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Current Economic Outlook



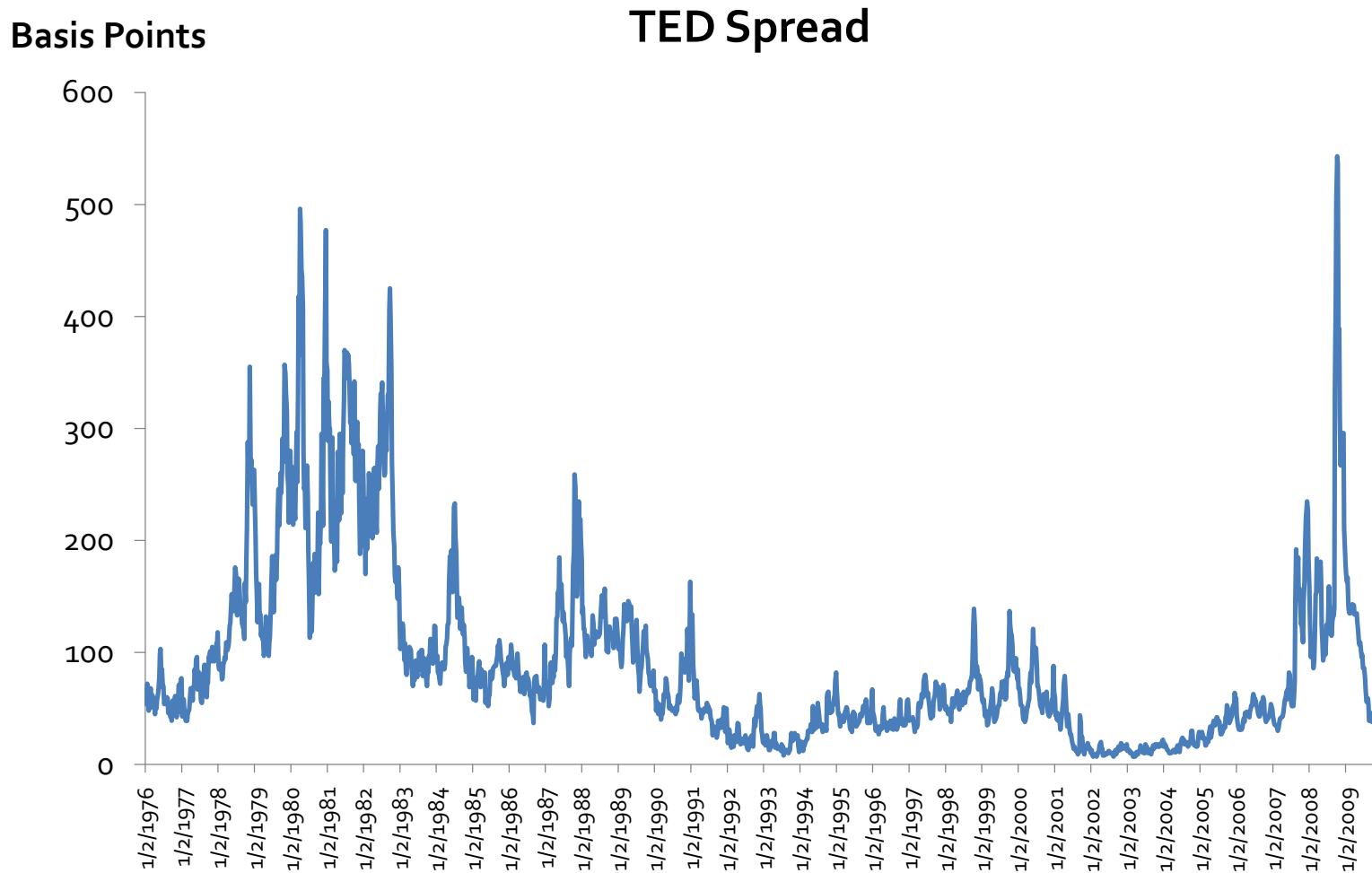
The views expressed are those of the author and do not necessarily reflect the opinions of the Federal Reserve Bank of Kansas City or the Federal Reserve System.

Today's Roadmap

- **Financial crisis update**
- **Economic update**
- **The Federal Reserve's balance sheet and exit strategy**



The financial market crisis has eased.



Source: Federal Reserve Board of Governors



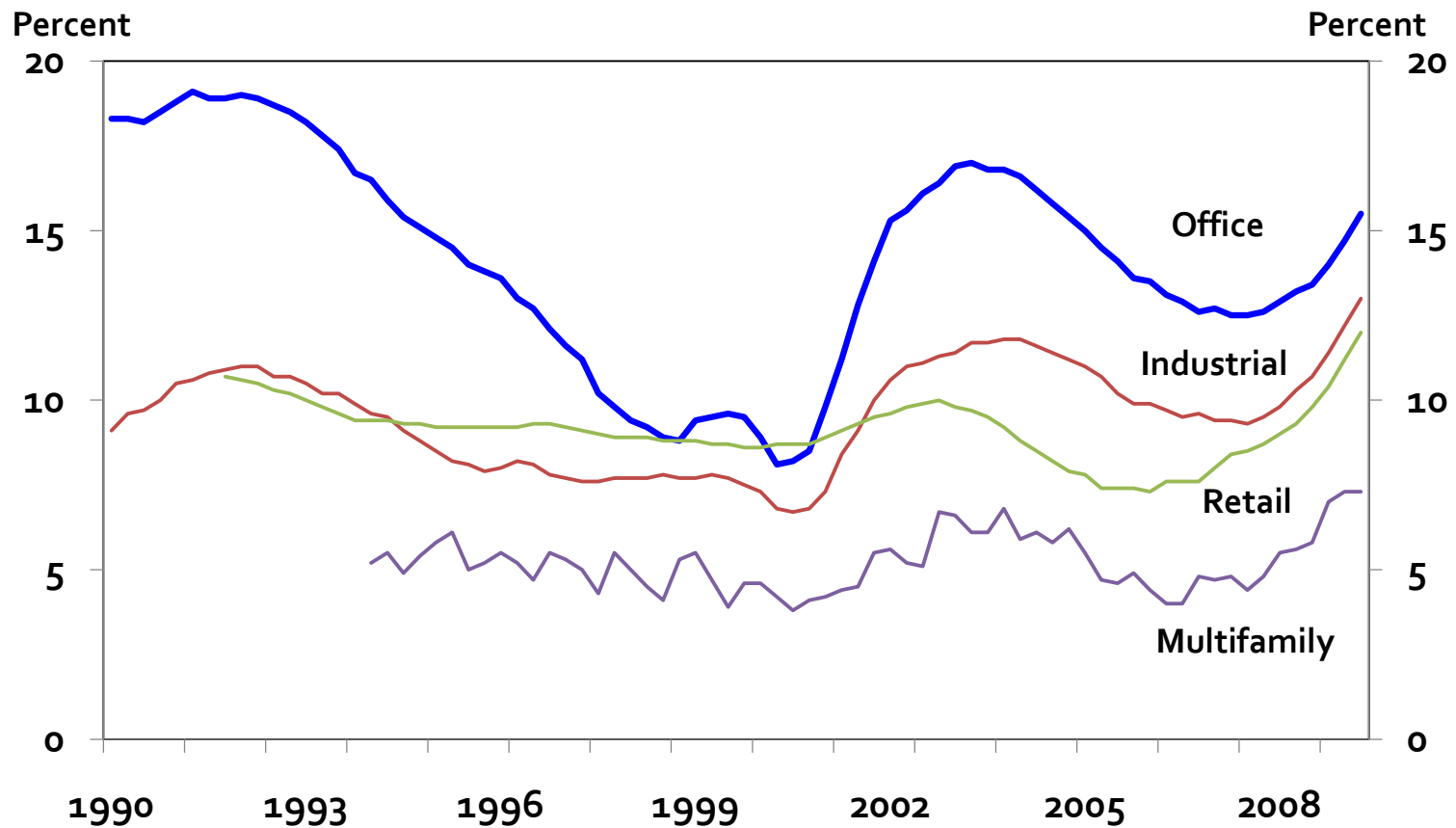
While the financial crisis has eased, risks still exist in the economy.

- 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

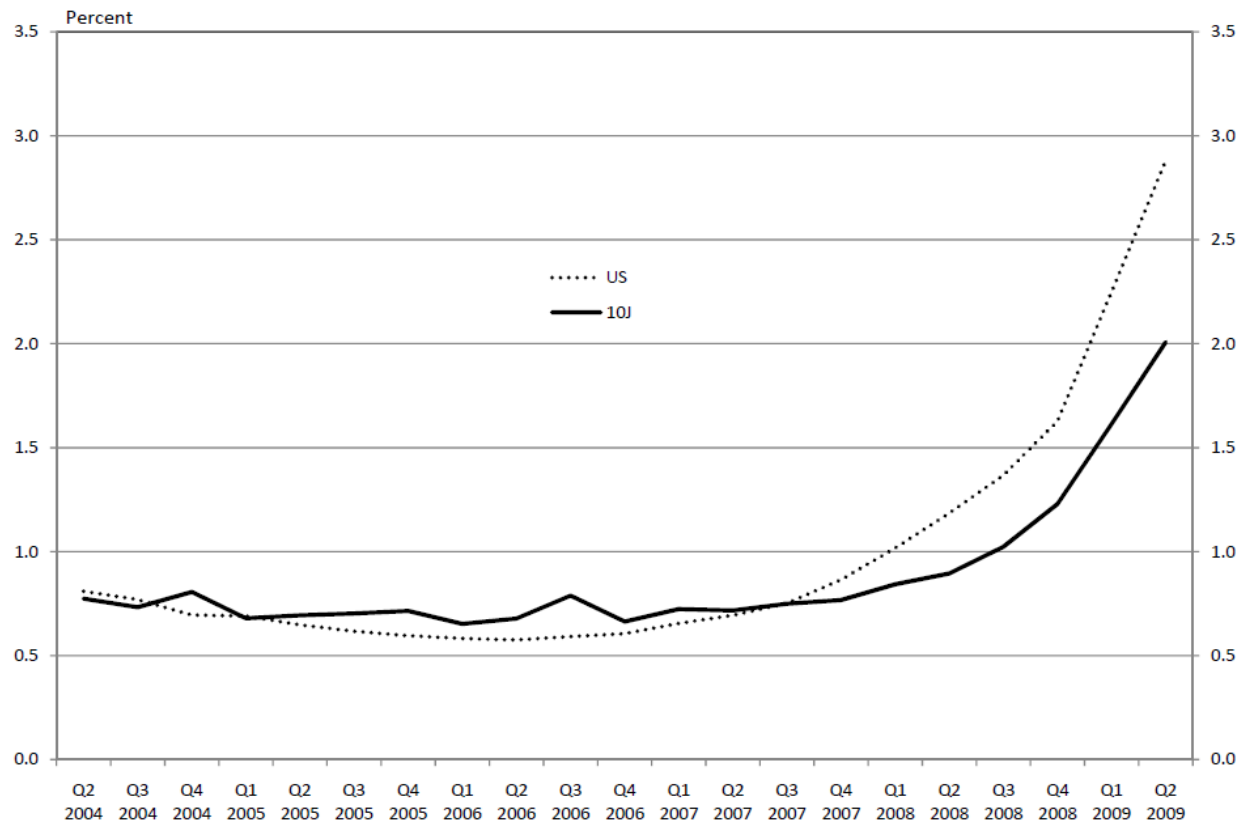


Source: Torto-Wheaton Research



The share of CRE loans past due are rising.

Share of CRE loans past due

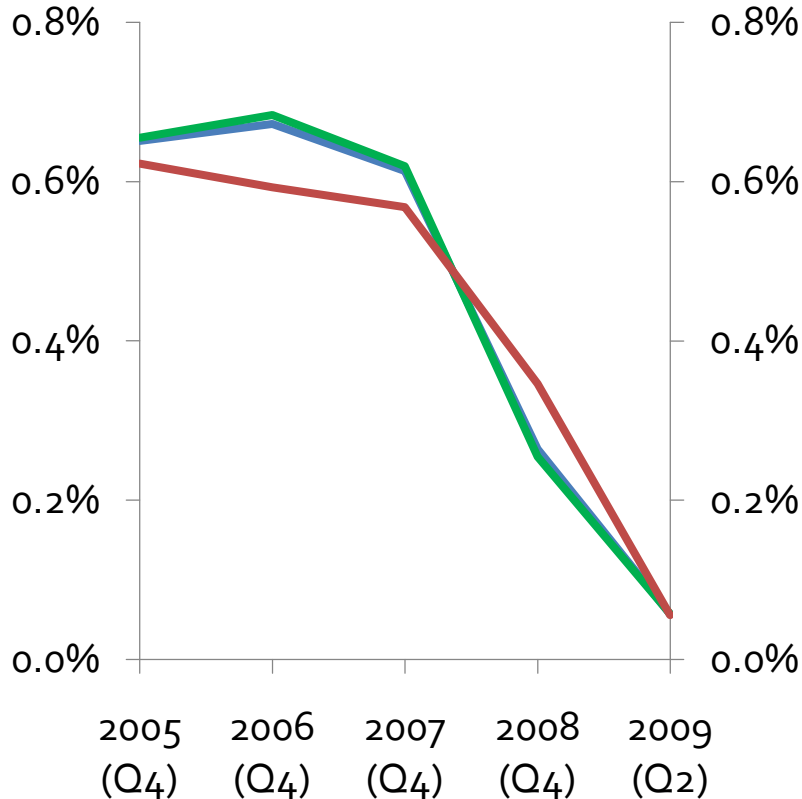


Source: FDIC



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

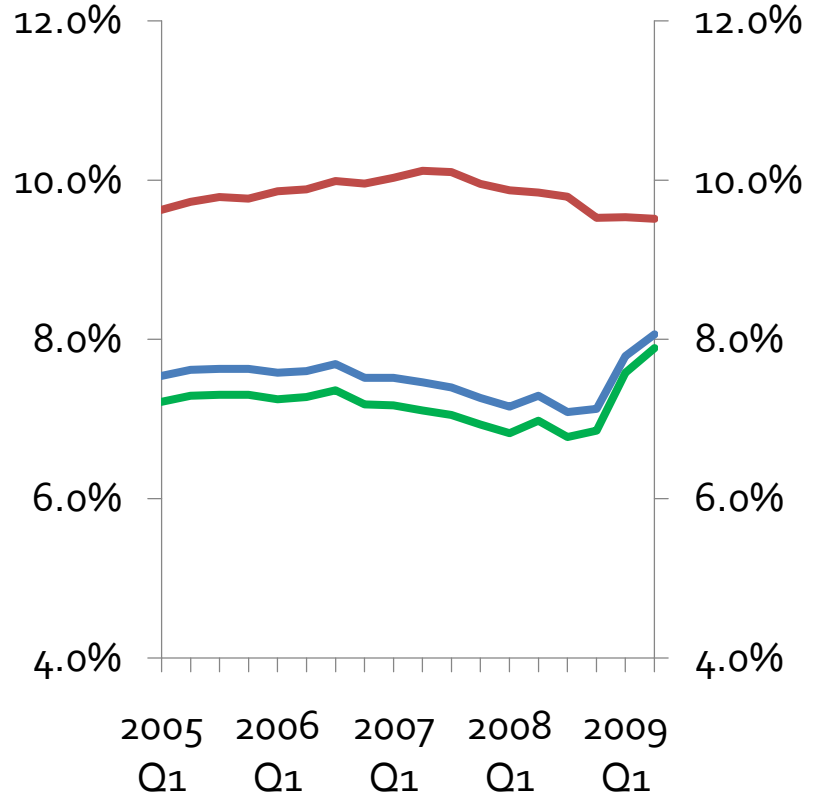
Return on Assets



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

Source: FDIC

Tier 1 Capital Ratio



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

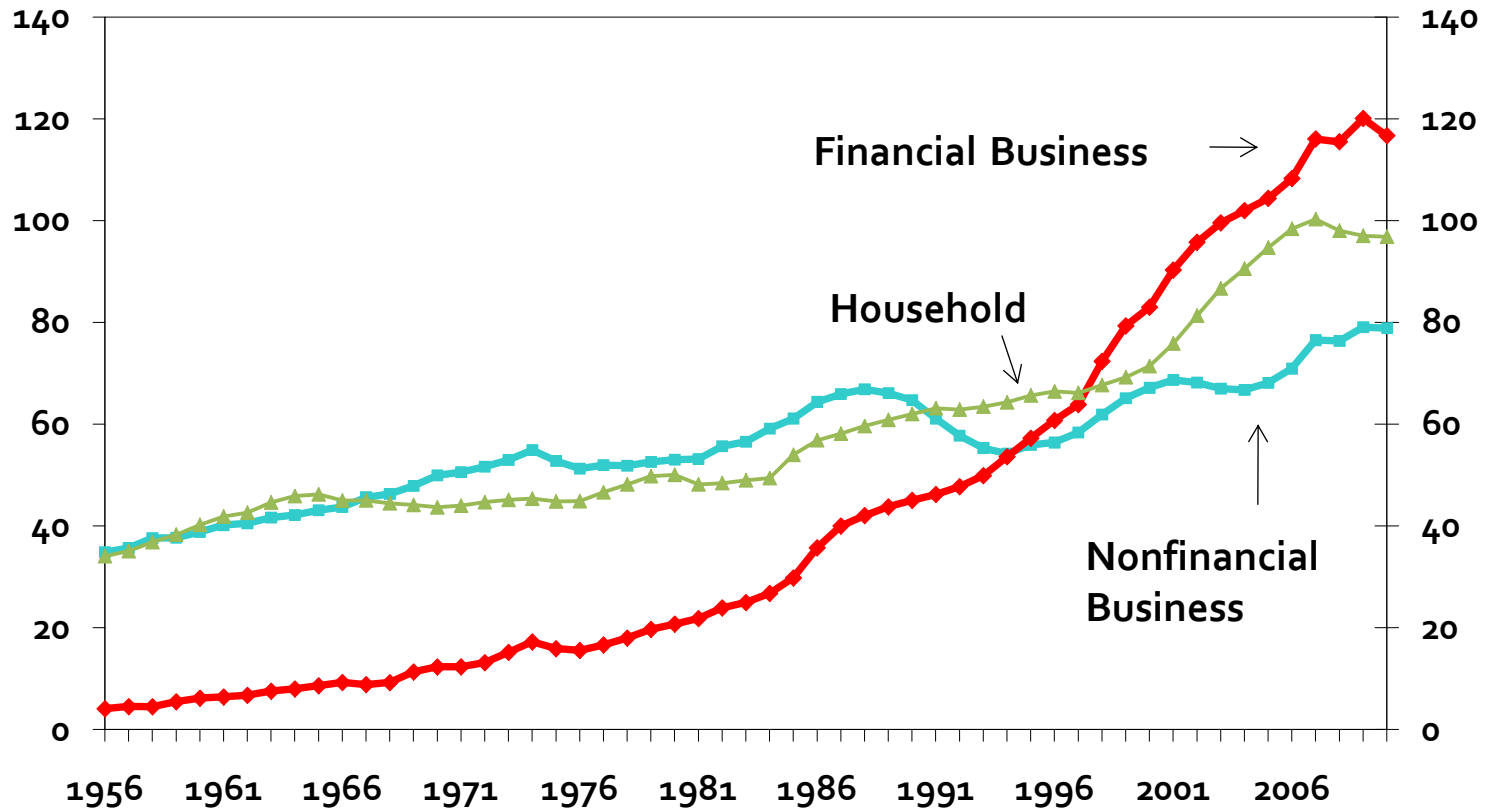
Source: FDIC



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

Domestic Debt Outstanding

Percent of GDP



Source: Federal Reserve Board of Governors



Today's Roadmap

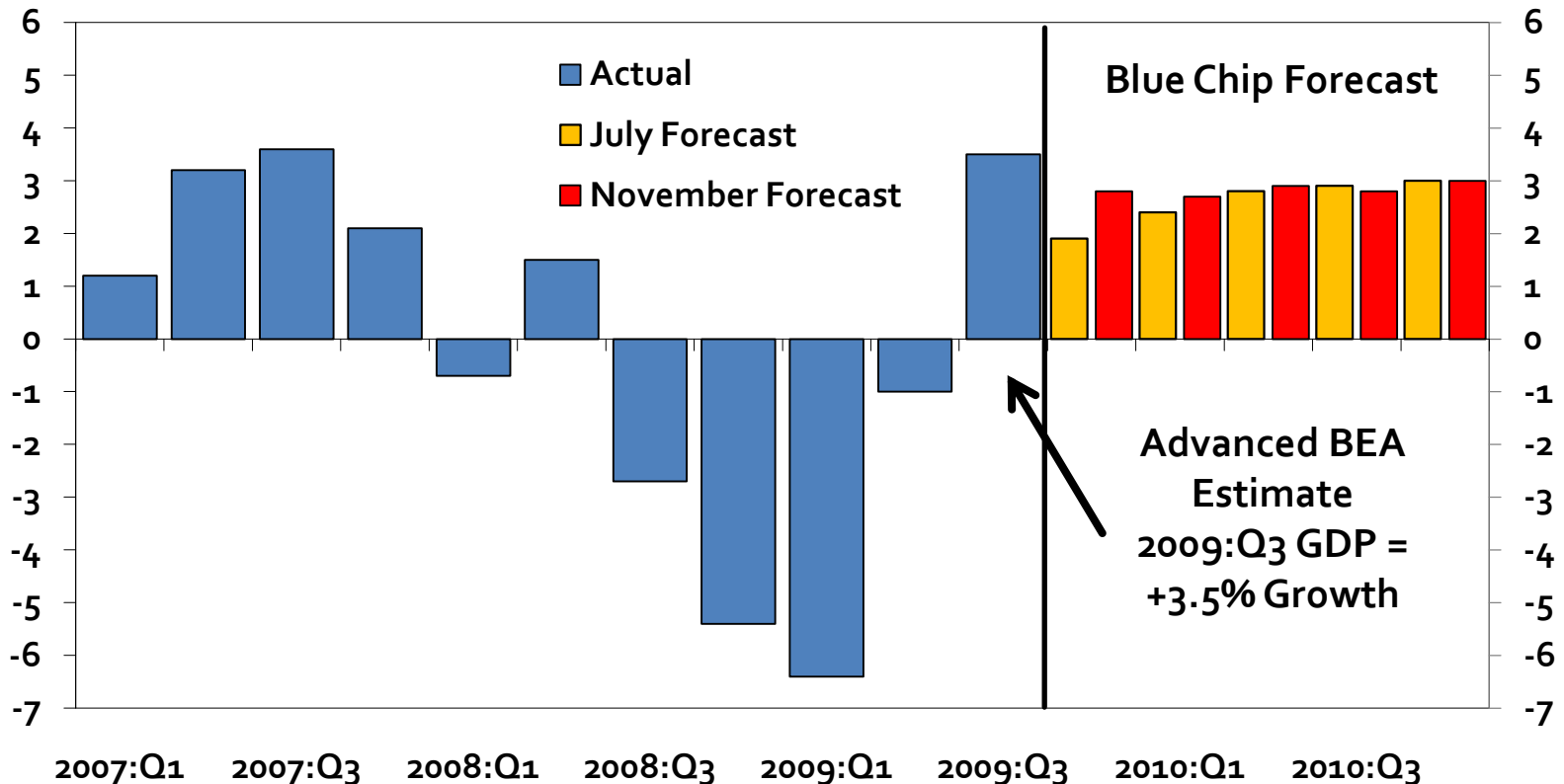
- **Financial crisis update**
- **Economic update**



Advanced estimate indicates Q3 growth, and forecasters expect continued future growth.

Real GDP Growth

Annualized percent change from previous quarter

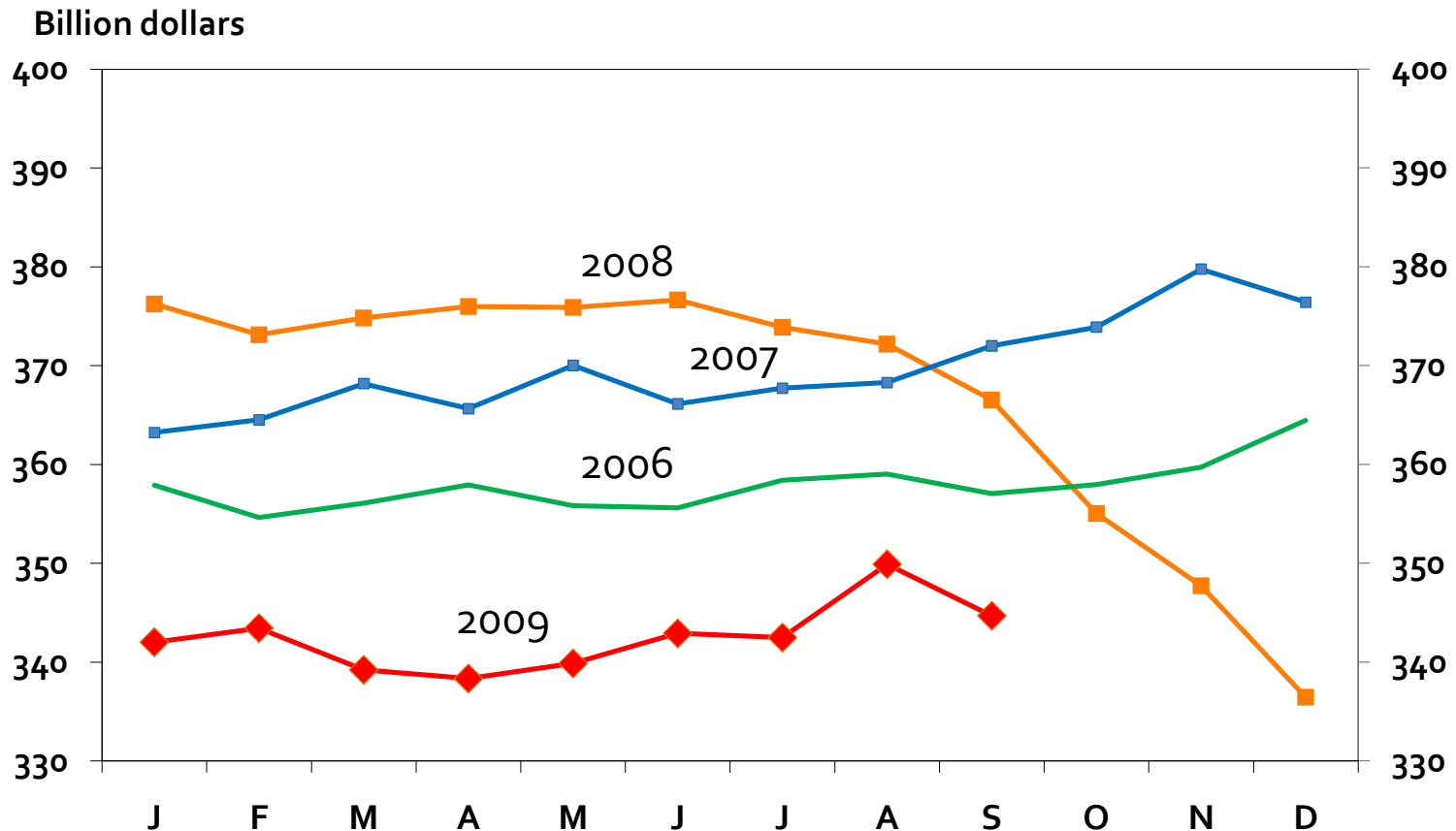


Source: Bureau of Economic Analysis and Blue Chip Economic Indicators



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

U.S. Monthly Retail and Food Sales

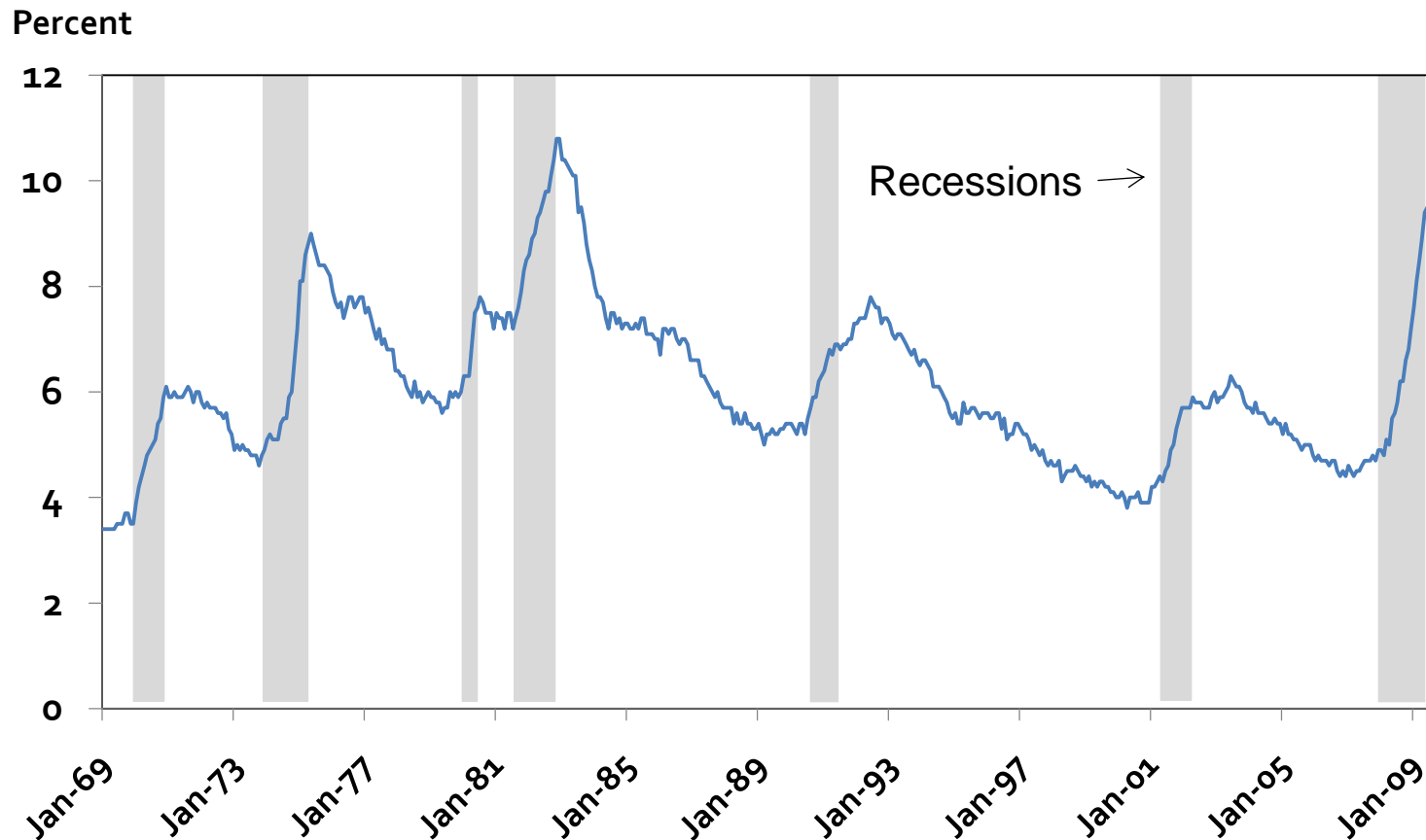


Source: U.S. Census Bureau



The unemployment rate continues to rise.

U.S. Unemployment Rate

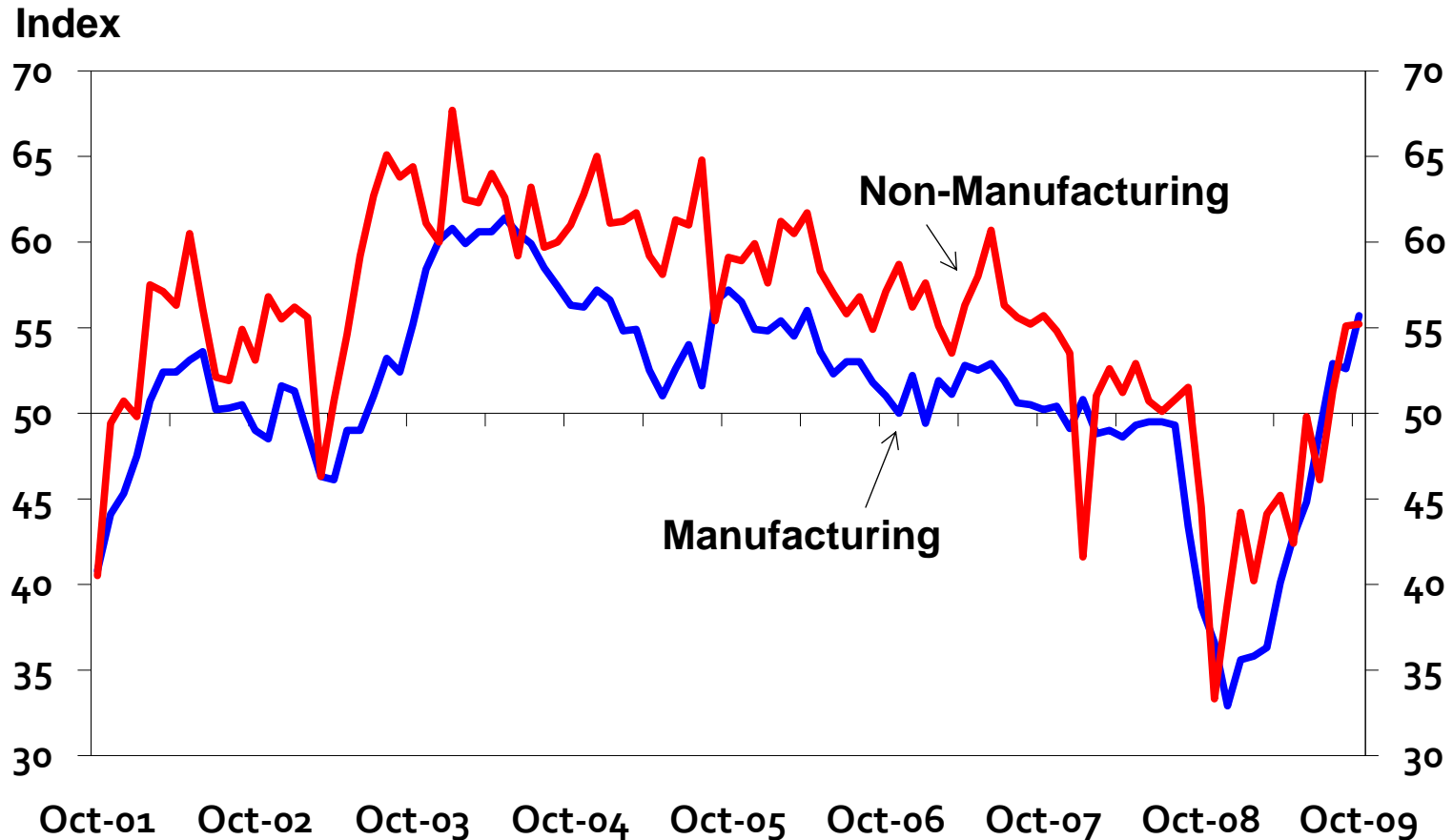


Source: Bureau of Economic Analysis



Business activity is expanding.

U.S. Business Activity Indices

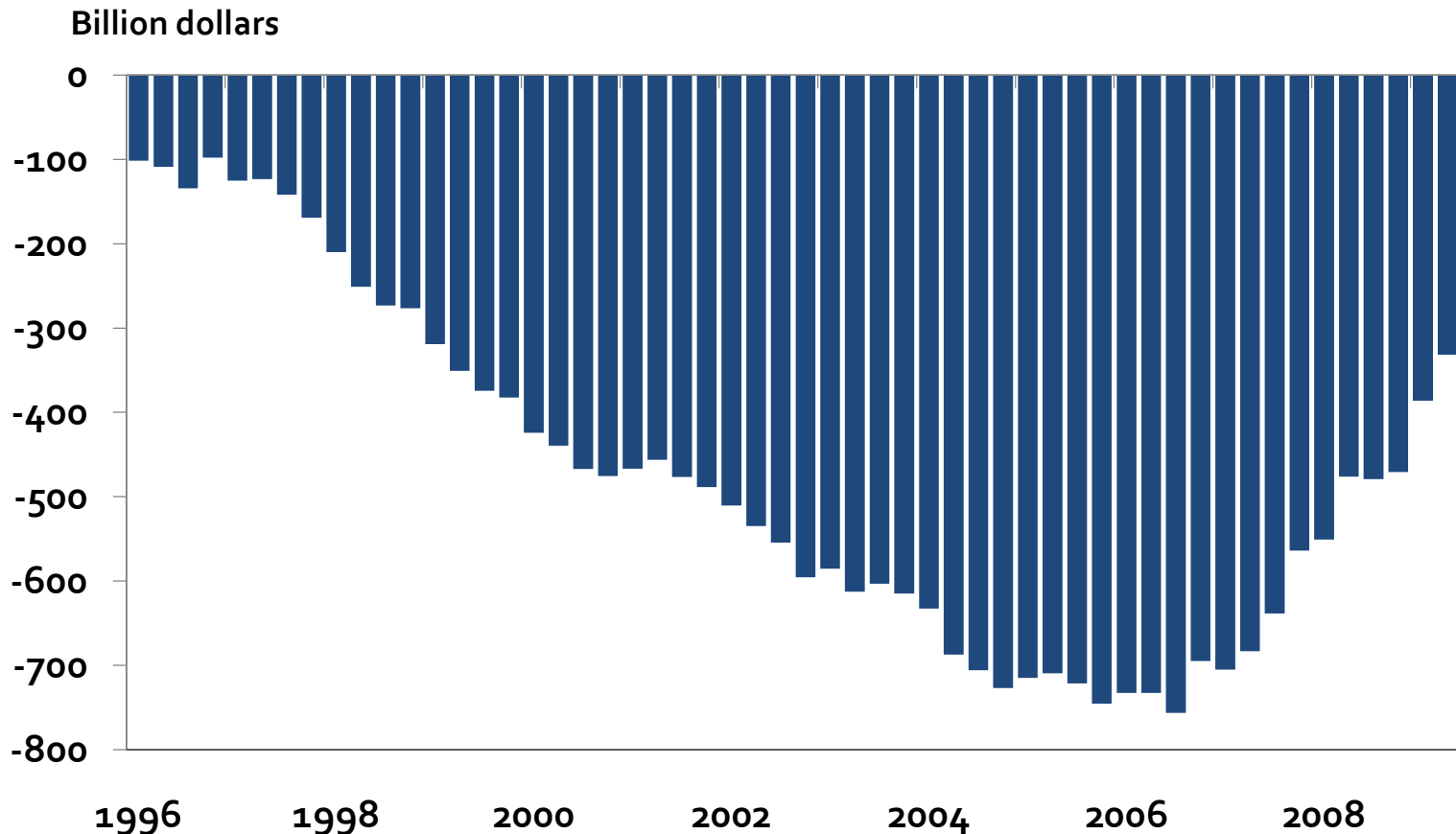


Source: Institute of Supply Management



Improvements in the U.S. trade balance continue.

Real Net Exports of Goods and Services

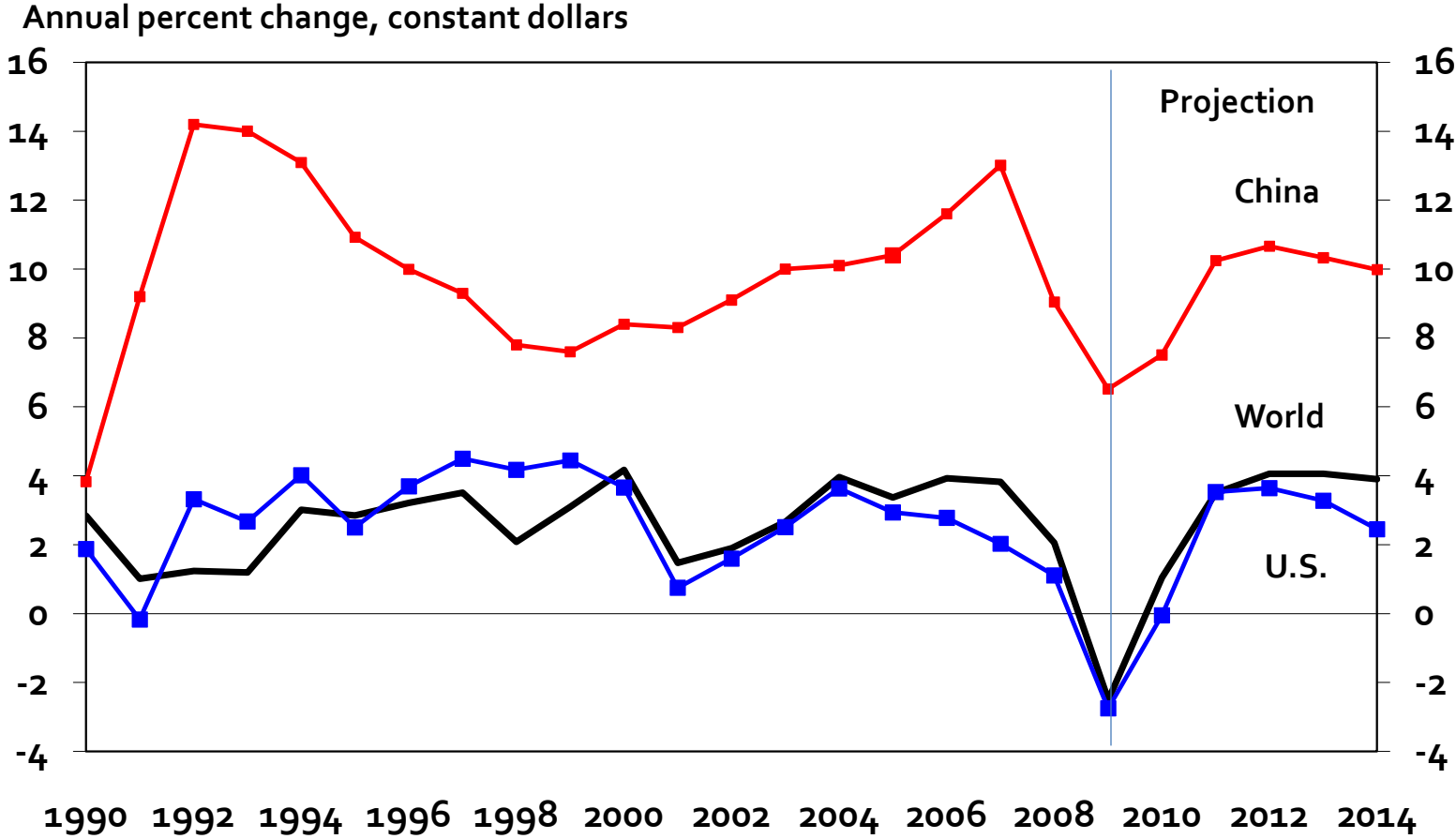


Source: Bureau of Economic Analysis



Will emerging countries lead the recovery?

GDP Growth



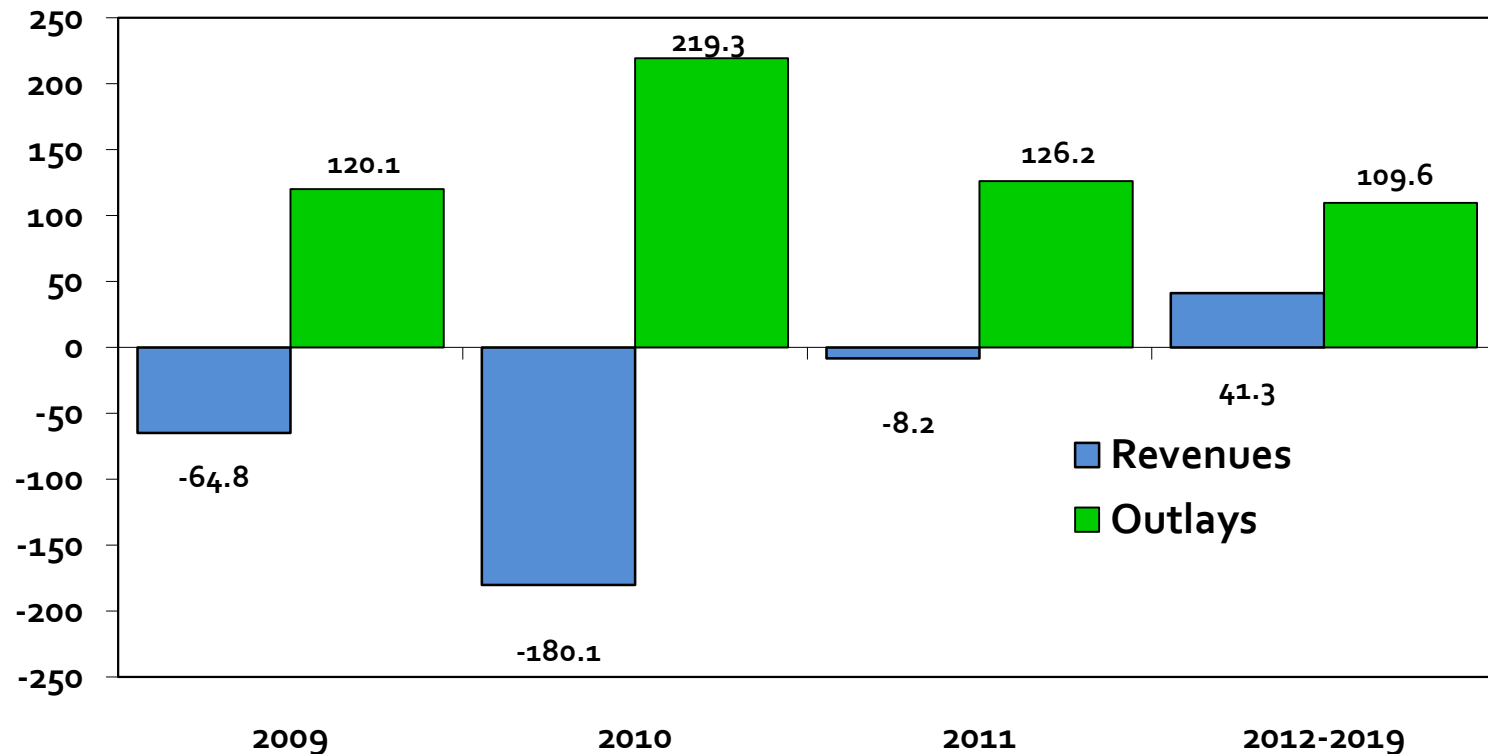
Source: International Monetary Fund, April 2009



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



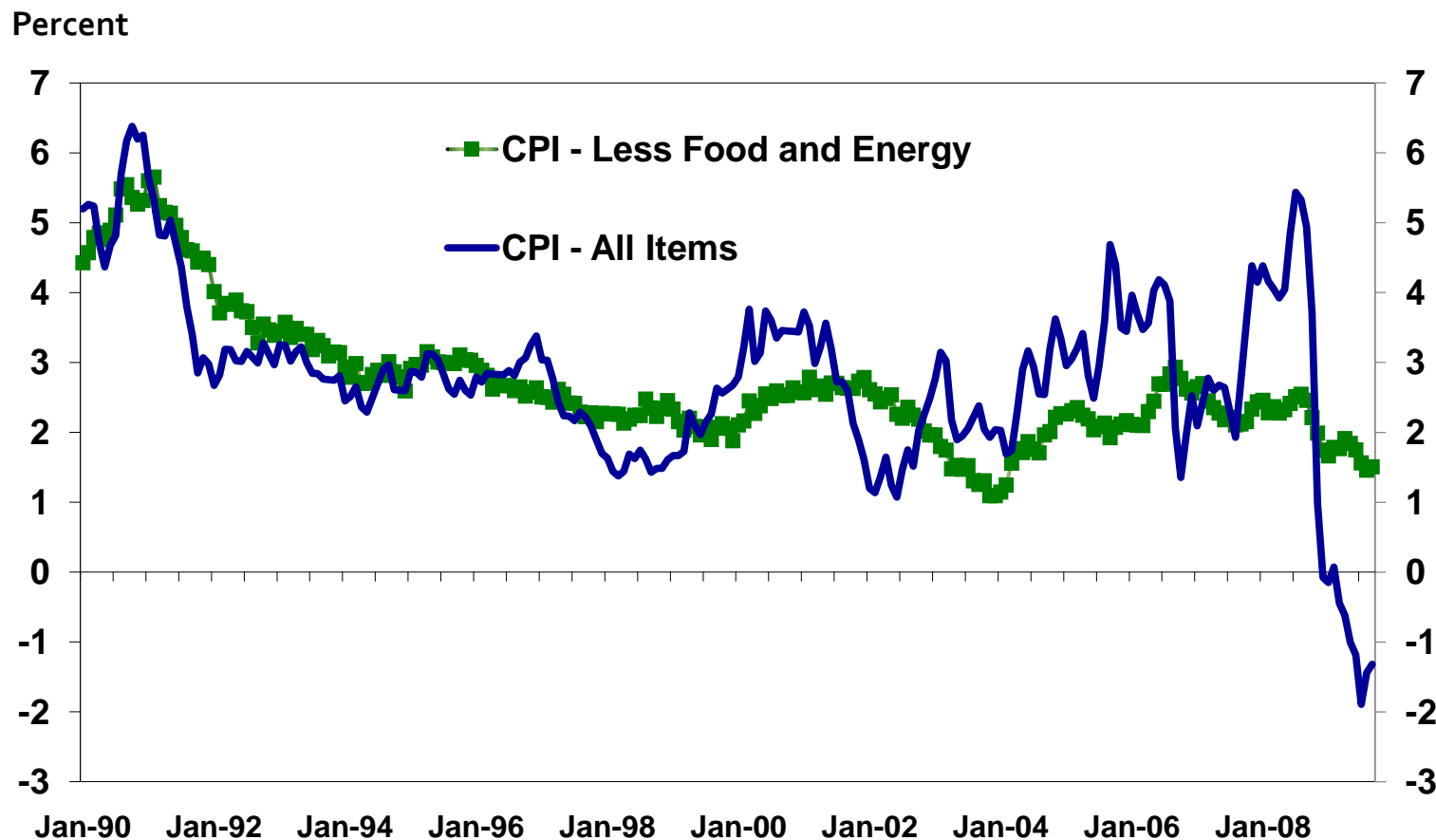
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The financial crisis and recession created a disinflationary environment.

Consumer Price Inflation



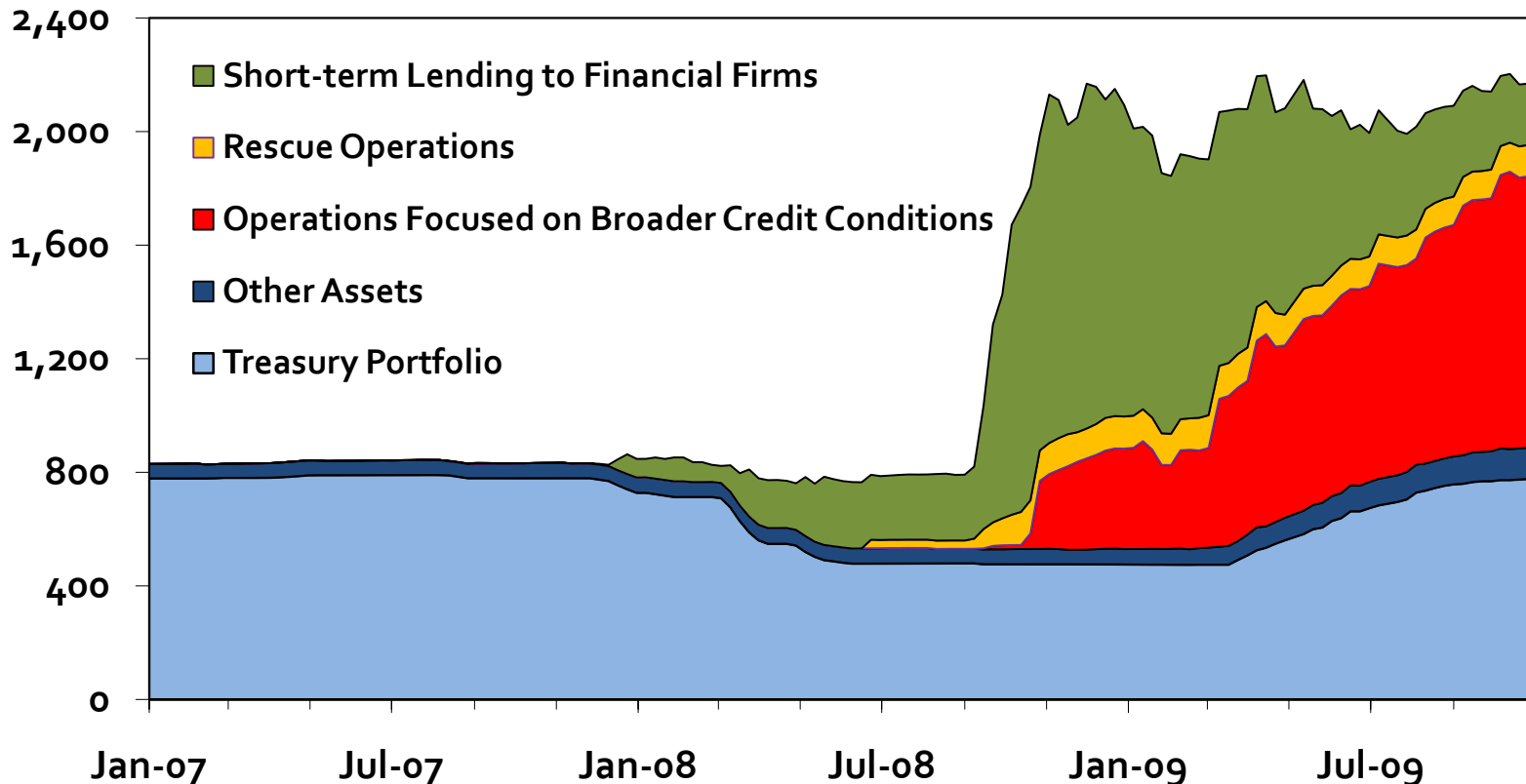
Source: Bureau of Labor Statistics



In response, the Fed Funds rate went to the zero bound and bank reserves surged.

Federal Reserve Balance Sheet

Billion Dollars

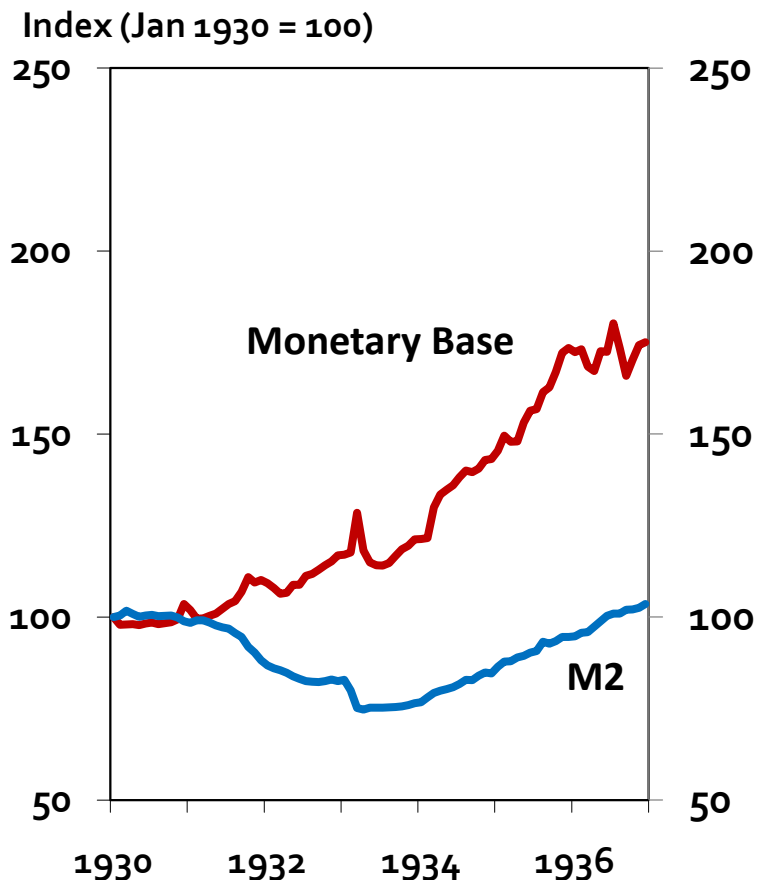


Source: Federal Reserve Board of Governors

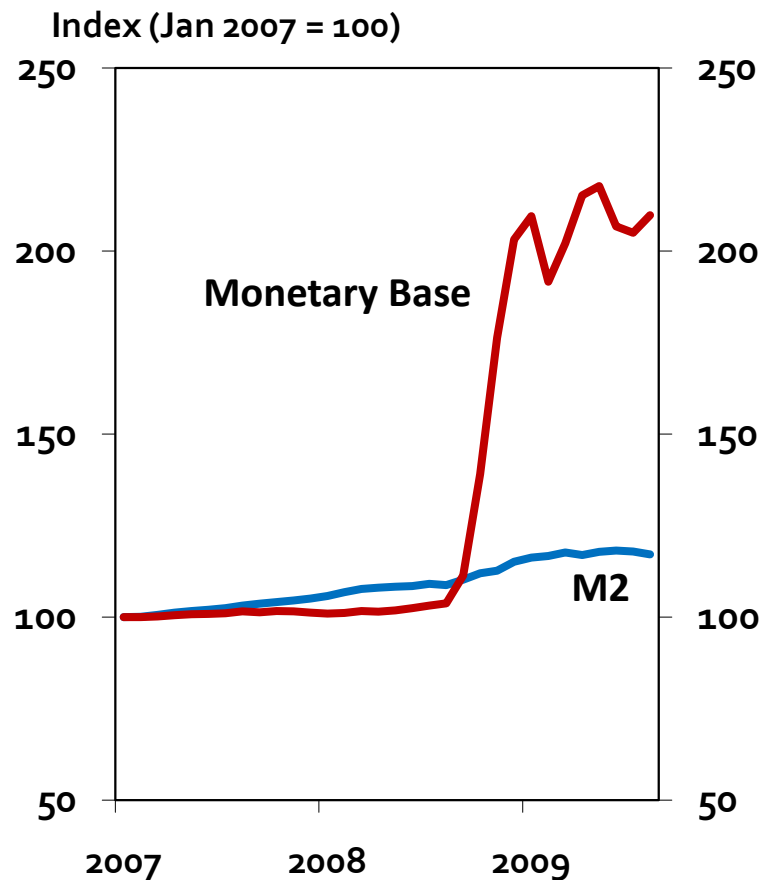


Unlike the Great Depression, money stock (M2) has edged up with a surge in the monetary base.

Growth in Monetary Aggregates



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



Source: Federal Reserve Board of Governors



What will the future hold? Inflation, disinflation, deflation?

- Today, monetary policy is extremely accommodative
 - Bank excess reserves are large and interest rates are low
- Fiscal deficits are large
- The U.S. appears to be returning to growth
- So, what about inflation and the expectations of future inflation?



Inflation is expected to remain contained.

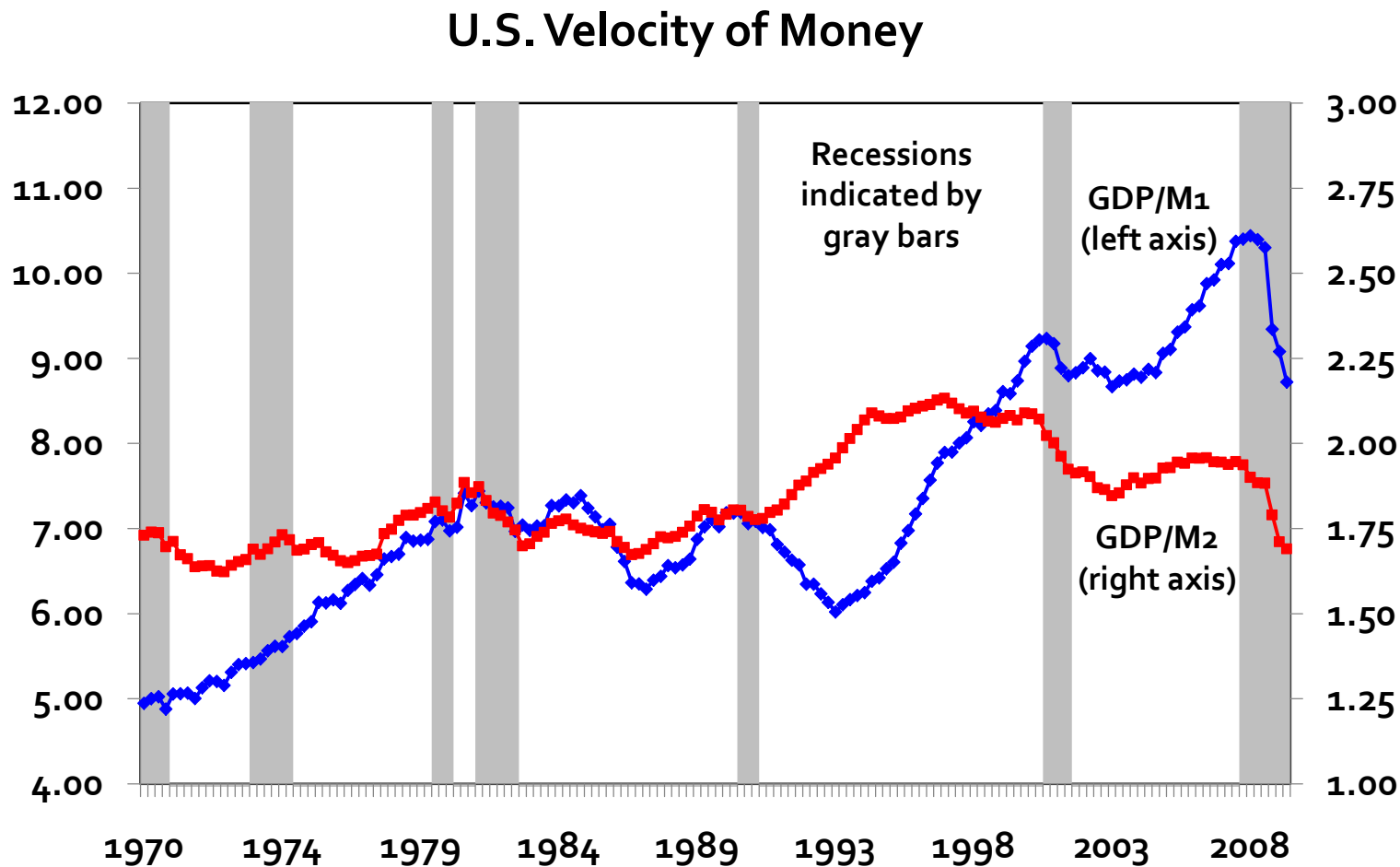
Average Annual Inflation Expectations: Consumer Price Index



Source: Survey of Professional Forecasters



The velocity of money has plummeted.



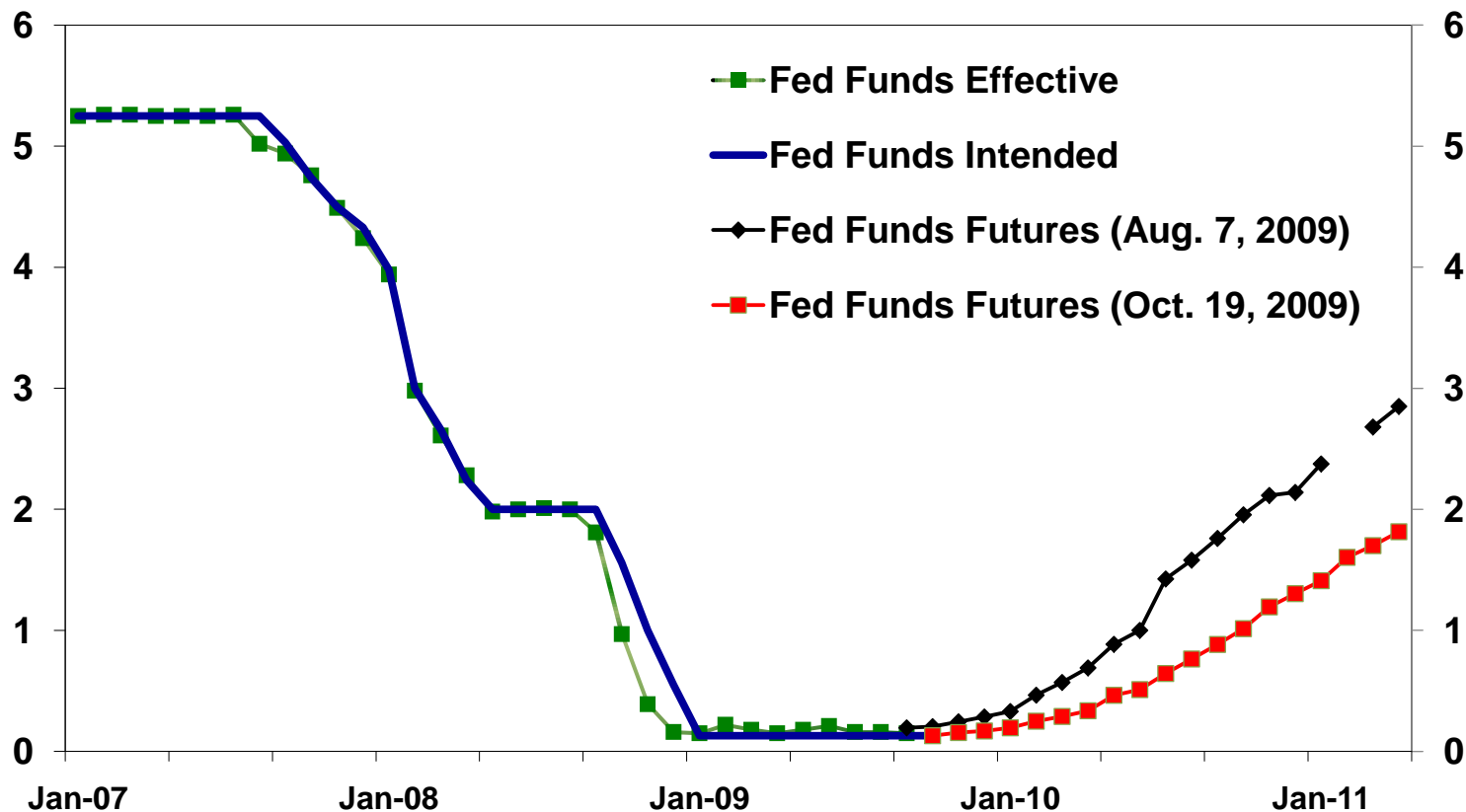
Source: BEA and Federal Reserve Board of Governors



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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