



FEDERAL
RESERVE
BANK
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Nashville Branch

A View from the Fed: monetary policy & today's economy

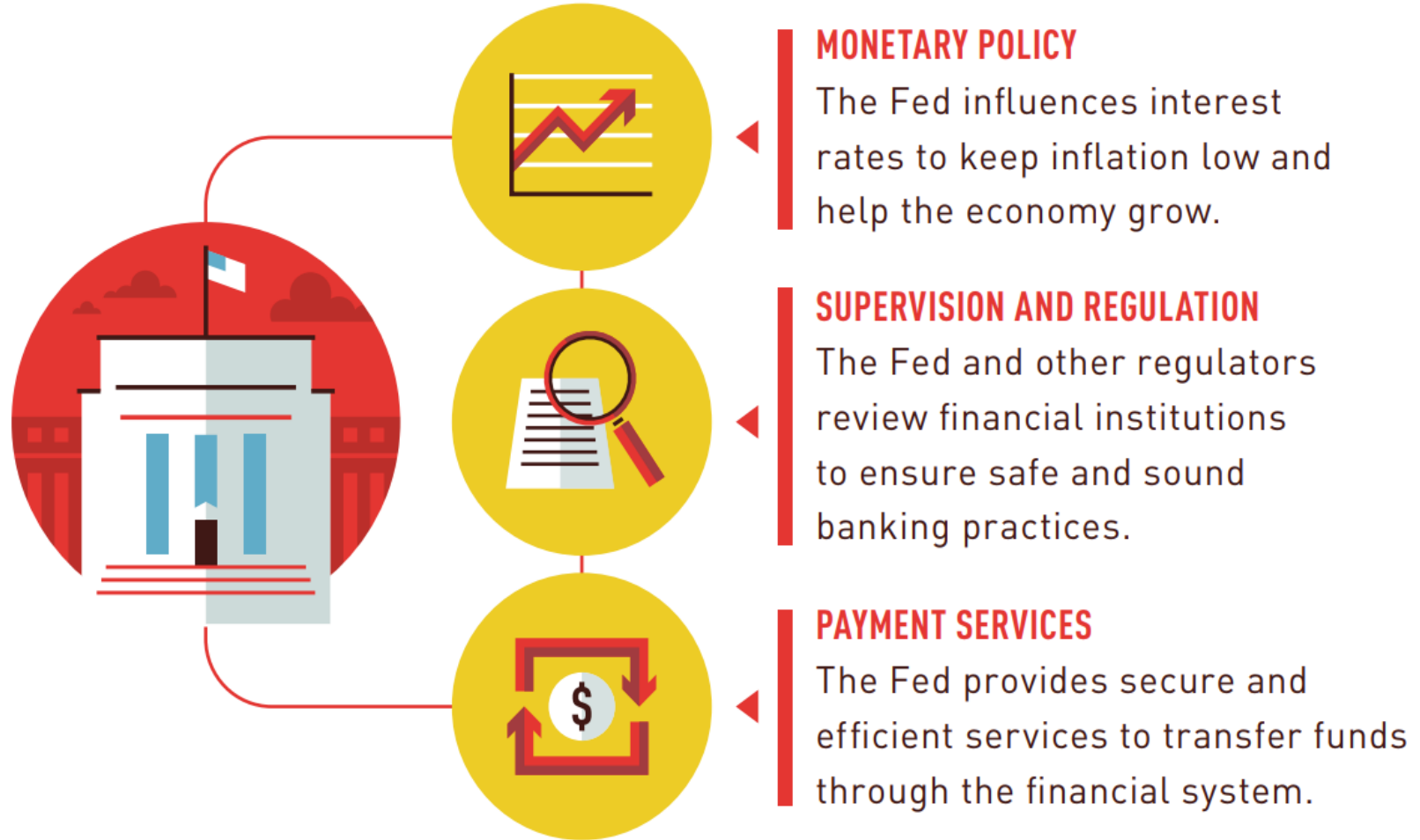
Laurel Graefe

October 2019

The Line-Up:

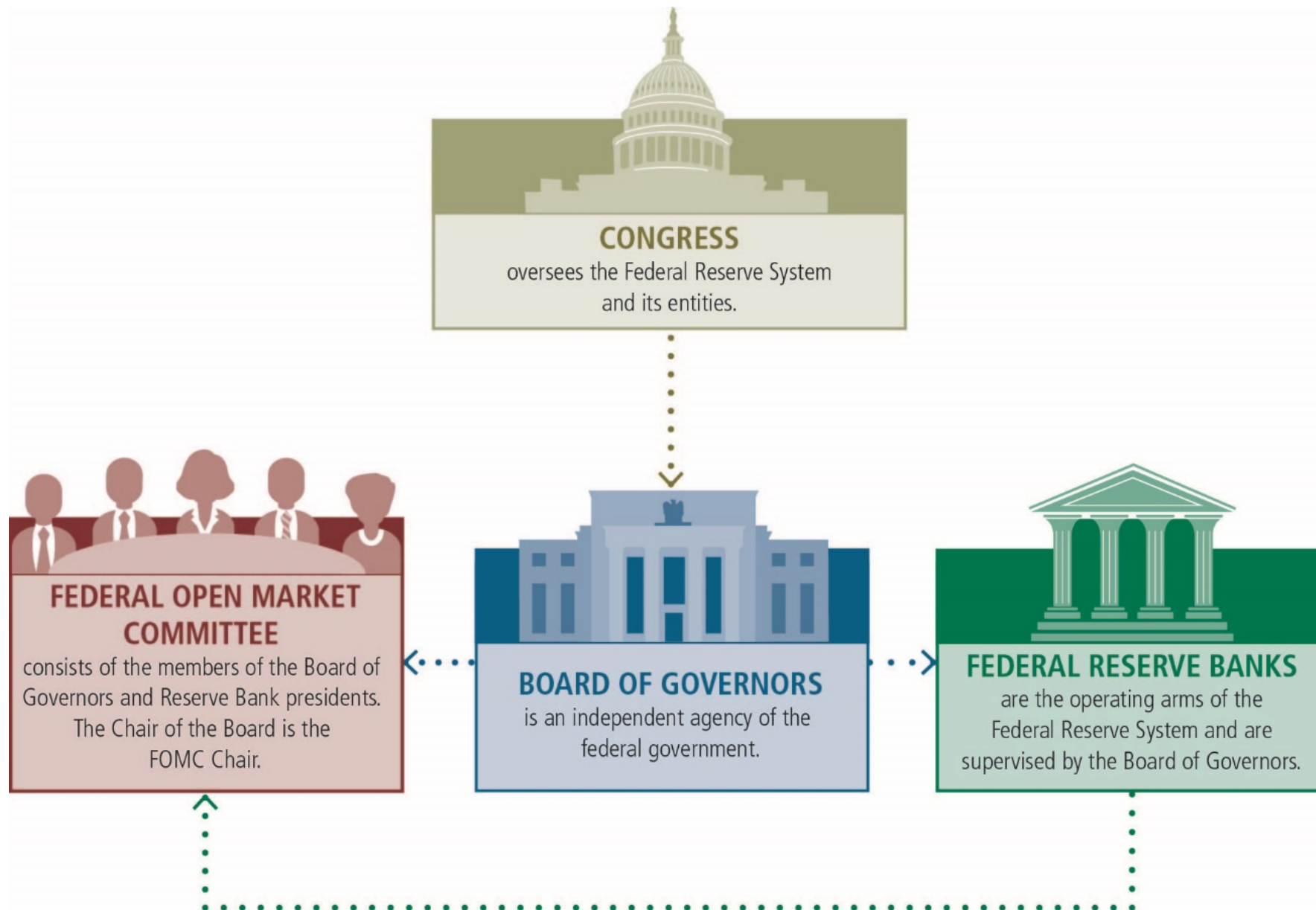
- The Fed – A Primer
- The Role of Grass Roots Information
- Economic Outlook + Monetary Policy

THE FED'S ROLE IN THE ECONOMY

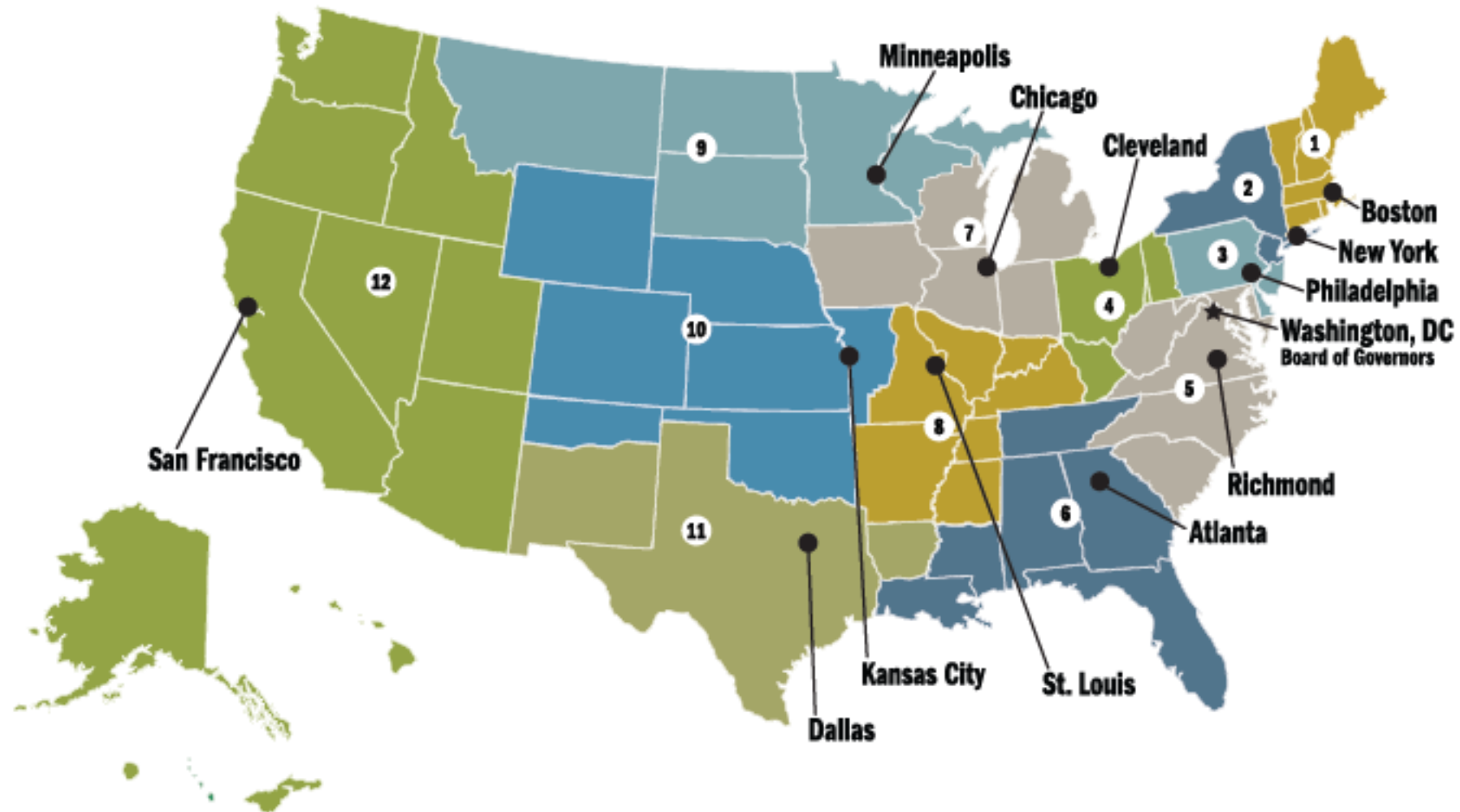


Source: Richmond Fed

The Federal Reserve's Public Mission



The 12 Federal Reserve Districts



The Sixth District



Raphael Bostic
President & CEO

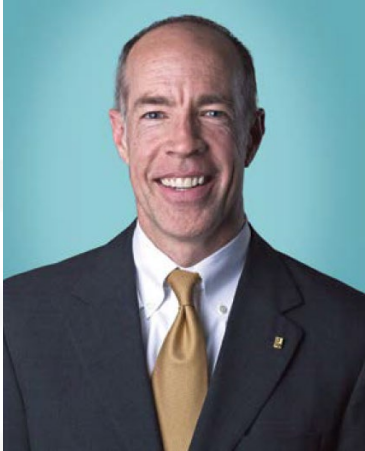
Monetary Policy: The Fed's Dual Mandate

- The Fed is pursuing two objectives as given to us by Congress—**maximum employment and price stability**.
- The maximum level of employment is largely determined by nonmonetary factors that affect the structure and dynamics of the job market, although a stronger economy does help with job creation.
- The Federal Open Market Committee (FOMC) has chosen an inflation target of two percent year-over-year growth over the longer term.

Monetary Policy-

- Because monetary policy acts with a lag, the Federal Open Market Committee has to take both the **present situation** *and* the **economic forecast** into consideration
- Use both **quantitative** and **qualitative** sources to paint a broad picture of economic conditions

One important source of economic insight: Nashville Board of Directors



Matthew Bourlakas
Goodwill of Middle TN
(Chair)



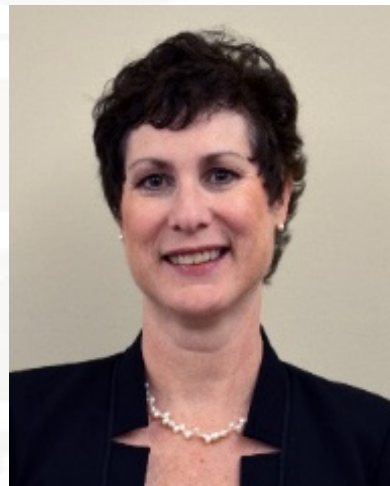
Beth Chase
Ankura



John Garratt
Dollar General



Heath Holtz
Nissan North America



Amber Krupacs
Clayton Homes



Leif Murphy
TeamHealth



Thomas Zacharia
Oak Ridge National Lab

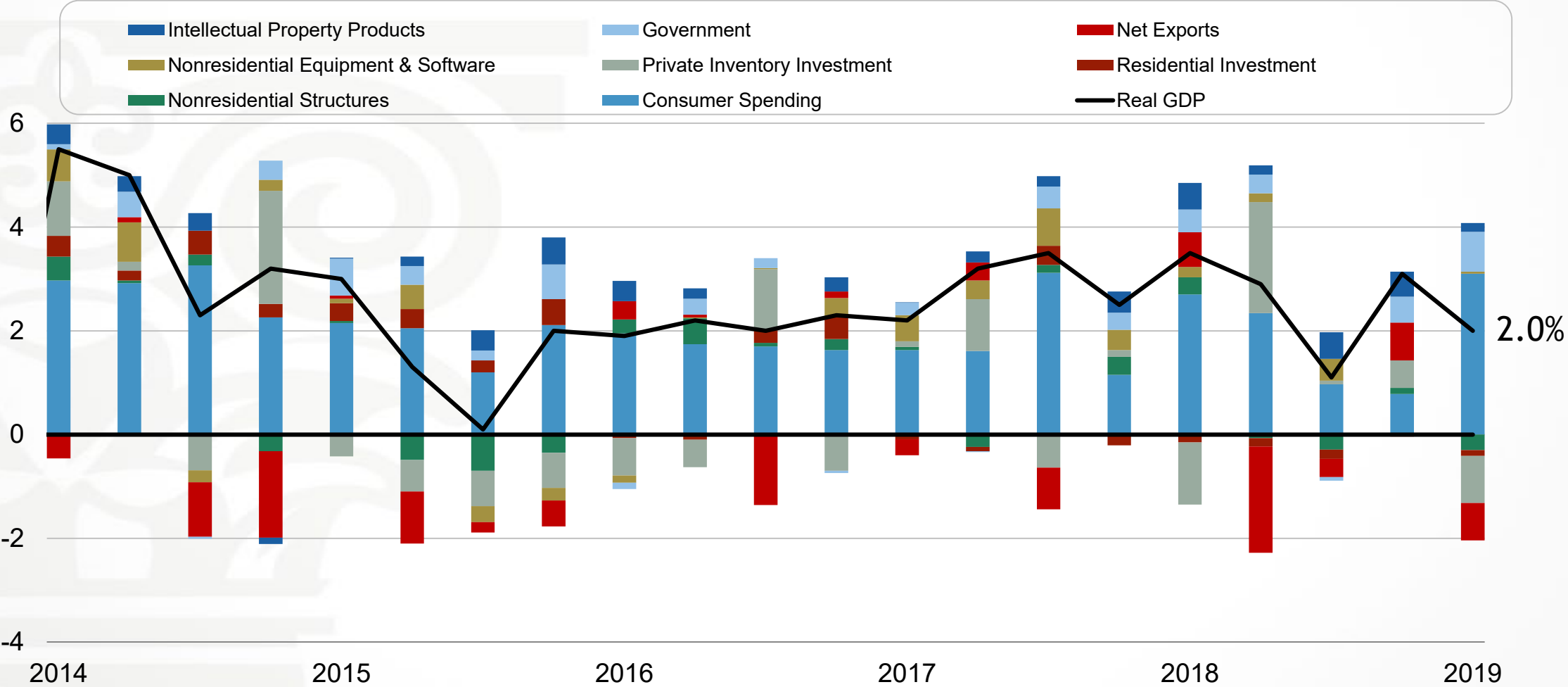
So, how is the economy shaping up today?



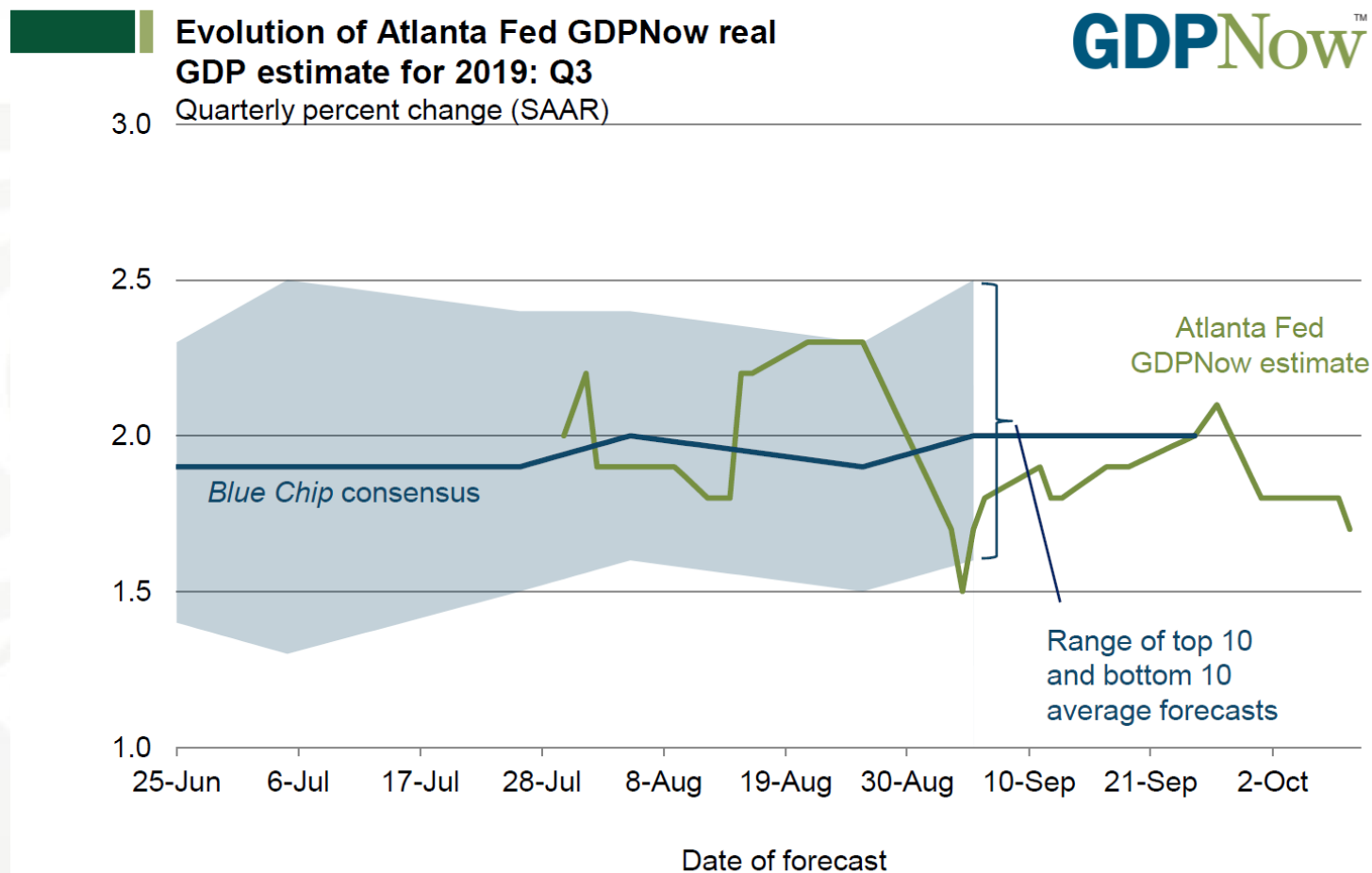
The US economy grew 2% in the second quarter, as sluggish business investment and declining exports were overshadowed by strong consumer spending

Contributions to Real GDP Growth

quarterly, percent, seasonally adjusted annualized rate



The latest read from GDPNow has Q3 GDP coming in at 1.7 percent



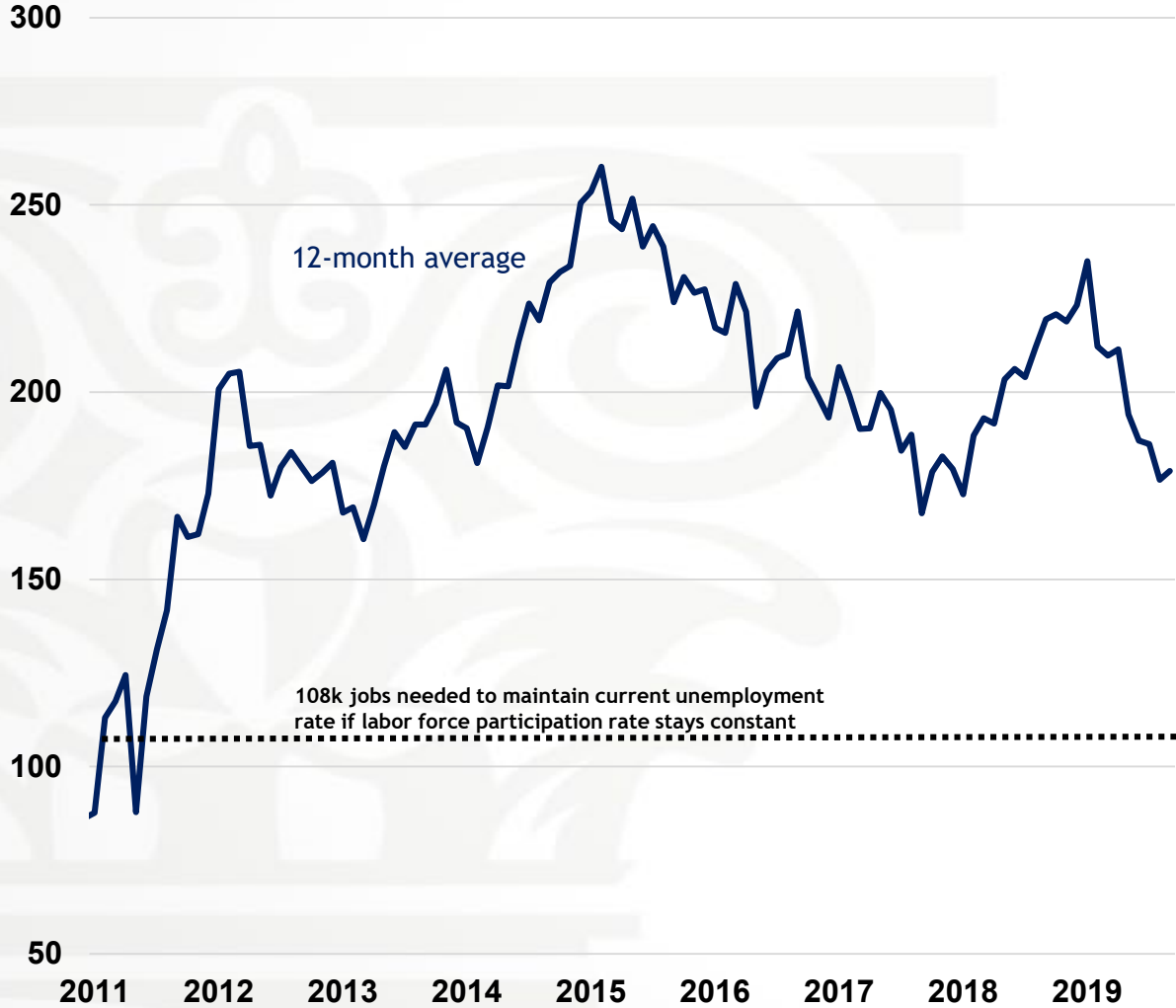
Sources: *Blue Chip Economic Indicators* and *Blue Chip Financial Forecasts*

Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the *Blue Chip* survey.



Job gains continue to outpace what is needed to maintain the current unemployment rate (holding labor force participation rates constant).

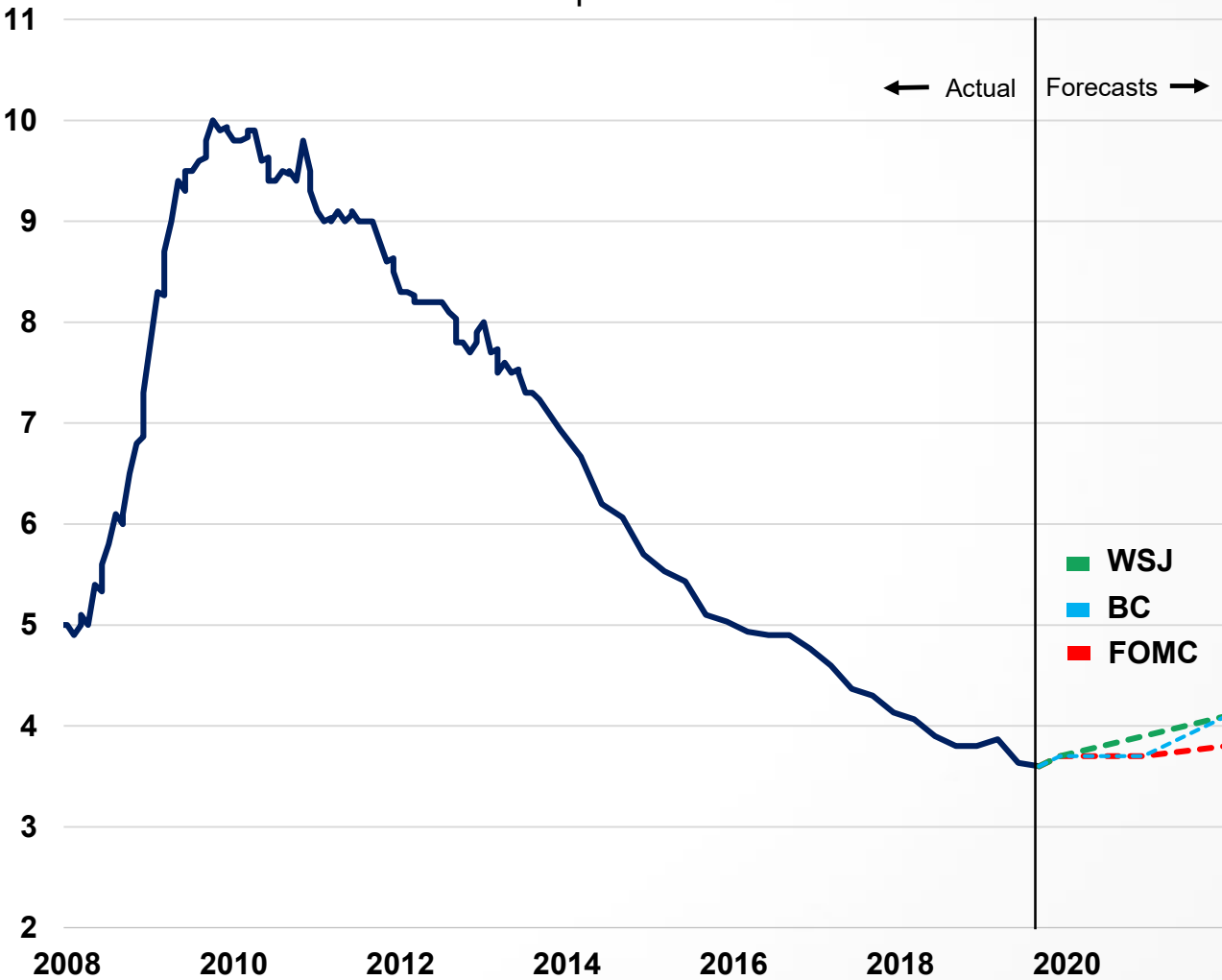
Payroll Employment Growth
thousands of jobs, sa



Sources: Bureau of Labor Statistics, staff calculations; Haver Analytics

data through September 2019

Unemployment Rate and Projections
percent



Sources: Bureau of Labor Statistics, Blue Chip Economic Indicators, Wall Street Journal, September 2019 *Summary of Economic Projections*; Haver Analytics

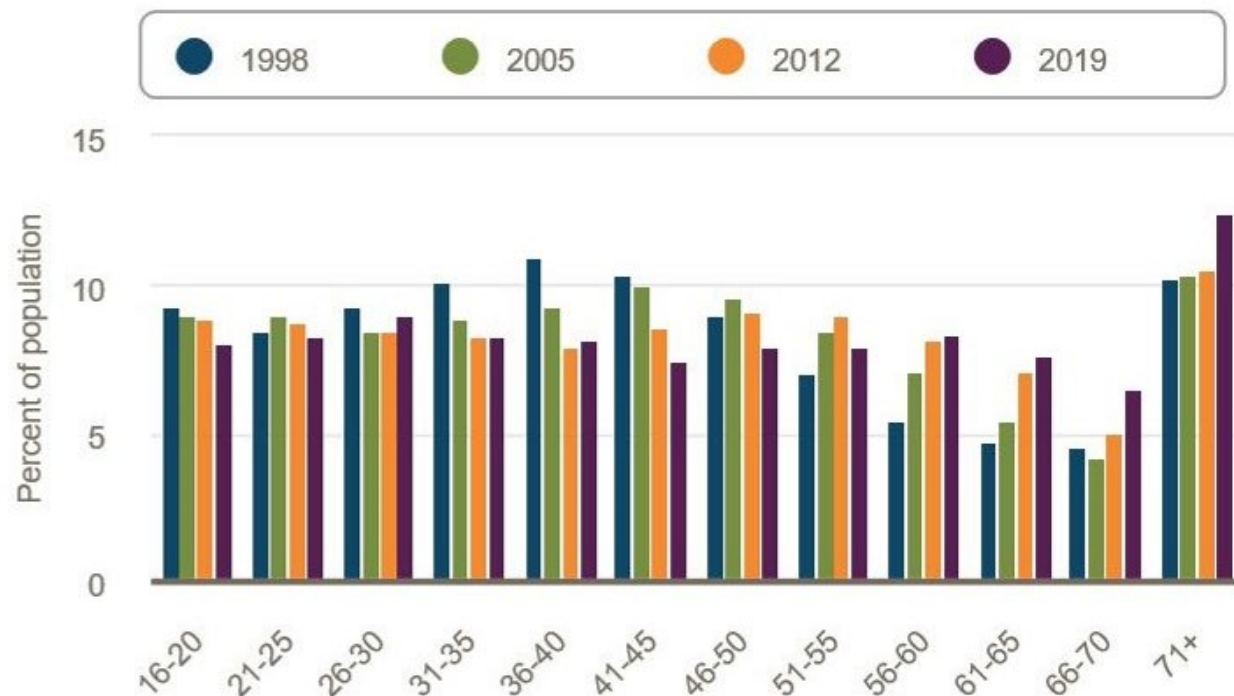
data through 2019:Q3

With a growing share of the population over 55, the participation choices of ageing workers is likely helping to support ongoing strength in the labor market

Population Distribution

all genders of all ethnicities with all education types

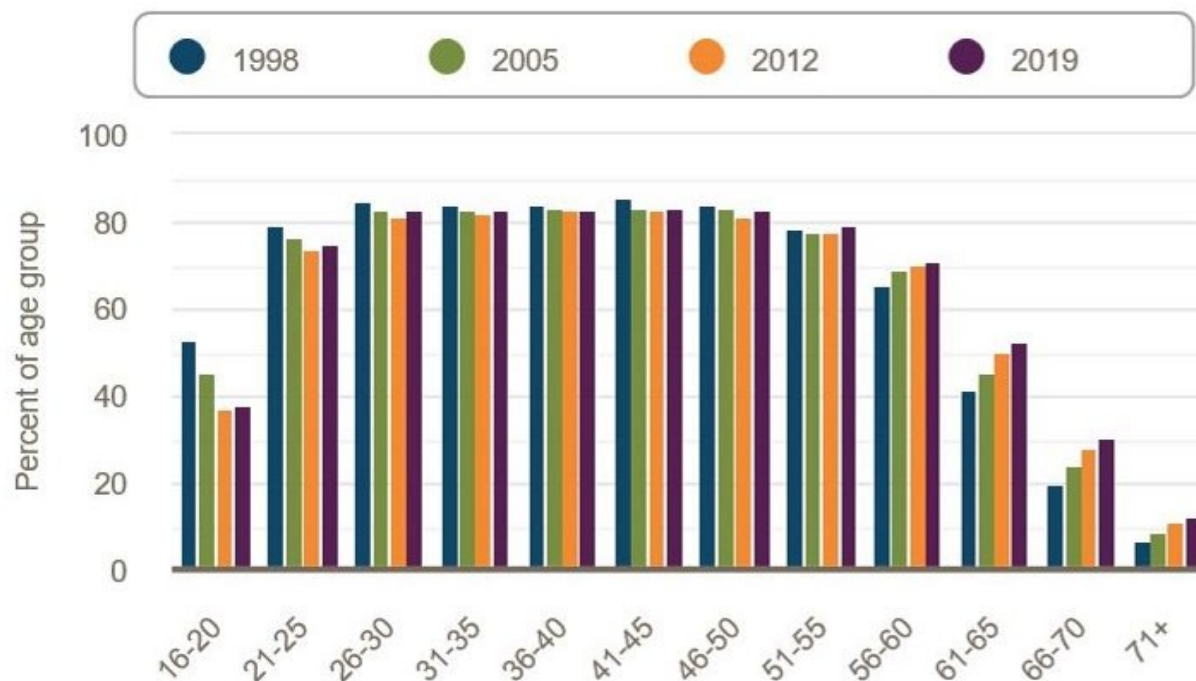
Export



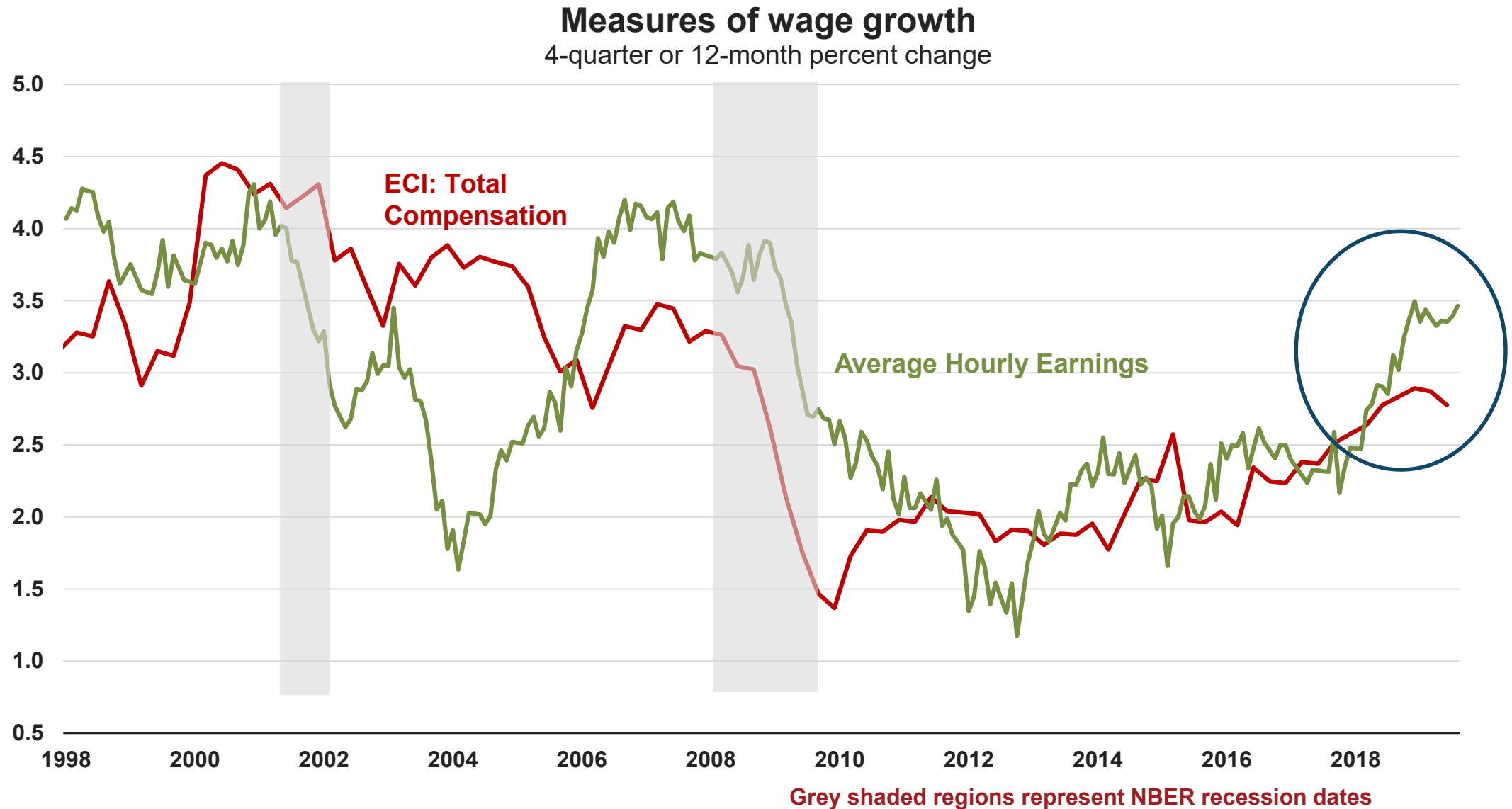
Labor Force Participation Rate

all genders of all ethnicities with all education types

Export



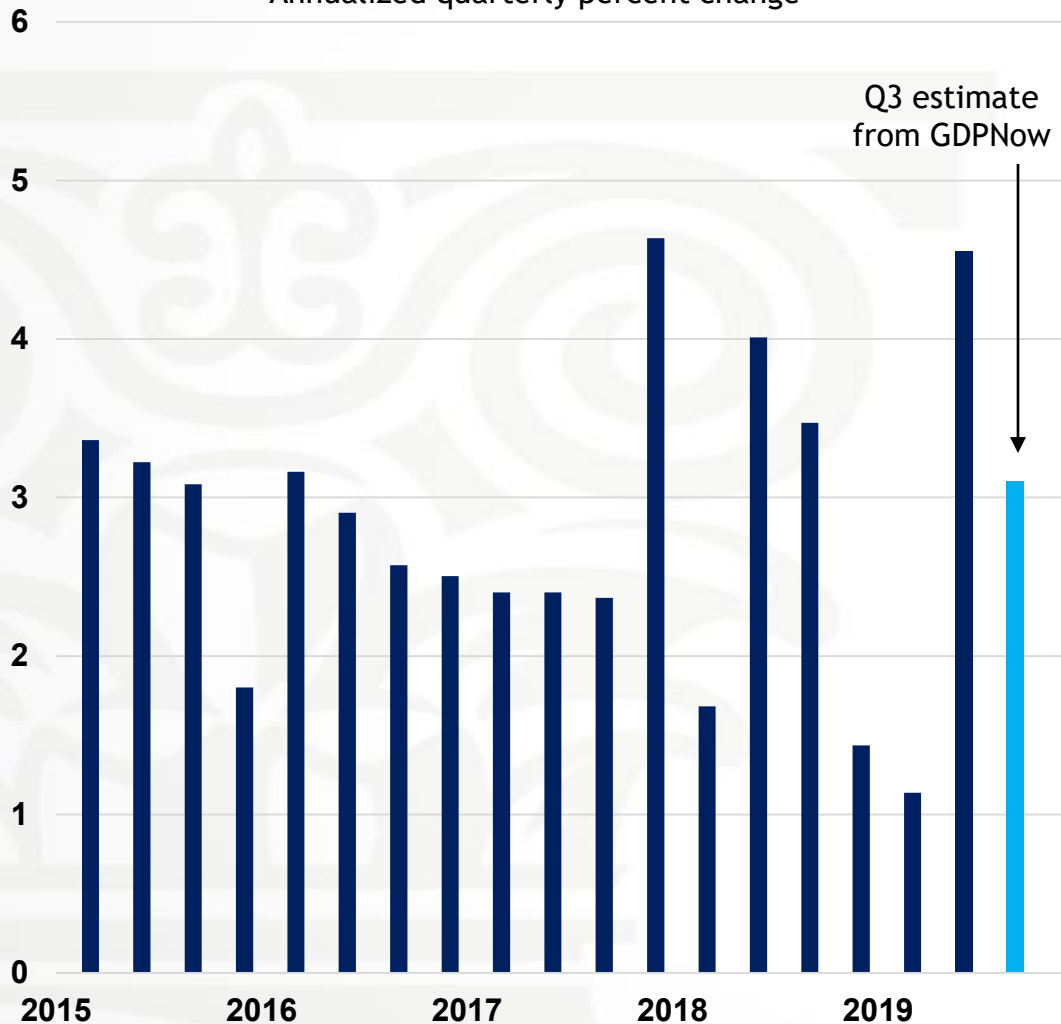
Wage growth is coming to life, though still lower than the peak levels of the last two expansions...



The recent monthly data suggest ongoing strength in consumer spending in the third quarter. Consumer attitudes remain at a favorable level.

Real Personal Consumption Expenditures

Annualized quarterly percent change

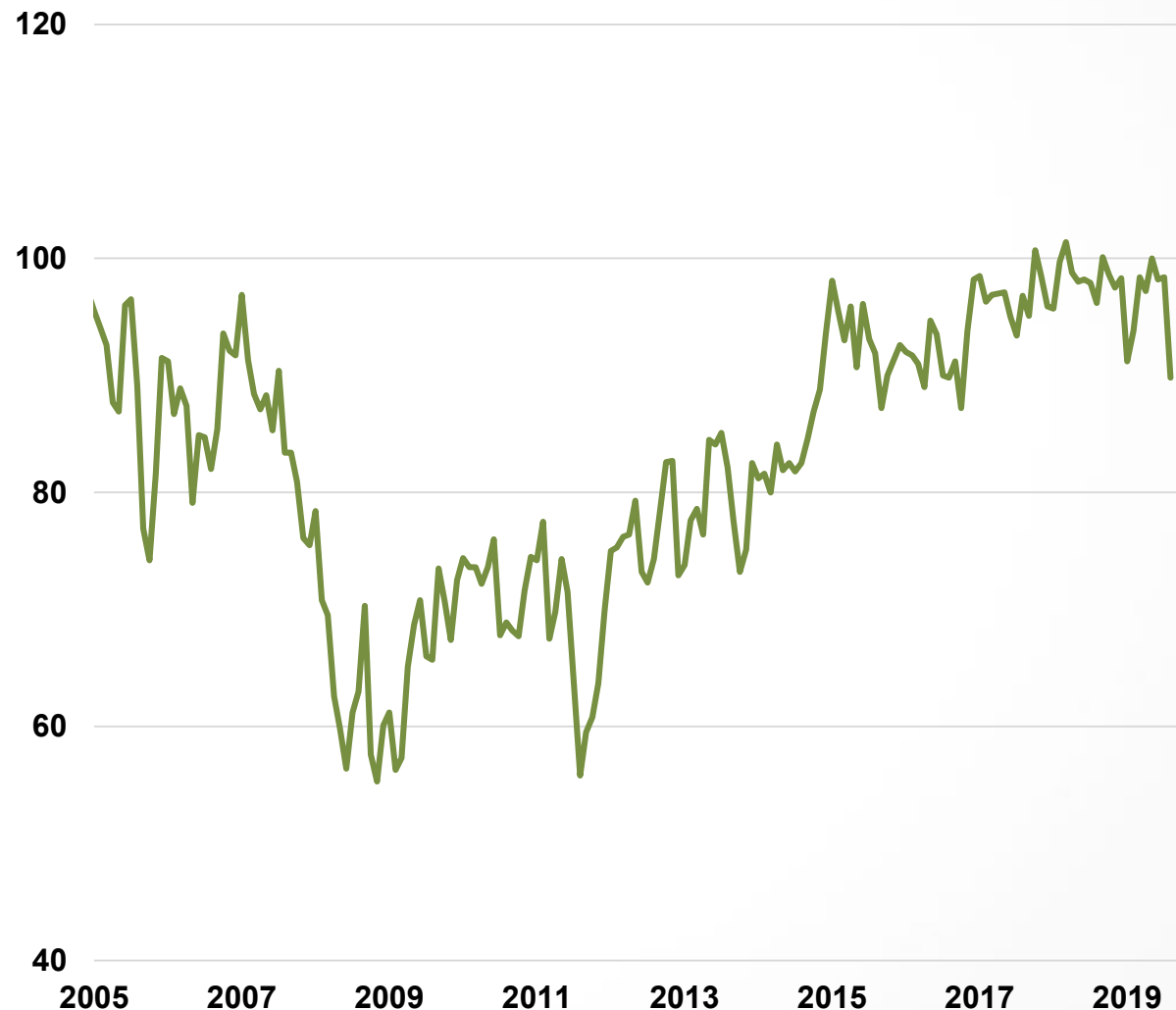


Sources: Bureau of Economic Analysis, FRBA GDPNow, and Haver Analytics

data through Q2:2019

Consumer Sentiment

Index: Q1-66=100



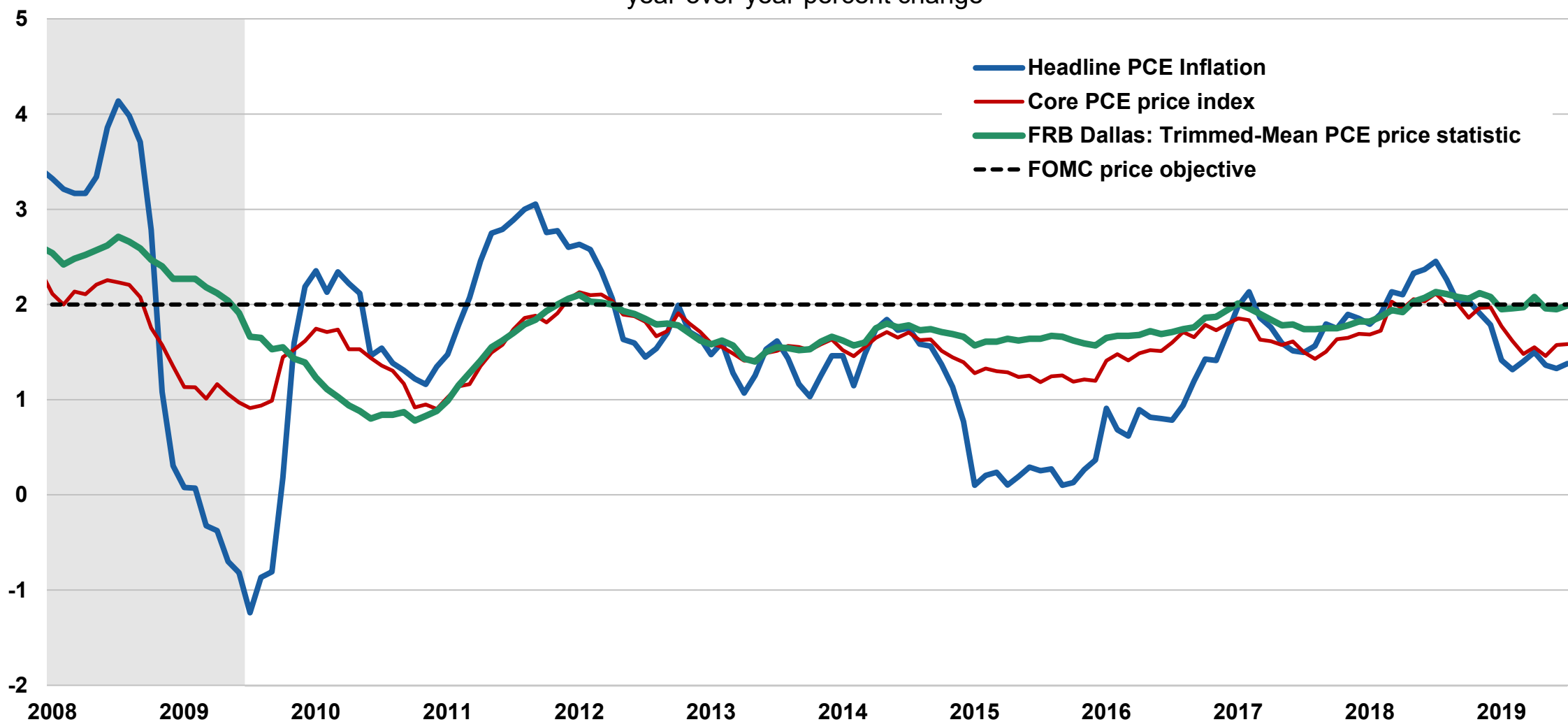
Source: University of Michigan *Survey of Consumers*; Haver Analytics

data through August 2019

Over the past year or so, underlying inflation—as measured by the Dallas Fed’s trimmed-mean PCE inflation statistic—has been much closer to 2 percent. This price statistic is much less volatile than either headline or the core (ex food and energy) inflation and tends to be a better predictor of future inflation.

PCE Inflation Measures

year-over-year percent change



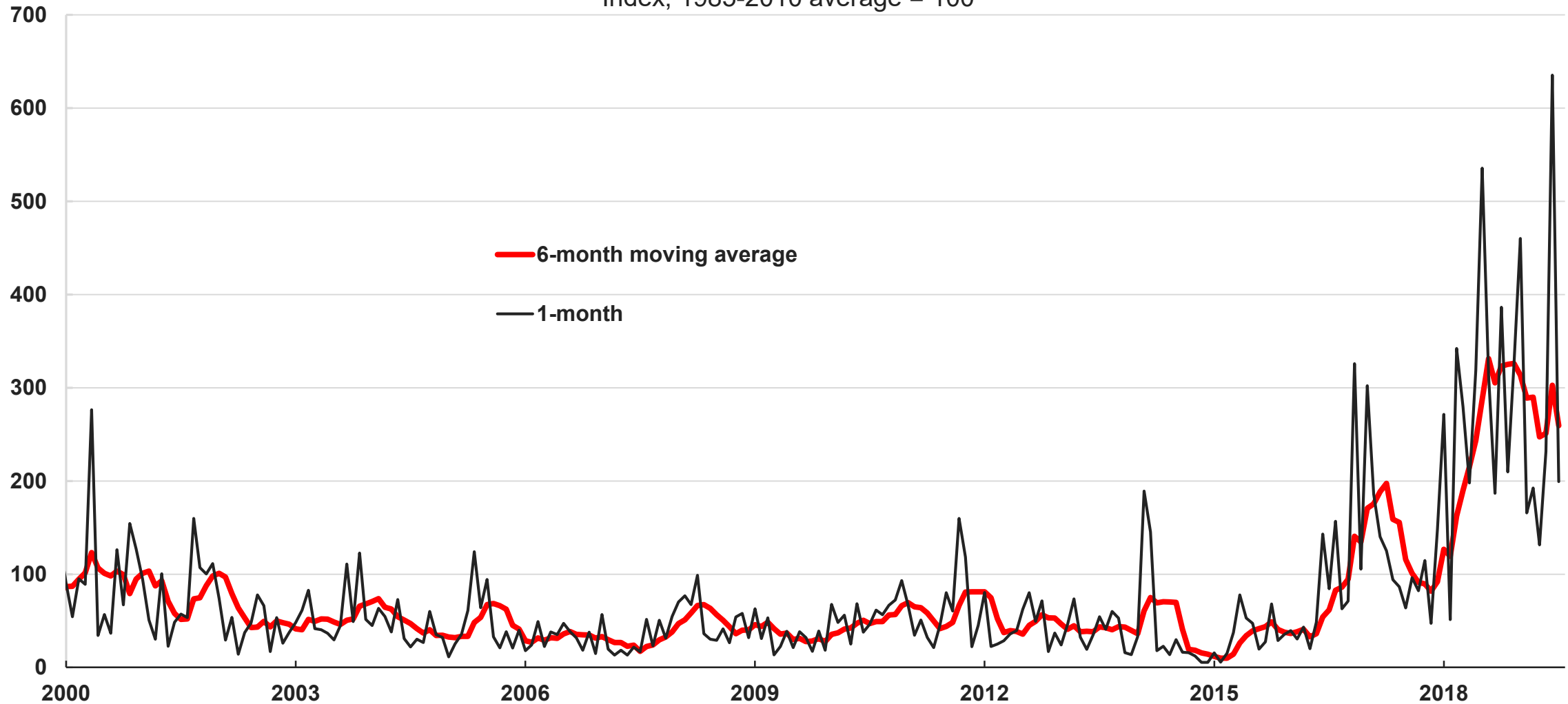


So... what
could possibly
go wrong?

Trade policy uncertainty is high (no duh).

Baker, Bloom and Davis Trade Policy Uncertainty Index

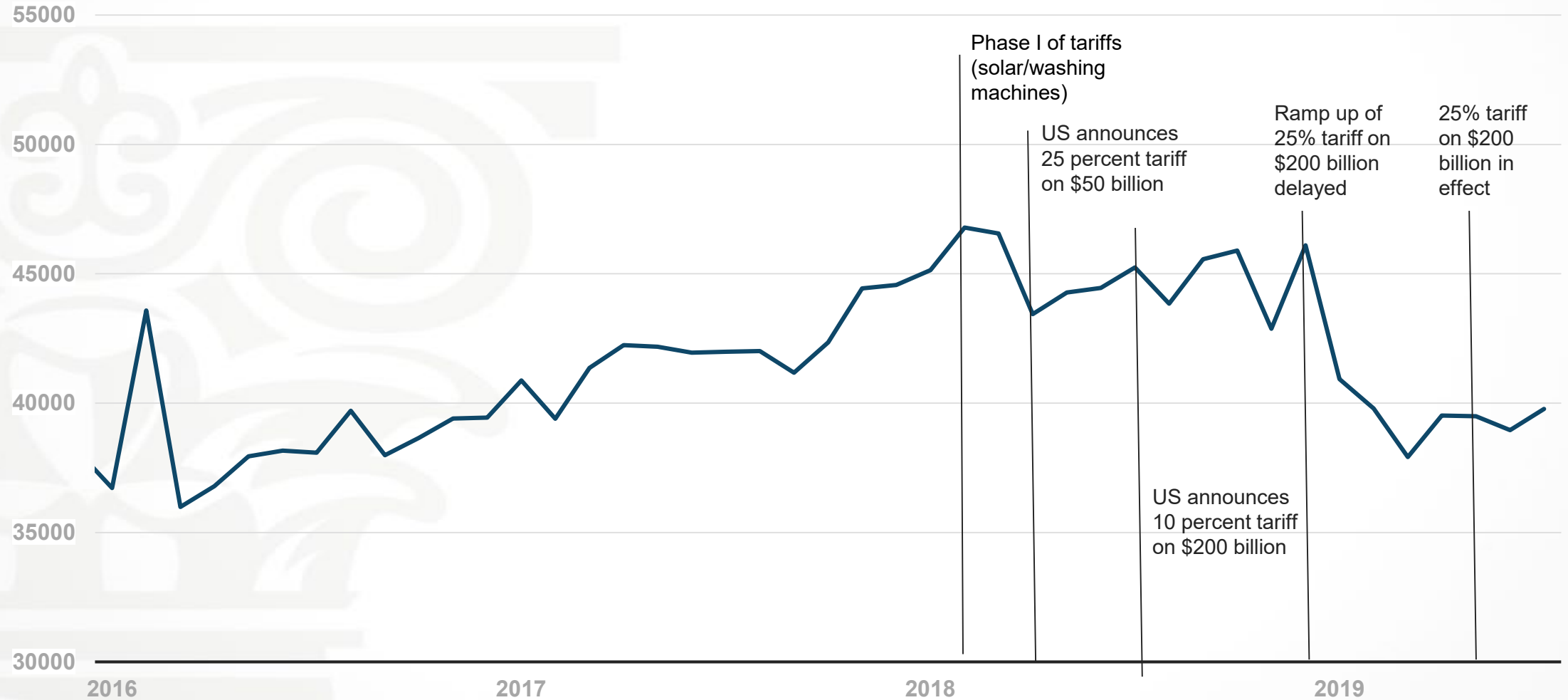
Index, 1985-2010 average = 100



Since last June, when trade frictions began to escalate in earnest, the U.S. has appeared to substitute away from Chinese imports.

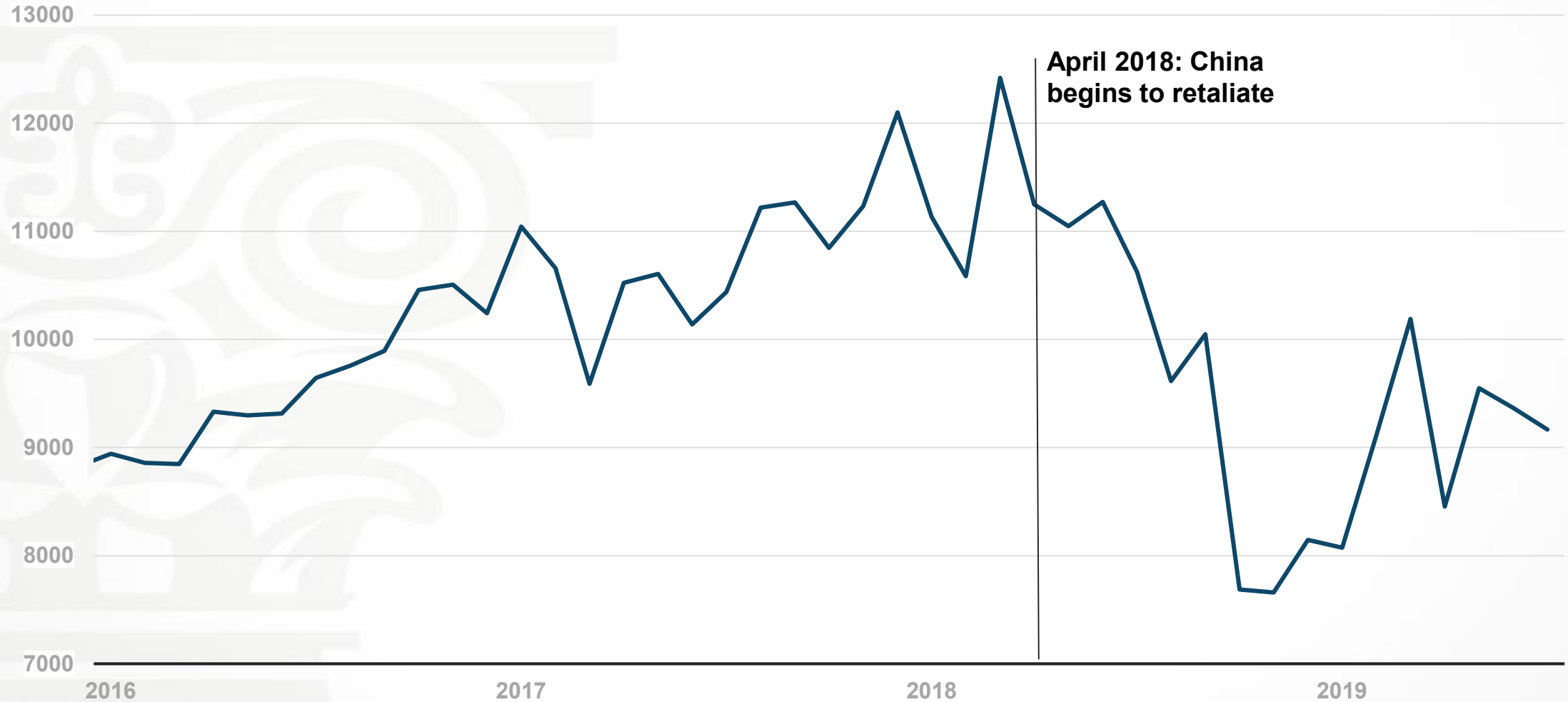
Nominal Imports from China to US

Millions, customs value



Since last June, when trade frictions began to escalate in earnest, the U.S. exports to China have also suffered.

Nominal US Exports to China
Millions, customs value



China has retaliated, mostly through agricultural products to date, though tariffs are set to increase markedly for the auto sector in December.

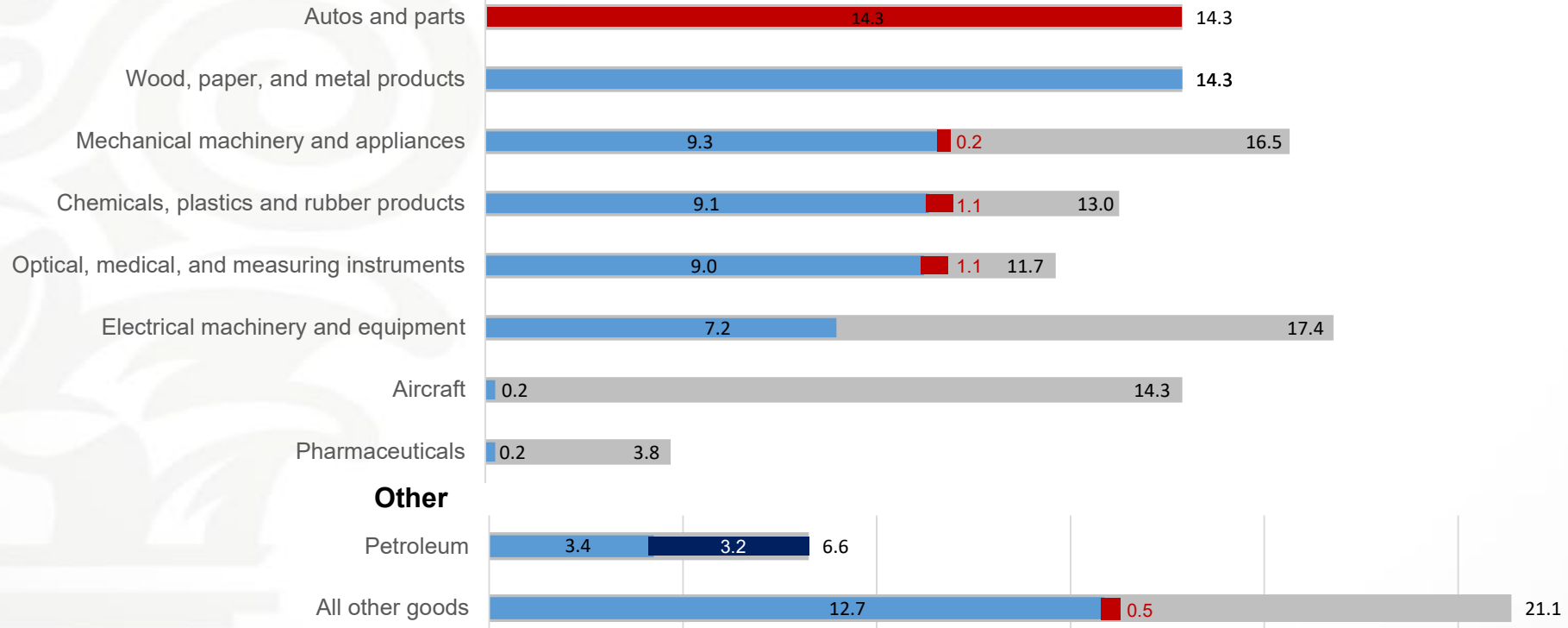
U.S. exports to China covered by Chinese retaliatory tariffs

■ As of June 1, 2019 ■ Effective September 1, 2019 ■ Effective December 15, 2019 ■ Total US exports to China

Agriculture



Manufacturing



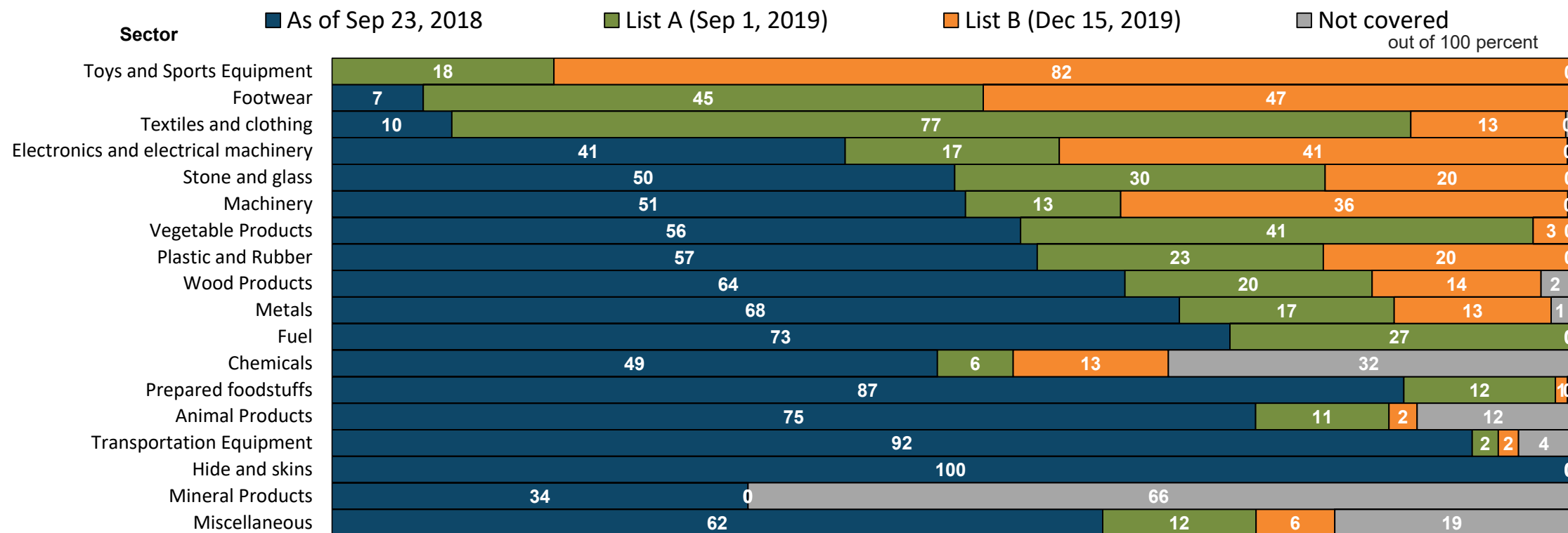
Other



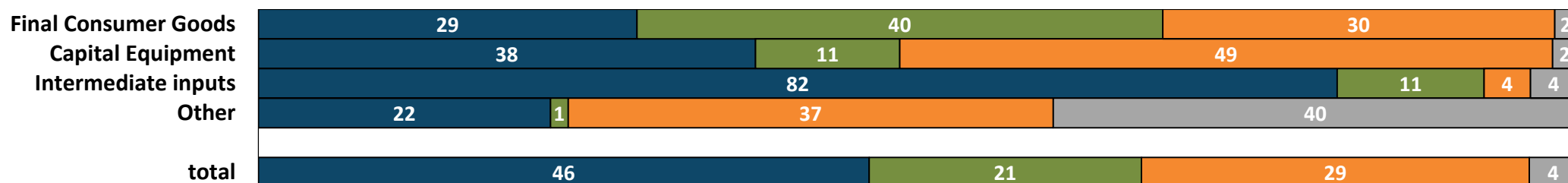
Sources: Peterson Institute for International Economics (PIIE). Updated on August 23, 2019, Bown, Jung, and Zhang (2019). Constructed with data on China's 2017 imports from Trade Map (international Trade Centre, marketanalysis.intracen.org) and China's Ministry of Finance's announcements

By December, nearly all goods imported from China will be tariffed.

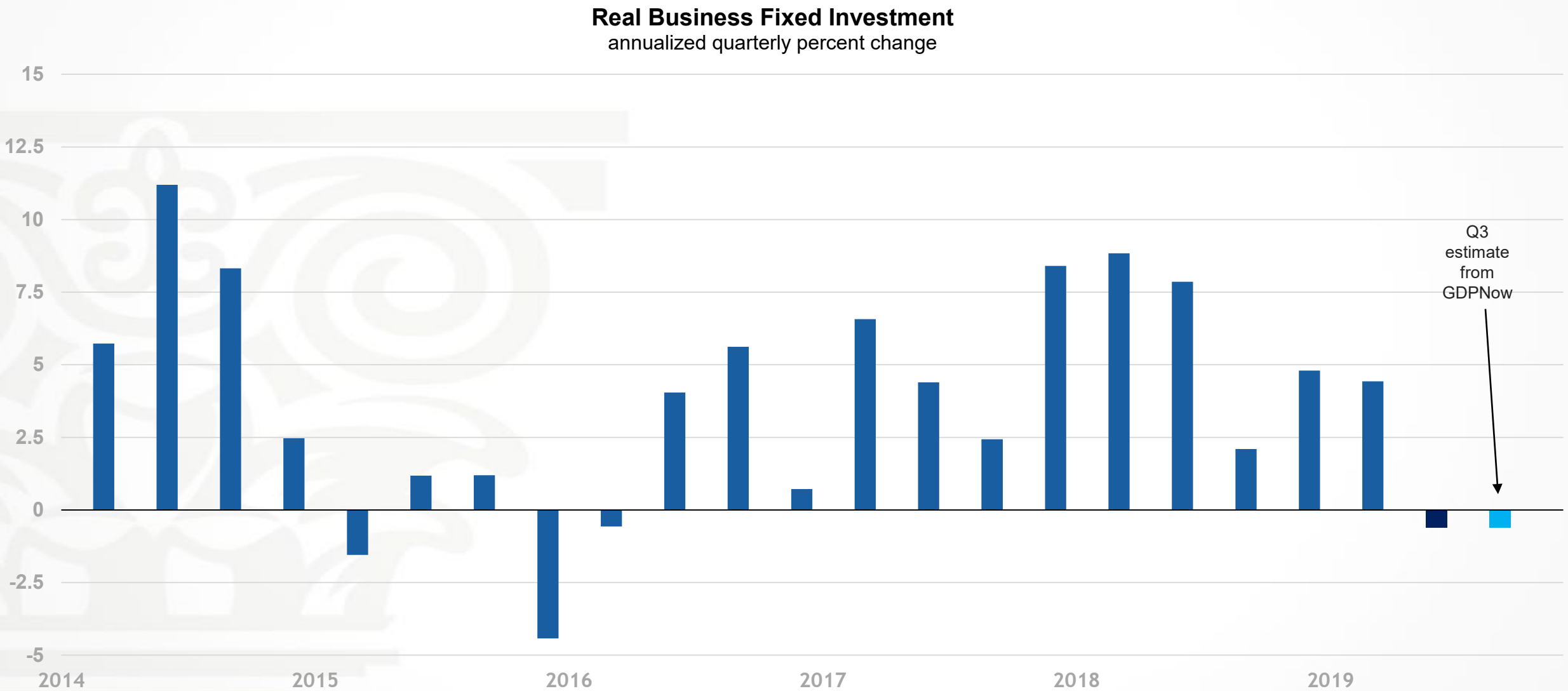
Percent of US imports from China subject to Section 301 tariffs



Product Type



Following strong gains in 2018, business fixed investment has softened considerably.



Sources: Bureau of Economic Analysis,
FRBA GDPNow; Haver Analytics

data through Q2:2019

New orders of capital goods (ex aircraft) – a *forward looking* measure of equipment expenditures – have faded.

Manufacturers' Shipments and New Orders
Nondefense Capital Goods ex. aircraft
year-over-year percent change

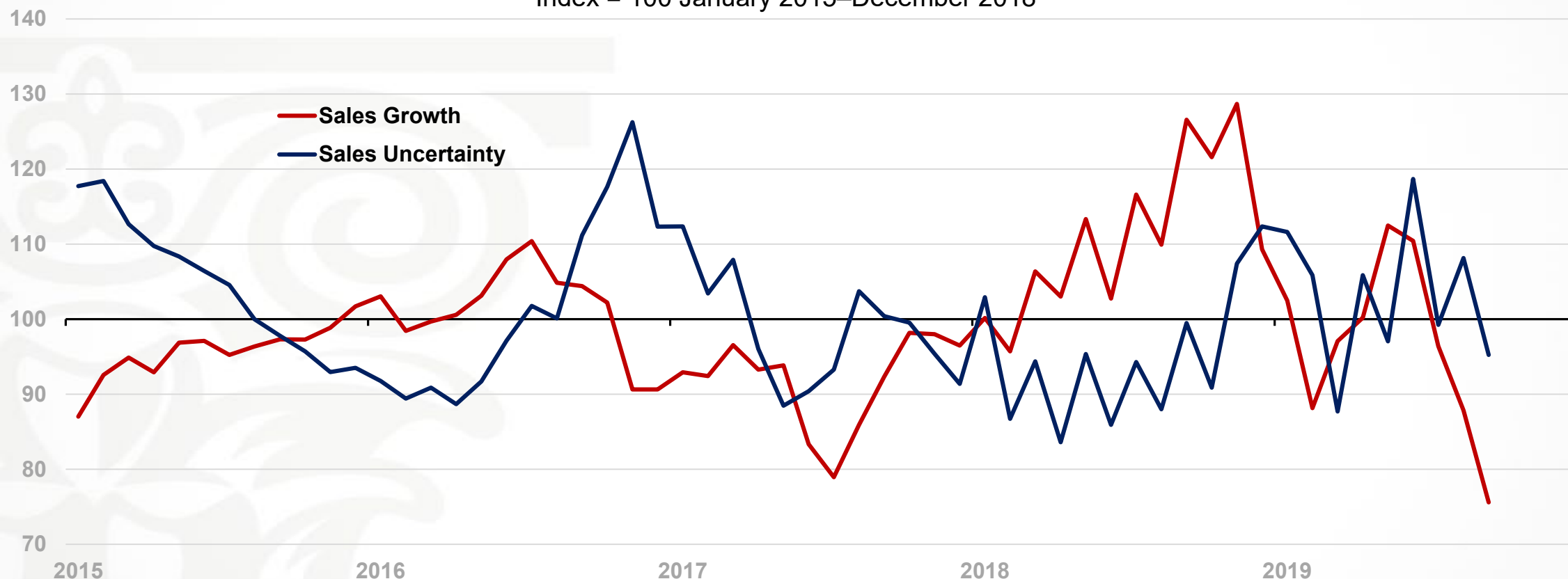


Survey measures of businesses' sales expectations slipped further in September, while uncertainty remained relatively unchanged.

SBU: Sales Revenue Growth Expectations and Uncertainty

4-quarter ahead expectations

Index = 100 January 2015–December 2018

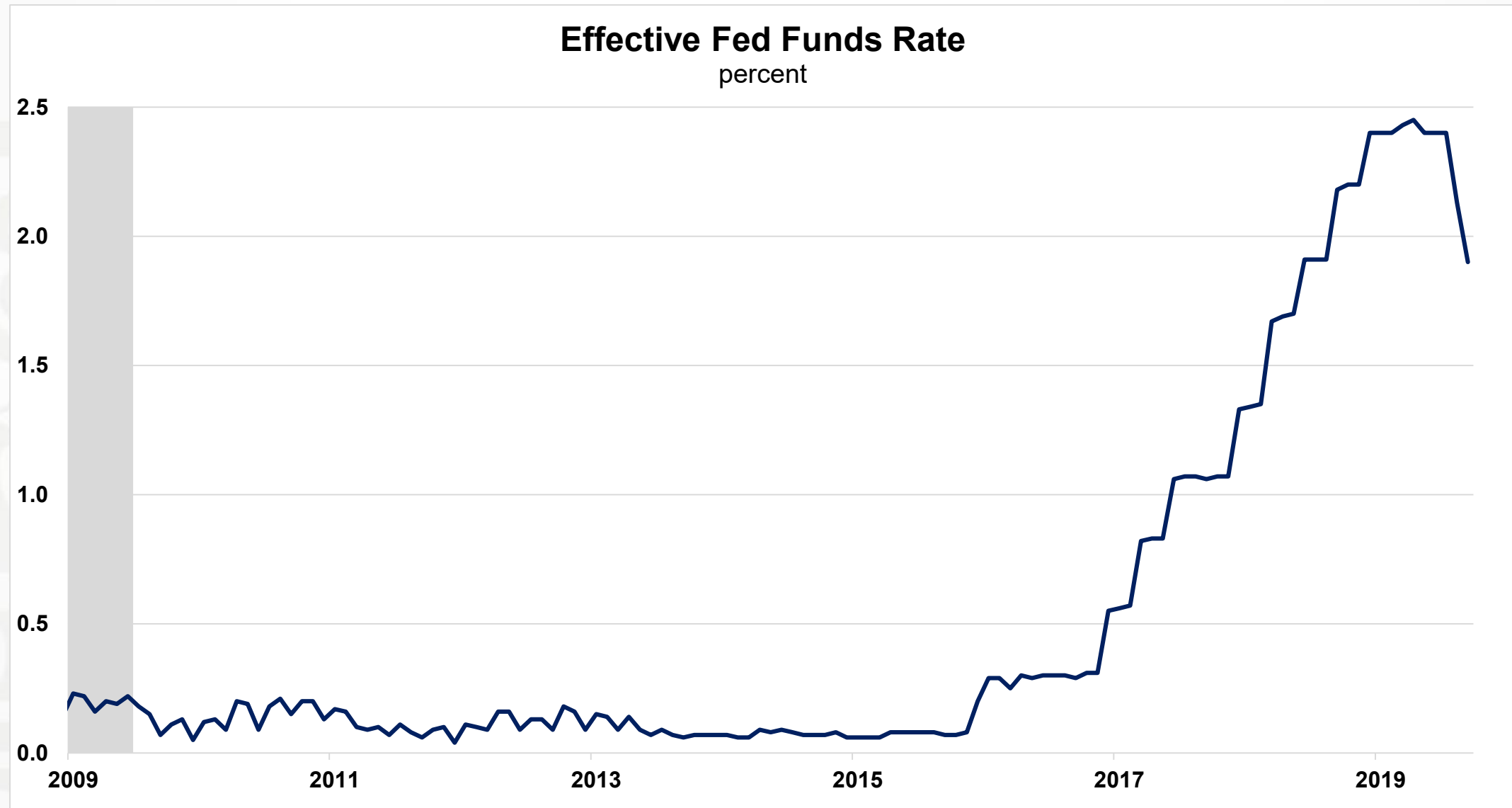


The **Business Expectations Index** reflects firms' expectations about the growth of their own sales, employment, and capital expenditures over the next 12 months. The index can respond to news about the overall economy, changes in business sentiment, policy developments, stock market moves, interest rate changes, and changes in the outlook of firms in the sample.

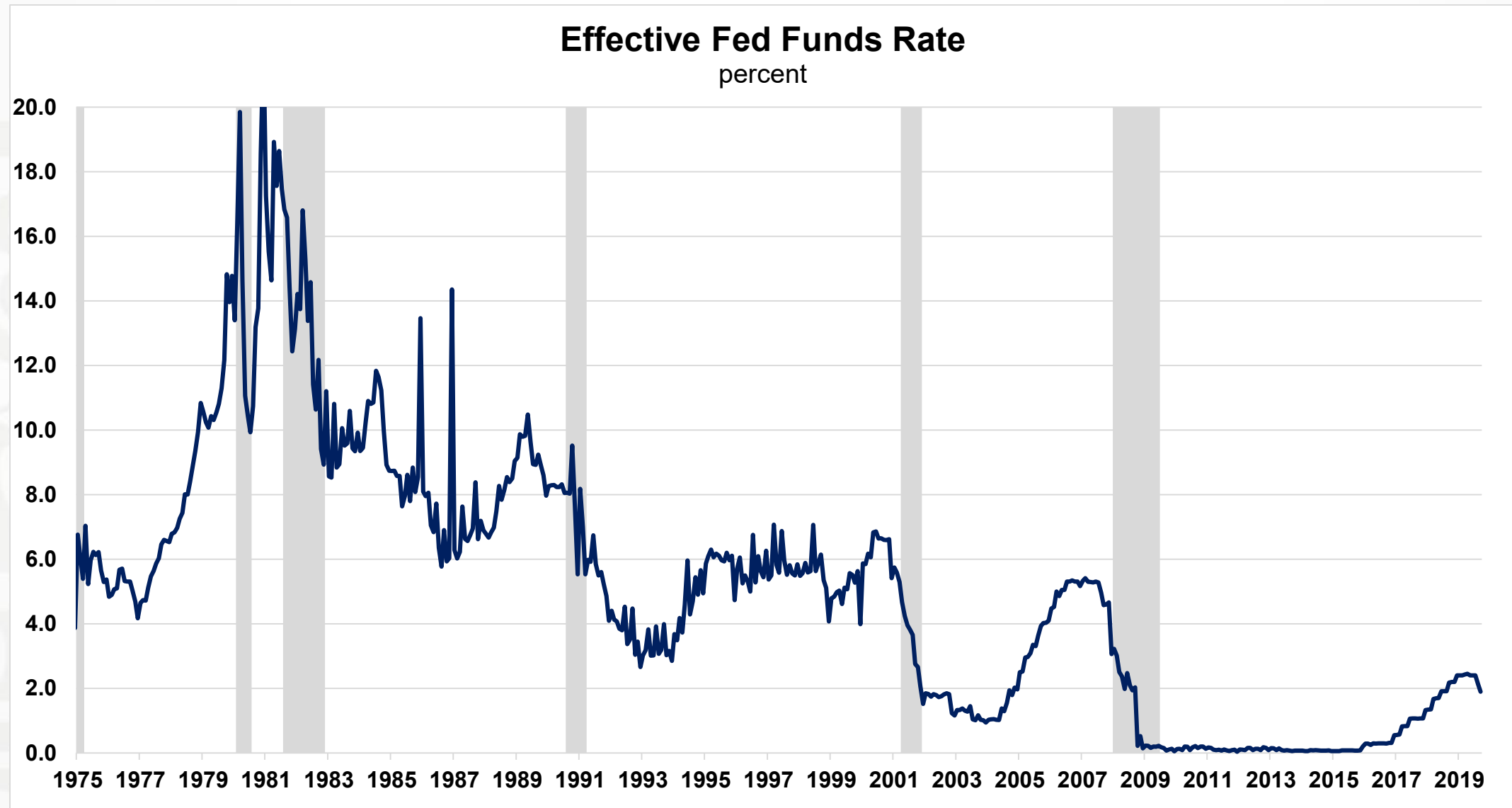
The **Business Uncertainty Index** reflects firms' uncertainty about the growth of their own sales, employment, and capital expenditures over the next 12 months. respond to the same forces that move the Business Expectations Index.

The **Business Uncertainty Index** captures uncertainty about the outlook for sample firms, while the **Business Expectations Index** captures the expected direction and magnitude of change. Each index is standardized to have a mean of 100 and a standard deviation of 10 in the period from January 2015 to December 2018.

In September, the Committee decided to reduce the target range for the federal funds rate to a range between 1.75 and 2 percent.



Still, in comparison with even relatively recent history, interest rates remain extraordinarily low.



Excerpts from Chair Powell's September 18 Press Conference

- “Since the middle of last year, the global growth outlook has weakened, notably in Europe and China. Additionally, a number of geopolitical risks, including Brexit, remain unresolved.
- Trade policy tensions have waxed and waned, and elevated uncertainty is weighing on U.S. investment and exports
- Today’s decision to lower the federal funds rate target by 1/4 percent to 1-3/4 to 2 percent is appropriate in light of the global developments I mentioned, as well as muted inflation pressures.
- Since our last meeting, we have seen additional signs of weakness abroad and a resurgence of trade policy tensions, including the imposition of additional tariffs.
- The Federal Reserve has no role in the formulation of trade policy, but we do take into account anything that could materially affect the economy relative to our employment and inflation goals.
- The future course of monetary policy will depend on how the economy evolves and what developments imply for the economic outlook and risks to the outlook.”

The future path of policy will be data dependent.

- In determining the timing and size of future adjustments to the target range for the federal funds rate, the FOMC **will assess realized and expected economic conditions** relative to its objectives of maximum employment and 2 percent inflation.
- This assessment will take into account a wide range of information, including:
 - Labor market measures
 - Inflation pressures and expectations
 - Readings on financial and international developments



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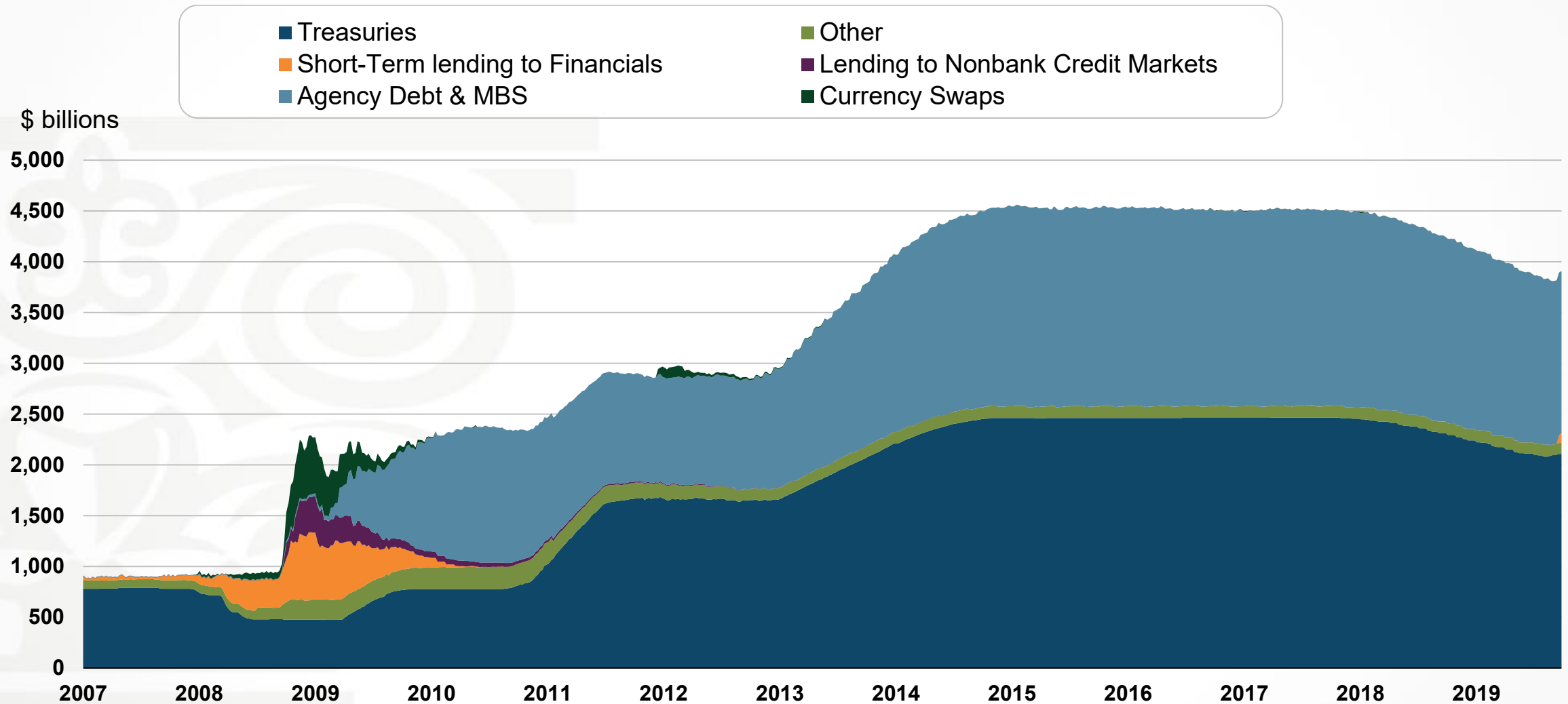


The Monetary Policy Response, continued:

Monetary Policy Tools:

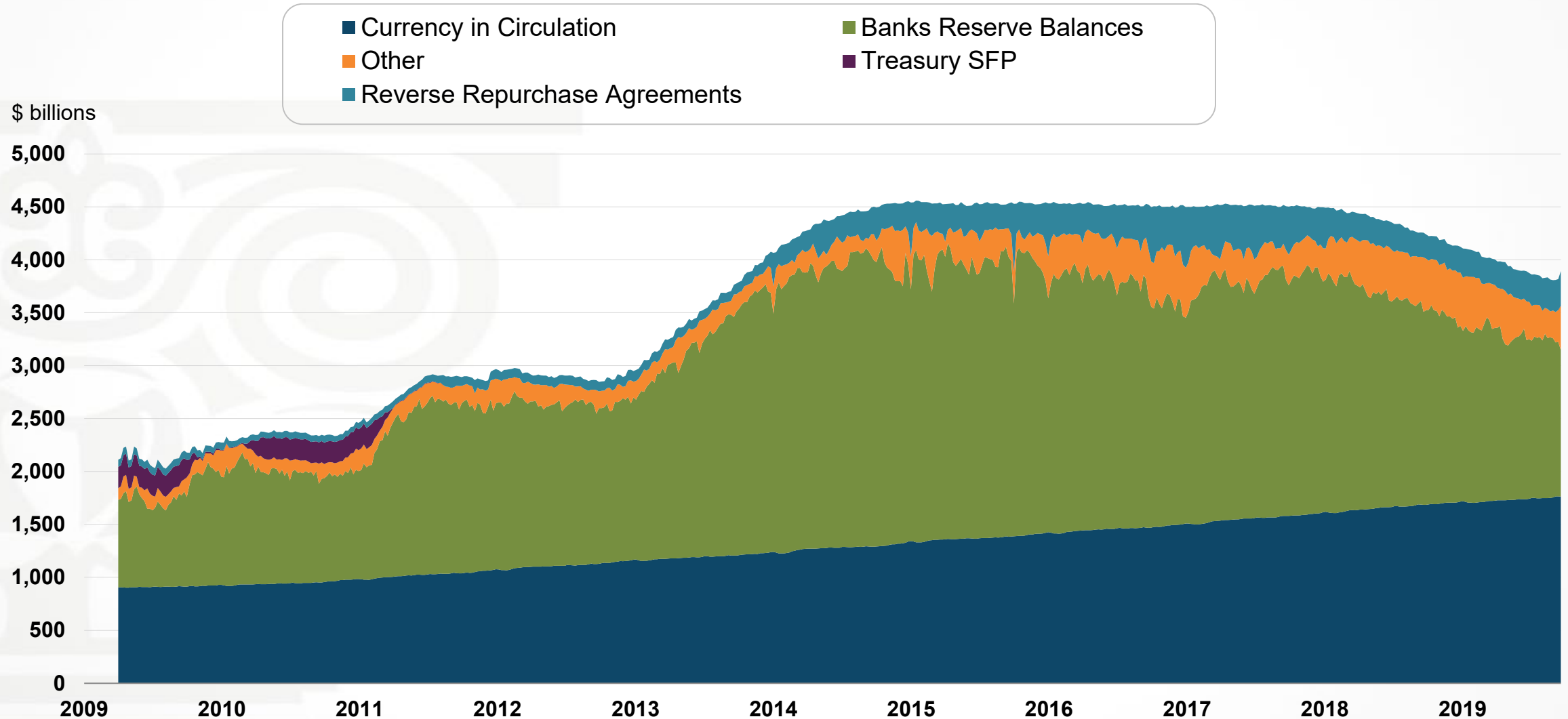
- Federal Funds Rate and Interest on Excess Reserves (IOER)
 - Federal Funds Rate to be moved into the target range set by the FOMC primarily by adjusting the interest rate the Federal Reserve pays on excess reserve balances, or IOER.
- Overnight Reverse Repurchase Agreement Facility
 - To be used as needed to help control the federal funds rate, only to the extent necessary and then phased out.
- Balance Sheet
 - Securities holdings to be reduced in a gradual and predictable manner primarily by ceasing to reinvest repayments of principal on securities after liftoff. This is not expected to be an active tool of the Committee.

Federal Reserve Assets (Uses of Funds)



Note: "Other" = Other assets, Float, Gold Stock, SDRs, Currency outstanding, Holdings of Maiden Lane I, II, III and Foreign Currency Assets.

Federal Reserve Liabilities (Sources of Funds)



Note: "Other" = Other liabilities & capital, Treas. cash holdings, and Deposits with FRB.