

Defining Data Dependence

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- Atlanta Fed president and CEO Raphael Bostic presents his view of the current economy, his economic outlook, and his definition of data dependence at the Chattanooga Area Chamber of Commerce.
- Bostic says that 2018 was a stellar year in terms of aggregate economic statistics and that the Federal Open Market Committee has likely come close to achieving a neutral monetary policy stance.
- His current baseline outlook for the U.S. economy in 2019 is for another year of solid growth, although a bit slower than in 2018 as the temporary effects from fiscal stimulus and tax reform begin to fade.
- Bostic says that the execution of data dependence employs multiple efforts at the Atlanta Fed that go well beyond just tracking the official statistics. He also leans heavily on an extensive network of business contacts, community groups, and nonprofit organizations.
- Bostic notes that grassroots intelligence from Main Street and messages from Wall Street indicate heightened uncertainty and concern about the economy, but the aggregate economic data continue to paint a robust picture.
- Bostic feels the appropriate response to these mixed signals is to be patient in adjusting the stance of policy and to wait for greater clarity about the direction of the economy and the risks to the outlook.

Good morning. I'm pleased to be here in Chattanooga. I'd like to recognize Ben Brock, one of our Bank's Nashville Branch directors, and Craig Holley, a former Nashville Branch director, as well as to thank Chattanooga mayor Andy Berke and Hamilton County mayor Jim Coppinger.

We at the Federal Reserve Bank of Atlanta see Chattanooga as an important city in the Sixth District. Three years ago, the Atlanta Fed's community and economic development staff highlighted your city's well-documented resurgence as part of its Small Cities Study Tour. They went so far as to describe Chattanooga as "the poster child for the modern American small city renaissance." What made the difference? A unique network of committed funders, leaders, and volunteers drove development and innovation. This network has been complemented by an engaged and active local government that sustained these efforts.

Over time, progress has become an expectation here. You are driven by moving toward the next great thing for your city and then by telling your story well. Many of you are responsible for this inspiring story. I applaud your vision and energy.

At a national level, we begin the new year with some of that hopefulness for the economy. Yet there seems to be a dichotomy between the strength of the economic data we have in hand and the many expressions of uncertainty we've been hearing about the economy's forward path. Today, I'd like to explain how I am analyzing these crosscurrents as I form my views on monetary policy.

I'll begin with current conditions and talk about some of the tools we have and outreach we conduct at the Atlanta Fed that go well beyond the official statistics to help inform us of emerging trends. I'll explain how the Fed's connection with Main Street is a key element of what I mean by data dependence. Then I'll offer my economic outlook and some of the risks I am seeing around that outlook.

As always, the views I will express are my personal views. My colleagues on the Federal Open Market Committee, or FOMC, and in the Federal Reserve System may not agree.

Current economic conditions

Looking back, it is clear that 2018 was a stellar year. Real gross domestic product (GDP) likely expanded by more than 3 percent on a year-over-year basis in 2018, making it the strongest full year for growth during the current expansion, now more than nine years long.

Perhaps equally as impressive, the unemployment rate was at or below 4 percent for much of 2018, and payrolls increased by more than 2.5 million workers. Inflation—as measured by the personal consumption expenditures, or PCE, price index—on a year-over-year basis trended toward the Federal Open Market Committee's 2 percent inflation objective.

In short, the official aggregate statistics for 2018 looked quite good. This is an economy that, by all appearances, ought to be able to stand on its own, without much support, or accommodation, from monetary policy.

And it is largely from this standpoint that I supported the 25-basis-point increase in the federal funds rate at the December FOMC meeting. With this move, I think the Committee has likely come close to achieving a neutral policy stance—one that is neither providing accommodation nor is being restrictive and attempting to actively slow the economy.

I say “likely” because the neutral interest rate is not something we directly observe, but is something that we infer from mounds of data, economic and statistical models, and a healthy dose of judgment. There’s a fair amount of uncertainty regarding these estimates of the neutral rate, so we need a data-dependent approach to monetary policy going forward.

What is data dependence?

Any avid Fed watcher has, without a doubt, heard the phrase “data dependence” myriad times. If you’ll indulge me for a moment, I’d like to explain what it means to me. Yes, data dependence means paying close attention to official data releases that help inform us about the aggregate economy from three-lettered organizations headquartered in the Washington, DC, area—places like the BEA (the Bureau of Economic Analysis) and the BLS (the Bureau of Labor Statistics), for example. But it also includes monitoring data regarding financial market conditions, data that inform me about global economic conditions, and data from a variety of surveys to keep me abreast of changes in sentiment that may affect business and consumer decision-making.

I look to these other sources because, more often than not, available data aren’t sufficient to get a full view of developing economic conditions. This is the reason that my execution of data dependence employs multiple efforts at the Atlanta Fed that go well beyond just tracking the official statistics.

In some cases, we have taken publicly available data and created new tools that are more closely tailored to the needs of a central banker. One of these tools is the Wage Growth Tracker, which gives us a read on wage growth that’s less likely to be influenced by changes in the flow of people into and out of employment. Another is GDPNow, a tracking estimate of current-quarter real GDP growth designed to mimic the BEA’s procedures and give us an early heads-up on the next official GDP estimate. Both of these are available on our website, and I encourage you to sign up and follow them.

In addition, my views are substantially informed by several efforts at the Atlanta Fed that leverage the knowledge of people like those of you in this room. Two important initiatives are our Business Inflation Expectations Survey and the Survey of Business Uncertainty, which we developed with partners at the Chicago Booth School and Stanford University. These surveys fill gaps in the data regarding the inflation expectations of firms and how today’s environment is affecting their decision-making and uncertainty about hiring and capital investment plans.

But I also lean heavily on an extensive network of business contacts, community groups, and nonprofit organizations. Some of you are familiar with the Atlanta Fed’s Regional Economic Information Network (or REIN). Many of you know Laurel Graefe and her colleagues at our Nashville Branch, who are with us here this morning. Laurel’s full-time job is to keep me

plugged in to the economic conditions on the ground. And she's not alone. REIN executives and their staffs in our four other branches and the Atlanta office help me glean a broader, more in-depth picture of the health of the economy than I could capture with my own outreach efforts or from economic models and official data alone. REIN is my critical connection to Main Street. This Main Street connection is a key element of what I mean by data dependence.

Economic outlook and risks

Ultimately, I have to turn all of these various data-collection efforts into an outlook for the overall economy. By its very nature, monetary policy has to be forward looking. The various sources of hard and soft data are useful in guiding my assessment of what the future is likely to bring and what important risks there are to that outlook.

My current baseline outlook for the U.S. economy in 2019 is for another year of solid growth, although I do expect growth to be a bit slower than in 2018 as the temporary effects from fiscal stimulus and tax reform begin to fade. From there, my projection is that growth will ease further to a bit below 2 percent by the end of 2020. It is important to stress that this lower pace of growth does not show fundamental pessimism about the economy. Rather, it mostly reflects the reality that the size of the working-age population—the key input into producing goods and services—is expected to grow much more slowly over the next decade or so than it has in the past.

Inflation, in my baseline projection, remains relatively close to the FOMC's 2 percent target, reflecting my confidence that monetary policy will be able to foster price stability amid robust labor markets and alongside the solid trajectory for growth that I just mentioned.

Could the economy grow faster than I expect without causing a breakout of much higher inflation? Yes. It is possible that labor productivity—the ability to produce extra value for every hour worked—will grow more rapidly than it has over the last decade. Over the past 10 years, productivity growth has averaged around 1.3 percent a year, a stark contrast to the nearly 3 percent pace experienced during the early 2000s.

So, why don't I have a significant pickup in productivity growth baked into my outlook? Primarily because a key driver of productivity growth is capital spending, and readings on capital spending since mid-2018 have been relatively subdued. They are not consistent with the business sector ramping up for significantly expanding capacity. For example, overall investment in equipment and software appears to have slowed, while investment in nonresidential structures has declined. Moreover, recent business survey readings on the outlook for capital expenditures in 2019 have softened considerably.

I'll admit that changes in productivity are difficult to anticipate, and perhaps we are on the cusp of a new era of higher productivity growth. Absent a sustained uptick in productivity growth, better-than-expected GDP growth will require a continued strong pace of hiring. But the prospect of continuing to add roughly 200,000 new jobs to the economy each month will become increasingly doubtful without risking a significant rise in labor costs and potentially higher inflation.

By most measures, labor markets are already tight. The national unemployment rate is at a roughly 50-year low, and here in the Chattanooga area, it is as low as it was during the late 1990s. Business leaders I speak with have been increasingly frustrated by the difficulty in filling vacancies and retaining staff. Workers are leaving their current jobs for new ones at a high rate, yet firms are reporting that it is taking longer and longer to fill vacancies. That said, we haven't yet seen any evidence that growth in labor costs has become significantly disentangled from average productivity growth and stable inflation. But it's definitely something I'm watching as 2019 unfolds.

As you might expect given the recent upheaval in financial markets, there are many additional risks to my baseline outlook. I view recent market turmoil as not the cause, but a symptom of the various concerns and uncertainties surrounding the outlook. These include slowing global growth, uncertain trade policy, worries over the trajectory of growth domestically, and concern regarding the expected stance of monetary policy.

In face-to-face interviews with contacts and through the efforts of REIN, businesses in the Sixth Federal Reserve District appear to be growing more concerned about future business conditions, creating a "risk-off" environment with regard to business plans. To this end, I heard a few reports that companies are starting to examine their own business strategies and initiatives in anticipation of slowing economic conditions—either through deleveraging or holding off on expansionary projects.

Worries over tariffs and trade have dominated the conversations about the outlook and are present in the survey evidence we collect. Every December for the past few years, we have asked Sixth District firms in our Business Inflation Expectations Survey to provide their biggest concerns for the year ahead. We then categorize their responses into a broad set of topics. Over the past three years, "costs" has topped the list. The interesting part is that inside this broad category, the main driver of cost concerns has changed each year. This year, tariffs emerged as the dominant source of concern regarding business costs in the year ahead, even outstripping concerns over labor costs.

While these businesses appear to have absorbed the initial rounds of tariffs, should tariff rates increase from here or encompass a broader set of goods, my contacts have said this would likely create significant challenges. Many appear to have reached their limit on cost-absorbing measures, making a possible next round of tariffs a more direct hit to the consumer. Concerns

over what that would do to sales growth are top of mind among these business contacts at the moment.

Data-dependent approach to monetary policy

So grassroots intelligence from Main Street and messages from Wall Street indicate heightened uncertainty and concern about the economy. But the aggregate economic data continue to paint a robust picture. What is a policymaker to conclude from these mixed signals?

To me, the appropriate response is to be patient in adjusting the stance of policy and to wait for greater clarity about the direction of the economy and the risks to the outlook.

Should conditions play out along my baseline outlook, I see little need to engage in restrictive monetary policy and push the federal funds rate above a neutral stance. All the available evidence at the moment points to caution regarding firms' approach to expansion. As long as that caution exists, I suspect it will act as a natural governor, limiting inflationary forces without the need for a muscular stance of policy. But I am not taking this outcome for granted. My staff and I will continue to closely monitor the path of our progress in meeting the Federal Reserve's objectives for both maximum employment and price stability.

To sum up, my view is that a patient approach to monetary policy adjustments in the coming year is fully warranted in light of the uncertainties about the state of the economy and about what level of policy rates is consistent with a neutral stance. That is what I mean by data dependence.