William C Dudley: Road to recovery – Hudson Valley

Remarks by Mr William C Dudley, President and Chief Executive Officer of the Federal Reserve Bank of New York, at the State University of New York at New Paltz, New Paltz, New York, 19 May 2011.

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Good morning. I am pleased to be in New Paltz to speak to you and meet with the business, community and academic leaders of the Hudson Valley. I particularly want to thank the Ulster County Chamber of Commerce and Community Capital Resources of the Hudson Valley, the Dutchess County Regional Chamber of Commerce, the Dutchess County Economic Development Corporation and the Orange County Chamber of Commerce who assisted us with our recent survey of small business finances. More than 100 businesses responded from the mid-Hudson region. The survey results will be published early this summer and, of course, we will share the results with you and post them on our website.

Each visit to this area gives me a chance to deepen the Bank's relationship with the people whom I represent as head of the Federal Reserve Bank of New York. Last summer I travelled through central and western New York and met with community leaders, business people, academics, bankers and government officials.

On this visit I will also meet with a wide range of people to talk about what we do and to hear first-hand the economic and financial issues important to you in the Hudson Valley so that I can best represent all my constituents in my work at the Fed. I also look forward to walking across that magnificent old railroad bridge, the Walkway Over the Hudson, for the spectacular view that I'm told awaits me.

I thank the Center for Research, Regional Education and Outreach for inviting me to speak at SUNY New Paltz today. This morning I will talk about economic conditions in the nation and the region, paying particular attention to how the recession has affected the labor market here. 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 (that is, the committee that sets interest rates – also known by its initials as the FOMC).

Introduction to the New York Fed

By way of introduction, let me start with a synopsis of what the New York Fed is, what we do and what makes my job so interesting.

The New York Fed is part of the Federal Reserve System, America's central bank, which was created by Congress in 1913. With this act, Congress delegated to the Fed System its constitutional authority to manage the supply of money in the nation's economy.

The Fed System is comprised of the Board of Governors in Washington, D.C. – a federal agency currently led by Chairman Ben Bernanke – plus 12 regional Reserve Banks that span the country. For example, the district overseen by the New York Fed includes all of New York, the 12 northern counties of New Jersey; Fairfield County, Connecticut; Puerto Rico and the U.S. Virgin Islands.

Each Reserve Bank is distinct, with its own charter and a board of directors drawn from its district, but overseen by the Board of Governors. The law that created the Federal Reserve made the central bank independent so that policymakers could make decisions about monetary policy – such as whether to adjust interest rates – in the national interest, somewhat insulated from political pressure. However, the Fed is accountable to Congress.

Congress has set an explicit objective for monetary policy: To pursue the highest level of employment consistent with price stability. This objective is often referred to as our "dual mandate," because it combines two goals: high employment, and low and stable inflation. In order to promote these objectives, we also pay close attention to financial stability, because without financial stability, it is very hard to achieve our goals for jobs and inflation.

The Federal Open Market Committee consists of the Board of Governors plus the presidents of each of the 12 district Banks. It meets in Washington, D.C., eight times per year to deliberate and vote on monetary policy, that is – should we change interest rates and, if so, how much. As the current New York Fed president, I am vice chairman at these meetings. At these meetings, each committee member presents his or her current outlook for the economy. For these assessments, we augment input from our research departments with critical information about local economic conditions supplied by our boards of directors, regional advisory councils and conversations with local stakeholders. My visit to New Paltz today is a part of these regional activities in which I learn first-hand about the economic and financial conditions important to you.

One thing that makes my job even more interesting is that New York has some roles unique within the Fed. For example, the New York Fed is the Reserve Bank charged with implementing monetary policy. This means that at the direction of the FOMC, we buy and sell Treasury securities in order to adjust short-term interest rates. We are also the eyes and ears of the Fed on Wall Street, and we supervise many of the largest financial institutions in the country. We operate Fedwire® – the conduit for large money transfers between banks. And, we provide banking services to the U.S. Treasury, and central banks and governments from around the world.

At the regional level, we continually track economic conditions in our District with the help of a number of tools that we have created for this purpose. For example, to fill a void in current measures of economic output, my staff produces indexes of economic activity which approximate output for New York State and New York City on a monthly basis. We also have initiated a consumer credit panel so that we can monitor local credit conditions. And, we have begun a quarterly survey of small business finances to track the issues related to credit and financing for this key job-generating sector. If you are not already part of the survey, I invite you to give your business card to my staff and we will add you to our survey universe, so that it can reflect your views, too.

To share the information that we gather and produce about our diverse district, we have created a rich website with very localized current data and maps on conditions in the region. I invite you to visit us on the web to explore the highly detailed information on small business, credit and housing conditions that we provide.

Finally, and crucially, in the aftermath of the financial crisis, we are working with our colleagues in Washington and at other agencies in the United States and abroad to help put the nation's financial system on a firmer footing. As regulators, we have made progress, for instance, in crafting tougher capital rules for the biggest banks, but much remains to be completed and we are determined to keep at it. I recognize fully that there can be no return to pre-crisis business as usual – whether on the part of the financial sector or on the part of regulators like ourselves. We must learn from the economic catastrophe of the past few years so that the financial system is able to perform its essential role in supporting economic activity without being a source of instability for the economy as a whole.

All in all, there is a lot to keep my colleagues and me quite busy – even in normal times.

National economic conditions

Now, what is the outlook for and risks to economic activity, employment and inflation in the nation?

Since the recession ended in 2009, the economy has grown at a relatively modest pace. Economic growth in the first quarter of 2011 was somewhat softer than anticipated, with the advanced reading of real gross domestic product (GDP) – that's the economic output of the economy – increasing at only a 1.8 percent annual rate. A number of factors contributed to the slowdown. Construction activity fell – likely reflecting the continued large supply of unsold homes – and government expenditures at the federal, state and local levels declined.

In addition, real consumption growth (that is, spending on goods and services adjusted for price increases) in the first quarter was slower than in the last quarter of 2010. This occurred, in part, because of the rise in gasoline and food prices that pushed up consumer price inflation last quarter and reduced the amount of income available for other household purchases, a pattern that continued to be evident in retail sales for April. High energy prices have contributed to weaker consumer confidence, which also may have negatively affected consumer spending.

However, the weakness of real output growth in the first quarter probably will prove temporary. Although manufacturing production fell in April, largely because of supply disruptions associated with the earthquake in Japan, business survey indicators, including the New York Fed's own Empire State Manufacturing Survey, generally continue to signal growth, suggesting that production should soon return to more robust growth. And financial conditions have continued to improve, albeit gradually. The temporary reduction in payroll taxes and other fiscal measures also are providing support to demand. In addition, demand abroad – particularly in Asia – remains robust, supporting our exports.

Most importantly, the labor market has shown further improvement, as demonstrated by the latest employment report. Although payroll job growth has been subdued during most of this recovery, the latest figures show the economy added 244,000 jobs in April – and an average of 233,000 over the past three months. While the unemployment rate – which is based on a different survey – ticked higher last month to 9 percent it is nonetheless 0.8 percentage points lower than it was in November, a relatively rapid decline by historic standards. Private-sector job growth has been strong enough to more than offset government layoffs, particularly at the state and local levels.

A particularly encouraging sign is the rapid growth of manufacturing jobs over the past year and the recent broadening strength in services employment. While the exact pace of a jobs market recovery is always hard to predict, we were expecting the rate of job growth to pick up over the first half, and I am hopeful that job growth will continue to strengthen in the coming months. We would welcome this. However, even if the economy added 300,000 jobs per month from now on, we would likely still have considerable labor market slack at the end of 2012.

Despite these clearly encouraging signs, there are still some downside risks to the growth outlook that bear watching. Let me list them for you:

- As I mentioned earlier, high oil and commodity prices have cut into household purchasing power, a difficult situation for many families that could constrain overall spending more than I anticipate.
- The renewed decline in home prices could dampen consumer spending and housing activity more than I expect.
- Finally, aggressive near-term government spending cuts or tax increases could slow economic growth at least in the short- to medium-term. I would emphasize, however, that a credible plan for medium-term fiscal consolidation is sorely required and would have many economic benefits.

Although these issues bear watching, they remain risks rather than likely outcomes.

In regard to inflation, after a period in which inflation was below the levels the Fed judges to be most consistent with its statutory objectives, on a year-over-year basis, headline CPI (consumer price index) has increased more than 3 percent, which is somewhat above this desired level. The rise in commodity prices over the past year probably will push up headline inflation further in the next few months. It is noteworthy, however, that even with the sharp rise in oil and food prices over the past year (and notwithstanding the more recent drops), there has been limited pass-through into the prices of other goods and services. In fact, most measures of underlying inflation trends – such as core inflation (which excludes volatile food and energy prices) – remain below levels consistent with our mandate for price stability.

Going forward, futures markets do not signal that investors expect rapid ongoing increases in commodity prices from current levels. Provided these prices stabilize (or indeed retreat further), I would expect headline inflation to move back to a more mandate-consistent rate. While this process plays out, however, it is critical that we ensure that inflation expectations do not become unmoored. It is much harder to keep inflation in check if people begin to raise their expectations of inflation. At this point, measures of inflation expectations overall remain stable.

Economists at the New York Fed have examined inflation expectations using a unique survey that we sponsor. As reported in a recent post on our new Liberty Street Economics blog, they find no evidence to suggest that a wage-price inflation spiral is getting underway. However, we will continue to monitor expectations for medium-term inflation very closely.

To sum up, economic conditions have improved in the past year. Yet, the recovery remains moderate and we still have a considerable way to go to meet the Fed's dual mandate of full employment and price stability.

Regional economic conditions

So, how is our region doing? As some of you may know, the New York Fed produces Indexes of Coincident Economic Indicators to help monitor the performance of the region. Based on these measures, the downturn in economic activity in New York ended in November of 2009, and since then activity in New York State and New York City has been recovering steadily at a moderate pace.

Regional employment trends

Let me turn specifically to employment trends in the region. In particular, I want to describe our region's experience during the recession and recovery.

Nationally, the Great Recession, which began in December 2007, has been the deepest economic downturn since World War II. When employment finally bottomed out in February 2010 – about seven months after the official end of the recession – the country had lost almost 6.5 percent of its jobs and the unemployment rate had more than doubled. Many people lost their jobs or saw their hours or income cut, and the duration of unemployment for jobless workers reached a historical high. For many families, this distress was compounded by losses of wealth from declining home prices. Since that low point of employment, job creation has resumed, albeit at a slower pace than we would like, and unemployment has retreated by a percentage point. As in other parts of the country, employment in our region declined substantially during the recession. But, the various parts of our region had very different experiences.

Employment in much of New York State, including the Hudson Valley, declined less severely than the nation. Both the state and city lost about 3.8 percent of their jobs. Part of the reason for the more moderate decline in jobs in New York during the recession was a less pronounced boom-bust housing cycle. Indeed, as a percentage, the city and state lost fewer jobs during this recession than they did during either of the last two downturns.

Now, as in the nation, a labor market recovery has begun across much of the region. Over the past year, New York State has added roughly 100,000 private-sector jobs. Within the state, the recovery has been somewhat uneven. New York City has been gaining jobs for more than a year now – at roughly the same pace as the nation, while to date, the Hudson Valley has seen little overall job growth.

Conditions in the Hudson Valley

Continuing to drill down geographically, let me talk in more detail about conditions here the mid-Hudson Valley. I am referring to Dutchess and Orange counties, which comprise the Poughkeepsie-Newburgh-Middletown metropolitan area, and Ulster County – which is also the Kingston metropolitan area.

First, what does the mid-Hudson Valley region look like from an economic standpoint? There is a lot of economic activity here. All told, about 850,000 people live here and 420,000 jobs are located here. And, over the past decade, all three counties added people more rapidly than the state.

People here are, on average, more highly educated than in the nation as a whole, as measured by the over 30 percent of residents who have college degrees. So, it is not surprising that median household income in all three counties is above the national median.

The industrial composition varies by county.

- Ulster County employs a relatively large share of people in its hotels and resorts, reflecting the importance of tourism. And, SUNY New Paltz is a major employer in the county.
- Dutchess County's jobs are heavily weighted toward high-tech manufacturing, with growing diversification.
- In Orange County, transportation accounts for a relatively large share of employment, partly due to Stewart Airport. West Point Military Academy is a major employer, and many Orange County residents commute to New York City, Westchester or Rockland for work.

Now, how has the area fared during the recent recession and recovery? I will address this from three perspectives: housing, credit conditions and jobs.

Unlike central and western New York, this region experienced a modest boom and bust housing cycle. During the boom period from 2000 to 2006, home prices more than doubled in the Poughkeepsie area and increased by 150 percent around Kingston – exceeding the U.S. rise of roughly 90 percent and the average rise of roughly 50 percent that prevailed in our region. The price declines in the bust period, from 2007 to 2009, were somewhat less severe than the nation, falling by roughly 20 percent in both areas, compared with 30 percent nationally. Recently – and this is a hopeful sign – home prices in both areas have steadied.

Next, how are families in the Hudson Valley doing in restoring their finances? During the recession, all across the nation, debt delinquencies soared and many families found that they needed to reduce their debt to a sustainable level. We keep track of the credit conditions in the Second District – including the average debt that people in area carry and whether they are current with their payments – using the Federal Reserve Bank of New York's Consumer Credit Panel. In the Hudson Valley, debt per person with a credit report is now down by 5 percent from its peak level in 2008. As of the first quarter of this year, debt was continuing to fall modestly. At the same time, delinquency rates continue to rise. The proportion of debt that is at least 90 days delinquent has risen from 2 percent in 2005 – which was low for New York – to 9 percent currently, matching the delinquency rate statewide. These patterns suggest that households in the area are making progress on restoring their balance sheets, but they may not have completed the process.

With regard to jobs, employment losses in the area during the 2008–09 downturn were steeper than in most of New York State, although less severe than for the Unites States as a whole. As of the first quarter of 2011, the Hudson Valley had yet to see a clear upturn in employment. The private sector has actually seen brisk job gains in the leisure and hospitality sector, and the professional and business service sector added jobs in the Poughkeepsie-Newburgh-Middletown metro area. And private-sector employment has held steady in the Kingston area over the past year. Both areas, however, have seen continuing job losses in retail trade and, especially, government employment. State and local government employment has declined by about 3.5 percent in the past year and has weighed down overall job growth in both areas.

Unemployment rates in the mid-Hudson valley peaked at 8.4 percent in late 2009 – well below the national peak of 10 percent and moderately below the state-wide peak of 8.9 percent. Nevertheless, as in much of the region and the nation, jobless rates have not retreated much thus far and remain stubbornly high.

Thus, the area was severely affected by the recession, but somewhat less so than the rest of the country. The recovery has begun, but some signs of distress remain in housing, credit and labor markets.

In the near-term, the regional economy, and indeed the economy of the entire state, faces a number of challenges. Among them is the need to address the large state budget gap. New York is not alone in having seen its tax revenue decline as the economy weakened and, thus, facing hard choices. As I mentioned, state and local government employment has already weakened in many areas. Going forward, further contraction in this sector continues to pose some risks to the recovery.

Longer term, one of the key challenges for this region is to ensure that it trains and attracts a highly skilled workforce that can meet the needs of innovative and rapidly changing firms. A region's human capital – that is, the skills and education of its work force – determines a large part of its economic success and resiliency. The education and research taking place in local colleges and universities, such as SUNY New Paltz, directly helps to build those skills and sustain economic growth.

Conclusion

To sum up, the national economy experienced a soft patch in activity during the first quarter of 2011, while the recovery in much of the region continued at a good pace.

In the region, the continued expansion of employment across the nation should help increase economic activity and employment in the Hudson Valley. Yet, as elsewhere, state and local government will likely be a drag for some time.

And, both nationally and regionally, unemployment remains unacceptably high.

Thank you for your kind attention. I will now be happy to answer some questions.