FEDERAL RESERVE BANK of ST. LOUIS

Economic Conditions and Monetary Policy

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The text is as prepared for delivery.

Good afternoon. I would like to thank my FOMC colleague, Neel Kashkari, and the Economic Club of Minnesota for inviting me to speak with you today. I look forward to the dialogue and your questions. First, I would like to offer a few thoughts about the economic outlook and implications for monetary policy. Let me stress that these are my personal views, which do not necessarily reflect the views of my FOMC colleagues.

In short, I believe that monetary policy is currently well positioned. I will continue to actively monitor incoming information to assess the impact of tariffs and other factors on the economic outlook. My perspective is driven by four main observations.

First, while the pace of economic activity has moderated in recent months, the U.S. economy continues to exhibit underlying strength. Despite some cooling, the labor market has shown resilience and remains at or near full employment. Inflation has continued to ease but remains above the FOMC's 2% target. Near-term expectations have risen, and while one survey of long-term inflation expectations has risen, other measures of longer-term inflation expectations have remained stable.

Second, the range of possible economic outcomes for the next few quarters is wide. Economic policy uncertainty is unusually high. Major new trade, immigration, fiscal and regulatory policies could have a material impact on the economy in different ways and at different time horizons. As we get more clarity on these policies, the macroeconomic and monetary policy implications should become more evident.

Third, announced tariffs are higher, have been more broadly applied and have prompted stronger retaliation than I and many others had expected. Ongoing negotiations with trading partners might dial back tariffs significantly and durably, as we have seen with the recently announced 90-day reduction in reciprocal tariffs with China. However, if a cycle of high tariffs and retaliation is sustained, economic activity and employment are likely to moderate meaningfully over the next few quarters, and inflation is likely to rise.

Fourth, I believe monetary policy is well positioned to respond in a timely way to economic developments and greater clarity about the outlook. Should tension between our dual mandate goals arise, I believe a balanced response to both inflation and employment is feasible—provided the public continues to expect inflation will return to 2%. Ultimately, well-anchored medium- to long-term inflation expectations are necessary for achieving both price stability and maximum employment for the American people.

Let me now offer more detail about each of those observations.

Economic Activity, the Labor Market and Inflation

With regard to economic activity, the negative first-quarter growth in real GDP was largely due to unusual, one-off circumstances. Most reports indicate that economic activity has continued to expand since the beginning of the year. In the first quarter, growth in final sales to private domestic purchasers, growth in personal consumption expenditures, and growth in non-residential fixed investment were all solid.

April data have been mixed. Following robust increases in March, total retail and light vehicle sales were flat in April, and manufacturing output declined. Still, most tracking forecasts project solid real GDP growth for the second quarter.[1]

First-quarter and April expenditure data must be interpreted cautiously as reports suggest there was considerable buying ahead of new tariffs, a surge that is unlikely to persist. Surveys and other soft data reveal material declines in household and business sentiment, suggesting that spending and hiring growth could fall sharply in coming months.[2] Measures of business confidence and expectations aren't much better.[3] Recent surveys by several Federal Reserve banks find fewer firms planning to increase employment or capital investment.[4]

[1] For example, as of May 16, the Atlanta Fed's GDPNow tracking forecast estimate for second-quarter real GDP growth stood at 2.4%.

[2] For example, the Conference Board's index of consumer confidence declined in April for the fifth consecutive month, and the Board's Expectations Index fell to a 13-year low. The University of Michigan's preliminary survey of consumers showed a further decline in sentiment in May.

[3] For example, the S&P Global Flash US PMI sentiment measure fell sharply in April to its lowest level since July 2022 and is well below its long-run average. The National Federation of Independent Business Small Business Optimism Index has similarly fallen sharply since reaching a post-pandemic high in December.

[4] Summary based on surveys conducted by the Federal Reserve banks of Dallas, Kansas City, Philadelphia, Richmond and Chicago, and the Federal Reserve Bank of New York's Business Leaders and Empire State Manufacturing surveys.

While surveys suggest economic activity could slow appreciably, financial and financing conditions appear to remain generally supportive despite some recent tightening. Banks reported a modest tightening of lending standards in the first quarter for commercial and industrial loans, commercial real estate loans and credit card loans, but no material changes for residential real estate loans, auto loans and other consumer loans.[5]

Corporate bond and equity prices have recovered from the losses incurred after the April 2 tariff announcement, and credit spreads have declined to manageable levels. Bank lending picked up in April, and total gross debt issuance appears to have rebounded to normal levels in the first two weeks of May.

The labor market has continued to show resilience, with solid gains in employment and only limited layoffs through April. New claims for unemployment insurance benefits remain low. Compensation growth has moderated to a rate that is more consistent with 2% inflation, and the labor market does not appear to be a significant source of inflationary pressure.

Inflation remains above target but has more recently resumed progress toward it. The April increase in consumer prices was a shade lower than forecasters had predicted and producer prices declined, but core CPI inflation measured over the past 12 months was unchanged at 2.8%. Based on elements of the CPI and PPI reports, forecasters estimate that core PCE inflation, which I view as the best measure of underlying inflation, was 2.5% in April, a step down from 2.6% in March and 2.9% in December.

However, and looking ahead, price pressures appear to be building. Anecdotally, I've heard from business contacts that many firms are imposing price surcharges to recoup the costs of higher tariffs. In addition, recent Federal Reserve bank surveys of manufacturers and service-providing firms found higher percentages of firms with plans to increase sales prices over the next six months compared with what we saw in earlier surveys.[6]

The public also appears to expect inflation to rise over the near term, as evidenced by both survey and financial market measures. With the notable exception of a University of Michigan survey, which has continued to rise, other measures of longer-term inflation expectations have remained stable.[7] I continue to monitor inflation expectations closely at all horizons, especially for signs that elevated near-term inflation expectations may be seeping into longer-term

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[5] See the Fed's April 2025 Senior Loan Officer Opinion Survey on Bank Lending Practices.

[6] Summary based on surveys conducted by the Federal Reserve banks of Dallas, Kansas City, New York and Philadelphia linked in Footnote 4. In addition, the S&P Global Flash US PMI found that average prices charged for goods and services rose in April at the highest rate in 13 months. See the April 23, 2025, S&P Global Flash US PMI.

[7] See the latest Conference Board release on consumer confidence, University of Michigan Surveys of Consumers and New York Fed Survey of Consumer Expectations for measures of near-term inflation expectations, and the University of Michigan surveys for a measure of longer-term expectations.

expectations. Inflation expectations can be self-fulfilling as expectations of higher prices in the future can drive up current demand relative to supply, pushing prices up.

Economic Outlook and Monetary Policy

I will now offer a few comments on the economic outlook and monetary policy implications.

Economic policy uncertainty is high, which makes the path of the economy especially difficult to project. New trade, fiscal, regulatory and immigration policies and other factors will affect the outlook in different ways and on different time horizons, and it will be important to consider their net total effects.

The tariff increases announced on April 2 and the retaliation that followed were substantially larger than I had anticipated. Even after the de-escalation of May 12, they seem likely to have a significant impact on the near-term economic outlook. On balance, tariffs are likely to dampen economic activity and lead to some further softening of the labor market. Tariffs are also likely to have direct one-off effects on the prices of imported final goods, indirect effects on the prices of domestically produced goods and services, and possibly second-round effects on inflation.

How should monetary policy respond if trade negotiations do not soon and durably reduce tariffs and retaliation, and inflation moves higher while the labor market softens? Two scenarios that seem equally likely are possible, depending on the persistence of higher inflation. Appropriate monetary policy will depend on which scenario comes to pass.

In the first scenario, tariffs could have only a modest and temporary impact on inflation concentrated in the remainder of 2025, as businesses run down inventories and pass tariffs onto customers as one-off price increases. The effects of higher tariffs on economic activity might slow aggregate demand and thus dampen some of the inflation.

Under this scenario, a monetary policy of looking through the temporarily higher inflation and possibly easing policy to counter negative effects on employment could be appropriate.

However, a “look through” policy has risks and costs. Committing now to ignoring higher inflation from tariffs, or to easing policy, runs the risk of underestimating the level and persistence of inflation. Parsing the direct price-level effects from indirect and second-round inflation effects is difficult in real time. Getting the persistence of inflation wrong could prove costly, especially if persistent inflation leads the public to expect higher inflation to continue over the medium to long term.

In the second scenario, it seems at least equally likely that the inflationary impetus from higher tariffs could be more persistent for the following reasons:

- The pre-tariff starting point for inflation is above target;
- The recent period of high inflation likely has raised the public's sensitivity to it;
- Some measures of inflation expectations have risen; and
- Tariffs apply broadly to intermediate inputs, encouraging rearrangement of global supply chains.

In this scenario, a balanced monetary policy that is responsive to deviations of inflation from target and to employment shortfalls will be appropriate, provided that longer-term inflation expectations are well anchored. Otherwise, it will be necessary to focus on a policy path that returns inflation to 2% and inflation expectations to levels consistent with our inflation target.

Price stability and well-anchored inflation expectations are the foundation for maximum employment. History tells us that restoring price stability is more costly for the public in terms of forgone employment and economic activity if inflation expectations are not well anchored. Thus, I believe policy should prioritize price stability in the face of persistent inflationary pressures that threaten to dislodge long-term inflation expectations.

So far, I have focused on high and broad-based tariffs being sustained along with retaliation by trading partners. Conceivably, however, ongoing trade negotiations will durably de-escalate trade tensions and lead to a resumption of global trade flows with only a modest reconfiguration of supply chains. If that were to happen soon, the U.S. economy could remain close to the path that it was on—one with a resilient labor market and ongoing convergence of inflation to target.

In this scenario, the current stance of monetary policy, which is focused on bringing inflation back to 2% in the context of a full employment labor market, will remain appropriate.

Conclusion

To conclude, the underlying strength of the U.S. economy, the resilient labor market, above target inflation, and some inflation expectations moving higher indicate to me that the FOMC's modestly restrictive monetary policy remains appropriate. Higher tariffs are likely to both dampen activity and exert inflationary pressure, at least in the near term. There remains considerable uncertainty about where tariff rates will ultimately settle and what their effects will be. I will continue to assess incoming information for clarity about which scenario seems most likely for the U.S. economy and monetary policy. I will also be considering how other prospective fiscal, immigration and regulatory policy changes could materially affect the economic outlook.

This is a time to maintain the public's confidence about keeping up the fight against inflation. Through rigorous forward-looking analysis of incoming information, and with careful attention on inflation expectations, I believe that monetary policy is well positioned to navigate material changes in the economic outlook as they become apparent, and to deliver stable prices and maximum employment for the American people over time.

Thank you, and I look forward to an engaging discussion.