Exploring Economic Conditions and the Implications for Monetary Policy

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Labor Markets

- Employment report last week
- Areas of concern
  - Payroll employment: 136,000
  - Manufacturing weak
- Positive aspects
  - Unemployment rate 3.5 percent – a nearly 50-year low
  - Some upward revisions in payroll from earlier months
- My view – elevated downside risks, but outcomes not much different than what most forecasters expected 6 months ago
Downside Risks Remain

- Tariffs and potential for additional tariffs
  - Depress exports
  - Contribute to weakness in manufacturing and agriculture

- Geopolitical concerns
  - Attack on Saudi oil production
  - Potential for difficult Brexit
  - Global recovery faces risks

- Despite ongoing risks
  - Real GDP growth 2 percent in Q2
  - Private forecasters expect second-half growth around potential
Resilience Despite Risks

- Consumption has been quite strong
- Consumer bolstered by:
  - Plentiful jobs and tight labor market
  - Strong growth in personal income
  - Increases in household wealth (rising stock and home prices)
- Continued strength in consumption not guaranteed given risks
- Implications:
  - Stance of monetary policy is already accommodative
  - Can be patient and evaluate incoming data
  - Should risks materialize with growth materially below potential, I would support aggressive easing
### Figure 1: Economic Projections of Federal Reserve Board Members and Federal Reserve Bank Presidents for 2019

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<thead>
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<tbody>
<tr>
<td>Real GDP Growth (%, Fourth Quarter Change from Previous Fourth Quarter)</td>
<td>2.1</td>
<td>2.2</td>
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<tr>
<td>Unemployment Rate (%, Fourth Quarter)</td>
<td>3.7</td>
<td>3.7</td>
</tr>
<tr>
<td>PCE Inflation (%, Fourth Quarter Change from Previous Fourth Quarter)</td>
<td>1.8</td>
<td>1.5</td>
</tr>
<tr>
<td>Core PCE Inflation (%, Fourth Quarter Change from Previous Fourth Quarter)</td>
<td>2.0</td>
<td>1.8</td>
</tr>
</tbody>
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Source: FOMC, Summary of Economic Projections, March 20, 2019 and September 18, 2019
Figure 2: Measures of Inflation
January 2018 - September 2019

Note: Core PCE and the Dallas trimmed mean PCE for September have not yet been released.

Source: BEA, BLS, Federal Reserve Bank of Dallas, Haver Analytics
Figure 3: Unemployment Rate
January 2018 - September 2019

Note: The estimate of full employment is the median of the estimates for the unemployment rate in the longer run from the most recent Summary of Economic Projections (SEP).

Source: BLS; FOMC, Summary of Economic Projections, September 18, 2019; Haver Analytics
Economic Conditions Close to Mandate

- At or beyond full employment
- Inflation near 2 percent
- September median forecast of FOMC
  - 2019 real GDP growth 2.2 percent
  - No significant slowdown in second half
- Key question: whether risks are so elevated that further easing is required, despite already accommodative policy
Figure 4: Ten-Year Treasury Yield
January 5, 2018 - October 4, 2019

Note: Figures are weekly averages.
Source: Federal Reserve Board, Haver Analytics
Figure 5: Moody’s Seasoned BAA Corporate Bond Spread Over Ten-Year U.S. Treasury Yield
January 5, 2018 - October 4, 2019

Note: Figures are weekly averages. Dashed line is average spread over the past 25 years.
Source: Federal Reserve Board, Moody’s, Haver Analytics
Figure 6: Stock Market Indices
January 5, 2018 - October 4, 2019

Note: Figures are weekly averages. Index level January 5, 2018=100.
Source: DJ, S&P, WSJ, Haver Analytics
Figure 7: Brent Crude Oil Price
January 5, 2018 - October 4, 2019

Note: Figures are weekly averages.
Source: FT, Haver Analytics
Figure 8: Exchange Rate: British Pounds Per U.S. Dollar
January 5, 2018 - October 4, 2019

Note: Spot exchange middle rate, New York close. Figures are weekly averages.
Source: WSJ, Haver Analytics
Figure 9: U.S. Trade with China
2018:Q1 - 2019:Q2

Source: U.S. Bureau of the Census, Haver Analytics
Figure 10: Blue Chip Forecasts for Real GDP Growth

Source: Blue Chip Economic Indicators, March 10, 2019 and October 10, 2019
Figure 11: Federal Funds Rate
January 5, 2018 - October 4, 2019

Note: Federal funds rates are weekly averages. The longer-run federal funds rate estimate is the median of the estimates for the federal funds rate in the longer run from the most recent Summary of Economic Projections (SEP).

Source: Federal Reserve Board; FOMC, Summary of Economic Projections, September 18, 2019; Haver Analytics
Concluding Observations

- With 2 recent easings of 25 basis points each, monetary policy is accommodative
- Sustaining growth depends on the consumer to offset weakness in exports and business fixed investment
- Appropriate to closely monitor incoming data
  - With growth near potential, can be patient
  - If risks materialize, can ease further
- There are also risks to easing too aggressively
- Reach-for-yield behavior at wrong stage of cycle