SPEECHES

A Story of Economic Progress

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

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- Atlanta Fed President and CEO Dennis Lockhart, in an August 10, 2015, speech to the Atlanta Press Club, discusses the economic progress achieved since the Great Recession and the anticipated FOMC decision to move the federal funds rate off zero.
- Lockhart says that from its peak of 10 percent, the rate of unemployment has fallen to 5.3 percent. However, the average rate of inflation over the six-plus years of recovery has been 1 1/2 percent. He expects to see convincing evidence emerge that inflation is rising to a safer level and approaching the FOMC's 2 percent target.
- Lockhart reiterates that the economy has made great gains and is approaching an acceptable normal, and policy should shortly acknowledge this reality. He is prepared to see mixed data, but he thinks the time to begin normalizing monetary conditions is close.
- Lockhart stresses that the path of interest-rate increases will likely be gradual and such a stance of policy will be appropriate for some time after liftoff.

I very much appreciate the chance to address the Atlanta Press Club. As members of the fourth estate (and their guests), you certainly understand the qualities of a good story.

The daily news story, I'm told, mostly follows the format of who-what-where-when-why. Longer stories—both nonfiction and fiction—make the greatest impression when there is a hero or heroine, when there's a conflict that builds dramatically and with suspense to a climax, and when the point of highest drama is followed by resolution. The French have a great word for that part of the story—dénouement.

Today I want to begin my remarks by telling the story of the U.S. economy over recent years. We might think of the economy itself as the hero. The recovery from deep recession is the struggle. The impending decision to begin raising interest rates is the climax. And the normalization of monetary policy, along with the further normalization of our economy, is the dénouement.

If that seems a tad contrived for this venue and this audience, please indulge me.

To put all this in a more conventional framework—one you might expect from a central banker—the story I'll tell is one of how far we've come, economically speaking. Specifically, I'll discuss how far we've come in terms of employment and labor market health. I'll tell the curious story of inflation, a story of less progress. And I'll present my personal forecast of how the story will play out for a couple of years after the point of liftoff, as it's called.

As always, you will be hearing my personal views. I don't speak for the Federal Reserve or the Federal Open Market Committee (the FOMC, or the Committee). This must be emphasized given the current context of intense interest in what, when, and why the FOMC will decide to do something or not. I'm speaking only for myself.

How far we've come

The story could begin in the summer of 2009, when the economy emerged from the Great Recession and the long recovery began. However, I prefer to begin the story in December 2008, when the FOMC completed a rapid, year-long downward march of its policy rate, the federal funds rate.

The federal funds rate—the overnight rate for bank-to-bank lending—is the Fed's chief policy rate. Where this rate is set affects other borrowing rates broadly across the economy.

The downward march of the policy rate began in September 2007, when the Committee dropped the federal funds rate from 5 1/4 percent to 4 3/4 percent.

As the crisis unfolded, the FOMC pushed the rate lower, and it reached zero, effectively, in December 2008. It has been there ever since.

The economic conditions that evoked that policy response in 2008 were extraordinary, to say the least. Let me describe the situation of the national economy at that time.

When the Fed's policy rate hit zero in December 2008, the official rate of unemployment had already climbed from a low of 4.4 percent to 7.3 percent and was rising fast. It would peak at 10 percent in less than a year. Between December 2007 and February 2010, U.S. payrolls fell by more than 8.7 million workers.

In the fourth quarter of 2008, real gross domestic product contracted at an annualized rate of 8.2 percent. The economy's performance in that quarter was its worst in 50 years. In December 2008, the economy had already been in recession for a year. The recession wouldn't officially end until the following June. When it finally did end, the cumulative loss in national output amounted to the greatest contraction in economic activity in the post–World War II era. The recession was extraordinarily deep, and it was broad.

By early 2009, a substantial majority of U.S. industries had either stopped hiring or were cutting their workforce. Construction activity and employment entered their deepest and most protracted decline since World War II. Industrial production was hard hit, too. In January 2009, for instance, four of five manufacturers and other industrial producers were generating output below levels six months earlier. Retail spending was off more than 10 percent from year-earlier levels. And measures of consumer confidence had fallen to near historic lows. Virtually every region of the nation and every economic sector were under substantial stress.

Let me contrast this picture of the state of our economy at the end of 2008 and early 2009 with the picture we see today.

Since bottoming out in the second quarter of 2009, real economic output is up about 13 percent. Said differently, the economy is 8 1/2 percent larger than its prerecession peak. To give a sense of the scale of improvement, the U.S. economy has added activity about equal to the economy of Mexico.

Although the pace of improvement in output has been slower than hoped for, by most measures, real gross domestic product is approaching its full current potential.

From its peak of 10 percent, the rate of unemployment has fallen to 5.3 percent. We received a new employment situation report on Friday. The official unemployment rate remains at 5.3 percent. This level of unemployment is just a shade above what some economists think is consistent with full employment. A broader measure of unemployment and underemployment—one that includes marginally attached workers and those working part-time involuntarily—continued to fall in July, to 10.4 percent. From the employment trough, the economy has added more than 12 million jobs.

Consumer spending is almost 14 percent above its recessionary bottom, and consumer confidence has recently climbed back to near, and by some measures above, pre-crisis levels.

To sum up, the economy has come a long way in the more-than-six-and-a-half years since the federal funds rate hit bottom. The subtext is that the recovery has been slow. It's taken more than six years of recovery to accomplish what I just described. Clearly, this is a rather long story. The recovery has proceeded at an average annual pace of expansion of only 2.1 percent.

Over this period, the economy has faced a number of headwinds and shocks. We've pushed through several domestic fiscal showdowns, including one federal government shutdown, two major winter weather events, geopolitical tensions, and wide swings of global energy prices. Most recently, the Greek and European Union stare-down was unsettling with its potential for a major financial event or worse. These developments slowed activity, shook confidence, and bred cautious economic behavior on the part of American consumers and businesses. These spells of cautious behavior have contributed to a slow pace of recovery.

The curious tale of inflation

The expansion over these six years has been sustained by extraordinary policy medicine involving not only ultra-low interest rates but also three episodes of quantitative easing, or QE. The Fed undertook these large-scale asset purchase programs to exert even more downward pressure on interest rates. QE3 ended last December in recognition of substantial improvement in the state of the economy.

One constant over this period has been the FOMC's focused attention on achievement of our Congress-mandated policy objectives. "True north" in the Committee's setting of monetary policy is maximum employment and low and stable inflation.

In January 2012, the FOMC took the step of defining a formal target rate of inflation. The Committee set the inflation target at an annual rate of 2 percent to be achieved over the longer run. The Committee believes this rate of inflation is most compatible with healthy growth, healthy conditions in the economy, and an adequate cushion against disinflation and eventual deflation.

There are many inflation statistics. The Committee chose to apply the headline, or total, rate of inflation according to the index of personal consumption expenditures, an index calculated by the Bureau of Economic Analysis.

The curious thing is that over six years of expansion, inflation has chronically remained well below this target. The average rate of inflation over the six-plus years of recovery has been 1 1/2 percent. Some of this weak price pressure can be explained by temporary influences such as falling oil prices and the appreciating dollar's effect on import prices. Oil prices, for instance, have fallen by about 50 percent since last summer and have fallen another 12 percent in the past month alone.

Those downward pressures on the rate of inflation are not yet entirely behind us. Because of such factors, it has been difficult to discern the true underlying rate of inflation and its trend. This analytical challenge continues, and I expect it to persist for a while. But even if we heavily discount the influence of transitory forces on the headline inflation trend, inflation has remained low relative to our objective.

The plot progresses

A few months ago, anticipating an eventual change of policy, the Committee set out two qualitative criteria for an initial interest-rate increase. We said we want to see "further improvement in labor market conditions," and we want to be "reasonably confident" that the inflation rate will rise over the medium term to 2 percent.

The Committee has also repeatedly emphasized that the decision will be data-dependent. This means there is no foreordained date, and the incoming numbers will dictate the timing of the decision. When the Committee is comfortable that these two tests have been met, the policy move will come.

My colleagues and I always intensely monitor economic data, and that has especially been the case over recent months. Progress since the first of the year has been quite encouraging. As regards labor market conditions, almost one-and-a-half million more jobs have been added to U.S. payrolls since last December. And the national unemployment rate has fallen by half a percentage point in the past eight months. After a weak first quarter of 2015, during which the economy barely grew, the economy bounced back to some extent in the second quarter to record a solid rate of growth in excess of 2 percent.

Key to my own thinking on impending policy decisions is the outlook from here. I expect somewhat stronger growth in the second half of the year. I expect the employment markets to continue to tighten. I expect continuing labor market progress to begin to put upward pressure on wages across the economy. And I expect convincing evidence to emerge that inflation is rising to a safer level and approaching our 2 percent target.

The story's climax

The economy has made great gains and is approaching an acceptable normal. Policy should shortly acknowledge this reality. The Fed took extraordinary policy measures in response to extraordinary economic conditions. Conditions are no longer extraordinary.

Compared to earlier in the year, we know a lot more and can shelve some concerns. We appear to be past the most acute concerns of a spillover from Europe. I have more confidence in the resilience of the economy today compared to even a few months ago. I am much less concerned about a reversal of economic fortune. We are getting closer and closer to what feels like a healed state of the economy.

For me, the cumulative evidence of the economy's healing, and the likelihood the economy is on a path to achieving the Fed's mandated objectives, makes me comfortable that the economy can handle a gradually rising interest-rate environment.

Fed Chair Janet Yellen has stated she expects conditions to jell, justifying a start to policy normalization sometime later this year. I agree. I think the point of liftoff is close.

As the Committee approaches what I consider a historic decision, I am not expecting the data signals to point uniformly in the same direction. I don't need this. I'm prepared to see mixed data. Data are inherently noisy month to month and quarter to quarter. Given the progress made over the recovery and the overall recent tone of the economy, I for one do not intend to let the gyrating needle of monthly data be the decisive factor in decision making.

The dénouement

This is not to say that the process of policy normalization should be implemented with urgency, requiring a rapid pace of rate increases. Indeed, there are reasons to approach normalization with patience and at a deliberate pace. While the economy is a considerable distance from where it was when our zero-interest-rate policy was put in place, we have somewhat further to go.

The Committee has provided guidance that the path of interest-rate increases will likely be gradual. I expect such a stance of policy to be appropriate for some time after liftoff. This is perhaps the most important message to reinforce today.

A private-sector economist whose commentary I follow has typecast monetary policy options as aggressively stimulative, stimulative, neutral, restrictive, and aggressively restrictive. I think this is a useful framework. In those terms, policy will likely transition from aggressively stimulative toward merely stimulative.

Let me recap my main points. Much progress has been achieved since December 2008, when the Fed's policy rate reached zero, and mid-2009, when the recession ended. That progress has been accomplished with the support of extraordinary monetary policy. Current and prospective economic conditions increasingly do not demand the most aggressive stance of policy. I think the time to begin normalizing monetary conditions is close. Once underway, the process of raising interest rates to more normal, sustainable levels will likely be gradual. It has been a long story, sometimes frustratingly so, but one I am increasingly confident will have a happy ending.

Contact: Jean Tate 404-498-8035

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