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Perspectives on the Economy

Remarks at the Annual Convention of the Maine Bankers Association

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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. Price stability is essential for a well-functioning economy, and an important precondition for maximum employment that is sustainable over time.

Collins continues to hear about the challenges households and firms face related to too-high inflation. The focus at the Fed remains bringing inflation down to the 2 percent target.

2. While recent inflation readings have been encouraging, inflation remains too high. Some important components of inflation have yet to show sustained improvement.

Although still elevated, inflation is down from its earlier peak. However, most of the moderation in core inflation has come from a decline in *goods* inflation. *Shelter* inflation has also moderated recently, and will likely ease further. However, inflation in core *services excluding shelter* (over half of the Fed's preferred inflation measure) has yet to show improvement consistent with price stability.

3. Collins fully supports the FOMC's attentiveness to inflation risks and commitment to price stability.

Sustained reductions in inflation will require demand coming into better balance with supply across the economy. While there is some evidence this realignment is underway, especially in the labor market, economic activity continues to be above trend and it is too soon to be confident that inflation is on a sustainable trajectory back to target. Collins agrees with the policy guidance in the median SEP projections which show rates staying higher, and for longer, than previous projections had suggested; and further tightening is certainly not off the table.

4. This phase of policymaking requires considerable patience, to extract the signal from noisy data and to allow some temporary factors to play out. Collins is realistic about risks, but optimistic about restoring price stability with an orderly realignment of demand with supply.

The economic circumstances surrounding the pandemic and recovery have been, and continue to be, highly unusual. This phase of monetary policy requires patience. Collins is a "realistic optimist" – realistic about the uncertainties, but optimistic that price stability can be restored with only a modest increase in the unemployment rate. She believes the pathway to achieving this outcome has widened.

5. Across Maine (and New England), local leadership efforts are addressing economic challenges and promoting resurgence.

There are many dimensions to economic prosperity – so the Fed has a broad portfolio, including encouraging local initiatives to foster economic resurgence in areas facing long-term struggles. An essential element is cross-sector collaboration among local individuals. In Maine, there are six such "Working Places" efforts, and the Fed simply helps the local networks emerge and flourish. Collaborating to improve opportunities for people and places to not be left behind – but rather join in the economy – is good economics, good citizenship, and good business.

Good morning. It is a pleasure being with you. I am always grateful for the opportunity to meet with Mainers, no matter the location, and have been to Maine multiple times. In fact, I've made a point of visiting all the New England states in this role – and will continue to do so.

I'll start by thanking two people. First is Jim Roche, president of the Maine Bankers' Association. We appreciate his continued engagement with us at the Boston Fed, as we all work to support a safe and sound banking system, which is so essential to a vibrant and inclusive economy. Second, I want to thank Jeanne Hulit, president and CEO of Maine Community Bancorp. Jeanne is of course a member of your association's executive committee. She's also a member of the Boston Fed's board of directors. We so appreciate the insights into Maine and New England business conditions she shares as a member of our board.

In the time we have today, I'll make some initial remarks, before taking a few questions. Of course, I'll share my views about the economic outlook and monetary policy. Then I'll provide a few perspectives on banking in New England and in particular Maine – highlighting the importance of banks of all sizes to a vibrant, inclusive economy. I'll end with a few points about the Fed's work across the region, and our shared opportunities to collaborate in the public interest.

The Economic Outlook and Monetary Policy

I'll start with some of my current views on the economy, the outlook, and monetary policy – especially given the Federal Open Market Committee's (FOMC's) decision on policy rates this week.[1] But first, my standard disclaimer: the views I express are my own; I'm not speaking for any other Fed policymaker.

Our focus at the Fed remains bringing inflation down to our 2 percent target.[2] Price stability is essential for a well-functioning economy, and an important precondition

[1] https://www.federalreserve.gov/newsevents/pressreleases/monetary20230920a.htm
[2] "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

for maximum employment that is sustainable over time – so reducing inflation relates to *both* parts of our dual mandate from Congress. And as I travel around the district, I continue to hear about the challenges households and firms face related to too-high inflation. On one of my trips to Maine I recall hearing about residents who were unable or unwilling to move within the state to take job offers, due in part to the rising costs of fuel, shelter, transportation, and other necessities.

However, there has been some promising news. Although still too high, inflation is down from its earlier peak. And there is some evidence demand and supply are realigning, especially in labor markets, which is needed to reduce the upward pressure on prices. Importantly, the current policy phase requires *patience*, allowing time to better separate the signal from the noise in the data.

I'd like to say a bit about the FOMC's decision earlier this week, and the related economic projections from policymakers. As widely expected, the FOMC left interest rates unchanged. However, the policy statement makes clear that this decision need not imply having reached the peak federal funds rate in this tightening cycle. Future decisions will depend on a holistic assessment of incoming data.

The FOMC also released an updated Summary of Economic Projections (SEP) prepared by all the Fed Board's governors and Reserve Bank presidents, which certainly reinforces the statement's message. The median expectation for the federal funds rate in the SEP features one more 25 basis-point increase this year and, relative to the June projections, a more gradual process of policy normalization in 2024 and '25.

This federal funds rate projection underscores the Committee's focus on restoring price stability while also recognizing the other part of our mandate: maximum sustainable employment. Indeed, the median SEP forecast expects a normalization of labor market conditions that contributes to inflation running at levels consistently close to target by 2025 to '26.

achievement of both parts of the dual mandate."
https://www.federalreserve.gov/monetarypolicy/monetary-policy-what-are-its-goals-how-does-it-work.htm

I fully support the FOMC statement and agree with the policy guidance in the median SEP projections. I expect rates may have to stay higher, and for longer, than previous projections had suggested, and further tightening is certainly not off the table. Policymakers will stay the course to achieve the Fed's mandate.

My views on policy reflect my assessment of current conditions and the outlook for inflation and real activity. I noted earlier that there are some promising signs that inflation is moderating and the economy rebalancing. But progress has not been linear and is not evenly distributed across sectors.

Starting with inflation, I'll focus on so-called core inflation, which excludes the important but volatile food and energy components, because it is typically a better gauge of underlying trends than total inflation. Recent readings have been encouraging – but disaggregating the key components provides valuable insight into recent pricing patterns. In particular, doing so highlights that most of the moderation in core inflation has come from a noticeable decline in core *goods* inflation, as supply bottlenecks have resolved. A second key component, *shelter* inflation, has also moderated recently, and will likely ease further as slower growth in new market rents is reflected in the overall index. However, inflation in core *services excluding shelter*, which accounts for over half of our preferred core inflation measure, has yet to show the sustained improvement that would be consistent with price stability.

So while there have been promising developments, it is too soon to be confident that inflation is on a sustainable trajectory back to the 2 percent target. I'll also note the importance of caution in reading too much from individual data points, or even from a few months of information. The monthly inflation data, for example, have always been noisy. But the variability of core inflation has increased since the pandemic. Considerable uncertainty remains around underlying inflation conditions. Extracting trends and patterns from noisy incoming data will take patience.

I've also noted that sustained reductions in inflation will require demand coming into better balance with supply across the economy. Some signs that a broad rebalancing process is underway can be found in the labor market – which is still resilient overall, but cooling. In particular, the pace of hiring has slowed, although it remains above trend. Job vacancies have declined and quit rates are nearly down to pre-pandemic levels. Also contributing to the labor market rebalancing is an improvement in supply. Indeed, we've seen some encouraging recent increases in labor force participation, especially for prime-age workers (those aged 25-54).

Over time, labor market rebalancing should result in wage growth that reflects, in addition to productivity gains, cost-of-living increases consistent with the Fed's 2 percent target. Such rebalancing should contribute to a moderation in inflation in the context of maximum sustainable employment.

This brings me to my outlook for the economy. Monetary policy has tightened considerably to date, but economic activity has been resilient – and it may be taking longer than usual to see the broader economic impact of monetary policy actions.

In particular, demand may have been less sensitive to higher interest rates so far, because policy tightening has occurred amidst business and household fundamentals that are sound compared with previous cycles. Many firms have been insulated from the rate hikes by extending the maturity of their debt when rates were low, and because of higher profit margins. But cash levels are returning to pre-pandemic norms and debt-market activity is picking up. In addition, households' excess saving accumulated during the pandemic is declining, while reliance on credit card spending is rising. This all suggests that business and household spending are likely to become more interest sensitive, helping to temper demand growth and realign it with supply.

I continue to expect that the full effects of monetary policy will eventually show through and place inflation on a sustainable trajectory back to 2 percent. But I'll note that the timing and ultimate impact of policy tightening to date remain uncertain. Historical evidence is largely based on experiences in which policy rates moved more slowly than in the current cycle.

In all, the economic circumstances surrounding the pandemic and recovery have been, and continue to be, highly unusual, with important implications for policy setting. As I've said before, this phase of policy requires considerable patience, enabling policymakers to better extract the correct signal from the incoming data, and allowing some factors that have been supporting near-term activity to play out. The risk of inflation remaining persistently high must be weighed against the risk that activity will slow more than expected. I also recognize the potential for higher short-term rates to place more pressure on some banks' balance sheets and reduce bank credit provision more than I anticipate.

I continue to be a “realistic optimist” – realistic about the uncertainties and risks to my baseline outlook, but optimistic that price stability can be restored with an orderly slowdown in activity, and only a modest unemployment rate increase associated with supply and demand in labor markets coming into better balance. Importantly, the ongoing resilience I see in the economy and the progress on inflation so far lead me to believe that the pathway to achieving this desirable outcome has widened.

Policy remains well positioned to proceed cautiously in this uncertain economic environment, recognizing and balancing the risks while remaining resolute and data-dependent, with the flexibility to adjust policy appropriately as conditions warrant.

Maine’s Economy and Banking Sector

I’ll turn now from the national economy to Maine’s. In my recent visits to your state, I spoke with a range of people, and learned about some of the unique challenges and economic strengths. Challenges include the fact that Maine has a population that is older, and aging faster, than the New England region and the rest of the nation. That reality tends to reduce the availability of labor, which is something businesses large and small mentioned often.

Access to affordable housing also remains a major issue. Maine employers told me about their difficulties finding and hiring workers for needed roles, in part because prospective employees are unable to find affordable housing in the area. And I know that expanding access to broadband in Maine’s rural counties has been challenge, but remains a priority.

I’ve also learned about Maine’s many wonderful economic strengths. Among them are the state’s rich natural resources – on land and in the Gulf of Maine – as well as strong retail and healthcare industries, robust tourism and hospitality sectors, abundant small businesses, and a strong sense of community and pride of place.

Another strength, of course, is Maine's banking industry. Your banks employ as many as 9,000 Mainers, serving households and businesses across the state in communities large and small. Of course, banks face challenges, in addition to those in the current interest rate environment. Evolving customer preferences require increasing investment in technology, and you're seeing increased margin pressure related to competition for deposits, and competition from new market entrants.

Today I want to recognize the critical role that banks of all sizes play in creating vibrant, inclusive economies. Community banks, like those in Maine, have remained resilient and continue to leverage the close working relationships they have within smaller cities, towns, and rural areas. Community banks provide a critical source of funding for small businesses. This was demonstrated, for example, during the implementation of the federal government's Paycheck Protection Program, as community banks played a major role in ensuring those funds reached businesses.

Fed Chair Jerome Powell has noted that a robust and dynamic banking system, along with effective and efficient regulation and supervision, helps to ensure that banks of all sizes can meet the needs of households and businesses in every community throughout our country, in good times and in bad. And I fully agree that we must preserve and build on these strengths, and that diversity.

The Federal Reserve and the New England Region

Finally, let me say a bit about the Fed's activities. I like to say that our overarching mission at the Boston Fed is supporting a vibrant, inclusive economy that works for everyone. As you know, an economy's strength has many dimensions – so the Fed has a broad portfolio of activities and engagements – all in the public interest – including monetary policymaking, economic research and analysis, bank supervision, financial stability work, serving as lender of last resort for banks, community and economic development activities, and initiatives and infrastructure related to payments, technology, and finance. They all support our mission and our mandate.

I'll very briefly mention some of our work to support economic vibrancy in all areas of New England, with a goal of expanding opportunities for everyone to participate in the economy. Since 2014, we have focused on encouraging local efforts to find economic resurgence in smaller cities and rural areas facing long-term struggles – we call it "Working Places." It's based on research showing that an essential element of place-based economic resilience is cross-sector collaboration, among local individuals willing to take on shared leadership. In Maine, there are such local efforts in six areas: Greater Bangor, the Katahdin region, Lewiston-Auburn, Maine Highlands, Sagadahoc County, and in Washington County with the Passamaquoddy Tribe.

The Fed's work helps the local, collaborative networks emerge and flourish. We find that people really do want to work together to solve problems. I suspect that's because improving opportunities for people and places to not be left behind – but rather join in the economy – is good economics, good citizenship, and good business! I'm encouraged that local, tangible efforts like these are adding up to real strength in our region. I know Maine's bankers work to provide the services and credit that help communities prosper, and at the central bank we look forward to continuing to collaborate with you in the public interest.

Concluding Observations

In conclusion, I'll say that the privilege and responsibility of a policymaking role like mine makes frequent 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 economy and the financial system.

Since its inception 110 years ago and by its very design, the U.S. central bank has deep and varied interactions with banks and bankers; ranging from safety and soundness to payments infrastructure, to credit access and economic development. I look forward to continuing to work with you to support the people and places of Maine, New England, and the nation with a vibrant, inclusive economy and financial system.

Thank you again for having me join you today.