

## **Entrepreneurs and the Economy**

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Thank you very much for this opportunity to address such a distinguished group of business leaders and advocates for entrepreneurship within the Twin Cities' communities of color. It is truly an honor to be with all of you today as we celebrate the achievements of the Metropolitan Economic Development Association and its many clients.

The theme for this year's Annual Recognition Luncheon is resilience. Merriam-Webster defines "resilience," in part, as the "ability to recover from or adjust easily to misfortune or change." I think we can all agree that we have had our share of misfortune and change in the economy these past two years. As I will describe, the economy is on the way back to recovery—and that is due in no little measure to resilience on the part of entrepreneurs like you.

Now, I have to admit that resilience is a hard concept for an economist like me. Economists are all about numbers and measurement, and so we tend to find intangible qualities like resilience to be pretty frustrating. Nonetheless, recent research has taught us that it's impossible to understand why people become entrepreneurs without understanding exactly these kinds of intangibles. Of course, there are financial returns to being an entrepreneur. But the recent research makes clear that these financial returns are not notably higher than investing in the stock market. Small business owners do what they do in large part because they love what they are doing. Like resilience, their passion is hard to quantify—but is nonetheless essential.

I think that these kinds of intangible returns to entrepreneurship underscore the importance of support organizations like MEDA. Obviously, MEDA provides concrete

ways to help you increase the financial returns to your businesses. But, through events like this one, MEDA also provides a vehicle for you to interact with others like yourselves and share your experiences, both good and bad. In this way, MEDA enhances the nonfinancial returns to entrepreneurship—and helps support this invaluable part of our economy.

Let me move on to my forecast for the overall economy—but entrepreneurs will play a role there as well. Essentially, I am optimistic, especially regarding growth prospects and the impact of inflation. However, that optimism is tempered by my concerns about continued weakness in labor markets. As I will explain, I see these problems in labor markets as being closely related to difficulties in the banking sector—difficulties of significant import for entrepreneurs like you.

First, the good news: GDP growth has been positive in each of the past three quarters and was 3 percent in the first quarter of this year. I expect GDP growth to be near 3 percent again in the current quarter, and to average close to 3.5 percent over the next two years. The recovery is well under way.

I am often asked about the possible impact of European difficulties and uncertainties on my forecast. European growth remains low (less than 1 percent annualized in the first quarter of 2010), and many European countries face significant fiscal challenges. Europe's troubles can affect the United States in two ways. The first is direct: If they slip back into recession, then their demand for our goods will fall. The second is indirect: Our banks and other financial institutions face some amount of credit risk and exchange rate risk through their holdings of European securities. Fortunately,

both of these channels are small—for example, we export less than 2 percent of our total GDP to the European Union. For this reason, I believe that a European downturn would have only a modest impact on the pace of our recovery.

There is also good news about inflation. Over the first quarter of 2010, annualized PCE inflation was 1.5 percent. I expect it to remain at about this level during the rest of this year. We can get a market-based measure of inflation expectations over the next five years using yields to inflation-protected TIPS bonds. Those expectations are also under 2 percent.

On the other hand, I am concerned about the ongoing lack of vitality in the American labor market. The national unemployment rate is 9.7 percent. Correspondingly, private sector job creation remains weak—only 41,000 private sector jobs were created in May.

Unemployment is always slow to recover after recessions. However, its recovery seems likely to be even slower than usual this time, because of weakness in the banking sector. Bank lending continues to be highly subdued. In part, the low level of bank lending can be attributed to low loan demand. However, it is also attributable to ongoing difficulties in the banking sector. Some banks have asset quality problems. Most face significant uncertainty about the ultimate impact of proposed regulatory changes. These difficulties in the banking sector are likely to persist for the next year or even two.

The challenges in the banking sector affect job creation in ways that matter for you as entrepreneurs. Banks provide the majority of credit used by small businesses. Small businesses are an important source of job creation during economic recoveries.

Thus, the challenges for banks translate into difficulties for small businesses in obtaining requisite credit and into slower job creation for our country.

With all of these factors in play, I would be surprised if the national unemployment rate were to fall below 9 percent before the end of 2010 or below 8 percent by the end of 2011.

These problems in the labor market are short-term ones. In the longer term, I have great confidence in the resilience of American entrepreneurs and their ability to create jobs. Organizations like MEDA help support that resilience. And so I would like to close by offering congratulations to all those receiving special recognition today, and to all the entrepreneurs in this room and out there in the economy, and also to MEDA for all the great work that you do. Thank you.