Can Nebraska’s Economy Buck National Trends?

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

- Economic outlook:
  - When will the economic recovery gain steam?

- Monetary policy:
  - When will the Fed withdraw economic stimulus?

- It’s about timing, and it depends.
Despite contractions in total jobs, businesses continue to add jobs at a modest pace.

**Headline:**
*Employment falls in June*

- The Census distorts the job market.
- In May, total jobs rose sharply with modest gains in private sector jobs.
- In June, total jobs fell, while private sector gains strengthened.
- In addition, the April and May job numbers were revised up.
- Private sector gains were widespread across sectors.

*U.S. Nonfarm Employment*

Change in Employment

- Total Nonfarm Jobs
- Private Sector Jobs

Source: BLS
Nebraska is the last bastion of low unemployment.
The U.S. economy is projected to rebound in 2010.

Real GDP Growth

Annual percent change

Source: Bureau of Economic Analysis  Federal Reserve Board of Governors
Economic conditions:
• Consumers are shopping.
• Businesses are investing.
• Exports are rising.
• The federal government is spending.

Why are people still concerned?
• The speed is sluggish.
• How are they financing it?
Consumer spending is rebounding.

U.S. Retail Sales

Source: U.S. Census Bureau
*Data through May

NE Net Taxable Retail Sales

Source: NE Dept. of Revenue
*Data through March
Has the housing sector hit bottom?

- What happens after home buyer tax credits end?
- How much will home sales slow, especially for lower priced homes?
- Will home prices hold across the U.S. and in Nebraska?
- What will spark the rebound in housing activity?
- What will happen with the GSEs: Fannie and Freddie?
Today’s Roadmap

- Economic conditions:
  - Consumers are shopping.
  - Businesses are investing.
Can stronger manufacturing activity sustain a business recovery?

- Manufacturing is leading a rebound in business activity.
- Businesses are investing in equipment and software.
- When will investments in structures rebound to support CRE and construction?
- With loan defaults easing, will access to capital and credit standards improve?
- When will increased activity spur robust job gains?

Source: Institute of Supply Management and Federal Reserve Bank of Kansas City
Today’s Roadmap

- Economic conditions:
  - Consumers are shopping.
  - Businesses are investing.
  - Exports are rising.
Will stronger global economies and a lower dollar boost export activity?

Manufactured Exports

Billion dollars

U.S. (left axis)

Nebraska (right axis)

Source: WISERTrade
After dramatic improvements since 2007, U.S. net exports have stabilized.

U.S. Real Net Exports of Goods and Services and Value of the Dollar

Source: Bureau of Economic Analysis and Federal Reserve Board of Governors
Stronger economic growth is expected through 2011.

GDP Growth

Source: IMF, April 2010
Today’s Roadmap

- Economic conditions:
  - Consumers are shopping.
  - Businesses are investing.
  - Exports are rising.
  - The federal government is spending.
In the short run, deficit spending is an economic stimulus.

U.S. Government Outlays

Billion Dollars


Projected

Source: Congressional Budget Office, March 2010
Today’s Roadmap

- Economic conditions:
  - Consumers are shopping.
  - Businesses are investing.
  - Exports are rising.
  - The federal government is spending.

- Why are people still concerned?
  - The speed is sluggish.
  - How are they financing it?
How will surging federal debt levels affect economic conditions long-term?

U.S. Debt as a Percent of GDP

Source: Congressional Budget Office, November 2009
How much de-leveraging will take place?

U.S. Debt as a Percent of GDP

Source: Calculations based on Federal Reserve and BEA data
Today’s Roadmap

- What are macroeconomic conditions in the U.S. and Nebraska?

- Economic outlook:
  - When will the economic recovery gain steam?

- Monetary policy:
  - When will the Fed withdraw economic stimulus?
Inflation is based on money and velocity.

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 \( Q \downarrow \)
The Fed has increased the monetary base.

Federal Reserve Balance Sheet: Assets

Billion Dollars

Source: Federal Reserve Bank of Cleveland
Banks are holding money in excess reserve, which limits velocity.
How will the Federal Reserve shrink its balance sheet with Agency and MBS debt?

- Hold to maturity
- Sell assets
- Keep reserves on deposit at the Fed.
  - Interest on excess reserves
  - Reverse repurchase agreements
  - Term deposits
- All strategies lead to higher interest rates.
  - When?
  - How fast?
Inflation remains well anchored.

**Consumer Price Inflation Expectations**

- Blue line: Inflation over next 4 quarters
- Red line: Inflation over next 10 years

Source: Survey of Professional Forecasters
Two Perspectives on Monetary Policy and Resource Allocation

- The Issue: long periods of low interest rates lead to financial imbalances.

- Two Perspectives:
  - “… My preference at this time is to use prudential regulation and supervision to strengthen the financial system and lean against developing financial imbalances.”
    Donald Kohn, Vice Chairman, Federal Reserve Board of Governors, May 13, 2010.
  - “It was after a period of too-low interest rates, too much credit, too much leverage that the collapse of the housing bubble, the rapid deleveraging and the ensuing financial crisis occurred.” ...

“Monetary policy is a powerful tool. Certainly lowering interest rates is the appropriate monetary policy response to the onset of an economic recession and rising unemployment. But it is also a blunt instrument that has a wide set of unintended consequences that can and have worsened economic outcomes including misallocation of precious resources, inflation and long-term unemployment.”

Thomas Hoenig, President and CEO, Federal Reserve Bank of Kansas City, June 3, 2010
Is a farmland bubble brewing?

Farmland Values to Rent Ratio

- Iowa Farmland Value to Rent
- East NE Irrigated Cropland Value to Rent
- S&P PE Ratio (Average since 1945)

Calculations based on Iowa State University and University of Nebraska data
To identify a bubble, follow the debt.

U.S. Debt Repayment Capacity Utilization

Farmers do not have enough income to service debt

Farmers do have enough income to service debt

On average, debt is low. But, the debt is held by 30% of the farmers.

Source: USDA
The strength of the Federal Reserve System is its regional structure and Main Street perspective.
Conclusions

- When will the recovery gain steam?
  - Stronger consumer demand is boosting business activity.
  - But, debt will limit the recovery.
- When will the Fed begin its exit strategy?
  - Will high unemployment limit inflation?
  - What will start the “chasing”?
- The economic recovery brings opportunities for Nebraska, but headwinds remain.

What was the “Great Recession’s” primary lesson?

Debt and Leverage