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Perspectives on the Economy from Susan M. Collins

President & CEO Federal Reserve Bank of Boston

Please note, these views are my own and may not reflect the views of colleagues at the Board of Governors, on the Federal Open Market Committee, or at other Reserve Banks.

Before heading to the Federal Reserve's annual symposium at Jackson Hole, Wyoming, I have been meeting with stakeholders in the economy from across New England, the Boston Fed's region – hearing their experiences and sharing my take on current conditions and monetary policy. And, as always, monitoring a great deal of economic data.

I am pleased to share a summary of my views in this *Perspectives*.

Overall, I see recent economic activity as expanding at a near-trend pace and labor market conditions as broadly consistent with maximum or full employment, one part of the Fed's dual mandate. But with inflation still too high, I remain particularly concerned about the price stability portion of the dual mandate.

A balanced, if unusual, labor market

Labor market conditions have been stable, with the unemployment rate just above 4 percent and fluctuating within a narrow range since mid-2024. Layoffs continue to be limited, and initial unemployment-insurance claims remain at the lower end of the range seen since 2022. While volatile from month to month, hiring has picked up relative to late 2025 and become somewhat more broad-based across industries.

Of course, the aggregate data mask significant variation across place, occupation, and industry. In discussions, I hear from some employers seeing numerous strong job applicants and from others struggling to find the skilled workers they need.

I view risks to the labor market as two-sided. On the upside, stronger-than-expected economic growth could tighten labor market conditions, raising price pressures. On the downside, less optimistic views about short-term AI-related returns could lead to stock-market repricing with adverse effects on business and consumer spending – and thus demand for labor. In some cases, AI could also displace, rather than complement, labor. And with a low job-finding-rate in this low-hire, low-fire environment, some workers could become discouraged and leave the labor force.

So overall, I see labor market conditions as broadly balanced – although it is an unusual balance and not without risks. But with sharply reduced immigration and an aging population, labor demand should grow enough to match labor force growth, keeping the labor market near full employment over the coming months.

Inflation concerns

Against this stable labor market backdrop, I am particularly focused on inflation, which has been running above the FOMC's 2 percent target for over five years. Concerns about high prices are pervasive in my conversations with stakeholders across New England. In particular, high energy costs are cutting further into households' discretionary income. I also hear of people taking on multiple jobs to make ends meet, and more generally, of increased financial stress among lower-income households.

In the coming months, I will be looking for evidence that inflation is durably returning to 2 percent, consistent with my modal, or most likely, outlook for the remainder of this year. This outlook is predicated on seeing limited additional tariff increases and some degree of reopening of the Strait of Hormuz, two developments I am watching closely. In this modal scenario, the pass-through to prices of previous tariffs should largely have played out by now, and the impact of high energy costs should begin to wane.

Furthermore, I see three factors that should help with the gradual disinflation process. First, a balanced labor market, with economic activity growing near trend, should not be a source of additional price pressures. Second, mildly restrictive monetary policy, together with the recent rise in longer-term interest rates, should mitigate, at least to some extent, a possible re-acceleration in household and business spending. And third, solid productivity growth – if it continues – should put some downward pressure on prices.

But less benign scenarios are also quite plausible. In particular, there are upside risks to inflation from both additional adverse supply shocks, and a stronger-than-expected pace of economic activity. With regards to the latter, I'll note that the AI build-out appears to be putting upward pressure on core goods inflation.

While June and July inflation reports were mildly encouraging, monthly readings can be volatile. It remains to be seen whether the recent improvements will be sustained, and data in the weeks ahead should shed additional light on the trajectory of underlying inflation – and the extent to which it is receding.

Factors to focus on

Overall, the interplay of demand and supply factors over the near term will continue to shape my outlook for real activity and inflation. I'll highlight a few key aspects I am focused on:

- One important question is the extent to which ongoing productivity growth can offset inflationary pressures from demand or supply sources. Evidence indicates that since the pandemic, industries where labor productivity has risen the most are also the ones where price growth has been more moderate. While this dynamic has yet to show clearly in aggregate data, it could become more apparent as the effects of previous adverse supply shocks wane over the coming months. At the same time, productivity gains could slow.

- New adverse supply shocks, or an acceleration in demand, could outweigh such potentially favorable dynamics. I am particularly concerned about the continued closure of the Strait of Hormuz, as oil inventories have dropped to historically low levels. We could also see additional tariff increases.

- Given the prolonged period of above-target inflation, another rise in inflation could lead longer-term inflation expectations to unmoor. In that regard, I am carefully monitoring a wide range of inflation expectations measures, and how they are influencing firms' price-setting behaviors and workers' wage demands.

Implications for monetary policy

Given the many possible scenarios, policy will need to be nimble. I was comfortable with July's FOMC decision to maintain the current target range for the federal funds rate. For now, this mildly restrictive policy stance should leave the Committee well positioned to address evolving economic conditions and return inflation to target in a reasonable amount of time. But for me, maintaining the current federal funds rate target range will require continued evidence that inflation is indeed coming down.

Without such evidence, it will be more difficult to rule out other inflationary forces being at play – including the possibility that firms' price-setting behavior has become inconsistent with 2 percent inflation.

Should evidence of sustained inflation progress not materialize, I believe it will be appropriate to tighten policy soon to ensure we deliver price stability in a reasonable time frame.

In this time of significant uncertainty and following a series of large, unusual shocks to the economy, I particularly value the range of perspectives expressed around the FOMC table. I look forward to the on-going robust, substantive, and data-driven discussion with my fellow Committee members, as we continue to seek the best path to achieving our dual mandate.