Assessing the Economy's Progress

Eric S. Rosengren
President & CEO
Federal Reserve Bank of Boston

November 9, 2015

Newport County Chamber of Commerce
Portsmouth, Rhode Island

bostonfed.org

Continued Reduction in Labor Market Slack

- U.S. Employment report on Friday
  - Unemployment now 5.0 percent
  - Payroll employment growth: 271,000 jobs
  - Continued reduction in slack nationally
- New England labor markets have also improved significantly
  - Largest decline in unemployment rate for last year was the 1.8 percentage point decline in Rhode Island, to 5.4 percent
  - NH and VT unemployment rates are now below 4 percent and MA and ME are below my estimate of (national) full employment of 4.8 percent

Context from Monetary Policy Meetings

- September – No change in short-term rates
  - Prudent decision given risk management concerns
  - Impact of emerging market problems uncertain at that time – but the worst of those concerns have not materialized
- October – No change in short-term rates
  - Monitoring global conditions
  - Determining whether it will be appropriate to raise rates in December
- Recent data have been positive

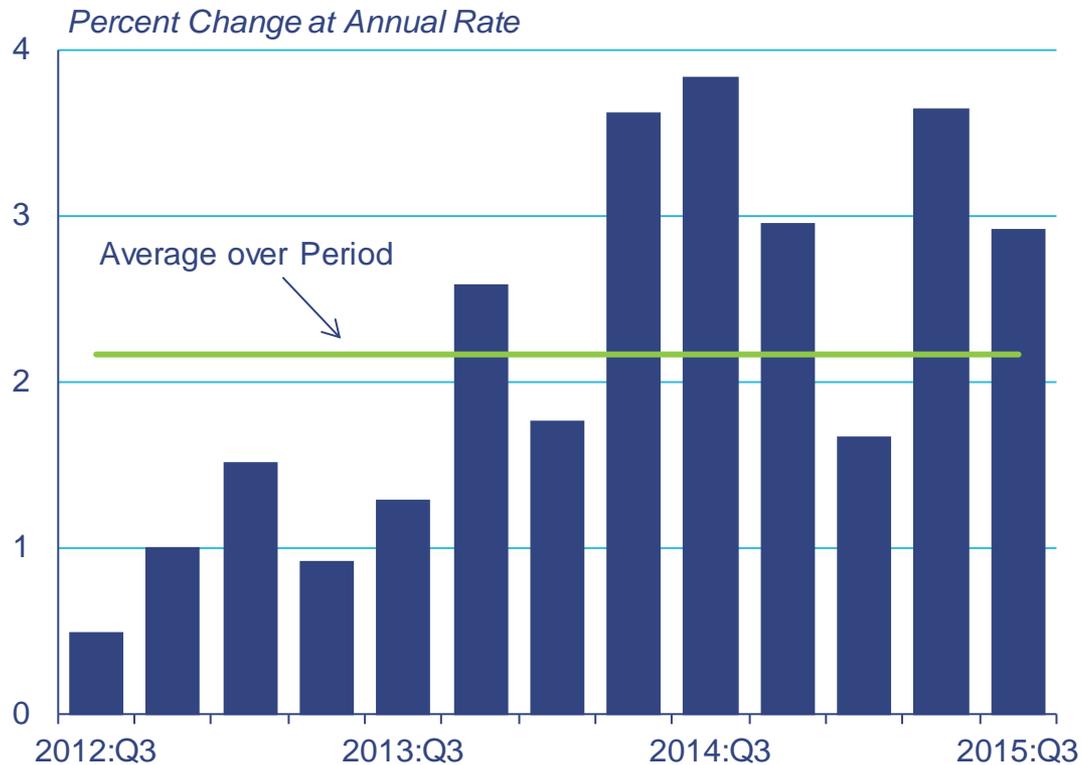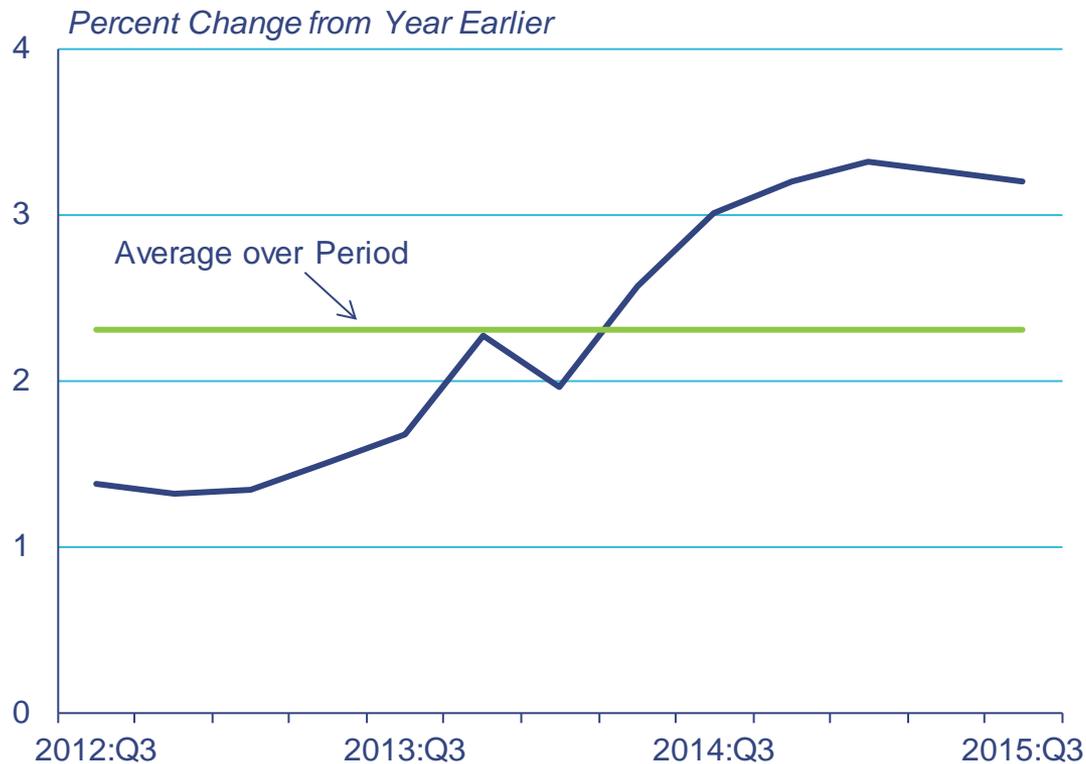Figure 1: Real Final Sales to Domestic Purchasers
2012:Q3 - 2015:Q3

Figure 2: Real Consumer Spending
2012:Q3 - 2015:Q3


Percent Change from Year Earlier

Average over Period

Implications of Q3 GDP

▶ Domestic markets little affected by emerging market problems or the resulting financial-market turbulence

▶ Employment report – firms still confident enough to hire workers

▶ Domestic strength likely to offset external weakness

▶ If real GDP grows above potential, expect gradual tightening of labor markets

Figure 3: Measures of Labor Underutilization
January 1994 - October 2015

Percent

Legend:
- U-6 Unemployment Rate
- Civilian Unemployment Rate (U-3)
- Recession
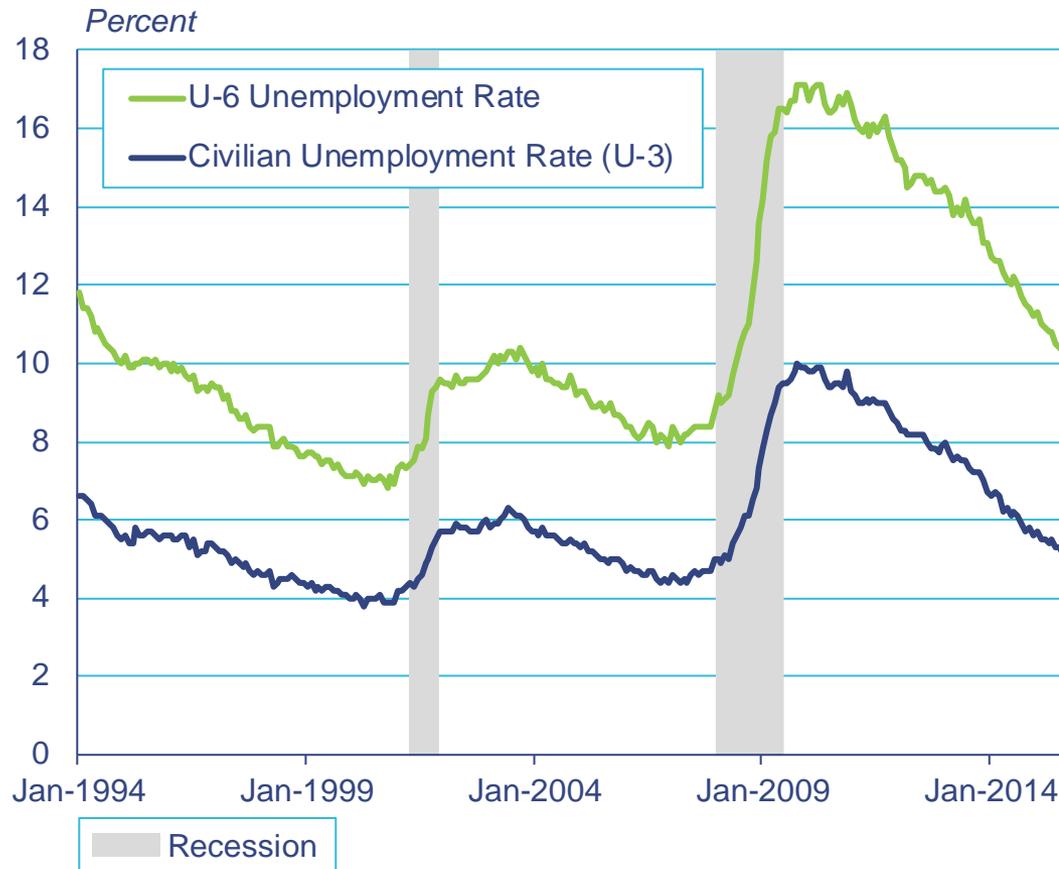
Note: The U-6 measure is total unemployed, plus all persons marginally attached to the labor force, plus total employed part time for economic reasons, as a percent of the civilian labor force plus all persons marginally attached to the labor force.

Source: BLS, NBER, Haver Analytics

Figure 4: Unemployment Rate Projections of Federal Reserve Governors and Federal Reserve Bank Presidents, September 2015

2015:Q4 - 2018:Q4
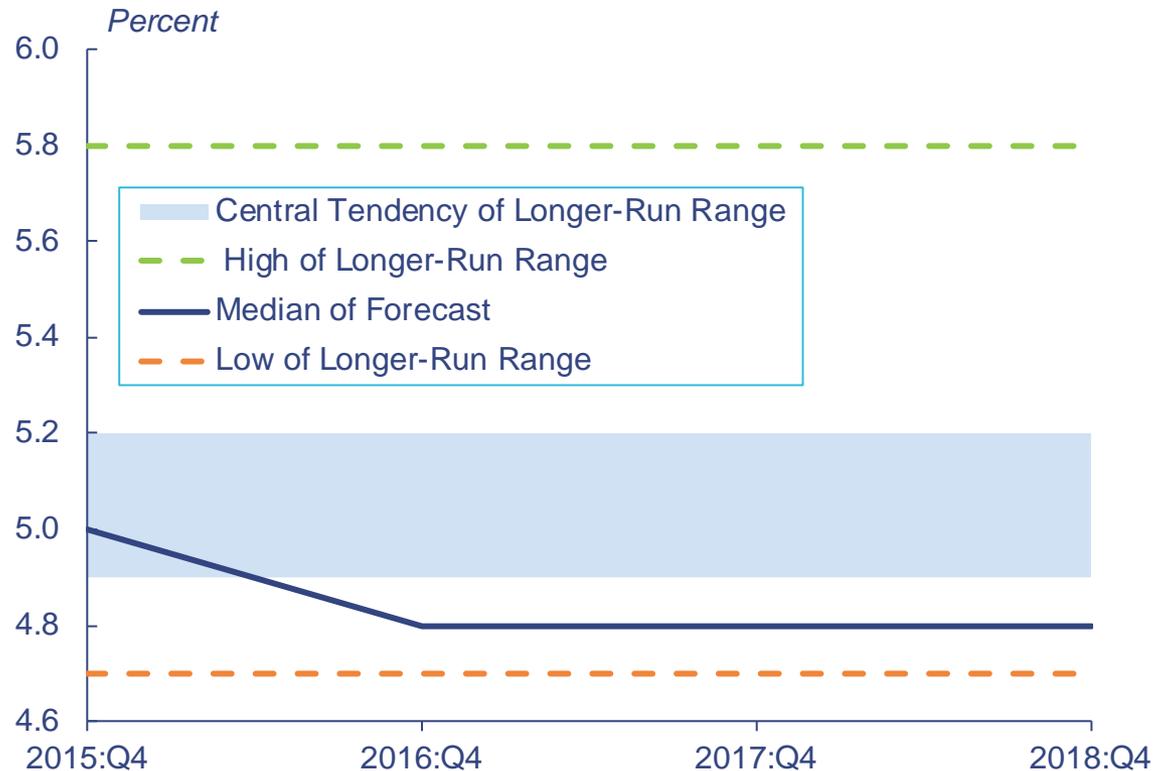
Note: The central tendency excludes the three highest and three lowest projections in each period.
Source: FOMC, Summary of Economic Projections (SEP), September 2015

Figure 5: Real Federal Funds Rate
January 1990 - October 2015

Note: The real federal funds effective rate is calculated by subtracting the core PCE inflation rate from the nominal federal funds effective rate. A core PCE inflation rate of 1.3% is assumed for October.

Source: BEA, Federal Reserve Board, NBER, Haver Analytics

Figure 6: Real Federal Funds Rate and the Civilian Unemployment Rate
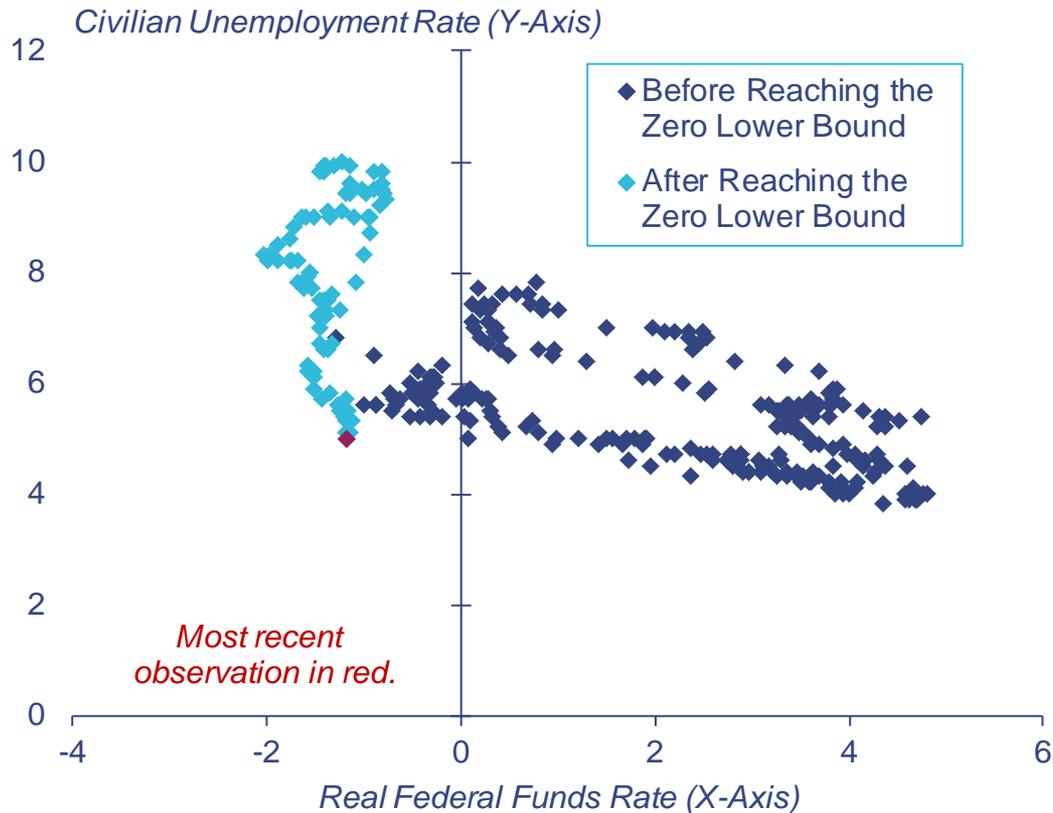## January 1990 - October 2015

Note: The real federal funds effective rate is calculated by subtracting the core PCE inflation rate from the nominal federal funds effective rate. In December 2008, the FOMC lowered the Federal Funds Target to a range of 0 to 25 basis points. A core PCE inflation rate of 1.3% is assumed for October.

Source: BEA, BLS, Federal Reserve Board, Haver Analytics

Figure 7: Real Federal Funds Rate and the Inflation Rate

January 1990 - October 2015

Percent Change in Core PCE from Year Earlier (Y-Axis)

- ◆ Before Reaching the Zero Lower Bound
- ◆ After Reaching the Zero Lower Bound

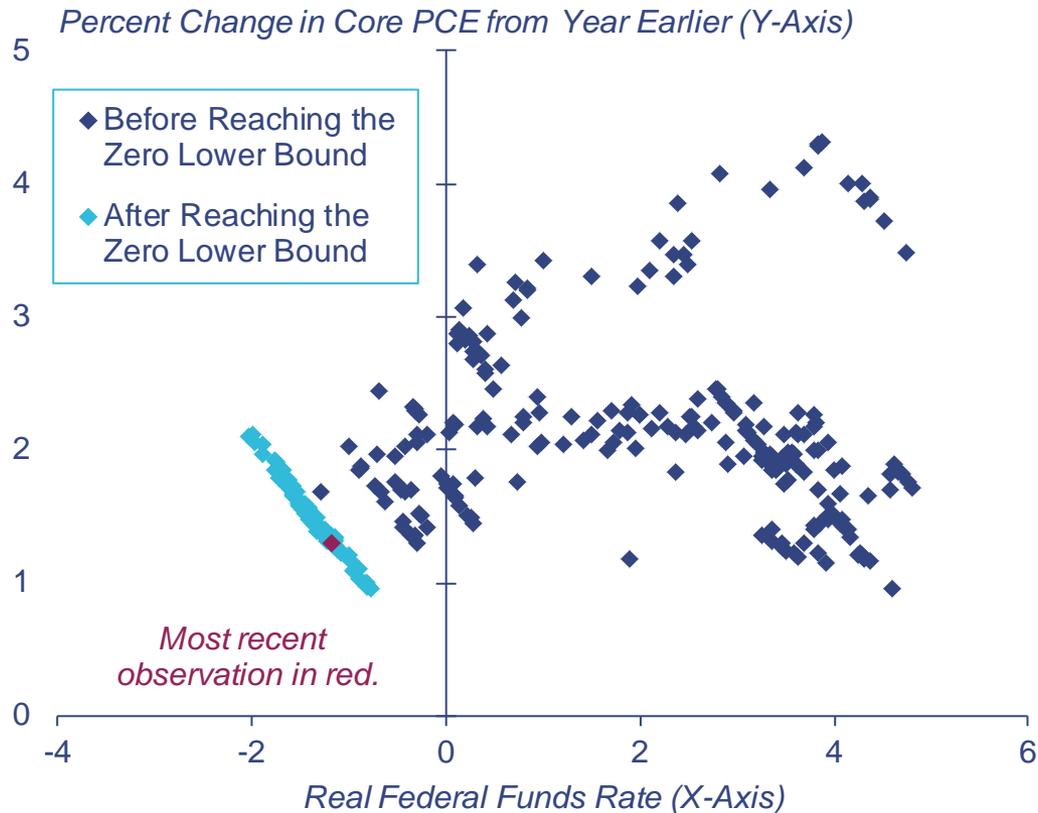*Most recent observation in red.*
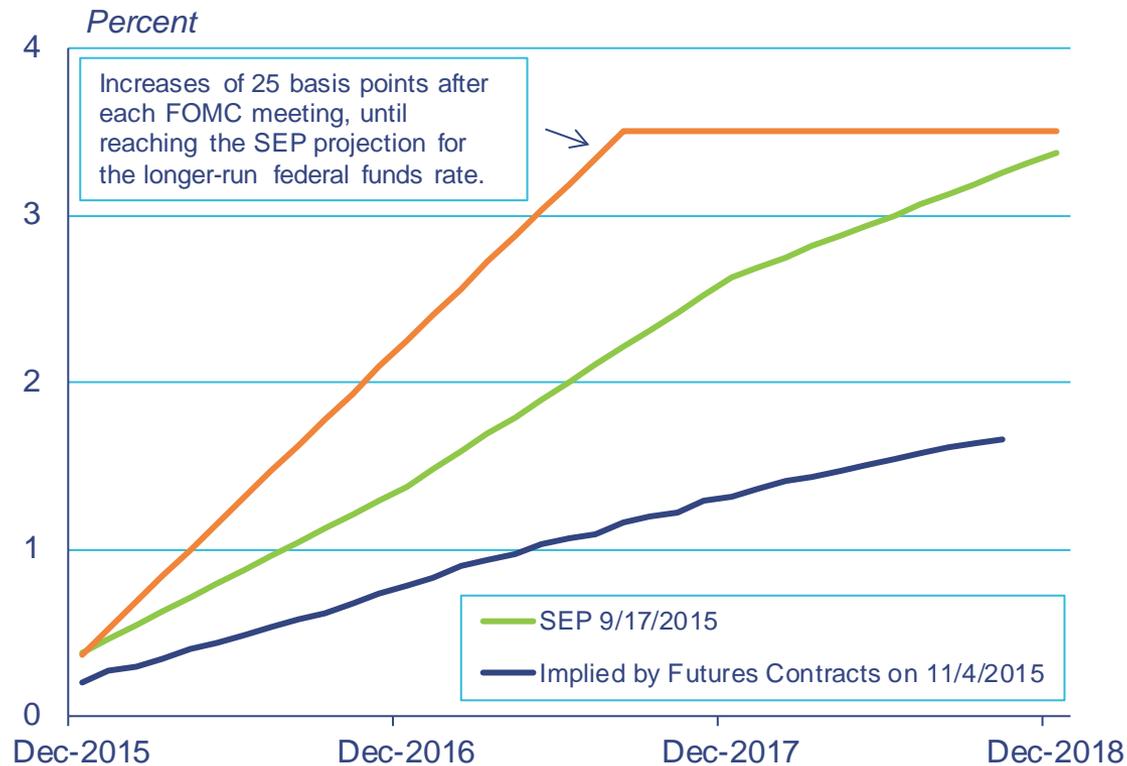
Real Federal Funds Rate (X-Axis)

Note: The real federal funds effective rate is calculated by subtracting the core PCE inflation rate from the nominal federal funds effective rate. In December 2008, the FOMC lowered the Federal Funds Target to a range of 0 to 25 basis points. A core PCE inflation rate of 1.3% is assumed for October.

Source: BEA, Federal Reserve Board, Haver Analytics

Figure 8: Federal Funds Rate Projections of Federal Reserve Governors and Federal Reserve Bank Presidents and the Federal Funds Futures Market

December 2015 - December 2018

Percent

Increases of 25 basis points after each FOMC meeting, until reaching the SEP projection for the longer-run federal funds rate.

SEP 9/17/2015

Implied by Futures Contracts on 11/4/2015

Note: Estimates from the Summary of Economic Projections (SEP) are the medians of the projections for the midpoint of the target range at yearend for 2015 -2018. The orange line provides a smoothed path based on an assumption that there are increases of 25 basis points following each FOMC meeting until the rate reaches the SEP longer-run projection.

Source: FOMC, Summary of Economic Projections, September 2015, Bloomberg

Figure 9: Real GDP Growth Projections of Federal Reserve Governors and Federal Reserve Bank Presidents, September 2015

2015:Q4 - 2018:Q4

Percent Change from Year Earlier
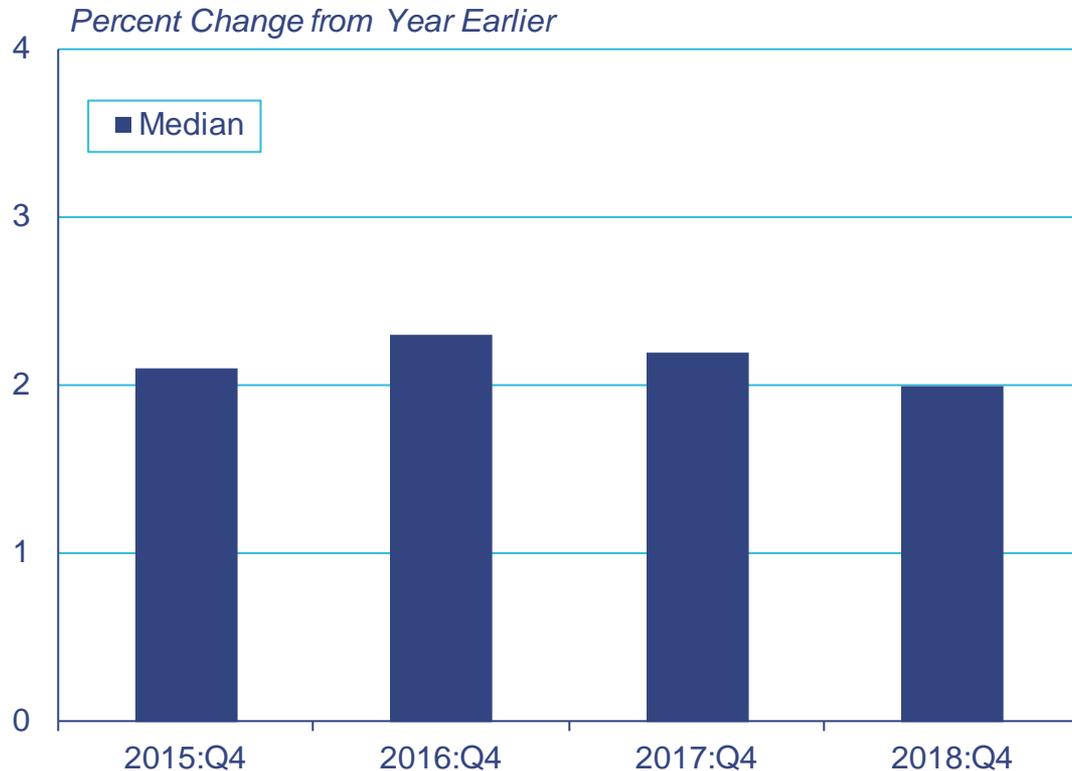
Implications

- ▶ Little in wage and price pressures and modest economic growth – so a more gradual path of normalization may be necessary

- ▶ My own view of appropriate interest rate path is closer to the market expectations path

- ▶ Other advantages of a gradual tightening

  - ▶ More time to analyze effectiveness of tools

  - ▶ More time to evaluate impact on economy

    - ▷ reduces risk of more or less aggressive action than needed or intended

    - ▷ probe how tight labor markets can be, consistent with inflation target

Financial Stability Considerations

▶ When far from goals, returning to more normal state with monetary stimulus is critical

▶ As economy attains more balance, financial stability concerns that imply risks to future balance should be considered

▶ May incent behavior to seek higher returns and more risk

▶ "Search for yield" may be showing up in commercial real estate prices

Figure 10: NCREIF Commercial Real Estate Transactions-Based Real Price Indices
1994:Q1- 2015:Q3
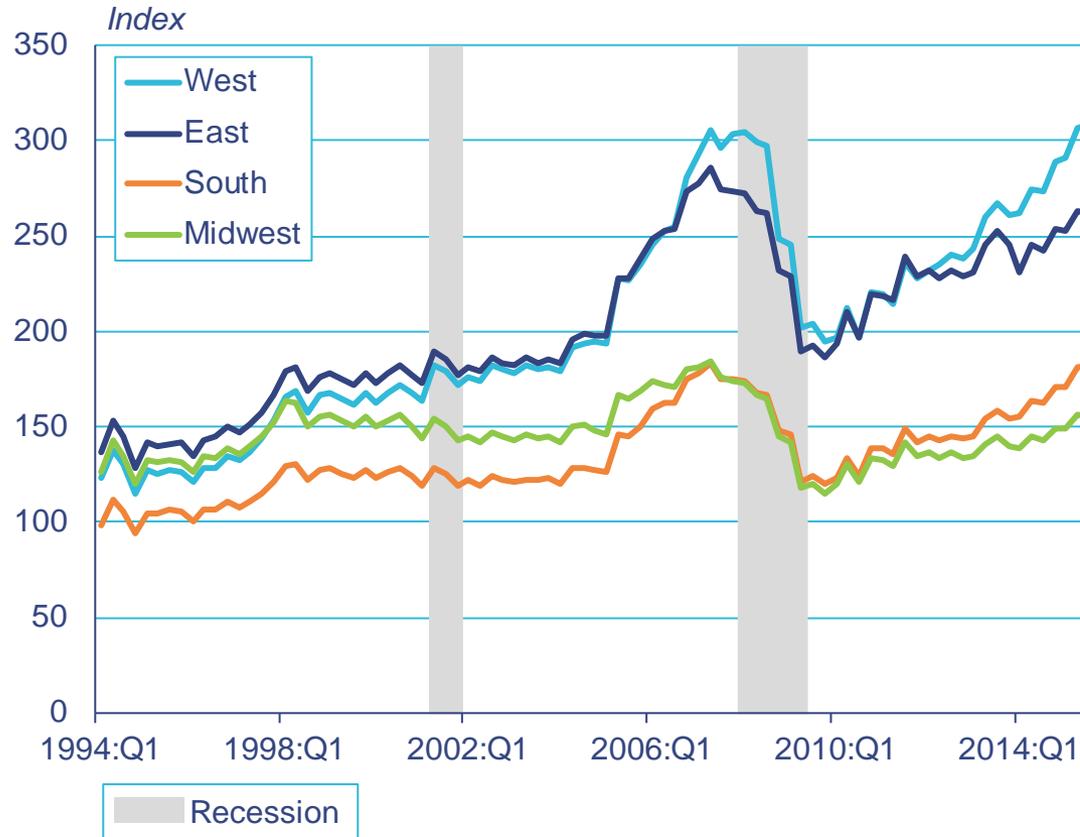
Note: Series are adjusted for inflation using the GDP Deflator.

Source: National Council of Real Estate Investment Fiduciaries (NCREIF), BEA, NBER, Haver Analytics

Concluding Observations

▶ Labor markets greatly improved, the economy is now at or close to many estimates of full employment

▶ Reasonably confident of reaching 2 percent inflation over the medium term

▶ December could be appropriate time for raising rates as long as the economy progresses as projected

▶ Path of normalizing rates should be gradual once we do move off the zero lower bound