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February 1, 2010

Macro Economic Outlook: Why Should Students Care?



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

- **Macro Economics and the Federal Reserve System**
- **Financial Crisis – Disruption of Credit Markets**
- **Combating the Financial Crisis and Potential Consequences**
- **The Macro Economy: What Matters Most**



Macro versus Micro

- In a nut shell...
- What is macroeconomics?
 - How the national economy functions
- What is microeconomics?
 - The study of buying and selling behavior of individuals and firms in markets and market failures



A Key Player in Managing the Macro Economy is the Federal Reserve System

- **The 'Fed' was founded in 1913 with 3 core missions:**
 - Promote an efficient payments system
 - Safeguard the competitiveness, safety and soundness of the banking system
 - Conduct monetary policy



An Independent Fed

- **The Fed is self-supporting to maintain political independence.**
- **Income sources:**
 - Interest on loans to financial institutions
 - Income from services
 - Interest income from US Treasury bonds, bills and notes
- **Balance of Power: The Political Fight for an Independent Central Bank, 1790 – Present**
 - <http://www.kc.frb.org/>



Structure of the Fed

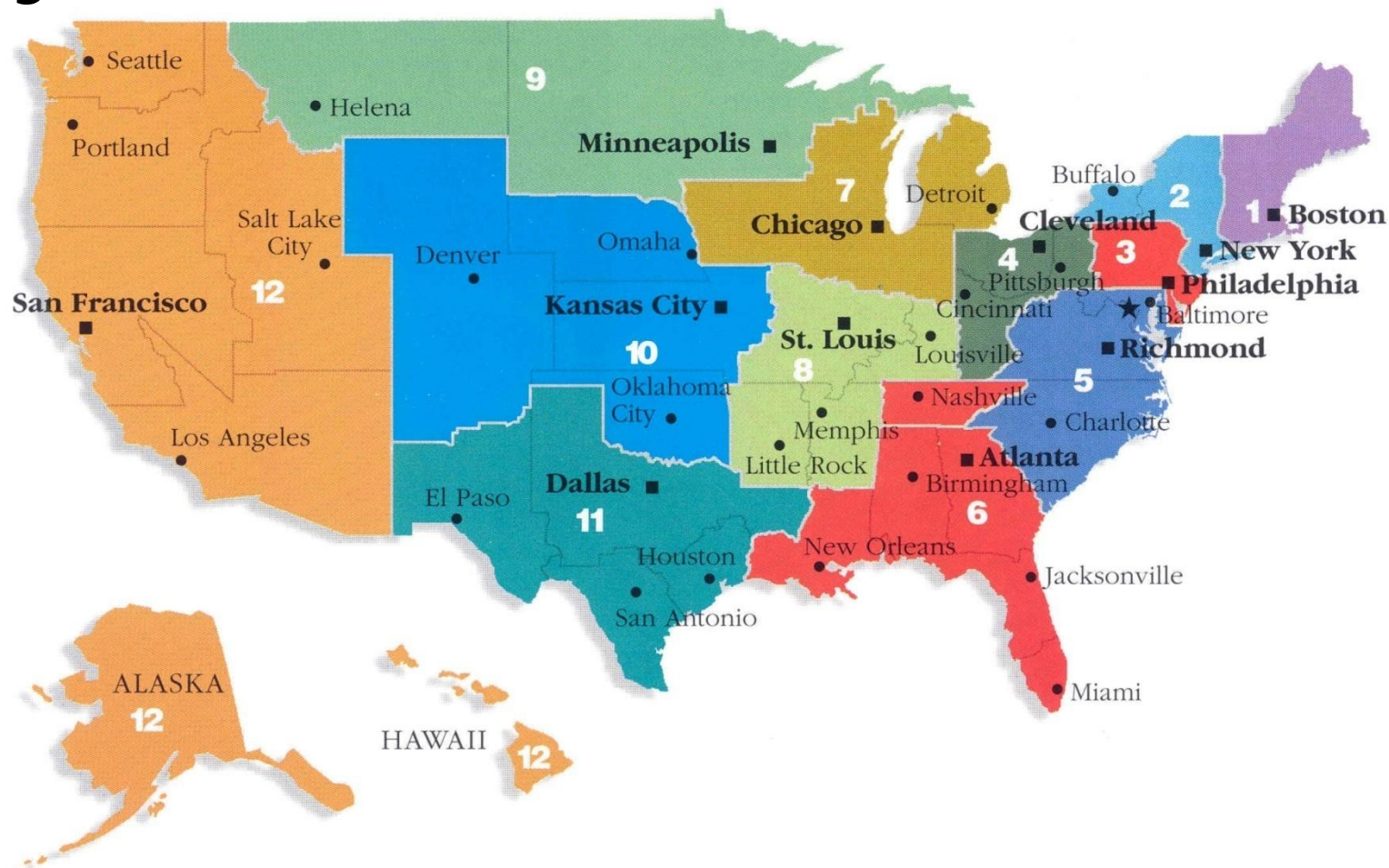
- **Board of Governors**
- **12 Regional Reserve Banks**
- **Federal Open Market Committee**



Regional Reserve Banks

- 25 branch offices

- Fed member banks



Monetary Policy Objectives

- Primarily two all encompassing objectives:
 - Sustainable economic growth
 - Price stability



Today's Roadmap

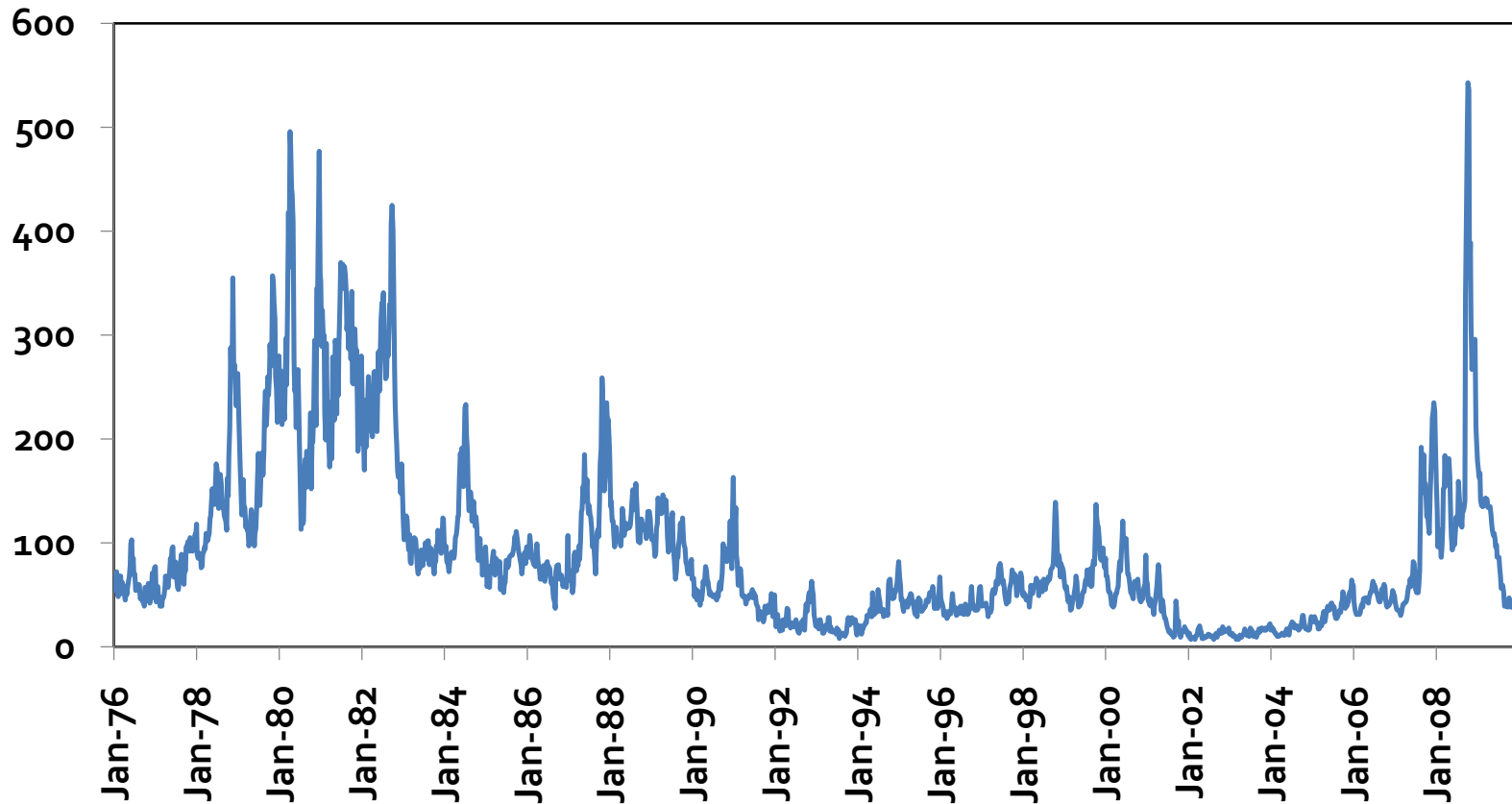
- **Macro Economics and the Federal Reserve System**
- **Financial Crisis – Disruption of Credit Markets**



The financial crisis has eased.

TED Spread

Basis Points

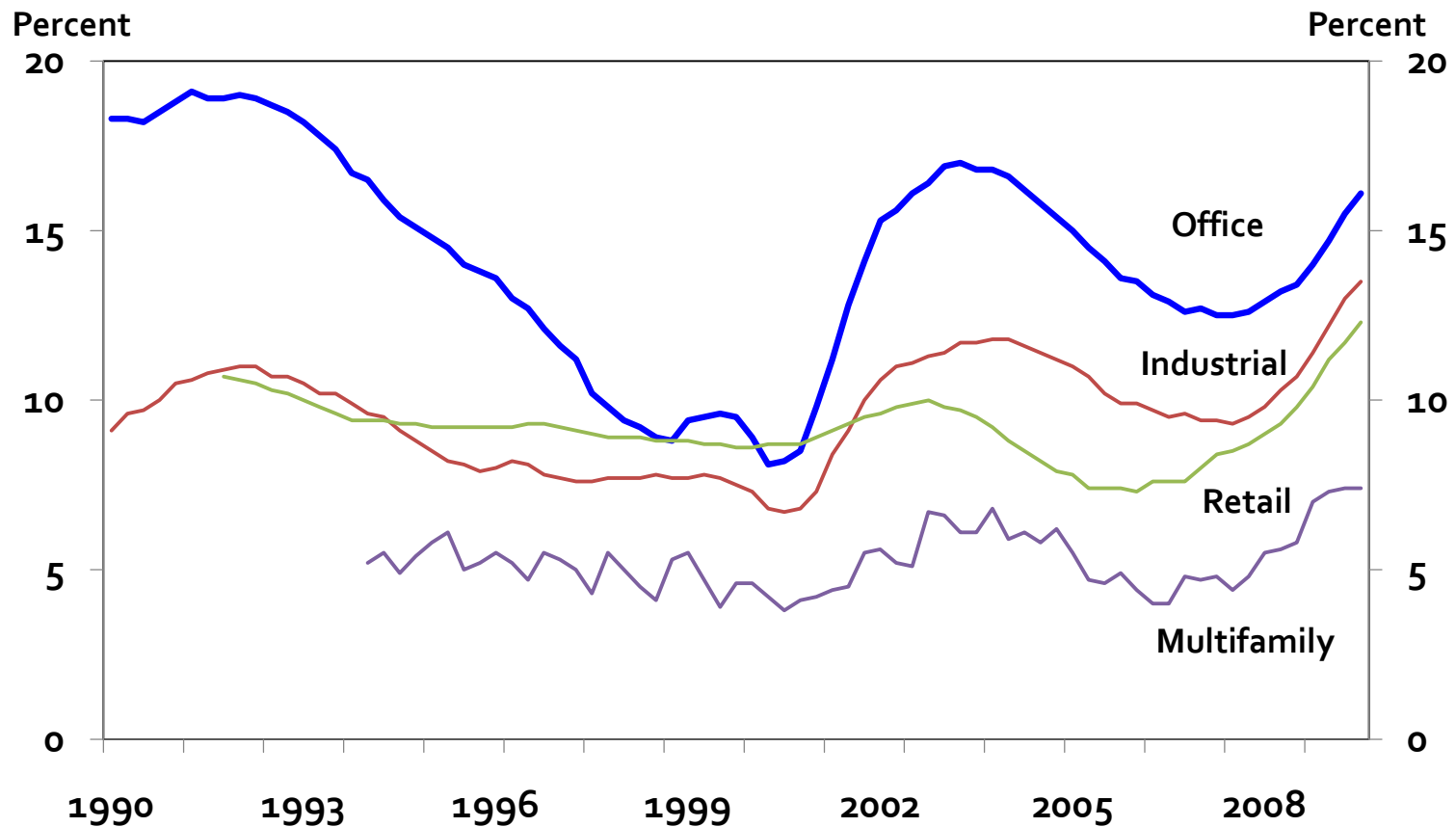


Source: Federal Reserve Board of Governors



Financial markets may not be in the clear partly because of commercial real estate.

U.S. Commercial Real Estate Vacancy Rates



Source: Torto-Wheaton Research



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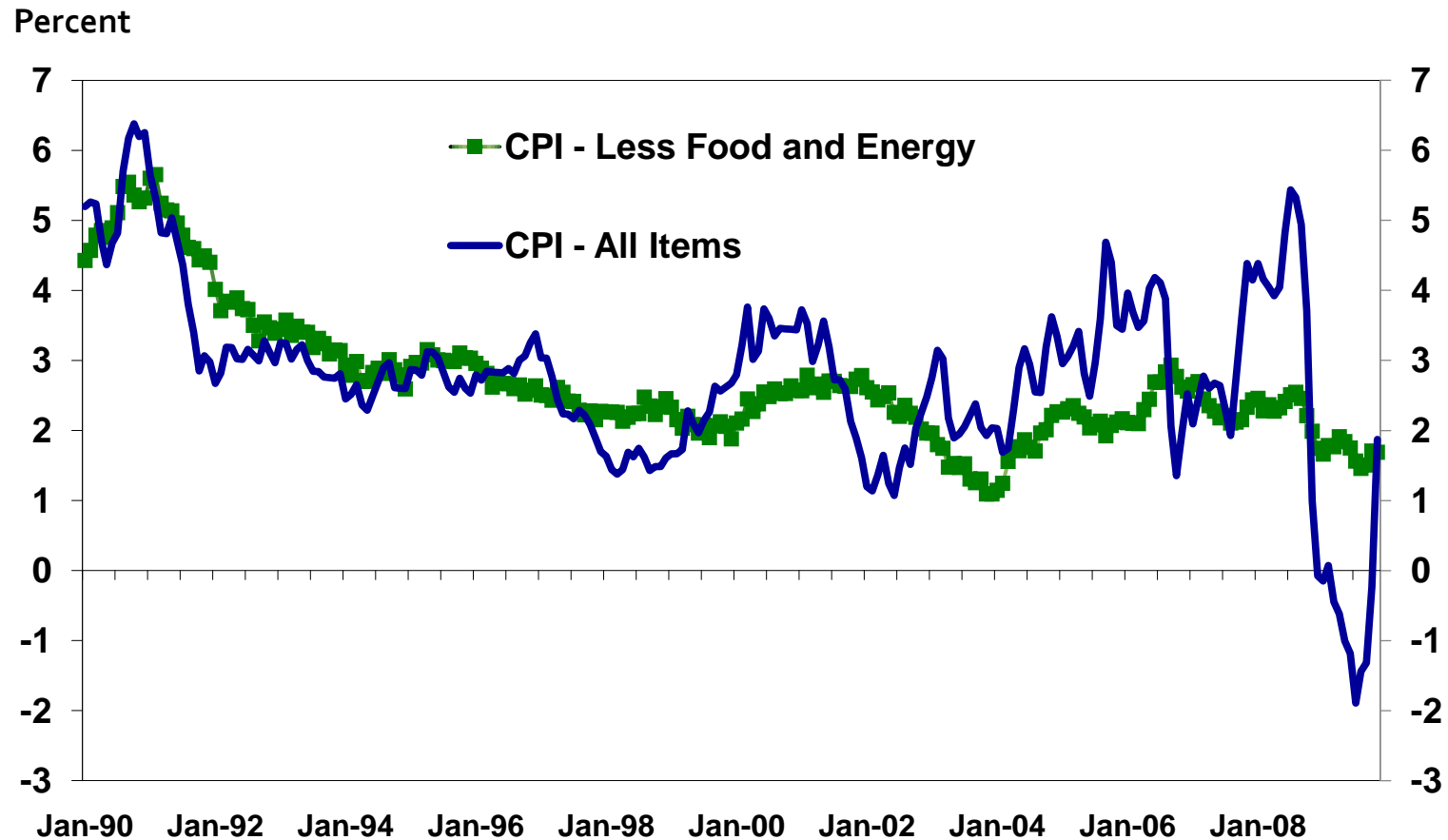
Deflation, Disinflation, Inflation: What is the difference?

- Deflation: a **fall** in the general level of prices of goods and services in an economy over a period of time.
For example, $CPI < 0$
- Inflation: a **rise** in the general level of prices of goods and services in an economy over a period of time.
For example, $CPI > 0$
- Disinflation: **a decrease in the rate of inflation** – a slowdown in the increase of the general price level of goods and services over time.
For example, $CPI > 0$, but falling from 2.5 to 1.5%



The U.S. is experiencing disinflation.

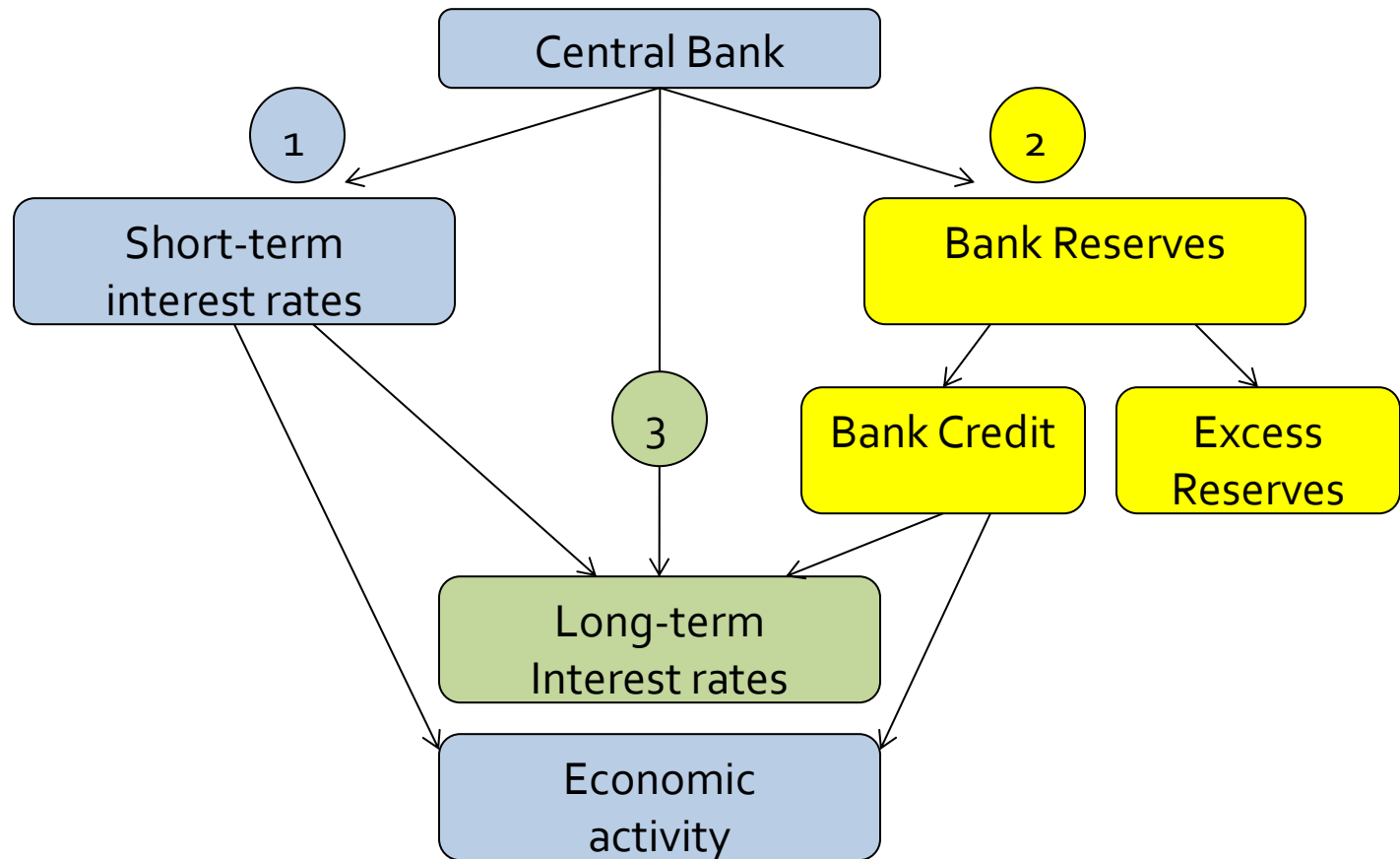
Consumer Price Inflation



Source: Bureau of Labor Statistics



Monetary Policy Transmission Mechanisms



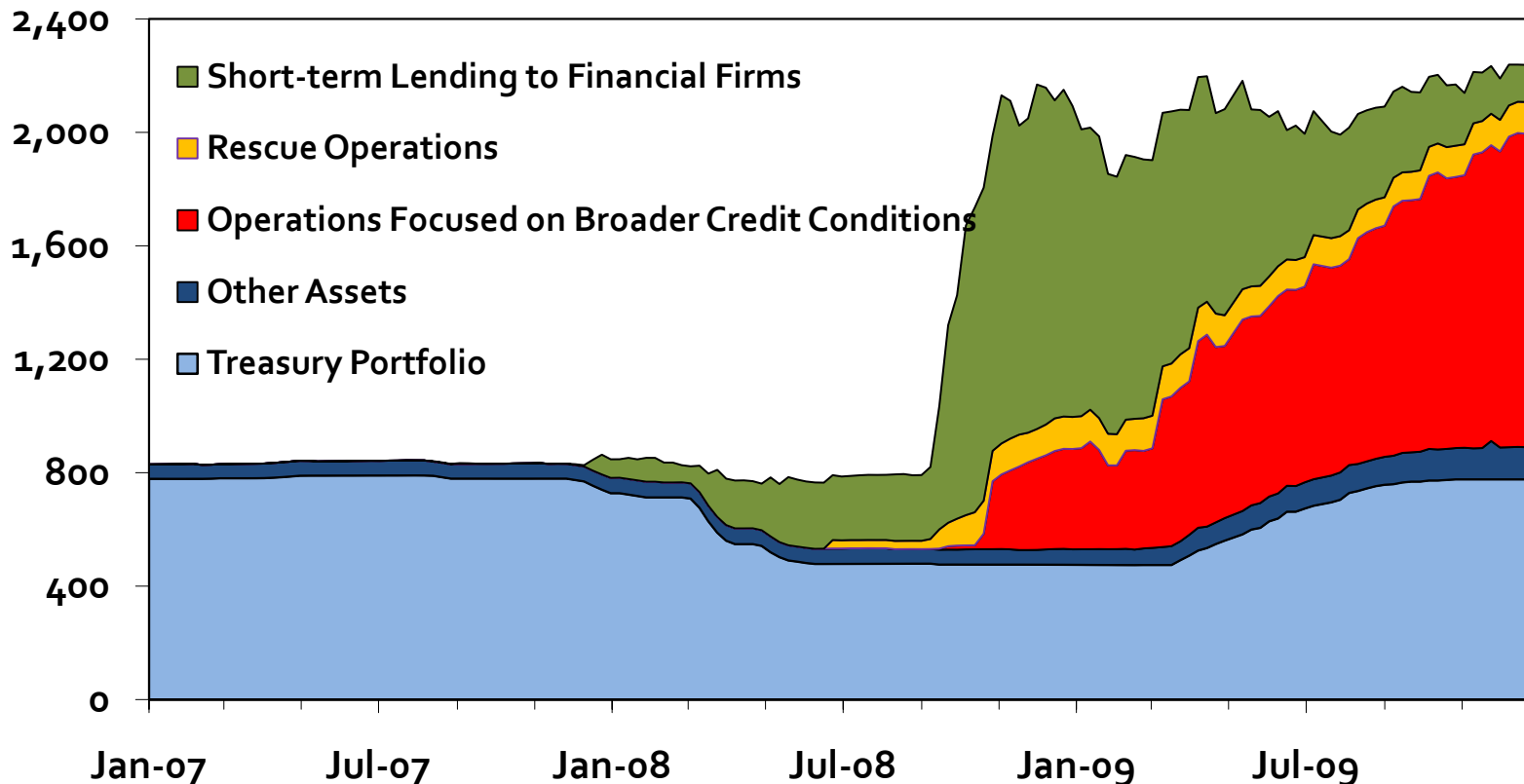
Source: Gordon Sellon (2003) "Monetary Policy and the Zero Bound: Policy Options When Short-Term Rates Reach Zero"
Economic Review <http://www.kansascityfed.org/Publicat/ECONREV/PDF/4q03sell.pdf>



To combat the financial crisis and recession, the Federal Reserve has expanded its balance sheet

Federal Reserve Balance Sheet: Assets

Billion Dollars

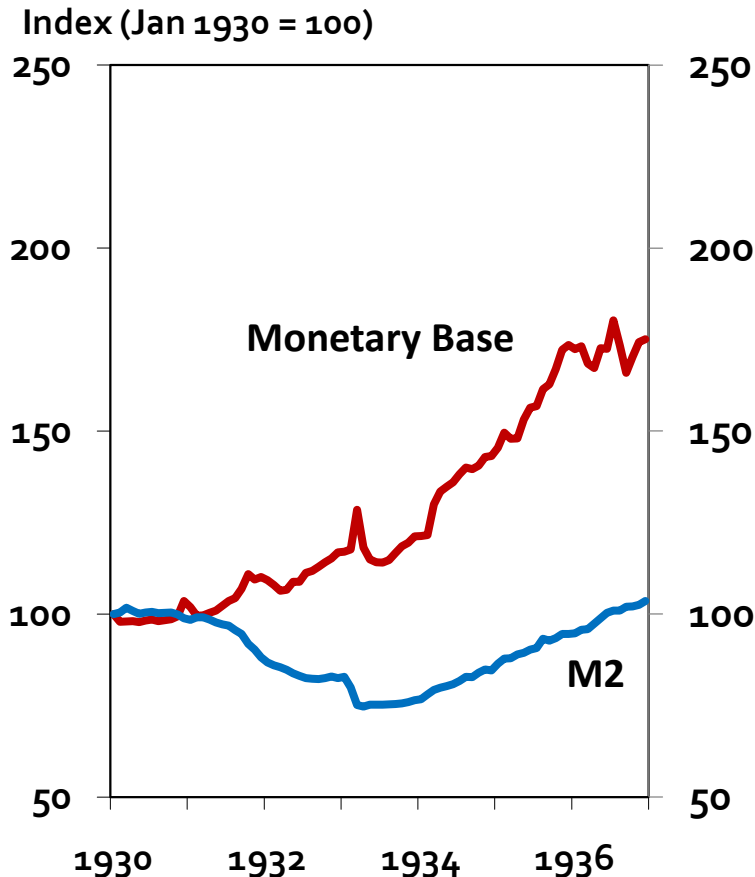


Source: Federal Reserve Board of Governors

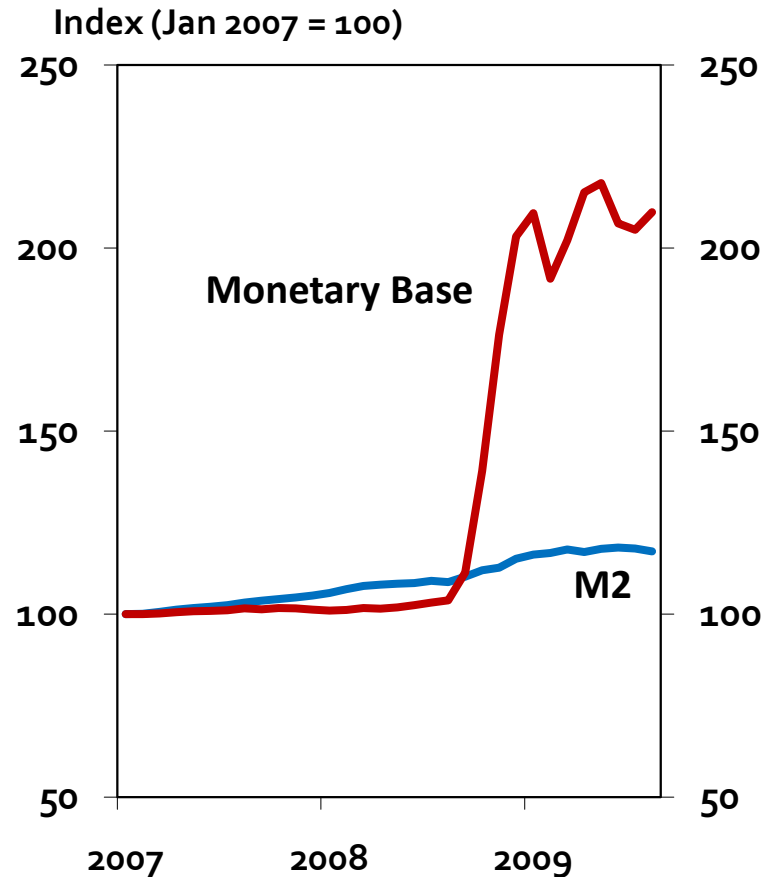


Despite a surging monetary base, inflation has been subdued.

Growth in Monetary Aggregates



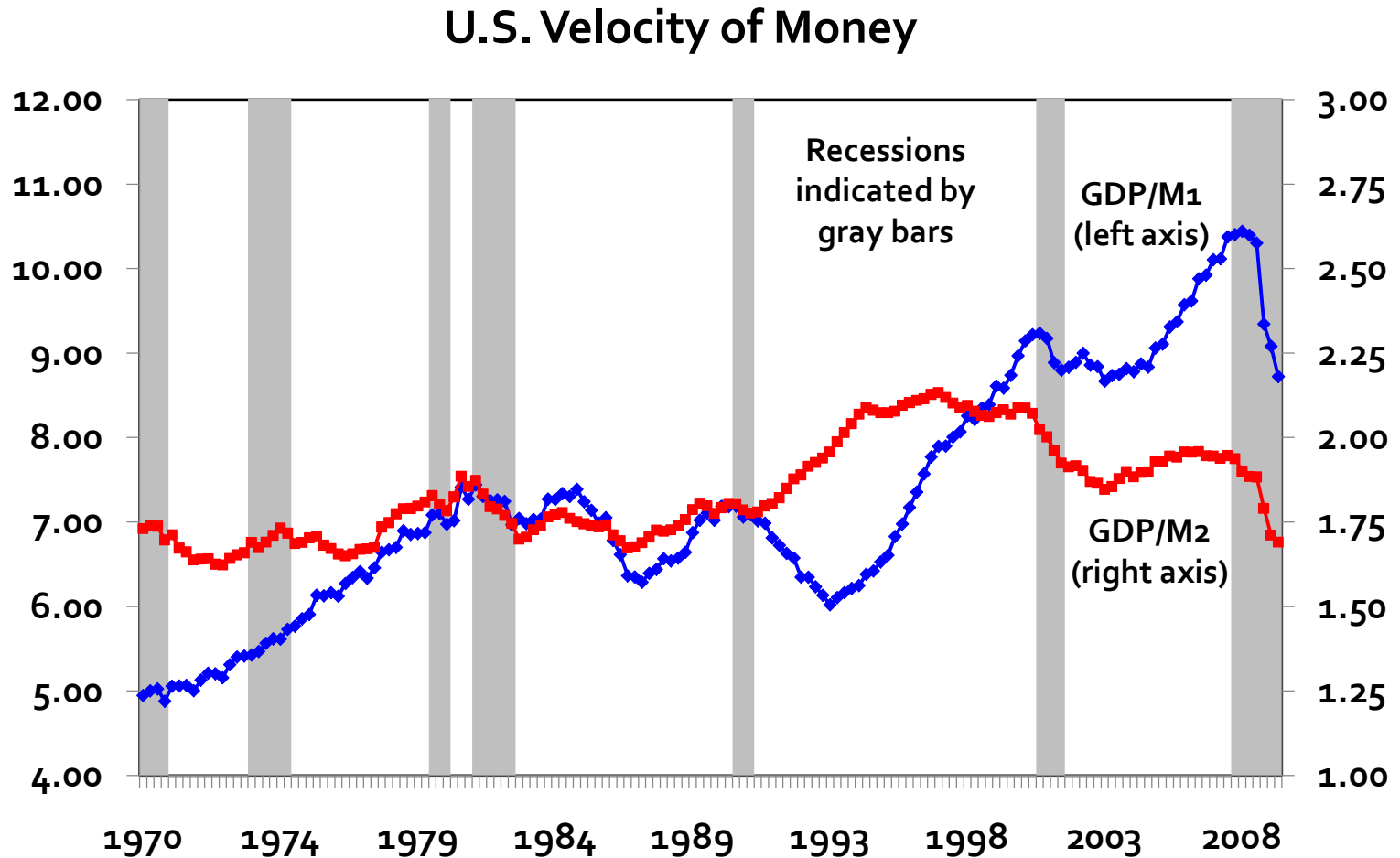
Source: Federal Reserve Bank of St. Louis, Friedman and Schwartz



Source: Federal Reserve Board of Governors



Inflation has been subdued because the velocity of money has plummeted.



Source: BEA and Federal Reserve Board of Governors



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How Gross Domestic Product (GDP) is Measured

$$Y = C + I + G + NX$$

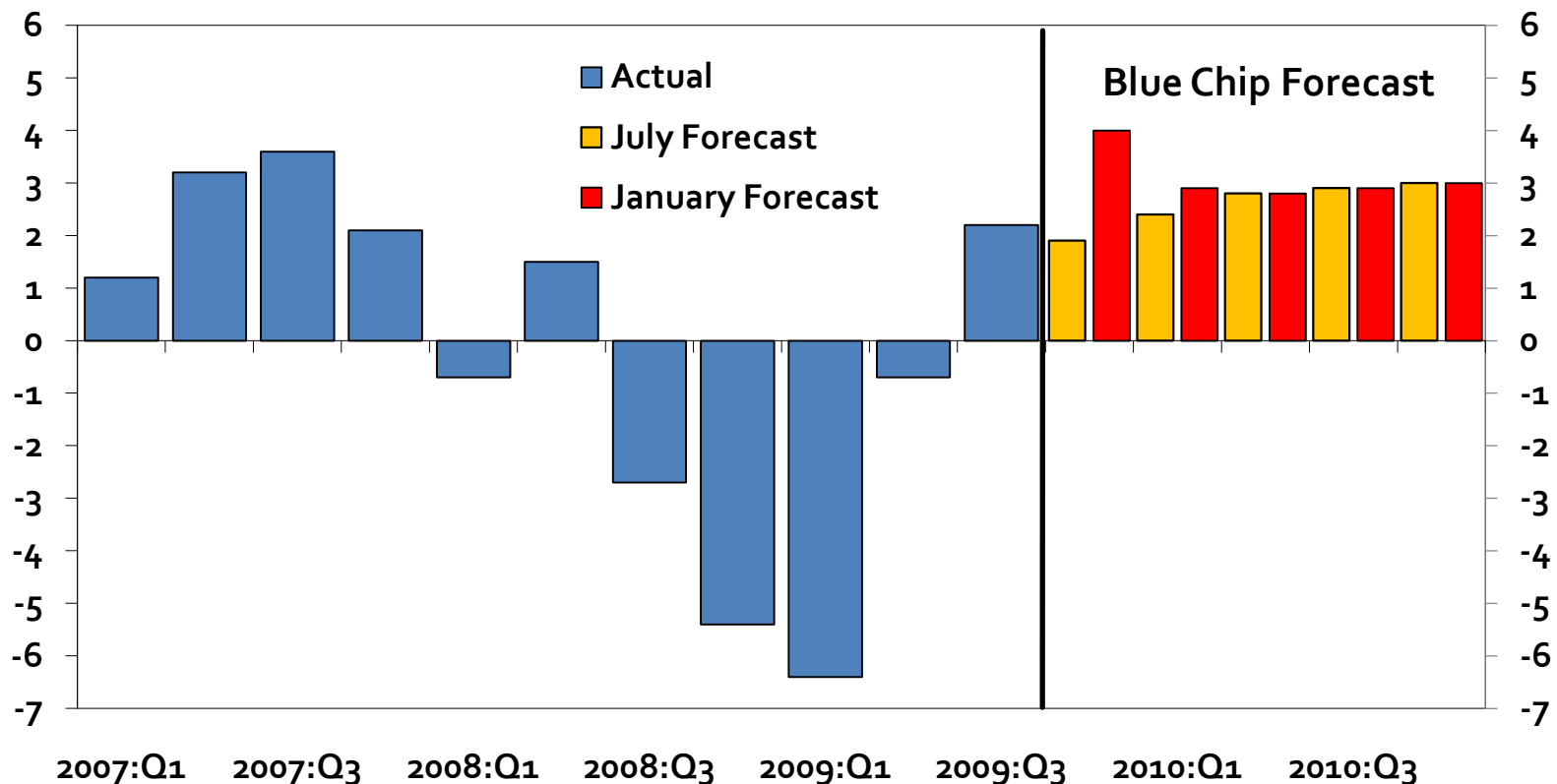
- Y is GDP
- C is Consumption (presently $\approx 70\%$ of Y)
- I is Investment (presently $\approx 15\%$ of Y)
- G is Government Spending (presently $\approx 20\%$ of Y)
- NX is Net Exports (presently $\approx -5\%$ of Y)



Forecasters expect a slow U.S. recovery.

Real GDP Growth

Annualized percent change from previous quarter

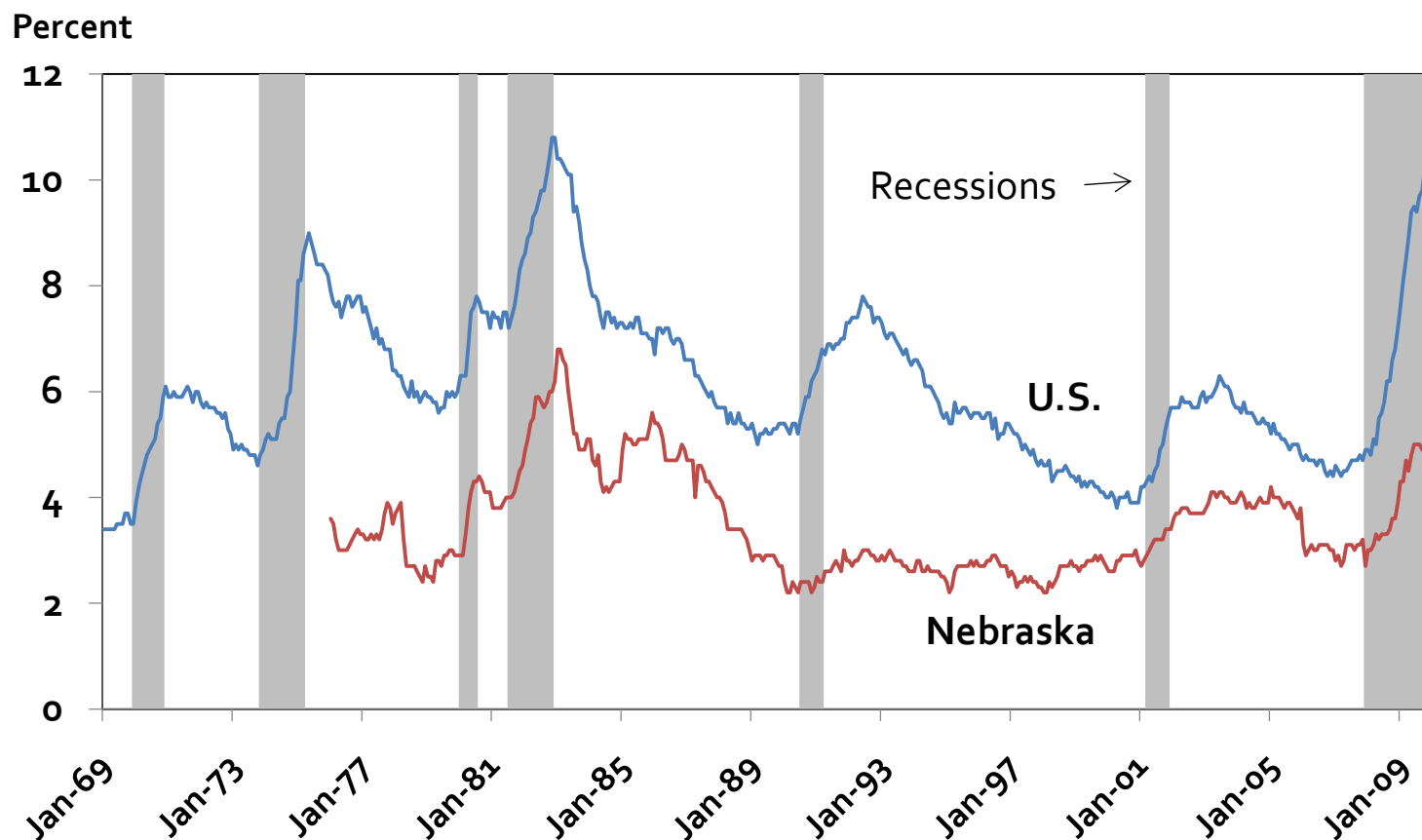


Source: Bureau of Economic Analysis and Blue Chip Economic Indicators



An elevated unemployment rate is one reason for the slow recovery.

U.S. and Nebraska Unemployment Rate

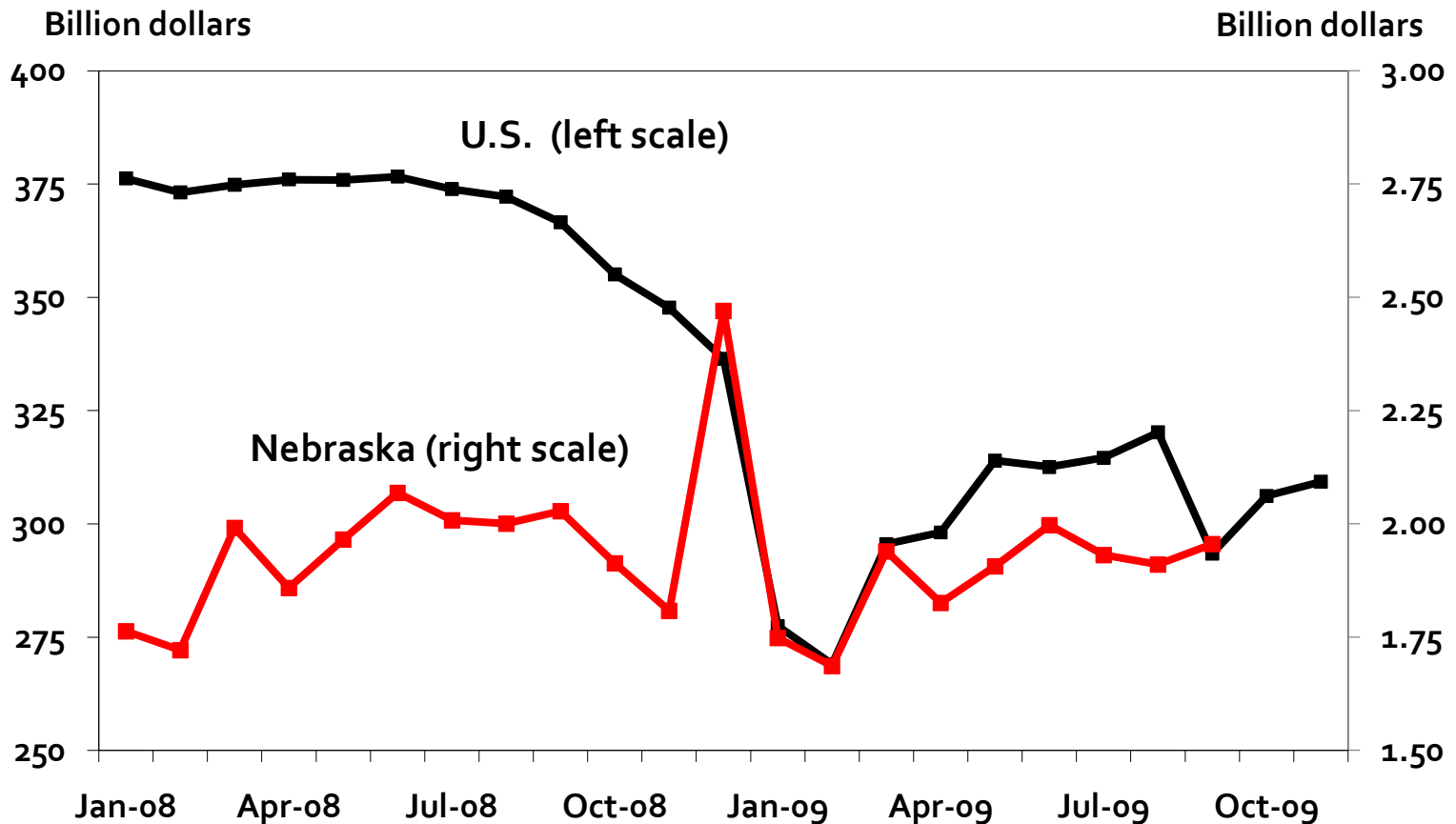


Source: Bureau of Economic Analysis and Bureau of Labor Statistics



Retail sales fell, but have rebounded slightly.

U.S. and Nebraska Retail Sales



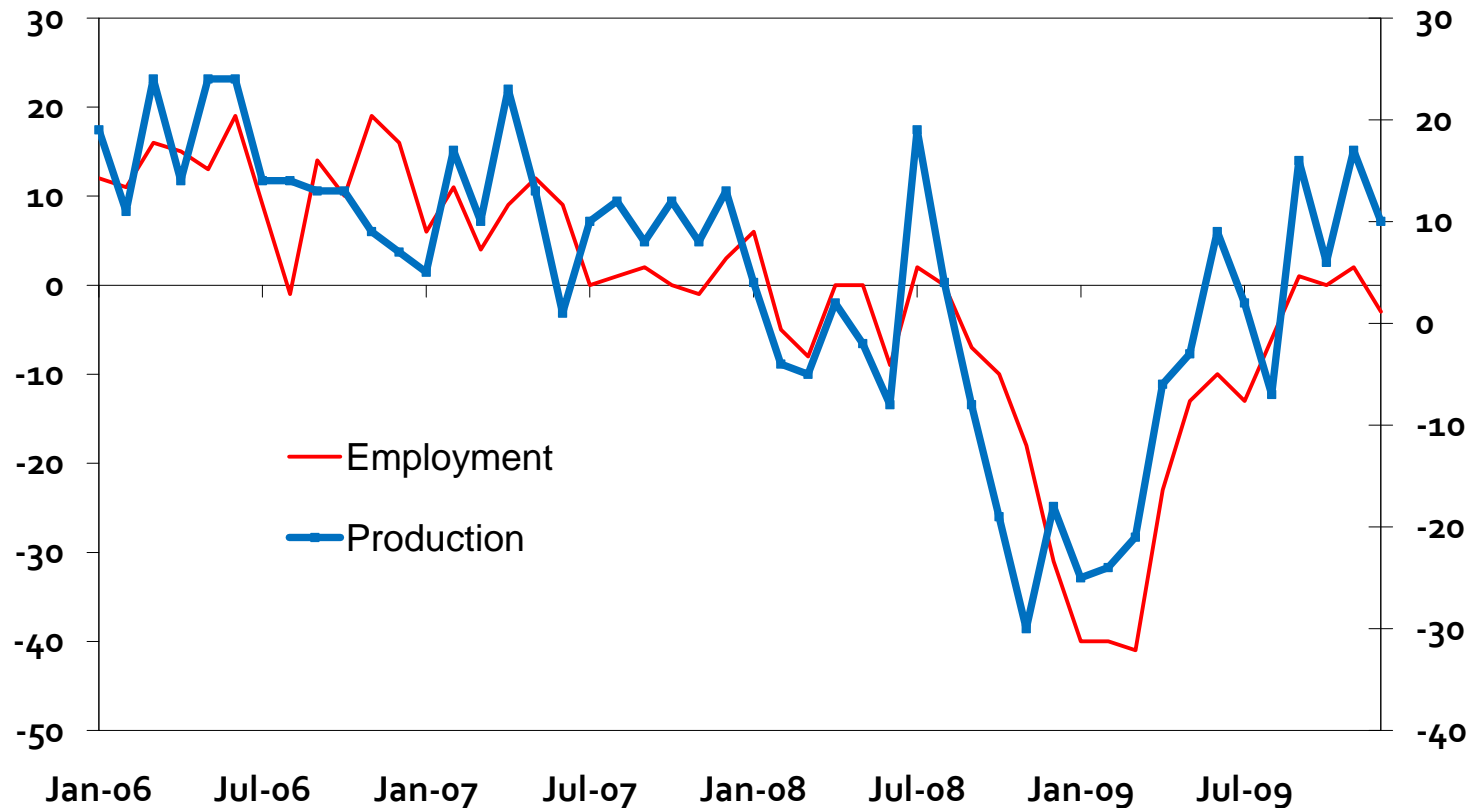
Source: U.S. Census Bureau and Nebraska Department of Revenue



Manufacturing activity has improved, but uncertain domestic and international demand pose future risks.

Tenth District Manufacturing Activity

Diffusion Index



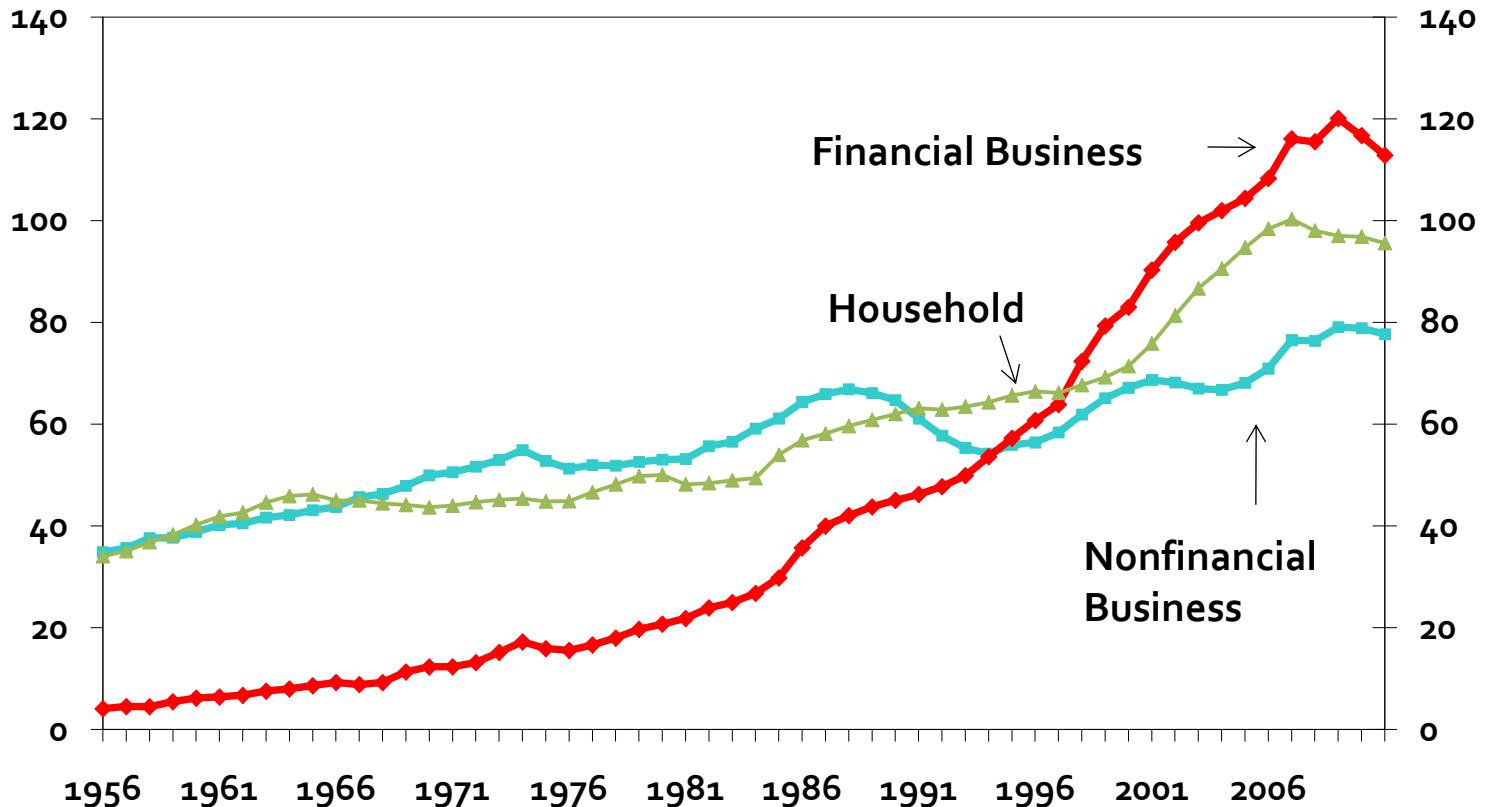
Source: Federal Reserve Bank of Kansas City



Deleveraging should contribute to a slow recovery...returning to saving habits.

Domestic Debt Outstanding

Percent of GDP



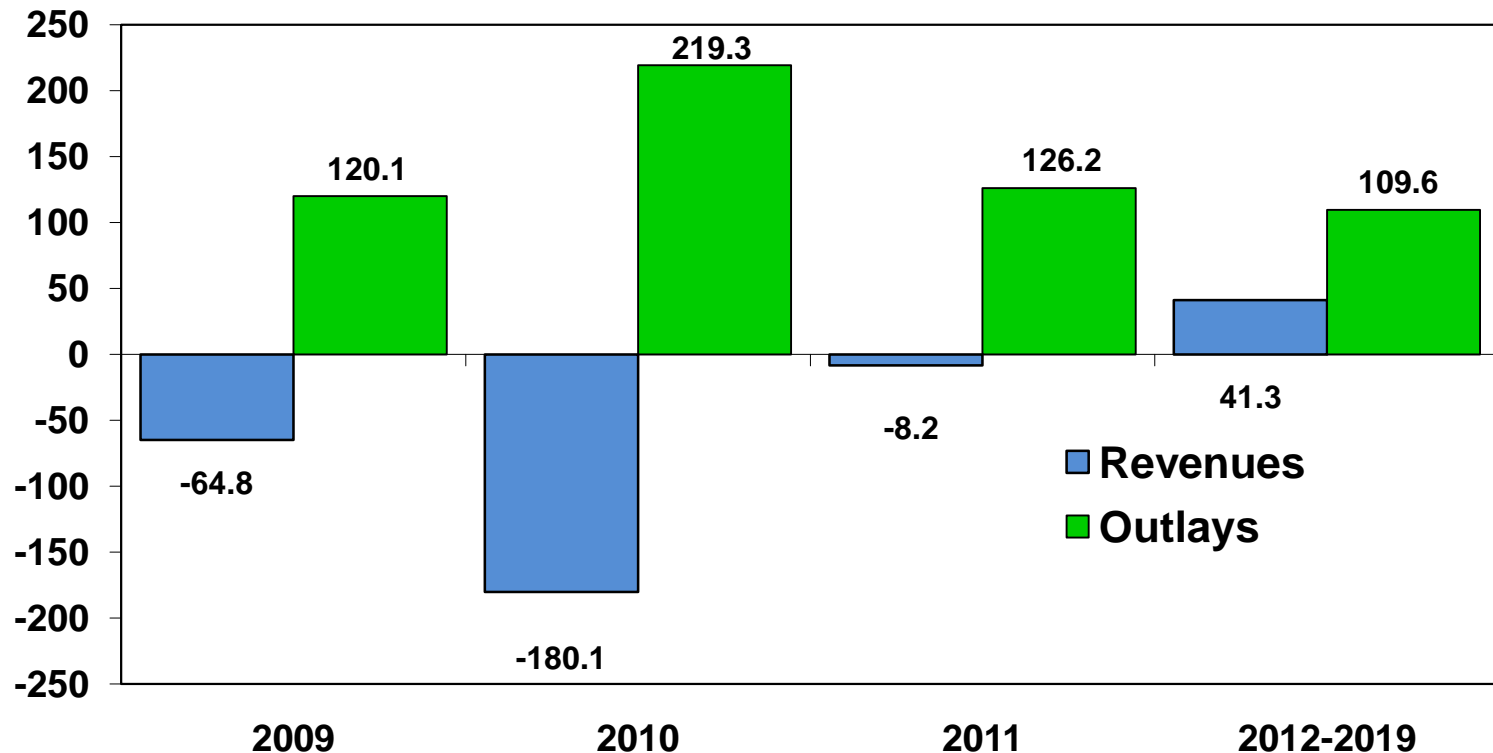
Source: Federal Reserve Board of Governors



Will the stimulus package spur growth in 2010?

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

Billion Dollars

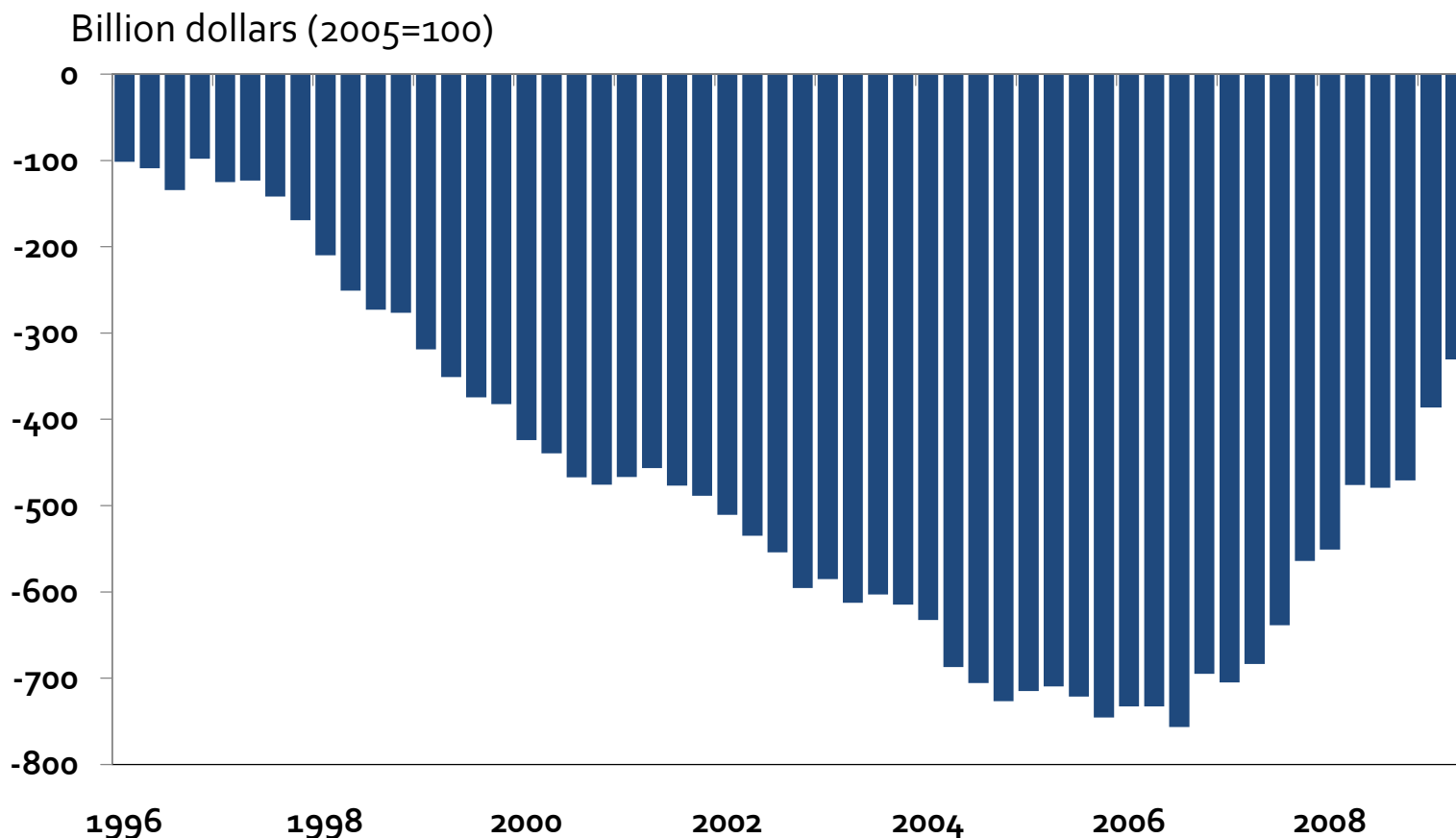


Source: Congressional Budget Office, February 13, 2009



The trade balance has improved.

Real Net Exports of Goods and Services



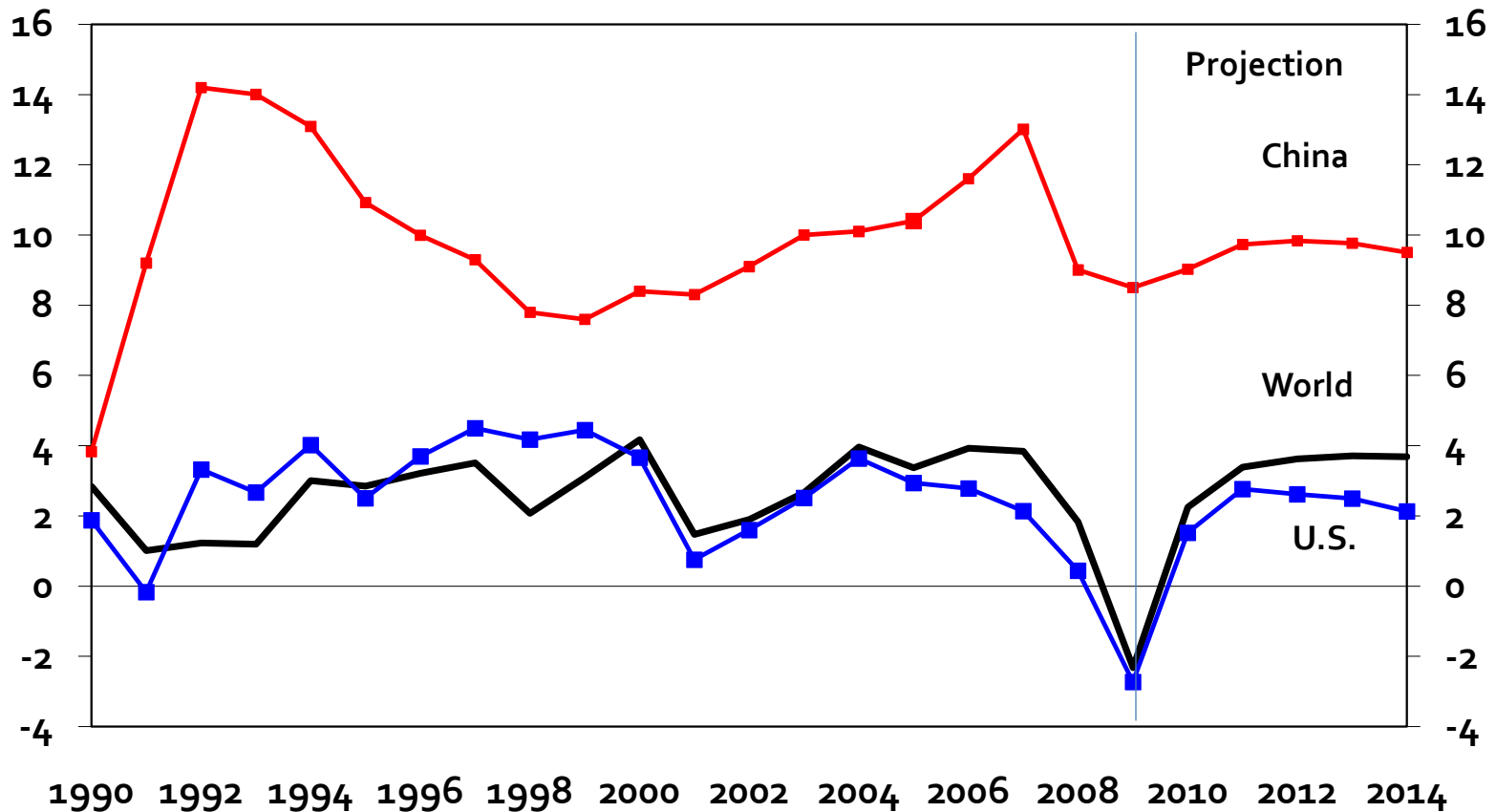
Source: Bureau of Economic Analysis



Will emerging and developing countries lead the global recovery?

GDP Growth

Annual percent change, constant dollars



Source: International Monetary Fund, October 2009



Questions?

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Branch

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