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Economic Outlook

Global Interdependence Center Central Banking Series Conference
Nassau, Bahamas

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The views expressed today are my own and not necessarily those of the Federal Reserve System or the Federal Open Market Committee (FOMC).

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Thank you, it is my pleasure to join you all for this conference.

This is the last time I will be attending a Global Interdependence Center (GIC) event as president and CEO of the Federal Reserve Bank of Philadelphia, given my upcoming retirement at the end of June. So, please, and for perhaps the last time, allow me to remind you that the views I am about to express are my own do not necessarily reflect those of my colleagues throughout the Federal Reserve System or on the Federal Open Market Committee (FOMC).

I must also express my sincere thanks to GIC, and Executive Director Jill Fornito, for bringing us together.

GIC's work to enhance understanding of the underpinnings of global economic conditions through convenings such as this — whether we be central bankers, academics, or private-sector economists and experts — has prepared us to knowledgably face challenges and find opportunities.

As president of the Philly Fed, I feel somewhat an obligation to, at this moment, mention our fair city's most-celebrated citizen, Benjamin Franklin, who is widely quoted to have said, "An investment in knowledge pays the best interest." Now, he said those words before the United States was even the United States and over a century before the Federal Reserve System was established. But leave it to Ben Franklin to provide timeless guidance.

So, I sincerely hope the time we're investing together now will similarly pay interest by presenting ideas on how we can, together, foster greater global economic opportunity, stability, and growth.

And now that I've uttered the "I" word, I might as well get into my outlook!

As you know, two-and-a-half weeks ago, the FOMC voted to hold the policy interest rate steady at 4.25 to 4.5 percent. Even though I am not a voting member of the Committee this year, I do fully support this decision.

Across the final three FOMC meetings of 2024, the Committee decided to reduce the policy rate by a full percentage point. In doing so, we recalibrated the stance of monetary policy to a point where it remains restrictive, but less so than last summer, when the policy rate had been above 5 percent for more than 12 months. The recalibration has left policy in good position for the road ahead. We will remain data dependent, looking for the underlying conditions, and making decisions based on our best assessment of the outlook and risks.

Looking at inflation — and at personal consumption expenditure (PCE) inflation, specifically — the December-to-December annual rate of 2.6 percent headline and 2.8 percent in the core categories largely met expectations. The latest Consumer Price Index (CPI) data for January point to a bit of a bump for prices. Though I must say, *again*, in January. In the last decade, CPI inflation in January has surprised on the upside nine out of 10 times. My conjecture is that seasonal adjustments are struggling to keep up with a fast-changing economy, and we need to parse the underlying trends from the month-to-month noise.

To be sure, inflation has remained elevated and somewhat sticky over the past several months, both in the overall and core figures. But that notwithstanding, I do believe that our current positioning will bring inflation back to target, in the next two years if conditions broadly evolve as I expect. If we were to look at monetary policy as we would a gauge on our car dashboards, the needle would still be pointing to the "restrictive" side, albeit less so than it was five or more months ago. We need to continue letting monetary policy do its work and letting the data roll in. But, indeed, there are also upside risks which we cannot easily dismiss, which I'll touch on in a moment.

Labor markets have largely returned to balance. Last year ended with a stellar report for job growth, and this year started pretty well too, so the signs indicate hiring has continued at a decent clip.

So, I am concerned when I hear or read observers referring to the jobs numbers as representing a "slow down" in hiring. Well, yes, it is slower when compared to the torrid pace of growth in the months coming out of the pandemic. Some jobseekers may be taking longer today to find new employment than they had in, say 2022, but the numbers imply that persistence pays off and workers are finding jobs. And in an overall historic context, I'd suggest that the labor market has recalibrated to where it was in 2018 or 2019. And I don't know many of us who would argue that the labor market was in poor shape then. Quite the opposite.

Now, surely, it is our nature to want to parse out month-over-month fluctuations. But, as I said earlier, I am more interested in trends gleaned by looking over a longer time horizon than I am noise from a single report. In the labor picture, one thing I see is average monthly employment creation over the entire course of 2024 largely mirroring the pace of growth of the years immediately preceding the pandemic.

The unemployment rate remains low and is about in line with my projections. Meanwhile, GDP growth has similarly continued apace, with 2024 proving the American economy more resilient than some forecasts had predicted. And while fourth-quarter growth came in lower than the previous quarter, the economy stood firm especially in the face of an October highlighted by a major labor strike and multiple natural disasters. And yet again, consumers came in with another strong quarter of spending, even if there are some clouds in the distance that we should not ignore as I'll touch on, as well.

I would also point to the Philadelphia Fed's own Aruoba-Diebold-Scotti business conditions index, which measures a slew of high-frequency indicators. This index has been moving upward since October and has been tracking in generally positive territory since late November.

As we started the year, the Philly Fed's January *Manufacturing Business Outlook Survey* — the MBOS — registered its biggest jump in current activity in nearly four years. Now, obviously, one month does not a trend make, so I will certainly be looking at the release of this month's MBOS later this week for greater guidance.

All in all, the current data paints a picture of an American economy that continues to function from a position of strength. Inflation is still elevated and the mission is not yet accomplished — but I am encouraged both by the longer-view, which clearly points to disinflation in the last two years, and the zoomed-in view, seeing key categories like shelter move in the right direction. GDP and production remain resilient. Labor is largely in balance. And these are reasons enough for holding the policy rate steady.

And while I won't commit to a specific timetable, I remain optimistic that inflation will continue a downward path and the policy rate will be able to decline over the long run. This does not mean that there aren't areas of potential concern. In fact, the only thing I can say with any certainty is that there are many uncertainties.

Upside risks to inflation and downside risks to employment remain in the balance. With regard to inflation, we simply do not yet know what, if any, impacts we may see from new economic policies and priorities, whether they be domestic or foreign in nature and impact.

As a reminder, it is not the Fed's role to devise, let alone comment upon, any such policies. Our role is to use the monetary policy tools at our disposal to ensure we can meet our dual mandate within those chosen frameworks. And there are risks from entirely non-governmental happenings as well, such as the impact that avian flu may have not just on the price of eggs but also on all the products which rely upon eggs for production.

Moreover, I must acknowledge that as far as I can stand here and say that the American economy is operating from a position of overall strength, there are many, many families and

businesses for whom that pronouncement rings somewhat hollow. And, in fact, I see some of the basis for their sentiment in the data we collect at the Philadelphia Fed.

For example, the Philly Fed has access to a long data series looking at consumer credit. In the aggregate, overall credit card delinquency rates have been moving sideways. But our staff has found an increasing practice of consumers making only the minimum payment toward their credit card balances, with more than one-in-nine active accounts now making just the minimum monthly payment. Now, certainly, not every minimum payment will become a missed payment, and not every account is going to fall into the hole of delinquency. Some consumers, surely, will cure their accounts and clear their balances. But the data show the increasing stress that many consumers are facing in managing to keep their heads above a financial waterline.

Moreover, our Consumer Finance Institute (CFI) recently conducted a survey in which it asked individuals expressly about the cost of their home or renters, health, and auto insurance premiums. The CFI report of the survey is yet to be final, but I do wish to share some of its insights with regard to homeowners insurance, specifically. First, insurance holders reported increases in their premiums over the prior year at a higher rate than any other insurance product. Moreover, more of them described the increase as "significant." Second, homeowners were much more likely to have taken on a higher deductible as a means of managing the increase in premiums. In other words, they are willing to take financial risks in the future, literally betting the house, in order to improve their liquidity position right now.

Now, when it comes to the inflation indices — whether you are looking at the CPI or PCE — insurance costs may not carry enormous weight within in the overall equations. But, around kitchen tables they do, especially among households which already feel financial stress.

And as GDP has been buoyed by the resilience of consumer spending, it does raise a concern as to how long this appetite for spending will persist.

At the moment, these are still just clouds on the horizon. Whether they dissipate or gather is still, pardon the pun, up in the air. We just need to make sure we're watching very carefully because while there certainly is no virtue to acting too late there is also no virtue to acting too soon.

Against this backdrop, the responsible play is to watch the hard data as they come in, along with the soft data we glean from our contacts, to listen to the story they are telling us, and then acting accordingly to the moment. I have only three more FOMC meetings to attend before my retirement, but this is the playbook that I will be following. Between our January meeting and the next FOMC meeting in March, we will have received two additional CPI and PCE readings, along with two months' worth of employment reporting.

That allows us ample time to read deep into a whole lot of data. And that's good. In this work we disengage from hypotheticals and focus on realities. The more data points we have, the better these realities come into focus. Our actions, let alone our public pronouncements, cannot be based on conjecture but rather on facts. And by "us" and "our" I do not mean those of us sitting around the FOMC conference table, but all of us here.

I thank you for allowing me these few moments and, Bill, I look forward to our discussion.