Twelfth Federal Reserve District

FedViews

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Reuven Glick, group vice president at the Federal Reserve Bank of San Francisco, states his views on the current economy and the outlook:

- The economy has shown more signs that it is on the rebound, with the recovery proceeding at a moderate pace.

- GDP growth for the fourth quarter of 2009 was revised up to 5.9 percent from 5.7 percent. However, 3.9 percentage points, about two-thirds of that number, was due to inventory investment as firms sharply slowed their rates of inventory liquidation. This is expected to make a much smaller contribution to growth in the future as the inventory cycle ends.

- Recent monthly readings indicate that final sales are growing moderately. Real consumer spending rose by 0.3 percent in January, up 1.4 percent from 12 months ago. However, vehicle sales for February remained weak after spiking in mid-2009 because of the car allowance rebate program. The February figure may have been depressed by bad weather and concerns about Toyota safety.

- The level of private consumption remains below its prerecession trend, in part because households remain quite cautious. Going forward, consumption faces headwinds from a combination of factors, including a weak labor market, credit constraints on some households, and eroded balance sheets.

- Underscoring the recovery of the manufacturing sector, the Institute for Supply Management index for February, while falling slightly, remained comfortably in expansionary territory. Factory data for January show that orders and shipments of core capital goods both fell, but the three-month moving average growth rate was positive. Equipment and software investment have been leading the way.

- Weak residential investment continues to be a drag on growth. Both new and existing homes sales were weak in January. The first-time homebuyer tax credit program that expired in November evidently boosted home sales last year at the expense of sales this year. The credit program has since been extended, suggesting a possible sales bump later this year. However, continued foreclosures overhang future sales.

- The February jobs report was surprisingly good, considering the effect extreme weather conditions had on employment. Nonfarm payrolls fell by 36,000 jobs. Over the past four months, job losses have averaged 27,000 per month. The unemployment rate for February held steady at 9.7 percent for the second month in a row, down from its peak of 10.1 percent last October.

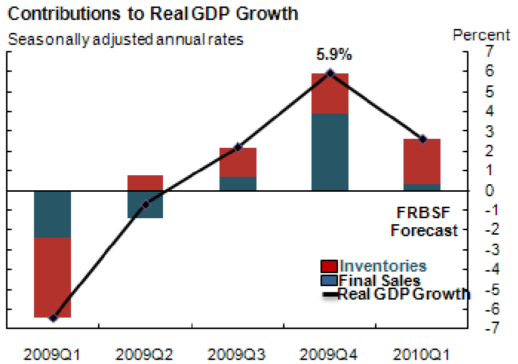
- Temporary hiring and the average workweek continue to trend up, providing more evidence of increased labor demand. A reversal of weather effects and faster hiring by the Census Bureau suggest a sizable expansion in payrolls in March is likely. A total of 8.4 million jobs have been lost since the recession began in December 2007. However, in view of the depth of the recession, substantial labor market slack will likely persist for the next few years.

- Our current assessment is that real GDP is likely to rise at an annual rate of about 2½ percent during the first quarter of 2010, by about 3½ percent during the rest of the year, and about 4½ percent in 2011. We project unemployment will fall slowly to near 9 percent by the end of 2010 and to 8 percent by the end of 2011. A key risk to the outlook is whether household and business spending will improve sufficiently to offset waning stimulus over the next two years.

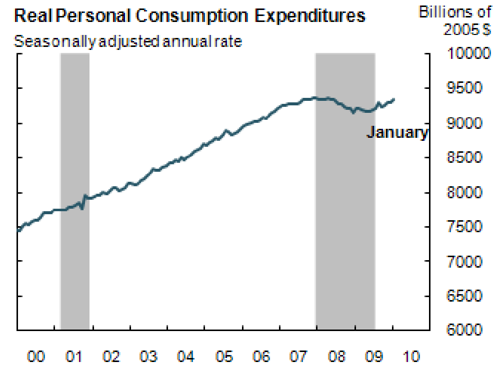
- Inflation remains subdued as a result of slack in the labor and goods markets. In January, the core consumer price index (CPI) fell 0.1 percent, while the core personal consumption expenditures price index (PCEPI) remained unchanged. Over the past 12 months, the core CPI and core PCEPI have risen by 1.5 percent and 1.4 percent respectively. Going forward, we expect ongoing weakness in product and labor markets to cause these inflation readings to moderate slightly, with core PCEPI averaging near 1 percent in 2010.

- The Federal Reserve has communicated that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period of time. Market participants expect no change in the federal funds rate over the next few months, though some increase is expected by the end of the year.

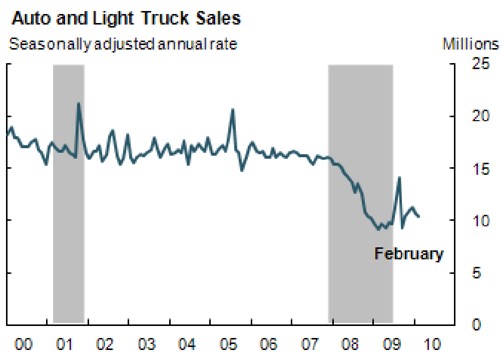
Inventories behind Q4 growth



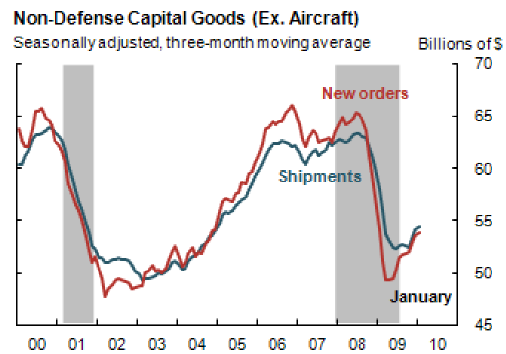
Consumption growing modestly



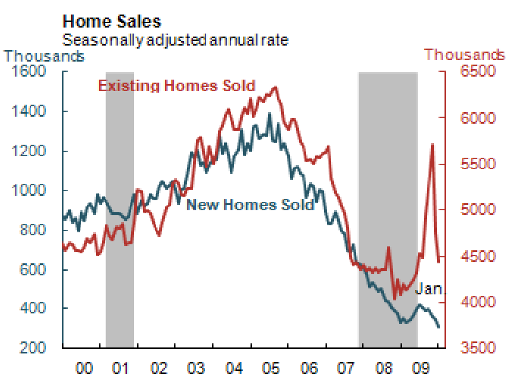
Vehicle sales remain weak



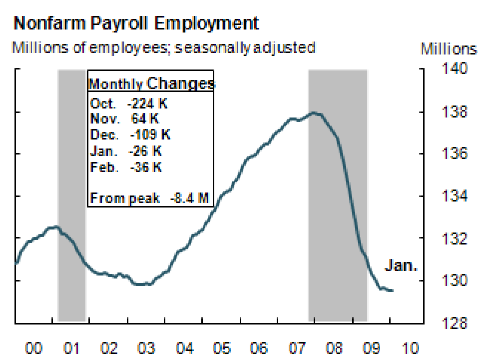
Investment goods rebounding



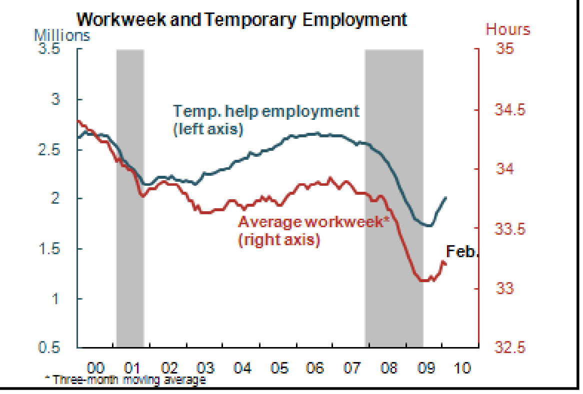
But home sales weakening



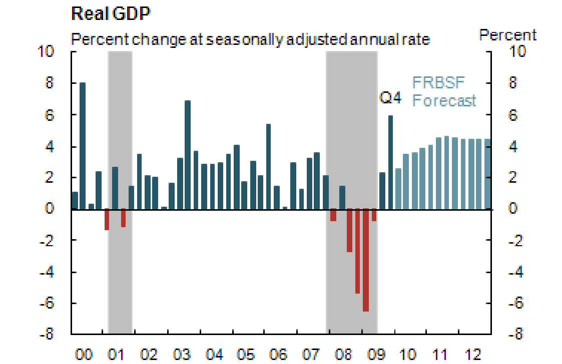
Labor market near trough?



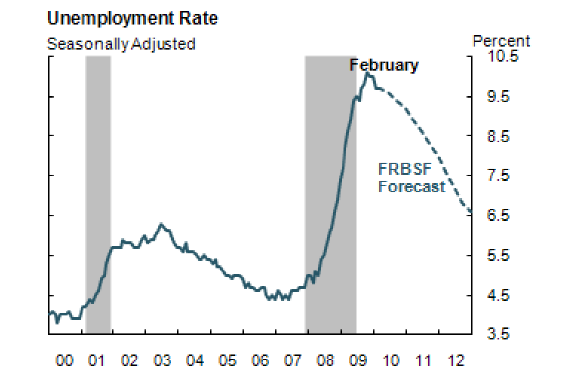
Advance indicators of employment pick up



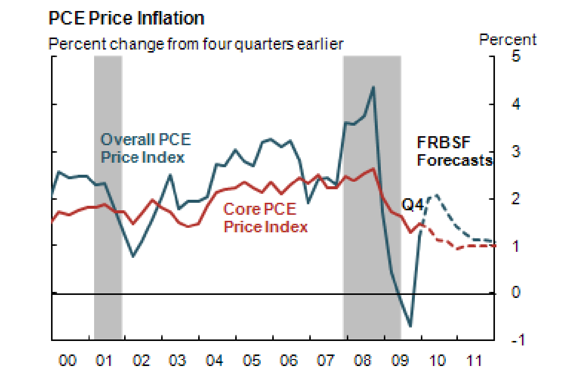
Outlook for moderate growth



Unemployment will remain elevated



Inflation to remain subdued



Markets expect rate hikes by end-2010