Longer-Term Labor Market Trends, the Economic Outlook and Monetary Policy

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I'm pleased to be in Albuquerque with our Kansas City and Denver office boards of directors.

As a regional Federal Reserve Bank president, I gain important insights about the regional and national economy from visits like this one, where I have the opportunity to meet with business and community leaders. Their perspectives and concerns, combined with economic data and analysis, help shape my own views on monetary policy.

In my remarks today, I'll talk about the economic issues we see in New Mexico and the nation. I'll also note the current stance of interest rate policy, and why, as a voting member of the Federal Open Market Committee this year, I have argued that interest rates should gradually return to more normal levels. Before I continue, however, I want to note that these are my own views and are not necessarily representative of others in the Federal Reserve System.

The New Mexico Economy

New Mexico has struggled to recover from the recession that ended nearly seven years ago. Although employment has increased, the gains have been modest and held back by several factors. First, the construction sector was slow to bounce back after the severe downturn in the housing sector. The crisis left the state with high inventory levels and sharply lower prices. Then, austerity measures at the federal government level led to cutbacks that were sharply felt here. As neighboring states recovered more quickly, New Mexico saw workers move out of the state, exacerbating its challenges.

Over the past year, new concerns have emerged and growth has slowed once again. Parts of the state that had been doing quite well are now facing sharp declines in activity due to weakness in the energy and agriculture sectors. Employment in the energy sector has declined 26 percent in New Mexico over the past year, and weakness is starting to spread to related industries, with the transportation and wholesale trade sectors also reporting employment losses. The drop in energy activity is also starting to weigh on state and local finances, which can lead to government spending cuts that can further weigh on employment.

At the same time, there are other sectors and areas of the state that are doing better. Employment growth in Albuquerque recently reached its fastest pace since mid-2013, and outside of energy and agriculture-dependent areas, it appears that the recovery is accelerating. Home inventory levels have dropped significantly in the metro area, home prices have stabilized, and residential construction activity is finally picking up. The healthcare sector also continues to expand and tourism activity has picked up over the past couple of years. Yesterday, I had the opportunity to visit the Sandia Peak Tramway and the Anderson Abruzzo International Balloon Museum with our Kansas City and Denver Branch Boards of Directors. We heard about the robustness of the tourism industry in the state and the wonderful Balloon Fiesta that takes place here each fall. Then, this morning, we heard about another growing sector in the New Mexico economy—entrepreneurship.

Overall, healthcare, tourism, construction and entrepreneurship are poised to drive growth in the Albuquerque area, though softness in the energy, agriculture, and state and local government sectors will likely remain for some time.

The U.S. Economic Outlook

You may ask how the economic developments facing New Mexico fit into the larger regional, as well as national, picture. Throughout the Tenth Federal Reserve District, which covers seven states, the fall in commodity prices has been a major economic shock. While the recent increase in the price of some commodities offers a bit of relief, there is little doubt that lower prices will require some major adjustments. For example, energy production will likely continue to decline and workers in the sector will need to look to other industries that are doing better, such as construction. In addition, the manufacturing and export sectors have been contracting, reflecting both the decline in energy activity and the strong dollar.

Even as these sectors of our economy face strains, other aspects of the regional and national economy show more robust growth. In fact, the U.S. economy has proven itself to be quite resilient in recent years, and I expect the moderate pace of growth experienced during this recovery will continue. Granted, the economy is subject to some short-term ups and downs. We saw GDP growth was rather weak during the first quarter, but the growth rate over the past year is near 2 percent—a pace that is close to the average during this recovery. More importantly, employment growth has remained strong. The economy has added close to 200,000 jobs on average each month this year.

The longer-term pace of job growth has also been quite robust. As a result, the unemployment rate currently stands at about 5 percent, compared to 10 percent after the financial crisis in 2009. Of course, the unemployment rate is an imperfect measure of the labor market, so I also pay close attention to other data. For example, one development I find promising is that many individuals who had dropped out of the workforce are finding jobs. After the crisis, the percentage of people participating in the labor market fell sharply. Some of this is because our population is aging, so people naturally work less as they get older. However, some of the decline in labor force participation was due to workers being discouraged about their job prospects. More recently, however, we have seen an upswing in people finding jobs who had previously stopped looking for one. For example, close to 2 million workers returned to the labor force over the past six months. This pace of re-entry is close to the fastest pace in more than 15 years.

Despite these positive developments, wage growth has remained sluggish and many people still feel like they have limited options in the labor market. That being the case, let me spend some time on the labor market.

Labor Market Trends From Two Perspectives

As I travel around my region to meet with business, community, and labor leaders, I often hear them describe the job market from two very different perspectives. One perspective is of a booming labor market, rising wages and an abundance of opportunity. The other perspective is of stagnant wage growth, limited upward mobility and job insecurity.

How can these different views be reconciled? Looking at general labor market data, we have seen a steady improvement in employment over the past seven years. In fact, 14 million net new jobs have been created since the crisis. Along with an unemployment rate that is currently near normal, the economy appears to be close to full employment. As a result, many business leaders often discuss the challenge of hiring workers with the right skills and say that numerous job openings remain unfilled. In fact, there are currently around 5.8 million job openings in the United States, which is near the highest level on record. I often hear about the need to raise wages rapidly to retain these workers, and as a result, the national data showing slow wage growth doesn't ring true to many business leaders. But while this aspect of job growth looks pretty good, there are underlying trends that suggest that the recovery has not been evenly spread across all types of workers.

The other perspective on labor market developments reflects a trend that has been present over the past three decades. In particular, the share of workers in middle-skill jobs has fallen sharply. For decades, these jobs were the bedrock professions of the middle class. If we look back to the 1980s, examples of middle-skill jobs that were much more prevalent than today include assembly-line manufacturing jobs, clerical and administrative positions.

The steady decline in these types of jobs is not a new story. However, demand for both higher-skilled and lower-skilled workers is growing faster relative to middle-skilled workers. This employment phenomenon is called "job polarization." In 1983, nearly 60 percent of all jobs were in middle-skill occupations. By 2016, that share has declined to 44 percent. By current employment levels, this would be equivalent to a shift of 22 million jobs away from middle-skill occupations toward both high- and low-skill occupations.

The decline in middle-skill jobs is the result of a number of sweeping changes affecting the economy. With the adoption of computers and advanced technologies, businesses have fundamentally changed the way they operate and the types of workers that they require. At the same time, the rapid increase in globalization has provided new opportunities for some companies, while increasing competition for others.

Manufacturing, for instance, is a sector that has historically demanded a large number of middle-skilled jobs. However, both global forces and technological advances have had a profound effect on manufacturing employment. Today, fewer than 10 percent of workers in the United States are employed in the manufacturing sector compared to more than 20 percent in 1980. These trends are unlikely to reverse, and continued technological innovations will likely broaden their reach into both higher- and lower-skilled jobs.

The dramatic shifts tied to job polarization offer some explanation as to why many people feel that their economic prospects haven't improved. On average, salaries for middle-skill jobs are close to the median income for all workers. As opportunities for working in a middle-skill job, and thus a middle-class lifestyle, have dwindled, workers have increasingly been faced with a choice between two distinct paths. For workers who acquire the education and training required for high-skill jobs, they have the opportunity to pursue employment in jobs that typically pay 50 percent more than the median salary. But for those workers who do not have the needed training and skills, their options are increasingly shifting toward low-skill jobs that typically pay 50 percent below the median salary.

Understanding these trends helps to reconcile the two versions of the labor market I described earlier. Business leaders trying to develop new businesses and technologies require high-skilled workers, which remain in short supply. Alternatively, the millions of other workers in traditional middle-skill occupations may not have the option of spending months, or years, to update their skills. These workers face insecurity about their career.

The Role of Monetary Policy

As the Federal Reserve considers these and other economic trends, it must weigh a number of crosscurrents to determine the appropriate interest rate policy. In the short-run, I continue to monitor how the energy, agricultural and manufacturing sectors are adjusting relative to the national economy. And over the longer-run, I evaluate what trends like job polarization mean for monetary policy. These are challenging questions with no easy answers. For the most part, monetary policy is limited in the support it can offer any particular sector. It is also limited in its ability to affect trends like job polarization.

Instead, monetary policy has the broad goals of promoting stable prices, full employment, and moderate long-term interest rates. Since the crisis, conditions have improved sufficiently that the FOMC deemed it appropriate to raise the target range for the federal funds rate by 25 basis points last December. This was a significant step, as it was the first increase in short-term interest rates since the middle of 2006. No further adjustments have occurred this year, as the FOMC weighs economic developments and monitors risks to the outlook. The current setting for the federal funds rate is well below what the FOMC expects will prevail in the longer term. The plan is to move gradually and in a way that is responsive to economic developments.

I support a gradual adjustment of short-term interest rates toward a more normal level, but I view the current level as too low for today's economic conditions. The economy is at or near full employment and inflation is close to the FOMC's target of 2 percent, yet short-term interest rates remain near historic lows. Just as raising rates too quickly can slow the economy and push inflation to undesirably low levels, keeping rates too low can also create risks. Interest-sensitive sectors can take on too much debt in response to low rates and grow quickly, then unwind in ways that are disruptive. We witnessed this during both the housing crisis and the current adjustments in the energy sector. Because monetary policy has a powerful effect on financial conditions, it can give rise to imbalances or capital misallocation that negatively affects longer-run growth. Accordingly, I favor taking additional steps in the normalization process.

Moving rates to a more-normal level and at a gradual pace is necessary to minimize distortions in the economy that can build over many years when rates are held so low. With gradual adjustments, the Federal Reserve is more likely in my view to achieve its long-run goals and by doing so, foster conditions for steady growth that benefit both New Mexico and the nation.