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Perspectives on the Economy and Policy

Remarks at the University of Michigan's Gerald R. Ford School of Public 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 sees the economy "in a good place overall, with inflation heading back to the 2 percent target amid a healthy labor market." The primary job for monetary policy in this context is sustaining these favorable conditions going forward.

"I expect additional adjustments will likely be appropriate over time, to move the policy rate gradually from its current restrictive stance back into a more neutral range. However, policy is not on a pre-set path."

2. Overall, Collins sees the inflation picture as encouraging – especially with inflation expectations well-anchored – and she cautions against overreacting to any one data release.

"The volatility in inflation highlights the need to assess the data holistically, to separate the signal from the noise, and not overreact to any one monthly reading." Anchored inflation expectations make returning to 2 percent inflation "feasible without the economy staying below capacity for a time, as would be the case if expectations had risen and needed to be re-anchored." The stability of long-run expectations speaks to the credibility of the Fed in fighting inflation.

3. Separating core inflation into three components illustrates that "most of the remaining elevation comes from shelter." While shelter inflation has come down some, progress has been slow and uneven.

The key question is whether elevated housing inflation reflects the effects of ongoing price pressures from new leases, or simply the catch-up of existing leases to current market rents. The good news is that the data show little evidence of price pressures from current market rents.

4. A normalizing labor market and solid labor productivity growth have been important contributors to the disinflation process.

Other advanced economies have not experienced similar favorable productivity gains. Given the labor productivity and price developments to date, Collins sees little scope for wages to disrupt the ongoing disinflation progress, even if wages continue to grow at a somewhat faster pace than before the pandemic.

5. Collins believes "some additional easing of policy is needed, as policy currently remains at least somewhat restrictive."

The intent is not to ease too quickly or too much, hindering the disinflation progress to date. At the same time, easing too slowly or too little could unnecessarily weaken the labor market. She added that at this stage, any further slowing in hiring would be undesirable. Policy is well-positioned to deal with two-sided risks and achieve the Fed's dual mandate goals in a reasonable amount of time.

6. Collins emphasized how the Fed's design, structure, and breadth of portfolio make the central bank "representative of the country, appropriately accountable, and also independent enough to make hard choices in the longer-term public interest."

She described the Fed's work in research, supervision, financial stability, payments transactions and infrastructure, liquidity, and support for economic development as reflecting data-driven analysis. She also discussed how the Fed acts as a convener and catalyst for collaboration across sectors.

Thank you, Dean Watkins-Hayes – Celeste – for such a warm welcome, or I should say, welcome *back*. Michigan's Ford School is truly a special place, and it has been wonderful to be back on campus, here in Weill Hall, spending time with students, faculty and staff, including some dear friends, as well as many new faces. I have enjoyed learning about the exciting new developments and initiatives underway – and am thrilled, but not at all surprised, to see the Ford School continuing to thrive. So, thank you for hosting me – it is a pleasure to be here with you.

Today, I'd like to share my perspectives on the U.S. economy and monetary policy, focusing more on where we are than how we got here, and offering some thoughts looking ahead. I also know that the Federal Reserve is a bit of a mystery to many people. So, I'll take the opportunity, at the end of my remarks, to talk briefly about the Fed itself, and, focusing on the Boston Fed, will give some examples of the breadth of work we do in support of our mission and our mandate from Congress. Then, I look forward to your questions.

The National Economy – Some Context

I'll begin with my perspective on the national economy – but first, my standard disclaimer. My comments reflect my own views, not necessarily those of my policymaker colleagues on the Fed's Board of Governors, or at other Reserve Banks.

I like to provide a bit of context before diving into a topic, use a few charts to illustrate key points, and give my "bottom-line up front." For context: Congress has given the Fed a mandate to maintain price stability and maximum employment. The FOMC (or Federal Open Market Committee, which is the Fed's monetary policymaking body) defines price stability as 2 percent inflation. Maximum employment is less specifically defined, but I think of it as a broad, inclusive goal of job opportunities for all Americans in a context of price stability.

Figure 1 provides some history. The left-hand panel shows the Fed's preferred measure of inflation calculated using the personal consumption expenditures (PCE)

price index. The blue line is 12-month total (headline) inflation, the green line is the 2 percent target, and the red line is "core" inflation, which excludes the volatile though obviously important categories of food and energy. The right-hand panel shows the evolution of the unemployment rate – a good indicator of overall labor market conditions, though, of course, I and my team follow a wide range of indicators to gauge the state of the labor market.

When I began my role as Boston Fed President and FOMC member in July 2022, the U.S. economy was coming out from the worst of the pandemic. Unemployment was way down from its COVID-19 shutdown peak. In fact, the chart shows that unemployment fell very rapidly, instead of the more gradual decline that historically has followed recessions (shown in the figure by the gray shaded bars). This is one of many ways in which the recent cycle has been unusual. At the time, firms were struggling to find workers – which was one factor fueling upward pressure on wages and prices. Supply bottlenecks were still extensive, exacerbated by Russia's war in Ukraine. Demand outstripping supply had caused a surge in inflation, and higher prices were already very challenging for firms, and for households (especially those with low and moderate incomes).

Getting inflation back under control was the clear policy priority for the Fed, and the FOMC responded by rapidly raising the federal funds rate (the FOMC's main policy tool), to the range of 5¼ to 5½ percent by July 2023. This shift from a very accommodative policy stance to a quite restrictive one helped realign demand and supply, relieving wage and price pressures and thus reducing inflation.

So where are we today? As Figure 1 shows, inflation has come down significantly – though core inflation is still somewhat elevated. The unemployment rate is higher than it was a year ago, but it remains low by historical standards. And as I'll discuss shortly, economic growth remains robust.

My bottom line is that I see an economy that is in a good place overall, with inflation heading back to the 2 percent target amid a healthy labor market. The primary

job for monetary policy in this context is *sustaining* these favorable conditions over time, focusing on both sides of our dual mandate. Past experience teaches that this is the environment which enables the benefits from a vibrant economy to be shared widely. Given the significant progress towards our goals, it was appropriate for the FOMC to begin recalibrating policy, easing rates in September, and again when we met earlier this month.

Before saying more about my outlook, the balance of risks, and implications for policy, I'll go into some additional detail on economic conditions, starting with inflation.

Inflation

The left chart in **Figure 2** shows core PCE inflation at the 3- and 12-month horizons. The progress on inflation since 2022 is apparent, with the most recent values for the three-month gauge close to 2 percent. The figure also makes it clear that progress has been uneven. The favorable readings in the second half of 2023 were followed by an increase in inflation early this year. As the right panel shows, monthly inflation volatility remains elevated relative to pre-pandemic levels. This volatility highlights the need to assess the data holistically, to separate the signal from the noise, and to not overreact to any one monthly reading. Overall, I see the inflation picture as encouraging. However, we should not be surprised if measured progress on a 12-month basis slows a bit in the near term, as the low readings at the end of last year drop out of the 12-month computation window. This will likely continue until we are past the higher numbers from early this year.

Separating core inflation into three components, as shown in **Figure 3**, illustrates that most of the remaining elevation comes from housing. Core goods inflation, in the left-hand panel, has been back down in its pre-pandemic range for many months. The 3-month annualized measure of services inflation excluding housing, in the right-hand panel, has also returned to its pre-pandemic range. If that continues, the 12-month

measure will decline over time. However, while housing price inflation has come down some, progress has been slow and uneven.

Here, the good news, as shown in **Figure 4**, is that the data show little evidence of new price pressures from market rents, an important driver of shelter inflation. All three measures of the change in rents associated with new leases are back down from their 2021-22 surge. Shelter inflation is high because rents for existing tenants are still catching up to this past surge. While this catch-up process may continue to be slow and uneven, it does not raise concerns for me about the durability of inflation's trajectory back to 2 percent – as long as new tenant rent inflation remains subdued and overall inflation expectations stay well-anchored.

As **Figure 5** highlights, the situation regarding inflation expectations is favorable. Short-run expectations are near their pre-pandemic range (as shown in the left panel). More importantly, long-run expectations (in the right panel) have stayed well-anchored throughout the inflationary episode. This makes returning to 2 percent inflation feasible *without* the economy staying below capacity for a time, as would be the case if expectations had risen and needed to be re-anchored. The stability of long-run expectations during this period further speaks to the credibility of the Fed in fighting inflation.[1]

The Labor Market and Supply Developments

What about the labor market? The three panels in **Figure 6** show just a few of the many indicators I follow – the unemployment rate remaining near 4 percent, low unemployment claims, and declines in both job openings and quit rates. These indicators are also near levels seen around 2018, when labor market conditions were

[1] This credibility is also rooted in the Federal Reserve's independence from other branches of government. For further discussion of the importance of central bank independence in delivering low and stable inflation and anchored inflation expectations see, for example, the recent speech by Governor Kugler on central bank independence and the conduct of monetary policy - Federal Reserve Board.

arguably consistent with full employment. In other words, the labor market has normalized from unsustainably tight conditions a year or two ago and is consistent with inflation durably returning to the 2 percent target. This healthy picture of the labor market is also reflected in conversations with employers across the Boston Fed district, which encompasses most of New England. However, I'll note that payroll growth has slowed over the past year, and job creation has become more concentrated in a few sectors.

The combination of disinflation with a labor market near full employment is taking place amid robust output growth, as shown in **Figure 7**. The blue line depicts the evolution of real GDP, which has been growing considerably faster than estimates of trend output growth from 2015 to 2019 – the dashed blue line.[2] An economy near full employment entails GDP near trend – and, as suggested by the dashed red line, in the current context this implies a notably higher trend growth rate since the pandemic.

Strong growth with no meaningful signs of new price pressures highlights the important role favorable *supply* developments have played so far in the recovery. One of these developments has been an expansion of labor supply, which came, in part, from a larger than expected increase in labor force participation. Interestingly, as **Figure 8** shows, this rise has occurred across gender (as shown on the left) and racial/ethnic groups (as shown on the right). Although not shown, increased immigration was also a major contributor to this expansion in labor supply. There is work underway – and to be done – to better understand these developments, their implications and the extent to which they are likely to persist.

Another positive supply development has been a notable rise in labor productivity. **Figure 9** shows one such measure – real output per hour for the nonfinancial corporate sector. The initial surge in labor productivity reflected the sharp drop in employment early in the pandemic, which was followed by severe labor

[2] Trend output growth from 2015-19 is assumed to be 1.9 percent based on the median longer-run projection for GDP growth from the December 2019 FOMC Projection materials.

shortages that were partially reversed when firms were able to replenish their workforces. Still, even after the catch-up in employment, productivity remains on a higher trend than it was before the pandemic. Notably, other advanced economies have not experienced the same favorable productivity developments.

A number of reasons have been cited to potentially explain the strength in U.S. labor productivity. First, some firms learned to do more with fewer workers by investing in labor-saving technologies and restructuring aspects of production. **Figure 10** highlights some sectors where this seems likely to have occurred. For professional and business services, productivity gains do not seem to be slowing much. But it is possible that some of these level improvements are now behind us, so that productivity may revert to previous trends. This could be the case in sectors such as healthcare and leisure and hospitality, shown on the right.

However, other developments could prove more persistent. In particular, there has been a surge in new business formation since 2020, as shown in **Figure 11**. This is a promising development that is in stark contrast to what has been described as the "broad-based slowdown in U.S. business dynamism from 1970 to 2020." Indeed, the entry and dynamics of new firms has been shown to be a "significant driver of job creation, innovation and productivity growth."[3] Finally, A.I. could be behind some of these improvements. In my view, however, the overall impact of A.I. at this point is still likely to be small but could increase meaningfully going forward.[4]

Importantly, given the labor productivity improvements to date, I see little scope for wages to disrupt the ongoing disinflation progress. Indeed, analysis by my staff shows that labor remains relatively inexpensive, given recent productivity gains and

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[3] See "The Recent Rise in US Labor Productivity" by Luke Pardue, published by the Aspen Economic Strategy Group of the Aspen Institute (Labor Productivity In Brief)

[4] For a discussion of the potential impact of A.I. on the economy see the proceedings from the recent Atlanta Fed Conference on Technology Enabled Disruption, available at https://www.atlantafed.org/news/conferences-and-events/conferences/2024/10/01/technology-enabled-disruption/agenda.

price developments. Therefore, even though wages are growing faster than they were before the pandemic, this is not placing additional pressures on inflation.[5]

With many workers still grappling with the effects of high prices, preserving the current favorable conditions also means maintaining an environment in which they can continue to see increases in the purchasing power of their wages and improvements in their economic well-being. This is one reason why restoring and sustaining price stability is so important.

Monetary Policy and the Balance of Risks

Against this backdrop, it was appropriate to begin recalibrating monetary policy this fall. I expect additional adjustments will likely be appropriate over time, to move the policy rate gradually from its current restrictive stance back into a more neutral range. However, policy is not on a pre-set path. The FOMC will need to make decisions meeting-by-meeting, based on the data available at the time and their implications for the economic outlook and the evolving balance of risks. I will close this section of my remarks by saying a bit more about my thinking here.

Figure 12 shows the path of the federal funds rate, with the left side giving historical context. The panel on the right focuses on the recent period, in which the FOMC increased the rate rapidly, from essentially zero in 2022 to 5½ percent in July 2023, then held the rate at that level for 16 months before cutting by 50 basis points in September, and another 25 earlier this month.

Restrictive monetary policy has clearly been one factor helping to rein in inflation. Combined with the supply improvements I have already mentioned, it has played a role

[5] For recent analyses on this topic, see Is Post-pandemic Wage Growth Fueling Inflation? - Federal Reserve Bank of Boston (bostonfed.org), and Productivity Improvements and Markup Normalization Can Support Further Wage Gains without Inflationary Pressures - Federal Reserve Bank of Boston (bostonfed.org).

in rebalancing demand with supply, reducing pressure on wages and prices. However, as I have also discussed, the overall effects from restrictive policy on the labor market and real economic activity have been relatively modest so far.

One reason for this has to do with factors unique to the pandemic recovery that strengthened the financial positions of households and firms. The left panel of **Figure 13** shows how pandemic-era household support programs, combined with limited spending opportunities when much of the economy was shut down, led to the accumulation of significant amounts of extra savings, as shown by the red line. In addition, many firms were able to lock in longer-term debt at very favorable rates. As shown in the right-hand panel, corporate cash holdings increased notably. These developments likely provided some cushion from the full effects of high interest rates.

But Figure 13 also makes clear that these special buffers have waned. Most of the excess household savings are now depleted. And though still elevated, corporate cash holdings have fallen notably.

Given these developments, monetary policy needs to adjust in order to achieve our dual mandate goals. While the final destination is uncertain, I believe some additional policy easing is needed, as policy currently remains at least somewhat restrictive. The intent is not to ease too quickly or too much, hindering the disinflation progress to date. At the same time, easing too slowly or too little could unnecessarily weaken the labor market.

Importantly, there are risks to achieving both our inflation and our employment goals. On the inflation side, demand has been surprisingly resilient, and we could see more consumption growth than anticipated, putting upward pressure on prices. Indeed, household net worth remains quite elevated, and equity prices have generally moved higher recently. Households may also be more inclined to access the equity in their homes as interest rates decline.

On the other hand, as I have mentioned, job growth is moderating, with recent gains concentrated in just a few sectors. At this stage, any further slowing in hiring

would be undesirable. In addition, an economy growing near trend may be more vulnerable to adverse shocks – and geopolitical risks remain elevated.

All told, I see the risks to my quite favorable baseline outlook as roughly in balance. Inflation is returning sustainably, if unevenly, to 2 percent, and to date, labor market conditions are healthy overall. Policy is well-positioned to deal with two-sided risks and achieve our dual mandate goals in a reasonable amount of time. The policy adjustments made so far enable the FOMC to be careful and deliberate going forward, taking the time to holistically assess implications of the available data for the outlook and the associated balance of risks.

The Federal Reserve: Serving the Public in a Variety of Ways

As noted at the outset, I would like to round out my discussion of the economy and monetary policy with some perspectives on the Fed itself – focusing on the Boston Reserve Bank.

I know that the Federal Reserve – and central banking more generally – can seem a bit mysterious. In fact, my colleagues and I are eager for the American public to know about and have confidence in the work we do. So, I'll say a bit about our structure, grounding, roles, and the breadth of work in our portfolio.

The Federal Reserve's design is unique, emphasizing the wide range of stakeholders and regions in our economy, and the range of perspectives needed to support it. As you see in **Figure 14**, our federated structure has 12 regional Reserve banks, representing every part of the country, and the Board of Governors in Washington. And our senior policymakers are appointed to their roles[6] in different ways.

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[6] The seven Governors are nominated by the President of the United States subject to the advice and consent of the Senate. One governor is additionally nominated to be chair, one to be vice chair, and one to be vice chair for bank supervision. The 12 presidents of the regional Reserve Banks are selected by the non-banker members of the boards of directors of each Reserve Bank, with the approval of the Board of Governors. The Federal Open Market Committee, or FOMC, sets U.S. monetary policy. The 12 voting

All of this makes the Fed representative of the country, appropriately accountable, and also independent enough to make hard choices in the longer-term public interest.

Congress created the Federal Reserve and gave us the mandates to guide our monetary policy responsibilities, as I noted earlier. One of the things my colleagues and I find inspiring about our Congressional mandates, and more broadly our role in serving the public, is the fact that our mission and mandate are for the public – for all the American public. At the Boston Fed, our vision is "A vibrant economy that works for all."[7]

To do all of this, we have a variety of roles and responsibilities. I've discussed monetary policy, where our contributions are rooted in extensive, and very rigorous, research and analysis. Our researchers also do important work on various aspects of the economy. I have already mentioned our analysis concluding that, given recent productivity Improvements, there is room for further wage gains without inflationary pressures. A second example is our research on aspects of the housing challenges so prevalent in New England, and across the nation.[8] A third is reflected in the topic of our 68th Economic Conference, held just last week, on the future of finance. The conference looked at the implications of technological innovation for small businesses, financial inclusion, financial stability and more; and considering both the promise and the challenges.[9]

In addition to rigorous work with quantitative data, we also put a strong emphasis on understanding how different people and places experience the economy. Pursuing

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members include the seven members of the Board of Governors; the president of the Federal Reserve Bank of New York; and four of the remaining 11 Reserve Bank presidents, who serve one-year terms on a rotating basis. The remaining seven Reserve Bank presidents attend FOMC meetings and participate in FOMC deliberations. See The Fed Explained - Who We Are.

[7] And our mission is "to serve the public by promoting a strong, resilient, and inclusive economy and financial system for New England and the nation."

[8] See Addressing Housing Shortages through Tax Abatement, The Pass-through of Gaps between Market Rent and the Price of Shelter, Report on the Potential Impacts of Property Tax Abatement on Rental Housing Construction in Boston, A Faster Convergence of Shelter Prices and Market Rent: Implications for Inflation, House Prices and Rents in the 21st Century, and Local Zoning Laws and the Supply of Multifamily Housing in Greater Boston.

[9] The Future of Finance: Implications of Innovation - Federal Reserve Bank of Boston

the mandate for price stability requires us to understand inflation's impact on people in all areas and across the income spectrum. Pursuing the mandate for maximum employment requires us to understand not just national aggregates (such as aggregate unemployment, and national job openings), but also the different outcomes for various people and places.

While I always immerse myself in economic data, I complement this with conversations across the economy's stakeholders, and some examples of these interactions are shown on **Figure 15**. It is very valuable to hear how people are experiencing the economy, so I meet with business owners, entrepreneurs and innovators, workers, advocates, bankers, educators, and a host of others. We meet in rural New England, suburbs, downtowns, former mill towns – in areas where former engines of the local economy have declined or gone away, as well as areas that are thriving.

The Fed has other roles in its portfolio, reflecting the importance banks and the financial system have to the economy's health and the public good. We supervise some of the region's financial institutions for safety and soundness.[10] In addition, our team researches and analyzes financial stability pressures, and it extends credit to depository institutions to promote the smooth functioning of the payment system and help relieve liquidity strains in the banking system.

The Fed also supports the infrastructure for the payments transactions we all make and receive, and that firms and financial institutions rely on to be secure, reliable, and resilient. The Federal Reserve developed, and operates, payments systems: for the automated clearing house (the "ACH" – think direct deposit of a paycheck, for example), wire transfers, cash distribution through banks, check processing, and now real-time

[10] In the U.S., bank supervision is shared among several agencies, including the Federal Reserve Board, which delegates some of the on-the-ground supervisory activity to Reserve Bank staff.

payments with FedNow.[11] The number and value of transactions handled each day by these payment systems is huge.

The Boston Fed has a history of innovation at the intersection of payments, technology, and finance, most recently by taking a leading role in developing FedNow, the new real-time payments system, launched in July 2023. It's the first new payments platform built by the Fed in nearly 50 years, bringing the immediacy we all now expect in our lives to payments. Individuals and businesses whose financial institutions adopt the service can send and receive instant payments any time, with immediate funds availability.[12]

Finally, I'll mention the Fed's support for community economic development. We conduct research to help illuminate challenges and opportunities, and we help as a convener and catalyst for collaboration across sectors.[13] We've found that local people and institutions, collaborating on shared challenges, holds the best potential for progress in addressing challenges to local economic resurgence.

One of the things we're proud of is illuminating, in a rigorous and nonpartisan way, issues that have a profound effect on people's experience of the economy and their ability to participate in it. An example is dependent care – absolutely an economic

[11] You can learn more about the Federal Reserve's work in payments at the following link: The Fed Explained - Payment Systems.
[12] Over time, we expect instant payments to be used routinely for many everyday payments. Businesses and consumers are starting to benefit from use cases such as account-to-account transfers, bill pay, earned wage access, digital wallet funding/defunding and many others. Workers completing their shifts can get access to their wages immediately when it's deposited into their account at a participating financial institution. Insurers can instantly disburse claim-related funds to people impacted by a natural disaster. Small businesses can use instant proceeds from sales or services to ensure steady cash flow and avoid the need for short-term credit. Account holders can move funds from a brokerage account to a checking account with no delay in accessing transferred funds. Digital wallet holders can fund or defund their wallets with immediate funds availability.
[13] See my talk, A Partnership for Progress (https://www.bostonfed.org/news-and-events/speeches/2024/a-partnership-for-progress.aspx), and also the podcast "Working Places at 10" with Colleen Dawicki.

issue, given that its availability and cost directly impact the ability of many people to participate in the labor market.[14]

Concluding Observations

It means a great deal to be back at the Ford School – it's a very special place. I appreciate the opportunity to share my analysis of the economy and some information about how the Federal Reserve fits into the American framework for policymaking.

Reflecting on my time here at the Ford School, and more recently at the Fed, and on the missions of these institutions, I will end by stating that the central bank shares your articulated dedication to the public good, your grounding in service, and your commitment to evidence-based policymaking.

Thank you and my very best wishes to each of you, the Ford School, and the University of Michigan. *Go Blue!*

[14] See Recent Trends in Vermont Childcare: A Decrease in Capacity, Increases in Cost and Quality, and Policy Responses and Early Child Care for Working Parents