Federal Reserve Bank of San Francisco

Calibrating Policy in an Uncertain Time

Mary C. Daly

President and Chief Executive Officer

Federal Reserve Bank of San Francisco

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Good morning. It's great to be here in Utah. I am especially delighted to be with all of you at the Salt Lake Chamber, this time live and in person. So, thank you very much for the invitation, and I look forward to a great discussion.

Top of mind for many of you are recent stresses in the banking system and what they mean for businesses, consumers, and the broader economy.

The most important thing to know is this: The banking system is sound and resilient. As my colleagues Chair Powell and Vice Chair Barr have said, the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and the Department of the Treasury took decisive actions to protect the U.S. economy and to strengthen public confidence in our banking system.[1] These actions demonstrate that we are committed to ensuring that all deposits are safe. We will continue to closely monitor conditions in the banking system and are prepared to use all of our tools for any size institution, as needed, to keep the system safe and sound.[2] The strength of our financial system rests on having a wide range of institutions, including regional and

[1] See Board of Governors of the Federal Reserve System (2023b).

[2] With the support of the Treasury, the Federal Reserve Board also created the Bank Term Funding Program to ensure that banks that hold safe and liquid assets can, if needed, borrow reserves against those assets at par; see Board of Governors of the Federal Reserve (2023a). This program, along with the normal discount window, ensures that banks have the liquidity they need.

community banks. And we are committed to supporting all institutions and the valuable role they play in our financial system.

Finally, as many of you know, the Federal Reserve Board, under the direction of Vice Chair for Supervision Michael Barr, is currently conducting a thorough review of the supervision and regulation of Silicon Valley Bank before its failure. This review will be completed by May 1, at which time the Board will share the results publicly.

While the recent banking stresses have received a lot of attention, they are only part of the economic picture right now. In the remainder of my time today, I will discuss the full slate of factors the Federal Open Market Committee (FOMC) must consider as we work to assess the economy and calibrate monetary policy in this uncertain time.

But before I go on, let me say that the remarks I make today are my own and do not necessarily reflect the views of anyone else within the Federal Reserve System.

Ongoing Economic Strength and High Inflation

By almost any measure, the U.S. economy remains strong. GDP growth, consumer spending, and the labor market all continue to outperform expectations. Moreover, these indicators are expanding at rates well above levels consistent with returning inflation to the FOMC's longer-run goal of 2 percent on average over time.

We see this strength most clearly in the labor market. The U.S. economy has added close to 350,000 jobs per month over the first three months of this year. This far exceeds the 90,000 jobs needed each month to keep up with the growth of the labor force. This has kept unemployment historically low and job vacancies unusually high, especially for firms in rapidly growing sectors including travel, leisure, and hospitality, among others.

Of course, there are a number of signs that the labor market is starting to cool, but it remains extremely tight and is likely to come back into balance only gradually.[3]

The sustained imbalances in the economy have translated into persistently high inflation, well above the Fed's 2 percent target.[4] The most recent data tell the story. Looking at the personal consumption expenditures, or PCE, price index, the Fed's primary measure of inflation, it rose 5 percent over the 12 months ending in February, the latest reading we have. That's down from

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[3] Signs of cooling include the following. Average hourly earnings growth over the previous 12 months has moderated from 5.9% in March 2022 to 4.2% in March 2023. The quits rate is down to 2.6% from a high of 3%. And the number of job openings fell below 10 million in February from above 12 million in March 2022.

[4] Federal Open Market Committee (2023) specifies the 2 percent target as measured by the price index for personal consumption expenditures.

the peak of 7 percent in the middle of last year, but not yet close to levels consistent with price stability.

And American families are feeling the impact. This is apparent in sentiment surveys and well summarized by a single striking fact:[5] For most workers, inflation is rising faster than wage growth, consistently eroding purchasing power and leaving them worse off over time.[6]

My colleagues and I are deeply aware of the toll that high inflation takes on the economy and the lives and livelihoods of all Americans, especially those least able to bear it. And we remain resolute and committed to bringing inflation down to our 2 percent goal. It is essential for both sides of our mandate, and we have the tools and the resolve to get the job done.

Policy Decisions under Uncertainty

And that brings me to policy and what lies ahead in terms of our decisions. We have taken aggressive action over the past year, moving the federal funds rate from near zero to between 4.75 and 5 percent as of our March meeting. These actions have been warranted and consistent with our commitment to restore price stability.

While the full impact of this policy tightening is still making its way through the system, the strength of the economy and the elevated readings on inflation suggest that there is more work to do.

How much more depends on several factors, all with considerable uncertainty attached to their evolution.

For one, there is the banking stress and the impact that it could have on credit conditions. History tells us that as banks evaluate the changing economic outlook and manage their liquidity and balance sheets, they are likely to tighten credit availability.

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[5] According to the University of Michigan's Surveys of Consumers, higher prices have consistently been the most cited reason among respondents over the past 12 months who have indicated that their families were worse off financially than they were one year earlier. Furthermore, the number of Google searches for "inflation" continues to be elevated by historical standards.

[6] The consumer price index (CPI) and PCE price index have risen faster than average hourly earnings over the past year. In addition, for full-time wage and salary workers, between the first quarter of 2021 and the fourth quarter of 2022 (latest available), real weekly earnings fell for those at the 50th percentile and above when earnings are deflated by the headline PCE index, and they fell for those at the 25th percentile and above when earnings are deflated by the headline CPI index.

We are already starting to see this in the data. Credit standards have risen over the past year and are expected to increase further in coming quarters.[7] And recent data on lending activity already point to declines in lending volumes in several sectors.[8]

How much credit tightening will ultimately occur is not yet known. What we do know is that tighter credit conditions translate into less spending and investment by households and businesses, resulting in a slower pace of economic growth. So we will need to monitor this impact carefully as we determine our own policy path.

A second factor affecting the economy and our decisions is developments in the global economy. Global monetary policy tightening, international bank conditions, and greater fiscal restraint abroad all translate into slower global growth.[9] This serves as a headwind to U.S. growth and could also help temper commodity and goods price inflation. Again, the extent of these global headwinds and their impact on U.S. growth and inflation is unknown, so careful monitoring will be required.

Finally, there is the impact of our own monetary policy actions. The FOMC has increased the policy rates considerably over the past year, and it will likely take some time for those increases to take their full effect. But how much more time and how much additional slowing is coming is unclear. So like the other factors I have mentioned, we will need to carefully monitor the situation as we assess what it means for policy.

The Prudence of Data Dependence

In all actions, the FOMC is guided by a commitment to our mandated goals of full employment and price stability. When we are off either of our goals, Americans bear the cost, and we have an urgency to restore balance. But that urgency must be coupled with an awareness of the uncertainty we are facing, and the risks it poses to the economy.

Looking ahead, there are good reasons to think that policy may have to tighten more to bring inflation down. But there are also good reasons to think that the economy may continue to slow, even without additional policy adjustments.

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[7] According to the Senior Loan Officer Opinion Survey (SLOOS), domestic banks have been tightening credit standards for commercial and industrial loans to large and midsize firms, as well as for consumer loans over the past year.

[8] Over a two-week period following the recent banking stress, banks cut back corporate and real estate lending as they experienced a large decline in deposits. Moreover, financial institutions participating in the Dallas Fed's Banking Conditions Survey reported a decline, on net, in total volume of lending in late March relative to early February.

[9] Credit default swap spreads of several major European banks increased in response to recent conditions in the banking sector. On fiscal policy, the European Commission indicated that it supports the pullback from broad-based stimulus (see https://ec.europa.eu/commission/presscorner/detail/en/statement_23_2010).

So, we will need to make decisions calibrated by data. Not just last week's data or last month's data, but all the data. Looking back and looking ahead as we navigate the uncertainty that surrounds us. This is what prudent policymaking requires, and what restoring price stability and achieving both of our mandates demands.

Thank you.

References

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