U.S. Monetary Policy and National Economic Outlook

February 10, 2012

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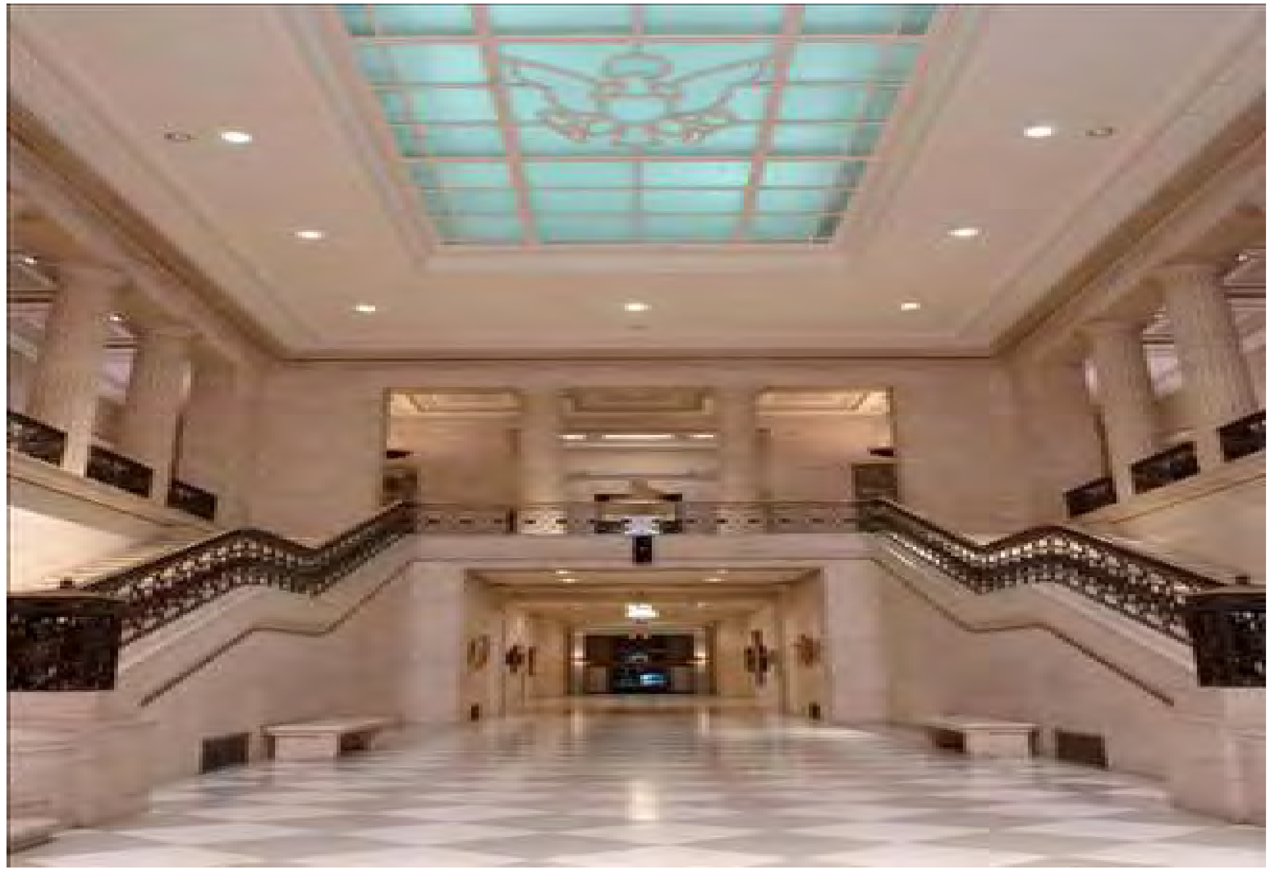
Presentation Overview

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

Federal Reserve System



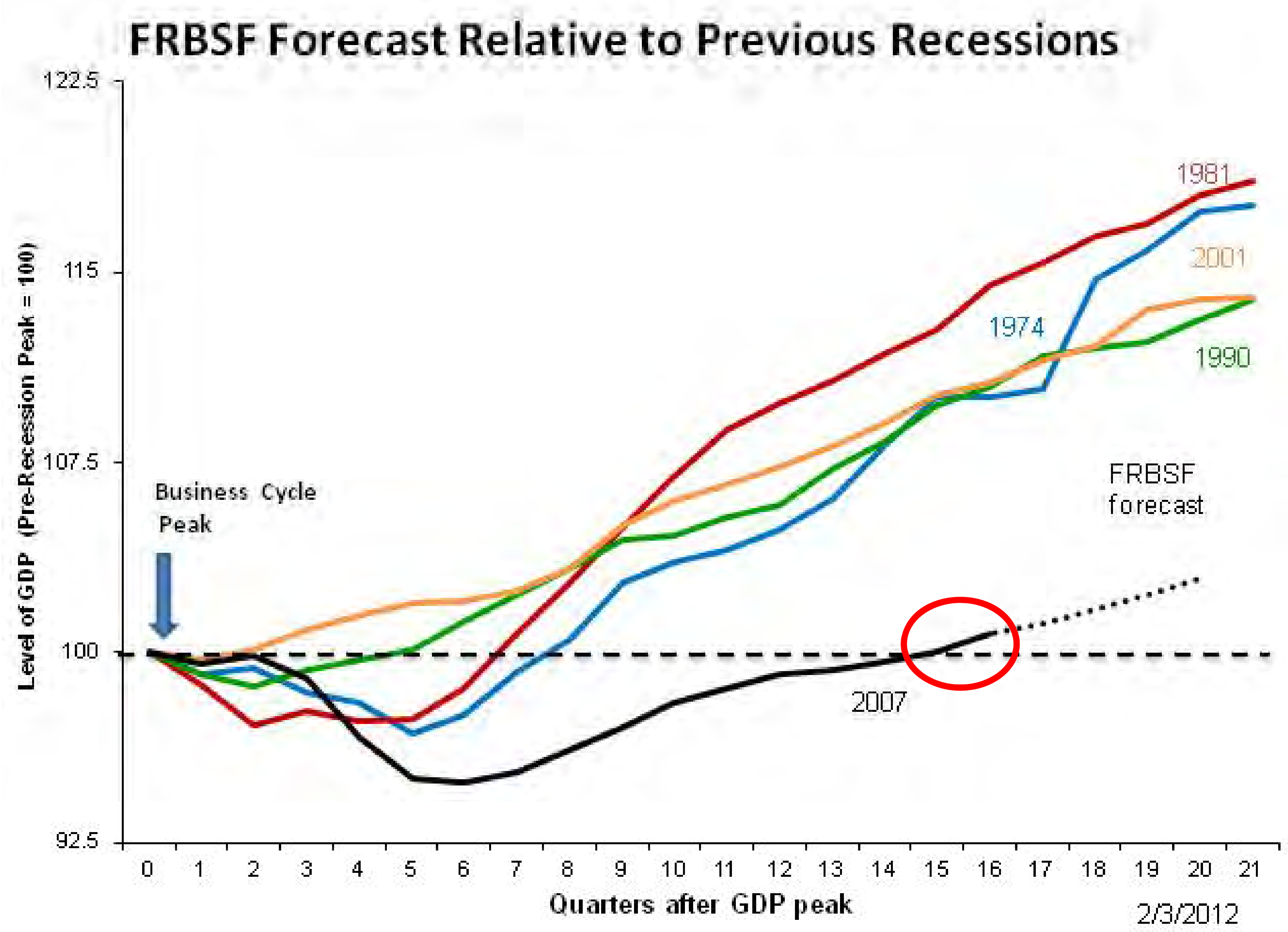
- **Mission**
  - Promote the safety, soundness, and stability of our nation's financial system
- **Monetary Policy Goals**
  - Promote maximum *sustainable* output and employment and stable prices

CURRENT NATIONAL SITUATION

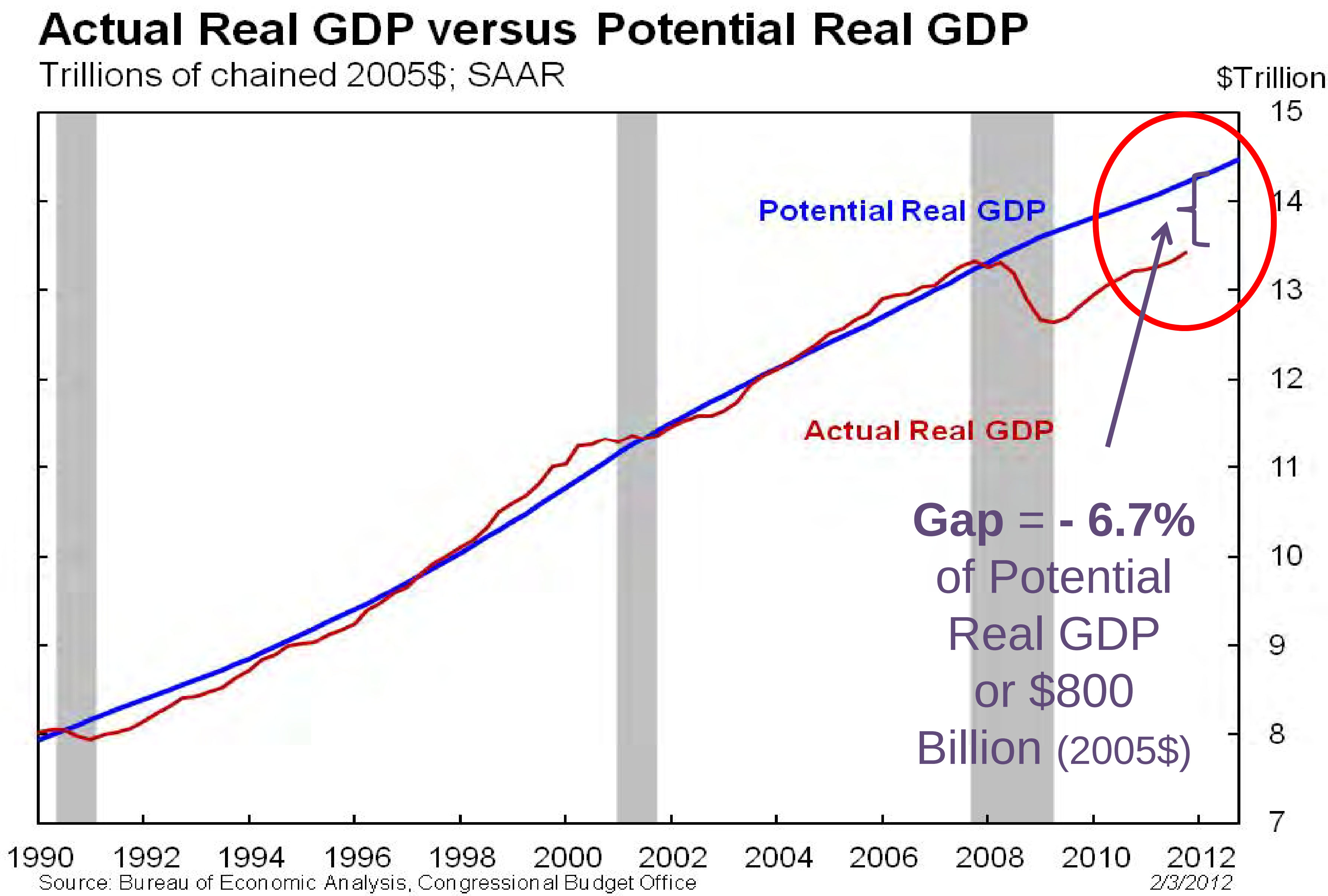
Economic Overview

- **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.**

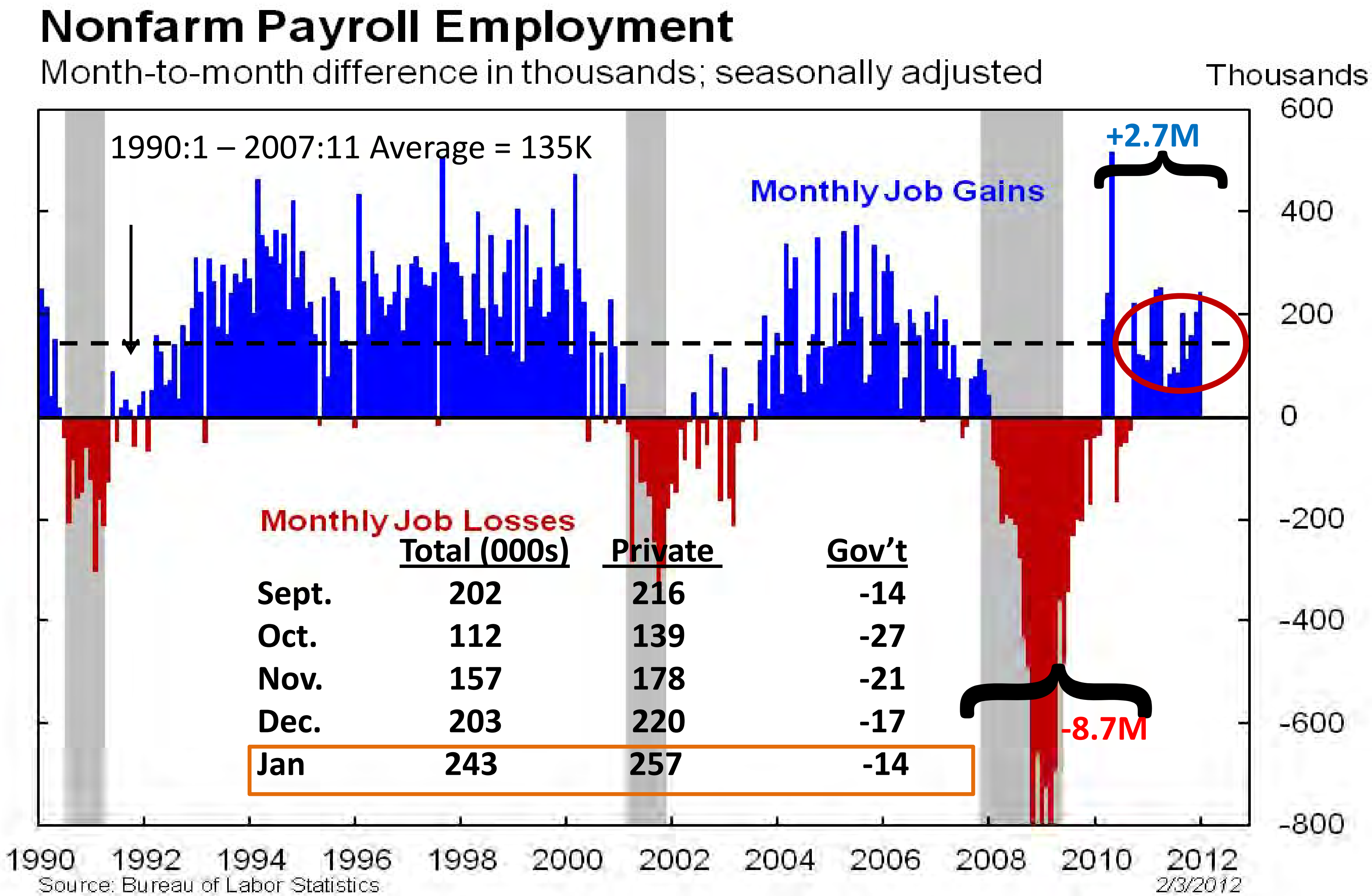
Four Years After the Recession Began, Output has Finally Surpassed Pre-Recession Levels



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

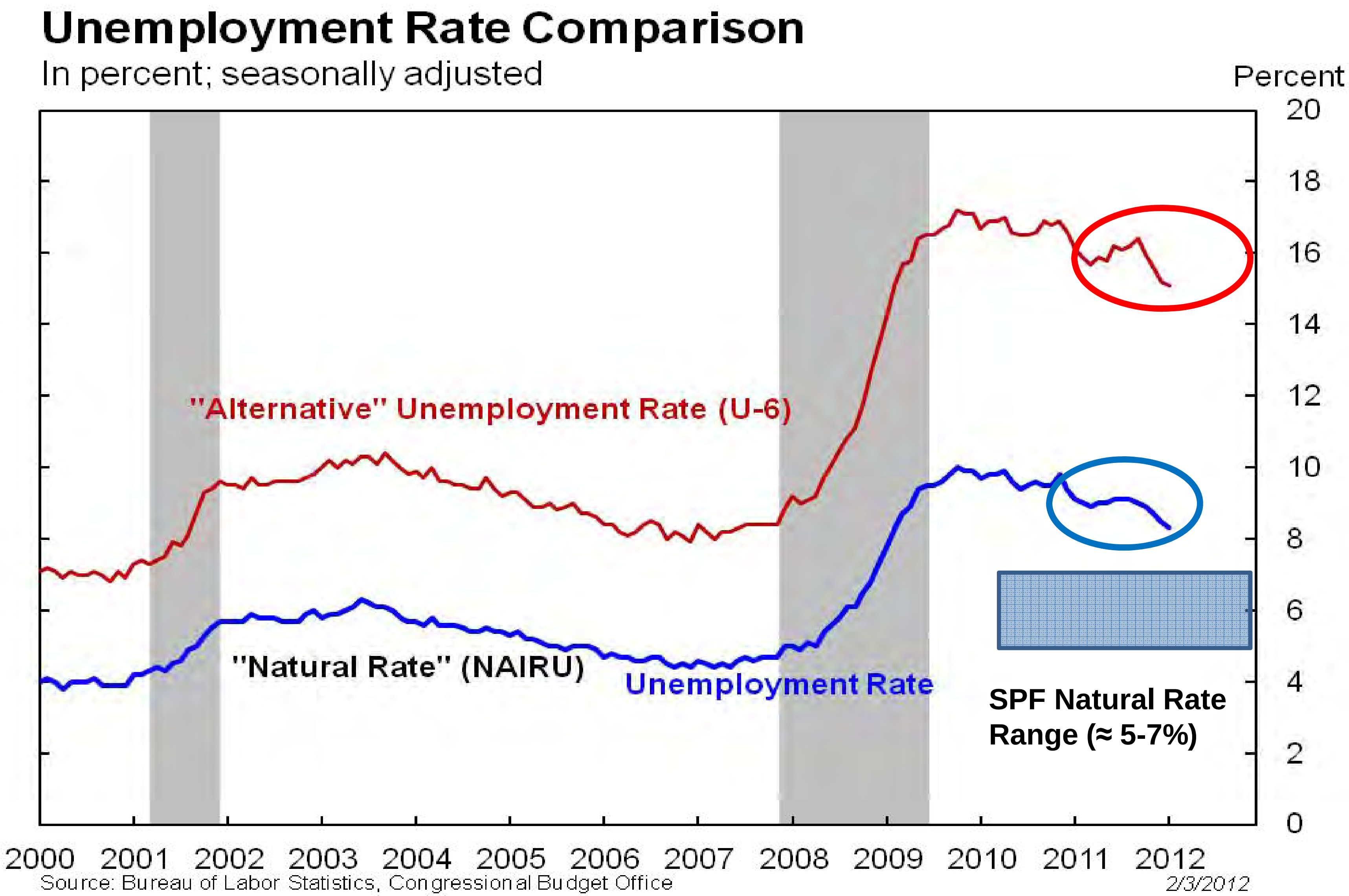


U.S. Labor Market Is Showing Signs of Improvement— but , It Is Only Adding Jobs at the Average for the 1990-2007 Period



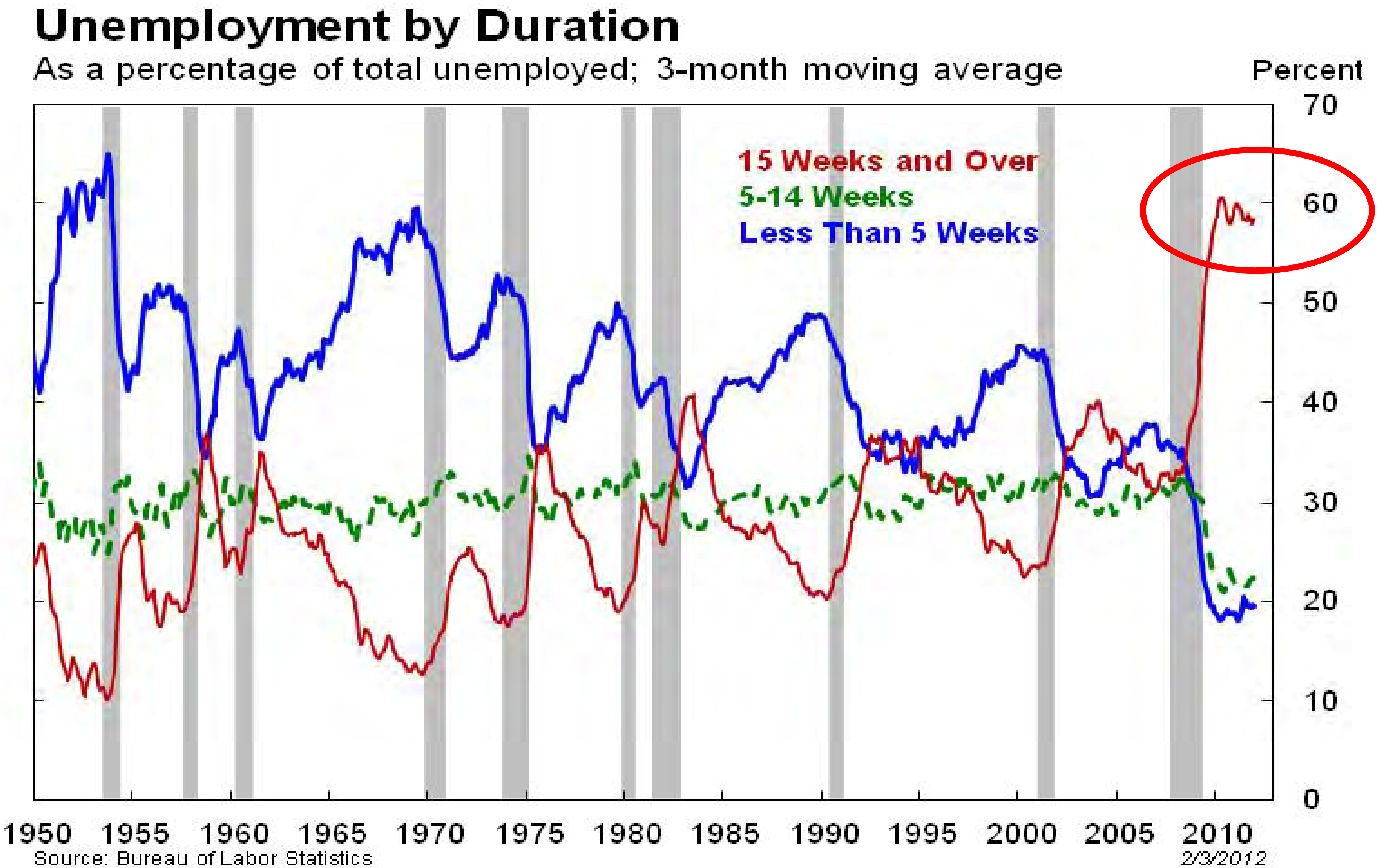
	Total (000s)	Private	Gov't
Sept.	202	216	-14
Oct.	112	139	-27
Nov.	157	178	-21
Dec.	203	220	-17
Jan	243	257	-14

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

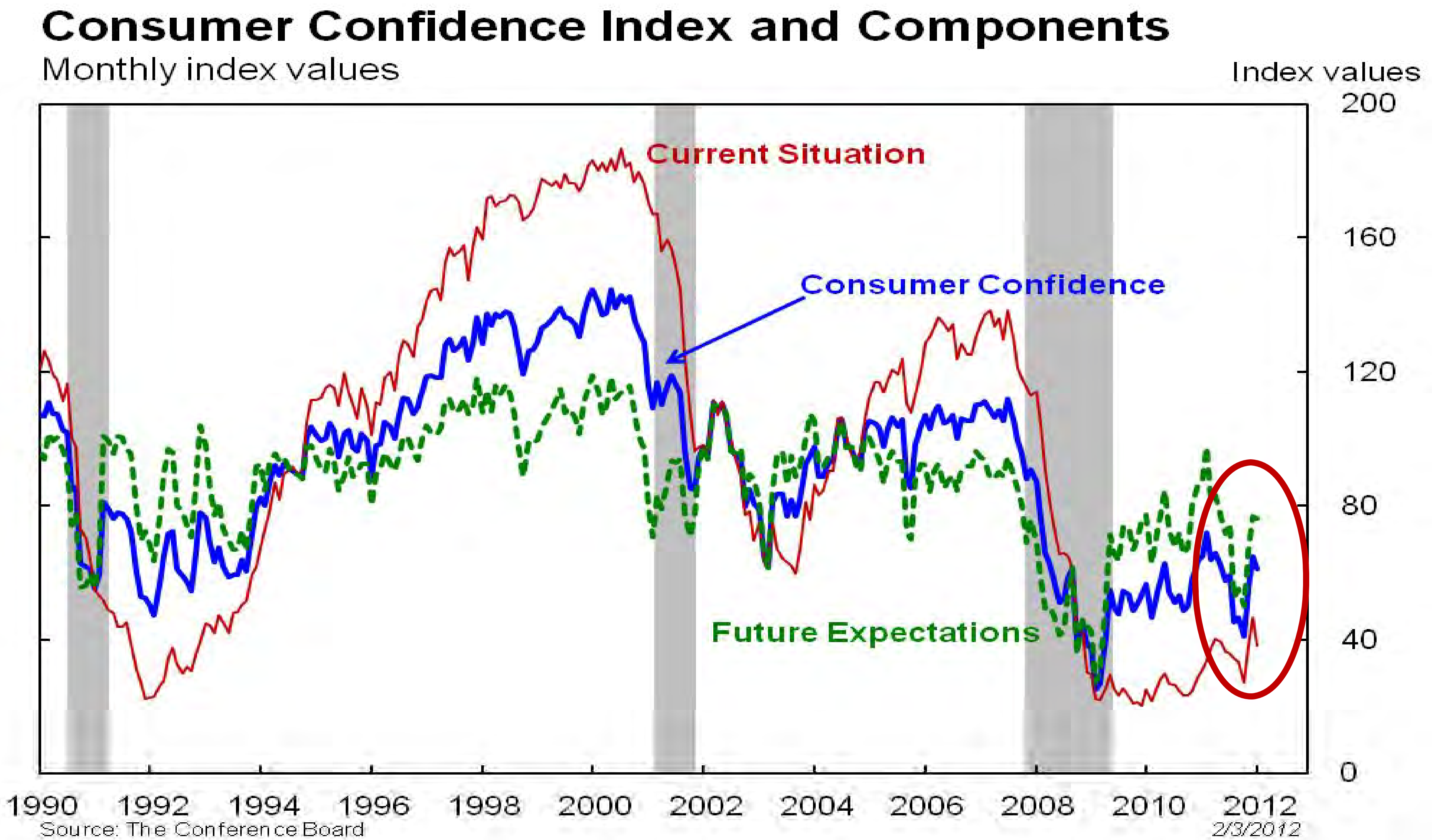


SPF = Survey of Professional Forecasters, FRB Philadelphia.

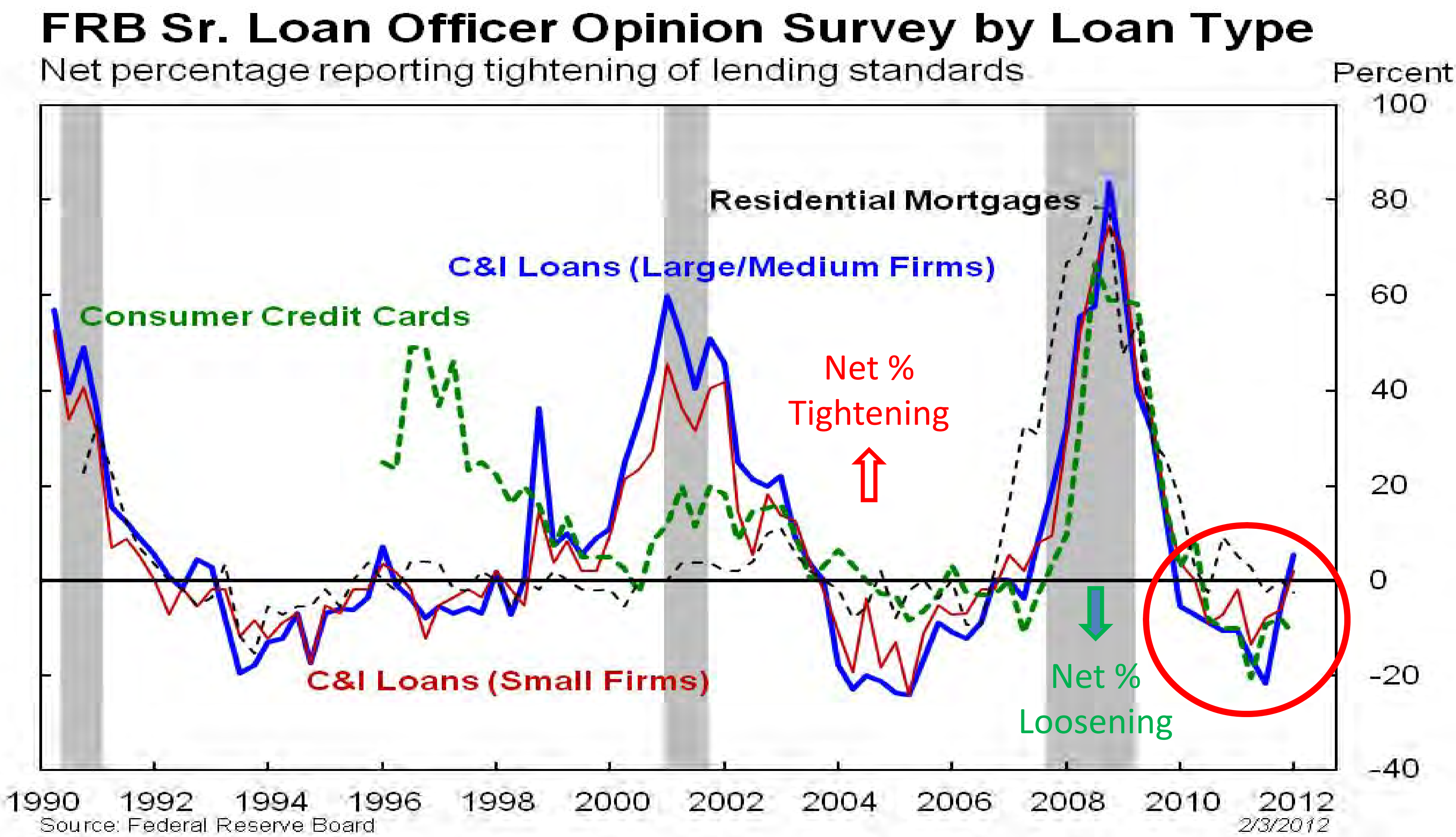
Unemployment Duration Remains Very Long by Historic Standards



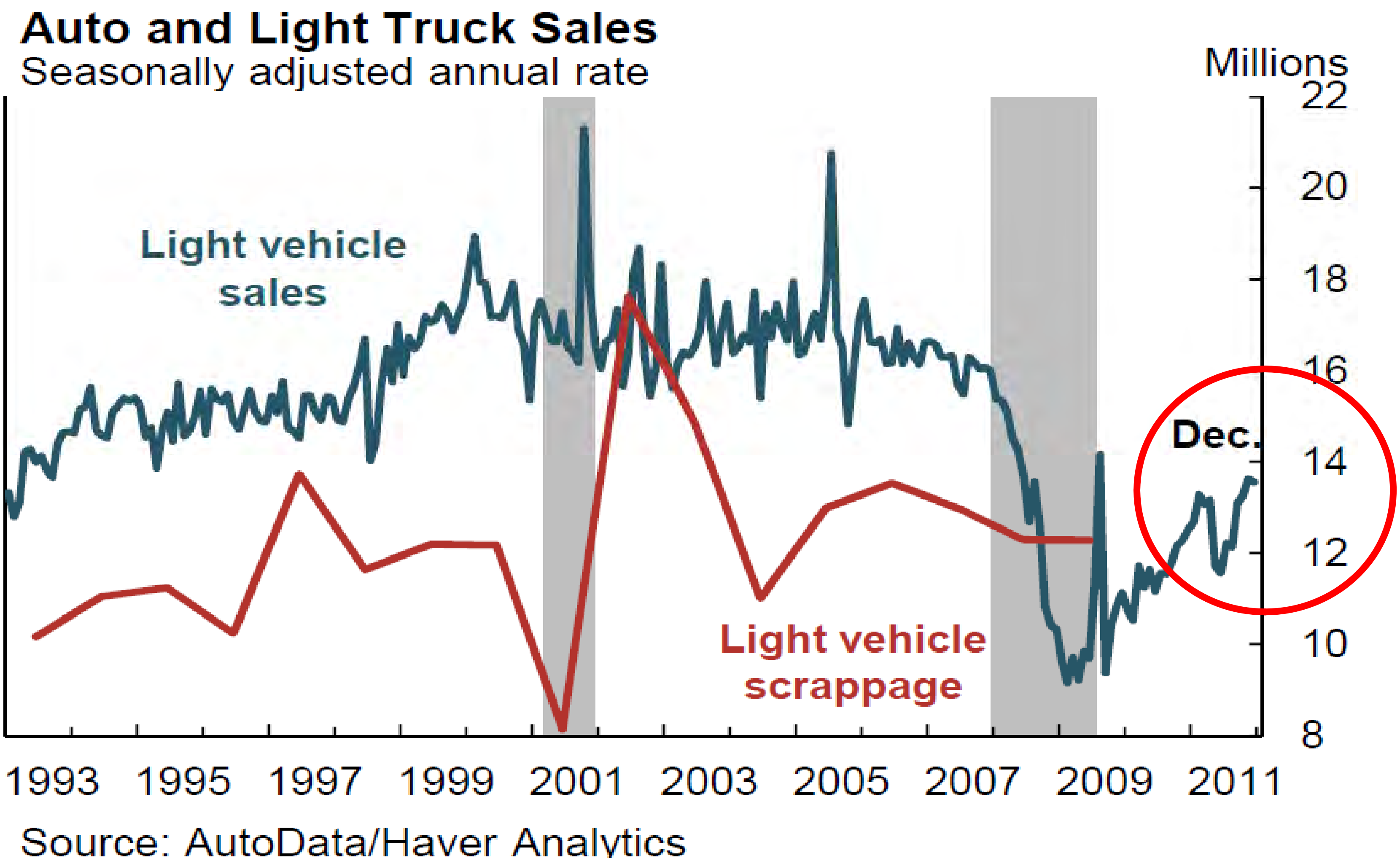
Although Consumer Confidence Picked Up In Late 2011, It Remains Far Below Levels in Prior Expansions; Its Volatility Reflects the Slow Uneven Recovery



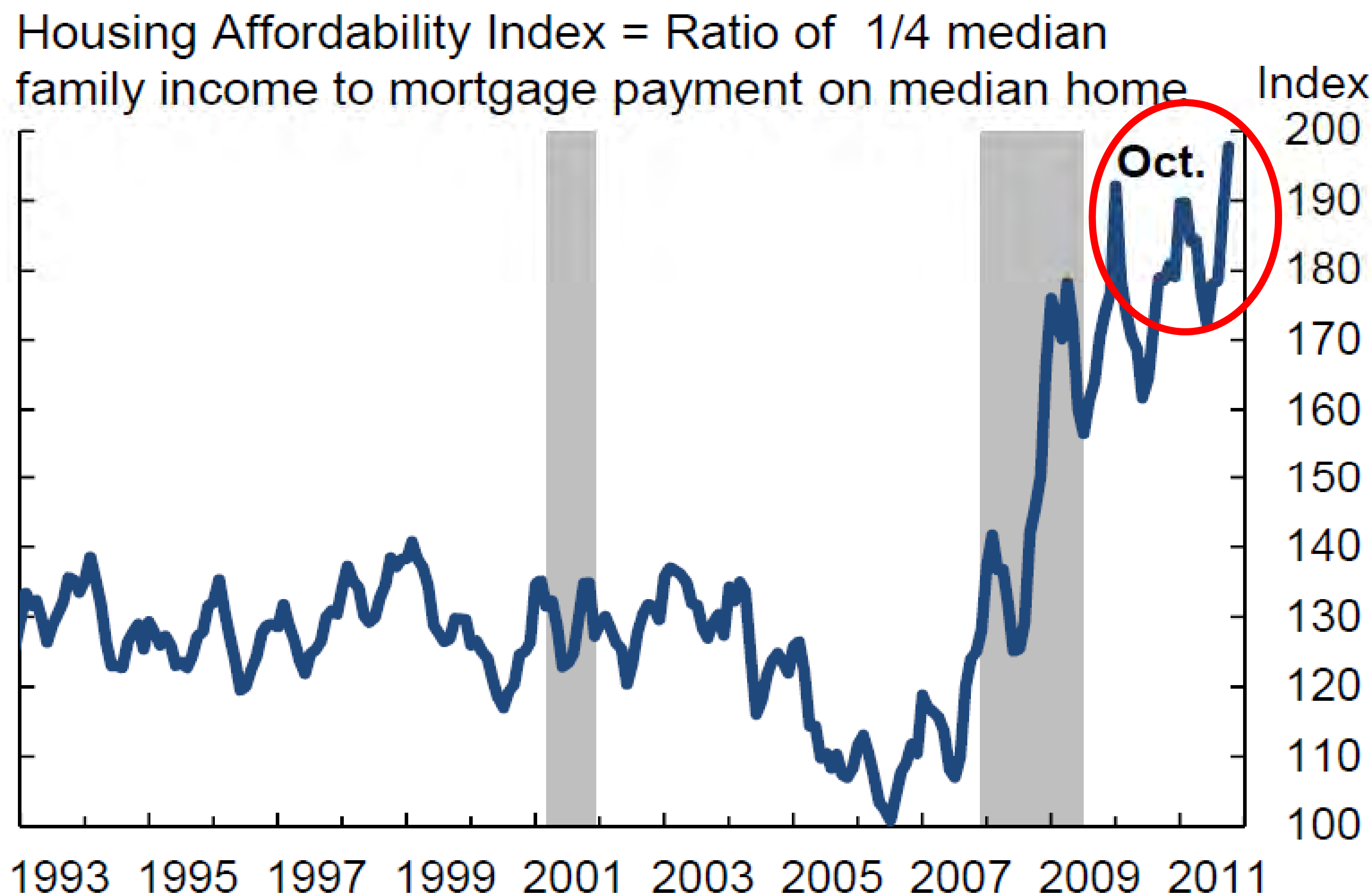
U.S. Bank Lending Standards Continue to Show Net Loosening in 2011, Although Credit Remains Tight for Many Households and Small Businesses



Auto Sales Continue to Recover

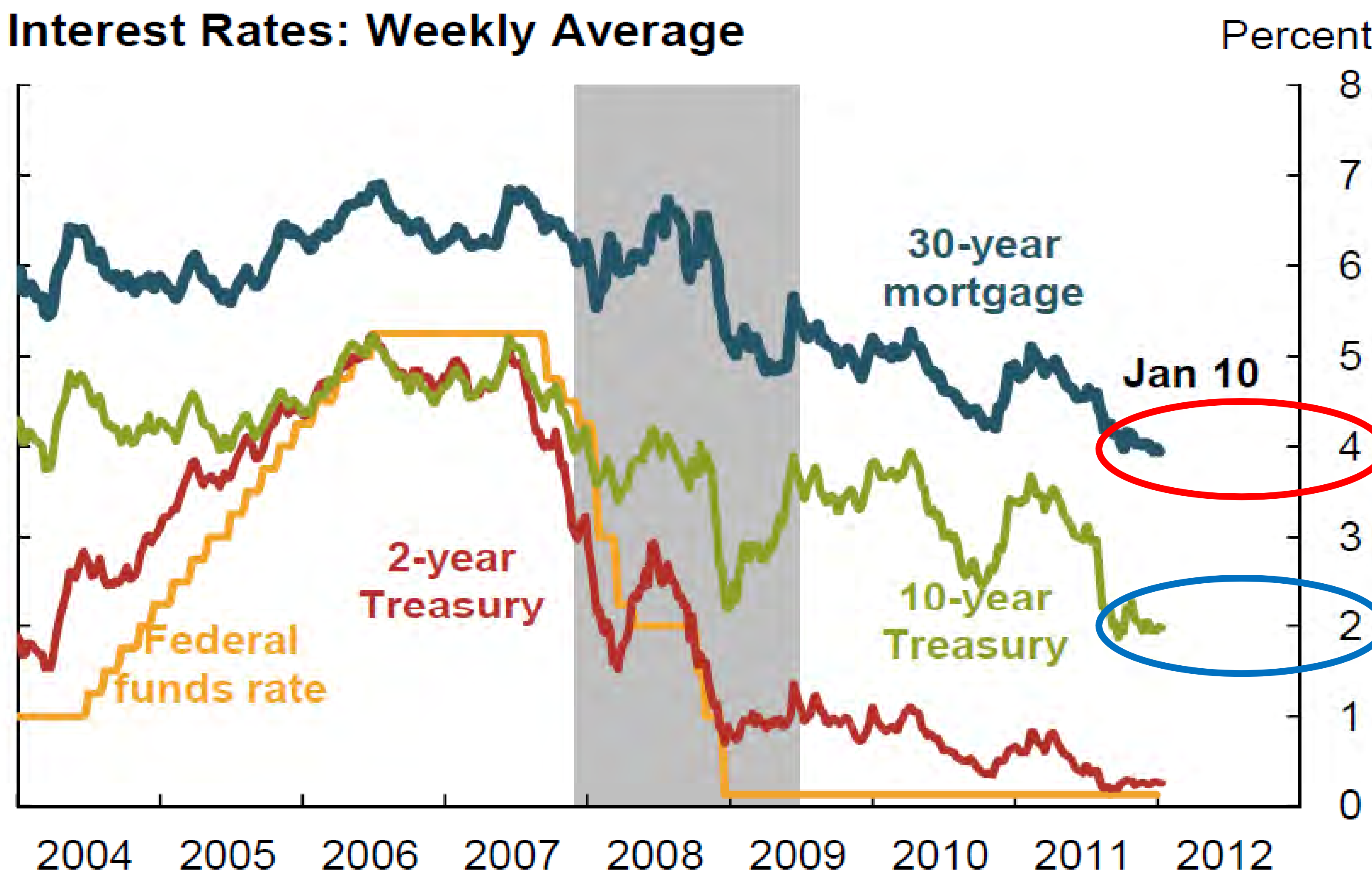


Housing Affordability at an All-Time High

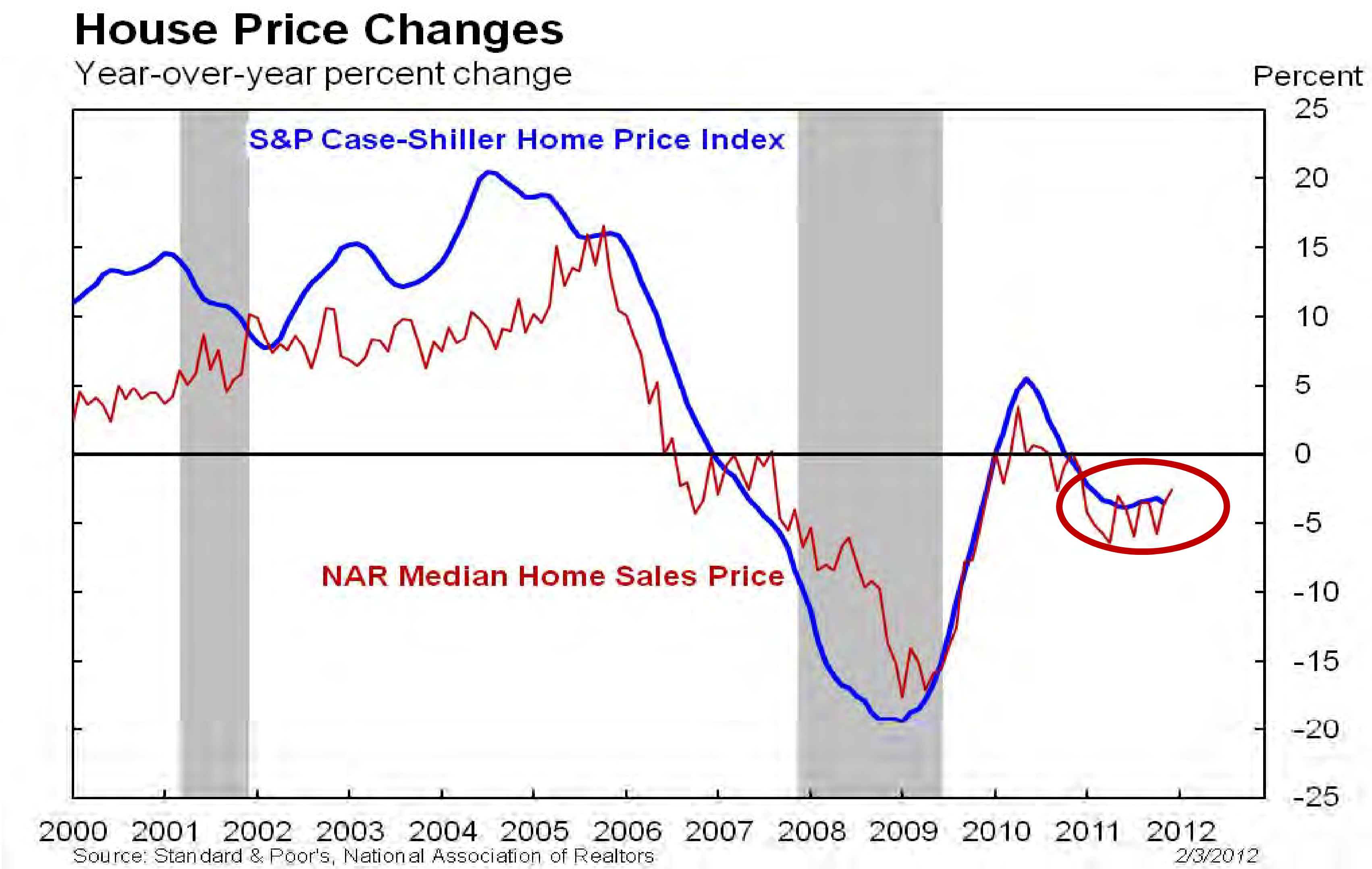


Source: National Association of Realtors/Haver Analytics

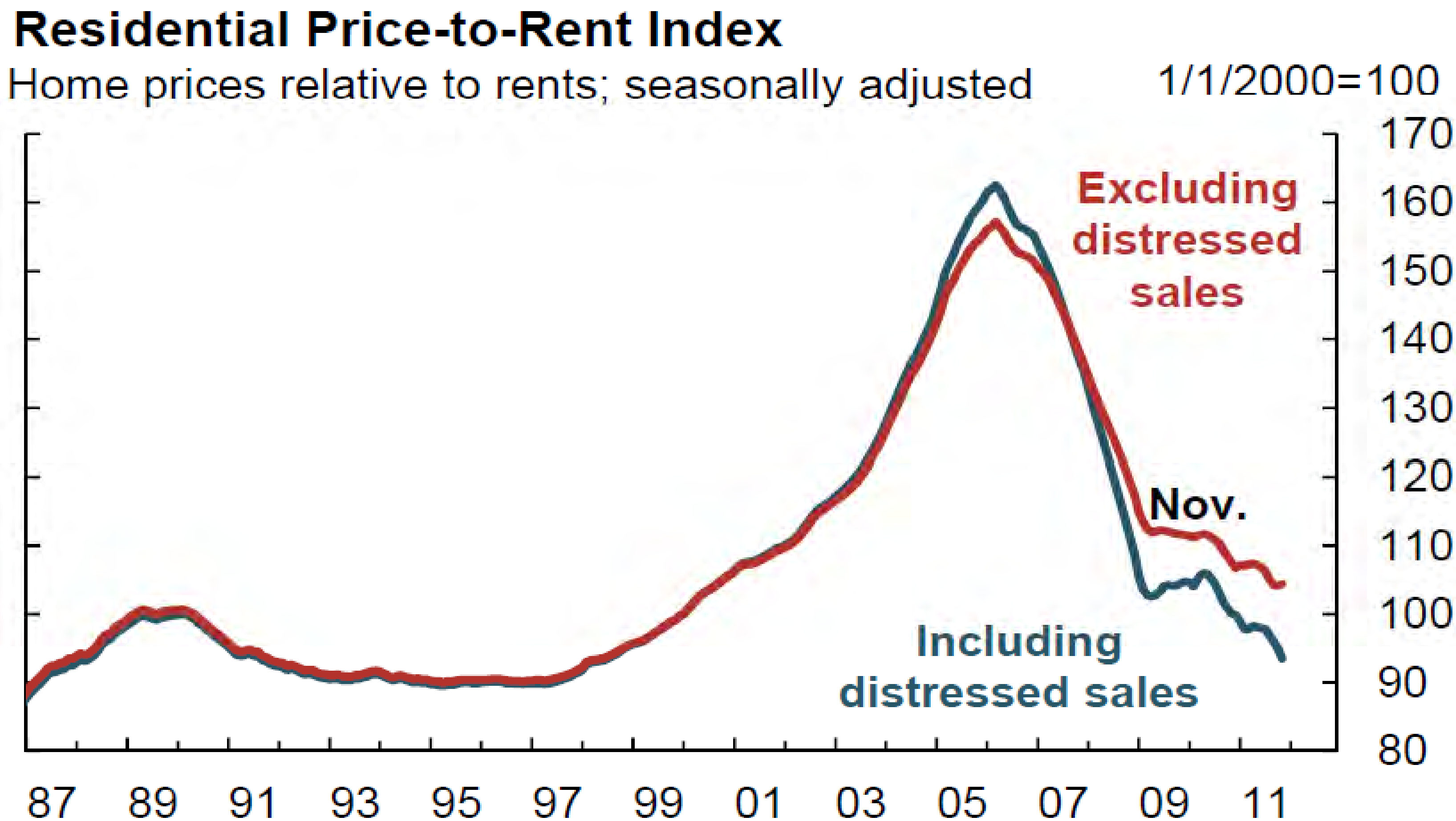
Mortgage Rates at Historic Lows



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

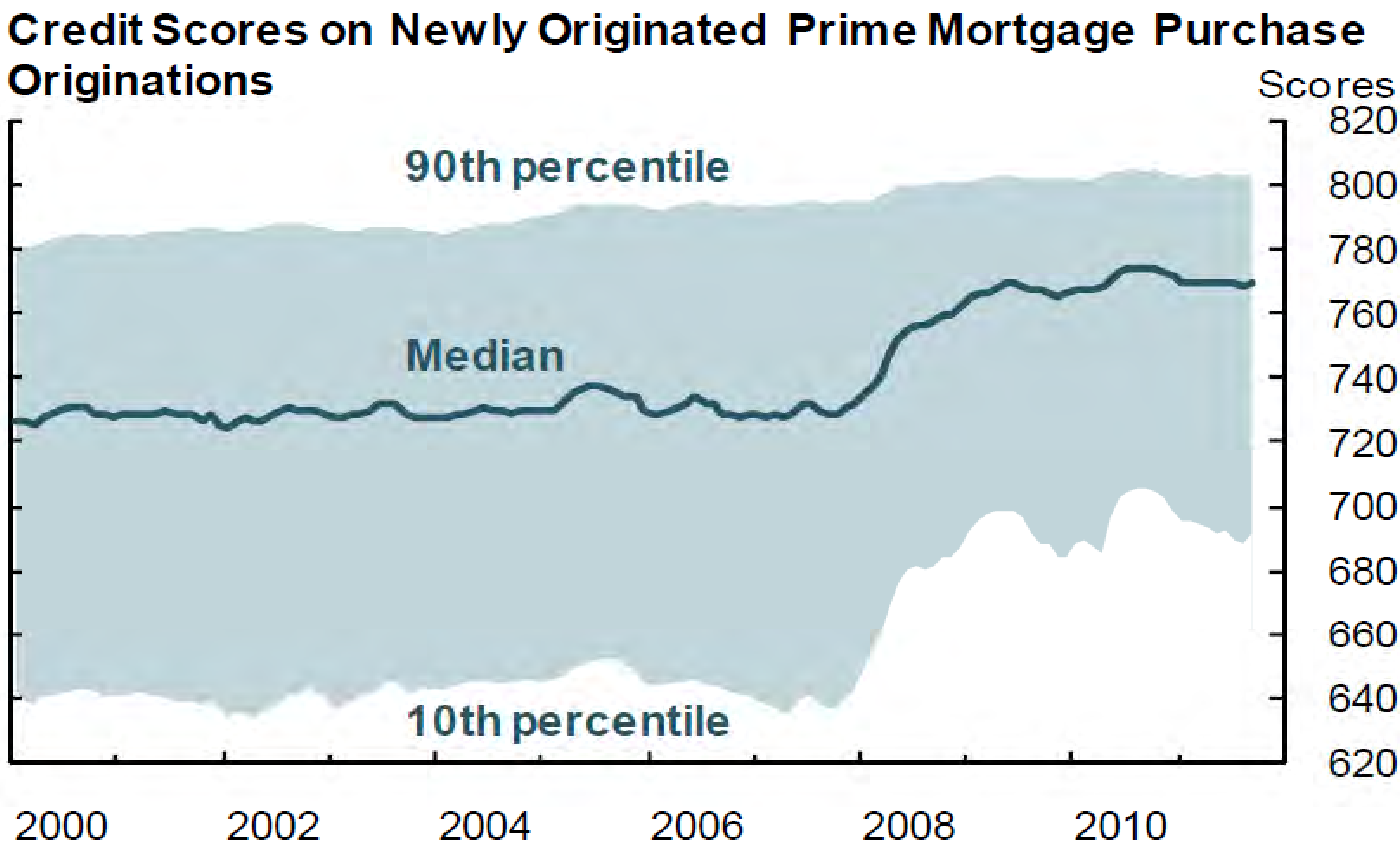


Price-to-Rent Ratios Back to Lower Levels



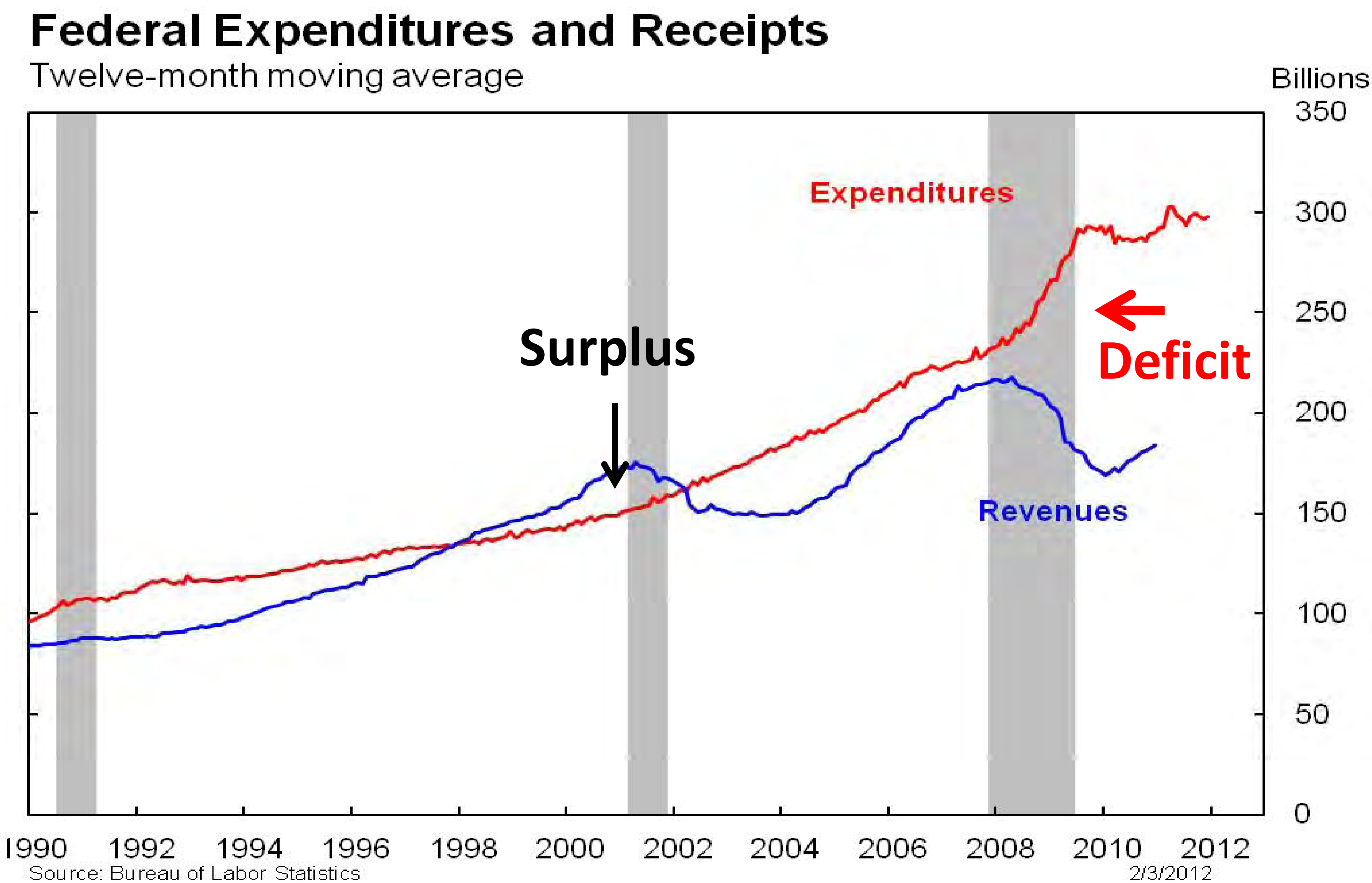
Ratio calculated with CoreLogic National Home Price Index, relative to primary residence's rent component of CPI.

Mortgage Standards Remain Very Tight

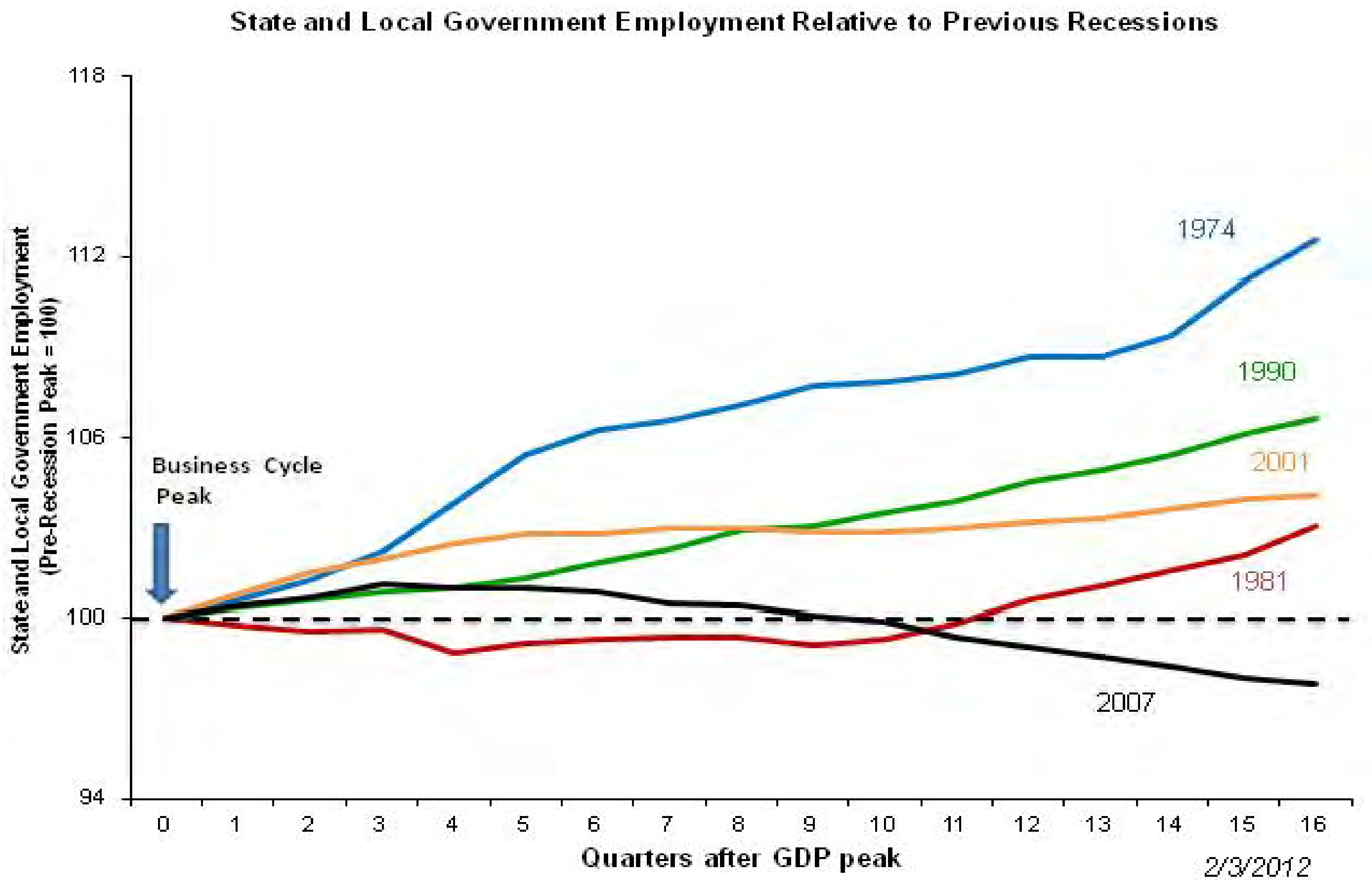


Source: Calculations from LPS Applied Analytics data

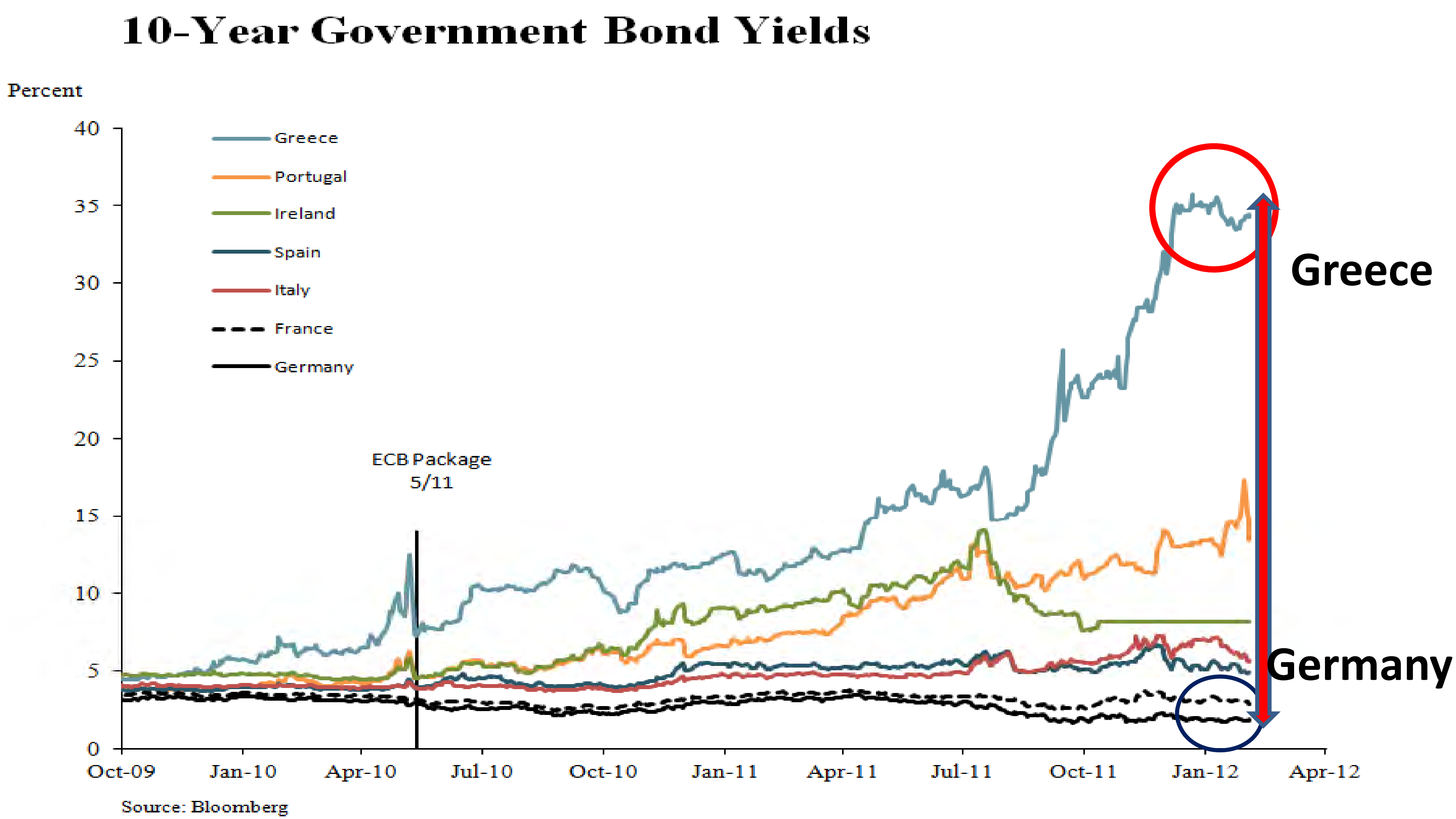
Contractionary Federal Fiscal Policy Subtracted 0.6 Percentage Points from the Real GDP Growth Rate in 2011:Q4



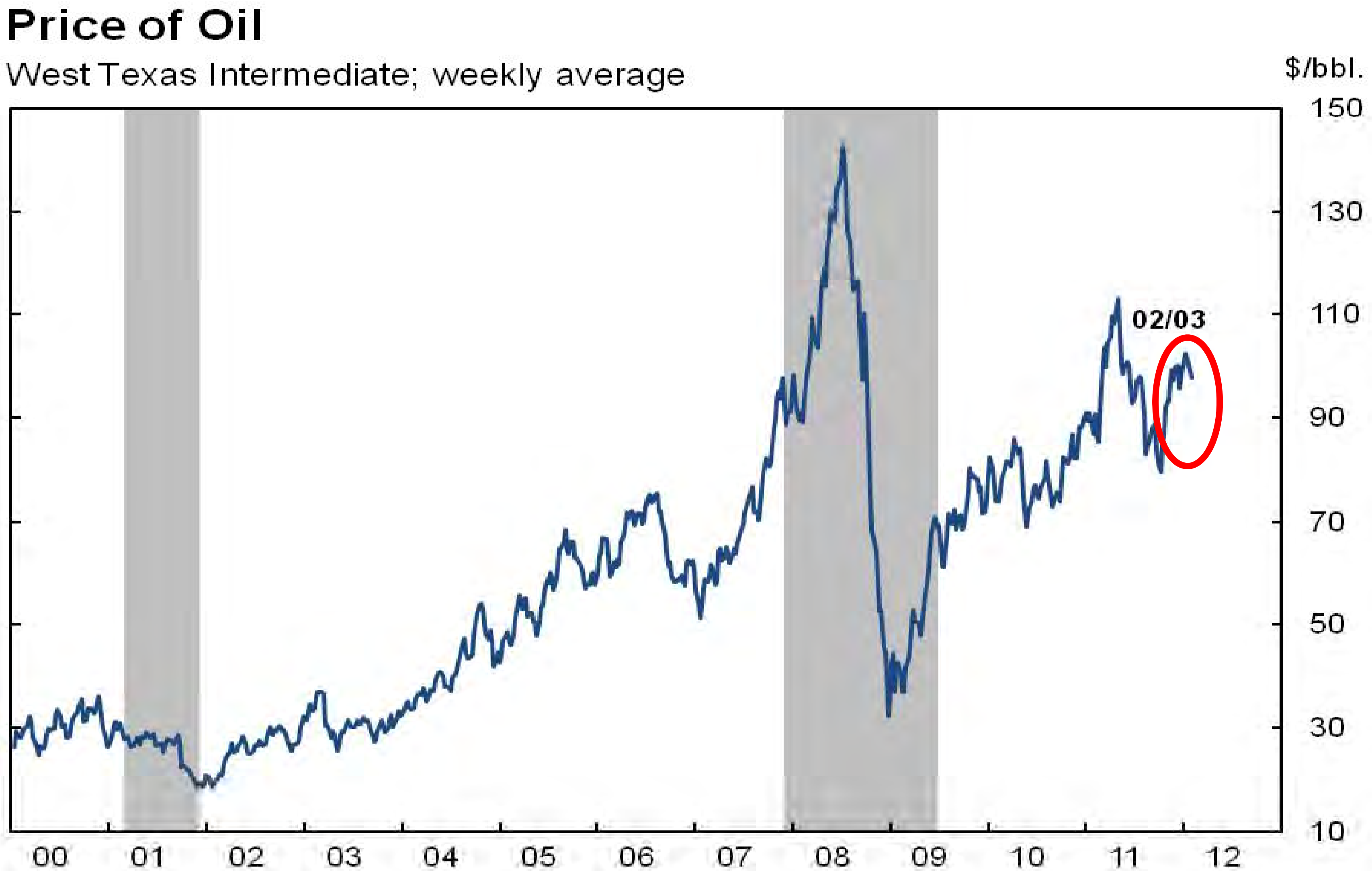
State & Local Governments Continue to Shed Jobs; Sector Subtracted 0.3 Percentage Points from GDP Growth in 2011:Q4



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

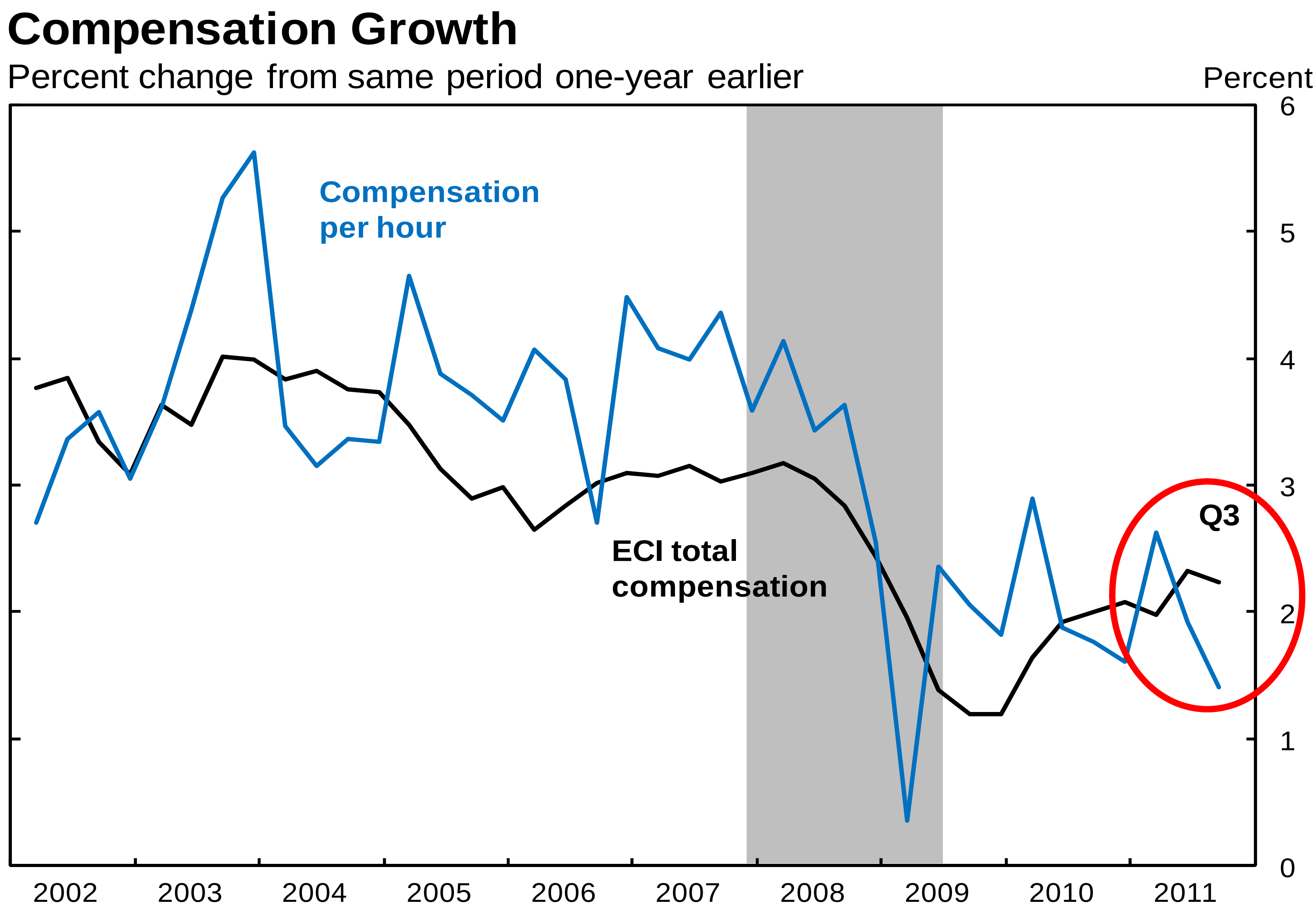


Oil Prices Are Below 2011 Peak, but Periodic Increases Add to Concerns About Consumer Spending and Inflation



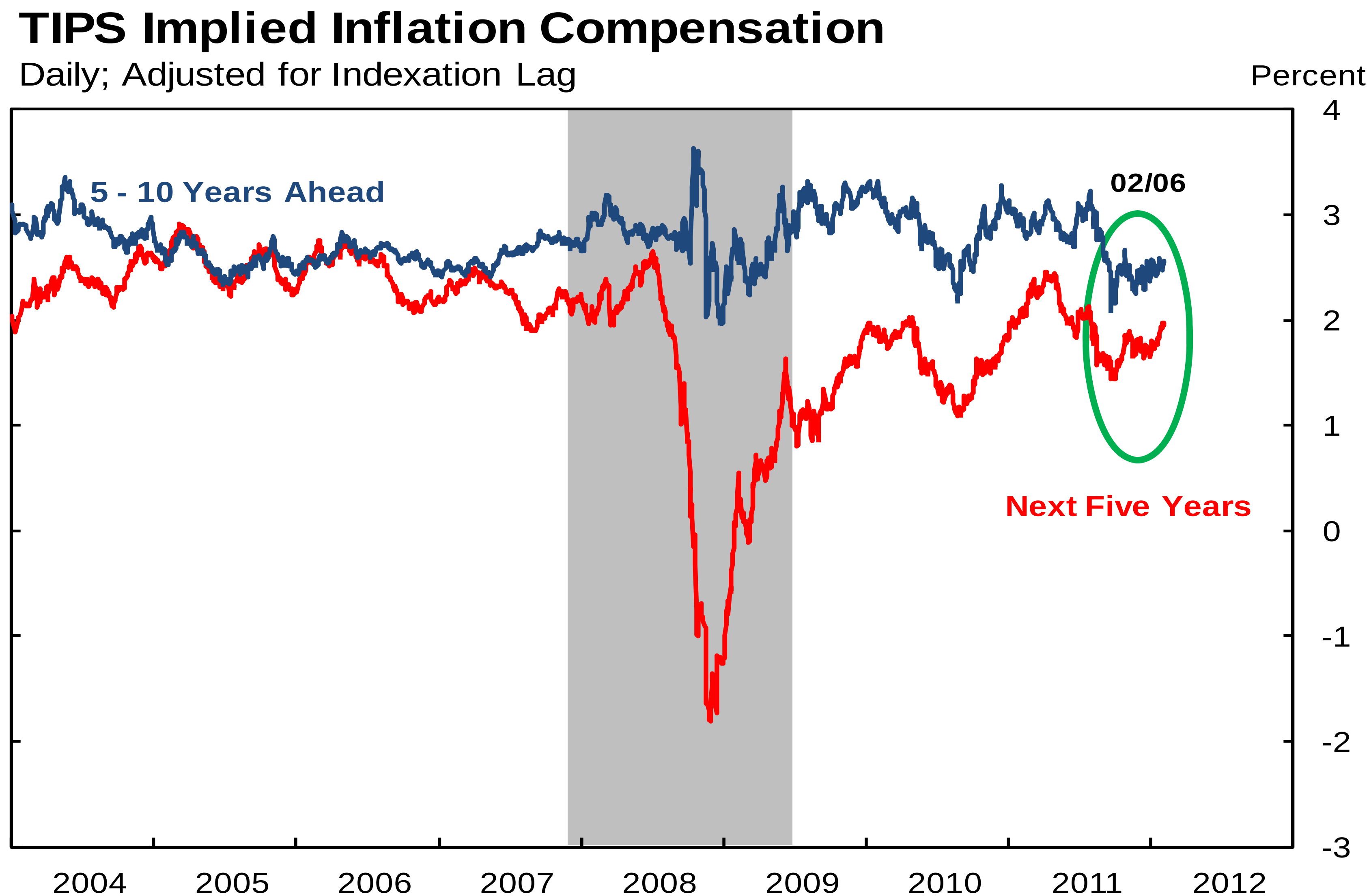
Source: Bloomberg.

Modest Wage Growth Anchors Costs/Prices



Source: BLS.

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



Source: Federal Reserve Board.

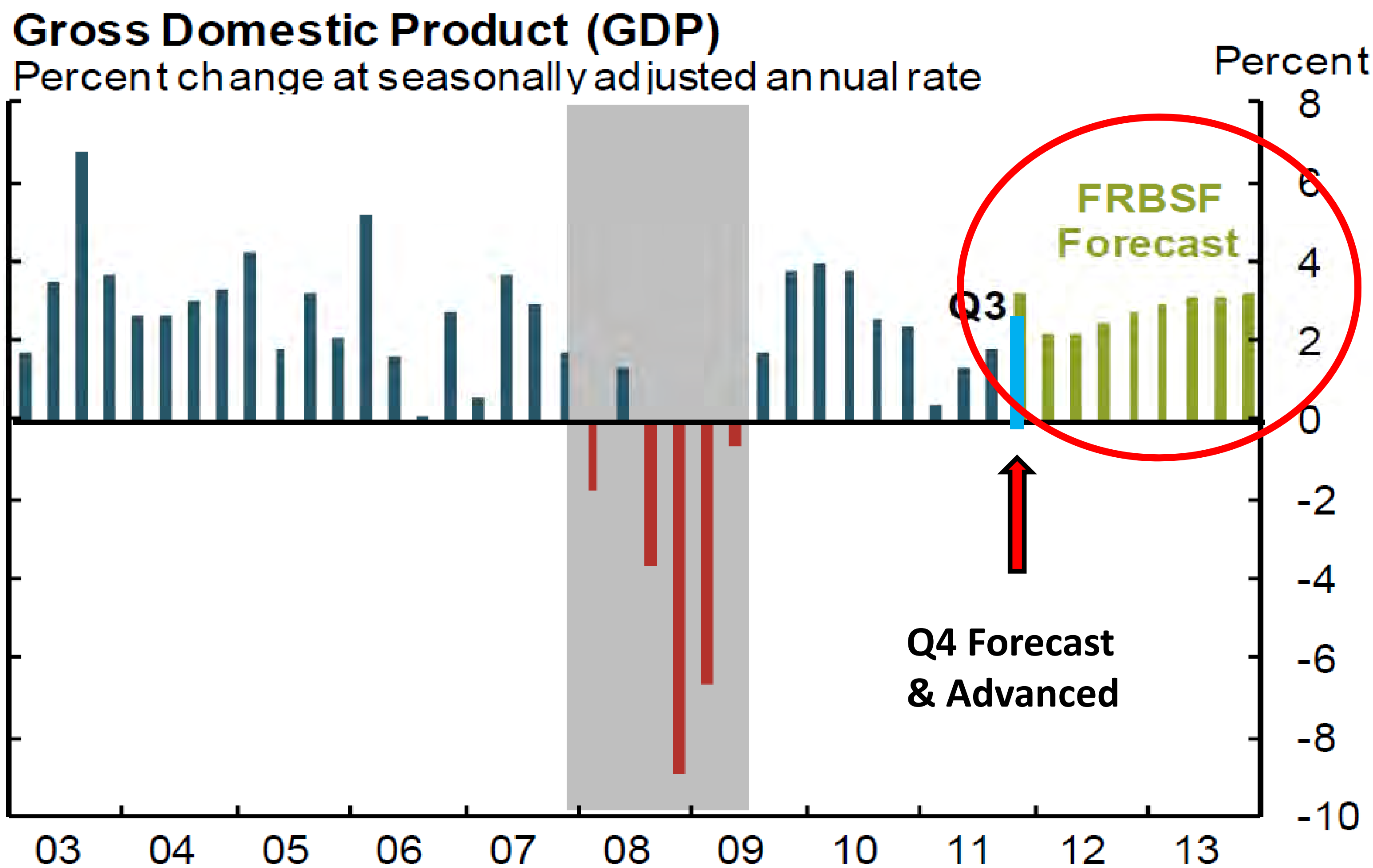
FRBSF ECONOMIC FORECAST

(***FEDVIEWS***) JANUARY 12, 2011

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

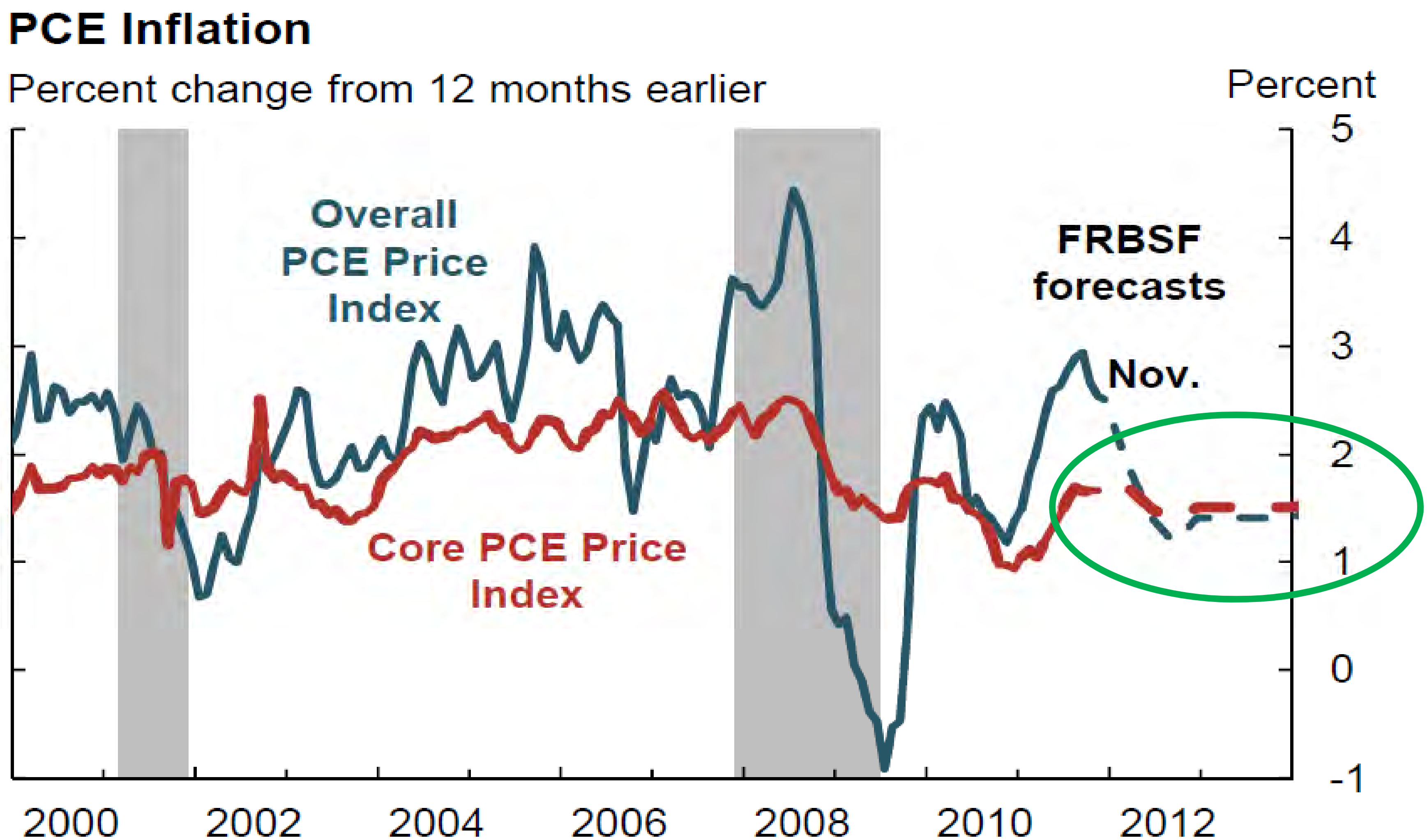
The next *FedViews* is scheduled to be released on or before February 13, 2012.
You can find it online at:
http://www.frbsf.org/publications/economics/fedviews/index.php

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

FEDVIEWS

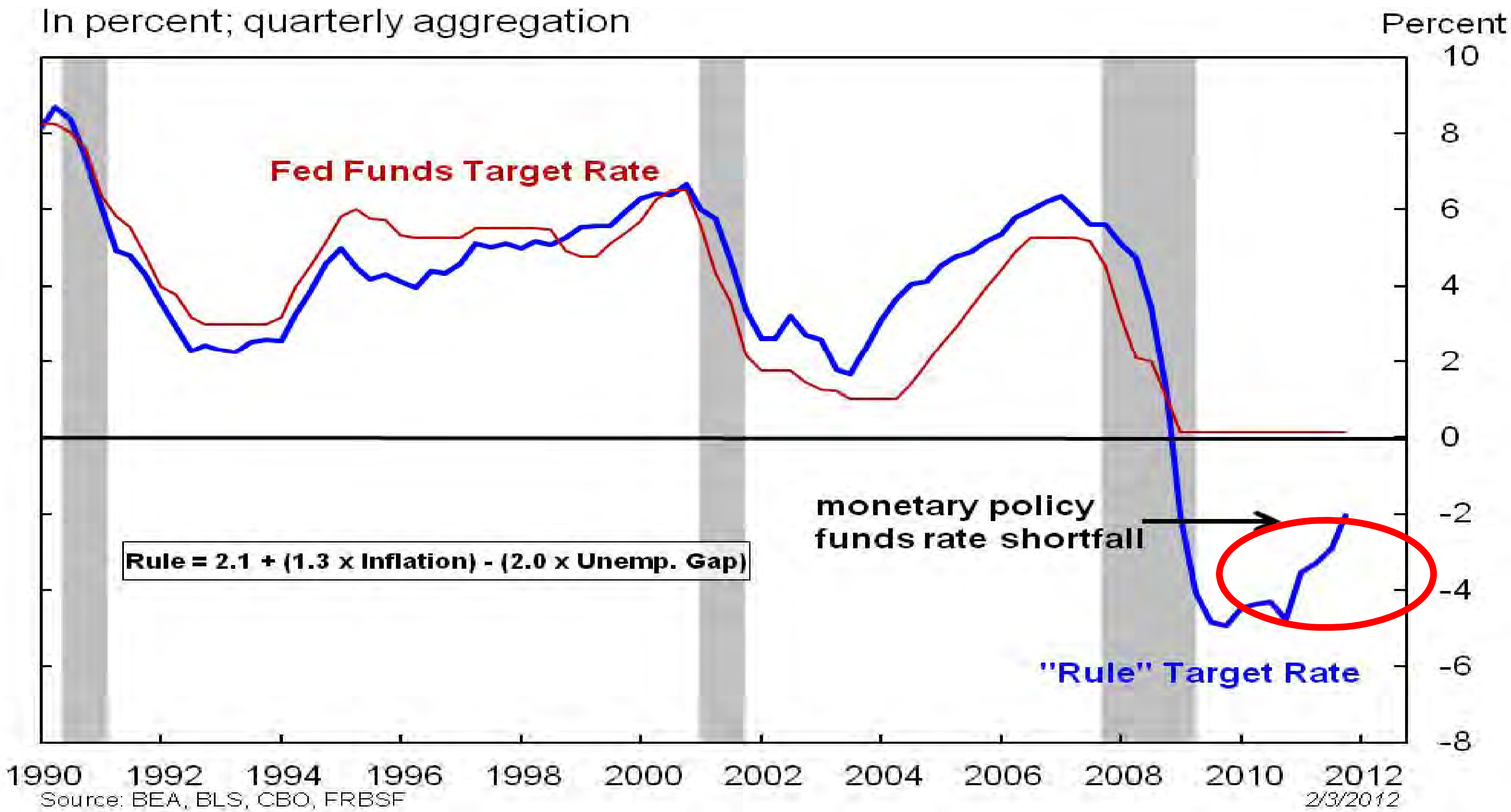


Source: **January 2012 *Fedviews***
http://www.frbsf.org/publications/economics/fedviews/index.php

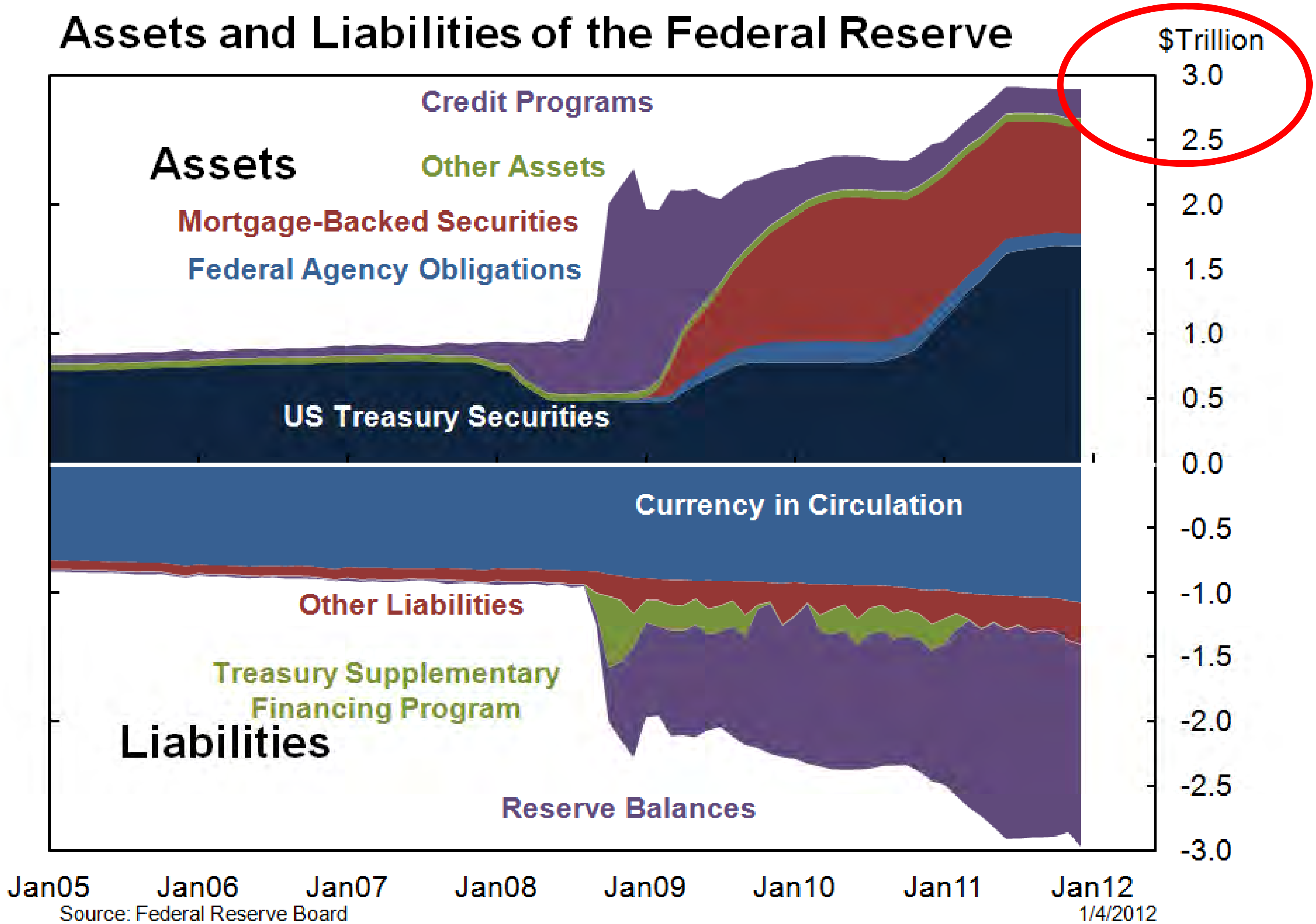
MONETARY POLICY

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



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

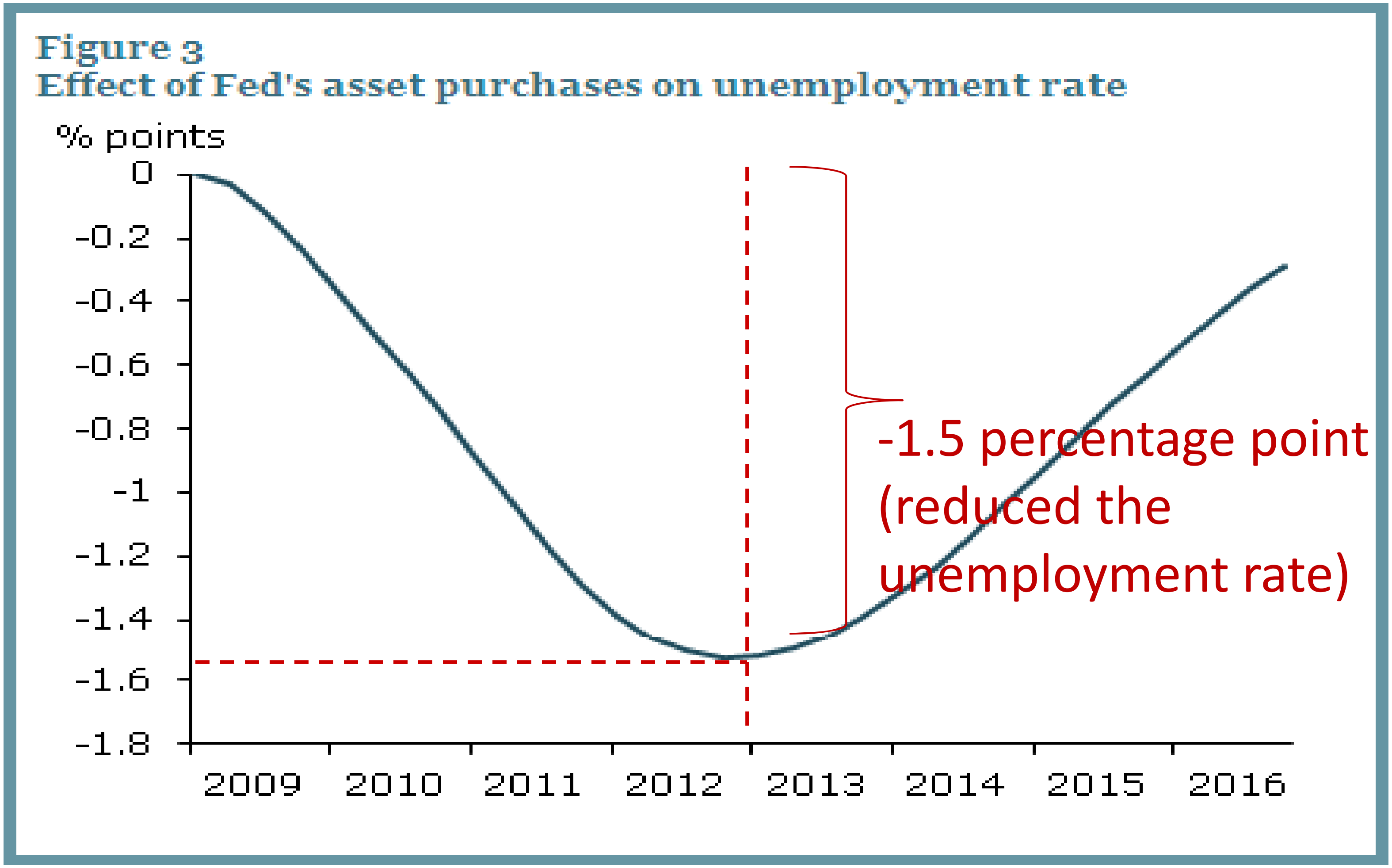
- **First LSAP (November 2008 & March 2009 announcements) -** $1.25 trillion in agency MBS, $170 billion in agency debt issued by housing-related government-sponsored enterprises, and $300 billion in longer-term Treasury securities
- **Second LSAP (November 2010 announcement)** $600 Billion in longer-term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

  $400 billion maturity extension program for Fed Treasuries

Objectives

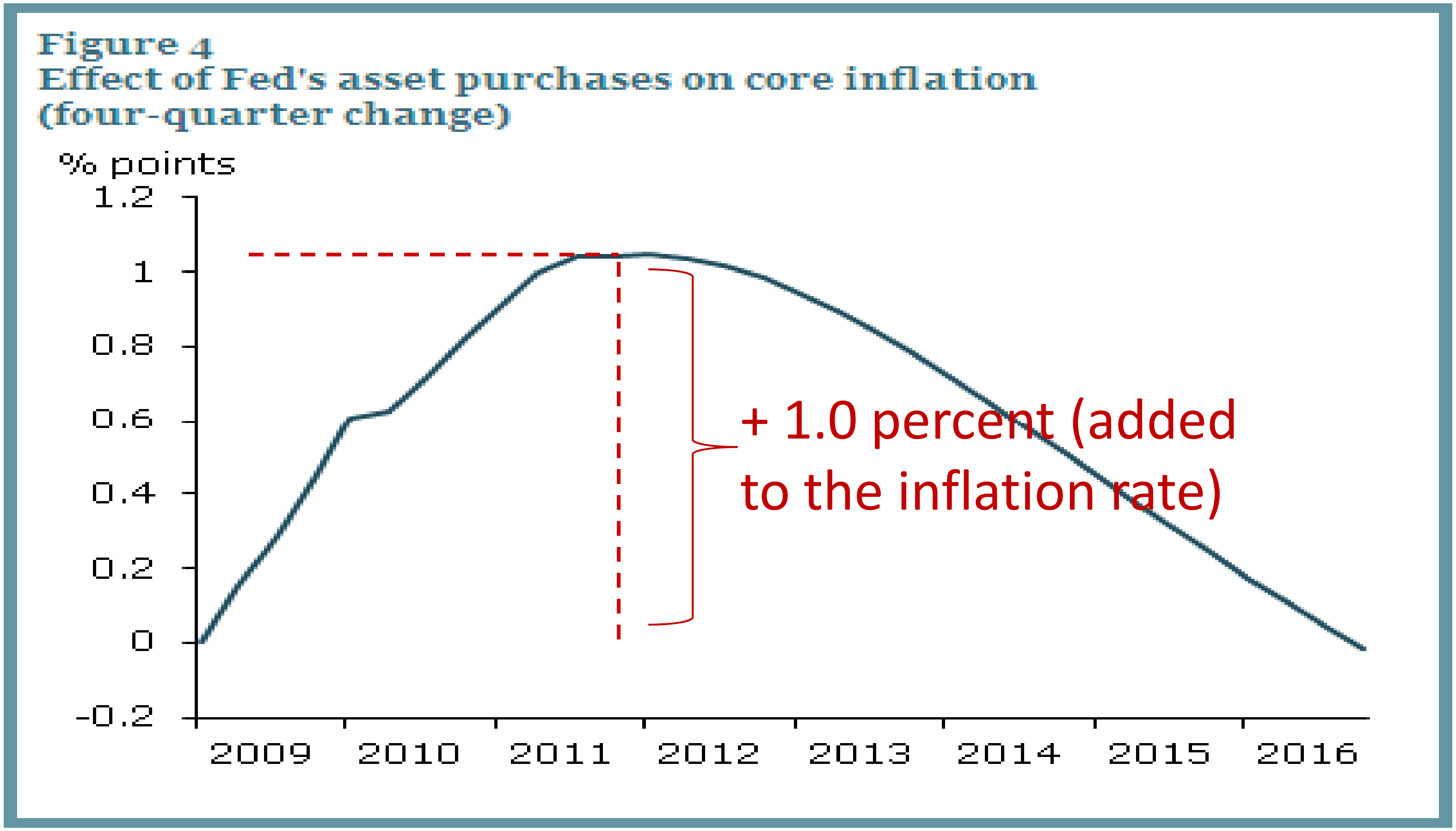
- **Reduce longer-term yields**
- **One Estimate for LSAPs:** Chung et. al., suggests in 2011 the combined LSAP purchases reduced rates by about 50 basis points

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



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

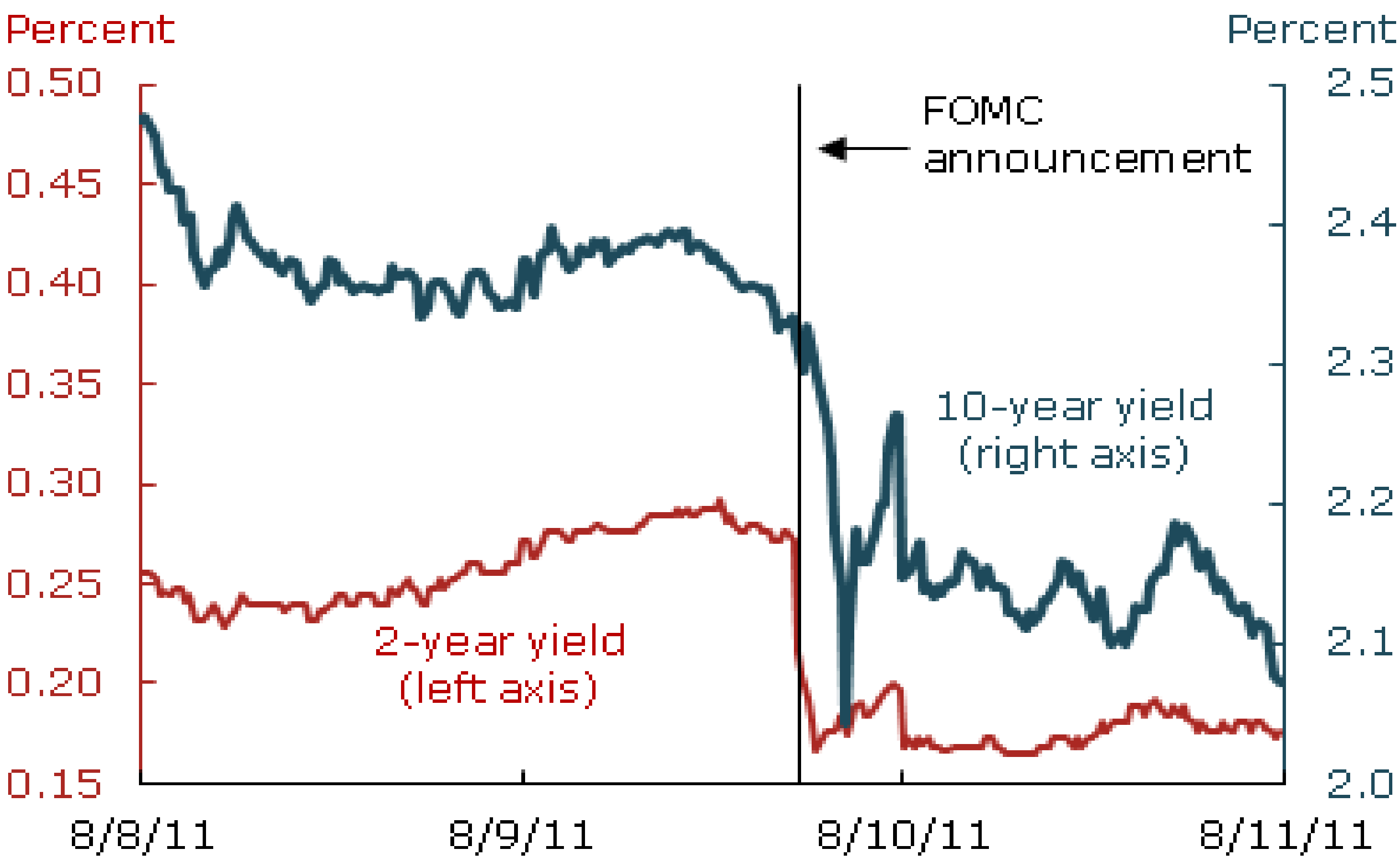
Forward Policy Guidance: A 2011 Case Study

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

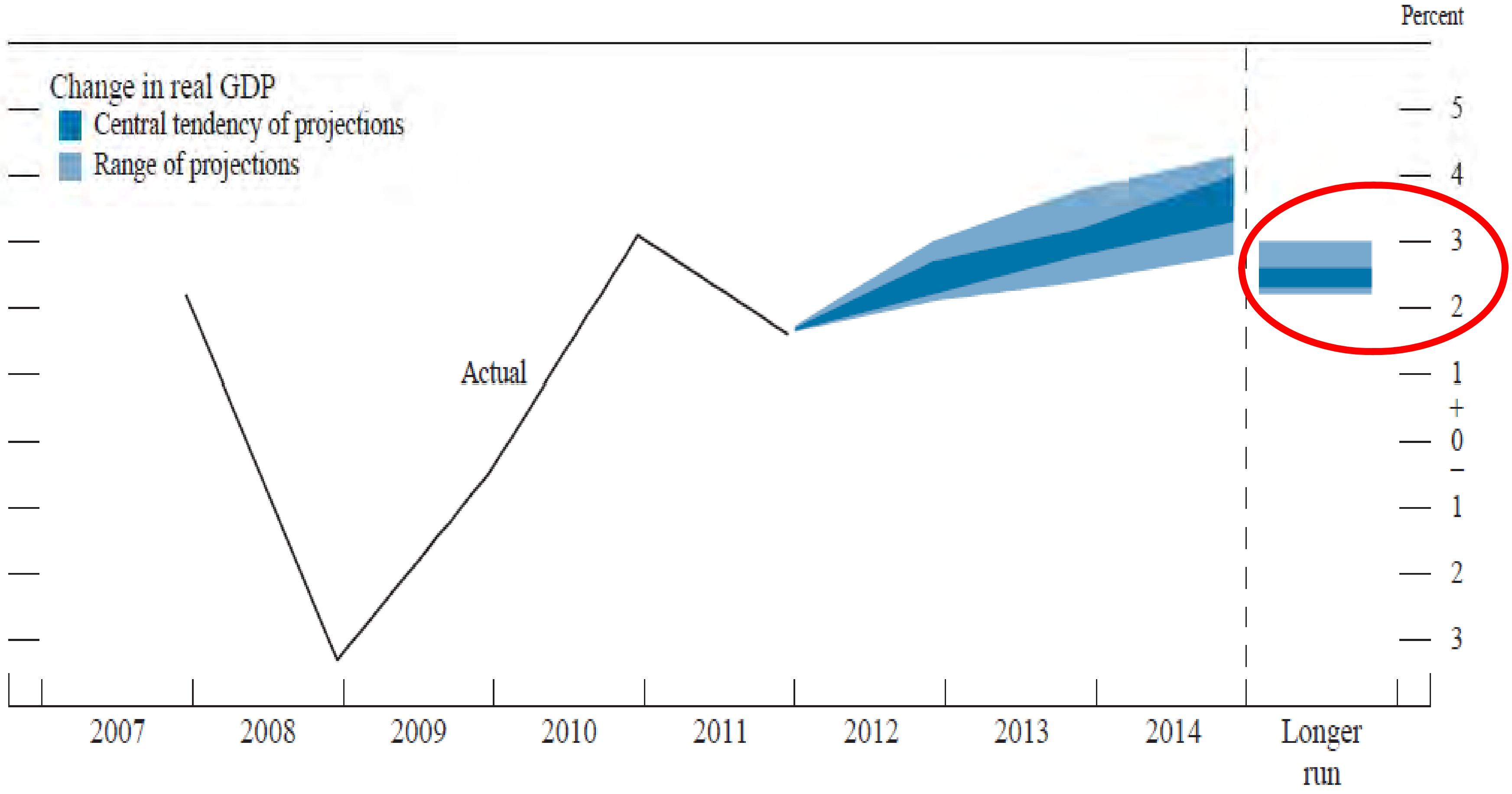
Federal Open Market Committee (FOMC):

- 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."**

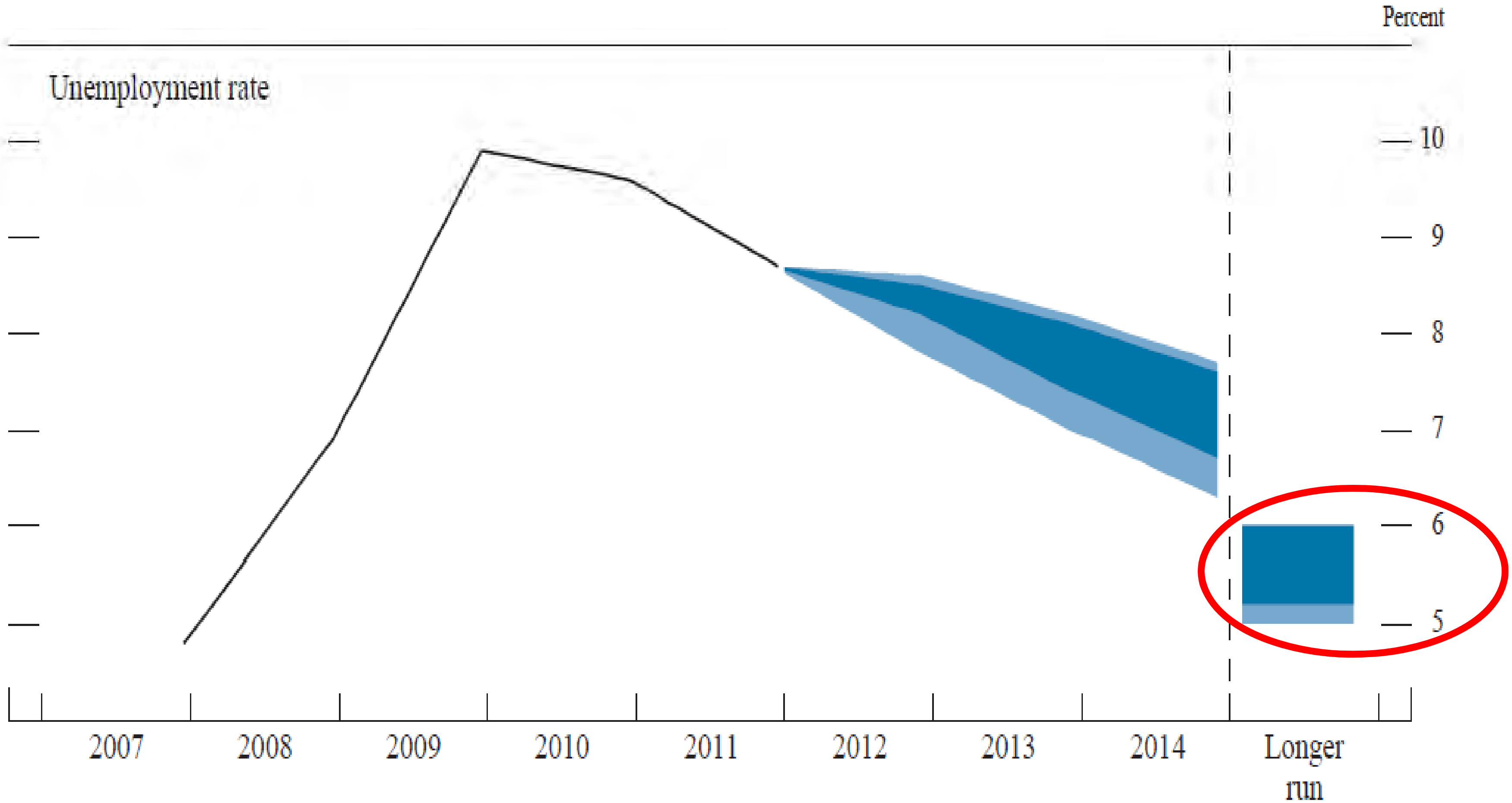
Released Projections for Real GDP, Unemployment Rate, Inflation, and the Fed Funds Rate Target

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

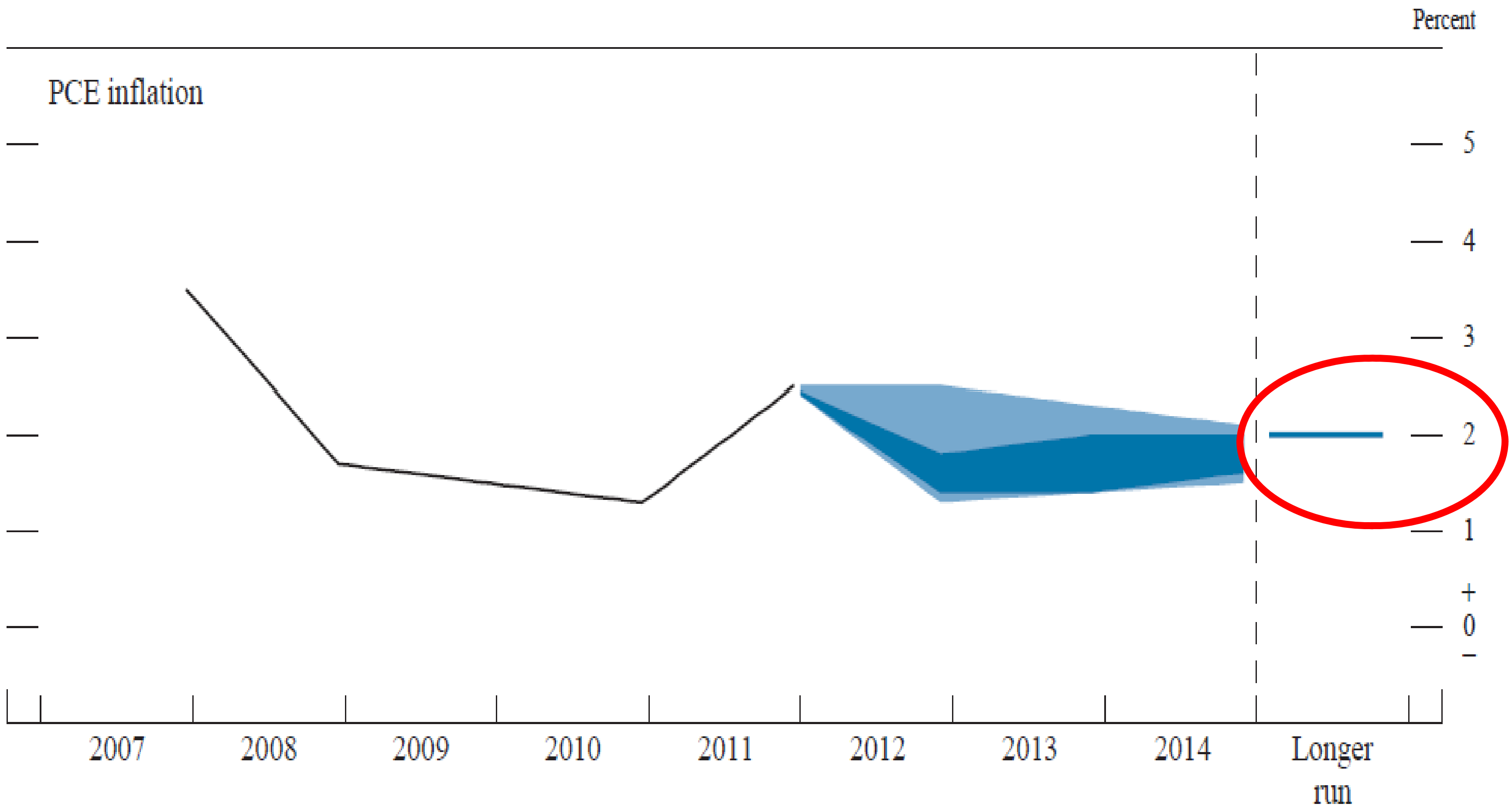
FOMC's GDP Projections



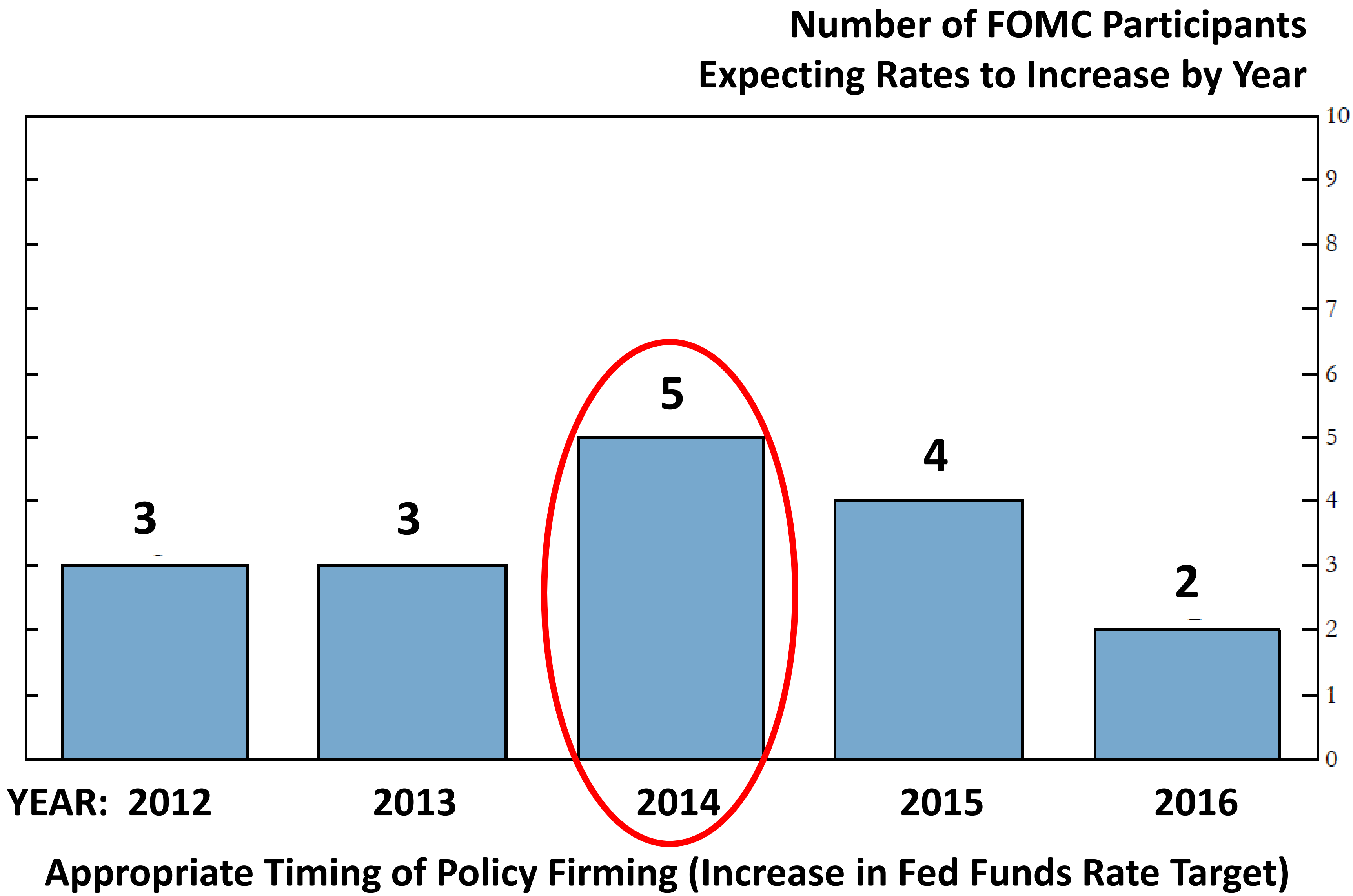
FOMC's Unemployment Projections



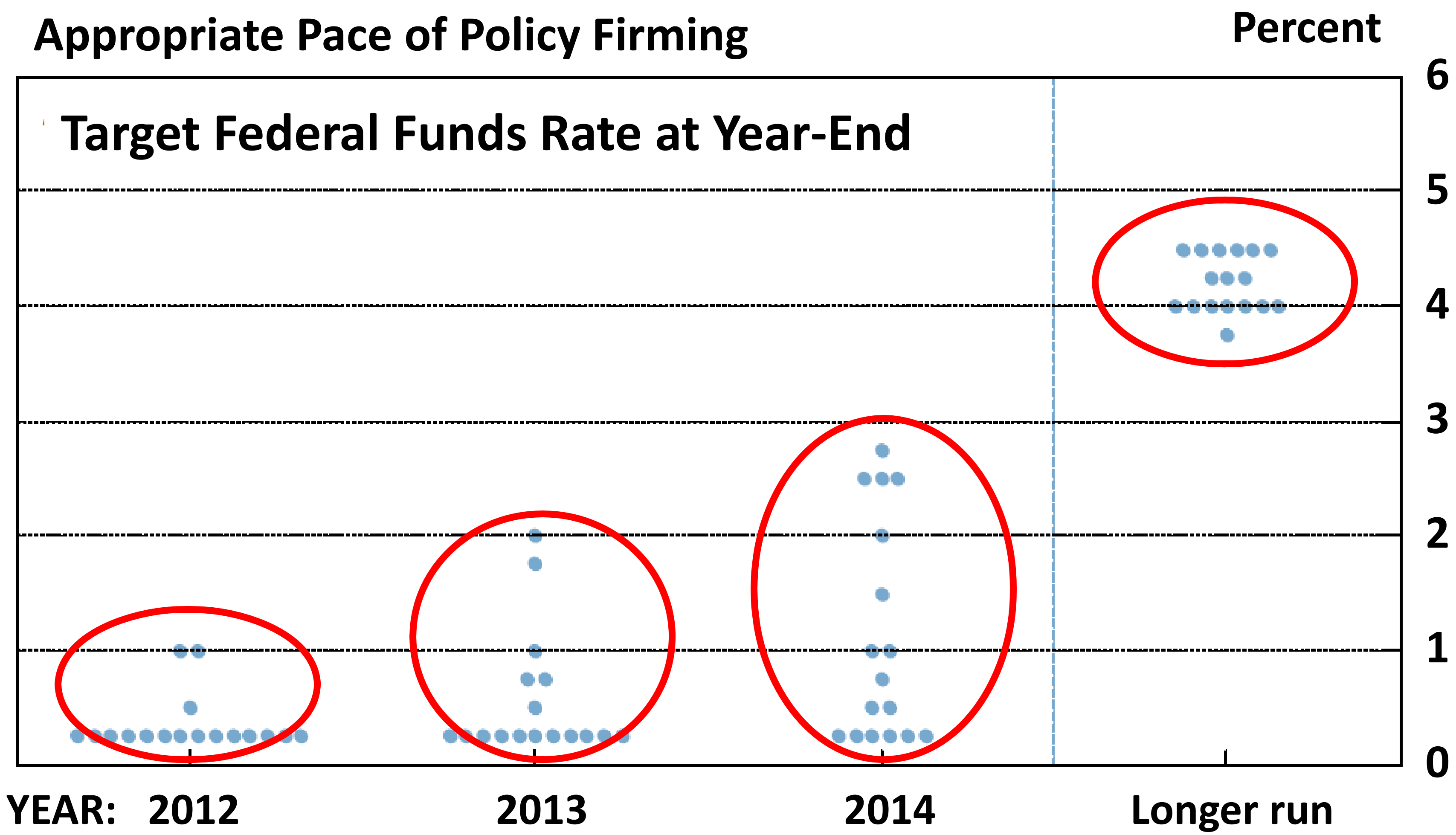
FOMC's Inflation (Headline) Projections



FOMC Target Federal Funds Rate Projections by Year of Increase



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?

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