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The Economic Outlook: The View from the Fed

The House Budget Committee recently heard testimony from The Hon. Jerome H. Powell, Chair of the Board of Governors of the Federal Reserve System (Fed). This was the first time that the Fed chair appeared before the Committee since 2012. In his testimony, Chair Powell discussed the outlook for the economy, monetary policy, and the federal budget. Below are four key takeaways from the hearing.

The Labor Market Still Has Room to Run

Chair Powell touted the United States' record-long economic expansion, which began under President Obama and is now in its 11th year, but noted that trade tensions and a global economic slowdown present risks to the outlook. In spite of these headwinds, the Fed forecasts a strong labor market going forward and believes there remains considerable room for the labor market to further improve.

"Labor force participation is a very important issue for the United States that needs urgent attention" – Labor force participation among people in their prime working years (the share of the 25-54 year-old population that is either employed or looking for a job) has steadily increased since 2015, but it remains below its peaks before the Great Recession. Critically, as Chair Powell emphasized, we "lag other comparable countries, essentially all of them now, in labor force participation." Powell noted that a variety of policies have been found to stimulate participation, including those "that support childcare and family leave." Achieving higher labor force participation rates would, Powell argued, "be a very positive supply shock" and "lead to higher growth and be a positive thing for everyone."

"We bring significant humility to the question of what is the level of maximum employment" – Chair Powell explained that though the unemployment rate has fallen steadily since the recession to half-century lows, "inflation is not under a lot of upward pressure from labor markets being too tight or the economy being too strong." This has led the Fed to believe "we are in the neighborhood" of full employment, "but we have no reason to think that the current level of unemployment is unsustainable." Powell additionally noted that while wage gains picked up over the last year as the labor market tightened, "We have wondered why they haven't moved up further." He suggested several potential factors – including declining unionization, market concentration, globalization, automation, and demographic trends – that would explain "why wages haven't gone up more."

Fiscal Policy Will Be Critical in the Next Recession

Chair Powell also highlighted the significant role fiscal policy must play in fighting the next economic downturn – a topic the Committee explored in a hearing earlier this year. With interest rates already very low, the Fed will have less room to cut rates in response to a weakening economy than it has in the past. This places greater responsibility on Congress to deploy fiscal policy quickly and aggressively when the next recession hits.

"Fiscal policy has always played a very important role in significant downturns" – Chair Powell reminded members that fiscal policy, through both automatic stabilizers and discretionary spending, has long been a critical tool for countering economic downturns. While the Fed stands ready to cut interest rates and use other "unconventional" policies – such as forward guidance and large-scale asset purchases – "aggressively, as appropriate" in response to a future recession, Powell emphasized that "fiscal policy is very powerful in supporting demand in a weak economy." Moreover, because the Fed has "a little bit less" capacity to respond to a downturn than in previous years, it is even more important that Congress be prepared to do its part and help fight the next recession.

"There is fiscal space to react today, and there will be for some time" – Chair Powell repeatedly affirmed that the United States has the budgetary capacity to respond to the next recession, whenever it comes. At the same time, he warned that rising debt levels over time could eventually "make Congress less willing to take steps to support the economy at times when that is needed." Accordingly, Powell argued that returning the federal budget to a sustainable long-term path is critical to "help ensure that policymakers have the space to use fiscal policy to assist in stabilizing the economy if it weakens."

Our Fiscal Challenge is Long Term

Chair Powell underscored that the federal debt is on an unsustainable path, noting that "the debt can't ultimately continue to grow faster than the economy." But in contrast to Republican claims that we are teetering on the brink of a full-blown fiscal crisis, Powell stressed that "these are longer-term challenges" that must be addressed over time. As he explained, there is no obvious tipping point the federal debt is approaching, and other countries have much larger debt burdens that have not fueled fiscal crises. Instead, to avoid the "slow-motion stagnation" that high and rising debt levels risk triggering, Congress must take steps to *gradually* return our debt to a sustainable course.

"I think that the most successful plans to get back on a sustainable path are those that take place consistently over a long period of time" – Drawing on historical experience, Chair Powell advised that our fiscal challenge should be addressed steadily over several decades and warned that sharp spending cuts – including for discretionary programs, many of which "add to the longer run economic growth of the United States" – would be unwise. As he argued, "You don't have to pay the debt off. You don't have to balance the budget in any particular year. You just have to have the economy growing faster than the debt. And that should happen over a long period of time." Powell further emphasized that there is no "substitute for having a national consensus around the need to get on a more sustainable path over time, and that takes leadership."

"The problem we have is really around health care delivery" – Chair Powell identified inefficient health care delivery as "what really is driving the unsustainability of our budget." He explained the United States spends 17 percent of GDP on health care while other advanced economies spend 10 percent of GDP. But "it is not that we are delivering too good health, by the way. We are delivering pretty average health, and we are spending a trillion and a half more than we need to spend to do that." Powell suggested that our health care delivery system "is where I would be looking" to address the nation's long-term fiscal challenge.

Investing in Our Future Will Strengthen Our Economic Outlook

Chair Powell also highlighted other critical challenges facing the United States economy over the longer run, notably inequality and slowing labor force growth – issues the Committee explored in depth in hearings this year and that Democrats remain committed to addressing.

"We want prosperity to be widely shared across all spectrums of society" – Chair Powell pointed to the "relative stagnation of median incomes and lower incomes" and declining economic mobility as two concerning trends facing Congress. As he explained, "We think of ourselves, and proudly so, as a country where anybody can make it to the top, but the statistics show that people who are born in the bottom quintile of income or wealth in the United States have less of a chance to make it to the third quintile or the top quintile." Powell suggested that investing in education and training is vital to ensuring that economic growth is shared more broadly across the income distribution.

"A growing workforce is a source of growth, and immigration can be part of that" – Chair Powell explained that labor force growth is the primary driver, along with productivity, of our potential economic growth over the long run. Over the last several decades, however, U.S. labor force growth has slowed considerably as the population has aged, critically undermining our long-term economic potential. Powell argued that because half of the labor force growth we see today comes from immigrants, it follows that "if we are going to grow more as a country…those of you who do have responsibility for immigration policy…should know that that is a factor worth considering." At the end of the day, "We want to have a growing labor force."