Lockhart: Economy Achieving Liftoff Conditions

December 10, 2015

In early November, Atlanta Fed President Dennis Lockhart said he believed the nation's economy was near a turning point. Extraordinary economic times, calling for unconventional monetary policy, were giving way to a more normal environment for policymaking, Lockhart said in a speech in Switzerland.

A month on, that turning point appears nearer still. The economy has largely achieved the two conditions for "liftoff" of the federal funds rate set in March 2015 by the Federal Open Market Committee (FOMC): further improvement in labor market conditions and reasonable confidence that inflation would approach the Committee's 2 percent target in the medium term, Lockhart said in a December 2 speech in Fort Lauderdale, Florida. The FOMC meets once more this year, on December 15 and 16.

The two conditions, of course, embody the Fed's dual congressional mandate to strive for full employment and low and stable inflation. Mission almost accomplished, Lockhart said at the Broward Workshop.

"I think the economy is closing in on full employment," said the Atlanta Fed president, a voting FOMC member in 2015.

Inflation held down by temporary factors

Inflation, meanwhile, continues to hover below the FOMC's target. However, calculations by the Fed and other economists suggest "that much of what's suppressing inflation is transitory in nature," Lockhart said.

Additional data will come in before the FOMC's December meeting. "That said, absent information that drastically changes the economic picture and outlook, I feel the case for liftoff is compelling," he stated.

Lockhart looking deeply at GDP, employment, inflation

If a fed funds rate increase happens, it would be the first such increase in almost 10 years. And it would be the first since Lockhart became Atlanta Fed president in March 2007.

He is approaching the decision with great care. In his remarks, Lockhart shared some of the considerations he's pondering before what he termed a possibly "historic" FOMC session. (Lockhart also discussed the FOMC meeting process in a recent *Economy Matters* podcast.) In describing his policymaking process to the audience, he assessed the reliability of some of the major barometers used to gauge inflation, gross domestic product (GDP) growth, and employment.

In short, there's good news on all three fronts.

In judging inflation, the price statistics themselves are "fairly reliable," in Lockhart's view. But as has been the case lately, the "underlying inflation signal" can be obscured by price movements that come and go quickly. To dig through the distortion, the Atlanta Fed follows a number of inflation statistics. For example, so-called trimmed-mean inflation estimates, which throw out the widest monthly price swings, have been running much closer to 2 percent than overall inflation measures, Lockhart pointed out.

Reliability of GDP estimates: medium

Quarterly GDP growth estimates are "of medium reliability," Lockhart said. These statistics are frequently—and sometimes substantially—revised. To get a more thorough reading of overall economic growth, Lockhart and his staff examine a second method that calculates gross domestic income, or GDI. Lately, GDI statistics seem to echo the GDP numbers, Lockhart said, buttressing the case that the economy is growing solidly despite challenges.

Turning to the labor market, Lockhart deemed monthly employment numbers "not terribly reliable." He puts more stock in longer-run results. "The average gain of 234,000 jobs per month we've experienced the past two years gives me substantial confidence that the employment growth trend is for real," he remarked.

For a deeper understanding of the labor market, he and Atlanta Fed researchers consider numerous measures beyond monthly job growth and the headline unemployment rate. One of those other measures is the U-6 unemployment rate. Unlike the better-known U-3 rate, U-6 tracks workers in part-time jobs who want full-time work and people available to work but not seeking a job, in addition to jobless people. The U-6, Lockhart noted, is bringing good news. It fell to 9.8 percent in October, more than 7 percentage points below its early 2010 peak and a full point lower than it was in March 2015.

"Confirming evidence" that full employment is near might come from bigger paychecks, the Atlanta Fed president stated. Indeed, after years of weakness, wage growth might finally be perking up. In October, average hourly earnings rose at a 4.4 percent annual clip, much better than the postrecession trend of just over 2 percent.

All this adds up to a virtuous economic cycle, in Lockhart's view. Solid job gains and rising household incomes could help boost consumer spending growth. Growing consumer demand should in turn encourage more hiring. "I think this dynamic is at work," said Lockhart, "and will continue into 2016."

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