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Statement by

Janet L. Yellen

Chair

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Joint Economic Committee

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Chairman Coats, Ranking Member Maloney, and members of the Committee, I appreciate the opportunity to testify before you today. In my remarks I will discuss the current economic outlook before turning to monetary policy.

The Economic Outlook

The U.S. economy has recovered substantially since the Great Recession. The unemployment rate, which peaked at 10 percent in October 2009, declined to 5 percent in October of this year. At that level, the unemployment rate is near the median of Federal Open Market Committee (FOMC) participants' most recent estimates of its longer-run normal level. The economy has created about 13 million jobs since the low point for employment in early 2010, and total nonfarm payrolls are now almost 4-1/2 million higher than just prior to the recession. Most recently, after a couple of months of relatively modest payroll growth, employers added an estimated 271,000 jobs in October. This increase brought the average monthly gain since June to about 195,000--close to the monthly pace of around 210,000 in the first half of the year and still sufficient to be consistent with continued improvement in the labor market.

At the same time that the labor market has improved, U.S. economic output--as measured by inflation-adjusted gross domestic product (GDP), or real GDP--has increased at a moderate pace, on balance, during the expansion. Over the first three quarters of this year, real GDP is currently estimated to have advanced at an annual rate of 2-1/4 percent, close to its average pace over the previous five years. Many economic forecasters expect growth roughly along those same lines in the fourth quarter.

Growth this year has been held down by weak net exports, which have subtracted more than 1/2 percentage point, on average, from the annual rate of real GDP growth over the past

three quarters. Foreign economic growth has slowed, damping increases in U.S. exports, and the U.S. dollar has appreciated substantially since the middle of last year, making our exports more expensive and imported goods cheaper.

By contrast, total real private domestic final purchases (PDFP)--which includes household spending, business fixed investment, and residential investment, and currently represents about 85 percent of aggregate spending--has increased at an annual rate of 3 percent this year, significantly faster than real GDP. Household spending growth has been particularly solid in 2015, with purchases of new motor vehicles especially strong. Job growth has bolstered household income, and lower energy prices have left consumers with more to spend on other goods and services. Increases in home values and stock market prices in recent years, along with reductions in debt, have pushed up the net worth of households, which also supports consumer spending. Finally, interest rates for borrowers remain low, due in part to the FOMC's accommodative monetary policy, and these low rates appear to have been especially relevant for consumers considering the purchase of durable goods.

Other components of PDFP, including residential and business investment, have also advanced this year. Indeed, gains in real residential investment spending have been faster so far this year than last year, although the level of new residential construction still remains fairly low. And outside of the drilling and mining sector, where lower oil prices have led to substantial cuts in outlays for new structures, business investment spending has posted moderate gains.

Turning to inflation, it continues to run below the FOMC's longer-run objective of 2 percent. Overall consumer price inflation--as measured by the change in the price index for personal consumption expenditures--was only 1/4 percent over the 12 months ending in October. However, this number largely reflects the sharp fall in crude oil prices since the summer of 2014.

Because food and energy prices are volatile, it is often helpful to look at inflation excluding those two categories--known as core inflation--which is typically a better indicator of future overall inflation than recent readings of headline inflation. But core inflation--which ran at 1-1/4 percent over the 12 months ending in October--is also well below our 2 percent objective, partly reflecting the appreciation of the U.S. dollar, which has pushed down the prices of imported goods, placing temporary downward pressure on inflation. Even after taking account of this effect, however, inflation has been running somewhat below our objective.

Let me now turn to where I see the economy is likely headed over the next several years. To summarize, I anticipate continued economic growth at a moderate pace that will be sufficient to generate additional increases in employment and a rise in inflation to our 2 percent objective. Although the economic outlook, as always, is uncertain, I currently see the risks to the outlook for economic activity and the labor market as very close to balanced.

Regarding U.S. inflation, I anticipate that the drag due to the large declines in prices for crude oil and imports over the past year and a half will diminish next year. With less downward pressure on inflation from these factors and some upward pressure from a further tightening in U.S. labor and product markets, I expect inflation to move up to the FOMC's 2 percent objective over the next few years. Of course, inflation expectations play an important role in the inflation process, and my forecast of a return to our 2 percent objective over the medium term relies on a judgment that longer-term inflation expectations remain reasonably well anchored.

Monetary Policy

Let me now turn to the implications of the economic outlook for monetary policy. In the policy statement issued after its October meeting, the FOMC reaffirmed its judgment that it would be appropriate to increase the target range for the federal funds rate when we had seen

some further improvement in the labor market and were reasonably confident that inflation would move back to the Committee's 2 percent objective over the medium term. That initial rate increase would reflect the Committee's judgment, based on a range of indicators, that the economy would continue to grow at a pace sufficient to generate further labor market improvement and a return of inflation to 2 percent, even following the reduction in policy accommodation. As I have already noted, I currently judge that U.S. economic growth is likely to be sufficient over the next year or two to result in further improvement in the labor market. Ongoing gains in the labor market, coupled with my judgment that longer-term inflation expectations remain reasonably well anchored, serve to bolster my confidence in a return of inflation to 2 percent as the disinflationary effects of declines in energy and import prices wane.

Committee participants recognize that the future course of the economy is uncertain, and we take account of both the upside and downside risks around our projections when judging the appropriate stance of monetary policy. In particular, recent monetary policy decisions have reflected our recognition that, with the federal funds rate near zero, we can respond more readily to upside surprises to inflation, economic growth, and employment than to downside shocks. This asymmetry suggests that it is appropriate to be more cautious in raising our target for the federal funds rate than would be the case if short-term nominal interest rates were appreciably above zero. Reflecting these concerns, we have maintained our current policy stance even as the labor market has improved appreciably.

However, we must also take into account the well-documented lags in the effects of monetary policy. Were the FOMC to delay the start of policy normalization for too long, we would likely end up having to tighten policy relatively abruptly to keep the economy from significantly overshooting both of our goals. Such an abrupt tightening would risk disrupting

financial markets and perhaps even inadvertently push the economy into recession. Moreover, holding the federal funds rate at its current level for too long could also encourage excessive risk-taking and thus undermine financial stability.

On balance, economic and financial information received since our October meeting has been consistent with our expectation of continued improvement in the labor market. And, as I have noted, continuing improvement in the labor market helps strengthen our confidence that inflation will move back to our 2 percent objective over the medium term. That said, between today and the next FOMC meeting, we will receive additional data that bear on the economic outlook. These data include a range of indicators regarding the labor market, inflation, and economic activity. When my colleagues and I meet, we will assess all of the available data and their implications for the economic outlook in making our policy decision.

As you know, there has been considerable focus on the first increase in the federal funds rate after nearly seven years in which that rate was at its effective lower bound. We have tried to be as clear as possible about the considerations that will affect that decision. Of course, even after the initial increase in the federal funds rate, monetary policy will remain accommodative. And it bears emphasizing that what matters for the economic outlook are expectations concerning the path of the federal funds rate over time: It is those expectations that affect financial conditions and thereby influence spending and investment decisions. In this regard, the Committee anticipates that even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run.

Summary

In closing, the economy has come a long way toward the FOMC's objectives of maximum employment and price stability. When the Committee begins to normalize the stance of policy, doing so will be a testament, also, to how far our economy has come in recovering from the effects of the financial crisis and the Great Recession. In that sense, it is a day that I expect we all are looking forward to.

Thank you. I would be pleased to take your questions.