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Remarks at the 22nd Annual Regional and Community Banker's Conference
at the Federal Reserve Bank of Boston

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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. Collins knows inflation is still taking a toll across New England, but inflation is moderating.

In her travels around New England, Collins has spoken with residents and business owners who are continuing to struggle with higher prices. But she sees the Fed making progress in its efforts to lower inflation, as some signs are emerging that demand and supply are realigning.

2. Despite some favorable indicators, Collins says it's too soon to be confident that inflation is on a sustained trajectory back to the Fed's 2 percent target.

Collins says much of the recent moderation in the core inflation measure is due to declines in core goods inflation, which can be traced to improvements in supply chain conditions. But she adds that firms' incentives to pass on these costs savings may be short-lived unless demand slows. Meanwhile, core services inflation remains elevated.

3. The recovery from the pandemic has been unusual, and Collins says that in this highly uncertain environment, policymaking requires patience.

Collins says that policymakers need time to draw conclusions about the data and allow special factors that have been supporting near term activity to play out. She adds it's unlikely we've yet seen the full effects of the Fed's actions to date, so patience is critical as policymakers weigh the risk of inflation remaining persistently high against the risk of activity slowing more than expected.

4. Recent increases in long-term interest rates reinforce Collins' view that we're very near or perhaps at the peak of the current tightening cycle.

Collins noted the 10-year Treasury yield has moved up since mid-September, and that increase has been accompanied by higher corporate bond yields and mortgage rates. Collins says the rise in these rates implies some tightening of financial conditions, which if persistent could reduce the need for further monetary policy tightening. It also reinforces her view that we are very near or perhaps at the peak of this tightening cycle.

5. Collins' travels around New England have given her insight into its strengths and challenges and shown her again how important community banks are to regional economic health.

Shared concerns include childcare, housing, and infrastructure. At the same time, the region benefits from its collective brainpower, a diverse and skilled workforce, and relatively high job opportunity. Collins says the region's banking industry plays an essential role everywhere, serving communities of all sizes and providing households and businesses with the funding they need for economic health and growth.

Good afternoon. I'm delighted to join you today, for the 22nd Annual Regional & Community Bankers Conference. I'd like to thank the team here at the Boston Fed – including the Supervision, Regulation & Credit group, and our New England Public Policy Center – for their contributions to this year's conference.

And I'd like to thank all of you for attending. It's wonderful to have banking-sector members from all parts of New England here today. In my visits to each New England state, to learn from a range of stakeholders, I hear from workers, entrepreneurs, small businesses, local employers, bankers, community development experts, civic leaders, and many others. It's clear from those conversations that regional and community banks are a crucial, valued element of the financial and economic infrastructure of the region.

And we appreciate your constructive engagement with us at the Boston Fed. It takes all of us to support a safe and sound banking system, which is so essential to a vibrant and inclusive economy.

In our time today, I'll provide some remarks before sitting down for a discussion with my colleague Mike Ravid from the Fed's regional and community supervisory team. For the most part, I'll share my views about the economic outlook and monetary policy. I will also provide some perspectives on banking, and talk briefly about the Fed's work across the region and in payments innovation.

Before I begin, let me note, as always, that my remarks today are my own views. I'm not speaking for any of my colleagues at other Federal Reserve Banks or at the Board of Governors.

The Economic Outlook & Monetary Policy

I'll start with the economy, and highlight the impact of some of the recent data on my views about the outlook and appropriate monetary policy – recognizing that some readings have been a bit surprising, such as the stronger than expected September payroll employment. The Consumer Price Index or CPI report for September was released this morning, and I'll describe recent trends in inflation a bit later in my remarks.

As you know, the Fed has a dual mandate from Congress, for price stability and maximum sustained employment – and our current focus remains on bringing inflation down to our 2 percent target in a reasonable amount of time. Price stability is essential for a wellfunctioning economy, and is an important precondition for maximum employment that is sustainable over time. So, reducing inflation relates to *both* parts of our mandate.

High inflation takes a toll on everyone. As I travel around New England, I continue to hear about the challenges people face related to too-high inflation. Households with lower incomes are struggling to make ends meet and businesses are grappling with the higher costs and added complexity that elevated inflation brings, for planning and investment decisions.

So the battle with inflation is important, and in the public interest. As a result, the Federal Open Market Committee (FOMC) raised rates rapidly, relative to prior monetary policy tightening cycles, before shifting to a more gradual approach this summer. We have made some progress on inflation, as I'll discuss, but it is still too high. And given the persistent strength in economic activity, it is too soon to determine whether the slowdown in price growth will continue.

Overall, I continue to believe that the current phase of policy requires patience, allowing us time to review available information holistically, to separate the signal from the noise in the data, and to balance competing risks.

<u>Outlook</u>

A few weeks ago, the FOMC released its Summary of Economic projections or SEP, reflecting the outlook of participants (the Fed Governors and Reserve Bank presidents).[1] The median SEP forecast is for inflation to near our target by 2025-26, as still-hot labor market conditions normalize. Further, the median forecast sees the appropriate monetary policy to achieve such an outcome involving an additional 25 basis points increase in the federal funds rate this year, and then holding rates in restrictive territory for an extended period.

This outlook in the SEP remains similar to my own. I believe we may be at, or very near, the peak for this cycle, although I would not take further tightening off the table yet. And looking beyond the "how high" discussion to focus on the "how long" part of this tightening cycle, I will say I expect rates may have to stay higher for longer than *previous* SEP forecasts had suggested.

Let me add that I continue to be a "realistic optimist," and I think that perspective is important to emphasize. I'm realistic about the uncertainties and risks to my baseline outlook.

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[1] Summary of Economic Projections, September 20, 2023 (federalreserve.gov)

But I am optimistic that price stability can be restored with an orderly slowdown in activity, and only a modest increase in the unemployment rate to cool the mismatch in labor demand and supply.

Progress Realigning Demand and Supply

As you know, recent reports on real economic activity have been strong, and overall demand remains resilient. Payroll growth jumped in September, with upward revisions to job gains for July and August. And although the average pace of job gains has slowed this year relative to 2022, it remains well above trend.

Since demand outstripping supply in the labor markets has been a key factor driving wage pressures, and hence price pressures, some further rebalancing will be required for the deceleration we have seen in inflation to be sustained. With rates in restrictive territory, I do expect that payroll growth and economic activity more generally will slow in the coming months.

There is already some evidence of demand and supply realigning in the labor market, even though it remains strong overall, with unemployment still near historic lows. On the demand side, the previously very high voluntary quit rate has fallen to pre-pandemic levels. Job vacancies have also been trending down overall, and are a good bit below their peak – though they remain elevated, and posted a surprising increase in August.

We are also seeing promising developments in terms of labor supply. Labor force participation has increased, especially for prime-age workers (those aged 25 to 54), and since the second half of 2022, there has been a noticeable pickup in employment of foreign-born workers, helping to alleviate labor shortages in some areas.

And importantly, despite the tight labor market, average hourly earnings growth continued to slow through September — especially on a 3-month annualized basis. This is consistent with increased supply helping to alleviate some of the wage pressures. These developments are promising, but to be sure demand and supply are coming into better alignment, we will need to see the recent labor market trends continue and broaden, including a moderation of hiring to a near-trend pace. This would be evidence of the sustained cooling in the labor markets needed to bring inflation to 2 percent in a reasonable amount of time.

In addition, strong job growth and the overall tight labor market continue to support consumption, which was quite solid in July and August. High frequency data suggest spending may have slowed in September, but we will have to see whether this is borne out in the official retail sales release next week.

Indeed, household expenditures have remained remarkably resilient to date, even in the face of tighter financial conditions. This continued strength is also likely due in part to healthy household balance sheets from savings accumulated during the pandemic. These stockpiles are diminishing, but recent data revisions suggest the possibility of somewhat higher remaining excess saving than previously thought – which could support household spending a bit longer, going forward. Still, we are seeing some signs of consumers becoming more financially constrained as credit usage is rising and delinquency rates are increasing. So faced with high interest rates, it is unlikely that consumption will remain as resilient going forward.

Inflation

Turning to inflation, I will focus on the core measure, which excludes the important but volatile food and energy components, since it is typically a better gauge of underlying trends than total inflation. Core inflation, whether measured by the CPI or the PCE price index, has moderated but a key question is whether the recent progress will be sustained. Today's CPI release is a reminder that restoring price stability will take time.

Disaggregating the key components of this measure provides valuable insight into the drivers of recent movements. Much of the positive news comes from declines in core *goods* price inflation, helped by the improvement in supply conditions. But firms' incentives to pass the costs savings from supply chain improvements through to prices may be short-lived, unless demand slows.

Housing or shelter inflation is moderating overall, but the September pickup in CPI shelter inflation – driven in part by the volatile "lodging away from home" category – highlights that progress may prove uneven. In particular, we will have to see whether the recent pickup in house price growth will put further pressure on new rents, slowing the deceleration in measured inflation in this sector.

That brings me to core services excluding housing, which accounts for a significant portion of the consumption basket. Inflation for this component remains elevated and overall progress has been limited. Bringing core non-housing services inflation down will likely require labor market conditions to cool more, as labor accounts for a large share of costs in this sector.

Overall, it is too soon to be confident that inflation is on a sustainable trajectory back to the 2 percent target we associate with price stability. I'll also note that it is important not to read too much into 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. Extracting underlying patterns from noisy incoming data will take some time.

<u>Pandemic Uncertainties</u>

I'll say that the mixed signals we are getting from the recent data highlight the need to focus on trends and take a holistic approach to interpreting incoming information and determining the implications for appropriate policy. Here I will highlight that the economic circumstances surrounding the pandemic and recovery have been, and continue to be, highly unusual.

Yesterday I spoke at length at Wellesley College about the role of uncertainty in policymaking, notably after an episode like the pandemic.[2] While the nature of the uncertainty has evolved, there is currently a high degree of uncertainty about economic indicators, including around underlying inflation conditions and employment growth.

As a result, this phase of policy requires considerable patience. Policymakers need time to draw correct conclusions from the incoming data and to allow some special factors that have been supporting near-term activity – and perhaps limiting the impact of higher interest rates on the economy – to play out. This includes households' excess savings that I mentioned earlier, as well as firms' elevated cash holdings and debt previously refinanced at low rates. As consumers' savings and firms' cash holdings decline further, and more corporate debt needs to be refinanced, tight credit conditions should act to restrain activity. We will need to continue monitoring these trends carefully.

Since it is likely that we have yet to see the full effects of our past policy actions, patience is also needed in order to best weigh the risk of inflation remaining persistently high against the risk of activity slowing more than expected. I recognize that higher short-term rates may place additional pressure on some banks' balance sheets and reduce bank credit provision

[2] Reflections on Phasing Policy Amidst (Pandemic) Uncertainty – 2023 Goldman Lecture at Wellesley College.

more than anticipated. I'll also note that, before the FOMC meeting at the end of this month, we will receive additional, important data on inflation and real activity that will help me, and the committee, in making an informed policy decision.

Longer-Term Rates

Finally, as we consider appropriate policy, it is important to take movements in long-term interest rates into account. Since mid-September, the 10-year Treasury yield has moved up noticeably, though it retreated a bit this week. However, on net, this yield is now somewhat higher, as are corporate bond yields and mortgage rates. Several factors may be driving these overall gains in long-term yields, and it will be important to see whether the increase is sustained, especially given the rate volatility in recent days.

Importantly, the rise in long-term yields implies some tightening of financial conditions. If it persists, it likely reduces the need for further monetary policy tightening in the near term. This reinforces my view that we are very near, and perhaps at, the peak federal funds rates for this tightening cycle.

In sum, I believe the current phase of the monetary policy requires patience and a holistic assessment of available data, while we stay the course to restore price stability. I expect we'll need to hold rates at restrictive levels for some time – until we see evidence that inflation is on a sustained path back to 2 percent.

Patience will give us time to carefully separate signal from noise as we assess the incoming data. It will also allow us to balance risks, as the effects of tighter policy continue to work through the economy.

New England's Economy and Banking Sector

I'll now turn from the national economy to the regional economy, building from my colleague Jeff Thompson's remarks earlier today. In my travels around New England, I've learned about unique challenges and economic strengths, as well as common threads that exist across much of the region. The challenges I hear about that prevent people from participating in the economy or the workforce include real economic issues like childcare, housing, and infrastructure such as transportation and broadband. In addition, pockets of the region face persistent social and economic challenges. Those gaps for people and places are essential to recognize, and can be hidden by overall aggregates that are quite favorable.

I also hear about and see New England's many economic strengths. Among them: the region's collective brainpower, a diverse and skilled workforce, and an ecosystem of innovation. New England is home to world-class institutions and organizations in many fields. Additionally, we are fortunate that job opportunities have historically been plentiful in this region – though with some variation by area.

Another strength is the region's unique regional and community banking industry. Your banks serve households and businesses in communities large and small. Of course, banks face challenges apart from those linked to 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.

I want to recognize the critical role that banks of all sizes play in creating vibrant, inclusive economies. Community banks have remained resilient as they continue to leverage the close working relationships they have within smaller cities, towns, and rural areas. Community banks provide critical sources of funding for small businesses. This was demonstrated, for example, when the federal government's Paycheck Protection Program was implemented, and 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 ensure that banks of all sizes can meet the needs of households and businesses in every community, in good times and bad. I fully agree that we must preserve and build on these strengths, and that diversity.

The Federal Reserve and the New England Region

As I conclude, I'll say just 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. It includes monetary policymaking, economic research and analysis, bank supervision, financial stability work, and serving as lender of last resort for banks. We're also involved in community and economic development activities and initiatives and infrastructure related to payments, technology, and finance. All of it supports our mission and our mandate.

I'll briefly mention some of our work to expand opportunities throughout New England so that everyone can participate in the economy. Since 2014, we have focused on encouraging local efforts to bring economic revitalization to smaller cities and rural areas that have faced long-term struggles. We call this initiative "Working Places." Our approach is based on research that shows that an essential element of place-based economic resilience is collaboration among local individuals from different sectors who are willing to share leadership. In nine years, Working Places has expanded to 30 communities in five New England states.

The Fed's work helps local, collaborative networks emerge and flourish. Communities participating in Working Places report solving problems, making changes that create opportunities and jobs, and enlisting new voices and partners to shape progress. Local teams develop goals and strategies in areas including workforce development, poverty reduction, affordable housing, and removing barriers to entrepreneurship. Local, tangible efforts like these are adding up to real strength in our region.

Additionally, I'd like to mention the Fed's work in payments innovation. Since its founding, the Federal Reserve has played a role in ensuring the country's payments infrastructure can effectively meet the public's needs. We demonstrate this commitment through continuous improvements to our financial services, and by taking accountability for safe, accessible, and efficient payments. As everyone in this room knows, the U.S. payments system – the way consumers, workers, and employers make and receive payments – has evolved mightily over time. Not that long ago, the Fed was helping move checks around the country. But we worked with the banking industry to digitize check clearing, and create other automated channels. In July, the Fed launched the FedNow® Service, a new payments "rail" to make instant payments secure and convenient. FedNow enables instant payments to be processed at any time of day, on any day of the year, for a broad array of transactions. The FedNow Service is core payments infrastructure available to all depository institutions.

Concluding Observations

In conclusion, I'll note that since its inception 110 years ago, and by design, the U.S. central bank has deep and varied interactions with banks and bankers. These range from preserving safety and soundness, to managing and improving payments infrastructure, to promoting access to credit that facilitates economic progress. I look forward to continuing to work together to support the people and places of New England – and the nation – with a vibrant, inclusive economy and financial system.

With that, thank you for the opportunity to be with you today. I look forward to sitting down with Mike for some questions.