Assessing Economic Conditions and Risks to Financial Stability

By Eric S. Rosengren

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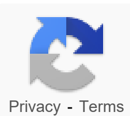
1. **Takeaway: The central bank's monetary policy stance is already accommodative, whether the Fed Funds rate is judged relative to inflation or relative to its long-run neutral level.**

   Excerpt: *"Yet, it is notable that the federal funds futures market is pricing in a significant probability of another decrease by year end. The market apparently believes the economy needs added stimulus to continue the expansion. My own view is different."*

2. **Takeaway: The economic data suggest continued expansion. The national unemployment rate is currently at 3.7 percent – very low by historical standards. And inflation is moving toward the Fed's 2 percent target.**

   Excerpt: *"Current economic conditions are quite favorable, and stable, and private forecasters expect those conditions to remain quite similar through the end of the year. […] The data we have in hand suggest instead that the*



recovery would continue apace even with little monetary policy accommodation. […] In my view, with inflation near target, this level of accommodation is not needed.”

3. **Takeaway: Risks to the economic outlook are of concern, to be sure. The trade dispute with China is having an impact on both the U.S. and global economies. Still, growth near its estimated sustainable rate is continuing.**

   Excerpt: *“Even with these trade-related impediments, real GDP grew 2 percent in the second quarter, a bit above my estimate of its sustainable rate. And economic forecasts, which incorporate the effects of tariffs and slower global growth on the U.S. economy, expect growth to continue in real terms at close to 2 percent.”*

4. **Takeaway: Responding to the risks to the outlook with too much monetary accommodation entails costs, and introduces risks of its own. One such risk is the potential build-up of economic instability as households and firms respond to lower interest rates by taking on too much debt.**

   Excerpt: *“The current situation involves pushing rates lower when asset prices, and in particular some risky asset prices, already seem inflated. I don’t see current financial risks as causing a downturn, but such conditions have the potential to amplify a downturn should it occur. […] Additional accommodation is not needed for an economy where labor markets are already tight – and risks further inflating the prices of riskier assets, and encouraging households and firms to take on what may be too much leverage.”*

5. **Takeaway: The costs of credit conditions that are too accommodative can appear in unexpected places. One potential financial stability risk has to do with an evolving market model of co-working spaces in many major urban office markets.**

   Excerpt: *“This is an important time in the cycle to be thinking about structures and situations that could challenge financial stability in a downturn. The combination of reaching for yield with runnable liabilities is a common problem in financial stability situations. It’s important to think about the potential for runs on commercial real estate stemming from a situation where short-term leases might not be renewed in recession, and long-term leases are no longer economically viable. Interest rates play into the situation, as low rates potentially lead to a reach for yield, and building owners are more willing to lease to SPEs to get higher returns (rents) at a time when capitalization rates are quite low.”*

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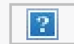
collapse all  expand all

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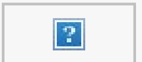

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