SPEECH

The National and Regional Economic Outlook

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Good morning. I am pleased to be here on Long Island. It is always a pleasure to speak with the business community because of the leadership role you play in your communities and in shaping the economic landscape in the region. So, I thank you all for coming today.

Over the past few years, I have been engaged in a series of outreach meetings all across my Federal Reserve District. For example, in 2010 I visited several upstate cities. Early last year I made visits to various parts of the city—Brooklyn, the Bronx, Queens—and to Puerto Rico. In August, I met with community and business leaders and elected officials in Newark, Patterson and Jersey City. In November, I went to West Point and the Capital region.

I consider these visits just as important as my trips to Washington, D.C., to help formulate monetary policy or to Switzerland to help shape international bank regulation. Each visit within the region helps me to deepen the relationships with the people I represent. I believe that the understanding of issues and concerns that I gain today will help ensure that the Fed's policy decisions reflect the public interest in the broadest sense.

Today, I want to talk with you first about the Fed—what we do and why we do it. Then I'll provide some thoughts about the economic outlook nationally and locally. How the economy performs is important in many ways. At the personal level, for example, it affects your family's finances and students' job prospects at graduation time. Collectively, it affects the potential of our nation to confront and deal with the many challenges we face.

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.

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.

I am vice chair of the FOMC, which 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 at hand, and you should view this as completely appropriate: these are hard questions— particularly at times like this. In fact, I think we make better decisions as a committee because we don't all think alike. But we are united in our commitment to our dual mandate and in our belief that Fed independence is essential to the public interest, because it allows us to make 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. This trip includes a meeting with the Long Island Housing Partnership—and a visit to some distressed neighborhoods, a tour of the D'Addario string factory and lunch with its workers; and concludes with a tour and meeting at the Brookhaven National Laboratory.

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, the entire state of New York, and New Jersey. These indexes are essentially measures of local output—similar to gross domestic product, or GDP, at the national level. These measures provide a more complete gauge of activity than the employment report, which is another important metric at the state level. We have also constructed a consumer credit panel to track local household credit conditions, including the amount and type of personal debt and whether payments are being made in a timely way.

In addition, we have a periodic poll about the credit needs of small businesses, which are an important source of new jobs. We are just launching our latest survey that also includes questions about the skill needs of small businesses and if the right kinds of skilled labor are available. Almost 900 regional businesses responded to our last poll, of which roughly 5 percent were from Long Island. If you, as part of a small business, would like to participate in our current poll, please pass your card to my colleagues, who are in the audience, or see me after the speech and we will be glad to add you as a respondent.

In December, we hosted a workshop for small businesses in the New York City metro area to provide information about how they can export their products and services. The Export-Import Bank, the Small Business Administration and the U.S. Department of Commerce were on hand to tell participants how to tap demand in the global marketplace and what government programs are available to enhance credit and to increase lines of working capital. In 2012, we're further developing our small business program. We hope to partner with many of you to support the small business sector.

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. Here on Long Island there are pockets that suffered greatly in the recession. In Nassau County, communities in Hempstead, Baldwin, Roosevelt and New Hyde Park have a foreclosure rate over four times the national average.[*] The same holds true for parts of Brentwood, Central Islip and Patchogue, in Suffolk County.

We have worked hard to help neighborhoods that face high foreclosure rates. Over the past three years, my staff has come to Long Island to meet with housing counselors and legal services practitioners. We have provided housing advocates with the latest information on mortgage conditions, via mortgage briefs, roundtables, presentations and newsletters. We have now developed an online resource that shows delinquency and foreclosure conditions in neighborhoods each month. We believe that this site will be a useful complement, aiding the work of housing counselors and other parties seeking to help these communities.

To share what we learn about our diverse District, we have a website, with detailed information about the region. I invite you to visit newyorkfed.org to explore our highly localized maps and information on small business, credit and housing conditions and even the latest job openings at the New York Fed.

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. Much has been done, 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 myself and my colleagues busy.

National Economic Conditions

The incoming data on the U.S. economy has been a bit more upbeat of late, suggesting that the recovery may be finally establishing a somewhat firmer footing. Real GDP expanded at a 3 percent annual rate in the fourth quarter of 2011, the fastest growth since the first half of 2010. The average monthly gain in nonfarm payroll employment moved up to 256,000 in January and February from 164,000 in the fourth quarter. Sales of light-weight motor vehicles rose to a seasonally adjusted annual rate of 15.1 million in February, the highest since early 2008. The ISM nonmanufacturing index rose for the third consecutive month in February and now stands at its highest level in a year. Even the housing starts data have firmed somewhat, although from quite depressed levels.

While these developments are certainly encouraging, it is far too soon to conclude that we are out of the woods. To begin with, the economic data looked brighter at this point in 2010 and again in 2011, only to fade as we got into the second and third quarters of those years.[1] Moreover, the United States has experienced unusually mild weather over the past few months, with the number of heating degree days in January and February about 17 percent below the average of the preceding five years. While this reduces the amount that households and businesses must spend for heating, I suspect that it temporarily boosts economic activity overall. For example, the mild weather is certainly conducive to higher than normal levels of construction activity, and we did see a surge in hours worked in that sector over the past few months.

More importantly, real economic activity has yet to be strong enough on a sustained basis to make a big dent in the overall amount of slack in the U.S. economy. While it is true that growth was stronger in the fourth quarter, most of that growth was due to inventory accumulation. Growth of final sales was actually quite weak. Historically, a quarter in which inventory investment makes a significant growth contribution is typically followed by a quarter in which that growth contribution is modest or even negative. That appears to be what is shaping up for the first quarter of this year.

Based on available data, current expectations are that real GDP will expand at around a 2 percent annual rate during the first quarter of 2012. Despite the increase of light vehicle sales, overall consumer spending has been sluggish. While growth of retail sales in February was reasonably strong in nominal terms, it was considerably less impressive when the large increase of gasoline prices that occurred that month is taken into account. Based on data for the first half of March, gasoline prices are continuing to move higher which will further sap consumers' real purchasing power. And growth of business investment spending, which was quite strong in the second and third quarters of 2011, entered the new year with little forward momentum.

To put the recent pace of growth into perspective, we believe that the economy's long-run sustainable growth rate (what economists call the potential growth rate) is around a 2 1/4 percent annual rate. We need sustained growth above that rate to absorb the substantial amount of unused productive capacity. Thus, our recent growth rates are barely keeping up with our potential.

Although the sharp decline in the unemployment from 9 percent last September to 8.3 percent in February suggests we are doing better than that, it is important to recognize that about half of that decline was due to a declining labor force participation rate. In fact, had the labor force participation rate not declined from around 66 percent in mid-2008 to under 64 percent in February, the unemployment rate would still be over 10 percent. Also, it appears that productivity growth has slumped recently. Although that means that a given amount of growth translates into bigger employment gains, it certainly is not an unmitigated good development.

Also, we cannot lose sight of the fact that the economy still faces significant headwinds and there are some meaningful downside risks. In the headwinds department, I would include the run-up in gasoline prices mentioned earlier because that will sap purchasing power, the continued impediments to a strong recovery of the housing sector, and fiscal drag at the federal and state and local levels. In terms of downside risks, these include the risk that growth abroad disappoints and the risk of further disruptions to the supply of oil and higher oil prices.

On the inflation front, the overall rate of increase of consumer prices, as measured by the 12-month change of the consumer price index slowed to 2.9 percent in February from a recent peak of 3.9 percent last September. Despite the recent rise of gasoline prices mentioned above that may interrupt this pattern, we expect this moderation in the growth rate of consumer prices to resume later this year. While the underlying core inflation rate, that strips out volatile food and energy prices, has been somewhat higher than expected a few months back, it appears that the annual rate of core inflation[2] has peaked and we expect it to begin to decline later this year.[3] Finally, inflation expectations, which play an important role in the inflation process, remain well anchored. By this I mean that people expect that the rate of inflation will continue to be relatively low for some time to come.

Regional Economic Conditions

So how is the recovery proceeding in the state and the region? As I mentioned, the New York Fed produces indexes that help us track economic activity in the region. Based on these measures, the economic recovery got underway in both New York State and New York City in late 2009, and economic activity has continued to expand through early 2012.

The New York Fed also conducts the monthly Empire State Manufacturing Survey to monitor conditions for regional manufacturers. The most recent survey, for which a number of Long Island firms participated, points to continued expansion in manufacturing activity throughout the first quarter of 2012 and heightened optimism about the general business outlook.

Recently released employment revisions indicate that the economic recovery has taken hold on Long Island. But there still is a long way to go. Employment on the island declined by a little over 4 percent in the downturn—a steep drop, to be sure, but only about two-thirds of the decline that occurred nationally. Since bottoming out in late 2009, employment here on the island has rebounded by almost 2 1/2 percent. So we've come a bit more than halfway back to the early 2008 peak.

Moreover, these job gains have come despite ongoing job cuts in local government. While other parts of the region sustained job losses in local government starting in 2010, Long Island's just started in the spring of last year, creating a drag on the labor market overall. Nevertheless, the private sector has picked up the slack. This is most pronounced in professional and business services, finance, leisure and hospitality, and health care. Even the island's manufacturing sector has added jobs over the past year.

Another sign that a recovery is taking hold on Long Island is that banks that were created just before or just after the financial crisis—while only a small portion of the local market—are starting to show signs of growth.

Long Island's labor market has also been aided by its proximity to New York City. With a large portion of the island's workforce commuting to New York City, especially from Nassau County, the brisk job creation we've seen in the city has helped matters here as well. Unemployment here on the island topped out at 7.6 percent back in late 2009, and it has hovered around 7 percent for most of the past year—a high rate to be sure, but well below both the national and state levels.

Turning to the housing market—there matters are more dreary. After more than doubling between 2000 and 2006, home prices on Long Island are down more than 20 percent from their peak and prices have yet to show any strong signs of bottoming out. This weakness is underscored by our latest quarterly consumer credit panel data. This dataset shows that mortgage delinquency rates on the island are much higher than in other parts of the state and continued to edge higher in the fourth quarter of last year.[4]

The housing crisis also has also put pressure on local school finances. Historically, the island has been heavily dependent on local sources for its school funding, and the housing debacle has generated a sharp drop in local property tax revenue. State aid has been generally insufficient to make up for these losses and school administrators have been forced to cut both instructional and non-instructional spending.

Despite some of these ongoing problems, I believe that the long-term outlook for Long Island's economic growth is quite positive. The island's workforce is particularly well educated, with well over a third of adults holding a college degree. It has a sizeable industrial base, which is concentrated in high-tech manufacturing. Moreover, Brookhaven Labs and Cold Spring Harbor Laboratory, as well as a fine array of academic institutions, provide a strong foundation for the island's tech sector and business sector more broadly. The recent move to create stronger ties between the business community, research labs and SUNY (State University of New York) is a welcome development. It has the potential to help leverage the island's existing assets to enhance the prospects for economic development.

Conclusion

To sum up, the incoming data on the U.S. economy has been a bit more upbeat of late, suggesting that the recovery may be getting better established. But, while these developments are certainly encouraging, it is far too soon to conclude that we are out of the woods in terms of generating a strong, sustainable recovery. On the inflation front, the year-over-year rate of consumer price inflation has slowed in recent months, and despite the recent rise of gasoline prices, we expect inflation to moderate further in 2012.

Looking ahead, the key challenge for the Long Island economy will be to continue to prepare its residents for the best jobs being created here. Expanding educational access and opportunity and the skills that go along with it will go a long way to broadening participation in the economy to all residents and bolstering Long Island in the future.

Thank you for your kind attention. I would be happy to take a few questions.

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[1] This recurring pattern has led some economists to question whether the depth and duration of the Great Recession has distorted the usual patterns of seasonal adjustment.
[2] As measured by the 12-month change in core CPI.
[3] See for instance, the behavior of the three- and six-month core CPI.
[4] For more information, see the New York Fed's consumer credit panel.

* The foreclosure rate reference for these communities was calculated with a partial subset of active loans. While communities in Hempstead, Baldwin and Roosevelt have foreclosure rates far higher than the national average, analysis of a larger pool of loans reveals that New Hype Park’s foreclosure rate is in line with the national average. Visit the New York Fed’s Regional Mortgage Conditions webpage for additional information.