

Economic Developments and the Outlook

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**Keynote presentation at the
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NJ Department of Banking and Insurance
November 28, 2012**



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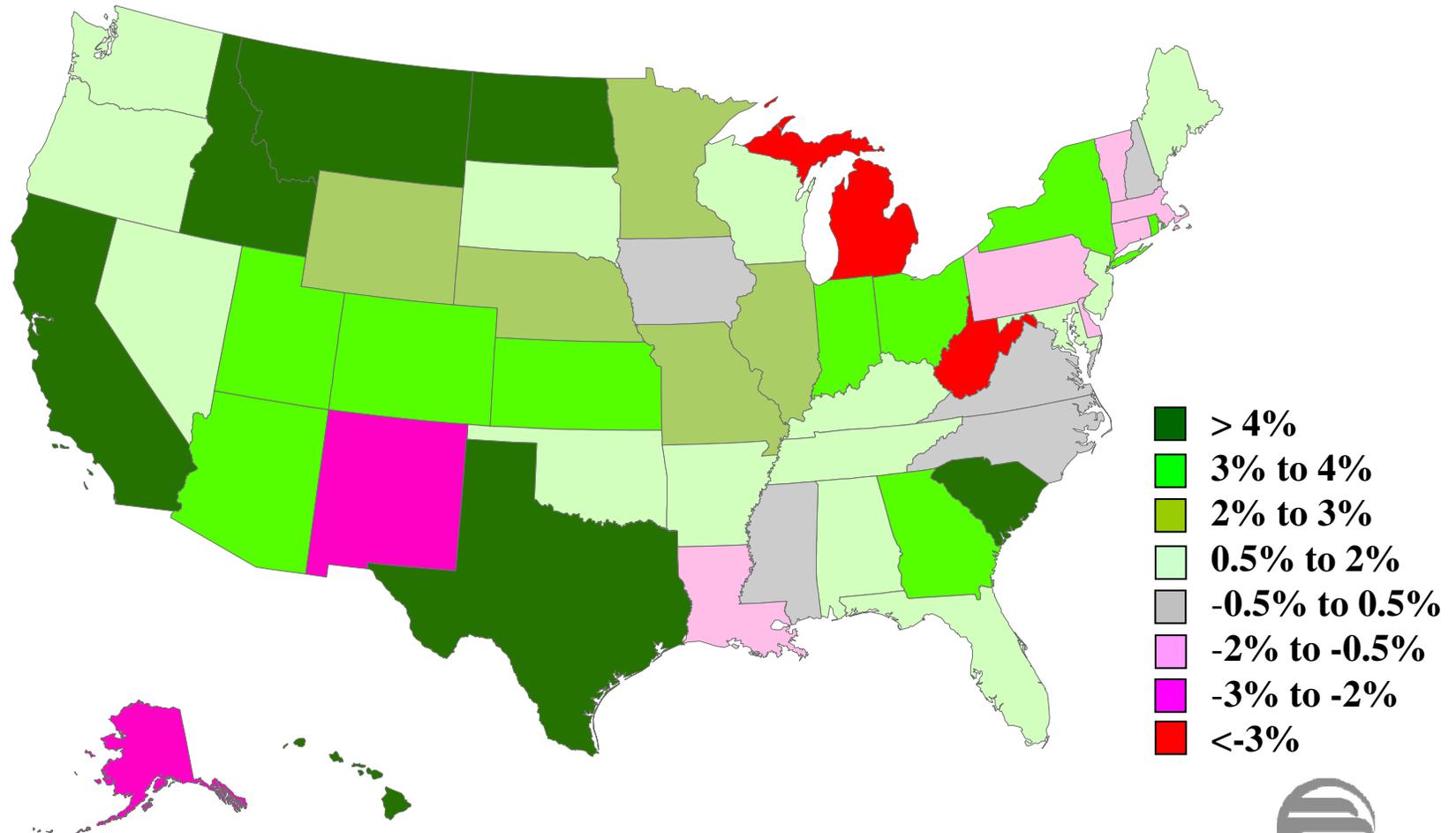
***The views expressed in this presentation are those of the author and do not necessarily reflect those of the Federal Reserve Bank of Philadelphia, the Federal Reserve System, or the Federal Open Market Committee.**

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



Economic activity continues to expand in most states

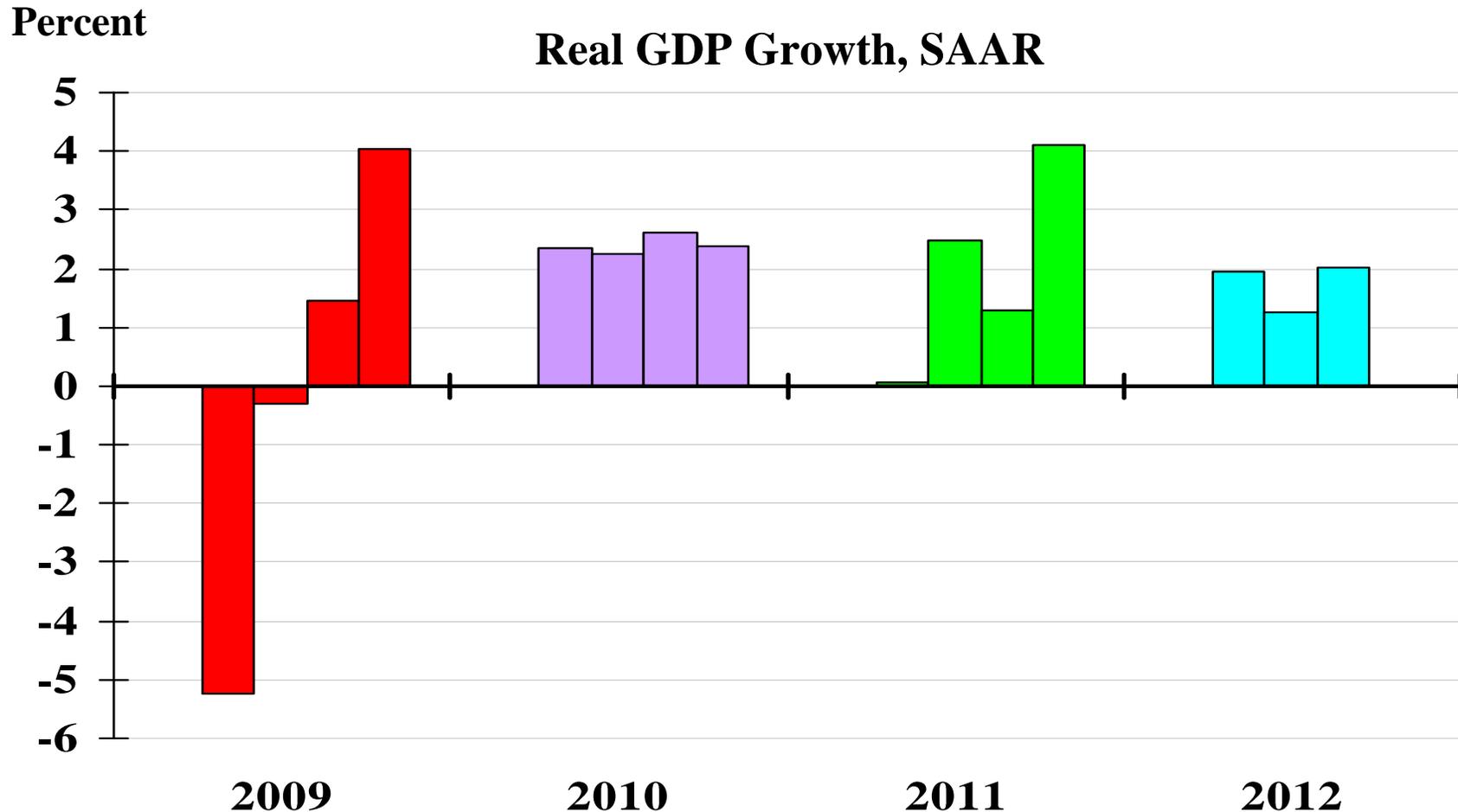
Philadelphia Fed Current Economic Activity Indexes,
annualized growth over the three months ending in September 2012



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Growth continues at a moderate pace.

Hurricane Sandy has not changed the national outlook, but will result in a small reduction in growth in 2012Q4, which will be made up in 2013.



Quarterly data: Last point plotted is 2012Q3

**FOMC forecasters expect growth to accelerate,
unemployment to gradually decline, and
inflation to move toward its long-run goal of 2 percent.
They are more optimistic on growth than our SPF forecasters.**

	Central tendency of Fed Governors and Presidents September 2012 Forecasts		Survey of Professional Forecasters 2012 Q4 Survey	
	<u>2012</u>	<u>2013</u>	<u>2012</u>	<u>2013</u>
Real GDP Growth*	1.7 to 2.0 %	2.5 to 3.0 %	1.8 %	2.3 %
Unemployment Rate in Q4	8.0 to 8.2 %	7.6 to 7.9 %	7.9%	7.6%
PCE Inflation (Q4/Q4 growth)	1.7 to 1.8 %	1.6 to 2.0 %	1.7 %	2.0 %

*Q4/Q4 SPF forecast calculated from the underlying survey data



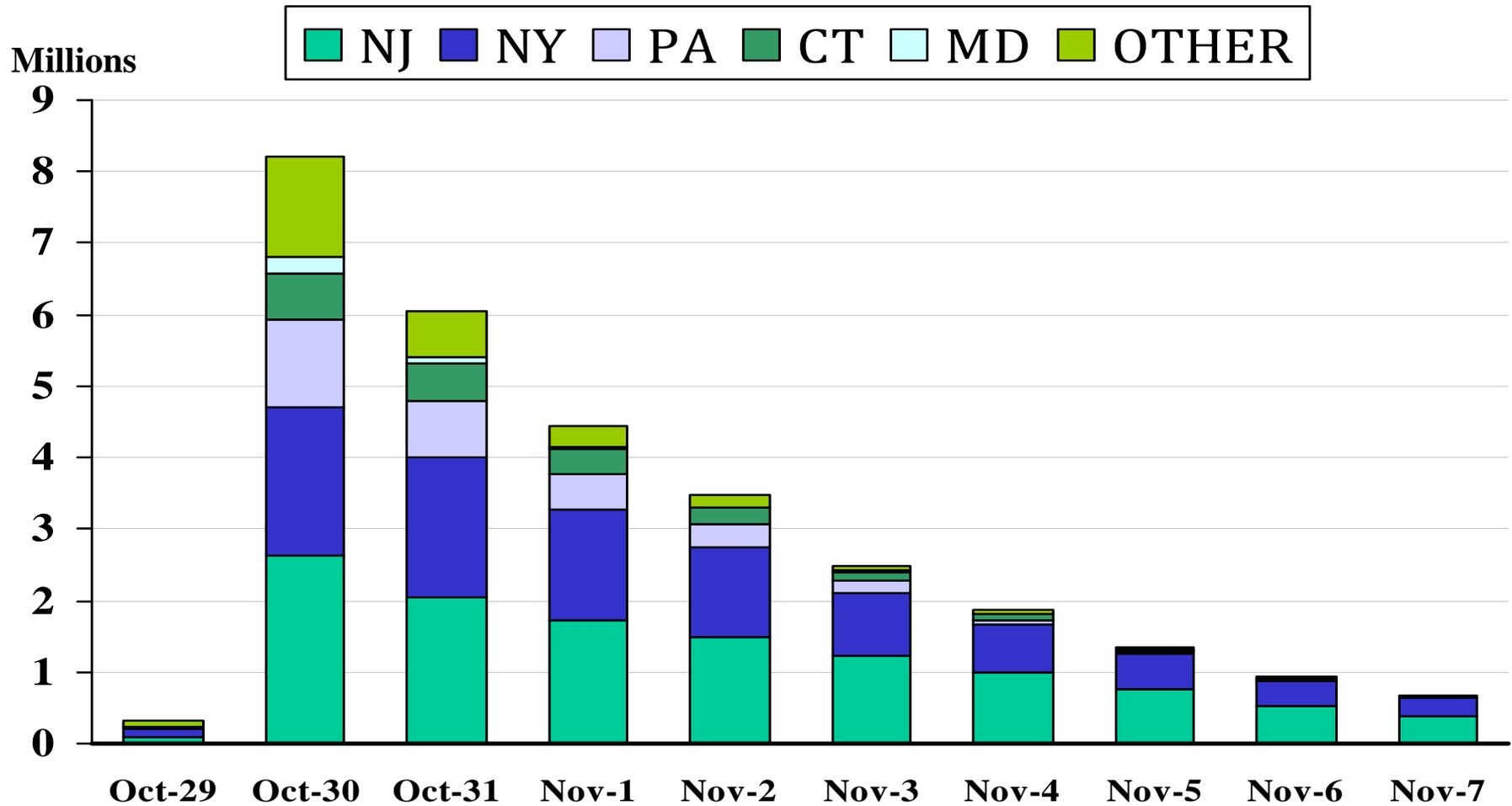
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Hurricane Sandy left over 8 million customers in the dark in 21 states.

Our region was hard hit:

over 50% of customers in NJ lost power and 25% were without power for a week.

Customers with power outages



DOE Emergency Situation Reports

**Hurricane Sandy impacted the Northeast U.S.,
a region accounting for about 13% of U.S. GDP and over 10% of employment.**

**Economic losses, including property damage and lost output, will be high.
The impact will cut $\frac{1}{4}$ - $\frac{1}{2}$ % pt. from growth in 2012Q4
and add a similar amount in 2013.**

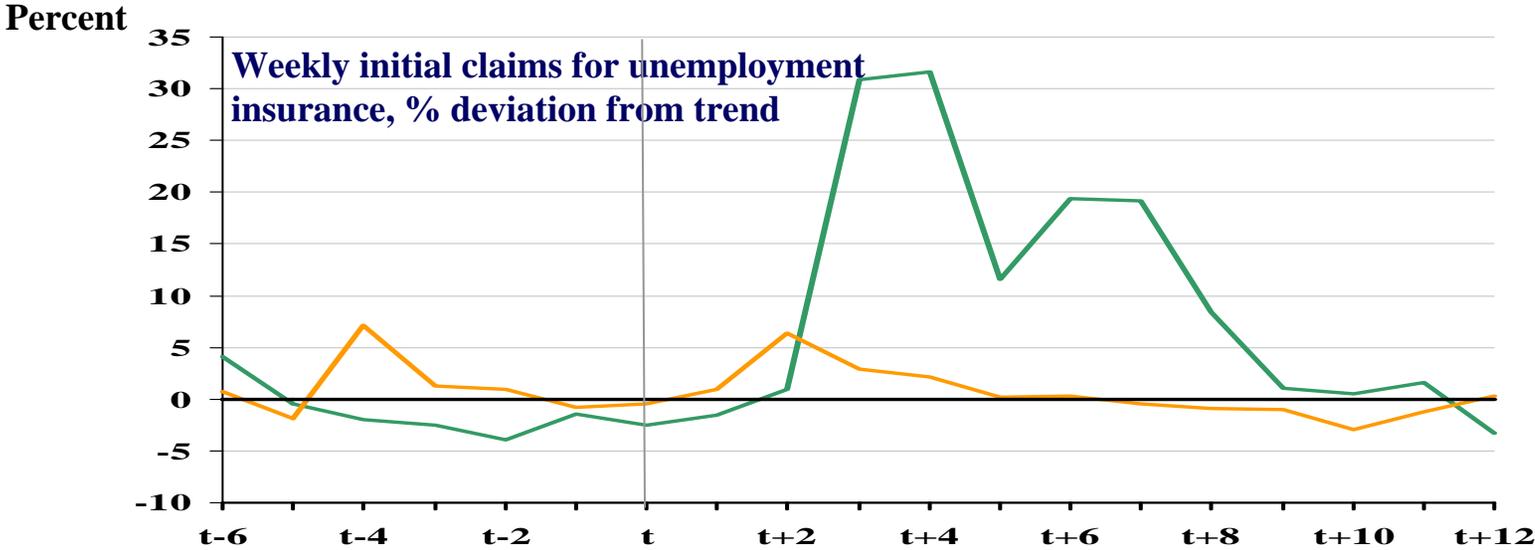
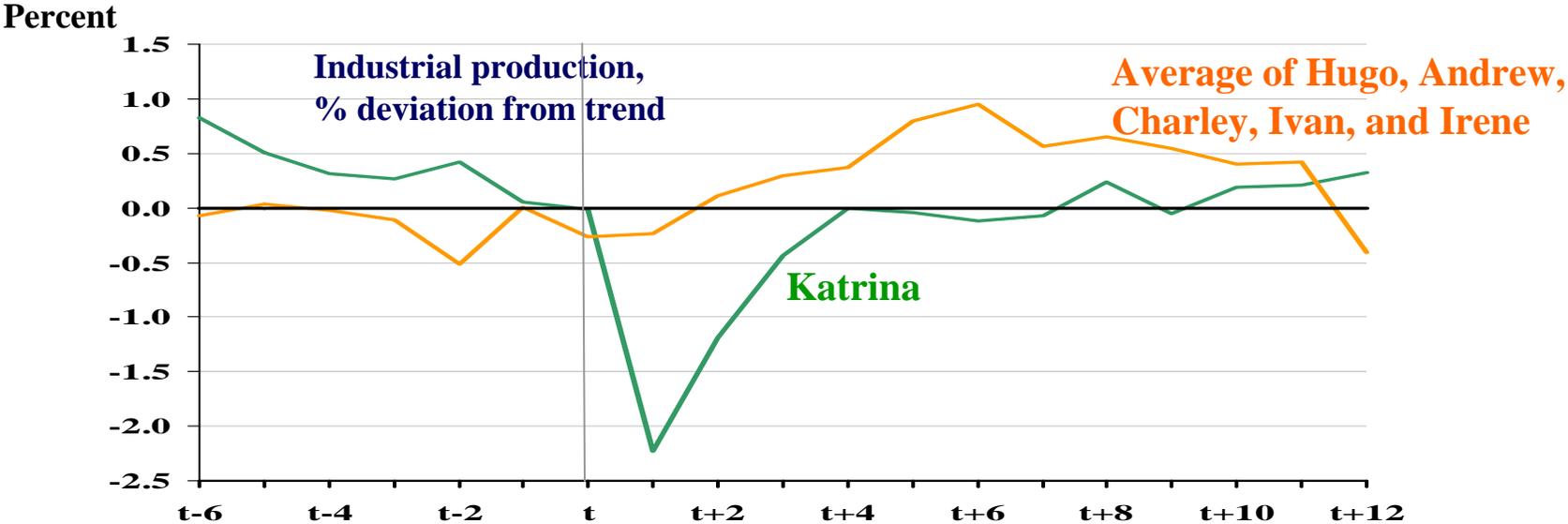
Hurricane	Year	Region	Cost (bil 2011 \$)	Cost (% GDP)
Katrina	Aug 2005	Gulf of Mexico	\$ 146.3	1.10 %
Sandy	Oct 2012	Northeast, US	50 - 60	0.33 – 0.40 %
Andrew	Aug 1992	Miami, FL	44.3	0.43
Ike	Sep 2008	Gulf of Mexico	28.9	0.20
Wilma	Oct 2005	Florida	18.7	0.14
Charley	Aug 2004	Florida	18.2	0.14
Ivan	Sep 2004	Gulf of Mexico	16.9	0.13
Irene	Aug 2011	Northeast, US	10.0	0.06

Source: Nomura Securities and author's calculations



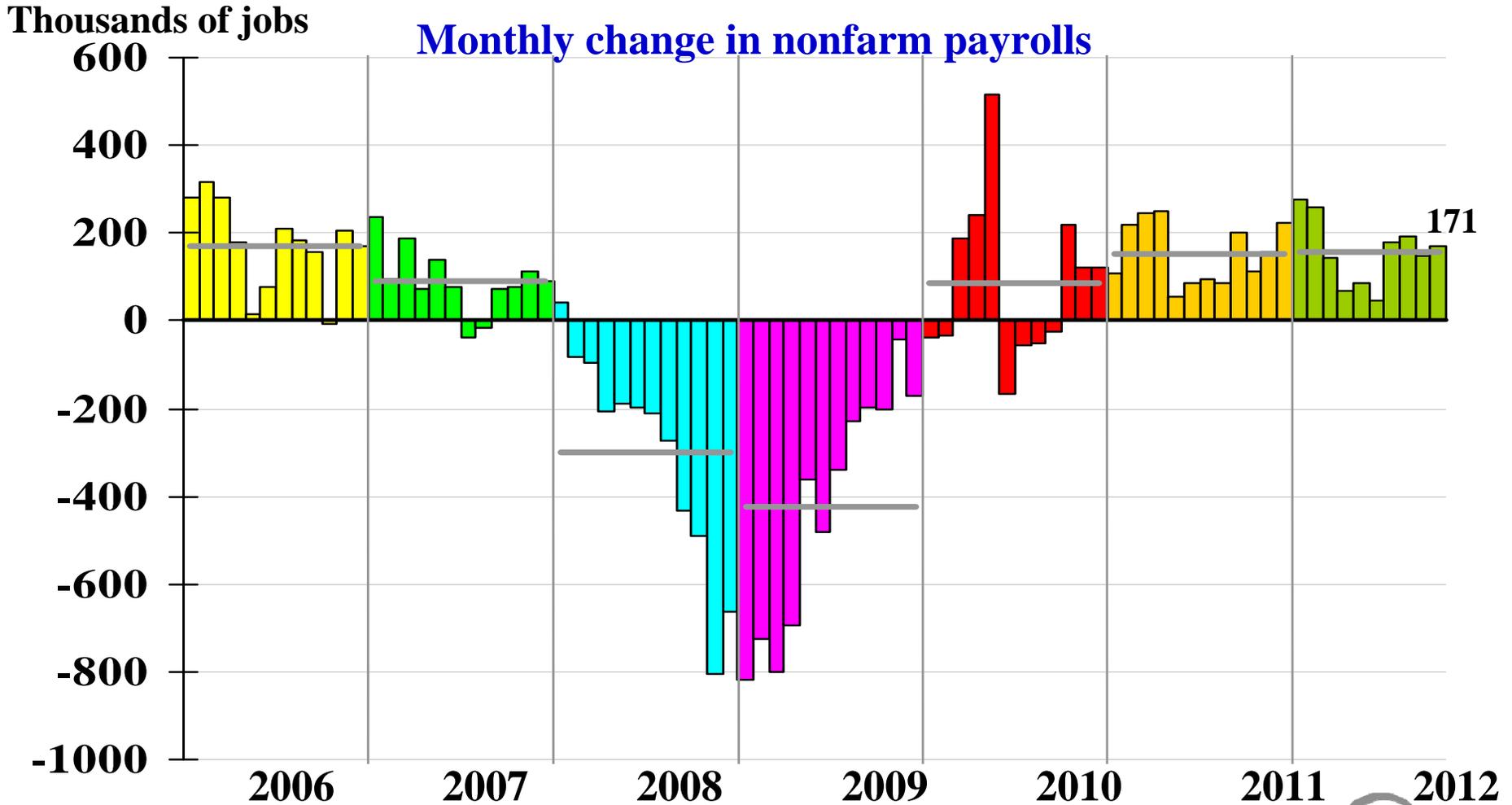
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The hurricane may show up in some of our monthly data



Time t = month or week of hurricane landfall

**Employment growth has picked up over the past four months.
 In October, payrolls rose by 171 thousand jobs.
 So far this year, job gains have averaged 157 thousand per month,
 compared with 153 thousand per month last year.**



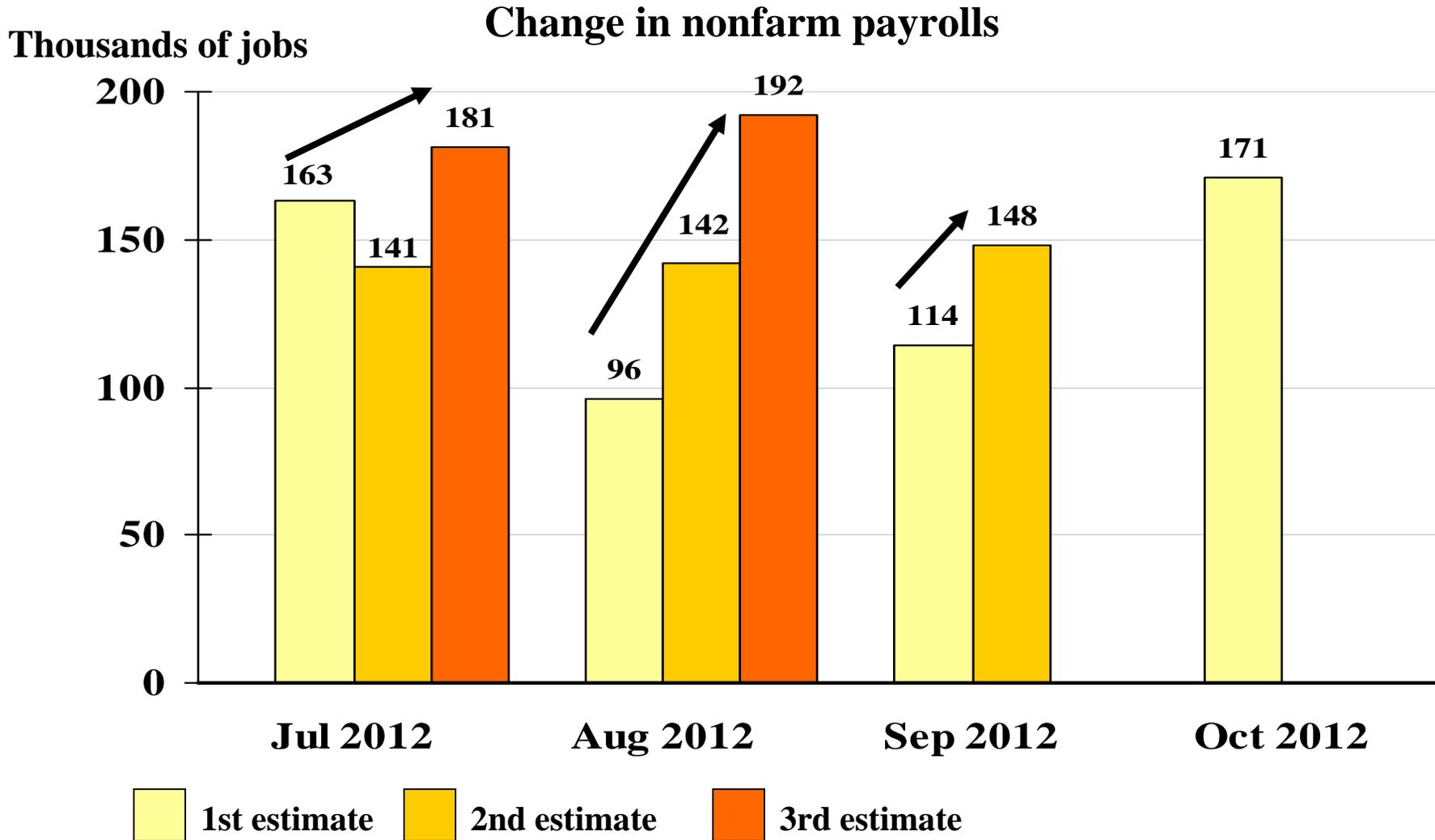
Last month plotted is October 2012

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



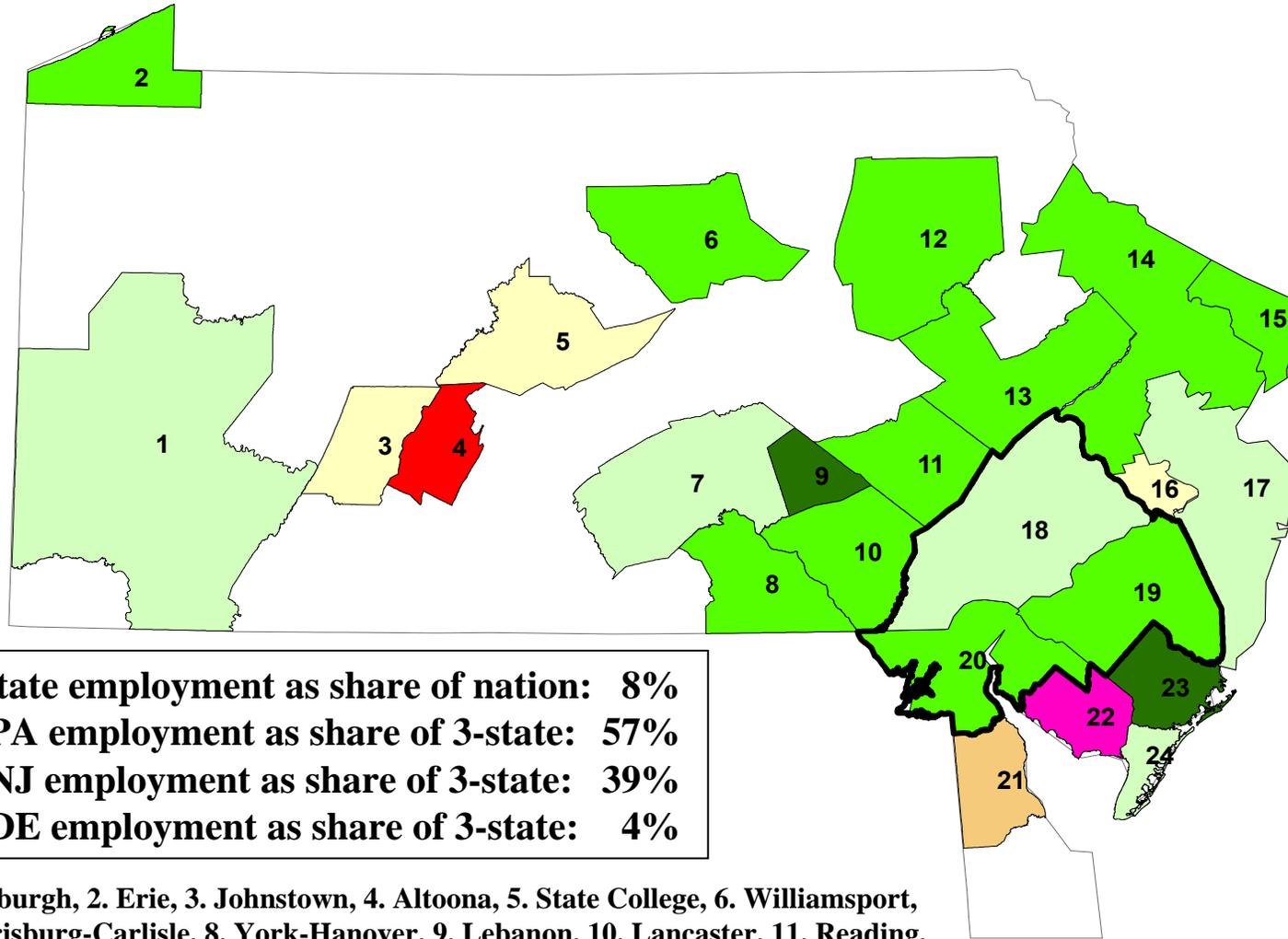
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**Recent months' readings on payrolls have been revised up.
Total revisions July to Sept have added 148K jobs.**



Pennsylvania and New Jersey have been adding jobs this year

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



**Job growth
ann. yr-to-date
as of Sep 2012**

US: 1.3%
3-state: 0.7%
PA: 0.5%
NJ: 1.1%
DE: -0.4%



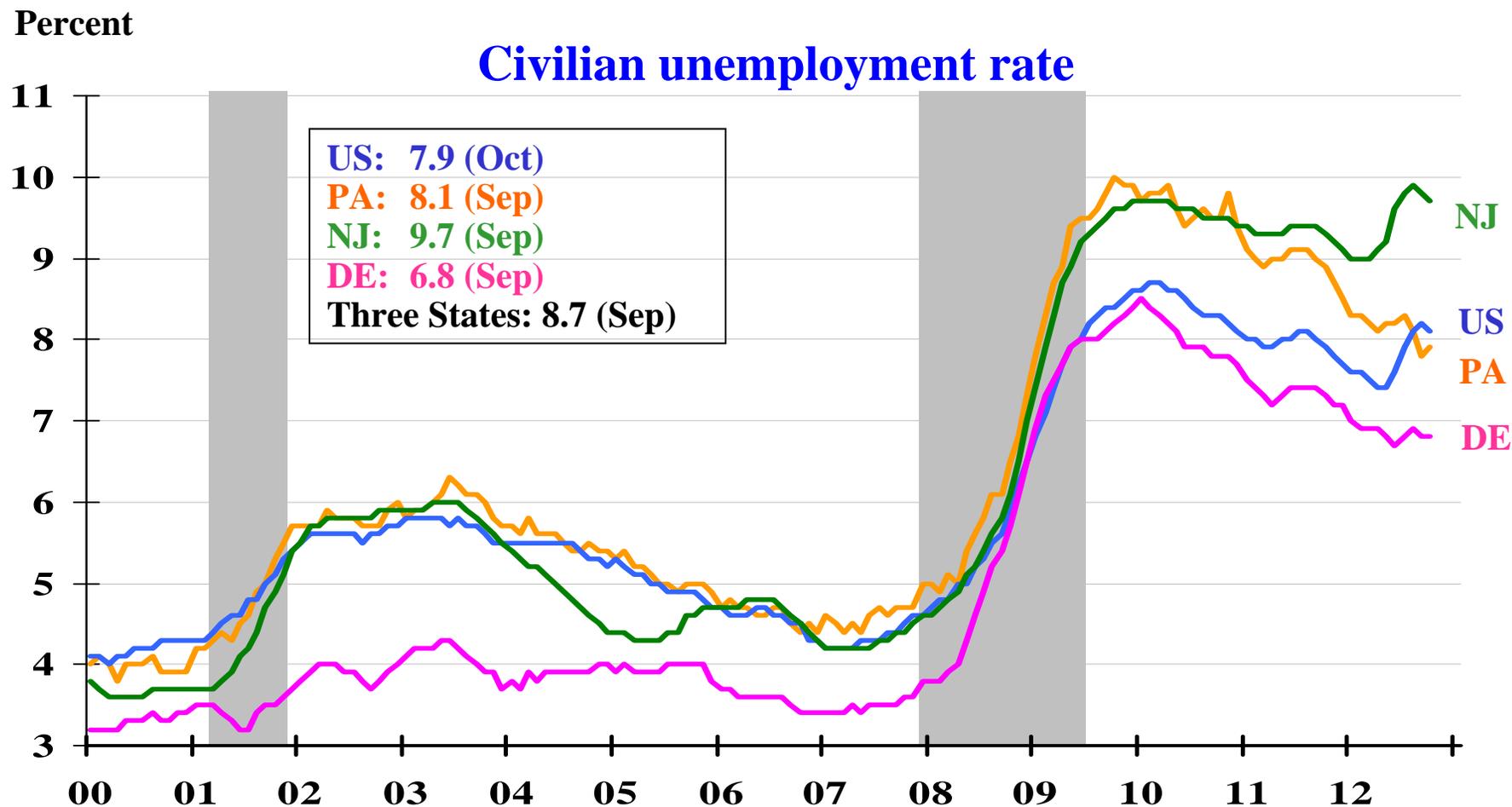
3-state employment as share of nation: 8%
PA employment as share of 3-state: 57%
NJ employment as share of 3-state: 39%
DE employment as share of 3-state: 4%

- 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



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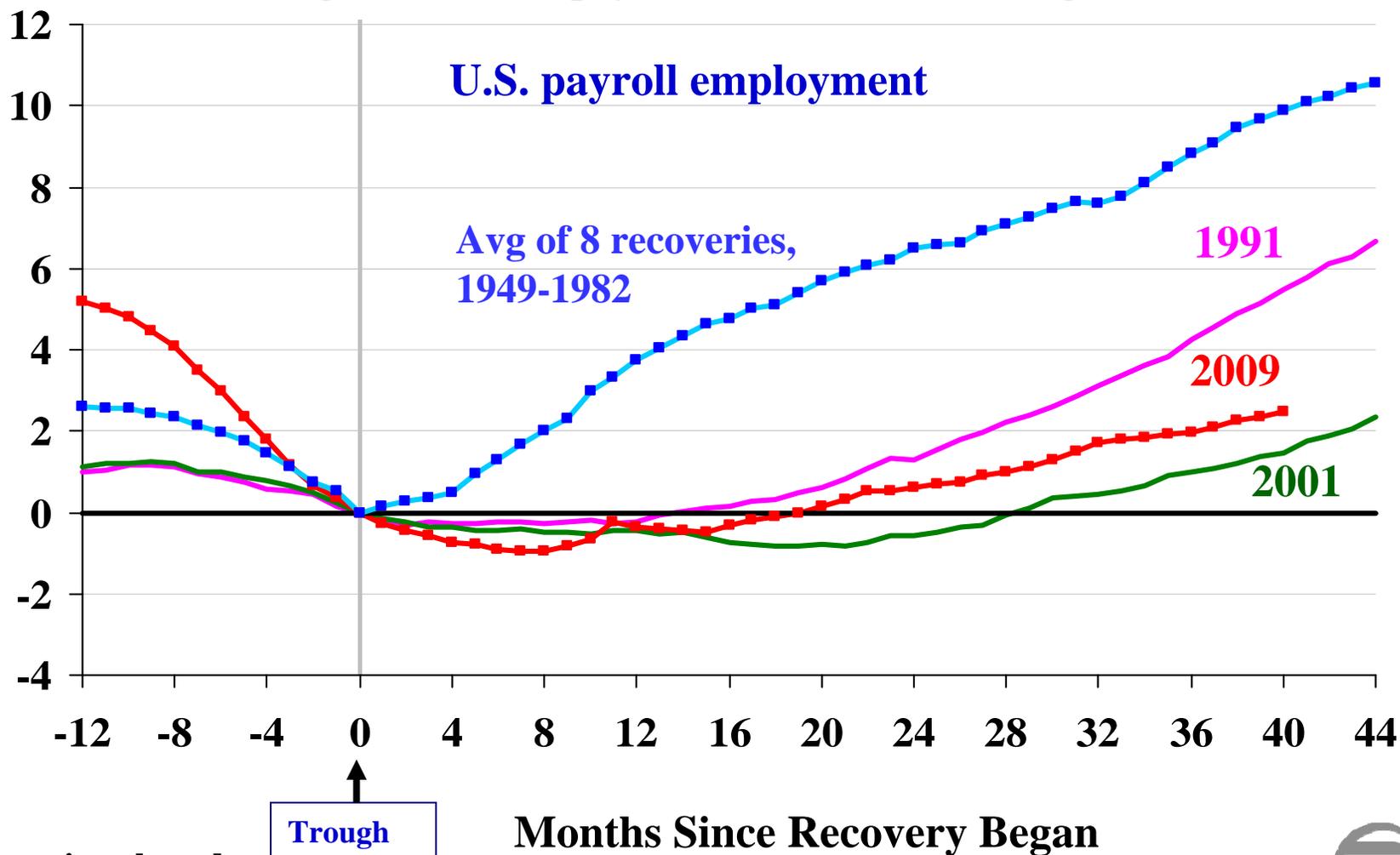
Unemployment rates remain elevated



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

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

Cumulative % change in nonfarm payrolls since recession trough

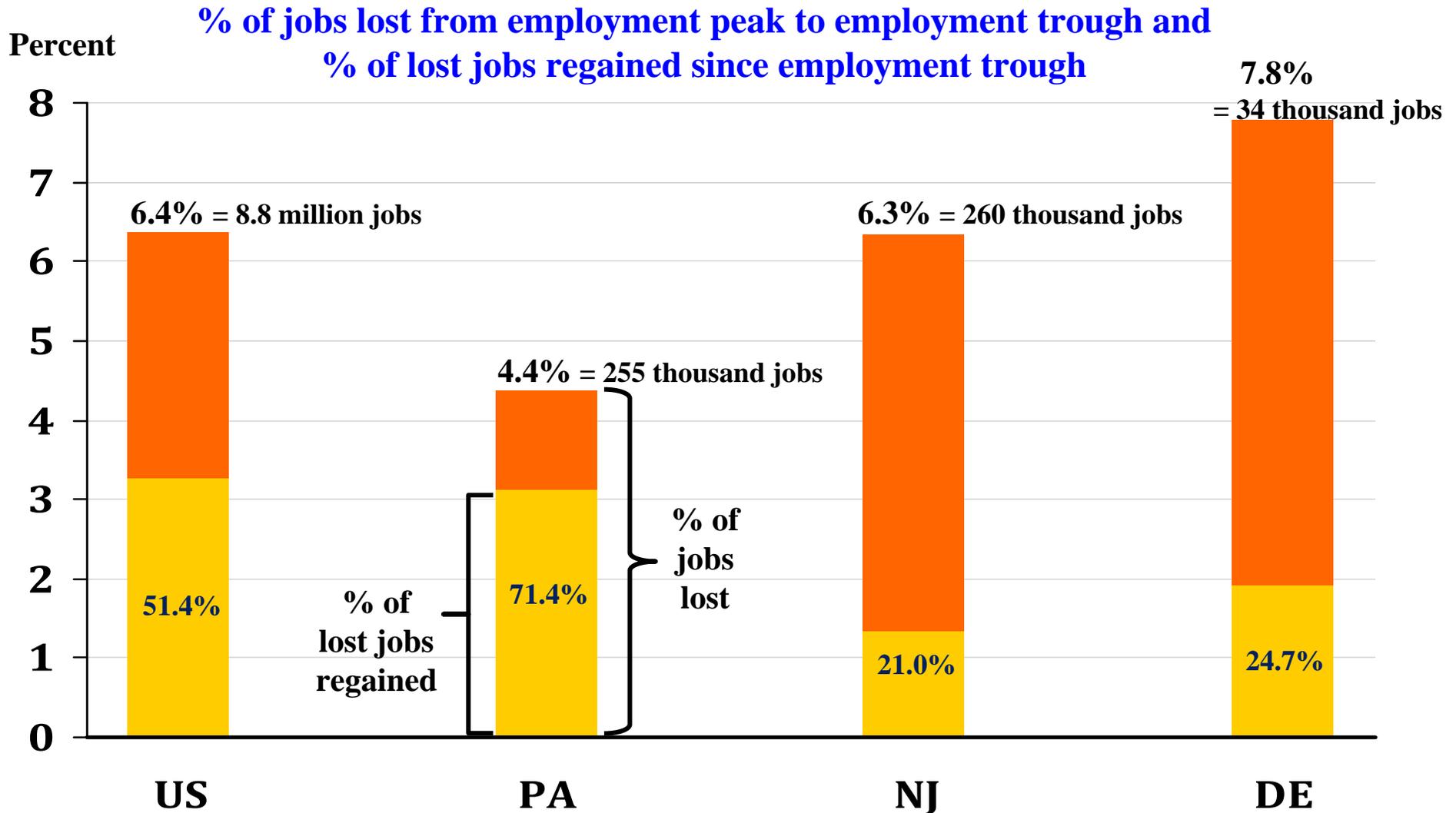


Last point plotted
for 2009 recovery
is October 2012

↑
Trough
 Mar 1991
 Nov 2001
 Jun 2009

Months Since Recovery Began

We have reached the halfway point on recovering lost jobs. Pennsylvania is outperforming the nation and the rest of the region.

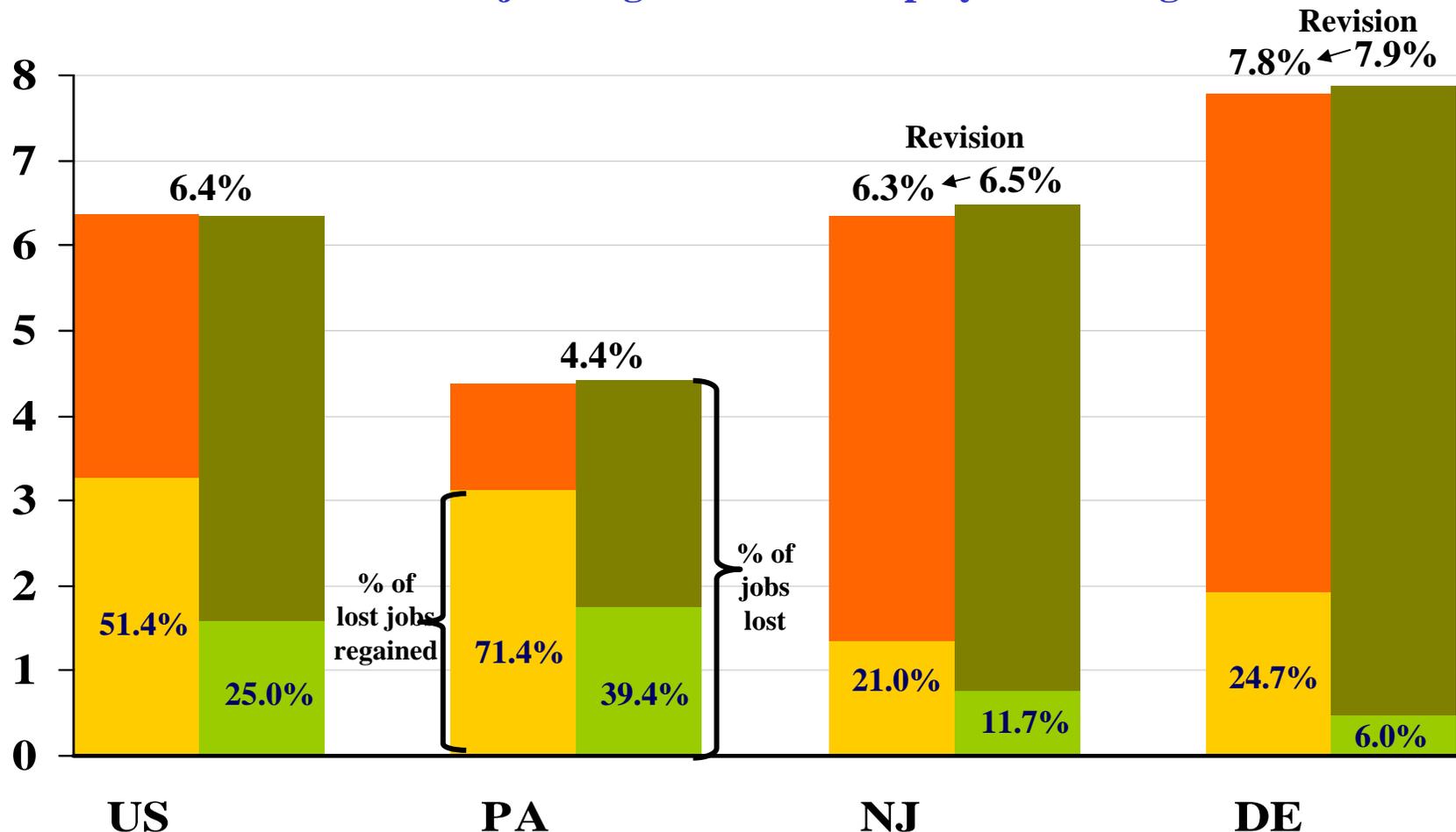


Incorporates October 2012 data for US and states

Progress is being made: Compare this year's chart with last year's.

**% of jobs lost from employment peak to employment trough and
% of lost jobs regained since employment trough**

Percent



Monthly data: Orange/yellow bars: As of Nov 2012; incorporates Oct 2012 data for U.S.

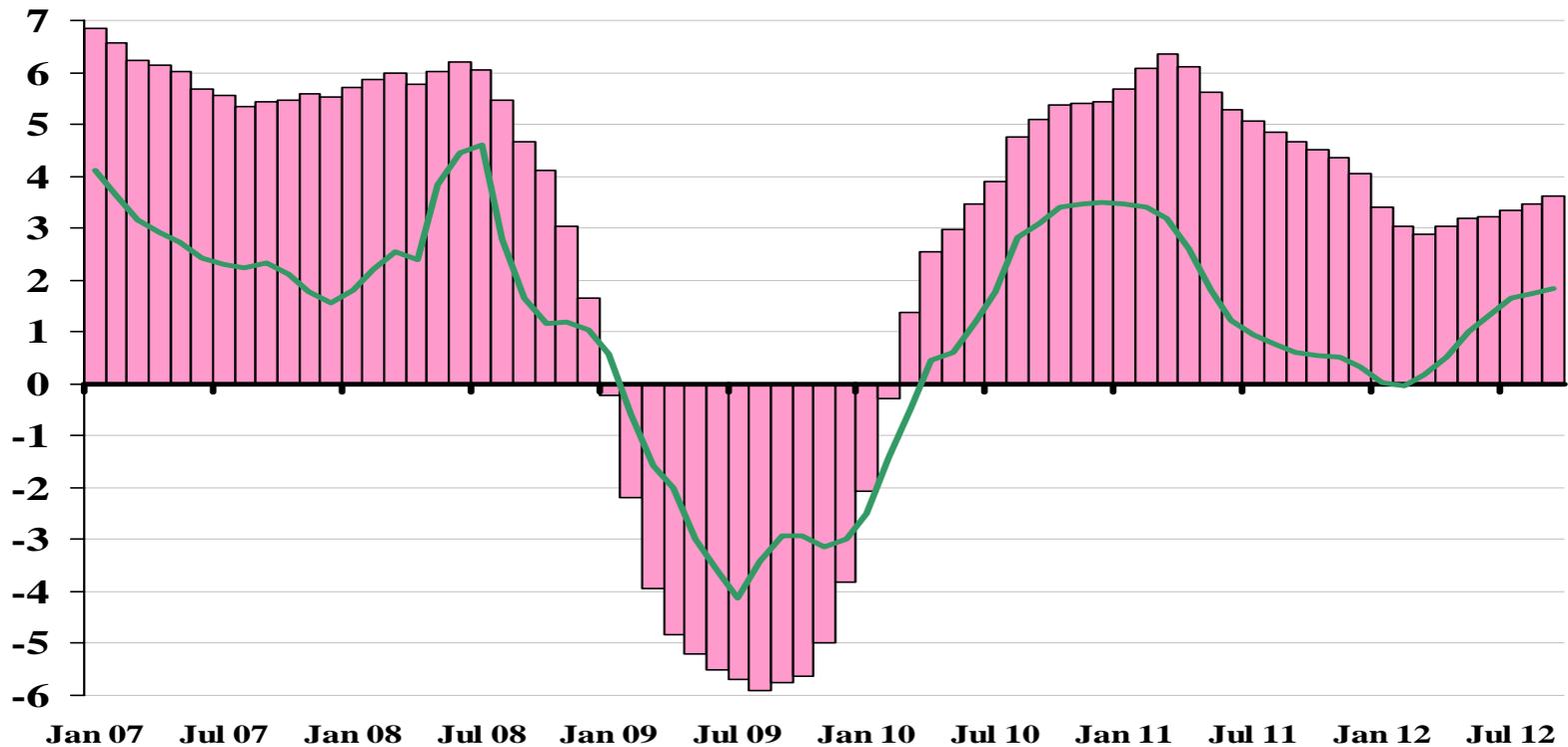
and states. Green bars: As of Nov 2011; incorporates Sep 2011 data for U.S. and states.

Note, for NJ and DE, % of jobs lost peak to trough for 2011 and 2012 differ because of data revisions.

The gradual growth in employment has lead to a gradual pickup in personal income growth this year

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

Percent

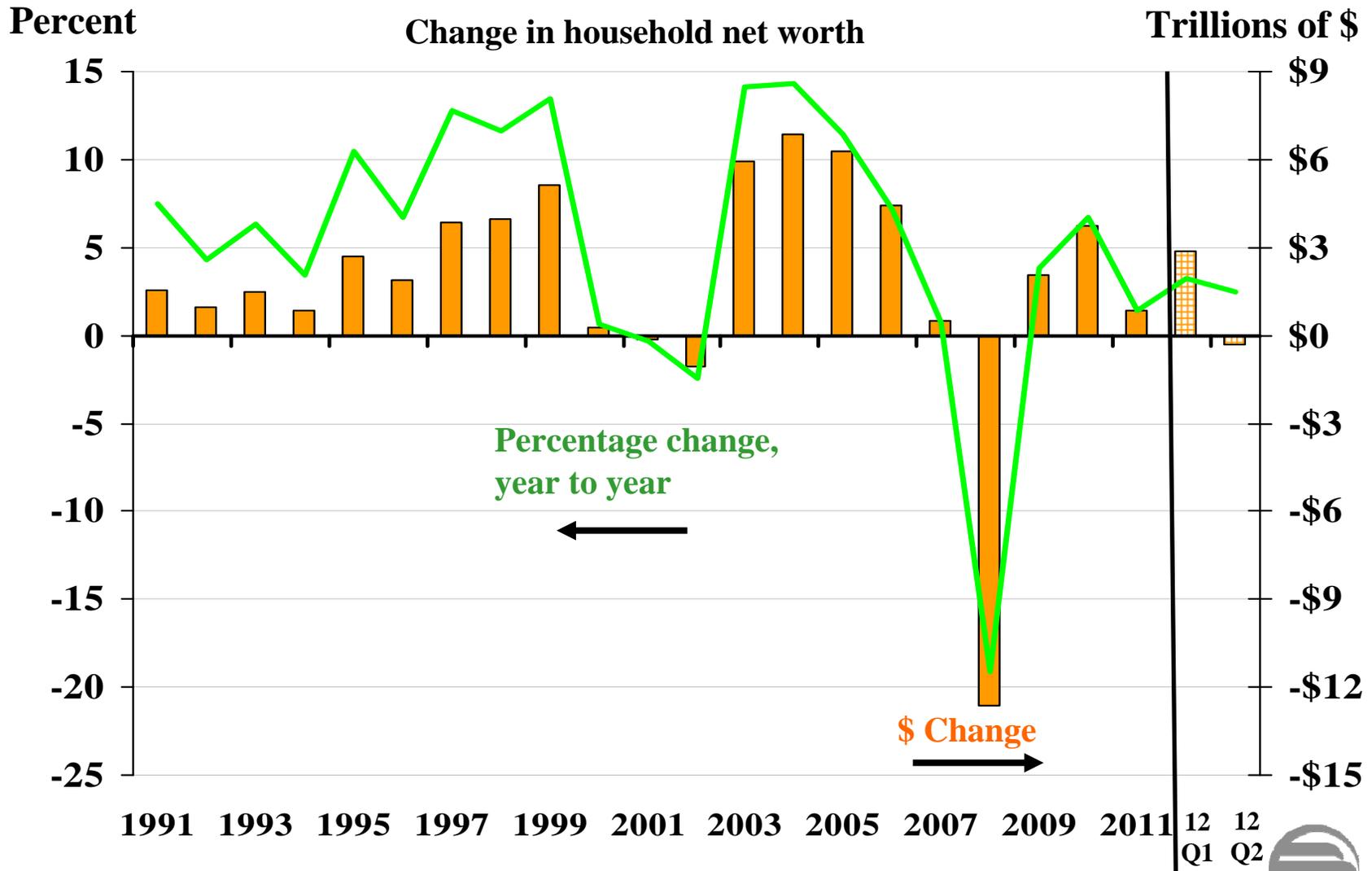


Monthly data: Last point plotted is September 2012



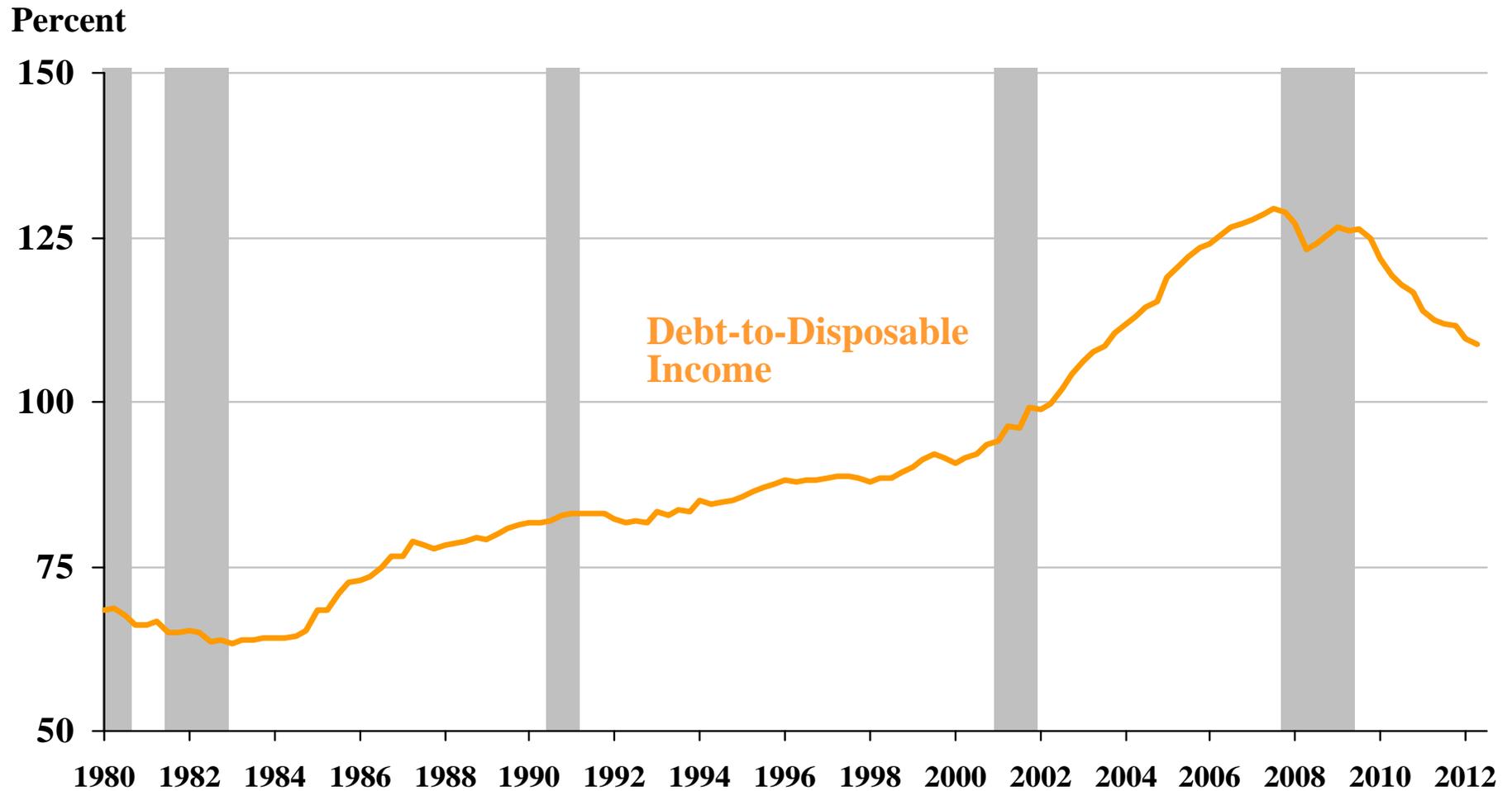
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Since the steep decline in 2008, household net worth has been rising



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

Household debt-to-disposable income is falling



Quarterly data: Last point plotted is 2012 Q1

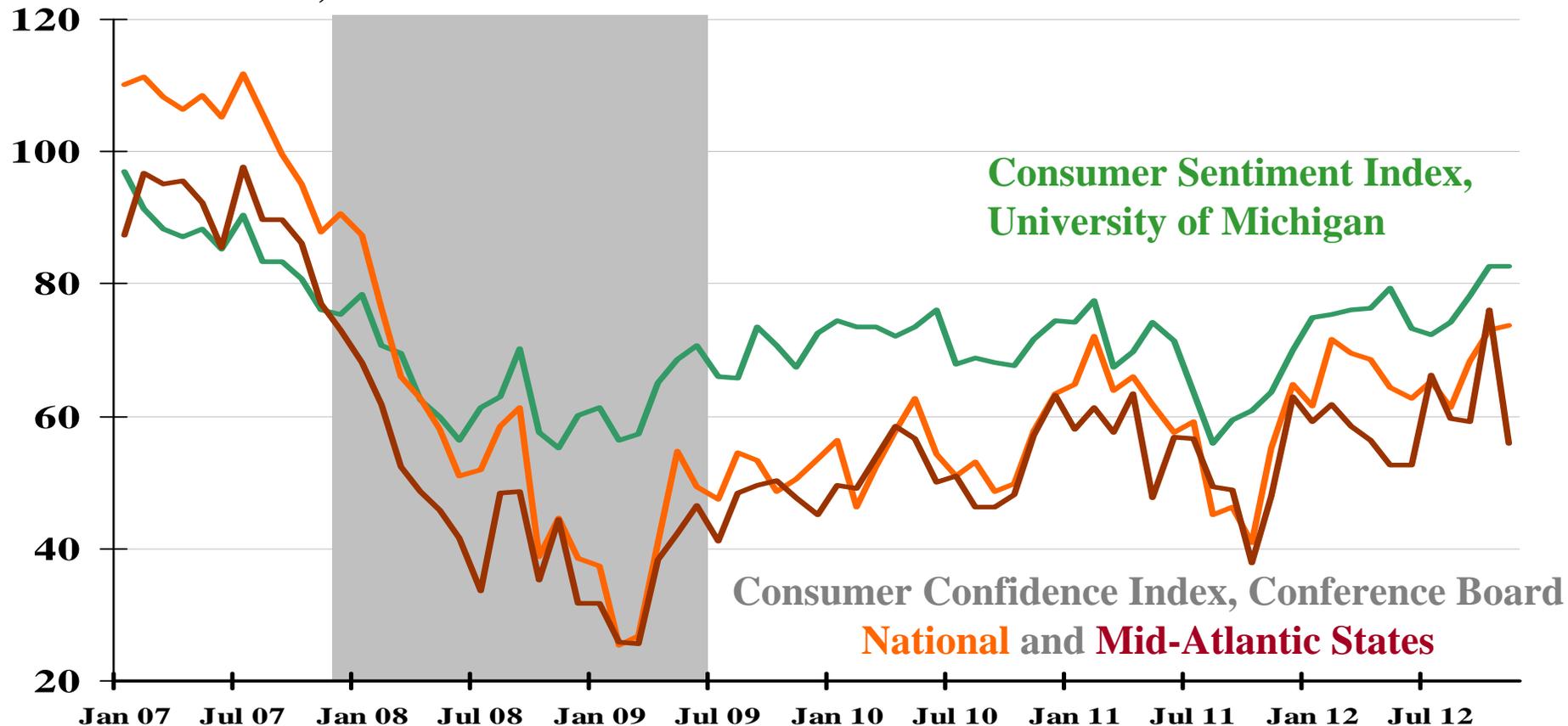


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Nationally, consumer sentiment has been on an upswing since the summer, and is now at a five-year high. Regionally, the hurricane dashed confidence.

Sentiment index, 66Q1 = 100

Confidence index, 1985 = 100



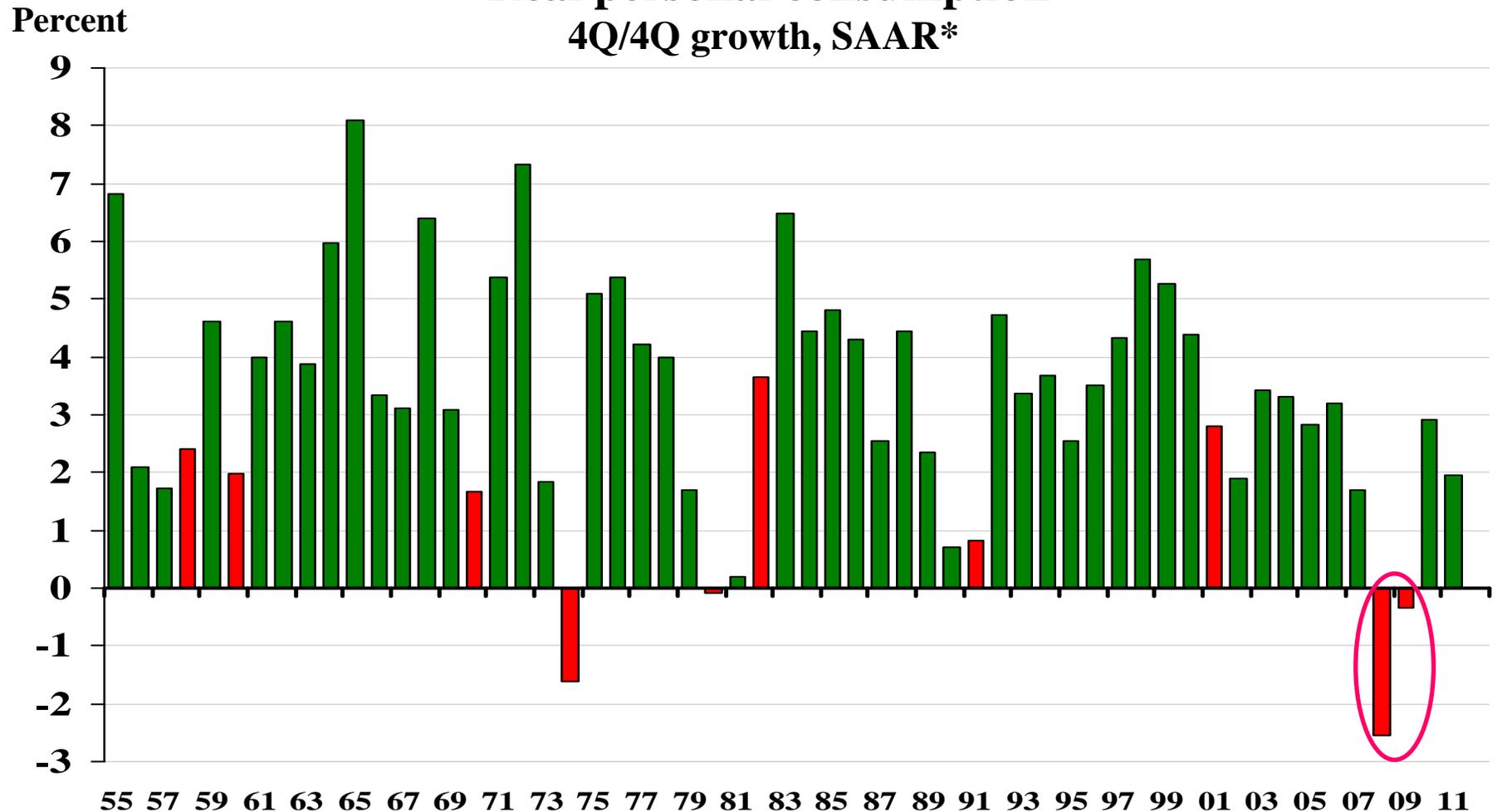
Monthly data: Last point plotted is November 2012



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The recession was very deep

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



Last point plotted is 2011; Red bars indicate two or more quarters during the year occurred during a recession



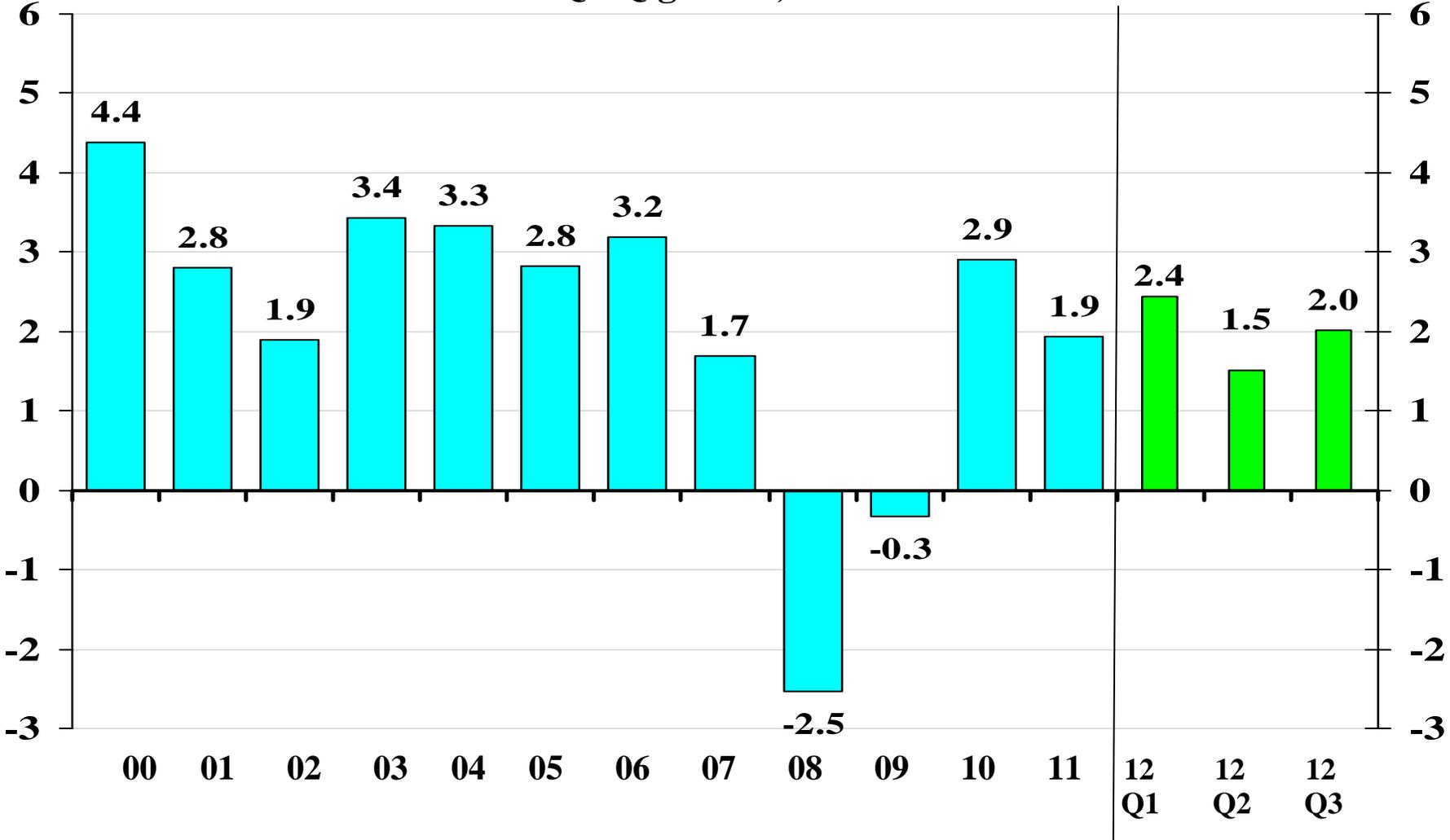
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The recession was very deep, but consumer spending is recovering

Real personal consumption

4Q/4Q growth, SAAR

Percent

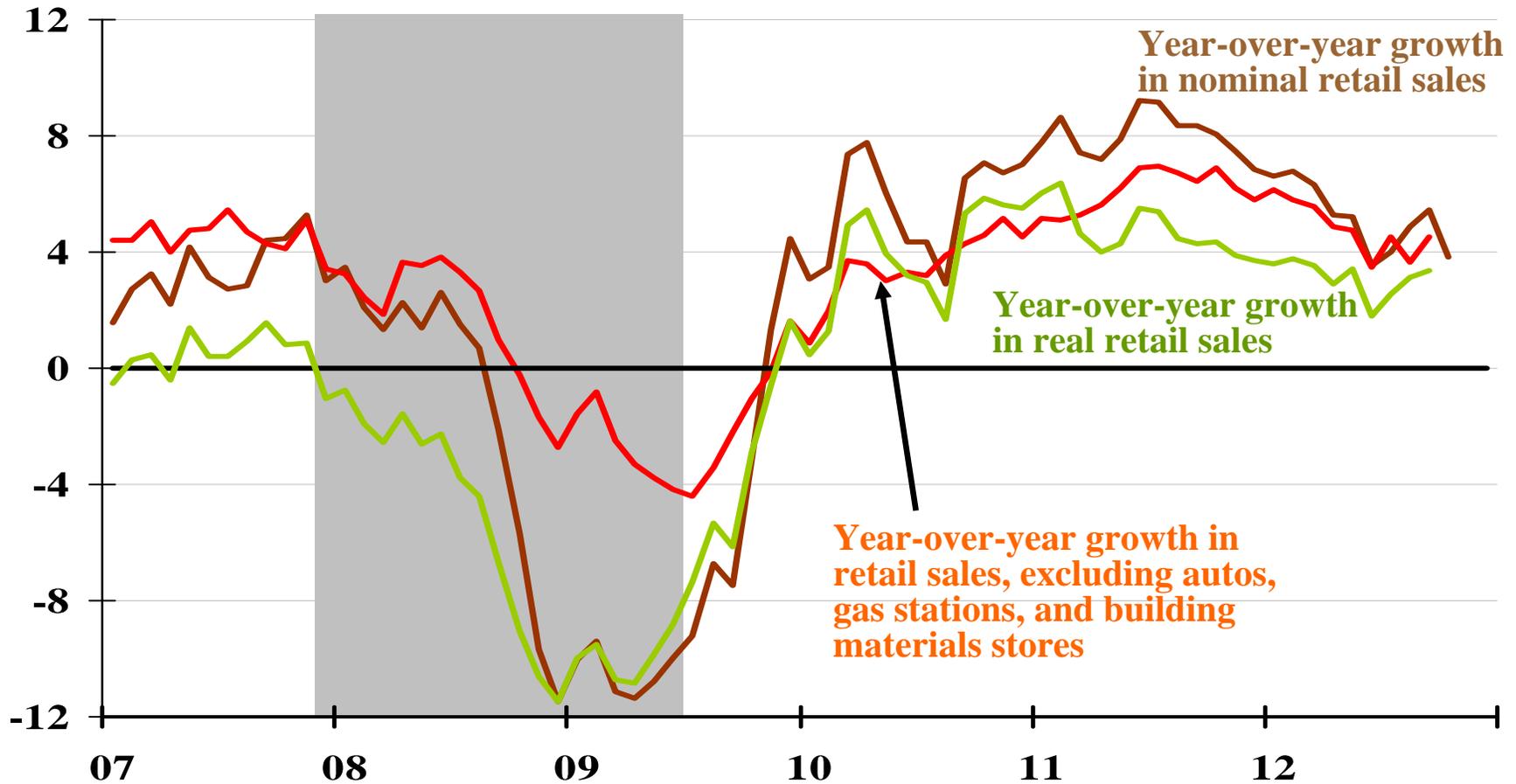


Annual data through 2011 (4Q/4Q growth), quarterly data for 2012 (Q/Q growth, annualized)

Retail sales have held up.

Hurricane Sandy may have affected the numbers in October.

Percent



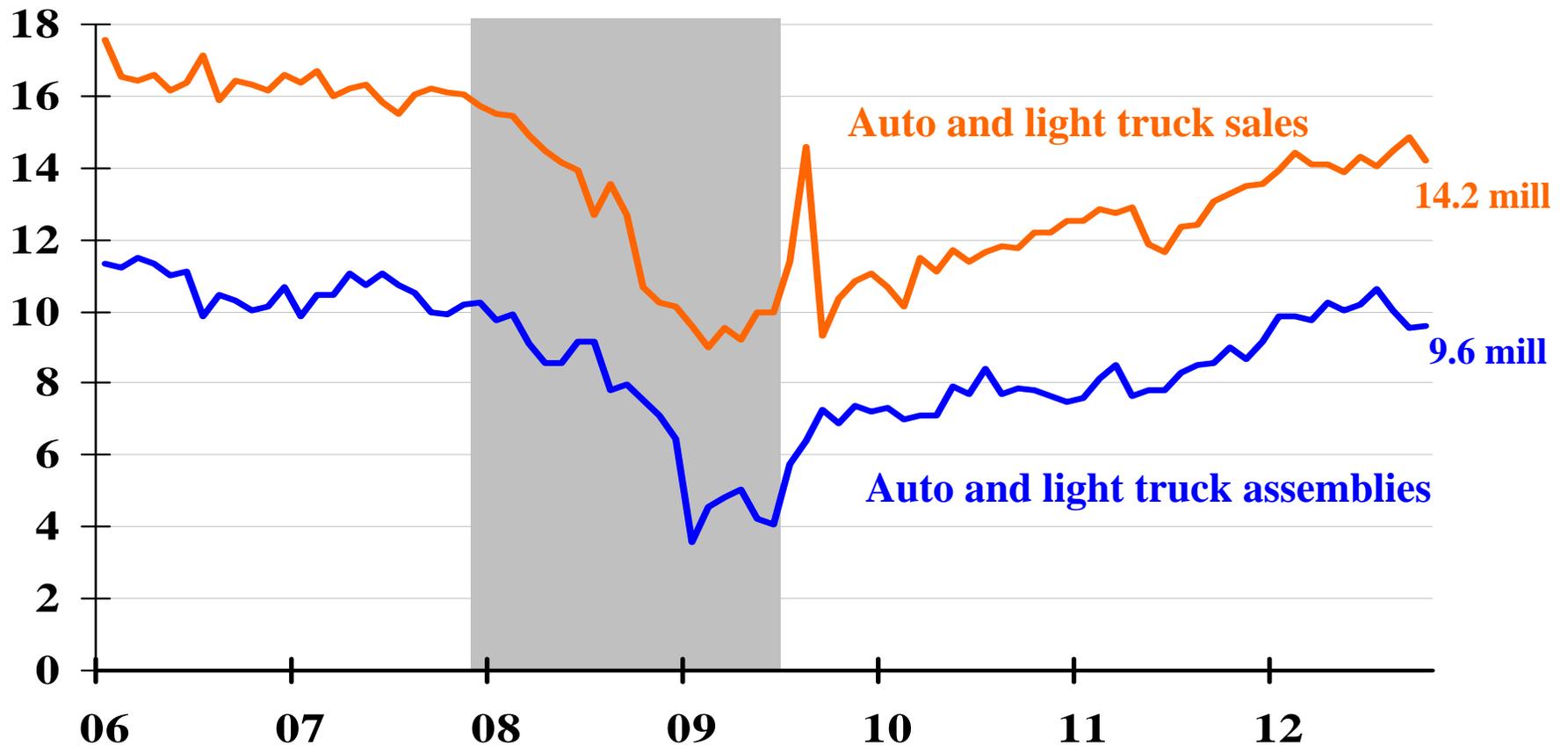
Monthly data: Last point plotted is October 2012 for real and nominal retail sales, and September 2012 for retail sales excl. autos, gasoline, and building materials



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**Auto sales have been strong this year.
Dealers attribute October's decline to Hurricane Sandy.
Both sales and production are expected to increase
as cars destroyed in the hurricane are replaced.**

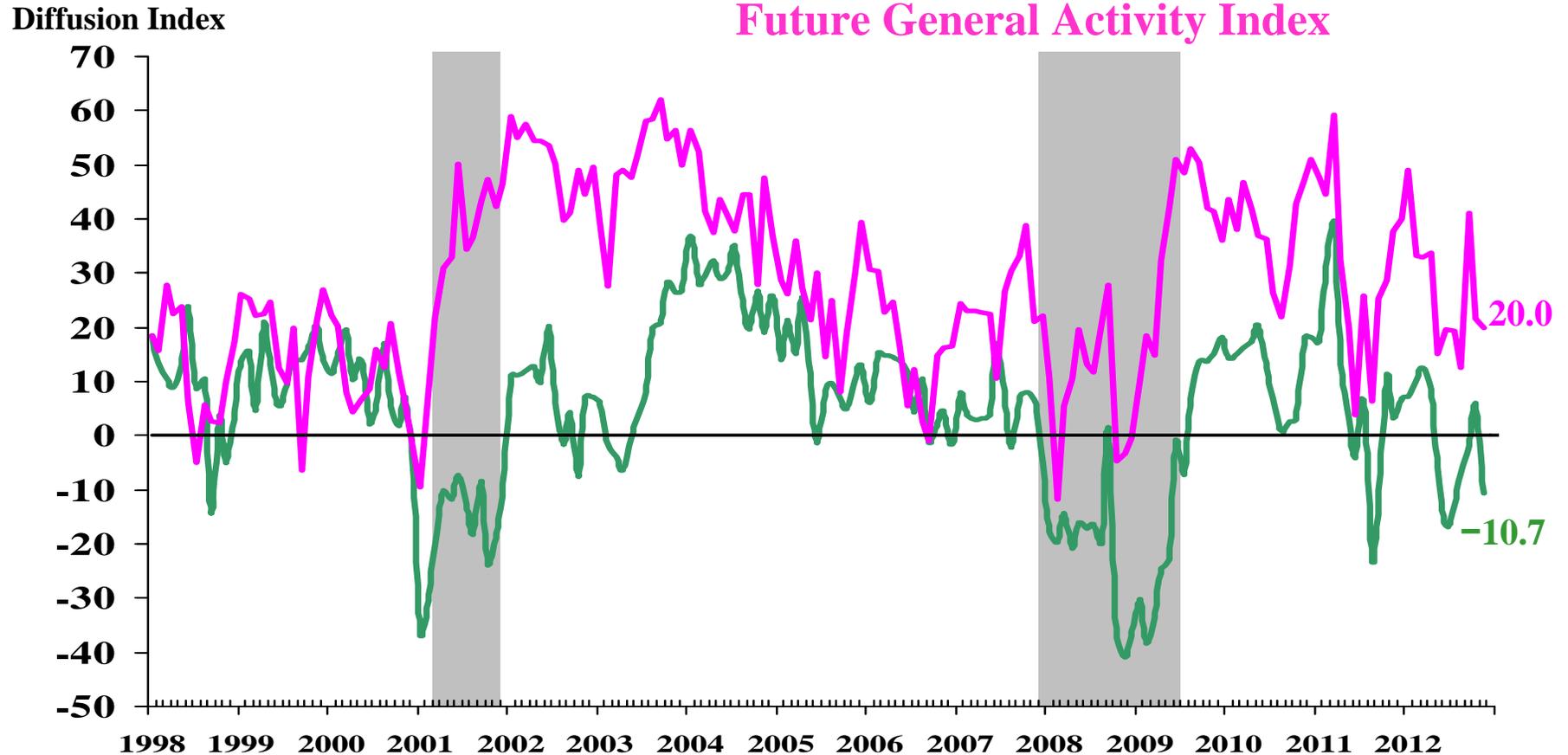
Millions of Units, Annual Rate



Monthly data: Last point plotted is October 2012

The general activity index in the Philadelphia Fed *Business Outlook Survey* of regional manufacturing fell back into negative territory in November. This may reflect the hurricane.

Business Outlook Survey: General Activity Index
Future General Activity Index



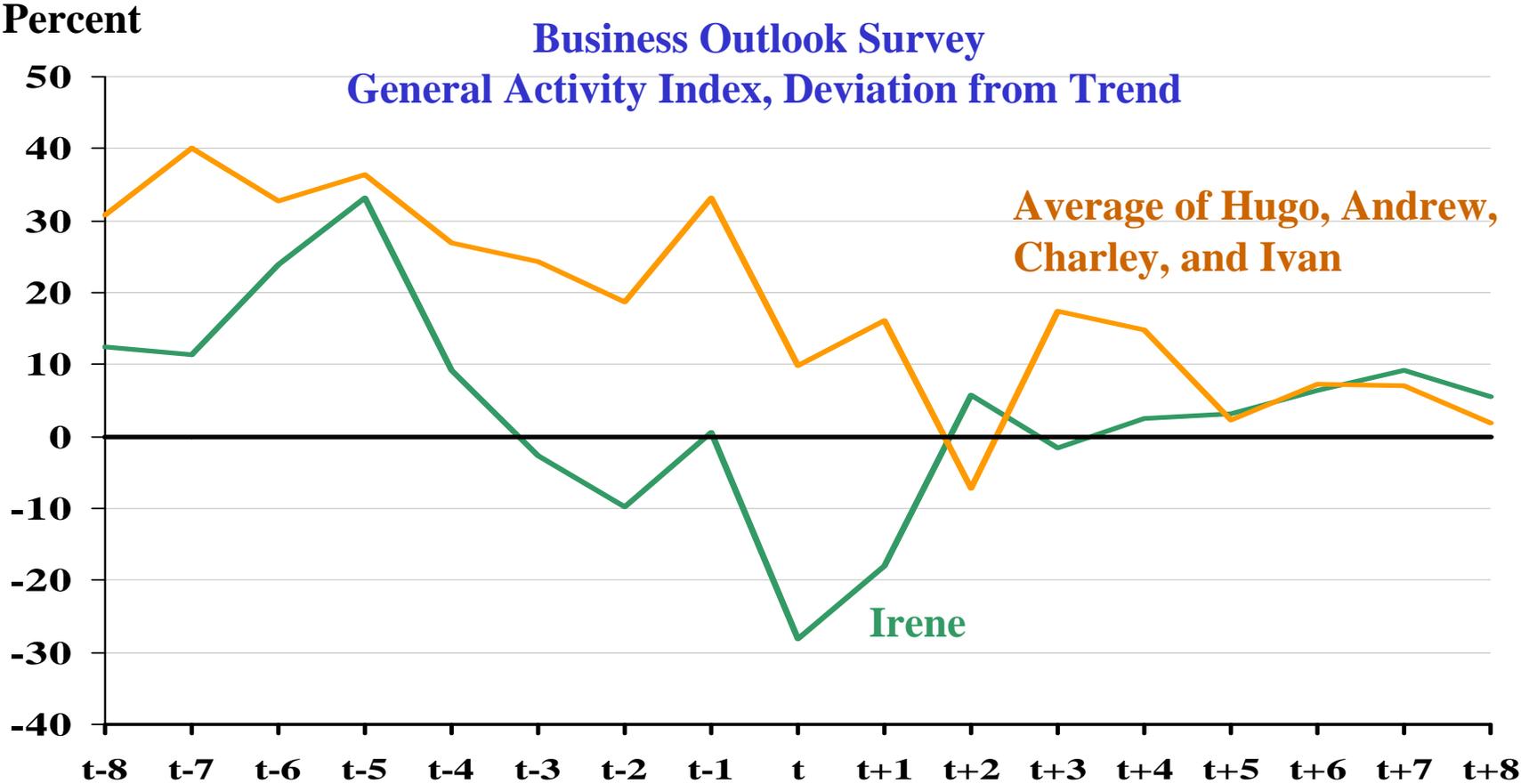
Index represents percentage of respondents reporting an increase minus percentage reporting a decrease.

Monthly data: Last point plotted is November 2012



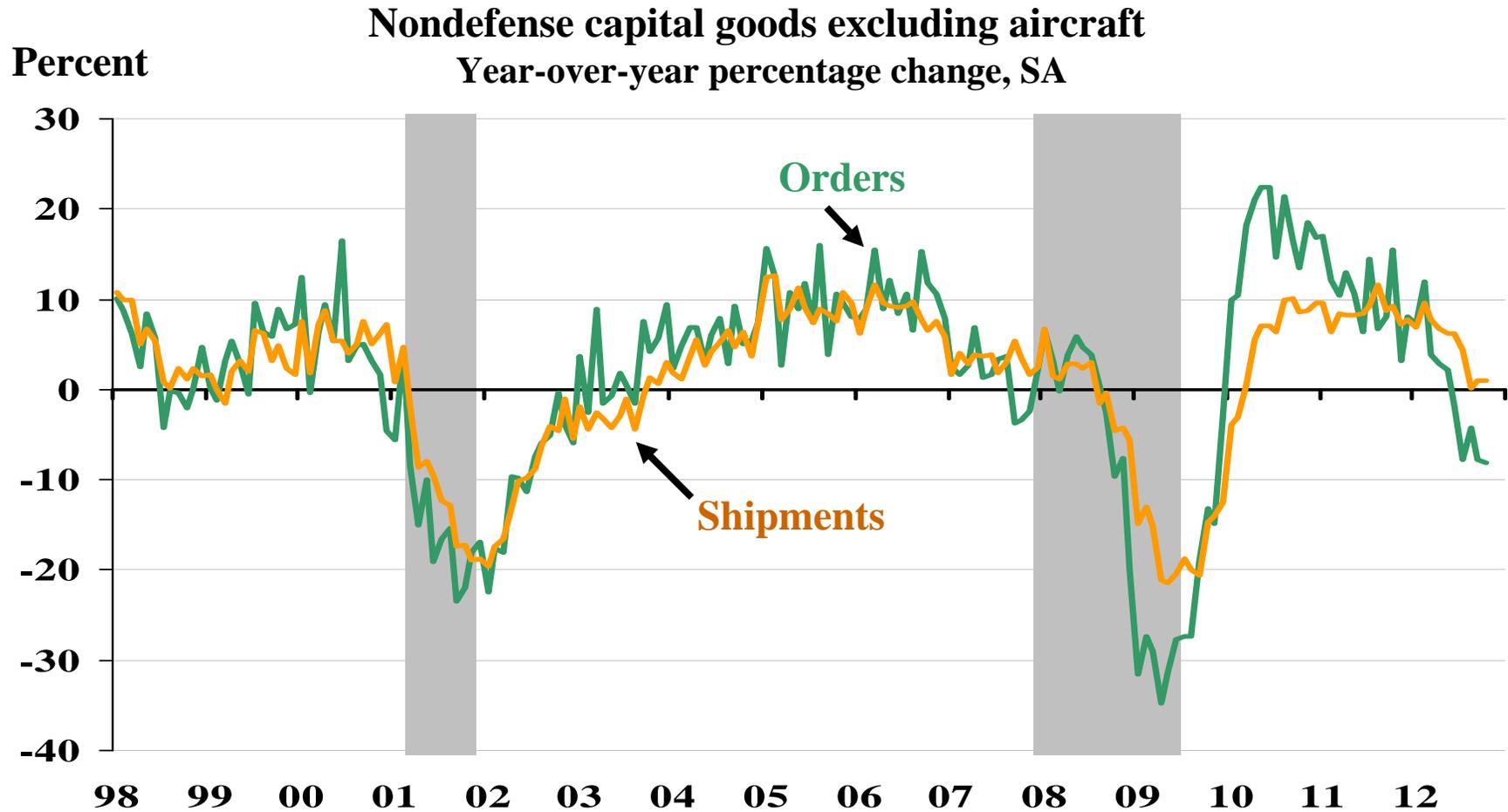
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The hurricane may show up in some of our monthly data.
Last year, our BOS fell sharply below trend in August when hurricane Irene hit.



Time t = month of hurricane landfall

**Business investment in equipment and software has been weak.
Uncertainty surrounding U.S. fiscal policy is a factor
weighing on business spending.**

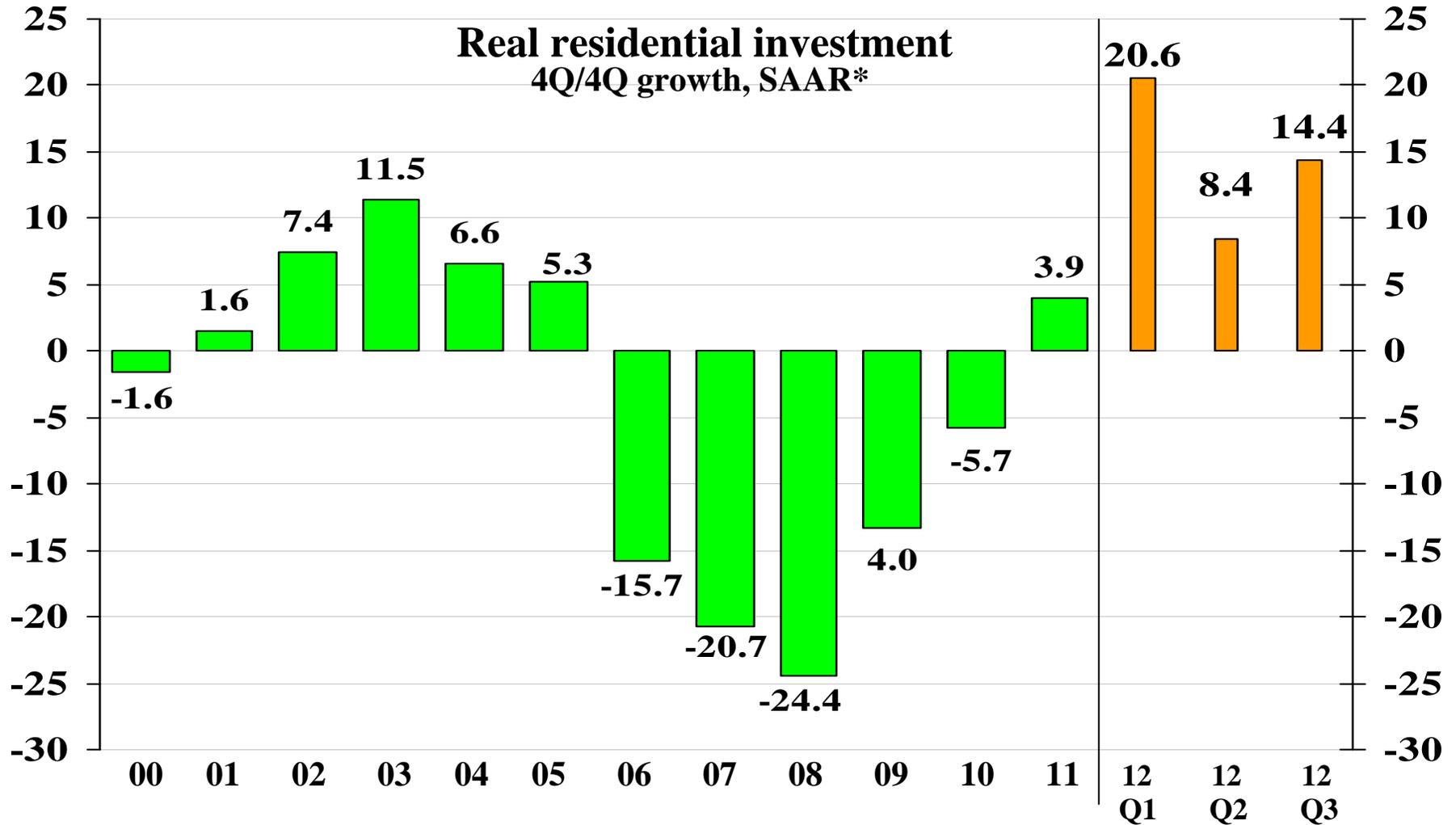


Monthly data: Last point plotted is October 2012

Residential investment has added to growth in 2012, but it is a smaller share of the economy than it was during the boom

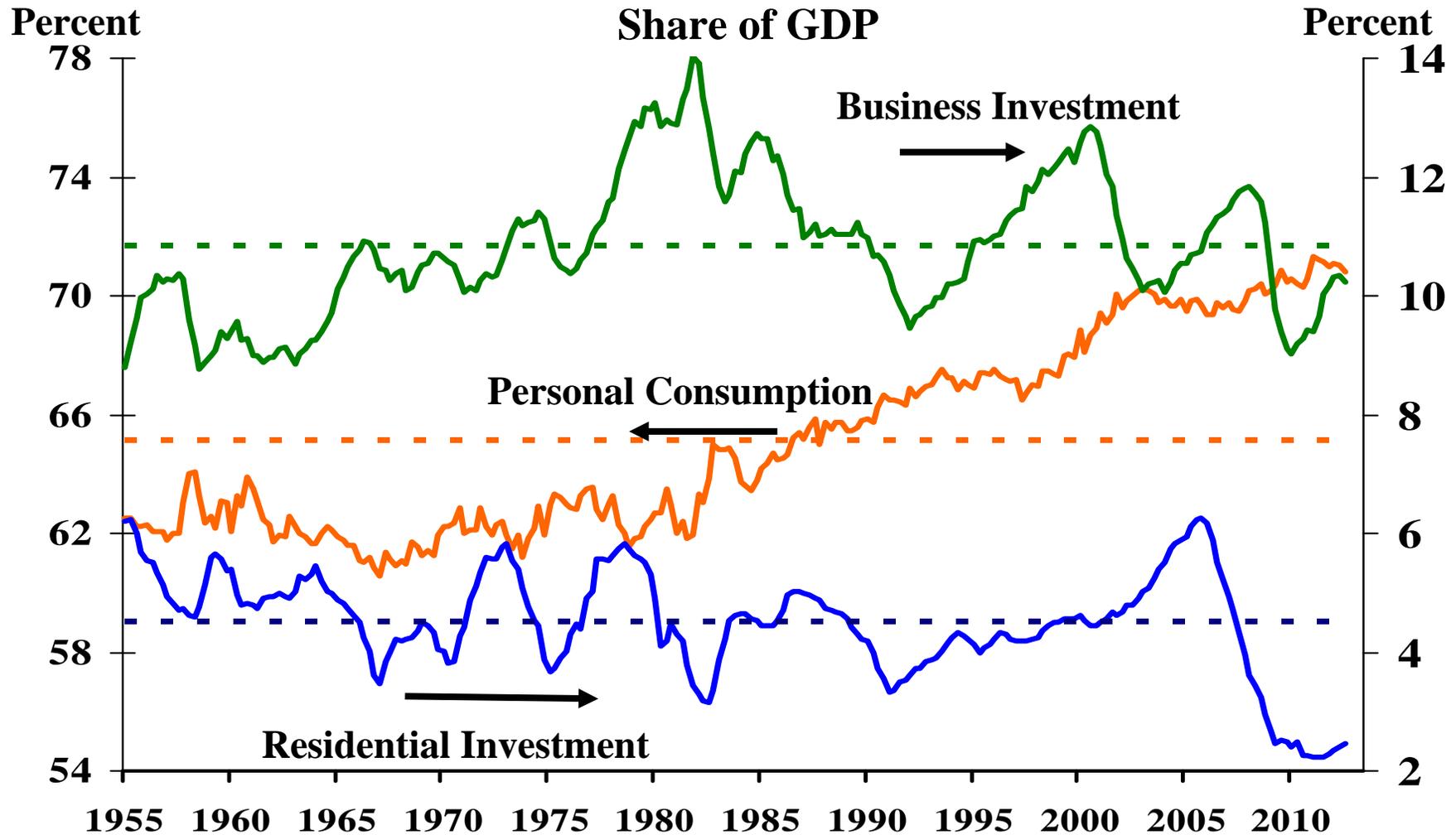
Residential investment is now 2.4% of output, down from 6.3% during the boom.

Percent



Annual data through 2011 (4Q/4Q growth), quarterly data for 2012 (Q/Q growth, annualized)

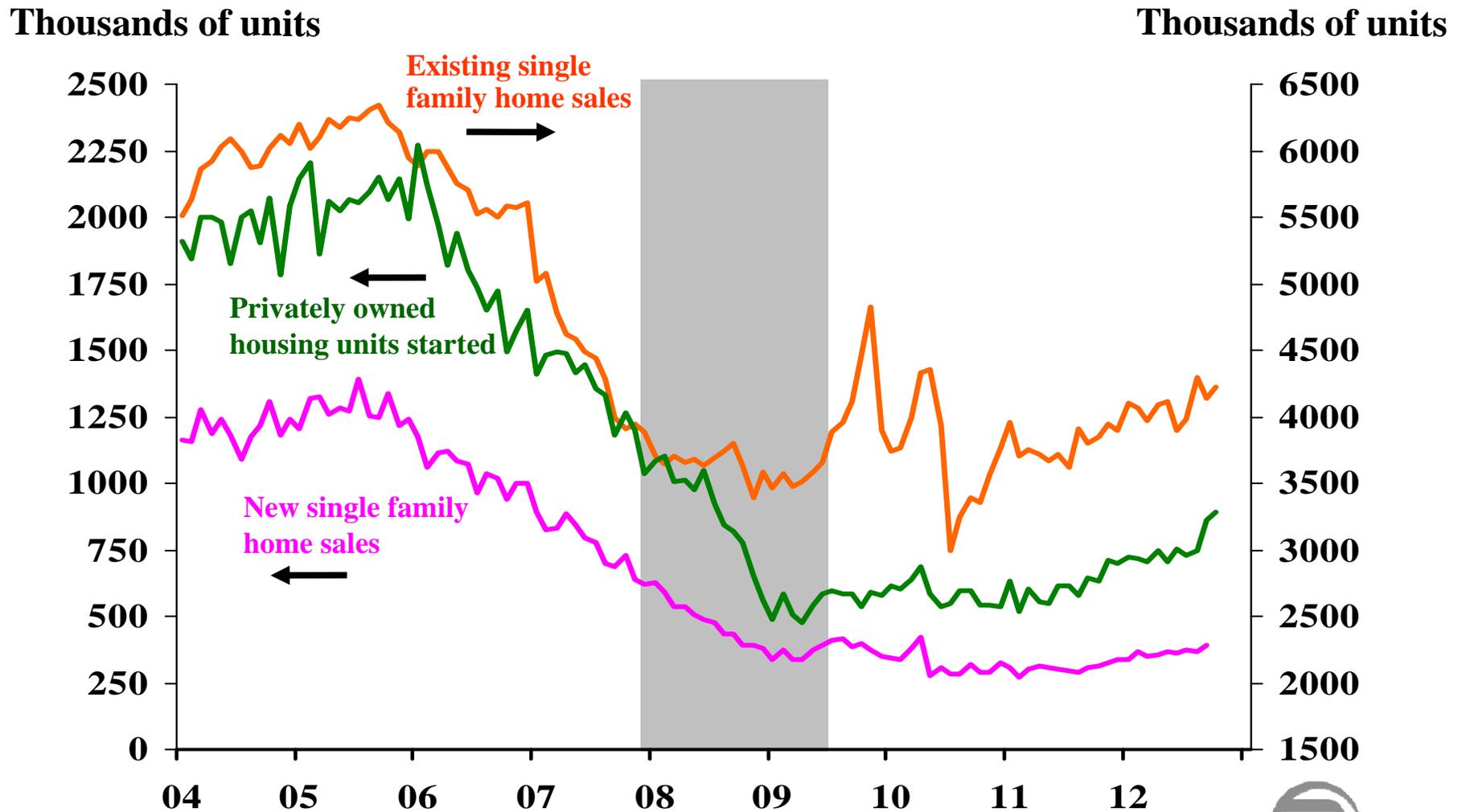
Housing as a share of the economy is at its post-WWII low



Dotted lines represent average shares from 1955Q1 – 2012Q3



Housing is beginning to recover, with sales and starts moving up, albeit from very low levels



Monthly data: Last point plotted is October 2012 for housing starts and existing home sales and September 2012 for new home sales.

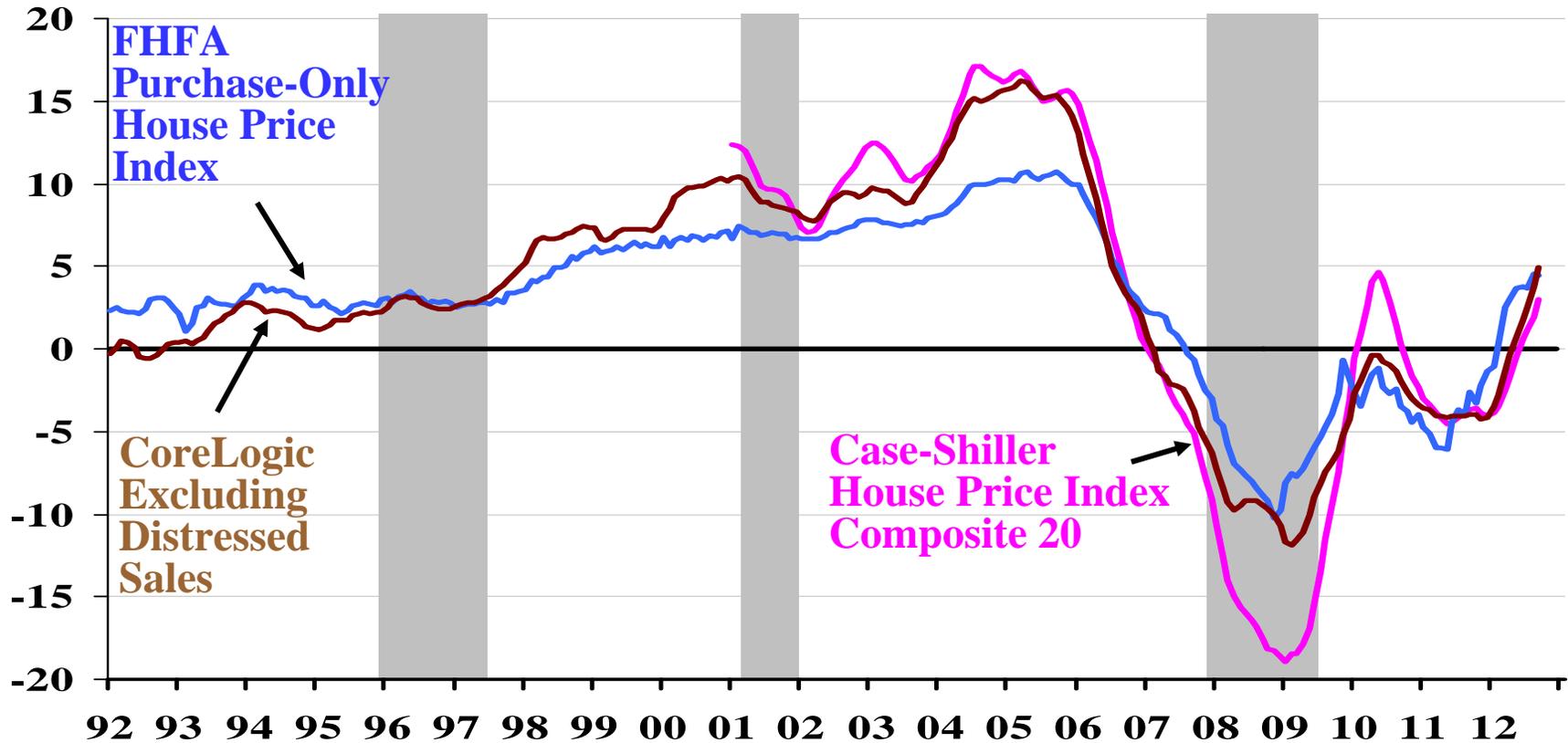


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House prices are now rising at the national level

Percent

Year-over-year percentage change



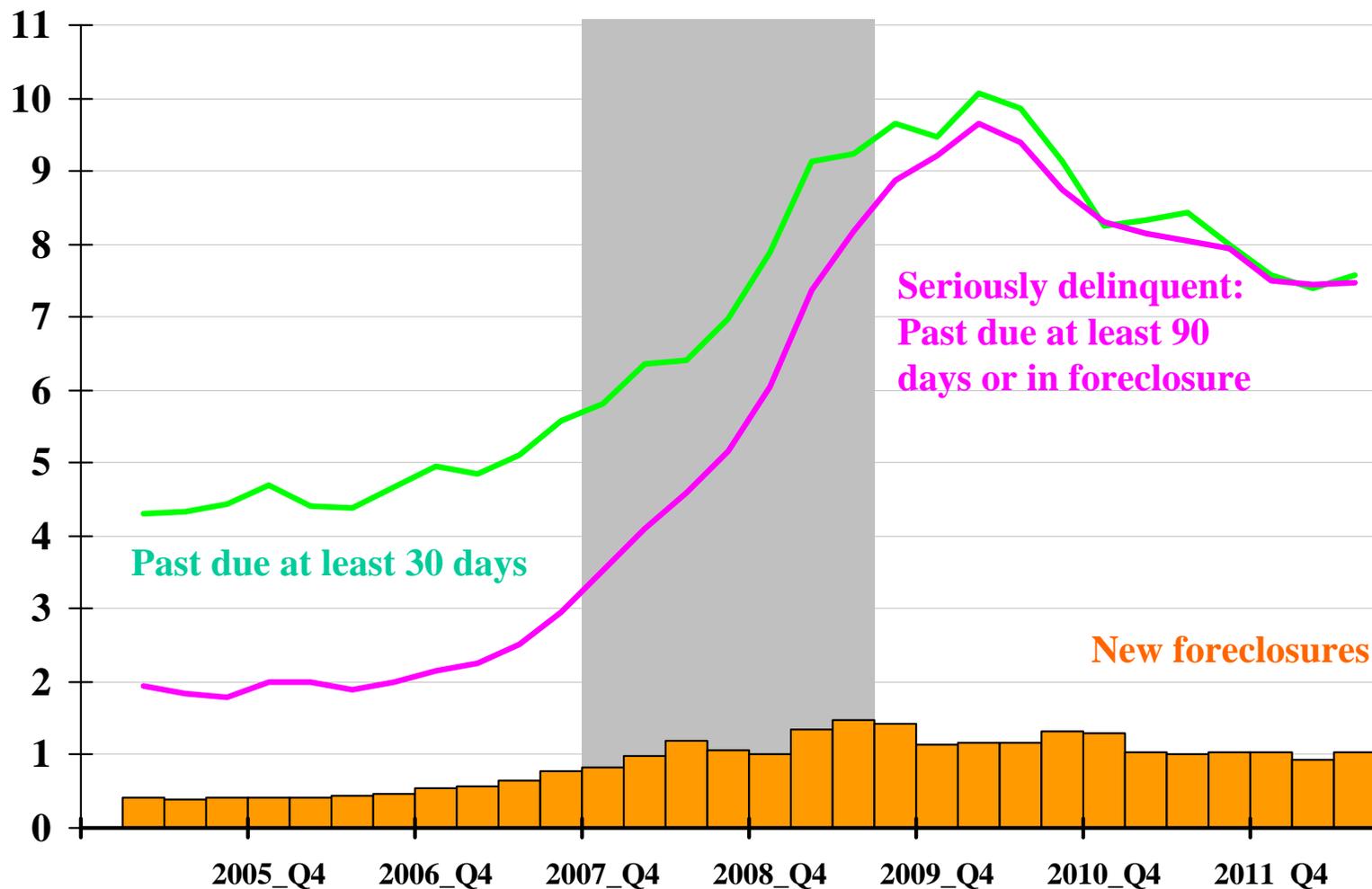
Monthly data: Last point plotted is September 2012



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

Percent of all mortgages outstanding,
1-4 residential units



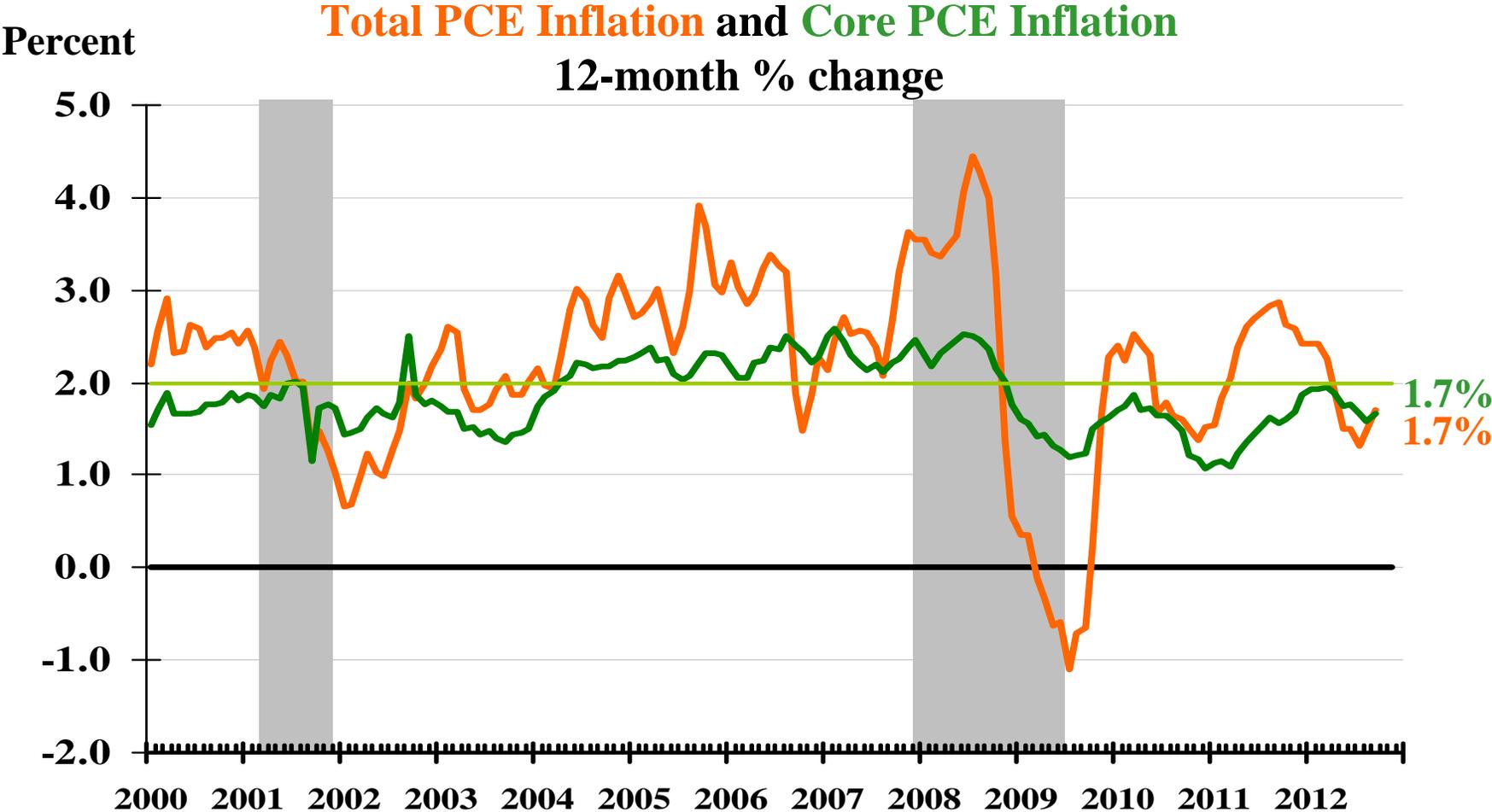
Quarterly data: Last point plotted is 2012Q2

Source: Mortgage Bankers Association, seasonally adjusted



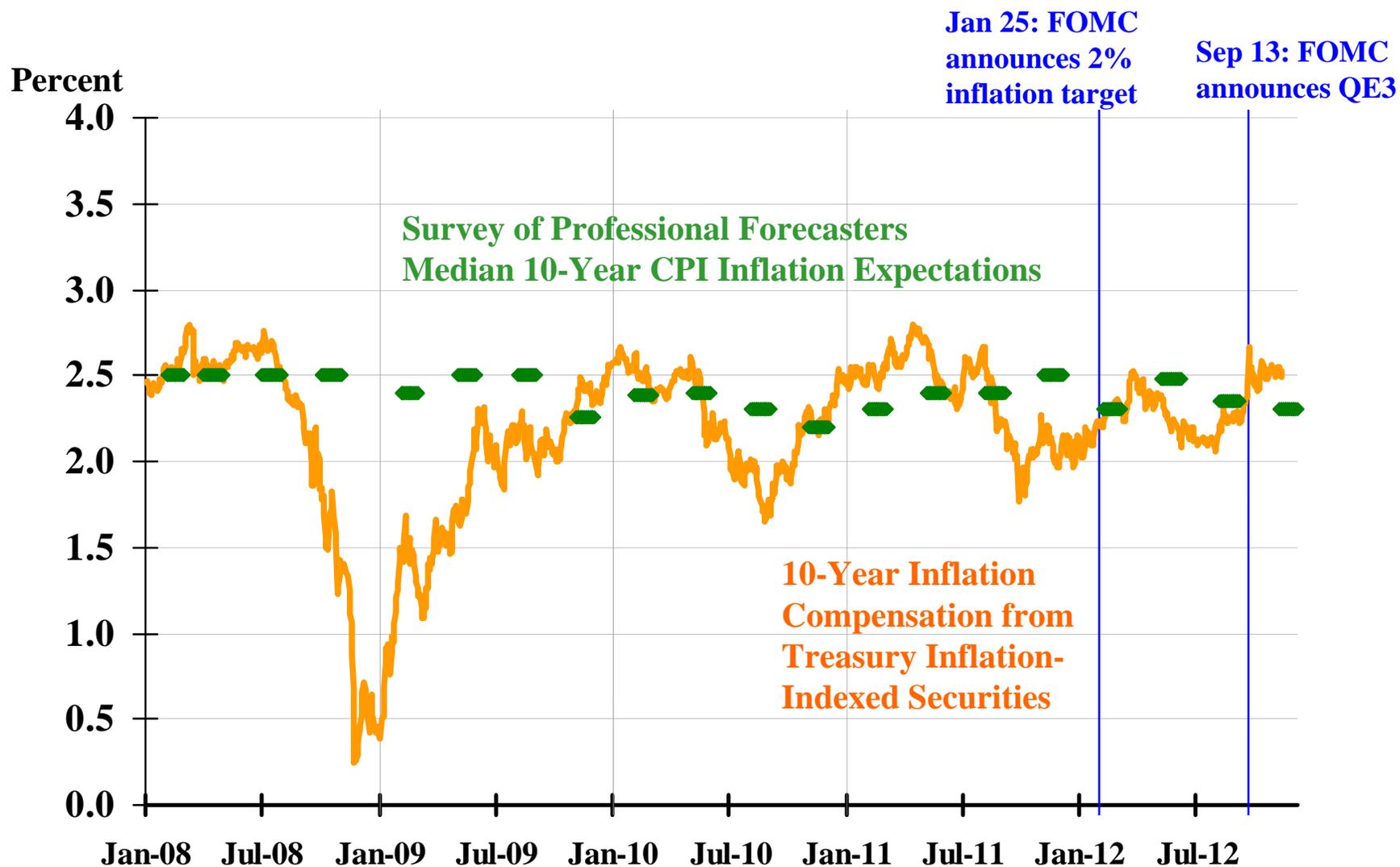
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Inflation remains near the FOMC's longer-run goal of 2 percent



Monthly data: Last month plotted is September 2012

**Longer-term inflation expectations appear to be well-anchored,
however, the measures based on TIPS have increased since the summer**

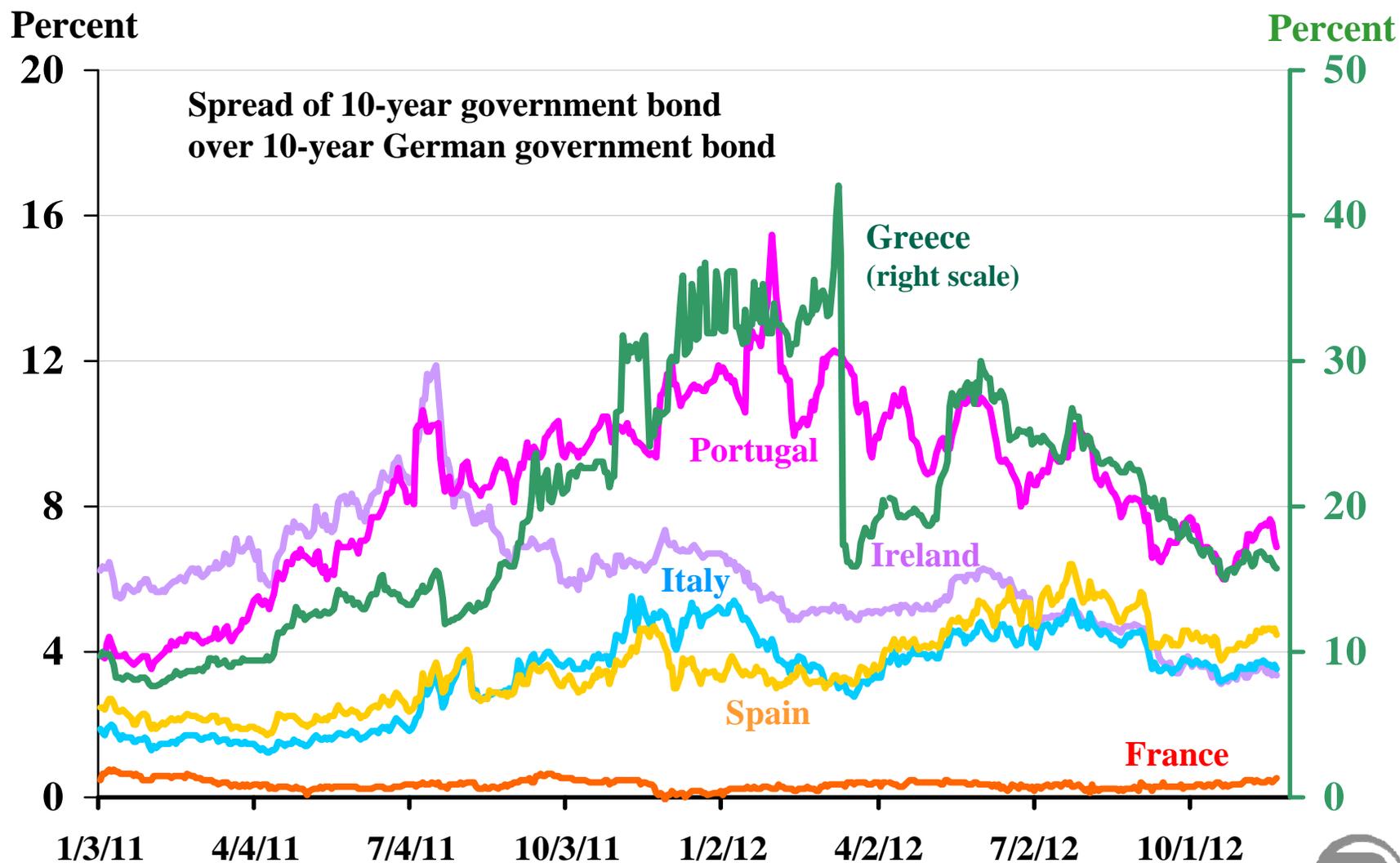


**Daily data: Last point plotted is November 6, 2012 for inflation compensation
and Fourth Quarter 2012 SPF for 10-year CPI inflation expectations**



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**European sovereign debt and banking problems
continue to cloud the global outlook and Europe is in recession,
but European countries have taken some positive steps**



Daily: Last point plotted is November 20, 2012

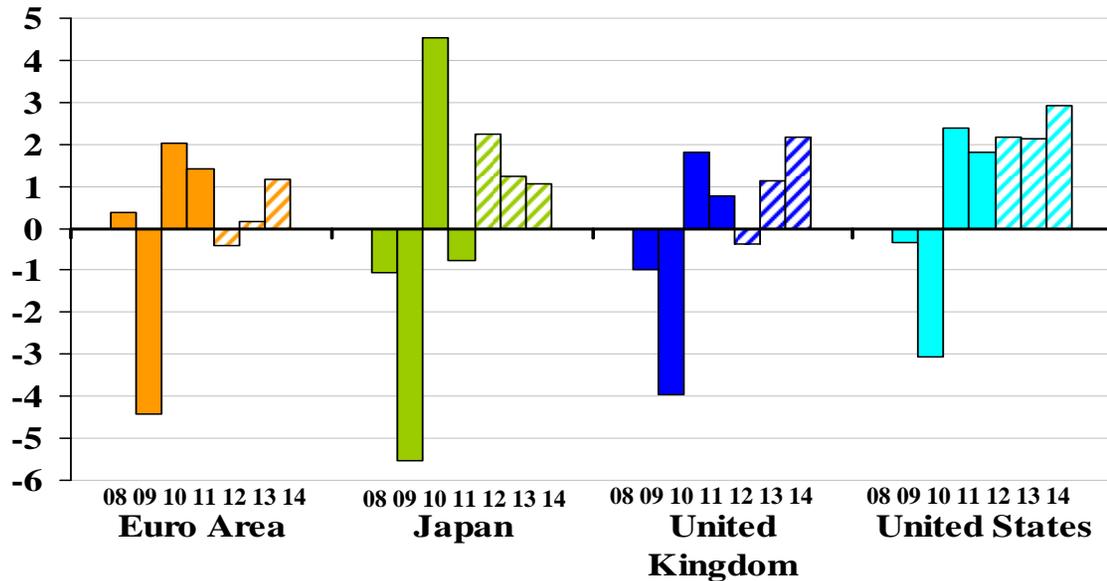


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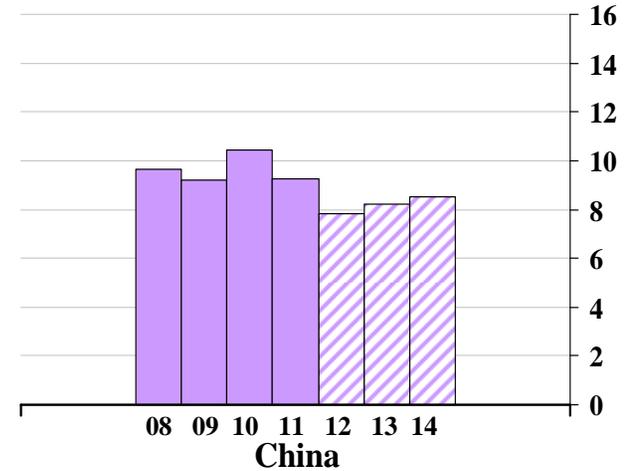
Slow growth abroad will be a drag on U.S. exports next year

Real GDP Growth, SAAR

Percent



Percent

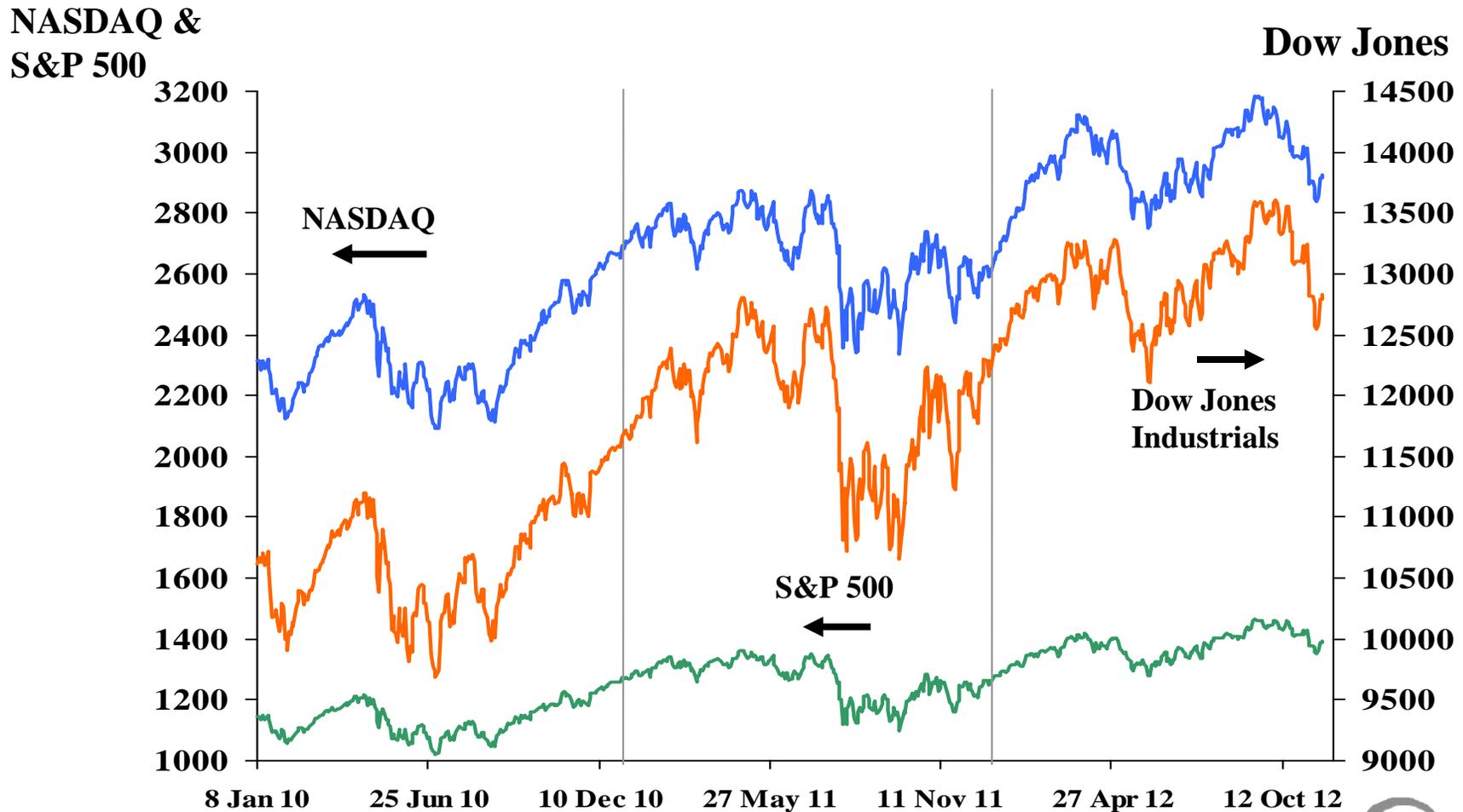


Source: IMF World Economic Outlook, October 2012.
Hatched bars are forecasts.



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Stock prices were volatile over the election period, and have moved down recently on concerns about the fiscal cliff and geopolitical risk in the Middle East. The S&P 500 is up about 10 percent, on net, year-to-date.



Daily data: Last point plotted is November 21, 2012



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**Interest rates remain very low across the maturity spectrum.
The Fed has kept the fed funds rate at essentially zero for 4 years.
30-year mortgage rates are under 3.5% and 10-year Treasury yields are under 1.7%.**



Weekly data: Last point plotted is November 16, 2012

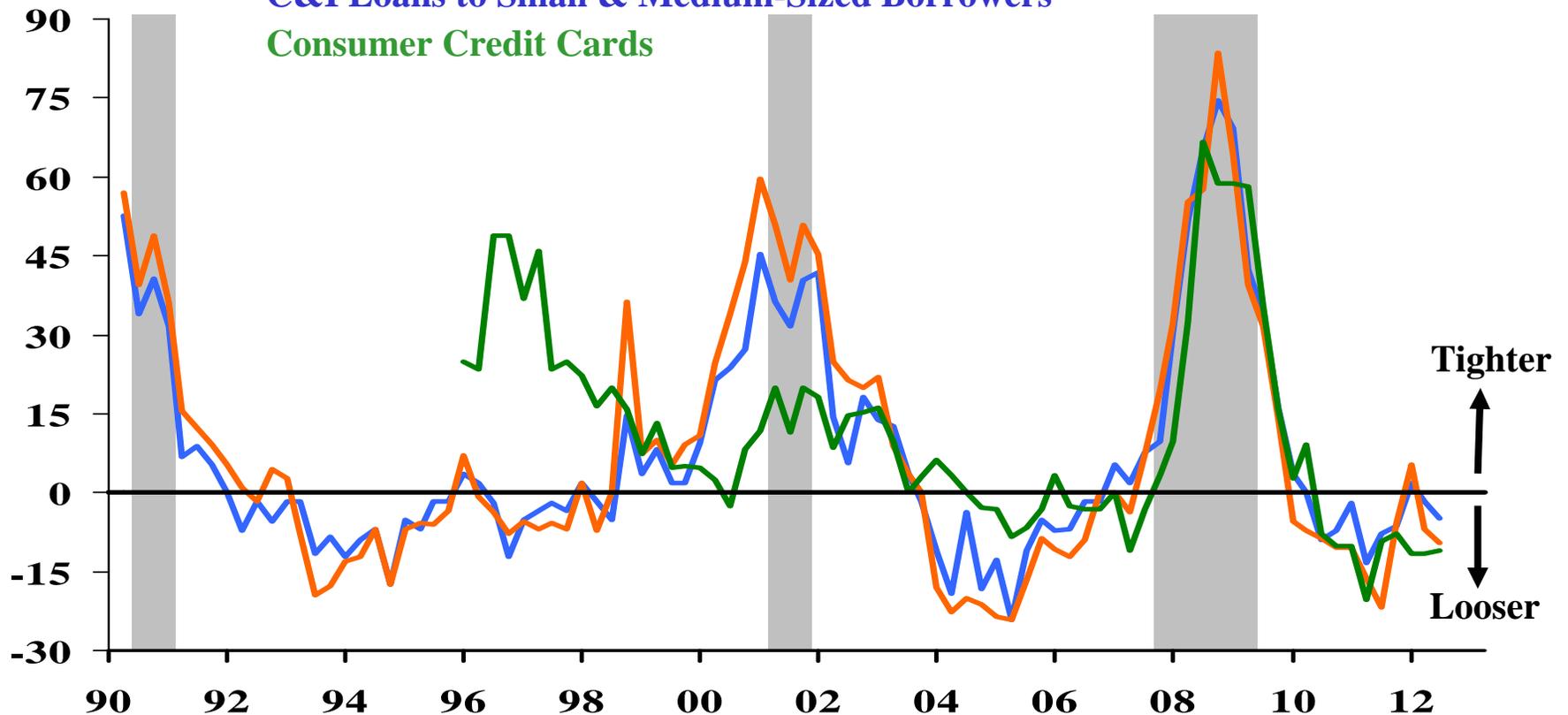
Banks continue to loosen credit conditions as borrower creditworthiness improves

Senior Loan Officer Opinion Survey Net Percentage of Banks Tightening Standards

C&I Loans to Large Borrowers

C&I Loans to Small & Medium-Sized Borrowers

Consumer Credit Cards

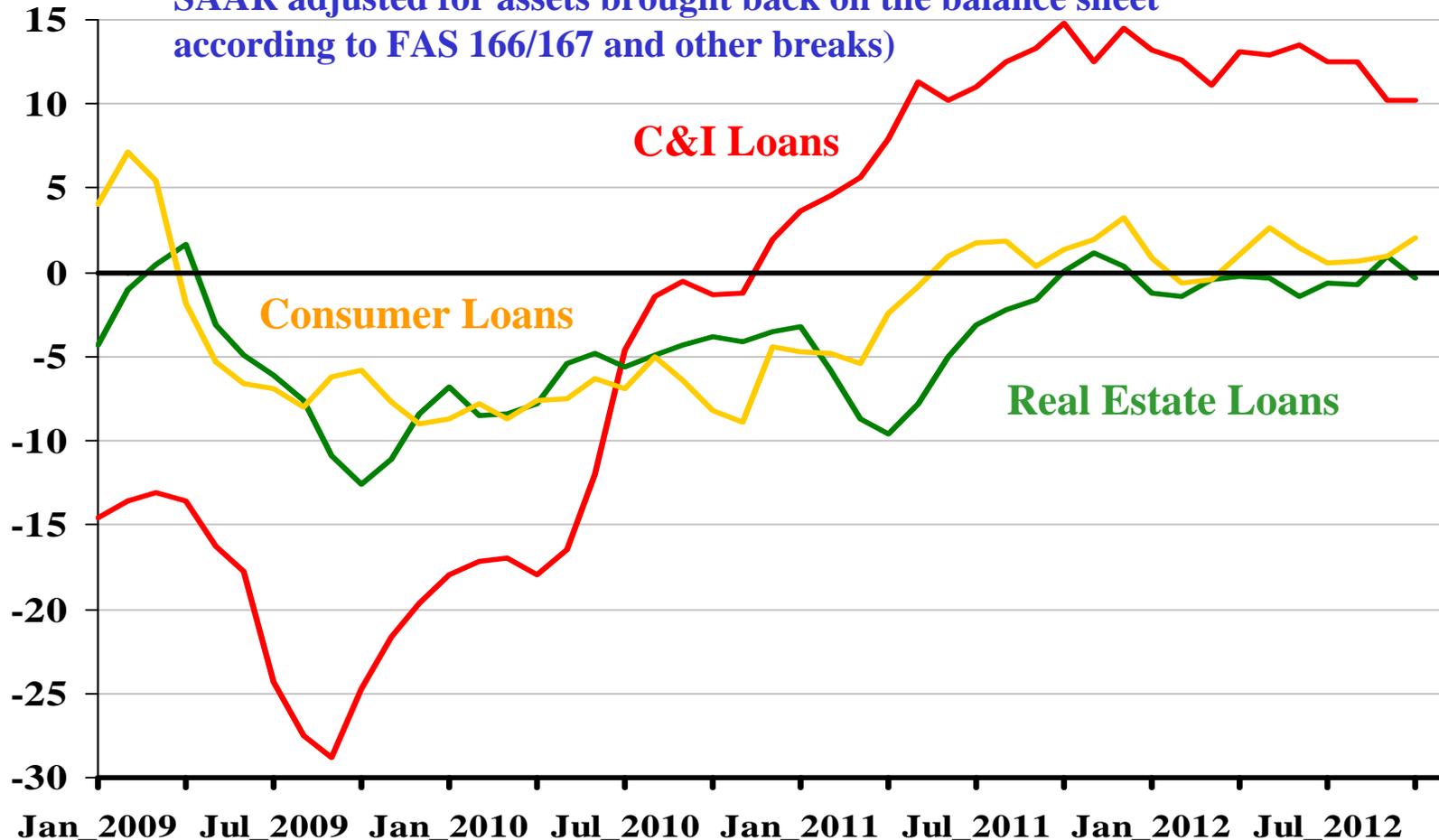


Business lending is growing

Moving 3-month average of annualized monthly loan growth at all domestically-chartered commercial banks

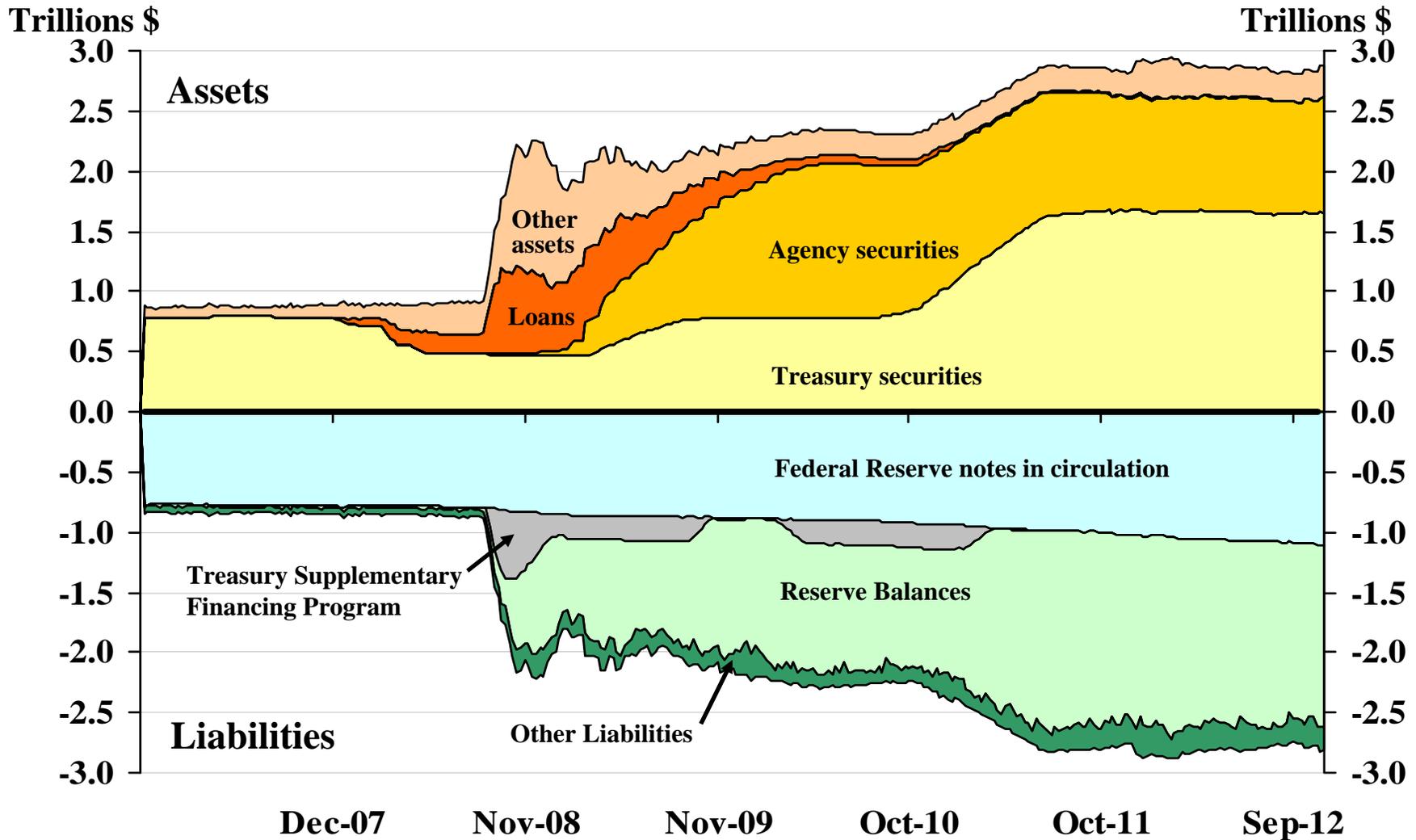
Percent

SAAR adjusted for assets brought back on the balance sheet according to FAS 166/167 and other breaks)



Source: Federal Reserve H.8 Statistical Release
Monthly Data: Last point plotted is October 2012

The Fed is buying agency mortgage-backed securities again and 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 November 21, 2012

The FOMC took further action in September to ease financial conditions, and reiterated its policy in October

Balance Sheet Policy

- QE3: Purchase agency MBS at a pace of \$40 billion per month.
- Operation Twist: continue through the end of the year the program to extend the average maturity of Fed balance sheet assets.
- Continue to reinvest principal payments from agency debt and agency MBS into agency MBS.

=> These three actions combined increase longer term assets on the balance sheet by \$85 billion per month through year-end.

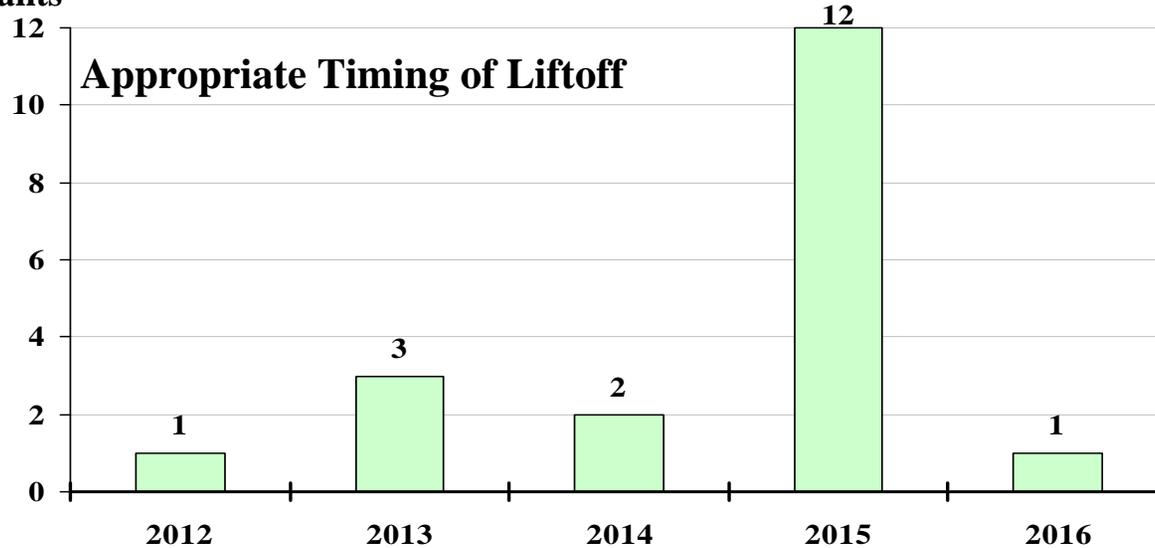
Forward Rate Guidance

- Likely to keep fed funds rate at 0 to 1/4 percent at least through mid-2015.
- Highly accommodative stance of monetary policy will remain appropriate for a considerable time after the economic recovery strengthens.
- If the outlook for the labor market does not improve substantially, do more.

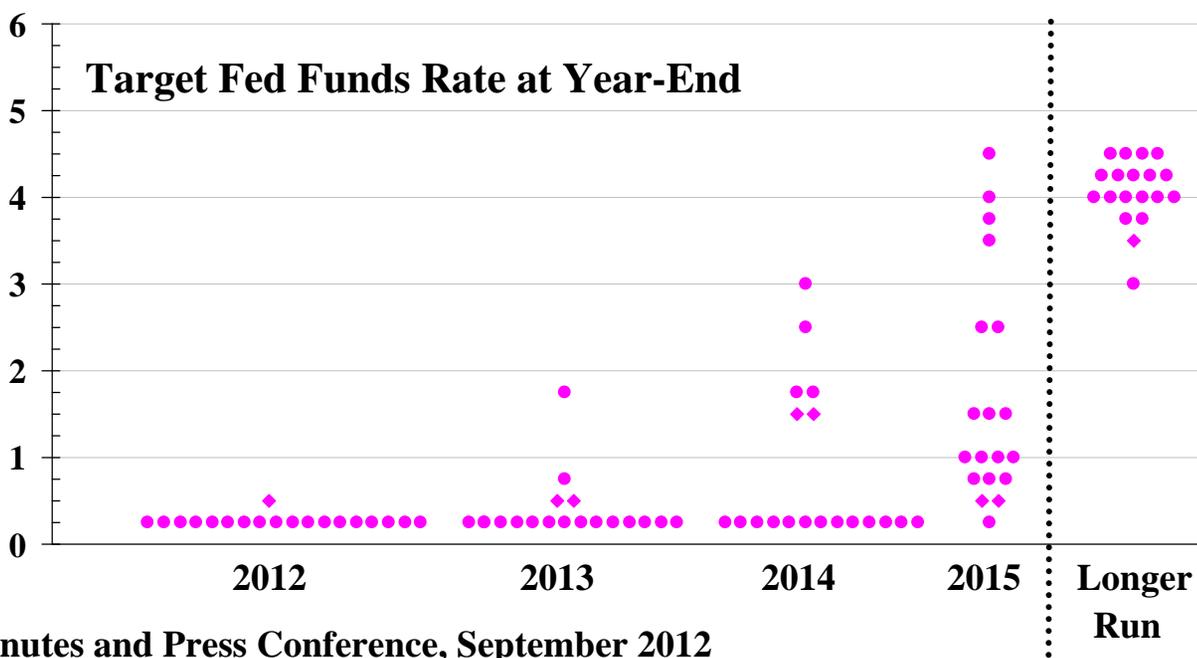


Majority of FOMC participants believe it will not be appropriate to raise the funds rate until 2015.

Number of Participants



Percent



Source: FOMC Minutes and Press Conference, September 2012

**The fiscal cliff is a risk to the forecast:
forecasts assume we will avoid diving off the cliff
but we might put our foot over the edge**

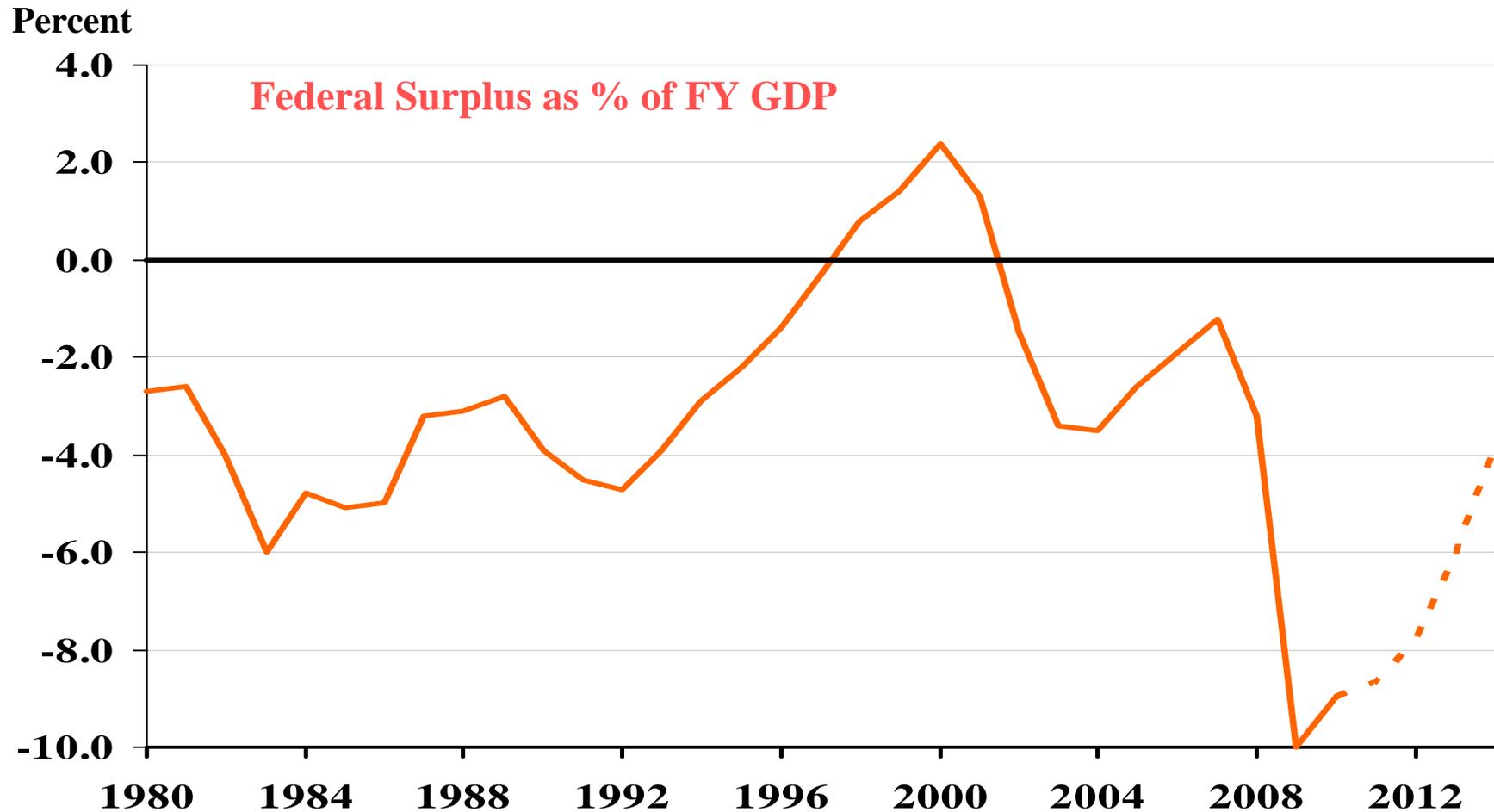
	<u>\$ billions</u>	<u>% of FY13 GDP</u>
<i>Changes in Revenue Policies</i>	399	2.5%
Expiration of tax provisions and adjustments to AMT	221	1.4%
Expiration of employee's payroll tax reduction	95	0.6%
Other expiring provisions	65	0.4%
Taxes included in Affordable Care Act	18	0.1%
 <i>Changes in Spending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

Source: Congressional Budget Office, May 2012



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**The government budget deficit as a percent of GDP
is expected to decline over the next two years,
but current fiscal policy is not sustainable over the longer-run.**



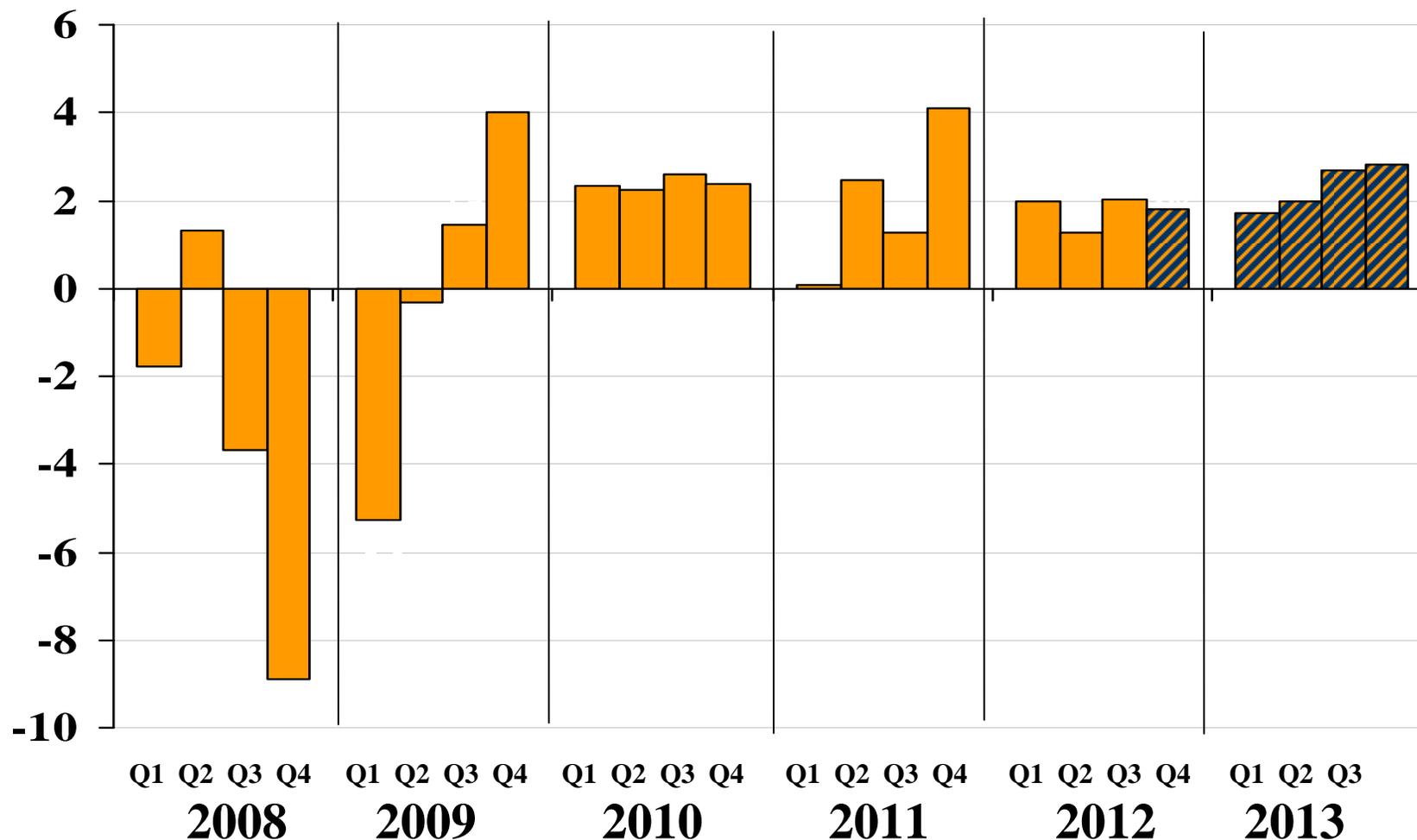
Source: Office of Management and Budget Mid-Session Review, July 2012



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The latest Philadelphia Fed *Survey of Professional Forecasters* forecasts sustained economic recovery with growth around trend

Percent



Hatched bars are median forecasts from the 2012Q4 *Survey of Professional Forecasters*



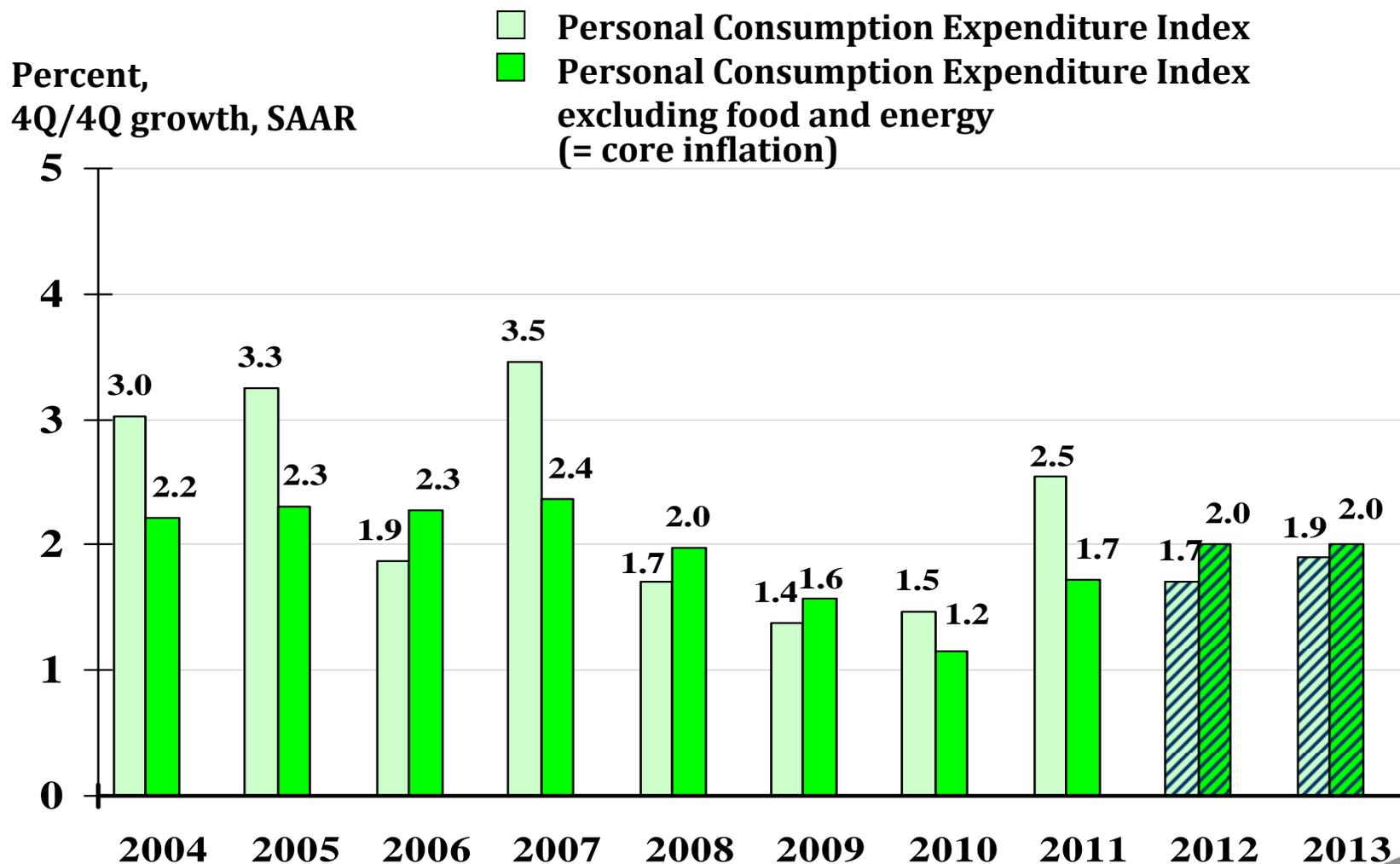
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The latest Philadelphia Fed *Survey of Professional Forecasters* indicates the unemployment rate will continue to decline over the year but will remain high



Dotted line is median forecast from the 2012Q4 *Survey of Professional Forecasters*
Last point plotted is forecast for 2013 Q4.

The Philadelphia Fed 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 Q4 *Survey of Professional Forecasters*



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