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The U.S. and Regional Economies: A Monetary Policymaker's Perspective

I. Good afternoon. It's a pleasure to be with you.

- A. In my remarks, I'm going to focus mainly on the national economy and its implications for monetary policy
- B. But I also want to say a few words about the economy here in the Bay Area.

II. Let me start with the national picture.

- A. One of the hallmarks of the U.S. economy for quite some time now has been its remarkable productivity performance.
  - 1. After more than two decades of growing at only about a one and a half percent rate,
    - a. the pace of productivity growth
      - (1) picked up around the end of 1995
      - (2) and averaged a rapid two and a half percent for the next five years.
  - 2. After that, it really took off—
    - a. —over the past three years, the rate has averaged an extraordinary *four and a quarter* percent!
- B. 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.

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

III. 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 current quarter,

1. the data so far have been somewhat uneven.

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

IV. 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.

D. What accounts for this overall weakness?

1. Although demand for goods and services has been advancing robustly, it has been matched or outpaced by faster productivity growth.

2. And that has limited the need for businesses to hire more workers.

E. 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

b. and, as a result, economic growth should stay robust.

V. 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. As a result, even though we've seen fast growth in the last few quarters,

a. we'll probably need to see relatively strong growth for a few more quarters before we work off that slack.

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

D. Now, there are a couple of things offsetting these 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.

VI. 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. and the FOMC has been able to "be patient" in removing its stance of policy accommodation.

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

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

VII. Now let me turn a little closer to home and focus on conditions in the Bay Area.

A. As you well know, the Bay Area was pummeled by the tech downturn more than almost any other region in the country.

1. The Bay Area has lost one out of nine jobs.

2. Within the tech sector, more than one out of three jobs have evaporated.

3. Part of the collateral damage, of course, is that office vacancy rates have

shot up.

B. At this point, there are some conflicting signals for the tech sector—and for the Bay area more generally.

1. A "warning" signal is that we've yet to see a convincing rebound in overall employment here.

a. And employment in the tech sector continues to slide, though at milder rates than we saw previously.

2. A positive signal is that orders and revenues have been increasing for a large number of area firms that produce

a. computers,

b. semiconductors,

c. semiconductor equipment,

d. communications gear,

e. and software.

VIII. Looking ahead, I *am* optimistic about the future for economic and job growth in the Bay Area.

A. My optimism stems from a couple of factors about this region that I've come to appreciate during my tenure at the Fed.

1. First, the Bay Area has some great amenities that make it a very desirable place to live and work.

2. Second, and more important, the area's spirit of entrepreneurship and innovation is alive and vibrant.

a. Firms headquartered here continue to spend large sums on research and development.

b. For example, the Bay Area is home to four large federal research laboratories, and their budgets have been increasing a brisk pace in recent years.

c. And new technological breakthroughs are constantly occurring.

3. I don’t know which technologies will rise to be the nation’s fastest-growing industries in the future,

   a. but I’m pretty confident that they’ll have a strong presence here.

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