SPEECH

The National and Regional Economic Outlook

October 24, 2011

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Remarks at Fordham University's Gabelli School of Business, Bronx, New York

As prepared for delivery. Text modified in sixth paragraph at 3:00 p.m.

Good morning. I am pleased to be at Fordham University, one of the crown jewels of the Bronx. It is always a pleasure to speak with students, faculty and senior university advisors because you are key leaders in your communities.

Over the past 20 months, I have been engaged in a series of outreach meetings all across my Federal Reserve District. I consider these visits just as important as my trips to Washington, D.C., to help formulate monetary policy or to Switzerland to shape international bank regulation. The understanding of issues and concerns that I gain today will help ensure that my policy decisions reflect the public interest in the broadest sense.

Each visit within the region helps me deepen relationships with the people I represent. As you may know, the New York Fed's District includes all of New York State; 12 counties in northern New Jersey; Fairfield County, Connecticut; Puerto Rico; and the U.S. Virgin Islands. In August, I met with community leaders, businesses and elected officials in Newark, Patterson and Jersey City. Earlier this year I went to Brooklyn, Queens and Puerto Rico, while last year I visited several upstate cities.

Although the Bronx is the second smallest borough, it is hardly small. It would take the combined population of three to four average U.S. cities to add up to the 1.4 million residents found here. You host world-class institutions such as the Yankees, the Bronx Zoo, the New York Botanical Garden, the Montefiore Medical Center, the Hunts Point Market and Fordham University. You also are home to the largest Dominican population in the City and sizable groups from Jamaica, Mexico, Ecuador, Ghana and Honduras. In sum, the Bronx is a major metropolitan area and economic force in its own right.

What the New York Fed Does

By way of introduction, I will briefly review what the New York Fed does and what makes my job so interesting. As always, what I have to say reflects my own views and not necessarily those of the Federal Reserve System or the Federal Open Market Committee, also known as the FOMC.

I am vice chair of the FOMC—a Federal Reserve committee that meets eight times a year in Washington to set interest rates and make other decisions about monetary policy. The members of this committee all strive to set policy to advance the mandate given to us by Congress to promote the maximum level of employment consistent with price stability. Sometimes we have different views on the specific policy choice on hand, and you should view this as completely appropriate: these are hard questions, particularly at times like this, and we make better decisions as a committee because we don't all think alike. But we are united in our commitment to our mandate and in our belief that Fed independence is essential in the public interest, because it allows us to take tough decisions insulated from short-term political pressures.

At FOMC meetings, each Committee member presents a current outlook for his or her region and the nation. For these assessments, we consult our researchers and add critical information that we learn from listening to our boards of directors, regional advisory councils and community leaders, such as you and others I'll meet on this visit. Later today I'll meet with the people at the Bronx Chamber of Commerce, Baldor Foods, Aging in America—a skilled nursing facility—and housing advocates.

At the New York Fed, we continually track conditions in our District, and we have created a number of tools for that purpose. For example, my staff produces monthly indexes of economic activity for New York City, New Jersey and New York State. These indexes are essentially local measures of output—similar to gross domestic product, or GDP at the national level. We have also started a consumer panel to track local household credit conditions, including the amount and type of debt owed by an average person and whether payments are being made in a timely way.

In addition, we have a new survey about credit and financing for small businesses, which are an important source of new jobs. The survey asks firms about credit applications and reasons for not seeking credit. Almost 900 regional businesses responded to our May 2011 poll—nearly 10 percent were from the Bronx. The next survey will be in January.

This December we will also host a workshop for the New York City metro area's small businesses—to provide them with information about credit enhancements and access to loans from the Small Business Administration.

As you know, even states as wealthy as New York have large pockets of poverty. So, we target some key initiatives specifically to low- and moderate-income groups. We have worked hard to help neighborhoods, including some in the Bronx, that face high foreclosure rates. For the past three years we have provided housing advocates with the latest information on mortgage conditions, via roundtables, presentations and newsletters. Later today, I'll tour some hard-hit areas with Matthew Wambua, commissioner of New York City Housing Preservation and Development.

This year, we'll hold our second Financial Awareness Video Competition in New York City. We invite college students to produce videos that encourage young adults to make sound financial decisions. Five Bronx colleges will participate this year.

To share what we learn about our diverse District, we have a rich website. I invite you to visit newyorkfed.org to explore our highly localized, current maps and information on small business, credit and housing conditions.

Finally, and crucially, in the aftermath of the financial crisis, we are working with our colleagues in Washington, D.C., and at other agencies to help put the nation's financial system on a firmer footing. Yet, much remains to be done and we are determined to keep at it. I recognize fully that there can be no return to pre-crisis business as usual—whether on the part of the financial sector or on the part of regulators like ourselves.

All in all, there is a lot to keep my colleagues busy.

National Economic Conditions
Now, let me update you on national economic conditions.

Put simply, growth in 2011 has been disappointing. We entered the year with some momentum, spurred by fiscal and monetary policy stimulus. GDP—the output of the U.S. economy—grew at a 3 percent annual rate from mid-2009 through 2010. While hardly a blistering pace, this growth was sufficient to add nearly 1 million jobs and reduce the unemployment rate by a half percentage point during 2010. Then, during the first half of 2011, growth slowed abruptly to a 0.8 percent annual rate. Job growth slowed so much that the unemployment rate rose back up to 9.1 percent.

Growth slowed partly because of temporary factors. As these factors have subsided, growth has picked up. At the moment, the consensus expectation for growth of real GDP in the third quarter—the first estimate of which we'll see on Thursday morning—is for an annual rate of 2.4 percent. But this is still quite disappointing relative to what we'd like to see or what we normally might expect at this stage in the economic recovery process.

Looking forward, I regard continued modest growth as the most likely outcome. This sluggishness convinces me that other, more persistent factors must also be holding back economic growth. And, given the depressed level of household and business confidence and the fragility evident in financial markets, I would also conclude that there remain significant downside risks.

It is worth taking a moment to elaborate on these points. First, what are the temporary factors that slowed growth in early 2011? Of the items noted in the published notes from our FOMC meetings, two bear special mention:

- Energy and commodity prices rose sharply over the six-month period ending in May 2011. This sapped households' real purchasing power here and abroad, so they responded by both consuming less and cutting savings.
- April's tragic earthquake and tsunami in Japan disrupted many global supply chains. For example, many automobiles assembled in the United States contain Japanese-made parts. When Japan was unable to produce these parts, U.S. vehicle production and sales slowed.
  I am certain that parts shortages also affected other sectors here and abroad.

These temporary factors are now waning. Energy prices are no longer rising rapidly. Manufacturing growth has rebounded. Sales of cars and light trucks have begun to recover. In addition, business investment in new equipment and software is expanding, business investment in nonresidential buildings is recovering, and export growth remains healthy.

Nonetheless, the economy clearly entered the second half of 2011 with only modest forward momentum. What are the factors that are preventing a more vigorous recovery? I'll call attention to four:

- First, problems in the housing market are a serious impediment to a stronger economic recovery. Residential construction —which typically boosts economic activity during a recovery—is at a standstill. Moreover, many homeowners are now consuming less because the decline in house prices reduced their wealth and they are concerned that the decline in home values and wealth may not be over.

  Mortgage rates are at record lows and house prices no longer appear overvalued on affordability measures. But obstacles to refinancing and access to credit for home purchases are limiting the support provided by low rates to house prices and consumption. Meanwhile, the large supply of foreclosed homes for sale—and the prospect that unemployment and negative equity will continue to feed the foreclosure pipeline—continues to put downward pressure on home values. The risk of further house price declines in turn discourages would-be buyers from entering the market.

Continued house price declines could lead to even more defaults, foreclosures and distress sales, undermining wealth, confidence and spending. Breaking this vicious cycle is one of the most pressing issues facing policymakers.

- Next, cutbacks in employment and spending by state and local governments intensified in 2011 and are likely to continue. Since mid-2008, state and local governments have shed 600,000 jobs. Spending adjusted for price increases is down by more than 2 percent in the past year, led by cuts in investments, such as spending on roads and bridges. Looking forward, states are likely to cut spending further as the federal government stimulus aid to states peters out.
- In addition, by law now on the books, the federal government will soon end much of the support it has been providing to the economy through stimulus programs. In 2012, certain investment incentives, emergency unemployment benefits and the reduction in employee payroll taxes will all expire. These changes will likely lead households to consume less and businesses to invest less for a while. Furthermore, the new Budget Control Act calls for more sharp cuts in federal spending. Our nation needs to get its public finances in order. Done correctly, with a focus on the long term, this could support confidence and growth. But it will be very important to avoid excessive short-term cutbacks or tax increases that could harm the recovery.
- Finally, the sovereign debt crisis in Europe has weakened the outlook for global growth and with it, U.S. exports. These problems have also contributed to pressures in financial markets globally that have resulted in a decline in stock market wealth. In addition, some financial institutions are facing pressures to cut back lending. To date, these effects have been much more acute in Europe than in the United States, but there are spillovers to our nation, and we need to monitor them carefully.

Thus, our economy continues to face some serious headwinds.

Without robust growth, the economy is more vulnerable to negative shocks, which unfortunately seem to keep coming. It is like riding a bicycle—at a slow speed, the bicycle wobbles and the risk of falling rises. Politics here and abroad have not helped. The intense debate around raising the debt ceiling and the subsequent downgrading of the federal debt took a toll on household and business confidence. More recently, the difficulties in Europe, along with lower U.S. growth prospects made investors less inclined to take risks. So, we saw a major stock market sell-off and widening credit spreads. All these events increase the downside risks to the growth outlook.

Let me turn now to the inflation outlook. As you may know, the FOMC has two charges: we are asked to promote stable prices as well as sustainable growth. This has been a tough year for both parts of our mandate. We've already discussed how unemployment is too high and the challenges in reducing it. At the same time, inflation has risen more than expected. Nevertheless, because monetary policy works with a lag, we have to make policy based not on where inflation is today, but where it is headed in the future. I believe that underlying fundamentals will help to subdue inflation over the next few quarters.

As of August, the 12-month change for a broad measure of consumer prices was 2.9 percent, almost double the 12-month change the year before. However, the bulk of that increase was due directly to the run-up of energy and other commodity prices that are very volatile, which means they bounce around a lot.

Measures of the underlying rate of inflation have moved up too, but by less and to levels broadly consistent with price stability. It is important to remember that a year ago many experts were worried that deflation—meaning a persistent, widespread decline in prices—might take hold. Deflation tends to inhibit growth because families and companies have a harder time paying down debt and tend to defer investments and purchases when prices and wages are falling. Avoiding outright deflation is a very good thing.

Some non-commodity prices have increased a bit more than expected over the past months, but I expect those to subside, as well. Rising rents for housing are likely be constrained by the large supply of vacant homes. Likewise, the surge in prices of apparel and new vehicles should soon be over.

Thus, barring more energy price jumps, which futures markets do not anticipate, I expect the inflation rate to fall late this year and next. All the fundamentals point in that direction. Many people are out of work, so wage pressures are unlikely to rise. Corporate profit margins are quite high, likely prompting greater price competition going forward. Moreover, households' inflation expectations remain well anchored. This last point is of critical importance. It is much harder to keep inflation in check if people begin to expect higher inflation. By the same token, low and stable inflation expectations help us to deliver low and stable inflation.

In light of the current weak outlook, the FOMC issued a statement after our last meeting saying that we expect to keep short-term interest rates exceptionally low at least through mid-2013. The committee also said it would change the composition of the assets the Fed holds on its balance sheet for monetary policy purposes. We are selling some of the short-term government debt that we hold and buying longer-term debt. This exchange should provide some additional support for growth. In addition, we discussed the range of policy tools available to promote a stronger economic recovery even as we keep inflation pressures in check.

Just like interest rate cuts in normal times, our monetary policy provides support through lower interest rates that encourage private-sector business investment and household spending. This policy tool should not be confused with fiscal stimulus or government spending.

I believe that the actions we have taken recently will be helpful in supporting growth and jobs. However, I do not think that monetary policy is all-powerful. To get the strongest possible recovery we need reinforcing action in areas such as housing and fiscal policy.

- Stabilizing the housing sector is particularly important because housing equity is an important part of household wealth. This calls for a comprehensive approach to housing policy, starting with an urgent effort to remove the obstacles that make it difficult for all borrowers to refinance at today's low mortgage rates, but extending beyond this to tackle other problems weighing on housing. Taken together, such efforts could help shift people's expectations about future house prices. If prospective homeowners no longer fear that prices could decline further, they will be more willing to enter the market to take advantage of reduced prices and low financing costs, and existing homeowners will feel more confident about spending. A vicious cycle could be replaced by a virtuous circle, in which stabilization in house prices supports spending, growth and jobs.
- On the fiscal side, it is important that we see progress in Washington in addressing the long-term fiscal challenges facing the country in a manner that is credible and supports economic recovery. Not only is this important to reassure households and business that the U.S. budget is on a sustainable path, but also this would be important from a larger confidence perspective —demonstrating to our citizens and the world that the political process can still work to make tough choices in the national interest. In this regard, the ability of the so-called Congressional "Super Committee" to reach agreement on a way forward is an important opportunity that I hope is not squandered.

Regional Economic Conditions

Now, how has the region fared during the downturn and how is the recovery proceeding? As I mentioned, the New York Fed produces indexes to help monitor the regional economic conditions.[1] Based on these measures, the downturn in the economy in New York City ended in November of 2009. Since then, New York City's economy has been on the mend, and our numbers for September show that the recovery continues at a healthy clip.

The local economy has not fared as poorly as the national economy during this recession and recovery. Citywide employment fell by nearly 4 percent during the downturn, much less than the nationwide job loss of 6.5 percent. During the recovery, New York City has already regained half of the net jobs lost during the recession. This has happened without much help from the securities industry (Wall Street), which has been a driving force behind local economic recoveries in the past. This time, the strongest contributors to job growth have been professional and business services, leisure and hospitality, and—importantly for the Bronx—education and health services.

While the Bronx is closely linked to the rest of the City, the borough has a rich history and vibrant economy of its own. The Bronx economy has evolved substantially over the past century and a half. Through much of the 1800s, Mott Iron Works produced cast stoves, pipes and many other iron products in the neighborhood we now call Mott Haven. In the early 20th century, the Bronx was a major hub of piano manufacturing. Between 1900 and 1930, as the economy here boomed, the population increased more than six-fold.

Of course, from the 1950s to the late 1970s, the Bronx had its troubles. Construction of the Cross Bronx Expressway took a toll on many neighborhoods. Yet the borough persevered, and rebounded somewhat in the 1980s.

Today, I note that some manufacturing remains, particularly in food, apparel and textiles. In addition, Hunts Point is reported to be the world's largest food distribution center. However, the largest sectors—health and education services—together account for nearly half of all private-sector jobs in the borough. The Bronx is home to many fine institutions of higher education, including Fordham University, Lehman College and the Albert Einstein College of Medicine. In addition, the Bronx High School of Science and the High School of American Studies are among the city's finest high schools. As for health services, the Bronx has a large number of medical care facilities. Montefiore Medical Center is now the borough's largest employer.

I am pleased to report that the Bronx, unlike the nation and the city as a whole, sustained almost no net job loss during the recession. While national employment remains well below its pre-recession peak, the Bronx has added 10,000 jobs since the start of the recession. Some of this resilience is due to the concentration in health and education—the only sectors that added jobs across the nation during the recession. Another factor is that the Bronx is largely a borough of renters, making it less vulnerable to the fallout from the housing crisis.

This is not to say that all is well here. Some 12 percent of the Bronx workforce—a painfully high share—is jobless and less than a fifth of its adult population holds a college degree. The seeming disconnect between the pace of job creation here and high unemployment reflects commuting patterns. Many Bronx residents work in Manhattan and other places where job trends have been less favorable. In addition, not all jobs in the Bronx are filled by borough residents.

High unemployment and low average levels of education help explain why the per capita income here is more than a third below the national average. A quarter of the population here lives below the poverty line, more than double the nationwide rate. Reducing poverty and raising the graduation rate are clearly major challenges for policymakers here.[2] Thus, there is much room for improvement even though the Bronx, like New York City, seems headed in a promising direction.

How are families here doing in restoring their finances? During the recession, all across the nation, the number of debt delinquencies soared and many families found that they needed to reduce their debt to more sustainable levels.

Let me tell you what we see in the Bronx, using the special consumer credit panel I mentioned earlier.[3] Although families here stopped adding on debt at the end of 2007, they have not yet succeeded in reducing what they owe. As of June, the average debt owed by Bronx residents with a credit report was about $27,000—about the same as three years before. This amount of debt is smaller than the New York State and national averages of about $50,000, partly because the Bronx's many renters have no mortgages. However, it worries me that in contrast to falling debt levels elsewhere, Bronx residents have not reduced their indebtedness during the last two years.

Another troubling sign is how many people here are behind on their loan payments. About 17 percent of household debt in the Bronx is seriously delinquent. That is very high: roughly double the rate in New York State and the nation, and almost three times the rate in 2006. Plus, the number of delinquencies is still climbing here, even though they are falling in the rest of the state and the nation. All of this tells me that Bronx households have a considerable way to go before they reach more comfortable debt levels.

Conclusion

To sum up, over the first half of 2011, the slowing of economic growth in the nation and the weak labor market has been a major disappointment. Growth has picked up modestly in the second half of 2011, but not enough to bring unemployment down. While there are some bright spots in the U.S. economy and the financial system, strong headwinds are preventing a more vigorous recovery. Inflation, which has risen in recent months, is poised to slow soon. The Fed is doing—and will continue to do—everything within its power to promote jobs and price stability.

High poverty, unemployment and delinquency rates suggest that the Bronx faces a number of challenges. However, the continued job growth in the Bronx and rest of the city should create more opportunities for Bronx residents to improve their incomes and personal finances.

Going forward, the key challenge for the Bronx will be to prepare its residents for the best jobs being created here, in the city and in the accessible areas north of the city. The Bronx must strive to build the human capital—that is, education and skills—of its workforce. A region's human capital determines a large part of its economic success. The Bronx needs to ensure that it can attract and train workers for the broad range of tasks that an advanced economy demands. In addition, expanding education and skills goes a long way to broaden participation in the economy to all residents.

Thank you for your kind attention.

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[1] Regional Indexes of Coincident Economic Indicators »

[2] See, for additional discussion of this topic, William Dudley. 2011. "Job Creation in the Region." Remarks at the Quarterly Regional Economic Press Briefing, New York City. August 12. »

[3] Quarterly Report on Household Debt and Credit, August 2011. »