Reuven Glick, group vice president at the Federal Reserve Bank of San Francisco, provides his views on current economic developments and the outlook.

- We expect the economic recovery to continue at a moderate pace this year and next, despite ongoing federal deficit reductions. We project growth of 2½% in 2013 and 3¼% in 2014.

- The housing sector continues to improve. Sales of new and existing homes rose, and private construction increased in April, offsetting continued weakness in public-sector building. House prices surged in April and are up by more than 12% over the past 12 months according to the CoreLogic index.

- Vehicle sales are holding their own. In April, weaker car sales raised concerns about the durability of the sales recovery. But May’s rebound to a 15.3 million annual sales rate allayed those concerns.

- Overall manufacturing activity has displayed some weakness. Manufacturing output declined in April for the second month in a row, and the Institute for Supply Management (ISM) manufacturing orders index for May contracted for the first time since November 2012. However, the ISM nonmanufacturing index rose in May, suggesting that the services sector is resisting any slowing in the economy.

- Consumer spending has been very resilient despite the drag of higher taxes that began in January and the federal sequester imposed in March. The three-month average for core retail sales—which excludes spending on gas, cars, and building materials—fell in April but rose in May. Moreover, real consumption expenditures—which include spending on all goods and services adjusted for inflation—rose in April. Consumer spending was partly dampened by lower utility costs in April compared with March, when weather was unseasonably cold in some parts of the country.

- The strength of consumer spending has been somewhat surprising given the very sluggish growth in personal disposable income since the recovery began. Personal income spiked briefly at the end of 2012 as businesses accelerated payouts of bonuses and dividends to avoid anticipated tax increases. Since then, though, income growth has returned to its earlier subpar pace. In the four years since the recovery began, income has grown by less than 2% per year.

- Consumer spending has been driven largely by rising household wealth. Since the depths of the recession, the value of equity assets owned by households has risen strongly, consistent with the rising stock market. More recently, housing asset values started to climb along with increasing home prices.
Households also have improved their balance sheets by reducing their debt. Household debt built up steeply starting in 1999, primarily through mortgages. Since the housing bubble burst, consumer debt has declined significantly. With less cash devoted to debt repayment, households have freed up funds for other uses, including consumption.

Wealth effect calculations imply that the $3 trillion increase in wealth in the first quarter of 2013 boosted spending by about $90 billion. These calculations assume that a $1 increase in household wealth raises spending by around three cents.

Consumer sentiment continues to improve. Both the Conference Board and the Thomson Reuters/University of Michigan surveys of consumer confidence reached post-recovery highs in May, providing further evidence that households are more optimistic about economic conditions.

Job status is a key factor in consumer spending power. Employers added 175,000 new jobs in May, primarily in the services sector. Over the past six months, employers have added an average of 194,000 jobs per month. The federal government, on the other hand, lost 14,000 jobs in May, with most of the losses likely a direct result of the sequester.

The unemployment rate edged up one-tenth to 7.6%, as more people entered the labor force. The unemployment rate has declined fairly steadily over the past three years. Even with the May increase, the rate is one-half point lower than in August 2012, just before the Federal Reserve began its latest round of large-scale asset purchases. We continue to expect that output growth will not push the unemployment rate below the Federal Open Market Committee’s 6½% threshold for raising the federal funds rate until sometime in the middle of 2015.

Recent inflation numbers generally have come in on the low side, and the April personal consumption expenditures price index was no exception. Core inflation, excluding food and energy prices, was up 1.1% in April over the past 12 months, while headline prices were up 0.7%. We continue to project that inflation will rise gradually towards the Fed’s 2% target.
Moderate recovery is continuing

GDP Growth: Actual and FRBSF Forecast
Annualized growth rate, seasonally adjusted

-10 -6 -2 2 6

2007 2008 2009 2010 2011 2012 2013 2014

Actual FRBSF Forecast

Q1

Source: Bureau of Economic Analysis and FRBSF staff

Existing and new home sales growing

Home Sales
Seasonally adjusted annual rate

Existing home sales (right axis)
New home sales (left axis)

0.2 0.4 0.6 0.8 1.0 1.2 1.4 1.6 1.8 2.0

2000 01 02 03 04 05 06 07 08 09 10 11 12 13

Source: National Association of Realtors

Motor vehicle sales holding up

Auto and Light Truck Sales
Seasonally adjusted annual rate


Source: Autodata

Overall manufacturing activity is weaker

Manufacturing Sector

ISM New Orders Index* (left axis)
Manufacturing Production** (right axis)


Source: Federal Reserve Board, Institute for Supply Management

* >50 means orders increasing. ** 3-mo. % change, annualized.

Consumers remain resilient

Core Retail Sales and Real Personal Consumption
Seasonally adjusted annualized 3-mo. % change


Core Retail Sales
Real Personal Consumption

Source: Bureau of Economic Analysis, Census Bureau

Household income growth is sluggish

Consumption and Disposable Personal Income
Indexed to 100 at July 2009

Real Personal Consumption Expenditures
Real Disposable Personal Income

2009 2010 2011 2012 2013

Source: Bureau of Economic Analysis / Haver Analytics
Household wealth is rebounding

*Household Equity and Real Estate Assets*

- Multiples of disposable income


Source: Financial Accounts of the United States, Federal Reserve Board.

Mortgage debt is declining

*Household debt as percentage of total income*

Q1

00 01 02 03 04 05 06 07 08 09 10 11 12 13

Source: Financial Accounts of the United States, Federal Reserve Board.

Consumer confidence is rising

*Consumer Sentiment and Consumer Confidence*

May


Source: Conference Board, Michigan Survey

Labor market continues to improve

*Nonfarm Payroll Employment*

- Millions of employees; seasonally adjusted

May

04 05 06 07 08 09 10 11 12 13 14

Source: Bureau of Labor Statistics

Unemployment rate expected to decline

*Unemployment rate*

- Seasonally adjusted; forecast is quarterly average

May

04 05 06 07 08 09 10 11 12 13 14

Source: Bureau of Labor Statistics and FRBSF staff

Inflation running below 2%

*PCE Inflation*

- Percent change from four quarters earlier

Q1

04 05 06 07 08 09 10 11 12 13 14

Source: Bureau of Economic Analysis and FRBSF staff