The First Phase of the U.S. Recovery

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President and CEO
Federal Reserve Bank of St. Louis

Commerce Bank Economic Breakfast
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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
Forecastsers See 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.
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

Growth Rate in Real GDP, SAAR, Percent

Source: Barclays Capital Global Economic Weekly.

India
8.0, 9.5, 9.0

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

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

South Africa
-3.0, 0.0, 2.2
Manufacturing Around The Globe Is Improving

Source: Financial Times and Thomson Reuters Datastream.
U.S. Consumption Is Stabilizing

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

Billions of Chained 2005 Dollars

Source: Bureau of Economic Analysis.

WTI crude oil price tops $100/barrel
Lehman Brothers' collapse
House Prices Are Stabilizing

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

Percent

Case-Shiller Composite 20

FHFA: PO

LP-HPI

Source: Loan Performance/FHFA/S&P
Housing Market Begins Recovery?

Civilian Unemployment Remains High…

…But the Pace of Job Losses Has Slowed

Nonfarm Payroll Employment Growth

Thousands

7.3 Million Jobs have been lost since December 2007

Financial Markets and Inflation
Credit Spreads Have Narrowed

Bond Spreads to 10-Yr Treasury
(Monthly data. Last Observation: Oct. 2009)

Source: Federal Reserve.
Credit Default Swap Prices Are Improving

Basis Points

Source: Bloomberg.
Equity Markets Are Improving

Source: Standard and Poor’s and Wall Street Journal.
Inflation Remains Low…

PCE Inflation
3-month percentage change

Source: Bureau of Economic Analysis/Macroeconomic Advisers.
… But Inflation Uncertainty is Elevated

Source: Federal Reserve.
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

Rate (%)

Jan-07  Jul-07  Jan-08  Jul-08  Jan-09  Jul-09

U.K.  U.S.  Japan  Euro Area  Canada
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)

Billions $
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)

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<tbody>
<tr>
<td>Citigroup Inc.</td>
<td>$2,187</td>
<td>10.9%</td>
<td>10.9%</td>
<td>BHC</td>
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<tr>
<td>Bank of America Corp.</td>
<td>1,715</td>
<td>8.5</td>
<td>19.5</td>
<td>BHC</td>
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<tr>
<td>JPM Chase &amp; Co.</td>
<td>1,562</td>
<td>7.8</td>
<td>27.3</td>
<td>BHC</td>
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<tr>
<td>Goldman Sachs Grp.</td>
<td>1,119</td>
<td>5.5</td>
<td>32.9</td>
<td>BHC</td>
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<tr>
<td>AIG</td>
<td>1,060</td>
<td>5.3</td>
<td>38.2</td>
<td>Insurance</td>
</tr>
<tr>
<td>Morgan Stanley</td>
<td>1,045</td>
<td>5.2</td>
<td>43.4</td>
<td>BHC</td>
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<tr>
<td>Merrill Lynch</td>
<td>1,020</td>
<td>5.1</td>
<td>48.5</td>
<td>Inv. Bank</td>
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<tr>
<td>Fannie Mae</td>
<td>882</td>
<td>4.4</td>
<td>53.9</td>
<td>GSE</td>
</tr>
<tr>
<td>FHL Mortg.</td>
<td>794</td>
<td>3.9</td>
<td>56.9</td>
<td>GSE</td>
</tr>
<tr>
<td>Wachovia Corp.</td>
<td>782</td>
<td>3.9</td>
<td>60.8</td>
<td>BHC</td>
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# Large S&P500 Financial Firms (As of 2007:Q4)

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<tr>
<td>Lehman Bros.</td>
<td>691</td>
<td>3.4</td>
<td>64.2</td>
<td>Inv. Bank</td>
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<tr>
<td>Wells Fargo</td>
<td>575</td>
<td>2.8</td>
<td>67.1</td>
<td>Thrift</td>
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<tr>
<td>MetLife Inc.</td>
<td>558</td>
<td>2.7</td>
<td>69.9</td>
<td>Insurance</td>
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<tr>
<td>Prudential Financial</td>
<td>485</td>
<td>2.4</td>
<td>72.3</td>
<td>Fin. Adv./Ins.</td>
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<tr>
<td>Hartford Financial Svcs.</td>
<td>360</td>
<td>1.8</td>
<td>74.1</td>
<td>Insurance</td>
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<tr>
<td>Washington Mutual</td>
<td>327</td>
<td>1.6</td>
<td>75.7</td>
<td>Thrift</td>
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<tr>
<td>U.S. Bancorp</td>
<td>237</td>
<td>1.1</td>
<td>76.9</td>
<td>BHC</td>
</tr>
<tr>
<td>Countrywide Financial Corp.</td>
<td>211</td>
<td>1.0</td>
<td>78.0</td>
<td>Thrift</td>
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<tr>
<td>Bank of NY Mellon Corp.</td>
<td>197</td>
<td>0.9</td>
<td>79.0</td>
<td>BHC</td>
</tr>
<tr>
<td>Lincoln National</td>
<td>191</td>
<td>0.9</td>
<td>79.9</td>
<td>Insurance</td>
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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.