

Economic Outlook in 2010

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The views expressed in this presentation are strictly those of the authors and do not necessarily reflect the positions of the Federal Reserve Bank of Dallas or of the Federal Reserve System.





**Inflation or Deflation,
Tell me if you can.**



**Will we be Zimbabwe
Or will we be Japan?**

- Merle Hazard



Where We Are Currently

Base of Stabilization

- Two quarters of GDP expansion
- Manufacturing, services, IP expanding
- Employment about flat; Temps increasing
- Consumption rising, discretionary spending still weak

Negative Surprises

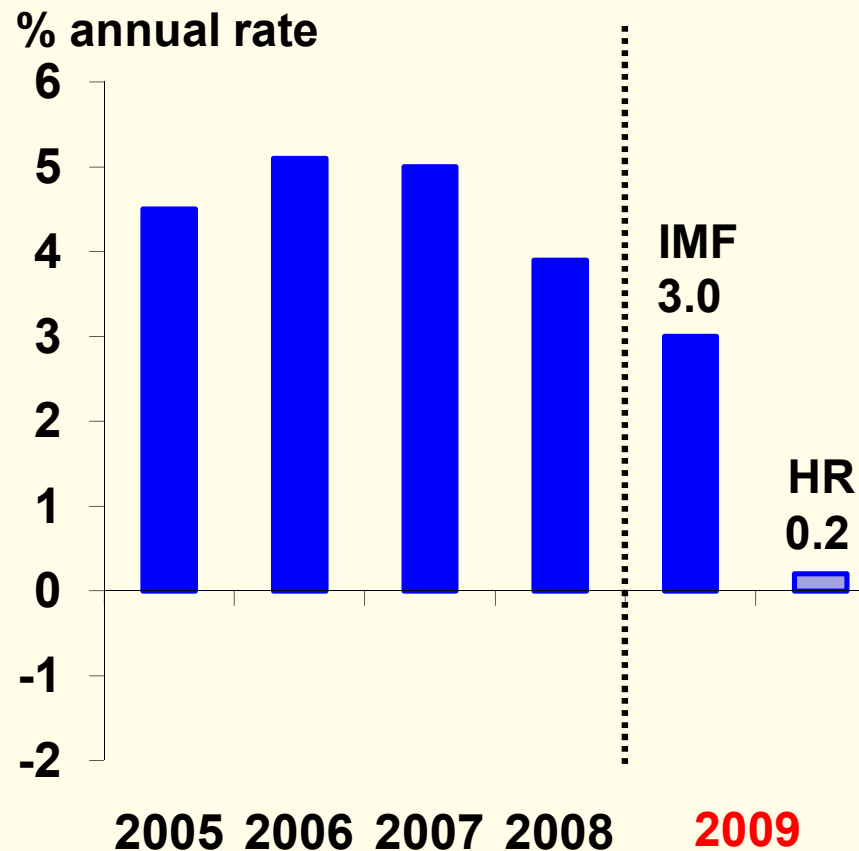
- Home sales dropped over last three months
- Consumer confidence faltered anew



How Did We Get Here?

IMF World Economic Outlook: What a Difference a Year Makes

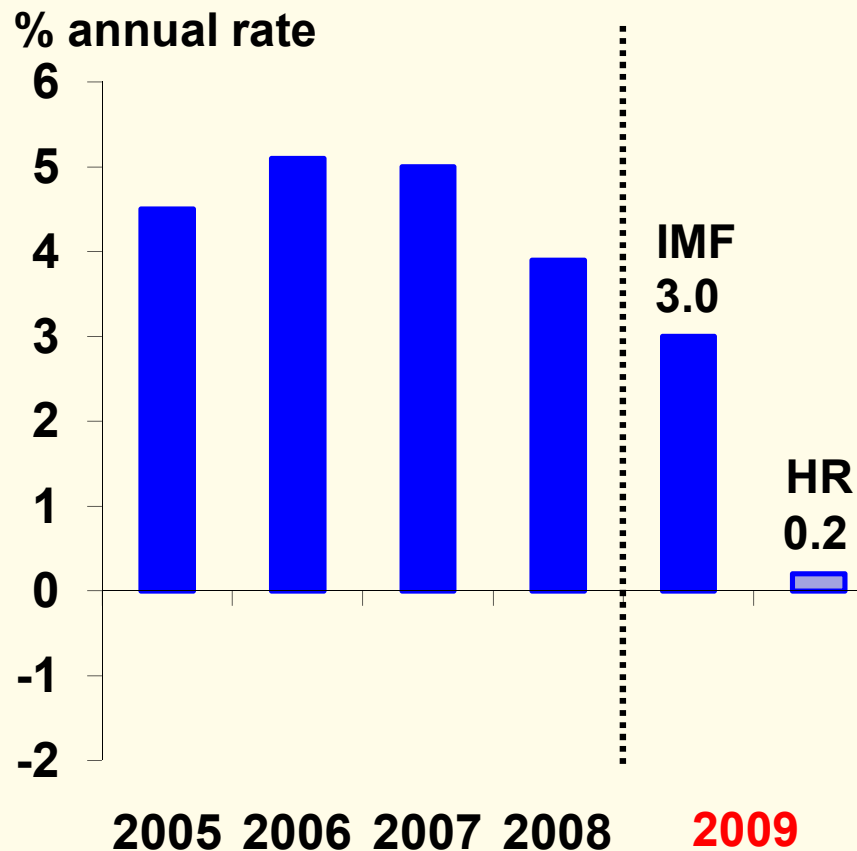
One Year Ago: 2009 Forecast



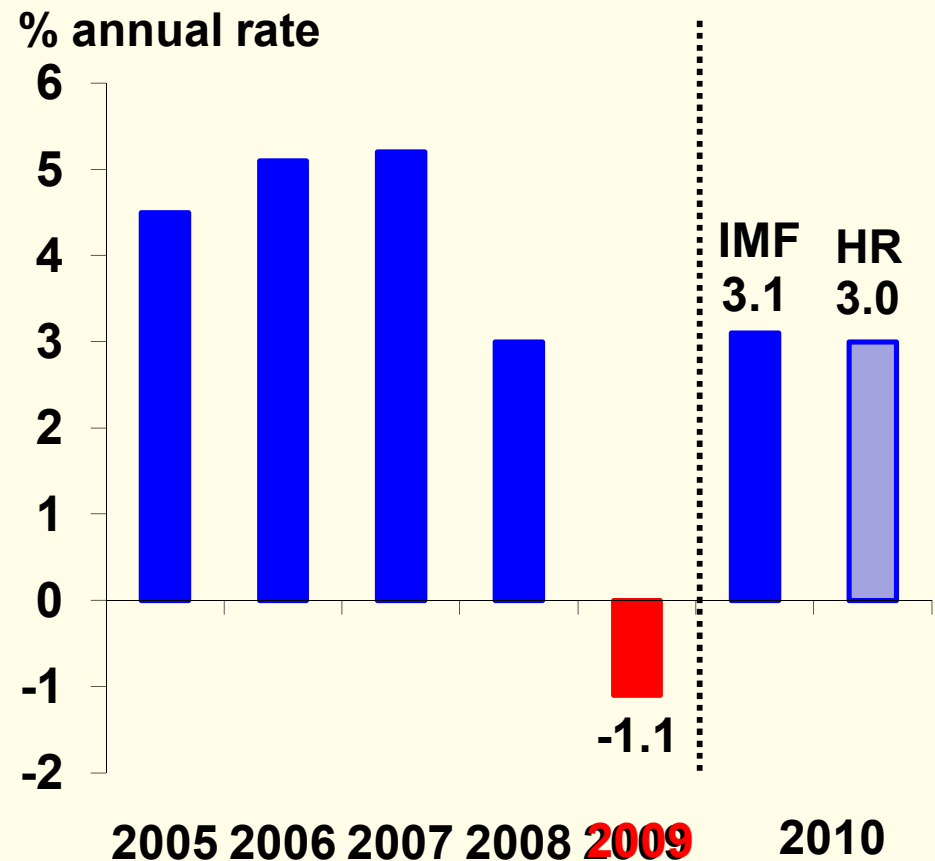
Source: IMF World Economic Outlook, Oct. '08/'09

IMF World Economic Outlook: What a Difference a Year Makes

One Year Ago: 2009 Forecast



Current: 2010 Forecast

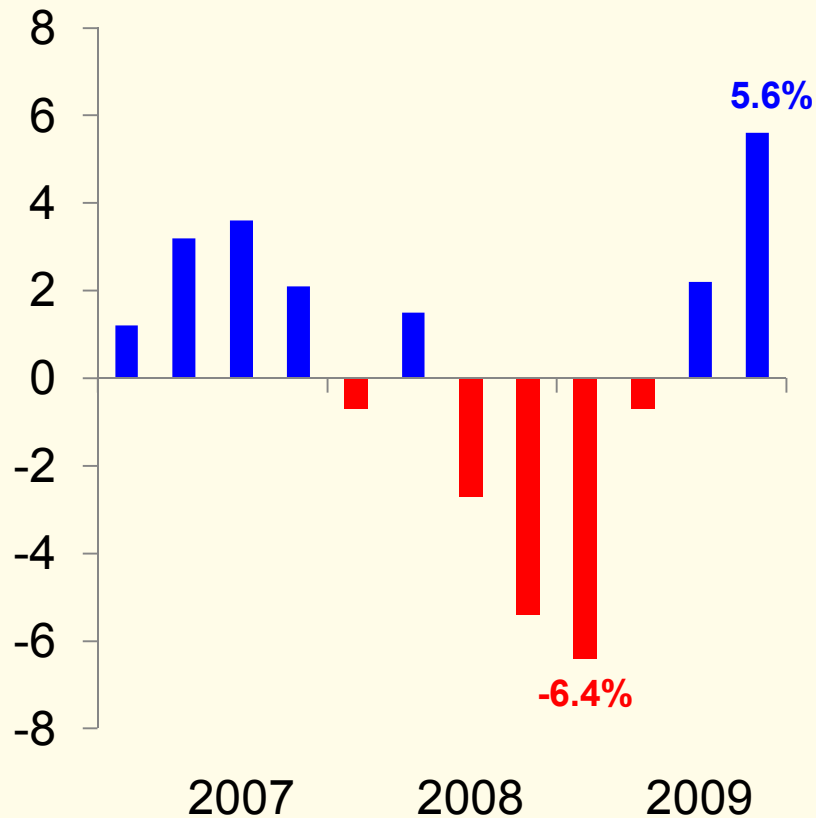


Source: IMF World Economic Outlook, Oct. '08/'09

GDP and Inflation

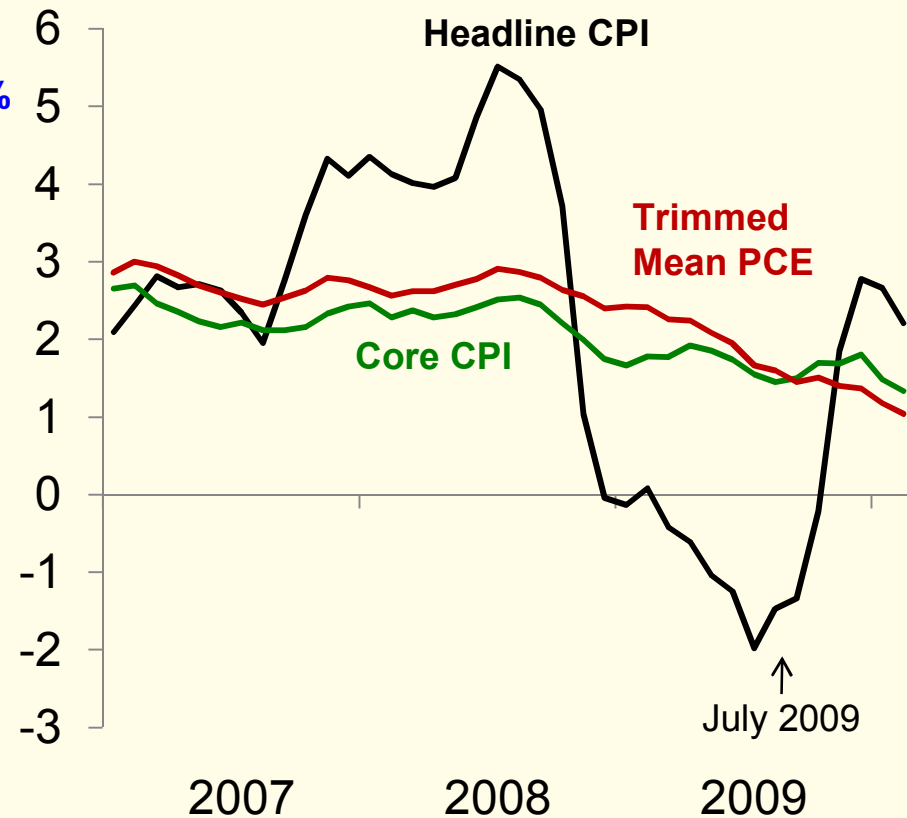
Real GDP Growth

SAAR, % change



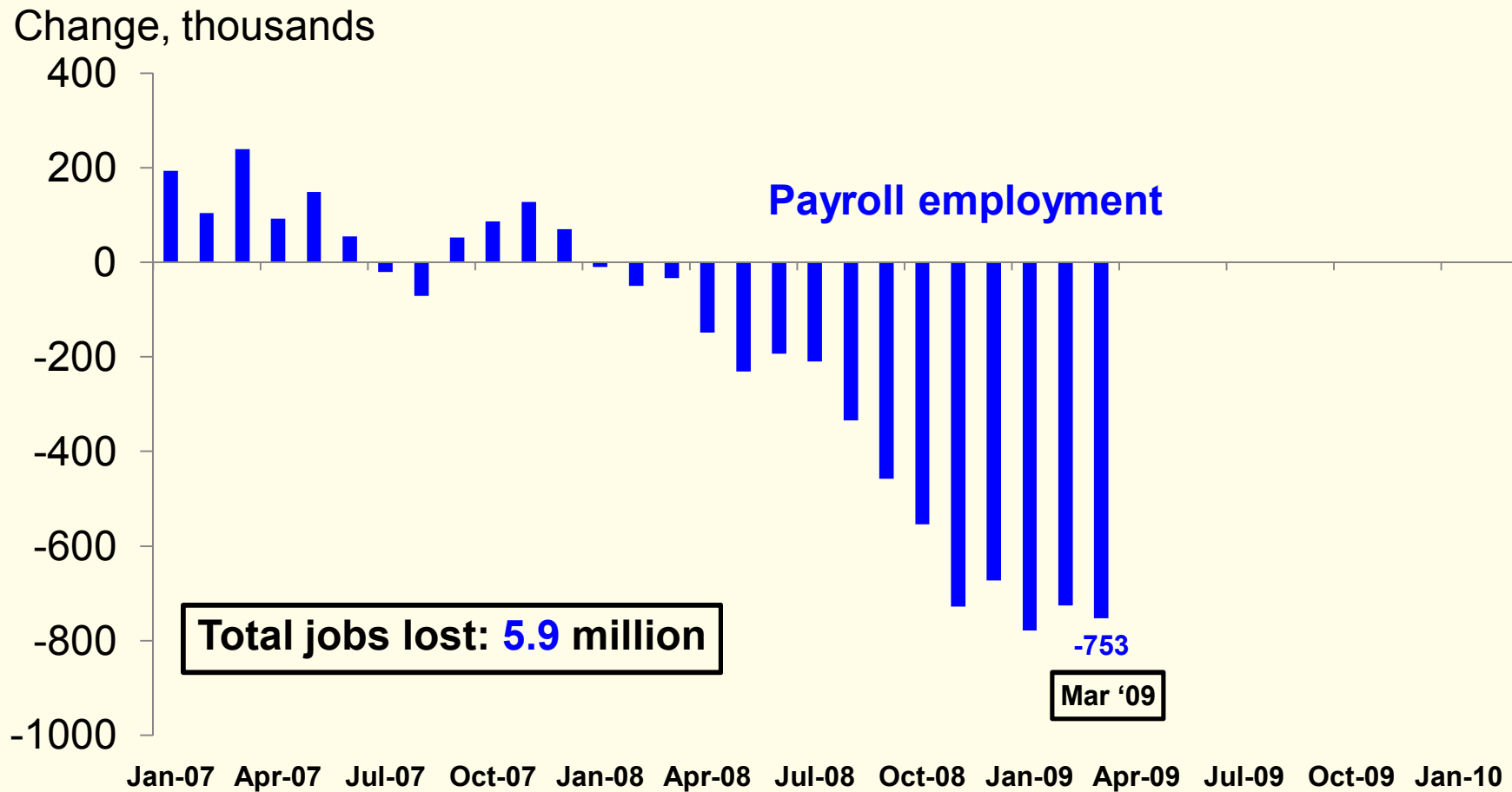
Low-to-Moderate Inflation

% Yr/yr



Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Dallas Fed

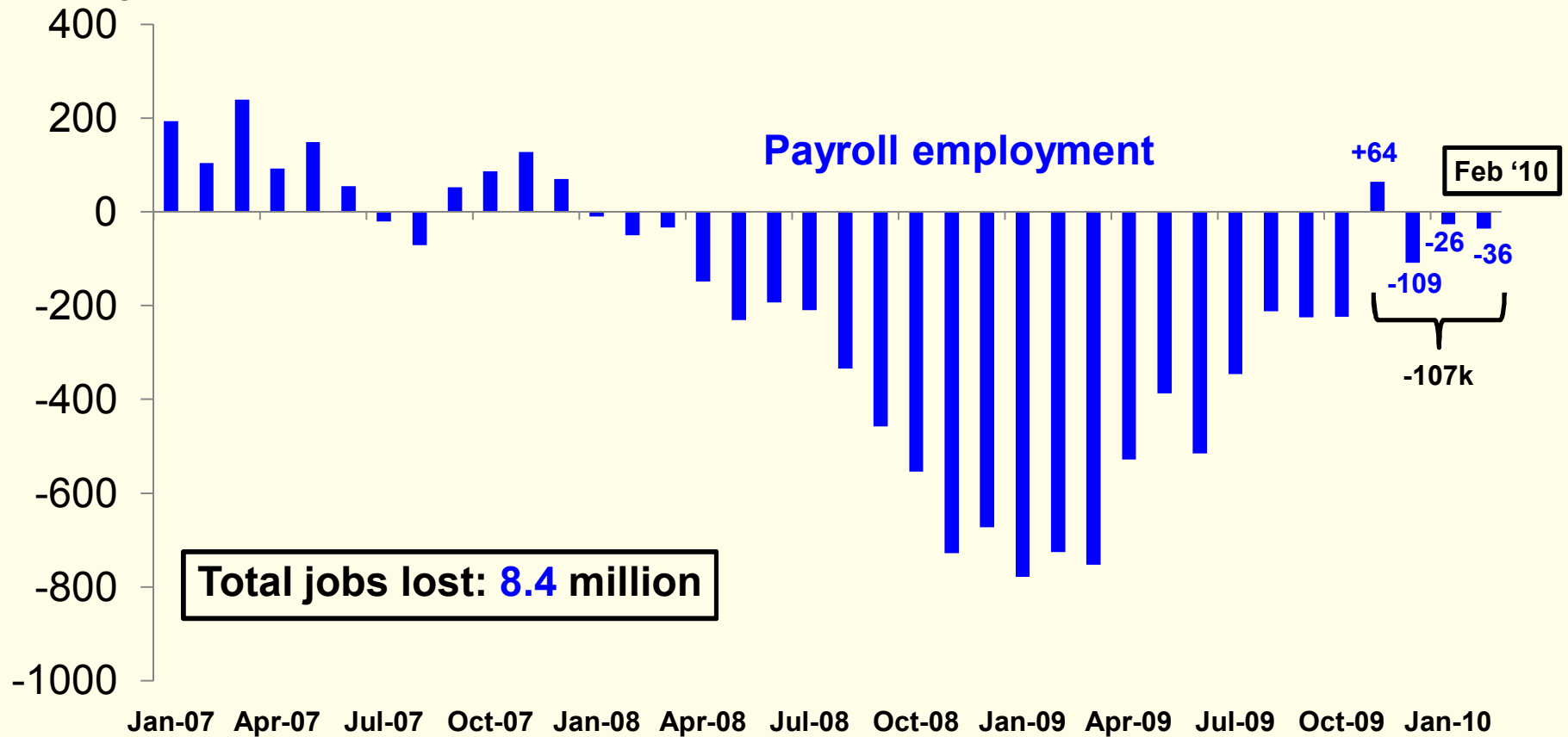
Job Market Seems About Flat



Source: Bureau of Labor Statistics

Job Market Seems About Flat

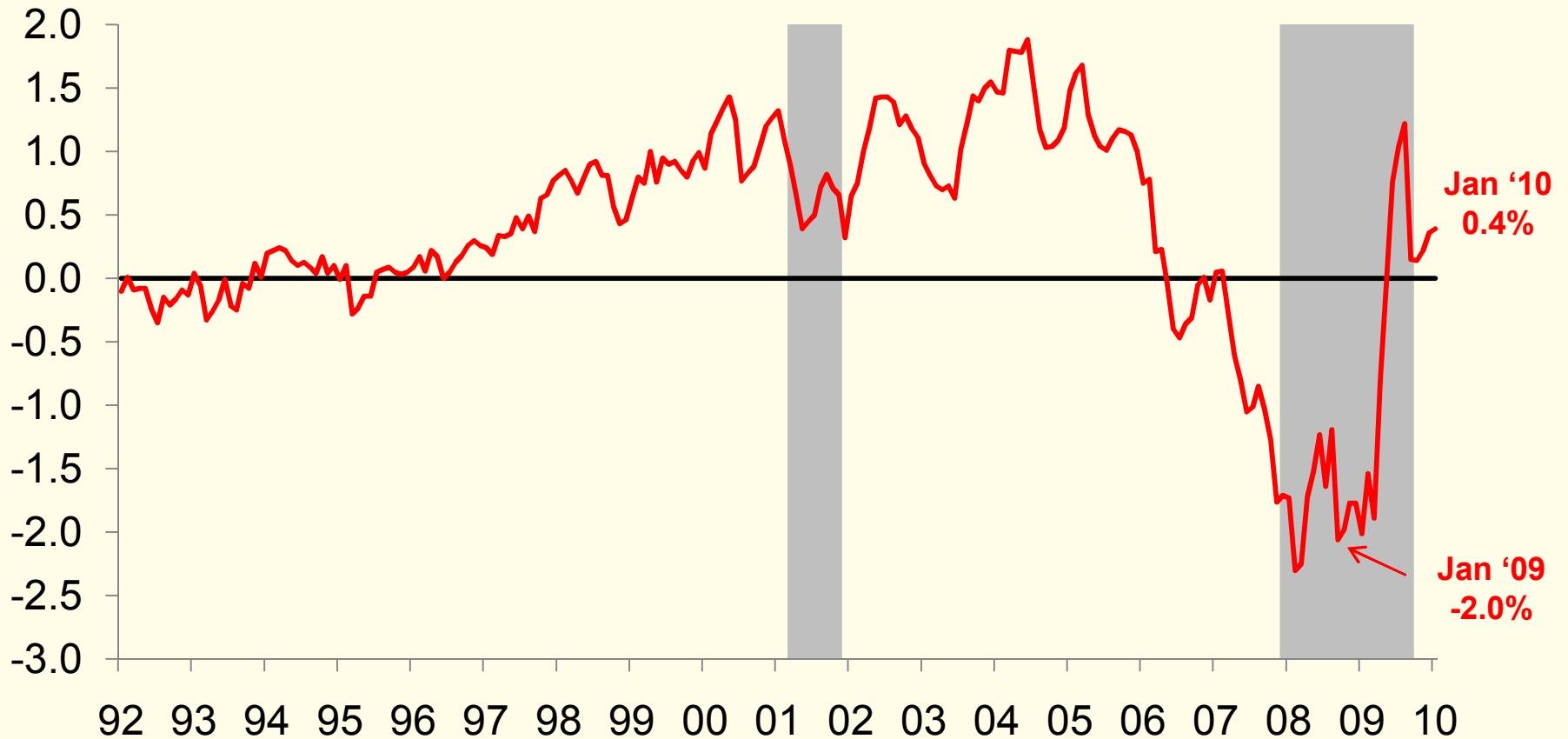
Change, thousands



Source: Bureau of Labor Statistics

U.S. House Price Index (Case-Shiller)

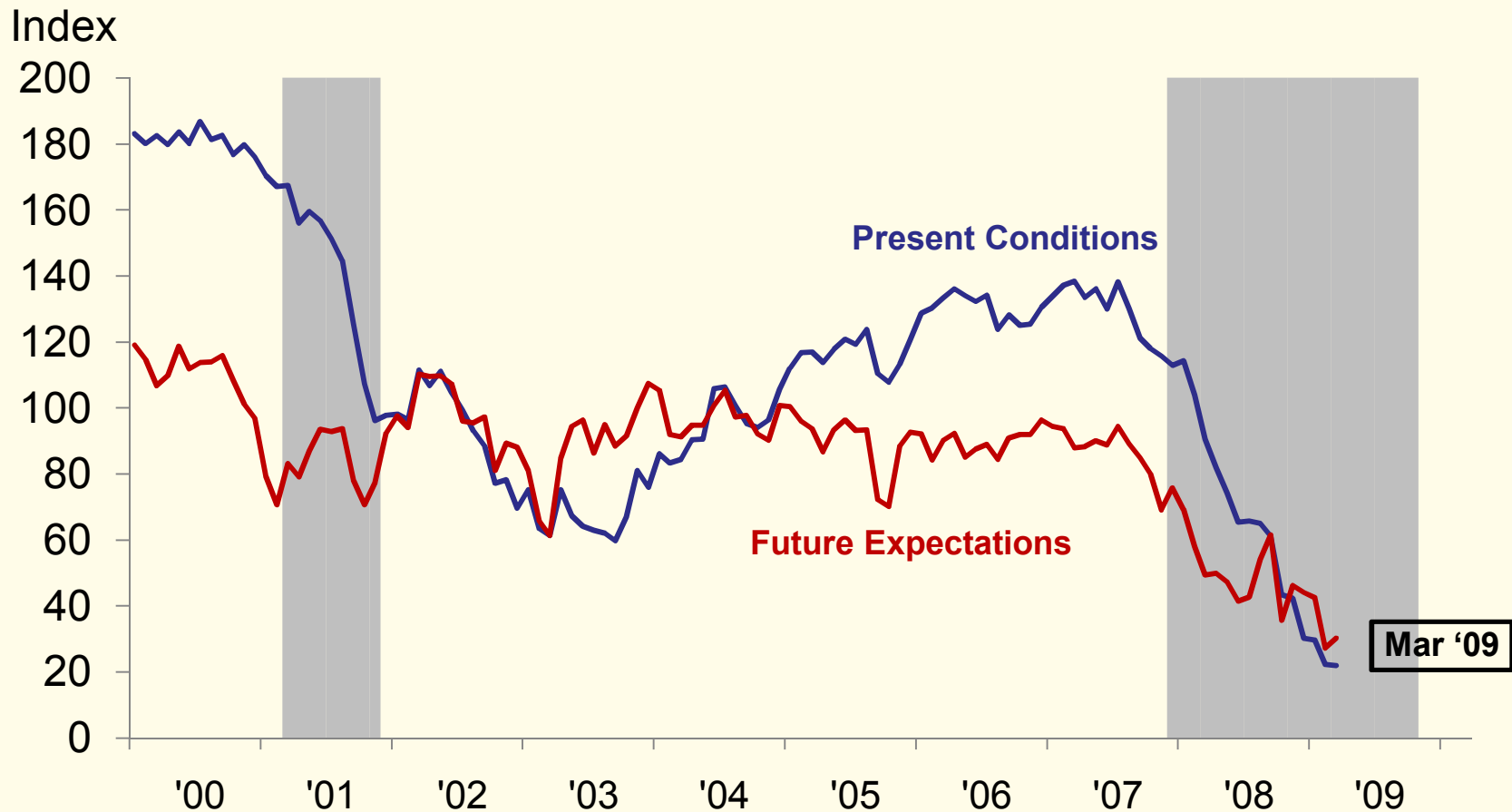
Percent change



Source: S&P, Fiserv, MacroMarkets LLC

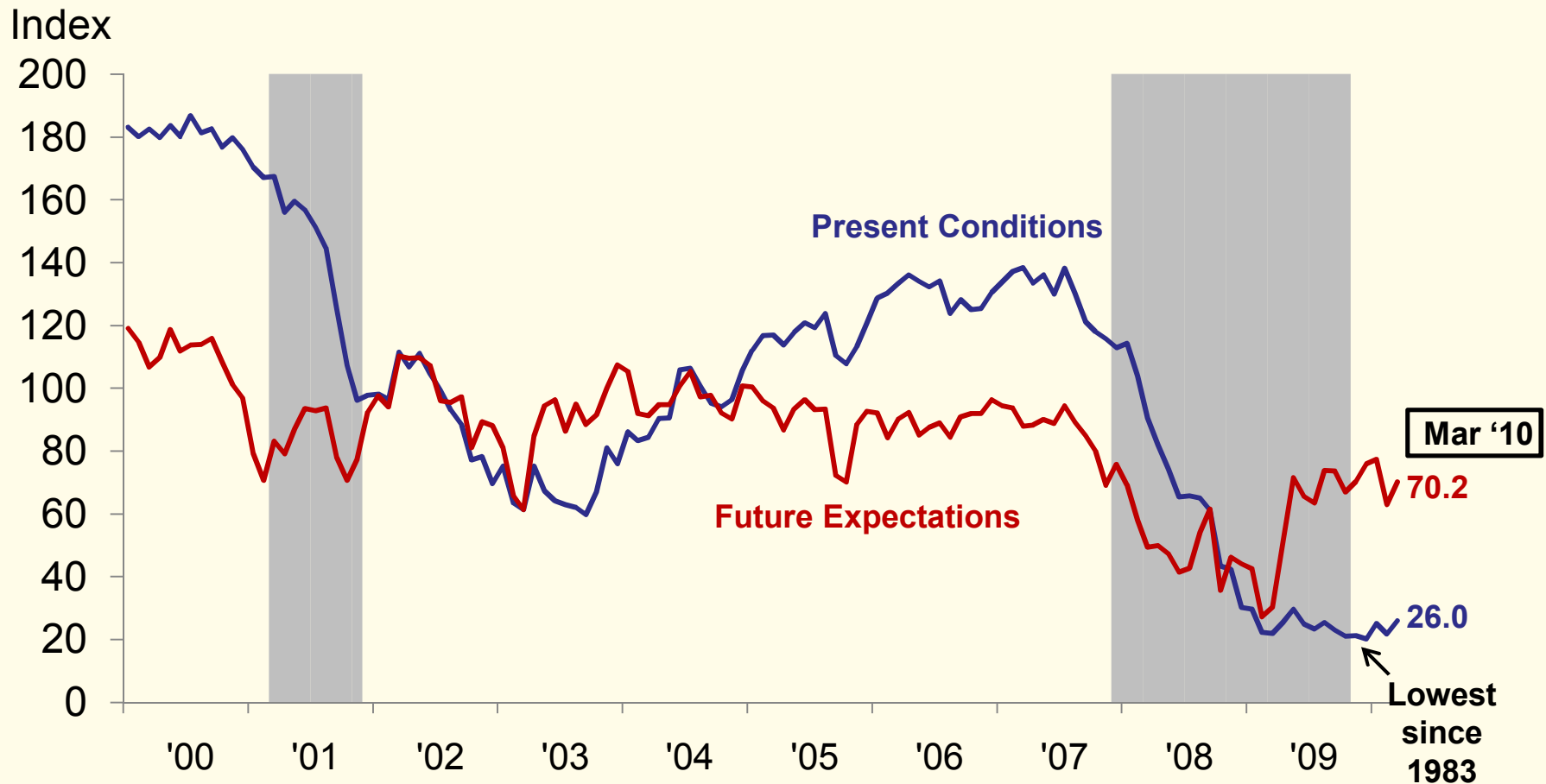
Note: Composite 10-City Index

Consumers Still Very Concerned About Present Economy



Source: The Conference Board

Consumers Still Very Concerned About Present Economy

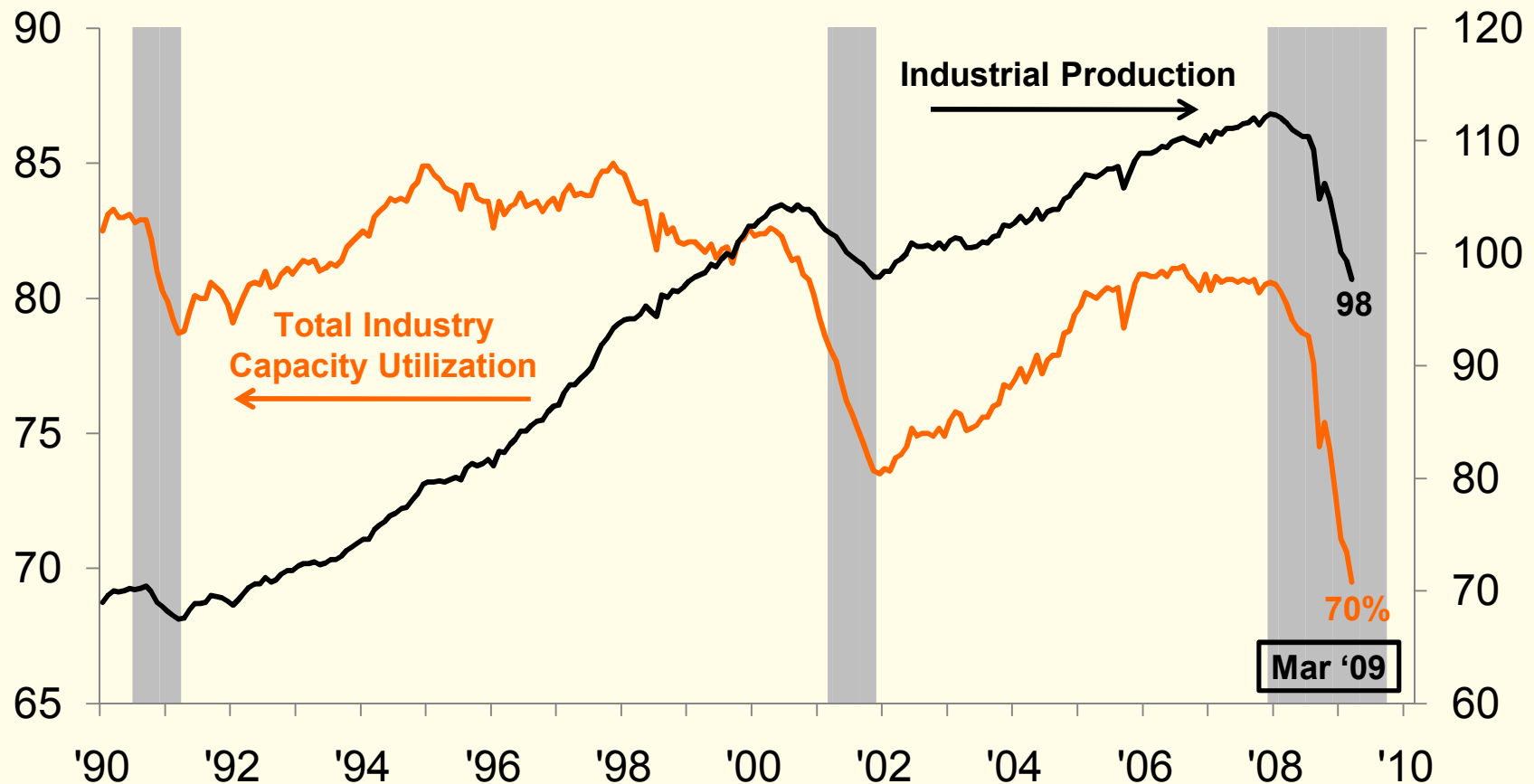


Source: The Conference Board

Industrial Production and Capacity Utilization

SA, Percent of Capacity

Index, 2002=100

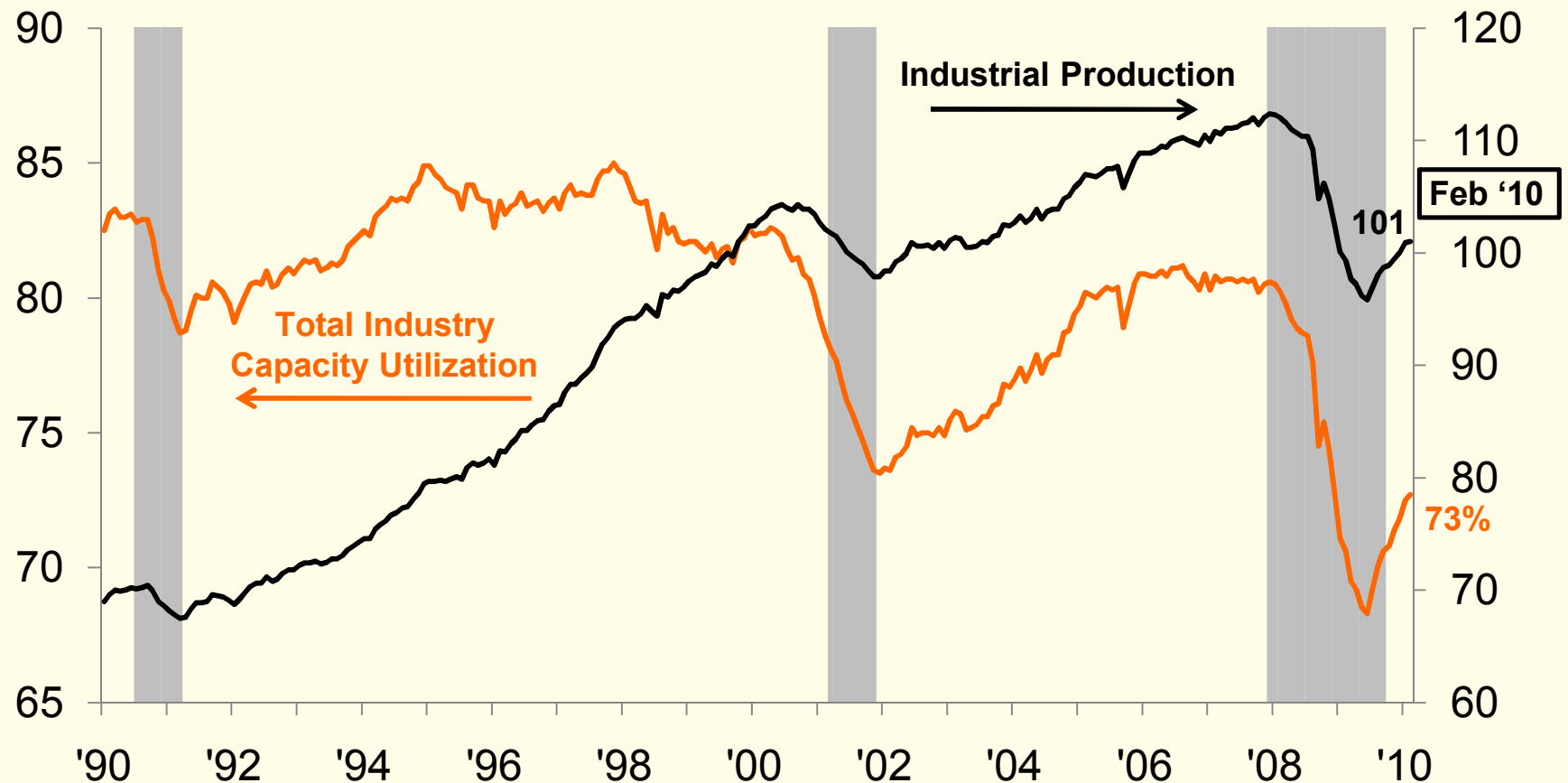


Source: Federal Reserve Board

Industrial Production and Capacity Utilization

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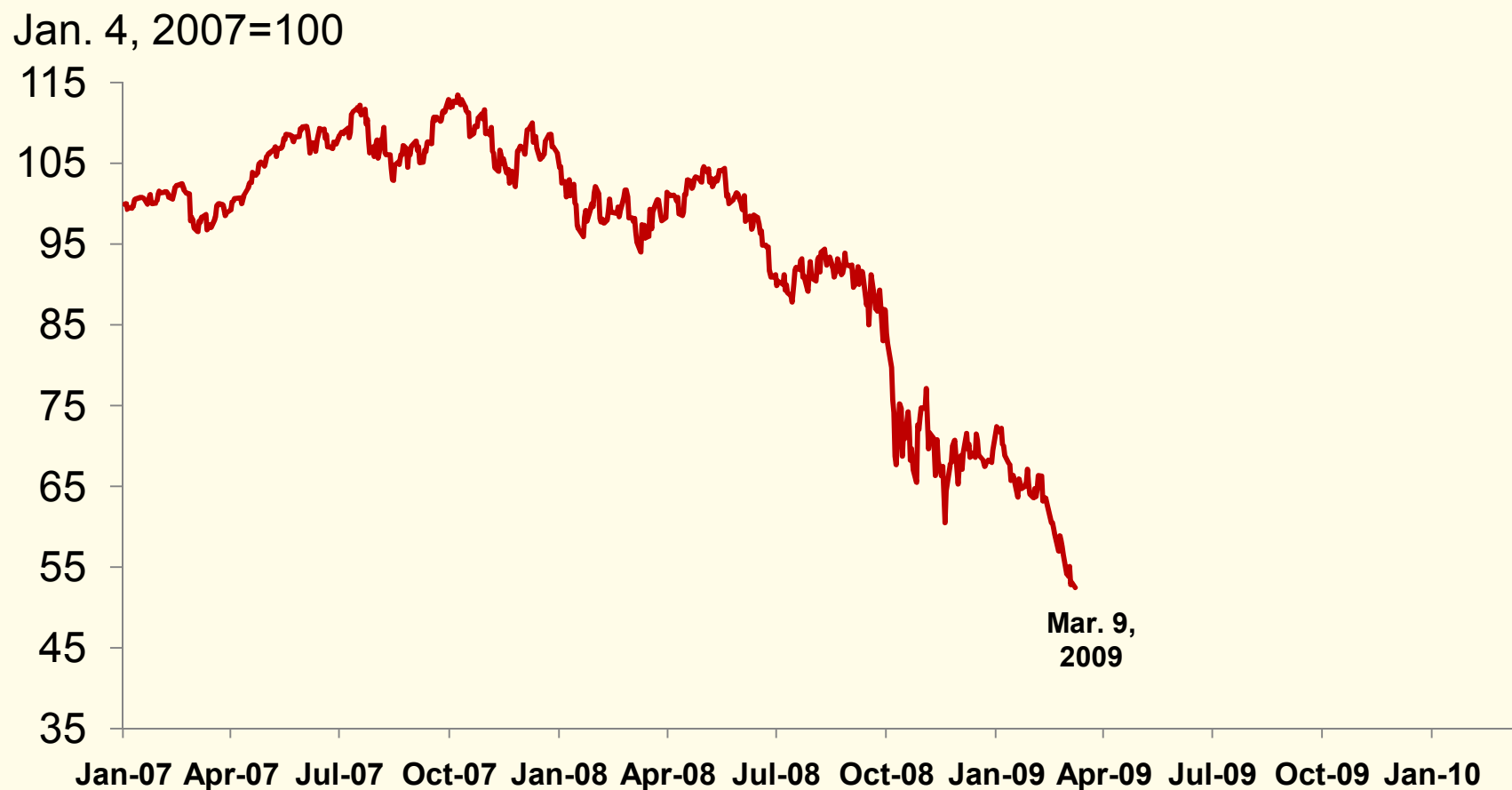


Source: Federal Reserve Board



Stock Market Plunged...

Dow Jones 30

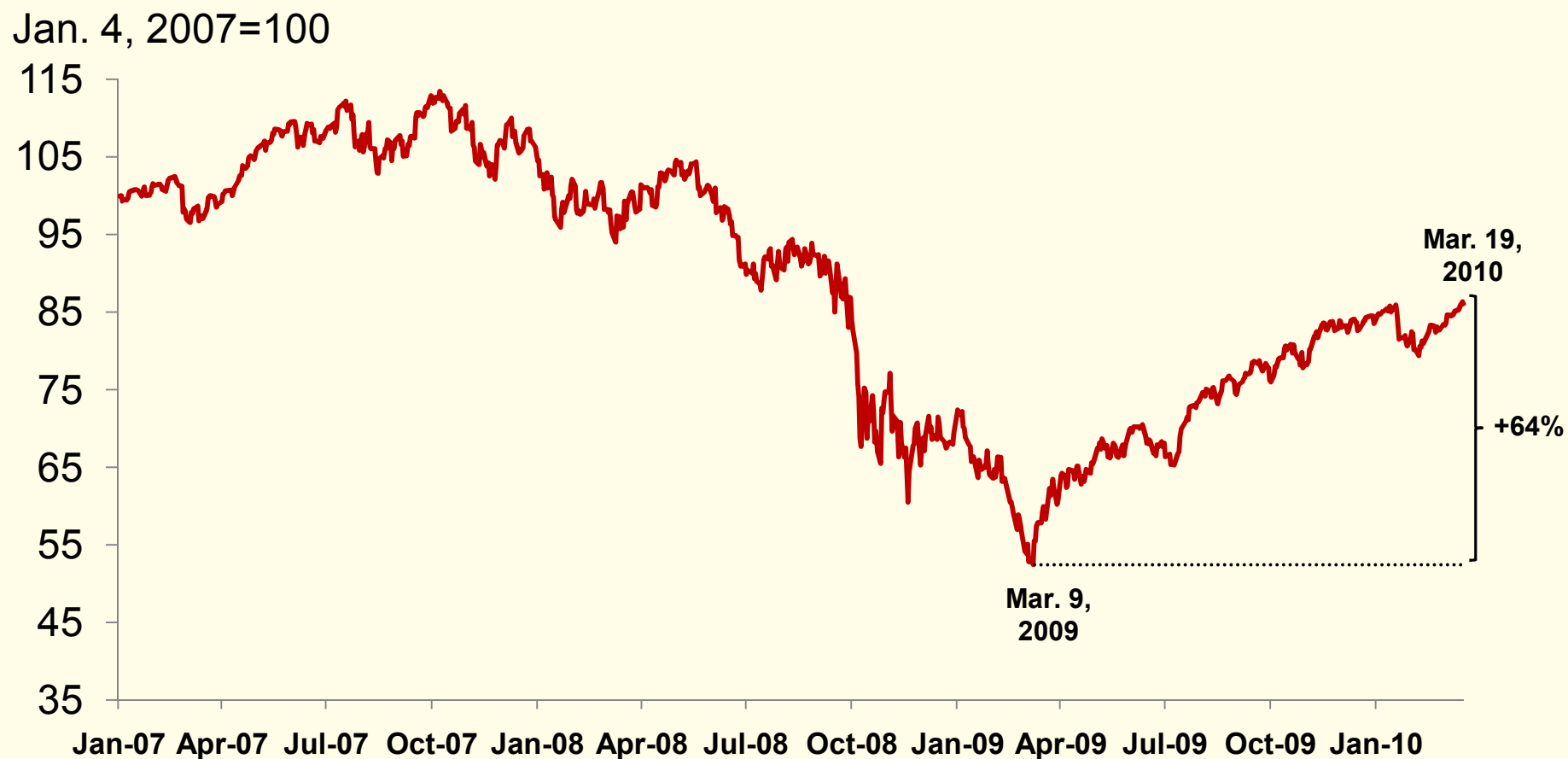


Source: Dow Jones



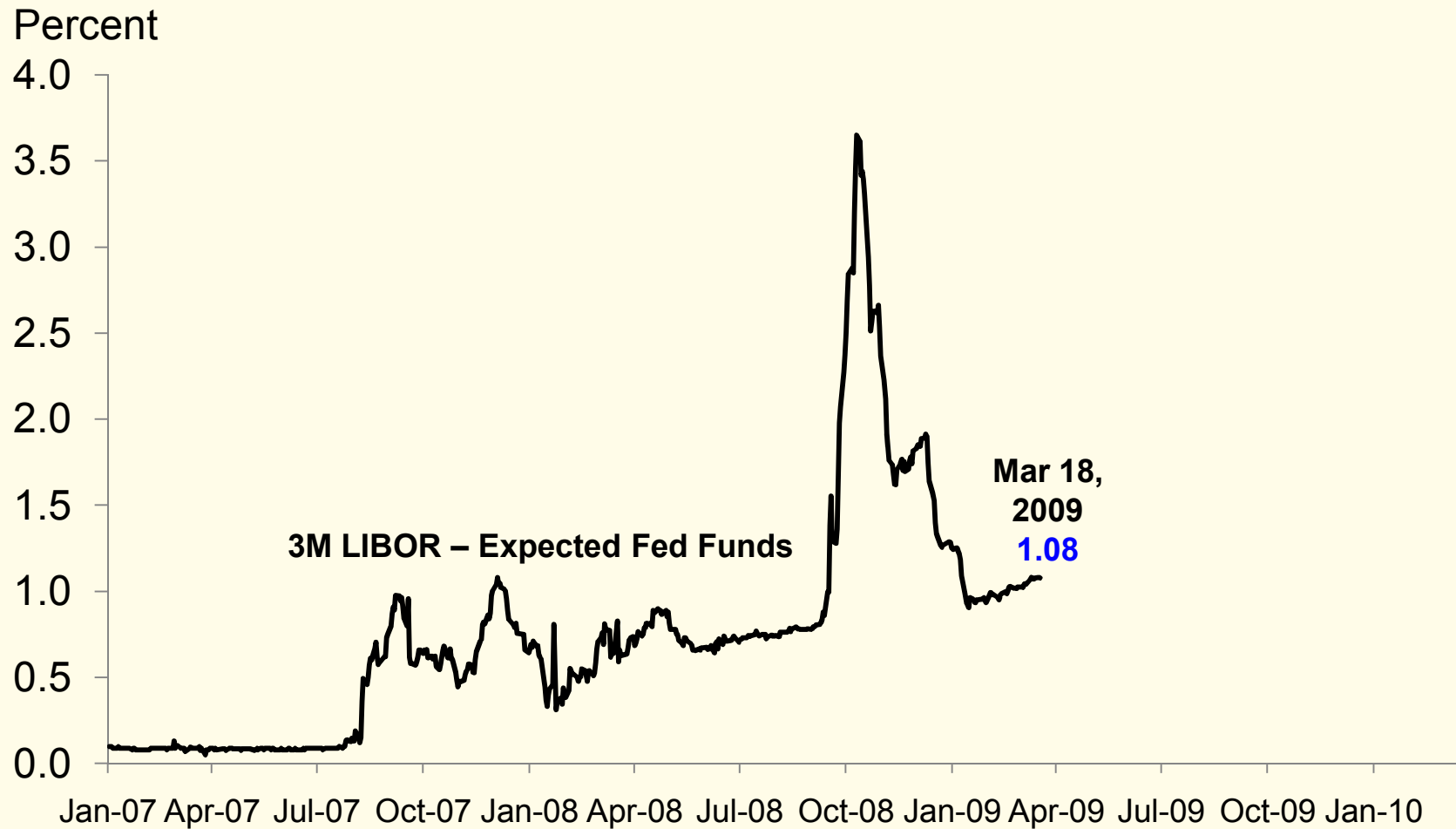
...And Has Since Recovered.

Dow Jones 30



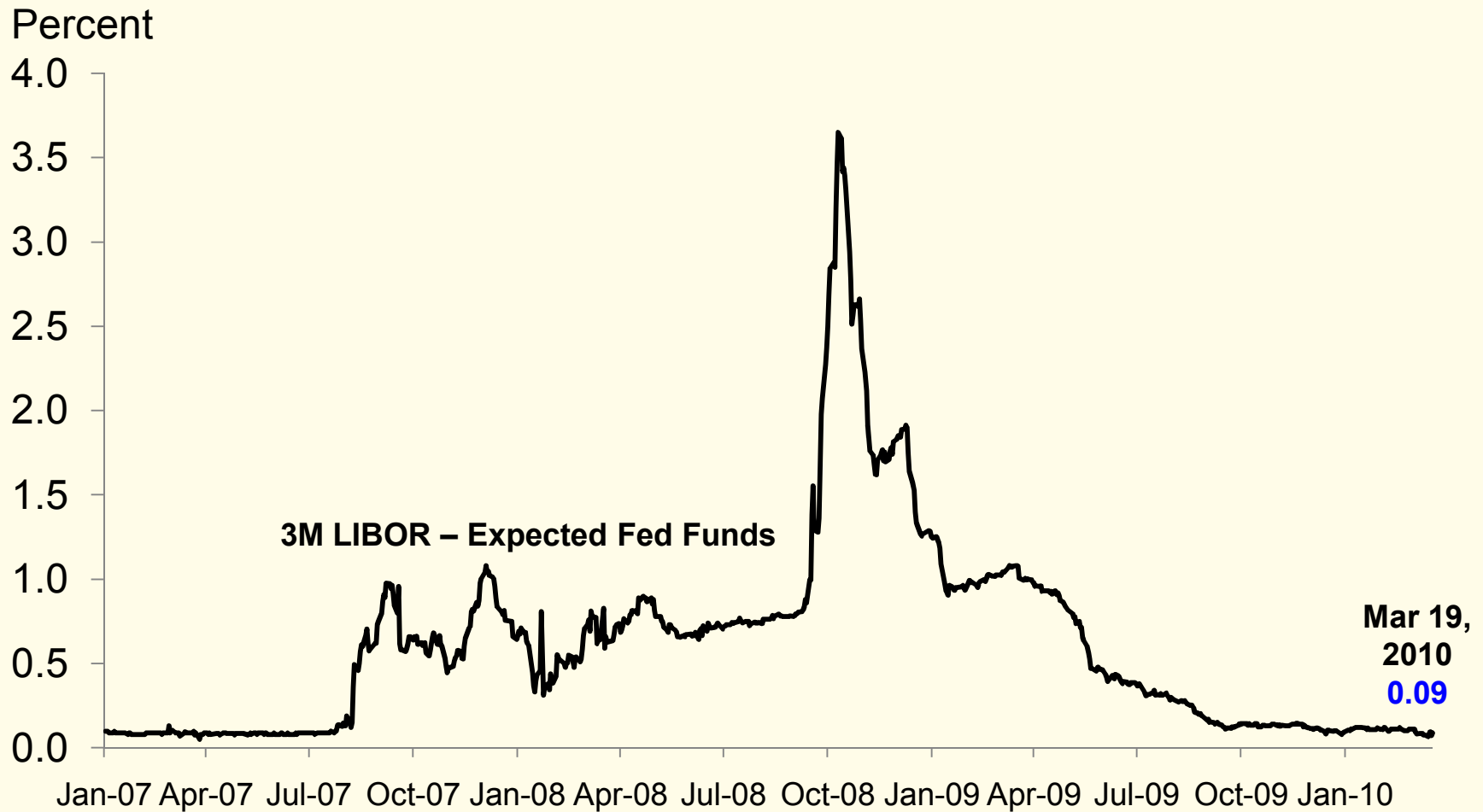
Source: Dow Jones

Interbank Frictions Mostly Gone



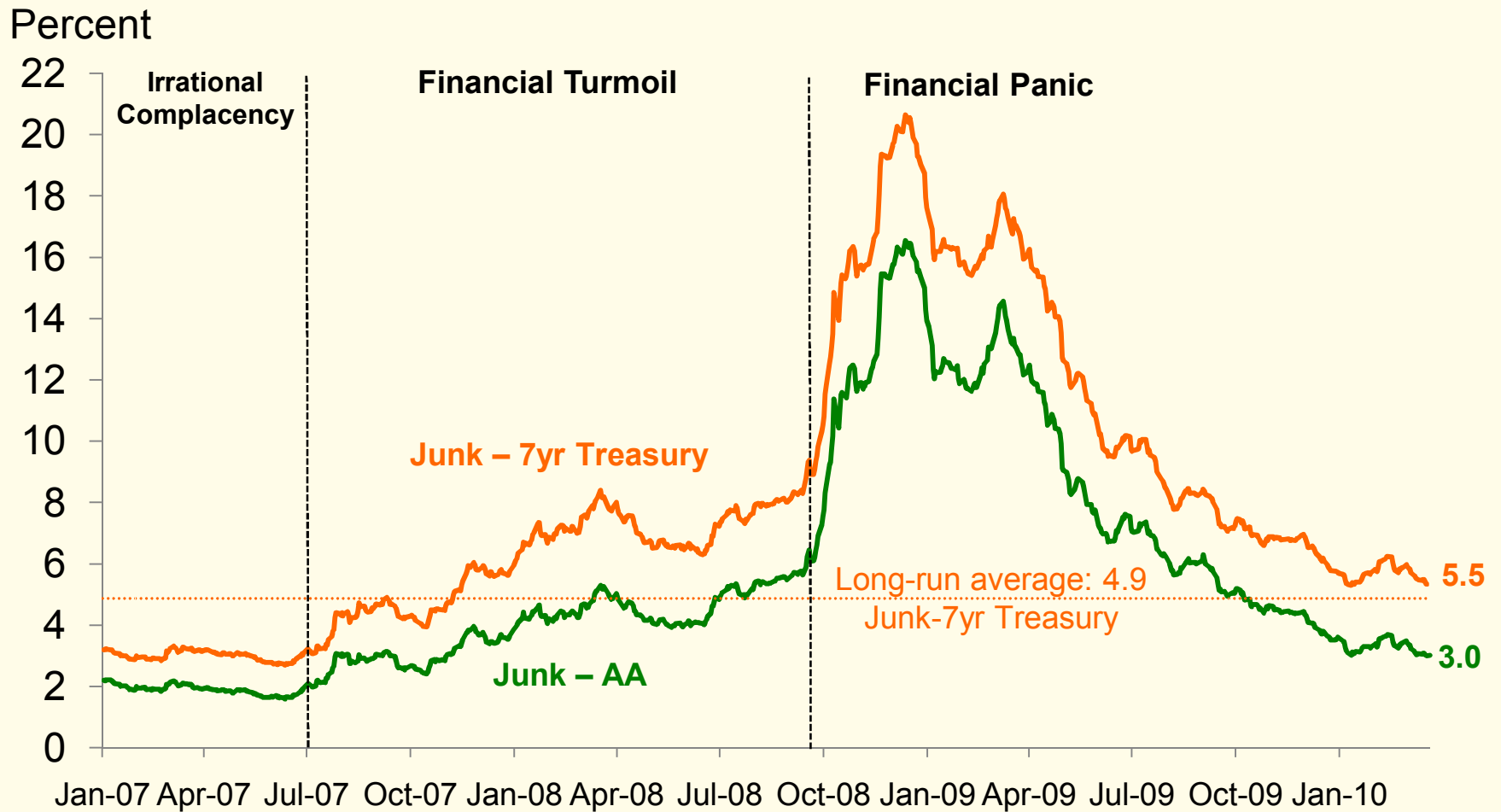
Source: *Financial Times*, Reuters

Interbank Frictions Mostly Gone



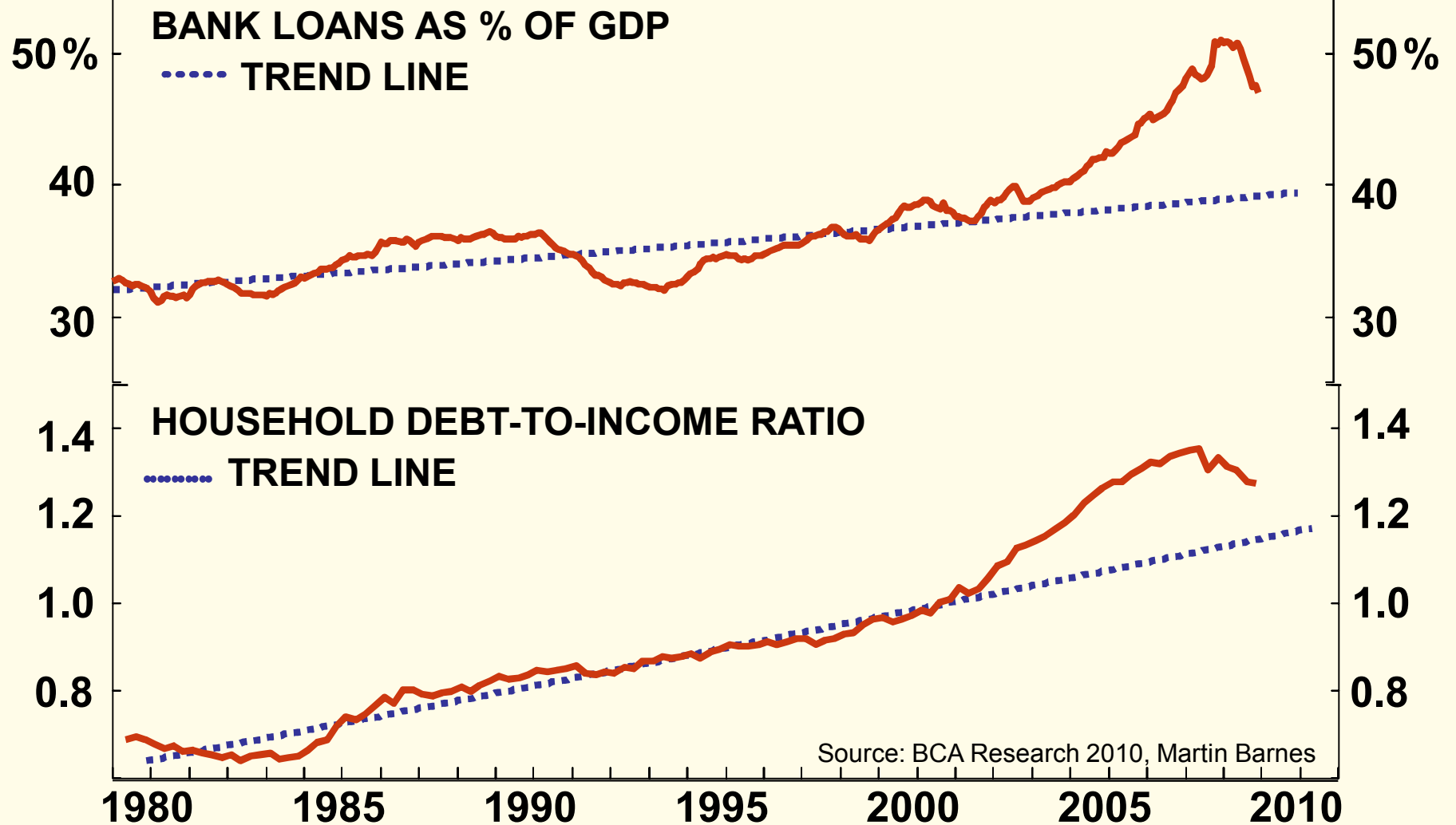
Source: *Financial Times*, Reuters

Junk Spreads Near Pre-Crisis Levels



Source: Merrill Lynch, Moody's, Federal Reserve Board

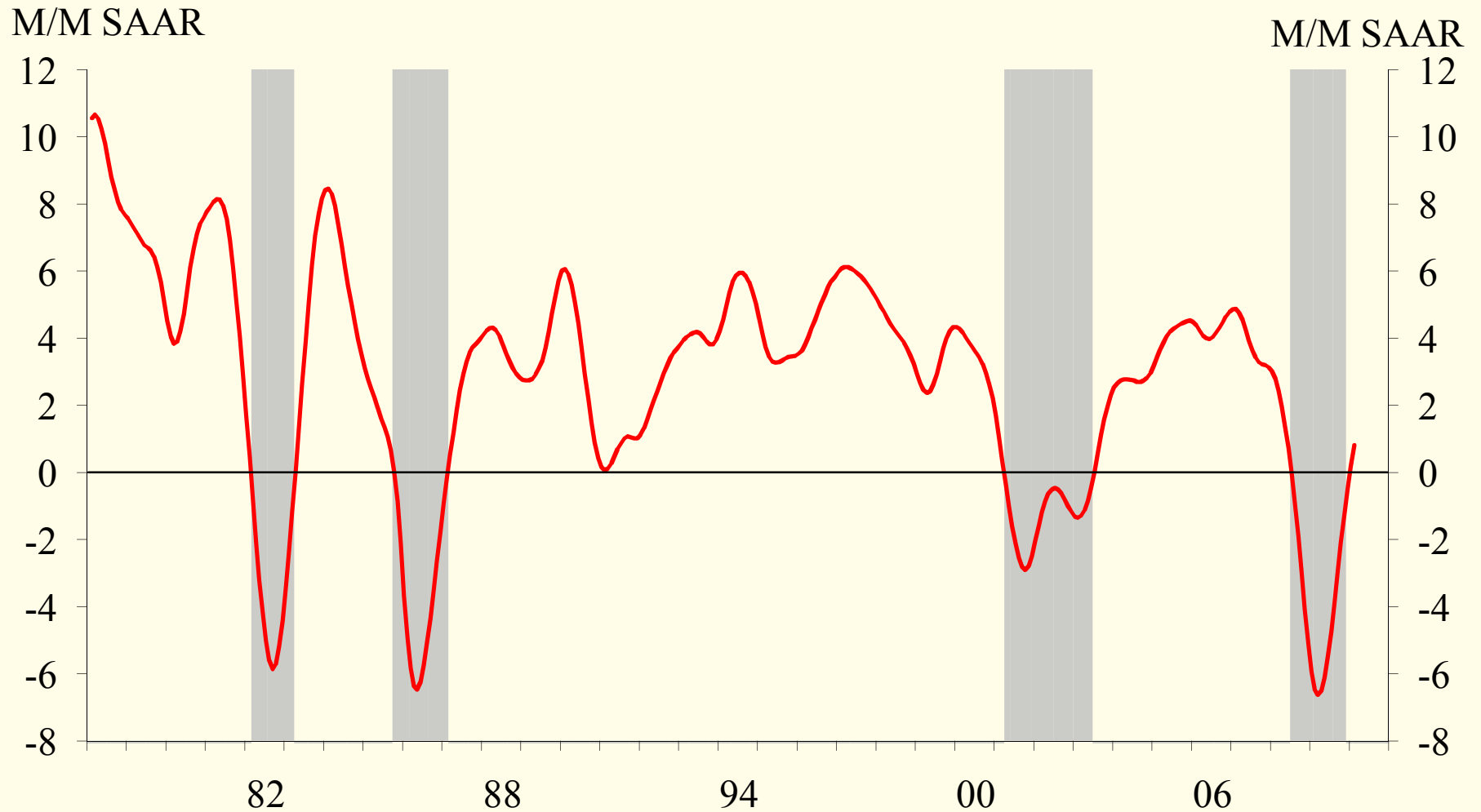
The Credit Overshoot Has Not Been Unwound





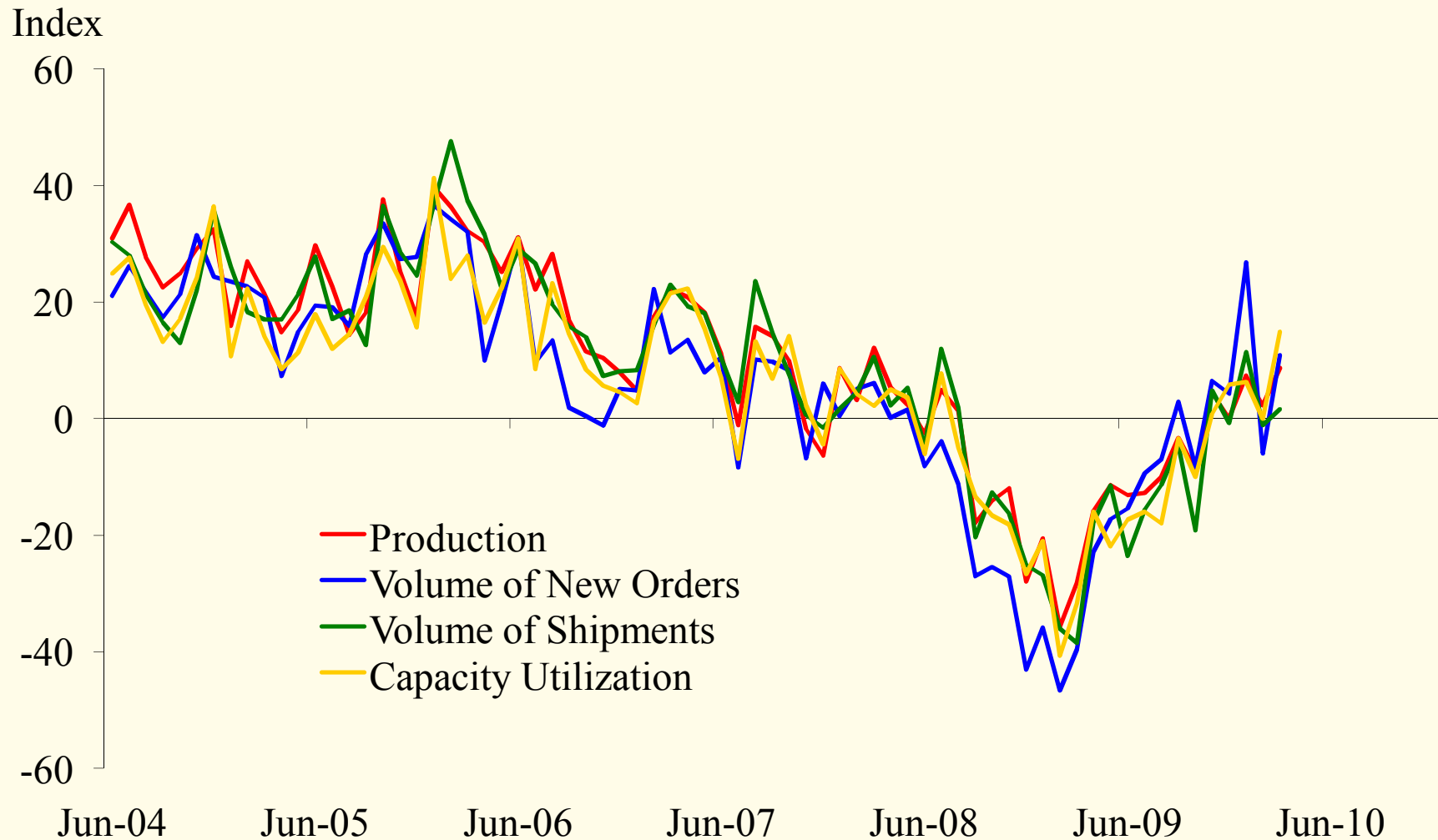
A Look At The Region

Texas Business Cycle Index Suggests that Recession is Over

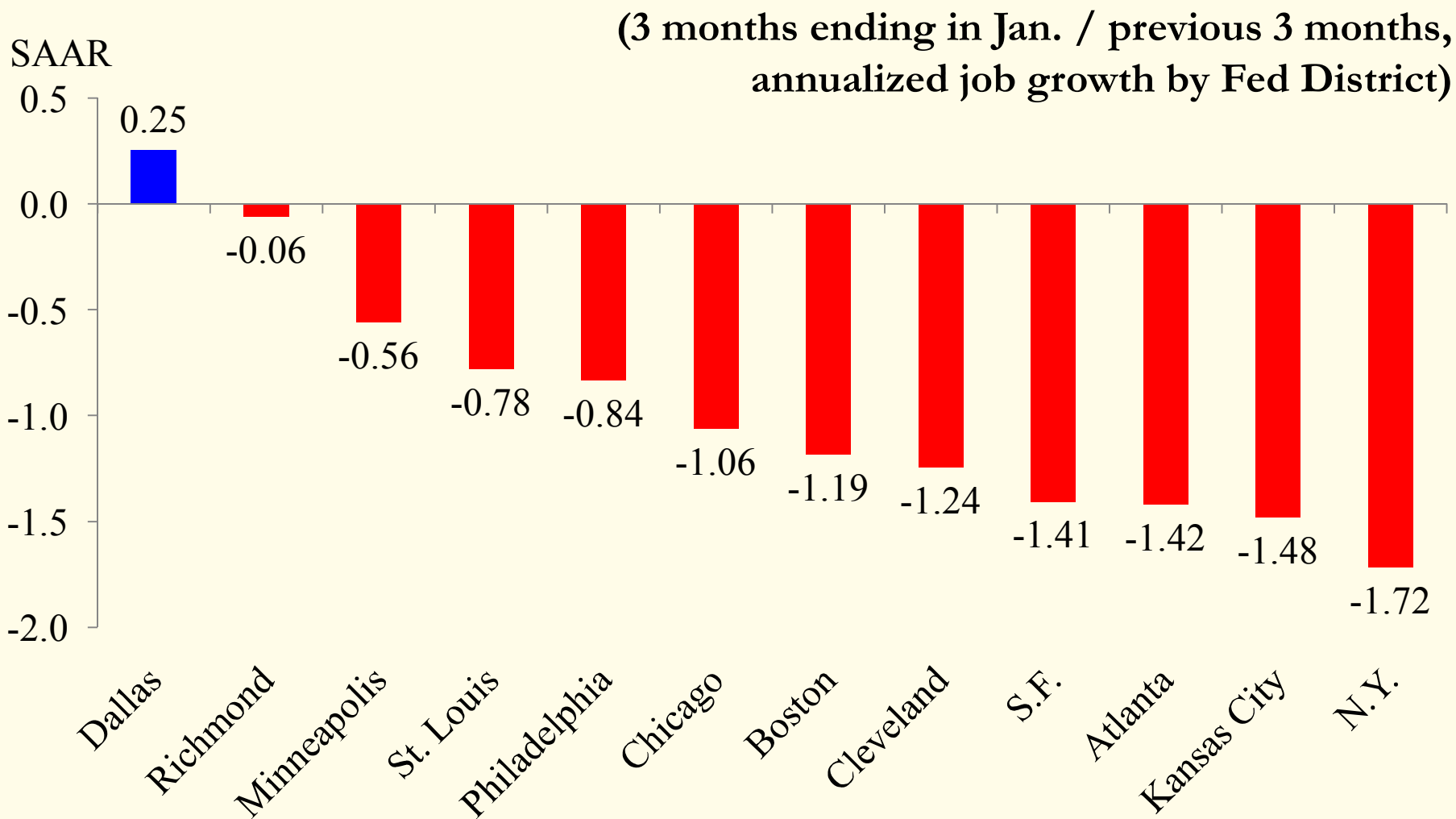


Texas Manufacturing Outlook

Survey Shows a Rebound in Activity



Dallas District at Front of the Pack in the Current Recovery

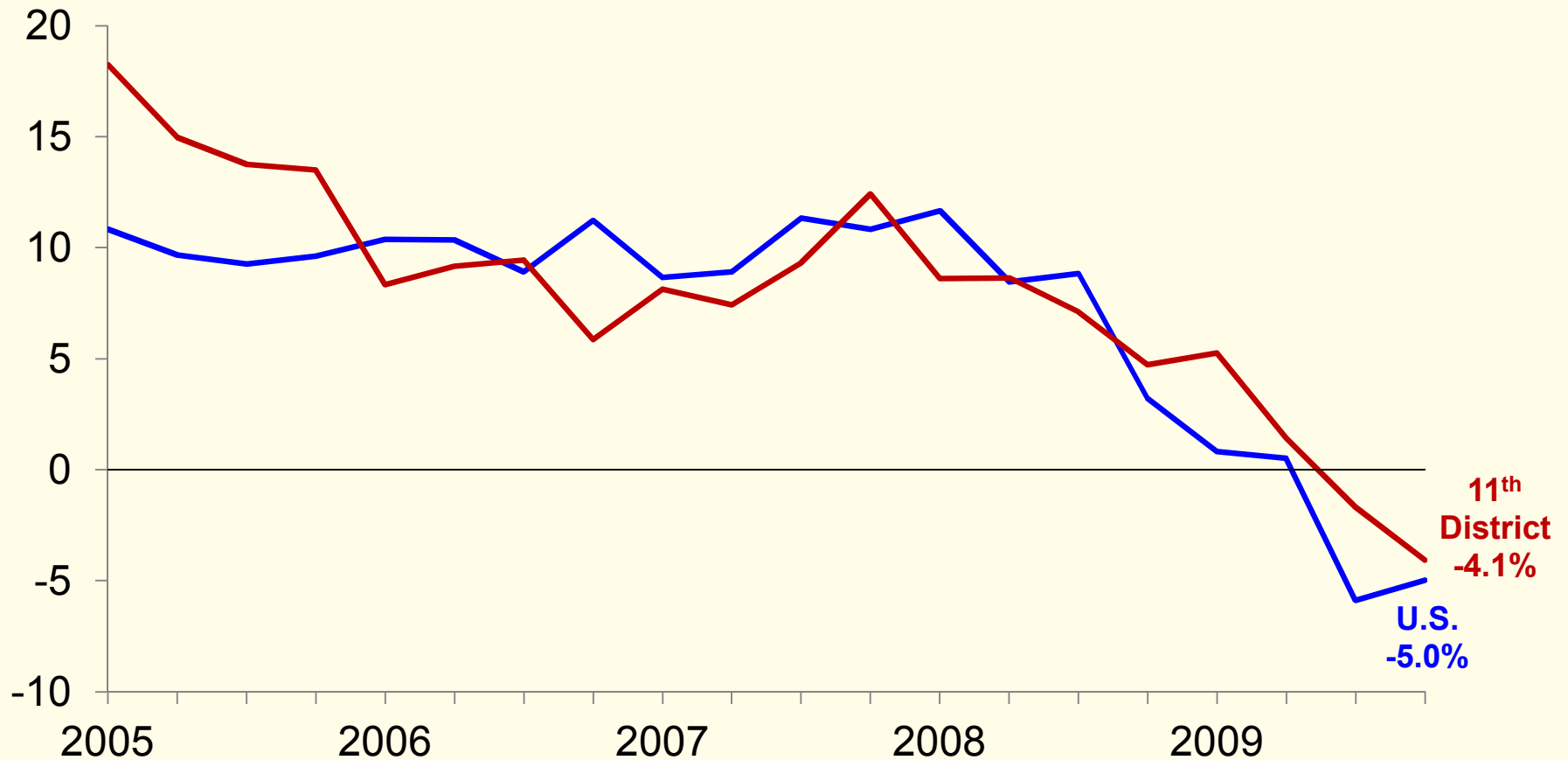




A Look At Banking

Loan Growth

Percent, Yr/yr

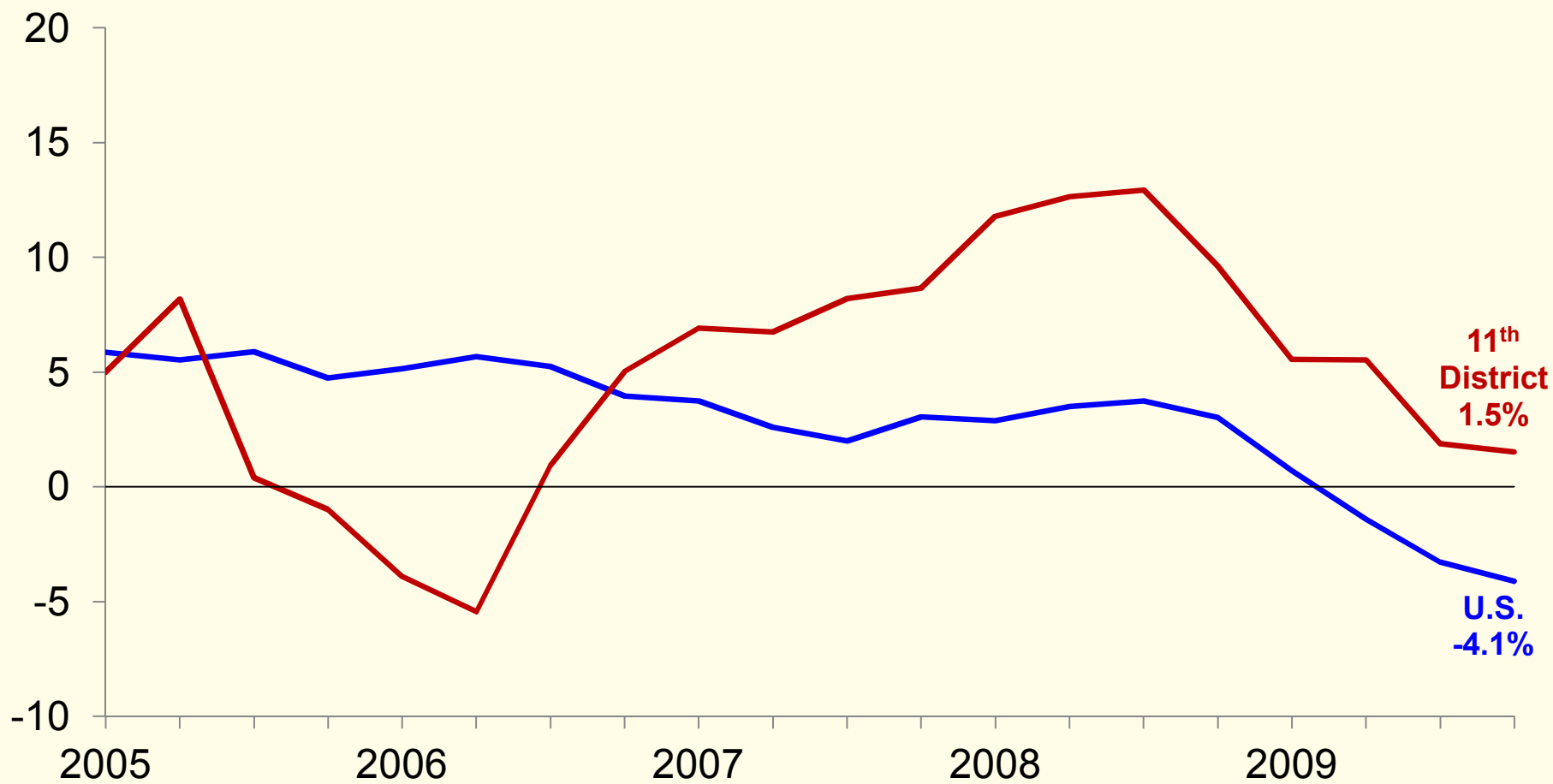


Note: Data for 11th District banks have been adjusted to include Comerica in all time periods and exclude Wells Fargo Bank South Central.

Loan Growth

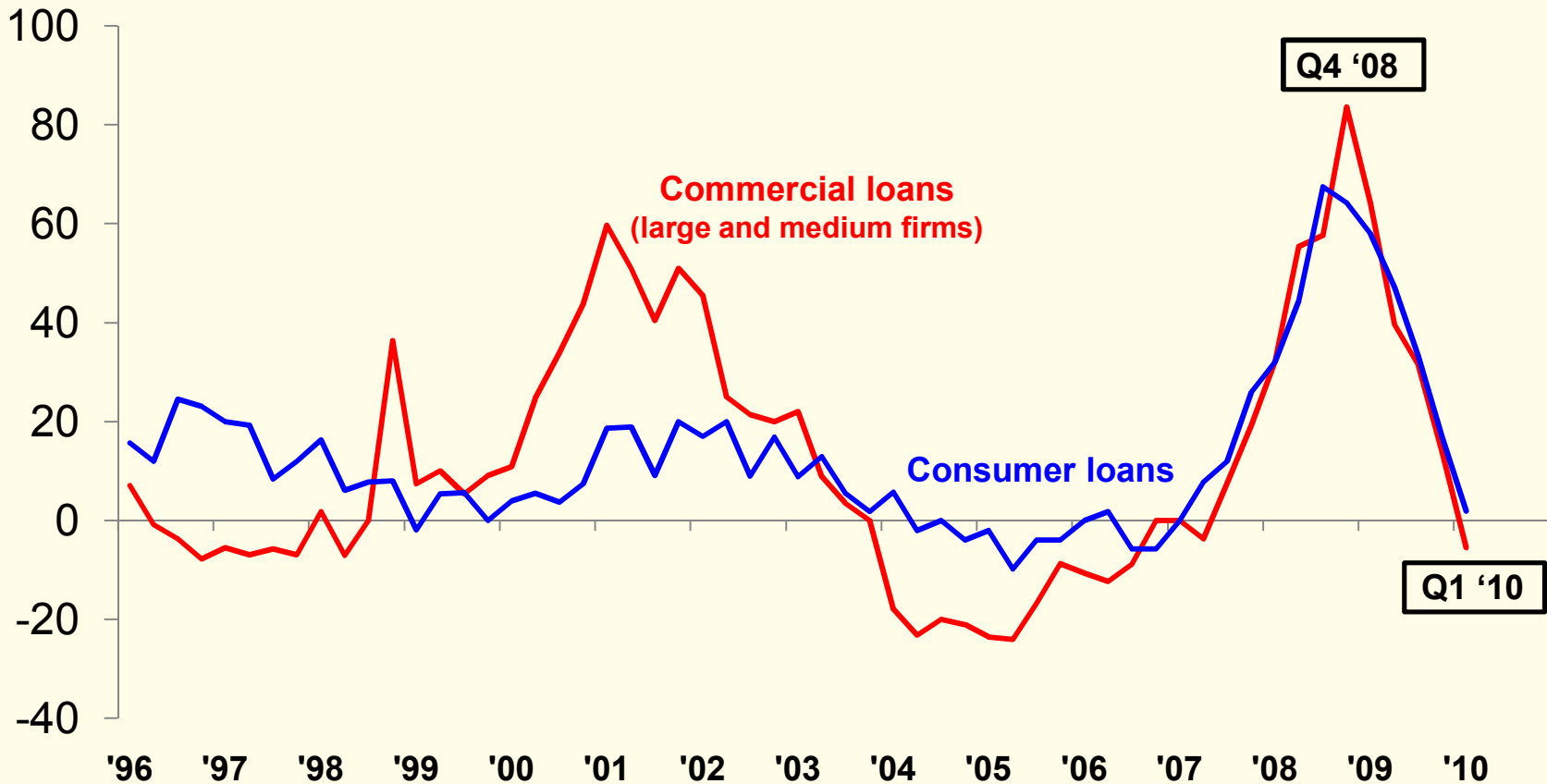
Banks with Assets < \$1 Billion

Percent, Yr/yr



Banks Close to Beginning an Easing of Credit Standards

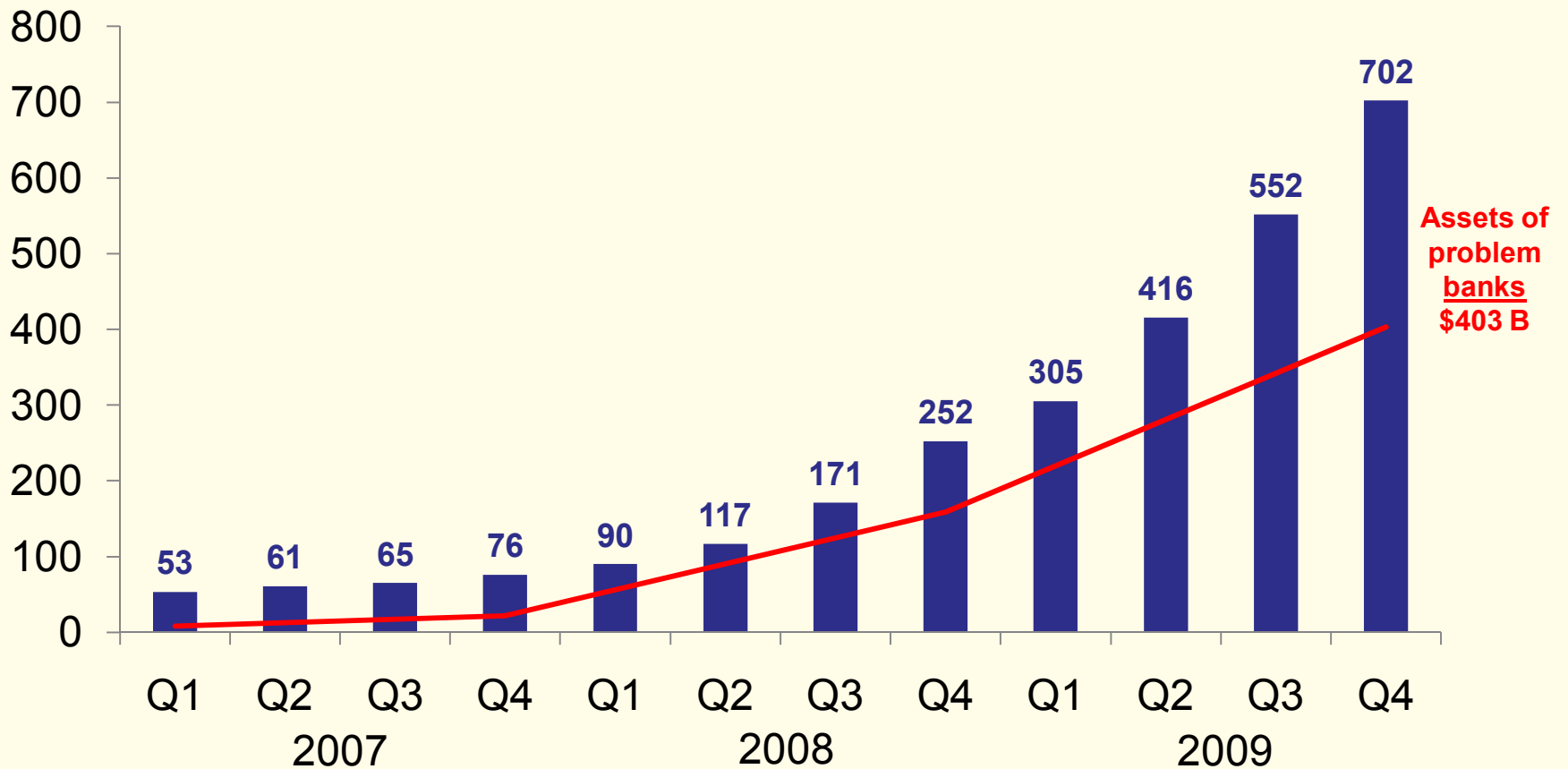
Percent tightening standards



Source: Senior Loan Officer Opinion Survey on Bank Lending Practices (Federal Reserve Board)

But, High Number of “Problem” Institutions on the FDIC’s List

Number of banks, or
\$ Billions



Source: FDIC



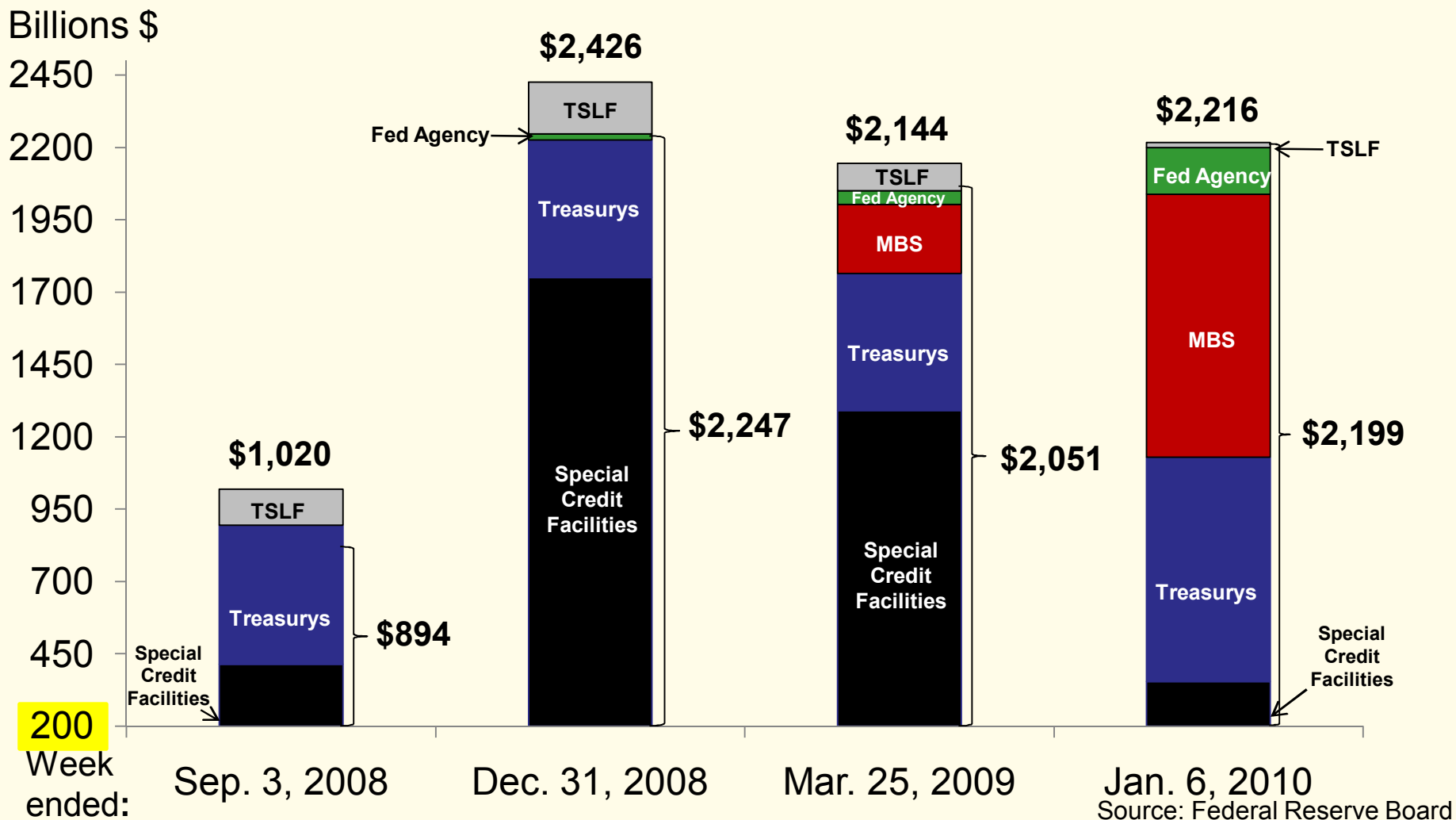
Monetary Policy



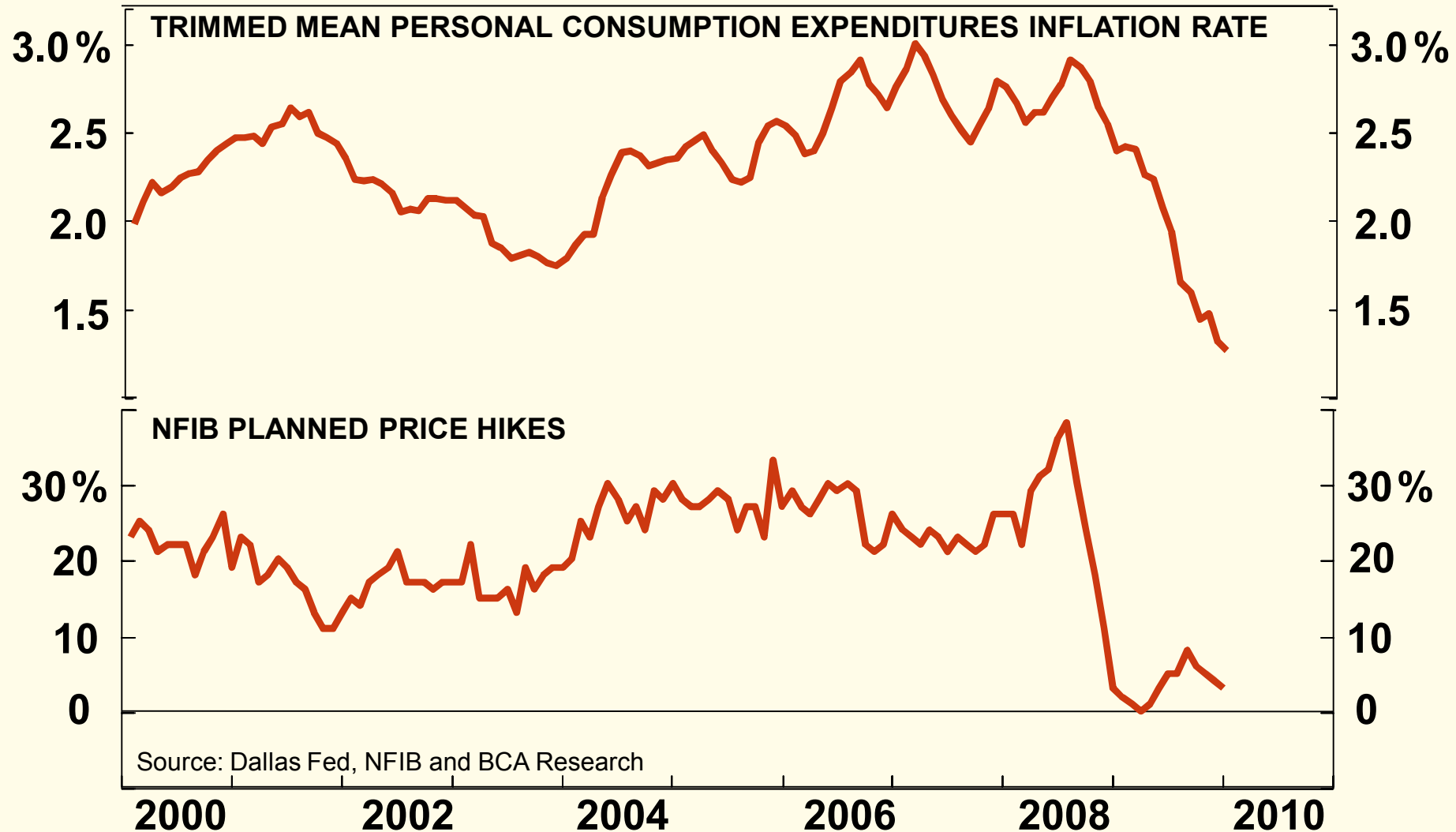
Rosenblum's First Law

**For every Federal Reserve
policy action, there is an
equal and opposite criticism.**

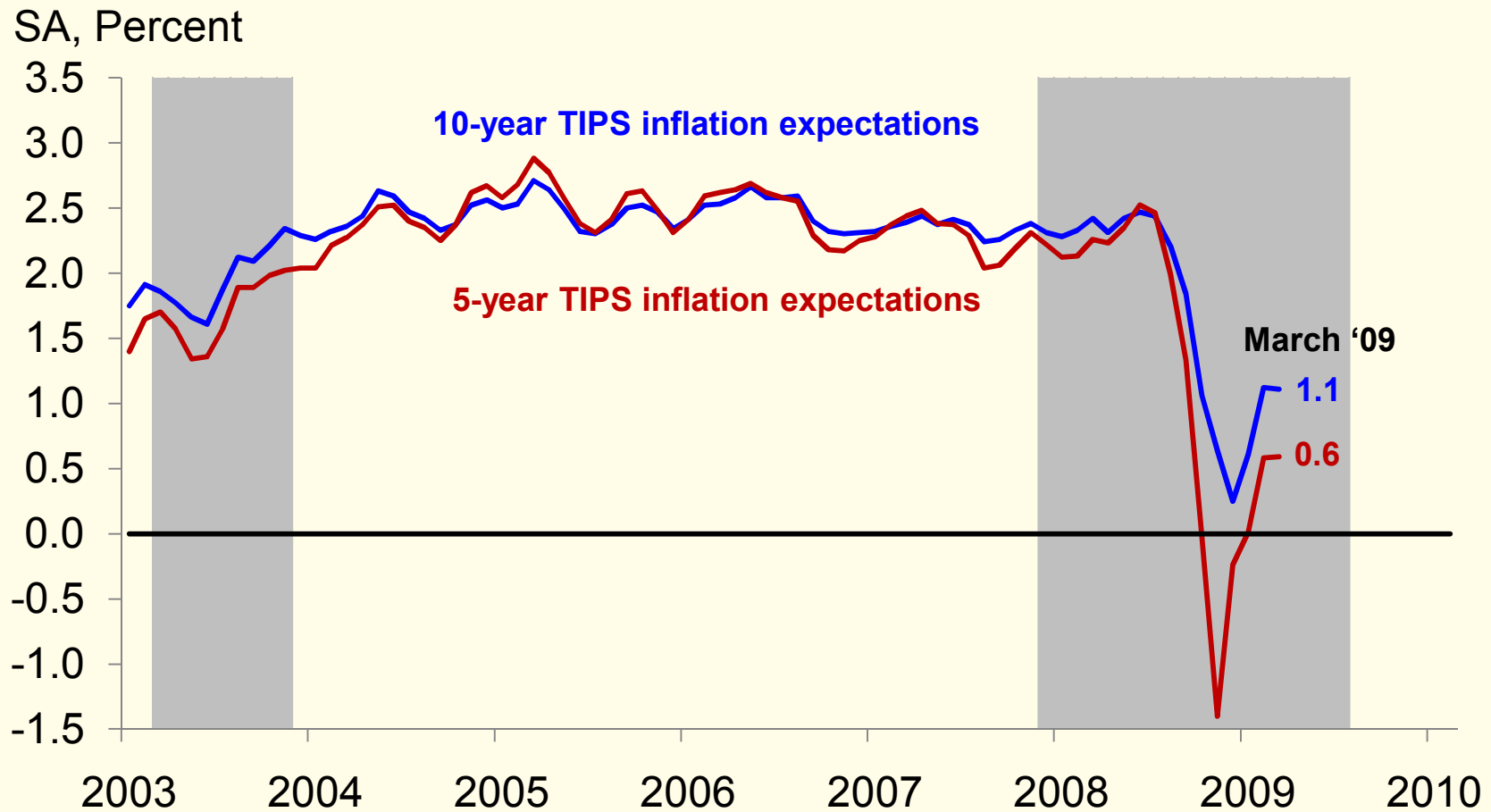
Fed Balance Sheet Outstanding: Economy Still on Life Support



Inflation is Muted Due to Lots of Excess Capacity

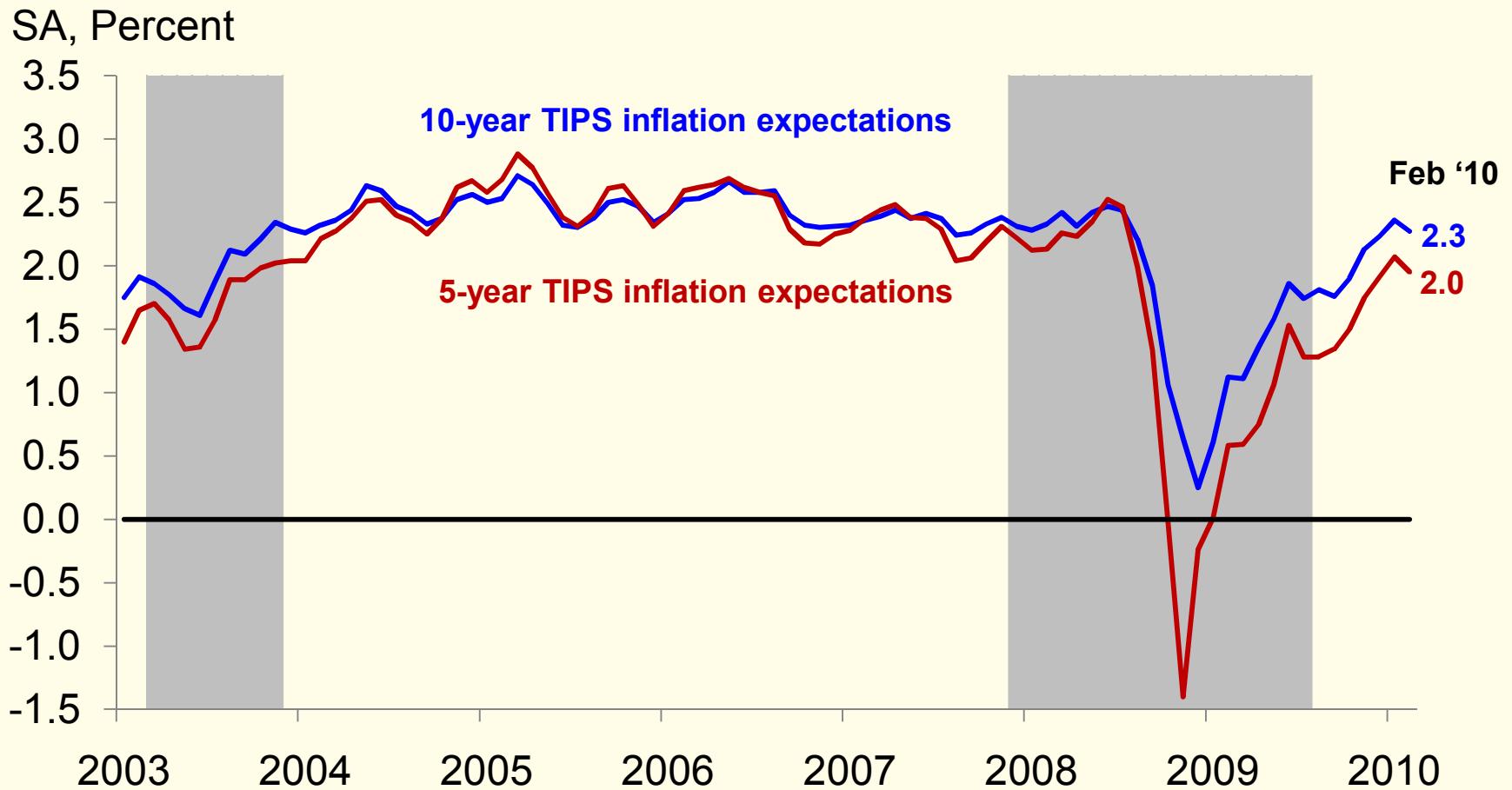


Inflation Expectations Subdued



Source: Federal Reserve Board

Inflation Expectations Subdued



Source: Federal Reserve Board



Timing of Exit Strategies

- FOMC will focus particularly on anticipated resource utilization, inflation and inflation expectations in its decisions on exit timing
- Fed has **no prior experience** in creating or removing monetary stimulus of this **magnitude and diversity**



A Humble Note


“The way events have unfolded over the past few months simply has no precedent... No one knows the outcomes of an unprecedented event. No one.”

Zachary Karabell

“The Economic News Isn’t All Bleak”

Wall Street Journal

Dec. 26, 2008, p.A13



**Economic models are like
bikinis: what they reveal is
suggestive, but what they
conceal is vital.**

- John Cassidy



Economic Conclusions

- Economy gaining some traction
- Monetary policy inflationary
- Economy riddled with deflationary forces
- Inflation not an immediate concern
- Time to develop and implement exit strategies

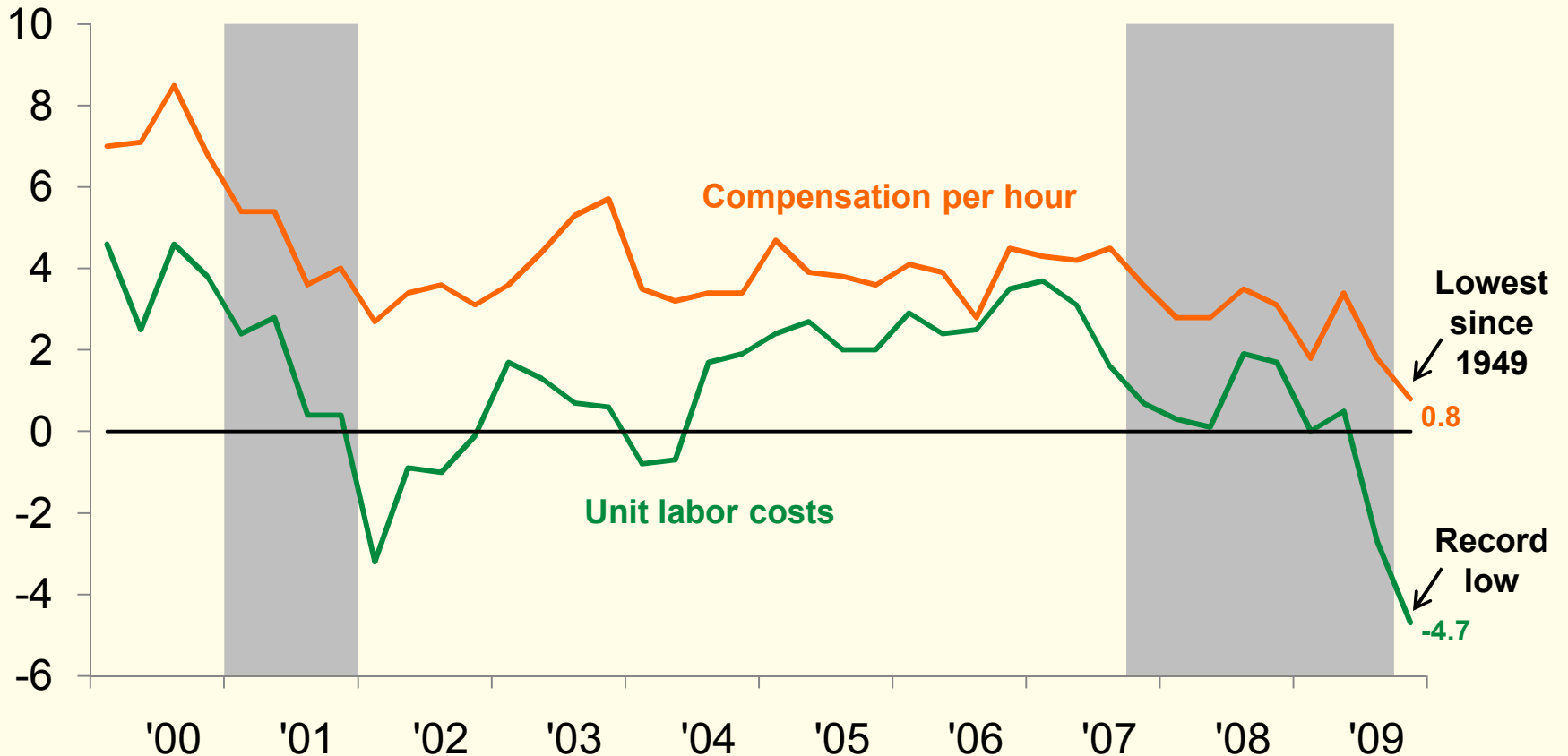


Back of Tray



Forces Working to Spur Profits, Not Inflation

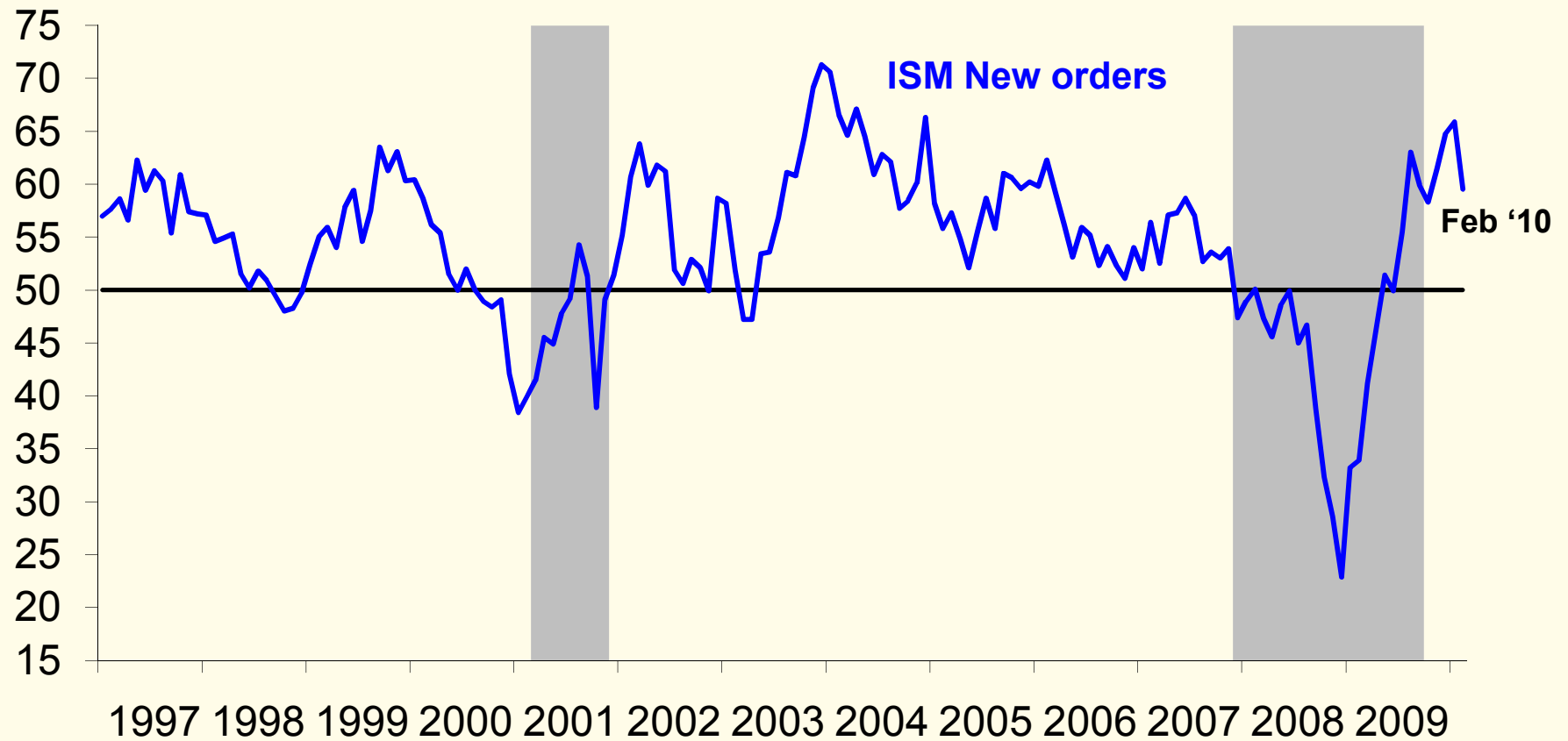
SA, % change, year-ago



Source: Bureau of Labor Statistics

Manufacturing Orders

50+ = Expanding



Source: Institute for Supply Management



The World of Finance: What a Difference a Year Makes

- S&P 500: +68%
 - Junk spread: -12.5 percentage pts.
 - Libor-OIS: -1.0 percentage pts.
 - 10yr-1yr Treasury: +1.1 percentage pts.
-
- Credit card rates: +1.6 percentage pts.



FOMC Exit from Extraordinary and Massive Monetary Stimulus

- Drop phrase “likely warrant exceptionally low rates for **an extended period.**”
- Allow special liquidity facilities to expire
 - Many have expired as of Feb. 1, 2010
 - TALF will soon expire
- End large-scale asset-purchase programs
 - Scheduled to end by end of 2010 Q1 with slowing pace of purchases announced



FOMC Exit from Extraordinary and Massive Monetary Stimulus (Cont.)

- To reduce the credit-growth and money-growth potential of the current \$1.1 TRILLION of excess reserves:

Use in
combo. to
increase
Fed funds
rate

- Begin reverse repurchase agreement program
- Raise interest rate on excess reserves
- Establish a Fed term-deposit facility for banks
- Outright sales of assets

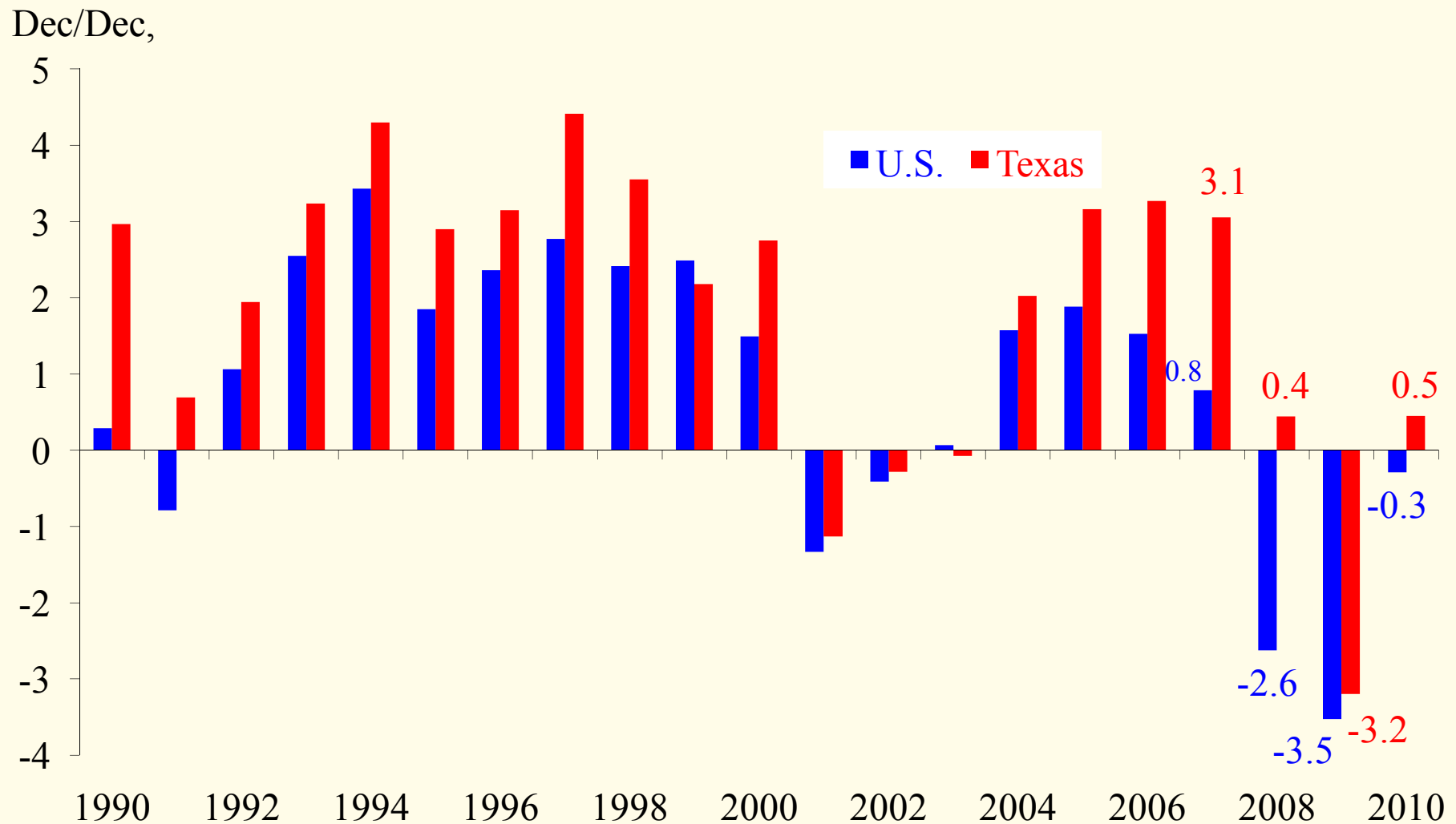


Timing of Exit Strategies

Depends on:

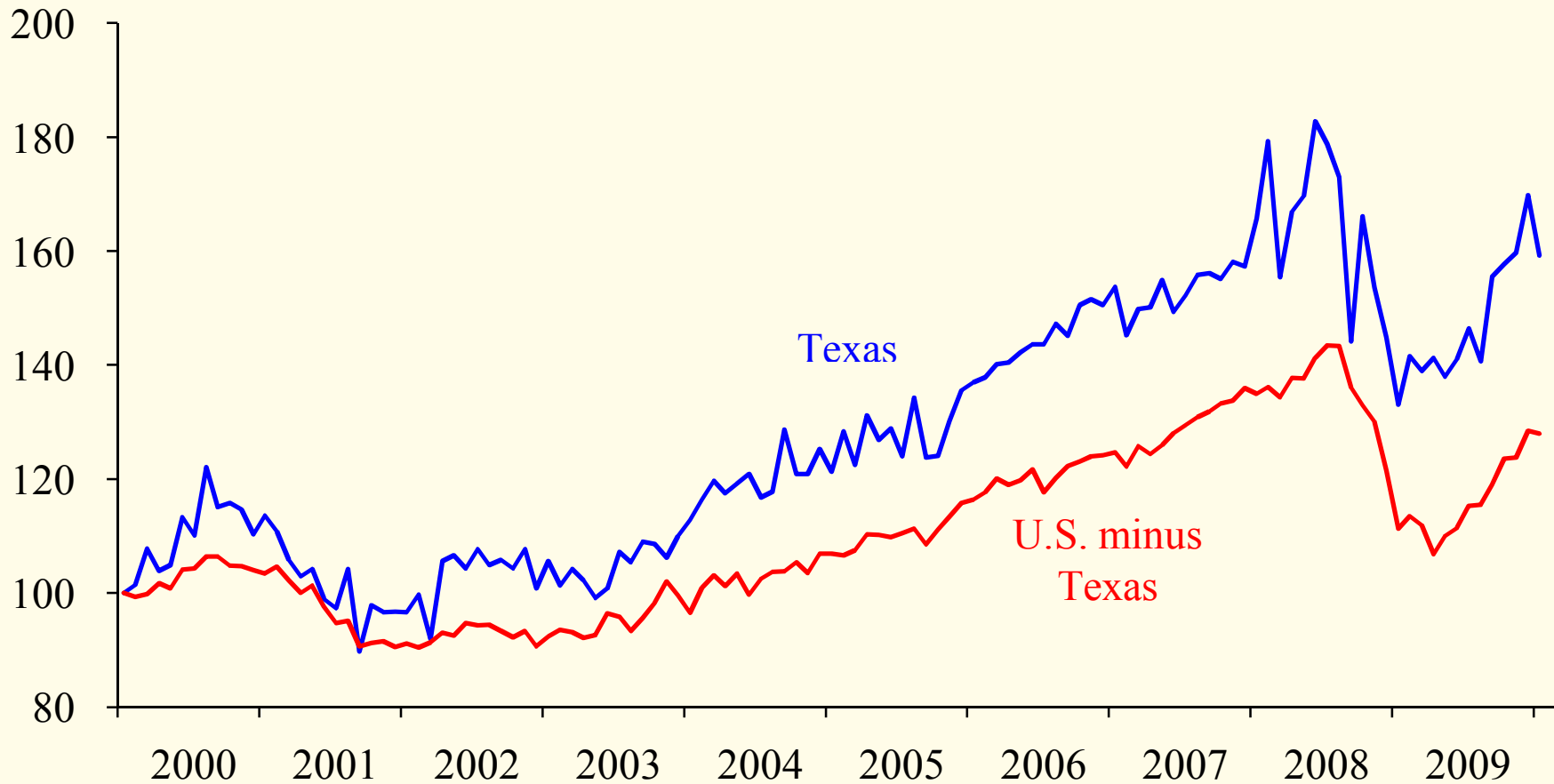
- Long time lags for monetary policy to impact economic growth and inflation
- **Forecasts** of when economy will return to more normal patterns
 - Cannot wait for return to actual high resource utilization

Texas Jobs Declined at a Similar Pace as the Nation in 2009



Texas Exports Increasing

Index, SA Real
Jan. 2000=100



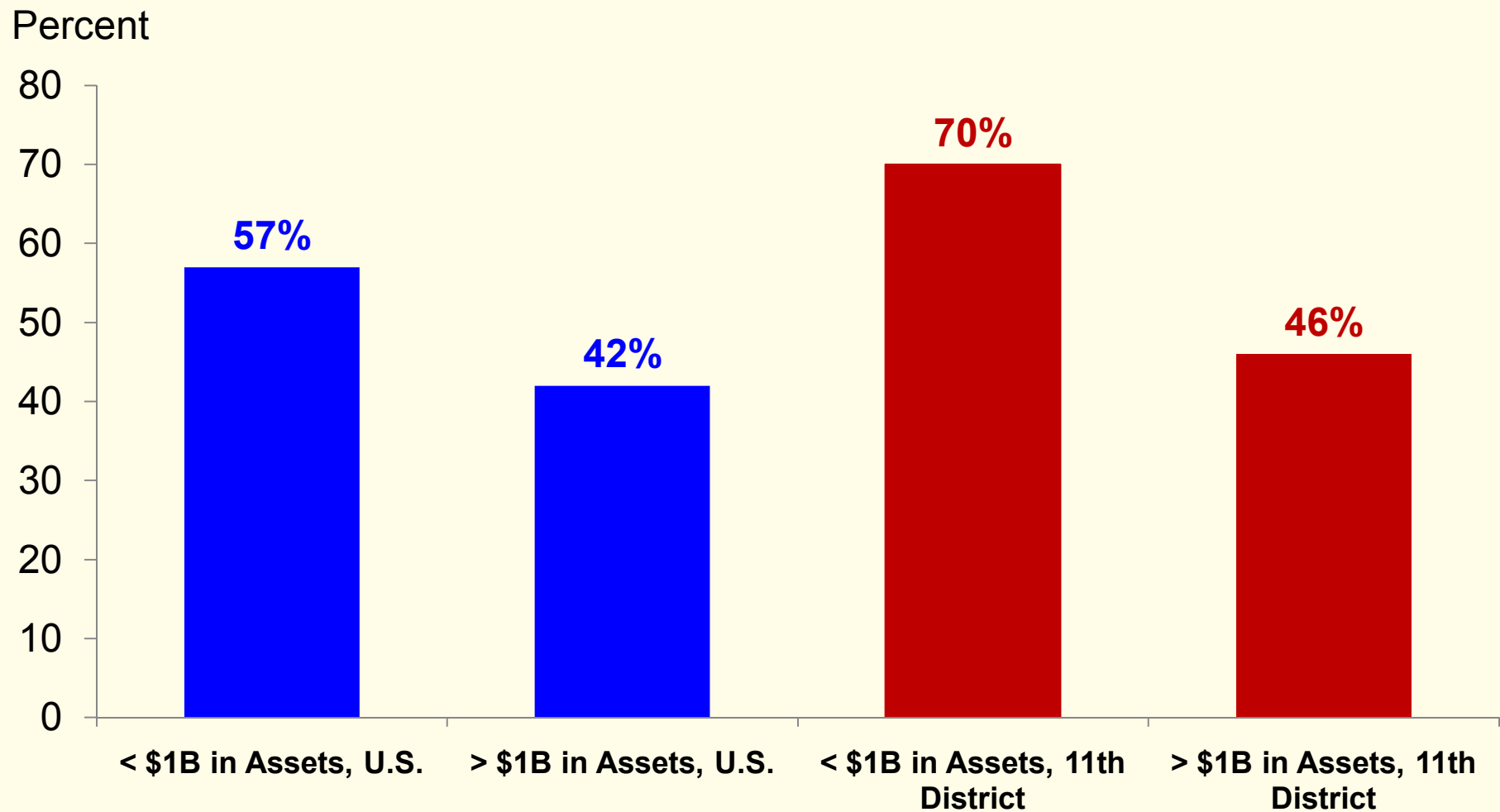


Texas vs. Other States

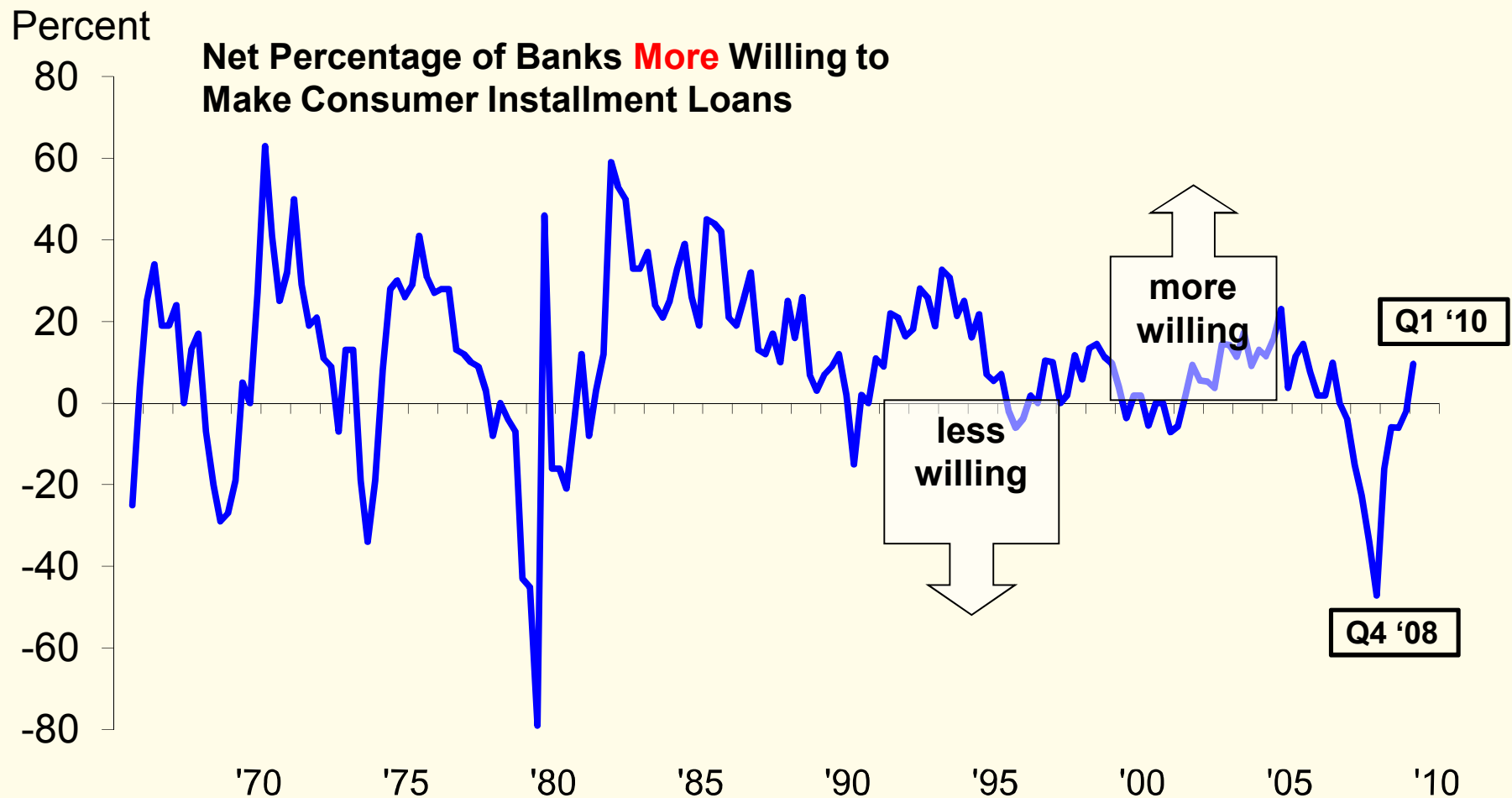
- Leading indicators turning positive in most states:
 - Housing permits
 - Initial claims
 - Exports
 - Consumer confidence
 - State budgets
- Jobs declined in all states in 2009:
 - But declines have narrowed
 - 11th District at head of pack

Bank Loan Growth

Percent of Banks Increasing Lending in 2009



Long-Term Willingness of Banks to Make Consumer Loans is Increasing



Source: Senior Loan Officer Opinion Survey on Bank Lending Practices (Federal Reserve Board)