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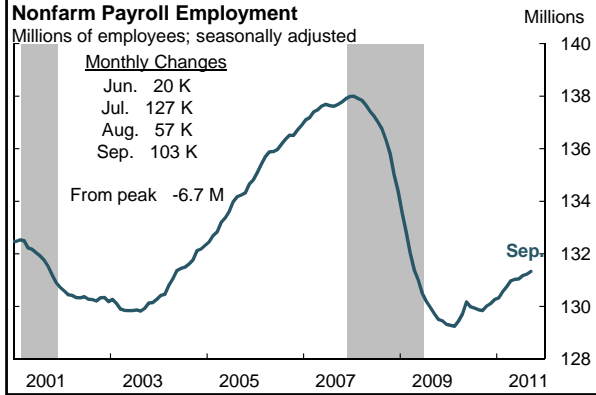
Bharat Trehan, research advisor at the Federal Reserve Bank of San Francisco, states his views on the current economy and the outlook.

- Recent data have been somewhat better than expected, helping ease concerns that the economy may be stalling.
- Payroll employment rose by 103,000 in September. At the same time, payroll data for July and August were revised up by an average of about 50,000 jobs per month. So it now looks like the economy added roughly 96,000 jobs per month in the third quarter. However, the unemployment rate remains stuck at 9.1%. Moreover, initial claims for unemployment insurance are still hovering around the 400,000 level, which suggests little improvement in the unemployment rate in the near future.
- Orders for nondurable goods excluding aircraft rose by 0.9% in August, while shipments rose by 2.8%. Over the past six months, orders have grown at about an 18% annual rate, while shipments have grown at a 19% rate. While this is unambiguously good news, surveys indicate that business sentiment is subdued, suggesting that capital spending is likely to remain restrained.
- Manufacturing output also grew at a healthy rate in August, pushed along by an increase in motor vehicle demand and an easing of supply chain restrictions arising from the Japanese earthquake and tsunami in March. Vehicle sales jumped from a 12.1 million annual rate in August to a 13.1 million rate in September. Other consumption data were not as encouraging. Real personal consumption expenditures were unchanged in August. Over the past three months, consumption expenditures have increased at a 1% rate.
- On net, we view these data as positive for output growth in the third quarter, but they have not led to other significant changes in our forecast. We expect that real GDP will grow moderately through the end of next year. Such slow growth is unlikely to push down the unemployment rate this year, and we anticipate only modest declines next year. So, the unemployment rate is projected to remain above the full employment level for quite a while.
- There are some serious downside risks to this outlook. The economic outlook has worsened worldwide of late, and in particular in the developed economies. The sovereign debt crisis in Europe creates a significant risk that economic growth, both globally and in the United States, could fall noticeably below even the reduced forecasts shown here.
- The continuing European debt crisis has flared up in the past few months as European policymakers struggle to deal with issues related to Greek debt, the recapitalization of European banks, and funding for the European Financial Stability Facility, the euro zone vehicle for making loans to

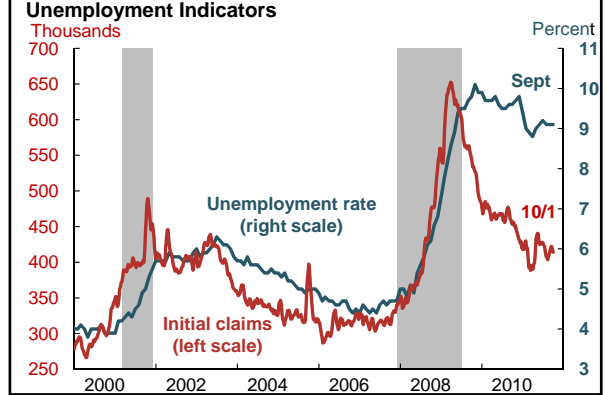
member states. For much of this year, credit markets have considered the debt of three sovereign European states—Greece, Ireland, and Portugal—to be riskier than low-grade U.S. corporate debt.

- The European debt crisis has led to increased volatility in financial markets, with alternating spells of optimism and pessimism triggered by stories and rumors of actions, plans, or simply discussions aimed at addressing the situation. Stock markets outside Europe remain depressed as well, indicating that the crisis is global in scope.
- Investors have engaged in a general flight from risky to safe assets. Accordingly, U.S. Treasury yields have declined sharply, helped along by recent monetary policy actions. Yields on high-grade risky corporate bonds have not fallen as much, while yields on low-grade bonds have actually risen quite substantially.
- Finally, given our forecast of moderate real GDP growth and persistently high levels of unemployment, we see little reason to expect higher inflation. Instead, inflation is projected to decline a bit from recent levels and stay at or slightly below the level that most Federal Open Market Committee participants appear comfortable with.

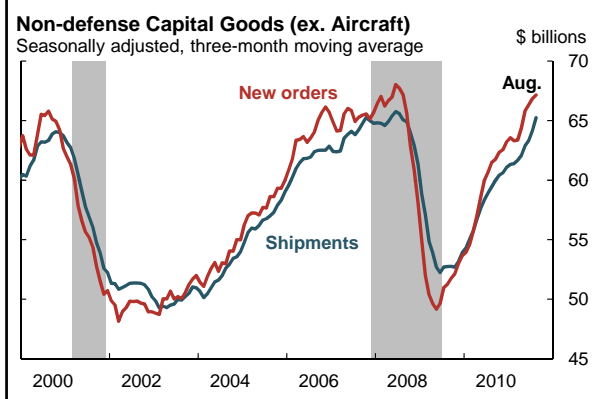
Employment Continues to Grow, Sluggishly



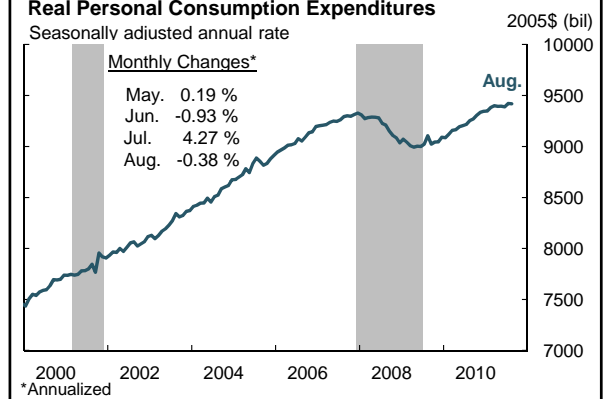
Unemployment Rate Still Unusually High



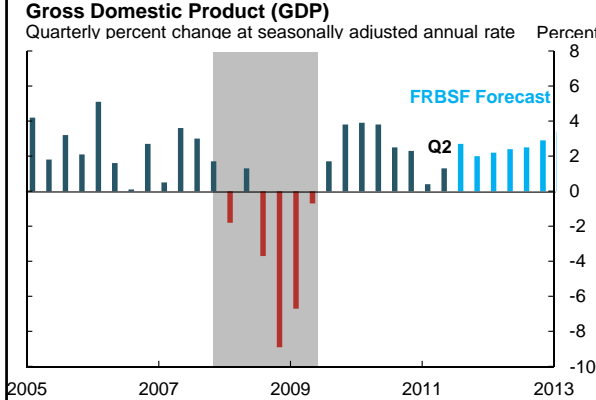
Orders (Almost) Back to Previous Peak



Consumption Growth Remains Sluggish



Output Expected to Grow at Moderate Pace



Growth Projections Revised Down Everywhere

