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U.S. Economic Outlook and Monetary Policy

Remarks by

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Board of Governors of the Federal Reserve System

at the

Economics Department Special Lecture, Lafayette College

Easton, Pennsylvania

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Thank you, Professor Smith. It is an honor to be speaking to you today here at Lafayette College.[1] I am glad to have the opportunity to return to such a historically important place as Easton, Pennsylvania, and the Lehigh Valley. This area was part of this country's colonial beginnings, it was instrumental in the rising of the industrial age, and, as the home to Crayola, it very literally played a role in coloring how we see the world. Today, this region is leading the way forward with its many outstanding institutions of higher education, very prominently including, of course, Lafayette College.

Today, I would like to take this opportunity to share with you my outlook for the U.S. economy and my views of appropriate monetary policy. This is a useful time to do that, as my colleagues and I on the Federal Open Market Committee (FOMC), the Federal Reserve's primary monetary policymaking body, held our first meeting of 2025 just last week.

Overall, the U.S. economy is starting the year in a good position. I expect inflation's slow descent to continue, and I anticipate that economic growth and labor market conditions will remain solid. I have learned, however, that it is wise to be humble about my projections. There is always a great deal of uncertainty around any economic forecast, and currently we face additional uncertainties about the exact shape of government policies, as well as their economic implications.

Last week, my FOMC colleagues and I discussed the latest economic developments and reviewed data that arrived since our previous policy meeting in December. At the conclusion of that meeting, I voted in support of the Committee's decision to maintain the target range for the federal funds rate at 4-1/4 to 4-1/2 percent.

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[1] The views expressed here are my own and are not necessarily those of my colleagues on the Federal Reserve Board or the Federal Open Market Committee.

This decision was made in support of our goals to achieve maximum employment and inflation at the rate of 2 percent over the longer run. I remain focused on setting policy to achieve the dual-mandate goals given to us by Congress: maximum employment and stable prices. Sound monetary policy and positive supply-side developments have contributed to the achievement of sustained economic growth in recent years, the return of low unemployment, and inflation moving sustainably toward our 2 percent objective. I remain committed to returning inflation to our target while sustaining the solid labor market. Now is an appropriate time to assess the path forward for the economy. I am happy to be here today to share my views with you.

Economic Activity

The U.S. economy appears to be maintaining its momentum after growing at a solid pace last year. Last year's growth was notable because many private forecasters in 2023 projected a significant downturn sometime in 2024.[2] However, data over the past year painted a very different picture. GDP grew 2.3 percent in the fourth quarter of 2024, according to last week's data release.[3] As you can see in figure 1, that extends a stretch of solid quarterly growth over the past couple of years. Shortly, when I discuss the labor market, I will say more related to the large swing in GDP growth in 2020 that stands out in this chart. For all of 2024, the economy grew 2.5 percent, which is a modest slowing from the 3.2 percent growth in 2023. The economy has been benefiting from positive

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[2] See Harriet Torry and Anthony DeBarros (2023), "A Recession Is No Longer the Consensus," *Wall Street Journal,* October 15.

[3] See Bureau of Economic Analysis (2025), "Gross Domestic Product, 4th Quarter and Year 2024 (Advance Estimate)," news release, January 30, https://www.bea.gov/sites/default/files/2025-01/gdp4q24-adv.pdf.

supply developments, including more workers joining the labor force and higher labor productivity.

The resilience of American consumers is the driving force behind the solid economic growth seen in recent quarters. Household spending, adjusted for inflation, grew 3.2 percent in 2024, slightly stronger than in 2023. The consumer spending data we have received recently have surprised me to the upside. As you can see in figure 2, personal consumption increased at a faster pace each quarter last year. Nominal retail sales rose briskly in the second half of last year. Private-sector data are consistent with GDP figures. According to private surveys of businesses, activity in the services sector, which accounts for about two-thirds of all consumer spending, has been on a general upward trajectory since mid-2020.[4]

Elsewhere in the economy, growth has been less robust. Residential investment has been fairly flat over the past three quarters, and growth of business fixed investment cooled last year from its strong 2023 pace. Much of the equipment investment that did take place came from imports. Indeed, domestic manufacturing industrial production was flat last year. Overall, I see the economy as continuing to grow at a healthy pace this year, though I anticipate growth to be slightly lower than what we observed in 2024. Households and firms face an uncertain environment, and that tends to lower consumer spending and business investment. If consumer spending continues to grow at the same pace as it has in the past two years, however, that could cause me to revise up my outlook for overall economic growth.

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[4] See the December 2024 Services ISM *Report on Business,* which is available on the Institute for Supply Management's website at https://www.ismworld.org/supply-management-news-and-reports/reports/ism-report-on-business/services/december.

Labor Market

Turning to employment, I see the labor market as being in a solid position, with conditions broadly returning to balance after a period of being overheated. It's helpful to step back and look at the labor market's path over the past five years. Looking at figure 3, you can see that the unemployment rate surged in early 2020, peaking at 14.8 percent in April 2020, when the COVID-19 pandemic first took hold and a wide swath of the global economy was shutdown. The unemployment rate subsequently fell swiftly as the economy recovered. By April 2023, it touched 3.4 percent, a half-century low. At that point, many employers reported that they were struggling to fill openings. Then, over the latter part of 2023 and early 2024, the unemployment rate rose nearly a percentage point, an unusual pattern outside of a recession. As a policymaker, I took note of this rise when considering our dual-mandate objectives. Now, I have also taken note that the unemployment rate has effectively held steady since the middle of last year. I view that as a sign that downside risks in the labor market have abated.

The latest jobs report showed that the unemployment rate was 4.1 percent in December, the same reading as in June 2024.[5] That is low by historical standards and close to estimates of the longer-run rate that is consistent with our employment mandate. In the three months ending in December, payrolls rose by an average of 170,000 jobs a month. While employment growth has eased somewhat from the early part of last year, the steady unemployment rate suggests that payroll gains have been sufficient to absorb new entrants to the labor market. The general moderation in hiring is consistent with

[5] See Bureau of Labor Statistics (2025), "The Employment Situation—December 2024," news release, January 10, bls.gov/news.release/pdf/empsit.pdf.

other measures showing that the demand for labor has come into better balance with the supply of workers.

Looking at figure 4, you can see that as of November, there were 1.2 job openings for every unemployed person seeking work. That ratio is down from 2.0 in 2022, when the labor market was overheated. Also notice that the current vacancy-to-unemployment ratio is just a little below its value before the pandemic took hold. And while hiring has eased from the pace in 2023, layoffs have not increased. As you can see in figure 5, the number of Americans seeking first-time unemployment benefits has trended at historically low levels for the past three years. Consistent with a moderation in hiring and a steady unemployment rate, workers' wage gains have slowed from when the labor market was overheated. Still, the pace of increase in average hourly earnings has been healthy, increasing 3.9 percent during the 12 months ending in December, and shows that, on average, worker pay has grown at a faster rate than the rate of inflation.

Looking broadly across the past several months, I see a labor market that is in solid condition and not a source of significant inflationary pressure. While the downside risks of a rapidly weakening labor market appear to have lessened, I expect some further softening that could cause the unemployment rate to edge just slightly higher this year but stay in a range consistent with recent readings.

Inflation

Thinking about the other component of our dual mandate, inflation has come down a great deal over the past two and a half years but remains somewhat elevated relative to our 2 percent objective. Inflation, as measured by the 12-month change in the personal consumption expenditures (PCE) price index, peaked at 7.2 percent in June

2022. Looking at the blue line in figure 6, you can see that it has since come down to 2.6 percent as of this past December. Economists also pay close attention to core inflation, which excludes often volatile food and energy costs. That core PCE inflation figure, shown by the red dashed line, peaked at 5.6 percent in 2022. By December 2024, it had eased to 2.8 percent. Annualized inflation over the past three months has been closer to our 2 percent objective. As you can see, the path of disinflation has been bumpy. I expect that to continue to be the case.

I find it helpful to look at the components of inflation to better understand underlying trends. Looking at figure 7, core goods inflation, the blue line, is running close to pre-pandemic levels, reflecting a better alignment between supply and demand after pandemic-related distortions. Nonhousing services inflation, the red dashed line, has cooled largely in line with slower wage growth. Housing services inflation, the purple dotted line, remains somewhat elevated, but I expect more progress in that category as the earlier slowing in growth of rents for new tenants feeds through into growth of average rents.[6]

With supply and demand conditions having moved into better balance, wage growth slowing to a more sustainable pace, and longer-term inflation expectations remaining well anchored, I see a path for inflation to continue its progress toward our longer-run goal. While the easing of overall inflation in recent years has been encouraging, the fact is that it remains above our 2 percent objective. Monthly inflation readings tend to be volatile, consistent with the bumpy path I described, but the 12-month

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[6] See Philip N. Jefferson (2024), "U.S. Economic Outlook and Housing Price Dynamics," speech delivered at the Mortgage Bankers Association's Secondary and Capital Markets Conference and Expo 2024, New York, May 20, https://www.federalreserve.gov/newsevents/speech/jefferson20240520a.htm.

readings have held in a fairly consistent range somewhat above our target over the second half of last year.

Monetary Policy

In the current environment, I attach a high degree of uncertainty to my projections. As I have already mentioned, there have been notable recent instances where forecasters have been surprised. That said, I see the risks to achieving our employment and inflation goals as being roughly in balance, and I am attentive to the risks to both sides of our mandate. That better balanced position is partly a result of the monetary policy actions over the past few years, which I will review briefly.

As you can see in figure 8, the FOMC responded to elevated inflation by raising the policy rate 5-1/4 percentage points over about 15 months, starting in March 2022, and then holding the rate at that restrictive level for more than a year. This contributed to inflation easing from a 40-year high to near current levels while maintaining a solid labor market. That outcome was historically unusual but greatly welcomed. By September of last year, I had growing confidence that with an appropriate recalibration of our policy stance, strength in the labor market could be maintained in a context of moderate economic growth and inflation moving sustainably down to 2 percent. The FOMC reduced the federal funds rate by a full percentage point over the course of our final three meetings last year. As a result of those actions, our policy stance is now significantly less restrictive than it was when we began lowering the federal funds rate. Given current economic conditions—specifically, inflation that remains modestly above our target and a labor market that is solid—and my projections of future economic conditions, I voted last week to maintain our current policy stance. As long as the economy and labor market remain strong, I see it as appropriate for the Committee to be cautious in making further adjustments.

Over the medium term, I continue to see a gradual reduction in the level of monetary policy restraint placed on the economy as we move toward a more neutral stance as the most likely outcome. That said, I do not think we need to be in a hurry to change our stance. In considering additional adjustments to the federal funds rate, I will carefully assess incoming data, the evolving outlook, and the balance of risks. As is always the case, monetary policy is not on a preset course. To that end, I could envision a range of scenarios for future policy. For example, if the economy remains strong and inflation does not continue to move sustainably toward 2 percent, we can maintain policy restraint for longer.

Alternatively, if the labor market were to weaken unexpectedly or inflation were to fall more quickly than anticipated, it may be appropriate to reduce the policy rate more quickly. Our current stance of policy is well positioned to deal with the risks and uncertainties that we face in pursuing both sides of our dual mandate.

As I conclude, I want to assure you that I am mindful that monetary policy decisions affect communities, families, and businesses across the country. I highly value opportunities to visit places like Lafayette College and Easton to share my views, hear from you, and see how the economy is experienced firsthand in your community. I remain fully committed to supporting maximum employment and bringing inflation sustainably to our 2 percent goal. Our success in delivering on these goals matters to all Americans.

Thank you.

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Philip N. Jefferson

Vice Chair, Federal Reserve Board

Lafayette College, February 4, 2025

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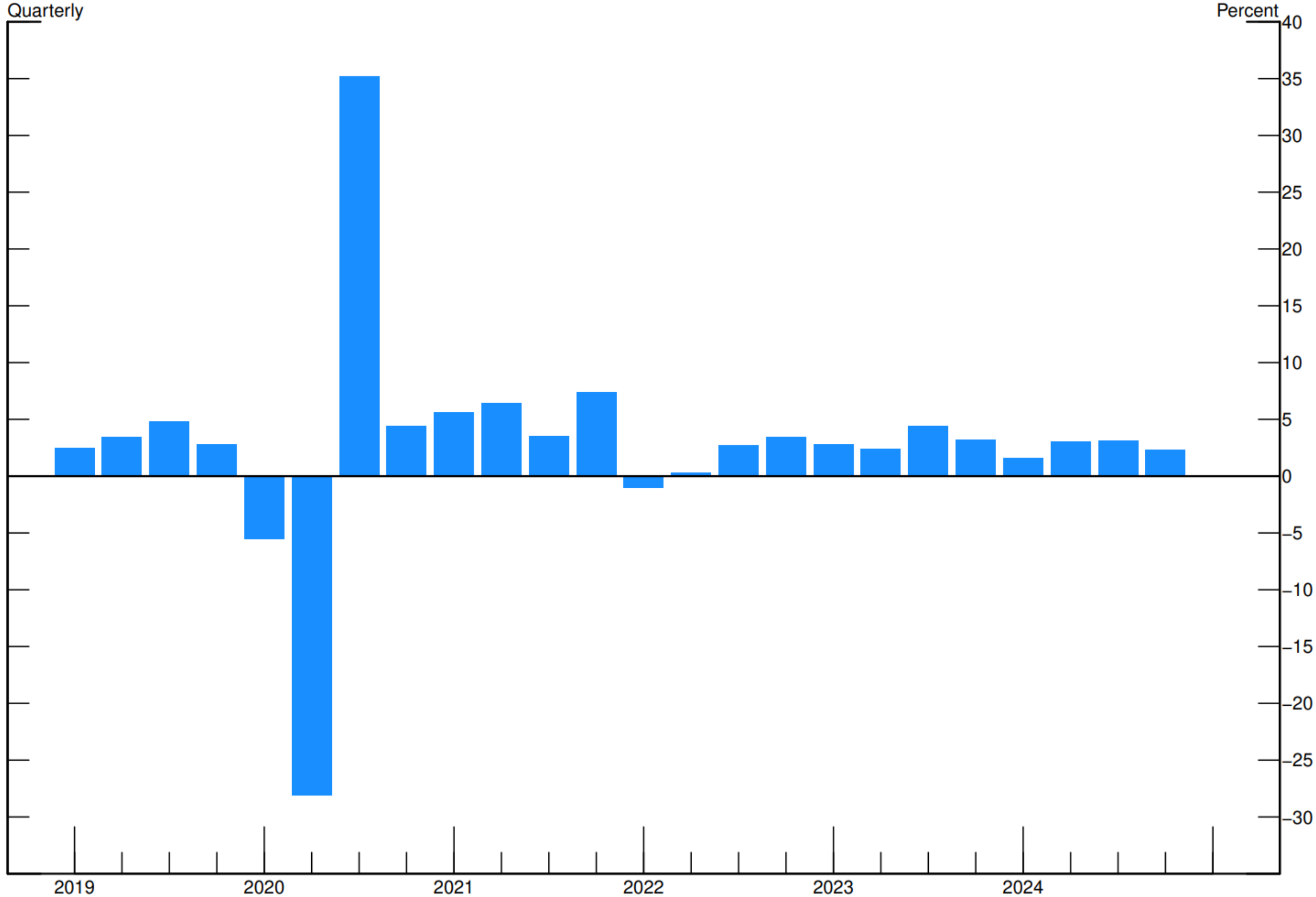
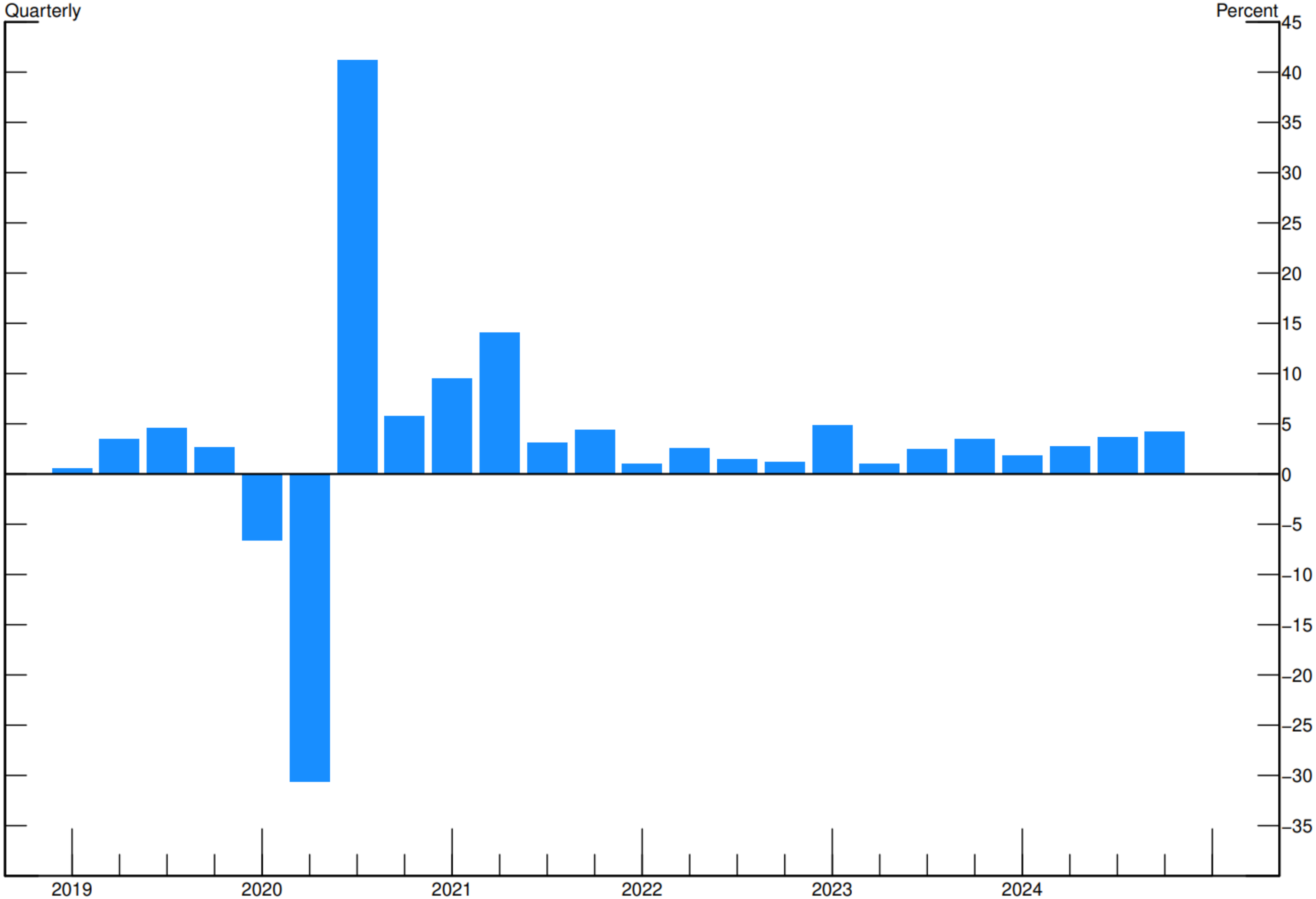
Figure 1: Real GDP



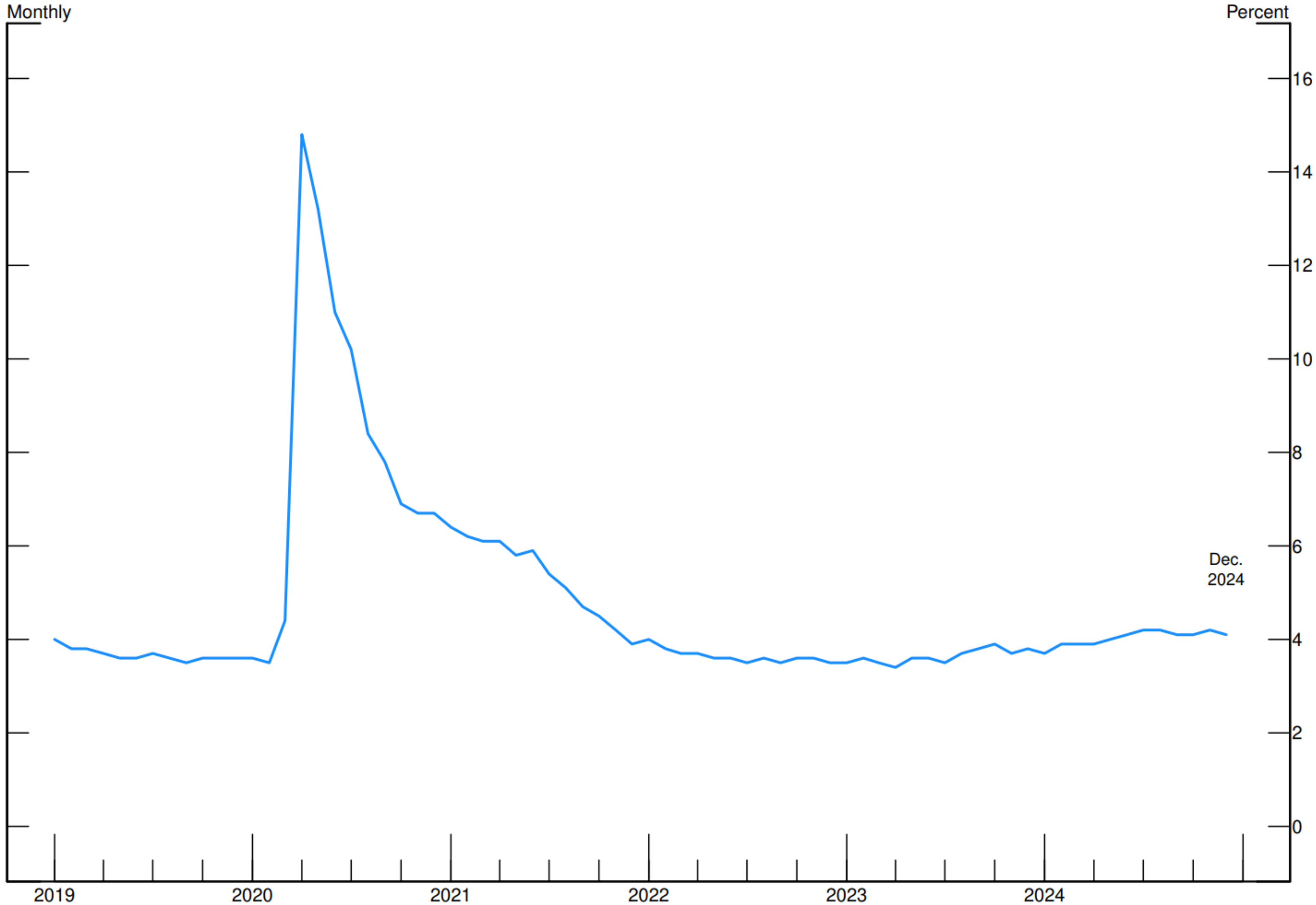
Note: Percent change from preceding period, seasonally adjusted annual rate.
Source: U.S. Bureau of Economic Analysis, Real Gross Domestic Product, retrieved from FRED, Federal Reserve Bank of St. Louis.

Figure 2: Real Personal Consumption Expenditures



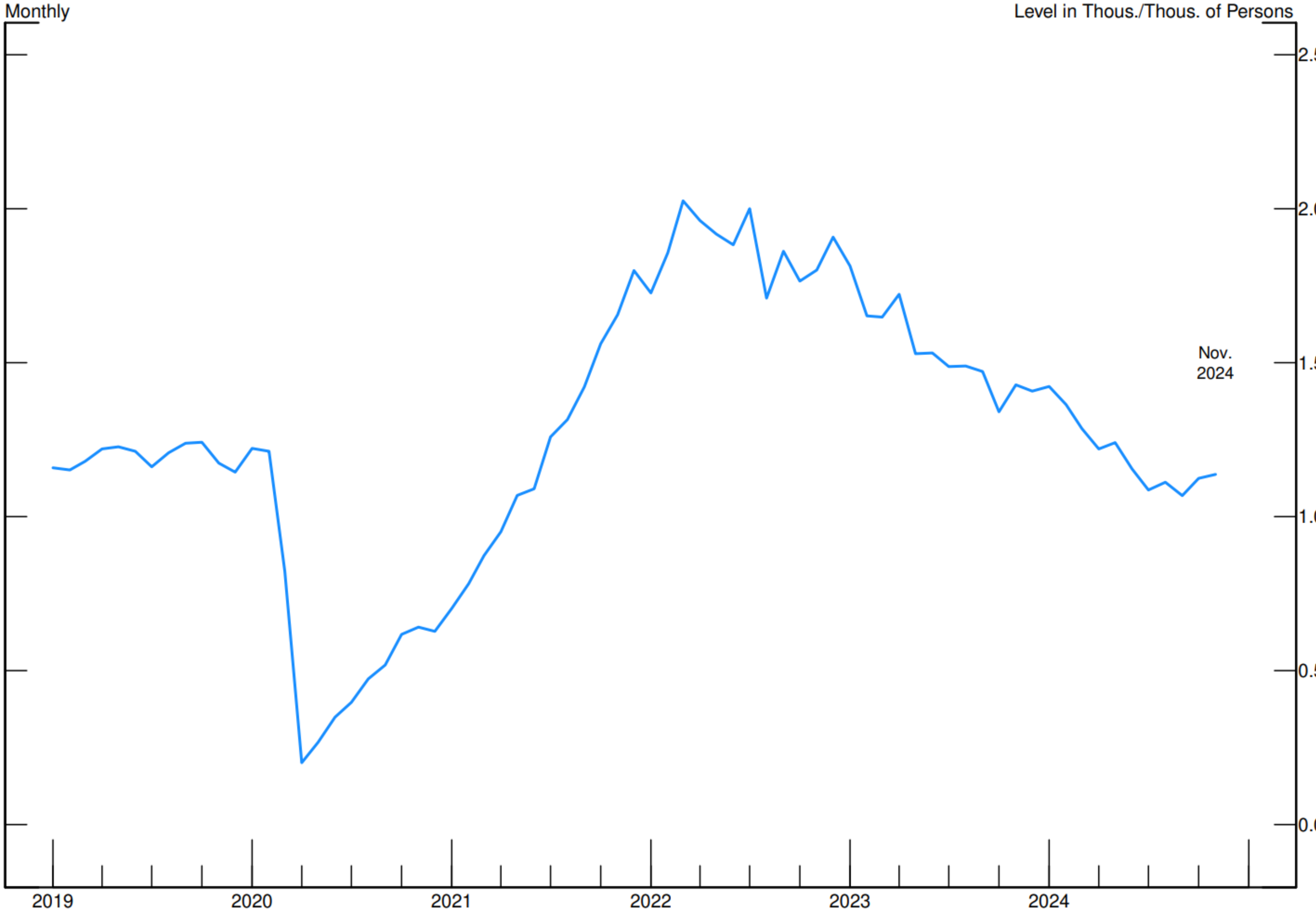
Note: Percent change from preceding period, seasonally adjusted annual rate.
Source: U.S. Bureau of Economic Analysis, Real Personal Consumption Expenditures retrieved from FRED, Federal Reserve Bank of St. Louis.

Figure 3: Unemployment Rate



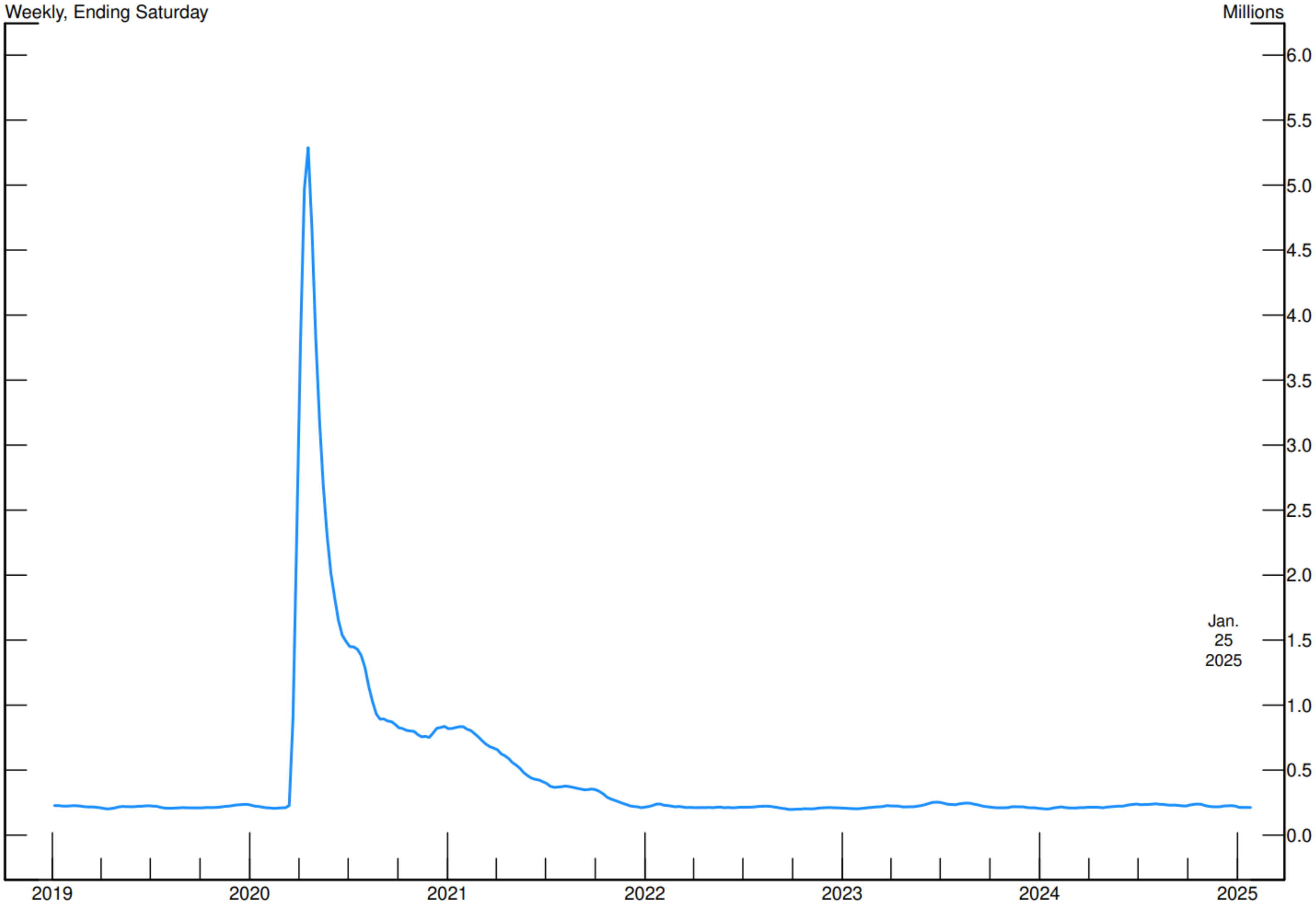
Source: U.S. Bureau of Labor Statistics, Unemployment Rate, retrieved from FRED, Federal Reserve Bank of St. Louis.

Figure 4: Job Openings: Total Nonfarm/Unemployment Level



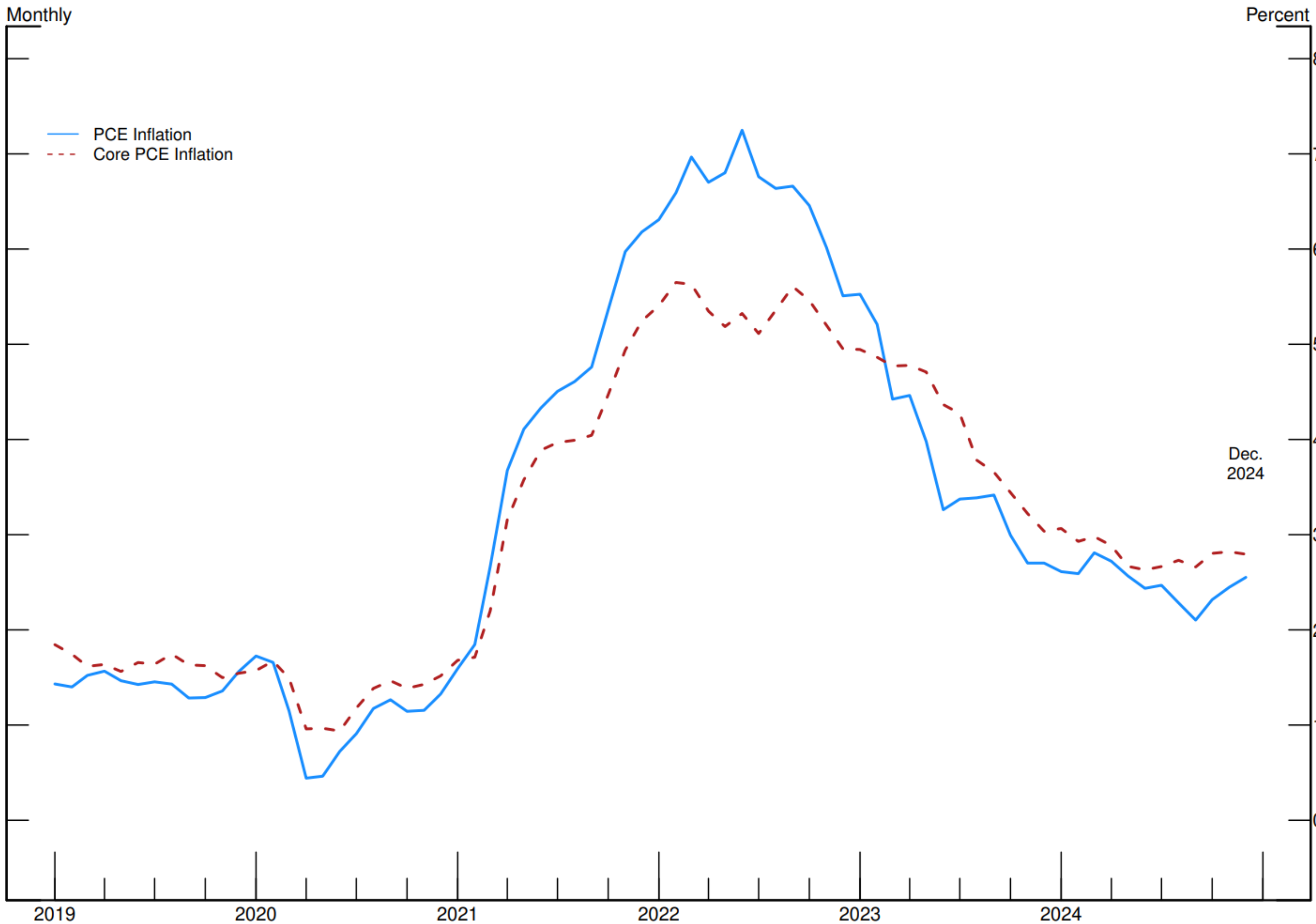
Note: Seasonally adjusted.
Source: U.S. Bureau of Labor Statistics, Job Openings: Total Nonfarm and Unemployment Level, retrieved from FRED, Federal Reserve Bank of St. Louis.

Figure 5: 4–Week Moving Average of Initial Claims



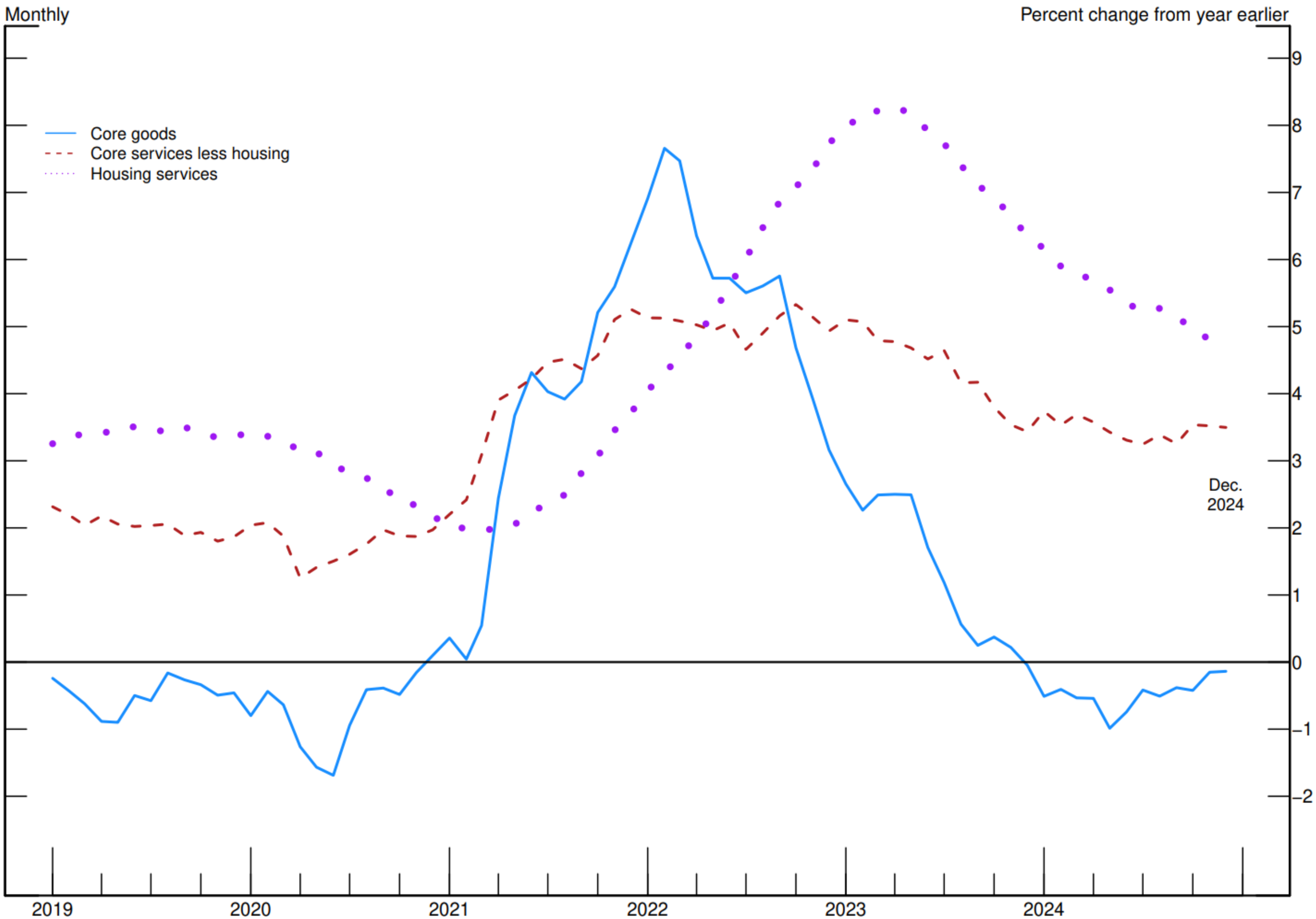
Source: U.S. Employment and Training Administration, 4–Week Moving Average of Initial Claims, retrieved from FRED, Federal Reserve Bank of St. Louis.

Figure 6: 12–Month PCE and Core PCE Inflation



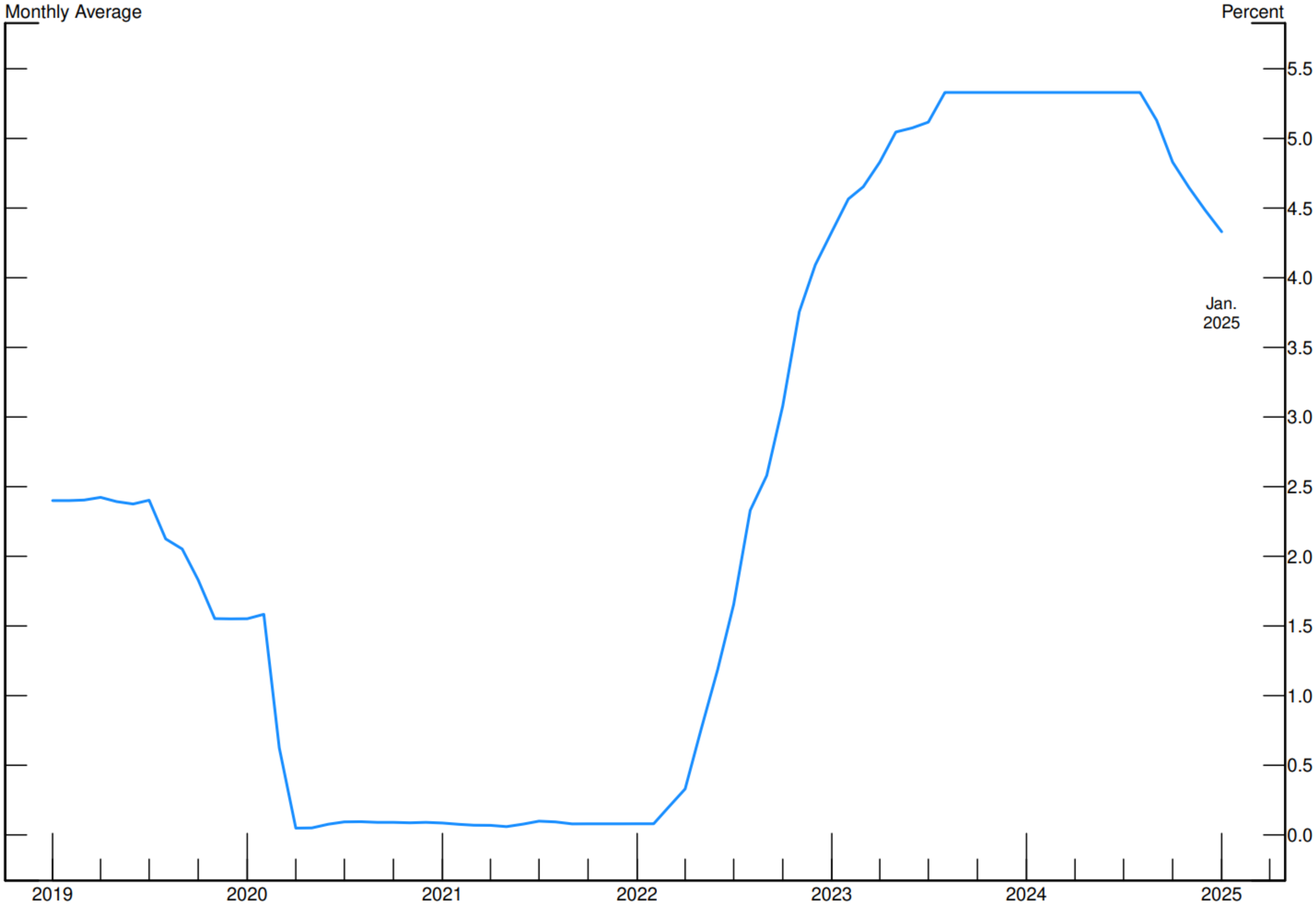
Note: PCE Inflation is the change in the personal consumption expenditures price index and core PCE Inflation is the change in PCE price index excluding food and energy.
PCE and core PCE are 12–Month inflation percentages calculated using seasonally adjusted annual rates.
Source: U.S. Bureau of Economic Analysis, Personal Consumption Expenditures: Chain–type Price Index and Personal Consumption Expenditures Excluding Food and Energy (Chain–Type Price Index), retrieved from FRED, Federal Reserve Bank of St. Louis.

Figure 7: Components of Core PCE Inflation



Note: Core goods Inflation is the change in the personal consumption expenditures price index exlcuding energy and food. Core services Inflation is the change in the PCE price index excluding energy services.
Source: U.S. Bureau of Economic Analysis.

Figure 8: Federal Funds Rate



Source: Federal Reserve Bank of New York.

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