The U.S. Economy: An Optimistic Outlook, But With Some Important Risks

By Eric S. Rosengren

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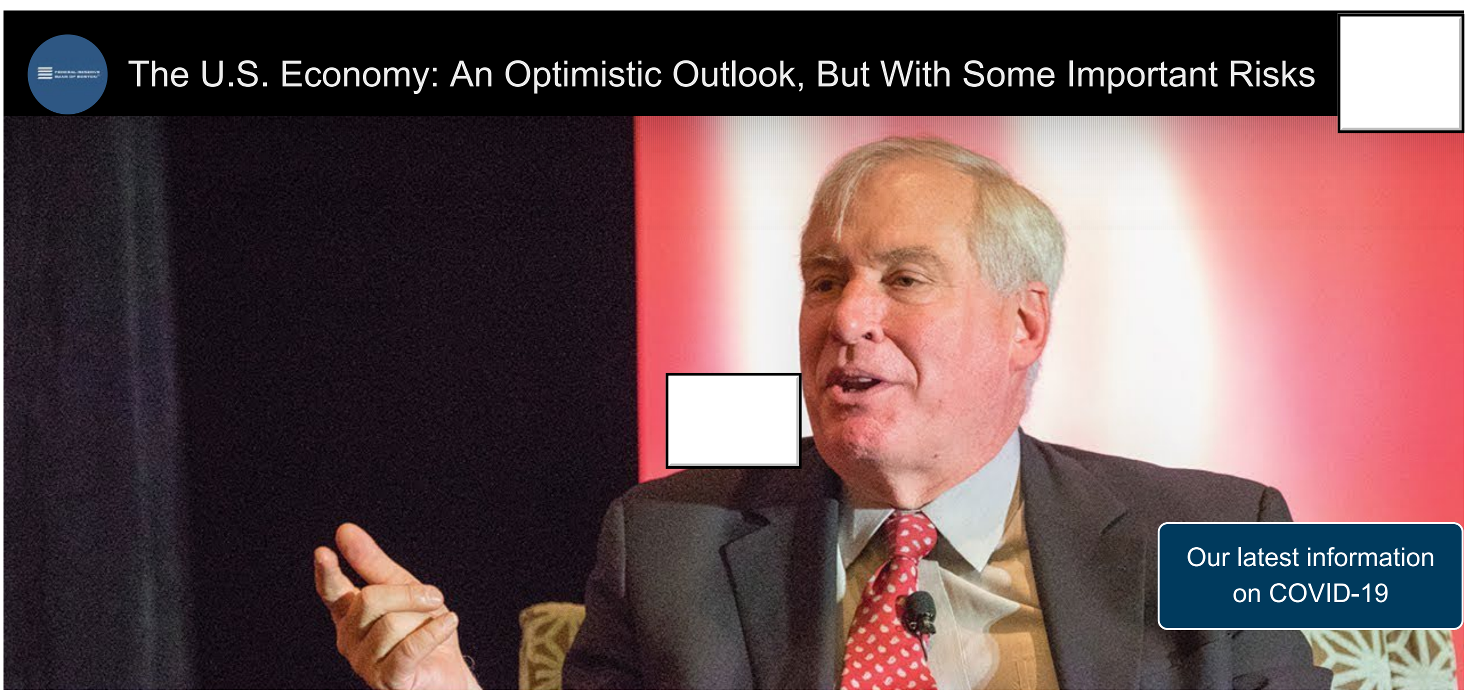

Boston Fed President Eric Rosengren said Friday that his own economic forecast and the forecasts of his colleagues on the Fed's policy committee are "quite positive" – citing fairly strong economic growth, job creation, falling unemployment, and inflation rising close to the Federal Reserve's 2 percent target.

But Rosengren detailed both short-run and longer-run risks to that positive outlook.

On short-run risks, Rosengren is not forecasting significant trade disruptions or substantial boom-bust problems, but said "I think it is important to identify risks worth thinking about and watching for."

"It would take a significantly broader set of trade actions than those reported to date to materially reduce the roughly $2.4 trillion in annual U.S. exports," Rosengren said. "Still, spillover effects are possible." He added that concerns about these possible disruptions likely explain some of the heightened volatility in stock prices of late.

Also, an overheated "boom-bust" scenario could become more likely if unemployment moves far below where policymakers expect labor markets to settle in the long-run, Rosengren said. He noted that today's unemployment rate is below the Congressional Budget Office's estimate of the natural rate.

"Periods in which unemployment dipped significantly and persistently below the estimated natural rate historically have tended to generate conditions that resulted in a recession," Rosengren said, showing the relevant historical charts.

Turning to longer-run risks to the economic outlook, Rosengren said that the current status of fiscal and monetary policy buffers "call into question" their ability to work against a shock or downturn.

"By using up so much fiscal capacity now – by which I mean the ability to lower tax rates or boost federal spending to offset economic weakness –

the country risks not having sufficient fiscal capacity in the future when it might be needed," Rosengren said.

Additionally, there is "some reason" to be concerned about how aggressively monetary policy can respond to a large adverse shock, noting the median forecast among FOMC members for longer-run interest rates is 2.9 percent – "quite low" by historical standards, resulting from slow labor force growth coupled with slow growth in productivity.

"Since in many recessions we lower rates by as much as 5 percentage points, it is quite likely that interest rates would reach zero again in a downturn," Rosengren said.

Rosengren is, in sum, hopeful these risks can be avoided. "The economic outlook is good, but we all must be attuned to what could go wrong in the short term and in the long term, and what that implies for appropriate monetary policy."

Rosengren was speaking at the Greater Boston Chamber of Commerce's Economic Outlook Breakfast 2018 in Boston, MA.

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