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Eric Swanson, senior research advisor at the Federal Reserve Bank of San Francisco, states his views on the current economy and the outlook.

- The number of employees on nonfarm payrolls rose by a seasonally adjusted 200,000 in December, according to the Bureau of Labor Statistics. Private-sector payrolls gained about 212,000, while state, local, and federal government payrolls fell by about 12,000 jobs. The increase in nonfarm payrolls was somewhat higher than the average over the past several months, but nevertheless below the rate of job growth in a typical recovery. Even in 2004–07, payrolls grew at a substantially stronger rate than at present. Moreover, the total number of employees on nonfarm payrolls remains about 6.1 million workers fewer than at the start of the recession, a dramatic shortfall.
- The unemployment rate fell by a seasonally adjusted 0.2 percentage point in December to 8.5%. Over the past three months, the unemployment rate has fallen 0.5 percentage point, a substantial decline. However, even with the recent declines, the unemployment rate remains far above its level in the 2001 recession and subsequent recovery. Initial claims for unemployment insurance provide a broadly similar perspective on the labor market.
- Auto and light truck sales in December were a touch weaker than in November on a seasonally adjusted basis. Nevertheless they were consistent with a steady uptrend since the depths of the recession in early 2009. It is interesting to compare these sales to light vehicle scrappage, which is computed from Federal Highway Administration annual data on vehicle registrations. Auto sales fell dramatically below scrappage in 2009, the most recent year for which data are available. That was historically unprecedented, showing the severity of the auto sector downturn. Auto sales remain roughly in line with the scrappage trend, suggesting that December's sales rate is easily sustainable and has room to run somewhat higher.
- Consumer attitudes have rebounded over the past few months from the lows registered in August. Over the summer, attitudes appear to have been dampened by financial market volatility arising from the sovereign debt crisis in Europe, the rating agency downgrade of U.S. debt, and the congressional fight over the federal debt limit. As those concerns faded, consumer sentiment seems to have improved, though remaining far below pre-recession levels. Higher consumer confidence bodes well for purchases of big-ticket items, such as autos, furniture, appliances, and homes.
- Existing home sales posted a healthy gain in November. Even more encouraging was the level of pending home sales calculated by the National Association of Realtors, which shot up to the highest level since May 2007, aside from spikes in 2009 and 2010 driven by federal homebuyer tax credits. Pending home

sales are a leading indicator of future sales, so November's high level suggests that completed home sales will rise in December and January. An index of homebuilder sentiment also rose to its highest level since the spring of 2007, excluding the months right before the federal homebuyer tax credits.

- The National Association of Realtors reported that housing affordability rose to an all-time high in October. It's easy to see why: Mortgage rates continue to hit historic lows and have averaged less than 4% for several weeks. Moreover, house prices are well off their boom-year highs and have continued to drift down over the past year. The ratio of the cost of buying a house compared with the cost of renting one has also fallen dramatically over the past five years and is now close to historical averages.
- However, mortgage lending standards remain very tight, limiting sales activity. A borrower with a FICO credit rating of 620 or above is generally considered a prime borrower. Many of the housing boom excesses involved deteriorating lending standards for subprime borrowers, but the credit quality of prime borrowers was relatively unchanged from 2000 through 2007, with a median FICO score of about 730. However, since the start of the recession, the median FICO score for prime borrowers has risen about 40 points to around 770 and has not declined. Thus, a prospective homeowner must have a much higher credit rating than in the past to qualify for a loan.
- Data over the past month have led to relatively little change in our forecast. We think that gross domestic product expanded at about a 3.2% annual rate in the fourth quarter of 2011, partly reflecting transitory factors such as a buildup of manufacturing inventories. We expect GDP growth to moderate in the first half of 2012, averaging only about an annualized 2.1%. The recovery should gradually pick up steam over 2012 and into 2013. This pace of growth is likely to be too slow to bring the unemployment rate down much. We expect that unemployment will fall only slightly below 8.5% by the end of this year and to only a bit less than 8% by the end of 2013.
- Recent data on core inflation, as measured by the personal consumption expenditures price index excluding food and energy, have come in at an annual rate of about 1.5%. Given the lack of wage pressures, we expect these muted readings to continue. Overall inflation, including the prices of food and energy, has trended down lately. Twelve-month average inflation should fall over coming months as some of the larger price increases early in 2011 get left behind. We expect overall inflation to gradually return to the level of core inflation, about 1.5%.



