For release on delivery
10:10 a.m. EDT
March 25, 2021

U.S. Economic Outlook and Monetary Policy

Remarks by

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at the

2021 Institute of International Finance Washington Policy Summit

Washington, D.C.
(via webcast)

March 25, 2021

It is my pleasure to meet virtually with you today at the 2021 Institute of International Finance (IIF) Washington Policy Summit.[1] I regret that we are not doing this session in person, but I do hope next time we will be gathering together in Washington. I look forward, as always, to a conversation with my good friend and one-time colleague Tim Adams, but first, please allow me to offer a few remarks on the economic outlook, Federal Reserve monetary policy, and our new monetary policy framework.

Current Economic Situation and Outlook

In the second quarter of last year, the COVID-19 pandemic and the mitigation efforts put in place to contain it delivered the most severe blow to the U.S. economy since the Great Depression. Gross domestic product (GDP) collapsed at a roughly 31.5 percent annual rate in the second quarter of 2020, more than 22 million jobs were lost in March and April, and the unemployment rate rose from a 50-year low of 3.5 percent in February to almost 15 percent in April. Since then, economic activity has rebounded, and it is clear that the economy has proven to be much more resilient than many forecast or feared one year ago. GDP grew by almost 8 percent at an annual rate in the second half of last year, and private forecasters project that GDP will grow roughly 6 percent—and possibly 7 percent—this year. As shown in the latest Summary of Economic Projections (SEP), the median of Federal Open Market Committee (FOMC) participants' projections for 2021 GDP growth is 6.5 percent.[2] If these projections are realized, GDP will grow at the

[1] The views expressed are my own and not necessarily those of other Federal Reserve Board members or Federal Open Market Committee participants. I would like to thank Chiara Scotti for her assistance in preparing these remarks.

[2] The most recent SEP is available on the Board's website at https://www.federalreserve.gov/monetarypolicy/fomccalendars.htm.

fastest four-quarter pace since 1984. And, as this is a virtual meeting of the IIF, I would be remiss if I did not highlight that if these projections for U.S. economic activity are realized, rising U.S. imports will serve as an important source of external demand to the rest of the world this year and beyond.

As with overall economic activity, conditions in the labor market have recently improved. Employment rose by 379,000 in February, as the leisure and hospitality sector recouped about two-thirds of the jobs that were lost in December and January. Nonetheless, employment is still 9.5 million below its pre-pandemic level for the economy as a whole. The unemployment rate remains elevated at 6.2 percent in February, and once one factors in the decline in the labor force since the onset of the pandemic and the misclassification of some workers on temporary layoff as employed, the true unemployment rate is closer to 10 percent.

It is worth highlighting that in the baseline projections of the FOMC presented in the latest SEP released last week, my colleagues and I substantially revised up our outlook for the economy, projecting a relatively rapid return to levels of employment and inflation consistent with the Federal Reserve's statutory mandate as compared with the recovery from the Global Financial Crisis. In particular, the median FOMC participant now projects the unemployment rate to reach 4.5 percent at the end of this year and 3.5 percent by the end of 2023.

With regards to inflation, the median inflation projection of FOMC participants is 2.4 percent this year and declines to 2 percent next year before moving back up to 2.1 percent in 2023. Over the next few months, 12-month measures of inflation are expected to move temporarily above our 2 percent longer-run goal, owing to a run of year-over-year comparisons with depressed service-sector prices recorded in the spring of 2020 and supply bottlenecks limiting how quickly production can respond in the near term. However, I expect most of this increase to be transitory and for inflation to return to—or perhaps run somewhat above—our 2 percent longer-run goal in 2022 and 2023. This outcome would be entirely consistent with the new framework we adopted in August 2020 and began to implement at our September 2020 FOMC meeting.[3] In our new framework, we aim for inflation outcomes that keep inflation expectations well anchored at 2 percent. This means that following periods when inflation has been running below 2 percent—as has been the case for most of the past decade—monetary policy will aim for inflation to moderately exceed 2 percent for some time. And this brings me to the next topic.

Recent FOMC Decisions and the New Monetary Policy Framework

At our most recent FOMC meetings, the Committee made important changes to our policy statement that upgraded our forward guidance about the future path of the federal funds rate and asset purchases, and that also provided unprecedented information about our policy reaction function. As announced in the September statement and reiterated in the following statements, with inflation running persistently below 2 percent, our policy will aim to achieve inflation outcomes that keep inflation expectations well anchored at our 2 percent longer-run goal.[4] We expect to maintain an accommodative stance of monetary policy until these outcomes—as well as our maximum-employment

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[3] The statement is available on the Board's website at https://www.federalreserve.gov/monetarypolicy/review-of-monetary-policy-strategy-tools-and-communications-statement-on-longer-run-goals-monetary-policy-strategy.htm.

[4] The statements issued after the September and subsequent FOMC meetings are available, along with other postmeeting statements, on the Board's website at https://www.federalreserve.gov/monetarypolicy/fomccalendars.htm.

mandate—are achieved. We also expect it will be appropriate to maintain the current target range for the federal funds rate at 0 to 1/4 percent until labor market conditions have reached levels consistent with the Committee's assessments of maximum employment, until inflation has risen to 2 percent, and until inflation is on track to moderately exceed 2 percent for some time.

In addition, in our December FOMC statement, the Committee combined our forward guidance for the federal funds rate with enhanced, outcome-based guidance about our asset purchases. We indicated that we will continue to increase our holdings of Treasury securities by at least $80 billion per month and our holdings of agency mortgage-backed securities by at least $40 billion per month until *substantial further progress* has been made toward our maximum-employment and price-stability goals.

The changes to the policy statement that we made over the past few FOMC meetings bring our policy guidance in line with the new framework outlined in the revised Statement on Longer-Run Goals and Monetary Policy Strategy that the Committee approved last August. In our new framework, we acknowledge that policy decisions going forward will be based on the FOMC's estimates of "*shortfalls* [emphasis added] of employment from its maximum level"—not "deviations."[5] This language means that going forward, a low unemployment rate, in and of itself, will not be sufficient to trigger a tightening of monetary policy absent any evidence from other indicators that inflation is at risk of moving above mandate-consistent levels. With regard to our price-stability mandate, while the new statement maintains our definition that the longer-run goal for inflation is 2 percent, it elevates the importance—and the

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[5] The most recent version of the 2012 statement is available on the Board's website at https://www.federalreserve.gov/monetarypolicy/files/FOMC_LongerRunGoals_201901.pdf.

challenge—of keeping inflation expectations well anchored at 2 percent in a world in which an effective-lower-bound constraint is, in downturns, binding on the federal funds rate. To this end, the new statement conveys the Committee's judgment that, in order to anchor expectations at the 2 percent level consistent with price stability, it will conduct policy to achieve inflation outcomes that keep long-run inflation expectations anchored at our 2 percent longer-run goal. As Chair Powell indicated in his Jackson Hole remarks, we think of our new framework as an evolution from "flexible inflation targeting" to "flexible average inflation targeting."[6] While this new framework represents a robust evolution in our monetary policy strategy, this strategy is in service to the dual-mandate goals of monetary policy assigned to the Federal Reserve by the Congress—maximum employment and price stability—that remain unchanged.[7]

Concluding Remarks

While our interest rate and balance sheet tools are providing powerful support to the economy and will continue to do so as the recovery progresses, it will take some time for economic activity and employment to return to levels that prevailed at the business cycle peak reached last February. We are committed to using our full range of tools to support the economy until the job is well and truly done to help ensure that the economic recovery will be as robust and rapid as possible.

[6] See Jerome H. Powell (2020), "New Economic Challenges and the Fed's Monetary Policy Review," speech delivered at "Navigating the Decade Ahead: Implications for Monetary Policy," a symposium sponsored by the Federal Reserve Bank of Kansas City, held in Jackson Hole, Wyo. (via webcast), August 27, https://www.federalreserve.gov/newsevents/speech/powell20200827a.htm.

[7] See Richard H. Clarida (2020), "The Federal Reserve's New Monetary Policy Framework: A Robust Evolution," speech delivered at the Peterson Institute for International Economics, Washington (via webcast), August 31, https://www.federalreserve.gov/newsevents/speech/clarida20200831a.htm; and Richard H. Clarida (2020), "The Federal Reserve's New Framework: Context and Consequences," speech delivered at "The Economy and Monetary Policy," an event hosted by the Hutchins Center on Fiscal and Monetary Policy at the Brookings Institution, Washington (via webcast), November 16, https://www.federalreserve.gov/newsevents/speech/clarida20201116a.htm.