

Jason Henderson
Vice President and Branch Executive
Federal Reserve Bank of Kansas City – Omaha Branch
www.kansascityfed.org/omaha
July 7, 2010

Can Nebraska's Economy Buck National Trends?



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

- Economic outlook:
 - When will the economic recovery gain steam?
- Monetary policy:
 - When will the Fed withdraw economic stimulus?
- It's about timing, and it depends.

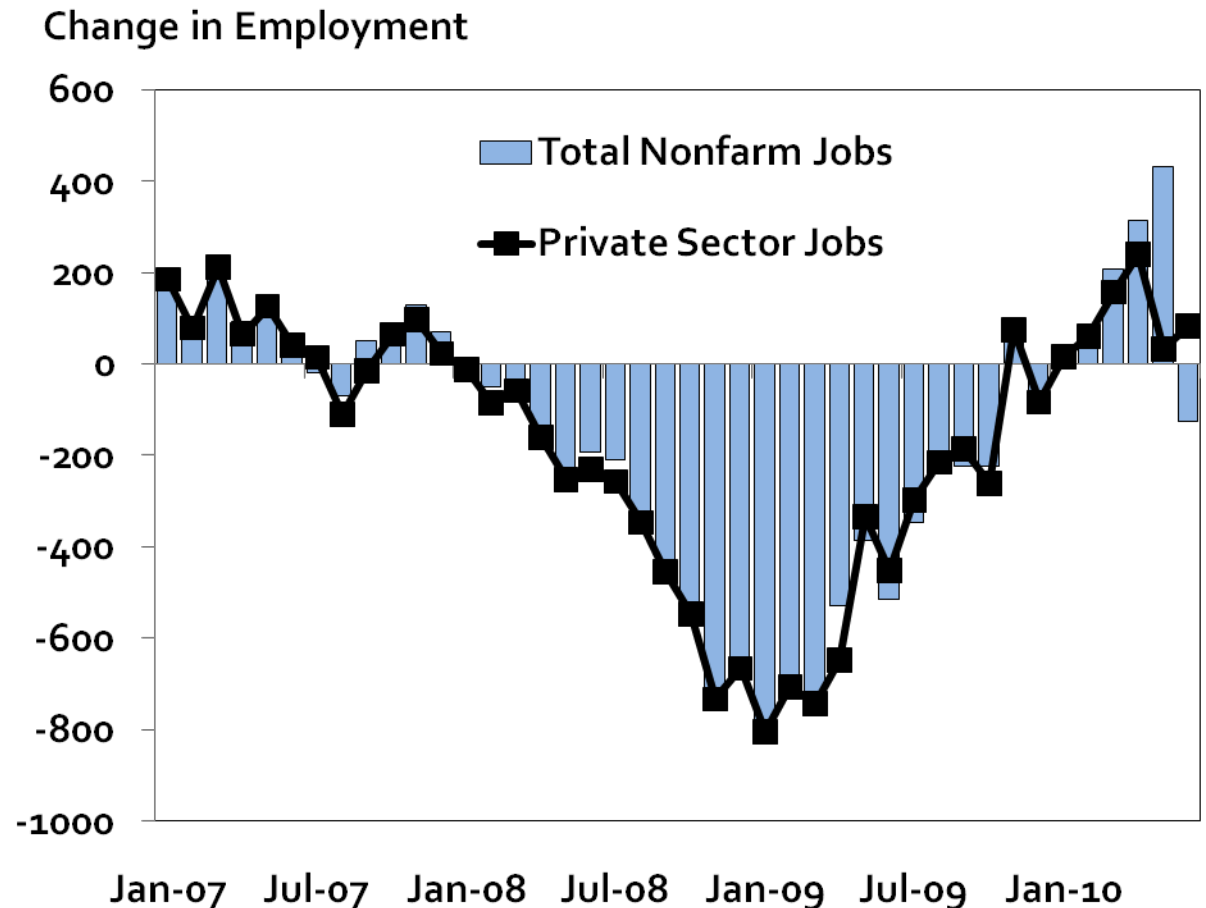


Despite contractions in total jobs, businesses continue to add jobs at a modest pace.

Headline: Employment falls in June

- The Census distorts the job market.
- In May, total jobs rose sharply with modest gains in private sector jobs.
- In June, total jobs fell, while private sector gains strengthened.
- In addition, the April and May job numbers were revised up.
- Private sector gains were widespread across sectors.

U.S. Nonfarm Employment

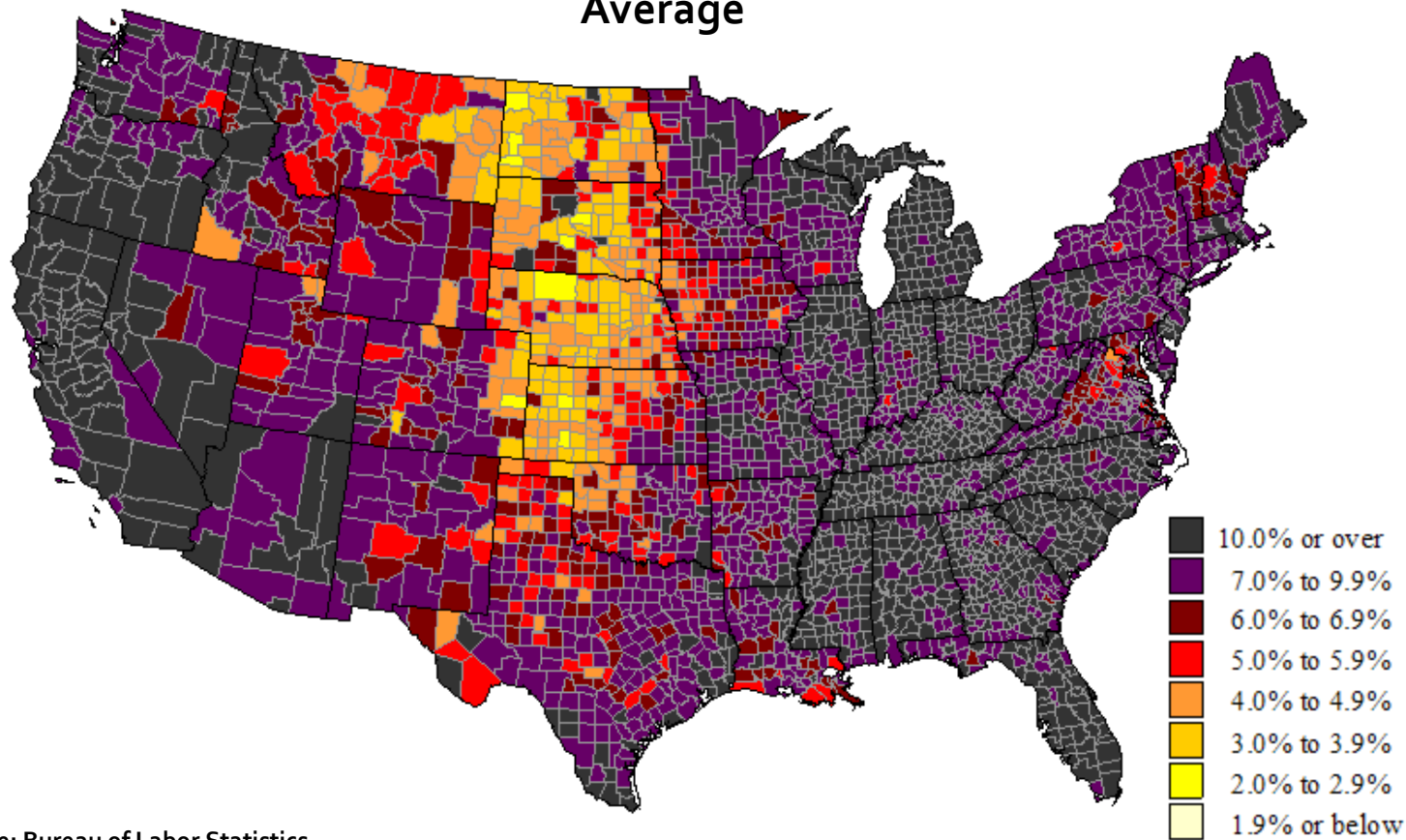


Source: BLS



Nebraska is the last bastion of low unemployment.

Unemployment Rate
June 2009 – May 2010
Average

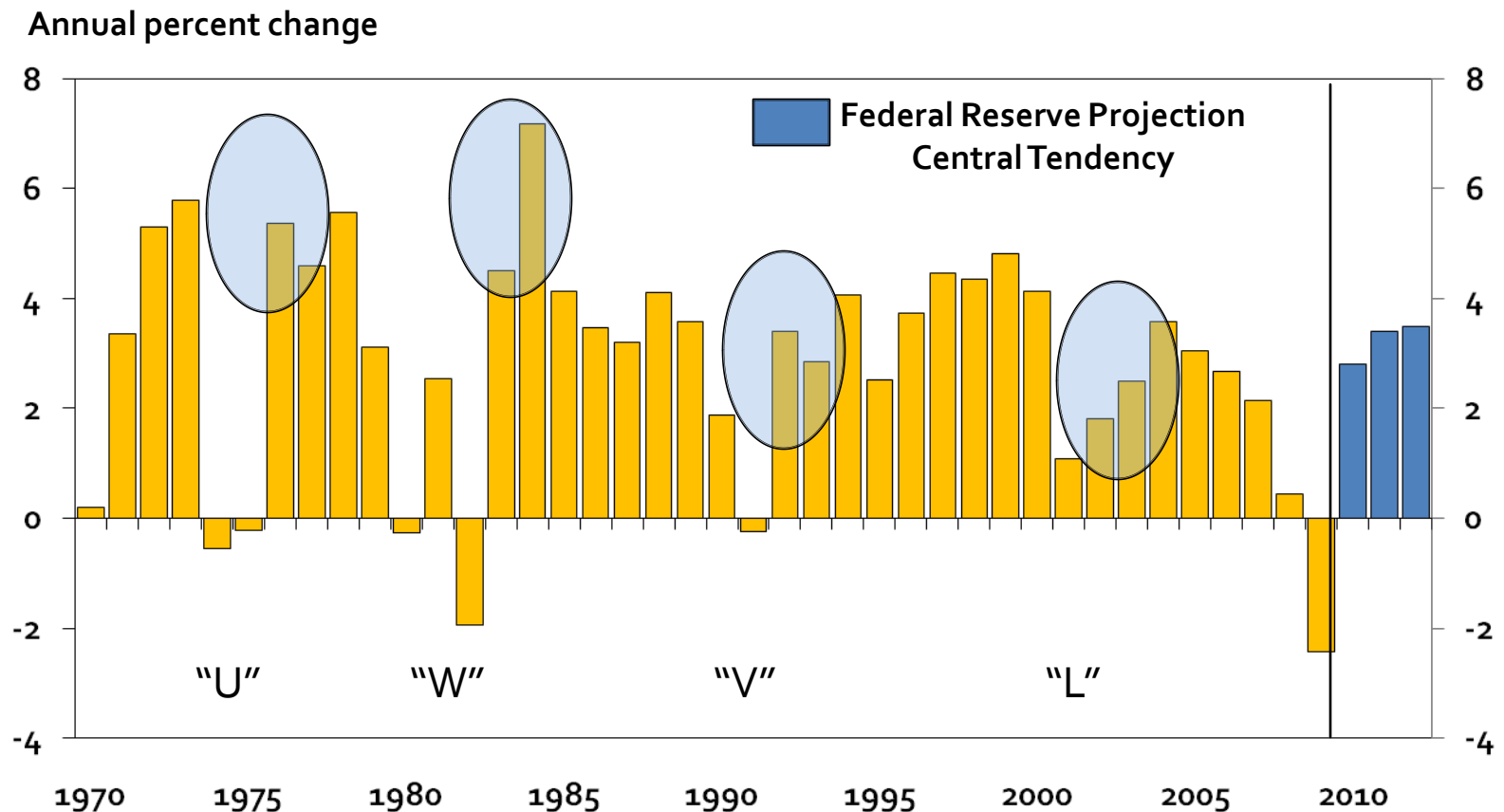


Source: Bureau of Labor Statistics



The U.S. economy is projected to rebound in 2010.

Real GDP Growth



Source: Bureau of Economic Analysis Federal Reserve Board of Governors



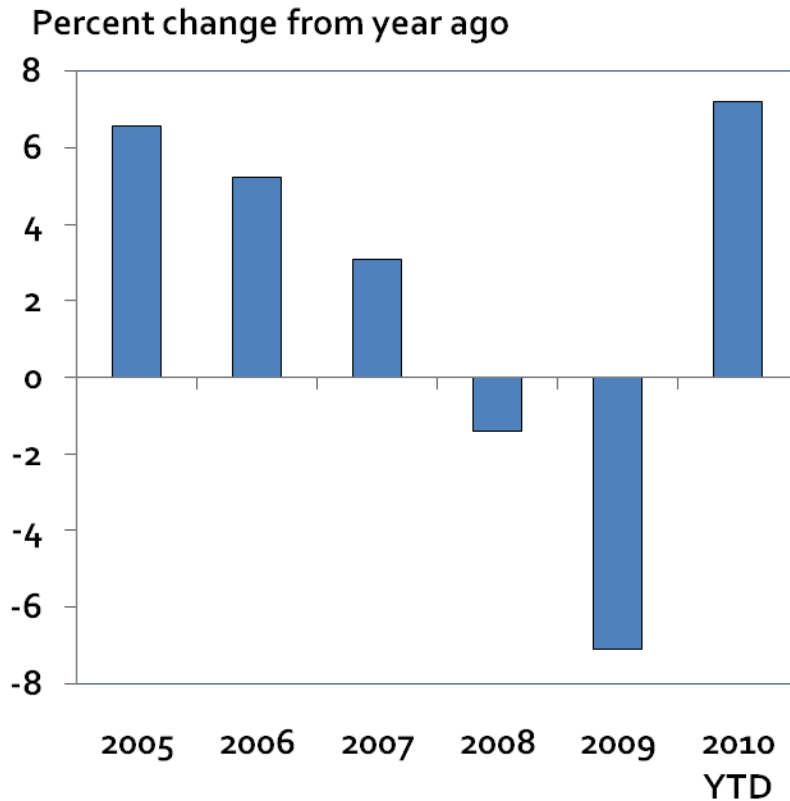
Today's Roadmap

- Economic conditions:
 - Consumers are shopping.
 - Businesses are investing.
 - Exports are rising.
 - The federal government is spending.
- Why are people still concerned?
 - The speed is sluggish.
 - How are they financing it?



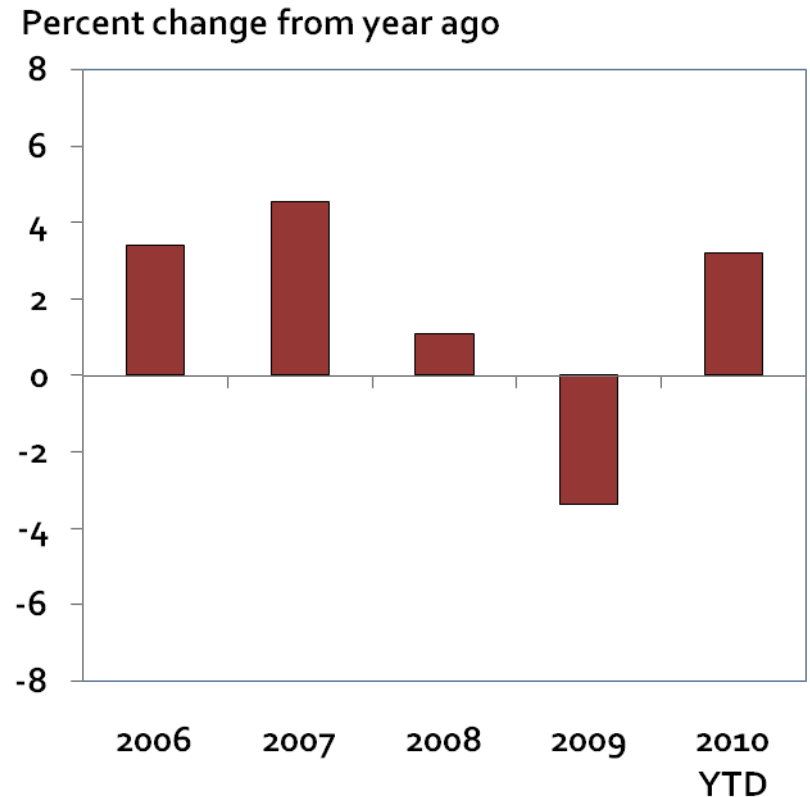
Consumer spending is rebounding.

U.S. Retail Sales



Source: U.S. Census Bureau
*Data through May

NE Net Taxable Retail Sales



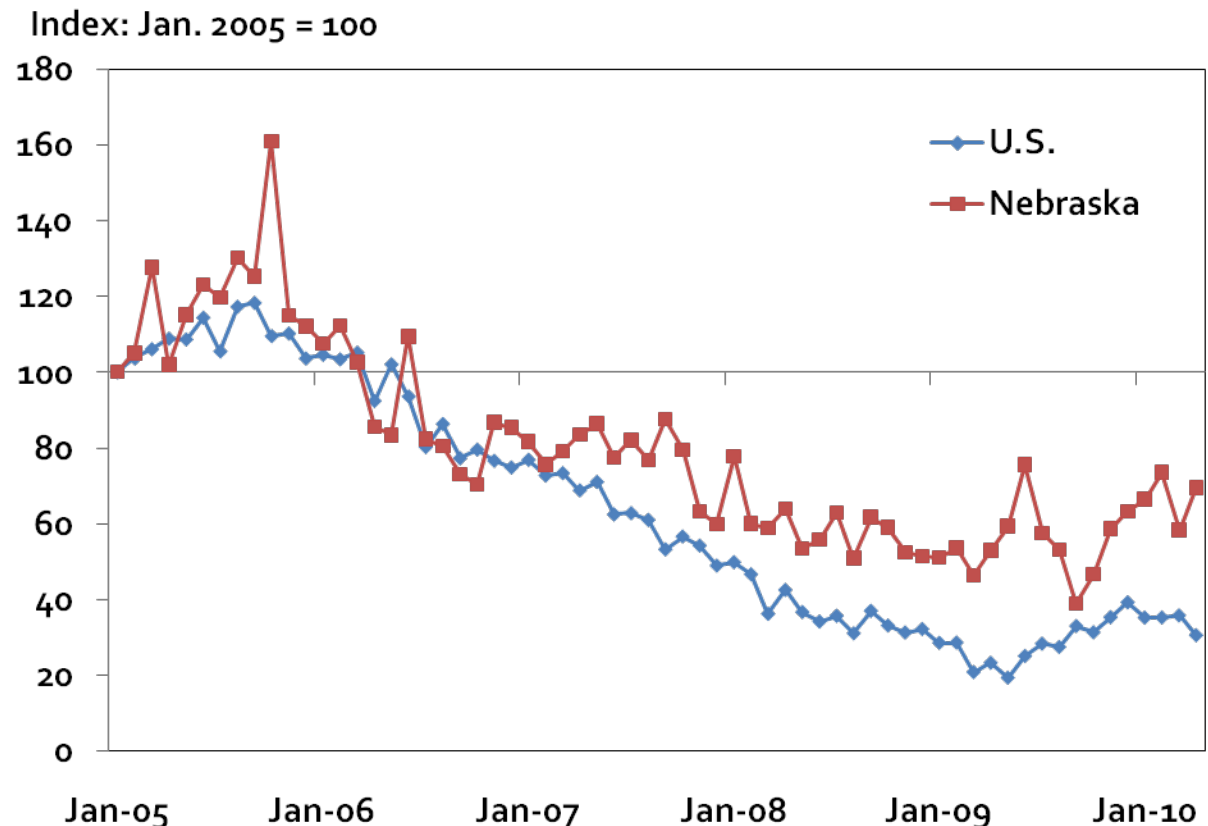
Source: NE Dept. of Revenue
*Data through March



Has the housing sector hit bottom?

- What happens after home buyer tax credits end?
- How much will home sales slow, especially for lower priced homes?
- Will home prices hold across the U.S. and in Nebraska?
- What will spark the rebound in housing activity?
- What will happen with the GSEs: Fannie and Freddie?

U.S. and Nebraska Single-Family Housing Permits



Source: U.S. Census Bureau



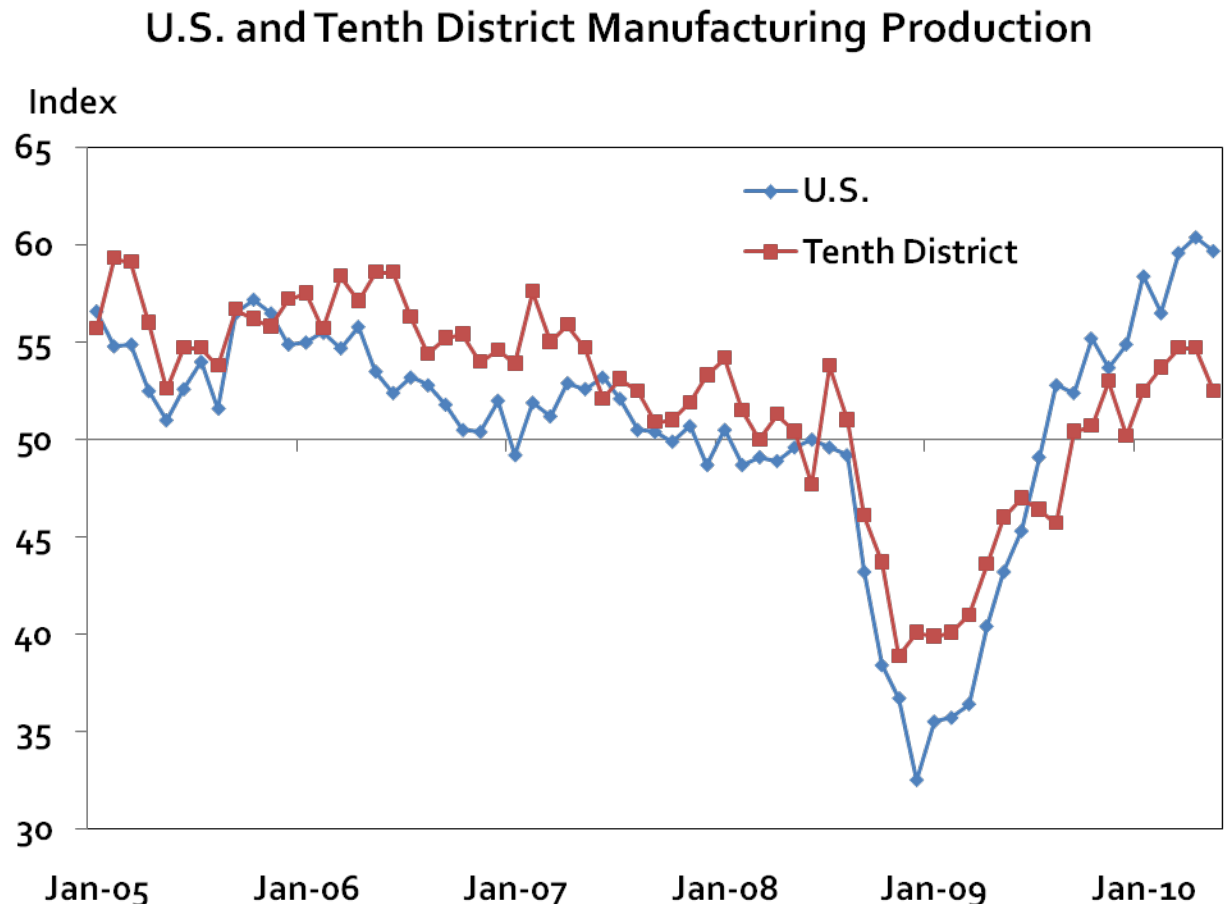
Today's Roadmap

- Economic conditions:
 - Consumers are shopping.
 - Businesses are investing.



Can stronger manufacturing activity sustain a business recovery?

- Manufacturing is leading a rebound in business activity.
- Businesses are investing in equipment and software.
- When will investments in structures rebound to support CRE and construction?
- With loan defaults easing, will access to capital and credit standards improve?
- When will increased activity spur robust job gains?



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



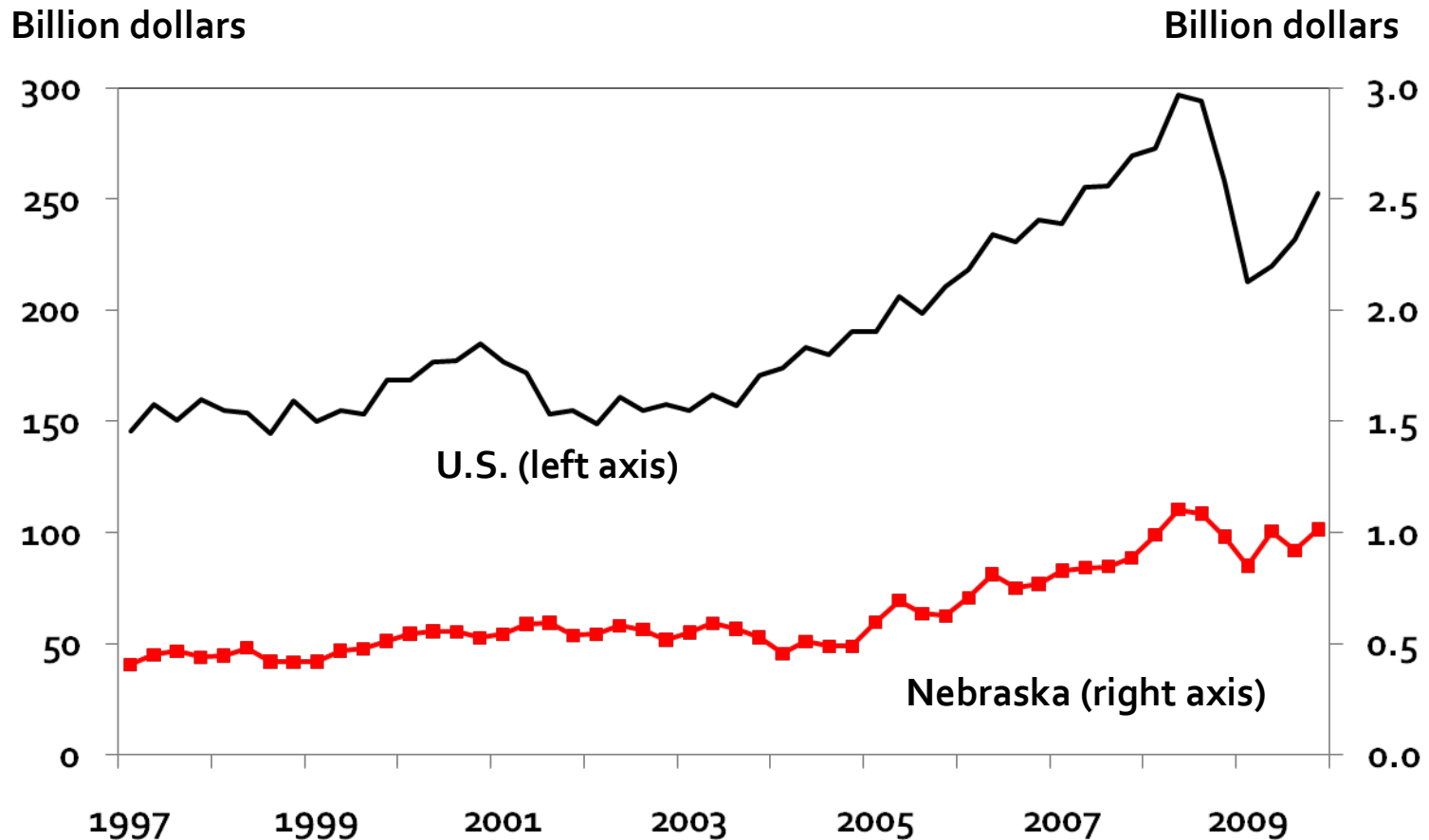
Today's Roadmap

- Economic conditions:
 - Consumers are shopping.
 - Businesses are investing.
 - Exports are rising.



Will stronger global economies and a lower dollar boost export activity?

Manufactured Exports

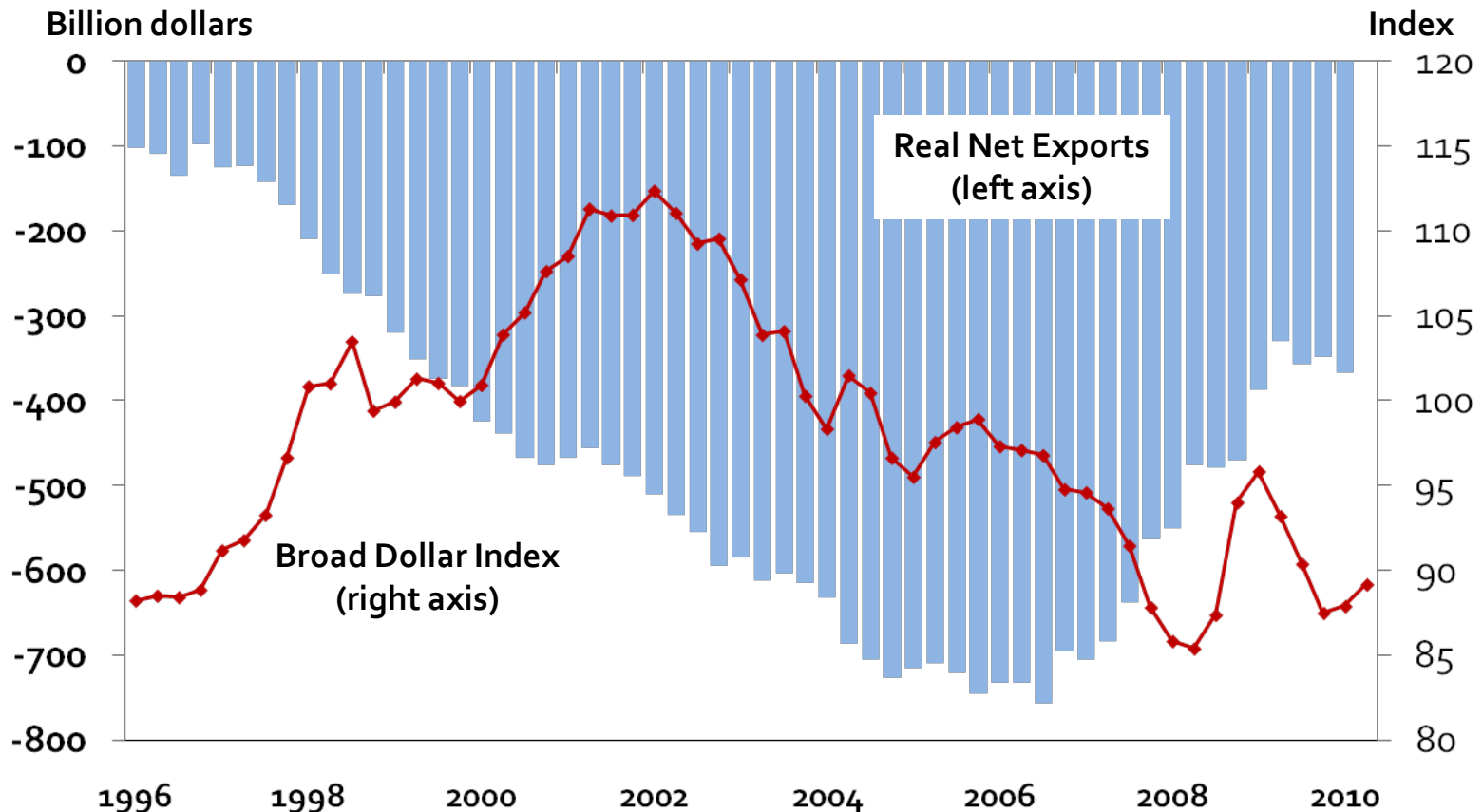


Source: WISERTrade



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

U.S. Real Net Exports of Goods and Services and Value of the Dollar



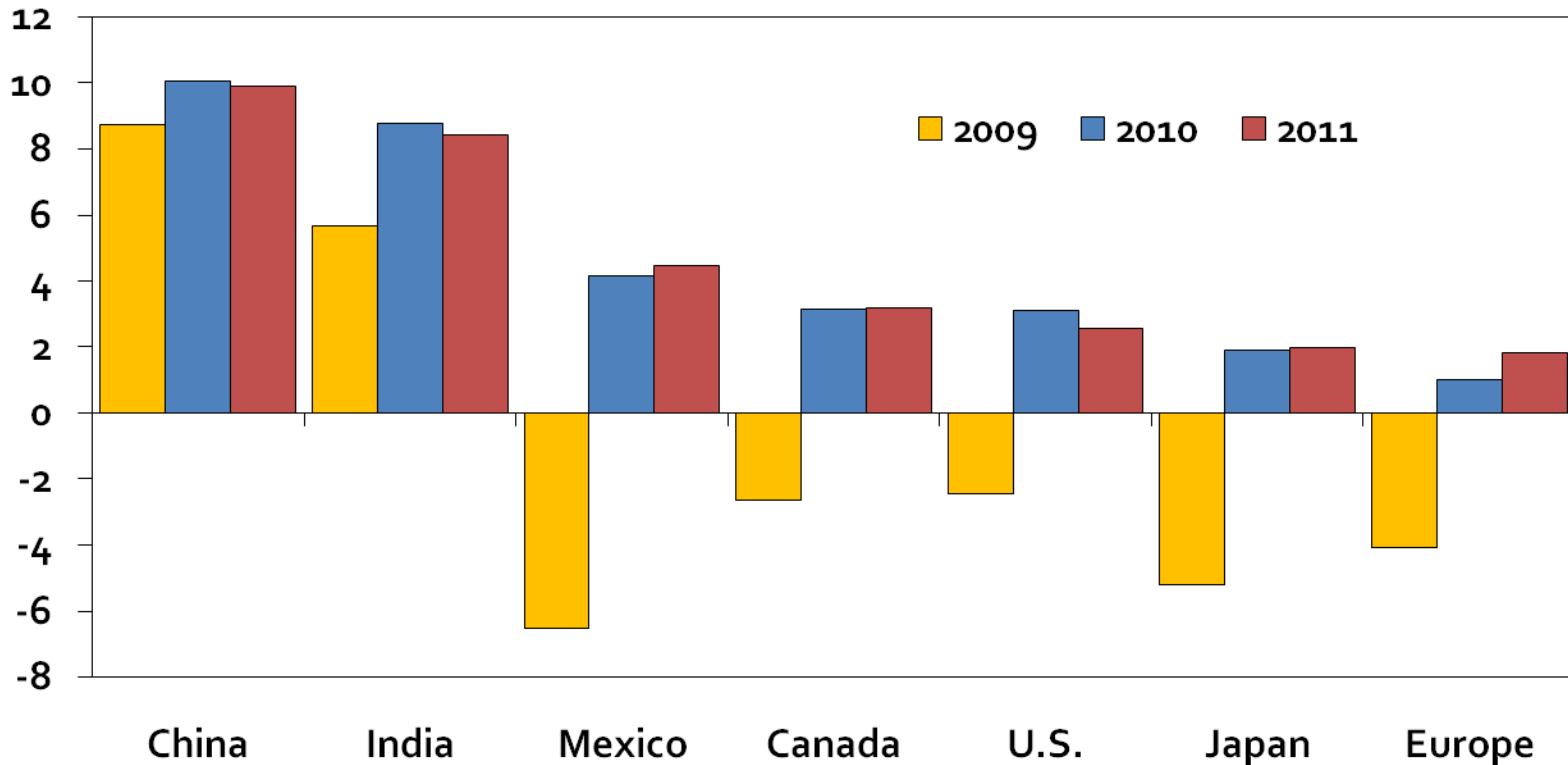
Source: Bureau of Economic Analysis and Federal Reserve Board of Governors



Stronger economic growth is expected through 2011.

GDP Growth

Percent Change



Source: IMF, April 2010



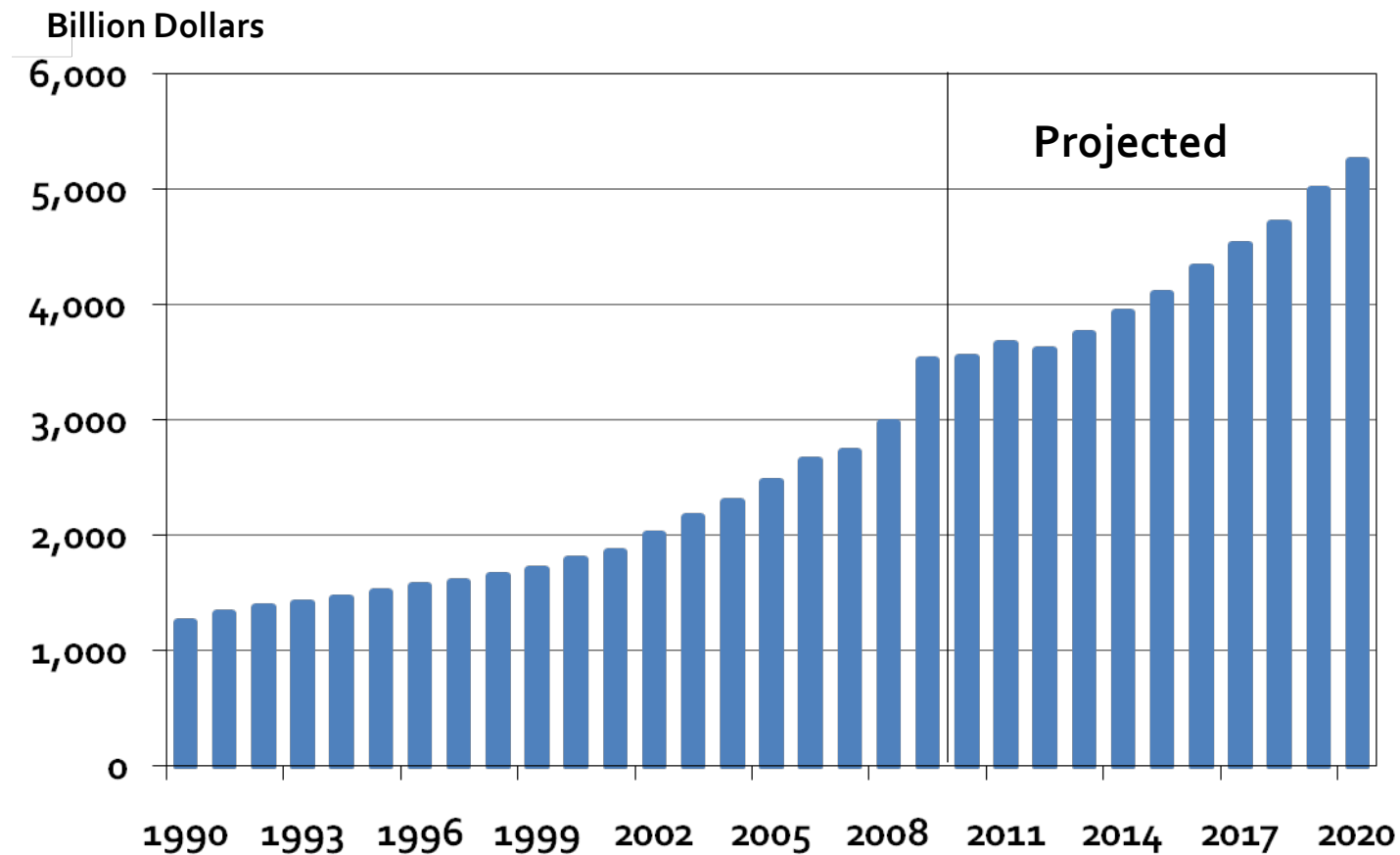
Today's Roadmap

- Economic conditions:
 - Consumers are shopping.
 - Businesses are investing.
 - Exports are rising.
 - The federal government is spending.



In the short run, deficit spending is an economic stimulus.

U.S. Government Outlays



Source: Congressional Budget Office, March 2010



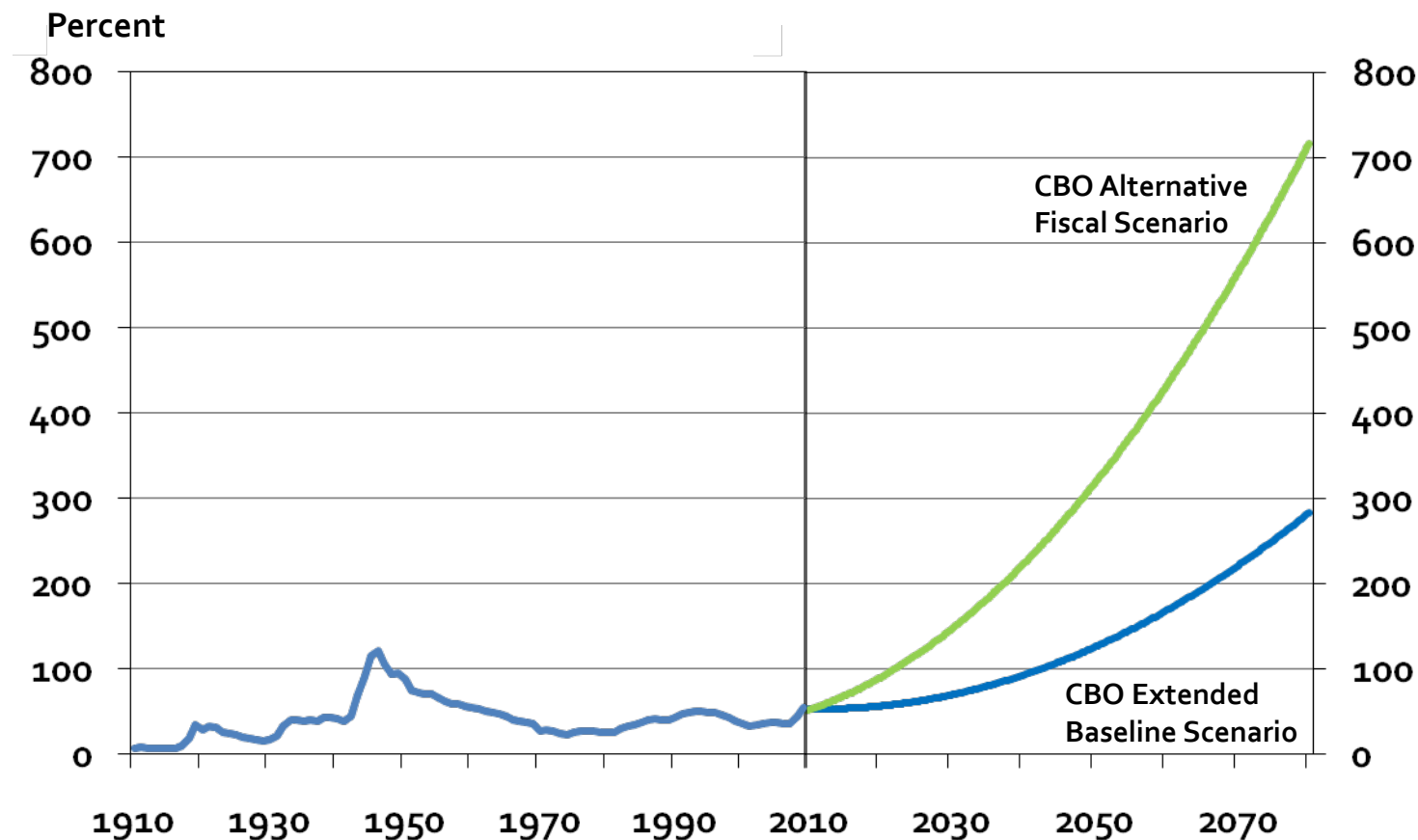
Today's Roadmap

- Economic conditions:
 - Consumers are shopping.
 - Businesses are investing.
 - Exports are rising.
 - The federal government is spending.
- Why are people still concerned?
 - The speed is sluggish.
 - How are they financing it?



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

U.S. Debt as a Percent of GDP

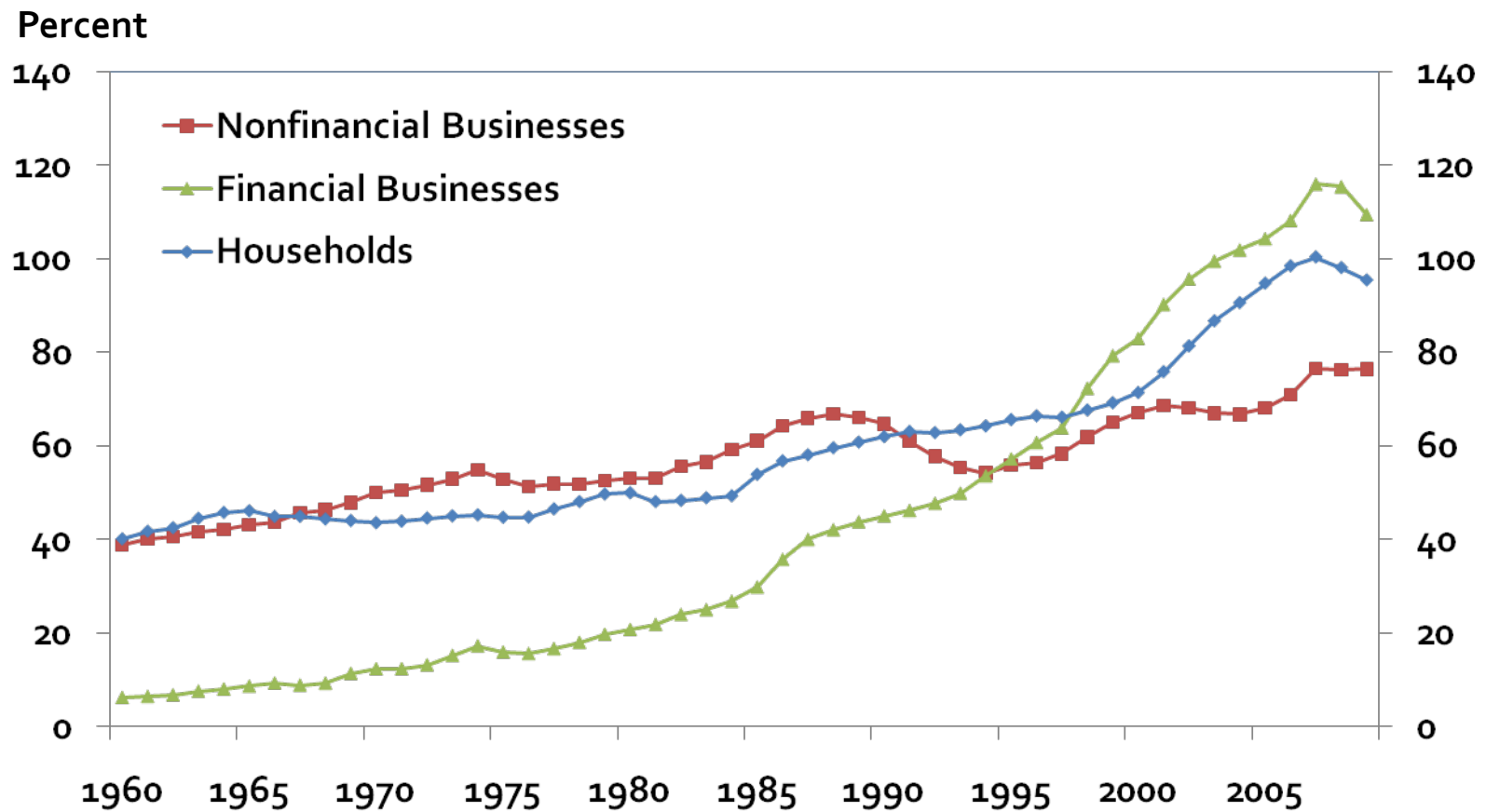


Source: Congressional Budget Office, November 2009



How much de-leveraging will take place?

U.S. Debt as a Percent of GDP



Source: Calculations based on Federal Reserve and BEA data



Today's Roadmap

- What are macroeconomic conditions in the U.S. and Nebraska?
- Economic outlook:
 - When will the economic recovery gain steam?
- Monetary policy:
 - When will the Fed withdraw economic stimulus?



Inflation is based on money and velocity.

Quantity Theory of Money

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

Definition of Inflation:

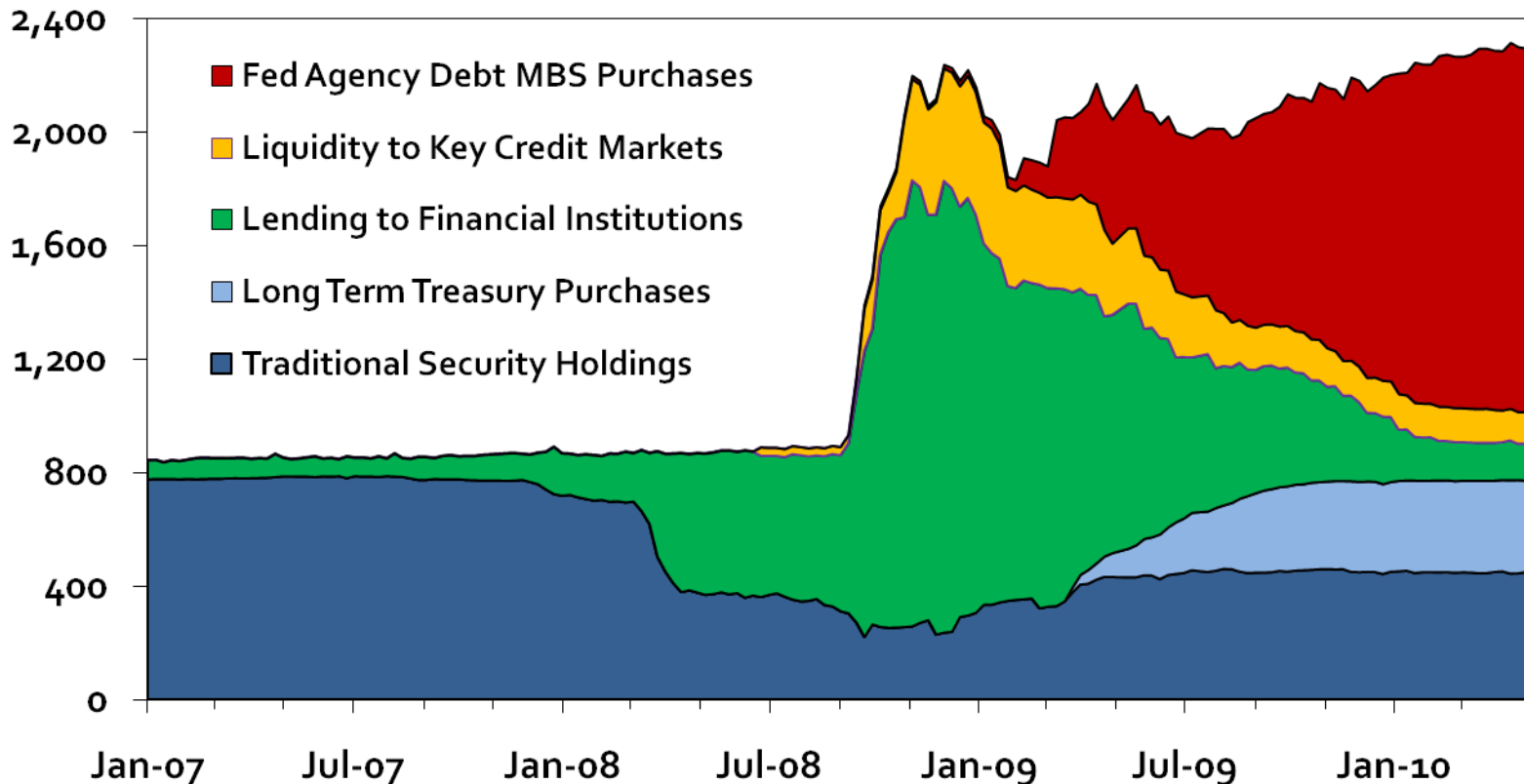
Too much money $M \uparrow$
chasing $V \uparrow$
too few goods $Q \downarrow$



The Fed has increased the monetary base.

Federal Reserve Balance Sheet: Assets

Billion Dollars



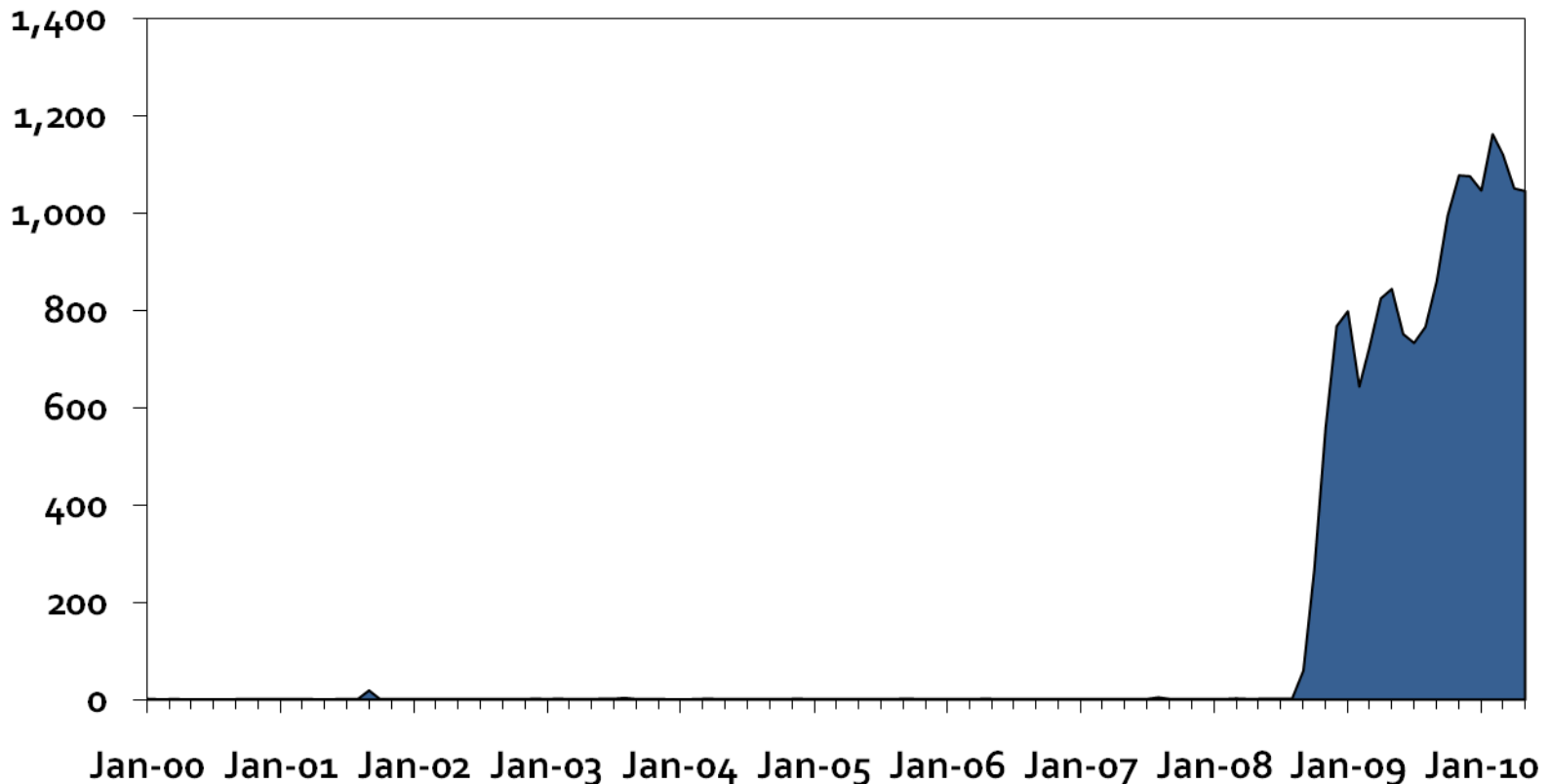
Source: Federal Reserve Bank of Cleveland



*Banks are holding money in excess reserve,
which limits velocity.*

Excess Reserves of Depository Institutions

Billion Dollars



Source: Federal Reserve Board of Governors



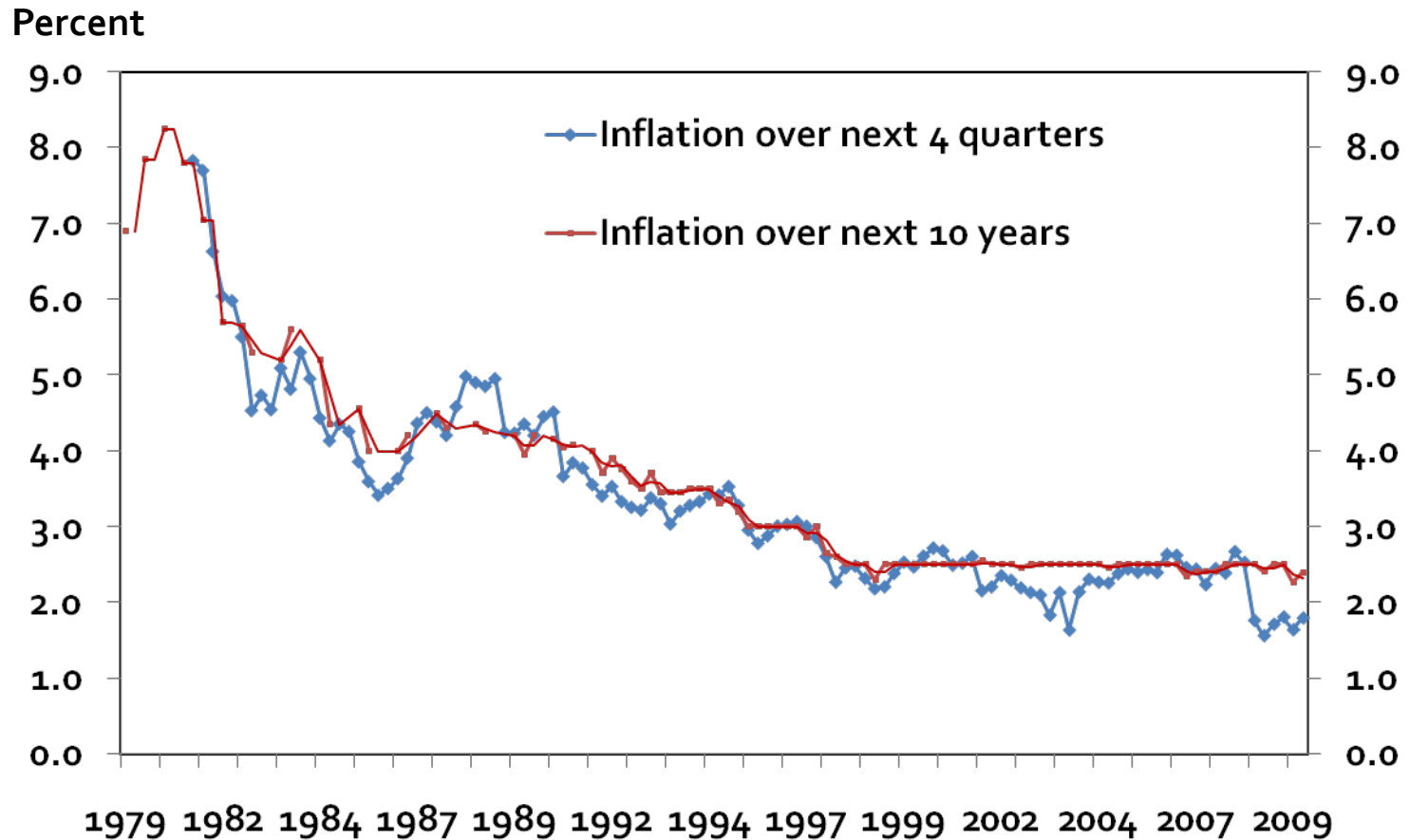
How will the Federal Reserve shrink its balance sheet with Agency and MBS debt?

- Hold to maturity
- Sell assets
- Keep reserves on deposit at the Fed.
 - **Interest on excess reserves**
 - **Reverse repurchase agreements**
 - **Term deposits**
- All strategies lead to higher interest rates.
 - **When?**
 - **How fast?**



Inflation remains well anchored.

Consumer Price Inflation Expectations



Source: Survey of Professional Forecasters



Two Perspectives on Monetary Policy and Resource Allocation

- The Issue: long periods of low interest rates lead to financial imbalances.
- Two Perspectives:
 - "... My preference at this time is to use prudential regulation and supervision to strengthen the financial system and lean against developing financial imbalances."
Donald Kohn, Vice Chairman, Federal Reserve Board of Governors, May 13, 2010.
 - "It was after a period of too-low interest rates, too much credit, too much leverage that the collapse of the housing bubble, the rapid deleveraging and the ensuing financial crisis occurred." ...

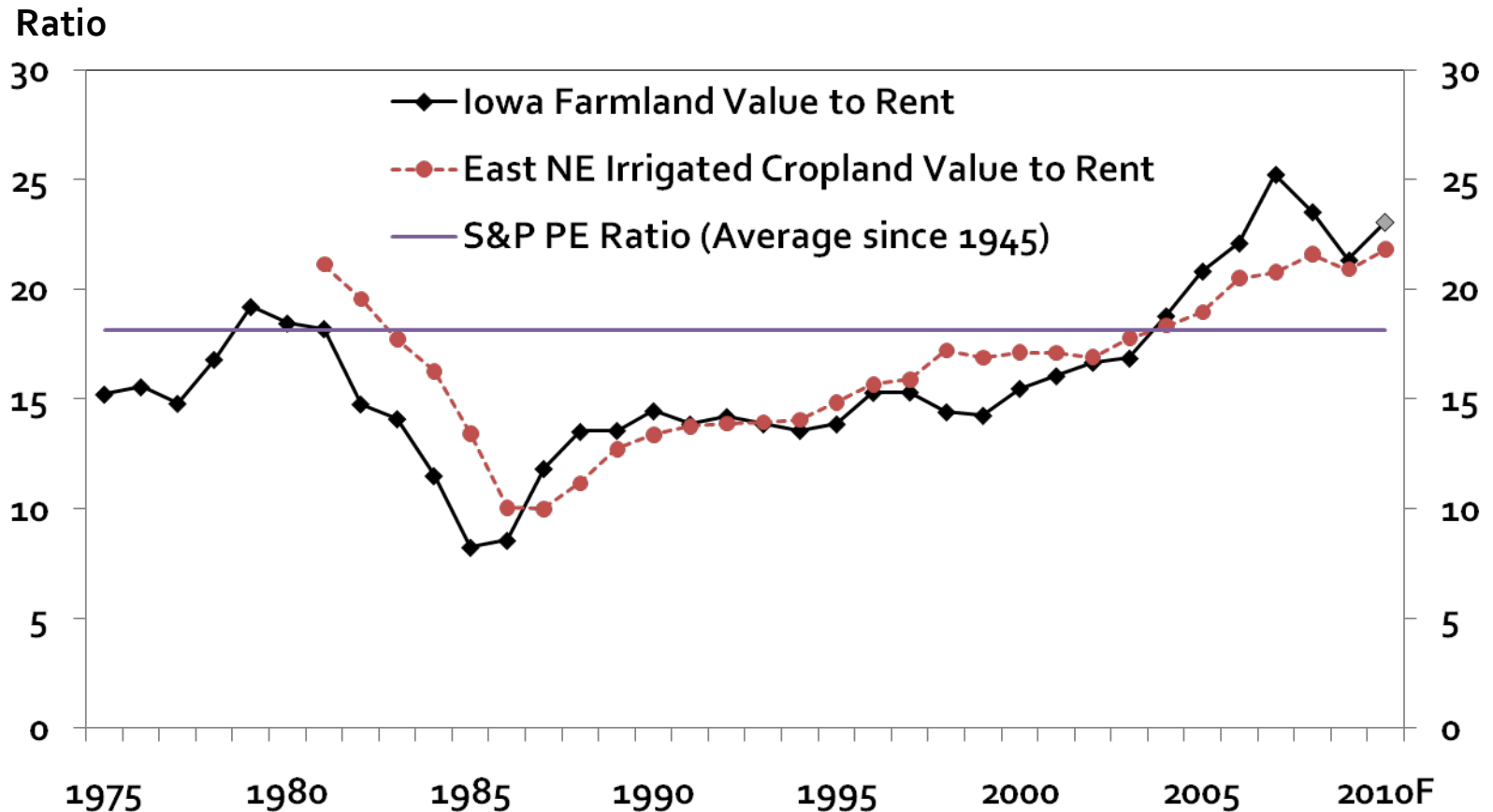
"Monetary policy is a powerful tool. Certainly lowering interest rates is the appropriate monetary policy response to the onset of an economic recession and rising unemployment. But it is also a blunt instrument that has a wide set of unintended consequences that can and have worsened economic outcomes including misallocation of precious resources, inflation and long-term unemployment."

Thomas Hoenig, President and CEO, Federal Reserve Bank of Kansas City, June 3, 2010



Is a farmland bubble brewing?

Farmland Values to Rent Ratio

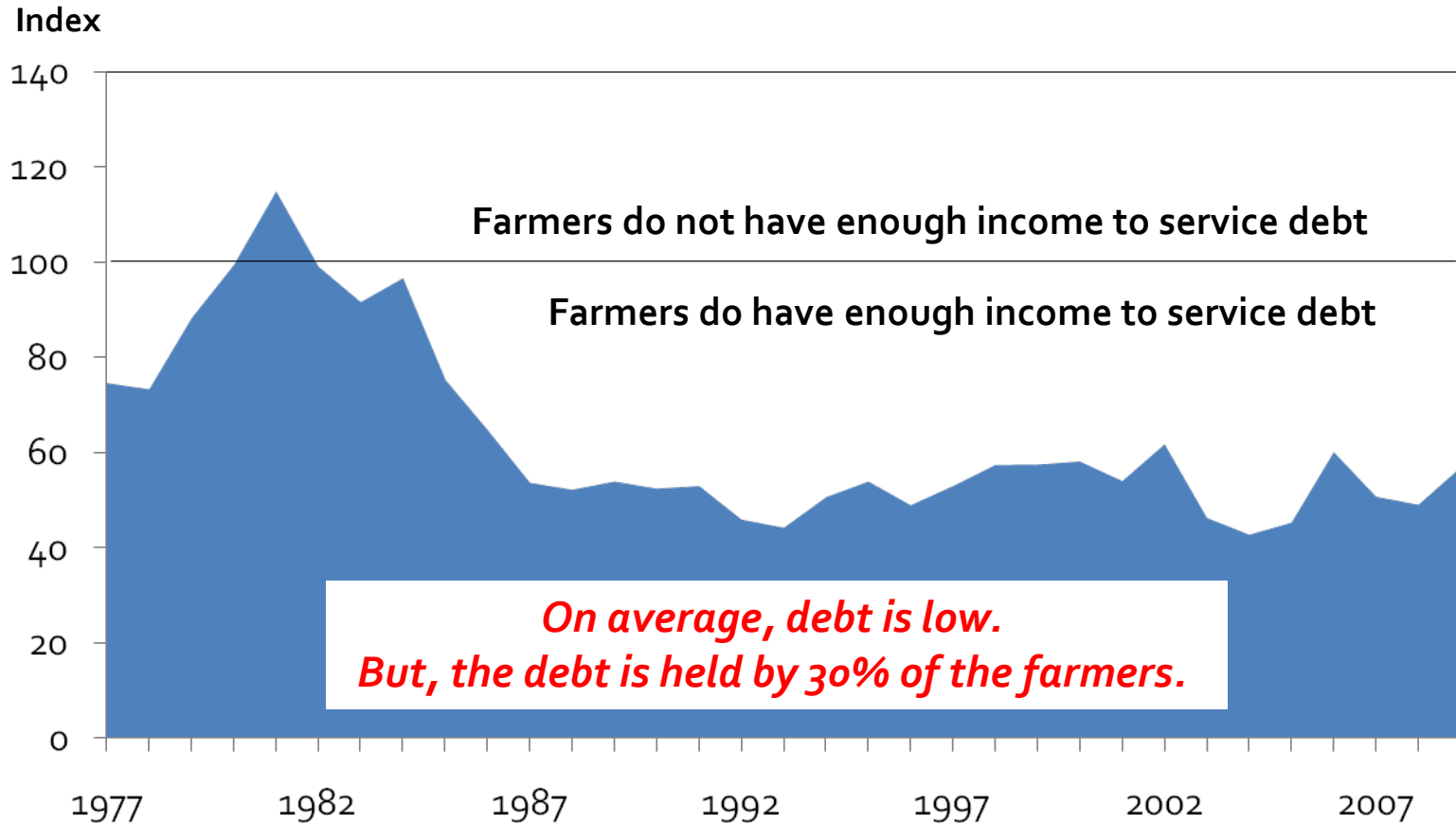


Calculations based on Iowa State University and University of Nebraska data



To identify a bubble, follow the debt.

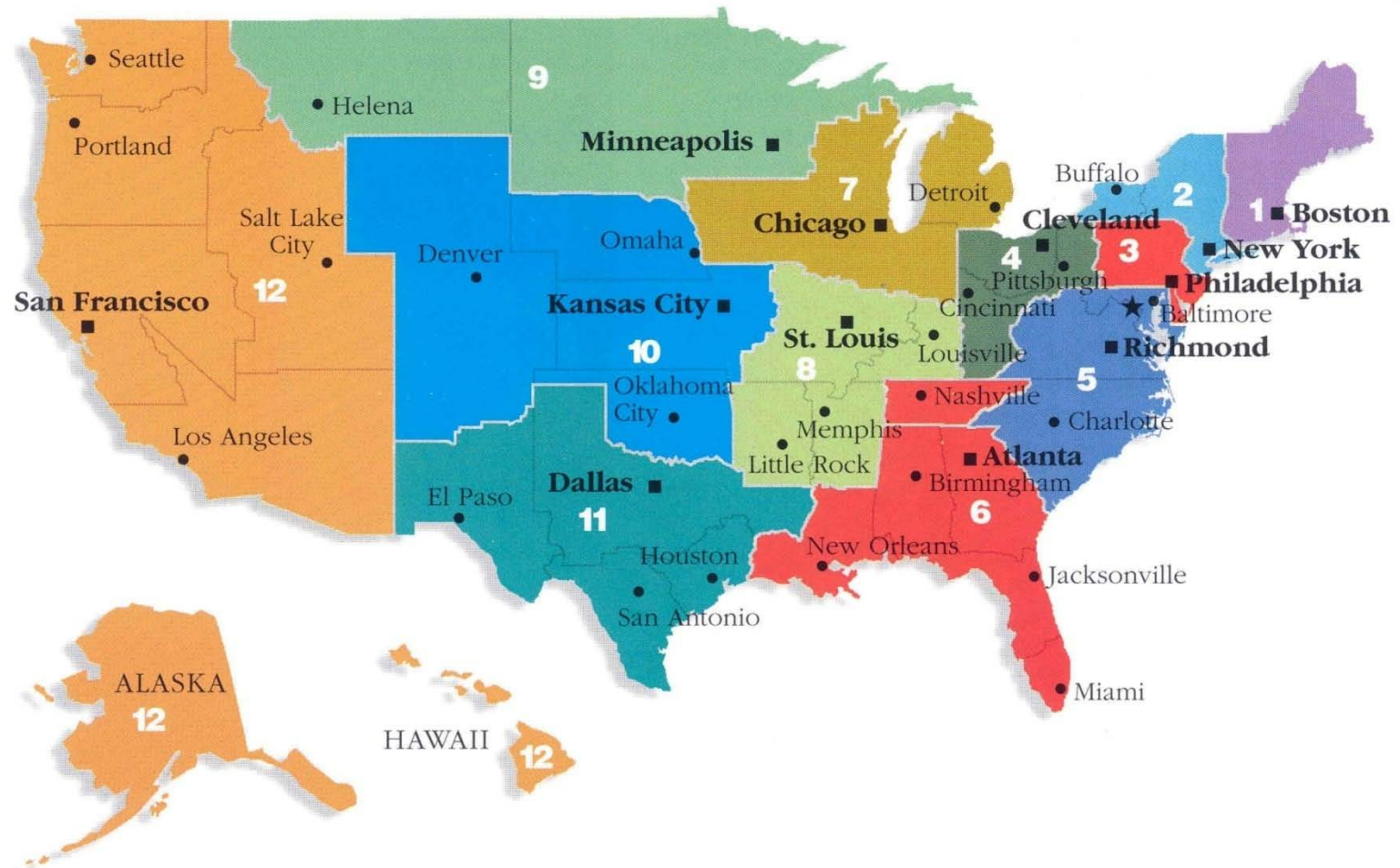
U.S. Debt Repayment Capacity Utilization



Source: USDA



The strength of the Federal Reserve System is its regional structure and Main Street perspective.



Conclusions

- **When will the recovery gain steam?**
 - Stronger consumer demand is boosting business activity.
 - But, debt will limit the recovery.
- **When will the Fed begin its exit strategy?**
 - Will high unemployment limit inflation?
 - What will start the “chasing”?
- **The economic recovery brings opportunities for Nebraska, but headwinds remain.**

***What was the “Great Recession’s” primary lesson?
Debt and Leverage***

