The Fed and the Economy in 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

- Functions – 40 staff
  - Economic research and outreach for U.S. monetary policy purposes
  - Examinations and inspections of Oklahoma financial institutions
  - Economic and financial education outreach to teachers and citizens
  - Community development outreach to low and moderate income areas

- 2012 board of directors
  - Jim Dunn (chair), Chairman, Mill Creek Lumber and Supply, Tulsa
  - Linda Capps, Vice Chairman, Citizen Potawatomi Nation, Shawnee
  - Pete Delaney, Chairman, CEO, & President, OGE Energy Corp., OKC
  - Jacque Fiegel, Senior EVP and COO, Coppermark Bank, OKC
  - Doug Tippens, President and CEO, Bank of Commerce, Yukon
  - K. Vasudevan, Chairman, Service and Technology Corp., Bartlesville
  - Rose Washington, Exec. Director, Tulsa Economic Development Corp.
U.S. Economy and Monetary Policy

• U.S. economic growth has slowed in recent months, as uncertainties have risen again

• The FOMC expects continued improvement in unemployment, and for inflation to stay low

• The range of views among FOMC members about monetary policy are relatively wide
U.S. GDP growth eased slightly in Q2, as consumer spending and investment slowed.

Growth in Components of Real GDP

Percent change from the previous period, SAAR

- Total GDP: 2012 Q1 2.0, 2012 Q2 1.5
- Consumer spending: 2012 Q1 2.4, 2012 Q2 1.5
- Residential investment: 2012 Q1 20.5
- Exports: 2012 Q1 4.4, 2012 Q2 5.3
- Government spending: 2012 Q1 -3.0, 2012 Q2 -1.4

Source: U.S. Bureau of Economic Analysis
July data have been mixed but moderate overall—with jobs up but surveys sluggish.
Readings on the ISM factory index below 50 have not always meant recession
The European Trilemma

- **Sovereign debt crisis** – Poor fiscal management and rising bond yields in some countries threaten fiscal sustainability.

- **Banking crisis** – A property bust in some markets and a decline in sovereign debt values have impaired the balance sheets of some Euro zone banks.

- **Slow growth and recession** – Tighter fiscal policy and financial conditions, plus the uncertain climate, is weighing on European growth
The impact on the U.S. of an intensification of the European crisis

- Long-term rates would fall and support U.S. economic activity

- Credit standards would likely tighten, so fewer households and businesses would have access to the lower rates

- Appreciation of the U.S. dollar would weigh on exporters

- Commodity prices would likely decline

- Sharp fall in confidence and heightened uncertainty
Financial stress in Europe remains higher than a few years ago, but is stable in U.S.

Eurozone and U.S. Financial Stress

Source: FRBKC
The “fiscal cliff” and political uncertainty are also weighing on the U.S. economy.

Estimated Impact on 2013 GDP
Worst Case

- Sequestration (automatic discretionary cuts)
- 2001 and 2003 tax cuts lapse
- AMT fix expires
- End extended unemployment benefits
- End payroll tax holiday

Sources: Goldman Sachs
At its June meeting, the FOMC expected unemployment to gradually fall further.
And for inflation to remain at or below its long-term target

PCE Inflation Index

Percent change, year-over-year

June FOMC Forecast Ranges in Yellow

Long Term

Source: U.S. Bureau of Economic Analysis, FOMC
The majority of FOMC members expect interest rates to stay low through 2014.

Federal Funds Rate
Year-end target

Note – Number of participants who project the initial increase will occur in the specified year in parenthesis

Source: U.S. Bureau of Economic Analysis, FOMC
The Fed’s balance sheet is at historically high levels

Federal Reserve Balance Sheet

Source: Federal Reserve Board
The Oklahoma Economy

• Oklahoma economic growth remains much stronger than the nation

• The relative strength reflects solid energy, manufacturing, and trade activity

• Europe is less of a direct risk to the state, but drought is having an impact, and energy prices are always a factor
Oklahoma has grown twice as fast as the nation the past year, after milder recession.

Payroll Employment

Year-over-year percent change

Source: U.S. Bureau of Labor Statistics
There remains considerable variation in economic strength in the nation and region.

**Employment Growth, Year-over-Year (percent)**
**June 2012**

Scale:
- Dark green: 1.83 - 6.53
- Light green: 1.21 - 1.83
- Light yellow: 0.65 - 1.21
- Very light yellow: -0.85 - 0.65

Source: U.S. Bureau of Labor Statistics
Except for Tulsa, employment in Oklahoma is back above pre-recession levels.
Unemployment is especially low in northwest and south central Oklahoma.

County Unemployment Rates
June 2012

Unemployment Rate

- 2.6% - 4.1%
- 4.2% - 6.1%
- 6.2% - 8.9%

Source: OK Employment Security Commission
Oklahoma job growth has varied by industry the past year, but consistently led by energy
Home prices continue to hold up much better in Oklahoma than in the nation.
And banks remain in much better shape than in the nation as a whole.

Noncurrent Loans as a Share of Total Loans
Commercial Banks

Source: FDIC
The state’s factory exports to Europe are declining, but are holding up to other places.

Oklahoma Manufacturing Exports
Q1 2008 – Q2 2012

Percent change, year-over-year

Note – Q2 2012 includes April and May data only

Source: WISERTRADE
And exports to Europe are a relatively small part of the Oklahoma economy.

Exports as Share of GDP, 2010

Sources: U.S. Bureau of Economic Analysis, USDA, WISERTRADE
Moreover, overall regional factory expectations remain relatively solid.
But drought is now extreme to exceptional in all of Oklahoma, squeezing some sectors.
Energy activity remains high but gas drilling has slowed, and NGL prices have eased.
Conclusions

- Growth in the U.S. economy has slowed moderately, as concerns about Europe and politics remain elevated.

- Inflation has remained low, and monetary policymakers disagree about future paths.

- Oklahoma economic growth remains better than in the nation, but drought and low natural gas prices have hurt.
For more information about the Oklahoma economy, subscribe to the quarterly Oklahoma Economist at:

www.kansascityfed.org/publications/research/oke