



CENTRAL
to
AMERICA'S
ECONOMY™

The U.S. Economic Situation and Regulatory Reform

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Federal Reserve Bank of St. Louis

A Day with the Commissioner

Nashville, TN

12 May 2010

This Talk

- State of the U.S. economy
- Tennessee's economy
- The global economy
- Monetary policy
- Risks to the outlook
- Financial regulatory reform

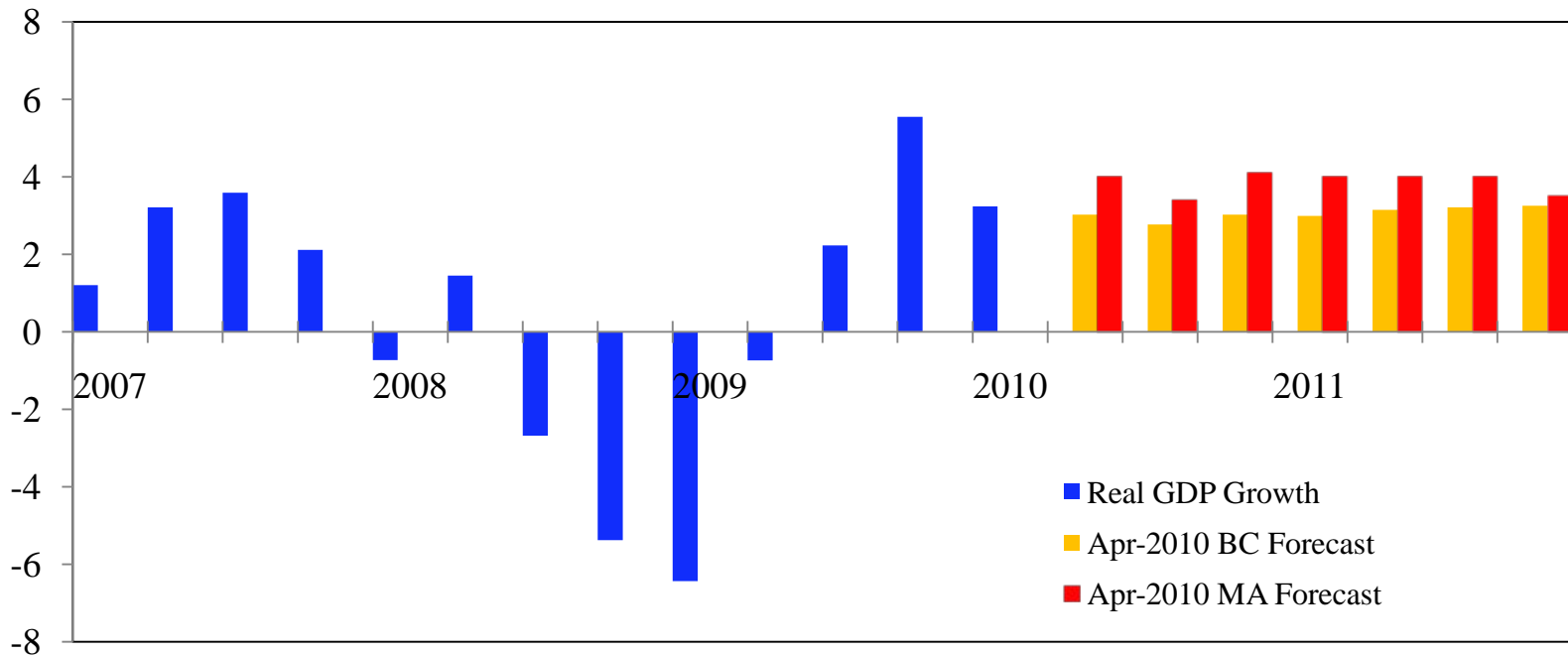
State of the U.S. Economy

Continued signs of recovery

Real Gross Domestic Product

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

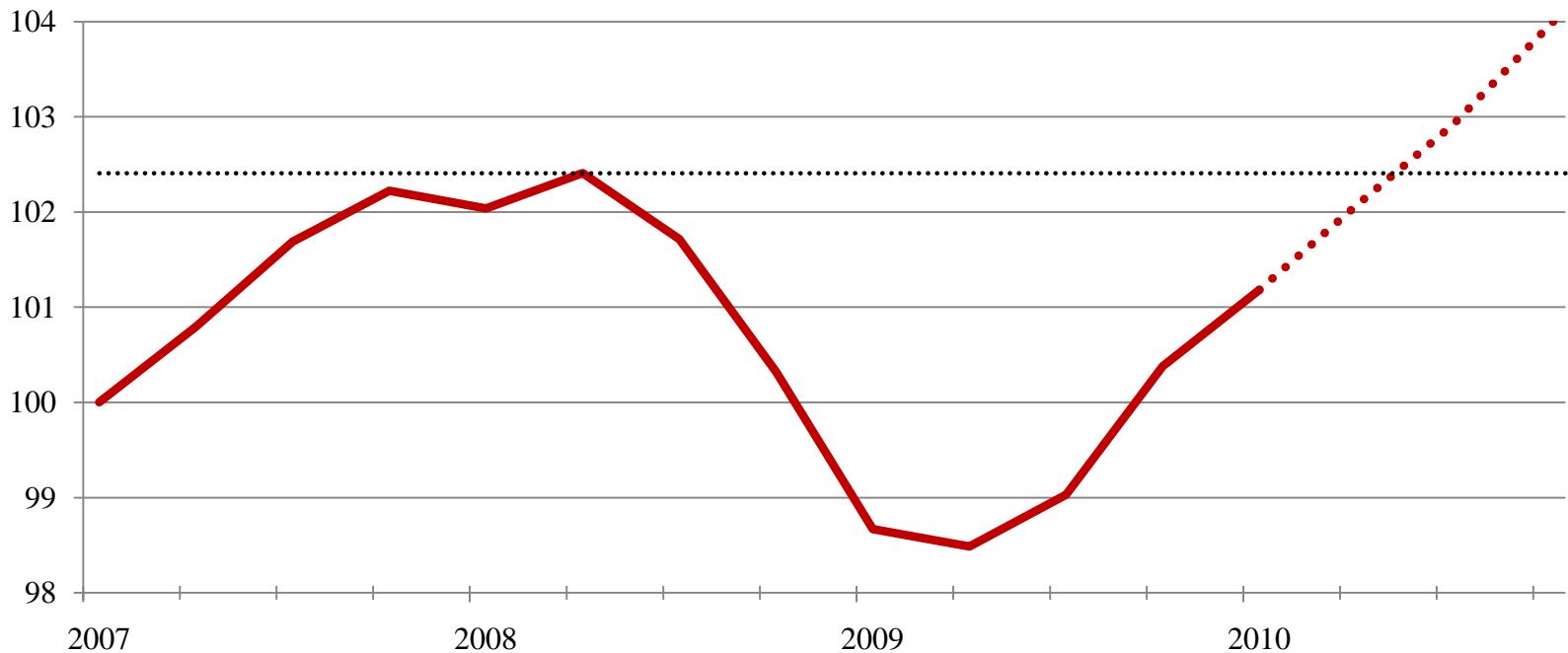
Percent



GDP expected to reach 2008:Q2 peak before year-end

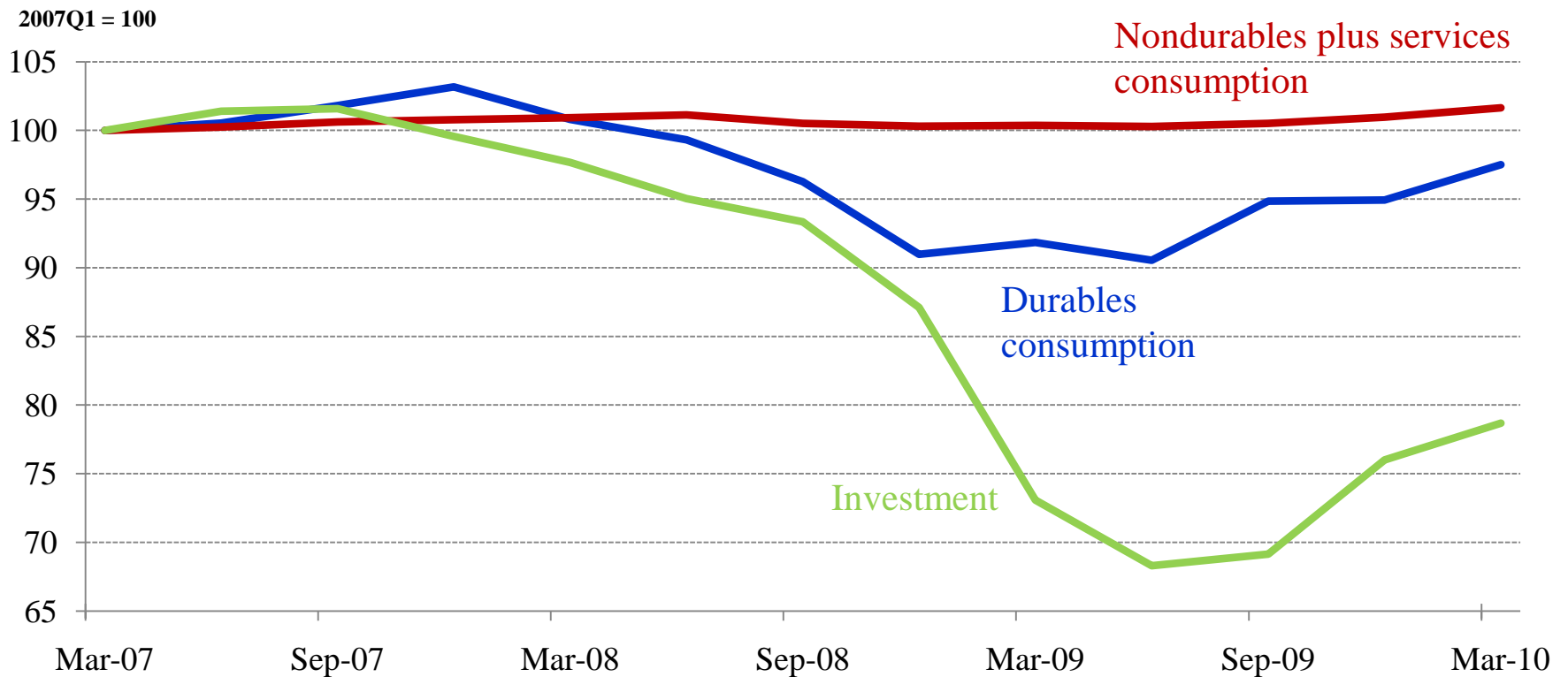
Real Gross Domestic Product and MA Forecast
(As of May 10, 2010)

2007:Q1 = 100



Composition of real output

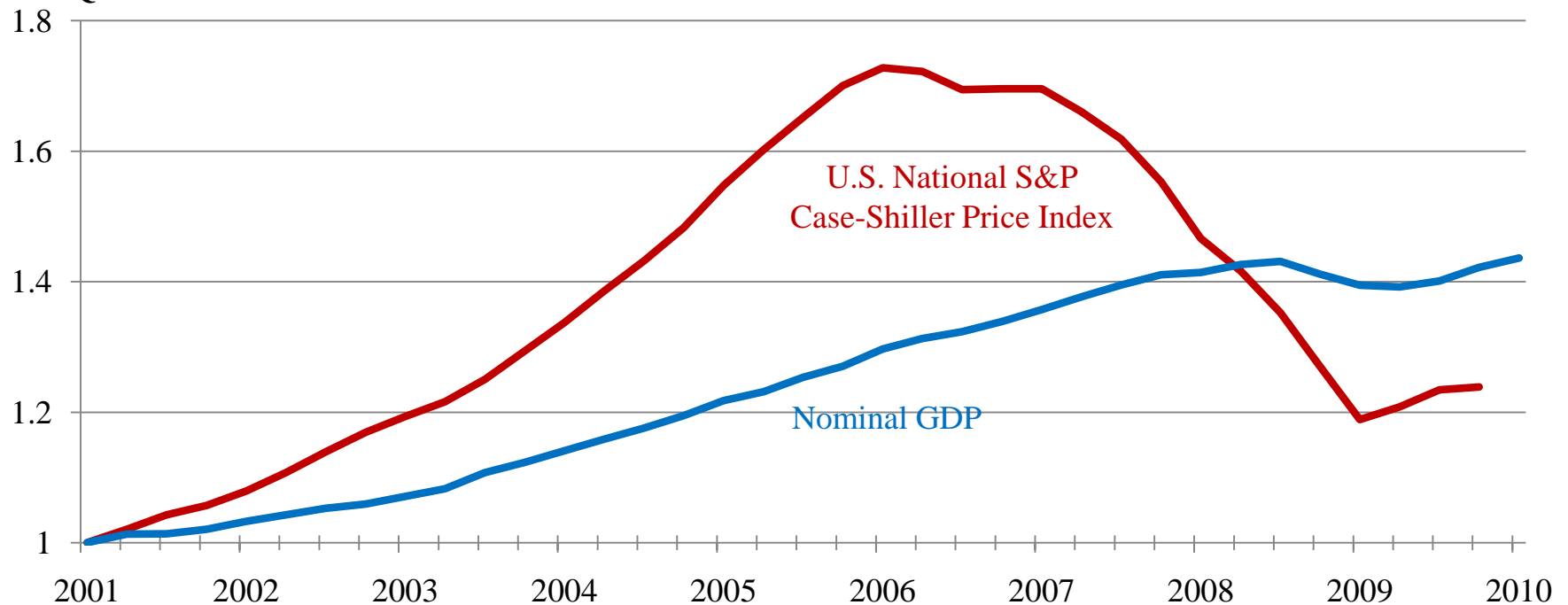
Components of Real Gross Domestic Product



Home prices are increasing but remain low

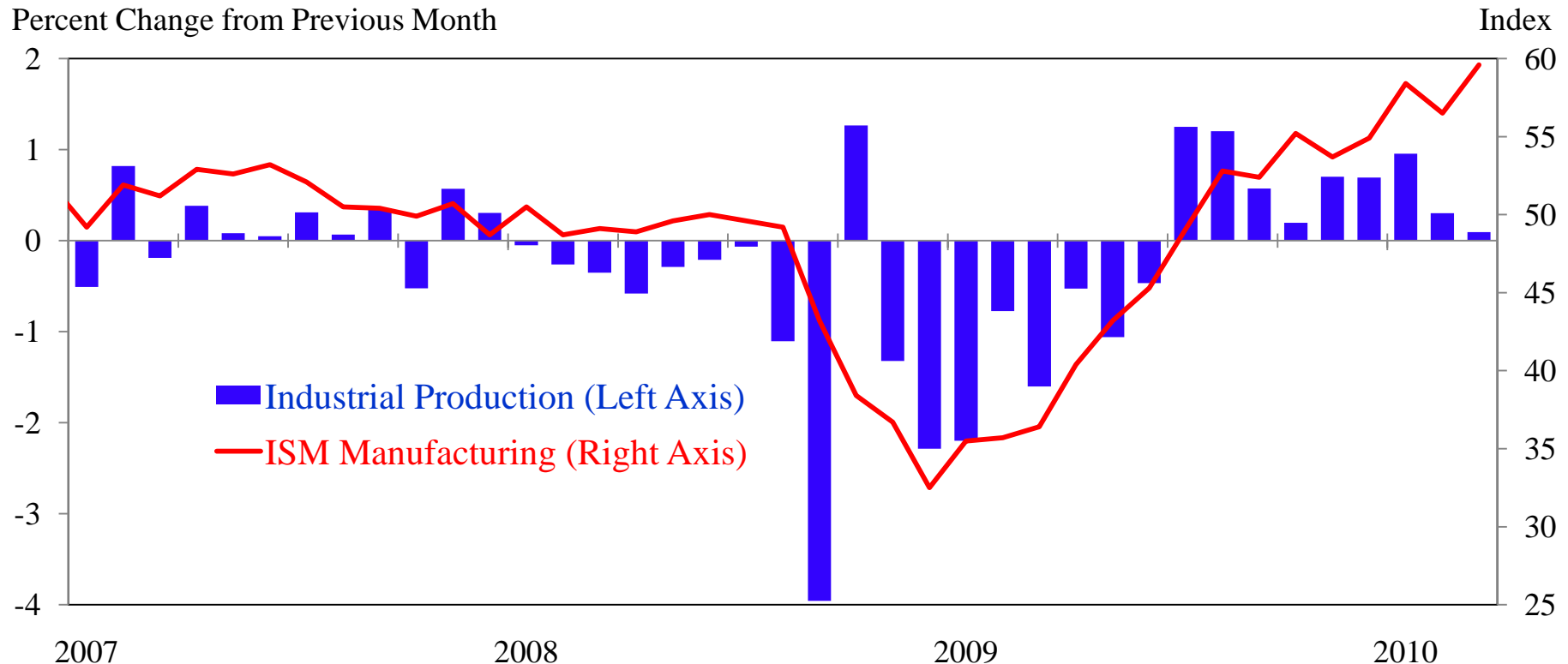
S&P Case Shiller House Prices and Nominal GDP

2001Q1=1



Manufacturing has rebounded

Industrial Production and the ISM Manufacturing Index

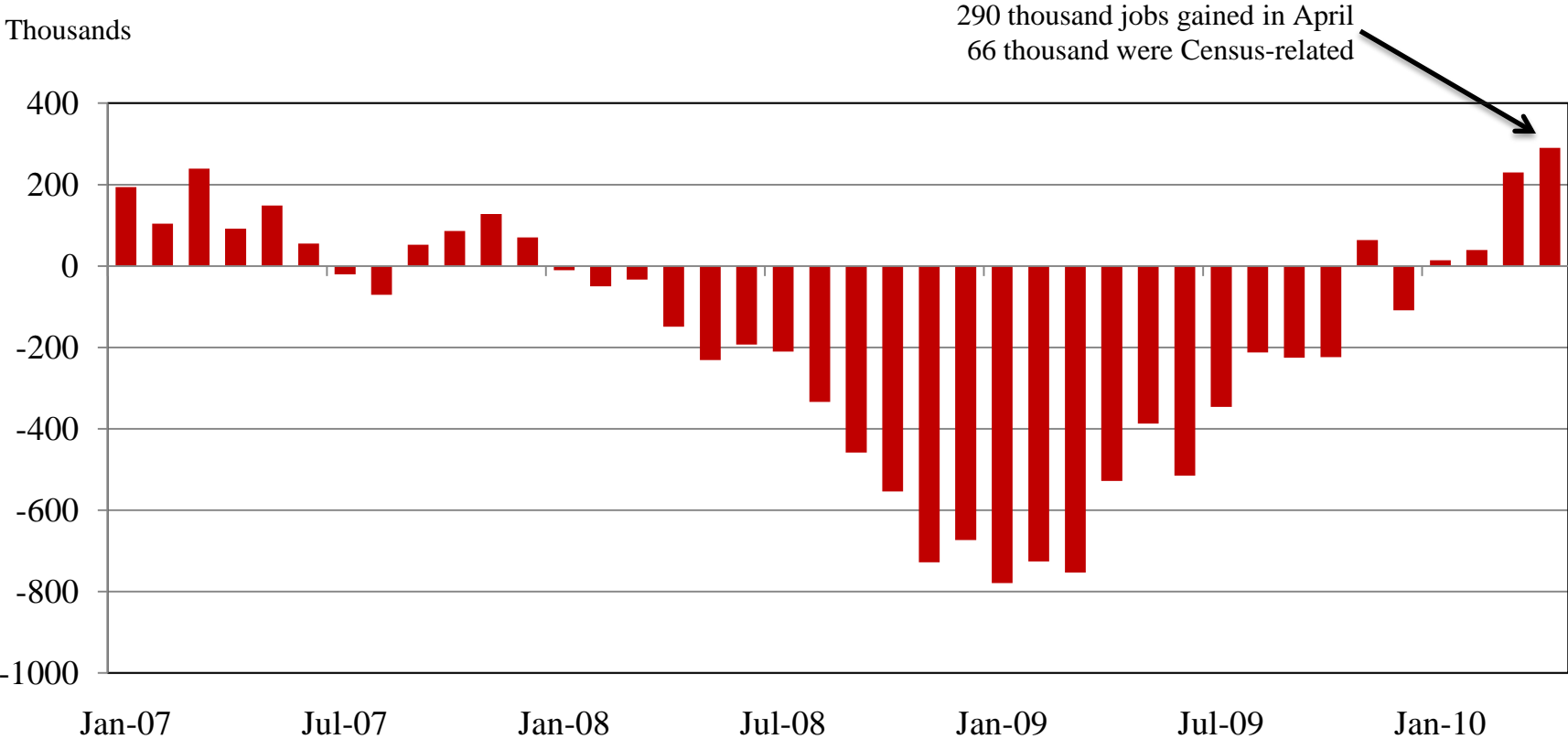


Labor market conditions are slowly improving

Nonfarm Payroll Employment Growth

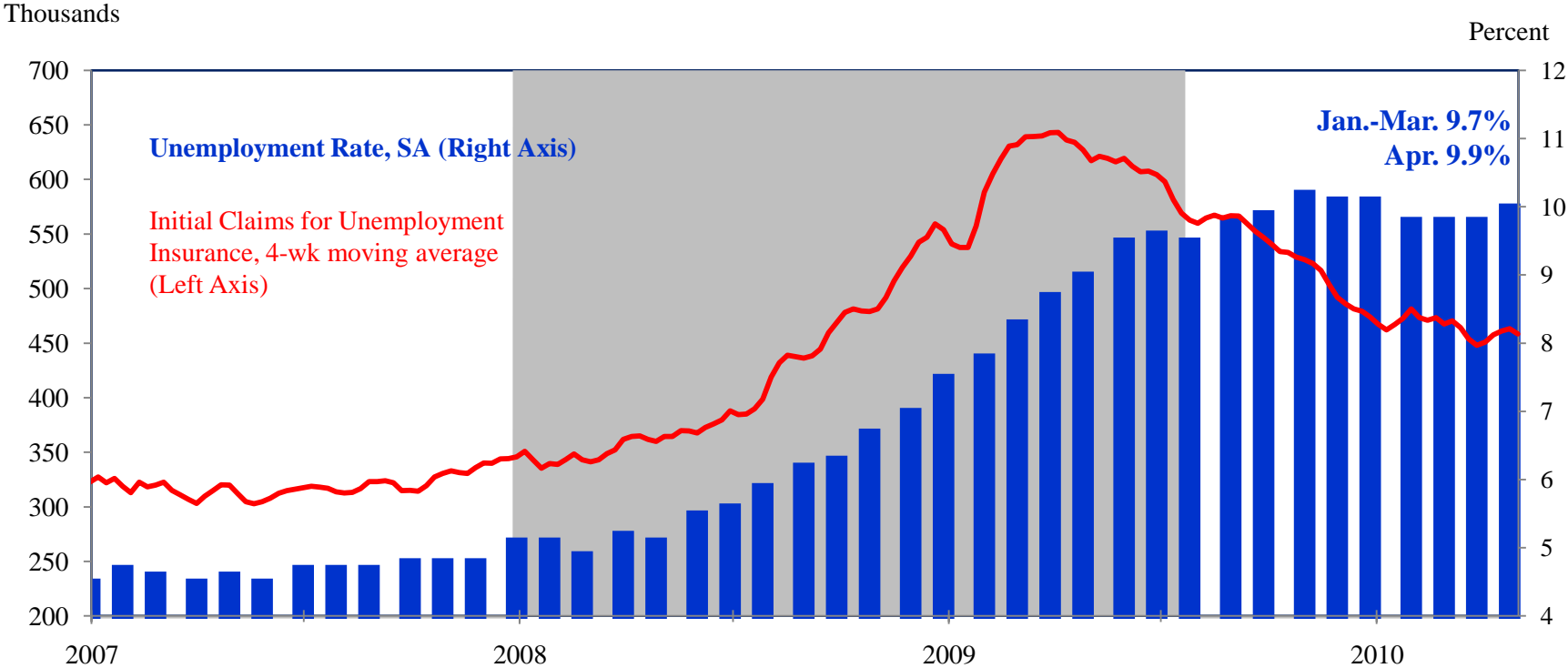
Change from previous month.

Thousands



Unemployment remains high

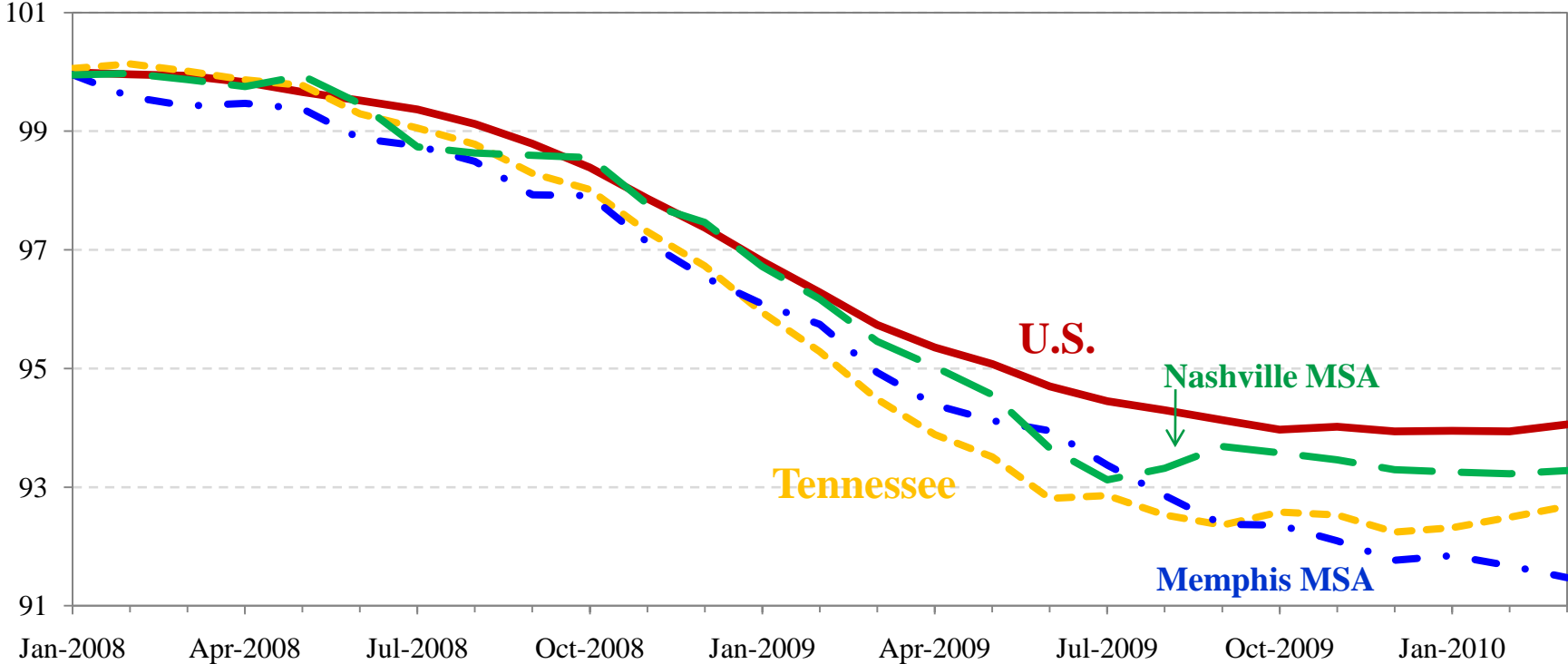
Unemployment and Initial Claims



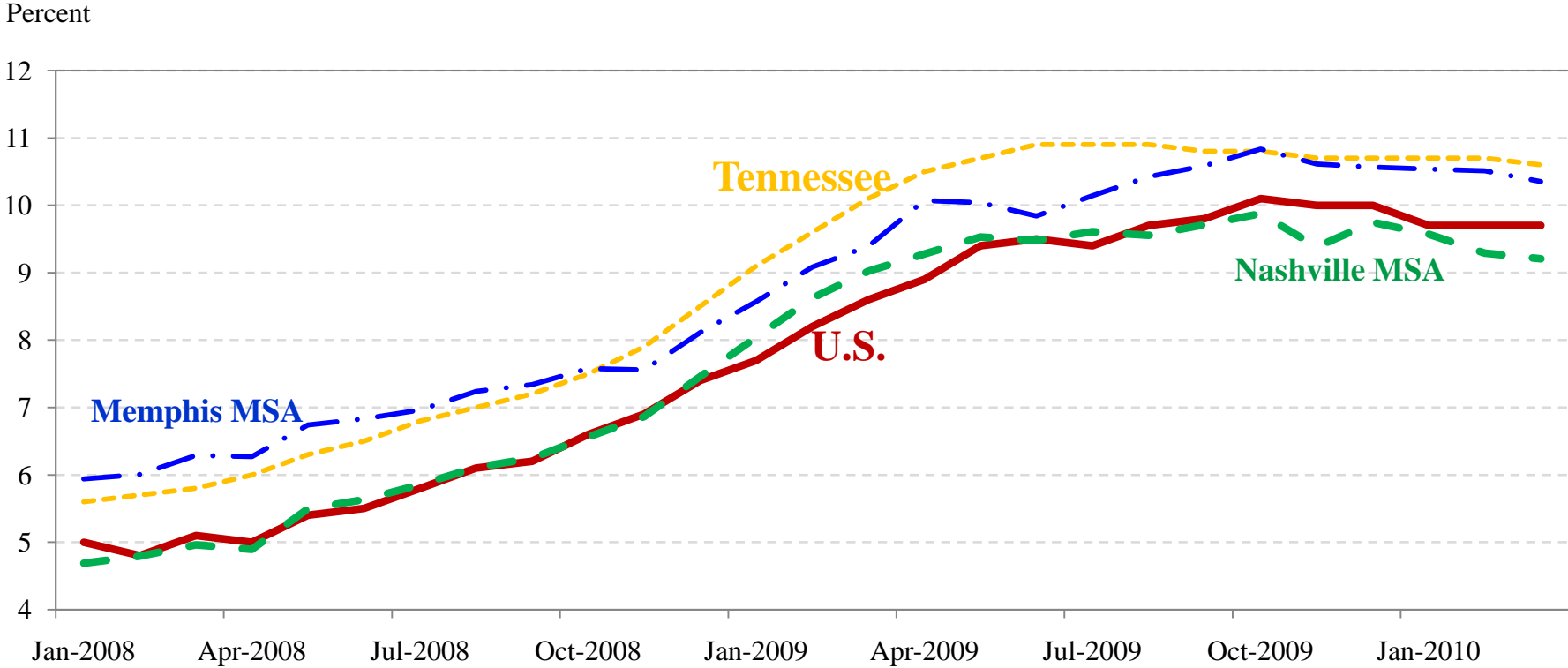
Tennessee's Economy

Payroll employment during the recession

Dec. 2007=100

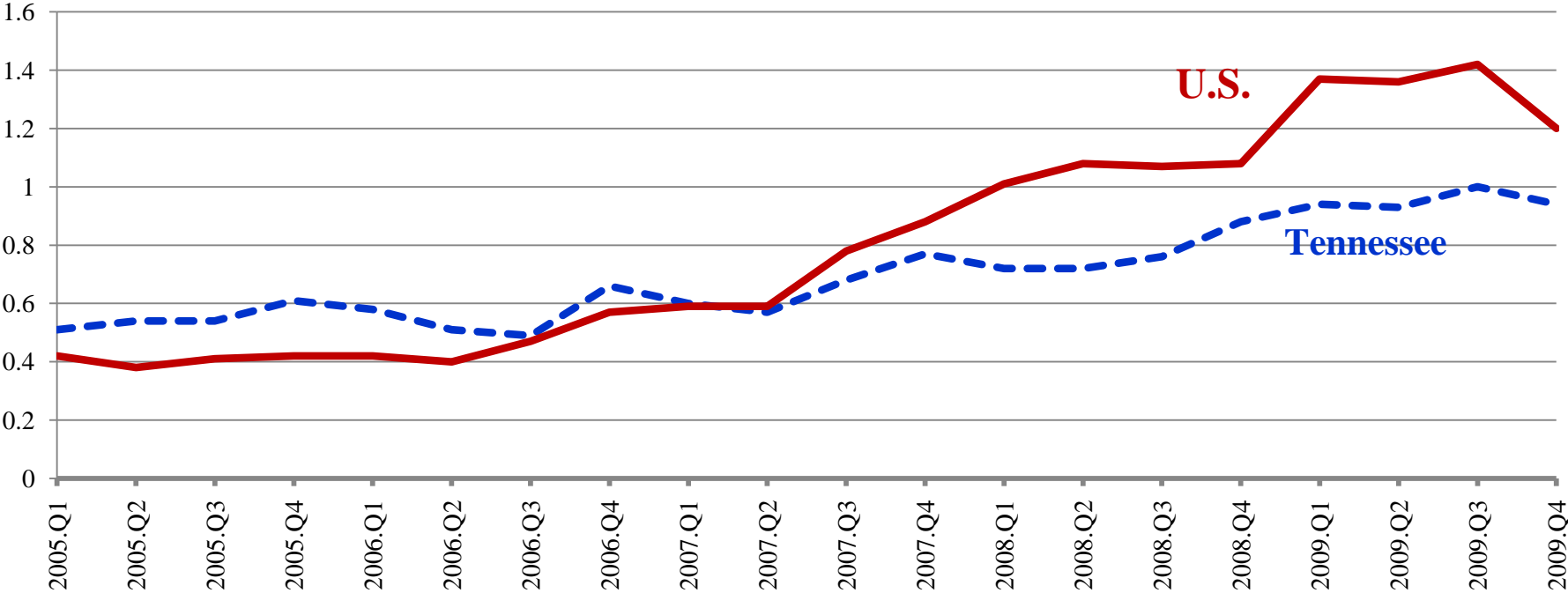


Unemployment rate



Foreclosure trends

Foreclosure Rate
(% of Mortgages in Foreclosure)

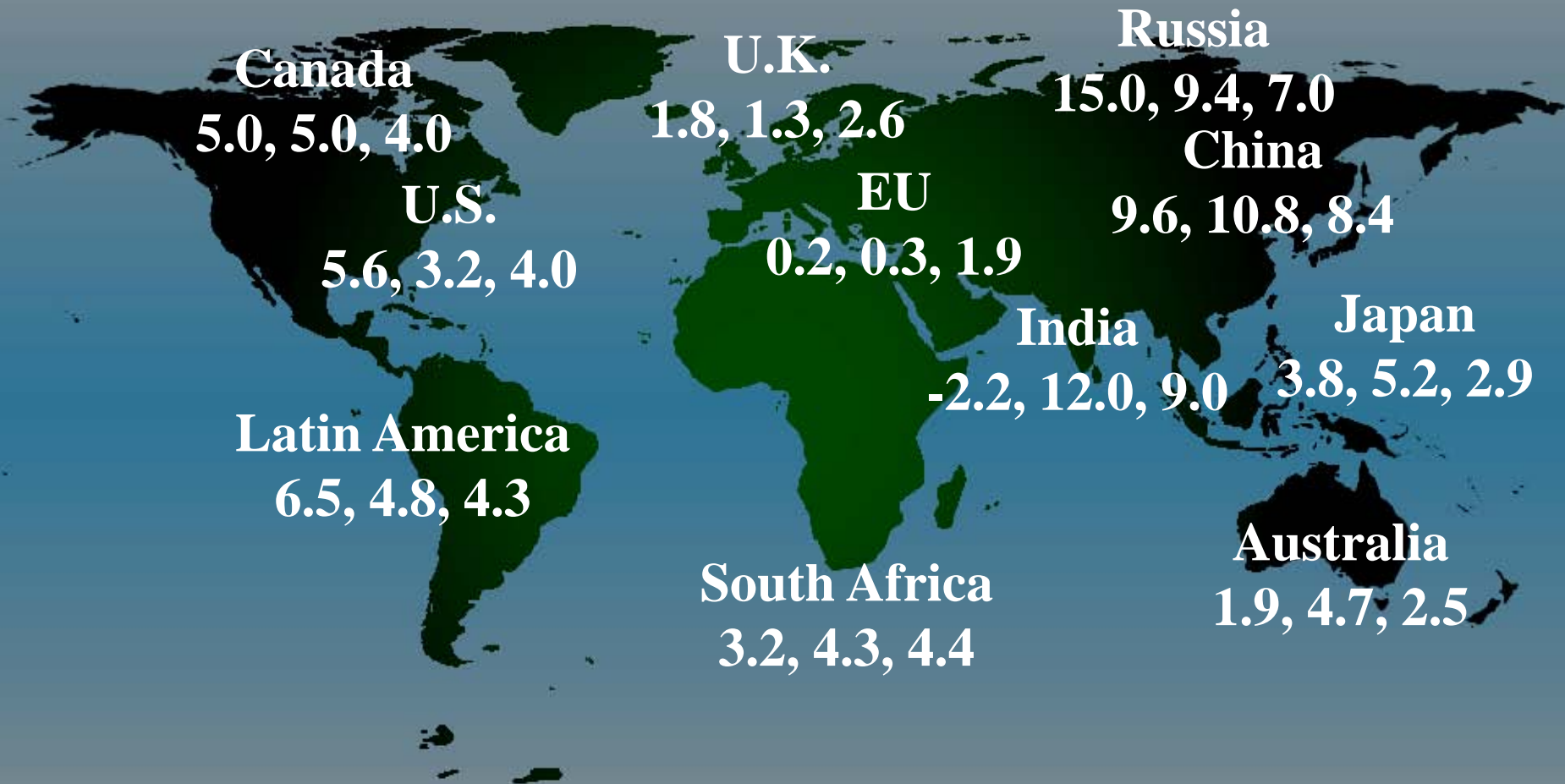


Tennessee's fiscal picture

	2007 Mill. of \$	2008 Mill. of \$ (Prev. year % ch.)	2009 Mill. of \$ (Prev. year % ch.)	% Change 2007-2009
Corporate Income Taxes (Tenn.)	1,067	922 (-14.6%)	847 (-8.5%)	-23.1 %
Sales Taxes (Tenn.)	6,913	6,723 (-2.8%)	6,173 (-8.5%)	-11.3%
Total Taxes (Tenn.)	11,314	11,224 (-0.8%)	10,362 (-8%)	-8.8%
Total Taxes for All States	694,320	772,612 (+10.7%)	684,562 (-12.1%)	-1.4%

The Global Economy

Global growth



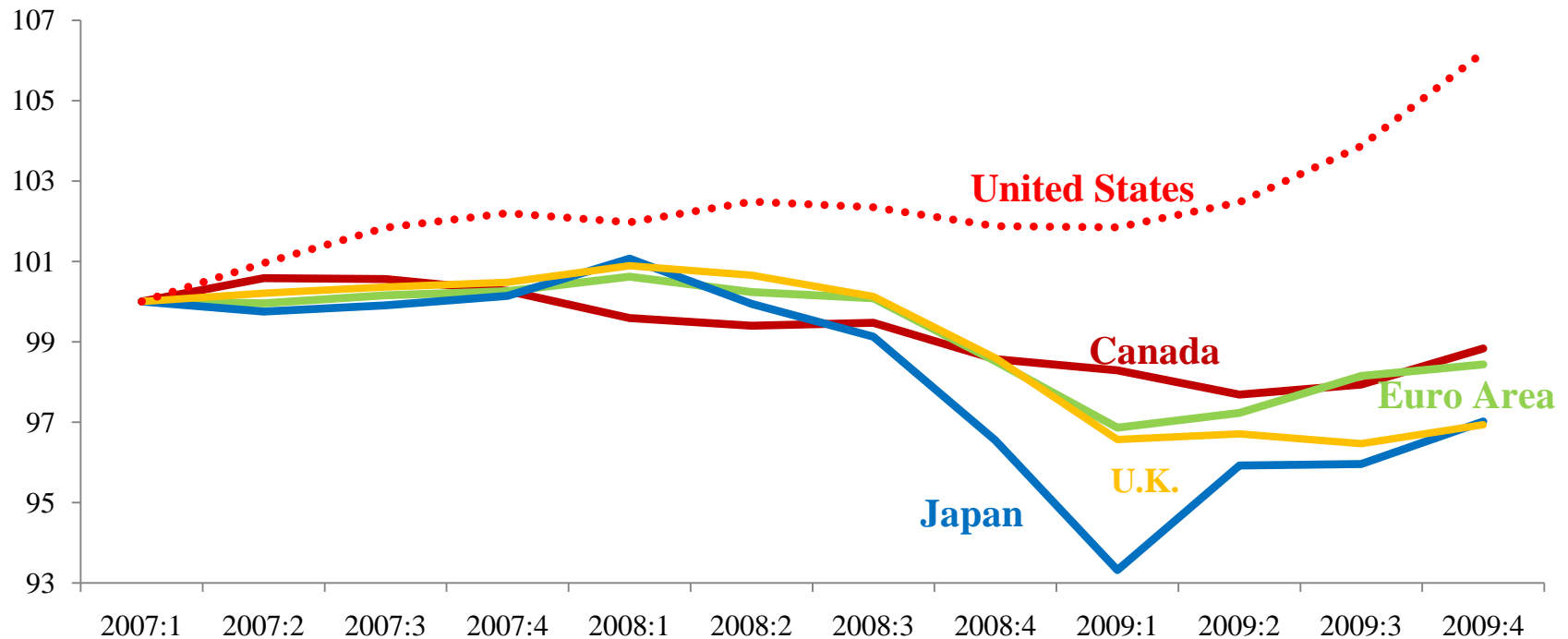
Real GDP growth, SAAR, Percent, 2009:Q4, 2010:Q1, and 2010:Q2

Source: Barclays Capital Global Economic Weekly.

U.S. leads major partners in productivity

Output per Employed Person

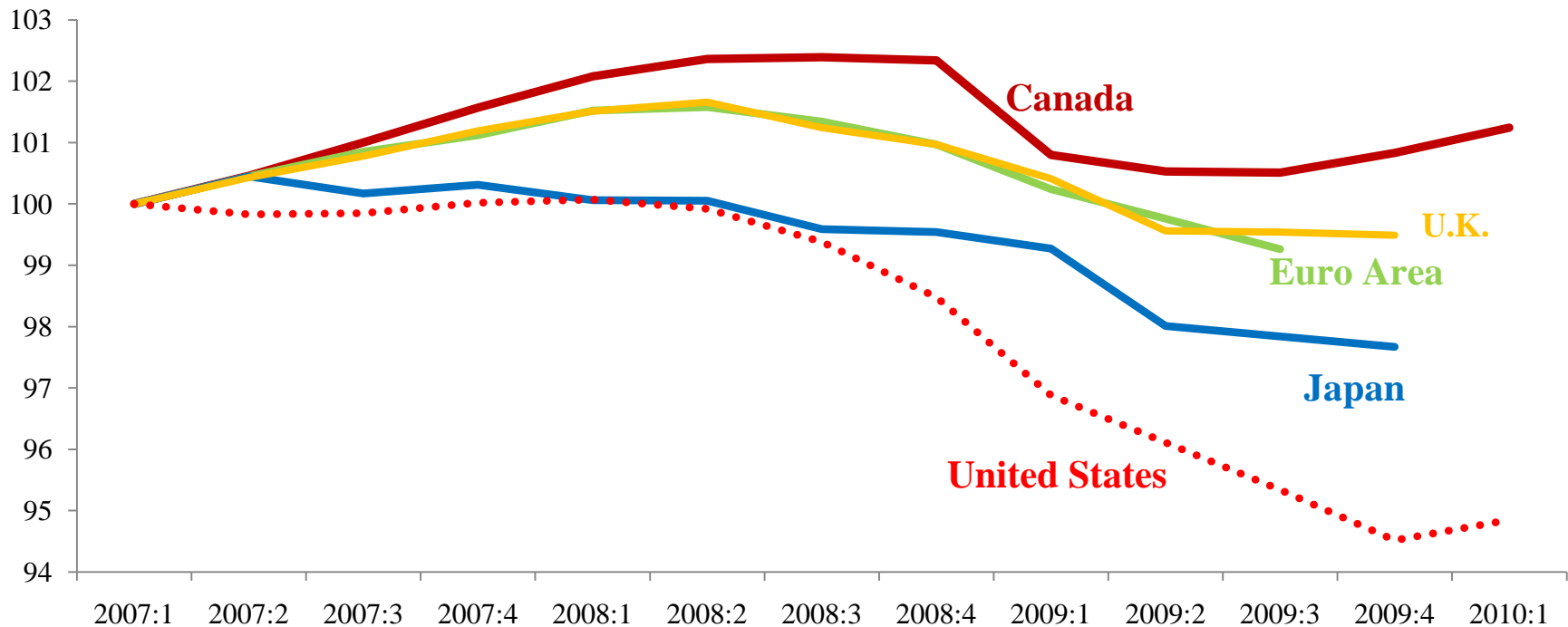
Index, 2007:Q1 = 100



But the U.S. shed a larger percentage of the workforce

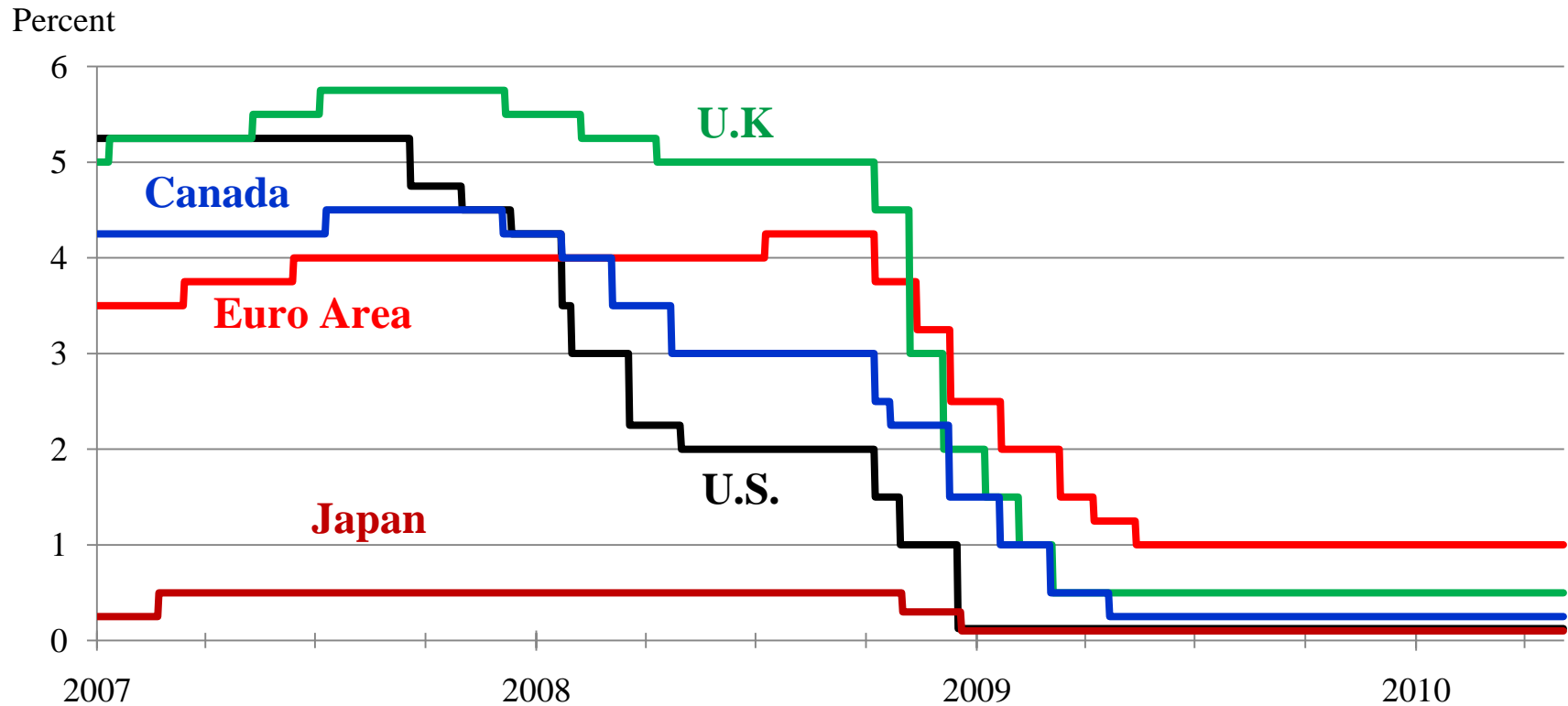
Employment

Index, 2007:Q1 = 100

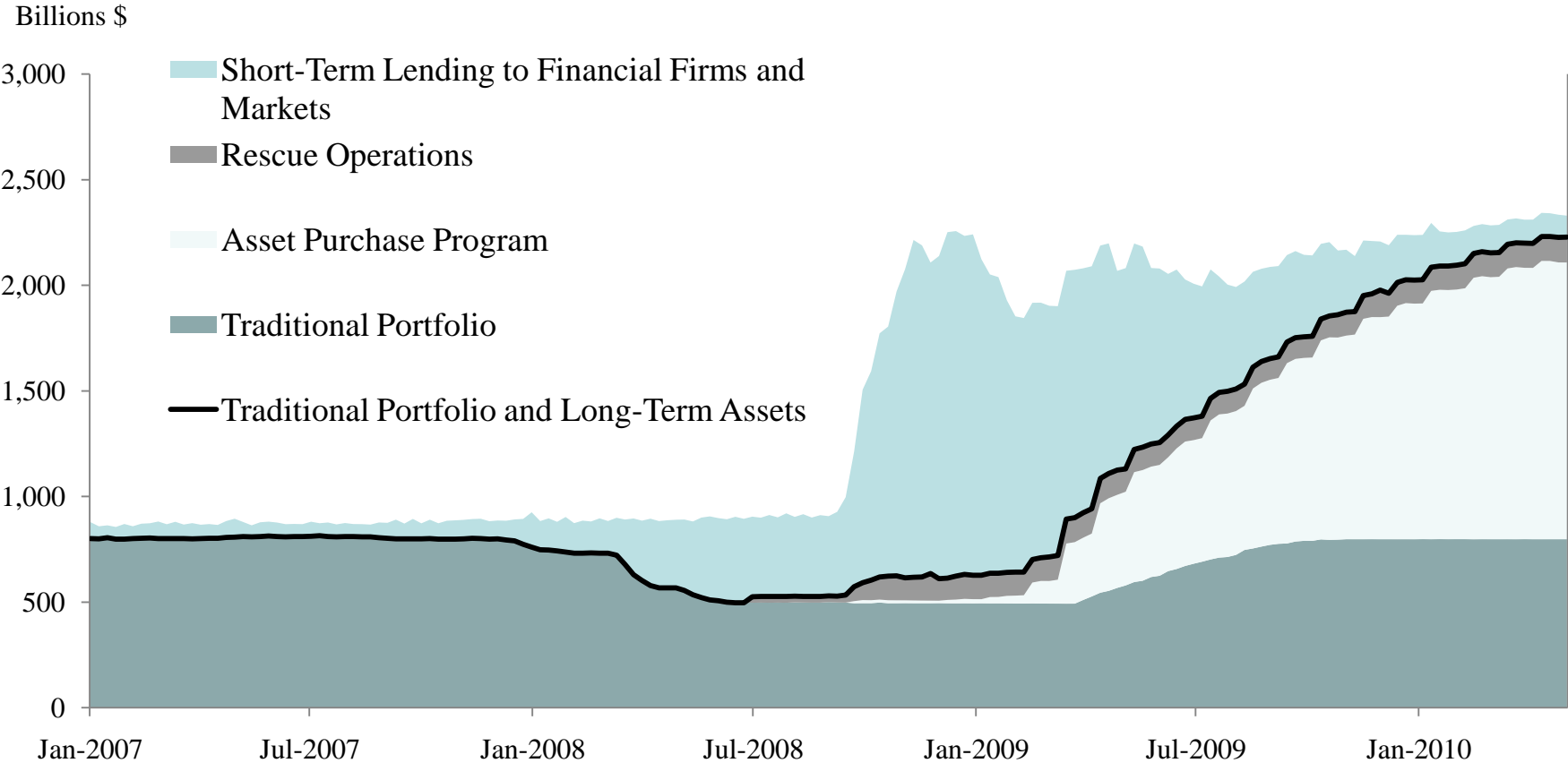


Monetary Policy

Near-zero policy rates in the G-7



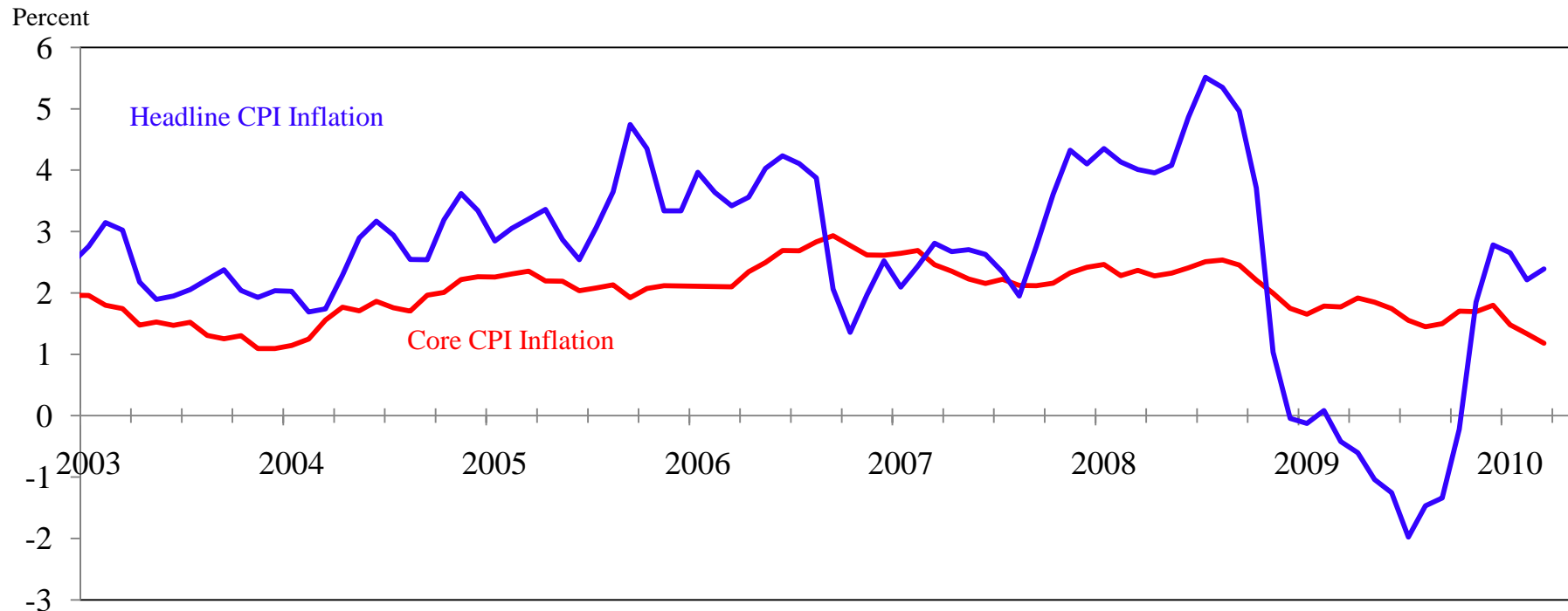
Federal Reserve balance sheet



Inflation remains low

Headline CPI Inflation and Core CPI Inflation

(Year-over-year percent change. Monthly data. Last observation: March 2010.)

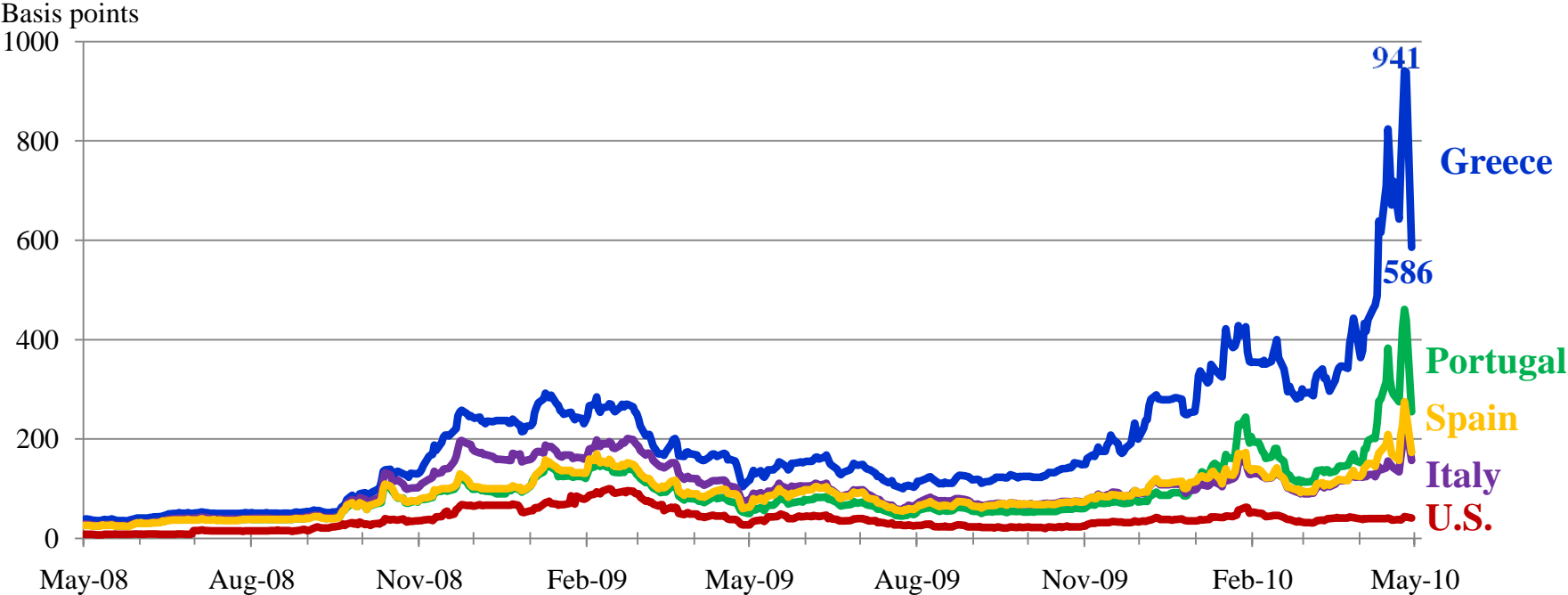


Risks to the Outlook

Sovereign credit protection

Five Year CDS

Daily, Last Observation is May 10, 2010



Flight to safety

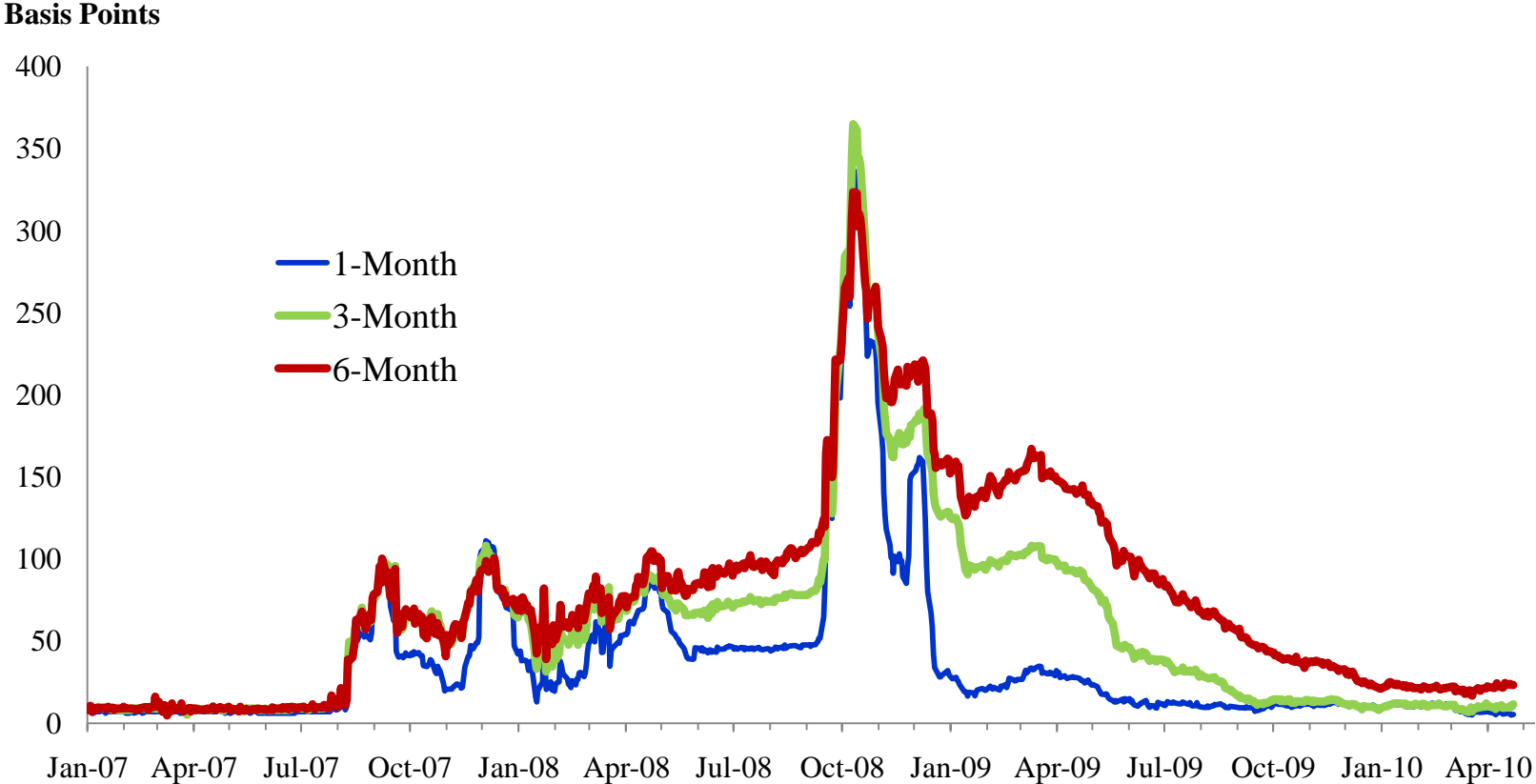
10-Year Treasury Note Yield at Constant Maturity

Daily data as of May 10, 2010

Average, % p. a.



LIBOR-OIS spread



U.S. state debt burdens

Debt Ratios of the 10 Most Populous States Ranked by Ratio of Debt to Personal Income

State	Moody's / S&P/ Fitch	Debt to Personal Income	Debt per Capita
Texas	Aa1/AA+/AA+	1.4%	\$520
Michigan	Aa3/AA-/A+	2.2%	\$766
Pennsylvania	Aa2/AA/AA	2.5%	\$950
Ohio	Aa2/AA+/AA	2.8%	\$962
Florida	Aa1/AAA/AA+	2.9%	\$1,115
Georgia	Aaa/AAA/AAA	3.0%	\$984
California	Baa1/A/BBB	4.4%	\$1,805
Illinois	A1/AA-/A	4.6%	\$1,877
New York	Aa3/AA/AA-	6.3%	\$2,921
New Jersey	Aa3/AA/AA-	7.3%	\$3,621

Financial Regulatory Reform

Community banks

- Regulation works well for the thousands of community banks in the U.S.
- The system features deposit insurance plus prudential regulation.
- The system allows failure—capitalism at work—but prevents bank runs and the associated panic.
- Community banks did not cause the crisis and do not need to be re-regulated.

The Fed and community bank regulation

- Some regulatory proposals would have created a “Wall Street only” Fed.
- The Fed should remain involved with community bank regulation so that it has a view of the entire financial landscape.
 - It is important that the Fed does not become biased toward the very large, mostly New York-based institutions.
- Community banks tend to fund smaller businesses, an important source of job growth for the economy.
- Understanding this process helps the Fed make sound monetary policy decisions.

Fed structure

- The Federal Reserve has three parts.
 - Washington: Board of Governors.
 - New York: One bank in the nation's financial capital.
 - Main Street: Eleven banks in the rest of the nation.
- The regional structure was designed to keep some power out of New York and Washington.
- It allows for input on key policy questions from around the U.S.
- This system has been very successful.

Fed governance

- The Board of Governors members are appointed by the President and confirmed by the U.S. Senate.
- The Board of Governors has oversight authority for the Fed.
- This includes budget authority.
- It also includes authority over key appointments in the Fed.
 - This means Presidents, First Vice-Presidents, as well as the Chair and Vice-Chair of the Board of Directors at each Reserve Bank.
- There is considerable accountability in the Roosevelt-era re-design of the Federal Reserve.

Auditing monetary policy

- Monetary policy is vigorously debated every day, both inside and outside the Fed.
- The Fed is extensively audited—our rough estimate is about 425,000 hours annually:
 - Internal audit function.
 - Board of Governors oversight.
 - External auditor (Deloitte).
- Each hour of audit time requires staff time for compliance.
- In addition, the Fed is subject to auditing by the GAO, the investigative arm of Congress.
- Additional audits are welcome, so long as they do not constitute political meddling.

Federal Reserve independence

- Allowing short-term politics to mix too closely with monetary policy leads to poor economic outcomes.
- This has occurred frequently in the developing world over the past 50 years.
- In the U.S., erosion of Fed independence could result in a 1970s-style period of volatility.
- The consequences for the U.S. and the global economy would be large.
- No one would be served well by this outcome.



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Federal Reserve Economic Data (FRED)
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