

## Janet 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 Banking, Housing, and Urban Affairs, US Senate, Washington DC, 14 February 2017.

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Chairman Crapo, Ranking Member Brown, and other 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 briefly discuss the current economic situation and outlook before turning to monetary policy.

### Current economic situation and outlook

Since my appearance before this Committee last June, the economy has continued to make progress toward our dual-mandate objectives of maximum employment and price stability. In the labor market, job gains averaged 190,000 per month over the second half of 2016, and the number of jobs rose an additional 227,000 in January. Those gains bring the total increase in employment since its trough in early 2010 to nearly 16 million. In addition, the unemployment rate, which stood at 4.8 percent in January, is more than 5 percentage points lower than where it stood at its peak in 2010 and is now in line with the median of the Federal Open Market Committee (FOMC) participants' estimates of its longer-run normal level. A broader measure of labor underutilization, which includes those marginally attached to the labor force and people who are working part time but would like a full-time job, has also continued to improve over the past year. In addition, the pace of wage growth has picked up relative to its pace of a few years ago, a further indication that the job market is tightening. Importantly, improvements in the labor market in recent years have been widespread, with large declines in the unemployment rates for all major demographic groups, including African Americans and Hispanics. Even so, it is discouraging that jobless rates for those minorities remain significantly higher than the rate for the nation overall.

Ongoing gains in the labor market have been accompanied by a further moderate expansion in economic activity. U.S. real gross domestic product is estimated to have risen 1.9 percent last year, the same as in 2015. Consumer spending has continued to rise at a healthy pace, supported by steady income gains, increases in the value of households' financial assets and homes, favorable levels of consumer sentiment, and low interest rates. Last year's sales of automobiles and light trucks were the highest annual total on record. In contrast, business investment was relatively soft for much of last year, though it posted some larger gains toward the end of the year in part reflecting an apparent end to the sharp declines in spending on drilling and mining structures; moreover, business sentiment has noticeably improved in the past few months. In addition, weak foreign growth and the appreciation of the dollar over the past two years have restrained manufacturing output. Meanwhile, housing construction has continued to trend up at only a modest pace in recent quarters. And, while the lean stock of homes for sale and ongoing labor market gains should provide some support to housing construction going forward, the recent increases in mortgage rates may impart some restraint.

Inflation moved up over the past year, mainly because of the diminishing effects of the earlier declines in energy prices and import prices. Total consumer prices as measured by the personal consumption expenditures (PCE) index rose 1.6 percent in the 12 months ending in December, still below the FOMC's 2 percent objective but up 1 percentage point from its pace in 2015. Core PCE inflation, which excludes the volatile energy and food prices, moved up to about 1-3/4 percent.

My colleagues on the FOMC and I expect the economy to continue to expand at a moderate

pace, with the job market strengthening somewhat further and inflation gradually rising to 2 percent. This judgment reflects our view that U.S. monetary policy remains accommodative, and that the pace of global economic activity should pick up over time, supported by accommodative monetary policies abroad. Of course, our inflation outlook also depends importantly on our assessment that longer-run inflation expectations will remain reasonably well anchored. It is reassuring that while market-based measures of inflation compensation remain low, they have risen from the very low levels they reached during the latter part of 2015 and first half of 2016. Meanwhile, most survey measures of longer-term inflation expectations have changed little, on balance, in recent months.

As always, considerable uncertainty attends the economic outlook. Among the sources of uncertainty are possible changes in U.S. fiscal and other policies, the future path of productivity growth, and developments abroad.

## **Monetary policy**

Turning to monetary policy, the FOMC is committed to promoting maximum employment and price stability, as mandated by the Congress. Against the backdrop of headwinds weighing on the economy over the past year, including financial market stresses that emanated from developments abroad, the Committee maintained an unchanged target range for the federal funds rate for most of the year in order to support improvement in the labor market and an increase in inflation toward 2 percent. At its December meeting, the Committee raised the target range for the federal funds rate by 1/4 percentage point, to 1/2 to 3/4 percent. In doing so, the Committee recognized the considerable progress the economy had made toward the FOMC's dual objectives. The Committee judged that even after this increase in the federal funds rate target, monetary policy remains accommodative, thereby supporting some further strengthening in labor market conditions and a return to 2 percent inflation.

At its meeting that concluded early this month, the Committee left the target range for the federal funds rate unchanged but reiterated that it expects the evolution of the economy to warrant further gradual increases in the federal funds rate to achieve and maintain its employment and inflation objectives. As I noted on previous occasions, waiting too long to remove accommodation would be unwise, potentially requiring the FOMC to eventually raise rates rapidly, which could risk disrupting financial markets and pushing the economy into recession. Incoming data suggest that labor market conditions continue to strengthen and inflation is moving up to 2 percent, consistent with the Committee's expectations. At our upcoming meetings, the Committee will evaluate whether employment and inflation are continuing to evolve in line with these expectations, in which case a further adjustment of the federal funds rate would likely be appropriate.

The Committee's view that gradual increases in the federal funds rate will likely be appropriate reflects the expectation that the neutral federal funds rate—that is, the interest rate that is neither expansionary nor contractionary and that keeps the economy operating on an even keel—will rise somewhat over time. Current estimates of the neutral rate are well below pre-crisis levels—a phenomenon that may reflect slow productivity growth, subdued economic growth abroad, strong demand for safe longer-term assets, and other factors. The Committee anticipates that the depressing effect of these factors will diminish somewhat over time, raising the neutral funds rate, albeit to levels that are still low by historical standards.

That said, the economic outlook is uncertain, and monetary policy is not on a preset course. FOMC participants will adjust their assessments of the appropriate path for the federal funds rate in response to changes to the economic outlook and associated risks as informed by incoming data. Also, changes in fiscal policy or other economic policies could potentially affect the economic outlook. Of course, it is too early to know what policy changes will be put in place or how their economic effects will unfold. While it is not my intention to opine on specific tax or spending proposals, I would point to the importance of improving the pace of longer-run

economic growth and raising American living standards with policies aimed at improving productivity. I would also hope that fiscal policy changes will be consistent with putting U.S. fiscal accounts on a sustainable trajectory. In any event, it is important to remember that fiscal policy is only one of the many factors that can influence the economic outlook and the appropriate course of monetary policy. Overall, the FOMC's monetary policy decisions will be directed to the attainment of its congressionally mandated objectives of maximum employment and price stability.

Finally, the Committee has continued its policy of reinvesting proceeds from maturing Treasury securities and principal payments from agency debt and mortgage-backed securities. This policy, by keeping the Committee's holdings of longer-term securities at sizable levels, has helped maintain accommodative financial conditions.

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