The Economy and Manufacturing in the U.S. and Kansas

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History and Structure of the Federal Reserve System

- Founded by Congress in 1913 as the nation’s third central bank, the Fed consists of 3 main entities:
  - Board of Governors: 7 members appointed by U.S. President
  - Federal Reserve Banks: 12 total; semi-independent by design
  - Federal Open Market Committee (FOMC): 19 members; 12 voting

- As with most central banks around the world, the Fed’s responsibilities fall within four general areas:
  - Monetary policy – control money supply to affect growth and inflation
  - Lender of last resort – provide liquidity in times of financial crisis
  - Bank regulation – ensure safety and soundness, consumer rights
  - Financial services – bank for banks, bank for federal government
Federal Reserve Districts and Office Locations
The U.S. Economy

- Credit market conditions have improved, and the U.S. economy is growing again.

- But recovery is expected to be moderate, as debt and uncertainty remain high.

- Inflation is expected to remain tame in the near term, but longer-run risks exist.
Broad measures of financial stress have moved back to normal levels

Variables include:
3-mo LIBOR/TED spread
2-year swap spread
Off/on 10-yr Trs spread
Aaa/10-yr Trs spread
Baa/Aaa spread
Junk/Baa spread
Cons ABS/5-yr Trs spread
Corr of stock/bond returns
Volatility of stocks (VIX)
Volatility of bank stocks
Dispersion of bank stocks

Source: KCFRB
And early 2010 data show continued improvement in the U.S. economy

Heading forward, Fed policymakers generally expect a moderate recovery.
With unemployment remaining high for some time.

Source: U.S. Bureau of Labor Statistics, FOMC
Consumer debt could constrain short-run growth and federal debt projections are a concern.
Both business and consumer loan demand remain sluggish

Net Percentage of Banks Reporting Increased Loan Demand

Source: FRB Senior Loan Officer Survey
Inflation is expected to remain tame in the near term, but will require careful oversight.

PCE Inflation Index

Source: U.S. Bureau of Economic Analysis, FOMC
The Fed’s balance sheet is still large, with extra assets now largely MBS.

Federal Reserve Balance Sheet

Source: Federal Reserve Board of Governors
The Kansas Economy

- Like much of the Tenth Fed District, Kansas entered late into the recent recession.

- But the state then shed jobs rapidly in 2009, especially in Wichita.

- Signs of stabilization are emerging, and conditions remain better than in the nation.
After steep declines in 2009, Kansas employment appears to have bottomed.

Source: U.S. Bureau of Labor Statistics
Employment stabilized across industries in Q1 2010, following a rough year in 2009

Kansas Employment Change by Industry

Number of jobs gained/lost

-60000 -50000 -40000 -30000 -20000 -10000 0 10000 20000 30000 40000 50000 60000

Mfg Prof & Bus Services Trade, Transp, & Utilities Const Leisure & Hosp Info Fin Activities Nat Res & Mining Govt Edc & Health

2009 Q1 2010

Source: U.S. Bureau of Labor Statistics
With the shorter recession, unemployment in the region is much lower than the nation.

Unemployment Rate, March 2010

U.S. = 9.7
Wichita = 8.1 (NSA, Feb)

Source: Bureau of Labor Statistics
Banks in the state also remain in somewhat better shape than in the nation.
The Manufacturing Sector

- National and state factory activity is rising solidly and is expected to rise further.

- But excess capacity and uncertainty remain, keeping a damper on capital spending.

- Exports could provide future opportunities.
U.S. industrial production is rising, but much excess capacity remains.
Factory activity in Kansas has also resumed growth, but remains below year-ago levels.
Recent U.S. productivity growth has been sizable, suggesting hiring could begin soon.
Rough measures of Kansas factory productivity have also risen in recent months.

Source: FRBKC Manufacturing Survey
Kansas production and hiring plans are increasing, but capex plans remain modest.

**Kansas Manufacturing Indexes**
Six-month ahead, 3-month moving avg.

Source: FRBKC Manufacturing Survey
Uncertainty about future conditions is a bigger reason than in the past for lower capex

**Top Reasons for Not Increasing Capital Spending**
Share of firms choosing each reason, Jan. 2010

- Expected Low Sales Growth
- Low Capacity Util.
- Increased Econ./Fin. Uncertainty
- No Need To Replace Other Capital
- Decreased Cash Flow
- No Need To Replace IT Equip.
- Decreased Financing Conditions
- Outsourcing

Source: FRBKC Manufacturing Survey
Pricing power may be another challenge, though some Kansas firms are raising prices.

Source: FRBKC Manufacturing Survey
Longer-term, the U.S. trade imbalance provides opportunities for manufacturing

Source: Bureau of Economic Analysis
Kansas exports have edged higher in recent months following sharp declines in 2009.

Source: WISERTrade
Summary

- The U.S. economy is growing again, but recovery speed is expected to be modest.
- The Kansas economy is stabilizing, at a better level than in the nation.
- Manufacturing activity is rising again in the nation and state, but some caution remains.