Remarks on the U.S. Economic Outlook and Monetary Policy

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Good afternoon. I would like to thank the Paducah Area Chamber of Commerce and Greater Paducah Economic Development for inviting me to speak with you today. I have been president and CEO of the Federal Reserve Bank of St. Louis for almost a year. During that time, I have welcomed the opportunity to visit and to hear from the people in the many unique communities that make up the Eighth Federal Reserve District. So, thank you for being here today.

When Congress established the Federal Reserve System more than 100 years ago, it recognized that economic conditions vary across the United States. Congress intentionally gave the Fed a regional structure to ensure that Main Street perspectives are heard and considered in setting our nation’s monetary and banking policies. That structure works. I have found my visits to the different parts of the Eighth District valuable in preparing for meetings of the Federal Open Market Committee, or FOMC. In talking with business and community leaders, I have learned about economic conditions across our District, the nation and the global economy. I share insights from these conversations when I participate in FOMC meetings, and my colleagues from other Reserve banks do the same by reporting on their regions. Together, these reports help us as we seek maximum employment and price stability for the American people throughout the United States.

Before addressing some questions that may be on your mind, I would like to first offer some comments on the U.S. economic outlook and monetary policy. Let me stress that these are my personal views and not necessarily those of my FOMC colleagues.

I have three main observations:

First, the U.S. economy is continuing to expand, but the pace of growth appears to have moderated in the first quarter, reflecting both rough winter weather and elevated economic policy uncertainty. Growth is being sustained by a healthy, full-employment labor market and

generally supportive financial conditions. However, recent data on consumer spending have been weaker than expected and other data have been mixed. Surveys suggest that households and businesses have become more cautious, posing some risk to economic activity in the near term.

Second, there is more work to do to bring inflation down to our 2% target. Inflation has declined considerably from its peak but remains elevated. Since mid-2024, there has been limited further progress toward 2%, even before the potential impact of tariffs or other factors. The risks that inflation will stall above 2% or move higher in the near term appear to have increased. New tariffs are expected to have both direct and indirect effects. The direct effects are essentially one-time price-level increases that should not have a persistent impact on inflation. But the indirect, second-round effects on non-imported goods and services could have a more persistent impact on underlying inflation.

I will monitor measures of inflation expectations closely. When people expect inflation to increase, it can often be self-fulfilling. Market-based and survey measures indicate that near-term inflation expectations have risen, but thus far longer-term expectations appear stable. I am watching closely for signs that elevated near-term expectations could seep into longer-term inflation expectations, which would make the job of restoring price stability and maintaining full employment more difficult.

Third, I supported the FOMC's decision last week to leave its target range for the federal funds rate—the Committee's policy interest rate—unchanged.[1] If the economy remains strong and inflation remains above our target, then I believe the current, modestly restrictive policy will remain appropriate until there is confidence inflation is converging to 2%. If the labor market remains resilient and the second-round effects from tariffs become evident, or if medium- to longer-term inflation expectations begin to increase actual inflation or its persistence, then modestly restrictive policy will be appropriate for longer or a more restrictive policy may need to be considered. If labor market conditions were to deteriorate, with inflation stable or declining toward target and inflation expectations anchored at a level consistent with 2% inflation, policy could be eased further. At this juncture, a patient approach, involving careful assessment of incoming information, the outlook and risks, will help us as we seek maximum employment, price stability and a durable economic expansion.

I will now expand on these points, drawing partly on what we've been hearing from businesspeople and others in the Eighth District.

[1] I also supported the Committee's decision to slow the pace at which the size of the Fed's balance sheet is reduced. That action was a technical adjustment that has no bearing on the stance of monetary policy.

Economic Activity, Labor Markets and Inflation

The pace of consumer spending appears to have moderated in the first two months of the year and estimates of first-quarter real GDP growth have been tracking lower.[2] Rough winter weather undoubtedly accounts for some reduced spending, as spending at “brick-and-mortar” establishments has been weaker than e-commerce sales. Many of our retail contacts reported significantly reduced foot traffic and sales when the weather was bad, but a rebound when conditions improved. Conceivably, consumer spending growth will accelerate with the arrival of spring. However, surveys indicate that consumer confidence has been falling, which could weigh on household spending and the overall pace of economic activity going forward.

Recently, we have also seen reports of growing caution among businesses. Our conversations with Eighth District firms suggest business leaders generally remain cautiously optimistic, but many comment that uncertainty about tariffs and other economic policies and their likely effects has made planning difficult. Until there is more clarity, many businesses have adopted a wait-and-see posture rather than going forward with significant new hiring or fixed investment.

Measures of economic policy uncertainty have risen to levels that could pose some downside risk to the outlook.[3] Across the United States, recent surveys by Reserve banks and the National Federation of Independent Business found smaller percentages of firms have plans to add jobs or increase capital expenditures over the next three to six months compared with prior surveys, though the net percentages of firms expecting to expand are still positive.[4] These reports suggest the economic expansion is continuing but at a reduced pace.

A healthy labor market, reflected in solid payroll growth, a low unemployment rate and rising real wages, should help propel consumer spending and the economy forward. The labor market has normalized over the past 18 months and is no longer a significant source of inflationary pressure. District employers report that job applications have risen, time to hire has fallen and attrition rates are low. Firms also report wages are growing at normal rates consistent with

[2] The St. Louis Fed’s dashboard Economy at a Glance, which is powered by FRED, the St. Louis Fed’s signature database, provides a high-level overview of current U.S. economic conditions.

[3] For a widely followed measure of economic policy uncertainty, see the US Monthly Economic Policy Uncertainty Index. Baker, Bloom and Davis (2016) and Jackson, Kliesen and Owyang (2020) show that increases in economic policy uncertainty foreshadow declines in investment, output and employment, and propagate through both household consumption spending and business fixed investment.

[4] Surveys of business confidence include the National Federation of Independent Business (NFIB) January 2025 Small Business Optimism Index, with results reported in a Feb. 11, 2025, article, “Small Businesses Remain Optimistic, But Uncertainty Rising on Main Street,” and the Jan. 24, 2025, S&P Global Flash US PMI. Surveys reporting capital expenditure intentions include the NFIB Small Business Economic Trends report, surveys by the Federal Reserve banks of Dallas, Kansas City, Philadelphia and Richmond, and the Federal Reserve Bank of New York’s Business Leaders and Empire State Manufacturing surveys.

productivity growth. Analysis by my staff suggests that positive demand conditions have been the main driver of solid payroll and wage growth.

As I mentioned a few minutes ago, inflation remains above the FOMC's 2% target and recent convergence toward the target has been limited, even before potential tariff effects. Core PCE inflation, which I consider a good measure of underlying inflation, was 2.6% in January measured from a year earlier. Data for February will be released later this week. Forecasters estimate the core PCE price index increased by 0.3% in February, which would put the core inflation rate measured over the past 12 months at about 2.8%.

The risks that inflation will stall above 2% or move higher in the near term appear to have increased. Market and survey measures indicate that near-term inflation expectations have risen, with higher tariffs often cited as the main driver.[5] Thus far, market data and surveys suggest that longer-term inflation expectations have not risen appreciably and have in fact been stable, but the most recent University of Michigan survey of consumers is a notable exception.[6]

Several recent surveys indicate that more firms have or are planning to raise prices in coming months compared with surveys from the fourth quarter of 2024. For example, the NFIB recently reported the net percentage of businesses raising average selling prices rose 10 points between its January and February surveys, which was the largest one-month increase since April 2021.[7] Those results are consistent with reports from Eighth District business leaders who tell us they expect to pass higher materials costs on to their customers. Firms also tell us their suppliers have recently raised prices or have warned that increases are coming after tariff increases are implemented.[8]

Monetary Policy

Looking ahead, my expectation is that the economic expansion will continue at a moderate pace, the labor market will remain healthy around full employment, and inflation will decline to 2% by 2027. However, I see the risks as skewed toward some further cooling of the labor market and inflation remaining above 2% or possibly rising in the near term. This aligns with the views of many professional forecasters, who have tended to mark down their expectations for

[5] For example, the Federal Reserve Bank of Atlanta Business Inflation Expectations (BIE) survey shows respondents' one-year ahead inflation expectations have risen each month since December.
[6] See the University of Michigan's Surveys of Consumers, preliminary results of the March survey.
[7] See the March 11, 2025, NFIB article, "Small Business Optimism Recedes in February."
[8] In a March survey of manufacturers by the Federal Reserve Bank of Philadelphia, 48% of respondents reported increases in input prices and none reported decreases. A prices paid index based on the survey has risen for four consecutive months to its highest level since July 2022.

economic growth and mark up their forecasts for inflation for 2025. A similar shift is apparent in the median projections of FOMC participants between December and March.[9]

A scenario involving labor market softening and above-target or rising inflation would present a challenging environment for monetary policy. This scenario could occur for a variety of reasons, though higher tariffs and reduced immigration have been widely discussed and thought by many as likely to raise prices and soften aggregate demand and employment, at least in the near term. Higher tariffs potentially involve both direct and indirect effects on economic activity, the labor market and inflation, depending on how tariffs are implemented and any retaliation by trading partners.

Considering both direct and indirect effects, my staff estimates that, if fully implemented, a 10% increase in the effective U.S. tariff rate—roughly the increase that would be associated with tariff hikes announced to date—could increase the PCE inflation rate by as much as 1.2 percentage points. The direct and one-time price-level effect is estimated to be on the order of 0.5 percentage points. The indirect effects are estimated to be on the order of 0.7 percentage points and could contribute to more persistent underlying inflation through second-round effects on non-imported goods and services. The effects are proportional. So, for example, the near-term inflation effects of a 5% increase in the effective tariff rate would have half the impact of those associated with a 10% increase.

From the standpoint of monetary policy, it could be appropriate to "look through" direct effects of higher tariffs on the price level and at the same time "lean against" indirect and second-round effects. The direct price-level effects are expected to have only a brief and limited impact on inflation, but the indirect effects could have a more persistent impact on inflation. Distinguishing, especially in real time, between direct, indirect and second-round effects entails considerable uncertainty.

The potential effects of retaliation by trading partners are yet another consideration. Conceivably, retaliation could cool economic activity and mitigate inflationary pressures, creating a motive for less restrictive monetary policy.[10]

The relative importance of these forces will determine the best path for policy. I would be wary of assuming that the impact of tariff increases on inflation will be entirely temporary, or that a full "look-through" strategy will necessarily be appropriate. I would be especially vigilant about indirect, second-round effects on inflation. I would also be uncomfortable if medium- to longer-term inflation expectations begin to rise. With inflation already above 2% in a full-employment

[9] See the FOMC's Summary of Economic Projections from March 19, 2025.

[10] Bergin and Corsetti (2023) examine the optimal monetary policy response to tariff shocks and conclude that the optimal response depends on the extent of retaliation and other factors.

economy, the stakes are potentially higher than they would be if inflation were at or below target, and if consumers and businesses had not recently experienced high inflation, raising their sensitivity to it.

In a recent speech, I described two disinflation episodes with very different outcomes for the real side of the economy.[11] In the first episode, which occurred in the early 1980s, disinflation was accompanied by a deep recession and prolonged high unemployment. In the other, which began in 2022 and is ongoing, disinflation has thus far been accompanied by solid real GDP growth and a strong labor market that has stayed close to full employment.

A key difference between the two episodes involves inflation expectations. In the early 1980s, after more than a decade of rising inflation, the public did not have faith that the Fed would restore price stability. Consequently, expected inflation remained high even after inflation had fallen significantly. The recent disinflation has been much different. This time, longer-term inflation expectations have remained close to 2%, reflecting the confidence of consumers, businesses, financial market participants and professional forecasters that inflation will return to target. That expectation has enabled restrictive monetary policy to bring about disinflation without a significant slowing of the economy or high unemployment.

The lesson is clear. If longer-term inflation expectations are well anchored, monetary policy can be responsive to both sides of the dual mandate and the economic costs of disinflation are smaller than if longer-term inflation expectations are not anchored. Thus, in my view, ensuring that medium- to longer-term inflation expectations remain well anchored should be an important consideration for monetary policy.

Conclusion

To sum up, the U.S. economy is continuing to expand, but the pace of growth appears to have moderated. There is more work to do to bring inflation down to our 2% target and I am committed to doing so.

And that is why I supported the FOMC's decision last week to leave its target range for the federal funds rate unchanged and maintain a modestly restrictive policy stance. A patient and vigilant approach will help us as we seek maximum employment, price stability and a durable economic expansion for the American people.

Thank you.

[11] See "Remarks on the Economic Outlook and Monetary Policy," given March 3, 2025, at the National Association for Business Economics Economic Policy Conference.

References

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