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After the Recession: A Monetary Policymaker Looks Ahead

I. Good afternoon.

   A. It's a pleasure to be here with you today.

   B. I want to focus my remarks on the national economy and the implications for monetary policy.

      1. I'll also say a few words about conditions here in Portland.

   C. I'll be glad to take your questions afterward, as well as any comments you may have.

II. As I'm sure you know, the Federal Open Market Committee sets the nation's monetary policy.

   A. And at each of this year's three meetings, we decided to hold the federal funds rate steady, at 1-3/4 percent.

      1. In our press releases in March and May, we explained that we felt the risks for the foreseeable future were balanced between our two main goals—

         a) —price stability

         b) and sustainable economic growth.

   B. Let me explain my own thinking about where policy stands.

III. First, I think we've gotten a good bit of positive economic news this year.

   A. The economy grew very fast in the first quarter.

      1. And that makes it pretty clear that last year's recession—the first in ten years—is over.

   B. A key factor is a big turnaround in business spending on inventories.

1. During the recession, this spending plummeted—

    a) —but that worked to set the stage for growth this year.

2. In fact, this category of spending actually accounted for nearly two-thirds of the growth in the first quarter,

    a) and it probably will continue to boost growth for a while longer.

3. But inventory spending is a temporary factor—

    a) —once inventories approach desired levels, spending will taper off.

C. So, to keep the expansion going, we'll need to see businesses pick up their spending on what they use to *produce* their goods and services—

1. —this category of investment is known as equipment and software.

2. During the boom years, this type of investment basically "overshot" —especially when it came to high-tech.

    a) For five solid years up through 2000, firms invested in high-tech at phenomenal rates.

    b) And when they pulled back, beginning in 2001, they did so sharply.

3. In the last quarter, we did see some signs of improvement here.

    a) Although businesses were still pretty cautious about spending on equipment and software,

    b) they were less so than they had been last year.

    c) Moreover, business investment in *information processing equipment* and software showed an increase for the first time in over a year.

D. Turning to the consumer side, spending so far this year has been growing at a rate I'd have to call respectable, especially considering how well it held up during the recession.

1. Moreover, we've also seen remarkable strength in the housing sector.

E. Looking ahead, a very positive sign is our productivity performance.

1. It grew

a) at a very strong rate in the last quarter of 2001,

b) and at a rather astounding rate in the first quarter of this year.

F. Of course, some of that performance is due to *temporary* factors, especially those related to September 11.

1. Since that day,

a) a lot of firms have trimmed their workforces or been cautious about expanding jobs—

(1) —because they thought the economy might be weak.

2. Now that the economy has turned out to be so much stronger,

a) firms have managed to increase production

(1) by getting their people to work overtime

(2) or just by getting them to work harder.

b) And this obviously can't go on for long.

G. Beyond the temporary factors, though, the sheer strength of the productivity numbers suggests that more enduring forces *also* are at work.

1. For one thing, productivity growth was positive during the recession—which is pretty unusual.

a) In a typical recession, productivity growth turns *negative*.

2. For another, there's reason to think that all the technological change and investment in high-tech I mentioned before are probably *still* boosting productivity.

a) After all, it often takes some time for workers and firms to realize *all* the potential of new technologies,

b) so it also takes some time for the full effects to show up in the productivity data.

3. Finally, those strong numbers support the view that the process of technological innovation that drives productivity in the long run is still alive and well.

H. The last positive I'll mention is the stimulus that's in the pipeline from both fiscal and monetary policy.

1. Congress

a) passed two packages last year that are providing substantial stimulus this year.

b) And this March, they passed a package that includes

(1) extended unemployment benefits

(2) and a big tax break on equipment and software spending made between September last year and September 2004.

2. On the monetary policy side,

a) the Fed cut interest rates eleven times last year

(1) for a total reduction of four and three-quarters percentage points.

b) That brings the federal funds rate to a very low 1-3/4 percent.

IV. Now let me turn to the risks.

A. One has to do with consumers.

1. In most recoveries, there's a big bounce in demand as consumers get back into the spending mode—especially for big-ticket items.

2. But, as I said, during the recession, consumers didn't really slow their spending that much,

a) so growth isn't likely to get that big a push from consumer spending.

B. Another possibly tempering factor involves uncertainties about

1. corporate profits

2. and the value of equities.

a) These uncertainties, of course, have been accentuated by concerns about corporate accounting practices.

3. Both factors are important in determining how much firms invest in capital going forward.

4. And, of course, equity values also affect consumer spending.

C. Finally, there's the oil situation.

1. So far, the surge in oil prices hasn't had a big effect on the economy.

2. But the turmoil in the Middle East creates a lot of uncertainty on that front.

V. Let me wrap up this discussion of the national economy with some of my views on how these developments play out for monetary policy.

A. As I said, we decided to leave the federal funds rate at 1-3/4 percent.

1. That's the lowest rate in 40 years,

2. and it's quite stimulative.

B. Let me explain what I mean by "stimulative."

1. The "real interest rate"—that is, the rate adjusted for inflation—

a) —is below the "equilibrium real interest rate"—that is, the rate where overall supply and demand in the economy are in balance.

2. To put some rough numbers on those concepts—

a) —with the core consumer inflation rate somewhere between 1 and 2-1/2 percent,

(1) the real interest rate today is near zero.

b) And most economists figure that the current real equilibrium rate is between 2 and 3-1/2 percent.

3. Rough as these numbers are, they show that the real interest rate is well below the real equilibrium rate, and that stimulates demand.

C. So, once the expansion really takes hold,

1. the funds rate will have to move up,

2. or we'll ignite inflationary pressures.

D. For now, though, I think we can be deliberative in approaching the issue of when policy has to change and how aggressive it has to be.

1. For one thing, core inflation doesn't appear to be an imminent problem,

a) because there's still quite a bit of excess capacity left in the economy,

b) and because accelerating productivity growth will dampen inflationary pressures for a time.

2. For another, there's still some remaining uncertainty about the strength and durability of the recovery.

E. What's certain is that

1. the Fed will do what it takes to preserve the gains we've made against inflation,

2. because that's the best way we can contribute to economic growth and prosperity for our country.

VI. Now let me turn briefly to the local scene.

A. Here, the story I told about business investment in information technology—or "IT"— looms especially large.

1. Oregon ranks sixth among all states in the IT share of total employment, and seventh in the IT share of wages.

2. So when sales of IT products plummeted last year, the economy here took a big hit.

a) High-tech manufacturers and service providers cut employment sharply.

(1) These job losses had especially serious consequences for the rest of the economy as well,

(2) since, on average, Oregon's high-tech salaries are about twice as high as its overall salaries.

3. In fact, Oregon was one of the nation's slowest performers in 2001.

a) Overall employment fell several percentage points,

b) and Oregon has been vying with Washington for the unfortunate position of the state with the highest unemployment rate

(1) and the slowest growth in income per capita.

c) The fallout has been felt throughout the private sector,

d) and also by the state government,

(1) which faces a large revenue shortfall in the middle of its biennial budget cycle.

B. This recession has been deeper and longer for Oregon than the early 90s recession.

1. In that sense, your state's high-tech success in the 1990s has been a mixed blessing:

a) It propelled strong growth during the expansion

b) but left you more exposed to the downturn.

C. Fortunately, that downturn is coming to an end.

1. Job losses here have slowed,

2. and the firming of demand for high-tech equipment that I noted earlier should encourage business investment in coming months.

3. Moreover, in a sign of underlying strength, housing demand in Oregon has been very robust this year.

a) This suggests that income and wealth remain high.

b) And despite the weak economy,

(1) Oregon remains an attractive place to live, with its population growth ranked tenth among the states last year.

4. So although the state economy is not out of the woods yet,

a) the high quality of life will help Oregon return to a solid growth path once the national recovery is firmly in place.

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