One Policymaker’s Wait for Better Economic Data

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How Should We Evaluate Recent Weakness in Economic Data – Temporary Factors or Broader Changes?

- No one in New England needs reminders of the severe winter
- Economic data come out with a lag – so the data are forcing us to dredge up those bad memories
- The severe winter clearly impacted some economic activity, as it was difficult to
  - Get to work
  - Go out shopping
  - Eat out at a restaurant
- But data were weak before and after the storms
What are the Implications for Monetary Policy?

- Real GDP declined by 0.7 percent in the first quarter of 2015
- Real GDP growth was 2.2 percent in Q4 2014 and looks to be roughly 2 percent in Q2 2015
- If such a slow pace of growth persists, it is unlikely to be associated with further declines in the unemployment rate
- Reasons for optimism – positive growth in personal income, low gas prices, improved household net worth
- But so far, improvement is in the forecast, not the data
Economic Data Suggest there is Still Reason to be Patient

- The FOMC criteria for raising short-term rates are twofold:
  - First, further improvement in the labor market
  - Second, being reasonably confident that inflation will move back to our 2 percent target
- Need the economy to grow above potential
- Risks remain asymmetric – given rates near zero, monetary policymakers have limited ability to offset a negative shock from abroad
Figure 1: Private Sector Forecasts for Real GDP Growth
Forecasts as of November 2014

Source: Blue Chip Economic Indicators, Federal Reserve Bank of Philadelphia, BEA, Haver Analytics
Figure 2: Survey of Professional Forecasters
Mean Probabilities for Real GDP Growth in 2015
Forecasts as of February and May 2015

Source: Federal Reserve Bank of Philadelphia, Haver Analytics
Figure 3: Statewide Average Temperature Ranks
February 2015

Note: Rank over the period 1895 – 2015.
Source: National Oceanic and Atmospheric Administration (NOAA)
Figure 4: Real GDP Growth
2010:Q1 - 2015:Q1

Quarterly Percent Change at Seasonally Adjusted Annual Rate

Note: A dashed line marks the first quarter of each year.

Source: BEA, Haver Analytics
Figure 5: Real GDP Growth Preceding First Tightening Following Last Three Recessions

<table>
<thead>
<tr>
<th>Date of Recession Trough</th>
<th>Date of First Tightening</th>
<th>Real GDP Growth</th>
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</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Previous Two Years</td>
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<tr>
<td>November 1982</td>
<td>January 5, 1987</td>
<td>3.6%</td>
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<tr>
<td>March 1991</td>
<td>February 4, 1994</td>
<td>3.5%</td>
</tr>
<tr>
<td>November 2001</td>
<td>June 30, 2004</td>
<td>3.1%</td>
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</tbody>
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Source: BEA, NBER, Haver Analytics
Figure 6: Blue Chip Forecast for Growth in Real Personal Consumption Expenditures
Forecast as of November 2014

Source: Blue Chip Economic Indicators, BEA, Haver Analytics
Figure 7: Regional Retail Sales
January 2013 - April 2015

Source: Bank of Tokyo-Mitsubishi UFJ, Haver Analytics
Figure 8: Personal Saving Rate
January 1995 - March 2015

Source: BEA, NBER, Haver Analytics
Figure 9: Recent Trends in Oil Prices, Stock Prices, Housing Prices and Employment
January 2013 - April 2015

Source: BLS, EIA, FHFA, S&P, Haver Analytics
Figure 10: Inflation Rate: Change in Total and Core Personal Consumption Expenditures (PCE) Price Indices

January 2005 - March 2015

Percent Change from Year Earlier

2% Inflation Target

Total PCE
Core PCE

Recession

Source: BEA, NBER, Haver Analytics
Figure 11: Longer-Run Unemployment Rate Projections of Federal Reserve Governors and Federal Reserve Bank Presidents

June 2014 - March 2015

Range and Median for Longer-Run Unemployment Rate Projections

Source: FOMC, Summary of Economic Projections (SEP), Minutes of FOMC Meetings
Figure 12: Inflation Rate Projections of Federal Reserve Governors and Federal Reserve Bank Presidents

March 2015

Source: FOMC, Summary of Economic Projections (SEP), Minutes of FOMC Meetings
Figure 13: Federal Funds Rate Projections of Federal Reserve Governors and Federal Reserve Bank Presidents

March 2015

Source: FOMC, Summary of Economic Projections (SEP), Minutes of FOMC Meetings
Figure 14: Spread: Ten-Year Treasury Yield to Federal Funds Effective Rate
January 1995 - April 2015

Source: U.S. Treasury, Federal Reserve Board, NBER, Haver Analytics
Concluding Observations

- The economy has been softer in the first half of this year than many forecasters expected.
- It is too soon to know if this is a reflection of broader changes in the economy.
- For monetary policy to begin normalization, we need to be confident that we will return to full employment and 2 percent inflation over the next couple of years.
- That evidence is not yet reflected in the data.
- This, in my view, makes a compelling argument for continued patience in monetary policy.