The Economic Outlook for the U.S. and Oklahoma

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Overview of the Federal Reserve System

- The “Fed” consists of three main entities:
  - Board of Governors: 7 members appointed by U.S. President
  - Federal Reserve Banks: 12 total; semi-independent by design
  - Federal Open Market Committee: 19 members; 12 voting

- As with most central banks, the Fed’s primary responsibilities fall within four general areas:
  - Lender of last resort – provide liquidity in times of crisis
  - Monetary policy – promote full employment and low inflation
  - Bank regulation – ensure safety and soundness of banks
  - Financial services – bank for banks, bank for federal govt.
Federal Reserve Districts and Office Locations
The Oklahoma City Branch of the Federal Reserve Bank of Kansas City

**History, staff, and functions**

- Branch office opened in 1920; currently have about 35 staff
- Functions include economic research, bank examinations, public outreach

**2011 branch board of directors**

- **Steve Agee (chairman)**, Dean, Oklahoma City Univ. Business School, OKC
- **Bill Anoatubby**, Governor, Chickasaw Nation, Ada
- **Jim Dunn**, Chairman, Mill Creek Lumber and Supply Co., Tulsa
- **Jacque Fiegel**, Senior EVP and COO, Coppermark Bank, OKC
- **Rose Washington Rentie**, Executive Director, TEDC Creative Capital, Tulsa
- **Doug Tippens**, President and CEO, Bank of Commerce, Yukon
- **K. Vasudevan**, Chairman, Service and Technology Corp., Bartlesville
The U.S. Economy

- Review of 2011 economic data
- Discussion of recent events
- Inflation trends and risks
Real GDP growth has slowed in 2011, following solid growth in 2010

U.S. Real Gross Domestic Product

Source: U.S. Bureau of Economic Analysis, FOMC
Consumer and government spending were particularly weak in Q2

Growth in Components of Real GDP

Source: U.S. Bureau of Economic Analysis
Detailed GDP components reveal some interesting trends in the first half of 2011

Real GDP components that have grown 5% or more in 2011 (annualized)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Component</th>
<th>Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Transportation equipment produced (autos, aircraft, etc.)</td>
<td>27.2%</td>
</tr>
<tr>
<td>2</td>
<td>Mining exploration, shafts, and well structures built</td>
<td>20.4</td>
</tr>
<tr>
<td>3</td>
<td>Recreational goods and vehicles purchased (TVs, guns, RVs, etc.)</td>
<td>11.9</td>
</tr>
<tr>
<td>4</td>
<td>Other durable goods purchased (jewelry, luggage, books, etc.)</td>
<td>7.1</td>
</tr>
<tr>
<td>5</td>
<td>Information processing equipment and software produced</td>
<td>5.7</td>
</tr>
</tbody>
</table>

Real GDP components that have declined 5% or more in 2011 (annualized)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Component</th>
<th>Decline</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Power and communication structures built</td>
<td>-19.6%</td>
</tr>
<tr>
<td>2</td>
<td>Other structures built (schools, churches, hotels, etc.)</td>
<td>-11.8</td>
</tr>
<tr>
<td>3</td>
<td>Commercial and health care structures built</td>
<td>-11.0</td>
</tr>
<tr>
<td>4</td>
<td>Gasoline and other energy goods purchased</td>
<td>-6.3</td>
</tr>
<tr>
<td>5</td>
<td>Manufacturing structures built</td>
<td>-6.0</td>
</tr>
<tr>
<td>6</td>
<td>Motor vehicles and parts purchased</td>
<td>-5.3</td>
</tr>
<tr>
<td>7</td>
<td>Nondefense federal government expenditures</td>
<td>-5.1</td>
</tr>
</tbody>
</table>
States concentrated in energy, autos, and software have generally performed best

Employment Growth, Year-over-Year (percent)
June 2011

Scale

- 1.47 - 4.82
- 0.86 - 1.47
- 0.30 - 0.86
- -0.63 - 0.30

Source: U.S. Bureau of Labor Statistics
July data have been mixed but indicative of modest overall U.S. economic growth
Firms’ hiring and investment plans remained relatively solid through late July

Tenth District Manufacturing Survey Expectations
Net Share of Firms Planning to Expand in Next 6 Months

Source: KCFRB Manufacturing Survey
But Europe’s sovereign debt crisis has spread, prompting the ECB to respond.

Spreads to German Bunds (10-yr)

Source: Reuters, Financial Times
And U.S. government debt projections are still unsustainable, prompting a downgrade.

CBO Federal Government Debt and Projections

- * CBO June 2011 projection
- ** Projection after deficit deal

Percent of GDP

* Alternative scenario
** FRBKC calculations based on limited information

Source: CBO
Yet Treasury yields have continued to drift lower, while stock prices have tanked.
At its June meeting the FOMC forecast U.S. unemployment to come down only slowly.
And for inflation pressures to ease after rising with oil and food prices

PCE Inflation Index

Percent change, year-over-year

Source: U.S. Bureau of Economic Analysis, FOMC
The Fed’s balance sheet has tripled in size, and the federal funds rate is near zero.

Source: Federal Reserve Board
August 9, 2011 FOMC Statement

“The Committee now expects a somewhat slower pace of recovery over coming quarters than it did at the time of the previous meeting and anticipates that the unemployment rate will decline only gradually toward levels that the Committee judges to be consistent with its dual mandate. Moreover, downside risks to the economic outlook have increased. The Committee also anticipates that inflation will settle, over coming quarters, at levels at or below those consistent with the Committee's dual mandate as the effects of past energy and other commodity price increases dissipate further.”

“The Committee currently anticipates that economic conditions — including low rates of resource utilization and a subdued outlook for inflation over the medium run — are likely to warrant exceptionally low levels for the federal funds rate at least through mid-2013. The Committee also will maintain its existing policy of reinvesting principal payments from its securities holdings.”
The Oklahoma Economy

- Review of recent economic data
- A closer look at labor markets
- Trends in energy prices
Oklahoma had a much milder recession, and has been outpacing the nation recently.
Most Oklahoma sectors have grown solidly in 2011, but two continue to shed jobs.

Employment Growth
June 2011

Percent change year-over-year

Source: Bureau of Labor Statistics
Unemployment in much of the state is at what is often considered “full employment”

Unemployment Rate
Seasonally Adjusted*

Source: U.S. Bureau of Labor Statistics

* Estimated by FRBKC
However, labor markets may not be overly tight due to labor force dropouts.

Unemployment Rate by State
Seasonally Adjusted

<table>
<thead>
<tr>
<th>State</th>
<th>May-11</th>
<th>May-11 at 2007 LFPR*</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>9.1</td>
<td>11.8</td>
</tr>
<tr>
<td>10J</td>
<td>7.3</td>
<td>10.6</td>
</tr>
<tr>
<td>MO</td>
<td>8.9</td>
<td>11.9</td>
</tr>
<tr>
<td>CO</td>
<td>8.7</td>
<td>14.5</td>
</tr>
<tr>
<td>NM</td>
<td>6.9</td>
<td>9.7</td>
</tr>
<tr>
<td>KS</td>
<td>6.6</td>
<td>6.0</td>
</tr>
<tr>
<td>WY</td>
<td>6.0</td>
<td>9.4</td>
</tr>
<tr>
<td>OK</td>
<td>5.3</td>
<td>8.1</td>
</tr>
<tr>
<td>NE</td>
<td>4.1</td>
<td>6.2</td>
</tr>
</tbody>
</table>

*LFPR = Labor Force Participation Rate

Source: Bureau of Labor Statistics
As always, energy prices are Oklahoma’s biggest risk relative to nation.

Energy Prices

Crude oil (right scale)

Natural gas (left scale, per MMBTU)

Source: Bloomberg
Summary

- The U.S. economy is facing some headwinds following only modest expansion in the first half of 2011.

- Oklahoma’s growth has been more solid, and fundamentals remain better in the state than the nation.