

U.S. Economic Outlook

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The views expressed in this presentation are those of the author and do not necessarily represent the views of the Federal Reserve Bank of Boston or the Federal Reserve System.

Outline

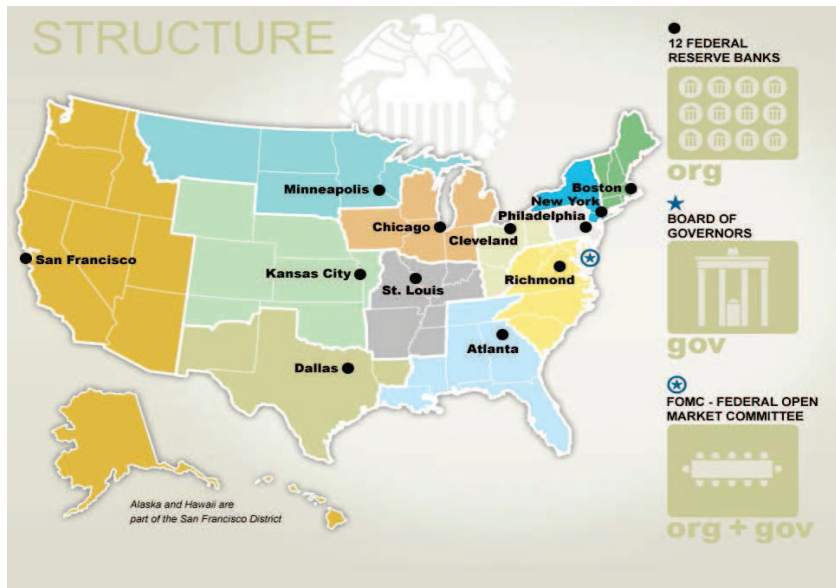
- 1 Background on the Federal Reserve
- 2 Current Economic Indicators and Outlook
- 3 The Road Ahead

1. What is the Federal Reserve?

The Federal Reserve is the central bank of the U.S. and has several responsibilities:

- Monetary policy
- Lender of last resort
- Bank regulation
- Payments system

1. What is the Federal Reserve?



1. What determines monetary policy?

- Price level, inflation, output, and financial stability
- Required by congress: maximum employment, stable prices, and moderate long-term interest rates
 - First two goals known as “dual mandate”
- What does historically?
 - Inflation, unemployment, output growth, and financial instability

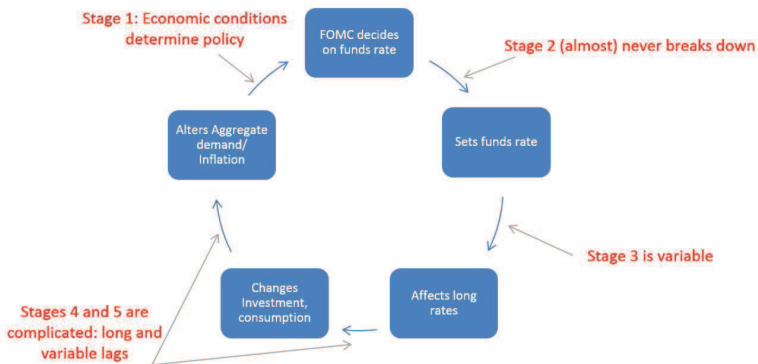
1. Dual Mandate.

- Two Goals:
 - Stable prices (low inflation)
 - Inflation goal: 2 percent per year
 - Maximum (sustainable) employment
 - Target often stated in terms of the unemployment rate relative to the so-called natural rate of unemployment or NAIRU (non-accelerating inflation rate of unemployment)

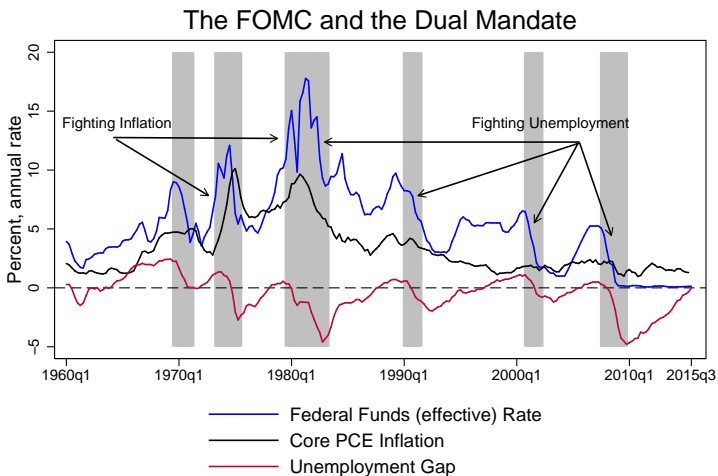
1. How can monetary policy achieve these goals?

- Monetary policy: “Actions undertaken by a central bank, such as the Federal Reserve, to influence the availability and cost of money and credit to help promote national economic goals.”

(Source: <http://www.federalreserve.gov/monetarypolicy/fomc.htm>)



1. Has the FOMC been successful historically?

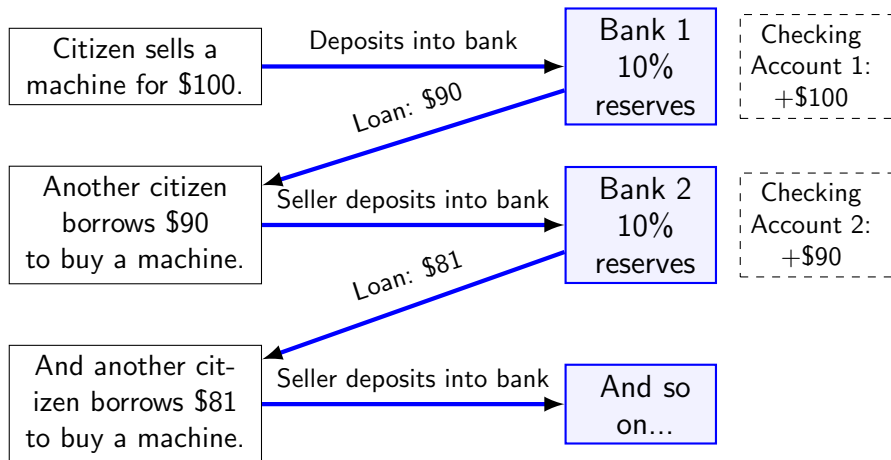


Source: FRB/BEA/BLS/CBO/Haver Analytics

1. How does the FOMC “set” the “interest rate”?

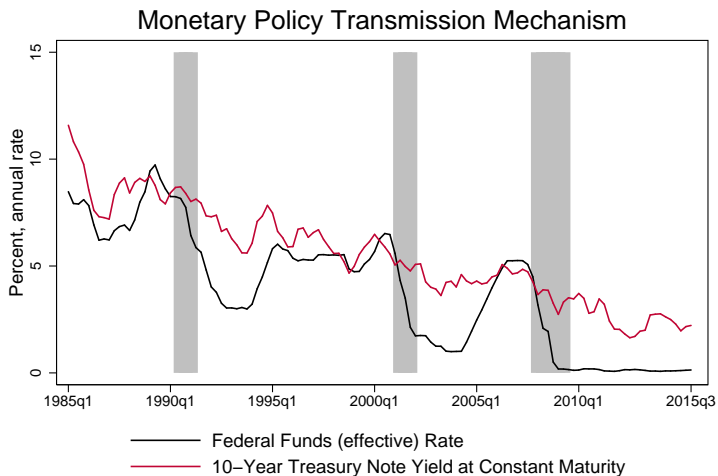
- The Federal Reserve requires banks to hold a minimum level of reserves based on their deposits, which can influence banks' funds available for lending
- Banks with excess reserves (liquidity) can lend to banks needing reserves to cover deposit shortfalls/lending needs.
- The FOMC sets a *target* for the Federal Funds Rate (FFR) — the overnight interest rate used by banks to borrow/lend reserve balances

1. The banking system: A stylized example.



- The initial \$100 deposit has been followed by creation of \$171 in new money. Bank reserves have increased by \$19.

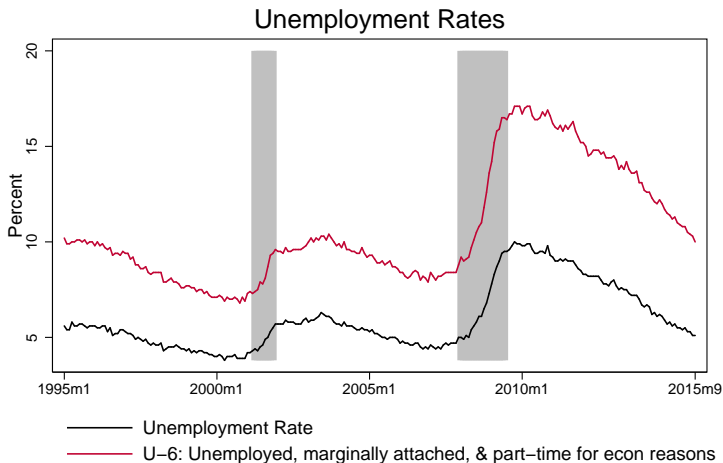
1. The transmission of monetary policy in action.



Source: Federal Reserve Board/Haver Analytics

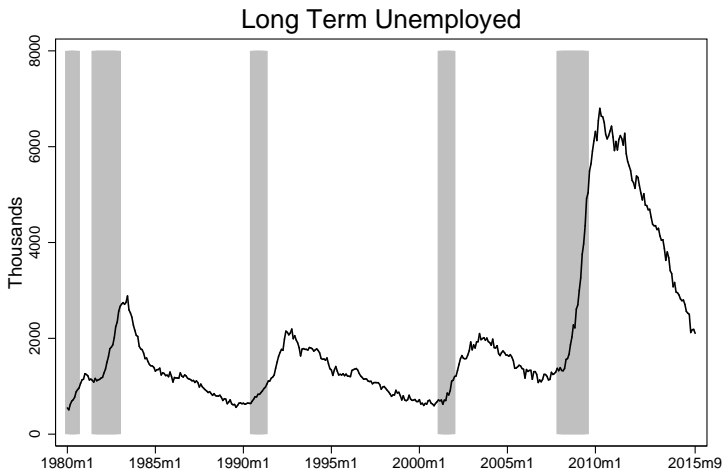
The Labor Market

2. The U.S. labor market has improved notably since the Great Recession. Unemployment is down...



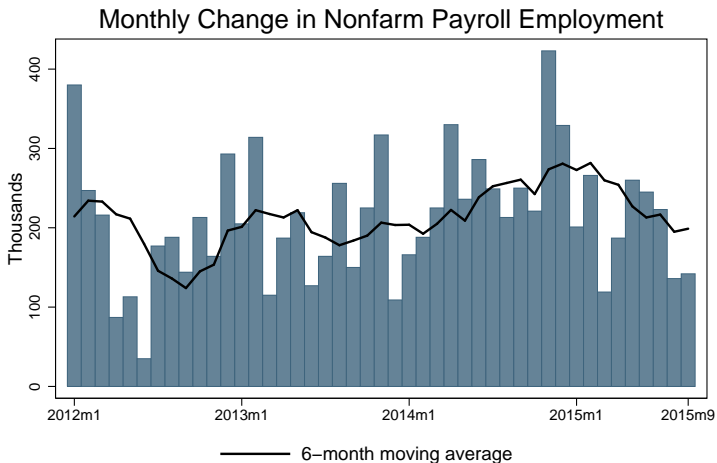
Source: Bureau of Labor Statistics/Haver Analytics
 Note: Seasonally Adjusted, 16 years-old and older

2. ...and the long-term unemployment rate is much improved.



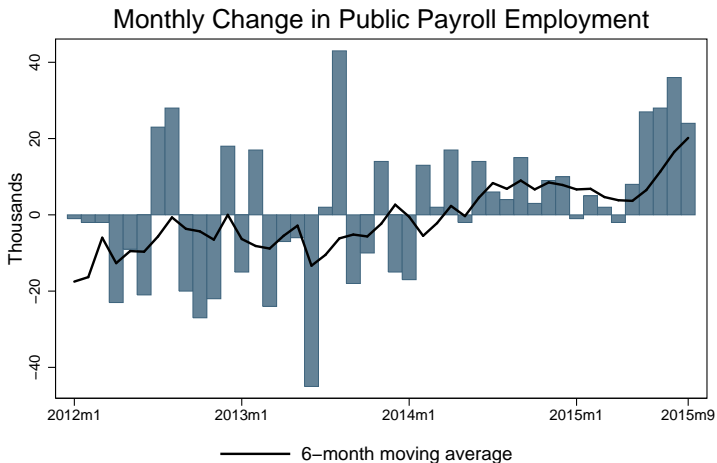
Source: Bureau of Labor Statistics/Haver Analytics
Note: Seasonally Adjusted

2. Nonfarm payroll gains also have been strong, although payroll growth has slowed a bit recently.



Source: Bureau of Labor Statistics/Haver Analytics
 Note: Seasonally Adjusted

2. In comparison, public sector employment has improved in recent months.

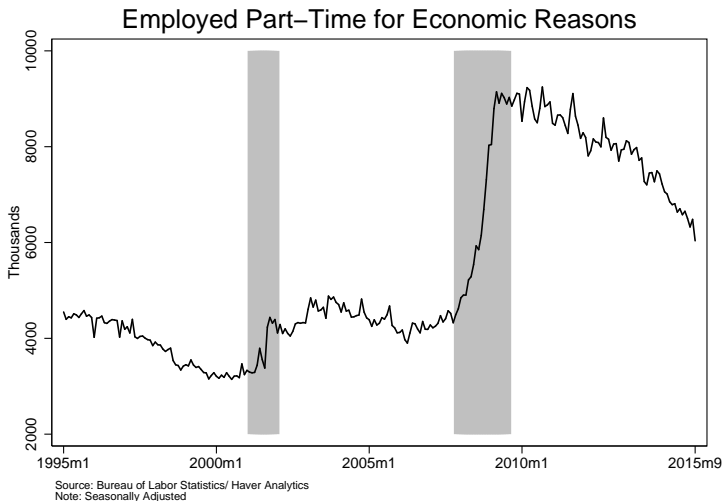


Source: Bureau of Labor Statistics/Haver Analytics
 Note: Seasonally Adjusted

2. Still, the labor force participation rate is quite low...

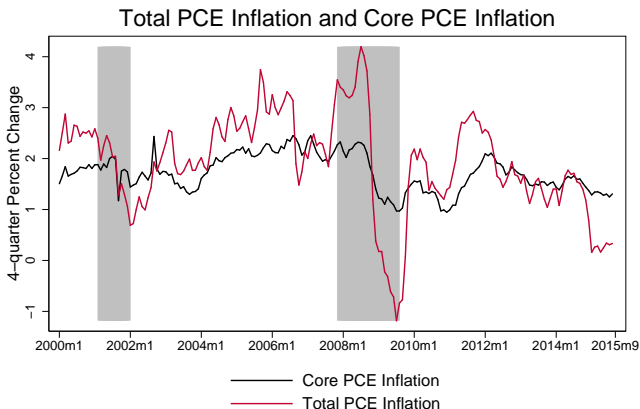


2. ...and the number of workers employed part-time for economic reasons remains elevated.



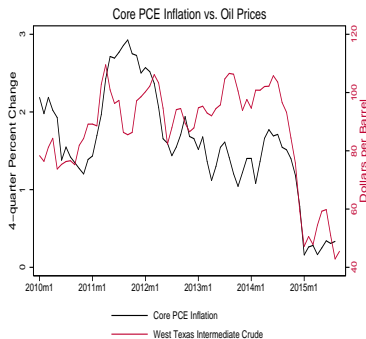
Inflation

2. PCE inflation is subdued despite the labor market improvement. Even core PCE inflation, which excludes volatile food and energy goods, is low.

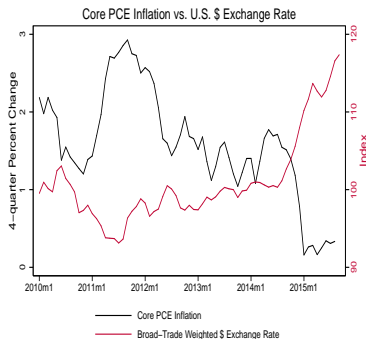


Source: Bureau of Economic Analysis/Haver Analytics
Note: Seasonally Adjusted, 2009=100

2. Transitory factors—such as oil prices and import prices—are thought to be holding down core PCE inflation.

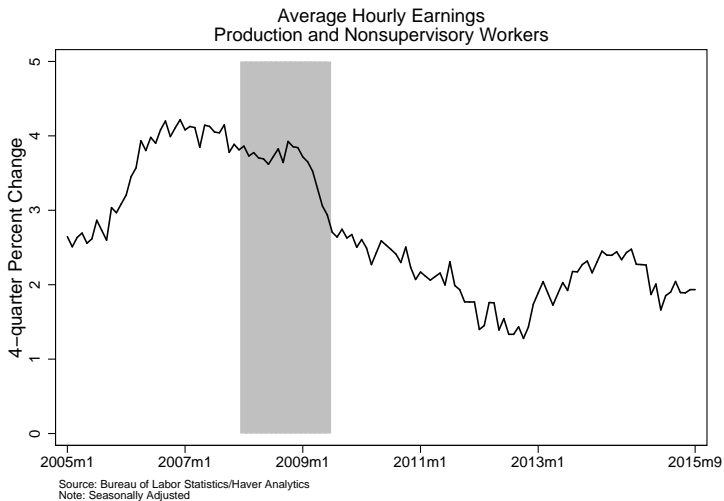


Source: BLS/Energy Information Administration/Haver Analytics

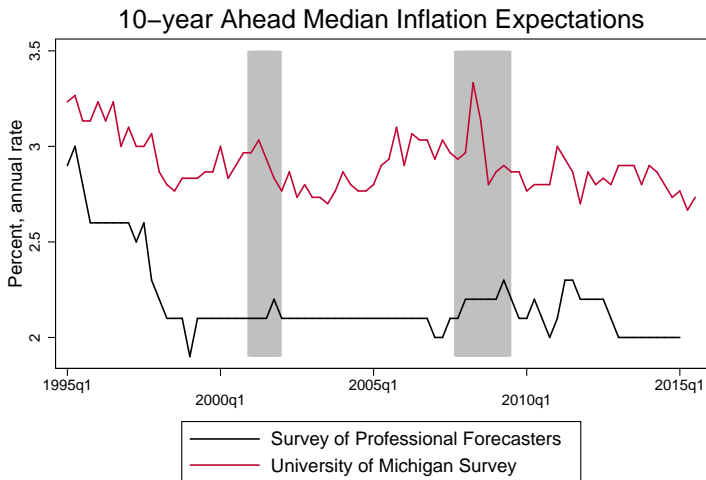


Source: BLS/JP Morgan/Haver Analytics

2. Wage growth also has yet to pick up substantially.



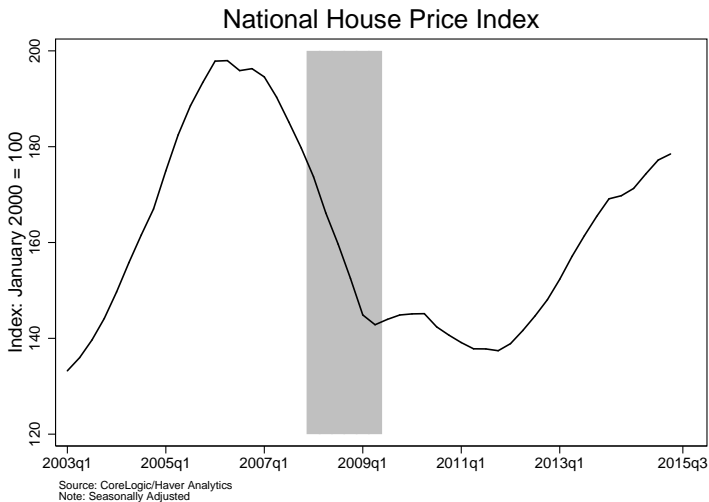
2. Inflation expectations remain stable and reasonably well anchored, but are being closely watched.



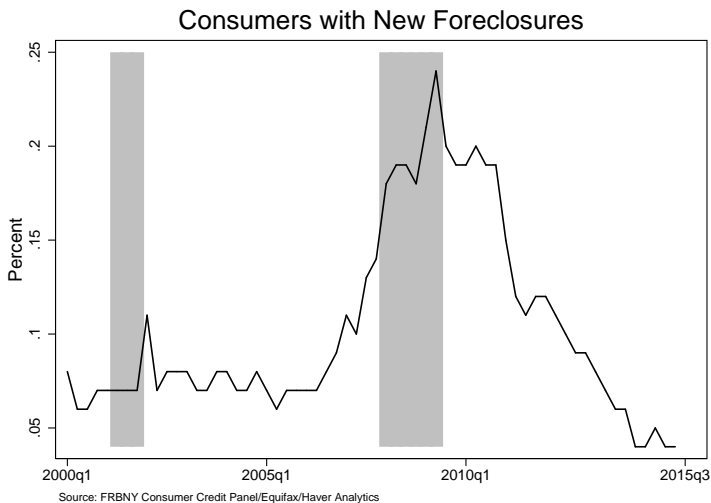
Source: University of Michigan/Federal Reserve/Federal Reserve Board of Governors/Haver Analytics

Household Sector

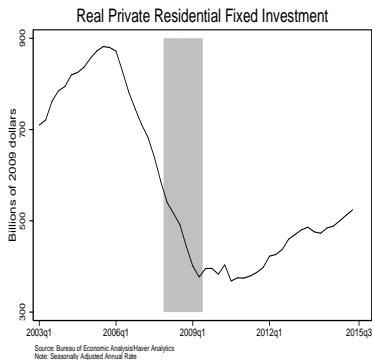
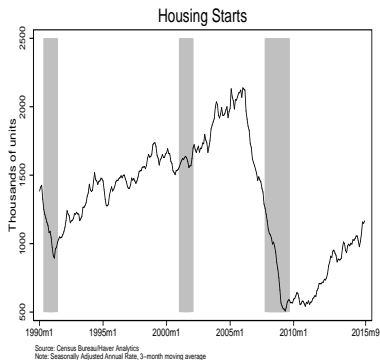
2. House prices have rebounded from their post-recession lows...



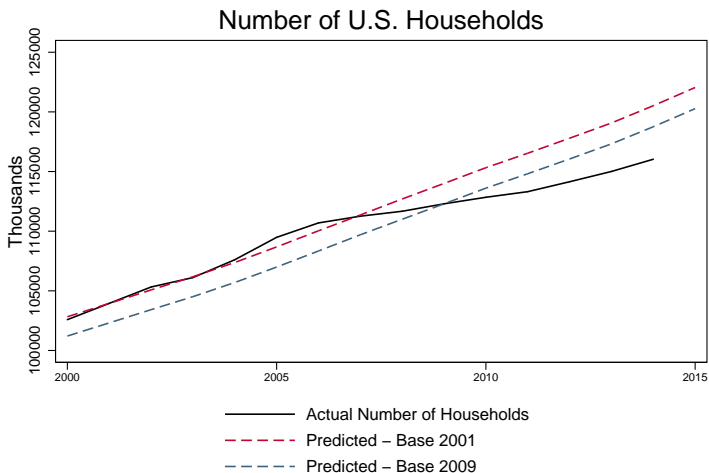
2. ...and foreclosures are way down...



2. ...but housing starts and residential investment remain at low levels...

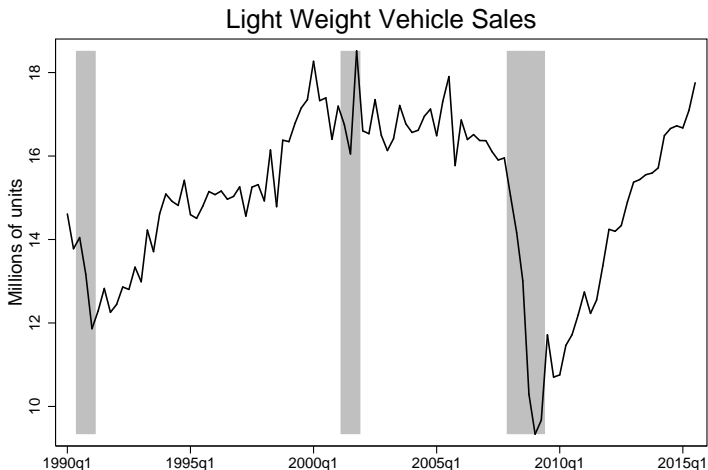


2. ...perhaps due to subdued household formation rates.



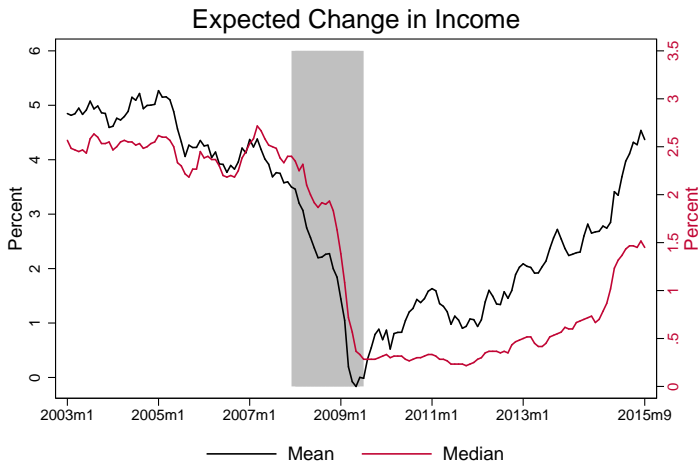
Source: Author's calculations using Census data

2. Indicators of consumer demand, such as vehicle sales, have been strong recently...



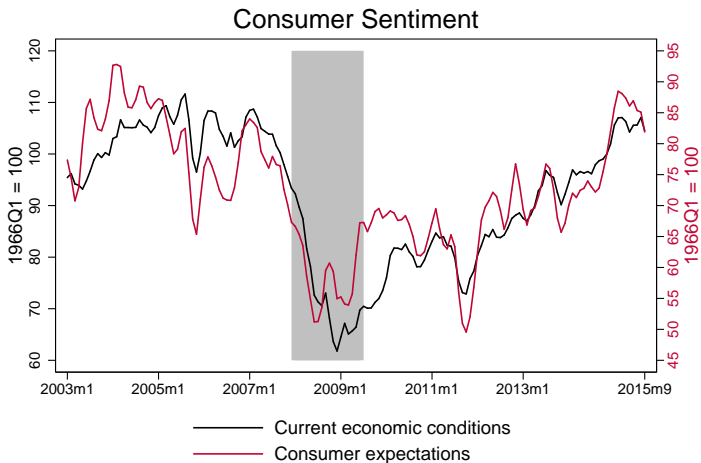
Source: Bureau of Economic Analysis/Haver Analytics
Note: Seasonally Adjusted Annual Rate

2. ...and households' future income expectations have moved a good bit higher in recent months.



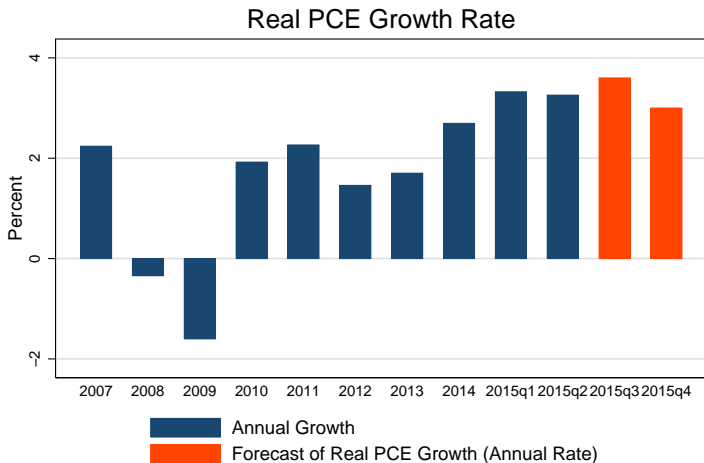
Source: Survey of Consumers/University of Michigan
 Note: 6-month moving average

2. Consumer sentiment has declined some recently, but remains at a high level.



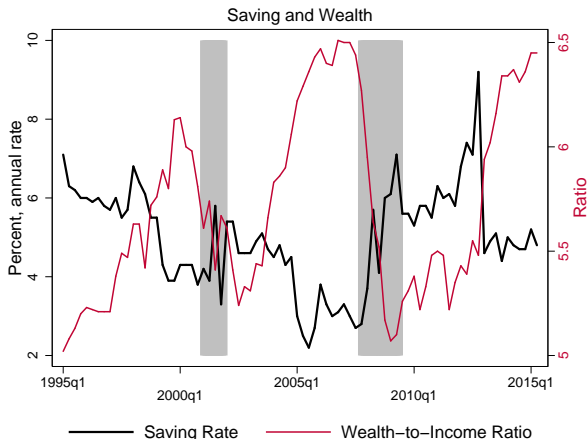
Source: University of Michigan/Haver Analytics
 Note: Seasonally Adjusted, 3-month moving average

2. Real consumption (PCE) growth has been strong, and is forecast to remain strong in the near-term.



Source: Bureau of Economic Analysis/Macroeconomic Advisers/Haver Analytics
 Note: Seasonally Adjusted Annual Rate

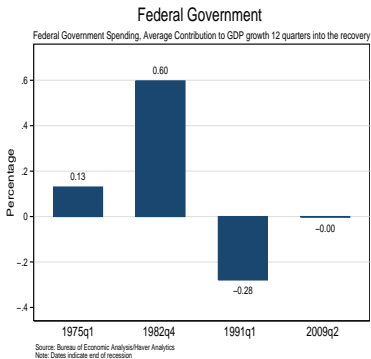
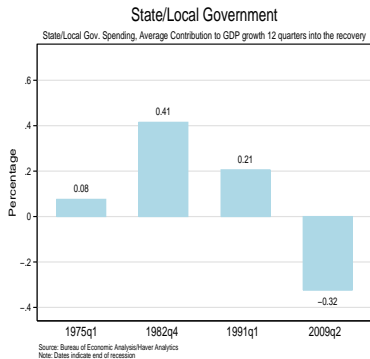
2. Still, saving remains above where we might expect given current levels of net worth, which poses a downside risk to the consumption outlook.



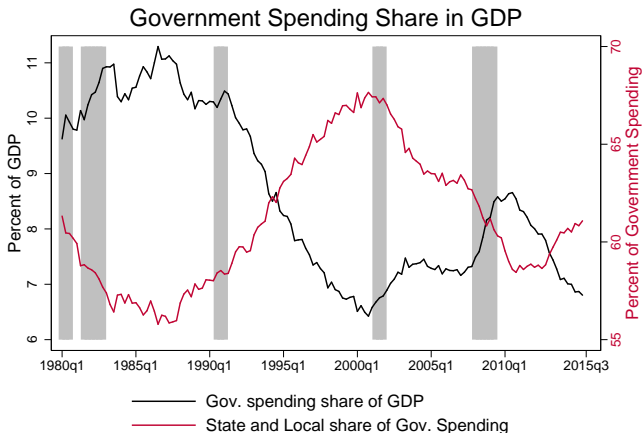
Source: BEA/FRB/Haver Analytics

Government Spending

2. State and local government spending was a big drag on output in the early part of the recovery.

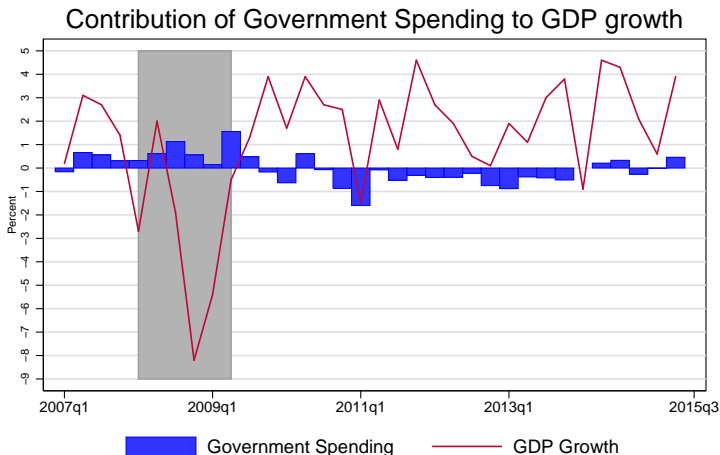


2. State and local government spending has improved recently, even as overall government spending has fallen as a share of GDP.



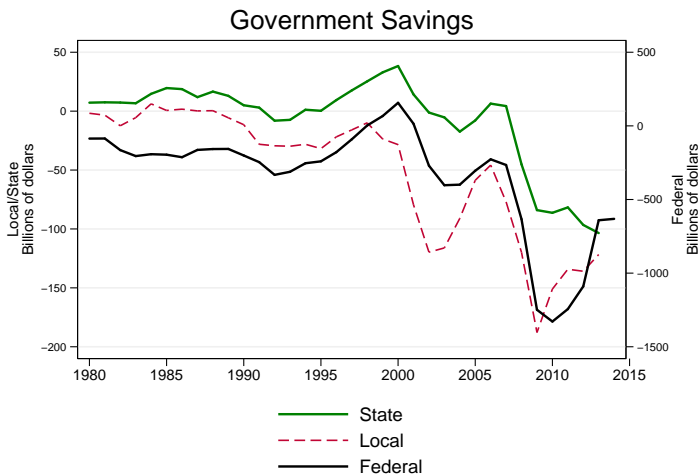
Source: Bureau of Economic Analysis/Haver Analytics

2. Indeed, government spending has made small positive contributions to GDP growth in recent quarters.



Source: Bureau of Economic Analysis /Haver Analytics
 Note: Seasonally Adjusted Annual Rate

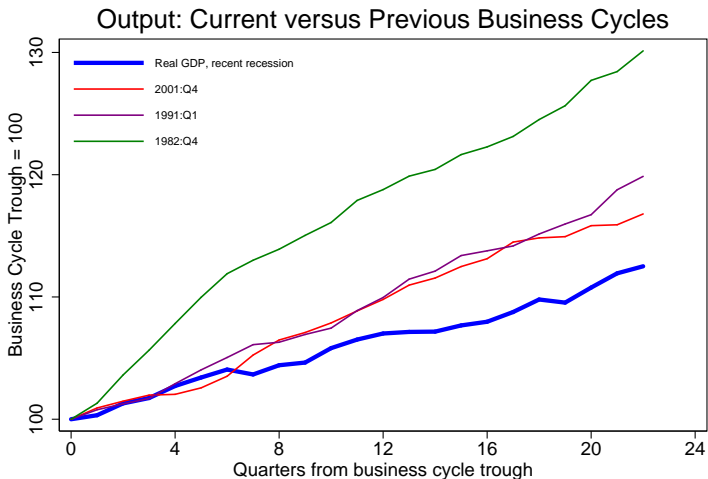
2. Local and federal budget deficits have also improved.



Source: Bureau of Economic Analysis/Haver Analytics

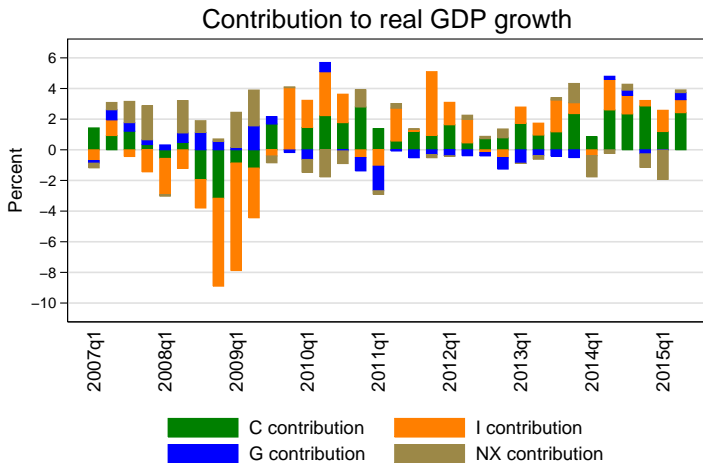
Output (GDP)

2. Output during this recovery has been sluggish compared to previous ones...



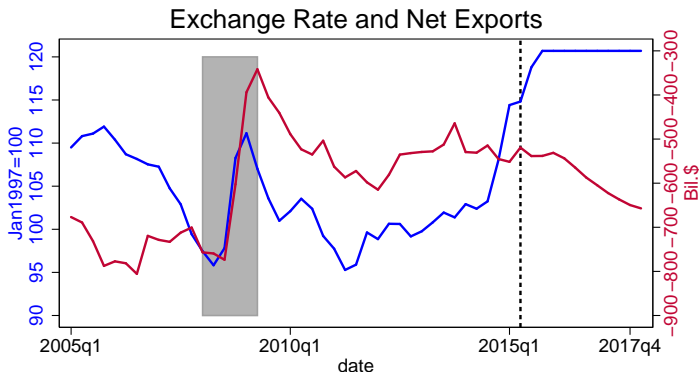
Source: Bureau of Labor Statistics /Haver Analytics

2. Consumption and investment have made positive contributions to GDP growth in recent quarters.



Source: Bureau of Economic Analysis /Haver Analytics
 Note: Seasonally Adjusted Annual Rate

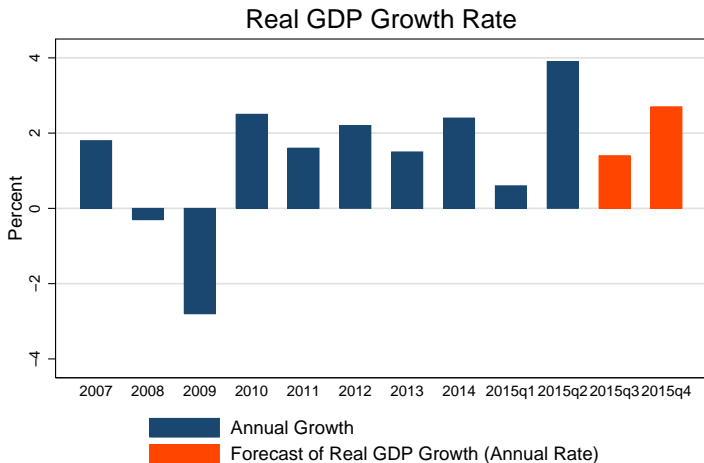
2. Net exports will act as a drag on output in the near-term...



— Trade-Weighted Exchange Value of the US\$
 — Net Exports of Goods and Services

(Exchange Rate) Source: Federal Reserve Board /Haver Analytics
 (Net Exports) Source: Bureau of Economic Analysis /Haver Analytics
 (Forecasts) Source: Macroeconomic Advisers /Haver Analytics

2. ...but overall GDP should continue to grow moderately as consumer spending is forecast to remain strong.



Source: Bureau of Economic Analysis/Macroeconomic Advisers/Haver Analytics
 Note: Seasonally Adjusted Annual Rate

The Road Ahead

3. The evolution of the FOMC's outlook

Core PCE Inflation (%)				
	2015	2016	2017	2018
Dec. 2014	1.7	1.9	1.9	n.a.
March 2015	1.4	1.7	1.9	n.a.
June 2015	1.3	1.8	2.0	n.a.
Sept. 2015	1.4	1.7	1.9	2.0
Real GDP Growth (%)				
Dec 2014	2.8	2.8	2.4	n.a.
Mar 2015	2.5	2.5	2.3	n.a.
June 2015	1.9	2.5	2.3	n.a.
Sept. 2015	2.1	2.3	2.2	2.0
Unemployment Rate (%)				
Dec 2014	5.3	5.1	5.1	n.a.
Mar 2015	5.1	5.0	4.9	n.a.
June 2015	5.3	5.1	5.0	n.a.
Sept. 2015	5.0	4.8	4.8	4.8

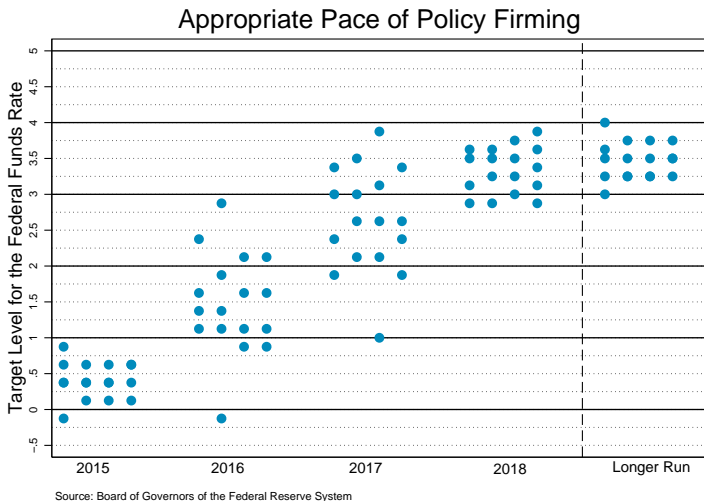
Source: FOMC Summary of Economic Projections.

Note: Table reports the median projection of FOMC participants.

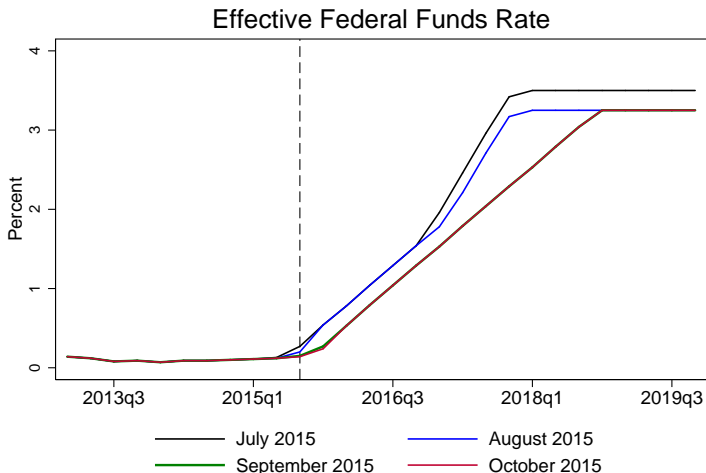
3. The current policy debate.

- The labor markets have improved and the unemployment rate is close to the natural rate.
- Inflation is subdued, and the longer-run inflation outlook has softened a bit.
- Output growth is expected to be moderate over the next few years.
- There is some downside risk to the outlook in the near-term from global economic conditions and financial market volatility.
- The key question is when the FOMC should begin raising the Federal Funds rate. This year? Next year?

3. The vast majority of FOMC participants in September anticipated “lift-off” in 2015.



3. However, the Federal Funds rate is anticipated to rise more gradually than previously thought.



Source: IHS Economics/Haver Analytics

Thank You