Assessing the Strength of the U.S. Economic Recovery

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Any opinions expressed here are my own and do not necessarily reflect those of the Federal Open Market Committee participants.
This Talk

- State of the U.S. economy
- The rest of the world
- 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

Source: Bureau of Economic Analysis, Macroeconomic Advisers, Blue Chip Economic Indicators.
GDP expected to reach 2008:Q2 peak before year-end

Real Gross Domestic Product and MA Forecast
(As of May 5, 2010)

Source: Bureau of Economic Analysis, Macroeconomic Advisers.
Composition of real output

Components of Real Gross Domestic Product

Source: Bureau of Economic Analysis.
Home prices are increasing but remain low

S&P Case Schiller House Prices and Nominal GDP

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

Industrial Production and the ISM Manufacturing Index

Source: Federal Reserve Board/Institute of Supply Management.
Labor market conditions are slowly improving

Nonfarm Payroll Employment Growth
Change from previous month.

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

Unemployment and Initial Claims

Unemployment Rate, SA (Right Axis)

Initial Claims for Unemployment Insurance, 4-wk moving average (Left Axis)

The Rest of the World
Global growth

Canada
5.0, 5.0, 4.0

U.S.
5.6, 3.2, 4.0

Latin America
6.5, 4.8, 4.3

U.K.
1.8, 1.3, 2.6

Europe
0.2, 0.3, 1.9

Russia
15.0, 9.4, 7.0

China
9.6, 10.8, 8.4

India
-2.2, 12.0, 9.0

Japan
3.8, 5.2, 2.9

South Africa
3.2, 4.3, 4.4

Australia
1.9, 4.7, 2.5

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

Index, 2007:Q1 = 100

Source: Board of Governors.
But the U.S. shed a larger percentage of the workforce
Monetary Policy
Near-Zero Policy Rates in the G-7

Percent

2007 2008 2009 2010

Canada

Euro Area

Japan

U.K

U.S.

FEDERAL RESERVE BANK of ST. LOUIS
CENTRAL to AMERICA'S ECONOMY™
Federal Reserve balance sheet

Source: Board of Governors.
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 rates
Basis Points

Source: Bloomberg.
# U.S. State Debt Burdens

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

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

Financial Regulatory Reform
Bank supervision

- The Fed should continue to supervise state member banks and bank holding companies of all sizes.
  - Understanding the entire financial landscape helps the Fed make sound monetary policy decisions.
  - It is important that the Fed remain connected with Main Street America, and not become biased toward the very large, mostly New York-based institutions.
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 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 Bank.
- There is considerable accountability in the Roosevelt-era re-design of the Federal Reserve.
Auditing monetary policy

- Monetary policy is vigorously debated everyday, 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.