Jerome H Powell: Semiannual Monetary Policy Report to the Congress

Testimony by Mr Jerome H Powell, Chairman of the Board of Governors of the Federal Reserve System, before the Committee on Financial Services, US House of Representatives, Washington DC, 27 February 2018.

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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.

On the occasion of my first appearance before this Committee as Chairman of the Federal Reserve, I want to express my appreciation for my predecessor, Chair Janet Yellen, and her important contributions. During her term as Chair, the economy continued to strengthen and Federal Reserve policymakers began to normalize both the level of interest rates and the size of the balance sheet. Together, Chair Yellen and I have worked to ensure a smooth leadership transition and provide for continuity in monetary policy. I also want to express my appreciation for my colleagues on the Federal Open Market Committee (FOMC). Finally, I want to affirm my continued support for the objectives assigned to us by the Congress—maximum employment and price stability—and for transparency about the Federal Reserve's policies and programs. Transparency is the foundation for our accountability, and I am committed to clearly explaining what we are doing and why we are doing it. Today I will briefly discuss the current economic situation and outlook before turning to monetary policy.

Current Economic Situation and Outlook

The U.S. economy grew at a solid pace over the second half of 2017 and into this year. Monthly job gains averaged 179,000 from July through December, and payrolls rose an additional 200,000 in January. This pace of job growth was sufficient to push the unemployment rate down to 4.1 percent, about 3/4 percentage point lower than a year earlier and the lowest level since December 2000. In addition, the labor force participation rate remained roughly unchanged, on net, as it has for the past several years—that is a sign of job market strength, given that retiring baby boomers are putting downward pressure on the participation rate. Strong job gains in recent years have led to widespread reductions in unemployment across the income spectrum and for all major demographic groups. For example, the unemployment rate for adults without a high school education has fallen from about 15 percent in 2009 to 5-1/2 percent in January of this year, while the jobless rate for those with a college degree has moved down from 5 percent to 2 percent over the same period. In addition, unemployment rates for African Americans and Hispanics are now at or below rates seen before the recession, although they are still significantly above the rate for whites. Wages have continued to grow moderately, with a modest acceleration in some measures, although the extent of the pickup likely has been damped in part by the weak pace of productivity growth in recent years.

Turning from the labor market to production, inflation-adjusted gross domestic product rose at an annual rate of about 3 percent in the second half of 2017, 1 percentage point faster than its pace in the first half of the year. Economic growth in the second half was led by solid gains in consumer spending, supported by rising household incomes and wealth, and upbeat sentiment. In addition, growth in business investment stepped up sharply last year, which should support higher productivity growth in time. The housing market has continued to improve slowly. Economic activity abroad also has been solid in recent quarters, and the associated strengthening in the demand for U.S. exports has provided considerable support to our manufacturing industry.

Against this backdrop of solid growth and a strong labor market, inflation has been low and stable. In fact, inflation has continued to run below the 2 percent rate that the FOMC judges to be most consistent over the longer run with our congressional mandate. Overall consumer prices, as measured by the price index for personal consumption expenditures (PCE), increased 1.7 percent in the 12 months ending in December, about the same as in 2016. The core PCE price index, which excludes the prices of energy and food items and is a better indicator of future inflation, rose 1.5 percent over the same period, somewhat less than in the previous year. We continue to view some of the shortfall in inflation last year as likely reflecting transitory influences that we do not expect will repeat; consistent with this view, the monthly readings were a little higher toward the end of the year than in earlier months.

After easing substantially during 2017, financial conditions in the United States have reversed some of that easing. At this point, we do not see these developments as weighing heavily on the outlook for economic activity, the labor market, and inflation. Indeed, the economic outlook remains strong. The robust job market should continue to support growth in household incomes and consumer spending, solid economic growth among our trading partners should lead to further gains in U.S. exports, and upbeat business sentiment and strong sales growth will likely continue to boost business investment. Moreover, fiscal policy is becoming more stimulative. In this environment, we anticipate that inflation on a 12-month basis will move up this year and stabilize around the FOMC's 2 percent objective over the medium term. Wages should increase at a faster pace as well. The Committee views the near-term risks to the economic outlook as roughly balanced but will continue to monitor inflation developments closely.

Monetary Policy

I will now turn to monetary policy. The Congress has assigned us the goals of promoting maximum employment and stable prices. Over the second half of 2017, the FOMC continued to gradually reduce monetary policy accommodation. Specifically, we raised the target range for the federal funds rate by 1/4 percentage point at our December meeting, bringing the target to a range of 1-1/4 to 1-1/2 percent. In addition, in October we initiated a balance sheet normalization program to gradually reduce the Federal Reserve's securities holdings. That program has been proceeding smoothly. These interest rate and balance sheet actions reflect the Committee's view that gradually reducing monetary policy accommodation will sustain a strong labor market while fostering a return of inflation to 2 percent.

In gauging the appropriate path for monetary policy over the next few years, the FOMC will continue to strike a balance between avoiding an overheated economy and bringing PCE price inflation to 2 percent on a sustained basis. While many factors shape the economic outlook, some of the headwinds the U.S. economy faced in previous years have turned into tailwinds: In particular, fiscal policy has become more stimulative and foreign demand for U.S. exports is on a firmer trajectory. Despite the recent volatility, financial conditions remain accommodative. At the same time, inflation remains below our 2 percent longer-run objective. In the FOMC's view, further gradual increases in the federal funds rate will best promote attainment of both of our objectives. As always, the path of monetary policy will depend on the economic outlook as informed by incoming data.

In evaluating the stance of monetary policy, the FOMC routinely consults monetary policy rules that connect prescriptions for the policy rate with variables associated with our mandated objectives. Personally, I find these rule prescriptions helpful. Careful judgments are required about the measurement of the variables used, as well as about the implications of the many issues these rules do not take into account. I would like to note that this *Monetary Policy Report* provides further discussion of monetary policy rules and their role in the Federal Reserve's policy process, extending the analysis we introduced in July.

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