



U.S. Monetary Policy and National Economic Outlook

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Yelena F. Takhtamanova, Economist
Federal Reserve Bank of San Francisco

Presentation Overview

1. Current national situation
2. FRBSF national economic forecast
 - Output and inflation
3. Monetary policy outlook
 - Conventional and unconventional tools overview
 - FOMC new communications initiatives

These remarks represent my views and not necessarily those of my colleagues in the Federal Reserve System and the Federal Reserve Bank of San Francisco.

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Federal Reserve System



- **Mission**

- Promote the safety, soundness, and stability of our nation's financial system

- **Monetary Policy Goals**

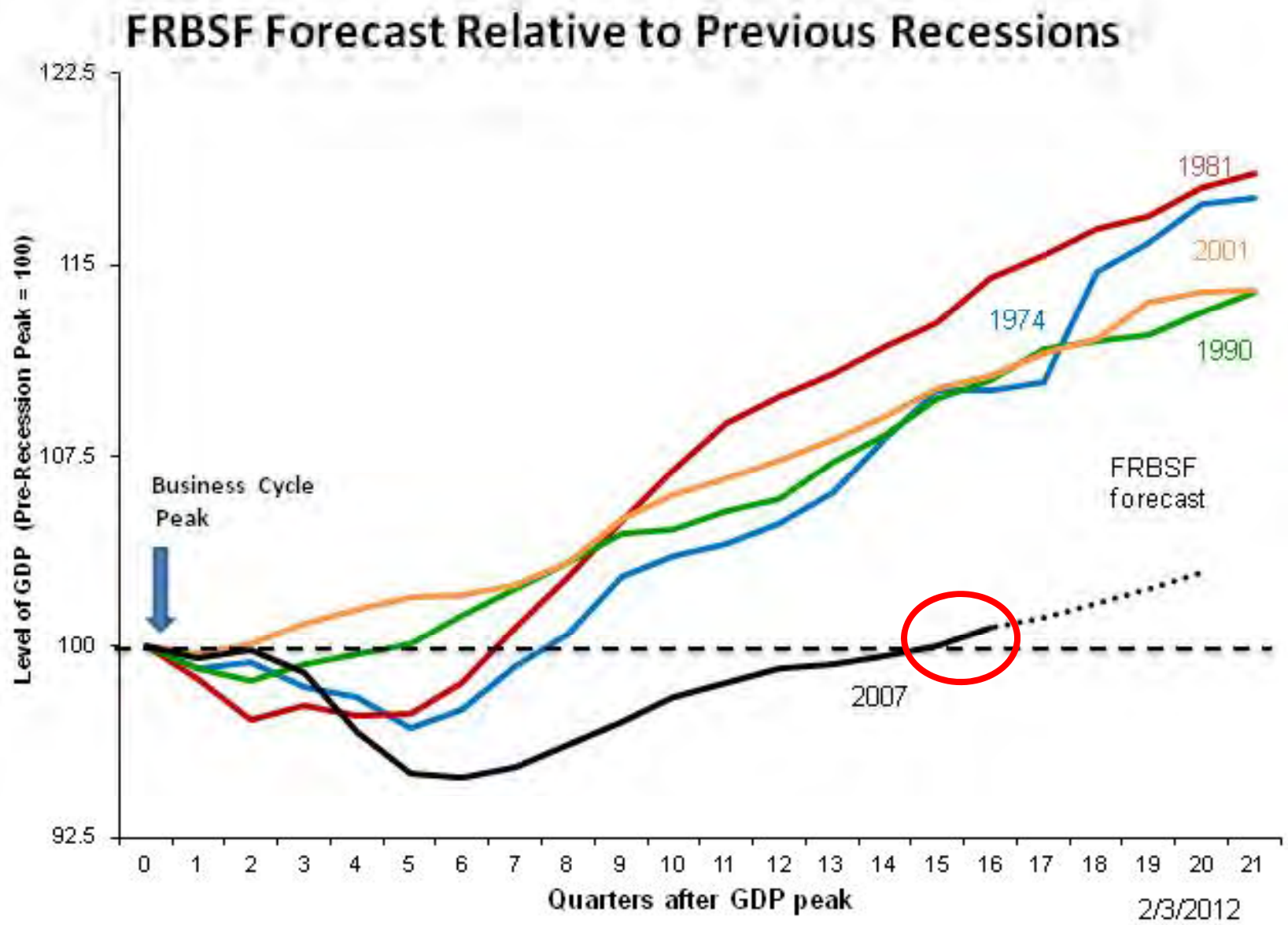
- Promote maximum *sustainable* output and employment and stable prices

CURRENT NATIONAL SITUATION

Economic Overview

- **U.S. growth picked up in 2011:H2, as temporary negative factors ebbed and inventories surged in Q4.**
- **Looking ahead: moderate growth is expected in 2012 and 2013. However downside risks to the outlook remain (mainly Europe).**
- **Past monetary policy accommodation and ongoing work on revisions to communicating future policy are expected to help.**

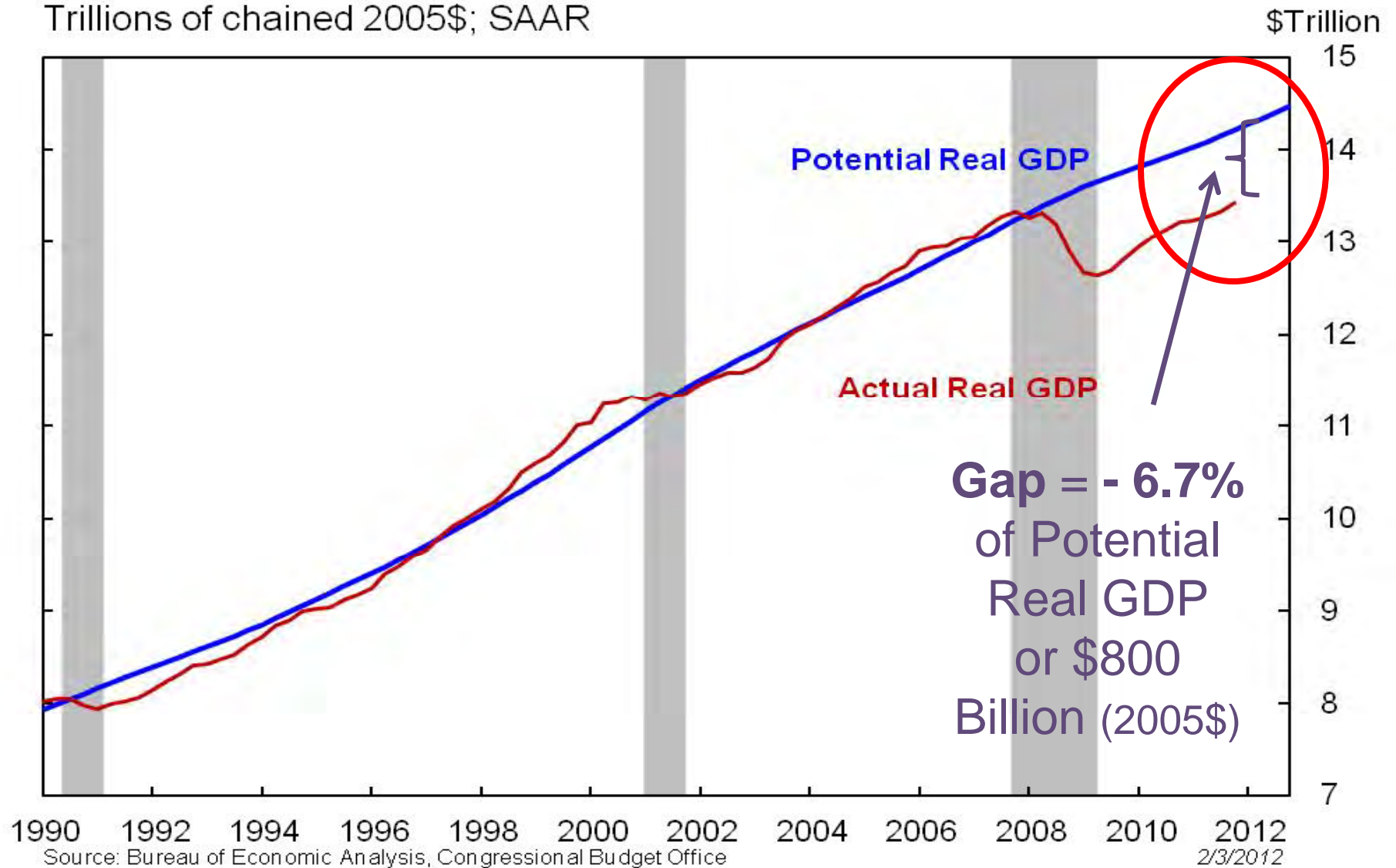
*Four Years After the Recession Began,
Output has Finally Surpassed Pre-Recession Levels*



The Long and Deep Recession and Mild and Volatile Recovery Have Resulted in an Economy Operating Far Below Capacity

Actual Real GDP versus Potential Real GDP

Trillions of chained 2005\$; SAAR

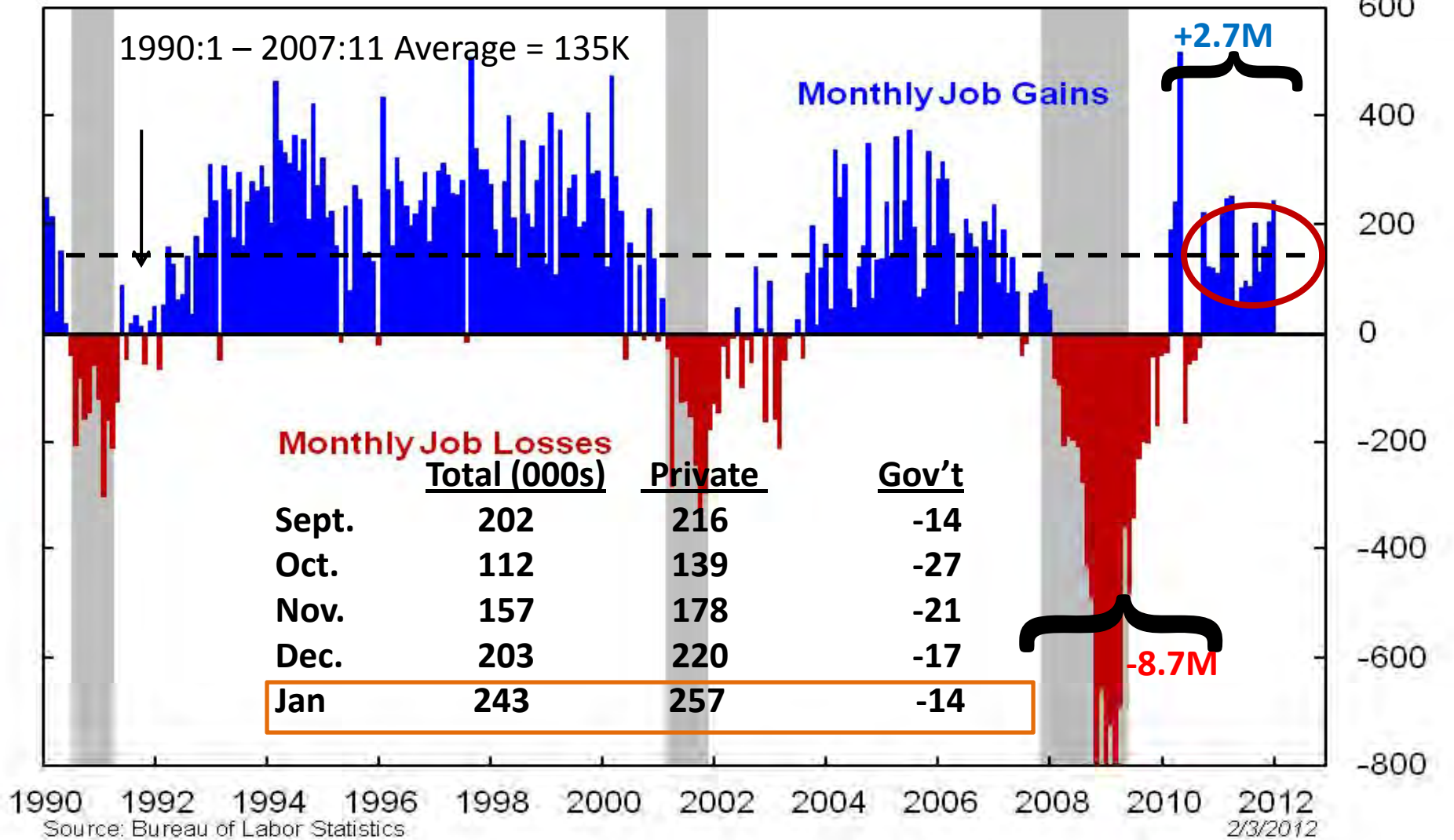


U.S. Labor Market Is Showing Signs of Improvement— but , It Is Only Adding Jobs at the Average for the 1990-2007 Period

Nonfarm Payroll Employment

Month-to-month difference in thousands; seasonally adjusted

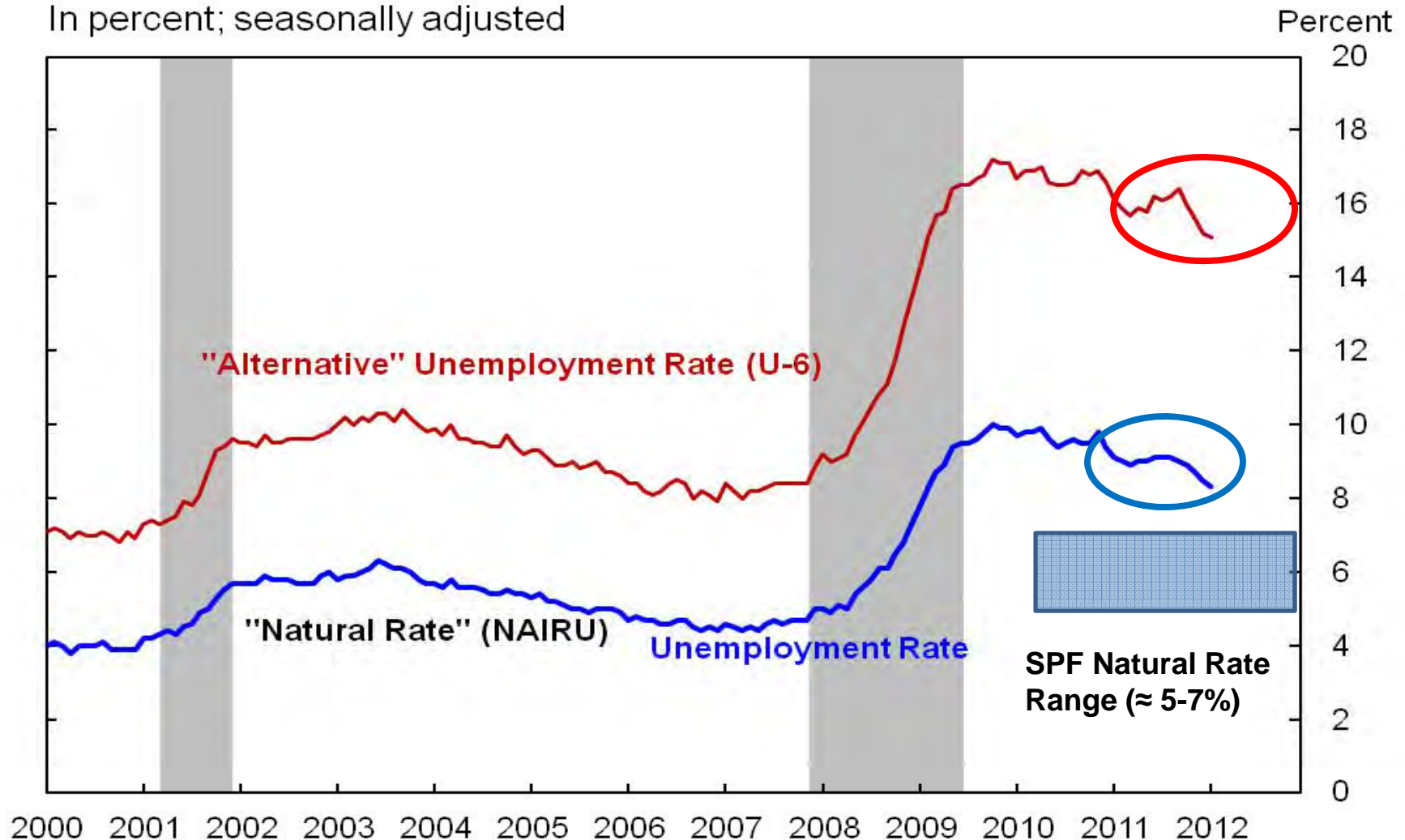
Thousands



U.S. Unemployment Rate Fell to 8.3 %, but Remains Well Above Estimates of the Natural Unemployment Rate

Unemployment Rate Comparison

In percent; seasonally adjusted



2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012
Source: Bureau of Labor Statistics, Congressional Budget Office
2/3/2012

SPF = Survey of Professional Forecasters, FRB Philadelphia.

Unemployment Duration Remains Very Long by Historic Standards

Unemployment by Duration

As a percentage of total unemployed; 3-month moving average

Percent

70

60

50

40

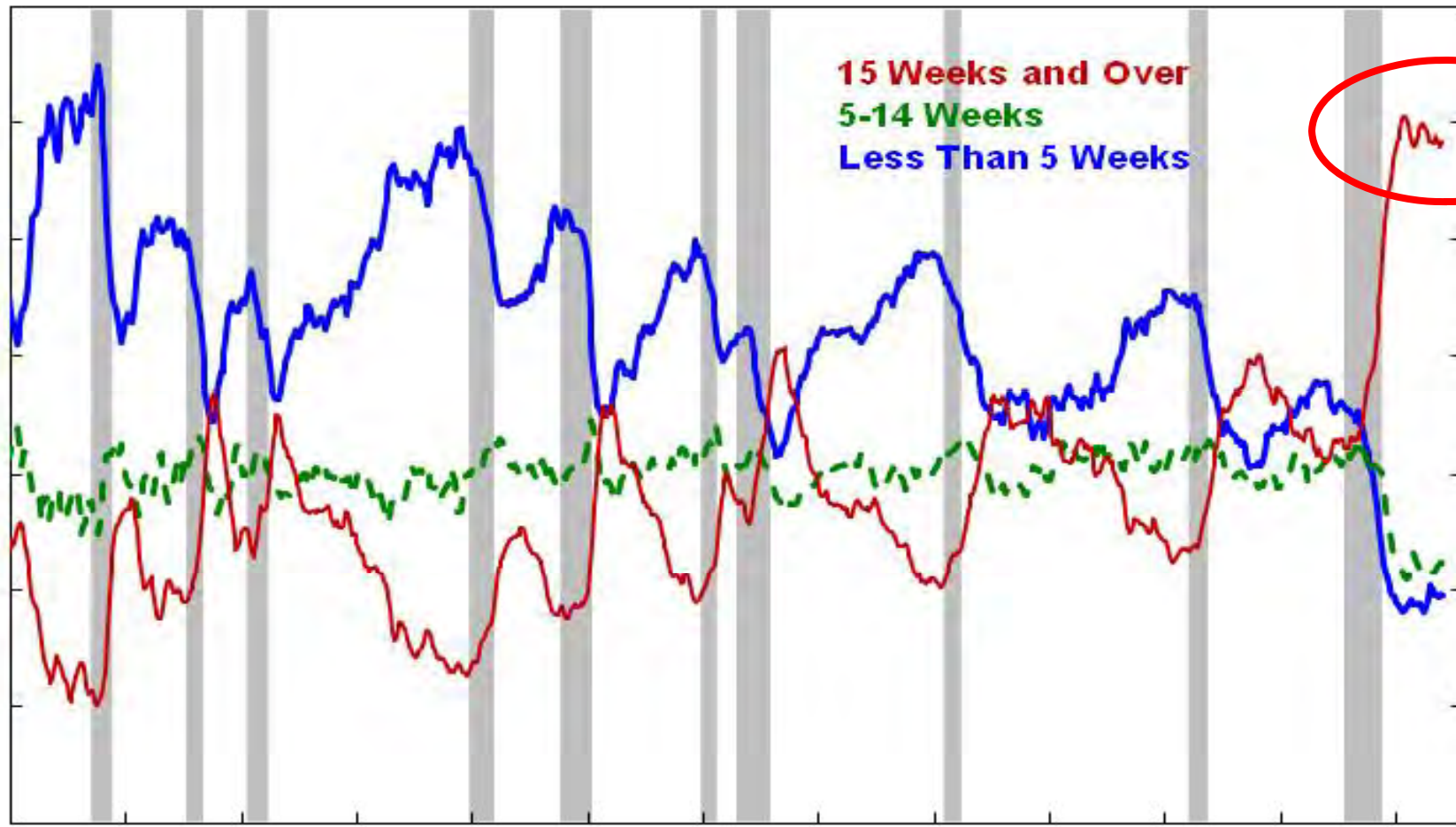
30

20

10

0

15 Weeks and Over
5-14 Weeks
Less Than 5 Weeks



1950 1955 1960 1965 1970 1975 1980 1985 1990 1995 2000 2005 2010

Source: Bureau of Labor Statistics

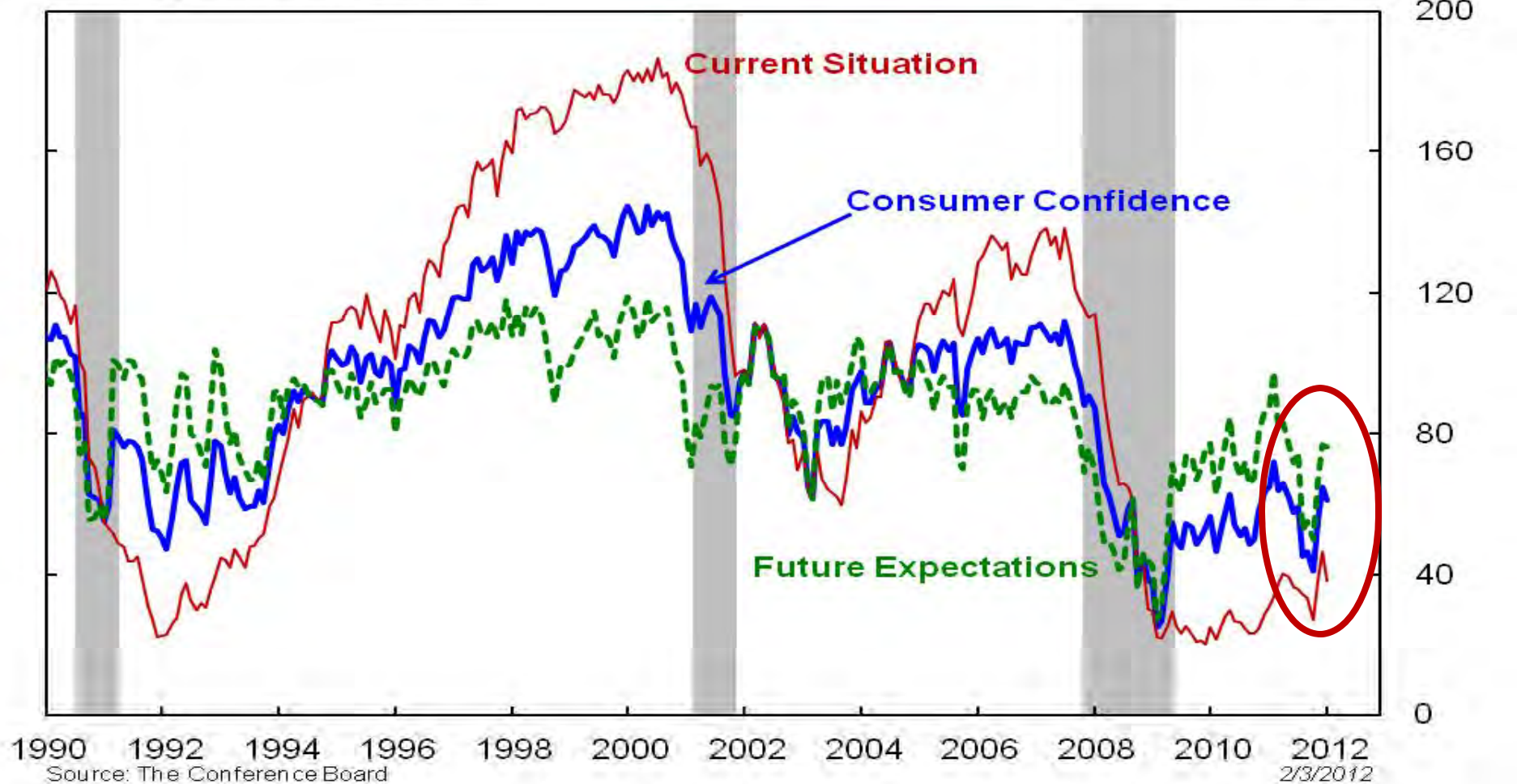
2/3/2012

Although Consumer Confidence Picked Up In Late 2011, It Remains Far Below Levels in Prior Expansions; Its Volatility Reflects the Slow Uneven Recovery

Consumer Confidence Index and Components

Monthly index values

Index values

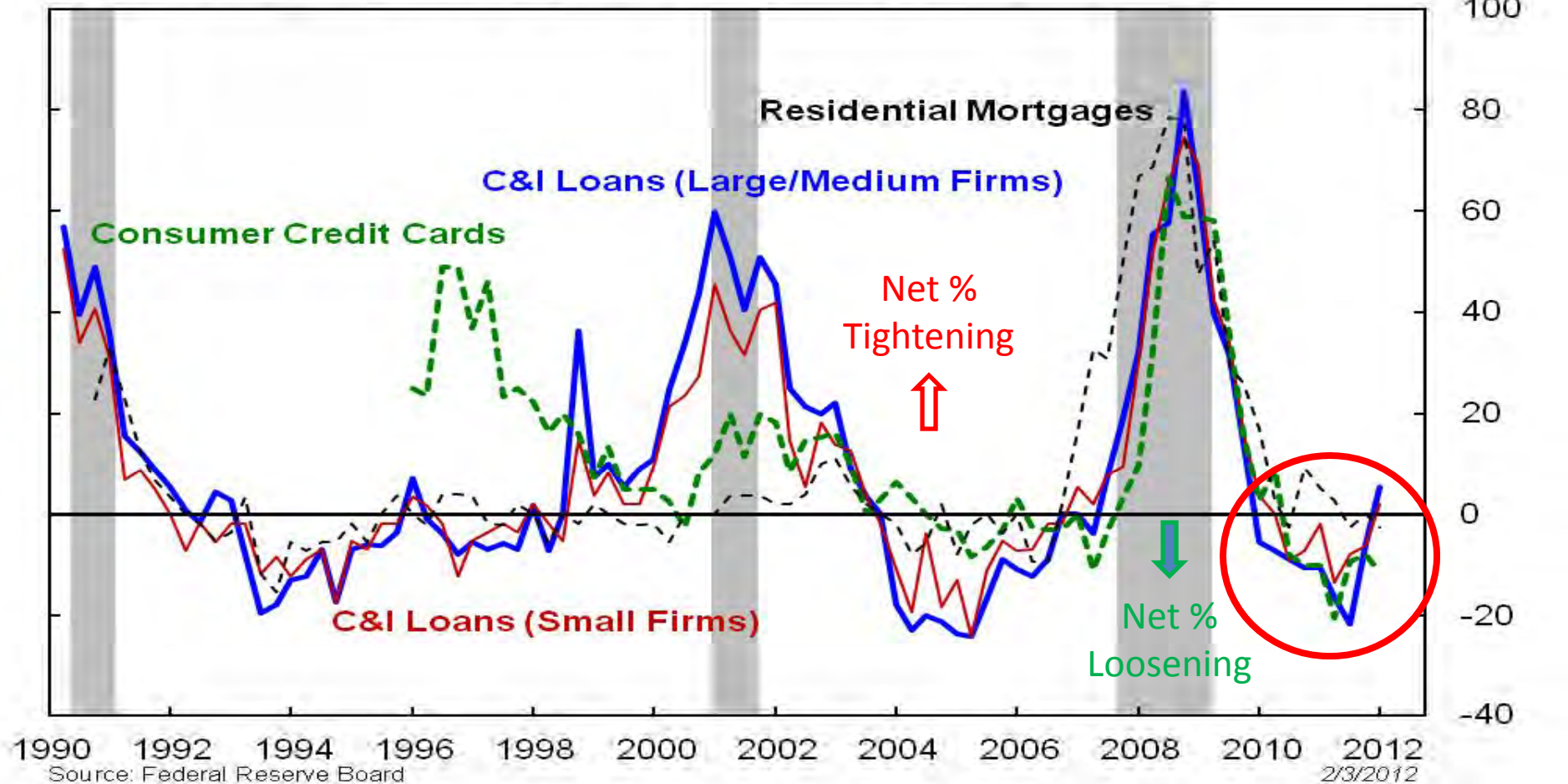


U.S. Bank Lending Standards Continue to Show Net Loosening in 2011, Although Credit Remains Tight for Many Households and Small Businesses

FRB Sr. Loan Officer Opinion Survey by Loan Type

Net percentage reporting tightening of lending standards

Percent



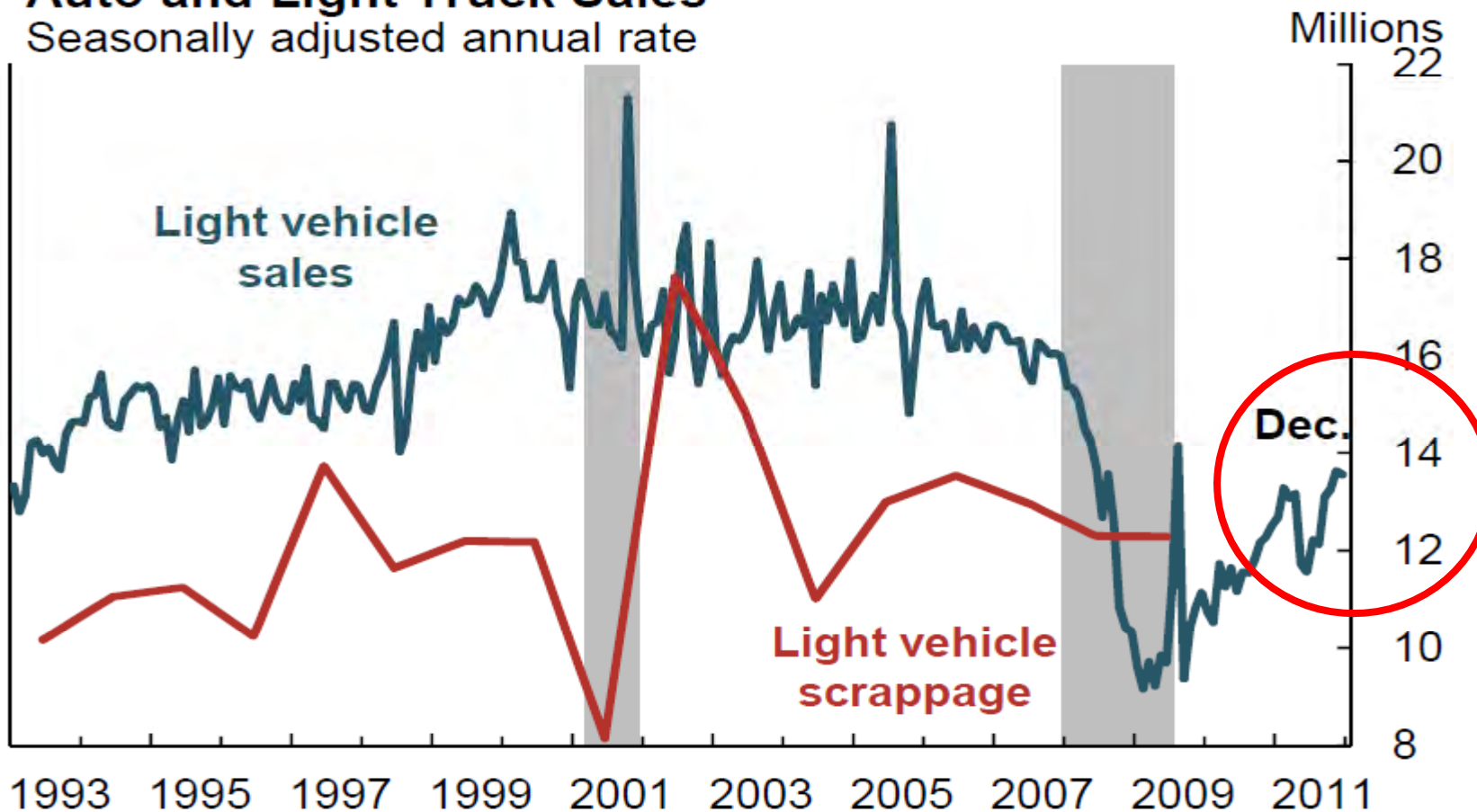
Source: Federal Reserve Board

2/3/2012

Auto Sales Continue to Recover

Auto and Light Truck Sales

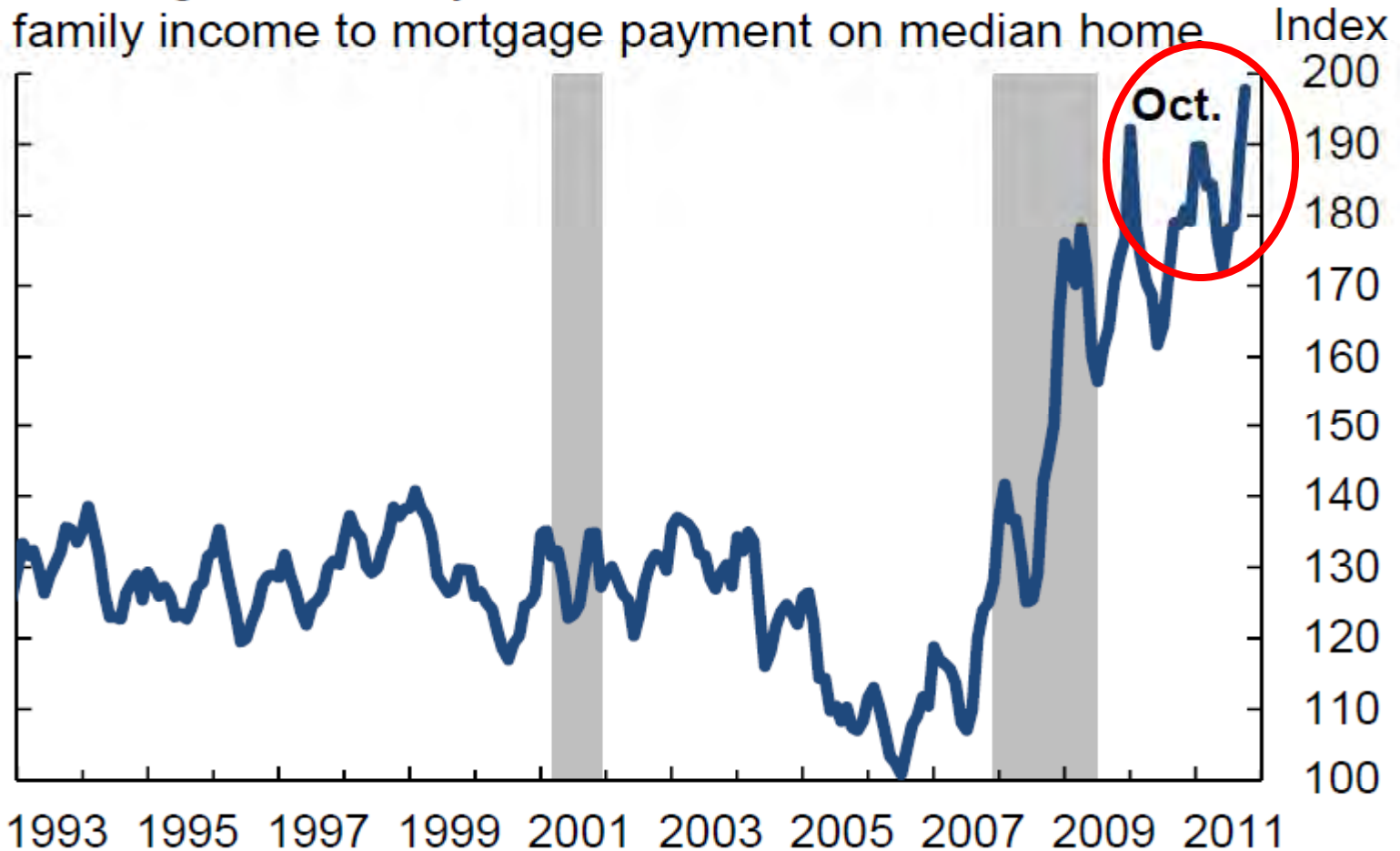
Seasonally adjusted annual rate



Source: AutoData/Haver Analytics

Housing Affordability at an All-Time High

Housing Affordability Index = Ratio of 1/4 median family income to mortgage payment on median home

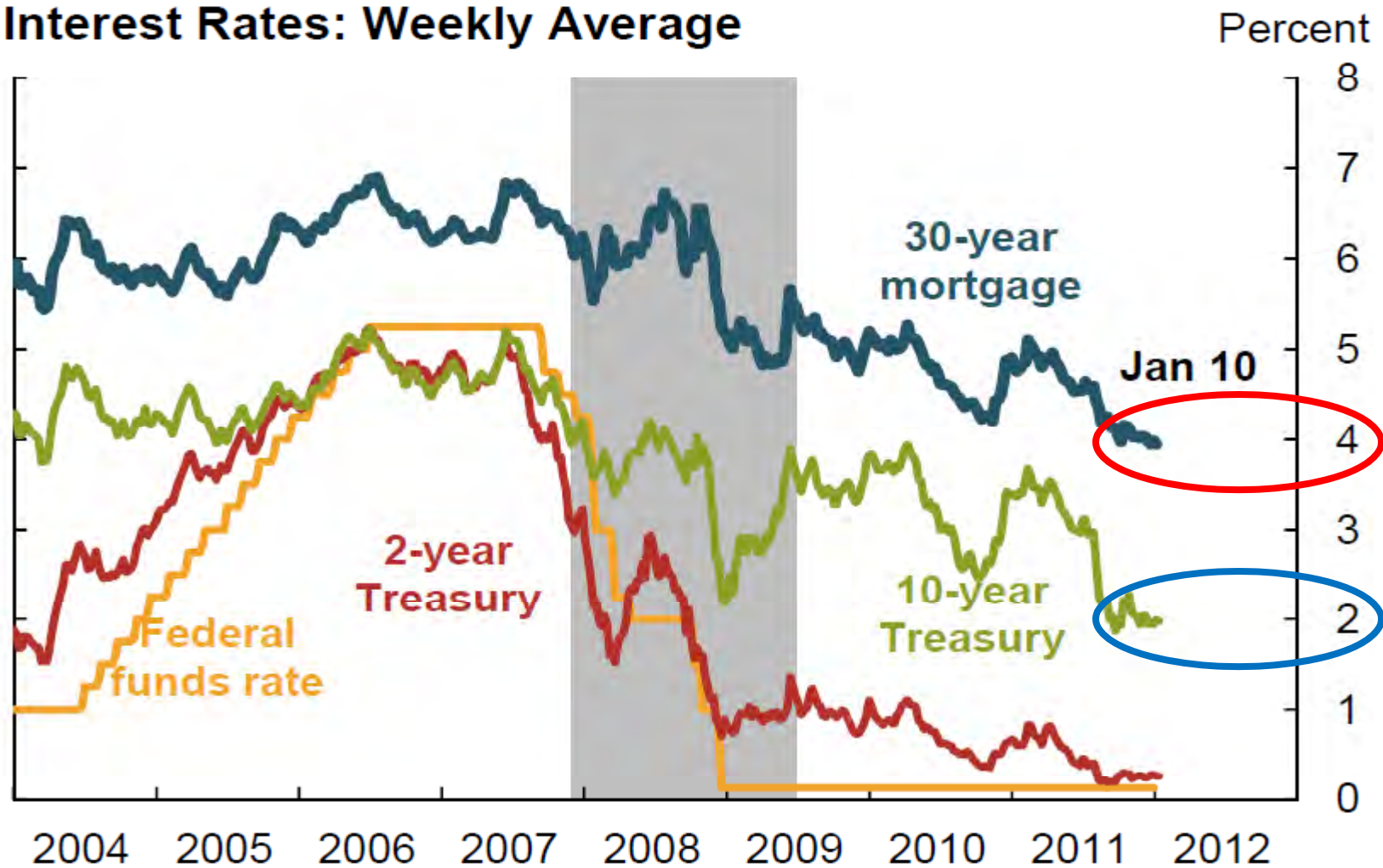


Source: National Association of Realtors/Haver Analytics

FEDVIEWS JANUARY, 2012

Mortgage Rates at Historic Lows

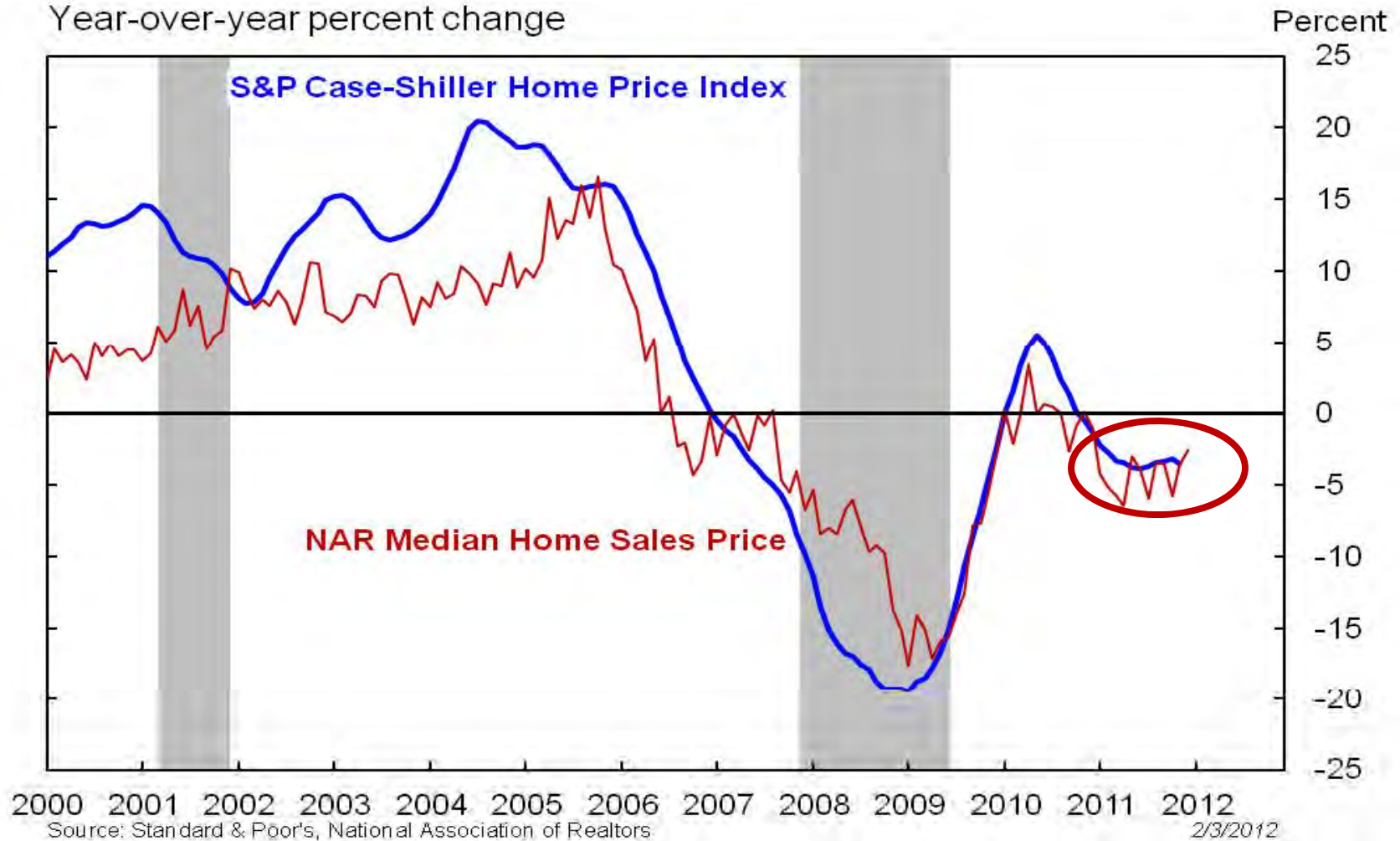
Interest Rates: Weekly Average



National Housing Prices Are Slipping by Most Measures (Year-over-year percent changes)

House Price Changes

Year-over-year percent change



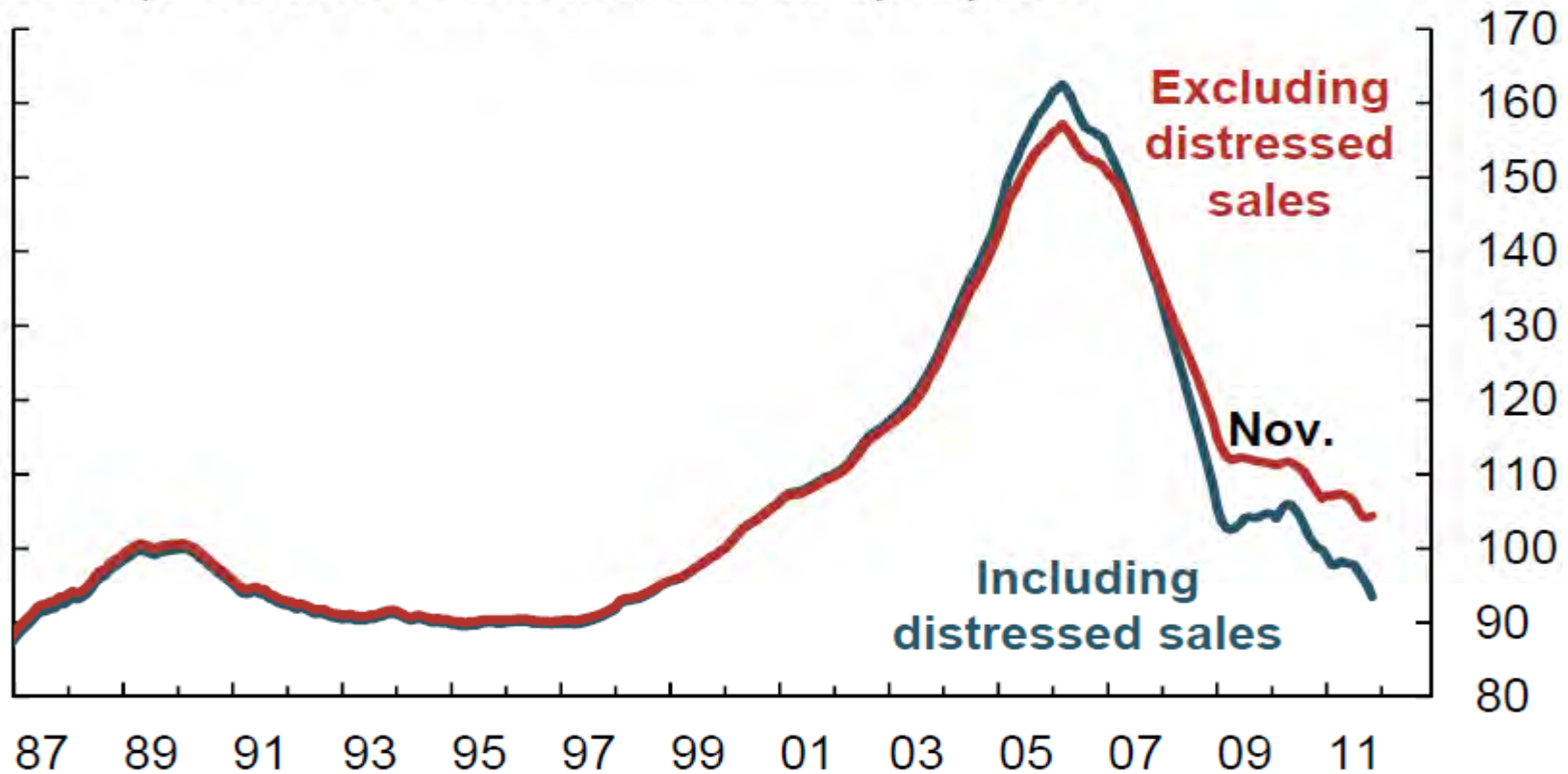


Price-to-Rent Ratios Back to Lower Levels

Residential Price-to-Rent Index

Home prices relative to rents; seasonally adjusted

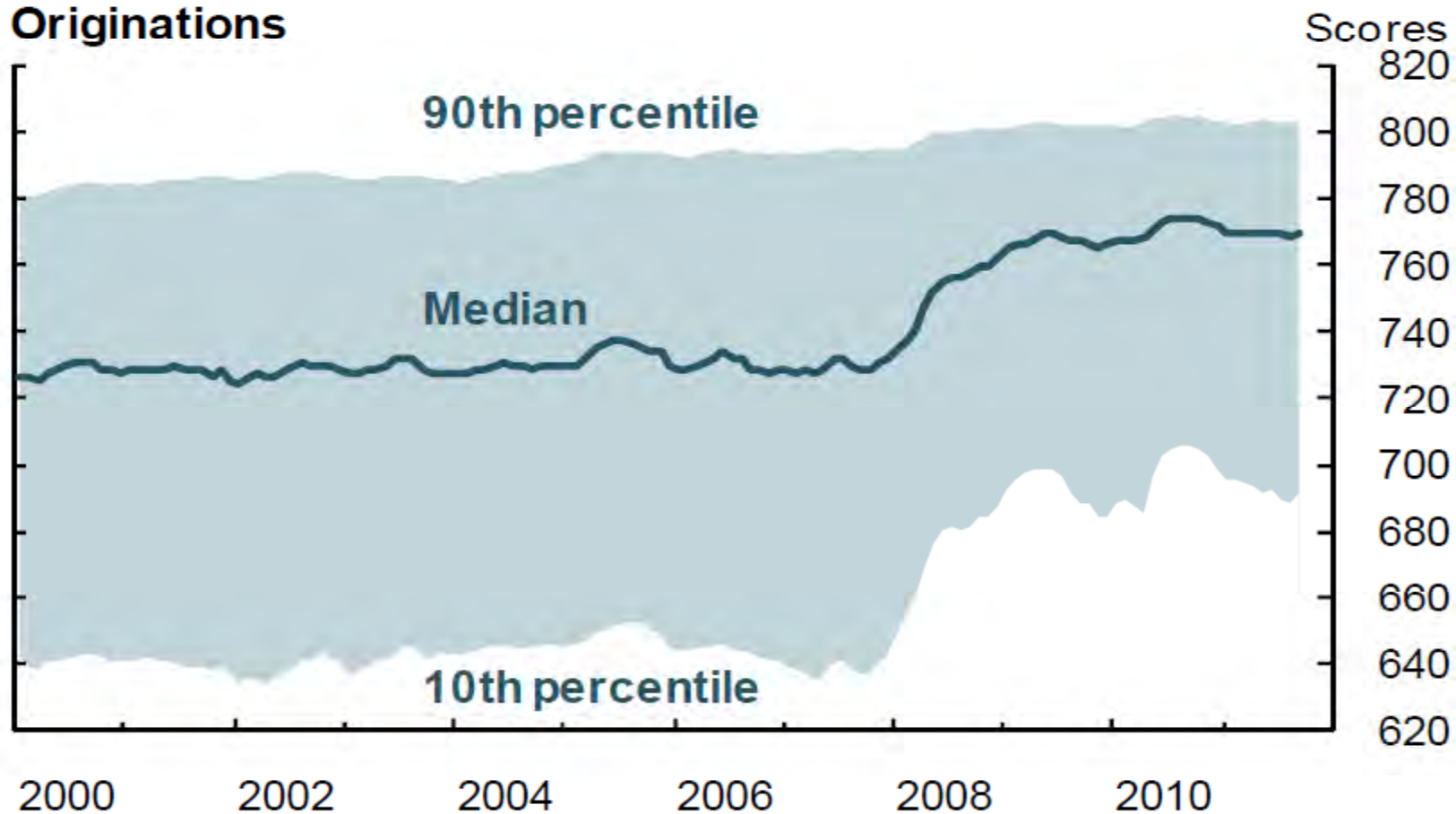
1/1/2000=100



Ratio calculated with CoreLogic National Home Price Index, relative to primary residence's rent component of CPI.

Mortgage Standards Remain Very Tight

Credit Scores on Newly Originated Prime Mortgage Purchase Originations

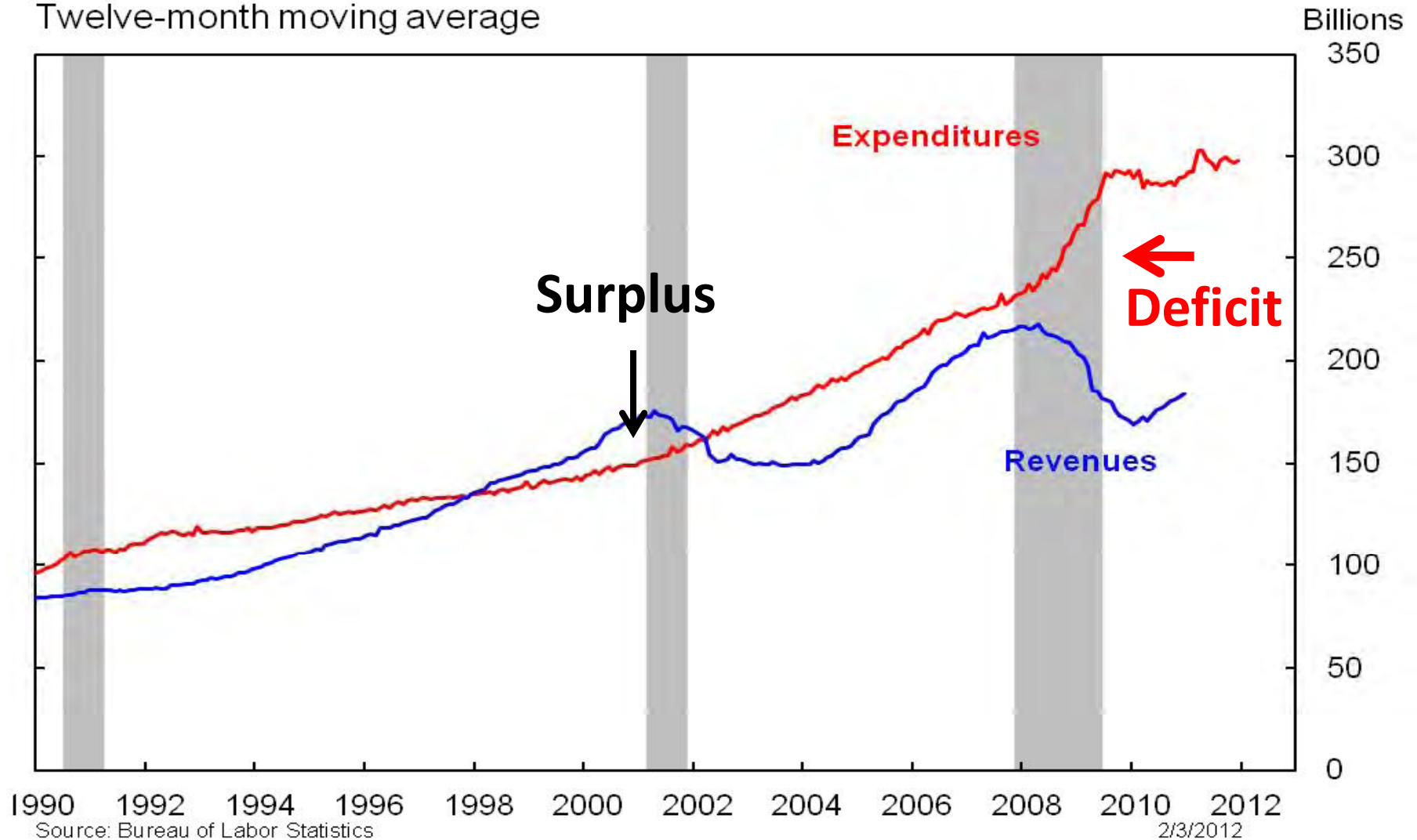


Source: Calculations from LPS Applied Analytics data

Contractionary Federal Fiscal Policy Subtracted 0.6 Percentage Points from the Real GDP Growth Rate in 2011:Q4

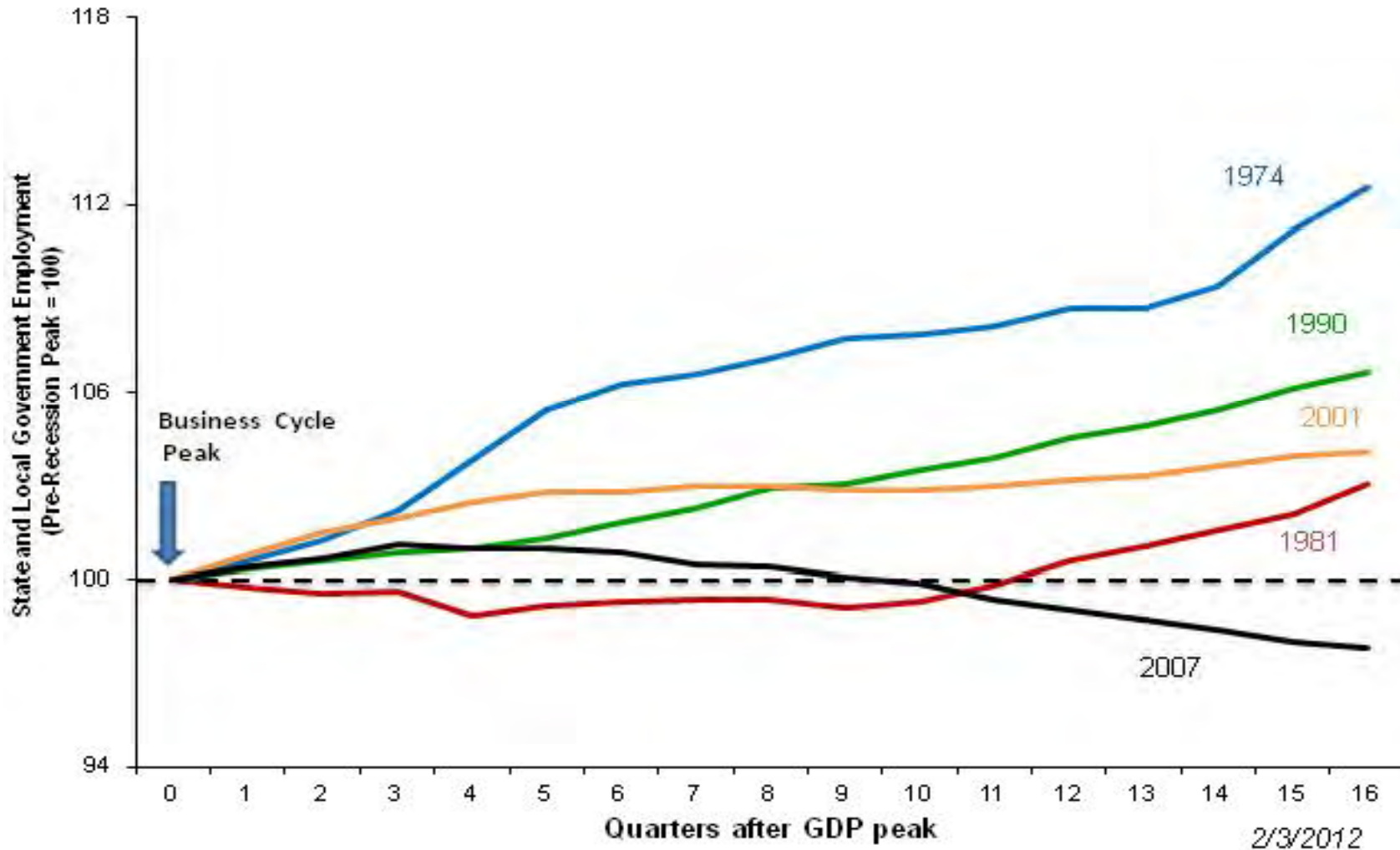
Federal Expenditures and Receipts

Twelve-month moving average



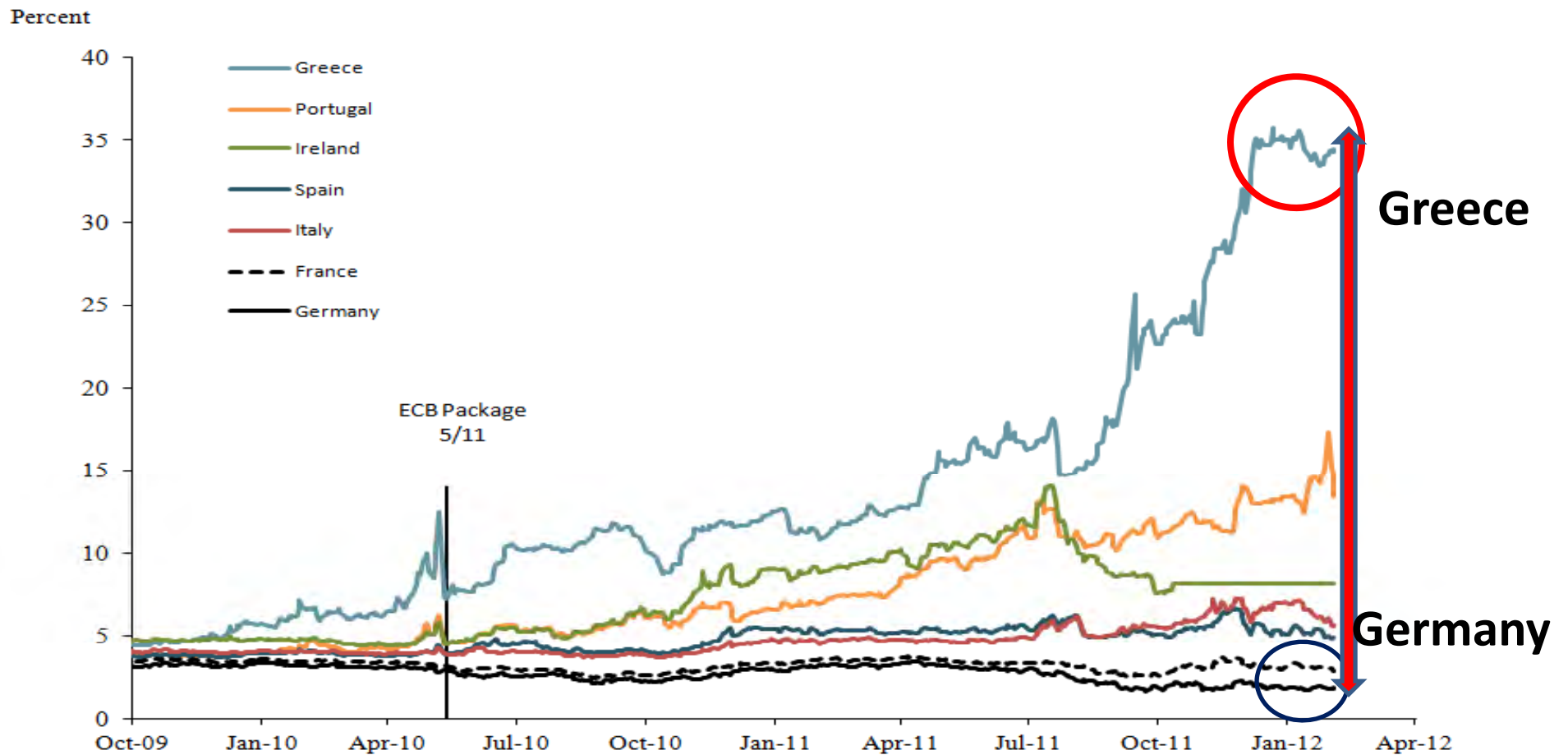
State & Local Governments Continue to Shed Jobs; Sector Subtracted 0.3 Percentage Points from GDP Growth in 2011:Q4

State and Local Government Employment Relative to Previous Recessions



European Debt Crisis Continues to Generate Significant Uncertainty and Raises Concerns about Spillover Effects

10-Year Government Bond Yields

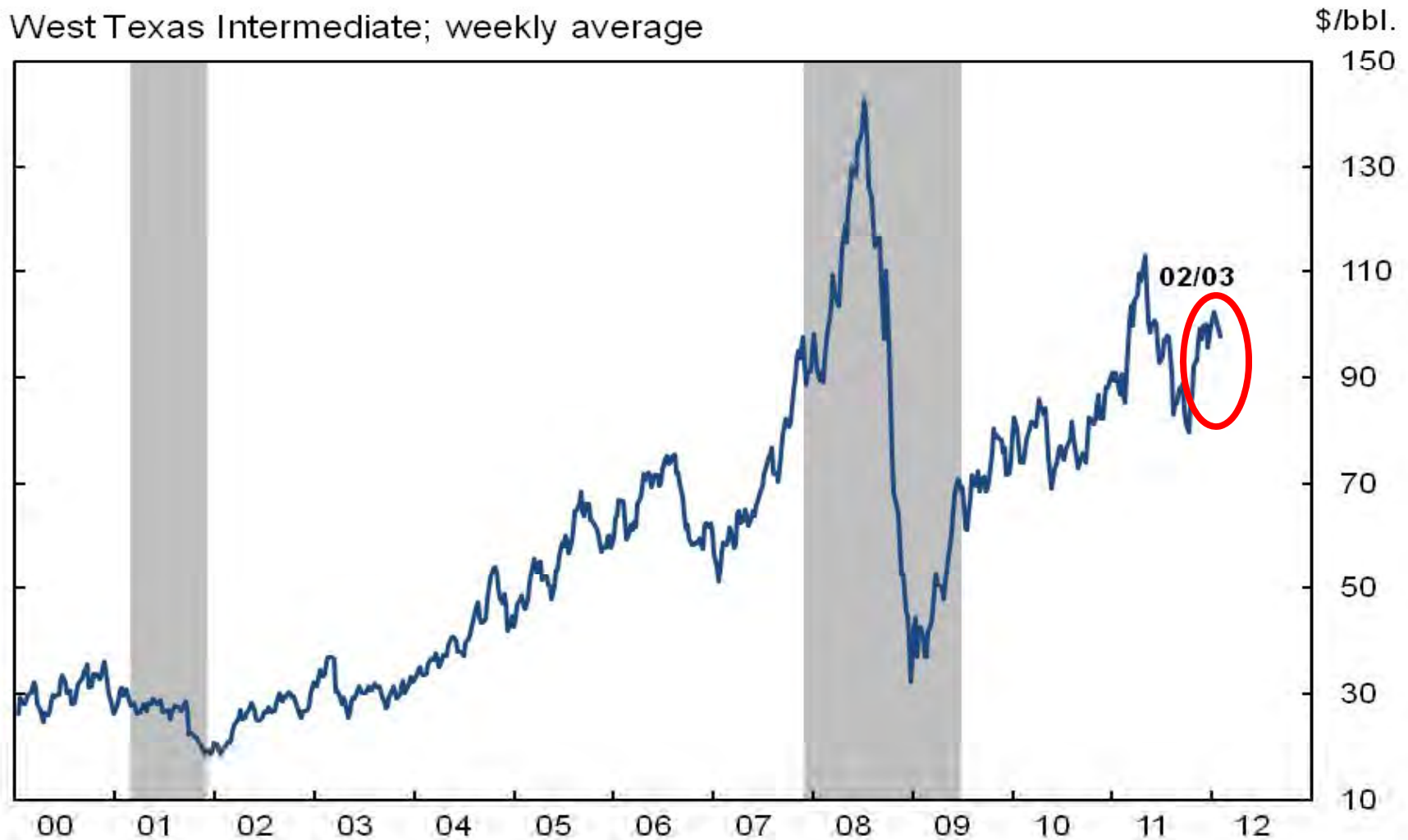


Source: Bloomberg

Oil Prices Are Below 2011 Peak, but Periodic Increases Add to Concerns About Consumer Spending and Inflation

Price of Oil

West Texas Intermediate; weekly average



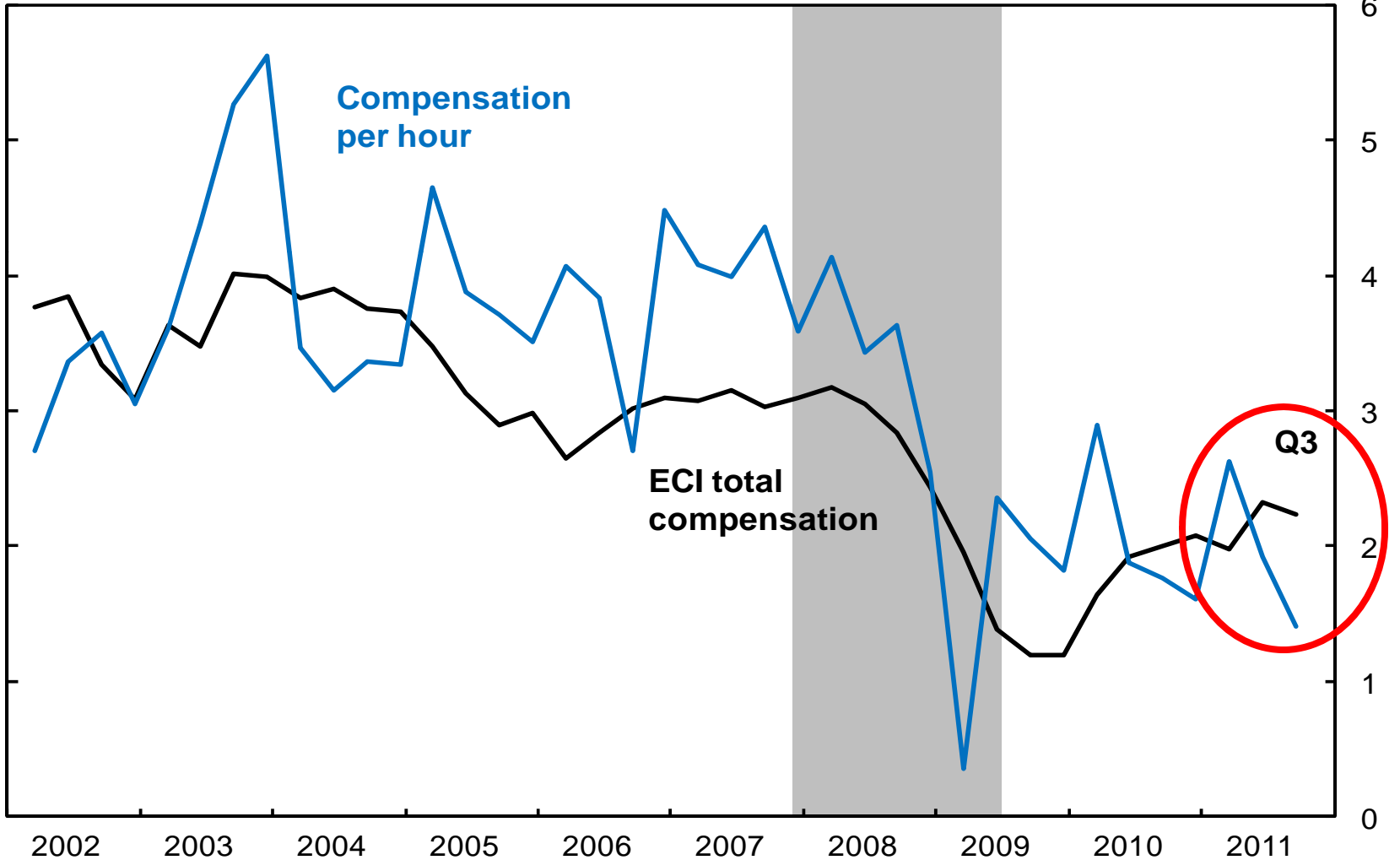
Source: Bloomberg.

Modest Wage Growth Anchors Costs/Prices

Compensation Growth

Percent change from same period one-year earlier

Percent

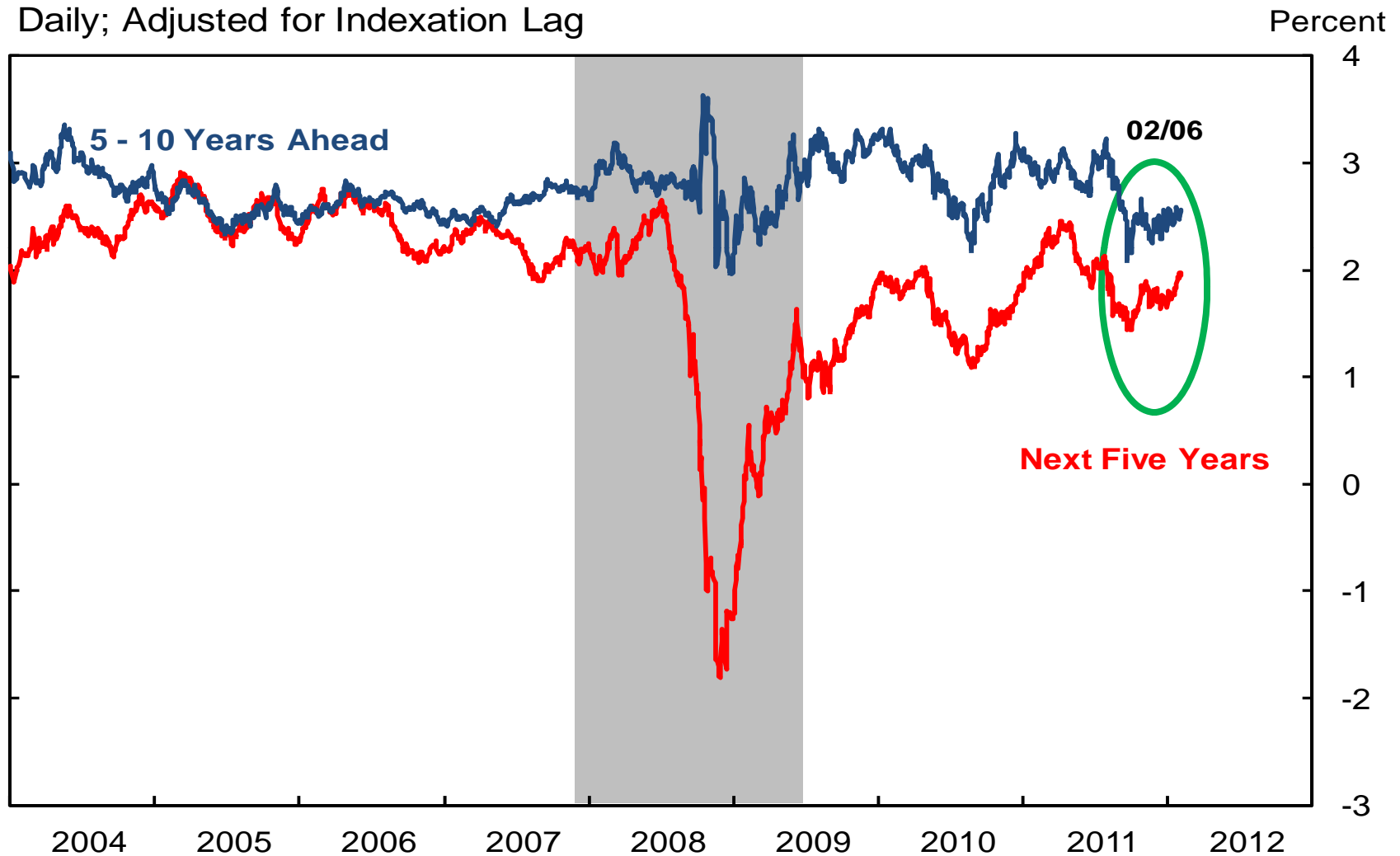


Source: BLS.

TIPS Inflation Expectations Remain Anchored (An Important Factor for the Inflation Outlook)

TIPS Implied Inflation Compensation

Daily; Adjusted for Indexation Lag



Source: Federal Reserve Board.



FRBSF ECONOMIC FORECAST

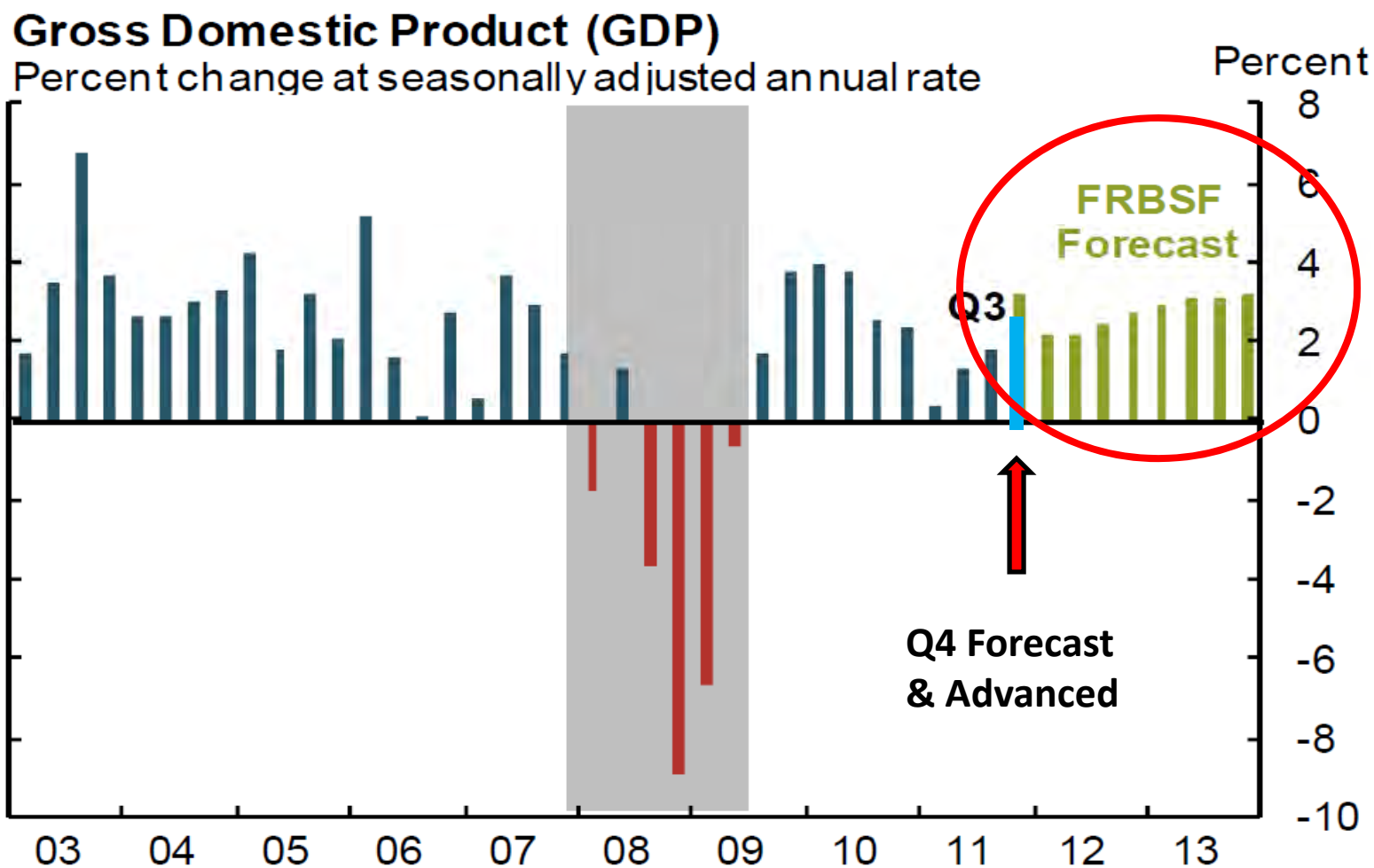
(*FEDVIEWS*) JANUARY 12, 2011

<http://www.frbsf.org/index.html>

The next *FedViews* is scheduled to be released on or before February 13, 2012.
You can find it online at:

<http://www.frbsf.org/publications/economics/fedviews/index.php>

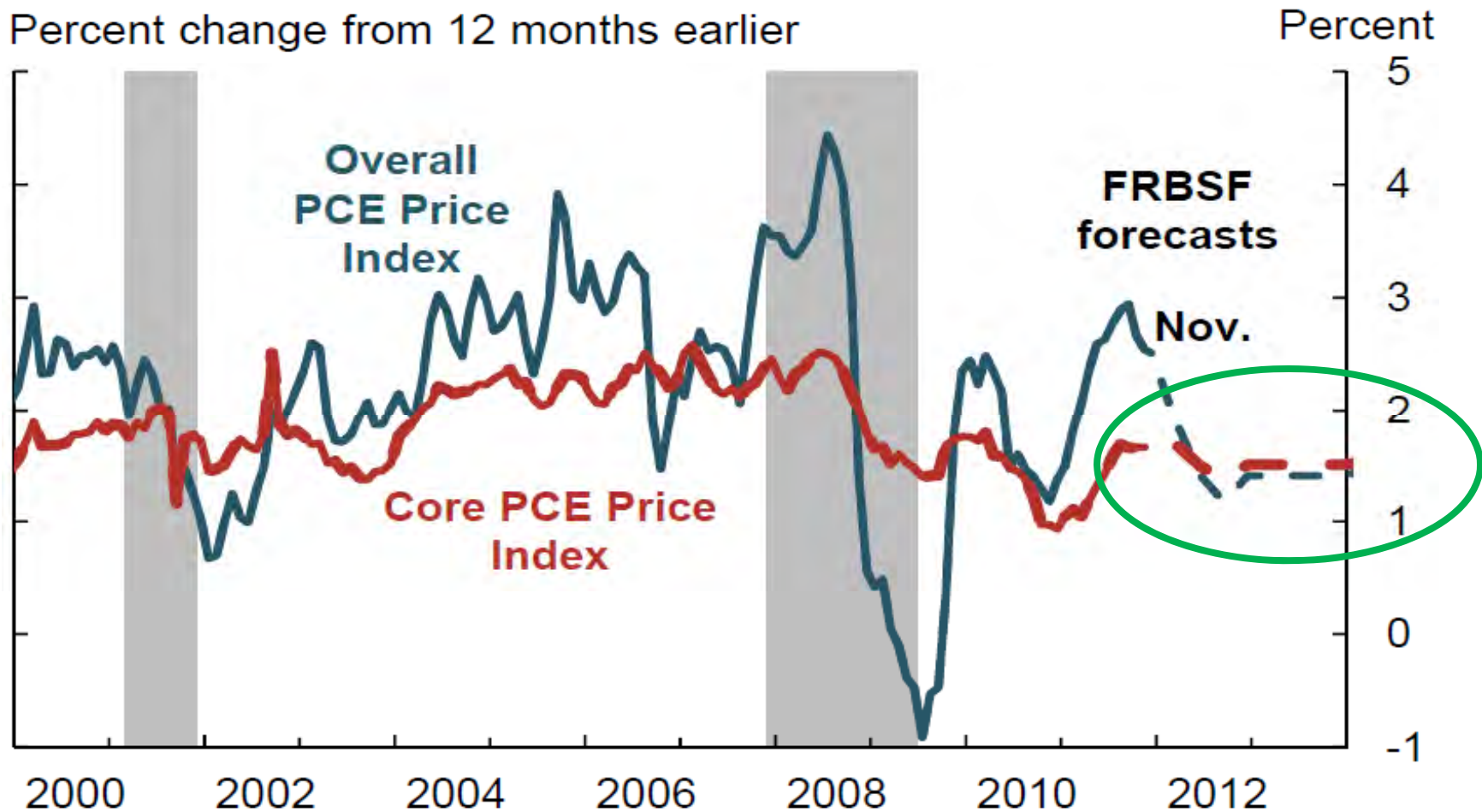
*Growth Expected to Moderate in 2012
Following Inventory Surge that
Pushed Up 2011:Q4 Real GDP Growth Rate*



Overall Inflationary Pressures to Ease Over Time

PCE Inflation

Percent change from 12 months earlier



Source: January 2012 Fedviews

<http://www.frbsf.org/publications/economics/fedviews/index.php>

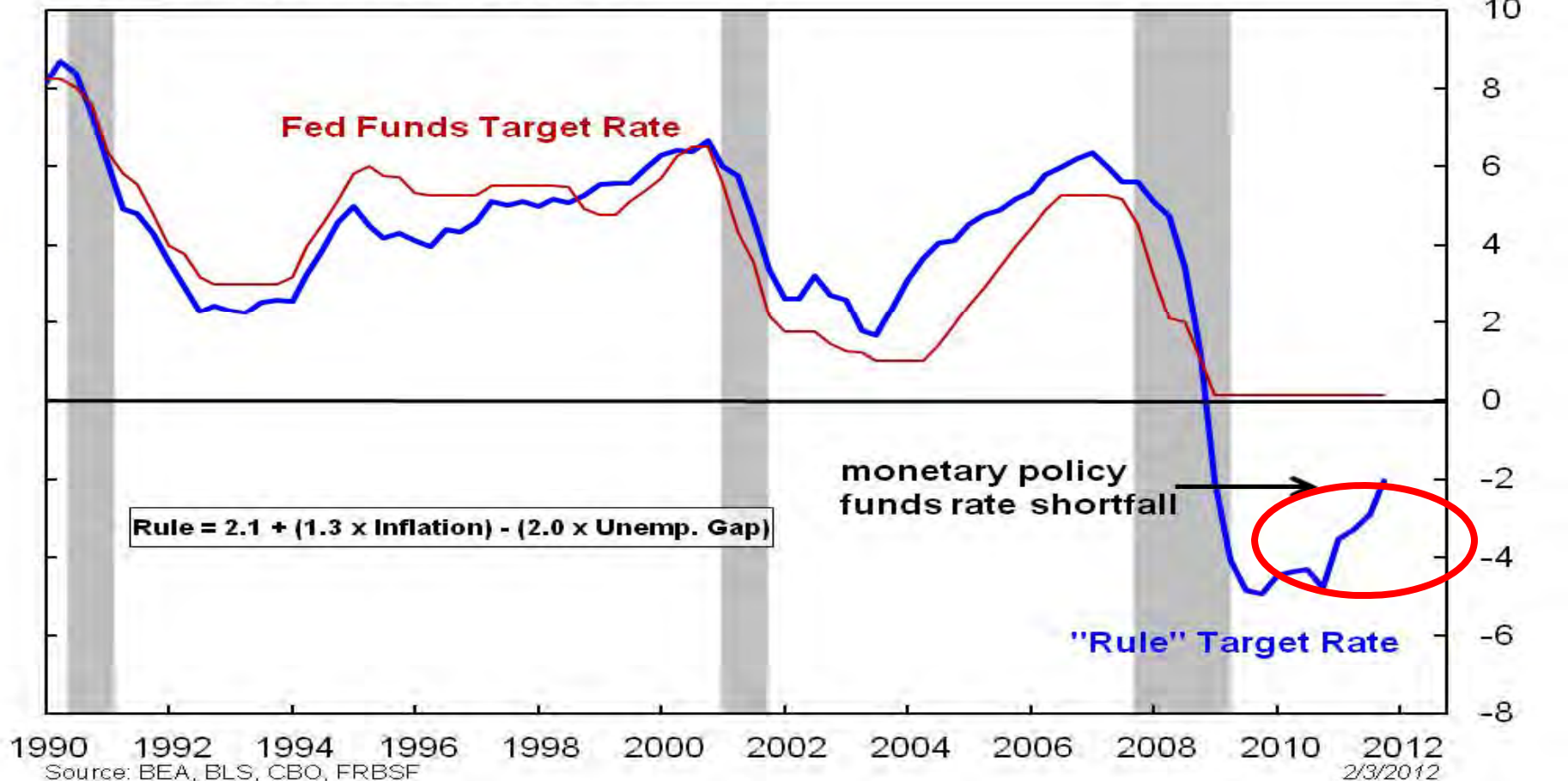
MONETARY POLICY

Traditional Monetary Policy Tool (Overnight Fed Funds Rate) Is Not Sufficient to Stimulate the Economy (because of the Zero Bound on Interest Rates)

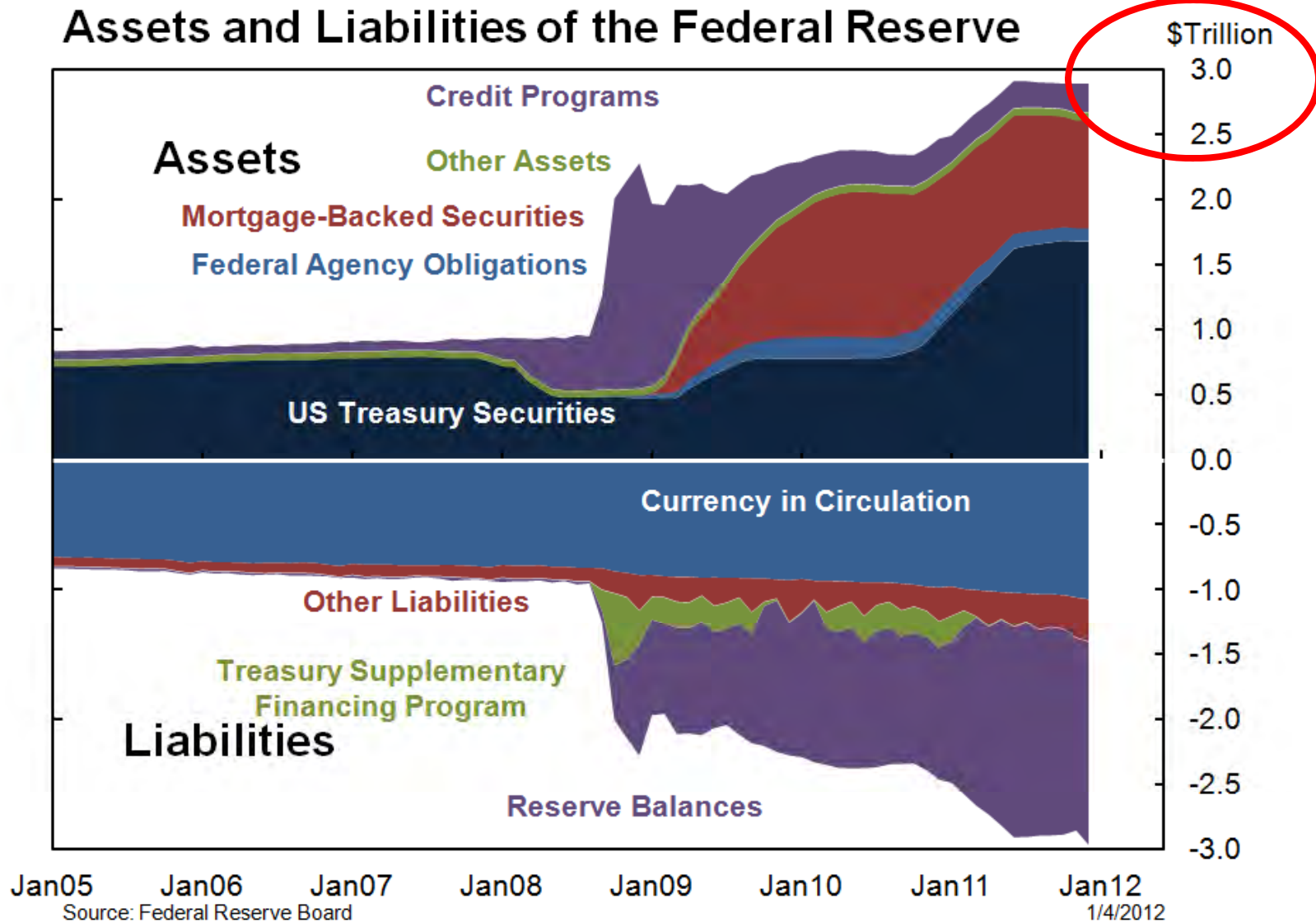
“Implied” Fed Funds Target Rate

In percent; quarterly aggregation

Percent



Balance Sheet Size Remains Stable after Second Round of Large-Scale Asset Purchases Was Completed in June 2011



Large-Scale Asset Purchases (LSAPs) and Maturity Extension Program (“Operation Twist”)

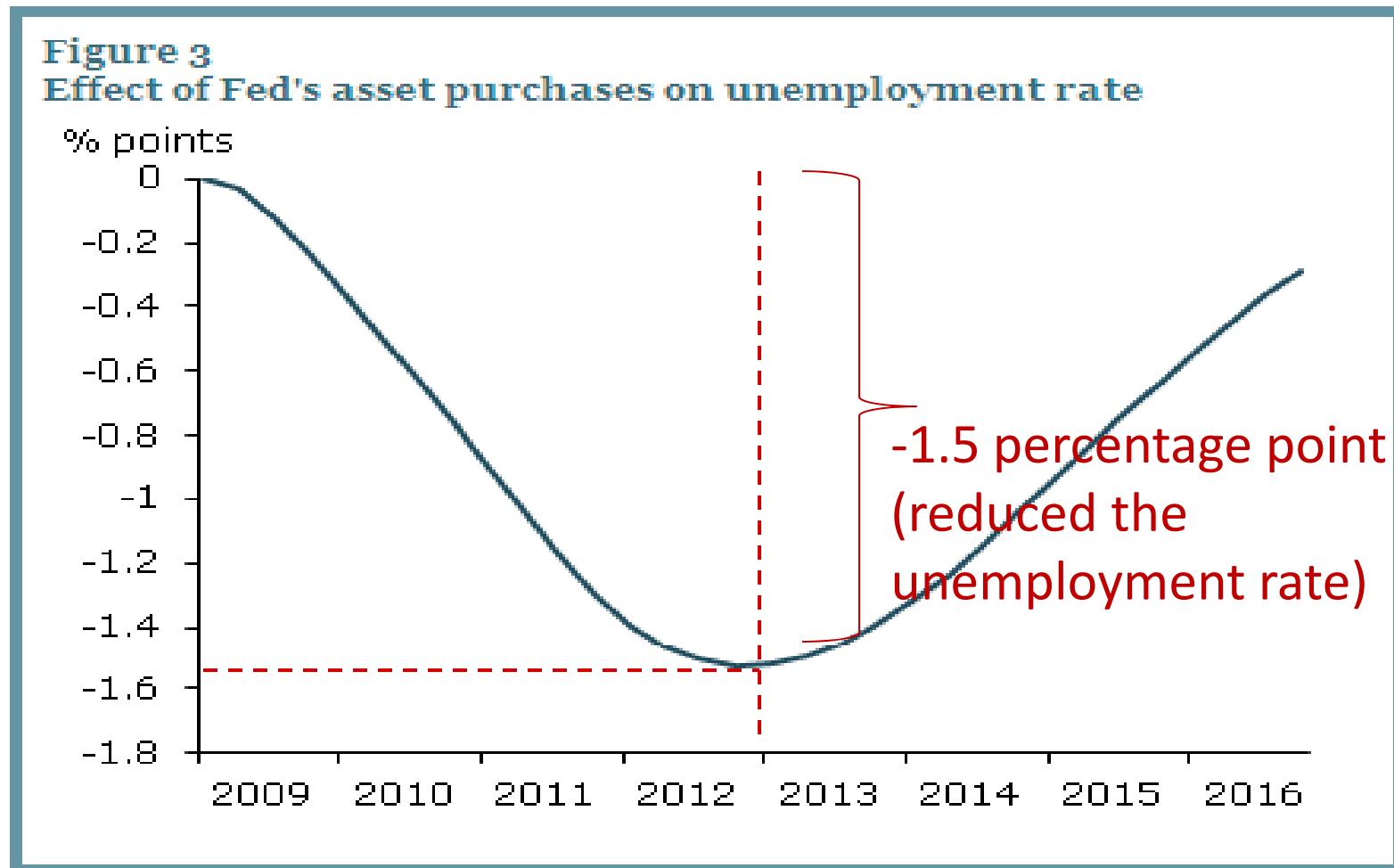
Background

- **First LSAP (November 2008 & March 2009 announcements)** - \$1.25 trillion in agency MBS, \$170 billion in agency debt issued by housing-related government-sponsored enterprises, and \$300 billion in longer-term Treasury securities
- **Second LSAP (November 2010 announcement)** \$600 Billion in longer-term Treasury Securities
- **Maturity Extension Program (Oct. 2011 to June 2012)** \$400 billion maturity extension program for Fed Treasuries

Objectives

- **Reduce longer-term yields**
- **One Estimate for LSAPs:** Chung et. al., suggests in 2011 the combined LSAP purchases reduced rates by about 50 basis points

Estimated Effect of the Fed's Large-Scale Asset Purchase Programs on the Unemployment Rate

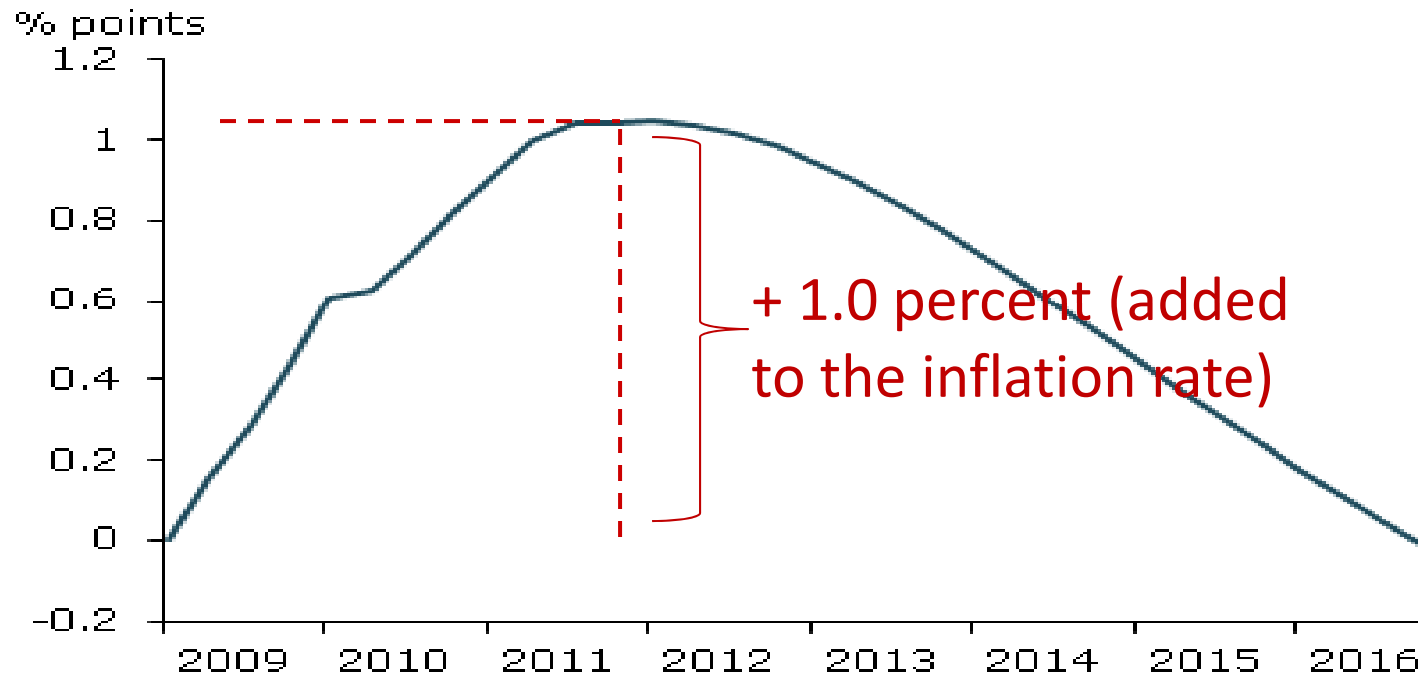


Source: FRBSF *Economic Letter* 2011-03, Chung et.al.

<http://www.frbsf.org/publications/economics/letter/2011/el2011-03.html>

Estimated Effect of the Fed's Large-Scale Asset Purchase Programs on Inflation

Figure 4
Effect of Fed's asset purchases on core inflation
(four-quarter change)



Source: FRBSF *Economic Letter* 2011-03, Williams, et. al.
<http://www.frbsf.org/publications/economics/letter/2011/el2011-03.html>

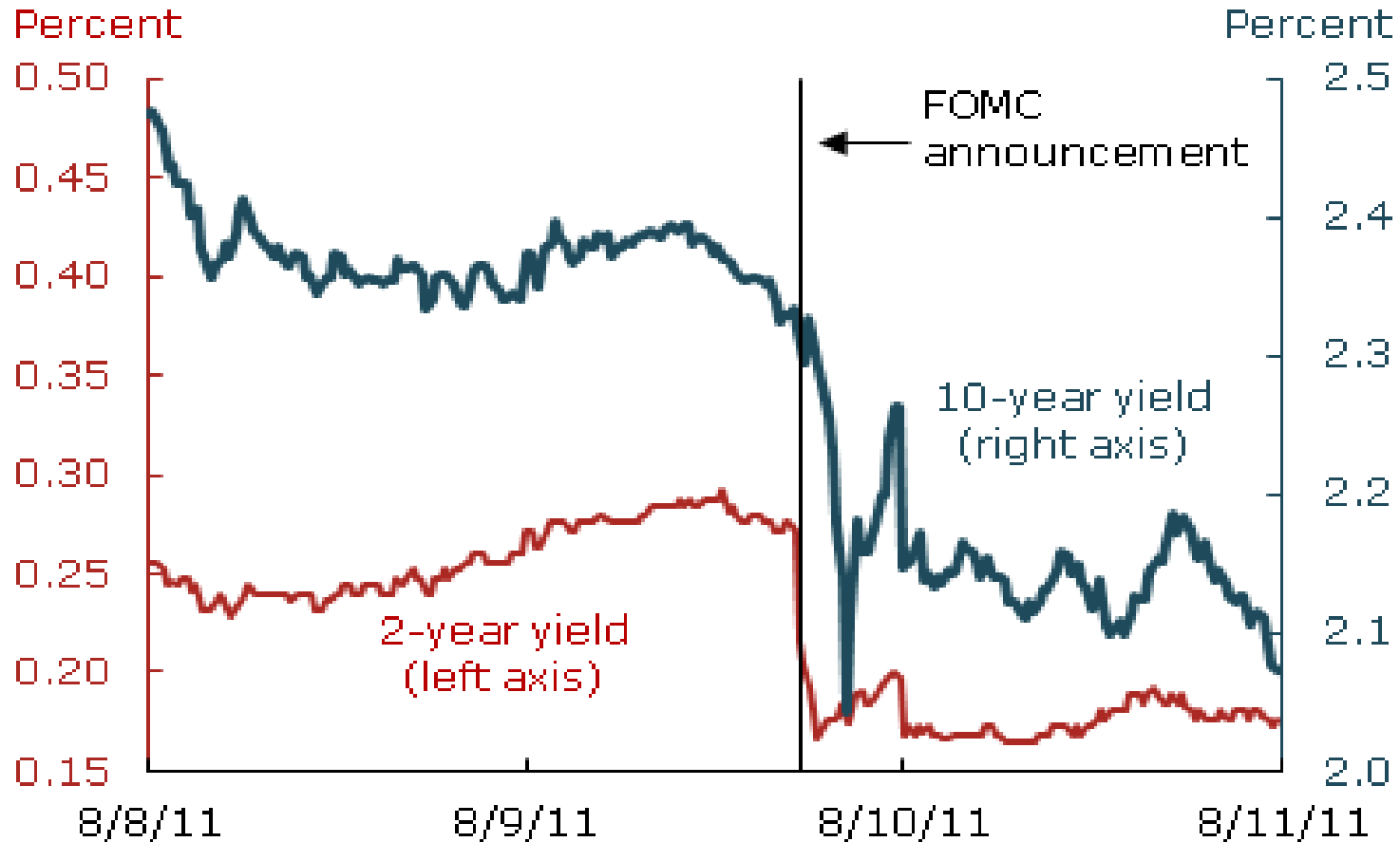
Forward Policy Guidance: A 2011 Case Study

August 2011 FOMC Statement:

“The Committee currently anticipates that economic conditions—including low rates of resource utilization and a subdued outlook for inflation over the medium run—are likely to warrant exceptionally low levels for the federal funds rate at least through mid-2013.”

(<http://www.federalreserve.gov/newsevents/press/monetary/20110809a.htm>)

Impact of August 2011 FOMC Statement on 2-year and 10-year Bond Yields



Source: FRBSF *Economic Letter* 2011-31
<http://www.frbsf.org/publications/economics/letter/2011/el2011-31.html>

FOMC Communications of January 25: FOMC Statement, Projections Materials & Longer-Run Goals and Strategy

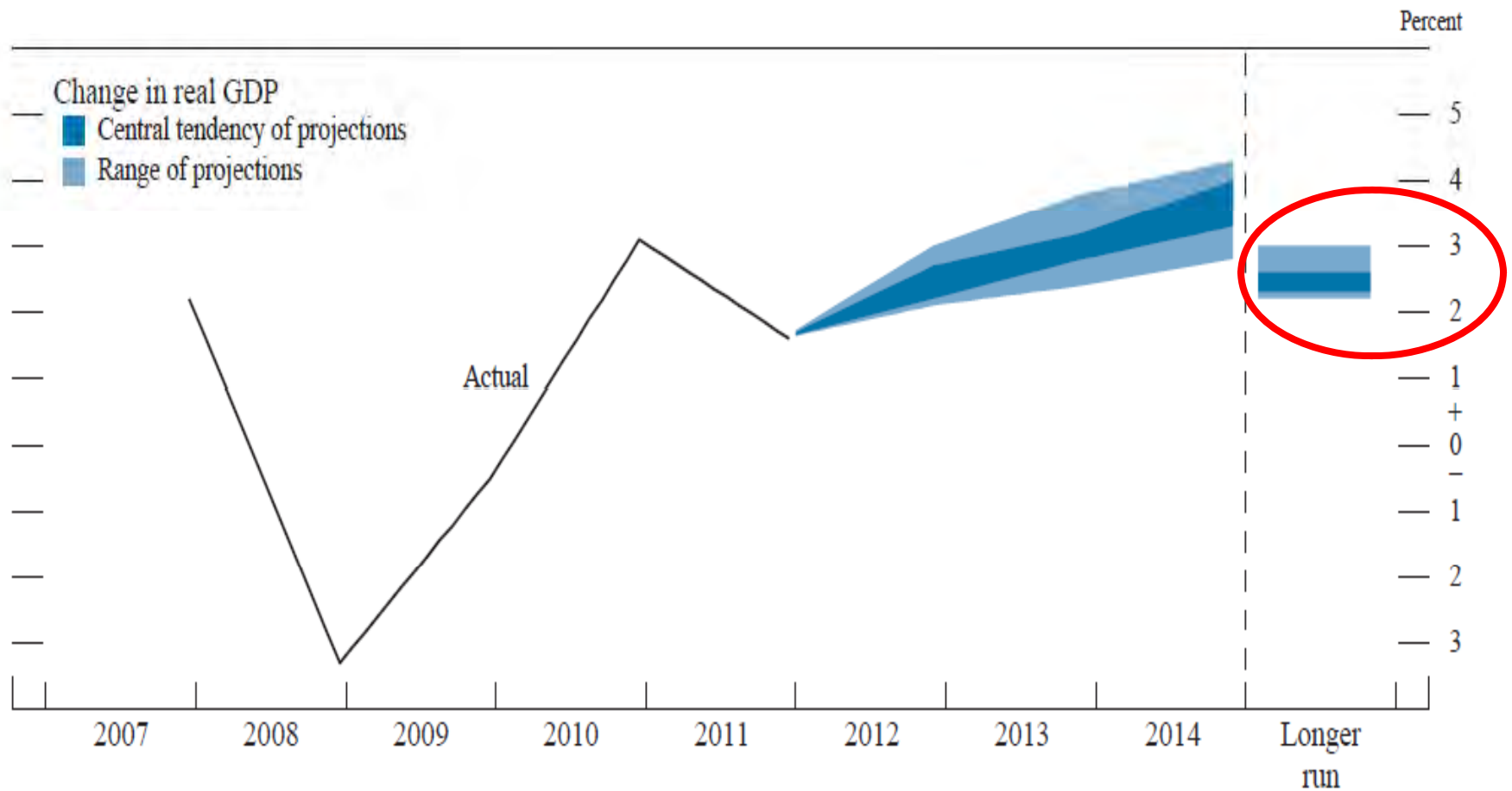
Federal Open Market Committee (FOMC):

- Committed to **statutory mandate from Congress** promoting maximum employment, stable prices, and moderate long-term interest rates.
- Adopts an **inflation rate target of 2 percent**, as measured by the annual change in the price index for personal consumption expenditures.
- “Economic conditions...are likely to warrant exceptionally low levels for the federal funds rate **at least through late-2014.**”

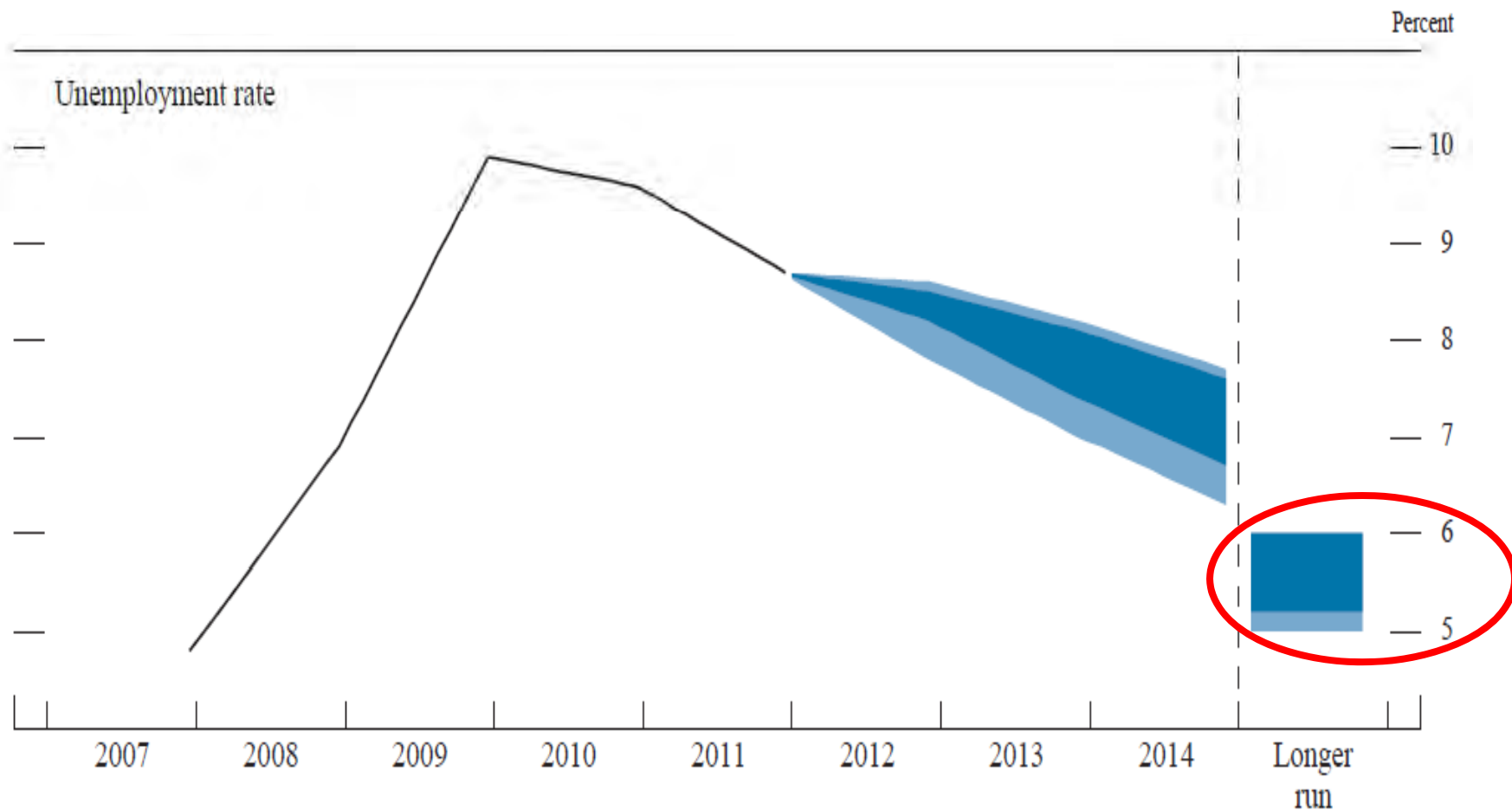
Released Projections for Real GDP, Unemployment Rate, Inflation, and the Fed Funds Rate Target

(<http://www.federalreserve.gov/monetarypolicy/default.htm>)

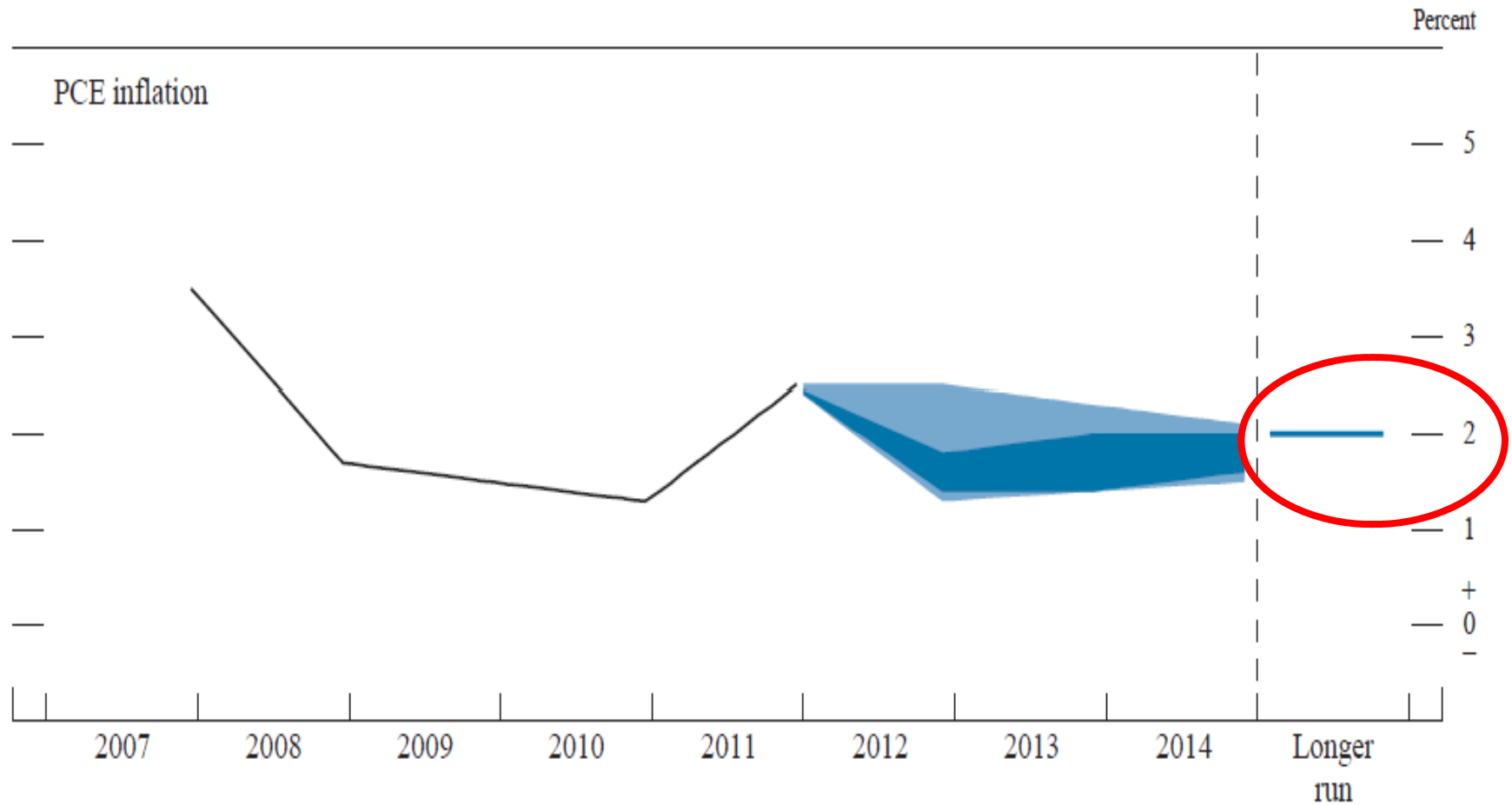
FOMC's GDP Projections



FOMC's Unemployment Projections

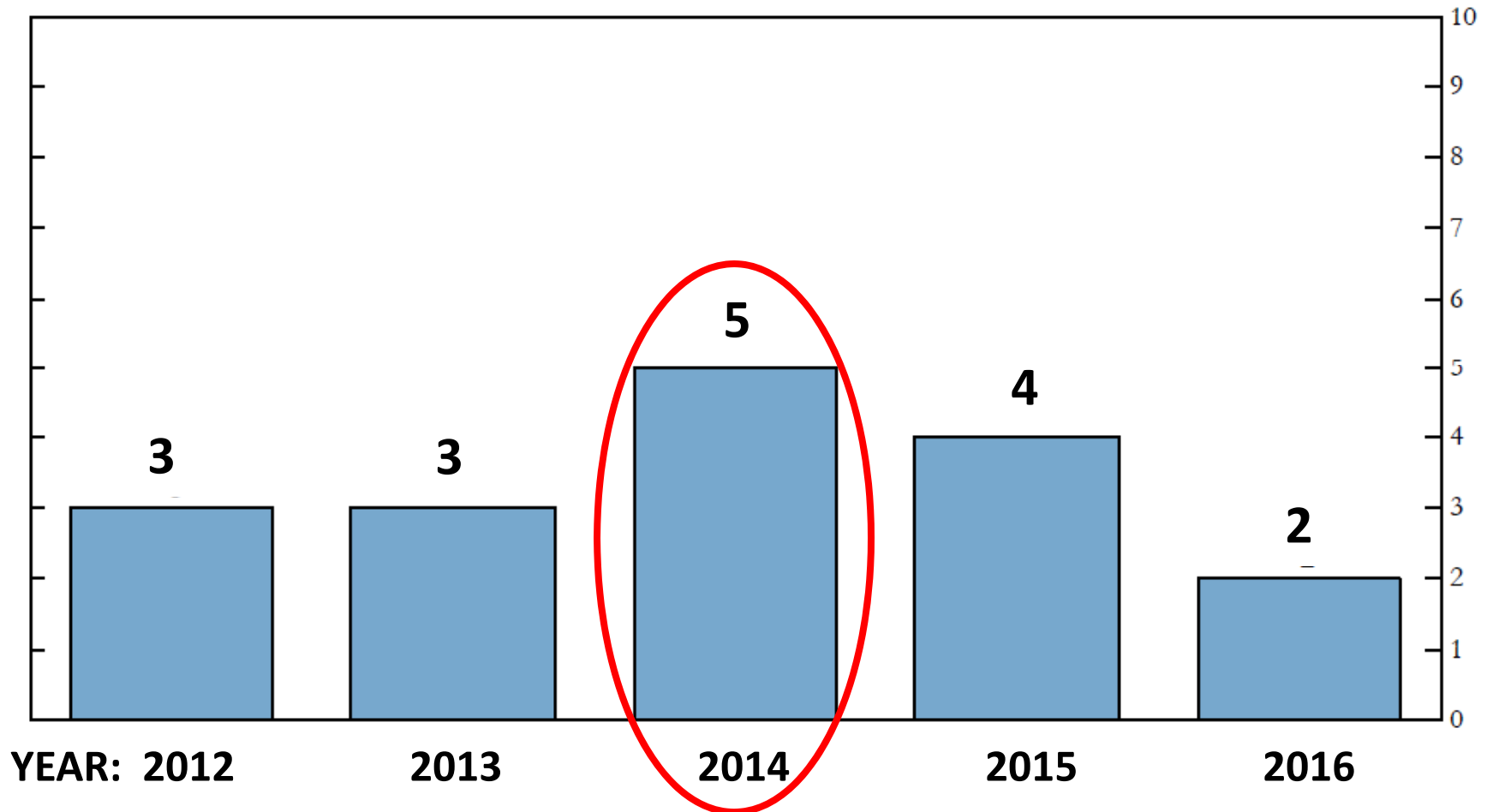


FOMC's Inflation (Headline) Projections



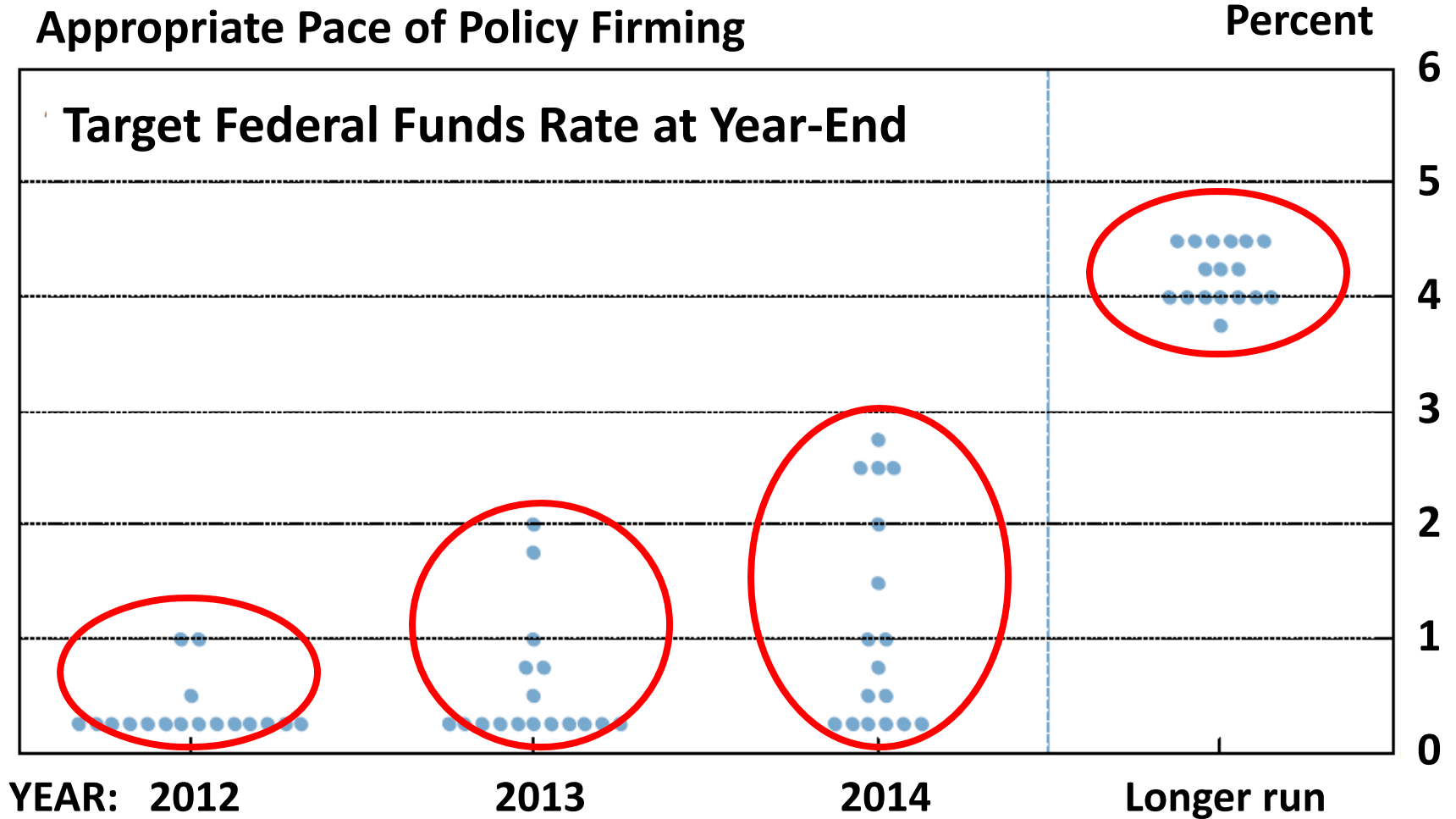
FOMC Target Federal Funds Rate Projections by Year of Increase

Number of FOMC Participants
Expecting Rates to Increase by Year



Appropriate Timing of Policy Firming (Increase in Fed Funds Rate Target)

FOMC Target Federal Funds Rate Projections by Year for Each FOMC Participant



Summary

Economic Outlook

- Economy is expanding moderately
- Modest growth is expected to continue in 2012
- Strains in global financial markets present significant downside risk to the outlook

Monetary Policy Outlook

- FOMC participants' fed funds rate year-end projections (for 2012-2014) are released for the first time
- New FOMC Statement wording: "Economic conditions...are likely to warrant exceptionally low levels for the federal funds rate at least through late-2014."
- New explicit PCE (total) inflation target of 2 percent rate
- Expected to facilitate decision making and reduce uncertainty for households and businesses

QUESTIONS?

Yelena F. Takhtamanova, Economist
Federal Reserve Bank of San Francisco