



EMBARGOED UNTIL MONDAY, OCTOBER 1, 2018 AT 12:55 P.M.; OR UPON DELIVERY

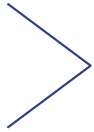
Exploring Current Economic Conditions and the Implications for Monetary Policy

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Federal Reserve Bank of Boston

October 1, 2018

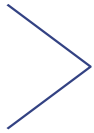
National Association for Business Economics (NABE)
60th NABE Annual Meeting
Boston, Massachusetts

bostonfed.org



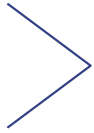
Recent Monetary Policy Actions

- ▶ 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
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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
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Figure 1: Initial Claims for Unemployment Insurance January 28, 1967 - September 22, 2018

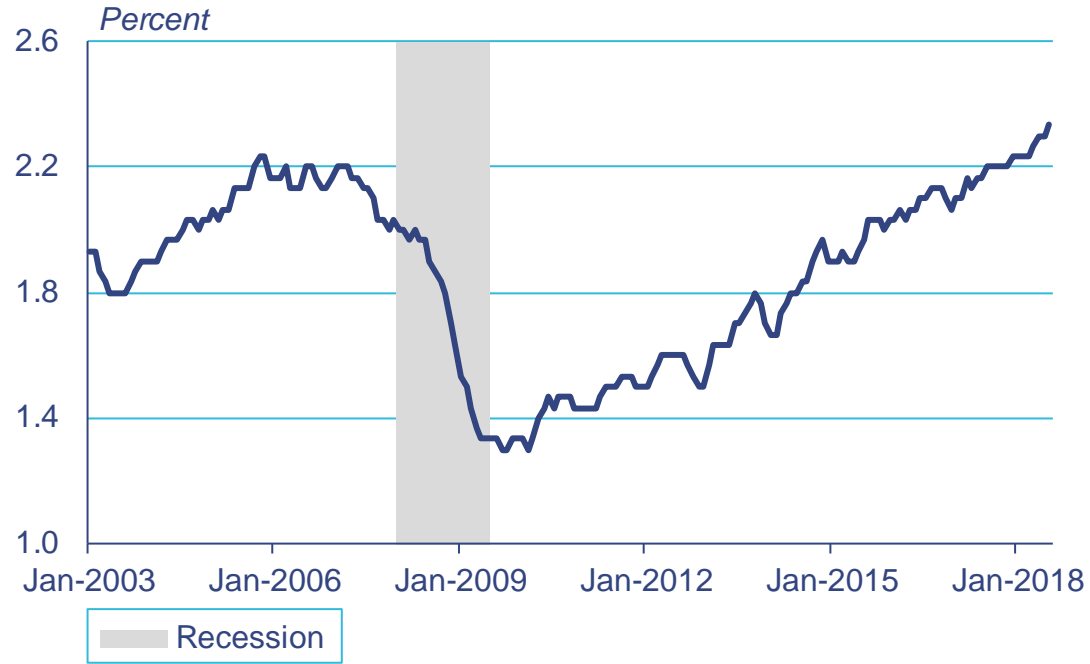


Note: Four-week moving average

Source: U.S. Department of Labor, NBER, Haver Analytics



Figure 2: Job Leavers: The Quits Rate January 2003 - July 2018

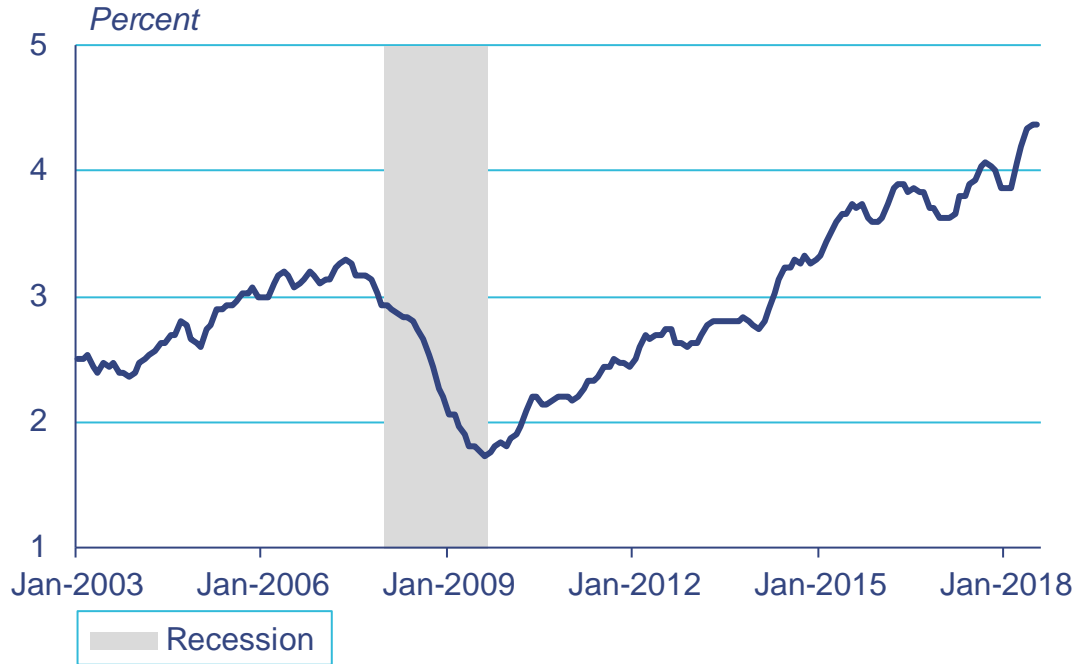


Note: The quits rate is the number of quits during the entire month as a percent of total employment. Pictured above is the three-month moving average.

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
Actual, 2003:Q1 - 2018:Q2 and Forecast, 2018:Q3 - 2019:Q4

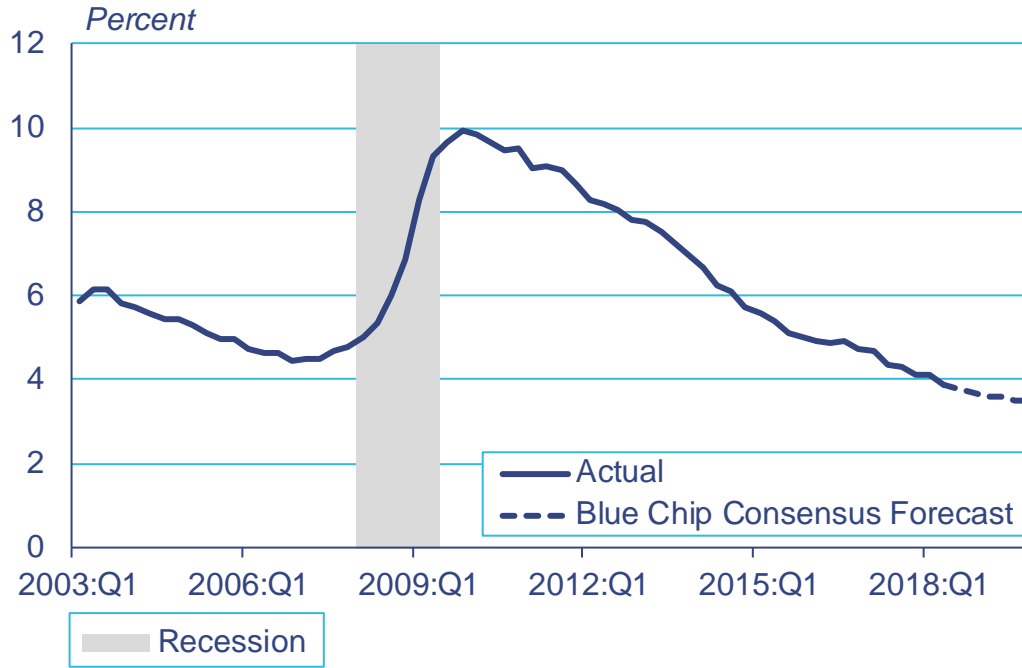




Figure 5: Average Hourly Earnings of Production and Nonsupervisory Private-Industry Employees
January 2003 - August 2018

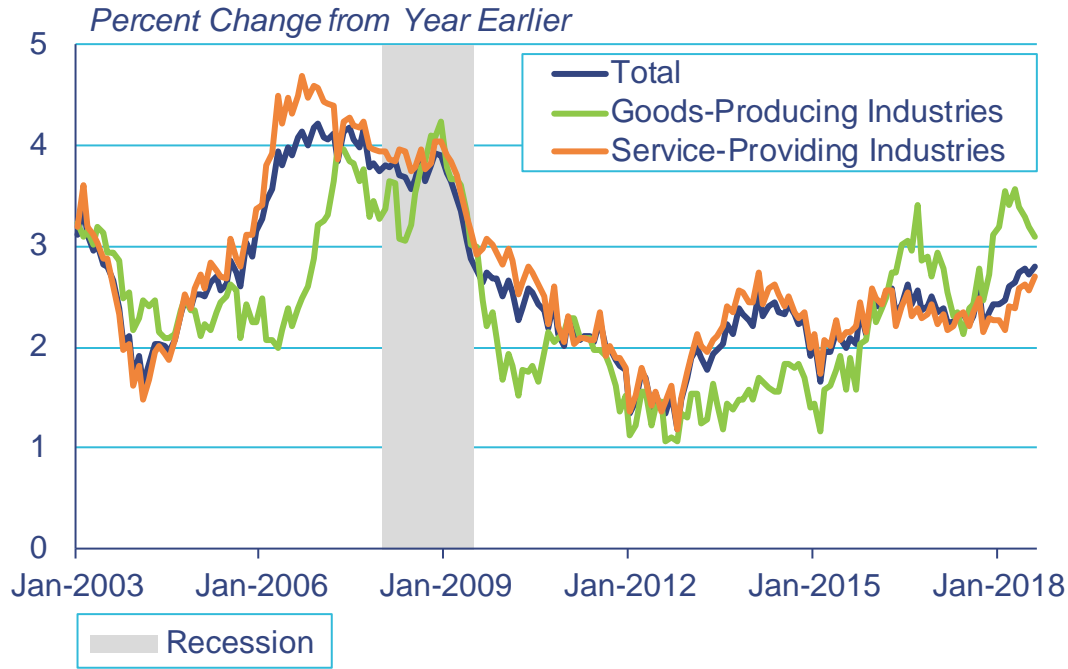
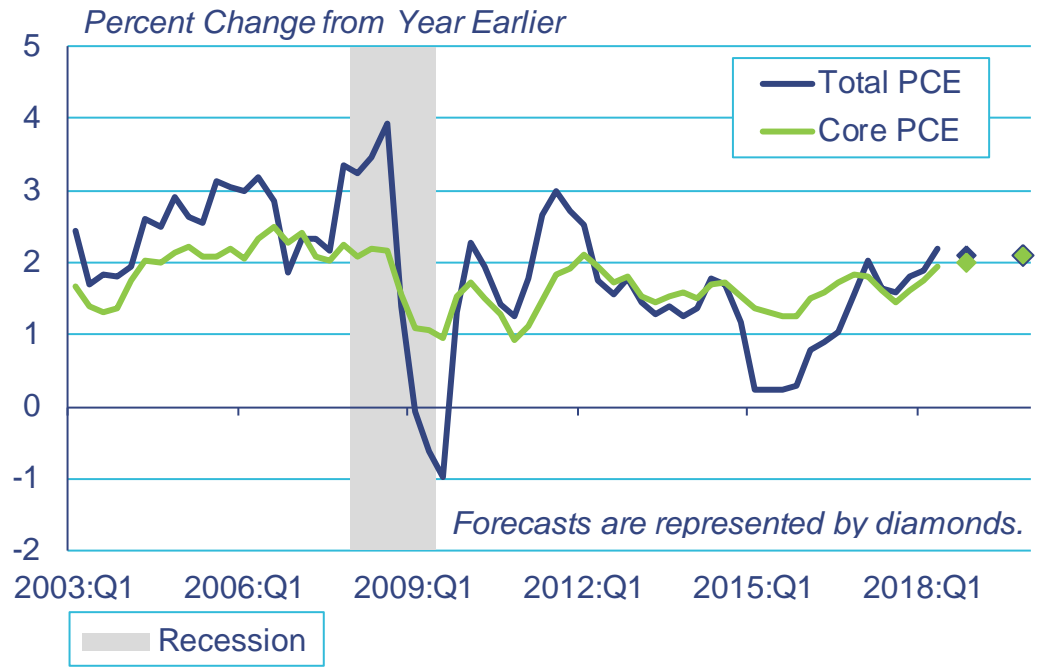




Figure 6: Inflation Rate: Change in Personal Consumption Expenditures (PCE) Price Indices

Actual, 2003:Q1 - 2018:Q2 and Forecast, 2018:Q4 & 2019:Q4

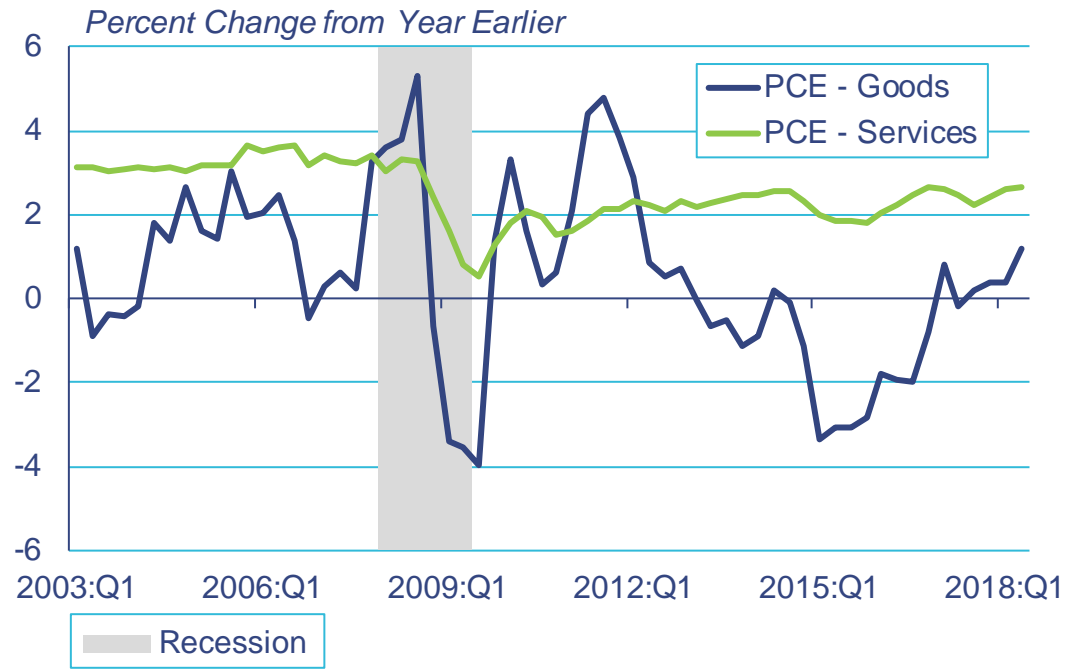


Note: Core PCE excludes food and energy.

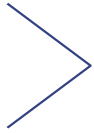
Source: BEA; Federal Reserve Bank of Philadelphia, Survey of Professional Forecasters; NBER; Haver Analytics



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
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Figure 8: Real GDP Growth: Actual and Forecast
Actual, 2003:Q1 - 2018:Q2 and Forecast, 2018:Q3 - 2019:Q4

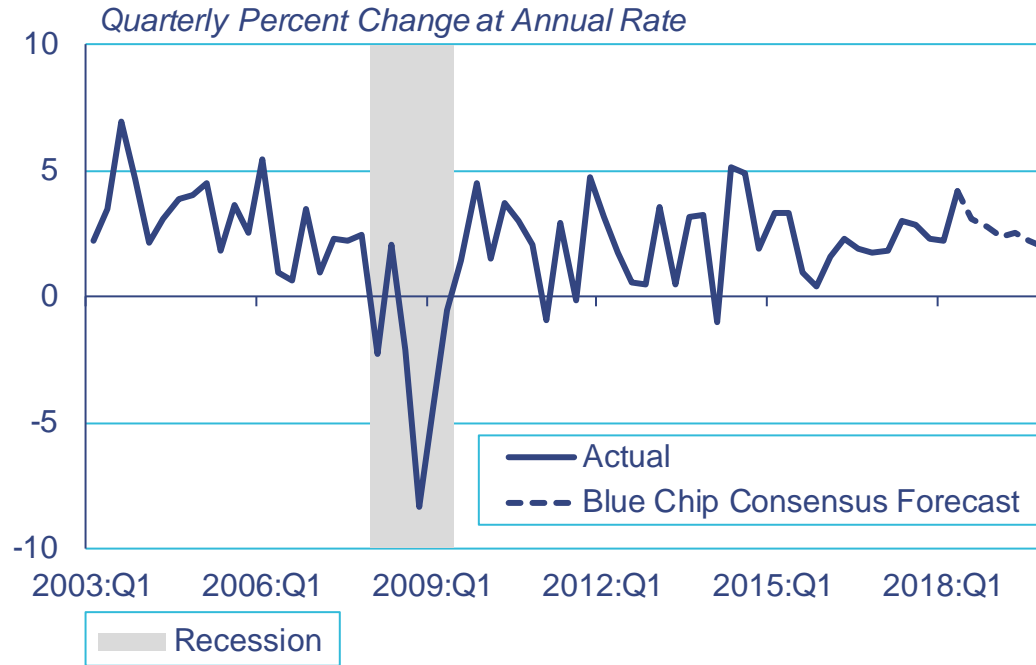




Figure 9: Real Consumption Growth: Actual and Forecast

Actual, 2003:Q1 - 2018:Q2 and Forecast, 2018:Q3 - 2019:Q4

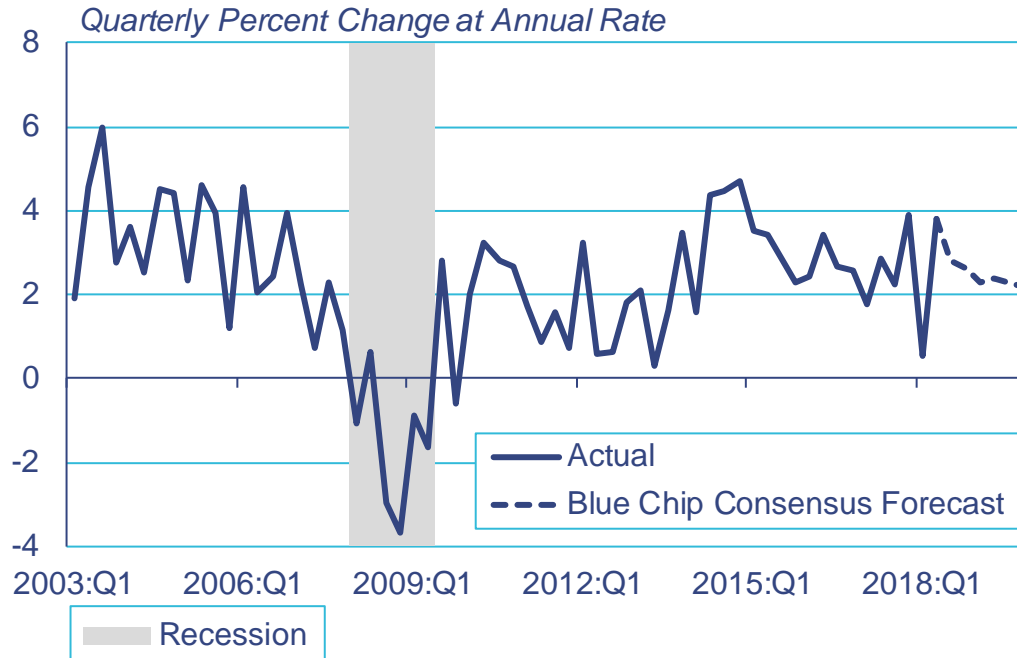
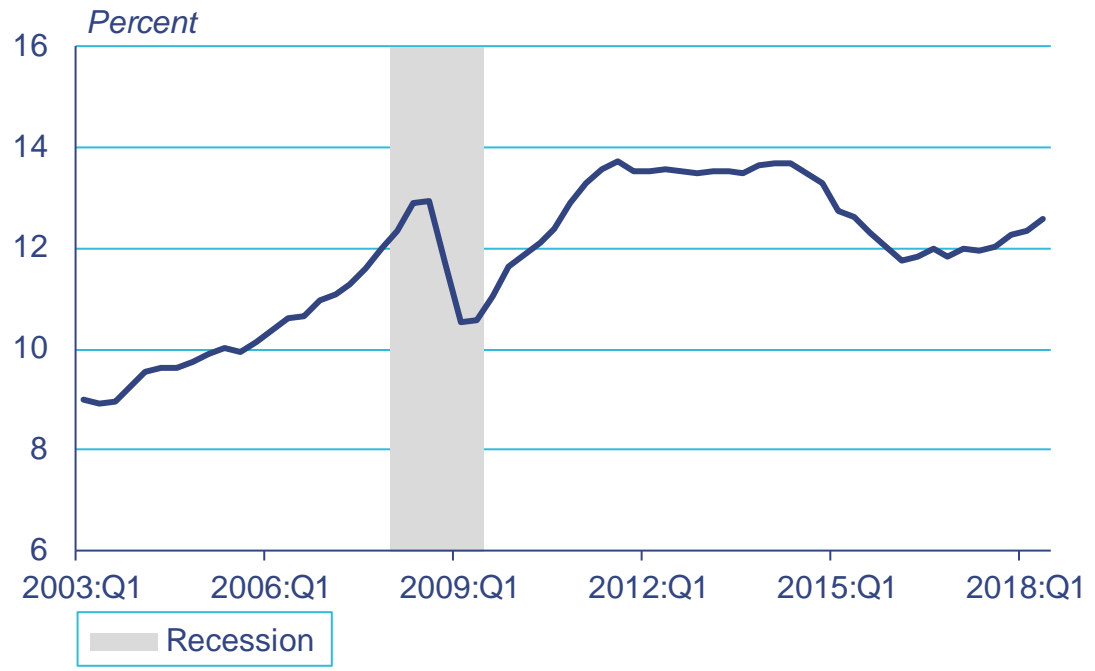


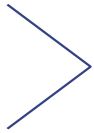


Figure 10: Exports of Goods and Services as a Share of GDP

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

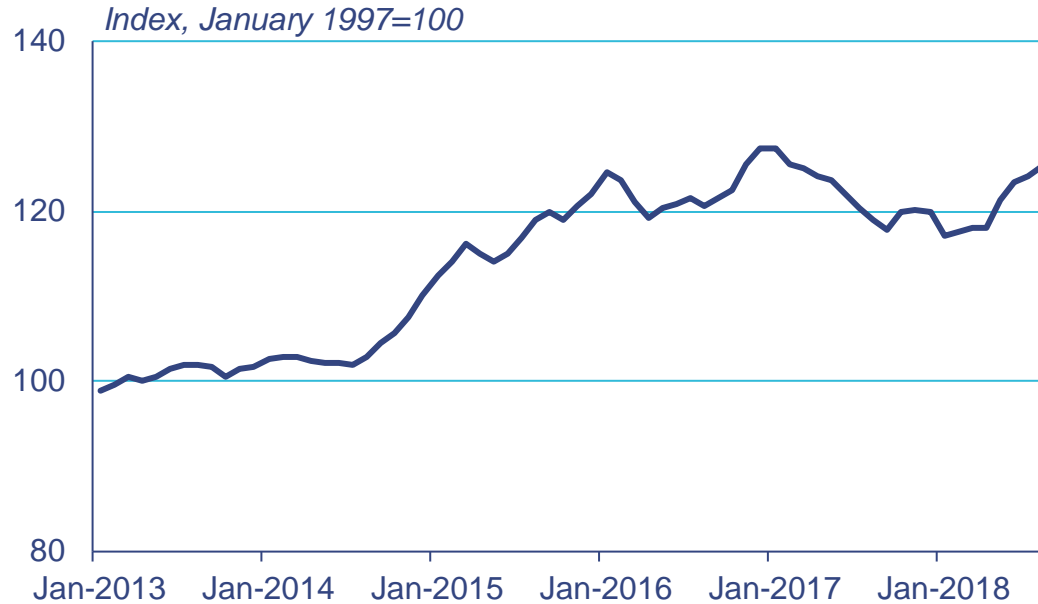
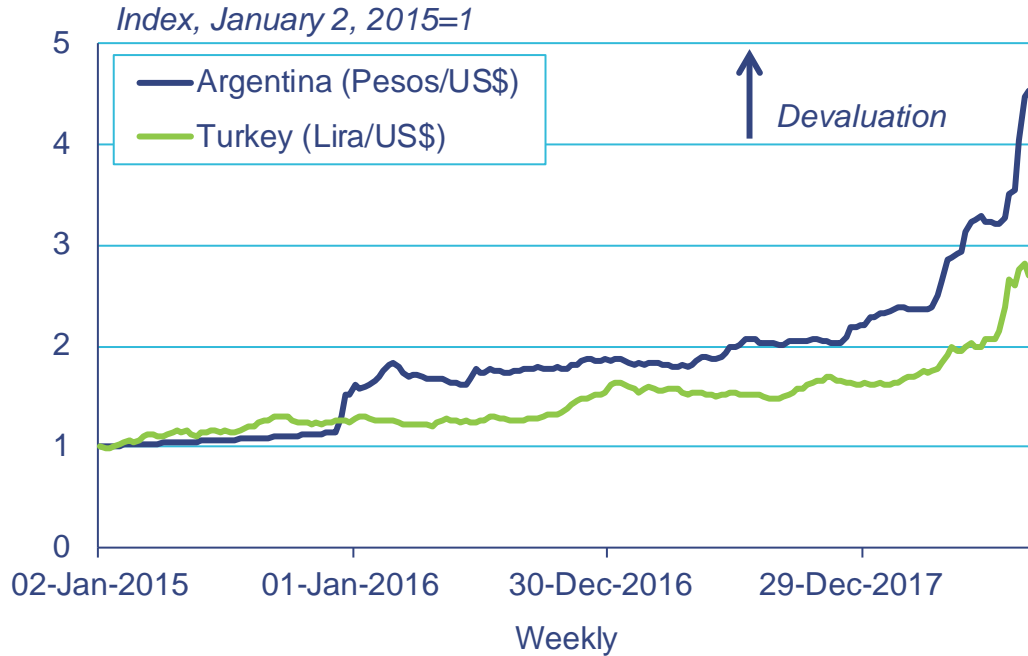




Figure 12: Spot Exchange Rates

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

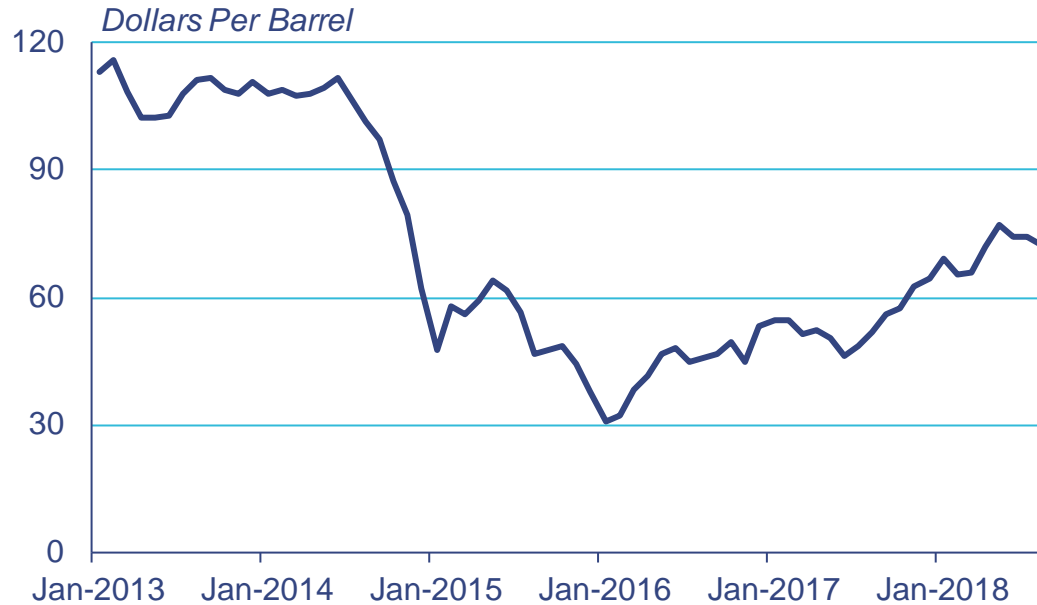




Figure 14: Emerging Markets Stock Price Index: The Shanghai Composite Index January 2013 - August 2018

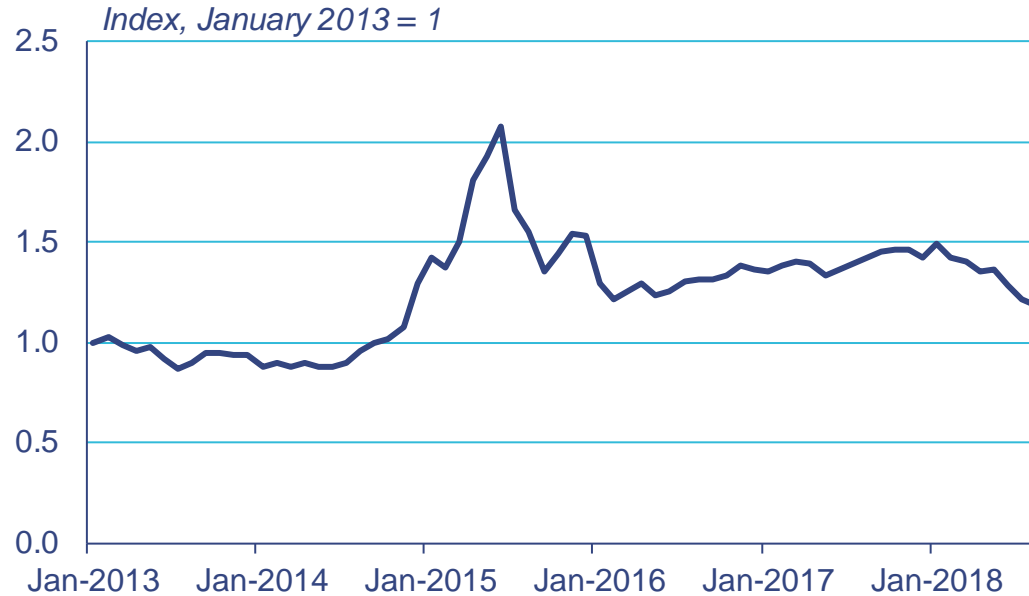
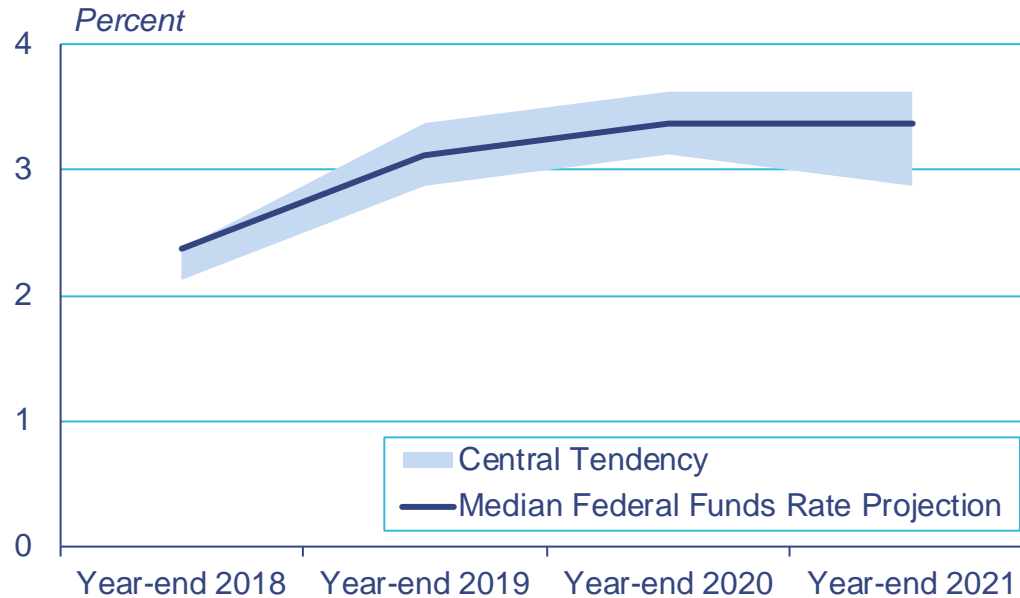




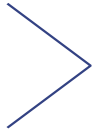
Figure 15: Median Federal Funds Rate Forecast from the Summary of Economic Projections

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
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