Presentation to Gettysburg College
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By Robert T. Parry, President and CEO of the Federal Reserve Bank of San Francisco
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**The U.S. Economic Outlook: A Monetary Policymaker's Perspective**

I. Good morning. It's a pleasure, as always, to come back to Gettysburg.

- A. Today I'd like to give you my views on conditions in the national economy.
- B. Then I'll draw out some of the implications I see for monetary policy.
- C. Afterward, I'll be very happy to answer your questions.

II. One of the hallmarks of the U.S. economy for quite some time now has been its remarkable productivity performance.

- A. After more than two decades of growing at only about a one and a half percent rate,
  - 1. the pace of productivity growth
    - a. picked up around the end of 1995
    - b. and averaged a rapid two and a half percent for the next five years.
- B. After that, it really took off—
  - 1. —over the past three years, the rate has averaged an extraordinary *four and a quarter* percent!
- C. This performance has been a fundamental force in the economy's growth.
  - 1. It bodes well for a continuation of the current upswing in economic activity,
    - a. because faster productivity growth creates business opportunities that stimulate spending.
  - 2. It also bodes well for long-run increases in living standards in the U.S.

III. Of course, the strong productivity performance is only *one* of the fundamental forces stimulating the economy's growth at this point.

   A. Let me mention two other important fundamentals.

      1. There's the stimulus in the pipeline from fiscal policy.

         a. This includes the pickup in defense spending to support the action in Iraq

         b. and a series of sizable tax packages.

      2. There's also the stimulus from monetary policy.

         a. The Fed cut short-term interest rates from six and a half percent to one and three-quarters percent in 2001.

         b. And we brought the rate down to one percent with additional cuts in November 2002 and last June.

         c. So, over the last two years, short-term rates have been at their lowest levels in more than forty-five years.

IV. With these forces at work, output has been growing at a robust clip.

   A. Real GDP advanced at a blazing rate of six percent in the second half of last year.

   B. And it's important to note that this strength was broad-based.

      1. It was especially encouraging to see the performance of business investment in equipment and software,

         a. where much of the sluggishness in the economy had been concentrated.

      2. This sector showed very rapid gains.

         a. And within the sector, the information processing equipment component was quite strong.

      3. This improvement in business investment has helped the beleaguered manufacturing sector, which has begun to grow in recent months.

   C. Finally,

1. profit reports have been excellent overall,

2. and the stock market has gained ground.

D. In terms of the first quarter of this year,

1. the data so far have been somewhat uneven.

2. But, taken together, they point toward a solid performance.

V. While output has been growing at a fast clip, I'm afraid the same can't be said for jobs.

A. Since the recession ended in November 2001, the overall number of jobs in the economy has fallen, on balance.

B. Of course, we *have* seen some improvements recently.

1. Growth in payrolls has been in positive territory in each of the past seven months,

2. and jobs jumped by over three hundred thousand in March.

C. But even though there are signs that the jobs market is finally strengthening,

1. we're still far below where we'd expect to be in a typical expansion.

VI. What accounts for this overall weakness? Well, several factors have been mentioned.

A. At an early stage in the recovery, it seemed that firms were very cautious about adding to payrolls,

1. largely because of uncertainty about the strength of the economy,

a. given the aftermath of the terror attacks and the corporate governance scandals.

B. More recently, we've heard a lot about firms holding off on hiring because of soaring health costs.

C. But while these explanations may have some merit, I suspect that the single most significant factor is the extraordinary productivity surge I've mentioned.

1. In the short term, this productivity surge has let businesses satisfy the demand for their products without having to hire new workers, on net.

D. Of course, the recent pace of productivity growth is not sustainable in the longer run.

1. Indeed, many economists estimate that, in the long run, it will be in the neighborhood of two and a half to three percent.

a. This is well below the phenomenal rates we've seen recently,

(1) but it's high by historical standards.

(2) In fact, it's similar to what we saw during the 1960s investment boom.

2. With productivity rates like that and a continuation of the strong demand we've seen,

a. businesses will need to hire a lot more workers.

VII. Now, in talking about the weakness we had seen in the job market, I'm sure some of you were expecting me to refer to "globalization," "outsourcing," or "offshoring."

A. We've certainly heard plenty of stories about them in the news.

1. And there's no doubt that some people are facing hard times because their jobs have moved overseas.

B. But in looking at the overall economy, frankly, I don't think it's having that big an effect.

C. I must admit, it's hard to tell exactly how big the effect is because the statistics aren't very good.

1. We don't have official data,

2. and, in any case, there are a lot of unsettled measurement problems associated with this issue.

D. But there are a couple of reports out there that came out with similar estimates.

1. One estimate is from Goldman-Sachs.

a. They report that the number of jobs lost to foreign workers between 2000 and 2003 was one hundred to one hundred and seventy thousand.

b. Another well-known report, by Forrester Research, a consulting firm, came up with a very similar estimate.

2. Those numbers sound high.

a. But they don't sound high when you put them in the context of all the job turnover that occurs every year in the U.S.

(1) Each year, some fifteen million jobs are lost for all kinds of reasons— voluntary employment changes, layoffs, firings, and so on.

(2) And in a growing economy, every year even more jobs are created.

3. So, on that basis, I wouldn't say outsourcing or offshoring is a significant cause of the weak labor market.

E. I think it's also worth pointing out that when you talk about "outsourcing," you can't ignore "insourcing."

1. The fact is, economic activity flows *both* ways—

a. —not just out of the U.S.,

b. but also *into* the U.S.

2. For example, according to the Commerce Department, even as the U.S. "loses" jobs when our companies send operations offshore, we also "gain" jobs as foreign corporations invest here.

a. Specifically, foreign firms employed almost six and a half million workers in the U.S. in 2001—up from about five million in 1991.

(1) These workers included highly paid Honda and Mercedes-Benz workers in the auto industry.

(2) And in 2006, Toyota is going to employ two thousand people building cars in San Antonio.

3. And there are plenty of similar examples.

a. Samsung is investing $500 million to expand its semiconductor plant in Texas.

b. And Novartis is moving its R&D operation from Switzerland to Massachusetts.

4. All of these considerations suggest to me that we have much more to lose than we have to gain

a. if we focus on erecting trade barriers to save jobs

b. rather than on helping workers

(1) to weather these dislocations and

(2) retrain so that they can qualify for the new jobs the economy generates.

VIII. Now, let me turn to the outlook for inflation.

A. Currently, core consumer inflation is probably around one and a half percent.

B. One reason inflation has been restrained is that, until the middle of last year, economic growth was pretty sluggish, and that led to slack in labor and product markets—

1. —the unemployment rate became relatively high,

2. and so did excess capacity in product markets.

3. That restraining effect on inflation, of course, will diminish,

a. as relatively strong economic growth gradually eliminates excess capacity.

C. Another factor that has restrained inflation is the acceleration in productivity growth I've been talking about.

1. Since productivity growth is unlikely to accelerate further,

a. its restraining effect on inflation also should diminish over time.

D. Now, there are a couple of things offsetting these restraining effects on inflation.

1. One is the rising prices of imports,

2. and the other is the effects of the higher price of oil on elements included in core inflation.

E. In fact, recent data have shown core inflation moving up a bit relative to the exceptionally low rates seen last year.

IX. Now I'd like to comment on monetary policy.

A. As you know, our primary goal is price stability—

1. —in other words, an environment where people and firms can make economic decisions

2. without worrying about where prices are headed.

B. Typically, we're aiming at price stability by working to bring the inflation rate *down.*

C. But conditions in this expansion haven't been typical.

1. In fact, this is the first expansion in over forty years that *began* with a very low inflation rate.

2. So the response of monetary policy hasn't necessarily been typical, either.

D. What's typical when an expansion starts to take hold?

1. Most of the time, the main concern is an upside surprise—

2. —that is, the possibility that the economy will come roaring back,

a. possibly pushing the inflation rate even higher,

b. or at least preventing a desired decline.

E. So, as long as the inflation rate has been low, upside surprises haven't been as much of a concern.

1. Of course, with the federal funds rate at only one percent,

a. short-term rates *will* need to move up significantly at some point to prevent a rise in inflation.

b. And a major issue for monetary policymakers is to determine when that process should begin.

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