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
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

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP Growth*</td>
<td>1.9 to 2.4%</td>
<td>2.2 to 2.8%</td>
</tr>
<tr>
<td>Unemployment Rate</td>
<td>8.0 to 8.2%</td>
<td>7.5 to 8.0%</td>
</tr>
<tr>
<td>PCE Inflation (Q4/Q4)</td>
<td>1.2 to 1.7%</td>
<td>1.5 to 2.0%</td>
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Survey of Professional Forecasters 2012 Q2 Survey

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<td>Real GDP Growth*</td>
<td>2.4 %</td>
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<tr>
<td>Unemployment Rate</td>
<td>7.9%</td>
<td>NA</td>
</tr>
<tr>
<td>PCE Inflation (Q4/Q4)</td>
<td>2.1 %</td>
<td>2.0 %</td>
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*Q4/Q4 growth for Fed forecasts and 2012 SPF; annual growth for 2013 SPF

The FOMC revised down their forecasts for 2012

The FOMC continues to expect growth to strengthen in 2013

Growth decelerated to around 2 percent in the first quarter and is running at about the same pace in the second quarter
Economic activity was stronger at the start of the year…

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

... than it is now.
But activity in most states is still increasing.

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

- US: 0.9%
- 3-state: 0.3%
- PA: -0.5%
- NJ: 1.8%
- DE: -3.2%

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

<table>
<thead>
<tr>
<th></th>
<th>US</th>
<th>3-state</th>
<th>PA</th>
<th>NJ</th>
<th>DE</th>
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<tr>
<td>Ann. yr-to-date as of May 2012</td>
<td>1.5%</td>
<td>0.8%</td>
<td>0.0%</td>
<td>2.1%</td>
<td>-0.1%</td>
</tr>
</tbody>
</table>

Recent modest job growth has retarded progress on recovering lost jobs

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

<table>
<thead>
<tr>
<th></th>
<th>% of jobs lost</th>
<th>% of lost jobs regained</th>
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<tbody>
<tr>
<td>US</td>
<td>56.2%</td>
<td>42.9%</td>
</tr>
<tr>
<td>PA</td>
<td>4.4%</td>
<td>56.2%</td>
</tr>
<tr>
<td>NJ</td>
<td>6.3%</td>
<td>26.9%</td>
</tr>
<tr>
<td>DE</td>
<td>7.8%</td>
<td>27.6%</td>
</tr>
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</table>

Incorporates May 2012 data
Unemployment rates are down since last August, but we have seen little movement over the past three months

Civilian unemployment rate

US: 8.2 (May)
PA: 7.4 (May)
NJ: 9.2 (May)
DE: 6.8 (May)
Three States: 8.1 (May)

Monthly data: Last point plotted is May 2012

Regional manufacturing activity slowed in May and June

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 June 2012
At the national level, manufacturing activity has shown more strength than suggested by the regional surveys. Auto production remains strong.

Industrial Production

Motor Vehicle Assemblies (right scale)

Manufacturing Output

Industrial Production

Monthly data: Last point plotted is May 2012

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.

West Texas Intermediate

Retail Gasoline

Brent

Weekly data: Last point plotted is June 15, 2012 for WTI and June 22, 2012 for Retail Gasoline and Brent.
As oil prices have fallen, inflation has moderated toward its longer-run goal of 2 percent.

Total PCE Inflation and Core PCE Inflation

12-month % change

Percent


Monthly data: Last month plotted is April 2012

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

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

Percent

Jan 07 Jul 07 Jan 08 Jul 08 Jan 09 Jul 09 Jan 10 Jul 10 Jan 11 Jul 11 Jan 12

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.

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

There are signs that housing is starting to recover, with sales and starts moving up, albeit from very low levels
Uncertainty surrounding the European sovereign debt and banking problems continues to cloud the global outlook.

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.
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.

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

Last month plotted is May 2012. Average monthly gains for each year are indicated by the grey lines.

Recent months’ readings on payrolls have been revised down

1st estimate 2nd estimate 3rd estimate
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

U.S. payroll employment

Avg of 8 recoveries, 1949-1982

2001

1991

2009

Last point plotted for 2009 recovery is May 2012

Months Since Recovery Began

Trough
Mar 1991
Nov 2001
Jun 2009

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

County Unemployment Rates: April 2012

Less than 7.5%
7.5% - 9.0%
9.0% - 11.0%
Greater than 11.0%
The share of unemployment that is long-term remains high

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.

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

Civilian unemployment rate by educational attainment

Monthly data: Last point plotted is May 2012
Unemployment among young people remains particularly high

Civilian Unemployment Rates by Age

- **16-19 Years**: 24.6%
- **20-24 Years**: 12.9%
- **25-54 Years**: 7.1%
- **55 Years & Older**: 6.5%

Monthly data: Last point plotted is May 2012

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

Civilian Labor Force Participation Rate (SA)

- **Percent**
- **Nonlinear trend**
- **63.8**

Quarterly data: Last point plotted for participation is 2012Q1
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

- Hispanics: 67.1%
- Whites: 64.2%
- Total: 63.8%
- African Americans: 61.3%

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

- Male: 70%
- Total: 60%
- Female: 50%

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

Labor Force Participation Rates

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

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

Monthly data: Last month plotted is May 2012
Longer-term inflation expectations appear to be well-anchored

Percent

Jan-08 Jul-08 Jan-09 Jul-09 Jan-10 Jul-10 Jan-11 Jul-11 Jan-12

Survey of Professional Forecasters
Median 10-Year CPI Inflation Expectations

10-Year Inflation Compensation from Treasury Inflation-Indexed Securities

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

Jan 25: FOMC releases 2% inflation target

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, 6Q1 = 100
Confidence index, 1985 = 100

Consumer Sentiment Index, University of Michigan
Consumer Confidence Index, Conference Board

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.

Billions of Dollars

Change in households’ stock and mutual fund holdings

Change in households’ real estate equity

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

Auto production remains strong

Millions of Units, Annual Rate

Auto and light truck sales

Auto and light truck assemblies

Monthly data: Last point plotted is May 2012
Household debt-to-disposable income is falling

Debt-to-Disposable Income

Quarterly data: Last point plotted is 2012 Q1

Households’ debt-service burdens are falling.
This partly reflects low interest rates.

Total financial obligations to disposable personal income*

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

Quarterly data: Last point plotted is 2011 Q4
Source: Federal Reserve Board
Inventories of unsold homes are down from their peaks

[Chart showing months' supply of single family homes and condos and co-ops over time.]

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

[Map showing change in FHFA House Price Index For Metro Areas as of 2012 Q1.]

Not Reported
Less than 0%
0% to 4%
4% to 8%
8% to 12%
Greater than 12%

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

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)