Economic Outlook

January 2013

Jason Henderson
Vice President and Omaha Branch Executive
Federal Reserve Bank of Kansas City
At the FOMC table

The Federal Open Market Committee has 12 members
  – The 7 members of the Board of Governors
  – 5 FRB Presidents (NY and 4 rotating members)

The President of the FRB Kansas City votes every three years, rotating with Minneapolis and San Francisco

All 7 Governors and 12 FRB Presidents participate equally in policy deliberations, but only “FOMC members” vote
Structure and Governance:
Board of Governors

- 7 members of the Board of Governors (staggered 14-year terms)
- Appointed by the President of the United States, confirmed by Senate

Ben S. Bernanke
January 31, 2020 - Governor
January 31, 2014 - Chairman

Janet L. Yellen
January 31, 2024 - Governor
October 4, 2014 - Vice Chairman

Elizabeth A. Duke
January 31, 2012

Daniel K. Tarullo
January 31, 2022

Sarah Bloom Raskin
January 31, 2016

Jeremy C. Stein
January 31, 2018

Jerome H. Powell
January 31, 2014
Structure and Governance: Reserve Bank Presidents

- Appointed by Reserve Bank Board of Directors (Class B and C), ratified by Board of Governors
- 5-year terms, mandatory retirement at age 65
Open market operations

• The NY Fed is authorized and directed by the FOMC
  – “To buy and sell government securities and U.S. agency securities in the open market” on behalf of the Fed
  – “To buy and sell foreign currencies” and maintain currency swap lines with foreign banks

• The FOMC can ease financial conditions by buying securities, which increases bank reserves and lowers the fed funds rate
The federal funds rate, discount rate and interest on reserves

- Federal funds rate – the overnight interest rate at which depository institutions trade balances held at the Fed
- Discount rate (primary credit rate) – the rate charged to depository institutions who borrow from the Fed’s discount window
- Interest on reserves balances – the rate paid on depository institutions’ required and excess reserve balances
The FOMC meeting

• “The Desk” reports on open market operations and financial conditions and the Board staff gives an economic outlook

• Two standard “go rounds”
  – Economic: All participants give an assessment of economic conditions in their region and national outlook
  – Monetary policy: All participants give their view on current policy and if voting, indicate support of a particular policy action
Will recent economic strength be sustained?

U.S. Real GDP Growth

Source: Bureau of Economic Analysis and Blue Chip

Blue Chip Forecast (Jan. 2013)
Housing markets have bottomed.

Source: Census Bureau
Source: National Association of Realtors
Source: Standard and Poor's
Source: National Association of Realtors
Consumer spending has rebounded.

U.S. Retail Sales

U.S. Autos and Light Truck Sales

Source: Census Bureau

Source: Federal Reserve
Investment slows with uncertainty.

- Potential changes in tax law sparked an increase in business investment at the end of 2011.
- Businesses report that increased economic, fiscal policy, and regulatory uncertainty are weighing on investments.

Source: Bureau of Economic Analysis
Although jobs openings increase, hiring advances more slowly.

Why are businesses not hiring people?

U.S. Employment Dynamics – Hirings and Openings

Source: BLS
Net exports: Global trade activity slows.

After rebounding in 2010, U.S. trade growth has slowed.
- Shifts in the value of the dollar
- Weaker global economies

U.S. Exports and Imports

Annual percent change

Source: Census Bureau
Asia’s economic growth is expected to strengthen in 2013.

World GDP Growth

Annual percent change

Source: Blue Chip
Caution signs for U.S. manufacturing

- Public and private sector manufacturing surveys indicate slowing activity.
- After contracting this fall, manufacturing employment rebounded in December.
- The slowdown occurred at durable goods factories.

Source: Census Bureau
Note: Nondefense goods excluding aircraft and parts.
Manufacturing activity slows.

U.S. Manufacturing and Non-manufacturing Activity

Source: Institute of Supply Management
The Monetary Base is not Money Supply

Quantity Theory of Money

\[ \text{Price} = \frac{\text{Money} \times \text{Velocity}}{\text{Quantity}} \]

Definition of Inflation:

- Too much money \( M \uparrow \)
- Chasing \( V \uparrow \)
- Too few goods \( Q \downarrow \)

Growth in Monetary Aggregates

Source: Federal Reserve Board of Governors
Lending is needed to create money.

Excess Reserves in Depository Institutions

Trillion dollars

Source: Federal Reserve Board of Governors
The FOMC statement

• The FOMC statement is the single most important means of communication regarding policy actions
• Every word is carefully scrutinized by the market, so extreme care is given with messaging
• The Board staff, with input from FOMC participants, proposes language for the statement
• Members that dissent are noted, along with the rationale, in the FOMC statement
The FOMC statement

• Three parts
  – Summary of Economic Conditions
  – Balance of Risks
  – Policy action

• The market immediately does a side-by-side comparison

August 1, 2012

the Committee expects to maintain a highly accommodative stance for monetary policy. In particular, the Committee decided today to keep the target range for the federal funds rate at 0 to 1/4 percent and 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 late 2014.

September 13, 2012

the Committee expects that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the economic recovery strengthens. In particular, the Committee also decided today to keep the target range for the federal funds rate at 0 to 1/4 percent and currently anticipates that exceptionally low levels for the federal funds rate are likely to be warranted at least through mid-2015.
Dissents are not uncommon: 46% of FOMC meetings over the past 25 years have had at least one dissenting vote.

Source: Federal Reserve Board
Pre-FOMC preparation: The Summary of Economic Projections

• Four times a year all FOMC participants submit forecasts for inflation, real GDP growth, and the unemployment rate

• The forecasts are made under each participant’s view of “appropriate monetary policy,” represented by the fed funds rate path

• The Chairman holds a press conference following FOMC meetings when the Committee produces a SEP
The Goal: Foster Maximum Employment and Stable Prices

Economic Projections of Federal Open Market Committee Members, Central Tendency, December 2012

<table>
<thead>
<tr>
<th></th>
<th>Longer Run</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP Growth</td>
<td>2.3 to 2.5</td>
<td>1.7 to 1.8</td>
<td>2.3 to 3.0</td>
<td>3.0 to 3.5</td>
<td>3.0 to 3.7</td>
</tr>
<tr>
<td>Sept. 2012 proj.</td>
<td>1.7 to 2.0</td>
<td>2.5 to 3.0</td>
<td>3.0 to 3.8</td>
<td>3.0 to 3.8</td>
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<tr>
<td>Unemployment Rate</td>
<td>5.2 to 6.0</td>
<td>7.8 to 7.9</td>
<td>7.4 to 7.7</td>
<td>6.8 to 7.3</td>
<td>6.0 to 6.6</td>
</tr>
<tr>
<td>Sept. 2012 proj.</td>
<td>8.0 to 8.2</td>
<td>7.6 to 7.9</td>
<td>6.7 to 7.3</td>
<td>6.0 to 6.8</td>
<td></td>
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<tr>
<td>PCE Inflation</td>
<td>2.0</td>
<td>1.6 to 1.7</td>
<td>1.3 to 2.0</td>
<td>1.5 to 2.0</td>
<td>1.7 to 2.0</td>
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Source: Federal Reserve Board of Governors
Views of appropriate policy differ widely across the FOMC

Appropriate pace of policy firming

Target federal funds rate at year-end

Source: Federal Reserve Bank of New York
The FOMC minutes

• Minutes are released three weeks after the FOMC meeting and provide additional details on policy deliberations:
  
  – July/August: The staff gave a presentation on using monetary policy rules to enhance communication
  
  – September: The FOMC was experimenting with formulating a consensus forecast
  
  – October: The staff gave a presentation on the use of thresholds in providing forward guidance
  
  – December: The staff gave a presentation on the options for the continuation of asset purchases
The FOMC minutes raised questions about the exit strategy.

Federal Reserve Balance Sheet: Assets

- Fed Agency Debt MBS Purchases
- Liquidity to Key Credit Markets
- Lending to Financial Institutions
- Long Term Treasury Purchases
- Traditional Security Holdings

Source: Federal Reserve Bank of Cleveland
The historical record – the FOMC transcripts

• The complete FOMC transcripts for a given year are released with a five-year lag
  – All 2007 transcripts will be released in January of 2013

• Transcripts are scrutinized immediately, mostly by journalists, but later by historians

• Provide a useful window into past policy making decisions