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 last week
  - 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 3.9 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

- Last week both the U.S. and China 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 - September 22, 2018

Note: Four-week moving average
Source: U.S. Department of Labor, NBER, Haver Analytics
Figure 2: Job Leavers: The Quits Rate
January 2003 - July 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 - July 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


Source: BLS, Blue Chip Economic Indicators, NBER, Haver Analytics
Figure 5: Average Hourly Earnings of Production and Nonsupervisory Private-Industry Employees
January 2003 - August 2018

Source: BLS, NBER, Haver Analytics
Figure 6: Inflation Rate: Change in Personal Consumption Expenditures (PCE) Price Indices

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

Source: BEA, Blue Chip Economic Indicators, NBER, Haver Analytics
Figure 9: Real Consumption Growth: Actual and Forecast


Quarterly Percent Change at Annual Rate

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 - August 2018

Source: Federal Reserve Board, Haver Analytics
Figure 12: Spot Exchange Rates
January 2, 2015 - September 21, 2018

Note: Spot Exchange Middle Rate, NY Close
Source: WSJ, Haver Analytics
Figure 13: Brent Crude Oil Price
January 2013 - August 2018

Source: Energy Information Administration, Haver Analytics
Figure 14: Emerging Markets Stock Price Index: The Shanghai Composite Index
January 2013 - August 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