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Monetary Policy as the Economy Approaches the Fed's Dual Mandate

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February 15, 2017

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Continued Moderate Expansion

- Economy has continued to gradually improve
  - Expecting growth somewhat faster than 2 percent
  - Expecting gradual reduction in unemployment and continued movement towards the Federal Reserve’s 2 percent inflation target
- This growth forecast is consistent with recent data, but at a different “starting point” than a few years ago
  - Current unemployment rate is 4.8 percent, at or close to estimates of full employment
  - Inflation is nearing the 2 percent target
  - Potential of imbalances manifesting themselves in asset prices

Implications of Approaching Federal Reserve’s Dual Mandate

- Likely to be appropriate to raise short-term interest rates at least as quickly as SEP median, and possibly even a bit more rapidly than that forecast
- If GDP grows faster than potential, and we reach both elements of the dual mandate, we risk overshooting
- Want to avoid potentially jeopardizing the significant progress made since the financial crisis

Figure 1: Initial Claims for Unemployment Insurance

January 8, 2005 - February 4, 2017

Note: Four-week moving average

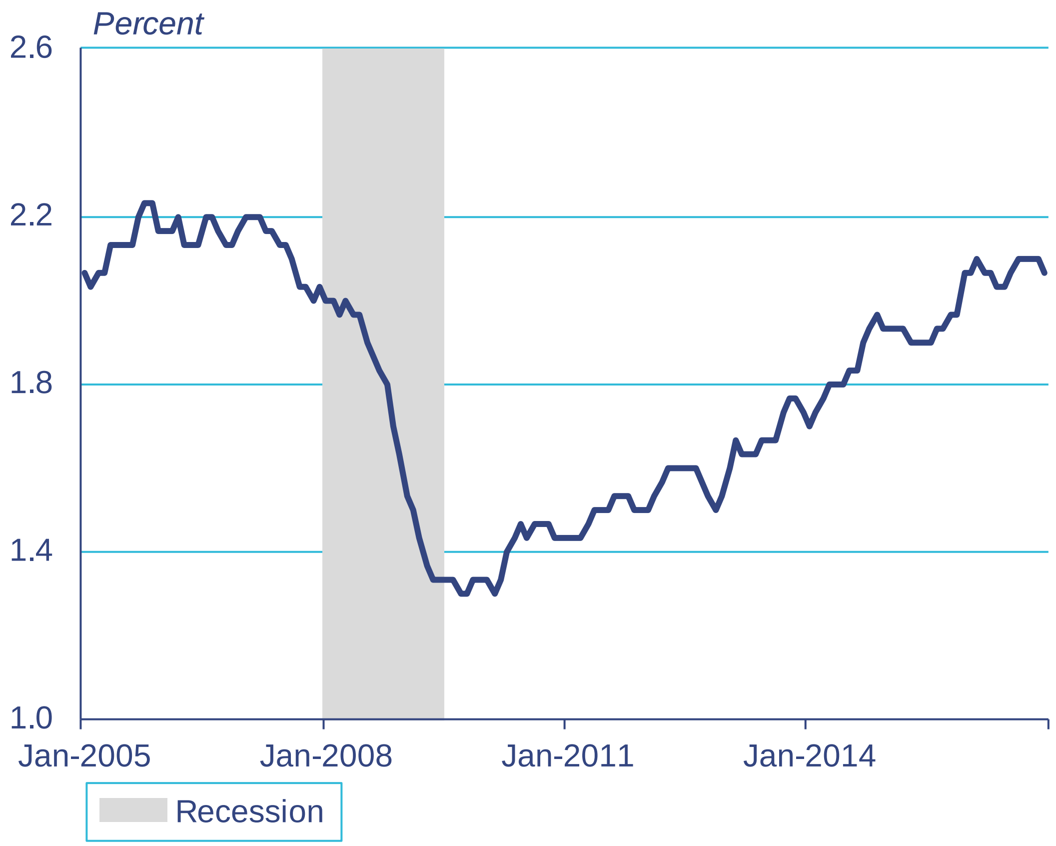
Source: U.S. Department of Labor, NBER, Haver Analytics

Implications of Rising Quits Rate

- Workers more confident of job prospects and willing to leave current job to improve employment situation
- Wages for workers may rise to reduce the incentive to quit in search of higher wages
- Evidence that workers believe that the labor market is robust

Figure 2: The Quits Rate

January 2005 - December 2016



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: Change in Payroll Employment

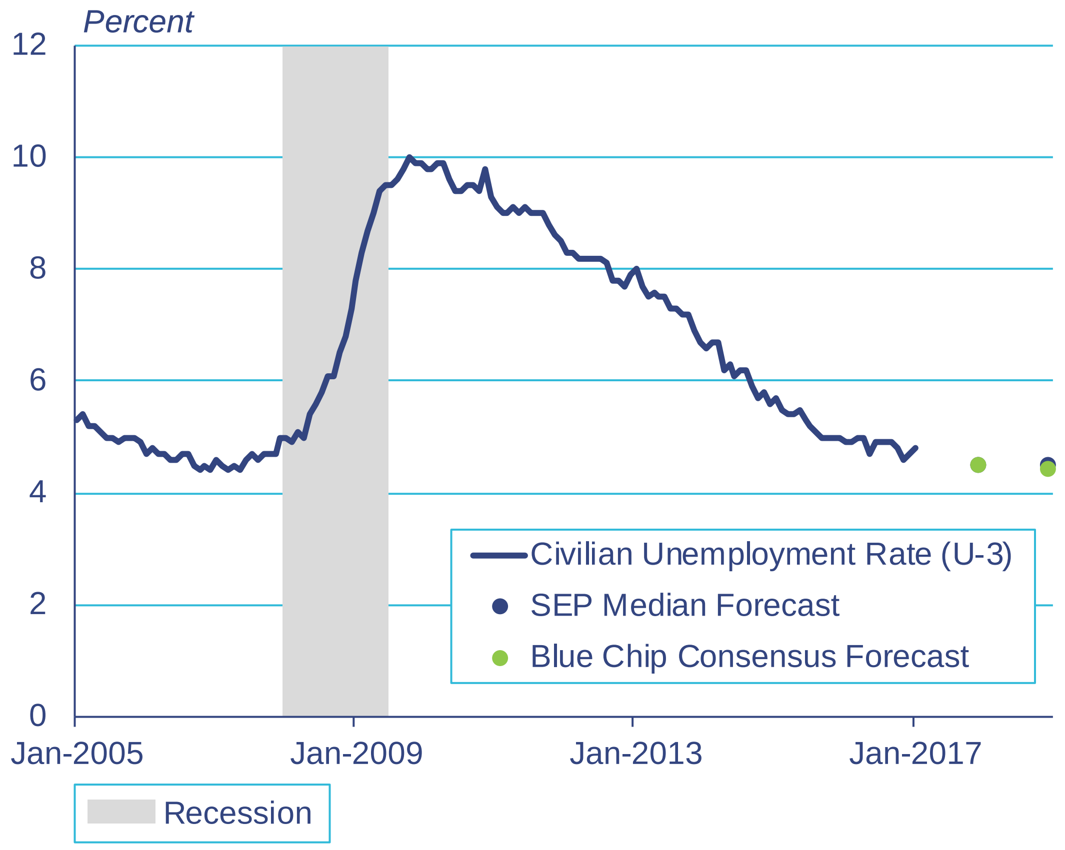
January 2005 - January 2017

Note: Three-month moving average

Source: BLS, NBER, Haver Analytics

Figure 4: Civilian Unemployment Rate

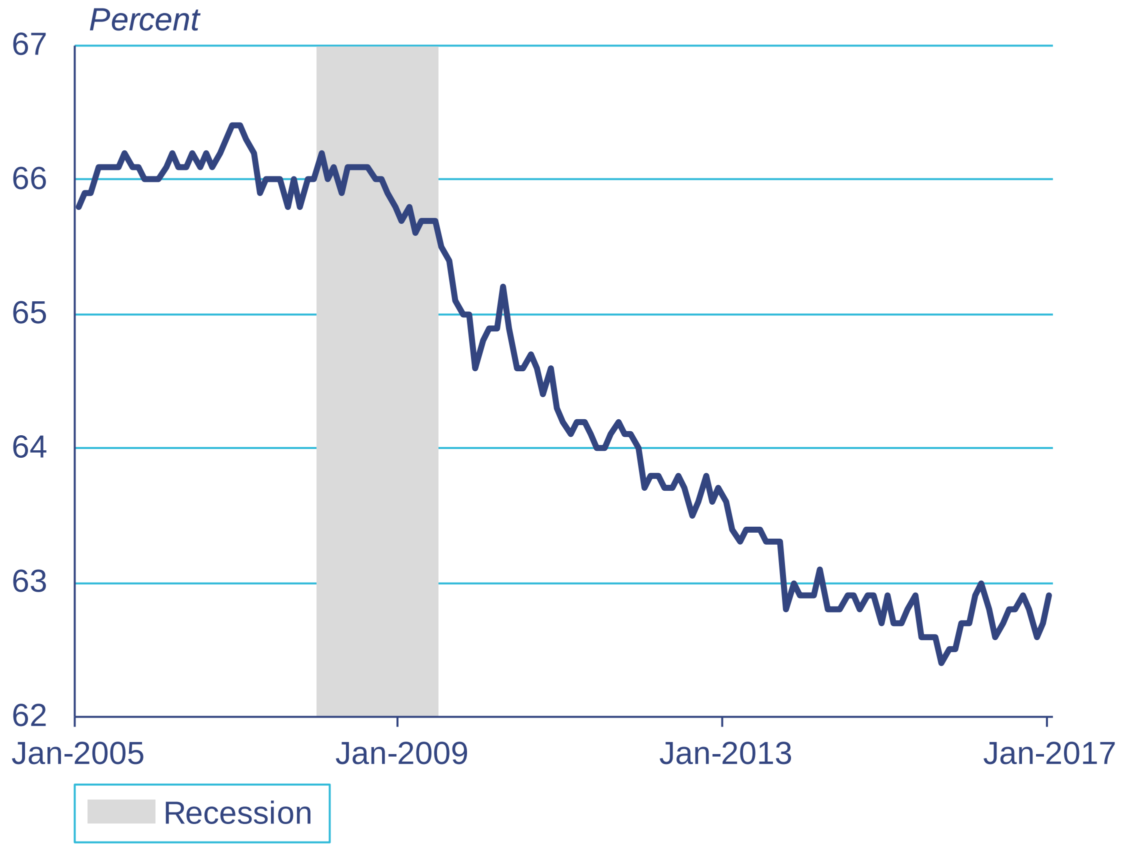
January 2005 - January 2017 and Forecasts for 2017:Q4 and 2018:Q4



Source: BLS; NBER; Blue Chip Economic Indicators, February 10, 2017; FOMC, Summary of Economic Projections (SEP), December 14, 2016; Haver Analytics

Figure 5: Labor Force Participation Rate

January 2005 - January 2017

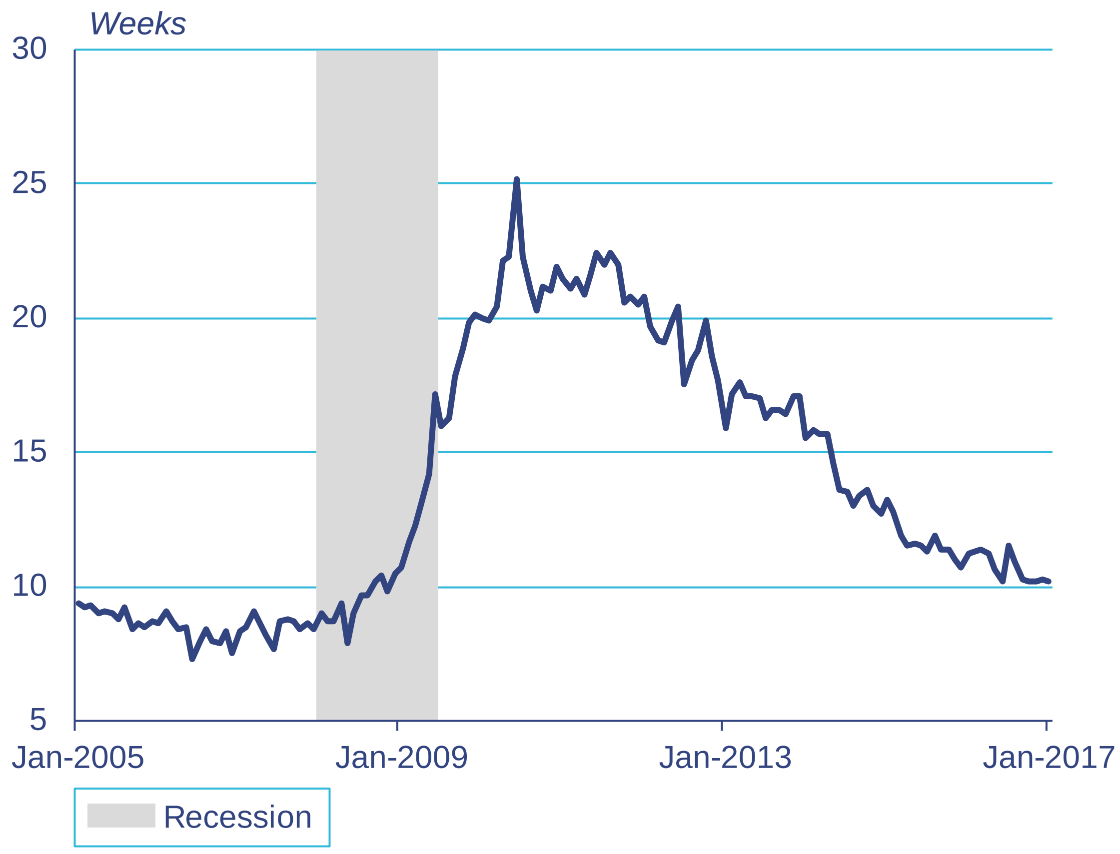


Note: The labor force participation rate is the share of the working-age population (16 and older) that is either working or actively seeking work.

Source: BLS, NBER, Haver Analytics

Figure 6: Median Duration of Unemployment

January 2005 - January 2017



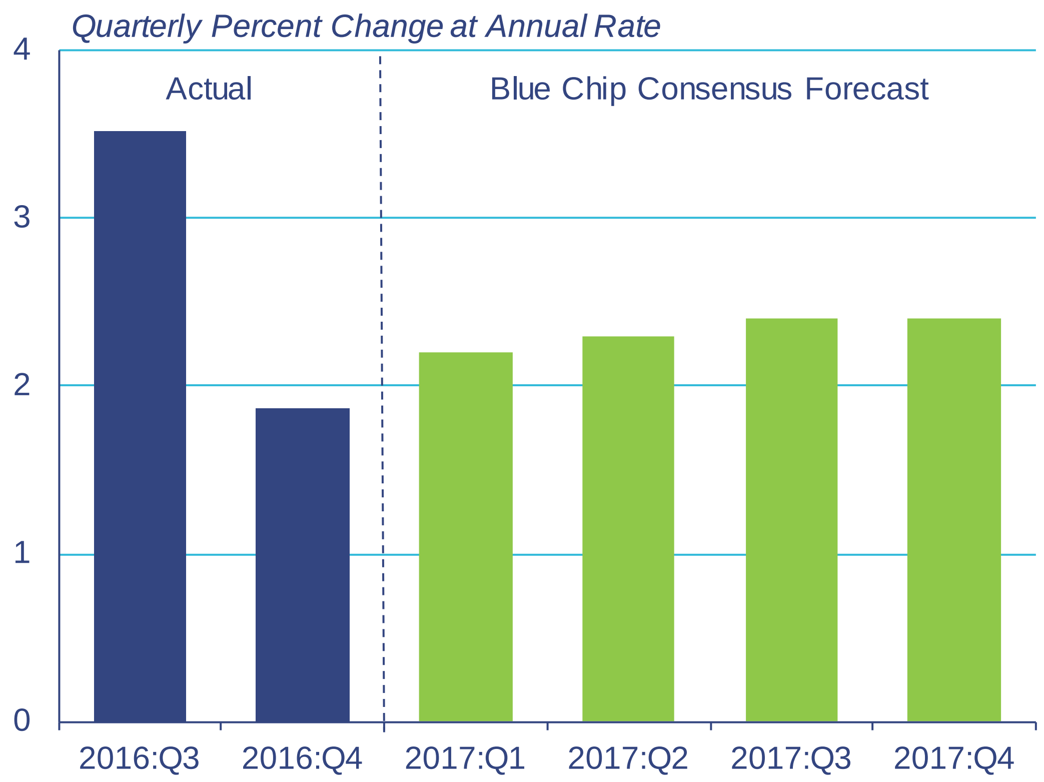
Source: BLS, NBER, Haver Analytics

Labor Market is Continuing to Improve

- My own assessment is that there is very limited slack remaining
- Unemployment is now at the SEP median forecast for unemployment in the longer run
- Employees are becoming more comfortable switching jobs
- The duration of unemployment has normalized
- If economy grows much faster than potential, employers will likely encounter increasing difficulty finding labor with the skills they need to grow

Figure 7: Real GDP Growth

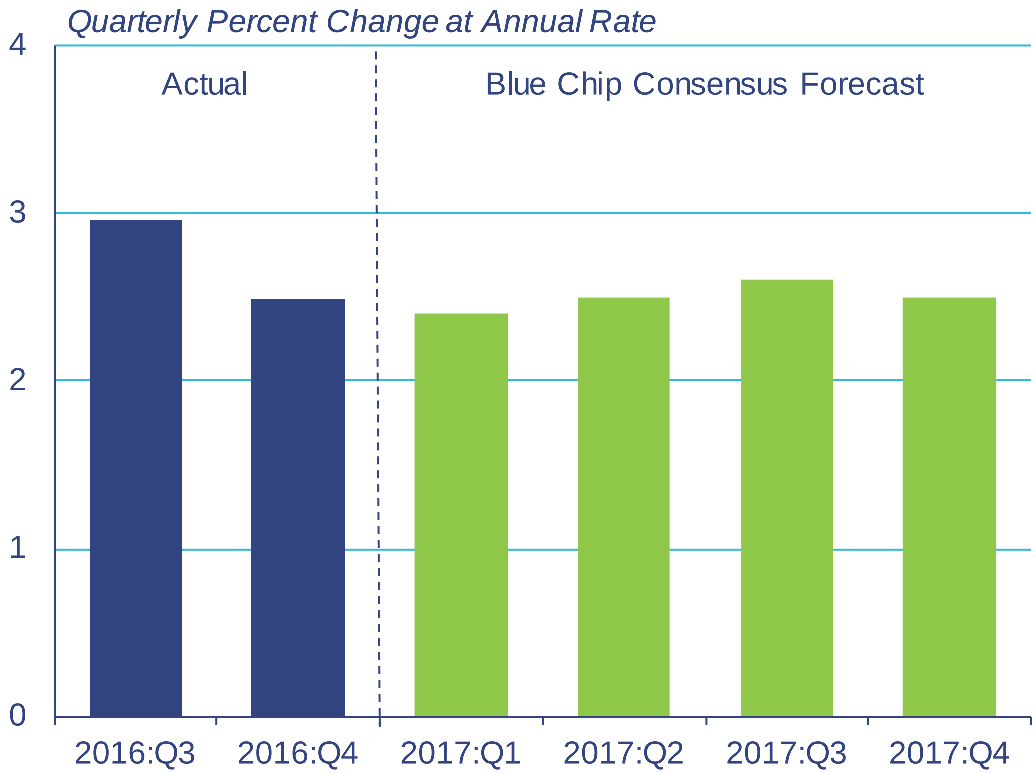
2016:Q3 - 2017:Q4



Source: BEA; Blue Chip Economic Indicators, February 10, 2017; Haver Analytics

Figure 8: Growth in Real Personal Consumption Expenditures (PCE)

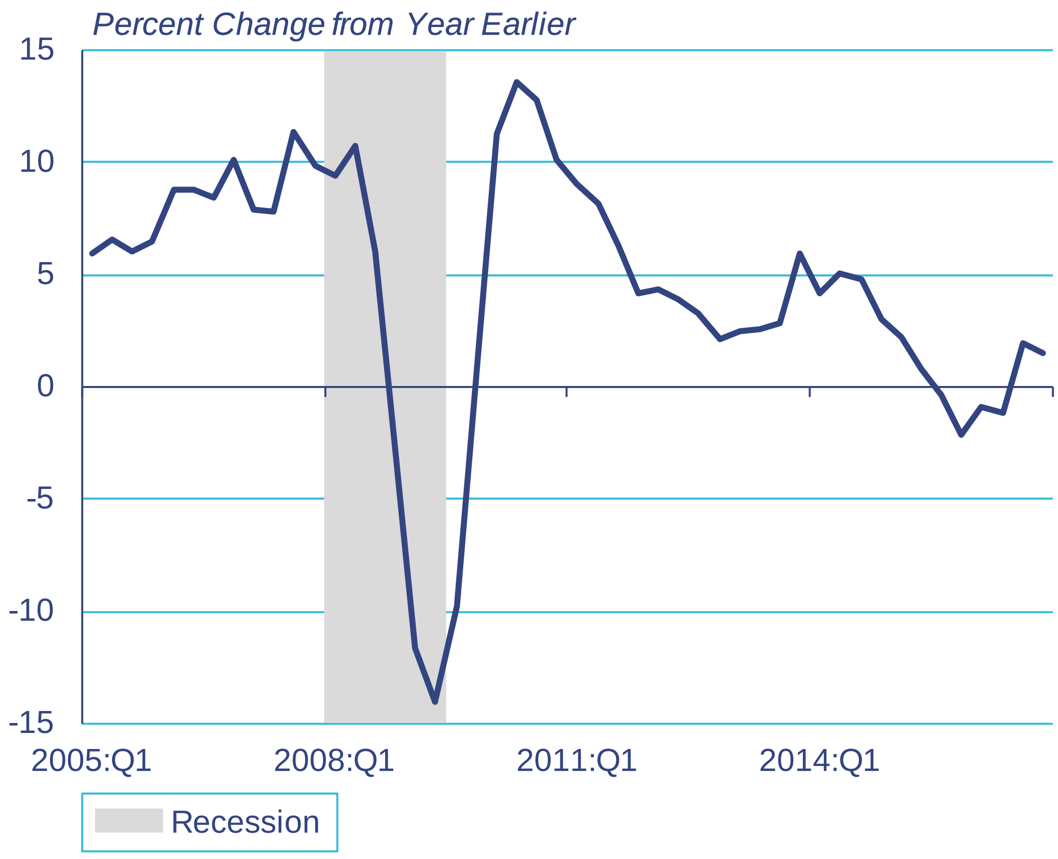
2016:Q3 - 2017:Q4



Source: BEA; Blue Chip Economic Indicators, February 10, 2017; Haver Analytics

Figure 9: Real Exports of Goods and Services

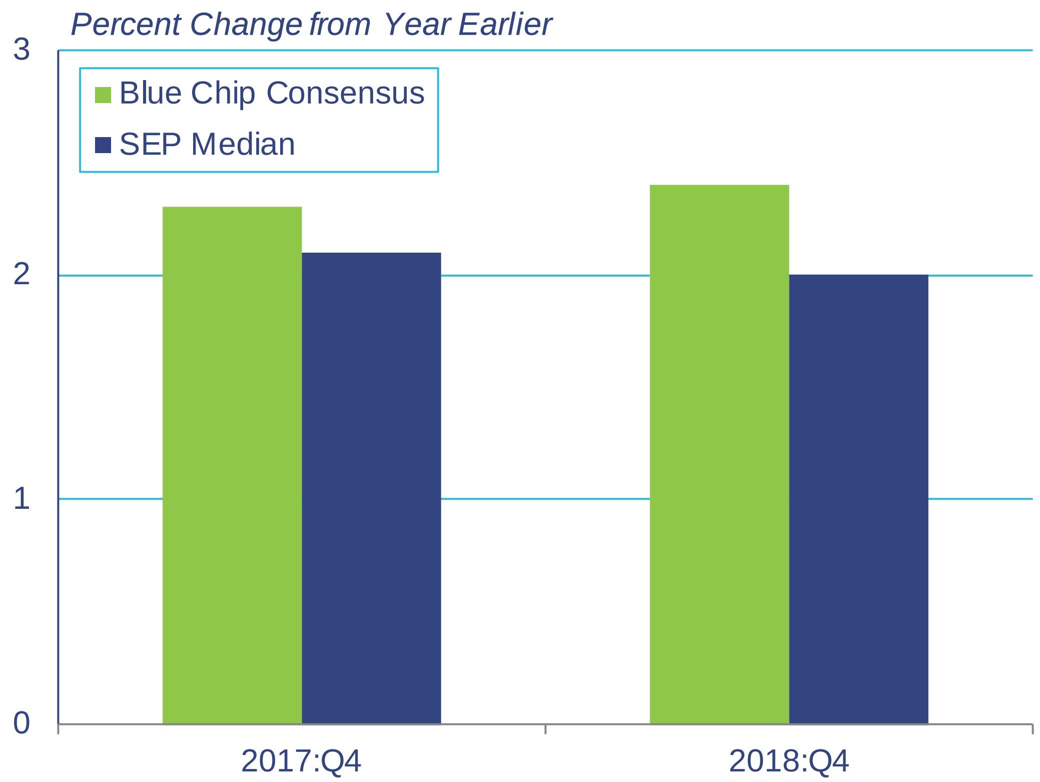
2005:Q1 - 2016:Q4



Source: BEA, NBER, Haver Analytics

Figure 10: Forecasts for Real GDP Growth

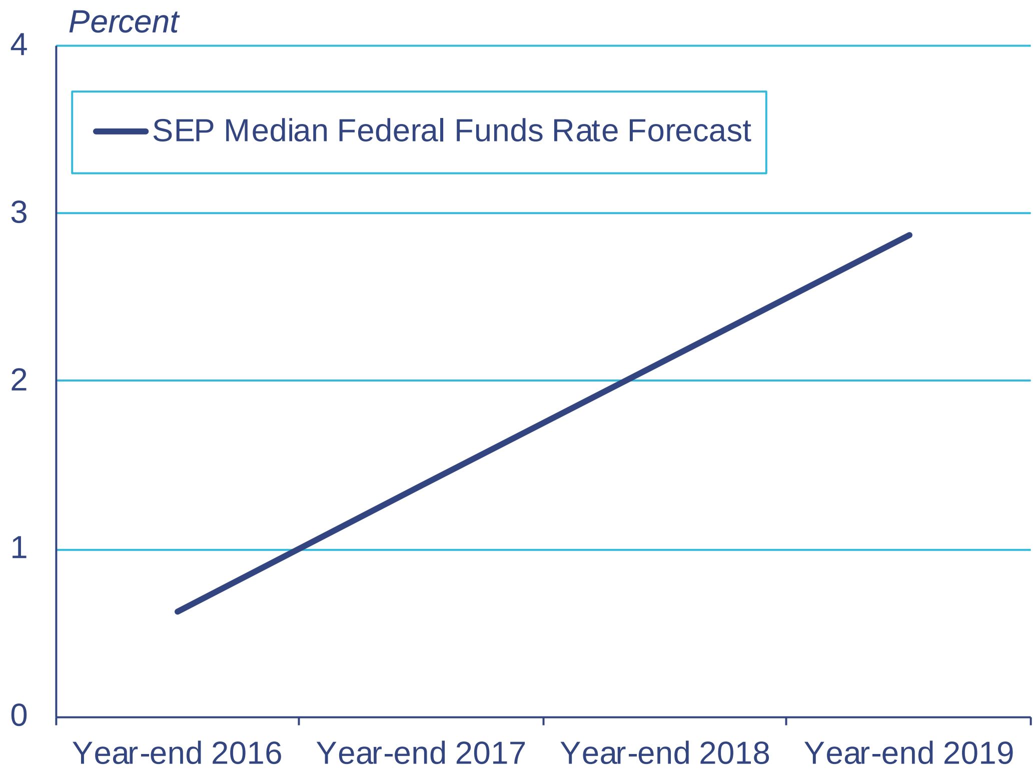
2017:Q4 and 2018:Q4



Source: Blue Chip Economic Indicators, February 10, 2017; FOMC, Summary of Economic Projections (SEP), December 14, 2016; Haver Analytics

Figure 11: Median Federal Funds Rate Forecast from the Summary of Economic Projections

Year-end, 2016 - 2019



Source: FOMC, Summary of Economic Projections (SEP), December 14, 2016

Economy Continues to Improve

- Most forecasters expect above-potential growth and gradual tightening in labor markets
- Such a path would justify a continued, gradual removal of monetary policy accommodation
- In my view, removing accommodation at least as quickly as suggested by the median SEP, and possibly even a bit more rapidly than that forecast
- Both international conditions and the likely path of fiscal policy remain quite uncertain, and these could materially impact the forecast, and appropriate policy