



EMBARGOED UNTIL THURSDAY, MAY 12, 2016 AT 12:20 P.M. EASTERN TIME OR UPON DELIVERY

Exploring the Economy's Progress and Outlook

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Gradual Improvement in the Economy

- ▶ Second-quarter indicators
 - ▶ Still quite early
 - ▶ Payroll employment – 160,000 jobs in April
 - ▷ Less than expected – 203,000 was the average monthly gain in Q1; but above “trend”
 - ▷ Enough to gradually tighten labor markets
 - ▷ Close to full employment
 - ▷ Higher wages and hours worked should be a positive driver for future consumption
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Pick-up in Spending Expected

- ▶ Q1 real GDP growth only 0.5 percent
 - ▶ Weaker than projected earlier in the year
 - ▶ Weakness not expected to persist
 - ▷ U.S. and foreign stock markets rebounded from mid-February
 - ▷ Euro area grew faster than U.S. in the first quarter
 - ▷ Some evidence that spending is increasing
 - ▶ Fewer headwinds from abroad and stronger consumption should improve spending for Q2
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Implications for Policy

- ▶ Relatively little data for second quarter as yet
 - ▶ Expect growth somewhat above my estimate of the “potential” rate of 1.75 percent
 - ▶ Gradual improvement in labor markets and inflation
 - ▶ The market remains too pessimistic about the fundamental strength in the US economy
 - ▶ In my view, likelihood for removing monetary accommodation is higher than is currently priced into financial markets
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Figure 1: Real GDP Growth 2014:Q1 - 2016:Q1

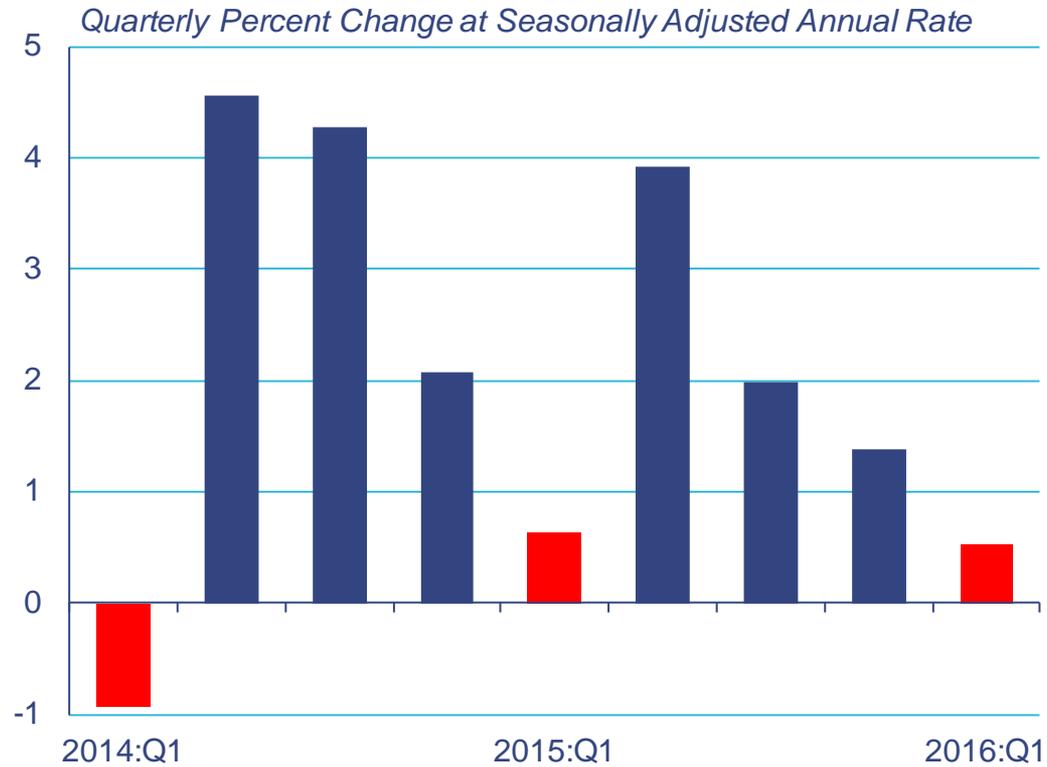




Figure 2: Auto and Light Truck Sales January 2014 - April 2016

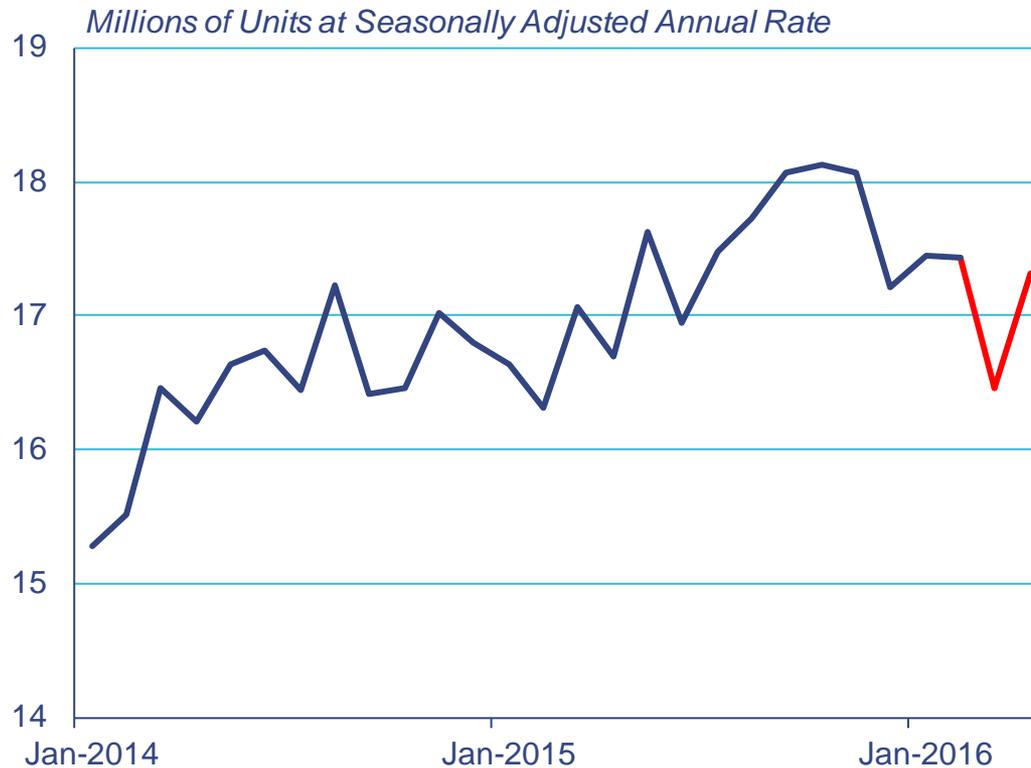




Figure 3: Change in Payroll Employment January 2014 - April 2016

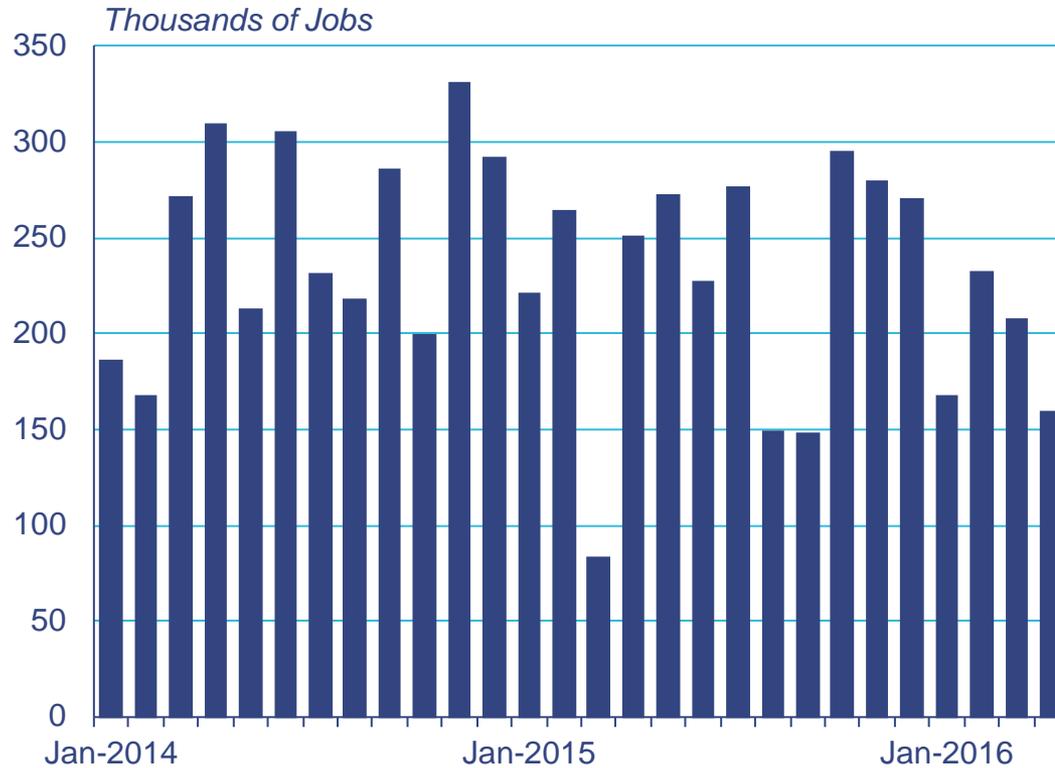
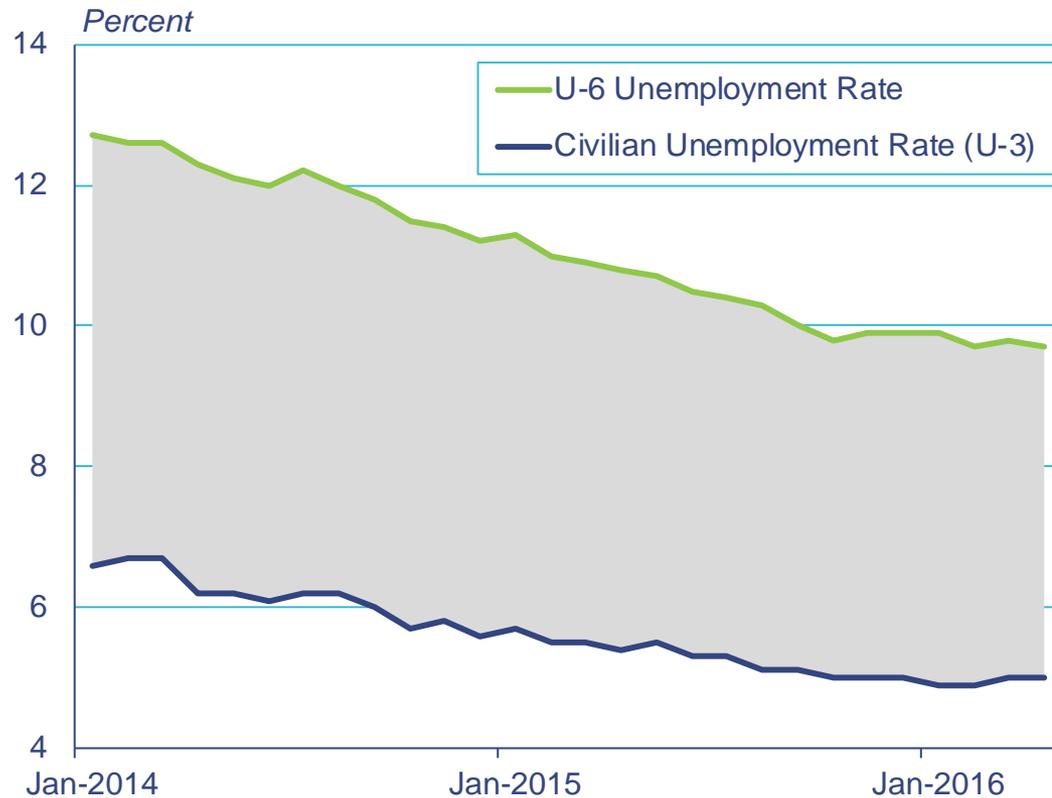




Figure 4: Measures of Labor Underutilization January 2014 - April 2016



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, Haver Analytics



Figure 5: Average Hourly Earnings of Employees on Private Nonfarm Payrolls

January 2014 - April 2016

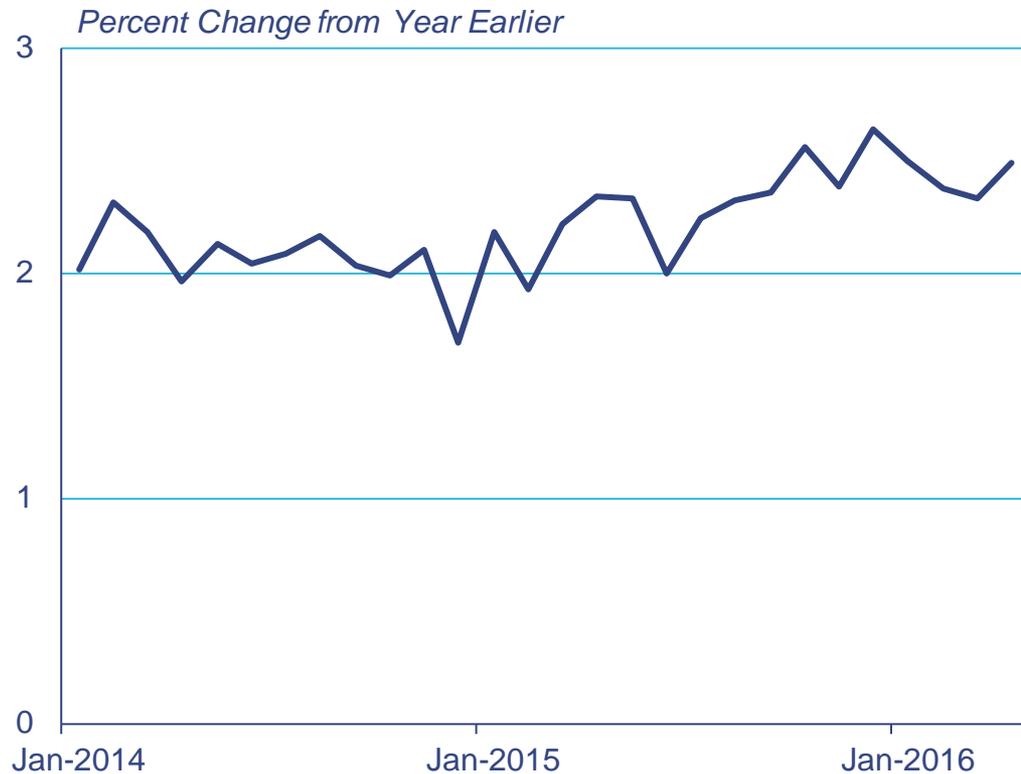
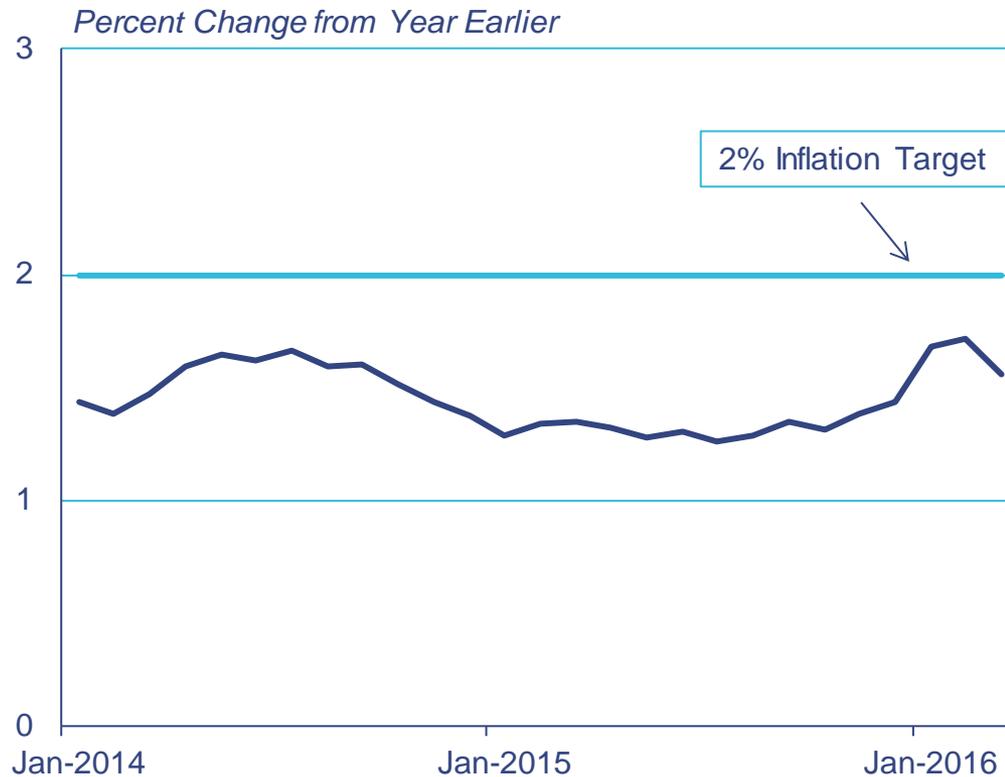




Figure 6: U.S. Inflation Rate: Change in Core Personal Consumption Expenditures Price Index January 2014 - March 2016





Economy Continues to Improve

- ▶ It is early in the quarter, but data consistent with gradual improvement
 - ▶ We are adding jobs faster than trend which should tighten labor market conditions
 - ▶ Limited spending data consistent with growth above potential
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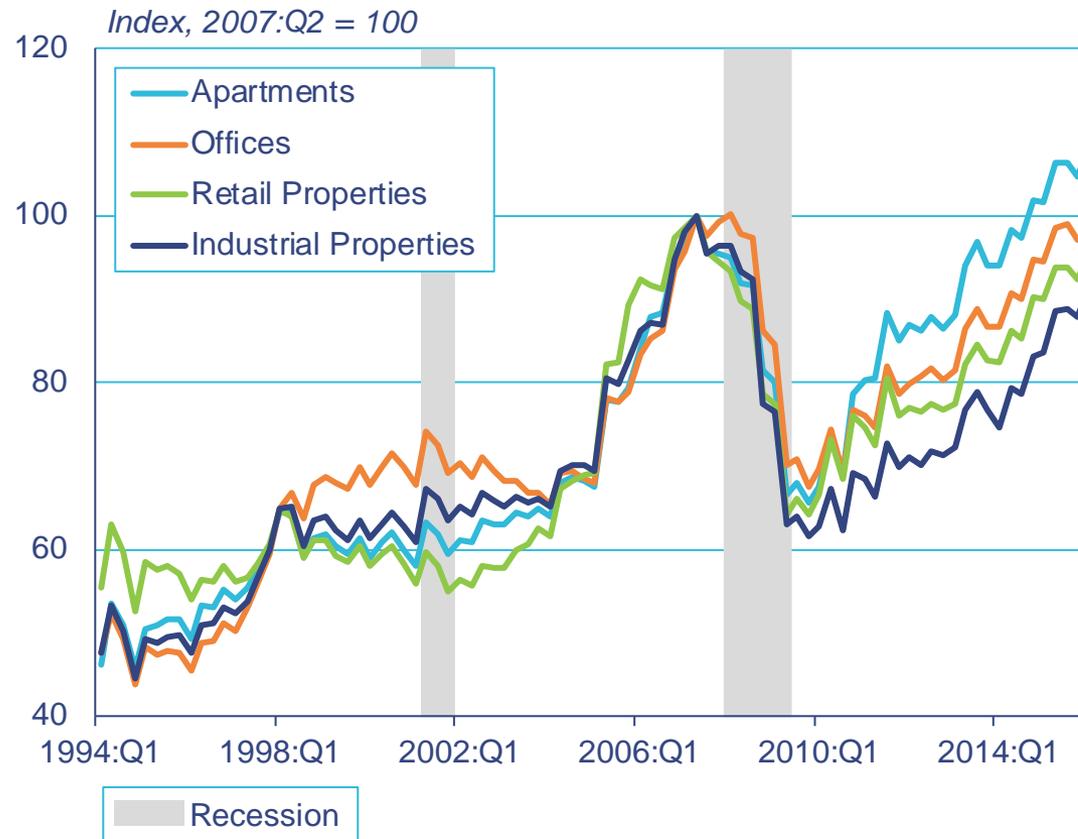


Risks Associated with Leaving Rates Too Low for Too Long

- ▶ Benefits of accommodative policy
 - ▶ Probe on the natural rate of unemployment
 - ▶ Workers rejoin the labor force, many of them previously having given up looking for work
 - ▶ Also potential costs of too much accommodation, for too long
 - ▶ Very low interest rates can encourage speculative behavior – I have some concerns about commercial real estate
 - ▶ It's difficult to “fine tune” the economy – if we overshoot the natural rate of unemployment, *gradually* increasing is difficult
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Figure 7: NCREIF Commercial Real Estate Transactions-Based Real Price Indices

1994:Q1- 2016:Q1



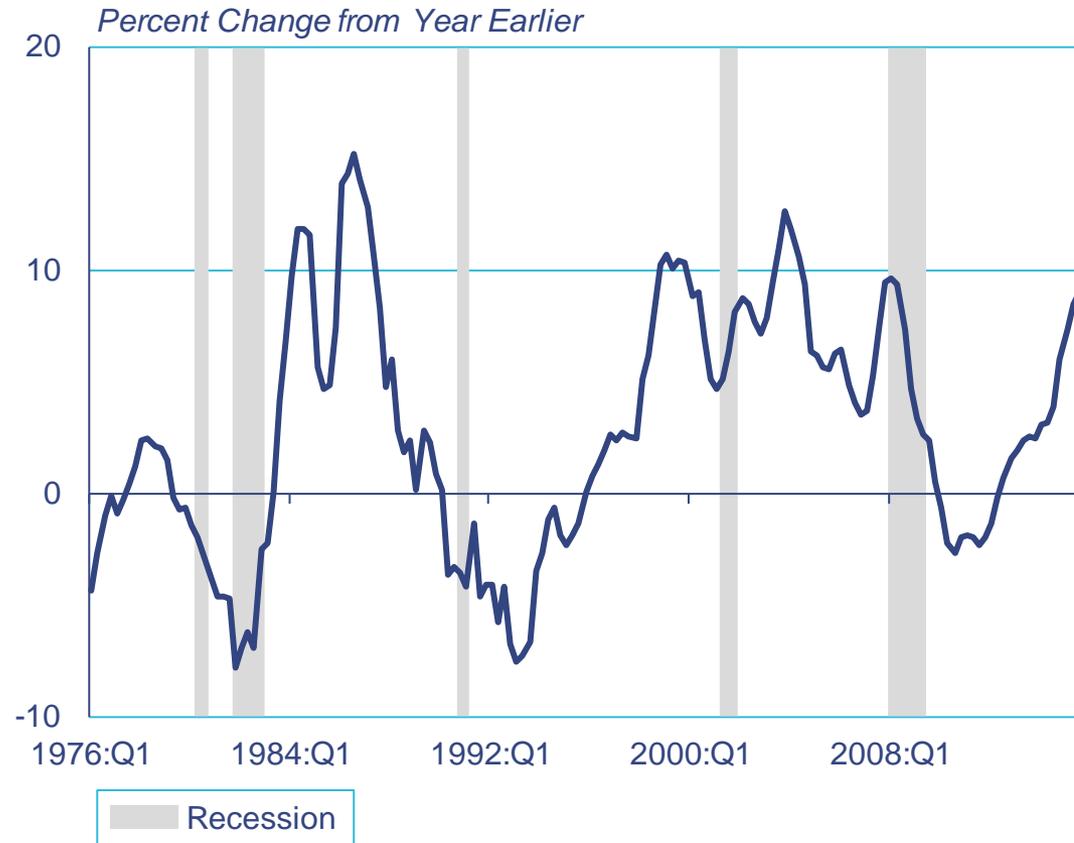
Note: Series are adjusted for inflation using the GDP Deflator.

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



Figure 8: Real Multifamily Residential Mortgage Growth

1976:Q1 - 2015:Q4



Note: Series is adjusted for inflation using the GDP Deflator.

Source: Federal Reserve Board, Financial Accounts of the United States, BEA, NBER, Haver Analytics



Why are Potentially Inflated Commercial Real Estate Prices a Problem?

- ▶ Financial instability often tied to real estate
 - ▶ Debt contracts on volatile underlying assets are a problem when prices fall
 - ▶ Problem for owner, debtor, and potentially others if the debt is to financial institutions
 - ▶ Historical context: New England in the late 1980s and early 1990s
 - ▶ Avoid problems of past cycles
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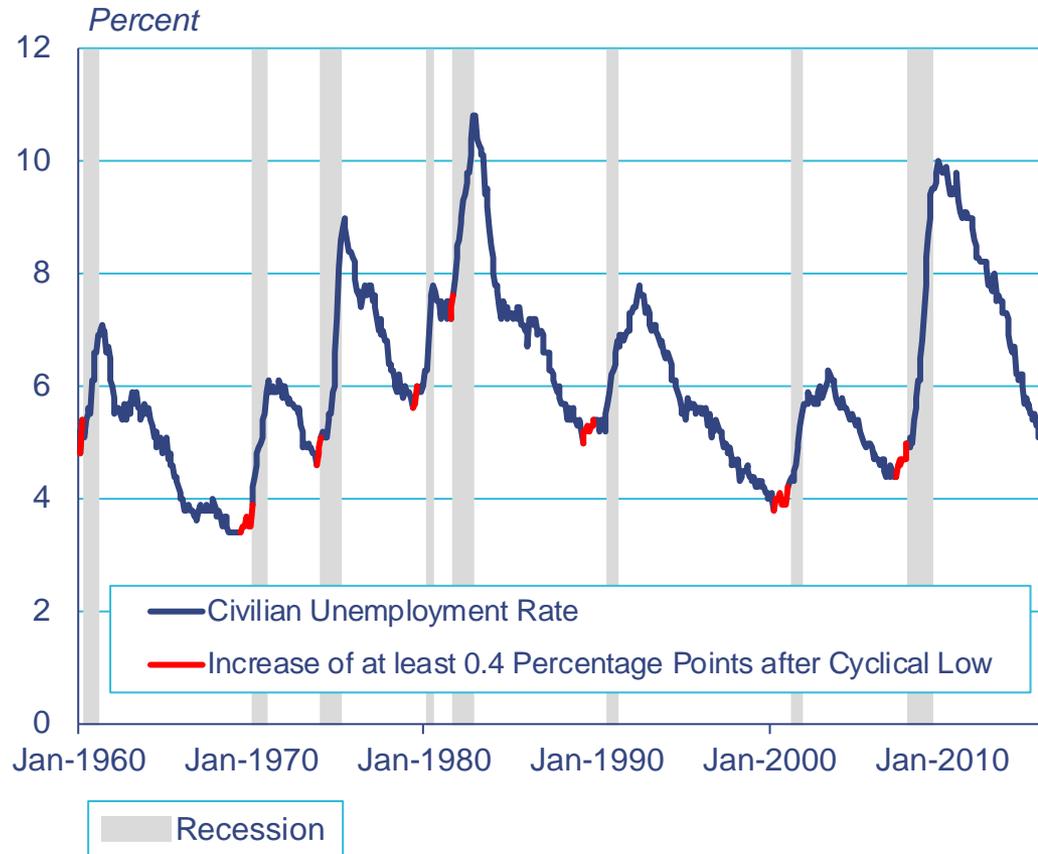


Supervisory Responses

- ▶ Interagency Statement on Prudential Risk Management for Commercial Real Estate Lending (SR 15-17)
 - ▶ Prudential risk management
 - ▶ Reemphasized earlier guidance on the need for exposure thresholds and increased monitoring
 - ▶ Supervision can only apply to regulated banks
 - ▶ Non-bank lenders
 - ▶ Foreign investors
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Figure 9: Civilian Unemployment Rate January 1960 - April 2016





Concluding Observations

- ▶ Economy improving gradually – employment and inflation are getting closer to the Fed’s dual mandate
 - ▶ My view is the Fed should be ready to gradually normalize rates, perhaps at a pace not currently anticipated by the federal funds futures market
 - ▶ We must remain data dependent – domestic and international disruptions could change outlook
 - ▶ However – such disruptions would need to materially change the outlook
 - ▶ As we make progress on dual mandate, gradual removal of monetary policy should continue
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