Functions of the Fed and the Current Economic Situation

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Key Points
• Lockhart expects gradual firming of underlying inflation pressures through 2011 and 2012 from current very low levels to healthier levels.

The Fed was established in December 1913 by Congress. The Federal Reserve is charged by Congress to pursue a dual mandate—to promote the two coequal objectives of maximum employment and price stability.

The Atlanta Fed covers the Sixth Federal Reserve District and, like other Reserve Banks, plays an important part in all the major functions of the Fed. The Sixth District includes Alabama, Florida, and Georgia, and parts of Louisiana, Mississippi, and Tennessee.

As part of the monetary policy-setting process, we at the Atlanta Fed gather economic intelligence from around our district. I estimate that we get input from about 1,000 citizens on ground-level economic conditions and the impact of monetary policy. Given that the Southeast economy is an excellent economic proxy for the whole country, this anecdotal information has relevance to correctly gauging economic conditions in the nation overall.

Thank you for the opportunity to speak at Miami Dade College. I'm looking forward to answering your questions. I'd like to begin by briefly discussing the role of the Federal Reserve System in the U.S. economy and my view of the current economic situation. After these remarks, I will take your questions.

The Federal Reserve System
The Federal Reserve System—commonly known as the Fed—is the central bank of the United States. The Fed sets monetary policy, regulates and supervises certain financial institutions, and plays a major role in operating the U.S. payments system. As it carries out these three functions, the Fed also helps to contain systemic risks in the financial markets and stabilize the nation's financial system.

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Economic update
Let me give you my view of the current conditions in the national economy. As I discuss the economy today, I should add that I am speaking for myself—my views may not be shared by my colleagues on the FOMC or in the Federal Reserve.

There are certainly differences in the state of the economy at the local level across the country. For example, the economy here in south Florida was and continues to be affected by the deep downturn in the residential real estate sector. On a more positive note, south Florida is a prime tourist destination, and that aspect of the local economy has improved recently.

On the national level, the pace of economic growth is picking up, and I believe much of the strength in the fourth quarter of last year has carried over into 2011. The moderate pace of economic expansion seems to have momentum, and I believe it should prove sustainable as the year progresses.

Confidence appears to be growing. According to the Conference Board, consumer confidence rose sharply in January. Business confidence is also building. Business leaders remain cautious regarding investment and hiring, but in my contacts with businesspeople across a range of industries I hear more optimism than I heard even a few weeks ago. I believe that as businesses become more assured that growth will continue and their revenues will grow, they will increase investment and hiring.

There are risk factors that I think bear careful watching. The sovereign debt problems in Europe could become more severe and spill over to negatively affect our economy through a number of channels. The weakness of the U.S. housing sector—particularly house prices—could reemerge as a major drag on consumer spending over and above the direct effect of slow construction activity. States and municipalities remain under intense fiscal pressure, and many will have to continue to reduce expenditures to avoid default on their debt obligations or downgrades of their debt ratings. These factors are risks to the improving outlook.

Employment is growing very slowly and is lagging behind the improvement in the broad economy. To an extent, this lag is normal. After recessions, other conditions get better before jobs return. In the current recovery, unemployment has hung up at high levels, currently 9.4 percent. A number of factors are restraining job growth, including the moderate pace of economic growth, slower business formation, and productivity enhancements in the workplace that have altered the need for workers. There are a number
of other contributing factors to the weak recovery in employment. For those of you with some time remaining before graduation, I believe the employment situation will improve for you.

Inflation is currently measured at lower-than-desired rates. A few months ago, fear of deflation was justified, but recently this concern has abated and the rate of inflation seems to have stabilized. Concern about inflation is rising because of higher gasoline prices and higher commodity prices, including food commodities. We are hearing stories that businesses incurring higher input costs may try to pass them through to retail prices. Higher input costs have not, however, translated to broad inflation of consumer goods and services. And, importantly, longer-term inflation expectations have stabilized in a healthy range. Through 2011 and 2012, I expect gradual firming of underlying inflation pressures from current very low levels to healthier levels.

There are definitely hopeful signs of sustained recovery in 2011. That said, I believe it is a bit early to declare victory, and, to be sure, employment is nowhere near acceptable levels. Progress is real, but fitful, and support of accommodative Fed policy is still required, in my view. The appropriate outlook at this juncture is one of cautious optimism, avoiding overstatement of the likely speed of improvement.

With this, I will conclude my remarks, and I look forward to your questions.

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