

For release on delivery
10:00 a.m. EDT (8:00 a.m. MDT)
May 5, 2021

The Economic Outlook and Implications for Monetary Policy

Remarks by

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at

The Colorado Forum

Denver, Colorado
(via webcast)

May 5, 2021

Thank you for this opportunity to address the members of the Colorado Forum, which has been an arena for thoughtful discussion and debate for more than 40 years. Today I would like to discuss a subject that I expect is of great interest to Coloradans and others: the outlook for the U.S. economy in 2021. I believe that the economy has gained momentum in the past several months and is well positioned to grow strongly in 2021. Nevertheless, we have further to go to recover from the economic damage inflicted by the COVID-19 pandemic, and risks remain.

As we all know, starting in late February or March of last year, widespread economic and social lockdowns and other effects of the pandemic caused the swiftest and deepest contraction in employment and economic activity since the Great Depression. Money markets, the Treasury market, and other parts of the financial system seized up, and there were fears of another severe financial crisis. The Federal Reserve stepped in quickly to assist, reviving several lending facilities used in the previous crisis and creating several new facilities. We also cut short-term interest rates to near zero and began purchasing large quantities of Treasury and agency securities to help sustain the flow of credit to households and businesses. Congress and the Administration also worked together to provide effective and timely support. Calm was restored in financial markets, and employment and output began growing in May, but it was a very deep hole to fill. Since that time, progress in controlling the pandemic has been a dominant force driving the economic recovery. Rapid progress last summer gave way to slower economic growth over the turn of the year, as infection rates once again surged. But after a substantial pickup in vaccinations and steep declines in virus-related hospitalizations and deaths, the economic outlook has brightened. Job creation had stalled over the winter

months but improved again starting in February. Over the past year, we've seen a return of nearly 14 million jobs.

Another significant factor contributing to the recovery is the resilience of private-sector businesses. Our economic recovery has been more rapid and stronger than many forecasters expected, partly due to the ability of businesses to adapt to conditions that none of them had planned for, and few even imagined could be possible. Initially, government assistance was important, but millions of businesses were at risk of closure. Instead, many are open and growing today due to the resourcefulness and determination of entrepreneurs and workers and their ability to adjust business plans and operations to deal with the effects of social-distancing and operating restrictions. Of course, technology helped a great deal, but businesses were able to find many other ways to maintain operations and sustain their connections to customers. In writing the history of these eventful times, I hope that the efforts of these businesses and the strength of America's market-based economy get the considerable credit they deserve.

Recently, the incoming data indicate that economic activity is on an upswing, and the risks of more negative outcomes—especially those from COVID-19—appear to be easing. Vaccinations and the easing of operating and social-distancing restrictions are boosting consumer and business confidence, with the results clear to see in the data on spending. Retail sales surged nearly 10 percent in March and are actually above the trendline that was interrupted by the pandemic a year ago. One particularly encouraging signal in that report was a sharp expansion in spending on food services. I hope this is an indication that consumers are finally returning to in-person dining as spring arrives and local authorities allow restaurants to accommodate more diners. If so, and my fingers are

crossed, it is a very good sign of further progress in one of the sectors hardest hit by the pandemic.

In the job market, job gains rebounded to 916,000 in March. At our March meeting, my view was broadly in line with the median of projections of other members of the Federal Open Market Committee (FOMC), which anticipated the economy would grow between 5.8 percent and 6.6 percent in 2021. But the outlook has improved since then, and it now appears that real gross domestic product may increase close to or even above the higher end of that range. This annual increase would be the largest in 36 years.

Likewise, the FOMC median in March was for unemployment to fall to 4.5 percent at the end of 2021, and now it seems possible that it may fall even further. With the economy continuing to reopen, I expect the pace of job creation to remain unusually strong over the spring and summer. Over the past few months many schools have resumed some form of in-person learning, which should translate into a rebound in labor force participation as more parents overseeing virtual education and child care are able to increase hours or return to the workforce.

The biggest risk to the outlook continues to be the course of the pandemic. I see good reasons to be optimistic. Vaccinations are proceeding at a rapid pace, and this progress is supporting decisions by state and local leaders to relax economic restrictions. Most importantly, deaths related to the virus have continued to fall steadily and are at roughly the rate as in early October of last year. I remain hopeful that progress in the economic recovery can stay ahead of new challenges that might emerge, like the spread of new virus variants. That would allow states and localities to continue easing economic and social distancing restrictions and encourage consumers and businesses to return to

normal activities. I understand that in Colorado, for example, officials are considering lifting social-distancing restrictions on individuals and businesses. I would be interested to hear from this group about how businesses in Colorado have been faring and whether they have seen an improvement in demand as the pandemic conditions are easing.

While I *am* optimistic about the ongoing recovery, one lesson of the past year is the significant degree of uncertainty about the course of the virus and its effect on the economy. We experienced periods of considerable progress last year, but we saw some of that progress overtaken by waves of the infection late in the year. Likewise, economic growth rebounded much more quickly than many had expected, but then slowed late in 2020 before regaining speed following the availability of the vaccine. Even with recent encouraging reports on food services, activity in the travel, leisure, and hospitality sectors is still severely compromised, but is showing glimmers of activity. It may be some time before we know whether old habits will resume or new habits have developed that may define a post-pandemic new normal. As I noted in a recent speech, I am particularly concerned about the longer-term effect on small businesses, many of which have held on with government aid and loan forbearance programs that will soon expire.¹ It will be several months before we know the final count of permanent small business closures from 2020, but it could be more than we expect.

I will now turn to how the Federal Reserve is proceeding in light of the strong signals of momentum building in the economy. The economic recovery is not yet complete, and the uncertain course of the pandemic still presents risks in the near term,

¹ See Michelle W. Bowman (2021), “The Economic Outlook and Prospects for Small Business,” speech delivered at the Economic Club of Oklahoma, Oklahoma City, Oklahoma (via webcast), March 22, <https://www.federalreserve.gov/newsevents/speech/bowman20210322a.htm>.

which is why my colleagues and I on the FOMC decided last week to maintain our highly accommodative stance of monetary policy. Despite the progress to date and the signs of acceleration in the recovery, employment is still considerably short of where it was when the pandemic disrupted the economy and it is well below where it should be, considering the pre-pandemic trend. In particular, our maximum employment mandate is intended as a broad and inclusive goal increasing employment and opportunity, but I remain concerned that employment gains for some minority groups have lagged behind those of others. While job creation has been and is expected to remain strong, the pace will eventually slow as the share of those who have been unemployed for the longer-term increases among those who are looking for work. We are making good progress toward our full employment goal, but we still have a long way to go, and risks remain.

This brings me to the other side of our policy mandate. Over the next several months, I expect that headline inflation measures will move above our long-run target of 2 percent. A main reason I expect this outcome is simply the fact that the very low inflation readings during last spring's deep economic contraction will drop from the usual calculation of 12-month price changes. But in addition, the unusually rapid rebound in economic activity that we've seen, along with the pandemic-driven shift towards goods purchases, has led to supply-chain bottlenecks in a number of areas, which in turn have pushed up prices for many goods. One prominent example is with semiconductor producers and their need to dramatically alter the mix of production to meet demands of the high-tech and automotive industries. Although I expect these upward price pressures to ease after the temporary supply bottlenecks are resolved, the exact timing of that dynamic is uncertain. If the supply bottlenecks prove to be more long-lasting than

currently expected, I will adjust my views on the inflation outlook accordingly. At this point, the risk that inflation remains persistently above our long-run target of 2 percent still appears small.

In summary, let me say that I am encouraged by the recent pace of the economic recovery, and I remain optimistic that this strength will continue in the coming months. One reason for my optimism is that businesses have been effective in responding to the challenges posed by the pandemic and by economic restrictions implemented in efforts to contain it. We really can't know how the pandemic will proceed and how that will affect the U.S. economy, but I think we are currently on a good path, and our policy is in a good place. Thank you again for inviting me to speak to you today, and I would be happy to respond to your questions.