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The Economy and Banking



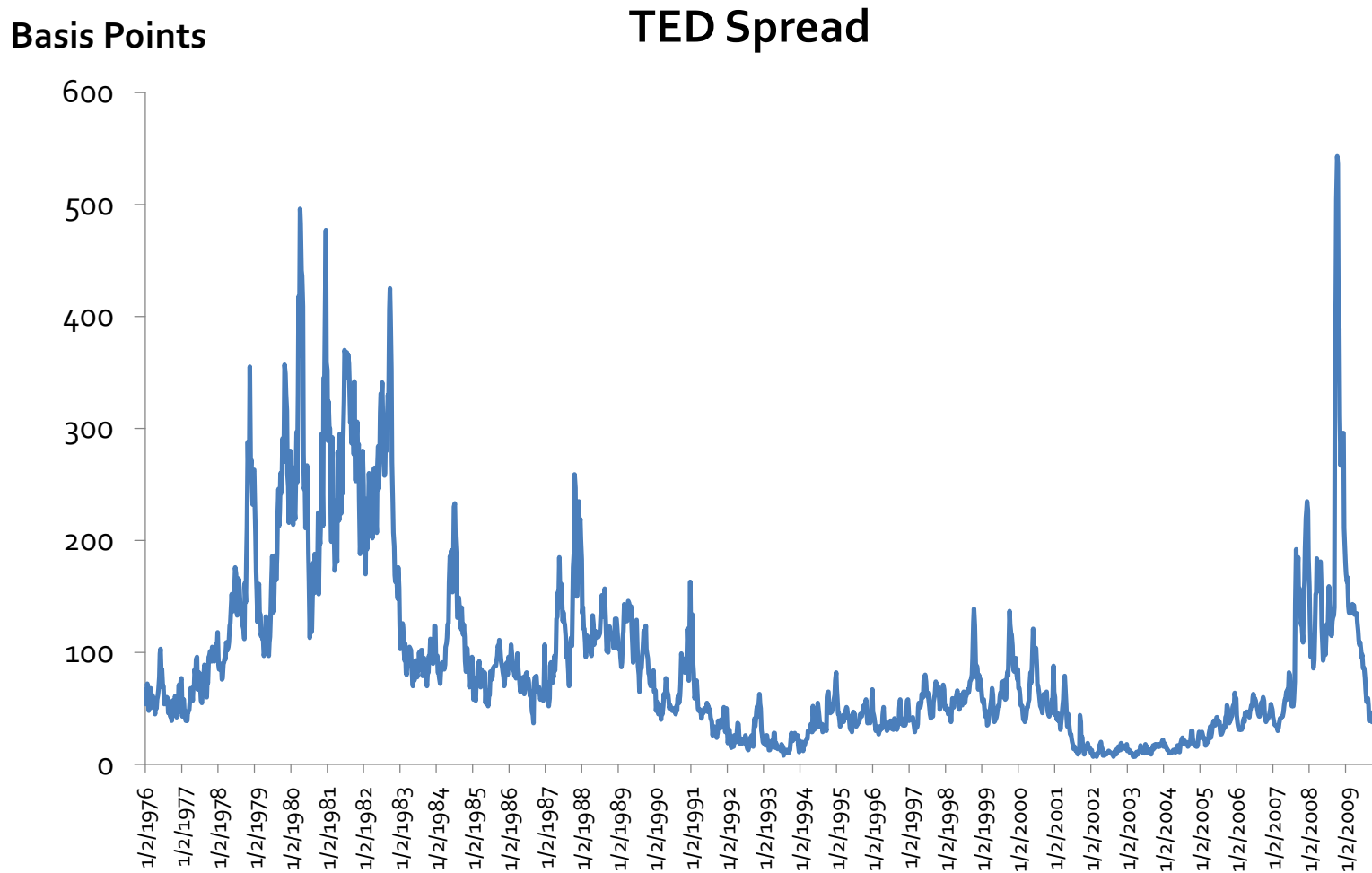
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Today's Roadmap

- **The financial crisis has eased, but risks still exist**
- **Economic update**
- **What to make of concerns regarding future inflation, disinflation, and deflation**



The financial market crisis has eased.



Source: Federal Reserve Board of Governors



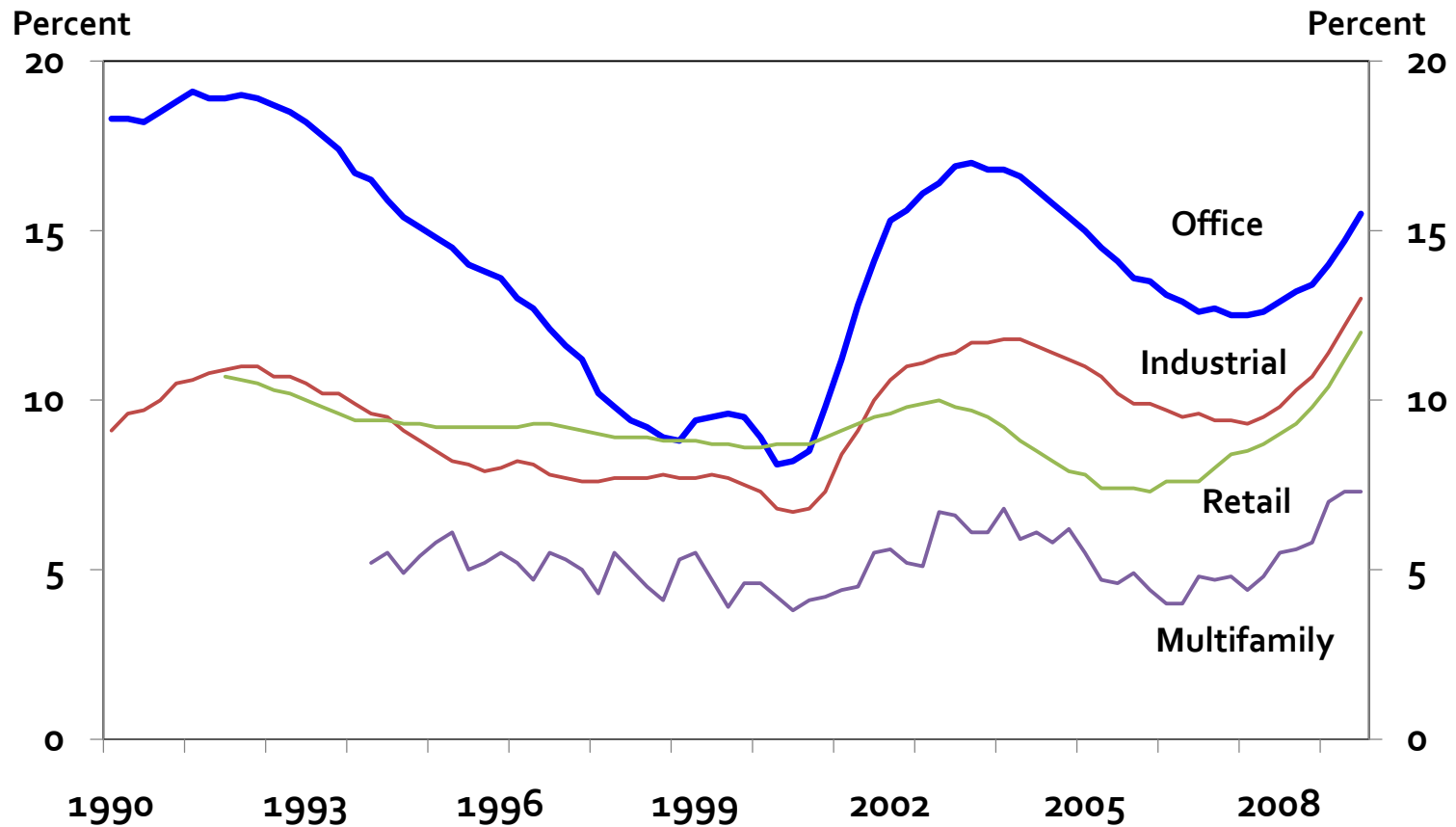
While the financial crisis has eased, risks still exist in the economy.

- Probably the one risk most talked about today is commercial real estate (CRE)
- Most banks are exposed to CRE and/or have exposures to commercial mortgage backed securities (CMBS)
- Eventually, CRE will need to be refinanced...who will do this in today's market?



U.S. commercial vacancy rates are rising.

U.S. Commercial Real Estate Vacancy Rates

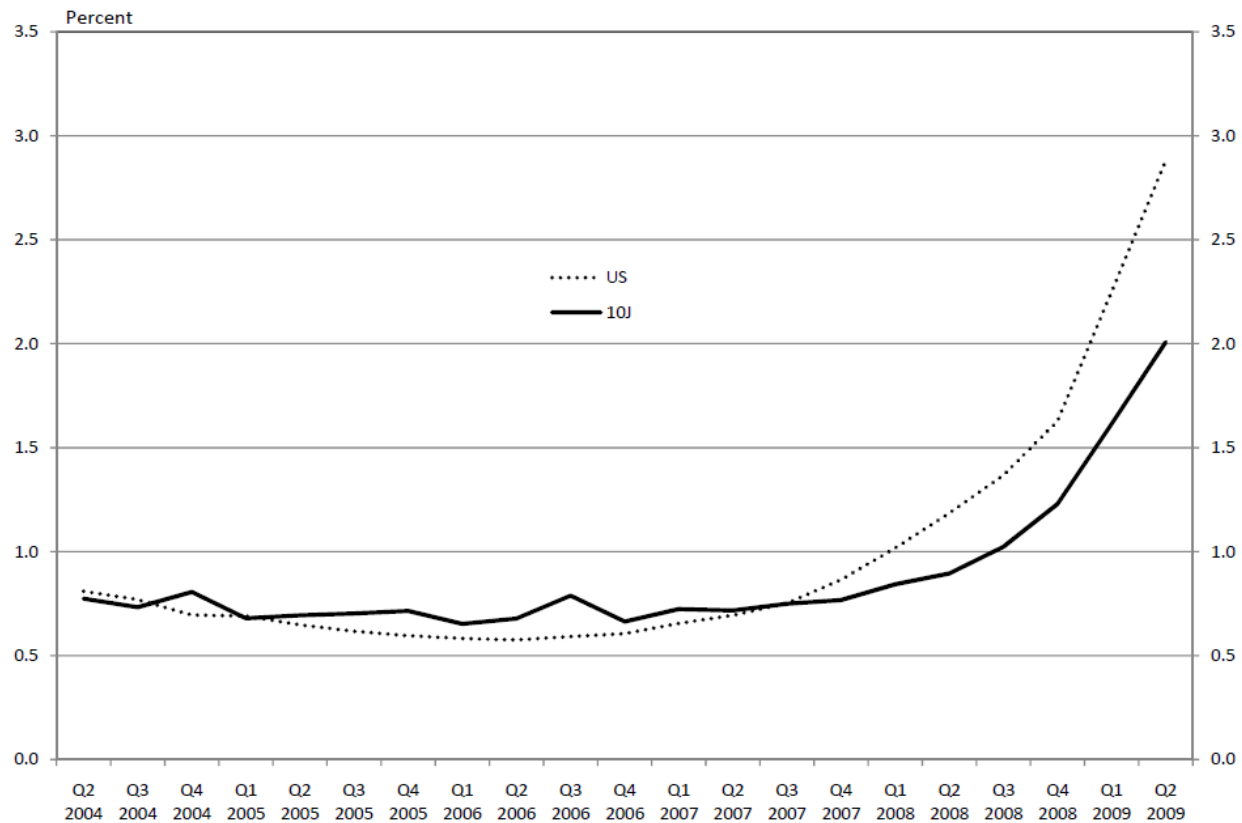


Source: Torto-Wheaton Research



The share of CRE loans past due are rising.

Share of CRE loans past due

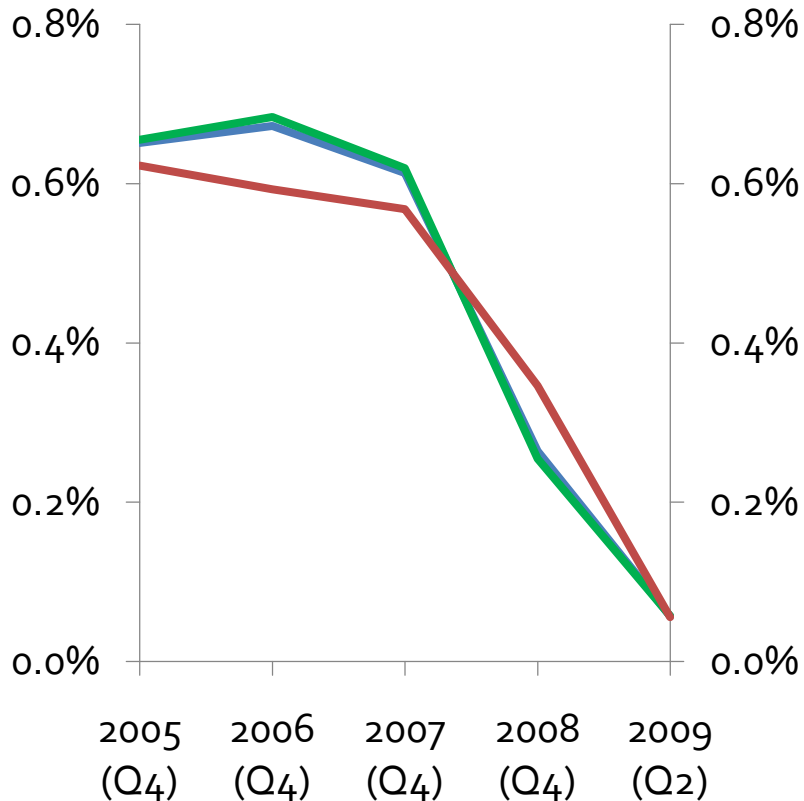


Source: FDIC



While commercial banks' profitability has fallen, capital levels have risen.

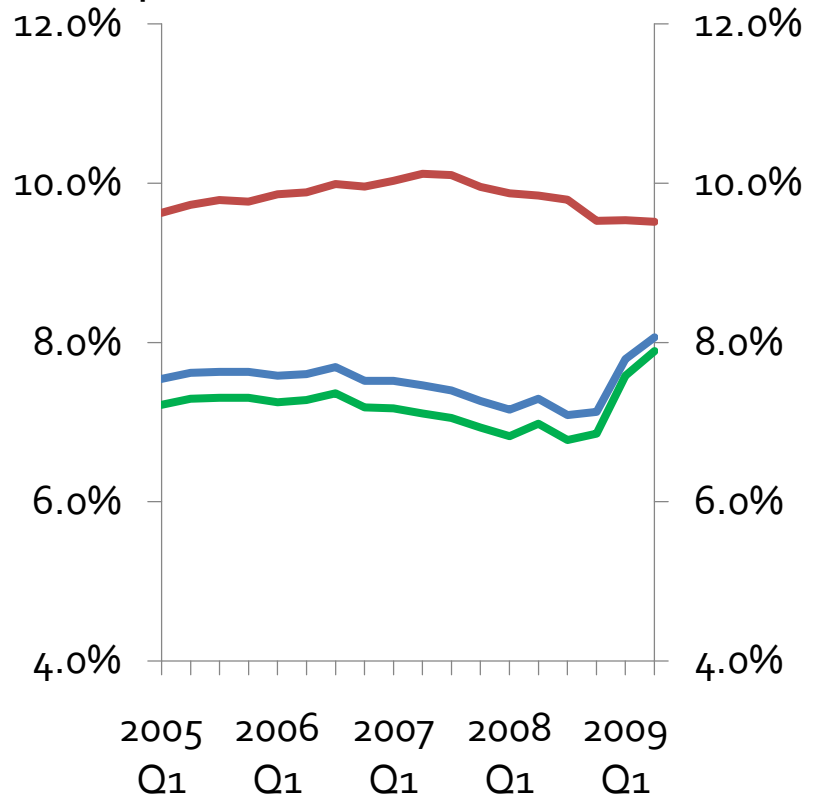
Return on Assets



— All Commercial Banks
 — Banks > \$1B Assets
— Banks < \$1B Assets

Source: FDIC

Tier 1 Capital Ratio



— All Commercial Banks
 — Banks > \$1B Assets
— Banks < \$1B Assets

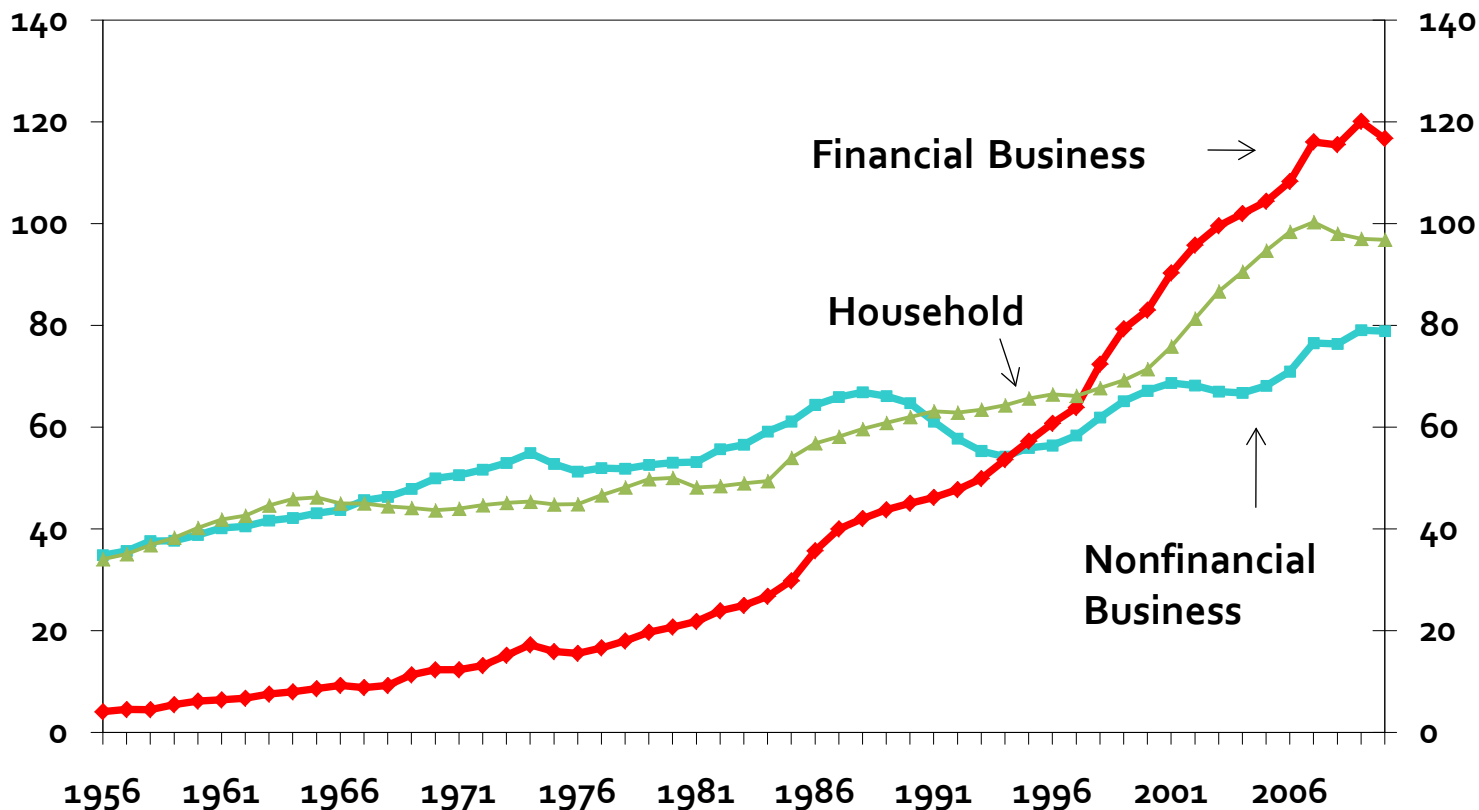
Source: FDIC



The U.S. is going through a de-leveraging process.

Domestic Debt Outstanding

Percent of GDP



Source: Federal Reserve Board of Governors



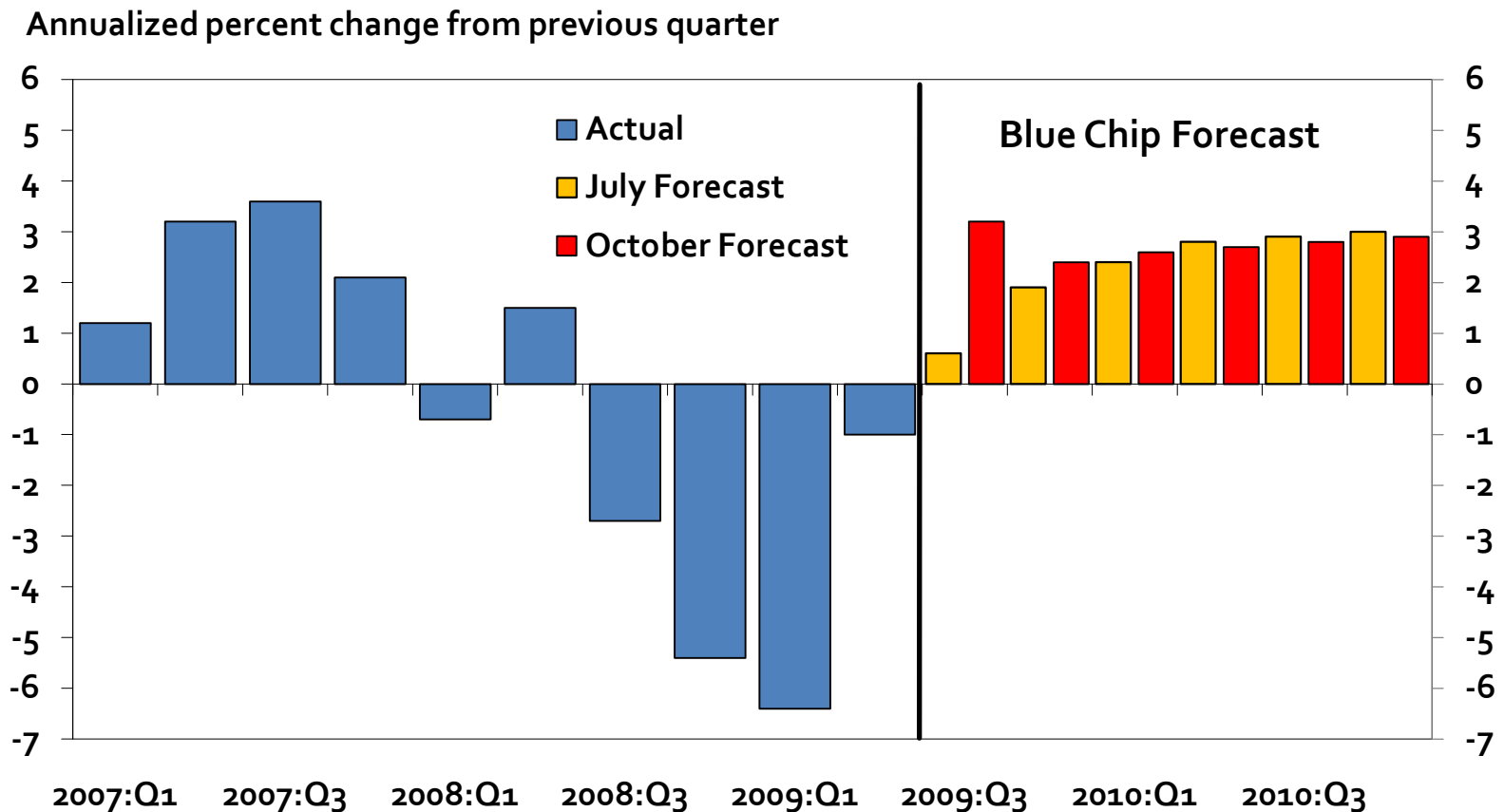
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Forecasters expect we have hit bottom and should return to growth.

Real GDP Growth

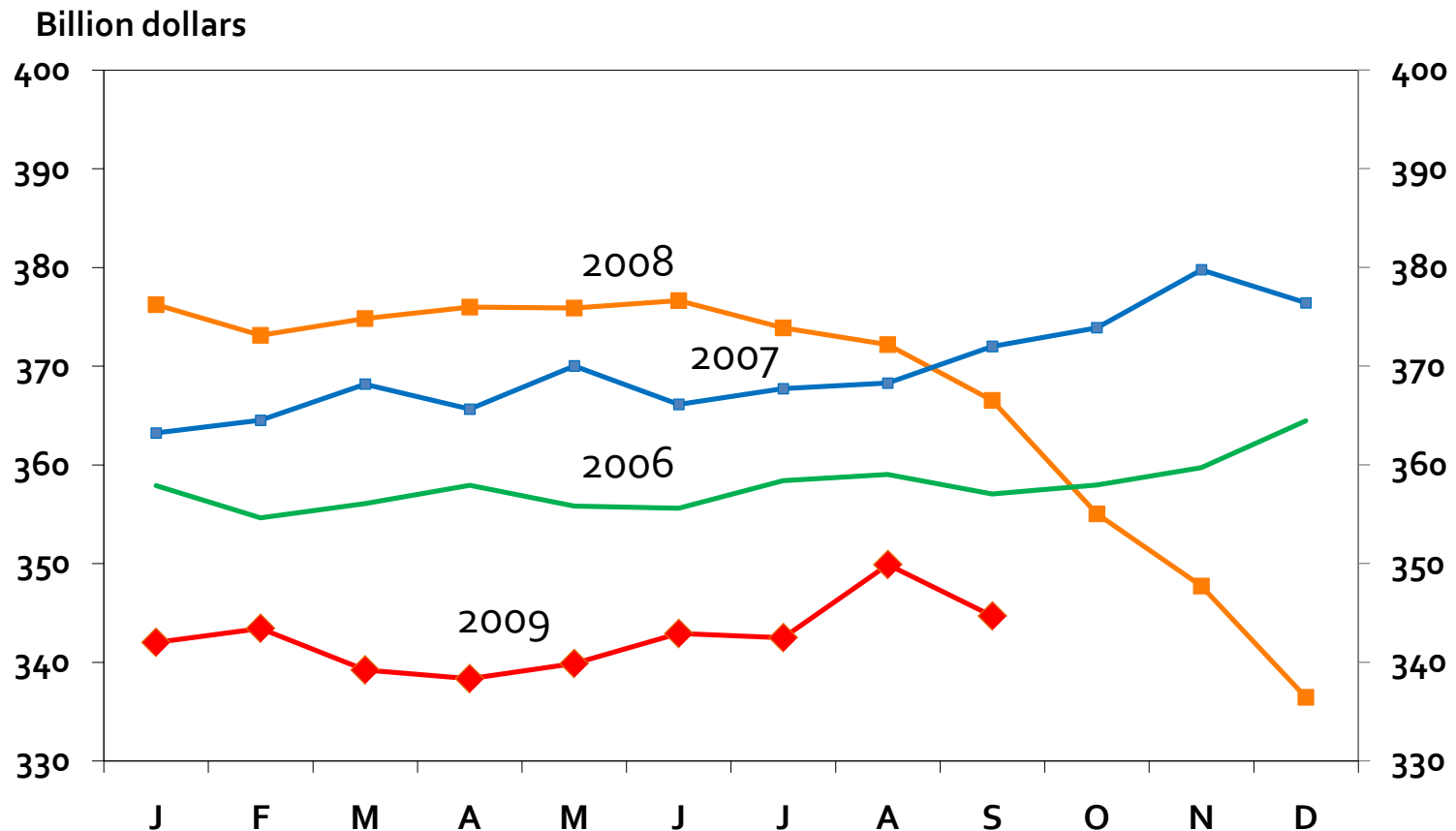


Source: Bureau of Economic Analysis and Blue Chip Economic Indicators



Since 2008, retail sales have fallen. Recent boost from cash-for-clunkers, but is it sustainable?

U.S. Monthly Retail and Food Sales

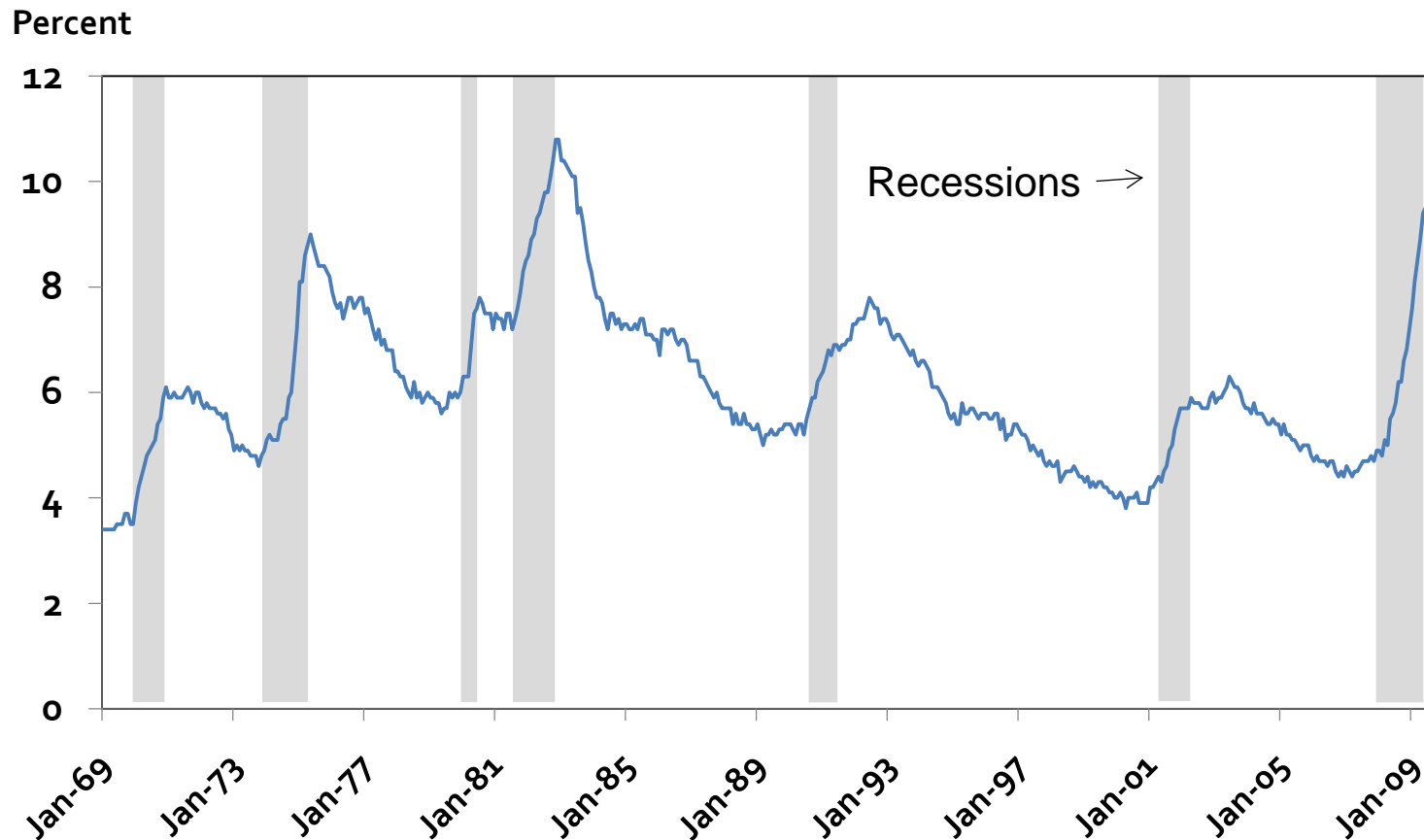


Source: U.S. Census Bureau



The unemployment rate continues to rise.

U.S. Unemployment Rate

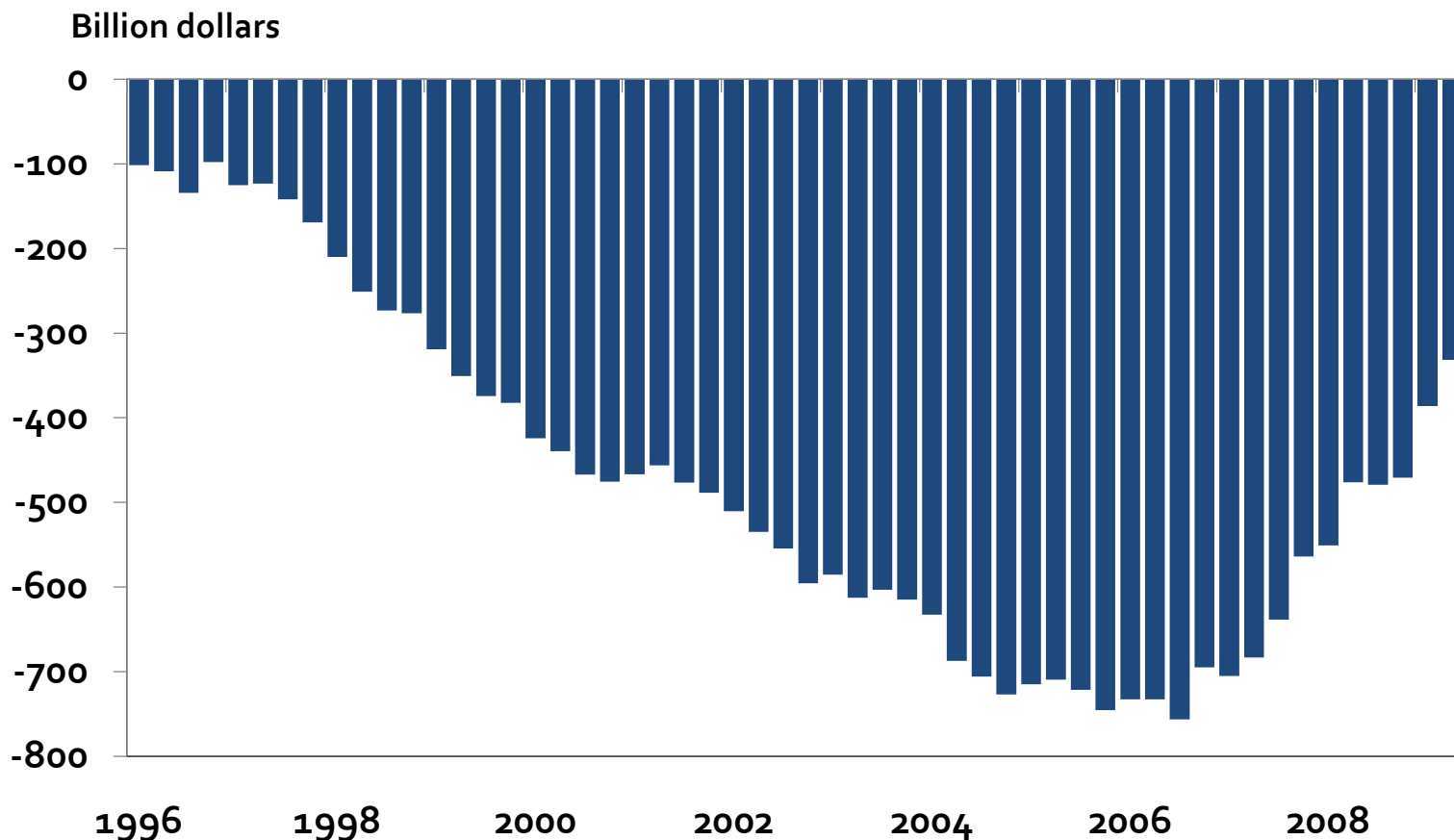


Source: Bureau of Economic Analysis



Improvements in the U.S. trade balance continue.

Real Net Exports of Goods and Services



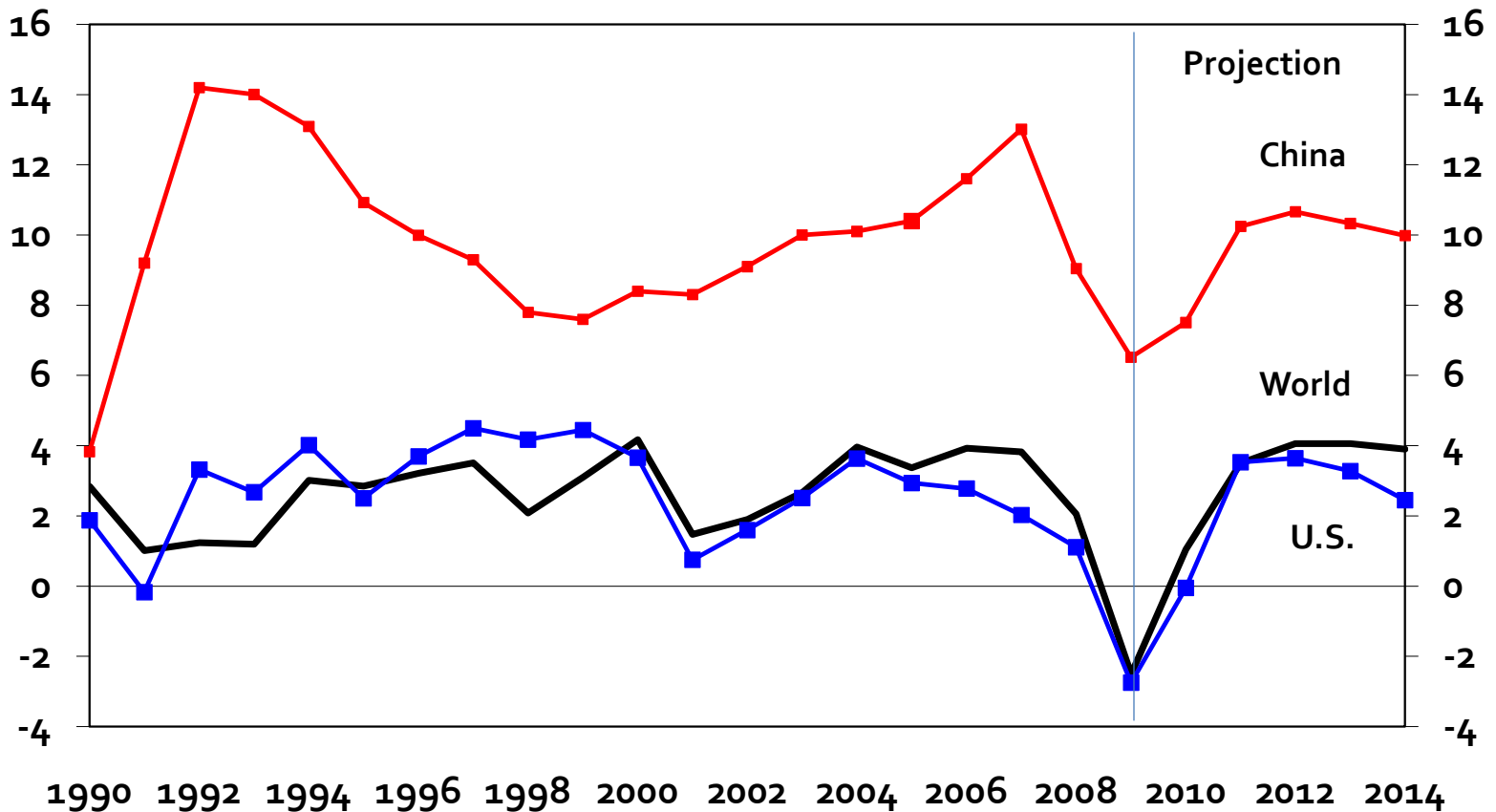
Source: Bureau of Economic Analysis



Will emerging countries lead the recovery?

GDP Growth

Annual percent change, constant dollars



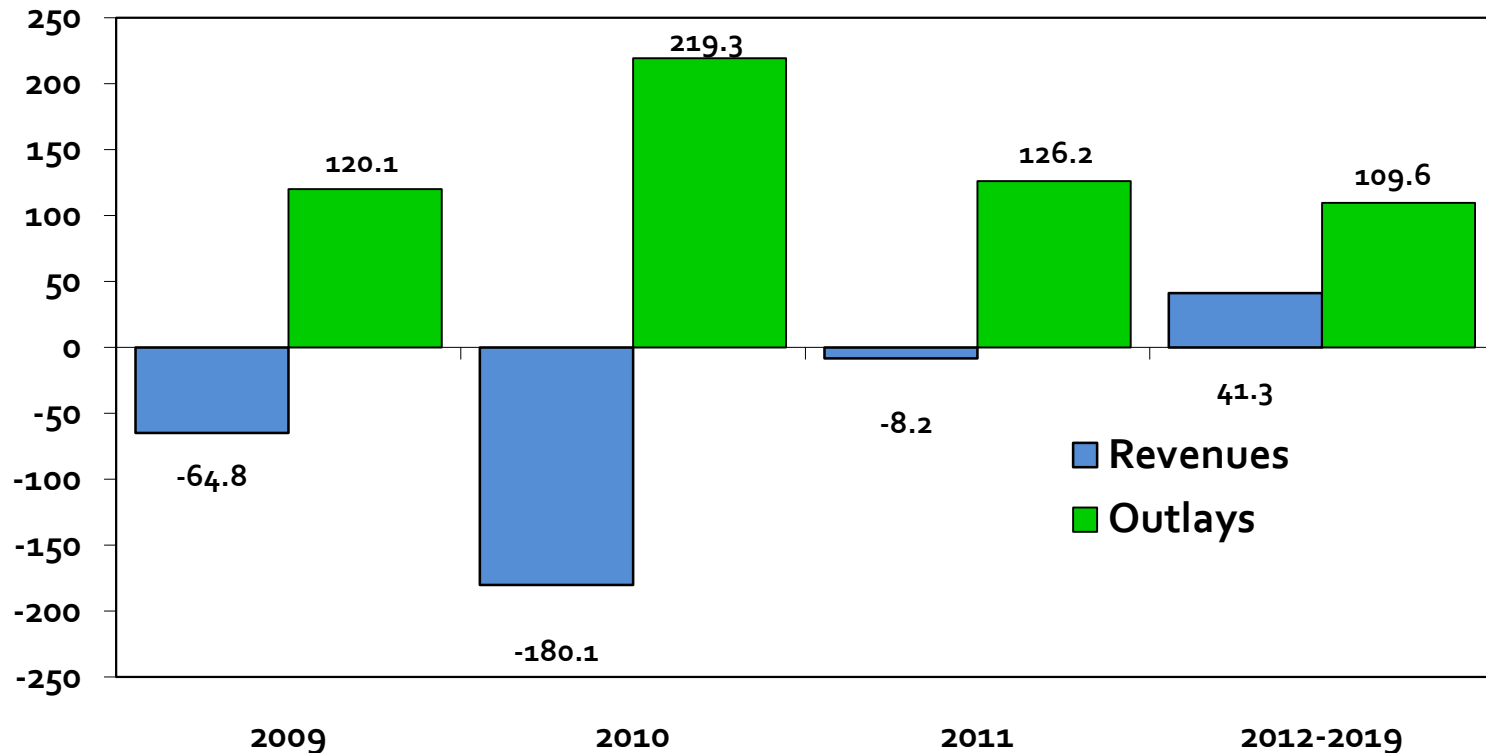
Source: International Monetary Fund, April 2009



The bulk of the stimulus package comes in 2010.

Estimated Budget Impact of American Recovery and Reinvestment Act (ARRA) of 2009

Billion Dollars



Source: Congressional Budget Office, February 13, 2009



Today's Roadmap

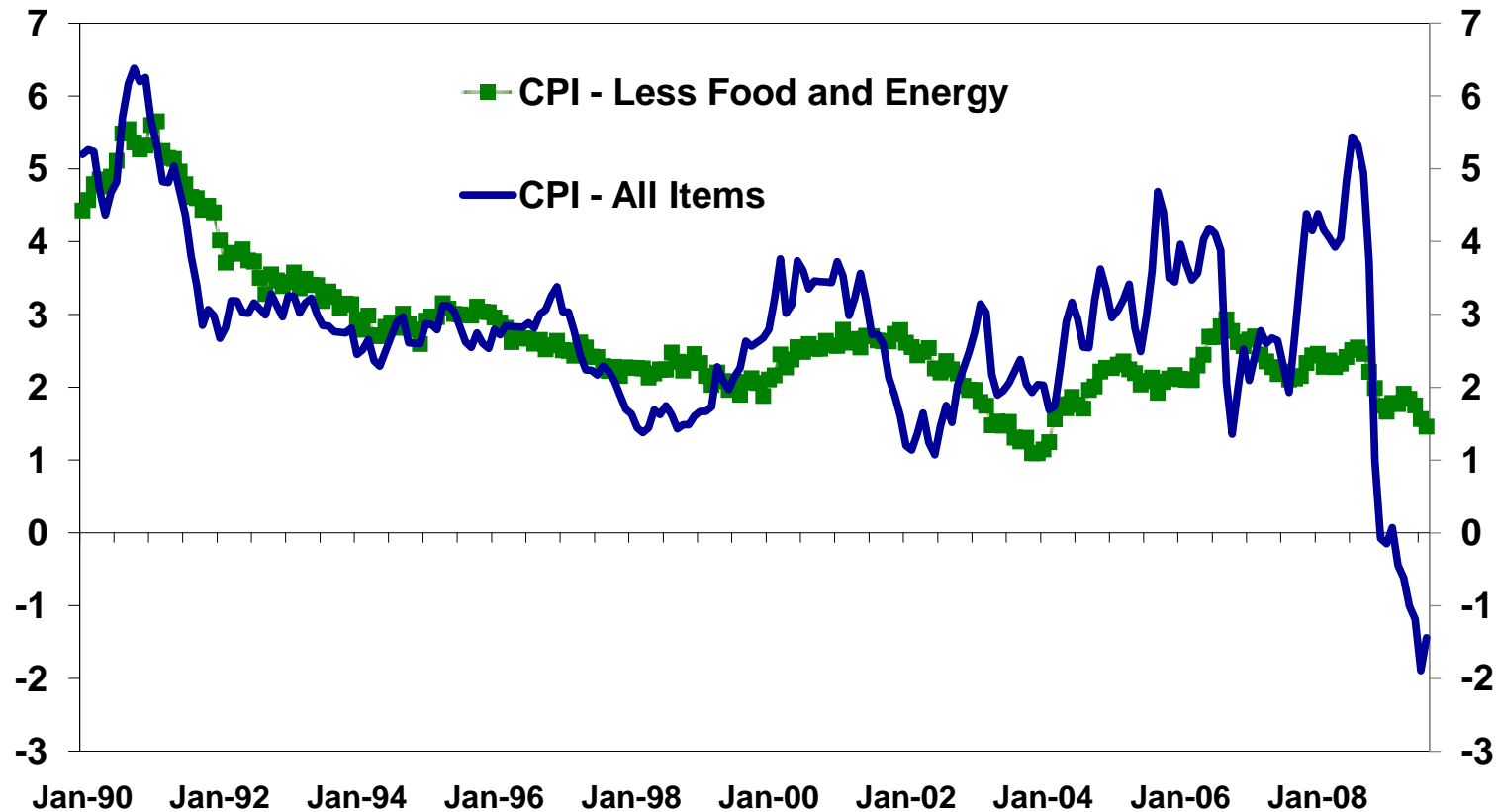
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The U.S. is experiencing disinflation.

Consumer Price Inflation

Percent



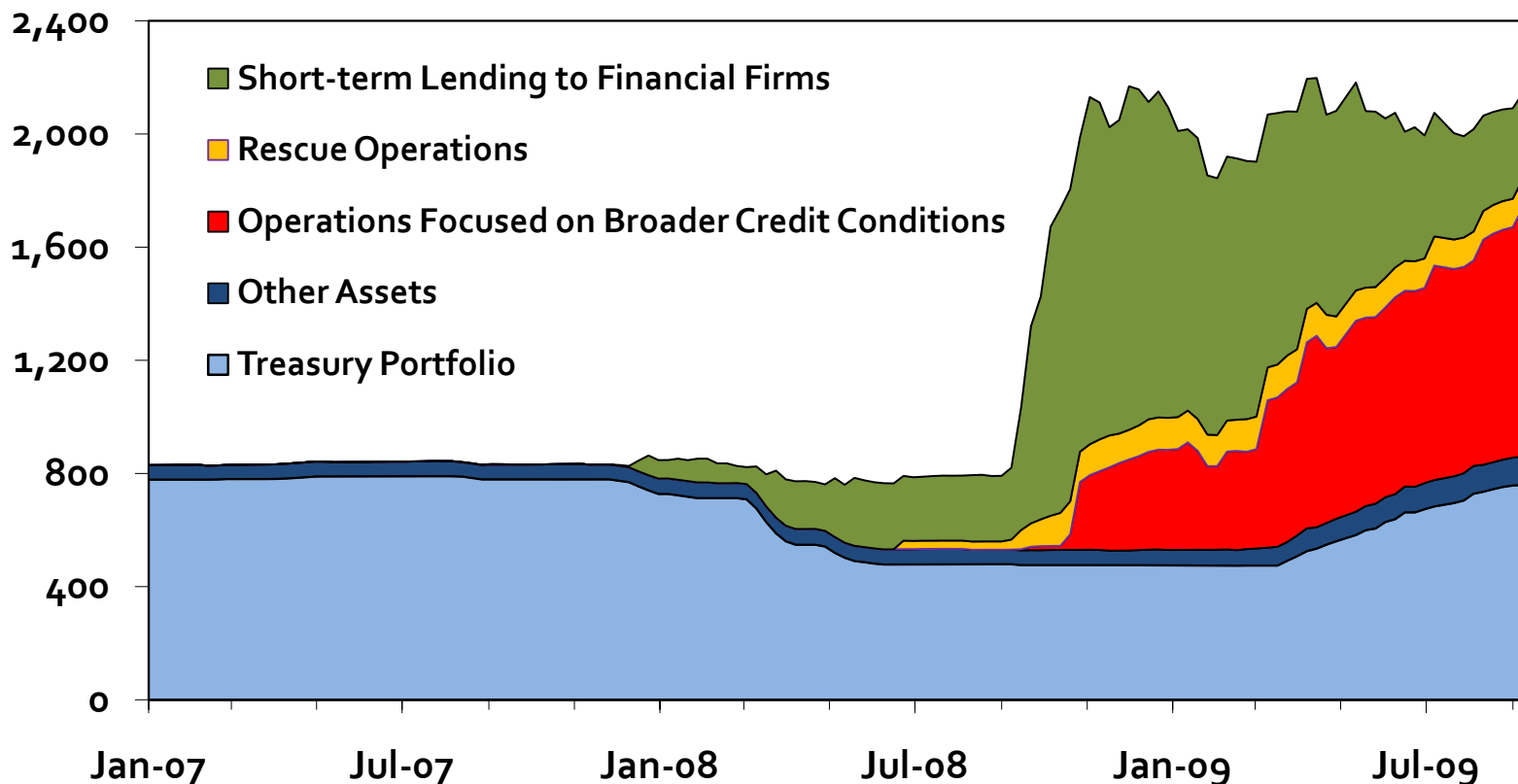
Source: Bureau of Labor Statistics



With the Fed Funds Rate at the zero bound, the Fed has expanded its balance sheet.

Federal Reserve Balance Sheet: Assets

Billion Dollars

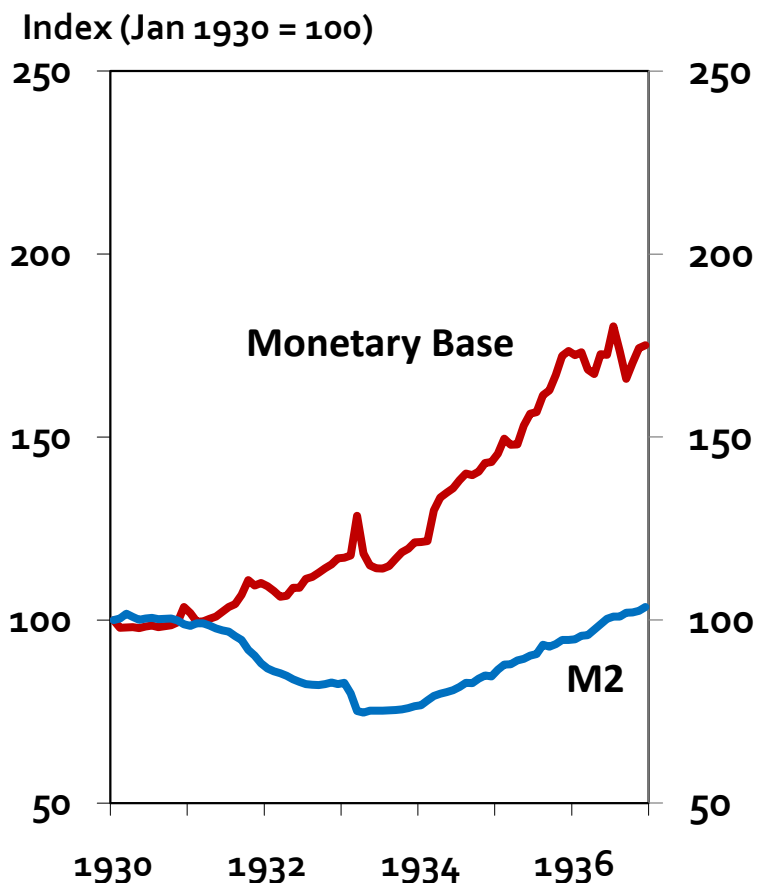


Source: Federal Reserve Board of Governors

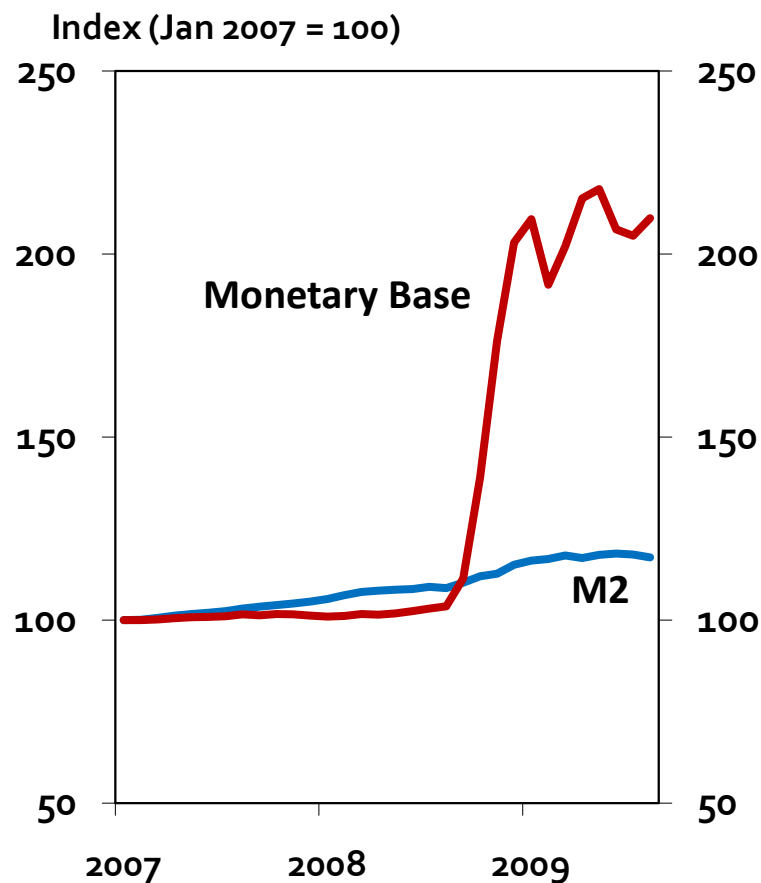


Unlike the Great Depression, money stock (M2) has edged up with a surge in the monetary base.

Growth in Monetary Aggregates



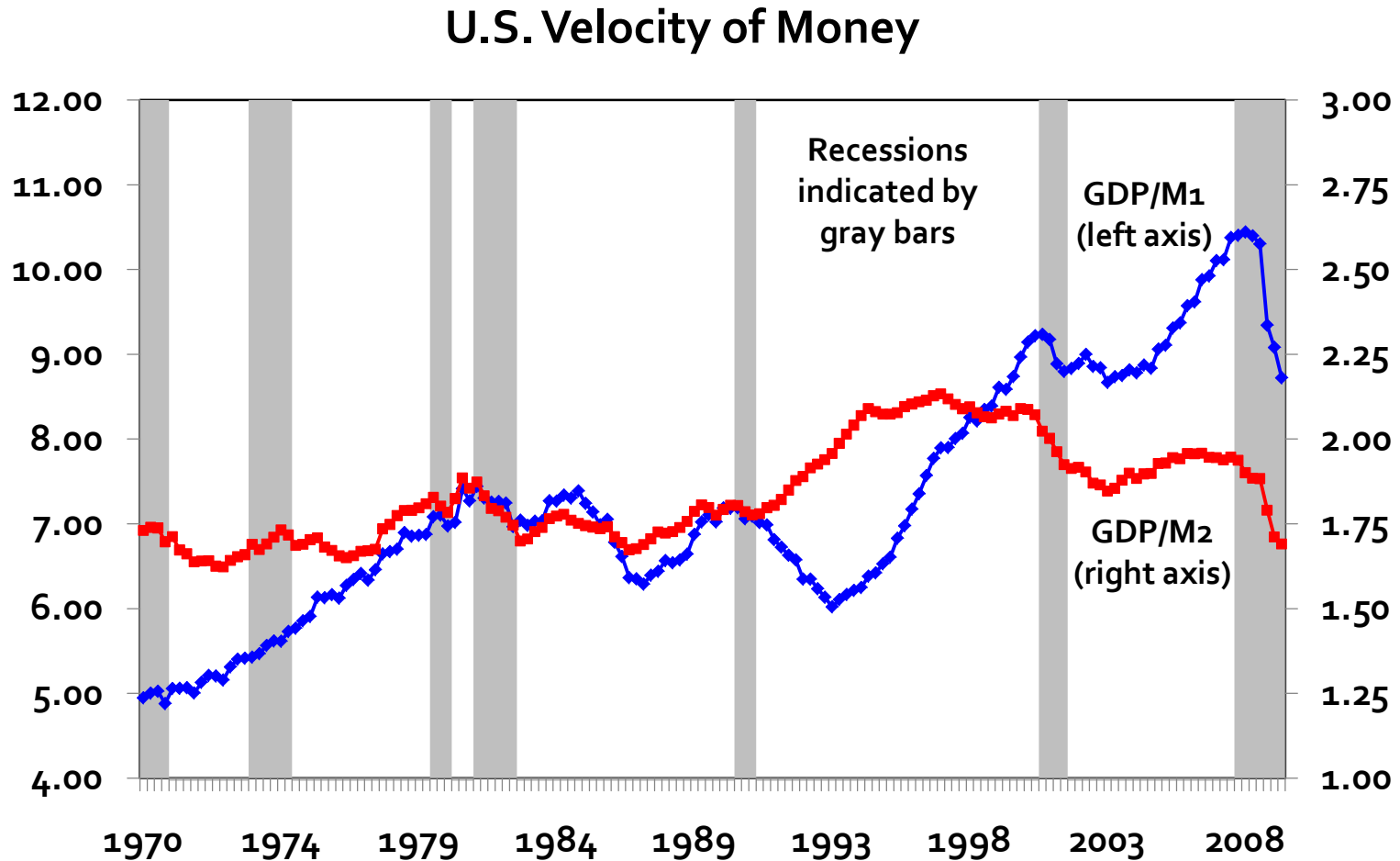
Source: Federal Reserve Bank of St. Louis, Friedman and Schwartz



Source: Federal Reserve Board of Governors



The velocity of money has plummeted.



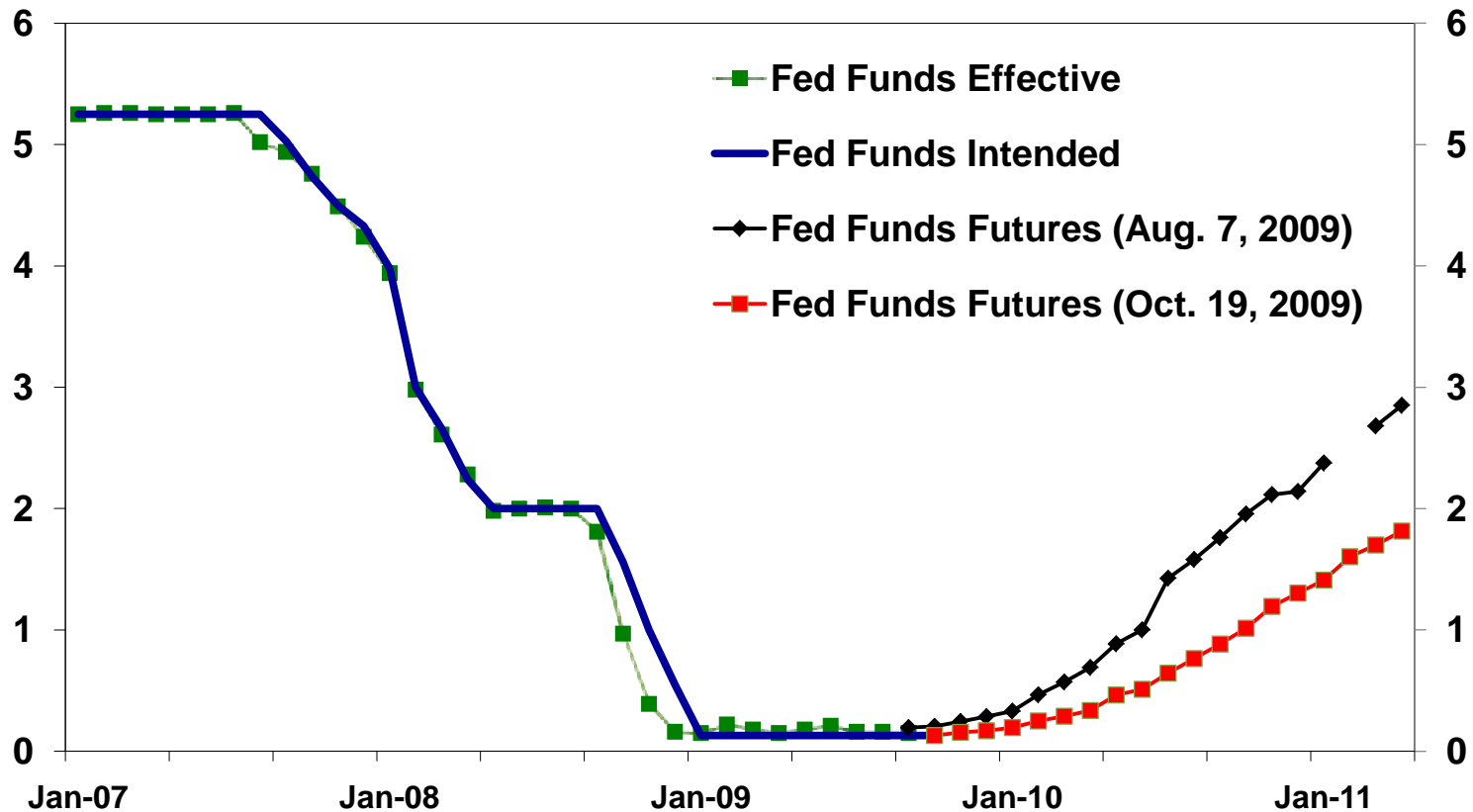
Source: BEA and Federal Reserve Board of Governors



What is the future path of interest rates?

Fed Funds Rate

Percent



Source: Federal Reserve Board of Governors and CME Group



Conclusion

- **The financial crisis and recession appear to be ending, but risks surround the recovery.**
- **The outlook hinges on consumer spending, both in the U.S. and globally.**
- **As the recovery strengthens, questions will switch from growth to inflation.**
- **When will consumers and investors start “chasing”?**



For More Information

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