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

- Some recent data have been below expectations, but the overall economic picture remains one of continued growth at a moderate pace. Some downside risks to the outlook are apparent, including weakness in consumer confidence, the labor market, and the real estate sector, as well as the economic situation in Europe.
- Real GDP increased at an annual rate of 2.7% in the first quarter of 2010, well below the 5.6% rate recorded in the fourth quarter of 2009. The reduced first-quarter figure primarily reflects a slowdown in inventory investment. At the same time, exports decelerated, residential housing investment turned down, and the robust rate of growth in business investment in equipment and software slowed.
- The Institute for Supply Management (ISM) indexes for both manufacturing and services dropped in June, but remained at levels indicative of expansion. The ISM index for manufacturing fell to 56.2 from 59.7 in May, while the ISM index for nonmanufacturing activity fell to 53.8 from 55.4.
- We expect continued moderate real GDP growth of 3.5% in the second quarter, but then a slowdown to 3.0% in the third quarter. The second-quarter bump is attributable to higher-than-expected state and local spending on construction and business equipment. But weakness in the labor market suggests a payback in the third quarter. Overall growth in 2010 is expected to average about 3.1%. Growth is expected to pick up next year to about 3.8%.
- Real personal consumption expenditures grew by 0.3% in May after being flat in April. However, a notable decline in consumer confidence registered in a widely followed survey raised some concern. The Conference Board Consumer Confidence Index released at the end of June dropped sharply to 52.9 from 62.7 in May. Still, the University of Michigan Consumer Sentiment Index released a week earlier came in slightly above expectations, increasing to 76.0 from 73.6 the previous month. Vehicle sales fell in June to an 11.1 million-per-year pace, down from an 11.6 million-unit pace in May.
- Private nonfarm payroll employment in the United States increased by 83,000 in June, modestly below market expectations. Overall employment levels actually declined by 125,000, but that figure was primarily attributable to scheduled layoffs of 225,000 government census workers. The unemployment rate dipped to 9.5%, reflecting the exit of 650,000 people from the labor force.
- Home sales dropped sharply in May, suggesting that the first-time home buyer tax credit has assisted sales even more than previously expected. The program's discontinuation portends additional housing sector weakness. Existing home sales fell by 2.2%, while sales of new homes plummeted 33% to a record low. New housing starts fell 10% in May relative to a month earlier.

- The trade deficit edged up in April to \$40.3 billion. Both exports and imports declined. The deficit's rise was more than explained by an increase in the bilateral trade gap with China, which accounts for close to half of the overall U.S. trade deficit. China recently said it was ending the peg of its currency, the yuan, against the U.S. dollar, which was reinstated in August 2008 in response to the global financial crisis. To date, however, the yuan's appreciation has been only modest, about 0.8%.
- Analysts generally do not expect the yuan to appreciate much more against the dollar for the remainder of the year because the broad yuan, measured against a basket of currencies, has already appreciated substantially due to the dollar's appreciation relative to the euro. Since October 2009, the broad yuan is up about 5% against the euro. The weight of the euro in the broad yuan is almost as high as the weight of the dollar.
- European nations have adopted ambitious schedules for deficit reduction. For example, Greece has announced deficit reductions to levels compliant with the Maastricht Treaty limit of 3% of GDP by 2014. European leaders are facing resistance from both unions and the general public against the adoption of austerity programs, but many measures have already gone forward. While fiscal consolidation is desirable in the long term, in the short term it is likely to be a drag on demand for U.S. exports.
- Inflation levels are below those identified by Federal Open Market Committee members as consistent with their desired longer-run price stability objectives. The headline personal consumption expenditures (PCE) price index was unchanged in May, while the core PCE price index rose 0.2%. The core PCE price index is up only 1.3% over the past 12 months. We expect core PCE prices to increase at a 1.3% annualized rate in the current quarter and by 1.0% for the year as a whole.
- Given these low inflation levels, combined with evidence of slack in the economy and the downside risks discussed above, the June FOMC statement reiterated the conclusion that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period.



