

An Economic View from the Fed

Jason Henderson

**Vice President and Branch Executive
Federal Reserve Bank of Kansas City**

Omaha Branch

www.kansascityfed.org

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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.



FOMC Statement ***(October 29, 2008)***

- The pace of economic activity appears to have slowed markedly, owing importantly to a **decline in consumer expenditures**.
- **Business equipment spending and industrial production have weakened** in recent months, and slowing economic activity in many foreign economies is **damping the prospects for U.S. exports**.
- Moreover, the intensification of **financial market turmoil** is likely to exert additional restraint on spending, partly by further **reducing the ability of households and businesses to obtain credit**.
- In light of the declines in the prices of energy and other commodities and the weaker prospects for economic activity, **the Committee expects inflation to moderate** in coming quarters to levels consistent with price stability.



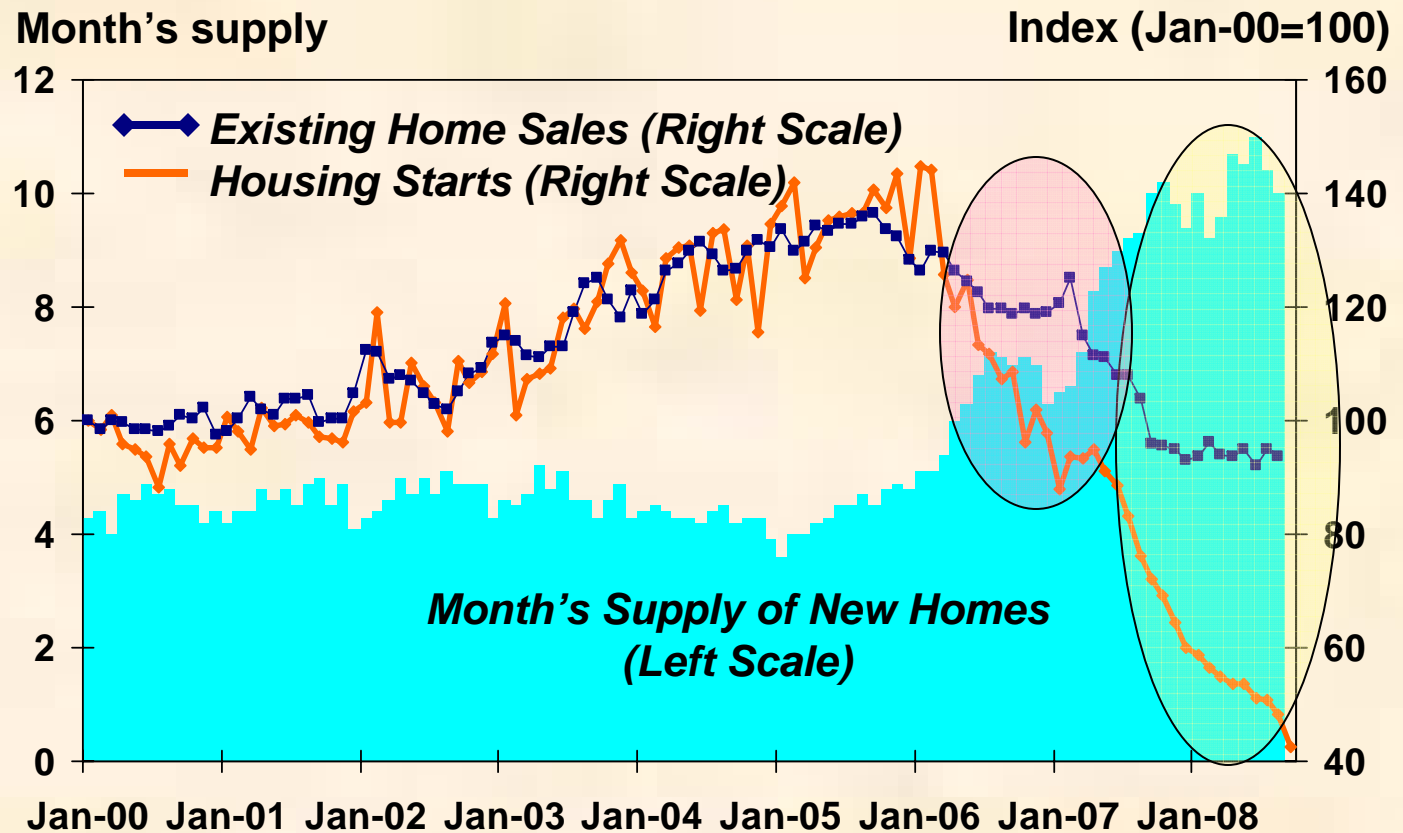
Today's Outline

- **Housing: The Correction Continues**
- **Financial Market: A Classic Run on Banks**
- **Commodity Prices: The Supply Shock Eases**
- **The Outlook: What Will Spark a Rebound?**



The Housing Boom Goes Bust.

Home Starts, Sales and Inventories

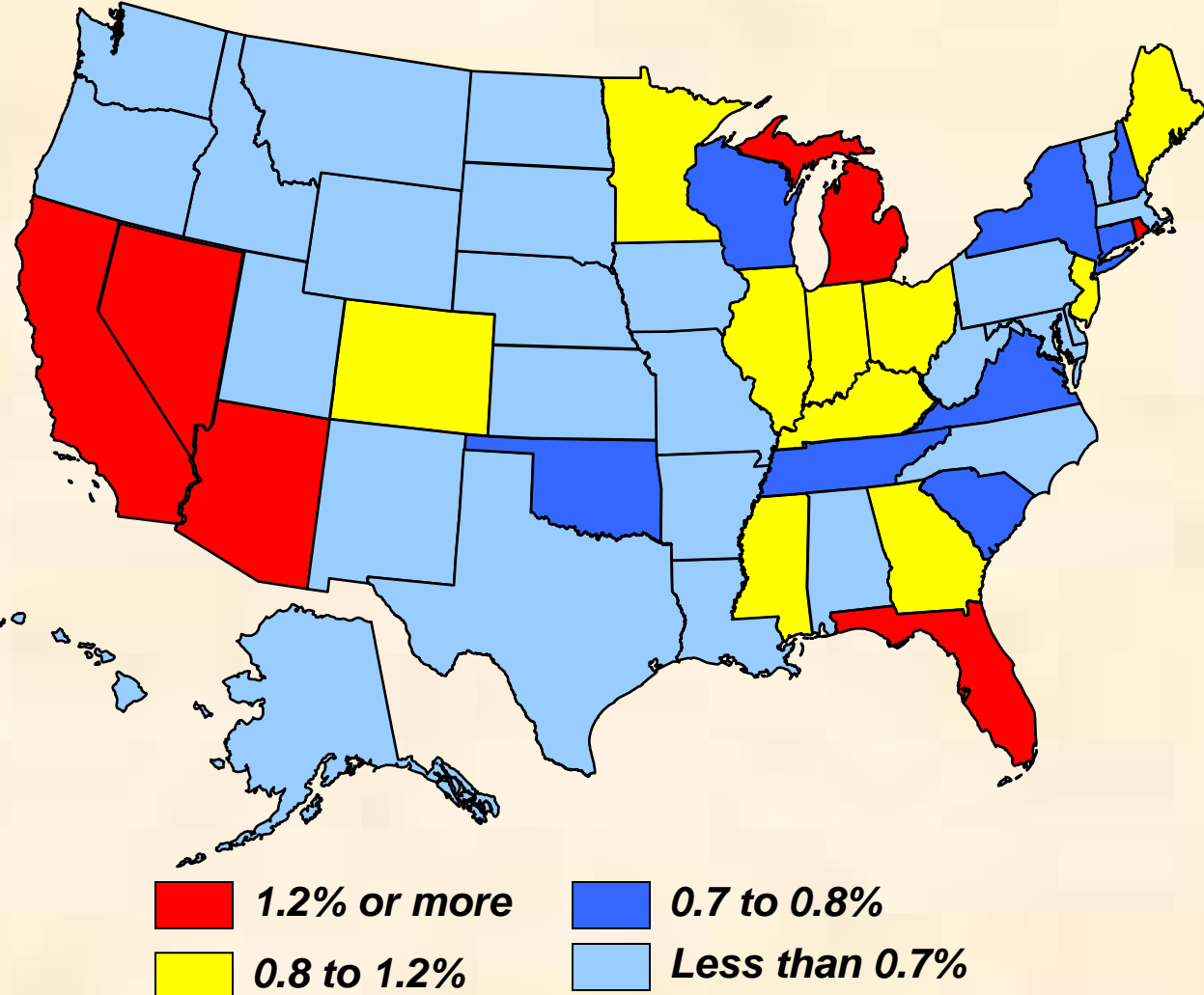


Source: Dept. of Commerce, National Association of Realtors



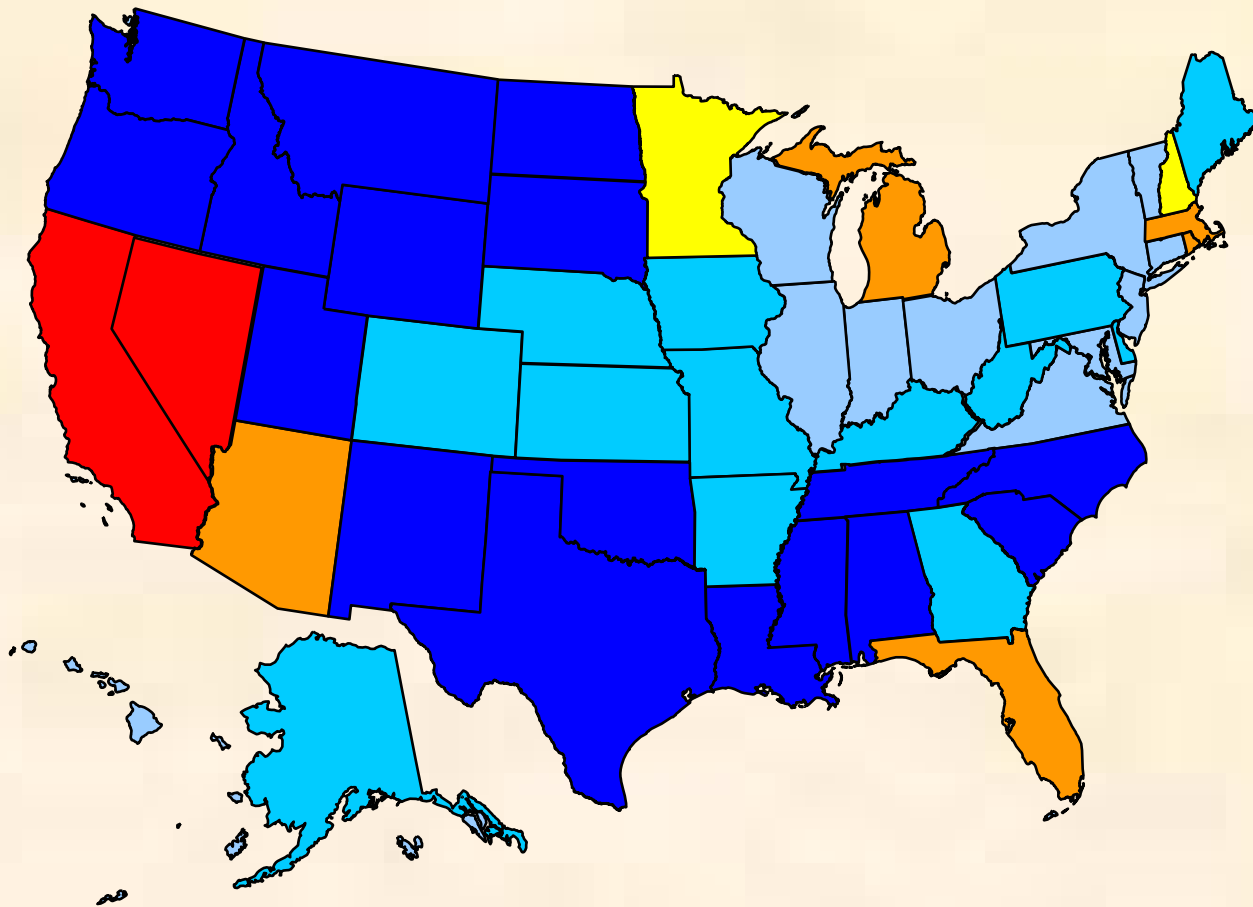
Percent of Loans in Foreclosure

(Started during the Second Quarter 2008)



Source: Mortgage Bankers Association

Home Price Appreciation since 2006 (Existing Single-Family Homes)



Red -10% to -20%

Yellow 0 to -5%

Cyan 5% to 10%

Orange -5% to -10%

Light Blue 0.1% to 5%

Dark Blue 10% to 23%

Source: OFHEO



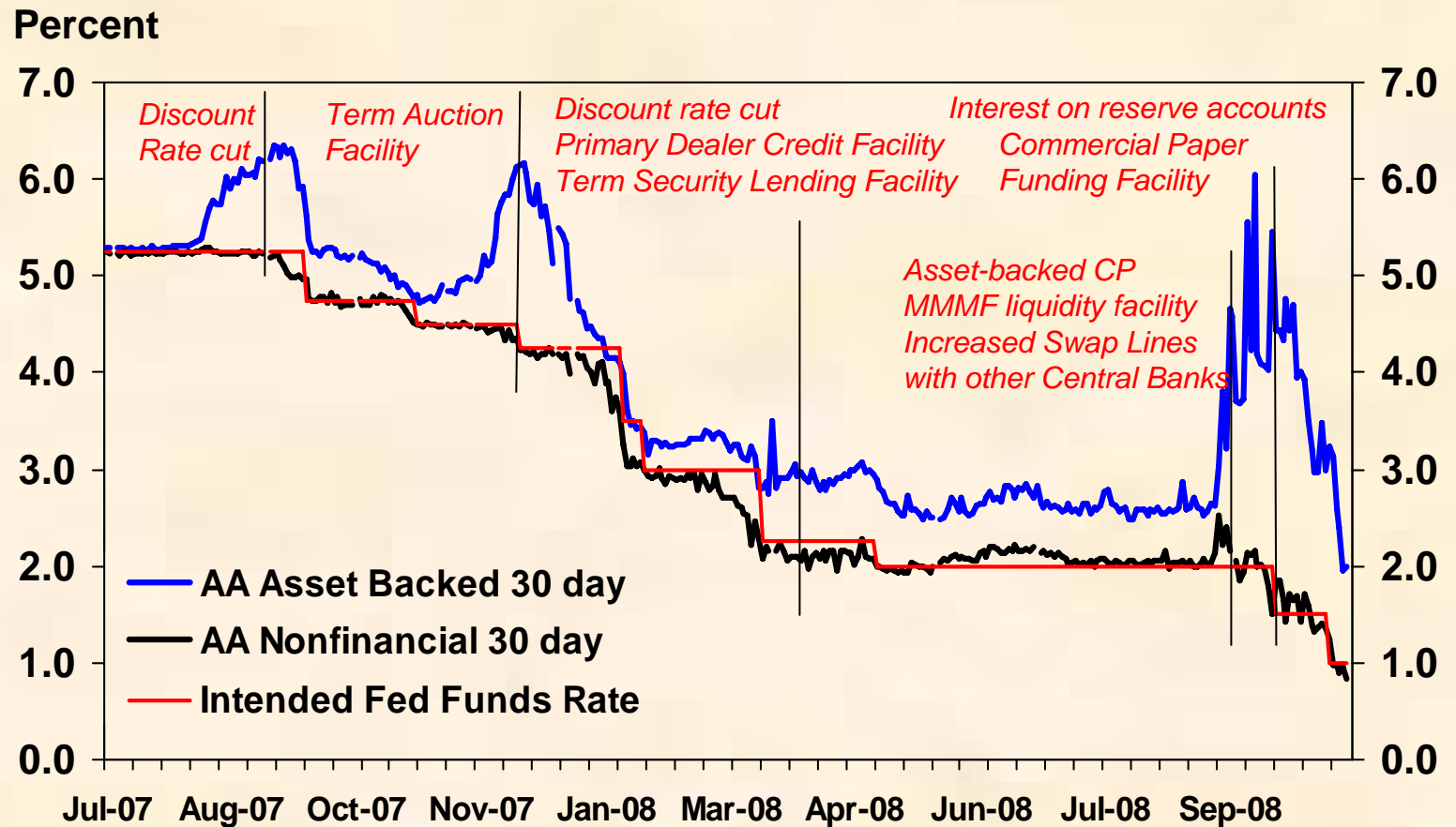
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Financial Markets Remain Volatile.

Commercial Paper Rates and Fed Funds Rate

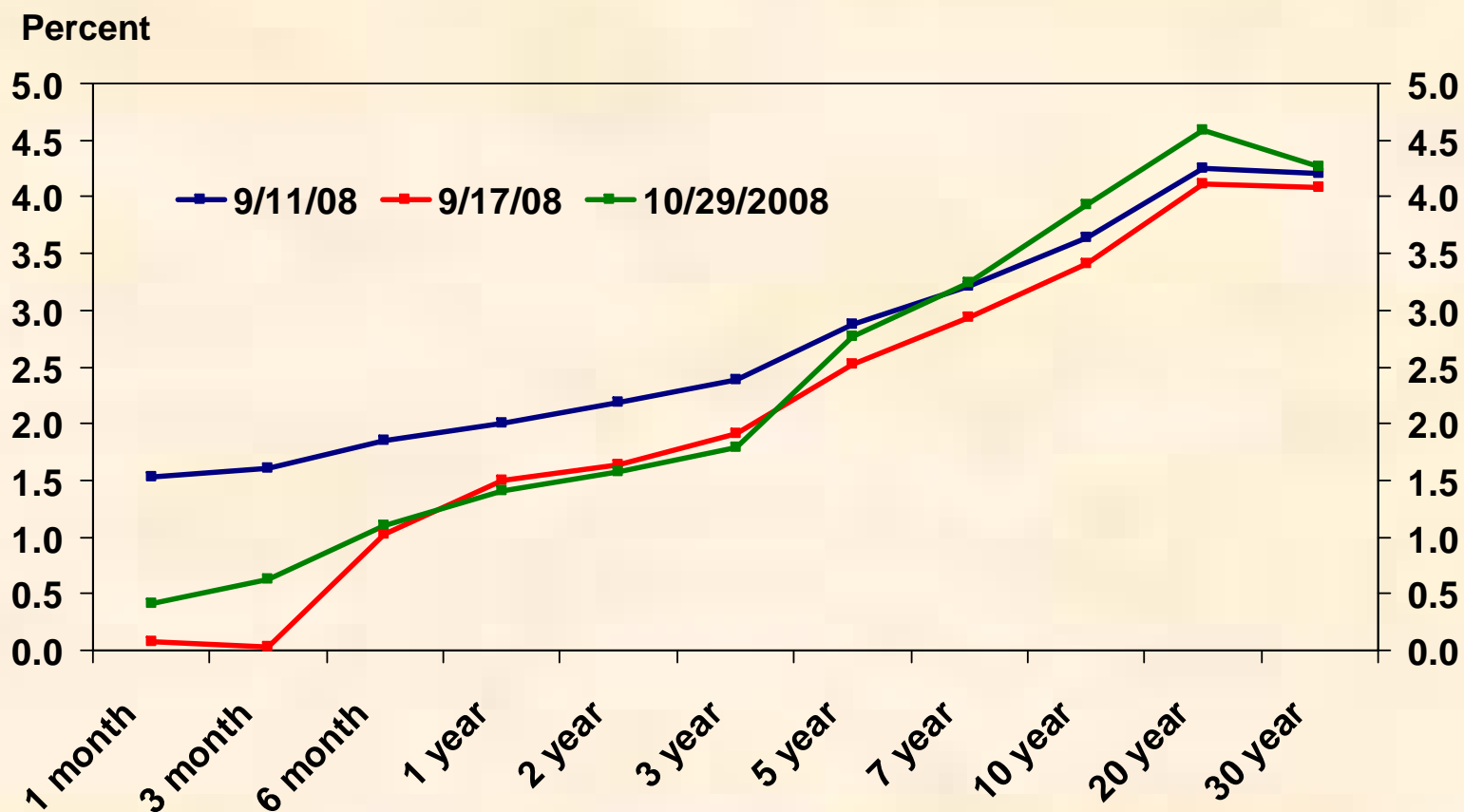


Source: Federal Reserve Board of Governors



Investors Turned to Treasury Securities.

Daily Treasury Yield Curve Rates

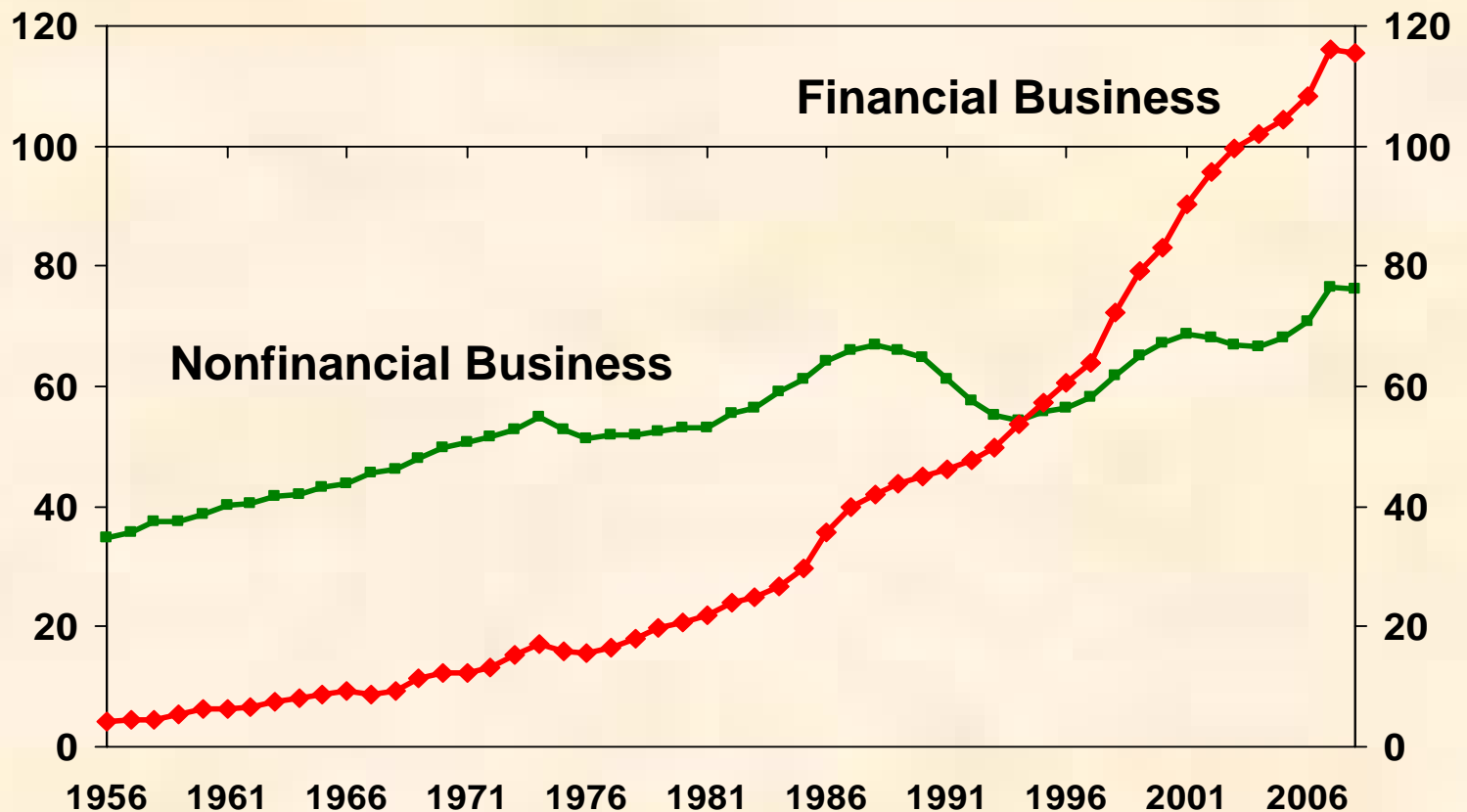


Source: Federal Reserve Board of Governors

Falling Asset Prices and High Debt Levels are a Recipe for Bankruptcy.

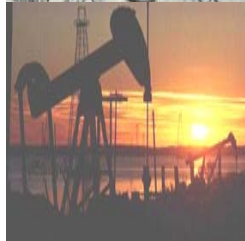
Domestic Business Debt Outstanding

Percent of GDP



Source: Federal Reserve Board of Governors



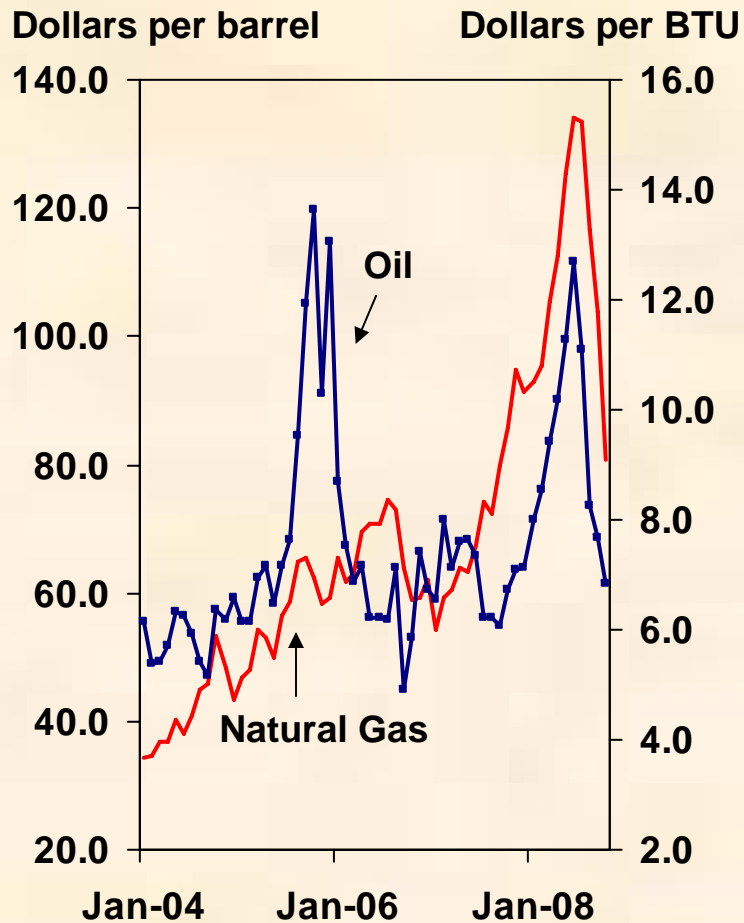


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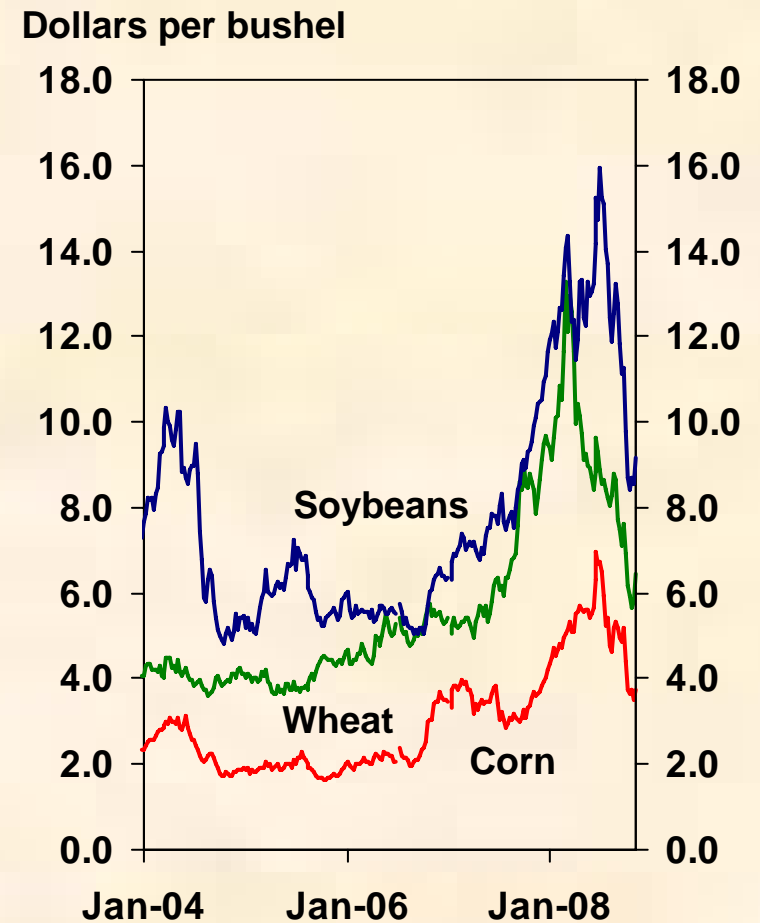
The Commodity Price Boom Ends.

Oil and Natural Gas Prices



Source: Bloomberg

U.S. Crop Prices

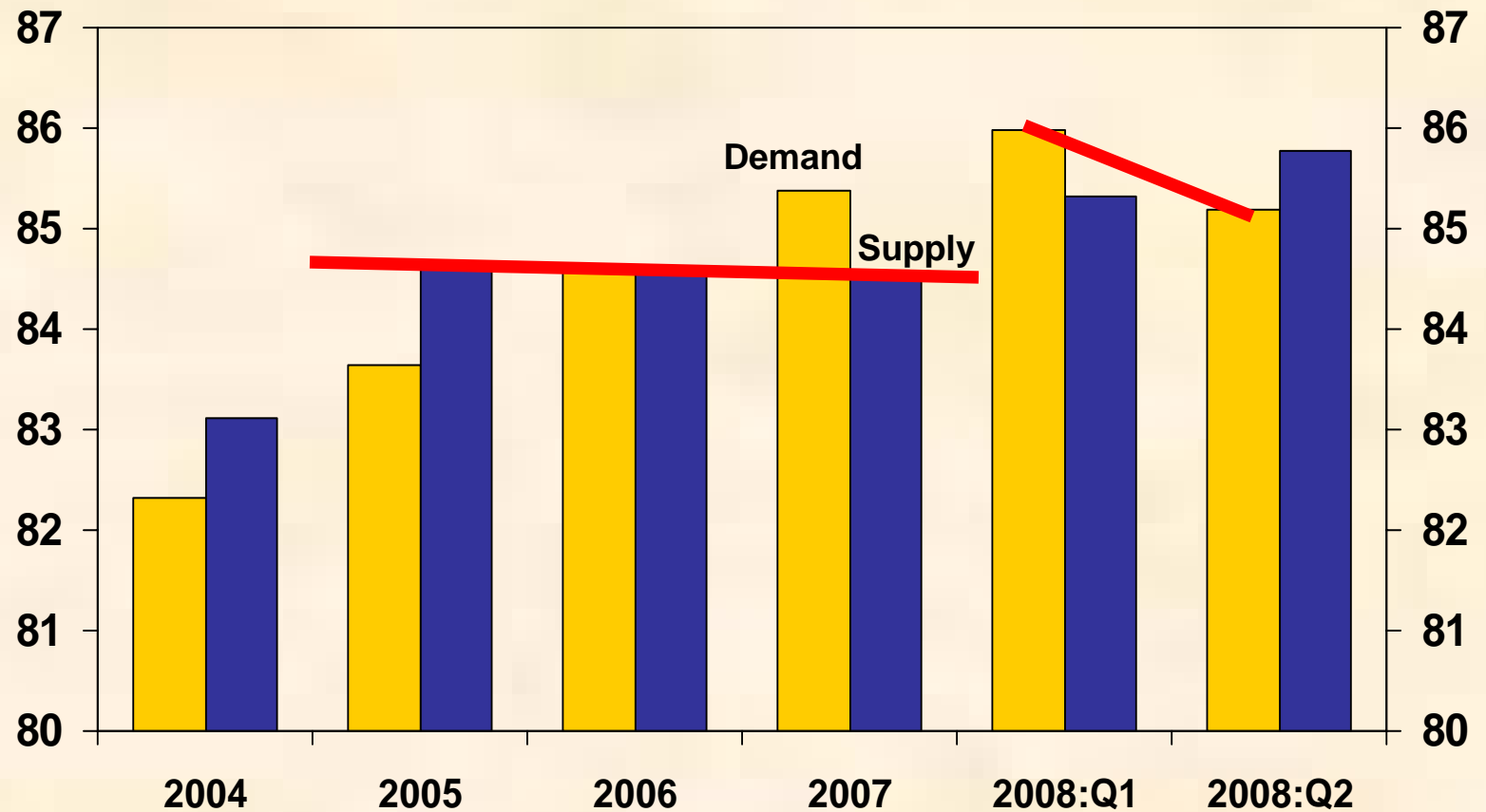


Source: Wall Street Journal

World Oil Demand has Fallen with Weaker Growth.

World Oil Balance

Million barrels per day



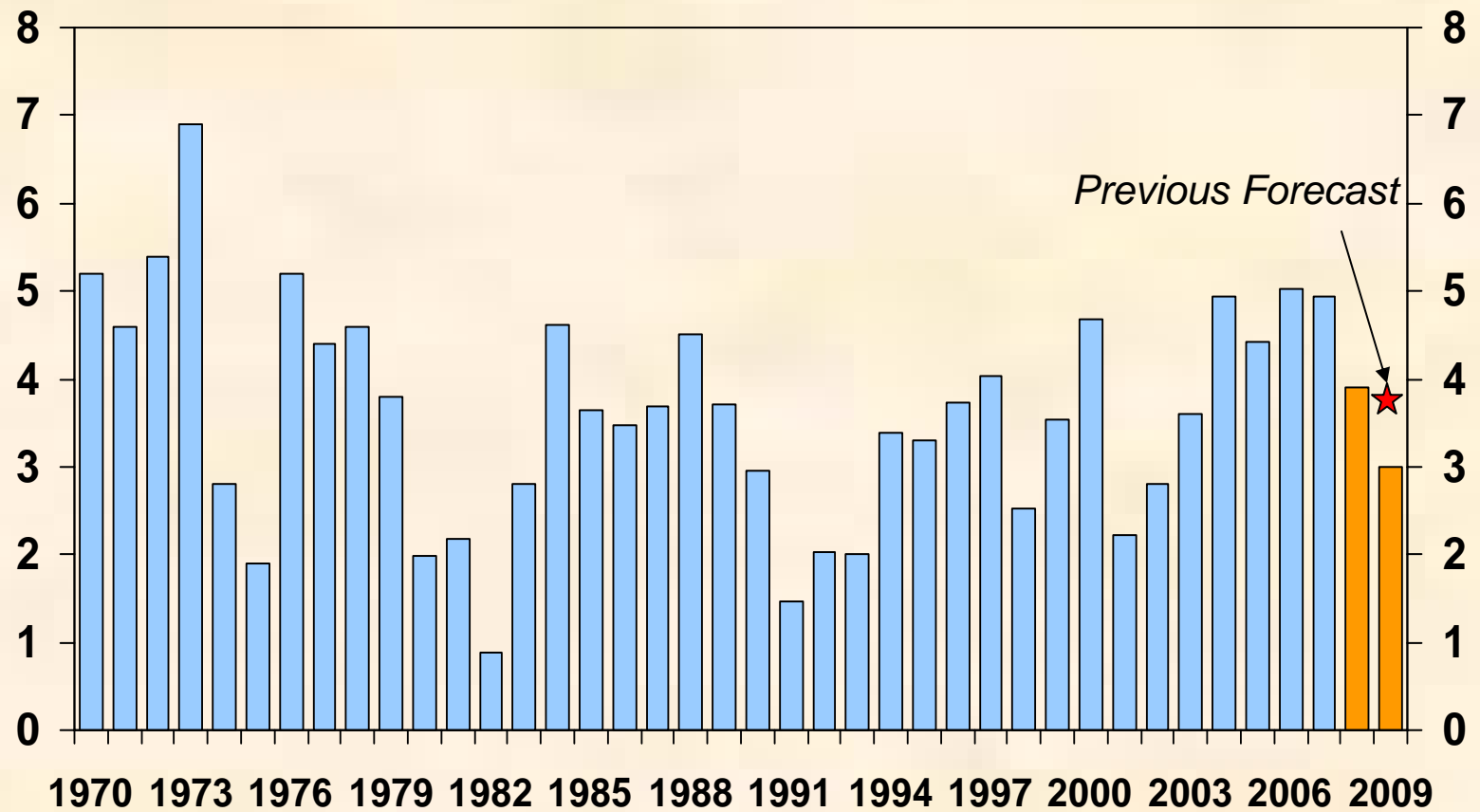
Source: Energy Information Administration



Economic Weakness Spreads Globally.

World GDP Growth

Annual percent change

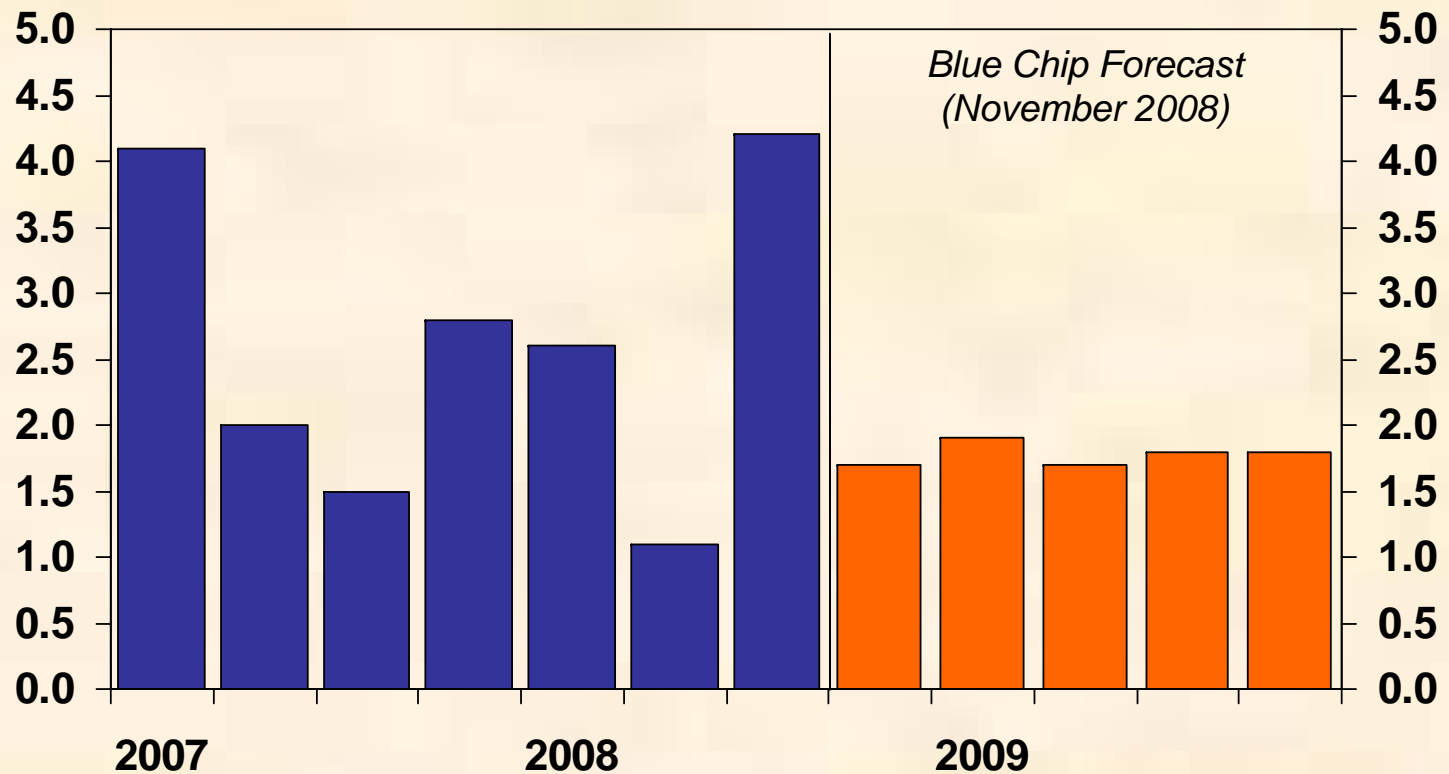


Source: International Monetary Fund, October 2008

Inflation is expected to ease.

GDP Price Index

Annualized percent change from previous quarter

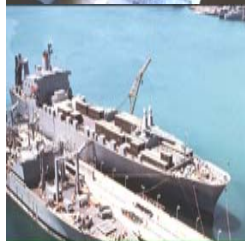
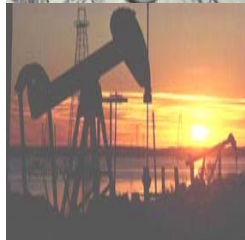


Source: Bureau of Economic Analysis and Blue Chip

Energy Costs are Driving Housing and Transportation Inflation.

Category	Relative Importance	Percent Change		
	Percent	June '08 to July '08	July '08 to August '08	August '08 to September '08
Housing	42.4	0.6	-0.1	-0.1
Shelter	32.5	0.2	0.1	0.3
Furnishings	4.7	0.4	0.2	0.5
Household Fuel	5.1	3.3	-1.1	-2.8
Transportation	17.7	1.7	-1.5	-0.6
Motor Vehicles	7.2	0.2	-0.4	-0.9
Motor Fuel	5.5	4.1	-4.2	-0.8

Source: Bureau of Labor Statistics



Today's Outline

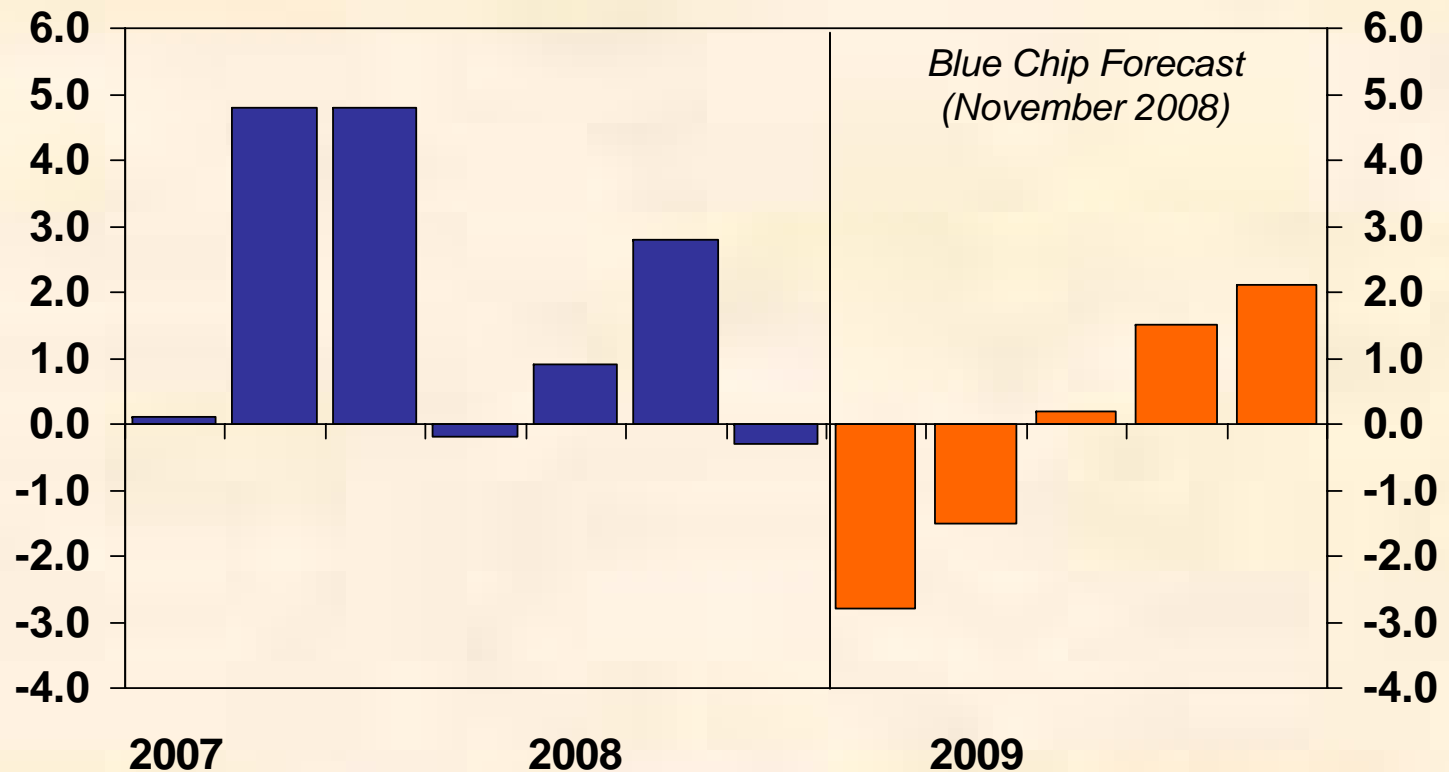
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Economic growth is expected to weaken.

Real Gross Domestic Product Growth

Annualized percent change from previous quarter



Source: Bureau of Economic Analysis and Blue Chip Forecast



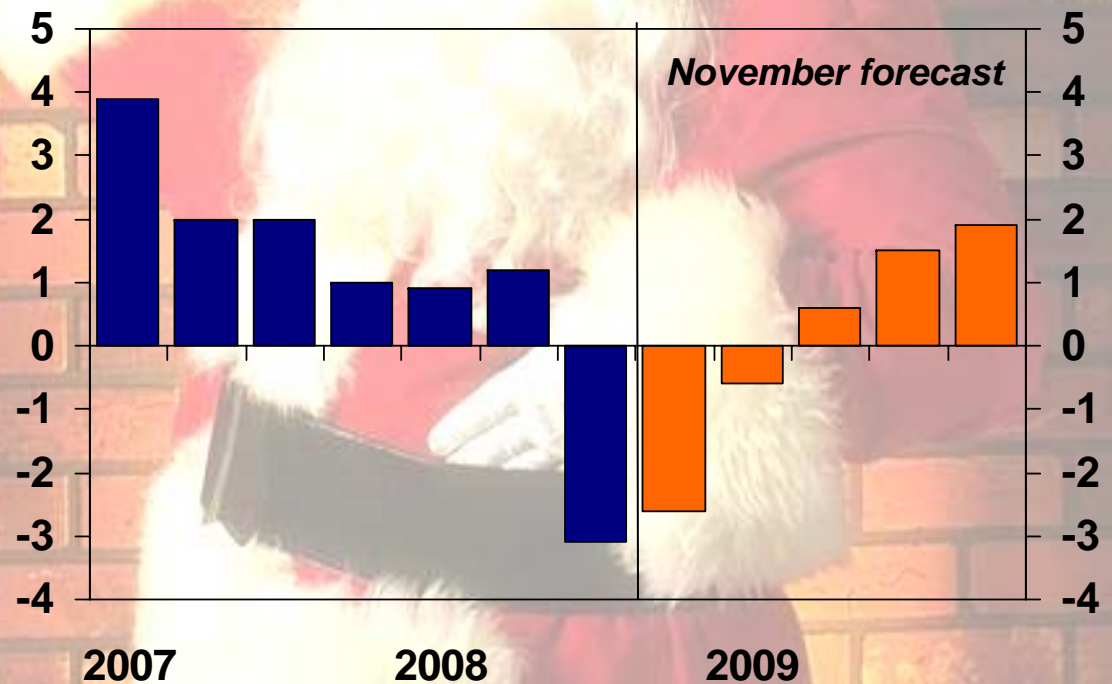
Length of U.S. Recessions

Start	End	Length (Months)
Nov. 1973	Mar. 1975	16
Jan. 1980	Jul. 1980	6
Jul. 1981	Nov. 1982	16
Jul. 1990	Mar. 1991	8
Mar. 2001	Nov. 2001	8
Average since World War II		10

What will Santa Bring This Year?

Consumer Spending

Annualized percent change



***Lumps of Coal
or
Renewed Growth***

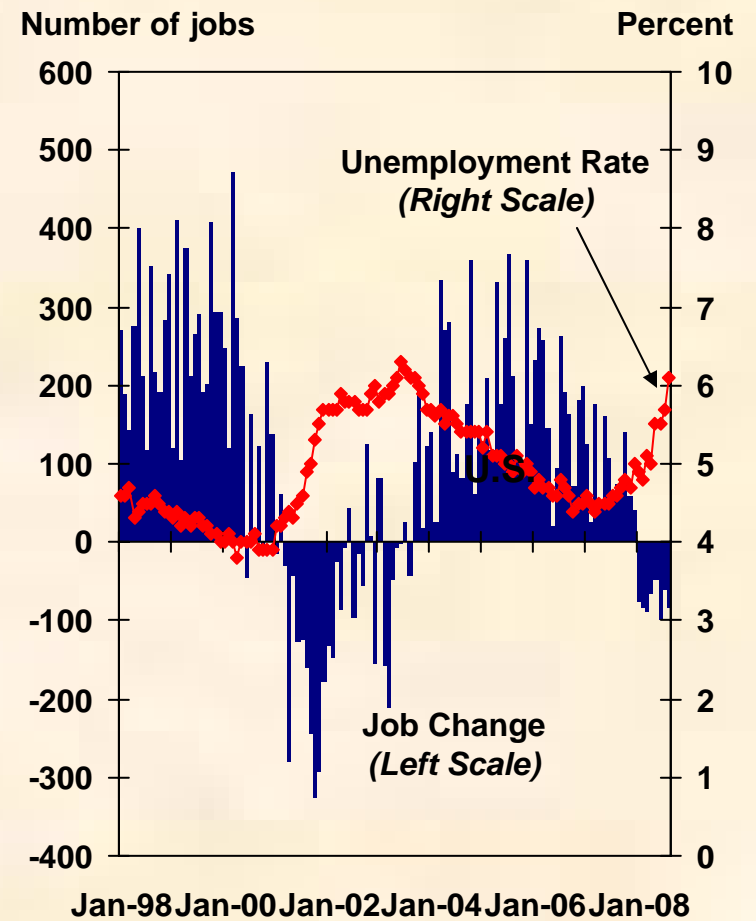
Source: Blue Chip Economic Indicators



Consumer Spending

- Will weaker job markets and income growth limit spending?

U.S. Non-farm Job Growth and Unemployment Rates



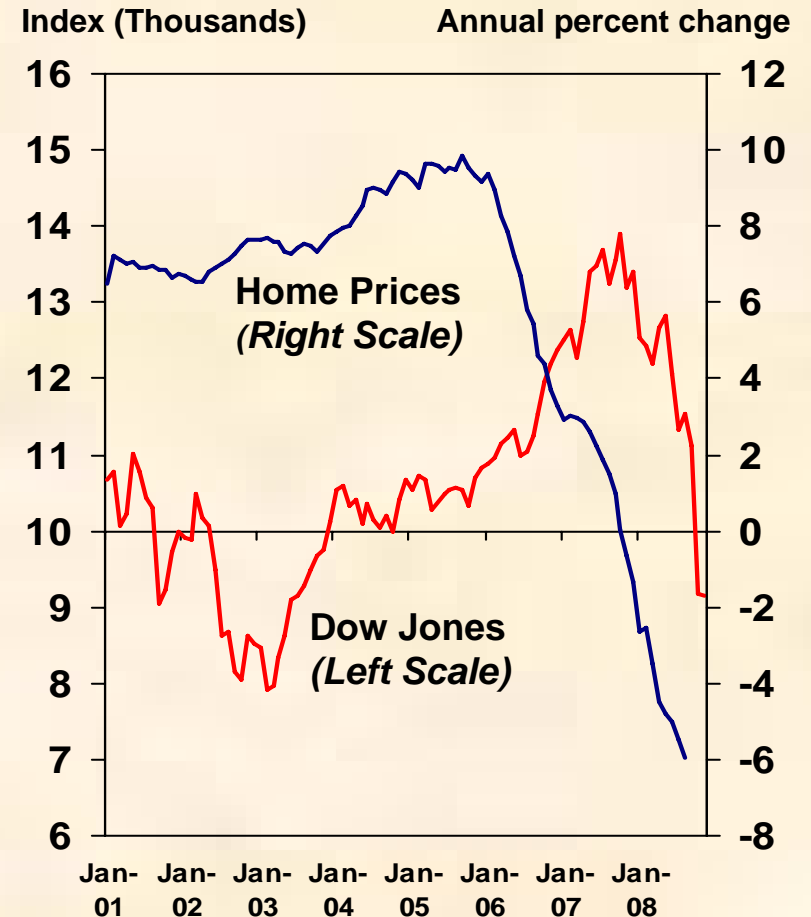
Source: BLS



Consumer Spending

- Will weaker job markets and income growth limit spending?
- Will loss of wealth from lower home values and stock prices limit spending?

Dow Jones Industrial Average and U.S. Home Price Appreciation

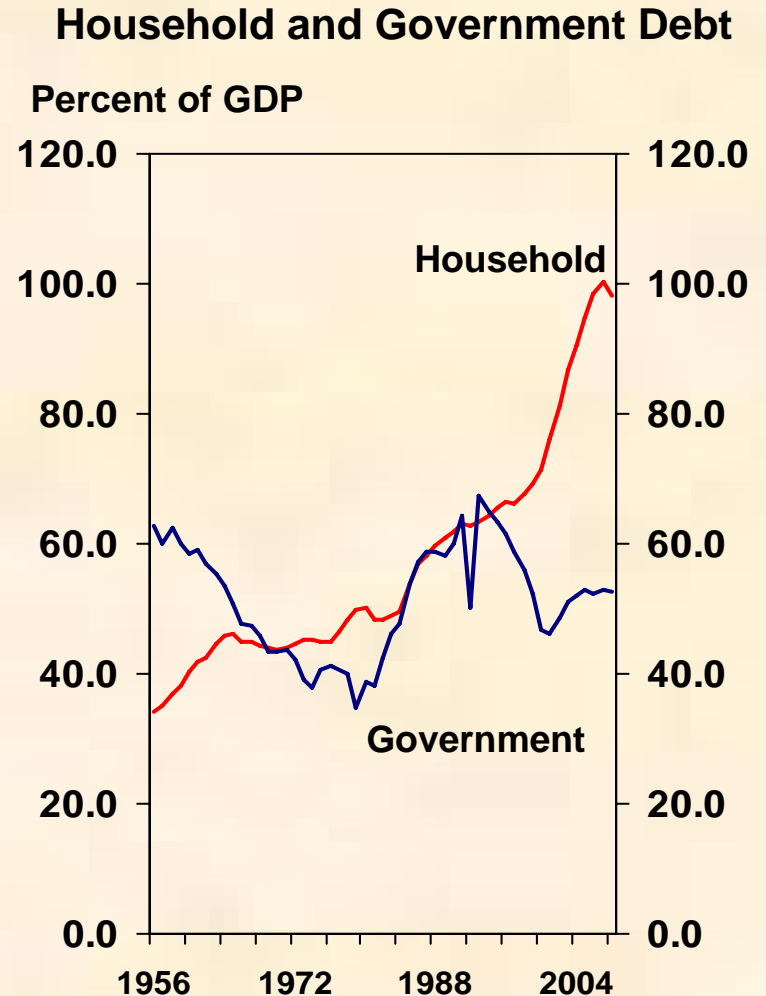


Source: Wall Street Journal and OFHEO



Consumer Spending

- Will weaker job markets and income growth limit spending?
- Will loss of wealth from lower home values and stock prices limit spending?
- Will high consumer debt levels limit spending?



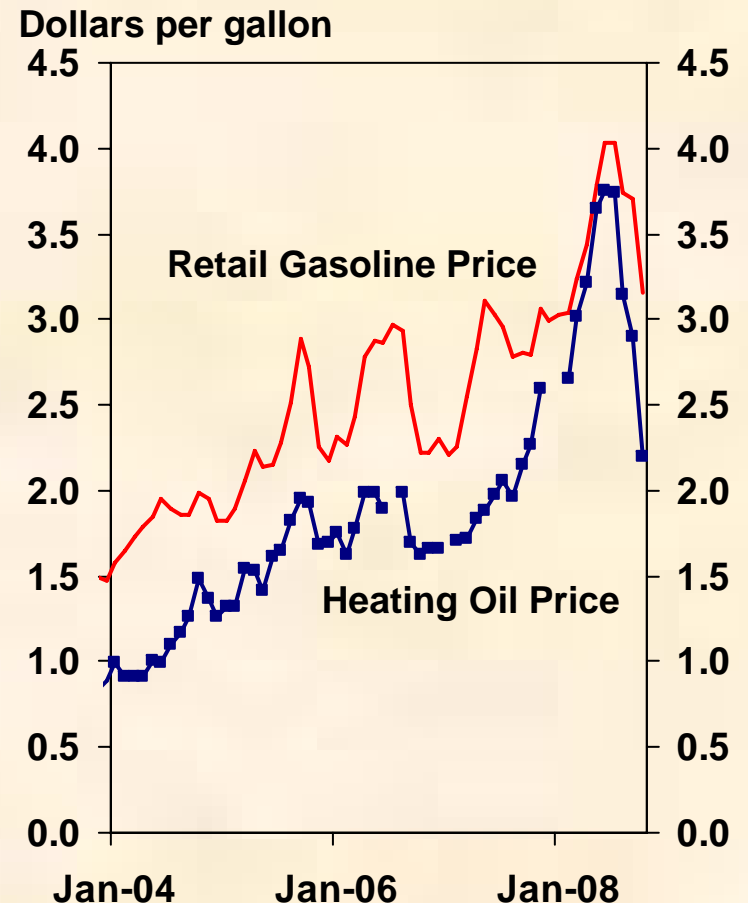
Source: Federal Reserve Board of Governors



Consumer Spending

- Will weaker job markets and income growth limit spending?
- Will loss of wealth from lower home values and stock prices limit spending?
- Will high consumer debt levels limit spending?
- Will lower gasoline and home heating costs boost Christmas shopping?

Gasoline and Heating Oil Price

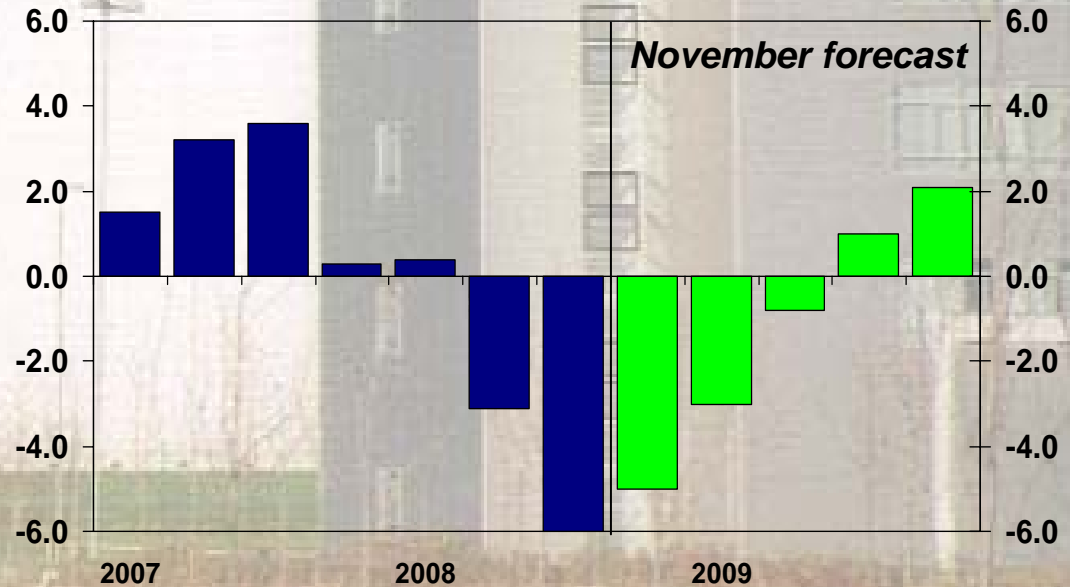


Source: Oil Price Information Service,
Commodity Research Bureau

Will Business Investment Be the Spark?

Industrial Production

Annualized percent change

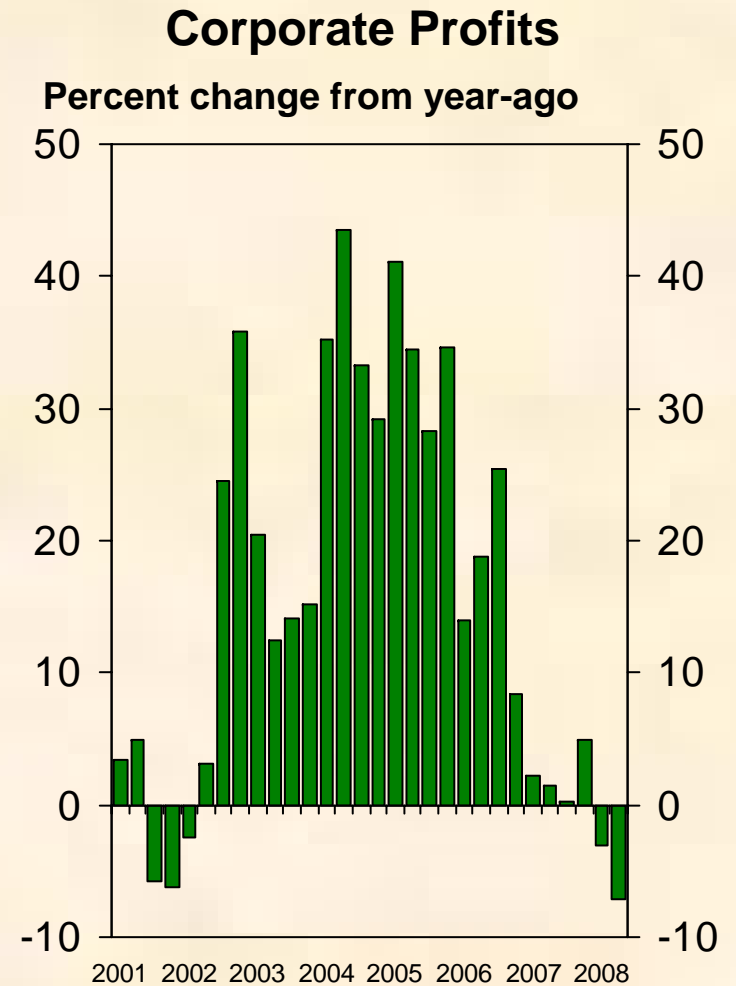


Source: Blue Chip Economic Indicators



Business Investment

- Will profit margins rebound to spur business investment?



Source: BEA



Business Investment

- Will profit margins rebound to spur business investment?
- When will credit standards ease?

**Credit Standards for
Commercial and Industrial Loans**
Percent of Bankers Tightening Standards



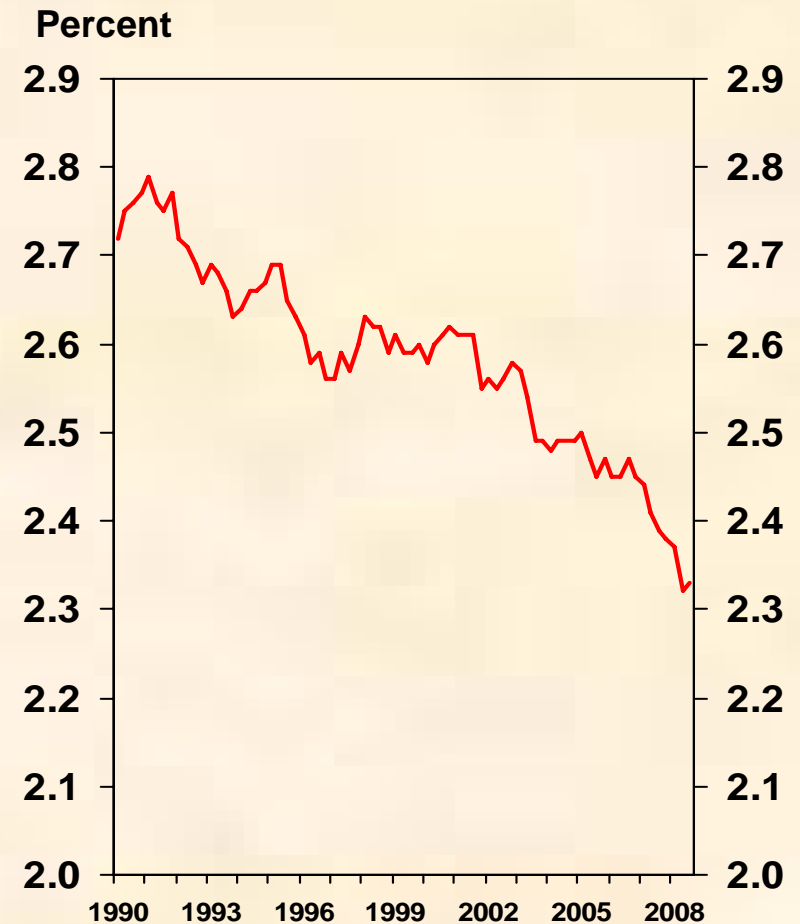
Source: Federal Reserve Board of Governors



Business Investment

- Will profit margins rebound to spur business investment?
- When will credit standards ease?
- Will leaner inventories support a turnaround?

Private Inventory to Final Sales



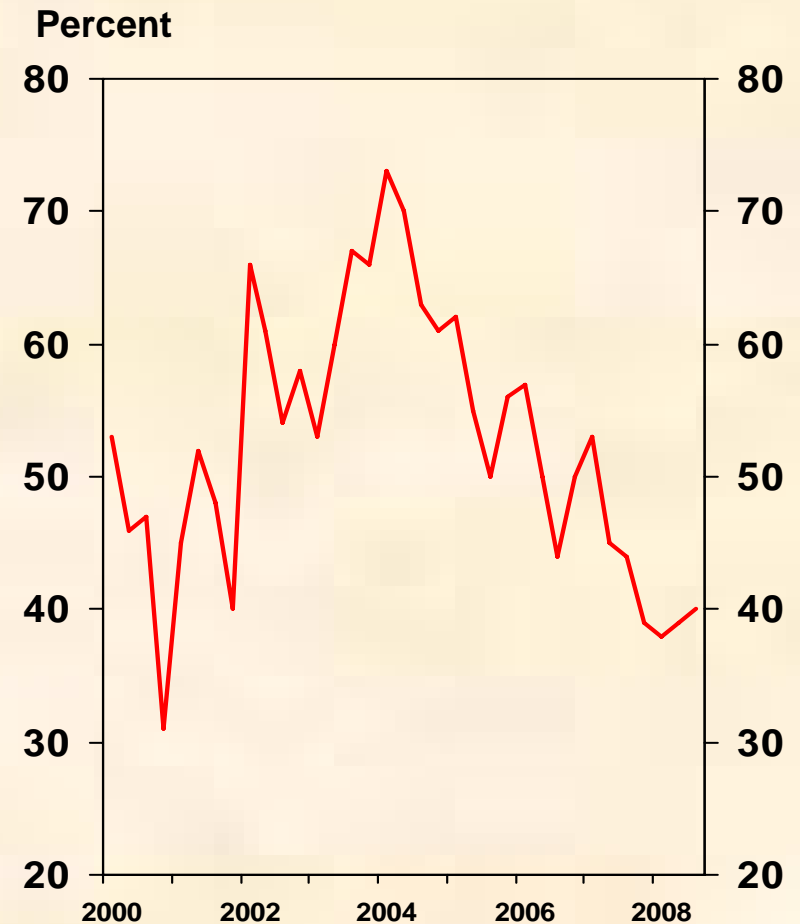
Source: The Conference Board



Business Investment

- **Will profit margins rebound to spur business investment?**
- **When will credit standards ease?**
- **Will leaner inventories support a turnaround?**
- **When will business confidence rebound and will it spur business investment?**

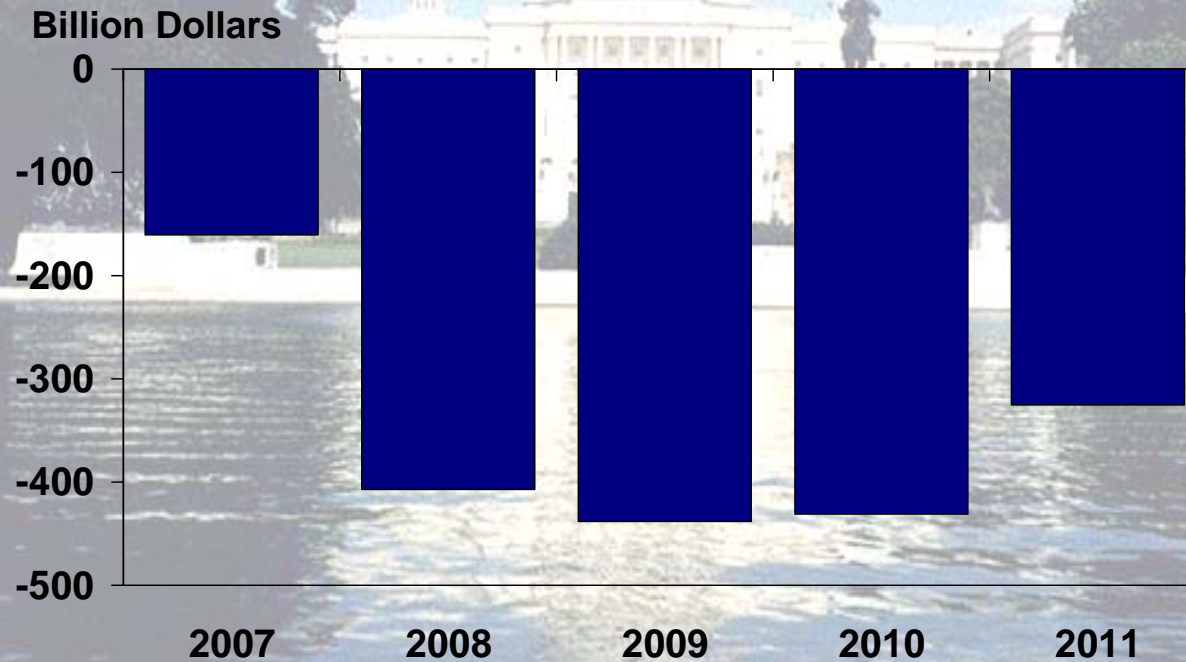
Business Confidence



Source: The Conference Board

Will Deficit Spending Spark a Rebound?

U.S. Federal Budget Deficit Projections



Source: Congressional Budget Office

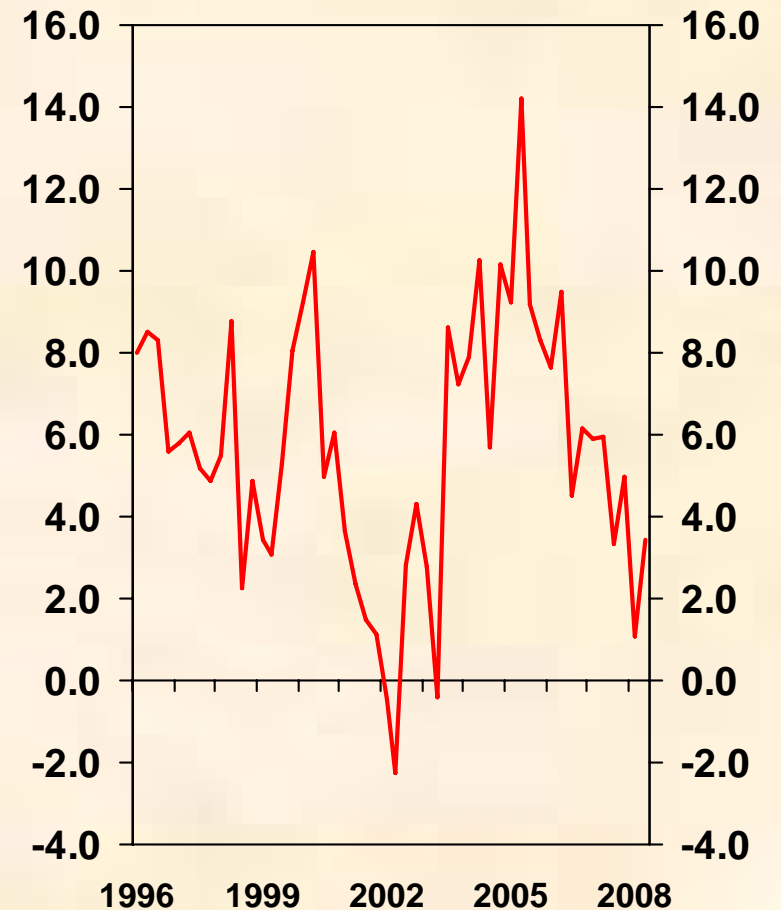


Government Spending

- Will deficit spending spark a rebound?
- Will slower state and local tax revenues contribute to slower growth?

Total State and Local Tax Revenues

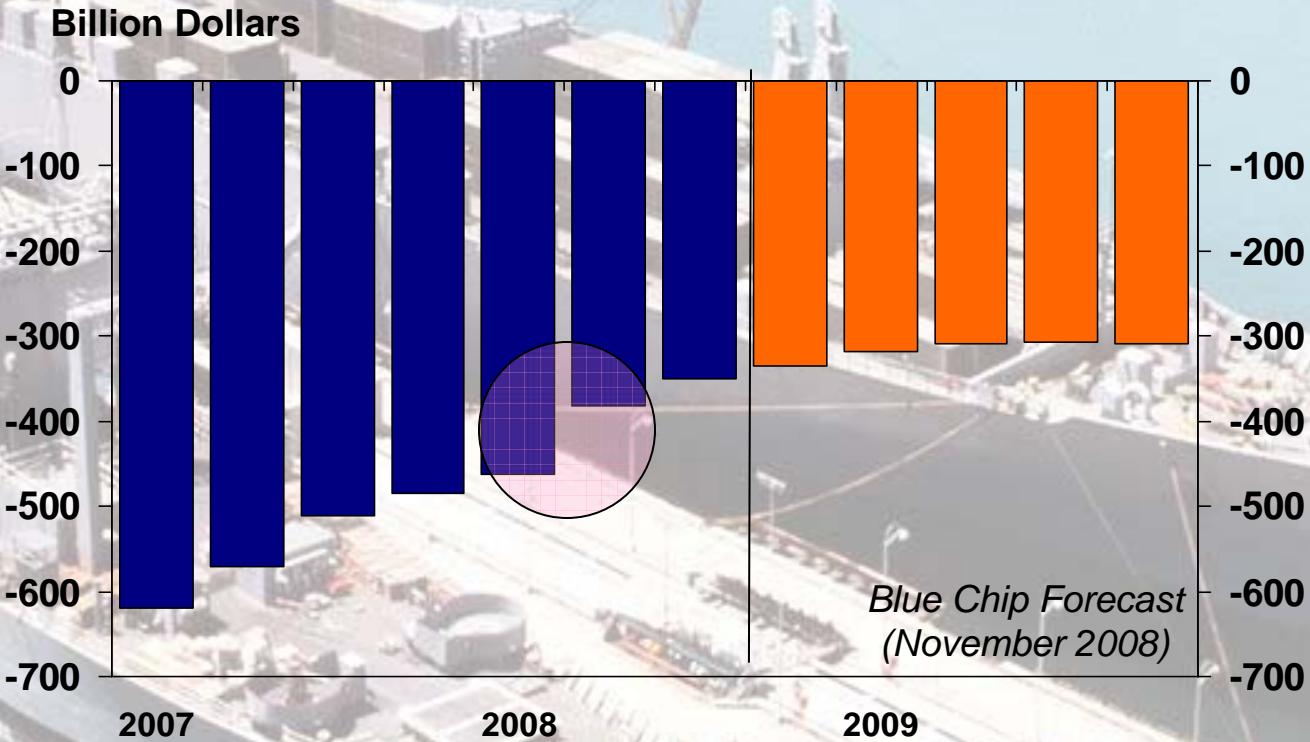
Percent change from year-ago



Source: U.S. Census Bureau

Can Rising Export Activity Spur a Rebound?

Real Net Exports

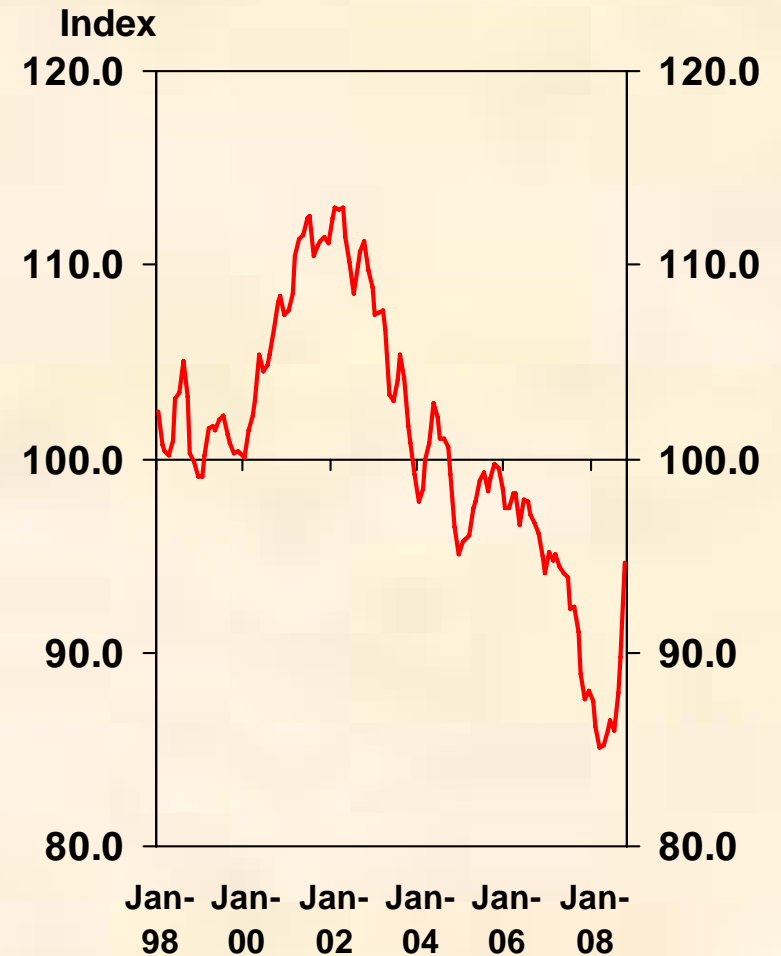


Source: Blue Chip Economic Indicators

Export Activity

- Will the value of the dollar continue to strengthen?

Value of the Dollar



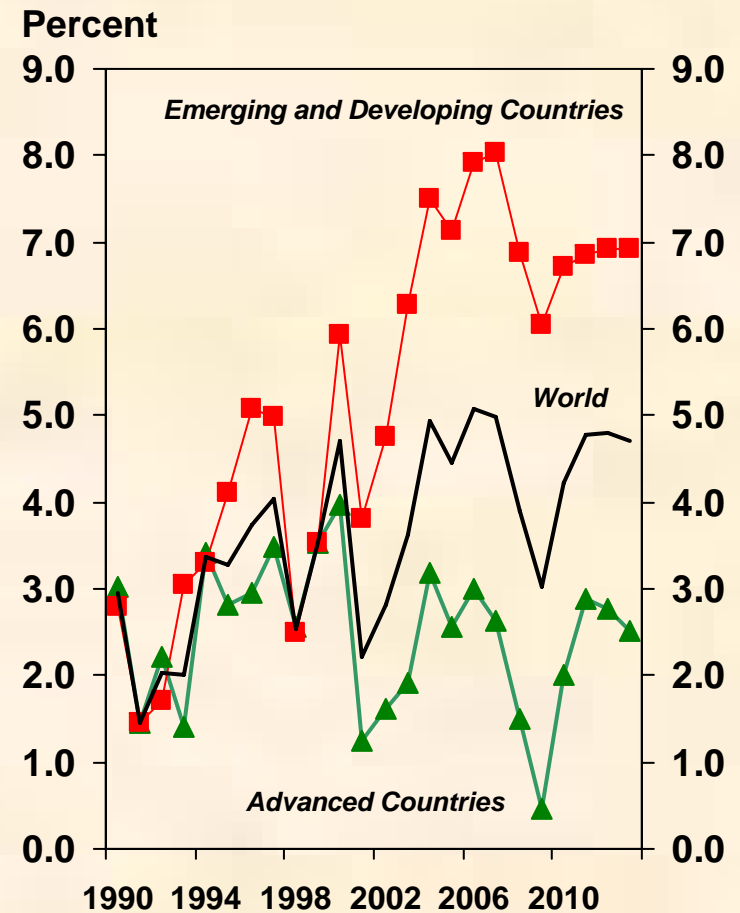
Source: Federal Reserve Board of Governors



Export Activity

- Will the value of the dollar continue to strengthen?
- Will world economic growth rebound as expected?

World Economic Growth

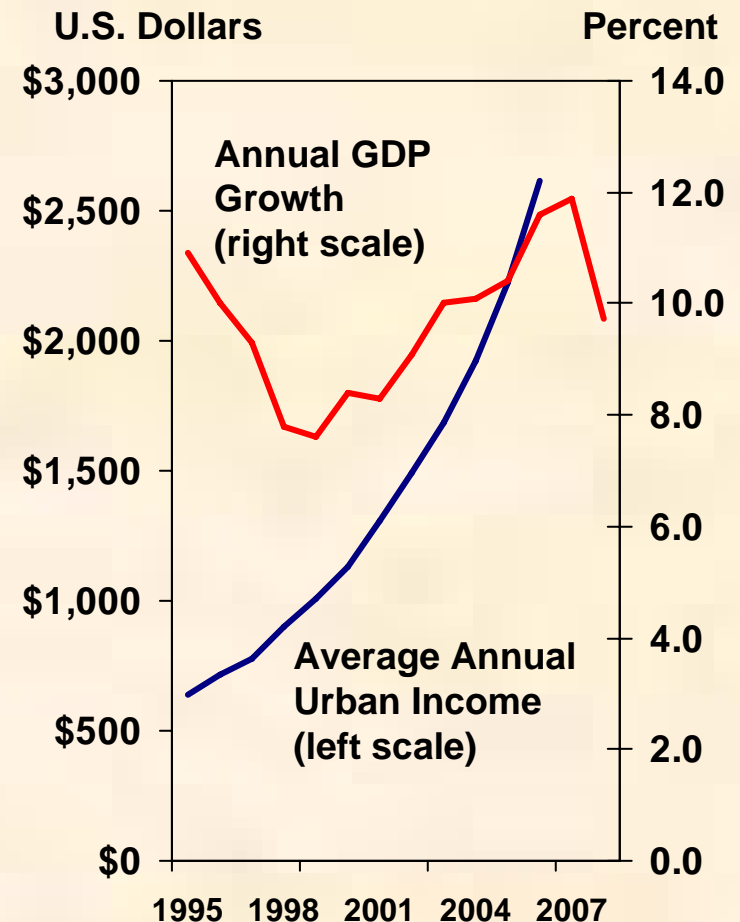


Source: IMF

Export Activity

- Will the value of the dollar continue to strengthen?
- Will world economic growth rebound as expected?
- Will the rising middle class in China continue to demand quality of life improvements?

Economic Growth in China



Source: IMF and China Statistical Yearbook

Conclusion

- **Housing risks fueled financial market volatility – when will they stabilize?**
- **Commodity prices have dropped with weaker global demand.**
- **Weak economic activity is expected to dampen inflationary pressures.**
- **What will spark the economic rebound?**

