

## Report on Economic and Financial Developments

Loretta J. Mester

Executive Vice President and Director of Research

June 21, 2012



FEDERAL RESERVE BANK  
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.

### Executive summary

- Economic growth has slowed over the past two months in both the nation and the district
- Near-term growth forecasts have been revised down about ½ percentage point
- Downside risks to the forecast have risen
  - European sovereign debt & banking system problems
  - U.S. fiscal situation looming at year-end
  - Slower global growth
- FOMC will implement Operation Twist 2 through year-end and said it is prepared to take further action



FEDERAL RESERVE BANK  
OF PHILADELPHIA

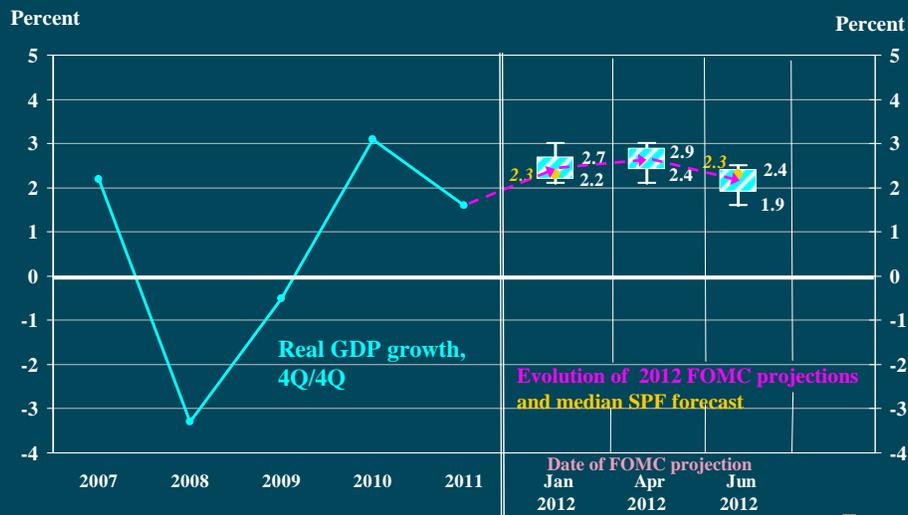
## The FOMC continues to expect moderate growth, a gradual decline in the unemployment rate, and inflation to move toward its longer-run goal of 2%

	Central tendency of Fed Governors and Presidents April 2012 Forecasts		Survey of Professional Forecasters 2012 Q2 Survey	
	2012	2013	2012	2013
Real GDP Growth*	1.9 to 2.4 %	2.2 to 2.8 %	2.4 %	2.7 %*
Unemployment Rate in Q4	8.0 to 8.2 %	7.5 to 8.0 %	7.9%	NA
PCE Inflation (Q4/Q4 growth)	1.2 to 1.7 %	1.5 to 2.0 %	2.1 %	2.0 %

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



## The FOMC revised down their forecasts for 2012

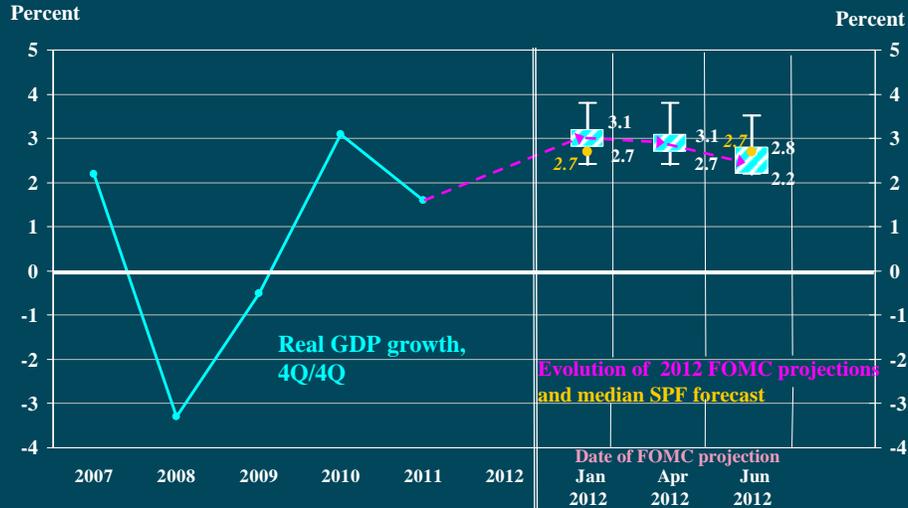


Sources: FOMC Minutes and Press Conference, and Philadelphia Fed Survey of Professional Forecasters (SPF).  
Note, survey dates for SPF are: Feb, May, Aug, Nov.

Projections for 2012



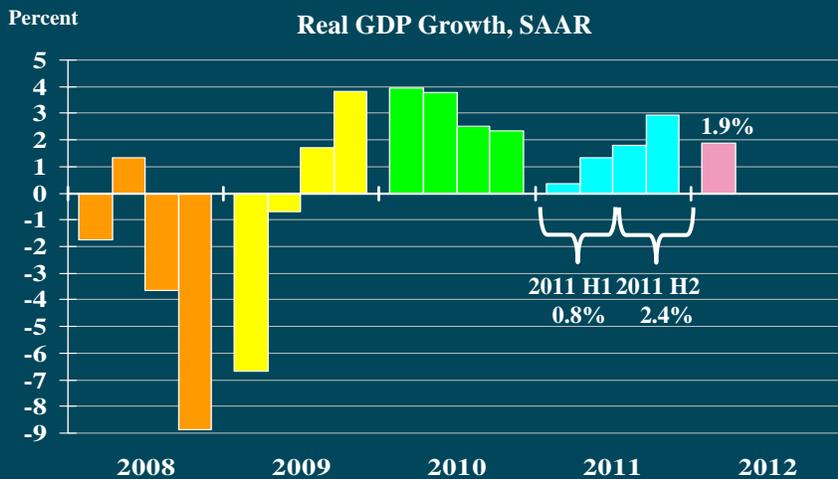
## The FOMC continues to expect growth to strengthen in 2013



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



## Growth decelerated to around 2 percent in the first quarter and is running at about the same pace in the second quarter

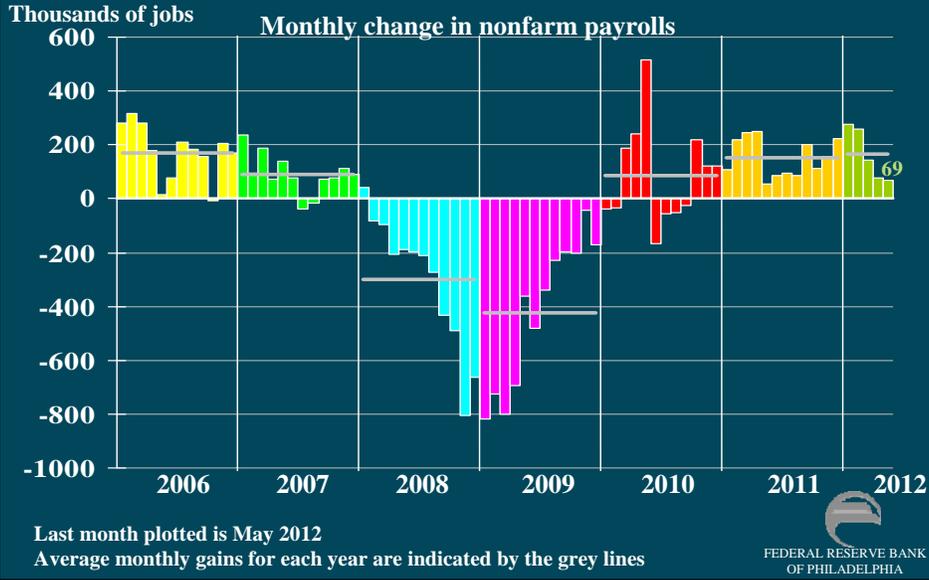


Quarterly data: Last point plotted is 2012Q1



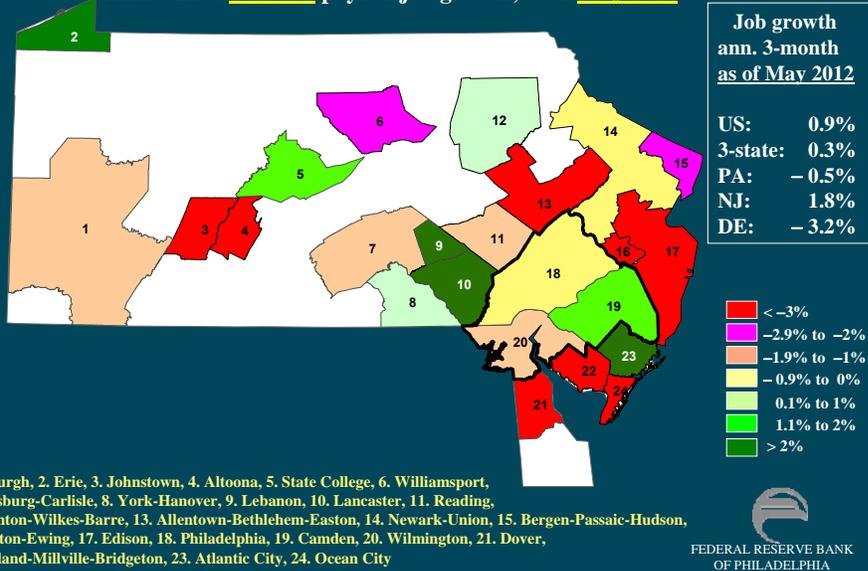


Employment growth has weakened since the start of the year.  
 In May, payrolls rose by only 69 thousand jobs.  
 Monthly job gains have averaged 165 thousand this year  
 compared with 153 thousand last year.



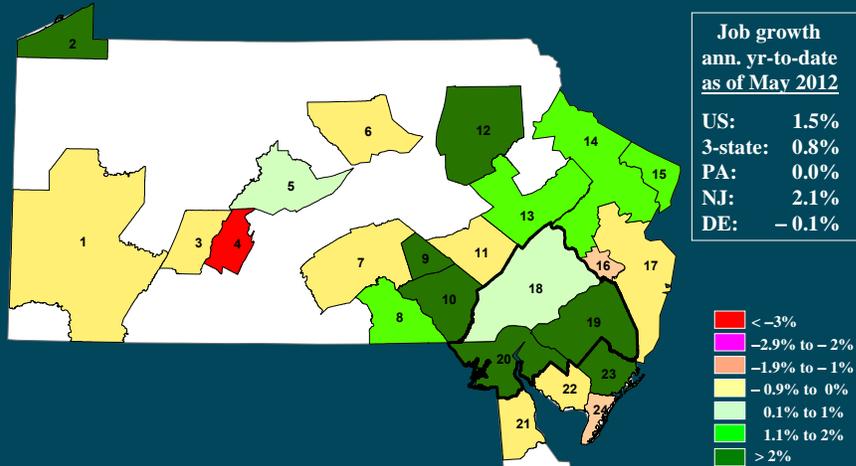
Employment in our three states  
 decelerated over the past three months

Annualized 3-month payroll job growth, as of May 2012



Employment growth in our three states is lower than in the nation.  
So far this year, job growth in NJ has offset weakness in PA and DE.

Annualized year-to-date payroll job growth, as of May 2012



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

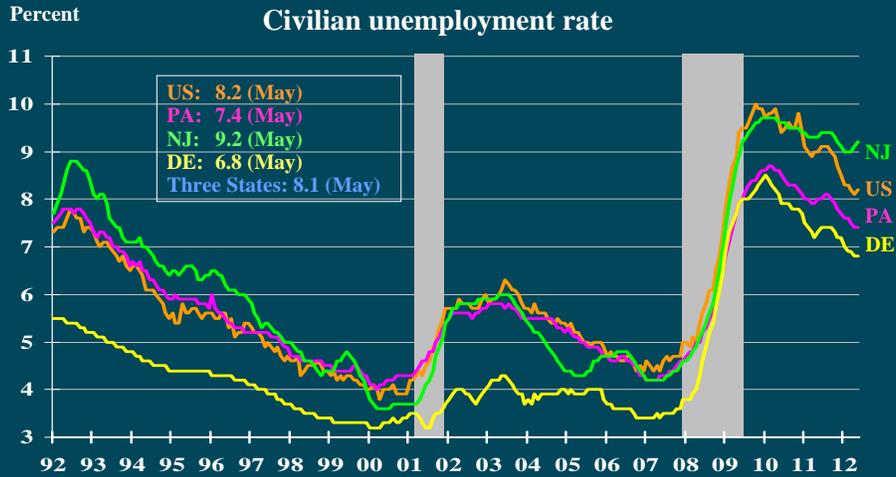


### Recent modest job growth has retarded progress on recovering lost jobs



Incorporates May 2012 data

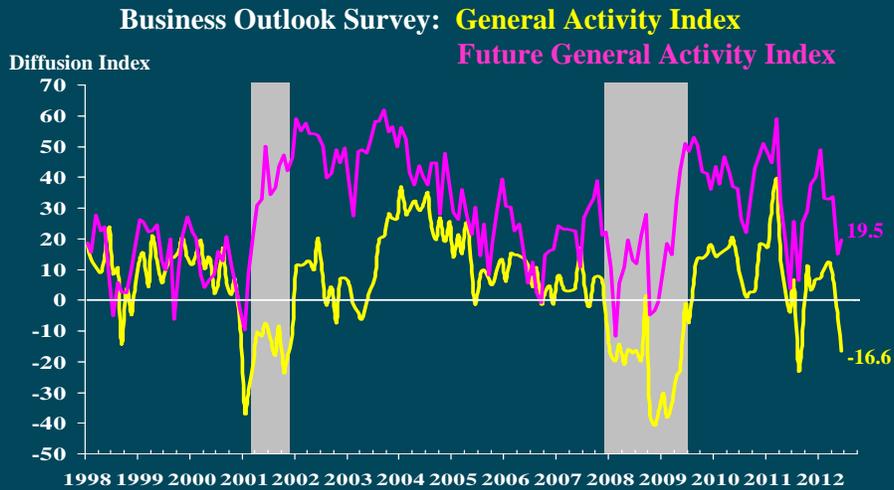
Unemployment rates are down since last August,  
but we have seen little movement over the past three months



Monthly data: Last point plotted is May 2012



Regional manufacturing activity slowed in May and June



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

Monthly data: Last point plotted is June 2012



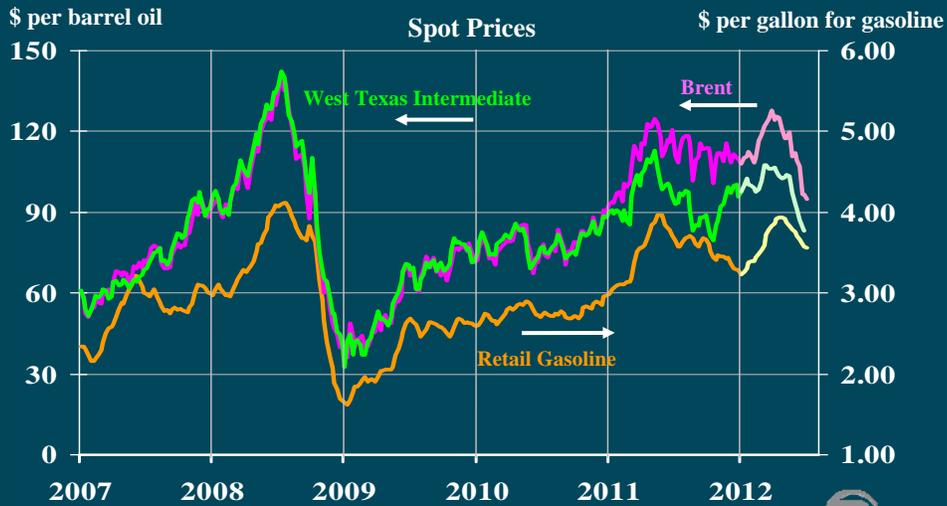
**At the national level, manufacturing activity has shown more strength than suggested by the regional surveys. Auto production remains strong.**



Monthly data: Last point plotted is May 2012

FEDERAL RESERVE BANK OF PHILADELPHIA

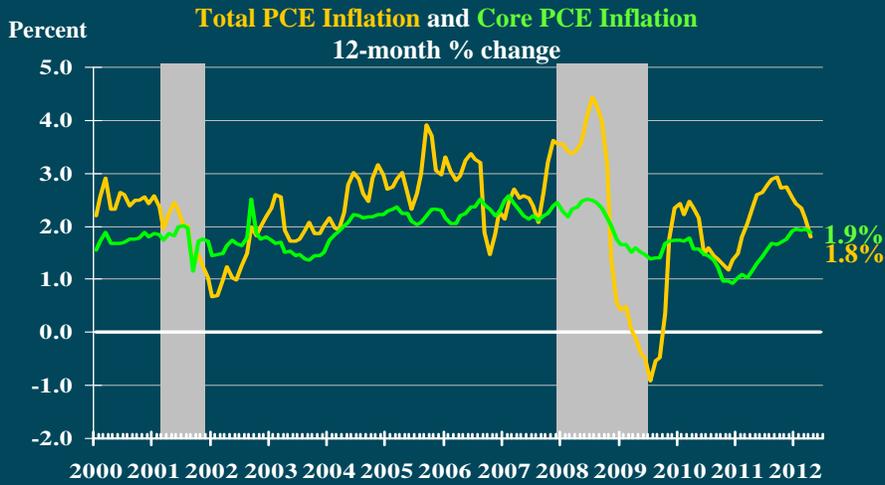
**Oil prices are down sharply since peaking in March. They are down about \$15 a barrel since the start of the year. Gasoline prices have fallen nearly 50¢ a gallon over the past three months.**



Weekly data: Last point plotted is June 15, 2012 for WTI and June 22, 2012 for Retail Gasoline and Brent.

FEDERAL RESERVE BANK OF PHILADELPHIA

**As oil prices have fallen, inflation has moderated toward its longer-run goal of 2 percent**



Monthly data: Last month plotted is April 2012



**Personal income growth has slowed in recent months consistent with slower employment growth**



Monthly data: Last point plotted is April 2012



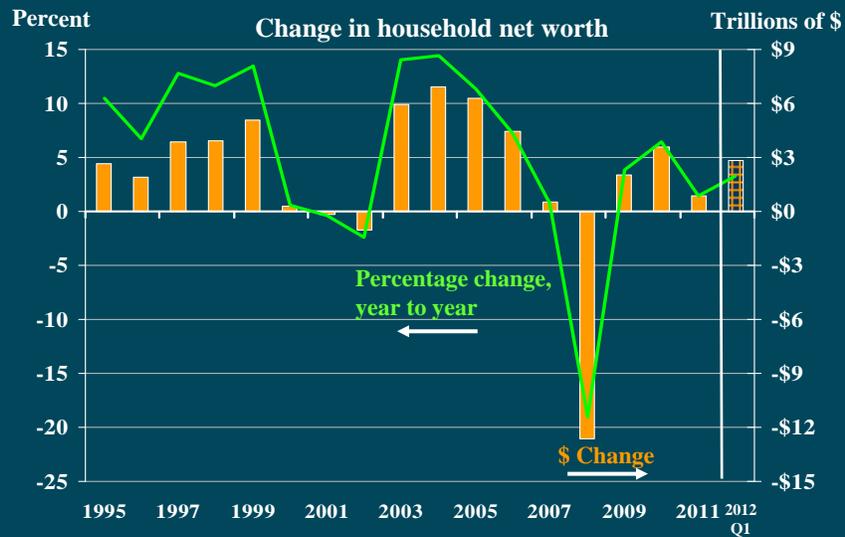
### Despite slower income growth, retail sales continue to grow at a moderate pace



Monthly data: Last point plotted is May 2012 for retail sales and April 2012 for sales excl. autos, gas, and building materials

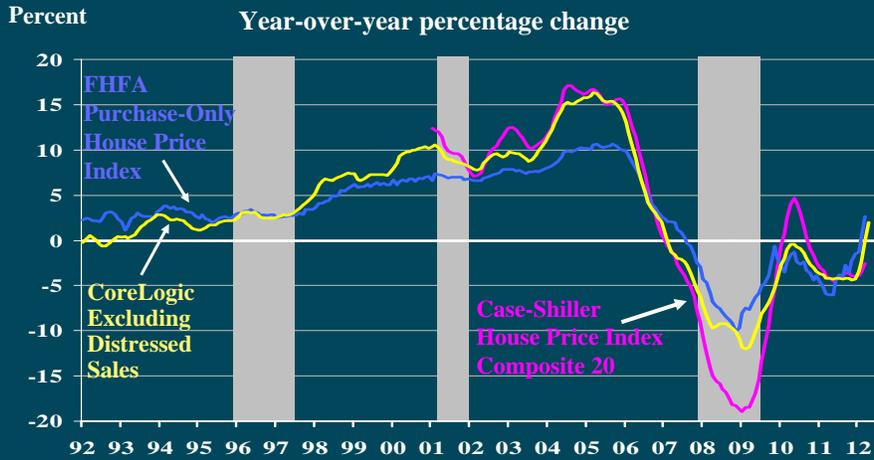


### Household net worth is beginning to recover after the sharp contraction in 2008



Source: FRB Flow of Funds, annual data for 1995-2011; quarterly data for 2012Q1

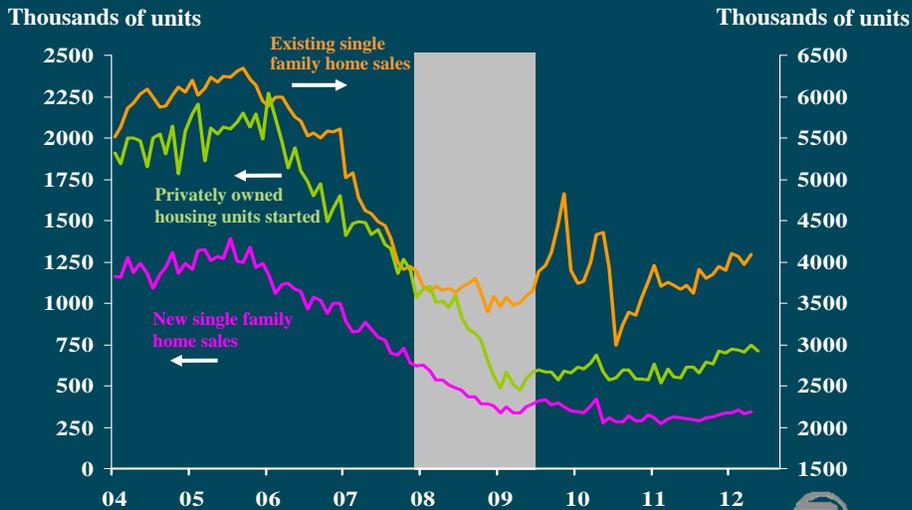
## House prices appear to have stabilized and may even be starting to rise



Monthly data: Last point plotted is March 2012 for Case-Shiller and FHFA and April 2012 for CoreLogic



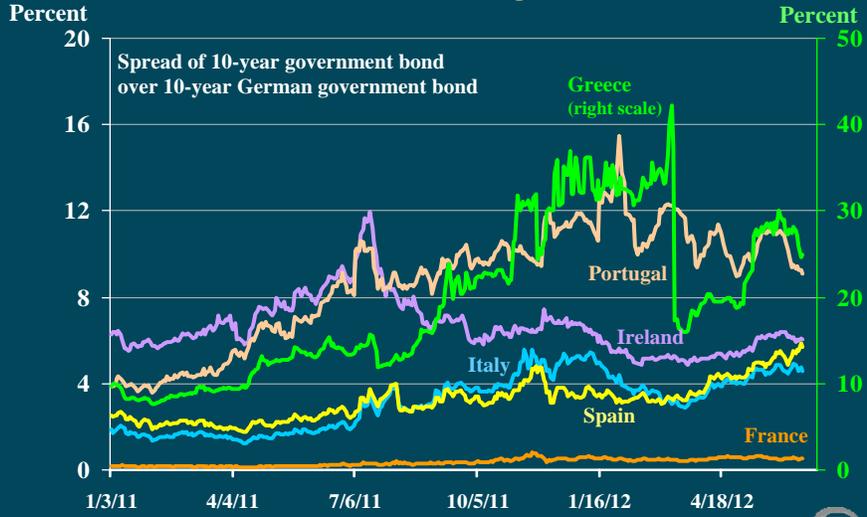
## There are signs that housing is starting to recover, with sales and starts moving up, albeit from very low levels



Monthly data: Last point plotted is April 2012



### Uncertainty surrounding the European sovereign debt and banking problems continues to cloud the global outlook



Daily: Last point plotted is June 19, 2012



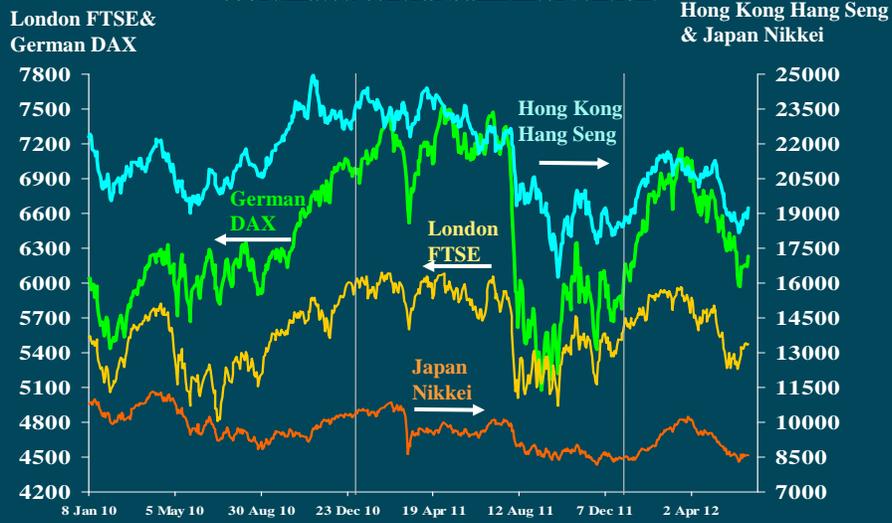
### Stock prices have been volatile on concerns about the European sovereign debt and banking situation. Year-to-date, the S&P500 is still up over 6 percent, on net.



Daily data: Last point plotted is June 20, 2012



Stock prices abroad have fallen on concerns about global recession and the European situation. In recent days, prices have risen on rumors of coordinated central bank intervention.



Daily data: Last point plotted is June 20, 2012

### The value of the dollar is rising on safe-haven flows

Trade-weighted value of \$ against major currencies



Weekly data: Last point plotted is June 7, 2012



Interest rates are very low across the maturity spectrum.  
 Longer-term interest rates have fallen as investors seek the safe haven of U.S. Treasury securities.  
 For three and a half years, the Fed has kept the fed funds rate at essentially zero.



Weekly data: Last point plotted is June 15, 2012



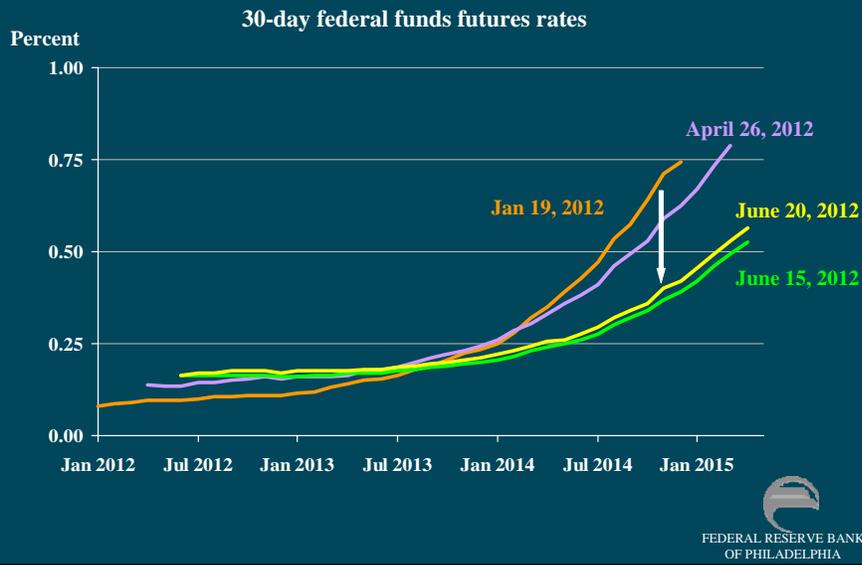
U.S. banks' on-balance-sheet exposure to the peripheral countries in Europe is relatively small



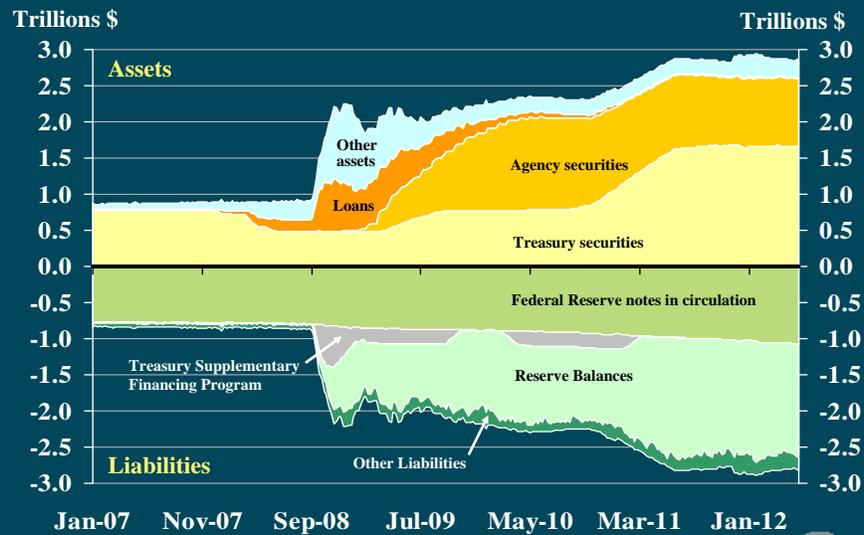
Source: BIS Consolidated Banking Statistics (June 2012 Report)



Market participants had priced in more accommodative policy given the weaker-than-expected economic data and worries about developments in Europe



The Fed holds nearly \$1 trillion in agency mortgage-backed securities and agency debt. Operation twist lengthened the portfolio's maturity.



Weekly data: Last point plotted is June 15, 2012

FEDERAL RESERVE BANK OF PHILADELPHIA

**The FOMC announced it will implement another round of operation twist through the end of this year**

- Operation twist 1 announced last September and completed at end of June
  - Purchased long-term Treasuries and sold short-term Treasuries
    - Bought \$400 billion of Treasuries with remaining maturities of 6 to 30 years
    - Sold \$400 billion of Treasuries with remaining maturities of 3 years or less.
- Operation twist 2 announce this week to be completed by year-end
  - Buy \$267 billion of Treasuries with remaining maturities of 6 to 30 years
  - Sell an equal amount with maturities of 3 years or less
  - Same pace of transactions as currently doing
- Fed will hold no short-term Treasuries once completed

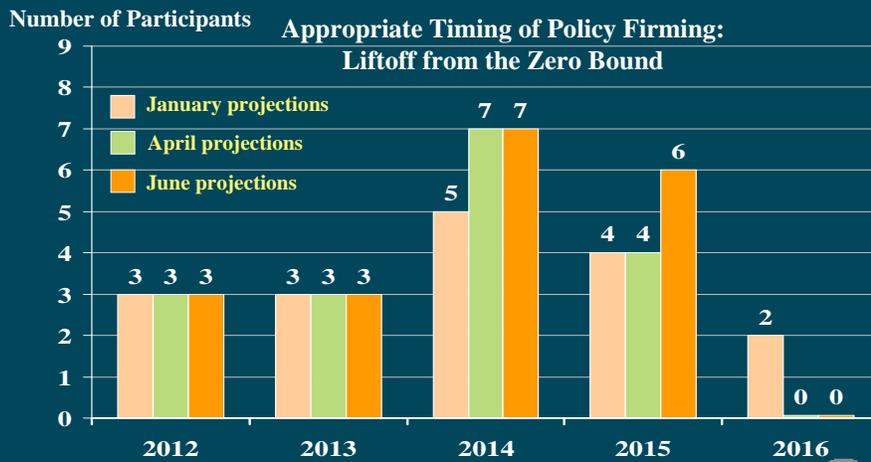


FEDERAL RESERVE BANK  
OF PHILADELPHIA

## Appendix: Additional Charts



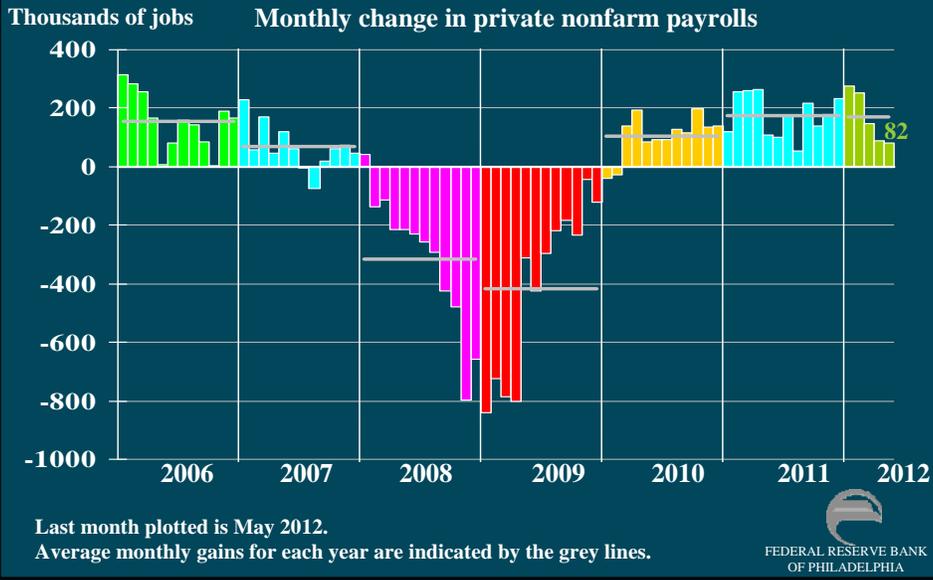
FOMC participants' assumptions about the appropriate policy paths underlying their economic projections have not changed much.  
[In June, two new Fed governors participated.]



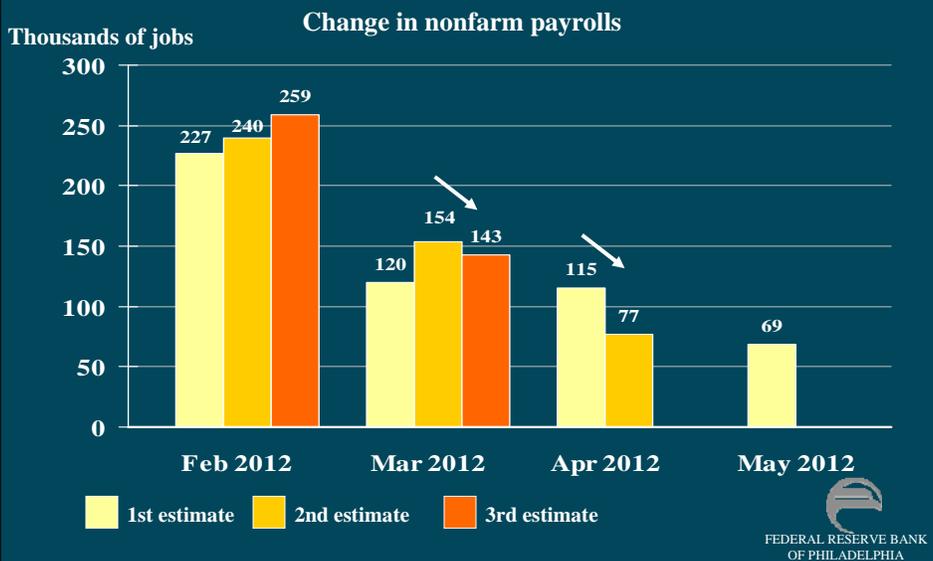
Source: FOMC Minutes and Press Conference



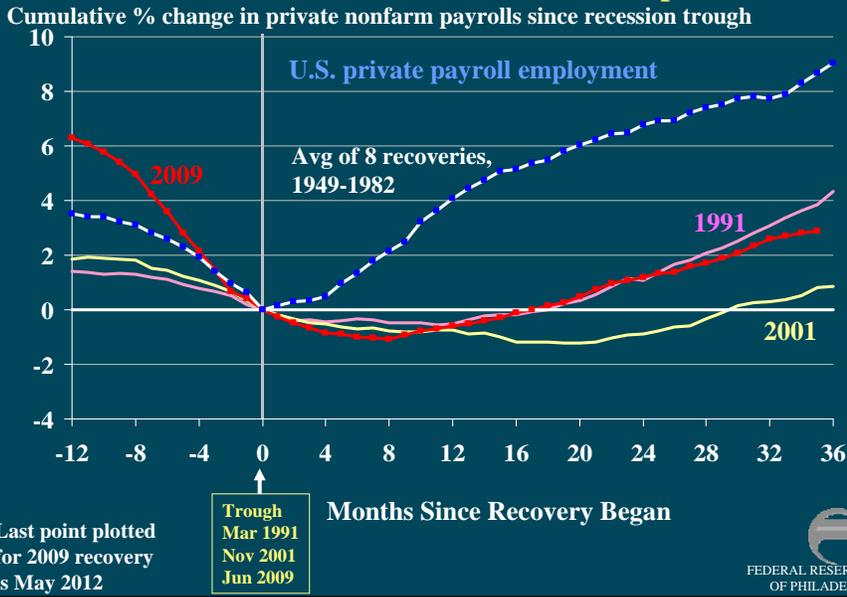
## Private sector payroll growth has slowed in recent months



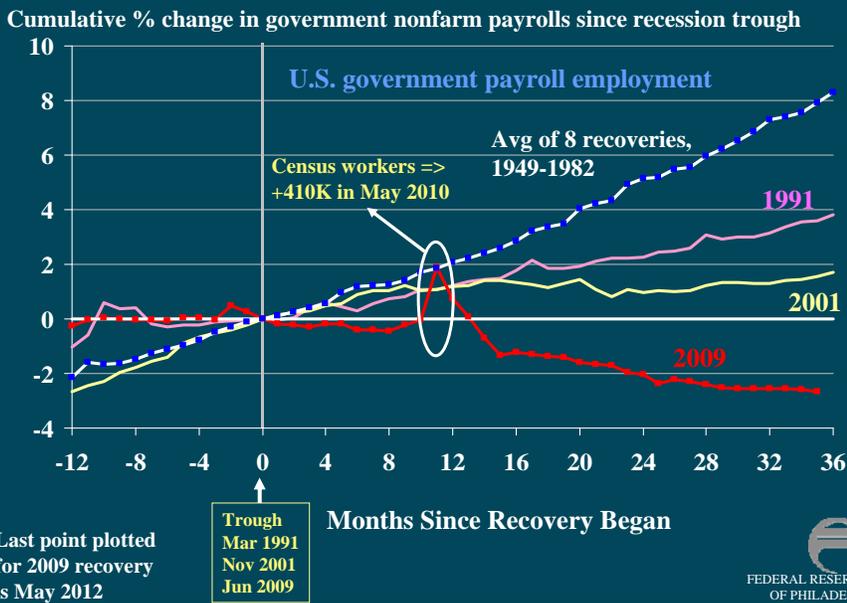
## Recent months' readings on payrolls have been revised down



**Private sector job growth in the U.S. is slowing a tad compared with the 1991 “jobless” recovery.  
And this recession was much sharper.**

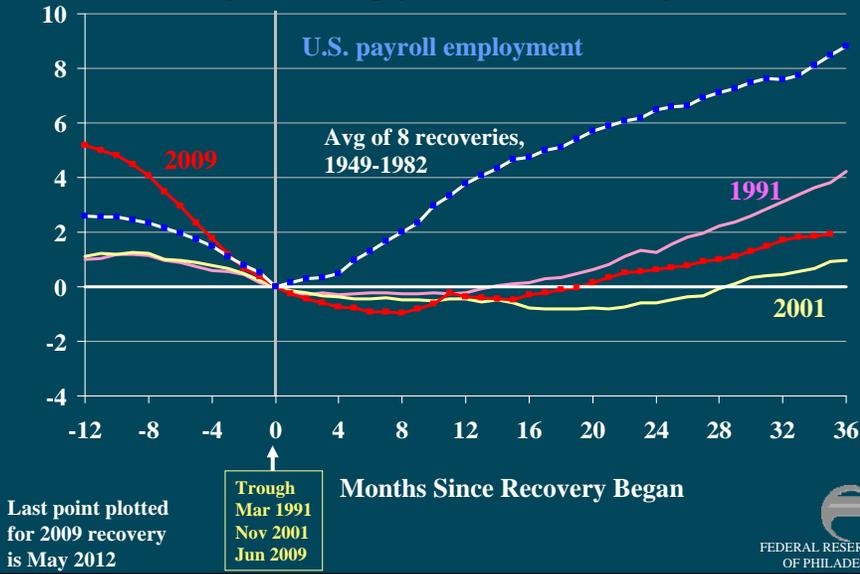


**Unlike prior recessions, government jobs are being cut**



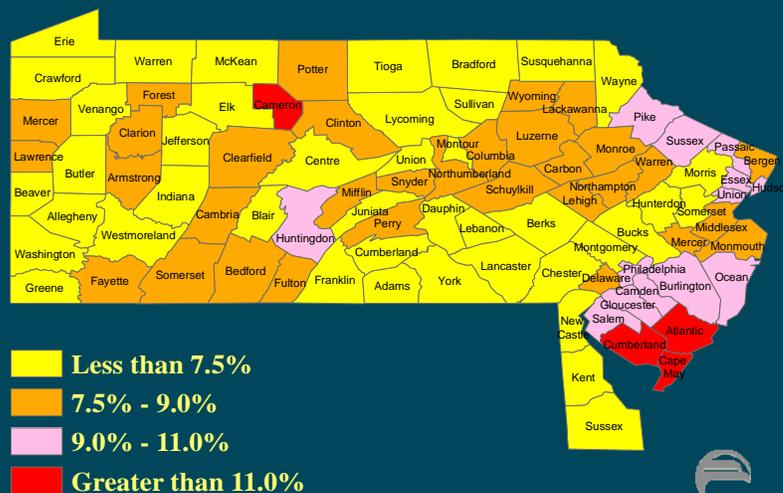
## Total employment growth in the nation is weaker than in the 1991 recovery

Cumulative % change in nonfarm payrolls since recession trough



## Unemployment rates vary across the region, with higher rates in southern New Jersey

County Unemployment Rates: April 2012



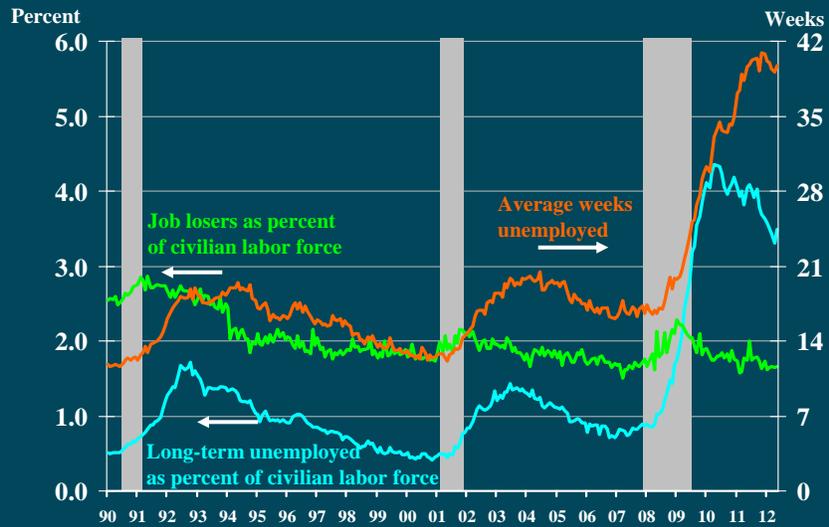
## The share of unemployment that is long-term remains high



Monthly data: Last point plotted is May 2012



## Long-term unemployment remains high



Monthly data: Last point plotted is May 2012.

Job losers are people unemployed for less than 5 weeks.

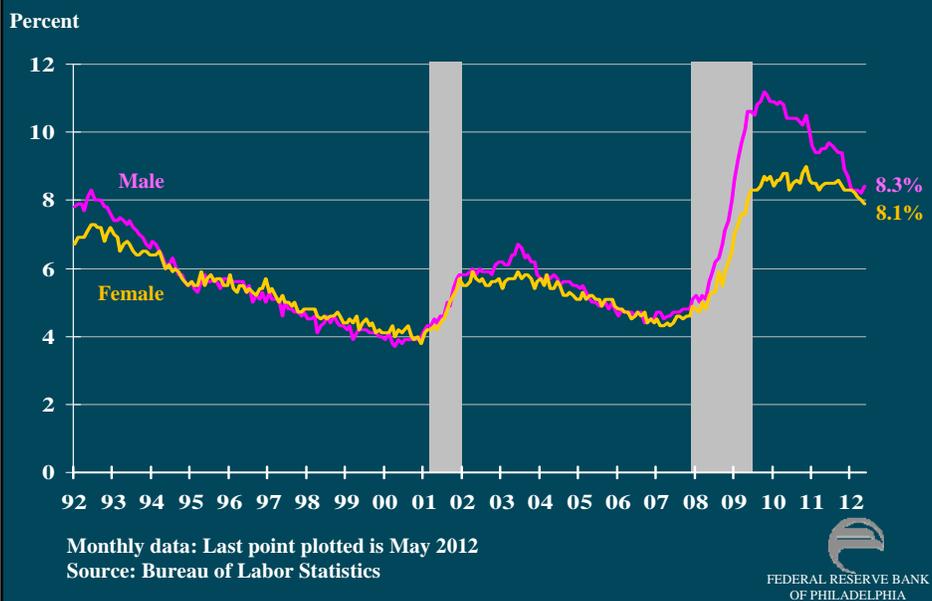
Long-term unemployed are people unemployed for more than 26 weeks.



**The unemployment rate is higher when we include all marginally attached workers and those working part-time for economic reasons. Both ticked up in May**



**Unemployment rates have differed by gender but are now converging**



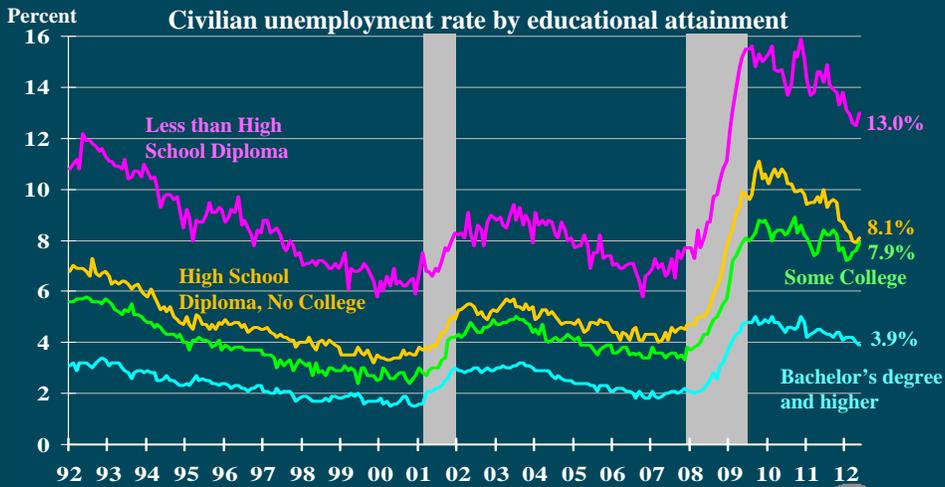
### Unemployment rates differ by race



Monthly data: Last point plotted is May 2012  
 Source: Bureau of Labor Statistics



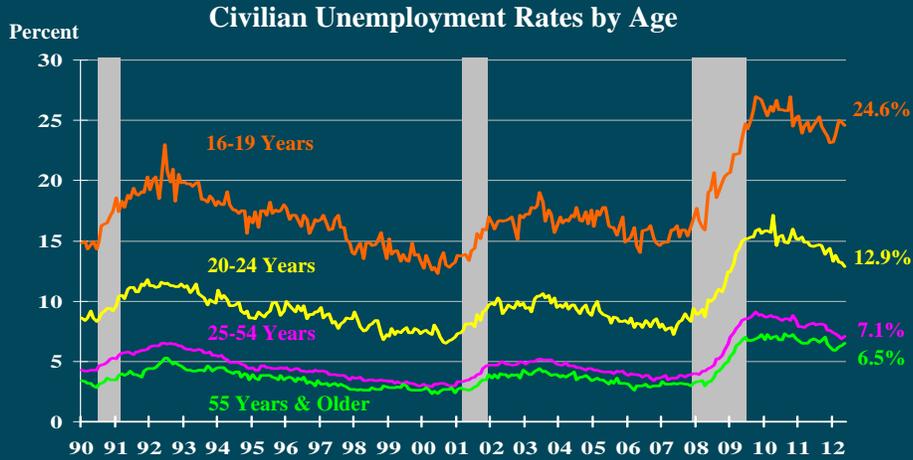
### Unemployment rates are significantly lower for those with more education. The only category with a drop in unemployment in May was the bachelor's degree or higher category.



Monthly data: Last point plotted is May 2012



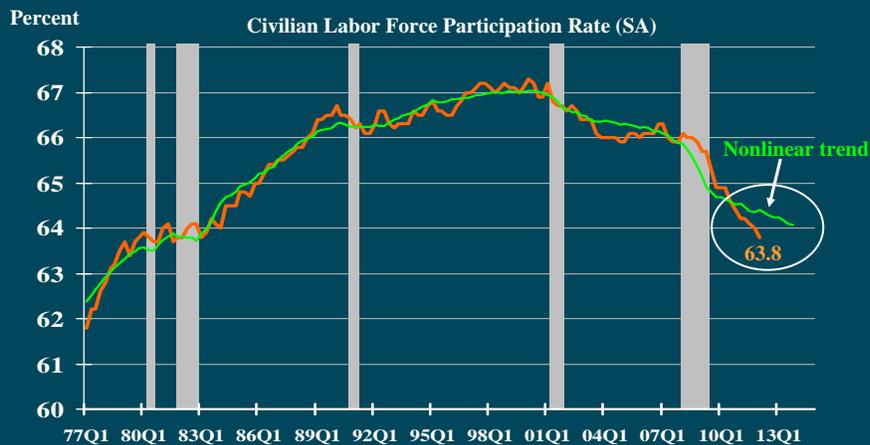
## Unemployment among young people remains particularly high



Monthly data: Last point plotted is May 2012



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

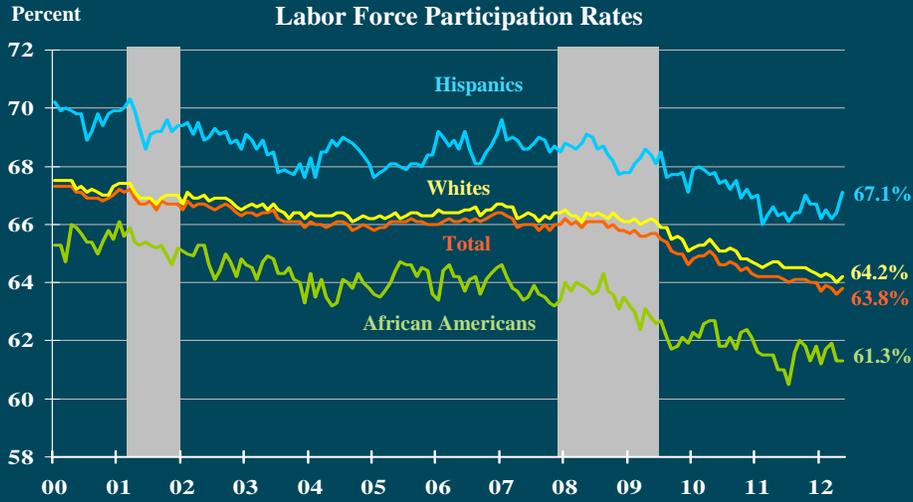


Quarterly data: Last point plotted for participation is 2012Q1

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.

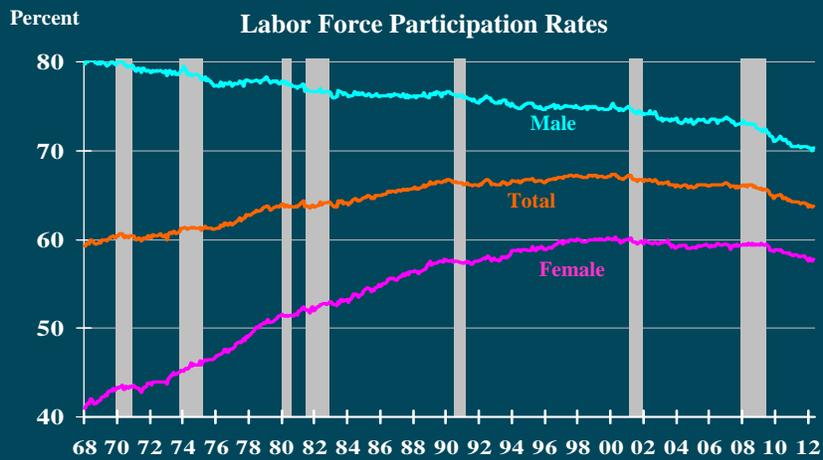
### Labor force participation rates differ by race



Monthly data: Last point plotted is May 2012  
 Source: Bureau of Labor Statistics



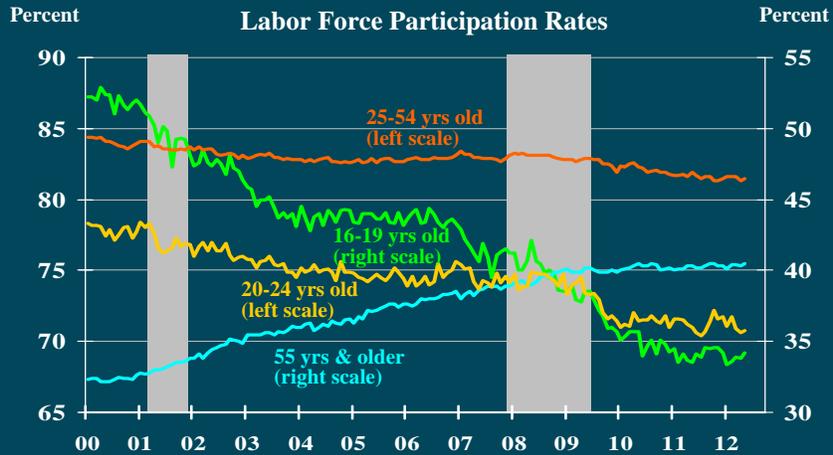
### Both male and female participation rates have declined since the recession ended



Monthly data: Last point plotted is May 2012  
 Source: Bureau of Labor Statistics

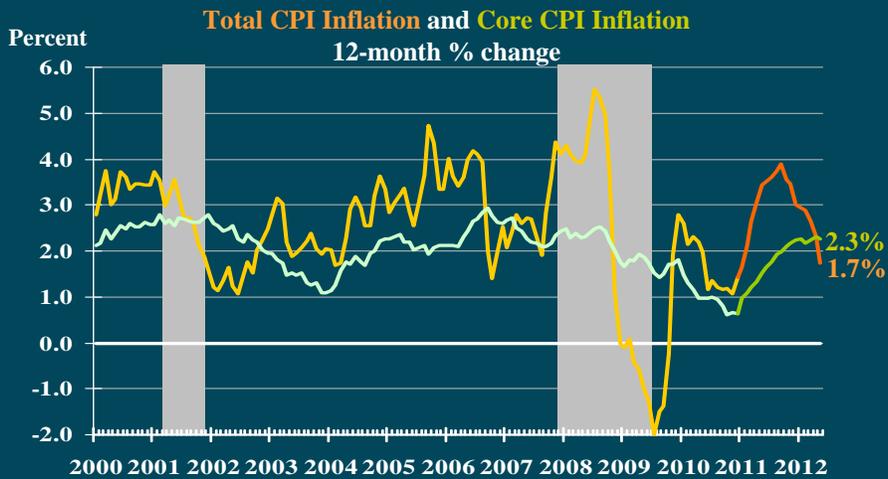


### Teenagers and young adults have seen the sharpest declines in labor force participation



Monthly data: Last point plotted is May 2012  
 Source: Bureau of Labor Statistics

### Total inflation is down from its peak reflecting the drop in oil prices



Monthly data: Last month plotted is May 2012



## Longer-term inflation expectations appear to be well-anchored

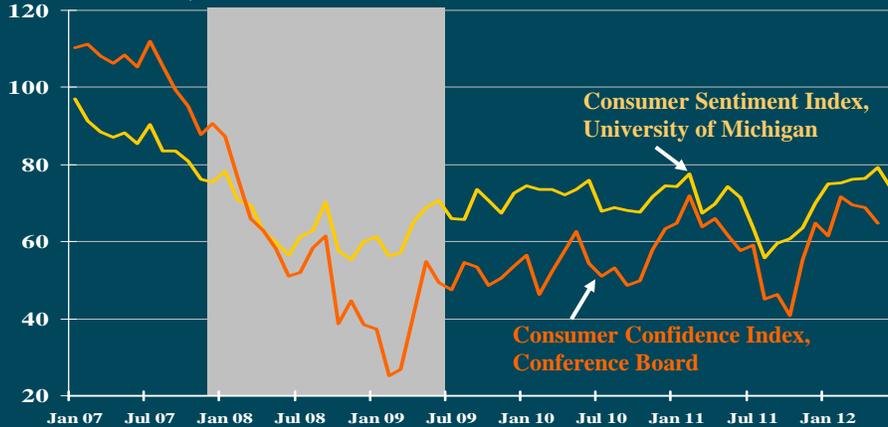


Daily data: Last point plotted is June 8, 2012 for inflation compensation and Second Quarter 2012 SPF for 10-year CPI inflation expectations



## Consumer sentiment fell the past two months on uncertainty over the European sovereign debt problems, the global slowdown, and U.S. fiscal problems looming at year-end

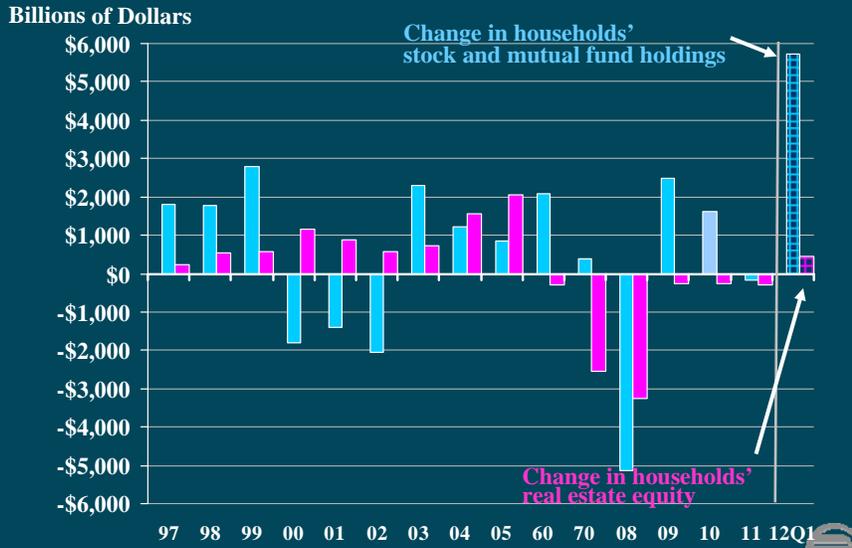
Sentiment index, 66Q1 = 100  
Confidence index, 1985 = 100



Monthly data: Last point plotted is June 2012 for sentiment and May 2012 for confidence

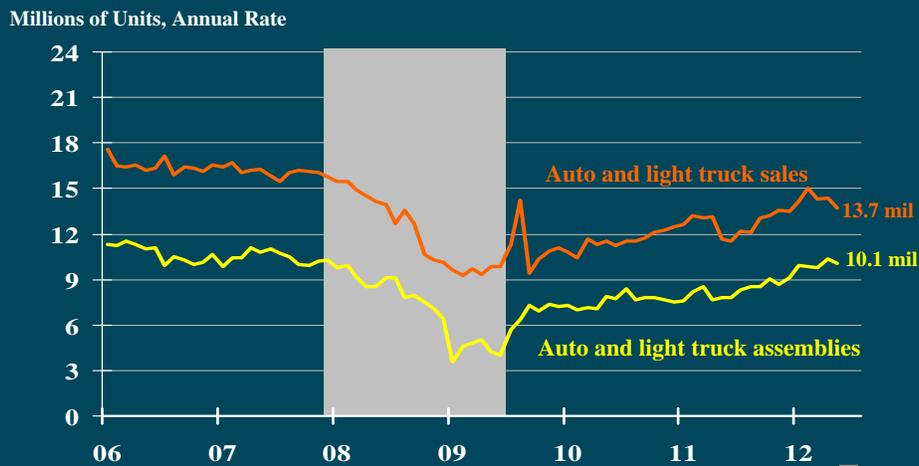


**The rebound in the stock market contributed to a sizable rise in household wealth in the first quarter**



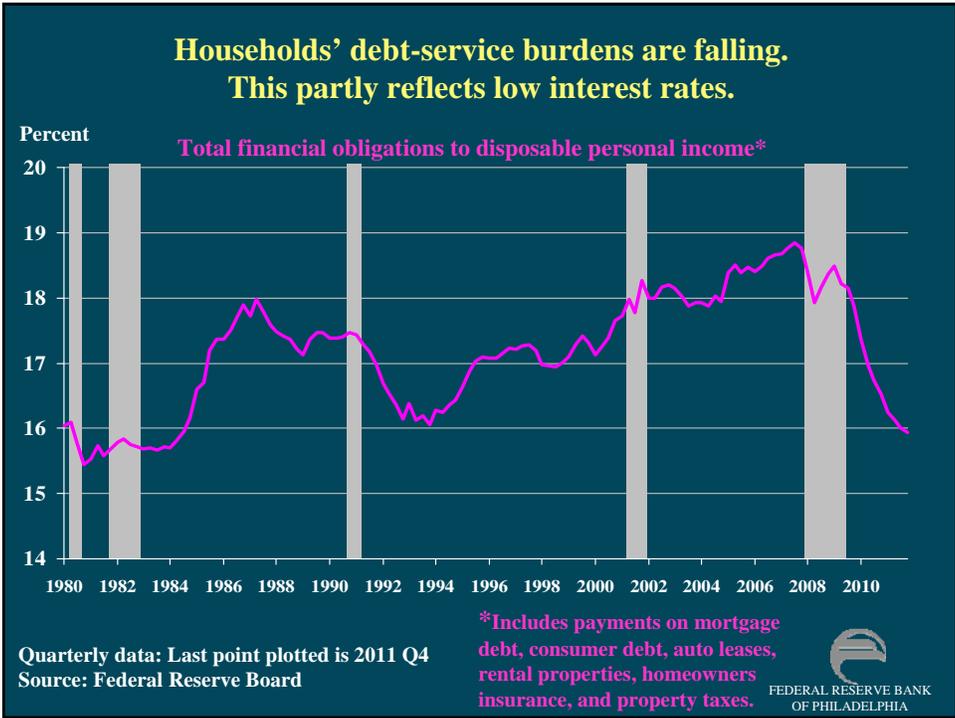
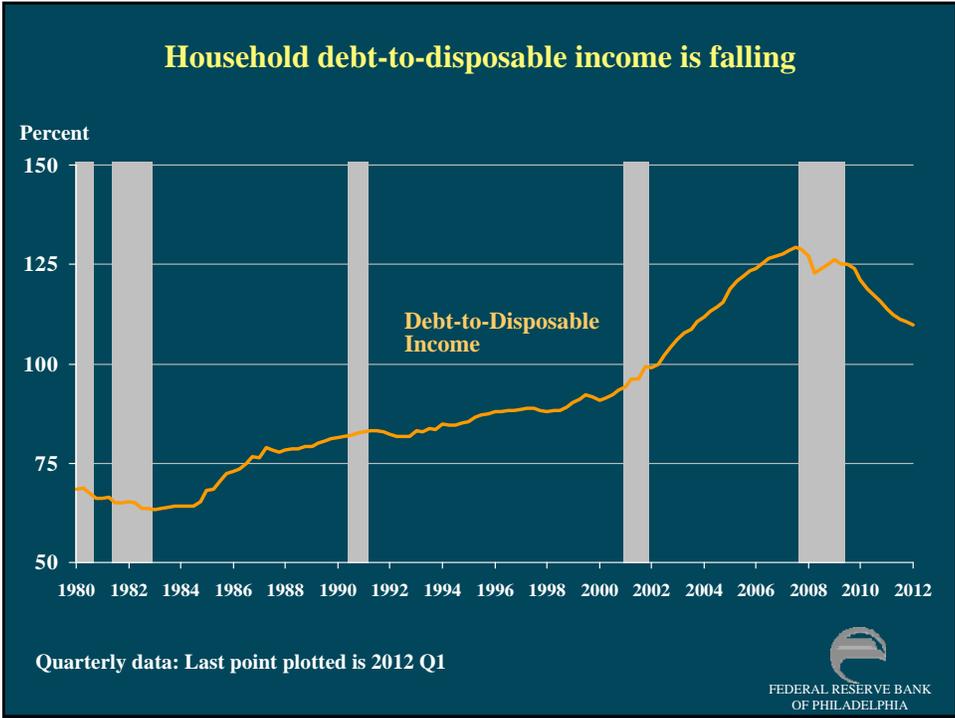
Source: FRB Flow of Funds, annual data for 1997-2011; quarterly data for 2012Q1

**Auto production remains strong**



Monthly data: Last point plotted is May 2012

FEDERAL RESERVE BANK OF PHILADELPHIA



## Inventories of unsold homes are down from their peaks

Months' supply at current sales pace

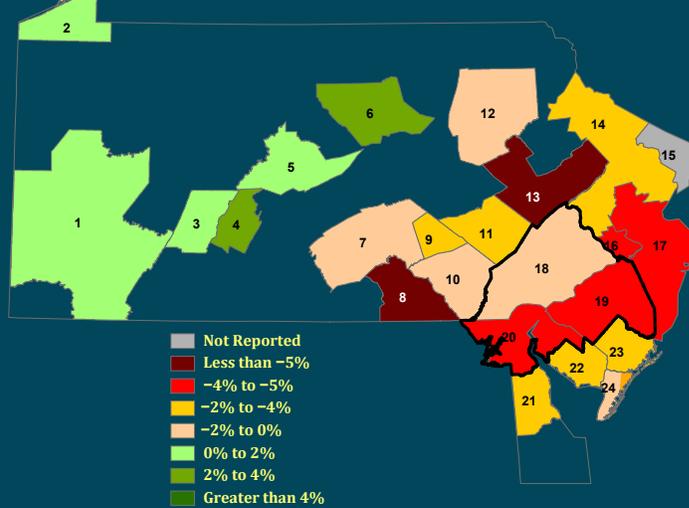


Source: National Association of Realtors  
 Monthly data: Last point plotted is April 2012



## House prices are firming in the western part of Pennsylvania and the Marcellus shale area

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

## Delinquencies continue to move down. Still, one in 13 mortgages is seriously delinquent.

Percent of all mortgages outstanding,  
1-4 residential units

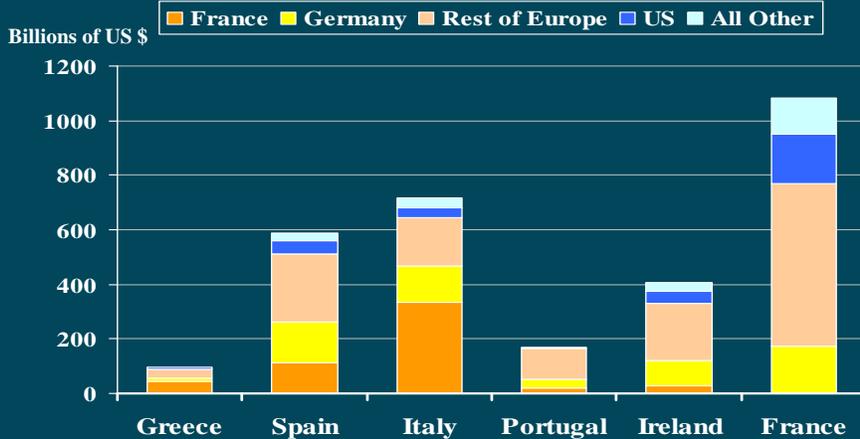


Quarterly data: Last point plotted is 2012Q1  
Source: Mortgage Bankers Association, seasonally adjusted



## European banks are the most exposed to Portugal, Italy, Ireland, Greece, and Spain

Banking System Credit Exposures to PIIGS as of 2011Q4



Source: BIS Consolidated Banking Statistics (June 2012 Report)





FEDERAL RESERVE BANK  
OF PHILADELPHIA