

THE “NEW NORMAL” FOR THE
ECONOMY
AND
MONETARY POLICY IMPLICATIONS

Current Topics in Tax-Exempt Finance
Jeff Fuhrer, EVP and Senior Policy Advisor
Federal Reserve Bank of Boston
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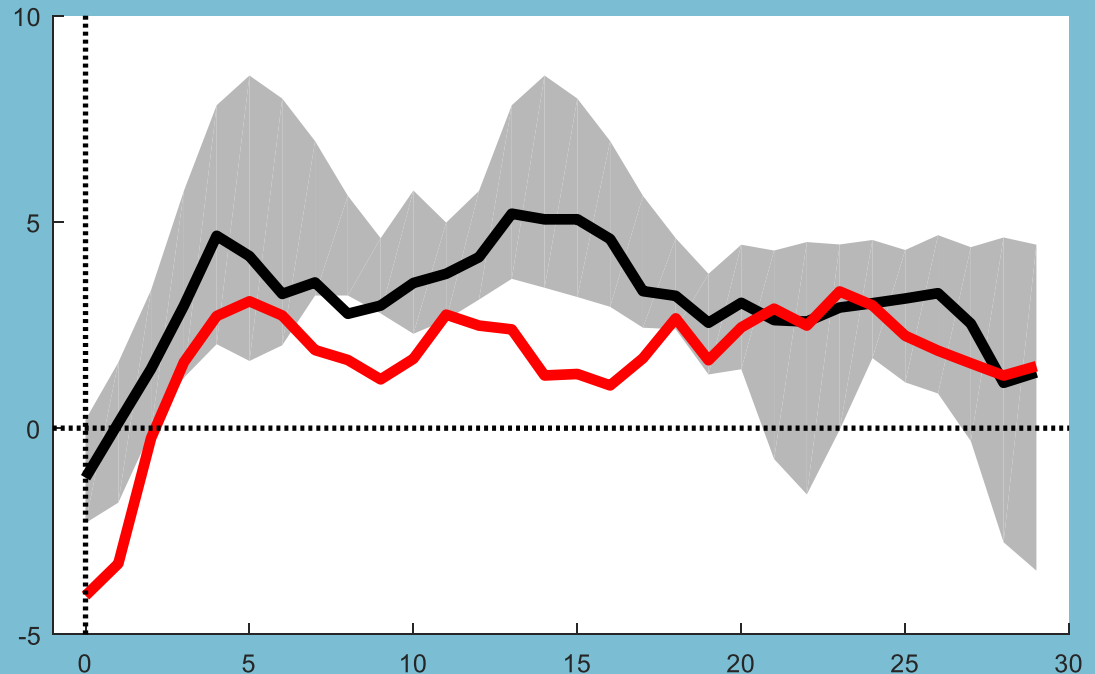
Topics for Today

- ▣ What has changed?
 - GDP growth has been slow compared to other recoveries
 - Employment has risen moderately
 - Still, unemployment has fallen significantly
 - This implies something about labor force participation
 - Slow growth also implies lower interest rates on average—how low?
- ▣ Why slow growth?
 - Slower productivity growth – how persistent?
 - Some temporary factors
- ▣ Implications of these changes for policy

GDP growth has been slower than usual for a recovery

- ❑ Slowest in the past 45 years
- ❑ We will come back to this

4-quarter growth in GDP during recoveries, 1973-present

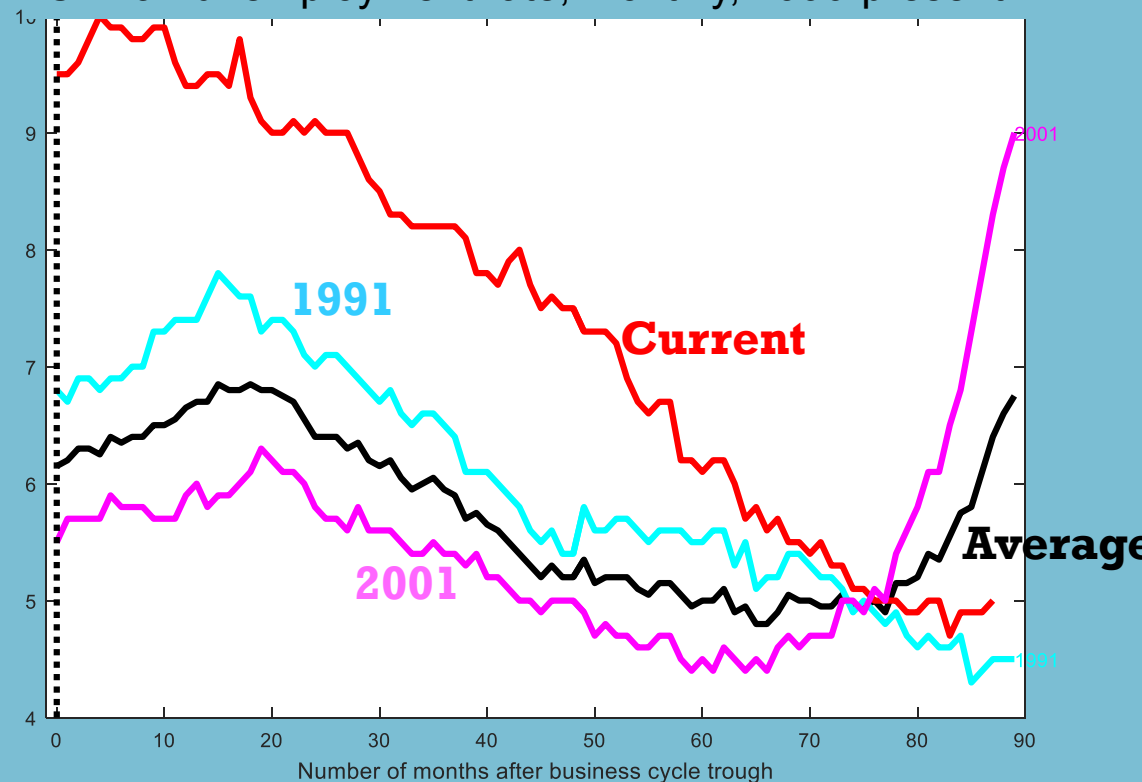


Number of quarters after business cycle trough
Heavy black line represents average of postwar recessions
Heavy red line represents current experience
Shaded area shows range of outcomes across all postwar business cycles

Still, unemployment has fallen significantly...

- Unemployment reached 6% at about the same horizon as previous two recessions, which started at much lower unemployment rates
- Hence, it dropped faster

Comparison of business cycle experiences from recession trough
Civilian unemployment rate, monthly, 1990-present

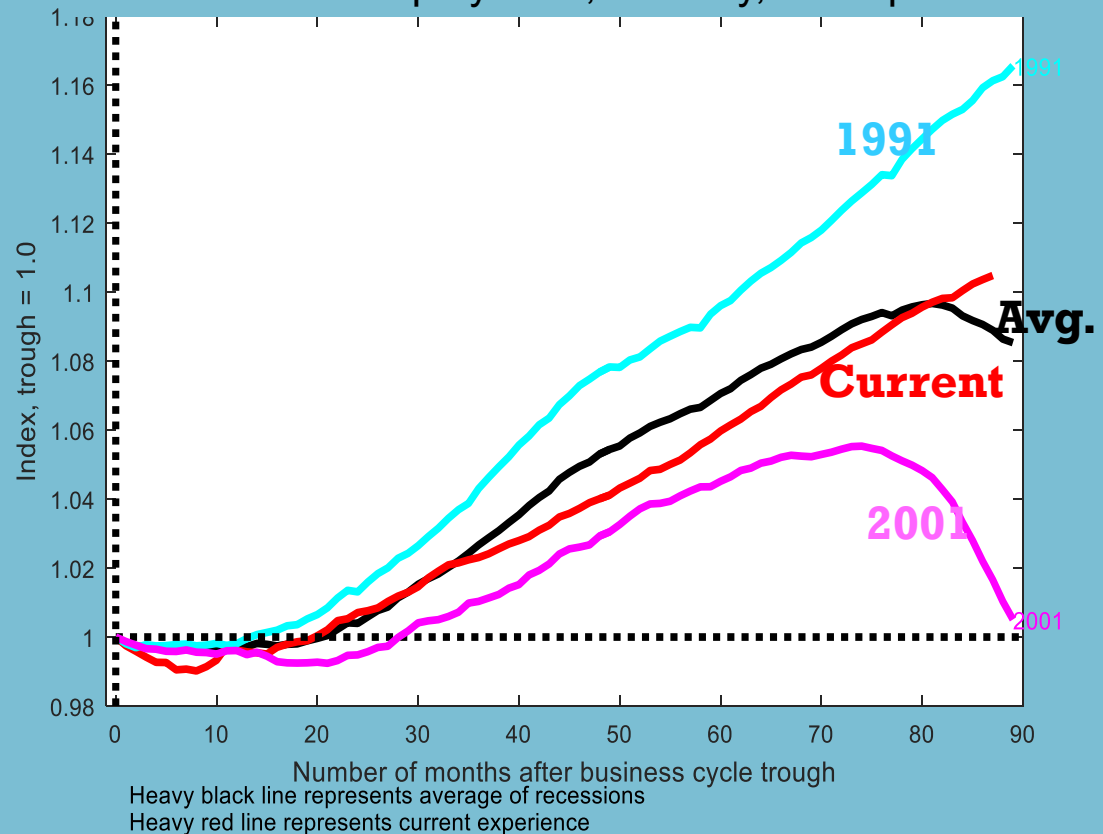


Heavy black line represents average of recessions
Heavy red line represents current experience

...while employment has risen moderately...

- Better than the 2001 “jobless” recovery, but not as fast as in 1991

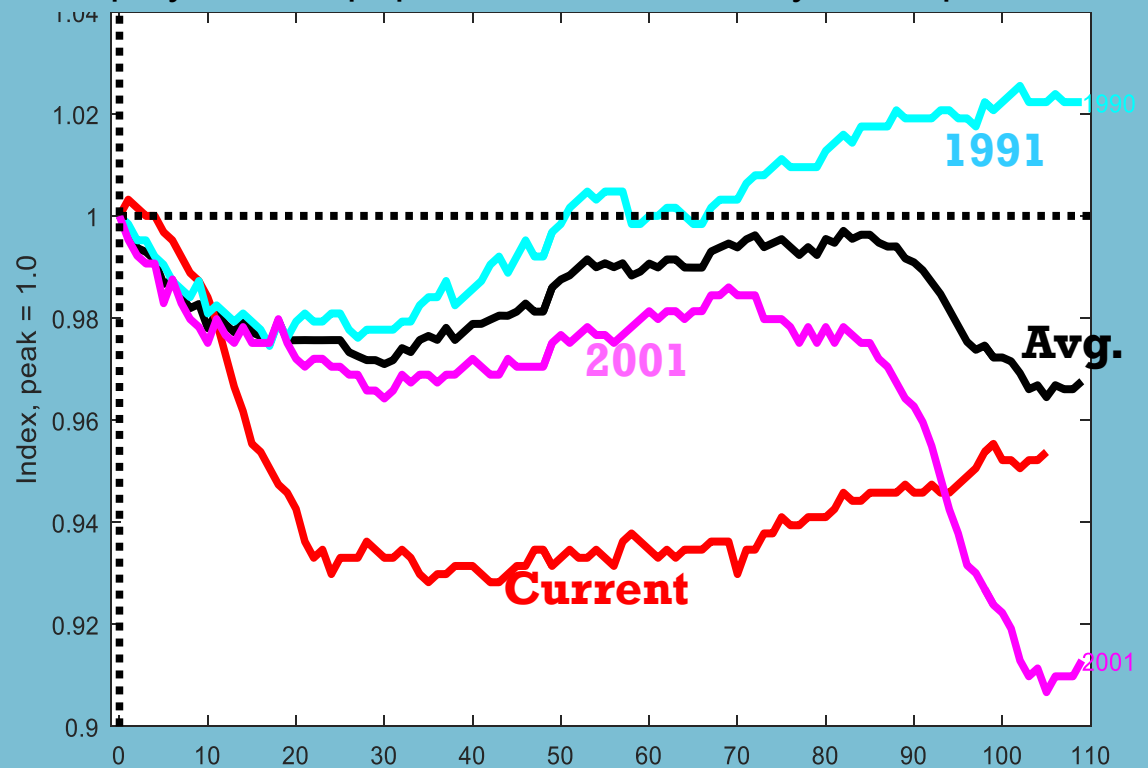
Comparison of business cycle experiences from recession trough
Total nonfarm employment, monthly, 1990-present



...but the share of the population that is employed has not fully recovered

- ▣ Improvement in employment, but not back to pre-recession level
- ▣ But is back to pre-recession level
- ▣ **MUST** say something about who's coming in and out of the labor force

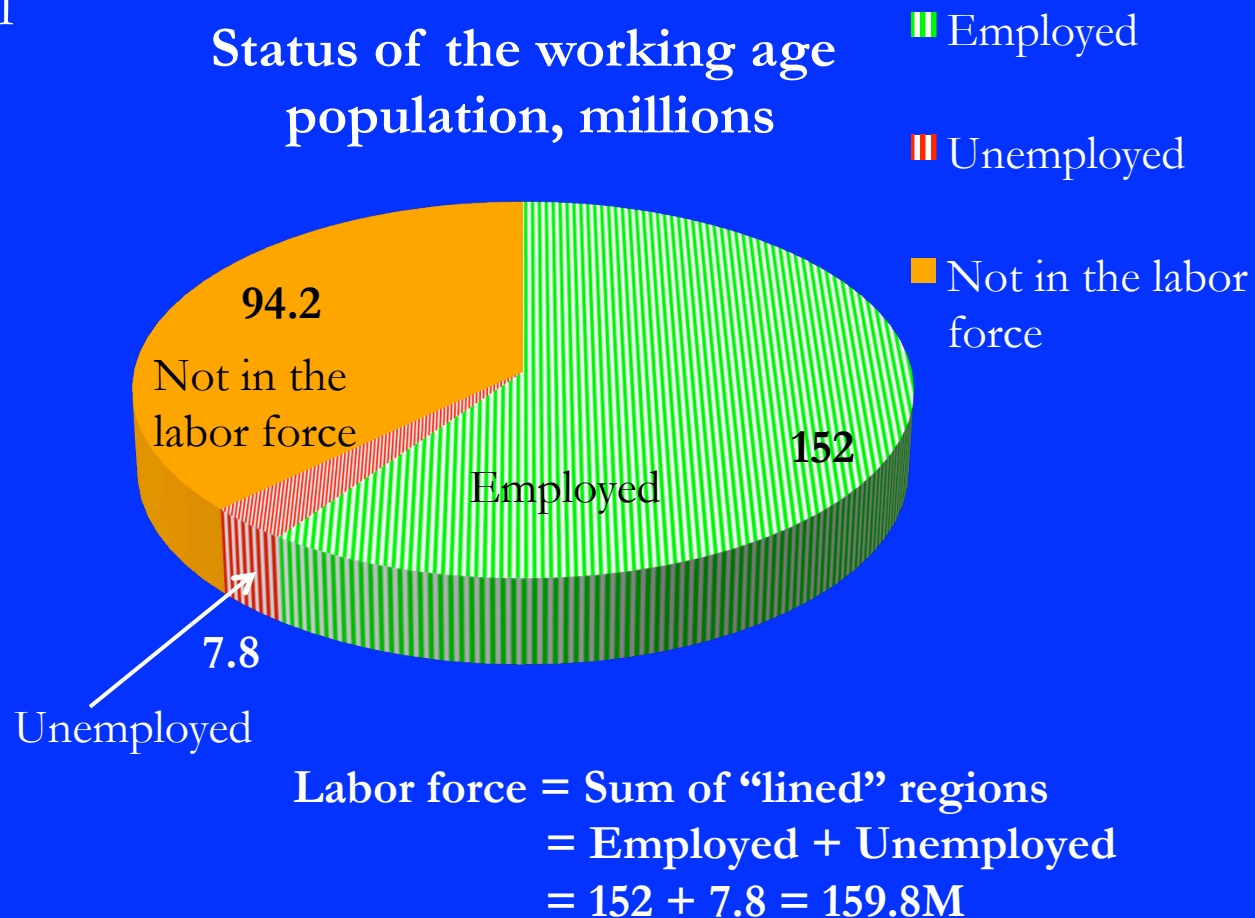
Comparison of business cycle experiences from recession peak
Employment-to-population ratio, monthly, 1990-present



Heavy black line represents average of recessions
Heavy red line represents current experience

These data imply shifts in labor force participation: Why is that?

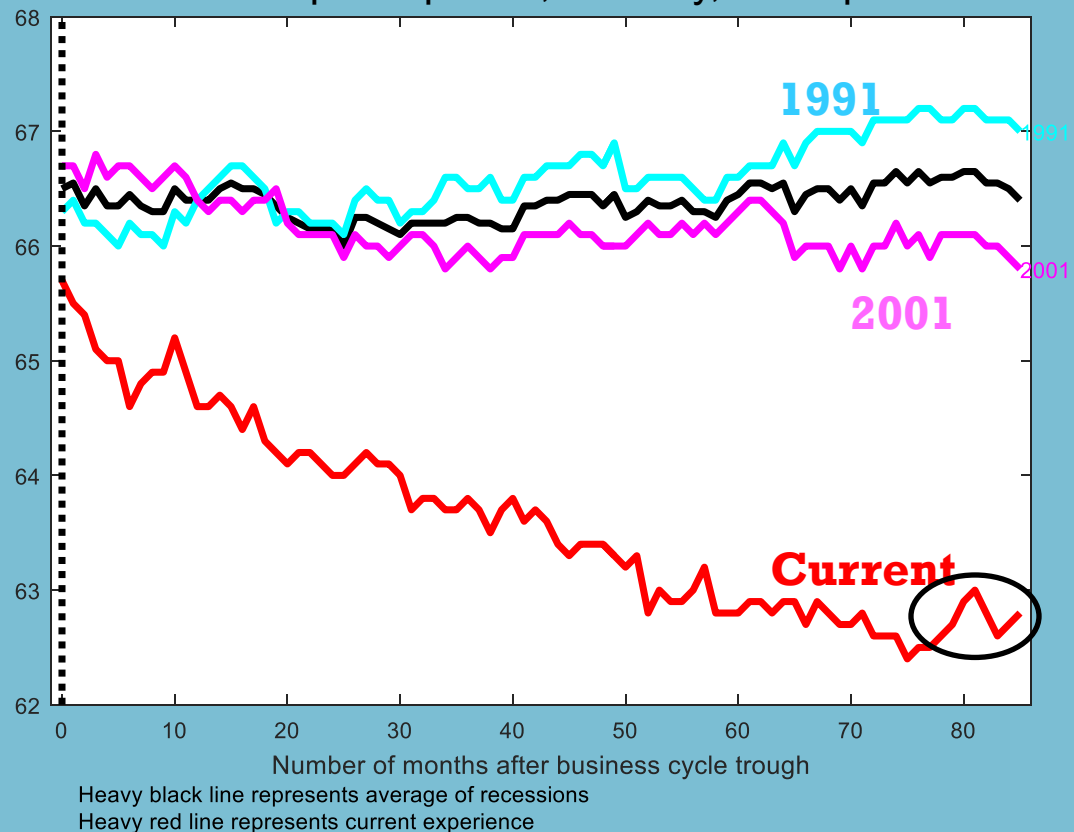
- Unemployment can fall for two reasons:
 - Unemployed become employed
 - Unemployed leave the labor force
- We saw that employment had not recovered fully
- So it must be that people left the labor force = lower participation



And in fact labor force participation has been falling

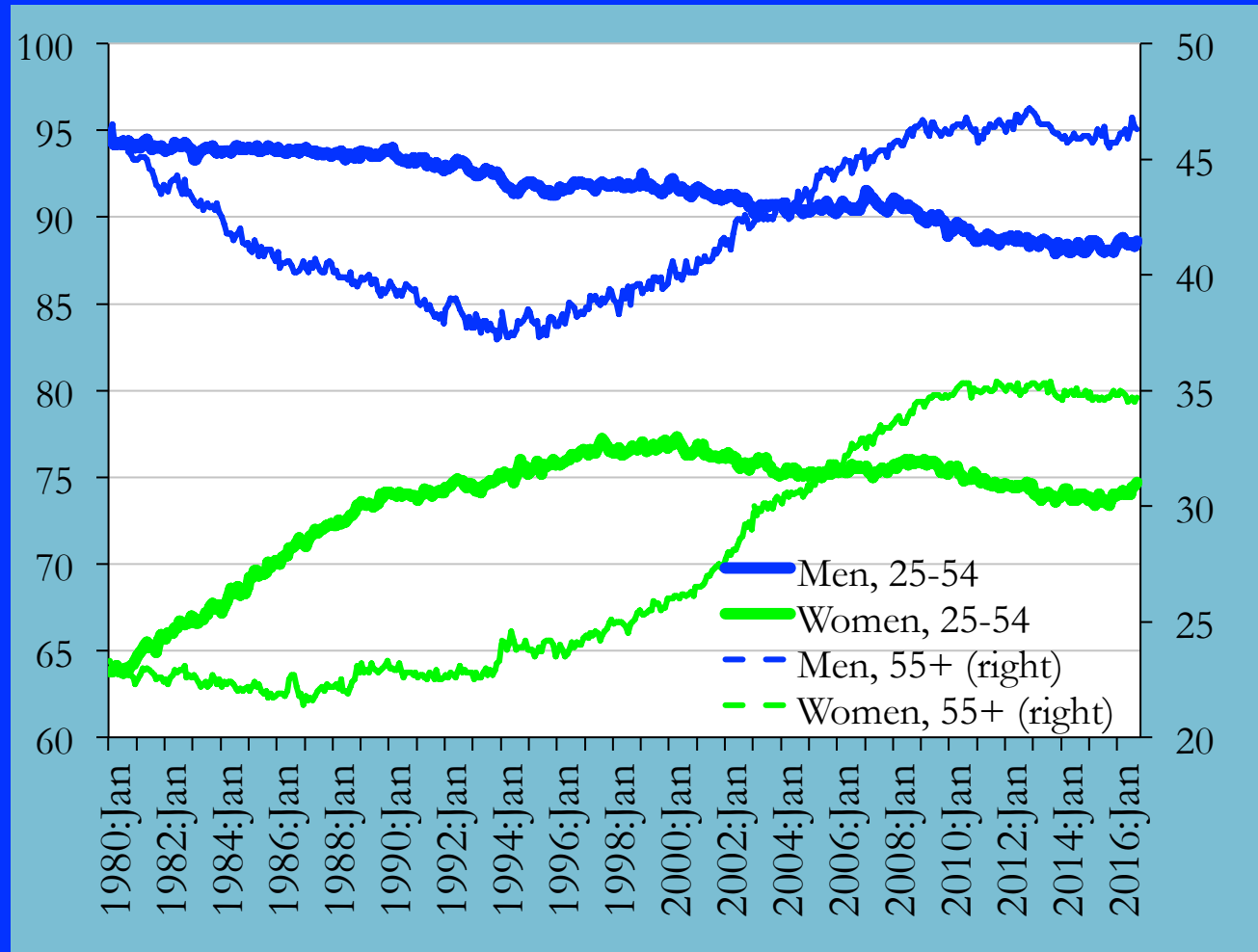
- Labor force participation continued its significant downward trend during the recovery
- Why such a trend?
 - Demographics

Comparison of business cycle experiences from recession trough
Labor force participation, monthly, 1990-present



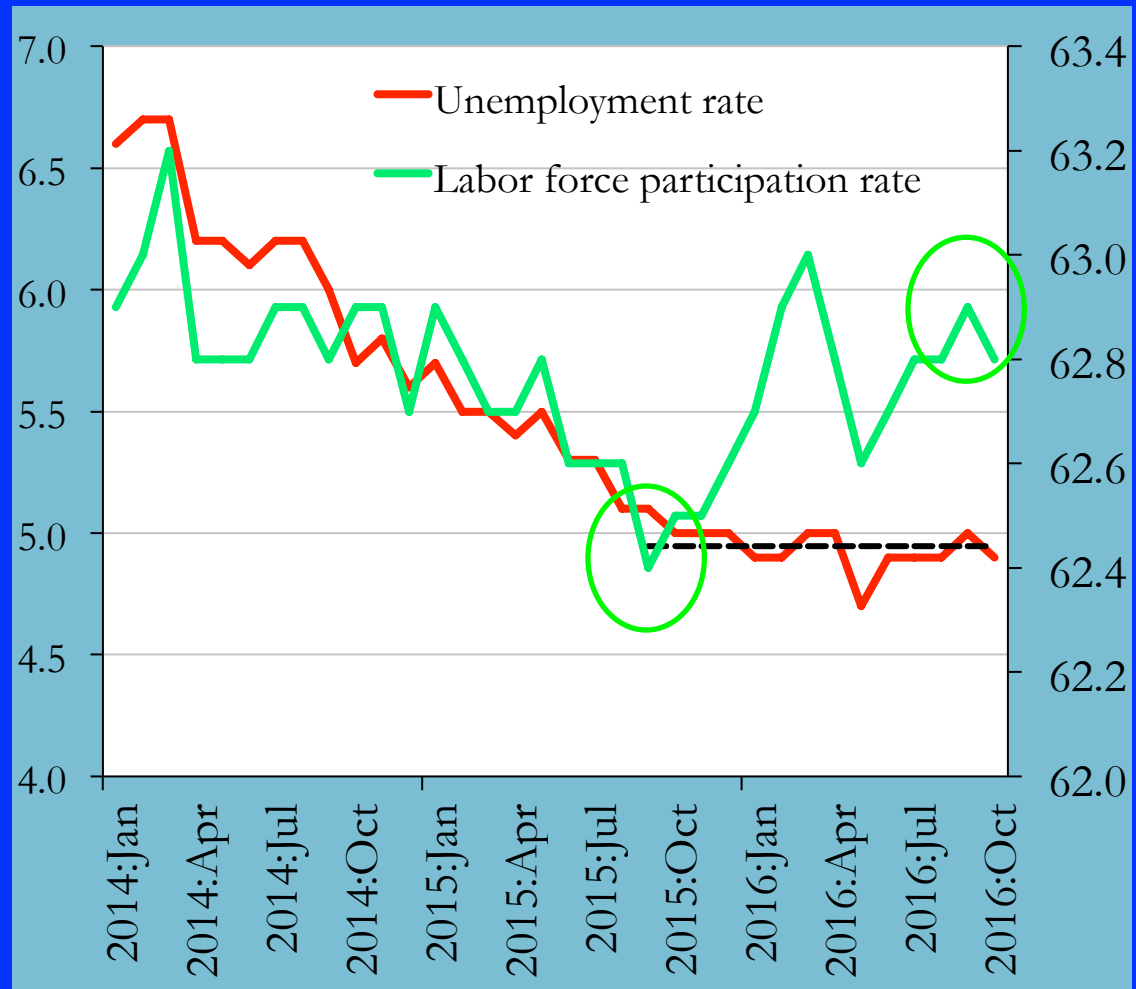
Underlying demographic trends have driven labor force participation

- Participation for prime-aged males (25-54) has been declining since 1990
- Female participation rose during that period, topping out around 1995
- Males and females 55+ have been rising in participation since mid-1990s
 - Plateaued recently



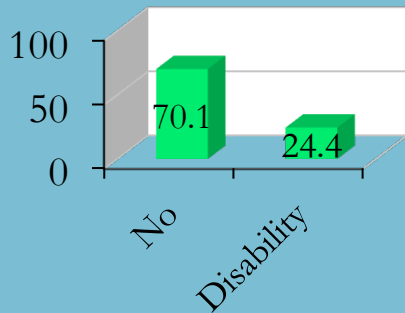
However recently, unemployment has been quite flat

- ▣ Constant at around 5% for more than a year
- ▣ During this time, participation has risen (more people looking for jobs is good; but some have not found them yet)

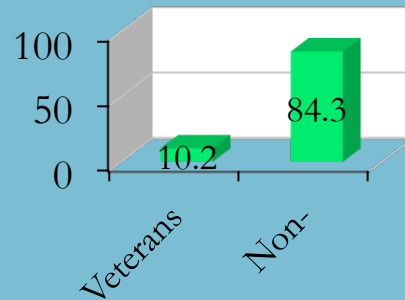


Will more workers who left the labor force return? (“Do we have run room?”)

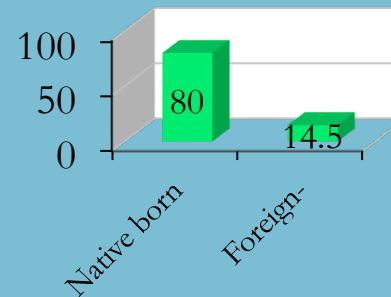
Disabilities (millions)



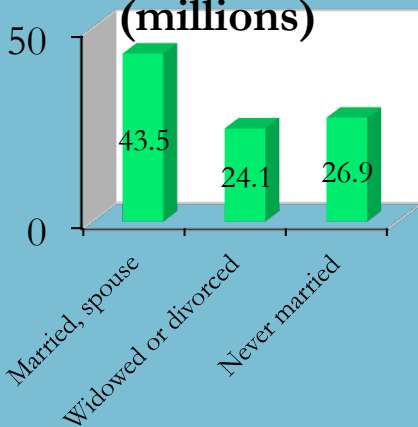
Veteran status (millions)



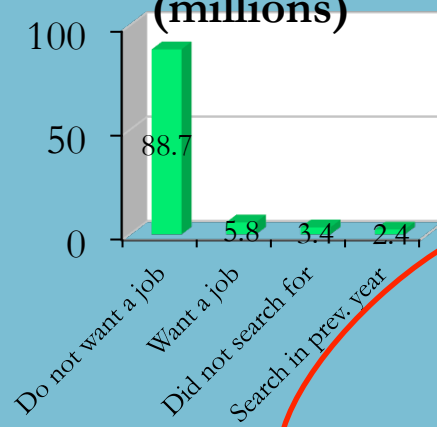
Native/foreign born (millions)



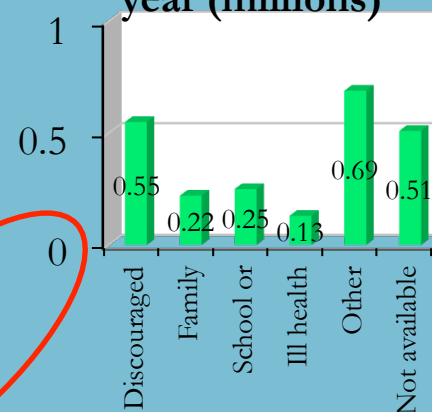
Marriage status (millions)



Reason for NILF (millions)



Searched in prev. year (millions)

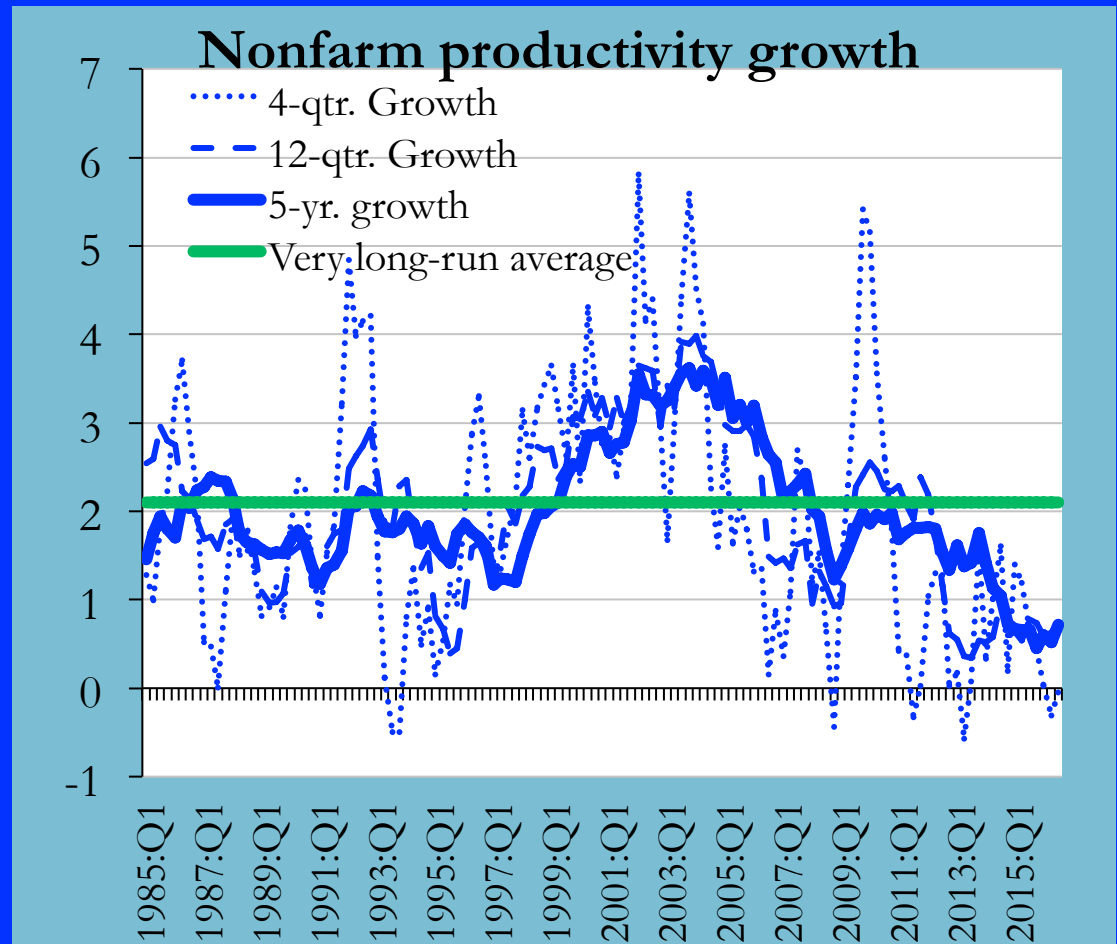


- Some “run room,” but limited
- The ↓ trend in participation will likely continue
- Thus we’re very near full employment
- Implication: If employment grows as expected, unemployment rate will likely fall

Why has growth been slower?

More persistent causes

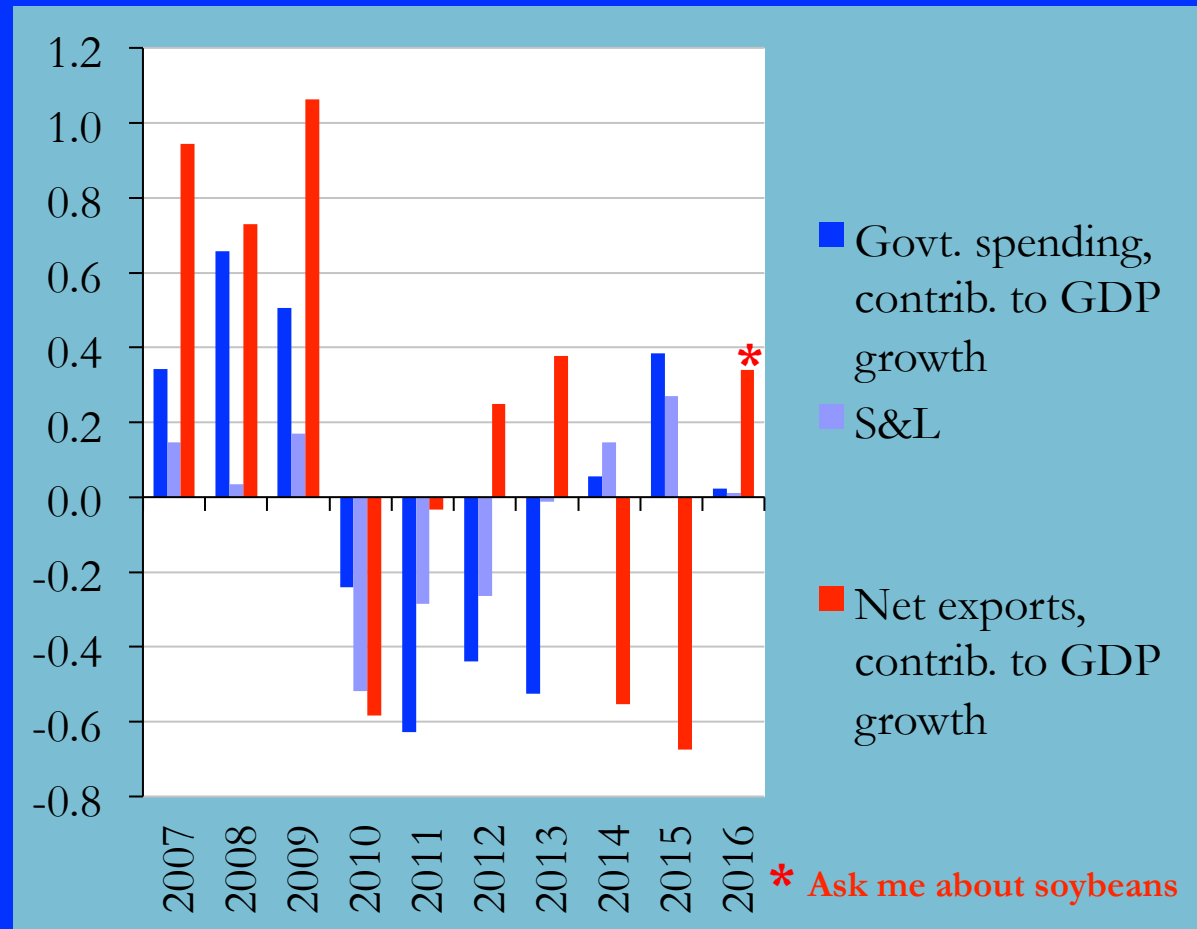
- Slower productivity growth
 - Long-run average is about 2%
 - Recently, 0.5%
- How persistent?
 - We don't know
 - Long-run history suggests a rebound
 - Depends on pace of investment, innovation and implementation of new ideas



Why has growth been slower?

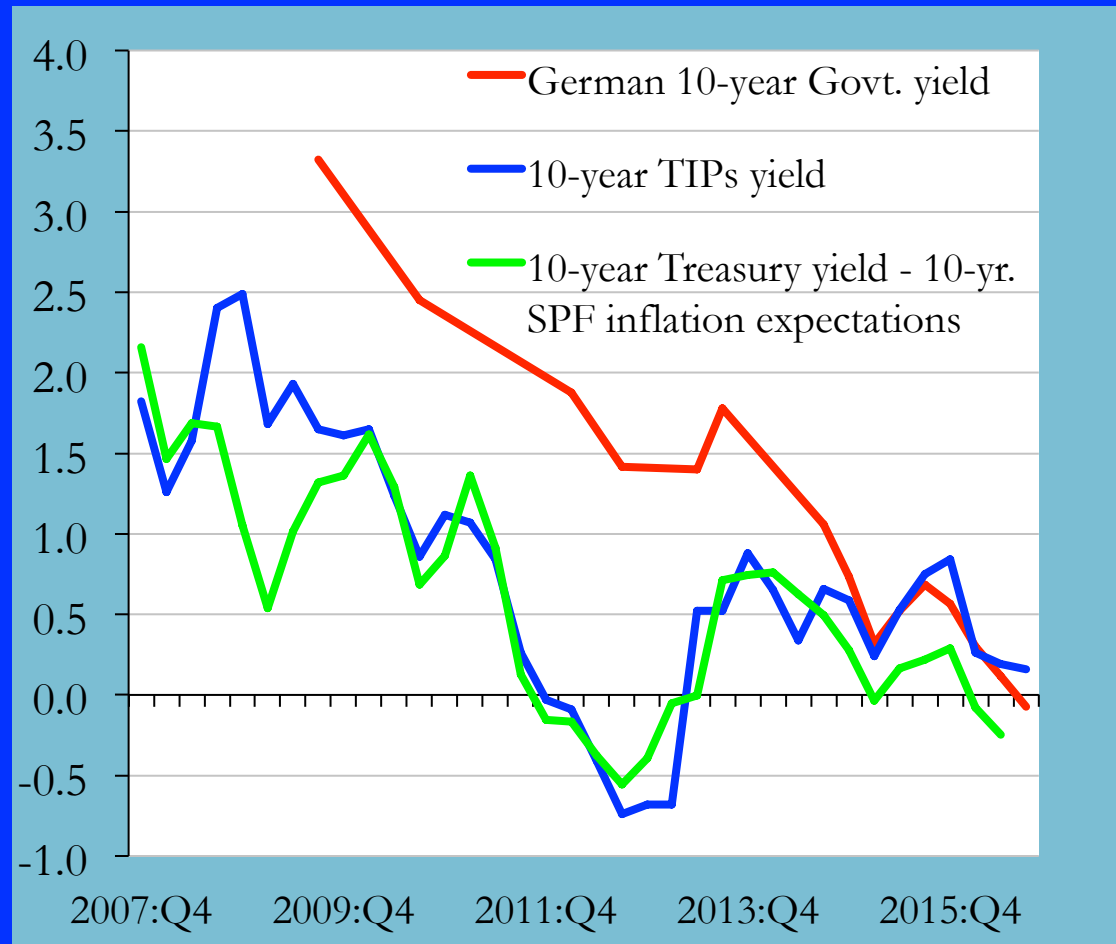
A few temporary factors

- ▣ Government spending
 - Supported at first, but then not so much
 - Both federal and state and local
- ▣ Trade
 - Foreign growth weak
 - Dollar appreciation



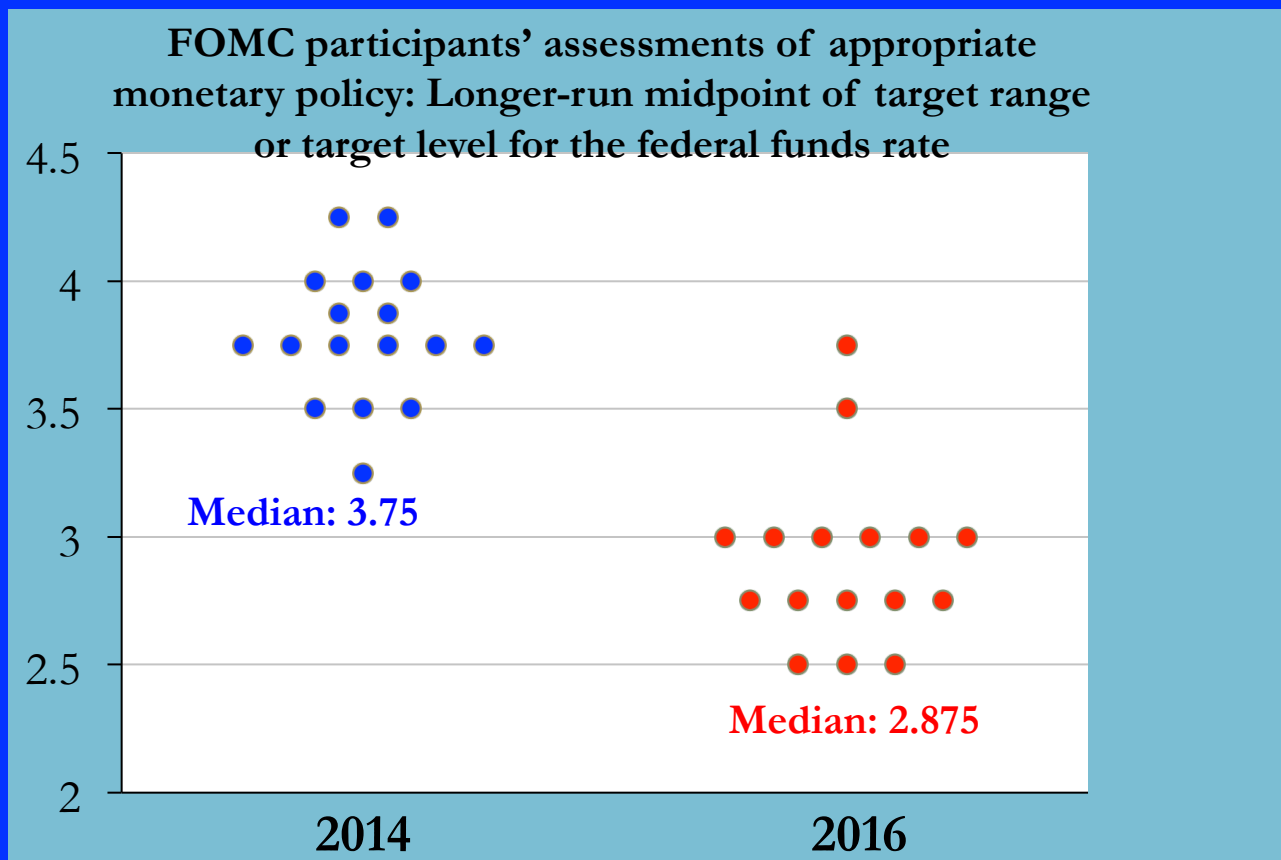
Slow growth has led to lower interest rates – here and abroad

- Partly a reflection of monetary policy responses (low rates) in developed economies
- But also appears to reflect lower “natural” or long-term interest rates
- Market rates in US suggest essentially zero real rate of return over next 10 years
- German rates—nominal rate shown—even lower



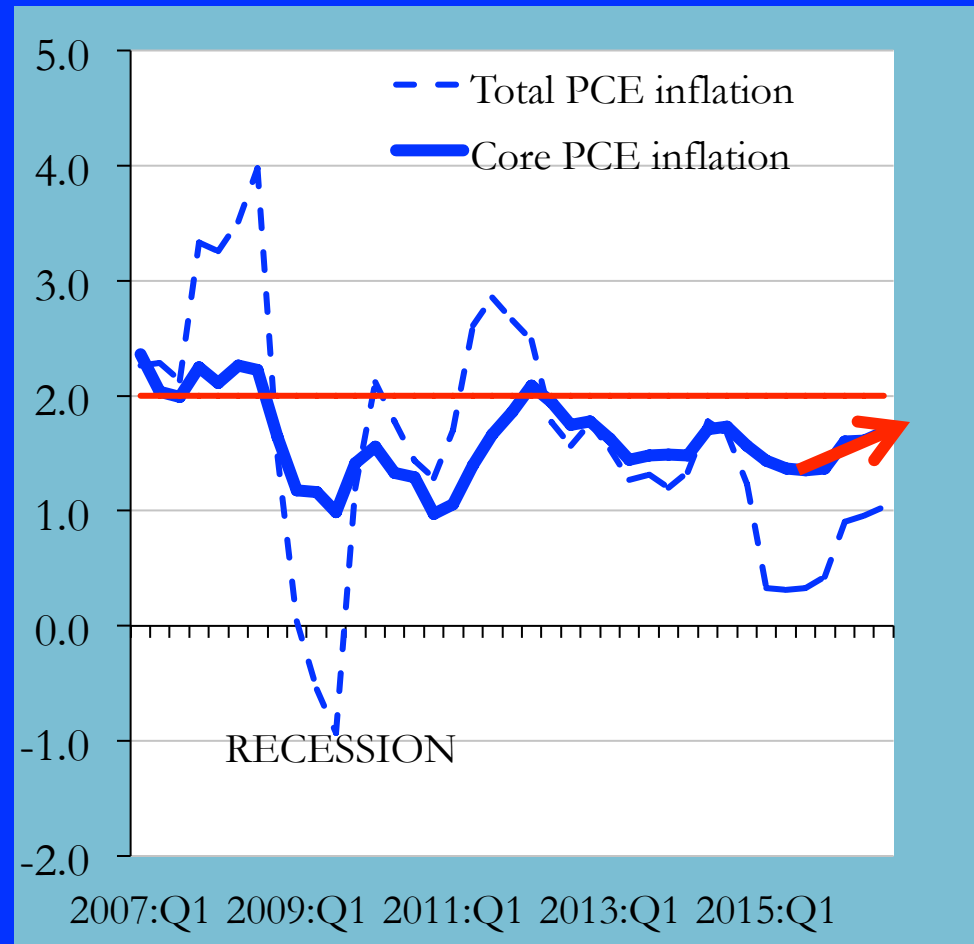
Why that matters for monetary policy:

- ▣ Suggests that the resting point (long-run equilibrium) for our policy rate may be lower
- ▣ Look at these projections made by members of the FOMC:



And now for a brief word on inflation...

- ▣ Inflation had been stubbornly low
- ▣ But it has risen gradually of late
- ▣ Some earlier restraining factors—declining oil prices, declining import prices—are now rising modestly
- ▣ So we expect inflation to move up gradually to about 2%



Implications for policy

- Growth is slower, and probably will continue to be
 - We care about growth relative to its sustainable rate
 - Growth may be slower than historical norms, but if it exceeds the sustainable rate (1.7%?), then we continue to make progress
- Labor markets have improved a lot
 - There is still probably a bit more “run room”—i.e. scope for workers to enter the labor force and get a job
 - But that is somewhat limited, so we can only push so far...
- Inflation is at 1.7% in the most recent readings
 - That’s pretty close to 2%--expect to move up over next two years
- No call for a tight monetary policy; no call to tighten rapidly
 - A small adjustment, followed by gradual normalization, seems reasonable
 - Will continue to support labor market improvement, small increase in inflation