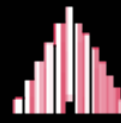


# U.S. Monetary Policy and the Economic Outlook



**Appraisal Institute®**

*Professionals Providing Real Estate Solutions*

*July 9, 2008*

**Federal Reserve Bank of San Francisco**

**Yelena Takhtamanova, Economist**

# Overview

- 1. Goals of U.S. monetary policy**
- 2. Current conditions:**
  - o Credit crunch
  - o Ongoing housing slump
  - o High and rising commodity prices
- 3. National forecast**
- 4. Risks to the forecast**

# U.S. Monetary Policy Goals

- **Monetary Policy Goals**
  - “to promote ‘**maximum**’ **sustainable output** and **employment** and to promote ‘**stable**’ **prices.**”



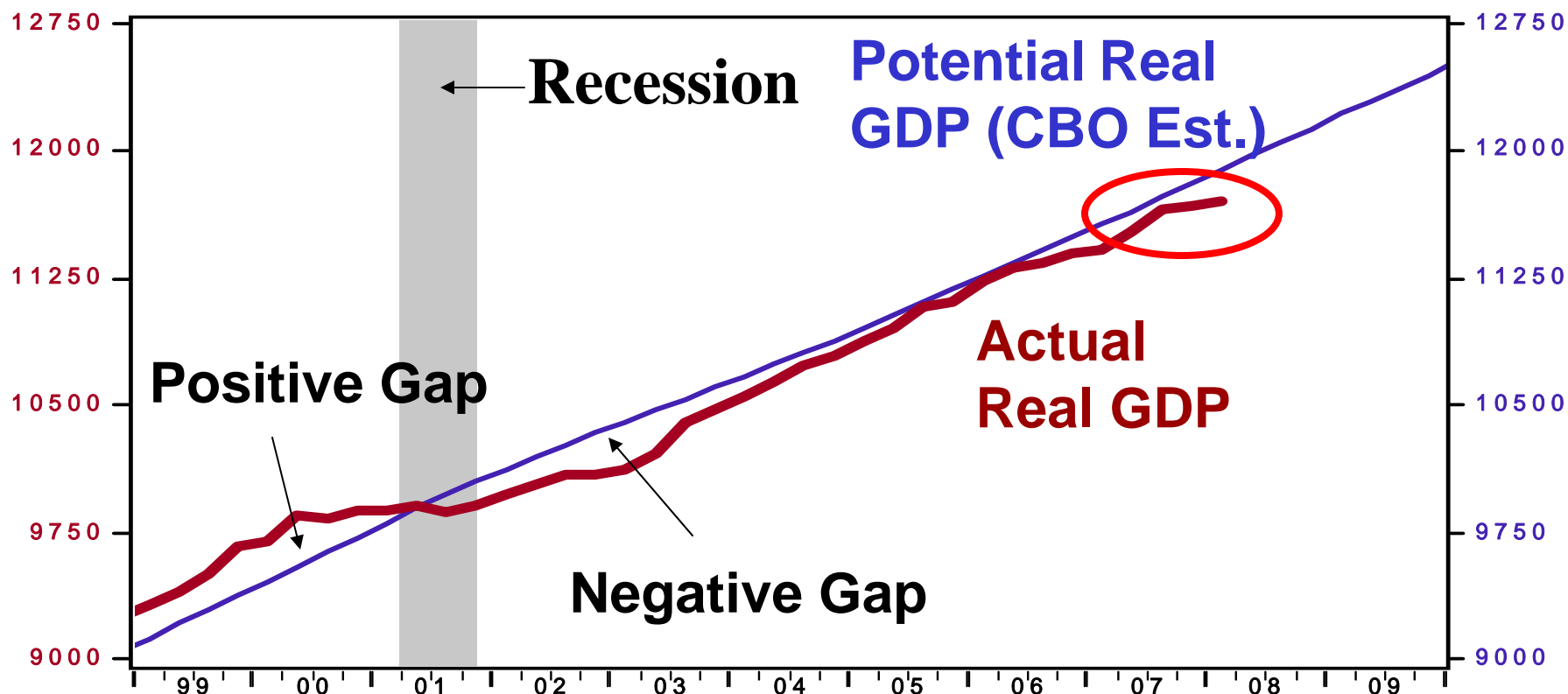
*U.S. Monetary Policy: An Introduction.* (2004), page 5  
Federal Reserve Bank of San Francisco

# U.S. Economic Output: Gap Between Real and Potential Gross Domestic Product (GDP) Has Widened

Real Gross Domestic Product  
SAAR, Bil.Chn.2000\$

Real Potential Gross Domestic Product {CBO}  
Bil.Chn.2000\$

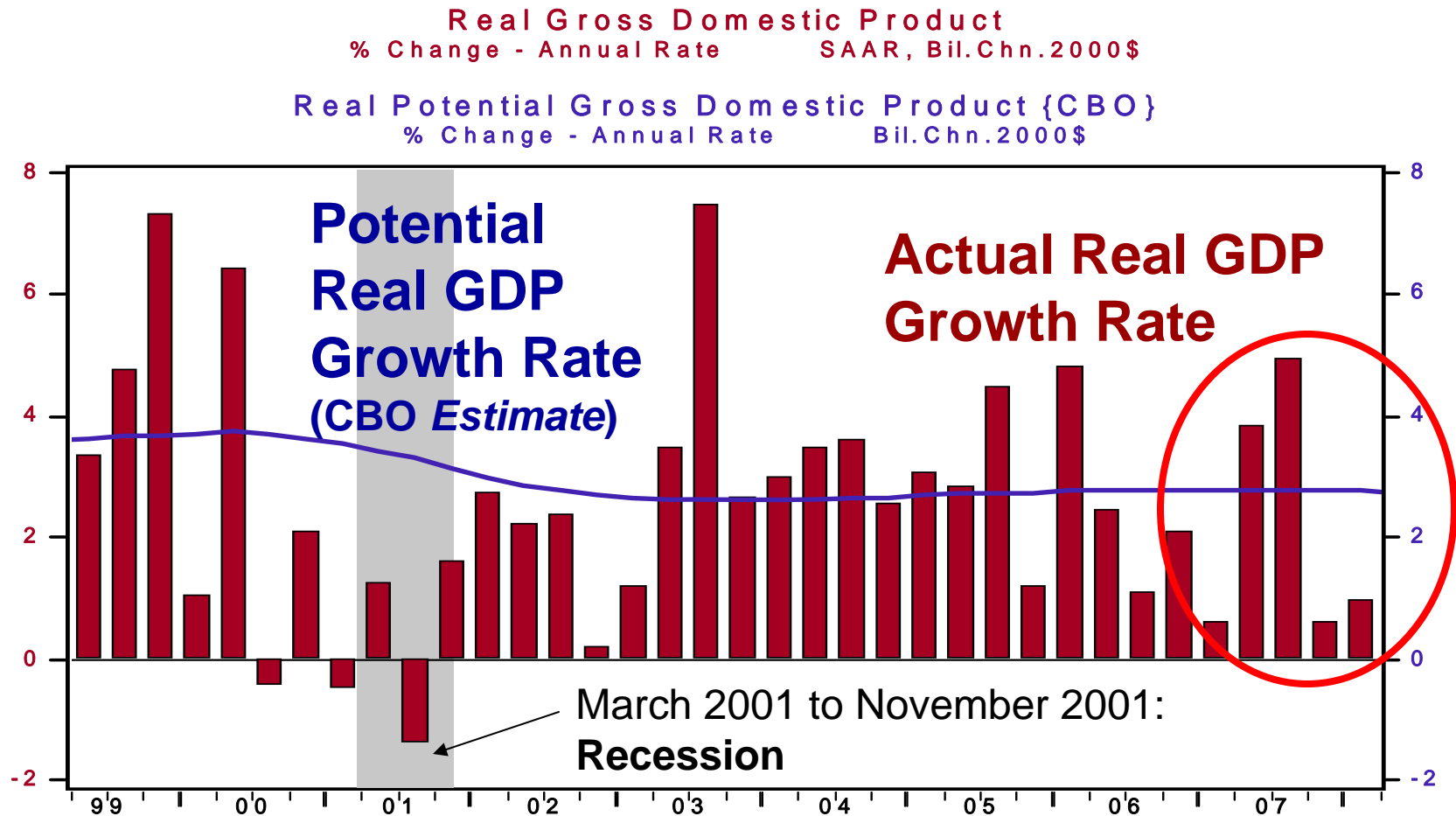
Billions 2000\$



Sources: BEA, CBO /Haver

07/07/08

# *Real GDP: Pronounced Weakening in Growth Rates for 2007:Q4 and 2008:Q1*



Sources: BEA, CBO /Haver

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**CBO = Congressional Budget Office, Real = Inflation adjusted**

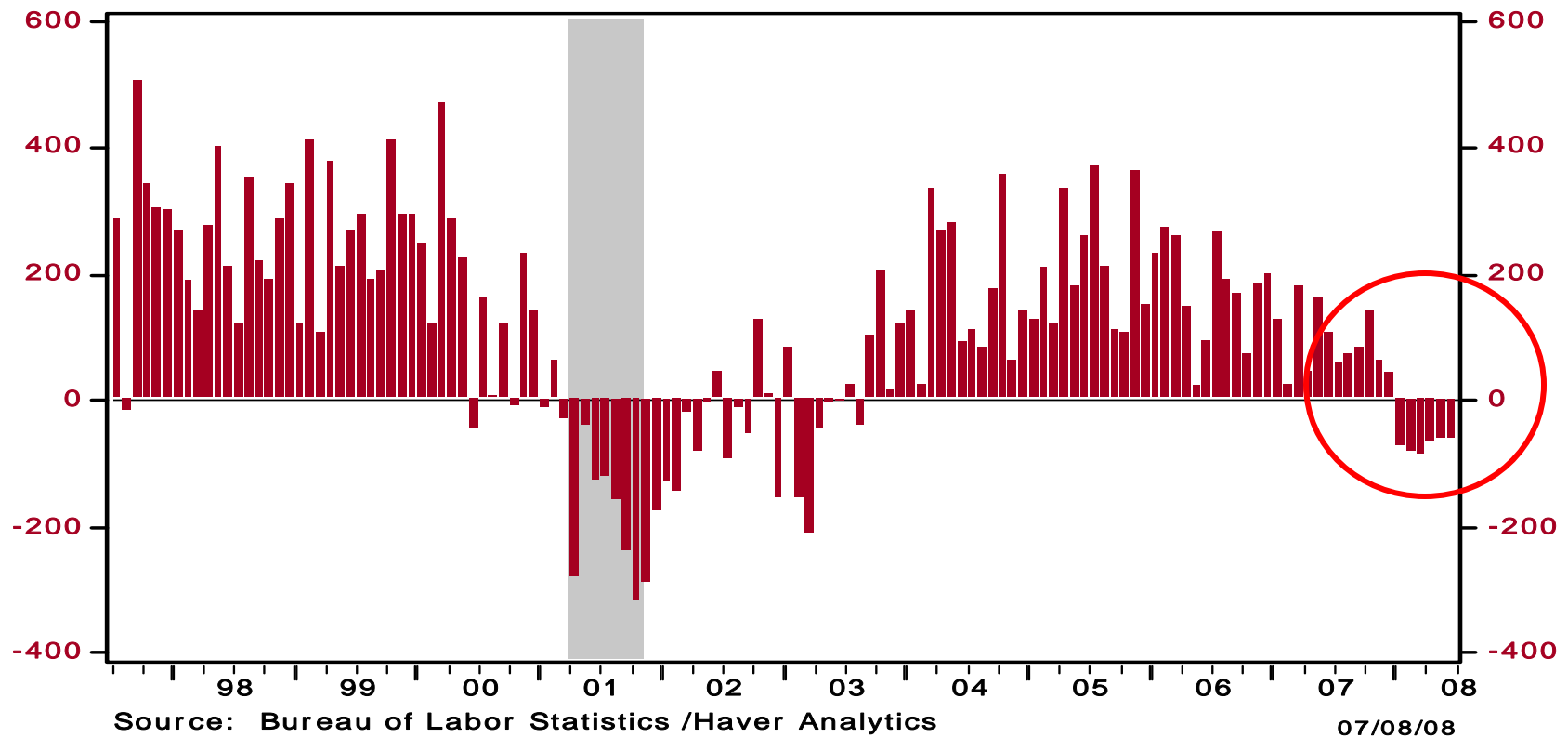
# *Employment:* Total Nonfarm Employment Has Fallen Every Month Since the Beginning of 2008

Jan: -76,000 jobs    Apr: -67,000 jobs

Feb: -83,000 jobs    May: -62,000 jobs

Mar: -88,000 jobs    Jun: -62,000 jobs

## Change in Payroll Jobs (000)

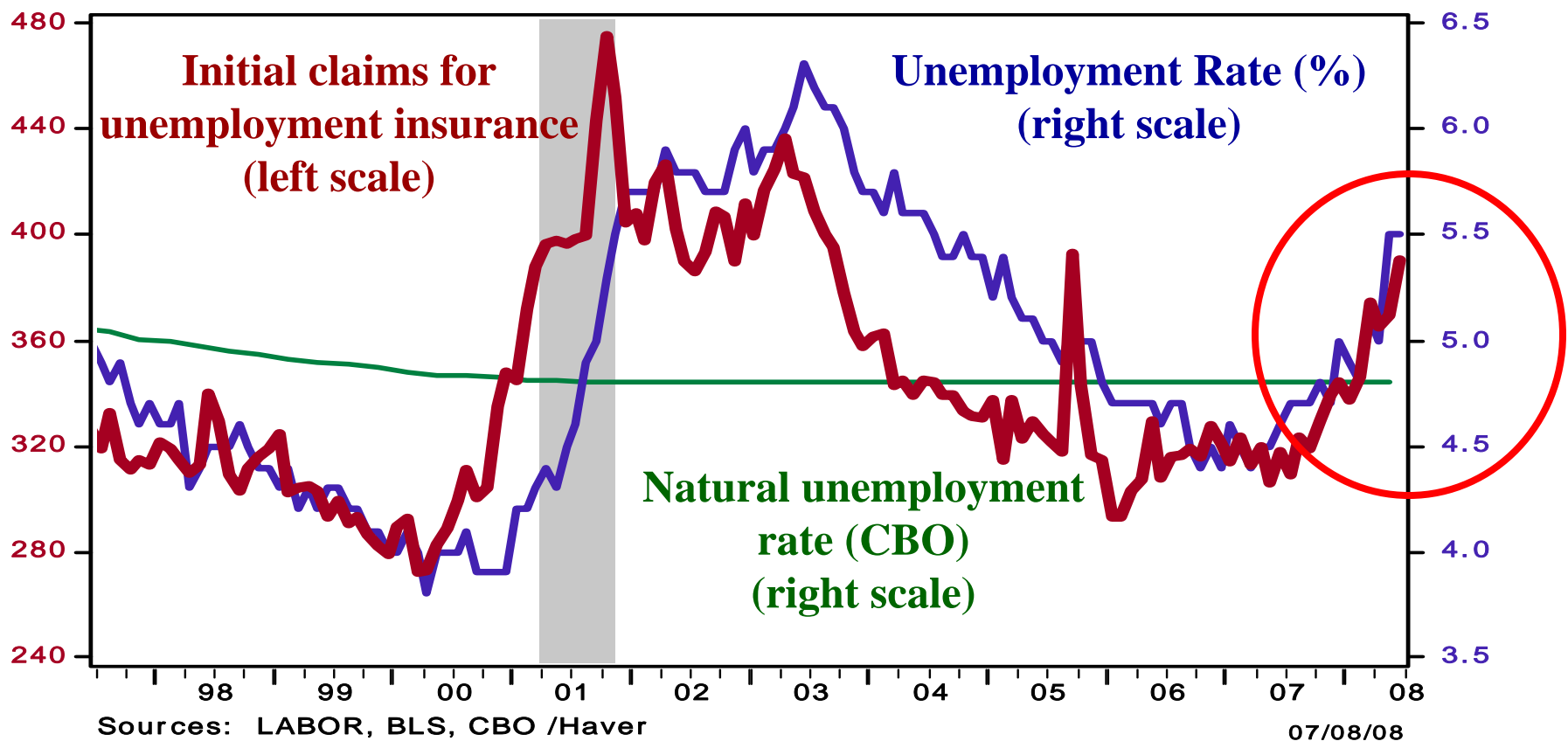


# *Unemployment: Above Natural Rate; Increase in Initial Claims*

Initial Claims for Unemployment Insurance, State Programs, Wkly Avg (SA, Thous)

Civilian Unemployment Rate: 16 yr + (SA, %)

Natural Rate of Unemployment {CBO} (%)

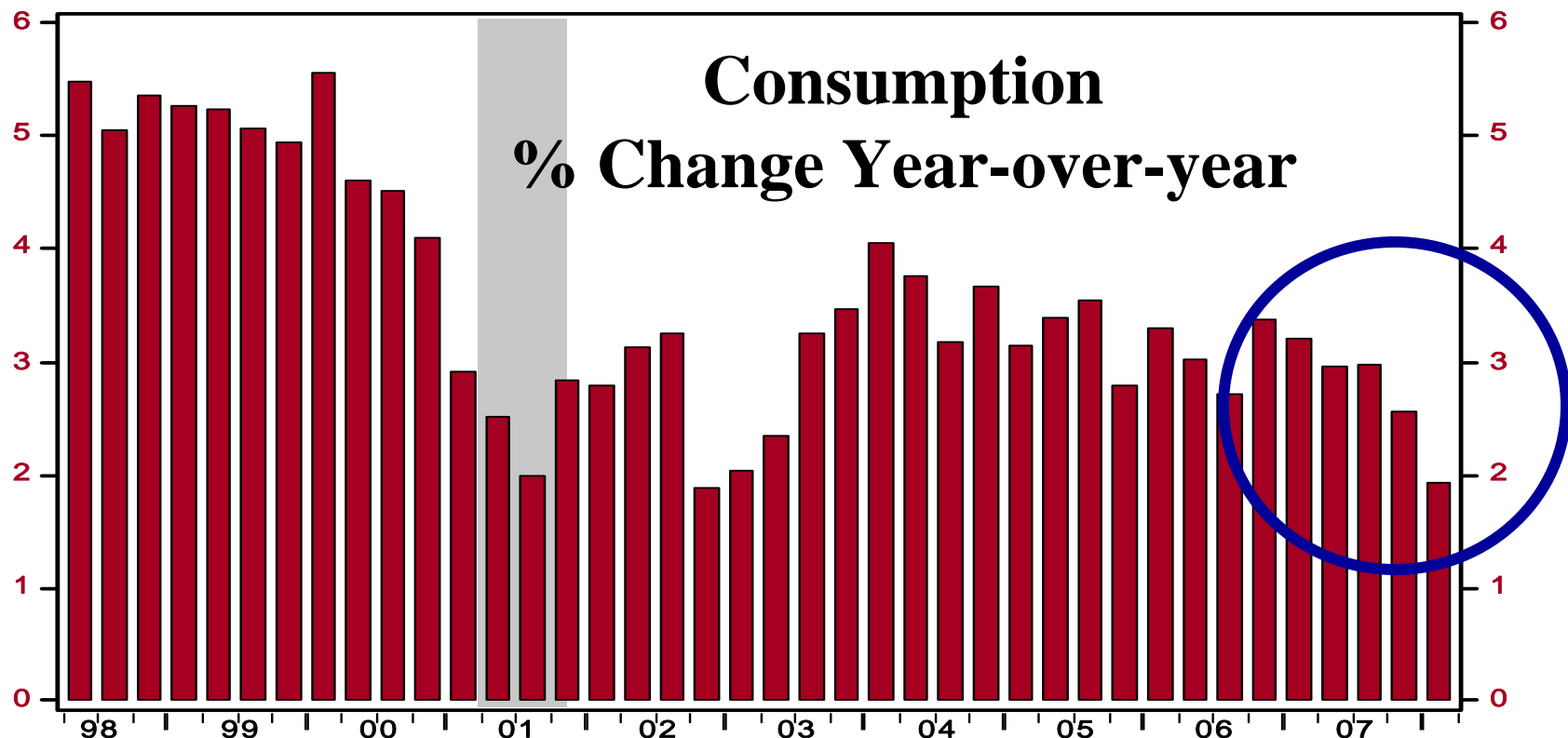


# *Real Personal Consumption Expenditures:* **Noticeable Slowdown**

## Real Personal Consumption Expenditures

% Change - Year to Year

SAAR, Bil.Chn.2000\$



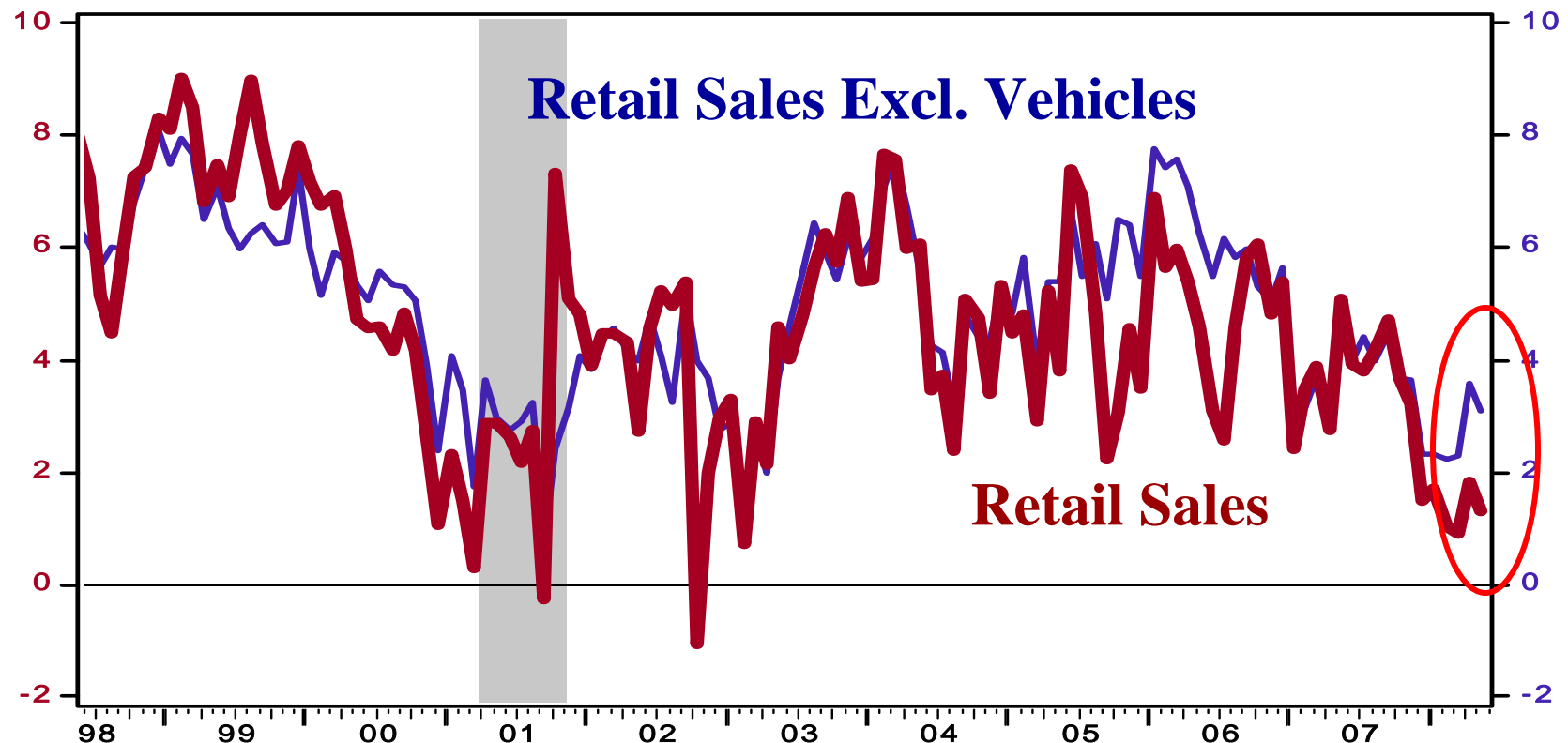
Source: Bureau of Economic Analysis /Haver Analytics

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# *Retail Sales: Some Signs of Strength in Sales Excluding Vehicles*

**Retail Sales: Retail & Food Services**  
% Change - Year to Year SA, Mil.Chn 2000\$

**Retail Sales: Retail & Food Services Ex Motor Vehicle & Parts**  
% Change - Year to Year SA Mil.Chn 2000\$



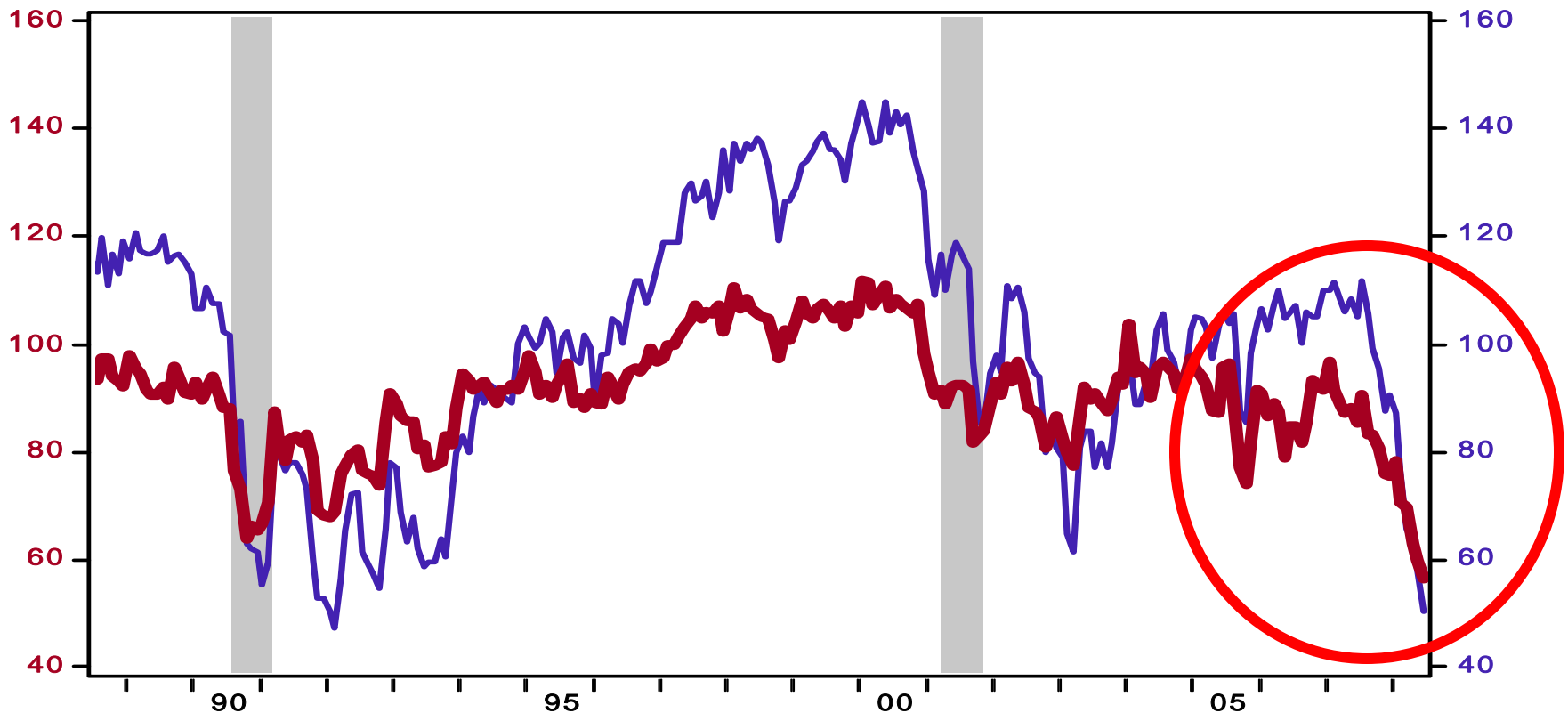
Source: Bureau of Economic Analysis /Haver Analytics

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# *Consumers' Attitudes: Two Measures Take Hits – Clues to Future Spending?*

University of Michigan: Consumer Sentiment  
NSA, Q1-66=100

Conference Board: Consumer Confidence  
SA, 1985=100



Sources: UMICH, CNFBOARD /Haver

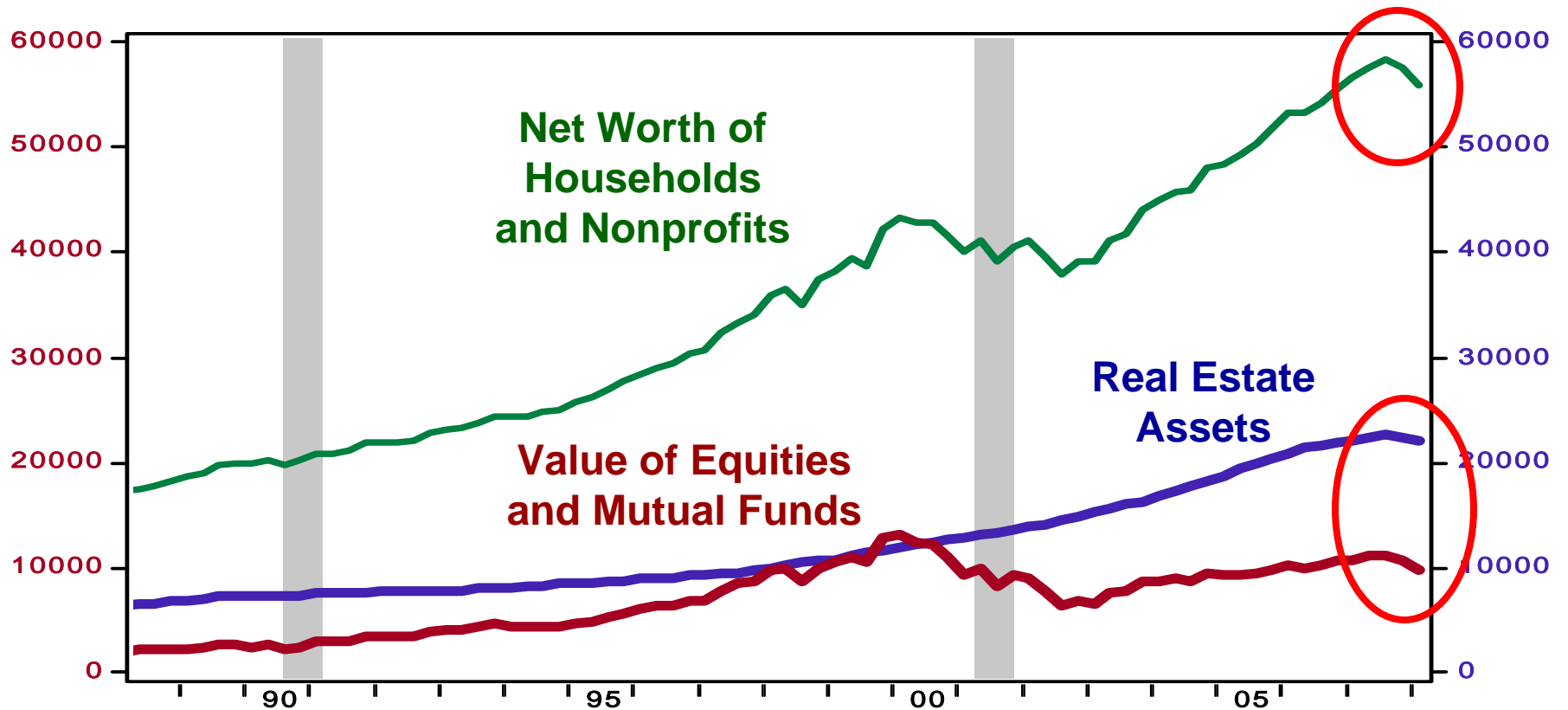
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# Household and Nonprofit Net Worth: Reduced by Declining Asset Values – Effect on Consumption?

Households & Nonprofit Org: Equities and Mutual Fund Shares (Bil. \$)

Households & Nonprofit Organizations: Total Real Estate Holdings (Bil. \$)

Households & Nonprofit Organizations: Net Worth (Bil. \$)



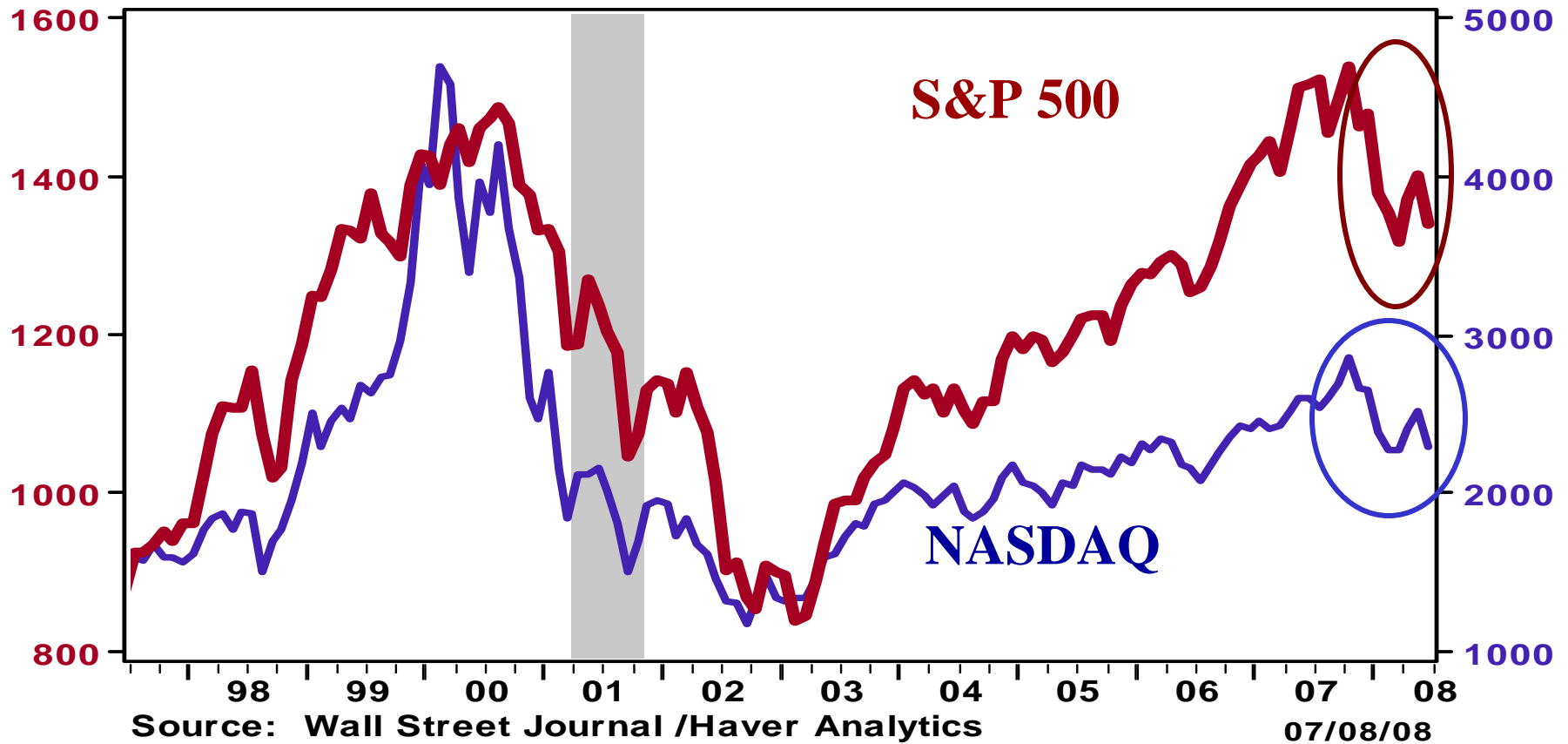
Source: Haver Analytics

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# *Equity Markets: Recent Decline in Financial Wealth*

**Stock Price Index: Standard & Poor's 500 Composite**  
1941-43=10

**Stock Price Index: NASDAQ Composite**  
EOP, Feb-5-71=100

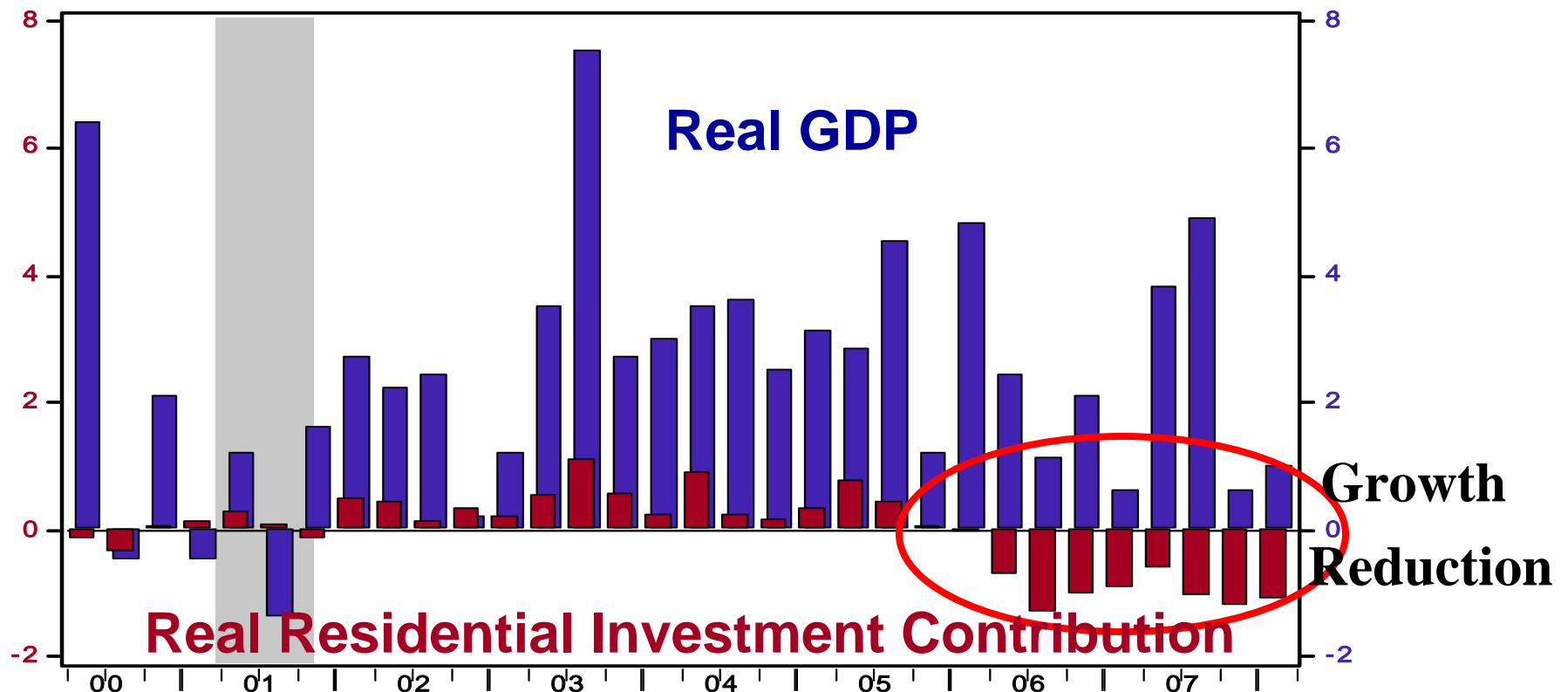


# Real GDP Growth: Reduced by Decline in Real Residential Investment

Real Residential Investment: Contribution to Real GDP Change  
SAAR, %

Real Gross Domestic Product  
SAAR, %Chg

Contribution in %

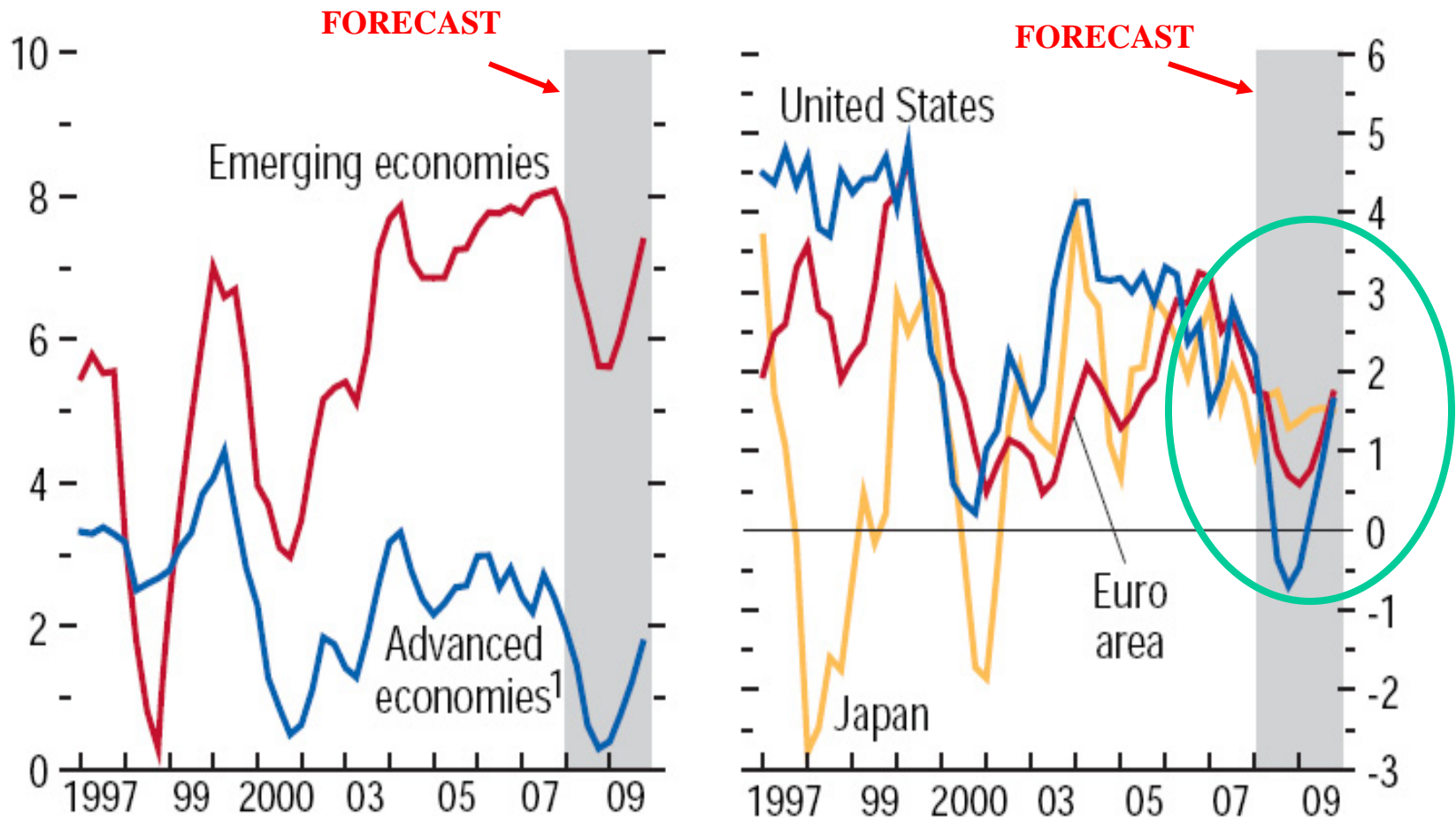


Source: Bureau of Economic Analysis /Haver Analytics

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# *IMF Projects Weaker Global Growth: Affects the Demand for U.S. Exports*

**X**

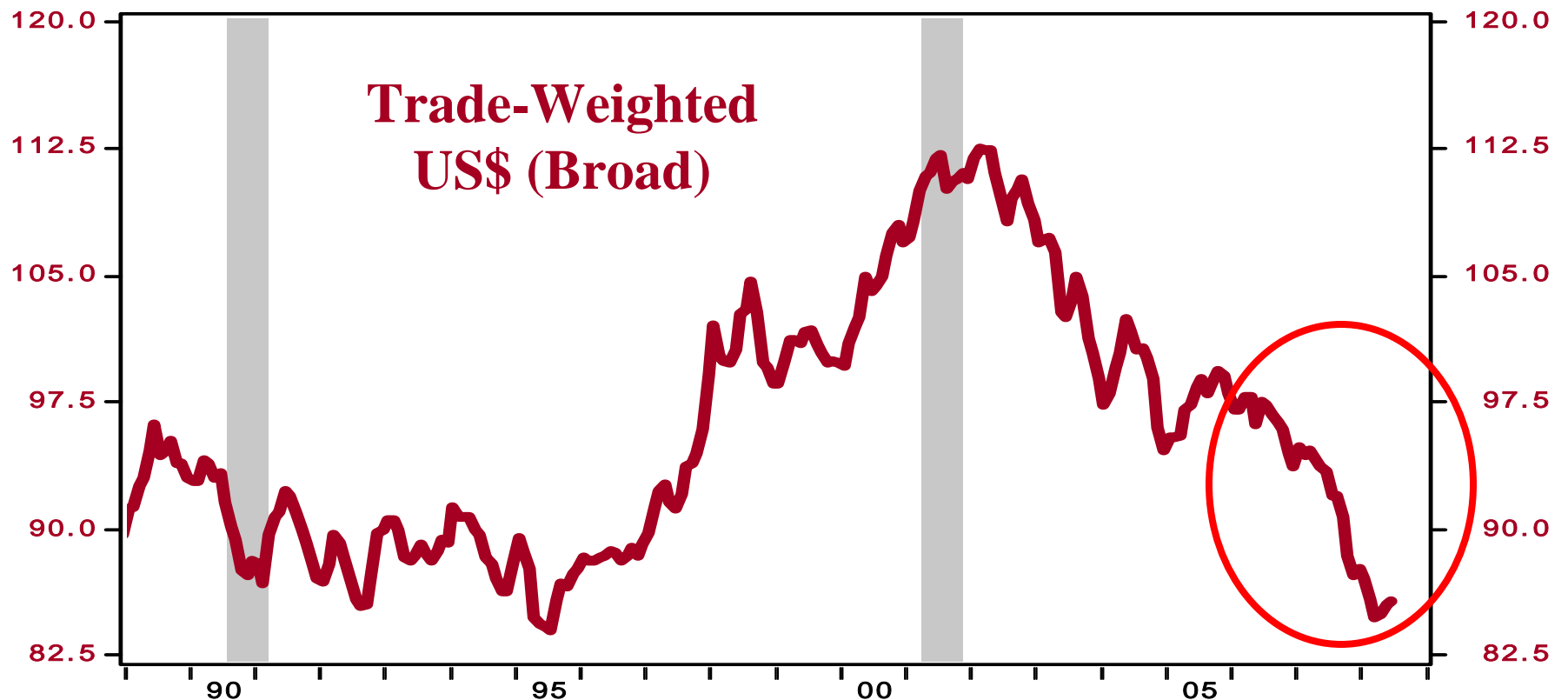


Source: International Monetary Fund

# *Weaker Dollar: Boosts Demand for U.S. Exports, but Adds to Inflationary Pressures*

Real Broad Trade-Weighted Exchange Value of the US\$

Mar-73=100



Source: Federal Reserve Board /Haver Analytics

07/08/08

# Foreign Demand for U.S. Goods: Boosted By Weak Dollar, Net Exports Have Helped Prop Up Growth

## Net exports have contributed to recent growth

### Real Gross Domestic Product (GDP) Growth

Percent change at seasonally adjusted annual rate

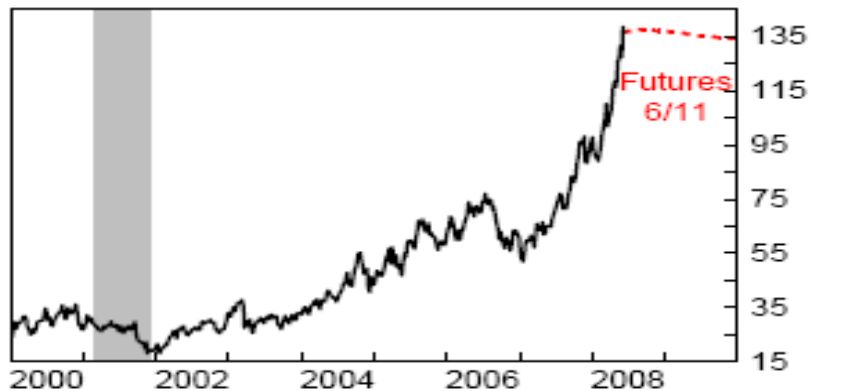


# Elevated Commodity Prices: Pass-through to Core Inflation? Impact on Growth, Spending?

Commodity prices are rising

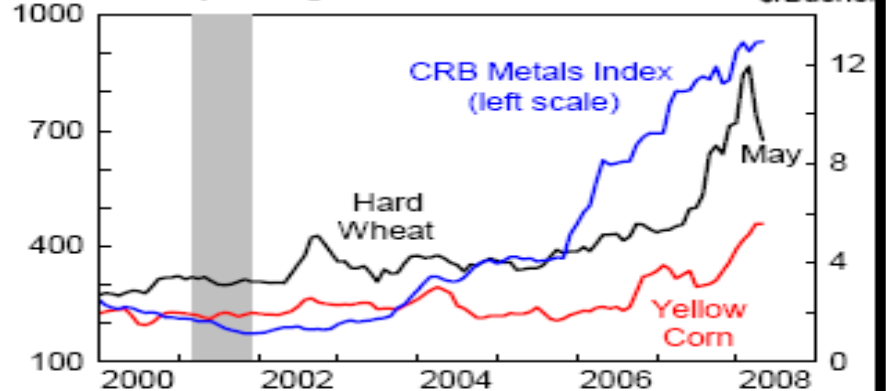
## Price of Oil

West Texas Intermediate; weekly closing price



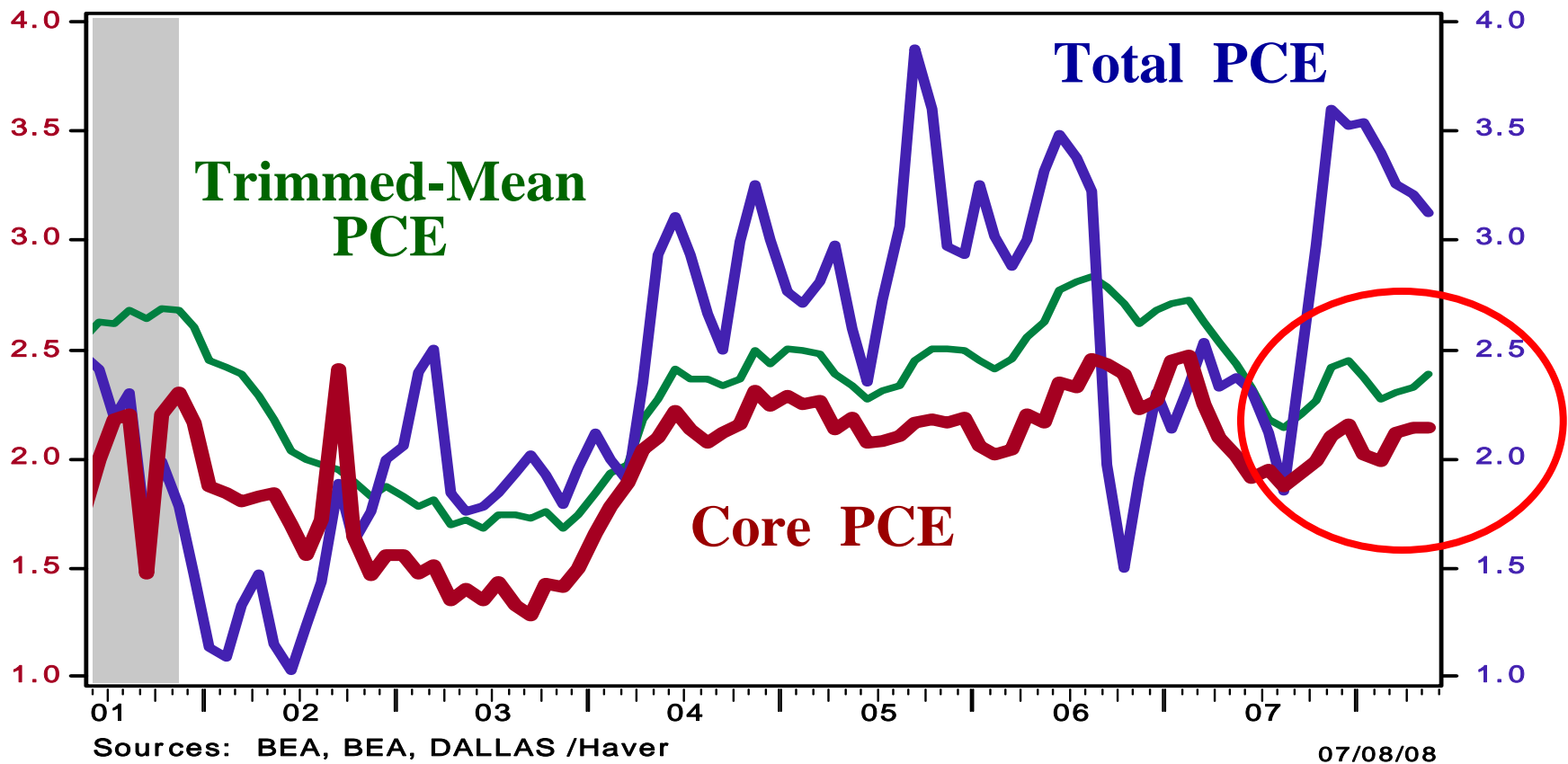
## Prices of Wheat, Corn and Metals

Spot Price Monthly average

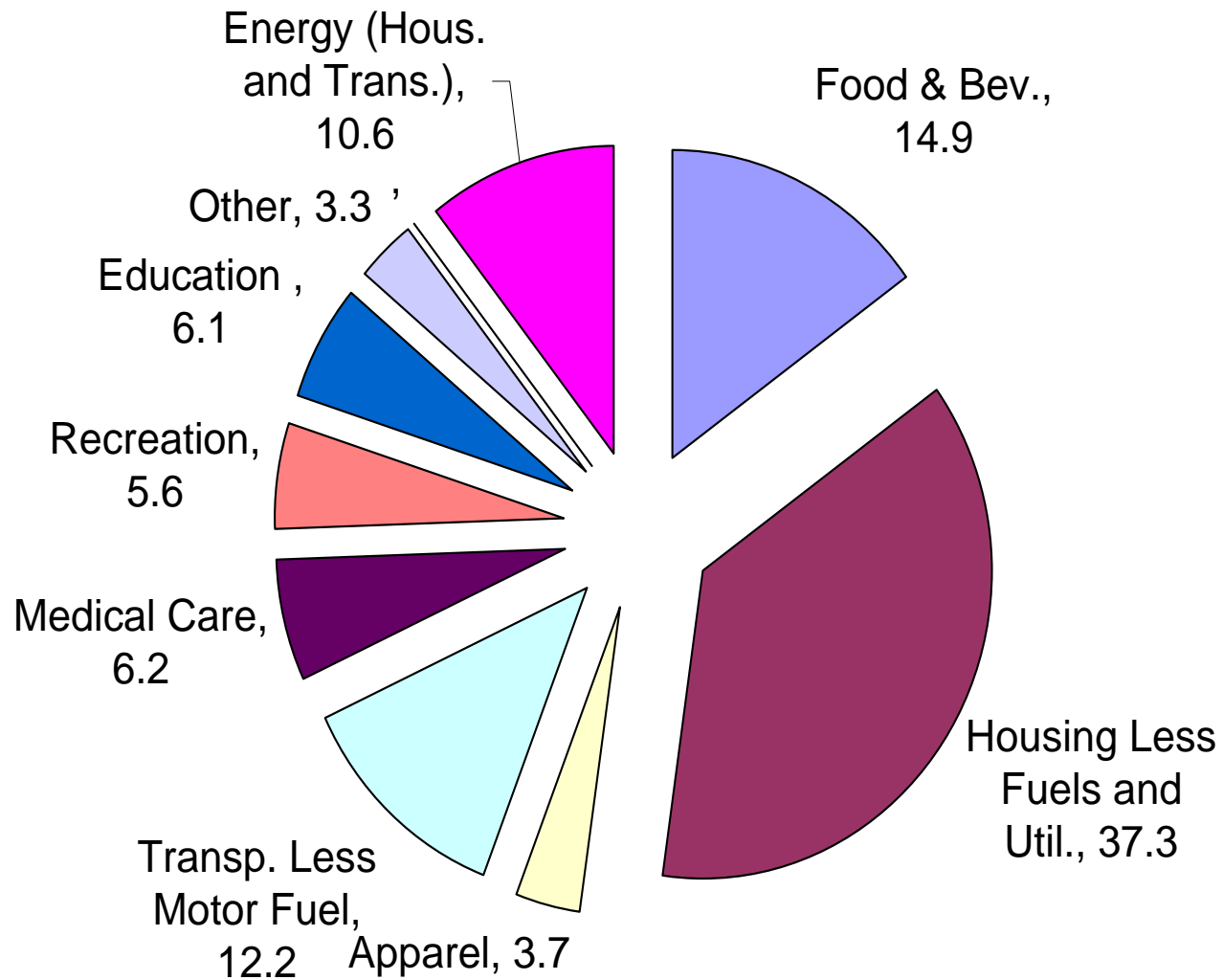


# *Inflation Measures: Amid Rising Food and Energy Prices, Inflation Has Been a Source of Concern*

**Total, Core (less food and energy), and Trimmed-Mean Personal Consumption Expenditure Price Index (PCE) Year-over-year % Change**



# *CPI-U: Relative Importance of Categories* Percent (2008)



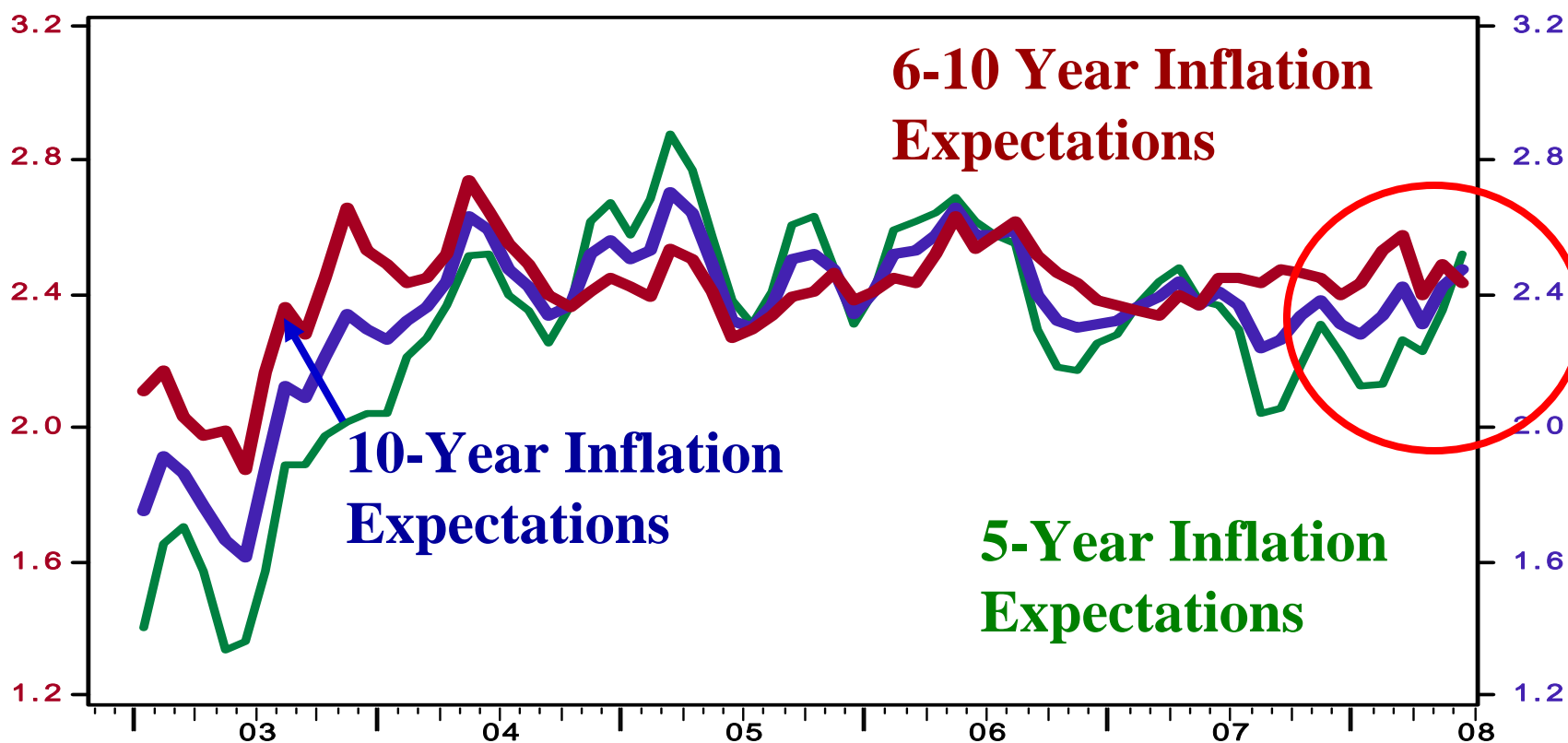
Source: BLS

# *Long-Term TIPS-Implied Inflation Expectations: Have Moved Up Slightly, Adding to Inflation Concerns*

Calculated 5-Year Forward Inflation Rate (%)

10-Year Nominal Minus 10-Year TIP Rate (%)

5-Year Nominal Minus 5-Year TIP Rate (%)



Source: Federal Reserve Board /Haver Analytics

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SERVICE...



...I THINK THIS IS A BIT MORE SERIOUS THAN WE THOUGHT....

NOPE... STILL CAN'T SEE IT...

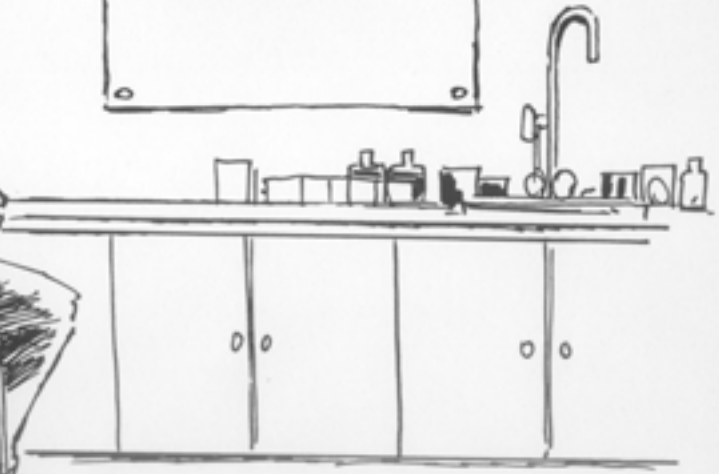
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## 2. *Going Forward: Slow but Steady Growth Predicted*

### **Real GDP forecast improved in June**

- ***FedViews***: Expects stronger growth in Q2-Q3 than was forecasted in May. After effect of fiscal stimulus wanes, expect growth to slow a bit in Q4 2008. 2009 growth anticipated to be around 3 percent.
- ***Blue Chip***: Consensus 2008 forecast in June was revised up to 1.6 percent (up from 1.5 in June) growth for 2008 and 1.7 percent (down from 1.9) for 2009.

From June 12, 2008 *FedViews*, & July 10, 2008 *Blue Chip Economic Indicators*

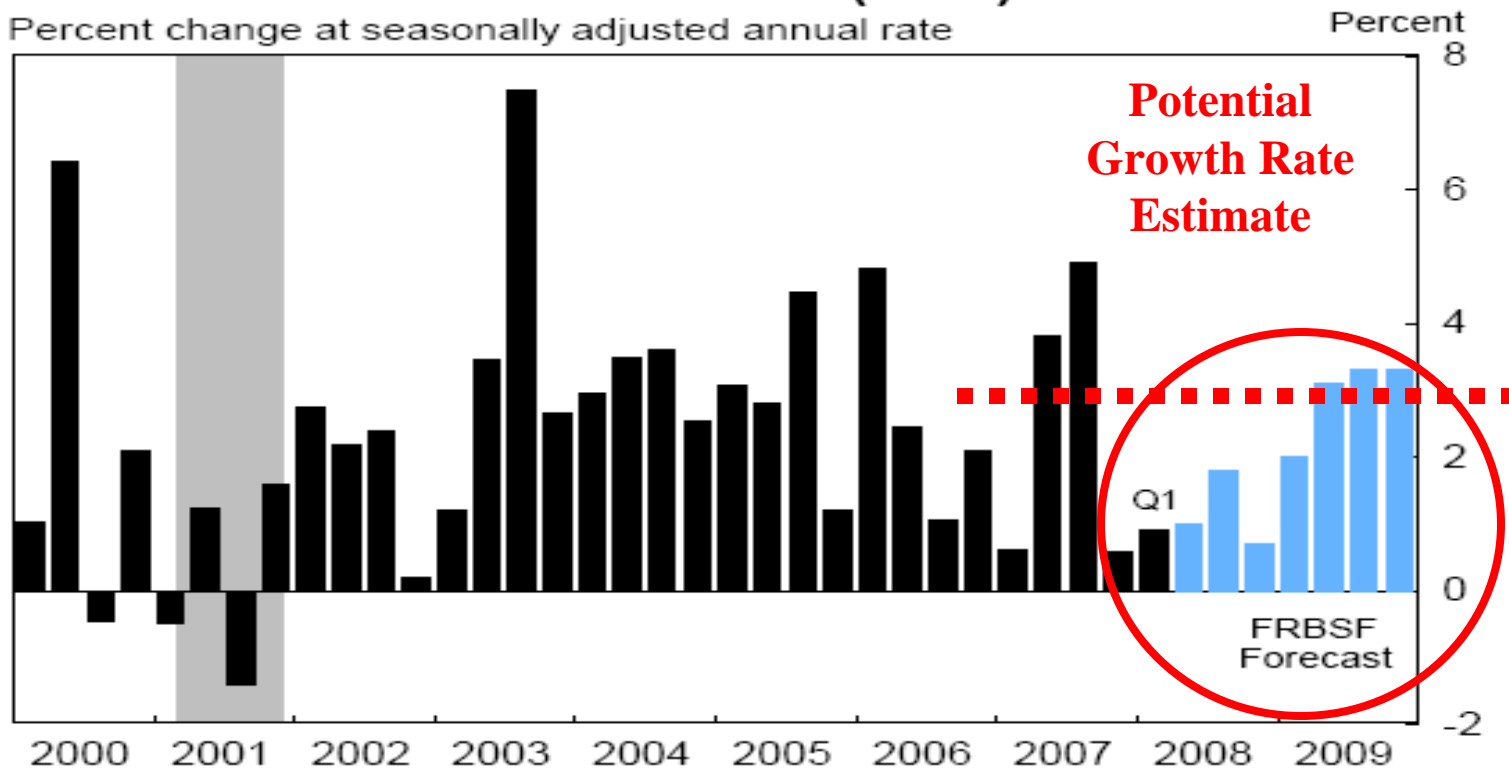
See *FedViews* @ [www.frbsf.org/publications/economics/fedviews/](http://www.frbsf.org/publications/economics/fedviews/)

# *FRBSF Real GDP Forecast: Stronger Growth in Q2-Q3 Expected, With Payback in Q4 2008*

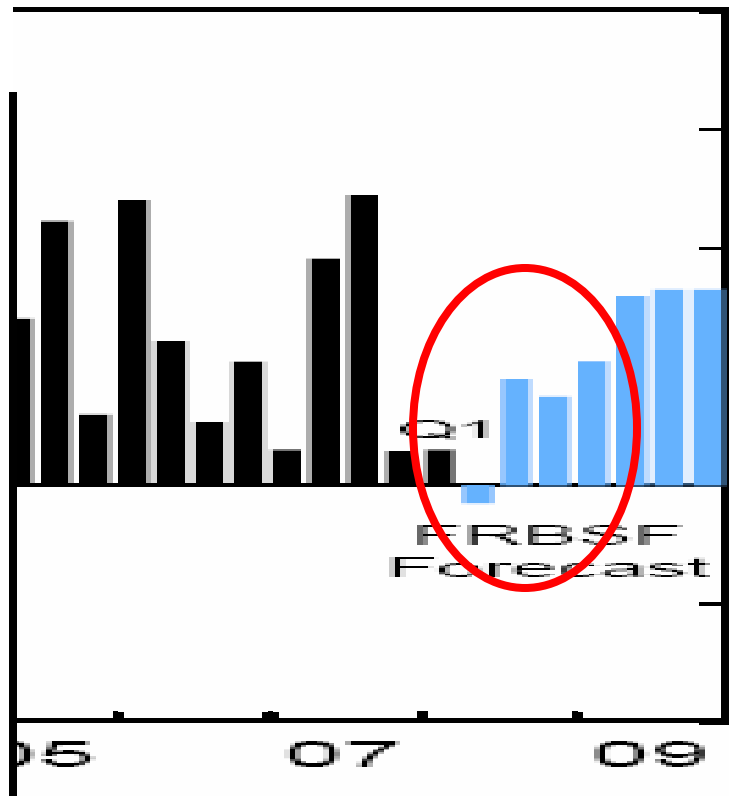
## Forecast gradual growth recovery

### Real Gross Domestic Product (GDP)

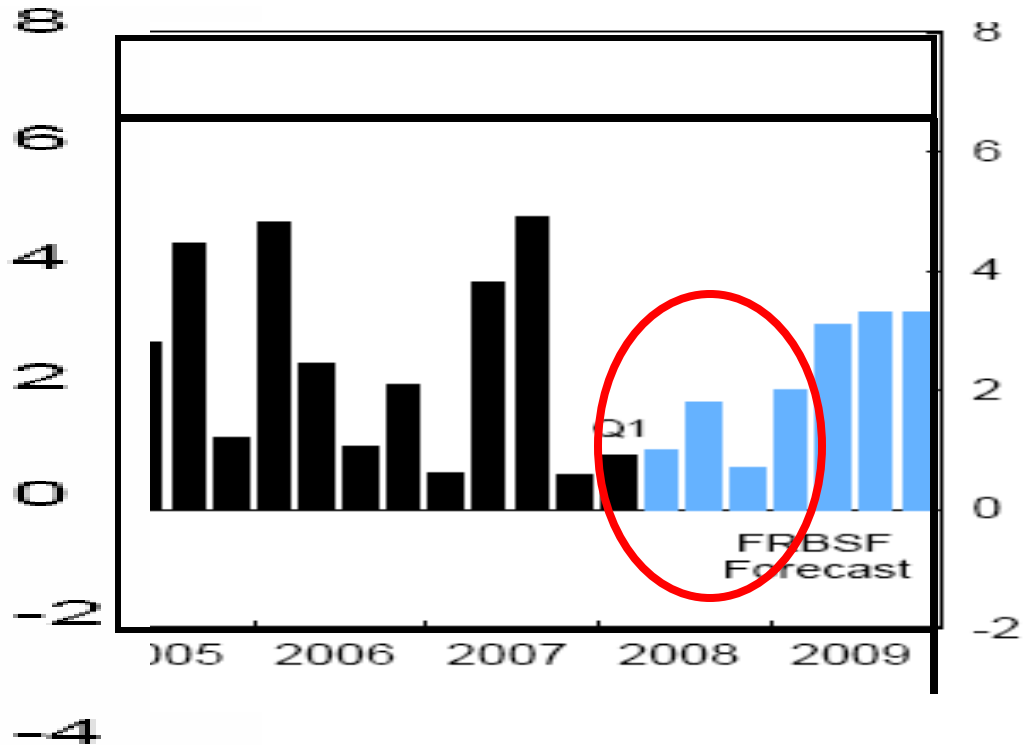
Percent change at seasonally adjusted annual rate



# *FRBSF Real GDP Forecast: June Forecast Is More Optimistic*



*FedViews of May 2008*

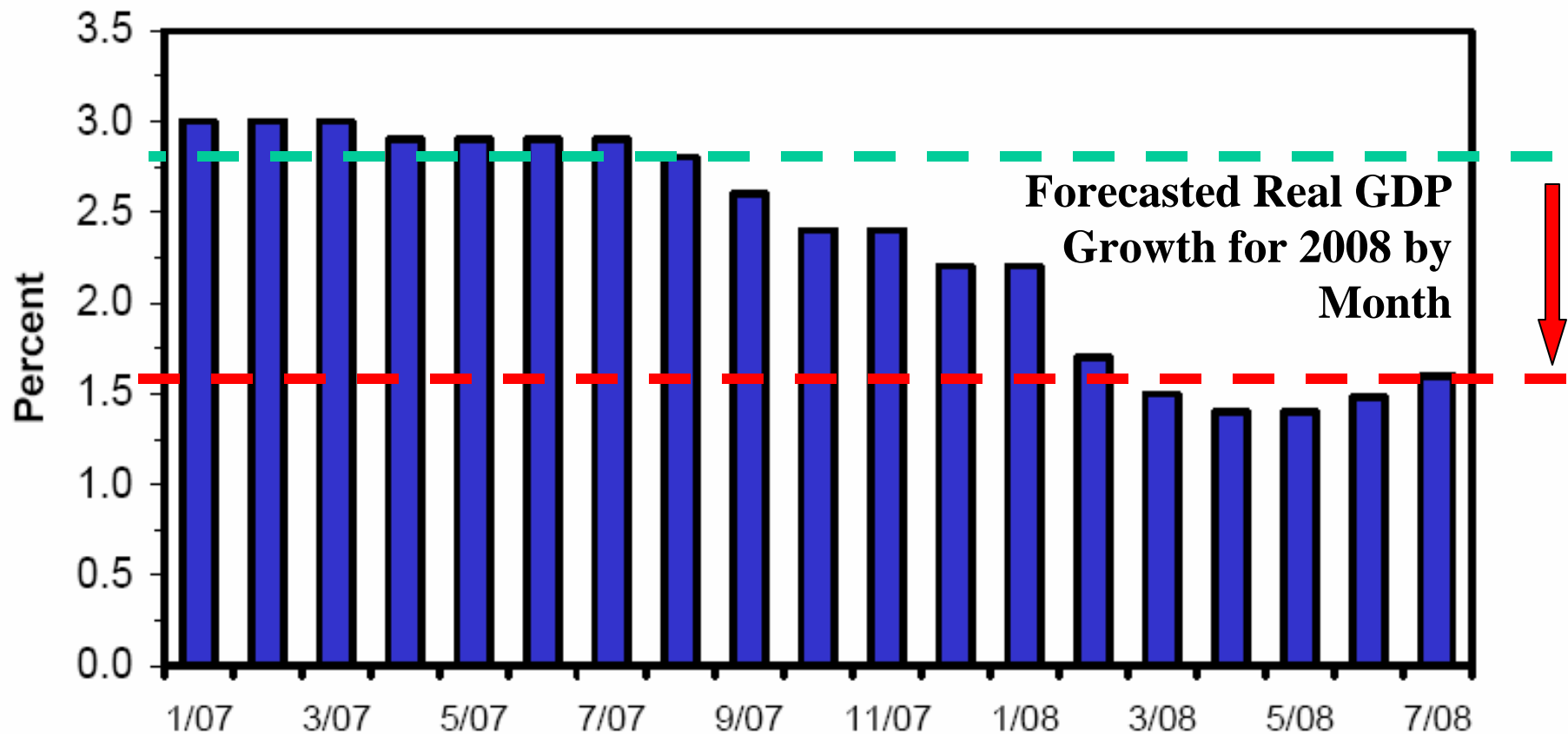


*FedViews of June 2008*

**Watch for July *FedViews*: Expected July 14, 2008 @ [frbsf.org](http://frbsf.org)**

# *Path of Blue Chip Growth Forecasts for 2008: Monthly Forecasts for 2008 Have Fallen Since August '07*

**Consensus Forecasts Of Y/Y % Change In Real GDP In 2008**



**Source: Blue Chip Economic Indicators, July 10, 2008.**

## *Going Forward:* Inflation Moderation Expected

### **Inflation rates should decline by end of 2009**

- *FedViews*: **Total PCE** expected to exceed 4 percent in Q2 and Q3, subsiding in Q4 2008. **Core PCE** expected to remain relatively stable, as slack in economy absorbs price pressures.
- *Blue Chip*: **Total CPI** is expected to rise 4.2 percent (up from June forecast of 3.9) in 2008 and increase 2.9 percent (up from May forecast of 2.6) in 2009.

**PCE** = Personal Consumption Expenditures, **CPI** = Consumer Price Index  
**Core Inflation** = All items less food and energy

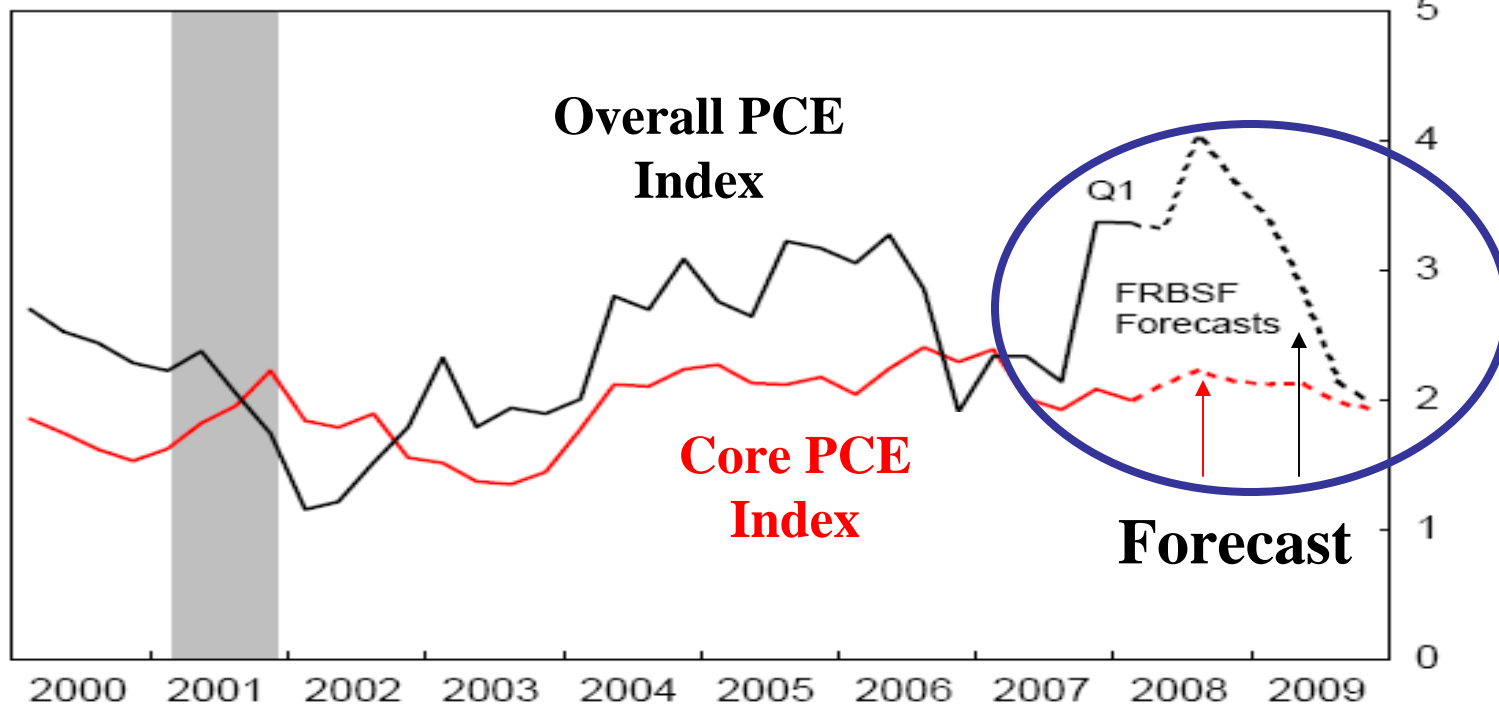
# *FRBSF Inflation Forecasts: Core Inflation Expected to Remain Relatively Stable*

## Inflation expected to recede

### PCE Price Inflation

Percent change from 4 quarters earlier

Percent





### 3. Potential Risks to the National Forecast

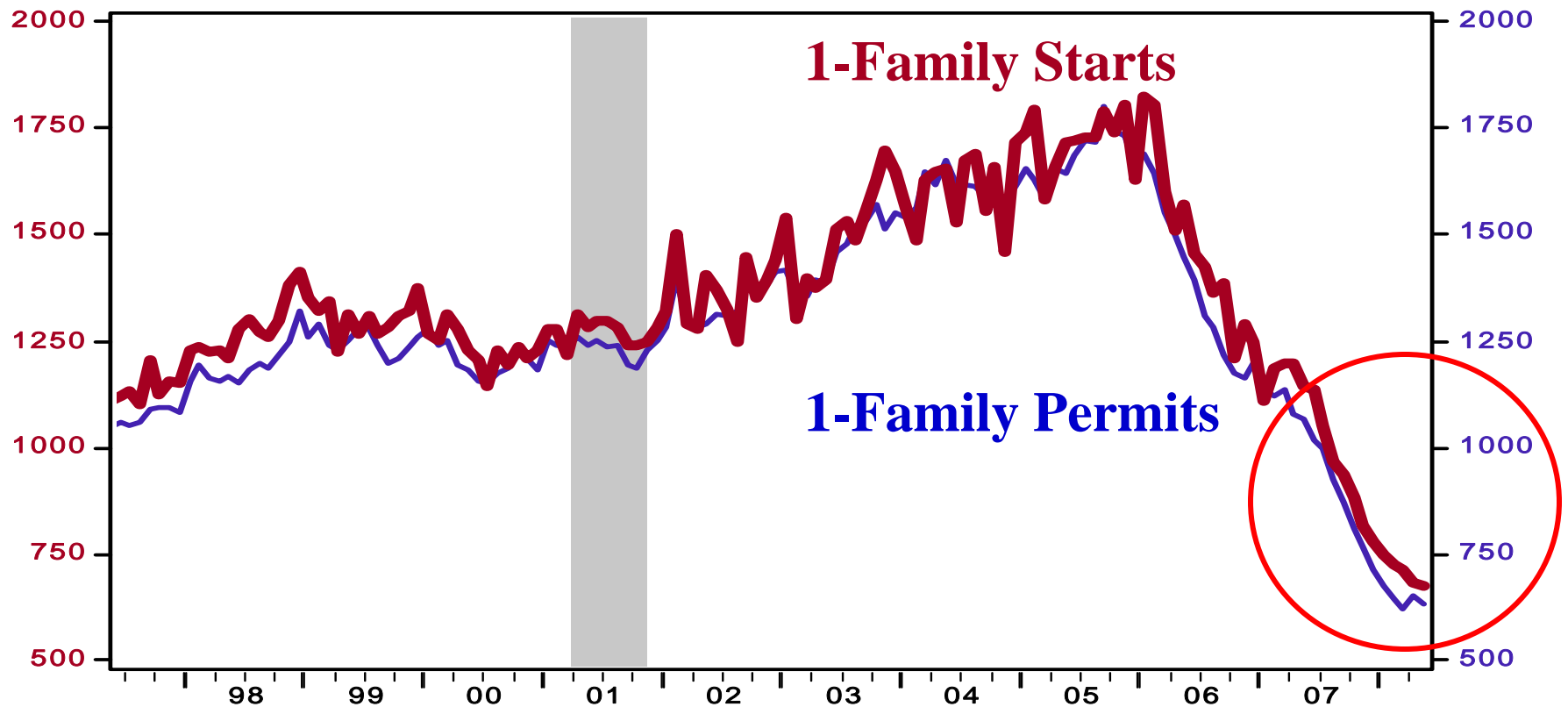
*Uncertainty about:*

- Housing slump*
- Credit Crunch*
- Energy & Commodities*
- + Monetary policy*
- + Fiscal stimulus*
- SHoCKS ???*

# *Housing Market Indicators: Homebuilders Have Cut Production Due to Large Inventories and Falling Prices*

Housing Starts: 1 Unit  
SAAR, Thous. Units

Housing Units Authorized: 1-Unit Structures  
SAAR, Thous. Units

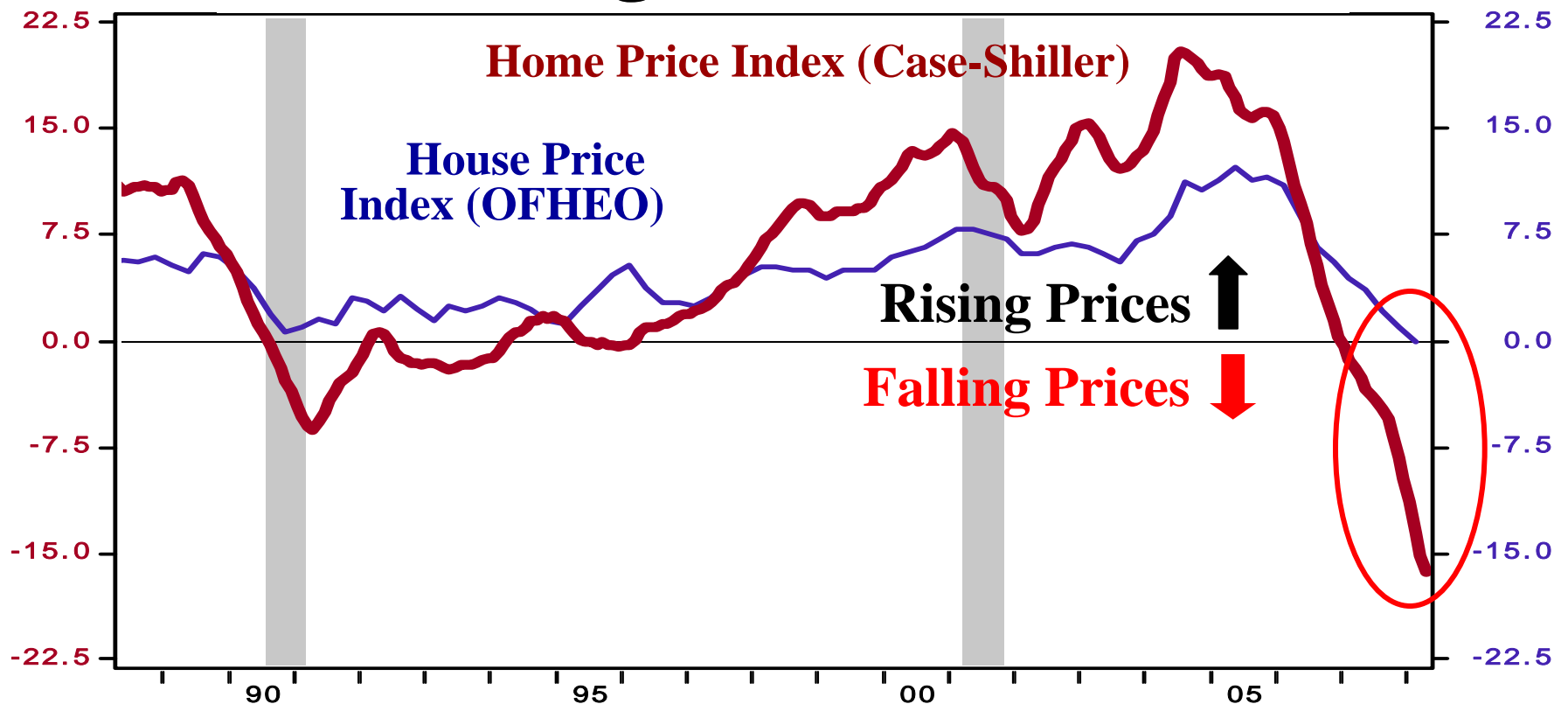


Source: Census Bureau /Haver Analytics

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# *U.S. Home Prices: Declines Expected to Continue— Impacts on Construction & Consumer Spending?*

## Home Price Indices % Change – Year-to-Year



Sources: S&P, OFHEO /Haver

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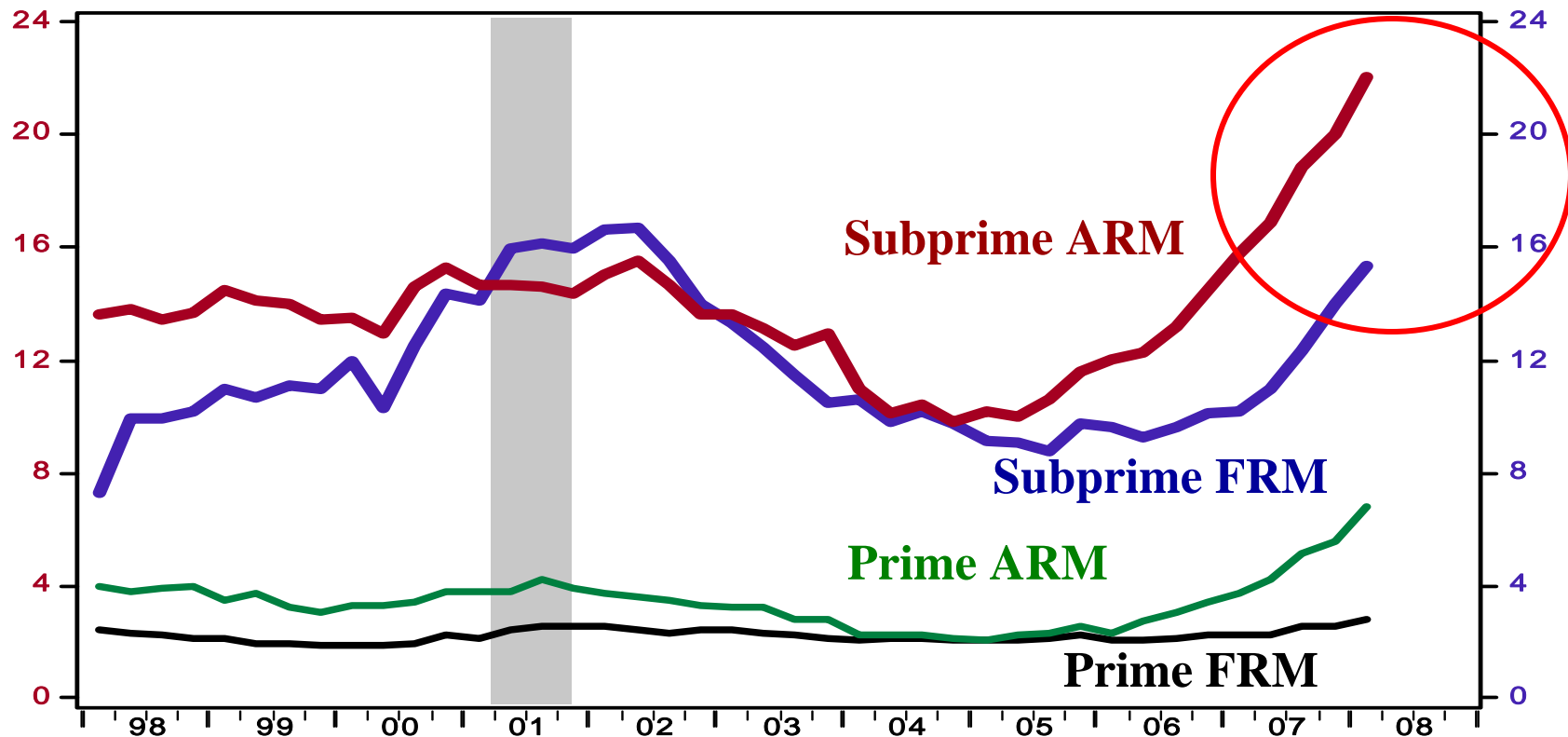
# Mortgage Delinquency Rates: Increases Most Dramatic for Subprime Mortgages

Conventional Subprime ARM Mortgages: Total Past Due: United States (SA, %)

Conventional Subprime FRM Mortgages: Total Past Due: United States (SA, %)

Conventional Prime ARM Mortgages: Total Past Due: United States (SA, %)

Conventional Prime FRM Mortgages: Total Past Due: United States (SA, %)

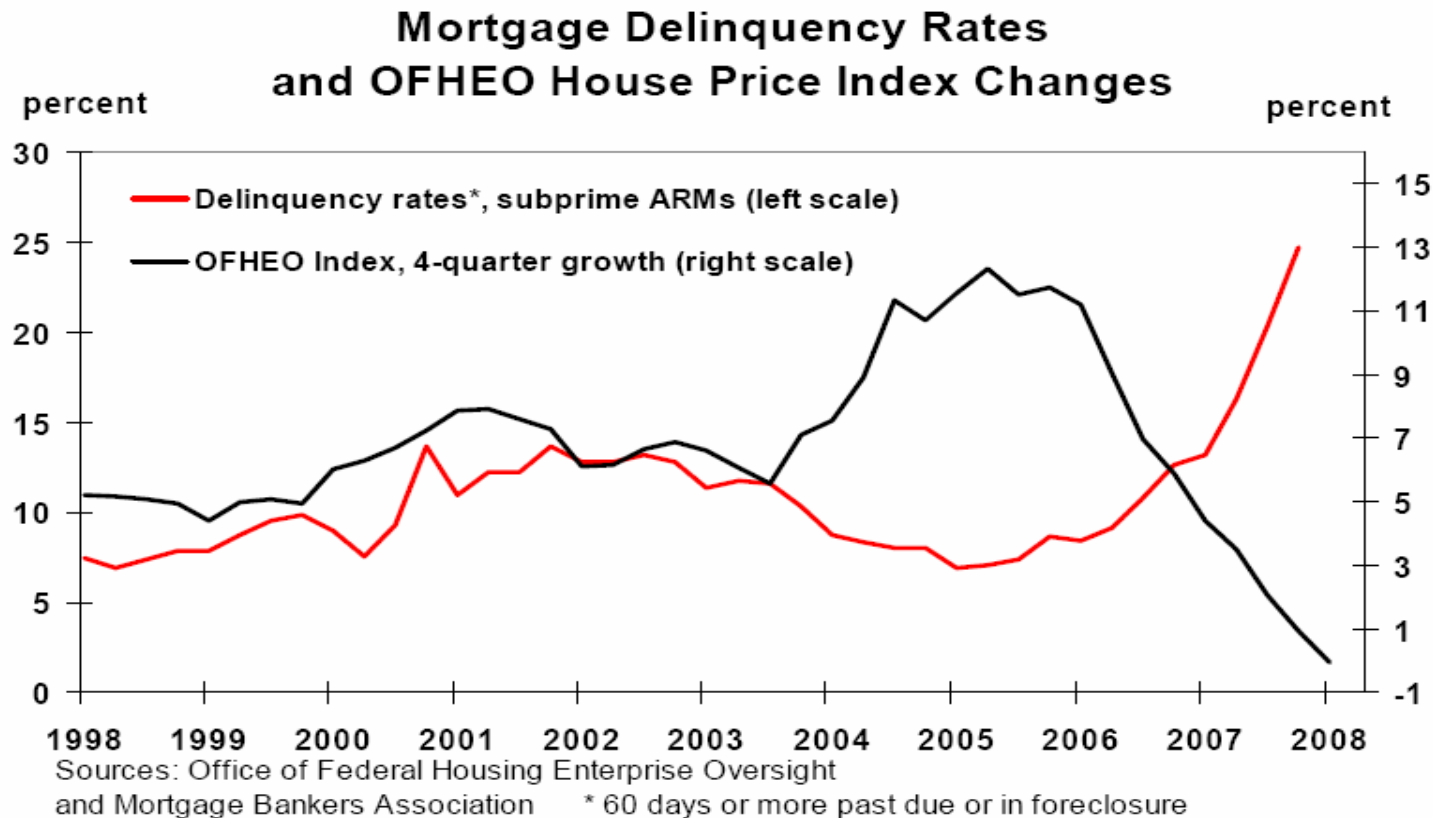


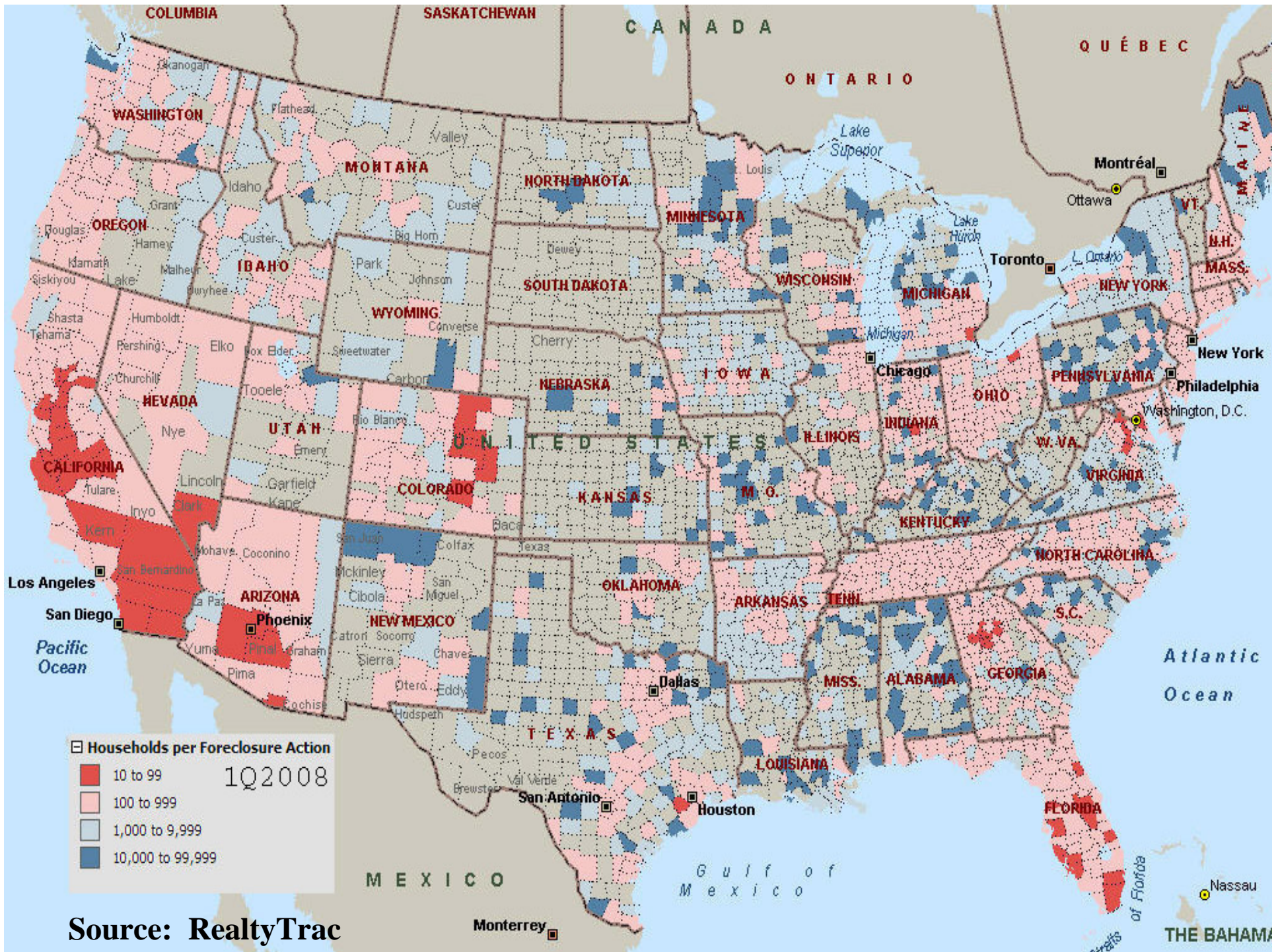
Source: MBA /Haver

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# *Falling Housing Prices: To date, the Single Most Important Predictor of Foreclosures*

***Subprime delinquencies rose as house price appreciation slowed***



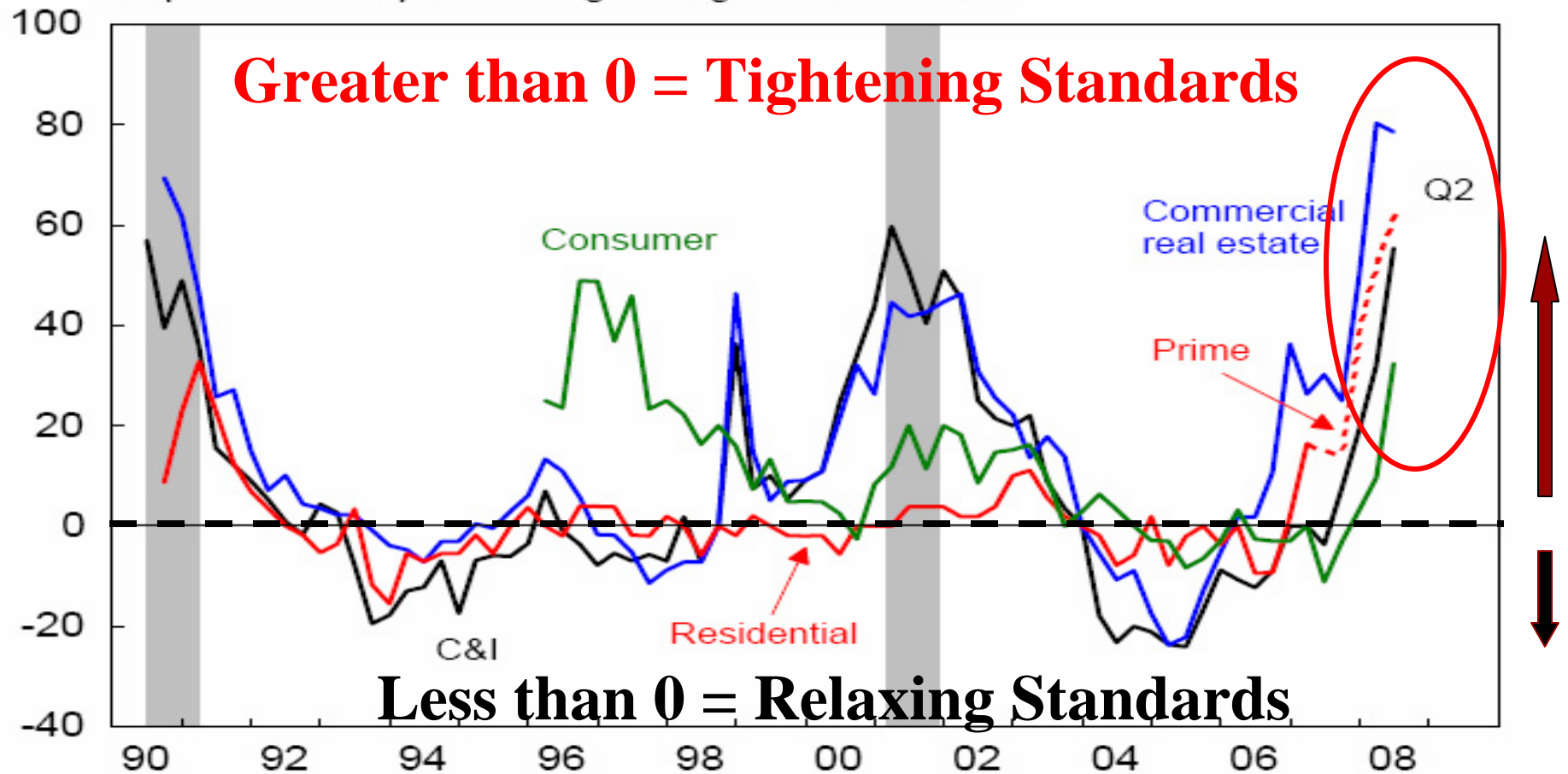


Source: RealtyTrac

# *Loans Are Less Available: Continued Tightening of Lending Standards (April 2008)*

## Credit Conditions, Domestic and Commercial Banks

Net percent of respondents tightening credit standards

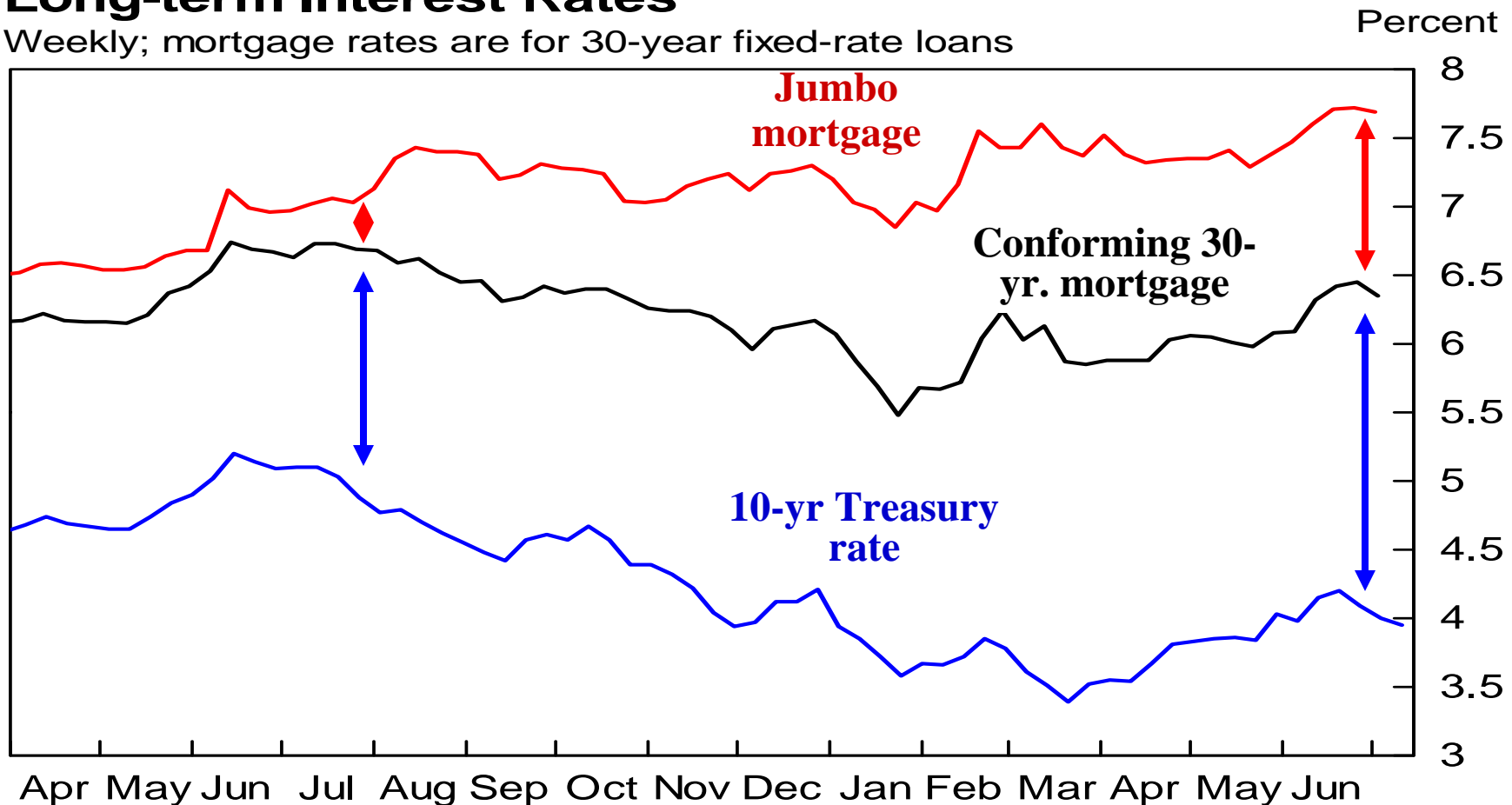


Source: Federal Reserve Senior Loan Officer Opinion Survey

# *Mortgages Remain Expensive: Rates Tick Down, but Spreads Remain High*

## Long-term Interest Rates

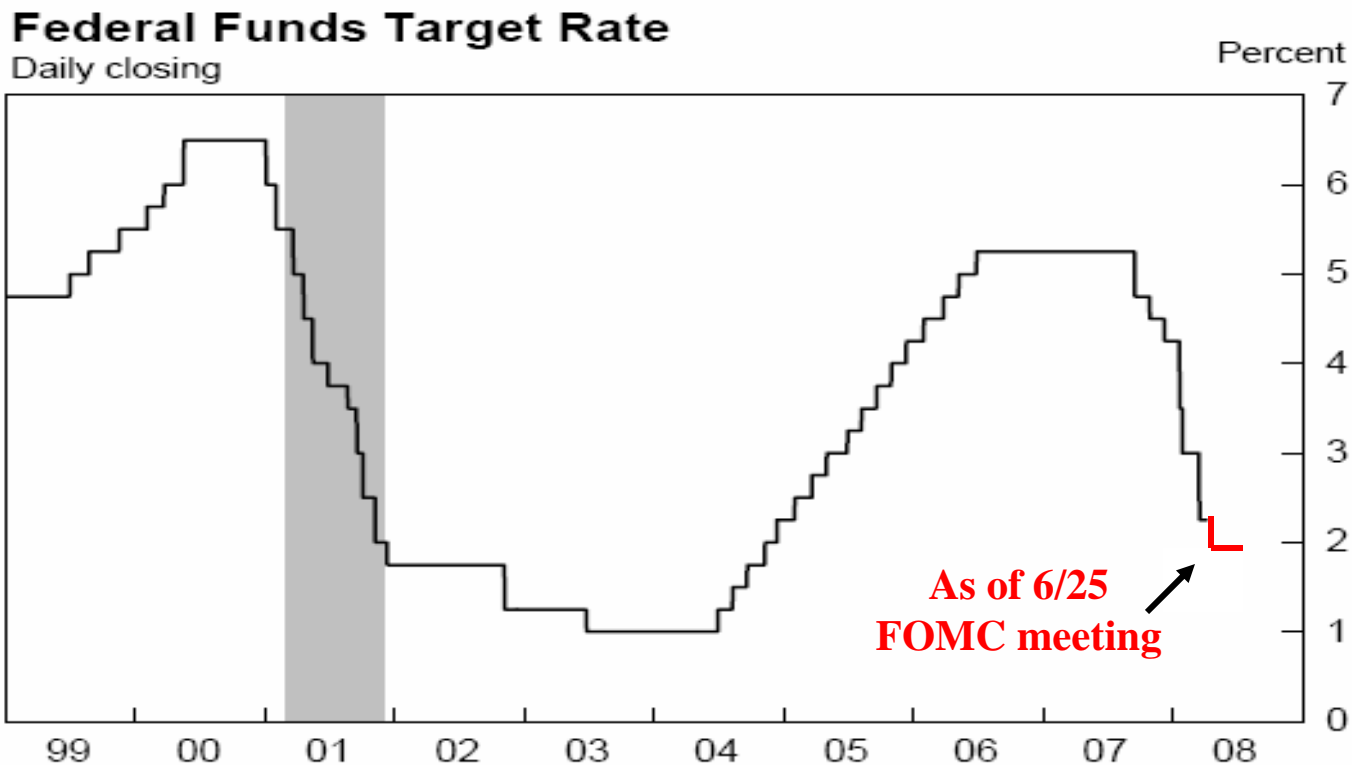
Weekly; mortgage rates are for 30-year fixed-rate loans



July 8, 2008

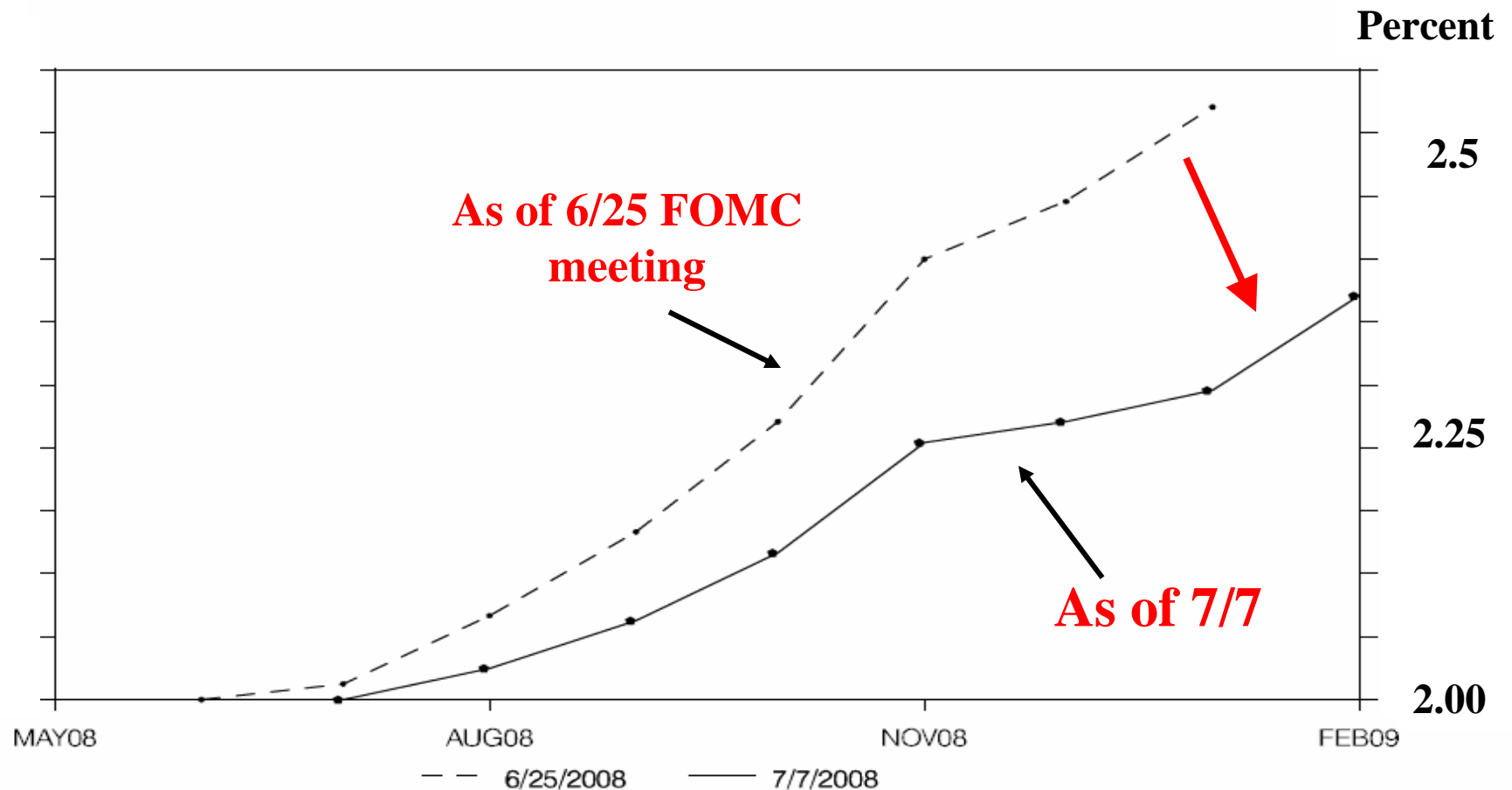
# Monetary Policy in Perspective: Current Stance Compared to Actions in 2001

## Similar policy response during last recession



# *Fed Funds Futures Market: Rate Expectations Have Fallen Since Last FOMC Meeting*

FORWARD FED FUNDS RATE IMPLIED FROM FED FUNDS FUTURES



Note: Based on Federal Funds Futures after adjusting for a one basis point per month term premium

# *Most Recent FOMC Statement:* **June 25, 2008**

**Action:** The Federal Open Market Committee decided today to keep its target for the federal funds rate at 2 percent.

**Rationale:** Recent information indicates that overall economic activity continues to expand, partly reflecting some firming in household spending. However, labor markets have softened further and financial markets remain under considerable stress. Tight credit conditions, the ongoing housing contraction, and the rise in energy prices are likely to weigh on economic growth over the next few quarters.

<http://www.federalreserve.gov/fomc/> The Committee expects inflation to moderate later this year and next year. However, in light of the continued increases in the prices of energy and some other commodities and the elevated state of some indicators of inflation expectations, uncertainty about the inflation outlook remains high.

# *Most Recent FOMC Statement:*

## **June 25, 2008**

**Risks:** The substantial easing of monetary policy to date, combined with ongoing measures to foster market liquidity, should help to promote moderate growth over time. Although downside risks to growth remain, they appear to have diminished somewhat, and the upside risks to inflation and inflation expectations have increased. The Committee will continue to monitor economic and financial developments and will act as needed to promote sustainable economic growth and price stability.

**Vote:** Voting for the FOMC monetary policy action were: Ben S. Bernanke, Chairman; Timothy F. Geithner, Vice Chairman; Donald L. Kohn; Randall S. Kroszner; Frederic S. Mishkin; Sandra Pianalto; Charles I. Plosser; Gary H. Stern; and Kevin M. Warsh. Voting against was Richard W. Fisher, who preferred an increase in the target for the federal funds rate at this meeting.

*Questions?*

**Thank you!**

**[yelena.takhtamanova@sf.frb.org](mailto:yelena.takhtamanova@sf.frb.org)**