Transcript of Chair Yellen's Press Conference Opening Remarks
December 16, 2015

CHAIR YELLEN: Good afternoon. Earlier today, the Federal Open Market Committee decided to raise the target range for the federal funds rate by 1/4 percentage point, bringing it to 1/4 to 1/2 percent.

This action marks the end of an extraordinary seven-year period during which the federal funds rate was held near zero to support the recovery of the economy from the worst financial crisis and recession since the Great Depression. It also recognizes the considerable progress that has been made toward restoring jobs, raising incomes, and easing the economic hardship of millions of Americans. And it reflects the Committee's confidence that the economy will continue to strengthen. The economic recovery has clearly come a long way, although it is not yet complete. Room for further improvement in the labor market remains, and inflation continues to run below our longer-run objective. But with the economy performing well and expected to continue to do so, the Committee judged that a modest increase in the federal funds rate target is now appropriate, recognizing that even after this increase monetary policy remains accommodative. As I will explain, the process of normalizing interest rates is likely to proceed gradually, although future policy actions will obviously depend on how the economy evolves relative to our objectives of maximum employment and 2 percent inflation.

Since March, the Committee has stated that it would raise the target range for the federal funds rate when it had seen further improvement in the labor market and was reasonably confident that inflation would move back to its 2 percent objective over the medium term. In our judgment, these two criteria have now been satisfied.

The labor market has clearly shown significant further improvement toward our objective of maximum employment. So far this year, a total of 2.3 million jobs have been added to the economy, and over the most recent three months, job gains have averaged an estimated 218,000 per month, similar to the average pace since the beginning of the year. The unemployment rate, at 5 percent in November, is down six tenths of a percentage point from the end of last year and is close to the median of FOMC participants' estimates of its longer-run normal level. A broader measure of unemployment that includes individuals who want and are available to work but have not actively searched recently and people who are working part time but would rather work full time also has shown solid improvement. That said, some cyclical weakness likely remains: The labor force participation rate is still below estimates of its demographic trend, involuntary part-time employment remains somewhat elevated, and wage growth has yet to show a sustained pickup.

The improvement in employment conditions this year has occurred amid continued expansion in economic activity. U.S. real gross domestic product is estimated to have increased at an average pace of 2-1/4 percent over the first three quarters of the year. Net exports have been restrained by subdued foreign growth and the appreciation of the dollar, but this weakness has been offset by solid expansion of domestic spending. Continued job gains and increases in real disposable income have supported household spending, and purchases of new motor vehicles have been particularly strong. Residential investment has been rising at a faster pace than last year, although the level of new home building still remains low. And outside of the drilling and mining sector, where lower oil prices have led to substantial cuts in investment outlays, business investment has posted solid gains.

The Committee currently expects that, with gradual adjustments in the stance of monetary policy, economic activity will continue to expand at a moderate pace and labor market indicators will continue to strengthen. Although developments abroad still pose risks to U.S.

economic growth, these risks appear to have lessened since late summer. Overall, the Committee sees the risks to the outlook for both economic activity and the labor market as balanced.

The anticipation of ongoing economic growth and additional improvement in labor market conditions is an important factor underpinning the Committee's confidence that inflation will return to our 2 percent objective over the medium term. Overall consumer price inflation--as measured by the price index for personal consumption expenditures--was only 1/4 percent over the 12 months ending in October. However, much of the shortfall from our 2 percent objective reflected the sharp declines in energy prices since the middle of last year, and the effects of these declines should dissipate over time. The appreciation of the dollar has also weighed on inflation by holding down import prices. As these transitory influences fade, and as the labor market strengthens further, the Committee expects inflation to rise to 2 percent over the medium term.

The Committee's confidence in the inflation outlook rests importantly on its judgment that longer-run inflation expectations remain well anchored. In this regard, although some survey measures of longer-run inflation expectations have edged down, overall they've been reasonably stable. Market-based measures of inflation compensation remain near historically low levels, although the declines in these measures over the past year and a half may reflect changes in risk and liquidity premiums rather than an outright decline in inflation expectations. Our statement emphasizes that, in considering future policy decisions, we will carefully monitor actual and expected progress toward our inflation goal.

This general assessment of the outlook is reflected in the individual economic projections submitted for this meeting by FOMC participants. As always, each participant's projections are conditioned on his or her own view of appropriate monetary policy. Participants' projections for real GDP growth are little changed from the projections made in conjunction with the September FOMC meeting. The median projection for real GDP growth is 2.1 percent for this year and rises to 2.4 percent in 2016, somewhat above the median estimate of the longer-run normal growth rate. Thereafter, the median growth projection declines toward its longer-run rate. The median projection for the unemployment rate in the fourth quarter of this year stands at 5 percent, close to the median estimate of the longer-run normal unemployment rate. Committee participants generally see the unemployment rate declining a little further next year and then leveling out. The path of the median unemployment rate is slightly lower than in September, and while the median longer-run normal unemployment rate has not changed, some participants edged down their estimates. Finally, FOMC participants project inflation to be very low this year, largely reflecting lower prices for energy and non-energy imports. As the transitory factors holding down inflation abate and labor market conditions continue to strengthen, the median inflation projection rises from just 0.4 percent this year to 1.6 percent next year and reaches 1.9 percent in 2017 and 2 percent in 2018. The path of the median inflation projections is little changed from September.

With inflation currently still low, why is the Committee raising the federal funds rate target? As I have already noted, much of the recent softness in inflation is due to transitory factors that we expect to abate over time, and diminishing slack in labor and product markets should put upward pressure on inflation as well. In addition, we recognize that it takes time for monetary policy actions to affect future economic outcomes. Were the FOMC to delay the start of policy normalization for too long, we would likely end up having to tighten policy relatively abruptly at some point to keep the economy from overheating and inflation from significantly overshooting our objective. Such an abrupt tightening could increase the risk of pushing the economy into recession.

As I have often noted, the importance of our initial increase in the target range for the federal funds rate should not be overstated: Even after today's increase, the stance of monetary policy remains accommodative, thereby supporting further improvement in labor market conditions and a return to 2 percent inflation. As we indicated in our statement, the Committee expects that economic conditions will evolve in a manner that will warrant only gradual increases in the federal funds rate. The federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run.

This expectation is consistent with the view that the neutral nominal federal funds rate--defined as the value of the federal funds rate that would be neither expansionary nor contractionary if the economy were operating near potential--is currently low by historical standards and is likely to rise only gradually over time. One indication that the neutral funds rate is unusually low is that U.S. economic growth has been only moderate in recent years despite the very low level of the federal funds rate and the Federal Reserve's very large holdings of longer-term securities. Had the neutral rate been running closer to its longer-run level, these policy actions would have been expected to foster a much more rapid economic expansion.

The marked decline in the neutral federal funds rate may be partially attributable to a range of persistent economic headwinds that have weighed on aggregate demand. Following the financial crisis, these headwinds included tighter underwriting standards and limited access to credit for some borrowers, deleveraging by many households to reduce debt burdens, contractionary fiscal policy, weak growth abroad coupled with a significant appreciation of the dollar, slower productivity and labor force growth, and elevated uncertainty about the economic outlook. Although the restraint imposed by many of these factors has declined noticeably over the past few years, some of these effects have remained significant. As these effects abate, the neutral federal funds rate should gradually move higher over time.

This view is implicitly reflected in participants' projections of appropriate monetary policy. The median projection for the federal funds rate rises gradually to nearly 1-1/2 percent in late 2016 and 2-1/2 percent in late 2017. As the factors restraining economic growth continue to fade over time, the median rate rises to 3-1/4 percent by the end of 2018, close to its longer-run normal level. Compared with the projections made in September, a number of participants lowered somewhat their paths for the federal funds rate, although changes to the median path are fairly minor.

I'd like to underscore that the forecasts of the appropriate path of the federal funds rate, as usual, are conditional on participants' individual projections of the most likely outcomes for economic growth, employment and inflation, and other factors. However, the actual path of the federal funds rate will depend on the economic outlook as informed by incoming data. Stronger growth or a more rapid increase in inflation than we currently anticipate would suggest that the neutral federal funds rate was rising more quickly than expected, making it appropriate to raise the federal funds rate more quickly as well; conversely, if the economy were to disappoint, the federal funds rate would likely rise more slowly.

The Committee will continue its policy of reinvesting proceeds from maturing Treasury securities and principal payments from agency debt and mortgage-backed securities. As highlighted in our policy statement, we anticipate continuing this policy until normalization of the level of the federal funds rate is well under way. Maintaining our sizable holdings of longer-term securities should help maintain accommodative financial conditions and should reduce the risk that the federal funds rate might return to the effective lower bound in the event of future adverse shocks.

Finally, in conjunction with our policy statement, we also released an implementation note that provides details on the tools that we are using to raise the federal funds rate into the new target range. Specifically, the Board of Governors raised the interest rate paid on required and excess reserves to 1/2 percent, and the FOMC authorized overnight reverse repurchase operations at an offering rate of 1/4 percent. Both of these changes will be effective tomorrow. To ensure sufficient monetary control at the onset of the normalization process, we have for the time being suspended the aggregate cap on overnight reverse repurchase transactions that has been in place during the testing phase of this facility. Recall that the Committee intends to phase out this facility when it is no longer needed to help control the federal funds rate. The Board of Governors also approved a 1/4 percentage point increase in the discount rate for primary credit to 1 percent.

Based on the extensive testing of our policy tools in recent years, the Committee is confident that the normalization process will proceed smoothly. Nonetheless, as part of prudent contingency planning, we will be monitoring financial market developments closely in the coming days, and are prepared to make adjustments to our tools if that proves necessary to maintain appropriate control over money market rates.

Thank you. I will be happy to take your questions.