Twelfth Federal Reserve District

FedViews

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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.

- Labor market conditions continued to improve in February. Payrolls increased by 227,000, with a gain of 233,000 jobs in the private sector offsetting government job losses. In addition, payroll figures for December and January were revised significantly upward. The unemployment rate remained unchanged in February at 8.3%. The labor force participation rate rose to 63.9% from 63.7%.

- The payroll increase was slightly better than expectations. Analysts were already anticipating continued improvement in the labor market following an earlier ADP National Employment Report showing solid private-sector job growth in February. We expect continued slow improvement in the labor market for the remainder of this year, with the unemployment rate remaining over 8%.

- Some other data releases were also modestly surprising on the upside. Real fourth-quarter 2011 gross domestic product growth was revised upwards to 3.0%, mildly above expectations. The Conference Board's consumer confidence index jumped in February to 70.8, its highest level since February 2011, largely due to the improved job market outlook. Light vehicle sales were also strong, with 15.1 million units sold in February. Retailers reported solid sales of apparel in February, which many stores attributed in part to exceptionally mild weather.

- However, some data releases suggested softening. Personal consumption expenditures have been relatively flat since October 2011. And recent increases in oil and gasoline prices may weigh on the consumption of other goods and services. The ISM manufacturing report's new orders index fell in February to 52.4 from 54.1 in January. Market participants had expected a modest increase to 54.5. Manufacturing has been a relative bright spot in the moderately paced recovery. Construction spending also dipped -0.1% in January, although data for November and December were modestly revised upwards.

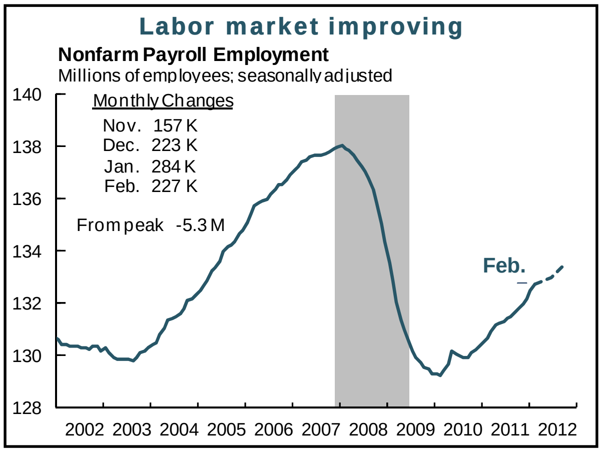
- Given the mixed data, we expect growth in the first half of 2012 to slow from the fourth quarter of 2011 to about a 2% pace. We then expect growth to pick up in the second half of 2012, with GDP registering about a 2¼% growth rate for the year as a whole.

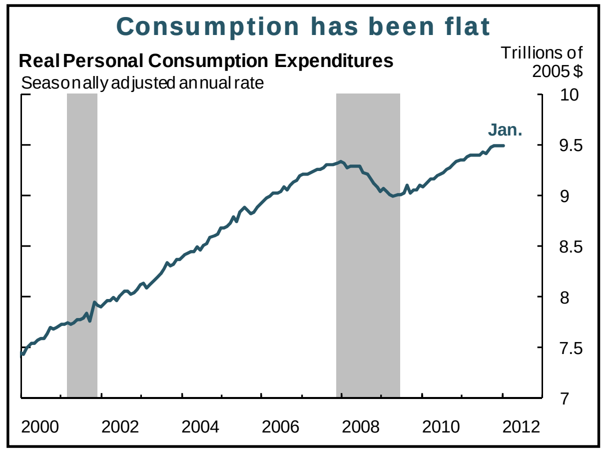
- Recent data show an increase in overall inflation, primarily reflecting increases in oil and gasoline prices. Indeed, in the latter part of 2011, overall inflation deviated markedly from core inflation, which excludes changes in food and energy prices. We expect overall, or headline, inflation to continue to exceed core inflation during the first half of the year. The personal consumption expenditures price index (PCEPI) is expected to run about 2¼% in the first half of the year, while the core PCEPI is expected to run about 1¾%. However, these figures are expected to moderate over the latter half of the year as the effects of energy price increases wear off. For the full year 2012, the PCEPI is expected to come in a bit under 2%. Notably, both overall and core inflation are expected to come in below the Federal Open Market Committee's announced 2.0% inflation target.

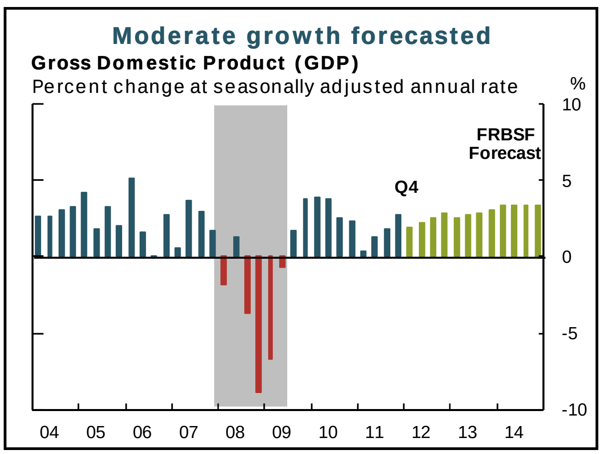
- Exports have played an important role in the U.S. recovery to date. However, continued difficulties in Europe are expected to weigh on economic performance in that region. This is particularly true in the euro area, where austerity measures recently adopted by a number of countries in the European periphery, combined with diminished, but continued, financial headwinds in that region, are likely to reduce European demands for U.S. exports. In contrast, economic performance in Asia is expected to remain relatively robust.

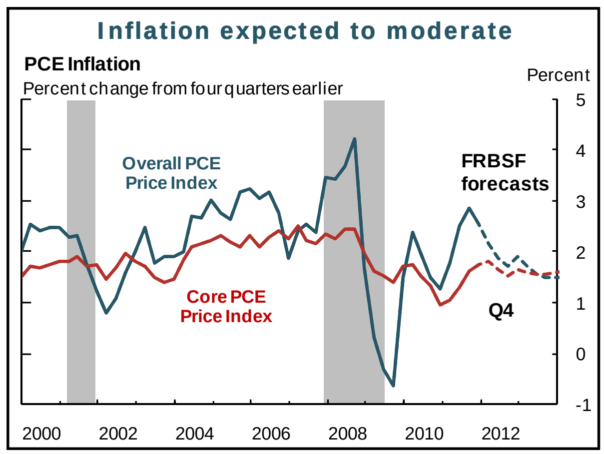
- Because of the prominent role played by exports in the current recovery and the relative weakness of Europe, much attention has recently been paid to the possibility of a slowdown in Asian demand for U.S. goods and services. China is a particular focus of concern. China's government recently lowered its growth target for 2012 to 7.5%. But China's five-year plan had already called for 7-7.5% growth, so this is not considered a major policy change.

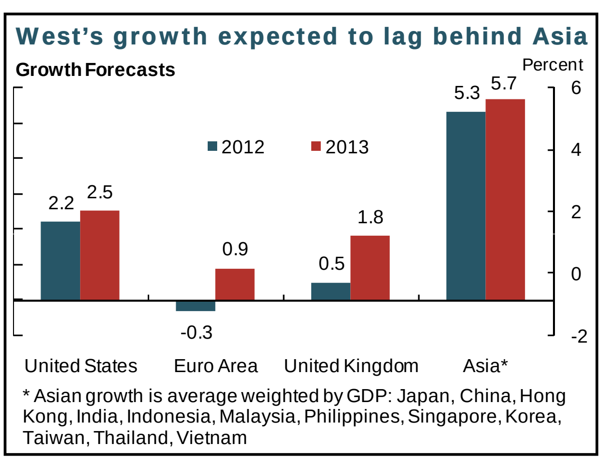
- While the Chinese economy appears to be slowing, there are also signs of resilience. China's manufacturing purchasing managers index edged up in February to 51. A score exceeding 50 indicates expansion. In addition, the Chinese government, which until recently had been tightening monetary policy in response to rising inflation, has moved towards an easier policy stance. The People's Bank of China has reduced reserve requirements. And one-year lending rates have not been raised since the middle of 2011.

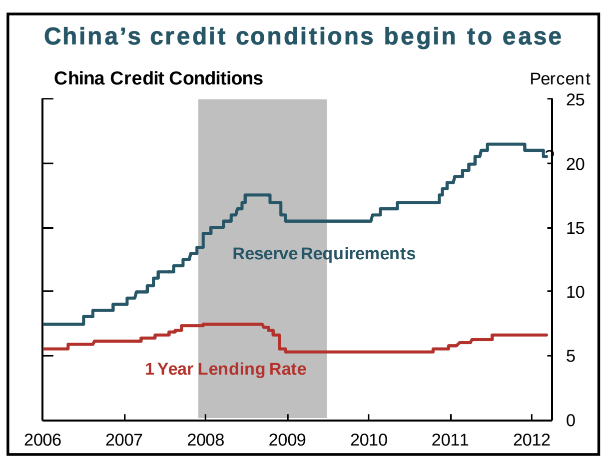

Labor market improving
Nonfarm Payroll Employment
Millions of employees; seasonally adjusted
Monthly Changes
Nov. 157 K
Dec. 223 K
Jan. 284 K
Feb. 227 K
From peak -5.3 M
Feb.
140
138
136
134
132
130
128
2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012


Consumption has been flat
Real Personal Consumption Expenditures
Seasonally adjusted annual rate
Trillions of 2005 $
Jan.
10
9.5
9
8.5
8
7.5
7
2000 2002 2004 2006 2008 2010 2012


Moderate growth forecasted
Gross Domestic Product (GDP)
Percent change at seasonally adjusted annual rate
%
FRBSF Forecast
Q4
10
5
0
-5
-10
04 05 06 07 08 09 10 11 12 13 14


Inflation expected to moderate
PCE Inflation
Percent change from four quarters earlier
Percent
Overall PCE Price Index
FRBSF forecasts
Core PCE Price Index
Q4
5
4
3
2
1
0
-1
2000 2002 2004 2006 2008 2010 2012


West's growth expected to lag behind Asia
Growth Forecasts
Percent
2012
2013
2.2
2.5
-0.3
0.9
0.5
1.8
5.3
5.7
6
4
2
0
-2
United States
Euro Area
United Kingdom
Asia*
* Asian growth is average weighted by GDP: Japan, China, Hong Kong, India, Indonesia, Malaysia, Philippines, Singapore, Korea, Taiwan, Thailand, Vietnam


China's credit conditions begin to ease
China Credit Conditions
Percent
Reserve Requirements
1 Year Lending Rate
25
20
15
10
5
0
2006 2007 2008 2009 2010 2011 2012