



CENTRAL
to
AMERICA'S
ECONOMY™

The First Phase of the U.S. Recovery

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Commerce Bank Economic Breakfast

18 November 2009

*Any opinions expressed here are mine and do not necessarily reflect those of other
Federal Open Market Committee members.*

Plan For This Talk

- The nascent recovery
- How to think about current monetary policy
- The regulatory reform debate

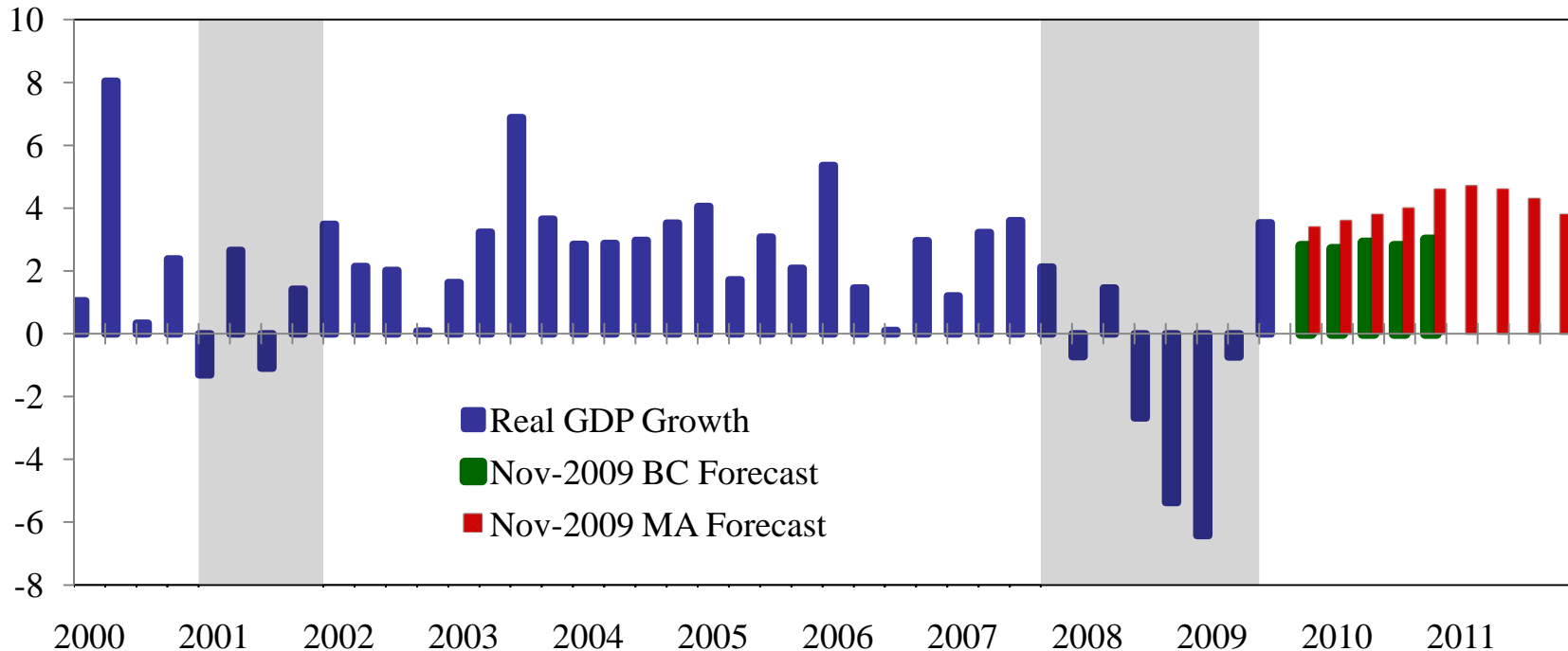
The Nascent Recovery

Forecasters See Growth Ahead

Real Gross Domestic Product.

Actual and forecasted, percent change from previous quarter at annual rate.

Percent



Forces Driving the Recovery

- Stronger-than-expected global growth, especially in Asia.
- Recovering consumption expenditure in the U.S.
- Less stress in financial markets.
- A stabilizing housing sector.

Global Growth is Improving

Canada
-3.4, 0.0, 5.0

U.S.
-0.7, 3.5, 4.0

Latin America
1.7, 4.5, 5.2

U.K.
-2.3, -1.0, 1.7

EU
-0.7, 1.8, 2.0

South Africa
-3.0, 0.0, 2.2

Russia
-2.2, 17.0, 13.7

China
16.4, 12.0, 9.6

Japan
2.3, 1.9, 2.4

Australia
2.5, 2.0, 1.9

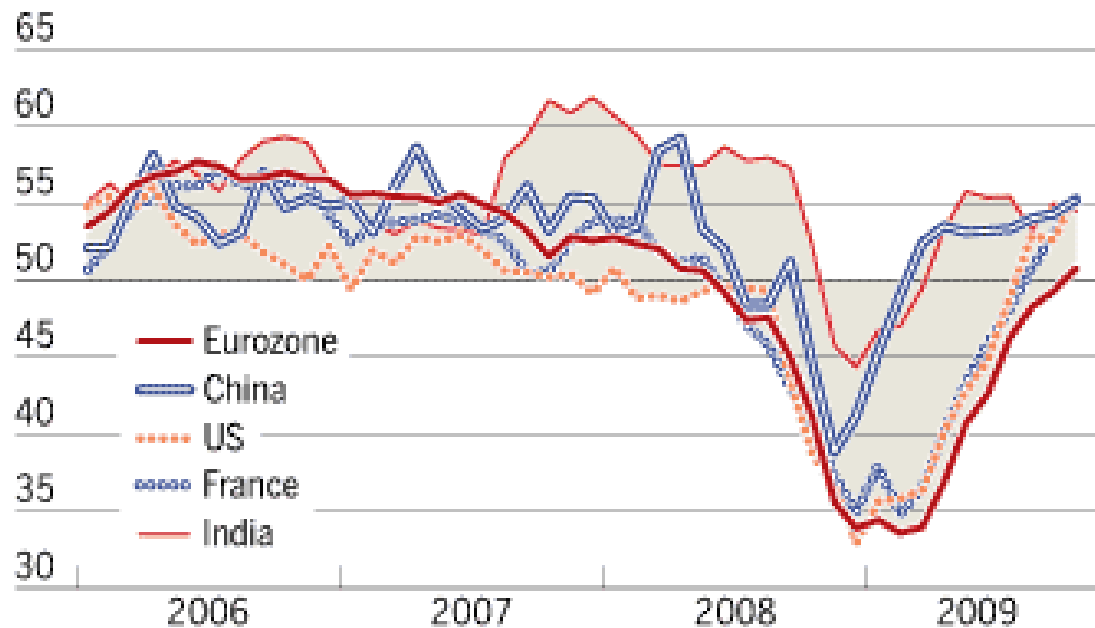
Growth Rate in Real GDP, SAAR, Percent
2009:Q2, 2009:Q3, 2009:Q4

Source: Barclays Capital Global Economic Weekly.

Manufacturing Around The Globe Is Improving

Purchasing managers' surveys

Index (above 50 = expansion)

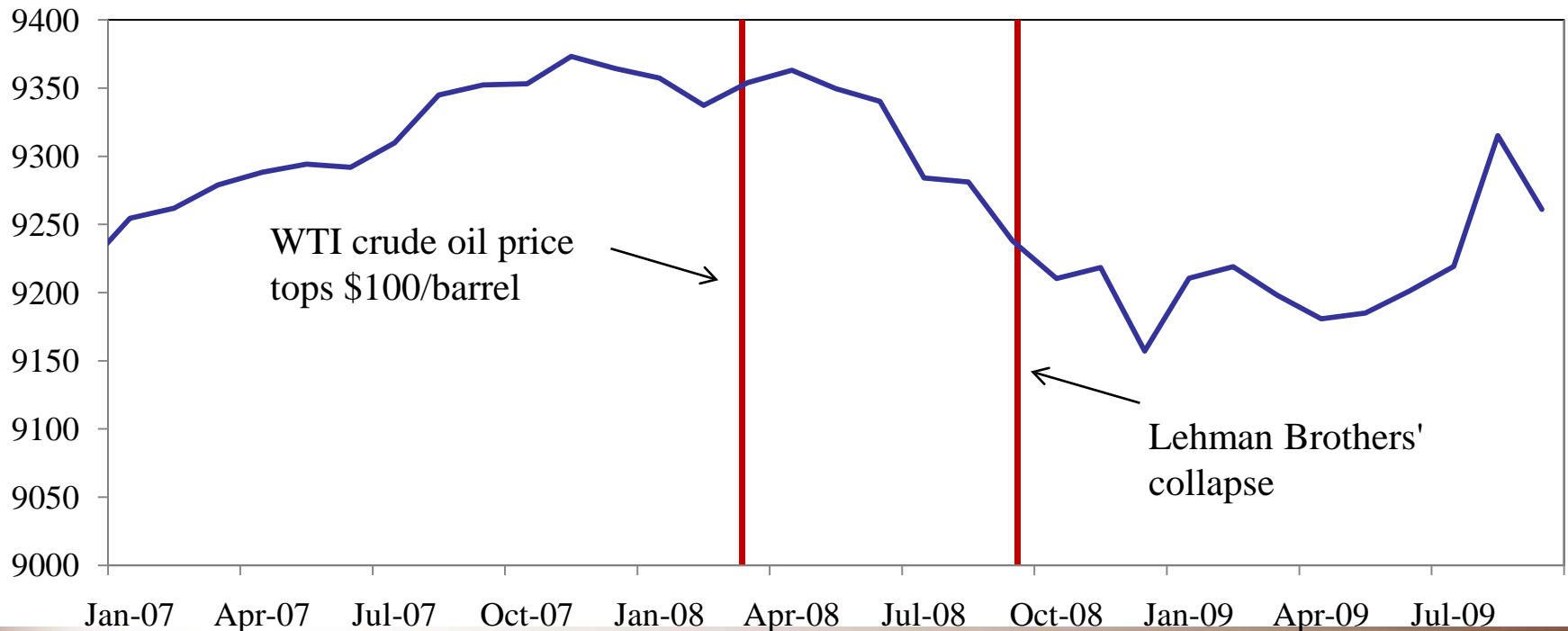


U.S. Consumption Is Stabilizing

Real Personal Consumption Expenditures

(Monthly Data. Last observation: Sept. 2009)

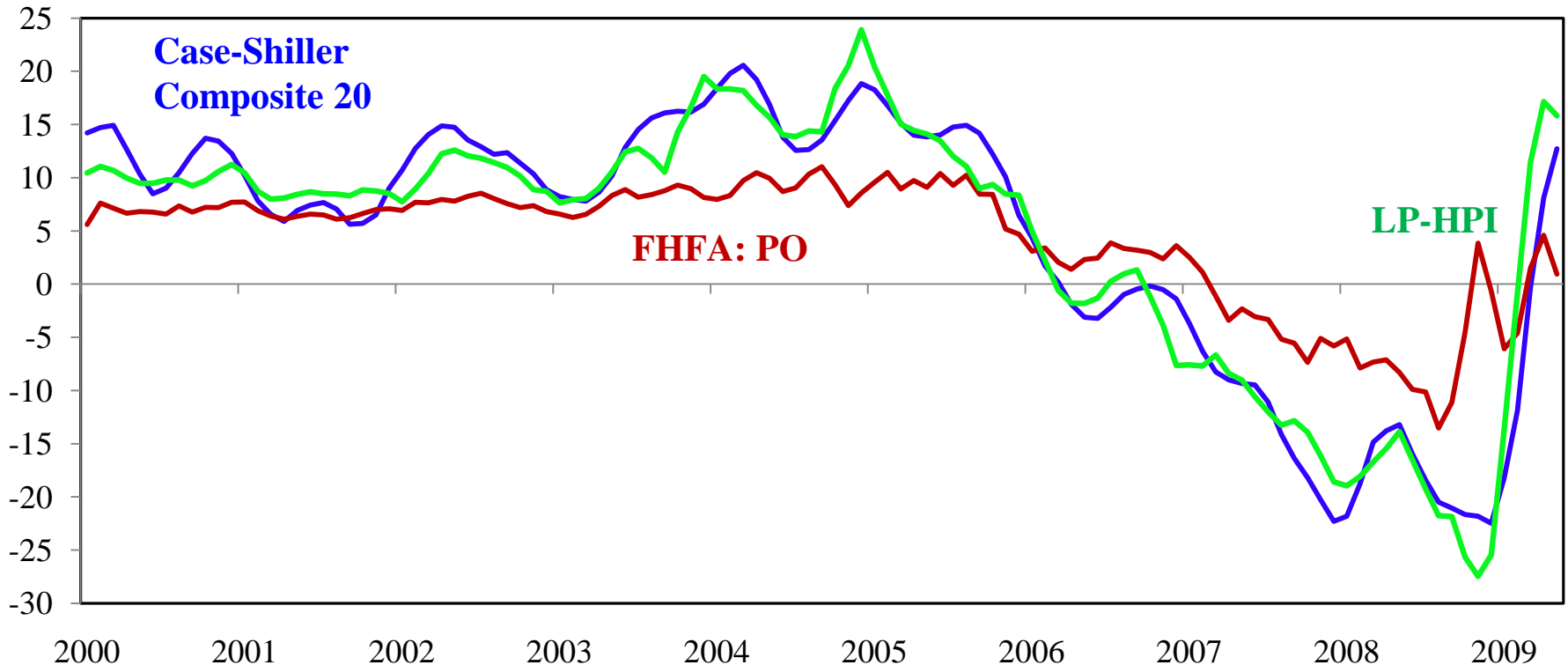
Billions of Chained 2005 Dollars



House Prices Are Stabilizing

Three-month percent change, annual rates (Monthly Data. Last observation: Aug. 2009)

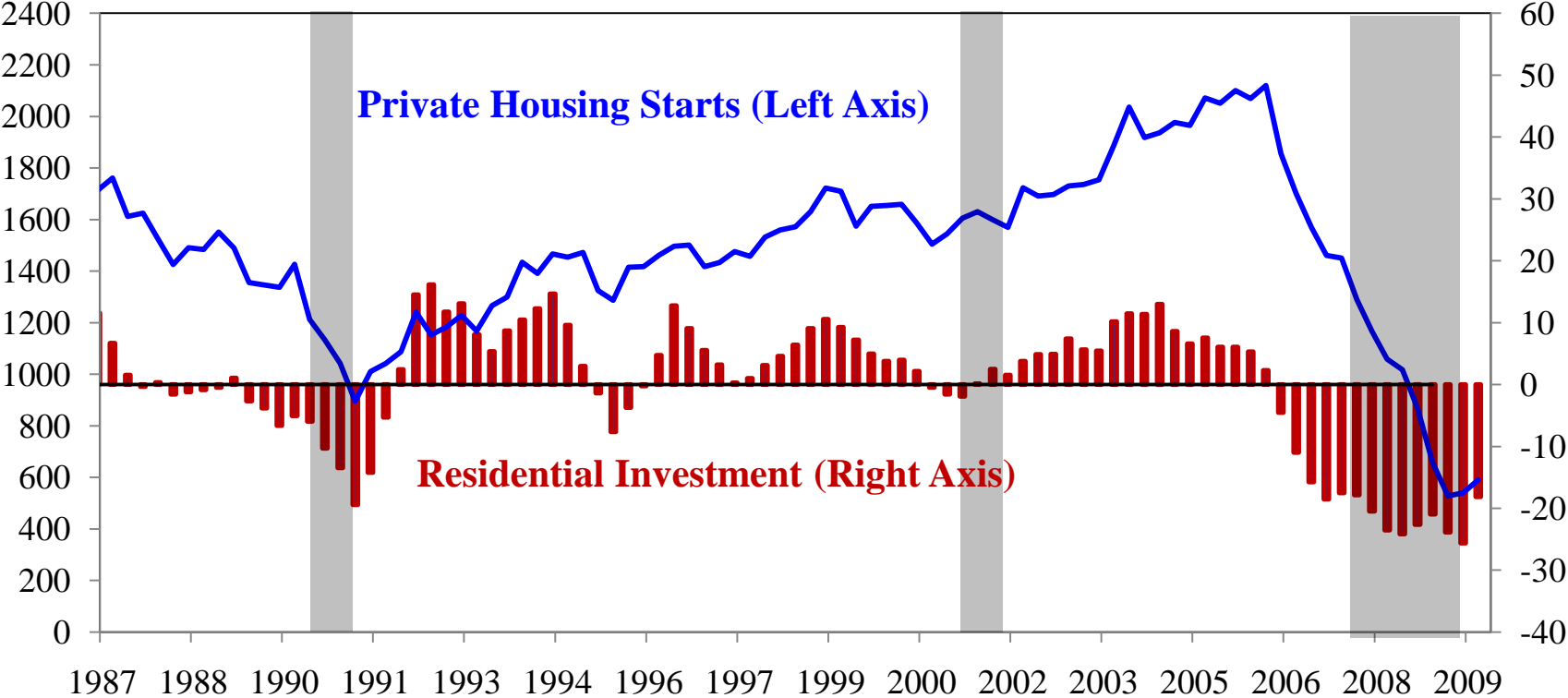
Percent



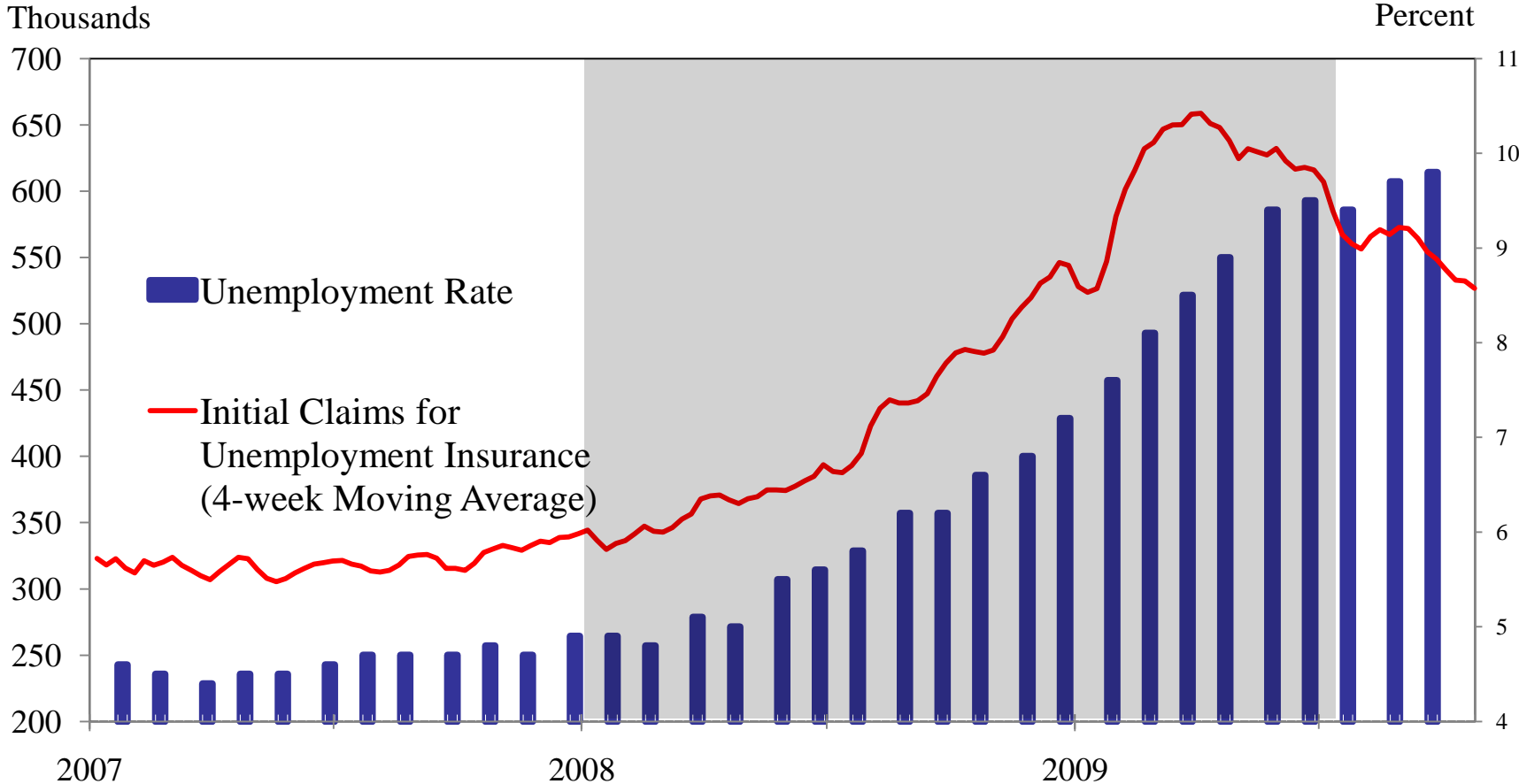
Housing Market Begins Recovery?

SAAR, Thousands of Units

4-quarter percent change



Civilian Unemployment Remains High...

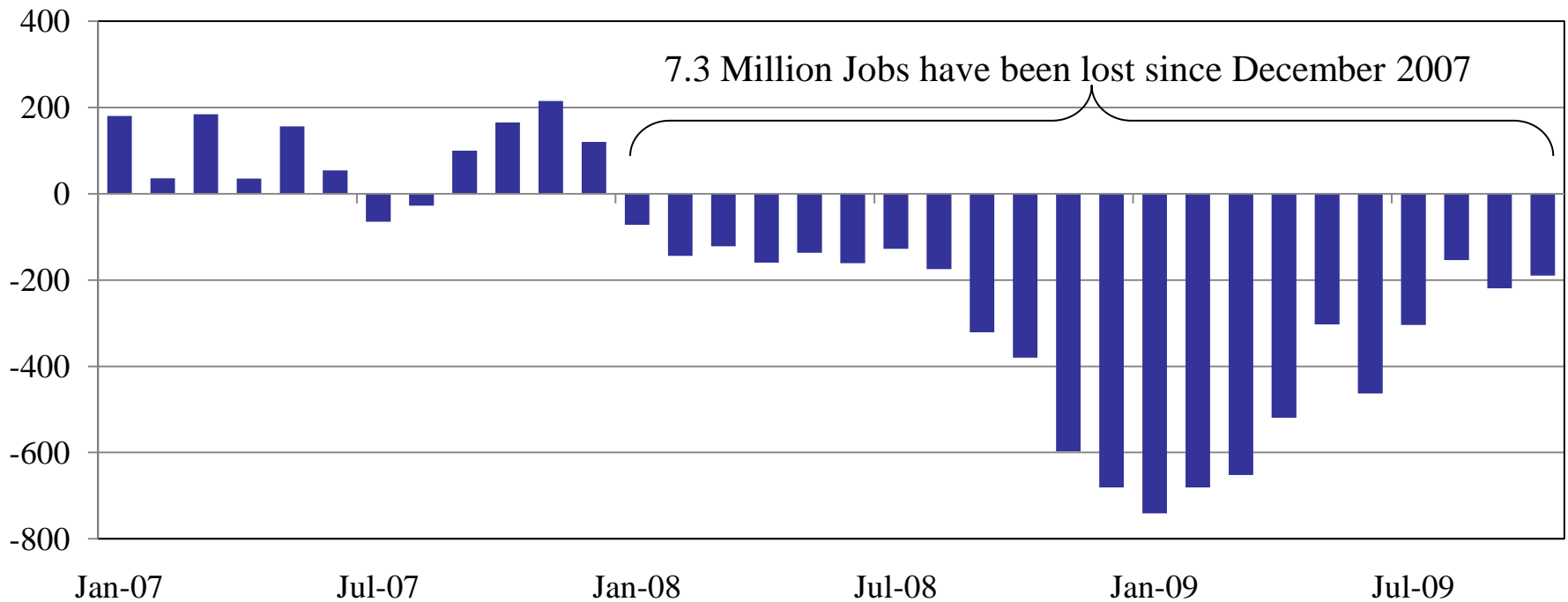


...But the Pace of Job Losses Has Slowed

Nonfarm Payroll Employment Growth

Change from previous month (Monthly Data. Last observation: Oct. 2009).

Thousands



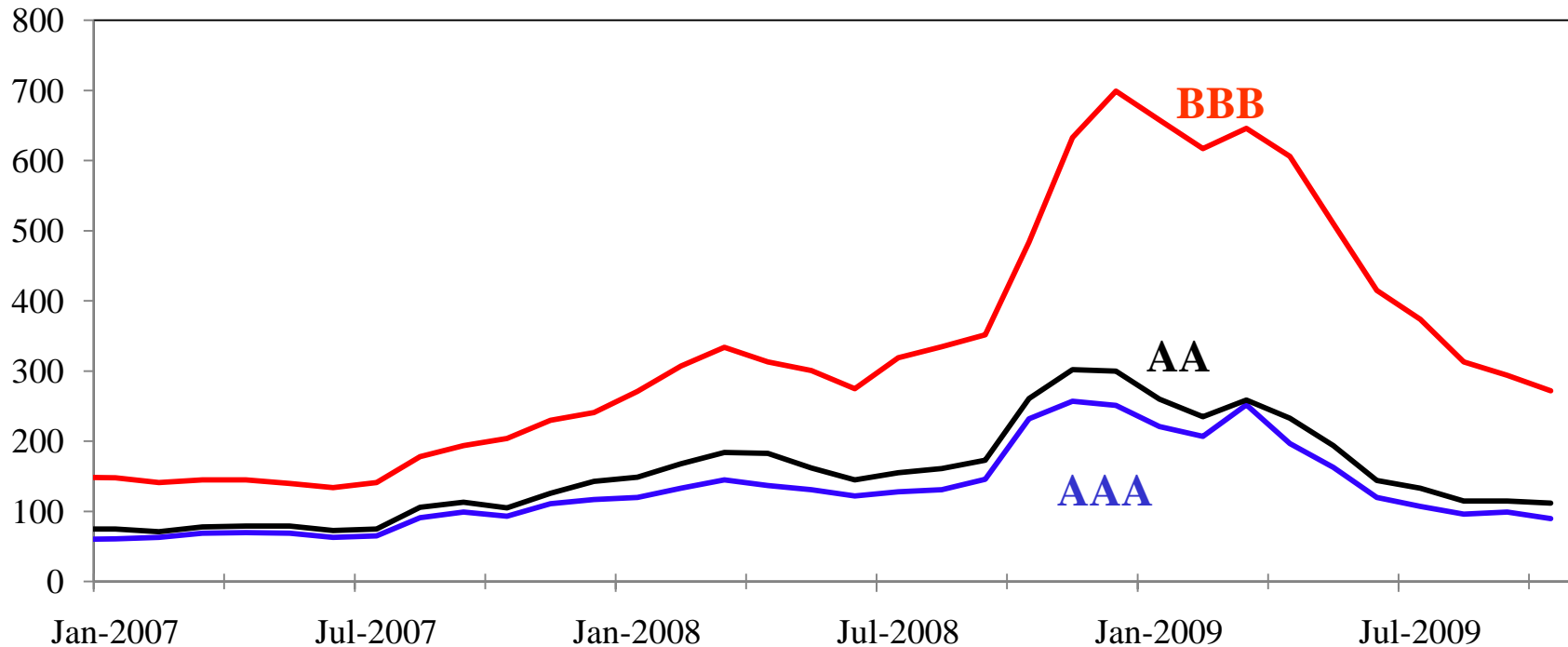
Financial Markets and Inflation

Credit Spreads Have Narrowed

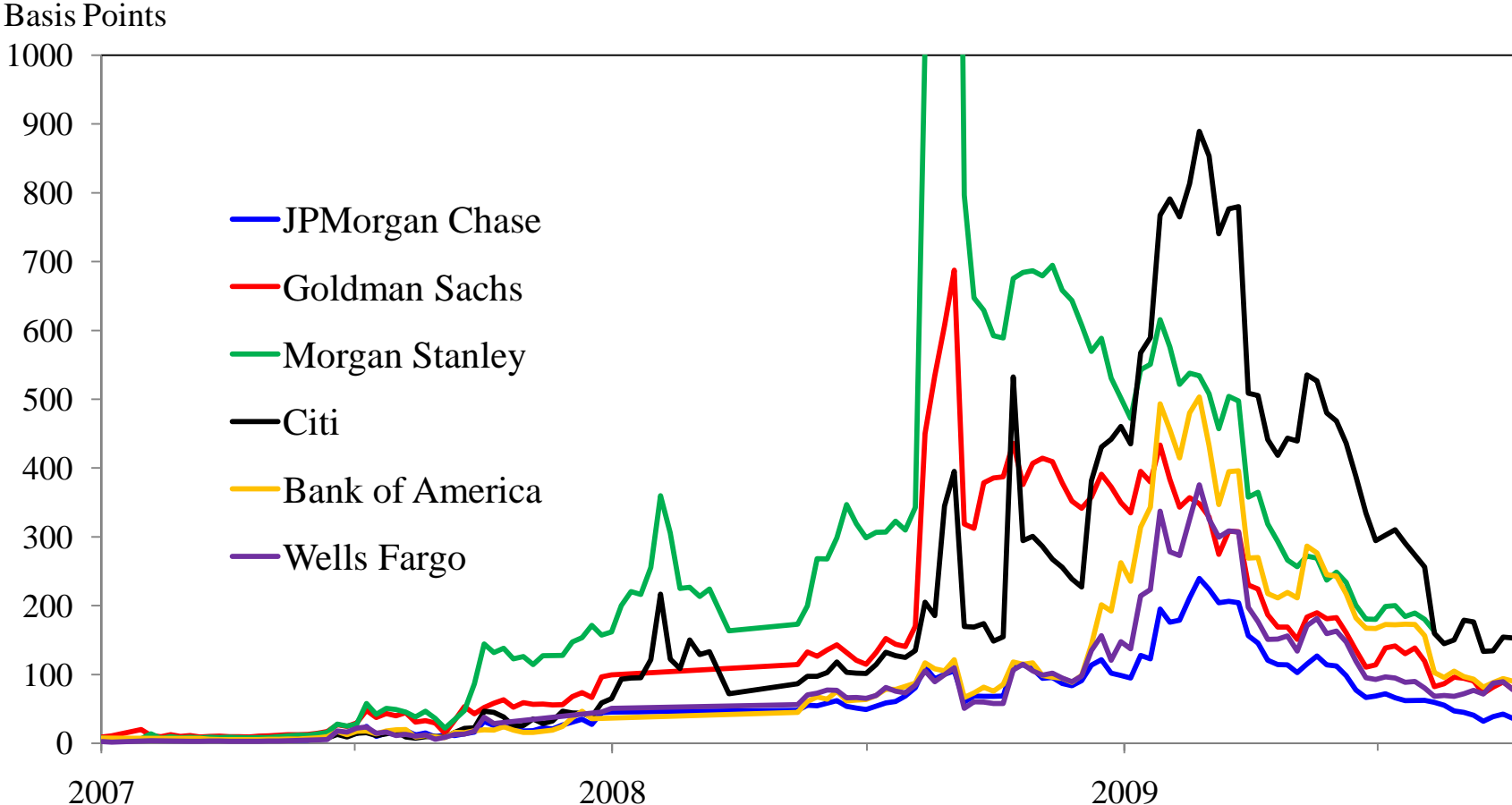
Bond Spreads to 10-Yr Treasury

(Monthly data. Last Observation: Oct. 2009)

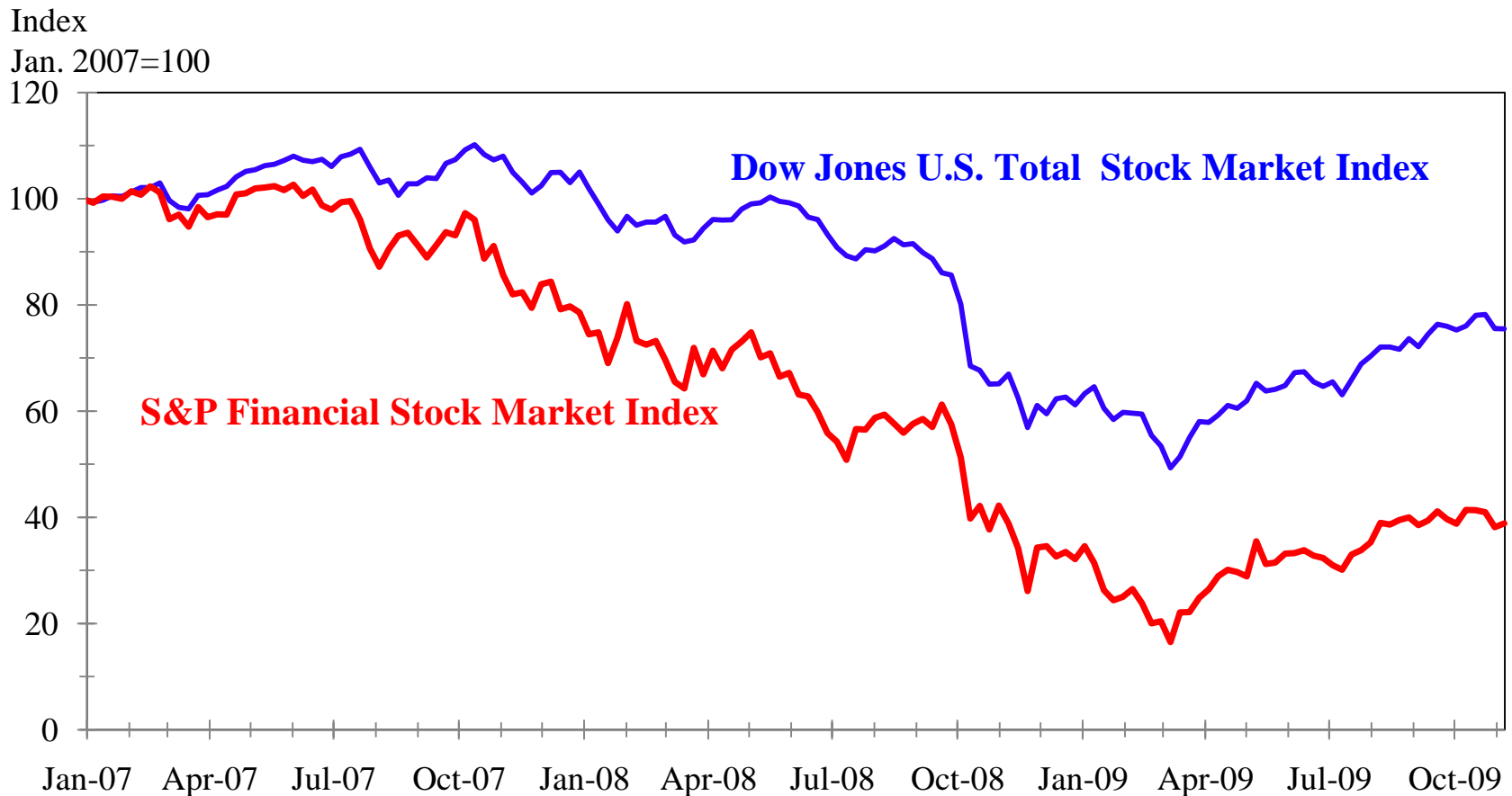
Basis Points



Credit Default Swap Prices Are Improving



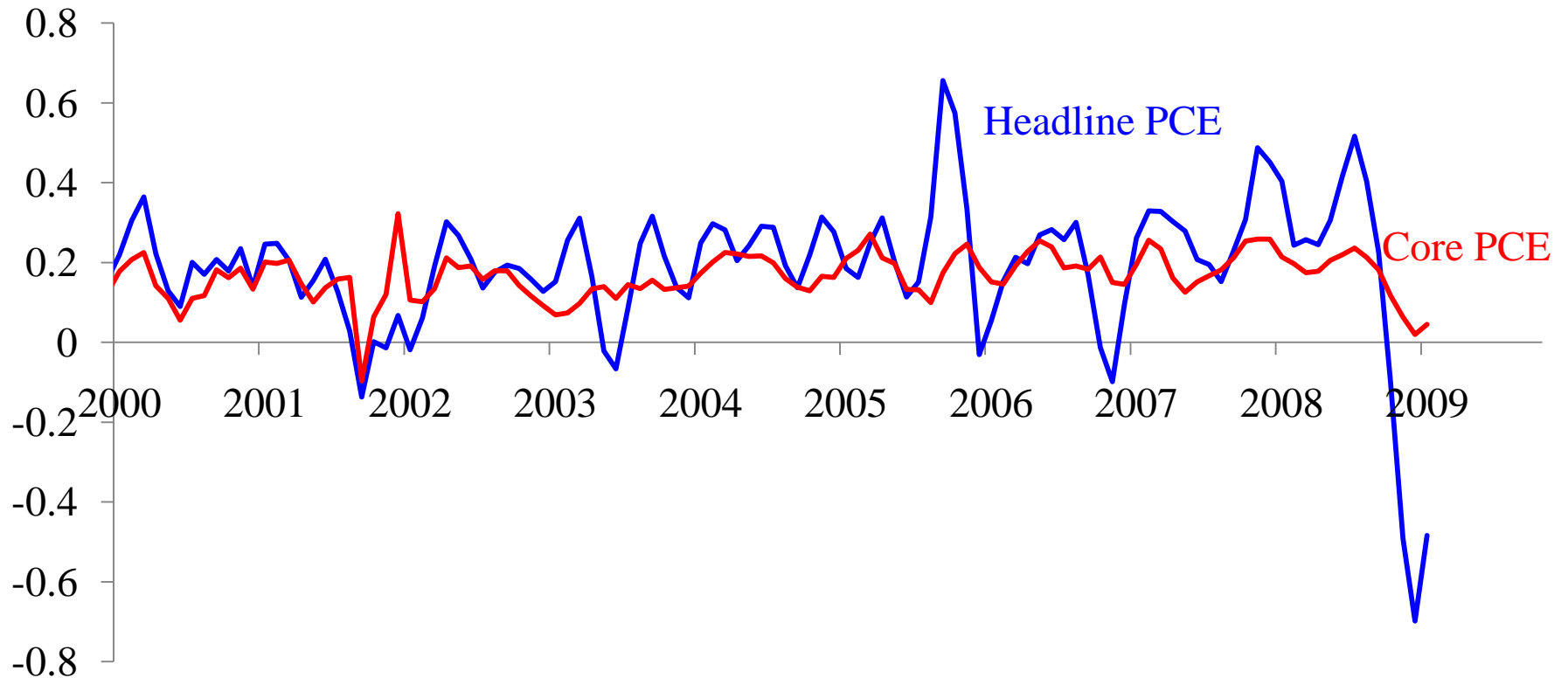
Equity Markets Are Improving



Inflation Remains Low...

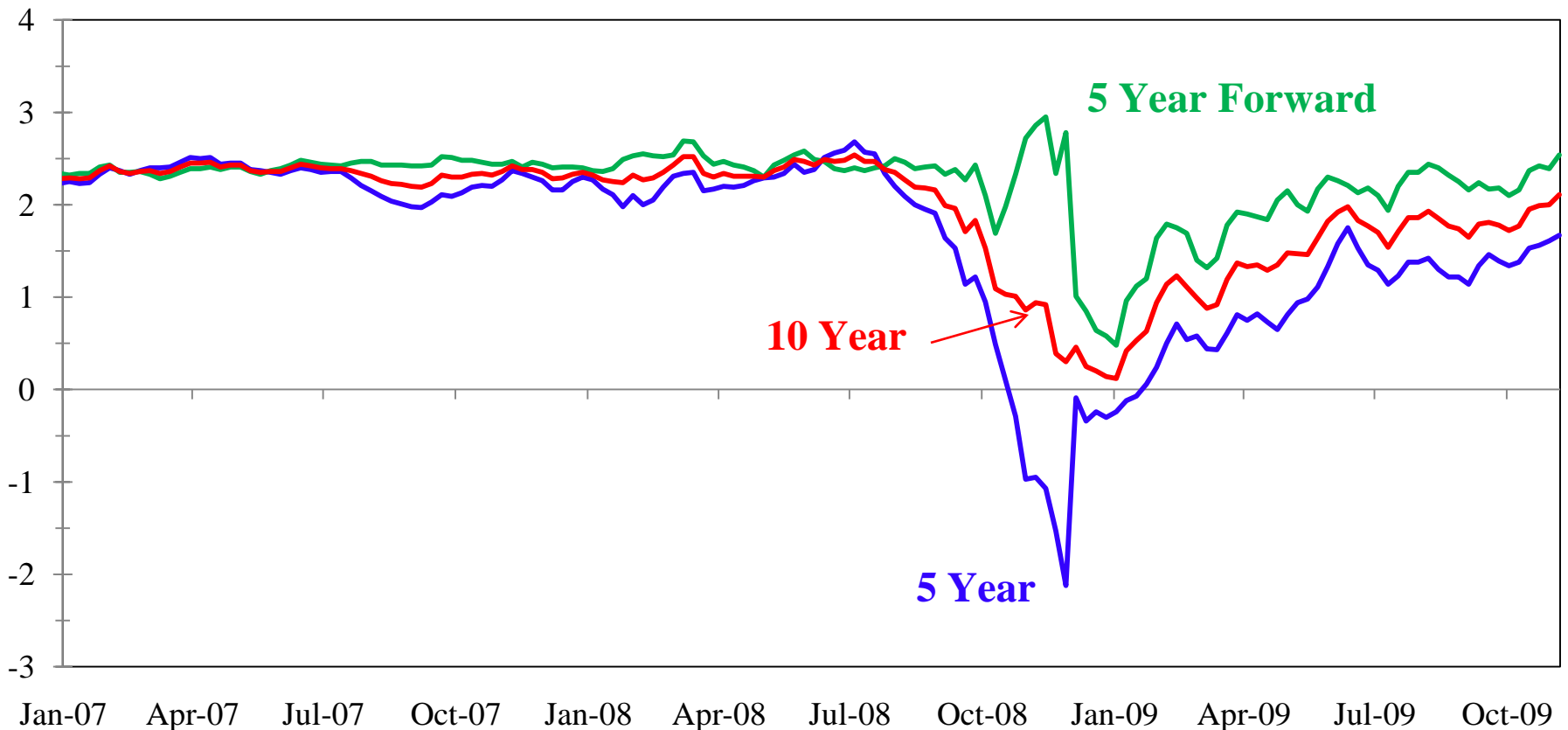
PCE Inflation

3-month percentage change



... But Inflation Uncertainty is Elevated

Percent, Constant Maturity



Monetary Policy

Three Parts to Current Monetary Policy

- Liquidity programs: lending on collateral to mitigate the panic.
- A near-zero interest rate policy.
- An asset purchase program, “quantitative easing.”

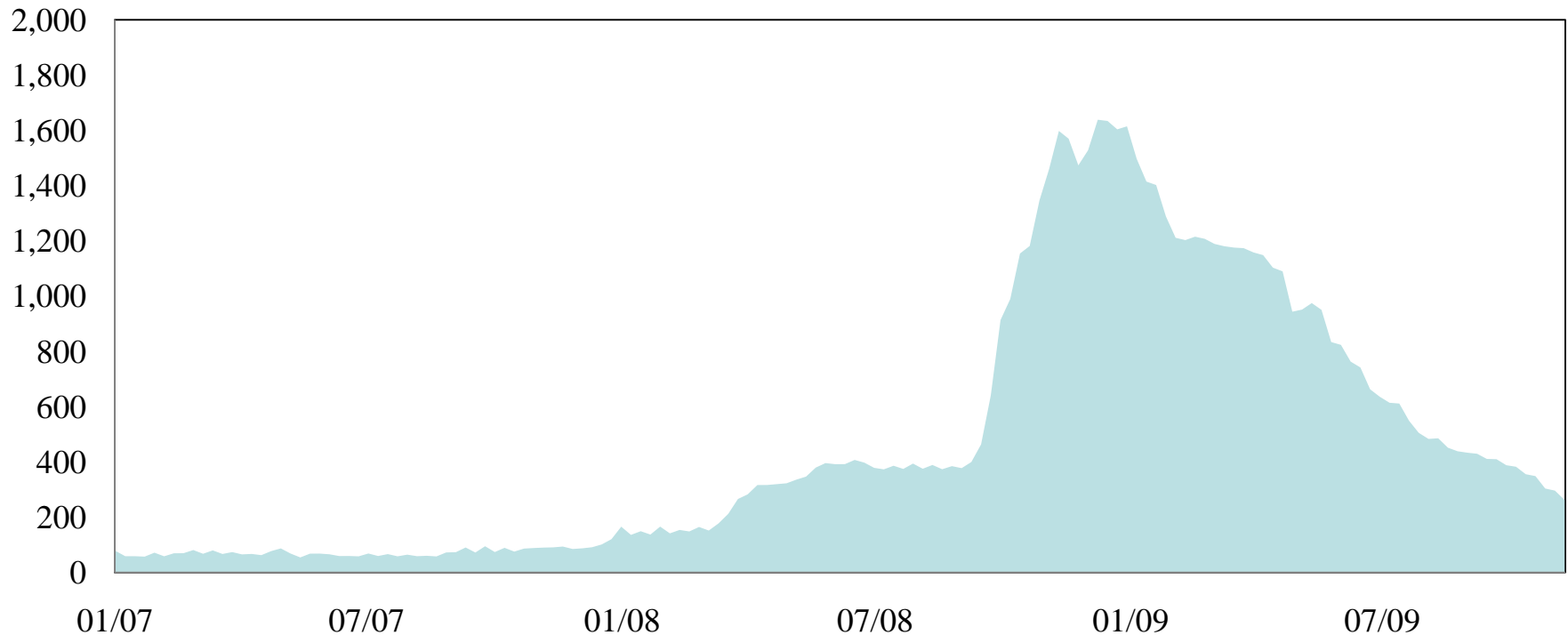
Liquidity Programs

- Liquidity programs: lending on collateral to mitigate the panic.
 - Standard central bank response to a financial crisis ...
 - ... this time on a grand scale.
 - The liquidity programs naturally taper off as the crisis recedes.
 - Not an inflationary concern.

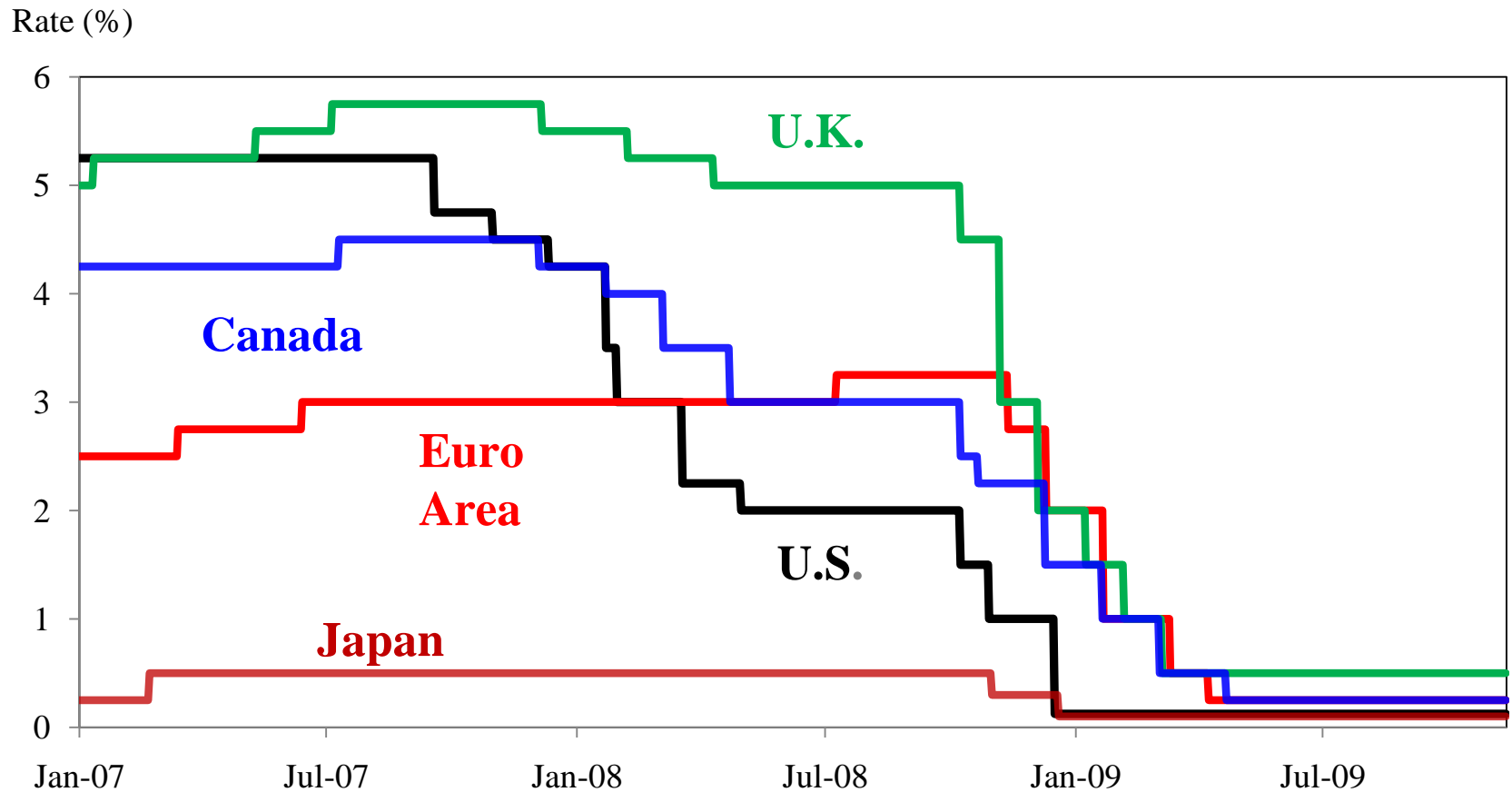
Liquidity Programs Naturally Tapering Off

Short-Term Lending to Financial Firms and Markets

Billions \$



Near-Zero Policy Rates in the G-7

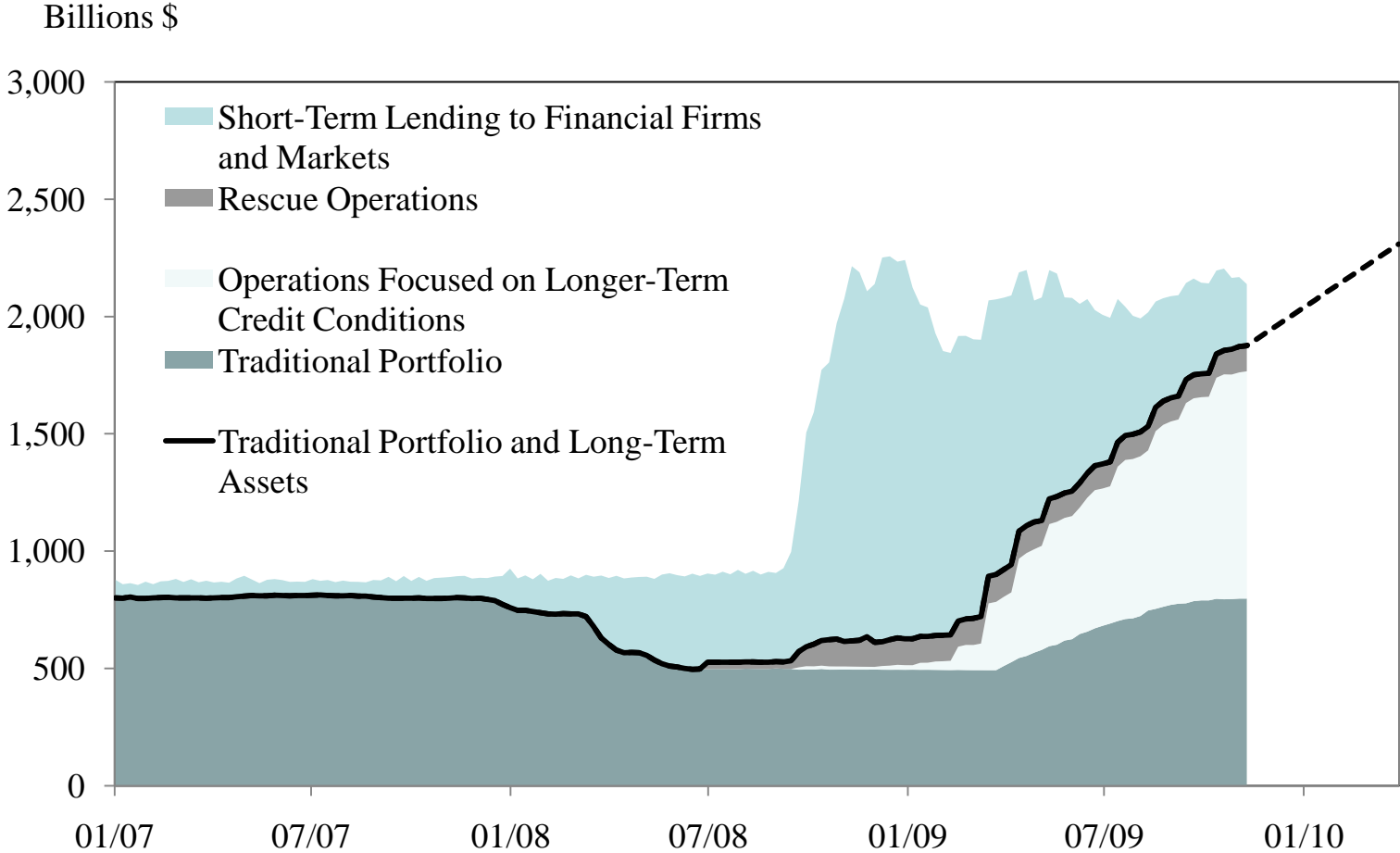


A Near-Zero Policy Rate

- A near-zero interest rate policy
 - Past two recessions: 2.5 - 3.0 years after the recession end before policy rate increases began.
 - The “too low for too long” argument may weigh heavily on the FOMC this time.
 - The market focus on interest rates is disappointing given quantitative easing.

Composition of Federal Reserve Assets

(Weekly Data. Last Observation: Nov. 11, 2009)



The Asset Purchase Program

- The Committee announced an intention to buy up to \$1.725 trillion in assets by 2010 Q1.
 - Considered successful as quantitative easing.
 - Causing a large and persistent increase in the monetary base ...
 - ... and a medium-term inflation risk.
- The FOMC asset purchase program does not have a state-contingent character.
- Main issue: How to adjust the asset purchase program going forward and not generate inflation?

Regulatory Reform

Key Problem: Too Big To Fail

- “Too Big to Fail” is an intolerable situation which must be addressed.
- Large, complex, global institutions, many of which are not banks.
- One important idea: A resolution regime for large financial firms.

Large S&P 500 Financial Firms (As of 2007:Q4)

Firm	Total Assets, Bill. (2007:Q4)	Pct. of Tot. Assets in S&P 500 Fin.	Cum. Percent	Type of Firm (2007: Q4)
Citigroup Inc.	\$2,187	10.9%	10.9%	BHC
Bank of America Corp.	1,715	8.5	19.5	BHC
JPM Chase & Co.	1,562	7.8	27.3	BHC
Goldman Sachs Grp.	1,119	5.5	32.9	BHC
AIG	1,060	5.3	38.2	Insurance
Morgan Stanley	1,045	5.2	43.4	BHC
Merrill Lynch	1,020	5.1	48.5	Inv. Bank
Fannie Mae	882	4.4	53.9	GSE
FHL Mortg.	794	3.9	56.9	GSE
Wachovia Corp.	782	3.9	60.8	BHC

Large S&P500 Financial Firms (As of 2007:Q4)

Firm	Total Assets, Bill. (2007:Q4)	Pct. of Tot. Assets in S&P 500 Fin.	Cum. Percent	Type of Firm (2007:Q4)
Lehman Bros.	691	3.4	64.2	Inv. Bank
Wells Fargo	575	2.8	67.1	Thrift
MetLife Inc.	558	2.7	69.9	Insurance
Prudential Financial	485	2.4	72.3	Fin. Adv./Ins.
Hartford Financial Svcs.	360	1.8	74.1	Insurance
Washington Mutual	327	1.6	75.7	Thrift
U.S. Bancorp	237	1.1	76.9	BHC
Countrywide Financial Corp.	211	1.0	78.0	Thrift
Bank of NY Mellon Corp.	197	0.9	79.0	BHC
Lincoln National	191	0.9	79.9	Insurance

The Role of the Fed

- Discount window: The Fed needs to have a role in regulating institutions to which it may lend.
- Monetary policy: To be effective, the Fed needs to know the condition of the financial system through hands on regulatory involvement.
- Fed independence is vital in maintaining credible monetary policy.



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