Macro Economic Outlook: Why Should Students Care?

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.
Today’s Roadmap

- Macro Economics and the Federal Reserve System
- Financial Crisis – Disruption of Credit Markets
- Combating the Financial Crisis and Potential Consequences
- The Macro Economy: What Matters Most
Macro versus Micro

- In a nut shell...
- What is macroeconomics?
  - How the national economy functions
- What is microeconomics?
  - The study of buying and selling behavior of individuals and firms in markets and market failures
The ‘Fed’ was founded in 1913 with 3 core missions:

- Promote an efficient payments system
- Safeguard the competitiveness, safety and soundness of the banking system
- Conduct monetary policy
An Independent Fed

- The Fed is self-supporting to maintain political independence.
- Income sources:
  - Interest on loans to financial institutions
  - Income from services
  - Interest income from US Treasury bonds, bills and notes
- Balance of Power: The Political Fight for an Independent Central Bank, 1790 – Present
Structure of the Fed

- Board of Governors
- 12 Regional Reserve Banks
- Federal Open Market Committee
Regional Reserve Banks

- 25 branch offices
- Fed member banks
Monetary Policy Objectives

- Primarily two all encompassing objectives:
  - Sustainable economic growth
  - Price stability
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The financial crisis has eased.

TED Spread

Basis Points

Source: Federal Reserve Board of Governors
Financial markets may not be in the clear partly because of commercial real estate.

U.S. Commercial Real Estate Vacancy Rates

Source: Torto-Wheaton Research
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Deflation, Disinflation, Inflation: What is the difference?

- **Deflation**: a *fall* in the general level of prices of goods and services in an economy over a period of time.
  
  *For example, CPI < 0*

- **Inflation**: a *rise* in the general level of prices of goods and services in an economy over a period of time.
  
  *For example, CPI > 0*

- **Disinflation**: *a decrease in the rate of inflation* – a slowdown in the increase of the general price level of goods and services over time.
  
  *For example, CPI > 0, but falling from 2.5 to 1.5%*
The U.S. is experiencing disinflation.

Source: Bureau of Labor Statistics
Monetary Policy Transmission Mechanisms

To combat the financial crisis and recession, the Federal Reserve has expanded its balance sheet.
Despite a surging monetary base, inflation has been subdued.

Growth in Monetary Aggregates

Index (Jan 1930 = 100)

Monetary Base

Index (Jan 2007 = 100)

Monetary Base

Source: Federal Reserve Bank of St. Louis, Friedman and Schwartz

Source: Federal Reserve Board of Governors
Inflation has been subdued because the velocity of money has plummeted.

Source: BEA and Federal Reserve Board of Governors
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How Gross Domestic Product (GDP) is Measured

\[ Y = C + I + G + NX \]

- \( Y \) is GDP
- \( C \) is Consumption (presently \( \approx 70\% \) of \( Y \))
- \( I \) is Investment (presently \( \approx 15\% \) of \( Y \))
- \( G \) is Government Spending (presently \( \approx 20\% \) of \( Y \))
- \( NX \) is Net Exports (presently \( \approx -5\% \) of \( Y \))
Forecasts expect a slow U.S. recovery.

**Real GDP Growth**

- **Actual**
- **July Forecast**
- **January Forecast**

Annualized percent change from previous quarter

Source: Bureau of Economic Analysis and Blue Chip Economic Indicators
An elevated unemployment rate is one reason for the slow recovery.

U.S. and Nebraska Unemployment Rate

Source: Bureau of Economic Analysis and Bureau of Labor Statistics
Retail sales fell, but have rebounded slightly.

U.S. and Nebraska Retail Sales

Source: U.S. Census Bureau and Nebraska Department of Revenue
Manufacturing activity has improved, but uncertain domestic and international demand pose future risks.

Tenth District Manufacturing Activity

Diffusion Index

Source: Federal Reserve Bank of Kansas City
Deleveraging should contribute to a slow recovery...returning to saving habits.
Will the stimulus package spur growth in 2010?

Estimated Budget Impact of American Recovery and Reinvestment Act (ARRA) of 2009

Billion Dollars

Source: Congressional Budget Office, February 13, 2009
The trade balance has improved.

Real Net Exports of Goods and Services

Billion dollars (2005=100)

Source: Bureau of Economic Analysis
Will emerging and developing countries lead the global recovery?

GDP Growth

Annual percent change, constant dollars

Source: International Monetary Fund, October 2009
Questions?

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www.kansascityfed.org/omaha