Economic Outlook & Federal Reserve Overview

LAI Baltimore Chapter – June, 2016 meeting

At the June lunch meeting of the Baltimore LAI Chapter, Andrew Bauer, Senior Regional Economist, provided his assessment of the Mid-Atlantic economy, as well as an overview of the Federal Reserve banking system.

Mr. Bauer works for the 5th Fed District, one of 12 across the United States, which encompasses MD, DC, WVA, VA, and N&S Carolina. Each of the 12 regional Fed Reserve Bank districts has a vote on the Federal Open Market Committee ("FOMC"), which sets the Country's monetary policy decisions.

Given that the FOMC was meeting at the same time as Mr. Bauer was speaking to our LAI Chapter, he was in a bit of an uncomfortable position – not able to discuss monetary policy while the FOMC meeting is ongoing. Mr. Bauer therefore took the opportunity to provide an overview of, and a bit of history on, the FOMC with the following highlights:

- The overarching goals of the FOMC are stable prices and maximum employment
- FOMC meets eight times per year
- On four of those occasions, a press conference follows the FOMC meeting
- Starting in 1994, the first FOMC "statement" was released to discuss its outlook & decisions
- FOMC members started submitting individual forecasts soon thereafter
- Recently the FOMC established a formal inflation target, which has been set at 2%. No formal unemployment goal has been set

Further highlighting the rather opaque view of the Federal Reserve held by the general public, Mr. Bauer asked for a show of hands as to how many audience members believed that as a 5th District Fed economist, he is a Government employee. This writer raised his ignorant hand – and was quickly disabused of that misconception. The reality is that the 12 Fed Reserve Banks that comprise the Fed Reserve banking system, are all private entities that are owned by the banks within each of the 12 regions. National Banks within each region are required to be shareholders of that regions Fed Reserve Bank. State chartered banks can opt to be shareholders, in which case they are regulated by the Fed Reserve, and those that choose not to be shareholders are regulated by the FDIC.

With that brief history lesson as a backdrop, Mr. Bauer moved on to the unusual role played by the Fed Reserve during our Country's recent financial crisis, explaining that during the "Great Recession", the Fed used its balance sheet to invest approximately $3 trillion into the U.S. economy. By purchasing Mortgage Backed Securities originated by Fannie Mae and Freddie Mac, as well as other asset-backed commercial paper, the Fed Reserve's balance sheet has ballooned to approximately $4.5 trillion as a result of its efforts to stabilize the economy. And as the Fed Reserve is "not a line item in the U.S. Budget", these stimulus efforts on the part of the Fed Reserve did not add to the budget deficit woes of our Federal Government. Rather, the income generated by the Fed Reserve's burgeoning balance sheet has become a tempting target for our political class to tap. Mr. Bauer explained that $20 billion was recently taken from the Fed Reserve's balance sheet to fund a Transportation Bill Congress passed in 2016 (which reminds this writer of the famous Willie Sutton response to the question, why do you rob banks? "Because that's where the money is!"). Mr. Bauer advised that Congress is now considering legislation that would "tinker with how Regional Fed Reserve Bank presidents are appointed". The implication drawn by this writer being that our ever profligate Congress members are following the logic of Mr. Sutton.

Regarding the U.S. economic outlook, Mr. Bauer conveyed that he was "upbeat about the National economy", despite May's poor jobs report. He opined that the 2nd quarter of this year will show favorable economic growth due to consumer spending growing at about 3%. With consumer spending comprising a majority of economic activity, GDP growth will naturally follow suit. Mr. Bauer then addressed the conundrum of why the U.S. economy has been stuck at a low overall growth rate of 2% or less since the Great Recession. He opined that this stubbornly low growth has been the result of (i) the labor force not growing – demographics resulting from all the retiring Baby Boomers, and (ii) productivity growth slowing. Other notable "soft spots" in the economy are the energy sector (substantial drop in oil & gas prices globally), and the negative impact on manufacturing/exporting caused by the Dollar's rise over the past several years.

With respect to the regional Mid-Atlantic economy, Mr. Bauer was sanguine, noting that the energy industry's difficulties are not impacting the Mid-Atlantic, and that manufacturing in a not a large portion of our region's output. "We have some manufacturing here but not a lot". He expects his 5th Fed District to outperform national GDP growth as a result of the absence of these drags on the rest of the country.

As our allotted luncheon timeframe came to a close, Mr. Bauer had to conclude his highly informative remarks and our LAI members & guests were reluctantly forced to face their afternoon work schedules. I'm sure I speak for all attendees that Mr. Bauer's remarks were quite illuminating and left us all with an improved knowledge of both the Federal Reserve System and our economic outlook for the balance of the year.