FEDERAL RESERVE BANK OF BOSTON™

The Economic Outlook and Monetary Policy

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May 29, 2013

Economic Progress Since the Resumption of the LSAP

- Last September the FOMC decided that with August unemployment at 8.1 percent and slow growth, more policy accommodation needed
- Since then, some evidence of strengthening labor markets – the unemployment rate is 7.5 percent and payroll employment growth over recent months has averaged over 200,000 jobs
- Despite headwinds from fiscal policy, we are seeing gradual improvement

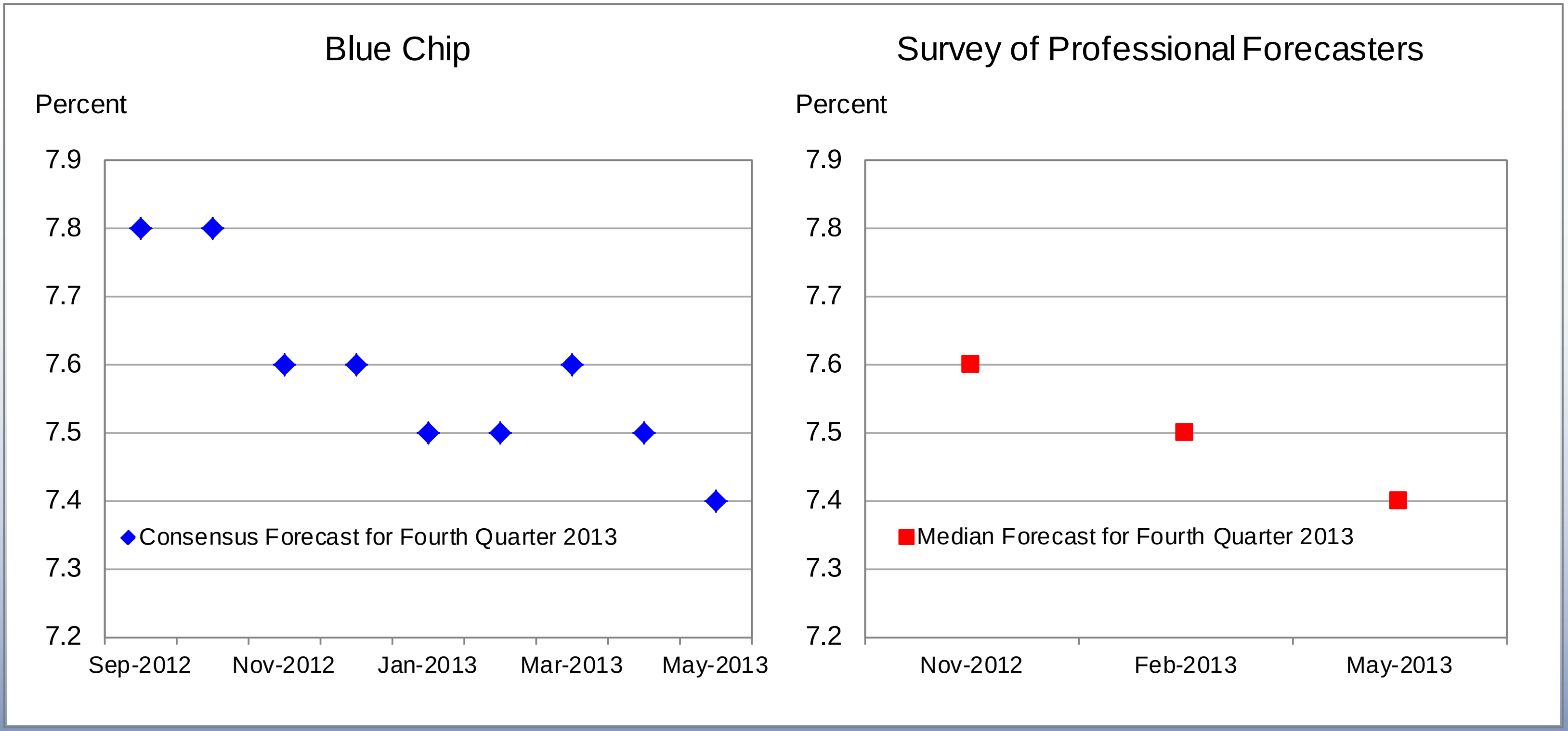
Implications for LSAP

- Program designed to continue until there was a substantial improvement in the outlook for the labor market, as long as the benefits of the purchases outweighed the costs
  - My own view is benefits of this accommodative monetary policy program still significantly outweigh the costs
  - While some improvement in labor markets has been achieved, it does not yet constitute progress sufficient to merit halting the asset purchase Program
  - The Fed is and should be very attuned to unintended consequences – at this point it seems that fundamentals are prevailing, and potential costs are well contained

Implications Continued

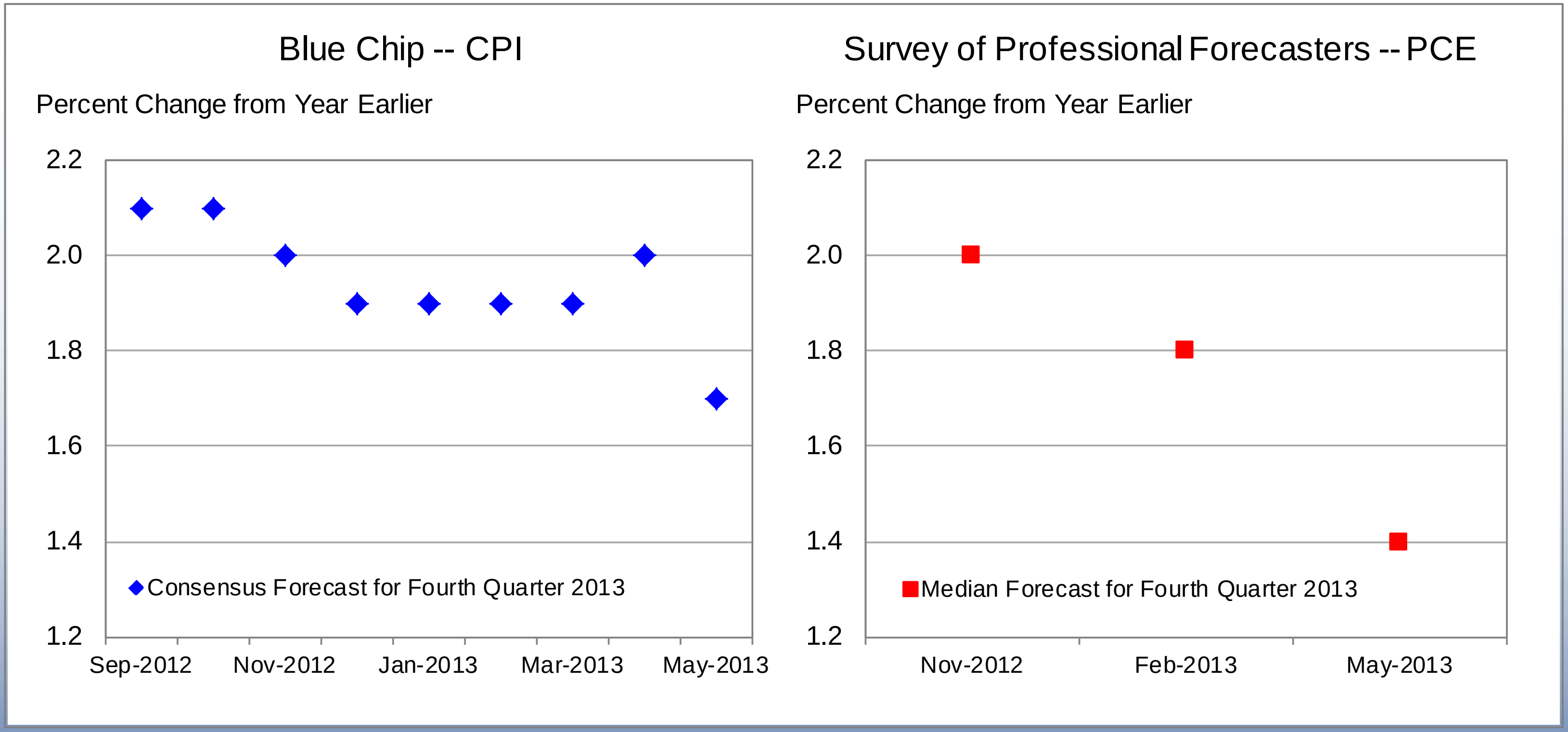
- Federal Reserve should make adjustments to the program based on economic outcomes – either up or down
- The rate of purchases could be gradually reduced, rather than suddenly stopped, once we have achieved substantial improvement in labor markets

Figure 1
Forecasts for Fourth Quarter 2013 Unemployment Rate



Source: Blue Chip Economic Indicators, Federal Reserve Bank of Philadelphia / Haver Analytics

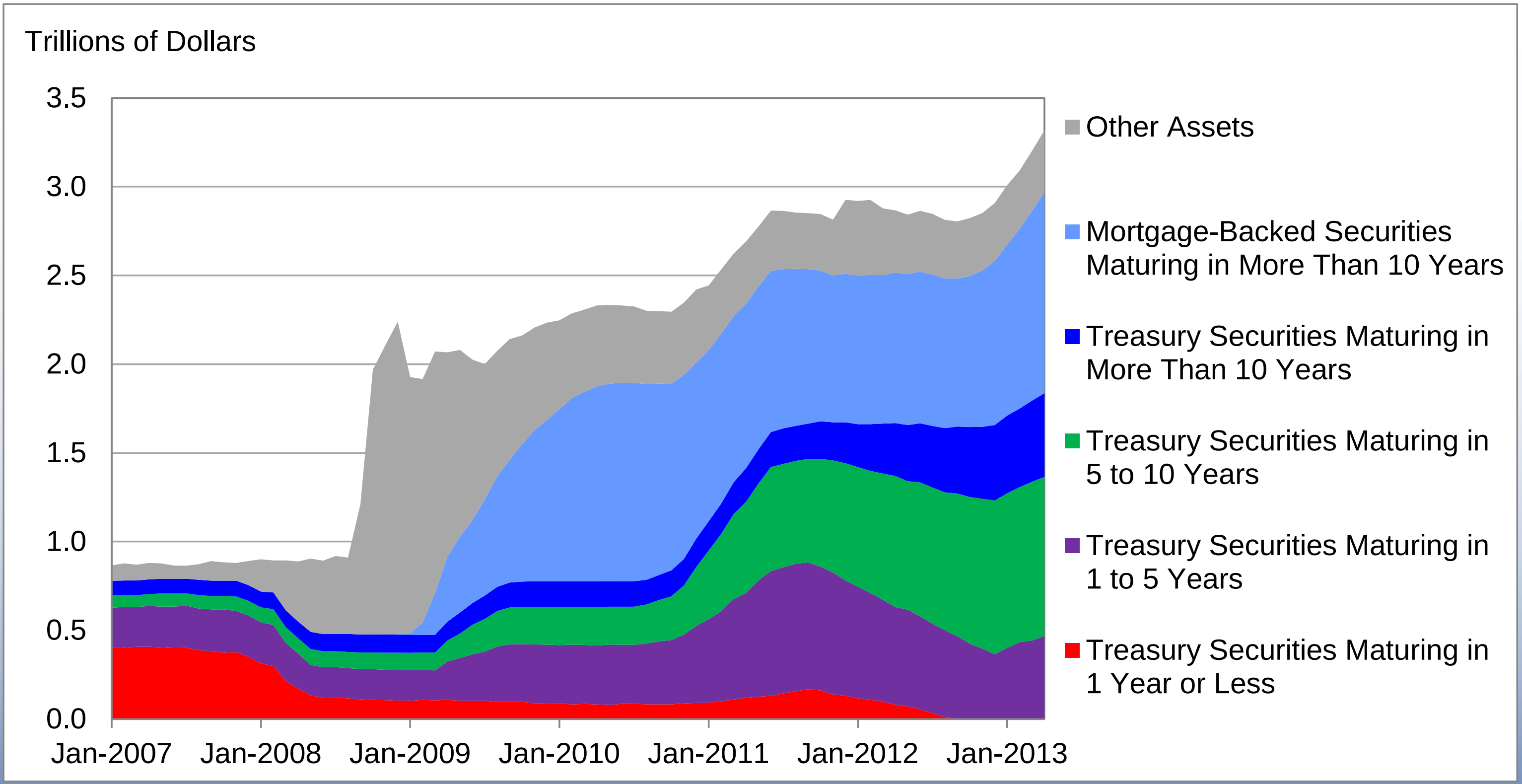
Figure 2
Forecasts for Fourth Quarter 2013 Inflation Rate



Source: Blue Chip Economic Indicators, Federal Reserve Bank of Philadelphia / Haver Analytics

Figure 3
Federal Reserve System Assets

January 2007 - April 2013

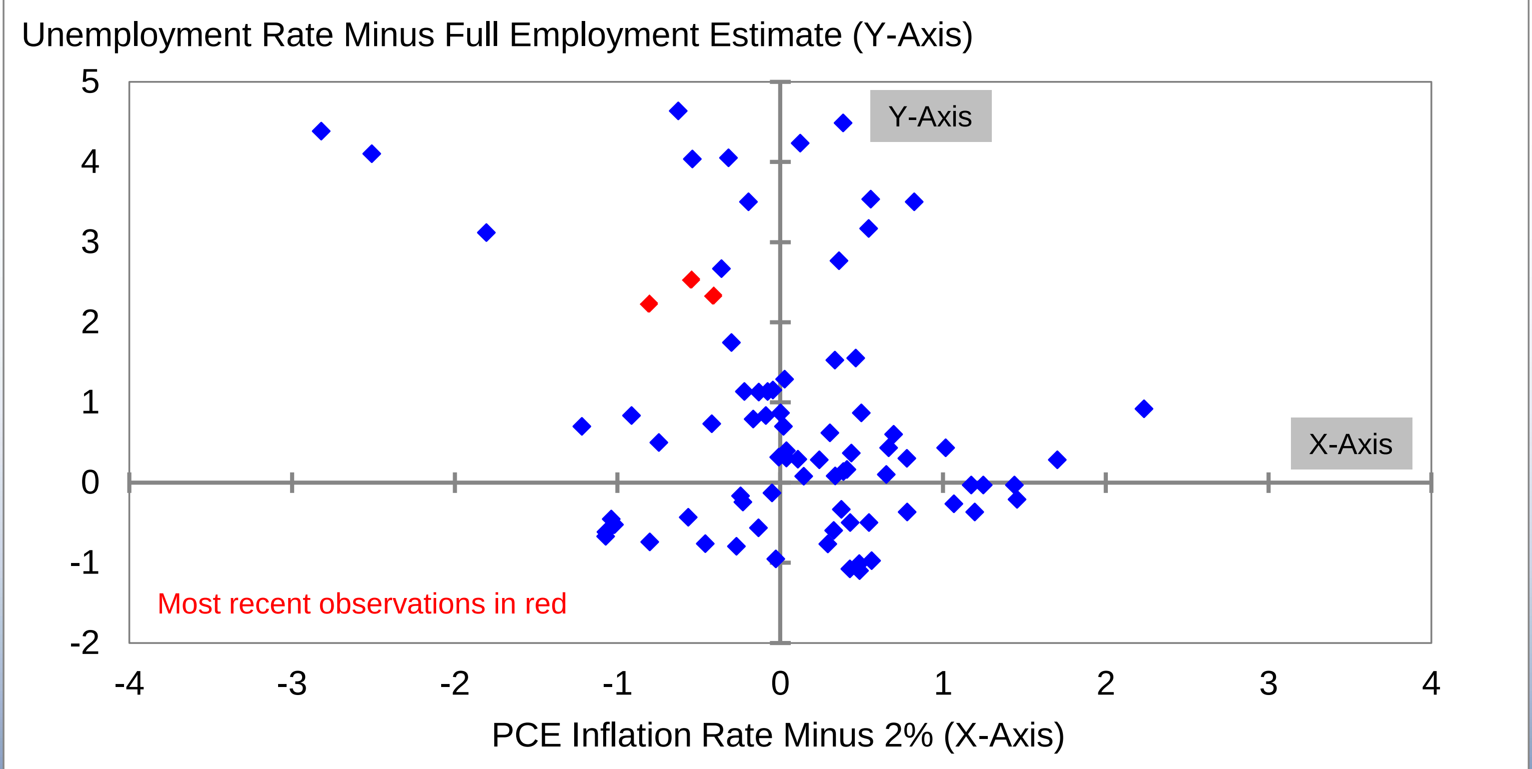


Note: Discount window lending and liquidity facility lending are included in other assets.

Source: Federal Reserve Board / Haver Analytics

Figure 4
Deviations from Full Employment and Inflation Targets in the United States

1993:Q1 - 2013:Q1

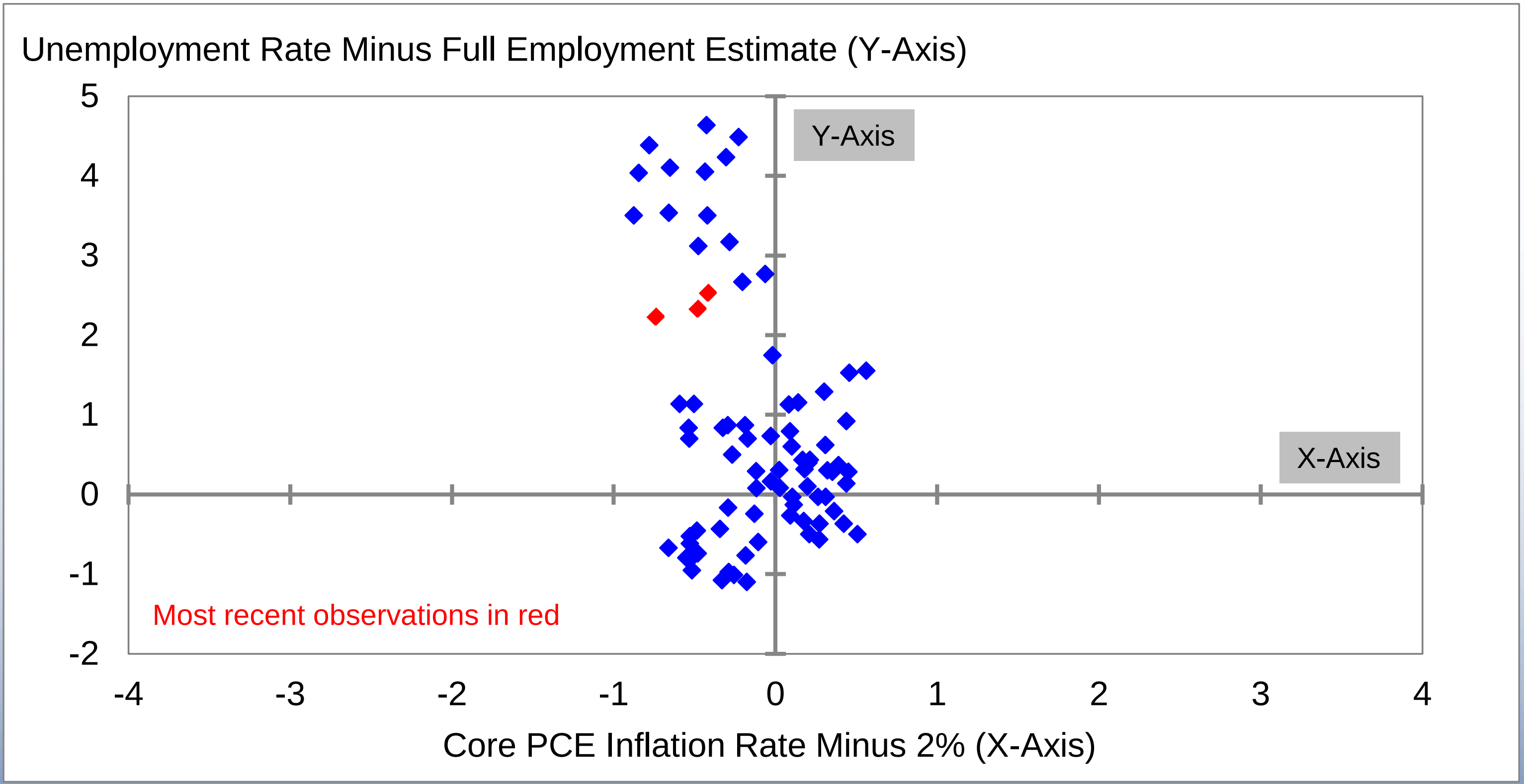


Note: Full employment is the CBO estimate of the natural rate of unemployment.
PCE inflation rate is the percent change in the PCE price index from one year earlier.

Source: BEA, BLS, CBO / Haver Analytics

Figure 5
Deviations from Full Employment and Core Inflation Targets in the United States

1993:Q1 - 2013:Q1

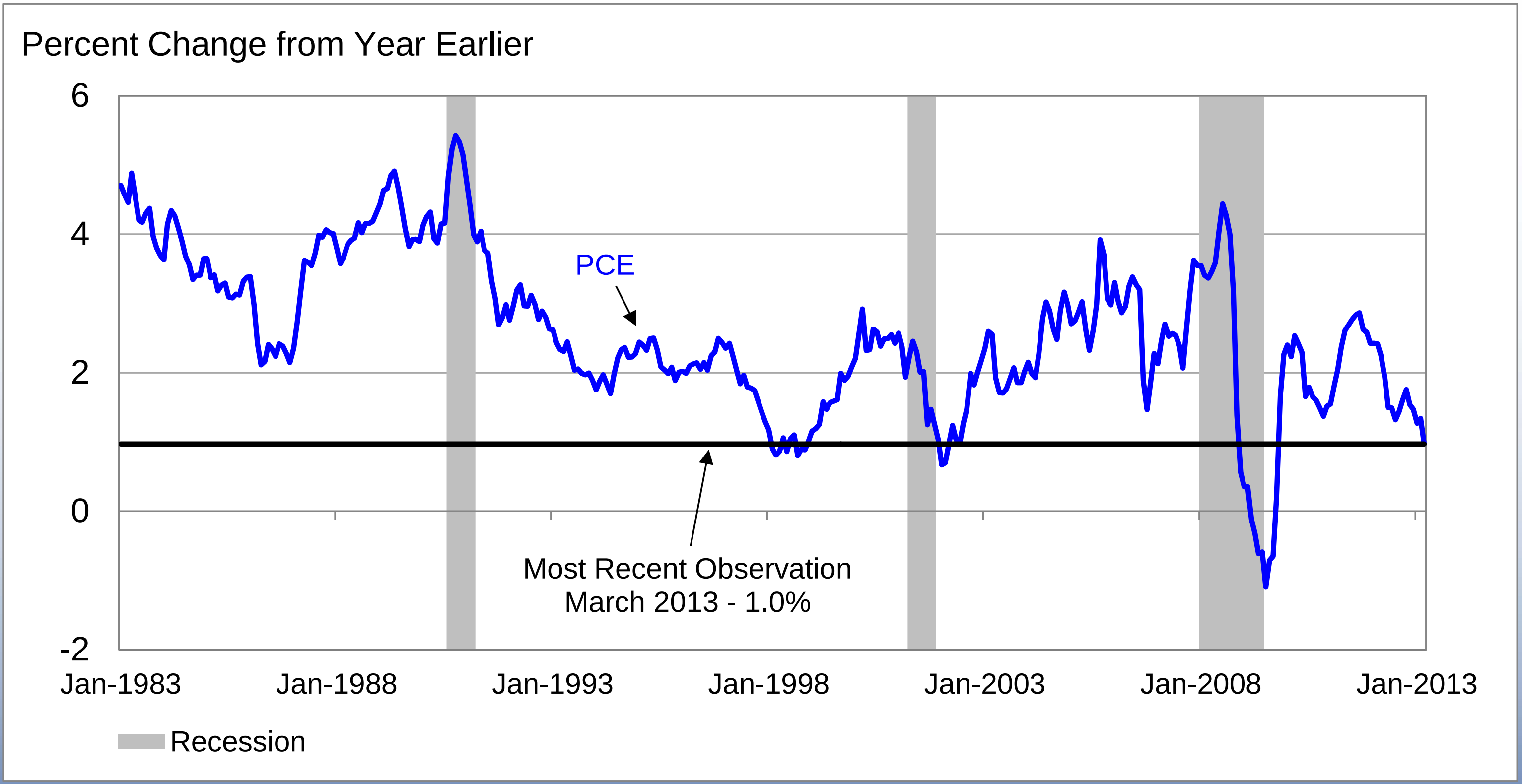


Note: Full employment is the CBO estimate of the natural rate of unemployment.
Core PCE inflation rate is the percent change in the Core PCE price index from one year earlier.

Source: BEA, BLS, CBO / Haver Analytics

Figure 6
Inflation Rate: Change in Personal Consumption Expenditures (PCE) Price Index

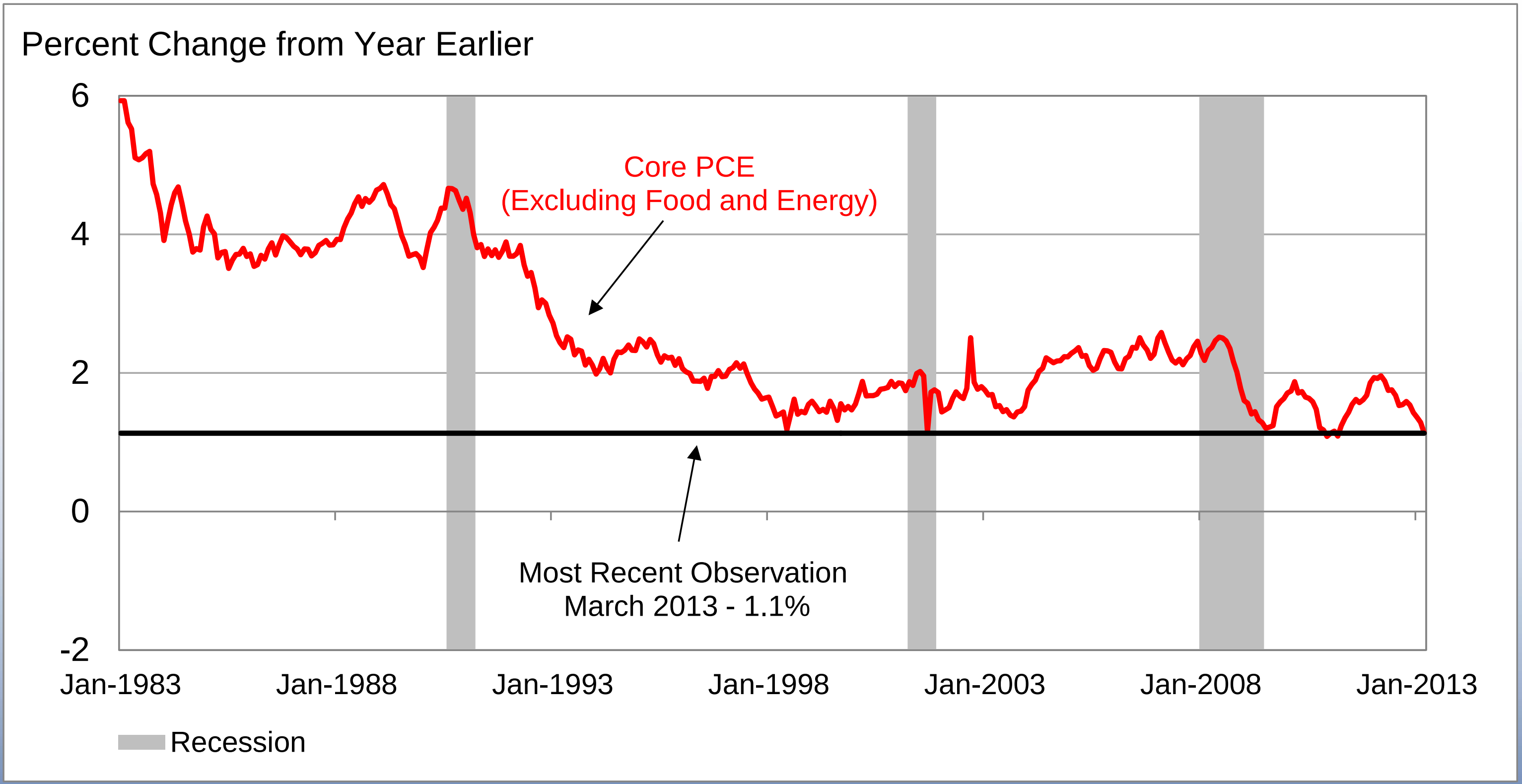
January 1983 - March 2013



Source: BEA, NBER / Haver Analytics

Figure 7
Core Inflation Rate: Change in Core Personal Consumption Expenditures (PCE) Price Index

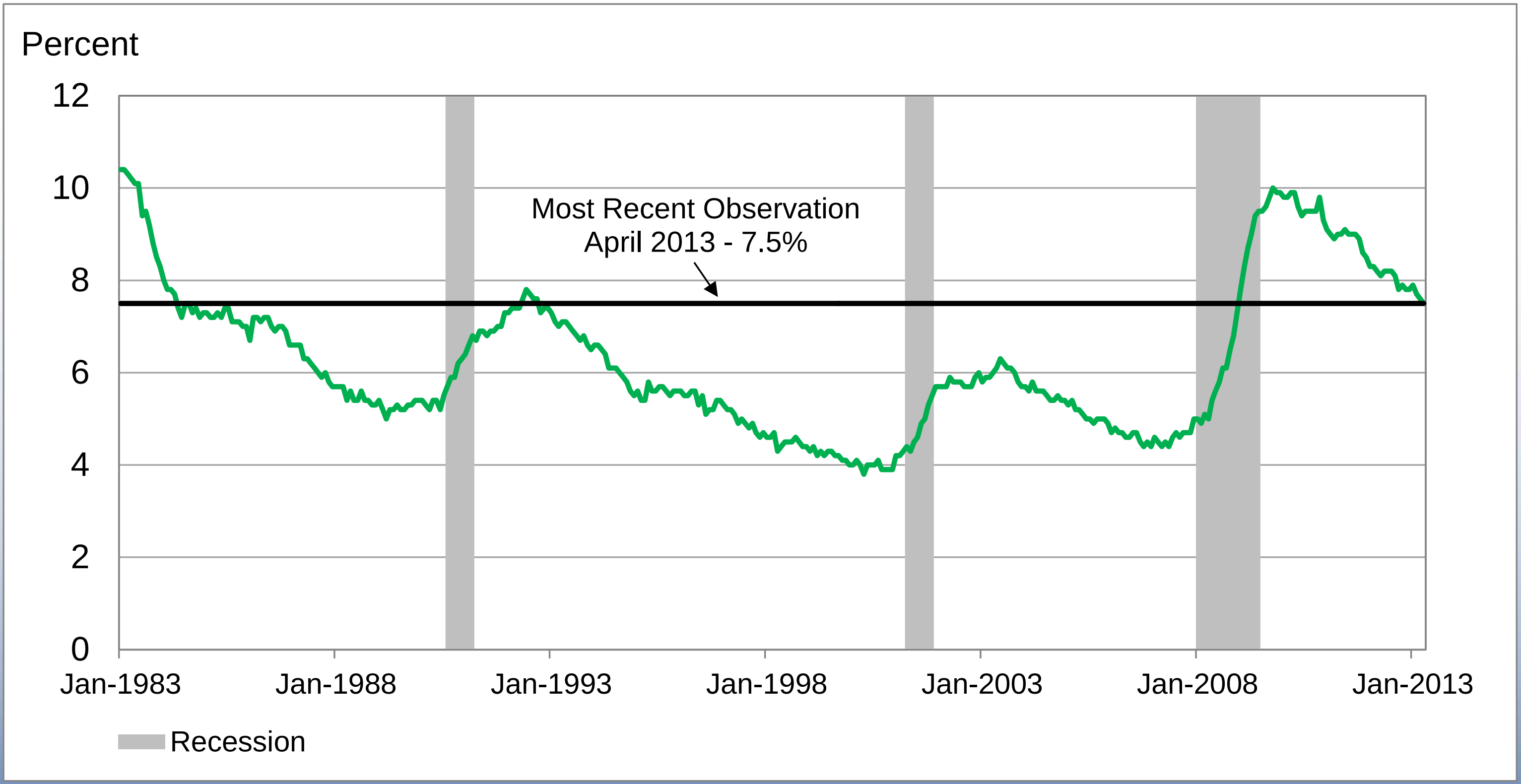
January 1983 - March 2013



Source: BEA, NBER / Haver Analytics

Figure 8
Civilian Unemployment Rate

January 1983 - April 2013



Source: BLS, NBER / Haver Analytics

Summarizing the Data

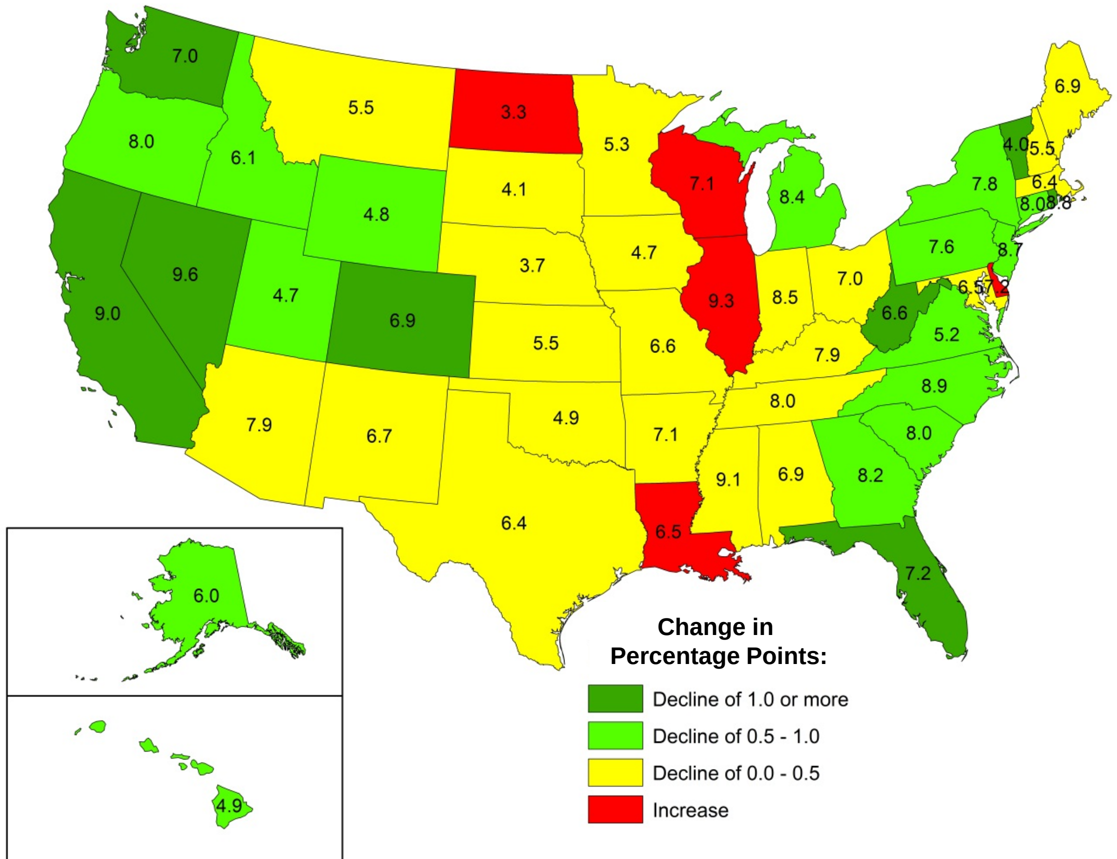
- While we have seen some improvement in labor markets, the unemployment rate remains well above what can be considered full employment
- Inflation remains well below target
- Core inflation remains at the very low end of recent experience
- The unemployment rate is close to the cyclical peaks of the past two recessions

Summarizing the Data Continued

- Potential unintended costs of the accommodative policy are not currently evident
- As a result, significant accommodation remains appropriate at this time

Figure 9
Change in Unemployment Rate by State

September 2012 - April 2013

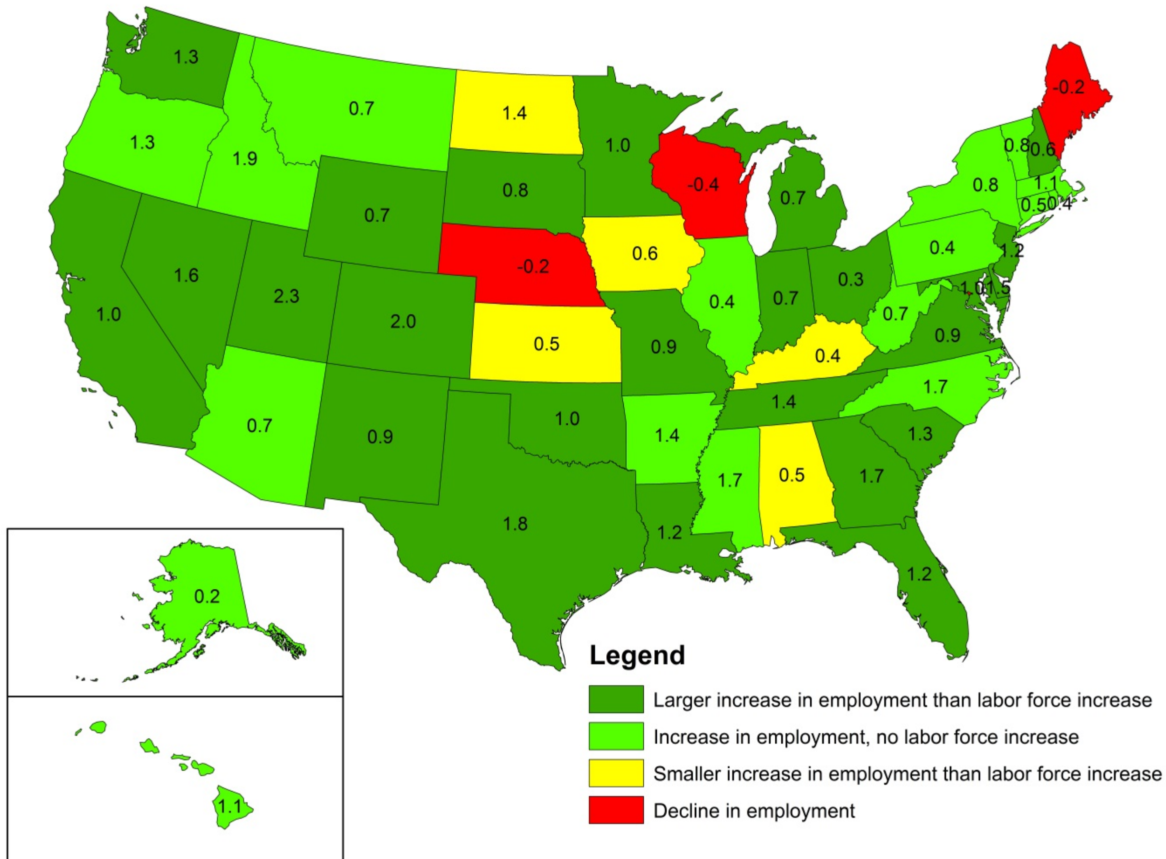


April 2013 unemployment rate displayed for each state

Source: BLS / Haver Analytics

Figure 10
Payroll Employment Growth by State

September 2012 - April 2013



Employment growth (%) displayed for each state

Source: BLS / Haver Analytics

Concluding Observations

- Since last September, there has been continued slow improvement in labor markets
  - Most regions of the country now have better labor market conditions than they did last September
  - Economic recovery is <u>beginning</u> to positively impact most regions of the country
  - Economy remains far from full employment, with unemployment at levels close to the peaks of the past two recessions

Monetary Policy

- It would in my view be premature to stop the Fed’s large-scale asset purchase program at this time
- Should continue until we see more sustained improvement in labor markets and have greater confidence that the economic recovery is sufficiently self-sustaining

Monetary Policy Continued

- Undesirable to abruptly stop purchases
  - Need to see a few months more of gradual improvement in labor markets and improvement in the overall growth rate in the economy before making modest adjustment
  - Adjustments, could be up or down, depend on economy

Balance Sheet Implications

- Changing the flow of purchases does not necessarily yield, in the end, a smaller central bank balance sheet
  - Even if we adjust the rate of monthly purchases, the ultimate size of the Fed’s balance sheet depends on the point of cessation
  - Bottom line: Need the economy to grow faster than the 2.1 percent it has averaged over the recovery