

William C Dudley: The national and local economic outlook – an update

Remarks by Mr William C Dudley, President and Chief Executive Officer of the Federal Reserve Bank of New York, at the University of Bridgeport, Bridgeport, Connecticut, 8 April 2016.

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Good morning. I am very pleased to be in Bridgeport and to speak with you today. I would like to give a special thanks to the University of Bridgeport for their part in making this event possible.

My visit today is part of our ongoing efforts at the Federal Reserve Bank of New York to better understand the regional economy. We plan trips like this so that we can meet with a diverse array of stakeholders in the region to gain insights and perspectives on the local economy. These trips also allow us to hear from Main Street about the major issues and concerns affecting people and businesses in the area. Fairfield County is our first destination in 2016, and this is the second time we have visited the area in the past three years.

I am looking forward to meeting with a number of different groups today. After starting our day here at the University of Bridgeport, we will meet with an organization called The WorkPlace to hear about some of the nationally-recognized programs they have successfully developed to help the long-term unemployed find jobs. Long-term unemployment is a significant problem in the broader economy, and something that I will discuss in more detail later in my remarks. Next, we will take a tour of the American Job Center, an organization that provides workforce assistance to job seekers in conjunction with local businesses. Later we will attend, a roundtable lunch with members of the Bridgeport Regional Business Community. And, finally, we will meet with leadership from the Housing Development Fund, New Horizons and NeighborWorks America to hear about the state of affordable housing and community development in Fairfield County.

These trips are valuable to us, and represent one of the many ways in which the New York Fed engages with people and businesses in our region. Another one of our efforts in this vein is our *Small Business Credit Survey* – the latest version of which was released last month. This survey – which includes responses from across 26 states – helps us understand the challenges facing small businesses in the region, focusing on financing needs and impediments to obtaining credit. We partnered with multiple organizations throughout Connecticut to produce this survey – some of which are right here in Bridgeport – and received responses from nearly 200 small business owners from around the state. I'd like to personally thank those who participated in the survey.

The remainder of my remarks will focus on recent developments in the national and local economy. As always, what I have to say today reflects my own views and not necessarily those of the Federal Open Market Committee (FOMC) or the Federal Reserve System.

U.S. economic outlook

Despite the swings we have seen in financial markets over the past few months and the recent divergences across different economic and financial market indicators, recent developments have not led me to make a fundamental change in my outlook for the U.S. economy. I continue to expect that the economy will expand over the course of this year at a pace slightly above its long-term trend – sufficient to push the unemployment rate down a bit further and to more fully utilize the nation's labor resources. On inflation, although recent data have been somewhat firmer, it still appears that inflation for this year will fall short of our

2 percent objective for the personal consumption expenditure (PCE) deflator. However, I anticipate an eventual return to our objective as the transitory factors that have held down inflation dissipate over time.

In assessing the current state of the U.S. economy, recent news has generated divergent signals. Several sectors have been showing signs of softness. Real consumer spending growth appears to have moderated somewhat from the relatively robust pace of the second half of 2015. Both new and existing home sales have flattened since the middle of last year. Finally, indicators of real business investment spending point to continued softness. In contrast, manufacturing production – which had been a particular weak spot of the U.S. economy in 2015 – rose in the first two months of this year. Recent survey data, including our own *Empire State Manufacturing Survey*, indicate further improvement in conditions for the manufacturing sector in March.

Through it all, the U.S. labor market has remained healthy. Payroll employment increased an average of about 229,000 per month over the course of 2015, and the gains in the first quarter of this year were nearly as high. Even though the unemployment rate ticked up in March to 5 percent, the amount of slack in the labor market still appears to be diminishing. Both the share of the population that is employed and the labor force participation rate have risen a bit over the past several months, with the employment-to-population ratio now at its highest level since the end of the recession. However, measures of aggregate wage growth have remained quite subdued, which suggests there is still some slack in the labor market.

An important question is how to reconcile these cross-currents. I continue to anticipate that consumption and housing activity will expand at a moderate pace this year. Continued job and wage gains, combined with still-low energy prices, should sustain real disposable income growth and support consumer spending. The housing market should remain on a solid trajectory, supported by rising employment and low mortgage rates. In contrast to previous years, fiscal policy should also provide a moderate stimulus this year. I believe that these positive factors will be sufficient to offset weakness in other areas, such as net exports and fixed business investment that will continue to be adversely impacted by the still-strong dollar, weak foreign growth, and low energy and commodity prices.

Putting this all together, I expect real GDP growth of about 2 percent in 2016, slightly below the average pace of growth in this expansion, but a bit above my estimate of the potential growth of the U.S. economy. If this materializes, then we should see some further reduction in the unemployment rate to around 4¾ percent – my estimate of the rate that I view as consistent with stable inflation over the long term.

Turning to the outlook for inflation, on a year-over-year basis, both headline and core inflation have recently risen above the low levels that prevailed through most of 2015. Nevertheless, inflation still remains below the Federal Reserve's 2 percent objective. As the FOMC noted in its March statement, this continued low inflation is partly due to declines in energy prices and non-energy import prices. Although energy prices have stopped falling and the dollar has stopped appreciating, earlier movements in these factors still appear to be weighing on inflation.

A concern with this long period of low inflation is that it has the potential to reduce inflation expectations, which, in turn, would tend to continue to hold down inflation. As past experience shows, it is difficult to push inflation back up to the central bank's objective if inflation expectations fall meaningfully below that objective. Japan's experience is cautionary in this regard.

Recent evidence on inflation expectations suggests some firming, but there is still cause for concern. Although both measures of longer-term inflation compensation based on nominal and inflation-indexed Treasury securities as well as some survey measures of inflation expectations have risen modestly since mid-February, the levels of many of these measures remain quite low.

Now, as I have noted, the low level of market-based inflation compensation probably reflects factors besides inflation expectations, in particular lower term premiums. Still, it would be prudent to consider the possibility that longer-term inflation expectations of market participants may have declined somewhat. Even after a rise in its most recent reading, the median of the three-year inflation expectations from the New York Fed's *Survey of Consumer Expectations* remains near its lowest reading over its short history. Renewed declines in survey measures would be worrisome. However, at this point, my conclusion is that inflation expectations have not become unanchored.

In sum, I anticipate that the combination of decreasing resource slack and anchored longer-term inflation expectations will help push inflation up to our 2 percent objective over the medium term. The recent rise in inflation and in measures of inflation expectations have increased my confidence around this outlook compared to earlier in the year, but it is still possible that the return of inflation to our objective could take longer than I anticipate.

The forecast that I have just described is my best assessment of how the U.S. economy will evolve this year. As always, there is uncertainty and risk relative to this forecast, which also needs to be taken into consideration in assessing the implications of the outlook for monetary policy. I see the uncertainties around my forecast to be somewhat greater than usual. This assessment reflects the divergent economic signals I highlighted earlier. In addition, the factors behind the financial turbulence we saw earlier this year do not yet appear to be resolved fully.

Although the downside risks have diminished since earlier in the year, I still judge the balance of risks to my inflation and growth outlooks to be tilted slightly to the downside. The low levels of energy and commodity prices may signal more persistent disinflationary pressures than I currently anticipate, while renewed tightening of financial market conditions could have a greater negative impact on the U.S. economy. Also, there is significant uncertainty about economic growth prospects abroad and how this will affect the U.S. economic outlook. I continue to monitor global economic and financial market developments closely to assess their implications for the outlook.

Given my outlook and risk assessment, I judge that a cautious and gradual approach to policy normalization is appropriate. Moreover, caution is also called for because of our limited ability to reduce the policy rate to respond to adverse developments, recognizing that we could also use forward guidance and balance sheet policies to provide additional accommodation if that proved warranted. Of course, the trajectory of short-term interest rates and the timing of future monetary policy adjustments will continue to be informed by the incoming data – both economic and financial – and how that data influences the outlook.

The problem of long-term unemployment

Before turning to the outlook for the local economy, I would like to spend a few minutes talking about the problem of long-term unemployment. The Great Recession was very severe, resulting in a large decline in output and damage to the labor market. From peak to trough, non-farm payroll employment declined by 8.7 million. The unemployment rate peaked at 10 percent. At the same time, the average duration of unemployment increased significantly. The number of individuals classified as long-term unemployed – that is, those who were unemployed for at least 27 weeks – peaked in December 2010 at 6.4 million, an increase of 5.3 million from the cyclical low in May 2007. Long-term unemployment as a fraction of total unemployment increased from 16.7 percent to 44.8 percent. The hardships of prolonged unemployment touched many families around the country and this is tragic.

The very accommodative monetary policy that we implemented in response was aimed at helping to heal the labor market and promote price stability. Slowly, the economy began to respond and to recover. In October 2014, the FOMC announced the end of its latest asset purchase program citing that “there has been substantial improvement in the outlook for the labor market since the inception of its current asset purchase program.” In March 2015, the

FOMC set out conditions for the decision to begin to normalize monetary policy, stating “The Committee anticipates that it will be appropriate to raise the target range for the federal funds rate when it has seen further improvement in the labor market and is reasonably confident that inflation will move back to its 2 percent objective over the medium term.” The FOMC judged at its December 2015 meeting that those conditions had been met.

The improvement that we have seen in the labor market is very welcome. It took until May 2014 for the labor market to recover the jobs lost in the recession, but now there are 5.3 million jobs beyond the prior cyclical peak. The unemployment rate has declined to 5.0 percent. With this improvement, the number of long-term unemployed has been reduced to 2.2 million. Despite these gains, it is important to emphasize that more needs to be done to improve the labor market. The current number of long-term unemployed is still higher than the prior cyclical peak in June 2003, and is more than a million above the prior cyclical low in October 2006.

Further progress on transitioning these unemployed workers back into jobs requires sustained effort on many fronts. Essential to this effort are programs such as the Platform to Employment developed by The WorkPlace. I am looking forward to my visit there later today to hear more about this program. The Platform to Employment program has been replicated in nearly 20 communities across the country from Newark to San Diego. Helping the long-term unemployed regain employment needs to be a priority for all of us.

The ongoing challenge in reducing the number of long-term unemployed is also a reminder of the importance of financial stability and sustainable economic growth. Recessions can quickly undo years’ worth of hard-earned progress in the labor market. Making the financial system and the economy more resilient so we can avoid such deep downturns in the future is a responsibility that I take very seriously.

Local economic outlook

Turning now to the region, while Fairfield County’s economy has recovered from the Great Recession, its job growth has lagged behind both New York City and the nation. Only recently has employment approached its pre-recession levels, and it is still well shy of where it was back in 2000. Other barometers of the Fairfield County economy, such as home prices, also indicate a slow recovery from the recession. There are still a sizable number of properties that are either in foreclosure or up for foreclosure sale, which has weighed down the local housing market. Yet, Fairfield County has not been the only place in the metro region to see a sluggish recovery – notably, both northern New Jersey and the Mid-Hudson Valley have yet to see employment return to their pre-recession peaks.

This picture is in contrast with New York City’s economic performance, which has been exceptionally strong throughout this expansion, and has been a driver of growth for the whole tri-state region. Why is New York City seeing so much stronger job growth than Fairfield County? After all, it wasn’t so long ago that Stamford was attracting finance-sector jobs away from Manhattan. The answer lies in a mix of cyclical and secular trends. On the cyclical side, while finance employment has been sluggish in both New York City and Fairfield County, New York City is benefiting from strong employment gains in technology, construction, retailing and advertising – sectors that are not contributing to the same degree in Fairfield County. In addition, Stamford has had to deal with the relocations of UBS and RBS, while Fairfield faces the prospective relocation of GE.

One potential long-term trend that is likely affecting the region is a renewed urbanization: that is, a gradual but broad-based shift of preferences to urban living, especially for younger generations. Throughout the second half of the 20th century, we saw a steady and widespread migration from cities to suburbs. More recently, this suburbanization trend seems to have halted; and there are signs that cities, especially major cities, have been gaining relative to their suburbs. It’s too early to say if this is the start of a secular trend, and the implications for Fairfield County are unclear. However, Stamford and Bridgeport stand to

benefit from a shift in preferences toward more urban living, given their high population densities and strong transit links to New York City.

Even now, while Fairfield County may have lagged in job growth, population growth has remained quite sturdy – not only across the county, but here in Bridgeport as well. In fact, Bridgeport’s population has grown by about 6 percent since 2000 – its first sustained increase since the 1940s – while Stamford’s has grown by almost 10 percent.

Fairfield County can leverage its proximity to the New York City job market. While most residents of Fairfield County rely on job opportunities locally, many residents commute to jobs in Manhattan. So the strength in New York City’s economy should be of significant help to Fairfield County. Over the past year, New York City’s economy has, on average, added more than twice as many jobs each month as the total expected job losses from the relocations of GE, UBS and RBS. While a majority of these jobs may not have been in high-paying-industry sectors, some of them were – especially in technology-related industries. So, as long as New York City keeps adding jobs at such a brisk pace, Fairfield County will benefit. In addition, research indicates that a strong central city is critical for the well-being of its suburbs, meaning that a healthy and growing New York City economy is critically important to Fairfield County.

What else can the region do to foster economic growth going forward? It certainly helps for cities like Bridgeport and Stamford to be attractive locations for businesses to locate and grow. It is also important to focus on quality of life issues that make people want to live here – like good schools and low crime, and also amenities ranging from nice parks to good restaurants. Bridgeport has clearly been making progress in this regard, both along the waterfront at Steelpointe Harbor and along Main Street. With New York City’s large and booming economy nearby, and Metro North providing a convenient mass transit link, anything that makes people more inclined to live here – and perhaps even set up shop here – is bound to boost the local economy. And finally, one of the most important ingredients for a healthy urban economy is a well-trained and motivated work force. It cannot be overstated how important it is to help provide residents with the skills and tools they need to be productive and successful, so that they can realize their full potential.

College graduates finding good jobs

I would like to close with a message for the students in attendance today, especially those of you who will be graduating soon. If you started college four or five years ago, you may have heard about the difficult time that graduates have had finding good jobs, perhaps even making you wonder about the value of obtaining a college degree. Indeed, in the years following the Great Recession, unemployment and underemployment among recent college graduates reached highs not seen in decades. So, it wouldn’t be surprising if many of you are concerned about your ability to find a good job after graduation.

I want to make two points that should temper these concerns. First, it is not unusual for college graduates to take some time to find the right job when they transition from school to the working world. In good economic times, as well as in bad times, there is often an adjustment period as newly-minted graduates search for a job that best fits their skills and interests. Second, as the job market has continued to strengthen through the expansion, it has gotten easier for those graduating from college to find a good job.¹

While job opportunities for those with a college degree were flat between 2011 and early 2014, demand for college graduates has been on the rise for about two years now. As a

¹ We have been tracking these developments using data our economists have developed to help us better understand the job prospects facing recent college graduates. These data are available on our website and are updated regularly. See [The Labor Market for Recent College Graduates](#).

result, for the first time during this recovery, both unemployment and underemployment among recent college graduates has generally been falling. This means that, not only has it become easier to find a job upon graduation, but more college graduates are taking jobs that better utilize their degrees. In addition, starting salaries for recent college graduates have been increasing for the past couple of years, reflecting the growing demand for their skills in a tighter job market.

To conclude, while there are economic challenges facing both the nation and the region, I am optimistic that we will continue to make progress on both fronts over the next few years. Achieving our dual mandate of maximum sustainable employment and price stability will help those who will graduate soon to achieve their own aspirations.

Thank you for your kind attention. I would be happy to take some questions.