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U.S. Economic Outlook and Monetary Policy

Remarks by

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at

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It is my pleasure to meet virtually with you today at the National Association for Business Economics International Symposium: A Vision of the Economy Post COVID.¹ So much has happened since we last met in Washington in February 2020, but I am grateful that technology is allowing us to gather once again, if only virtually. I look forward, as always, to my conversation with Ellen Zentner, 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 February 2020, none of us could have imagined that in a few short weeks the COVID-19 pandemic and the mitigation efforts put in place to contain it would deliver the most severe blow to the U.S. economy since the Great Depression. Gross domestic product (GDP) collapsed by more than 30 percent at an annual rate in the second quarter of 2020; more than 22 million jobs were lost, wiping out a decade of employment gains; the unemployment rate rose from a 50-year low of 3.5 percent in February to almost 15 percent in April; and inflation plummeted in response to a collapse in aggregate demand that dwarfed the contraction in aggregate supply.

But with the benefit of hindsight, it is clear that the economy has proven to be much more resilient than many forecast or feared one year ago. With timely support from monetary and fiscal policy—unprecedented in both scale and scope—and the rapid development and deployment of several effective vaccines, the economy stabilized and began a robust recovery in the second half of 2020 that both we and outside forecasters

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.

expect to pick up steam this year. So far, the economic activity data we have received this year is consistent with this outlook. For example, GDP rose by an impressive 6.4 percent in the first quarter, with real final sales to private domestic purchasers up an eye-popping 10.6 percent. Household spending on goods is rising robustly, and spending on services is also picking up as contact-intensive sectors begin to reopen and recover. Business and residential investment have more than fully recovered from the 2020 collapse and are operating above pre-pandemic levels.

However, after looking at the details of Friday's disappointing employment report, the near-term outlook for the labor market appears to be more uncertain than the outlook for economic activity. Employment remains 8.2 million below its pre-pandemic peak, and the true unemployment rate adjusted for participation is closer to 8.9 percent than to 6.1 percent. At the recent pace of payroll gains—roughly 500,000 per month over the past three months—it would take until August 2022 to restore employment to its pre-pandemic level. But what this necessary rebalancing of labor supply and demand means for wage and price dynamics will depend importantly on the pace of recovery in labor force participation as well as the extent to which there are post-pandemic mismatches between labor demand and supply in specific sectors of the economy and how long any such imbalances persist.

Readings on inflation on a year-over-year basis have recently increased and are likely to rise somewhat further before moderating later this year. Over the next few months, 12-month measures of inflation are expected to move above our 2 percent longer-run goal, largely reflecting, I believe, transitory factors such as a run of year-over-year comparisons with depressed service-sector prices recorded last spring as well as the

emergence of some supply bottlenecks that may limit how quickly production can rebound in certain sectors. However, under my baseline outlook, these one-time increases in prices are likely to have only transitory effects on underlying inflation, and I expect 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 the Federal Reserve unanimously adopted in August 2020 and began to implement at our September 2020 Federal Open Market Committee (FOMC) meeting.²

Recent FOMC Decisions and the New Monetary Policy Framework

At FOMC meetings convened since the new framework was announced last August, 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 to bring it in line with our new framework. As announced in the September 2020 FOMC statement and reiterated in the following statements—including the most recent one—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

² The 2020 Statement on Longer-Run Goals and Monetary Policy Strategy 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>.

³ The statements issued after the September 2020 and subsequent FOMC meetings are available, along with other postmeeting statements, on the Board's website at <https://www.federalreserve.gov/monetarypolicy/fomccalendars.htm>.

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 2020 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*, measured relative to the December 2020 announcement, has been made toward our maximum-employment and price-stability goals.

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.”⁴ 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.⁵ To this end, the new

⁴ 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.

⁵ The Fed staff’s index of common inflation expectations—which is now updated quarterly on the Board’s website—is a relevant indicator that this goal is being met. See Hie Joo Ahn and Chad Fulton (2020), “Index of Common Inflation Expectations,” FEDS Notes (Washington: Board of Governors of the Federal Reserve System, September 2), <https://doi.org/10.17016/2380-7172.2551>; and Hie Joo Ahn and Chad Fulton (2021), “Research Data Series: Index of Common Inflation Expectations,” FEDS Notes (Washington: Board of Governors of the Federal Reserve System, March 5), <https://doi.org/10.17016/2380-7172.2873>.

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 a “flexible form of 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

Notwithstanding the recent flow of encouraging macroeconomic data, the economy remains a long way from our goals, and it is likely to take some time for substantial further progress to be achieved. Our guidance for interest rates and asset purchases ties the path of the federal funds rate and the size of the balance sheet to our employment and inflation goals. We are committed to using our full range of tools to support the economy for as long as it takes until the job is well and truly done.

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>.