A Strong Economy – But We Can Aim Higher

Remarks by

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To

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AS PREPARED FOR DELIVERY

Introduction

Thanks very much for that kind introduction. I'd like to thank Park Price for helping organize this event and for his long service as a San Francisco Fed Director. Park is the definition of a Fed Family member, and I am delighted to deliver my first speech as the president and CEO of the Federal Reserve Bank of San Francisco in the community Park calls home.

I would also like to recognize our veterans who have chosen to spend part of their day with us; we thank you for your service.

I've been coming to Idaho since 1997, when I was just a rookie economist. It was love at first sight, the mix of agriculture and technology, rural and urban, the natural beauty, and all the things I love to do: skiing, biking, and hiking. Indeed, when days get hard my mantra is, I'm packing up and moving to Idaho. Apparently I am not the only one. Boise was recently flagged by *Forbes* magazine as the fastest-growing metro area in the country,[1] and Eastern Idaho is sure to be right behind.

More generally, Idaho's economy is flourishing, so it's a perfect backdrop to talk about the broader U.S. outlook, which is very favorable. As the president of the San Francisco Fed, my job is to represent most of the western states—from Idaho and Utah out to Hawaii and Alaska—in the formulation of the nation's monetary policy. The Fed's goal, simply put, is to keep the expansion on a solid and sustainable footing. Congress has given us two mandates meant to support this: full employment and stable prices. Most of our job focuses on the short run, not letting the economy get too hot or too cold, but we also have to consider the economy's longer-term performance. My remarks today will focus on each of these in turn.

Now, before I dive in, let me say that my views are my own and do not necessarily reflect those of anyone else in the Federal Reserve System.

Current economic conditions

I'll start with the current state of the economy, which is very good. The expansion is over nine years old and seems destined to set a new record for the longest period without a recession in U.S. history, which it should reach in the middle of next year. The labor market is booming. Household and business balance sheets are very healthy, and confidence is high. All these factors point to significant underlying economic momentum, which is being boosted by tailwinds including the federal fiscal

[1] Sharf (2018).

stimulus and global growth that, despite some recent unevenness, has been solid over the past few years.

Even in this strong economy, though, some people are getting left behind. There are pockets of economic distress, and we need to do all we can to ensure that growth is inclusive and everyone has an opportunity to benefit.

Monetary policy, however, can't do everything. Our job is to keep the overall economy healthy, thus helping promote sustainable economic growth. By doing this, monetary policy supports economic well-being and creates opportunities for all to advance.

Implications for monetary policy

This principle of sustaining a healthy expansion has guided our recent policy and plans. As you probably know, the Fed's monetary policy group, the Federal Open Market Committee, or FOMC, meets eight times per year. We left interest rates unchanged at our meeting last week. More generally, though, we've been gradually increasing rates in order to bring the stance of monetary policy closer to neutral.

This policy normalization, or return to neutral, reflects our commitment to the Fed's dual mandate. One goal is "maximum" or full employment. This means an unemployment rate that is very low, reflecting normal worker turnover in a thriving labor market. Recent unemployment numbers below 4 percent strongly suggest that the labor market has reached or exceeded full employment. But there are other indicators as well, and I'll return to them in a moment.

Our other goal is stable prices. In 2012, the FOMC determined that aiming for price inflation of 2 percent was most consistent with that broad long-run goal.[2] We'd been mostly running below that target since the Great Recession ended in 2009. Recently, though, inflation has come back up and is basically on target. I expect this modest uptrend to continue, with inflation rising to just a bit above 2 percent over the next year or so. Of course, there are risks on both sides of that projection.

[2] Board of Governors (2012).

Inflation could pick up more rapidly than expected, or it could drop back down again.[3] For now, though, the inflation numbers are very encouraging.

These conditions, with both of the Fed's goals essentially met, merit the gradual normalization of monetary policy.

So why gradual? I view this gradualism as a process of iterated learning, guided by incoming data. That is, we take a policy action, wait, learn about the economy's response, and repeat. The information gathered through this gradual approach is crucial for determining the speed and size of the subsequent policy adjustments. Of course, since monetary policy acts with a significant lag—likely a few years—policymakers must plan ahead, but need to be ready to adjust if the data or the environment change.[4]

In other words, the FOMC is not on autopilot, with quarterly rate increases locked in. We're constantly looking at the data and adjusting the monetary policy path as needed in response.

Are we at full employment?

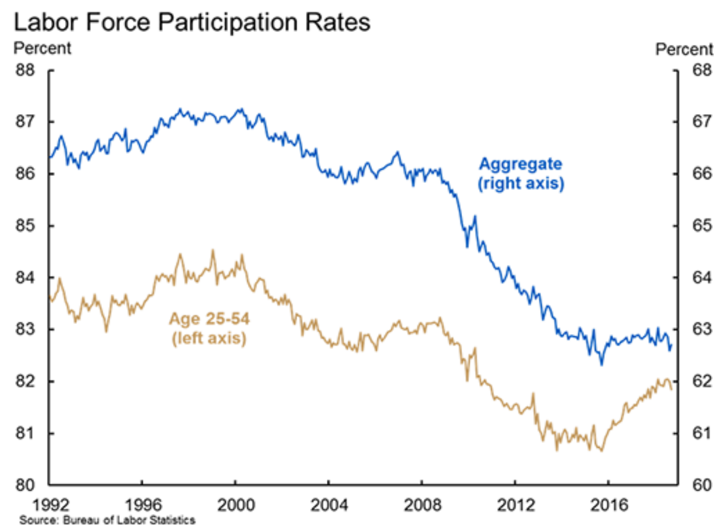
That summarizes where I see the economy and policy headed. But there are always uncertainties. We've been surprised at how long it's taken inflation to return to target. This has raised questions about whether the economy has truly reached its full potential. In other words, are we at the point where growth will be increasingly constrained by bottlenecks and other supply factors, rather than inadequate demand?

In the labor market, this idea of an economy at its potential corresponds to full employment. Hence the question: "Are we at full employment?" [slide]. While we frequently summarize the state of the labor market with the unemployment rate, we always look at a wide variety of other labor market indicators. These include broader measures of *underemployment* that take into account individuals who are out of the labor market or stuck in part-time jobs. We also watch an array of independent data series on job openings, worker quit rates, reported job availability and difficulties filling jobs, and

[3] These risks are discussed in Powell (2018). See also Shapiro (2018, forthcoming).
[4] Havranek and Rusnak (2013).

others. Essentially all of these indicators are flashing bright green: they've met or moved beyond their values from past peaks, signaling a labor market that is indeed at full employment.

The key exception is continued low rates of labor force participation. This refers to the fraction of the working-age population that is either employed or is unemployed and actively seeking work. My first chart shows the patterns in participation over the past 25 years for the overall population ages 16 and over and for workers in their prime working years, corresponding to ages 25 to 54.



You can see that the overall rate has generally been on the decline since the year 2000. Demographics play a big role—specifically aging, as many of the baby boom generation head off for retirement.

But an aging population doesn't explain everything. The chart also shows a drop in labor force participation among prime-age workers. Like the overall rate, prime-age participation peaked around the year 2000. It fell around the 2001 recession and then took an even steeper tumble during and after the Great Recession of 2007 through 2009. It reached a low point in 2015, nearly eight years after the initial downturn. We've seen a bit of improvement since then. But currently, the prime-age participation rate is significantly lower than it was in the 1990s.

This raises the question—why aren't Americans working like they used to? Some observers think this reflects a labor market that hasn't yet recovered from the last recession. But my reading of the evidence suggests that longer-term factors are at play.

A number of influences have been identified. Research by San Francisco Fed economist Nicolas Petrosky-Nadeau and his coauthor Bob Hall suggests that some of the drop owes to economically secure families opting in favor of one employed spouse rather than two.[5] In other words, there may have been some shift toward the "life" end of the work-life balance.

Another factor behind the decline is ongoing job polarization that favors workers at the high and low ends of the skill distribution but hinders those in the middle. This is mainly due to changing technology. I know for myself, I never call a travel agent anymore. With a few taps and swipes on my phone, I can book a trip to almost anywhere in the world in seconds. But it goes far beyond that: our economy is automating a wide range of jobs in the middle-skill range, from assembly lines, to call center workers, to grocery checkers.

A growing body of research finds that these pressures on middle-skill jobs leave a big swath of workers on the sidelines, wanting work but not having the skills or flexibility to keep pace with the ever-changing economy.[6]

What to do?

I've argued that low workforce participation reflects long-term challenges. Good monetary policy can't directly cure these problems. But as I've already noted, it can help by keeping the expansion going. Recessions cause long-term damage to workers' employment and wage prospects.[7] Keeping the economy on an even keel can help avoid these problems.

But much can be done *beyond* good monetary policy. We shouldn't think of "full employment" as a fixed target, but instead think of it as something that can be moved. From that perspective, there appears to be quite a bit of upside potential for U.S. workforce participation.

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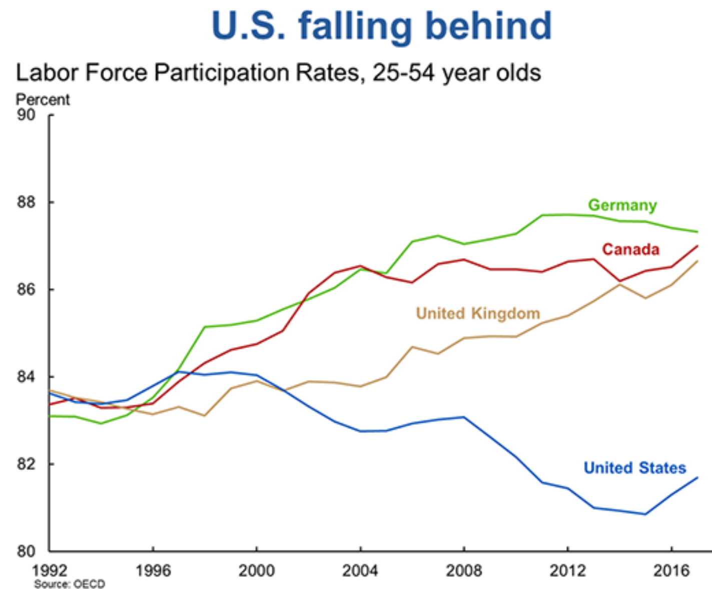
[5] Hall and Petrosky-Nadeau (2016).
[6] See Abraham and Kearney (2018), Autor, Katz, and Kearney (2006), Autor (2010), and Valletta and Barlow (2018).
[7] See for example Davis and von Wachter (2011).

International comparisons are helpful on this point. The next chart shows the prime-age participation rate in Germany, Canada, the United Kingdom, and the United States. In these other advanced economies, participation has increased overall and now stands well above the rates observed in the United States. This is especially striking because, just like the United States, these countries are facing long-term challenges like labor market polarization. Yet, they have managed to offset the downward pull on participation rates.



What factors have contributed to this growing divergence between us and other countries?

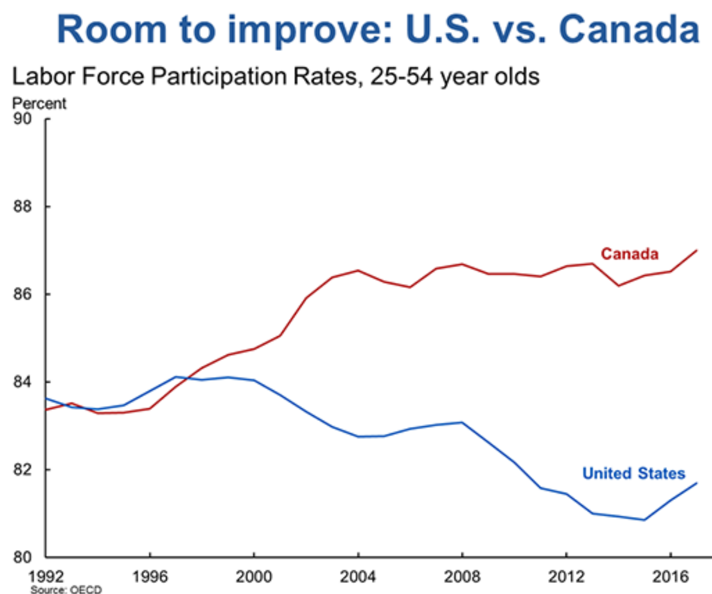
Education is one. Like most advanced economies, job creation in the United States has tilted toward jobs that require a college degree.[8] But we're not adequately preparing our new workers for the jobs of the future. Although the share of young people with four-year college degrees is rising, we are falling behind many of our international competitors.[9]

So where should we focus our efforts when it comes to increasing college education? A good place to start would be reducing the educational attainment gap across students of different races and ethnicities. Equalizing opportunity and access to higher education has substantial upside potential

[8] Carnevale, Smith, and Strohl (2013), OECD (2018a).
[9] OECD (2018b).

for overall growth, as well as for enhancing the economic mobility that is at the core of our American identity.[10]

But education is not the only answer. There are other things that can be done. The United States versus Canada comparison is especially telling (chart). You can see a growing participation gap between the two countries since the late 1990s. By 2017, the prime-age participation rate was over 5 percentage points higher in Canada than in the States. This is a startling difference. It represents about 6.7 million additional individuals in the U.S. who could be in the labor force.



In a research report scheduled for public release tomorrow, I worked with current and former San Francisco Fed staff to try to understand this gap.[11] We found that it's mostly due to differences for women: they account for about three-fourths, or 5 million, of that 6.7 million total. And it's not a matter of differences in educational attainment: the Canadian edge is generally evident across all educational groups.

[10] Further discussion is provided in Daly (2018).
[11] Daly et al. (2018).

Why is there such a large gap in women's participation rates across the two countries? We discuss some tentative but compelling answers in our research note. Government subsidies for the cost of childcare in Canada may play a role, supporting the return to work for parents—especially mothers—with young children.

Probably more important, though, are Canada's generous parental leave policies. Workers are assured of being able to return to their prior job, with the same compensation, after taking a prolonged parental leave—up to a year and a half in some provinces. They also receive payments that replace much of their lost income during leave, funded out of the nation's employment insurance system. This system encourages people to return to jobs rather than drop out of the labor force following the birth of children.

Now I'm not advocating we adopt the Canadian system or recommending any particular policy. But the comparison with Canada, as well as with other industrialized nations, shows that policy matters and that, with the right mix of skills and support, there's meaningful potential for increasing U.S. workforce participation.

The Fed can help by making sure that the economy continues to grow, creating work opportunities for wide swaths of the population. But over the long term, it is equally important to develop more supportive educational and family policies, so that individuals are encouraged to take advantage of those opportunities.

Conclusion

To wrap up, the U.S. economy is in very good shape. Keeping it that way requires continuing on the path of consistent, thoughtful monetary policy. In conjunction with policies designed to encourage workforce participation, this also may help boost our economy's longer-term growth potential, thereby supporting economic advancement for all Americans. Thank you.

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