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## President of San Francisco Fed Sees Slow Recovery, Especially in Jobs

By [SEWELL CHAN](#)

The United States faces the prospect of a jobless recovery, with painfully slow employment growth and the economy not operating at its full potential until 2013, a top [Federal Reserve](#) official said Monday.

The official, Janet L. Yellen, president of the Federal Reserve Bank of San Francisco, said that a sharp increase in worker productivity was “here to stay.”

She predicted that unemployment, now at 9.7 percent, would fall to 9.25 percent by the end of the year and around 8 percent by the end of 2011. And she described the current inflation rate as “undesirably low.”

The Fed has repeatedly said that it would not start to tighten credit for at least several months. When the time comes, Ms. Yellen said, the Fed will probably start by raising the interest rate it pays on bank reserves. Only after that will it gradually sell the [Treasury securities](#) and mortgage-related assets it bought to hold down long-term interest rates and support the recovery.

Markets are acutely interested in the timing and sequence of the Fed’s withdrawal of monetary stimulus, particularly after the Fed raised the rate it charges banks for short-term loans last week, a largely technical move but a crucial step toward the normalization of lending.

Ms. Yellen, who was chairwoman of the [Council of Economic Advisers](#) during the Clinton administration and is one of the best-known economists among the Fed’s leaders, spoke at the University of San Diego. In hearings on Wednesday and Thursday, the Fed’s chairman, [Ben S. Bernanke](#), is to present the central bank’s semiannual report on monetary policy to Congress.

Ms. Yellen offered a fairly grim outlook. Although gross domestic product rose at an annual rate of 5.7 percent

in the last quarter — the best gain in six years — the improvement was attributable to businesses reducing their inventories, rather than growth in sales, making a “V-shaped recovery” unlikely, she said.

She estimated that the economy would grow about 3.5 percent this year and 4.5 percent next year. Although the Fed lowered its benchmark interest rate to near zero in December 2008 and made big loans and asset purchases, Ms. Yellen said, “all in all, monetary policy can’t give the same kick to the economy that it delivered in past recoveries.”

Ms. Yellen also tried to explain why Okun’s Law, which describes the relationship between unemployment and changes in output, “let us down big time in 2009.” Given the lag between potential and actual output, unemployment should be lower than it is.

Ms. Yellen said she believed that the culprit was an increase in business efficiency and labor productivity.

“Strapped by tight credit and plummeting sales, businesses have overhauled the way they manage supply chains, inventory, production practices and staffing,” she said. “Stores don’t order merchandise unless they think they can sell it right away. Manufacturers and builders don’t produce unless they have buyers lined up. My business contacts describe this as a paradigm shift and they believe it’s permanent.”

Ms. Yellen believes that “economic slack and downward pressure on wages and prices are pushing inflation down.”

Large federal deficits have helped to buffer the economy from the [financial crisis](#) and the [recession](#), but if they persist into the recovery, they could push interest rates up and absorb private savings that would be otherwise used in productive investments, Ms. Yellen said.

Still, she said there was “no evidence that government deficits cause high inflation in advanced economies with independent central banks, like the Fed.” If anything, she said, Japan — which has run big deficits for years — has “suffered from persistent [deflation](#), not inflation.”

She called the underutilization in the American economy “the most worrisome challenge for price stability over the next few years.”

One of the problems cited by Ms. Yellen was the bleak state of the commercial real estate market, where mortgage-backed defaults and losses have been rising.

On Monday, the chairman of the Senate Banking Committee, [Christopher J. Dodd](#), Democrat of Connecticut, wrote to Mr. Bernanke and other federal regulators, asking them to report on efforts to stabilize that market.

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