The President’s Report to the Board of Directors

November 10, 2014
CURRENT ECONOMIC DEVELOPMENTS - November 10, 2014

Data released since your last Directors’ meeting show that economic growth slowed a bit in the third quarter, yet still improved upon its first half performance, and suggest the moderate growth will continue through the rest of the year. The labor market showed further signs of strengthening and support from manufacturing has improved, while consumer spending and residential investment have slowed. Overall, recent data remains consistent with a moderately growing economy, while the downside risks stemming from weakness in growth abroad remain a concern.

In October, nonfarm payrolls posted a sizeable increase and job gains for the previous two months were revised higher. The unemployment rate fell one-tenth of a percentage point to 5.8% in October, as an increase in the labor force was outpaced by a larger gain in civilian employment. Initial claims for unemployment insurance continued to decrease in October, reaching a fourteen-year low.

The growth in real GDP in the third quarter primarily reflected positive contributions from personal consumption expenditures, exports, nonresidential fixed investment, federal government spending, and state and local government spending. Those effects were partly offset by a negative contribution from private inventory investment. Imports, which are a subtraction in the calculation of GDP, decreased.

Consumer attitudes improved in October to their highest levels in seven years, with the majority of respondents more optimistic about future conditions for the overall economy and for their personal financial situations. Durable goods orders increased in the third quarter on both a year-over-year and quarterly basis, while core orders were also up from their year-ago levels, despite falling a bit from the previous quarter. The ISM index rose in October, suggesting further expansion in the manufacturing sector.

Total consumer inflation decelerated in the third quarter, as did the core index. Oil prices fell steadily through October and into November, reaching their lowest levels in over two years.
Initial claims for unemployment insurance declined on average in the third quarter. Claims edged down further in October, reaching their lowest monthly average in over fourteen years.

Real GDP growth decelerated in the third quarter. The lower rate was due primarily to a downturn in private inventory investment and decelerations in PCE, in nonresidential fixed investment, in exports, in state and local government spending, and in residential fixed investment that were partly offset by a downturn in imports and an upturn in federal government spending.
Real consumption growth eased in the third quarter and was a smaller contributor to GDP growth. Growth in both real and nominal incomes also slowed in the third quarter. However, despite the lower than expected income growth, consumption is likely to improve somewhat in the near term due to strengthening measures of consumer attitudes.

Total lightweight vehicle sales in October were below their third quarter average, but rose slightly from their September pace. Falling gasoline prices and improving consumer attitudes likely contributed to the monthly increase in sales, which are roughly in line with their pre-recession levels.
Business investment slowed in the third quarter, due in part to lesser equipment and software growth, after both series posted strong increases in the prior quarter.

![Business Investment](chart)

On a year-over-year basis, new orders for durable goods surged in the third quarter, after decelerating in each of the previous four quarters. The third quarter acceleration was due, in part, to a large increase in civilian aircraft orders in July. Meanwhile, orders of nondefense capital goods, excluding aircraft, rose on a year-over-year basis, but eased a bit when compared to the second quarter.

![Durable Goods Orders](chart)
Residential investment posted a small gain in the third quarter, increasing at a slower rate than that seen in the second quarter.

Residential Investment

![Residential Investment Chart]

Source: U.S. Census Bureau / Haver Analytics.

Housing data improved in the third quarter. Existing home sales rose for the second consecutive quarter, and new home sales increased to their highest quarterly average so far this year.

New and Existing Home Sales

![New and Existing Home Sales Chart]

Source: U.S. Census Bureau / Haver Analytics.
In the third quarter, government spending posted a gain for the second consecutive quarter. The improvement was due to a surge in federal government spending, as state and local spending eased in the third quarter.

Export growth slowed in the third quarter, but offset a decrease in imports, which resulted in a boost to GDP from net exports.
Measures of consumer attitudes improved in October, as the confidence index and the sentiment index increased above their third quarter averages and have both reached seven-year highs. In general, consumers were more optimistic towards the economic outlook and their personal finances.

The ISM index increased in October, matching the three-year high seen in August, and indicated continued expansion of the manufacturing sector. The employment index also improved in October from September, but was below its third quarter average.
Growth in total consumer prices eased in the third quarter, after accelerating in each of the past two quarters. Growth in core prices also decelerated in the third quarter.

Productivity rose in the third quarter, albeit at a slower pace than the upwardly revised rate in the second quarter, as output increased more than hours worked. In the third quarter, growth in compensation was unchanged from its rate in the prior quarter, and unit labor costs inched up after declining slightly in the previous quarter.
In the third quarter, total compensation growth continued to accelerate as the ease in benefit costs growth was more than offset by the acceleration in wages and salaries growth.

On average, oil prices in October dropped from the levels seen in the third quarter, reaching their lowest monthly average since June 2012. The daily closing prices fell consistently during the month and have continued to fall in early November, reaching $78.7 per barrel on November 7.
Data released since your last Directors’ meeting show that economic growth slowed a bit in the third quarter, yet still improved upon its first half performance, and suggest the moderate growth will continue through the rest of the year. The labor market showed further signs of strengthening and support from manufacturing has improved, while consumer spending and residential investment have slowed. Overall, recent data remains consistent with a moderately growing economy, while the downside risks stemming from weakness in growth abroad remain a concern.

![Short-Term Interest Rates](image-url)

Source: Federal Reserve Board of Governors / Haver Analytics.
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