FEDERAL RESERVE BANK of NEW YORK

CBIA and the Metro Hartford Alliance

Economic Summit & Outlook 2013

Recent Developments in the US Economy

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Disclaimer

The views expressed are the presenter's and not those of the Federal Reserve Bank of New York or the Federal Reserve System.

Overview

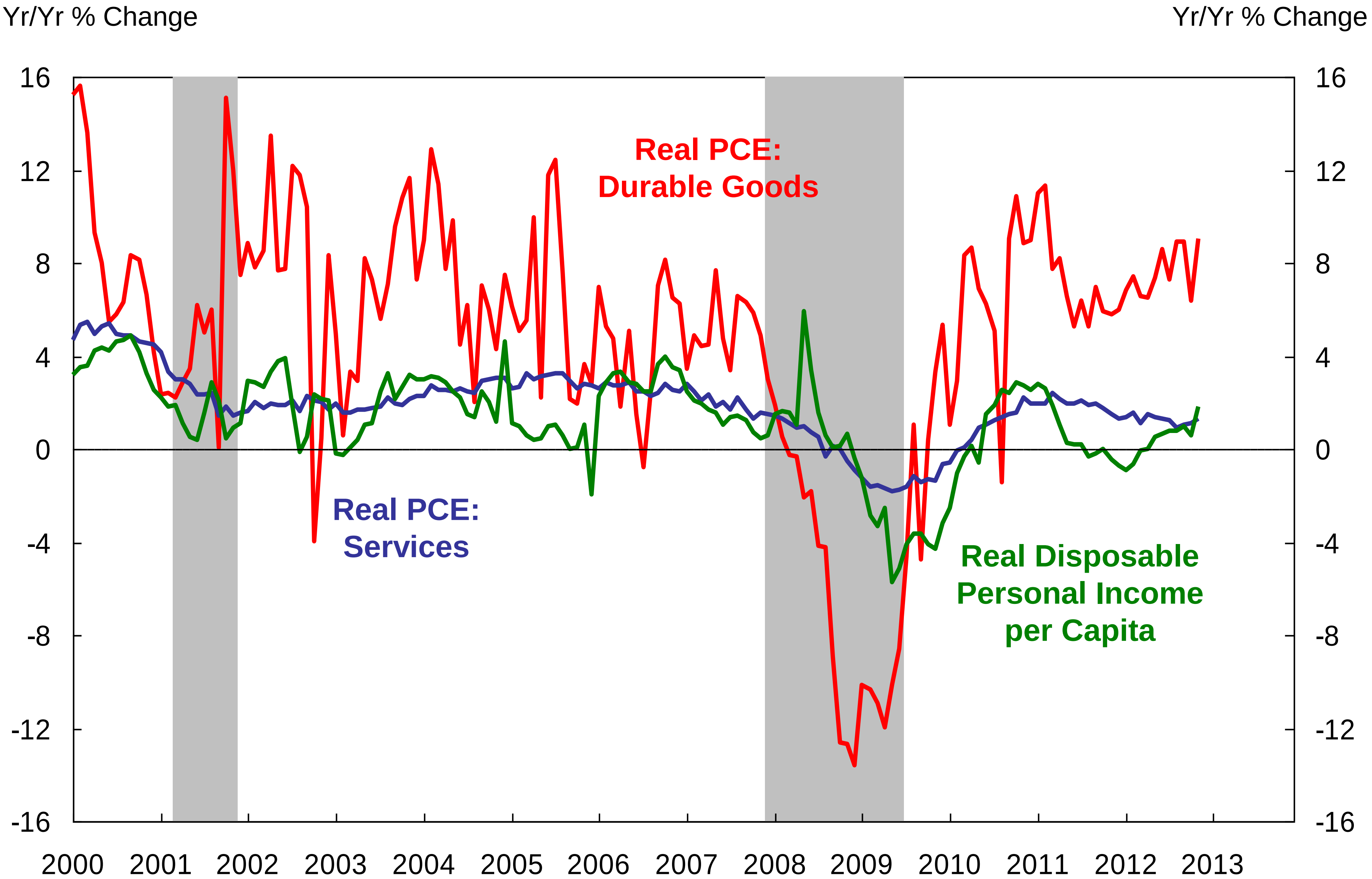
- Recovery from the Great Recession has been slower than earlier post-war recoveries. Some recent features:
  - Consumer spending on durable goods and housing gaining strength.
  - In contrast, growth of business fixed investment and exports has slowed substantially over the course of 2012.
  - Manufacturing output also declined in the second half of 2012.
  - Unemployment has remained fairly high; much of the fall reflects falling labor force participation, and the ratio of employed workers to working-age population has remained unusually low.

- Inflationary pressures are quite subdued, but episodes of energy and food price inflation keep inflation concerns alive.

- Policymakers face unfamiliar and difficult policy choices in both monetary and fiscal policy.

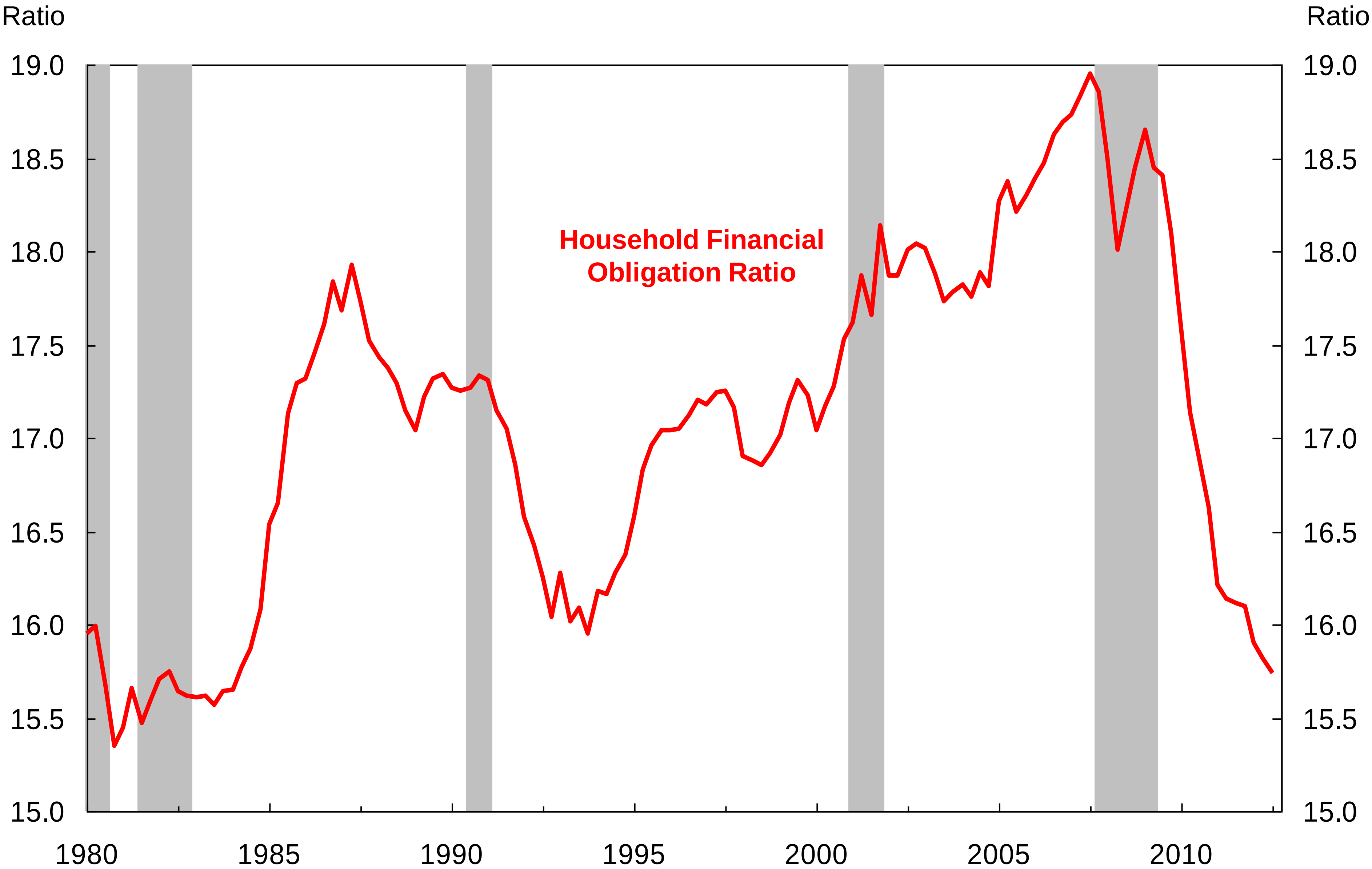
- Major changes in the global economy create some urgency in addressing the economic problems.

Growth of Real Consumer Spending and Income



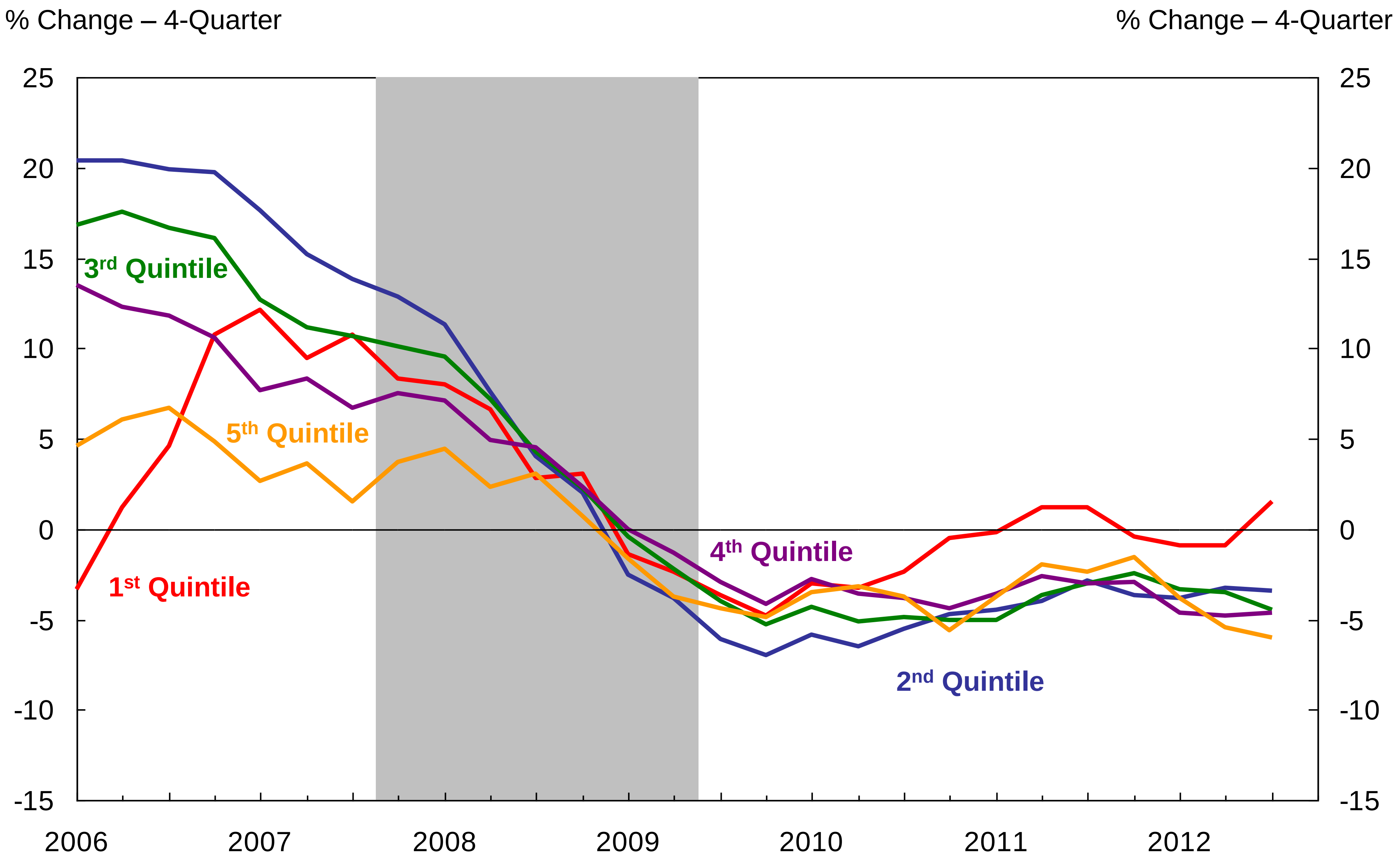
Source: Bureau of Economic Analysis

Household Financial Obligation Ratio



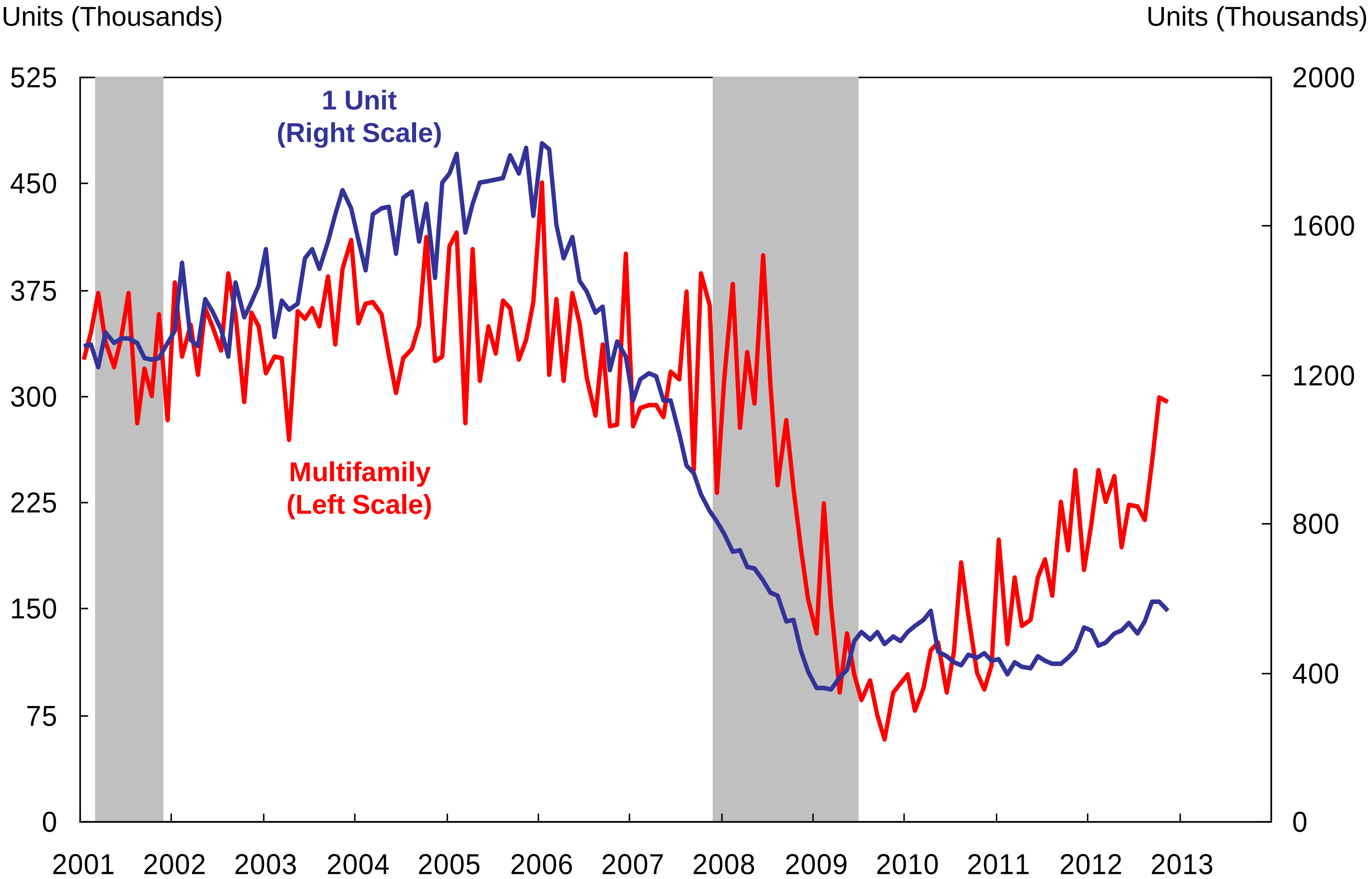
Source: Federal Reserve Board

Consumer Debt by Credit Score Quintile



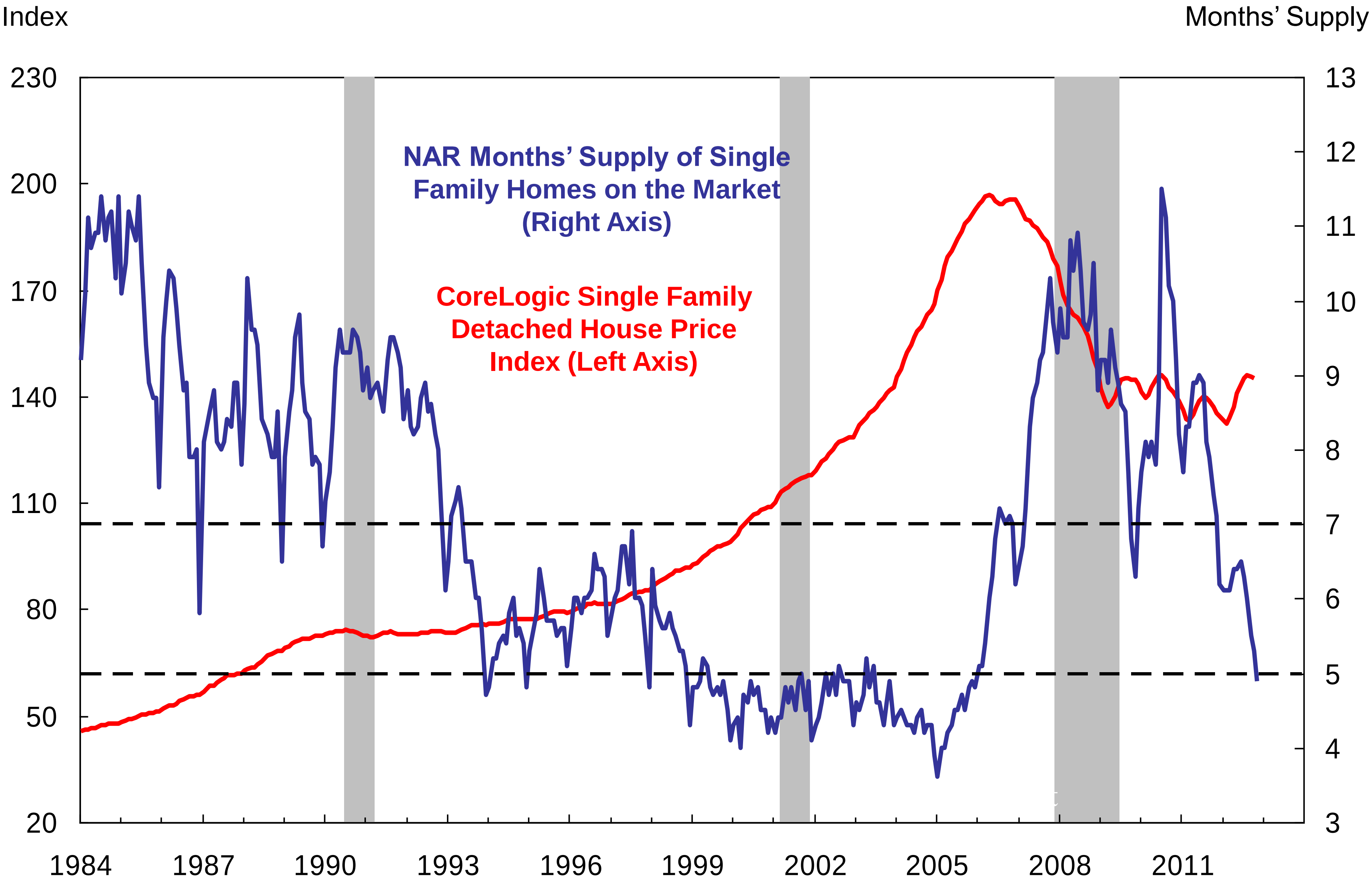
Source: FRBNY Consumer Credit Panel

Housing Starts



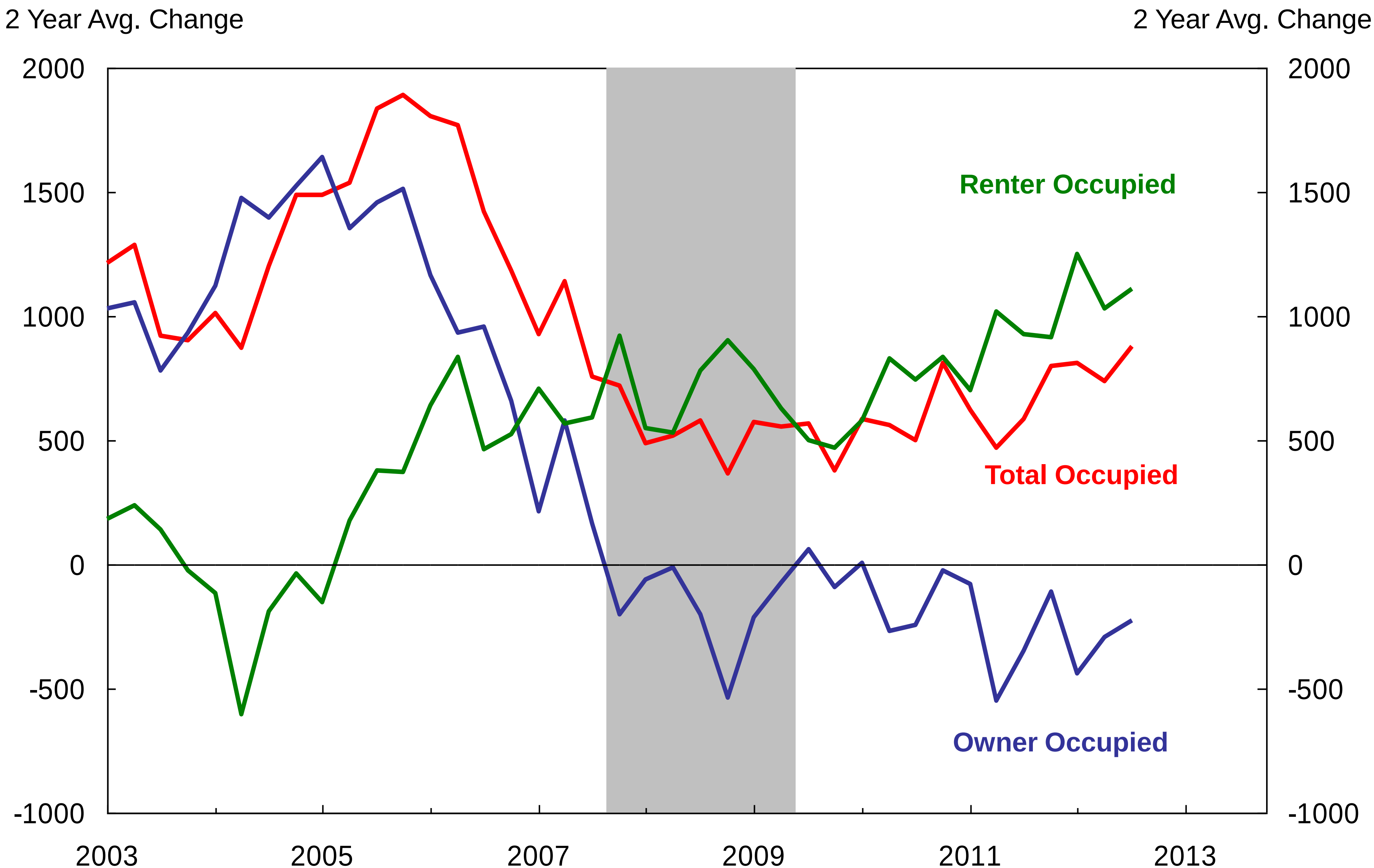
Source: Census Bureau

Single Family Housing Market



Source: CoreLogic, National Association of Realtors

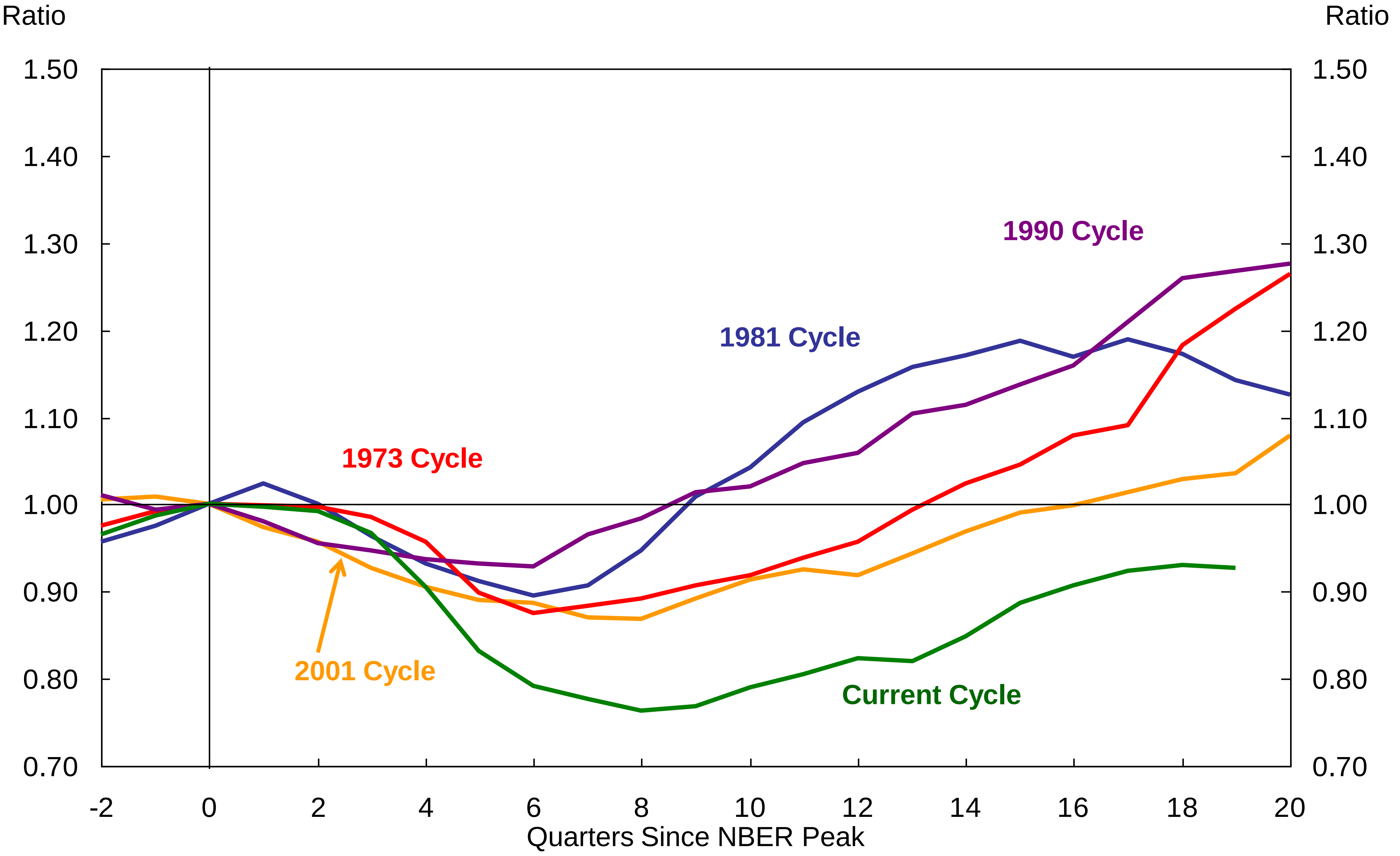
Household Formations



Source: Bureau of the Census

Real Business Nonresidential Fixed Investment

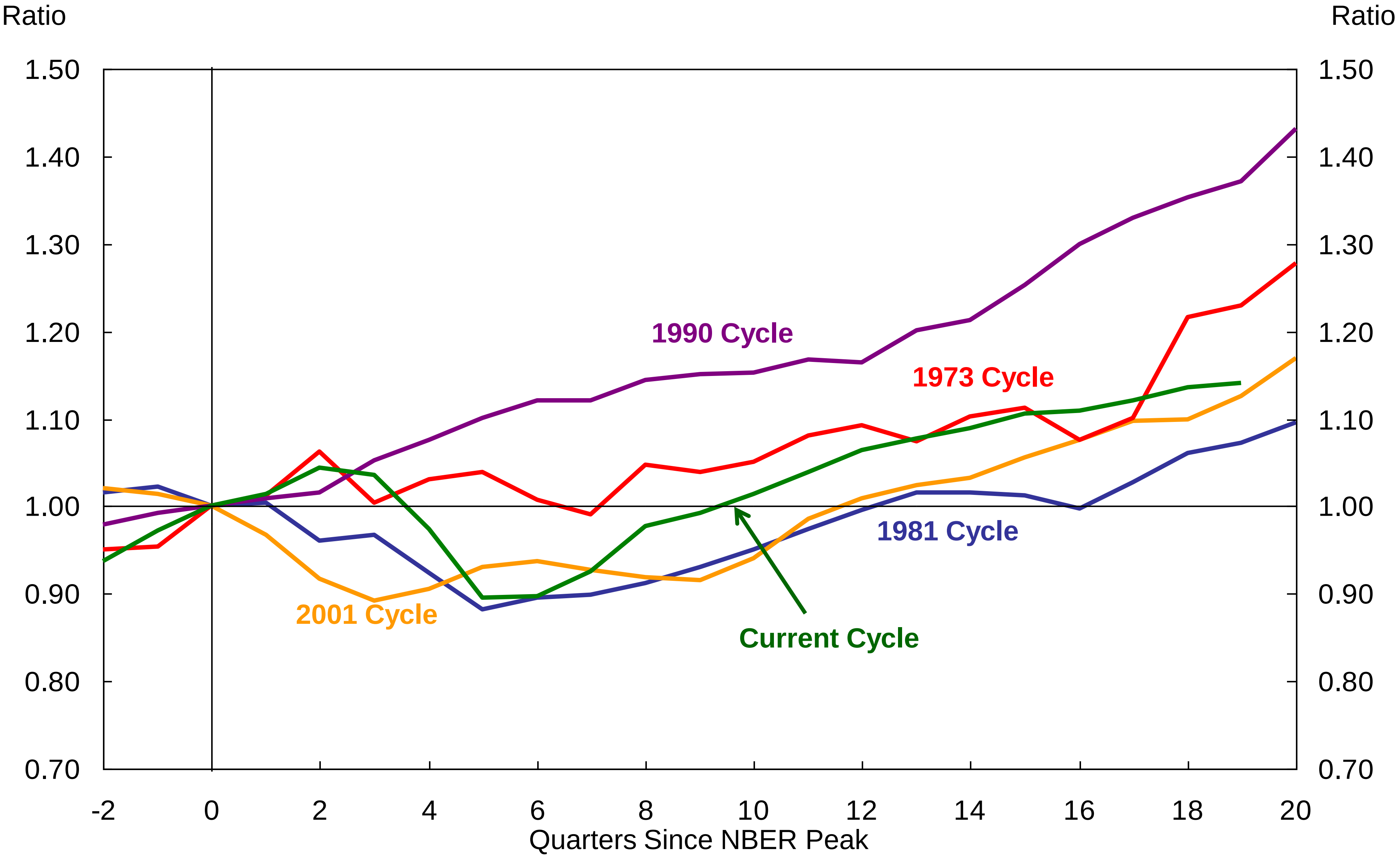
(Series Set to 1.00 at NBER Peak)



Source: Bureau of Economic Analysis

Real Exports of Goods and Services

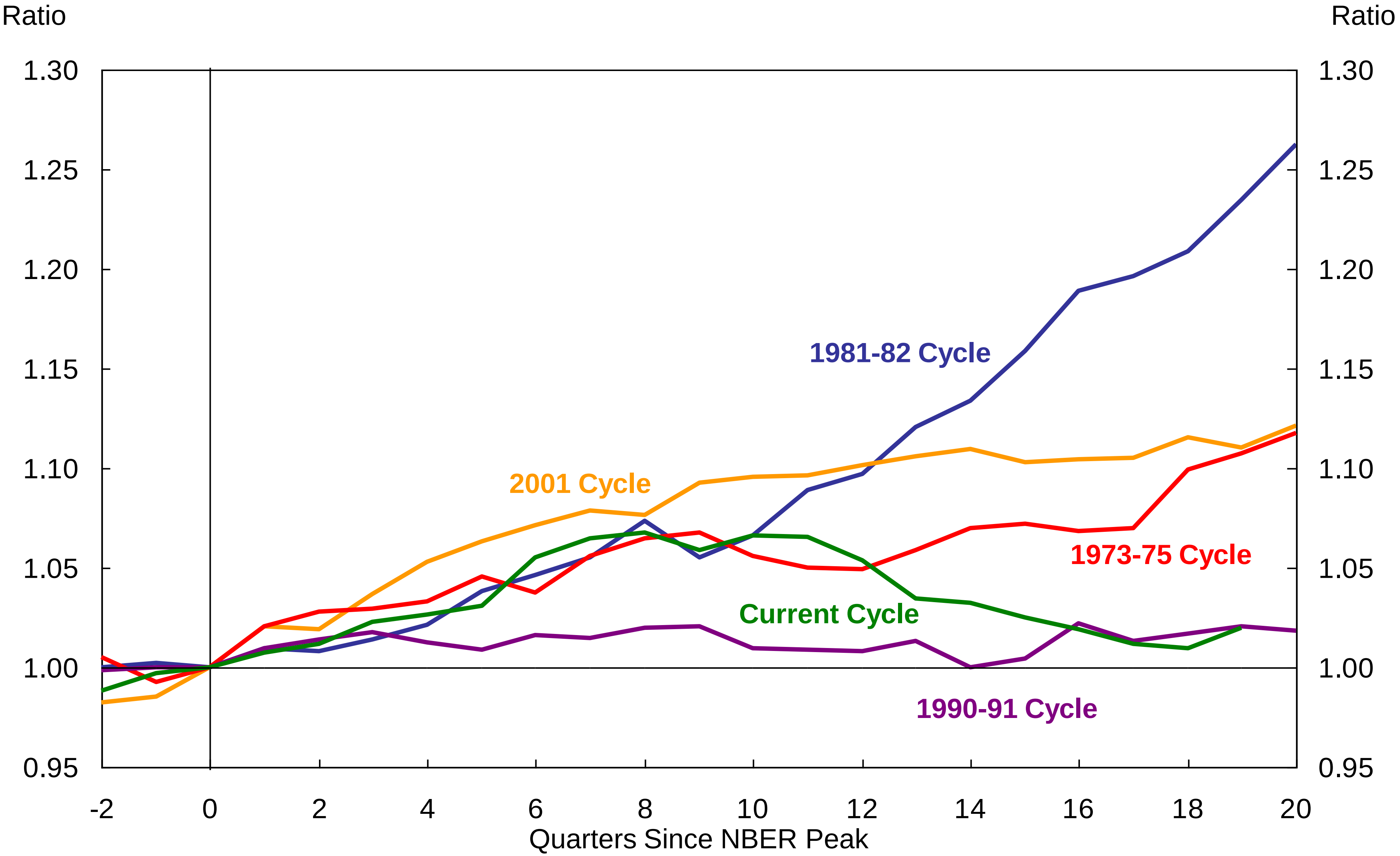
(Series Set to 1.00 at NBER Peak)



Source: Bureau of Economic Analysis

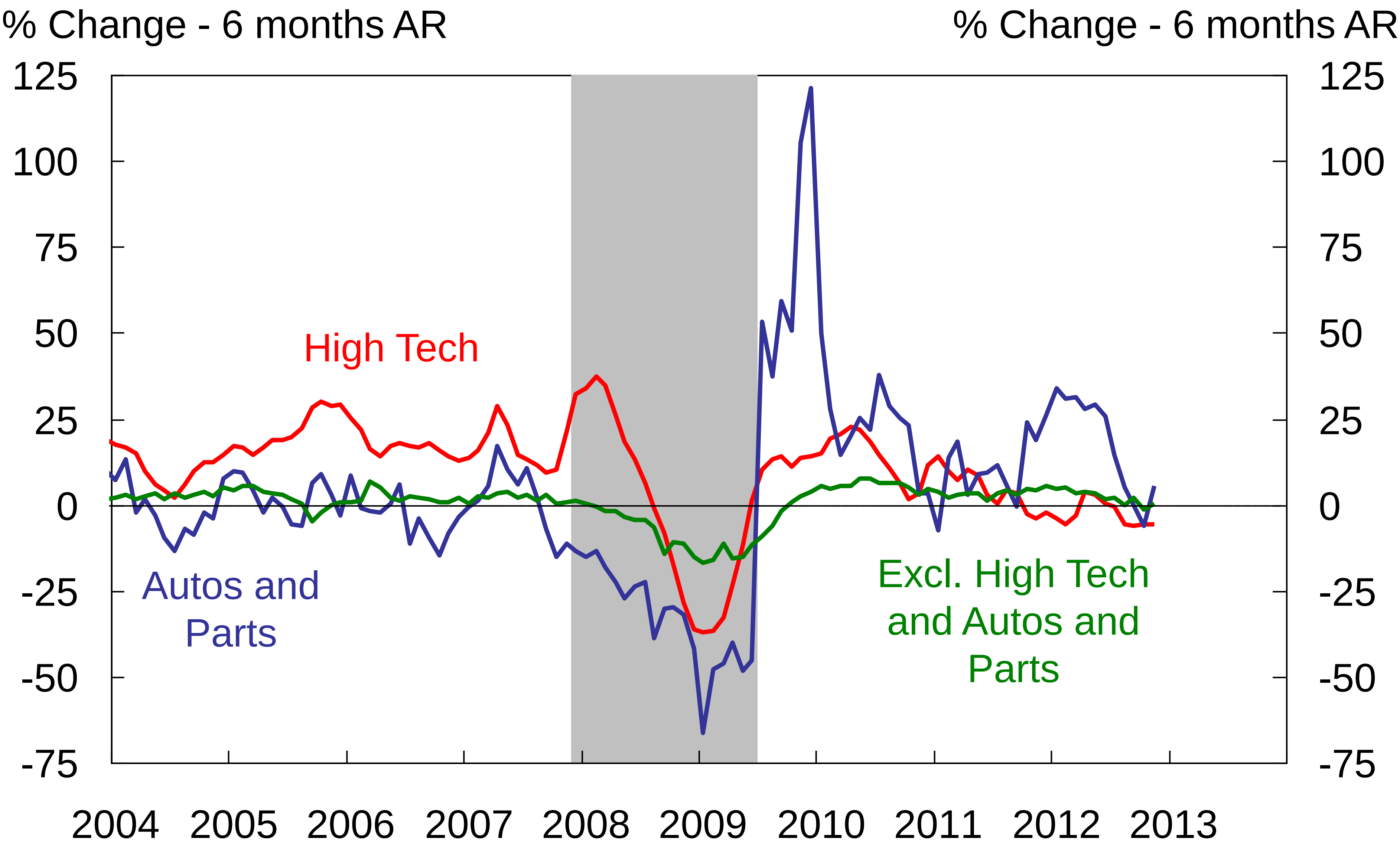
Real Government Expenditures & Investment

(Series Set to 1.00 at NBER Peak)



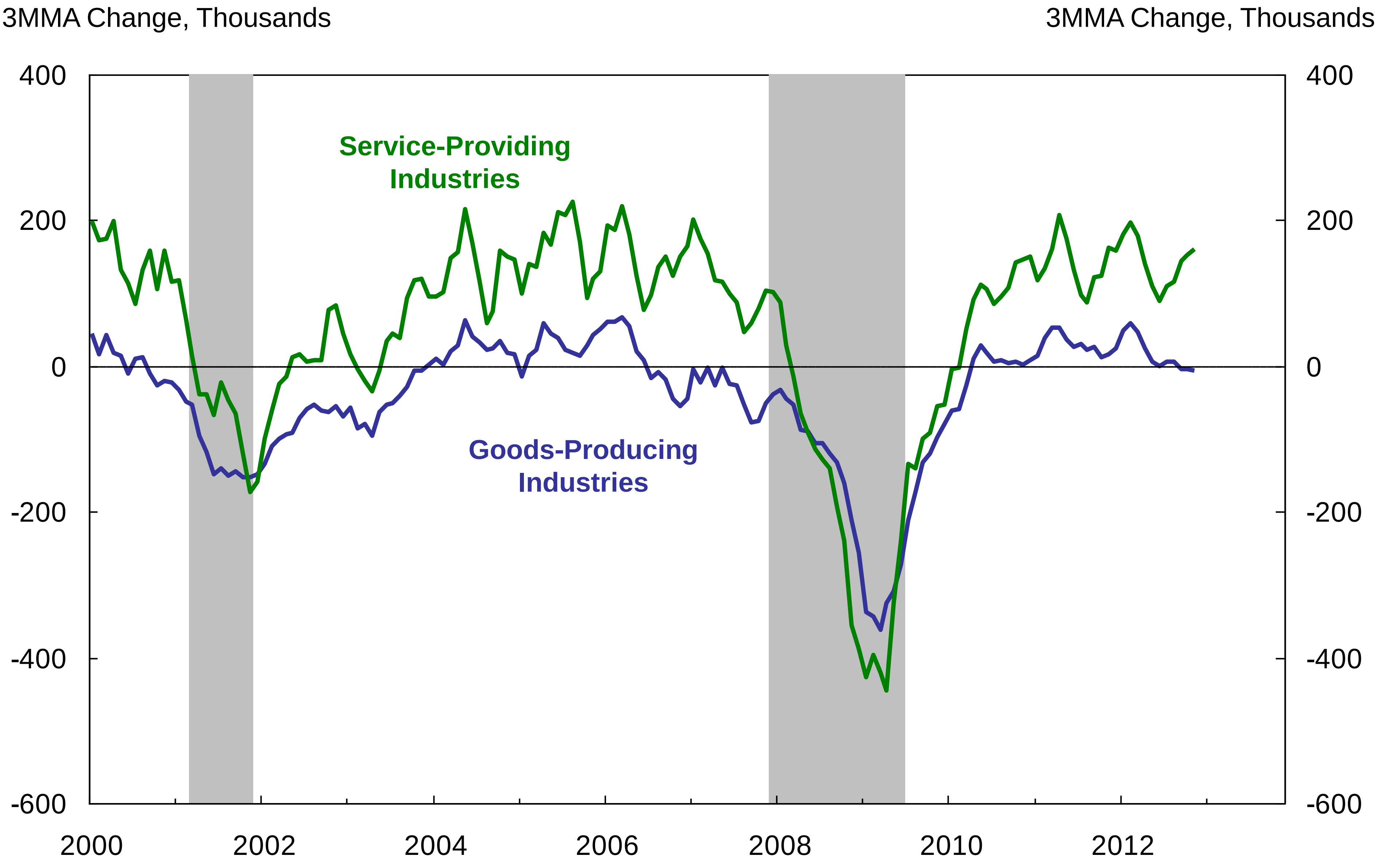
Source: Bureau of Economic Analysis

Industrial Production



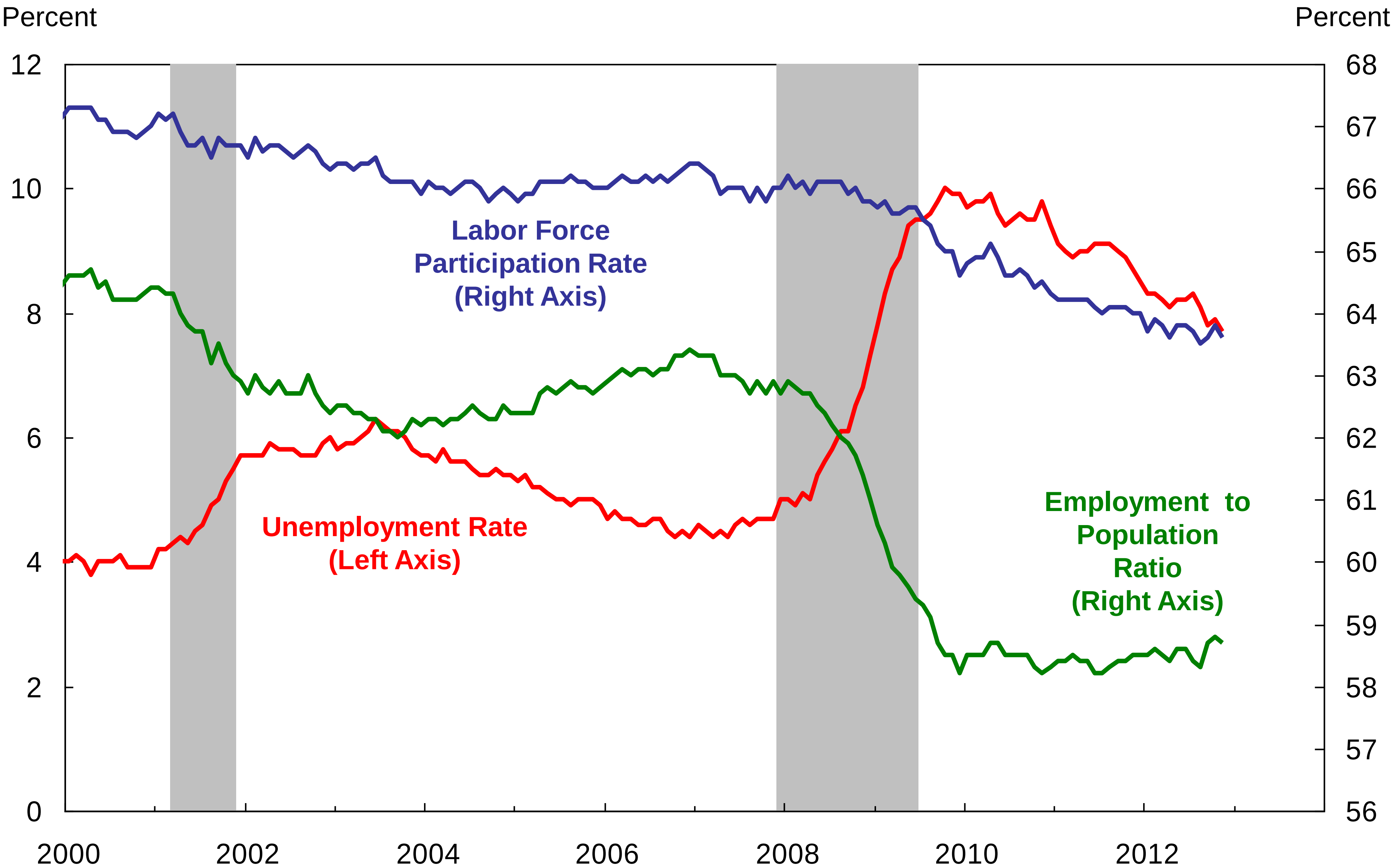
Source: Federal Reserve Board

Monthly Change in Private Employment by Sector



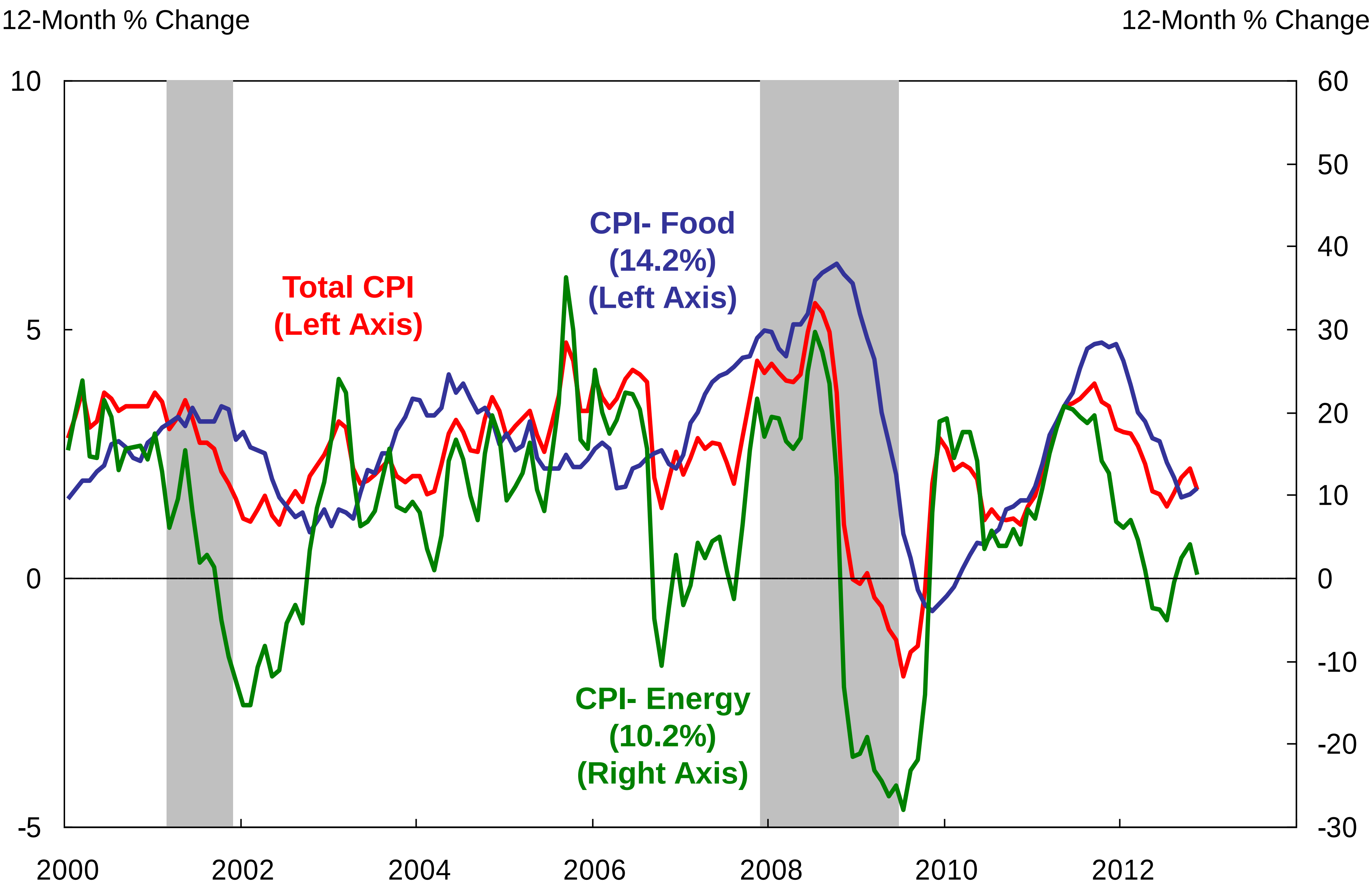
Source: Bureau of Labor Statistics

Measures of the Employment Situation



Source: Bureau of Labor Statistics

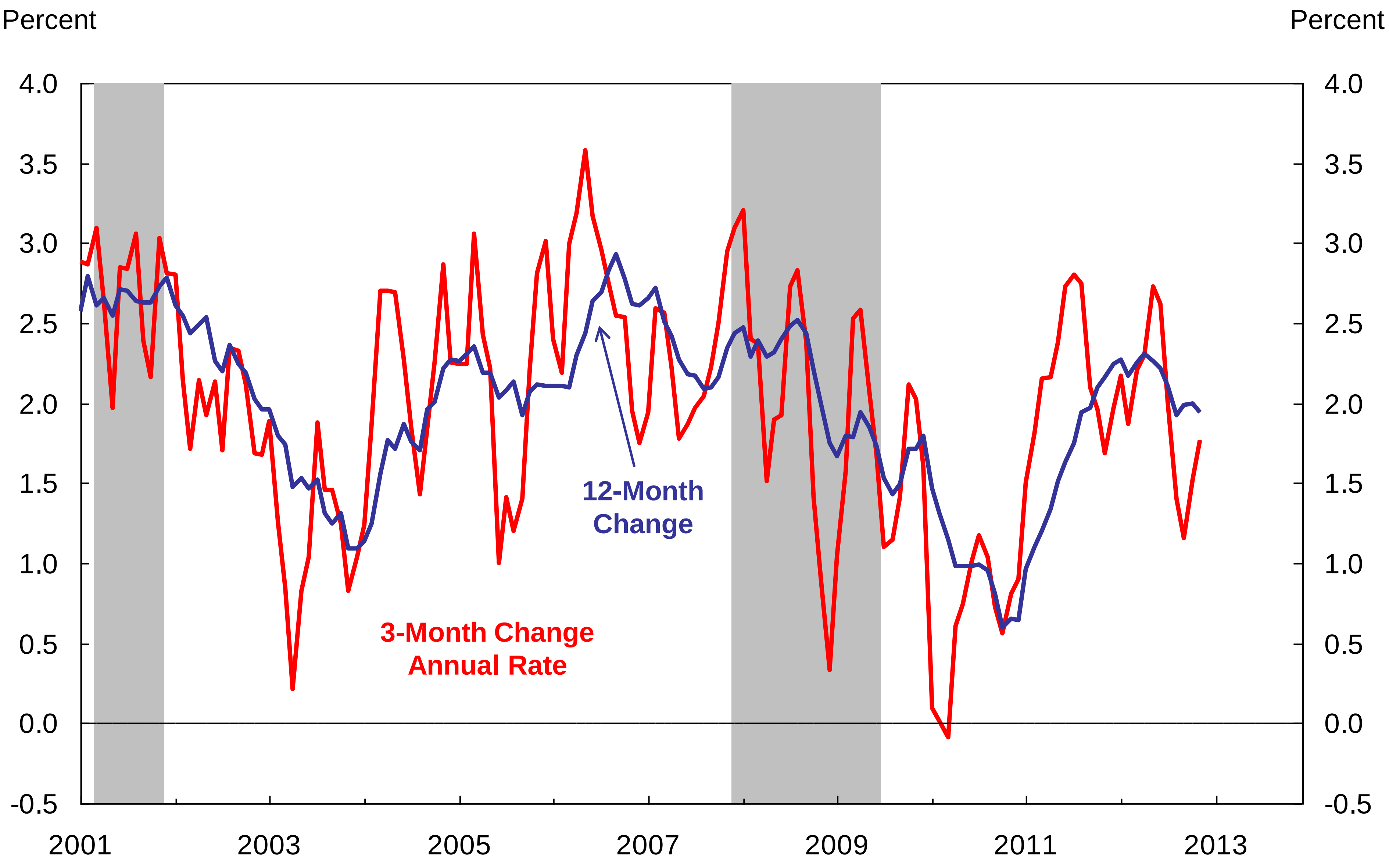
Consumer Price Inflation



Source: Bureau of Labor Statistics

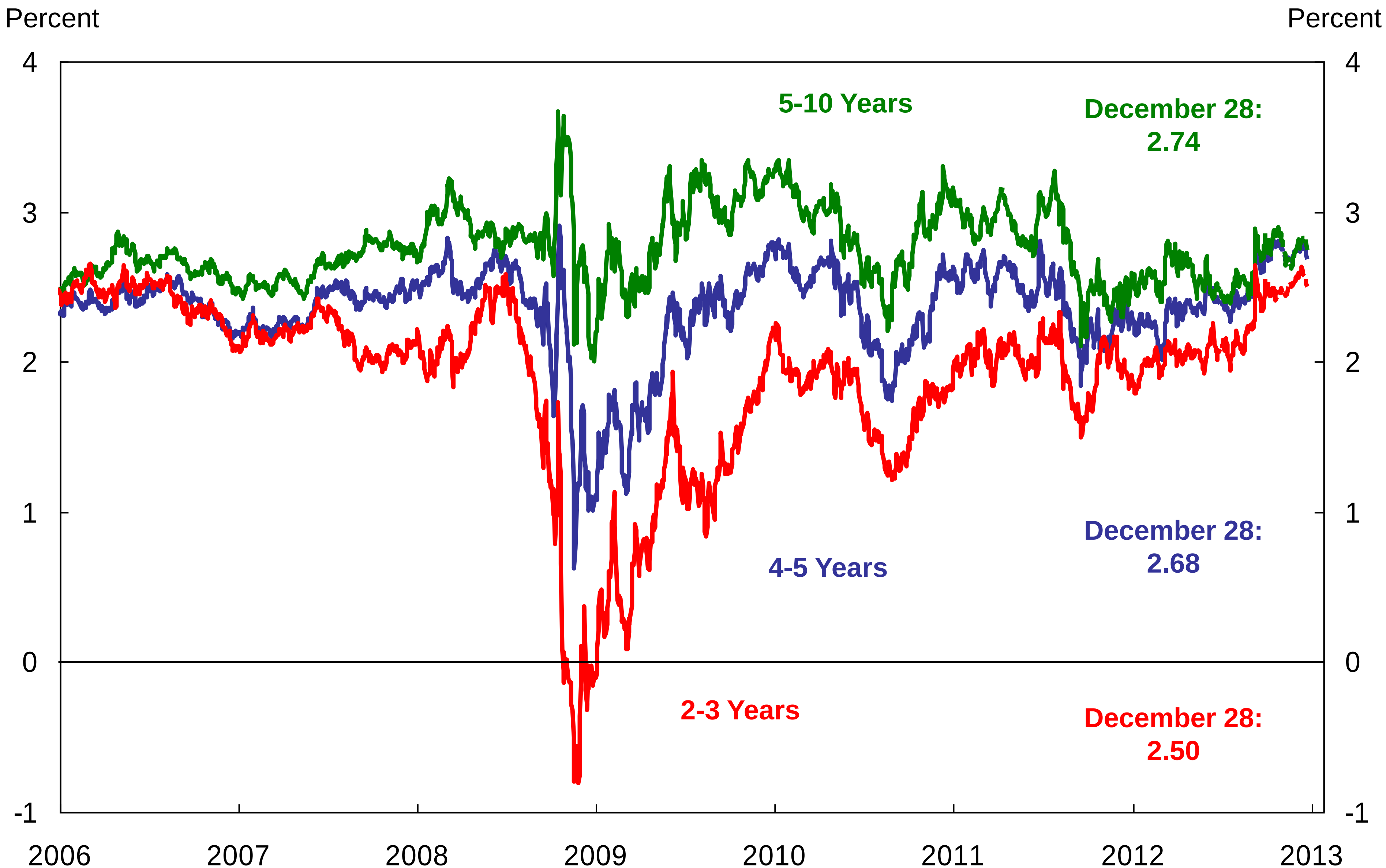
Note: Numbers in Parentheses Denote Latest Monthly Weights

Core CPI



Source: Bureau of Labor Statistics

TIPS Based Inflation Expectations



Source: Federal Reserve Board

Note: Carry-adjusted.

Policy Responses to the Slow Recovery

- The Great Recession involved both a deep recession and deep financial distress.
  - Well-documented that generating robust recovery in such circumstances is difficult.
  - Also well-documented that risk exists that premature policy tightening can stall out the recovery.

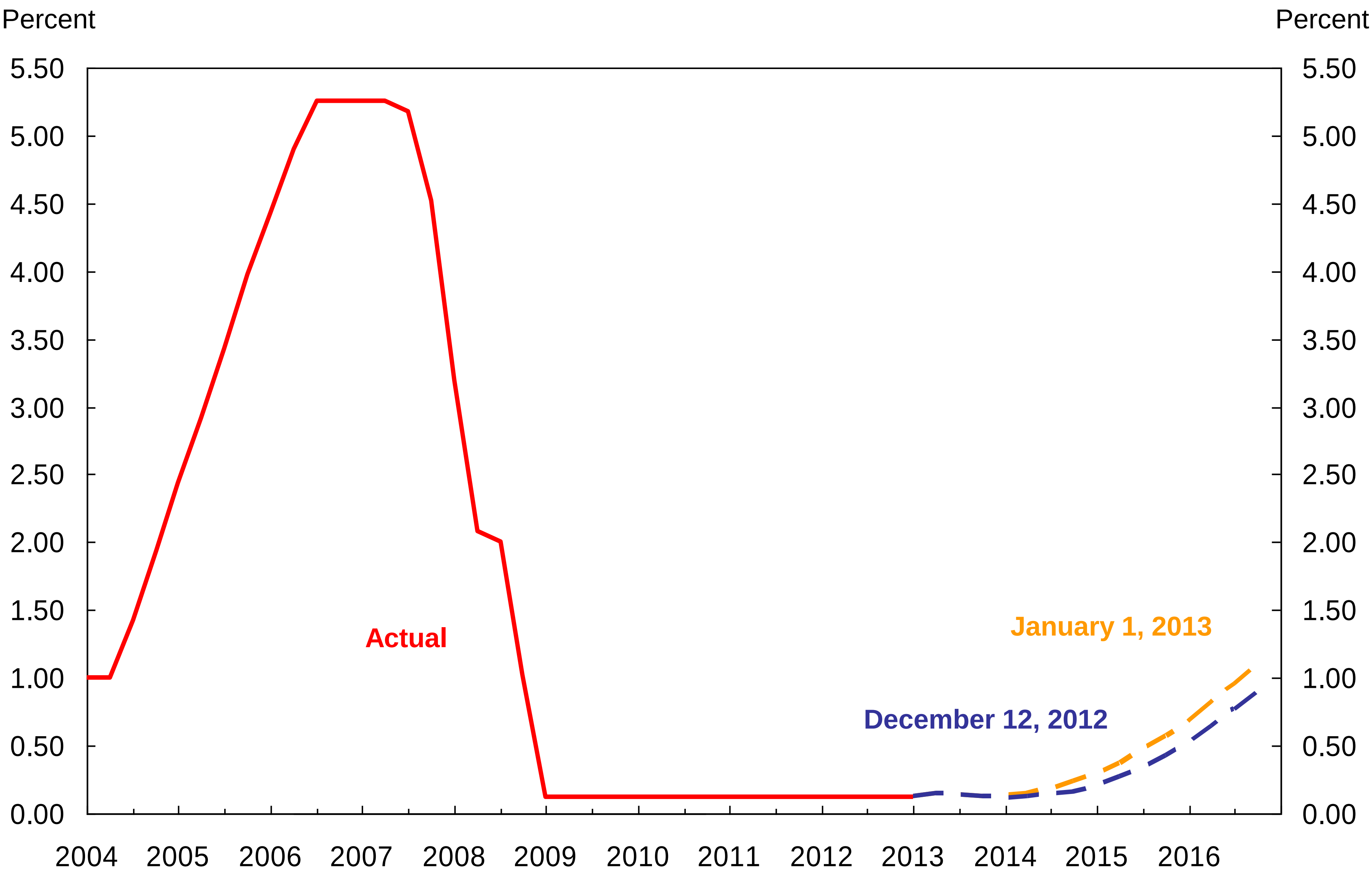
- Tools for generating the robust recovery:

  - Monetary Policy
  - Fiscal Policy
  - Trade policy/Regulatory policy

Monetary Policy

- From the Federal Open Market Committee’s December 12, 2012 statement:
- The FOMC’s intention is to support a stronger economic recovery and to help ensure that inflation, over time, is at the rate most consistent with its dual mandate.
- The Federal Funds rate target range is from 0 to ¼ point.
- The FOMC announced plans to purchase agency mortgage-backed securities at a pace of $40 billion per month and start purchasing longer-term Treasury securities, initially at a pace of $45 billion per month.
  - It expects the purchases to maintain downward pressure on longer-term interest rates, support mortgage markets, and make broader financial conditions more accommodative.
- The program of securities purchases is open-ended.
  - If the outlook for the labor market does not improve substantially, the Committee will continue its purchases of Treasury and agency mortgage-backed securities, and employ its other policy tools as appropriate, until such improvement is achieved
- The FOMC currently anticipates that the “exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6-1/2 percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee’s 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored.

Actual and Expected Fed Funds Target



Source: Federal Reserve Board and staff estimates.

Table 1: Tax and Spending Provisions of the "Fiscal Cliff"

	Impact on Calendar 2013 Deficit	
Baseline Provisions	**Billions of Dollars**	**% of GDP**
Payroll Tax Cut	-127	0.8
Affordable Care Act Taxes	-24	0.1
Emergency Unemployment Benefits	-35	0.2
Partial Expensing	-87	0.5
Discretionary Spending		
Budget Control Act caps	-29	0.2
Overseas defense drawdown	-15	0.1
Subtotal	**-317**	**1.9**
Additional Provisions of Full Fiscal Cliff		
2001-2003 tax cuts and AMT	-295	1.8
Medicare "Doc fix"	-15	0.1
Regular Tax extenders (ie, R&D credit)	-47	0.3
Full Sequester (additional amount)	-87	0.5
Subtotal	**-444**	**2.7**
Total	**-761**	**4.7**

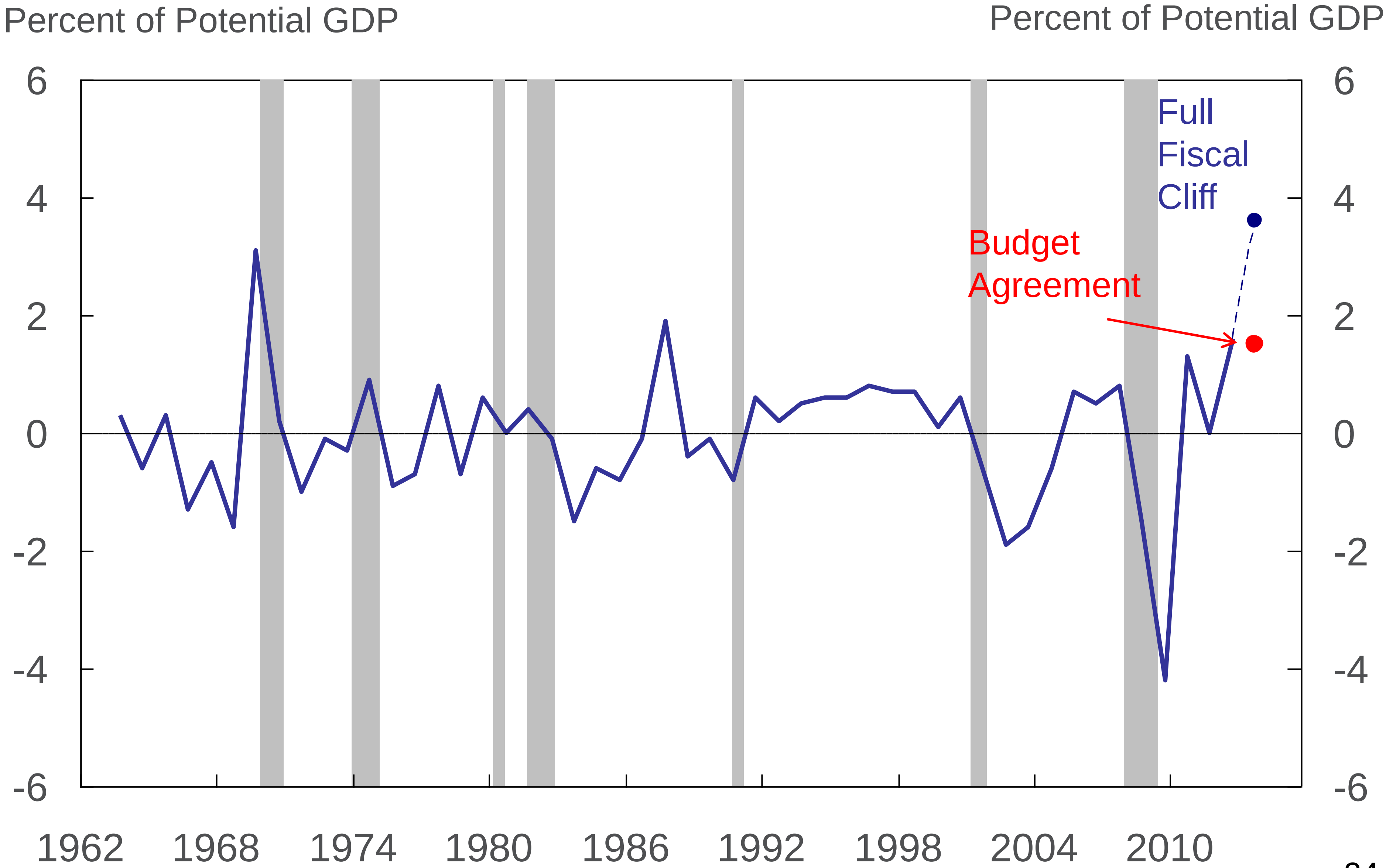
Source: Congressional Budget Office. Provisions incorporated in consensus baseline from National Association for Business Economics, October 2012.

American Taxpayer Relief Act of 2012

- **Major Individual Income Tax Provisions**
  - 2 percentage point reduction of payroll tax in effect in 2011 and 2012 is allowed to expire.
  - Extends permanently the Bush individual income tax rate schedule except as follows:
    - Creates a new 39.6% marginal tax rate on taxable income greater than $450,000 for a joint return, $400,000 for a single return.
    - Reintroduces the phasing out of personal exemptions and itemized deductions at the rate of 3% of the amount of AGI above $300,000 (joint return), $250,000 (single return).
    - Raises the tax rate on long-term capital gains and qualified dividends for those subject to the 39.6% marginal tax rate to 20% (from 15%). Additional ACA tax raises the rate to 23.8%.
  - Permanently establishes the estate tax rate at 40% with a $5 million exemption per spouse, indexed for inflation. (up from 35% in 2012).
  - Permanent Alternative Minimum Tax (AMT) fix.
    - Raise the AMT exemption amount for 2012 to $78,750 (joint) and index exemption, exemption phaseout threshold, and income bracket for inflation.
  - One year extension of deduction of state and local sales taxes.
- **Major Business Tax Provisions**
  - One year extension of 50% bonus depreciation for qualified investment.
  - One year extension of research and experimentation tax credit. One year increase in Section 179 expensing amount and threshold.
  - One year extension of tax credit for renewable electricity production.
- **Major Spending Provisions**
  - Extend Emergency Unemployment Benefits for one year.
  - Postpones for one year deep cuts in reimbursements for doctors seeing Medicare beneficiaries.
    - (This is paid for by $25 billion over 10 years in reduced reimbursement rates for hospitals and other providers.)
  - Postpones the sequester for 2 months.
    - (This is paid for with $24 billion of additional revenue and spending cuts?)

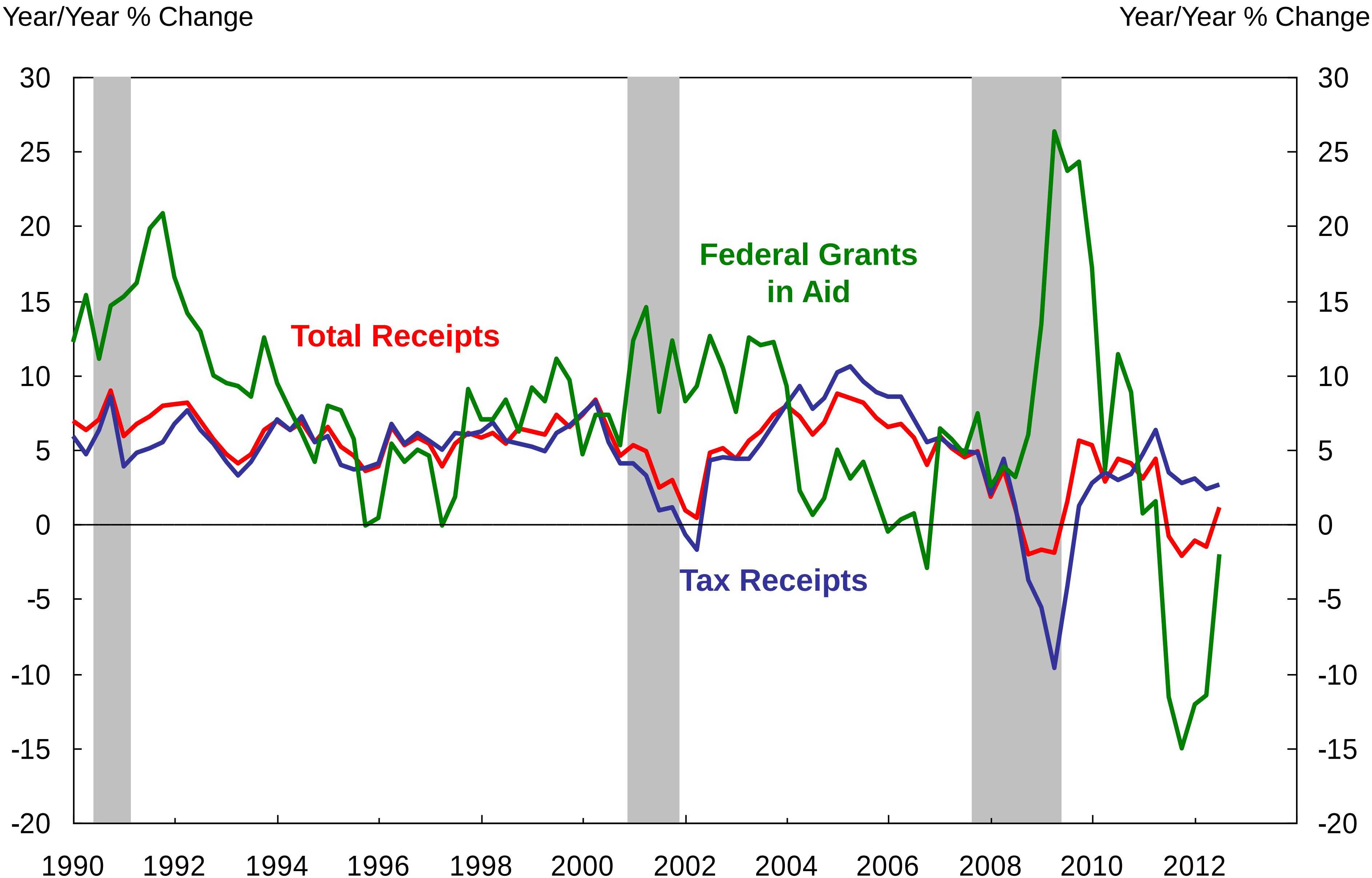
Stance of Fiscal Policy

Change in Full Employment Budget Balance as a Percent of Potential GDP



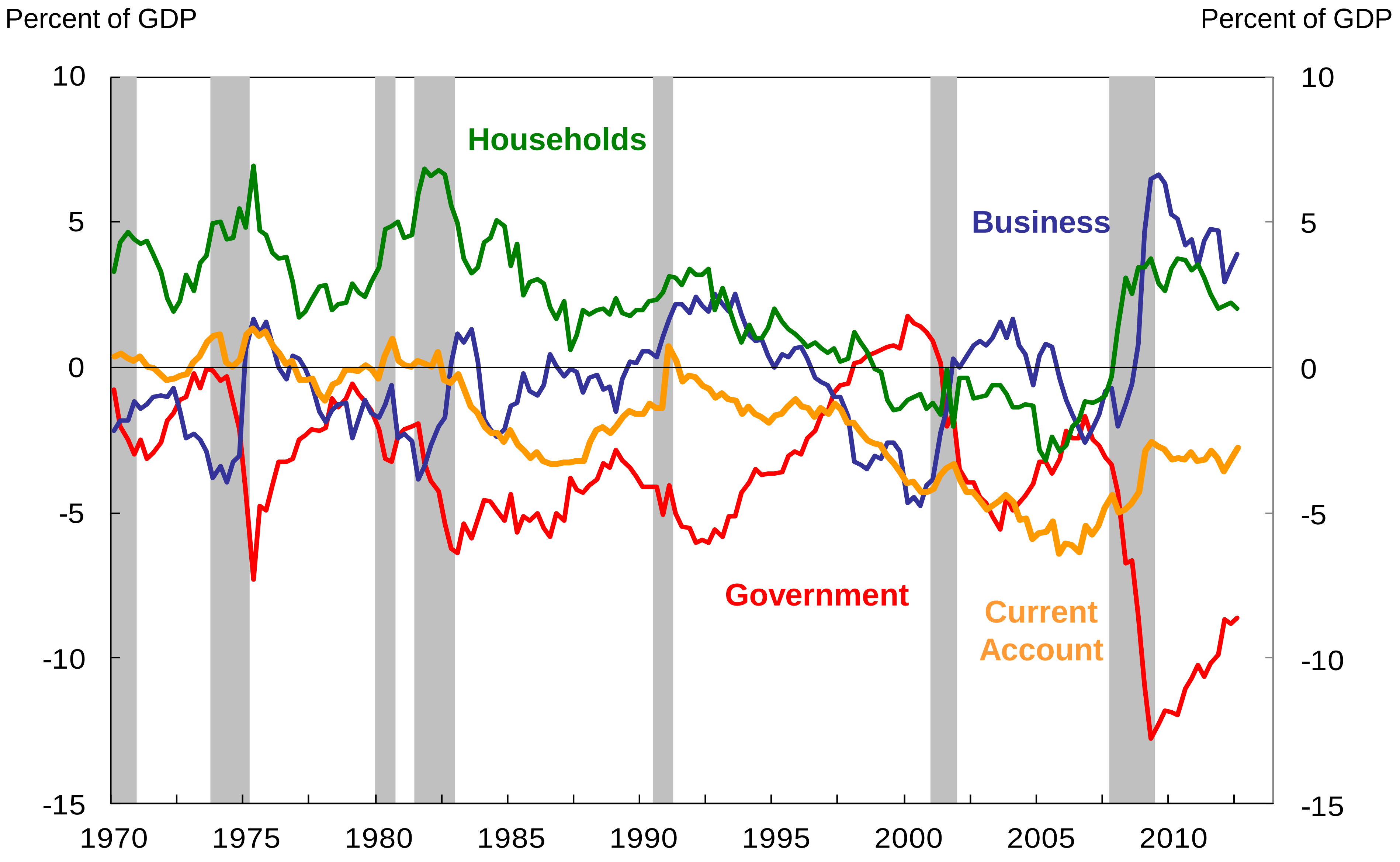
Source: Congressional Budget Office and staff estimate.

State & Local Government Receipts



Source: Bureau of Economic Analysis

Private and Public Balances



Source: Bureau of Economic Analysis

Note: Shading represents NBER recessions.

The US in the Global Economy

- Resolving our issues and resuming strong, sustainable growth is key to our economic leadership.
- The emerging market countries are beginning to achieve the income levels and wealth the US hoped for and worked toward in the early years after World War II.
- The growth in emerging market economies greatly outpaces growth in the advanced economies, but emerging market growth is slowing as standards of living start catching up to advanced country levels, demographic trends slowly converge to those of the advanced countries, and emerging markets' customers in the advanced economies have cyclically slowed.

The Advanced Economies: The U.S., Europe and Japan

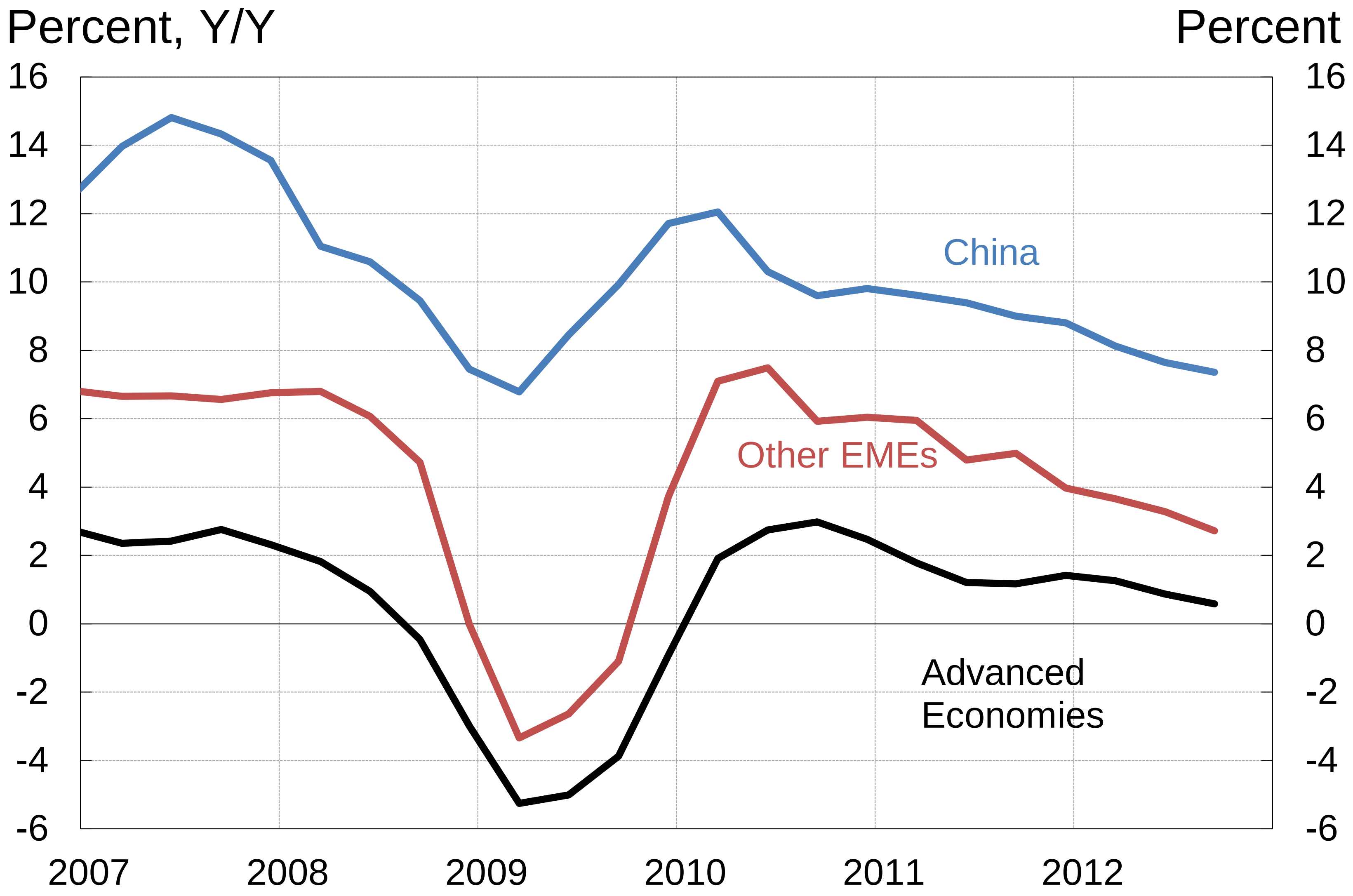
- While the details differ across the advanced economies, all have a similar dilemma:

  - All three major regions are experiencing slow growth and seeking more of a “break-out” recovery.
  - All have had substantial financial sector dislocations.

  - All have similar significant fiscal problems: high debt to GDP ratios, large deficits, high contingent liabilities such as public pensions and medical insurance.

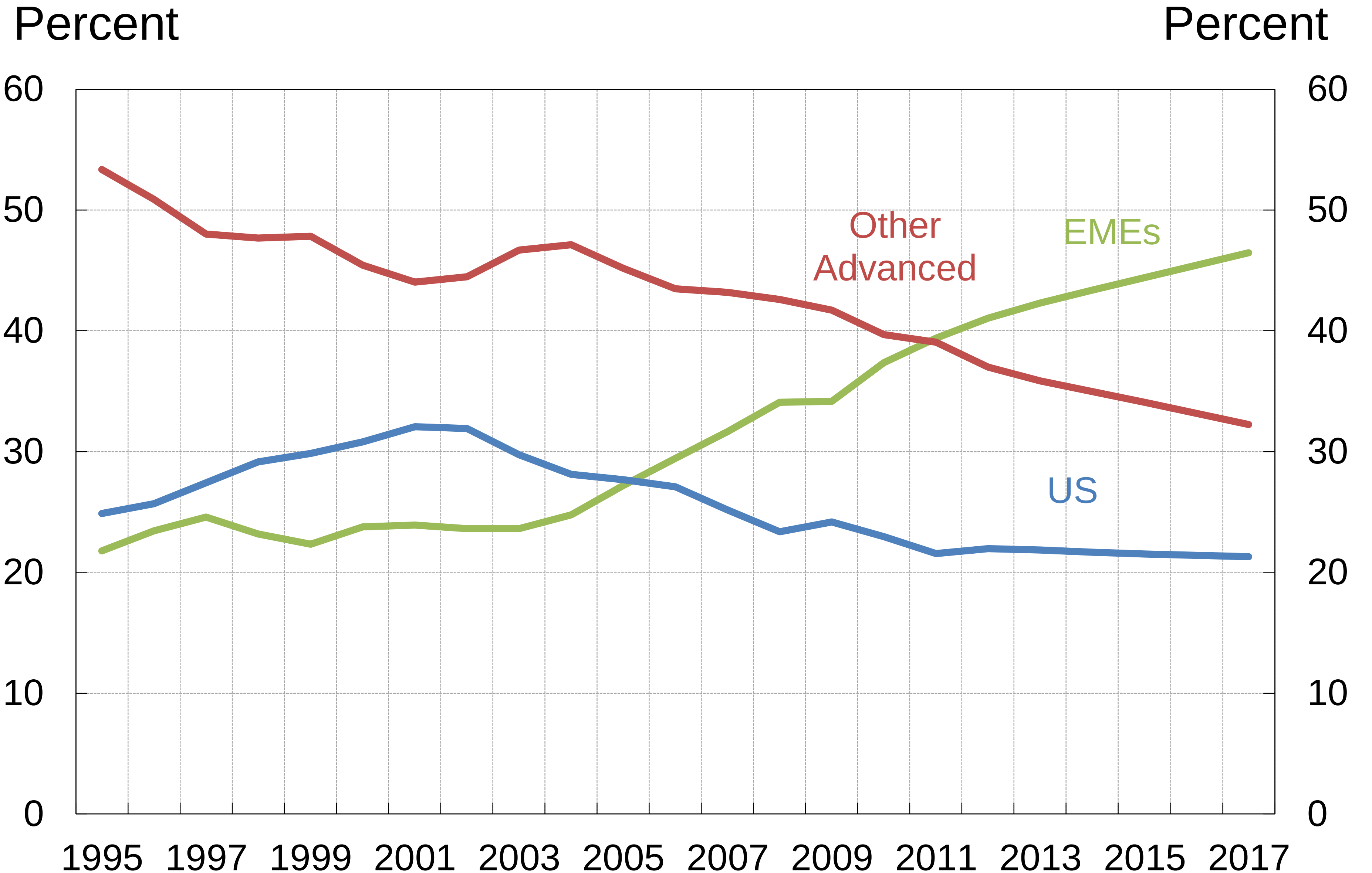
  - All are exploring unconventional monetary measures given the zero bound on interest rates and wrestling with fiscal choices.

Real GDP Growth



Other EMEs include India, Indonesia, Hong Kong, Korea, Malaysia, Philippines, Singapore, Taiwan, Thailand, Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela, Hungary, Russia, South Africa, Poland, Turkey, Ukraine (from 2002)
Source: National authorities

Percentage Distribution of Global GDP



Source: IMF