SPEECHES

Outlook and Policy Views

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DeKalb Chamber of Commerce
Atlanta, GA
November 19, 2015

- Atlanta Fed President and CEO Dennis Lockhart speaks to the DeKalb Chamber of Commerce in Atlanta on November 19, 2015, about the economy, interest-rate policy, and what he expects in a policy normalization phase.
- Lockhart believes some important aspects of the economic picture are weaker than a year ago, energy being a prime example. Inflation has been running below the FOMC's longer-run target for a while, but Lockhart expects the gap to close gradually.
- Still, Lockhart believes the national economy is on a reasonably solid trajectory. On balance, the data have been encouraging and affirm the economy is growing at a moderate pace.
- Lockhart is comfortable moving the federal funds rate off zero soon, conditioned on no marked deterioration in economic conditions.
- Lockhart expects the trajectory of policy rate rises to be dictated by the evolution of the economy and the balance of risks. There won't be a predetermined path, and policy decisions will continue to be data dependent. The normalization phase might look somewhat different than one's sense of normal based on historic episodes of rising rates.

Today I will offer a few thoughts on the position of the economy, the stance of interest-rate policy, and what I expect in a normalization phase.

As always, these will be my personal views and may not reflect those of my colleagues here or other colleagues on the Federal Open Market Committee (FOMC) or in the Federal Reserve System.

We are four weeks away from the December meeting of the FOMC. I won't predict the outcome. There are more data points to evaluate over the next four weeks. I will be processing that information to see whether the incoming data change my sense of the health and momentum of the economy—said differently, whether the data broadly support or undermine my base case outlook.

I believe the national economy is on a reasonably solid trajectory.

Certainly, there are some important aspects of the economic picture that are weaker than, say, a year ago. The energy sector—both investment and employment—is a prime example. The external sector—captured in the GDP accounting as net exports—is another aspect of the economy that is weaker than in 2014. Domestic manufacturing has been a bit softer as a result.

Still, on balance, the data have been encouraging, in my view, and affirm that the economy is growing at a moderate pace. Real final domestic demand data have been quite solid, driven in large part by robust consumer spending.

Supporting consumer spending, employment conditions are undeniably, in my opinion, much improved relative to even a year ago. We can debate the extent of remaining labor resource slack, but I think the Committee's earlier liftoff criterion of seeing "further improvement" has been met.

The inflation picture is not so clear, however. Inflation has been running below the Committee's longer-run target for a while. But I expect the gap to close gradually as the reduction in resource slack puts upward pressure on prices and the effects of the decline in oil prices and the rise of the dollar exchange rate subside.

For me, a key point regarding inflation is that conditions have not been deteriorating, just hanging below target. Consistent with my rather sanguine outlook for inflation, survey measures of inflation expectations are not signaling imminent broad disinflation, in my view.

My overall assessment of the economy and my medium-term outlook have not really changed much over the last year. Before the breakout of heightened financial market volatility in August, I was ready to support liftoff at the September meeting. But I supported the decision to hold off. I thought it was prudent to monitor global developments for a while.

I also supported the decision at the October meeting to keep the policy rate unchanged because not enough new information had accumulated regarding the drivers of the August volatility. I'm now reasonably satisfied the situation has settled down—at least as regards the likely causes of market volatility that converged in August.

So, I'm comfortable with moving off zero soon, conditioned on no marked deterioration in economic conditions. Given my reading of current conditions and my outlook views, I believe it will soon be appropriate to begin a new policy phase.

The term "normalization" has been used frequently to shape expectations for this post-liftoff phase.

Let me make a few points about what I expect normalization to look like, given what I know today.

I expect the trajectory of policy rate rises to be dictated by the evolution of the economy and the balance of risks, as you would expect. There won't be a pre-determined path, in my expectation. As other policymakers have said, policy decisions will continue to be data dependent.

In that context, I currently expect the path of policy increases to be relatively gradual or shallow, reflecting a cautious approach to the tightening of financial conditions shaped by policy. As a result, the pace of increases may be somewhat slow and possibly more halting than historic episodes of rising rates.

Moreover, to the extent the evolving economic picture allows a process leading to a "resting place" (a neutral or equilibrium rate), that point might be lower than in the past, as implied by a somewhat lower trend rate of economic growth.

I'll sum up by saying I think the normalization phase might look somewhat different than one's sense of normal based on historic episodes of rising rates.

As I said earlier, I am offering my personal views here. I will not predict the outcome of the next FOMC meeting. But I will say there are at least three contrary perspectives that could come out in a debate about the timing of the start of normalization.

First, there could be differing views on resource and output gaps. One might hold the view that economic conditions are just not yet close enough to the Committee's objective of full employment.

Second, there could be concern that we have seen little or no evidence of inflation moving in the desired direction. This has been called the "whites of their eyes" perspective. The reference, of course, is to the Revolutionary War officer's command not to shoot until troops could see the whites of the Redcoats' eyes. In this case, the idea is not to raise the policy rate until evidence of inflation moving higher is in hand.

Third, there could be continuing concern about risks associated with global conditions along with the prospect, for example, of further dollar appreciation weighing on domestic activity more than is currently estimated.

These are serious concerns. At this point, I don't find them persuasive enough to dissuade me from supporting in the near term a first move to raise rates.

In my opinion, the decision to raise the bedrock policy rate, when and if it comes, should be seen as affirming that the economic outlook is positive. I would hope the announcement effect would bolster confidence in our economic future and contribute to the very outcome I've forecasted as the outlook yields to reality.

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