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Show Me the Money: Unlocking the Mysteries of the Economy



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.

Mysteries of the Economy

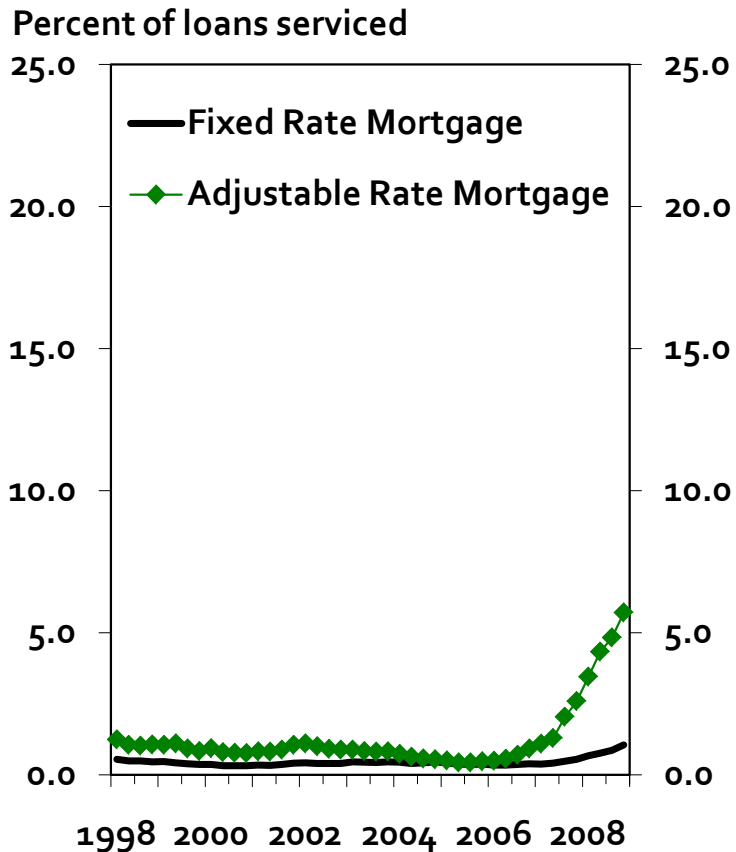
- **Housing and the Financial Crisis**
- **The Recession and Recovery**
- **Monetary Policy and the Federal Reserve**
- **Inflation or Deflation**
- **The Basis of Economic Growth**



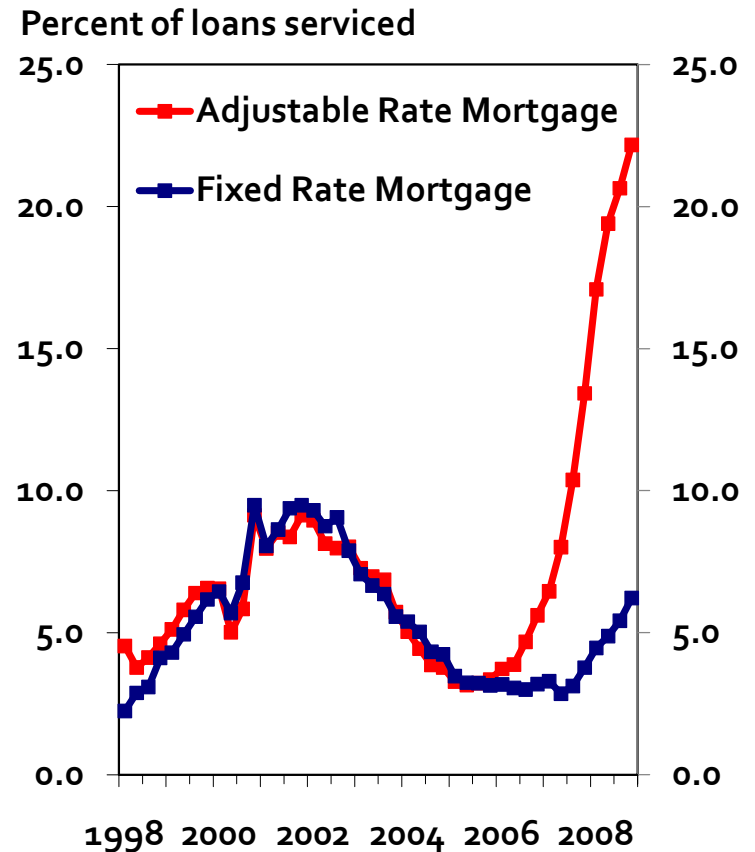
Home Foreclosures Rise, Especially for Sub-prime and Adjustable Rate Mortgages.

U.S. Foreclosure Rates by Mortgage Type

Prime Loans



Sub-prime Loans

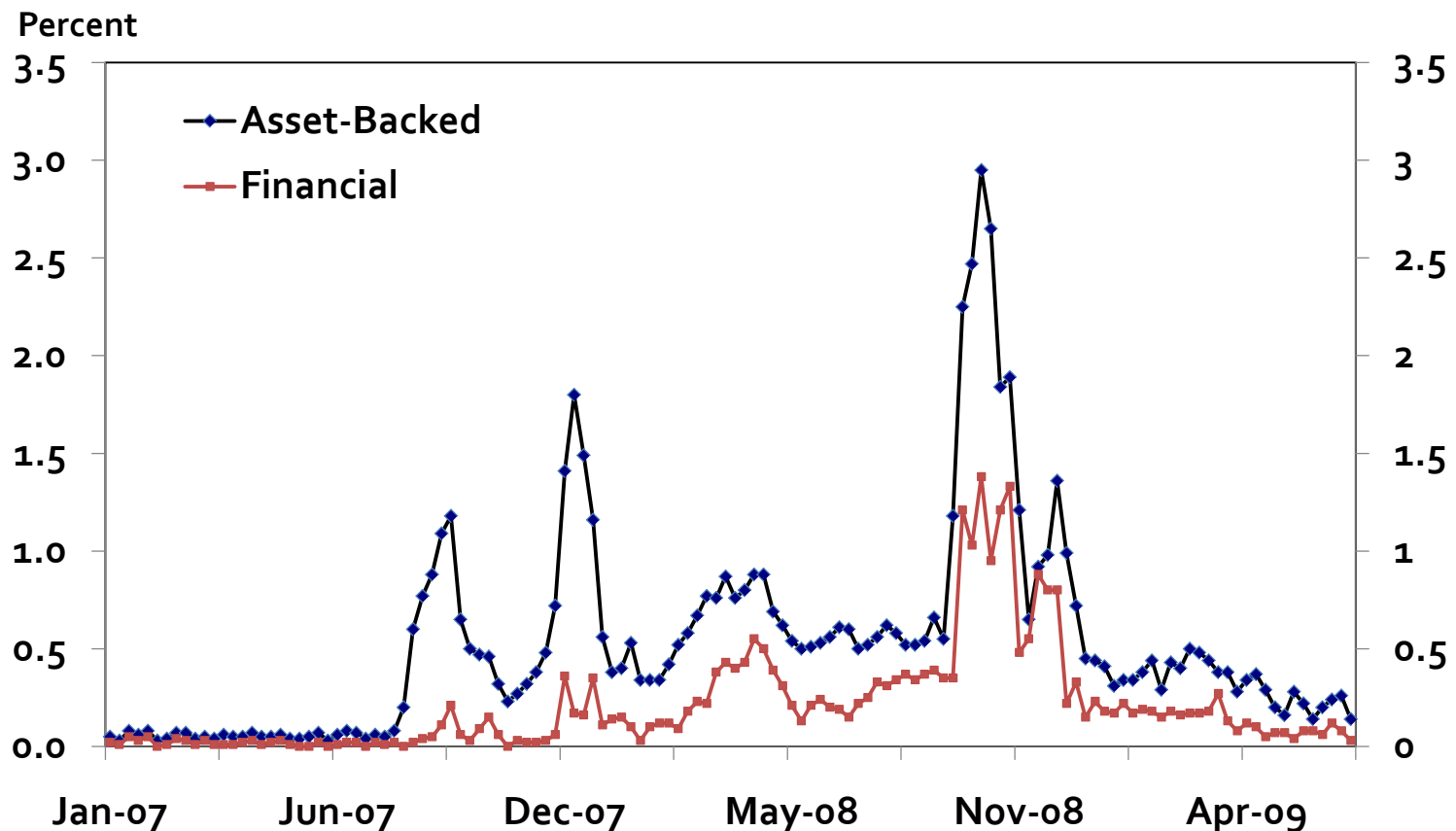


Source: Mortgage Bankers Association



Financial Market Stress has Eased, But Markets Remain Fragile.

Commercial Paper Rates Spreads
(Difference from Nonfinancial Commercial Paper)

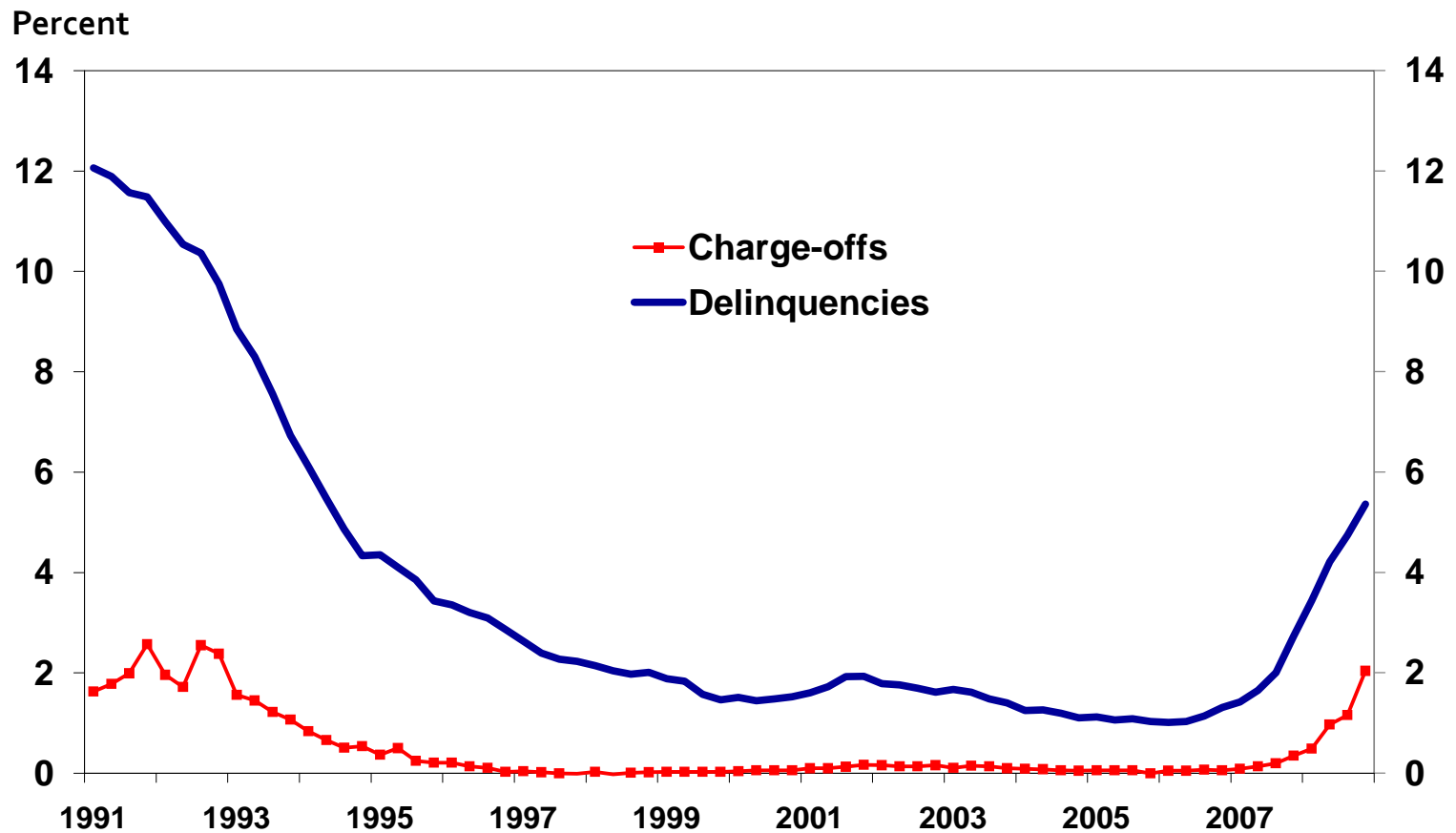


Source: Federal Reserve Board of Governors



Will Commercial Real Estate Foreclosures Strain Financial Markets?

Delinquency Rates and Charge-offs on Commercial Real Estate Loans at Commercial Banks



Source: Federal Reserve Board of Governors



Mysteries of the Economy

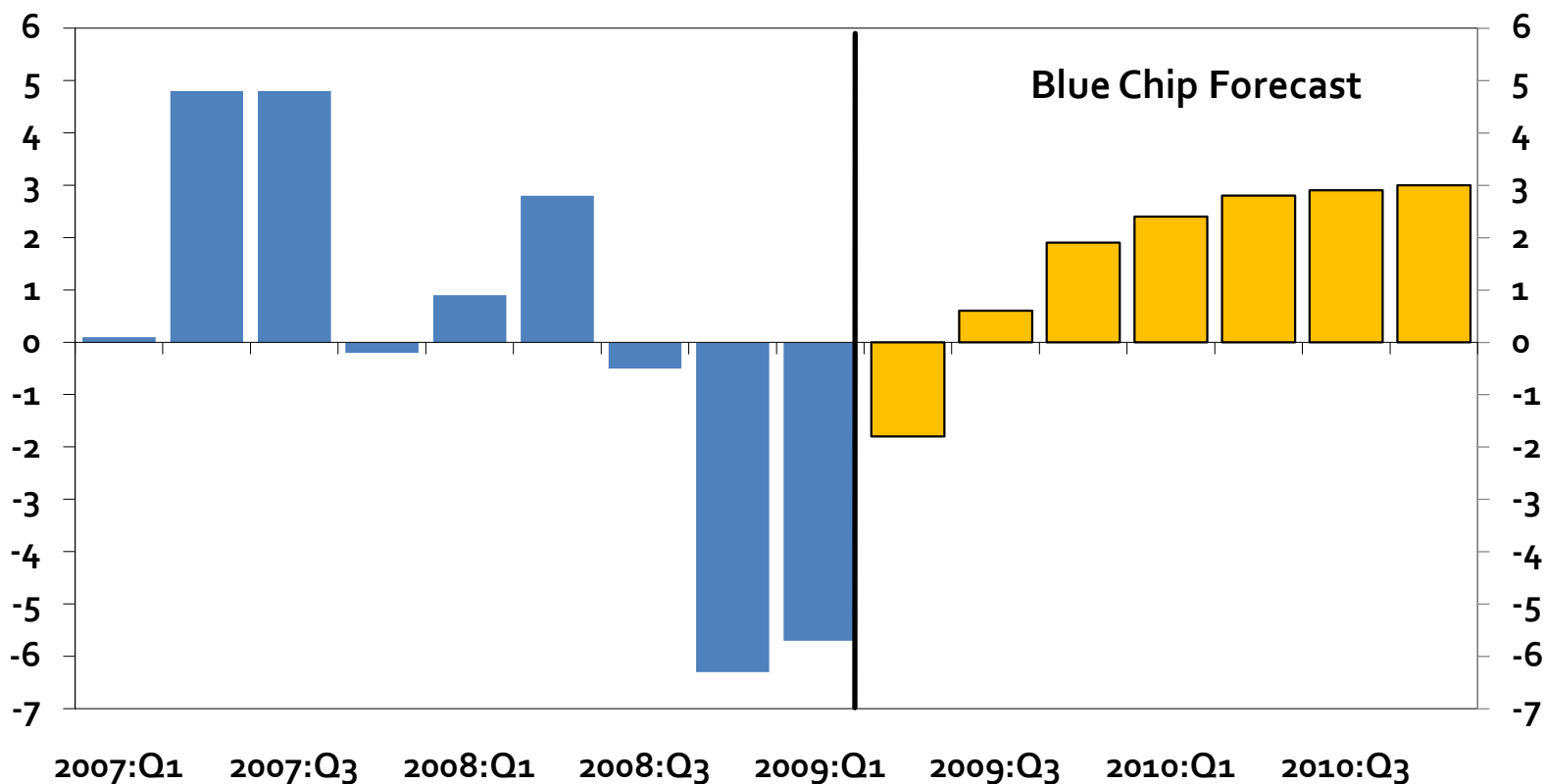
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If Forecasts Hold, the Bottom is Near.

Real GDP Growth

Annualized percent change from previous quarter

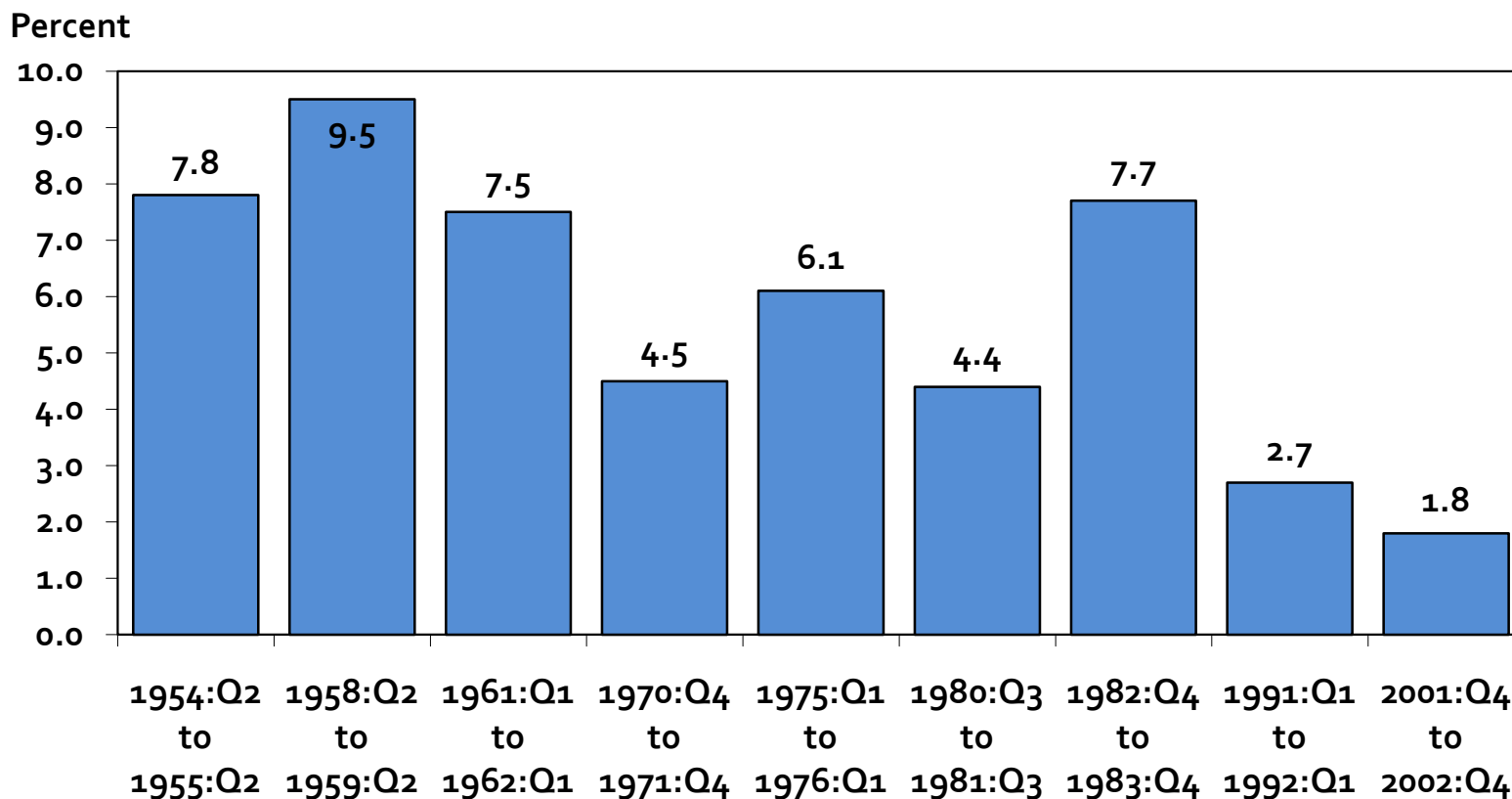


Source: Bureau of Economic Analysis and Blue Chip Economic Indicators



A Modest Recovery is Expected.

Annual GDP Growth the Year After the Recession



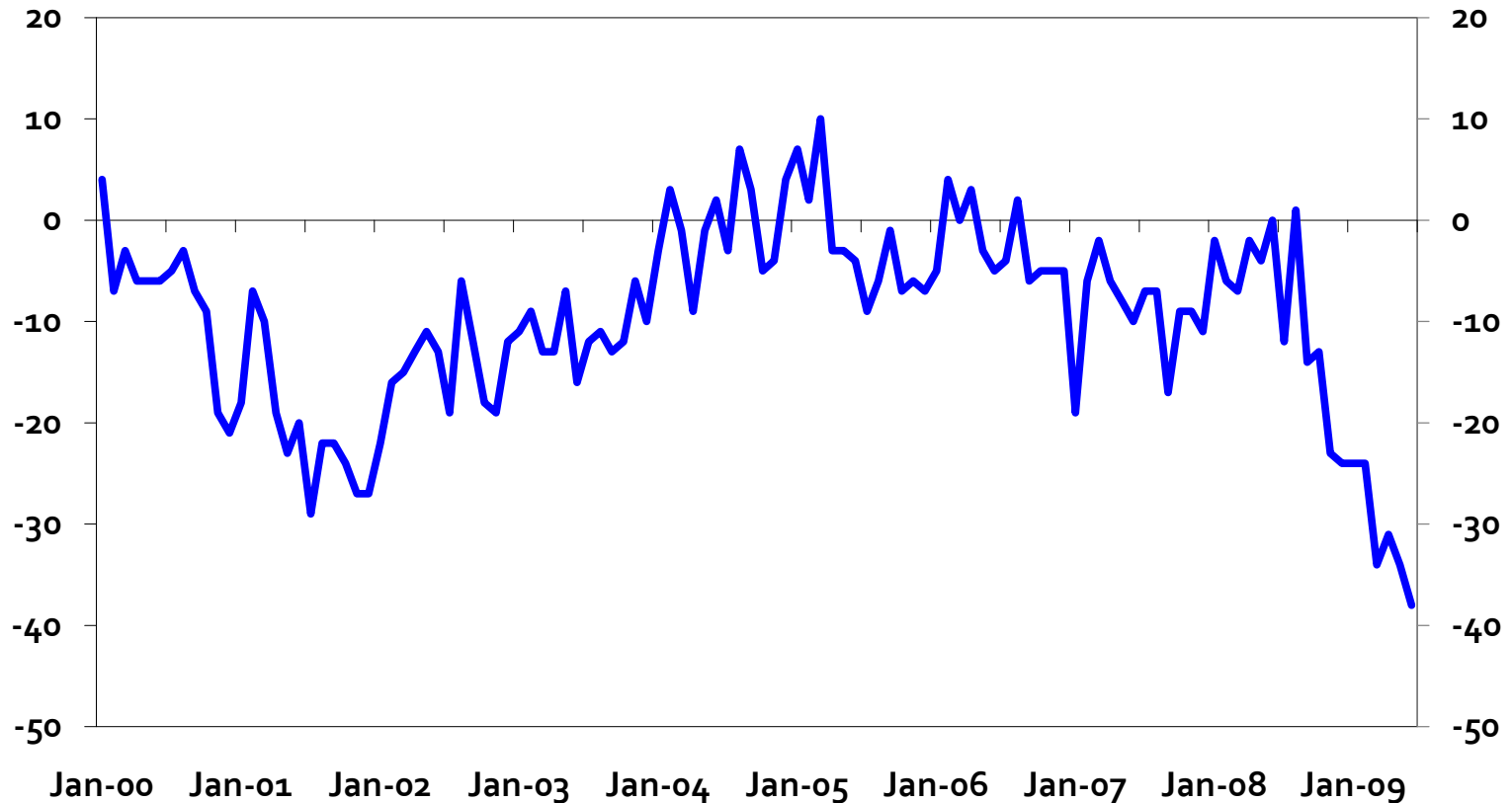
Calculations based on NBER and BEA



Manufacturers Have Low Inventories.

U.S. Manufacturing Inventories

Index (net percent reporting higher inventories)



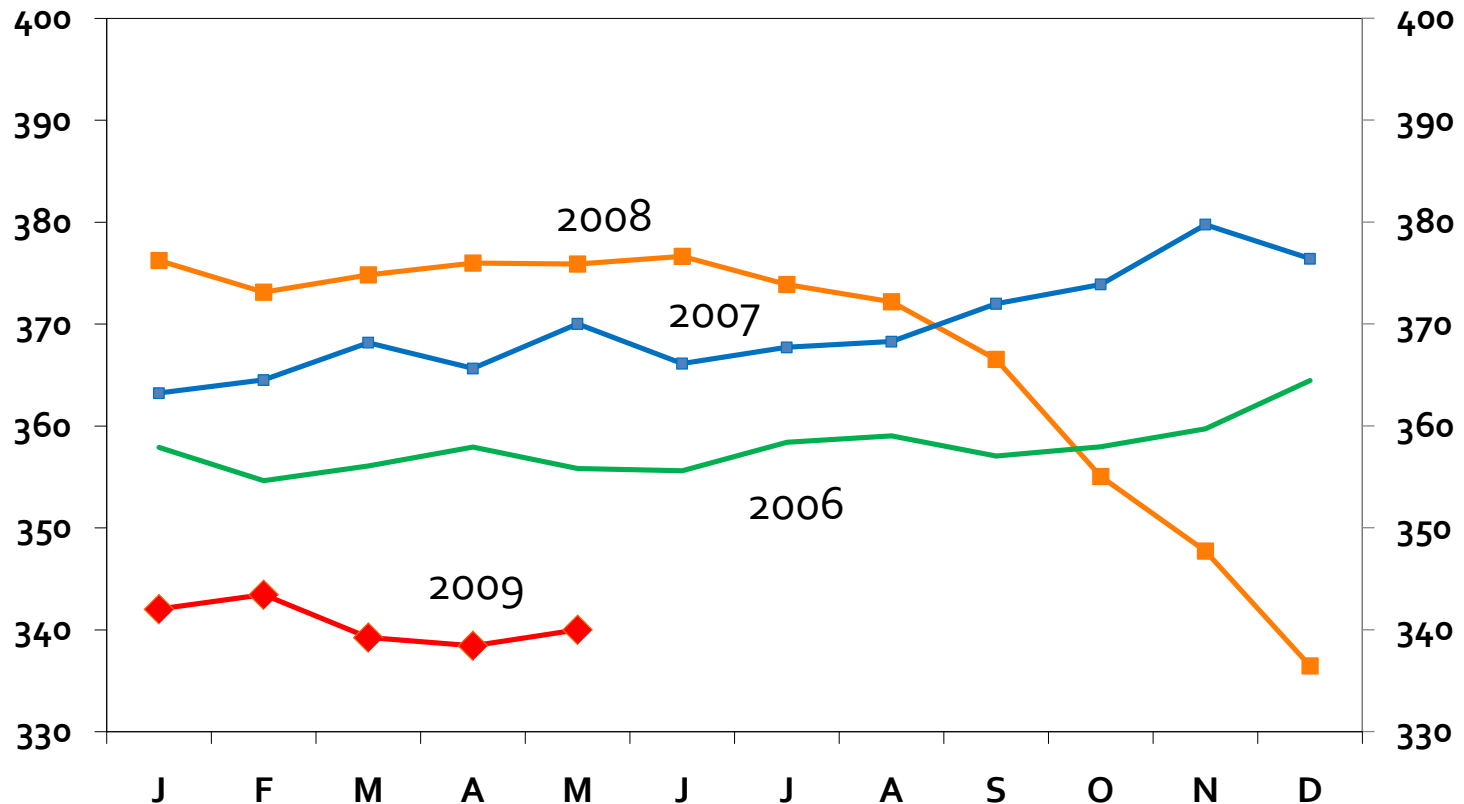
Source: Institute of Supply Management



Consumer Spending is Beginning to Stabilize.

U.S. Monthly Retail and Food Sales

Billion dollars

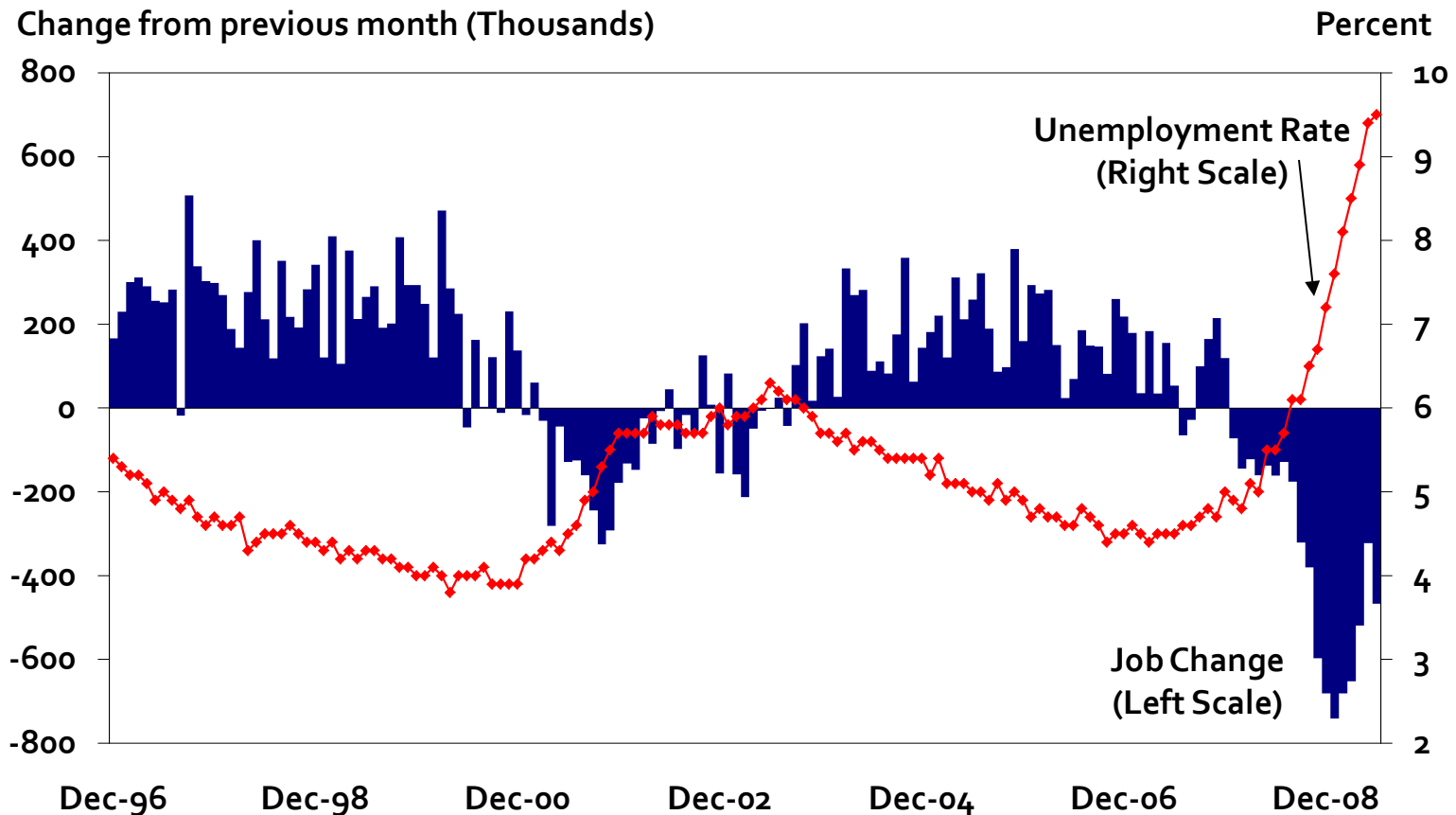


Source: U.S. Census Bureau



Rising Unemployment Will Limit Income and Spending Gains.

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

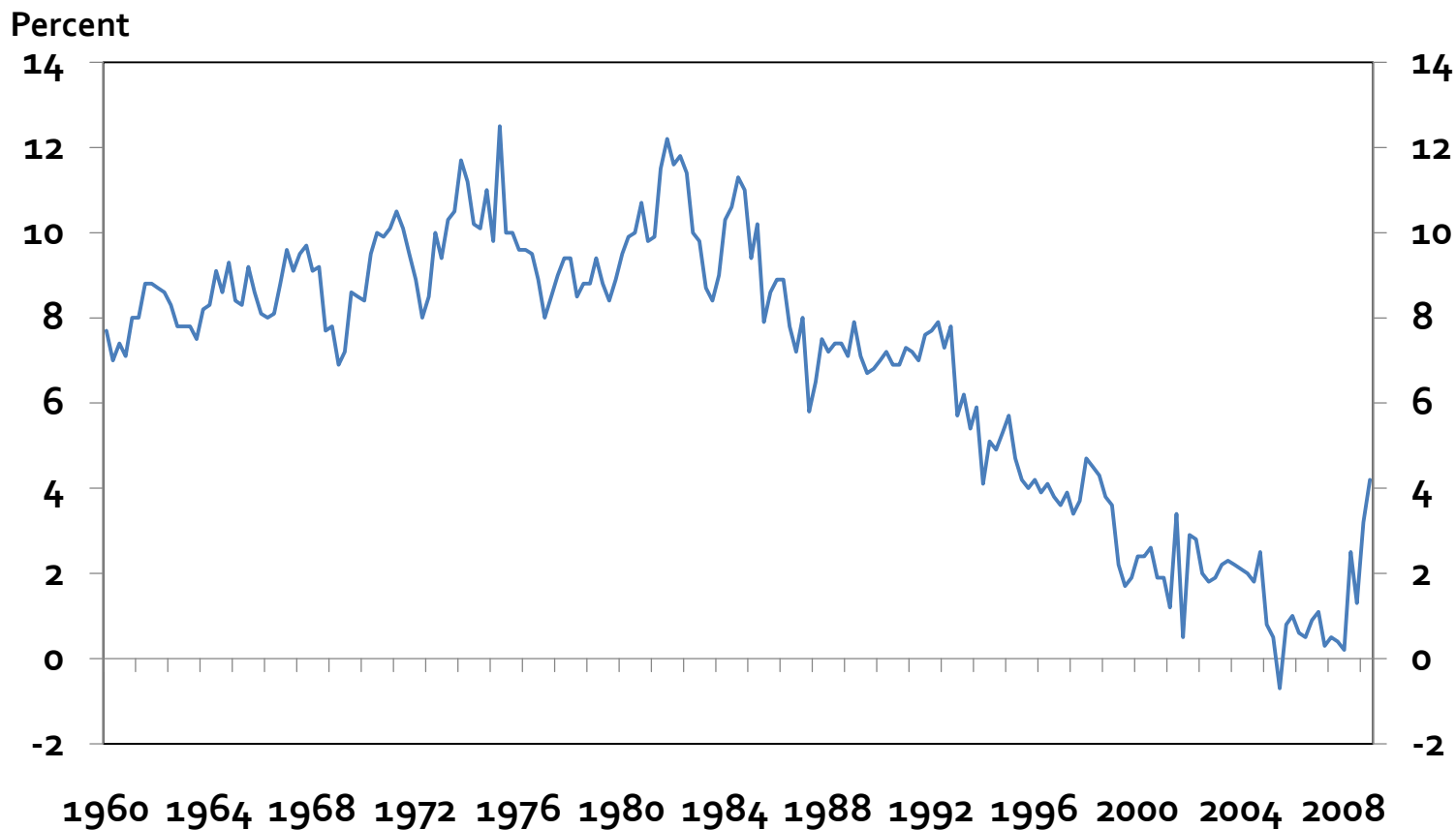


Source: Bureau of Labor Statistics



How Will Consumption Patterns Change? Will We Live Within Our Means?

Personal Savings as a Percent of Disposable Income



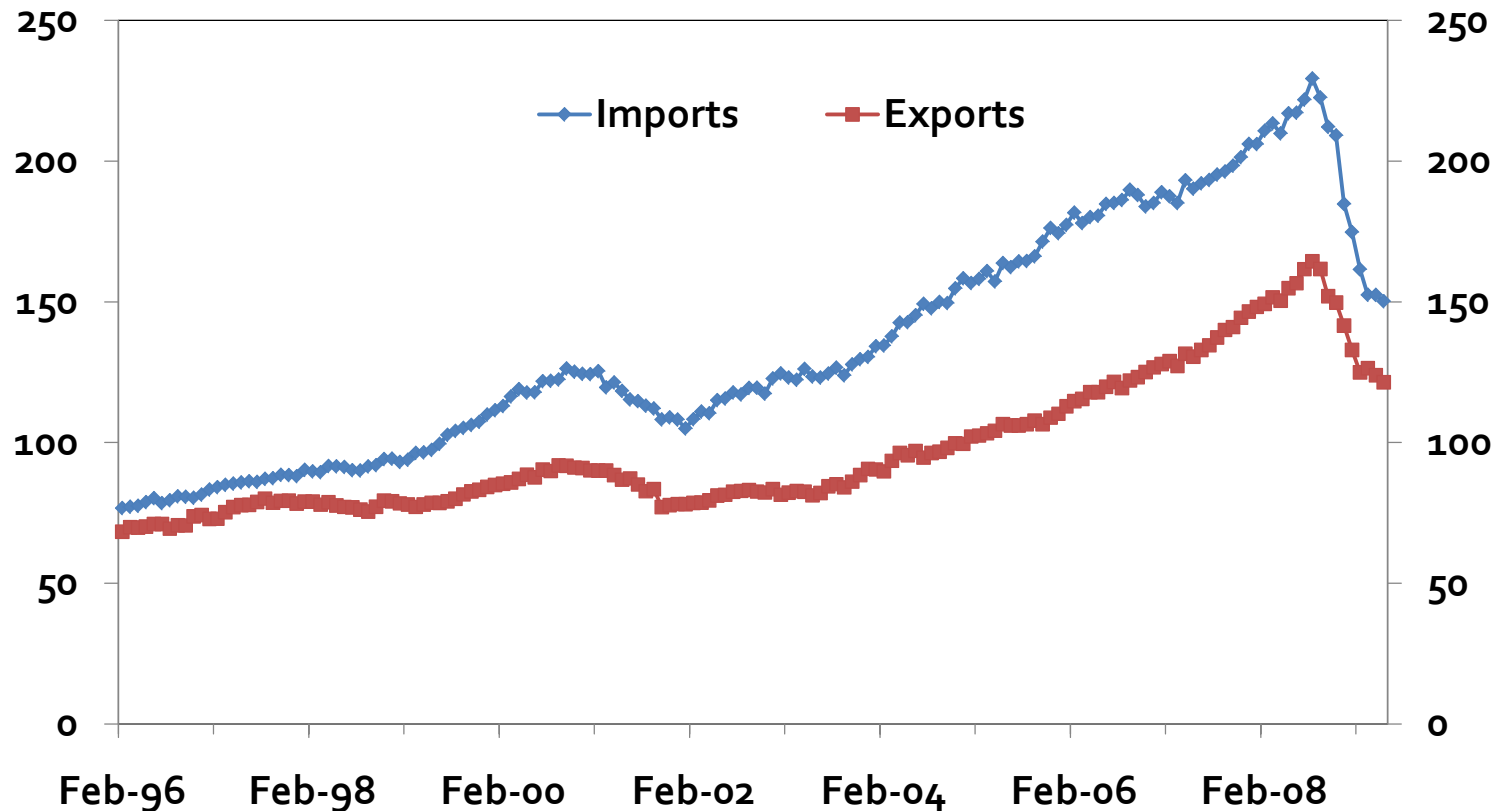
Source: Bureau of Economic Analysis



U.S. Trade Balance Improves Dramatically.

U.S. Exports and Imports of Goods and Services

Billion dollars

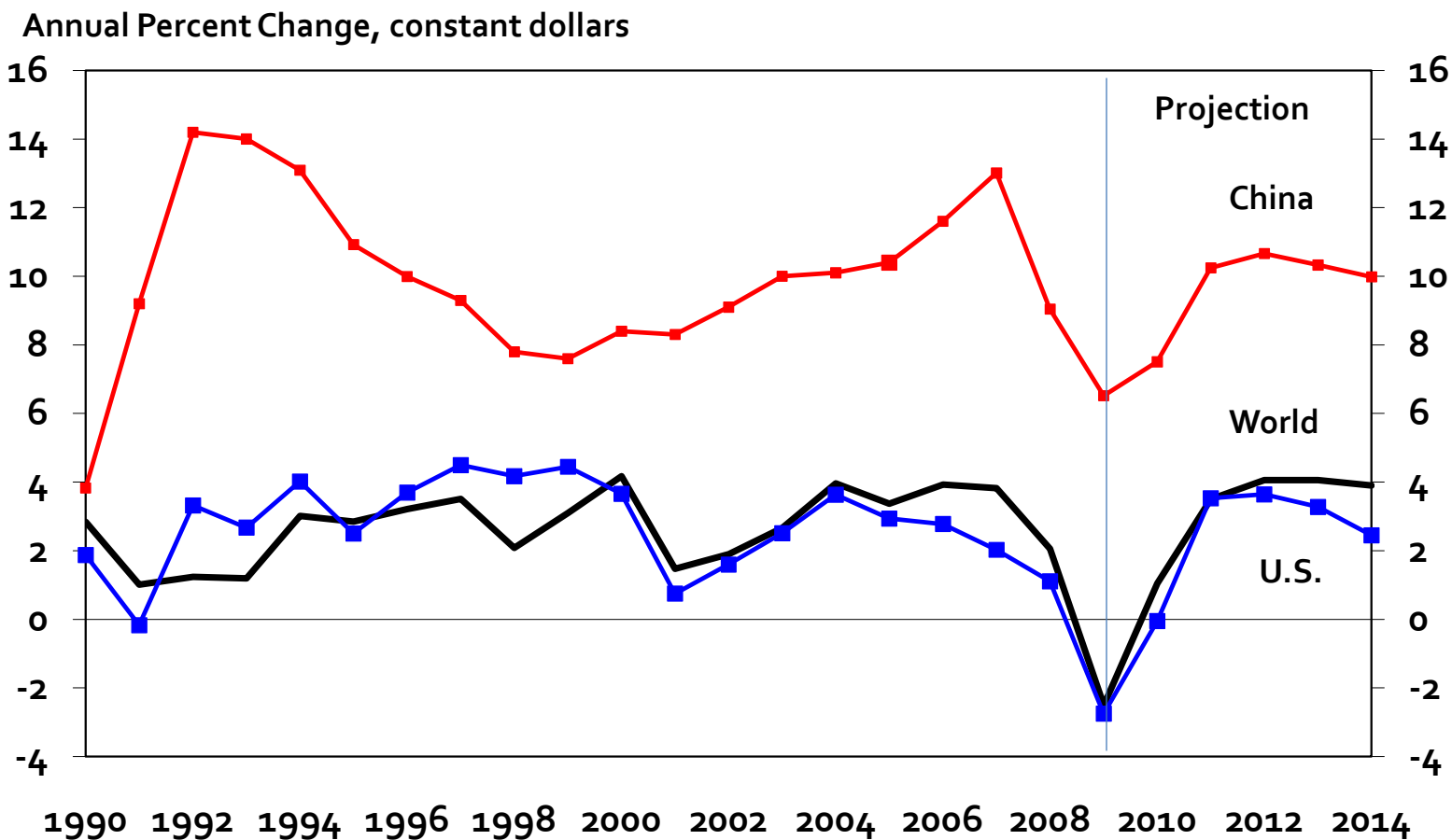


Source: Bureau of Economic Analysis



Will Emerging Countries Lead the Recovery?

GDP Growth



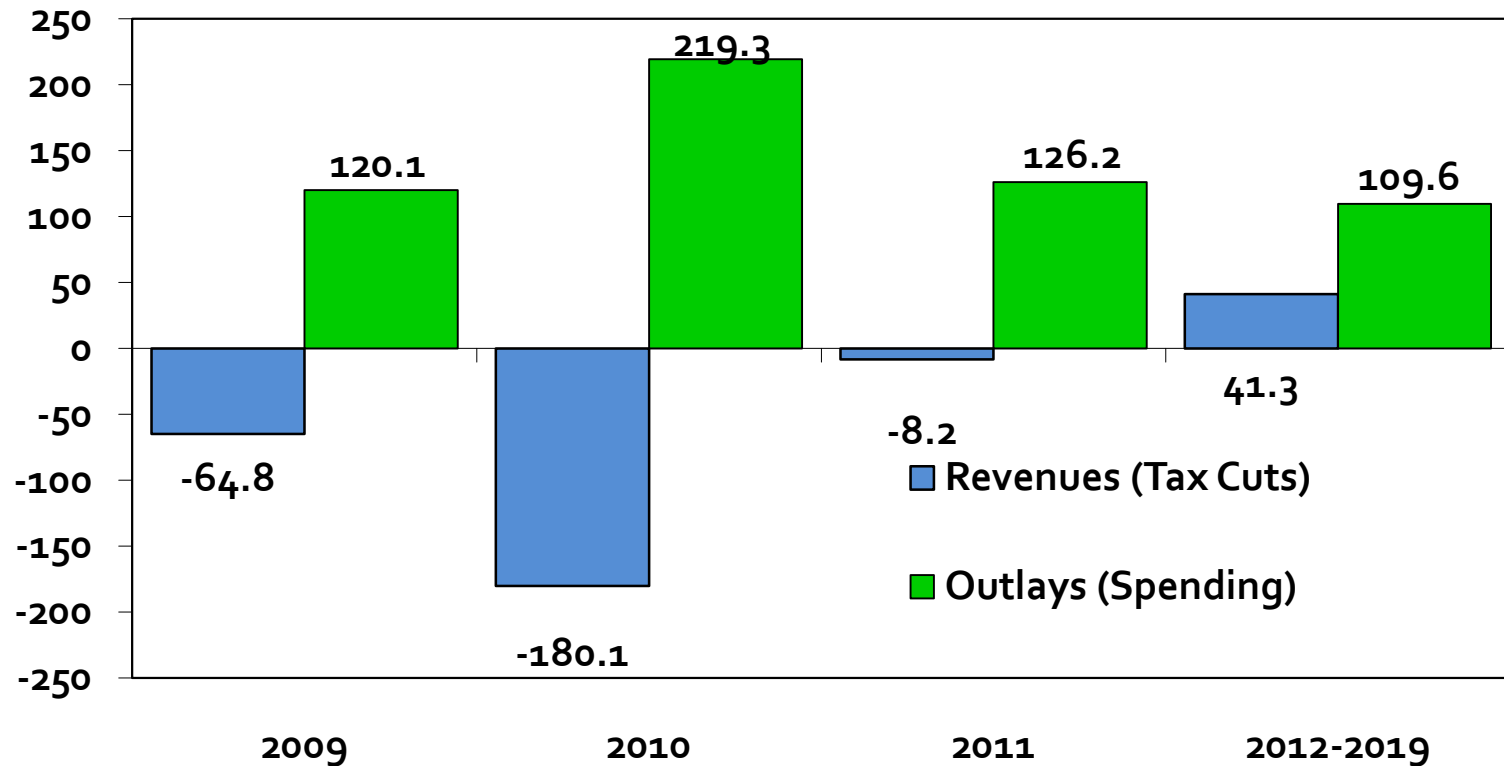
Source: International Monetary Fund, April 2009



The Bulk of the Stimulus Package is Scheduled for 2010.

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

Billion Dollars



Source: Congressional Budget Office, February 13, 2009



Mysteries of the Economy

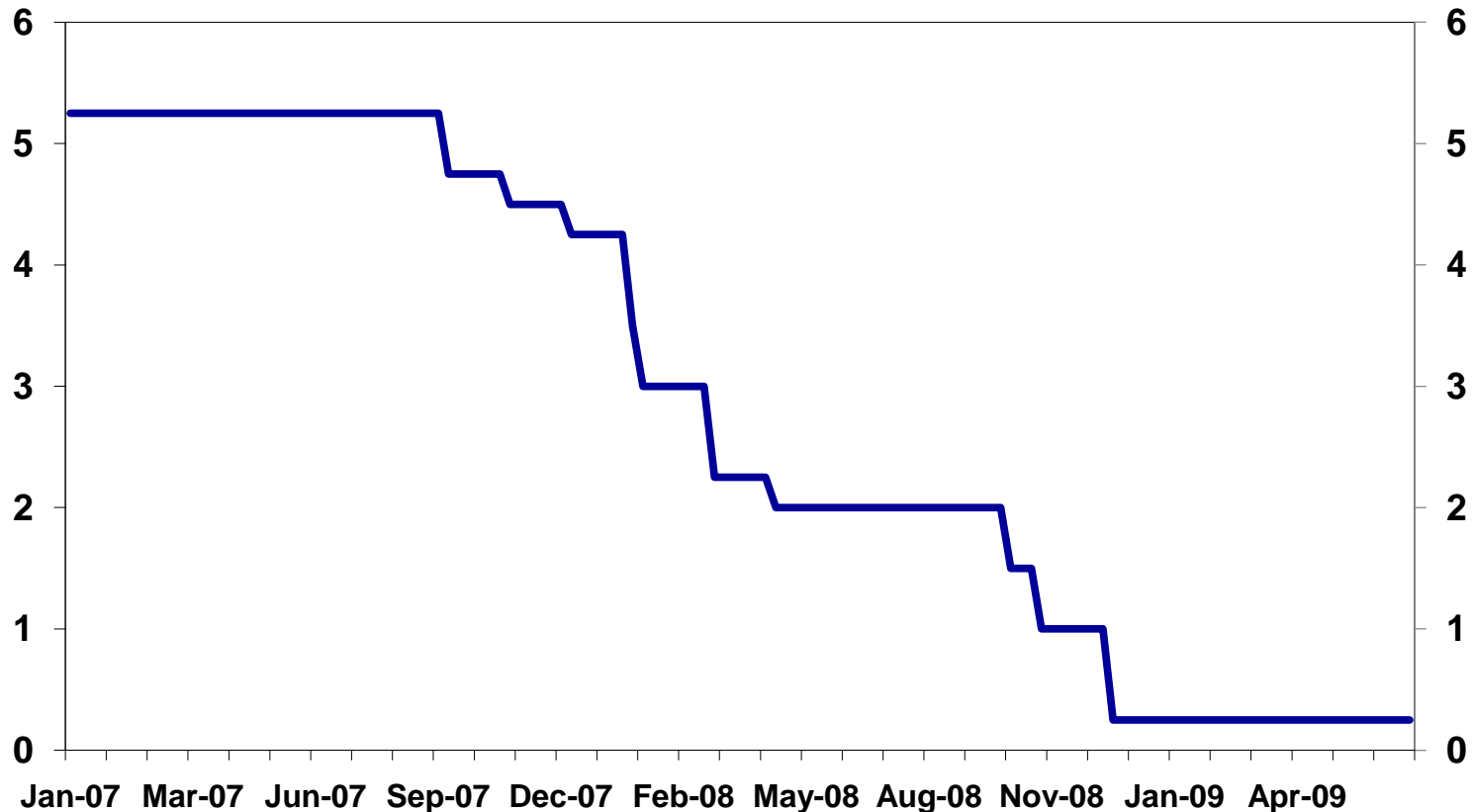
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What Happens to Monetary Policy at the Zero Bound?

Fed Funds Rate

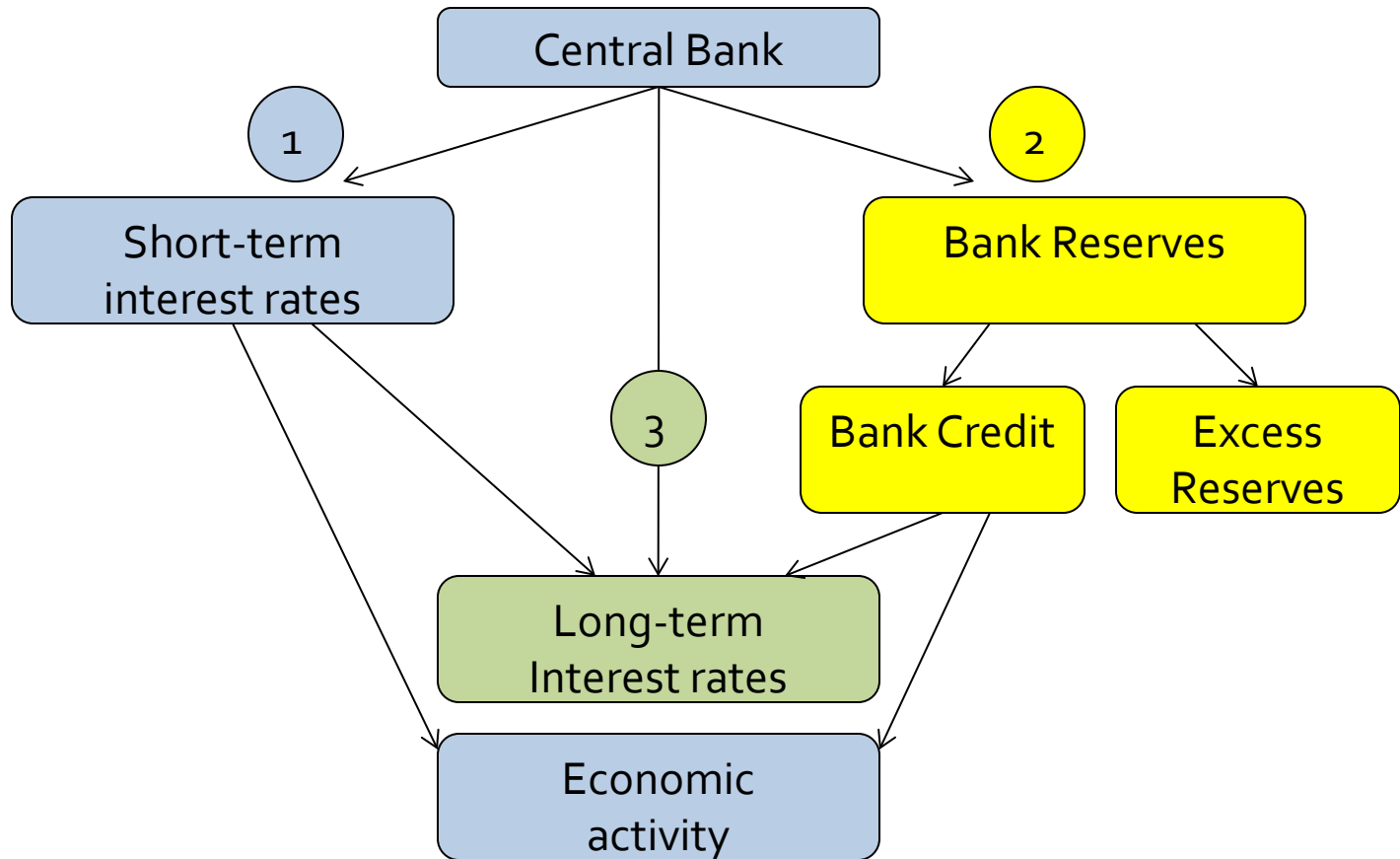
Percent



Source: Federal Reserve Board of Governors



Monetary Policy Transmission Mechanisms



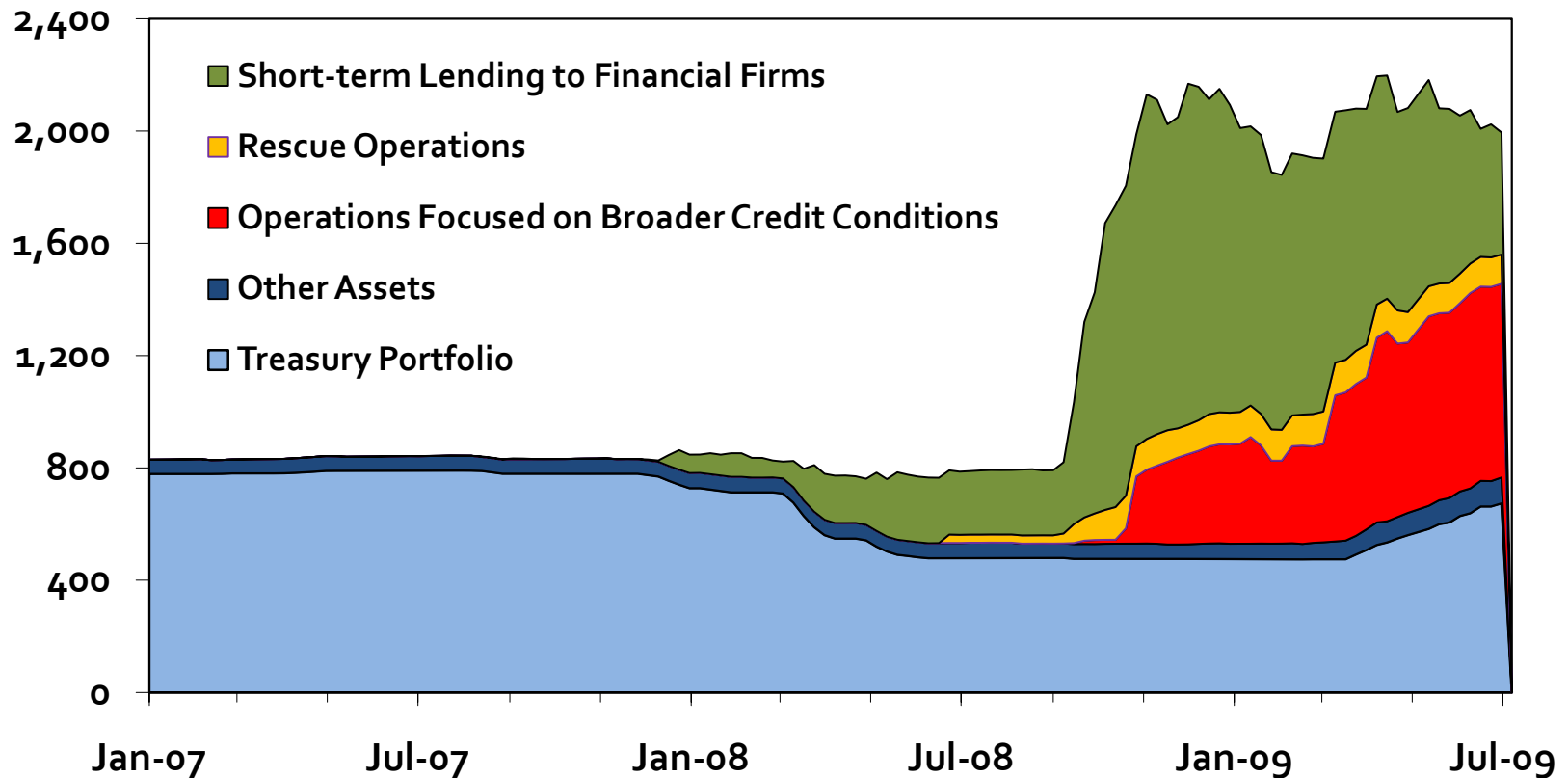
Source: Gordon Sellon (2003) "Monetary Policy and the Zero Bound: Policy Options When Short-Term Rates Reach Zero"
Economic Review <http://www.kansascityfed.org/Publicat/ECONREV/PDF/4q03sell.pdf>



The Fed Has Expanded its Balance Sheet.

Federal Reserve Balance Sheet: Assets

Billion Dollars



Source: Federal Reserve Board of Governors



Mysteries of the Economy

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- **Inflation or Deflation**



Has the Concern Switched from Deflation to Inflation?

- Deflation: ***A decline in general price levels,***
 - *often caused by a reduction in the supply of money or credit.*
 - *brought about by **direct contractions in spending**, either in the form of a reduction in government spending, personal spending or investment spending.*
- “In light of increasing economic slack here and abroad, the Committee expects that **inflation will remain subdued**. Moreover, the Committee sees some risk that **inflation could persist for a time below rates that best foster economic growth and price stability in the longer term.**”

FOMC Statement

April 29, 2009

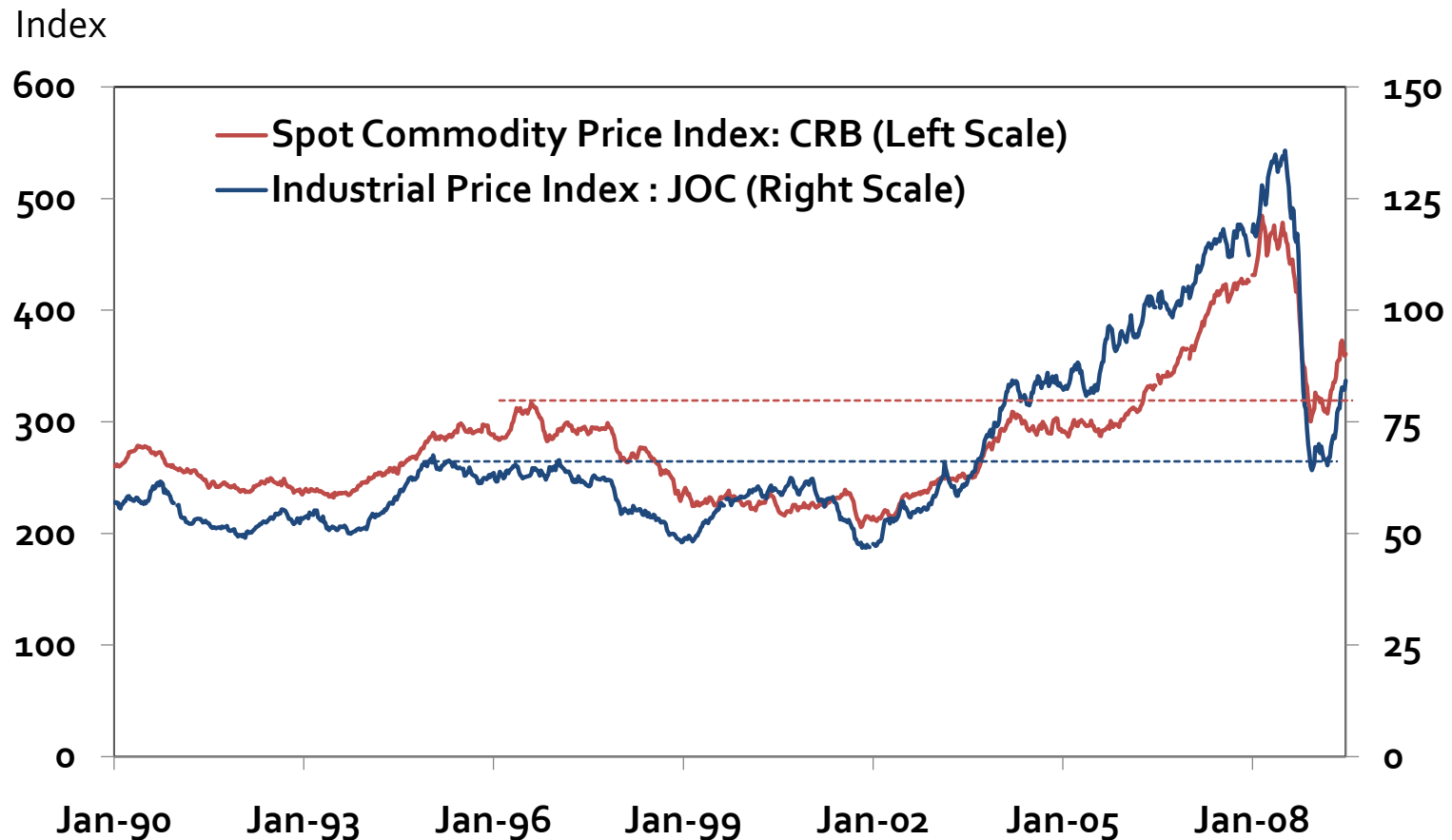
- The prices of energy and other commodities have risen of late. However, substantial resource slack is likely to dampen cost pressures, and the Committee expects that **inflation will remain subdued for some time.**

FOMC Statement

June 24, 2009



Are Commodity Prices a Leading Indicator?



Source: Journal of Commerce and Commodity Research Bureau



Long-term Inflation Expectations are Well-anchored.

Average Annual Inflation Expectations: Consumer Price Index



Source: Survey of Professional Forecasters



Mysteries of the Economy

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- **The Basis of Future Economic Growth**



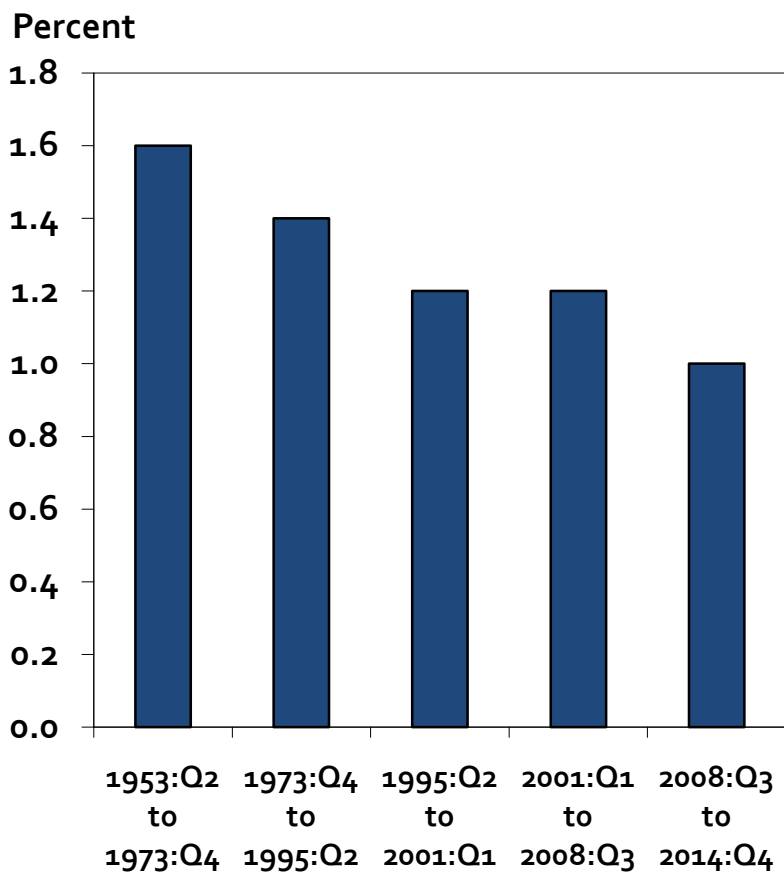
The Foundations of Economic Growth

- **Economic growth is based on people.**
 - **The number of people in the country,**
 - **How many of them work, and**
 - **How productive they are when they work.**

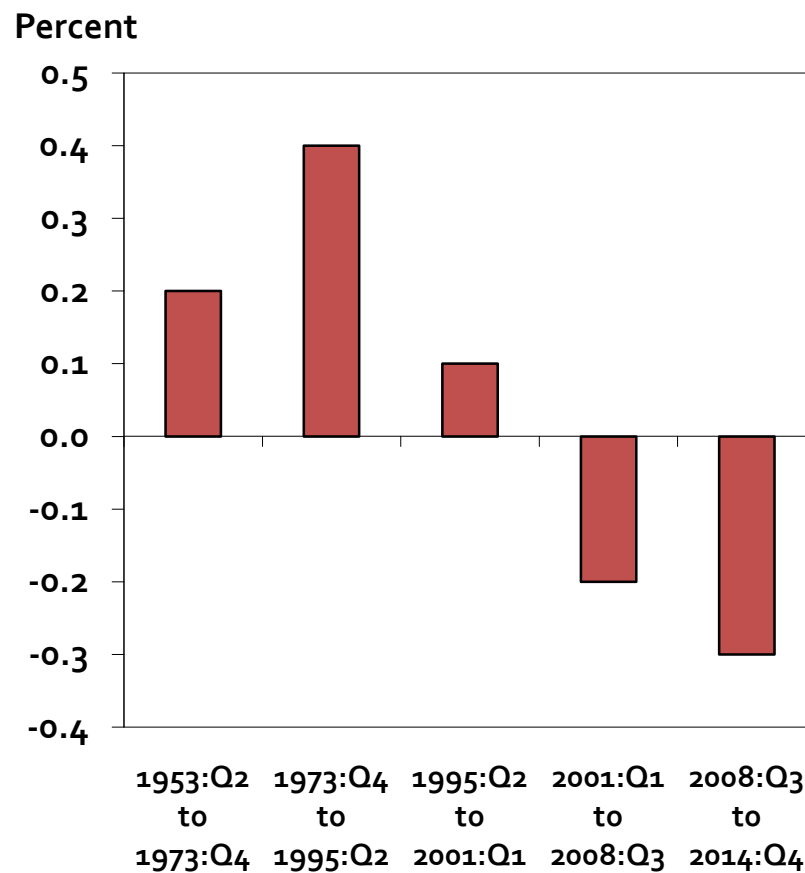


Working Age Population Growth Slows with Aging Populations.

Civilian Population Aged 16 and older



Labor Force Participation Rates



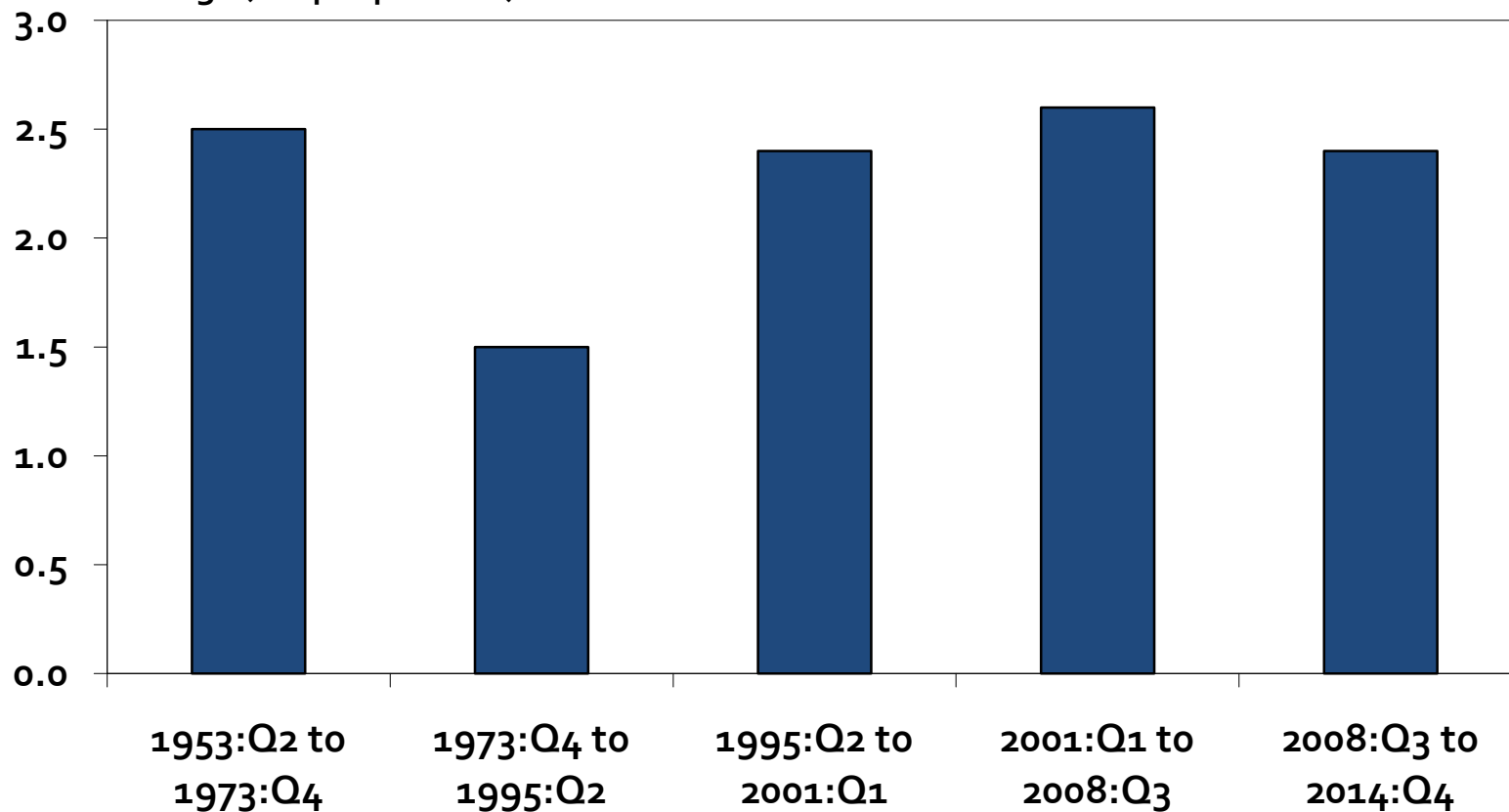
Source: Economic Report of the President, 2009



Economic Prosperity Depends on Productivity Gains.

U.S. Labor Productivity Growth

Percent change (Output per hour)



Source: Economic Report of the President, 2009



Conclusions

- **The recession appears to be coming to an end.**
 - Signs of economic stabilization are emerging.
 - Stress in financial markets has eased.
- **Setting the foundations for recovery.**
 - Who will lead the recovery: U.S. or foreign consumers?
 - How strong will the recovery be?
- **As the economy strengthens, the focus will turn from growth to inflation.**
- **In the long-run, economic prosperity will be shaped by labor productivity gains and skill attainment.**

