William C Dudley: Are recent college graduates finding good jobs?

Remarks by Mr William C Dudley, President and Chief Executive Officer of the Federal Reserve Bank of New York and Chairman of the Committee on the Global Financial System (CGFS), at the Regional Economic Press Briefing, New York City, 27 June 2013.

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Good morning and welcome once again to the New York Fed's Regional Economic Press Briefing. I am pleased to have this opportunity to talk with the journalists covering our region – and through you to the people in our District. This morning I will briefly discuss conditions in the national economy and then focus on regional economic conditions, with particular attention to the question of whether recent college graduates are finding good jobs. We will examine the trends and see how they are playing out in the region.

As always, what I have to say reflects my own views and not necessarily those of the Federal Open Market Committee (FOMC) or the Federal Reserve System.

National economic conditions

I would like to begin by taking stock of where we are at the moment. Then I will address my expectations for the performance of the economy over the remainder of 2013 and into 2014.

Since the end of the Great Recession in mid-2009, we have had 15 consecutive quarters of positive growth of real GDP. However, the average annual growth rate over that period has been just 2.1 percent. Although the unemployment rate has declined by 2.5 percentage points from its peak of 10 percent in October of 2009, much of this decline is due to the fact that the labor force participation rate has fallen by 1.5 percentage points over this period. Recall that discouraged workers who do not actively look for work are regarded as not participating in the labor force and so are not counted as unemployed even though they are without jobs. Using an alternative measure, the employment to population ratio, which is not influenced by changes in the number of discouraged workers, there has been limited improvement in labor market conditions. Job loss rates have fallen, but hiring rates remain depressed at low levels. Taken together, the labor market still cannot be regarded as healthy. Numerous indicators, including the behavior of labor compensation and household assessments of labor market conditions, are all consistent with the view that there remains a great deal of slack in the economy.

That being said, I see persuasive evidence of improved underlying fundamentals for much of the private sector of the U.S. economy. Key measures of household leverage have declined and are now at the lowest levels they have been in well over a decade. Household net worth, expressed as a percent of disposable income, has increased back to its average of the previous decade, reflecting rising equity and home prices and declining liabilities. Banks are beginning to ease credit standards somewhat after a prolonged period of tightness. As a result, we are now experiencing a fairly typical cyclical recovery of consumer spending on durable goods. For example, light-weight motor vehicles sold at a seasonally-adjusted annual rate of 15.3 million in May, not far from the 16.1 million sales in 2007.

Similarly, after five years in which housing production was well below what is consistent with underlying demographic trends, it now appears that we have worked off the excess supply of housing built up during the boom years of the last decade. Housing starts and sales are now on a clear upward trend, and a widely followed national home price index is up around

12 percent over the twelve months ending in April.[1] Indeed, anecdotal reports suggest that this higher-than-expected increase in home prices is due to a lack of homes for sale.

Unfortunately, the improvements in consumer spending on durable goods and housing are not yet showing through in the overall GDP growth rate due to the significant headwinds that we continue to face. First, federal fiscal policy has recently become quite contractionary. Estimates from the Congressional Budget Office (CBO) indicate that this fiscal restraint is on the order of 1.75 percentage points of potential GDP this year. In the period since 1960, there have been only two previous episodes of fiscal contraction of this order of magnitude – 1969 and 1987 – both of which occurred when the economy was on a more solid footing than it is today. Second, the euro area is experiencing a protracted recession and growth in many of the largest emerging economies has slowed. This has resulted in a very sharp slowing of U.S. exports, with an associated slowing in production and employment growth in the U.S. manufacturing sector.

Thus, I continue to see the economy as being in a tug-of-war between fiscal drag and underlying fundamental improvement, with a great deal of uncertainty over which force will prevail in the near-term. This tug-of-war is clearly seen in the monthly employment data. Over April and May, the average monthly gain in employment in the private service-providing sector has been well maintained at 175,000. In contrast, employment in the manufacturing sector and the federal government declined a combined 20,000 per month. And the resulting uncertainty is, I believe, an important contributing factor behind the relatively sluggish pace of business investment spending.

My best guess is that growth for all of 2013, measured on a Q4/Q4 basis, will be about what it has been since the end of the recession. But I believe a strong case can be made that the pace of growth will pick up notably in 2014. The private sector of the economy should continue to heal, while the amount of fiscal drag will begin to subside. I also see some indications that growth prospects among our major trading partners have begun to improve; for example, the rise in the June euro area composite Purchasing Managers' Index. And this combination of events is likely to create an environment in which business investment spending will gather strength.

Finally, I believe this tug-of-war analogy is useful in explaining the recent inflation dynamics. As is well known, total inflation, as measured by the personal consumption expenditures (PCE) deflator, has slowed sharply over the past year and is now running below the FOMC's expressed goal of 2 percent. Much of the slowing of total inflation is due to declining energy prices resulting from the weakening of global growth mentioned earlier combined with increased energy production here in the U.S. However, it is also the case that core inflation, that is, excluding food and energy, has slowed sharply as well. A decomposition of the slowing in core inflation reveals that some of it is due to slowing in the rate of increase in prices of non-food and non-energy goods. This probably is due in large part to the softening of global demand for goods and the modest appreciation of the dollar that has occurred since mid-2011.

In the service sector, the rate of increase in prices of medical services and "non-market" services – the latter includes some financial services – also has slowed notably recently. In contrast, the rate of increase in prices for other non-energy services has been relatively stable. Comparing this set of conditions to that in 2010, the recent slowing of inflation has been less widespread across core goods and core services, and inflation expectations so far have declined less appreciably than they did in 2010. Thus, my best guess is that core goods prices will begin to firm in the months ahead as global demand begins to strengthen and inventories get into better alignment with sales.

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[1] CoreLogic Report Shows Home Prices Rise by 12.1 Percent Year Over Year in April.

As is always the case, there is substantial uncertainty surrounding this forecast. Moreover, there is always the possibility of some unforeseen shock. Thus, we will be monitoring U.S. and global economic conditions very carefully and will adjust our views on the likely path for growth, inflation and the unemployment rate accordingly in response to new information.

At its meeting last week, the FOMC decided to continue its accommodative policy stance. It reaffirmed its expectation that the current low range for the federal funds rate target will be appropriate at least as long as the unemployment rate remains above 6.5 percent, so long as inflation and inflation expectations remain well-behaved. It is important to remember that these conditions are thresholds, not triggers. The FOMC also maintained its purchases of $40 billion per month in agency MBS and $45 billion per month in Treasury securities, with a stated goal of promoting a substantial improvement in the labor market outlook in a context of price stability.

In its statement, the FOMC said that it may vary the pace of purchases as economic conditions evolve. As Chairman Bernanke stated in his press conference following the FOMC meeting, if the economic data over the next year turn out to be broadly consistent with the outlooks that the FOMC sees as most likely, which are roughly similar to the outlook I have already laid out, the FOMC anticipates that it would be appropriate to begin to moderate the pace of purchases later this year. Under such a scenario, subsequent reductions might occur in measured steps through the first half of next year, and an end to purchases around mid-2014. Under this scenario, at the time that asset purchases came to an end, the unemployment rate likely would be near 7 percent and the economy's momentum strengthening, supporting further robust job gains in the future.

Here, a few points deserve emphasis. First, the FOMC's policy depends on the progress we make towards our objectives. This means that the policy – including the pace of asset purchases – depends on the outlook rather than the calendar. The scenario I outlined above is only that – one possible outcome. Economic circumstances could diverge significantly from the FOMC's expectations. If labor market conditions and the economy's growth momentum were to be less favorable than in the FOMC's outlook – and this is what has happened in recent years – I would expect that the asset purchases would continue at a higher pace for longer.

Second, even if this scenario were to occur and the pace of purchases were reduced, it would still be the case that as long as the FOMC continues its asset purchases it is adding monetary policy accommodation, not tightening monetary policy. As the FOMC adds to its stock of securities, this should continue to put downward pressure on longer-term interest rates, making monetary policy more accommodative.

Third, the Federal Reserve is likely to keep most of these assets on its balance sheet for a long time. As Chairman Bernanke noted in his press conference last week, a strong majority of FOMC participants no longer favor selling agency MBS securities during the monetary policy normalization process. This implies a bigger balance sheet for longer, which provides additional accommodation today and continuing support for mortgage markets going forward.

Fourth, even under this scenario, a rise in short-term rates is very likely to be a long way off. Not only will it likely take considerable time to reach the FOMC's 6.5 percent unemployment rate threshold, but also the FOMC could wait considerably longer before raising short-term rates. The fact that inflation is coming in well below the FOMC's 2 percent objective is relevant here. Most FOMC participants currently do not expect short-term rates to begin to rise until 2015.

Some commentators have interpreted the recent shift in the market-implied path of short-term interest rates as indicating that market participants now expect the first increases in the federal funds rate target to come much earlier than previously thought. Setting aside whether this is the correct interpretation of recent price moves, let me emphasize that such an expectation would be quite out of sync with both FOMC statements and the expectations of most FOMC participants.

Regional economic conditions

Let me turn now to the regional economy, the focus of our presentations today. Our last briefing on the regional economy took place at a difficult time – soon after Superstorm Sandy. While economic life has returned to normal across most of the metro area, some of the hardest-hit areas are still struggling to recover and rebuild. Just blocks from here, in fact, the South Street Seaport business district is still far from business-as-usual. And there are many such neighborhoods across the metropolitan region, from the low-lying and coastal areas of New Jersey to Brooklyn, Queens and Long Island; from Staten Island to southern Connecticut. One encouraging sign, though, is that our broader regional economy has shown remarkable resilience. It has been growing and adding jobs at a reasonably good pace. Moreover, the rebuilding effort appears to be giving a bit of a boost to the job market in industries such as construction.

As we've discussed before, the New York Fed produces economic activity indexes to help monitor the performance of New York State, New York City and New Jersey. Based on these measures, New York City has continued to grow strongly, and New Jersey's economy has seen some pickup in growth since the beginning of this year. However, growth in New York State has slowed, and Puerto Rico's economy is not faring well at all; the activity index produced by the Government Development Bank for Puerto Rico shows that the Island's economy has yet to show any signs of bottoming out.

The job situation has varied somewhat across our region. Improvement has generally been broad-based, with New York City and Long Island doing particularly well, though Puerto Rico continues to weaken. Both Connecticut and New Jersey have recently been growing roughly in line with the nation thus far in 2013. Unemployment rates across the region are roughly matching the national rate, with the exception of the relatively high rate that has characterized Puerto Rico's labor market for some time. Housing continues to be a focus of our regional monitoring efforts and home prices in our region appear to have bottomed. Our economists will elaborate on these points this morning.

Are recent college graduates finding good jobs?

The special topic of today's press briefing is a look at how well recent college graduates are faring in the job market, both nationally and here in our region. A college education represents an important investment in one's human capital, meaning the knowledge and skills people build. Historically, it's been pretty clear that those who've invested in a college education have tended to earn a sizeable economic return. And the benefits of college-educated citizens go well beyond the individual. Regions with a higher concentration of college graduates tend to be more innovative, have higher living standards and experience more rapid economic growth.[2] So a college education plays an important role in helping individuals prosper, as well as in strengthening the broader economy.

More recently, though, rising costs, increasing student debt and widespread reports of recent college graduates not being able to find good jobs have raised some troubling questions about whether going to college is still a good investment. In fact, some of our own research, including material that we discussed at our last press briefing, has shown the dramatic increase in student debt over the past decade.[3] In today's briefing, we're going to take a

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[2] See, for example, Edward L. Glaeser, Jose A. Scheinkman, and Andrei Shleifer (1995) "Economic Growth in a Cross-Section of Cities," *Journal of Monetary Economics*, 36, 117–43; Gerald A. Carlino, Satyajit Chatterjee, and Robert M. Hunt (2007) "Urban Density and the Rate of Invention," *Journal of Urban Economics*, 61, 389–419; and Jaison R. Abel and Todd M. Gabe (2011) "Human Capital and Economic Activity in Urban America," *Regional Studies*, 45, 1079–90.

[3] See, for example, Press Briefing on Q4 2012 Household Debt and Credit Report; Meta Brown and Sydnee Caldwell, "Young Student Loan Borrowers Retreat from Housing and Auto Markets Liberty Street Economics

close look at the question of just how weak today's labor market is for new college graduates by putting their recent experience into context using some hard data.

It is important for us to undertake this kind of analysis because, as we'll show, newly minted graduates always take some time to transition into the labor market and find jobs that utilize their education. And young people with college degrees still fare far better than those without. At the same time, with the sluggish jobs recovery from the recession, it's clear that the transition of recent graduates into the labor market is taking longer, and they've experienced higher unemployment and higher underemployment than in years past.[4] Still, while times have gotten tougher for recent graduates, we shouldn't be too hasty in concluding that getting a college education won't help people find good jobs.

I will now ask Jason Bram to present an update of economic conditions in our region.

Blog Post, April 17, 2013; and Andrew Haughwout, Donghoon Lee, Wilbert van der Klaauw, and Joelle Scally, "Just Released: The Geography of Student Debt," Liberty Street Economics Blog Post, May 14, 2013.

4 Underemployment, for purposes of this presentation, refers to college graduates working in jobs that typically don't require a college degree.