The Outlook and Current Policy Challenges
Emerging Leaders in New England’s Banking Industry
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I have to say this...

Disclaimer: The views represented in this presentation are solely those of the author, and do not reflect the views of the Federal Reserve Bank of Boston, the Board of Governors of the Federal Reserve System, or the Federal Open Market Committee
A brief update on the outlook

- Labor market strength continues
- Spending data a bit weaker for the first quarter
  - Slower consumption growth, but moderate investment spending
- Still, the underpinnings for growth are good
  - Income, wealth, financial conditions, tax cuts, federal spending, ROW growth

Sources: Bureau of Labor Statistics (employment), Bureau of Economic Analysis (GDP), author’s calculations, Haver Analytics
Income, wealth, financial conditions are still supporting
- Sentiment highest since 2004

Fiscal policy: both tax cuts and increased federal spending boost GDP

ROW growth improved, but flattening

Sources: Flow of Funds (wealth), BEA (income), Wall Street Journal (stock prices), Federal Reserve (Treasury yield, exchange rate), Haver Analytics
Now approximately at our 2% goal
- Earlier, temporary factors held down inflation
- Those have faded

Core inflation (PCE) currently at 1.8% for past 12 months
- 2.0% for past 6 months, annualized

Source: BEA (PCE inflation), Haver Analytics
Above-trend growth
- For 2018, 2019
- At or a bit below trend in 2020?

Falling unemployment
- To the mid-3’s?

Gradually rising inflation
- Near 2% this year (by Q4)
- A bit higher later on

All conditioned on gradually rising interest rates

Sources: BEA (GDP), BLS (unemployment), Summary of Economic Projections (Board of Governors), Haver Analytics
There are some downside risks...

- **Trade wars**
  - Hard to predict
  - Likely adding to uncertainty
  - Small effect to date

- **Geopolitical uncertainty**
  - Iran, Syria, North Korea, Italy
  - Reflected in oil prices and bond yields

- **Limited policy capacity**
  - We’ll return to this

Sources: EIA, Haver Analytics
A statistical regularity
- When short rates rise above long rates, recessions tend to follow

It’s clear why this occurred in earlier episodes
- The Fed was tightening short rates to cause a recession

Today?
- Probability models suggest at best a modest probability of recession

Sources: FRB H.15 release, Haver Analytics
Our responsibilities, as delegated to us by Congress:

- The “Dual Mandate”: low inflation, maximum (sustainable) employment
- Where are we in achieving these goals? First, employment:

**Measures of labor market slack**

- Civilian unemployment rate
- "U-6" (broader measure of unemployment (right scale))

Estimates of long-run sustainable rate

Pre-recession low

Sources: Bureau of Labor Statistics (unemployment, employment, AHE wage growth, nonfarm compensation), Haver Analytics
Why have we raised rates?
Part 2: Inflation

- You saw this chart before
- What’s our goal? 2%
- How close are we?
  - Pretty darned close
  - Dip below 2% appears to have been temporary
- If unemployment dips well below 4%, will nothing happen?
- Expect gradual rise to 2% and a bit above

Core inflation trends, PCE

Sources: Bureau of Economic Analysis, Haver Analytics
Current policy assessments
(Policymaker and financial market assessments)

Fed’s predictions of rate increases versus reality

- Number of increases expected in next calendar year
- Actual (next year)

As of December FOMC meeting in year indicated, except for March 2018

Financial market assessments of future Fed policy (5/31/18)

- No further increase
- 2 increases or more
- 3 increases or more this year
- 4 increases or more this year

Source: Summary of Economic Projections, 9/20/17, Federal Reserve Board, CME Group FedWatch tool
A risk to too-low interest rates

- Low rates imply falling unemployment
- In every episode post WW II, unemployment slipping too far below normal leads to a recession—and/or financial upheaval
- We’d prefer a stable, sustained recovery

Sources: Bureau of Labor Statistics (unemployment rate), Congressional Budget Office (natural rate of unemployment), Haver Analytics
A Note on Policy “Capacity”

- The idea: How much room do monetary and fiscal policy have to operate?
- i.e. How much capacity to stabilize the economy in the event of a recession?
- What to do about these constraints?

Sources: CBO (debt projections), Wall Street Journal (funds rate), Board of Governors (SEP long-run rate), Haver analytics
What to conclude?

- The economy continues to grow steadily
- The labor markets are fully recovered
  - Some risk of overheating
- Inflation is at or very near target
  - Ok to be a bit above or below
- Policy is moving toward “neutral”