U.S. Economic Outlook and Monetary Policy: Navigating the Recent Cross-Currents

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The views expressed are those of the author and do not necessarily represent the views of the Federal Reserve System or the Federal Reserve Bank of Chicago.
Overview

- Solid fundamentals on real activity and inflation

- Juxtaposed with heightened uncertainty and financial market turbulence

- Too early to tell whether the cross-currents will turn out to be headwinds or tailwinds
  - Glass half-empty or half-full?

- A “wait-and-see” attitude during periods of heightened uncertainty is not unusual
  - consistent with a risk-management approach to monetary policy
Glass Half-Empty

The New York Times  Jan. 25, 2019
Shutdown Sets Off Airport Delays as F.A.A. Announces Staffing Shortages

Bloomberg  January 14, 2019
The World’s Biggest Economies Are Moving Deeper Into a Slowdown

npr  December 6, 2018
Huawei Finance Chief’s Arrest Threatens To Inflame U.S.-China Tensions

The Wall Street Journal  Jan. 1, 2019
U.S. Indexes Close With Worst Yearly Losses Since 2008
Glass Half-Full

*The Washington Post*  
January 25

Trump signs bill to open the government, ending the longest shutdown in history

*FINANCIAL TIMES*  
January 4, 2019

Wall Street notches one of the biggest rallies since 2011 as bulls regain footing

*USA TODAY*  
Feb. 1, 2019

Employers add booming 304,000 jobs in January, marking 100th straight month of employment gains
Strong Labor Markets

Unemployment Rate (percent)

- 2.7m jobs added in 2018
- Additional 304,000 in January
- 1.8m entered the labor force in 2018

Source: Bureau of Labor Statistics from Haver Analytics
Strong Consumption, Solid Business Investment

Real Personal Consumption Expenditures (Q4/Q4 percentage change)

Core Capital Goods Orders and Shipments ($ bil.)

Source: Bureau of Economic Analysis and Census Bureau from Haver Analytics
### Banner 2018, Still Solid Near-Term Growth Ahead

<table>
<thead>
<tr>
<th></th>
<th>Q4</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Macroeconomic Advisers</strong> (Feb 4)</td>
<td>2.4</td>
<td>3.0</td>
<td>2.1</td>
</tr>
<tr>
<td><strong>Blue Chip</strong> (Jan 9 &amp; Feb 1)</td>
<td>2.6</td>
<td>3.1</td>
<td>2.2</td>
</tr>
<tr>
<td><strong>GDPNow (FRB Atl)</strong> (Feb 6)</td>
<td>2.7</td>
<td>3.1</td>
<td></td>
</tr>
<tr>
<td><strong>FRBC Nowcast</strong> (Feb 6)</td>
<td>2.5</td>
<td>3.1</td>
<td></td>
</tr>
<tr>
<td><strong>Dec FOMC SEP</strong> (Dec 19)</td>
<td></td>
<td>3.0</td>
<td>2.3</td>
</tr>
</tbody>
</table>
Longer Term GDP Outlook Also Still Solid

Real GDP Growth
(Q4/Q4 percentage change)

Source: Bureau of Economic Analysis and FOMC’s December 2018 Summary of Economic Projections from Haver Analytics
Mixed Inflation Factors

**Wage Growth**
(year-over-year percentage change)

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Jan-2019

**TIPS 5/5F Inflation Compensation**
(percent)

4

04-Feb-2019

Source: Board of Governors of the Federal Reserve System and Bureau of Labor Statistics from Haver Analytics
Inflation Near Target

PCE Inflation
(year-over-year percentage change)

<table>
<thead>
<tr>
<th>Core CPI</th>
<th>Oct</th>
<th>Nov</th>
<th>Dec</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monthly</td>
<td>0.2</td>
<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>Yr/Yr</td>
<td>2.1</td>
<td>2.2</td>
<td>2.2</td>
</tr>
</tbody>
</table>

Source: Bureau of Economic Analysis and FOMC’s December 2018 Summary of Economic Projections from Haver Analytics
Many Sources of Investor Anxiety

- Concerns over a slow-down in growth abroad
- Disorderly Brexit with significant spill-overs
- Other geopolitical risks
- Concerns over a slow-down in the U.S.
- Uncertainty over trade and other government policies
  - The effects of the prolonged government shutdown
- Concerns that the FOMC will tighten too much
Re-assessment of Risks

S&P 500 Index

Corporate Bond Spreads
(spread over 10yr treasury, percent)

Source: Wall Street Journal and ICE/Merrill Lynch from Haver Analytics
Re-assessment of Risks

10 Year Treasury Rate
(percent)

Foreign Exchange Rates
(index, Jan-2018 = 100)

Source: Board of Governors of the Federal Reserve System from Haver Analytics
Similar Movements in Asset Markets Abroad

Stock Price Indices
(index, Dec-31 = 100)

Volatility Indices
(index)

Source: Financial Times and Hang Seng Co. from Haver Analytics
Signs of a Global Slowdown

Global PMI Manufacturing Indicators (index)

Source: Institute for Supply Management(*) from Haver Analytics, China Federation of Logistics and Purchasing (**), and JP Morgan Global Composite PMI (***)

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International GDP Forecasts

Euro Area
(annual, %)

UK
(annual, %)

Japan
(annual, %)

China
(annual, %)

Source: IMF Interim World Economic Outlook (Jan 2019) and OECD
One-Year-Forward Price/Earnings Ratio, S&P 500 Composite

Corporate Bond Spreads
(spread over 10-year Treasury rate)

Historical Perspective

- - Average since 2000
(excl. crisis)

Source: ICE/Merrill-Lynch from Haver Analytics and Bloomberg
Impact on Households

Consumer Loan Rates
(percent)

Household Net Worth
(as a percentage of disposable personal income)

Source: New York Times and Board of Governors of the Federal Reserve System from Haver Analytics
Overall Financial Conditions Still Accommodative

Chicago Fed National Financial Conditions Index
(relative to average)

<table>
<thead>
<tr>
<th>Period</th>
<th>Change in the NFCI</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997 Asian Crisis</td>
<td>0.18</td>
</tr>
<tr>
<td>1998 Russian Crisis</td>
<td>0.56</td>
</tr>
<tr>
<td>2010 Greek Crisis</td>
<td>0.19</td>
</tr>
<tr>
<td>2011 Euro Fiscal Concerns</td>
<td>0.46</td>
</tr>
<tr>
<td>2013 Taper Tantrum</td>
<td>0.06</td>
</tr>
<tr>
<td>Nov. 2015-Feb.2016 Episode</td>
<td>0.17</td>
</tr>
<tr>
<td>Current Episode</td>
<td>0.03</td>
</tr>
</tbody>
</table>

Source: Federal Reserve Bank of Chicago
FOMC’s Expected Monetary Policy Path

Target Federal Funds Rate at Year End (percent)

Each shaded circle indicates the value (rounded to the nearest 1/8 percentage point) of an individual participant’s judgment of the appropriate level of the target federal funds rate at the end of the specified calendar year or over the longer run. Red dots indicate the median projection. Inertial Taylor rule uses data from the FOMC’s SEPs.
Investors' Policy Expectations

Distribution of Federal Funds Rate Target at Year End (percent)

Blue Chip Survey (Feb 1)

Fed Funds Futures (Feb 4)

Source: CME
“Patient” with future adjustments to policy

Wait-and-see how the cross-currents resolve

Usual approach during periods of heightened uncertainty
Evolution of the Fed Balance Sheet

2006 (billions)

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
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<tr>
<td>Treasuries</td>
<td>Reserves + All Other Liabilities</td>
</tr>
<tr>
<td>Other Liabilities</td>
<td>Capital</td>
</tr>
</tbody>
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Present (Week of 1/2) (billions)

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- MBS + Agency
- Treasuries
- Currency
New Monetary Policy Framework

- June 2017 Statement: Adjust balance sheet size to implement monetary policy effectively and efficiently

- January 30, 2019 statement:
  - “Ample” reserves;  
  - FFR the primary tool; controlled through administered rates (i.e. IOER, ON RRP, primary credit rate) without active management of reserves;  
  - Adjust balance sheet normalization if needed;  
  - Use all policy tools if reductions in FFR are not sufficient