Good afternoon. I am pleased to be here with the Business Council of Fairfield County. I am told that your meetings are very inclusive—that you routinely invite education professionals, executives of local not-for-profit agencies and community leaders as well as business leaders. In doing so, you assemble the type of broad Main Street audience that I most enjoy addressing. So, thank you for inviting me here today.

Today I want to talk a bit about the outlook for the nation and the region. As many of you know, I was scheduled to speak at this forum on October 29 of last year but that meeting had to be postponed because of the arrival of Superstorm Sandy which hit on that very day. The region covered by the New York Fed was at the center of the storm, and Fairfield County, as well as parts of the Connecticut shoreline suffered extensive damage.

Immediately following the storm, our Regional and Community Outreach function worked with all of the affected areas as part of a needs assessment. We asked: “How can the New York Fed best leverage our resources to help our community?” We heard that it could be challenging to find key recovery information and advice online. So we pulled key resources under one roof—or I should say under one URL. We developed our Sandy Information Center with the best information we could find for residents and businesses impacted by Sandy—including key deadlines along with expert legal, finance and insurance guidance.

Conditions are not entirely back to normal, and restoration and repair activities continue in a number of hard-hit neighborhoods. Connecticut, along with New York, New Jersey, Maryland and Rhode Island, have been appropriated federal funding for relief efforts and this should help move the area’s recovery forward. I am confident that these areas will recover over the course of the year. The legislation also contains funding for helping coastal communities to prepare to weather future storms better.

My meeting with you today is part of our continuing efforts to understand what is going on at the grassroots level of our economy. Let me offer a few examples from this trip. Yesterday evening I met with some of Stamford’s business leaders to discuss the local state of economic and business conditions. This morning I met with Mayor Finch and key economic development staff to discuss Bridgeport’s redevelopment initiatives. Local efforts such as these and your business council are essential complements to the Fed’s support for economic recovery. I applaud the efforts of state and local governments and community leaders to bolster the recovery in Bridgeport, Stamford and elsewhere in the district.

I also met with Joan Carty from the Connecticut Housing Development Fund. We discussed innovative approaches for addressing the foreclosure crisis here and across the state. Housing has been a major impediment to a more rapid economic recovery and we at the Fed have been working hard to help homeowners and the overall housing market recover. Afterwards, I spoke with small business leaders about the opportunities and challenges they are facing today. I traveled to Sikorsky Aircraft Corporation with several goals in mind. I wanted to learn how sequestration was affecting ground-level operations, to understand the local and regional economic impact of Sikorsky, and to view state-of-the-art manufacturing at work.

After this program, I will be meeting with Joseph Carbone of The Workplace to discuss best practices and emerging approaches to workforce development, particularly his innovative program for the long-term unemployed which I understand he is piloting in five different cities across the nation. At the end of the day I will be meeting with University of Connecticut (UConn) Stamford campus staff, your own executive director Chris Bruhl and other officials to learn about the ecosystem that is being created to spur further economic development locally. I’ll end the day with a meeting with Governor Malloy to better understand the complex issues and opportunities facing the state.

The agenda for these visits is always packed, but that’s part of the point—to meet with a diverse array of representatives in order to get a comprehensive picture of what’s happening on Main Street and its interaction with state and national developments. At the end of my talk I will be happy to answer any questions you have about the economic outlook from my perspective.

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.

National Economic Conditions
I would like to begin by taking stock of where we are at the moment. Then I will address my expectations for the performance of the economy over the remainder of 2013 and into 2014.

Since the end of the Great Recession in mid-2009, we have had 15 consecutive quarters of positive growth of real GDP. However, the average annual growth rate over that period has been just 2.1 percent. Although the unemployment rate has declined by 2.5 percentage points from its peak of 10 percent in October of 2009, much of this decline is due to the fact that the labor force participation rate has fallen by 1.5 percentage points over this period. Recall that discouraged workers who do not actively look for work are regarded as not participating in the labor force and so are not counted as unemployed even though they are without jobs. Using an alternative measure, the employment to population ratio, which is not influenced by changes in the number of discouraged workers, there has been limited improvement in labor market conditions. Job loss rates have fallen, but hiring rates remain depressed at low levels. Taken together, the labor market still cannot be regarded as healthy. Numerous indicators, including the behavior of labor compensation and household assessments of labor market conditions, are all consistent with the view that there remains a great deal of slack in the economy.

That being said, I see persuasive evidence of improved underlying fundamentals for much of the private sector of the U.S. economy. Key measures of household leverage have declined and are now at the lowest levels they have been in well over a decade. Household net worth, expressed as a percent of disposable income, has increased back to its average of the previous decade, reflecting rising equity and home prices and declining liabilities. Banks are beginning to ease credit standards somewhat after a prolonged period of tightness. As a result, we are now experiencing a fairly typical cyclical recovery of consumer spending on durable goods. For example, light-weight motor vehicles sold at a seasonally-adjusted annual rate of 15.3 million in May, not far from the 16.1 million sales in 2007.

Similarly, after five years in which housing production was well below what is consistent with underlying demographic trends, it now appears that we have worked off the excess supply of housing built up during the boom years of the last decade. Housing starts and sales are now on a clear upward trend, and a widely followed national home price index is up around 12 percent over the twelve months ending in April. Indeed, anecdotal reports suggest that this higher-than-expected increase in home prices is due to a lack of homes for sale.

Unfortunately, the improvements in consumer spending on durable goods and housing are not yet showing through in the overall GDP growth rate due to the significant headwinds that we continue to face. First, federal fiscal policy has recently become quite contractionary. Estimates from the Congressional Budget Office (CBO) indicate that this fiscal restraint is on the order of 1.75 percentage points of potential GDP this year. In the period since 1960, there have been only two previous episodes of fiscal contraction of this order of magnitude—1969 and 1987—both of which occurred when the economy was on a more solid footing than it is today. Second, the euro area is experiencing a protracted recession and growth in many of the largest emerging economies has slowed. This has resulted in a very sharp slowing of U.S. exports, with an associated slowing in production and employment growth in the U.S. manufacturing sector.

Thus, I continue to see the economy as being in a tug-of-war between fiscal drag and underlying fundamental improvement, with a great deal of uncertainty over which force will prevail in the near-term. This tug-of-war is clearly seen in the monthly employment data. Over April and May, the average monthly gain in employment in the private service-providing sector has been well maintained at 175,000. In contrast, employment in the manufacturing sector and the federal government declined a combined 20,000 per month. And the resulting uncertainty is, I believe, an important contributing factor behind the relatively sluggish pace of business investment spending.

My best guess is that growth for all of 2013, measured on a Q4/Q4 basis, will be about what it has been since the end of the recession. But I believe a strong case can be made that the pace of growth will pick up notably in 2014. The private sector of the economy should continue to heal, while the amount of fiscal drag will begin to subside. I also see some indications that growth prospects among our major trading partners have begun to improve; for example, the rise in the June euro area composite Purchasing Managers’ Index. And this combination of events is likely to create an environment in which business investment spending will gather strength.

Finally, I believe this tug-of-war analogy is useful in explaining the recent inflation dynamics. As is well known, total inflation, as measured by the personal consumption expenditures (PCE) deflator, has slowed sharply over the past year and is now running below the FOMC’s expressed goal of 2 percent. Softness in energy prices, resulting from the weakening of global growth mentioned earlier combined with increased energy production here in the U.S. has contributed to the slowing of total inflation. However, it is also the case that core inflation, that is, excluding food and energy, has slowed sharply as well. A decomposition of core inflation reveals that some of the decline is due to slowing in the rate of increase in prices of non-food and non-energy goods. This probably is due in large part to the softening of global demand for goods and the modest appreciation of the dollar that has occurred since mid-2011.

In the service sector, the rate of increase in prices of medical services and “non-market” services—the latter includes some financial services—also has slowed notably recently. In contrast, the rate of increase in prices for other non-energy services has been relatively stable. Comparing this set of conditions to that in 2010, the recent slowing of inflation has been less widespread
across core goods and core services, and inflation expectations so far have declined less appreciably than they did in 2010. Thus, my best guess is that core goods prices will begin to firm in the months ahead as global demand begins to strengthen and inventories get into better alignment with sales.

As is always the case, there is substantial uncertainty surrounding this forecast. Moreover, there is always the possibility of some unforeseen shock. Thus, we will be monitoring U.S. and global economic conditions very carefully and will adjust our views on the likely path for growth, inflation and the unemployment rate accordingly in response to new information.

At its recent meeting, the FOMC decided to continue its accommodative policy stance. It reaffirmed its expectation that the current low range for the federal funds rate target will be appropriate at least as long as the unemployment rate remains above 6.5 percent, so long as inflation and inflation expectations remain well-behaved. It is important to remember that these conditions are thresholds, not triggers. The FOMC also maintained its purchases of $40 billion per month in agency MBS and $45 billion per month in Treasury securities, with a stated goal of promoting a substantial improvement in the labor market outlook in a context of price stability.

In its statement, the FOMC said that it may vary the pace of purchases as economic conditions evolve. As Chairman Bernanke stated in his press conference following the FOMC meeting, if the economic data over the next year turn out to be broadly consistent with the outlooks that the FOMC sees as most likely, which are roughly similar to the outlook I have already laid out, the FOMC anticipates that it would be appropriate to begin to moderate the pace of purchases later this year. Under such a scenario, subsequent reductions might occur in measured steps through the first half of next year, and an end to purchases around mid-2014. Under this scenario, at the time that asset purchases came to an end, the unemployment rate likely would be near 7 percent and the economy's momentum strengthening, supporting further robust job gains in the future.

Second, even if this scenario were to occur and the pace of purchases were reduced, it would still be the case that as long as the FOMC continues its asset purchases it is adding monetary policy accommodation, not tightening monetary policy. As the FOMC adds to its stock of securities, this should continue to put downward pressure on longer-term interest rates, making monetary policy more accommodative.

Third, the Federal Reserve is likely to keep most of these assets on its balance sheet for a long time. As Chairman Bernanke noted in his most recent press conference, a strong majority of FOMC participants no longer favor selling agency MBS securities during the monetary policy normalization process. This implies a bigger balance sheet for longer, which provides additional accommodation today and continuing support for mortgage markets going forward.

Fourth, even under this scenario, a rise in short-term rates is very likely to be a long way off. Not only will it likely take considerable time to reach the FOMC's 6.5 percent unemployment rate threshold, but also the FOMC could wait considerably longer before raising short-term rates. The fact that inflation is coming in well below the FOMC's expectations. If labor market conditions and the economy’s growth momentum were to be less favorable than in the FOMC’s outlook—and this is what has happened in recent years—I would expect that the asset purchases would continue at a higher pace for longer.

To reiterate what I said last week, some commentators have interpreted the recent shift in the market-implied path of short-term interest rates as indicating that market participants now expect the first increases in the federal funds rate target to come much earlier than previously thought. Setting aside whether this is the correct interpretation of recent price moves, let me emphasize that such an expectation would be quite out of sync with both FOMC statements and the expectations of most FOMC participants.

**Regional Economic Conditions**

Turning to the regional economy, my colleagues and I at the New York Fed continually track conditions in our District, and we have a number of tools we use for that purpose.

To promote growth in our local communities, we publish extensive data and analysis on the local economy. We provide outreach initiatives, such as our workshops on access to global markets to help small businesses learn about loan programs and sources of credit enhancements. We also run an annual video festival for college students in the Second District. In this program student teams produce videos aimed to help young adults make sound personal financial decisions. A panel of advertising and video professionals selects winning video productions for screening in local movie theaters.

As you know, even states as wealthy as Connecticut have large pockets of poverty. So, we target some of our work specifically to low- and moderate-income groups.

We have worked hard to help neighborhoods that face high foreclosure rates. This work is important obviously because
And at the end of October, Superstorm Sandy hit the region, causing major damage and disruption. While most of the news jobs; but those were offset by job losses not only in finance, but also in the goods-producing and distributing sectors.

Overall, while this upturn in home prices is encouraging, it has been considerably weaker than in other parts of our region and percent between 2006 and early 2012, home prices have risen by 5 percent in Fairfield County and 3 percent across Connecticut.

This year single-family construction has begun to move up as well. Home values have also begun to recover. After falling about 25 percent over several years. The county's delinquency rate on that debt is now 5.7 percent, similar to the national average. And the mortgage crisis continues to take a toll on local homeowners. As of the first quarter, about 6 percent of mortgage debt in Fairfield County was 90-plus days delinquent, slightly higher than the national delinquency rate.

The New York Fed’s measures of regional credit conditions suggest continued financial challenges for families here. As of the first quarter of 2013, average debt per person was about $60,000 in Connecticut and over $90,000 in Fairfield County—little changed over several years. The county’s delinquency rate on that debt is now 5.7 percent, similar to the national average. And the mortgage crisis continues to take a toll on local homeowners. As of the first quarter, about 6 percent of mortgage debt in Fairfield County was 90-plus days delinquent, slightly higher than the national delinquency rate.

It is also important to recognize the county’s strengths that will support recovery and the rise in household income over the longer term—over and above just being close to a thriving New York City. In particular, the above-average educational attainment of residents and the numerous educational institutions position the area well to move into the expanding knowledge-based economy. Also, its diverse industry mix has a good representation of jobs in high-paying sectors and the area maintains its
attractiveness as a location for corporate headquarters.

Thank you for your kind attention and I will now be happy to take a few questions.

1 CoreLogic Report Shows Home Prices Rise by 12.1 Percent Year Over Year in April