Outlook for the Economy in the New Year

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January 7, 2014

Economic Summit & Outlook 2014
Connecticut Business & Industry Association and MetroHartford Alliance
Hartford, Connecticut
Outlook for 2014

- Most forecasters expect real GDP growth rate to be above the potential rate in 2014, as:
  - The drag from fiscal austerity wanes
  - Consumers regain confidence and increase demand
  - Housing market solidifies its nascent recovery
- I share the view that we can expect 3 percent growth beginning this year
Overview of My Remarks

- Improved “tone” to incoming data (and revisions)
- Yet, the economy remains far from our 2 percent inflation target and full employment (5.25 percent)
  - Inflation, both in the U.S. and in many developed countries, is lower than the targets set by central banks
  - Prolonged unemployment can cause longer-lasting damage to individuals if skills atrophy, but also to families suffering the financial hardship
  - Prolonged unemployment also impacts the labor market and economy more broadly – possibly even after the recovery is complete
- U.S. policymakers should remove monetary accommodation gradually, to minimize the costs and risks of not returning to full employment more quickly
# Figure 1: Payroll Employment Growth: Data and Revisions

**Released July 5, 2013 - December 6, 2013**

Payroll Employment Growth in Thousands of Jobs
Initial Estimates and Subsequent Revisions

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Source: BLS, Haver Analytics
Figure 2: Civilian Unemployment Rate
January 1980 - November 2013

Source: BLS, NBER, Haver Analytics
Figure 3: Growth in Real Government Spending
2007:Q1 - 2013:Q3

Source: BEA, NBER, Haver Analytics
Figure 4: Consumer Confidence
January 2007 - December 2013

Source: Conference Board, Haver Analytics
Figure 5: Dow Jones 30 Industrials
December 31, 2012 - January 3, 2014

Source: Dow Jones, Haver Analytics
Figure 6: Unemployment and Inflation Gaps
December 2007 - November 2013

Note: Unemployment gap is relative to a 5.25% unemployment rate at full employment. Inflation gaps are relative to a 2% inflation target.

Source: BEA, BLS, Haver Analytics
Figure 7: Measures of Inflation: Changes in Total, Core and Trimmed Mean CPI and PCE Indices
January 2012 - November 2013

Source: BEA, BLS, Federal Reserve Bank of Cleveland, Federal Reserve Bank of Dallas, Haver Analytics
Figure 8: Price Level Path: Total and Core Personal Consumption Expenditure (PCE) Price Indices
December 2007 - November 2013

Source: BEA, Haver Analytics
Figure 9: Measures of Inflation Targeted by Central Banks
January 2012 - November 2013

Source: BEA, Eurostat, Japan’s Ministry of Internal Affairs and Communications, Haver Analytics
Problems with persistently low inflation rates

- First, at very low inflation rates, a sizable negative shock to the economy can result in negative inflation – deflation – which can become entrenched in expectations.
- A second concern with low inflation is that with nominal rates bound at zero, *real* short-term interest rates are determined by the inflation rate and may remain too high.
Figure 10: Real Interest Rates
January 2012 - November 2013

Source: BEA, Federal Reserve Board, Haver Analytics
Figure 11: Quits Rate
December 2000 - October 2013

Note: Quits rate is the number of quits during a month as a percent of total employment.

Source: BLS, NBER, Haver Analytics
Figure 12: Employment-to-Population Ratio for Individuals Age 25 - 54
January 2007 - November 2013

Source: BLS, NBER, Haver Analytics
Figure 13: Long-Term Unemployment: Percent Unemployed for 27 Weeks or More
1980:Q1 - 2013:Q3

Source: BLS, NBER, Haver Analytics
Still Significant Slack in Labor Markets

- Implications of a continued slow recovery
  - Permanent loss of workers from the formal labor force
  - Skills atrophy and workers despair of a match to existing jobs
- Policymakers need to consider the cost of a slow recovery relative to the risk of taking actions that would more quickly return the economy to full employment
Concluding Observations for Monetary Policy

- The FOMC reduced purchases of long-term securities from $85 billion to $75 billion, but noted:
  - The removal of accommodation would be gradual
  - Short-term interest rates were likely to remain at the zero lower bound well past the time the unemployment rate fell below the 6.5 percent unemployment threshold
  - There are significant costs to a slow recovery, and this one has been too slow
  - Gradual normalization of support is very appropriate given that the unemployment rate remains high and the inflation rate remains low