The U.S. Economic Situation and Regulatory Reform

James Bullard  
President and CEO  
Federal Reserve Bank of St. Louis

A Day with the Commissioner  
Nashville, TN  
12 May 2010

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
- 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

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 10, 2010)

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

Components of Real Gross Domestic Product

- Nondurables plus services consumption
- Durables consumption
- Investment

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

S&P Case Shiller 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

Percent Change from Previous Month

Index

2007 2008 2009 2010

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

Nonfarm Payroll Employment Growth
Change from previous month.

Thousands

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

Unemployment and Initial Claims

 Thousands

2007 2008 2009 2010

Unemployment Rate, SA (Right Axis)

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

Jan.-Mar. 9.7% Apr. 9.9%

Tennessee's Economy
Payroll employment during the recession

Dec. 2007=100

U.S.
Nashville MSA
Memphis MSA
Tennessee
Unemployment rate

Tennessee

Memphis MSA

U.S.

Nashville MSA
Foreclosure trends

Foreclosure Rate
(% of Mortgages in Foreclosure)
# Tennessee’s fiscal picture

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

**Source:** Nelson A. Rockefeller Institute of Government.
The Global Economy
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

EU
0.2, 0.3, 1.9

South Africa
3.2, 4.3, 4.4

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

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

Output per Employed Person

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

- Canada
- Euro Area
- Japan
- U.S.
- U.K
Federal Reserve balance sheet

- Short-Term Lending to Financial Firms and Markets
- Rescue Operations
- Asset Purchase Program
- Traditional Portfolio
- Traditional Portfolio and Long-Term Assets

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
Daily, Last Observation is May 10, 2010

Source: Bloomberg LP.
Flight to safety

10-Year Treasury Note Yield at Constant Maturity

Daily data as of May 10, 2010

Source: Federal Reserve Board.
LIBOR-OIS spread

Source: Reuters and Financial Times.
## U.S. state debt burdens

<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
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.