The Fed and the Economic Outlook for the Nation and Virginia

Central Virginia Chapter of the Institute of Internal Auditors
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Overview

The Federal Reserve System
- Short history
- Structure and governance
- Mission and functions
- Focus on monetary policy

The National Economy
- Measures of output
- Labor markets
- Business investment
- Residential investment

The Virginia Economy
- Business activity
- Labor markets
- Housing markets
The Federal Reserve System
Why Do We Have a Central Bank?

Before the Fed was created a century ago...
How is the Fed Structured?

Federal Reserve System

Board of Governors (Washington, D.C.)
A government agency

12 Regional Reserve Banks
Private nonprofit

Federal Open Market Committee (FOMC)
7 governors + 5 RB presidents
Each Reserve Bank has a Board of Directors that:

- Oversees Reserve Bank operations
- Provides “grassroots” information on economic conditions

Board members that represent the public appoint Reserve Bank presidents.
Fed’s Mission & Core Functions

Mission: To foster a stable banking system and a healthy, growing economy.

Monetary Policy

Bank Supervision and Regulation

Payment Services
The Fed supervises financial institutions to help ensure safe and sound banking practices.

- Board of Governors: Writes regulations
- Reserve Banks: Enforce regulations through supervision
Fed is one of several U.S. regulators

- When jurisdictions overlap, the Fed works with other regulators

**Richmond Fed supervises approximately:**

- 80 state member banks
- 240 holding companies

**Examiners look at:**

- Sufficiency of capital, earnings, and liquidity
- Quality of management and assets
- Sensitivity to interest rate changes
- Compliance with consumer protection laws and regulations
The Fed helps move payments from point A to point B.

- Cash
- Checks
- Electronic payments
- Services to U.S. Treasury
Check Processing Sites: 1 Today
Monetary Policy

Definition

Actions taken by the central bank to influence interest rates in the economy

Objectives (mandate from Congress)

1. Maximum employment
2. Stable prices
3. Moderate long-term interest rates
Goals of Monetary Policy

Explicit price stability goal

- Inflation is determined primarily by monetary policy
- Inflation goal (specified by FOMC): 2 percent on average

No explicit employment goal

- In long run, employment is determined by factors outside monetary policy
- So, not appropriate to set fixed employment goal
The Federal Open Market Committee (FOMC)

- 7 governors + 5 Reserve Bank presidents (4 rotating)
- Meets 8 times per year
- Analyzes economic conditions
- Determines policy
Reserve Banks’ Role in Monetary Policy

- Economists conduct research, analyze economy
- Regional group collects data and information
- Advisory councils and Board of Directors provide anecdotal insight
- President attends FOMC armed with this information
- Structure provides for diversity of views on FOMC
Fed’s operations are audited by Congress, but monetary policy isn’t.

Why?

- It is politically tempting to boost employment through monetary policy.
- But in the long run, employment is determined by factors outside monetary policy.
- Continual monetary stimulus would raise inflation, with no positive effect on employment.
- Independence allows the Fed to stay focused on longer-term goals, while being able to achieve short-run objectives.

*Independence insulates monetary policy from short-term political influences.*
Independence with Transparency

Fed’s independence is balanced by transparency and accountability.

How?

- Balance sheet made public, updated weekly
- Minutes of FOMC released within a month of meetings
- Verbatim transcripts of FOMC released with five-year lag
- Chair testifies to Congress twice a year
- FOMC statements, Chair press conferences, speeches
National Economy
U.S. Real Gross Domestic Product

% Change, SAAR

Q3: 2016
US: 3.5%

Source: Bureau of Economic Analysis via Haver Analytics
### Real Gross Domestic Product

<table>
<thead>
<tr>
<th></th>
<th>2015 Q3</th>
<th>2015 Q4</th>
<th>2015 Q1</th>
<th>2016 Q2</th>
<th>2016 Q3</th>
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</thead>
<tbody>
<tr>
<td><strong>CHANGE FROM PREVIOUS QUARTER AT COMPOUND ANNUAL RATE [PERCENT]</strong>:</td>
<td></td>
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<tr>
<td>Gross Domestic Product</td>
<td>2.0</td>
<td>0.9</td>
<td>0.8</td>
<td>1.4</td>
<td>3.5</td>
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<tr>
<td>Personal Consumption Expenditures</td>
<td>2.7</td>
<td>2.3</td>
<td>1.6</td>
<td>4.3</td>
<td>3.0</td>
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<tr>
<td>Nonresidential Fixed Investment</td>
<td>3.9</td>
<td>-3.3</td>
<td>-3.4</td>
<td>1.0</td>
<td>1.4</td>
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<tr>
<td>Structures</td>
<td>-4.3</td>
<td>-15.2</td>
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<td>-2.1</td>
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<tr>
<td>Equipment</td>
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<td>-2.6</td>
<td>-9.5</td>
<td>-2.9</td>
<td>-4.5</td>
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<td>Intellectual Property Products</td>
<td>2.1</td>
<td>4.6</td>
<td>3.7</td>
<td>9.0</td>
<td>3.2</td>
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<tr>
<td>Residential Fixed Investment</td>
<td>12.6</td>
<td>11.5</td>
<td>7.8</td>
<td>-7.7</td>
<td>-4.1</td>
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<tr>
<td>Exports of Goods &amp; Services</td>
<td>-2.8</td>
<td>-2.7</td>
<td>-0.7</td>
<td>1.8</td>
<td>10.0</td>
</tr>
<tr>
<td>Imports of Goods &amp; Services</td>
<td>1.1</td>
<td>0.7</td>
<td>-0.6</td>
<td>0.2</td>
<td>2.2</td>
</tr>
<tr>
<td>Government Consumption Expenditures &amp; Gross Investment</td>
<td>1.9</td>
<td>1.0</td>
<td>1.6</td>
<td>-1.7</td>
<td>0.8</td>
</tr>
<tr>
<td>Final Sales to Domestic Purchasers</td>
<td>3.0</td>
<td>1.7</td>
<td>1.2</td>
<td>2.4</td>
<td>2.1</td>
</tr>
</tbody>
</table>

| LEVEL IN QUARTER AT SEASONALLY ADJUSTED ANNUAL RATE [Billions of Chained (2005) Dollars]: |         |         |         |         |         |
| Change in Private Inventories | 70.9    | 56.9    | 40.7    | -9.5    | 7.1     |
| Net Exports of Goods & Services | -547.1  | -566.6  | -566.3  | -558.5  | -522    |

Source: Bureau of Economic Analysis via Haver Analytics
Retail Sales

Source: Census Bureau via Haver Analytics

YoY % Change
September: 3.3%
October: 4.2%
November: 3.8%

Source: Census Bureau via Haver Analytics
Total Employment Growth

Average Monthly Change, Thous.

Monthly Change
September: 208
October: 142
November: 178

Source: Bureau of Labor Statistics/Haver AnalyticsC
Unemployment Rate

Source: Bureau of Labor Statistics/Haver Analytics

November 2016
US: 4.6%
Average Hourly Earnings

Source: Bureau of Labor Statistics/Haver Analytics

November: 2.5%
Residential Fixed Investment

% Change, SAAR

Source: Bureau of Labor Statistics/Haver Analytics

3Q:2016 -4.1%
Single-family Existing vs New Home Sales

Source: Census Bureau via Haver Analytics
Private Single-Family Housing Starts & Permits

Millions, SAAR

- Single-family Housing Permits
- Single-family Housing Starts

90's Average Permits: 1.010
90's Average Starts: 1.105

November 2016
Permits: 0.780 million
Starts: 0.828 million

Source: Census Bureau via Haver Analytics
Multi-Family Housing Starts & Permits

November 2016
Permits: 0.432 million
Starts: 0.262 million

90's Average Permits: 0.313
90's Average Starts: 0.268

Source: Census Bureau via Haver Analytics
Core Personal Consumption Expenditure Price Index

Source: Bureau of Economic Analysis, Board of Governors via Haver Analytics
Virginia Economy
Virginia Payroll Employment

Average Monthly Change, Thous.

Monthly Change (Thous.)
September: 11.9
October: 3.5
November: -13.6

Source: Bureau of Labor Statistics/Haver Analytics
Virginia Payroll Employment

Source: Bureau of Labor Statistics/Haver Analytics

November 2016
US: 1.6%
VA: 1.0%
Virginia Industry Structure

Source: Bureau of Labor Statistics/Haver Analytics
Virginia Industry Growth

November 2016

Total
Natural Resources & Mining
Construction
Manufacturing
Trade, Transportation & Utilities
Information
Financial Activities
Professional & Business Services
Education & Health Services
Leisure & Hospitality
Other Services
Government

YoY % Chg (SA)

Source: Bureau of Labor Statistics/Haver Analytics
Virginia Industry Growth
January 2007 through November 2016

Index, 100 =
December 2007

Professional & Business Services
Education & Health Services
Total

Source: Bureau of Labor Statistics/Haver Analytics
September 2016
US: 6.3%
VA: 2.1%

Source: CoreLogic Information Solutions
Summary

• Economic growth in the U.S. was strong in the third quarter, with some indication of recovery in the business investment sector.

• Consumer spending continued to grow, bolstered by continued labor market tightening.

• Housing market activity expanded slowly in most areas, despite the sluggish third quarter in national residential investment.

• Labor markets in Virginia struggled in November, leaving the state with choppy employment growth over the course of 2016. Housing markets continued to exhibit slow but positive activity.
More Information

Access publications and other information online at:

- richmondfed.org
- federalreserve.gov
- FederalReserveHistory.org

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