Garden State Economic Forum: The Road Ahead

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OF PHILADELPHIA

Continue with "operation twist," reinvesting in MBS, and forward guidance

***November 2, 2011 FOMC Statement*:**

- To promote a stronger pace of economic recovery and to help ensure that inflation, over time, is at levels consistent with the dual mandate ... the Committee decided today to continue its program to extend the average maturity of its securities...The Committee is ... reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities.

- The Committee will maintain the target range for the federal funds rate at 0 to 1/4 percent and 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 for at least through mid-2013.

"Whereas deeds never done before are what occupy my mind."

Wotan

Die Walküre, Act Two, Scene One

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During and after the crisis, the Fed has taken unprecedented policy actions to ease short-term funding pressures, contain systemic fallout, and support economic recovery

<u>Standing Facilities</u>

- Longer maturity Discount Window loans
- Primary Dealer Credit Facility

<u>Term Lending Facilities</u>

- Term Auction Facility (TAF)
- FX Swaps with other central banks

<u>Targeted Credit Facilities</u>

- Asset-Backed Commercial Paper Money Market Mutual Fund Lending Facility (AMLF)
- Commercial Paper Funding Facility (CPFF)
- Money Market Investor Funding Facility (MMIFF)
- Term Asset-Backed Securities Loan Facility (TALF)

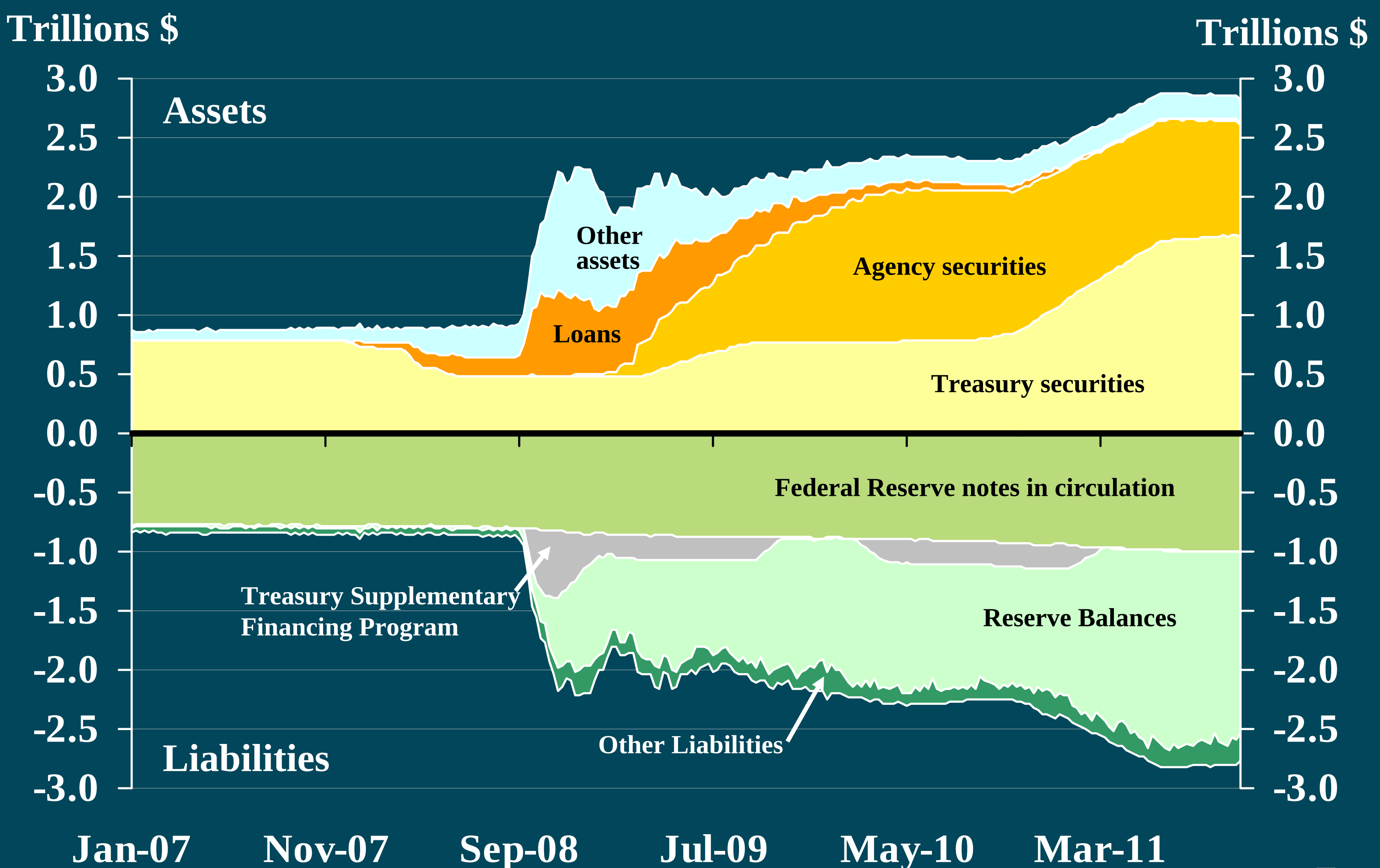
<u>Programs to Individual Firms to Contain Systemic Fallout</u>

- Bear Stearns, AIG, Citigroup

<u>Programs Focused on Longer-Term Asset Prices</u>

- Purchases of the direct obligations of and MBS guaranteed by the housing-related GSEs
- Purchases of longer-term Treasury securities
- Maturity extension program = “Operation Twist”
- Forward guidance

The asset purchases have tripled the size of the Fed's balance sheet



Weekly data: Last point plotted is November 2, 2011

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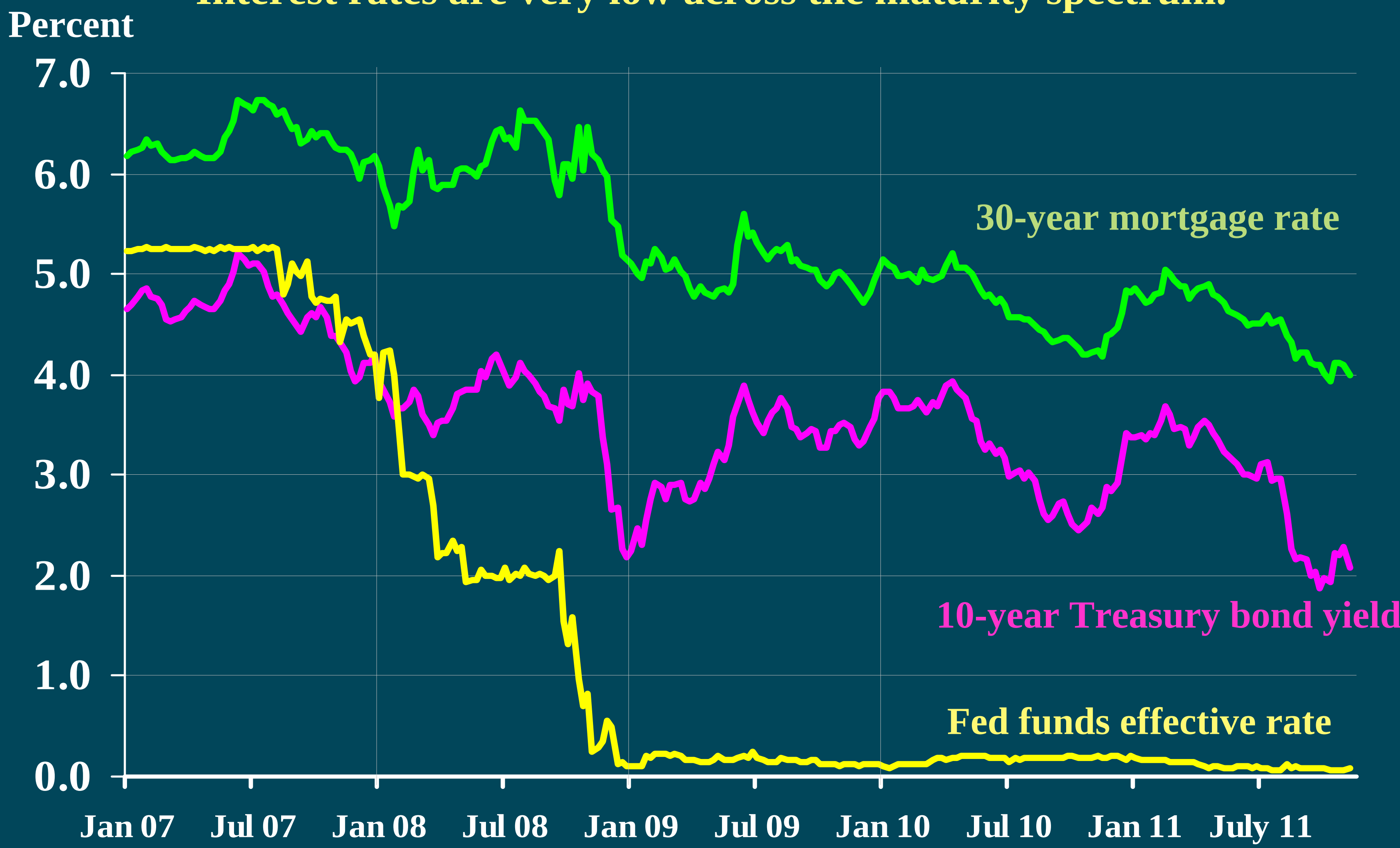
For almost three years, the Fed has kept the fed funds rate at essentially zero and it expects the funds rate to remain there at least through mid-2013. Interest rates are very low across the maturity spectrum.



Weekly data: Last point plotted is November 4, 2011

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Nonconventional monetary policy works on expectations and the term premium

Long-term interest rate = Average of current and expected future short-term interest rate + Term premium

Real rate = Nominal rate – Expected inflation

<u>Nonconventional monetary policy at zero bound</u>

To lower real borrowing rates:

- Lower expected future short-term rates
- Lower the term premium on long rates
- Increase inflation expectations if too low

With the fed funds rate at zero, the Fed will need to consider other tools if it wants to ease policy further

Long-term interest rate = Average of current and expected future short-term interest rate + Term premium

Real rate = Nominal rate – Expected inflation

(1) Forward guidance: Communication and commitment

- Announce commitment to keep rates low for specified period of time or until specified event occurs

(2) Quantitative easing

- Add more reserves to the banking system than needed to keep ff rate = 0 by buying assets
- Use composition of the Fed's balance sheet to target borrowing rates in particular markets (e.g., mortgages)

(3) "Operation twist": Buy longer-term Treasury securities and sell shorter-term Treasuries

- Direct effect on long rates; might put downward pressure on term premium by increasing total demand for long-term issues, and reducing supply available to the public

(4) Target inflation at a higher level

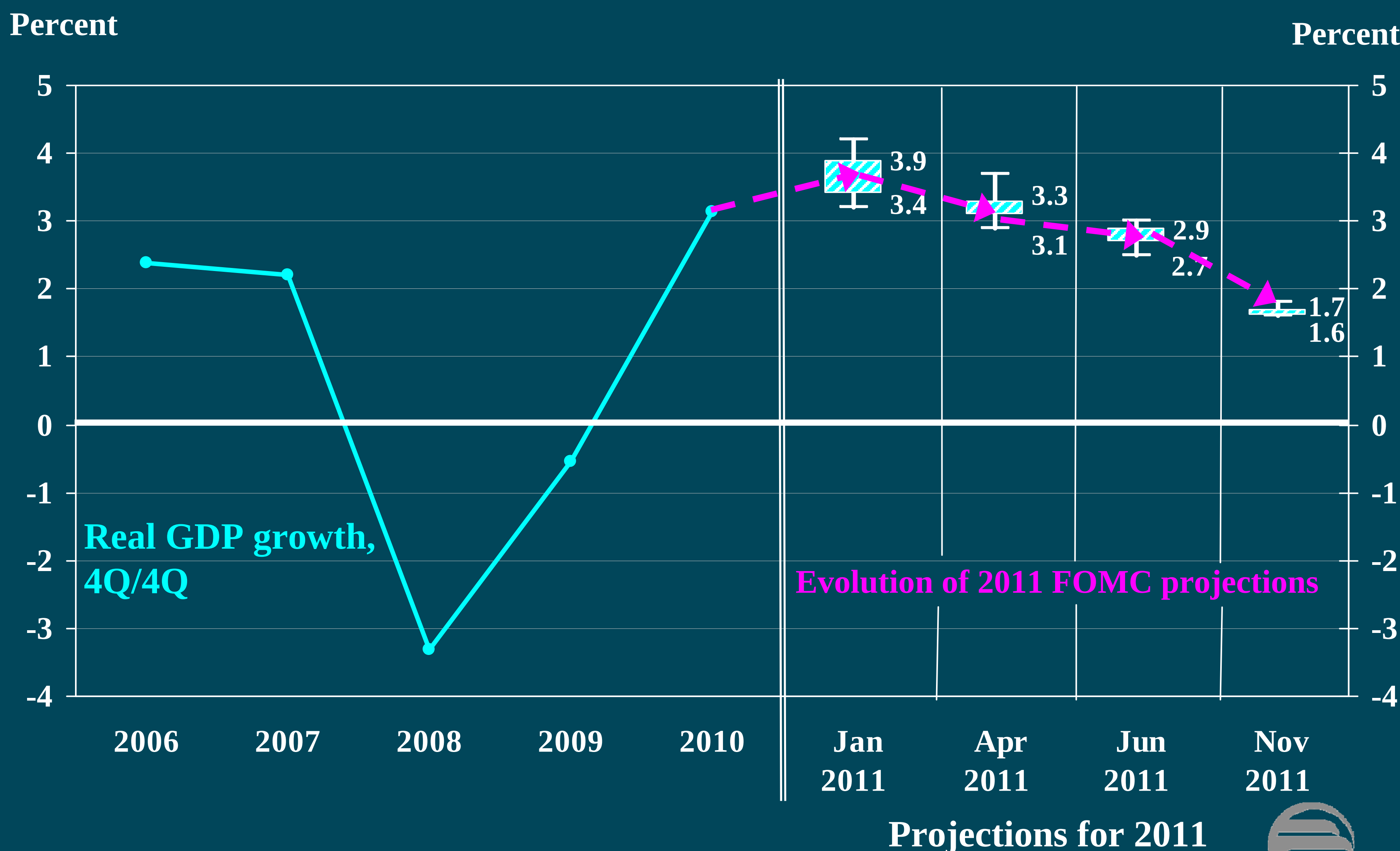
(5) Lower the rate that the Fed is paying banks on their reserves

FOMC forecasters expect moderate growth and slow declines in unemployment

Central tendency of
Fed Governors and Presidents
November 2011 Forecasts

	2011	2012	2013
Real GDP Growth (Q4/Q4 growth)	1.6 to 1.7%	2.5 to 2.9%	3.0 to 3.5%
Unemployment Rate (Q4)	9.0 to 9.1%	8.5 to 8.7%	7.8 to 8.2%
PCE Inflation (Q4/Q4 growth)	2.7 to 2.9%	1.4 to 2.0%	1.5 to 2.0%

The FOMC has been revising down the 2011 forecast throughout the year



Source: FOMC Minutes and Press Conference

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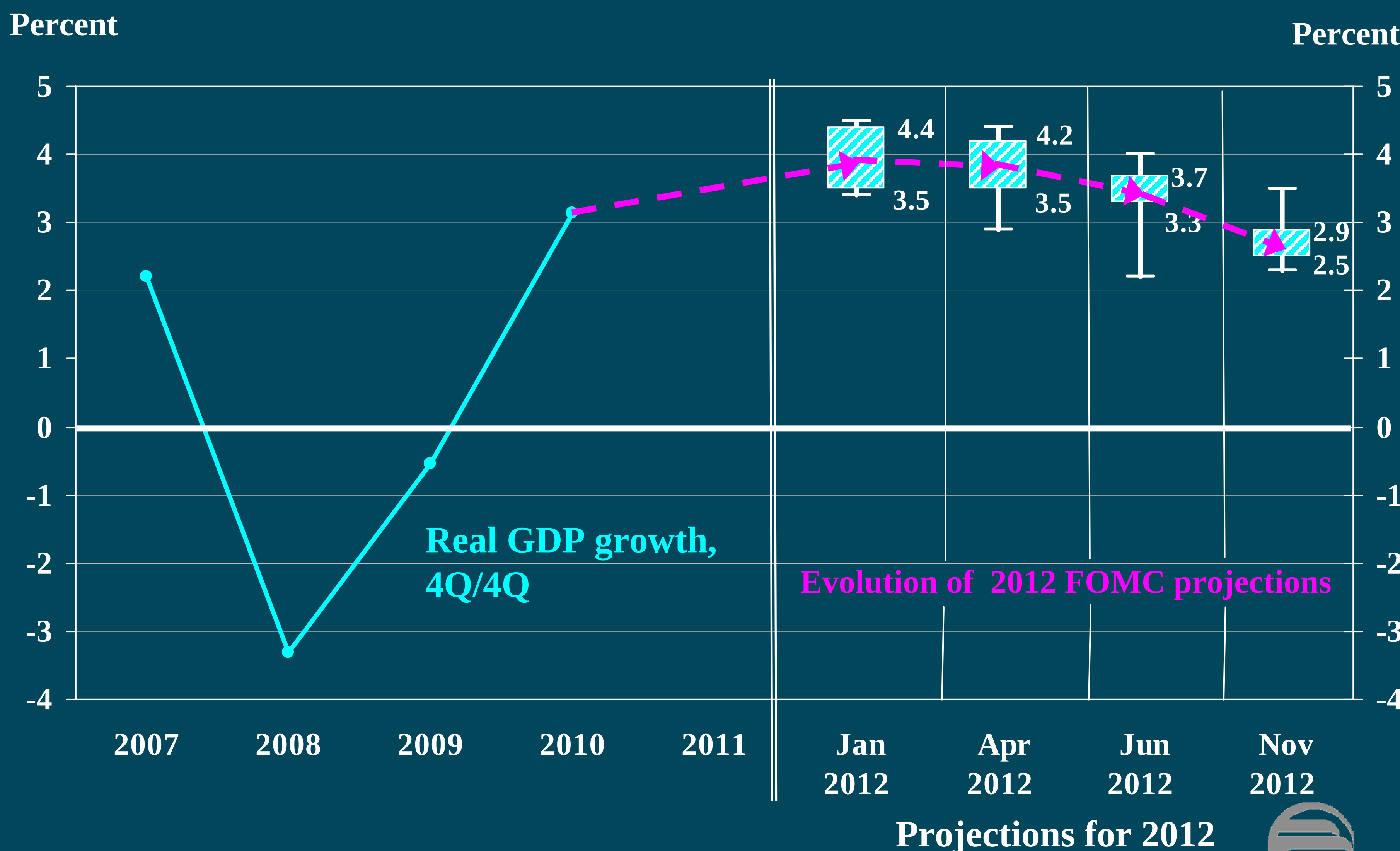
The FOMC continues to expect growth to strengthen in 2012 but it will be weaker than in earlier projections



Source: FOMC Minutes and Press Conference

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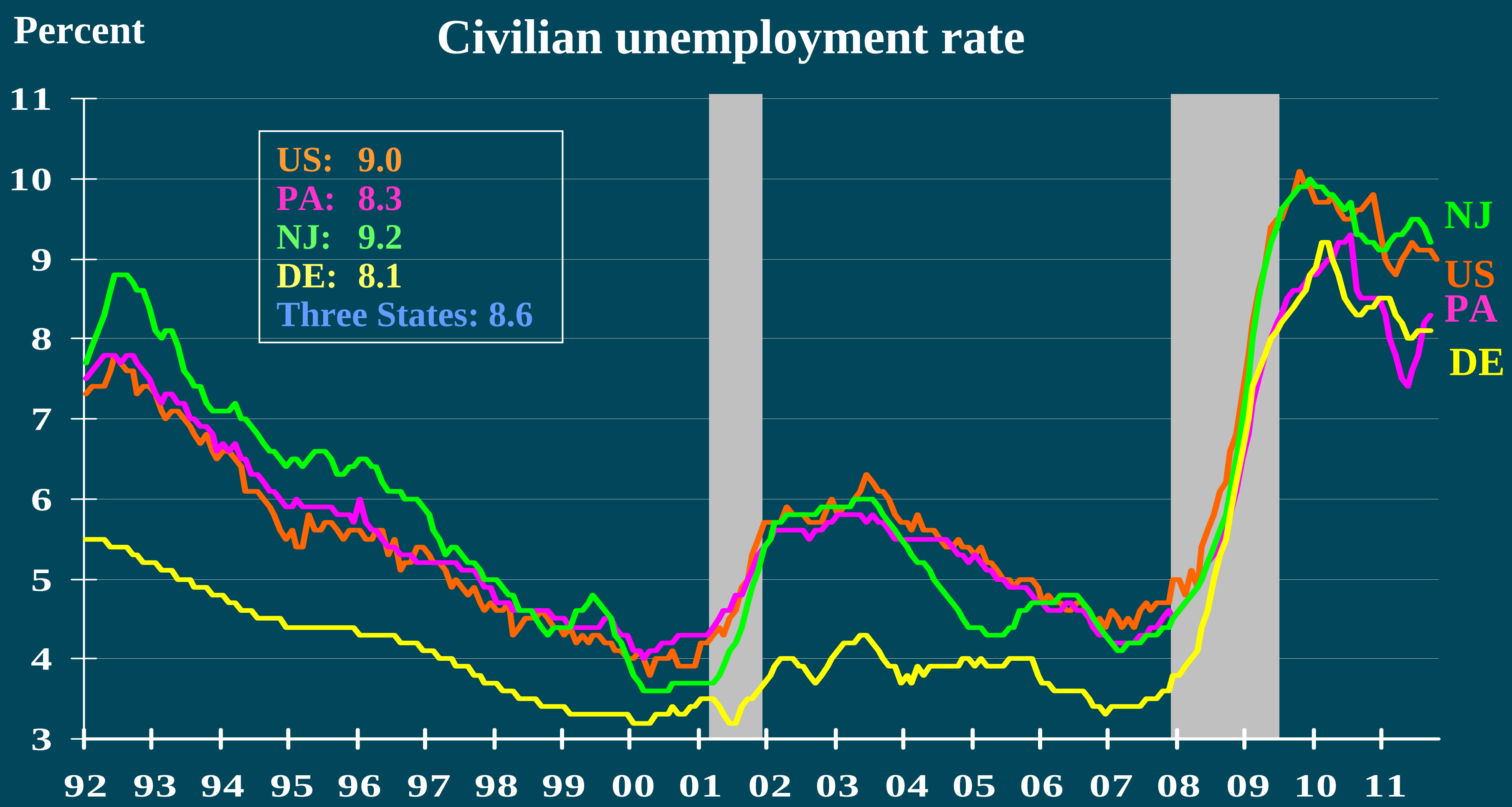
Unemployment rates are high



Monthly data: Last point plotted is October 2011 for U.S. and September 2011 for the states

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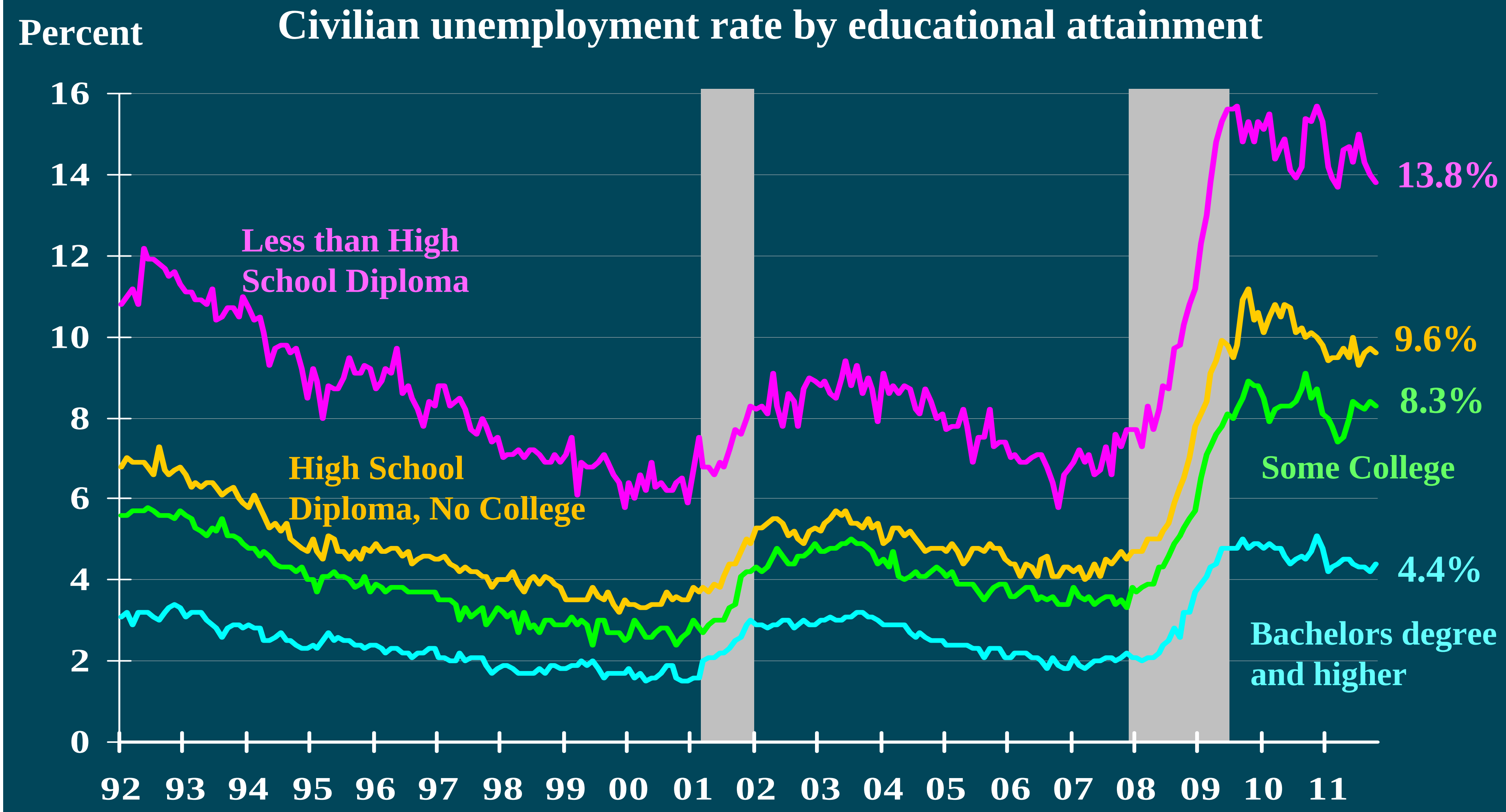
Tell your kids to stay in school!



Monthly data: Last point plotted is October 2011

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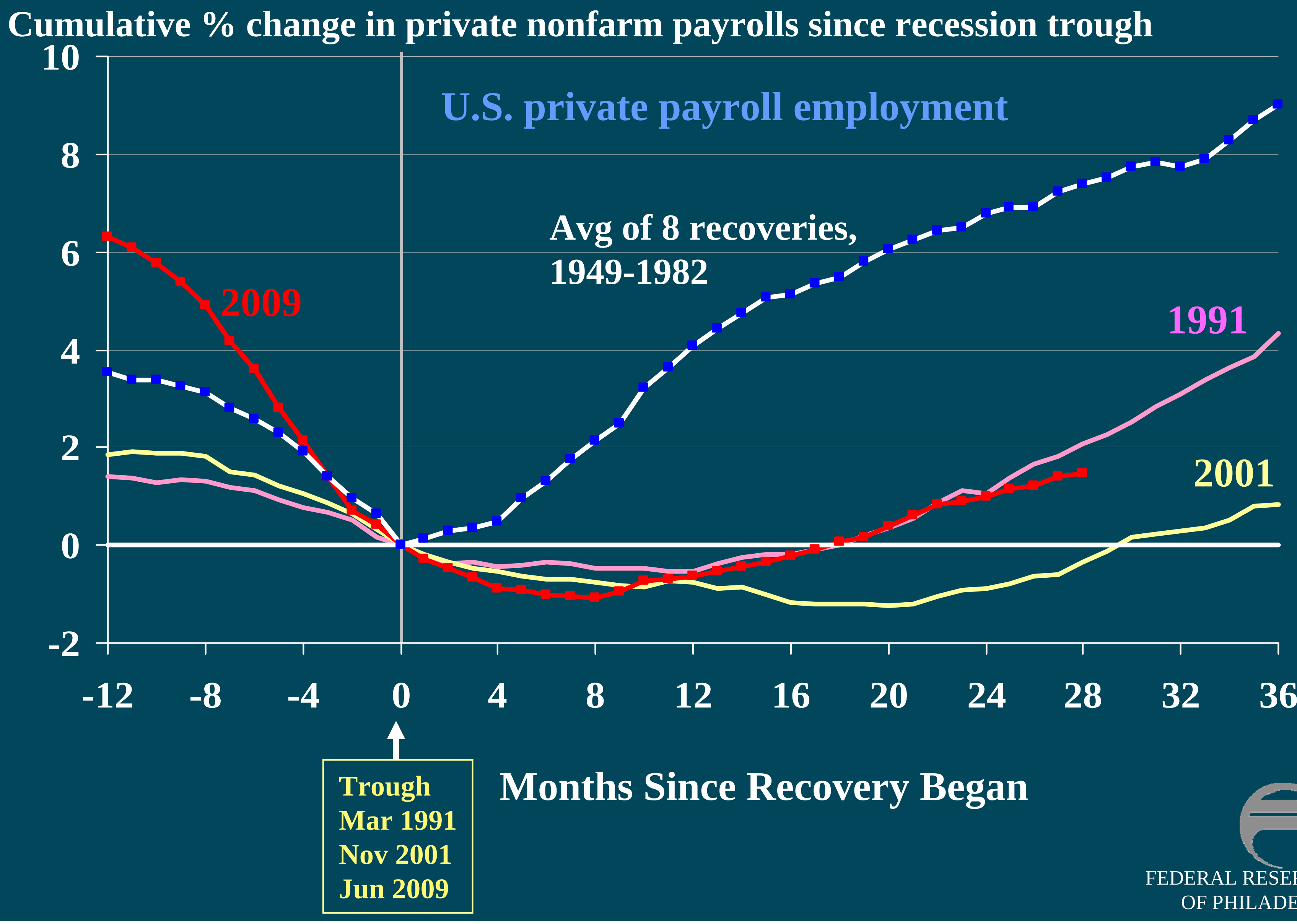
Private sector job growth in the U.S. is now tracking with the 1991 "jobless" recovery – but this recession was much sharper



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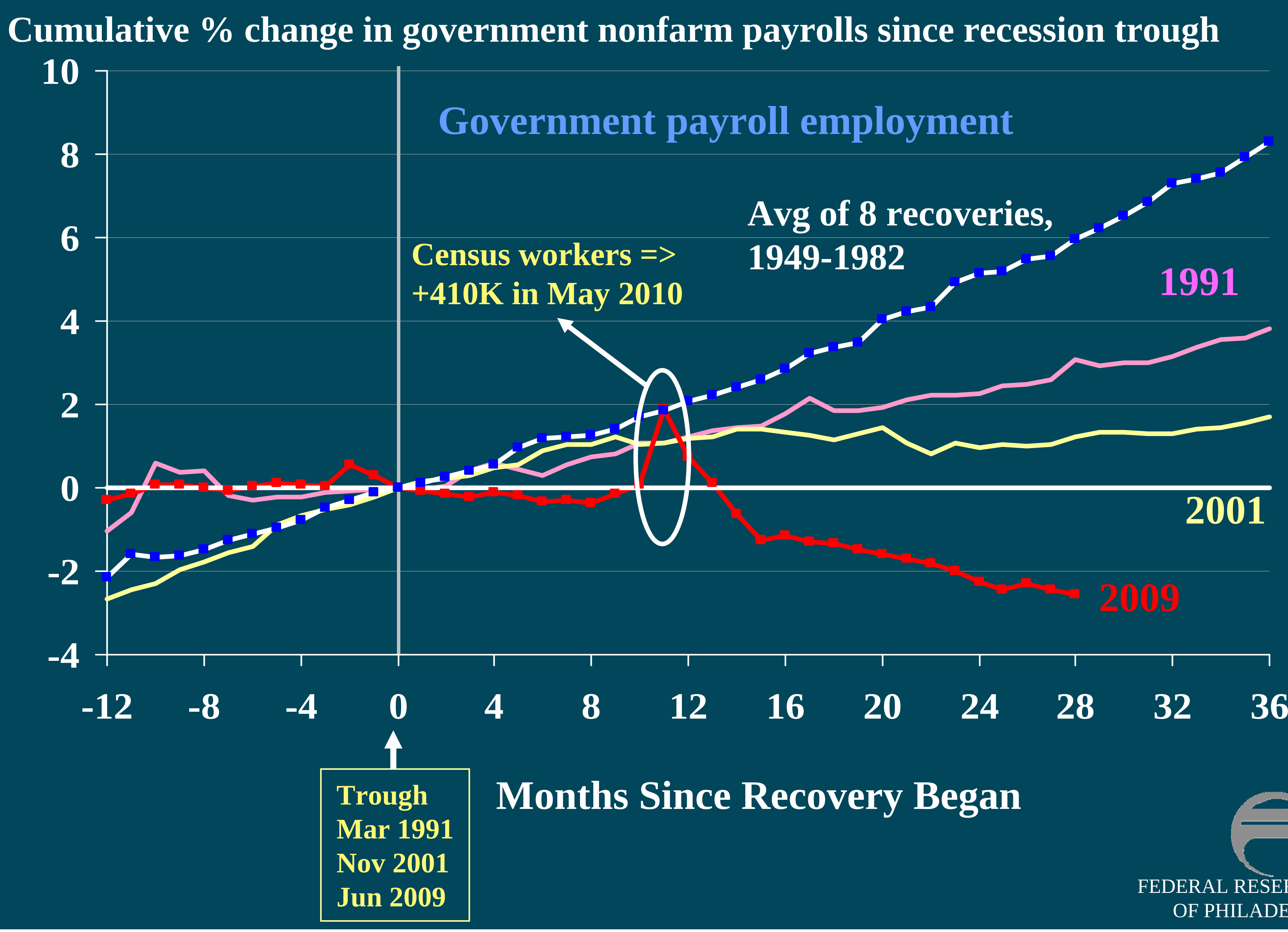
Unlike prior recessions, government jobs are being cut



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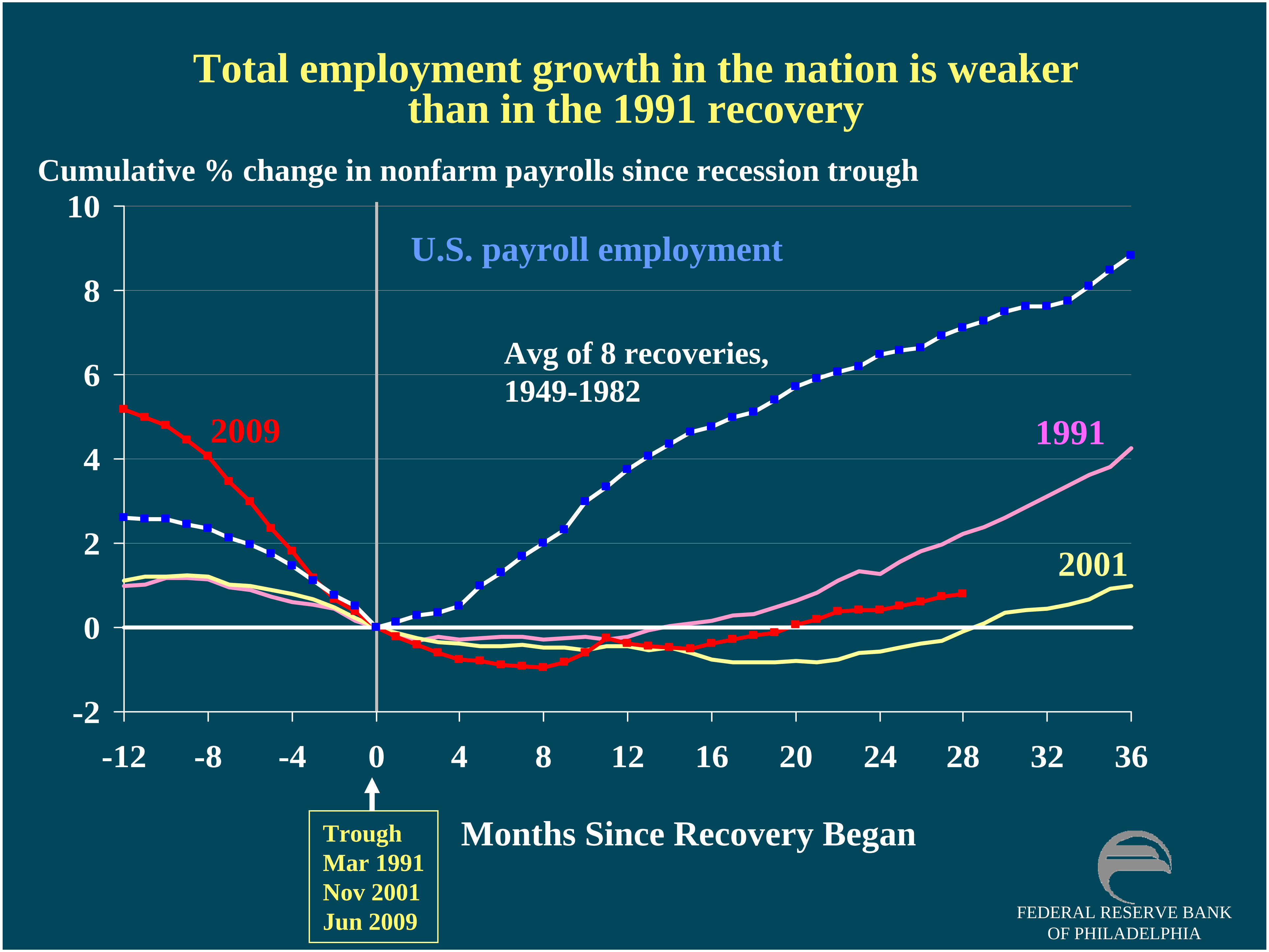

Total employment growth in the nation is weaker than in the 1991 recovery
Cumulative % change in nonfarm payrolls since recession trough
U.S. payroll employment
Avg of 8 recoveries, 1949-1982
2009
1991
2001
10
8
6
4
2
0
-2
-12
-8
-4
0
4
8
12
16
20
24
28
32
36
Trough
Mar 1991
Nov 2001
Jun 2009
Months Since Recovery Began
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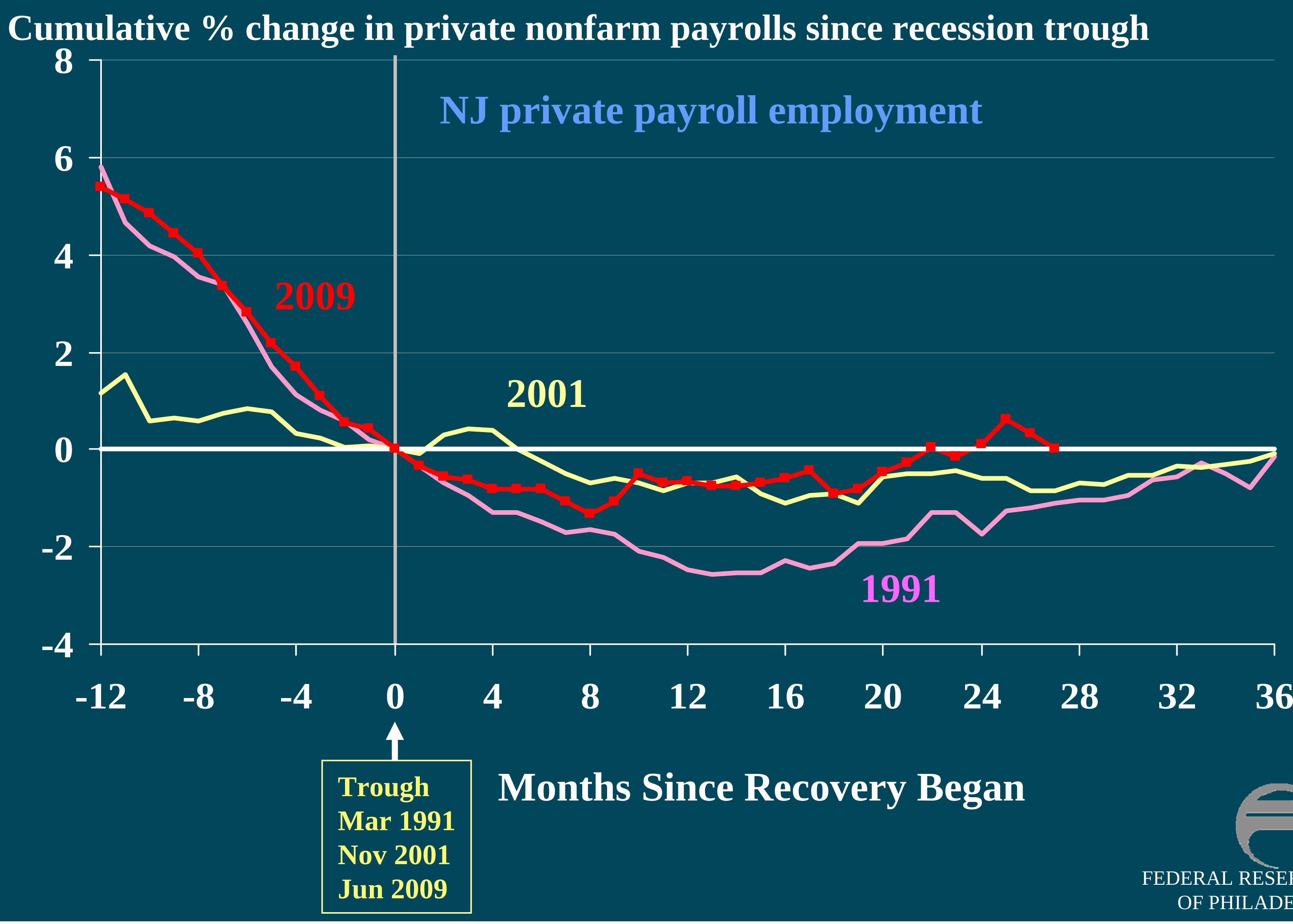
Private sector jobs in New Jersey are no higher than at the start of the recovery – but this is better performance than in the past two jobless recoveries



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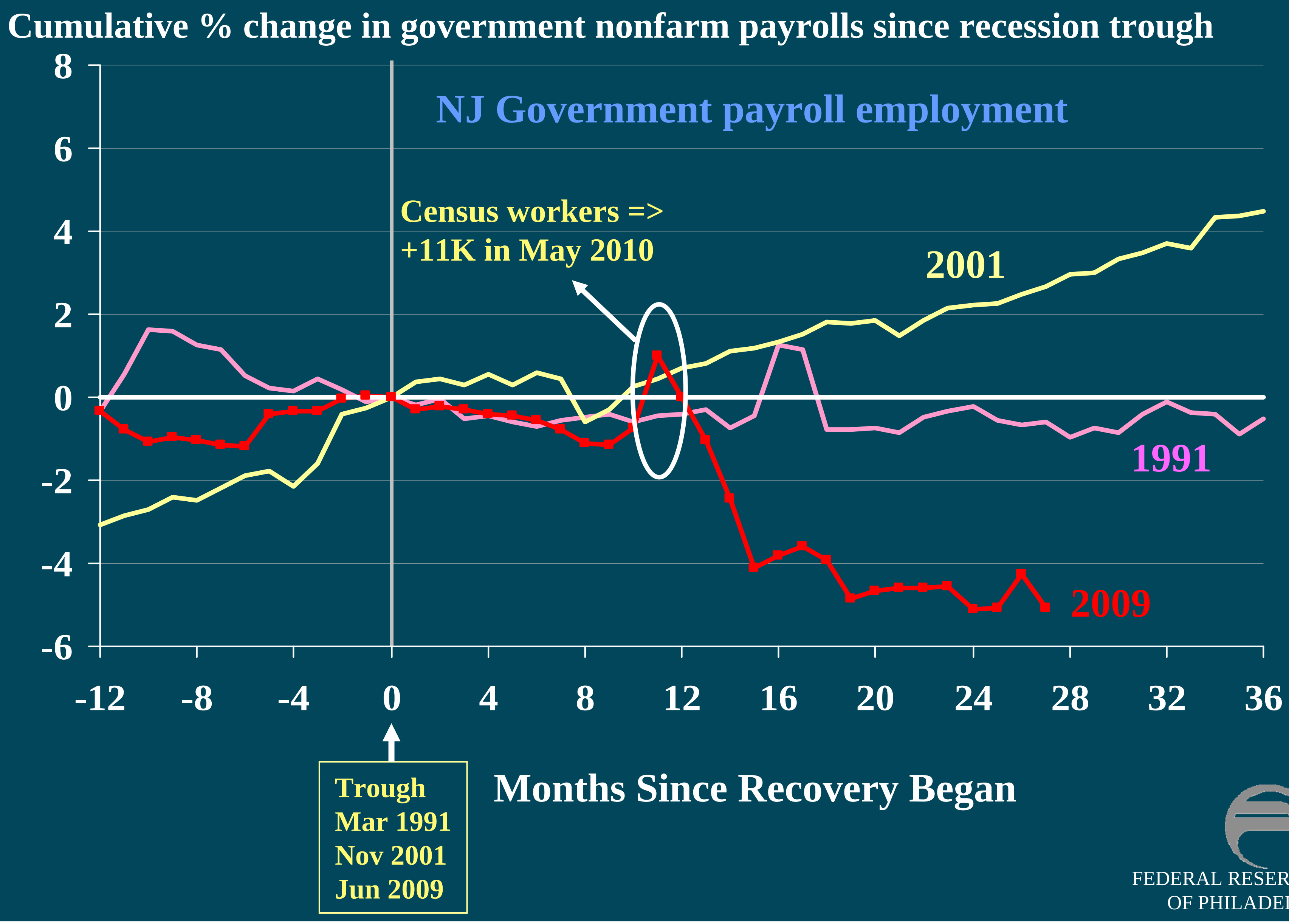
Government job cuts are significant in New Jersey



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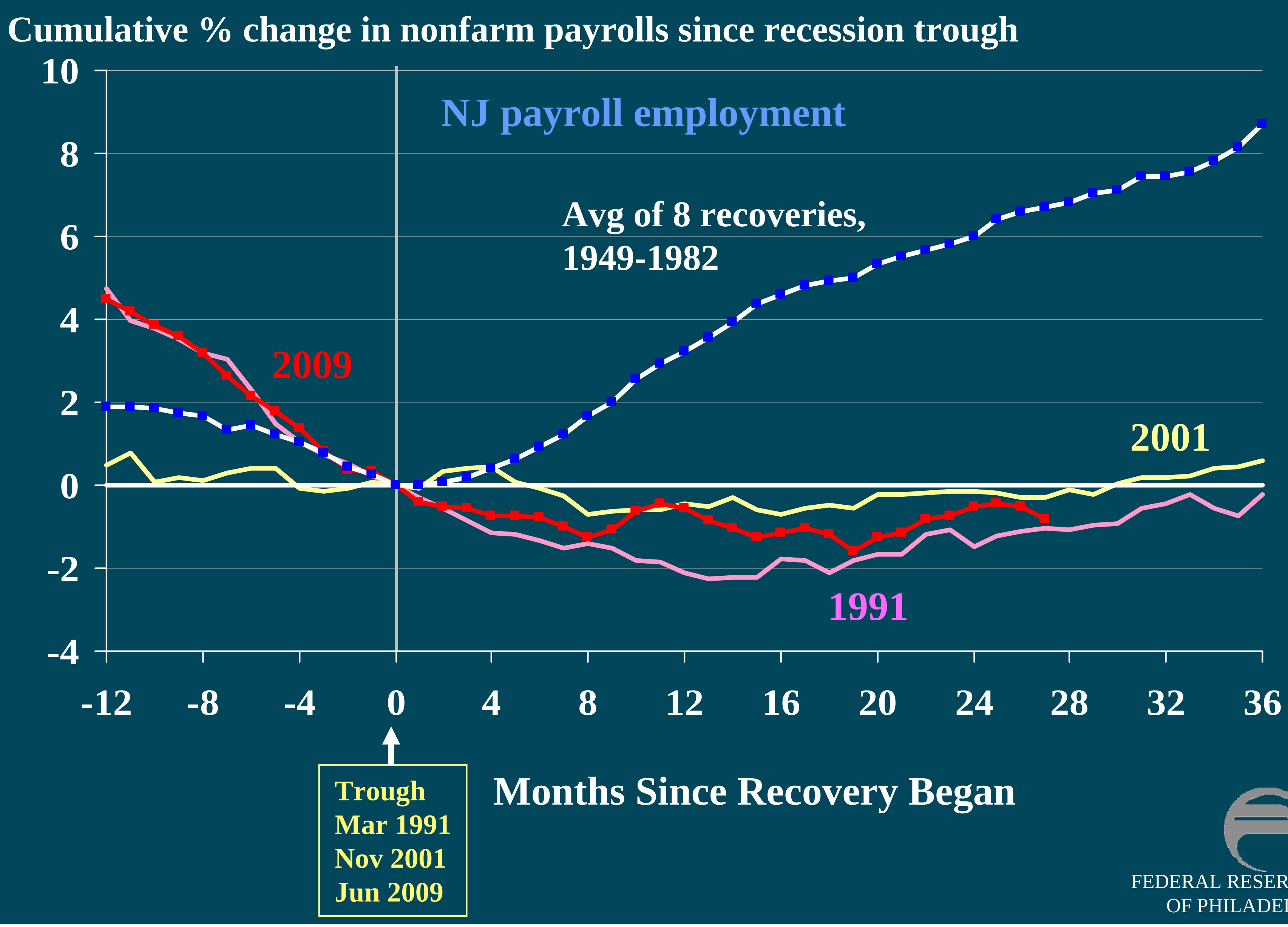
Total employment in NJ is below its level at the start of the recovery



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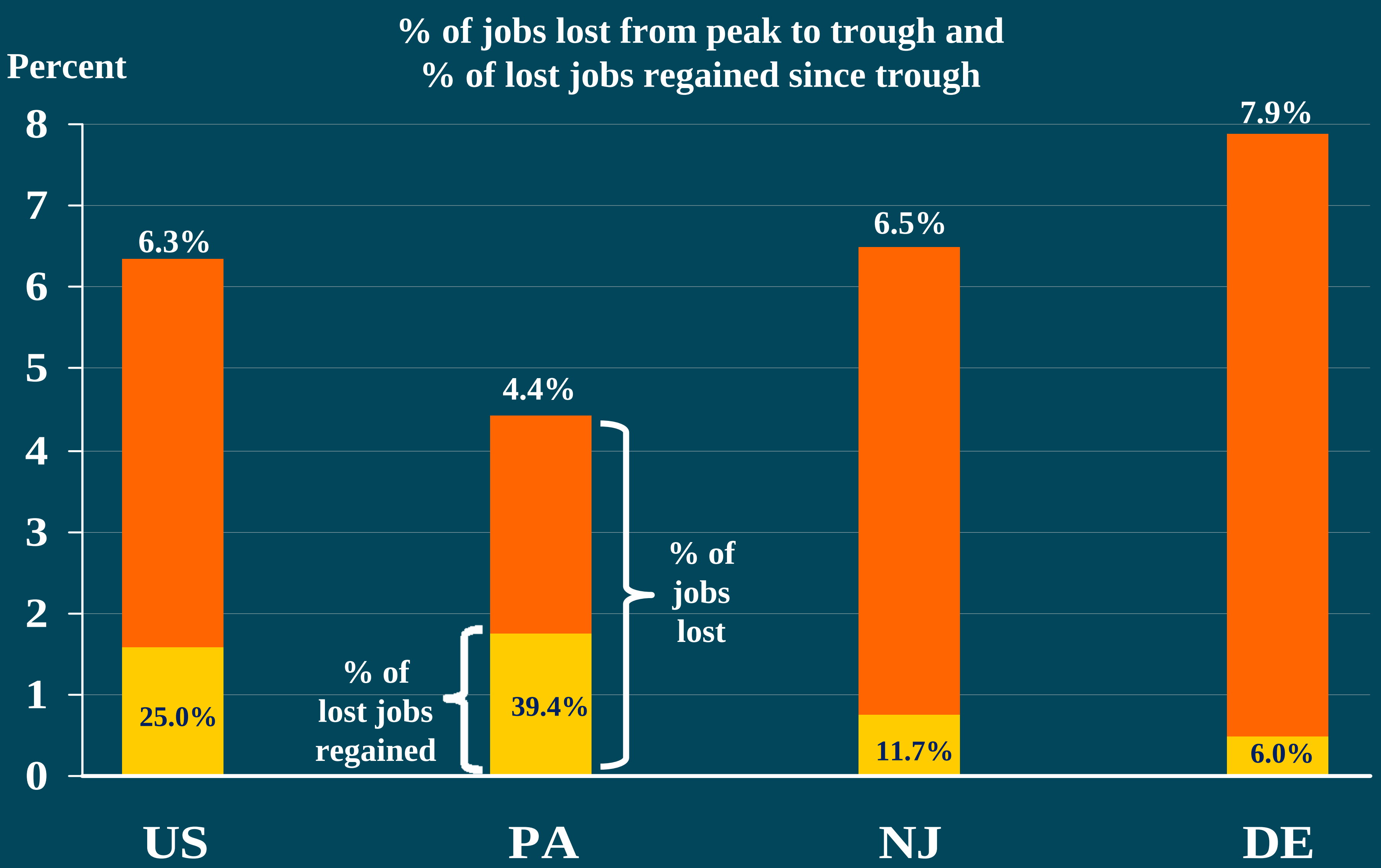
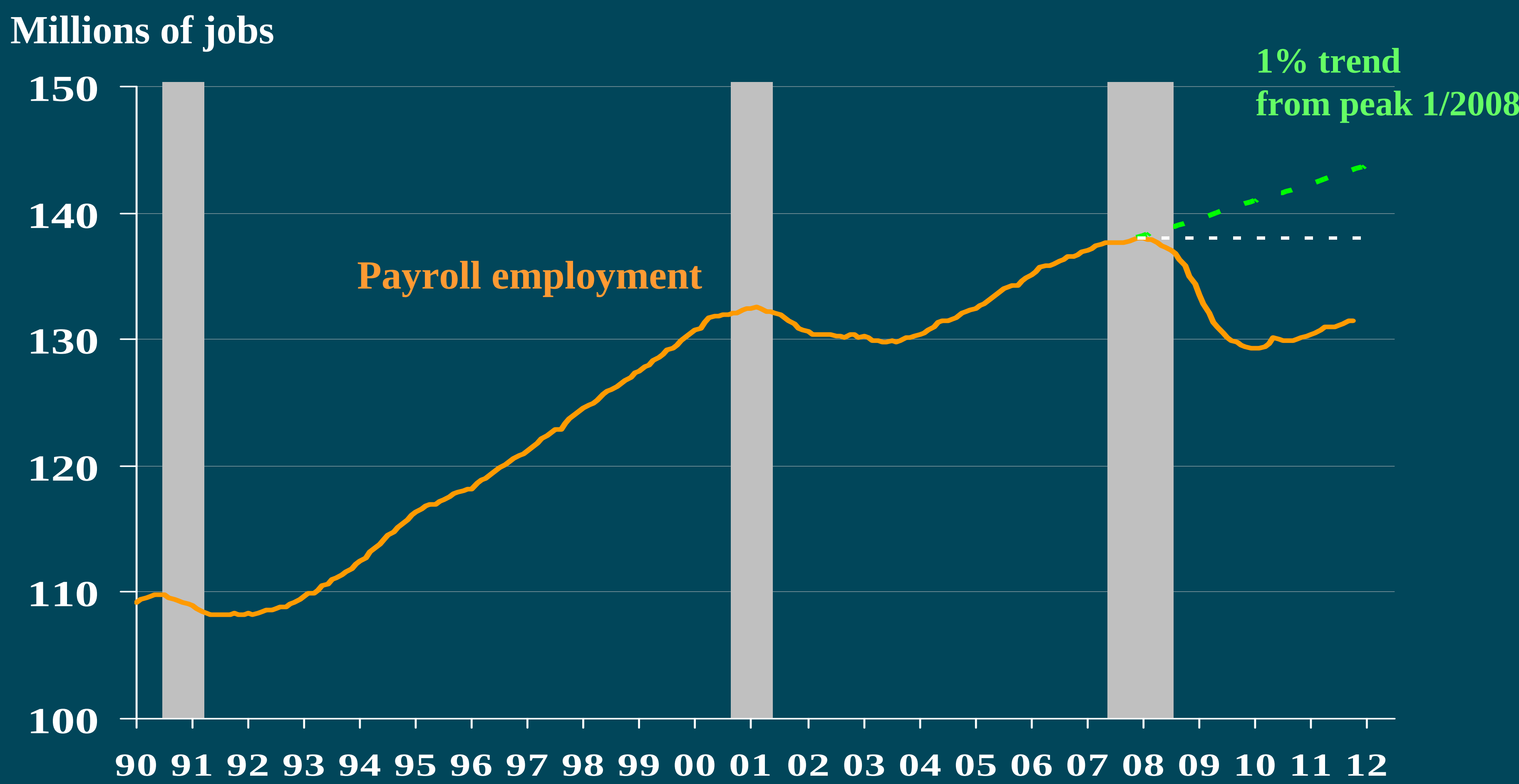
There has been only slow progress on recovering lost jobs



Incorporates September 2011 data

Payrolls are nearly 5 percent below their peak, a net loss of over 6 million jobs. At the current pace of job creation it will take 4 years to make up those losses. If job creation speeds up to what it was earlier this year, it will take 2-1/2 years.



Monthly data: Last data point plotted is October 2011

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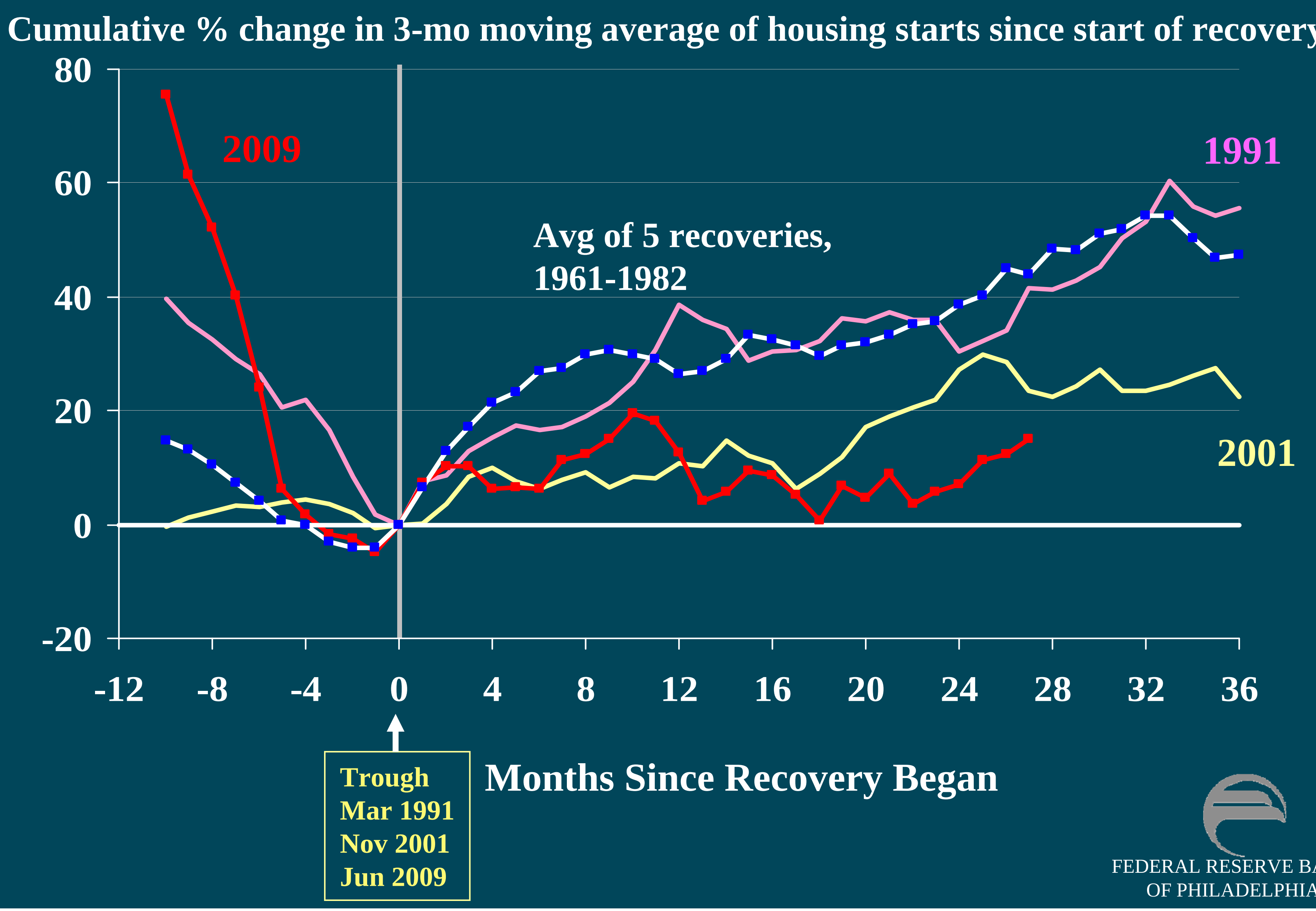
Housing is considerably weaker in this recovery than in earlier ones



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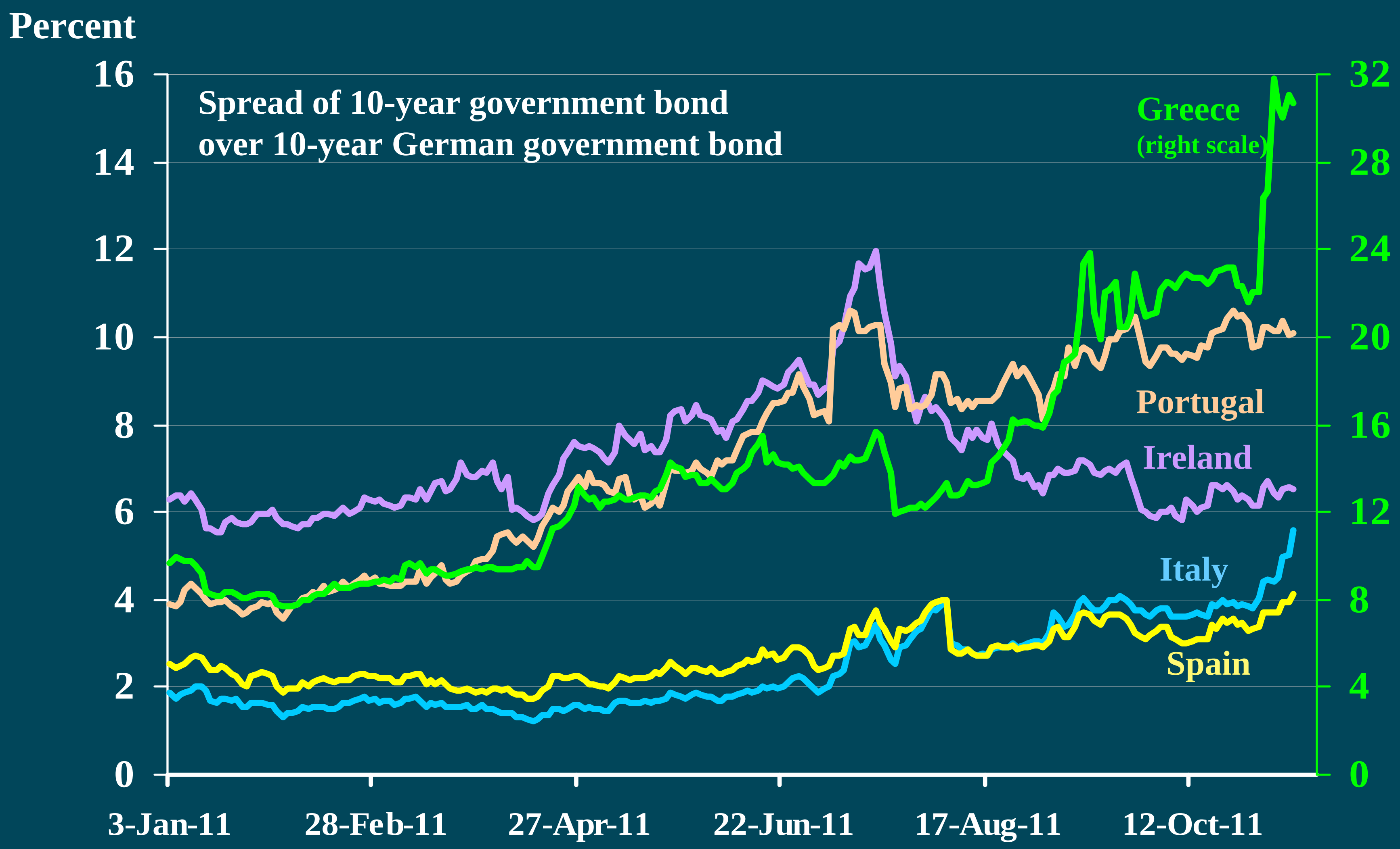
The sovereign debt problems in Europe are a risk to the forecast. European banks, which hold sovereign debt, are under stress.



Daily: Last point plotted is November 9, 2011

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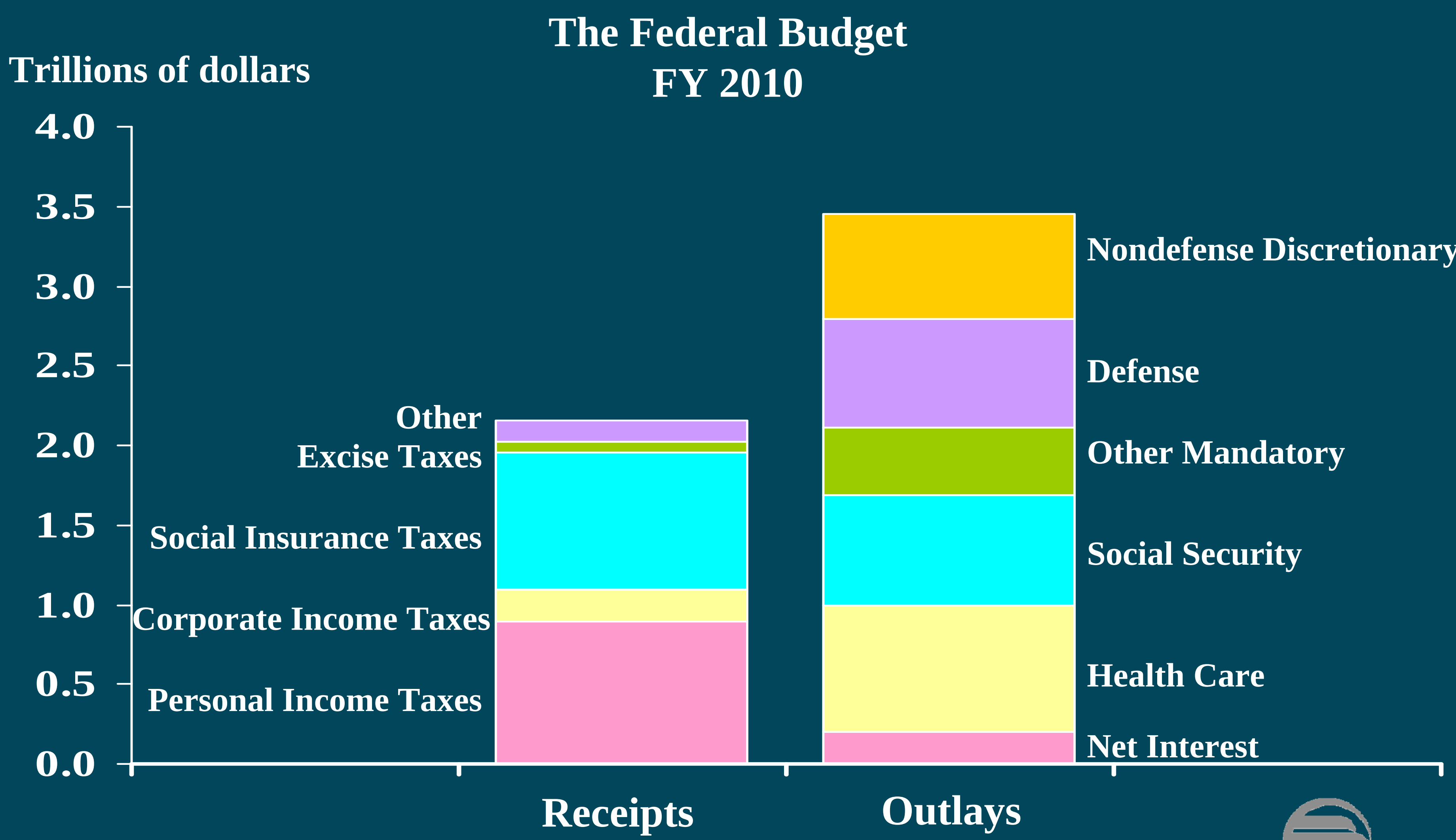
The U.S. is running unsustainably large deficits



Source: Congressional Budget Office

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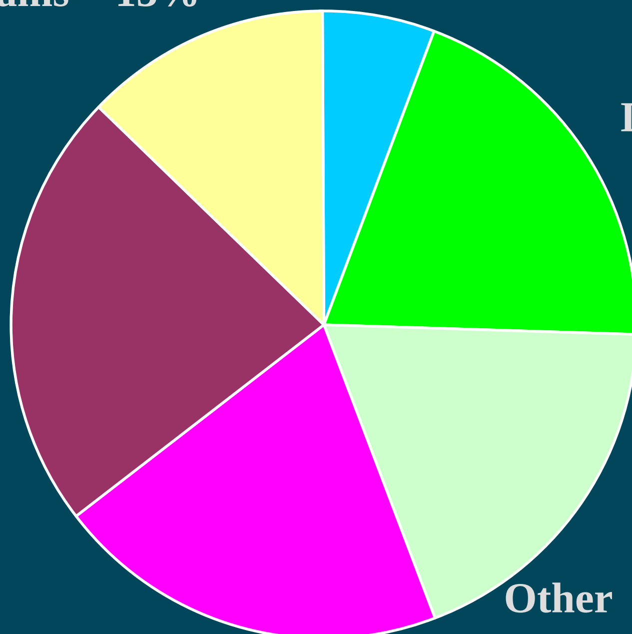
Federal outlays were 24% of GDP in 2010. A large share of government expenditures are on defense, Social Security, Medicare, and Medicaid.

2010 Federal Outlays



Source: Haver Analytics/Congressional Budget Office
Items do not sum to 100 due to rounding.

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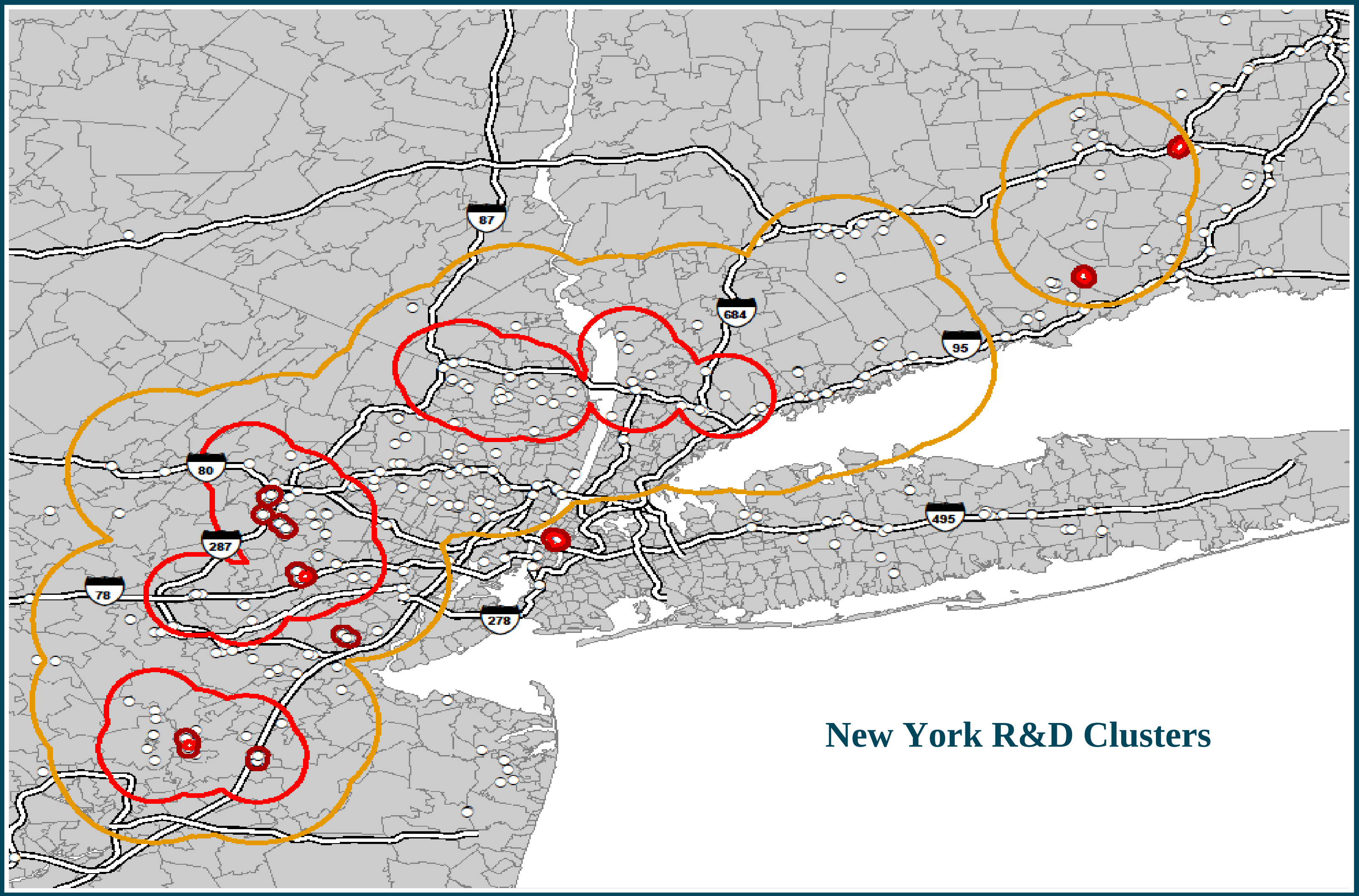
Philadelphia Fed research shows that access to major research universities helps determine the location of innovative activity



Source: Carlino, Carr, Hunt, and Smith, Phila Fed Working Paper 11-42, September 2011

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