

# Report on Economic and Financial Developments

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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.**

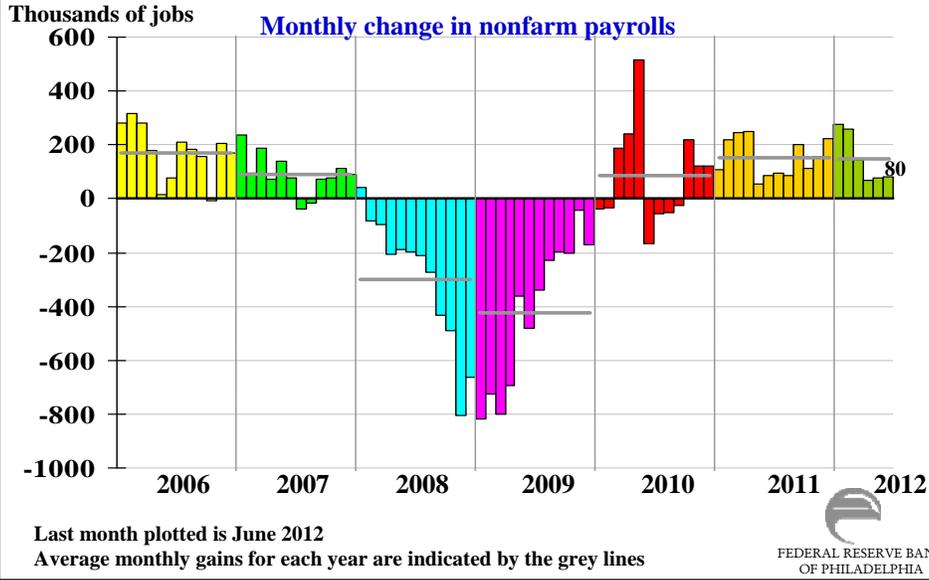
## Executive summary

- Economic growth slowed in the second quarter in both the nation and the district
- Downside risks include:
  - European sovereign debt & banking system problems
  - U.S. fiscal situation looming at year-end
  - Slower global growth
- Several central banks have taken further steps to try to boost growth
- Policy questions:
  - Has the outlook changed enough to warrant further action?
  - If so, what action?

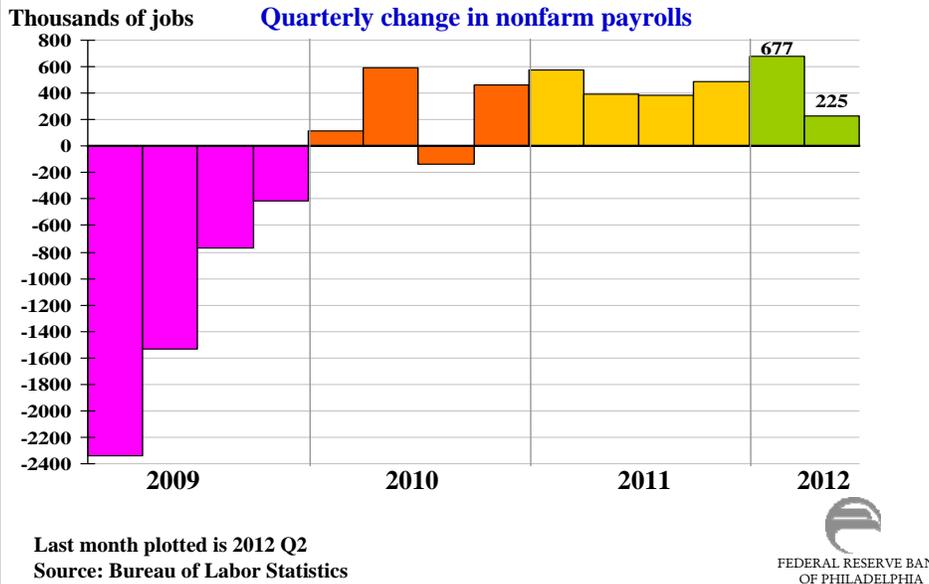


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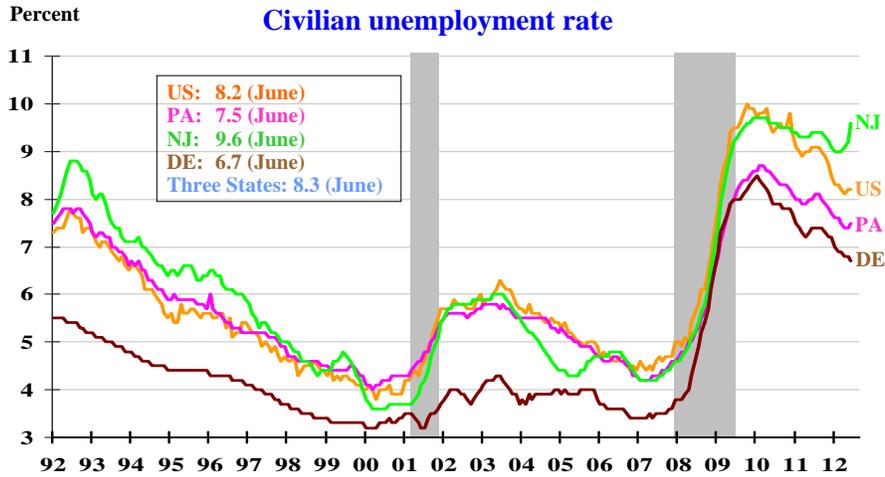
Employment growth has weakened since the start of the year.  
 In June, payrolls rose by 80 thousand jobs.  
 Average monthly job gains this year are no higher than last year.



Quarterly job gains in the second quarter were  
 only 1/3 of what they were in the first quarter



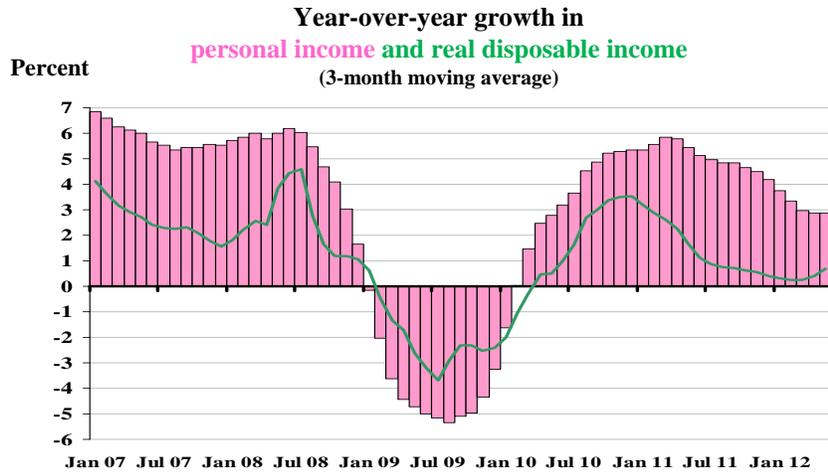
Progress on unemployment has stalled over the past three months.



Source: Bureau of Labor Statistics and Phila Fed Research Department.  
 Monthly data: Last point plotted is June 2012.



Personal income growth has stabilized to a modest 3 percent pace over the past three months



Monthly data: Last point plotted is May 2012



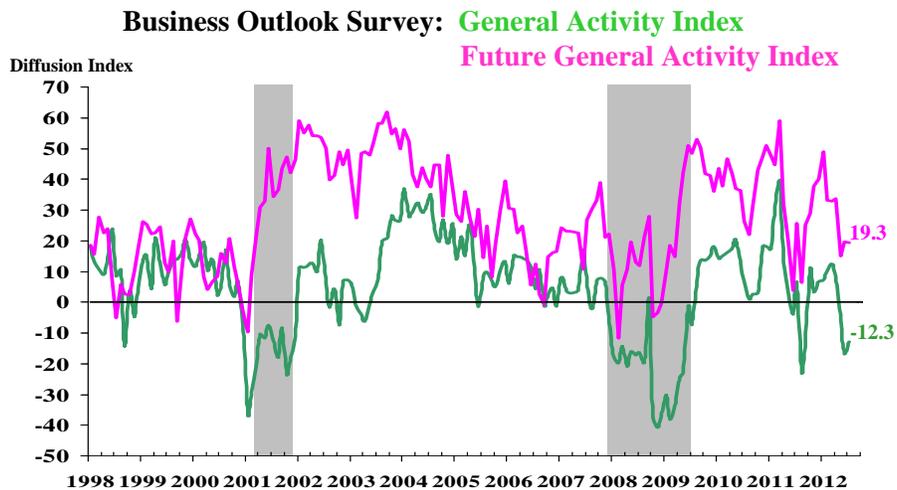
### Retail sales growth moderated in June



Monthly data: Last point plotted is June 2012



### Regional manufacturing activity has slowed over the past three months, similar to last summer

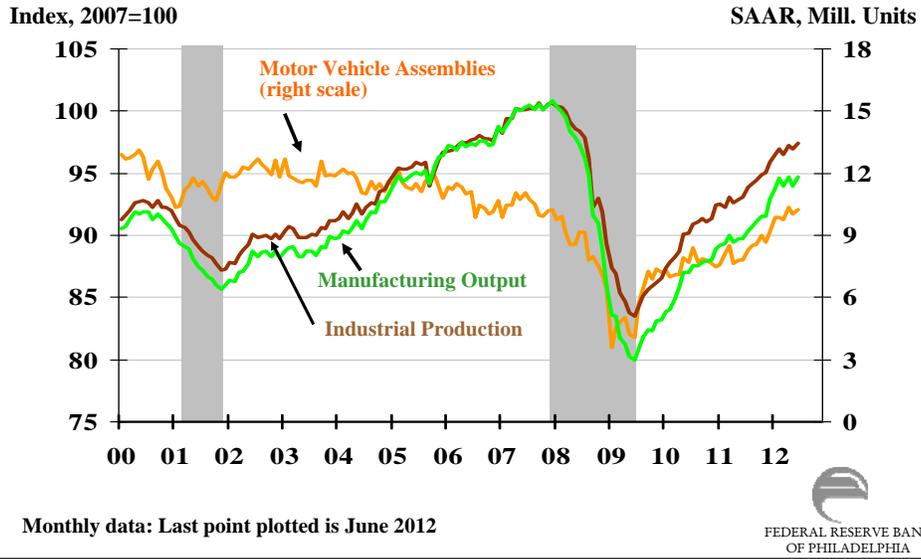


Index represents percentage of respondents reporting an increase minus percentage reporting a decrease.

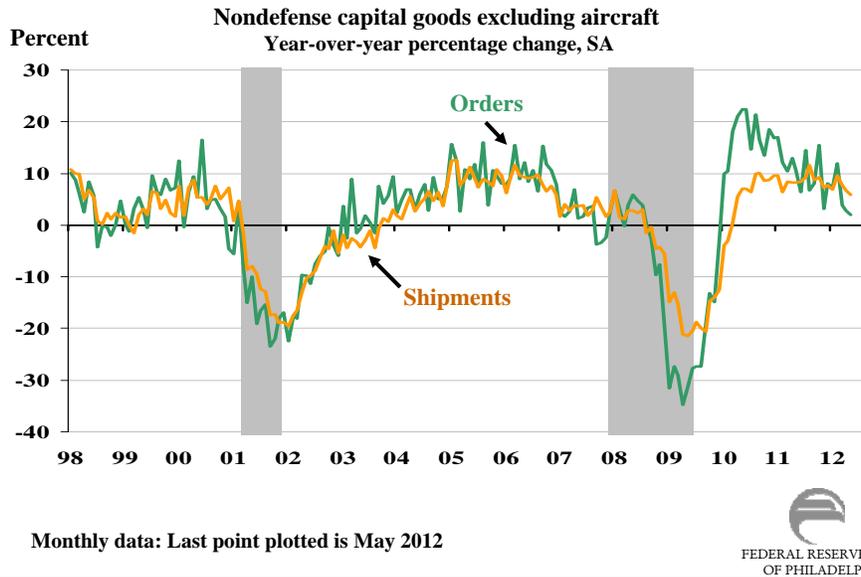
Monthly data: Last point plotted is July 2012



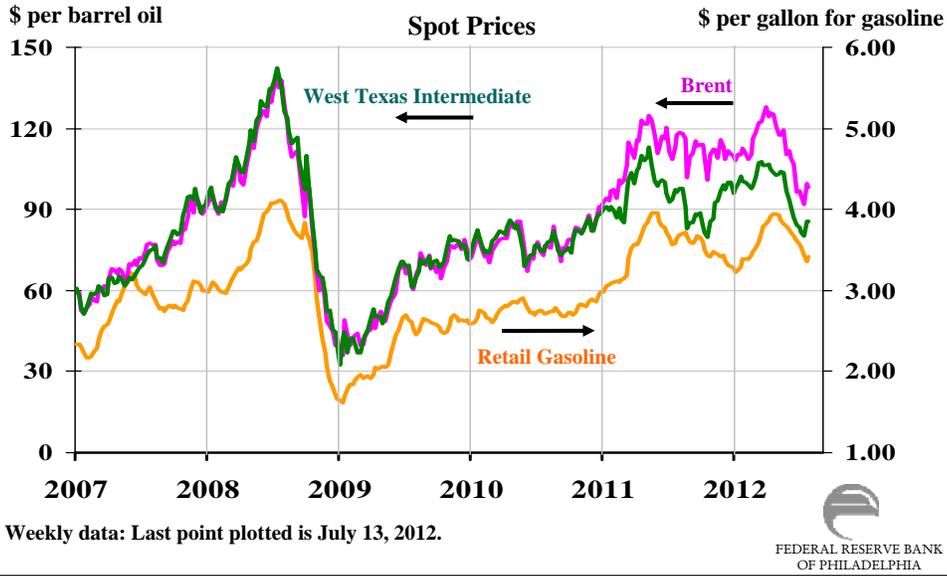
**At the national level, manufacturing activity rebounded in June, but its pace stepped down in Q2 compared to Q1**



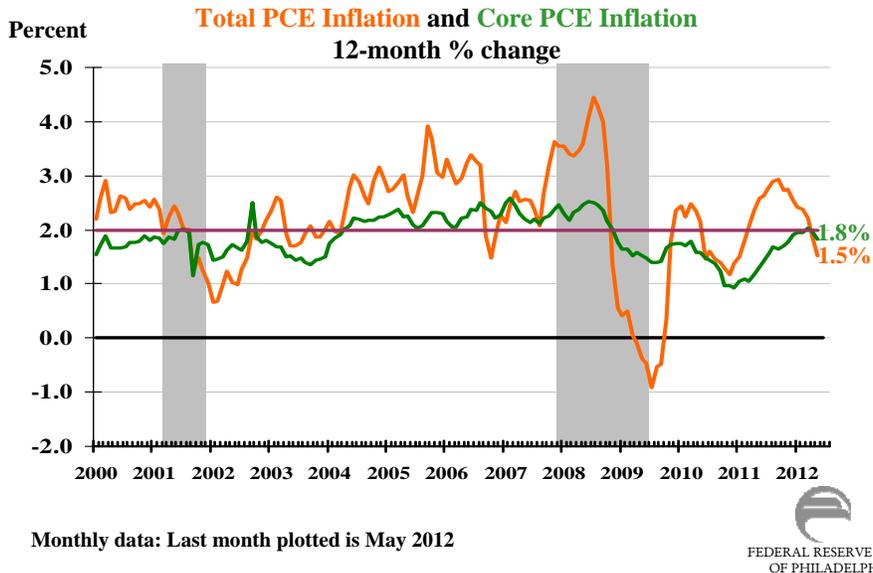
**Business investment in equipment and software has also softened**



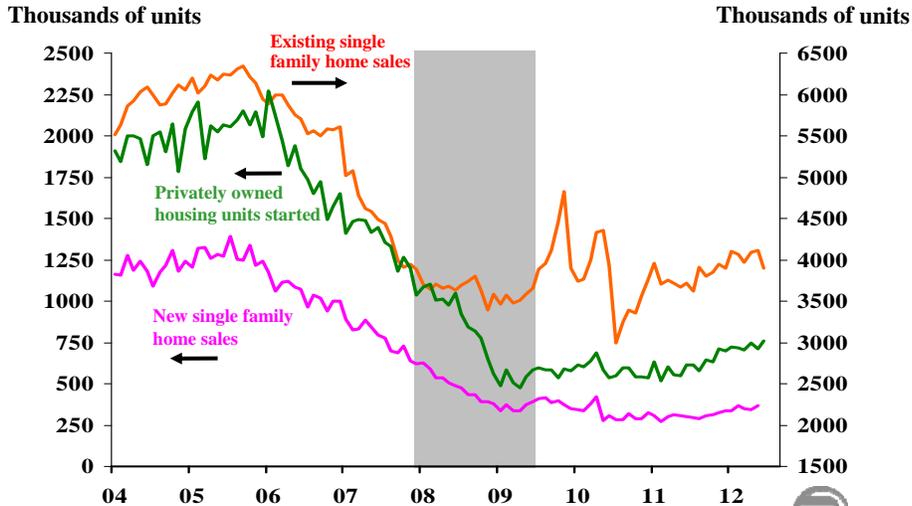
Oil prices have firmed over the past month,  
but are down about \$14 a barrel since the start of the year.  
Gasoline prices remain under \$3.50 a gallon.



As oil prices have fallen, inflation has moderated  
to slightly under the FOMC's longer-run goal of 2 percent



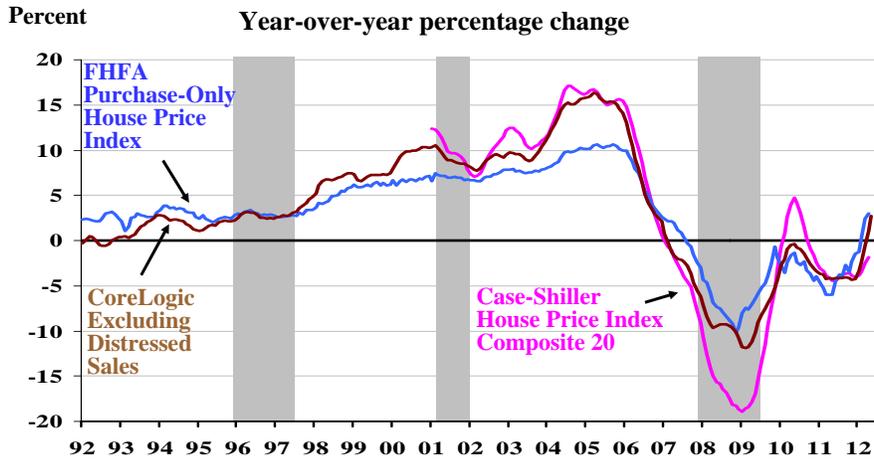
**There are signs that housing is starting to recover, with sales and starts moving up, albeit from very low levels**



Monthly data: Last point plotted is June 2012 for starts and existing home sales and May 2012 for new home sales

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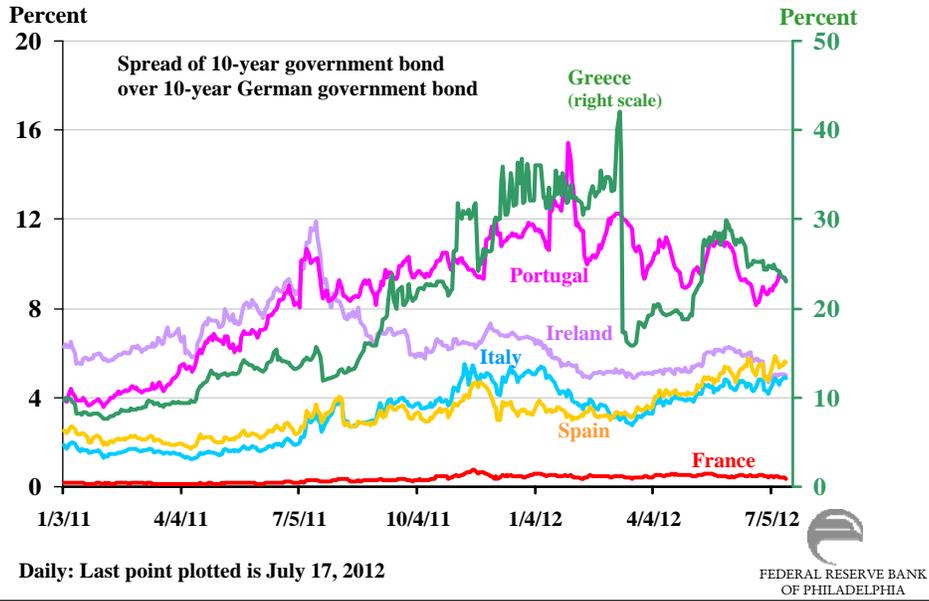
**House prices appear to have stabilized and may even be starting to rise**



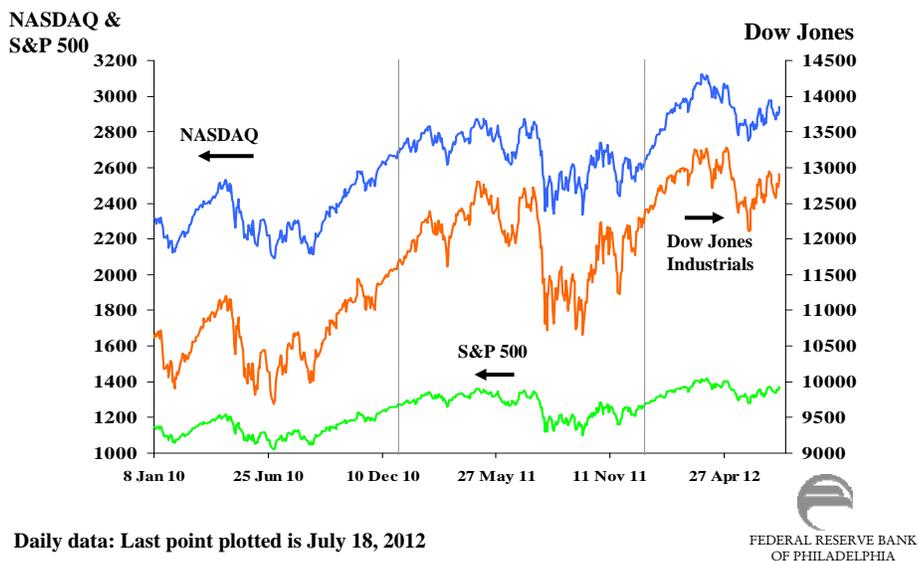
Monthly data: Last point plotted is April 2012 for Case-Shiller and FHFA and May 2012 for CoreLogic

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**Uncertainty surrounding the European sovereign debt and banking problems continues to cloud the global outlook, but European countries have taken some positive steps**



**Stock prices continue to be volatile on concerns about Europe and the global growth slowdown. The S&P500 is little changed, on net, over the past month, but is up over 8 percent, on net, year-to-date.**



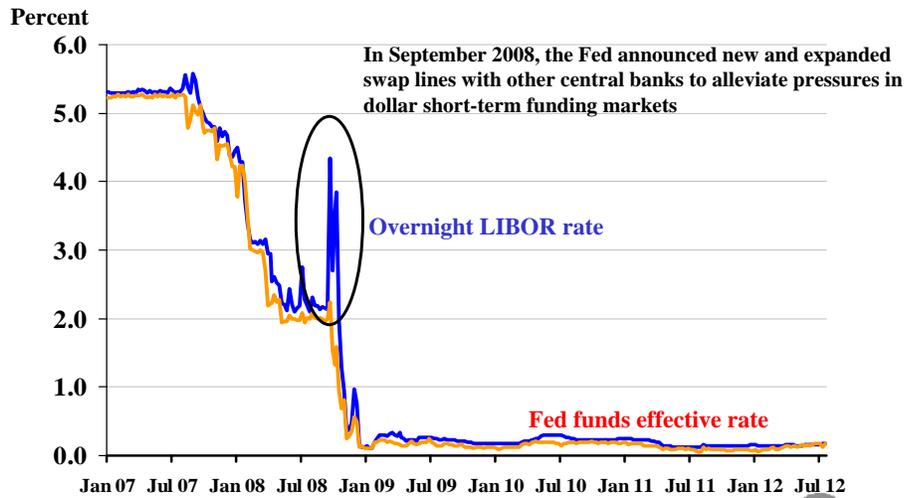
**Interest rates are very low across the maturity spectrum.  
 Longer-term interest rates have fallen as investors  
 seek the safe haven of U.S. Treasury securities.  
 The Fed has kept the fed funds rate at essentially zero for 3-1/2 years.**



Weekly data: Last point plotted is July 12, 2012



**Calculation of LIBOR has come under increased scrutiny**



Weekly data: Last point plotted is July 12, 2012



## What is LIBOR?

- LIBOR = London Interbank Offered Rate
- “At what rate could you borrow funds, were you to do so by asking for and then accepting interbank offers in a reasonable market size just prior to 11 am London time?”
  - Not based on actual transactions
  - Rates for 10 currencies and 15 maturities
- British Bankers Association collects responses from 18 banks; Thompson Reuters calculates the trimmed arithmetic mean
  - 3 US banks: Bank of America, Citigroup, JP Morgan Chase
- Used as a reference rate in a variety of financial contracts including swaps, commercial loans, mortgages, student loans
  - In the US, mortgages tied to LIBOR:
    - 6% of number of 1<sup>st</sup> mortgages = 3 million loans
    - 9% of outstanding principle of 1<sup>st</sup> mortgages = \$800 billion



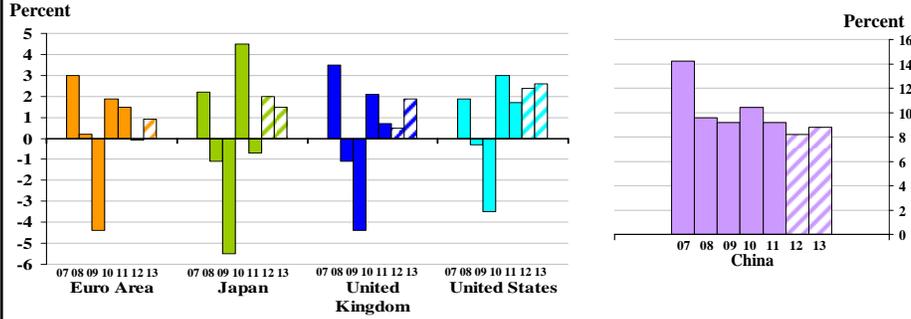
## Central banks around the world have been easing monetary policy

- Fed
  - Extended operation twist to year-end
- China, Brazil, South Korea, Australia, Denmark
  - Cut policy rates
- Japan:
  - Increased Treasury bill purchases under Asset Purchase Program
- ECB
  - Cut central bank lending and deposit rates
- United Kingdom
  - Increased asset purchases
  - “Funding for Lending Scheme” – low-cost funding to banks that increase lending to households and firms



Growth is expected to be modest in many countries over the next two years

Real GDP Growth, SAAR



Source: OECD Economic Outlook, May 2012 for China and June 2012 for others. Hatched bars are forecasts.



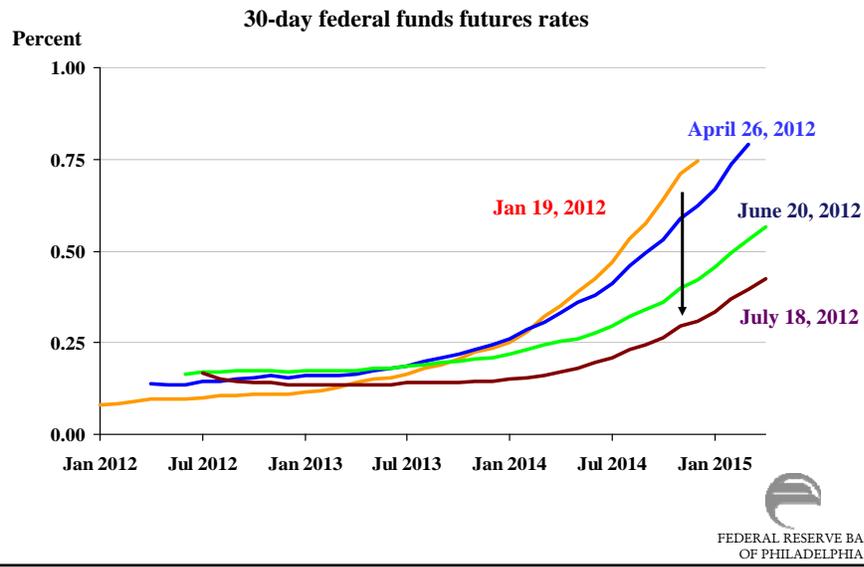
The fiscal cliff is a risk to the forecast

	\$ billions	% of FY13 GDP
<b>Changes in Revenue Policies</b>	<b>399</b>	<b>2.5%</b>
Expiration of tax provisions and adjustments to AMT	221	1.4%
Expiration of employee's payroll tax reduction	95	0.6%
Other expiring provisions	65	0.4%
Taxes included in Affordable Care Act	18	0.1%
<b>Changes in Spending Policies</b>	<b>103</b>	<b>0.6%</b>
Automatic sequestration	65	0.4%
Expiration of emergency unemployment benefits	26	0.2%
Reduction in Medicare payment rates for doctors	11	0.1%
<b>Other Changes in Revenues and Spending</b>	<b>105</b>	<b>0.7%</b>
<b>Total Change in Deficit</b> <i>(without economic feedback effects)</i>	<b>607</b>	<b>3.8%</b>

Source: Congressional Budget Office, May 2012



**Market participants continue to price in more accommodative policy given the weaker economic data**



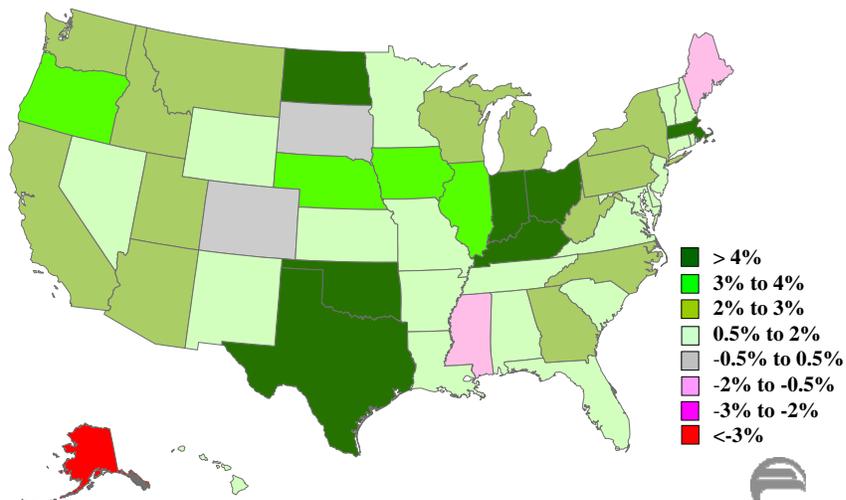
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## Appendix: Additional Charts

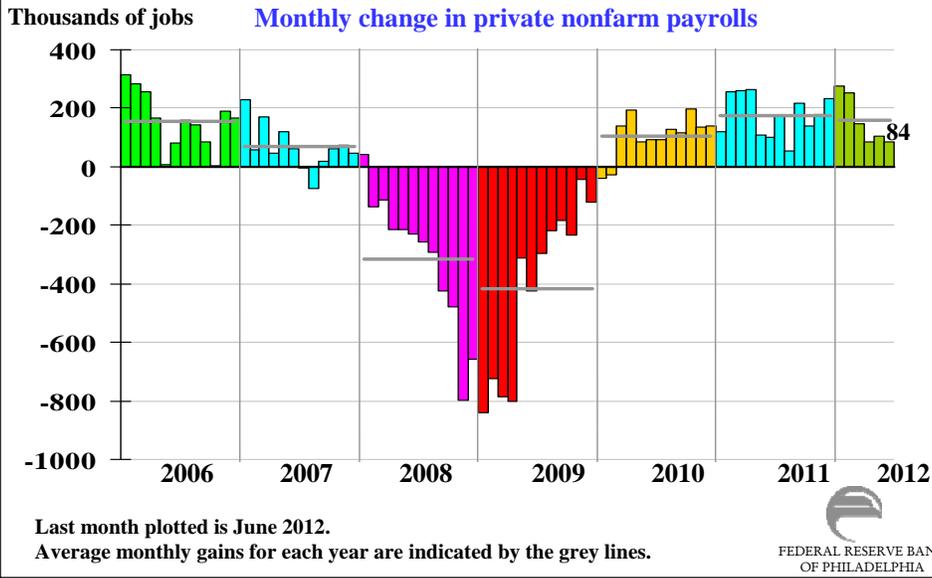


### Economic activity continues to expand in most states, but at a slower pace than earlier this year

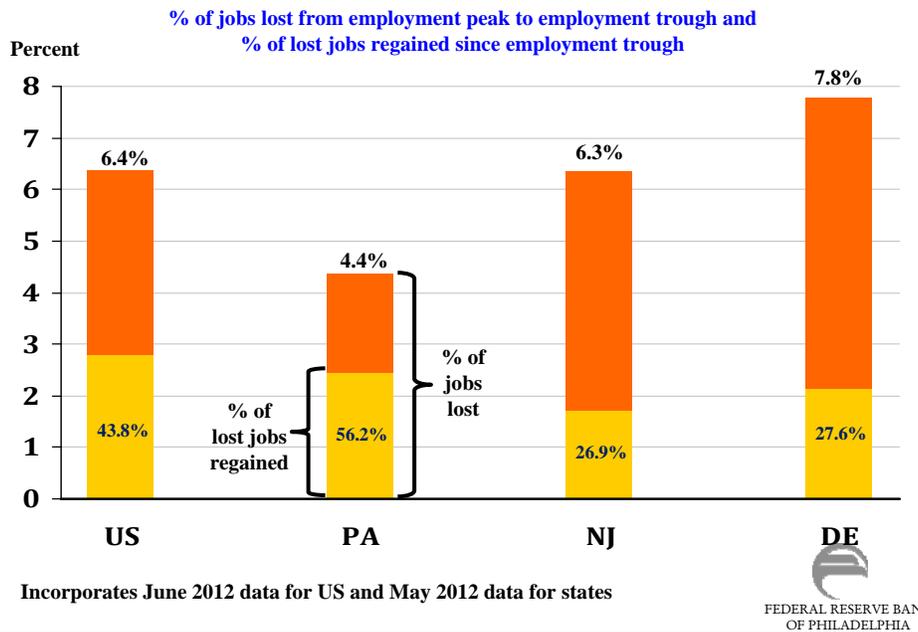
Philadelphia Fed Current Economic Activity Indexes,  
annualized growth over the three months ending in **May 2012**



### Private sector payroll growth has slowed in recent months

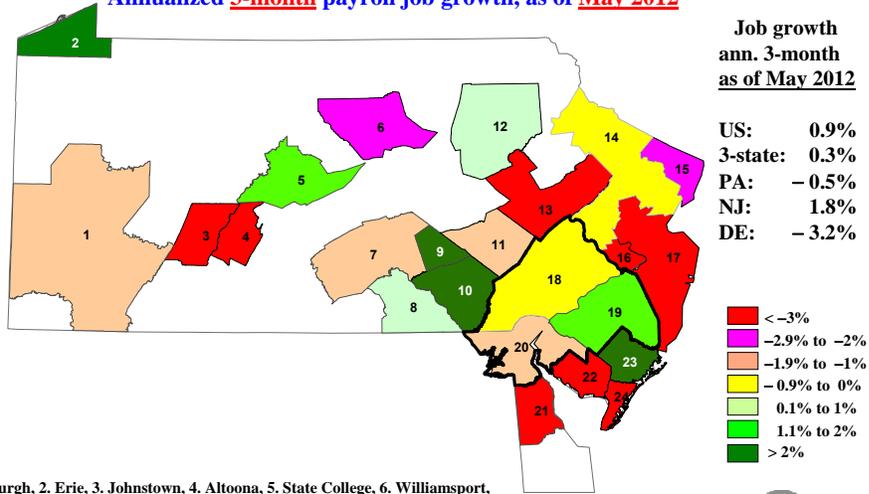


### Recent modest job growth has retarded progress on recovering lost jobs



**Employment in our three states  
decelerated since the beginning of the year**

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

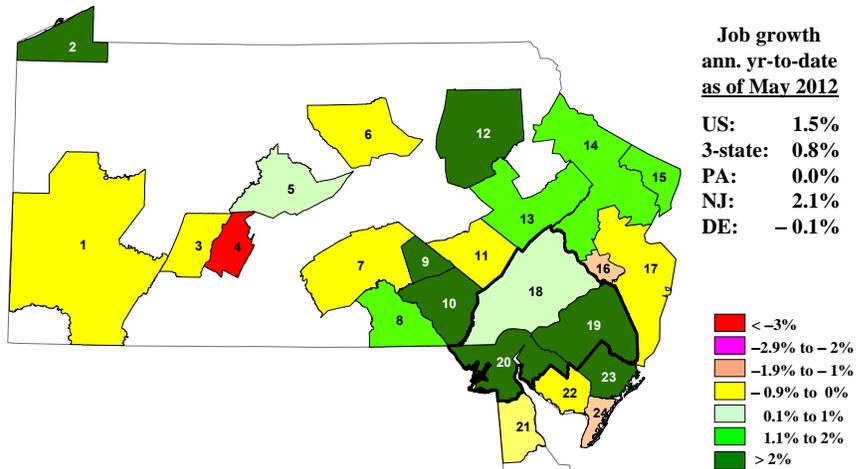


1. Pittsburgh, 2. Erie, 3. Johnstown, 4. Altoona, 5. State College, 6. Williamsport, 7. Harrisburg-Carlisle, 8. York-Hanover, 9. Lebanon, 10. Lancaster, 11. Reading, 12. Scranton-Wilkes-Barre, 13. Allentown-Bethlehem-Easton, 14. Newark-Union, 15. Bergen-Passaic-Hudson, 16. Trenton-Ewing, 17. Edison,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



**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.**

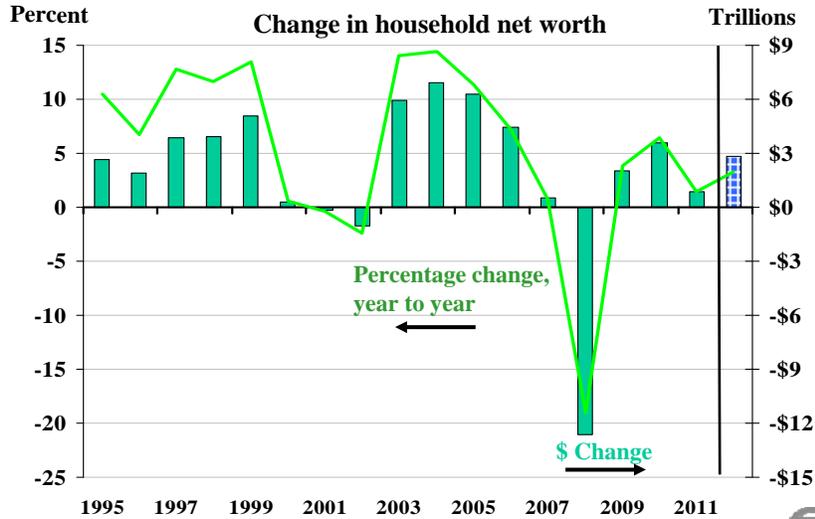
Annualized year-to-date payroll job growth, as of May 2012



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



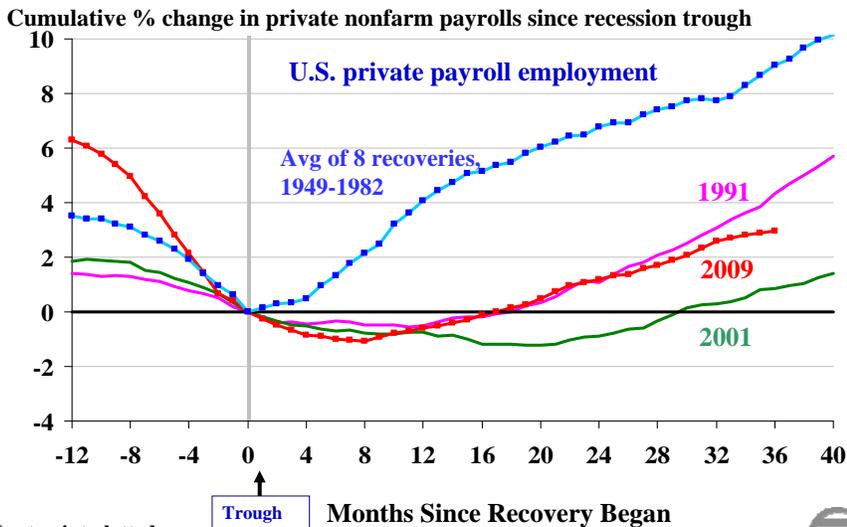
### Household net worth is beginning to recover after the sharp contraction in 2008



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



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



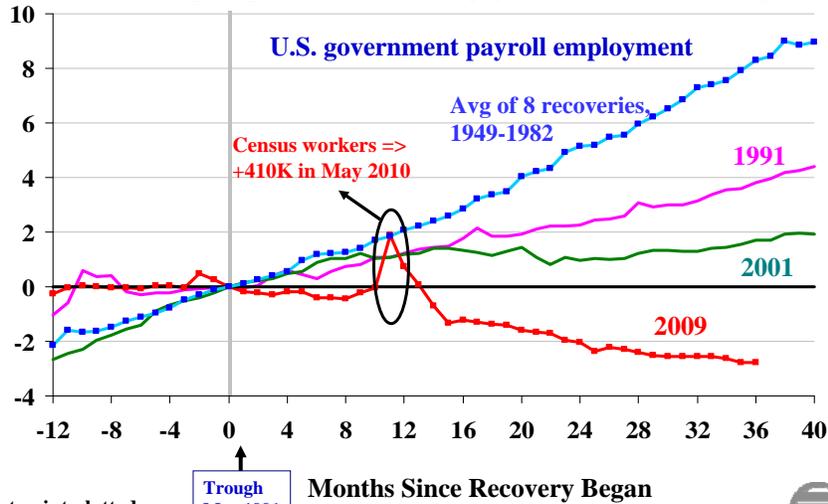
Last point plotted for 2009 recovery is June 2012

Trough  
Mar 1991  
Nov 2001  
Jun 2009



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

Cumulative % change in government nonfarm payrolls since recession trough

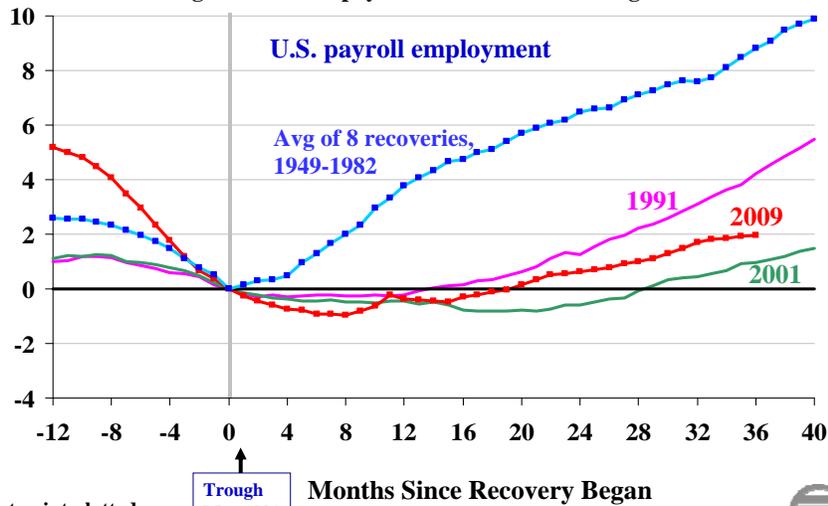


Last point plotted for 2009 recovery is June 2012



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

Cumulative % change in nonfarm payrolls since recession trough

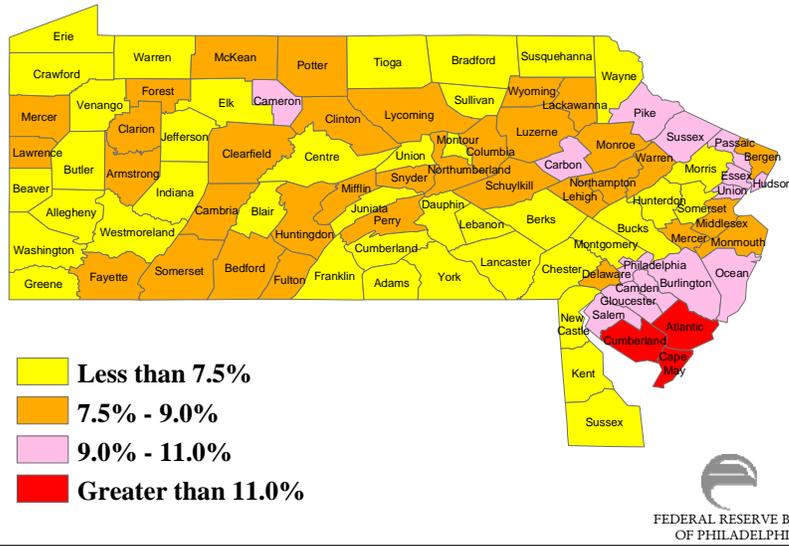


Last point plotted for 2009 recovery is June 2012

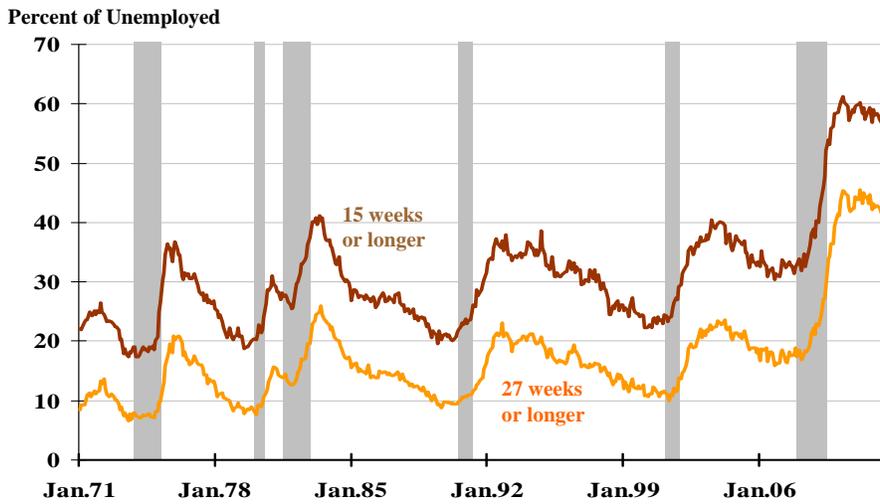


Unemployment rates vary across the region,  
with higher rates in southern New Jersey

County Unemployment Rates: May 2012 (Preliminary)



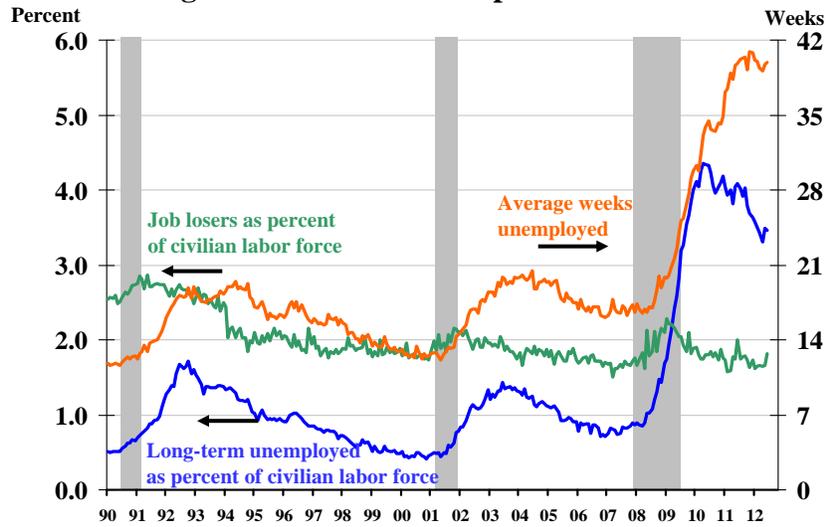
The share of unemployment that is long-term remains high



Monthly data: Last point plotted is June 2012

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**Long-term unemployment remains high.  
Progress has stalled in the past two months.**



Monthly data: Last point plotted is June 2012.  
Job losers are people unemployed for less than 5 weeks.



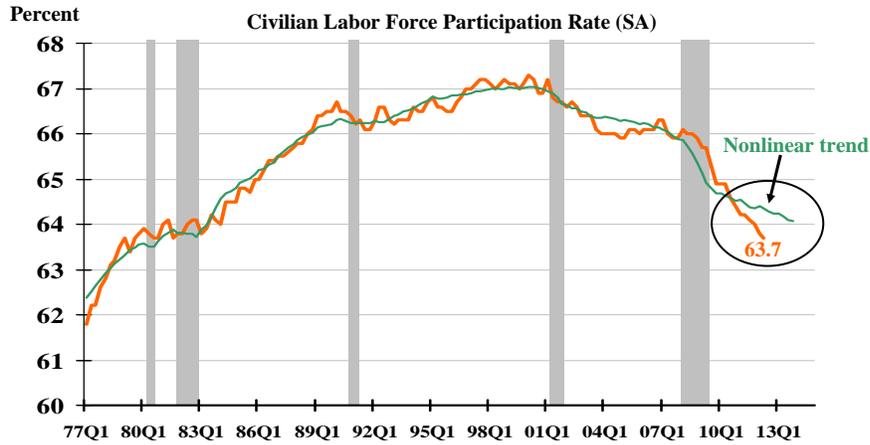
**The unemployment rate is higher  
when we include all marginally attached workers  
and those working part-time for economic reasons.  
This rate ticked up in May and June.**



Monthly data: Last point plotted is June 2012



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

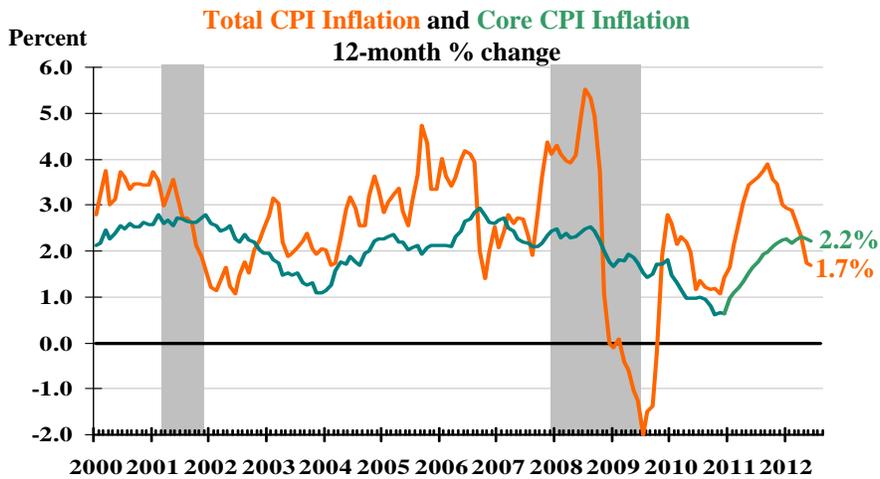


Quarterly data: Last point plotted for participation is 2012Q2

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.

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



Monthly data: Last month plotted is June 2012



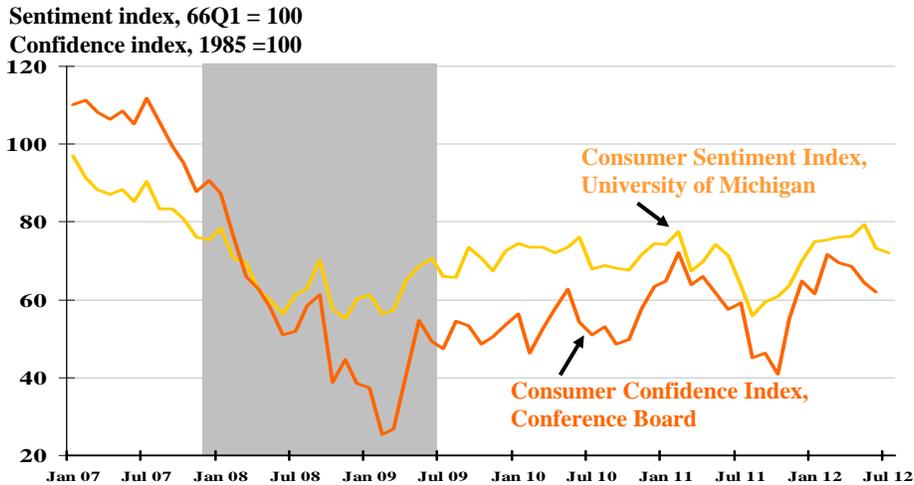
**Longer-term inflation expectations appear to be well-anchored**



Daily data: Last point plotted is July 13, 2012 for inflation compensation and Second Quarter 2012 SPF for 10-year CPI inflation expectations



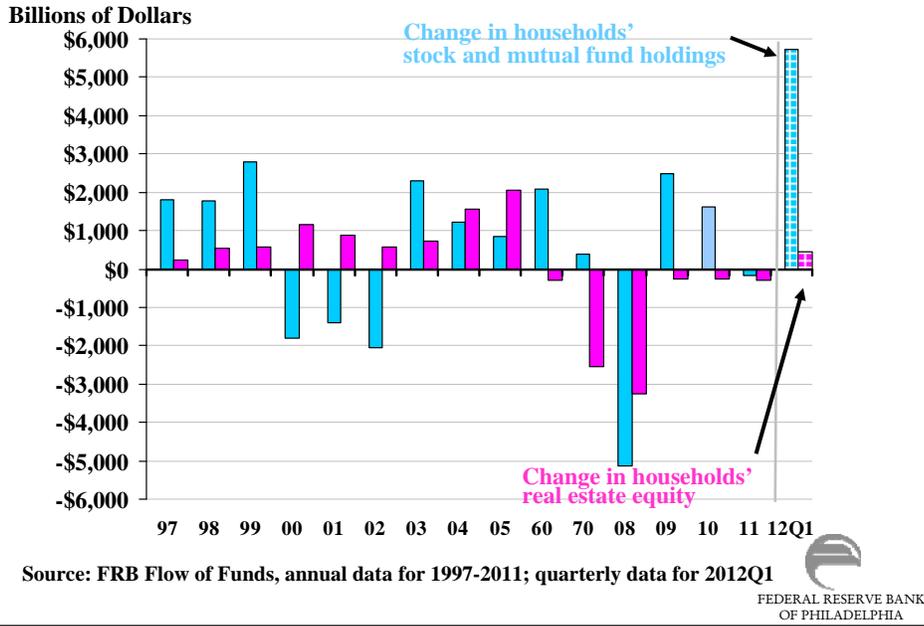
**Consumer sentiment has fallen over the past three months on uncertainty over the European sovereign debt problems, the global slowdown, and U.S. fiscal problems looming at year-end**



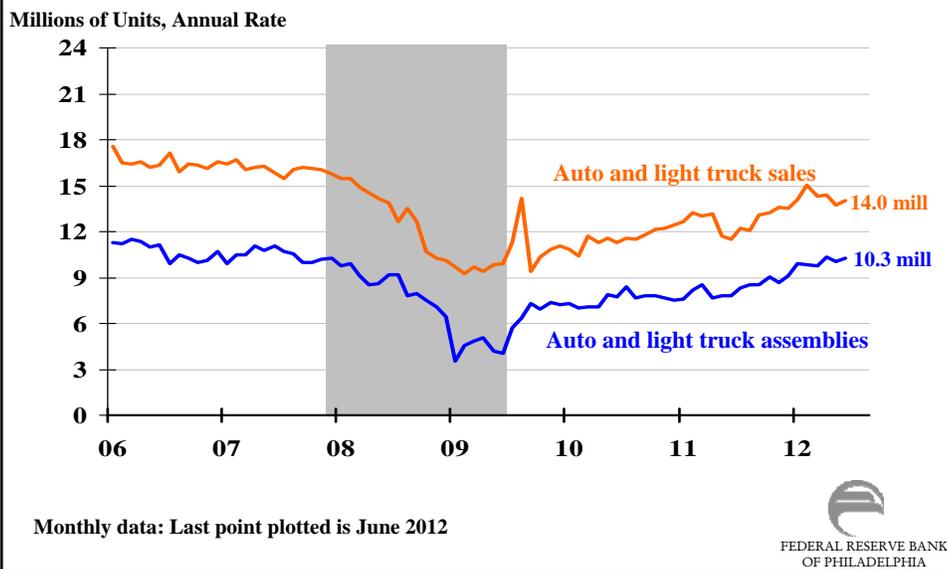
Monthly data: Last point plotted is June 2012 for Confidence and July 2012 (preliminary) for Sentiment

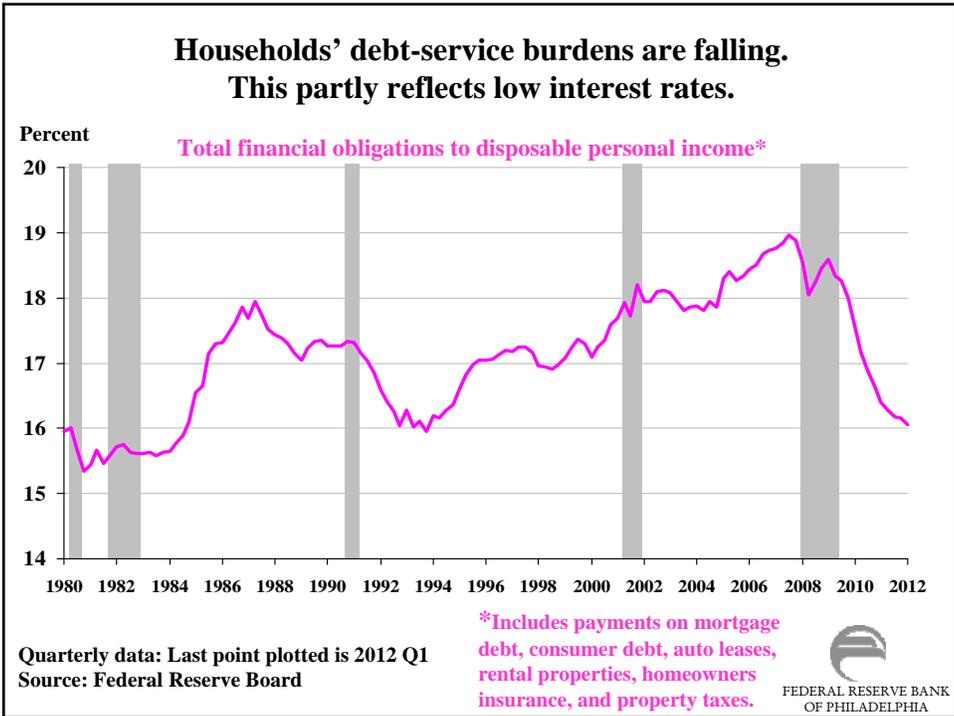
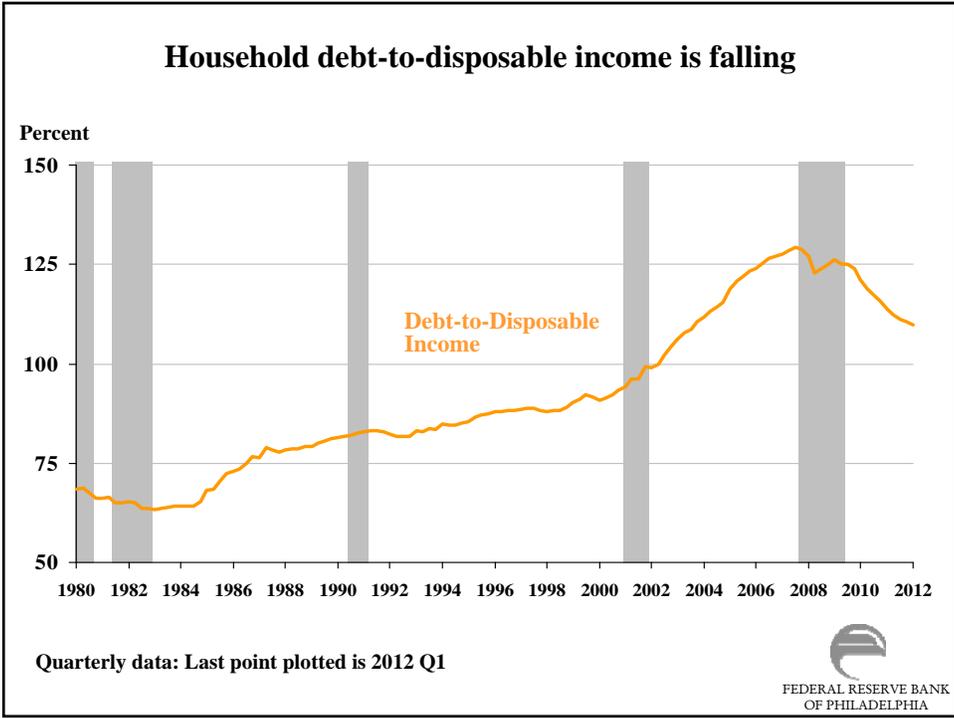


**The rebound in the stock market contributed to a sizable rise in household wealth in the first quarter**



**Auto production remains strong.  
Auto sales slowed in the second quarter from the robust first quarter pace.**

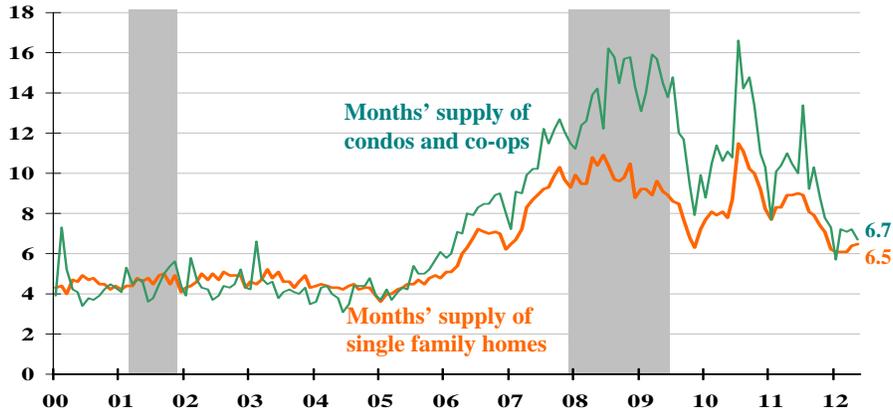




\*Includes payments on mortgage debt, consumer debt, auto leases, rental properties, homeowners insurance, and property taxes.

## Inventories of unsold homes are down from their peaks

Months' supply at current sales pace

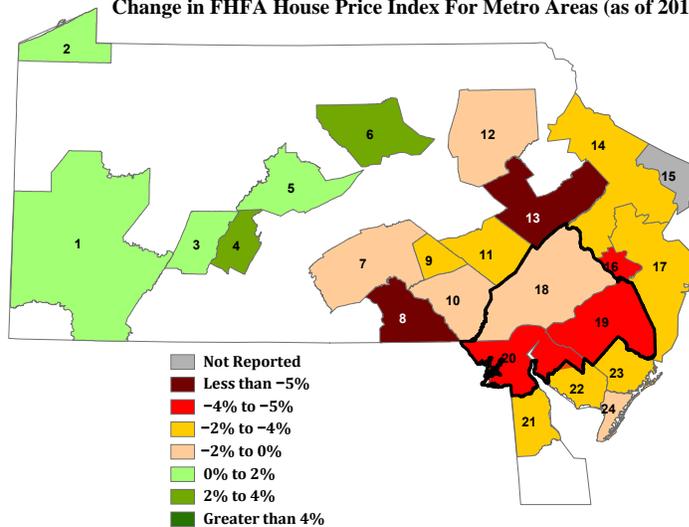


Source: National Association of Realtors  
Monthly data: Last point plotted is May 2012



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

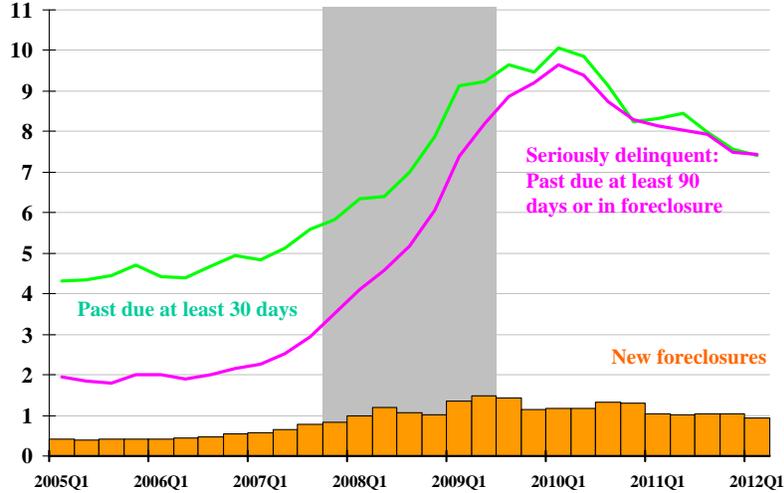
Change in FHFA House Price Index For Metro Areas (as of 2012 Q1)



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.**

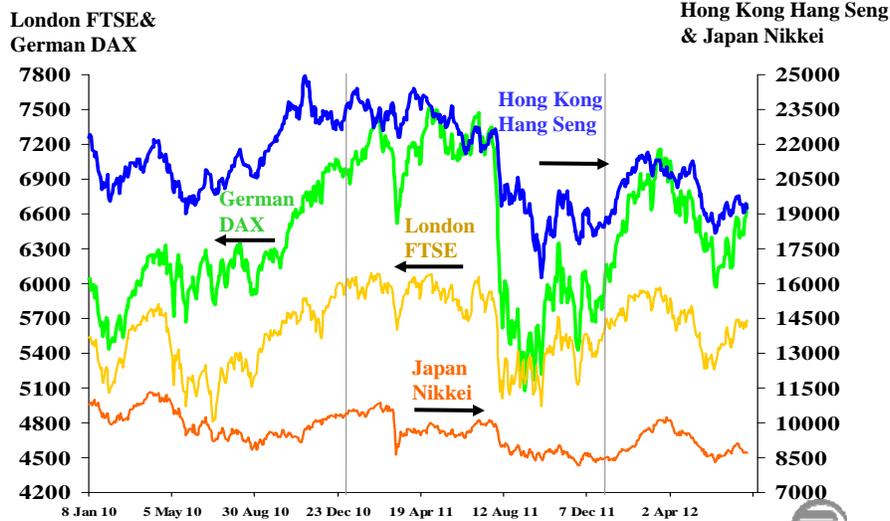
Percent of all mortgages outstanding,  
1-4 residential units



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



**Stock prices abroad have recovered a bit as the European countries have agreed on some initiatives to help with the sovereign debt and banking problems**

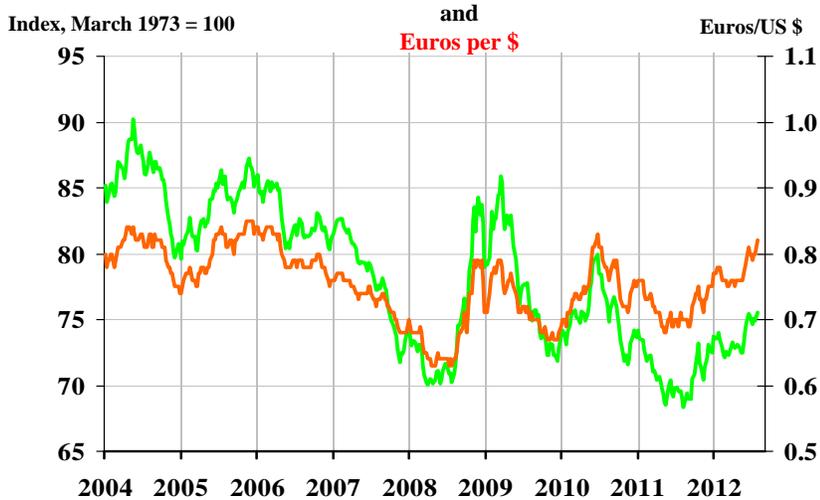


Daily data: Last point plotted is July 18, 2012



**The value of the dollar continues to rise on safe-haven flows**

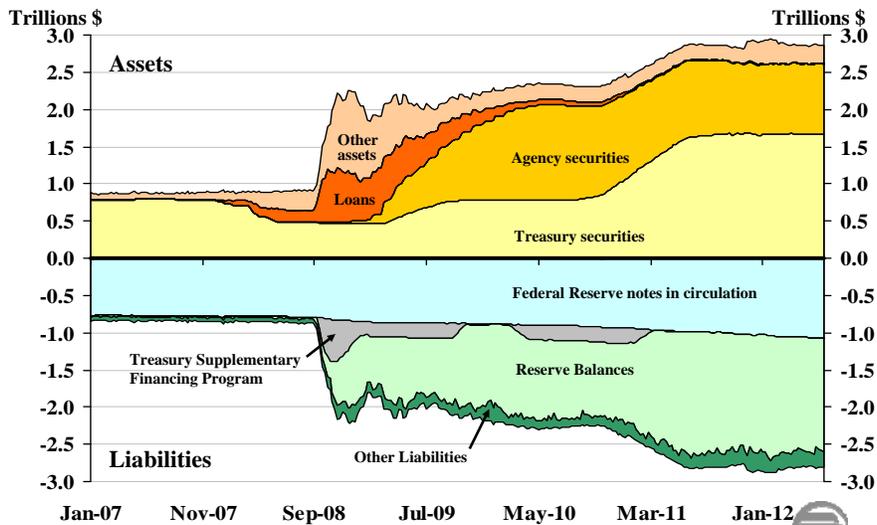
Trade-weighted value of \$ against major currencies



Weekly data: Last point plotted is July 13, 2012



**The Fed holds nearly \$1 trillion in agency mortgage-backed securities and agency debt. Operation twist continues to lengthen the portfolio's maturity. By the end of the year, the Fed will hold no short-term Treasury securities.**



Weekly data: Last point plotted is July 9, 2012





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