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November 19th, 2010

Economic Outlook – A Year Later



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.

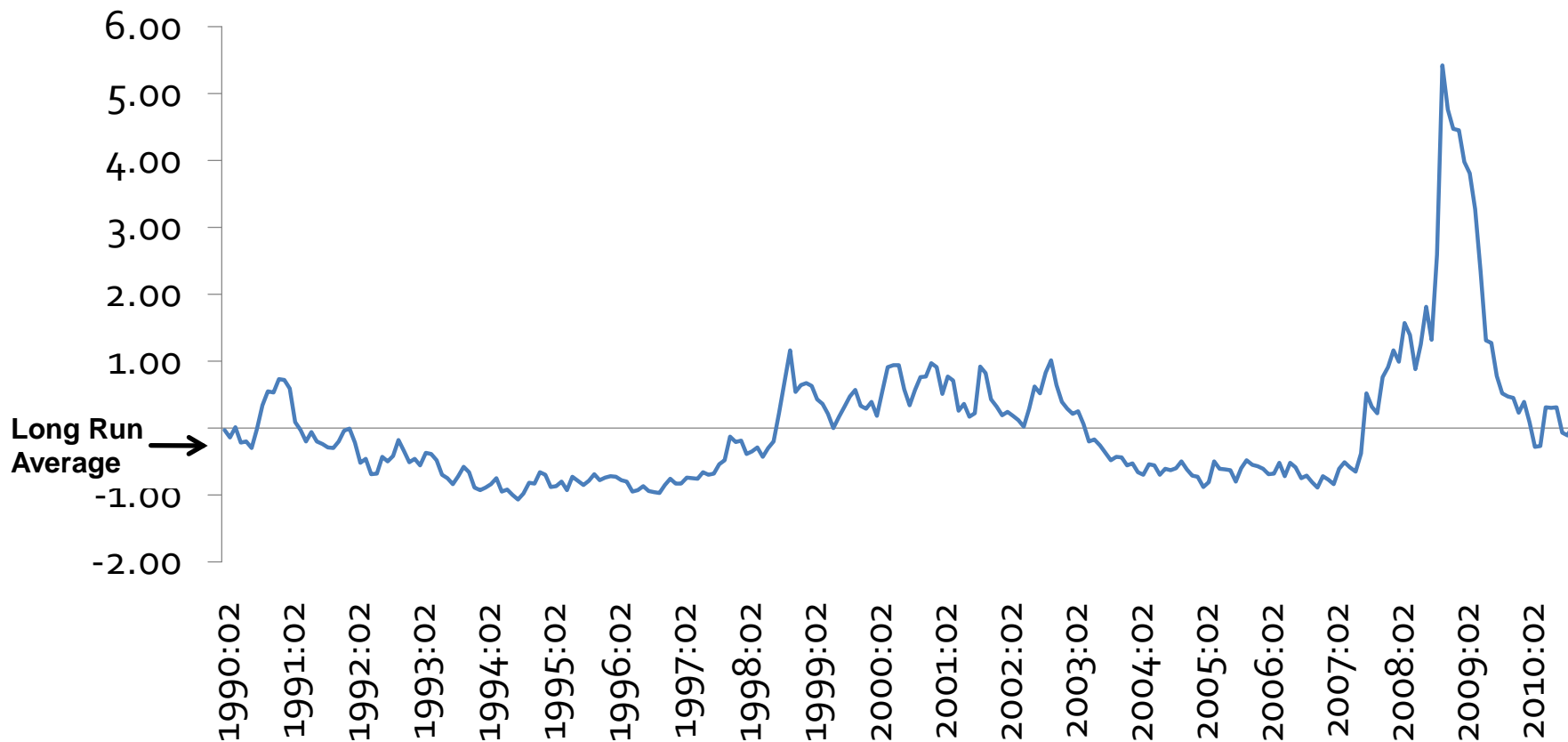
Economic Outlook

- Financial markets have improved, but CRE markets are one challenge
- The recovery is underway, but it is slow
- Fiscal and monetary challenges



Recently, financial stress has moved closer to its long-run average.

Kansas City Financial Stress Index

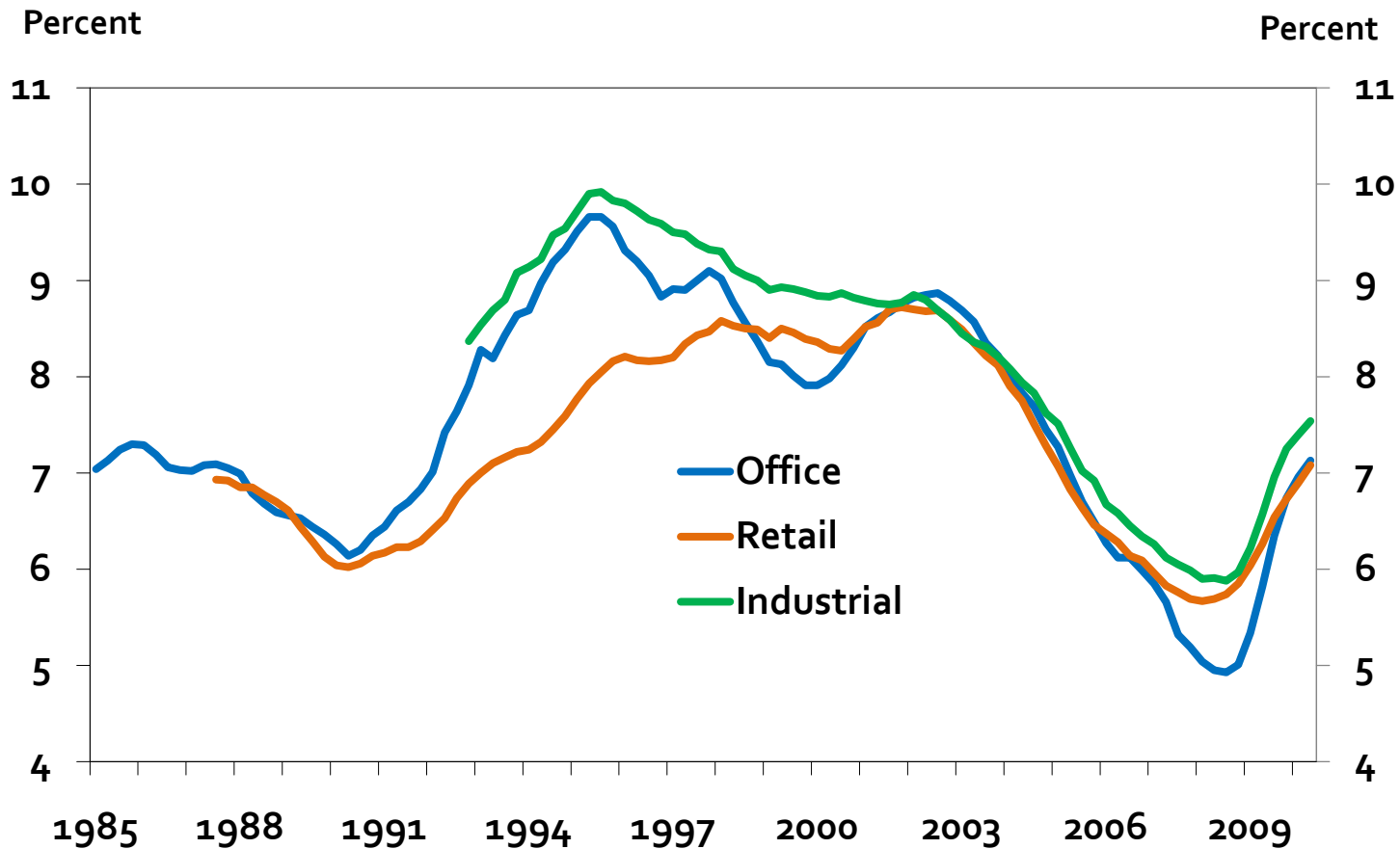


Available at www.kansascityfed.org



Prices have fallen faster than rents, leading to higher cap rates.

U.S. Commercial Real Estate Capitalization Rates



Source: Torto-Wheaton Research



Economic Outlook

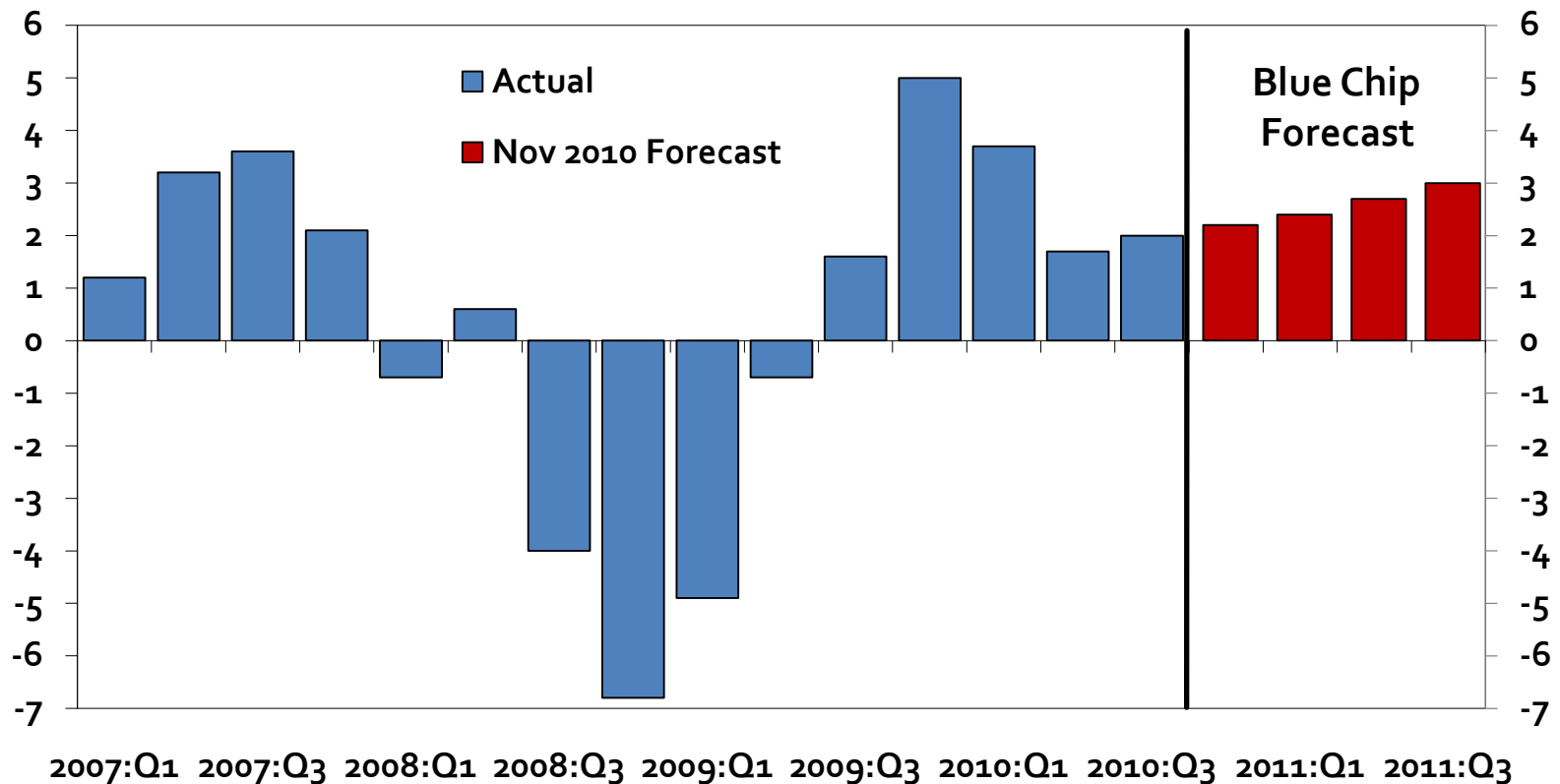
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Growth over the last four quarters points to recovery, but it is expected to be slow.

Real GDP Growth

Annualized percent change from previous quarter

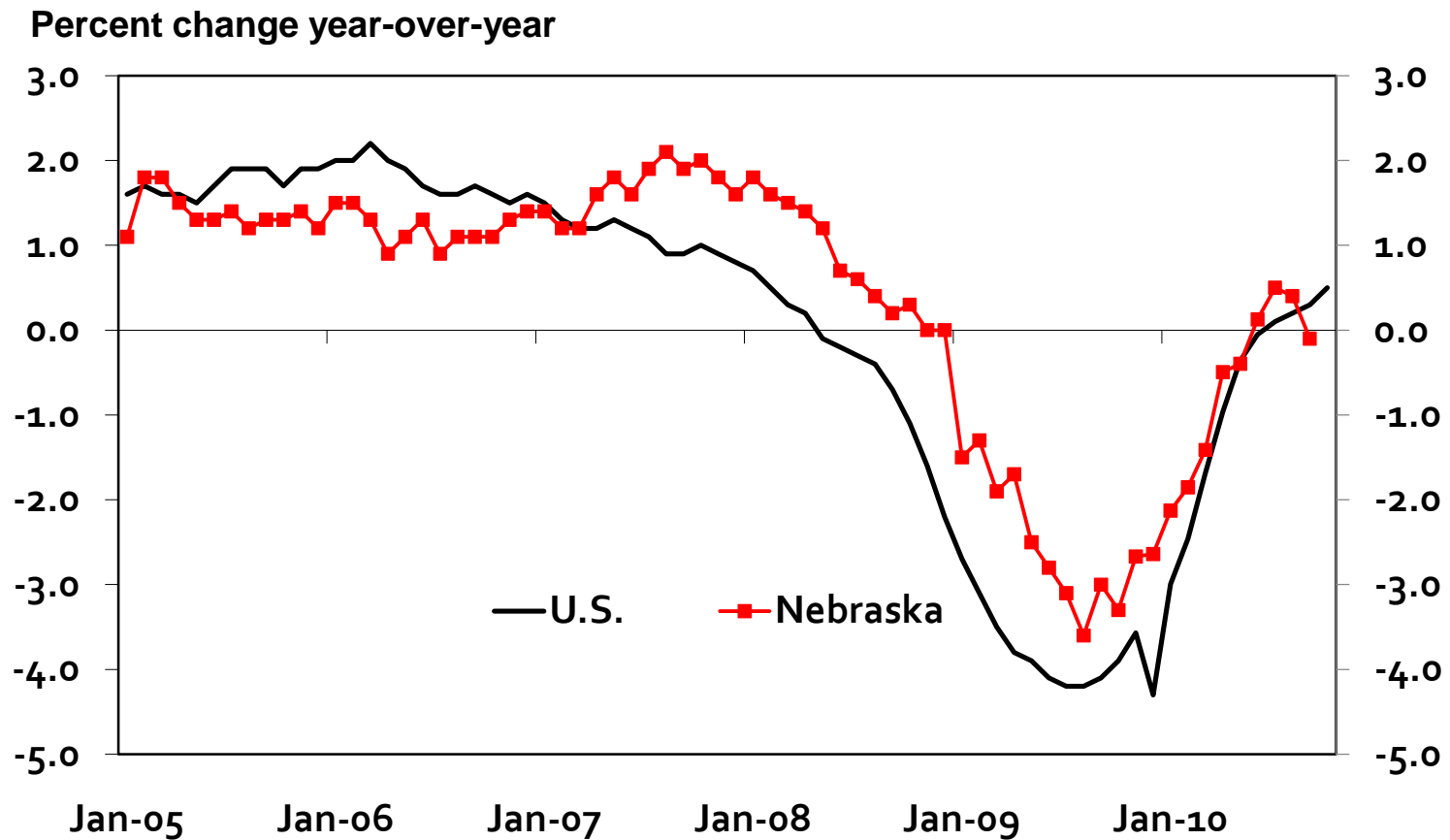


Source: Bureau of Economic Analysis and Blue Chip Economic Indicators



Non-farm employment growth has improved.

Total Non-Farm Employment Growth

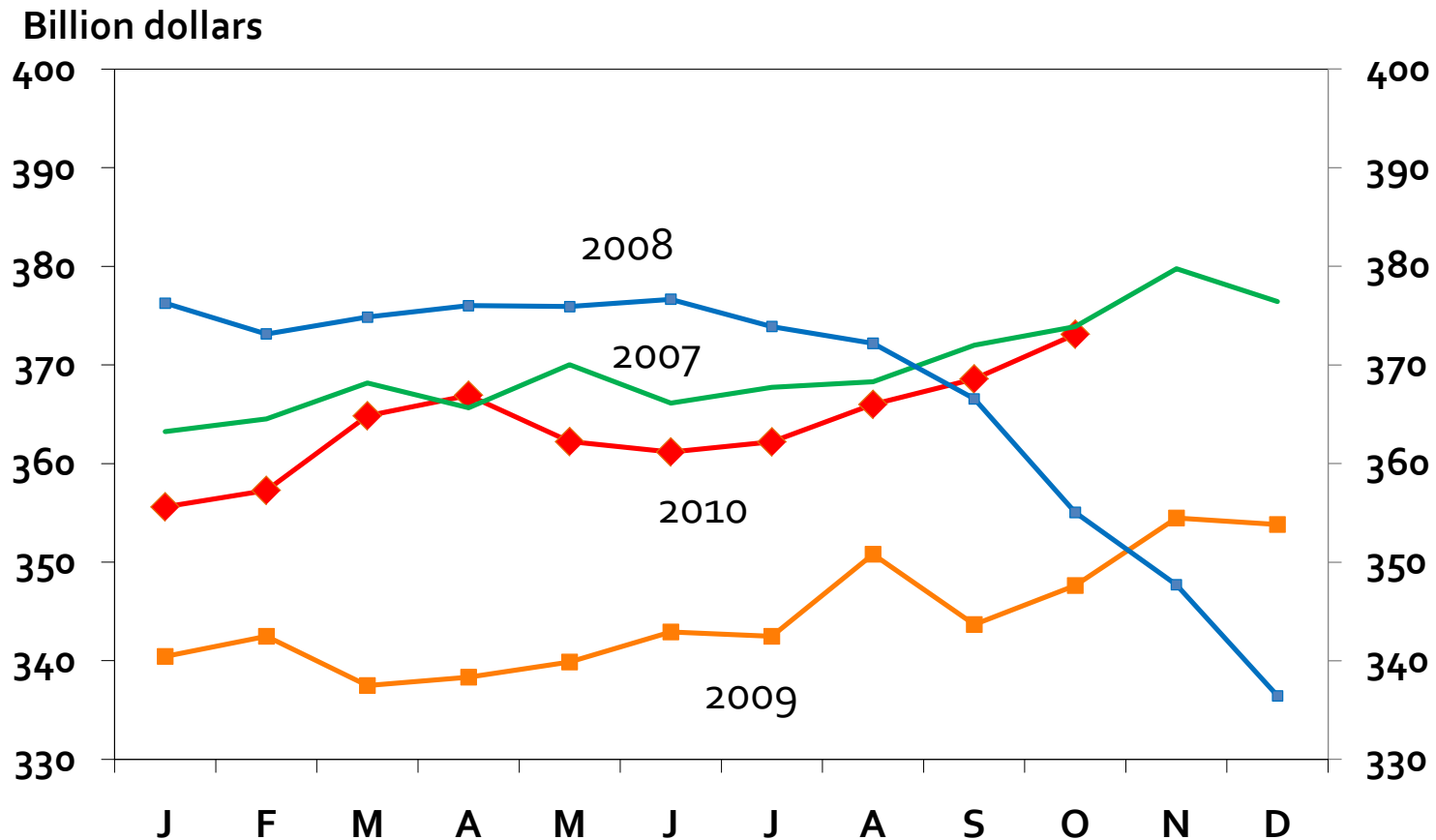


Source: Bureau of Labor Statistics



U.S. consumers are spending money.

U.S. Monthly Retail and Food Sales



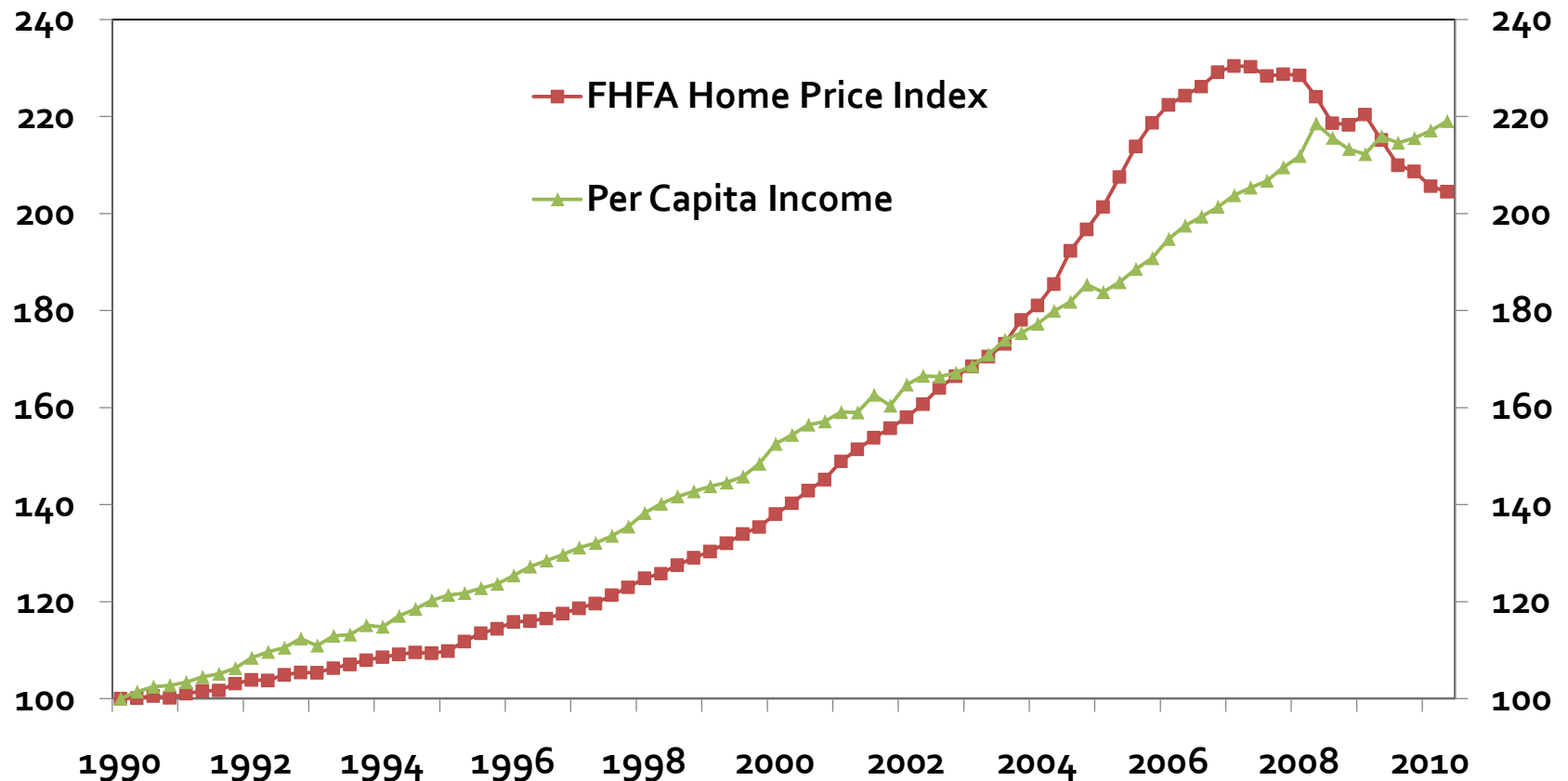
Source: U.S. Census Bureau



Home prices outpaced personal incomes.

U.S. Home Prices and Personal Incomes

Index (1990 = 100)

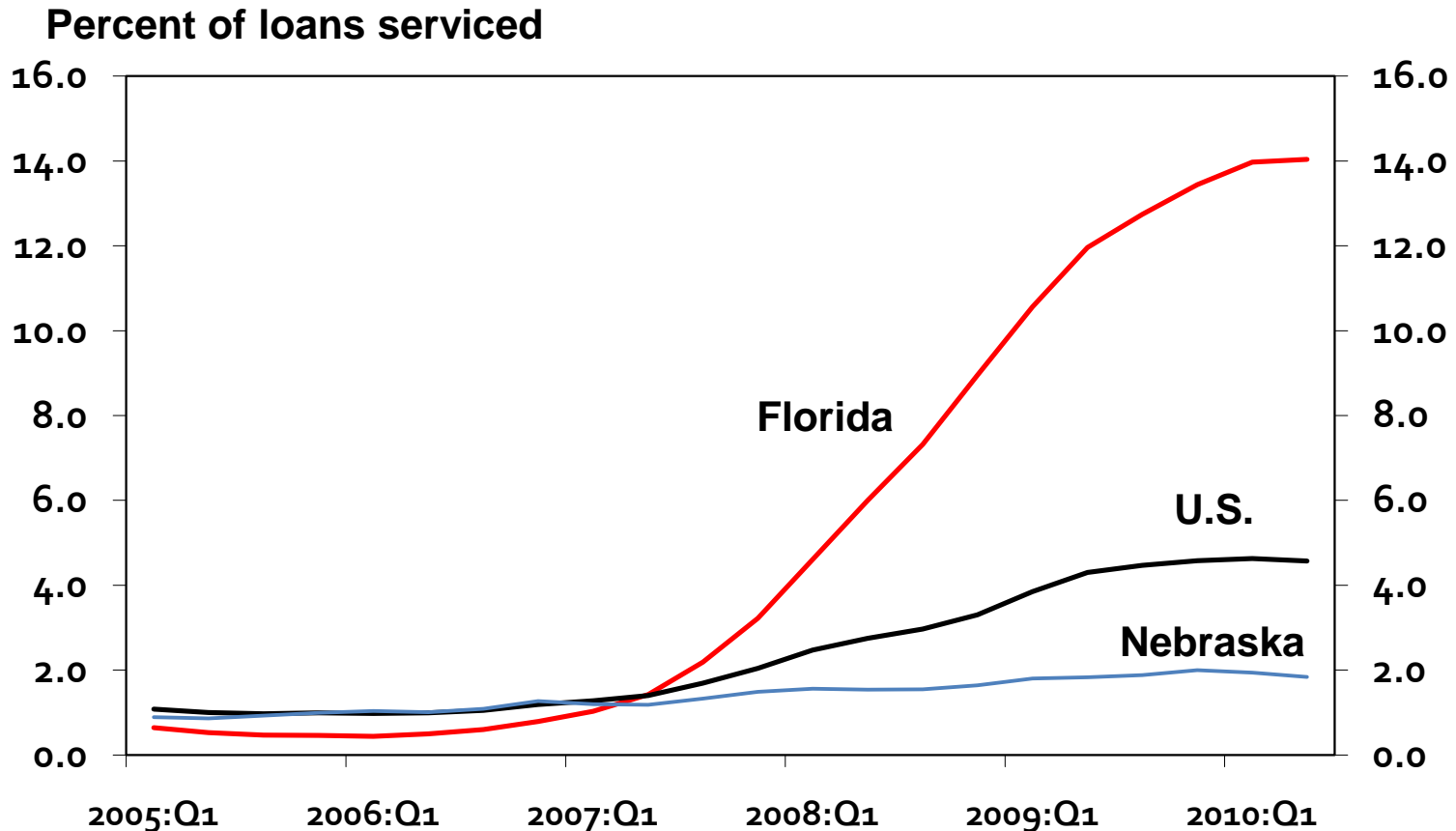


Source: Bureau of Economic Analysis and Federal Housing Finance Agency



Home foreclosures surged in some parts of the U.S.

Home Foreclosure Inventory



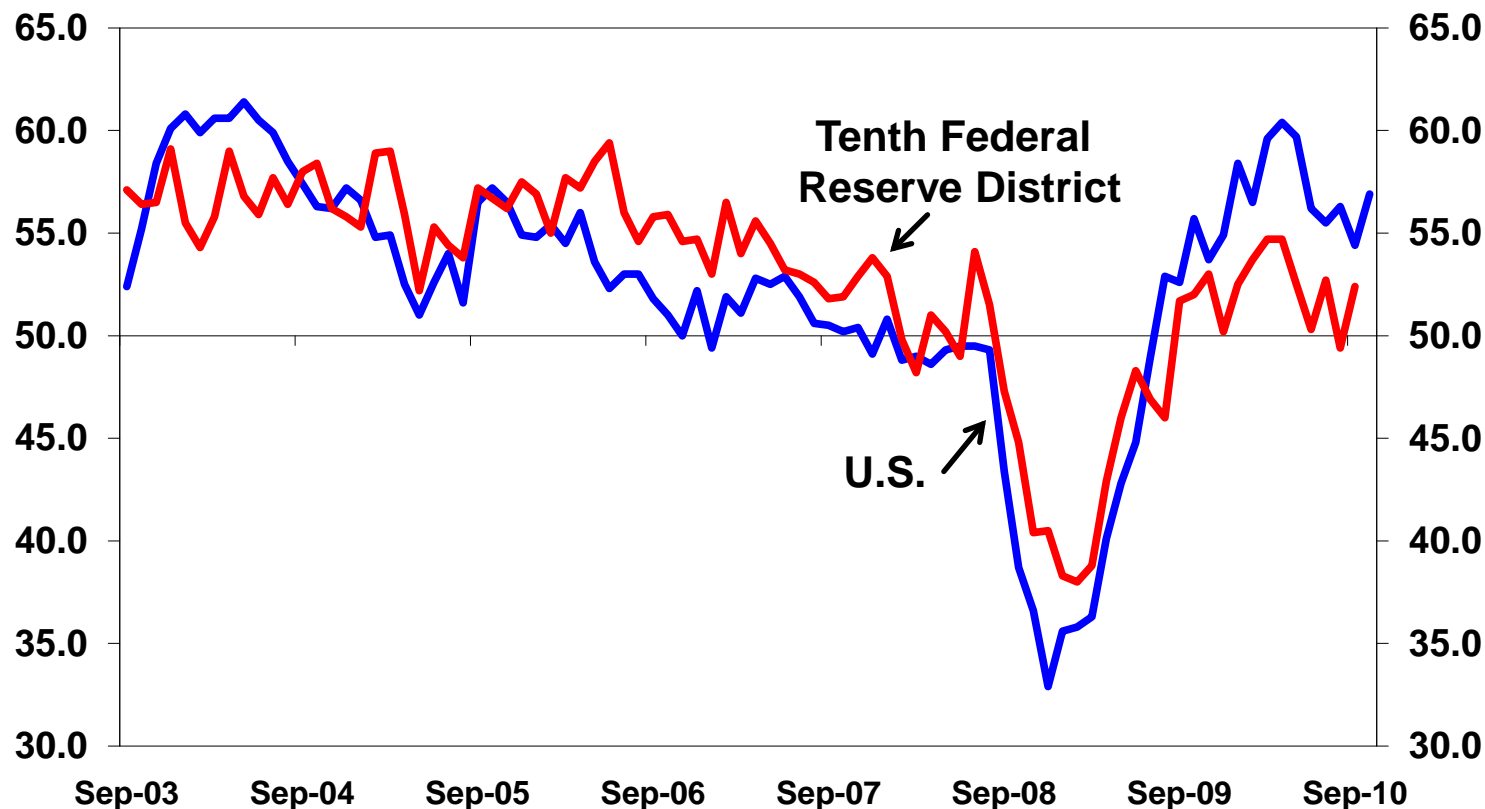
Source: Mortgage Bankers Association



U.S. manufacturers are producing more than the Tenth Federal Reserve District.

U.S. and Tenth District Manufacturing Production Indices

Index

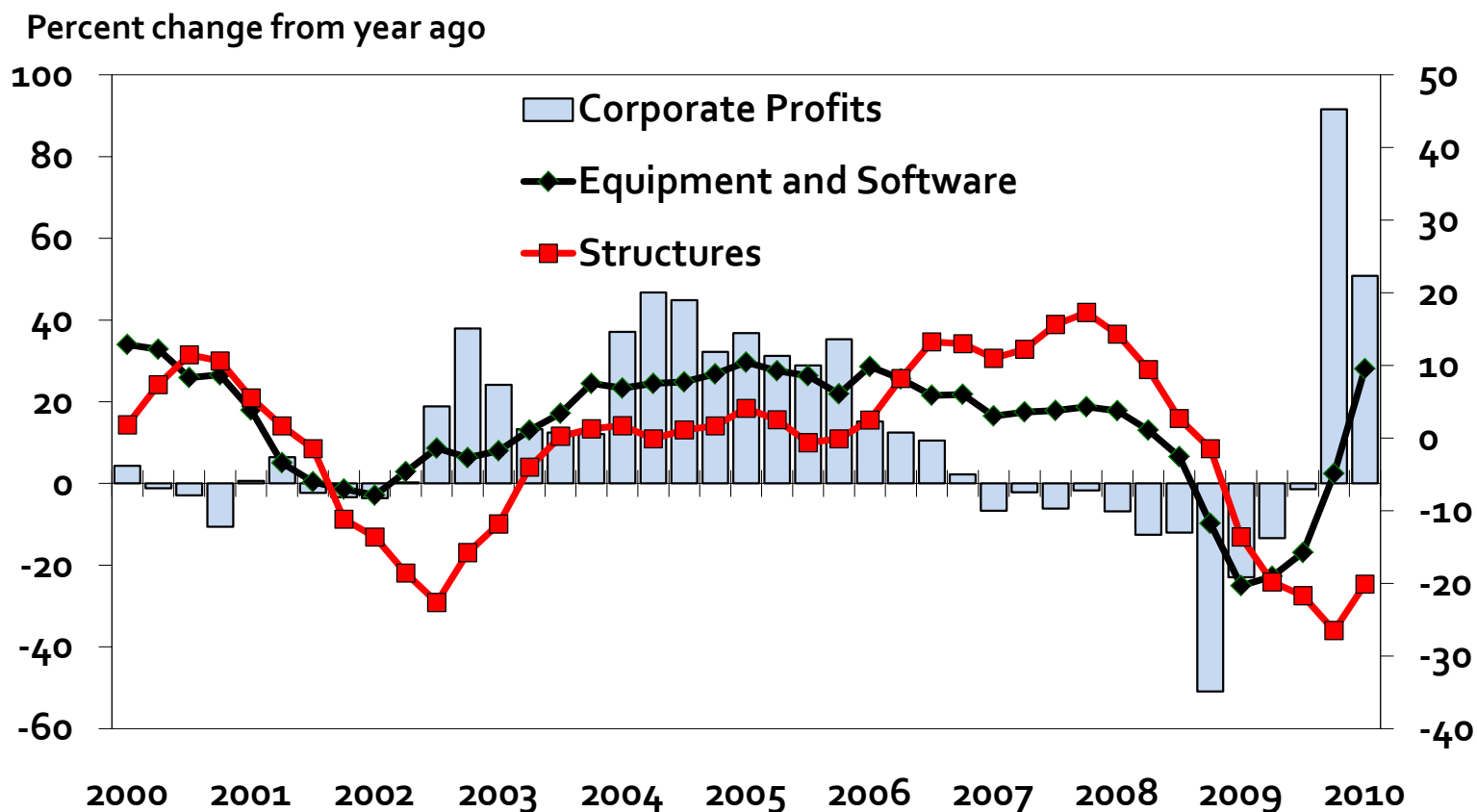


Source: Institute of Supply Management and Federal Reserve Bank of Kansas City



Corporate profits and business investment are beginning to rebound.

Corporate Profits and Nonresidential Fixed Investment

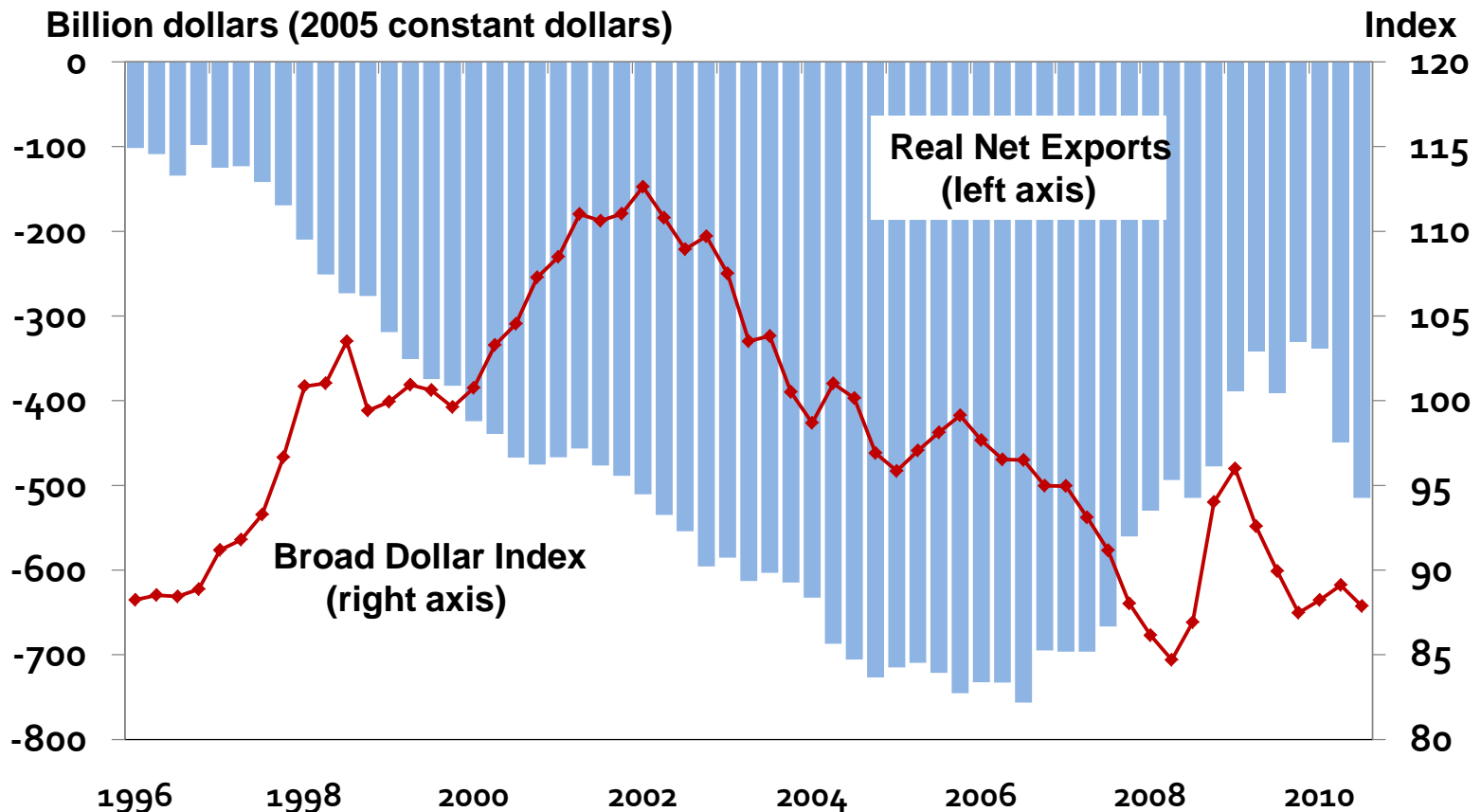


Source: Bureau of Economic Analysis



After dramatic improvements since 2007, U.S. net exports have fallen.

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



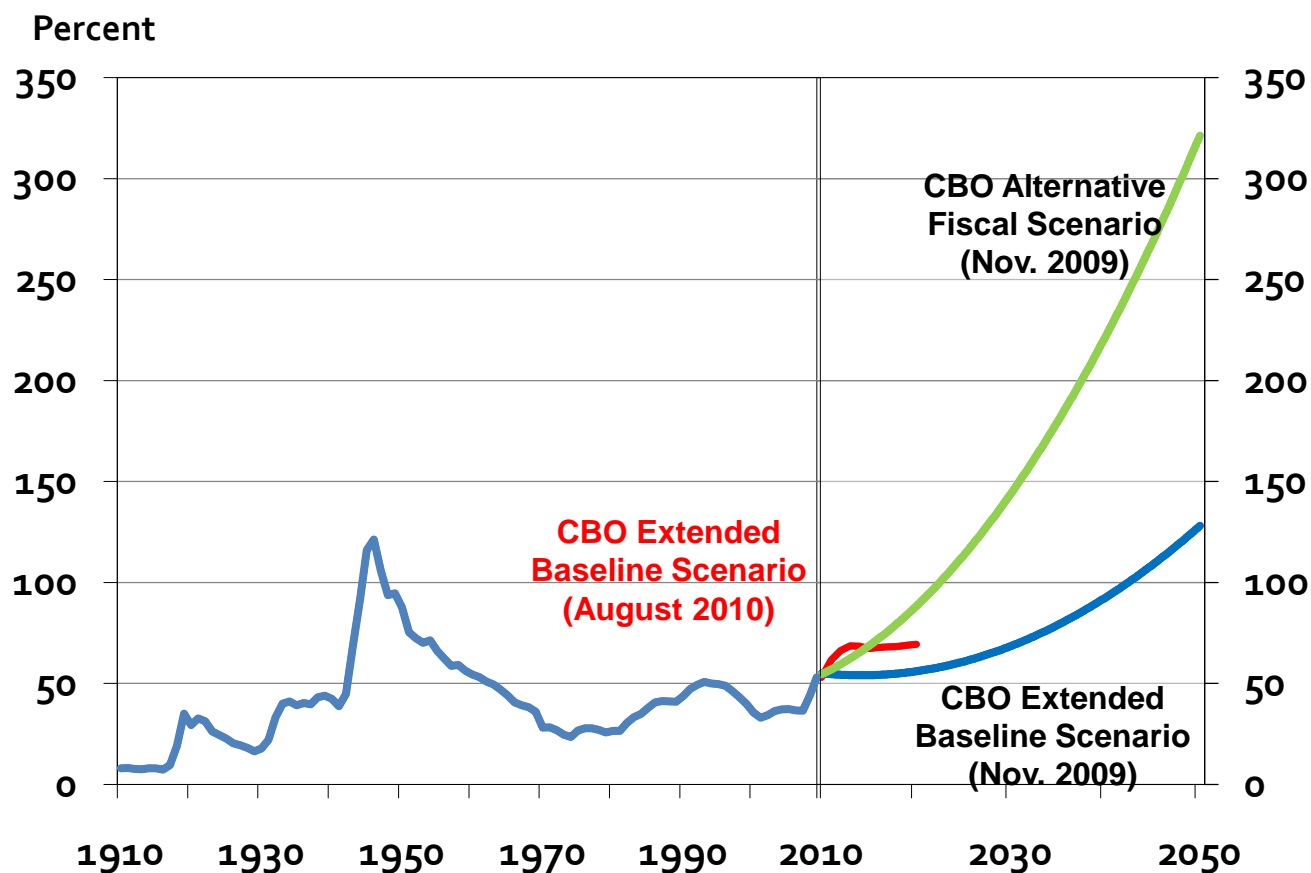
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How will surging federal debt levels affect economic conditions long-term?

U.S. Debt as a Percent of GDP

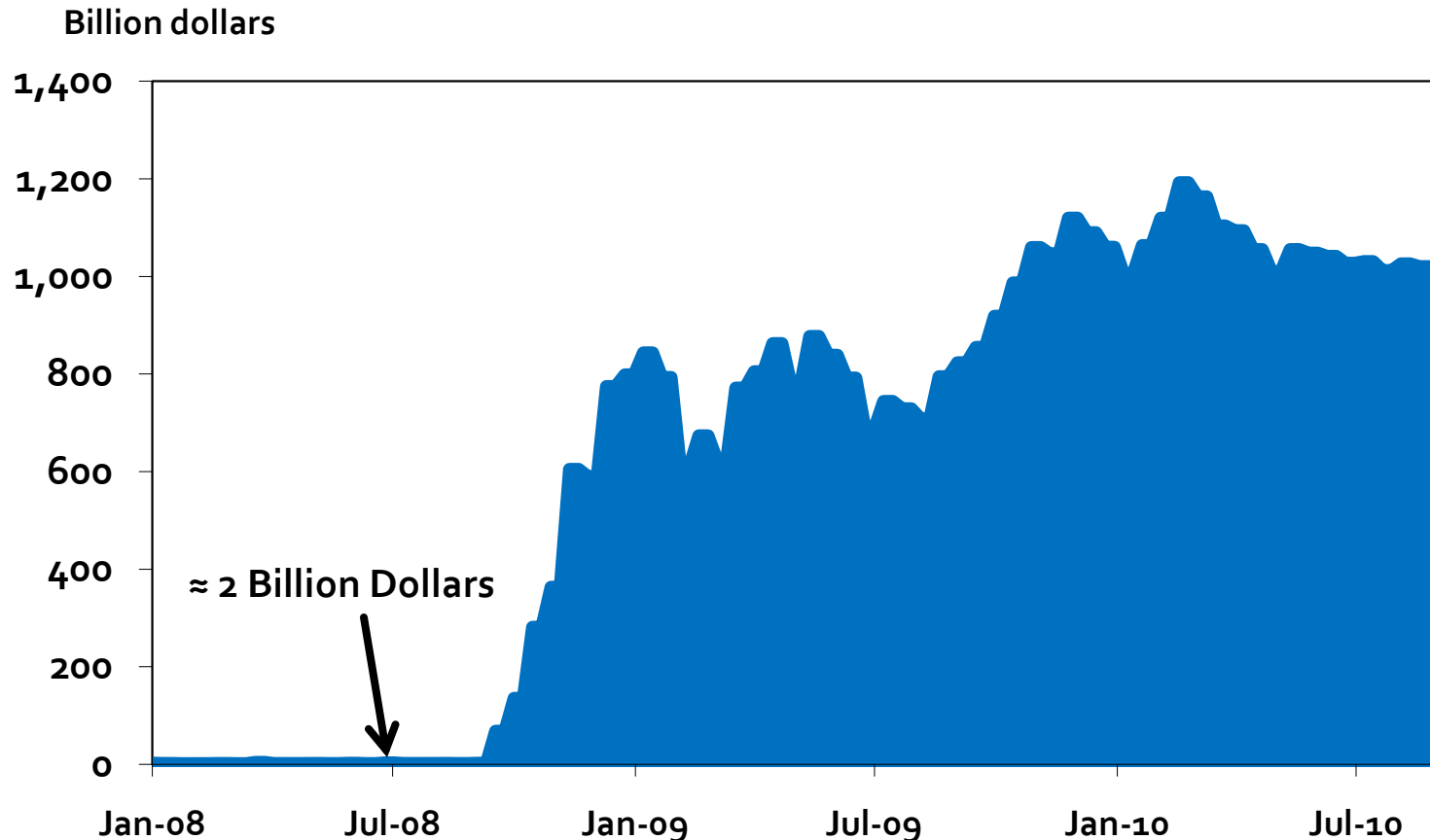


Source: Congressional Budget Office



Excess reserves held at the Fed have surged.

Excess Reserves of Depository Institutions



Source: Federal Reserve Board of Governors



Inflation is based on money and velocity.

Quantity Theory of Money

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

Definition of Inflation:

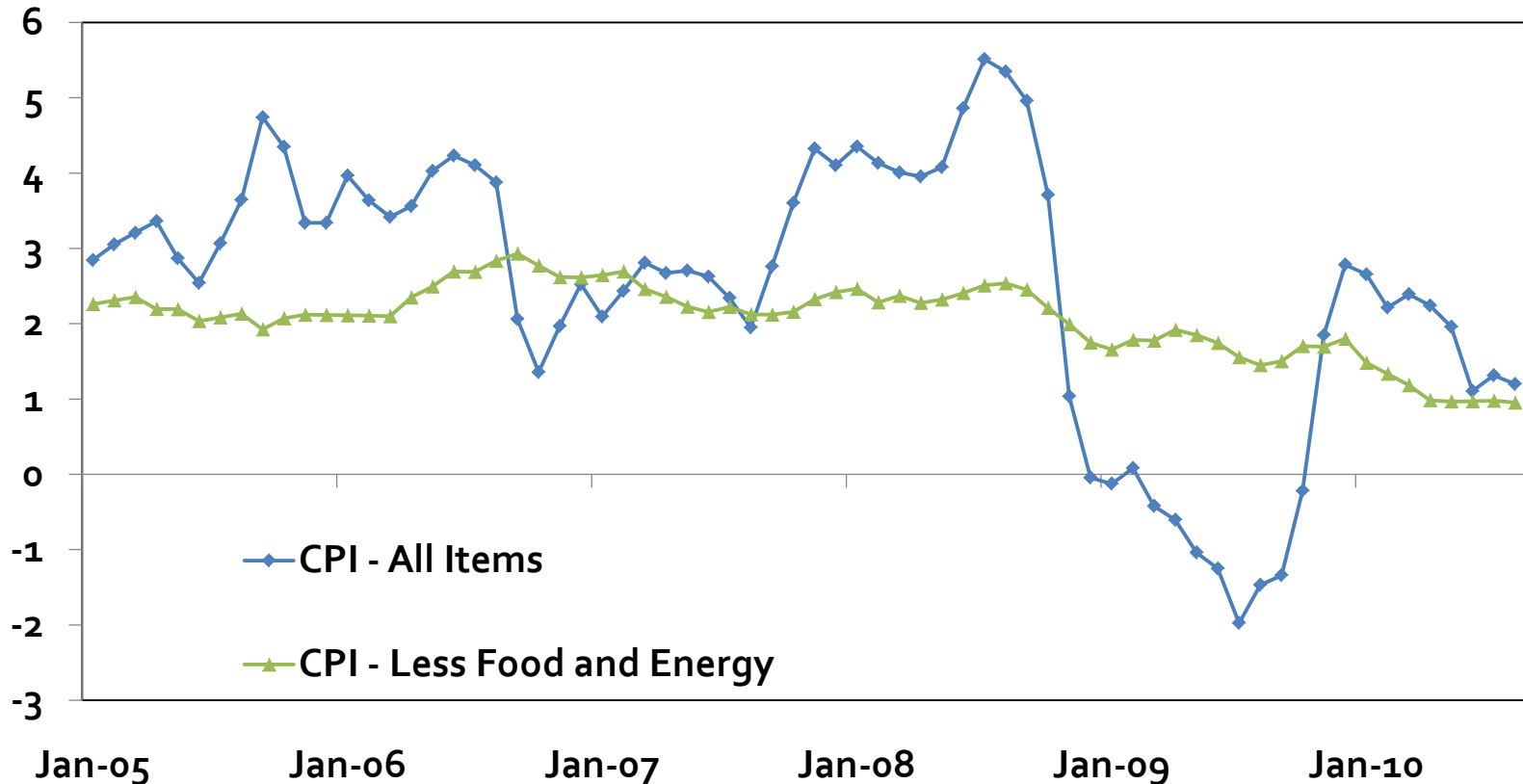
Too much money $M \uparrow$
chasing $V \uparrow$
too few goods $Q \downarrow$



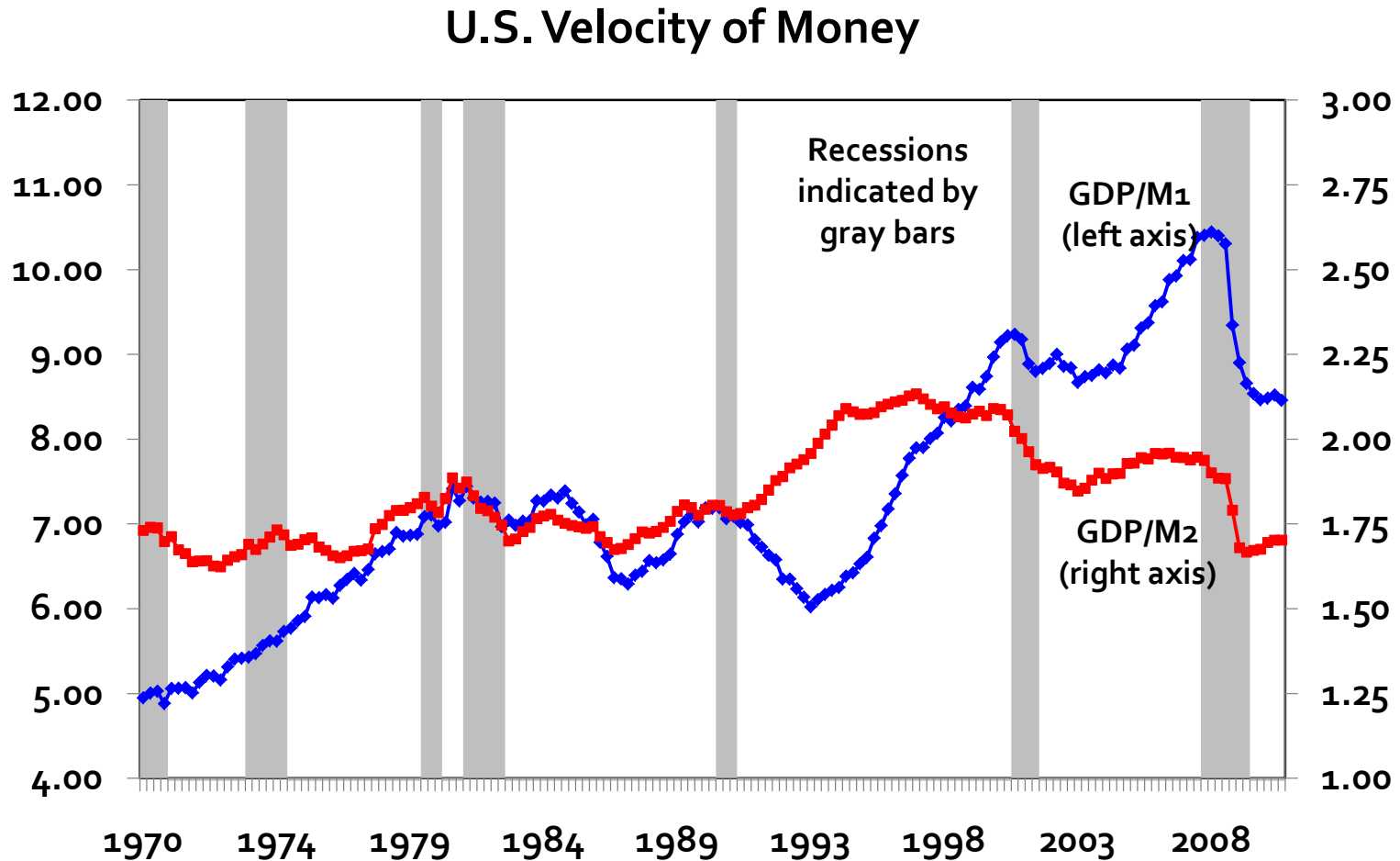
Inflation is trending lower.

Consumer Price Inflation

Percent change from year ago



Lower velocity contributes to lower inflation.



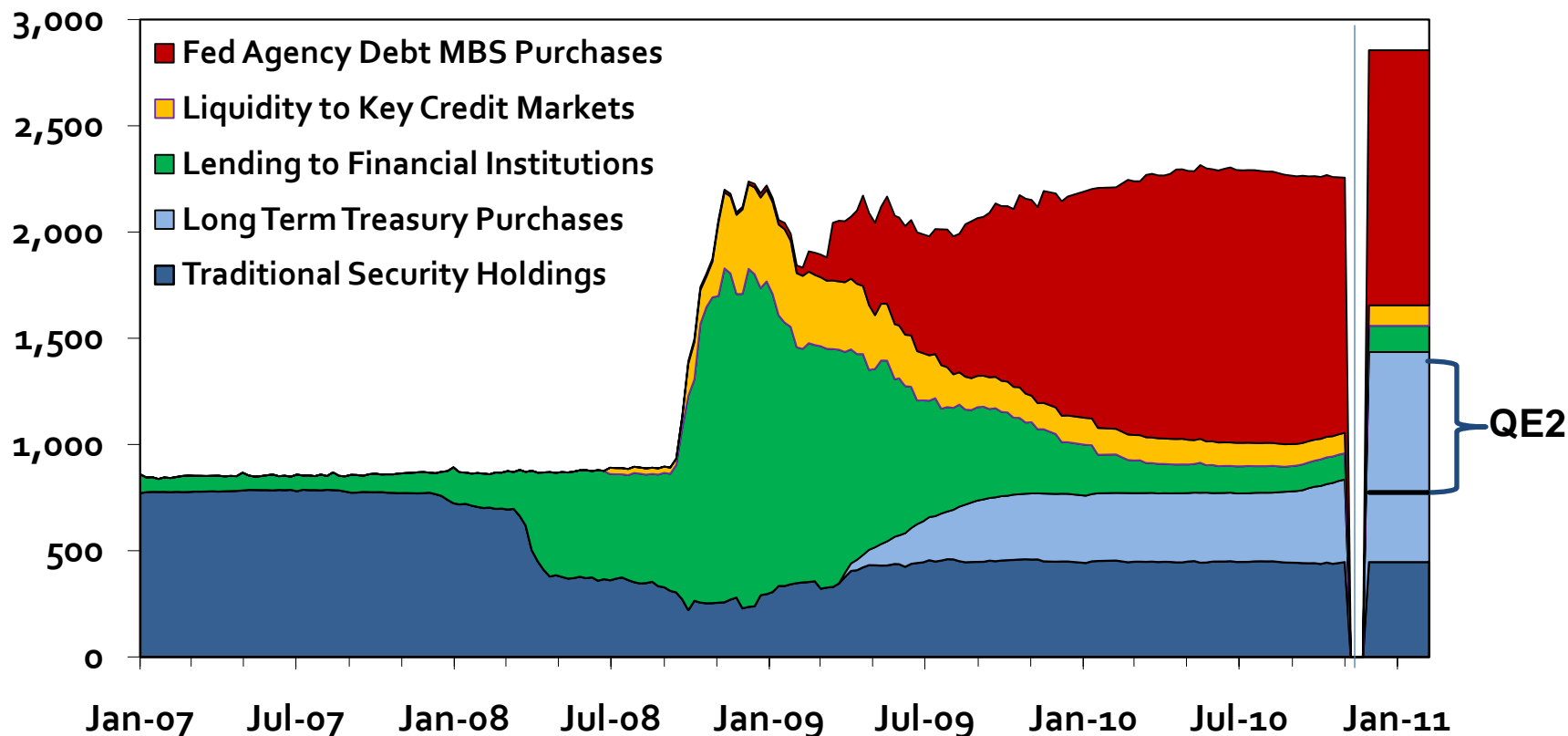
Source: BEA and Federal Reserve Board of Governors



Quantitative easing (QE) is designed to expand the Federal Reserve balance sheet to lower long term rates.

Federal Reserve Balance Sheet: Assets

Billion Dollars

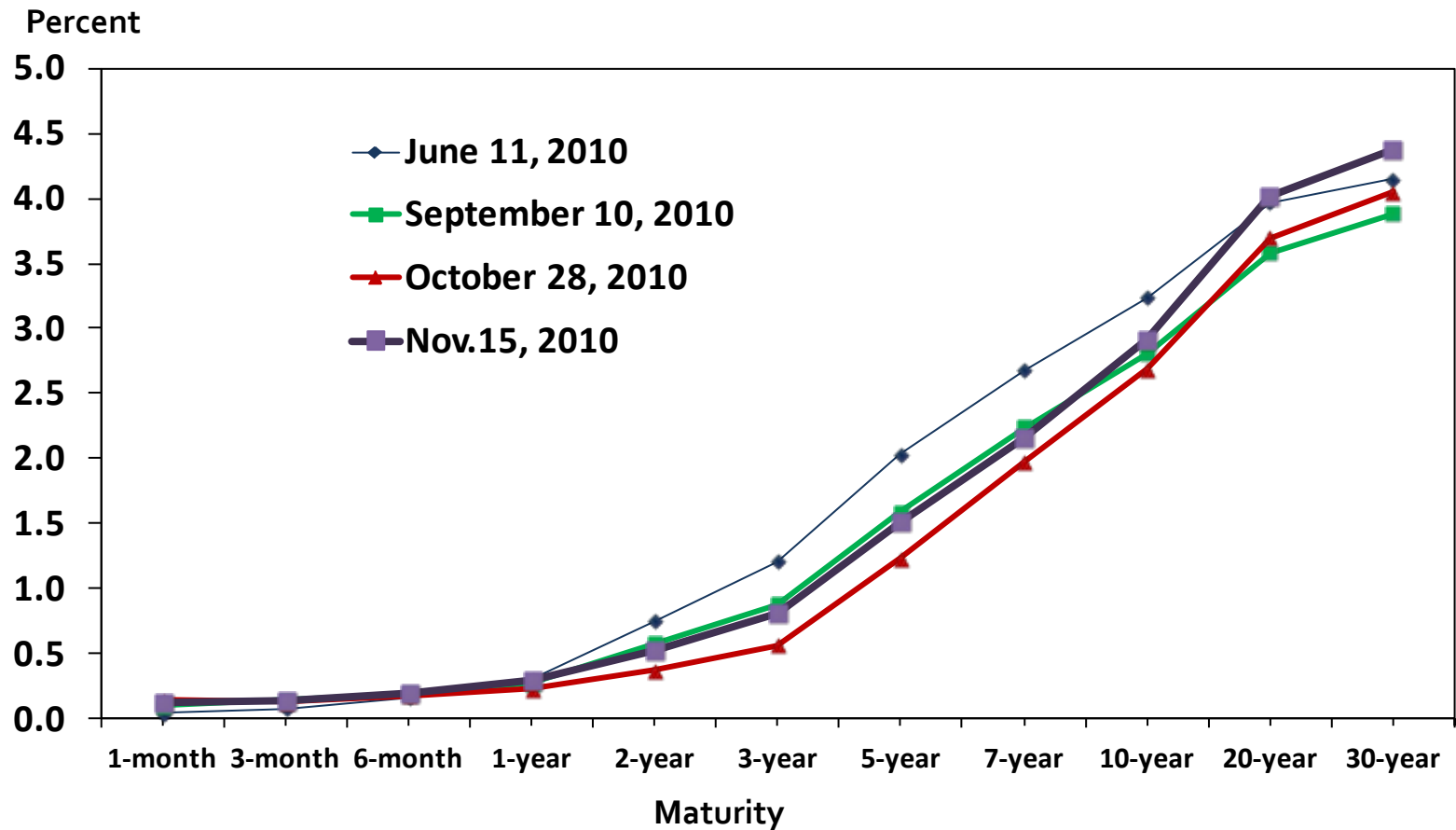


Source: Federal Reserve Bank of Cleveland



The yield curve recently steepened.

U.S. Treasury Yield Curve Rates



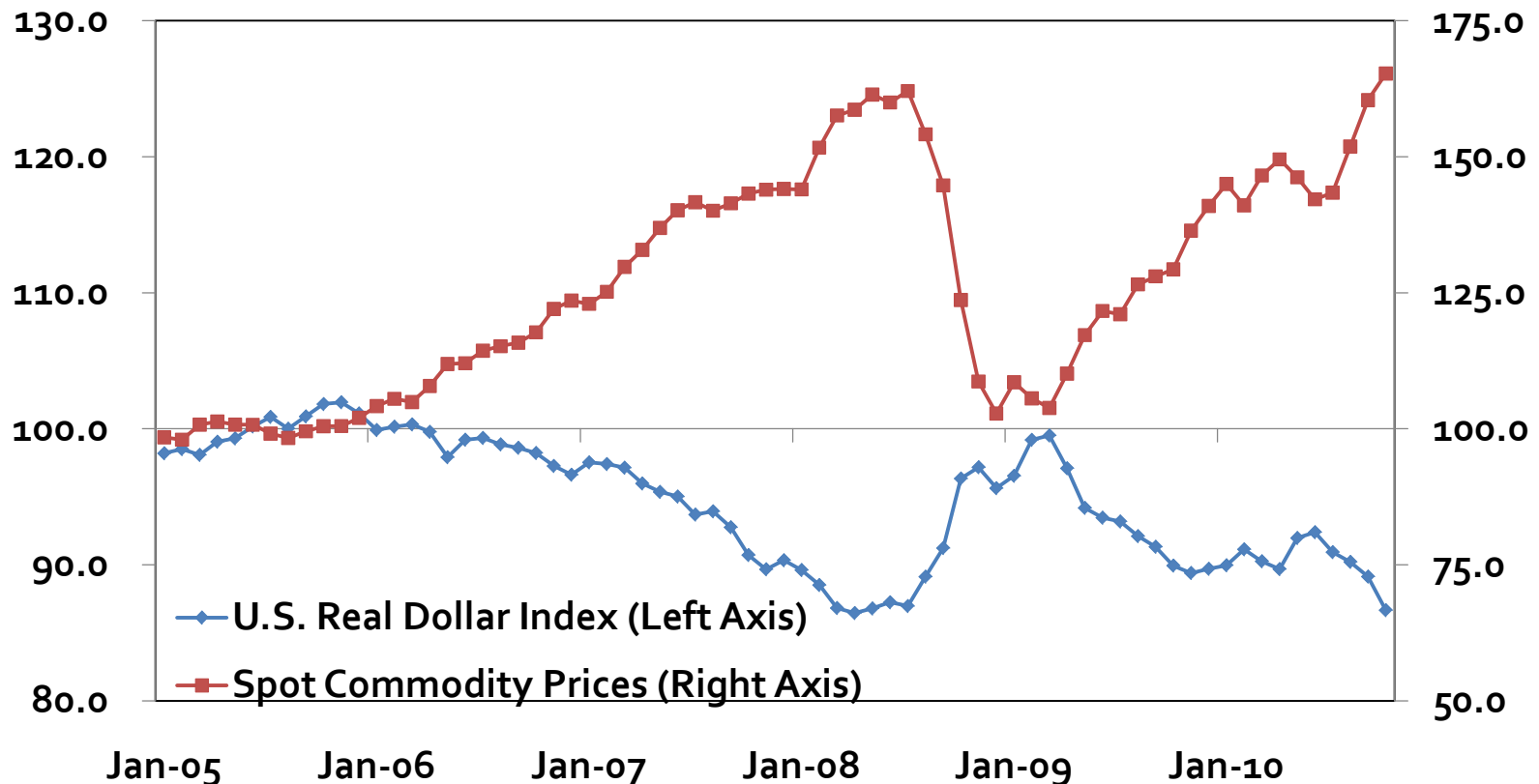
Source: Federal Reserve Board of Governors



A side effect of QE is a weaker dollar, which is associated with higher commodity prices.

U.S. Exchange Rates and Commodity Prices

Index (2005 average = 100)



Source: Commodity Research Bureau and Federal Reserve Board of Governors



Conclusions

- The recovery is underway but faces strong headwinds.
- Nebraska has held up much better in the recovery.
- With modest job gains and lower inflation, monetary policy has entered QE2.



For More Information

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