Monetary Policy and the U.S. Economy

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\(^1\)These views are my own and do not necessarily represent the views of the Federal Reserve Bank of Boston or the Federal Reserve System
U.S. monetary policymakers face a dilemma.
The unemployment rate is well below the equilibrium rate.
Inflation has been persistently below the FOMC’s 2 percent target.
The Fed has a dual mandate.
Different policy implications. Which deviation deserves more attention?
Missing FOMC’s targets by equal amounts. Should raise rates if policymakers’ loss function equally weights inflation and unemployment deviations.

- The unemployment rate is forecast to fall further, while inflation is expected to rise.
- Probability of December rate hike is about 90 percent.
- Median SEP forecast is for 3 hikes in 2018.
Why raise rates? Engineering a “soft landing” for unemployment is difficult.
What about the soft inflation data? Will inflation rise as predicted?

- Inflation has been low since March.
- Softness in inflation is believed to be transitory, but policymakers watching incoming data closely.
- Typically tight labor markets lead to higher inflation.
- Recent wage inflation data provide mixed signals.
Recent softness in inflation began in March with a large drop in wireless communications prices.
Inflation has also declined in other spending categories.

![Components of Core Inflation](image)

Note: Axes denote annualized 6-month inflation rate. Marker size scaled to reflect nominal shares of Core PCE (Core PCE isn't scaled).
Trimmed mean core PCE inflation, which removes outsized price changes in PCE components, has also moved down.
Still, while inflation expectations are lower, they have not fallen sharply.
Also, “missing” inflation is not in categories experiencing a lot of technological change or global pressures.

Wage growth often indicates underlying price pressures, but the signals have been mixed.
Firms’ labor costs are rising faster than wages. Higher prices ahead?

Wage Rate and the Wage Bill

12-Qtr. % Change at an Annual Rate

Employment Cost Index: Compensation of Civilian Workers

Employer Costs for Employee Compensation: Compensation of Civilian Workers
Of course wage growth could be low because inflation and productivity are low.
Still, wage indicators such as business compensation are abnormally low. Hard to imagine worker compensation will stay low indefinitely...

Note: *8-quarter moving average of annualized quarterly growth. Source: Bureau of Labor Statistics /Haver Analytics
...and core CPI prices have rebounded in recent months.
Regardless, recent strength in GDP growth suggests further declines in the unemployment rate...

![GDP Growth Chart]

Source: Bureau of Economic Analysis/Haver Analytics
...and restoring equilibrium in the labor market from too far below can be costly.

Hence, policymakers face a conundrum.
Thank You!