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Remarks at the Tuck School of Business at Dartmouth College:

“Observations on the Economy’s Performance and Outlook”

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Tuck School of Business at Dartmouth
Hanover, New Hampshire

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. The U.S. economy overall performed remarkably well in 2023: inflation slowed notably, while job growth and output growth remained quite strong. Importantly, the pandemic recovery has been unusually equitable, with employment gains having been broadly shared across racial and ethnic groups.
2. Recent economic data releases highlight that progress toward achieving the Fed's mandated goals **— price stability and maximum employment –** could continue to be bumpy. And with the volatility of monthly inflation remaining elevated, it is important not to overreact to individual data readings. More time is needed to discern whether the economy is sustainably on a path to price stability, amid a healthy labor market.
3. Collins notes she will need to see more evidence that the disinflationary process will continue before starting to carefully normalize policy – however expecting ***all*** of the data to speak uniformly is too high a bar. Some of the factors Collins plans to consider in assessing progress toward the Fed's dual mandate goals include inflation expectations remaining well anchored, as well as an orderly moderation in labor demand. She also wants to see continued evidence that wage growth is not adding inflationary pressures, consistent with the recent work by Boston Fed economists.
4. Collins also wants to see continued declines in housing inflation and non-shelter services inflation — the two subcomponents of inflation that have been stickier and are taking longer to return to pre-pandemic levels. The focus on inflation components is not about adding additional objectives – the Fed's target is 2 percent year-over-year growth of total PCE prices – but rather about gaining greater confidence in the overall inflation outlook.
5. Still, in Collins' view, the threat of inflation settling persistently above the Committee's 2 percent target has receded, and risks to the economy overall are moving into better balance. However, a durable return to 2 percent inflation will likely require demand growing at a more moderate pace this year. Collins sees the current stance of monetary policy as consistent with achieving this outcome. And while not on a preset path, she believes it will likely become appropriate to begin easing policy later this year.
6. Collins also notes that overall, the strength of an economy has many dimensions. In this regard, the Federal Reserve is involved in a breadth of activities to support a vibrant economy that works for all: monetary policymaking, economic research, bank supervision, infrastructure and services for the financial system, and supporting collaborations that expand prospects for progress in low- and middle-income communities.

It is truly a pleasure to be with you today. I appreciate the warm welcome, and particularly want to thank Dean Matthew Slaughter and Emily Weis of the Tuck School; the Center for Business, Government & Society; and Dartmouth College.

As always, I should mention that my comments today are my own views, not necessarily those of colleagues on the Federal Reserve's Board of Governors or the Federal Open Market Committee (FOMC), the Fed's interest rate setting committee.

At the time of the Tuck School's founding – as the world's first graduate school of management – Dartmouth's president "recognized the need for 'training commensurate with the larger meaning of business'."[1] I mention this because it overlaps with the spirit of my journey in New Hampshire today. Our focus at the Boston Fed, which covers most of New England, is on supporting a vibrant economy that provides opportunities for everyone to participate, contribute, and prosper.

As I prepare for deliberations on interest rates and monetary policy at the FOMC, I consume a lot of statistical data and analysis. I also listen to people in the economy – employers, employees, entrepreneurs, those struggling to participate in the labor force for one reason or another, and those helping to support and advance community economic development. Hearing how people are experiencing the economy is vital to policymaking, and incredibly meaningful to me and my team.

As a case in point, today I visited Hypertherm Associates to learn about that company's industrial cutting and shaping business and its workforce. Then I met with the Vital Communities Corporate Council – a group of business leaders that work to improve lives for area residents.[2] After this talk, I'll meet with economic and community development practitioners for their perspective on challenges and opportunities in the

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[1] https://www.tuck.dartmouth.edu/about/facts-and-figures/history

[2] https://vitalcommunities.org/corporate-council/?doing_wp_cron=1708393268.5731968879699707031250

regional economy. And I'll end the day hosting a business leader roundtable discussion, in Concord.

The Federal Reserve

I like to say our work at the Fed is all about supporting a vibrant, inclusive economy that works for everyone, not just for some people. Of course, an economy's strength and stability has many dimensions – so the Fed has a number of roles.

We are 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. We carefully analyze economic conditions – using data, doing research, and listening to stakeholders.

We're also supervisors of some of the nation's financial institutions, and provide vital back-end infrastructure and services to the financial 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 efficient.[3] Last July, the Fed launched a new instant-payments infrastructure, called FedNow®. When fully available, instant payments will provide substantial benefits for consumers and businesses, such as rapid access to funds when useful, and just-in-time payments helping to manage cash flows.[4]

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[3] 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.

[4] For example, individuals can instantly receive their paychecks and use them the same day, and small businesses can more efficiently manage cash flows without processing delays. Over the coming years, customers of banks and credit unions that sign up for the service should be able to use their financial institution's interfaces to send instant payments quickly and securely. Learn more about the FedNow® Service at https://explore.fednow.org/about

In addition, we examine factors that limit people's participation in the economy, and support collaborations that expand their opportunities.[5] In that spirit, during my last visit to New Hampshire, I explored the economic effects of limited child-care options – with providers, consumers, and advocates – in Manchester.[6]

The National Economy and Monetary Policy

I'll focus the rest of my remarks on the economy, monetary policy, and my outlook. As a Federal Reserve policymaker, I am resolutely committed to bringing inflation sustainably back to our 2 percent target in a reasonable amount of time. And I remain optimistic – realistically optimistic, I like to say – that this can be accomplished amid a healthy labor market.[7]

Recent Economic Performance

In elaborating on my views, I'll refer to some charts to illustrate key points. **Figure 1** sets the stage, showing the history of inflation and unemployment – encapsulating the facets of the Fed's dual mandate. Shaded bars indicate recessions.

The panel on the left depicts 12-month PCE inflation.[8] The blue line is total (or "headline") inflation, while the red line – core inflation – excludes the volatile, though

[5] One can learn more about the Bank's work to support growth in smaller cities and rural areas at https://www.bostonfed.org/community-development/supporting-growth-in-smaller-industrial-cities.aspx. 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 – issues like childcare, housing, transportation, and broadband. Studying factors that limit people from participating, and disparities for groups and places, can help expand opportunities, bring more people into the workforce, and strengthen overall economic growth and competitiveness.

[6] See https://www.bostonfed.org/news-and-events/news/2023/05/boston-fed-president-heads-to-new-hampshire-to-talk-child-care-business-economic-barriers.aspx

[7] This would achieve both goals of our Congressional mandate, price stability and maximum employment.

[8] The Personal Consumption Expenditures Price Index (https://www.bea.gov/data/personal-consumption-expenditures-price-index)

obviously vital, categories of food and energy. The chart clearly shows the recent surge in inflation, after many years of price stability. It is important to remember the challenges that high inflation poses for households, firms, and our economy.

While total inflation has come down significantly from its recent peak, it remains elevated, and progress returning it sustainably to our 2 percent target will likely continue to be bumpy. Indeed, core inflation, which historically provides a good indication of future inflation trends, has further to go to return to our target.

The unemployment rate, shown on the right, rises during recessions, then typically recovers gradually. The pandemic-induced unemployment spike was particularly severe, but the recovery was remarkably quick — not spread over many years. And unemployment has remained below 4 percent since February 2022.

With the goal of restoring price stability in a reasonable amount of time, the FOMC began raising the federal funds rate in March 2022. **Figure 2** shows that the rise was unusually rapid – an increase of 525 basis points over just 16 months. Roughly 80 percent of the increase came in the first nine months – moving the Fed's monetary policy stance from highly accommodative to restrictive. The FOMC has maintained the funds rate at its current level of 5¼ to 5½ percent since July 2023, and the Committee is carefully assessing when it will be appropriate to begin reducing the target range.

Despite tighter policy, economic activity has been remarkably resilient. Real GDP growth (the blue line in **Figure 3**) rebounded quickly and has recently been close to its pre-pandemic rate, when interest rates were much lower. GDP growth in 2023, at 3.1 percent,[9] was considerably stronger than most forecasters expected at the end of 2022.

The red line shows household consumption, which accounts for about two-thirds of GDP. This has been a crucial driver of economic growth in the aftermath of the pandemic and has continued to expand at a robust pace recently. And I'll note that

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[9] This GDP figure is current at the time these remarks were finalized, but updated data for 2023:Q4 is scheduled for release at 8:30 AM on February 28, and could entail a revision.

business investment growth – another key component of private domestic demand – has also held up well, despite the higher cost of credit.

In the labor market, continued strong economic activity has translated into an unemployment rate near historic lows, and robust recent wage growth. Importantly, these positive labor market developments have been associated with an unusually *equitable* recovery.[10]

The panels in **Figure 4** compare the evolution of employment (relative to population) during this labor market recovery (the blue lines) with the average for the past three recessions (the red lines) for different racial or ethnic groups. The panels show that job loss in the pandemic recession was sudden and sharp, but followed by a rapid recovery. And this time around, the employment recovery did not take longer for minority groups. Wage growth is not shown, but I'll note that it has been relatively favorable for lower-paying occupations, benefiting less advantaged groups. While these developments cannot be taken for granted, they represent tangible progress toward achieving a more broad-based and inclusive notion of full employment.

One of the reasons for the inflation surge was demand outpacing supply, putting upward pressure on prices and wages. So, the slowdown in inflation in the second half of 2023, in this context of strong growth, was remarkable. Indeed, core PCE inflation fell to around 2 percent over the last six months of 2023. Substantial disinflation amid sustained real activity points to improvements in *supply* having played an important role.

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[10] The fact that these positive economic developments have continued to be unusually equitable is a point highlighted by Cecilia Rouse, former chair of the Council of Economic Advisers and now president of the Brookings Institution, at the Boston Fed's economic conference last fall. Dr. Rouse's presentation can be found at https://youtu.be/inRU_TPE3z4. All the conference materials and videos can be found at https://www.bostonfed.org/news-and-events/events/economic-research-conference-series/rethinking-full-employment.aspx. The conference provided analysis of factors that likely prevent some people from participating fully in the labor market, even when the overall economy is thriving. Conference presenters explored past and current thinking on measuring full employment, paying particular attention to the role of long-term labor market trends as well as to more recent changes in labor market structure. Participants also discussed recent research on how monetary policy can be conducted to achieve full employment and price stability at the same time.

These developments can be traced largely to three factors: the resolution of supply chain bottlenecks, a rebound in prime age labor force participation[11] (driven in part by immigration), and notable labor productivity gains in some sectors. Narrowing the gap between demand and supply has put downward pressure on inflation.

So far, tight monetary policy has had a limited overall impact on economic activity. This is likely due to factors specific to this recovery, which have strengthened households' and businesses' balance sheets and made demand less interest sensitive. In particular, consumers have been able to finance expenditures by drawing on a buffer of savings built early in the pandemic. And many businesses were able to refinance and extend their debt maturity when interest rates were very low.

The Outlook

Given the evolution of economic conditions so far, what can we expect going forward, and what are the implications for conducting monetary policy in such an environment? A key but open question is how much longer supply-side progress might reduce inflationary pressures amid strong economic activity. **Figure 5** shows that the prime age labor force participation rate is above its pre-pandemic level — suggesting that the potential for more workers to "come off the sidelines" may be limited. However, the Congressional Budget Office recently increased its forecast for population growth, partially based on higher – though highly uncertain – projections for net immigration.

And productivity is always difficult to forecast. Many businesses, especially in services, have learned to operate with fewer workers – but this trend likely cannot continue indefinitely. And while it is possible we will see further reductions in price pressures from earlier supply improvements, firms' willingness to pass on additional cost savings will likely require a slower pace of demand going forward. I believe the

[11] Defined as 25-54 years of age.

current policy stance should deliver the more sustainable rate of growth, while preserving a healthy labor market.

In fact, I do see some signs consistent with an expected demand moderation. Delinquencies on credit card and auto loans have been rising and are at, or above, pre-pandemic levels. Some consumers are financing expenditures with revolving debt. Excluding aircraft, capital goods orders are slowing, suggesting that firms are becoming more interest sensitive. And despite recent hiring strength, there are indications the labor market is normalizing at healthy levels.[12]

But there is considerable uncertainty about when, and by how much, activity is likely to slow. The January FOMC statement acknowledges this uncertainty and says, "the Committee does not expect that it will be appropriate to reduce the target of the federal funds rate until it has gained greater confidence that inflation is moving sustainably toward 2 percent."[13]

Some of the recent data illustrate the need for greater clarity that inflation is sustainably on a path back to the 2 percent target before adjusting the policy stance. The January jobs report showed much more hiring than expected, with job gains for December also revised up. And the data we have for price growth in January was also on the high side.

So, more time is needed to have greater confidence about the outlook. My emphasis here is on "greater," because I do expect the economy will eventually slow as we see the full effects of past monetary policy actions take hold. But I also expect the path will continue to be bumpy, and we should not overreact to individual data readings.

Furthermore, I see the risks around the outlook as having come into better balance. It is essential not to ease policy too soon, to ensure price stability is restored. At the same time, waiting too long would run the risk of an excessive slowdown.

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[12] In particular, job turnover rates have declined noticeably since the first half of 2023.

[13] https://www.federalreserve.gov/monetarypolicy/files/monetary20240131a1.pdf

Policy Implications

What would I need to see in the data to determine when it will be appropriate to ease policy? Expecting *all* data to speak uniformly is too high a bar. Still, it will be important to see sustained, broadening signs of progress toward the Fed's dual mandate goals – while recognizing that progress may be uneven.

The higher-than-expected January CPI inflation numbers I just mentioned are an example of this unevenness. Indeed, **Figure 6** shows one measure of volatility in monthly core inflation.[14] While moderating, it remains elevated – highlighting the importance of not reading too much into one data point.

And in terms of inflation, I will continue to pay close attention to its main subcomponents. The three panels of **Figure 7** decompose core PCE inflation into core goods, housing, and core services excluding housing. In each panel, the blue line is the 12-month measure, and the red line shows 3-month annualized averages.[15]

While goods inflation has returned to and moved below its pre-pandemic levels, the other two subcomponents are more "sticky" and are taking longer. So, I will want to see continued declines in housing inflation, as well as non-shelter services inflation.

To be clear, the Fed's target is 2 percent year-over-year growth for total PCE prices – there are no individual objectives for the components. However, if the effects of supply chain improvements that have helped lower core goods inflation below historic levels wane, inflation in other components will need to decline for our goal to be met.

It is also important that short- and long-term inflation expectations remain well anchored and that wages evolve in a way that is ultimately consistent with price stability. And given the importance of labor market developments for wages and the overall outlook, I will continue to look for signs of an orderly moderation in labor demand.

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[14] Volatility is measured by the two-year trailing standard deviation of monthly inflation.

[15] In addition, the recent CPI release for January showed continued elevation in shelter and non-shelter services inflation.

I'll end by saying a bit more about wages, which have been rising faster than inflation. Recent work by Boston Fed economists, available on our website,[16] alleviates concerns that wage increases are fueling inflation. The blue line in **Figure 8** highlights that prior to the pandemic, wages (as measured by the Employment Cost Index or ECI) were growing consistently faster than inflation (the red line) to reflect labor productivity gains. Following the pandemic downturn, wage growth initially lagged price growth – despite the fact that productivity continued to improve during this period. Therefore, there is room for wages to continue increasing faster than the Fed's 2 percent inflation target plus trend productivity growth, *without necessarily being inflationary*, but to make up for previous productivity gains and price increases.

In sum, I remain what I call a "realistic optimist" in thinking that the economy is on a path to 2 percent inflation on a sustained basis, while maintaining a healthy labor market. The economy is in a good place overall, and policy is well positioned as policymakers carefully assess the evolving data and outlook.

I want to see more evidence of a sustained trajectory to price stability. Still, consistent with projections from FOMC participants,[17] I believe it will likely become appropriate to begin easing policy later this year. When this happens, a methodical, forward-looking approach to reducing rates gradually should provide the necessary flexibility to manage risks, while promoting stable prices and maximum employment.

Concluding Observations

In closing, thank you for having me here today. As a longtime educator, it is a pleasure to be back on a campus. There are so many issues for students to dig in to,

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[16] https://www.bostonfed.org/publications/current-policy-perspectives/2024/is-post-pandemic-wage-growth-fueling-inflation.aspx

[17] See https://www.federalreserve.gov/monetarypolicy/fomcprojtabl20231213.htm and https://www.federalreserve.gov/monetarypolicy/guide-to-the-summary-of-economic-projections.htm

and help remedy. I am excited about what we can accomplish when we care, collaborate, study issues, and act. My best wishes to you all.

Now I'm happy to join Dean Slaughter for conversation and questions.