Wilmington, 21- Dover, 22- Vineland-Millville-Bridgeton, 23- Atlantic City, 24- Ocean City

# Total inflation moved down in October but remains at a high level

## Total CPI Inflation and Core CPI Inflation 12-month % change

Percent



Monthly data: Last month plotted is October 2011

# Financial markets have been extremely volatile as investors focus on the fiscal situation in Europe

NASDAQ &  
S&P 500

Dow Jones

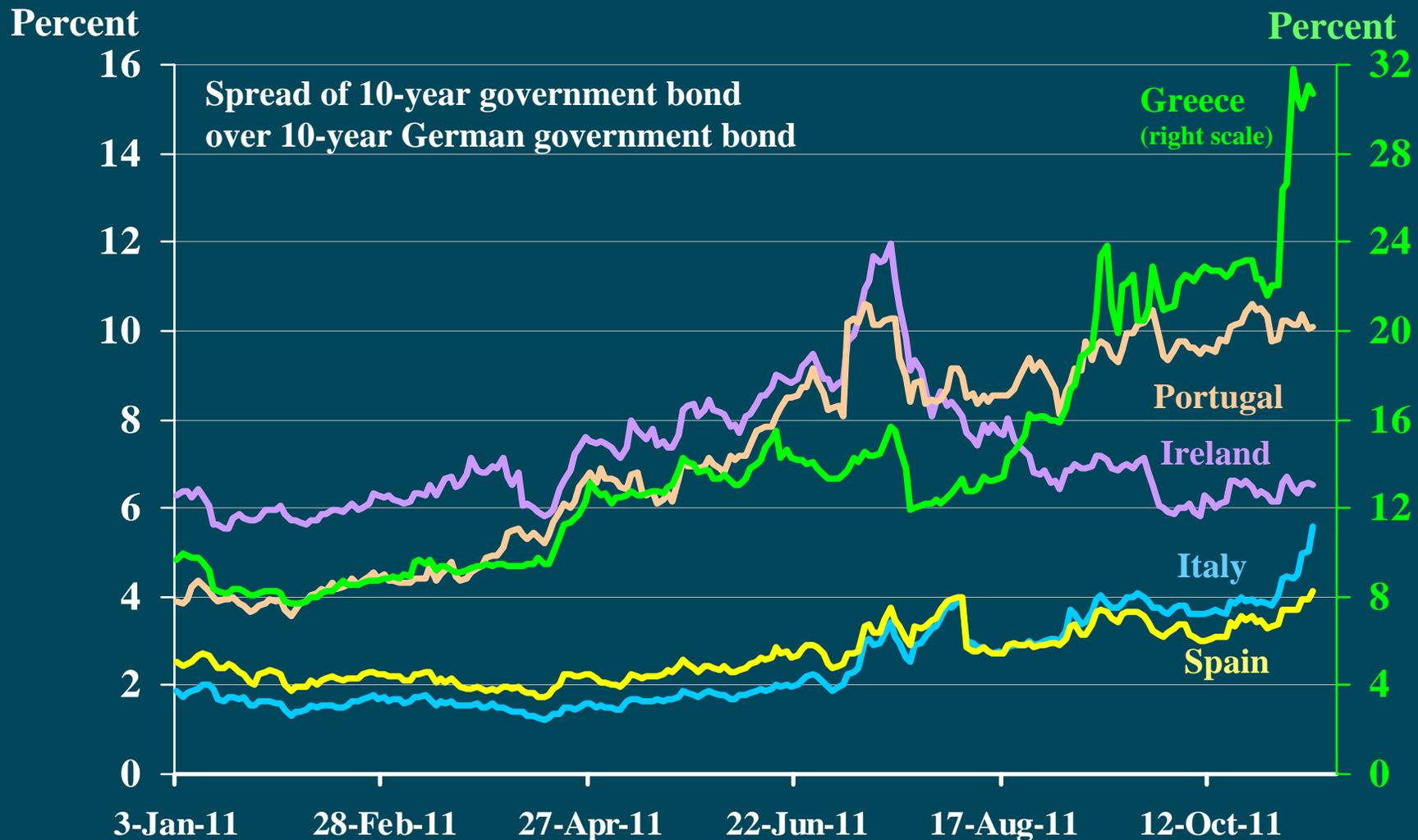


Daily data: Last point plotted is November 15, 2011



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# The sovereign debt problems in Europe are a risk to the forecast. European banks, which hold sovereign debt, are under stress.



Daily: Last point plotted is November 9, 2011

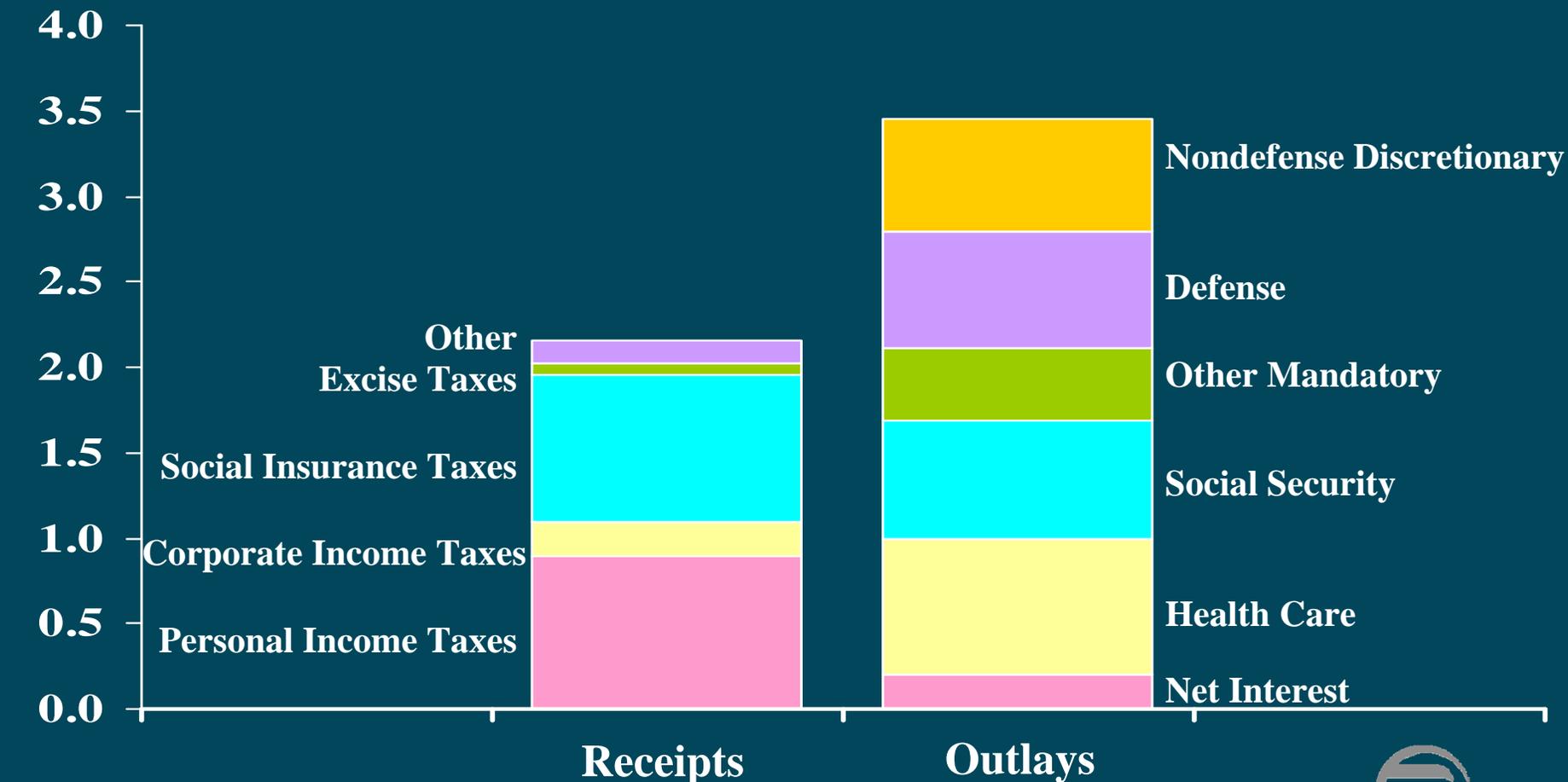


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# The Congressional super committee's deadline to agree on a plan to cut the federal budget deficit is next Wednesday

## The Federal Budget FY 2010

Trillions of dollars



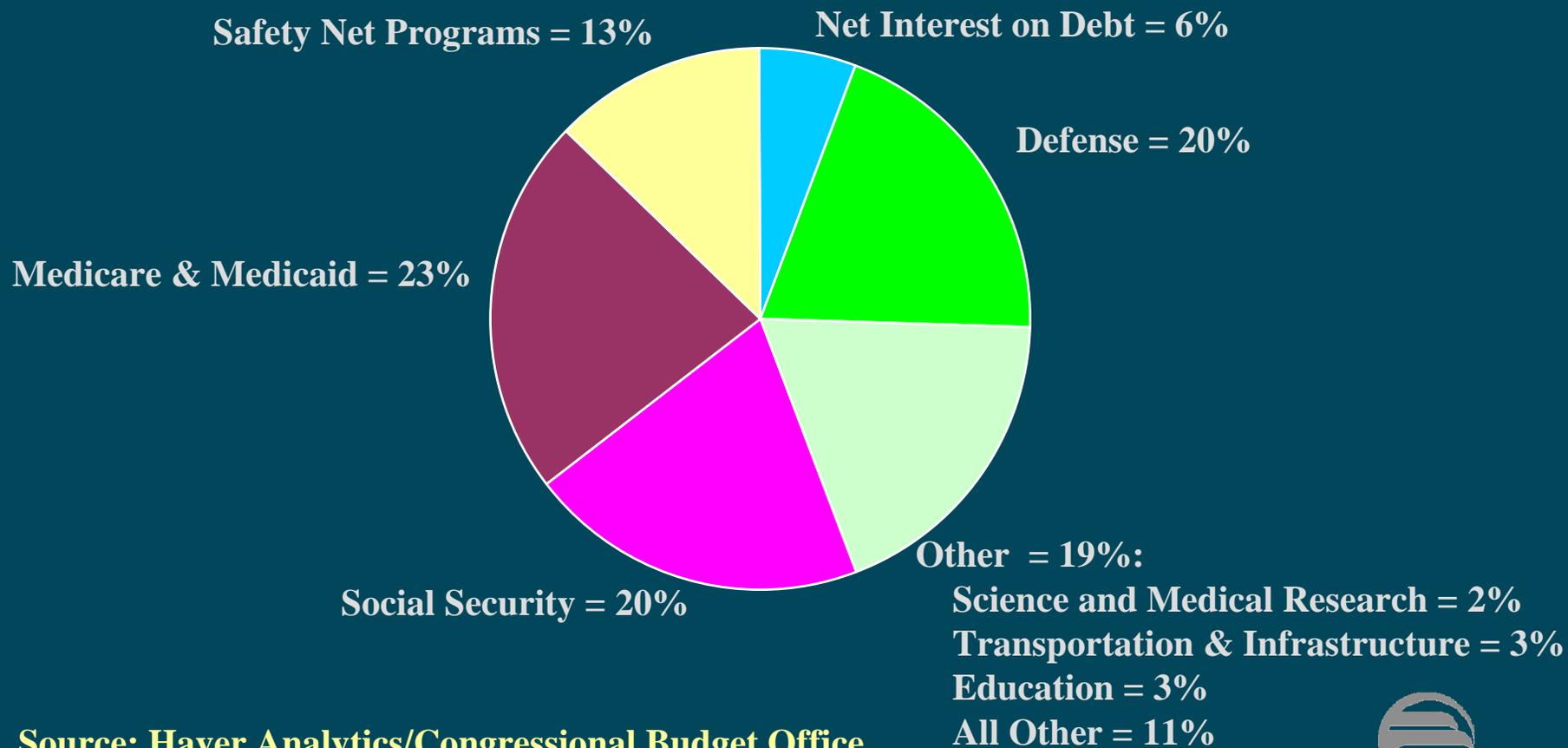
Source: Congressional Budget Office



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**Federal outlays were 24% of GDP in 2010.  
A large share of government expenditures are on  
defense, Social Security, Medicare, and Medicaid.**

### 2010 Federal Outlays



**Source: Haver Analytics/Congressional Budget Office  
Items do not sum to 100 due to rounding.**



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