

National Economic Update

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Outline

- Economic Update**

- Risks to the Update**

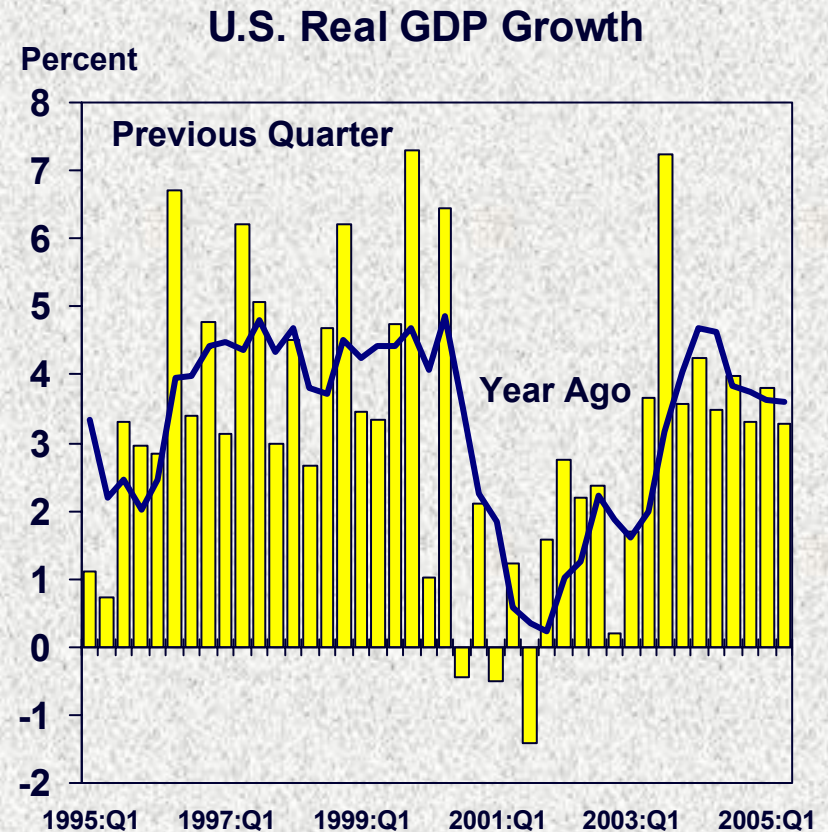
- **Is there a housing bubble?**

- **What is the impact of Katrina?**

- **What is the impact of high energy prices?**

Strong, Sustainable Economic Growth

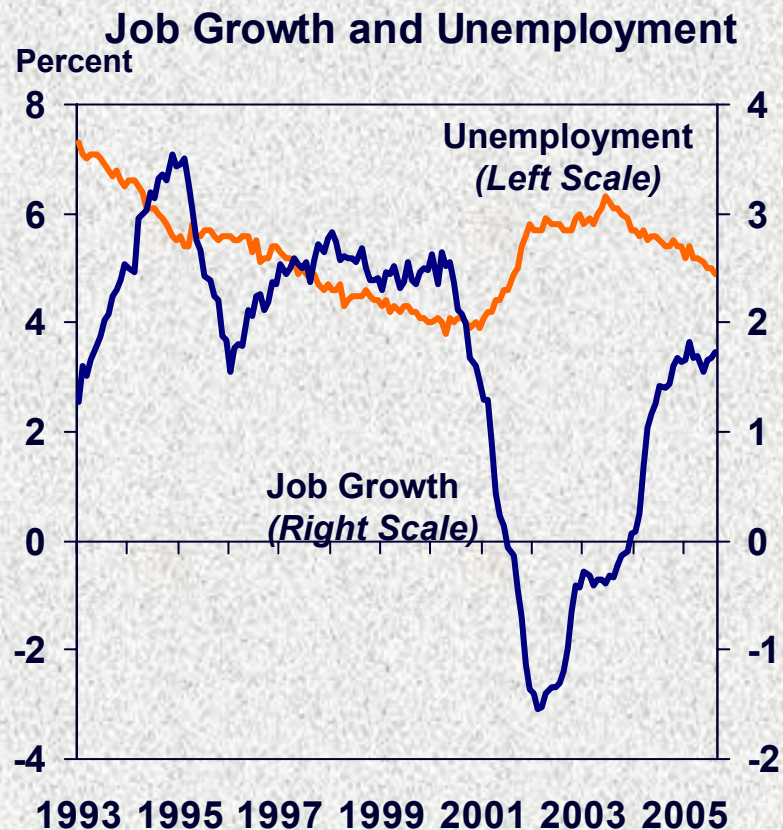
□ Output nears its long term trend.



Calculations based on Census Bureau data

Strong, Sustainable Economic Growth

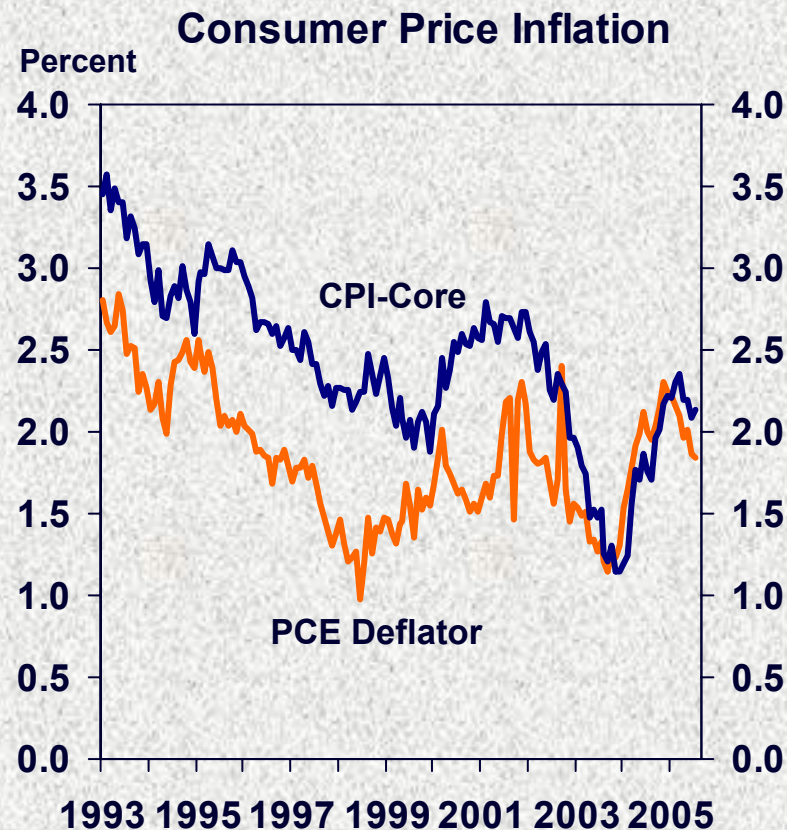
- Output nears its long term trend.
- Stronger job growth leads to low unemployment.



Calculations based on BLS data

Strong, Sustainable Economic Growth

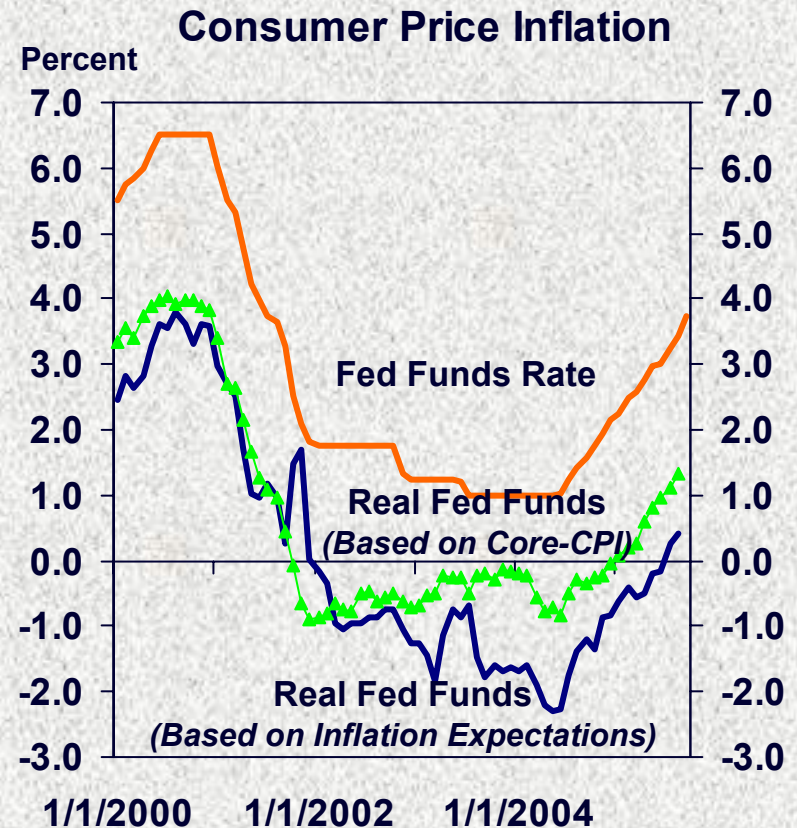
- Output nears its long term trend.
- Stronger job growth leads to low unemployment.
- Inflation pressures ease.



Calculations based on BLS and Census Bureau data

Strong, Sustainable Economic Growth

- Output nears its long term trend.
- Stronger job growth leads to low unemployment.
- Inflation pressures ease.
- The Fed continues to remove monetary stimulus.



Calculations based on BLS and Census Bureau data
Real fed funds in nominal value minus inflation rate.



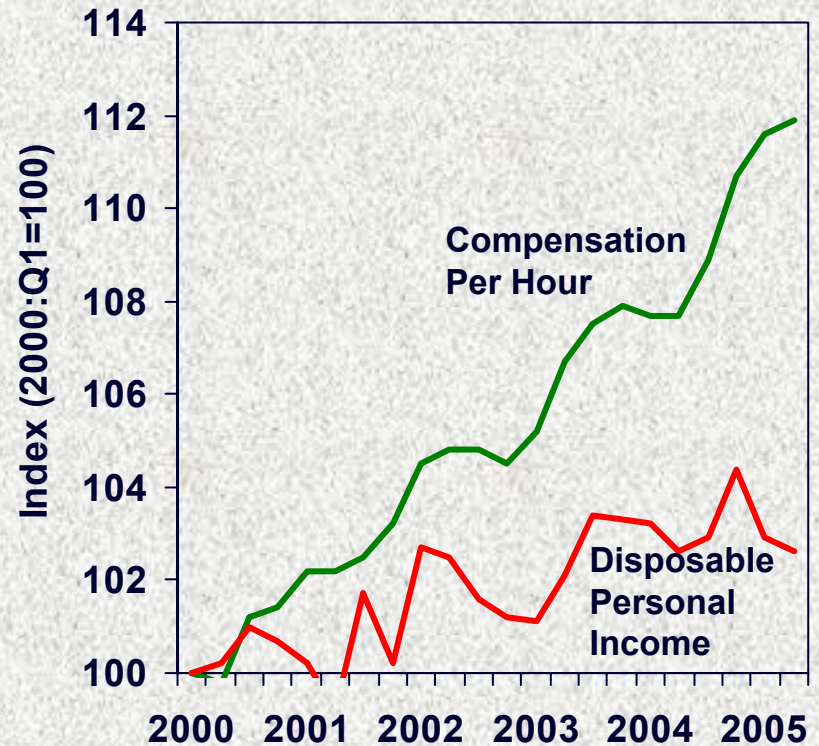
The Economic Update

□ Solid Consumer Spending

Solid Consumer Spending

☐ Incomes are rising.

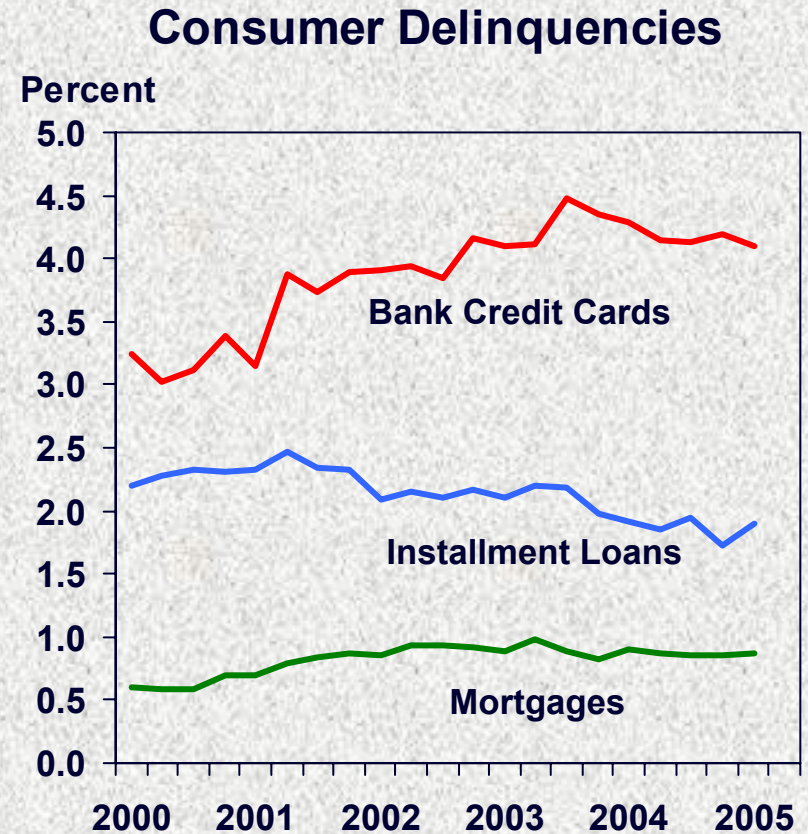
U.S. Compensation and Income (Real)



Calculations based on BLS and Census Bureau data

Solid Consumer Spending

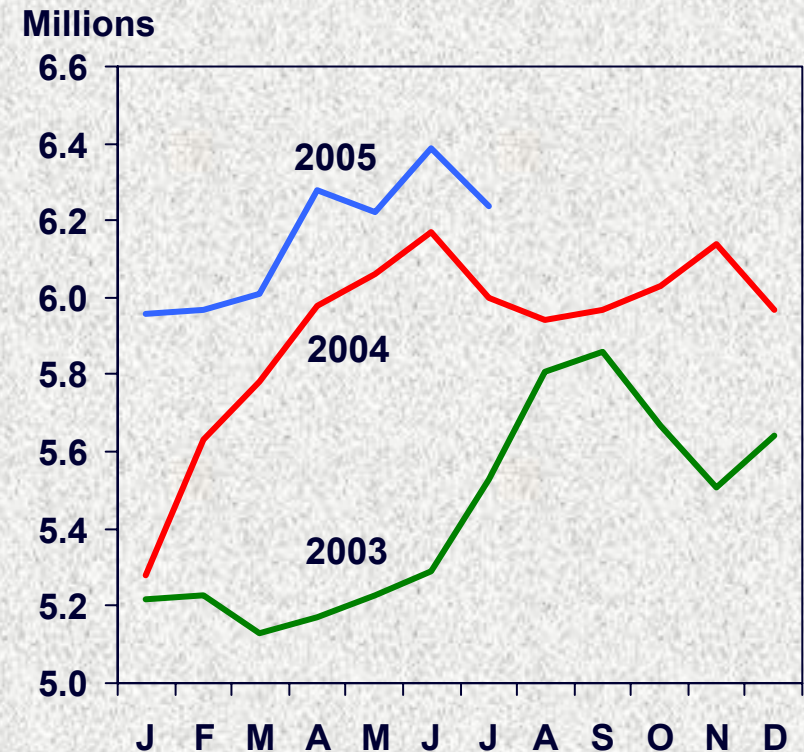
- Incomes are rising.
- Delinquencies are falling.



Solid Consumer Spending

- Incomes are rising.
- Delinquencies are falling.
- Housing is robust.

Existing Home Sales

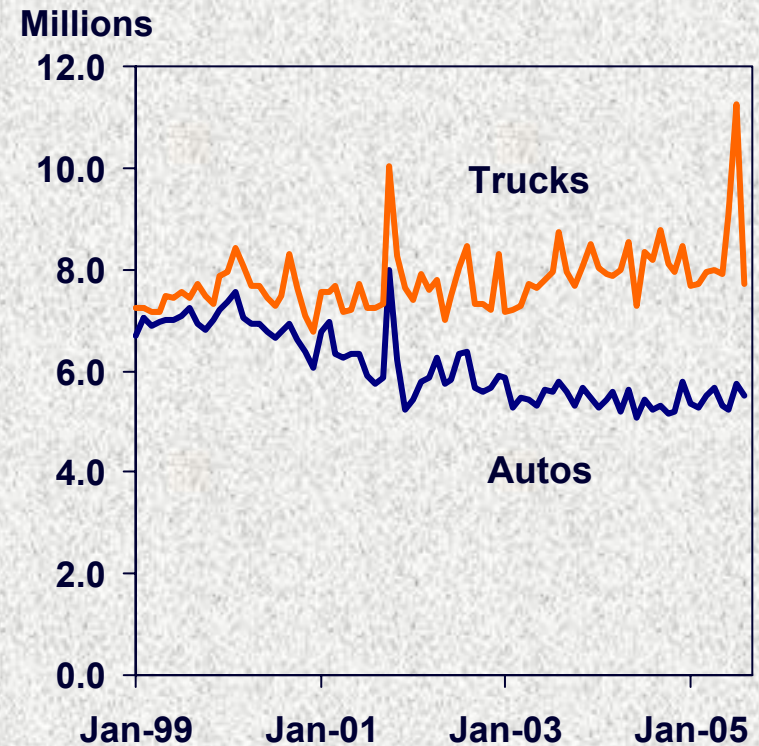


Source: Census Bureau

Solid Consumer Spending

- Incomes are rising.
- Delinquencies are falling.
- Housing is robust.
- Cheap trucks sell fast.

**Domestic Auto and Light
Truck Sales**

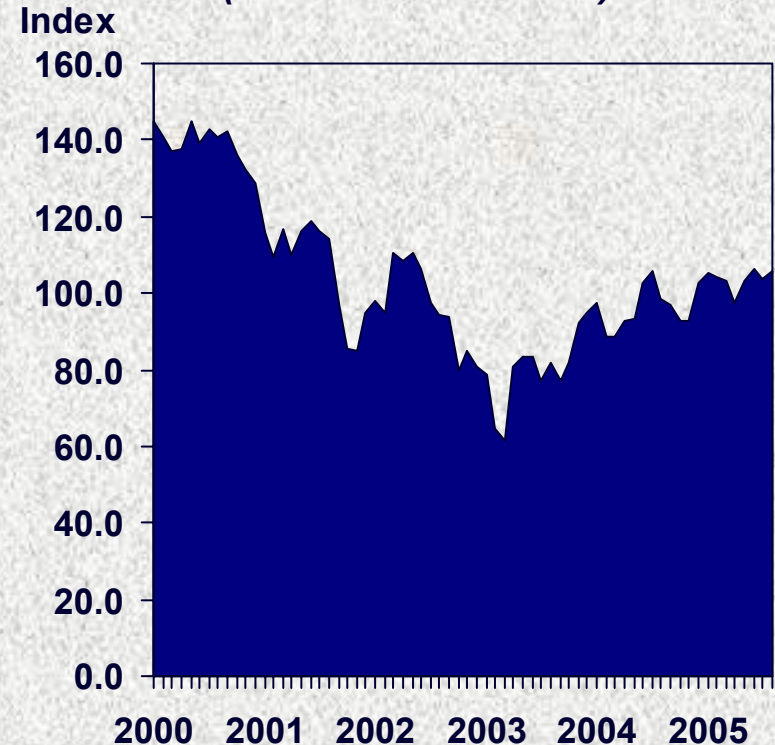


Source: Conference Board

Solid Consumer Spending

- Incomes are rising.
- Delinquencies are falling.
- Housing is robust.
- Cheap trucks sell fast.
- Confidence is solid.

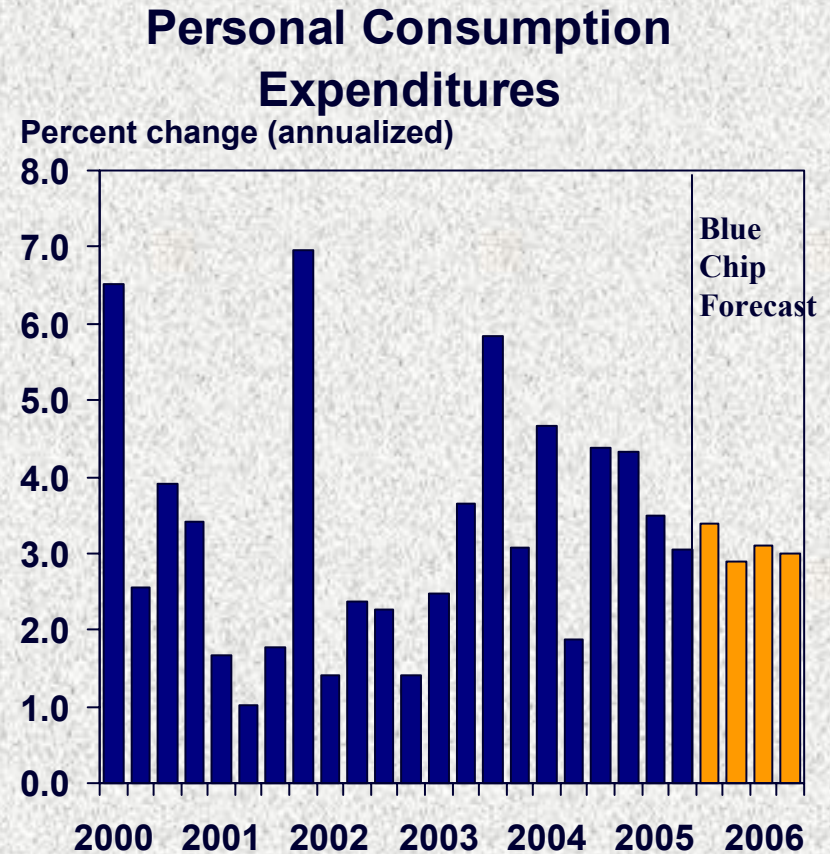
Consumer Confidence
(Conference Board)



Source: Conference Board

Solid Consumer Spending

- Incomes are rising.
- Delinquencies are falling.
- Housing is robust.
- Cheap trucks sell fast.
- Confidence is stable.
- Spending is solid.



Calculations based BEA data



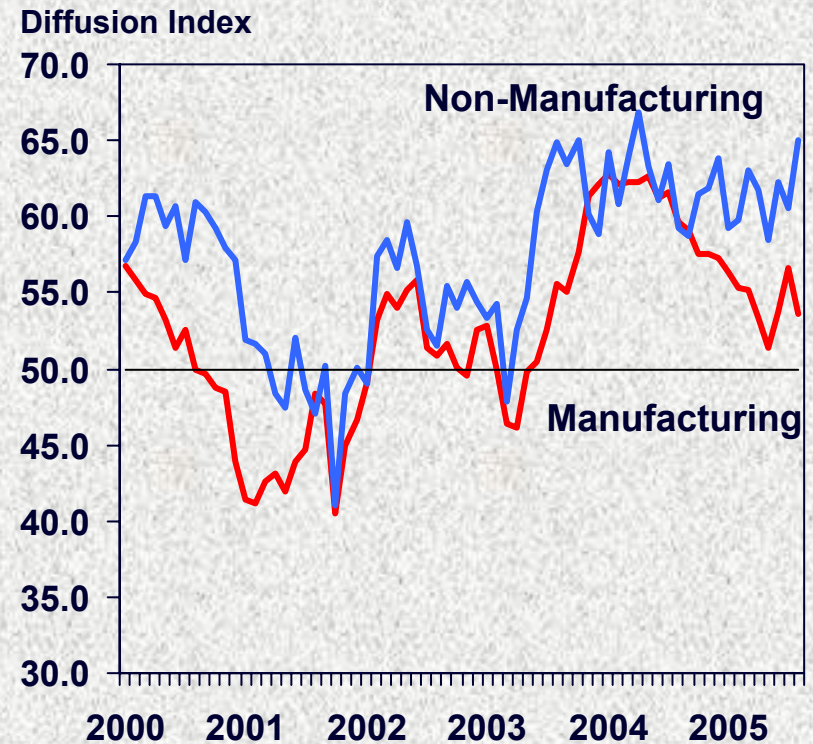
The Economic Update

- Solid Consumer Spending**
- A Stronger Business Environment**

A Stronger Business Environment

- Activity is expanding.
 - Service is growing at a robust and steady pace.
 - Manufacturing is expanding at a slower rate.

ISM Business Activity

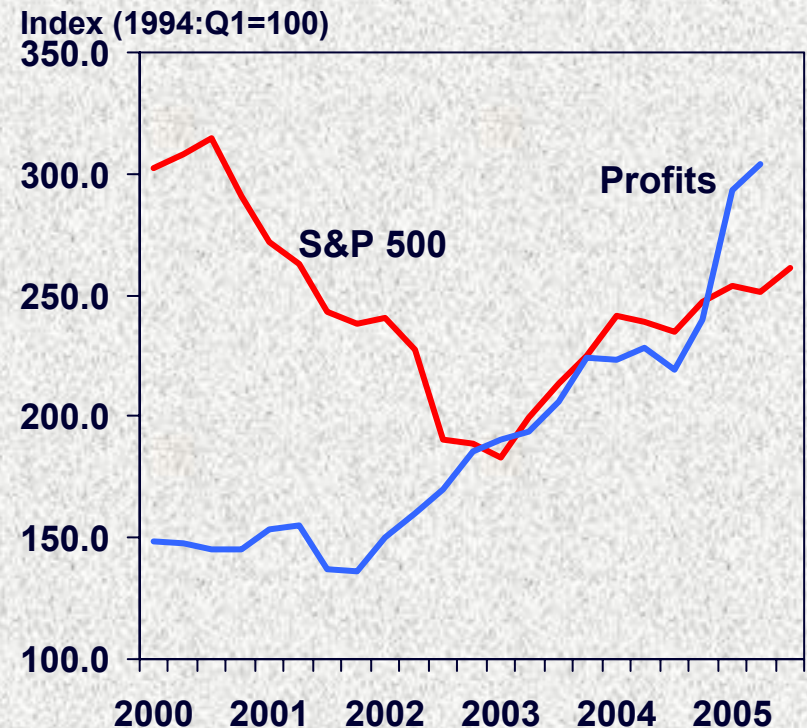


Calculations based ISM data

A Stronger Business Environment

- Activity is expanding
- Profits are surging.
- Stock prices are rising.

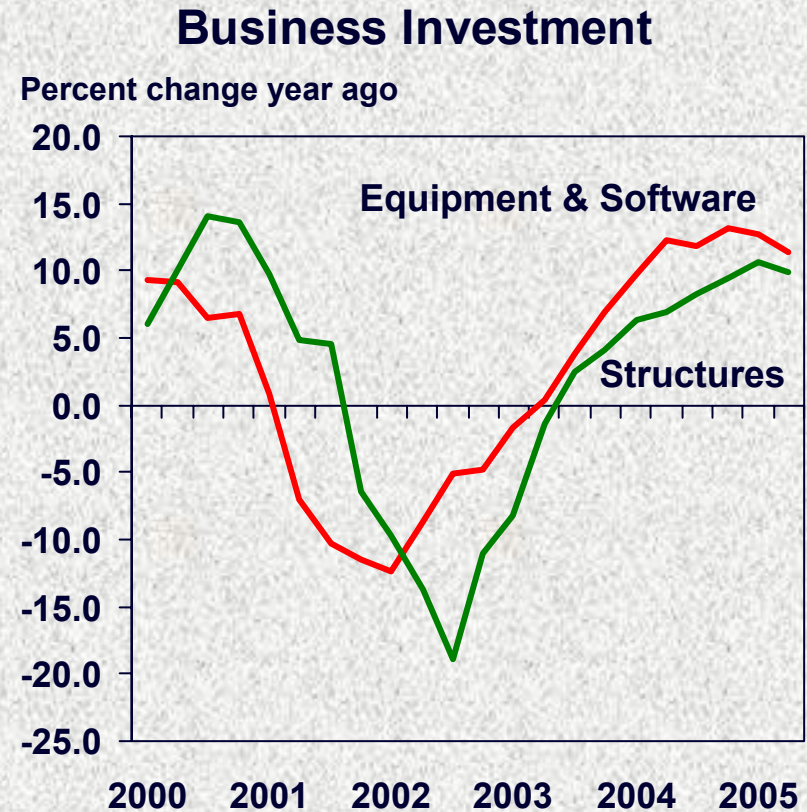
**Corporate Profits and
Stock Prices**



Calculations based BEA and Wall Street Journal data

A Stronger Business Environment

- Activity is expanding
- Profits are surging.
- Stock prices are rising.
- Investment is robust.



Calculations based BEA data



The Economic Update

- Solid Consumer Spending**
- A Stronger Business Environment**
- Improved Fiscal Health**

Improved Fiscal Health

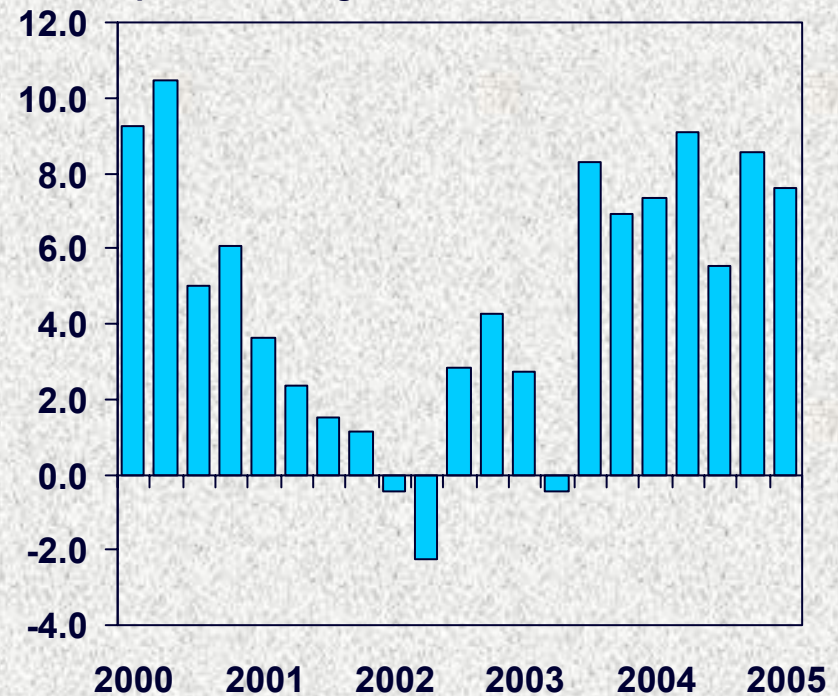
□ Tax revenues are rising.

■ Corporate income tax

■ Personal income tax

State and Local Tax Revenues

Annual percent change

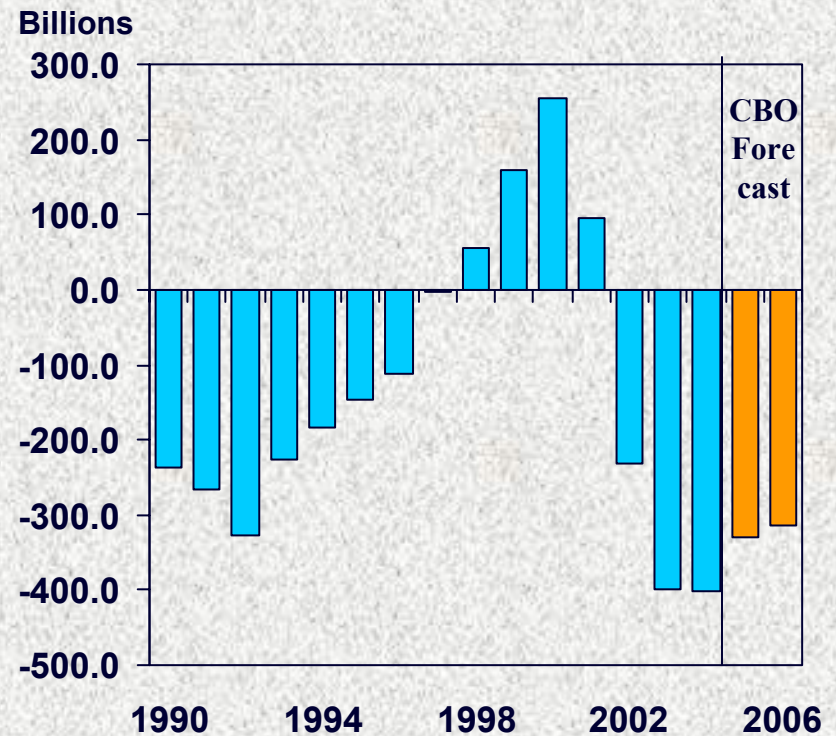


Calculations based Census data

Improved Fiscal Health

- Tax revenues are rising.
 - Corporate income tax
 - Personal income tax
- Federal deficits ease.
 - Shrink as a share of GDP.
 - 3.6% in 2004
 - 2.4% in 2006

Federal Budget Deficit



Source: BEA and CBO



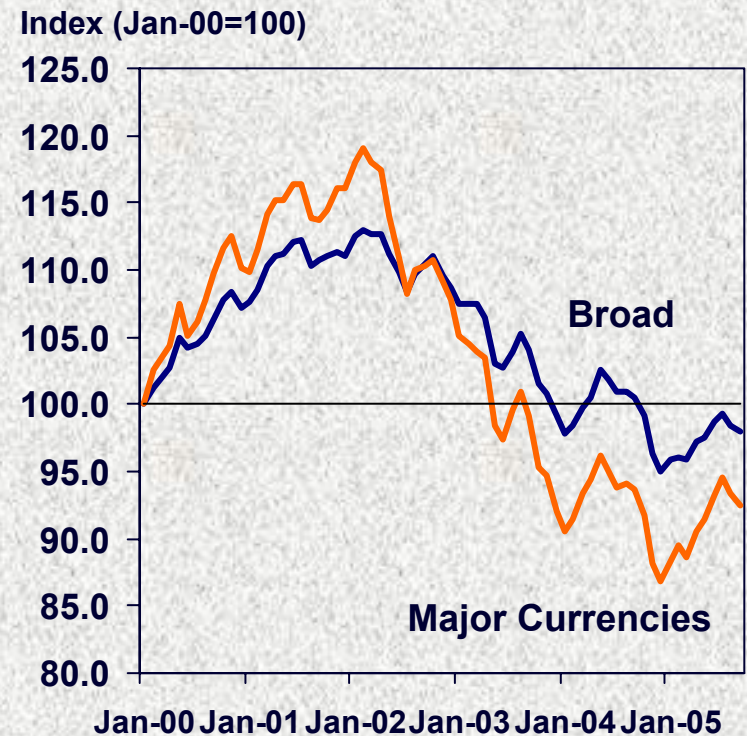
The Economic Update

- Solid Consumer Spending**
- A Stronger Business Environment**
- Improved Fiscal Health**
- A Stable Trade Deficit?**

A Stable Trade Deficit?

The dollar strengthens.

Dollar Exchange Rates

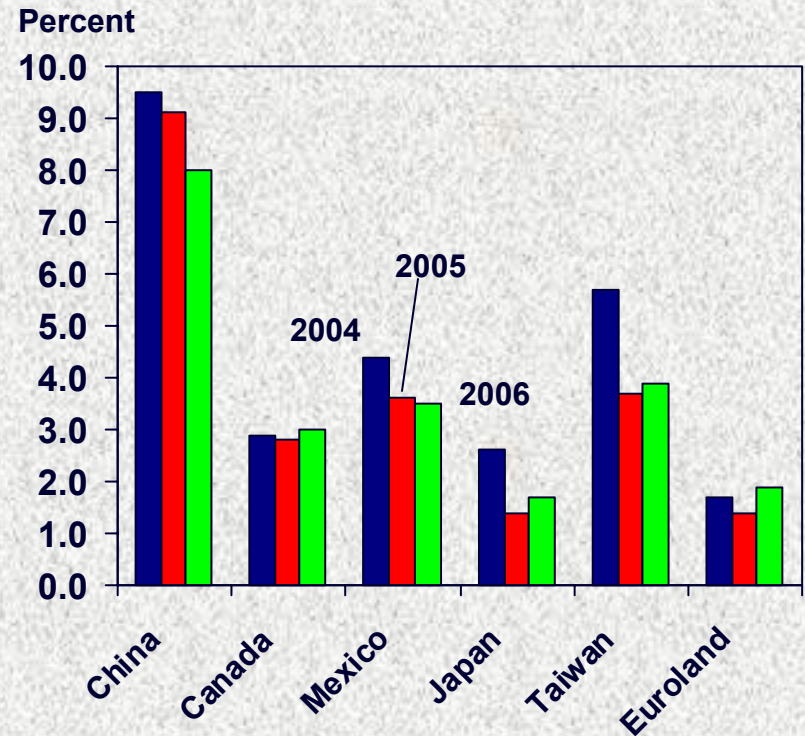


Source: Federal Reserve Board

A Stable Trade Deficit?

- The dollar strengthens.
- World growth slows.

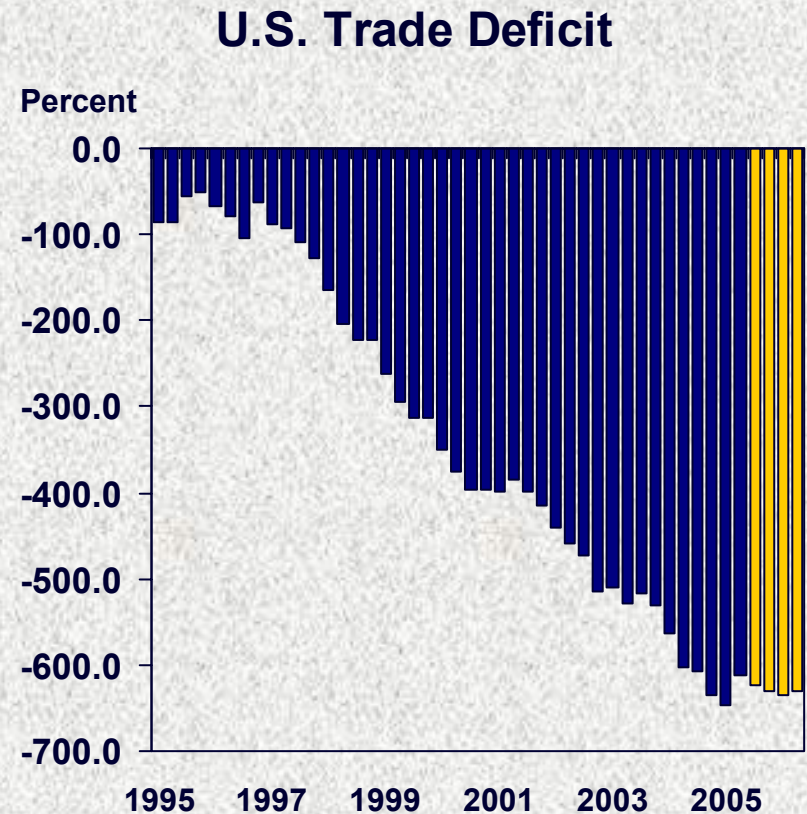
World GDP Estimates



Source: Blue Chip Forecast

A Stable Trade Deficit?

- The dollar strengthens
- World growth slows
- Trade deficit eases, but remains large.



Source: Census Bureau and Blue Chip Forecast

The FOMC Outlook

<u>Indicator</u>	<u>2005</u>	<u>2006</u>
Real GDP	3.5	3.25 - 3.5%
PCE Core Price Index	1.75 – 2.0%	1.75 – 2.0%
Unemployment Rate	5.0%	5%

Source: *Monetary Policy Objectives*, Federal Reserve Board, July 2005



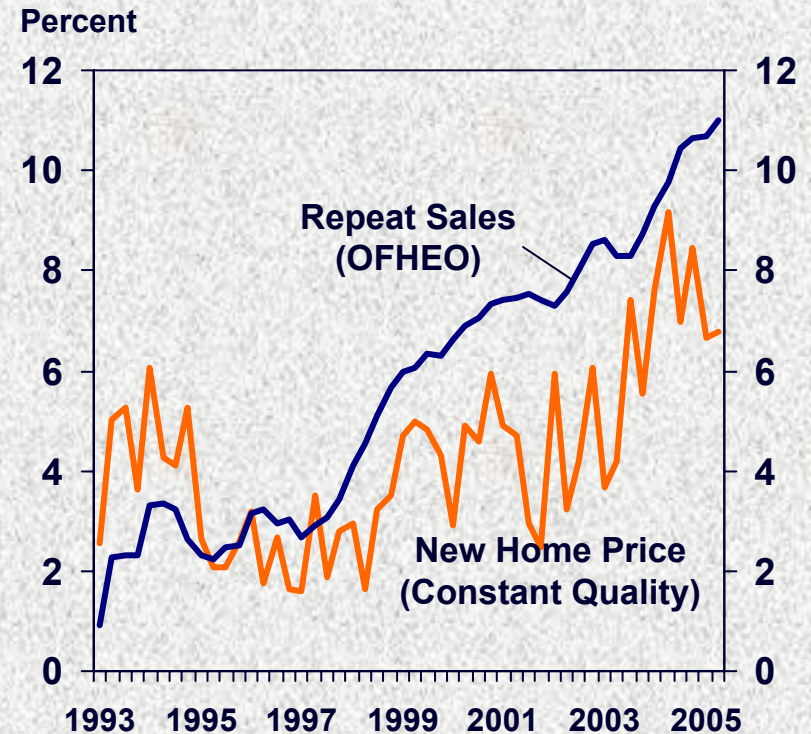
Risks to the Outlook

Is there a housing bubble?

Is There a Housing Bubble?

□ Housing prices surge.

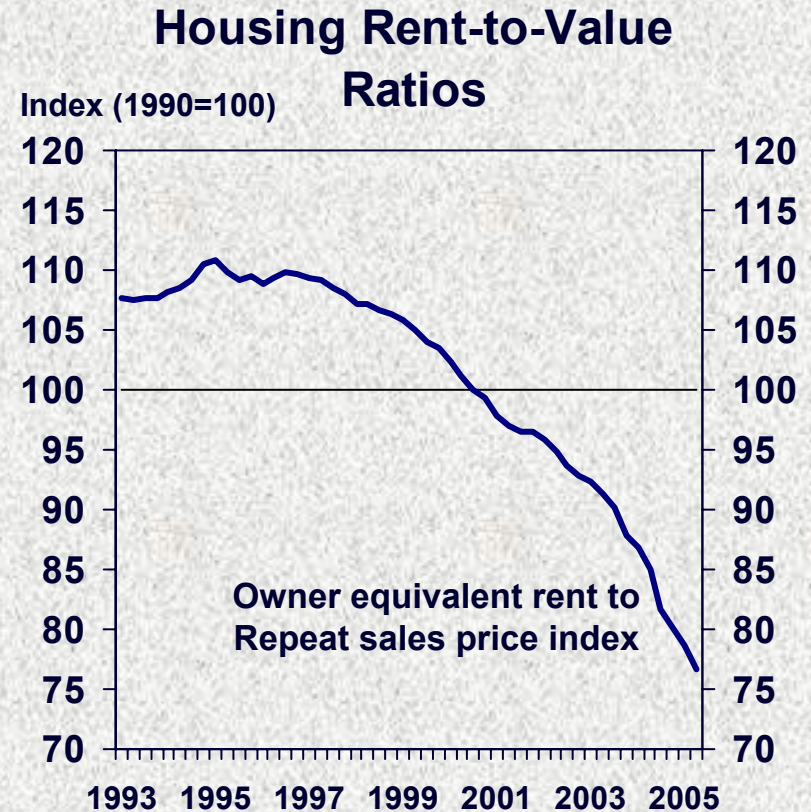
U.S. Housing Price Growth



Source: OFHEO and Census Bureau

Is There a Housing Bubble?

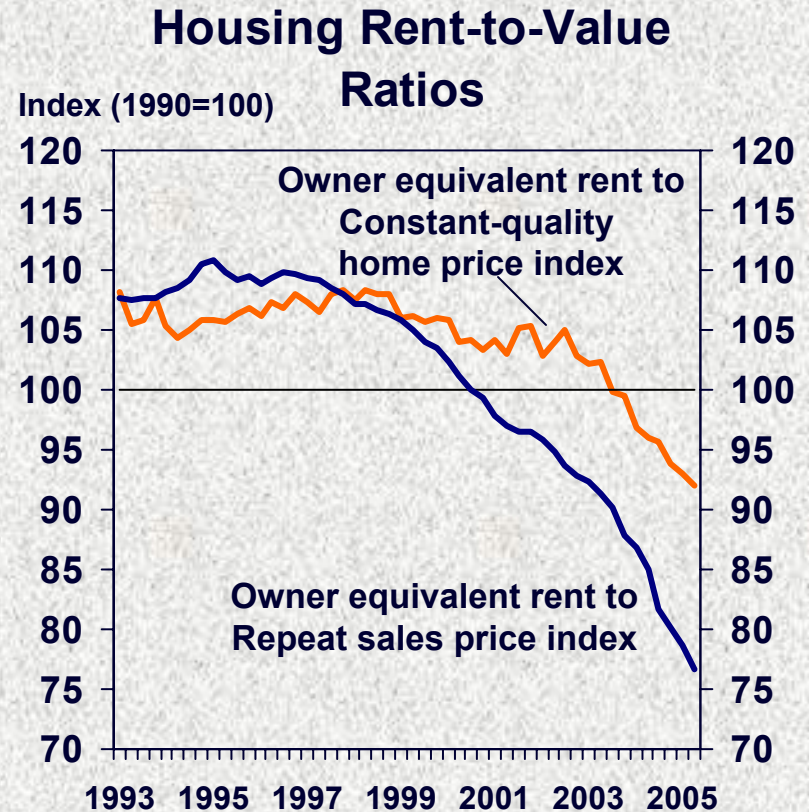
- Housing prices surge.
- A coastal price boom.
- Rent-to-Value ratios indicate that home prices are rising faster than rents.



Source: OFHEO and Census Bureau

Is There a Housing Bubble?

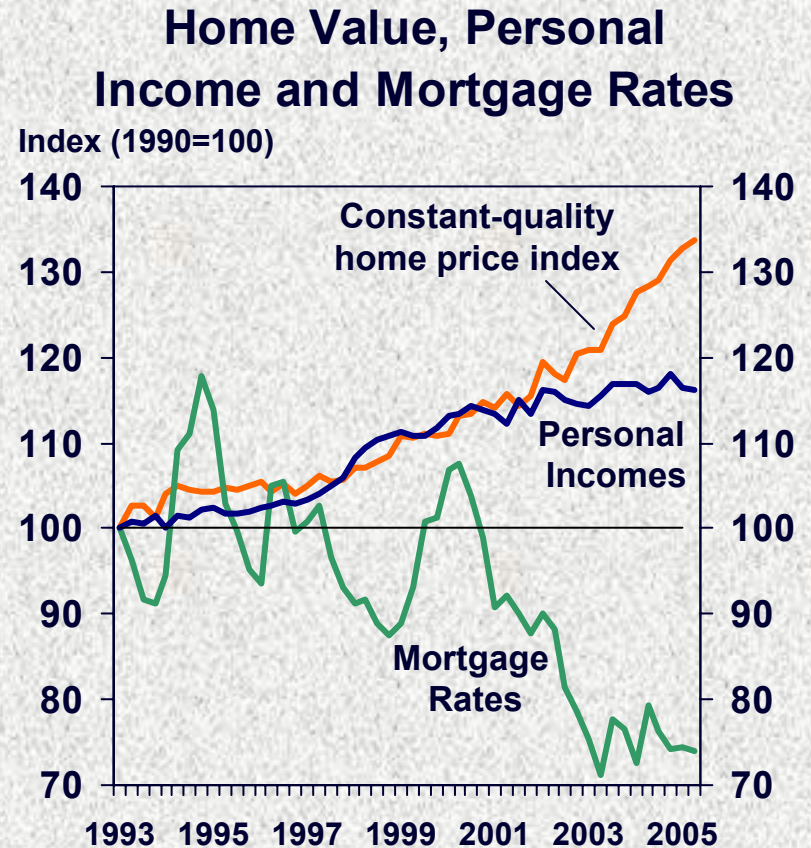
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- The ratio shrinks after controlling for quality.



Source: OFHEO and Census Bureau

Is There a Housing Bubble?

- Housing prices surge.
- A coastal price boom.
- Rent-to-Value ratios indicate that home prices are rising faster than rents.
- The ratio shrinks after controlling for quality.
- Higher incomes and low mortgage rates drive home values.



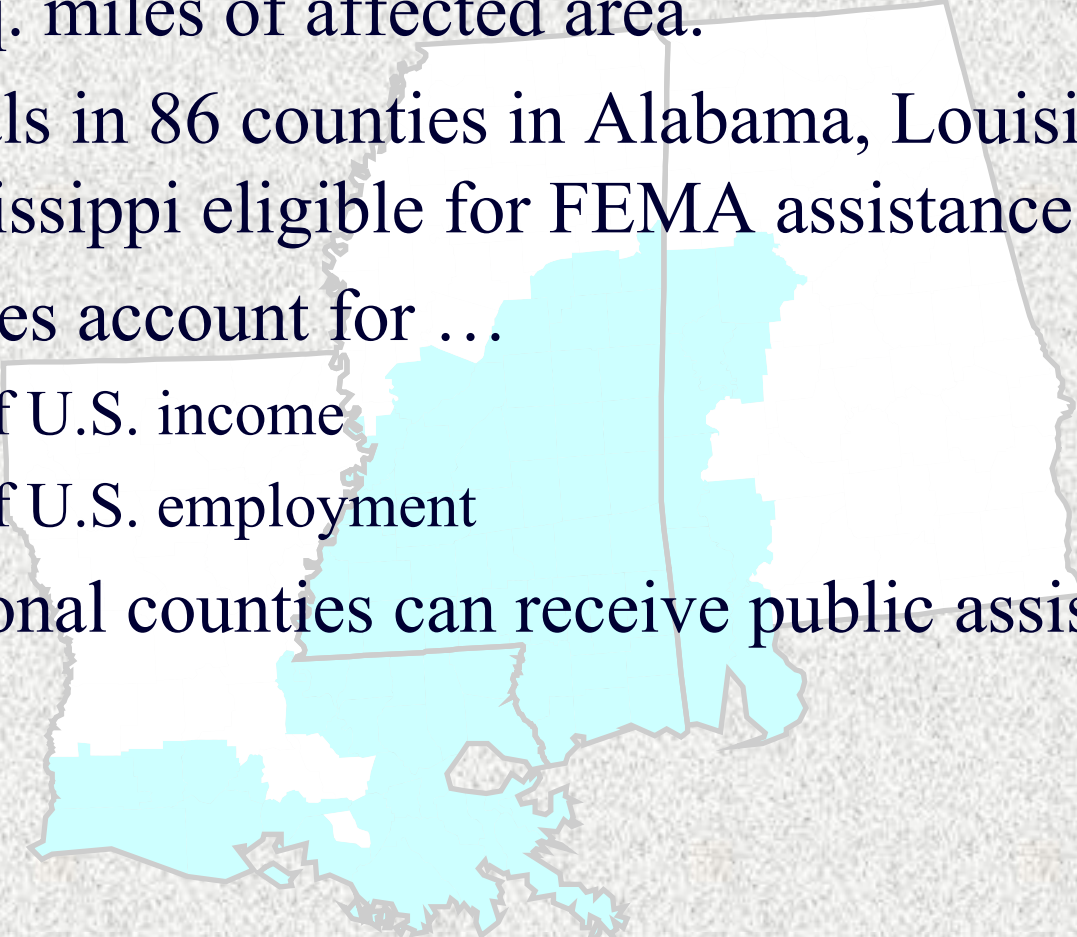
Source: OFHEO and Census Bureau



Risks to the Outlook

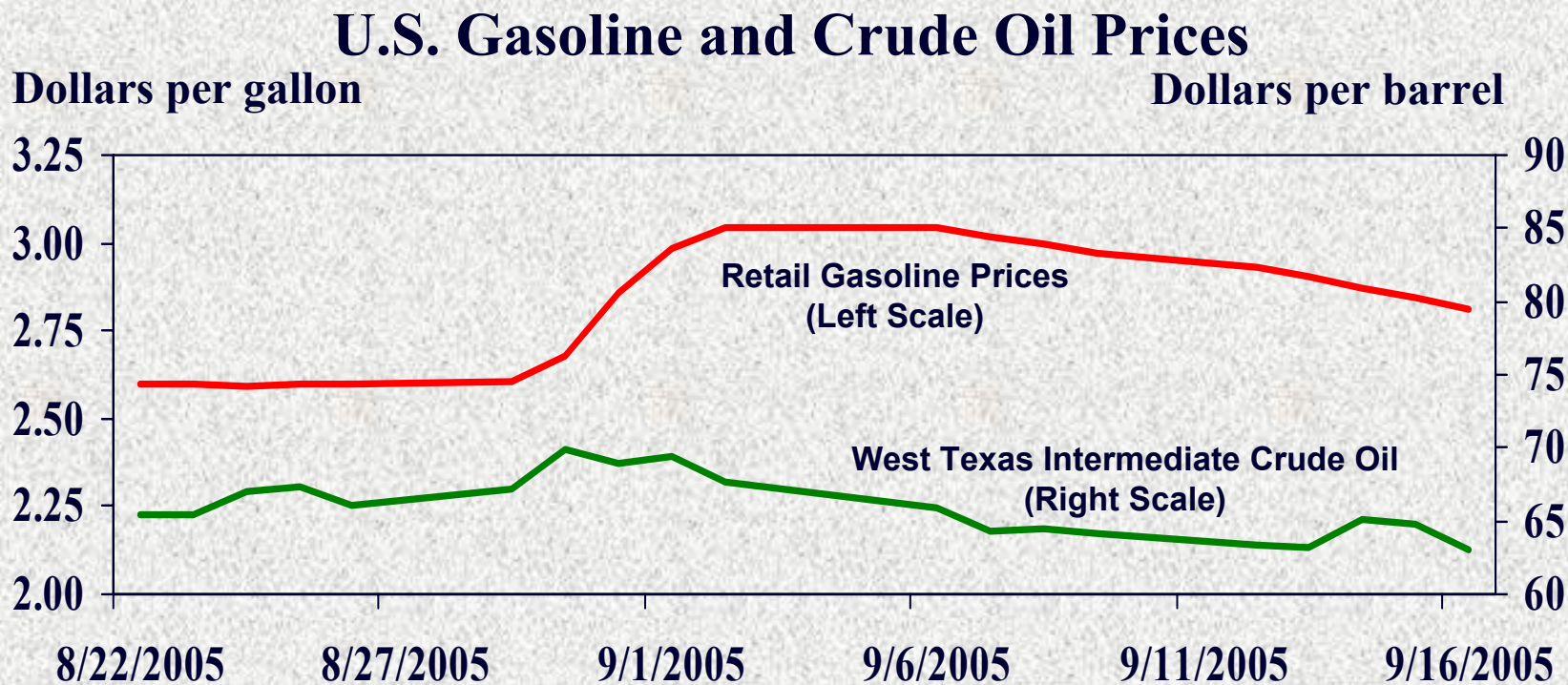
- Is there a housing bubble?**
- What is the impact of Katrina?**

What is the Impact of Katrina?

- ❑ 90,000 sq. miles of affected area.
 - ❑ Individuals in 86 counties in Alabama, Louisiana, and Mississippi eligible for FEMA assistance.
 - ❑ 86 counties account for ...
 - 1.7% of U.S. income
 - 1.9% of U.S. employment
 - ❑ 47 additional counties can receive public assistance.
- 
- A map of the Gulf Coast region of the United States, showing the states of Alabama, Louisiana, and Mississippi. The map highlights the areas affected by Hurricane Katrina in light blue. The affected areas include the coastal regions of all three states, as well as some inland areas. The map is overlaid on the text of the slide.

What is the Impact of Katrina?

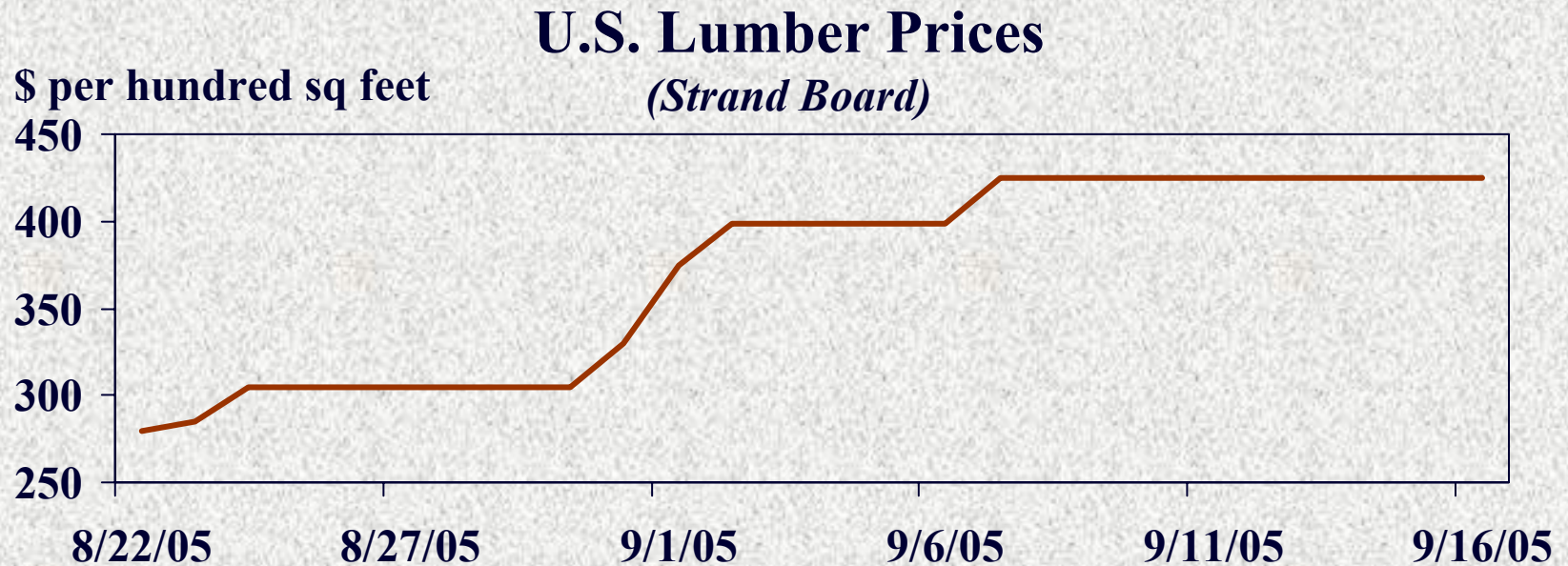
□ Gasoline Prices Spike.



Source: Wall Street Journal and Oil Price Information Service

What is the Impact of Katrina?

- Gasoline Prices Spike.
- Construction Costs Surge.



Source: Bloomberg

What is the Impact of Katrina?

- Gasoline Prices Spike.
- Construction Costs Surge.
- Increase in federal deficit.
- You name the price tag.

\$200 billion

Agriculture Defense Energy

\$150 billion

Transportation Treasury Education Justice

Labor Commerce Interior

Health and Human Services

\$10.5 billion

What is the Impact of Katrina?

- Gasoline Prices Spike.
- Construction Costs Surge.
- Increase in federal deficit.
- A Short Term Decline offset by Long Term recovery and reconstruction.

	2005:H2 (negative impact)	2006:H1 (positive impact)
GDP Losses (Various Sources)	0.3 to 1.0	0.2 to 0.8
Job Losses (Various Sources)	400 to 700K	

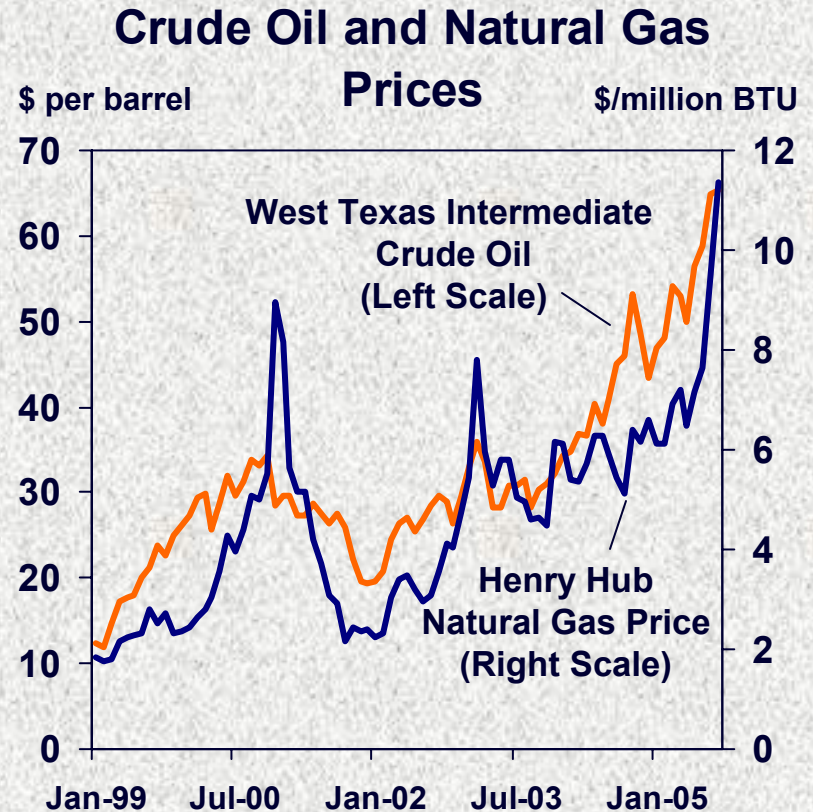


Risks to the Outlook

- Is there a housing bubble?**
- What is the impact of Katrina?**
- What is the impact of higher energy prices?**

What is the Impact of Higher Energy Prices

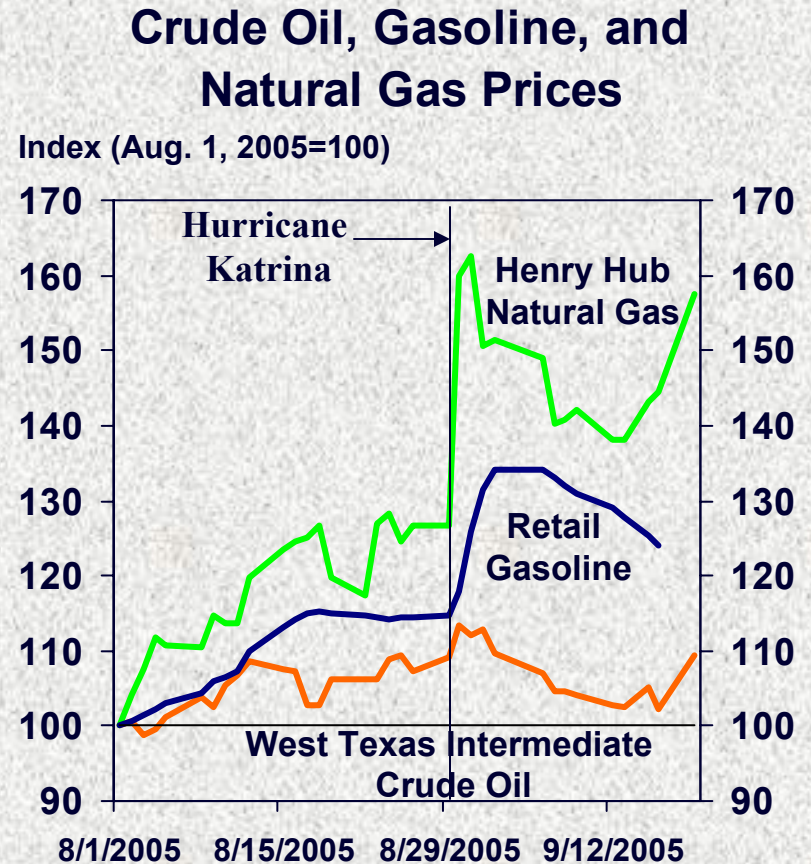
□ Energy Prices were rising before Katrina.



Source: DistFAME

What is the Impact of Higher Energy Prices

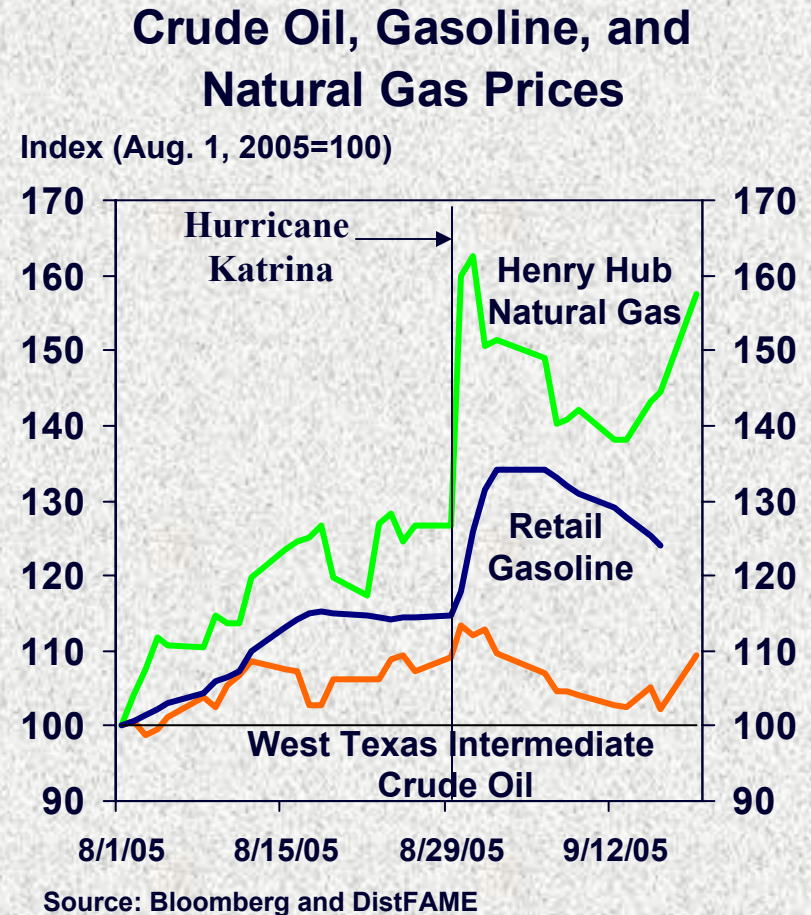
- Energy Prices were rising before Katrina.
- Oil prices returned to pre-Katrina levels, but not natural gas prices.



Source: Bloomberg and DistFAME

What is the Impact of Higher Energy Prices

- Energy Prices were rising before Katrina.
- Oil prices returned to pre-Katrina levels, but not natural gas prices.
- Will paying more to fill the tank and heat the home this winter limit consumer spending?



FOMC Statement

(September 20, 2005)

Pre-Katrina Growth was Strong.

“Output appeared poised to continue growing at a good pace before the tragic toll of Hurricane Katrina.”

Katrina’s Short-term Negative Impacts Offset by Long-term Rebuilding.

“The widespread devastation in the Gulf region, the associated dislocation of economic activity, and the boost to energy prices imply that spending, production, and employment will be set back in the near term. ... it is the Committee's view that they do not pose a more persistent threat.”

The FOMC will continue to raise rates to remove monetary stimulus and fight inflationary pressures.

“the Committee believes that policy accommodation can be removed at a pace that is likely to be measured. Nonetheless, the Committee will respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.”