
Challenges and Hopes for the U.S. Economy

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The views expressed today are my own and not necessarily
those of the Federal Reserve System or the FOMC.

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The Federal Reserve Bank of Chicago is pleased to host the Annual Development Banking Conference for the eighth straight year, reflecting our long-standing relationship with National Community Investment Fund. This annual event is a key resource for community development financial institution banks that use their local knowledge for critical services like repurposing foreclosed property, aiding in natural disaster recovery efforts, and serving borrowers who cannot access mainstream credit. The challenge these institutions face is in balancing financial health and capital concerns with mission goals and social impact. Let me note that these are my own views and not necessarily the views of my colleagues on the Federal Open Market Committee (FOMC) or within the Federal Reserve System.

The U.S. economy has struggled to generate sufficient growth to sustain a strong recovery due to a combination of issues.

First, fiscal restraint has been a massive drag on the economy since 2011. Reduced government spending and higher tax rates have had a significant negative effect on gross domestic product growth. These come on top of other headwinds holding back growth, such as the lingering effects of the financial crisis and sluggish international economic conditions.

Second, inflation is running well below the Federal Reserve's 2 percent target. Inflation is low not just in the U.S., but around the world as well. Unexpectedly low inflation makes it more difficult for households and businesses to pay back debt; in turn unexpectedly high debt burdens can reduce borrowing and spending and slow the economy.

Third, monetary policy has had limited room to maneuver in working to counteract these headwinds. The "zero lower bound" on interest rates has constrained the use of the traditional policy tool, the federal funds rate. Accordingly, the Federal Reserve has turned to other tools to stimulate the economy—namely large scale purchases of treasuries and agency mortgage backed securities and forward guidance about the future path of the federal funds rate. On the latter point, the Fed has stated it will keep interest rates at their current level at least as long the unemployment rate is above 6.5 percent and the outlook for inflation is below 2.5 percent. If appropriate, rates could be held down even longer.

These nontraditional policies have increased the Fed's balance sheet to an unprecedented level and resulted in expectations that interest rates will be low for an unprecedented length of time. Some worry about possible inflationary or financial

stability risks associated with these developments. The Fed is carefully monitoring the economy for such risks. Today they seem low; nonetheless, I believe that there are ample safeguards in place should problems arise.

Ultimately--with the continued support of highly accommodative monetary policy--the economy will recover. More customers will show up in stores; as businesses see the higher demand, they will expand and create more jobs. Incomes will grow, leading to more consumption, and the process will form a self-reinforcing upward spiral. There is still a long way to go, but 2014 may be the year that we see the breakout to more solid and sustained economic growth.