

The Economic Outlook

Newfield National Bank

June 1, 2012

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OF PHILADELPHIA**

***The views expressed here are those of the author and do not necessarily reflect those of the Federal Reserve Bank of Philadelphia or of the Federal Reserve System.**

According to Dante, those who seek to forecast the future are condemned to the fourth ditch of the eighth circle of hell!



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In accordance with the punishment described by Dante...

- Review 2011 economic performance
- Discuss the forecast for 2012 and 2013
- Discuss new steps toward more transparent communication about monetary policy



**We expected the recovery to take hold in earnest in 2011,
with a gradual improvement in labor markets and low inflation**

**Our labor market forecast was about right,
but our growth forecast was too optimistic
and prices accelerated more than expected**

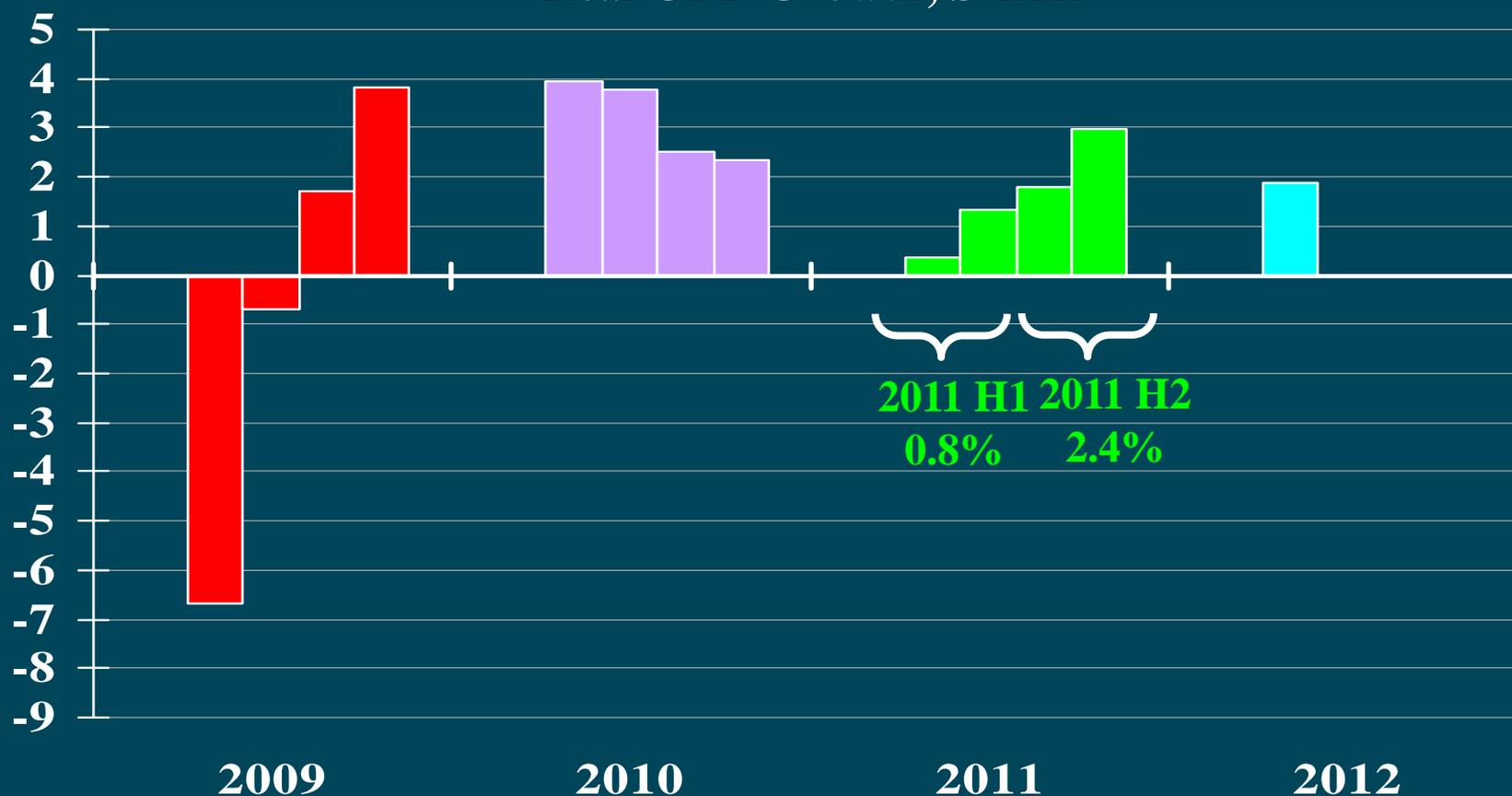
	FOMC Central Tendency in January 2011	Actual for 2011
Real GDP Growth (4Q/4Q)	3.4% to 3.9%	1.6%
Unemployment Rate (4th quarter average)	8.8% to 9.0%	8.7%
Total PCE Inflation (4Q/4Q)	1.3% to 1.7%	2.7%
Core PCE Inflation (4Q/4Q)	1.0% to 1.3%	1.8%



Transitory factors held growth down in the first half of 2011. Growth picked up in the second half.

Percent

Real GDP Growth, SAAR



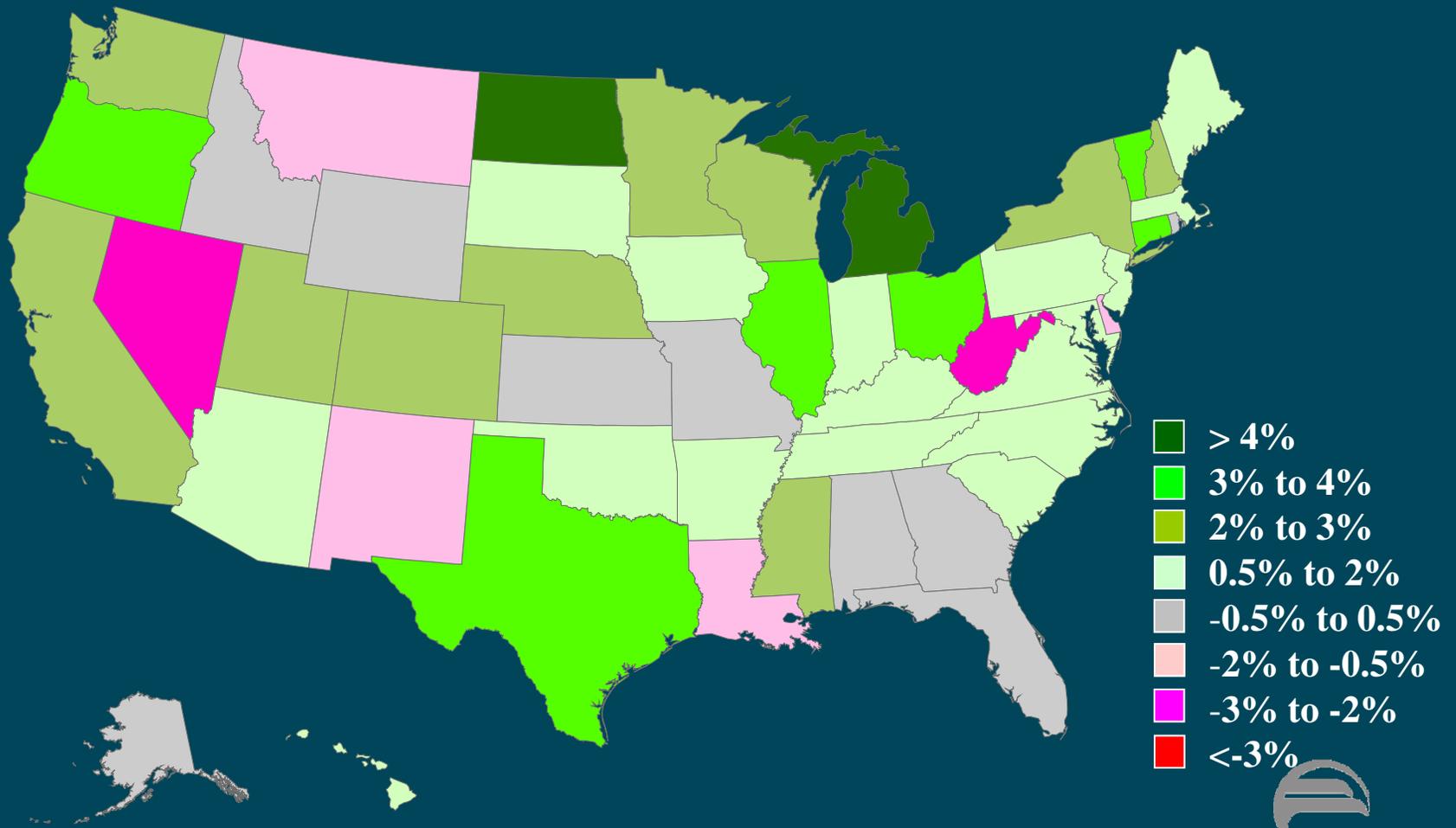
Quarterly data: Last point plotted is 2012Q1



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At the end of 2010, activity was increasing at a modest pace in many states, but was still flat or contracting in several

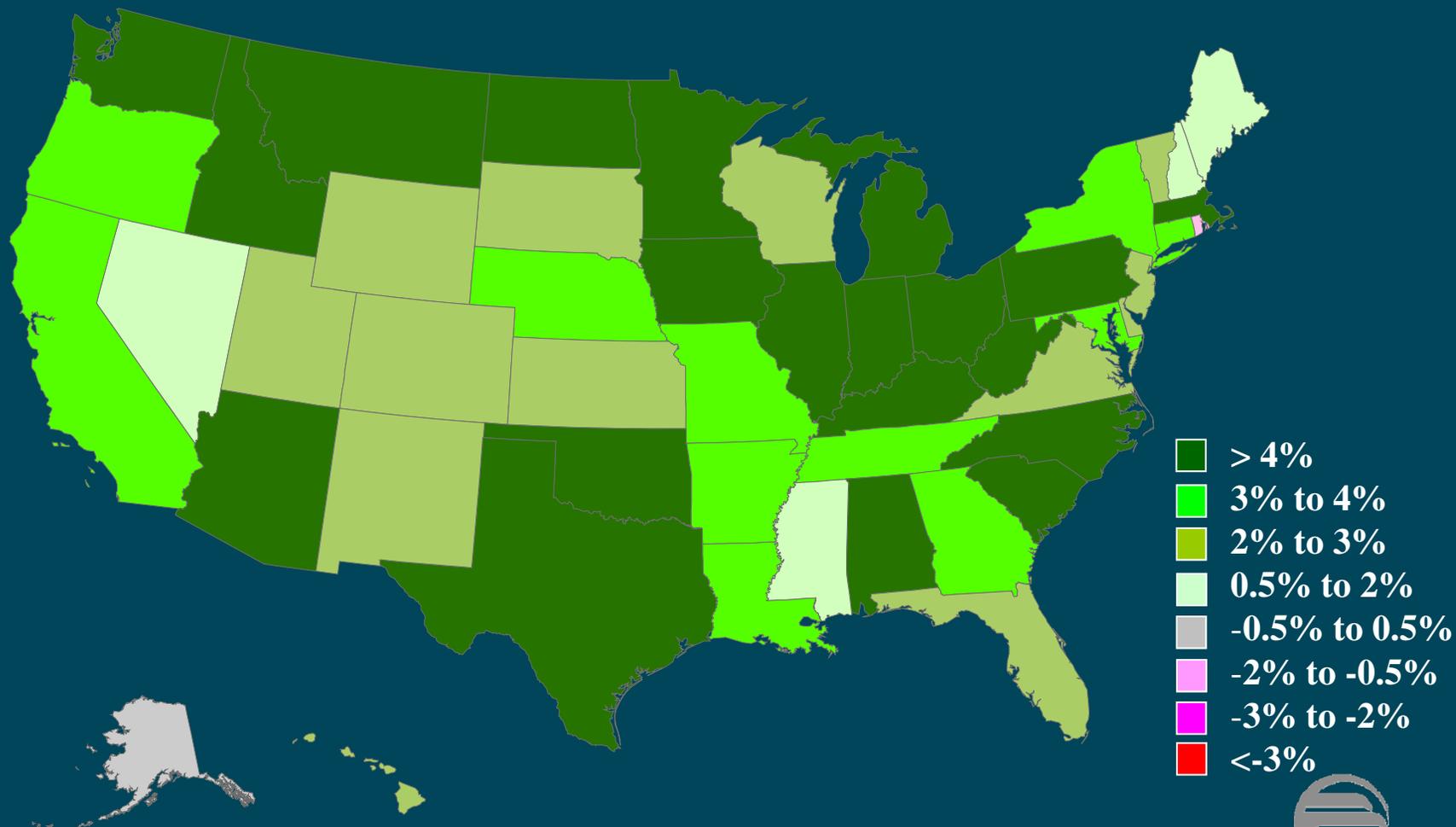
**Philadelphia Fed Current Economic Activity Indexes,
annualized growth over the three months ending in December 2010**



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By the end of 2011 and beginning of 2012, activity had strengthened in most states

Philadelphia Fed Current Economic Activity Indexes,
annualized growth over the three months ending in April 2012



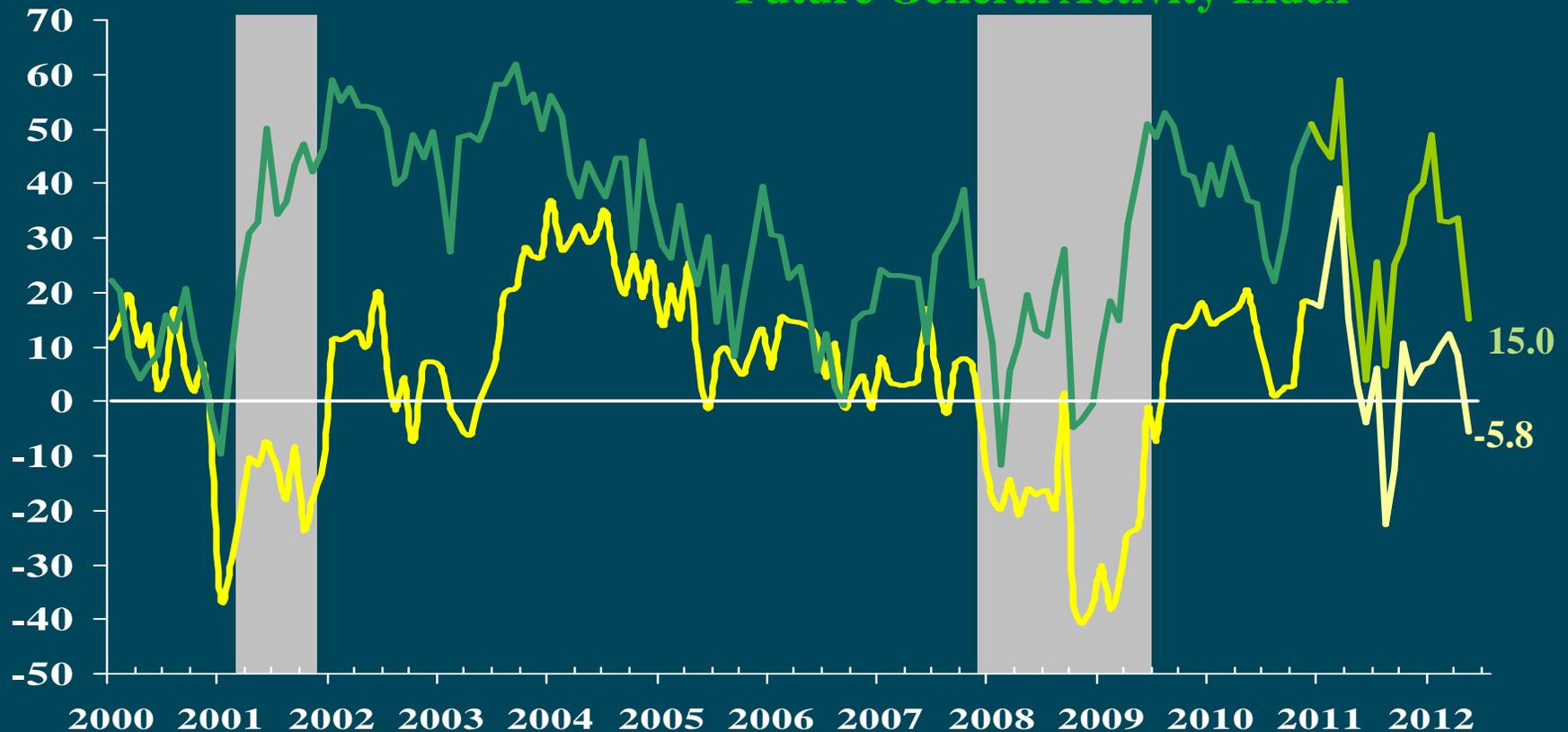
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Business investment in equipment and software was an economic strength, supported by strong corporate profits.

The natural disasters in Japan disrupted supply chains. Manufacturing activity was hurt but recovered later in the year.

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 May 2012.

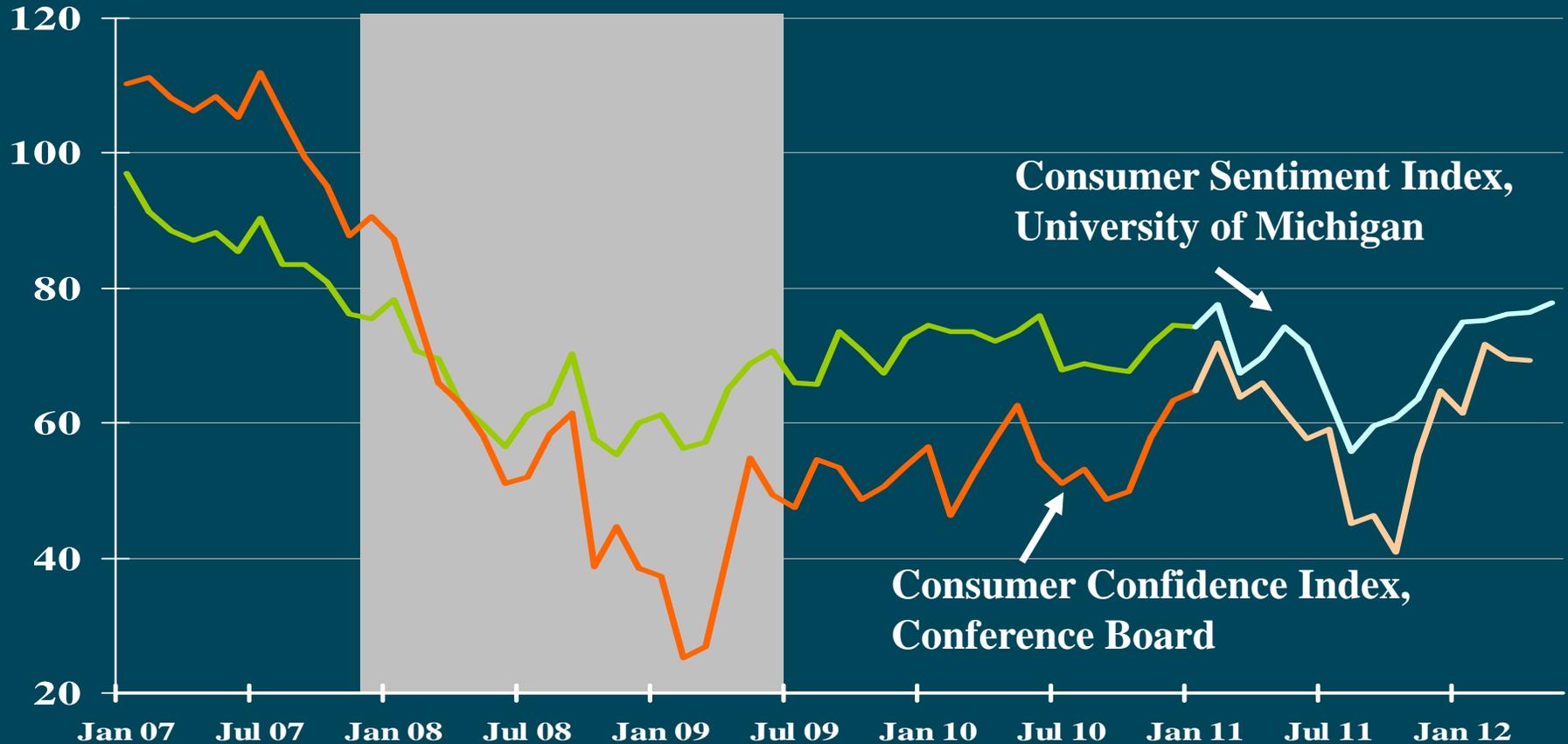


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Consumer sentiment plunged last summer but has rebounded consistent with improving labor market conditions

Sentiment index, 66Q1 = 100

Confidence index, 1985 = 100



Monthly data: Last point plotted is May 2012 for Consumer Sentiment and April 2012 for Consumer Confidence

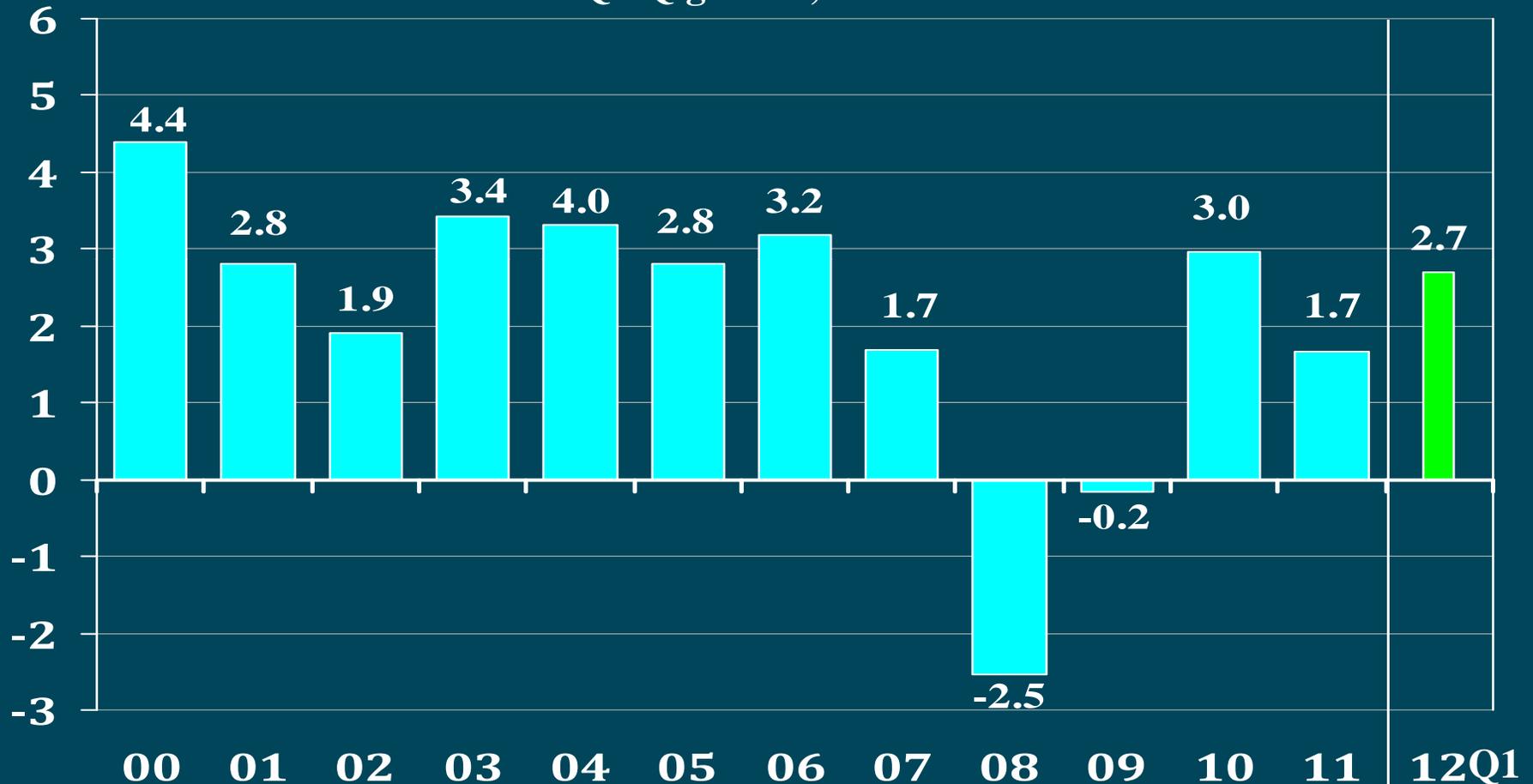


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Despite low consumer confidence and high oil prices, consumer spending held up in 2011 and has so far this year

Real personal consumption 4Q/4Q growth, SAAR*

Percent



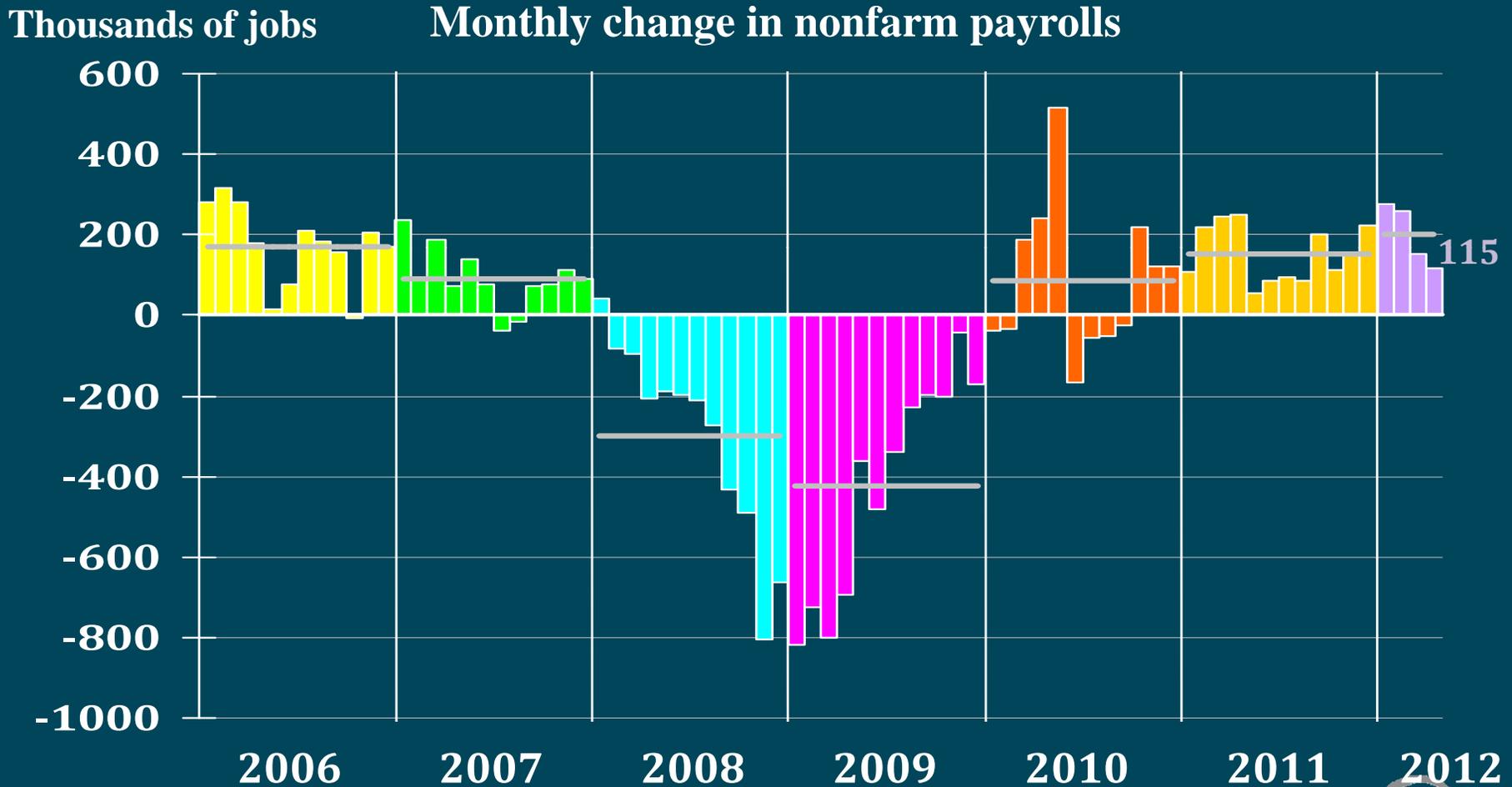
Annual data through 2011, quarterly data for 2012Q1



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Labor market conditions improved in 2011, and have held up this year.

Job gains averaged over 150 thousand per month last year
and about 200 thousand per month so far this year.



Last month plotted is April 2012.

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



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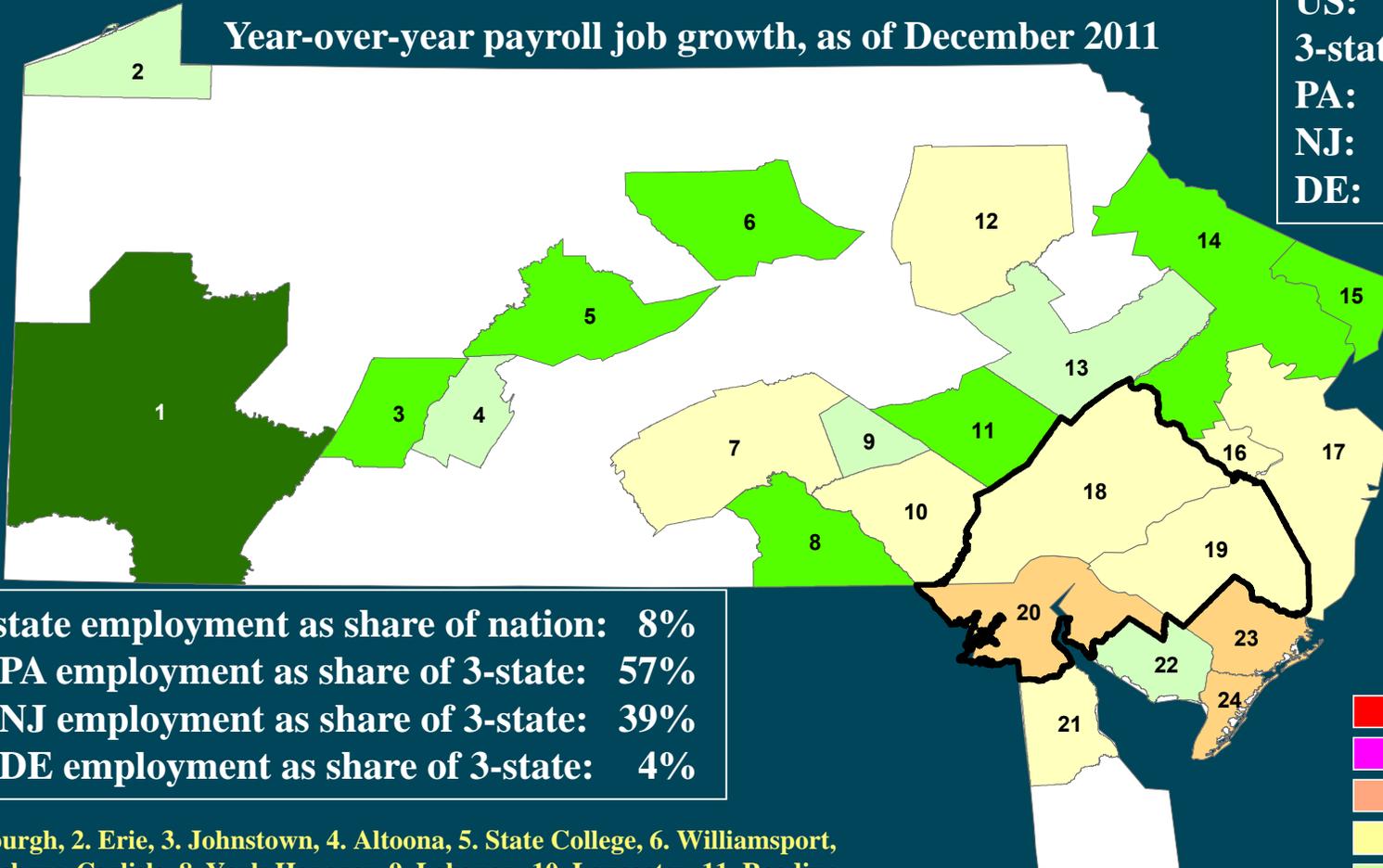
**Employment grew in each of our states, but the pattern was uneven,
with Delaware the weakest.**

PA and NJ lost government jobs last year, as did the nation.

Job growth in 2011

US:	1.4%
3-state:	0.8%
PA:	0.9%
NJ:	0.8%
DE:	0.1%

Year-over-year payroll job growth, as of December 2011

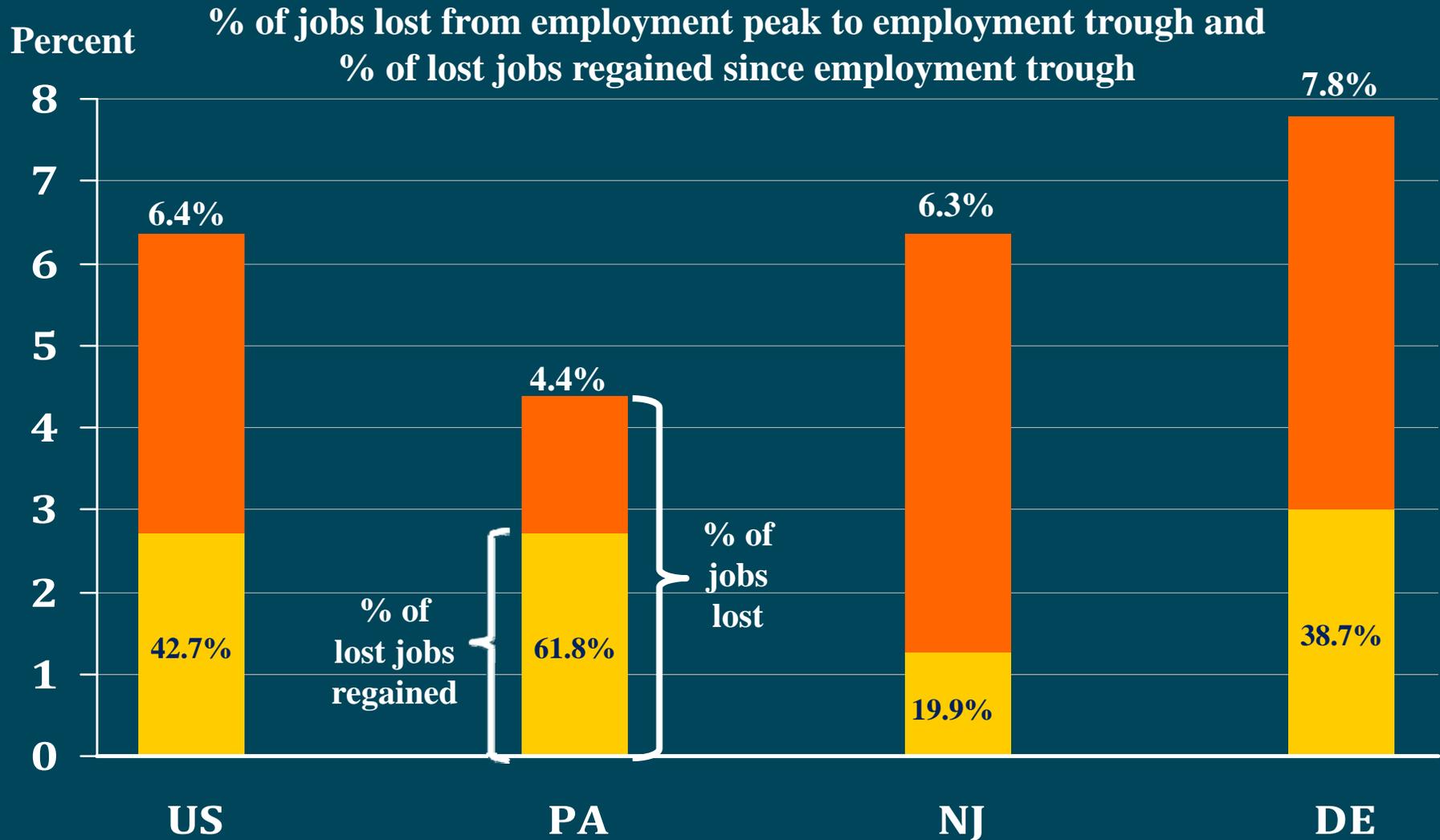


3-state employment as share of nation: 8%
PA employment as share of 3-state: 57%
NJ employment as share of 3-state: 39%
DE employment as share of 3-state: 4%

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



Pennsylvania has made more progress than the nation, New Jersey, and Delaware in terms of recovering lost jobs

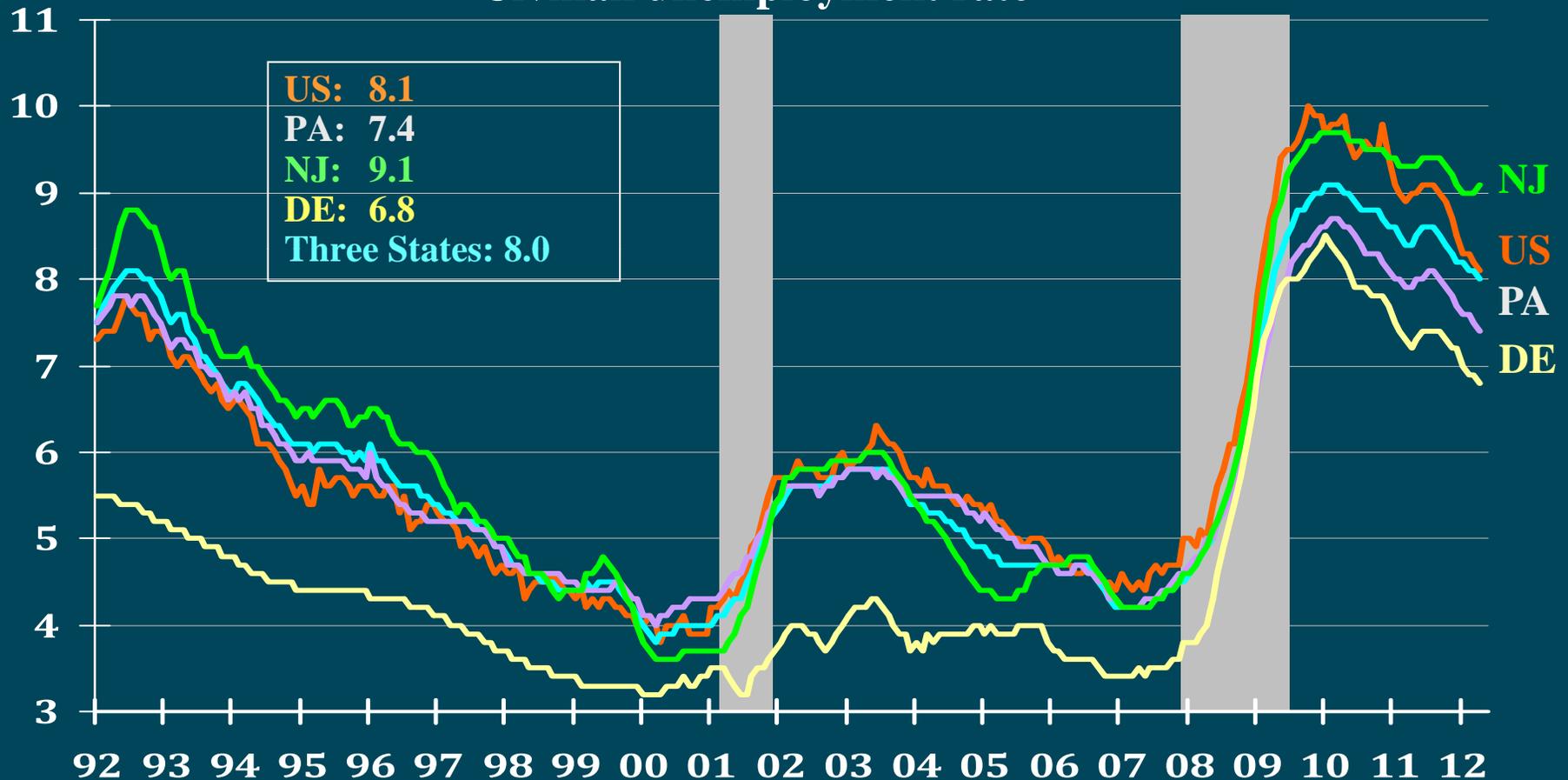


Incorporates April 2012 data

The unemployment rate has fallen significantly in the past year in the nation and in each of our states

Percent

Civilian unemployment rate



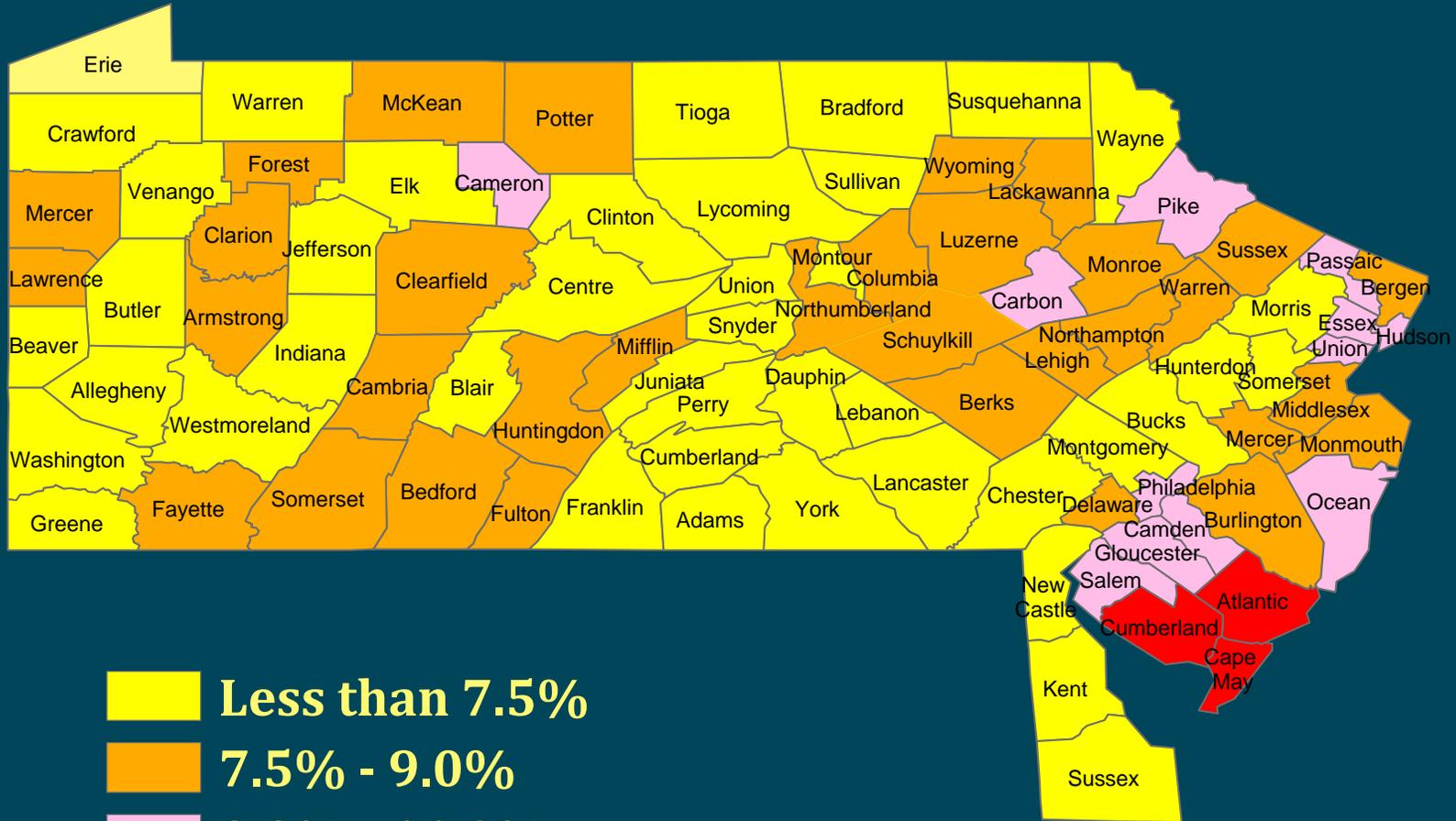
Monthly data: Last point plotted is April 2012



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Unemployment rates vary across the region, with higher rates in south NJ

County Unemployment Rates: March 2012

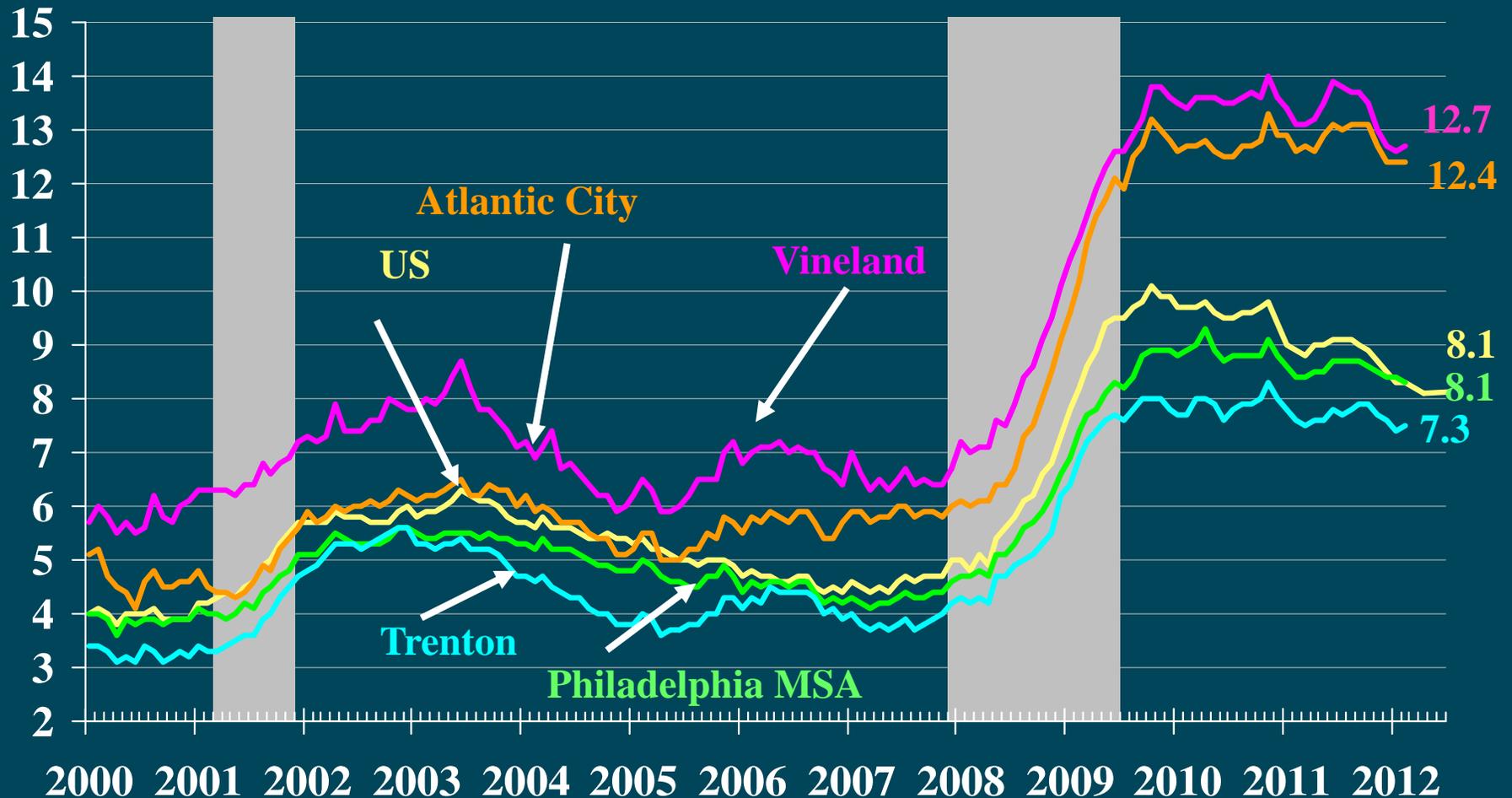


- Less than 7.5%**
- 7.5% - 9.0%**
- 9.0% - 11.0%**
- Greater than 11.0%**



**Unemployment rates are at different levels across the region, which is typical.
They are all down from their recession peaks.**

Percent



Monthly data: Last point plotted is April 2012 for U.S. and March 2012 for regional unemployment rates



The unemployment rate is higher when we include all marginally attached workers and those working part-time for economic reasons, but the trend is the same: both rates are down significantly from their peaks

Percent

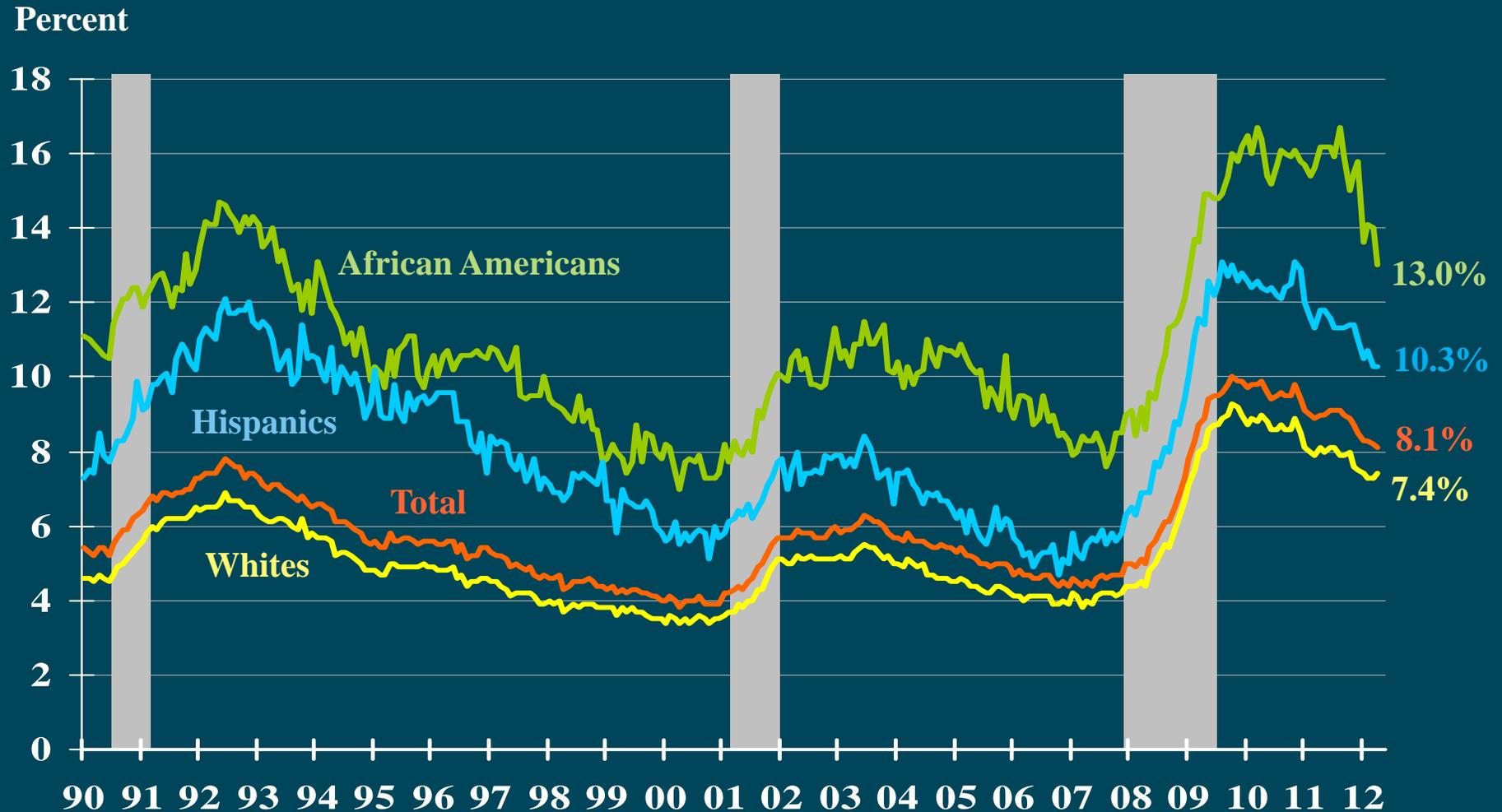


Monthly data: Last point plotted is April 2012



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Unemployment rates differ by race, but all have finally begun to fall



Monthly data: Last point plotted is April 2012

Source: Bureau of Labor Statistics

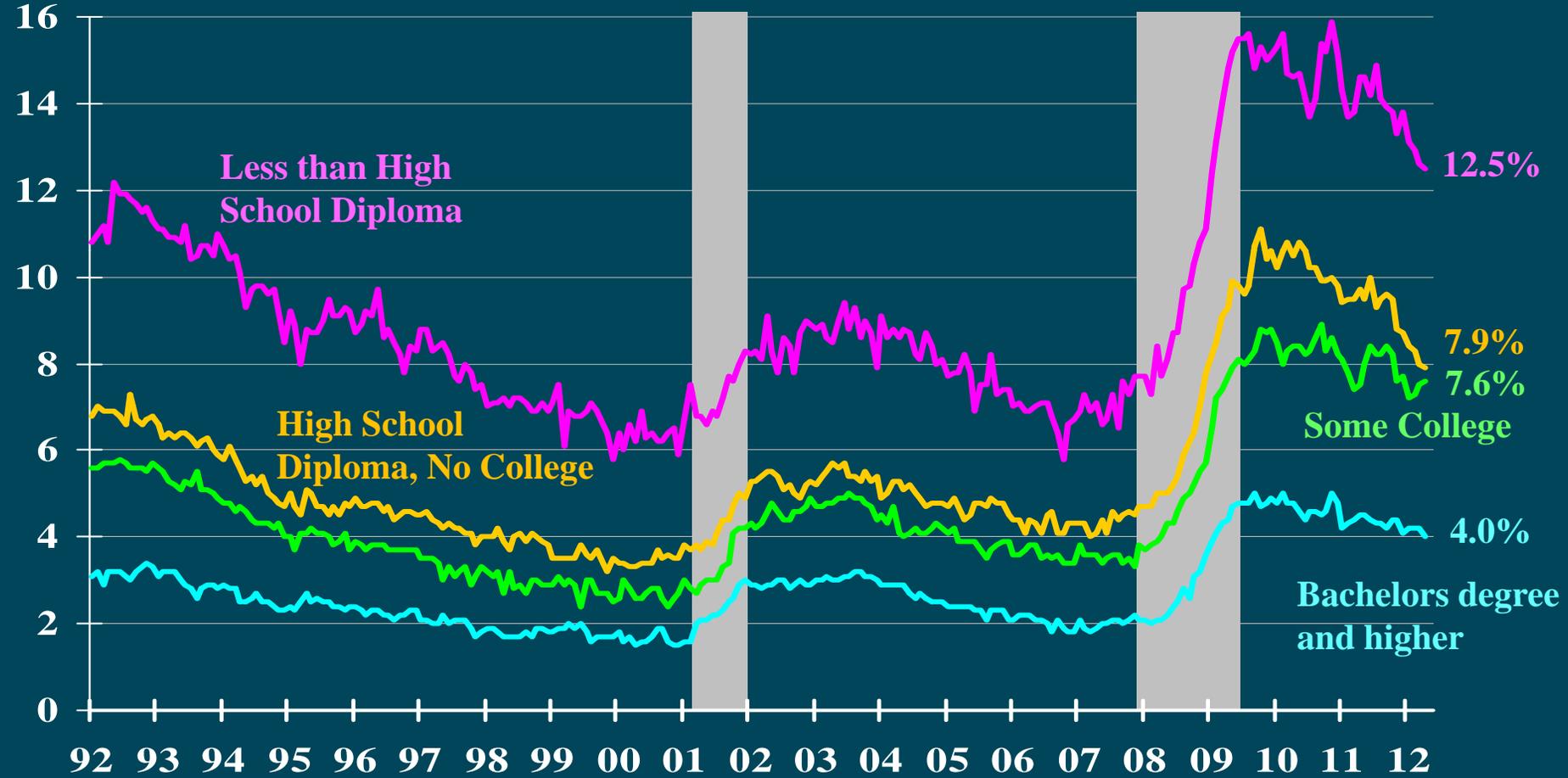


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Unemployment rates are significantly lower for those with more education, but all are lower than their peaks

Percent

Civilian unemployment rate by educational attainment



Monthly data: Last point plotted is April 2012

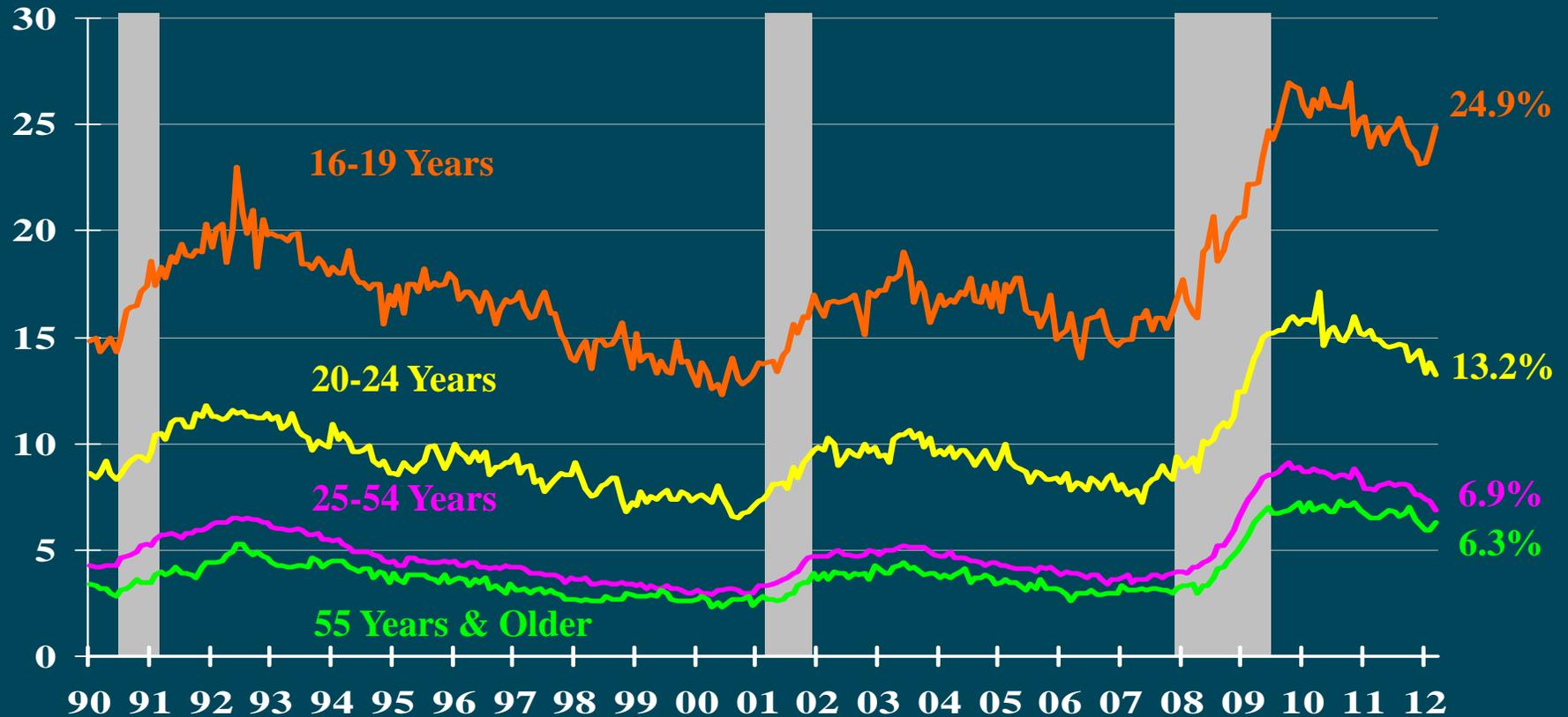


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Unemployment among young people is particularly high

Civilian Unemployment Rates by Age

Percent

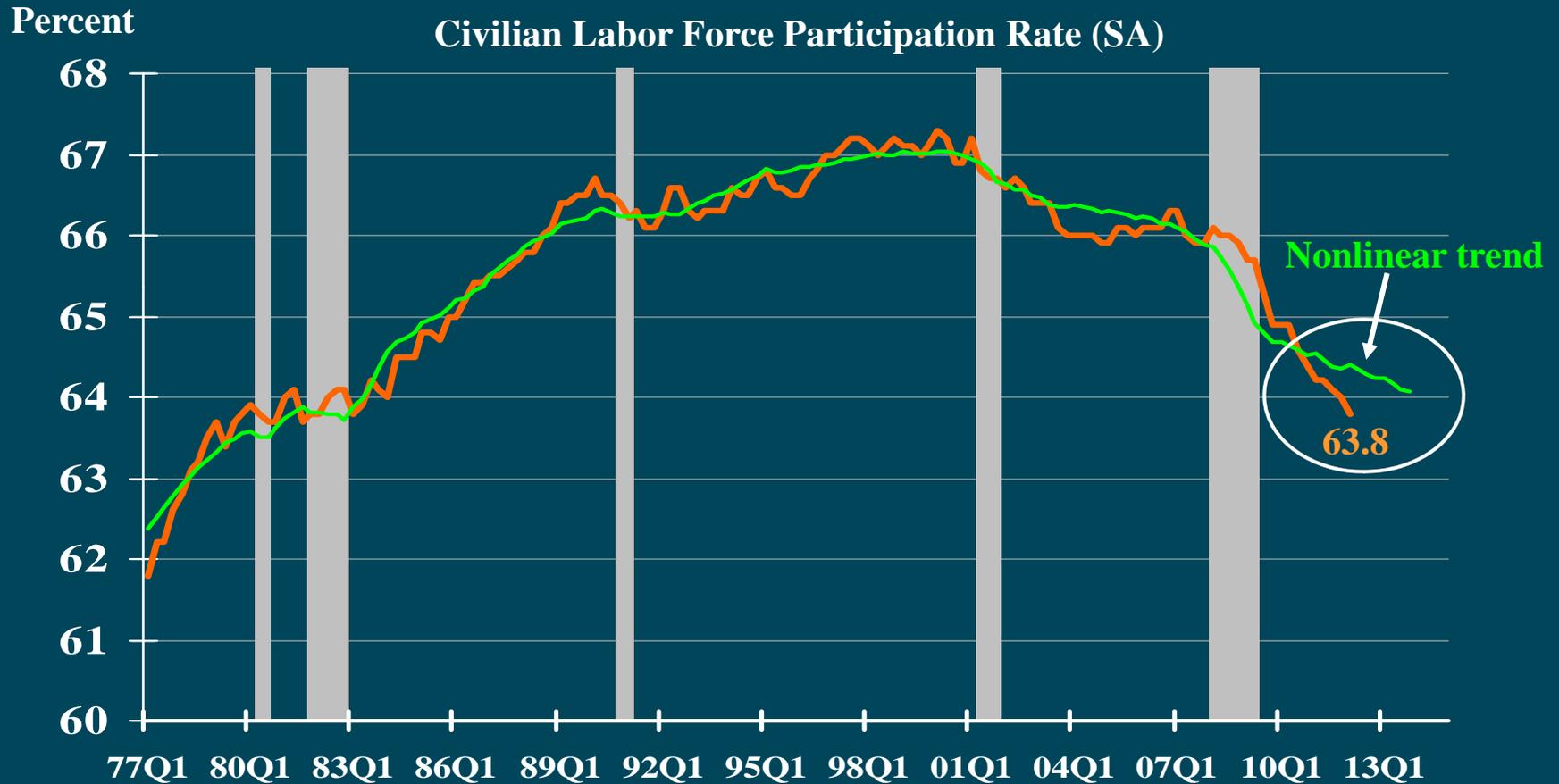


Monthly data: Last point plotted is April 2012



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Labor force participation is below the level that would be predicted by cyclical factors and demographics

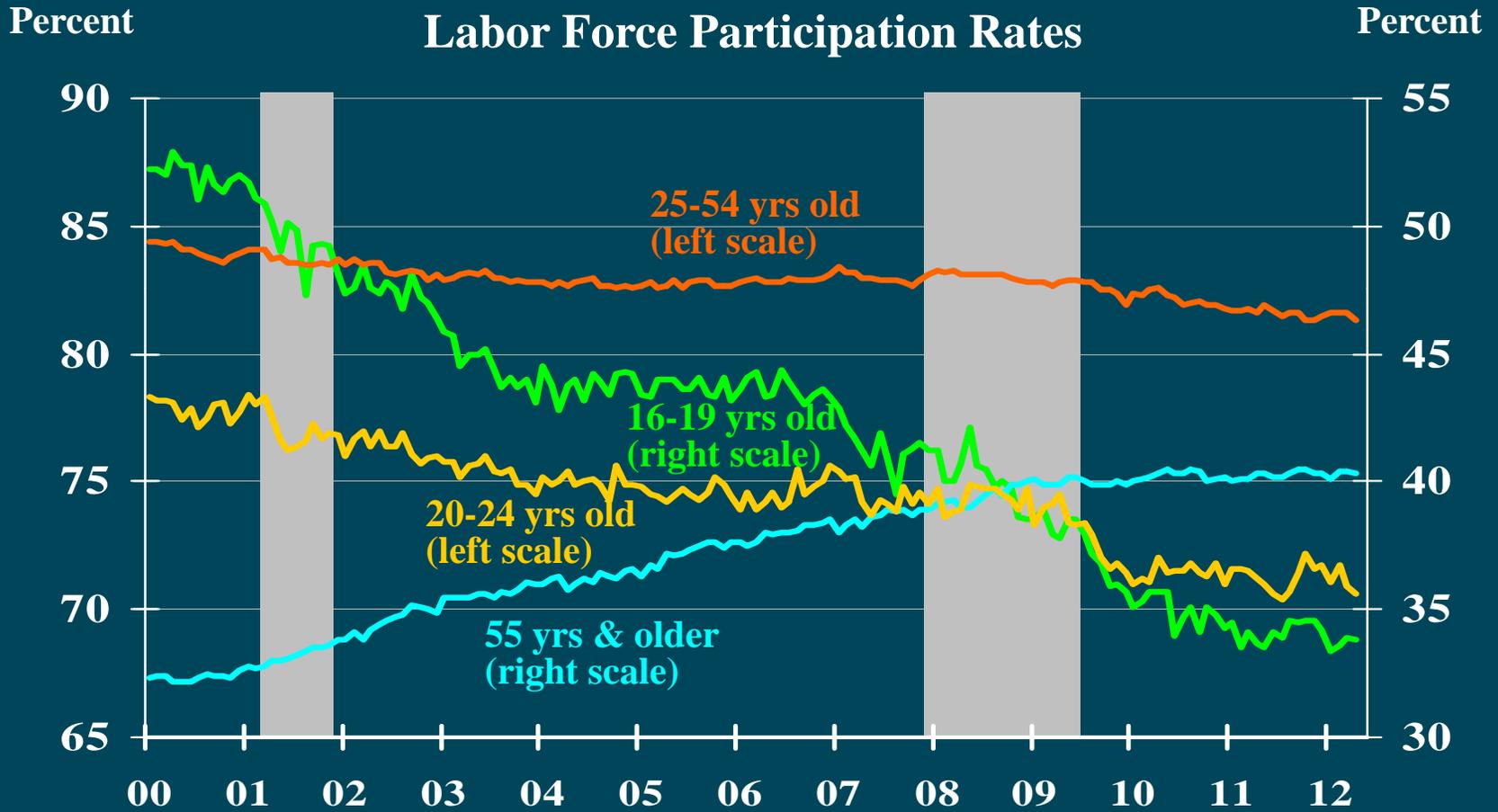


Quarterly data: Last point plotted for participation is 2012Q1

Source: Bureau of Labor Statistics.

Trend is author's calculation controlling for the unemployment rate, share of working age population over 65, share of working age population female, time, and time-squared.

Teenagers and young adults have seen the sharpest declines in labor force participation

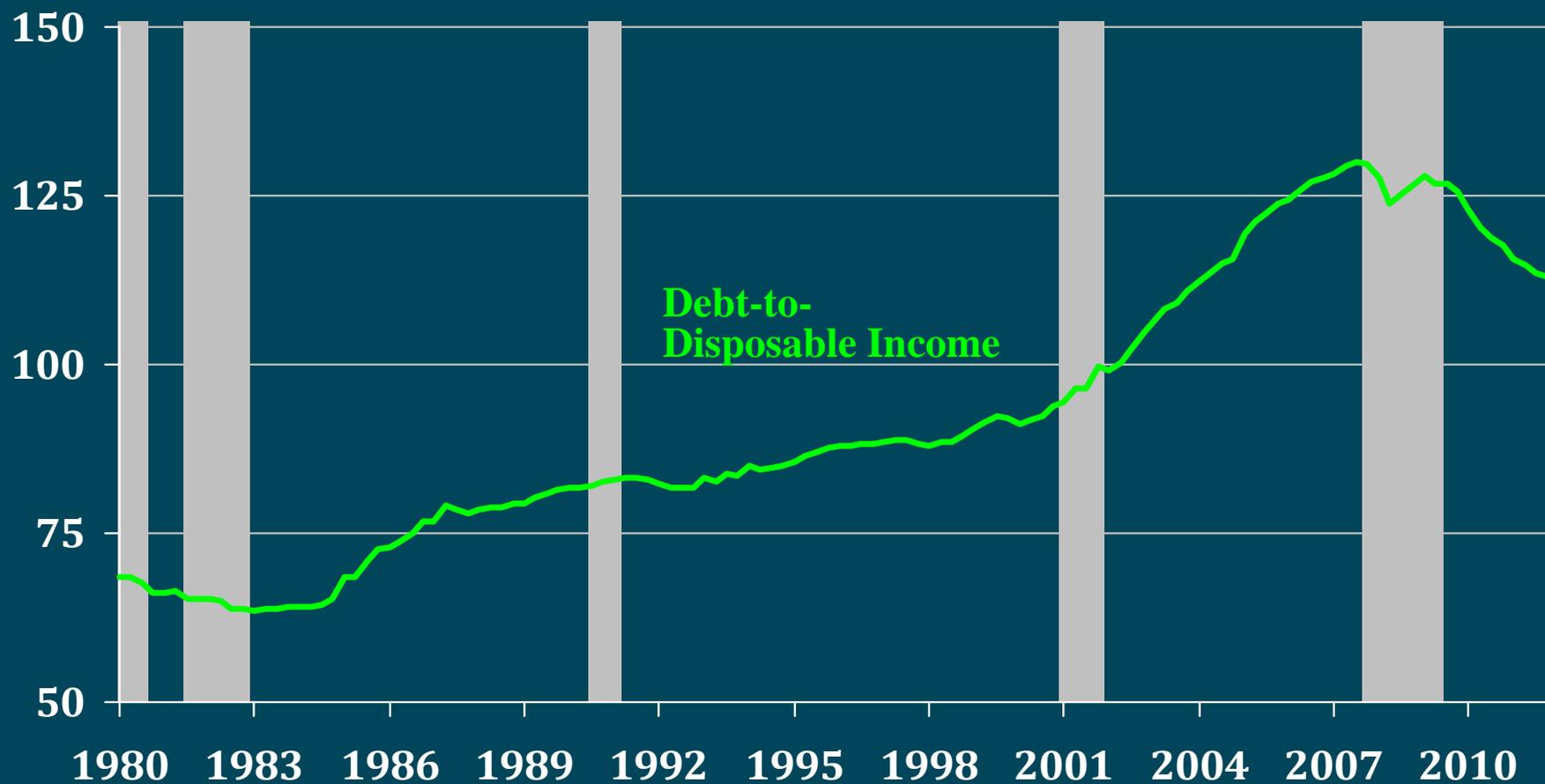


Monthly data: Last point plotted is March 2012

Source: Bureau of Labor Statistics

**Household debt-to-disposable income has fallen
and creditworthiness is improving.
Households will likely continue to deleverage.**

Percent

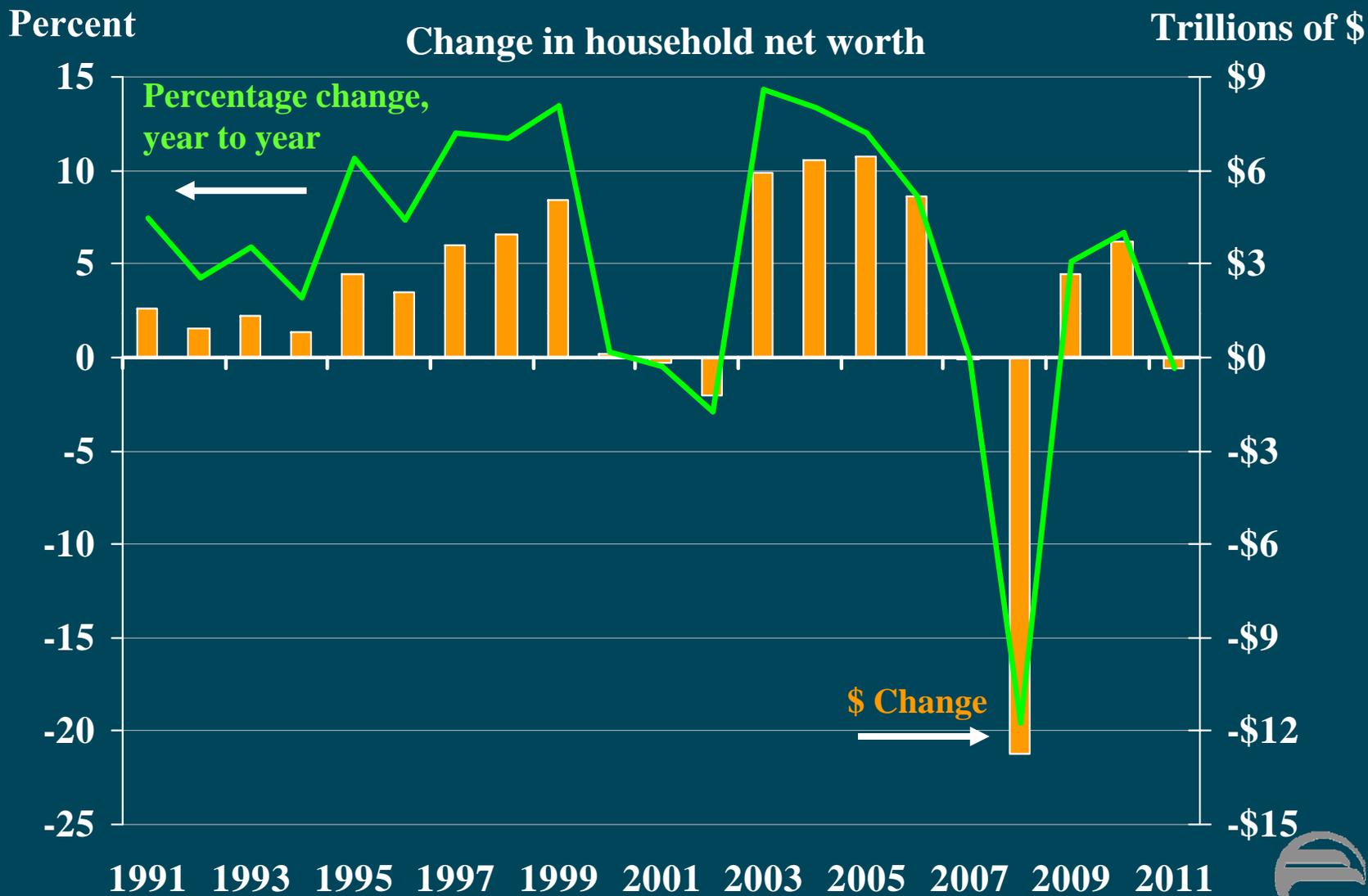


Quarterly data: Last point plotted is 2011 Q4



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**After rising in 2009 and 2010, household net worth fell slightly in 2011.
Both real estate and stock market wealth declined.**

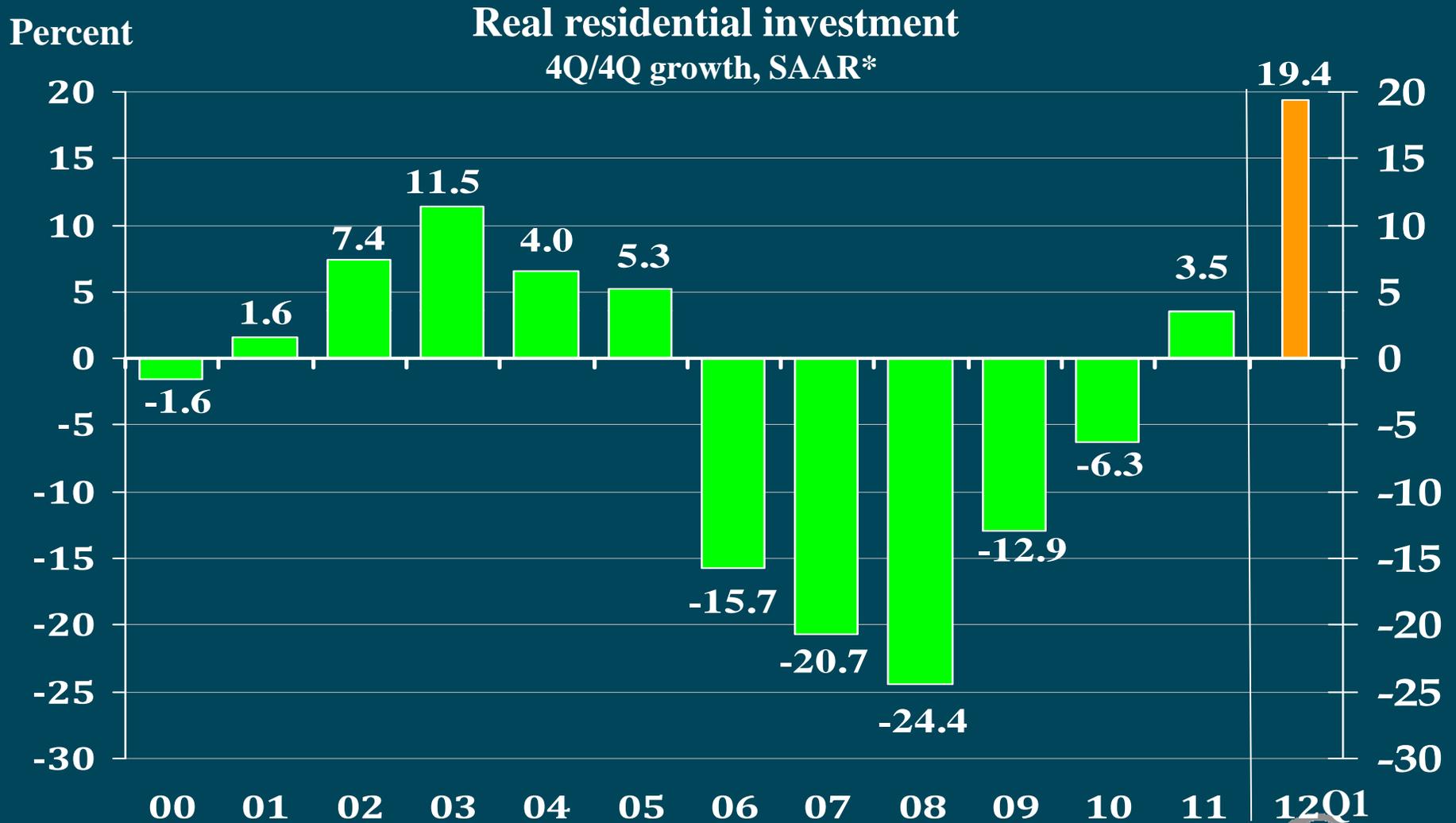


Source: FRB Flow of Funds, annual data for 1990-2011



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**Housing markets finally stabilized in 2011.
We had our first increase in residential investment in six years.
Residential investment continued to expand in 2012 Q1.**



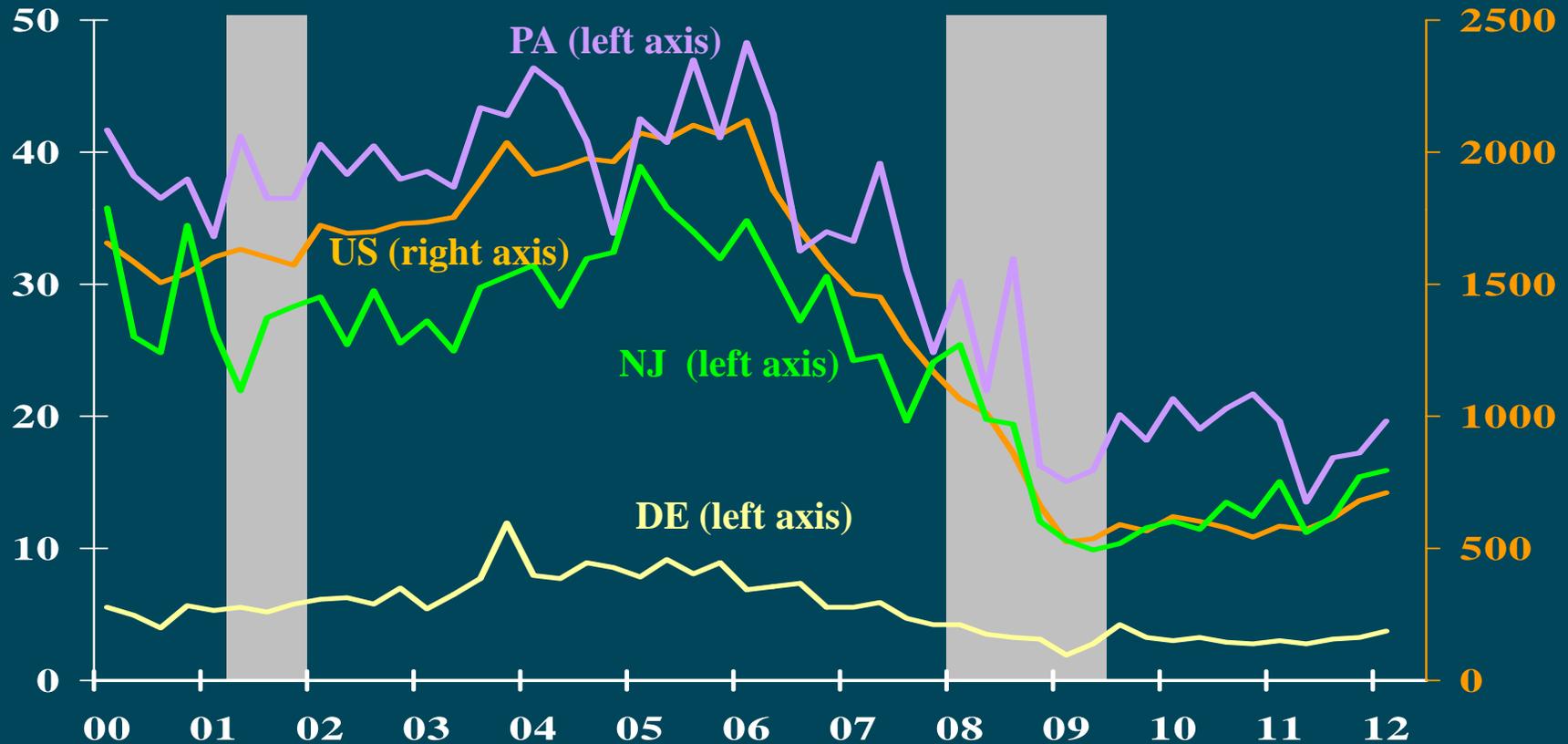
Annual data through 2011, quarterly data for 2012Q1

The levels of housing starts vary across the region, but the trends are similar

Privately owned housing units started

Thousands of units

Thousands of units

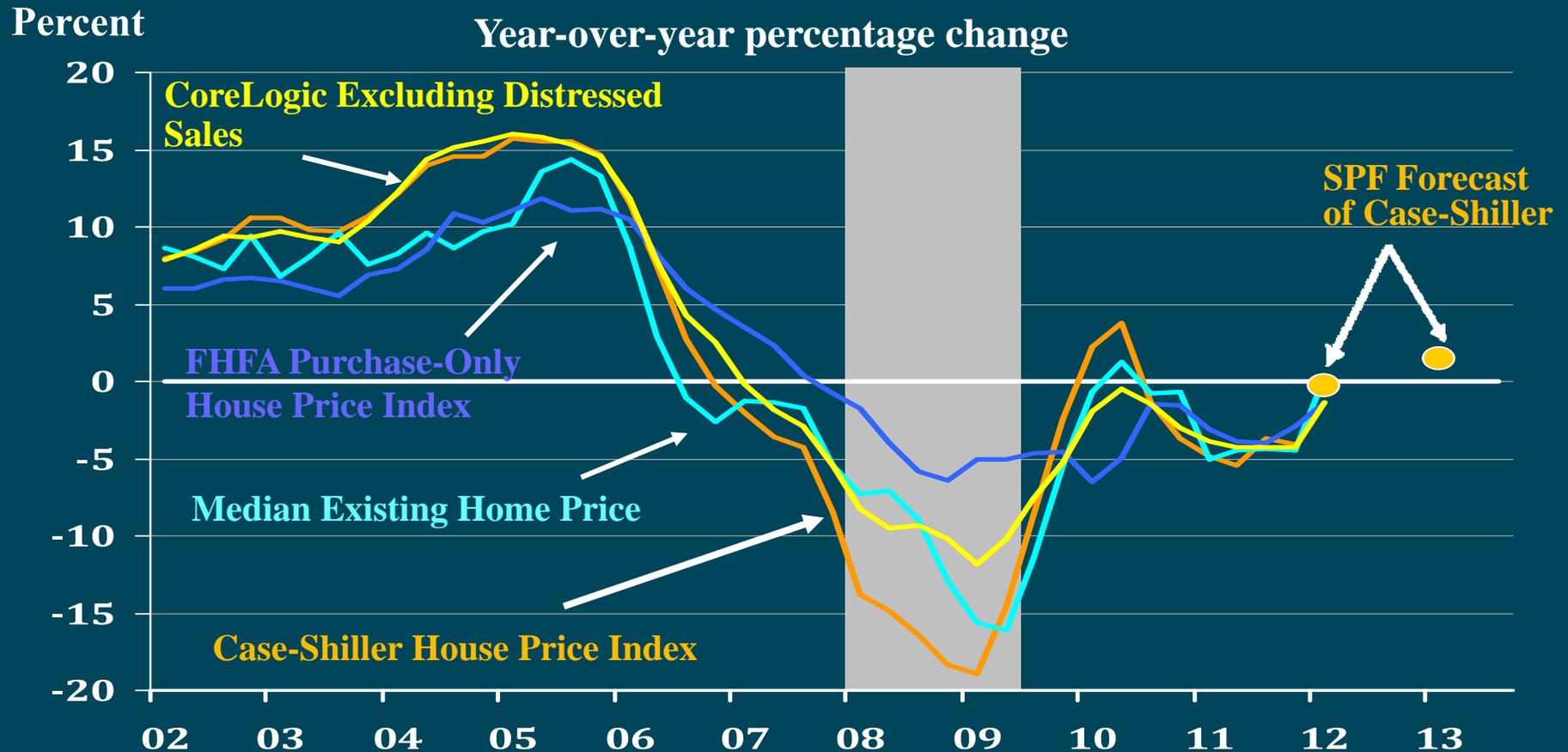


Source: Bank of Tokyo-Mitsubishi UFJ/Haver
Quarterly data: Last point plotted is 2012 Q1



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**House prices continued to fall last year, even excluding distressed sales.
 Respondents to our *Survey of Professional Forecasters*
 expect little change in house prices over the next two years.**



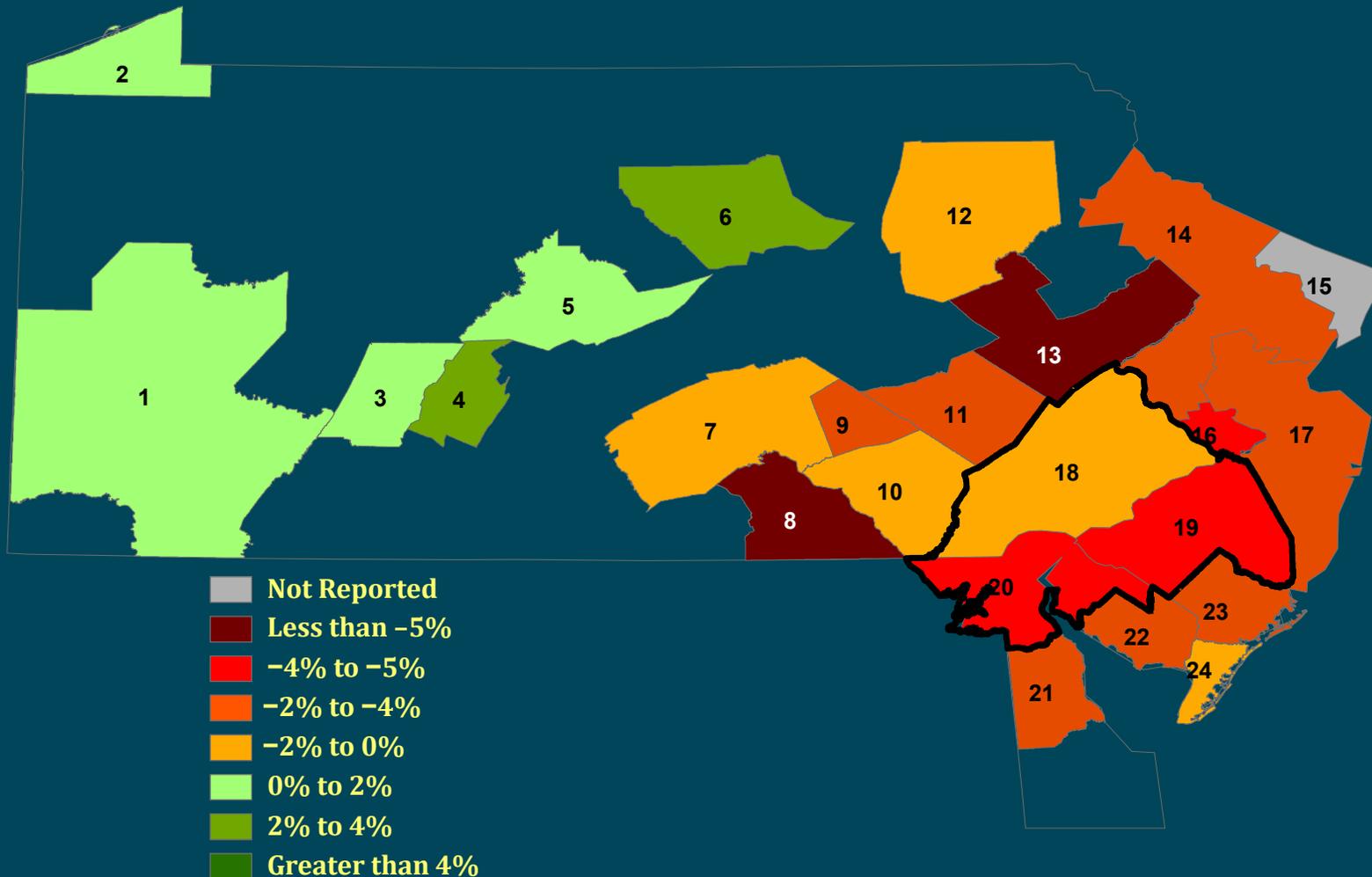
Quarterly data: Last point plotted is 2011 Q4 for Case-Shiller;
 2012Q1 for all others



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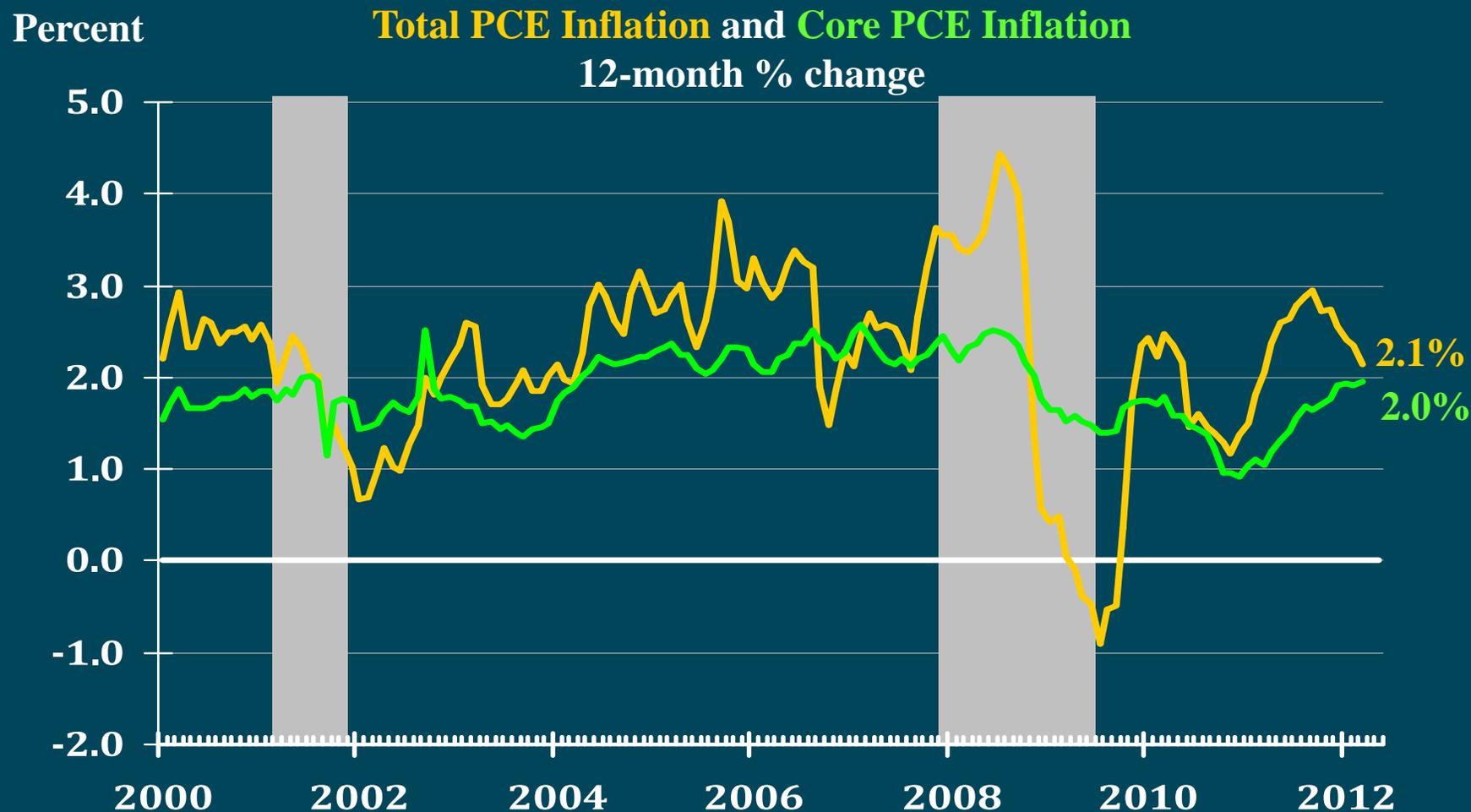
House prices are firming in the western part of Pennsylvania and the Marcellus shale area, but house prices continue to fall elsewhere in the region

Change in FHFA House Price Index For Metro Areas (as of 2012 Q1)



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

Last year, the surge in oil prices put upward pressure on inflation. Inflation has moderated toward the long-run goal of 2 percent.



Monthly data: Last month plotted is March 2012



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**The sovereign debt problems in Europe continue to be a significant risk.
European countries are considering further initiatives
to address the fiscal and banking crisis.**

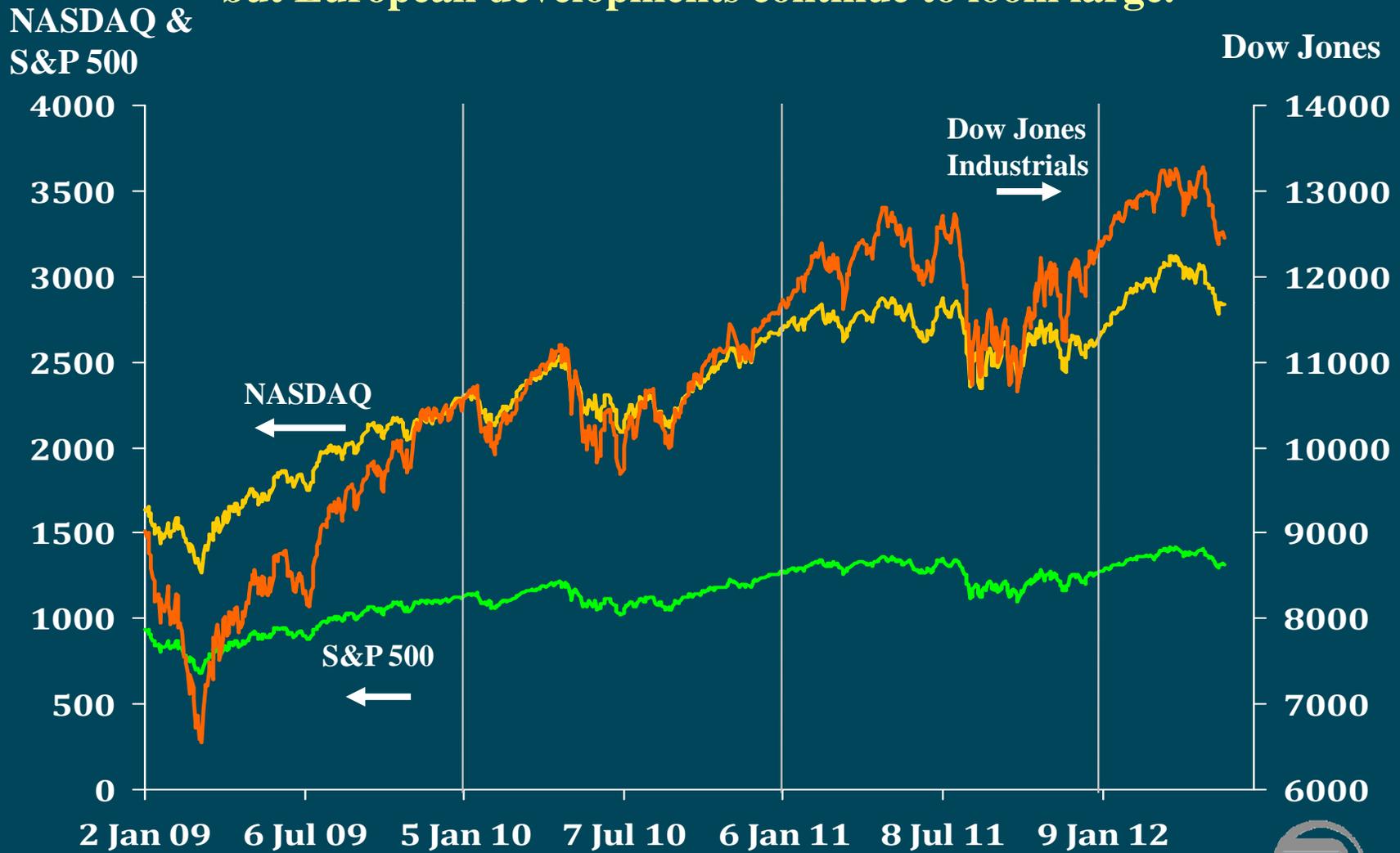


Daily: Last point plotted is May 25, 2012



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Financial markets were extremely volatile last year as investors focused on the fiscal situation in Europe. Stock prices are up, on net, since the start of the year, but European developments continue to loom large.



Daily data: Last point plotted is May 25, 2012

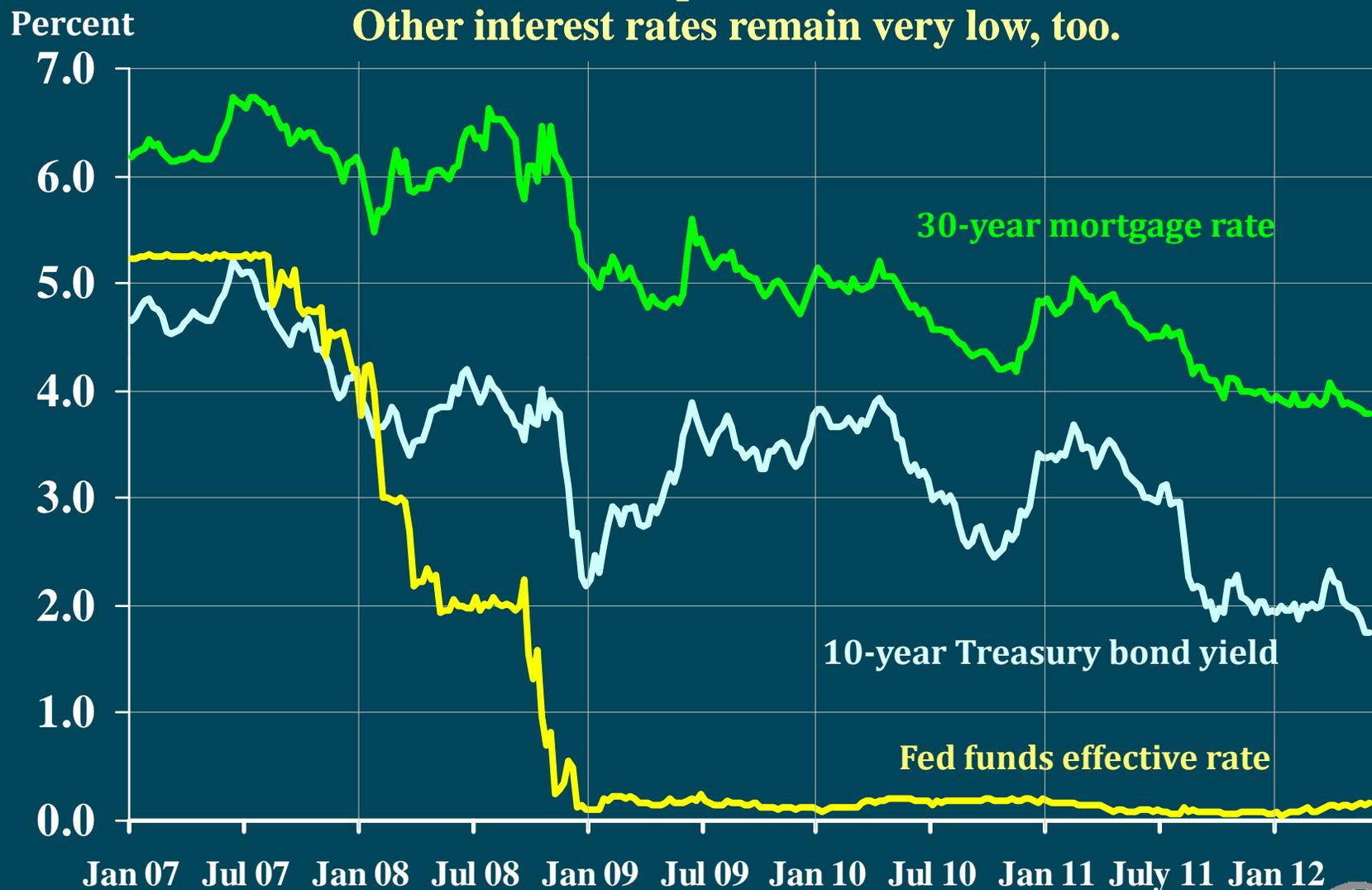


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Monetary policy remains very accommodative.

The fed funds has been at essentially zero for more than three years and the FOMC has said it anticipates it to remain there until late 2014.

Other interest rates remain very low, too.

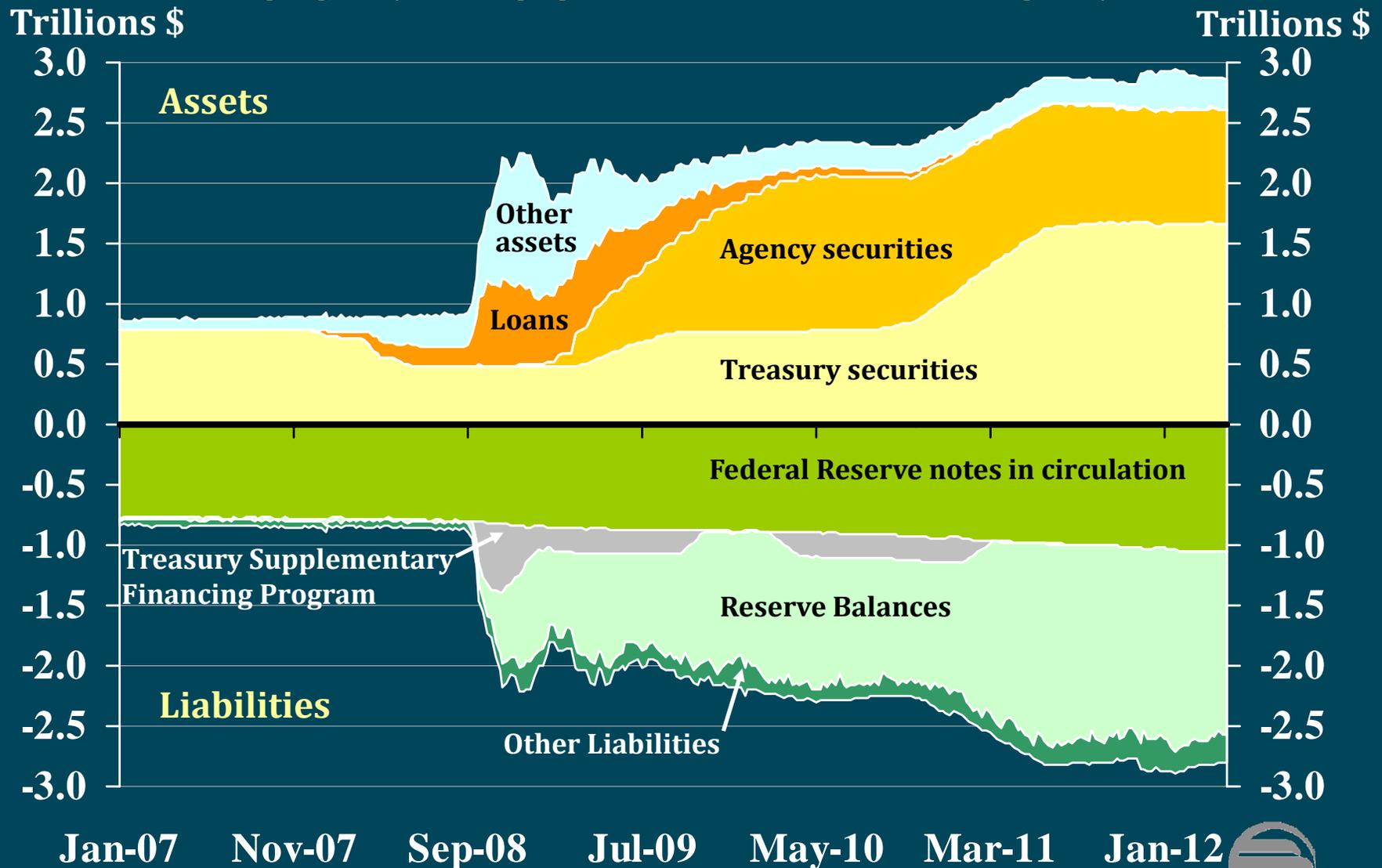


Weekly data: Last point plotted is May 25, 2012



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**The Fed's balance sheet remains very large.
The Fed holds nearly \$1 trillion in
housing agency mortgage-backed securities and agency debt.**



Weekly data: Last point plotted is May 14, 2012

What does the future hold?



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**Fed and private sector forecasters expect
growth to accelerate,
unemployment to gradually decline,
and inflation to move toward its long-run goal of 2%**

	Central tendency of Fed Governors and Presidents April 2012 Forecasts		Survey of Professional Forecasters 2012 Q2 Survey	
	<u>2012</u>	<u>2013</u>	<u>2012</u>	<u>2013</u>
Real GDP Growth*	2.4 to 2.9 %	2.7 to 3.1 %	2.4 %	2.7 %*
Unemployment Rate in Q4	7.8 to 8.0 %	7.3 to 7.7 %	7.9%	NA
PCE Inflation (Q4/Q4 growth)	1.9 to 2.0 %	1.6 to 2.0 %	2.1 %	2.0 %

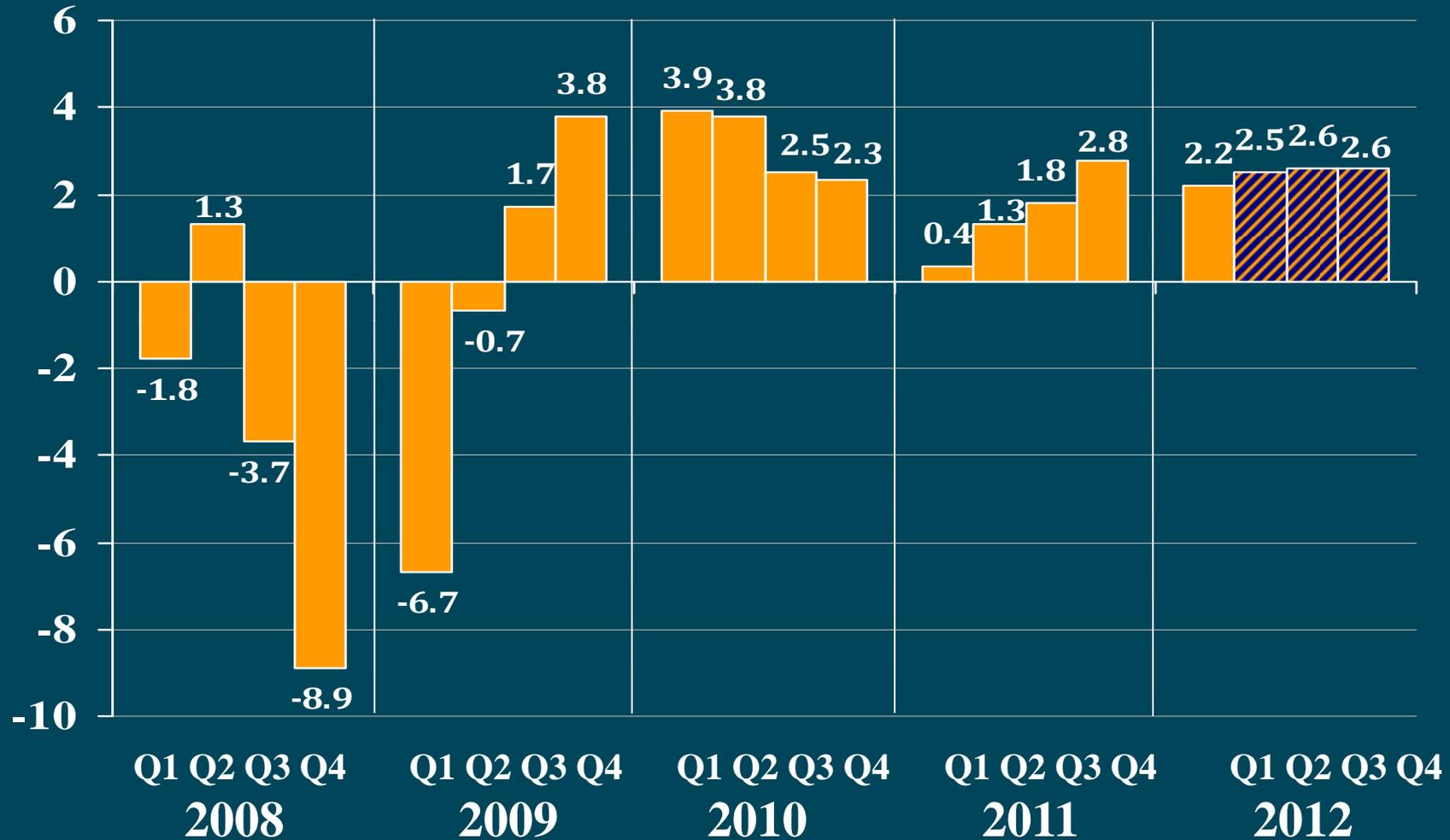
*Q4/Q4 growth for Fed forecasts and 2012 SPF; annual growth for 2013 SPF



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Our latest *Survey of Professional Forecasters* forecasts sustained economic recovery with growth at or slightly above trend

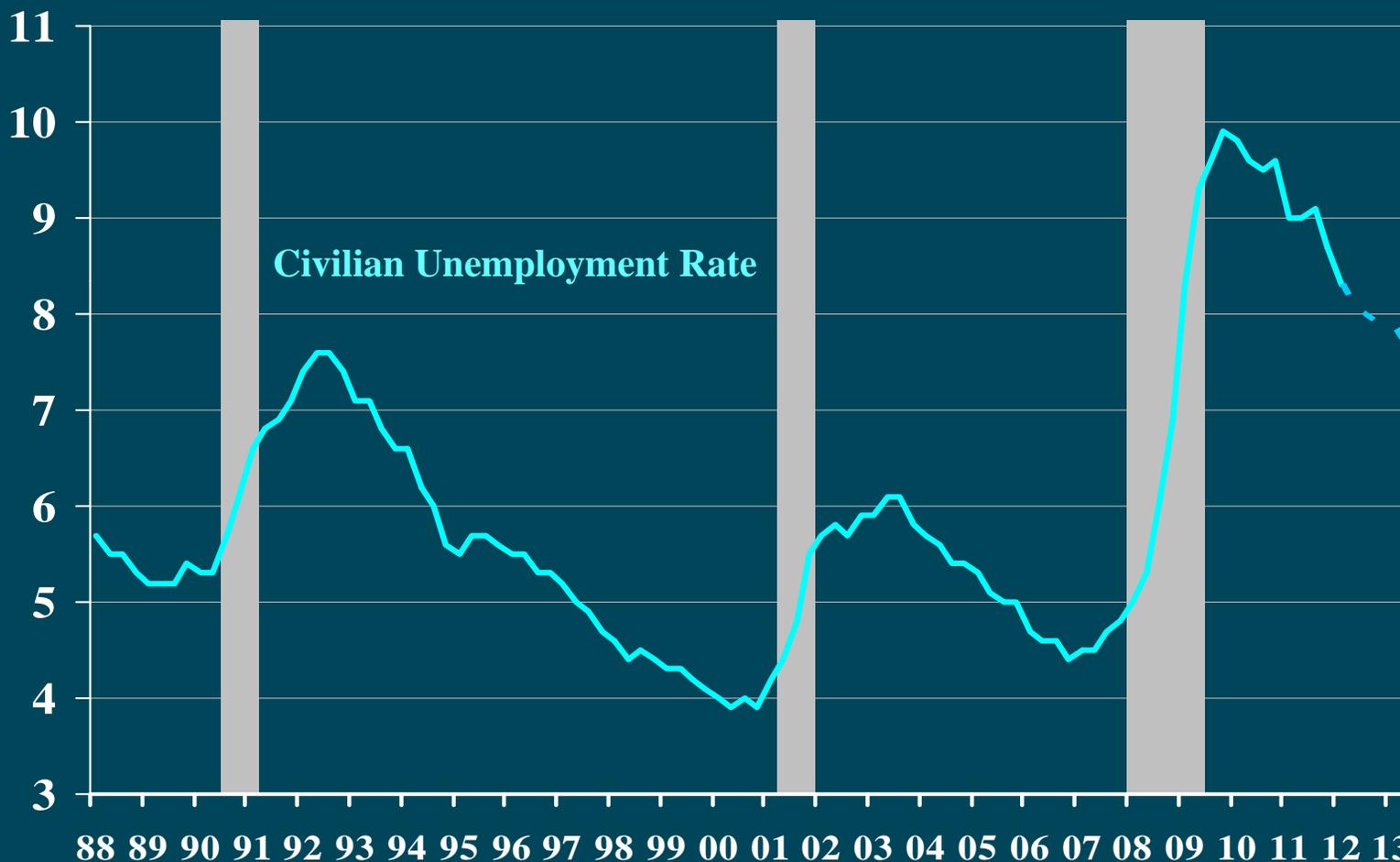
Percent



Hatched bars are median forecasts from the 2012Q1 *Survey of Professional Forecasters*

Our latest *Survey of Professional Forecasters* indicates the unemployment rate will continue to decline over the year but will remain high

Percent

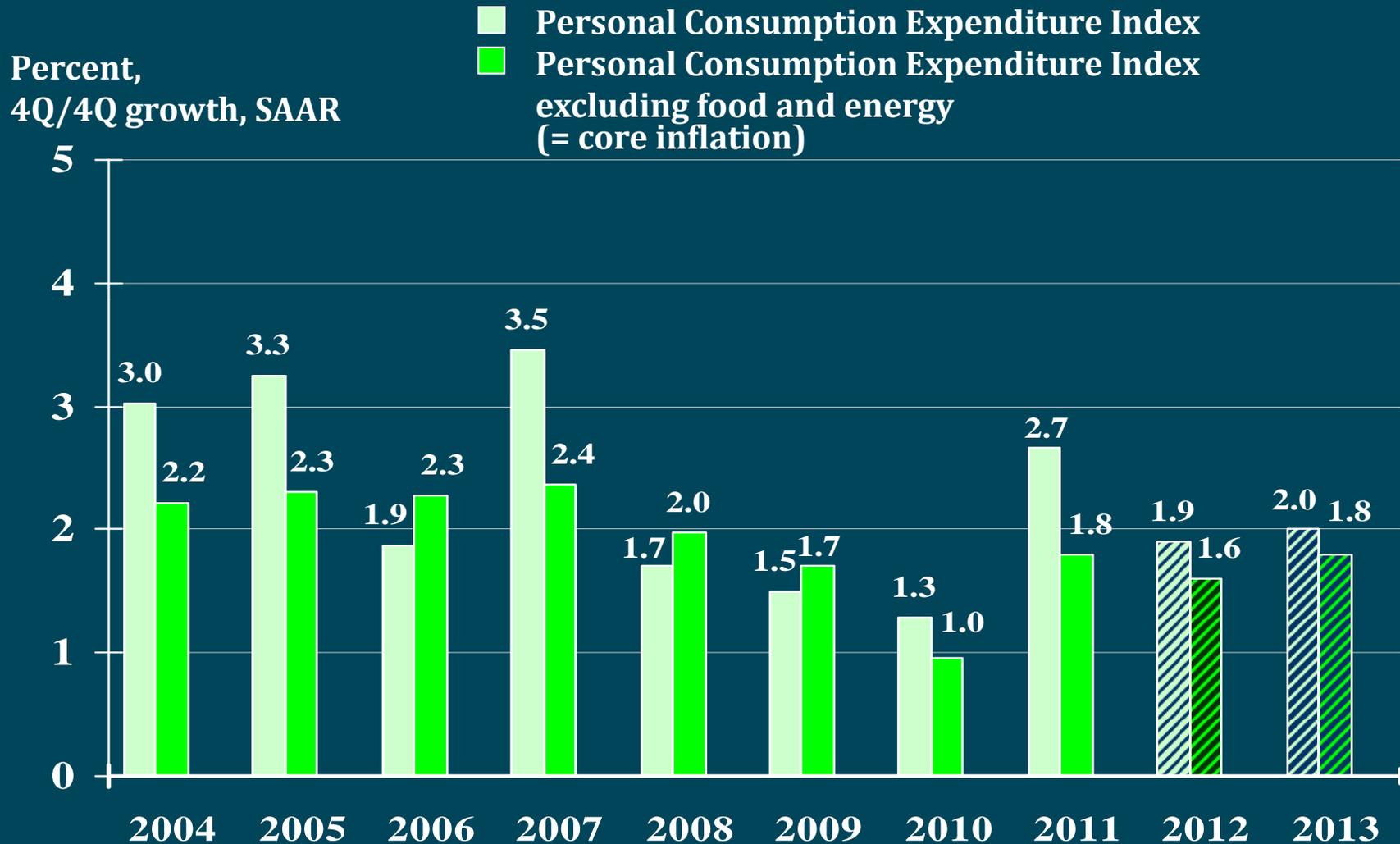


Dotted line is median forecast from the 2012Q2 *Survey of Professional Forecasters*
Last point plotted is forecast for 2013 Q2.



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Inflation is moderating.
Our SPF forecasts total PCE inflation will be 2% over the next two years,
consistent with the Fed's long-run goal.



Hatched bars represent median forecasts from the 2012 Q1 *Survey of Professional Forecasters*

Higher energy costs are a risk to growth and inflation



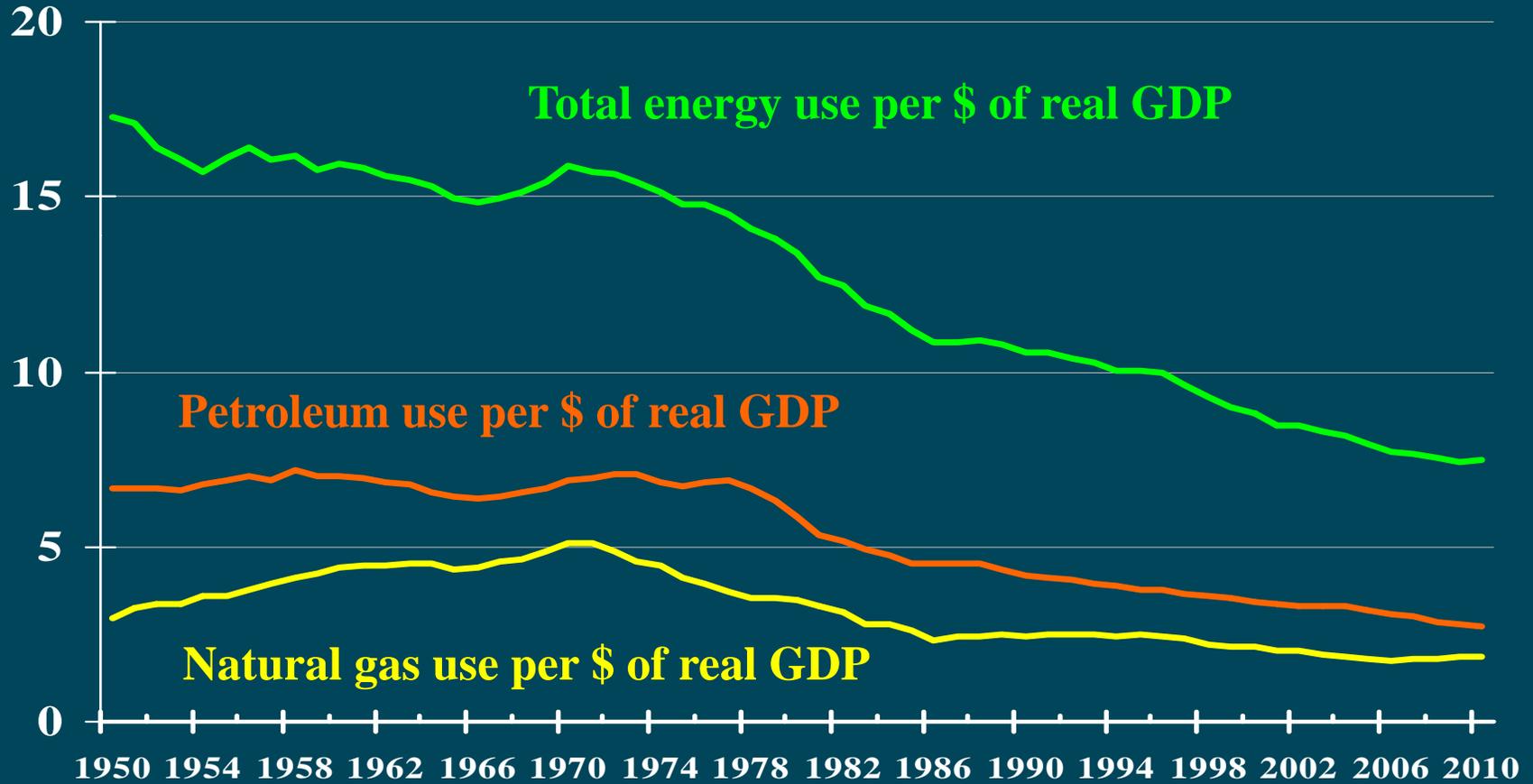
\$ per gallon



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US output is less dependent on energy than it used to be

1000 BTUs per \$ of real GDP



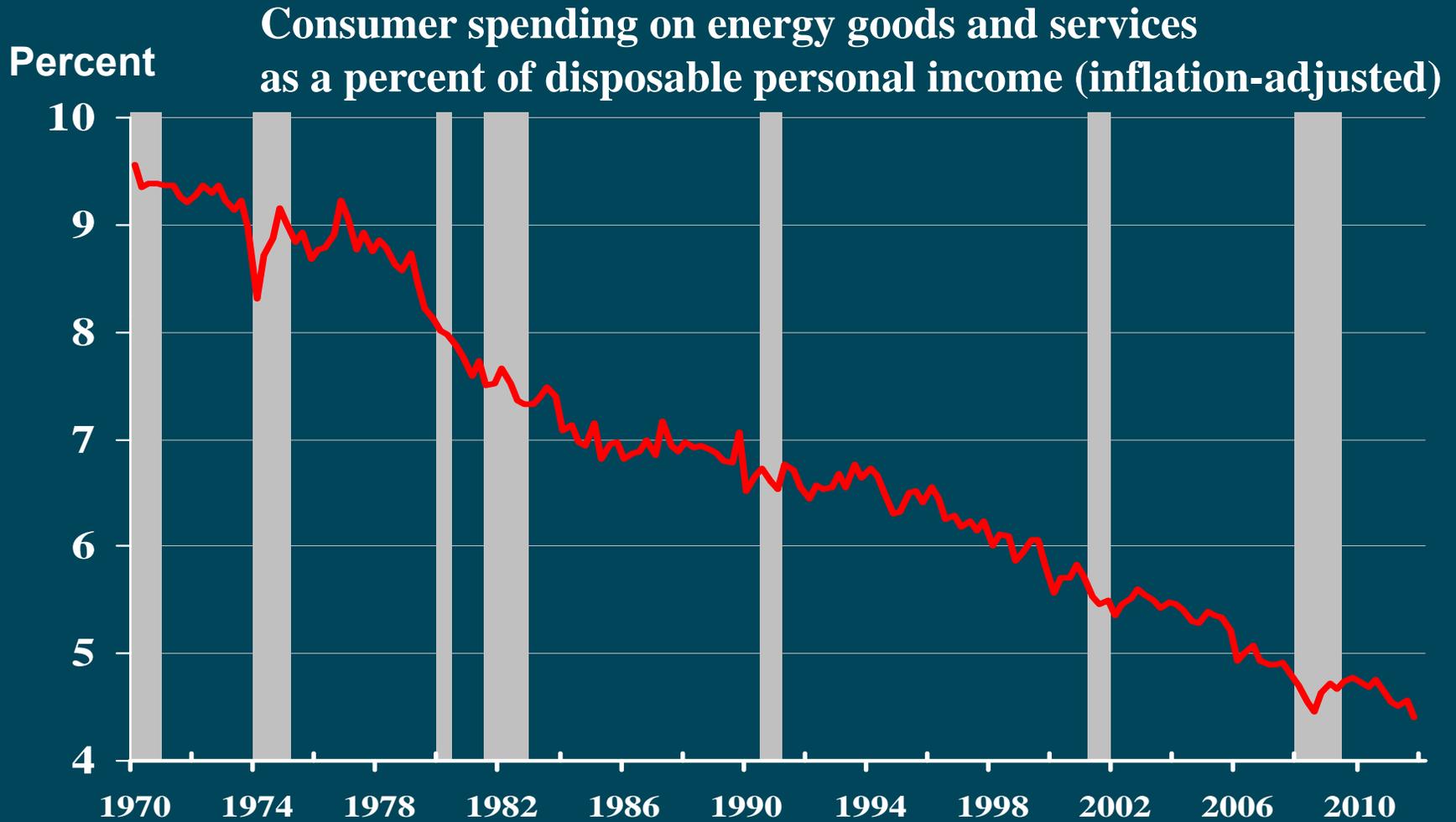
Annual data: Last point plotted is 2010

Source: U.S. Energy Information Administration



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Households spend a smaller share of their income on energy than they used to



Quarterly data: Last point plotted is 2011Q4

Energy goods: gasoline, fuel oil, and coal

Energy services: household operation (electricity and gas)



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The baseline forecast

- The economic recovery continues in 2012 and 2013, with growth at or slightly above trend – around 2-3/4% to 3%.
 - Supported by strong profits, businesses continue to invest in equipment and software at a healthy pace and hiring strengthens
 - Improvement in labor market conditions and households' balance sheets will support consumer spending
 - Residential investment will not contribute much, but won't be a major drag either
- Labor markets improve. Payroll growth strengthens and the unemployment rate falls gradually to around 8% at the end of 2012 and 7% at the end of 2013.
- Inflation moderates back to 2%, consistent with the Fed's long-run goal.
- European sovereign debt and banking problems are a significant risk to the forecast.



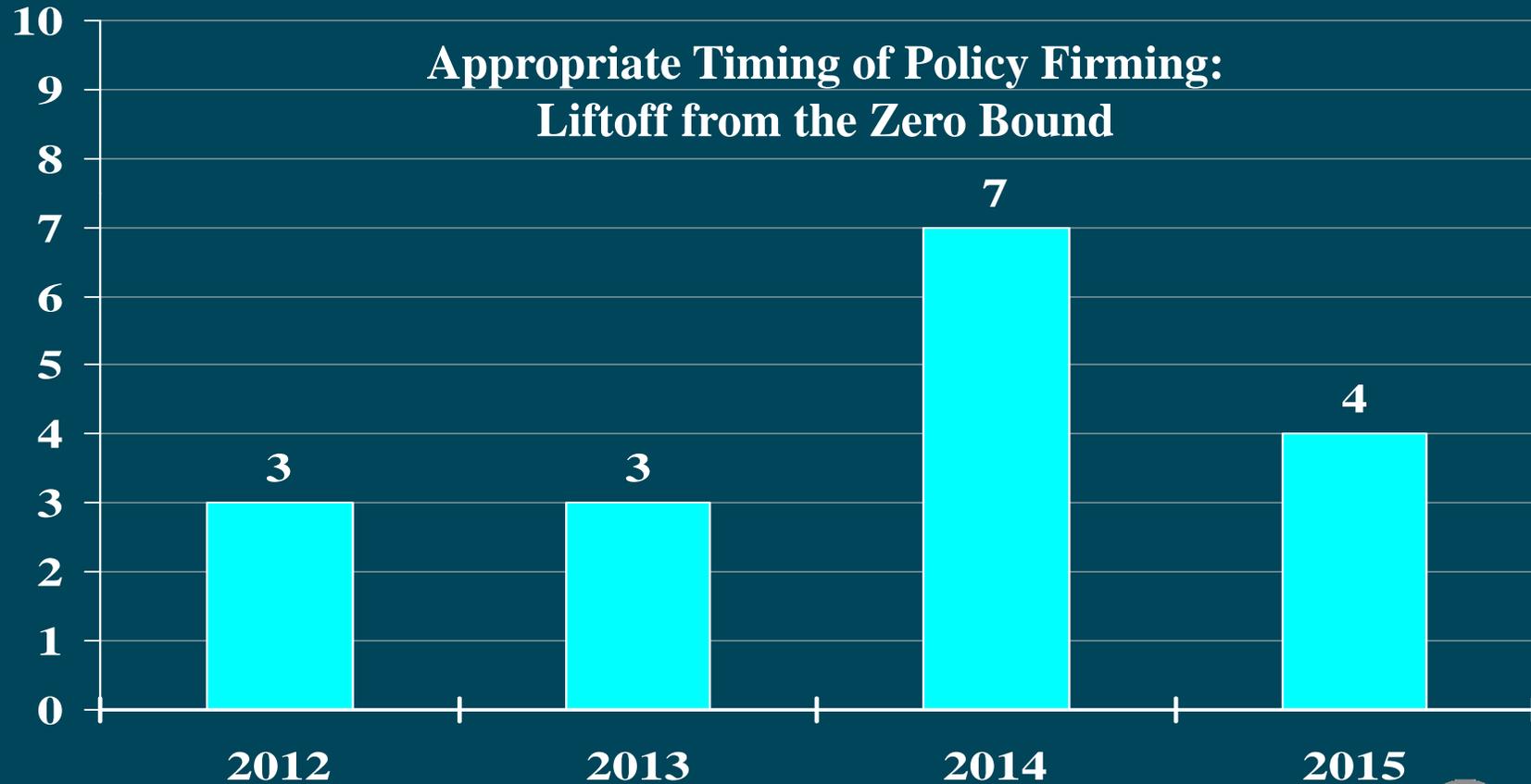
**The FOMC strives to improve
its communications about monetary policy
and in January took two steps toward increased transparency**

- The FOMC released a statement of principles about its longer-run monetary policy goals and strategy
 - The FOMC is committed to its statutory mandate to promote **maximum employment, stable prices, and moderate long-term interest rates.**
 - Set a longer-run inflation goal is **2 percent**, measured by the annual change in the PCE price index.
 - Did not set a maximum employment goal.
 - FOMC takes a balanced approach in promoting the goals
- The FOMC began releasing information on the policy assumptions underlying their economic projections.
 - These assumptions represent each individual participant's view of "appropriate policy."
 - "Appropriate policy" is the path of policy that is most likely to foster monetary policy's long-run goals of price stability and maximum employment.

The FOMC is releasing participants' assumptions about the appropriate policy paths underlying their economic projections.

Only six participants anticipate that the appropriate liftoff from the zero bound will be before 2014.

Number of Participants



Source: FOMC Minutes and Press Conference, April 2012

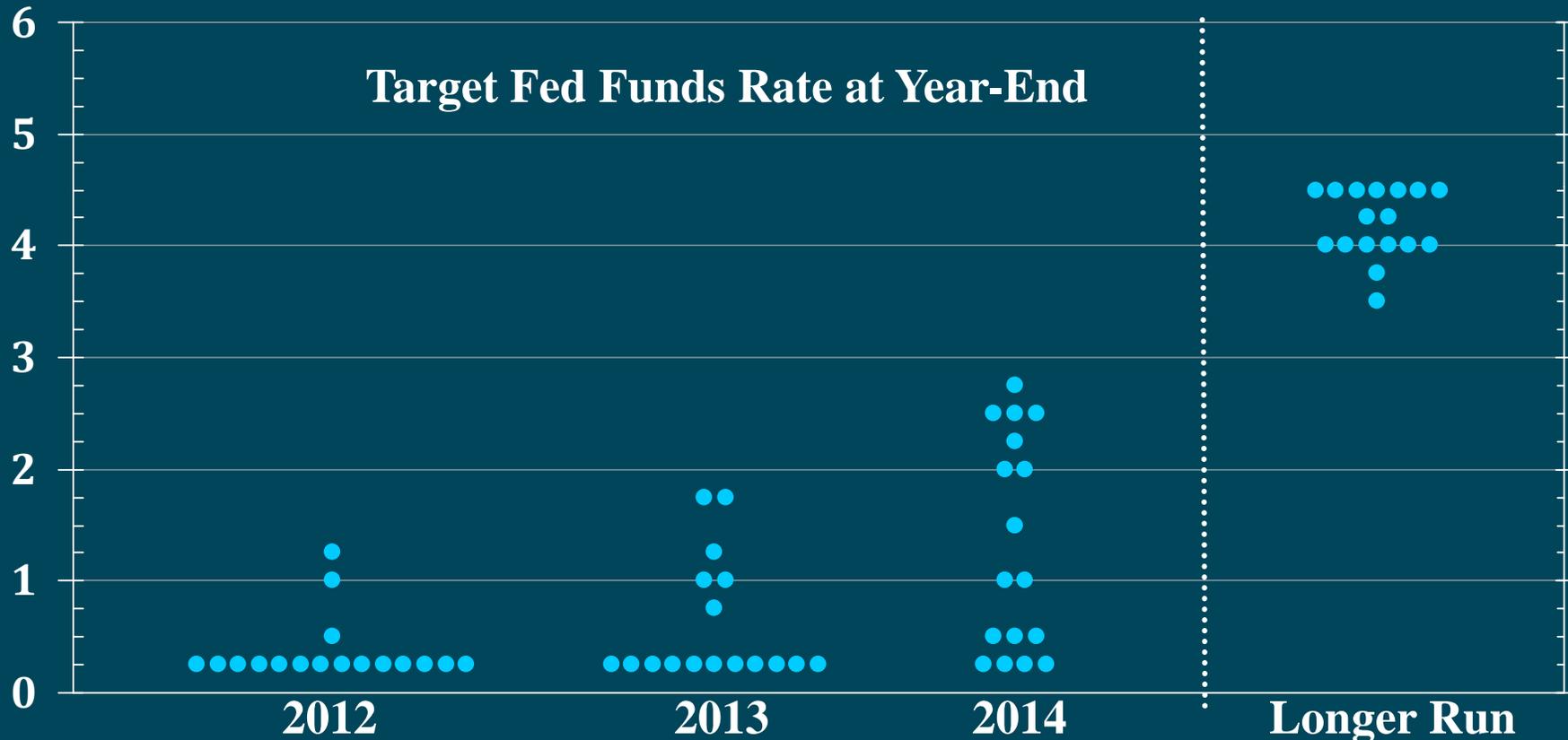


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The six participants projecting liftoff before 2014 anticipate that the fed funds rate target will need to rise to 2.0 to 2.75% at the end of 2014.

Seven other FOMC participants project that the appropriate fed funds rate will be 0.5% or less in 2014.

Percent



Source: FOMC Minutes and Press Conference



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www.philadelphiafed.org/research-and-data/