Richard H Clarida: US economic outlook and monetary policy

Speech by Mr Richard H Clarida, Vice Chairman of the Board of Governors of the Federal Reserve System, at the 35th Annual NABE Economic Policy Conference "Promoting Global Growth and Domestic Economic Security", Washington DC, 28 February 2019.

* * *

Thank you for the opportunity to participate in the 35th Annual Economic Policy Conference of the National Association for Business Economics. Before we begin our conversation, I want to share a few thoughts about the outlook for the economy and monetary policy.[1]

Current Economic Situation and Outlook

The U.S. economy expanded at a robust pace in 2018, and my baseline outlook for 2019 foresees somewhat slower but still-solid growth in the year ahead. In July, just about four months from now, the current economic expansion will become the longest on record. The Federal Reserve is charged by the Congress with achieving and sustaining a dual mandate of maximum employment and price stability, and the economy is as close as it has been in many years to meeting these goals.

The unemployment rate is near the lowest level recorded in 50 years, and average monthly job gains have continued to well outpace the increases needed over the longer run to provide jobs for new entrants to the labor force. Most measures of nominal wage growth are running at or somewhat above the 3 percent pace, and recent wage gains have been strongest for lower-skilled workers.

Moreover, the strength of the labor market appears to have encouraged people to join the labor force and others, who might have left it, to continue working. The labor force participation rate--the share of people who are either working or looking for work--has moved up 1/2 percentage point over the past year, and the participation rate of prime-age workers (those 25 to 54 years old) has risen about 1-1/2 percentage points over the past few years.

Inflation, as measured by the 12-month change in the price index for personal consumption expenditures (PCE), is estimated to have been a little bit below 2 percent of late, largely because of recent declines in energy prices. However, core PCE inflation, which excludes food and energy prices and tends to be a better indicator of future inflation, is estimated to have been about 2 percent. Market-based measures of inflation compensation have moved lower, on net, since last summer, though they have increased some recently, and some survey-based measures of longer-term inflation expectations are little changed. That said, taken together, the evidence suggests that measures of expected inflation are at the lower end of a range that I consider to be consistent with our price-stability goal of 2 percent PCE inflation.

While my baseline outlook for growth, employment, and inflation is a positive one, a number of crosscurrents that are buffeting the economy bear careful scrutiny. Global growth is slowing, particularly in China and Europe. Global policy uncertainty remains elevated. And financial conditions have been volatile, making efforts to extract signal from noise more challenging.

Monetary Policy

As I have indicated in recent speeches, monetary policy at this juncture needs to be especially data dependent, with the federal funds rate now in the range of Federal Open Market Committee (FOMC) participants' estimates of its longer-run neutral level. Moreover, with employment and inflation now at or close to our dual-mandate objectives, the FOMC in its January statement indicated it can afford to be patient as we assess the need for further adjustments in our policy stance.[2] Going forward, we need, I believe, to be cognizant of the balance we must strike between (1) being forward looking and (2) maximizing the odds of being right given the reality that the models that we consult are not infallible. For example, were a model to predict a surge in inflation, a decision for preemptive hikes before the surge is evident in actual data would need to be balanced against the considerable cost of the model being wrong. Given muted inflation and stable inflation expectations, I believe we can be patient and allow the data to flow in as we determine what future adjustments to the target range for the federal funds rate may be appropriate to strike this balance.

We also decided at our January meeting to maintain our current operating regimeIIa "floor" system--for implementing monetary policy.[3] The FOMC will continue to set the stance of policy by establishing the target range for the federal funds rate. The interest on excess reserves rate will be our primary tool to keep the federal funds rate in the target range. In this regime, we will provide an ample supply of reserves in the banking system to ensure that we remain on the flat portion of the reserve demand curve and that the federal funds rate is insulated from shocks to reserve demand and supply. With this decision on our operating regime made, the Committee can now decide on the appropriate timing and pace for concluding our balance sheet drawdown. In the longer run, the ultimate size of the balance sheet will be determined by the demand for Federal Reserve liabilities such as currency and reserve balances.

Finally, in November, we announced a review of the Federal Reserve's monetary policy strategy, tools, and communications practices. In this review, we will listen carefully to a broad range of stakeholders offering a full range of perspectives from across the country, and we will draw on these insights as we assess how best to achieve and maintain maximum employment and price stability in the most robust fashion possible. Taking these viewpoints on board, the FOMC will begin its own discussions this summer on how we might refine our framework and will provide a public assessment after the review is completed.[4]

Thank you for your attention, and I look forward to our conversation.

---

1 The views expressed are my own and not necessarily those of other Federal Reserve Board members or Federal Open Market Committee participants. I am grateful to Brian Doyle of the Federal Reserve Board staff for his assistance in preparing this text.

2 See Board of Governors of the Federal Reserve System (2019), "Federal Reserve Issues FOMC Statement," press release, January 30.

3 See Board of Governors of the Federal Reserve System (2019), "Statement Regarding Monetary Policy Implementation and Balance Sheet Normalization," press release, January 30.

4 Information about the review and the events associated with it are available on the Board's website at www.federalreserve.gov/monetarypolicy/review-of-monetary-policy-strategy-tools-and-communications.htm.