SPEECHES

On Economic Conditions and Building a Recovery

Dennis P. Lockhart
President and Chief Executive Officer
Federal Reserve Bank of Atlanta

U.S. Association of Energy Economics Annual Meeting
New Orleans, La.
December 4, 2008

Delivered in place of Richard Fisher, president and chief executive officer of the Federal Reserve Bank of Dallas, who was unable to speak because of an illness.

Today, I plan to offer remarks on current economic conditions with some brief comments on building a recovery. Let me offer the disclaimer that my remarks are mine alone and don't necessarily reflect the thoughts of my colleagues on the Federal Open Market Committee (FOMC). Afterwards, I will be glad to engage in dialogue with you and try to answer any of your questions.

Current conditions—economy and financial markets
Earlier this week, we learned the economy is officially in recession and has been since December 2007, according to the National Bureau of Economic Research. Already, we know that this recession has been longer than the past two recessions. At present we're in the midst of a long and painful adjustment process.

Let me discuss the major components of the economic downturn. Employment is weak. We'll get a better picture tomorrow [Friday, Dec. 5] with the release of November data. Commercial forecasters project a decline of another 300,000–350,000 jobs for last month.

These job losses would be in addition to an employment decline of 1.2 million for the first 10 months of the year. More than half of that job loss occurred between August and October, so the rate of job decline has accelerated. The most recent unemployment rate is 6.5 percent—the highest since 1994.

The U.S. industrial sector is sharply contracting. The ISM Manufacturing Index continued its steep decline in November, reaching its lowest point since the 1982 recession. Also, purchasing managers report a sharp falloff in costs for commodities such as fuels and chemicals. The prices paid measure, after a sharp run-up earlier this year, is at the lowest level in almost 60 years.

Consumer spending this year has declined sharply. Though retail sales for "Black Friday," the day after Thanksgiving, were better than expected, the National Retail Federation projects holiday sales will rise about 2 percent this year—the smallest increase since 2002.

The housing decline has continued with negative consequences on overall economic growth. Housing sales are soft, inventories are high, and prices are falling.

The United States is not alone in economic weakness. And just a few months ago the picture was entirely different with strong global demand, along with a weakening dollar, supporting solid growth in U.S. exports. In recent years, some assumed that U.S. economic strength or weakness had become decoupled from growth in developing nations. But a recent slowdown in global growth calls into question that decoupling theory. Now, there's very little evidence to support the view that a severe economic cold in the United States would not infect the rest of the world.

Economic outlook
Given this picture of a pretty dramatic worldwide economic slowdown, let me briefly describe the Atlanta Fed's near-term outlook, which is not encouraging. Employment is expected to weaken further. Also, house prices likely will continue to fall with a further erosion of household wealth. Personal consumption likely will decline—at least for the next few months.

With a worsening recession in the United States, the rest of the world probably won't do so well, either. The International Monetary Fund now projects that for 2009 economic growth in advanced economies will contract for the first time since World War II. Growth for emerging economies also is expected to slow to about 5 percent.

One positive bit of news is that falling commodity prices and increasing economic slack have eased global inflation pressure.

With regard to the U.S. economy, I expect very weak growth for much of 2009.

I hasten to add, however, that economic forecasts always involve substantial uncertainty. The elements interacting today include the complex and volatile behavior of financial markets globally, compounding weakness in the real economies of interdependent countries and regions, the political transition in this country, and the ever-present threat of noneconomic shocks from weather and geological events to pandemics to geopolitical crises.

This litany is intended to emphasize the challenge of economic forecasting.

As I evaluate options as a monetary policymaker, I believe the obvious questions when considering plausible scenarios are how deep will the recession be and how long it will last? If consensus forecasts are correct, we are experiencing the worst of this episode now and into early next year. It is difficult in these circumstances to hold any forecast with great conviction, but I do believe that process of adjustment necessary to recovery is ongoing.

Policy resources and elements of recovery
I think it's possible to isolate elements of the current circumstances that require resolution as a recovery develops. I hesitate to call them sine qua non prerequisites rather as primary contributors. They are 1) housing sector and house price stabilization, 2) a return of consumer confidence, and 3) credit confidence.

A direct path to recovery is unlikely, and, as we have seen, events arise that potentially threaten to knock us off the path to a more stable economic environment. Here I am thinking, of course, of the credit markets events of last spring and, especially, the last couple of months. In each of these cases, the Federal Reserve, U.S. Treasury, Congress, and other organizations stepped in to unfreeze frozen markets and limit, to the extent possible, damage to the broader economy.

What else can the Fed do? In my view, the Fed retains a number of options to help ease the economy through this difficult transition.

For instance, the Fed has the ability to influence the economy by adjusting the fed funds rate, which has been lowered to 1 percent. It is true that we are limited in this approach by the fact that the funds rate cannot fall below zero. But as Chairman Bernanke indicated in a speech a few days ago, there are many other mechanisms that the FOMC can use to provide liquidity beyond targeting overnight interest rates.

Beyond that, the Fed also has the ability to provide liquidity through various facilities, which have been expanded significantly in recent months. Also, the Fed has the ability to work with other central banks, and that process of international coordination of policy actions is continuing.

The recession has advanced to the point that it's well beyond the housing sector, where many of the problems started. The process of working through today's problems is ongoing. It has been painful, and the spillover of financial turmoil has been broad based.

Notably, that spillover has involved periodic and acute problems in credit markets. The Fed and other authorities have stepped in as appropriate to help address issues and have worked to dampen the effects of these problems along the way. I am fully confident that we have both the means and the will to continue to do so as events require.

Closing

The country faces very challenging circumstances. There is little to be encouraged about in current data. The near-term outlook does not, in my view, offer material relief. If current forecasts bracket reality, this quarter and the next one or two are likely as bad as it will get. Policymakers have policy tools remaining to respond to unwelcome surprises. And the intrinsic resilience of the economy at its core combined with the regenerative capacity of the financial system will carry us through.

Contact: Jean Tate 404-498-8035

RELATED LINKS: Atlanta Fed Speeches • Dennis Lockhart's biography