

HOW DO WE GET MORE JOBS?



MONETARY POLICY

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FISCAL POLICY

The good news was that the worst of the fiscal drag appeared to be over as 2013 ended. And the fiscal situations of states and municipalities generally improved.

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Stronger economic conditions, along with astute monetary and fiscal policy, can help accelerate job creation. Some of those conditions and policies are already in place. Some policies are widely accepted. Others are contentious and thus difficult to achieve.

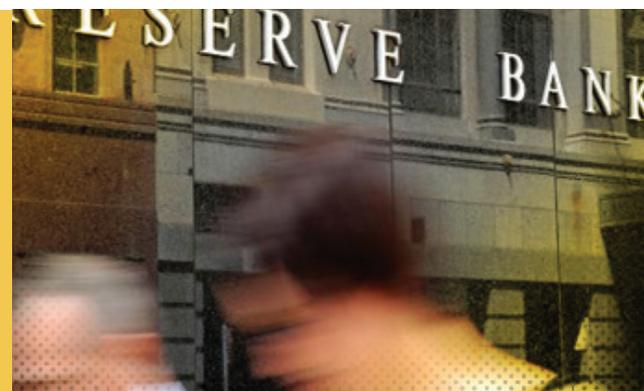


GENERAL ECONOMIC CONDITIONS

Watching inflation and wage growth can help gauge whether the economy is gathering the underlying strength it needs to quicken the healing of the labor market.

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MONETARY POLICY IMPORTANT BUT NO PANACEA



With the federal funds rate as low as it could effectively go, the Federal Open Market Committee (FOMC) used two unconventional policy tools in 2013: forward guidance about the expected path of the federal funds rate and large-scale asset purchases (often called quantitative easing, or QE), at a pace of \$85 billion per month. Both tools aimed to push down longer-term interest rates to spur households and businesses to borrow, spend, and invest—in turn, triggering a virtuous cycle that would include increased production, hiring, and more spending.

The FOMC conditioned the duration of the QE program on achieving substantial improvement in the outlook for labor markets. By the end of 2013, the unemployment situation had improved enough that the Committee voted to reduce its purchases by \$10 billion per month, thus beginning the much-anticipated “tapering” process.

With that transition under way, the key monetary policy question for the Fed is how long to keep the fed funds rate at zero. Throughout 2013, FOMC members continued to anticipate that the fed funds rate would stay put at least until the unemployment rate falls below 6.5 percent. In the statement following its December meeting, the Committee also noted that the near-zero rate would likely be appropriate “well past” the 6.5 percent threshold, especially if annual inflation continues to look like it will fall short of the Committee’s longer-run objective of 2 percent.

Is it working?

It’s difficult to isolate precisely the effects of the Fed’s monetary stimulus, in part because the linkages between policy and

employment are indirect. However, recent research suggests that monetary policy has helped push down interest rates and boost asset prices. And as Atlanta Fed President Dennis Lockhart noted in a February 2013 speech, the Fed’s monetary stimulus has “without question helped achieve the economic progress we’ve made since the end of the recession.”

The economy has recovered considerably, but the job is not done. The jobless rate, at 6.7 percent in December, remained well above FOMC members’ projections for the longer-run rate of unemployment, which ranged from 5.2 to 5.8 percent. Obviously, there’s still work to do. But with the appropriate monetary policy, the FOMC in December expected that the jobless rate would gradually decline toward levels the Committee judges consistent with its dual mandate.

“FISCAL DRAG” DISSIPATED LATE IN 2013



The executive and legislative branches of government control federal taxation and spending. But the Federal Reserve pays close attention to fiscal policy because it influences the economy and labor market.

Without advocating particular positions, it is possible to identify general fiscal conditions that would promote the ongoing recovery of the labor market. As Atlanta Fed President Dennis Lockhart explained in a September 2013 speech, public policy can foster economic dynamism “by removing obstacles to growth and entrepreneurship and contributing pro-growth actions that address investment in human capital and productive infrastructure.”

It is important for elected officials to set fiscal policy on a sustainable long-term path. Establishing a course on which the ratio of federal debt to gross domestic product (GDP) eventually stabilizes or declines is critical to ensure longer-run economic growth and stability, Lockhart pointed out. Yet even as policymakers address longer-range fiscal sustainability, they should avoid unnecessarily adding to forces that are slowing the economic recovery.

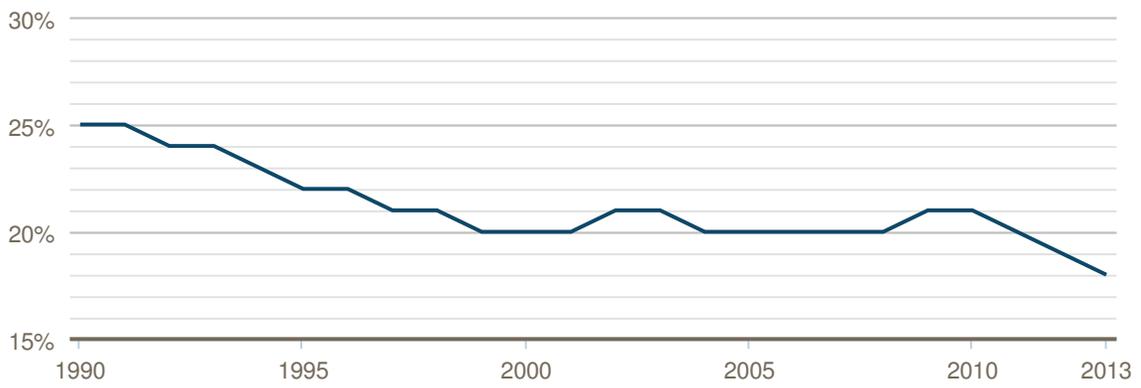
Those forces in 2013 included a “fiscal drag” consisting of the effects of tax increases early in the year, reduced spending, the partial federal government shutdown, and the impact of fiscal policy uncertainty on business investment and consumer spending.

The Congressional Budget Office (CBO) estimated that federal spending cuts lowered employment by between 300,000 and 1.6 million jobs. Meanwhile, the partial shutdown of the federal government in October reduced fourth-quarter GDP by an estimated 0.25 to 0.5 percentage point. In total, cuts in government spending

and tax increases likely lowered economic growth in 2013 by as much as 1.5 percentage points, according to the CBO.

The good news: the worst of the fiscal drag appeared to be over as 2013 ended. In December, Congress reached a budget compromise and in January 2014 passed a comprehensive spending bill. Further, the fiscal situations of states and municipalities generally improved during 2013, likely reducing the need for further cuts in employment and investment.

GOVERNMENT SPENDING AS SHARE OF GDP



Note: Includes federal, state, and local governments.
Source: U.S. Bureau of Economic Analysis

A HEALTHY ECONOMY IS THE BEST MEDICINE FOR THE LABOR MARKET



In large part, the conditions that characterize a generally healthy economy are the same conditions that will encourage increased hiring.

The second half of 2013 brought promising signs on both fronts. Overall economic growth, as measured by the gross domestic product (GDP), improved significantly in the third and fourth quarters compared to the previous three quarters. In the first half of 2013, real GDP—adjusted for inflation—expanded at a rate of 1.8 percent annualized, slower than the average during the recovery from the Great Recession. Growth then accelerated to an estimated annual pace of 3.3 percent in the second half of the year.

Some of the strength in the second half resulted from the buildup of inventory, which can't go on indefinitely. But the economy also exhibited renewed strength in consumer spending, business spending on equipment, and exports—which suggests rising confidence about future prospects for the economy. Anecdotal evidence from business contacts in the Southeast also indicated solid confidence.

Brighter sentiment and stronger consumer spending bode well for the labor market. What's more, these two factors—business confidence and consumption—feed off each other. If people running firms believe demand for their products and services is sufficiently strong, then they are more likely to invest in people through hiring. Likewise, better job prospects, along with rising stock and home prices, should fuel more consumer spending.

As 2013 ended, it was premature to declare the start of such a virtuous cycle. Moreover, it is almost always difficult to discern the precise state of the economy, as incoming data are rarely

unambiguously positive or negative. For example, because of declining labor force participation, the unemployment rate has been particularly difficult to read during the recovery. And month-to-month reports of employment growth can fluctuate dramatically. In such circumstances, measures of inflation can be especially helpful. In general, weak overall demand is associated with weak prices. Therefore, watching inflation and wage growth can help gauge whether the economy is gathering the underlying strength it needs to quicken the healing of the labor market.

Economic performance in the latter part of 2013 suggested glad tidings. If that pace of growth persists—thus signaling the long-awaited acceleration in the economic expansion—then better labor market conditions should follow.

Asking the question of what conditions need to be in place for employment growth is the same thing as asking the question about what conditions need to be in place for growth in general. That is, businesses have to have confidence in the fact that they're going to be able to make profits, which means they have to be confident that the demand will be there when they produce.

Monetary policy has an important role to play in supporting economic growth and employment growth. The Federal Open Market Committee [FOMC]—the decision-making branch of the Federal Reserve—has decided that it's going to keep in place the policy of accommodation—that is to say, really low interest rates—for some period of time to support exactly that growth in both jobs and in overall economic activity.

There's a lot of debate about how much of the employment picture is about structural developments—that is, things that monetary policy really can't fix—versus cyclical elements that have to do with not enough spending in the economy, for example. Monetary policy can do a lot about the spending side of the picture, and really, what we need to know is how much of the problem is associated with those demand-type problems.

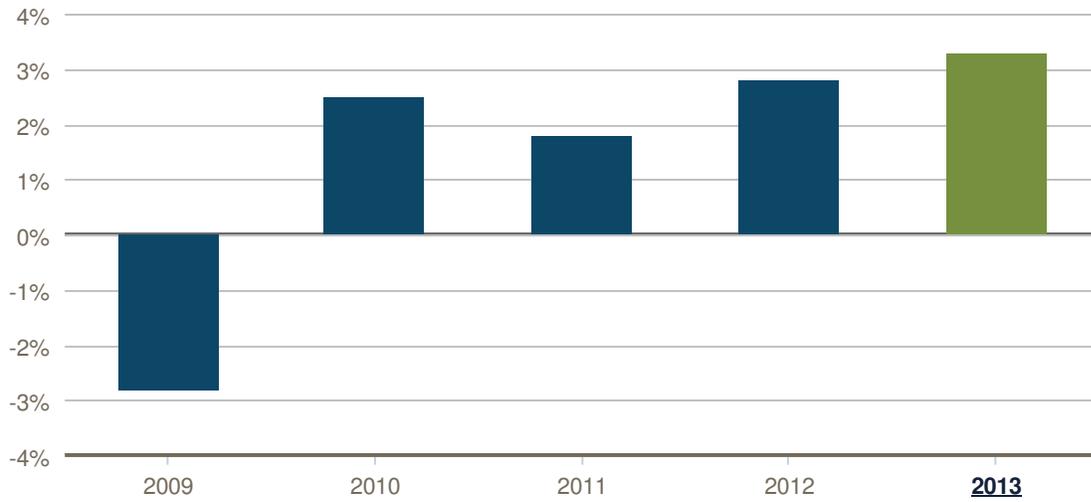
How will we know when we've met our employment goal? Well, that's a tricky question, but interestingly, our second goal—our inflation goal—will help us know that. In an economy that's weaker than it should be, the rate of inflation is likely to be below the 2 percent target that the FOMC has set. So by keeping our eye on the inflation goal, we are also keeping our eye on the employment goal.

The conditions for a pickup in employment growth appear to be with us today. We ended the year with substantial momentum that ought to take us into 2014. So not only will 2014 be a year of better GDP [gross domestic product] growth, but hopefully of better employment growth as well.

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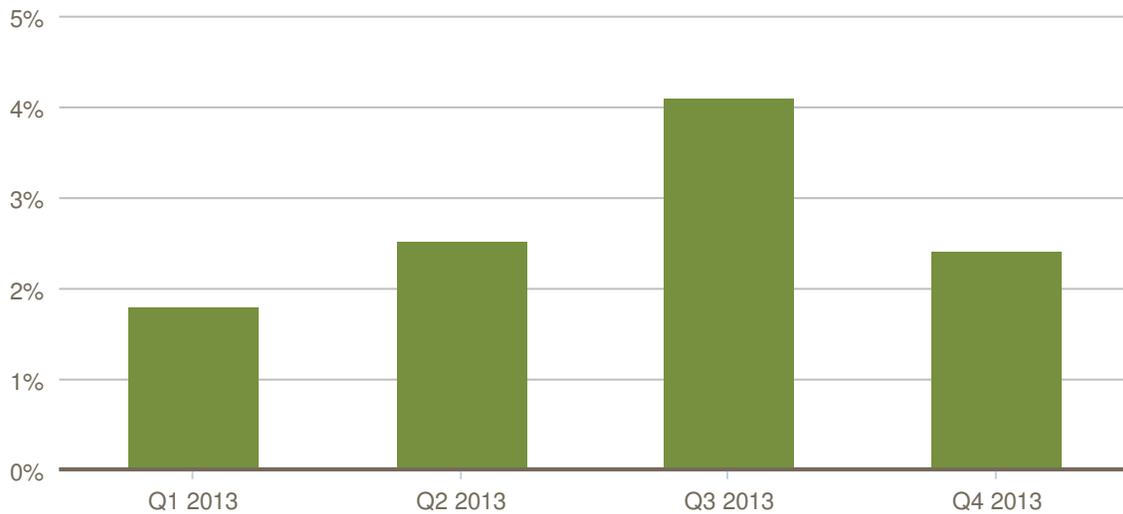


GDP GROWTH



Source: U.S. Bureau of Economic Analysis

GDP GROWTH IN 2013



Source: U.S. Bureau of Economic Analysis

INFLATION: PERSONAL CONSUMPTION EXPENDITURES INDEX



Source: U.S. Bureau of Economic Analysis