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The Outlook for Inflation and Monetary Policy

Remarks by

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Thank you to the Massachusetts Bankers Association for the opportunity to speak to you today. It is often good to get away from Washington to gain some perspective, and it's always worthwhile for me when I can get some perspective from bankers.

I will touch on some of the banking issues I expect are on your minds, but one of the biggest issues for everyone right now is inflation, what the Fed is doing to get inflation under control, and the implications for your businesses, your customers, and your communities.

Inflation is the highest we have seen in the United States in 40 years and so far it shows little sign of moderating. At the same time, the economy is growing at a moderate pace, and the labor market is extremely tight, as indicated by a variety of measures including reports of many employers unable to find workers despite significantly raising wages. That tightness is contributing to inflation, because labor is the largest input cost for producing goods and providing services. Inflation is a significant challenge for everyone, but it hits lower- and moderate-income people the hardest, since they spend a larger share of their incomes on necessities and often have less savings to fall back on. Inflation is also a burden for businesses that must somehow balance unpredictable costs while setting prices that aren't so high that they discourage customers from purchasing. Inflation that continues at these levels is a threat to sustained employment growth and to the overall health of the economy.

The inflation data show that, after moderating slightly for a short time, price increases for motor vehicles have picked up again, energy prices rose sharply in May, and prices for food have risen more than 10 percent from a year ago. The inflationary effect from the invasion of Ukraine has proven to be lasting for both energy and food commodity prices, with little prospect of the conflict or those price pressures abating very soon. More broadly, global supply chain issues continue, in part because of the effect of ongoing COVID-19 lockdown policies in China that have slowed production and shipping.

One important factor that we often point to in driving today's spending decisions and inflation outlook are expectations of future inflation. Near-term expectations tend to rise as current inflation increases, but when inflation expectations over the longer-term—the next 5 to 10 years—begin to rise, it may indicate that consumers and businesses have less confidence in the Fed's ability to address higher inflation and return it to the Federal Open Market Committee's (FOMC) goal of 2 percent. If expectations move significantly above our 2 percent goal, it would make it more difficult to change people's perceptions about the duration of high inflation and potentially more difficult to get inflation under control. As we see surveys like the Michigan survey report higher longer-term inflation expectations, we need to pay close attention and continue to use our tools to address inflation before these indicators rise further or expectations of higher inflation become entrenched.

As I mentioned earlier, one force driving inflation is the extremely tight labor market. The benefits from a tight labor market are easy to see—the U.S. economy continued to add jobs at a pace of 400,000 per month for the past three months, which is remarkable considering the low number of people looking for work. Today, most people who want to work can find a job, and wages and salaries have risen faster than they have in decades. Even with these gains, wages have not kept pace with inflation, which has made it much more difficult for many workers to make ends meet in the face of soaring housing, energy, and food costs.

Job creation signals strong labor market demand, particularly in the current environment, with a large number of available jobs and fewer job seekers. In addition, the tightness of the labor market is exacerbated by a labor force participation rate that remains far below the pre-pandemic benchmark, representing millions of workers sitting on the sidelines. Many of these are early retirees, some incentivized to retire during the pandemic, and those with family caregiving challenges including very high costs for childcare. While the strong job market has brought some of these workers back into the workforce, it seems that many are still waiting or may not return, meaning that labor shortages will likely persist in many sectors of the economy.

I've laid out many of the challenges, so now let me talk about what the Federal Reserve is doing to get inflation under control. In the face of inflation that continues to be much too high and in light of the recent high readings, the FOMC raised the federal funds rate by 75 basis points at our most recent meeting last week. That increase followed two rate hikes totaling 75 basis points earlier this year, and we indicated that further increases will likely be appropriate in the months ahead. On June 1, the Fed took a separate step to tighten monetary policy by beginning to reduce its large balance sheet of securities holdings.

I strongly supported the FOMC's decision last week, and I expect to support additional rate increases until we see significant progress toward bringing inflation down. Based on current inflation readings, I expect that an additional rate increase of 75 basis points will be appropriate at our next meeting as well as increases of at least 50 basis points in the next few subsequent meetings, as long as the incoming data support them. Depending on how the economy evolves, further increases in the target range for the federal funds rate may be needed after that. The case for further rate hikes is made stronger by the current level of the "real" federal funds rate, which is the difference between the nominal rate and near-term inflation expectations. With inflation much higher than the federal funds rate, the real federal funds rate is negative, even after our rate increases this year. Since inflation is unacceptably high, it doesn't make sense to have the nominal federal funds rate below near-term inflation expectations. I am therefore committed to a policy that will bring the real federal funds rate back into positive territory.

While I expect that the labor market will remain strong as the FOMC continues to tighten monetary policy, these actions do not come without risk. But in my view, our number one responsibility is to reduce inflation. Maintaining our commitment to restore price stability is the best course to support a sustainably strong labor market. The Fed's credibility, earned over decades of low inflation, is a powerful policy tool that is critical to our long-term success. If that credibility erodes, it must be re-earned.

As a step toward that goal, I also supported the Committee's action to begin reducing the Fed's balance sheet, which is providing unneeded economic stimulus making inflation worse. The current balance sheet is composed of Treasury securities and a significant amount of agency mortgage-backed securities (MBS). Since the longer-term goal of the balance sheet reduction plan includes a Treasuries-only balance sheet, it would make sense to eventually incorporate MBS sales into the plan so that reaching this goal does not take too long. My longer-term goal would be to get the Fed out of the business of indirectly intervening in the real estate market.

In closing, I know that inflation, and our efforts to lower it, may present challenges for banks. The first session on your agenda this morning discussed interest rate risk, and I would be interested to learn how you are managing this risk so far and what you expect as the year progresses. Many of your sessions and speakers overlap with the Fed's work in supervision and much of what I'm focused on, including innovation and how best to use technology like AI and fintech to level the playing field for banks. Attracting and retaining talent, along with succession planning, are absolutely critical for long-term sustainability. One other matter is the recently issued Community Reinvestment Act (CRA) proposed rule that would significantly change supervisory implementation and qualifying activities. I strongly encourage you to review this proposal and comment so that banks subject to the CRA understand the changes and will be able to continue to effectively serve their customers and communities.

I look forward to hearing your thoughts on these issues, and I look forward to our discussion. Thanks again for the invitation to join you this week—it's great to be here with you to discuss these and other important matters.