Janet L Yellen: Semiannual Monetary Policy Report to the Congress

Testimony by Ms Janet L Yellen, Chair of the Board of Governors of the Federal Reserve System, before the Committee on Financial Services, US House of Representatives, Washington DC, 15 July 2015.

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Chairman Hensarling, Ranking Member Waters, and members of the Committee, I am pleased to present the Federal Reserve's semiannual *Monetary Policy Report* to the Congress. In my remarks today, I will discuss the current economic situation and outlook before turning to monetary policy.

Current economic situation and outlook

Since my appearance before this Committee in February, the economy has made further progress toward the Federal Reserve's objective of maximum employment, while inflation has continued to run below the level that the Federal Open Market Committee (FOMC) judges to be most consistent over the longer run with the Federal Reserve's statutory mandate to promote maximum employment and price stability.

In the labor market, the unemployment rate now stands at 5.3 percent, slightly below its level at the end of last year and down more than 4–1/2 percentage points from its 10 percent peak in late 2009. Meanwhile, monthly gains in nonfarm payroll employment averaged about 210,000 over the first half of this year, somewhat less than the robust 260,000 average seen in 2014 but still sufficient to bring the total increase in employment since its trough to more than 12 million jobs. Other measures of job market health are also trending in the right direction, with noticeable declines over the past year in the number of people suffering long-term unemployment and in the numbers working part time who would prefer full-time employment. However, these measures – as well as the unemployment rate – continue to indicate that there is still some slack in labor markets. For example, too many people are not searching for a job but would likely do so if the labor market was stronger. And, although there are tentative signs that wage growth has picked up, it continues to be relatively subdued, consistent with other indications of slack. Thus, while labor market conditions have improved substantially, they are, in the FOMC's judgment, not yet consistent with maximum employment.

Even as the labor market was improving, domestic spending and production softened notably during the first half of this year. Real gross domestic product (GDP) is now estimated to have been little changed in the first quarter after having risen at an average annual rate of 3–1/2 percent over the second half of last year, and industrial production has declined a bit, on balance, since the turn of the year. While these developments bear watching, some of this sluggishness seems to be the result of transitory factors, including unusually severe winter weather, labor disruptions at West Coast ports, and statistical noise. The available data suggest a moderate pace of GDP growth in the second quarter as these influences dissipate. Notably, consumer spending has picked up, and sales of motor vehicles in May and June were strong, suggesting that many households have both the wherewithal and the confidence to purchase big-ticket items. In addition, homebuilding has picked up somewhat lately, although the demand for housing is still being restrained by limited availability of mortgage loans to many potential homebuyers. Business investment has been soft this year, partly reflecting the plunge in oil drilling. And net exports are being held down by weak economic growth in several of our major trading partners and the appreciation of the dollar.

Looking forward, prospects are favorable for further improvement in the U.S. labor market and the economy more broadly. Low oil prices and ongoing employment gains should continue to bolster consumer spending, financial conditions generally remain supportive of growth, and the highly accommodative monetary policies abroad should work to strengthen global growth. In addition, some of the headwinds restraining economic growth, including the effects of dollar appreciation on net exports and the effect of lower oil prices on capital spending, should diminish over time. As a result, the FOMC expects U.S. GDP growth to strengthen over the remainder of this year and the unemployment rate to decline gradually.

As always, however, there are some uncertainties in the economic outlook. Foreign developments, in particular, pose some risks to U.S. growth. Most notably, although the recovery in the euro area appears to have gained a firmer footing, the situation in Greece remains difficult. And China continues to grapple with the challenges posed by high debt, weak property markets, and volatile financial conditions. But economic growth abroad could also pick up more quickly than observers generally anticipate, providing additional support for U.S. economic activity. The U.S. economy also might snap back more quickly as the transitory influences holding down first-half growth fade and the boost to consumer spending from low oil prices shows through more definitively.

As I noted earlier, inflation continues to run below the Committee's 2 percent objective, with the personal consumption expenditures (PCE) price index up only 1/4 percent over the 12 months ending in May and the core index, which excludes the volatile food and energy components, up only 1-1/4 percent over the same period. To a significant extent, the recent low readings on total PCE inflation reflect influences that are likely to be transitory, particularly the earlier steep declines in oil prices and in the prices of non-energy imported goods. Indeed, energy prices appear to have stabilized recently.

Although monthly inflation readings have firmed lately, the 12-month change in the PCE price index is likely to remain near its recent low level in the near term. My colleagues and I continue to expect that as the effects of these transitory factors dissipate and as the labor market improves further, inflation will move gradually back toward our 2 percent objective over the medium term. Market-based measures of inflation compensation remain low – although they have risen some from their levels earlier this year – and survey-based measures of longer-term inflation expectations have remained stable. The Committee will continue to monitor inflation developments carefully.

Monetary policy

Regarding monetary policy, the FOMC conducts policy to promote maximum employment and price stability, as required by our statutory mandate from the Congress. Given the economic situation that I just described, the Committee has judged that a high degree of monetary policy accommodation remains appropriate. Consistent with that assessment, we have continued to maintain the target range for the federal funds rate at 0 to 1/4 percent and have kept the Federal Reserve's holdings of longer-term securities at their current elevated level to help maintain accommodative financial conditions.

In its most recent statement, the FOMC again noted that it judged it would 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 Committee will determine the timing of the initial increase in the federal funds rate on a meeting-by-meeting basis, depending on its assessment of realized and expected progress toward its objectives of maximum employment and 2 percent inflation. If the economy evolves as we expect, economic conditions likely would make it appropriate at some point this year to raise the federal funds rate target, thereby beginning to normalize the stance of monetary policy. Indeed, most participants in June projected that an increase in the federal funds target range would likely become appropriate before year-end. But let me emphasize again that these are projections based on the anticipated path of the economy, not statements of intent to raise rates at any particular time.

A decision by the Committee to raise its target range for the federal funds rate will signal how much progress the economy has made in healing from the trauma of the financial crisis. That said, the importance of the initial step to raise the federal funds rate target should not be overemphasized. What matters for financial conditions and the broader economy is the entire expected path of interest rates, not any particular move, including the initial increase, in the federal funds rate. Indeed, the stance of monetary policy will likely remain highly accommodative for quite some time after the first increase in the federal funds rate in order to support continued progress toward our objectives of maximum employment and 2 percent inflation. In the projections prepared for our June meeting, most FOMC participants anticipated that economic conditions would evolve over time in a way that will warrant gradual increases in the federal funds rate as the headwinds that still restrain real activity continue to diminish and inflation rises. Of course, if the expansion proves to be more vigorous than currently anticipated and inflation moves higher than expected, then the appropriate path would likely follow a higher and steeper trajectory; conversely, if conditions were to prove weaker, then the appropriate trajectory would be lower and less steep than currently projected. As always, we will regularly reassess what level of the federal funds rate is consistent with achieving and maintaining the Committee's dual mandate.

I would also like to note that the Federal Reserve has continued to refine its operational plans pertaining to the deployment of our various policy tools when the Committee judges it appropriate to begin normalizing the stance of policy. Last fall, the Committee issued a detailed statement concerning its plans for policy normalization and, over the past few months, we have announced a number of additional details regarding the approach the Committee intends to use when it decides to raise the target range for the federal funds rate.

Federal reserve transparency and accountability

These statements pertaining to policy normalization constitute recent examples of the many steps the Federal Reserve has taken over the years to improve our public communications concerning monetary policy. As this Committee well knows, the Board has for many years delivered an extensive report on monetary policy and economic developments at semiannual hearings such as this one. And the FOMC has long announced its monetary policy decisions by issuing statements shortly after its meetings, followed by minutes of its meetings with a full account of policy discussions and, with an appropriate lag, complete meeting transcripts. Innovations in recent years have included quarterly press conferences and the quarterly release of FOMC participants' projections for economic growth, unemployment, inflation, and the appropriate path for the Committee's interest rate target. In addition, the Committee adopted a statement in 2012 concerning its longer-run goals and monetary policy strategy that included a specific 2 percent longer-run objective for inflation and a commitment to follow a balanced approach in pursuing our mandated goals.

Transparency concerning the Federal Reserve's conduct of monetary policy is desirable because better public understanding enhances the effectiveness of policy. More important, however, is that transparent communications reflect the Federal Reserve's commitment to accountability within our democratic system of government. Our various communications tools are important means of implementing monetary policy and have many technical elements. Each step forward in our communications practices has been taken with the goal of enhancing the effectiveness of monetary policy and avoiding unintended consequences. Effective communication is also crucial to ensuring that the Federal Reserve remains accountable, but measures that affect the ability of policymakers to make decisions about monetary policy free of short-term political pressure, in the name of transparency, should be avoided.

The Federal Reserve ranks among the most transparent central banks. We publish a summary of our balance sheet every week. Our financial statements are audited annually by an outside auditor and made public. Every security we hold is listed on the website of the Federal Reserve Bank of New York. And, in conformance with the Dodd-Frank Act, transaction-level data on all of our lending – including the identity of borrowers and the amounts borrowed – are published with a two-year lag. Efforts to further increase transparency, no matter how well intentioned, must avoid unintended consequences that could undermine the Federal Reserve's ability to make policy in the long-run best interest of American families and businesses.

Summary

In sum, since the February 2015 *Monetary Policy Report*, we have seen, despite the soft patch in economic activity in the first quarter, that the labor market has continued to show progress toward our objective of maximum employment. Inflation has continued to run below our longer-run objective, but we believe transitory factors have played a major role. We continue to anticipate that it will be appropriate to raise the target range for the federal funds rate when the Committee 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. As always, the Federal Reserve remains committed to employing its tools to best promote the attainment of its dual mandate.

Thank you. I would be pleased to take your questions.