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?
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.

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

Source: Bureau of Labor Statistics
Progress on unemployment has stalled over the past three months.

![Civilian unemployment rate chart]


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

![Year-over-year growth in personal income and real disposable income chart]

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.

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

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

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

Calculation of LIBOR has come under increased scrutiny

In September 2008, the Fed announced new and expanded swap lines with other central banks to alleviate pressures in dollar short-term funding markets.

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 1st mortgages = 3 million loans
    - 9% of outstanding principle of 1st 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

<table>
<thead>
<tr>
<th>Changes in Revenue Policies</th>
<th>$ billions</th>
<th>% of FY13 GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expiration of tax provisions and adjustments to AMT</td>
<td>221</td>
<td>1.4%</td>
</tr>
<tr>
<td>Expiration of employee’s payroll tax reduction</td>
<td>95</td>
<td>0.6%</td>
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<tr>
<td>Other expiring provisions</td>
<td>65</td>
<td>0.4%</td>
</tr>
<tr>
<td>Taxes included in Affordable Care Act</td>
<td>18</td>
<td>0.1%</td>
</tr>
<tr>
<td>Total Change in Deficit (without economic feedback effects)</td>
<td>607</td>
<td>3.8%</td>
</tr>
</tbody>
</table>

Source: Congressional Budget Office, May 2012
Market participants continue to price in more accommodative policy given the weaker economic data.
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

Thousands of jobs

Monthly change in private nonfarm payrolls

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

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

Incorporates June 2012 data for US and May 2012 data for states
Employment in our three states decelerated since the beginning of the year.

### 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%

#### Job growth
- **Ann. 3-month**
- **As of May 2012**

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

- **US:** 1.5%
- **3-state:** 0.8%
- **PA:** 0.0%
- **NJ:** 2.1%
- **DE:** -0.1%

### 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**

#### Job growth
- **Ann. yr-to-date**
- **As of May 2012**

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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.

Cumulative % change in private nonfarm payrolls since recession trough

Last point plotted for 2009 recovery is June 2012
Unlike prior recessions, government jobs are being cut

Cumulative % change in government nonfarm payrolls since recession trough

U.S. government payroll employment

Avg of 8 recoveries, 1949-1982
Census workers => +410K in May 2010

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

U.S. payroll employment

Avg of 8 recoveries, 1949-1982

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.

Percent of Unemployed

Monthly data: Last point plotted is June 2012
Long-term unemployment remains high. Progress has stalled in the past two months.

Job losers as percent of civilian labor force

Average weeks unemployed

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.

Job losers are people unemployed for less than 5 weeks.

Monthly data: Last point plotted is June 2012
Labor force participation is below the level that would be predicted by cyclical factors and demographics.

![Graph of Civilian Labor Force Participation Rate (SA)](image)

Quarterly data: Last point plotted for participation is 2012Q2
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.

![Graph of Total CPI Inflation and Core CPI Inflation](image)

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

Jan 25: FOMC releases 2% inflation target

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 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

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

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.

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

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

Monthly data: Last point plotted is June 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 2012 Q1
Source: Federal Reserve Board
Inventories of unsold homes are down from their peaks

Months' supply at current sales pace

Months' supply of single family homes

Months' supply of condos and co-ops

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)

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

Index, March 1973 = 100

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