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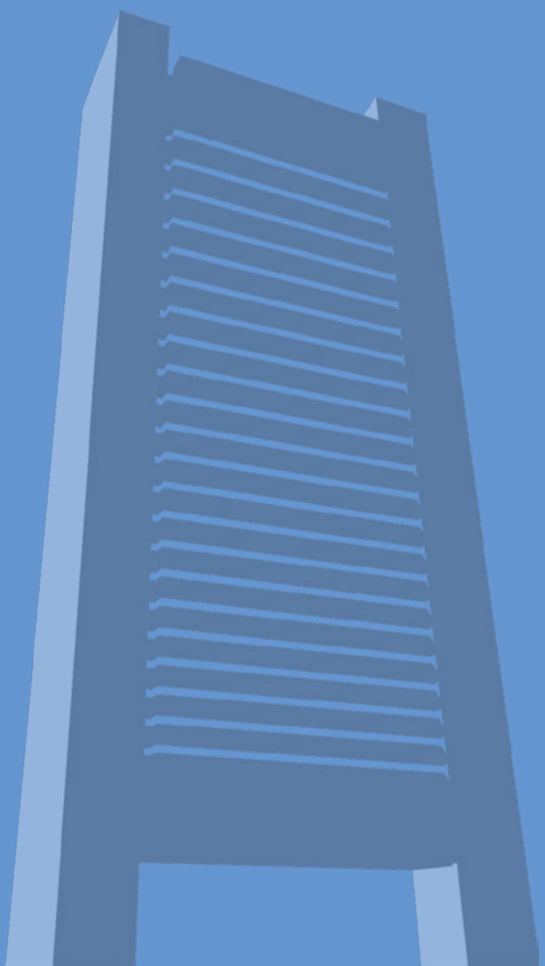

Assessing the Economy's Recent Progress

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The Economy Continues to Gradually Improve

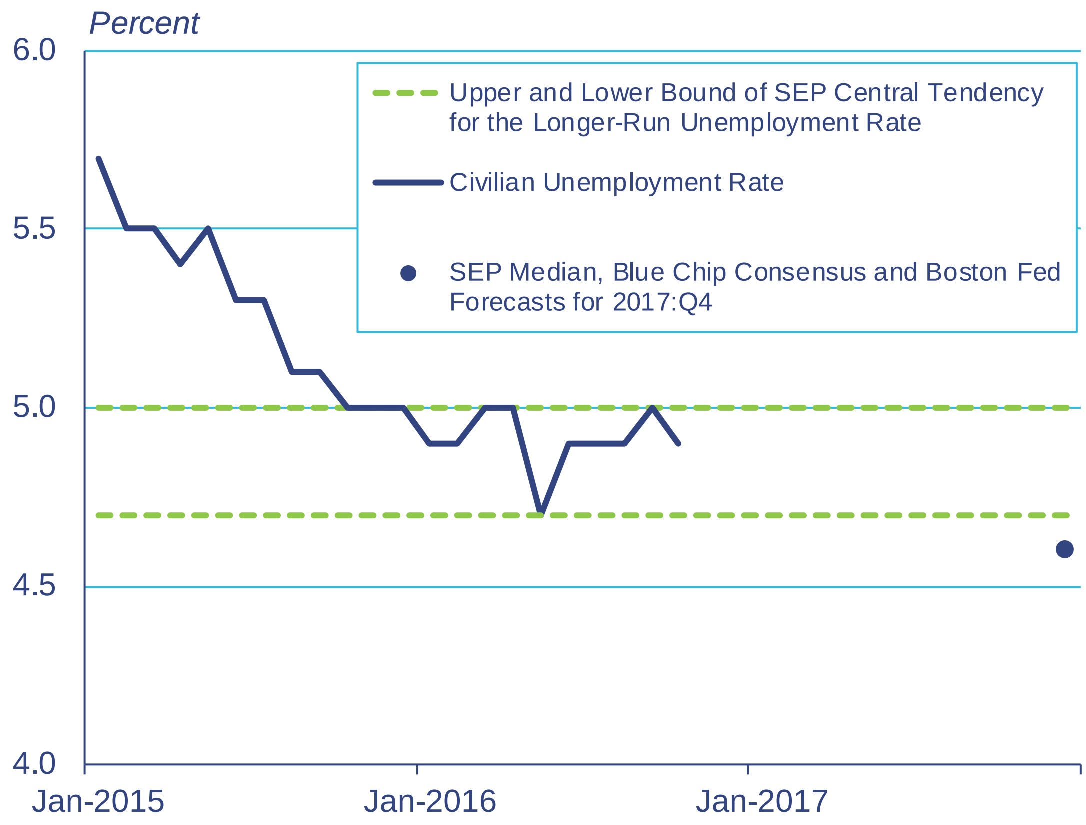
- Unemployment is now at 4.9 percent – close to most estimates of full employment
- Payroll employment growth of 161,000 jobs in October
- Core inflation fluctuated between just 1.3 and 1.4 percent last year, but now stands at 1.7 percent
- Expect next year the economy will be at full employment, and inflation at the 2 percent target

Policy Consistent with a Sustained Recovery

- Futures market's probability of a tightening in December has been high – in the vicinity of 75 percent
- Absent significant negative economic news over the next month, the market's assessment of the likelihood of tightening in December seems plausible to me
- For a sustained recovery, we must consider the risks inherent in waiting too long to gradually remove monetary accommodation

Figure 1: Civilian Unemployment Rate

January 2015 - October 2016 and Forecasts for 2017:Q4

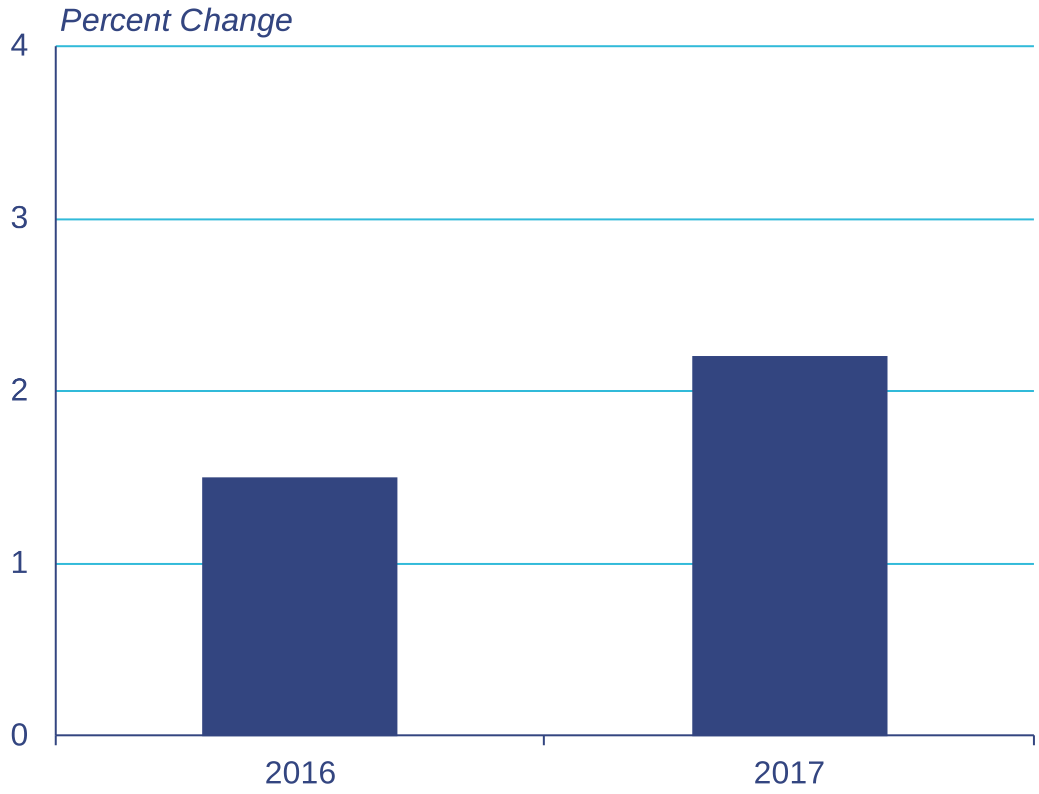


Note: The central tendency excludes the three highest and three lowest projections.

Source: BLS, Blue Chip Economic Indicators, FOMC Summary of Economic Projections (SEP), Haver Analytics

Figure 2: Survey of Professional Forecasters: Median Forecast for Annual-Average Real GDP Growth

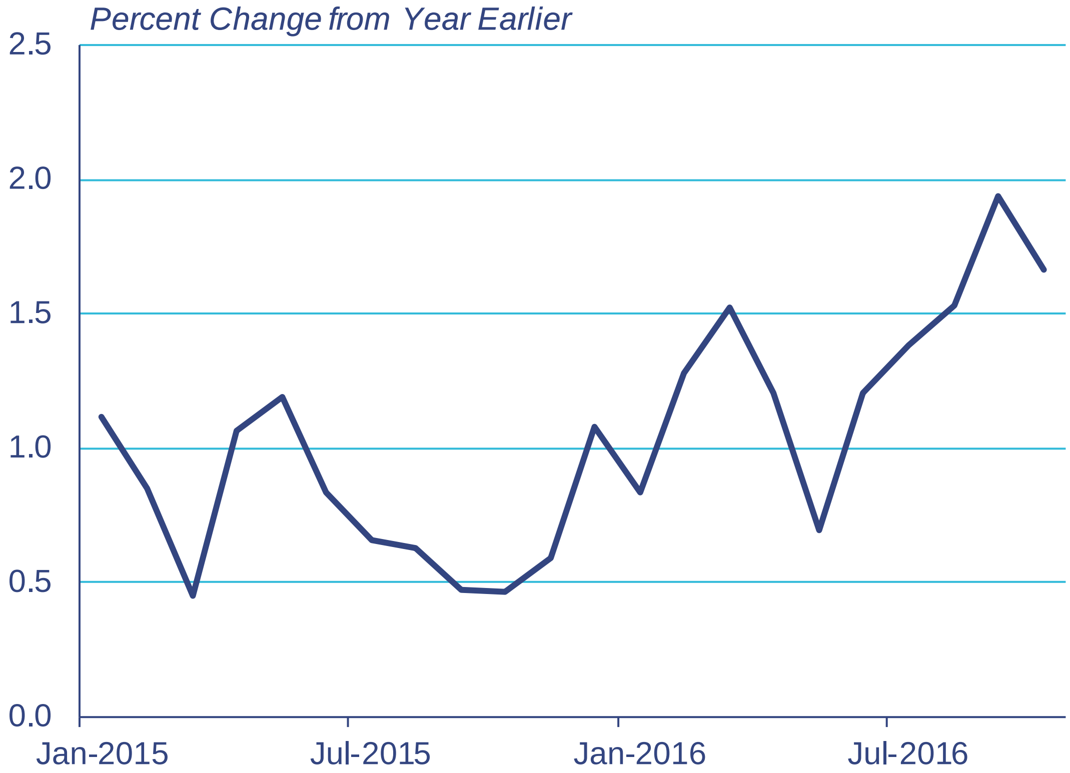
Forecast as of 2016:Q4



Source: Federal Reserve Bank of Philadelphia, Survey of Professional Forecasters

Figure 3: Civilian Labor Force Growth

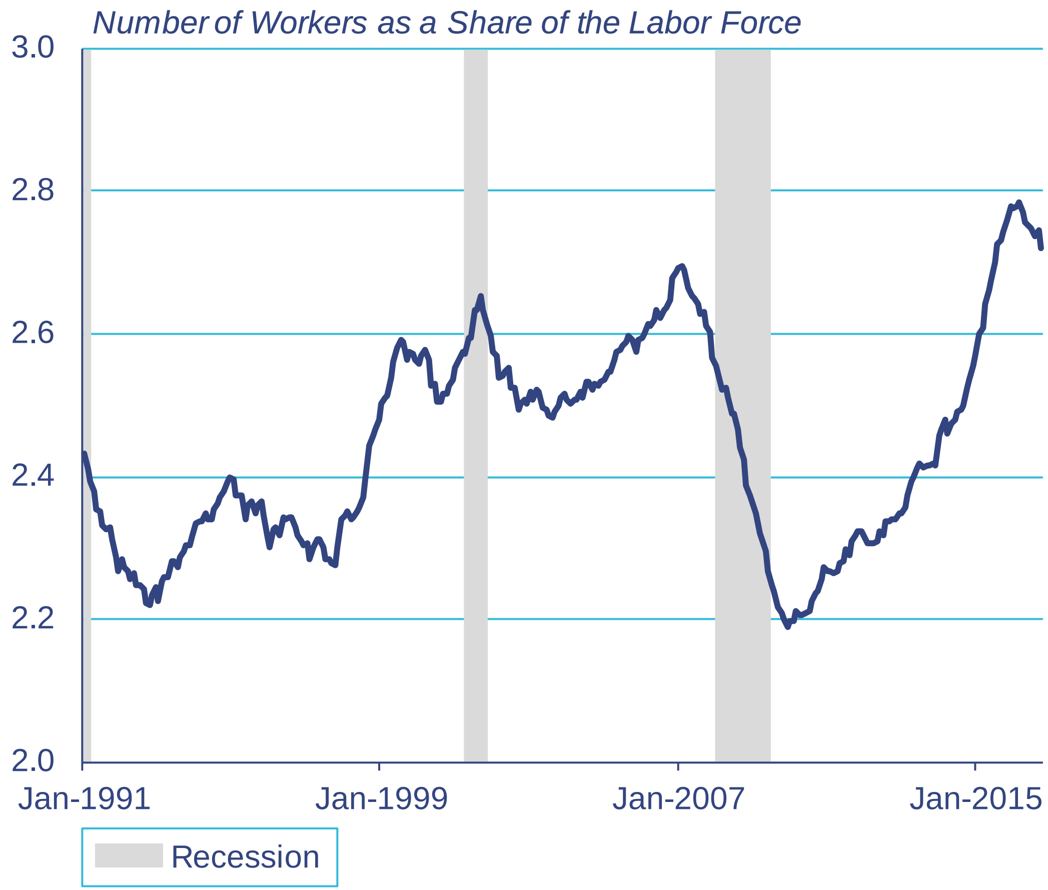
January 2015 - October 2016



Source: BLS, Haver Analytics

Figure 4: Flow from Not in the Labor Force to Employment

January 1991 - October 2016

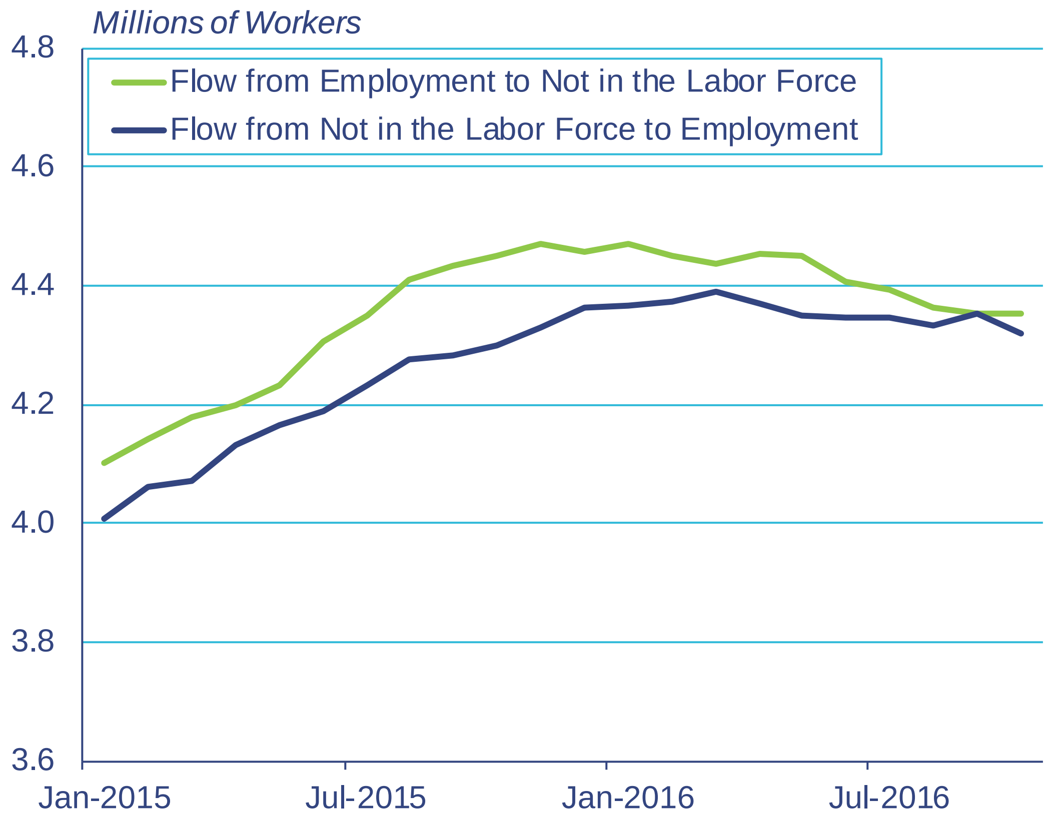


Note: Twelve-month moving average

Source: BLS, NBER, Haver Analytics

Figure 5: Flow from Not in the Labor Force to Employment and from Employment to Not in the Labor Force

January 2015 - October 2016

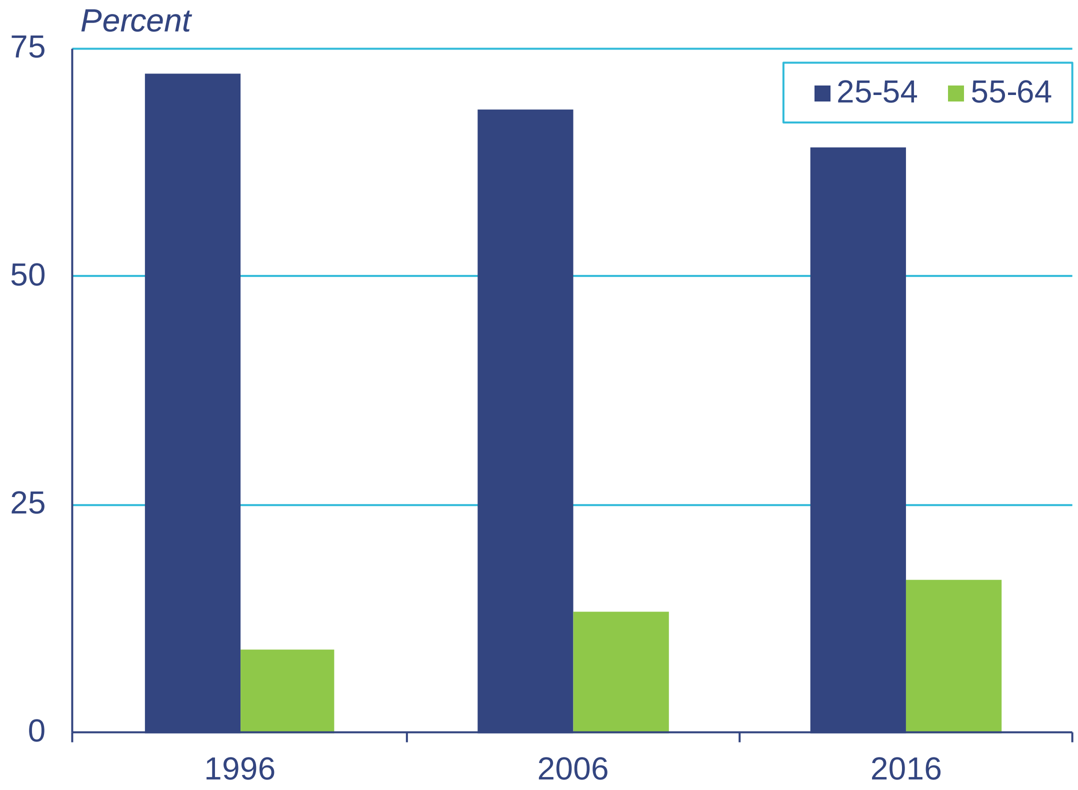


Note: Twelve-month moving averages

Source: BLS, Haver Analytics

Figure 6: Selected Age Groups as a Share of the Civilian Labor Force

1996, 2006, and 2016

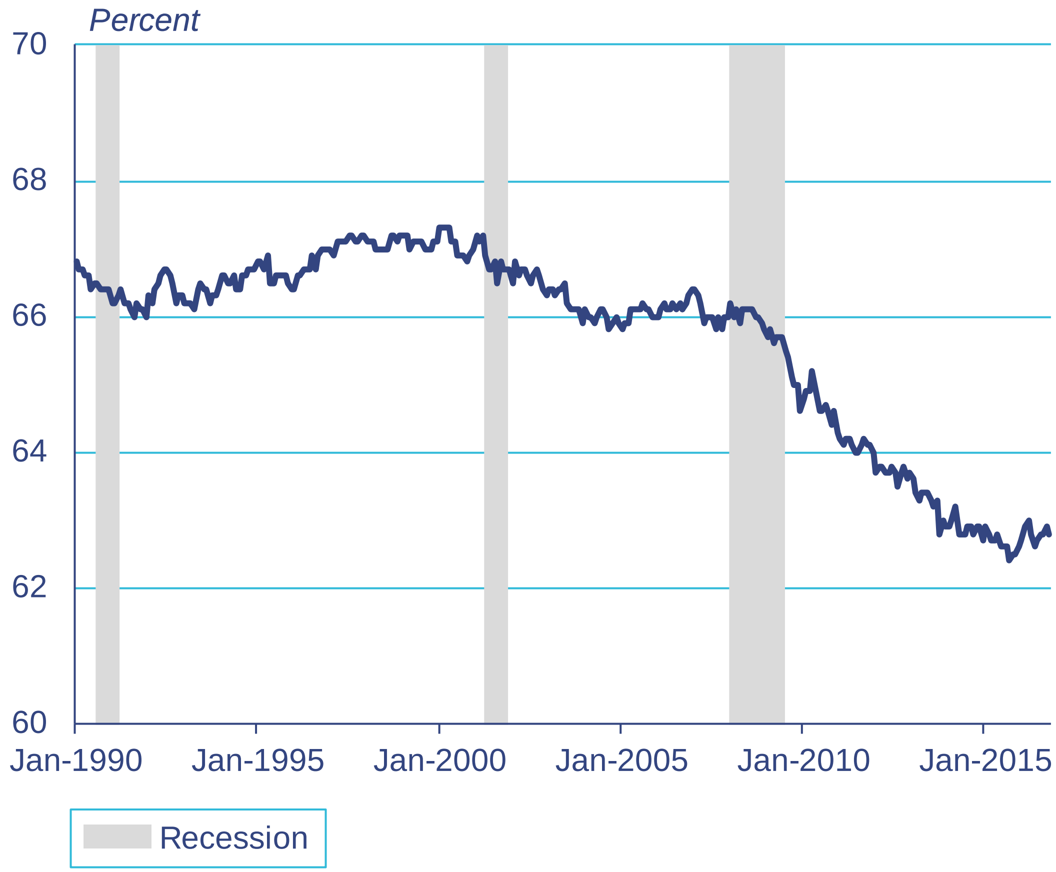


Note: Figures for 2016 are the averages of figures for January - October.

Source: BLS, Haver Analytics

Figure 7: Civilian Labor Force Participation Rate, 16 Years and Older

January 1990 - October 2016



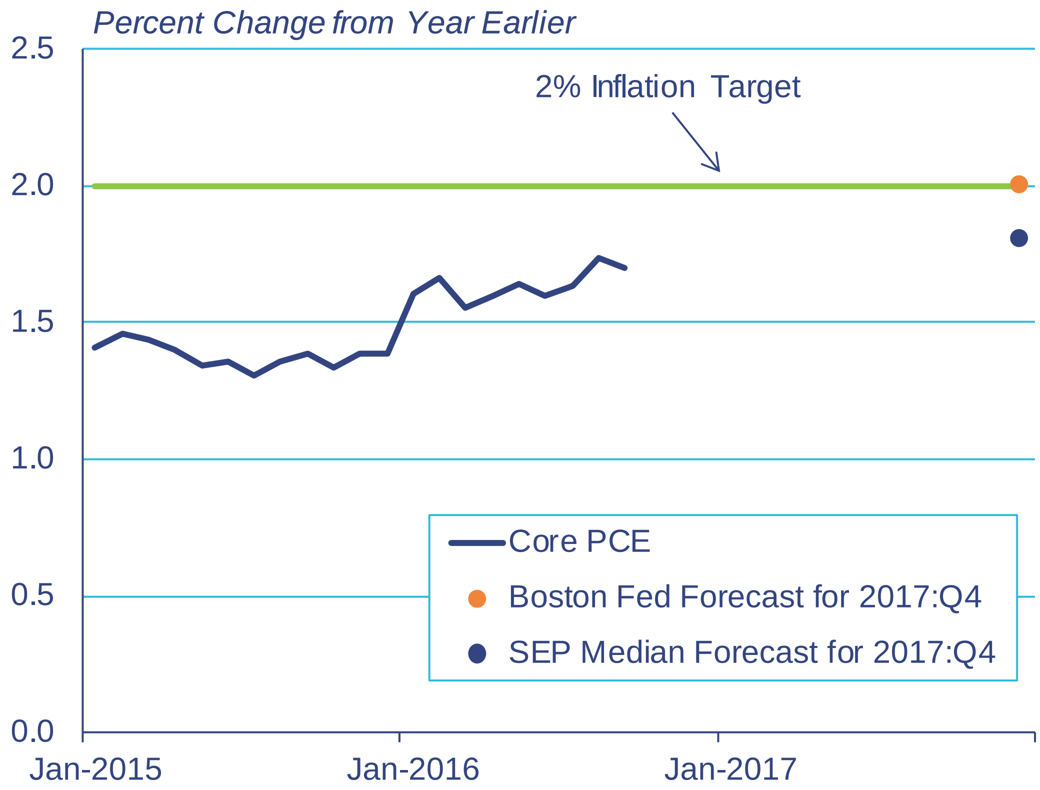
Source: BLS, NBER, Haver Analytics

Labor Market Conditions

- It is certainly good news that the labor force has grown more rapidly of late
- Labor force growth is likely to be limited going forward by the demographic changes in the workforce
- As a result, if the economy grows even somewhat faster than potential, further declines in the unemployment rate are likely
- Further declines would increase the risk of overshooting what is likely to be a sustainable unemployment rate in the longer run
- That could result in a need for more rapid removal of accommodation

Figure 8: Inflation Rate: Change in Core Personal Consumption Expenditures Price Index

January 2015 - September 2016 and Forecasts for 2017:Q4

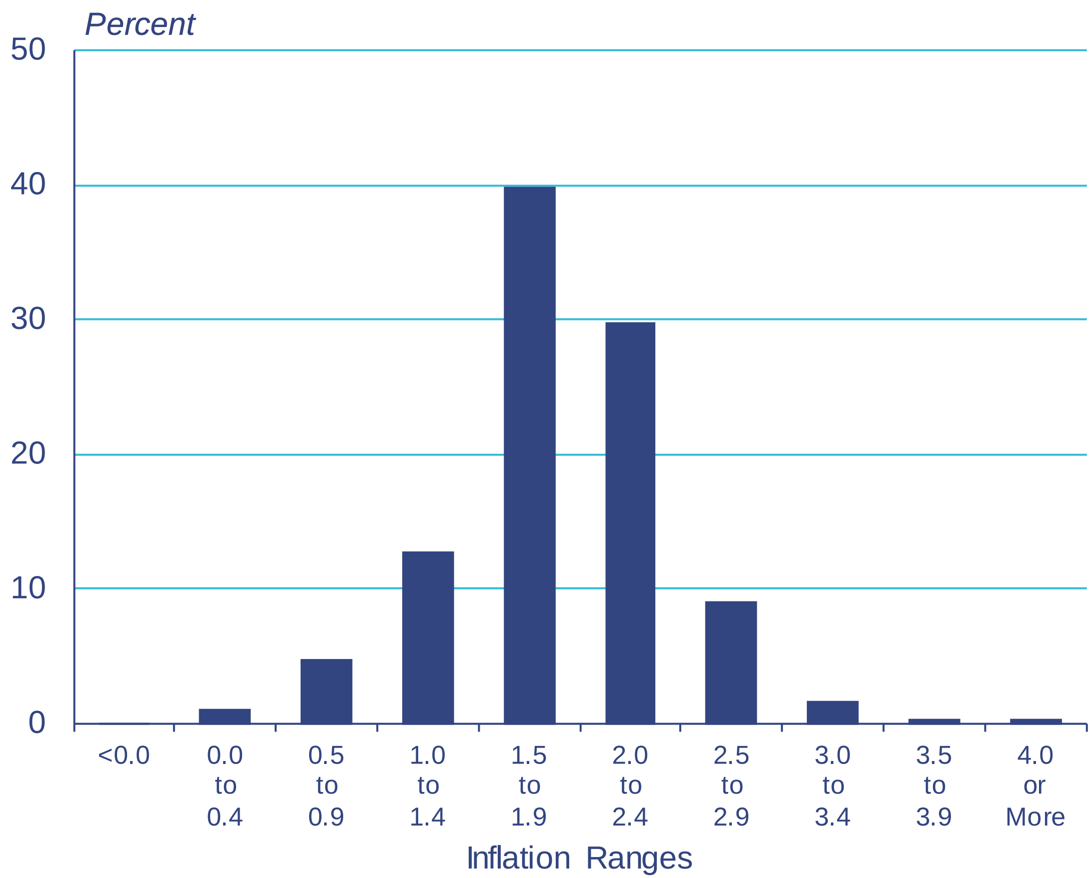


Note: Core PCE excludes food and energy.

Source: BEA, Federal Reserve Bank of Boston, FOMC Summary of Economic Projections (SEP), Haver Analytics

Figure 9: Survey of Professional Forecasters: Mean Probabilities for Core PCE Inflation in 2017

Forecast as of 2016:Q4

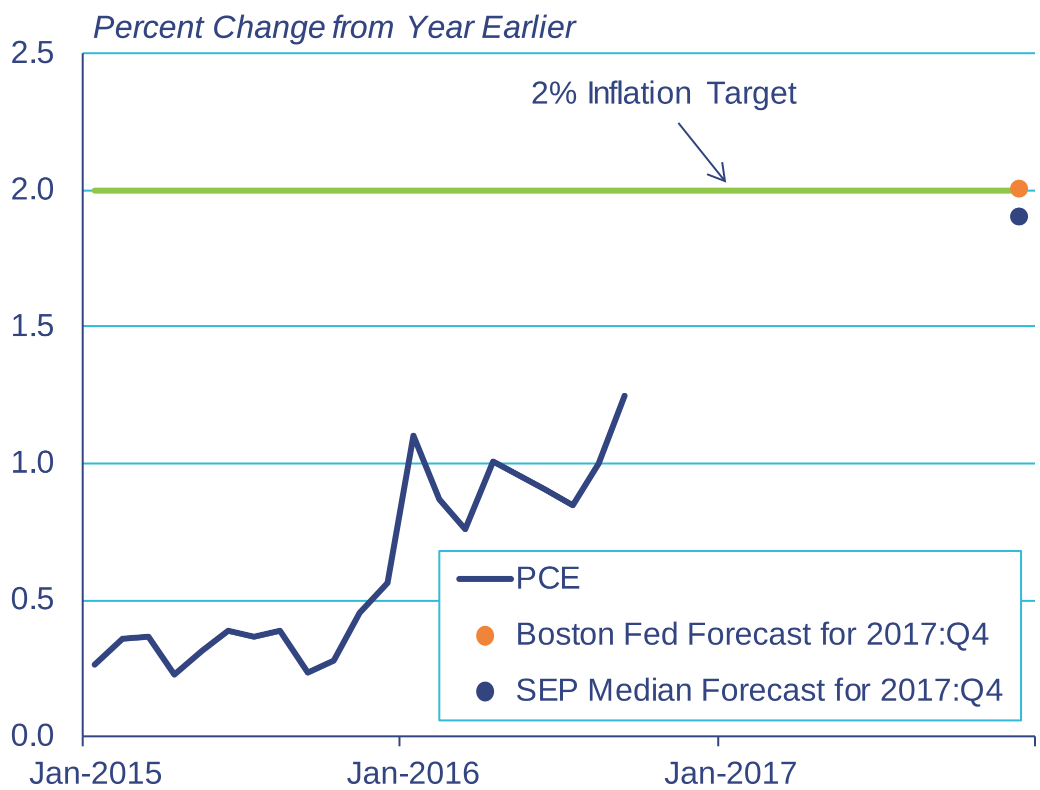


Note: The core PCE inflation rate is the forecasted change from 2016:Q4 to 2017:Q4.

Source: Federal Reserve Bank of Philadelphia, Survey of Professional Forecasters

Figure 10: Inflation Rate: Change in Personal Consumption Expenditures Price Index

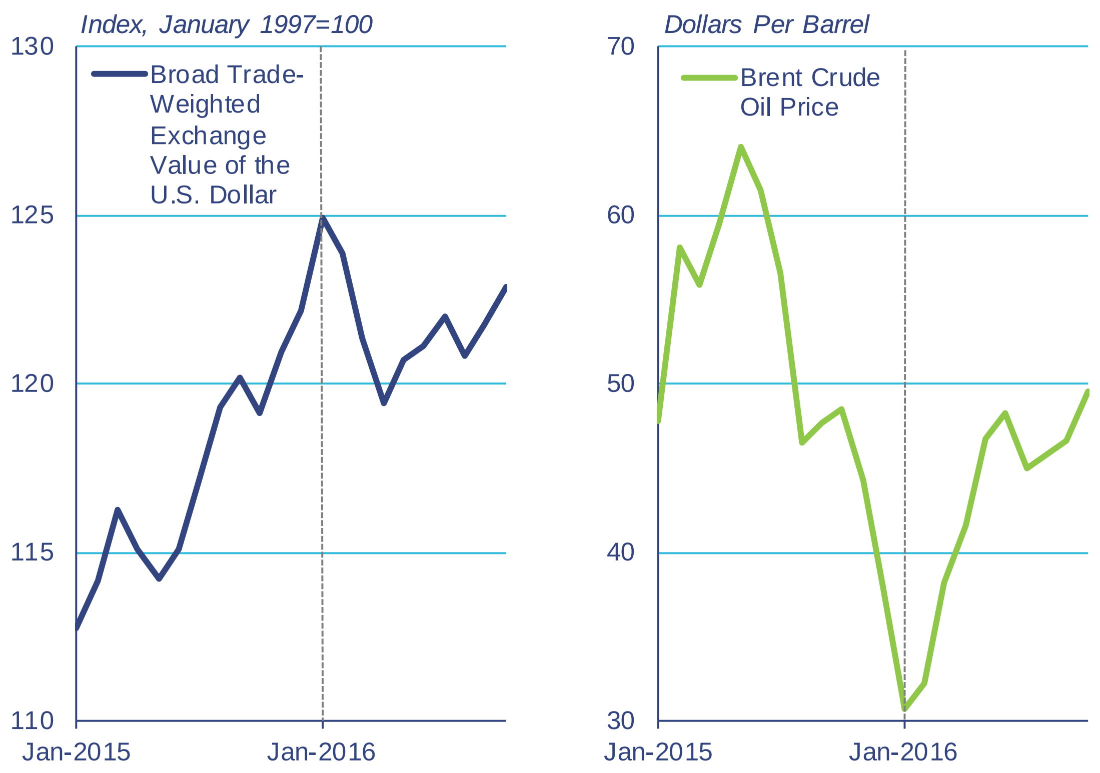
January 2015 - September 2016 and Forecasts for 2017:Q4



Source: BEA, Federal Reserve Bank of Boston, FOMC Summary of Economic Projections (SEP), Haver Analytics

Figure 11: Trade-Weighted Value of the U.S. Dollar and Crude Oil Prices

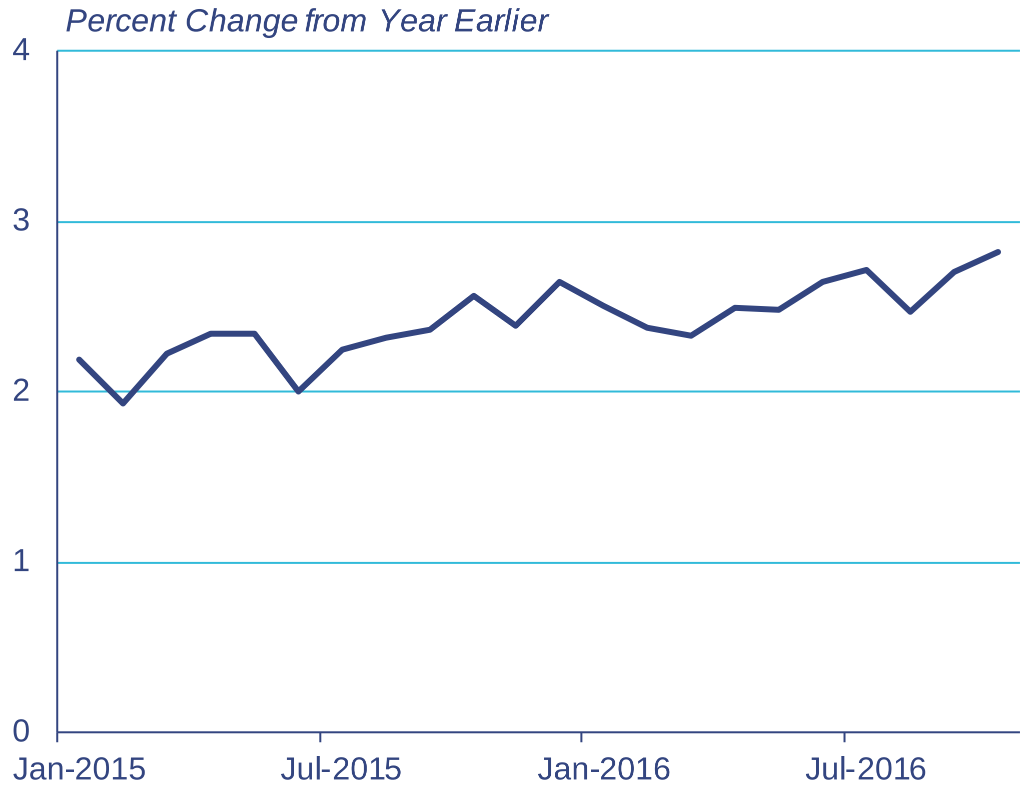
January 2015 - October 2016



Source: Energy Information Administration, Federal Reserve Board, Haver Analytics

Figure 12: Average Hourly Earnings of Private Industry Workers

January 2015 - October 2016



Source: BLS, Haver Analytics

Wages and Prices

- Inflation appears at last to be trending toward the Federal Reserve's 2 percent target
- The Boston Fed forecast expects both the total and core PCE inflation measures to hit 2 percent over the next year
- Wages are also trending up
- Progress to date and the expectation of further progress likely explain, in part, why markets have priced in a high probability of a rate hike in December

Concluding Observations

- At the September FOMC meeting, I voted to increase interest rates, arguing that if we waited too long to raise rates we could place at risk the sustainability of the recovery
- At the FOMC meeting earlier this month, however, I felt that the changes in the FOMC statement were well aligned with the notion (and the market perception) of a high likelihood of tightening in December. As a result, I did not dissent
- Going forward, I will be attuned to assessing whether my forecast – continued progress toward achieving our inflation target and employment goals – is on track