Economic Conditions and the Role of Trade
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- Atlanta Fed president and CEO Raphael Bostic speaks at the World Affairs Council Global Business Luncheon in Jacksonville, Florida, about his economic outlook and the influence of trade policy and uncertainty on that outlook.

- Bostic: The economy is arguably as close to the Fed's employment and inflation goals as it's been over this expansion.

- Bostic says feedback from business contacts indicates that labor market conditions have tightened, but he wouldn't characterize the situation as overheated.

- Recent reports suggest inflation is close to the FOMC's target rate of 2 percent. Bostic says inflation is likely to run a bit above target for a while but would not necessitate a more aggressive policy response.

- Bostic continues to see the economy growing above potential this year, around 2½ percent, and slowing to its longer-run growth rate of around 1¾ percent over the medium term.

- Bostic notes that businesses' optimism over tax policy early in the year has been replaced by uncertainty regarding proposed tariffs and the possibility of a trade war.

- Citing the challenges of economic change for some workers and communities, Bostic touts the benefits of aligning worker-focused workforce development and business-focused economic development.

Good afternoon. It's great to be back in Jacksonville today. I'm about to reach my first anniversary as head of the Atlanta Fed next month, so it's getting harder and harder to say that I'm new. For example, this is my third trip to Jacksonville, and I'm starting to recognize new developments and even lawn decorations. But I plan to keep on saying I'm new until someone really calls me out.

In my 11 months, I've come to enjoy my role as a monetary policymaker. As you probably know, the Federal Open Market Committee, or FOMC, decided to hold the federal funds rate target range steady last week.

In my remarks today, I'll try to provide some insight into how I see current economic conditions shaping up as we approach midyear and my outlook for the near term. I'll close by discussing my views on the role of trade policy and uncertainty as they influence that outlook.

Let me state the usual disclaimer before I begin. I'll present only my personal opinions today. I'm not speaking for anyone else in the Federal Reserve System or for the FOMC.

Current economic conditions

Congress has charged the Federal Reserve—or, more accurately, the FOMC—with promoting maximum sustainable employment in the context of price stability. From the perspective of that dual mandate, we're arguably as close to that goal as we've been over this expansion.

The unemployment rate has fallen to its lowest level since December of 2000. Broader measures of joblessness, like those that include people marginally attached to the labor force or those working part-time for economic reasons, have also improved to cyclical lows.

Despite the dramatic improvement in the employment picture, overall wage growth remains tepid compared with previous expansions. That said, we have seen evidence of increasing wages along some dimensions consistent with improvement in labor utilization rates. For instance, if you look at the typical wage growth experience of individual workers, as the Atlanta Fed's Wage Growth Tracker does, it shows that the premium for workers who change jobs is at a cyclical high.

My staff, including Chris Oakley and his team here in our Jacksonville Branch, spends a lot of time canvassing businesses in the Sixth District to assess whether the facts on the ground seem consistent with our read of things based on the official statistics. Feedback suggests that labor market conditions have tightened, though I wouldn't characterize the situation as overheated. This all leads me to conclude that the economy is close to or at "full employment" but not yet significantly beyond that point.

Turning to price stability, the other half of the FOMC's dual mandate, the Fed has determined that a 2 percent inflation rate, as measured by the Personal Consumption Expenditures (PCE) price index, is most consistent with the notion of stable prices. The year-over-year growth rate in headline PCE inflation has now hit this target, and the less-volatile core PCE measure is just a tenth of a percentage point shy of that mark.

This is a significant development considering that annualized inflation over this expansion—which is nearly nine years long now—has fallen short of the 2 percent goal by roughly half a percentage point. As part of the Fed's stewardship of policy, we have spent considerable effort over the course of the recovery trying to understand the reasons for the shortfall.

Early on in the recovery, it was easy to explain the absence of inflation given the extraordinary amount of slack in the economy. But as the recovery gained momentum and the unemployment rate fell, and we began hearing more reports of labor scarcity, increased voluntary job changes, and firms stepping up their efforts to retain and attract new employees, the absence of rising inflation has been something of a puzzle.

Some have suggested that new technologies, global interconnectedness, or changes in the structure of the economy have fundamentally altered the process that governs inflation dynamics. But I have to say that I view these alternative explanations with a skeptical eye.

A plausible explanation is that the natural rate of unemployment is now lower than it has historically been. Among other things, technological changes in how people search for jobs may have reduced the time needed to find job matches. This trend implies that, at a given unemployment rate, there is more slack in the labor market than there may have been in prior eras.

Another explanation is that inflation expectations have become anchored below levels consistent with our dual mandate. I have been particularly concerned that households and firms were beginning to adapt to the lower observed inflation trend by lowering their inflation expectations. If true, that would make it even more difficult for the Fed to hit its target in the longer run. Fortunately, recent developments have alleviated some of my concern.

On top of the recent inflation reports that suggest we are currently very close to our target, my staff and I are beginning to discern a shift in sentiment among our contacts and in our survey data that, if anything, suggests some upward pressure on inflation.

April data from the Atlanta Fed's Business Inflation Expectations survey reveal a sizable increase in reported unit cost pressures over the past few months. Despite the increase, nearly half of these firms see profit margins as in line with what they would consider "normal," and 15 percent reported "above normal" margins. Interestingly, the majority of those with "above normal" margins indicated they had achieved margin growth by increasing prices. So, there appears to be some evidence of pricing power that may end up affecting retail prices.

Also, while we don't have a very long history to draw from, longer-run business inflation expectations have risen to their highest level since early 2013, shortly after the Fed began its third round of quantitative easing. Still, reports on likely pricing pressure going forward are mixed. Significant pricing power appears contained to businesses and sectors that are exposed to cost pressures associated with actual or potential tariffs. But today, these are isolated developments.

On balance, I view the economy as on track and believe we are close to mandate-consistent outcomes for both inflation and employment. Given that measured inflation is already effectively on target, I won't be surprised to see a modest overshoot of our longer-run target. In fact, my own forecast is that, even with further gradual removal of monetary policy accommodation, inflation is likely to run a bit above 2 percent for a while.

In my judgment, such an outcome is not a problem that would, in and of itself, necessitate a more aggressive policy response. Rather, it is a feature of a well-calibrated approach that moves monetary policy to a neutral stance that will support both strong labor market conditions and our longer-run symmetric inflation goal.

I'll offer a caveat. Although I think we are on track in satisfying our dual mandate, this does not mean we can hang up our hats and head home. There is still work to do, and risks on the horizon need to be monitored. Perhaps the most obvious risk facing the economy at the moment is how firms will adjust to recent and proposed changes in trade policy, a concern I will return to in a moment.

Economic outlook

Looking forward, I continue to see the economy growing above potential this year, in the neighborhood of 2 ½ percent, and slowing to its longer-run growth rate of around 1 ¾ percent over the medium term.

Following a pattern we have seen for several years, gross domestic product, or GDP, growth in the first quarter softened after a strong reading in fourth quarter. This time, a large part of that slowdown was due to weakness in consumer spending. For now, I am willing to chalk up most of the recent softness to payback from a strong fourth quarter that was buoyed by rebuilding efforts from fall hurricanes.

One area to watch over the next year or so is how consumers respond to tax reform. To that end, I have received few, if any, reports of a noticeable acceleration in consumer spending attributable to the tax cuts. Retailers generally report steady sales growth overall, but our anecdotal reports are consistent with the survey data from the New York Fed indicating that consumer expectations on future spending growth are relatively flat.

I expect to see a recovery in consumer spending over the balance of the year, but as of yet I don't see an acceleration that would risk a development of imbalances between supply and demand.

A key swing factor in my outlook is the prospect for capital spending given tax reform. First-quarter growth in business fixed investment was in line with its trend rate over the past year, but the latest indicators on durable goods orders and shipments suggest a marked slowdown in investment spending on equipment going into the current quarter.

While this is only one month, and the monthly data on factory orders tend to be rather volatile, it is concerning given that the recent tax cut legislation should be providing some stimulus to investment spending. It's possible that uncertainty about changes in trade policy may be offsetting some of the impact that might otherwise be generated by the tax legislation.

Trade policy and uncertainty

In my conversations with Sixth District businesses, most appear to be reasonably satisfied with the current state of the economy, but their attitude shifts when we ask them about the future. Swelling optimism over tax policy in the beginning of the year has now been replaced almost completely by uncertainty regarding the proposed tariffs and the possibility of a trade war.

Though there are exceptions, I come away with the sense that for now, many firms may be responding to increased uncertainty by moving to the sidelines with respect to new cap-ex plans. I have gathered little indication that firms are pulling back on investment projects that are already in progress. But investment projects slated for the pipeline have been pushed out.

While it's not usually tallied when weighing the pros and cons of protectionist trade policy, the uncertainty touched off by the potential imposition of new tariffs appears to be affecting firms' decision making. I want to reinforce that I am talking about the uncertainty associated with the current trade discussions and not the specifics of any particular policy or policies. Indeed, trade policy is never as clear-cut as most of us would hope.

The benefits of free and unfettered trade are clear in a perfect world. By "perfect world," I mean one with few, if any, trading frictions. Things are more complicated when the world does not mirror this ideal. Any economist worth his or her salt can conjure up a case for policy interventions based on some impediment to fully efficient markets. The question is always whether policymakers have enough information about the nature of those impediments, and can intervene with enough precision, to make matters better by acting. We all have heard the phrase "unintended consequences," and we understand the potential for action to leave the situation worse. So this is truly tricky. The situation is even more complex when policy actions are taken against strategic players—consumers, businesses, and other policymakers—who will not be passive in the face of those actions.

But one thing is clear, and this is important. Even in a perfect world, economic change will typically create winners and losers. Let me use a concrete example. Consider the impact on the U.S. apparel industry from the rise in imports from less-developed countries during the 1990s. According to a Bureau of Labor Statistics study, in the mid-1990s, the average apparel worker in Honduras earned about 10 percent of the hourly wage of a comparable worker in the United States. The impact of the shift in production toward less-developed countries was dramatic. In Alabama, for example, employment in apparel production declined from around 45,000 in 1990 to a little over 5,000 by the mid-2000s. These jobs had provided stable employment in small towns across the South for many years. When those jobs went overseas, the dislocated workers had few options. U.S. consumers benefited from having access to cheaper clothing, but the affected U.S. apparel workers lost.

This reality need not be a problem. Many believe that the gains of the winners generally outweigh the losses of those who lose. If true, it should be possible in principle to redistribute the gains in such a way that nobody is worse off. But what is true in principle is very often hard to implement in practice. And that kind of redistribution rarely happens.

Whether disruptions are brought about by shifting trade and production across borders or by the imperatives of technological change, some will be left behind. To those who have been left behind, it does little good to note that in principle they **could** be made whole. To those who would promote fewer rather than more trade restrictions, or who would argue that roadblocks to technological advance are unwise, we need to confront the very real dislocations associated with the application of those views.

A major problem facing communities that have lost an industry is the lack of good-quality job opportunities. As a [2010 Brookings study] noted, there are at least two aspects to this problem. First, many displaced workers do not have the skills needed for the quality jobs that are available locally. Second, communities are not creating sufficient-quality jobs to absorb the displaced workers. Further deepening these challenges are significant declines in worker mobility—both between and within states. As fewer workers are moving to where jobs are, displaced mid- and late-career workers in particular face major challenges in finding well-paying jobs.

Solving these joint problems requires a coordinated workforce development system that acts in strategic partnership with the private sector and works alongside programs that encourage innovation and entrepreneurship. The Atlanta Fed's Center for Workforce and Economic Opportunity is contributing to this effort by helping to provide a bridge between research and practice. It connects researchers, businesses, and policymakers with innovative approaches to creating economic opportunity through education and employment.

I believe that communities that can align worker-focused workforce development and business-focused economic development will be much more resilient to economic shocks and better able to capitalize on opportunities for growth. This approach can ultimately benefit the overall economy, but there is more to do to achieve full and effective collaboration between workforce development and job creation efforts.

These are big challenges. As a monetary policymaker, I have a vested interest in how these challenges are met because they ultimately shape the nature of the Fed's goals. This is particularly true for the sustainable employment part of the FOMC's dual mandate.

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