Purposes and Structure of the Federal Reserve System

• Overall purposes of the Fed are to promote:
  • Maximum sustainable economic growth
  • Low and stable inflation
  • National financial stability

• The three primary functional areas of the Fed are:
  • Monetary policy – most visible role to the public, usually
  • Bank regulation – including lender of last resort
  • Payments systems – cash, checks, electronic payments

• The Federal Reserve System consists of:
  • Board of Governors: 7 members who are appointed by the U.S. President and confirmed by the Senate to serve 14-year terms.
  • Federal Reserve Banks: 12 Banks, each serving a unique district.
  • Federal Open Market Committee (FOMC): Comprised of the 7 Governors and the 12 Reserve Bank presidents (only 5 presidents are voting members, on a rotating basis).
Federal Reserve Districts and Office Locations
The Kansas City and Oklahoma City Federal Reserve Offices

• Headquarters in Kansas City
  • Nearly 1,000 staff involved in all mission areas
  • **New building** officially opened in June 2008

• Oklahoma City branch office
  • **Staff and functions** – 35 staff involved in economic research, bank examinations, and public and community affairs
  • **Branch board of directors** – 7 business and community leaders from the region who meet in advance of each FOMC meeting to provide economic information

• Oklahoma City branch board of directors
  • **Chairman Steve Agee**, President, Agee Energy, and Professor, OCU, Oklahoma City
  • **Terry Almon**, President, Oklahoma Community Capital Corp., Broken Arrow
  • **Bill Anoatubby**, Governor, Chickasaw Nation, Ada
  • **Jim Dunn**, Chairman, Mill Creek Lumber & Supply Co., Tulsa
  • **Fred Ramos**, COO, Latino Community Development Corp., Oklahoma City
  • **Doug Tippens**, President and CEO, Canadian State Bank, Yukon
  • **K. Vasudevan**, Chairman, Service and Technology Corp., Bartlesville
The U.S. Economic Outlook

- U.S. economic activity slowed in 2008 and has worsened markedly in recent months
- Credit markets froze up in the fall of 2008 but are showing some signs of improvement
- Forecasters are calling for sluggish activity for much of 2009, but for inflation to ease
The only U.S. economic sectors to grow measurably in 2008 were defense and exports.

Real GDP growth in 2008, including components

<table>
<thead>
<tr>
<th>Component</th>
<th>Percent, annualized, Q4 2007 to Q3 2008</th>
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</thead>
<tbody>
<tr>
<td>Overall GDP</td>
<td>1.1</td>
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<tr>
<td>National defense expenditures</td>
<td>10.6</td>
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<tr>
<td>Exports</td>
<td>6.7</td>
</tr>
<tr>
<td>Nondefense government expenditures</td>
<td>1.6</td>
</tr>
<tr>
<td>Business fixed investment</td>
<td>1.0</td>
</tr>
<tr>
<td>Personal consumption expenditures</td>
<td>(0.6)</td>
</tr>
<tr>
<td>Residential investment</td>
<td>(18.8)</td>
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</tbody>
</table>

Source: U.S. Bureau of Economic Analysis
Fourth quarter data showed a clear weakening of U.S. economic conditions.
Interbank credit markets worsened dramatically in fall 2008, but have improved recently.
Commercial paper rates have also improved in recent months.
Mortgage rates have also declined

Fixed and Adjustable Rate Mortgages

Percent

Source: Bloomberg
But lending standards on business and consumer loans have tightened.
And nearly all banks have tightened standards on mortgage loans.
Considerable uncertainty surrounds the near and intermediate-term economic outlook.
Unemployment is expected to rise further

Source: U.S. Bureau of Labor Statistics
Meanwhile, inflation is expected to continue to ease after rising in early 2008.
The Federal Open Market Committee decided today to keep its target range for the federal funds rate at 0 to 1/4 percent. The Committee continues to anticipate that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for some time.

Information received since the Committee met in December suggests that the economy has weakened further. Industrial production, housing starts, and employment have continued to decline steeply, as consumers and businesses have cut back spending. Furthermore, global demand appears to be slowing significantly. Conditions in some financial markets have improved, in part reflecting government efforts to provide liquidity and strengthen financial institutions; nevertheless, credit conditions for households and firms remain extremely tight. The Committee anticipates that a gradual recovery in economic activity will begin later this year, but the downside risks to that outlook are significant.

In light of the declines in the prices of energy and other commodities in recent months and the prospects for considerable economic slack, the Committee expects that inflation pressures will remain subdued in coming quarters. Moreover, the Committee sees some risk that inflation could persist for a time below rates that best foster economic growth and price stability in the longer term.
The Federal Reserve will employ all available tools to promote the resumption of sustainable economic growth and to preserve price stability. The focus of the Committee's policy is to support the functioning of financial markets and stimulate the economy through open market operations and other measures that are likely to keep the size of the Federal Reserve's balance sheet at a high level. The Federal Reserve continues to purchase large quantities of agency debt and mortgage-backed securities to provide support to the mortgage and housing markets, and it stands ready to expand the quantity of such purchases and the duration of the purchase program as conditions warrant. The Committee also is prepared to purchase longer-term Treasury securities if evolving circumstances indicate that such transactions would be particularly effective in improving conditions in private credit markets. The Federal Reserve will be implementing the Term Asset-Backed Securities Loan Facility to facilitate the extension of credit to households and small businesses. The Committee will continue to monitor carefully the size and composition of the Federal Reserve's balance sheet in light of evolving financial market developments and to assess whether expansions of or modifications to lending facilities would serve to further support credit markets and economic activity and help to preserve price stability.
The Regional Economic Outlook

- Economic conditions in the Tenth Federal Reserve District remain better than the nation.

- However, conditions in energy, agriculture, and manufacturing have weakened sharply in recent months, pushing up unemployment.

- The region has been late to the downturn and should benefit from national stimulus, but prices and costs in commodity sectors bear watching.
Unemployment remains relatively low in the middle part of the country.

Unemployment Rates, December 2008

Unemployment by State
- 7.5 to 10.6
- 6.1 to 7.4
- 3.4 to 6.0

Source: Bureau of Labor Statistics
But new claims for unemployment insurance are rising rapidly, including in Oklahoma.
Regional agricultural and energy activity have dropped with falling commodity prices.
And manufacturing activity in the region has fallen sharply since October.

Source: ISM, FRBKC Manufacturing Survey
Our relative source of strength remains the housing market, where prices are holding on

Quality-Adjusted Home Price Growth

Percent change year-over-year

Source: OFHEO
As such, foreclosures have been relatively low in the region compared to the nation.
Summary

- U.S. economic conditions have deteriorated with tightening credit, and the 2009 outlook is weak.

- Conditions remain better in the middle part of the country, including Oklahoma, where housing has held up better, but unemployment is rising.

- Efforts to boost U.S. growth should benefit the region, but commodity markets bear watching.