The Outlook and Current Policy Challenges

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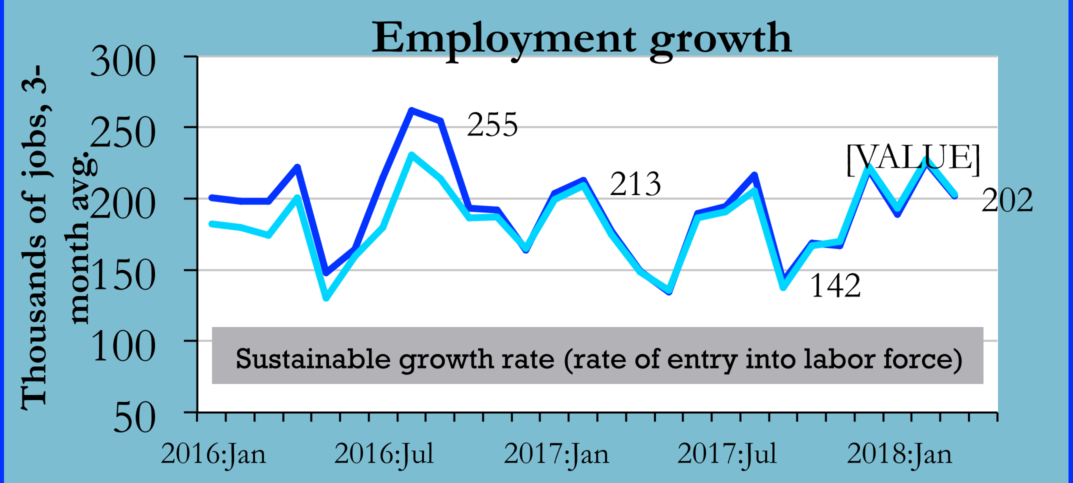
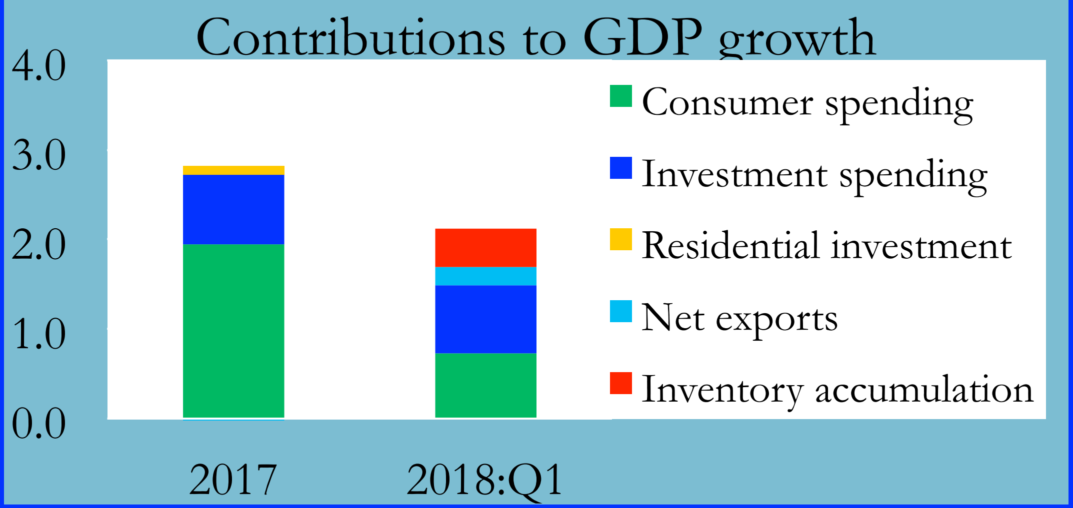
I have to say this…

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

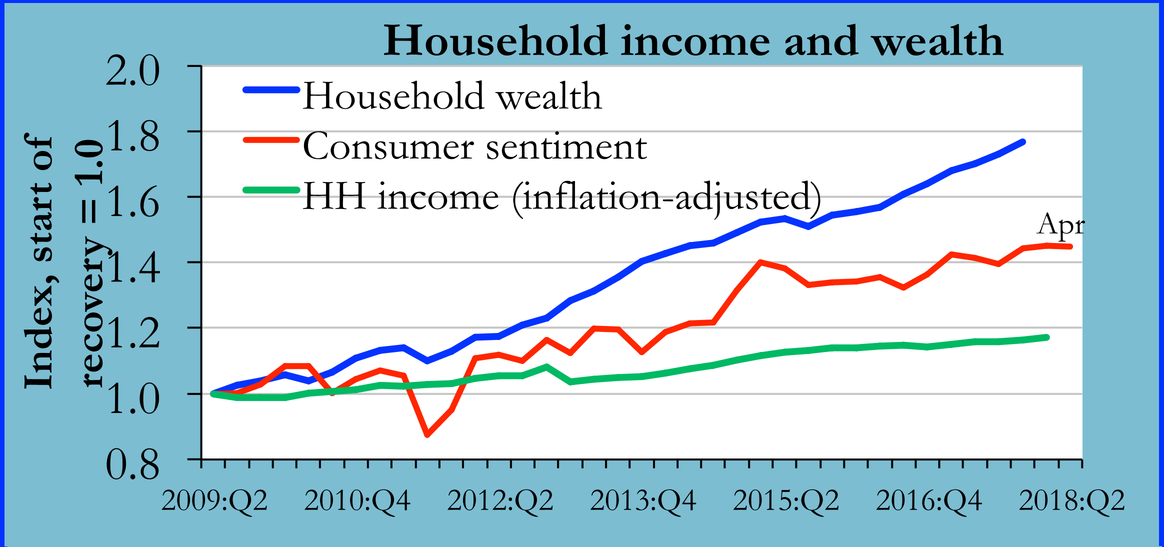


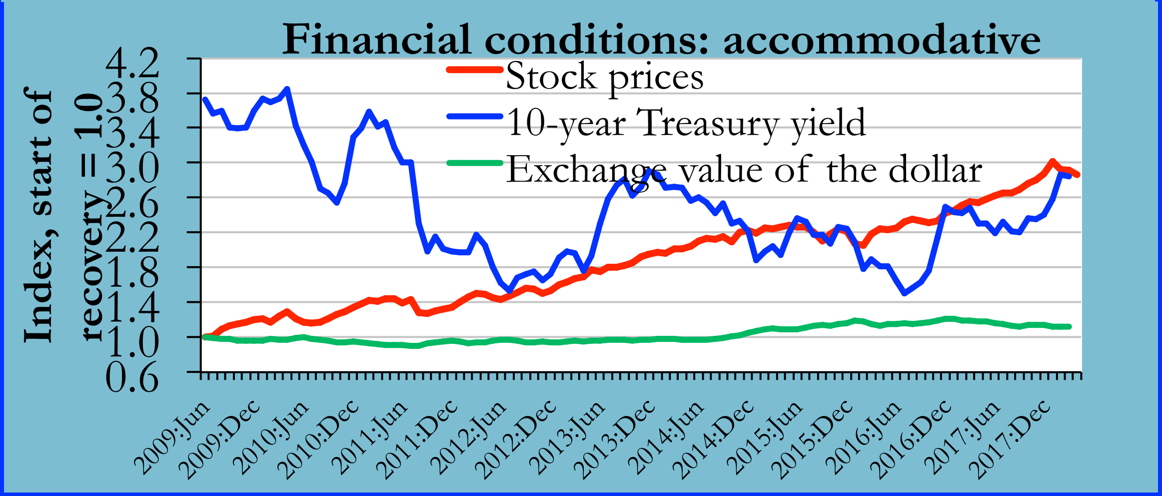


Sources: Bureau of Labor Statistics (employment), Bureau of Economic Analysis (GDP), author's calculations, Haver Analytics

A quick look at the underpinnings

- 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

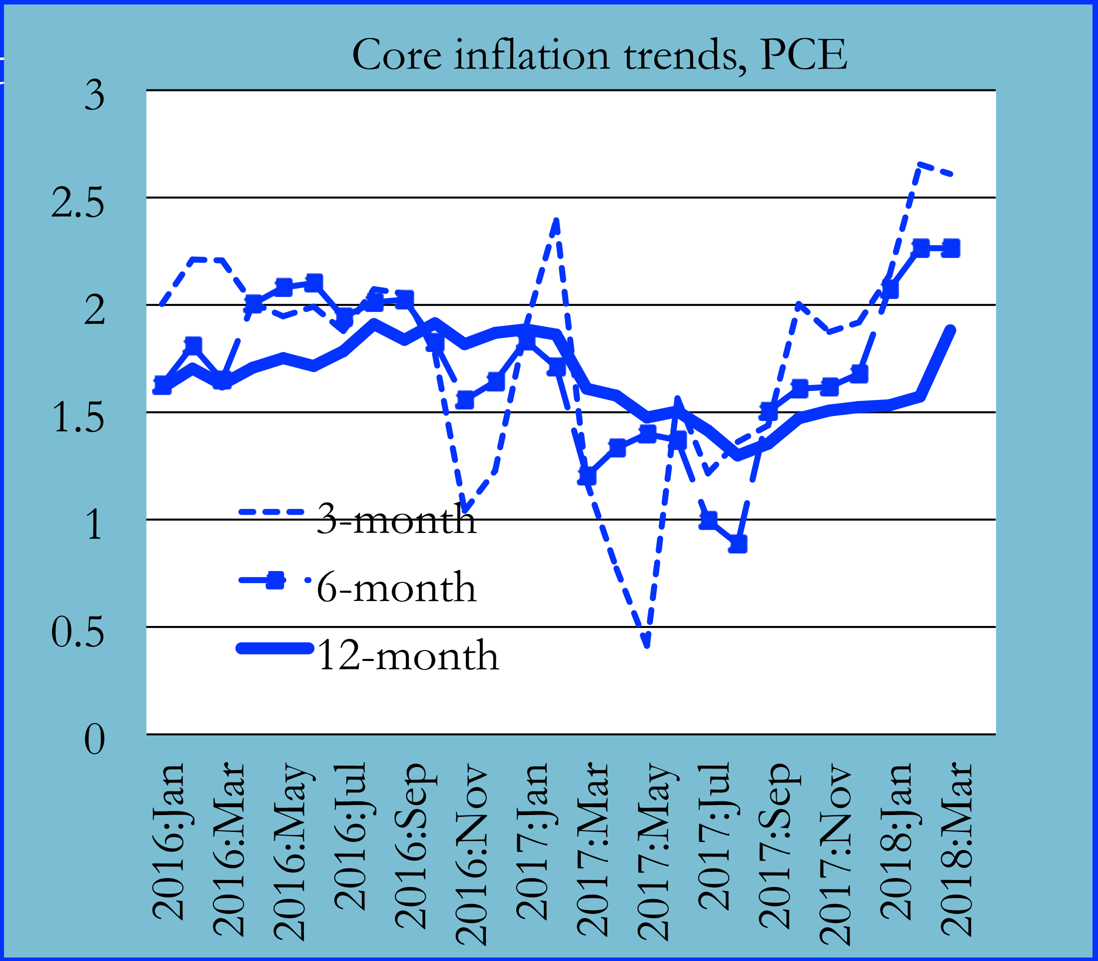




Sources: Flow of Funds (wealth), BEA (income), Wall Street Journal (stock prices), Federal Reserve (Treasury yield, exchange rate), Haver Analytics

Inflation trends

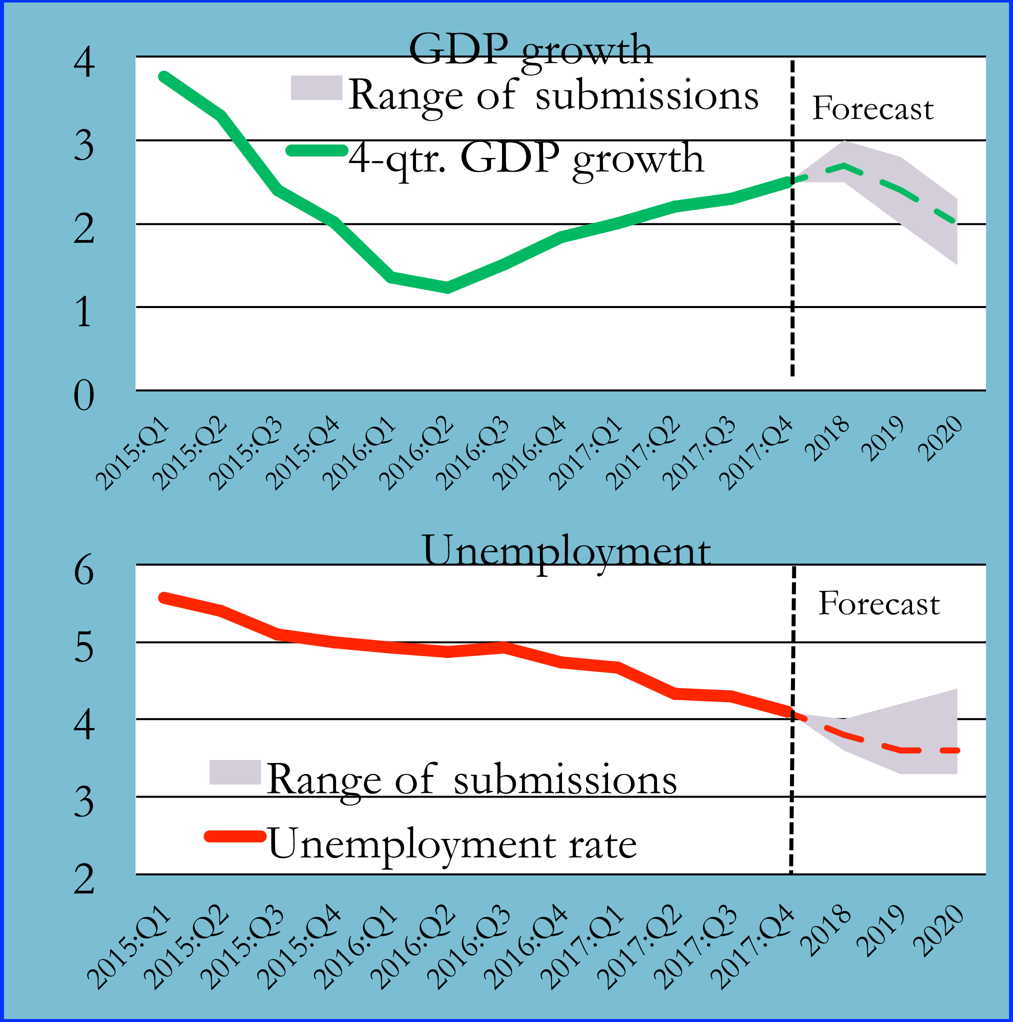
- Now approximately at our 2% goal
  - Earlier, temporary factors held down inflation
  - Those have faded
- Core inflation (PCE) currently at 1.9% for past 12 months
  - 2.25% for past 6 months, annualized



Source: BEA (PCE inflation), Haver Analytics

Outlook (FOMC's March 2018 projections)

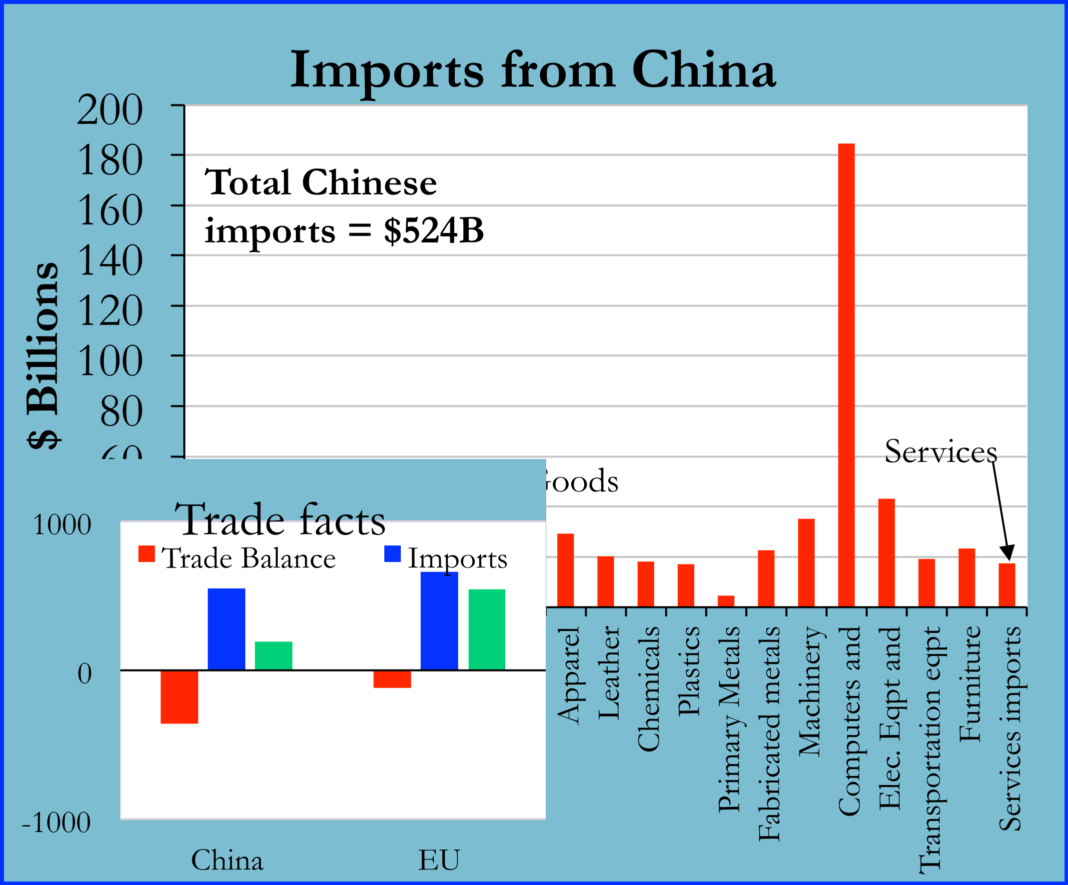
- Above-trend growth
  - For 2018, 2019
  - At or a bit below trend in 2020?
- Falling unemployment
  - To the mid-3's?
- Gradually rising inflation
  - Near 2% this year (by Q4)
  - A bit higher later on
- All conditioned on gradually rising interest rates



Sources: BEA (GDP), BLS (unemployment), Summary of Economic Projections (Board of Governors), Haver Analytics

Trade Wars—a downside risk

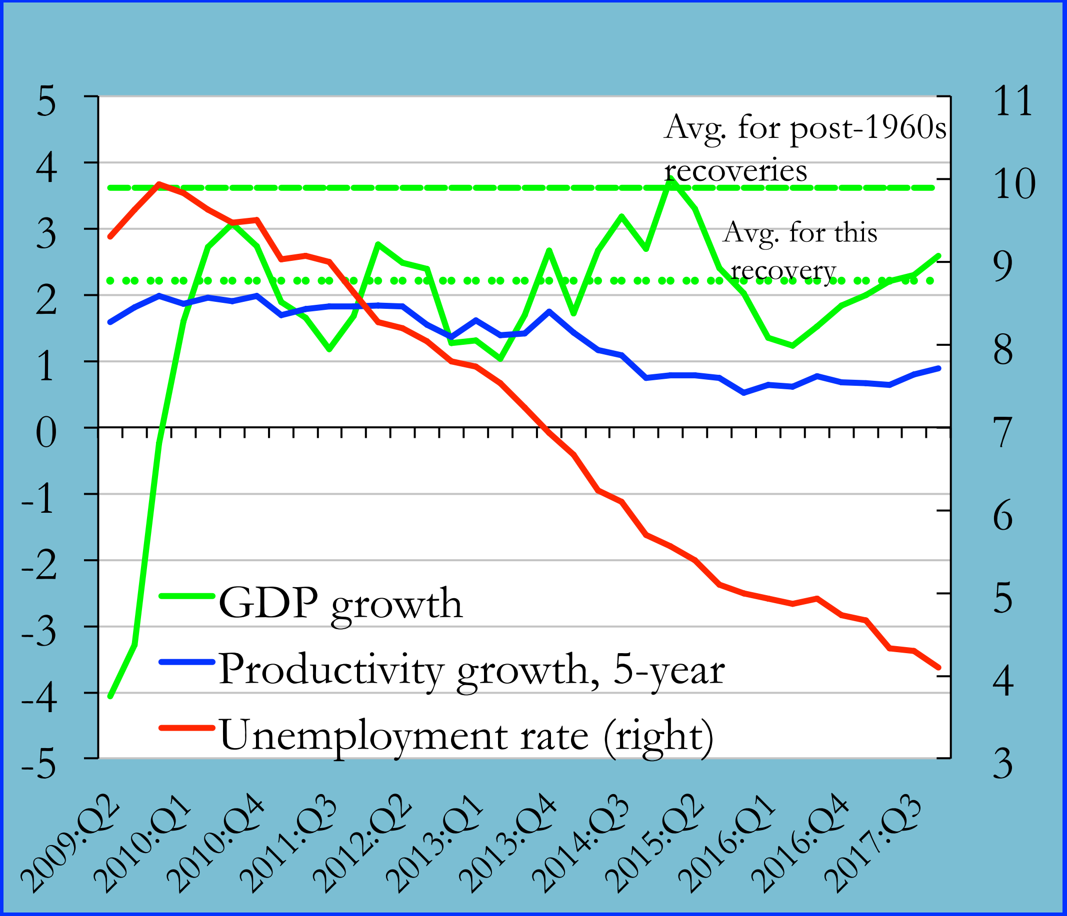
- Old news: Aluminum, steel (<2% of imports)
- New news: Exemptions from steel, aluminum tariffs for allies
- Newer news: US tariffs on Chinese imported goods—IP related?
  - No details yet.
- Newest news: China pre-emptively raising tariffs on imports from US (mostly agricultural)
- Fast-changing; mostly small changes; hard to gauge net impact



Sources: Bureau of the Census (trade data), Haver Analytics

A long recovery. A slow recovery. How come?

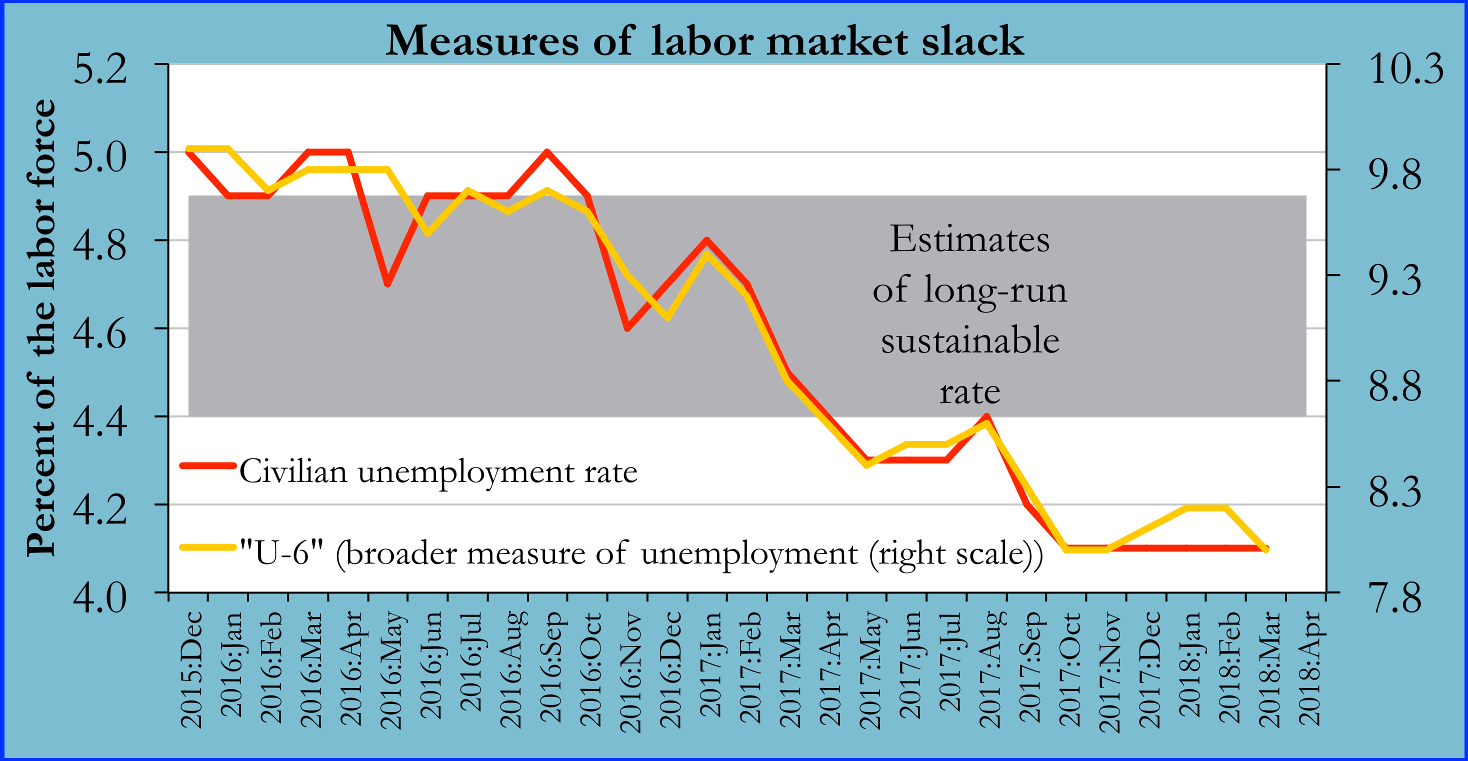
- Average growth = 2.2%
- Slow by historical standards
- Yet it produced a dramatic drop in unemployment
- Why so slow?
  - Productivity growth has been slow
  - Labor force growth slow
  - Thus "potential" or sustainable growth has been slow
  - Probably will be for a while



Sources: BEA (GDP growth), BLS (Productivity growth, unemployment rate), Haver Analytics

Why have we raised rates? Part 1: Labor markets

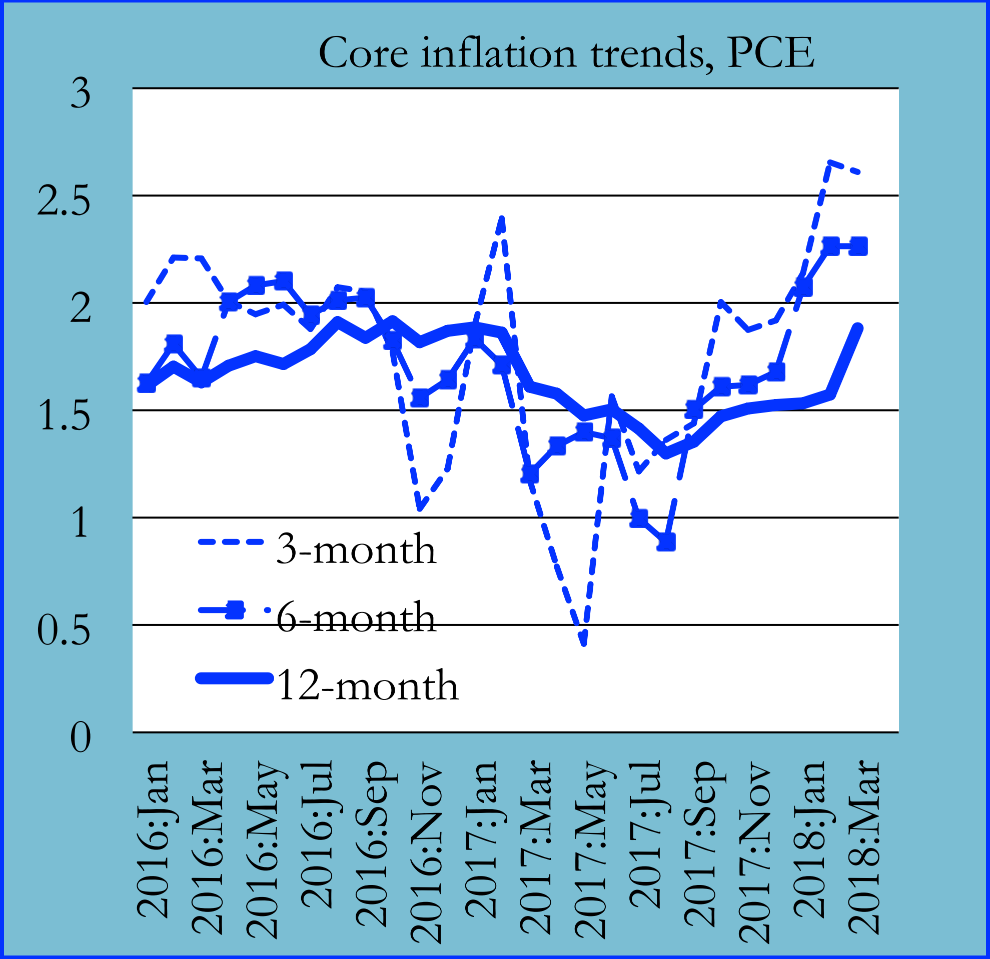
- Our responsibilities, as delegated to us by Congress:
  - The "Dual Mandate": low inflation, maximum (sustainable) employment
  - Where are we in achieving these goals? First, employment:



Sources: Bureau of Labor Statistics (unemployment, employment, AHE wage growth, nonfarm compensation), Haver Analytics

Why have we raised rates? Part 2: Inflation

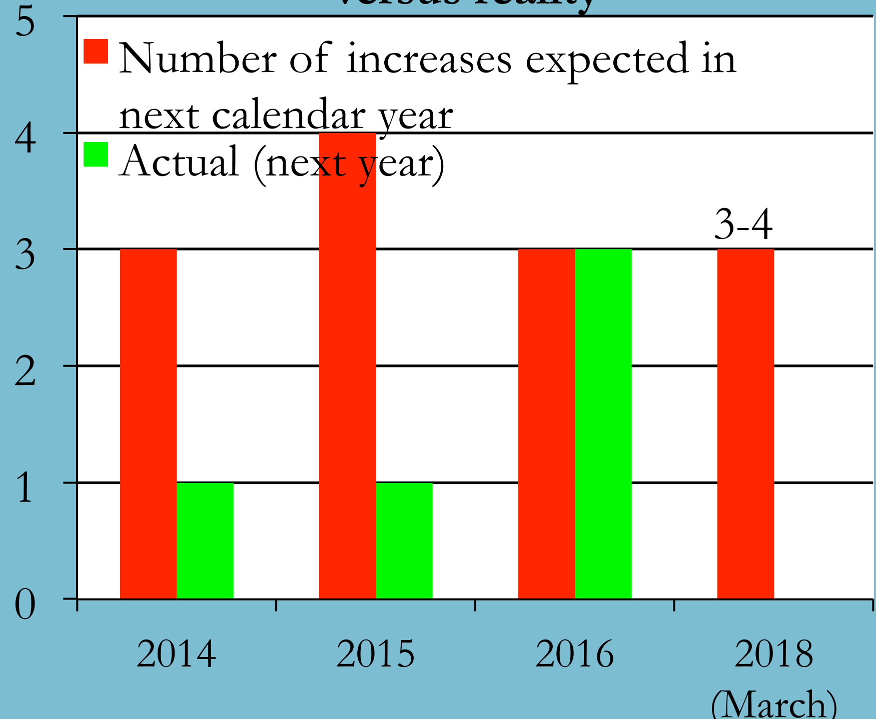
- You saw this chart before
- What's our goal? **2%**
- How close are we?
  - Pretty darned close
  - Dip below 2% appears to have been temporary
- If unemployment dips well below 4%, will nothing happen?
- **<u>Expect gradual rise to 2% and a bit above</u>**



Sources: Bureau of Economic Analysis, Haver Analytics

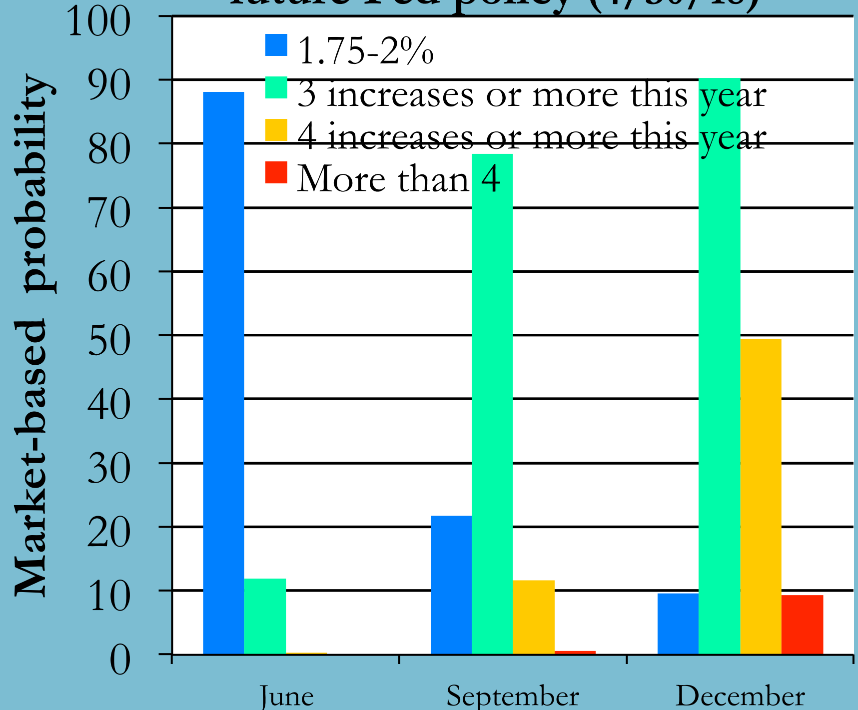
Current policy assessments
(Policymaker and financial market assessments)

Fed's predictions of rate increases versus reality



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

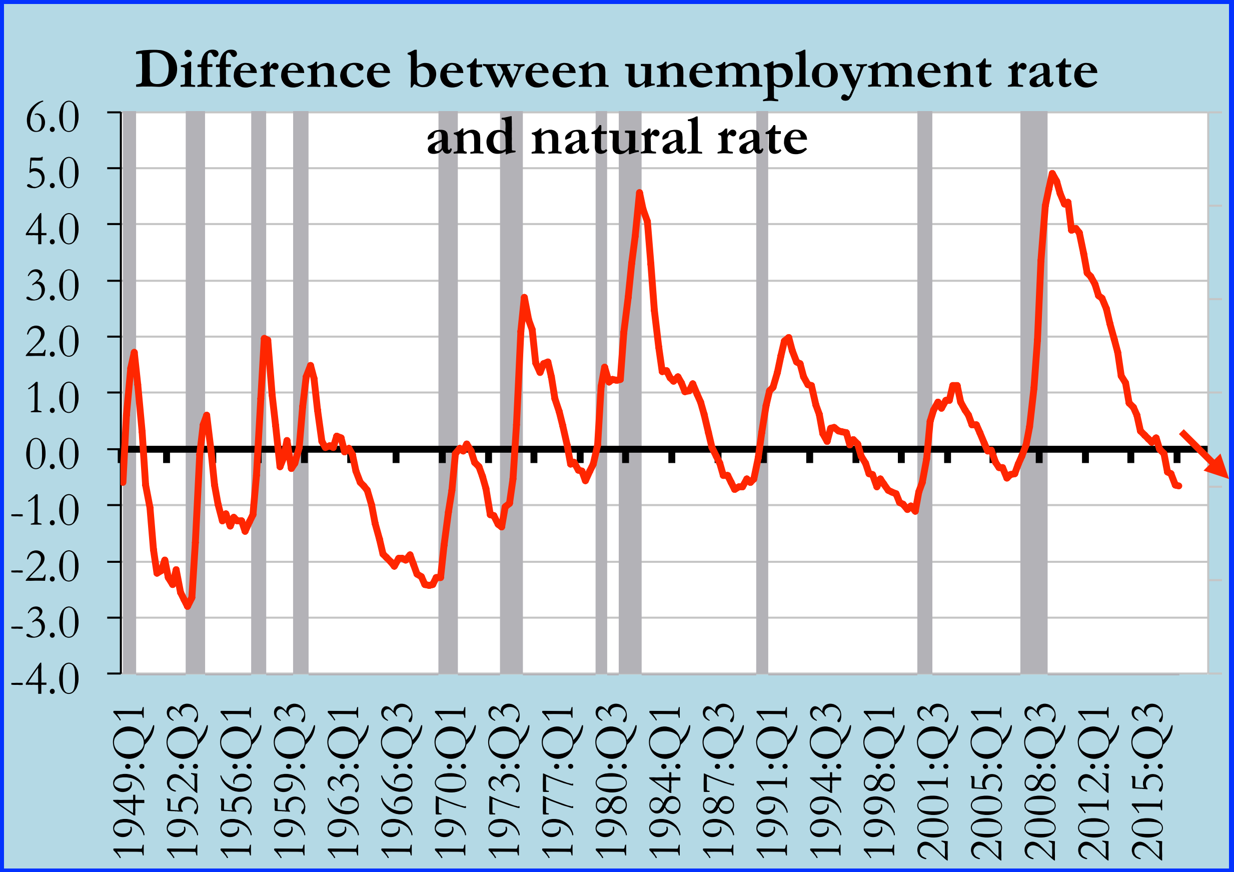
Financial market assessments of future Fed policy (4/30/18)



Source: Summary of Economic Projections, 9/20/17, Federal Reserve Board, CME Group FedWatch tool
http://www.cmegroup.com/trading/interest-rates/countdown-to-fomc.html/

A risk to too-low interest rates

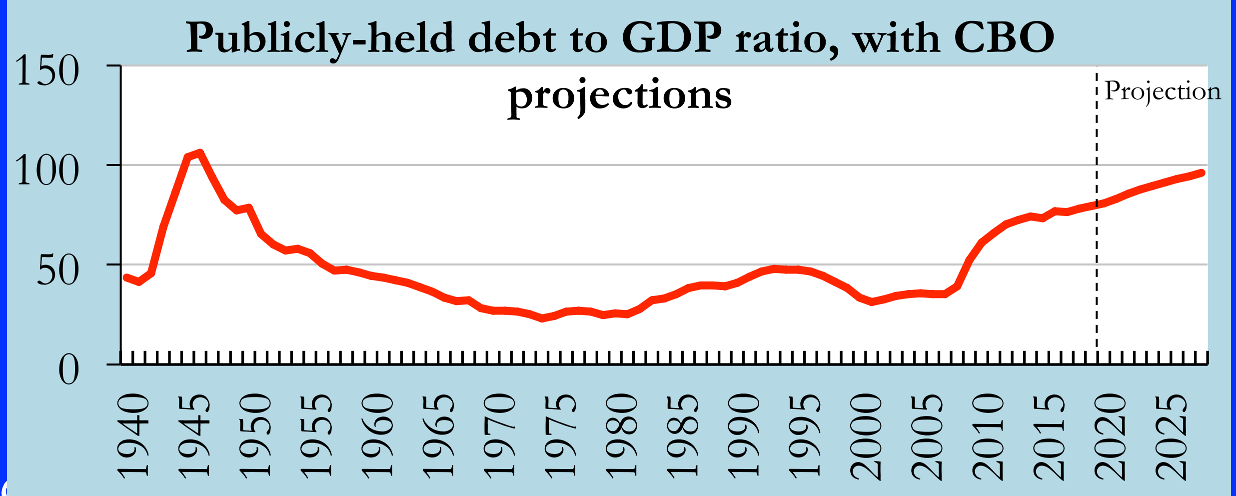
- Low rates imply falling unemployment
- In <u>every</u> episode post WW II, unemployment slipping <u>too far</u> below normal leads to a recession—and/or financial upheaval
- We'd prefer a stable, sustained recovery

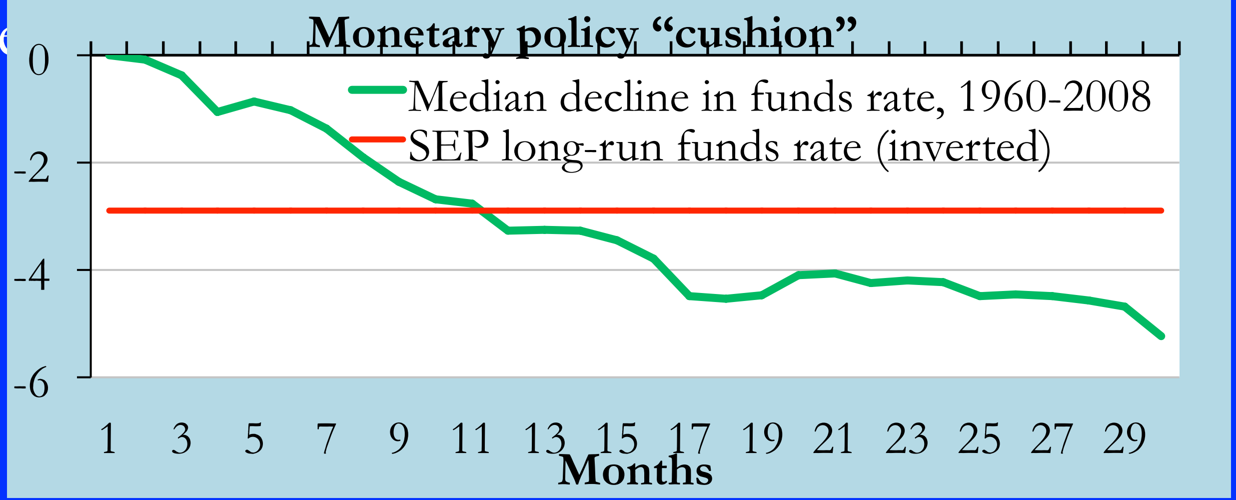


Sources: Bureau of Labor Statistics (unemployment rate), Congressional Budget Office (natural rate of unemployment), Haver Analytics

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?

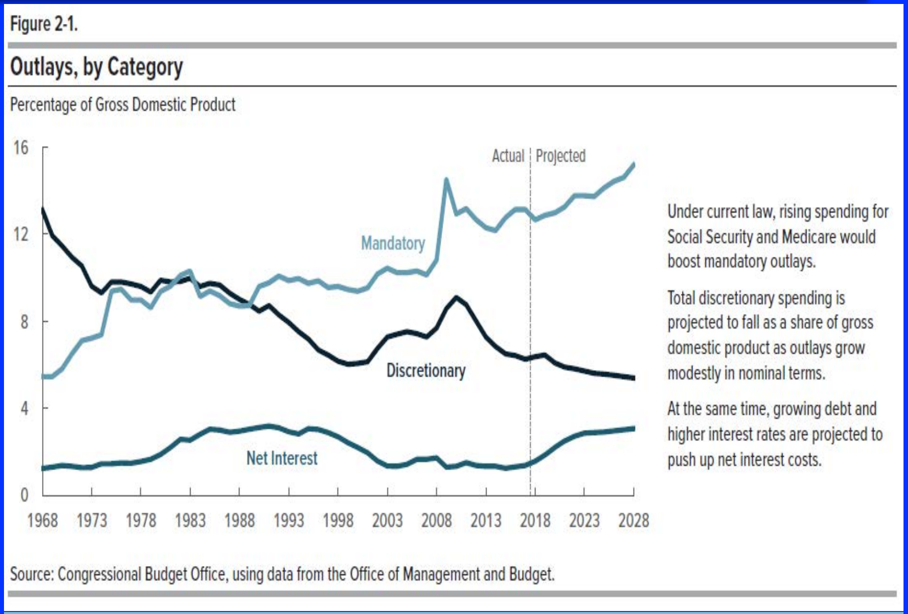


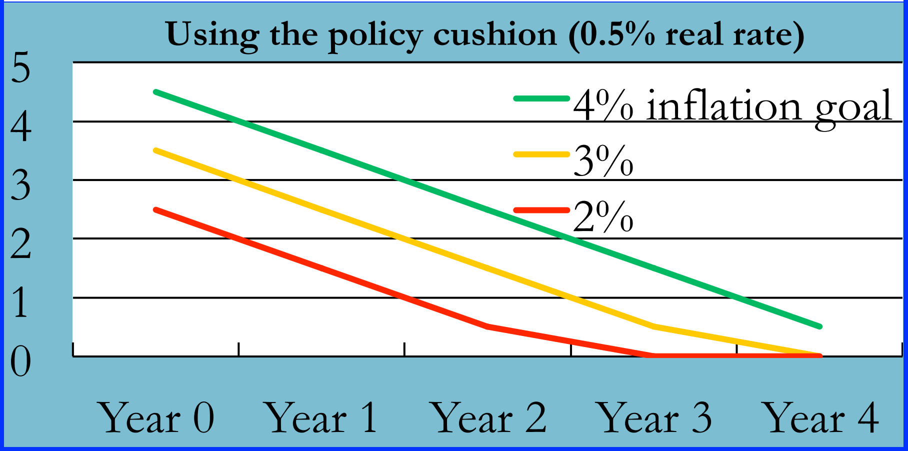


Sources: CBO (debt projections), Wall Street Journal (funds rate), Board of Governors (SEP long-run rate), Haver analytics

Ways to improve policy capacity

- Fiscal policy
  - Up to Congress
  - Given near-certain and immediate increases in Medicare and Social Security expenses, sooner is better
- Monetary policy
  - Raise the inflation goal (increase "cushion")
  - Adopt a flexible inflation goal (likewise)
  - Use QE?





Sources: CBO (outlays), author's calculations.

New leadership at the Fed

- Change at the top
- What does it mean?
  - Mostly, continuity, on
    - Monetary Policy, and
    - Regulation
- Other openings
  - Vice Chairman of the Board of Governors (Clarida, new!)
  - Three other Governor slots (one community banker nominated!)
  - President of the NY Fed (Williams, new!)

Jay Powell