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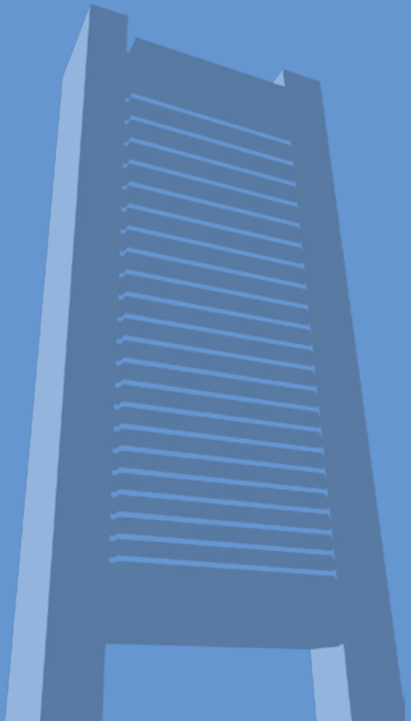

Exploring Current Economic Conditions and the Implications for Monetary Policy

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Recent Monetary Policy Actions

- FOMC raised federal funds rate by 25 basis points at September meeting
  - Third increase this year
  - Range of 2 to 2.25 percent exceeds inflation target of 2 percent
- Move reflects strong economic performance over past 2 quarters
- Monetary policy remains mildly accommodative, and fiscal policy is quite accommodative

Outlook – Continued Robust Growth

- Private-sector forecasts expect second half growth of approximately 3 percent
- Most FOMC participants have similar outlook
- With unemployment at 3.7 and strong growth:
  - Blue Chip forecast expects unemployment to fall to 3.5 percent by the end of next year
  - Below FOMC participants' estimates of the long-run unemployment rate

Clear Risks to the Forecast

- Both the U.S. and China recently increased tariffs – potential headwind over time
- Some emerging market economies are experiencing stress – Turkey, Argentina
- Europe still facing challenges – Brexit, exposure to emerging markets

How Should Policy Respond to Strong Base Forecast but Rising Risks?

- Closely monitoring
- My view of most likely outcome – a labor market that continues to tighten risking economic imbalances
- Gradual monetary tightening balances risk to avoid a more forceful response
- Assuming risks do not materialize – gradually raise rates until monetary policy is mildly restrictive

Figure 1: Initial Claims for Unemployment Insurance

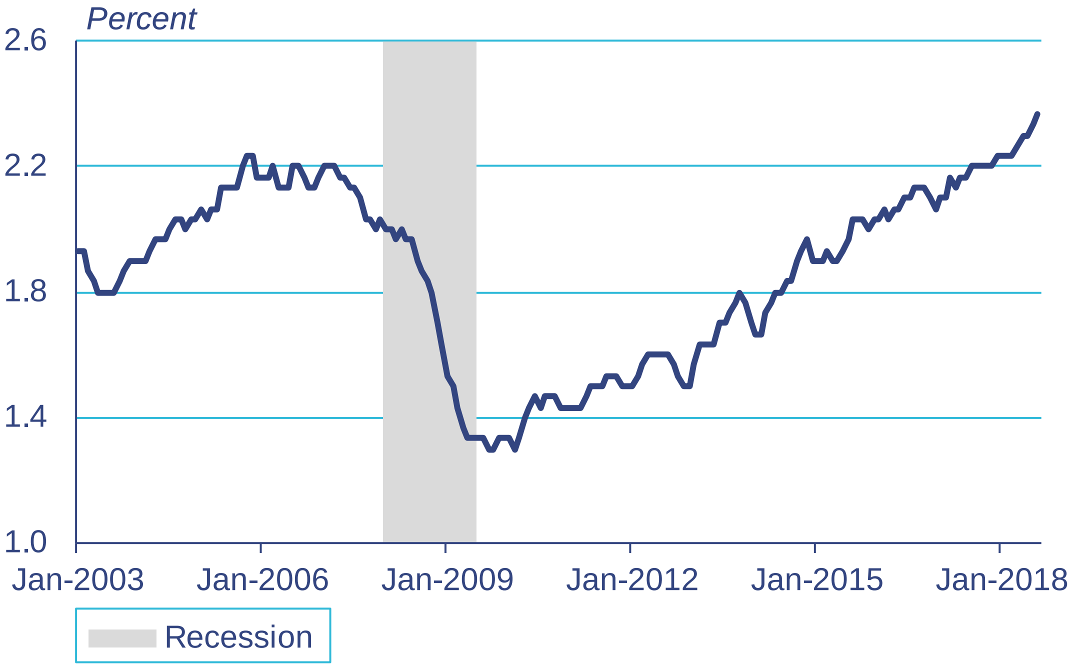
January 28, 1967 - October 13, 2018

Note: Four-week moving average

Source: U.S. Department of Labor, NBER, Haver Analytics

Figure 2: Job Leavers: The Quits Rate

January 2003 - August 2018

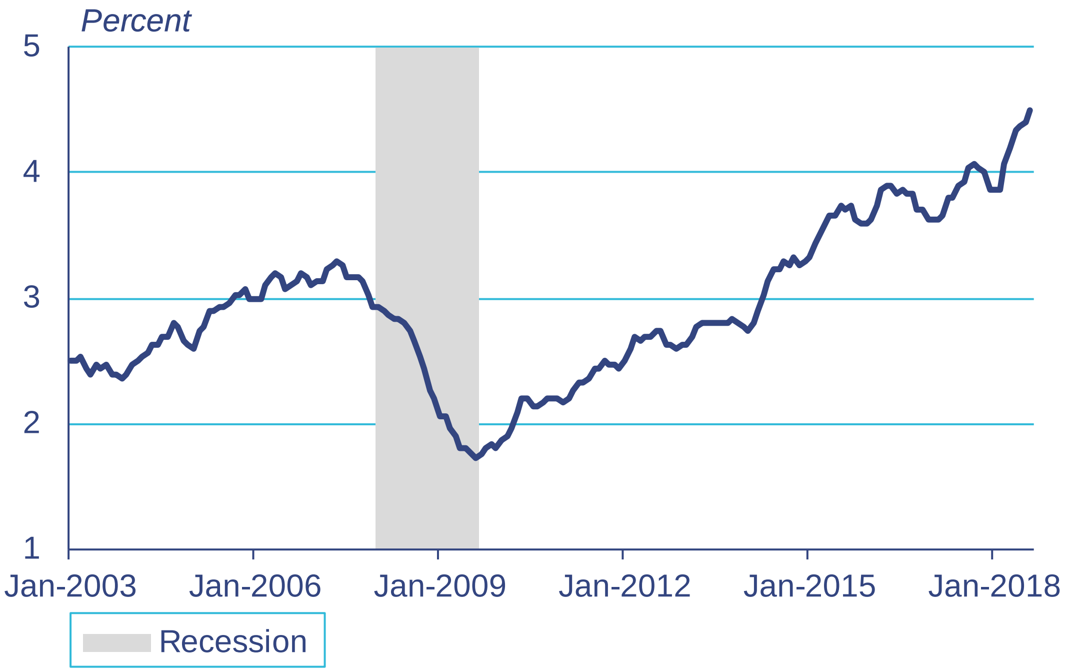


Note: The quits rate is the number of quits during the entire month as a percent of total employment. Pictured above is the three-month moving average.

Source: BLS, NBER, Haver Analytics

Figure 3: Job Openings Rate

January 2003 - August 2018

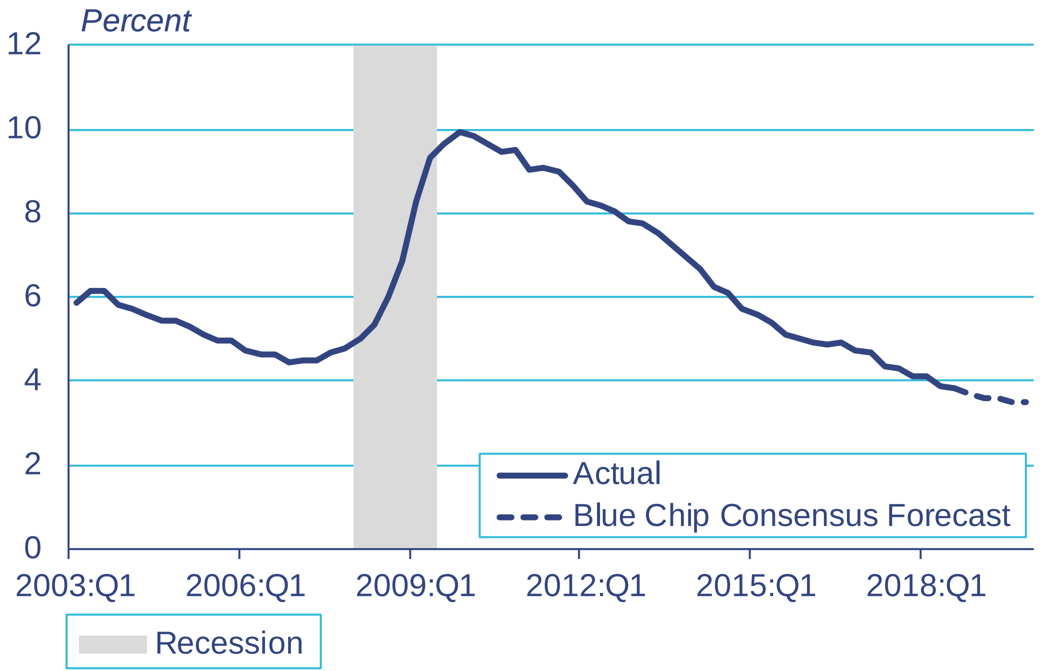


Note: The job openings rate is the number of job openings on the last business day of the month as a percent of total employment plus job openings. Pictured above is the three-month moving average.

Source: BLS, NBER, Haver Analytics

Figure 4: Unemployment Rate: Actual and Forecast

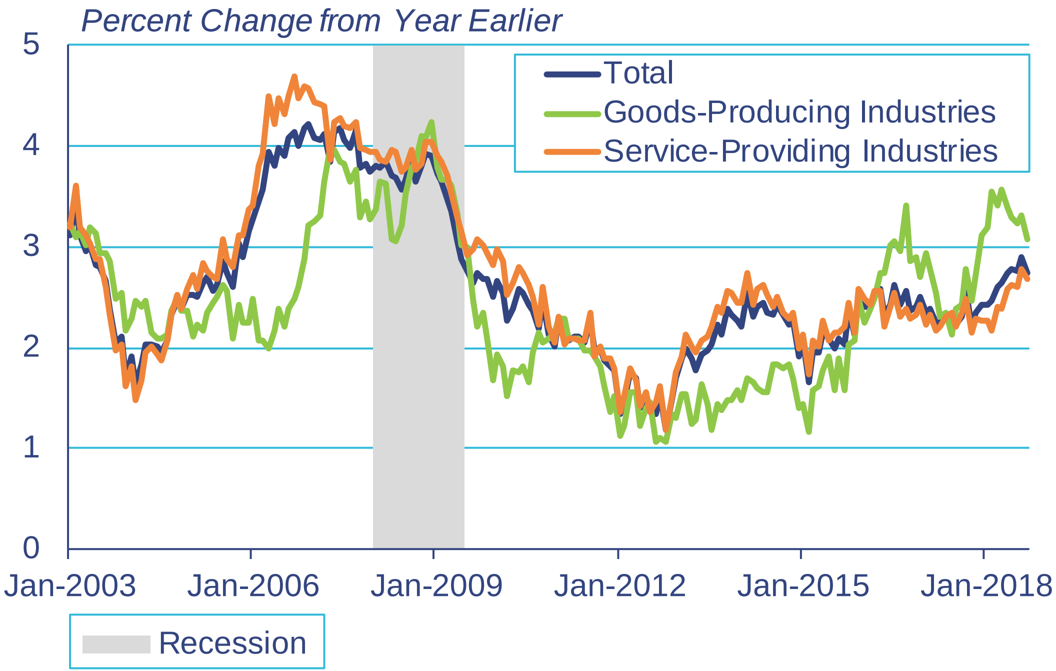
Actual, 2003:Q1 - 2018:Q3 and Forecast, 2018:Q4 - 2019:Q4



Source: BLS, Blue Chip Economic Indicators, NBER, Haver Analytics

Figure 5: Average Hourly Earnings of Production and Nonsupervisory Private-Industry Employees

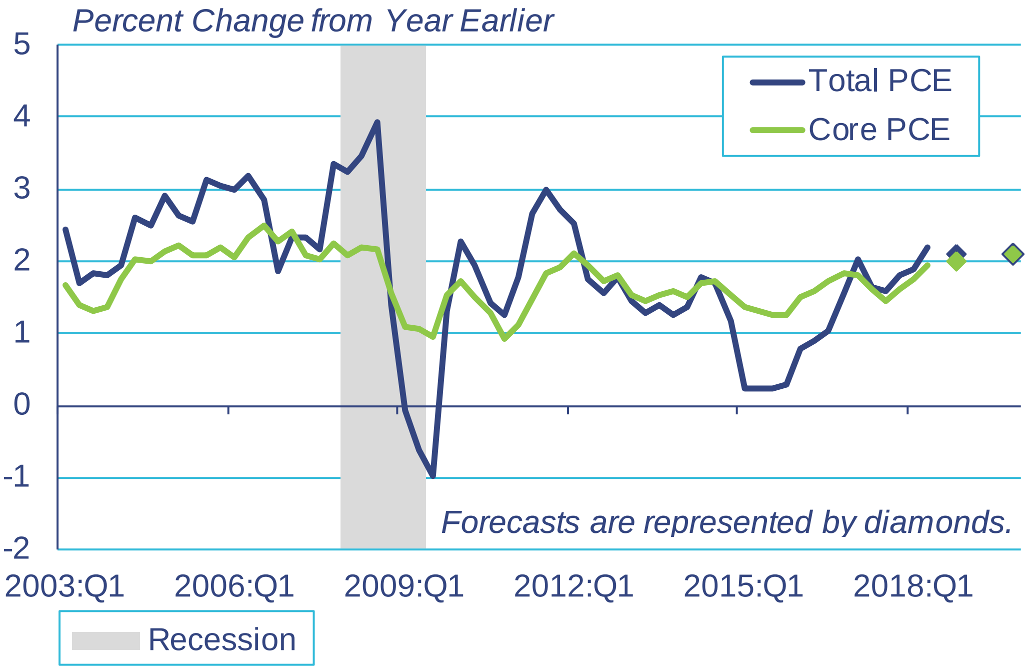
January 2003 - September 2018



Source: BLS, NBER, Haver Analytics

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

Actual, 2003:Q1 - 2018:Q2 and Forecast, 2018:Q4 & 2019:Q4

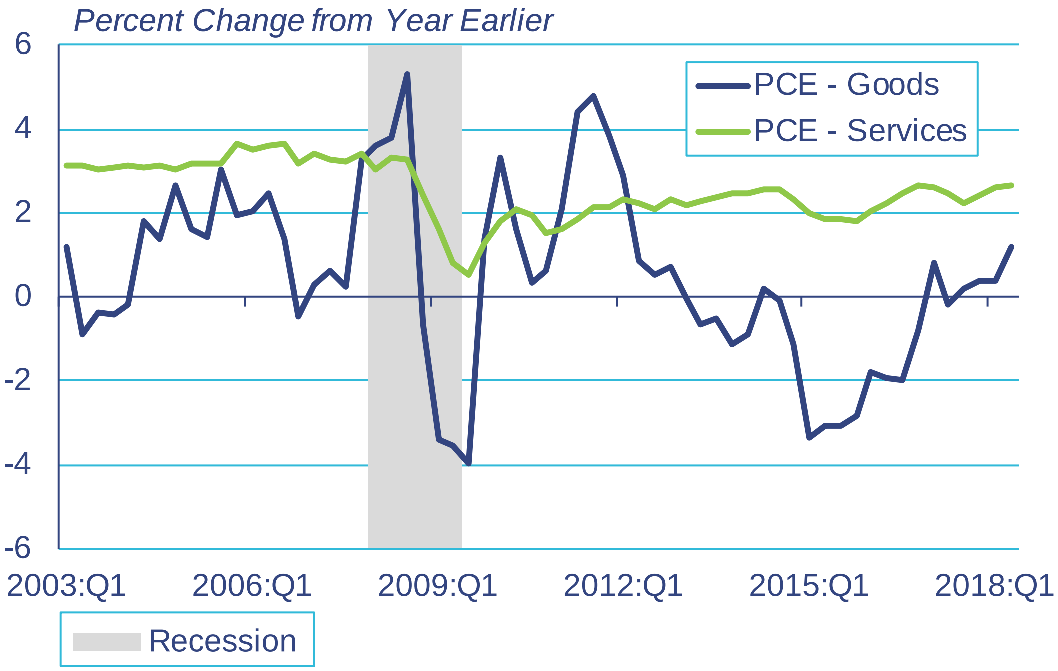


Note: Core PCE excludes food and energy.

Source: BEA; Federal Reserve Bank of Philadelphia, Survey of Professional Forecasters; NBER; Haver Analytics

Figure 7: Inflation Rate: Change in Personal Consumption Expenditures (PCE) Price Indices for Goods and Services

2003:Q1 - 2018:Q2



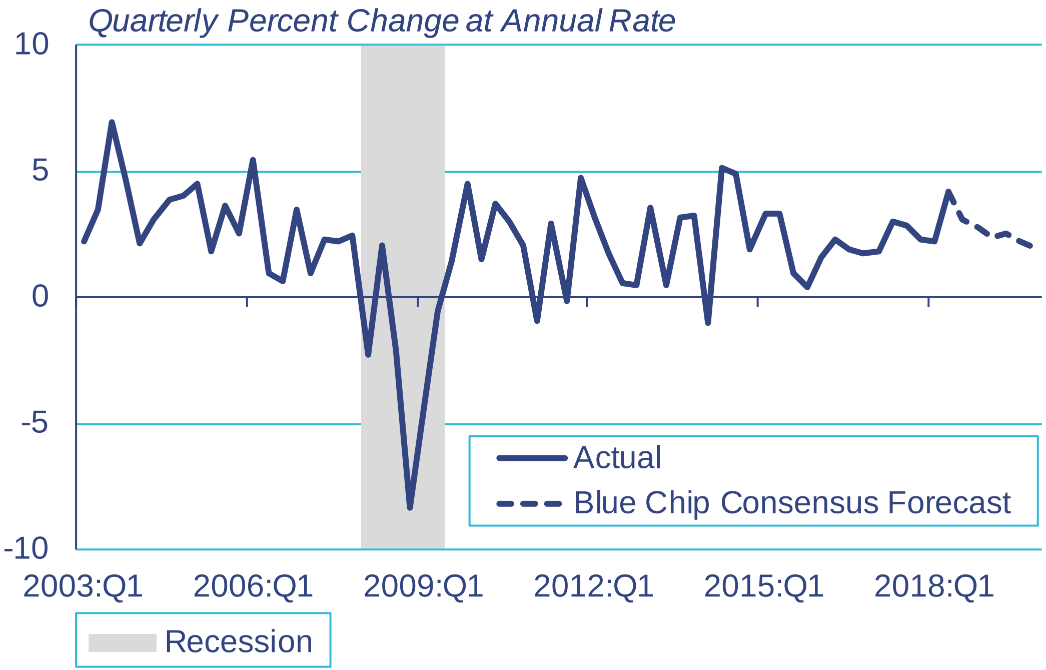
Source: BEA, NBER, Haver Analytics

Inflation for Goods and Services

- Services PCE inflation is above 2 percent
- Goods PCE inflation below 2 percent but rising
- Tariffs pose a potential risk
  - Tariffs may make it easier (provide “cover”) to raise prices, including for the cost of labor
  - Many New England businesses report less resistance to price increases
- Greater price flexibility, posing upside risk to measured inflation

Figure 8: Real GDP Growth: Actual and Forecast

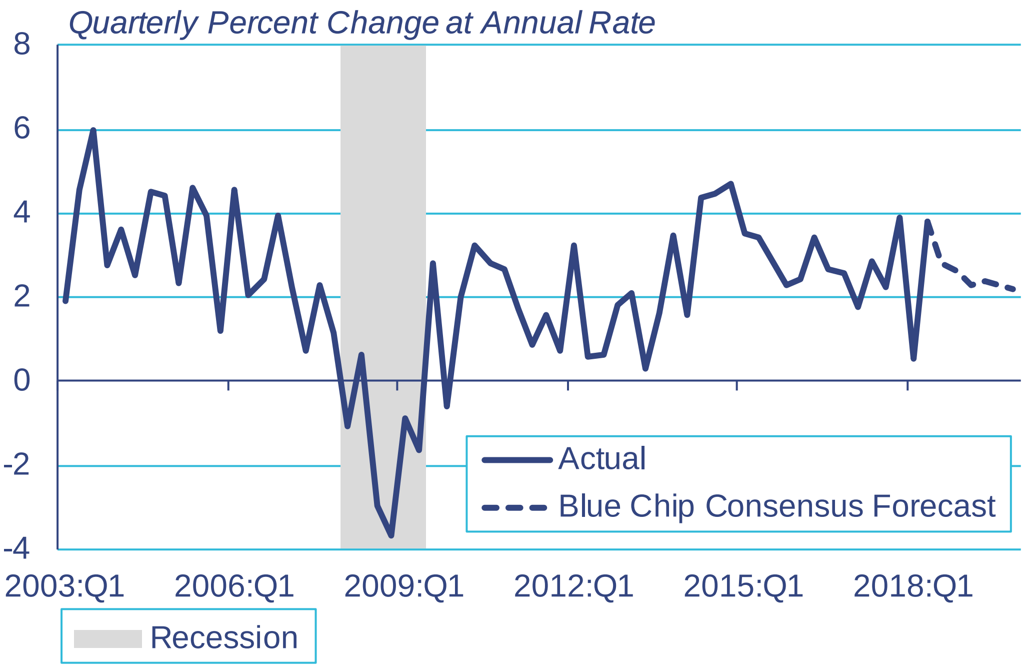
Actual, 2003:Q1 - 2018:Q2 and Forecast, 2018:Q3 - 2019:Q4



Source: BEA, Blue Chip Economic Indicators, NBER, Haver Analytics

Figure 9: Real Consumption Growth: Actual and Forecast

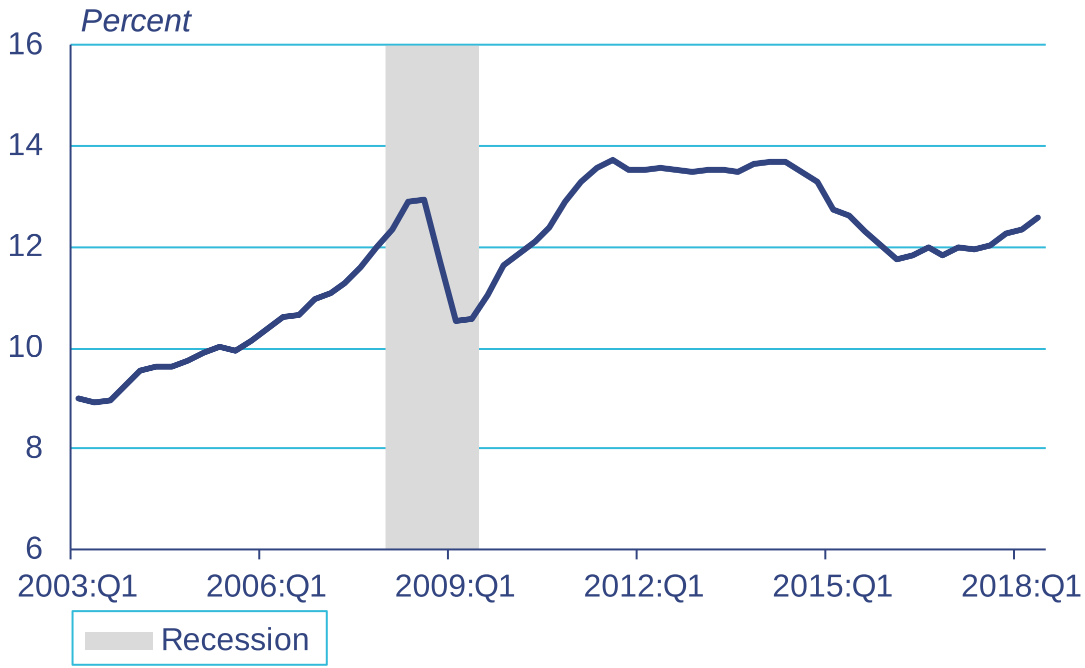
Actual, 2003:Q1 - 2018:Q2 and Forecast, 2018:Q3 - 2019:Q4



Source: BEA, Blue Chip Economic Indicators, NBER, Haver Analytics

Figure 10: Exports of Goods and Services as a Share of GDP

2003:Q1 - 2018:Q2



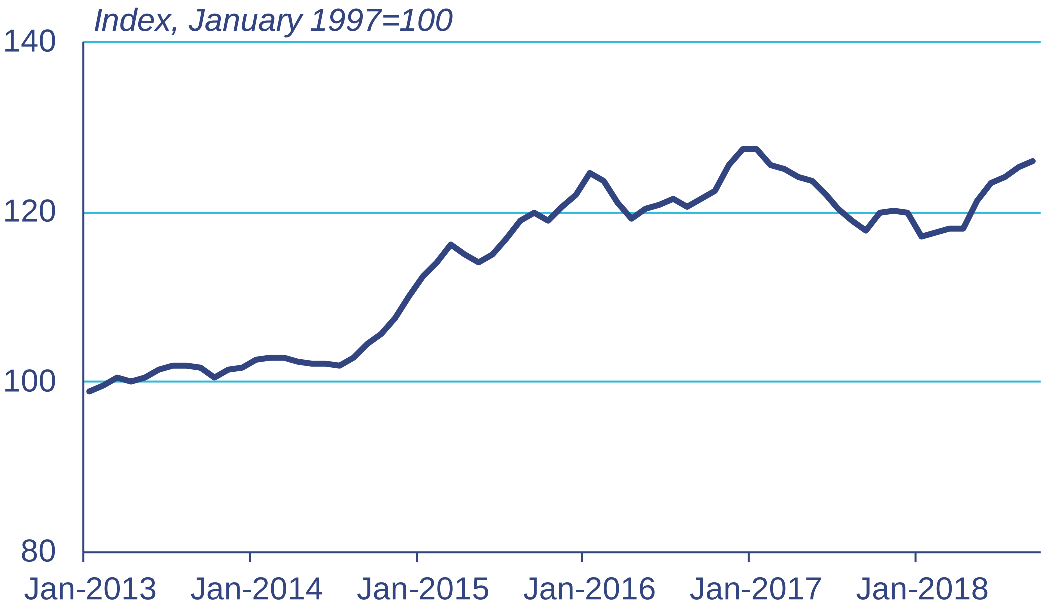
Source: BEA, NBER, Haver Analytics

Exports are Important and Uncertain

- Sizable share of GDP
- Highly uncertain if tariffs persist or increase
  - Trade disruptions could cause countries to source goods from new countries
  - Disruptions to supply chains
    - May cause firms to source from more costly – but potentially more reliable – suppliers
    - Adjustment will take time – implies an upward bias to the inflation forecast

Figure 11: Trade-Weighted Value of the U.S. Dollar

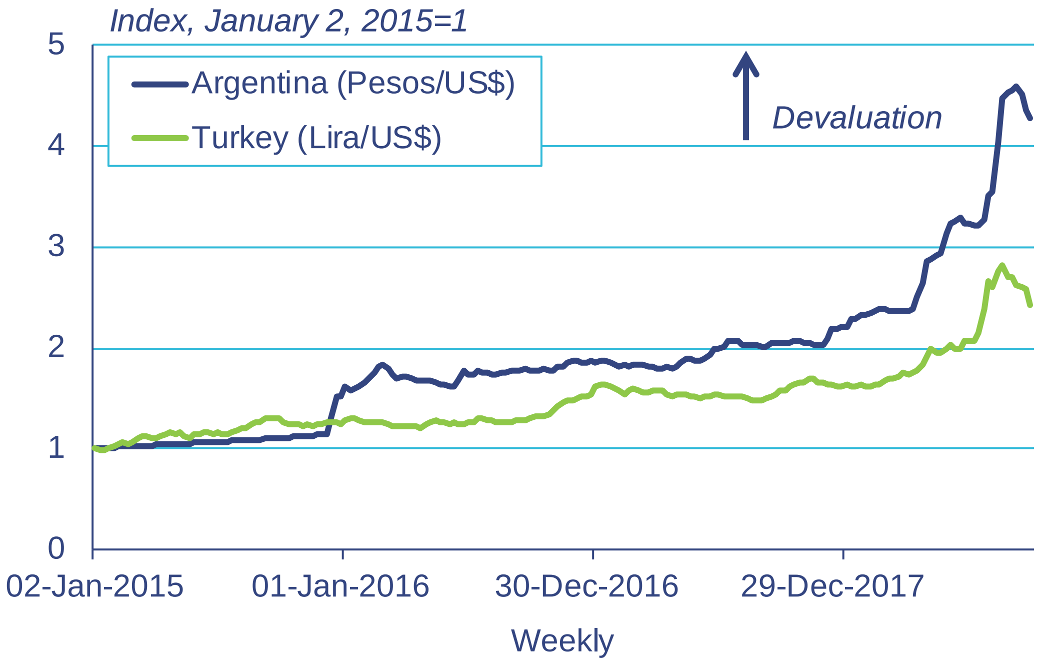
January 2013 - September 2018



Source: Federal Reserve Board, Haver Analytics

Figure 12: Spot Exchange Rates

January 2, 2015 - October 19, 2018

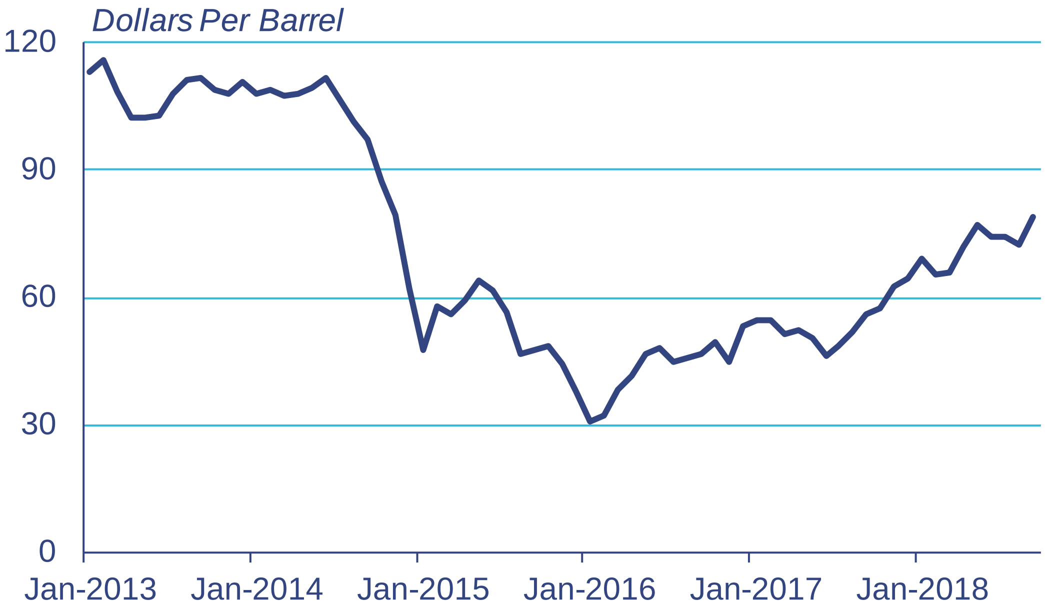


Note: Spot Exchange Middle Rate, NY Close

Source: WSJ, Haver Analytics

Figure 13: Brent Crude Oil Price

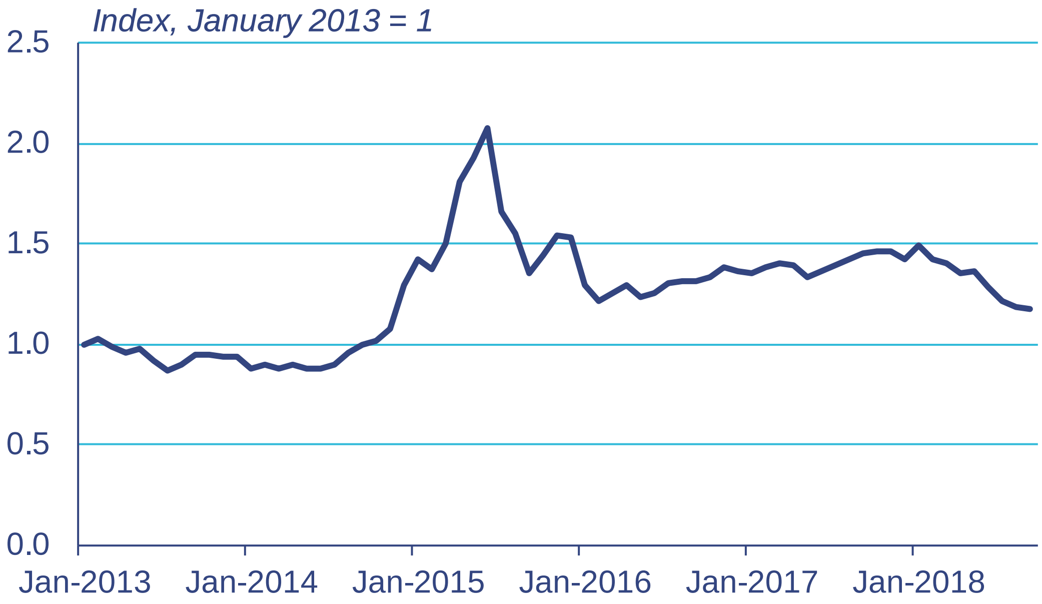
January 2013 - September 2018



Source: Energy Information Administration, Haver Analytics

Figure 14: Emerging Markets Stock Price Index: The Shanghai Composite Index

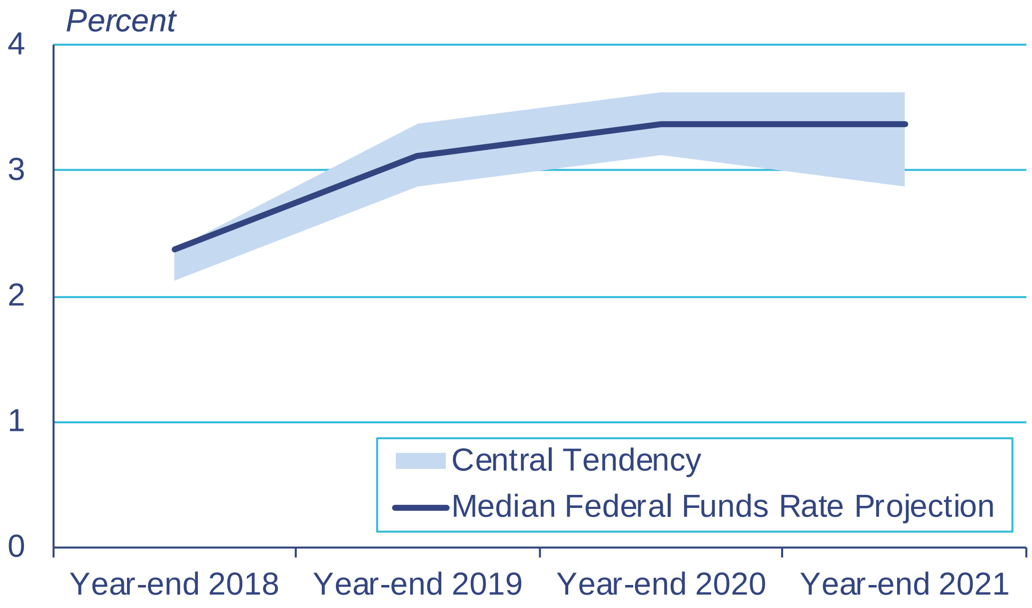
January 2013 - September 2018



Source: Bloomberg Finance L.P.

Figure 15: Median Federal Funds Rate Forecast from the Summary of Economic Projections

Year-end, 2018 - 2021



Note: The central tendency excludes the three highest and three lowest observations.

Source: FOMC, Summary of Economic Projections (SEP), September 26, 2018

Concluding Observations

- Median forecast of FOMC participants is that the federal funds rate will rise to 3.4 percent
- Moves seem likely to occur only gradually
- My own view is consistent with SEP forecasts:
  - Move interest rates gradually from a mildly accommodative stance to a mildly restrictive stance
- Of course, if risks become more germane, a different path may be warranted