Navigating Our Challenging Economy

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.
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
U.S. consumers are spending money.

Source: U.S. Census Bureau
Corporate profits and business investment are beginning to rebound.

Corporate Profits and Nonresidential Fixed Investment

Percent change from year ago

Source: Bureau of Economic Analysis
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
How will surging federal debt levels affect economic conditions long-term?

U.S. Debt as a Percent of GDP

Source: Congressional Budget Office

CBO Alternative Fiscal Scenario (Nov. 2009)
CBO Extended Baseline Scenario (August 2010)
CBO Extended Baseline Scenario (Nov. 2009)
Navigating Our Challenging Economy

Today’s Roadmap

- Our challenging economy
- What does this mean for real estate?
  - Residential markets: will the bottom hold?
  - Commercial markets: will signs of improvement emerge?
  - Agricultural markets: up, up, and ...
What was the real estate lesson of the 1980s farm crisis?

Real estate values should be based on cash flows.
Home prices outpaced personal incomes.

U.S. Home Prices and Personal Incomes

Index (1990 = 100)

- FHFA Home Price Index
- Per Capita Income

Source: USDA
**Have housing markets hit bottom?**

- Foreclosure rates have declined, but remain high.
- Housing starts have stabilized at low levels.
- Home sales have increased, primarily for low-priced homes.
- What happens after the end of the first-time home buyers tax credit?
Prices have fallen faster than rents, leading to higher cap rates.

U.S. Commercial Real Estate Capitalization Rates

Source: Torto-Wheaton Research
Commercial construction is beginning to stabilize at low levels.

- Commercial construction remains weak, with a few signs of improvement.
- In second quarter, vacancy rates declines in Denver, Kansas City, and Omaha. Will this trend continue?
- Industrial production and capacity utilization in manufacturing are edging up.
- Corporate profits have jumped, when will they invest in infrastructure?

Source: F.W. Dodge
Farmland values are rising again.

- After pausing in 2009, farmland values are rising.
- Robust farm demand with stronger incomes.
- Investor demand is rising.
  - Hedge against inflation
  - Limited returns on other assets.
- Fewer farms for sale.

Source: Federal Reserve Bank of Kansas City
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
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- Dealing with financial imbalances
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
Deflation or Inflation: What does the future hold?

Consumer Price Inflation Expectations

Source: Survey of Professional Forecasters
For More Information

Federal Reserve Bank of Kansas City
Omaha Branch

www.kansascityfed.org/omaha