BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF RESEARCH AND STATISTICS

Date: March 11, 2014

To: Federal Open Market Committee

From: David W. Wilcox

Subject: Assessing the downward pressure on price and wage inflation: Does the distinction between long-term versus short-term unemployment matter?

Several outside analysts have lately raised the possibility that the long-term unemployed might exert little or no downward pressure on price or wage inflation. These analysts have noted that while long-term unemployment remains very elevated by historical standards, short-term unemployment has returned roughly to its historical mean. If the long-term unemployed indeed do not hold inflation down, then inflation could move up substantially more quickly than is anticipated in the baseline staff forecast.

The attached memo, prepared by Katia Peneva, analyzes the empirical basis for the claim that the long-term unemployed do not matter for the evolution of price and wage inflation. The memo finds that the evidence in support of this claim is fragile. Accordingly, in gauging the extent of labor-market slack in the baseline forecast, we will continue to take into account the extent of long-term as well as short-term unemployment.