



# **Economic Insights:** Conversations with the Dallas Fed

January 28, 2011



# Economic Outlook for 2011

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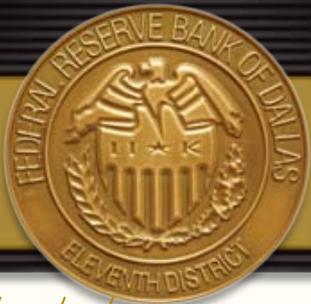
and Jessica Renier

Senior Economic Analyst

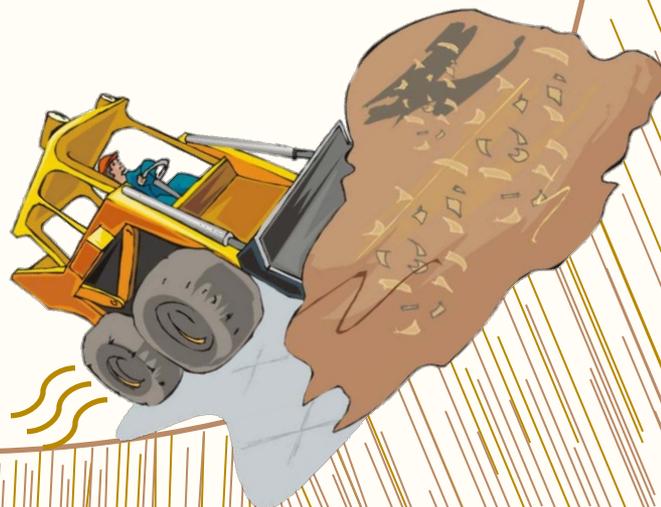
The views expressed are those of the speaker and should not necessarily be attributed to the Federal Reserve Bank of Dallas or the Federal Reserve System.



**It's time to talk UP  
the economy and  
stop talking it down.**



# Time to Cast Aside





# Dominant Macro Themes for 2011

- U.S. expansion gains traction
- European sovereign debt primarily a European problem
- Reduced headwinds from deleveraging
- Interest rates can only go UP from here



## Bottom Line

- 4% real output growth
- Steady, low inflation
- Falling unemployment



# Most Likely Scenario

	2009 (%)	*2010 (%)	2011 (%)
Real GDP	0.3	2.7	4.0+
<b>Inflation (eop)</b>			
Headline PCE	2.4	1.0	1.5
Trimmed Mean PCE	1.8	0.8	1.0
<b>Employment</b>			
Unemployment (eop)	10.0	9.4	8.9
Monthly Payroll Growth (thous)	-395	94	200

\*using latest release



# Where will GDP growth come from?

- Drivers of growth:
  - Consumption
  - Business investment
  - Net exports
- Neutral/Drag:
  - Housing
  - Government



# Momentum Changes

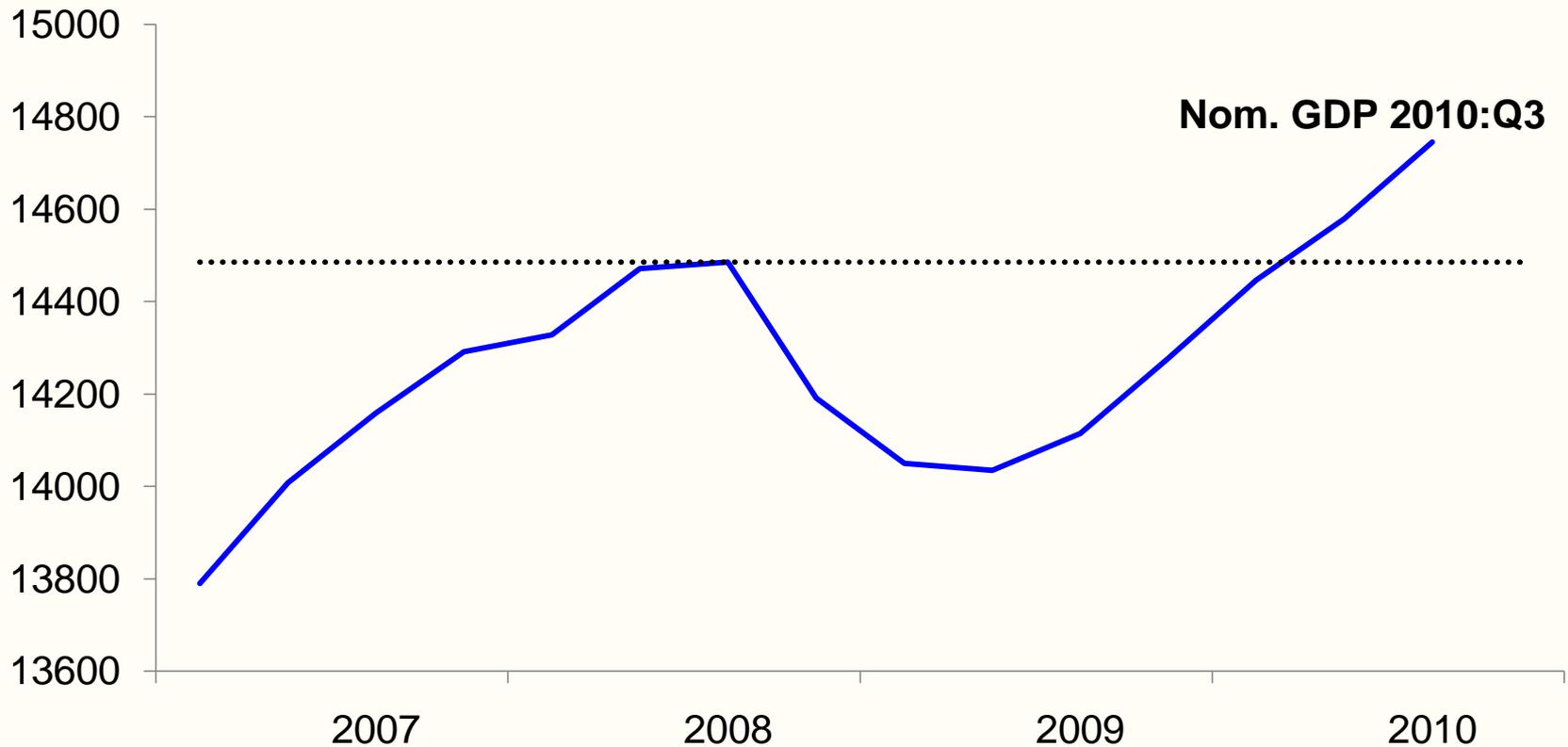
Perhaps some confirmatory bias:

- Money income now in expansion, not recovery
- Business Investment
- Autos
- Labor Market
- Credit Markets



# Money Income in Expansion Mode

SAAR, Bil. \$

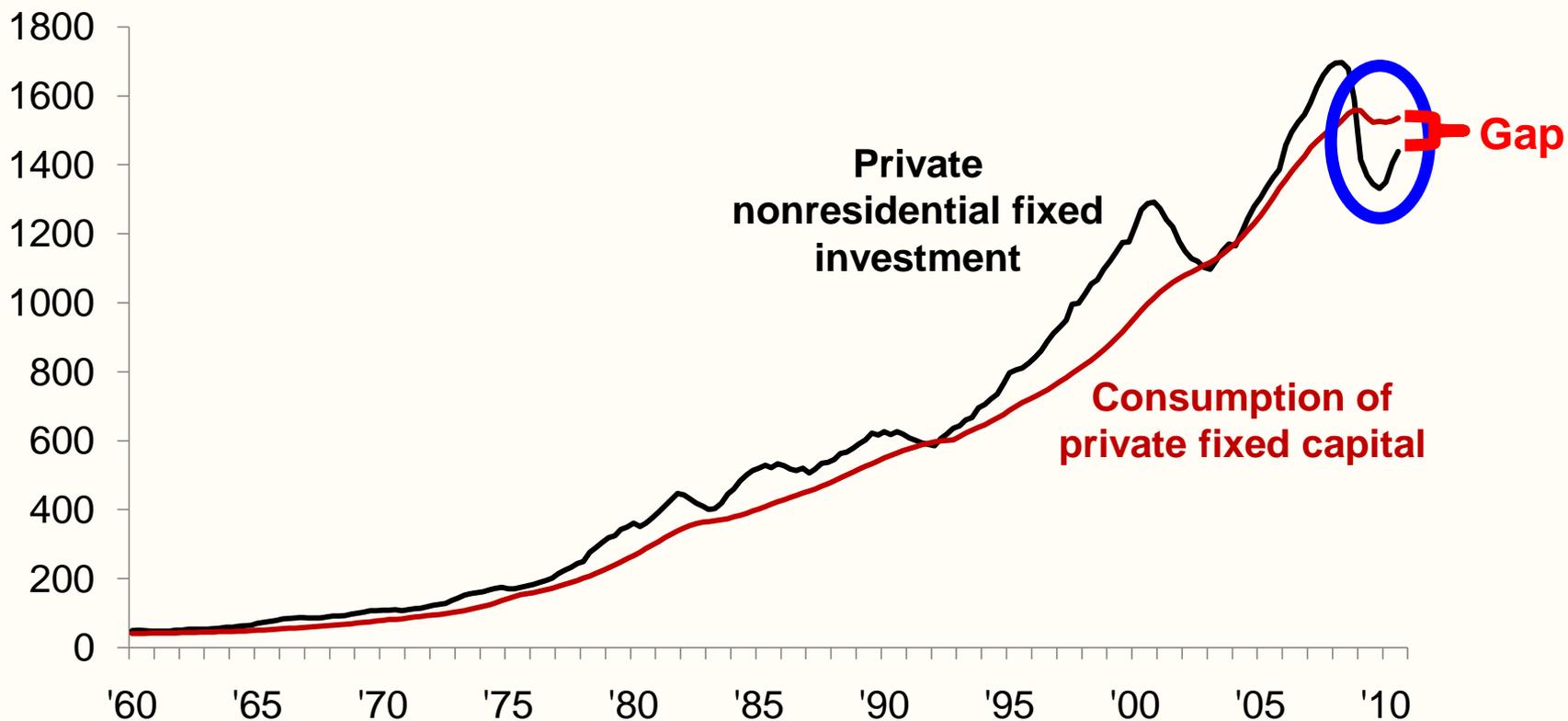


Source: Bureau of Economic Analysis



# Pent-Up Demand

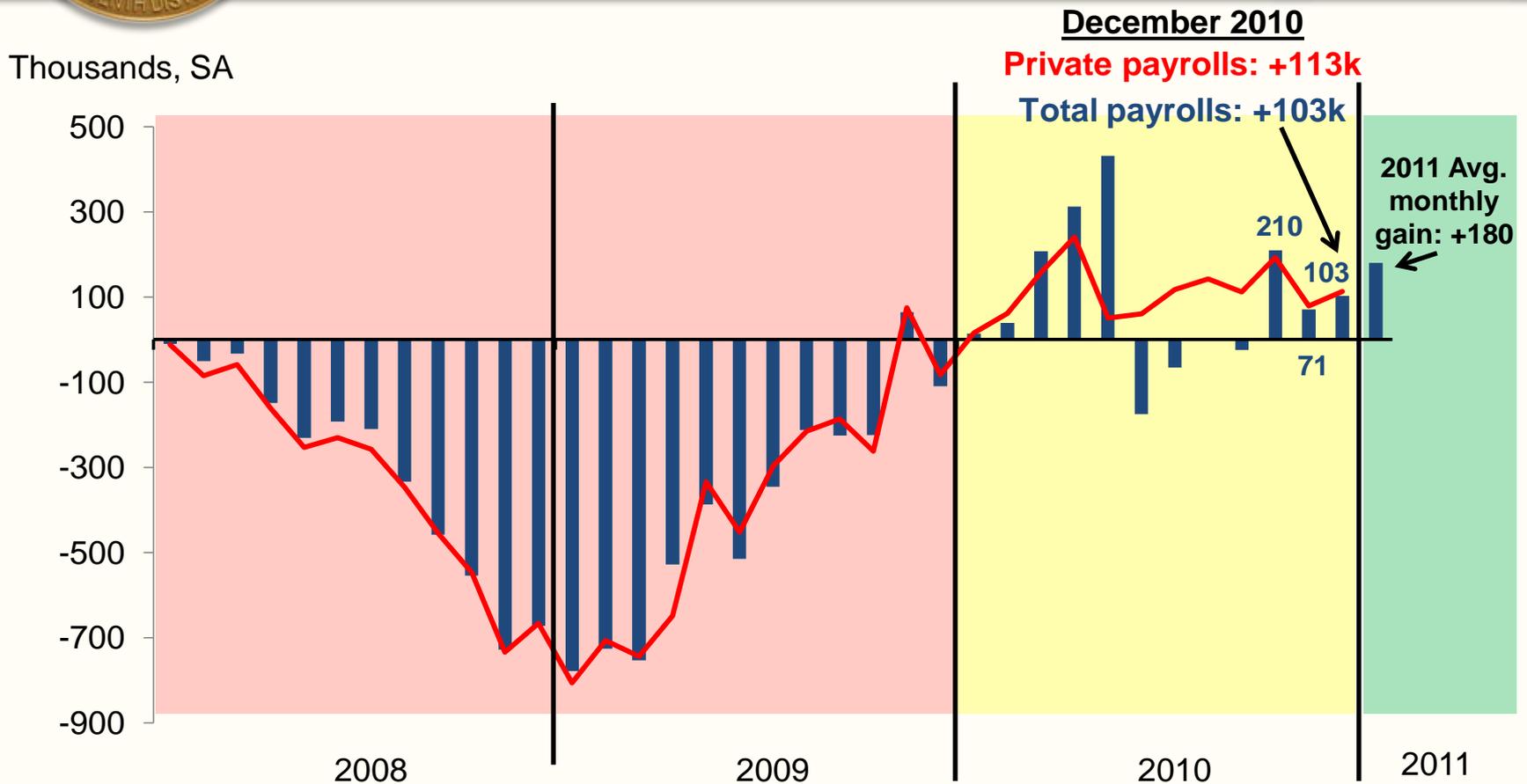
\$Bn SAAR



Source: Bureau of Economic Analysis



# Employment Outlook Improving, Finally



Source: Bureau of Labor Statistics



# BUT...

## Very Roughly...

- 10% unemployed

AND

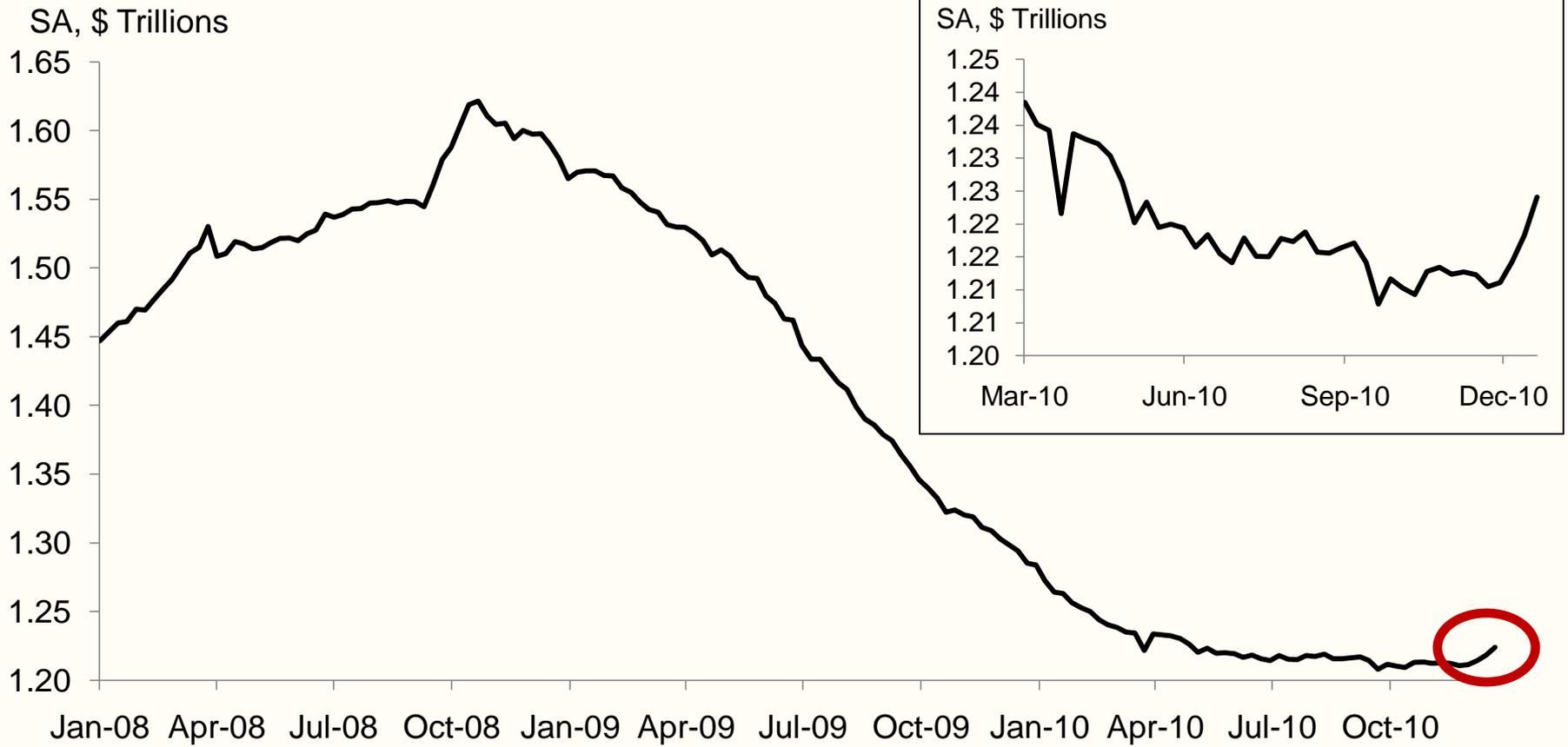
- 10% underemployed

AND

- 10% believe they'll become unemployed or underemployed within the next 6 months



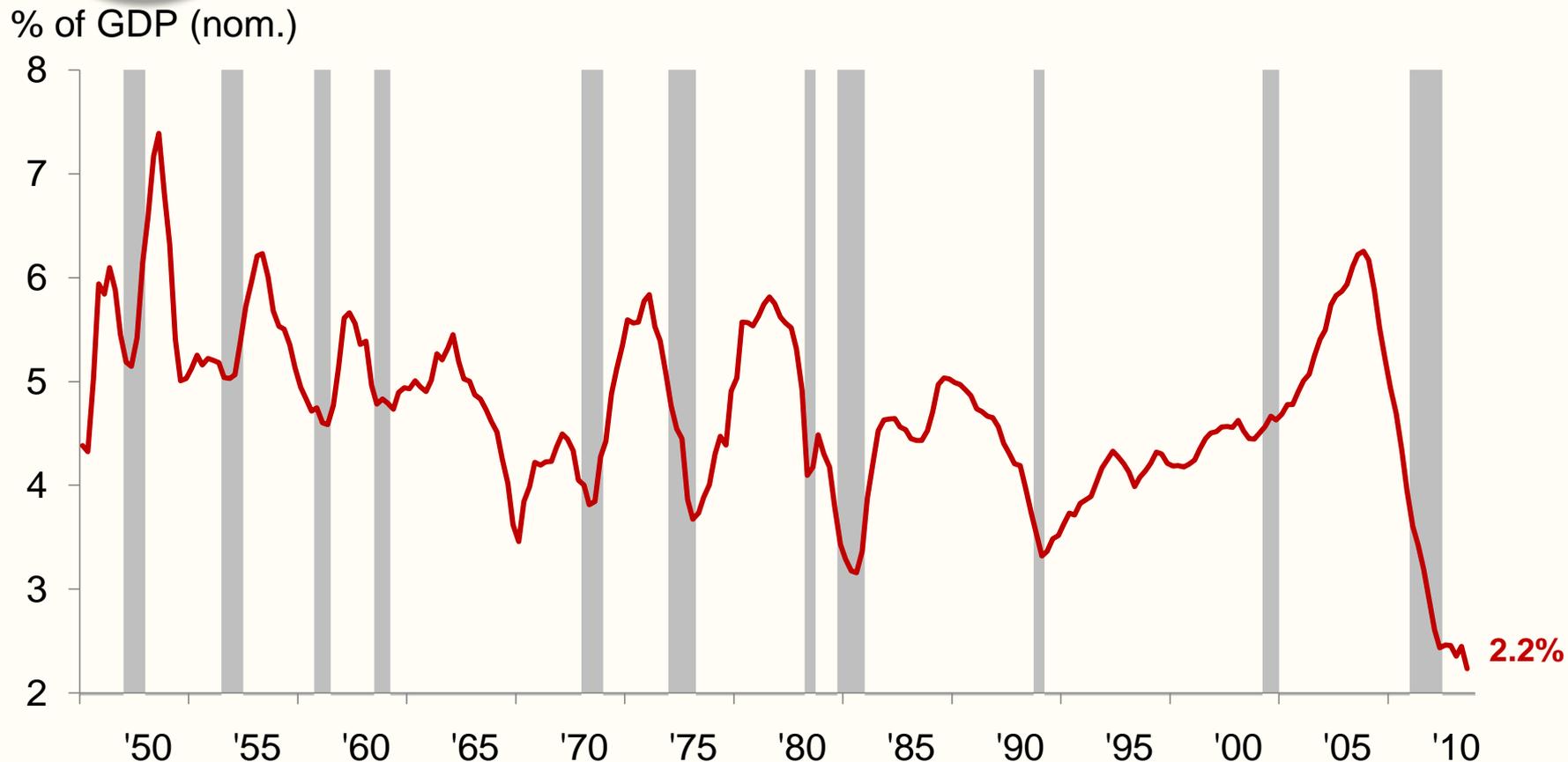
# C&I Bank Credit Outstanding Starting to Expand



Source: Federal Reserve Board



# Housing: The New Neutral

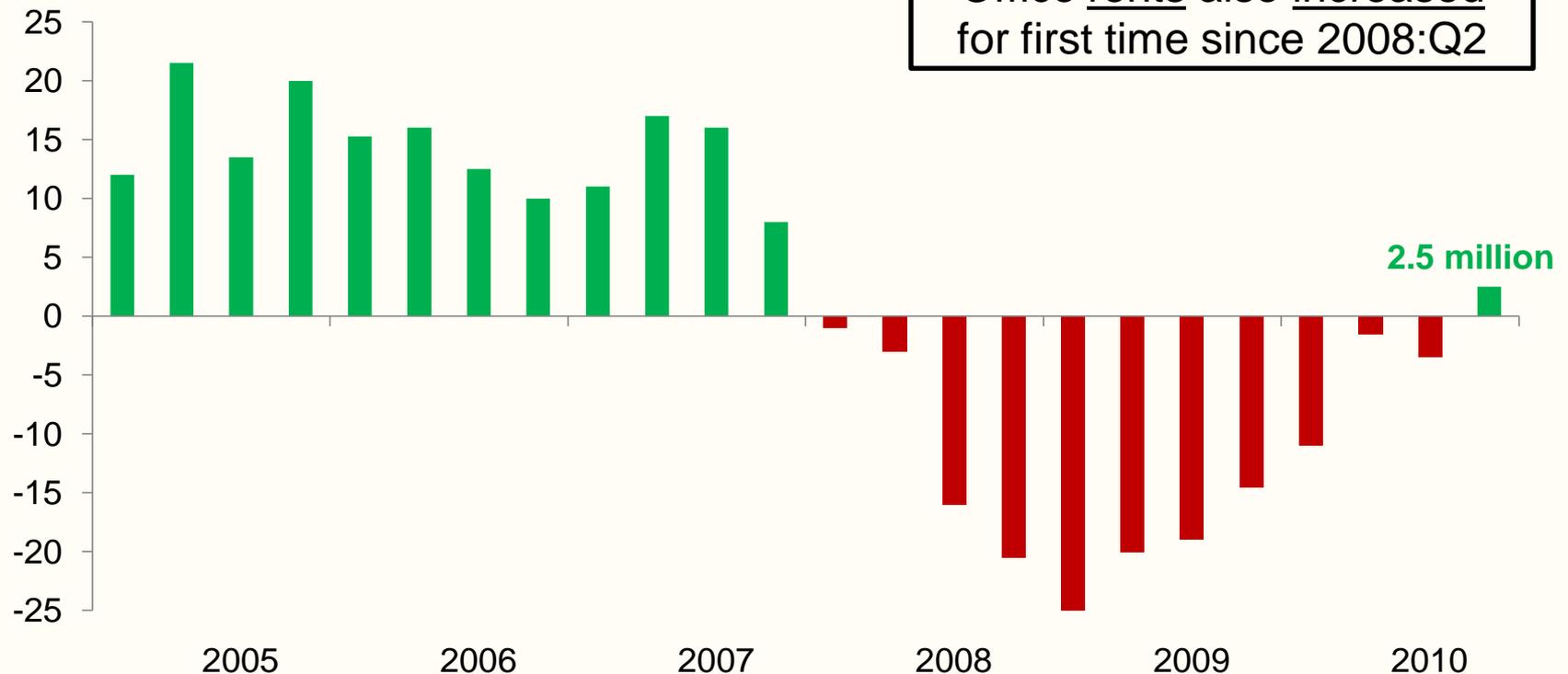


Source: Bureau of Economic Analysis



# Fresh Signs of Life in the Office Market

Change in occupied U.S. office space,  
sq. ft. (million)



Source: Reis Inc. (WSJ, Jan. 4, 2011)



# Europe's Problem

- European sovereign debt primarily a European problem
  - U.S. banks' exposure to European debt a "known unknown" with some spillover
  - Unlikely to derail U.S. expansion



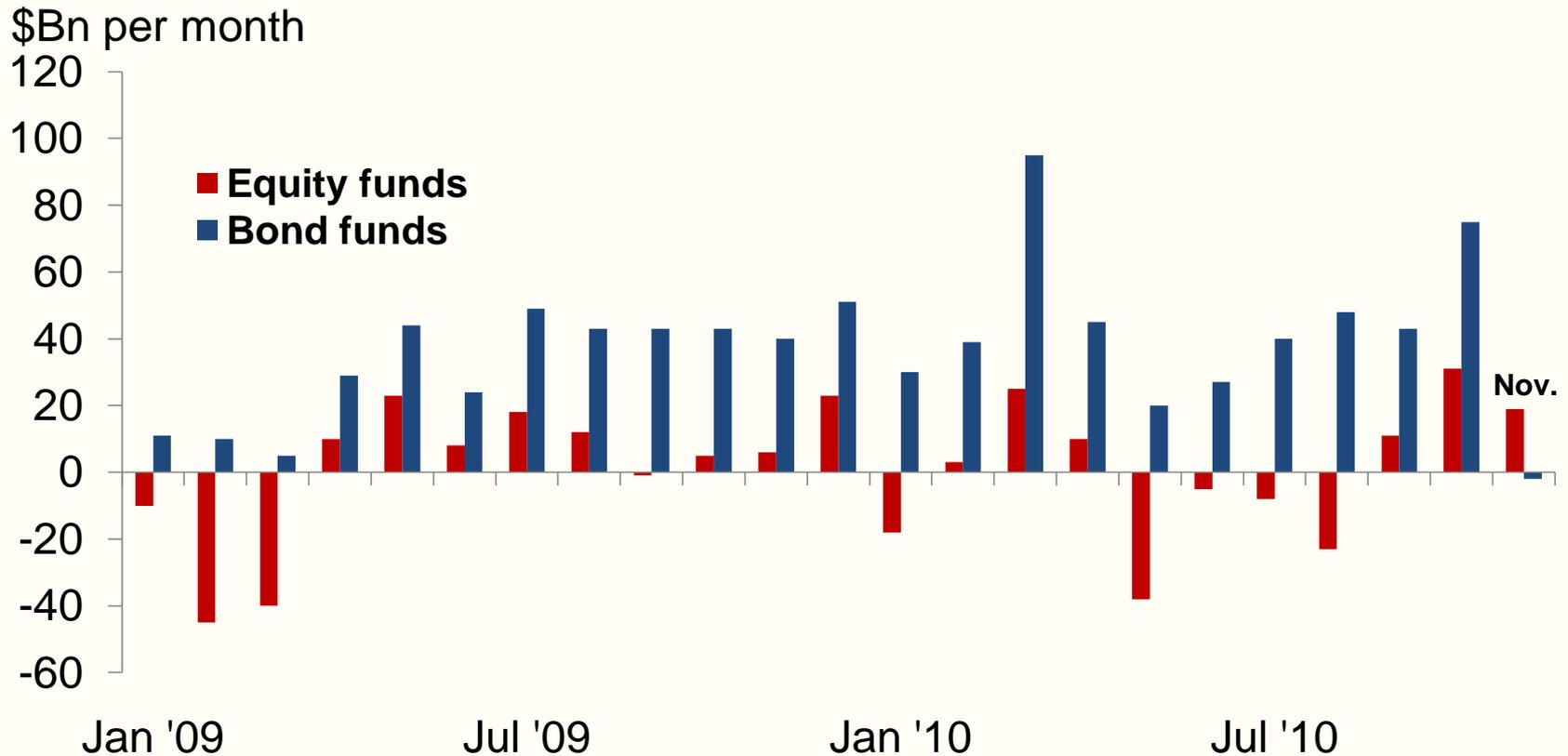
# Interest Rates

- Interest rates can only go UP from here
- Near-record lows
- Stronger growth
- Bonds must compete with equities

- 
- Upward interest-rate pressures limited by U.S. being “best horse in the glue factory” (low credit risk)
  - Limited upside inflation potential



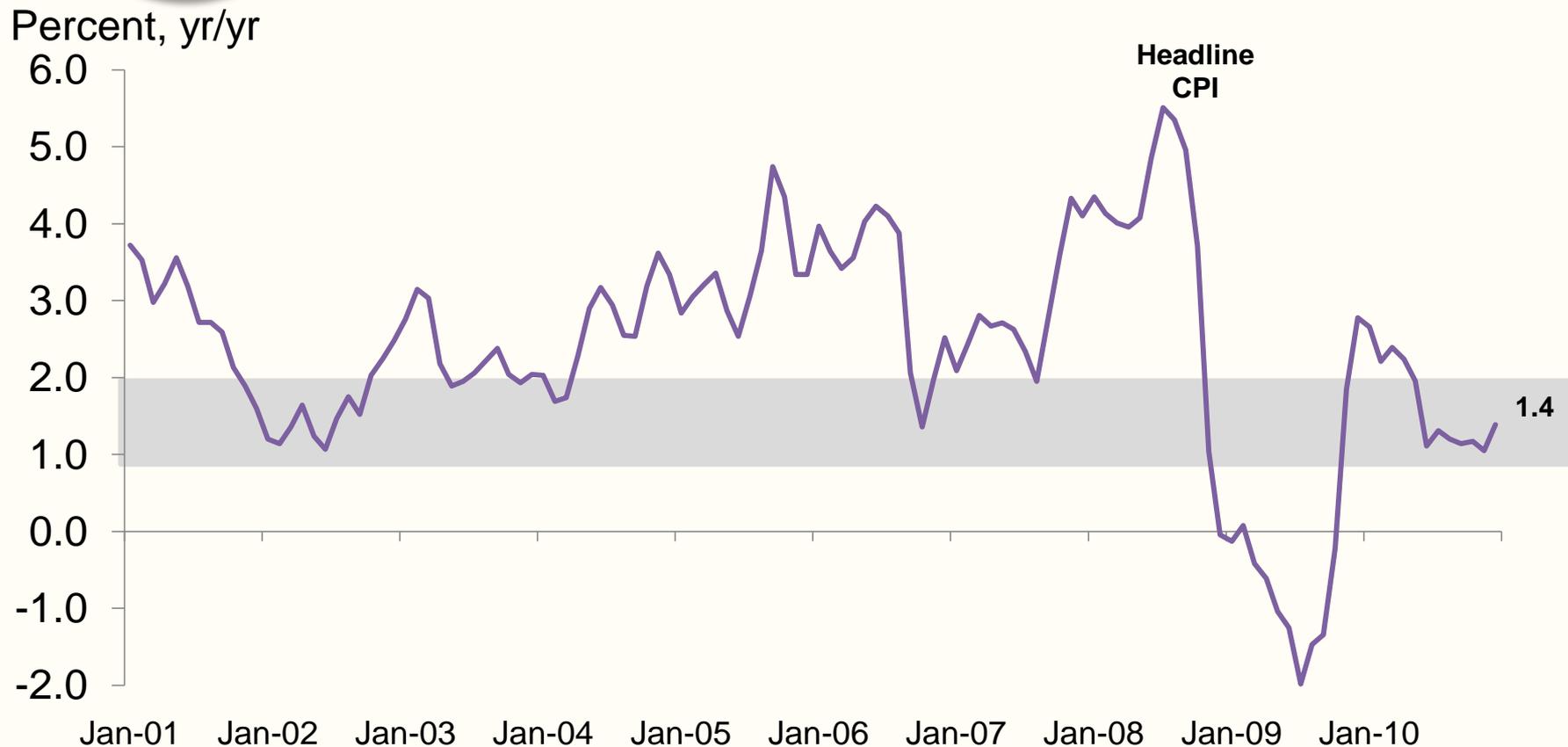
# Monthly Global Equity and Bond Fund Flows



Source: EPFR, J.P. Morgan (*Flows & Liquidity*, Dec. 3, 2010)



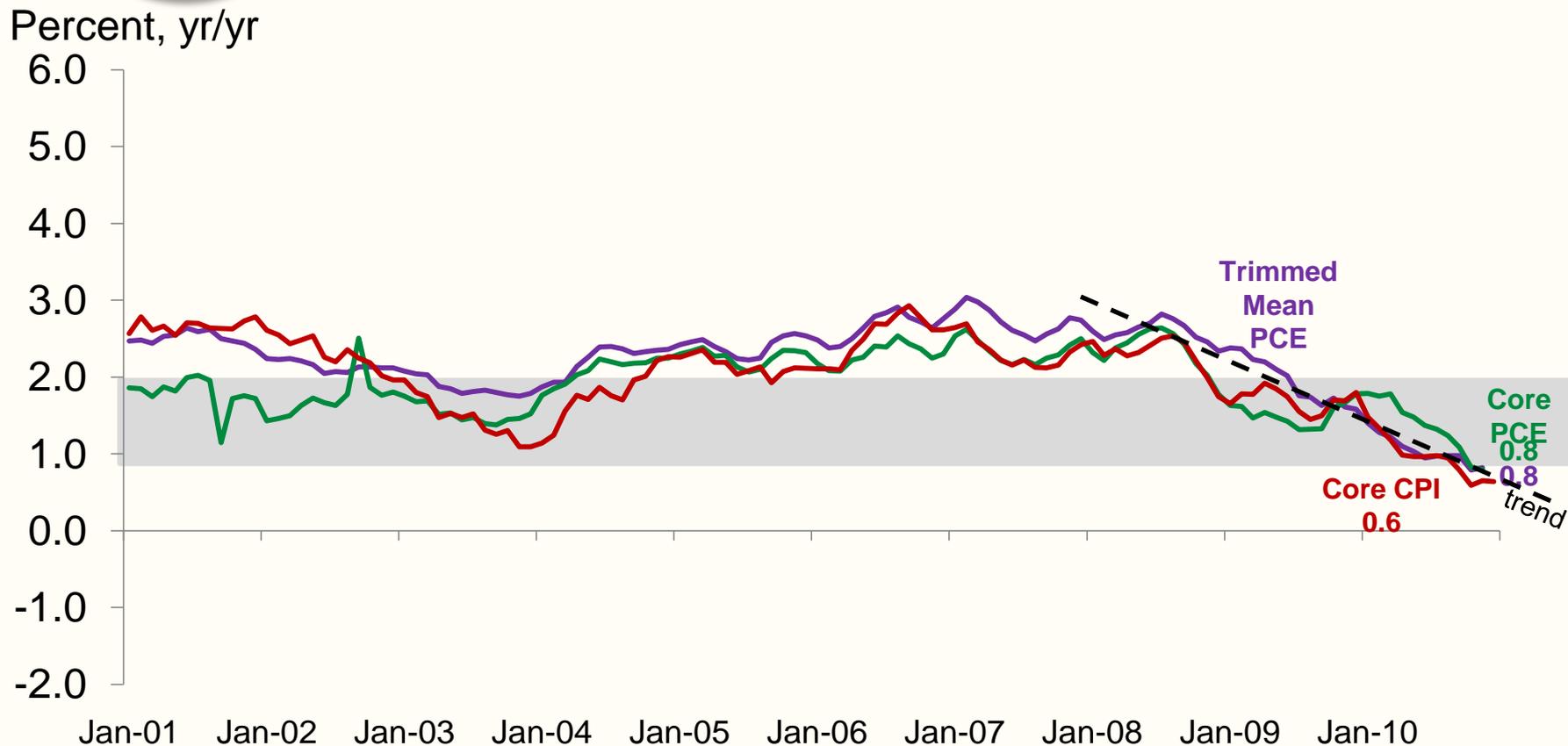
# Headline Inflation Stabilizing



Source: Federal Reserve Board, Dallas Fed, BEA, BLS



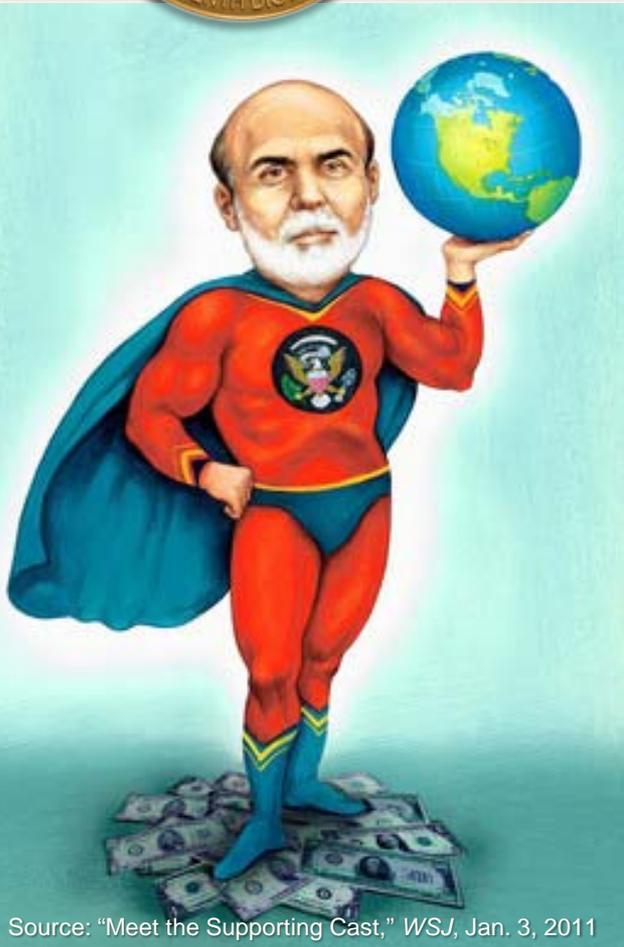
# Core Inflation Trending Down, But Likely Stabilizing



Source: Federal Reserve Board, Dallas Fed, BEA, BLS



# Ben's Year to Reap the Benefits



Source: "Meet the Supporting Cast," *WSJ*, Jan. 3, 2011

- GDP growth revving up
- Labor market recovering
- Slowly gaining confidence
- Inflation stabilizing
- Risks less likely to derail U.S. expansion



# Monetary Policy

As long as unemployment remains near 9% and inflation near 1%, the Fed will be under pressure to maintain or increase monetary policy accommodation.



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