The First Phase of the U.S. Recovery and Beyond

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

Plan For This Talk

- The Nascent Global Recovery
- The U.S. Recovery
- U.S. Financial Markets and Inflation
- Monetary Policy
- Asset price bubbles

The Nascent Global Recovery

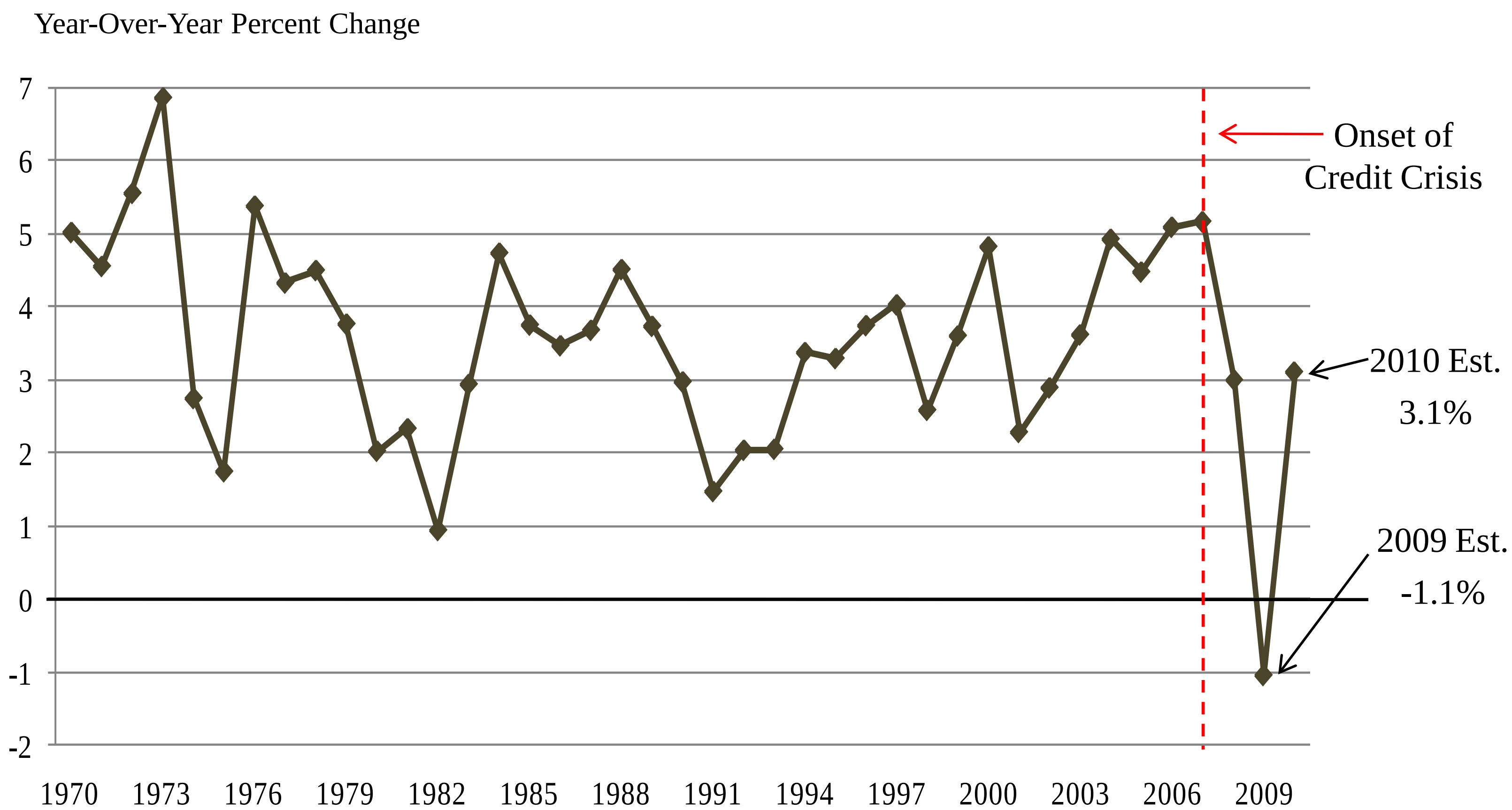
Global Growth is Improving

Growth Rate in Real GDP, SAAR, Percent

2009:Q3, 2009:Q4,2010:Q1

Source: Barclays Capital Global Economic Weekly.

World Real GDP Growth



Source: IMF World Economic Outlook , October 2009.

IMF Growth Forecasts for 2010

	2007	2008	2009	2010
World Output	5.2	3.0	-1.1	3.1
G-7 Economies				
United States	2.1	0.4	-2.7	1.5
Germany	2.5	1.2	-5.3	0.3
France	2.3	0.3	-2.4	0.9
Italy	1.6	-1.0	-5.1	0.2
United Kingdom	2.6	0.7	-4.4	0.9
Japan	2.3	-0.7	-5.4	1.7
Canada	2.5	0.4	-2.5	2.1
BRIC Economies				
Russia	8.1	5.6	-7.5	1.5
China	13.0	9.0	8.5	9.0
India	9.3	7.3	5.4	6.4
Brazil	5.7	5.1	-0.7	3.5

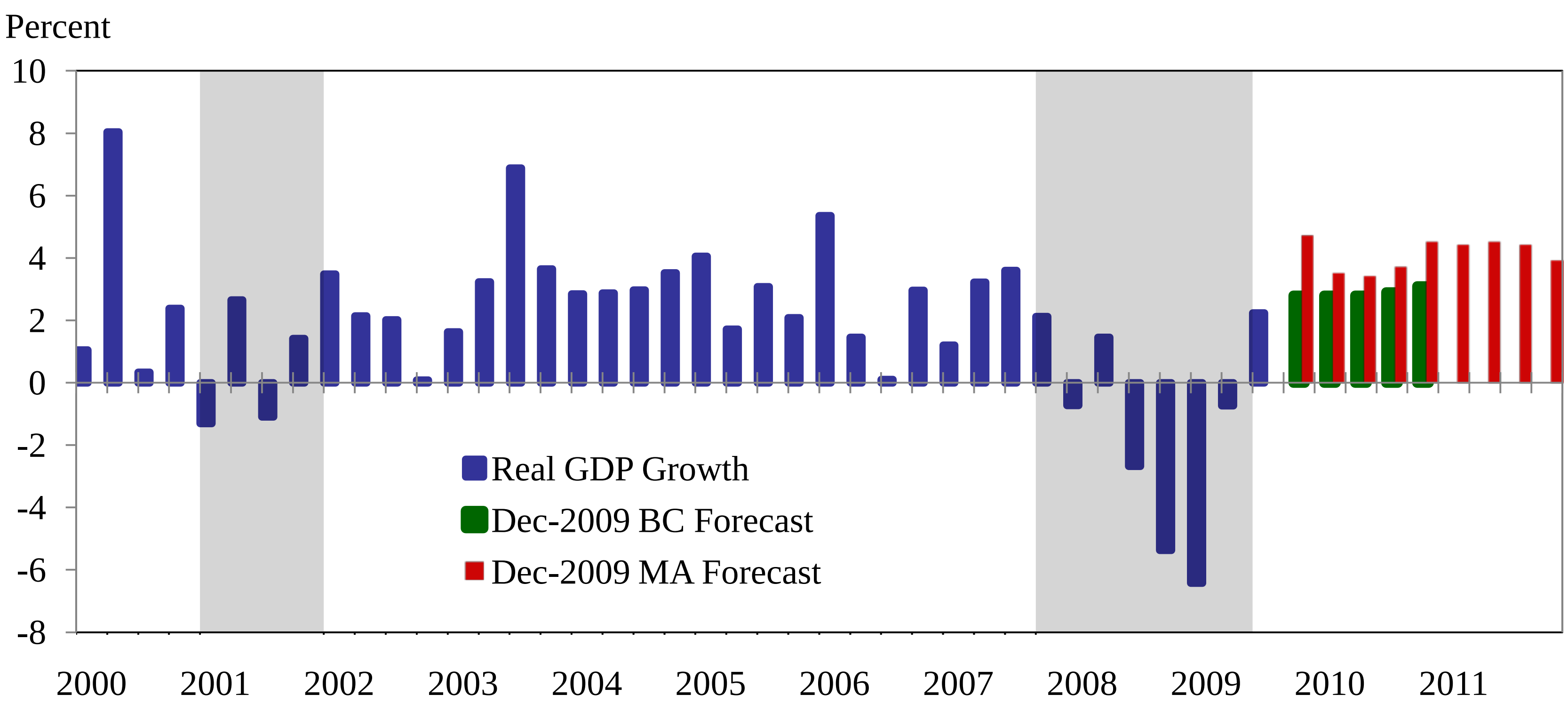
Source: IMF World Economic Outlook Database, October 2009. (Year-over-Year Percent Change.)

The U.S. Recovery

U.S. Forecasters: Growth Ahead

Real Gross Domestic Product.

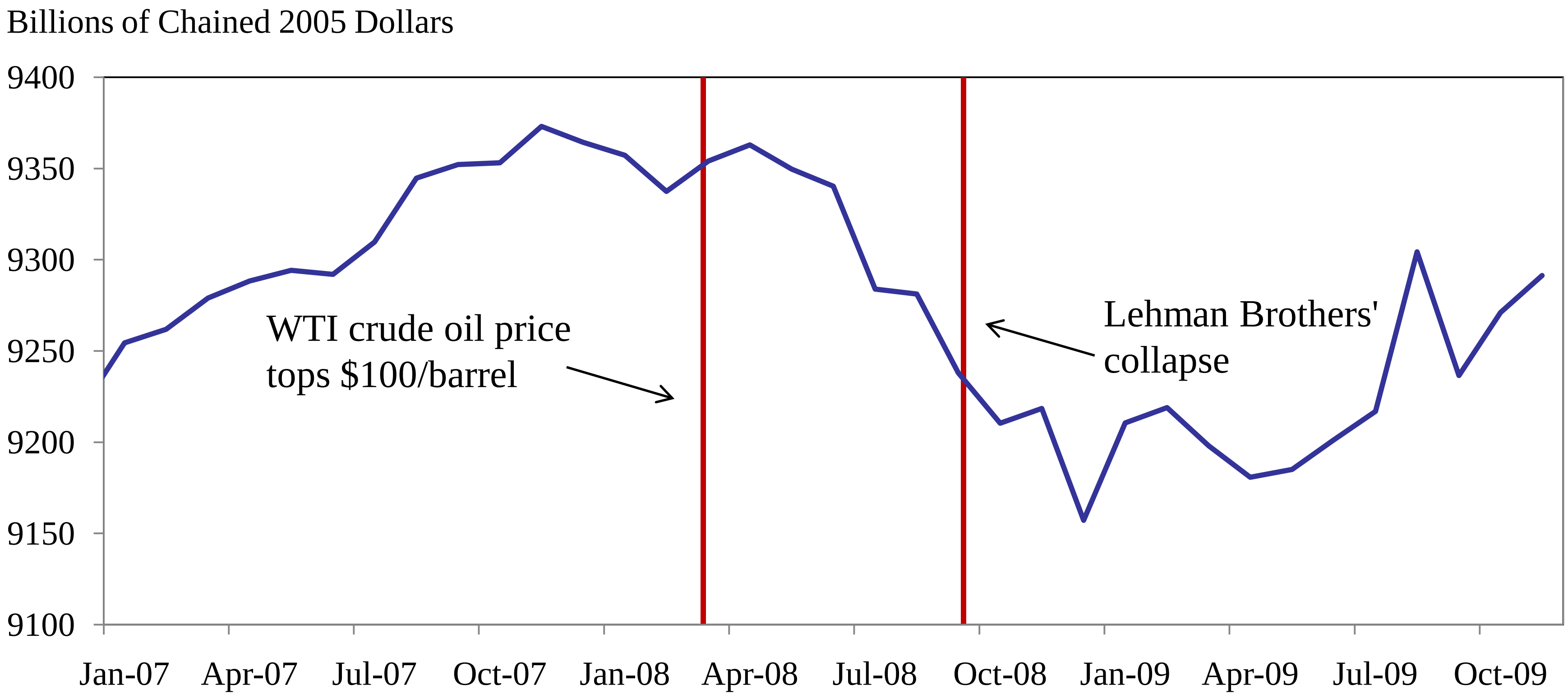
Actual and forecasted, percent change from previous quarter at annual rate.



Source: Bureau of Economic Analysis, Blue Chip Consensus, Macroeconomic Advisers.

U.S. Consumption Is Stabilizing

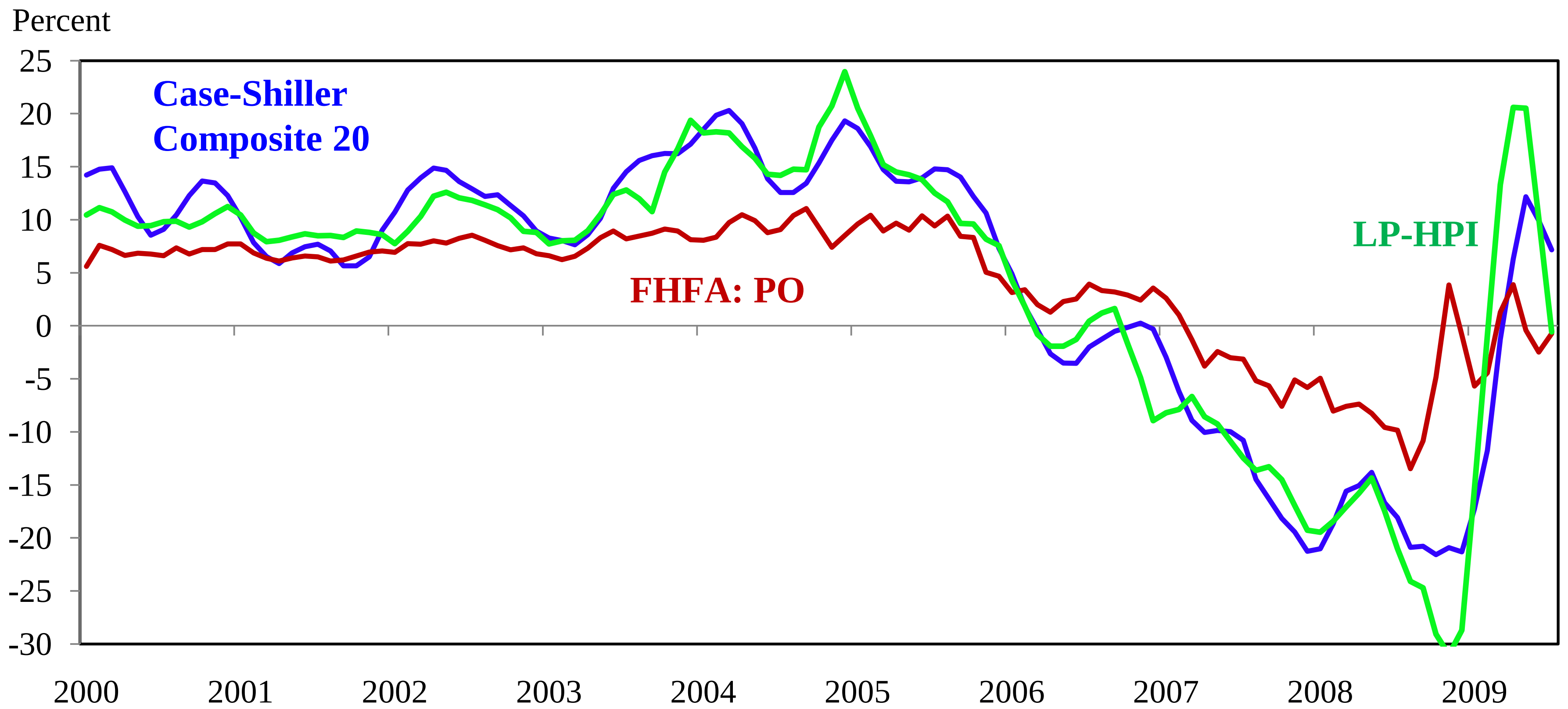
Real Personal Consumption Expenditures
(Monthly Data. Last observation: Nov. 2009)



Source: Bureau of Economic Analysis.

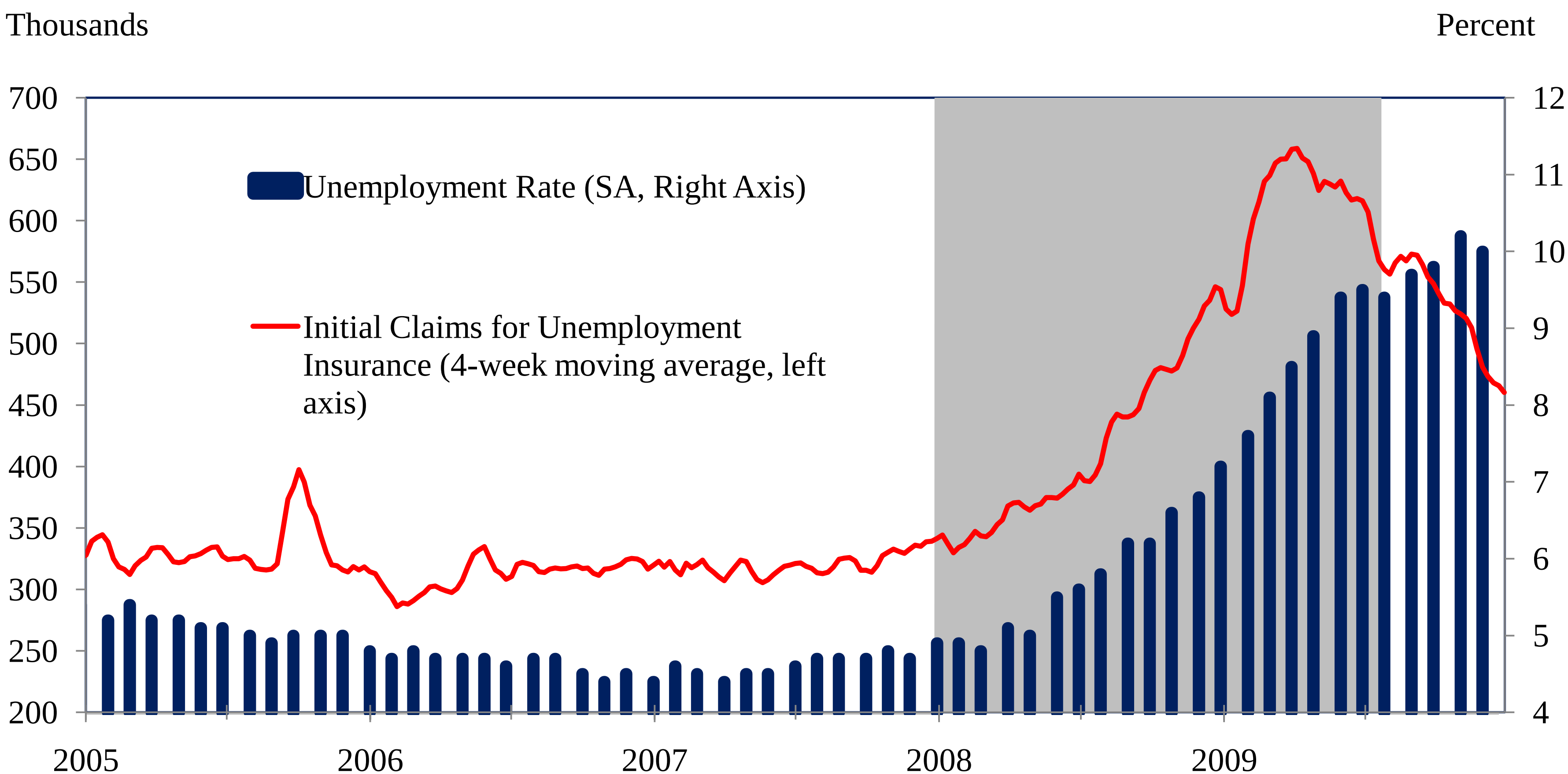
U.S. House Prices Are Stabilizing

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



Source: Loan Performance/FHFA/S&P.

U.S. Civilian Unemployment Remains High…



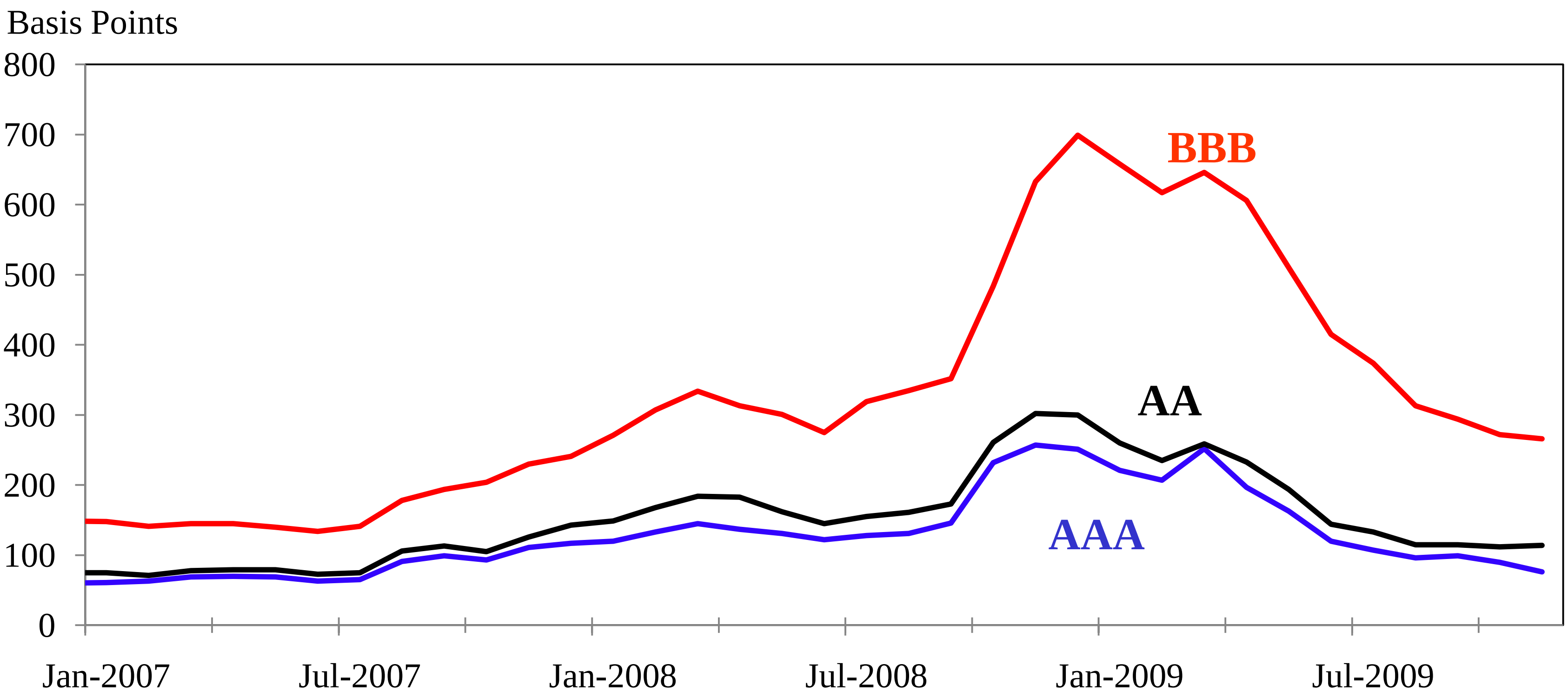
Source: Bureau of Labor Statistics/Department of Labor.

U.S. Financial Markets and Inflation

U.S. Credit Spreads Have Narrowed

Bond Spreads to 10-Yr Treasury

(Monthly data. Last Observation: Nov. 2009)



Source: Federal Reserve.

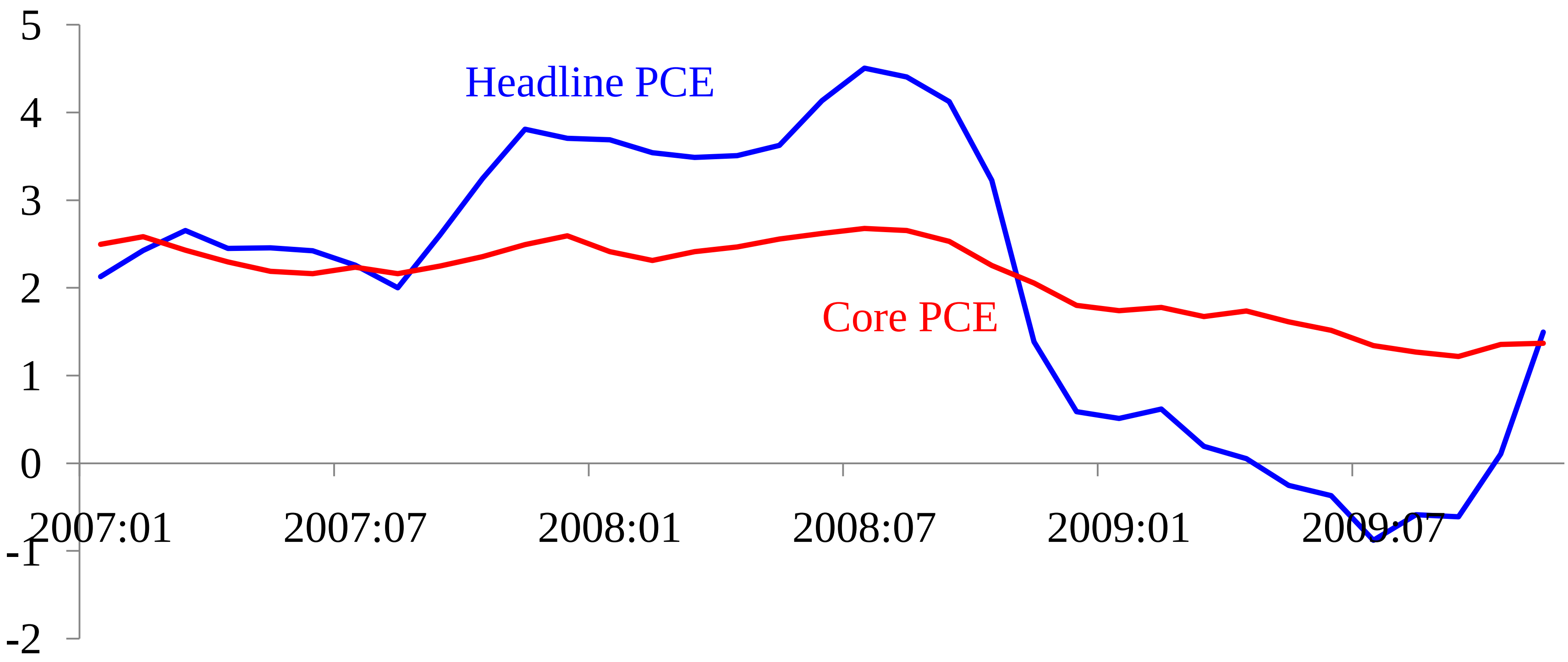
World Equity Prices Since Trough

Country	Peak Date	Trough Date	Peak-Trough % Change	Trough-12/30/2009 % Change
G7 Economies				
U.S.	Oct. 09, 2007	Mar. 09, 2009	-54%	61%
Germany	Jul. 16, 2007	Mar. 06, 2009	-55%	62%
France	Jun. 01, 2007	Mar. 09, 2009	-59%	56%
Italy	May. 2, 2007	Mar. 03, 2009	-63%	59%
U.K.	Jun. 15, 2007	Mar. 03, 2009	-49%	55%
Japan	Jul. 09, 2007	Mar. 10, 2009	-61%	49%
Canada	Jun. 18, 2008	Mar. 09, 2009	-50%	55%
BRIC Economies				
Russia	May 19, 2008	Jan. 23, 2009	-80%	188%
China	Oct. 16, 2007	Oct. 27, 2008	-72%	101%
India	Jan. 08, 2008	Mar. 11, 2009	-61%	113%
Brazil	May 20, 2008	Oct. 27, 2008	-60%	133%

Source: Wall Street Journal, Financial Times, Toronto Stock Exchange, and RTS Stock Exchange.

U.S. Inflation Remains Low…

PCE Inflation
Year-over-year percent change



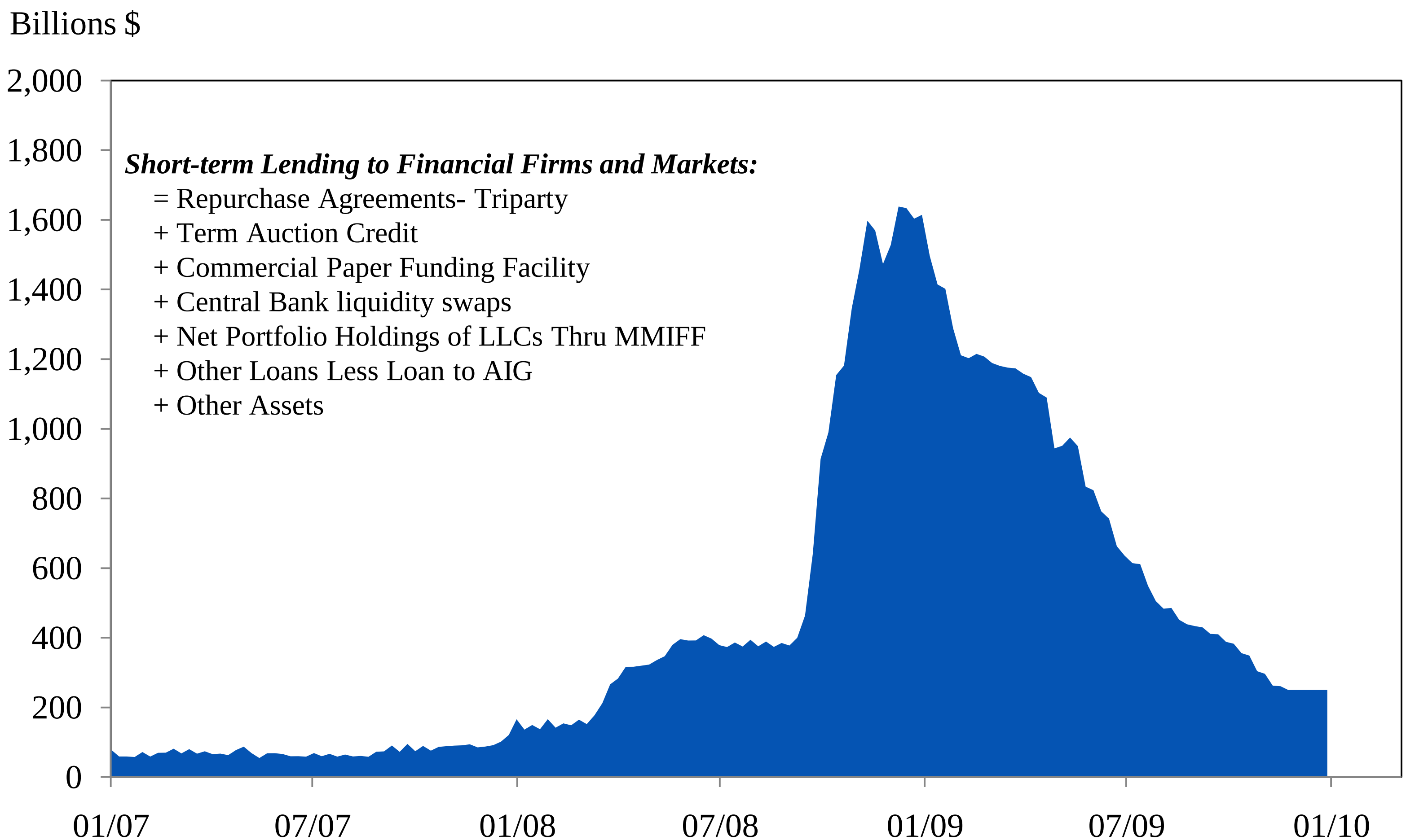
Source: Bureau of Economic Analysis/Macroeconomic Advisers.

Monetary Policy

Three Parts to U.S. Current Monetary Policy

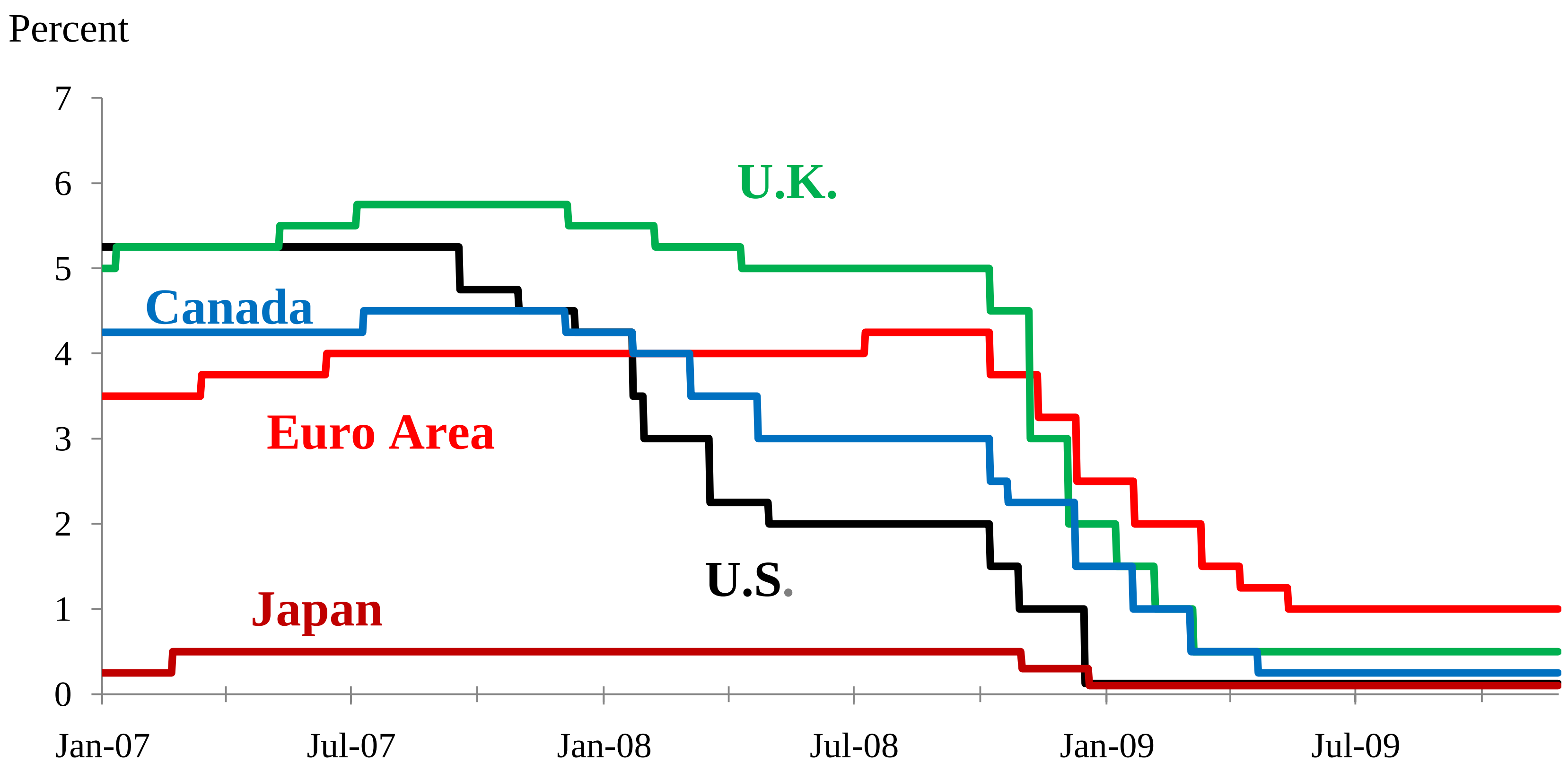
- Liquidity programs: lending on collateral to mitigate the panic.
- A near-zero interest rate policy.
- An asset purchase program, "quantitative easing."

U.S. Liquidity Programs Naturally Tapering Off



Source: Federal Reserve.

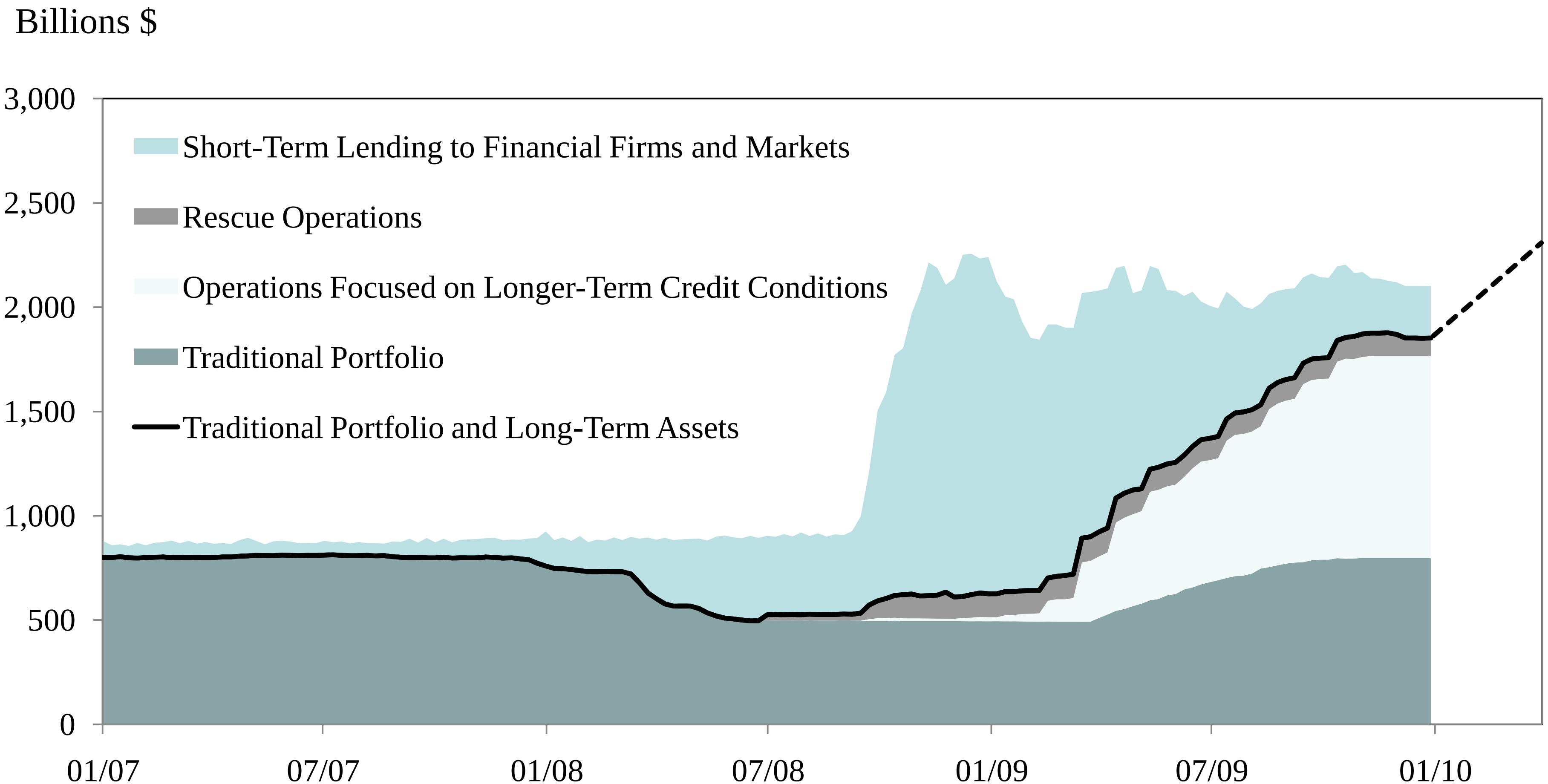
Near-Zero Policy Rates in the G-7



Source: Federal Reserve, Bank of England, European Central Bank, Bank of Canada, Bank of Japan.

Composition of Federal Reserve Assets

(Weekly Data. Last Observation: Dec. 30, 2009)

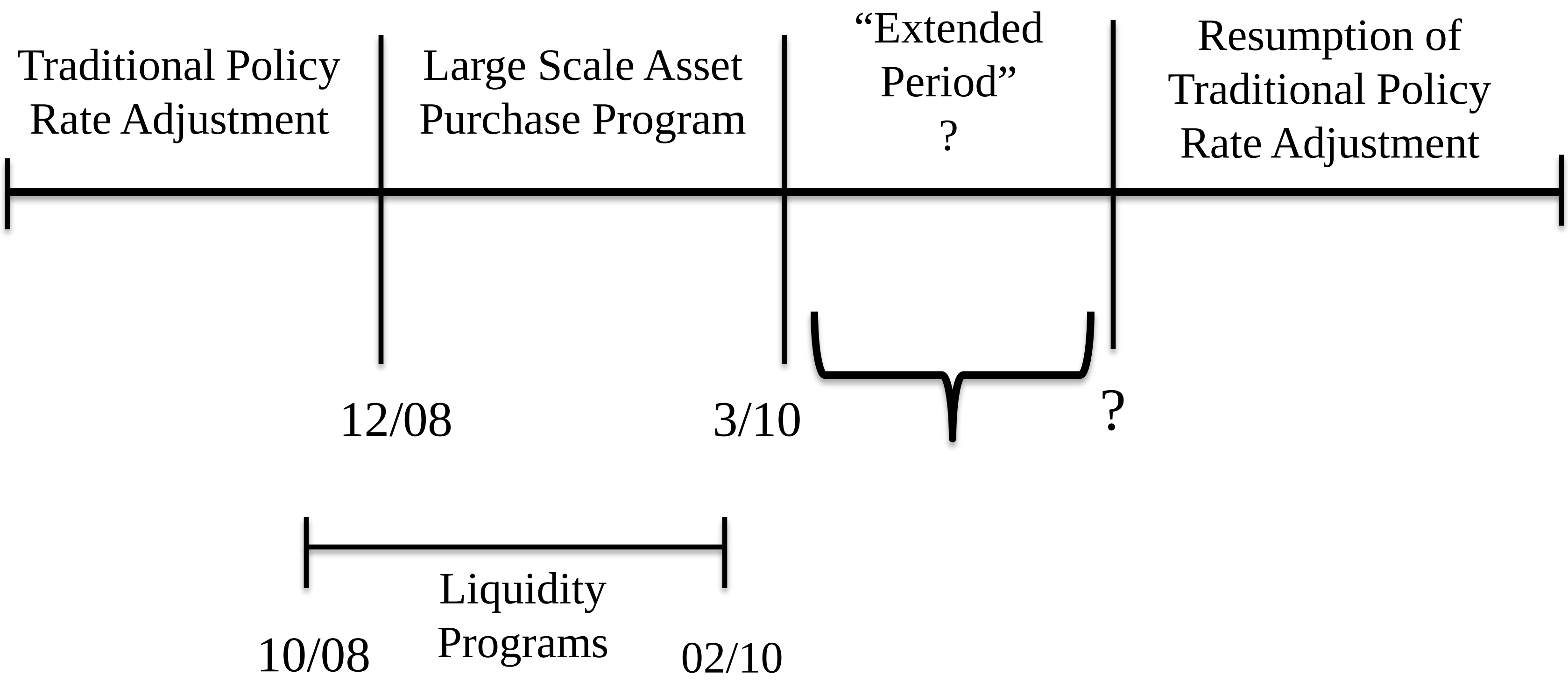


Source: Federal Reserve.

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?

Timeline of Monetary Policy

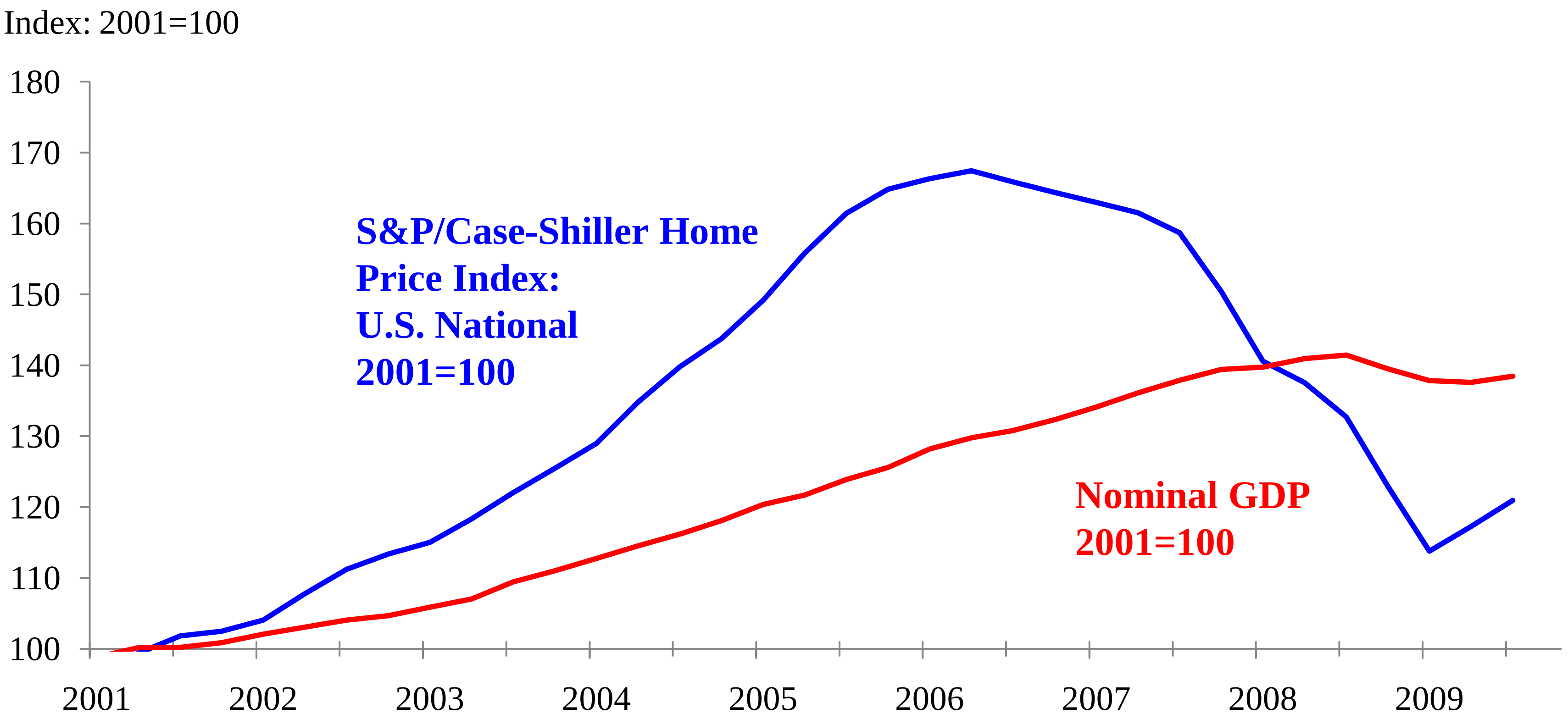


Asset Price Bubbles

Two decades, two "bubbles"

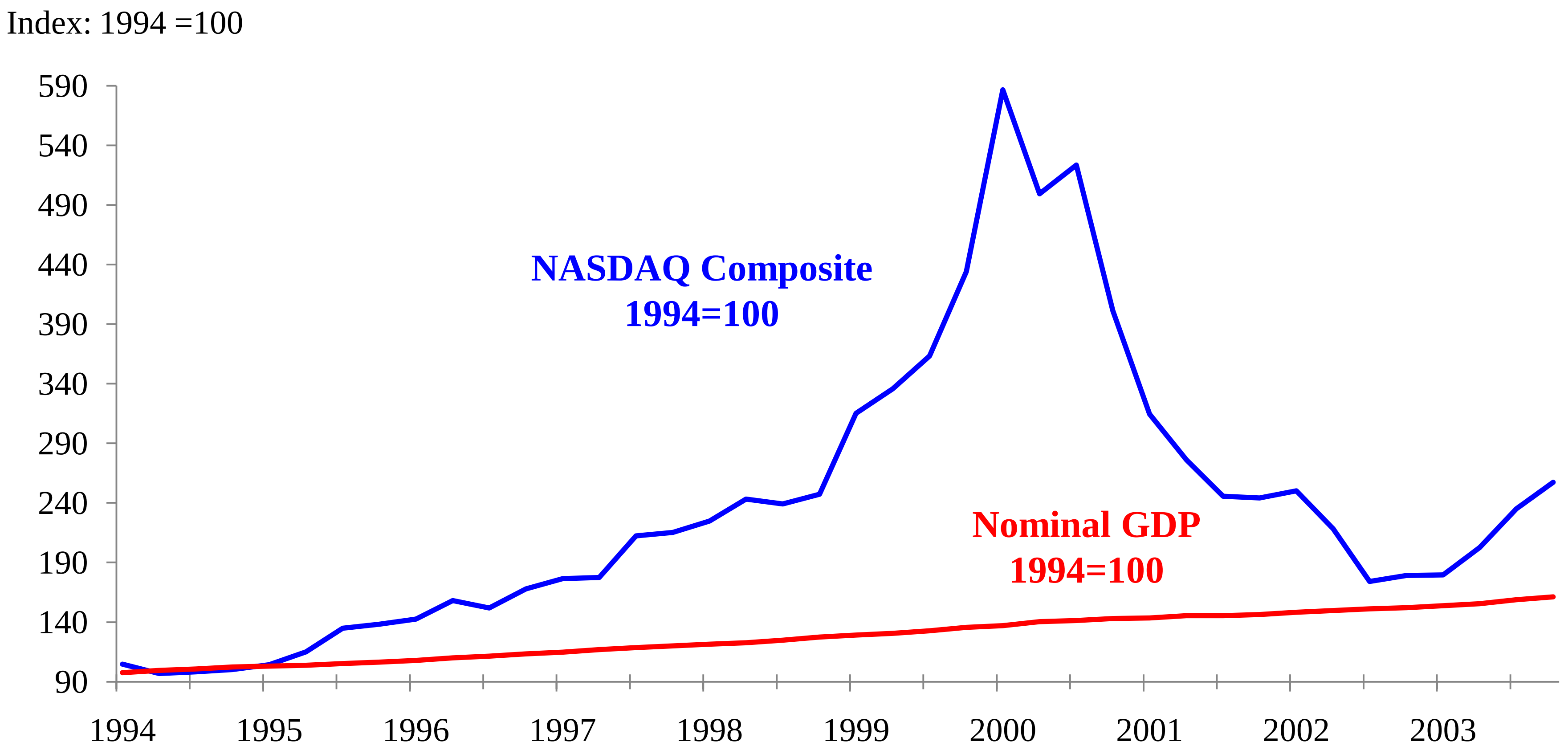
- Monetary policy necessarily affects asset prices and interest rates.
- Historically, this did not appear to create prolonged run-ups in asset prices.
- But changes in the recovery of employment in the past two recessions led the Fed to keep interest rates low for a long time.
- Both periods featured prolonged increases in certain asset prices: for technology in the 1990s, and for housing in the 2000s.
- The drag on the economy from the housing decline since 2006 has been especially severe.

U.S. Housing Bubble: 2001-2008



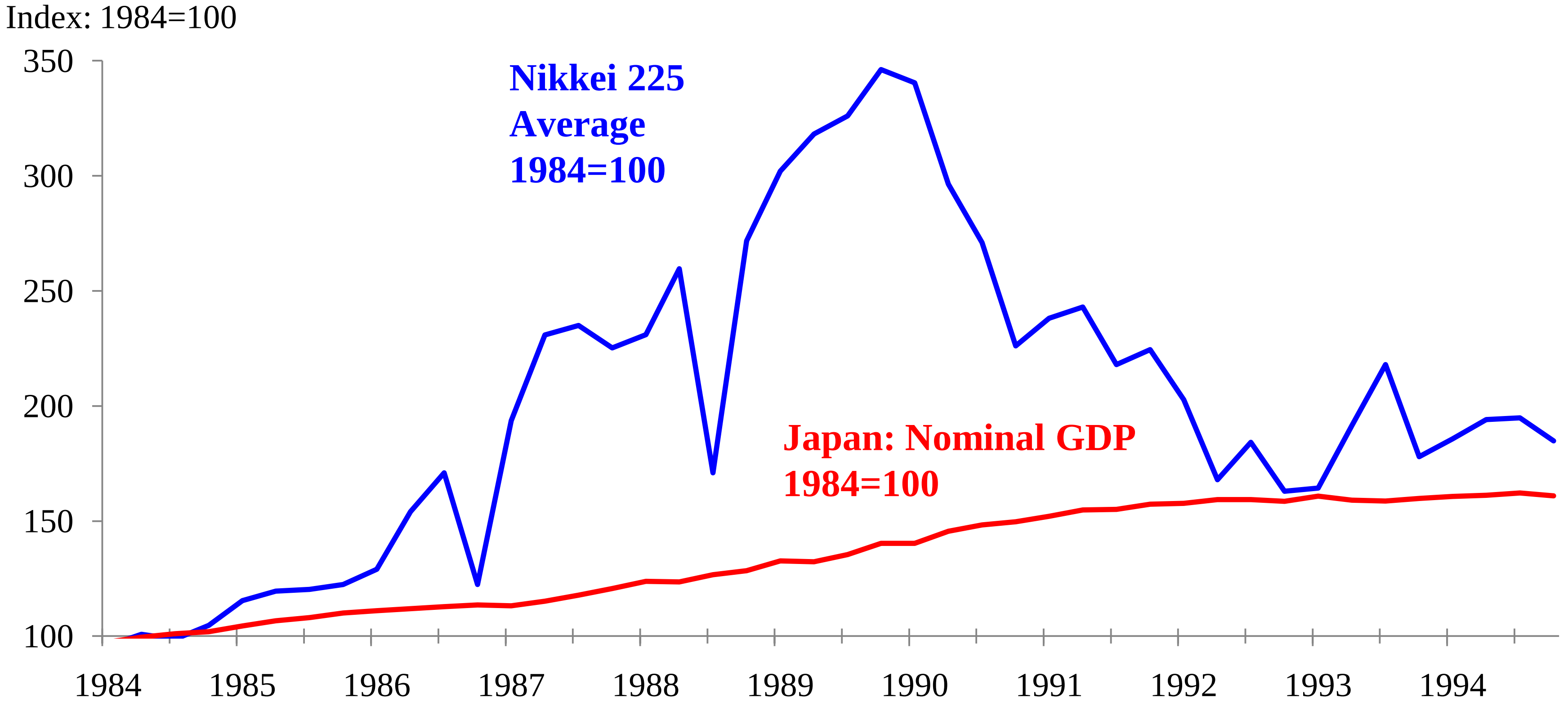
Source: S&P, Fiserv, MacroMarkets LLC, and Bureau of Economic Analysis.

U.S. Stock Market Bubble: 1994-2003



Source: Wall Street Journal, Bureau of Economic Analysis.

Japanese Stock Market Bubble: 1984-1994



Source: Wall Street Journal, Financial Times, IMF.

Monetary policy outcomes

- Still, monetary policy outcomes during the past two decades up to the current crisis have been good.
- Unemployment hit lows of 3.8 percent in 2000, and 4.4 percent in 2007.
- Inflation has been low and stable through this period.
- If policy was too low for too long in the 1990s and in the 2000s, why didn't we see more inflation?
- Yet, without an increase in inflation, asset price misalignments seem to have caused significant problems for the macroeconomy.
- This may mean that monetary policy should put more weight on asset prices going forward.

Summary for Asset Price Bubbles

- Asset price "bubbles" are a very serious issue for monetary policy.
- This issue has been debated extensively over the past 15 years, but the debate will now intensify.
- The main problem: It is hard to see what was “wrong” with previous policy, given conventional ideas about what policy is trying to accomplish.

Federal Reserve Bank of St. Louis

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Federal Reserve Economic Data (FRED)

research.stlouisfed.org/fred2/

James Bullard

research.stlouisfed.org/econ/bullard/