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The Economy Turns – Again



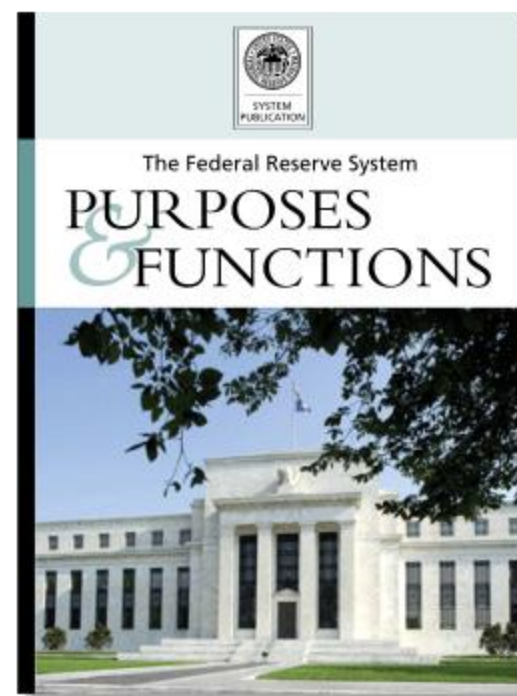
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What is the Federal Reserve?

**The Federal Reserve is the
Central Bank of the U.S.**
(formed in 1913)

Functions

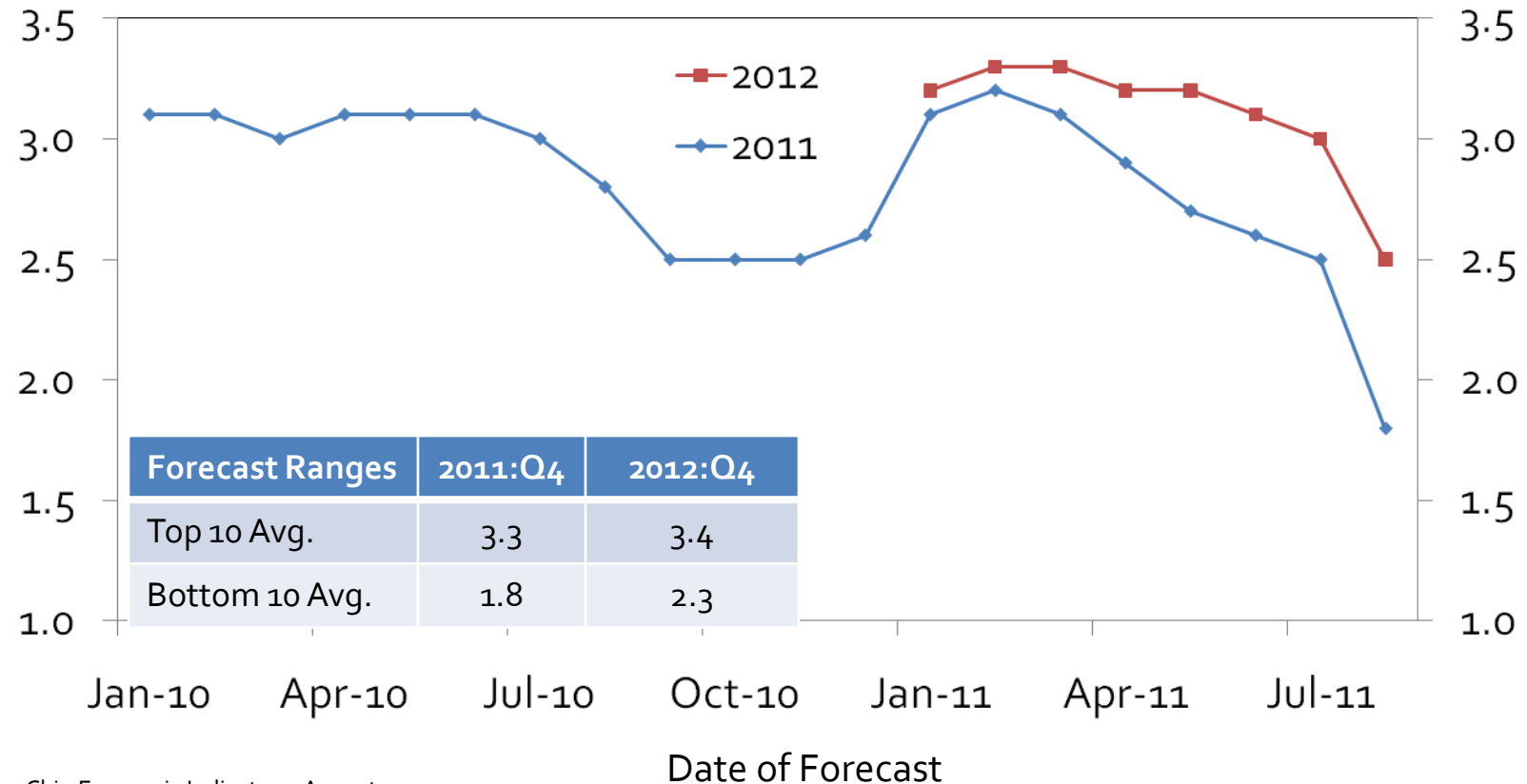
- *Conduct monetary policy*
- *Supervise and regulate banks*
- *Maintain stability of financial system*
- *Operate the nation's payment system*



Economic forecasts dropped sharply in August.

U.S. Real GDP Growth

Annual percent change



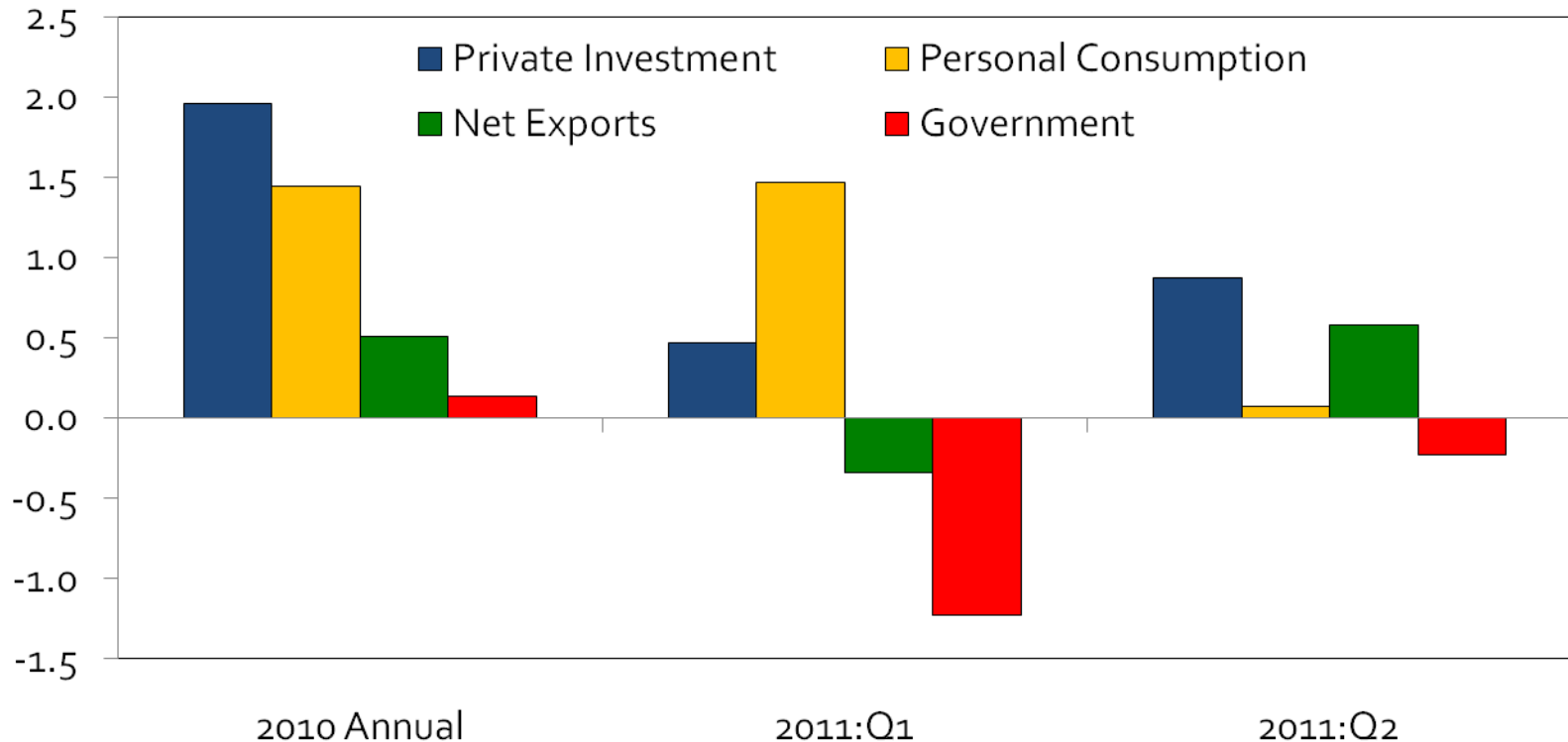
Source: Blue Chip Economic Indicators, August 2011



Sluggish government and consumer spending.

Contribution to U.S. Real GDP Growth

Annual percent change

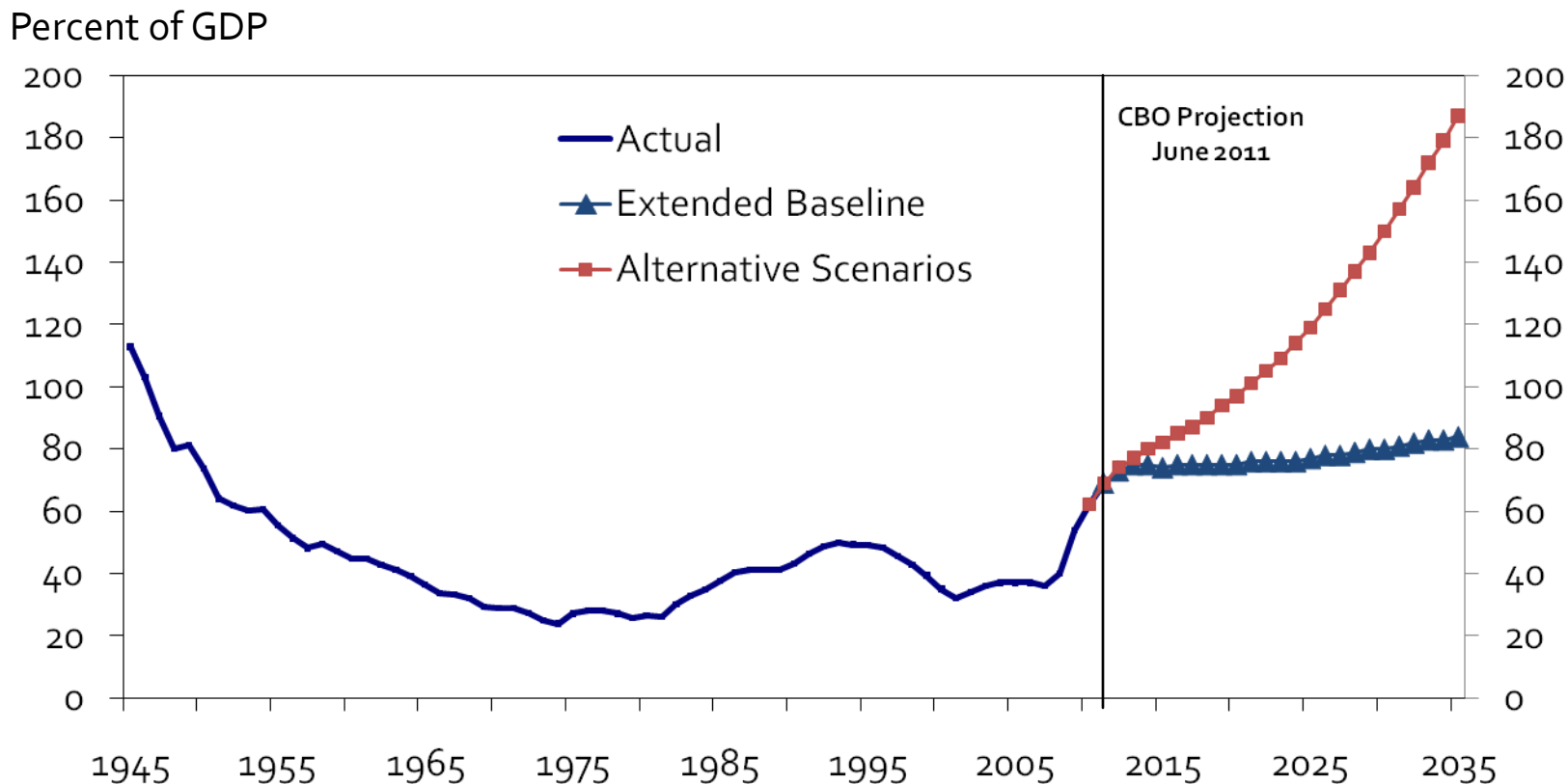


Source: Bureau of Economic Analysis



Will the federal government be able to control U.S. debt accumulation?

Federal Government Debt as a Percent of GDP



Source: Congressional Budget Office

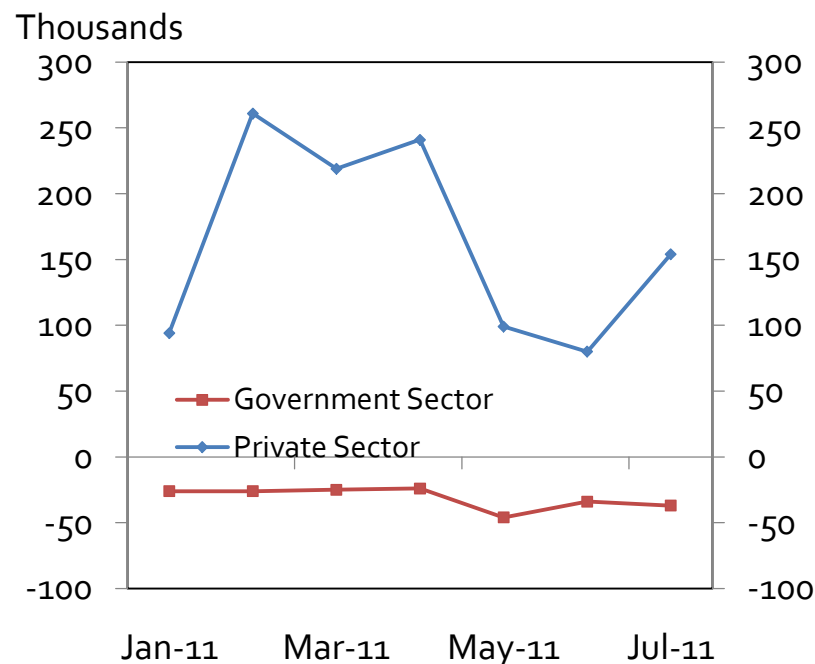


Can the private sector offset a smaller government sector?

What caused the private sector slump?

- Bad weather disrupts U.S. construction
- Supply chain disruptions in Japan
- High input costs - crude oil
- High food and gas prices for consumers
- Mideast turmoil (Arab Spring)
- European Debt Crisis: Greece
- U.S. debt concerns

U.S. Monthly Job Gains



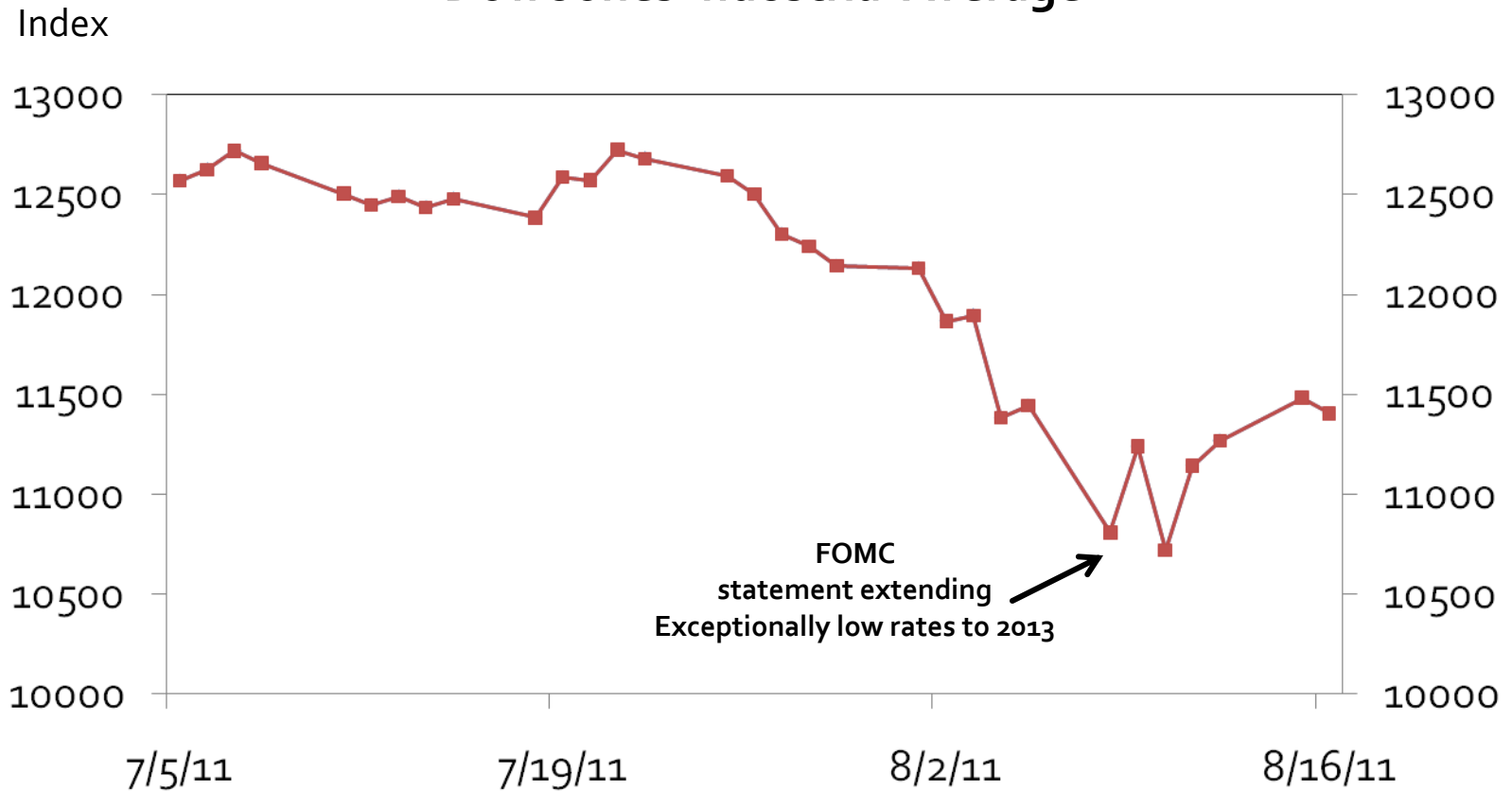
Source: Bureau of Labor Statistics

Structural Versus Cyclical Factors



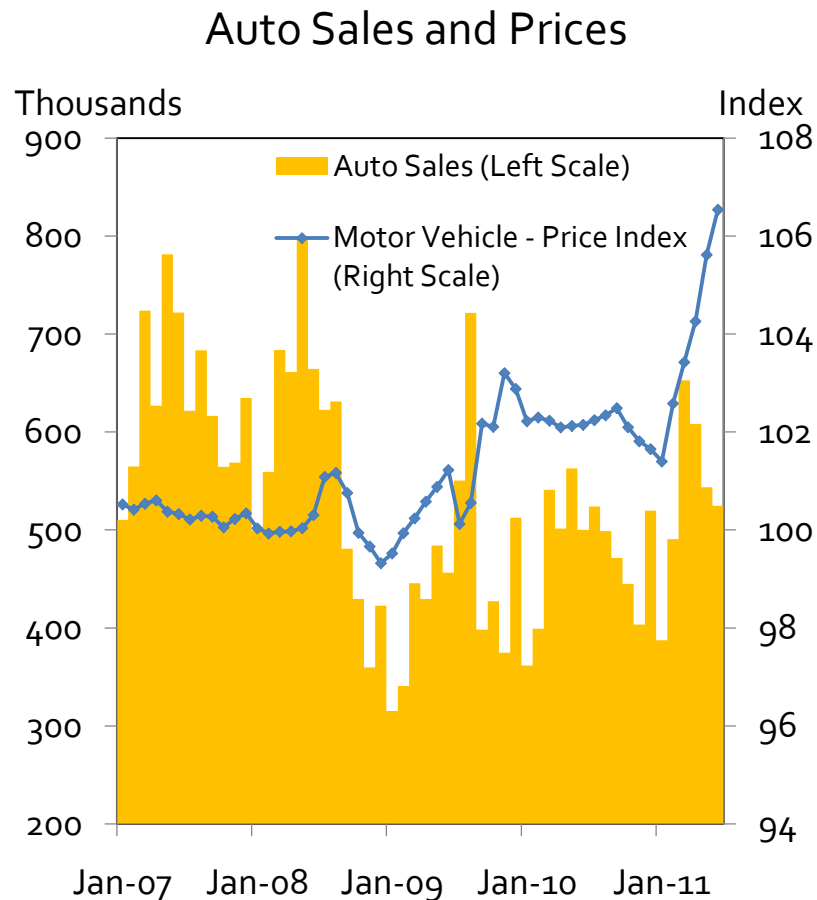
The Panic

Dow Jones Industrial Average



The U.S. consumer is deleveraging.

- Deleveraging means ...
 - Savings are up.
 - Housing is sluggish.
 - Spending is limited.
- Why?
 - Jobs prospects look bleak.
 - Income gains are modest.
 - Especially for the less-skilled
- Consumers are down, but not out.
 - Rising auto prices indicate consumers are buying.



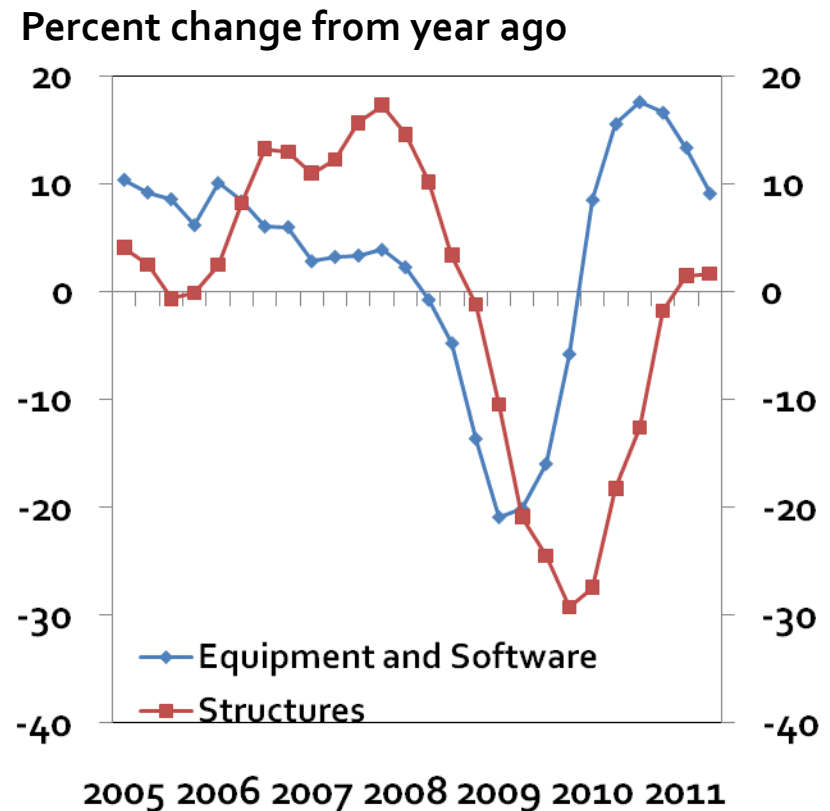
Source: Bureau of Economic Analysis



Slower profits contributes to weaker investment activity and job gains.

- In 2010, profits rebounded sharply.
- Businesses responded by upgrading equipment and software.
- Firms began to expand labor hours –
 - First by extending hours
 - Then by hiring temp workers
- New building activity stabilized.
- In 2011, corporate profits softened.
 - Business investment slowed.
 - Hiring weakened.

Business Investment



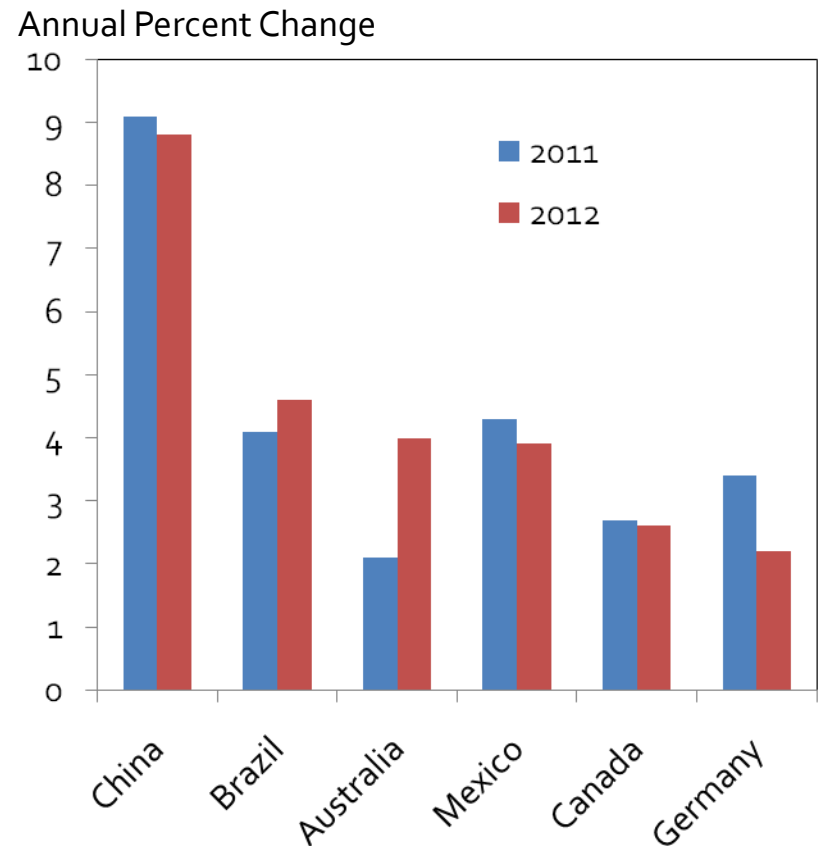
Source: Bureau of Economic Analysis



Global economic growth is mixed.

- A summer slowdown in global economic growth.
- Commodity based economies continue to expand.
- Europe is dealing with their debt issues
- Emerging markets are dealing with inflation.

Foreign GDP Growth



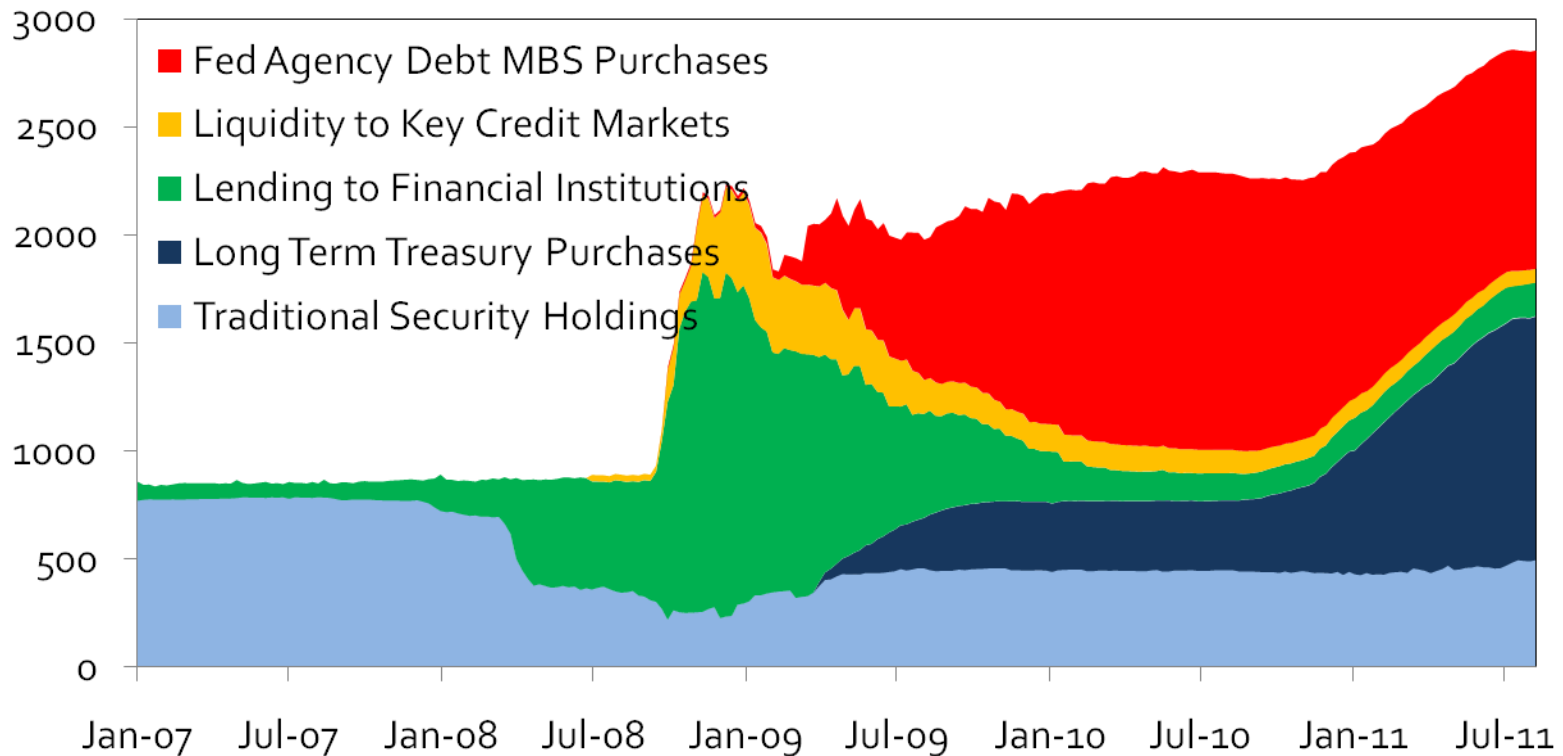
Source: Blue Chip Economic Indicators



With low interest rates through 2013, will the FOMC QE or not QE?

Federal Reserve Balance Sheet: Assets

Billion Dollars



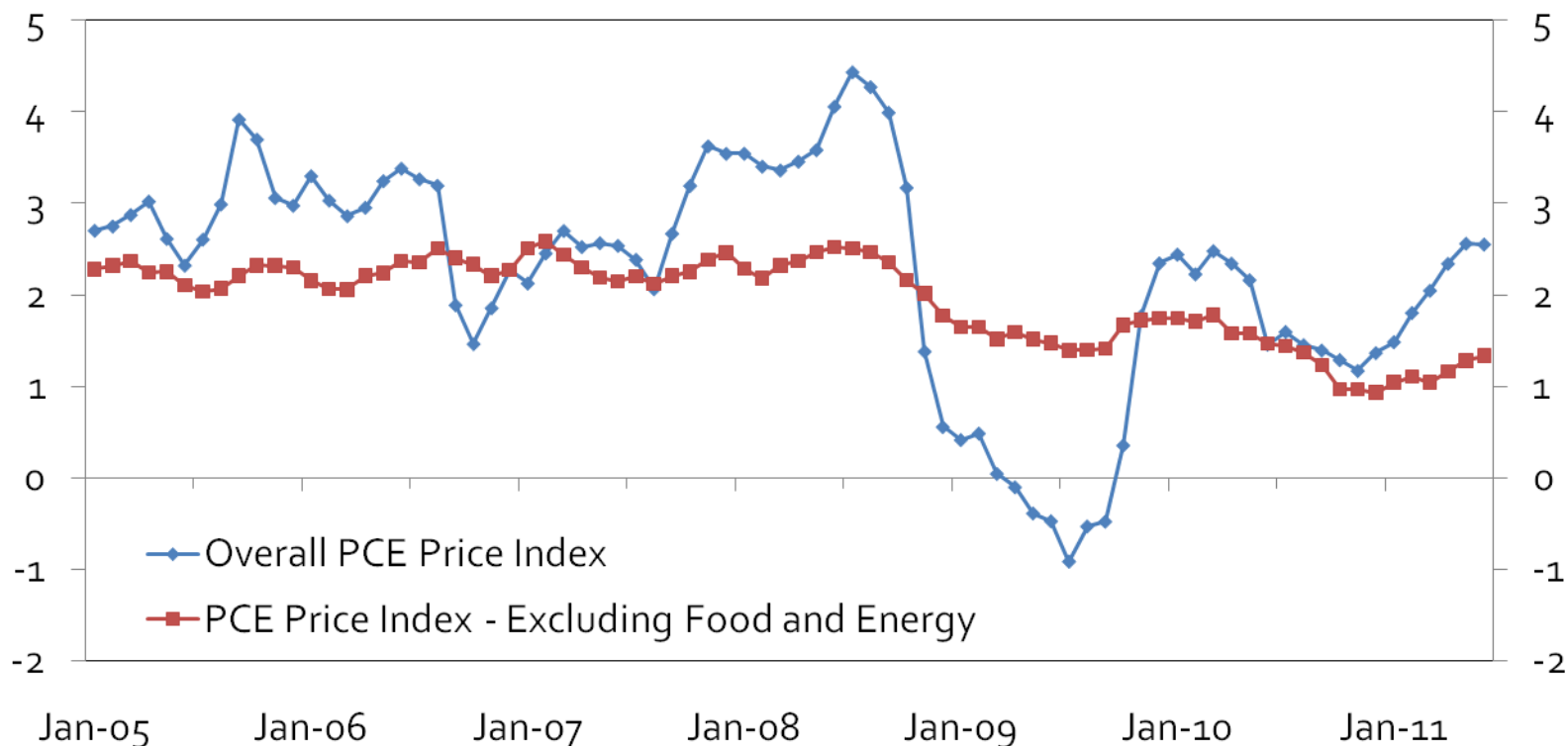
Source: Federal Reserve Bank of Cleveland



The balance sheet increases long-term inflation risk.

Personal Consumption Expenditures Price Index

Percent change from previous year



Source: Bureau of Economic Analysis



Inflation is based on money and velocity.

Quantity Theory of Money

$$\text{Price} = \frac{\text{Money} * \text{Velocity}}{\text{Quantity}}$$

Definition of Inflation:

Too much money $M \uparrow$
chasing $V \uparrow$
too few goods $Q \downarrow$



Who Wins?

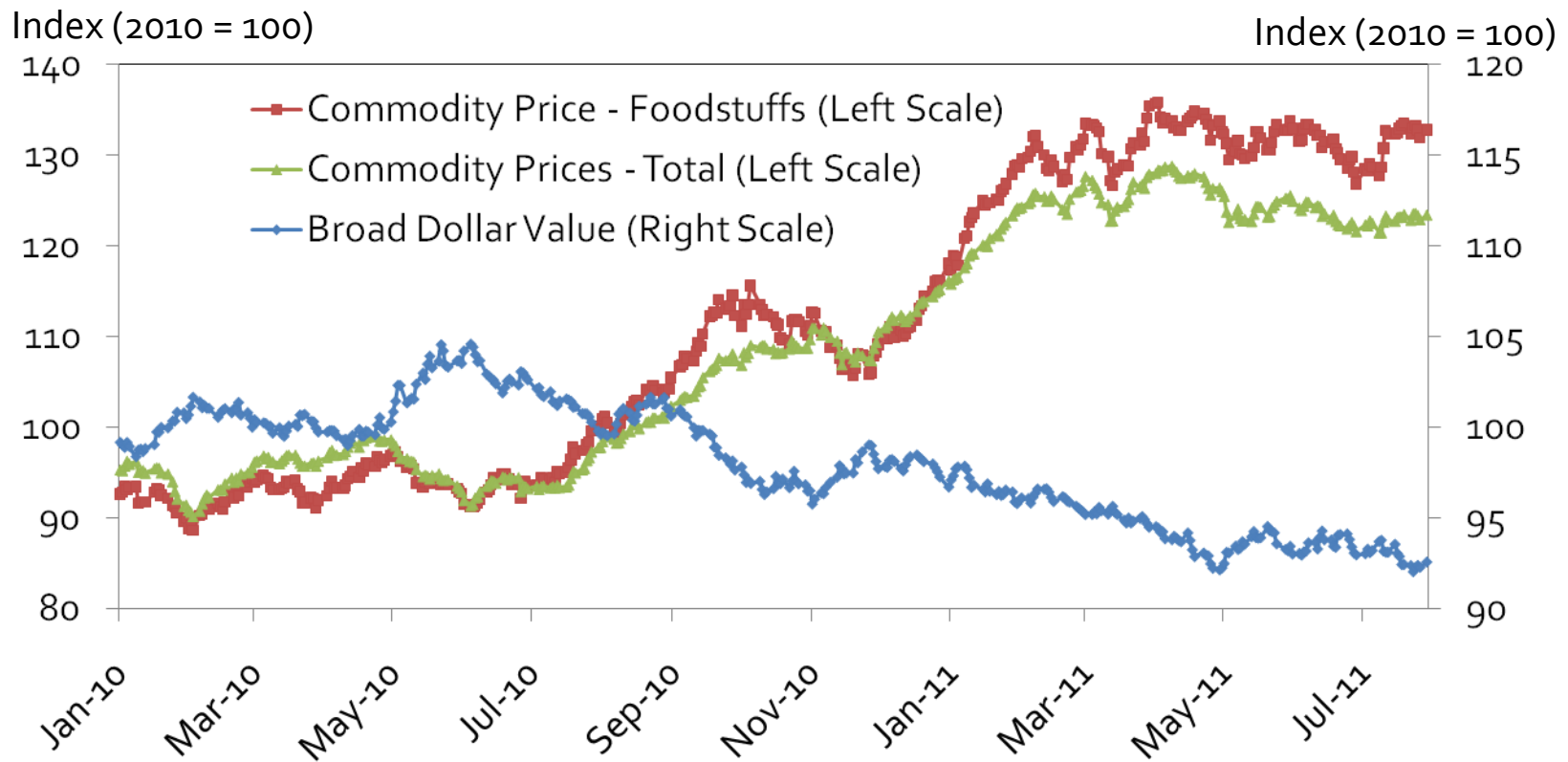
Commodity-based Economies

- 1) Exchange Rates
- 2) Interest Rates
- 3) Supply Shocks



Exchange rate movements affect commodity prices.

Commodity Prices and the Dollar

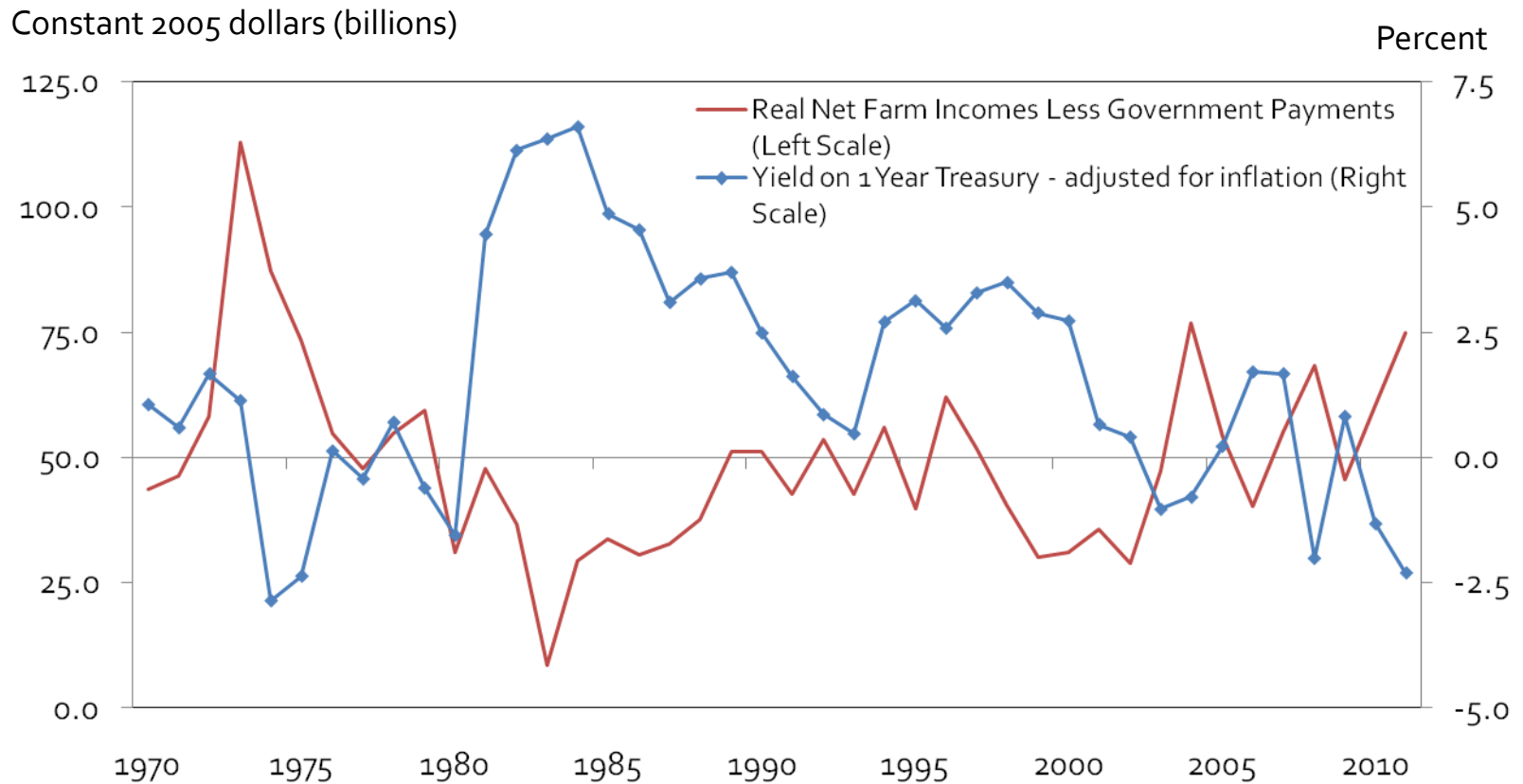


Source: Commodity Research Bureau and Federal Reserve



Farm incomes rise in low interest rate environments.

Farm Incomes and Interest Rates

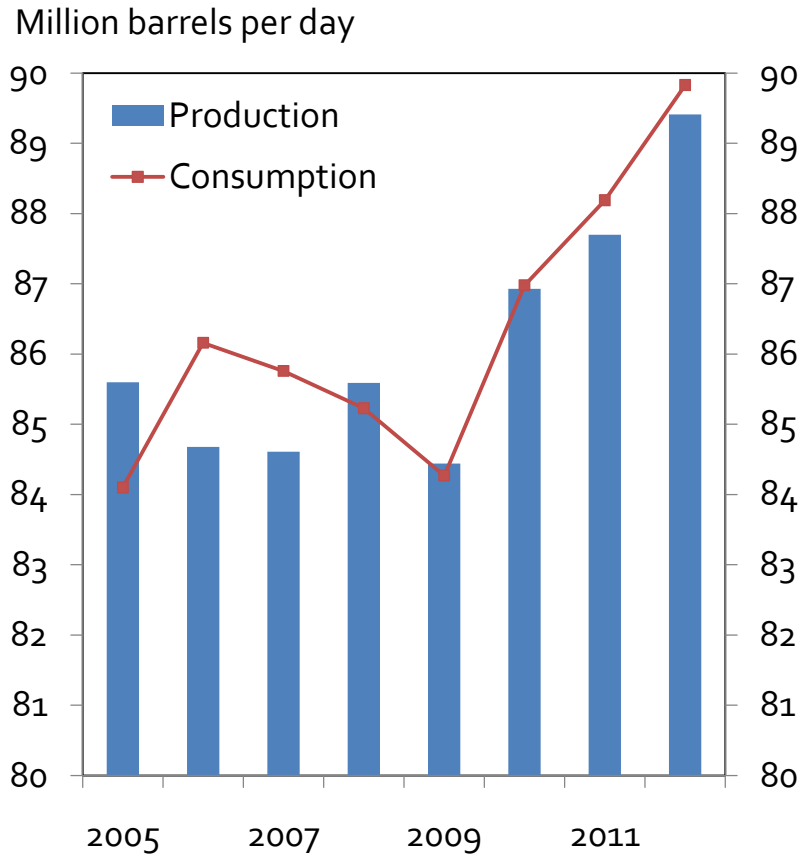


Sources: USDA , Federal Reserve, BLS



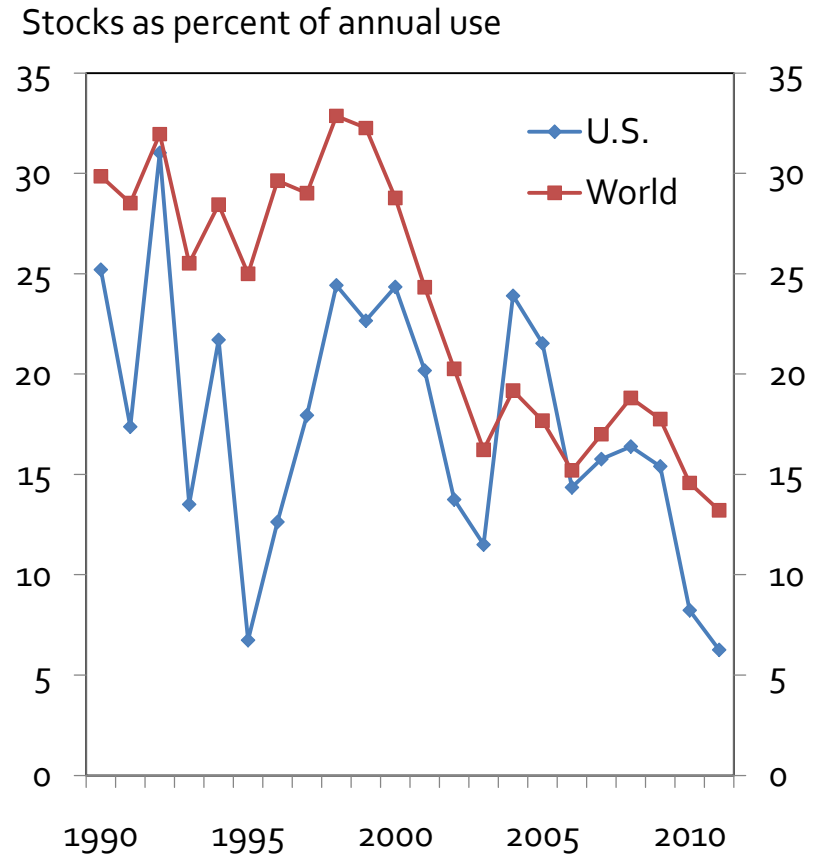
A classic supply shock in commodity markets.

World Crude Oil Production and Consumption



Source: Energy Information Administration

U.S. and World Corn Inventories



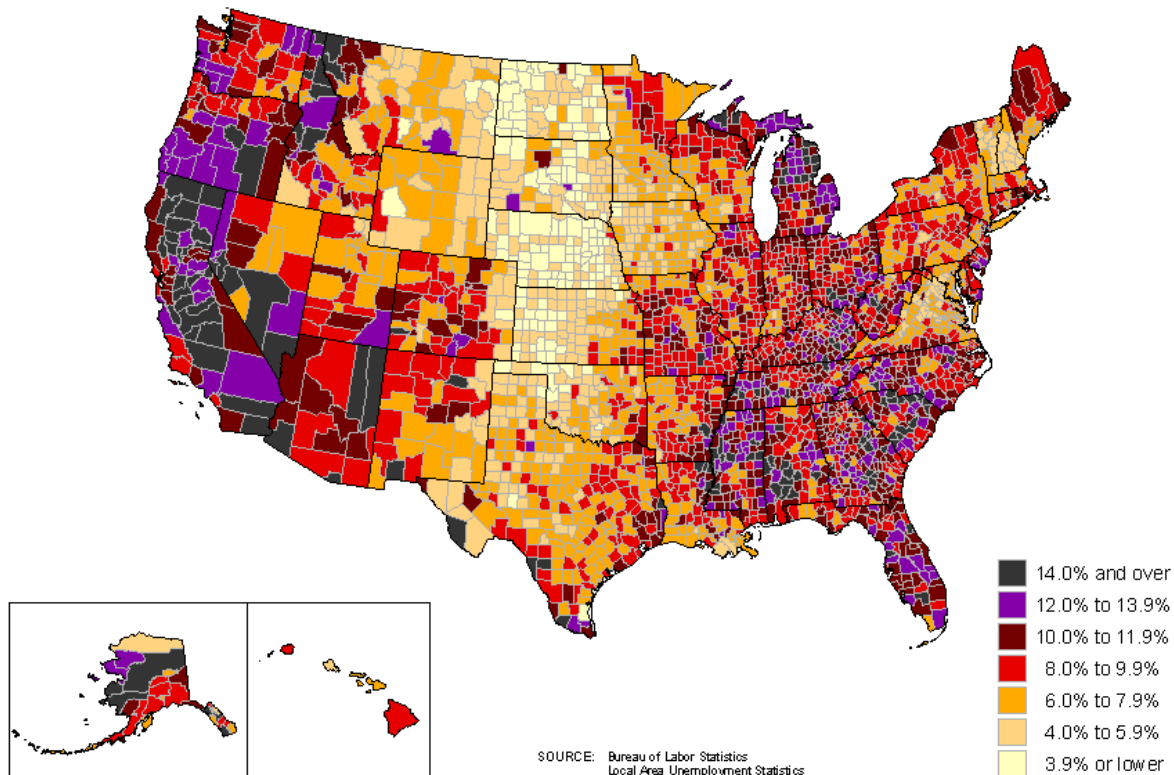
Source: USDA



The Great Plains reaps the benefits of the commodity boom.

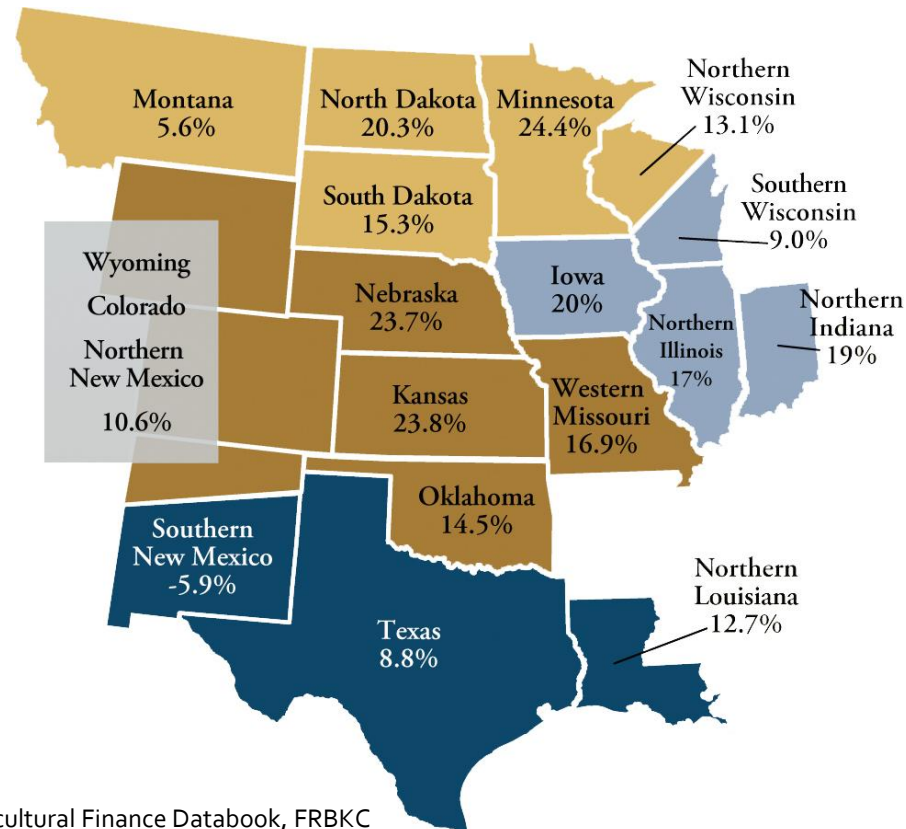
Unemployment rates by county,
July 2010 – June 2011 averages

(U.S. rate = 9.3 percent)



Asset values surge throughout the Corn Belt.

Non-irrigated Cropland Values (Percent change 2010:Q1 to 2011:Q1)



Source: Agricultural Finance Databook, FRBKC



Conclusion

- Economic growth has slowed with government and consumer spending.
- Despite panic, sluggish growth is expected in 2012.
- Deleveraging will mute the economic recovery.
- The outlook for Nebraska and other commodity driven economies looks brighter than other regions.
- Commodities follow boom/bust cycles.

How long will the boom last?

