The Economic Outlook for the U.S. and Oklahoma

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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 Oklahoma City Branch Office of the Federal Reserve Bank of Kansas City

- **Branch staff and functions**
  - 35 staff involved in economic research, examining banks, and public outreach

- **2010 branch board of directors**
  - Steve Agee *(chairman)*, President, Agee Energy, and Professor, OCU, OKC
  - Bill Anoatubby, Governor, Chickasaw Nation, Ada
  - Jim Dunn, Chairman, Mill Creek Lumber and Supply Company, Tulsa
  - Jacque Fiegel, Senior EVP and COO, Coppermark Bank, OKC
  - Rose Washington Rentie, Executive Director, TEDC Creative Capital, Tulsa
  - Doug Tippens, President and CEO, Bank of Commerce, Yukon
  - K. Vasudevan, Chairman, Service and Technology Corp., Bartlesville
Credit market conditions have improved, and the U.S. economy is growing again, but recovery is expected to be moderate.

Inflation is expected to remain tame in the near term, but will require diligent actions to stay in check over the longer run.
Broad measures of financial stress are nearing normal levels

**Kansas City Financial Stress Index**

**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.

Gross Domestic Product

Percent change, year-over-year

Source: U.S. Bureau of Economic Analysis, FOMC
With unemployment remaining high for some time

Source: U.S. Bureau of Labor Statistics, FOMC
Inflation is expected to remain tame in the near term, but will require careful oversight.
The Oklahoma Economy

- As usual in recessions, Oklahoma entered this recession much later than the nation, but then suffered huge job losses in 2009.

- Signs of recovery are increasing, and conditions remain much better than in the nation, but low natural gas prices are a risk.
Oklahoma usually enters recessions late but leaves around the same time as the nation

*Average Recession Path, 1956-2006*

Employment level 4 quarters before and 8 quarters after U.S. jobs peak

Indexed to U.S. jobs peak

Source: U.S. Bureau of Labor Statistics
Oklahoma entered this recession 3 quarters late and appears to have left 1 quarter late.

* Initial Claims for Unemployment Insurance

Index (Q1 2005=100)

- U.S.
- OK

* Through first three weeks of March

Source: Bureau of Labor Statistics
Revised state jobs data show a similar story of very late entry, slightly late exit

Nonfarm Payroll Employment Growth

Year-over-year percent change

Source: U.S. Bureau of Labor Statistics
Oklahoma City held up better in 2009 than Tulsa, but both appear to have bottomed.

Source: U.S. Bureau of Labor Statistics
With shorter recessions and better starting points, unemployment remains relatively low.

**Unemployment Rate**
Seasonally Adjusted*

<table>
<thead>
<tr>
<th></th>
<th>Dec-07</th>
<th>Feb-10</th>
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</thead>
<tbody>
<tr>
<td>U.S.</td>
<td>9.7</td>
<td>5.0</td>
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<tr>
<td>OKC metro</td>
<td>6.4</td>
<td>3.8</td>
</tr>
<tr>
<td>Tulsa metro</td>
<td>7.8</td>
<td>3.6</td>
</tr>
<tr>
<td>Lawton metro</td>
<td>5.7</td>
<td>3.9</td>
</tr>
<tr>
<td>Non-metro OK</td>
<td>7.2</td>
<td>3.7</td>
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</table>

Source: U.S. Bureau of Labor Statistics

* Estimated by FRBKC
Indeed, our entire region maintains relatively low unemployment rates.
Energy and construction finally shed jobs in OK in 2009, and manufacturing bled further

Oklahoma Employment Growth by Industry
February 2010

Percent change year over year

Source: U.S. Bureau of Labor Statistics
But manufacturing is showing solid output recovery in Oklahoma, slightly delayed.

Source: ISM, FRBKC Manufacturing Survey
And Oklahoma’s rig count has risen 72% since September: all horizontal, mostly gas.

Source: Baker Hughes
Home prices clearly held up better in Oklahoma, and have recently edged higher.

Source: FHFA
Mortgages are in much better position in Oklahoma than in the nation or even region.

**Share of Mortgages Underwater or Nearly So**

Q4 2009

<table>
<thead>
<tr>
<th>State</th>
<th>Percent</th>
<th>Near Negative (within 5%)</th>
<th>Negative Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>28%</td>
<td>2%</td>
<td>26%</td>
</tr>
<tr>
<td>10J</td>
<td>22%</td>
<td>1%</td>
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<td>CO</td>
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<td>15%</td>
<td>N/A</td>
<td>13%</td>
</tr>
<tr>
<td>OK</td>
<td>12%</td>
<td>N/A</td>
<td>10%</td>
</tr>
<tr>
<td>WY</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
</tbody>
</table>

Source: First American CoreLogic
Farmland values in the state also rebounded slightly in Q4 2009.
Overall, banks in the state remain in much better shape than in the nation.
Commercial real estate is a risk, but office vacancies remain lower than in the nation.
Weakening natural gas prices provide the biggest risk to Oklahoma’s growth

Energy Prices

Source: Bloomberg

Crude oil (right scale)

Natural gas (left scale, per MMBTU)
Summary

- The U.S. economy is growing again, but recovery speed is expected to be modest.

- Near-term inflation risks remain low, but long-term risks will require diligent action.

- Oklahoma’s economy is showing signs of recovery, and from a better level, but recent natural gas price trends are a risk.