Show Me the Low Inflation

Beth M. Hammack
President and Chief Executive Officer
Federal Reserve Bank of Cleveland

University of Kentucky Gatton College of Business and Economics
Economic Outlook Conference
Lexington, KY

February 11, 2025

Introduction

Hello and good morning. I'm grateful to the University of Kentucky's Gatton College of Business and Economics for the invitation to join you today. My savvy team knew not to schedule me on the day after the Super Bowl, when an estimated 23 million people missed work. Hopefully everyone is feeling rested and energized today. And in hopes of extending football season one more day, in the words of the movie *Jerry Maguire*, I hope I had you at hello.

This is my second trip to Kentucky since starting as Cleveland Fed president last summer, and I've only begun to scratch the surface of discoveries in your vibrant state. Among other engagements, I've visited the Kentucky Horse Park, discussed the local economy with Lexington business and community leaders, and toured a nonprofit workforce development program in Newport. However, I've not yet had a chance to make a single stop on the Bourbon Trail, so I would welcome your recommendations for must-visit distilleries.

Until then, I'm grateful to have the opportunity to tell you a little bit about how the Federal Reserve is working to make a positive difference in the economic lives of every American, including right here in Kentucky. I will also share with you my outlook for the economy and monetary policy. I especially look forward to your questions, because hearing what's on your minds is a key ingredient in my view of appropriate policy. In this way, you can help *me* help *you*, but more on that in a moment.

I understand that this conference regularly hosts speakers from the Fed, so to the extent that some of you are repeat participants, you may already know quite a bit about the institution. For everyone else, let me give you a brief overview of what the Fed does to support the economy and financial system on behalf of the American public—and how that affects you. Before I begin, please note that the views I express today

are my own and not necessarily those of the Federal Reserve System or my colleagues on the Federal Open Market Committee.[1]

The Federal Reserve

The Federal Reserve was established in 1913 in response to a wave of financial crises that swept the country in the late nineteenth and early twentieth centuries. The framers of the Federal Reserve Act saw the need for a central banking "system" rather than a single entity. The new system created a decentralized institution with public and private characteristics, one that is uniquely capable of serving the nation's economic and financial interests free from short-term political pressures.

In Washington DC, the Board of Governors is a federal government agency with seven members who are appointed by the president and confirmed by the Senate. The name you most likely recognize from this body is Jerome Powell, who serves as Board chair. Across the country, 12 regional Reserve Banks, including the one in Cleveland, serve as the operating arms of the Federal Reserve System. Although we were created by Congress and we serve the public, the Reserve Banks are not part of the federal government.

Each Reserve Bank has its own board of directors drawn from different parts of the regional community, and these boards include business, banking, and nonprofit leaders. The Cleveland Fed represents the Fourth Federal Reserve District, encompassing the eastern half of Kentucky, all of Ohio, and parts of Pennsylvania and West Virginia. The Fed's decentralized structure allows each Reserve Bank to have a laser focus on its region, gather on-the-ground insights, and bring them into the process of setting policy for the entire nation. I rely heavily on the perspectives of the Cleveland Bank's directors, including those in our branches in Cincinnati and Pittsburgh, and on the input from our advisory council members and

[1] I am grateful to members of my staff in the Research and Communications Departments, including Edward Knotek and Doug Campbell, for assistance with these remarks.

contacts across the District. We have an Eastern Kentucky Business Advisory Council, and we're always looking for new contributors. You can recommend candidates—or yourself—on our website, clevelandfed.org.

The Fed's structure is designed to keep us free from short-term political pressures so that we can focus on our core mission. A wide body of research has found that countries with politically independent central banks tend to experience lower inflation rates. Other research has concluded that the Fed's decentralized structure has allowed the Reserve Banks to contribute new ideas to policymaking as a whole.[2] But while most people know about the Fed's role in setting interest rates, there is much more to our work than that. We exist to broadly support the US economy and financial system for the public. To do that, we perform five general functions.

First, the Fed has a responsibility to promote financial stability, which again was the primary reason for its founding more than 100 years ago. The Fed monitors the financial landscape for emerging risks while enforcing rules and regulations aimed at promoting financial system resilience over the longer term. We also have tools to contain damage if a shock hits the financial system that could have adverse consequences for the economy.

Second is our supervision and regulation function. The Fed's Board of Governors in DC controls the regulatory side and has delegated the examination authority to the 12 Reserve Banks. Our goal here is to ensure that individual banks and other financial institutions operate safely and soundly. When individual institutions are stable and provide valuable credit services to households and businesses, they form the foundation of a strong financial system, one that in turn supports effective monetary policy.

---

[2] Bordo, Michael D., and Edward S. Prescott. 2023. "Federal Reserve Structure and the Production of Monetary Policy Ideas." Federal Reserve Bank of Cleveland, Working Paper No. 23-29. doi.org/10.26509/frbc-wp-202329.

Third on the list of Fed responsibilities is our support for the nation's payments system. Most of us spend very little time thinking about the payments system when it's working—it's like plumbing—but if something goes wrong, it's a big problem. The Fed's job is to help ensure the whole system runs smoothly behind the scenes.

A fourth responsibility of the Fed is to promote consumer protection and community development. To give you an example, I'll highlight some work by the Cleveland Fed's community development team, who conduct outreach and in-depth research on topics such as housing availability and workforce development. Recently, the team has examined the challenging recovery that eastern Kentucky faces from the catastrophic flooding that devastated the region in July 2022, destroying more than 500 homes and damaging thousands of others. Through both research and on-the-ground interviews, the team has noted a preexisting shortage of available workers in skilled trades to assist the redevelopment and the fact that many people have chosen to leave the area rather than rebuild their homes and lives there. A third factor slowing the recovery has been the need to find high-ground sites that will be less susceptible to flooding in the future.[3]

The good news is that progress is being made despite these obstacles. The Housing Can't Wait coalition has completed work on almost 400 homes, about 90 of which are new construction and the remainder rehabilitations. Much of the rebuilding is happening safely outside of the floodplain,[4] and funding may be available in the form of community development block grants for repairing flood-damaged infrastructure and for flood-preparation projects. The tougher news is that eastern Kentucky faces a longstanding

---

[3] See Klesta, Matt. 2023. "Resilience and Recovery: Insights from the July 2022 Eastern Kentucky Flood." Federal Reserve Bank of Cleveland, Community Development Reports. doi.org/10.26509/frbc-cd-20230927. See also Klesta, Matt. 2024. "'Below the Surface You Still See It': The Eastern Kentucky Flood, Two Years Later." Federal Reserve Bank of Cleveland, *Notes from the Field*. clevelandfed.org/publications/notes-from-the-field/2024/nftf-20240717-eastern-kentucky-flood-two-years-later.

[4] Gaffney, Austyn. 2025. "Kentucky's Mountaintop Mines Are Turned Into Neighborhoods," *New York Times*. nytimes.com/2025/01/28/climate/kentuckys-strip-mines-get-turned-into-neighborhoods.html.

housing shortage, one that will continue to make the region's efforts to attract new industry an uphill climb. The Cleveland Fed's community development team is continuing to monitor the situation and engage with stakeholders to identify innovative solutions to ensure that the economic recovery can continue apace. This work aligns with our mission to promote economic opportunity for all.

Collecting and sharing information about how regions like eastern Kentucky are faring is one of the lesser-known but critical roles that Fed staff play. Our teams conduct surveys and meet regularly with business and community leaders to learn about what they are seeing and experiencing. This information is usually available to us before official economic statistics, which can take time to compile and produce. A summary of this timely qualitative information from the Cleveland Fed and other Reserve Banks is released to the public two weeks before every FOMC meeting in a publication commonly known as the Beige Book.[5] I also make it a point to talk directly to stakeholders like you throughout the region about how you're experiencing the economy. I find this information highly valuable. It provides additional context and nuance behind the numbers. In essence, your views complete my picture of the economy, and it's one of the ways the Fed works to bring Main Street into the conversation about setting policy.

In many respects, the Fourth District is a microcosm of the national economy. Within its borders lies a range of industries, from manufacturing, agriculture, and mining to medicine and advanced technology. Like in the rest of the country, the region's economy has become less manufacturing-intensive and more services-oriented over time; about 20 percent of its employment today is in goods-producing industries, compared with 30 percent more than three decades ago. These sectors operate in a variety of communities, including older industrial cities and rural Appalachian areas.

[5] The Cleveland Fed's most recent Beige Book entry is available via clevelandfed.org/publications/beige-book.

The Cleveland Fed's regional analysis team takes the lead in collecting qualitative information from our business and community contacts in the District. From this information, they produce a series of indices to track economic trends along several dimensions, including current and expected business activity, labor market data on employment and wages, and inflation-related data on costs and prices. We deliberately survey a disproportionately higher number of firms that tend to be leading indicators of economic turning points, such as those in construction and manufacturing, talking to nearly 150 contacts each cycle. And starting last week, we began releasing these indices generated from our survey data to the public. The Cleveland Fed's Survey of Regional Conditions and Expectations, or SORCE, will be updated eight times a year and made available on our public website, clevelandfed.org, following the same publication cadence as the Beige Book.[6] You'll be able to see the same nearly real-time information that I see ahead of each FOMC meeting—a snapshot of economic conditions in our region.

And this brings me to the final Fed function, setting monetary policy for the nation. Monetary policy actions are undertaken by the Federal Open Market Committee, or FOMC, which comprises all 12 presidents of the Reserve Banks and the seven governors I mentioned earlier at the Board of Governors in Washington DC. The 12 Reserve Bank presidents rotate their voting years, with the exception of the president of the New York Fed, who is a permanent voting member and vice chair of the committee. The Cleveland Fed president votes in even-numbered years, alternating with the Chicago Fed president, who votes in odd-numbered years, while most other Reserve Bank presidents vote every three years. Whether voting that year or not, all of us speak to, listen to, and learn from one another at every meeting.

Our focus at every FOMC meeting is how to achieve the dual mandate of maximum employment and stable prices given to us by Congress. This mandate may sound straightforward, but the reality is that the

[6] For more information on SORCE, see https://www.clevelandfed.org/indicators-and-data/survey-of-regional-conditions-and-expectations and Elvery, Joel A. 2024. "Introduction to Cleveland Fed Survey of Regional Conditions and Expectations (SORCE)." Federal Reserve Bank of Cleveland, *District Data Brief*. doi.org/10.26509/frbc-ddb-20241125.

FOMC takes into account a wide range of information—including the reports that our District contacts share with us—in assessing how close or how far we are from achieving these goals and how likely the economy is to reach them, both today and over time.

So let me turn now to how I see the economic landscape.

Economic Activity

Over the last five years, the pandemic and its aftermath have caused tremendous swings in economic activity, marked by briefly high then very low unemployment, supply chain disruptions, and elevated inflation. As we start 2025, the US economy is strong, and the labor market is healthy. Inflation has eased considerably over the last two years, but it remains above the FOMC's 2 percent objective.

While not a part of our mandate, the broadest measure of economic activity is gross domestic product, GDP, which captures spending by consumers, businesses, and governments on a wide range of goods and services. Real GDP, which is adjusted for inflation, grew 2-1/2 percent over the last year. This pace of growth is similar to the average rate experienced during the 10 years before the pandemic-induced recession, and it's higher than most estimates of the economy's longer-run growth rate.

A key driver of this solid economic growth has been household spending. Consumer spending accounts for more than two-thirds of GDP in the national data. Consumer spending was strong throughout 2024 and grew at a robust pace in the fourth quarter of last year, supported by the healthy labor market, rising real wages, and elevated household wealth. We've heard from our regional business contacts that shopping at retail establishments accelerated late last year, with holiday sales coming in stronger than expected. Auto dealers report more-mixed activity, but they're optimistic that sales could rise in coming months now that auto loan rates have fallen.

In the Cleveland Fed's District, reports from our contacts point to modest overall growth in economic activity in recent weeks, a signal reflected in our Cleveland Fed SORCE indices. Activity has been firming across a range of sectors, including professional and business services, financial services, and residential construction. One exception has been manufacturing, where some contacts report that general uncertainty about potential government policy changes could account for the low demand they are seeing. In general, our contacts are reasonably optimistic and expect activity to increase further in the months ahead.

With national and regional data, it's important to recognize that averages and totals can obscure differences in individual experiences. Our contacts continue to paint a picture of a two-speed economic expansion, one in which affluent consumers spend readily. At the same time, lower-income households are more price conscious and, after a period of trading down, face ongoing challenges regarding housing affordability and food security.

Labor Market

In the labor market, conditions have cooled from where they were in early 2023 but remain healthy.

The Bureau of Labor Statistics' monthly employment situation report, usually released the first Friday of each month, provides a wealth of data on the state of the labor market. The report released last Friday showed that the unemployment rate was 4.0 percent in January and that total nonfarm payroll employment increased by 143,000. These are good numbers.

Because a single month's readings may be influenced by any number of idiosyncratic factors—such as abnormal weather patterns or worker strikes—I examine a variety of data to capture broad trends in the labor market.

In early 2023, the unemployment rate had fallen as low as 3.4 percent, the lowest such reading since 1969. While the unemployment rate then began to move higher, over the last nine months it has been quite steady, with readings between 4.0 and 4.2 percent, similar to my estimate of its longer run value.

Other measures also point to a healthy labor market. Job growth is slower than what it had been early in the recovery, but we have seen a pickup in job gains on average over the last three months. The ratio of job vacancies to unemployed workers has come down to levels that are roughly in line with the prepandemic ratio. Wage growth has moderated from its peak readings, as worker availability has increased and labor demand has slowed, but it remains elevated, a situation which may reflect strong productivity growth. Although hiring rates are low, reports of layoffs remain limited, both in the national data and regionally.

Recruiting workers in high-skill sectors remains an issue for some employers in the District. For example, a Lexington-area contact noted that hiring physicians and nurse practitioners from outside the region is difficult. Even though these professionals can command high salaries, the region's tight housing market means they are disappointed with the available housing options.

Nonetheless, Lexington is a star among Fourth District metro areas in terms of employment growth since the onset of the pandemic. Lexington's 5.5 percent employment growth from February 2020 through March 2024 is the highest of any metro area in the District and well above the 3.8 percent average growth for all US metro areas over this period.[7] I think this speaks to the strong spirit of collaboration that I've seen in Lexington among the private, public, and nonprofit sectors, including the University of Kentucky and the business community.

---

[7] See Mills, Russell, and Brett Huettner. 2025. "Postpandemic Employment Recovery in Fourth District Metro Areas." Federal Reserve Bank of Cleveland, *District Data Brief*. doi.org/10.26509/frbc-ddb-20250115.

Inflation

The cooling in the labor market has helped bring down inflation, but it's still not all the way back to where we want it to be. And it's important to note that a period of elevated inflation, like the one we recently experienced, leads to a large increase in the price *level*, which is unlikely to be reversed.

The Cleveland Fed has long been a leader in studying inflation, and the Bank's Center for Inflation Research produces and displays a number of useful inflation measures and other resources for economists, policymakers, and the interested public.[8] The FOMC's preferred measure of inflation is based on the price index for personal consumption expenditures, what you might know as "PCE inflation." Inflation as measured by the consumer price index, or CPI, generally runs a little higher but has followed a similar pattern. PCE inflation peaked at 7.2 percent in June 2022. As of this past December, it had fallen to 2.6 percent, helped by declines in energy prices last year, but this reading is still above our objective of 2 percent.

As I do with employment, I consider a variety of inflation measures to assess the role of outliers and to extract the broader trends. A number of these measures are higher than the most recent PCE inflation reading, suggesting that a portion of the decline in headline PCE inflation may not be sustained. While some components' inflation rates have returned to where they were before the pandemic, when inflation was running at or below 2 percent, other components' inflation rates have not.[9] A more hopeful signal comes from looking at the portion of the PCE price index that excludes food, energy, and prices that are imputed rather than observed in market-based transactions. The good news is that market-based core PCE inflation, as it's called, is currently running at 2.4 percent, a little below headline inflation. Cleveland Fed

---

[8] The Center for Inflation Research's homepage is available at clevelandfed.org/center-for-inflation-research.

[9] For example, housing-services inflation remains higher than its prepandemic inflation rate, reflecting catchup of existing tenant rents to the dynamics of new-tenant rents, as described in Loewenstein, Lara, Jason Meyer, and Randal J. Verbrugge. 2024. "New-Tenant Rent Passthrough and the Future of Rent Inflation." Federal Reserve Bank of Cleveland, *Economic Commentary* 2024-17. doi.org/10.26509/frbc-ec-202417.

research finds that this measure has usually had more predictive power for overall inflation than a number of alternatives.[10] However, market-based core inflation historically ran about 14 basis points lower than PCE inflation from 1990 to 2019. Based on this relationship, we will need to see further disinflation in market-based core, to readings below 2 percent.

Given that we are coming out of a period of elevated inflation, bringing inflation all the way down to 2 percent remains paramount. In the coming months, I will be watching closely to see if the beginning of this year again witnesses outsized price increases, similar to what we saw early last year. We are paying close attention to the ability of Fourth District businesses to raise prices. While contacts generally believe it has become more challenging to raise prices, approximately one-quarter reported that their outlook for price growth had increased over the past two months, while few reported reducing their expected price growth. I am also closely watching the behavior of inflation expectations to ensure they are at levels consistent with our 2 percent objective. The Cleveland Fed monitors and reports multiple inflation expectations measures, including the Survey of Firms' Inflation Expectations, which was just released yesterday. In some encouraging news, this measure is down from its fourth-quarter reading and at the upper end of its prepandemic range. Finally, I am carefully watching broad economic conditions and potential changes in government policies that could impact the outlook for inflation.

The experience of the last few years has reinforced that elevated inflation imposes both real and perceived costs.[11] And we know the distribution of these costs is not borne evenly. I often hear from low- and moderate-income individuals who continue to struggle with rising prices. The challenge for monetary policy is to maintain the current healthy labor market conditions while finishing the job of bringing inflation back to 2 percent on a sustained basis. There is more work to do.

---

[10] Bognanni, Mark. 2020. "A Forecasting Assessment of Market-Based PCE Inflation." Federal Reserve Bank of Cleveland, *Economic Commentary* 2020-01. doi.org/10.26509/frbc-ec-202001.

[11] See L'Huillier, Jean-Paul, and Martin DeLuca. 2023. "The Long-Run Costs of Higher Inflation." Federal Reserve Bank of Cleveland, *Economic Commentary* 2023-17. doi.org/10.26509/frbc-ec-202317.

Monetary Policy

The FOMC is firmly committed to achieving our dual mandate goals of maximum employment and price stability. Our primary tool for communicating and implementing monetary policy is the target range for the federal funds rate. During 2022 and 2023, the FOMC sharply increased the fed funds target range to help bring inflation under control. There were some concerns at the time that doing so would weaken the economy and the labor market as a necessary cost of reducing inflation.

Fortunately, the US economy is very resilient, and we avoided a sharp downturn while seeing considerable progress in lowering inflation. Reflecting that cumulative progress on inflation, the cooling in the labor market, and the evolving balance of risks, the FOMC reduced the fed funds target range last year by 1 percentage point, to 4-1/4 to 4-1/2 percent. We held the target range steady at our meeting in January.

Given the economy's momentum heading into 2025, and with a healthy labor market, we have the luxury of being patient as we assess the path forward for inflation. We have made good progress, but 2 percent inflation is not in sight just yet. As long as the labor market remains healthy, I am looking for broad-based evidence that inflation is sustainably returning to 2 percent before adjusting policy further. While monetary policy needs to be forward-looking in nature, forecasts are no substitute for realizations. Or as they might have put it in *Jerry Maguire*, "show me the low inflation."

In my mind, there are two major factors that support a patient approach to monetary policy at this juncture. First, while there are good reasons to expect that inflation will gradually come down to 2 percent over the medium term, this is far from a certainty, and upside risks to the inflation outlook abound. The ongoing strength in consumer spending bears watching to see whether it is consistent with easing inflation. Given the long and variable lags of monetary policy, it may take time to see the impact coming from last year's rate cuts, and an acceleration in activity could slow or stall the disinflationary process.

At the same time, there is uncertainty over what potential government policies may be implemented in the near term, and there is considerable uncertainty over their attendant economic effects. Thus far, there have been many proposed changes in regulation, tax and spending policies, immigration policies, and tariffs. As proposals are implemented, my approach will be to analyze the policies, gather information from our business and community contacts about the impacts they're seeing, review relevant academic literature and economic models, and, finally, observe the incoming financial and economic data before drawing firm conclusions about the appropriate policy response.

For recently proposed or implemented policies, it will take some time to do this analysis. Taking the case of tariffs as one example, it is appropriate for policy to be patient in assessing their ultimate effects. There will be some important questions to answer: How long will the tariffs be in place? What will the effect on import prices be, and how much will be passed through to consumer prices? Will economic growth be weighed down by higher prices? How will inflation expectations respond? And will this be a one-time change in the price level or a more persistent rise in inflation rates?

Given the recent history with elevated inflation, the risks to the inflation outlook appear skewed to the upside, and this could delay a return to 2 percent and further risk embedding elevated inflation into the economy.

A second reason to be patient is uncertainty over how restrictive monetary policy actually is. Figuring out the neutral rate, one which neither stimulates nor restricts economic activity, is always complicated. As I see strong economic growth, the low unemployment rate, and still-elevated inflation, my overall view as of today is that monetary policy is only modestly restrictive. But considerable uncertainty surrounds this assessment, and we may be at or close to a neutral setting already.

I believe that financial markets and the business community share this view. Broad financial conditions indices are accommodative, something which does not appear consistent with a view that policy is meaningfully restrictive. Equity market valuations are high, and the equity risk premium is near zero. As the FOMC cut the fed funds target over the final months of 2024, long-term interest rates, including mortgage rates, actually moved up. The increase appears to reflect a variety of factors, including somewhat higher expected future real rates, higher expected inflation, greater inflation risk, and a notably larger real term premium. This could reflect optimism among businesses and investors that the economy is on firmer footing than was initially perceived in September. It will be important to monitor a constellation of financial market variables alongside business leaders' outlooks to ascertain whether financial conditions are broadly consistent with achieving our dual mandate objectives.

Given current economic conditions, it will likely be appropriate to hold the funds rate steady for some time. A patient approach will allow us to assess the health of the labor market, whether inflation is returning to 2 percent on a sustained basis, and how the economy is performing in the current rate environment. We are well positioned to respond to changes in the outlook to achieve our maximum employment and price stability objectives.

Conclusion

I've covered a lot of ground today, so let me give you the bite-sized version: The Fed is focused on its mission to support the economy and financial system on behalf of the public. Right now, the economy is in a good place, and policy is calibrated to keep us here with healthy conditions in the labor market and continued downward pressure on inflation for a return to our 2 percent objective. We recognize that although the overall economic picture looks positive, there are families who are still struggling. At the Cleveland Fed, our teams are active in communities across the Fourth District, including Lexington, to

help us better understand regional economic developments. We have many resources to help you; please visit clevelandfed.org to see how you can engage with us.

One of the ways you can do that is to send me an email. You can find my contact information on our website. I look forward to your questions and comments, and believe me—you'll have me at hello.