



# ***The Economic Outlook: A Fed's Eye View***

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*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 Projections of the Federal Reserve Governors and Bank Presidents

Central Tendency <sup>1</sup>	2007 (Percent)	2008 (Percent)	2009 (Percent)	2010 (Percent)
Real GDP growth <i>Apr. 2008 projections</i> <i>Oct. 2007 projections</i>		1.0 to 1.6	2.0 to 2.8	2.5 to 3.0
		<b>Near-Term: Weaker Growth</b> <sup>1</sup>		
Unemployment rate <i>Apr. 2008 projections</i> <i>Oct. 2008 projections</i>		5.5 to 5.7	5.3 to 5.8	5.0 to 5.6
		<b>Long-Term: Stronger Growth</b>		
PCE inflation <i>Apr. 2008 projections</i> <i>Oct. 2008 projections</i>		3.8 to 4.2	2.0 to 2.3	1.8 to 2.0
		<b>Near-Term: Rising Inflation</b> <sup>0</sup>		
Core PCE inflation <i>Apr. 2008 projections</i> <i>Oct. 2008 projections</i>		2.2 to 2.4	2.0 to 2.2	1.8 to 2.0
		<b>Long-Term: Falling Inflation</b> <sup>3</sup>		

Source: Federal Reserve Board of Governors, June 25, 2008 FOMC Minutes

**Note:** Projections of the growth of real GDP, of PCE inflation, and of core PCE inflation are percent changes from the fourth quarter of the previous year to the fourth quarter of the year indicated. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated.

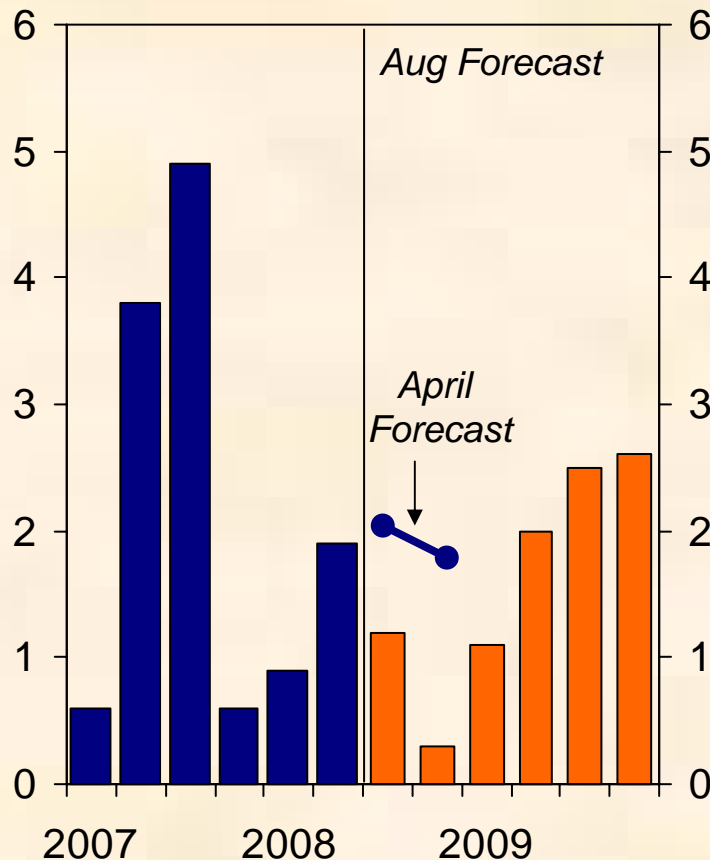
<sup>1</sup> The central tendency excludes the three highest and three lowest projections for each variable in each year.

# Private Sector Forecasts

**Near-term: weaker growth & higher inflation**  
**Long-term: stronger growth & lower inflation**

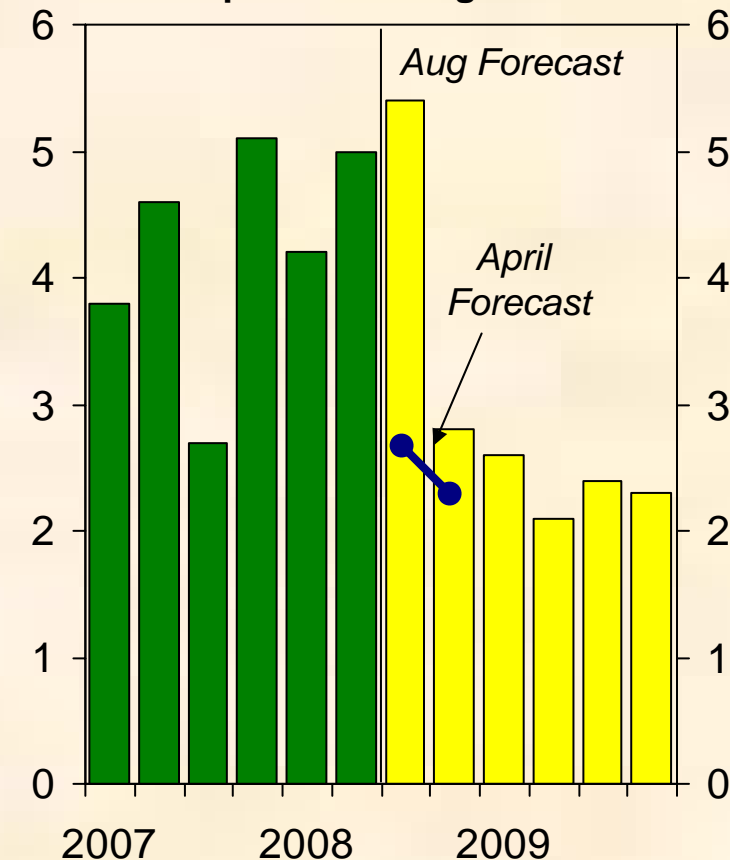
## Real GDP Growth

Annualized percent change



## Consumer Price Inflation

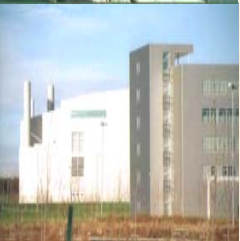
Annualized percent change



Source: Blue Chip Economic Indicators

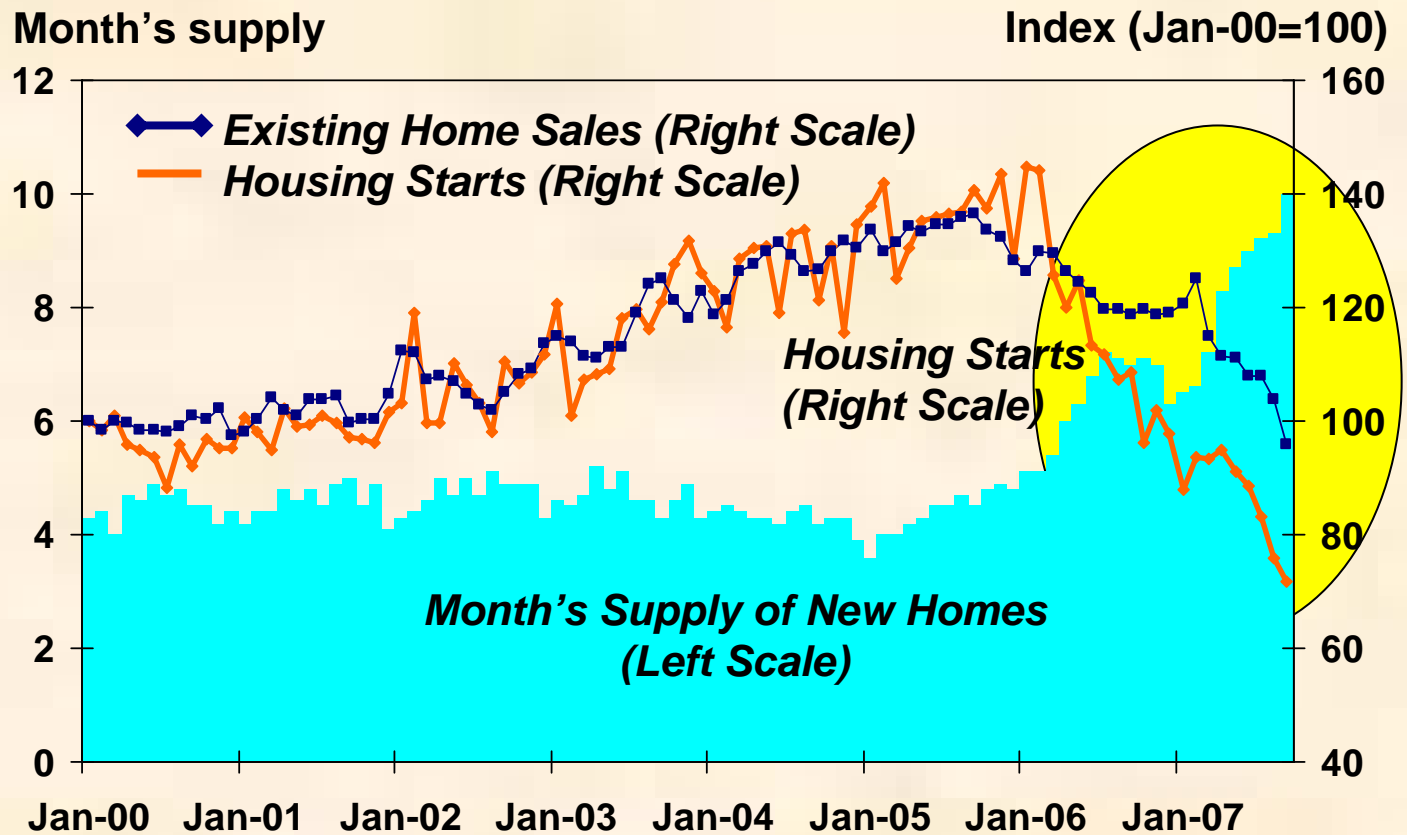
# ***Risks to the Outlook***

- Housing risks linger and spread to financial markets.



# Home construction slowed.

## Home Starts, Sales and Inventories

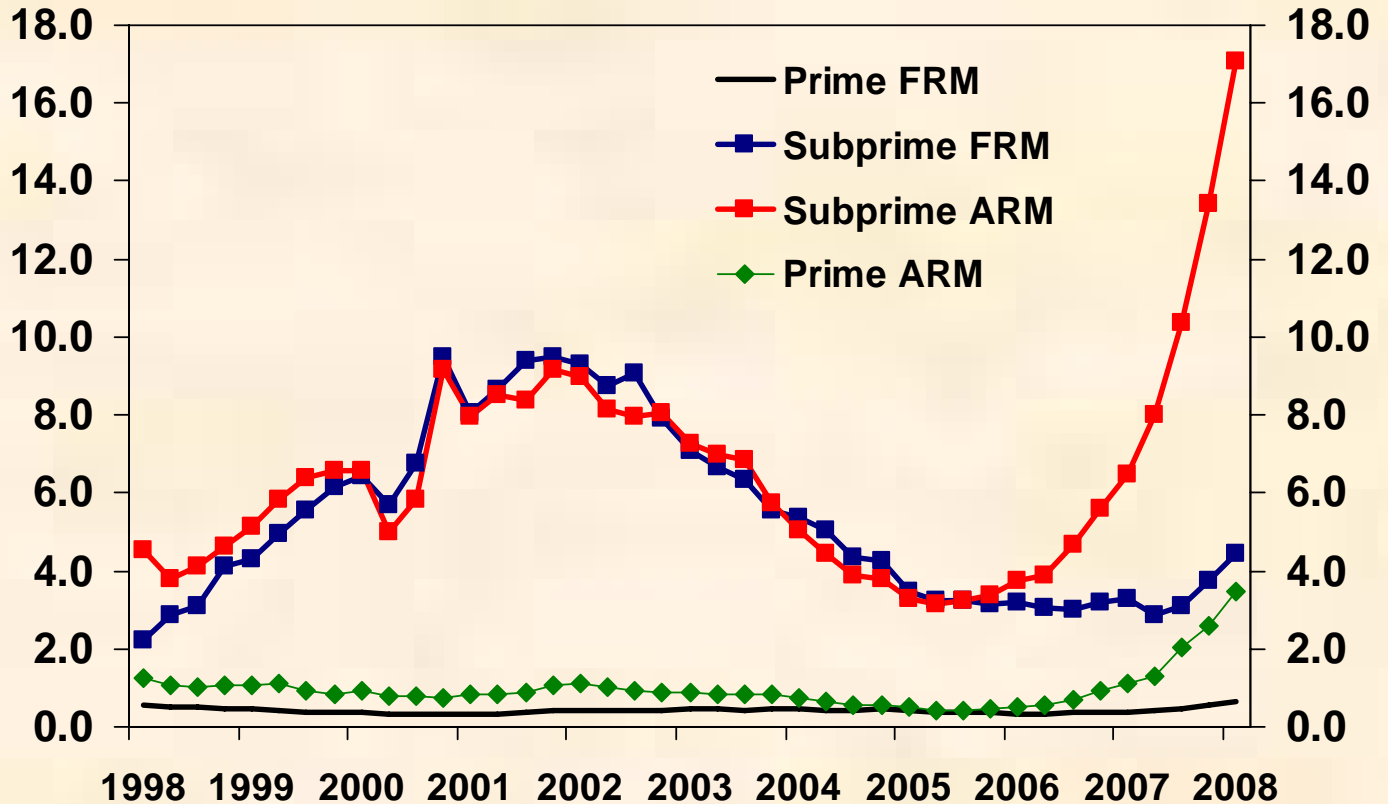


Source: Dept. of Commerce, National Association of Realtors

# Home foreclosures have surged.

## Foreclosure Rates by Mortgage Type

Percent of loans serviced

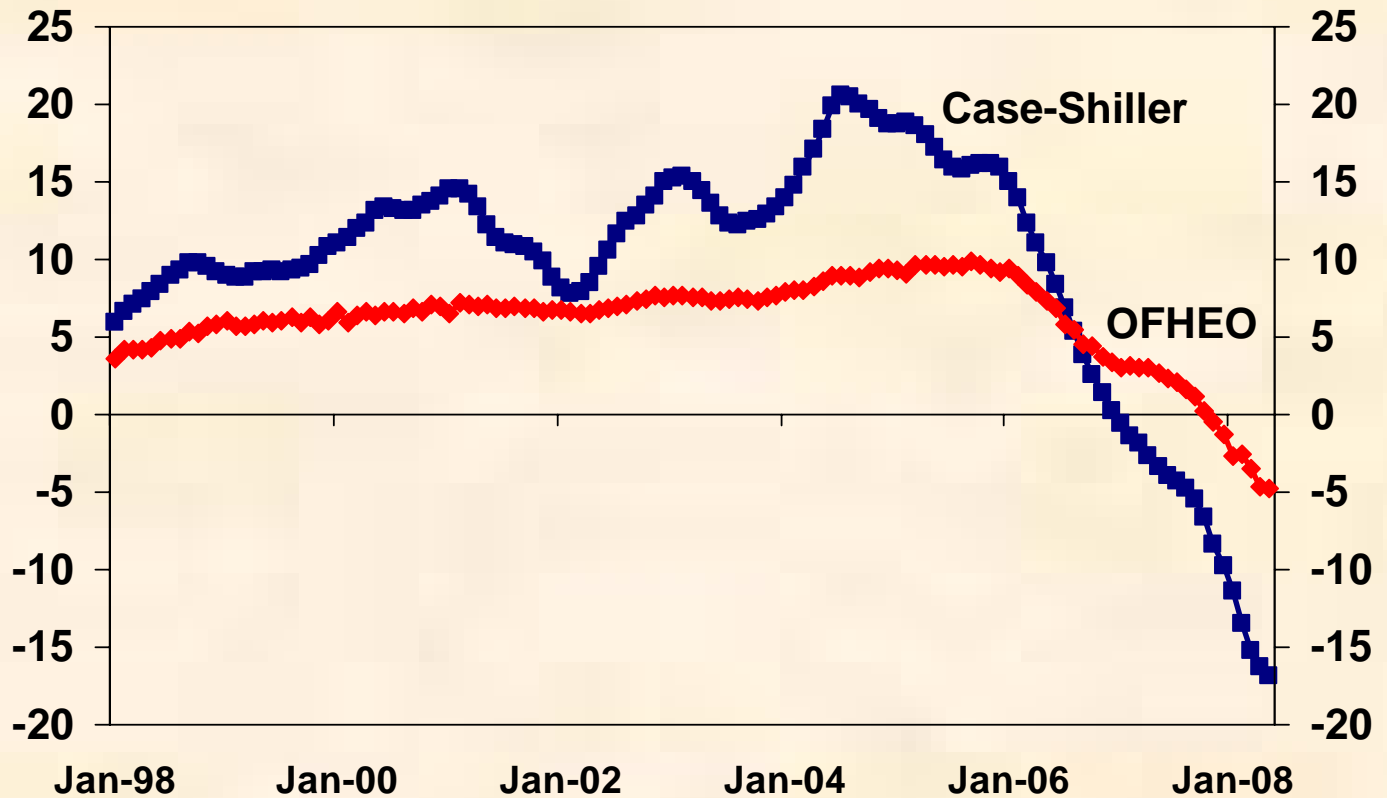


Source: Mortgage Bankers Association

***Nationally, home prices are falling.***

## U.S. Home Price Indexes

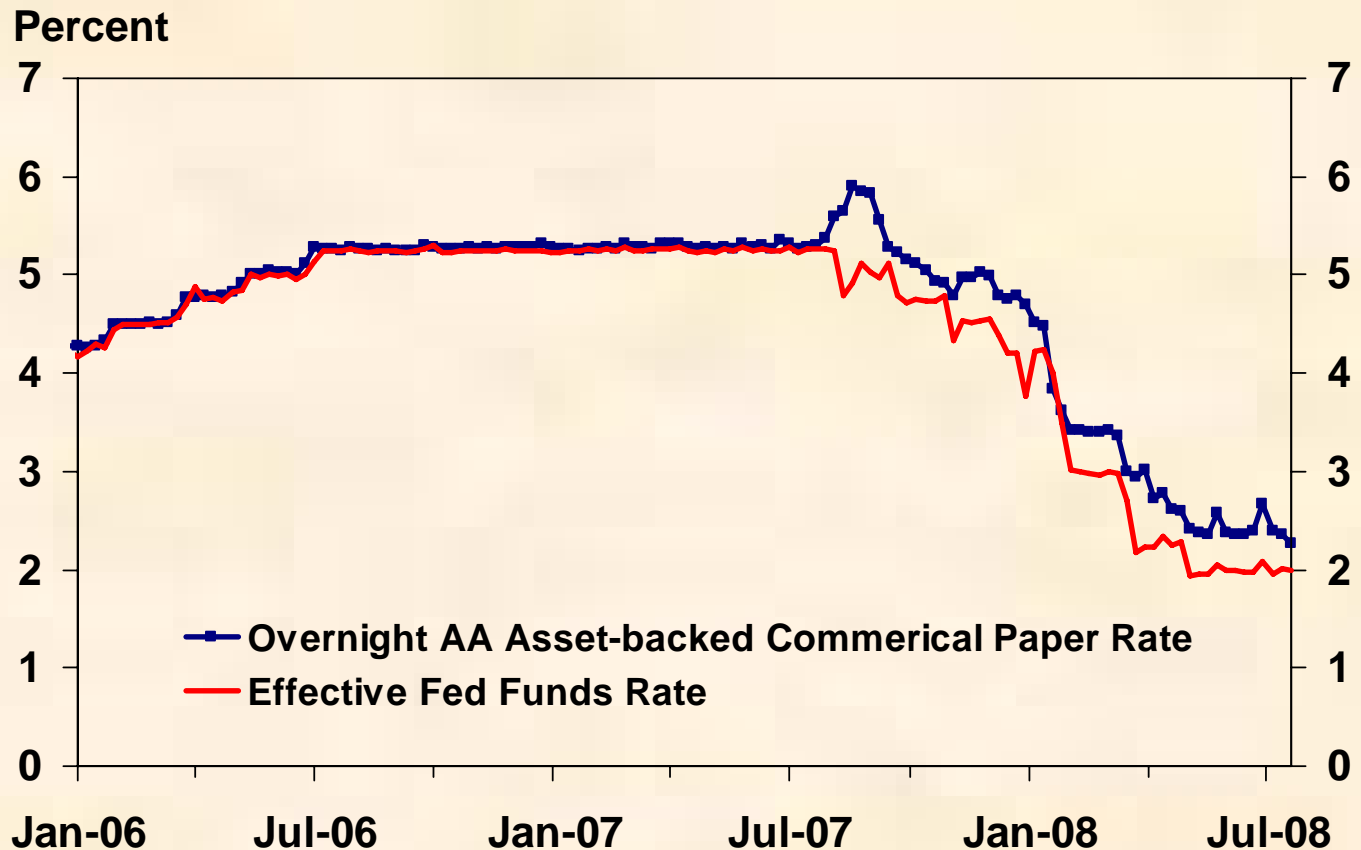
Percent change from previous year



Source: OFHEO and Standard & Poor's

# *A wider spread between mortgage-backed securities and other financial instruments.*

## Short-term Commercial Paper and Fed Funds Rates

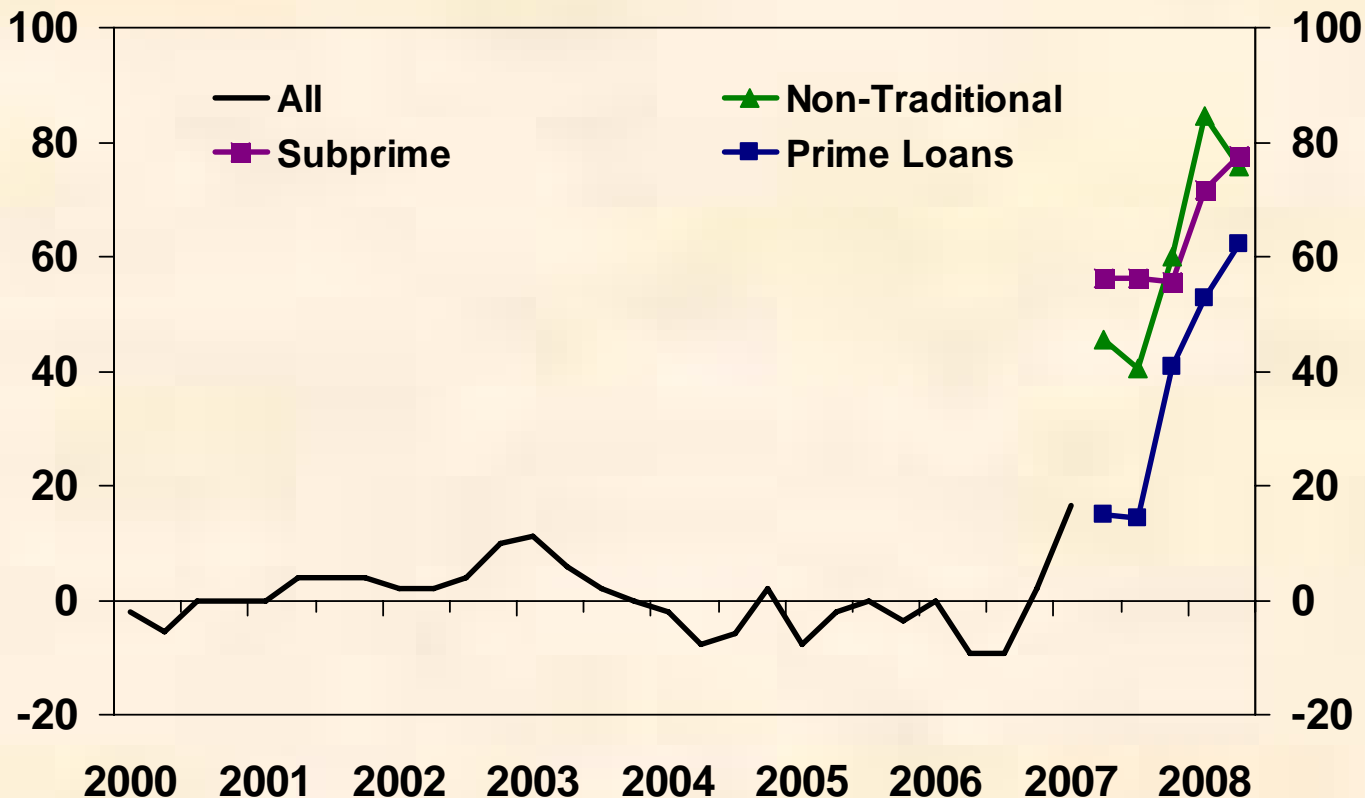




# Credit standards on home mortgages have tightened.

## Credit Standards on Residential Real Estate Loans

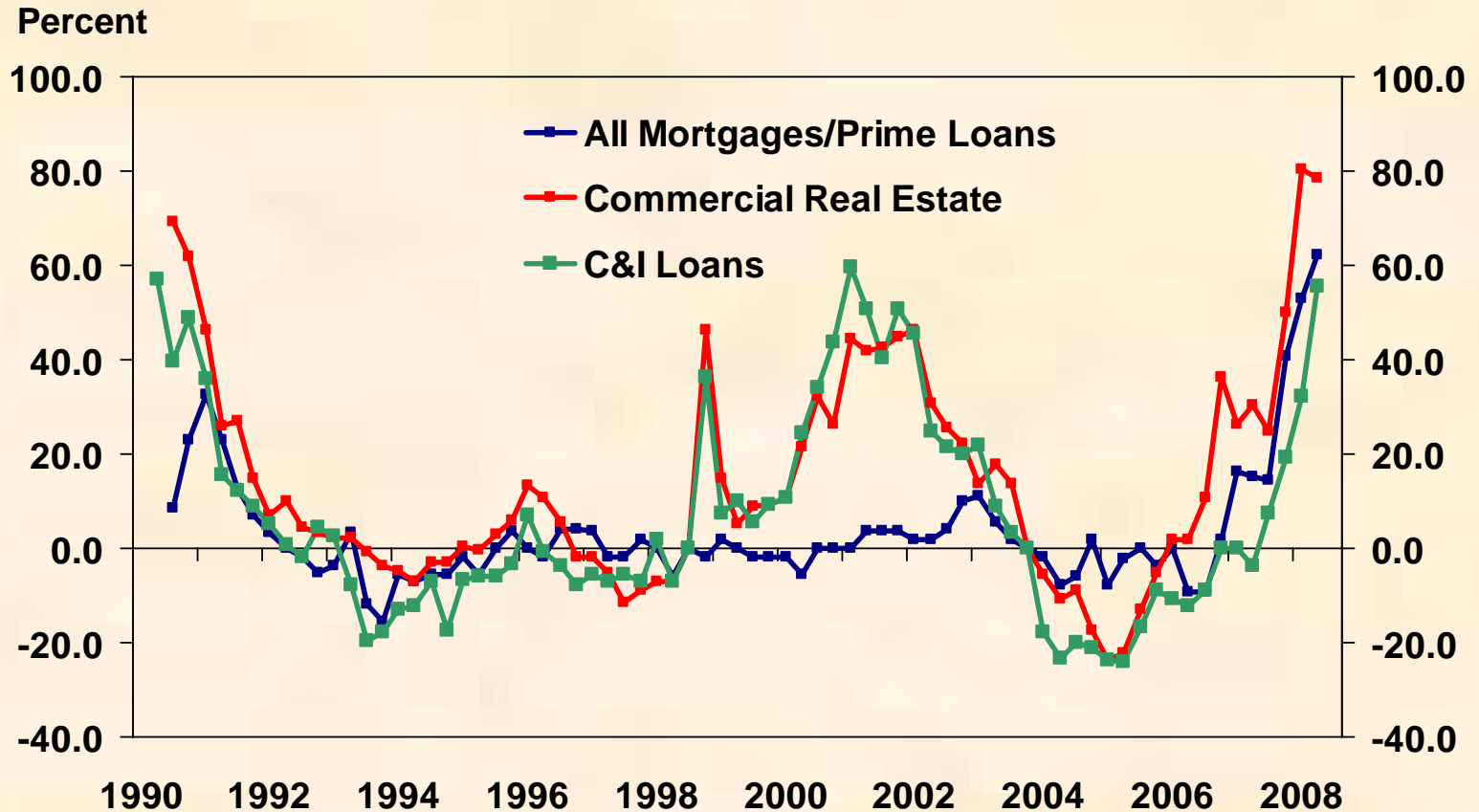
Net percent reporting tighter credit standards



Source: Federal Reserve Board of Governors

# ***Credit standards have tightened for other loans as well.***

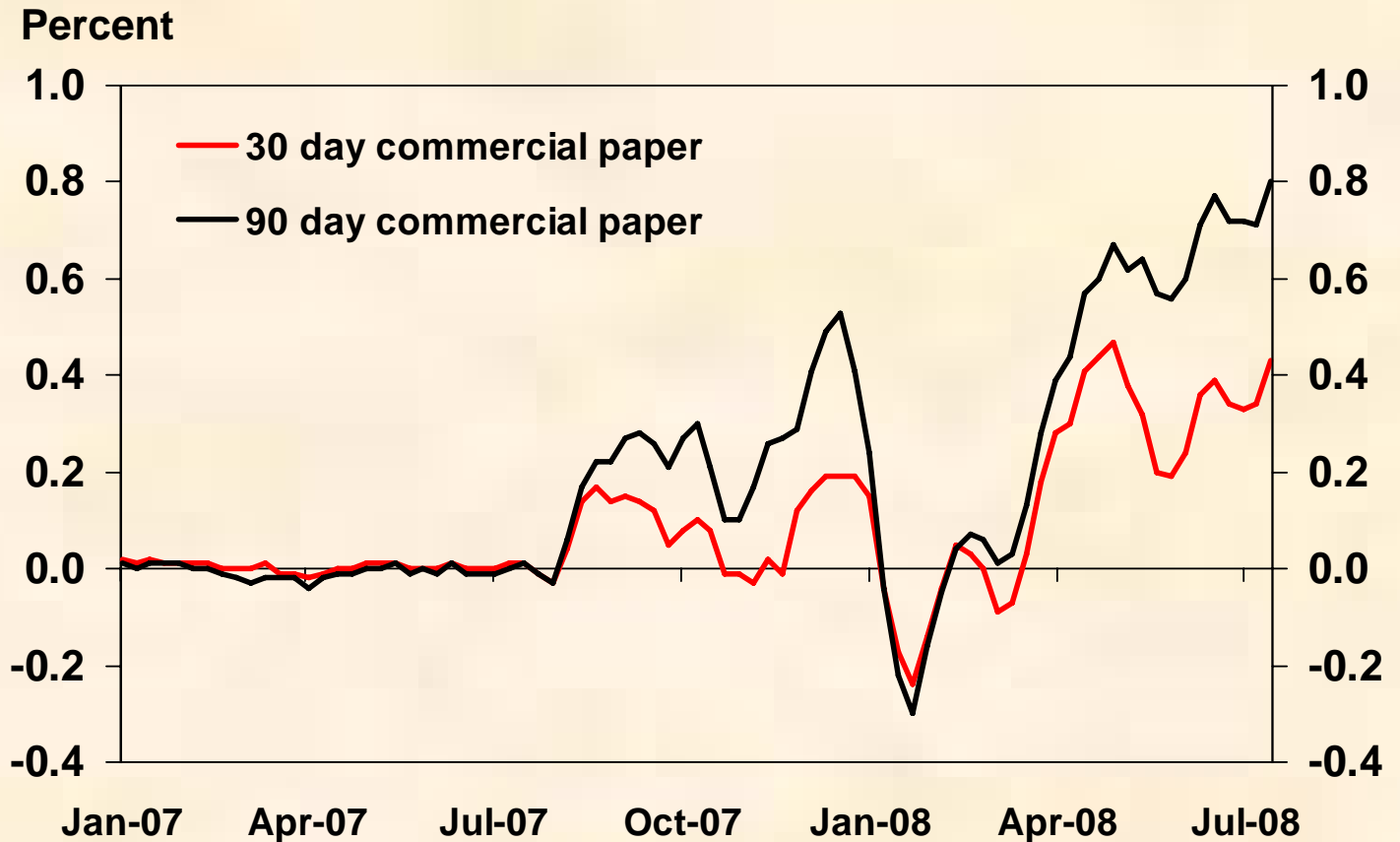
## ***Net Percent of Domestic Banks Tightening Credit Standards***



Source: Federal Reserve Board of Governors

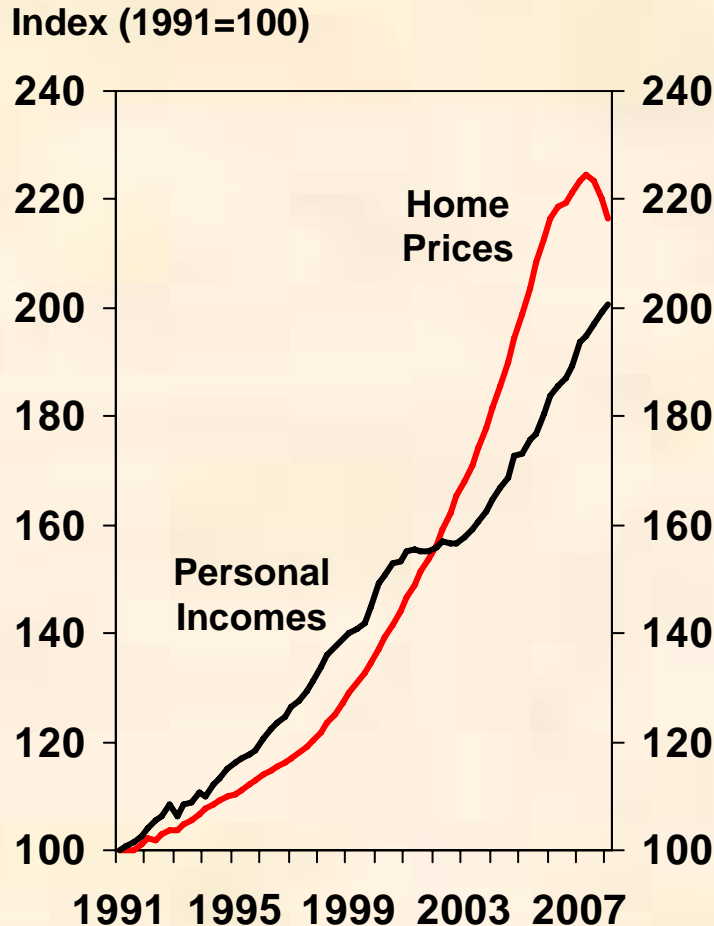
# *The cost of longer term funds has risen for financial firms.*

## Overnight and Longer Term Financial Commercial Paper Rates Spreads

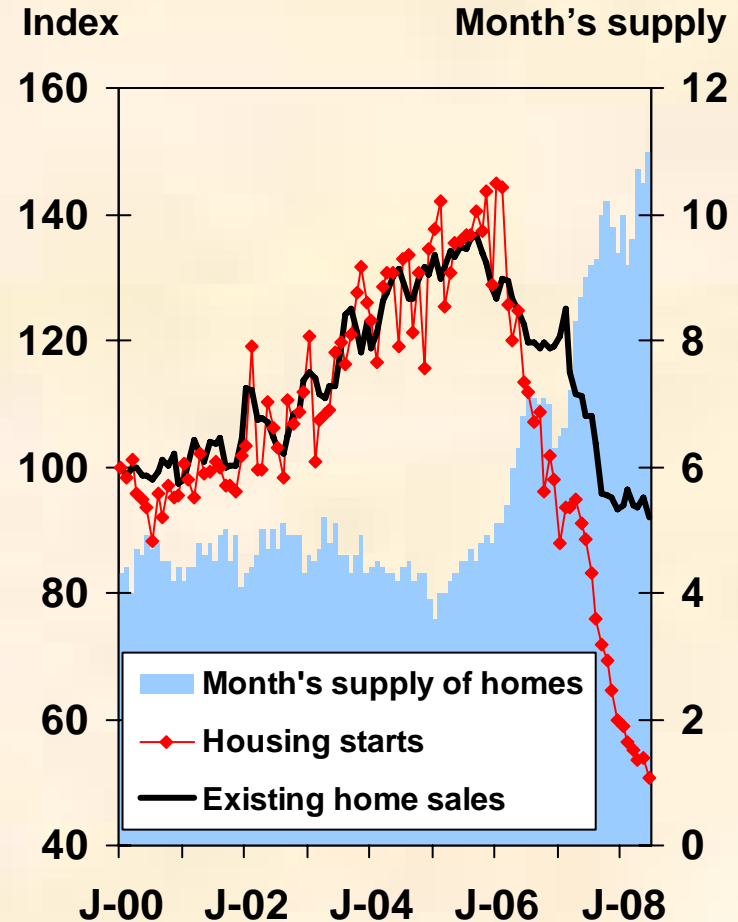


# A new balance in the housing market.

## Home Prices and Per Capita Incomes



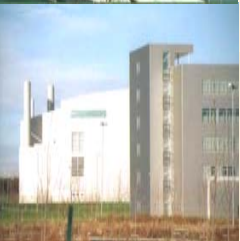
## Home Inventories, Sales, and Starts



Source: OFHEO, Bureau of Economic Analysis, NAR, Dept. of Commerce

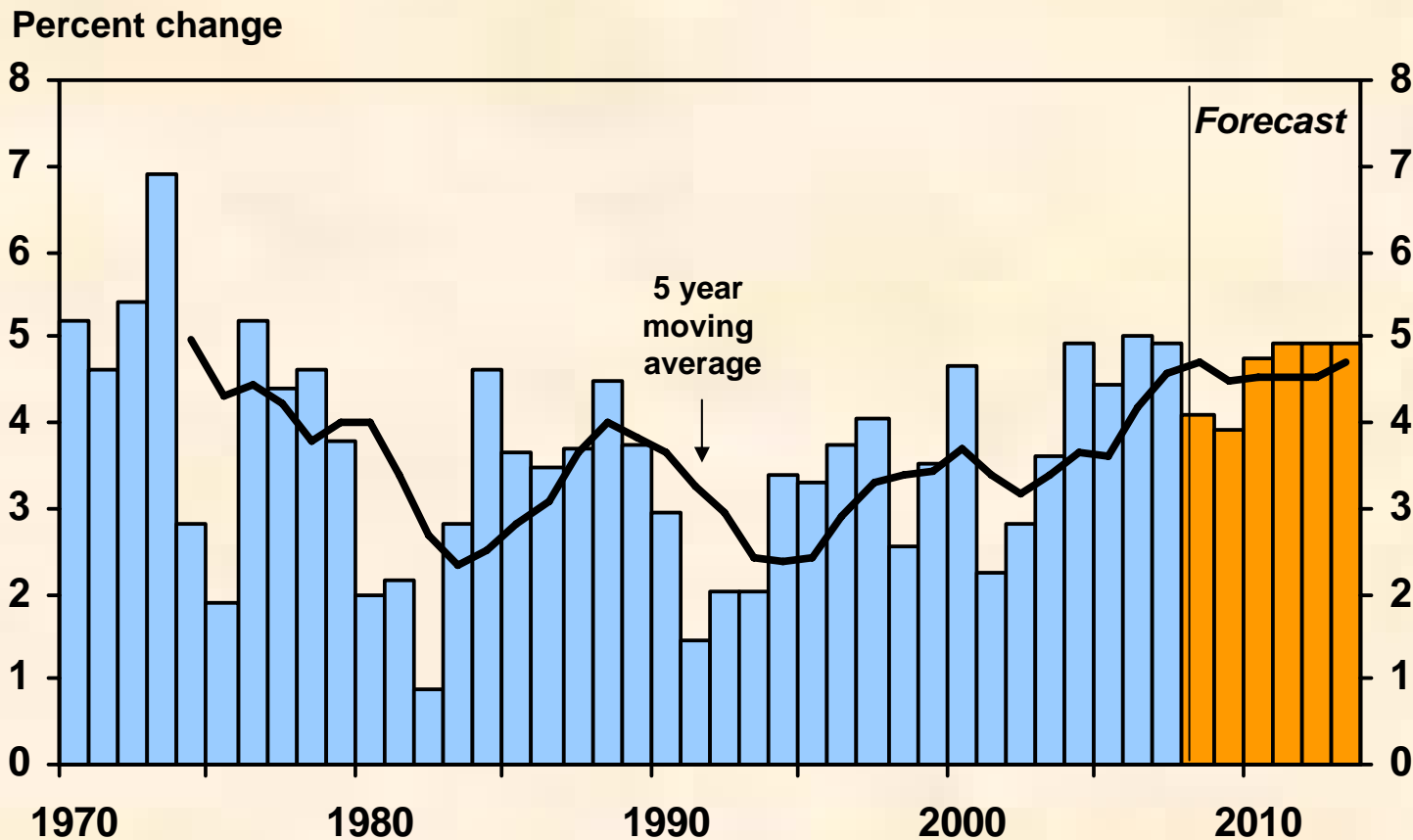
# *Risks to the Outlook*

- Housing risks linger and spread to financial markets.
- What is the impact of high energy prices on growth and inflation?
  - The cause: strong global demand.



# Strong Global Economies are Driving Energy and Food Demand.

## World GDP Growth

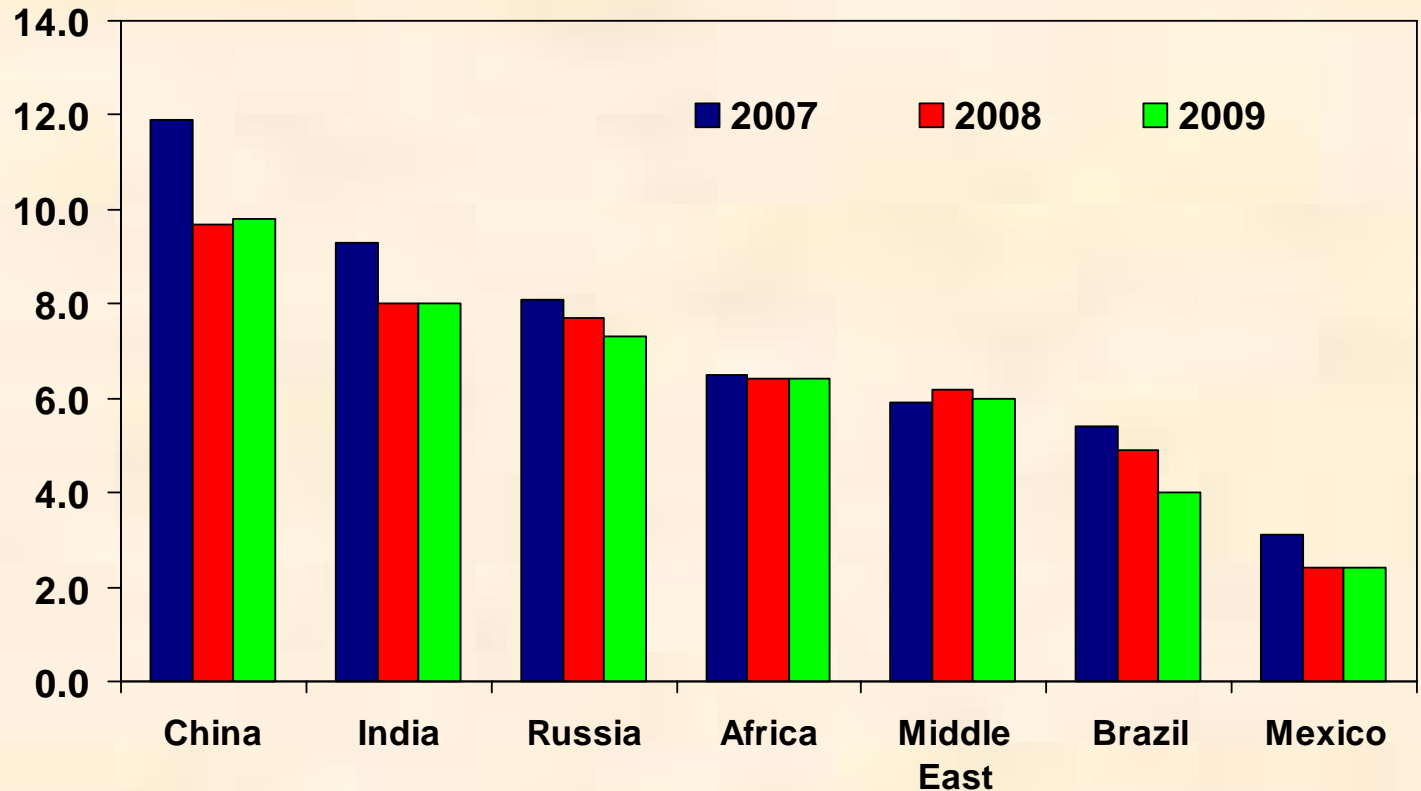


Source: International Monetary Fund

# *Economic growth in developing countries is widespread.*

## *World GDP Growth*

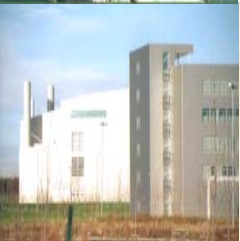
Percent



Source: International Monetary Fund (July 2008 forecast)

# *Risks to the Outlook*

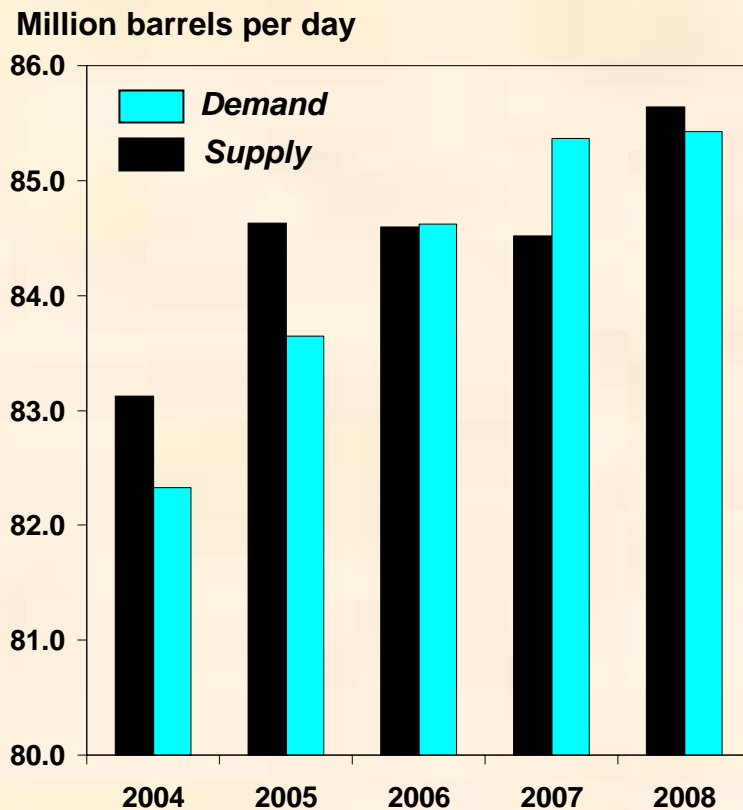
- Housing risks linger and spread to financial markets.
- What is the impact of high energy prices on growth and inflation?
  - The cause: strong global demand
  - The side effects:
    - rising commodity prices and inflation



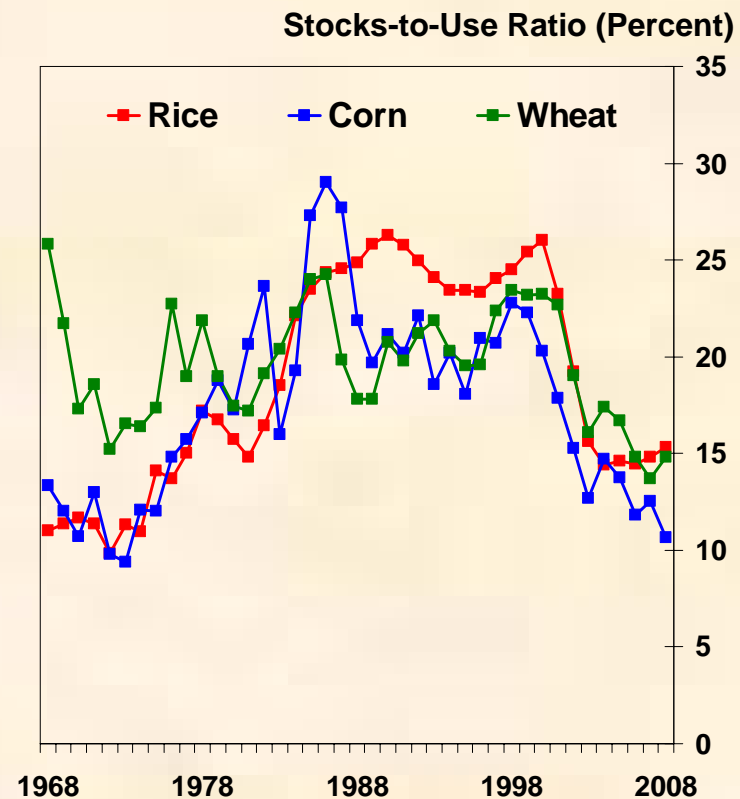


# Will Energy and Food Supplies Rise to Fulfill Increasing Global Demand?

## World Oil Balance 2004-2008



## World Crop Inventories



Source: Department of Energy and USDA

# *Energy and farm commodity prices have surged.*

## *WTI Crude Oil Prices*



## *Farm Commodity Prices*

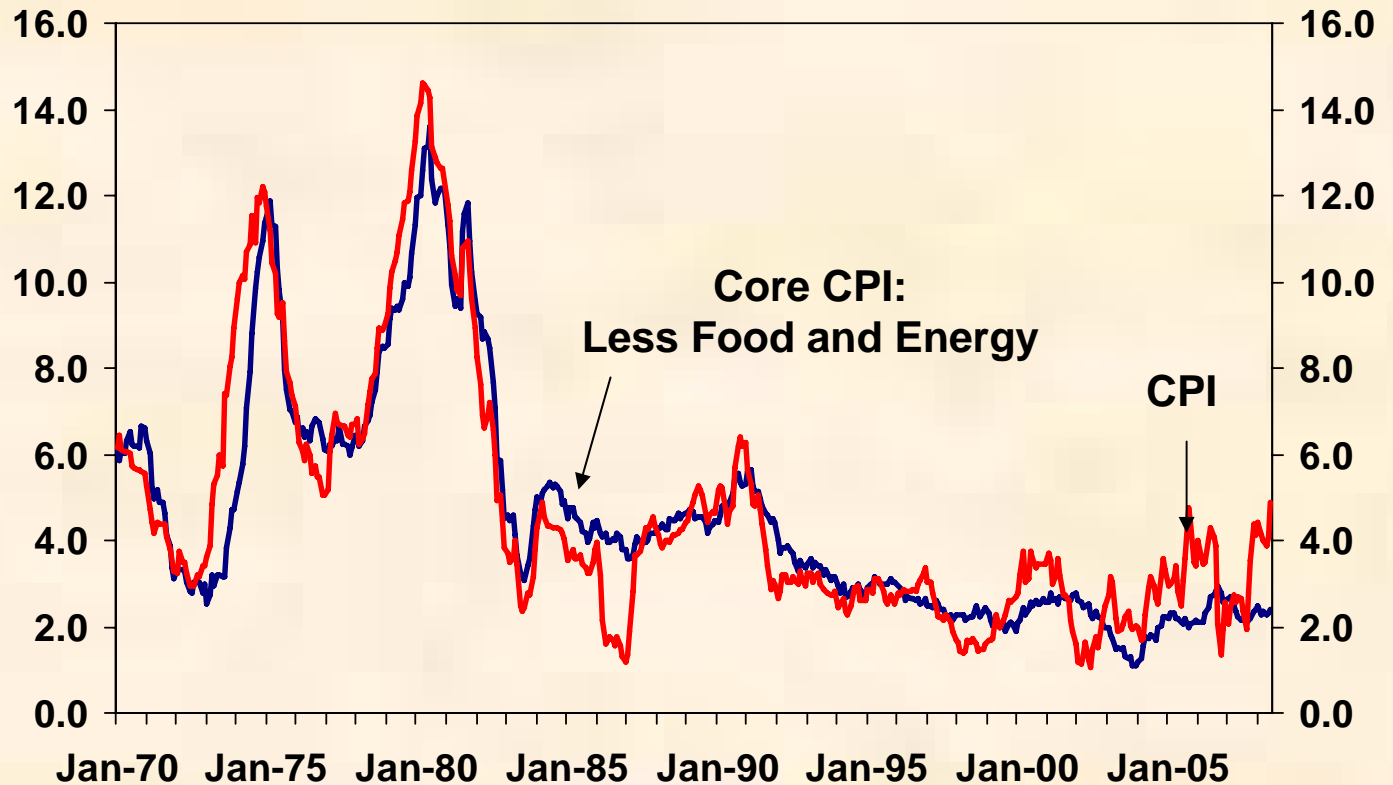


Source: Department of Energy and USDA

# *Inflation has jumped to its highest levels since the early 1990s.*

## **Consumer Price Inflation**

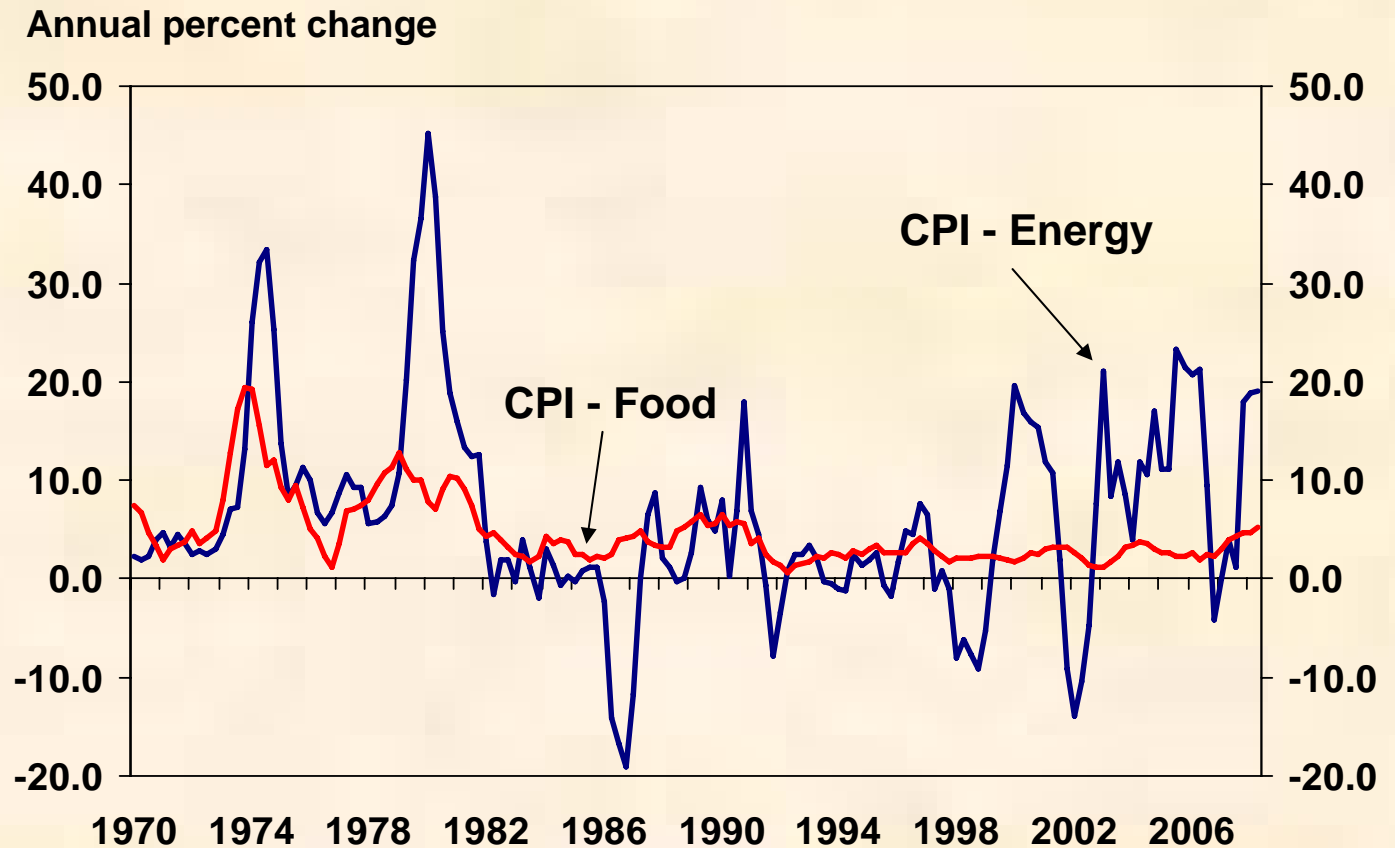
Annual percent change



Source: Department of Commerce

# *A Decade of High Energy Inflation.*

## *Consumer Price Inflation – Food and Energy Components*



Source: Bureau of Labor Statistics

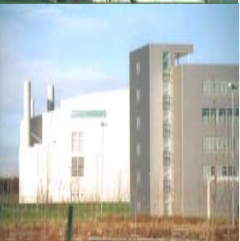
# *Energy Costs are Driving Housing and Transportation Inflation.*

Category	Share of CPI Core (Percent)	June 2007 (Percent change)	June 2008 (Percent change)
<b>Housing</b>	<b>55.8</b>	<b>3.4</b>	<b>3.5</b>
Shelter	42.6	3.8	2.5
Furnishings	6.1	0.0	0.2
<b>Household Fuel</b>	<b>6.7</b>	<b>4.4</b>	<b>12.2</b>
<b>Transportation</b>	<b>23.1</b>	<b>0.9</b>	<b>12.0</b>
Motor Vehicles	9.4	-1.9	-0.3
<b>Motor Fuel</b>	<b>7.2</b>	<b>4.9</b>	<b>33.3</b>


Source: Bureau of Labor Statistics

# *Risks to the Outlook*

- Housing risks linger and spread to financial markets.
- What is the impact of high energy prices on growth and inflation?
  - The cause: strong global demand
  - The side effects:
    - rising commodity prices and inflation
    - softer consumer spending



# Retail sales are mixed.



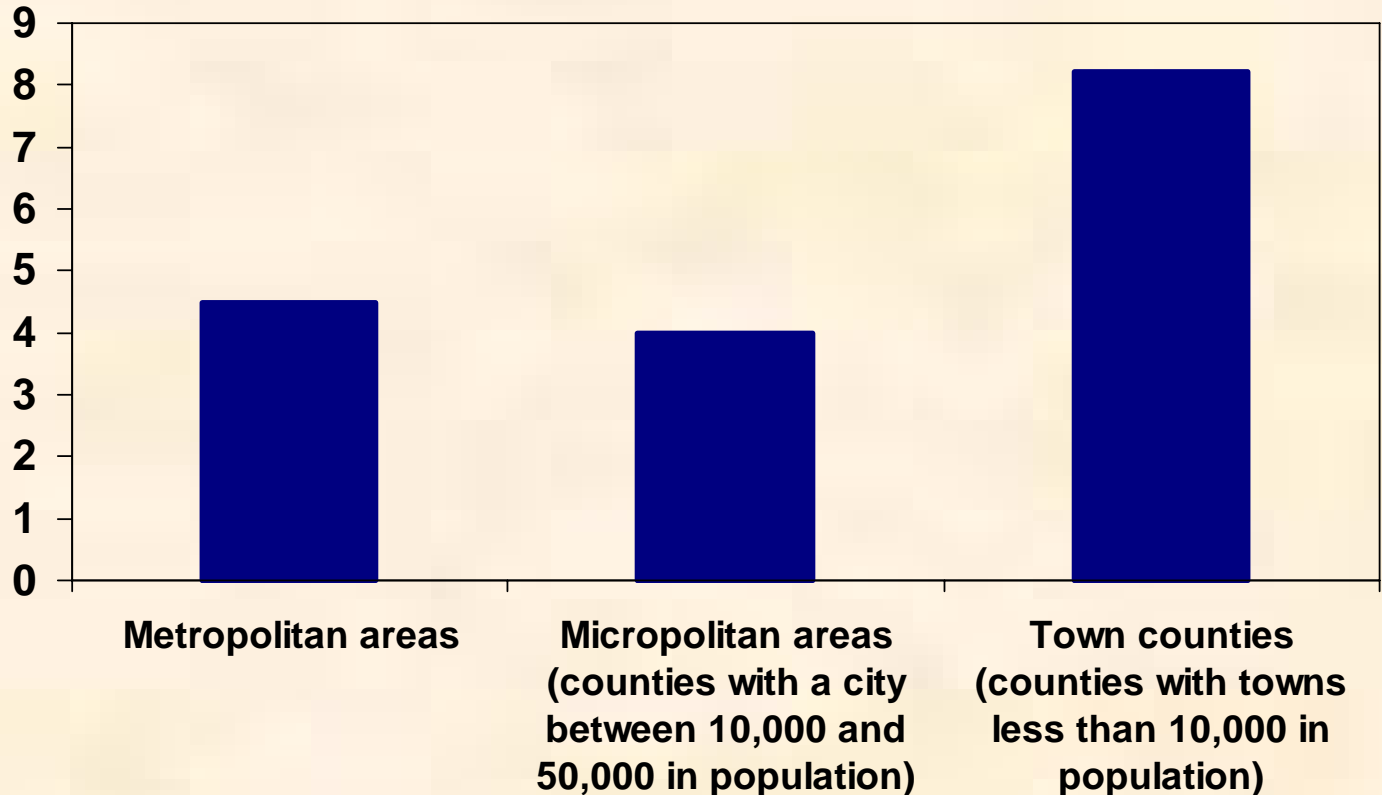
Retail Sales	Percent Change from June 2008 to June 2007
<b>Retail and Food Services</b>	<b>+3.0</b>
<b>Gasoline Stations</b>	<b>+24.5</b>
<b>General Merchandise Stores</b>	<b>+5.6</b>
<b>Food and Beverage Stores</b>	<b>+5.6</b>
<b>Food Services and Drinking Places</b>	<b>+3.6</b>
<b>Motor Vehicle and Parts Dealers</b>	<b>-9.5</b>
<b>Furniture and Home Furnishings Stores</b>	<b>-5.4</b>
<b>Building Material and Garden Equipment Dealers</b>	<b>-1.5</b>
<b>Department Stores (ex. L.D.)</b>	<b>-1.3</b>

Source: Census Bureau

# ***Tax receipts have risen in non-metro areas.***

## **Kansas Retail Sales Tax Receipts, 2007-08** *(Fiscal Year-to-Date, July to March)*

Percent change from previous year



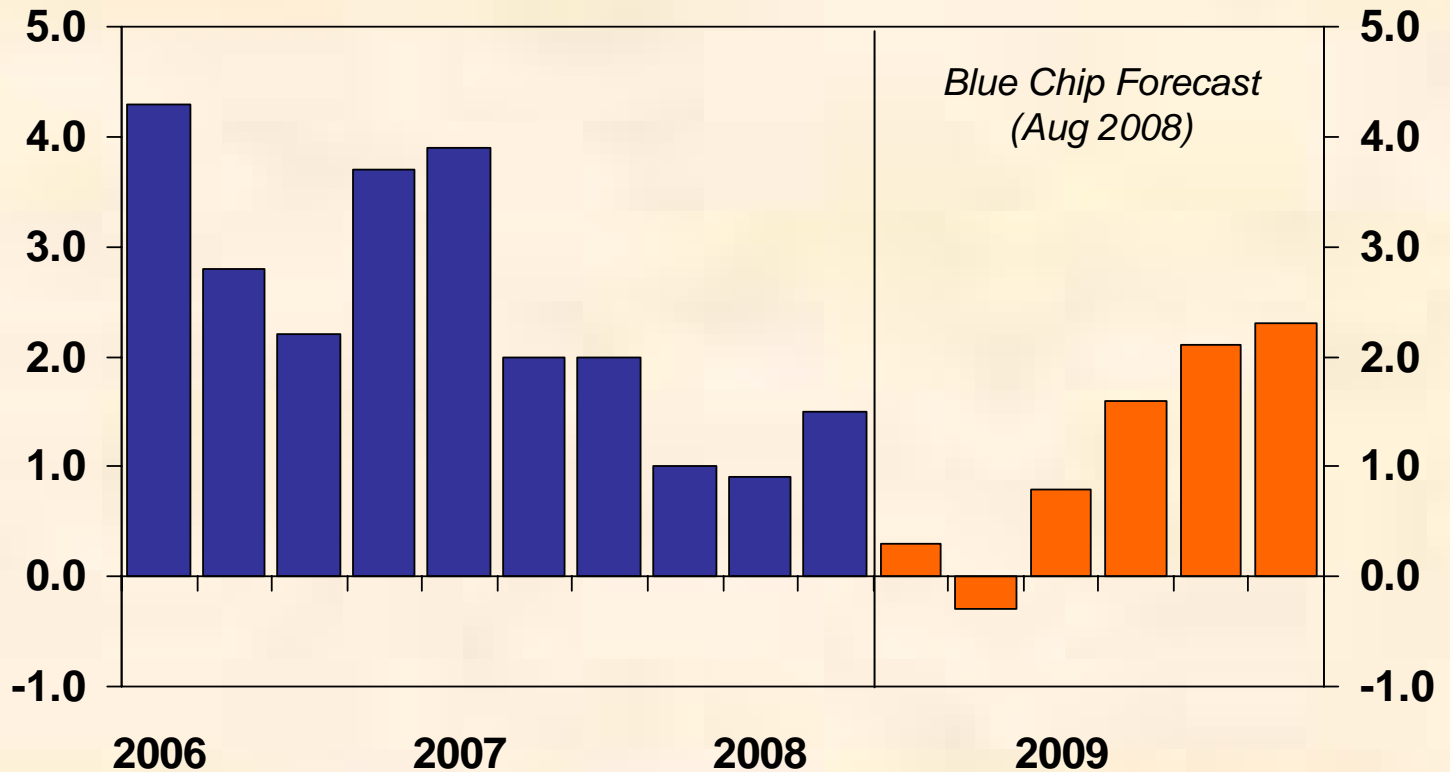
Source: Kansas Department of Revenue



# What stimulus is left after the rebates?

## Personal Consumption Expenditures

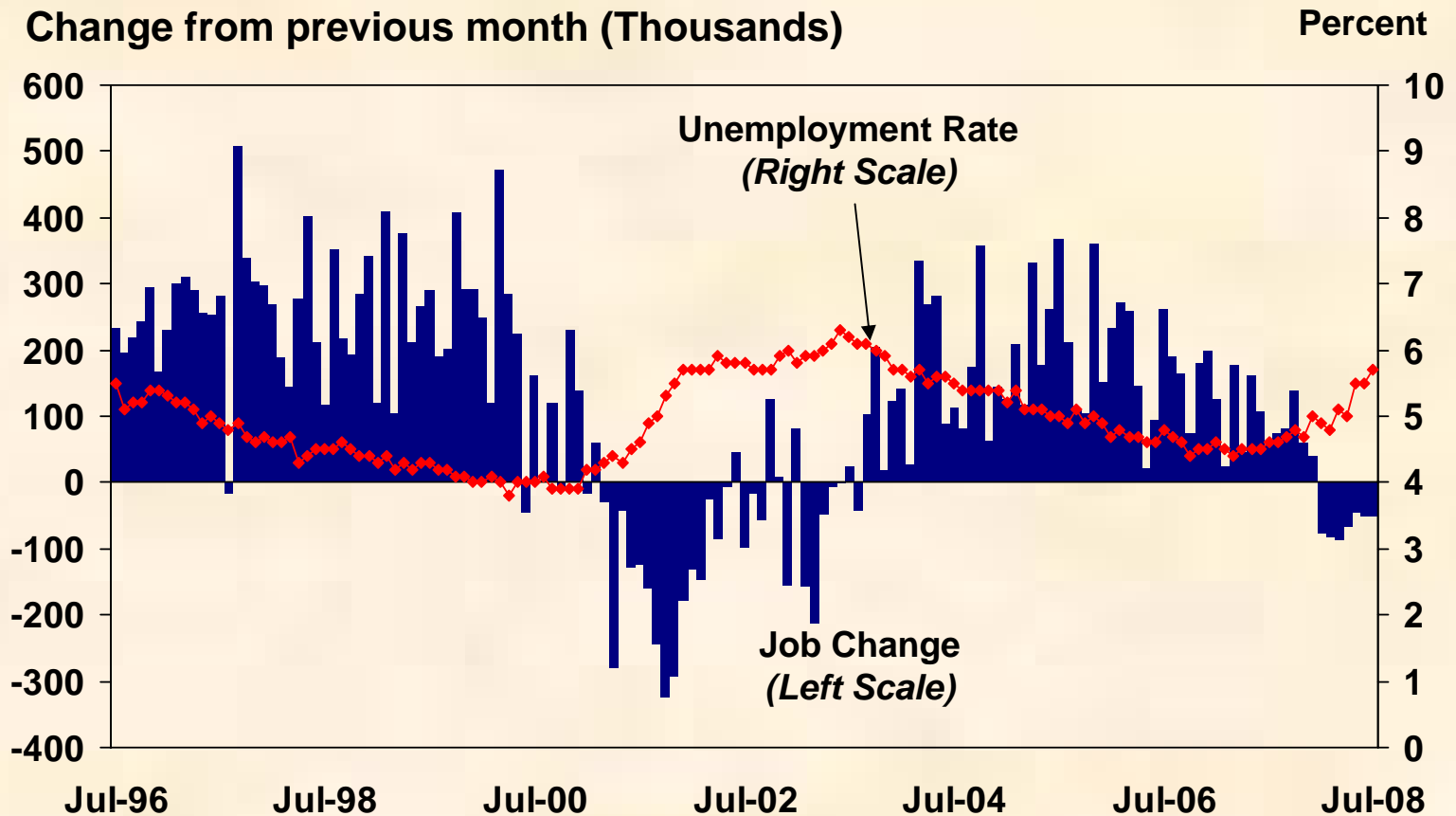
Annualized percent change from previous quarter



Source: Bureau of Economic Analysis and Blue Chip Forecast

# Will job losses slow consumer spending?

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

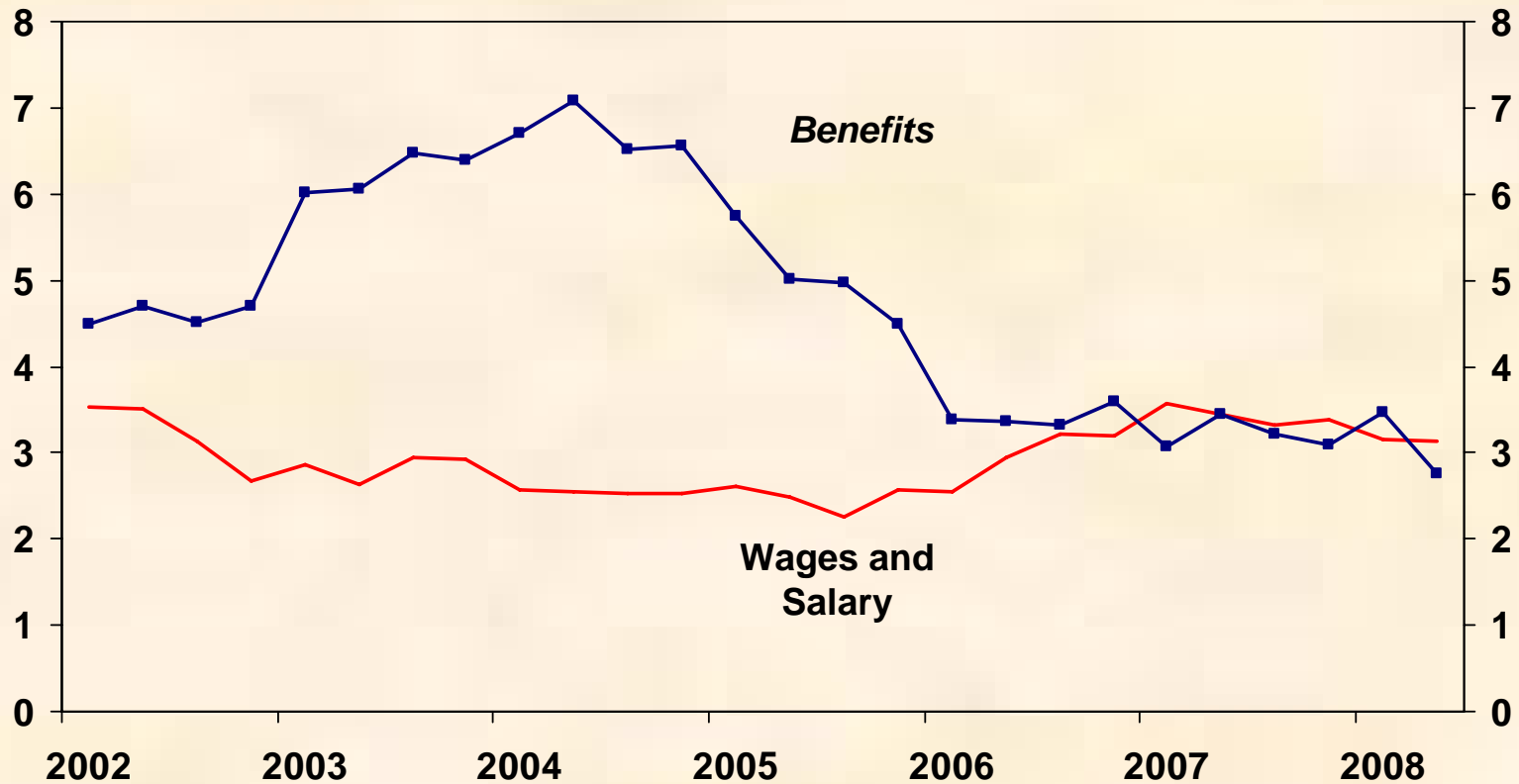


Source: Bureau of Labor Statistics

# Wage growth will have significant influence on inflation and growth.

## Employment Cost Index

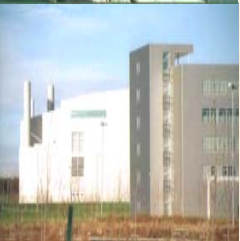
Percent change from year ago



Source: Bureau of Labor Statistics

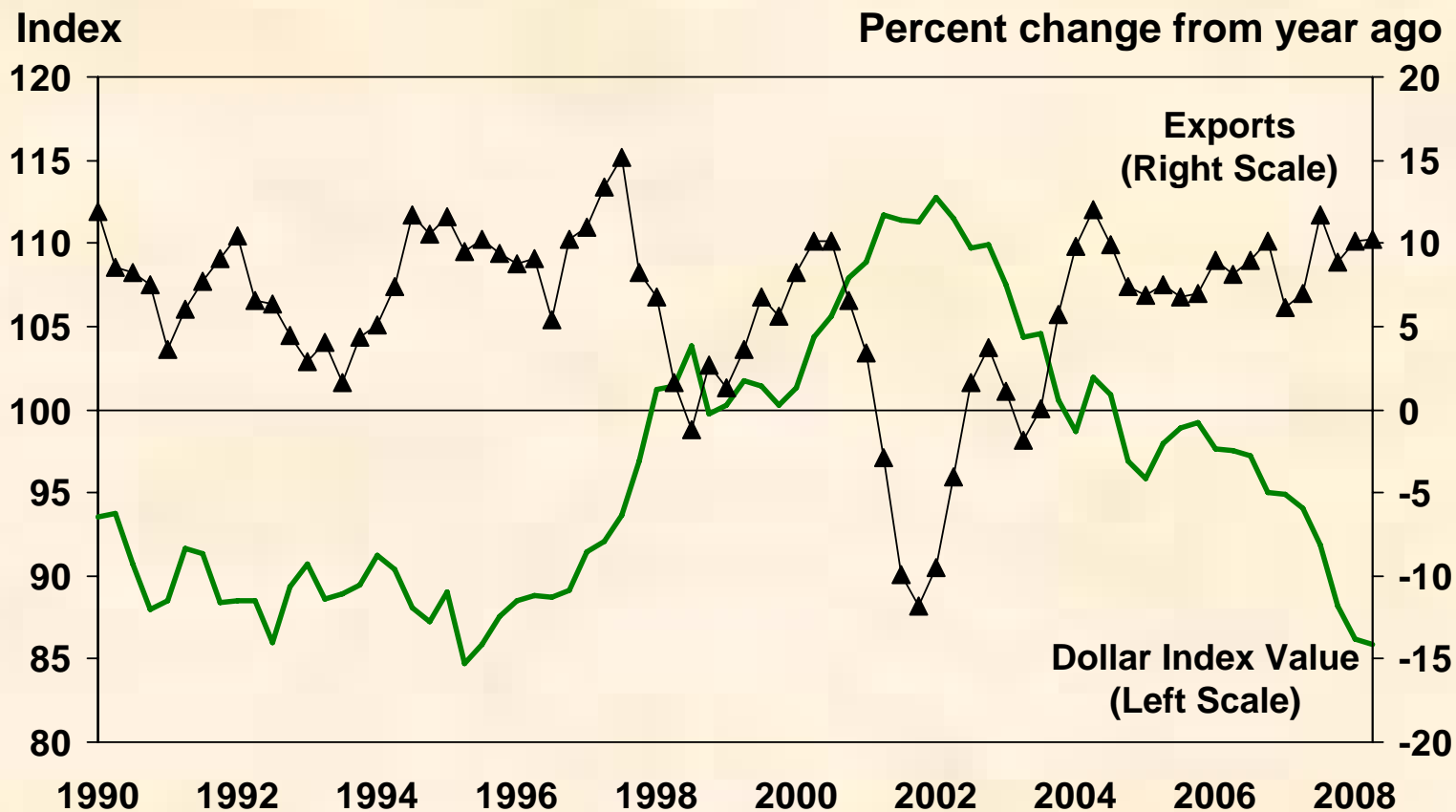
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- What is the impact of high energy prices on growth and inflation?
  - The cause: strong global demand
  - The side effects:
    - rising commodity prices and inflation
    - softer consumer spending
    - weaker business activity despite strong exports



# Exports have risen with a weak dollar.

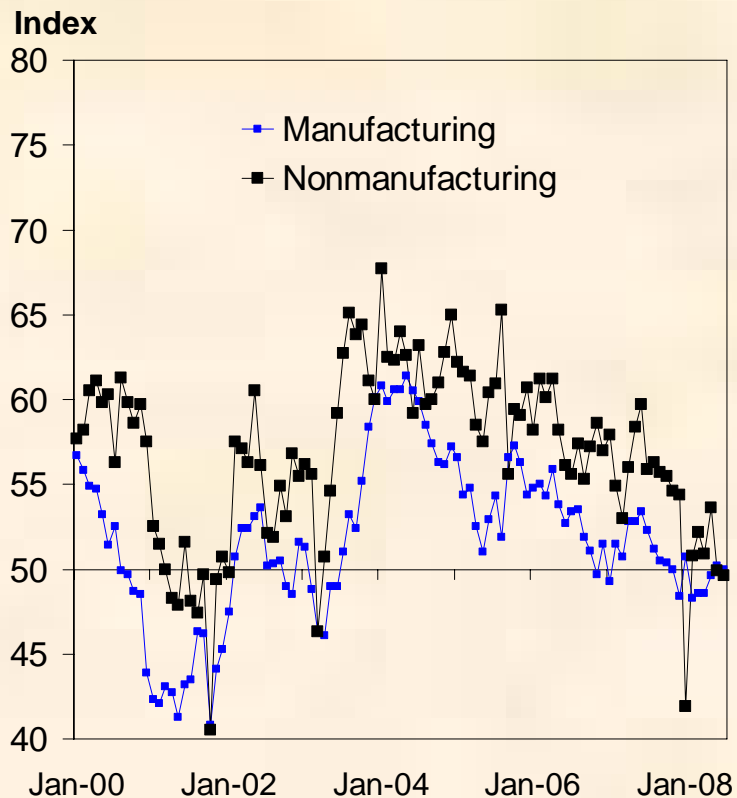
## Dollar Value and U.S. Net Exports



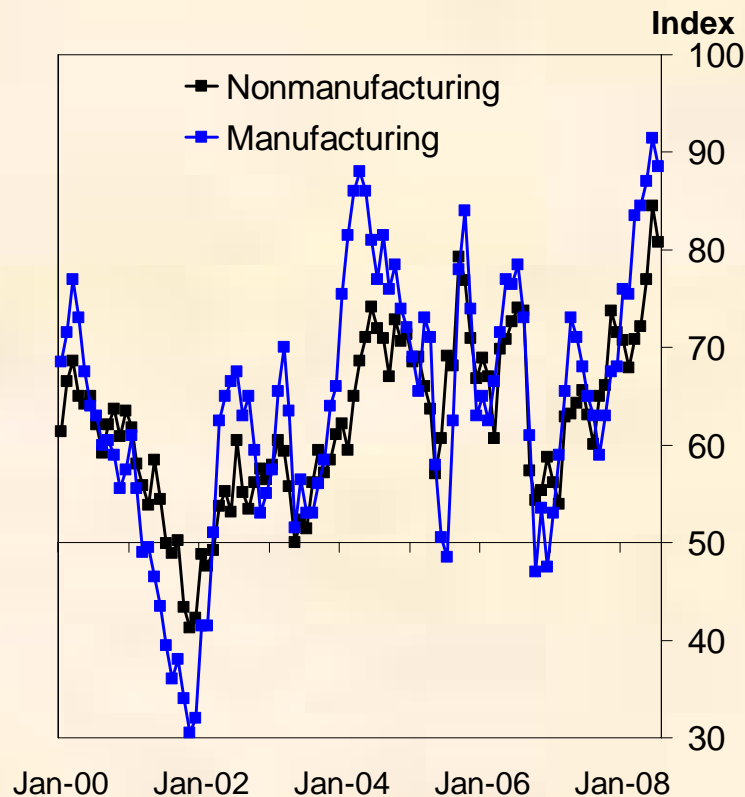
Source: Department of Commerce

# *Production activity has slowed with rising input prices.*

## ***Business Activity***



## ***Prices Paid***

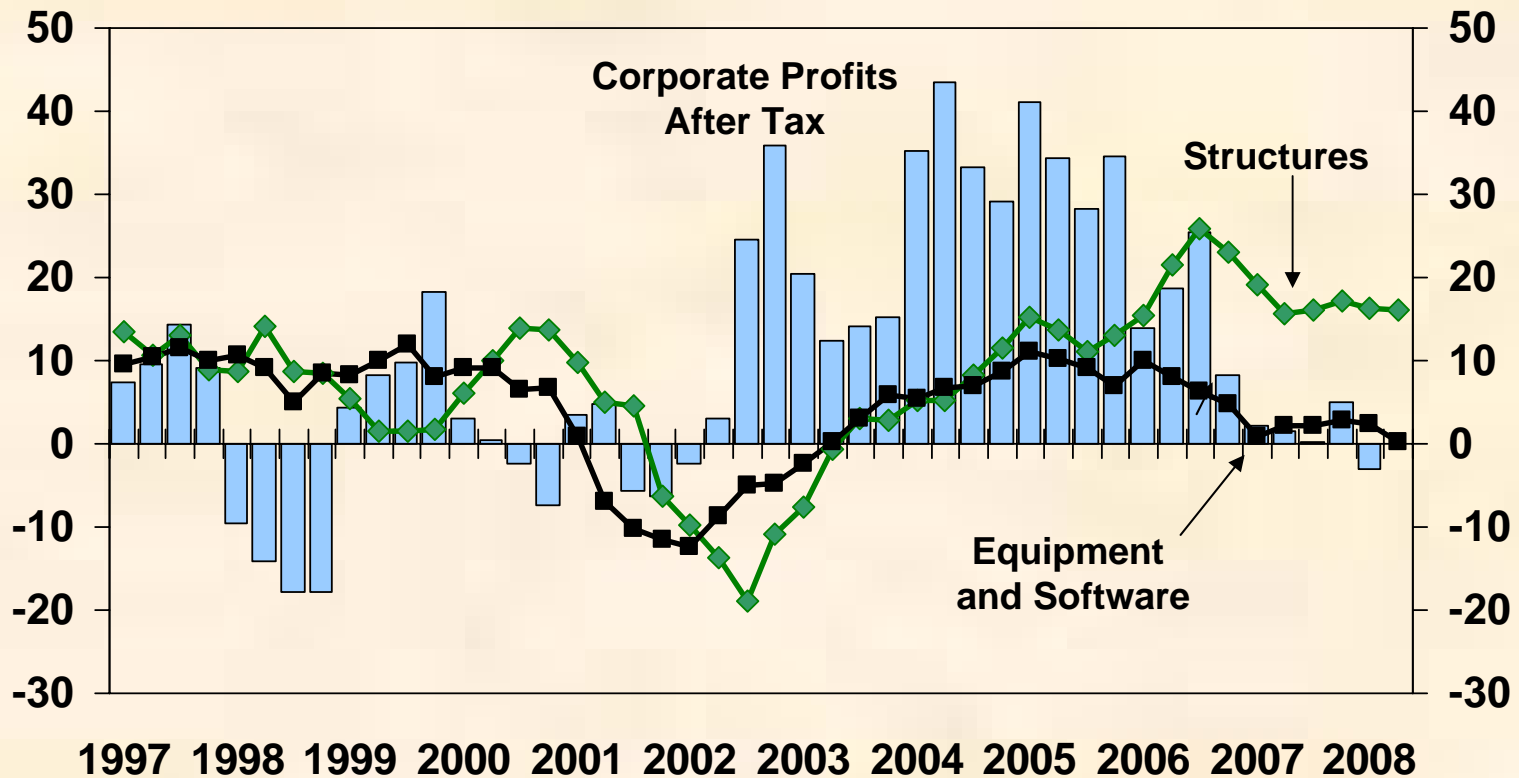


**Source: Institute of Supply Management**

# Weaker profits have slowed business investment.

## Corporate Profits and Nonresidential Fixed Investment

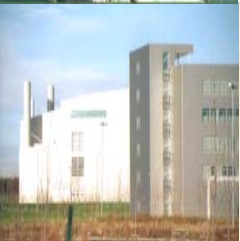
Percent change from year ago



Source: Bureau of Economic Analysis

# *The Energy Questions*

- Will high prices fix the inflation problem by trimming demand and stimulating supply?*
- What oil price balances economic growth and inflation, \$50, \$100, \$150 per barrel oil?*
- Markets will work, but how long will it take?*
- Will high energy prices spillover into more core areas?*
- Will higher prices become embedded in expectations?*





# *Conclusion*

- **Housing risks spread to financial markets.**
- **Commodity prices soared with strong global demand and limited supply gains.**
- **Rising energy prices have sapped U.S. economic growth and boosted inflation.**

***Will lower energy prices stimulate growth and reduce inflationary pressures?***

