The Economic Outlook: A Fed’s Eye View

Jason Henderson
Vice President and Branch Executive
Federal Reserve Bank of Kansas City
Omaha Branch
www.kansascityfed.org

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The views expressed are those of the author and do not necessarily reflect the opinions of the Federal Reserve Bank of Kansas City or the Federal Reserve System.
# Economic Projections of the Federal Reserve Governors and Bank Presidents

<table>
<thead>
<tr>
<th>Central Tendency¹</th>
<th>2007 (Percent)</th>
<th>2008 (Percent)</th>
<th>2009 (Percent)</th>
<th>2010 (Percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP growth</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Apr. 2008 projections</td>
<td>1.0 to 1.6</td>
<td>2.0 to 2.8</td>
<td>2.5 to 3.0</td>
<td>Near-Term: Weaker Growth¹</td>
</tr>
<tr>
<td>Oct. 2007 projections</td>
<td>1.0 to 2.0</td>
<td>2.0 to 2.7</td>
<td>2.5 to 3.0</td>
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<tr>
<td>Unemployment rate</td>
<td></td>
<td></td>
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<tr>
<td>Apr. 2008 projections</td>
<td>5.5 to 5.7</td>
<td>5.3 to 5.8</td>
<td>5.0 to 5.6</td>
<td>Long-Term: Stronger Growth</td>
</tr>
<tr>
<td>Oct. 2008 projections</td>
<td>5.5 to 6.0</td>
<td>5.3 to 5.8</td>
<td>5.0 to 5.6</td>
<td></td>
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<tr>
<td>PCE inflation</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Apr. 2008 projections</td>
<td>3.8 to 4.2</td>
<td>2.0 to 2.3</td>
<td>1.8 to 2.0</td>
<td>Near-Term: Rising Inflation⁰</td>
</tr>
<tr>
<td>Oct. 2008 projections</td>
<td>3.8 to 4.0</td>
<td>2.0 to 2.3</td>
<td>1.8 to 2.0</td>
<td></td>
</tr>
<tr>
<td>Core PCE inflation</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Apr. 2008 projections</td>
<td>2.2 to 2.4</td>
<td>2.0 to 2.2</td>
<td>1.8 to 2.0</td>
<td>Long-Term: Falling Inflation⁰</td>
</tr>
<tr>
<td>Oct. 2008 projections</td>
<td>2.2 to 2.4</td>
<td>2.0 to 2.2</td>
<td>1.8 to 2.0</td>
<td></td>
</tr>
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</table>

Source: Federal Reserve Board of Governors, June 25, 2008 FOMC Minutes

**Note:** Projections of the growth of real GDP, of PCE inflation, and of core PCE inflation are percent changes from the fourth quarter of the previous year to the fourth quarter of the year indicated. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated.

¹ The central tendency excludes the three highest and three lowest projections for each variable in each year.
Private Sector Forecasts

Near-term: weaker growth & higher inflation
Long-term: stronger growth & lower inflation

Real GDP Growth
Annualized percent change

Source: Blue Chip Economic Indicators

Consumer Price Inflation
Annualized percent change

Source: Blue Chip Economic Indicators
Risks to the Outlook

• Housing risks linger and spread to financial markets.
Home construction slowed.

Home Starts, Sales and Inventories

Month’s supply

Index (Jan-00=100)

- Existing Home Sales (Right Scale)
- Housing Starts (Right Scale)

Month’s Supply of New Homes (Left Scale)

Source: Dept. of Commerce, National Association of Realtors
Home foreclosures have surged.

Foreclosure Rates by Mortgage Type

Percent of loans serviced

Source: Mortgage Bankers Association
Nationally, home prices are falling.

U.S. Home Price Indexes

Percent change from previous year

Source: OFHEO and Standard & Poor’s
A wider spread between mortgage-backed securities and other financial instruments.

Short-term Commercial Paper and Fed Funds Rates

Percent

Jan-06 Jul-06 Jan-07 Jul-07 Jan-08 Jul-08

Overnight AA Asset-backed Commercial Paper Rate
Effective Fed Funds Rate
Credit standards on home mortgages have tightened.

Credit Standards on Residential Real Estate Loans

Net percent reporting tighter credit standards

Source: Federal Reserve Board of Governors
Credit standards have tightened for other loans as well.

Net Percent of Domestic Banks Tightening Credit Standards

Source: Federal Reserve Board of Governors
The cost of longer term funds has risen for financial firms.

Overnight and Longer Term Financial Commercial Paper Rates Spreads

Percent

Jan-07 Apr-07 Jul-07 Oct-07 Jan-08 Apr-08 Jul-08

-0.4 -0.2 0.0 0.2 0.4 0.6 0.8 1.0

30 day commercial paper
90 day commercial paper
A new balance in the housing market.

Home Prices and Per Capita Incomes

- **Home Prices**
- **Personal Incomes**

Home Inventories, Sales, and Starts

- Month’s supply of homes
- Housing starts
- Existing home sales

Source: OFHEO, Bureau of Economic Analysis, NAR, Dept. of Commerce
Risks to the Outlook

• Housing risks linger and spread to financial markets.
• What is the impact of high energy prices on growth and inflation?
  – The cause: strong global demand.
Strong Global Economies are Driving Energy and Food Demand.

World GDP Growth

Source: International Monetary Fund
Economic growth in developing countries is widespread.

World GDP Growth

Source: International Monetary Fund (July 2008 forecast)
Risks to the Outlook

• Housing risks linger and spread to financial markets.

• What is the impact of high energy prices on growth and inflation?
  – The cause: strong global demand
  – The side effects:
    • rising commodity prices and inflation
Will Energy and Food Supplies Rise to Fulfill Increasing Global Demand?

**World Oil Balance 2004-2008**
- Million barrels per day
- Blue: Demand
- Black: Supply

**World Crop Inventories**
- Stocks-to-Use Ratio (Percent)
- Red: Rice
- Blue: Corn
- Green: Wheat

Source: Department of Energy and USDA
Energy and farm commodity prices have surged.

WTI Crude Oil Prices

Source: Department of Energy and USDA
Inflation has jumped to its highest levels since the early 1990s.

Consumer Price Inflation

Source: Department of Commerce
A Decade of High Energy Inflation.

Consumer Price Inflation – Food and Energy Components

Source: Bureau of Labor Statistics
Energy Costs are Driving Housing and Transportation Inflation.

<table>
<thead>
<tr>
<th>Category</th>
<th>Share of CPI Core (Percent)</th>
<th>June 2007 (Percent change)</th>
<th>June 2008 (Percent change)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Housing</td>
<td>55.8</td>
<td>3.4</td>
<td>3.5</td>
</tr>
<tr>
<td>Shelter</td>
<td>42.6</td>
<td>3.8</td>
<td>2.5</td>
</tr>
<tr>
<td>Furnishings</td>
<td>6.1</td>
<td>0.0</td>
<td>0.2</td>
</tr>
<tr>
<td>Household Fuel</td>
<td>6.7</td>
<td>4.4</td>
<td>12.2</td>
</tr>
<tr>
<td>Transportation</td>
<td>23.1</td>
<td>0.9</td>
<td>12.0</td>
</tr>
<tr>
<td>Motor Vehicles</td>
<td>9.4</td>
<td>-1.9</td>
<td>-0.3</td>
</tr>
<tr>
<td>Motor Fuel</td>
<td>7.2</td>
<td>4.9</td>
<td>33.3</td>
</tr>
</tbody>
</table>

Source: Bureau of Labor Statistics
Risks to the Outlook

• Housing risks linger and spread to financial markets.
• What is the impact of high energy prices on growth and inflation?
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  – The side effects:
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    • softer consumer spending
Retail sales are mixed.

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<th>Retail Sales</th>
<th>Percent Change from June 2008 to June 2007</th>
</tr>
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<tbody>
<tr>
<td>Retail and Food Services</td>
<td>+3.0</td>
</tr>
<tr>
<td>Gasoline Stations</td>
<td>+24.5</td>
</tr>
<tr>
<td>General Merchandise Stores</td>
<td>+5.6</td>
</tr>
<tr>
<td>Food and Beverage Stores</td>
<td>+5.6</td>
</tr>
<tr>
<td>Food Services and Drinking Places</td>
<td>+3.6</td>
</tr>
<tr>
<td>Motor Vehicle and Parts Dealers</td>
<td>-9.5</td>
</tr>
<tr>
<td>Furniture and Home Furnishings Stores</td>
<td>-5.4</td>
</tr>
<tr>
<td>Building Material and Garden Equipment Dealers</td>
<td>-1.5</td>
</tr>
<tr>
<td>Department Stores (ex. L.D.)</td>
<td>-1.3</td>
</tr>
</tbody>
</table>

Source: Census Bureau
Tax receipts have risen in non-metro areas.

Kansas Retail Sales Tax Receipts, 2007-08
(Fiscal Year-to-Date, July to March)

Percent change from previous year

- Metropolitan areas
- Micropolitan areas (counties with a city between 10,000 and 50,000 in population)
- Town counties (counties with towns less than 10,000 in population)

Source: Kansas Department of Revenue
What stimulus is left after the rebates?

Personal Consumption Expenditures

Annualized percent change from previous quarter

Source: Bureau of Economic Analysis and Blue Chip Forecast
Will job losses slow consumer spending?

U.S. Non-farm Job Growth and Unemployment Rate

Change from previous month (Thousands)

Job Change (Left Scale)

Unemployment Rate (Right Scale)

Source: Bureau of Labor Statistics
Wage growth will have significant influence on inflation and growth.

Employment Cost Index

Percent change from year ago

Source: Bureau of Labor Statistics
Risks to the Outlook

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• What is the impact of high energy prices on growth and inflation?
  – The cause: strong global demand
  – The side effects:
    • rising commodity prices and inflation
    • softer consumer spending
    • weaker business activity despite strong exports
Exports have risen with a weak dollar.

Dollar Value and U.S. Net Exports

Source: Department of Commerce
Production activity has slowed with rising input prices.

Source: Institute of Supply Management
Weaker profits have slowed business investment.

Corporate Profits and Nonresidential Fixed Investment

Percent change from year ago

Source: Bureau of Economic Analysis
The Energy Questions

• Will high prices fix the inflation problem by trimming demand and stimulating supply?
• What oil price balances economic growth and inflation, $50, $100, $150 per barrel oil?
• Markets will work, but how long will it take?
• Will high energy prices spillover into more core areas?
• Will higher prices become embedded in expectations?
Conclusion

- Housing risks spread to financial markets.
- Commodity prices soared with strong global demand and limited supply gains.
- Rising energy prices have sapped U.S. economic growth and boosted inflation.

Will lower energy prices stimulate growth and reduce inflationary pressures?