



FEDERAL RESERVE BANK *of* NEW YORK

US Economic Overview

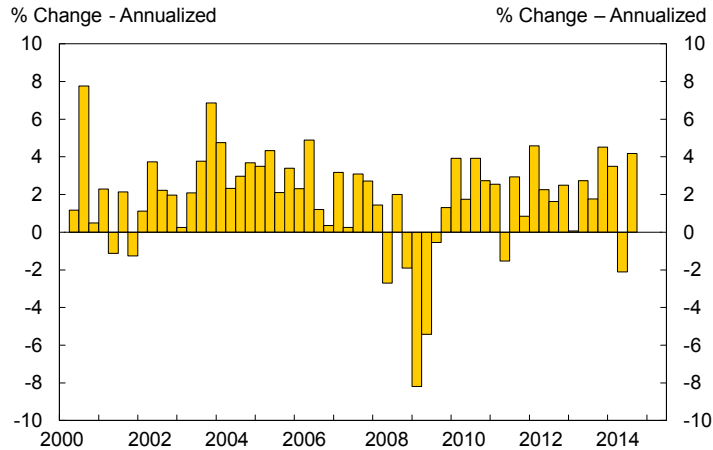
Research & Statistics Group

September 2014 – *DRAFT**

**The final September US Economic Overview will be issued next week, after the Labor Market Release of 9/5/2014*

The views expressed herein are solely those of the FRBNY Research & Statistics Group and do not necessarily reflect the official views of Federal Reserve Bank of New York or the Federal Reserve System.

GDP Growth

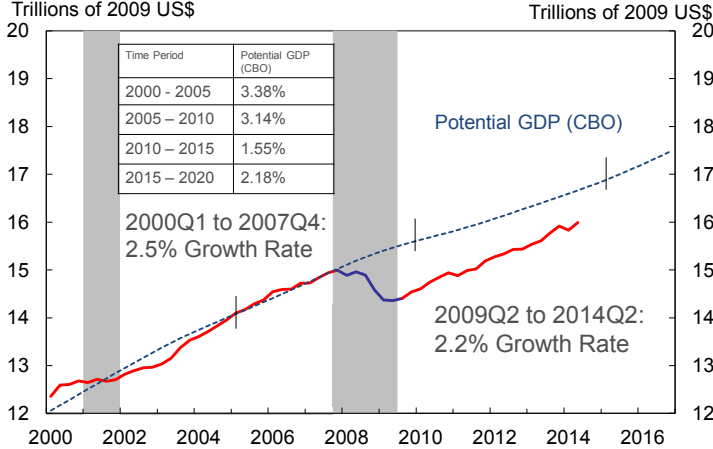


Source: Bureau of Economic Analysis, Congressional Budget Office

Output rebounded in Q2

- Real GDP increased at a 4.2% annual rate in Q2, consistent with the view that the Q1 drop was largely due to transitory factors.
- Activity in Q2 was supported by faster growth of inventories, robust spending on consumer goods (but not services), and a rise in residential investment.
- Final sales data suggest moderate underlying growth, however, recent mixed data indicate some near-term uncertainty.

GDP

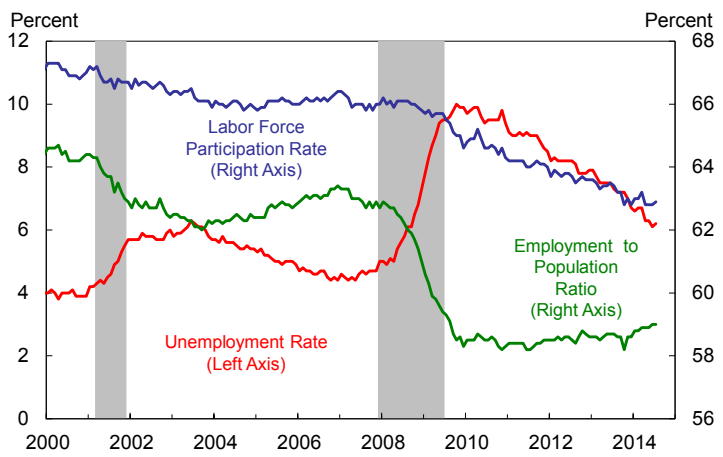


Source: Bureau of Economic Analysis, Congressional Budget Office

Real GDP is below its potential level

- GDP growth since the end of the Great Recession has been subdued compared to previous expansions.
- There is a gap of about 4% between output and the CBO's measure of potential output.
 - The CBO has been reducing its estimate of potential GDP.
- Historically, inflation has tended to be restrained if the economy is operating below potential.

Labor Market Indicators

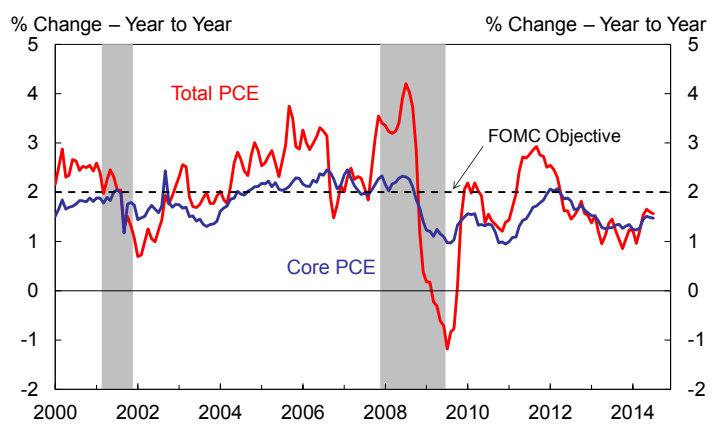


Source: Bureau of Labor Statistics

Some improvement in labor market, but slack remains

- The decline in the unemployment rate since 2010 has been associated with a drop in the labor force participation rate (LFP).
 - LFP has fallen considerably for those in their prime working-age years.
- The July labor market data indicated a continued gradual improvement in labor market conditions.
 - Aggregate wage growth measures remained subdued.
- The employment-to-population ratio remains below its level in 2007.

PCE Deflator

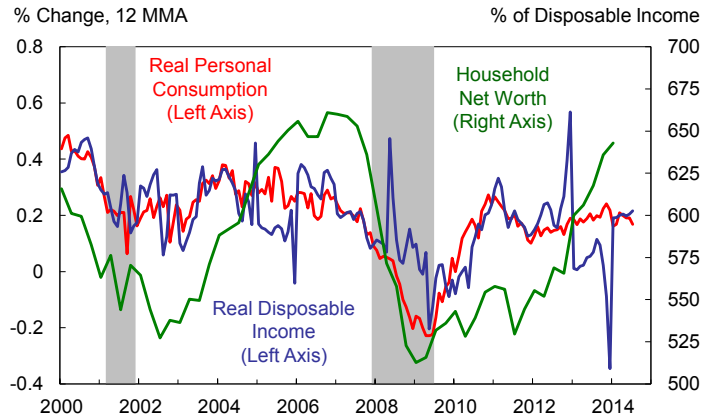


Source: Bureau of Economic Analysis

Inflation remains low

- Both total and core PCE inflation appeared to have stabilized in the past couple of months after rising in the spring
- On a 12-month basis, both measures are around 1½%, below the FOMC's longer-run objective of 2%.
- Based on historical patterns, any further reversion of core inflation toward the FOMC's longer-run objective will likely be gradual.

Disposable Income, Consumption, and Wealth

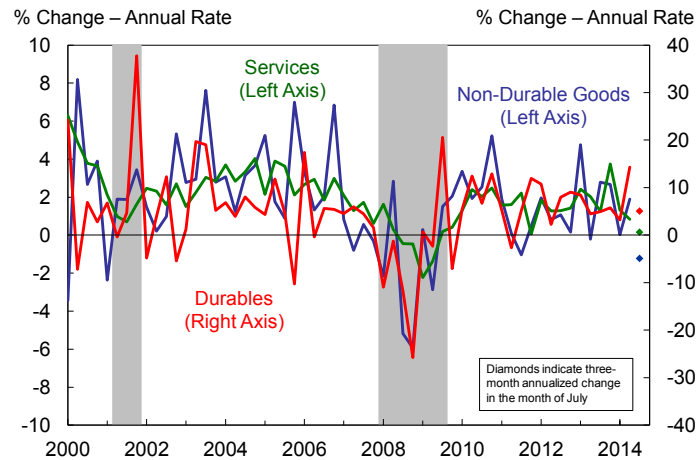


Source: Bureau of Economic Analysis, Federal Reserve Board

Household net worth is rising

- Household net worth is up sharply over the past two years, reflecting higher equity and home prices and slow growth in liabilities.
- Higher net worth is providing some support to consumer spending, in light of weak growth in disposable income.
- Even so, the personal saving rate has increased over recent months.

Services, Durable Goods, and Non-Durable Goods

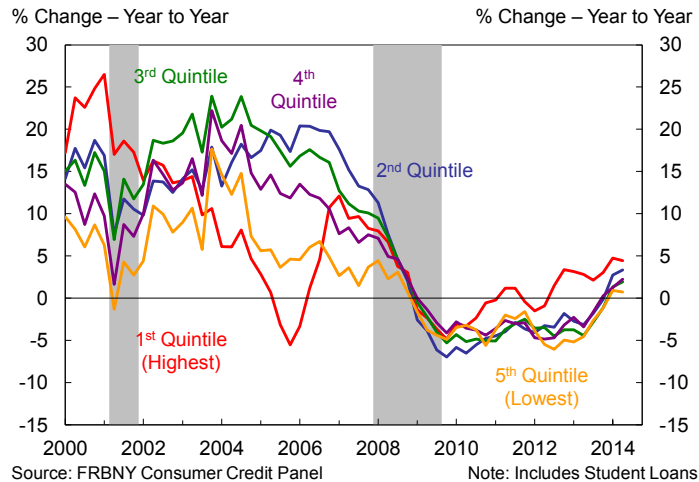


Source: Bureau of Economic Analysis

Consumer spending is on a slow trajectory

- Consumer spending has been sluggish this year after a strong second half of 2013.
- Spending unexpectedly declined in July, raising concerns about growth in the current quarter.
 - The decline was broad based with the largest decline in durable goods consumption, which was particularly strong in the second quarter
- Services consumption (the largest share of expenditures) continued to be restrained

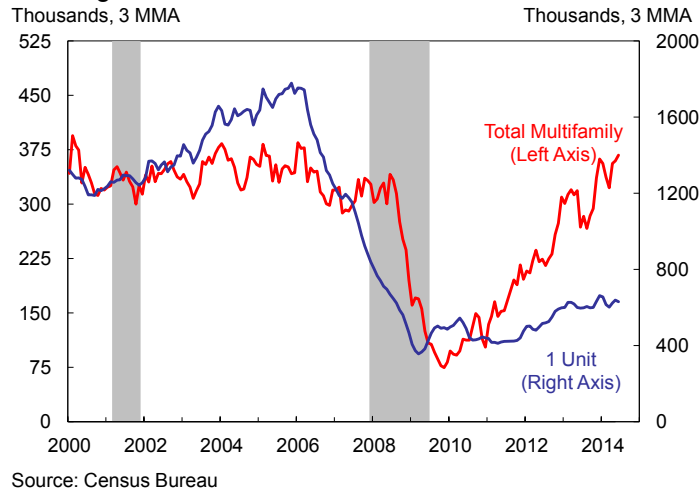
Consumer Debt by Credit Score



Consumer borrowing is rising again

- Total household liabilities have increased modestly over the last year, but paused in the second quarter
- The rise has been most pronounced for those with the highest credit scores.
- Auto loans have been particularly strong, mortgages have been weak.
- The rise in borrowing reflects progress in repairing household balance sheets since the recession and the increased availability of credit.

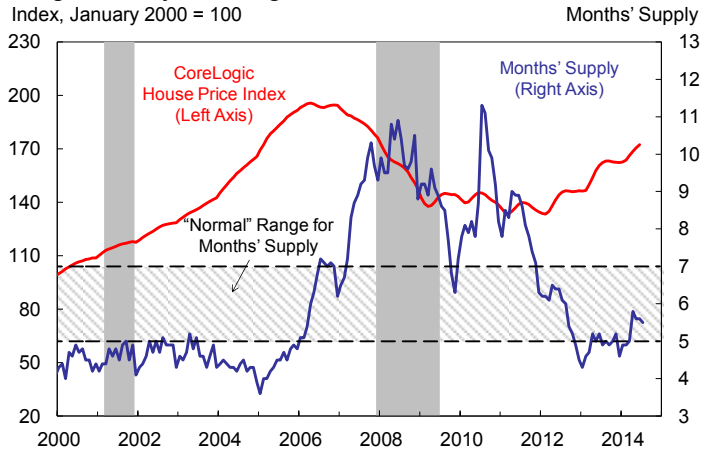
Housing Starts



Housing construction is recovering gradually

- Residential investment was on an uptrend through mid-2013, but it has been flat since. It remains below the previous peak and levels of the early 2000s.
- To date, the bulk of the recovery has been in multi-family units, most of which are rental properties.
- In contrast, single-family housing starts have not changed materially from that of early 2013.
 - Starts have been held back by tight mortgage underwriting standards and the slow growth of household formations.

Single Family Housing Market

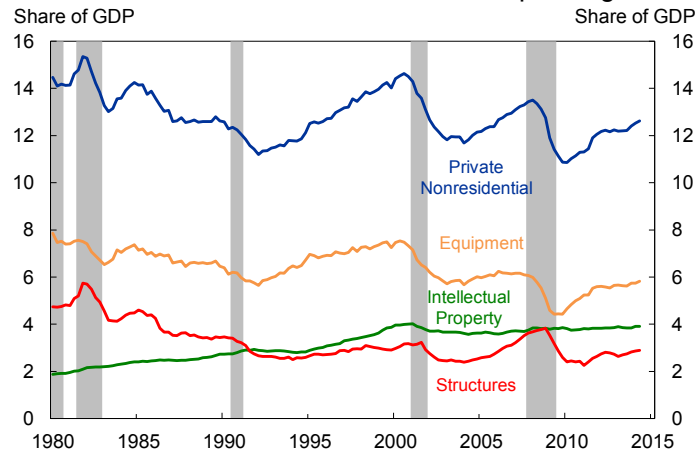


Source: CoreLogic, National Association of Realtors

Home price increases are moderating

- Year-over-year increases of home prices have slowed from the double-digits into the single-digits.
 - The CoreLogic home price index is up 30% from its February 2012 trough, but still 12% below its April 2006 peak.
- Slower home price growth has been accompanied by rising inventories of existing homes for sale.
- Many of the homes coming out of the foreclosure process have been purchased by investors for rental and that source of demand is now starting to fade.

Private Nonresidential Fixed Investment Spending

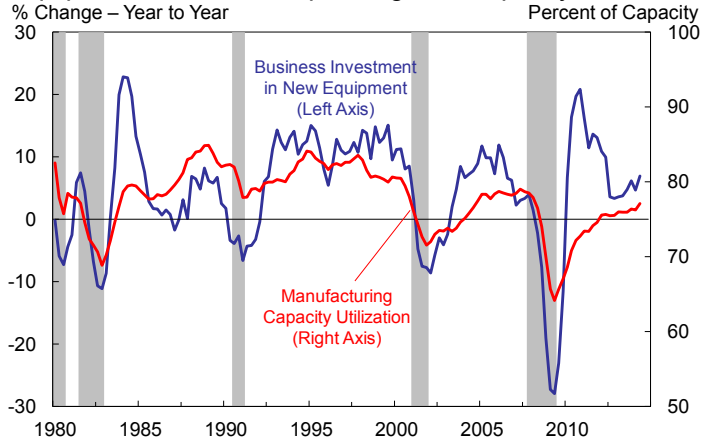


Source: Bureau of Economic Analysis

Business fixed investment remains subdued

- Investment spending, as a share of GDP, is low compared to levels during past expansions and typically would be rising rapidly at this point of the business cycle.
- Because the overall depreciation rate of capital has risen over time, current pace of investment spending is resulting in only slow growth of the business capital stock.

Equipment Investment Spending and Capacity

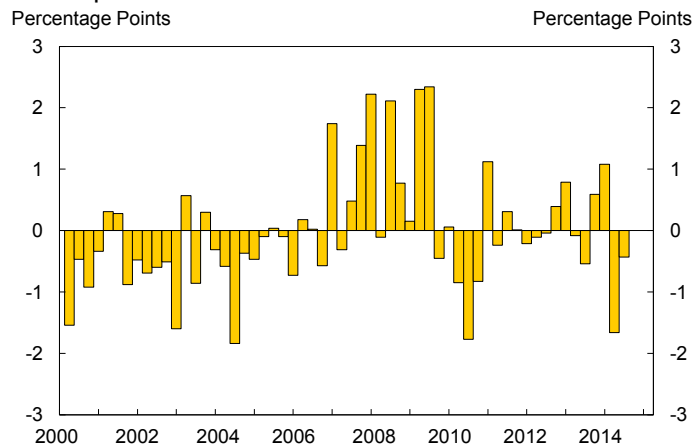


Source: Federal Reserve Board, Bureau of Economic Analysis

Spending on equipment picked up in Q2

- Data on capital goods orders and shipments indicates improved growth for equipment investment over the near term
 - The pace of equipment spending is expected to be moderate.
- Relatively low capacity utilization is restraining equipment spending.

Net Exports: Contribution to GDP Growth

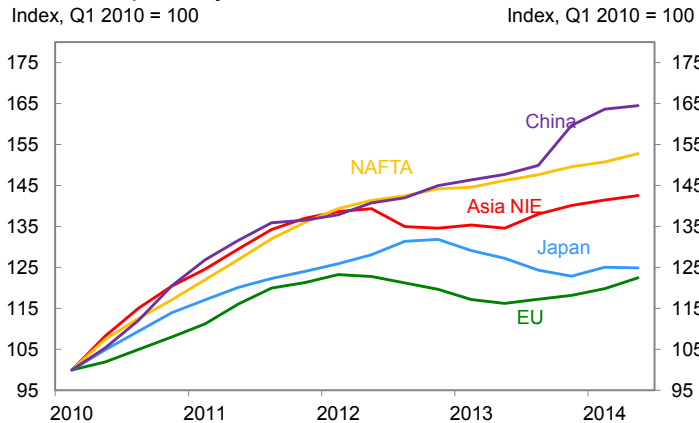


Source: Bureau of Economic Analysis

GDP growth was restrained by surge in imports

- Net exports subtracted 0.4 percentage point off Q2 GDP growth, following a 1.7 percentage points drag in Q1.
- Export volumes in Q2 offset a steep fall in Q1. The overall growth in real exports in H1 was only 0.4%.
- Imports jumped in Q2, following very low growth rates in the last few quarters. All major categories advanced except oil, which continues on a downward trend that started in 2010.

Goods Exports by Destination

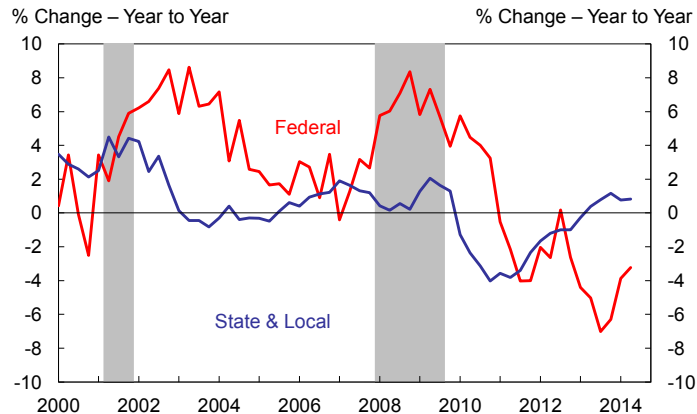


Source: Census Bureau. Data are 4 Quarter moving averages
 Share of exports: NAFTA 35%, EU 18%, China 7%, Asia NIE 9%, Japan 4%.

Europe was a strong export market in Q2

- Sales to the EU were up 9% over the year in Q2, while those to Japan were flat.
- Sales to China were up only 2% over the year in Q2.
 - China accounts for 7 percent of US exports, a doubling over the last 10 years.

Real Government Consumption and Gross Investment



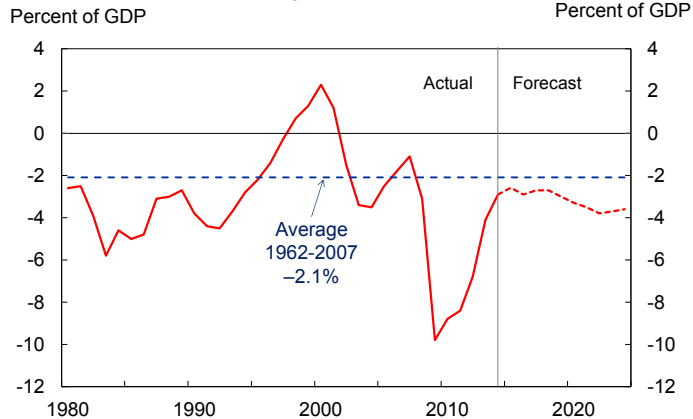
Source: Bureau of Economic Analysis

Total government spending is expanding

- Spending at the federal level has been declining since 2011, reflecting cuts in defense spending and the sequester.
 - Note: this concept of federal spending excludes transfer payments such as Social Security, Medicare, Medicaid, etc.
- State and local government spending has begun to grow again following a protracted decline following the Great Recession.
- As spending at the state and local level is about 60% above the comparable concept at the federal level, aggregate government spending is now expanding.

Federal Deficit

(CBO Current Law Baseline – August 2014)



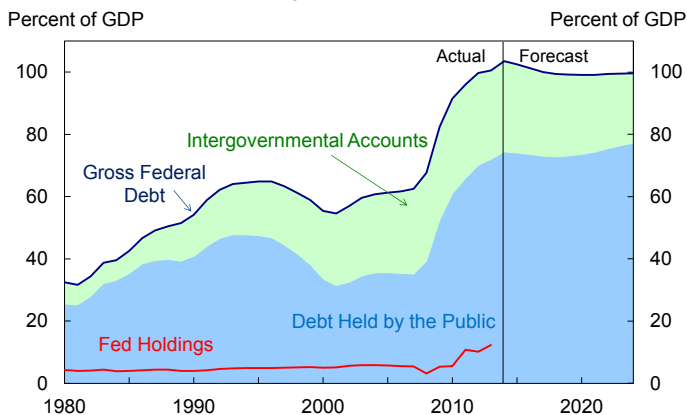
Sources: Bureau of Economic Analysis and Congressional Budget Office

The government deficit is shrinking

- The federal deficit was 4% of GDP in the 2013 fiscal year, down from 10% in 2009.
 - Note: outlays in this case are all outlays, including transfer payments, expressed on a cash basis.
- The Congressional Budget Office projects the deficit to stay in the range of 2.5% to 3.0% of GDP from 2014 through 2017.
- After 2017, the deficit is projected to start rising again due to faster growth of entitlement outlays.

Federal Debt

(CBO Current Law Baseline – August 2014)

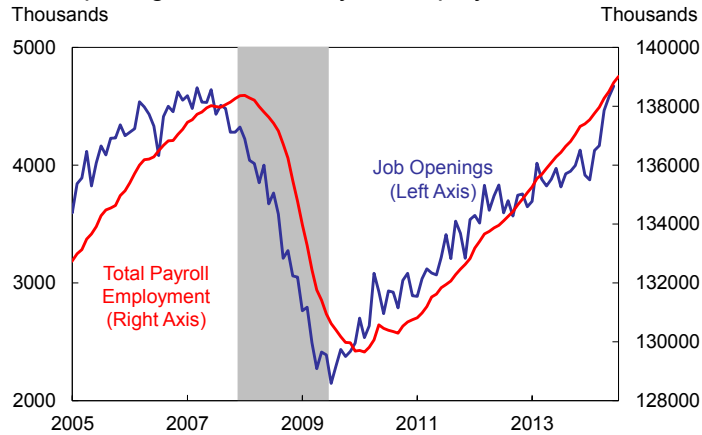


Sources: Bureau of Economic Analysis and Congressional Budget Office

Government debt is stabilizing

- The ratio of gross federal debt to GDP has risen rapidly over the past several years.
- The ratio is projected to stabilize for the next five years before moving gradually higher as deficits begin to increase again.

Job Openings and Total Payroll Employment



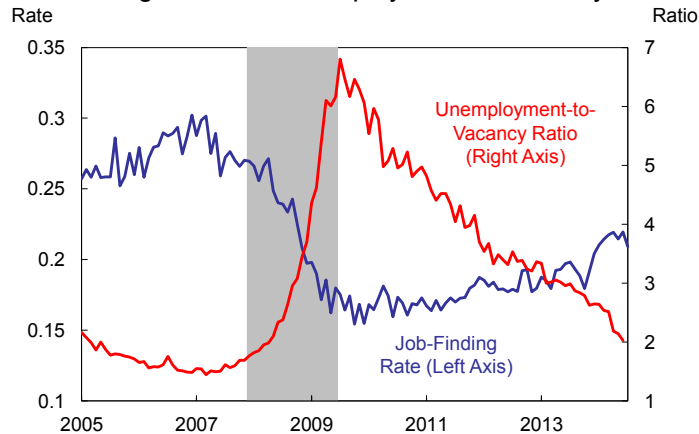
Source: JOLTS, CES

Note: Gray shading represents NBER recessions

Labor market continues to improve

- Total payroll employment has increased steadily since 2012; it finally reached its pre-recession peak in May 2014.
- The job-openings rate has also fully recovered to its pre-recession level after a marked rise in the last few months.

Job-Finding Rate and Unemployment-to-Vacancy Ratio



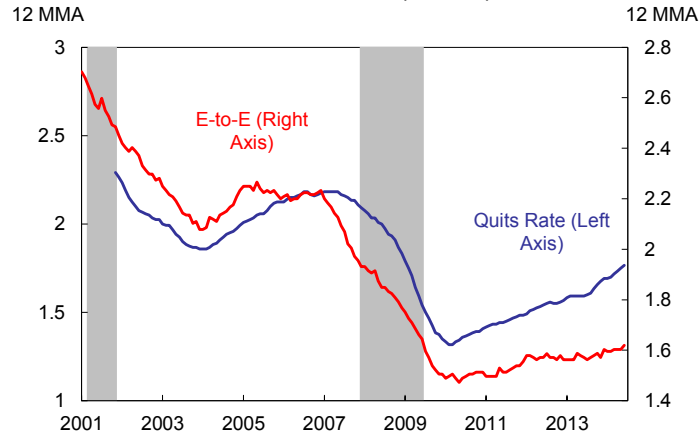
Source: JOLTS, CPS

Note: Gray shading represents NBER recessions

Job availability has picked up some

- The number of unemployed per job opening declined from a post-recession peak of around 7 to 2.
- The aggregate job-finding rate has risen in recent months as the labor market continued to tighten.
- Despite the recent improvement, both measures are still worse than their levels in 2007.

Quits and Job-to-Job Transition (E-to-E) Rate

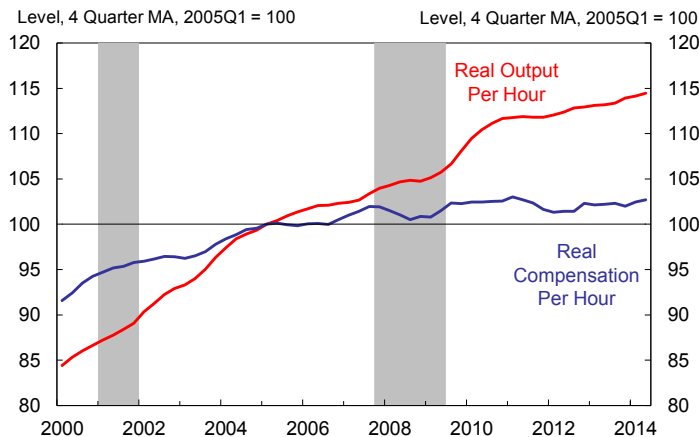


Source: JOLTS, CPS, Fallick and Fleischman (2004) Note: Gray shading represents NBER recessions

Still signs of labor market weakness remain

- The quits rate is near its trough from the mid 2000s.
- The job-to-job transition rate has not risen much.
- Both indicators suggest ongoing difficulty in finding better employment opportunities for employed workers.
- This shortfall in job switches continues to restrain compensation growth.

Productivity and Compensation

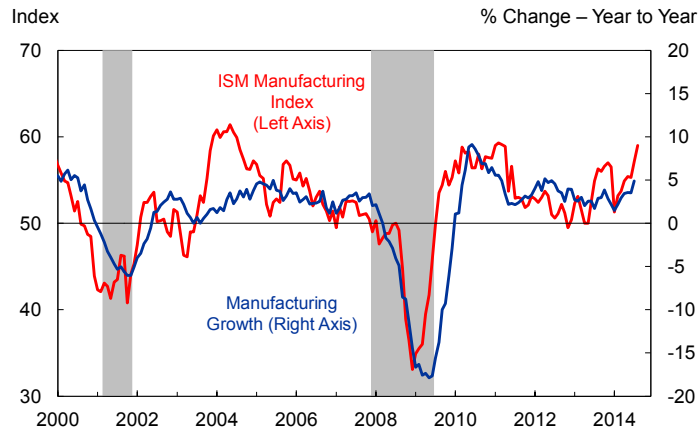


Source: Bureau of Labor Statistics

Real labor compensation lags productivity gains

- Compensation growth has been sluggish relative to labor productivity growth over the past 15 years regardless of labor market conditions.
- Consequently, the labor share of income has fallen while the corporate profit share has increased.
 - The profit share fell in Q1 from a post-1950 high, but rebounded in the second quarter.
- Sluggish compensation growth suggests there is still substantial slack in labor market.

ISM Manufacturing Index and Manufacturing

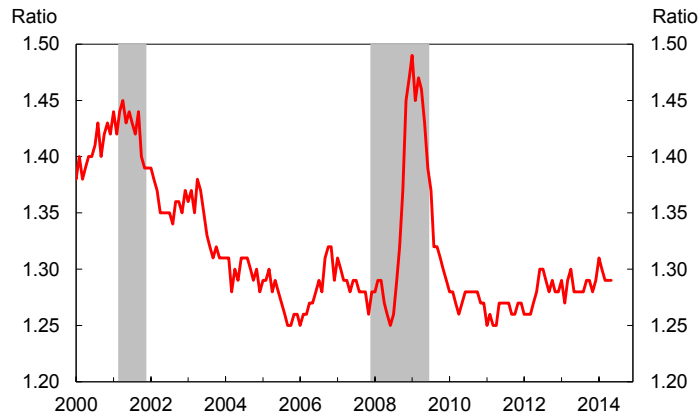


Source: Institute for Supply Management and Federal Reserve Board

Manufacturing growth is near recent rates

- In recent months, manufacturing output has rebounded from weather-related weakness during the winter.
 - The manufacturing capacity utilization rate reached 77.8% in July, the highest since February of 2008.
- The ISM manufacturing index and regional Fed indices suggest further strengthening in manufacturing output in August.
- The firming in manufacturing has been lead by rapidly rising output of motor vehicles and parts.
 - The rate of expansion of IT goods has also firmed but remains considerably below the rates from earlier in the expansion.
 - Growth of non-auto, non-IT goods has slowed in recent months.

Inventory-to-Sales Ratio: Business

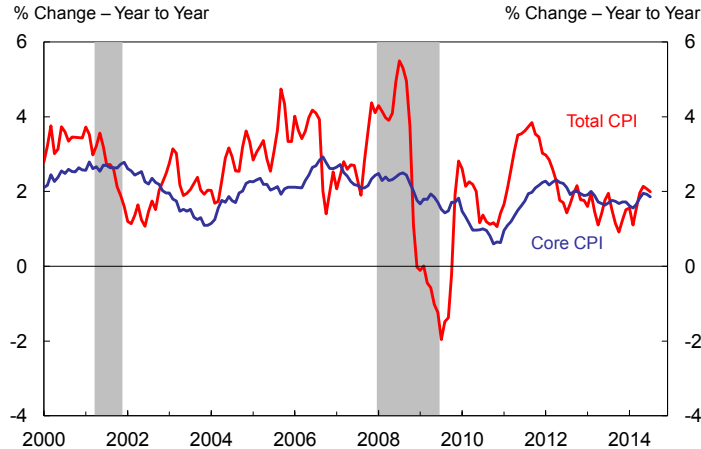


Source: Census Bureau

Inventory-sales (I/S) ratio remains stable

- The I/S ratio for the business sector declined from the mid-1980s to the mid-2000s with the adoption of new technology.
- This ratio has stayed within a relatively narrow range during this expansion.
- Inventory investment boosted Q2 growth after being a significant drag in Q1. The current I/S ratio suggests inventories are not a risk to the outlook.

CPI Inflation on the Rebound since March

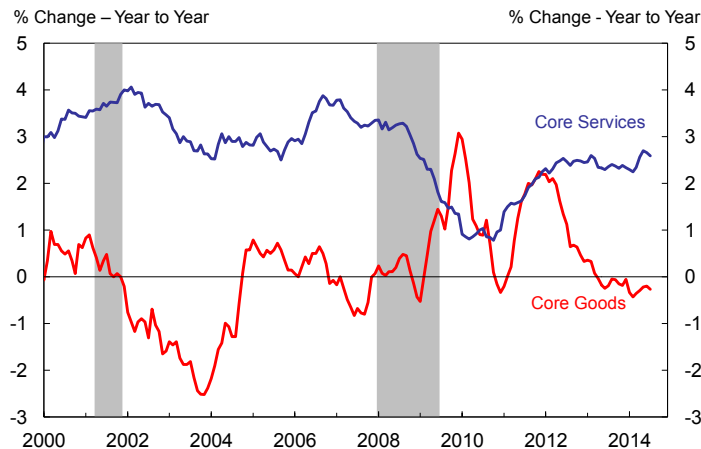


Source: Bureau of Labor Statistics

Core CPI inflation has eased somewhat

- 12-month headline and core inflation were 2% and 1.9% respectively in July.
- Core CPI inflation in June and July was modestly lower than readings in early 2014.
- Core inflation is still higher than it has been over the past two years.

CPI Inflation: Core Goods and Core Services

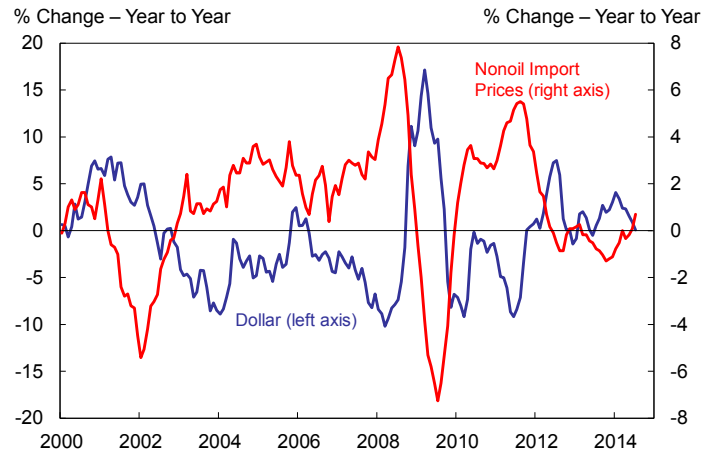


Source: Bureau of Labor Statistics

Core service inflation almost back to pre-recession levels, core goods inflation close to zero

- Core goods inflation remains close to zero.
- The early 2014 surge was mainly driven by core services inflation, which is almost back to pre-recession levels.
- Rent inflation, which is the largest component of core services, has been surging and is now at 3.3%.

Dollar Exchange Rate and Nonoil Import Prices

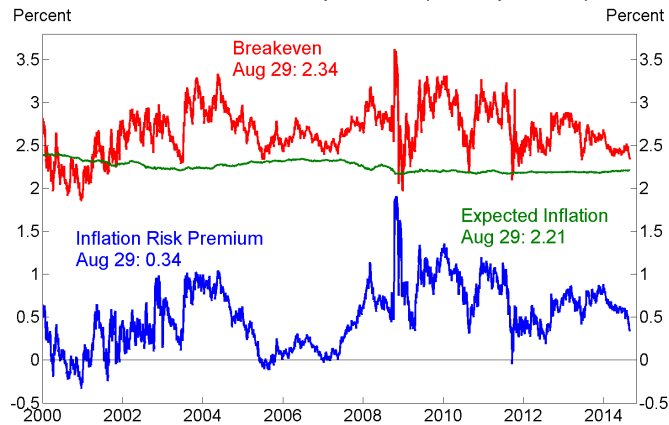


Sources: Federal Reserve Board, Bureau of Labor Statistics. Dollar is Board's Trade-Weighted Measure.

Non-oil import prices have been stable

- The trade-weighted dollar is near its year-ago level.
- A flat dollar has contributed to little change in import prices.

5-10 Year Forward Decomposition (2000-present)

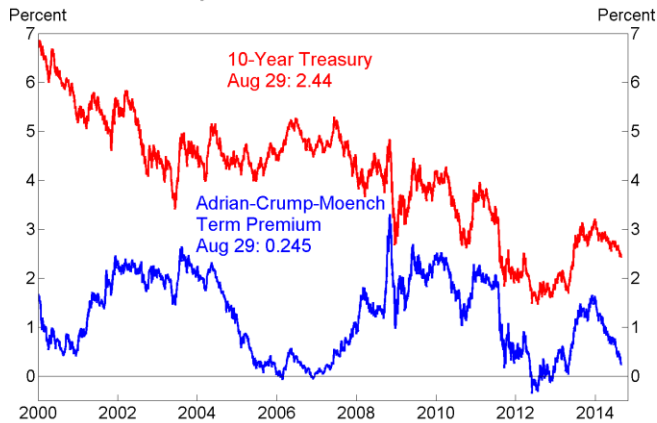


Source: FRBNY calculations

Inflation expectations remain well anchored

- Inflation expectations based on TIPS are within the range that has prevailed since 2011.
- The inflation risk premium has been trending downward over the course of 2014.
- Survey measures of households and economists also suggest inflation expectations are well anchored.

10-Year Treasury and Term Premia

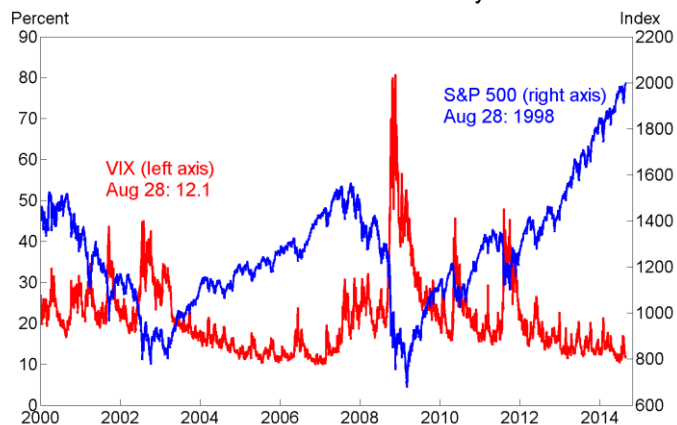


Source: FRBNY calculations, Federal Reserve Board

Long-term Treasury yields are stable

- The stability is due, in part, to a positive growth and inflation outlook.
- Yields at intermediate tenors have retraced their increase following the March FOMC meeting.
- Yields at long tenors are down to June 2013 levels.
- Term premia continue to decline though implied volatility measures have retraced slightly.

S&P 500 Index: Price Level and Volatility

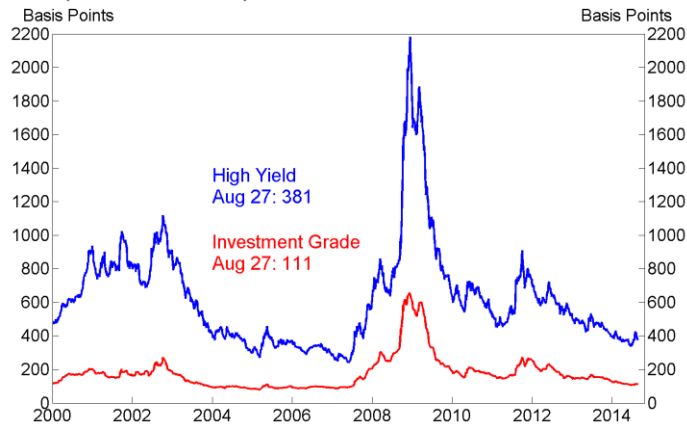


Source: Bloomberg

Equity prices are near record highs

- Equity prices continue to trend higher, with the S&P 500 breaking 2000 for the first time in history.
- Price-earnings ratios for large stocks are still in line with historical ranges.
- Implied equity volatility measures are near their lowest levels since 2007.

Corporate Credit Spreads

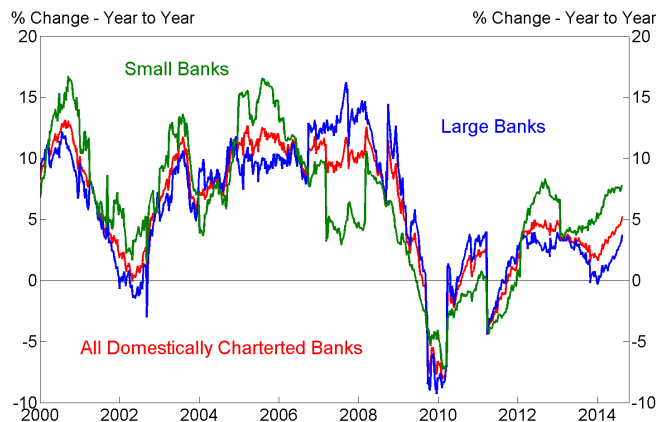


Source: Merrill Lynch

Corporate spreads at post-crisis lows

- Corporate credit spreads continued to decline in Q2 though spreads on high yield bonds have increased slightly over the last month.
- Corporate bond yields are at historically low levels.
- New issuance is brisk, with high-yield issuance up in Q2 relative to Q1.

Loans and leases in bank credit



Source: Federal Reserve Board

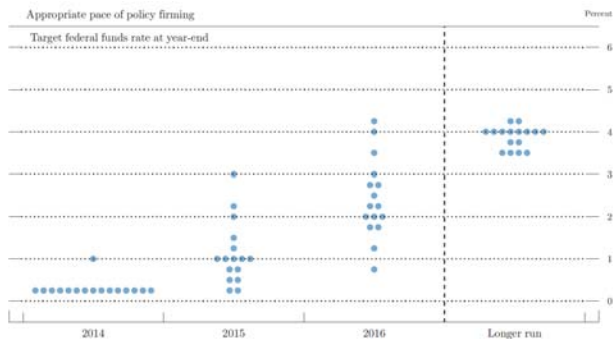
Note: "Large Banks" include the 25 largest domestically chartered banks, ranked by assets (about 2/3 of the total).

Bank lending continues to expand

- Bank lending continues to expand, driven to a significant extent by small banks.
- For small banks, growth is particularly strong for C&I and commercial real estate lending.
- For large banks, C&I lending is also growing, while real estate lending contracted over the past year.
- Both types of institutions also increased consumer lending over the past year.

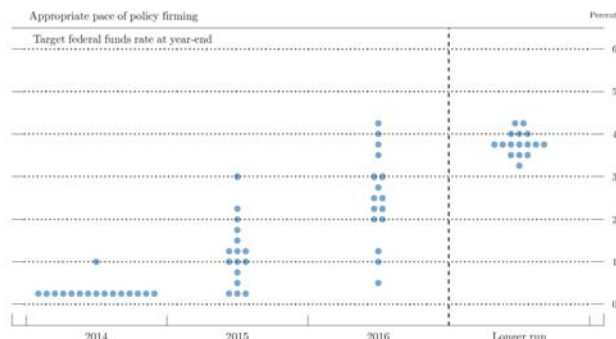
Comparison of Policy Expectations

Federal Funds Rate Projections – March 2014 SEP



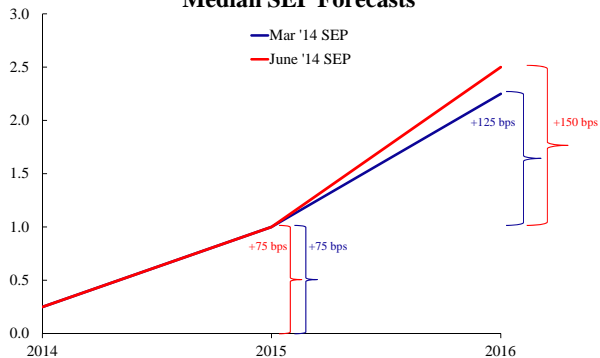
Source: Federal Reserve Board of Governors

Federal Funds Rate Projections – June 2014 SEP



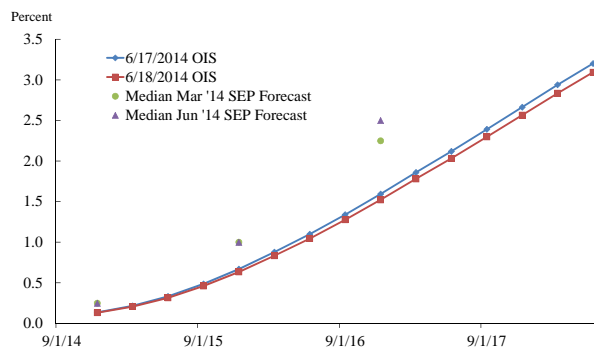
Source: Federal Reserve Board of Governors

Pace of Tightening Implied by Median SEP Forecasts



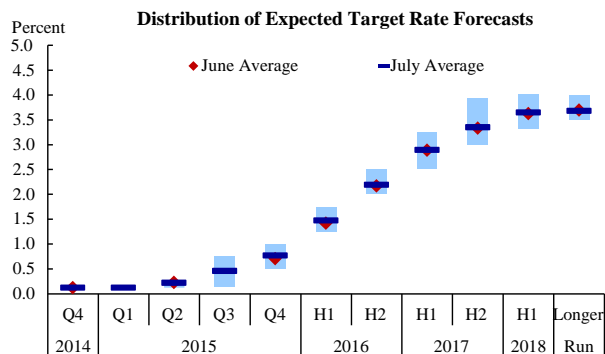
Source: Federal Reserve Board, Staff Calculations

Repricing After June SEP: OIS Implied FFR Path



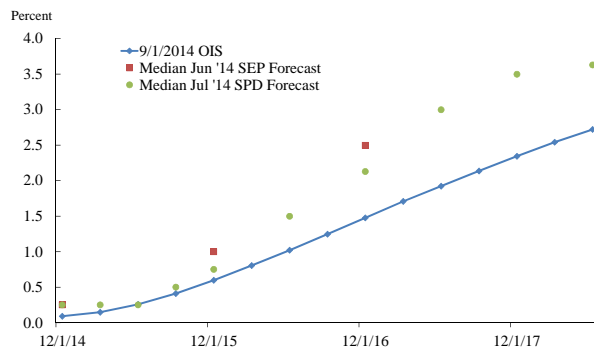
Source: Bloomberg, Federal Reserve Bank of New York, Federal Reserve Board of Governors

Survey of Primary Dealers, July 2014



Note: The bars represent the middle 50% of responses.

SEP vs. Current Market Implied and SPD FFR Paths



Source: Bloomberg, Federal Reserve Bank of New York, Federal Reserve Board of Governors