

## Fed Policies Sufficient to Dampen Deflation Threats?

The technical paper from St. Louis Fed President James Bullard is the kind of thing that only economists will love as he admits that it is pretty “geeky” but it brings up an interesting issue as far as current Fed policy. It has been obvious since the start of the recovery that the Fed has been trying to keep one eye on the threat of inflation and one on the pace of the recovery. The most important consideration has been to make sure that the economy doesn’t slide back into the recession and that has underpinned the desire to keep interest rates near zero for an extended period of time. This policy has been supported by almost constant reassurances that the rates will stay low as long as they need to. At the same time, the Fed has moved in some other areas to pull back as a means to hold off any sort of inflation burst that could force those rates back up.

The fear is that all of this anti-inflation talk will create the conditions that allow deflation to emerge as an issue and the US would end up facing the kind of problem that Japan has struggled with for the last decade or longer. Bullard’s paper suggests that all of these assurances that inflation will be fought as a high priority may have the unwanted effect of encouraging the development of a deflation threat as there is too much emphasis being placed on the inflation control mechanism. He points out that when the European crisis unfolded, the Fed made a point of reiterating that rates would remain low in response and this would have been expected to have an impact on inflation expectations. It didn’t as was indicated by the reaction by the TIPS market. These are The Treasury Inflation Protected Securities and they should have risen in response to the policy but they fell instead – suggesting there was very little inflation threat perceived.

**Analysis:** Bullard has made a case for the Fed to engage in more of what has been generally termed “quantitative easing”. This is the process of directly intervening in the system by the purchasing of bonds and securities like the mortgage backed securities the Fed was buying until earlier this spring. That effort was halted in May and Bullard is not exactly recommending that the Fed get back into that business but he does think that there need to be statements of intent – that if there is a threat of deflation the Fed is well prepared to get engaged in these purchases and as aggressively as the situation would warrant.

This is the real strength of the Fed – talking. It isn’t really the actions of the Fed that pull markets in one direction or another. By the time the Fed acts there is usually a consensus that this is the right thing to do and the markets are expecting the action. The power is in what the Fed might do and when they might do it. If the Fed keeps the markets and investors a little off balance there is more flexibility possible as far as policy is concerned. The point that Bullard is making is that the measures the Fed could use to dump some money in the economy would let the investment community know that some inflation can be stimulated at any time the Fed determines that such a move would be needed to blunt the threat of deflation. There is no sense that policy will change due to this paper but there will certainly be conversation about it in the weeks to come.

## Beige Book – Round Two

Yesterday we started to go through the twelve Fed districts to provide a synopsis of what the latest Beige Book readings might be. The first six are the districts that represent the eastern half of the US and for the most part the data supports the notion that there is still a recovery under way but that it is slow and halting. The most interesting data seemed to come from the Gulf region as there was evidence that measures taken to monitor the oil business have resulted in some very significant slowdowns in business. As we look at the districts that represent the Midwest and West, the variance is much larger as these districts cover a great deal of territory. There are some real bright spots in all this as well as some regions that have managed to miss out on many of the recent growth opportunities. All in all the Beige Book tells a story of near stagnation but not decline. This is far from good news but it is also not a signal of imminent return to the depths of a recession.

The data stream has been churning along this week and there have been other releases that add to the story. The most anticipated number today is the second quarter GDP assessment although this is only the first of several versions that will be released in the weeks to come. The sense is that the rate will be about 2.5% and that is down from the revised first quarter reading of 2.7%. The real concern is that the rate may be lower than what has been forecast and the markets in Asia and Europe have already been down somewhat in anticipation of unexpected bad news.



**Analysis:** District seven is in many ways a barometer for the US economy due to the diversity of the economy contained in these states. The region includes most of Michigan (all but the UP), northern Illinois and Indiana, southern Wisconsin and Iowa. It is headquartered in Chicago and with this combination of manufacturing, transportation, agriculture and the impact of one of the nation's largest cities it has a tendency to reflect the performance of the national economy as a whole. As one would expect, the data tells a complex story in which there are gains and retreats. The manufacturing base is in better shape than it has been but that is not saying much given the extent of the damage over the last couple of years. The sickest sector is still in automotive but there is at least some stability here as opposed to what was taking place only 18 months ago. The strongest sector has been agriculture and that is likely to expand through the year as most are anticipating a strong harvest this fall. The irony is that this strong season will probably mean that farmers will get lower prices across the board and that may impact the smaller banks. Consumers are cautious here and the housing market has ranged from awful in Michigan to decent in Iowa.

The eighth district is having a harder time of it these days. It consists of eastern Missouri, southern Illinois and Indiana, western Kentucky and Tennessee, northern Mississippi and Arkansas. It is headquartered in St. Louis and in the last couple of years it has struggled to deal with the slowdown in development. But in the last period there have been some signs of progress as the manufacturing sector has started to recover at the same time that retail business has improved. This is a region that is affected broadly by what happens with Wal-Mart but it also contains some traditional manufacturing communities in places like St. Louis and Memphis. The transportation and distribution business has been of growing importance – due to the FedEx operation in Memphis.

The ninth district is one of the larger ones and one of the more robust as it contains several of the states that sport low rates of unemployment and little budget crisis. It includes northern Wisconsin and the Upper Peninsula of Michigan and this is where the tourism industry has started to recover a little. It also includes Minnesota, North Dakota, South Dakota and Montana and is headquartered in Minneapolis. The latter three are among the most successful in the nation but their impact on the greater economy is limited by the fact that all three are small population states. The dominant business of these states has been energy development and that has been lucrative for the past few years with no expectation of decline. The growth in the farm sector has been helpful as well and the whole region has been lucky enough to have escaped the worst of the recession as far as the local banking community is concerned.

The tenth district includes western Missouri, Kansas, Colorado, Wyoming, Nebraska, Oklahoma and northern New Mexico. This is a region that has solid diversity as well – everything from the energy sector in Colorado and Wyoming, transportation along the I-35/I-29 corridor through Oklahoma, Kansas and Nebraska, farming in the eastern regions and some thriving high tech communities. The headquarters are in Kansas City and at this moment there is much planning underway for the annual Jackson Hole meeting in August. This session includes most of the world's central bankers and economists of note and they will have a lot to talk about in the weeks to come. This is a region that is often something of a harbinger for the country as a whole and right now the data looks pretty solid.

District eleven has been doing very well as compared to the rest of the nation as this includes Texas, northern Louisiana and southern New Mexico and it is headquartered in Dallas. Almost every sector is doing well in this area – with the possible exception of the housing market. Even in construction there is no real decline in sight – just a stall in development that has extended over the last couple of years. There has been growth in energy related development but general manufacturing has been doing well and so has the consumer sector. Texas is one of the few large states that has managed to avoid serious trouble and that has positioned it to rebound at a pretty rapid clip.

Finally there is the monster district – number twelve. There is still some conversation about the need to split this district into two parts but thus far there has been no proposal on the table. It is literally the western third of the US – California, Oregon, Washington, Idaho, Nevada, Arizona and Utah. It also includes Hawaii and Alaska. To assert that this part of the country has been in the thick of the crisis would be the understatement of the year – the epicenter of the housing and financial crisis was in California, Arizona and Nevada. The prospects for the region are still not great but they are getting better. The consumer is critical in California and thus far they have not yet rebounded as needed. Defense spending has been a bit boon for the California economy.

## More Good News in the Gulf

There is no attempt to downplay the seriousness of the disaster in the Gulf but there is positive news coming from the region every day and the hope is that this informs some of the future business and governmental decisions before some further damage is done to the local economy. The oil spill is vanishing faster than many thought possible but marine biologists are not all that shocked. It appears that the bacteria that eats oil has seen a population explosion commensurate with the available food. Seepage of oil is a constant and a natural occurrence regardless of drilling. The manmade activity has greatly accelerated the pace but there have always been organisms that feed on the oil. They are in high gear now and they have in turn provided food for creatures up the food chain.

**Analysis:** There are some hopeful signs that the Gulf will repair itself sooner than expected but there will be damage issues to contend with for years to come. There is no sign that either BP or the government plans to pull out anytime soon but the real debate is over when the moratorium on drilling will be rescinded. This has become the biggest threat to the local economy now. It is possible to return the oil production to normal while investigating ways to make the process safer and that should be the new strategy.

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## Global Immigration Issues Intensify

If you want to start an emotional exchange with someone just bring up the subject of immigration – illegal or otherwise. This is a sensitive subject under the best of conditions but when one mixed in a recession and high levels of unemployment, the debate quickly gets angry and bitter. There are many assumptions that play a huge role in the exchange and the vast majority of them are not all that accurate. The conversation has intensified in almost every part of the world in the last two to three years. The US is facing a showdown on the immigration policies that affect migrants from Mexico and other parts of Latin America, the British are facing a fight over the number of skilled workers that will be allowed into the nation, France is trying to reverse the flow of migrants from North Africa and parts of the Middle East, Germany is struggling with what to do with “guest workers” who are now unemployed but have lived in Germany for decades and have families with no ties at all to the “homeland”. Japan is worried about an aging population and what that will mean to their very strict immigration policy. The list goes on and on – there has never been a period in which migration has been such a hot issue.

The advocates for strict control assert that immigrants take jobs away from the native population but study after study indicates that this is not accurate. The native workers have massive advantages in terms of job seeking and the immigrant workers therefore drift to the positions that are not filled by the domestic workforce. These are generally jobs on the top and bottom of the employment food chain. At the top are those specialized and technical jobs that a given nation has not trained enough people to fill. This is why countries like the US, UK and many others have provisions to bring in these skills from outside but with limits. These limits are what drive the business community to distraction and economists criticize for restricting growth. At the other end of the spectrum are those jobs the domestic workforce wants no part of – field labor, menial work and the kind of jobs that are both physically demanding and pay little. This is also the category that attracts the illegal worker.

There is very little agreement on the core issue of immigration and that makes developing solutions almost impossible. To the business community it is the issue of getting the workers needed - whether it is a neurosurgeon to anchor a hospital program to a guy who can harvest Vidalia onions on time. The desire is for some kind of system that allows people to come and fill these jobs. The opponents assert that these jobs could go to domestic worker if the system was different – more students in medical school so that there are more neurosurgeons and higher pay for onion harvesters so that more people would be interested. The hospital wants the doctor now – not ten years from now and the onion farmer doesn't want to triple the price of the onion so that he can hire Americans.

The opponents of immigration throughout the world focus on many more issues besides that of economic competition. France is deeply concerned about the impact on their culture from the migration and many of the opponents in the US are similarly worried about the ability of the migrant population to assimilate. There are issues of legality as well and these are universal – from the illegal immigrant coming across the border into the US to the human smuggling rings in Europe to the migrations of economic migrants in many parts of Asia.

**Analysis:** The situation is expected to become far more complex in the coming years as the demographics of the world shift. The working populations in Europe, the US and Japan are aging very quickly and there has been little attention paid to the need to increase that population. Birth rates in the developed nations have been low and that means that new workers will come from outside these states. Japan is already starting to panic about what happens when their very monocultural society has to contend with millions of non-Japanese. Europe is struggling to assimilate the migrants of today. Thus far the US has done a good job of integrating the Latino culture but there are strains as the population continues to increase.

## Controversy Continues Over Leaks

The reaction to the 91,000 documents released by Julian Assange has ranged from dismissive to deeply shocking and there is plenty of posturing in the process. What is clear is that the material released is of very limited value from the standpoint of expose. Some has tried to paint this as the equivalent of the Pentagon Papers but this is an immense stretch. The Daniel Ellsberg revelation was of a sophisticated report that directly implicated President Johnson in a deliberate manipulation of the Vietnam War while this mass of data is nothing more than the daily stream of reports that soldiers and junior officers supply their superiors. There is no revelation of some strategy or development unknown until now and in most cases these reports are spotty.

**Analysis:** The most dangerous part of the release is that Assange did not take the time to expunge the names of those who have been listed as helping the US in that nation. These informants and allies are now at great risk and it is certain that most of them will be attacked and killed by the Taliban. The information released by Assange has done nothing to shed real light on the conflict but it will most certainly aid in the execution of Afghan citizens. This is quite the legacy for an “anti-war” activist as he refers to these deaths as collateral damage in the cause of the greater good. Is that “greater good” the extended fame of Julian Assange or an end to violence in Afghanistan.

## Mexican Drug Lord Killed

The death of Ignacio Coronel will either signal that the government has made some strides in attacking the power of the Sinaloa cartel or it will mean that an internal struggle in the gang has engaged the Mexican military unwittingly or not. The Sinaloa cartel is very strong and has been attacking many of the others but that strength also makes control of the cartel lucrative. It appears that Coronel was set up as informants gave the authorities the information needed to confront and kill him.

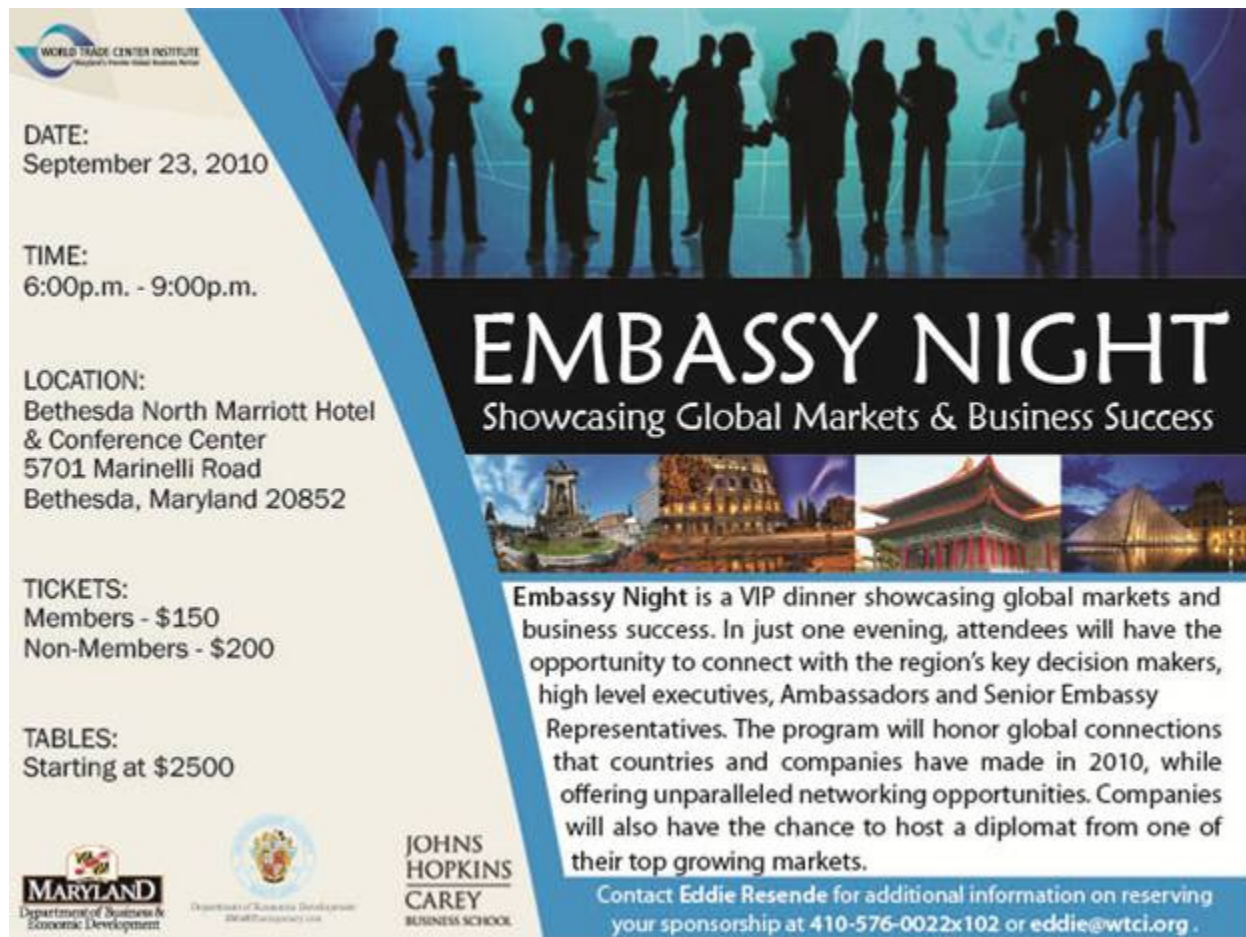
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## Less than Effective Techniques for Getting a Job

There are always those who manage to find new and exciting ways to ensure that they will remain on the rolls of the jobless for an extended period. One only has to wonder if they did these things with the expectation that the tactic would really have the impact they ostensibly thought. First on the list was the guy who noticed a businessman arriving at his “no-tell Motel” on a regular basis with a young lady and decided to film him before asking for an executive’s job in the company. It was assumed that his lack of credentials would be offset by his talent as a blackmailer. On the same theme there was the young lady who decided to disrobe before the interview was to begin but was chagrined to discover that the interview was going to be conducted by a group of what would be her co-workers – all of them women. Another favorite tactic was the guy who asked his future boss if he needed any help in finding a dealer – if so, he could be a big help as he dealt in many of the favorite drugs of choice.

**Analysis:** There are always the more mundane failures that seem to stem from ignorance and inexperience - the people who just don’t yet know how to present themselves. These are the folks that one hopes will get help in making that transition to the workforce but the ones who seem beyond the pale are the ones that have failed to grasp some of the basic elements of life. A police force in California placed a fictitious ad in the newspaper looking for burglars and they were asked to bring both tools and something recently stolen as a kind of resume. These paragons of society were soon arrested. Finally there was the applicant who wanted a job as a chef but had no experience at all in cooking. He demonstrated his qualifications by bursting into the kitchen where he verbally abused the staff, threatened waiters with a knife and then bellowed at several patrons before being hustled out. He was shocked at the response as he thought he was acting like Gordon Ramsay and thought that this was his ticket to a new career.



The poster for Embassy Night features a blue and white color scheme. At the top, there is a silhouette of a group of people in business attire. Below this, the event title "EMBASSY NIGHT" is prominently displayed in large, white, serif font, with the subtitle "Showcasing Global Markets & Business Success" underneath. The background of the poster includes images of various global landmarks and buildings. The text on the left side provides event details: date (September 23, 2010), time (6:00p.m. - 9:00p.m.), location (Bethesda North Marriott Hotel & Conference Center), tickets (Members - \$150, Non-Members - \$200), and tables (Starting at \$2500). The bottom section of the poster contains logos for the World Trade Center Institute, Maryland Department of Business & Economic Development, Johns Hopkins Carey Business School, and a contact information box for Eddie Resende.

**WORLD TRADE CENTER INSTITUTE**  
Empowering Global Business Success

**DATE:**  
September 23, 2010

**TIME:**  
6:00p.m. - 9:00p.m.

**LOCATION:**  
Bethesda North Marriott Hotel  
& Conference Center  
5701 Marinelli Road  
Bethesda, Maryland 20852

**TICKETS:**  
Members - \$150  
Non-Members - \$200

**TABLES:**  
Starting at \$2500

**EMBASSY NIGHT**  
Showcasing Global Markets & Business Success

Embassy Night is a VIP dinner showcasing global markets and business success. In just one evening, attendees will have the opportunity to connect with the region’s key decision makers, high level executives, Ambassadors and Senior Embassy Representatives. The program will honor global connections that countries and companies have made in 2010, while offering unparalleled networking opportunities. Companies will also have the chance to host a diplomat from one of their top growing markets.

Contact Eddie Resende for additional information on reserving your sponsorship at 410-576-0022x102 or eddie@wtci.org .

**MARYLAND**  
Department of Business & Economic Development

**JOHNS HOPKINS CAREY BUSINESS SCHOOL**

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