# Assessing the Economic Recovery

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# Fed’s Monetary Policy Partially Offsets “Headwinds”

- Purchasing Treasury and mortgage-backed securities totaling $85 billion per month
- Keeping short-term interest rates at their exceptionally low levels at least as long as the unemployment rate remains above 6.5 percent and inflation and inflation expectations are well anchored

# Some Positive Progress

- The national unemployment rate has declined from 7.9 to 7.2 percent since the beginning of the year
- Interest-sensitive sectors such as housing and autos have continued to improve
- Inflation has stabilized, but at rates well below the Fed’s 2 percent target

# However, We Need to See Much More Progress

- Inflation is below our target – levels that are too low risk a negative shock leading to deflation
- At 7.2 percent, unemployment is well above my estimate of the “full employment” rate (5.25 percent)
- Headwinds from fiscal policy, slow growth among trading partners, and lingering impact of the financial crisis

# Monetary Policy Needs to be Data Dependent

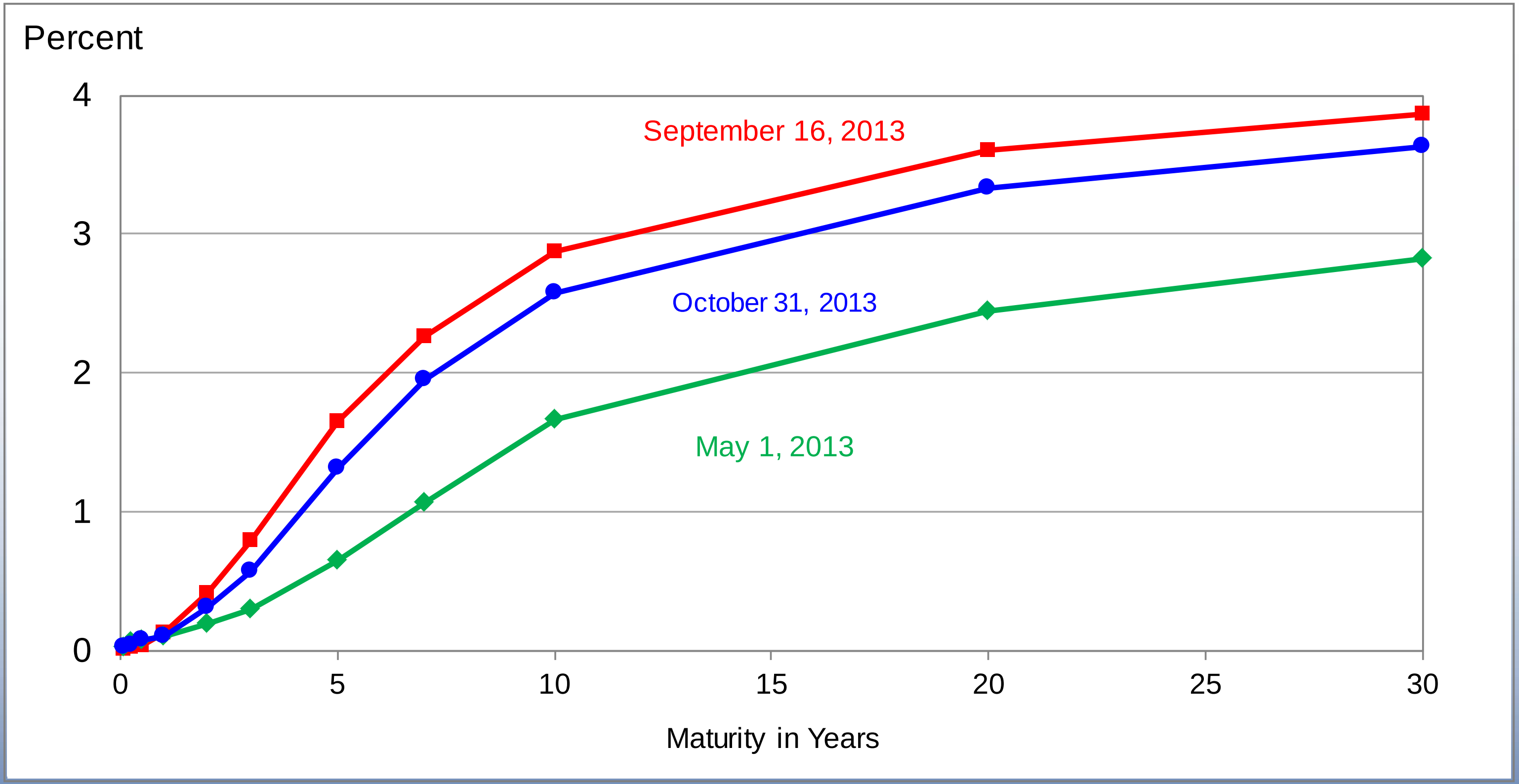
- Monetary policy should respond to the actual state of the economy and incoming data
- But policy should also be forward-looking, taking into consideration *how long* it is expected to take to return to full employment within a context of price stability

# Regarding the Fed's Asset Purchase Program

- When we see more compelling evidence of a sustainable recovery making satisfactory progress toward full employment, it may be appropriate to gradually reduce the size of our purchase program
- This will still be adding stimulus, but in smaller increments than before

# Figure 1
# Treasury Yield Curves

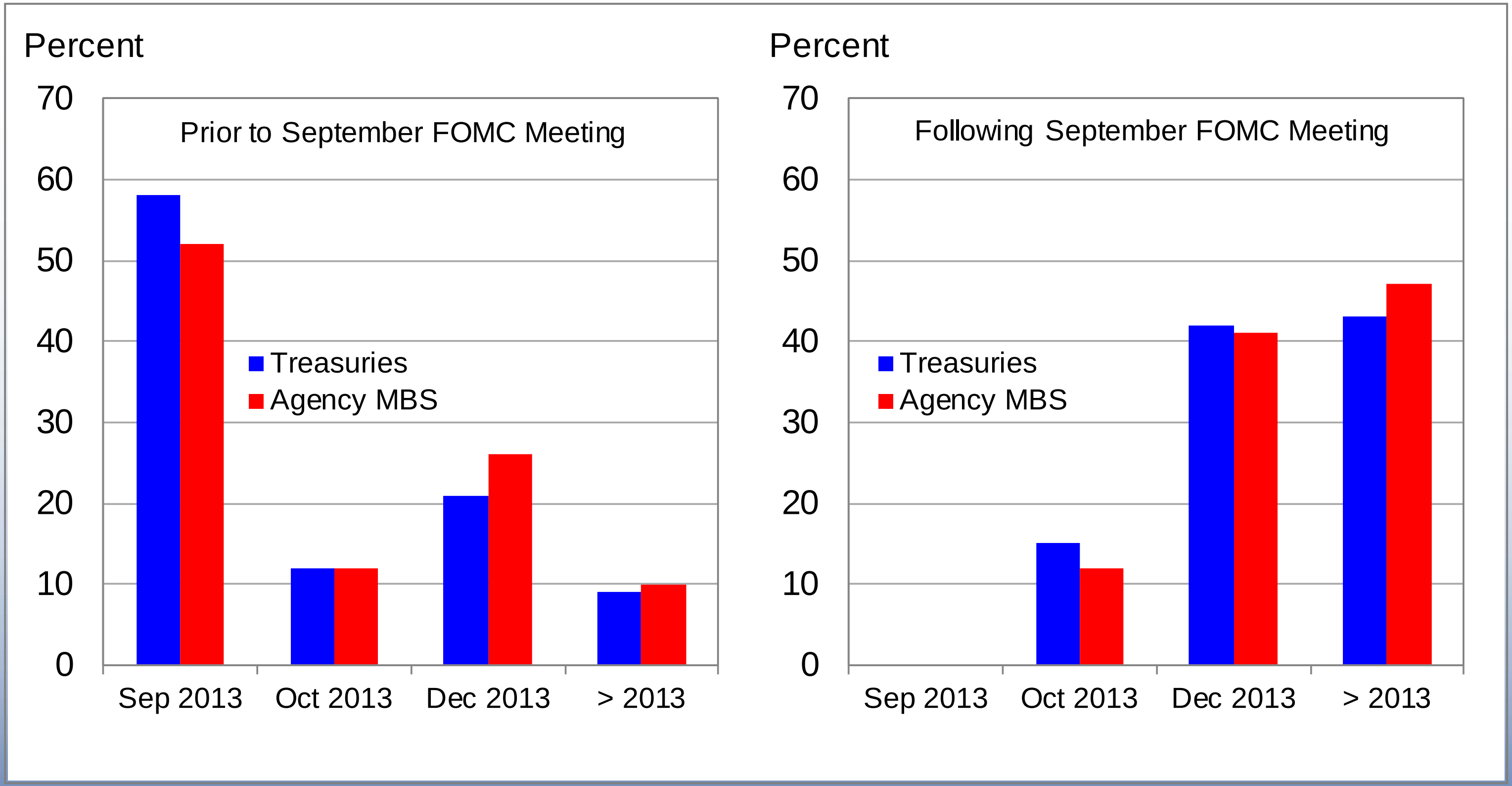
May 1, 2013, September 16, 2013, and October 31, 2013




Source: U.S. Department of the Treasury

# Figure 2
# Primary Dealer Survey Results: Distribution of Probabilities for the Timing of First Reduction

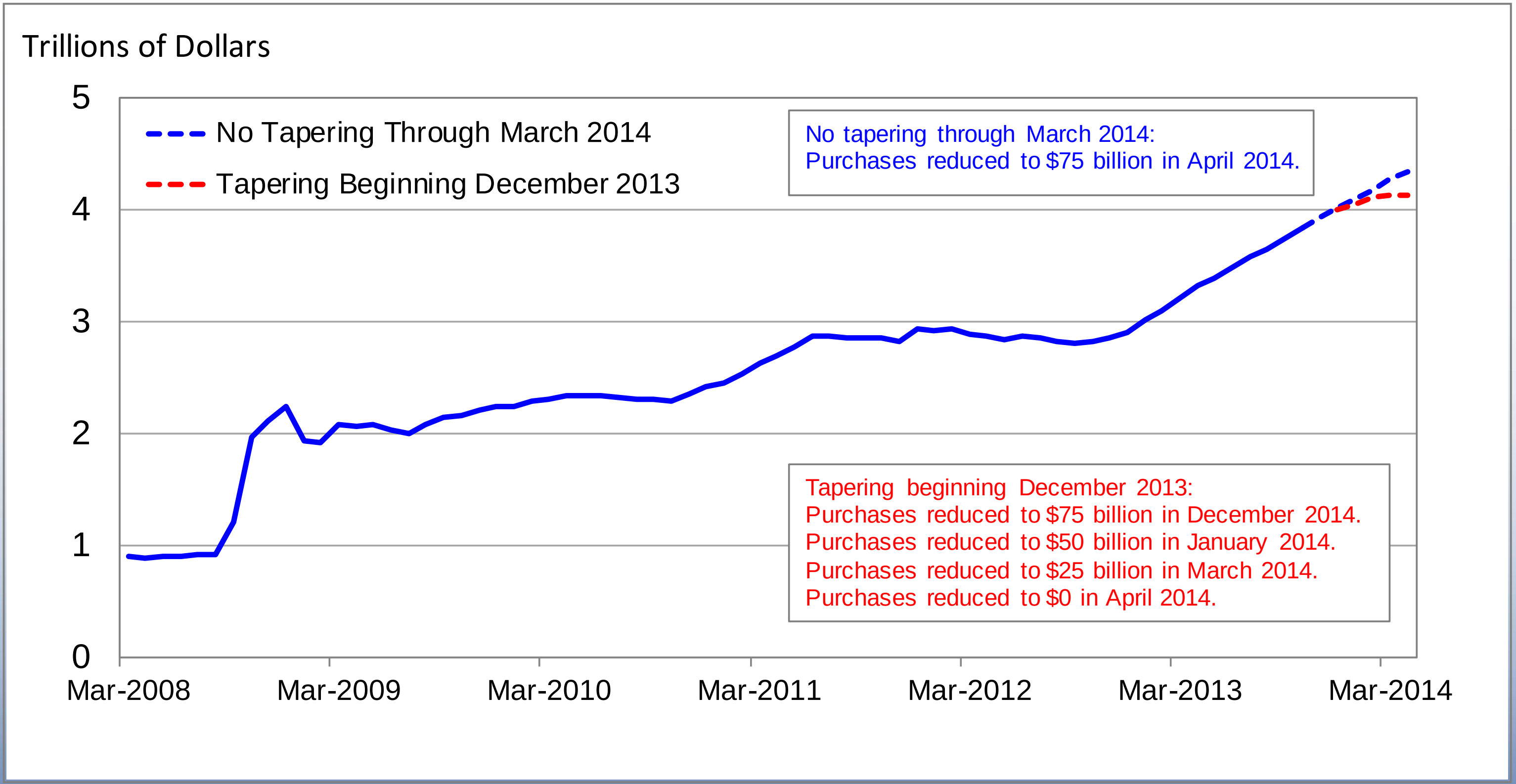
Survey Results as of September 9, 2013 and Updated as of September 23, 2013




Source: Federal Reserve Bank of New York, *Survey of Primary Dealers*, September 2013

# Figure 3
# Federal Reserve System Assets and Projections

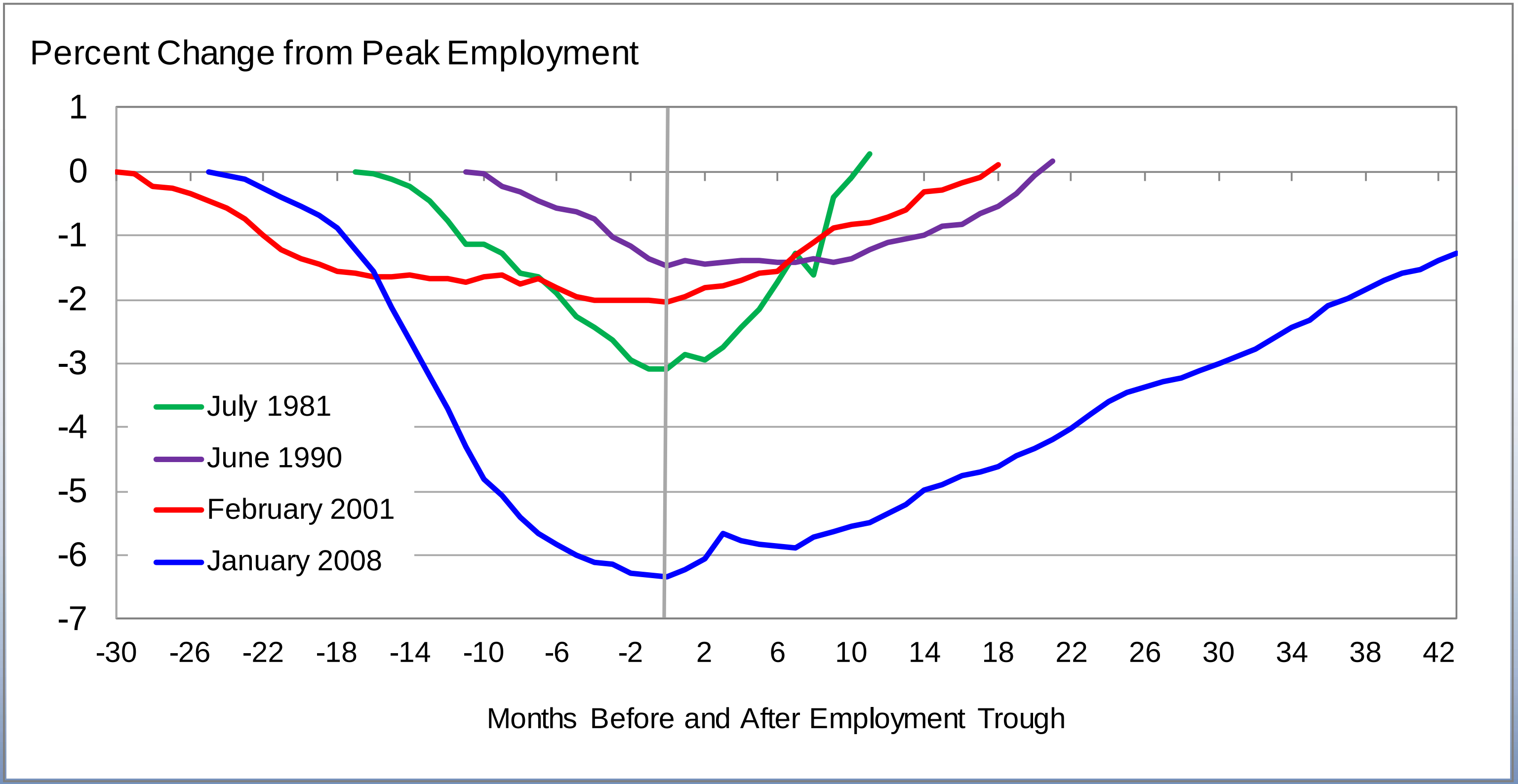
March 2008 - October 2013 Actual, November 2013 - April 2014 Projected




Source: Federal Reserve Statistical Release H.4.1 / Haver Analytics and author's calculations

# Figure 4
# Employment Change from Peak Employment

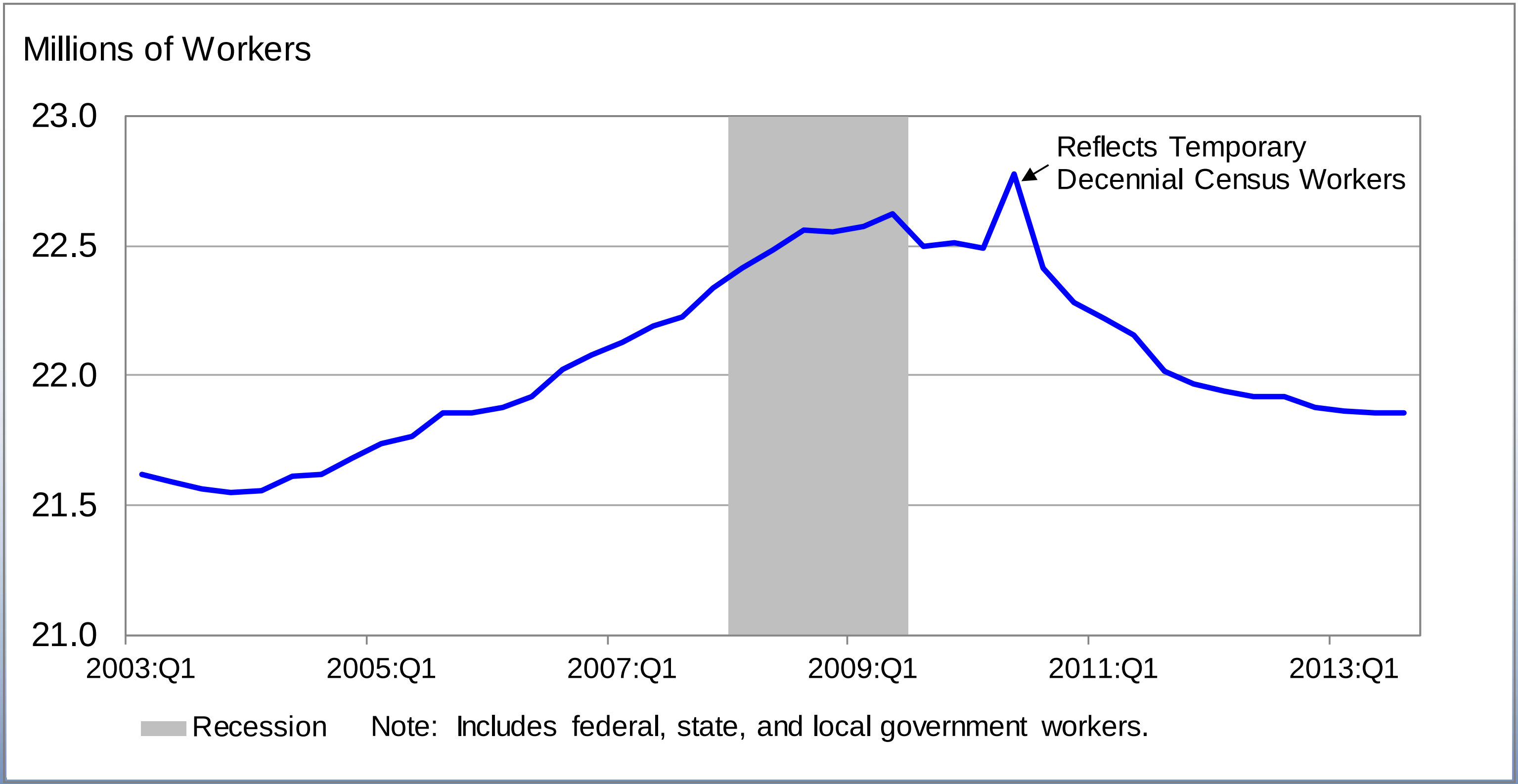
Most Recent and Three Previous Peaks




Source: BLS, NBER / Haver Analytics

# Figure 5
# Government Employment

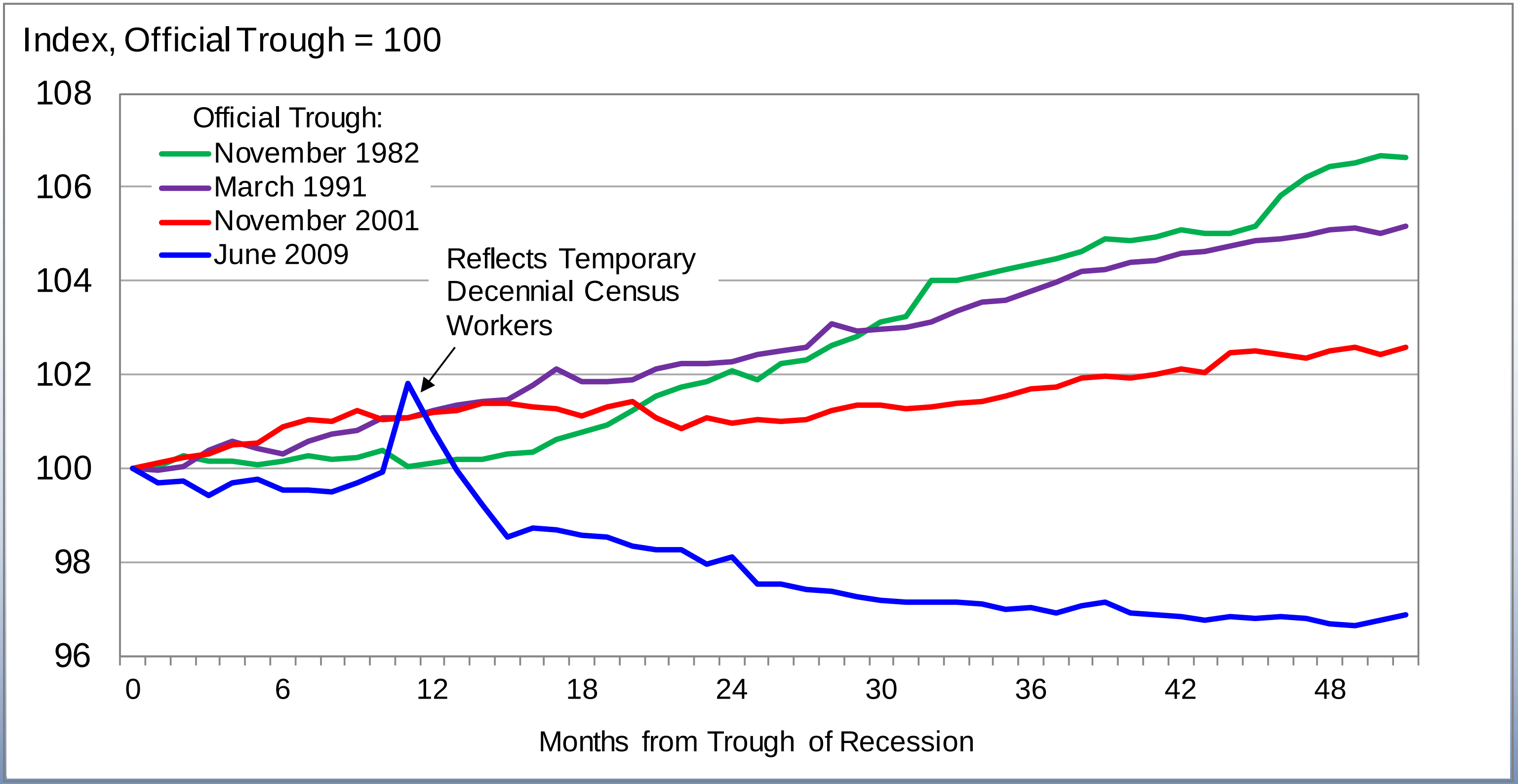
2003:Q1 - 2013:Q3




Source: BLS, NBER / Haver Analytics

# Figure 6
# Government Employment
# Change from Official Trough

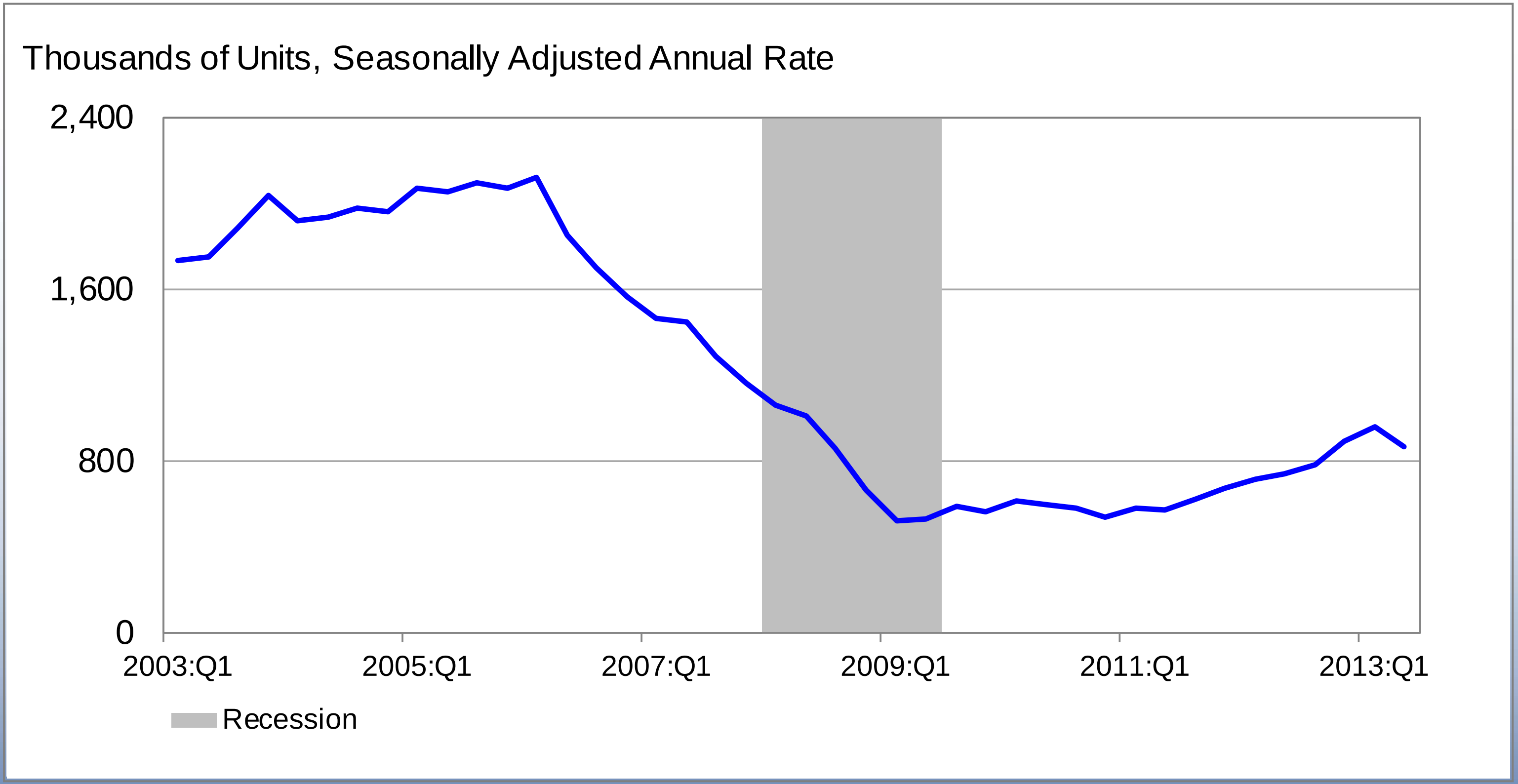
Current and Three Previous Recoveries




Source: BLS, NBER / Haver Analytics

# Figure 7
# Housing Starts

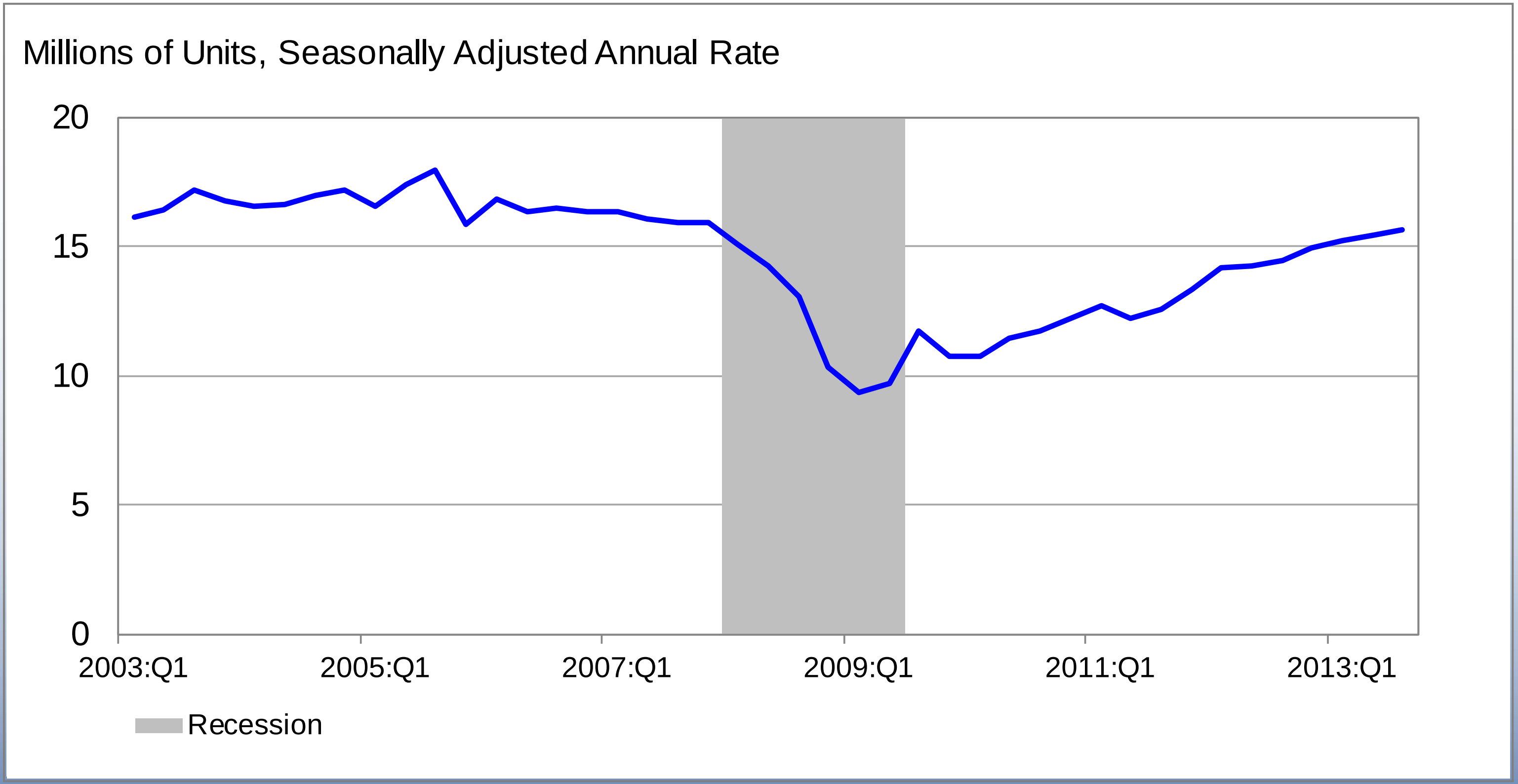
2003:Q1 - 2013:Q2




Source: Census Bureau, NBER / Haver Analytics

# Figure 8
# Auto and Light Truck Sales

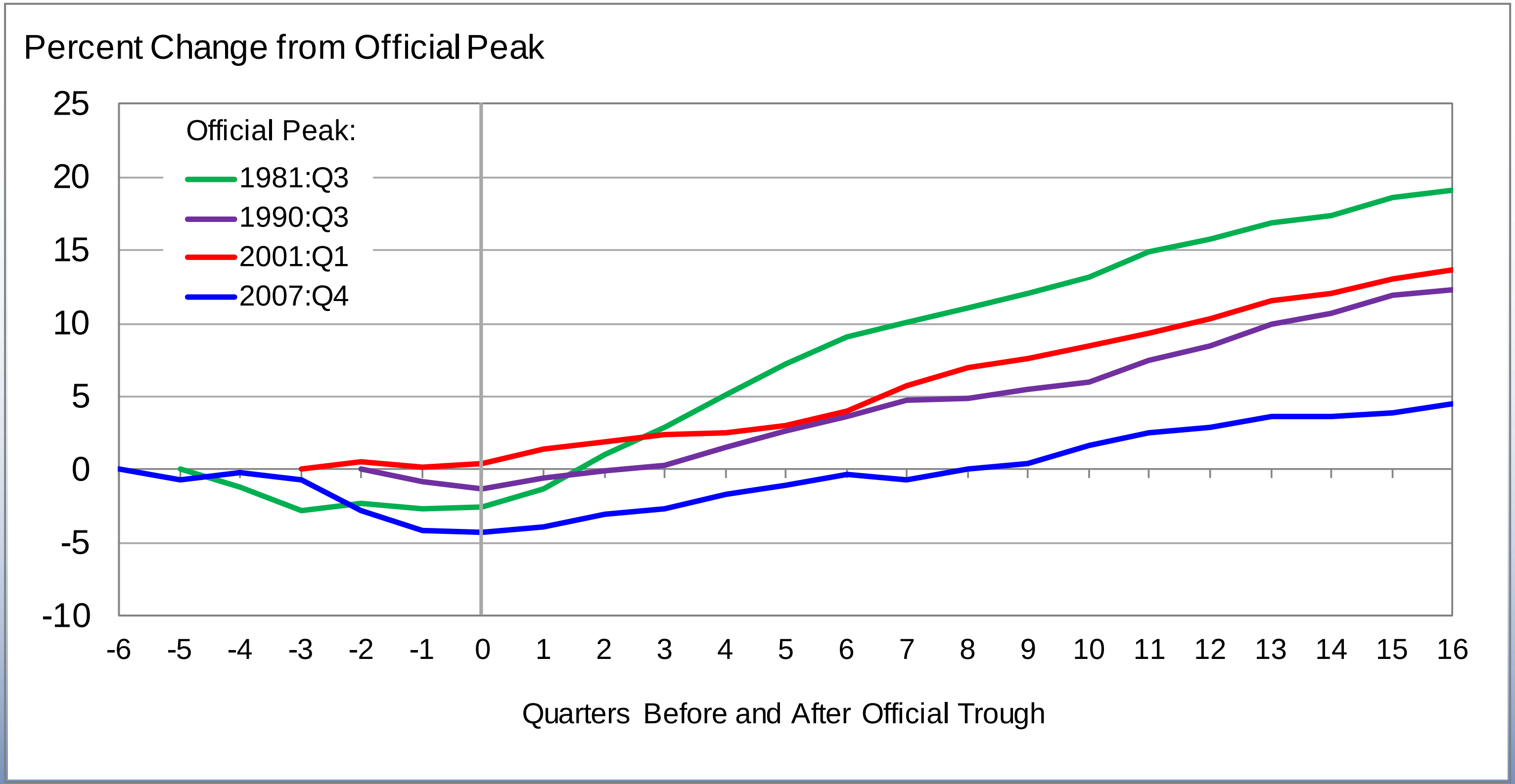
2003:Q1 - 2013:Q3




Source: BEA, NBER / Haver Analytics

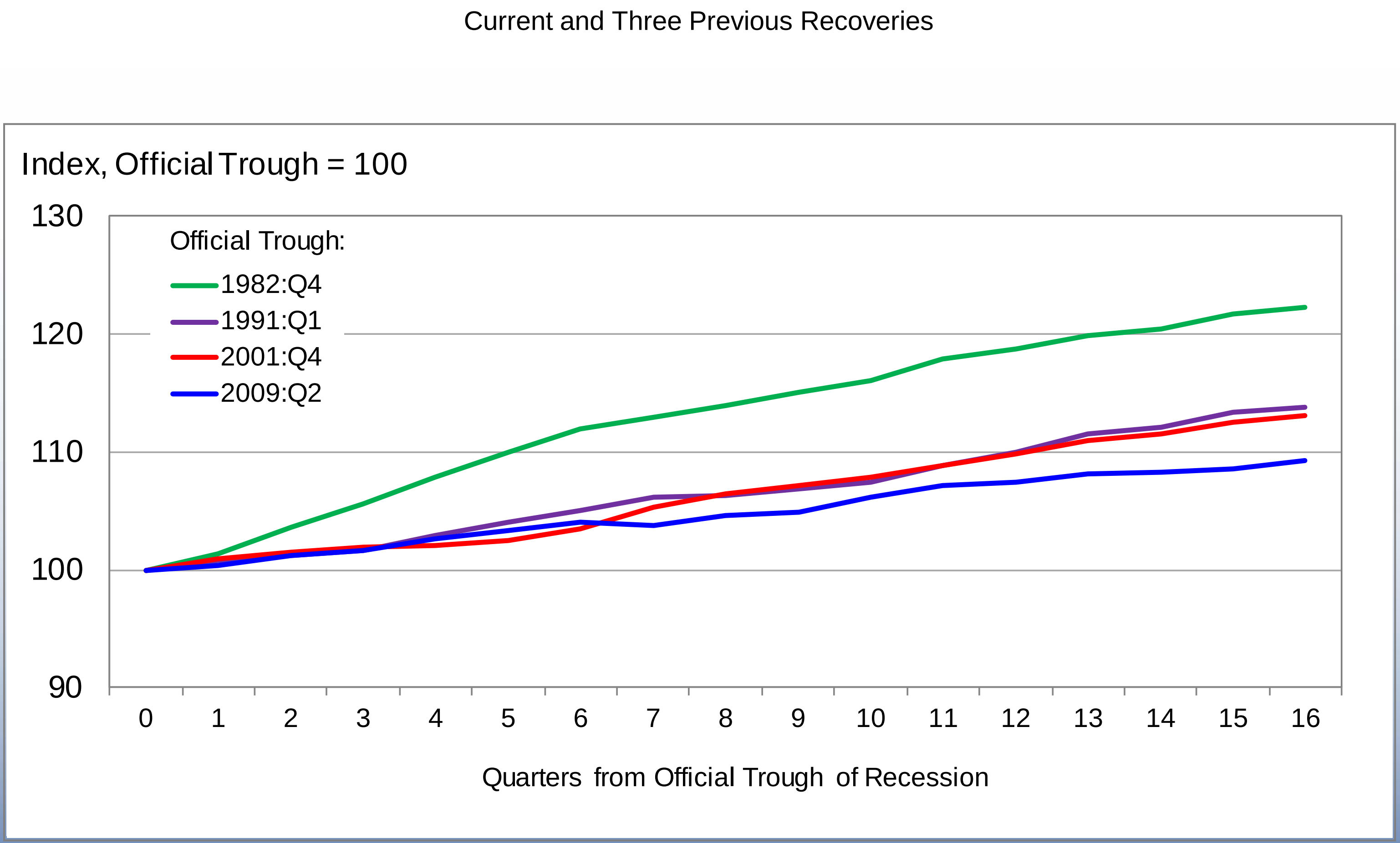
# Figure 9
# Change in Real GDP from Official Business Cycle Peak

Most Recent and Three Previous Peaks



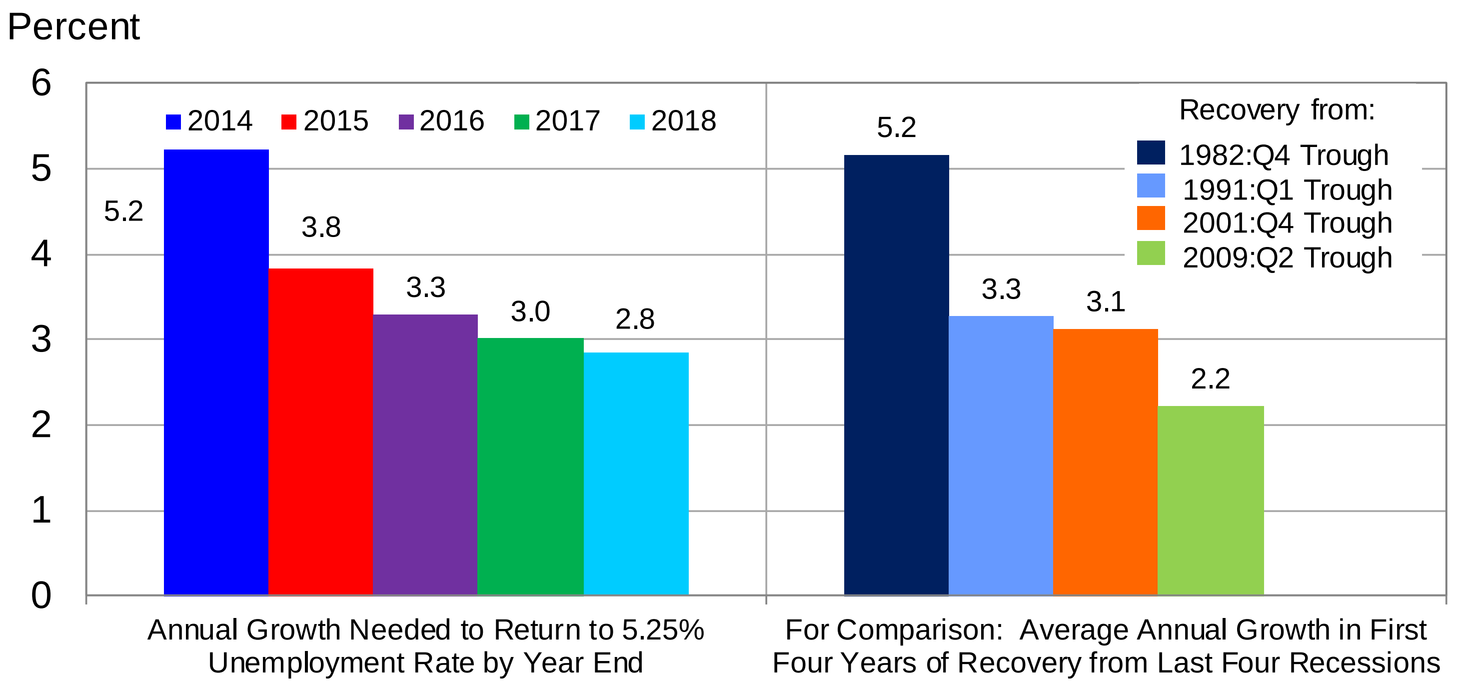

Source: BEA, NBER / Haver Analytics

# Figure 10
# Change in Real GDP from Official Trough




Source: BEA, NBER / Haver Analytics

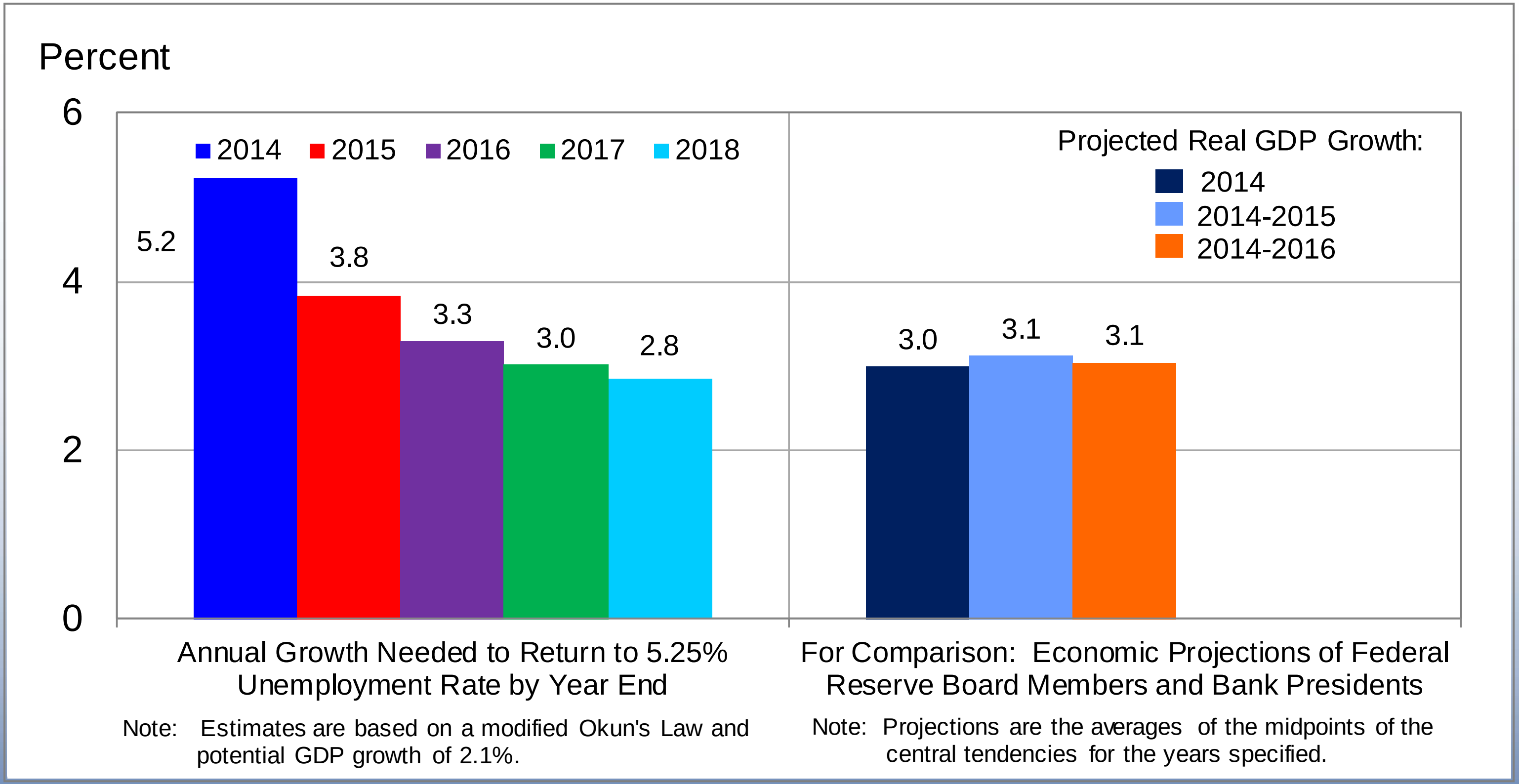
# Figure 11
# Estimates of Annual Real GDP Growth Needed to Return to Full Employment




Note: Estimates are based on a modified Okun's Law and potential GDP growth of 2.1%.

Source: BEA, NBER / Haver Analytics and author's calculations

# Figure 12
# Estimates of Annual Real GDP Growth Needed to Return to Full Employment




Source: BEA, NBER, FOMC Summary of Economic Projections / Haver Analytics and author's calculations

# Concluding Observations

- Highly accommodative monetary policy has partially mitigated the effects of the financial crisis, significant fiscal restraint, and slow growth of trading partners
- Remove the degree of accommodation as headwinds subside, economic growth increases, and labor markets improve
- Monetary policy is likely to need to remain accommodative for some time to achieve full employment within a reasonable forecast horizon

# Policy Conclusions

- Policy should be data driven, mandate focused, and achieve goals in an appropriate timeframe
  - We likely need to leave short-term interest rates at very low levels until there is much more progress reaching full employment and the inflation target
  - The pace at which the Fed raises rates, when that becomes appropriate, should be quite gradual, unless the economy picks up much faster than currently expected