



CENTRAL
to
AMERICA'S
ECONOMY™

The Economy in 2010: A Fed Perspective

**Remarks to the 117th Annual Grain and
Feed Association Convention**

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Outline

- The Big Picture
- Current Conditions
- Putting the Pieces Together

The Big Picture

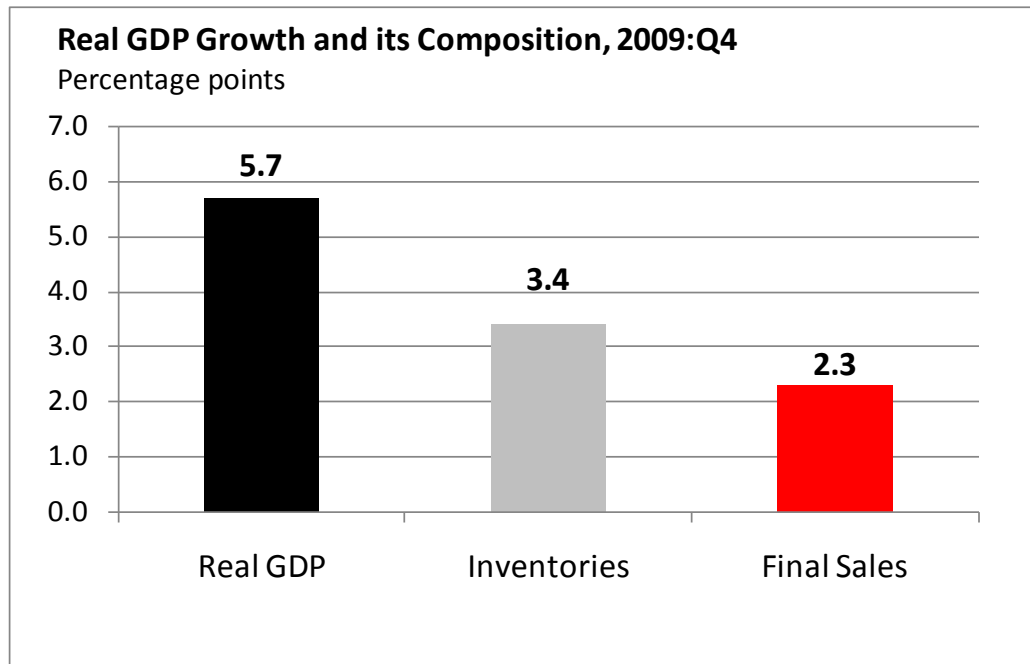
The Big Picture

- Signs point to a gradual recovery
- This recovery appears to be atypical
- The economy is still recovering from the housing bust and financial market turmoil
- An renewed emphasis on regulation . . . But be careful
- A year of decisions for monetary and fiscal policymakers
- Key worries: Reversing massive stimulus in a timely manner
- Longer term: Dealing with retirement of the Baby Boomers

Current Conditions

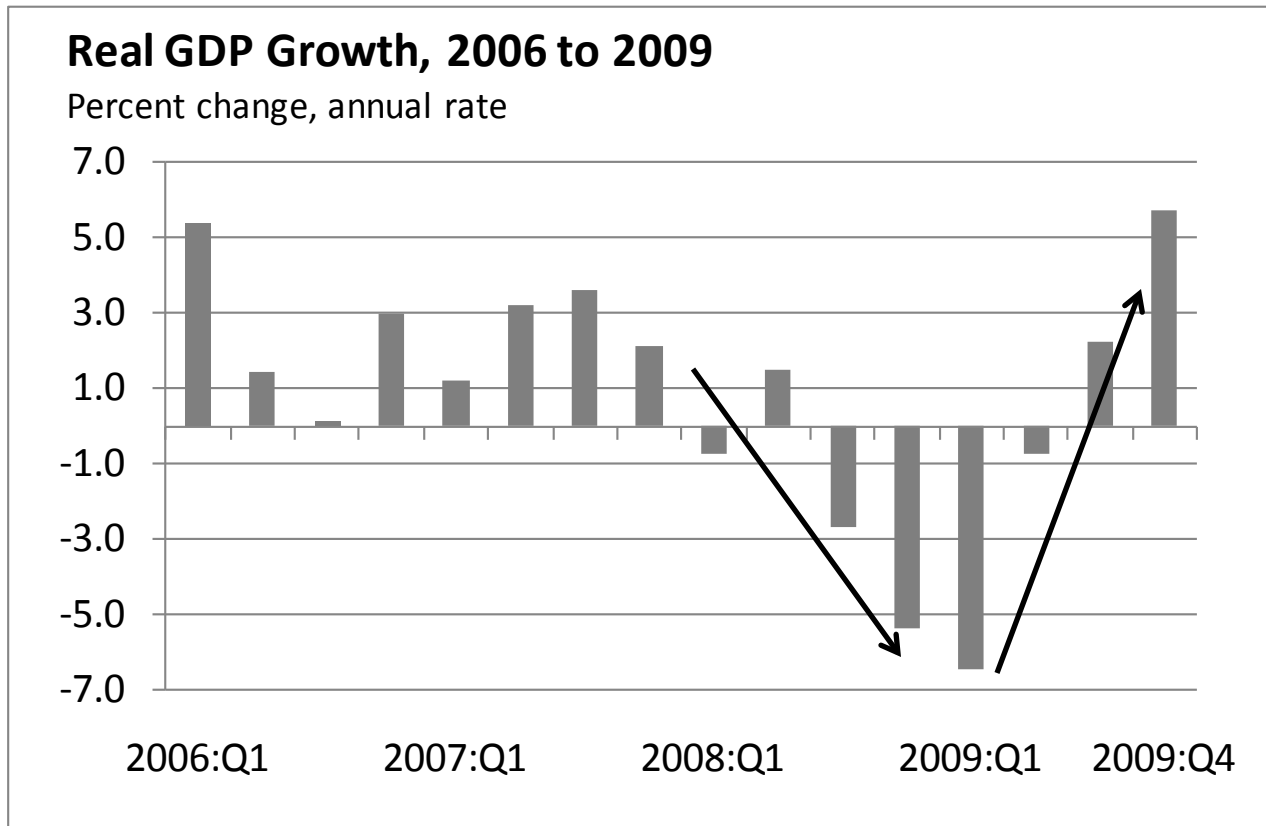
Current Conditions

1. The economy grew rapidly over the last three months of 2009. In part, this strength reflects the traditional post-recession inventory cycle.



Where did the rapid growth over the final three months of 2009 come from?

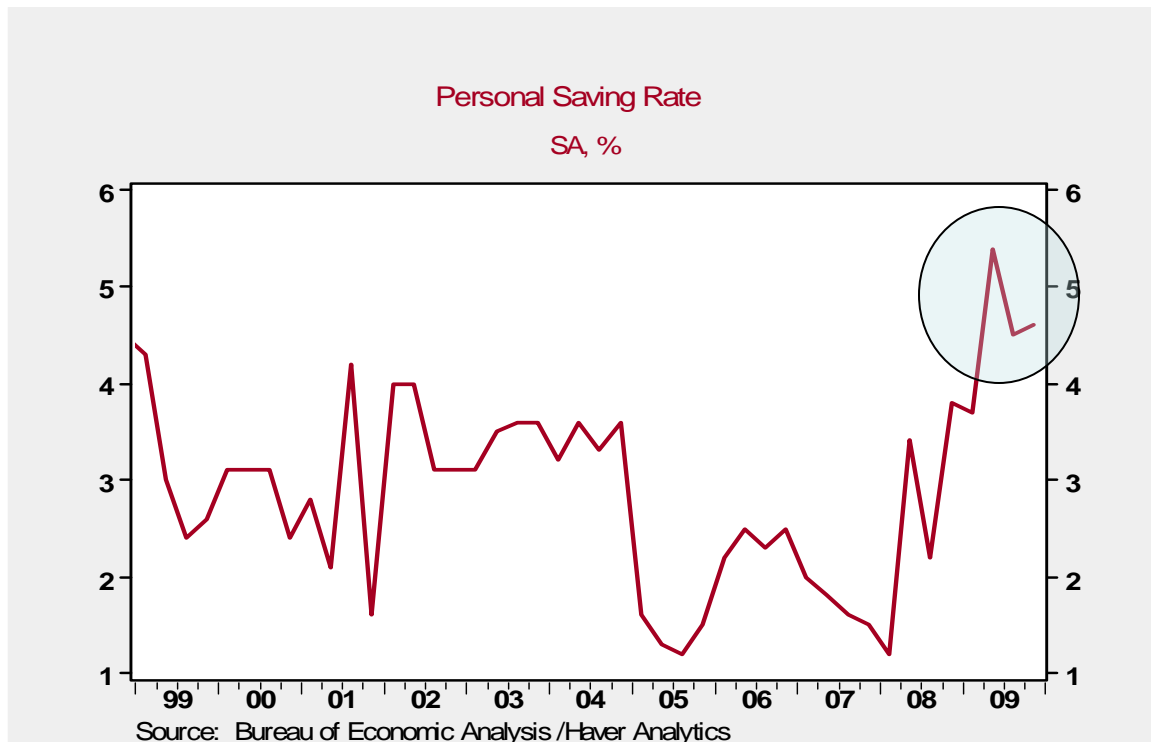
Current Conditions



A “V”, a “W” or something else?

Current Conditions

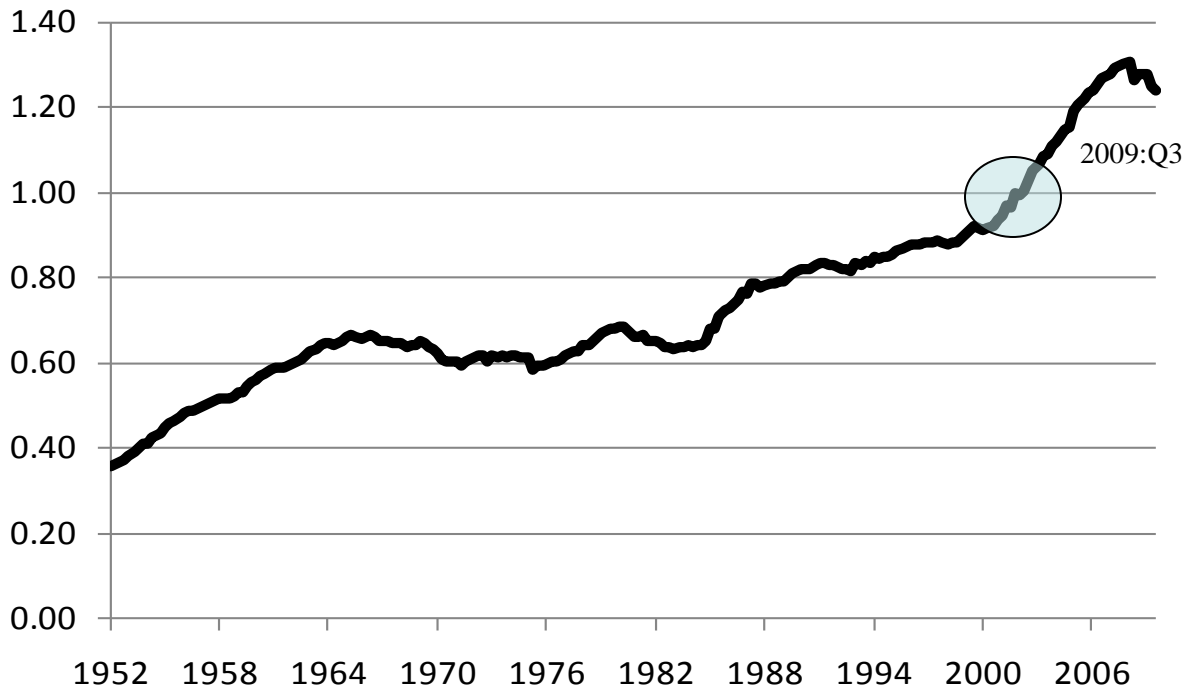
2. Consumer spending remains quite modest in the face of weak labor market conditions and a higher propensity to save.



Also at work:
Modest growth in
the services sector
(the largest part of
the economy)

Current Conditions

Household Debt as a Ratio of After-Tax Income

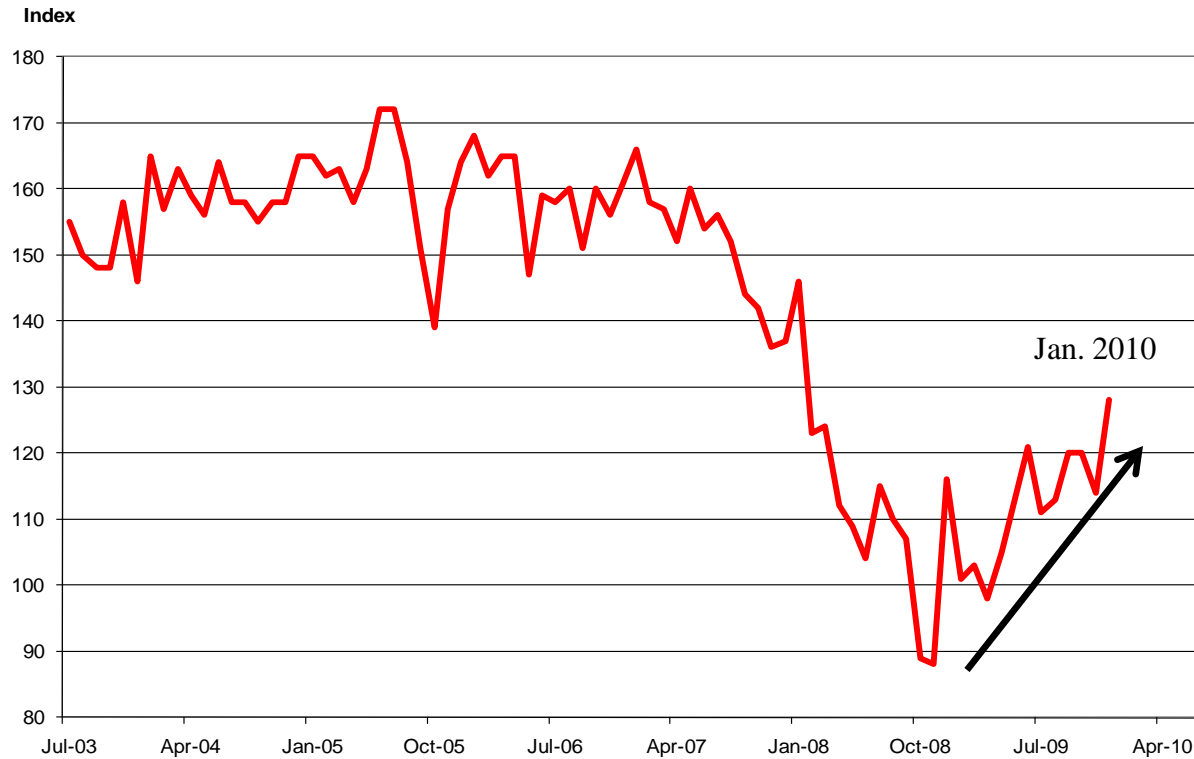


Household Debt per Person

1970	\$2,228
1980	\$6,001
1990	\$14,110
2000	\$24,063
2009	\$44,756

Current Conditions

Consumer Buying Plans -- Household Durables



SOURCE: University of Michigan Survey Research Center

Consumers may become more willing to spend on big-ticket items.

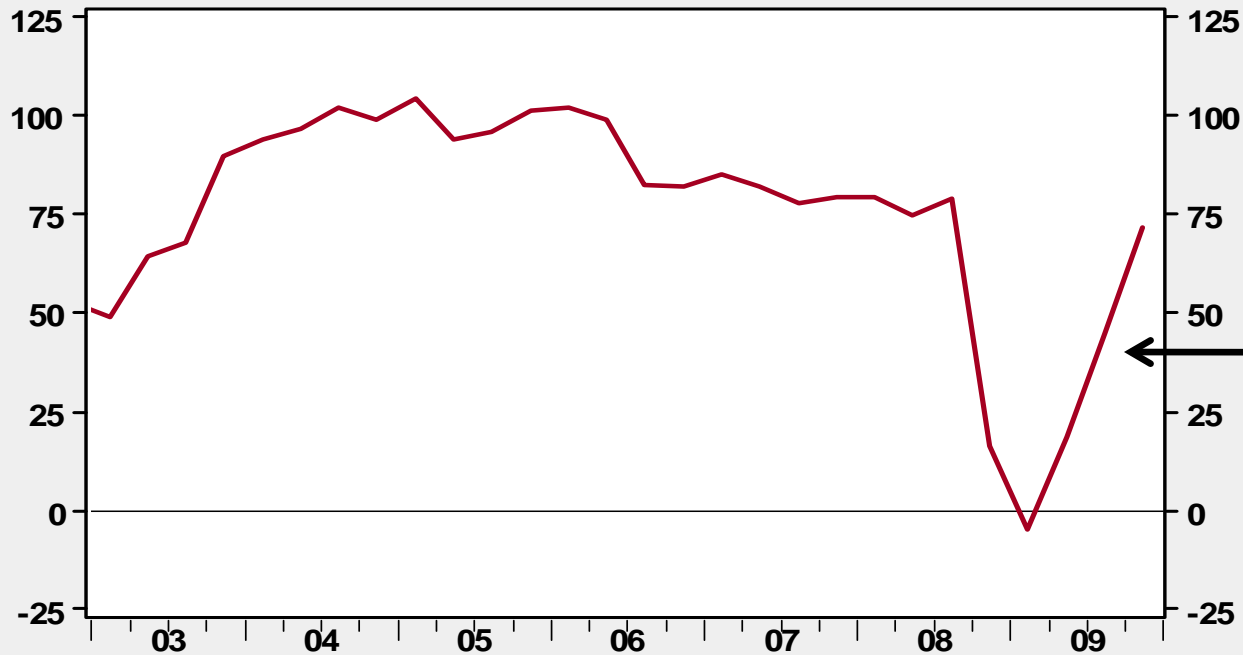
Current Conditions

3. Businesses still seem a bit reluctant to hire and invest, but spending on equipment is starting to turn around. This is important.

- Capital spending is key measure of business confidence

Current Conditions

CEO Economic Outlook Survey
Index Values > 50 Signal Expansion



Source: Business Roundtable /Haver Analytics

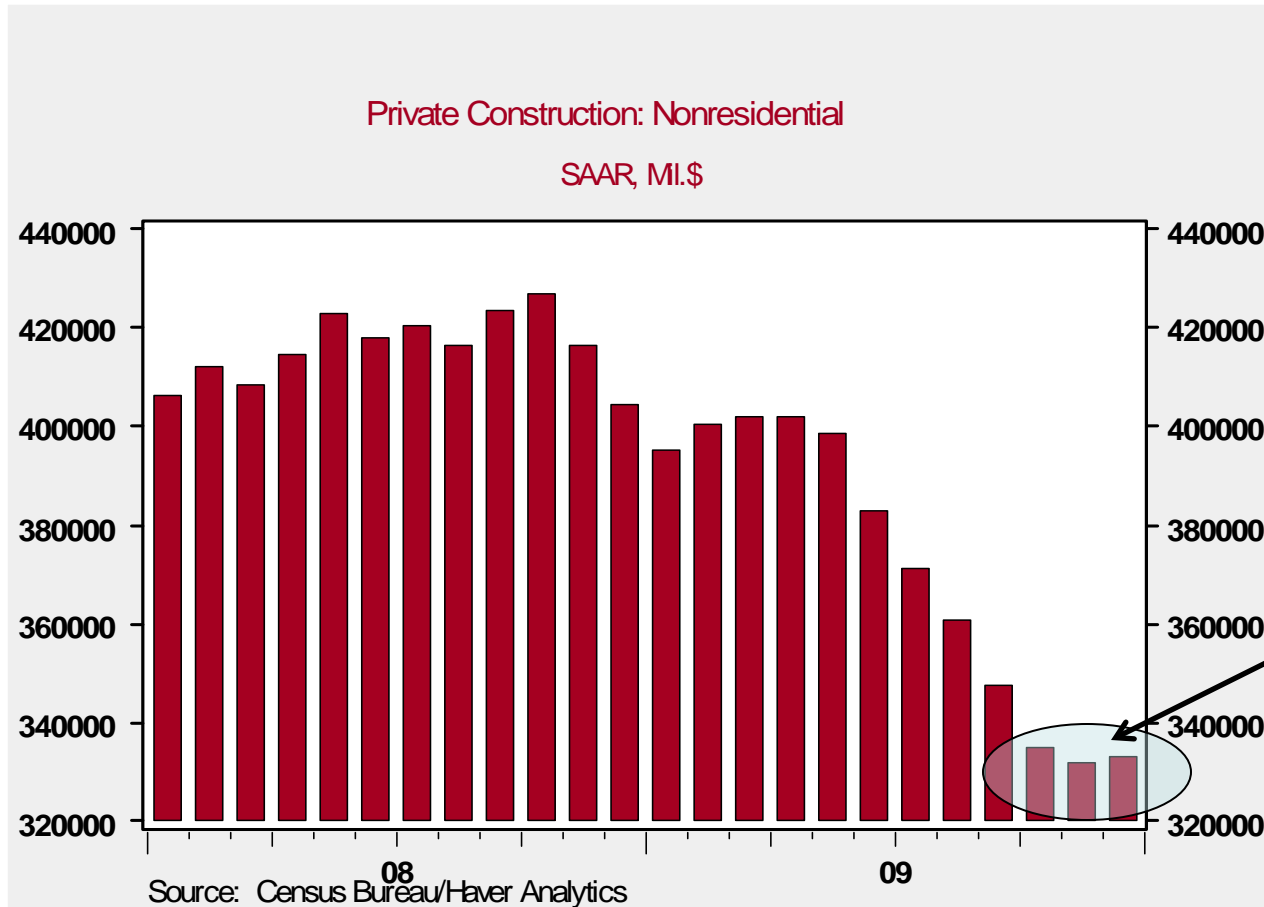
← If it look's like a
"V" ...

Current Conditions

4. The manufacturing sector is exhibiting robust growth in production. However, manufacturers remain reluctant to boost payrolls to the same degree.

- Order books are filling up
- Continued strong growth in exports
- Inventory cycle—production snapback following recessions
- Automotive manufacturers are increasing production
- Continued problems in commercial real estate, but some light at the end of the tunnel

Current Conditions



Stabilization?

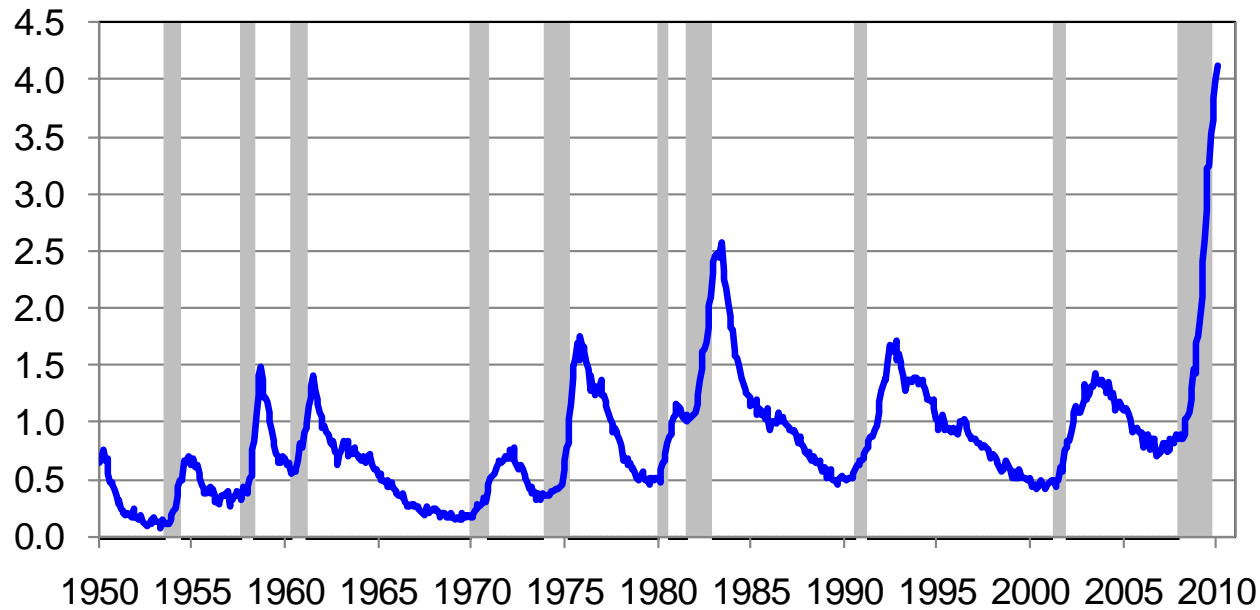
Current Conditions

5. Although labor market conditions remain weak, positive job growth may be imminent . . . But how robust will it be?

- Average weekly hours increased in 2 of the last three months
- Manufacturing overtime hours up in 3 of the last 4 months
- Unemployment rate dropped unexpectedly to 9.7% in January.
- Firms are relying on rapid productivity growth to boost output . . . at some point workers and machines wear down
- However, a large percentage of the nation's labor force has been unemployed for 7 months or longer.

Current Conditions

Percent of the Civilian Labor Force Unemployed for 27 Weeks or Longer



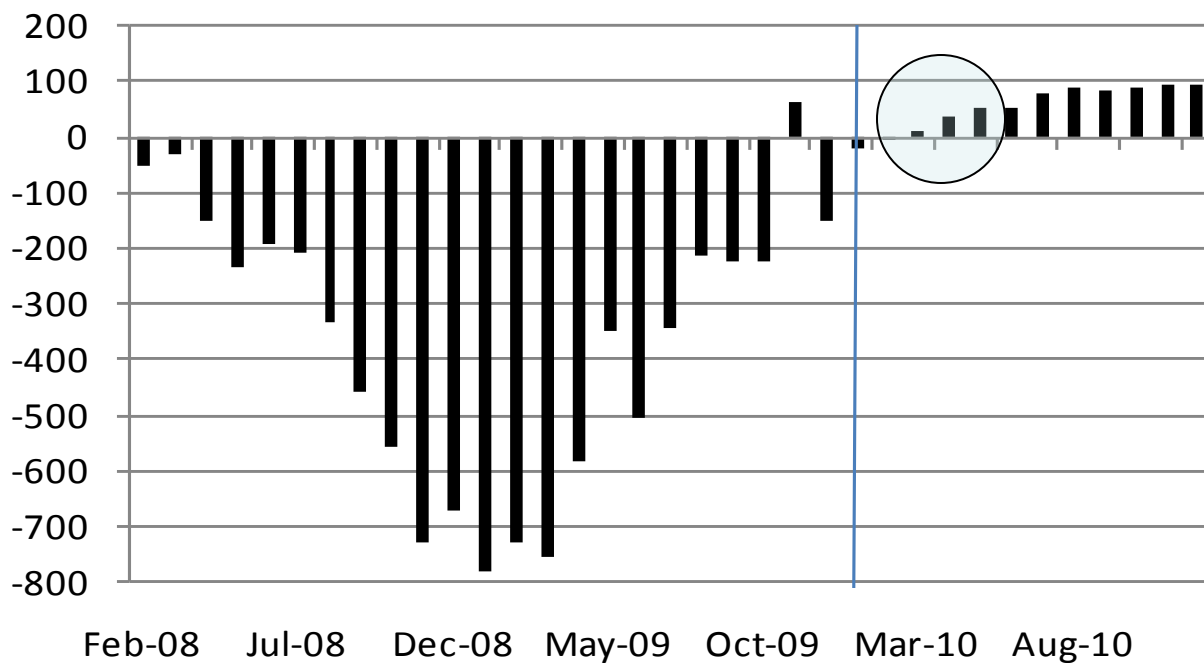
Source: Bureau of Labor Statistics.

This is much worse than 1982-83.

Current Conditions

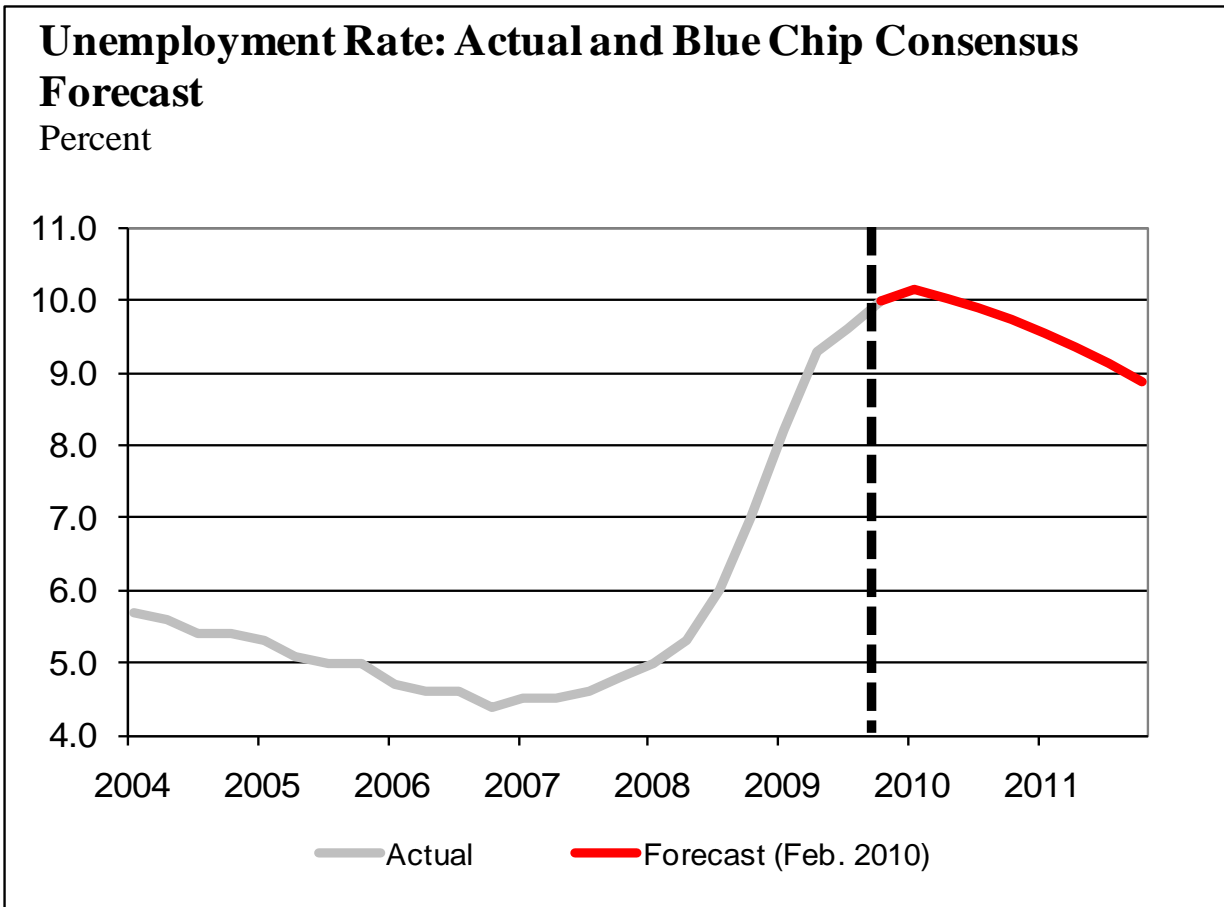
Monthly Changes in Employment: Actual and Forecast

Thousands of jobs



A spring-time hiring thaw is likely . . . helped along by the Census workers

Current Conditions



Forecasters expect the UR to peak at about 10.25% in Q1. Why is that unlikely?

Current Conditions

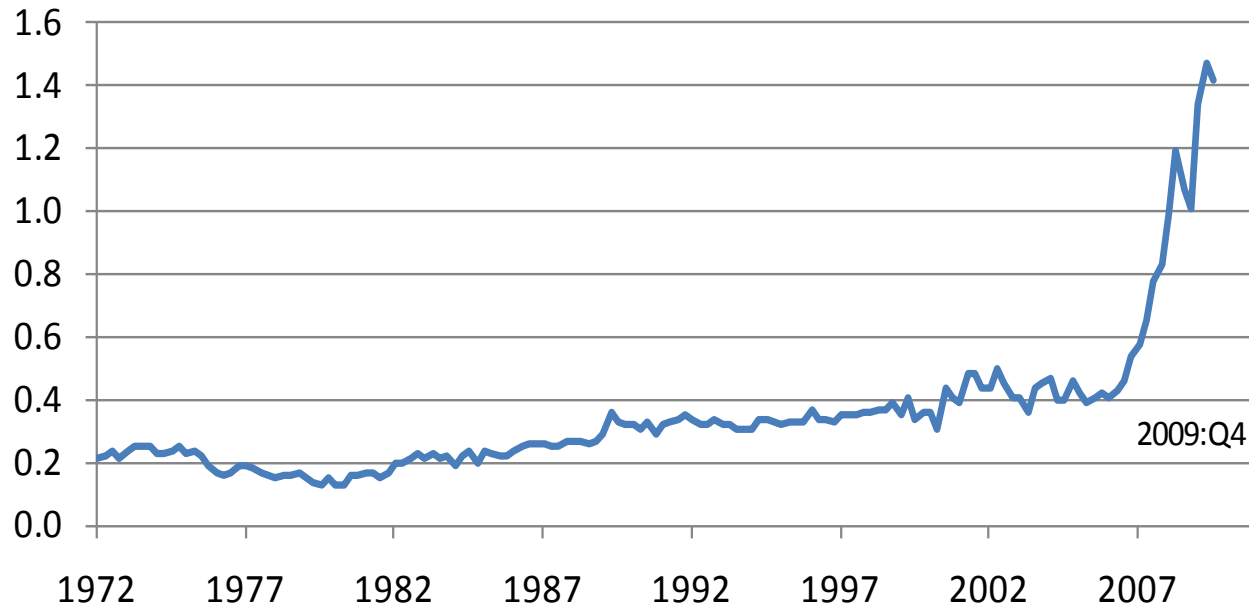
6. Housing activity weakened toward the end of 2009. Was this a temporary lull? Focus on these four keys to gauge the housing sector's strength in 2010-11:

- The strength of the economy and labor markets
- The level of mortgage rates
- The level of home foreclosures
- The direction of home prices

Current Conditions

Mortgage Foreclosures Started: United States

Percent of residential mortgage loans



Little evidence
of a peak in
foreclosures.

SOURCE: Mortgage Bankers Association

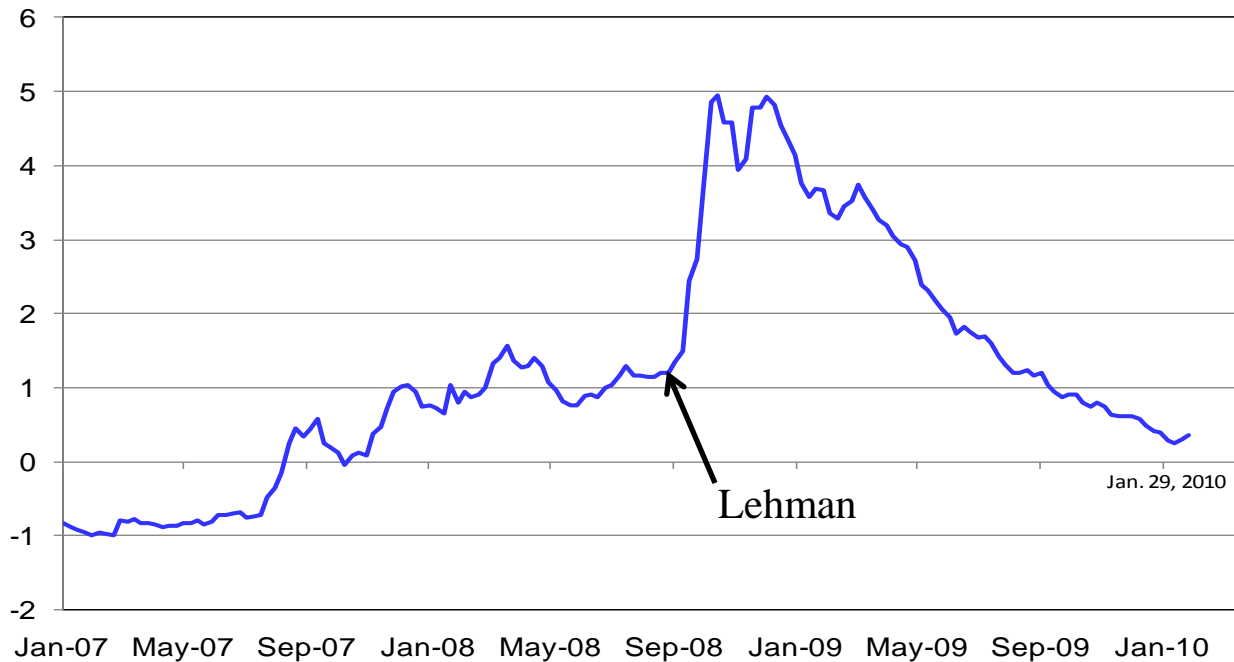
Current Conditions

7. Financial market conditions are much improved from a year earlier, interest rates remain low, but the volume of bank loans, especially to small firms, continues to contract.

- A healthy financial system is key to a sound economy
- The largest banks have raised capital and taken significant steps to repair their balance sheets
- Smaller and medium-sized banks appear to have a much larger degree of exposure to commercial real estate

Current Conditions

St. Louis Financial Stress Index
Weekly Data

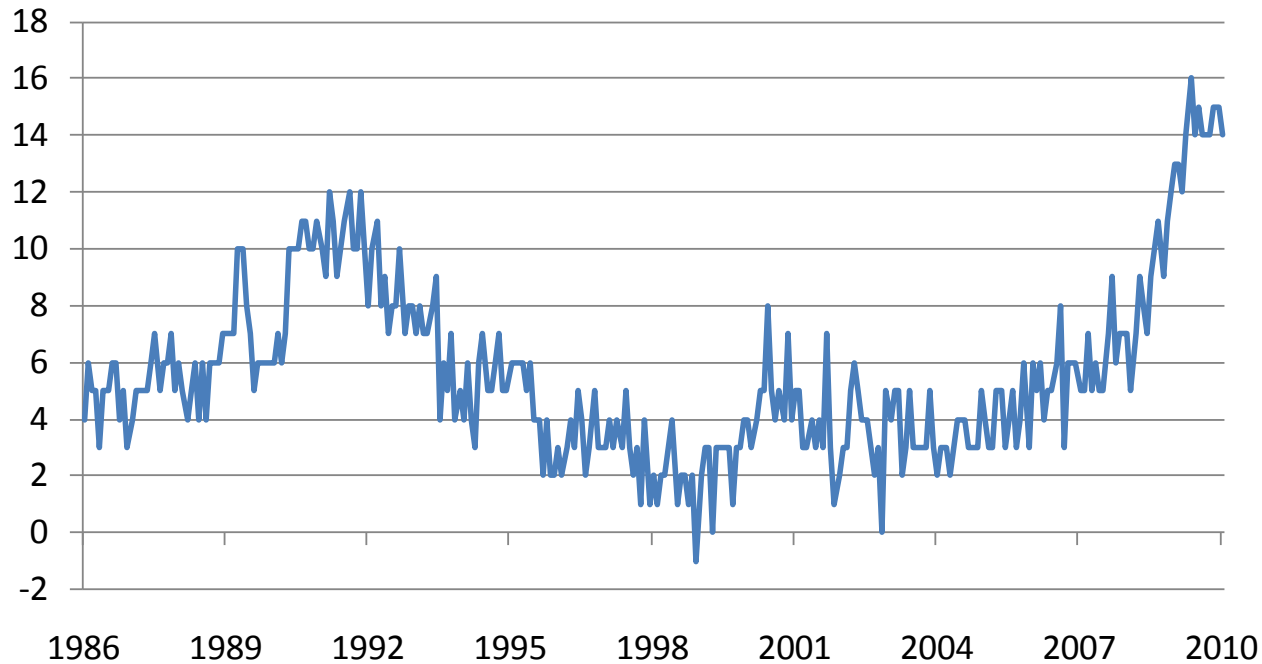


Financial stress is still slightly above normal (> 0).

Last observation is January 29, 2010.

Current Conditions

Percent of Small Business Reporting Credit is Harder to Get



SOURCE: National Federation of Independent Businesses

A rising percentage of small business owners report difficulties obtaining credit. Still . . . Only 5% say it's their biggest problem.

Current Conditions

8. Consumer prices (CPI) rose by about 2.75% in 2009, after declining slightly in 2008. There seems to be a lot of disagreement about the near-term inflation outlook

- Some look at slack in the economy, the lack of wage pressures, and rapid productivity growth
- Some look at the amount of “high-powered” money created by the Fed and worry about the possibility of an upsurge in inflation expectations
- Most others see little likelihood of either a sharp rise in inflation this year or the possibility of falling prices (deflation)
- The FOMC continues to see “subdued inflation for some time”

Current Conditions

9. Real net farm and net cash income fell sharply in 2009, as crop and livestock receipts fell sharply, as did farm exports. However, the USDA expects a modest rebound in 2010.

- Factors favoring the farm sector over the near-term: A healthy rebound in the world economy and relatively low interest rates
- Factors that may impart some drag on the farm sector over the near-term: A rebound in world economic growth, particularly in China, may put upward pressure on energy prices
- China appears to be trying to restrain an overheating economy

Putting the Pieces Together

The Outlook

- **An Economy in Transition (structural change)**
 - Rebalancing the economy from consumption toward business investment and exports
 - A multi-year transition most likely

The Outlook

- **An Economy in Transition (structural change)**
 - Rebalancing the economy from consumption toward business investment and exports
 - A multi-year transition most likely
- **Fiscal Uncertainties Weigh on the Outlook**
 - Direction of Economic and Regulatory Policies
 - Huge Budget Deficits and a rising Debt/GDP

The Outlook

Moody's Warns on U.S. Rating

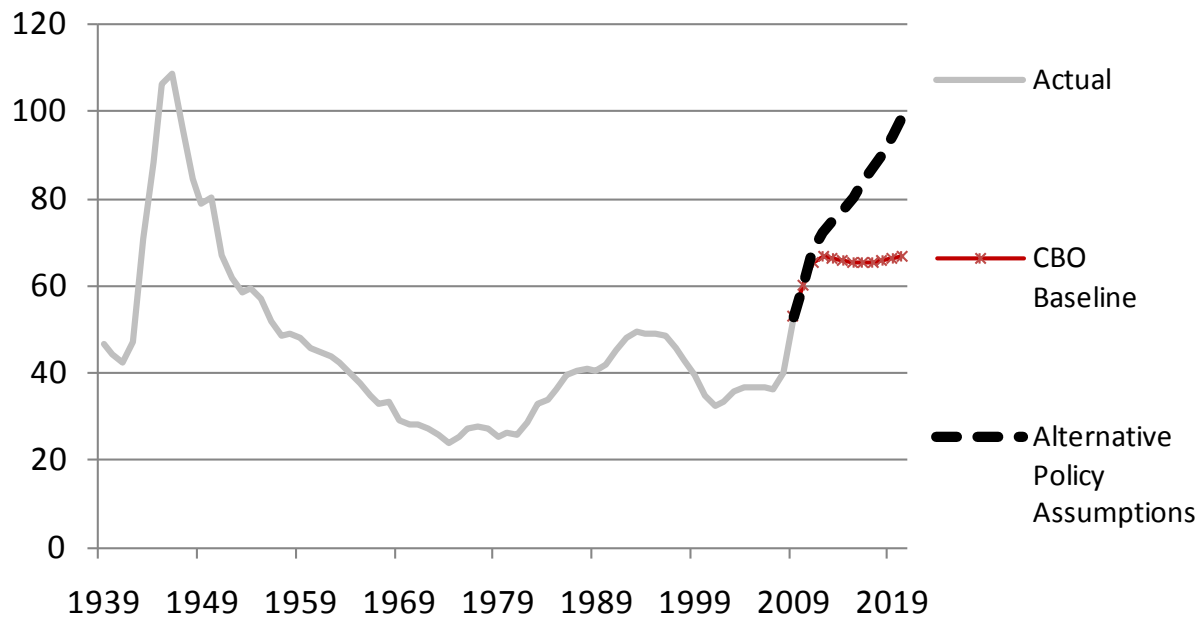
“Moody’s Investors Service fired off a warning yesterday that the triple A sovereign credit rating of the US would come under pressure unless economic growth was more robust than expected or tougher action was taken to tackle the country’s budget deficit.” *Financial Times*, Feb. 4, 2010

- Similar warnings issued to the U.K. last year and Japan late last month.

The Outlook

U.S. Debt Held by the Public: Actual and Projected, 1939-2020

Percent of GDP



SOURCE: Congressional Budget Office

Alternative policy assumptions:

- Expiring tax cuts will be extended for 2011 and beyond.
- Permanent AMT fix

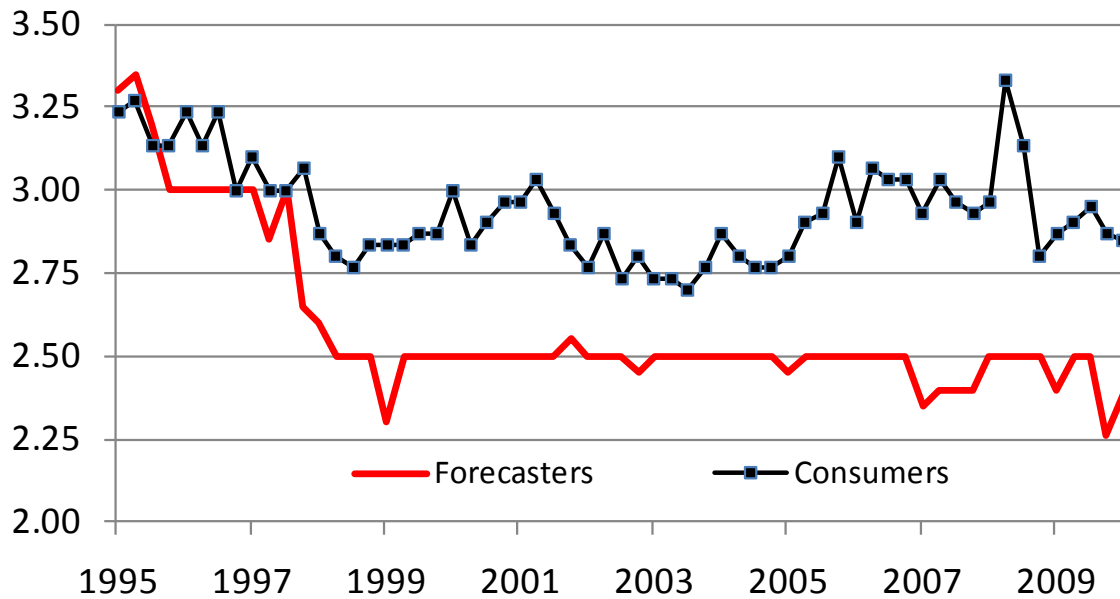
The Outlook

- An Economy in Transition (structural change)
- Fiscal Uncertainties Weigh on the Outlook
- **Threats to Inflation and Inflation Expectations Appear Contained . . . For Now**

The Outlook

CPI Inflation Expectations Over the Next 10 Years

Percent



SOURCES: FRB Philadelphia and University of Michigan.

Households and forecasters continue to expect 3% inflation or less over the next 10 years.

The Outlook

- **The Fed's Margin for Error Appears Narrow**
 - Withdrawing stimulus too early vs. too late
 - Many special lending facilities have been phased out or terminated based on pre-announced schedules and/or improvements in the economy and financial markets
 - Threats to the Fed's independence
 - Non-economic challenges

The Outlook

- **The Fed's Margin for Error Appears Narrow**
- **Threats From a Persistently High Unemployment Rate**
 - Diminishing skill levels
 - Pressure to put in place policies that reduce the flexibility of the economy and business
 - Budget and competitiveness implications

The Outlook

- **Putting the Pieces Together:**
 - Real GDP growth averages about 3% in 2010
 - Unemployment rate probably remains above 9% in 2010
 - Inflation around 2.5%, maybe a bit less
 - A cyclical rebound in long-term interest rates

Questions?