

Economic Conditions, Policy, and the Future

Raphael Bostic
President and Chief Executive Officer

Atlanta Press Club
Commerce Club
Atlanta, Georgia

September 26, 2017

- Atlanta Fed President and CEO Raphael Bostic, in a September 26 speech to the Atlanta Press Club, presents his views on monetary policy and the path ahead.
- Bostic says the recent hurricanes could shave a percentage point off third-quarter GDP growth but expects that will all be made up in the fourth quarter.
- Bostic believes that current monetary policy is not too accommodative because inflation remains low and prime-age labor force participation has been increasing.
- He says that an additional rate hike this year is possible if economic strength continues and inflation moves toward the Fed's 2 percent target.
- Bostic looks to explore further how structural factors, including technological change and globalization, are affecting the economy.

Good afternoon. I am delighted to address the Atlanta Press Club in my first official speech as Atlanta Fed president. I've been on the job since early June and already have three policy meetings under my belt. So I think I'm getting the hang of things in a hurry.

As you may know, I've never lived in the Southeast until now. Everyone asks me how I'm adjusting. I have to say that it has been wonderful so far. Southern hospitality is more than just a saying—it's a real thing that comes out in so many ways, from so many people and organizations. I feel right at home already.

This is a diverse region, but one that largely mirrors the national economy. And metro Atlanta itself is a powerhouse of opportunity for most people. I think it holds the promise of being a beacon for everyone.

Today I plan to offer my thoughts on the state of the national economy as I see it today, focusing on our two main policy objectives—low and stable inflation and maximum sustainable employment. Then I'll move to the monetary policy situation and some of the questions my staff and I are wrestling with. Finally, I'll tease up some broader issues in the economy that I've been thinking about for future consideration.

Before I get started, let me offer this disclaimer. I don't speak for any of my colleagues in the Federal Reserve or the Federal Open Market Committee (FOMC). I speak only for myself.

Overview of economic conditions

I'd like to start by talking a bit about how the national economy is performing as the third quarter draws to a close. I want to point out that the next few sets of data points may not provide clear signals, owing to the disruptions caused by hurricanes Harvey, Irma, Jose, and Maria. These hurricanes were terrible events and caused a lot of pain and loss. Our thoughts and prayers remain with those who suffered losses as a result. I must say that I was very impressed by the resilience shown by this region and the Sixth District in the wake of Hurricane Irma. The professionalism and preparation of emergency responders was robust, and people came together wonderfully. It was a marvel to watch, and I am grateful for their efforts and sacrifice.

In terms of economic performance, my staff estimates that Harvey and Irma may well shave up to a percentage point from third-quarter growth, but we expect to make that all up in the fourth quarter, if not exceed it, as recovery and rebuilding efforts ramp up.

Before the storms, real economic activity had been proceeding about as I expected. Growth in gross domestic product, or GDP, picked up in the second

quarter of this year after a relatively soft first quarter. The Commerce Department revised its estimate of second-quarter growth up to 3 percent.

Prior to Harvey and Irma, it appeared that the second-quarter strength was continuing into the third quarter. And even after the hurricanes, real GDP growth in the neighborhood of slightly better than 2 percent still seems like a reasonable expectation for this year as a whole.

Notwithstanding the somewhat softer-than-expected payroll employment growth in August, labor markets have generally surprised us to the upside. The U.S. economy has created an average of better than 175,000 jobs a month thus far in 2017.

All else equal, the number of jobs it would take to maintain the unemployment rate near its current level is about 115,000 per month, according to the Atlanta Fed's Jobs Calculator. So I think it is fair to say that the pace of job creation in the United States remains strong.

The official unemployment rate has fallen by a significant amount since the beginning of the year. It currently sits just below its pre-financial-crisis level, at 4.4 percent.

I could point to many other statistics to suggest the solid condition of the U.S. labor market, but there is one that deserves special mention: the share of people in their prime working years, ages 25 to 54, who are actively engaged with the labor market—either working or looking for work.

Over the last two years, the rate of prime-age labor force attachment has rebounded by more than 1 percentage point, after having fallen by about 3 percentage points from the beginning of the recession through 2015.

I think the fact that this rate is rising once again is meaningful. I'm going to return to this point in a few minutes when I turn to what I think all of this means for monetary policy.

I'll close my discussion of the state of the economy with a few words on inflation.

As you know, the FOMC has an inflation objective of 2 percent over the longer run, as measured by the annual increase in the price index for personal consumption expenditures.

Defining the “longer run” is a matter of some art and personal preference, but by almost any measure, year-over-year inflation has fallen short of this objective for the past five years. I think five years is a contender for a reasonable definition of the longer run.

As a monetary policymaker, I take seriously the continued shortfall of inflation from the Committee’s longer-term objective.

Assessing the stance of monetary policy

Now I’ll turn to how these facts inform my thinking about the appropriate course of monetary policy. If you think you hear a definitive tilt in my position, I urge you to resist that conclusion. None of what I am about to say should signal a locked-in stance about the appropriate course of policy. I just want to be as transparent as possible in how I am currently processing the data as well as input from our business contacts in the region.

If you follow the public commentary of my FOMC colleagues, you would likely, and correctly, conclude that they are devoting considerable energy to understanding what underlies weaker-than-expected inflation, not just in the United States, but globally.

One prominent explanation is advances in technology that have yielded ever-lower costs of production. Another candidate is ever-increasing competitive pressures that have kept the lid on prices.

I think the book is just being written on the impact of these developments, but I have some initial skepticism about whether these are adequate explanations for a long bout of lower-than-target inflation.

It is true that advances in technology should put downward pressure on costs, which should limit increases in the prices consumers face. But these advances should also spark growth in productivity.

Productivity growth has been exceptionally weak for most of the recovery. There are almost certainly issues in measuring productivity in times when technology is evolving rapidly. However, it is not yet clear to me that the measurement issue is large enough to resolve the inflation puzzle of the last five years or so.

What about increased competition as a cause of low inflation? This explanation certainly has some appeal. All we have to do is think of China and Amazon.

But here, too, I have some skepticism. If competitive pressures are the cause of ongoing low inflation, then we would expect to see, on average, persistently falling profit margins. I don't think the facts align with a story that fundamentally relies on an ongoing profit squeeze over the past five years.

As I say, the book is still being written on how well various explanations of lower-than-desired inflation hold up. But I think one extremely important point needs emphasis.

The FOMC has stated that "the inflation rate over the longer run is primarily determined by monetary policy, and hence the Committee has the ability to specify a longer-run goal for inflation."

To me this means that, in the longer run, a central bank should be able to achieve its inflation objective independent of secular trends that exert downward pressure on the rate of change in consumer prices.

Put more directly, if the inflation rate runs below a central bank's target for an extended period of time, it is difficult for me to conclude that monetary policy is overly easy.

Of course, over much of the past five years, there was a widespread consensus that monetary policy was not overly easy in light of economic circumstances. The question becomes, is that still the case today?

My inclination is that the stance of monetary policy is not currently too accommodative. Let me point to two reasons.

First, as noted, the rate of inflation remains below the FOMC's objective, with no sustained movement toward 2 percent.

Second, as I discussed earlier, I am impressed that the labor force participation rate for those in their prime working years has been increasing.

This increase reflects the effects of a robust labor market that is both encouraging more people who had been on the sidelines to enter the labor market and keeping more people engaged in the workforce who might have otherwise left.

Work at the Atlanta Fed [has shown](#) that the recent increase in the prime-age labor force participation rate has been concentrated among women, and especially women with a high school education or less.

As noted in [an article in the *Economist*](#), workers with less than a college degree tend to be "the first to suffer from recessions and the last to benefit from recoveries." One interpretation of the surge in participation in this group is that the process of full recovery from the Great Recession is not yet quite complete.

This increase in prime-age labor force participation, combined with the lack of rising pressures on either aggregate inflation or wage growth, leads me to think there remains some residual amount of slack in the labor markets. This, in turn, persuades me that the current stance of monetary policy is not overly easy for the circumstances.

I also want to note that U.S. monetary policy is not standing still. As you all are aware, at the last meeting the FOMC announced that it is beginning the process of slowly winding down the balance sheet from the elevated levels created by the Fed's policy responses to the financial crisis, recession, and slow recovery.

To summarize, I conclude that monetary policy is not currently overly easy. But this is not a statement as to whether or not further adjustments in policy are required. My staff's own projections indicate continued strength in the economy and progress toward the FOMC's inflation objective as the year concludes and we

move into 2018. I think clear evidence of this path could certainly be consistent with an additional rate hike this year.

As for now, however, I have an open mind on when the next step in the normalization process will be necessary.

Some future considerations

I'll conclude with some future considerations that I believe will merit our attention in the coming months and years. Decoding the data that inform monetary policy is complicated by ongoing, and enormous, structural changes in the global economy.

Though I am not yet convinced they provide an adequate explanation for recent inflation trends, there is little doubt that technological forces are generating important changes in the economic landscape. These changes go by many names: “the new machine age” and “the fourth industrial revolution” are among the more prominent ones.

Globalization, I might add, is both an effect and a cause of these technological forces. The combination of the two is rapidly altering the world as we know it. Think of examples like Uber and Airbnb, which have reimagined mainstream economic sectors.

The effects of these changes are not hard to find.

One is the shift in economic activity from medium-sized cities dominated by one or a few anchor businesses to big, diversified urban centers.

A second one is the decline of middle-income opportunities for individuals lacking specialized skills or training—and the inequality and social dysfunction that lack of opportunity brings. I will be speaking to some of these issues next week in Austin at a [workforce development conference](#) the Fed is cohosting with partners in business and academia.

A third effect of technological change is rapid financial innovation, often going under the rubric of “fintech,” which continues to transform familiar forms of

financial intermediation. This innovation is of particular interest to the central bank because of our role as a financial services regulator and provider.

As you may know, beyond the conduct of monetary policy, the Federal Reserve System promotes the stability of the financial system, the safety and soundness of individual financial institutions and payment and settlement systems, and consumer protection and community development.

The challenges of the new industrial revolution affect every one of these purposes and functions of the Federal Reserve System.

As the new president and CEO of the Atlanta Fed, I look forward to many opportunities to discuss these challenges and, perhaps more important, discuss how they might be best addressed.

Now I'll be glad to take a few of your questions.