

## **William C Dudley: The outlook for the national and local economy**

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 Staten Island Chamber of Commerce, Staten Island, New York, 16 April 2013.

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It is always a pleasure to speak with the business community given your important role in the community and in the region. I am particularly pleased to have the opportunity to speak to the Staten Island Chamber of Commerce and to be part of this distinguished panel. Thank you for inviting me today.

As you know I have the honor of serving as the president and CEO of the New York Fed, one of the 12 Federal Reserve Banks that together with the Board of Governors in Washington make up the Federal Reserve System, our nation's central bank. As head of the New York Fed I am vice-chairman of the Federal Open Market Committee (FOMC), the body that sets our nation's monetary policy.

The Fed was founded 100 years ago in 1913 to advance economic and financial stability. Over this century our nation's economic output and standard of living has increased greatly, but the United States also faced many different challenges – ranging from the Great Depression of the 1930s to the Great Inflation of the 1970s and most recently the financial crisis.

The Federal Reserve is independent from politics and the national government but is subject to oversight by Congress, which has set our dual mandate to promote maximum sustainable employment and price stability. The Federal Reserve is structured to ensure that the economic needs of people and businesses in every part of our country are fully considered in our policy deliberations. What I learn in my visit to Staten Island today is an important input to our policymaking process.

As New York Fed president I try to get out of my New York City office as much as I can to get a sense of regional economic conditions across what is known as the second Federal Reserve District. I've traveled throughout New York, New Jersey and Puerto Rico in recent years and plan to visit Fairfield County, upstate New York and Queens later this year.

These visits give me the opportunity to explain what the Federal Reserve is doing and to get your thoughts about the state of our economy and the challenges that you face.

Today, I will focus on the economic outlook regionally and nationally. After that, I'll be happy to answer any questions you have about what the Fed does, and about the economic outlook. As always, my views are my own and do not necessarily reflect those of the FOMC or the Federal Reserve System.

### **Regional economic conditions**

The financial crisis underscored the fact that the world is a complicated place and that the insights of professional economists and financial experts must be supplemented with a broader set of perspectives from households and businesses. Today's visit is in that spirit – I want to talk about what we are seeing in the economy but also to hear from you firsthand about your assessment of economic conditions.

So what do we see? Let me start with basic economic characteristics. While Staten Island is the city's least populous borough, its population has grown steadily and rapidly, more than doubling in the last half-century to close to one-half million residents. On its own, Staten Island is larger than all other cities in the entire New York–New Jersey region, with the obvious exception of New York City.

In many ways – homeownership, educational attainment, income, and demographics – Staten Island more closely resembles the nation than the rest of New York City. For example, the homeownership rate on Staten Island is almost 70 percent, well above the 30 percent average homeownership rate citywide. Still, with a sizable proportion of the borough's workers commuting to Manhattan (about ¼ of the island's workers or more than 50,000 people) Staten Island's economy is closely tied to the rest of the city's economy, as well as to northern New Jersey's. Thus, when Manhattan sees brisk job growth, the residents of Staten Island have better opportunities.

The New York City economy continues to rebound strongly from the 2008–09 downturn – more strongly than the nation as a whole. The New York Fed's index of economic activity for the city has grown solidly and steadily for the past three years, signaling a robust rebound in the local economy. This strength is reflected in strong job creation: while the U.S. economy has thus far recovered only about two-thirds of the jobs lost during the recession, New York City has recovered all its lost jobs and then some. In fact, total employment in the Big Apple recently surpassed not only its pre-crisis peak of 2008 but also its all-time peak of 1969.

Here on Staten Island job creation has not been quite as robust over the past couple years. It should be recognized, however, that Staten Island's economy was actually more resilient than Manhattan's during the recession, experiencing only minimal job losses. Staten Island's key industries – local-market sectors like health, education and retail trade – tend to be less susceptible to sharp economic downturns than more cyclical sectors, like manufacturing, construction and finance.

Even so, not all indicators of the local economy are improving. Unemployment remains stubbornly high, at just over 8 percent. And home prices, though recovering gradually, are still down about 15 percent from where they were back in 2007. This compares to nationally where they are down about 25 percent on average.

The New York Fed's quarterly measures of household credit conditions signal some recent improvement, though there clearly remain pockets of financial stress among families here. At year-end, for those people with a credit report, average debt per person in Staten Island ticked up, rising to about \$67,000, after trending down for a number of years. A similar uptick in debt was observed nationwide, potentially signaling that households are now somewhat more willing to take on debt. Delinquency rates, however, are still fairly high: 9.7 percent of all debt in the county is seriously delinquent, well above the national rate. On a more positive note, delinquency rates on Staten Island are declining and are at their lowest level in 3½ years. Mortgage delinquency rates, though still above the national rate, are also at a 3½-year low.

Recently, of course, Staten Island's greatest challenge has been the massive disruption and destruction caused by Superstorm Sandy. While many parts of the New York City metropolitan region were hard-hit by the storm, the devastation was particularly severe here on Staten Island. And this is something that has had large consequences for some of my colleagues at the Federal Reserve Bank of New York. Nearly 150 of our employees call Staten Island their home. While many, thankfully, were spared the full brunt of the storm, I know quite a few people whose homes were destroyed or severely damaged and others who lost many of their belongings.

Immediately following Sandy, our Regional and Community Outreach function reached out to all of the affected communities as part of a needs assessment. We asked: "How can the New York Fed best leverage our resources to help our community?"

After dozens of conversations with leaders of the community, we determined that pulling together key service providers under one roof would make a useful contribution. Our outreach team organized a free relief clinic in this very building. We brought together a wide variety of government agency representatives and other service providers. I would like to acknowledge what is a long list: Federal Emergency Management Agency (FEMA), the Small Business Administration (SBA), the Office of the New York Attorney General, the New York

State Department of Financial Services, the New York Legal Assistance Group, Staten Island Legal Services, the Legal Aid Society, MFY Legal Services, various bar associations, New York City Department of Small Business Services, Center for New York City Neighborhoods, Neighborhood Housing Services of Staten Island and the Northfield Local Community Development Corporation. I'm proud to say we were able to assist over 150 Staten Islanders, including homeowners, tenants and small business owners.

We also heard that it could be challenging to find key recovery information and advice online. So once again, we pulled key resources under one roof – or I should say one URL. We developed a Sandy Information Center with the best information we could find for folks impacted by Sandy – including key deadline dates along with expert legal, finance and insurance guidance. Over 2,000 have benefited from our web resources.

While we are not yet back to normal in neighborhoods like Midland Beach, Oakwood Beach, New Dorp Beach and Tottenville, the situation is improving and I expect that this recovery will continue over the coming year. We are going to continue to examine where we can provide assistance in supporting this effort. One effort, for example, is to provide assistance in collecting detailed data on the areas that were impacted by the storm.

From talking to some local business people late last November, we know that many residents and businesses had to wait a long time for insurance claims and small business loans, as well as to get their heat and power restored. We also know that eight public schools were closed.

Unfortunately, timely statistics pertaining specifically to Staten Island's economy are scarce, thus making it hard to accurately gauge the impact from Sandy or the strength and breadth of the ensuing recovery. So we truly value input from all of you – people on the front lines of the local economy – to assist us in gauging recent trends and developments in Staten Island's economy.

### **National economic conditions**

Turning to the national outlook, the U.S. economy remains on the slow growth track that has persisted since the recession ended in mid-2009. In fact, real gross domestic product (GDP) grew just 1.7 percent in 2012, below the 2.2 percent rate of the preceding two years. This lackluster and disappointing performance masks the fact that the underlying conditions that support growth have been gradually improving. However, in the near-term, this improvement in fundamentals is being offset by federal tax increases and spending cuts, which economists call "fiscal drag." The most obvious example of this is the end of the partial payroll tax holiday at the beginning of this year. This reduced the take-home pay for all those that pay into the Social Security system.

In a recent speech to the Economic Club of New York, I discussed a number of areas where economic fundamentals have improved. Here, let me concentrate instead on some areas of the economy where the impact of this improvement in fundamentals has been most evident: consumer spending, the housing market, and investment in equipment and software.

Despite the increase in payroll taxes and in high-income tax rates, real – that is, inflation-adjusted – personal consumption expenditures rose solidly in January and February. As has been the case for some time, the growth of consumer spending has been led by purchases of durable goods. Car and light truck sales in the first quarter were at the highest pace since the fourth quarter of 2007. This growth in consumer spending probably is due, in part, to improvements in labor market conditions, household balance sheets and household access to credit. However, retail sales were quite weak in March, suggesting that the tax increases that occurred at the start of the year may be beginning to have a material effect.

After a long period of being a drag on the economy, the housing market is now providing lift to economic activity, with upward trends evident in housing starts, home sales, and home prices. To see why this is so important, in 2009 residential investment exerted a

0.4 percentage point drag on GDP growth, while in 2013 it is likely to provide a boost to growth on the order of 0.5 percentage point – a swing of nearly a full percentage point. In addition, rising home prices can create positive spillovers to the rest of the economy as higher home prices lift household wealth and reduce the number of homeowners with negative equity.

Business investment in equipment and software, another component of private final demand, strengthened in the fourth quarter, and shipments and orders for nondefense capital goods suggest further growth in the first quarter. Moreover, indicators of the U.S. manufacturing sector, including the ISM manufacturing index and most Federal Reserve regional manufacturing indexes, point to continued moderate growth in the sector.

So why isn't the U.S. economy growing more quickly? The most important reason is the sharp shift in federal fiscal policy from mild restraint in 2012 to much greater restraint in 2013. The increase in payroll tax rates, the rise in high income tax rates, the increase in taxes associated with the Affordable Care Act, and the sequester will result in fiscal drag of about 1½ percentage points of GDP in 2013, an unusually large amount of fiscal restraint when the economy doesn't have strong forward momentum and unemployment is still elevated.

In terms of the labor market, we have seen only a moderate improvement in labor market conditions over the past six months or so. After an encouraging pick up in the pace of job creation around the turn of the year, the employment report for March showed a gain of only 88,000 jobs. While I don't want to read too much into a single month's data, this underscores the need to wait and see how the economy develops before declaring victory prematurely. I'd note that we saw similar slowdowns in job creation in 2011 and 2012 after pickups in the job creation rate and this, along with the large amount of fiscal restraint hitting the economy now, makes me more cautious.

Since September, payroll employment has increased an average of 188,000 per month, compared with an average of 172,000 per month over the previous two years. The unemployment rate has declined from a peak of 10 percent in October 2009 to 7.6 percent in March; however, much of the decrease is due to a fall in the number of people actively looking for a job. Furthermore, as of March there were still almost 3 million fewer jobs than at the end of 2007, and the ratio of employed Americans to the working age population was actually lower than it was at the end of the recession. Also, in an indication that employment is far from healthy, job finding rates have changed little since the recession. New York Fed staff research agrees with the broad consensus that cyclical factors are the major reason for the continued weakness in labor market conditions.

In sum, these developments lead me to expect sluggish real GDP growth over the course of 2013 of about 2 to 2½ percent. As such, I anticipate that the unemployment rate will decline only modestly through the rest of the year.

In the near term, there is considerable uncertainty about the outlook, particularly because the multiplier effects from fiscal drag and sequestration are still unclear. This uncertainty should gradually decline – for better or for worse – over the coming months, as the sequester's impact takes hold and more economic data come in, giving us a clearer picture of the forward momentum of the economy.

Inflation, as measured by the personal consumption expenditure deflator, is currently well below the Federal Reserve's objective of 2 percent. There is substantial slack in the labor market and in the markets for goods and services, and underlying measures of inflation are subdued. Moreover, peoples' expectations of inflation remain well anchored at levels consistent with our 2 percent longer-run objective. Thus, I conclude that the risk that inflation could significantly exceed our 2 percent objective is quite low over the next few years, even if the economy were to strengthen considerably.

With inflation well below its longer-run goal and high unemployment, the FOMC decided at its March meeting to maintain a “highly accommodative” policy stance: a federal funds rate in a range of 0 to 25 basis points with forward guidance based on economic thresholds. Moreover, to support a stronger economic recovery, the FOMC is purchasing long-term Treasury securities at a rate of \$45 billion per month and agency mortgage-backed securities (MBS) at a rate of \$40 billion per month, and will continue purchasing assets until it sees substantial improvement in the outlook for the labor market, conditional on ongoing assessment of benefits and costs. Combined, these actions are intended to ease financial conditions and thereby help to establish a self-sustaining economic expansion.

As I stated in my recent Economic Club speech, the benefits of our asset purchases – as reflected in improving financial conditions and the quickening pace of interest-sensitive spending such as that on consumer durable goods, housing, and capital goods – exceeds the costs. Furthermore, the labor market outlook has yet to show substantial improvement. Consequently, I see the current pace of asset purchases as appropriate.

At some point, I expect that I will see sufficient evidence of improved economic momentum to lead me to favor gradually dialing back the pace of asset purchases. Of course, any subsequent bad news could lead me to favor dialing them back up again. As Chairman Bernanke said in his press conference following the March FOMC meeting “when we see that the...situation has changed in a meaningful way, then we may well adjust the pace of purchases in order to keep the level of accommodation consistent with the outlook.”

## **Conclusion**

Let me reiterate how pleased I am to be here on Staten Island and to have the opportunity to speak to the members of the Chamber. Parts of Staten Island were among the most devastated areas in the region and we at the Federal Reserve Bank are committed to doing all that we can to help people and businesses recover. Many obstacles remain to be overcome but I am confident that Staten Island will meet the challenges that lay ahead.