

Randal K Quarles: The US economy after the Global Financial Crisis

Speech by Mr Randal K Quarles, Vice Chairman for Supervision of the Board of Governors of the Federal Reserve System, at "10 Years after the Global Financial Crisis: How Has the World Economy Changed and Where Will It Go?" 26th International Financial Symposium, sponsored by the Institute for International Monetary Affairs, Tokyo, 22 February 2018.

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I am very happy to be participating in this symposium on taking stock of the global economy a decade after the Global Financial Crisis, and I thank Hiroshi Watanabe for the invitation.¹ I have been asked to provide an overview of the U.S. economy since the advent of the crisis in no longer than 10 minutes, so I could either talk very quickly or focus my comments on more recent developments, perhaps throwing in a bit of historical context when appropriate.

To cut to the bottom line, the U.S. economy appears to be performing very well and, certainly, is in the best shape that it has been in since the crisis and, by many metrics, since well before the crisis. Recent volatility in equity markets is a reminder that asset prices can move rapidly and unexpectedly. However, it is my assessment that the underlying fundamentals of the U.S. economy are sound and much improved relative to earlier in the decade.

One easy and important place to see that improvement is in the labor market. After peaking at 10 percent in October 2009, the unemployment rate fell rather steadily to 4.1 percent in January—the lowest level, outside of a period from 1999 to 2000, since the 1960s. Job gains in recent months have continued at a pace that would be pushing the unemployment rate even lower if the labor participation rate had not stabilized in recent years, a welcome development and a sign that the strength of the labor market is pulling in or retaining workers who might otherwise be on the sidelines. Broader measures of labor market slack—for example, those that include individuals who are out of the labor force but say they want a job as well as those working with a part-time job but who would like to work full time—have largely returned to pre-crisis levels.

While the labor market has shown steady improvement over the past decade, the post-crisis performance of gross domestic product (GDP) growth has been more disappointing, averaging just 2 percent per year over the past seven years. However, beginning with the second quarter of last year, growth has shown some momentum. Over the past three quarters of 2017, real GDP increased at an average rate of almost 3 percent. While headline growth stepped back a bit in the fourth quarter, largely on account of increased drag from higher imports and lower inventories, underlying final private domestic demand—which is a better indicator of economic momentum—grew at its fastest pace in more than three years.

Recent survey data reveal a growing sense of economic optimism. Consumer confidence has returned to pre-crisis levels. Business optimism is also apparent in survey data as well as in the strength of investment. In 2017, investment in capital equipment increased at the fastest pace since 2011, accelerating through the year to a double-digit rate in the second half. It might be early, but it is possible that the investment drought that has afflicted the U.S. economy for the past five years may finally be breaking.

The tax and fiscal packages passed in recent months could help sustain the economy's momentum in part by increasing demand, and also possibly by boosting the potential capacity of the economy by encouraging investment and supporting labor force participation.

While the recent performance of the economy has been solid relative to much of the pre-crisis period, one area that continues to lag is productivity growth, a condition that has been common across the advanced economies. Beginning in 2011, the annual growth rate of labor productivity has averaged only 3/4 percent, compared with an average 2-1/4 percent pace in the two decades leading up to the financial crisis. Why productivity growth has been so weak defies easy

explanation. The weak pace of business investment is likely part of the story. In addition, some have argued that there has been a decline in business dynamism following the crisis; others do not link the slowdown to the crisis but rather to an exogenous slowdown in the rate of technological progress; and still others believe that productivity growth has not really slowed much at all and, instead, is just not being measured correctly in the official statistics. Regardless, given the importance of productivity growth for the long-run potential of the economy and living standards, it is vitally important that policymakers pursue policies aimed at boosting the growth rate of productivity.

Another aspect of the economy that has attracted a lot of attention is the apparent low level of inflation despite the tightness in labor markets. The 12-month increase in headline PCE prices was 1.7 percent in December, a touch below the Fed's 2 percent objective. After assessing the recent data, my take is that the current shortfall in inflation from target is most likely due to transitory factors that will fade through 2018, pushing inflation back up to target. Suffice to say, a deviation from our target of a few tenths of 1 percentage point, especially one I expect to fade, does not cause me great concern.

Against this economic backdrop, with a strong labor market and likely only temporary softness in inflation, I view it as appropriate that monetary policy should continue to be gradually normalized. An important component of this normalization was initiated in October, when we started to gradually scale back our reinvestment of proceeds from maturing Treasury securities and principal payments from agency securities.

With the balance sheet normalization plan set to remain on autopilot, barring a material deterioration in the economic outlook, the federal funds rate remains our primary tool for adjusting the stance of monetary policy. At our January meeting, the Federal Open Market Committee decided to maintain its target range for the federal funds rate between 1-1/4 percent and 1-1/2 percent.² In this range, monetary policy remains accommodative. I anticipate further gradual increases in the policy rate will be appropriate to both sustain a healthy labor market and stabilize inflation around our 2 percent objective. Of course, it should go without saying that I will keep a close eye on economic indicators—and their implications for the outlook for inflation and real activity—and adjust my views on appropriate monetary policy accordingly.

I would like to wrap up with a word on the financial sector. The Federal Reserve and our colleagues at other agencies have now spent the better part of the past decade building out and standing up the post-crisis regulatory regime. At this point, we have completed the bulk of the work of post-crisis regulation. As such, now is an eminently natural and expected time to step back and assess those efforts. It is our responsibility to ensure that they are working as intended, and—given the breadth and complexity of this new body of regulation—it is inevitable that we will be able to improve them, especially with the benefit of experience and hindsight.

¹ The views I express here are my own and not necessarily those of the Federal Reserve Board or the Federal Open Market Committee.

² See Board of Governors of the Federal Reserve System (2018), "Federal Reserve Issues FOMC Statement," press release, January 31, www.federalreserve.gov/newsevents/pressreleases/monetary20180131a.htm.