OUTLOOK FOR THE U.S. ECONOMY AND MONETARY POLICY

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Disclaimer: The views expressed here are those of the speaker and do not necessarily represent the views of the Federal Reserve Bank of Boston or the Federal Reserve System.
About the Federal Reserve Bank of Boston

- **Part of Federal Reserve System**
  - Board of Governors (Washington., DC)
  - 12 regional banks (including Boston)
  - Conducts monetary policy, supervises and regulates banks

- **Boston Fed’s role**
  - Advise on monetary policy decisions
  - Assist with banking supervision and regulation
  - Monitor regional economy and inform public policy in region
    - New England Public Policy Center, within Boston Fed
"WHAT SEPARATES US FROM THE ANIMALS IS OUR ABILITY TO CHANGE INTEREST RATES."
Preview

• Current economic situation
  • Have we fully recovered from the Great Recession?
• The current challenge for monetary policy
  • Making sense of slow wage growth & slow inflation
  • Achieving a “soft landing” for the economy
• Outlook
  • Is higher inflation on the horizon?
  • What can (or can’t) monetary policy do to boost growth?
Relative to Pre-Recession Peak, Economic Activity Up ~20%; Payroll Jobs up 6%
GDP Growth Accelerated in Q2, Driven by Final-Goods Consumption
Unemployment Rate Back to Pre-Recession Low; Broader U-6 Rate Still Elevated

Source: Bureau of Labor Statistics / Haver Analytics
Core PCE Inflation Still Below 2%, Has Slipped in Past Year

Source: Bureau of Economic Analysis/ Haver Analytics
Consumer Price Inflation (CPI) Up Since 2015, But Still Moderate

Source: Bureau of Labor Statistics / Haver Analytics
Wage Growth Still Modest Despite Low Unemployment

Source: Bureau of Labor Statistics / Haver Analytics
Why Aren’t Wages and Prices Rising Faster?

- Slow wage growth predicts low price inflation
- Low price inflation eases pressure on wages
  - mutually reinforcing cycle
- Possible causes of low price inflation
  - Globalization
  - Big tech firms achieve cost reductions via scale
- Possible causes of slow wage growth
  - Slow productivity growth
  - Decline in workers’ bargaining power
  - Slack still left in labor market
Stagnant Labor Force Participation Rate and Employment Rate: Hidden Labor Slack?

Source: Bureau of Labor Statistics / Haver Analytics
Average Productivity Growth Just 0.4 Percent 2011-2015

Possible explanations:

- Weaker physical capital investment
- Slower increase in educational attainment
- Slower pace of technological change
Wage Growth *Net of Productivity* Not Far Below 2 Percent, Consistent with Inflation Target

**Note:** Nominal wage growth is defined as 3-year average growth in ECI (private-sector wages and salaries). Productivity growth is defined as 3-year average growth in real output per hour in the nonfarm business sector.

Source: Bureau of Labor Statistics / Haver Analytics
Why Do We Care? Isn’t Low Inflation a Good Thing?

- Reason for low inflation matters for policy
  - If economy below full employment, Fed should maintain stimulus (keep rates low)
  - If economy at or above full employment, Fed should remove stimulus (raise rates)
- Inflation below target erodes Fed credibility
- Positive inflation enables higher interest rate than zero inflation
  - Gives Fed ammunition in case of recession
Two Views on Monetary Policy
Raise Fed Funds Rate Soon or Wait?

- Charles Evans (President, Chicago Fed):
  - “We need to see clear signs of building wage and price pressures before taking the next step in removing accommodation.”

- Eric Rosengren (President, Boston Fed):
  - Advises “regular and gradual removal of monetary accommodation.”
  - Rationale: inflation reacts to policy with a lag; could get too high if rates stay low.
The Proverbial “Soft Landing”
FOMC Projections: GDP Growth Slows to 2% by 2019; at 1.8% in Long-Run

FOMC: Unemployment Rate Falls Further in 2018-2019, Rebounds to 4.6% in Long-Run

FOMC: Inflation Picks Up in 2018; Reaches 2% by 2019

FOMC Members’ Assessments of Appropriate Federal Funds Rate: Below 4 Percent Through 2020; at 3.5 Percent or Below in Equilibrium

Risks to the Economic Outlook

- **Upside risks to growth**
  - Consumer spending on rise, fueled by strong job market and rising house and stock prices
  - Fiscal policy (tax changes and/or gov’t spending) could boost investment, productivity growth
    - Could alter potential growth rate, unlike monetary policy

- **Downside risks**
  - Fed could get rate path wrong, trigger recession
  - International geopolitical risks
  - Stock market correction
House Prices Increased 6-7% in Past Year, Following 4 Previous Years of Gains

Source: FHFA, NBER, S&P/Case-Shiller / Haver Analytics
Major Stock Indexes Above Pre-Recession Highs by 50% or More

Sources: Dow Jones, The Wall Street Journal/Haver Analytics
Consumer Confidence Exceeds Pre-Recession Highs

Source: The Conference Board / Haver Analytics
Recessions Tend to Follow Fed Tightening Cycles (Causality Uncertain!)

Source: Federal Reserve