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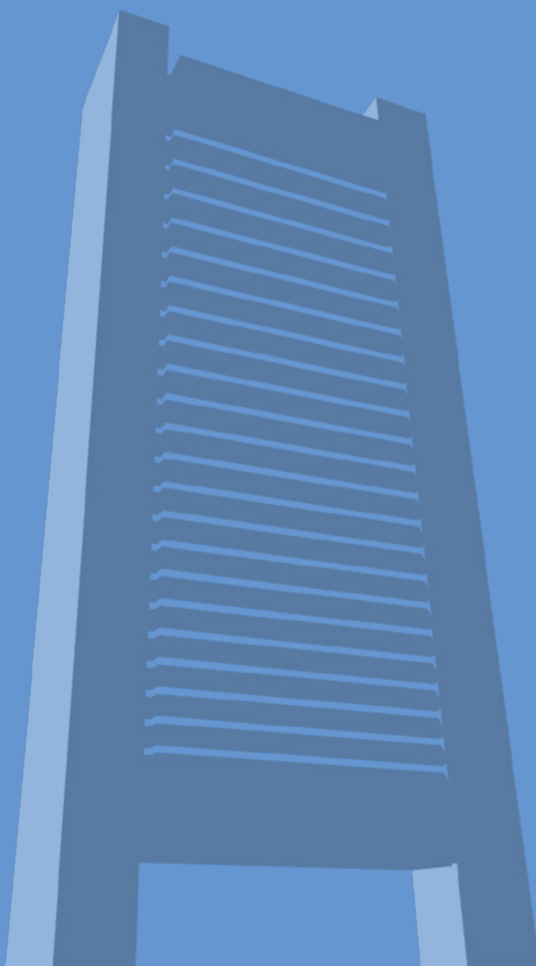

The U.S. Economy: An Optimistic Outlook, But With Some Important Risks

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

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Recent Data

- Mildly disappointing employment report
  - 103,000 jobs created in March
  - However, 202,000 jobs per month (average) over quarter
  - Average hourly earnings continues upward trend
  - Unemployment rate at 4.1 percent
- Tight labor markets – common concern of New England businesses

March Forecast of FOMC for 2018

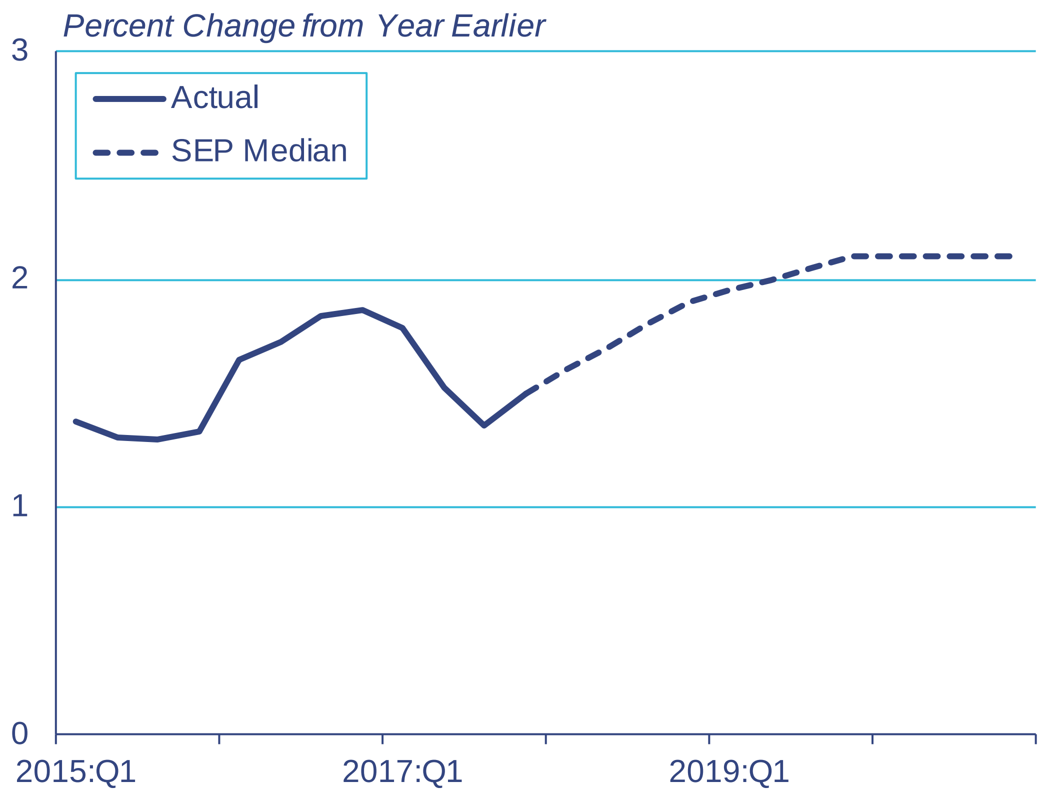
- Quite positive median forecast
  - Strong real GDP – 2.7 percent
  - Inflation – 1.9 percent
  - Unemployment – 3.8 percent
  - Conditioned on two additional increases this year
- My own forecast – a bit more inflation and a bit lower unemployment
- So, somewhat more tightening may be needed

Some Important Risks to Forecast

- Forecasts not outcomes – assumptions about hard-to-predict variables matter
  - Will international trade be better or worse this year?
  - Will oil prices tighten further?
  - Will other central banks begin tightening their monetary policy?
- Many model assumptions are about political outcomes not underlying economic relationships
- Today, will focus not only on the positive forecast, but also on risks to the forecast

Figure 1: Core PCE Inflation Rate: Actual and Forecast from the Summary of Economic Projections

Actual, 2015:Q1 - 2017:Q4 and Forecast, 2018:Q4 - 2020:Q4

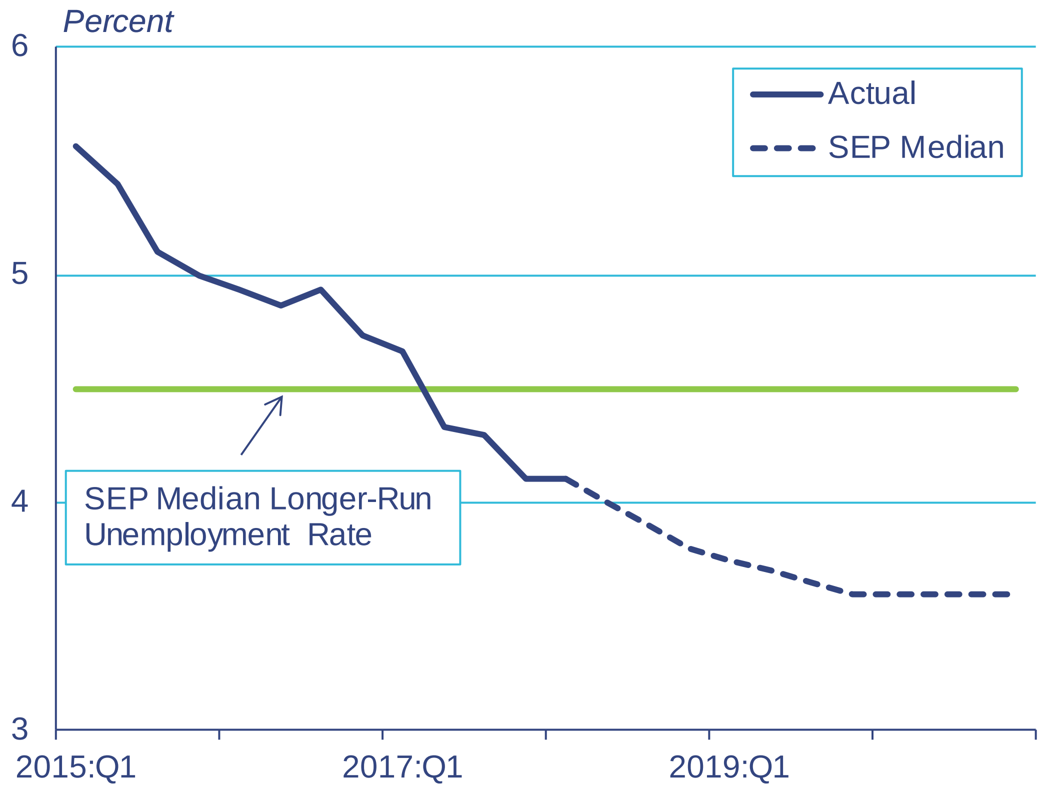


Note: SEP median projected values are for the percent change in the Core PCE Index from the previous fourth quarter to the fourth quarter of the year specified. The Core PCE Index excludes food and energy.

Source: FOMC, Summary of Economic Projections (SEP), March 21, 2018; BEA; Haver Analytics

Figure 2: Unemployment Rate: Actual and Forecast from the Summary of Economic Projections

Actual, 2015:Q1 - 2018:Q1 and Forecast, 2018:Q4 - 2020:Q4

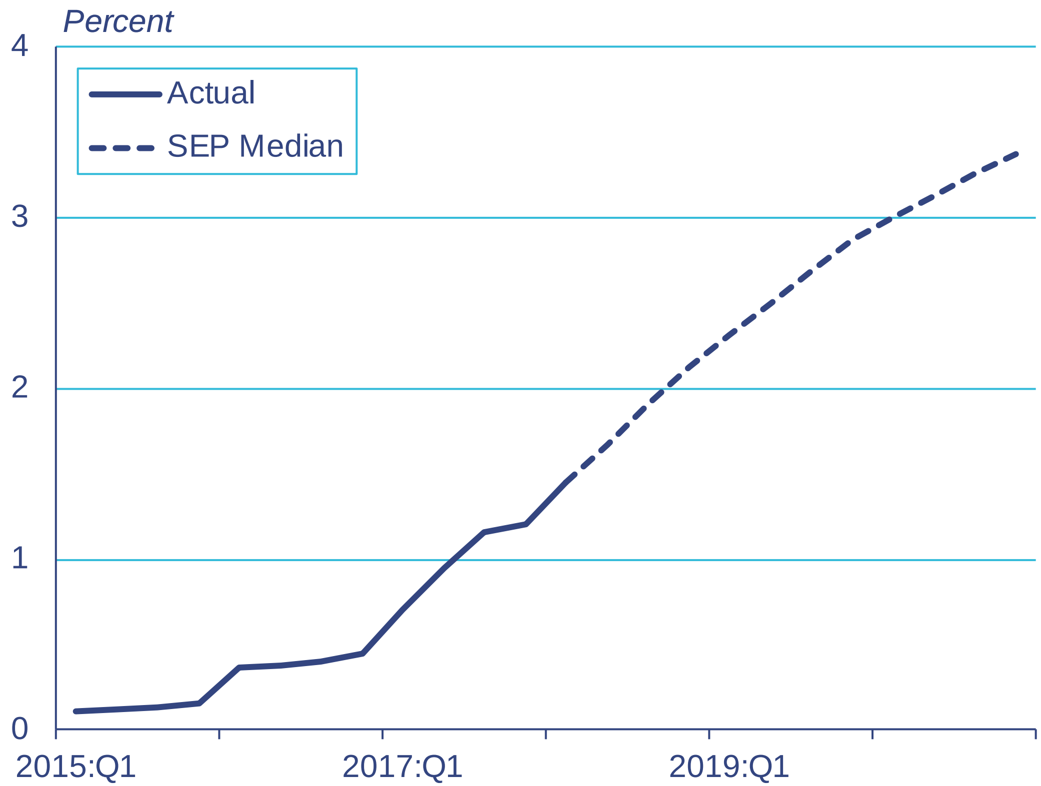


Note: SEP median projected values are for the unemployment rate in the fourth quarter of the year specified.

Source: FOMC, Summary of Economic Projections (SEP), March 21, 2018; BLS; Haver Analytics

Figure 3: Federal Funds Rate: Actual and Forecast from the Summary of Economic Projections

Actual, 2015:Q1 - 2018:Q1 and Forecast, 2018:Q4 - 2020:Q4



Note: SEP median projected values are for the federal funds rate in the fourth quarter of the year specified.

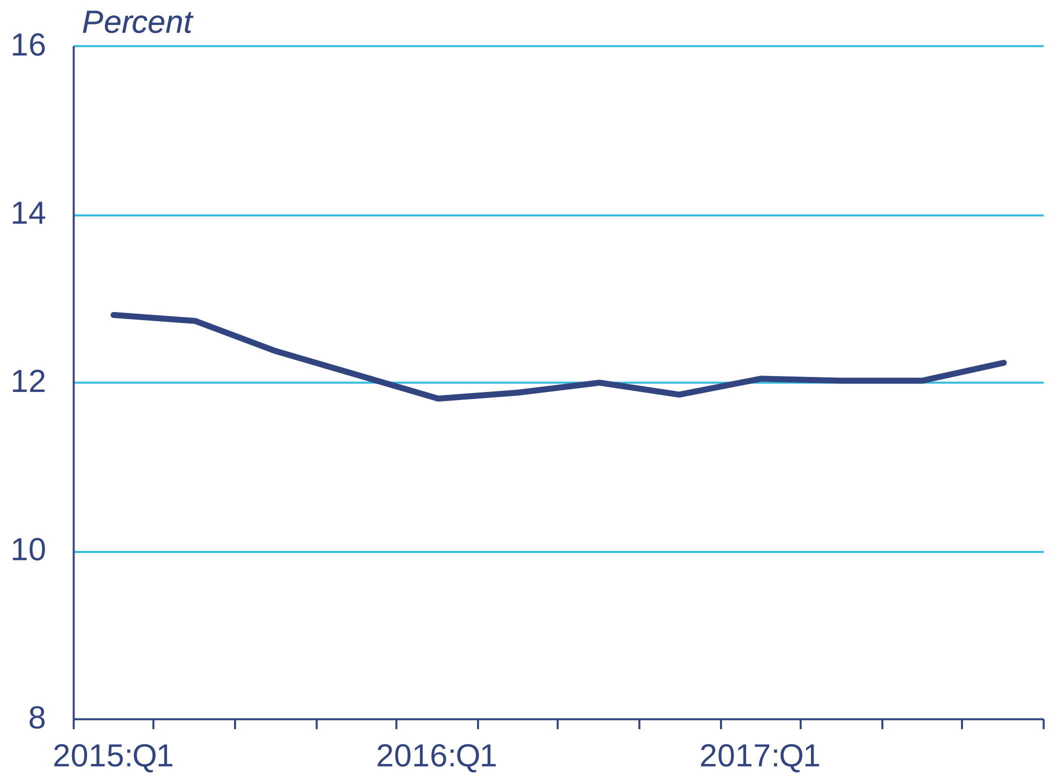
Source: FOMC, Summary of Economic Projections (SEP), March 21, 2018; BEA; Haver Analytics

A Positive Forecast

- Some of the underlying strength in this positive outlook comes from fiscal stimulus and still relatively accommodative monetary policy
- My own forecast is even a bit more positive – which is why somewhat more tightening, in my view, may be appropriate this year
- Despite the positive outlook, it is important to consider the risks around this forecast
- In my view, two short-run risks
  - Role of international trade
  - Potential for boom-bust

Figure 4: Exports of Goods and Services as a Share of GDP

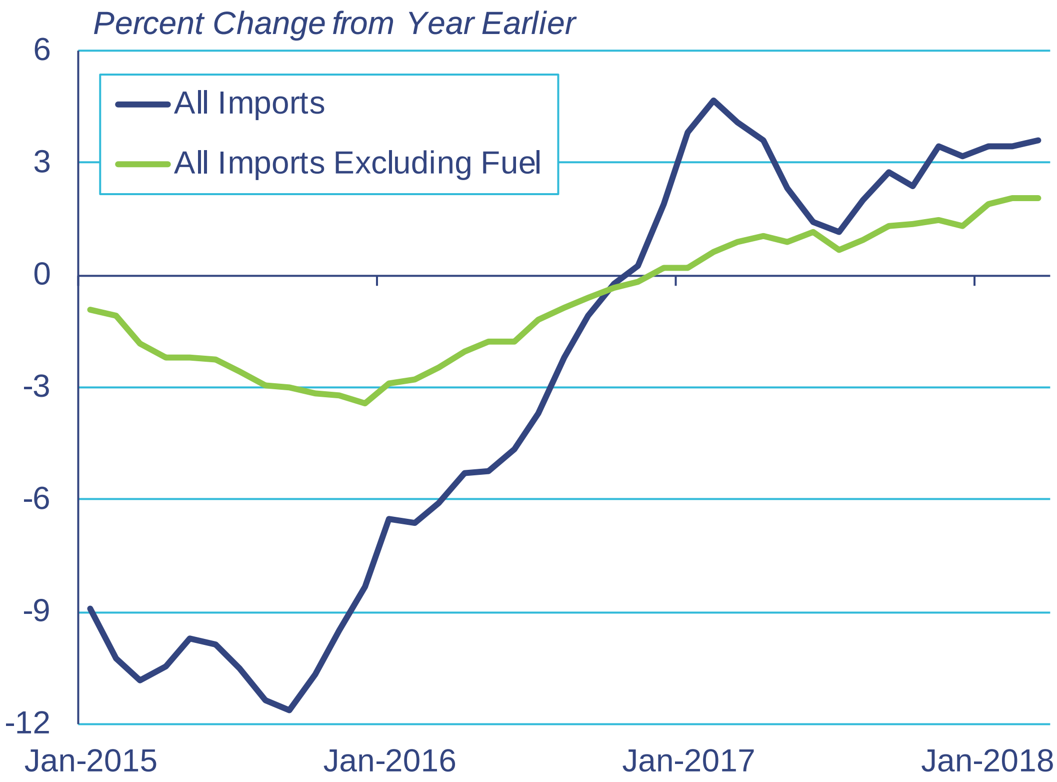
2015:Q1 - 2017:Q4



Source: BEA, Haver Analytics

Figure 5: Percent Change in Import Price Indices

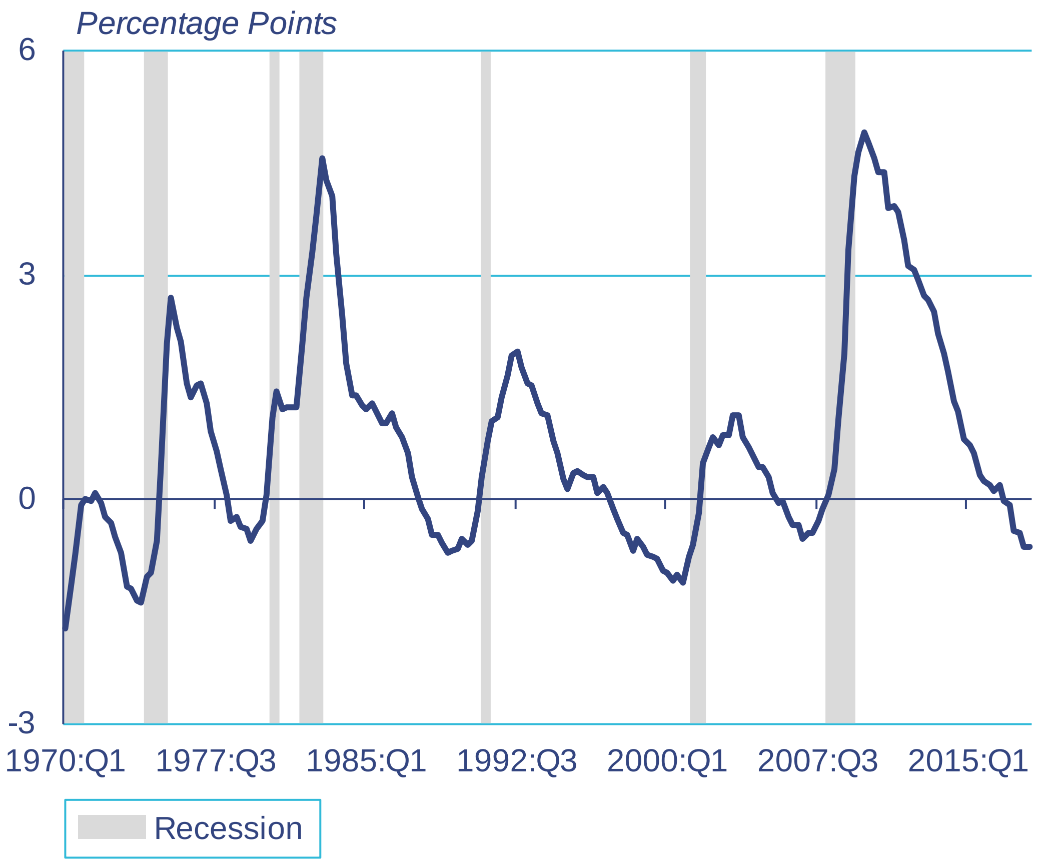
January 2015 - March 2018



Source: BLS, Haver Analytics

Figure 6: Unemployment Rate minus CBO Natural Rate of Unemployment

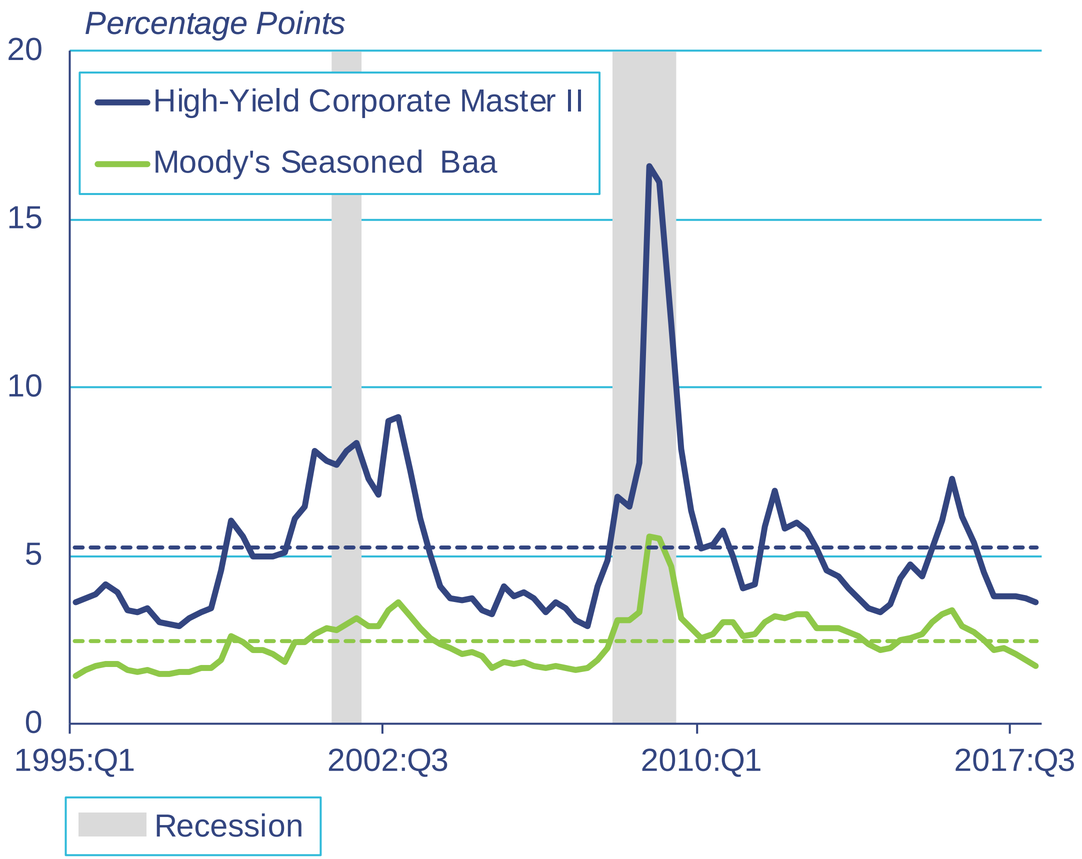
1970:Q1 - 2018:Q1



Source: BLS, CBO, NBER, Haver Analytics

Figure 7: Corporate Bond Spreads over 10-Year U.S. Treasury Yield

1995:Q1 - 2018:Q1



Note: Dashed lines are averages over the period.

Source: ICE/BofA Merrill Lynch, Moody's, Haver Analytics

Risks

Short-Run

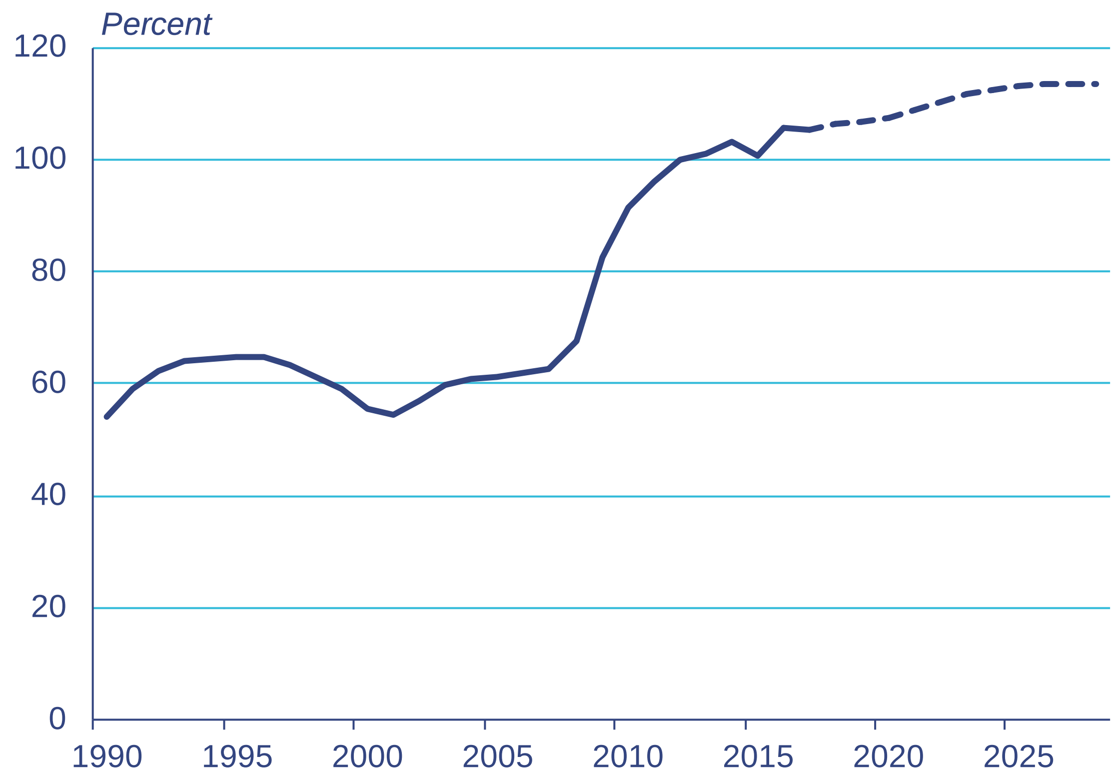
- Not expecting these risks, only identifying them
- Important to watch incoming data to see if they indicate that these risk scenarios are becoming more likely

Long-Run

- Longer-run policy risks: potentially inadequate buffers:
  - Fiscal buffers
  - Monetary buffers

Figure 8: Gross Federal Debt as a Percentage of GDP

Actual, 1990 - 2017, Projection, 2018 - 2028

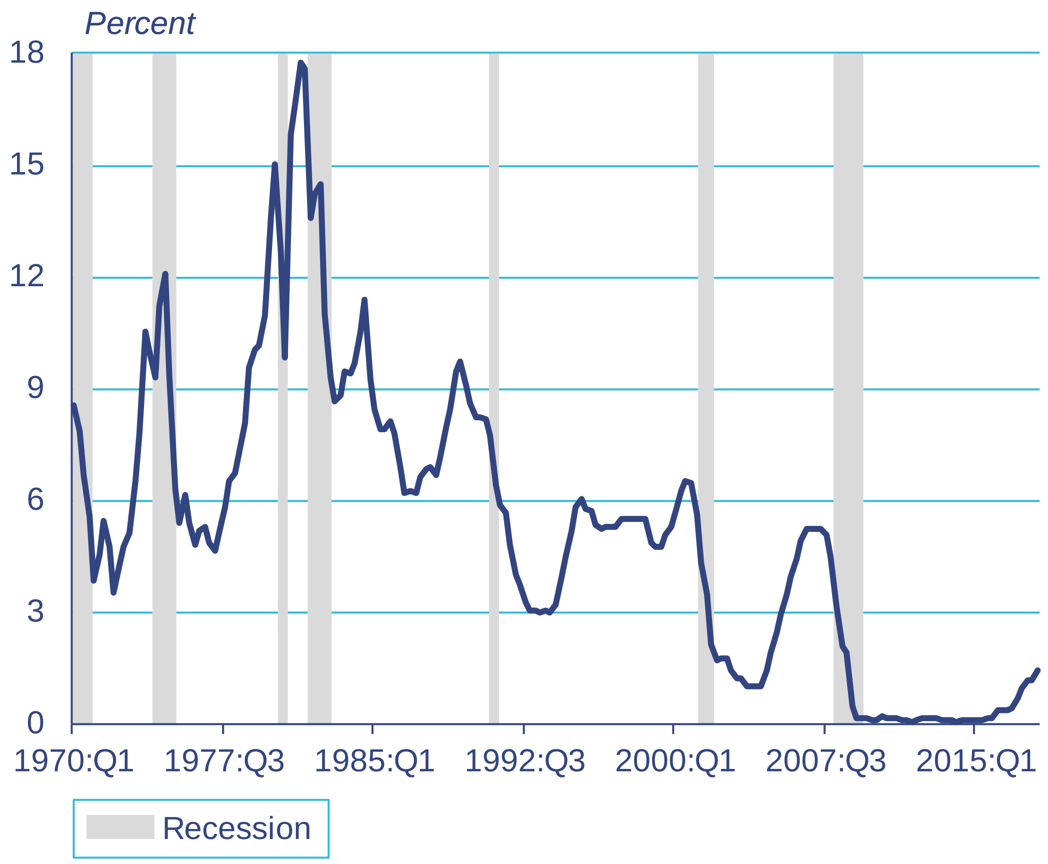


Note: CBO projections for the U.S. (2018 - 2028) were released on April 9, 2018 and include the recent tax changes and increases in the federal budget.

Source: OMB, CBO, Haver Analytics

Figure 9: Federal Funds Rate

1970:Q1 - 2018:Q1



Source: Federal Reserve Board, NBER, Haver Analytics

Concluding Observations

- March FOMC / SEP – positive outlook for the economy
- Short-run risks that could be problematic – but I am not expecting to occur
  - More serious trade concerns
  - Boom-bust economy
- Longer-run risks – do we have sufficient policy buffers?
  - Current fiscal stimulus may leave less room to react to negative shocks
  - Monetary policy buffer will be limited if rates remain low