Twelfth Federal Reserve District

# FedViews

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

- Around the New Year's Day holiday, Congress and the White House approved a partial agreement on the "fiscal cliff." The deal raises roughly $600 billion in revenue from higher tax rates on high earners and postpones until March 1 a set of across-the-board spending cuts amounting to about $10 billion per month for the next 10 years. Congressional debate over these spending cuts and the need to raise the current statutory limit on the federal debt are likely to intensify as we get closer to the March deadline.

- Nonfarm payroll employment rose by a seasonally adjusted 155,000 workers in December, according to the Bureau of Labor Statistics. Private-sector payrolls grew by about 168,000, while state, local, and federal government payrolls fell by about 13,000. The increase in nonfarm payrolls was in line with expectations and the average over the past several months, but nevertheless below the rate of job growth in a typical recovery. Moreover, the total number of nonfarm payroll positions remains about four million below its level at the start of the recession, a dramatic shortfall.

- The unemployment rate held steady in December at 7.8%. Over the past year, the unemployment rate has fallen moderately, by about 0.7%, and has declined from a peak of about 10% at the depths of the recession. Nevertheless, the unemployment rate remains quite high. For example, it remains well above the 6.3% peak reached in the 2001 recession and subsequent recovery.

- 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 recession's low point 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. A vehicle that is not reregistered from one year to the next is counted as scrapped. Auto sales fell dramatically below scrappage in 2009 and 2010, the most recent years for which data are available. That was historically unprecedented, showing the severity of the auto sector downturn. Although there is substantial year-to-year variation in the number of vehicles scrapped, there is an evident upward trend over time as the U.S. stock of autos has increased. Importantly, auto sales remain roughly in line with that scrappage trend, suggesting that December's sales rate of about 15.4 million vehicles per year is sustainable.

- Existing home sales posted a healthy gain in November and are now at their highest point since the recession, excluding a spike in late 2009 due to a temporary homebuyer tax credit. By contrast, new home sales have picked up only slightly from their post-recession lows. Altogether, home sales remain 20% or more below their average level before the recession and in the early 2000s.

- An important factor supporting the housing market has been the historically low level of interest rates facilitated by the Federal Reserve's accommodative monetary policy. The federal funds rate has been essentially zero for over four years and counting, and the 10-year Treasury yield is below 2%. Thirty-year fixed-rate mortgages remain below 3.5%. Interest rates on other types of consumer debt, such as four-year auto loans, also are at historic lows.

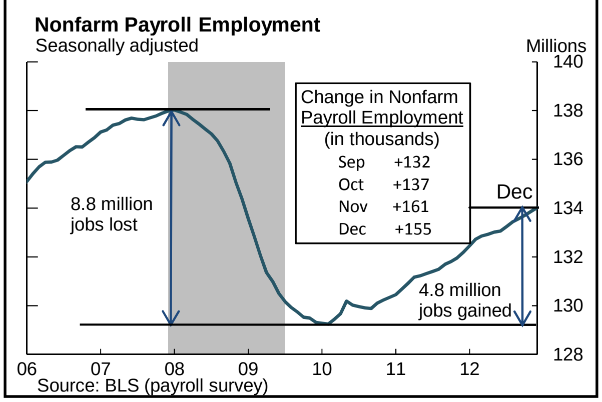
- However, mortgage lending standards remain very tight, making it difficult for many households to take advantage of low mortgage interest rates. A borrower with a FICO credit rating of 620 or above is generally considered a prime borrower and a safe credit risk. However, even prime borrowers have found mortgage lending standards much tighter since the start of the recession. For example, the median FICO score for prime borrowers has risen about 40 points to over 760 and has not declined even as the economy has been recovering. Thus, a prospective homeowner must have a much higher credit rating than in the past to qualify for a loan.

- In contrast to mortgages, credit availability for auto loans appears to be recovering more robustly. Although the total stock of outstanding auto loans fell during the recession, it has been growing since early 2010, and that growth rate picked up in 2012. The easier availability of credit in the auto sector may help to explain the better performance of auto sales relative to home sales, since both markets tend to be very sensitive to credit conditions.

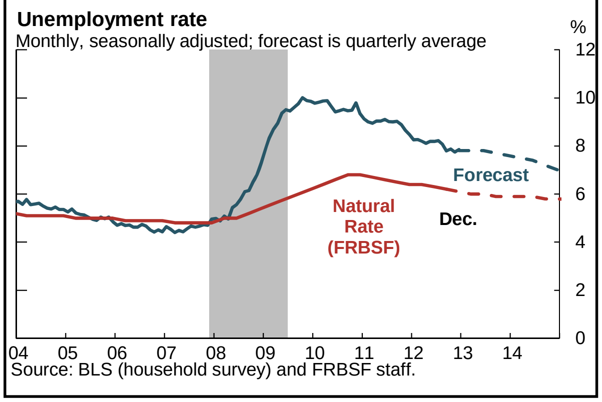
- On net, data over the past month have led to relatively little change in our forecast. We estimate that gross domestic product expanded at about a 1% annual rate in the fourth quarter of 2012, pushed down partly by temporary factors such as business inventories and the timing of federal defense expenditures. We expect GDP growth to average about 2% at an annual rate over the next few quarters, consistent with the average growth rate over the past several quarters. The recovery should gradually pick up steam over 2013 and into 2014, with growth averaging closer to 3%.

- Recent data on inflation have been subdued and continue to average less than the Federal Open Market Committee's (FOMC) stated objective of 2% over the longer run. Given the labor market weakness, we expect little upward pressure on wages for the next several quarters. Similarly, relatively modest demand in product markets suggests little upward pressure on product prices. Thus, we expect overall inflation to remain about where it currently is and gradually return toward the FOMC's 2% longer-term objective.

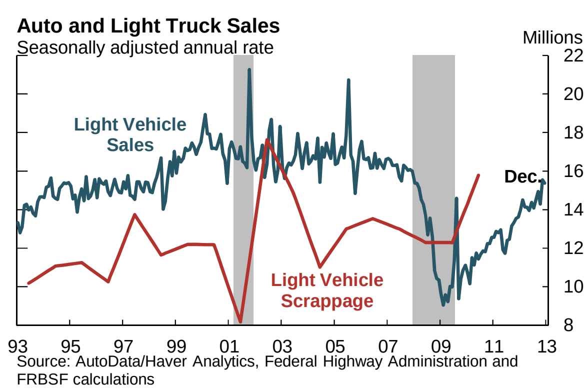
## Employment growth continuing slowly



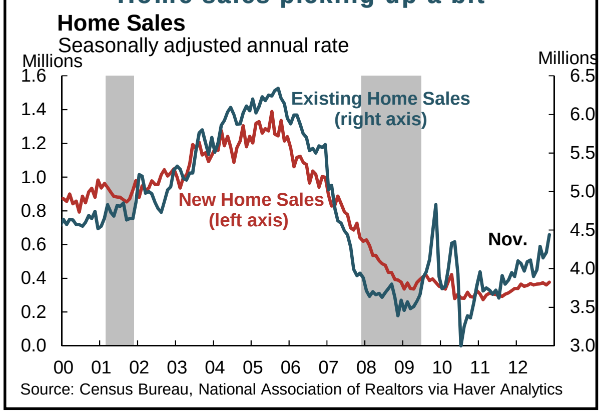

## Unemployment rate declining slowly



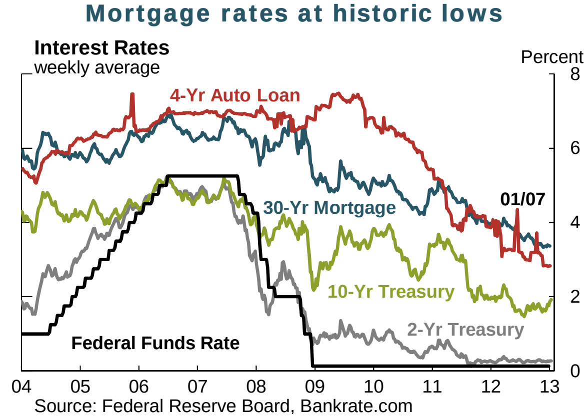

## Auto sales continuing strong rebound



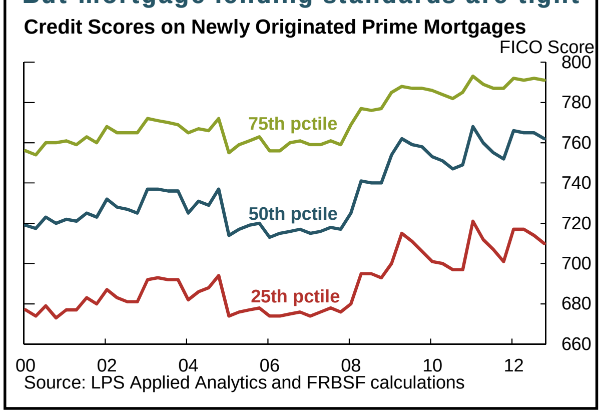

## Home sales picking up a bit



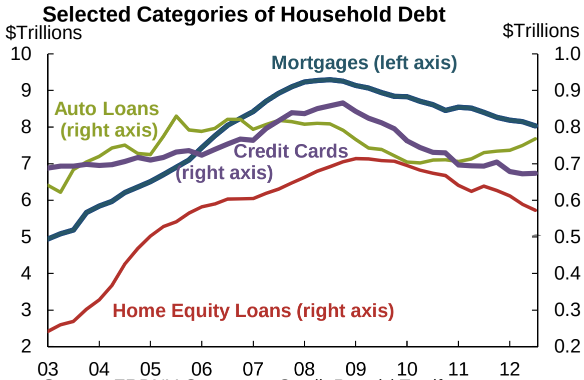

## Mortgage rates at historic lows




## But mortgage lending standards are tight

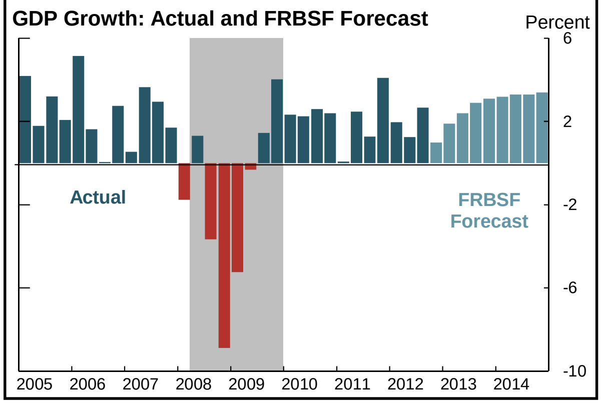


## Auto loan recovery better than mortgages

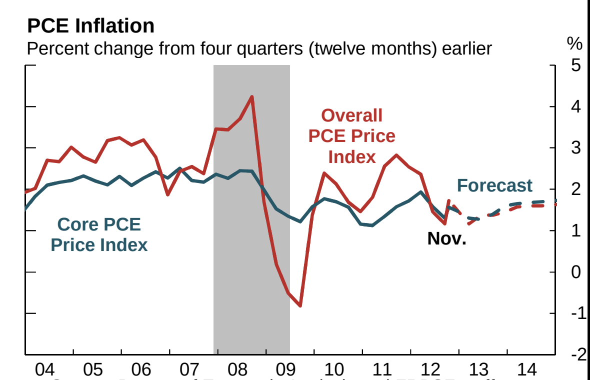



Source: FRBNY Consumer Credit Panel / Equifax

## We expect gradual pickup in GDP growth




## And inflation to remain below 2%




Source: Bureau of Economic Analysis and FRBSF staff.