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Remarks to the Economic Club of New York:

“The Importance of a Patient, Methodical, and Holistic Approach to Monetary Policy”

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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 expects inflation to return to 2% while the job market stays strong.

Collins is committed to returning inflation to the Fed's 2 percent target and expects this process to unfold over time, with the labor market remaining healthy. She notes that risks to the economy are two-sided (risks from cutting rates prematurely, as well as from waiting too long).

2. Collins continues to expect it will be appropriate to begin easing policy later this year, but more time is needed to gather information instilling greater confidence that progress will continue.

Policy decisions must be based on holistic data assessment, and the risks and uncertainties remain elevated. It may take longer to discern whether the economy is sustainably on a path back to 2 percent inflation, and thus less easing of policy this year than previously thought may be warranted. Monetary policy is currently well positioned for the requisite patient, methodical approach, and to manage the risks.

3. Supply improvements have so far played a key role in rebalancing the post-pandemic economy.

Improved supply chains, increased productivity, and growth in labor supply have resulted in better-than-anticipated outcomes in 2023. But we cannot count on these improvements to continue at the same pace, and demand growth will need to moderate to achieve further progress on inflation.

4. The lower risk that conditions are overly tight supports taking a more patient approach to deciding when to ease.

Economic activity has remained robust despite high interest rates. While this resilience is good news, it raises questions about the restrictiveness of the policy stance and broader financial conditions. In this context and with less sign of labor market fragility, Collins believes there are now fewer concerns about policy remaining too restrictive in the near-term.

5. Recent data haven't changed the outlook, but suggest patience rather than urgency.

Data highlight the likelihood that disinflation will continue to be uneven. We should not be surprised by some higher inflation readings after the low numbers in the second half of 2023. While expecting all indicators to be well aligned is too high a bar, further signs of progress towards the 2 percent inflation target will be necessary.

It is a pleasure to be at the Economic Club of New York – and to be back in the city where I grew up. I want to thank my Federal Reserve colleague – your board chair, John Williams – for the suggestion to join you. My thanks as well to club president Barbara Van Allen and her team, and to Abby Joseph Cohen for moderating the discussion after my remarks.

I want to commend the Club for providing an important forum to present views and analysis and discuss complex matters – in a setting that is nonpolitical and nonpartisan. Thoughtful engagement is essential – thank you for nurturing it.

It is important for policymakers to rigorously study data, for empirical insights – *and* to engage widely, explain what we are doing and why, and share perspectives. This is a key reason I am here today and, also, why I reach out to stakeholders across the economy, learning more about their economic conditions, challenges, and opportunities.

Today I'd like to share my perspectives on the U.S. economy and monetary policy, as we at the Fed work to achieve our mandates from Congress and, as I like to say, support a vibrant economy that works for all. Of course, my comments reflect my own views, not necessarily those of my colleagues on the Federal Open Market Committee.

In my remarks today, I'll start with an overview, briefly discuss some supply- and demand-side aspects of the economy, and end with comments about my outlook and monetary policy.

Overview

By way of overview, my read of the economic data supports my continued stance as a "realistic optimist." By this, I mean I expect to see further evidence that inflation is durably, if unevenly, returning toward 2 percent, and that the economy is coming into better balance, with demand and supply more closely aligned amid a healthy labor market. As a result, I do expect it will be appropriate to begin lowering the federal funds rate later this year.

However, in addition to that optimism, I am also realistic – about risks and uncertainties, which remain elevated. Recent data suggest it may take more time than I had previously thought to gain greater confidence in inflation's downward trajectory, before beginning to ease policy. A patient, methodical, and holistic approach is required. I see the current stance of policy as well positioned to balance the risks, which are two-sided – meaning, there is risk of easing too quickly, interrupting inflation's return to target; and, on the other hand, risk of staying restrictive too long, causing a more-than-necessary slowdown.

A striking feature of 2023 was that inflation declined significantly, as many expected – but instead of the widely forecast growth slowdown, the economy expanded robustly.[1] Along with the decline in inflation, we saw continued, well-anchored long-run inflation expectations, and a decrease in short-run inflation expectations to levels consistent with the 2 percent target. Furthermore, when inflation is high, price changes across sectors tend to become quite similar. In another welcome development, sectoral price changes showed much less synchronicity in 2023 than they had in 2021 and 2022.[2]

Strong economic activity combined with moderate inflation points to the key role of *supply* improvements in helping to rebalance the post-pandemic economy. Such improvements are very good news – but as I'll discuss, the extent to which they will

[1] GDP growth in 2023, at 3.1 percent on a Q4-over-Q4 basis, was considerably stronger than most forecasters expected at the end of 2022. In addition, the Q4-over-Q4 core PCE inflation reading at 3.2 percent was roughly 2 percentage points lower than at the end of 2022.

[2] For more details about sectoral price-change synchronicity, see Claudio Borio, Marco Lombardi, James Yetman, and Egon Zakrajšek, 2023, "The Two-Regime View of Inflation," BIS Papers No. 133, https://www.bis.org/publ/bppdf/bispap133.pdf.

continue is unclear. This adds to the list of uncertainties that are relevant in assessing the data and evaluating the outlook.[3]

In addition to increased supply, demand has remained robust – despite higher interest rates. Without ongoing supply improvements, we risk demand continuing to outpace supply and exacerbating pressure on prices. This implies that demand will need to moderate for the Fed to achieve its price-stability goal. So, while resilient activity is good news, it also raises questions about the extent to which the stance of monetary policy is actually restraining demand.

Supply Developments

Regarding supply, some of the improvements last year were expected. Most notably, we saw the unwinding of the pandemic supply-chain bottlenecks, which contributed to a significant decline in core *goods* inflation – now back within its pre-pandemic range. Improvements in labor productivity and labor supply were more surprising.

The recent acceleration in labor productivity is still evolving. It could partly reflect firms' need to find efficiencies, given labor shortages and rising costs.[4] Improved labor productivity could also partly reflect gains from labor market reallocation earlier in the recovery, when strong labor demand let many workers change jobs, likely improving employment matches overall.

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[3] For more on managing uncertainties in policymaking, see Susan M. Collins, 2023, "Reflections on Phasing Policy Amidst (Pandemic) Uncertainty," 2023 Goldman Lecture in Economics at Wellesley College, October 11, https://www.bostonfed.org/news-and-events/speeches/2023/reflections-on-phasing-policy-amidst-pandemic-uncertainty.aspx.

[4] From 2019:Q4 to 2023:Q4, labor productivity in the nonfarm business sector increased at an annual rate of about 1.6 percent, on average, roughly the pace of growth prevailing before the pandemic and going back to 2006. This improvement has occurred despite challenges to firms from severe supply-chain disruptions and high job turnover rates. Moreover, by 2023:Q4, labor productivity accelerated to 2.6 percent on a year-over-year basis, possibly reflecting some catch-up, and likely also ongoing changes in how firms do business.

Higher labor force participation among prime-age workers was another welcome surprise. It recovered notably – especially for women, despite continued challenges with the supply of childcare.[5]

I will also note that, so far, the robust labor market has allowed for remarkably *inclusive* outcomes by historical standards, with employment gains spread across racial and ethnic groups. This represents important progress towards a more broad-based notion of "full employment."[6]

In addition, increased immigration has expanded the labor supply – by more than previously thought.[7] With a larger population, the pace of monthly payroll growth consistent with a stable unemployment rate is likely much faster than before the pandemic.[8]

While I certainly hope to see further improvements in aggregate supply, there is considerable uncertainty around whether these changes will continue at a pace or scale that supports the rebalancing needed to achieve price stability.[9] But to be clear, while

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[5] As of March 2024, the 12-month average prime-age participation rate for men was essentially the same as before the pandemic (in February 2020), while the rate for prime-age women had surpassed its pre-pandemic level by a noticeable margin.

[6] See the presentation by Cecilia Rouse at the Federal Reserve Bank of Boston's 67th Economic Conference in November 2023, available at https://youtu.be/inRU_TPE3z4. Conference materials can be found at https://www.bostonfed.org/news-and-events/events/economic-research-conference-series/rethinking-full-employment.

[7] Higher immigration could help reconcile the large difference in job creation as measured in the establishment and household surveys. Indeed, the household survey may be slow to capture changes in migration from abroad – a sampling challenge that is less acute in the establishment survey. For more on this topic, see Wendy Edelberg and Tara Watson, 2024, "New Immigration Estimates Help Make Sense of the Pace of Employment," Hamilton Project at Brookings Institution, https://www.brookings.edu/articles/new-immigration-estimates-help-make-sense-of-the-pace-of-employment/.

[8] The upward revision to population growth also allays some concerns that the establishment survey might be portraying an overly optimistic picture of the labor market and, by extension, of economic activity.

[9] There are a number of reasons for this uncertainty. We may already have seen most of the benefits from resolution of global supply-chain bottlenecks. (It is possible that the tragic accident that led to the collapse of the Francis Scott Key Bridge and the partial closure of the Port of Baltimore may impact regional and national supply chains, but it is too soon to tell what that may imply for future price developments.) It is unclear whether the recent growth of labor productivity can be sustained. Immigration flows are difficult to predict. And we cannot count on additional increases in native-born labor supply, though there could be scope for some older workers to remain in or reenter the workforce.

the economy's productive capacity may not expand as quickly as it did in 2023, it should still grow at a solid pace this year and next.[10]

Robust Demand

Turning to demand, the evidence also points to it staying elevated, despite real interest rates that are high by the standards of the last two decades. In particular, consumption growth has remained robust, buoyed by household balance sheets that have remained strong.[11] And faster population growth likely contributed to increased spending, as well.

It is worth noting that firms have likely been able to maintain relatively high profit margins, not just due to productivity gains but also to robust demand. In turn, this profitability has enabled firms to draw on internal funds to expand their productive capacity – and hire more workers – rather than relying on the now more expensive sources of external finance – partly limiting the effects of higher credit costs.

Resilient demand could explain the increase in inflation so far this year. In particular, there are signs that household expenditures may be shifting away from goods and toward services, where price pressures are still high. Shelter inflation also remains elevated, with the moderation in market rents limited by continued strength in the labor market.

The Stance of Monetary Policy

Let me now turn to monetary policy. The intent is to help slow demand in a manner consistent with inflation sustainably returning to 2 percent, amid healthy labor

[10] I hear from contacts in the First District that businesses continue to explore ways to find untapped talent and seek efficiencies. And while forecasts of future immigration are highly uncertain, it is reasonable to expect somewhat faster-than-normal labor supply growth will continue in the near term.
[11] Moreover, household net worth is still high by historical standards.

market conditions. But given the continued economic strength, the extent to which monetary policy has been tempering growth is unclear – as is the extent to which it will do so going forward.

In fact, the current level of interest rates may provide less restraint than expected. Strong balance sheets have likely reduced the interest rate sensitivity of households and firms. In addition, the current low household saving rate may indicate that the return needed to incentivize saving may have increased. And for firms, the return to capital spending may be rising, due to the supply of additional workers and productivity improvements.

These considerations – together with equity market gains, continued narrow corporate bond risk spreads, and the growing availability of credit from nonbank institutions – suggest that current financial conditions may be only modestly restrictive. But to be clear, moderately restrictive policy *is* consistent with demand ultimately slowing, and inflation returning to target. Furthermore, the supply improvements I mentioned imply that the extent of slowing required to rebalance the economy is less than one might have thought, given the strength in activity.

This assessment of the monetary policy stance implies that the risks are two sided. On the one hand, there is the risk of inflation not continuing on a downward trajectory back to 2 percent – highlighting the importance of not easing prematurely. At the same time, the possibility of the economy slowing notably should not be discounted. We may not yet have seen the full effects of the FOMC's past policy actions, given the considerable uncertainty about the lags with which monetary policy affects the economy.[12] Furthermore, higher interest rates could make the economy more vulnerable to the effects of adverse economic or geopolitical shocks, should they occur.

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[12] Some estimates put the maximum impact of monetary policy on economic activity in the range of four to six quarters after a change in the policy stance – and I'll note that the federal funds rate has been near 5½ percent for about three quarters. Furthermore, those estimates were calibrated from more gradual tightening cycles. So, while it is not my baseline outlook, the economy could still slow abruptly, with policy having stayed too restrictive in hindsight.

However, in my view, the risks of monetary policy being too tight have receded. Earlier this year, I was concerned about policy restrictiveness, given an apparent rise in labor market fragility. At that time, data indicated that hiring was becoming concentrated in just a few, less-cyclical sectors. But recent payroll gains (and revisions to earlier data) have been more diffused across sectors. Indicators – including an unemployment rate that remains below 4 percent and quit rates that are back to their pre-pandemic range – point to a labor market that, while coming into better balance, is still robust. A lower risk of overly tight conditions supports taking a more patient approach in deciding when to ease policy.

Outlook and Policy Implications

Looking ahead, I remain realistically optimistic that we can achieve our dual mandate goals. At the same time, the slowdown in economic activity necessary for achieving price stability remains more in the forecast than in the actual data. But there may be some early signs pointing towards a slowing of demand. For example, liquid savings from pandemic-era stimulus programs dwindled in 2023, especially for lower-income and younger households. There is evidence of rising credit card utilization rates and delinquencies. And growth in business investment slowed in the second half of last year.

However, the potential impact and timing of these indications of slowing are uncertain. In a sign of still robust demand, payroll growth over the last quarter averaged 276,000 jobs per month, a pace that is likely faster than needed to keep up with population growth, even accounting for increased immigration. And core inflation has moved up relative to the low readings in the second half of last year.

The implications of these recent data for the evolution of inflation remain to be seen. For instance, we should not necessarily have been surprised by some higher inflation readings early this year, after the low numbers in the second half of 2023.[13] Overall, the recent data have not materially changed my outlook, but they do highlight uncertainties related to timing, and the need for patience – recognizing that disinflation may continue to be uneven. This also implies that less easing of policy this year than previously thought may be warranted.

To gain greater confidence that progress remains on track, I'll continue to monitor a wide range of quantitative and qualitative data. Expecting *all* indicators to be well aligned is too high a bar, but let me highlight five of the things I'll be watching or looking for:

- First, *the evolution of the components of inflation*. We do not have individual targets for the components, but the composition is informative, and dynamics differ. In particular, housing as well as non-shelter services price inflation, is taking longer to return to pre-pandemic trends. I'm looking to see additional progress there.
- Second, *further evidence of low synchronicity of price changes across sectors*. This is a typical feature of low-inflation environments, and it has been encouraging to see this indicator return to its pre-pandemic range.
- Third, *evidence that wages continue to evolve in a way that is consistent with price stability*. In fact, given past price increases and ongoing productivity developments, there is room for wages to grow at a relatively sustained pace without necessarily generating additional inflationary pressures.[14]

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[13] Moreover, the volatility of monthly inflation numbers, while declining, remains above pre-pandemic levels, and readings can be more difficult to interpret at the beginning of the year, an issue that may be compounded by changes to household and firm behavior since the pandemic.
[14] For more on wage dynamics and how they relate to prices and productivity, see Philippe Andrade, Falk Bräuning, José L. Fillat, and Gustavo Joaquim, 2024, "Is Post-pandemic Wage Growth Fueling Inflation?" Federal Reserve Bank of Boston Current Policy Perspectives, 2024-1, https://www.bostonfed.org/publications/current-policy-perspectives/2024/is-post-pandemic-wage-growth-fueling-inflation.aspx.

- Fourth, seeing *short- and long-term inflation expectations* remaining at levels consistent with the FOMC's 2 percent target.
- And fifth, *continued signs of labor demand moderating in an orderly way*, to a healthy, sustainable balance with supply.

Concluding Observations

In sum, recent developments continue to highlight the importance of a patient and methodical approach, as we holistically assess available information. Incoming data have eased my concerns about an imminent need to reassess the stance of monetary policy. It may just take more time than previously thought for activity to moderate, and to see further progress in inflation returning durably to our target. Less concern about labor market fragilities, combined with the possibility that policy is only modestly restrictive, also reduces the *urgency* to ease. Ultimately, though, policy is not on a preset path, and it remains well positioned to manage upside and downside risks.

Thank you, and I look forward to the conversation with Abby and to your questions.