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“Perspectives on the Economy and Policymaking”

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The views expressed today are my own, not necessarily those of my colleagues on the Federal Reserve Board of Governors or the Federal Open Market Committee.

Key Takeaways

1. Holistic Assessment: Collins reviews a wide range of information to assess the evolving economy. She looks for patterns and trends showing sustained reductions in inflation, and progress on the underlying goal of bringing demand and supply back into better balance. She notes that price stability is essential for a well-functioning economy and an important precondition for maximum employment that is sustainable over time.

2. Current Indications: Strong demand relative to supply has been a key factor driving higher inflation. While we are seeing some signs of moderation, demand continues to outpace supply, creating price pressures. Core inflation shows modest and relatively recent moderation. There are promising developments, but given continued strength in demand, Collins' view is that it is just too early to take the recent improvements as evidence that inflation is on a sustained path back to the 2% target.

3. Patience and Data Dependence: This phase of monetary policy calls for patience and holistic data dependence. One reason is the difficulty of extracting signal from noise in the data. Another is increased uncertainty about the timing and ultimate impact on the economy of policy tightening to date – including some reasons to expect longer lags than normal due to some unique aspects of the pandemic recovery.

4. Staying Resolute: Importantly, patience does not mean indecision, or a change in commitment to the 2 percent target and to achieving price stability in a reasonable amount of time. Collins expects we'll need to hold rates at restrictive levels for some time. And while we may be near, or even at, the peak, further tightening could be warranted, depending on incoming data. We are well positioned to proceed patiently, carefully, yet deliberately; recognizing the risks while remaining resolute.

5. Optimistic While Realistic: Continued restrictive monetary policy should temper demand further, to bring it into better balance with supply – however, Collins does not believe a significant slowdown is required. She remains realistic about the risks and uncertainties around the outlook, while optimistic that price stability is achievable with an orderly slowdown and only a modest unemployment rate increase – ideally preserving some of the current favorable labor market dynamics.

6. Engagement and Collaboration: The Fed's mandate and concern for a vibrant, inclusive economy lead us to study economic issues that prevent people from participating in the economy or workforce, as well as the gaps in wealth accumulation and prosperity. Collins will continue to prioritize hearing from those in a wide range of roles, who make up and shape our region's economy. The Boston Fed will continue working to support a vibrant, inclusive economy full of opportunity, working collaboratively with organizations across the region to understand and address challenges.

Good morning. It is a pleasure to be with you, at this podium where the New England Council hosts so many distinguished leaders. I'd like to thank Jim Brett for inviting me, early on, to speak with you.

I have been looking forward to this, because of my great appreciation for the Council, and its members, working to keep New England's economy vibrant. As a macroeconomist and former dean of a public policy school, I appreciate your focus on the ways policymakers, and organizations across New England, can collaborate in the public interest.

I also appreciate the New England Council's non-partisan nature, and the breadth of industries and sectors you work in. This an extraordinary region, in part because of that range – and the brainpower, innovation, and character New Englanders bring to the table.

My thanks as well to Jim, for contributing his insights over many years to an advisory council made up of small- and medium-sized businesses we convene at the Fed every quarter.

Today, I'll start with a bit of context about our work at the Fed. Then, I'll share some of my current views on the economy and monetary policy. Finally, I'll comment on some of the challenges and opportunities ahead, and the roles the Boston Fed and others can play. Then, I'll be happy to take questions. But first, my standard disclaimer: These perspectives are my own; I'm not speaking for any other Federal Reserve policymakers.

Context: Roles and Responsibilities Entrusted to the Fed

I like to say our work at the Fed is all about supporting a vibrant, inclusive economy that works for everyone, not just some people. As you know, the strength of an economy has many dimensions – so the Fed is involved in a number of activities, all in the public interest.

But let me underline an important distinction, which is not always well-understood. The Federal Reserve's activities are in monetary – not fiscal – policy. At the Fed, we're entrusted with *monetary* policymaking – in particular, setting short-term interest rates that ultimately affect the availability of money and credit for businesses and households. In this, we are guided by our dual mandate from Congress: stable prices and maximum employment. So we spend a lot of time analyzing economic conditions – using data, doing research, and listening to stakeholders locally and nationally.

The economy also needs reliable credit, and payment systems. The Fed is entrusted with responsibilities regarding the safety, soundness, and stability of the banking and financial systems; and we serve as a lender of last resort to financial institutions. We also provide back-end infrastructure to the banking system and the U.S. Treasury, ranging from currency and coin circulation, to various ways to transfer funds electronically. For many years we have been involved in innovating to make payments systems more effective and efficient.

The Economy, the Outlook, and Monetary Policy

I'll turn, now, to sharing some of my current views on the economy, the outlook, and monetary policy. Our focus at the Fed remains bringing inflation down to our 2 percent target.[1] Price stability is essential for a well-functioning economy and an important precondition for maximum employment that is sustainable over time – so reducing inflation relates to *both* parts of our dual mandate from Congress. And I continue to hear, in travels around New England, about the toll from high inflation on households – especially those with lower incomes, struggling to make ends meet – and on businesses, often as they grapple with higher costs and more complex planning and investment decisions.

I like to give my bottom-line up front, and in my view, this phase of our policy cycle requires patience, and holistic data assessment, while we stay the course. I expect we'll need to hold rates at restrictive levels for some time. And while we may be near, or even at, the peak for policy rates, further tightening could be warranted, depending on the incoming data. Patience will give us time to better separate "signal" from "noise" as we assess available data; and to balance risks, as the effects of tighter policy continue to work through the economy.

Let me briefly explain my rationale. Since I see holistic data assessment as particularly important in the current context, I've shared a handout with some charts showing just a few of the many data series I review, as part of the wide range of information I use to assess the evolving economy.

Current Economic Conditions

In reviewing economic data, I look for patterns and trends that show *both* sustained reductions in inflation, and progress on the underlying goal of bringing demand and supply back into better balance. I'll start there, because strong demand relative to supply has been a key factor driving higher inflation. While we are seeing some signs of moderation, demand continues to outpace supply, creating price pressures.

The black line in **Figure 1** shows how the level of real GDP (or the production of goods and services adjusted for inflation) has evolved *relative to trend*, shown by the

[1] "The FOMC judges that low and stable inflation at the rate of 2 percent per year, as measured by the annual change in the price index for personal consumption expenditures, is most consistent with achievement of both parts of the dual mandate." https://www.federalreserve.gov/monetarypolicy/monetary-policy-what-are-its-goals-how-does-it-work.htm

dotted line. The trend is an estimate of sustainable output for the economy over time.[2] A key takeaway is that GDP remains above trend — a sign of demand continuing to outstrip supply. Many forecasters expect continued above-trend growth this quarter. GDP growth has been supported, importantly, by resilient household consumption expenditures – shown by the light blue line – which is the largest component of aggregate demand.

What about inflation, in this context of demand still outpacing supply? There are many inflation indicators to watch, of course. Focusing on the Fed's preferred measure,[3] **Figure 2, Panel A** shows that on a year-over-year basis, total inflation (the dark blue line) has come down significantly from its peak but remains somewhat elevated. However, core inflation (the light blue line) shows considerably less progress, although with some improvement in recent months. While the core measure excludes the important but volatile food and energy components, it tends to better predict future inflation.

I'm showing these two panels side by side so you can see how the monthly inflation data – including core inflation, shown in **Figure 2, Panel B** – tend to be more variable than measures on a year-over-year basis. This variability has increased since the pandemic, a point I'll return to in a moment, and is one reason for being patient in assessing the data.

Figure 3 Panels A, B, and C show the three main components of core inflation. Since the components behave quite differently, looking at them separately helps to better assess price pressures. These charts include 3- , 6-, and 12- month annualized changes. The shorter horizons highlight recent developments – but are typically more variable, or "noisier." Looking at multiple time horizons can help paint a fuller picture of how inflation is evolving.

Panel A shows that the moderation in core inflation has come mainly from a significant decline in the core *goods* sector, where the resolution of supply chain bottlenecks has helped to better align demand with supply. Panel B shows that *shelter* inflation, though still high, has slowed recently as well: the 3-month change is below the 6-month. As moderation in new market rents continues to pass through, this decline will likely continue. However, as shown in Panel C, core *services* price inflation, excluding shelter, has slowed only modestly so far. This component accounts for about 55 percent of core inflation as measured by the price index for personal consumption expenditures (PCE).

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[2] This trend assumes real GDP growth of 1.8% per year. The shaded bar in the chart represents the pandemic recession.

[3] The Personal Consumption Expenditures or PCE index.

So, there are promising developments, but given the continued strength in demand, my view is that it is just too early to take the recent improvements as evidence that inflation is on a sustained path back to 2 percent.

I'll next turn briefly to the labor market. There too, demand continues to outstrip supply overall – a very familiar refrain in much of New England and across the country, for some time now – but we are seeing evidence of improved alignment. **Panel A of Figure 4** shows that payroll employment continues to grow above trend, but has been slowing. Lower voluntary quits and lower, though still high, job vacancies (not shown) are also consistent with a cooling but resilient labor market.

On the labor supply side, we've seen some recent increases in labor force participation, especially for prime-age workers (those aged 25-54) as shown **in Panel B.** It is encouraging that more people are entering the labor force, which is the reason why the unemployment rate ticked up to 3.8 percent in August — notably, a level that is still very low by historical standards.

I also review disaggregated labor market data, recognizing that aggregate numbers do not show the wide range of experiences across groups of people, sectors, and places. For example, **Figure 5** shows the persistent disparities in unemployment – for different racial and ethnic groups in panel A, and for people with different education levels in panel B. I'll have more to say about such disparities, in a moment.

Overall, then, rebalancing demand and supply in the labor market has some way to go. In particular, **Figure 6** shows wage inflation, measured here by the Employment Cost Index or ECI on a quarterly and yearly basis. Wage growth remains elevated in the current high inflation environment. Recognizing that workers benefit from increases in their *real* wages, or purchasing power, I look forward to returning to an environment with wage growth consistent with the 2 percent inflation target.[4]

Continued restrictive monetary policy should temper demand further to bring it into better balance with supply – however, importantly, I do not believe a significant slowdown is required. I have described myself for some time as a "realistic optimist" – realistic about the risks and uncertainties around a baseline outlook, while optimistic because the resilience I see leads me to believe price stability is achievable with an orderly slowdown and only a modest unemployment rate increase – ideally preserving some of the favorable labor supply dynamics.

Monetary Policy Lags and My Outlook

I'll shift now to a brief assessment of the impact of monetary policy actions to date, and my outlook.

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[4] Fed Chairman Jerome Powell has noted, "To be clear, strong wage growth is a good thing. But for wage growth to be sustainable, it needs to be consistent with 2 percent inflation." (see https://www.federalreserve.gov/newsevents/speech/powell20221130a.htm).

As **Figure 7** shows, starting in March 2022, we raised the federal funds rate target by five and a quarter percentage points in just 18 months, the fastest policy rate increase in 40 years. While the effects of higher interest rates were almost immediately evident in the housing sector, they have been slower to show through to broader indicators of activity, such as GDP and labor market statistics.

Typically, monetary policy actions are estimated to meaningfully affect broader measures of economic activity with a lag of four to six quarters.[5] But there is considerable variation around this estimate, and special factors in the pandemic recovery are likely making these lags longer than usual.

In particular, policy tightening has occurred amidst sound business and household fundamentals, compared to previous hiking cycles – likely implying a *longer* time for tighter credit conditions to work through the economy. For example, many firms had refinanced when interest rates were very low, somewhat insulating their investment plans from higher rates. And households that accumulated excess savings during the pandemic have needed to borrow less than usual so far, to finance expenditures.

So monetary policy may take longer than normal to affect the broader economy. But given that policy is clearly in restrictive territory, I do expect to see slowing growth by the end of this year and throughout 2024. And there are already some signs consistent with this outlook. Firms' cash levels are returning to pre-pandemic trends, and households' excess savings are declining.[6] Demand should slow as spending becomes more interest sensitive.

The goal is an orderly slowdown that better aligns demand with supply, which is essential to ensure that inflation is on a sustainable trajectory back to target.

Implications for Monetary Policy in an Uncertain Environment

I'll conclude my discussion of the economy by highlighting some considerations that underpin my outlook. The economic circumstances surrounding the pandemic and recovery have been, and continue to be, highly unusual, with implications for monetary policy. This complex topic is likely to be a long-term focus for analysis and research.

I've flagged two key dimensions: First, we're in a period where it is difficult to extract the signal from the noise in the data. As I noted, some data, such as monthly

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[5] These lags appear in various estimates of the effects of monetary policy, for instance those surveyed by Ramey (Ramey, V.A., 2016; "Macroeconomic Shocks and Their Propagation," in: J. B. Taylor & Harald Uhlig [ed.], *Handbook of Macroeconomics*, edition 1, volume 2, chapter 2, pages 71-162, Elsevier). A more recent study confirming significant lags in the effects is Romer and Romer (Christina D. Romer & David H. Romer, 2023; "Does Monetary Policy Matter? The Narrative Approach after 35 Years," *NBER Working Papers* 31170, National Bureau of Economic Research, Inc.).

[6] Some households, including those at the lower end of the income distribution, have likely already depleted any excess savings.

PCE inflation, are unusually volatile.[7] Second, there is increased uncertainty about the timing and ultimate impact on the economy from policy tightening to date. Reasons include the unusually sound initial business and household fundamentals, and the unusually rapid initial pace of tightening.

The risk of inflation staying higher for longer must now be weighed against the risk that an overly restrictive stance of monetary policy will lead to a greater slowdown in activity than is needed to restore price stability. This context calls for a patient and careful, but deliberate, approach to policy, allowing time to assess the effects of policy actions to date, and then acting appropriately. Importantly, patience does *not* mean indecision, or a change in the commitment to the 2 percent target, but rather time to ensure that the economy is on a clear trajectory to achieve price stability.

Overall, we are well positioned to proceed cautiously in this uncertain economic environment, recognizing the risks while remaining resolute and data-dependent, with the flexibility to adjust as conditions warrant.

A Vibrant, Inclusive Economy

I started with comments about the strengths of New England. I'd like to close by alluding to some of the *challenges* I hear about, too – and some of the things organizations like yours, and mine, are doing about them.

The privilege and responsibility of policymaking make engagement with stakeholders essential. So I will continue to prioritize taking cross-sector visits to each New England state, and hearing from those in a wide range of roles, who make up and shape our region's economy (see **Figure 8**).

Again, our domain at the Fed is monetary, not fiscal, policy. But our mandate and our concern for a vibrant, inclusive economy bring our focus to the challenges that prevent people from participating in the economy or the workforce – real economic issues like childcare, housing, climate, and infrastructure, such as transportation and broadband. And like many of you, we worry about the gaps in wealth accumulation and prosperity by group and place.[8]

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[7] Month-to-month consumer spending patterns have also been somewhat unusual and continue to evolve, complicating seasonal adjustment.

[8] The Boston Fed has a decades-long history of studying wealth disparities for groups and places. We believe better understanding these gaps can expand opportunities, making them more equitably available, help bring more people into the workforce, and strengthen economic growth and competitiveness. A healthy economy needs the best ideas, energy, and participation from everyone – with the opportunity to work hard, contribute, and prosper. In this context, the Boston Fed - working with community partners - recently launched a multi-year research initiative to explore wealth disparities in Greater Boston and across Massachusetts. Initial priorities for this work include measuring family wealth and exploring wealth differences between racial-ethnic groups and

These are very real challenges. But I remain optimistic about what we all, together, can accomplish when we care, collaborate, study, and act. Here are a few examples.

Many parts of New England that were once centers for manufacturing or natural resources have faced long-term challenges. Our Working Places initiative, started in 2014 under my predecessor Eric Rosengren, is based on research showing that an essential element of place-based economic resurgence is local, *cross-sector* collaboration. Now in 30 communities across 5 states, teams of local leaders choose a shared goal for improving the economy that benefits low-income people, and then develop and implement strategies. The Fed hosts, convenes, and supports these efforts – but not financially. The real work is in local ingenuity and commitment.[9]

Lack of affordable childcare is a very real economic issue across New England and nationally. Childcare gives options to parents who want or need to participate in the workforce. As an outgrowth of our Working Places effort, a team in Fitchburg has implemented a bilingual childcare entrepreneur training program to help support individuals in opening up their own small businesses in childcare. It has 80 graduates and just started its fifth cohort.[10]

Climate change is on many business and government leaders' minds, and the Fed's responsibilities make it important and prudent for us to study the issues. For example, our recent research examines potential costs related to climate change for Massachusetts cities and towns – and ultimately taxpayers. We find that per capita local spending could grow significantly in the decades ahead, with hotter and stormier weather increasing the cost of public works, government administration, operation of schools, and other public services.[11]

Last but not least, I mentioned earlier the Fed's work on payments. It wasn't that long ago that paper checks had to be flown around the country to settle at the bank they were drawn on – a slow, *costly* necessity. The Boston Fed and others helped pioneer digital check imaging, and expanded automated clearing – and more recently, creation of an entirely new instant-payments infrastructure to help banks of all sizes meet

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across geographies. We want to better understand why certain disparities persist, and hope the findings will be used by a broad group of public, private, and nonprofit organizations to develop solutions.

[9] Learn more about Working Places at https://www.bostonfed.org/workingplaces.aspx

[10] Learn more at https://www.bostonfed.org/workingplaces/news/2022/tackling-the-child-care-crisis-lele-teammates-see-child-care-training-need-fill-it.aspx. And similarly, the Waterbury, Connecticut Working Places team has provided training for residents looking to open licensed, home-based childcare facilities, opening 15 new facilities so far. The vision and effort is local, but organizations like ours can help spark or support the progress.

[11] See the summary by Larry Bean and the study by Bo Zhao: https://www.bostonfed.org/news-and-events/news/2023/01/price-tag-on-climate-change-bo-zhao-report-boston-fed-massachusetts.aspx

customer needs. In July, we launched the FedNow instant payments service – and the national program leader is the Boston Fed's C.O.O., Ken Montgomery.[12]

Concluding Observations

Across New England, I hear that people from all sectors want to collaborate and work together to solve problems like these. Efforts large and small, in combination, can make a real difference.

We will continue, at the Boston Fed, working to serve the public interest and support a vibrant, inclusive economy full of opportunity. It is a privilege and a responsibility, and we look forward to collaborating with many of you, to help the region thrive.

Thank you for having me join you today.

[12] See the announcement at https://www.frbservices.org/news/press-releases/072023-fednow-live-announcement