FEDERAL RESERVE
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Acting to Avoid a Great Stagnation

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September 20, 2012

Avoiding a Great Stagnation

- Historians use “Great” to reflect success – e.g., Alexander the Great
- Economists use “Great” to reflect difficult episodes and policy that contributes or fails to alleviate – e.g., Great Depression, Great Recession
- Forceful action necessary – and being taken – to avoid a Great Stagnation

What Would Constitute A Great Stagnation?

- Policymakers accepting as inevitable a slow growth economy and underutilized economic resources
- Allowing high unemployment to become a more permanent feature of the economy
- Policy only reacting to large negative shocks; accepting slow growth that makes little progress in returning to full employment

Acting to Avoid It: Our Monetary Policy Response to Global Slowdown

- Seek faster growth than has occurred or is likely to occur without action
  - Asset purchases (agency mortgage-backed and Treasury securities)
  - More open-ended focus on economic outcomes rather than calendar dates or amounts purchased
  - Communicating that we anticipate low short-term rates likely to be warranted at least through mid-2015; accommodative until recovery is sustainable
  - Context of price stability; assessment of costs, efficacy

Our Monetary Policy Response Continued…

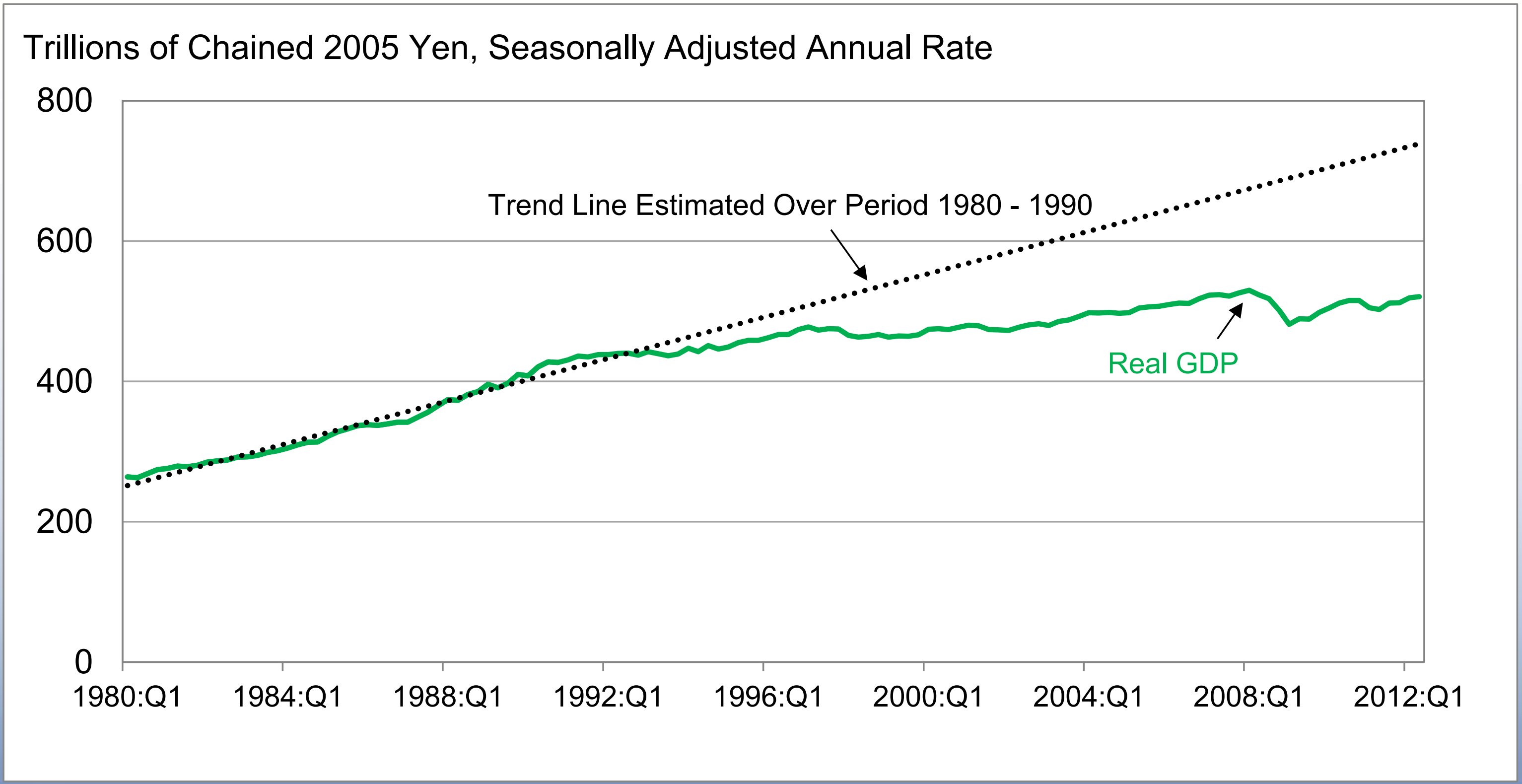
- Unconventional policy has risks, but they are preferable to the risk of another year or more of economic stagnation
- My rationale for policy change…

Real-World Example of Stagnation

- Japan and Europe have both suffered long periods of slow growth
- Today I will focus on Japan – despite some key differences from the U.S.
  - Demographics – Japanese population's average age is rapidly rising
  - Slow response to banking problems

Figure 1
Japan's Real Gross Domestic Product

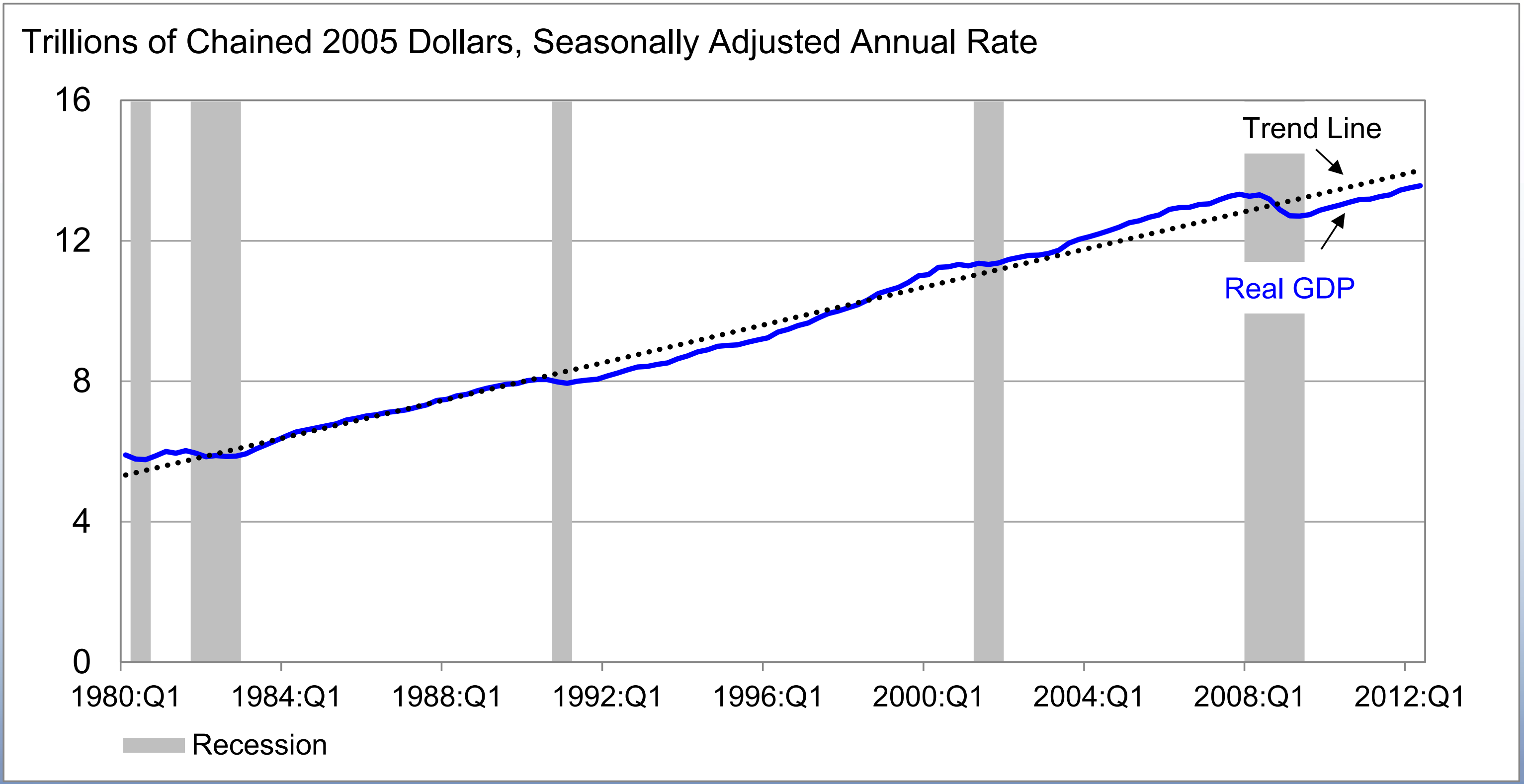
1980:Q1 - 2012:Q2



Source: Cabinet Office of Japan / Haver Analytics

Figure 2
U.S. Real Gross Domestic Product

1980:Q1 - 2012:Q2



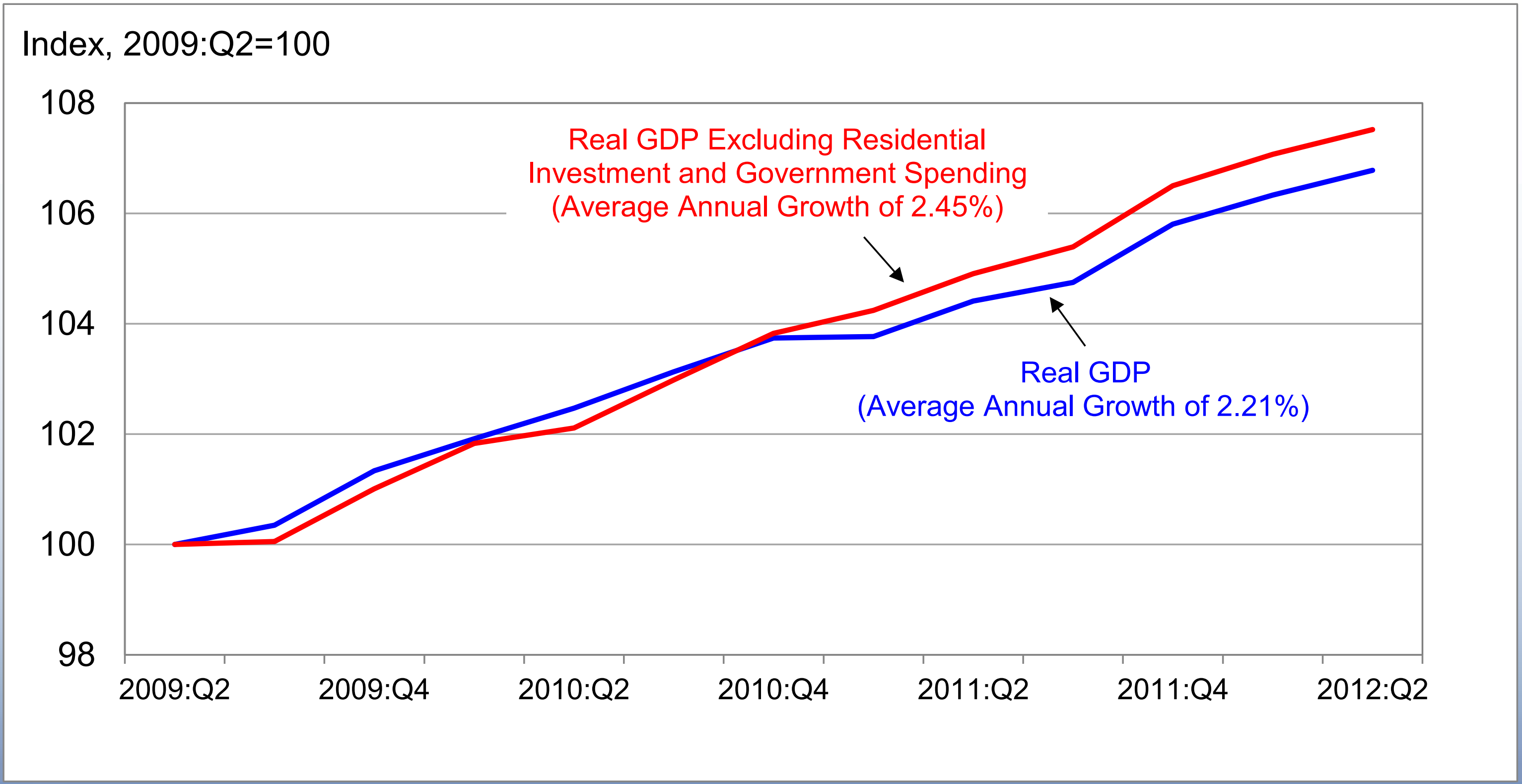
Source: BEA, NBER / Haver Analytics

Causes of Slow Growth

- Not unusual after a financial crisis
- Let's look at a few factors (not enough time for a detailed discussion)

Figure 3
Growth in Real GDP and Real GDP Excluding Housing and Government Spending

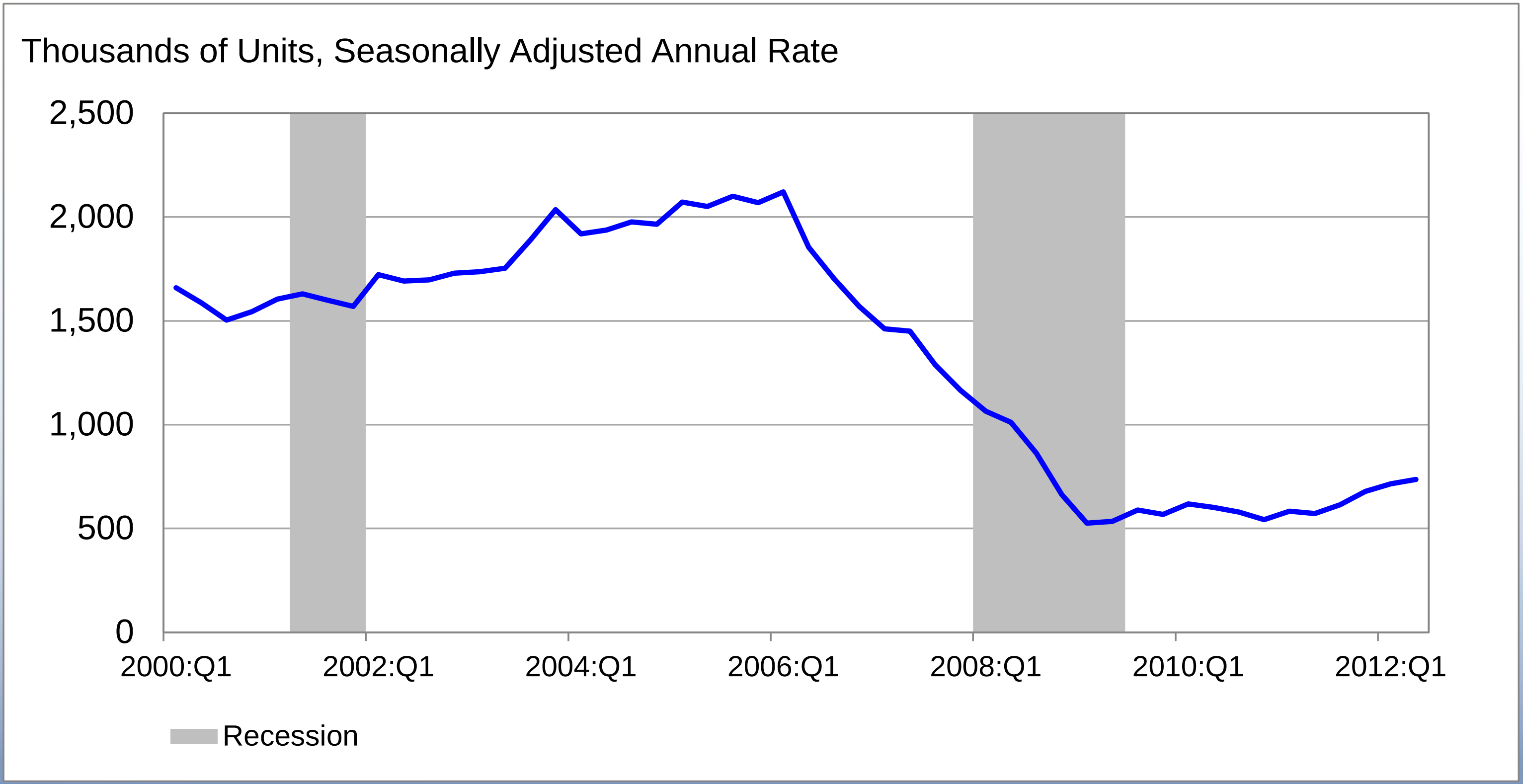
2009:Q2 - 2012:Q2



Source: BEA, NBER / Haver Analytics

Figure 4
Housing Starts

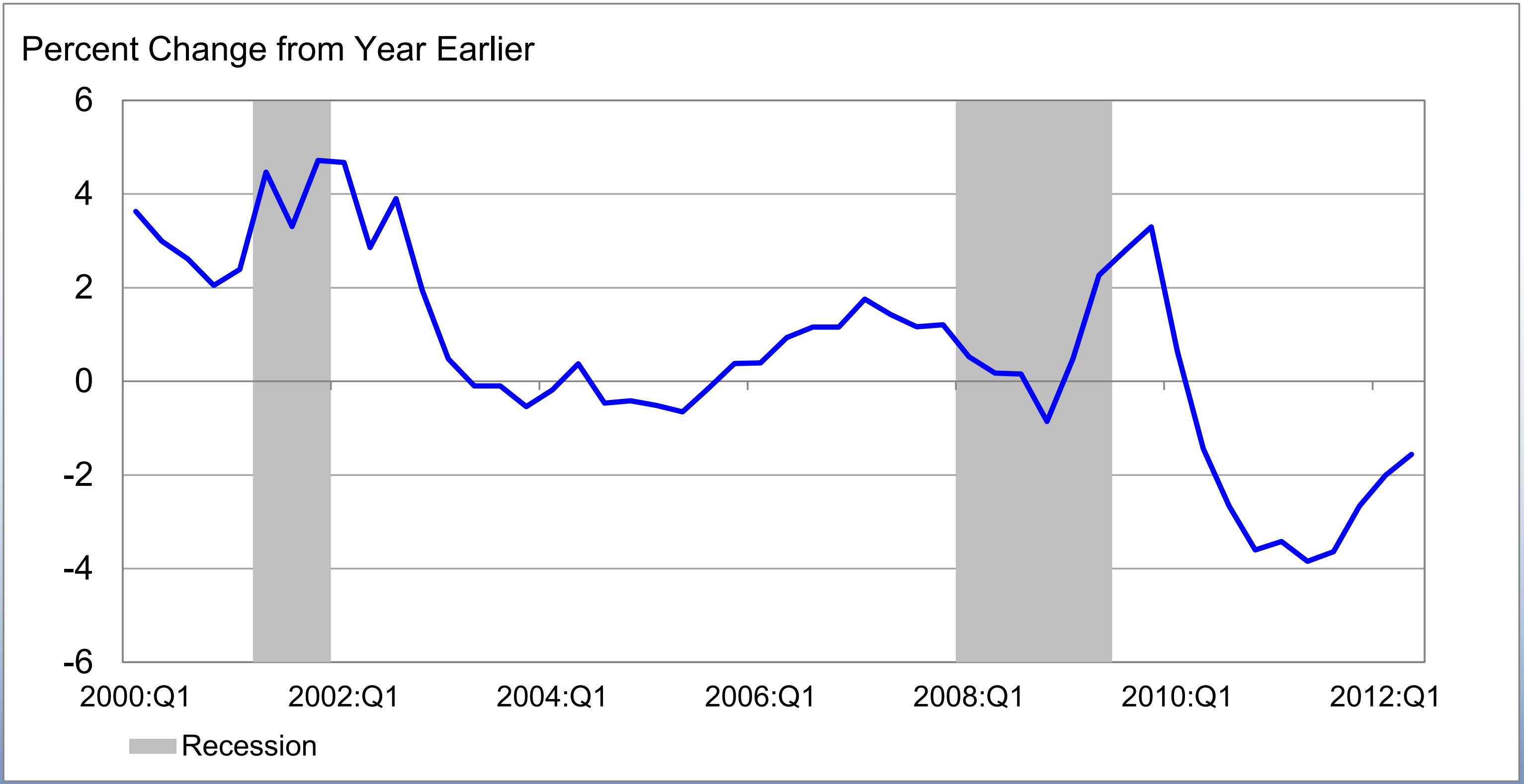
2000:Q1 - 2012:Q2



Source: Bureau of the Census, NBER / Haver Analytics

Figure 5
Growth in Real State and Local Government Spending

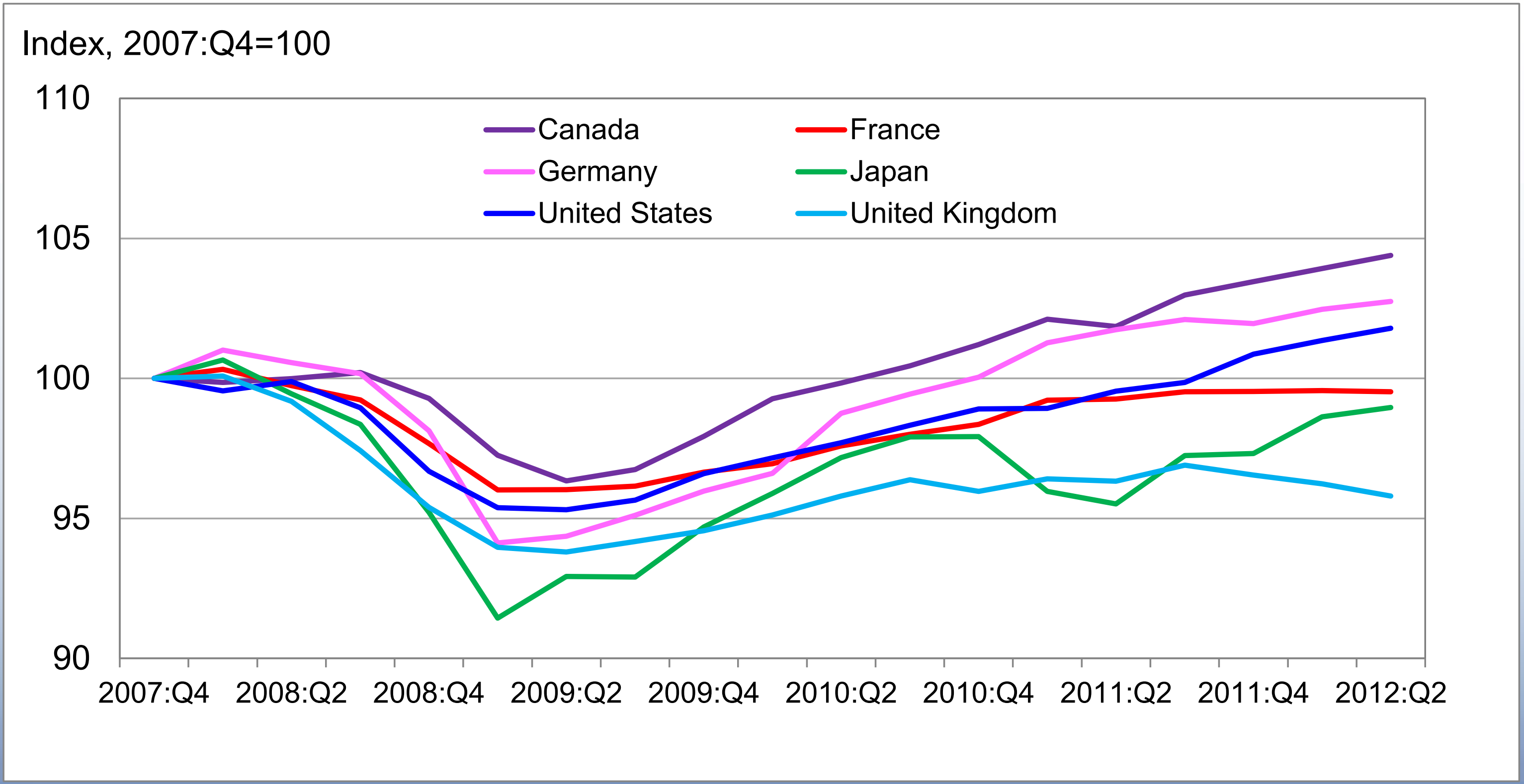
2000:Q1 - 2012:Q2



Source: BEA, NBER / Haver Analytics

Figure 6
Change in Real GDP from U.S. Business Cycle Peak by Country

2007:Q4 - 2012:Q2



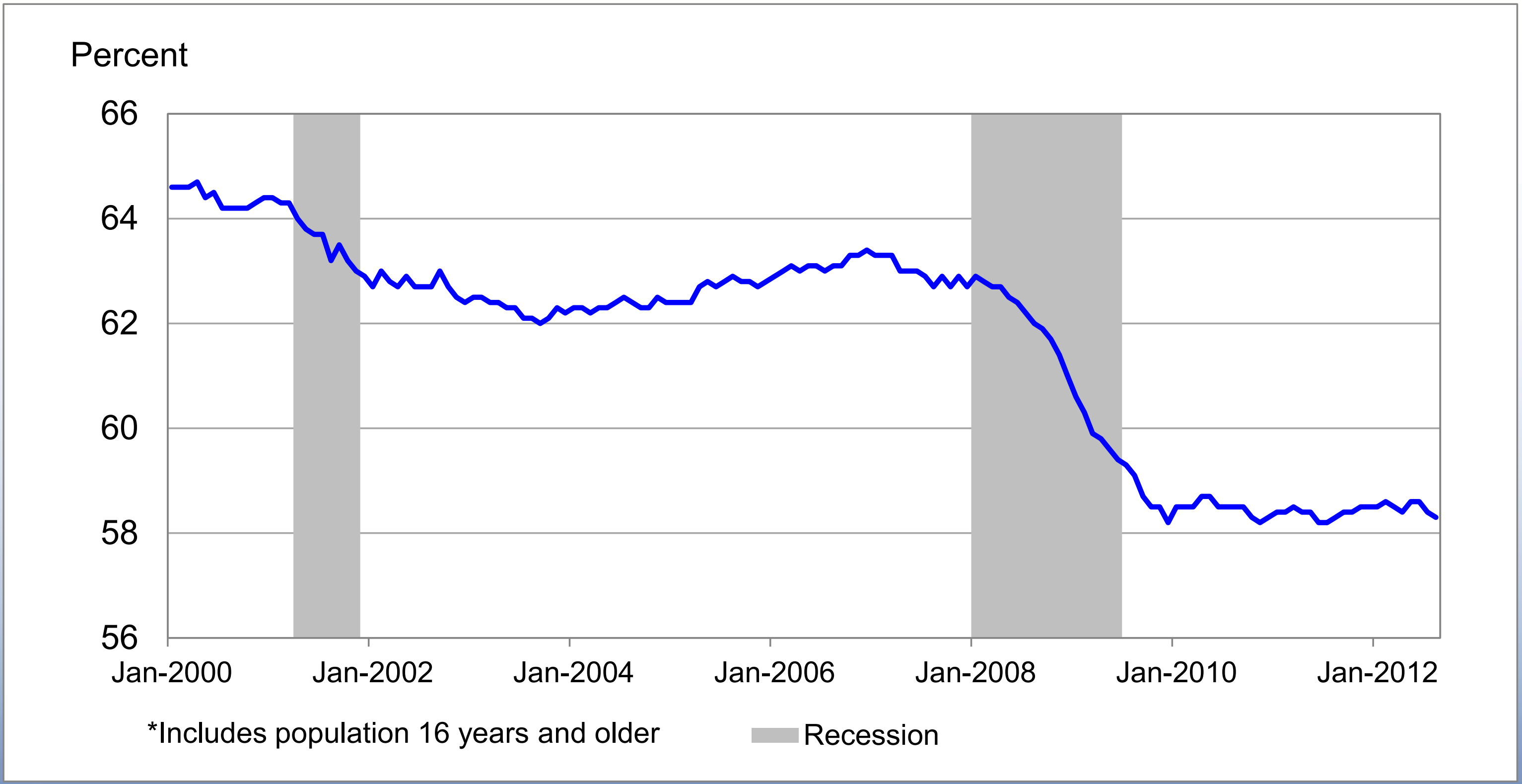
Source: BEA, CAO, Eurostat, ONS, INSEE, StatCan / Haver Analytics

The Significant Costs of a Slow Recovery

- Impact on those unemployed or underemployed
- Temporary labor market problems can eventually become more permanent because of a slow recovery

Figure 7
Employment-to-Population* Ratio

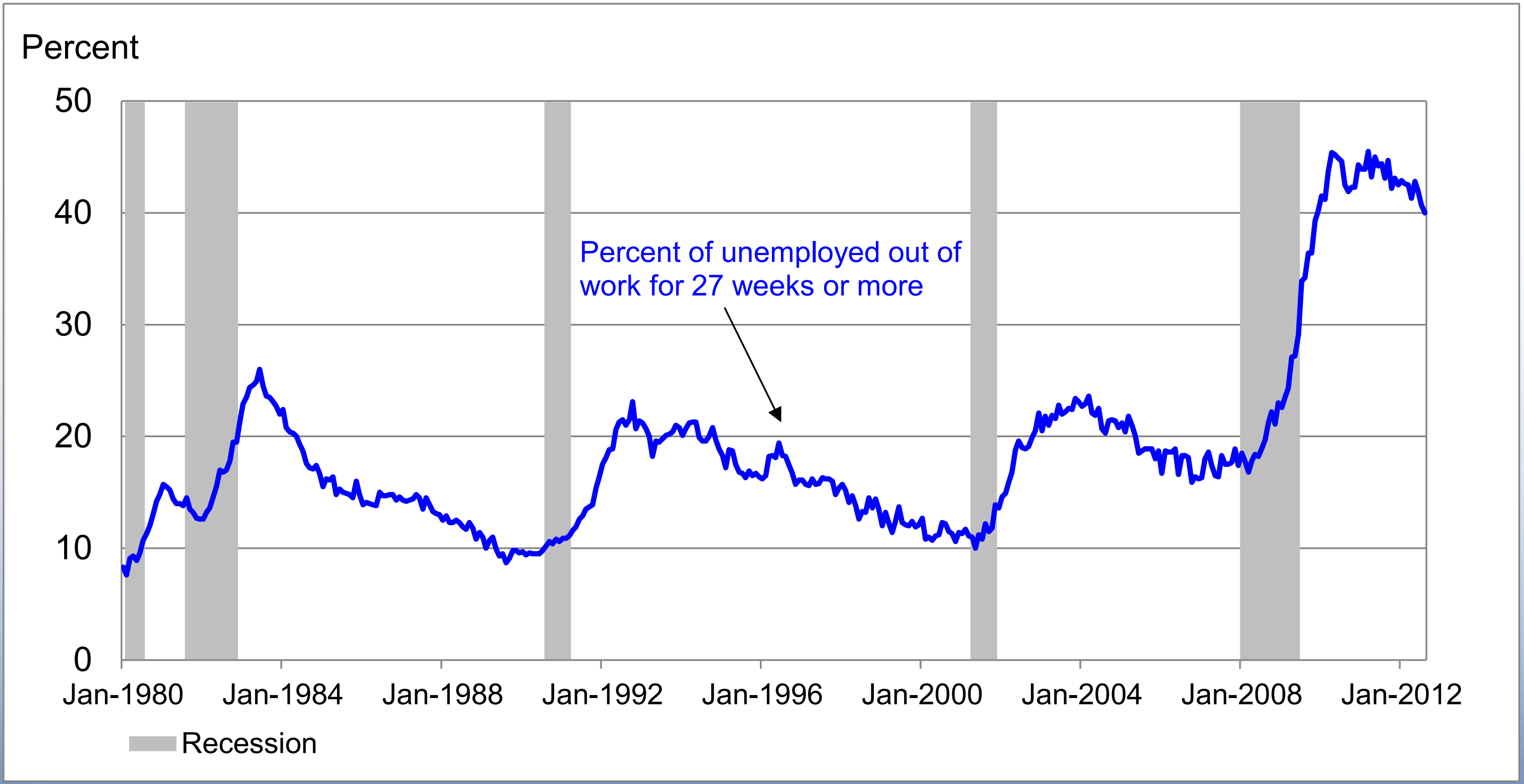
January 2000 - August 2012



Source: BLS, NBER / Haver Analytics

Figure 8
Long-Term Unemployment

January 1980 - August 2012



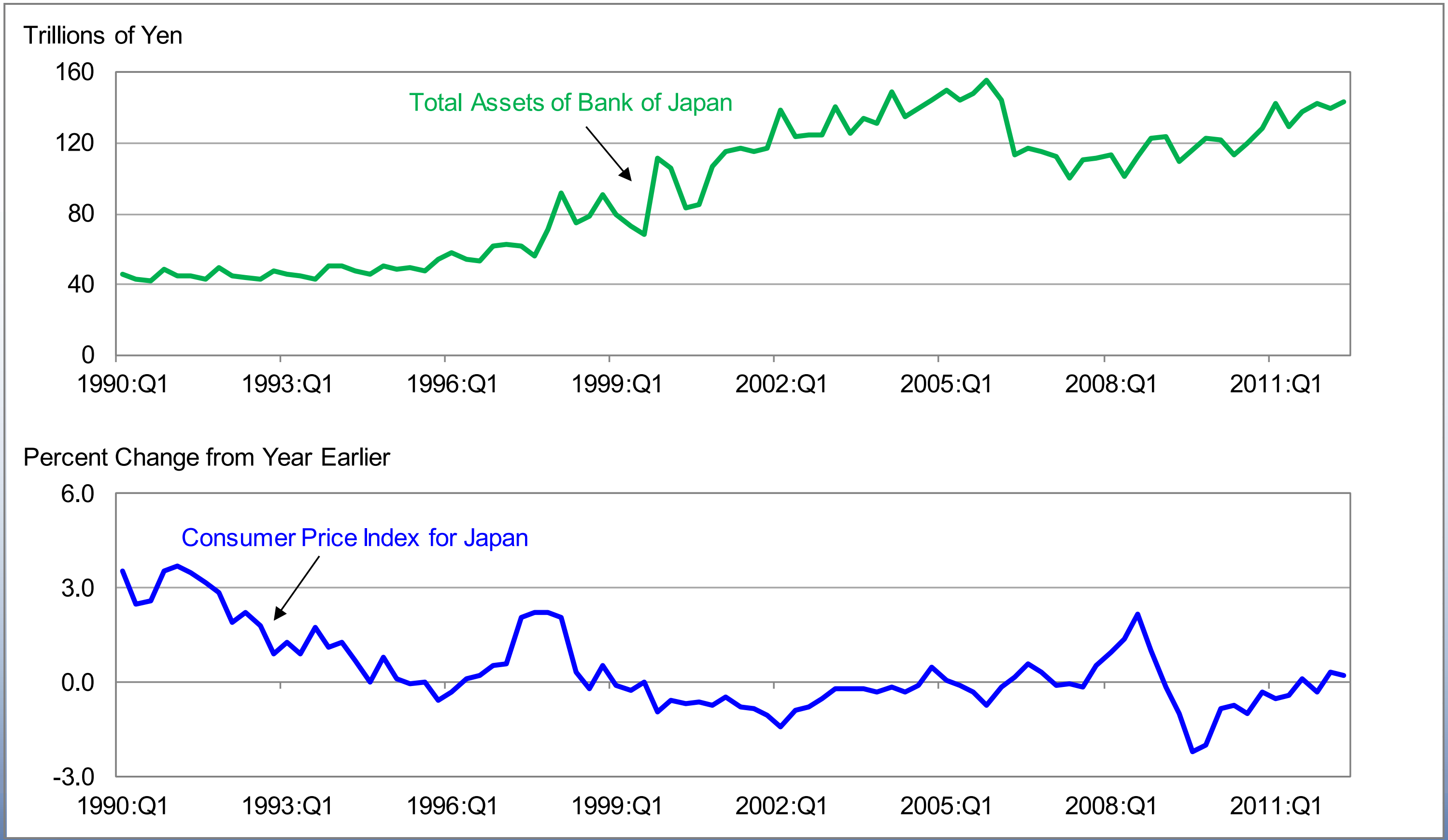
Source: BLS, NBER / Haver Analytics

What Should Monetary Policymakers Do?

- Conventional response – lower short-term rates… not possible at the zero lower bound
- Unconventional responses
  - More costs
  - Impact less certain
  - Still, not a reason to avoid necessary actions

Figure 9
Japan's Central Bank Assets and Inflation Rate

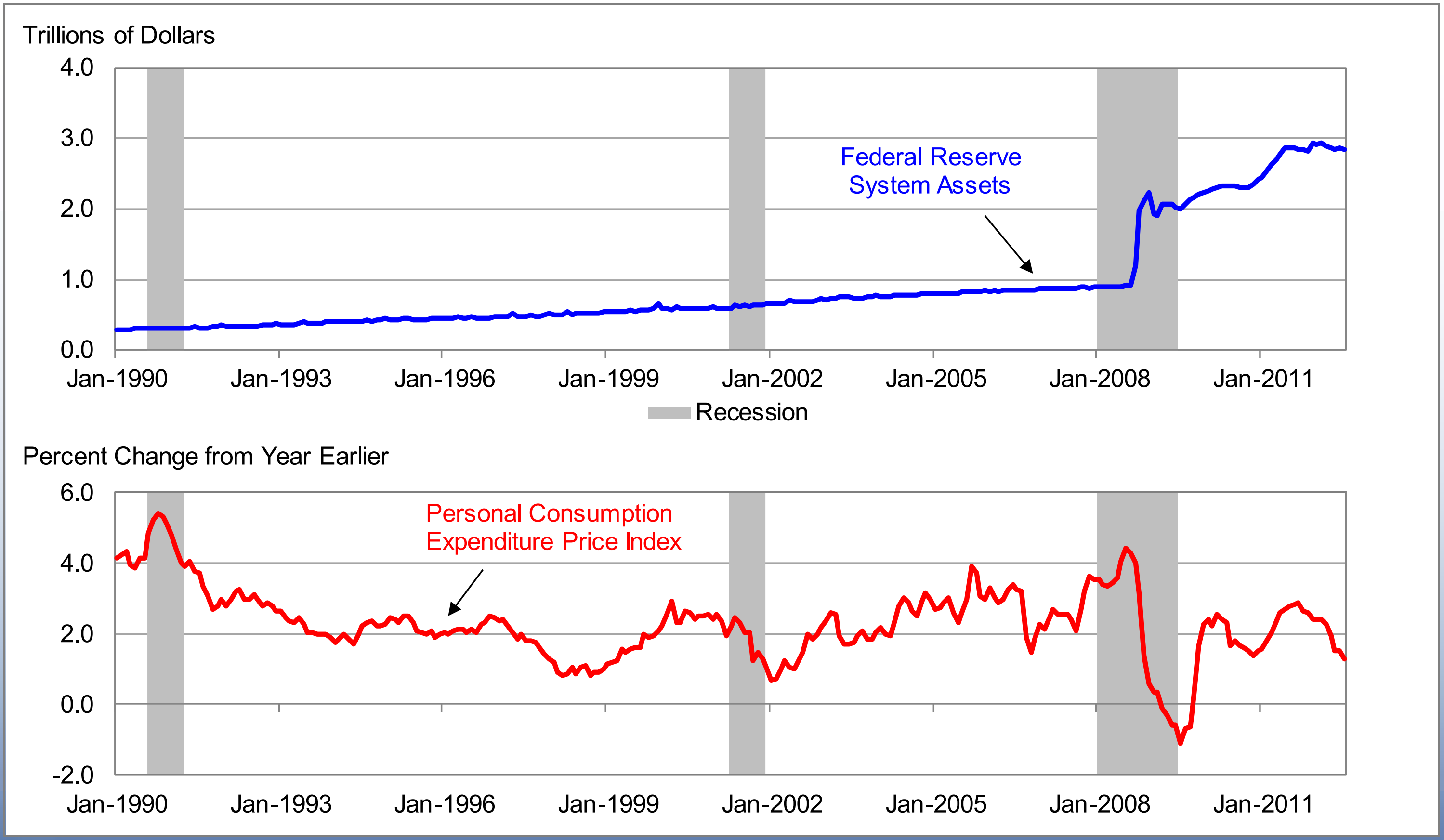
1990:Q1 - 2012:Q2



Source: Japanese Ministry of Internal Affairs and Communications, Bank of Japan / Haver Analytics

Figure 10
Federal Reserve System Assets and U.S. Inflation Rate

January 1990 - July 2012



Source: Federal Reserve Board / Haver Analytics

FOMC Announcement

- Asset purchases
  - $40 billion per month of agency Mortgage-Backed Securities (MBS)
  - Continued exchange of short-term Treasury securities for an equal amount of long-term securities through the end of the year – $45 billion per month – via the maturity extension program begun in June

Announcement Continued…

- Plan is more open-ended – continue purchases until there has been sustained improvement in labor markets – end based on economic outcomes, not a set purchase amount or a date
- Committee expects the highly accommodative stance of monetary policy will remain appropriate for a considerable time after the economic recovery strengthens – currently anticipate low rates are likely to be warranted at least through mid-2015

Figure 11
Financial Market Response to FOMC Announcement

August 1, 2012 - September 14, 2012

	September FOMC Statement 9/12 - 9/13	Day After FOMC Statement 9/12 - 9/14	Chairman Bernanke's Jackson Hole Speech 8/30 - 9/14	Previous FOMC Statement 7/31 - 9/14
S&P 500 (Percent Change)	+1.6%	+2.0%	+4.7%	+6.3%
Exchange Rate: Euros Per Dollar (Percent Change)	-0.1%	-1.9%	-4.9%	-6.3%
5-7-Year Investment-Grade Corporate Bond Yield (Change in Basis Points)	-4.4 bp	-3.8 bp	-5.4 bp	-12.9 bp
Yield on 30-Year FNMA Current Coupon MBS (Change in Basis Points)	-24.4 bp	-12.5 bp	-12.1 bp	-1.7 bp

Source: Federal Reserve Board, Bank of America Merrill Lynch, WSJ, Bloomberg / Haver Analytics

Conclusion

- Action intended to promote faster growth and return to full employment more quickly
- But monetary policy is not a panacea – large shocks can be mitigated, but likely not offset
- While policy will quicken recovery – it still will take time
- This underlines the importance of forceful and timely action necessary to avoid the dubious title of “Great”