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High Inflation and the Outlook for Monetary Policy

Remarks by

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at

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Before we get to our conversation on community banking, I would like to briefly discuss my outlook for the U.S. economy and my view of appropriate monetary policy.¹ As I see it, the main challenge for monetary policy now is to bring inflation down without harming the ongoing economic expansion.

Inflation is much too high. Last year I noted that inflationary pressures associated with strong demand and constrained supply could take longer to subside than many expected. Since then, those problems have persisted and inflation has broadened, reaching the highest rate that Americans have faced in forty years. High inflation is a heavy burden for all Americans, but especially for those with limited means who are forced to pay more for everyday items, delay purchases, or put off saving for the future. I intend to support prompt and decisive action to lower inflation, and today I will explain how the Fed is pursuing this goal.

In the near term, I expect that uncomfortably high inflation will persist at least through the first half of 2022. We may see signs of inflation easing in the second half of the year, but there is a substantial risk that high inflation could persist. In January, the Consumer Price Index rose to a 12-month rate of 7.5 percent, which, consistent with other recent monthly readings, was even higher than expected. Employment costs for businesses, as measured by average hourly wages, also rose last month. And continued tightness in the labor market indicates that upward pressure on wages and other employment compensation is not likely to moderate soon.

My base case is that inflation will moderate later this year, which will depend, in part, on appropriate actions by the Federal Open Market Committee (FOMC). But with

¹ My views on the outlook and monetary policy are my own and do not necessarily reflect those of my colleagues on the Federal Open Market Committee.

wage growth lagging behind inflation for the past year, many families may find it challenging to make ends meet and continued rising home prices will likely prevent many from entering the housing market. In addition, rising costs and hiring difficulties continue to be burdens for small businesses.

Turning to the labor market, which continues to tighten, indications are that the Omicron infection surge earlier this year has not left a negative imprint on the economy or slowed job creation. I expect to see continued strength in the job market this year, with further gains in employment, and my hope is that more Americans return to the labor force and find work. The strength in job creation is a big positive for those seeking employment and for their families. Even with the improving labor market, I still hear from businesses that qualified workers are difficult to find, and labor shortages remain a drag on hiring and on economic growth.

Now let me turn to the implications of this outlook for monetary policy. In my view, conditions in the labor market have been and are currently consistent with the FOMC's goal of maximum employment, and as such, my focus has been on the persistently high inflation. In part, the high inflation reflects supply chain disruptions associated with the economic effects of the pandemic and efforts made to contain it. Unfortunately, monetary policy isn't well-suited to address supply issues. But strong demand and a very tight labor market have also contributed to inflation pressures, and the FOMC can help alleviate those pressures by removing the extraordinary monetary policy accommodation that is no longer needed.

In our most recent monetary policy statement—which was released following our January meeting—we indicated that “with inflation well above 2 percent and a strong

labor market,” we expected that it would “soon be appropriate to raise the target range for the federal funds rate.”² I fully supported that assessment, and the data we have seen since then have only increased the urgency to get on with the process of normalizing our interest rate stance and significantly reducing the size of the Federal Reserve’s balance sheet. I support raising the federal funds rate at our next meeting in March and, if the economy evolves as I expect, additional rate increases will be appropriate in the coming months. I will be watching the data closely to judge the appropriate size of an increase at the March meeting. In early March, the FOMC will finally stop expanding the Federal Reserve’s balance sheet. The resulting end of our pandemic asset purchases will remove another source of unneeded stimulus for the economy. In the coming months, we need to take the next step, which is to begin reducing the Fed’s balance sheet by ceasing the reinvestment of maturing securities already held in the portfolio. Returning the balance sheet to an appropriate and manageable level will be an important additional step toward addressing high inflation.

I expect that these steps will contribute to an easing in inflation pressures in the coming months, but further steps will likely be needed this year to tighten monetary policy. Looking beyond this spring, my views on the appropriate pace of interest rate increases and balance sheet reduction for this year and beyond will depend on how the economy evolves. I will be particularly focused on how much progress we make on bringing down inflation. My intent would be to take forceful action to help reduce

² Board of Governors of the Federal Reserve System, “Federal Reserve Issues FOMC Statement,” press release, January 26, 2022, <https://www.federalreserve.gov/newsevents/pressreleases/monetary20220126a.htm>.

inflation, bringing it back toward our 2 percent goal, while keeping the economy on track to continue creating jobs and economic opportunity for Americans.

I appreciate the opportunity to share my views on monetary policy with you this morning. But since we are here to talk about community banking, let's get back to that important topic. Certainly prior to, but especially over the course of the pandemic, we have seen a heightened focus and urgency in incorporating technology and innovation into community banking. The adoption of technology and innovation is really at the heart of the major issues facing community banks. We see banks, fintech companies, and tech firms exploring various technologies to enhance their payments systems, expand consumer access, improve back-office operations, and create new financial products and services.

This interest and the increasing interest in crypto- and digital assets have created a need to work together with the other federal banking agencies to give the industry better and more useful regulatory feedback as banks consider approaches to integrating crypto- and digital asset related activities into their service offerings. Given the popularity of these types of assets, and the growing interest of banks in participating in the market, it's increasingly necessary for regulators to be able to engage with the industry on these issues.

Evolving financial services, a sharper focus on efficiency and timeliness in the industry, and the rapid increase in technology advances have also led the Federal Reserve to explore the potential benefits and risks of a central bank digital currency (CBDC). We recently issued a discussion paper as a first step in fostering a broad and transparent

public dialogue about CBDCs.³ The paper is not intended to advance any specific policy outcome and no decisions have been made at this time. We are genuinely committed to hearing a wide range of voices on this issue. The paper was published earlier this year with a 120-day comment period. We encourage your comments and feedback—generally, and in response to specific questions posed in the paper. As we engage in this dialogue and evaluation process, and throughout this initiative, I intend to keep an open mind about the usefulness of and potential business case for a CBDC. I strongly encourage community bankers and all of the other stakeholders who would be impacted by the creation of a CBDC to submit your comments and views to the Fed by May 20, the end of the scheduled public comment period.

Another area of intense interest is the expansion of financial activities beyond the traditional chartered banking institution construct. We are seeing an increase in the proposal of novel charter types under consideration across the country. These changes, and the coming availability of the Fed Now instant payment service, have the potential to vastly change the landscape of financial services and opportunities in the market. In anticipation of this evolution, our Federal Reserve Banks are receiving an increased number of requests for membership and access to Reserve Bank master accounts from institutions with these novel charters. Recognizing the importance of clarity and transparency in this space, and to facilitate and evaluate these activities in a consistent

³ Board of Governors of the Federal Reserve System, “Money and Payments: The U.S. Dollar in the Age of Digital Transformation” (January 2022), <https://www.federalreserve.gov/publications/money-and-payments-discussion-paper.htm>.

manner, the Board is in the process of issuing clearer guidance around the application and review process for novel bank charters and account access at the Federal Reserve.

I look forward to discussing these and other issues with you in just a few minutes, so I will stop there. It's such a pleasure to be in person with you again at the ABA's Conference for Community Banks, and I am looking forward to our conversation.