Twelfth Federal Reserve District

FedViews

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John C. Williams, executive vice president and director of research at the Federal Reserve Bank of San Francisco, states his views on the current economy and the outlook:

- Looking back, our 2010 economic forecast issued a year ago of moderate growth and low inflation proved relatively accurate. We predicted that real GDP would grow 3.4% last year. Based on data available today, growth appears to have been a bit below 3%. The slightly slower-than-expected growth reflects the soft patch the economy went through during the middle part of the year following the outbreak of the European fiscal crisis. Despite slight overoptimism on growth, our forecast of a 9.5% unemployment rate in the fourth quarter of 2010 missed by only 0.1 percentage point. Both core and overall inflation rates appear to have been about ¼ percentage point below our forecasts from a year ago.

- Economic growth appears to have picked up to about a 3¼% rate in the fourth quarter of 2010. Consumer spending posted solid gains in October and November and anecdotal reports indicate that holiday sales were brisk. Sales of light vehicles continued their steady rise following sharp declines during the recession. Real personal consumption expenditures likely increased at about a 4% annual rate in the fourth quarter of 2010. An increase in net exports looks to make a large positive contribution to fourth-quarter growth as well.

- The housing sector remains dormant. New construction activity is stuck at very low levels and home sales remain anemic. House prices continue to decline, with the CoreLogic house price index falling about 5% over the 12 months through November 2010.

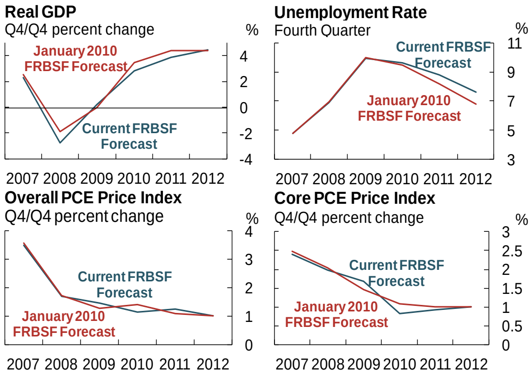
- The economic expansion appears to be building steam. After increasing 2.8% in 2010, we expect real GDP to grow nearly 4% this year and for growth to pick up to about 4½% in 2012. Pent-up demand for durable goods and eventually housing, and improving confidence are contributing to a steady improvement in the economy.

- Monetary policy, in the form of near-zero short-term interest rates and the Federal Reserve's purchases of longer-term assets, is providing considerable support to the recovery. A recent San Francisco Federal Reserve Bank research paper by Chung, Laforte, Reifschneider, and Williams (http://www.frbsf.org/publications/economics/ papers/2011/wp11-01bk.pdf) finds that the Fed's large-scale asset purchases will boost real GDP by nearly 3% in 2012 relative to what would have occurred absent the program. This translates into 3 million additional jobs and a 1.5 percentage point reduction in the unemployment rate. In addition, this program is found to have reduced the probability of a sustained episode of deflation in the United States.

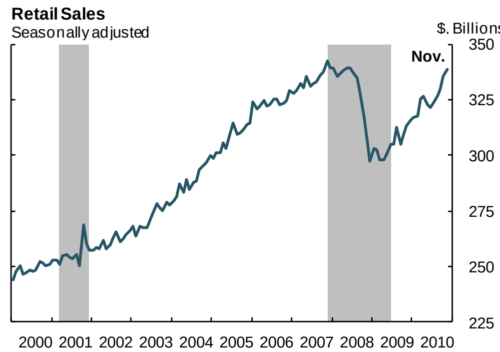
- Despite moderate growth in the second half of last year, the pace of job creation remains disappointingly slow. The economy added about 130,000 jobs per month in the final quarter of 2010, a pace insufficient to make much of a dent in the unemployment rate. The pickup in growth this year and next should bring more sizable job gains. We expect the unemployment rate to decline gradually to a little below 9% late this year and to about 7½% in late 2012.

- Inflation remains subdued. Commodity prices have increased significantly over the past year, in part reflecting the global economic recovery. Nonetheless, with economic slack holding down labor costs, we expect both core and overall measures of inflation to remain very low over this year and next.

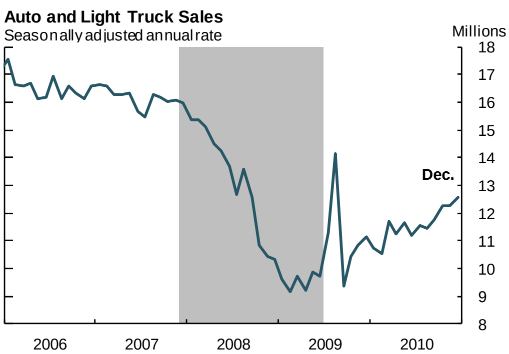
Year in Review



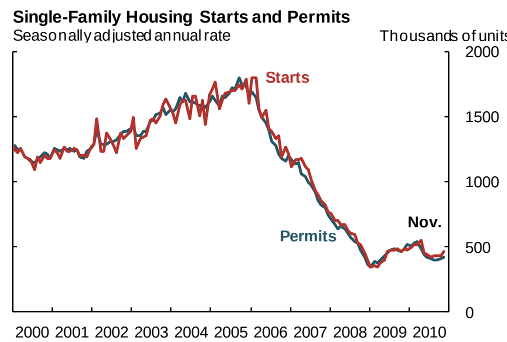
Shoppers Hitting the Malls



Auto Sales Continue to Climb Back

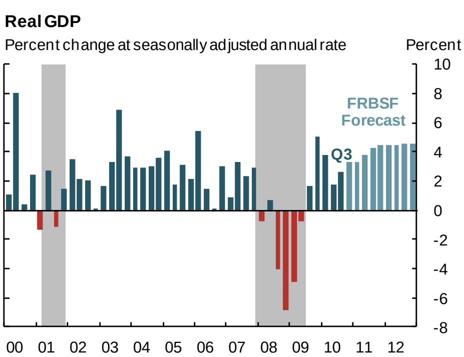


But, Housing Sector Still Dormant

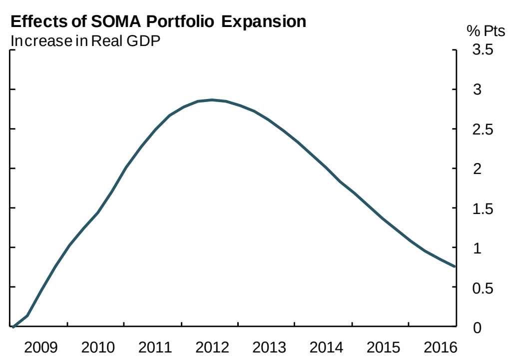


Note: Data refers to housing starts and permits in permit-issuing places.

Gradual Expansion on Track



Estimated Effects of the Fed's Asset Purchases



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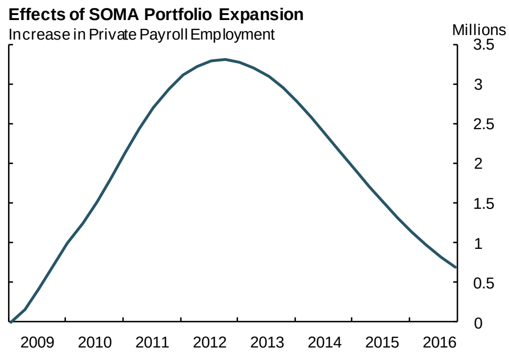

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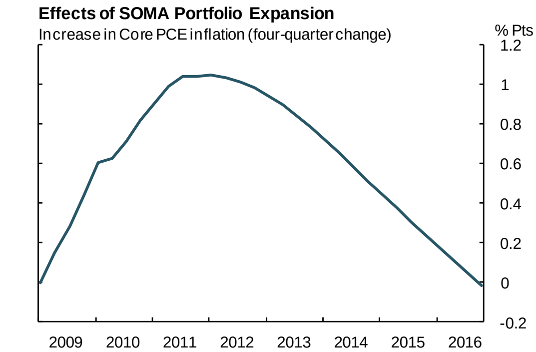
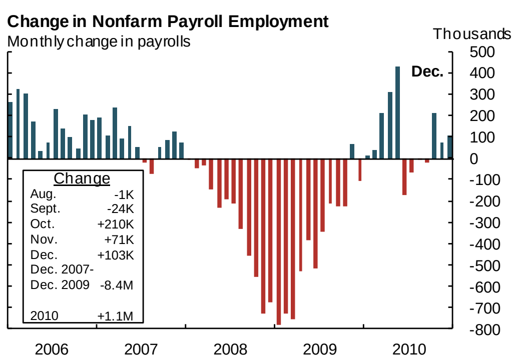
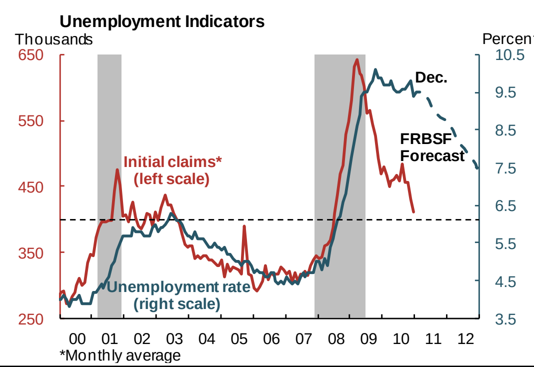


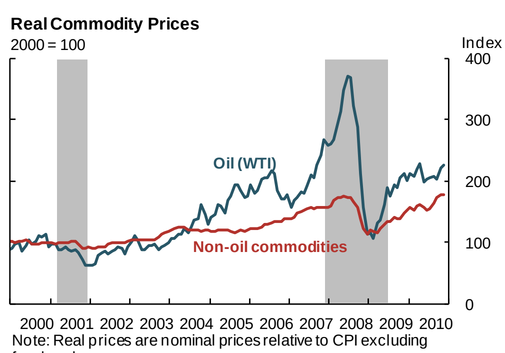
Job Creation Still Slow



Initial Claims Dropping Off



Commodity Prices Recover With Economy



Inflation Subdued