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U.S. Economic Outlook and Monetary Policy

Remarks by

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at the

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Council on Foreign Relations

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It is my pleasure to meet virtually with you today at the Council on Foreign Relations.[1] I regret that we are not doing this session in person, as we did last year, and I hope the next time I am back, we will be gathering together in New York City again. I look forward to my conversation with Steve Liesman and to your questions, 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 (coronavirus disease 2019) 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. Economic activity rebounded robustly in the third quarter and has continued to recover in the fourth quarter from its depressed second-quarter level, though the pace of improvement has moderated. Household spending on goods, especially durable goods, has been strong and has moved above its pre-pandemic level, supported in part by federal stimulus payments and expanded unemployment benefits. In contrast, spending on services remains well below pre-pandemic levels, particularly in sectors that typically require people to gather closely, including travel and hospitality. In the labor market, more than half of the 22 million jobs that were lost in March and April have been regained, as many people were able to return to work. Inflation, following large declines in the spring of 2020, picked up over the summer but has leveled out more recently; for those sectors that have been most adversely affected by the pandemic, price increases remain subdued.

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[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.

While gross domestic product growth in the fourth quarter downshifted from the once-in-a-century 33 percent annualized rate of growth reported in the third quarter, it is clear that since the spring of 2020, the economy has turned out to be more resilient in adapting to the virus, and more responsive to monetary and fiscal policy support, than many predicted. Indeed, it is worth highlighting that in the baseline projections of the Federal Open Market Committee (FOMC) summarized in the latest Summary of Economic Projections (SEP), most of my colleagues and I revised up our outlook for the economy over the medium term, 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 (GFC).[2] In particular, the median FOMC participant projects that by the end of 2023—a little less than three years from now—the unemployment rate will have fallen below 4 percent, and PCE (personal consumption expenditures) inflation will have returned to 2 percent. Following the GFC, it took more than eight years for employment and inflation to return to similar mandate-consistent levels.

While the recent surge in new COVID cases and hospitalizations is cause for concern and a source of downside risk to the very near-term outlook, the welcome news on the development of several effective vaccines indicates to me that the prospects for the economy in 2021 and beyond have brightened and the downside risk to the outlook has diminished. The two new SEP charts that we released for the first time following the December FOMC meeting speak to these issues by providing information on how the risks and uncertainties that surround the modal or baseline projections have evolved over

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

time. While nearly all participants continued to judge that the level of uncertainty about the economic outlook remains elevated, fewer participants saw the balance of risks as weighted to the downside than in September. Although a little more than half of participants judged risks to be broadly balanced for economic activity, a similar number continued to see risks weighted to the downside for inflation.

The Latest FOMC Decision 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 November and December, 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.[3] We expect to maintain an accommodative stance of monetary policy until these outcomes—as well as our maximum-employment 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 the December statement, we combined our forward guidance for the federal fund rate with enhanced, outcome-based guidance about our asset purchases.

[3] See the FOMC statements issued after the September, November, and December meetings, which are available (along with other postmeeting statements) on the Board's website at https://www.federalreserve.gov/monetarypolicy/fomccalendars.htm.

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 fall 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.[4] 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." 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 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 "seeks to achieve inflation that averages 2 percent over time," and—in the same sentence—that therefore "following periods when inflation has been running persistently below 2 percent, appropriate monetary policy will

[4] 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.

likely aim to achieve inflation moderately above 2 percent for some time." 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."[5] 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—which remain unchanged.[6]

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 and to help ensure that the recovery from this difficult period will be as robust as possible.

[5] 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.

[6] 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.