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

Realty Club of Chicago
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Hesna Genay
Vice President and Monetary and Financial Policy Advisor
Federal Reserve Bank of Chicago

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**

FINANCIAL TIMES
Theresa May's Brexit suffers historic
defeat JANUARY 16, 2019

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

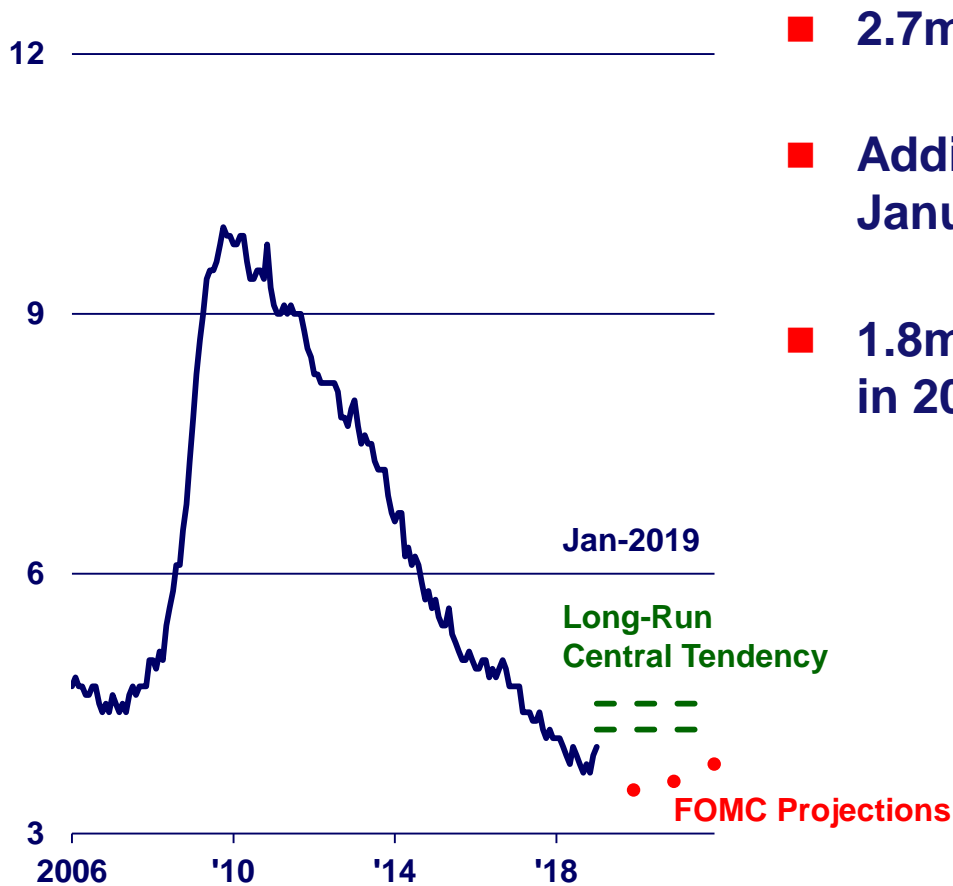
FINANCIAL TIMES JANUARY 4, 2019
Wall Street notches one of the biggest rallies
since 2011 as bulls regain footing

 **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)

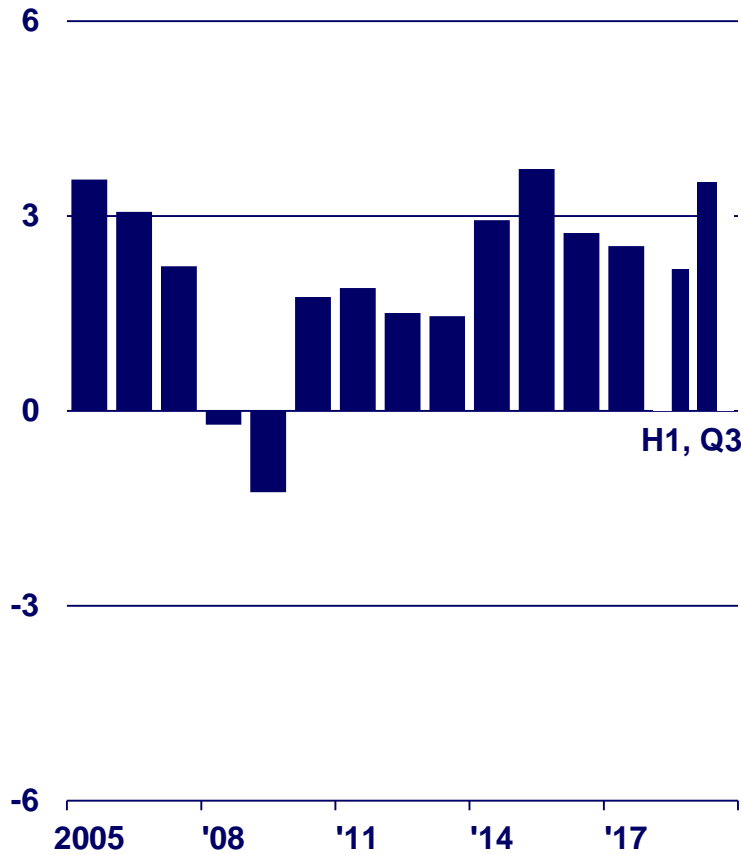


- 2.7m jobs added in 2018
- Additional 304,000 in January
- 1.8m entered the labor force in 2018

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

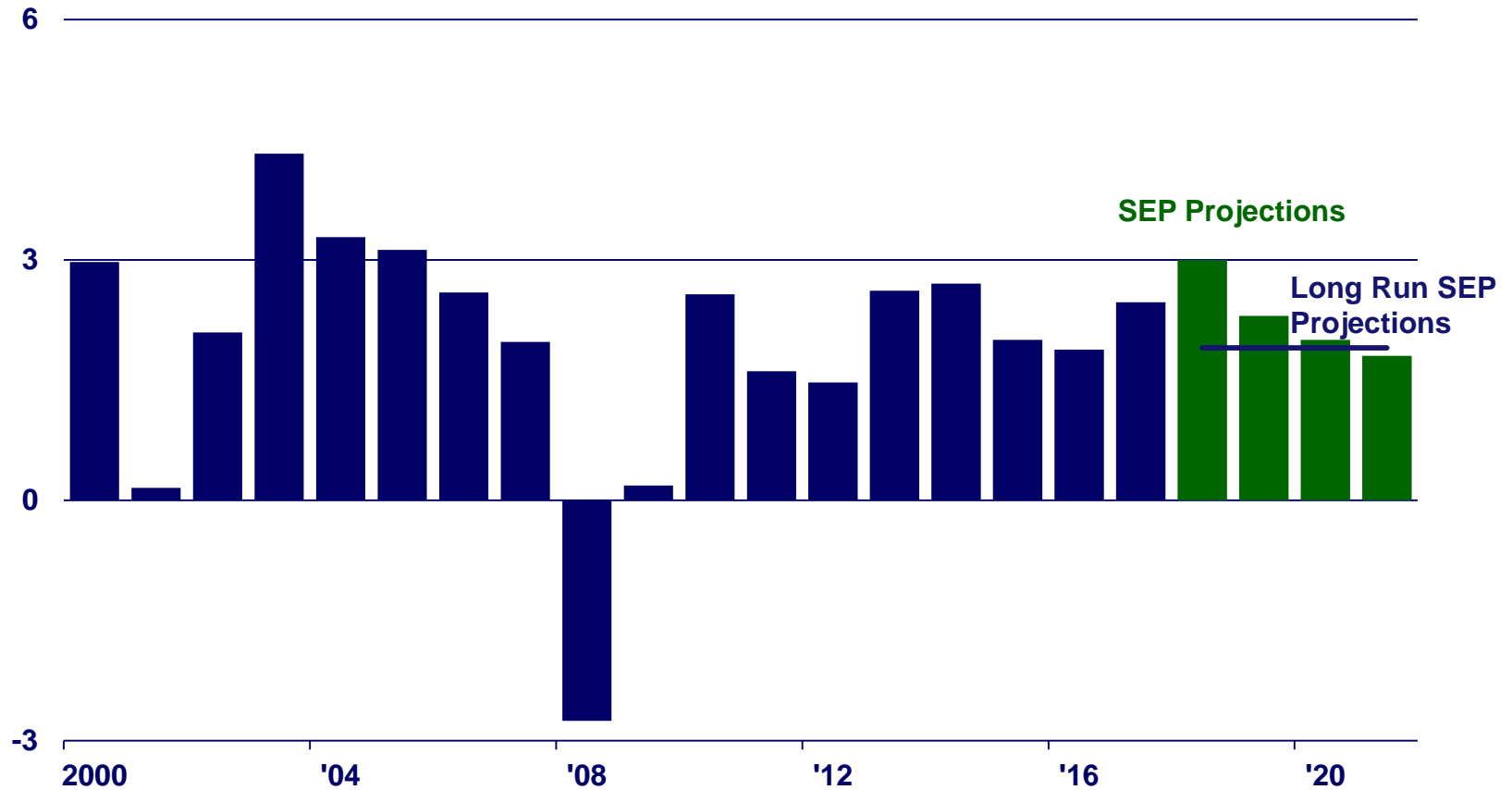
Banner 2018, Still Solid Near-Term Growth Ahead

	Q4	2018	2019
Macroeconomic Advisers (Feb 4)	2.4	3.0	2.1
Blue Chip (Jan 9 & Feb 1)	2.6	3.1	2.2
GDPNow (FRB Atl) (Feb 6)	2.7	3.1	
FRBC Nowcast (Feb 6)	2.5	3.1	
Dec FOMC SEP (Dec 19)		3.0	2.3

Longer Term GDP Outlook Also Still Solid

Real GDP Growth

(Q4/Q4 percentage change)

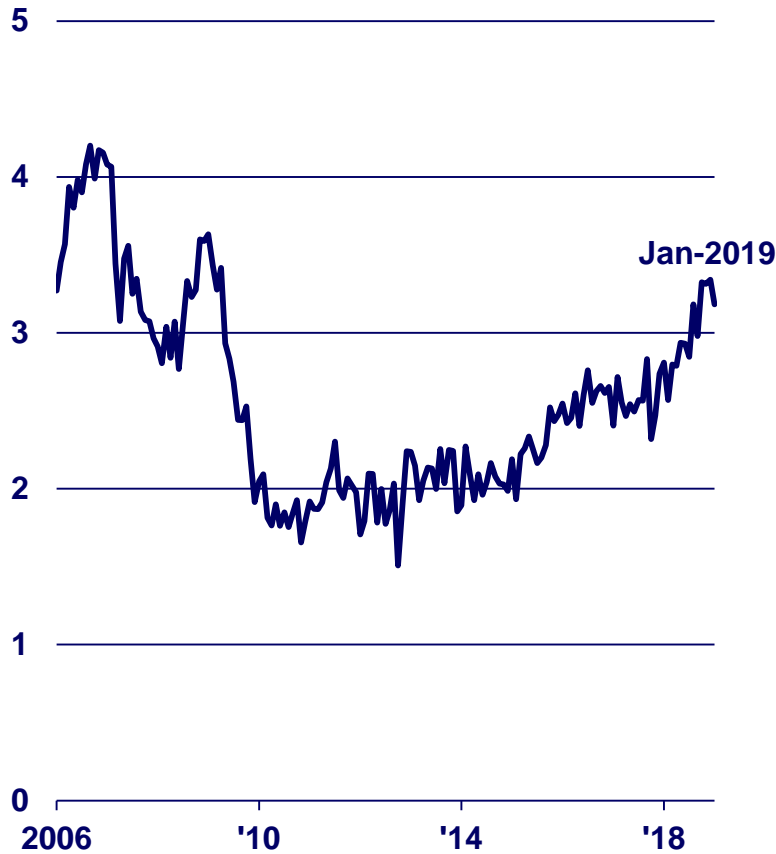


Source: Bureau of Economic Analysis and FOMC's December 2018 Summary of Economic Projections from Haver Analytics

Mixed Inflation Factors

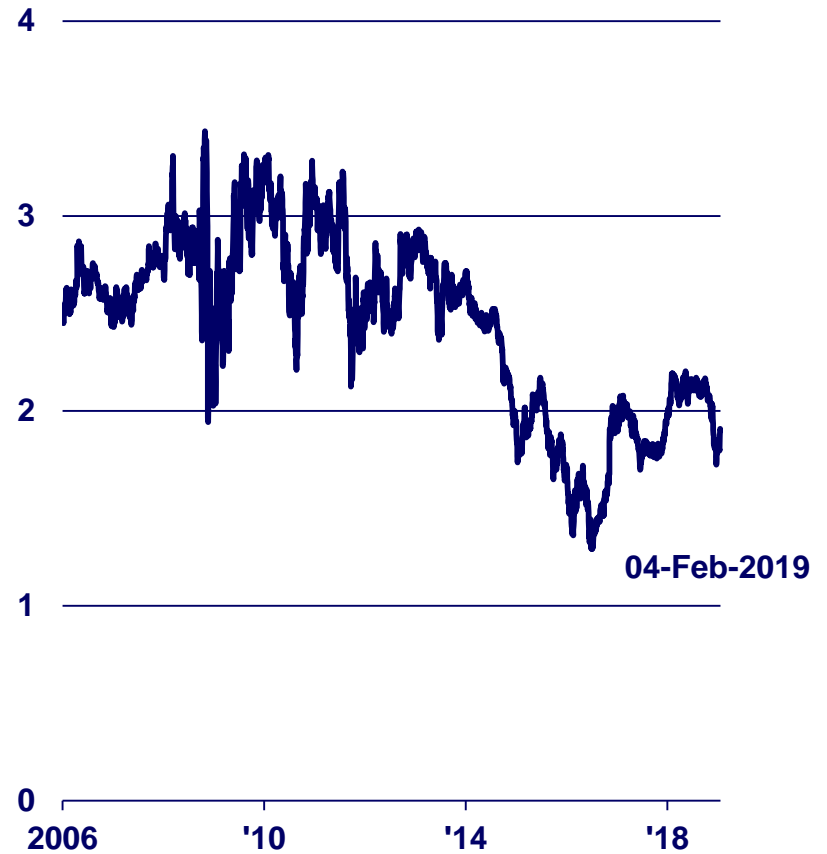
Wage Growth

(year-over-year percentage change)



TIPS 5/5F Inflation Compensation

(percent)



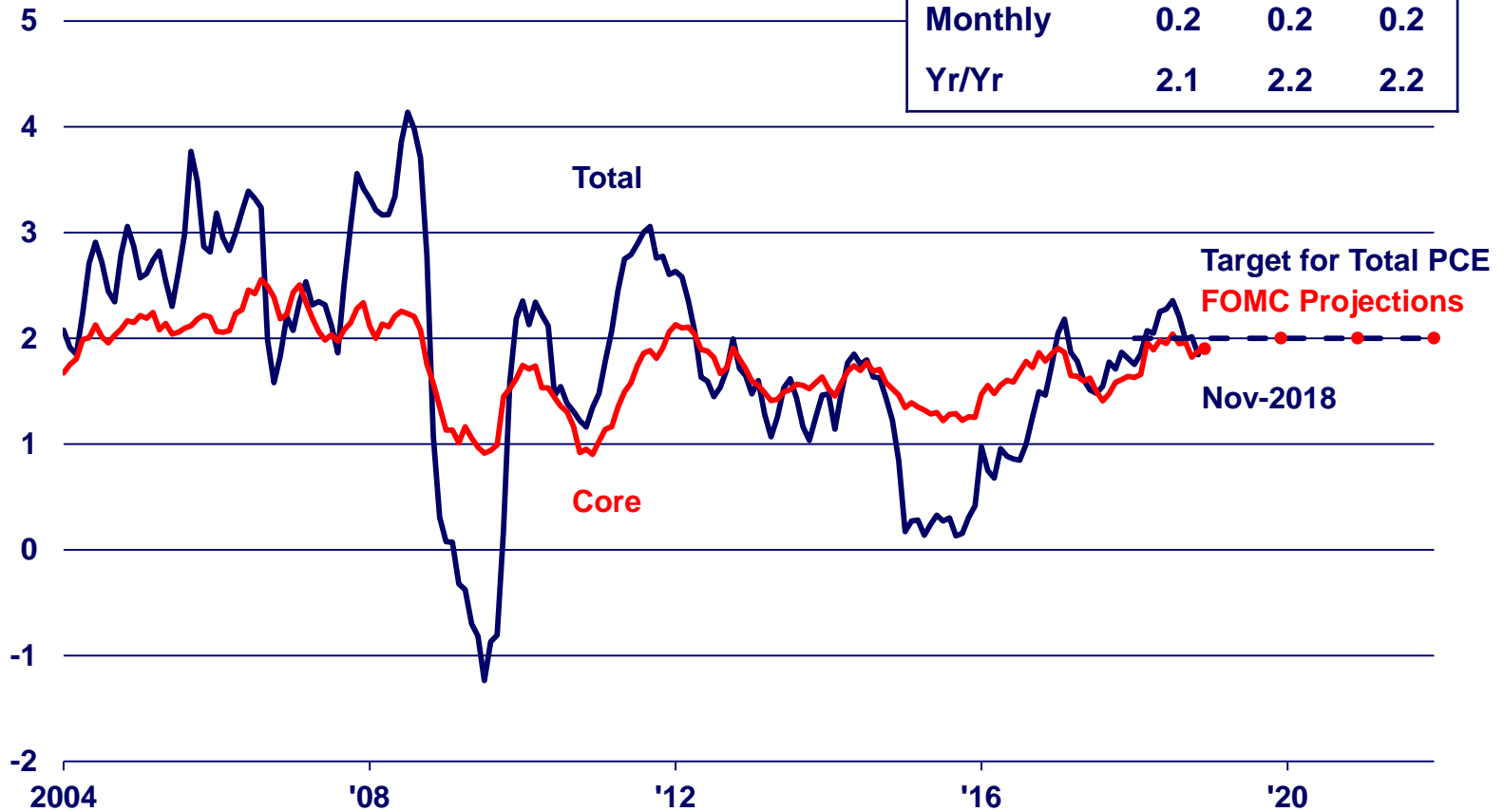
Source: Board of Governors of the Federal Reserve System and Bureau of Labor Statistics from Haver Analytics

Inflation Near Target

PCE Inflation

(year-over-year percentage change)

Core CPI	Oct	Nov	Dec
Monthly	0.2	0.2	0.2
Yr/Yr	2.1	2.2	2.2



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**

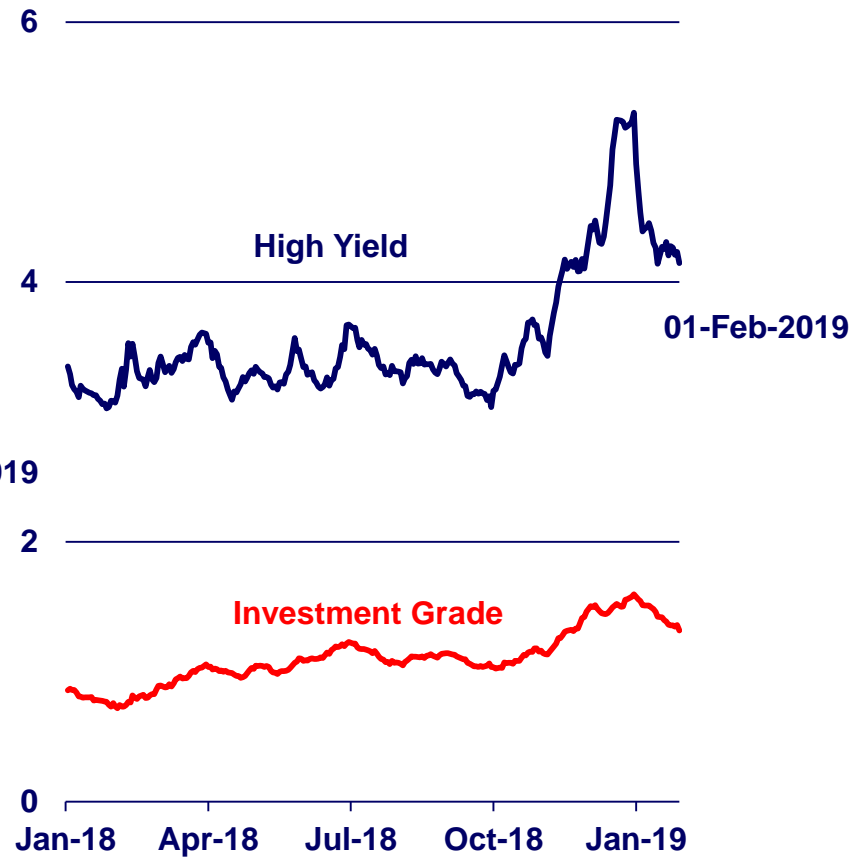
Re-assessment of Risks

S&P 500 Index



Corporate Bond Spreads

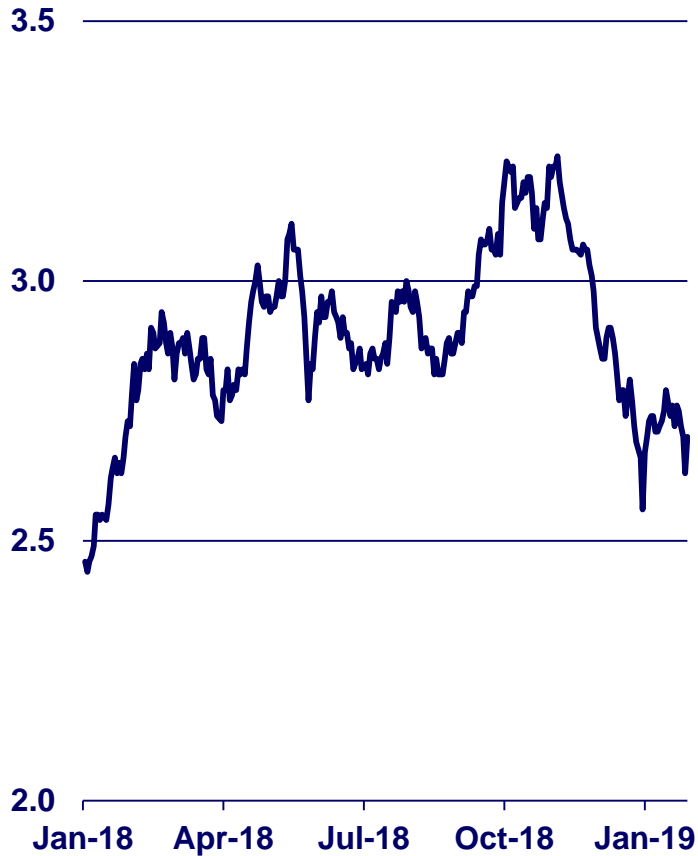
(spread over 10yr treasury, percent)



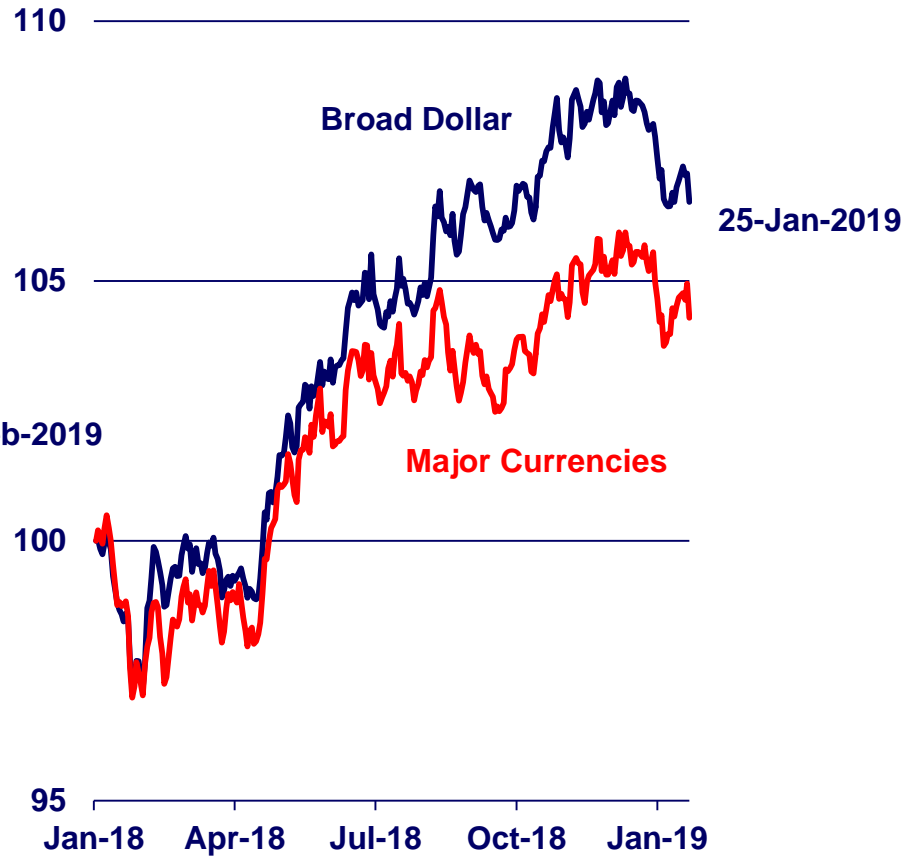
Source: Wall Street Journal and ICE/Merrill Lynch from Haver Analytics

Re-assessment of Risks

10 Year Treasury Rate
(percent)



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

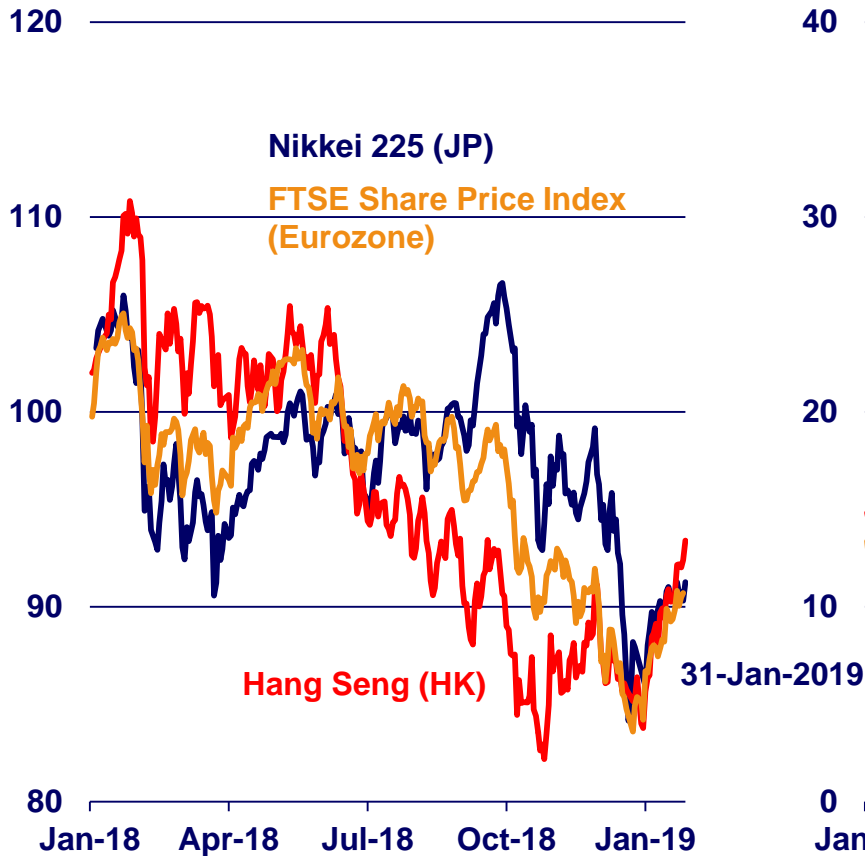


Source: Board of Governors of the Federal Reserve System from Haver Analytics

Similar Movements in Asset Markets Abroad

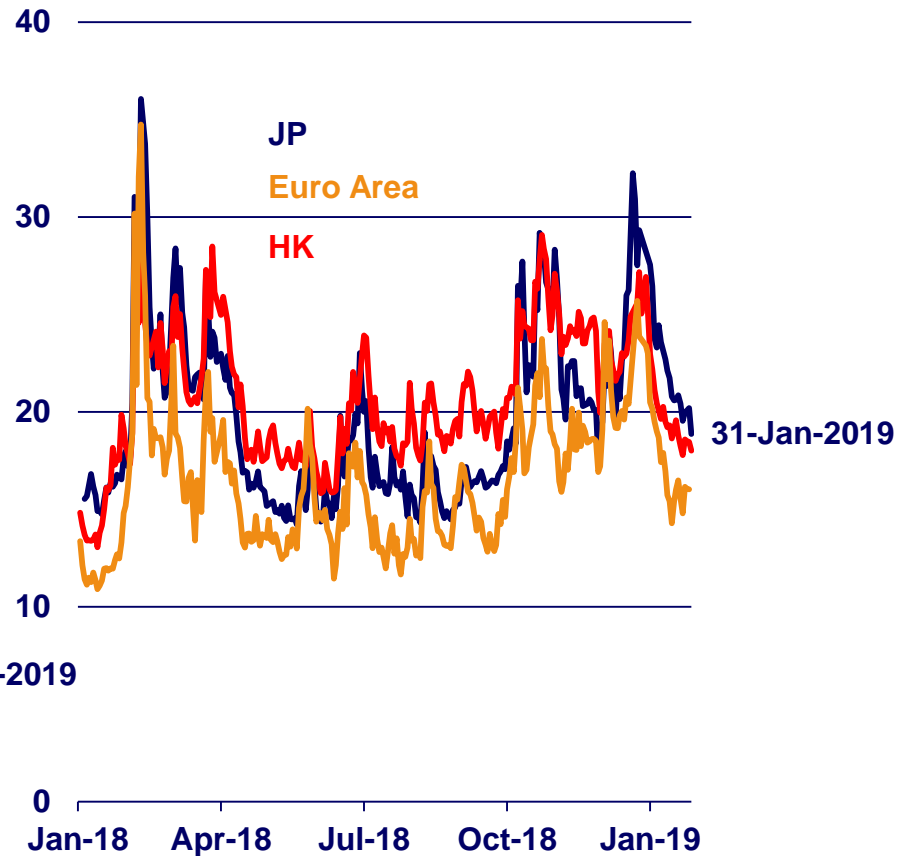
Stock Price Indices

(index, Dec-31 = 100)



Volatility Indices

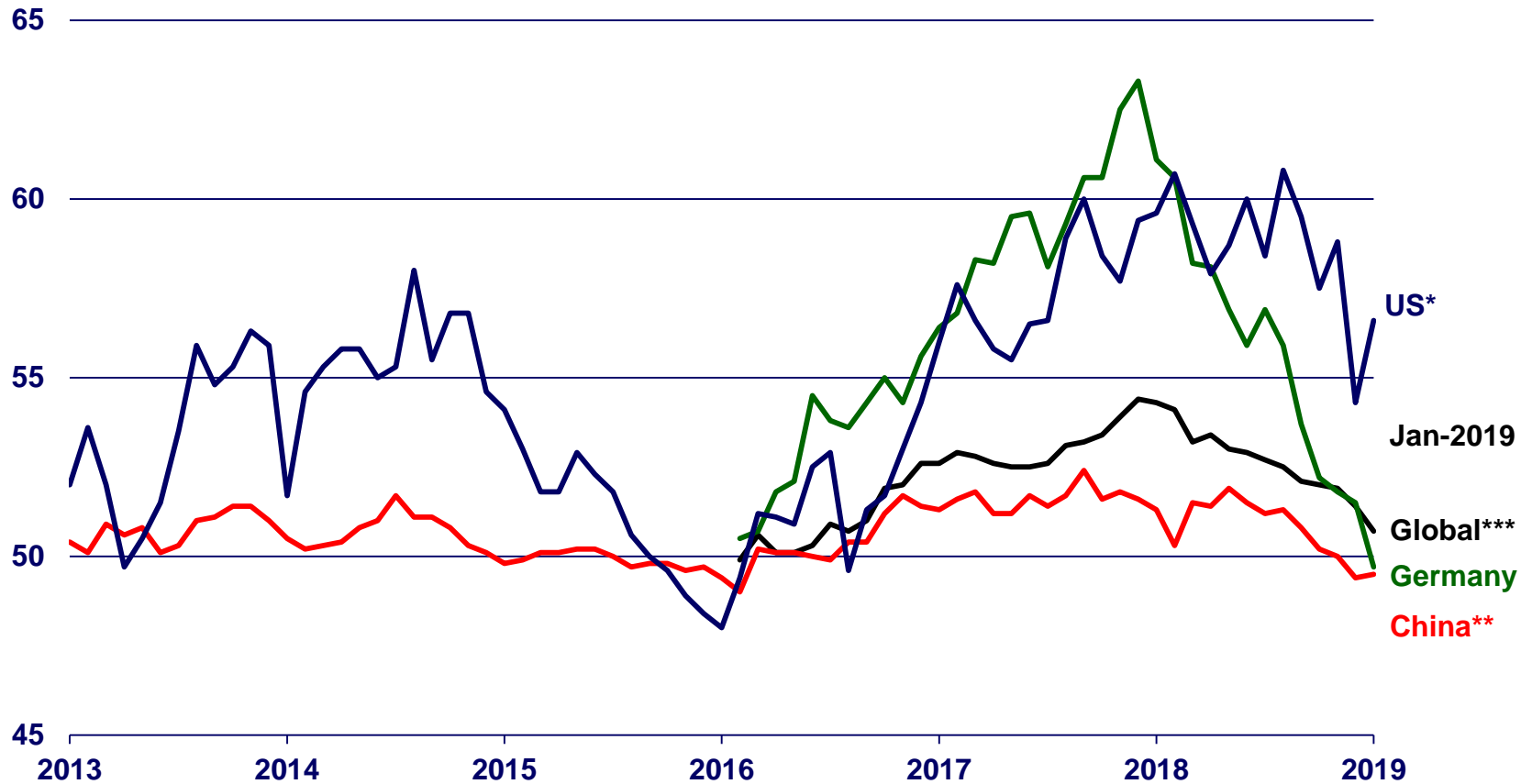
(index)



Source: Financial Times and Hang Seng Co. from Haver Analytics

Signs of a Global Slowdown

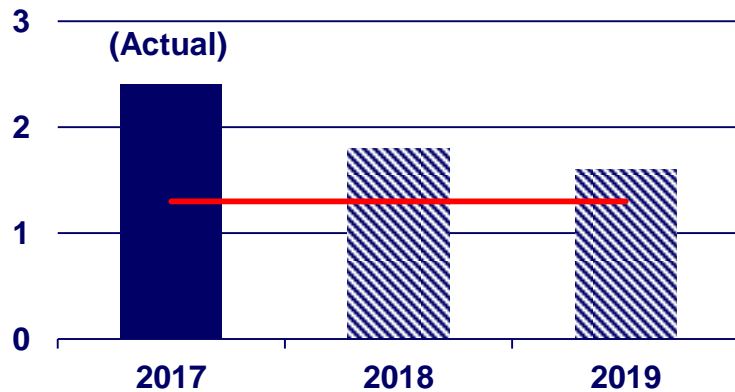
Global PMI Manufacturing Indicators (index)



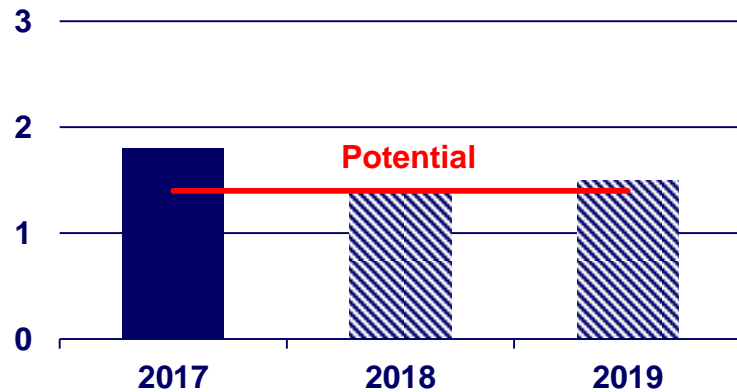
Source: Institute for Supply Management(*) from Haver Analytics, China Federation of Logistics and Purchasing (**), and JP Morgan Global Composite PMI (***)

International GDP Forecasts

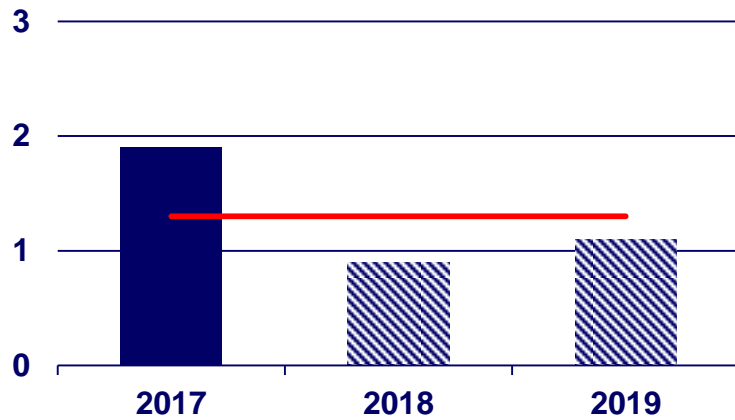
Euro Area
(annual, %)



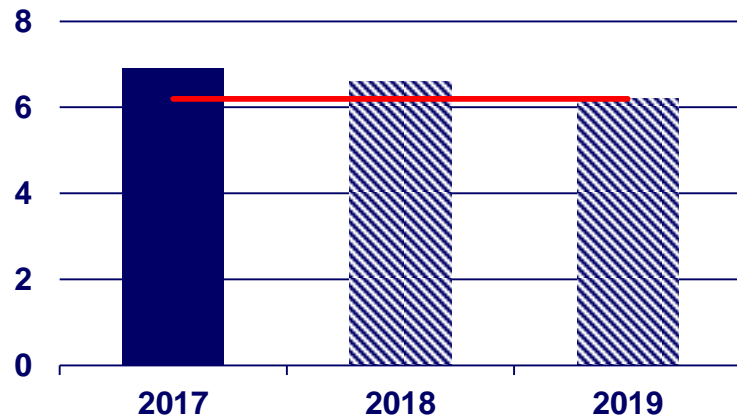
UK
(annual, %)



Japan
(annual, %)



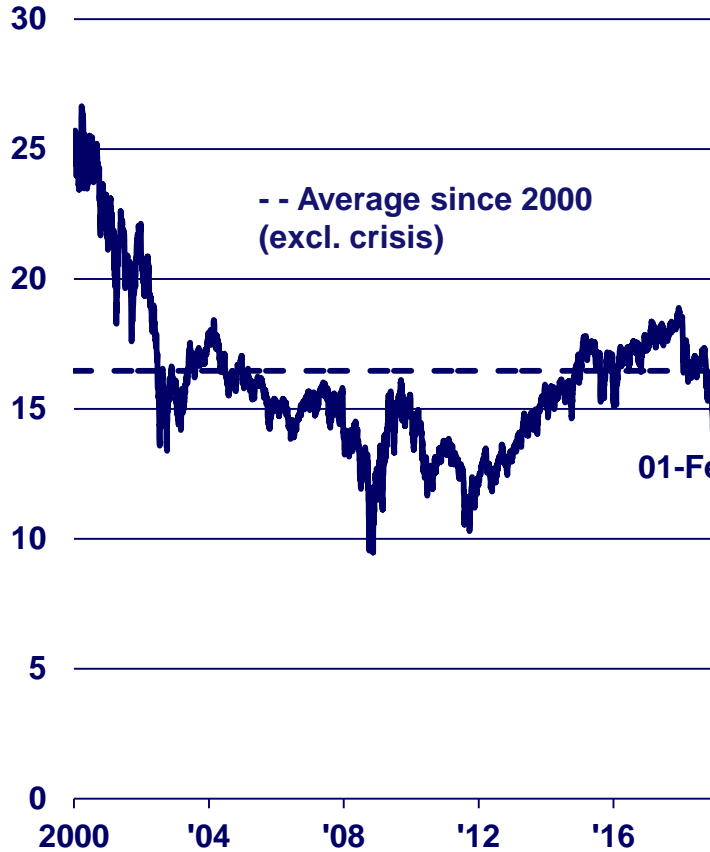
China
(annual, %)



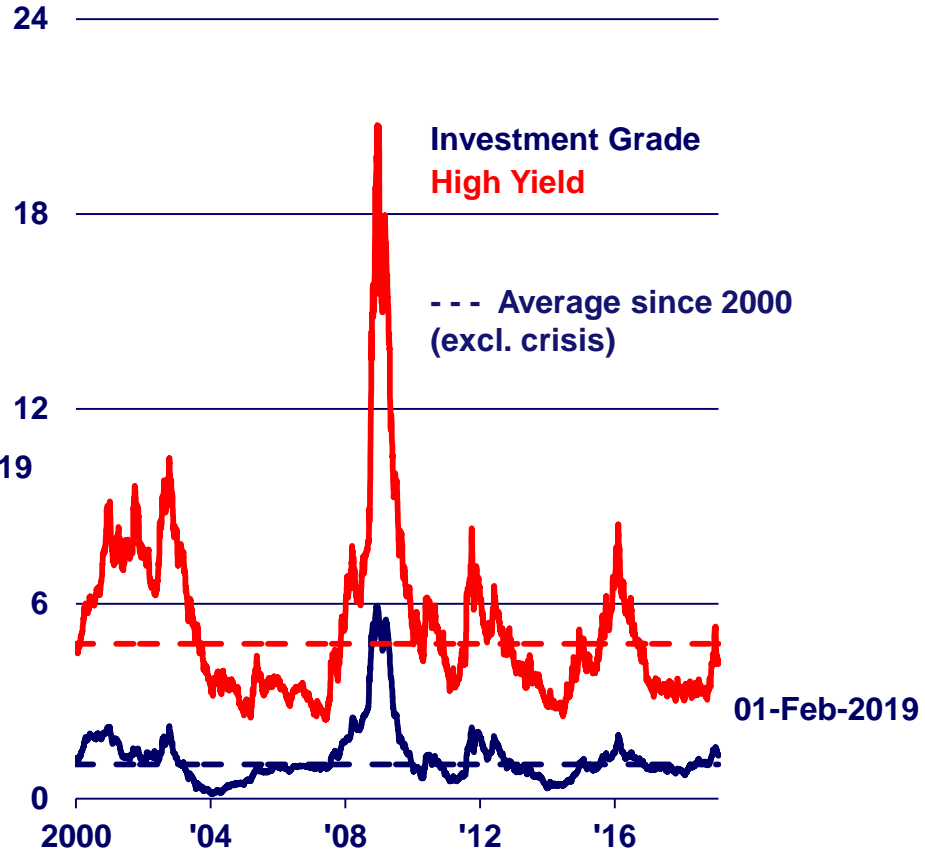
Source: IMF Interim World Economic Outlook (Jan 2019) and OECD

Historical Perspective

One-Year-Forward Price/Earnings Ratio, S&P 500 Composite
(Ratio)



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

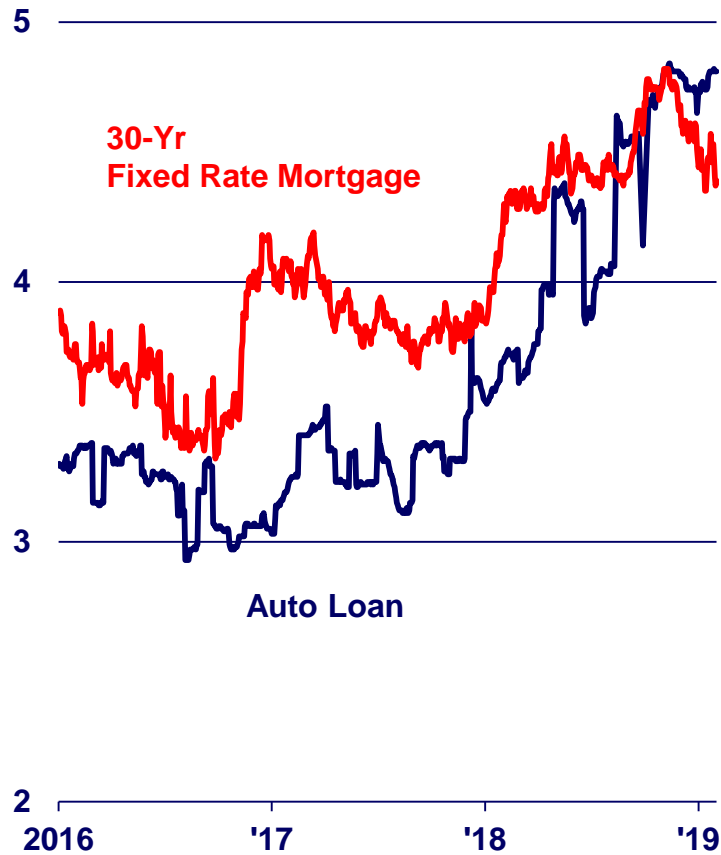


Source: ICE/Merrill-Lynch from Haver Analytics and Bloomberg

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

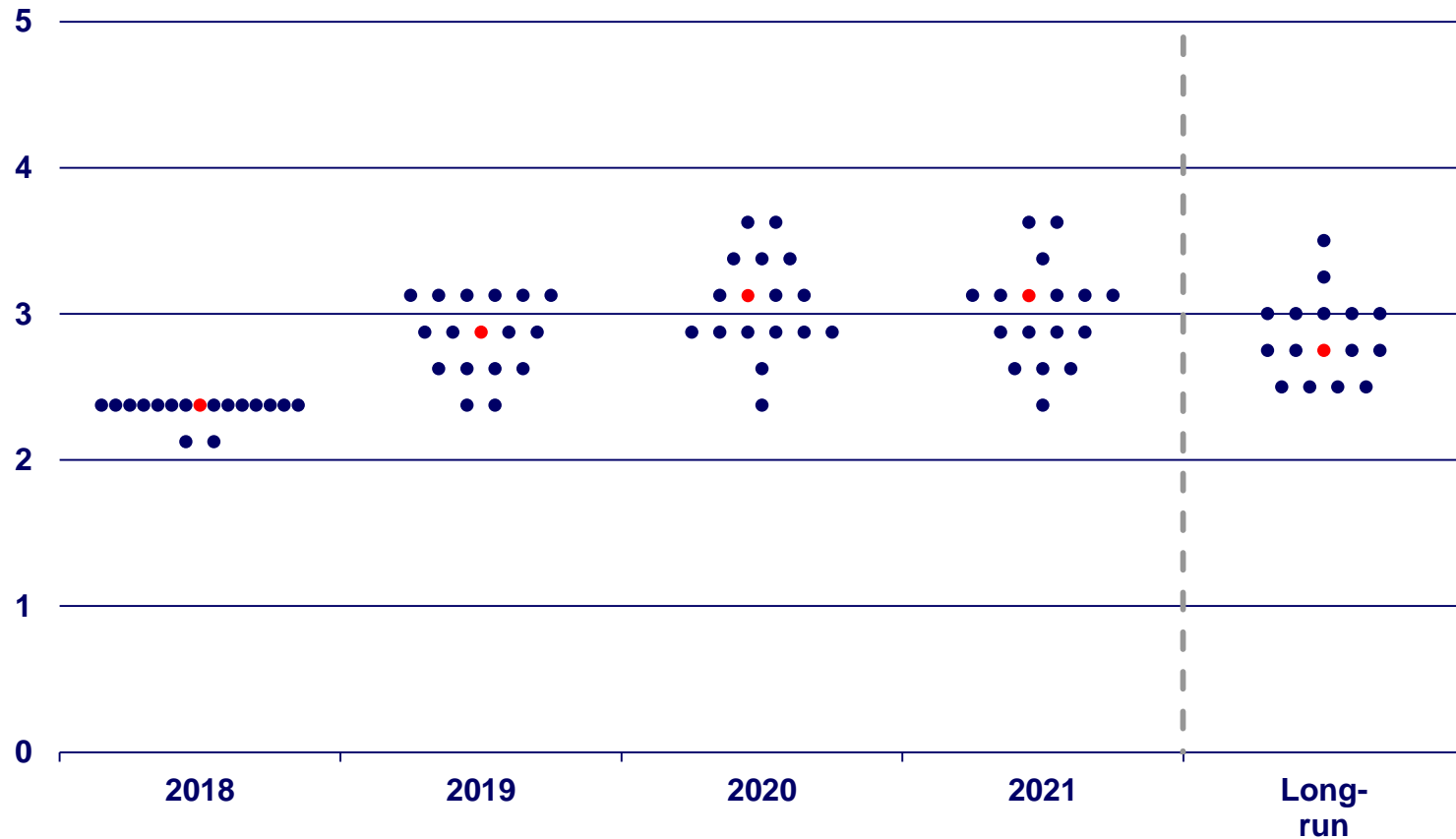
Chicago Fed National Financial Conditions Index (relative to average)



Source: Federal Reserve Bank of Chicago

FOMC's Expected Monetary Policy Path

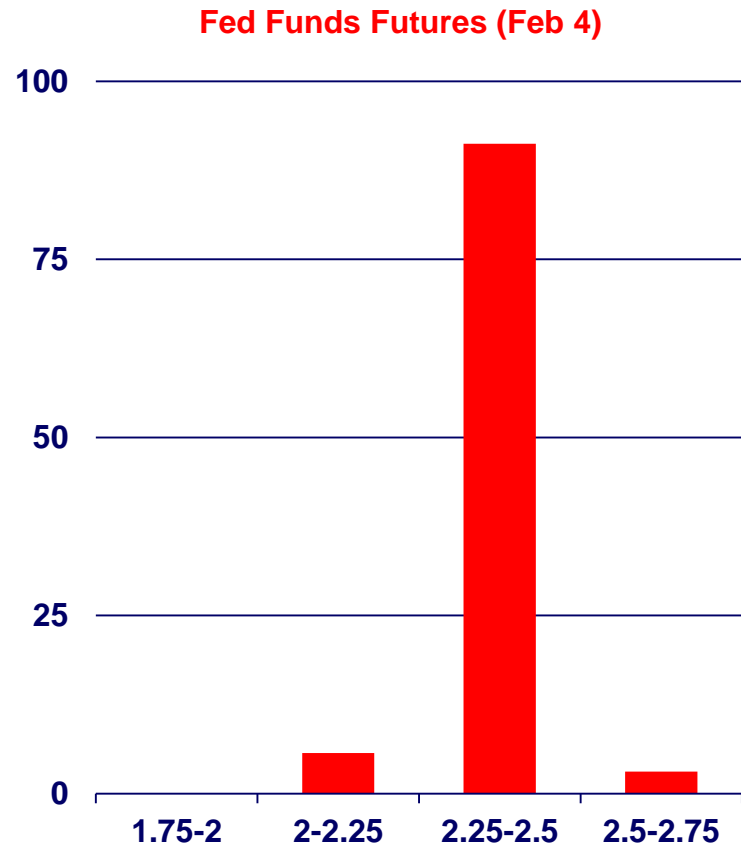
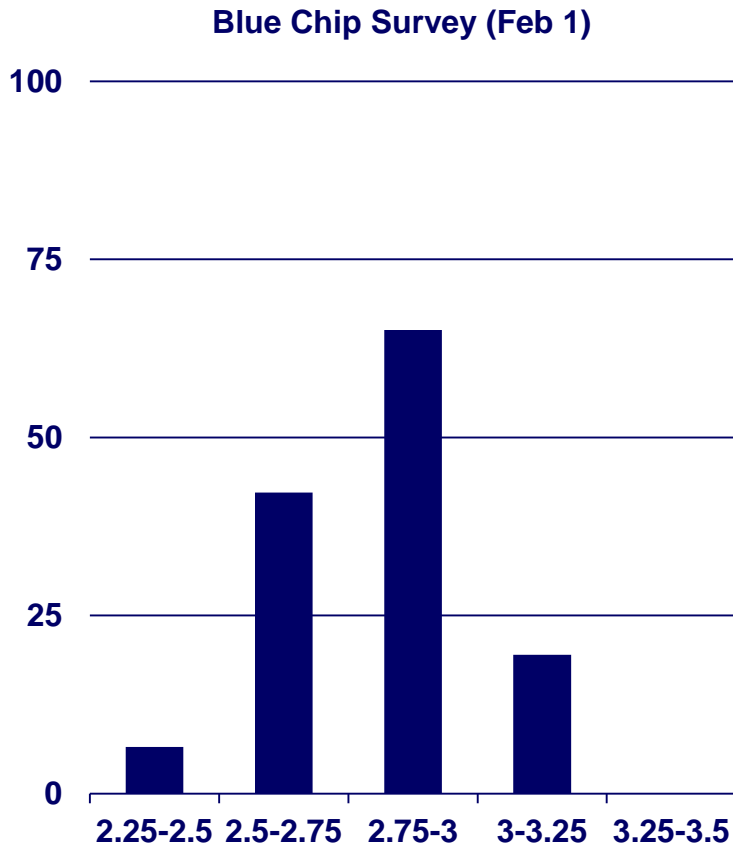
Target Federal Funds Rate at Year End (percent)



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)

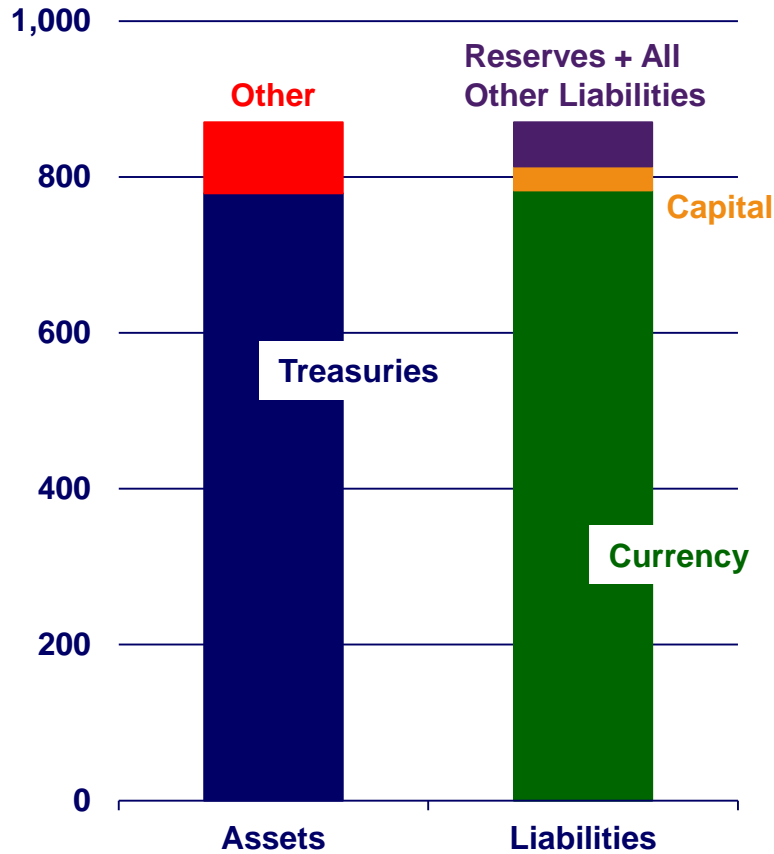


January 30, 2019 FOMC Statement

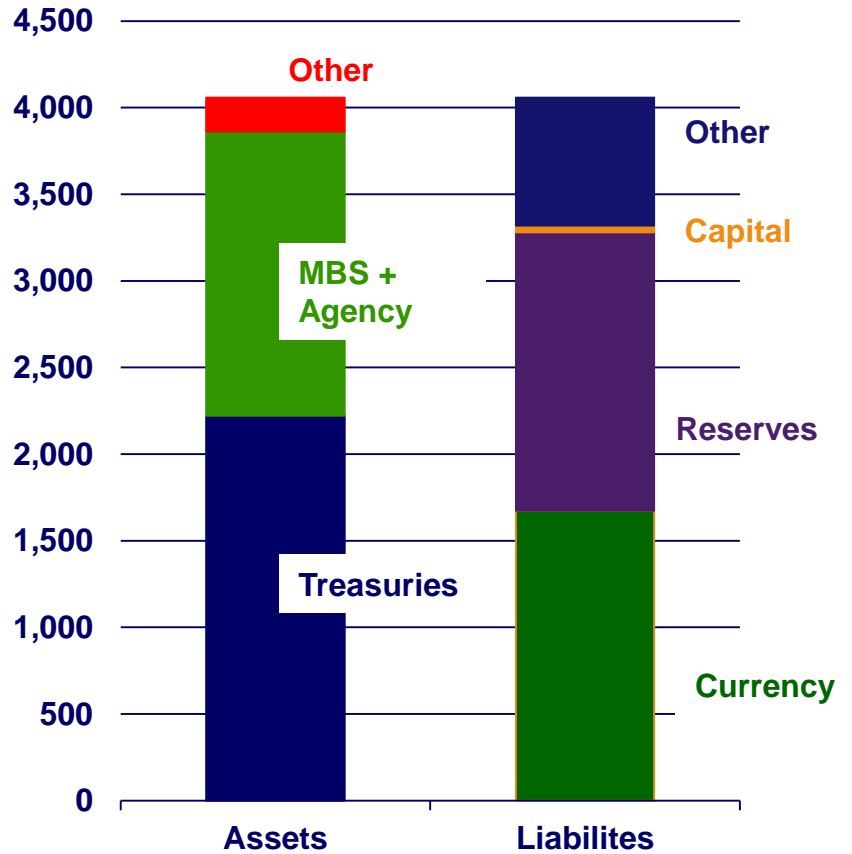
- **“Patient” with future adjustments to policy**
- **Wait-and-see how the cross-currents resolve**
- **Usual approach during periods of heightened uncertainty**

Evolution of the Fed Balance Sheet

2006
(billions)



Present (Week of 1/2)
(billions)



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