The Path to Economic Resilience

Raphael Bostic
President and Chief Executive Officer
Federal Reserve Bank of Atlanta

Rotary Club of Savannah
Savannah, Georgia

June 18, 2018

- Atlanta Fed president and CEO Raphael Bostic speaks at the Rotary Club of Savannah about the Fed's recent policy move and economic resilience.
- Bostic believes that economic conditions are reasonably close to the Federal Open Market Committee's dual mandate of full employment and stable prices. But, he says, the FOMC's real work is just beginning: to keep the expansion going in a sustainable manner.
- Bostic sees output growing at a moderately above-trend pace this year and next, then slowing to a pace that corresponds with the longer-run potential of the economy, which is slightly less than 2 percent.
- Bostic is comfortable continuing to move policy toward a more neutral stance—one where monetary policy is neither accommodative nor restrictive.
- Regarding economic resilience, Bostic says that even in southeastern cities where employment is growing, like Savannah, median household income and poverty rates have not shown positive progress.
- Bostic believes that community-based investment is one way to think about the kinds of local investments that help to translate growth into community assets that expand opportunity for people living in conditions of economic distress.

Good afternoon, everyone. It's a real delight to be here in Savannah. I've had the chance to see a bit of your city this morning, and it more than lives up to its reputation for charm and history.

As I am sure you know, the Federal Open Market Committee, or FOMC, voted to increase the federal funds rate target range by 25 basis points last week. Today, I'll explain why I think that action made sense in the context of current conditions and my economic outlook. Then I'll spend some time discussing economic resilience, particularly with regard to approaches we can take here in Georgia.

I'll offer my usual disclaimer before I get started. I'll present only my personal opinions today. I'm not speaking for anyone else in the Federal Reserve System or for the FOMC.

Current conditions

Let's begin with how the U.S. economy is performing at midyear. It appears to be in a pretty good place. Unemployment is at its lowest rate since the early 2000s, and inflation is running close to 2 percent. As I've said recently, the economy is about as close to target as we've seen over this expansion. That does not mean that the FOMC can go on recess until conditions change. I think just the opposite is true now. The job of a monetary policymaker is becoming more difficult.

For the past nine years, the Fed's goal has been to help bring the economy back to a more normal place following the financial crisis. Now, with conditions reasonably close to the FOMC's dual mandate of full employment in the context of stable prices, the real work begins. We'll continue to pick apart the incoming economic data and combine it with real-time information from our business contacts as we set the path forward. The goal is to keep this expansion going in a sustainable manner. We want to ensure that the economy is not overheating, but we also do not want monetary policy to become too restrictive and threaten to choke off the expansion.

It does appear that the growth of real gross domestic product this quarter will come in above my previous estimate. But I suspect that some of this strength is tied to transitory or idiosyncratic factors that do not signal a major shift in momentum. On the consumer side, the recent spending data look to have picked up quite a bit. However, much of the recent bump in expenditures on services can be tied to a spike in spending on utilities due to unusual weather patterns. Most of our reports from businesses tied to the consumer sector indicate no discernible changes in the pace of spending relative to recent trends. So I'm taking a bit of a wait-and-see approach with the recent consumer data.

In a similar way, I am not inclined to read too much into the recent acceleration in business investment growth. A fair amount of that pickup is due to a rebound in spending on structures related to the mining and energy sector. Excluding energy and oil investment, investment growth is still below 5 percent on a year-over-year basis—a bit lower than the typical expansion average.

Economic outlook

Regarding my outlook, my projection for overall growth hasn't changed materially since the beginning of the year. I still see output growing at a moderately above-trend pace this year and next, then slowing to a pace that corresponds with the longer-run potential of the economy, which is slightly less than 2 percent.

Given that the unemployment rate is already low by historical standards, and I expect growth to continue to outpace potential, one obvious concern I have is whether the economy is beginning to overheat in a destabilizing way. Here, I think it is important to recognize an important unknown. Most economists believe that even in periods of strong economic growth, some unemployment is inevitable, or “natural.” This either is due to the structure of labor markets or arises from typical flows of workers entering and exiting the labor market.

But the natural rate is unknown and has to be inferred from the available data. In last week’s policy meeting, estimates from FOMC participants ranged between 4.1 and 4.7 percent. According to these estimates, the current unemployment rate is already below its natural rate. We don’t need to go back that far in history to see how much the Committee’s thinking on this concept has changed. Back in September 2014, a little less than four years ago, estimates of the longer-run natural unemployment rate were between 5 and 6 percent.

My point here is that these estimates are not set in stone. In my mind, the most informative data for uncovering the natural rate comes from the nominal side of the economy—that is, inflation and wage growth.

Regarding inflation, I have not seen a dramatic shift in inflation expectations or measured retail price inflation. As for wage growth, I have yet to see evidence that it is accelerating at an unsustainable pace. In fact, aggregate wage growth appears to have flattened out over the past year or so at levels that appear to be in line with economic fundamentals (that is, productivity growth plus inflation).

Most of the Atlanta Fed’s business contacts characterize labor markets as tight, but not many of them plan to respond by raising wages across the board. I do hear some reports of planned accelerations in wages and salaries. But just as often, I hear that the issue is one of attracting sufficiently qualified workers. In these cases, firms are focusing on developing and training internal candidates and increasing investments in automation.

Reports of building price pressures are also sporadic. Although rising energy prices and anticipated tariff-related costs are generating more reports of upward price movement along the supply chain, we see few indications that the affected businesses expect to pass costs through to the final consumer.

The recent data on retail prices suggest inflation is running at or very near the FOMC’s 2 percent goal. I expect it to continue in that neighborhood over the next few years.

I began the year with a decided upside tilt to my risk profile for growth, reflecting business optimism following the passage of tax reform. However, that optimism has almost completely faded among my contacts, replaced by concerns about trade policy and tariffs. Perceived uncertainty has risen markedly. Projects already under way are continuing, but I get the sense that the bar for new investment is currently quite high. “Risk off” behavior appears to be the dominant sentiment among my contacts. In response, I’ve shifted the risks to my growth outlook to balanced.

The policy path forward

Should the recent data unfold in a manner similar to my outlook, I am comfortable continuing to move policy toward a more neutral stance—one where monetary policy is neither accommodative nor restrictive.

The level of the policy rate that qualifies as neutral is not something we know with precision. But we are getting close to the lower part of most plausible estimates of the neutral rate. I don't think we are quite at neutral yet, even after last week's rate hike. But a key policy question going forward is how many more rate increases are required to complete the transition to a policy stance that is neither accommodative nor restrictive.

Economic resilience

Now I'd like to shift my focus away from policy and talk about some factors that promote economic resilience in communities over time. I think this topic is particularly significant for smaller and midsized cities like Savannah.

One of the most important factors in creating the potential for positive economic outcomes is the presence of economic dynamism—that means a healthy amount of churning in a local or regional economy. Here at the Atlanta Fed, we recently published the second version of our Small City Economic Dynamism Index. You can get a copy of the report on our website under **Community Development**. In the report, we rank more than 400 small and midsized U.S. cities across 13 indicators of economic dynamism in four broad categories: demographics, economics, human and social capital, and infrastructure. Each indicator in the index has been shown to correlate with positive community and economic development outcomes. The index includes *growth* metrics as well as what we might call *opportunity* metrics.

Growth metrics capture information on things like population growth, employment growth, and population densification, which tracks the movement of people back into the city center. By these growth measures, Savannah and its peer cities in Georgia look pretty good over the past decade. Opportunity metrics include the rate of growth in poverty, median household income, and educational attainment. Here we see a mixed picture. Educational attainment seems to be improving, as measured by the share of people who have a bachelor's degree or higher. On the other hand, poverty and median incomes are moving in the wrong direction.

Even in cities where employment is growing, like Savannah, median household income and poverty rates have not shown positive progress. In these places, we are learning that job growth alone is insufficient if these jobs are not accessible because of transportation barriers or mismatched worker skills. Another issue is that many of the jobs being created are low-wage and don't allow families to rise above the deeper challenges of poverty.

This pattern—some indications of growth, accompanied by deepening pockets of distress and poverty—is especially pronounced in the Southeast. That means it's a significant concern for the Atlanta Fed, whose district spans six states within the region.

Connecting growth to community-based investment

So what can be done to improve economic outcomes? Community-based investment is one way to think about the kinds of local investments that help to translate growth into community assets that expand opportunity. Primarily, we're talking about either direct investment into projects or passive investment into intermediaries or funds that create housing, charter schools, facilities, and infrastructure projects, especially those that serve low-income families.

And more often, we're seeing community-based investments focused on programs and services that have historically been funded exclusively with public dollars. These include things such as early childhood education, prisoner recidivism, health interventions, and even workforce development. In markets where growth is creating development pressure and where socioeconomic outcomes lag, community-based investments like these can be viable pathways to improving conditions of distress while also generating a financial return.

So you might be thinking, where does community-based investment come from? Well, some of it comes from government programs. Some of it comes from banks, motivated by regulations like the Community Reinvestment Act. But foundations also provide a lot of subsidized capital for community-based investment. These dollars can lead other investors, they can mitigate risk creatively, and they can seed innovations.

My team at the Atlanta Fed took a look at where foundations and other nongovernmental grant providers are investing in community and economic development. This research, which we call "**Following the Money**," examined grants from larger foundations and other intermediaries that fill gaps in funding where the market or local tax revenues come up short.

So how did Savannah do in attracting these grants? From 2009 to 2014, the U.S. median metro area attracted $3.75 per capita each year in combined funding from large grant makers. By comparison, on average, the Savannah area attracted only about $2 per capita of this subsidy each year. These measures are adjusted for population. Compared to Atlanta and other smaller and midsized cities in Georgia, Savannah is attracting the fewest subsidy dollars from the outside to address community and economic development issues.

What does it take to attract these community-based investment dollars? Many of Georgia's smaller and midsized cities, including Savannah, are growing, but they're also wrestling with difficult challenges such as poverty, stagnant incomes, blight, and vacancy. The community-based investment framework offers a way to think about connecting growth to broader opportunity. Community-based investors are like airplanes. They are flying around, looking for opportunities that meet their particular interests. Those interests might include projects in housing, charter schools, community facilities, small business incubators, and so on.

But for those investments to land and create the outcomes, we need runways. And there's a whole set of intermediaries that build runways—public/private partnerships, community development financial institutions, community development corporations, and a constellation of nonprofit organizations that absorb community-based investment. These intermediaries allow the investments to land where they can create positive outcomes. Intermediaries do this by coordinating shared priorities, by creating a pipeline of investment opportunities, and by working with public officials to ensure that the environment is amenable to community investment.

If the goal is to connect growth to broader opportunity, and to attract more community-based investment from local sources as well as from those outside our market, then we need to build more runways. We need those runways to be visible and well lit—meaning that we need a clear pipeline of community-based investment opportunities that take economic advantage of the growth we are experiencing to broaden opportunity for people living in conditions of economic distress.

As I see it, this group gathered here today has the resources, aligned interests, and capacity to build and augment Savannah's runways. We at the Atlanta Fed stand ready to help.

Thank you. Now I'll be glad to take a few questions.