

For release on delivery
4:35 p.m. EDT
April 21, 2023

Important Questions for Economic Research

Remarks by

Lisa D. Cook

Member

Board of Governors of the Federal Reserve System

at the

Carroll Round Keynote Speech
Georgetown University McDonough School of Business

Washington, D.C.

April 21, 2023

Good evening. Thank you for the invitation to speak at the Carroll Round this year.¹

Economics, like any other discipline, has its own established canon and set of rules and models. But it is also constantly evolving, growing, and changing shape. New approaches and methods are developed. Unique forces arise and long-established behaviors can change—as we have seen over the past three years, and even the past decade. There will always be unasked questions and new trails to blaze. And, as in any field, the people who make up the profession lie at the heart of its growth and progress.

It is a pleasure to be here today among such a talented group of future economists. Your research reflects everything that is exciting about the discipline. Because you have interesting theses. Because you have used an impressive variety of data sets and models. And because you have a perspective that is unique to your generation and experiences.

As you know, I was a professor of economics and international relations at Michigan State University for nearly two decades before joining the Board of Governors. Among my favorite courses to teach were undergraduate research courses. It was magical to see the novel ways that students brought new ideas, literature, models, methods, and data to the most pressing problems of the day. I see some of that magic in the research represented here this evening.

In keeping with that spirit of inquiry, I would like to talk today about some of the open questions I see for understanding the economic outlook and for setting monetary policy. I will also focus on some of the data sources I find valuable for answering those questions.

¹ The views expressed here are my own and not necessarily those of my colleagues on the Federal Open Market Committee.

Inflation

For monetary policy, the foremost questions currently are about the inflation process. The pandemic-related economic shutdown created rapid shifts in demand, which continued through the reopening process and reflected people's wants and needs during that time. For instance, there was a sharp move away from in-person services and toward goods. This was coupled with disruptions to supply, both in global supply chains and the labor force. Russia's invasion of Ukraine last year further restricted access to commodities, and the subsequent surge in energy prices drove a spike in consumer price inflation to a peak in mid-2022, reaching levels not seen since the 1980s.

As energy prices have moderated and supply disruptions have eased, inflation has followed suit and started to abate. Last week, data on the consumer price index (CPI) showed 12-month inflation falling to 5 percent in March from a peak of about 9 percent last June. The Fed has a preferred consumer price measure, which is the personal consumption expenditures (PCE) price index. It covers a broader set of goods and services than the CPI, and its weighting of individual prices can change each month to reflect consumer spending behavior. Last week's data suggest that PCE inflation likely will be somewhat above 4 percent in March, also significantly lower than last June. The big question, however, is whether, and how quickly, inflation will continue its downward path toward our target of 2 percent. Much of the decline so far has been driven by the moderation in energy prices, and there is evidence that the path back to our low and stable inflation goal could be long and is likely to be uneven and bumpy.

Total (or headline) inflation tells us something critical about the effect on our daily lives—simply put, people need to eat, pay their bills, and get to work and school,

among other things, and their budgets feel the impact. We also look at core inflation, which omits volatile food and energy prices and tends to give a more accurate signal of total inflation's trajectory. The rise and fall in core measures has been less dramatic than that of total inflation. We also look at other measures of underlying inflation, that try to get at the central tendency of inflation, such as median or trimmed-mean inflation. All of these measures have come off their peaks but remain elevated, suggesting that inflation has become broad based in the economy.

Of course, economic data are generally backward looking. One question is whether timely data can give us a sense of where inflation is going. To this end, I have found several useful sources of data. For instance, to forecast core goods prices—which drove much of the initial surge in inflation—I look at various measures of supply chain disruptions and input prices. Those indicators helped predict the moderation in goods prices that emerged last fall. For automobiles, where shortages of semiconductors held down production and drove up prices for both new and used cars, I looked at wholesale used car prices as a leading indicator of retail prices. Those wholesale prices declined last fall but have turned up recently, suggesting that the moderation in goods prices may not be a smooth process.

A big contributor to inflation over the past two years has been housing services prices (rent and a measure called owners' equivalent rent—essentially what a homeowner would pay if they had to rent their home). To help forecast this component, I have looked at rent increases on new leases, which slowed sharply over the past six months, as a leading indicator. These data come from sources that might be familiar to you, like Zillow, Apartments.com, and Apartment List. One encouraging development is that last

week's CPI data showed a significant slowing in housing services inflation. This development likely reflects moderation in demand and has been helped by the additional supply of multifamily housing that is being completed. More places available to lease should contribute to easing rental prices.

Finally, in forecasting inflation, especially for the broader category of core services ex. housing, a looming question is how the relationship between inflation and measures of economic slack—including in the labor market—will play out. This relationship has been challenged in recent years, particularly in terms of trying to explain the large movements in inflation since the pandemic.

Labor Markets

The labor market poses its own set of questions. To what extent has the labor market recovered from the 2020 downturn, and in what ways will it continue to differ from its pre-pandemic structure? With a range of data to consult, which indicators best capture the state of the jobs market?

By many measures, the U.S. labor market is very strong. Payroll employment growth was robust in the first three months of this year, unemployment is near record lows, and job openings remain very high. A critical component of the labor market's fortitude is that it has extended its benefits to historically disadvantaged groups—those who have persistently seen gaps with their counterparts in other demographics, especially along racial lines. The African American unemployment rate historically has been about 4 to 5 percentage points above the overall unemployment rate, but that gap was cut in about half in 2019, following years of sustained expansion. After widening during the

pandemic, that gap has once again narrowed, this time more quickly, and African American unemployment was at a record low of 5.0 percent in March.

Similarly, workers in the lowest-income quartile have seen the strongest wage growth relative to other quartiles over the past two years. Those workers have benefitted from the availability of jobs and, in many cases, the ability to move to better, higher-paying jobs in the current strong labor market.

Nonetheless, there are some signs that this strong labor market is softening at the margin. Wage growth has moderated somewhat from the rates reached about a year ago. Indicators of hiring have slowed. Job openings, while still elevated, have declined in recent months. And the quits rate has retraced more than half of its pandemic-era rise, falling from a 3 percent peak in late 2021 to 2.6 percent in February. That could be significant, as much of the surge in wage growth a year ago may have been driven by outsized wage gains of those changing jobs and by employers raising wages to retain existing workers.

Supply

The wage moderation may partly reflect some improvement in labor supply. One factor is that new estimates show higher population growth over the past year amid a rebound in immigration from its reduced levels during the pandemic. Labor force participation also has edged up to 62.5 percent in the most recent data. Prime-age participation (for workers aged 25 to 54) is now back to pre-pandemic levels. In our series of *Fed Listens* events in 2019, when we talked with a wide range of people and community organizations, we heard that a strong labor market can pull in people from the

sidelines who have skills that can be developed if given a chance. That appears to be happening now.

The Fed cannot directly act to increase supply in the economy, but supply is a key input to our economic outlook. One important source of increased supply is productivity growth, which comes through both capital investment and innovation. My hope is that we will see increased innovation and productivity associated with the spurt of new businesses that have opened since the onset of the pandemic.

Supply-side issues, especially innovation and productivity, have been a theme of my own academic research, including papers on patents and on the growth and funding of small businesses. So I am so pleased to see many of your topics touching on these issues, often using novel data sets from a wide range of countries.

International

International issues are also an important area of research—and open questions—and have been another theme of my career. Much of the recent inflation episode was tied to international factors, including global supply chain disruptions and the surge in commodity prices. The continued war in Ukraine, China's economic reopening, and OPEC+ decisions on oil supply are some of the international forces that could affect the U.S. economy this year.

We can also learn a lot from comparisons across economies with different economic structures and different policy responses to global shocks such as COVID. The importance of watching and learning from foreign economies has also been a central tenet of my career in economics. Economic forces and reverberations cannot be contained within regional or national borders. Even a giant like the U.S. economy does

not operate alone. One of my top 10 pieces of advice for future economists is to study foreign economies (and languages, if you have the opportunity).

I wrote my dissertation on the Russian banking system. It certainly taught me a lot about Russia and its economy specifically, and, given that I was there during the post-Soviet transition, it was an immersive experience of change. What I saw in Russia taught me that you could apply the same playbook that had seen near-uniform success but see it fail when the necessary foundation was lacking. In this case, the banking system model that worked here could not take hold in post-Soviet Russia, because it was missing trust and universal faith in the rule of law, which are critical to the functioning of financial institutions in market economies. A major lesson for me was that models help clarify our thinking, but any particular model is not always relevant for the given time, situation, or context.

That experience was also possibly the best research training in the world. It is one thing to do your dissertation without the internet—it is another level to manually make your way through the records of the Kremlin’s statistical agency!

I will finish the “research abroad hard sell” by noting that nothing gives you quite the same clarity and perspective on a situation as seeing it through someone else’s eyes. Immersing yourself in a new culture is reward in and of itself, but it will also teach you as much about your own world as it does about that of others.

Monetary Policy

Stepping back into the United States in 2023, what does the state of the economy mean for monetary policy? Relevant questions include, what are the channels through

which policy tightening affects the economy? And what are the lags before the full effects are felt on the economy and on inflation?

Since my first Federal Open Market Committee (FOMC) meeting last June, my approach has been one of data dependence. It has also taken into account risk management, which concedes that the Federal Reserve cannot eliminate risks but can manage them. This data-dependent, risk-management framework has led me to support the FOMC's response of rapid monetary policy tightening—we have raised interest rates 475 basis points in a year to bring inflation under control. Currently, with the federal funds rate target near 5 percent, I am looking at what rate will be sufficiently restrictive to bring inflation down to 2 percent, over time.

I am weighing the implications of stronger momentum in the economy apparent in economic indicators over the past few months against potential headwinds from recent banking developments. If tighter financing conditions are a significant headwind on the economy, the appropriate path of the federal funds rate may be lower than it would be in their absence. But if data show continued strength in the economy and slower disinflation, we may have more work to do.

In setting monetary policy, I continue to be guided by our dual-mandate goals of maximum employment and price stability. I, like my colleagues on the FOMC, am committed to bringing inflation back to its 2 percent target over time, which will lay the foundation for sustainable strength in the labor market and the U.S. economy.

Thank you.