The Outlook for the Economy and Monetary Policy

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

Remarks for the Policy Panel
Hoover Monetary Policy Conference: Finishing the Job and New Challenges
Hoover Institution, Stanford University
Stanford, CA
May 9, 2025

Introduction

My thanks to the Hoover Institution for inviting me to speak on this esteemed panel. It's great to be back at my alma mater. I am especially grateful that yesterday I was able to join the celebration in honor of John Taylor. When we experience uncertain economic times with a wide range of possible paths for the economy, simple policy rules provide a good starting point for assessing how monetary policy may wish to respond in different scenarios. The Cleveland Fed's website has a section that looks at federal funds rate projections based on seven simple policy rules and multiple forecasts, including the rule that John Taylor published in the year I graduated from Stanford.[1] I combine this information with a variety of economic and financial data, forecasts, and anecdotes from business and community contacts as I think about the appropriate path for monetary policy.

Recently, the signals about the economy have been decidedly mixed. By many measures, the backward-looking data have been encouraging, but heightened uncertainty surrounding government policies is clouding the outlook and raising the risks of higher inflation, slower growth, and softening in the labor market. So let me briefly share my current view on finishing the job amid new challenges in the economy. As always, the views I present today are my own and not necessarily those of the Federal Reserve System or my colleagues on the Federal Open Market Committee.[2]

Economic Outlook

The economy entered this year with solid momentum, as real gross domestic product increased at a 2-3/4 percent annualized rate during the second half of last year. Based on the first estimate, GDP declined in the first quarter. Behind this weak headline number, consumer spending and business fixed investment

---

[1] See Knotek II, Edward S., Randal J. Verbrugge, Christian Garciga, Caitlin Treanor, and Saeed Zaman. 2016. "Federal Funds Rates Based on Seven Simple Monetary Policy Rules." Federal Reserve Bank of Cleveland, *Economic Commentary* 2016-07. doi.org/10.26509/frbc-ec-201607. Quarterly updates are available at clevelandfed.org/indicators-and-data/simple-monetary-policy-rules.

[2] I am grateful to Edward Knotek for assistance with these remarks.

both grew at solid rates. A key question is whether this will continue, as national survey measures of consumer and business sentiment have declined, with many respondents citing policy uncertainty.

At the Cleveland Fed, we compile feedback from regional business and community leaders into our SORCE indexes, which capture recent and expected trends in the Fourth District's economy.[3] In general, our contacts report subdued economic activity. In their comments to us, many contacts indicate that they have paused some spending in light of increased uncertainty surrounding government policies, including tariffs, immigration, federal spending, and employment. A growing share of contacts expect that their nonlabor costs are going to rise in the coming months, with many noting higher tariffs as a key factor.

Looking at our maximum employment goal, the US labor market has been healthy. The unemployment rate was 4.2 percent in April, a relatively low level and similar to readings over the last 12 months, with solid job gains on average through the first four months of this year.

On our inflation objective, we've made good progress, but there is still more work to do to return the economy to price stability. Headline PCE inflation was 2.3 percent through March. Core PCE inflation, which excludes the volatile food and energy sectors, was somewhat higher. The Cleveland Fed calculates several alternative inflation measures that focus on price changes in the center of the distribution in order to limit the influence of outliers and capture the inflation trend, including the median CPI, trimmed-mean CPI, and median PCE inflation. These measures have also come down from their highs but are running above headline inflation and our 2 percent objective. While the recent inflation data have been encouraging, they are backward-looking and do not capture very recent developments.

[3] Before each meeting of the FOMC, the Cleveland Fed provides updates regarding recent and expected regional business and community conditions via its Survey of Regional Conditions and Expectations (SORCE) indexes. See clevelandfed.org/sorce.

On net, the tariffs that have been put in place constitute a substantive change in trade policy. It will take some time for the overall economic effects of these recently enacted and other proposed changes to government policies to become clearer in the hard data.

In this dynamic environment, I am considering a variety of data to inform my view on progress toward our dual mandate goals of maximum employment and price stability. Beyond the usual monthly and quarterly indicators on growth, inflation, and the labor market, I am looking at higher-frequency data on evolving conditions. In these times, I find that anecdotal reports from business, community, and financial market contacts are especially helpful because they provide timely information and additional context to complement the hard data. Staff at the Cleveland Fed produce and update novel data series to help shed light on current conditions. One recent project uses natural language processing to quantify the sentiment of the Federal Reserve's Beige Book entries as a predictor of recessions.[4] In a second project, Cleveland Fed researchers compile data from advance layoff notices filed under the Worker Adjustment and Retraining Notification Act, or WARN Act, that serve as a leading indicator for layoffs.[5]

I also monitor financial conditions to assess their impact on households and businesses. In recent weeks, financial conditions have been volatile as markets have incorporated new information into asset prices. In response to tariff announcements in early April, financial conditions tightened on net, as major equity indices declined, credit spreads widened, and long-term interest rates increased. At the same time, the dollar weakened against a basket of foreign currencies. This pattern was different from recent "risk-off" episodes in which equity prices declined, credit spreads widened, the dollar appreciated, and US Treasury

[4] See Filippou, Ilias, Christian Garciga, James Mitchell, and My T. Nguyen. 2024. "Regional Economic Sentiment: Constructing Quantitative Estimates from the Beige Book and Testing Their Ability to Forecast Recessions." Federal Reserve Bank of Cleveland, *Economic Commentary* 2024-08. doi.org/10.26509/frbc-ec-202408. Data are updated and available at openicpsr.org/openicpsr/project/205881/version/V7/view.

[5] See Krolikowski, Pawel M., and Kurt G. Lunsford. 2022. "Advance Layoff Notices and Aggregate Job Loss." Federal Reserve Bank of Cleveland, Working Paper No. 20-03R. doi.org/10.26509/frbc-wp-202003R. Data are updated twice a month and available at openicpsr.org/openicpsr/project/155161/version/V31/view.

yields fell as domestic and international investors sought the safety of US government bonds. More recently, as tariff policy has shifted, some of these measures have largely retraced their initial moves. Markets respond to data and announcements at a high frequency. My job as a policymaker is to separate the signal from the noise in financial market fluctuations. Doing so allows me to incorporate into my outlook market trends that are likely to affect the real economy, recognizing that volatility on its own can have a dampening effect on spending and investment.

Monetary Policy

A common theme from talking with business, community, and financial market contacts is that uncertainty is elevated. I see risks around both legs of our dual mandate that could lead to higher inflation outcomes and to lower growth and employment outcomes in the near to medium term. This is a difficult set of risks for monetary policy to navigate.

Given the economy's starting point, with inflation still elevated and with both sides of our mandate expected to be under pressure, there is a strong case to hold monetary policy steady at its current modestly restrictive setting. I am usually inclined to take action; but in this case, taking no action may be the best choice to balance the risks coming from further elevated inflation and a slowing labor market. If this scenario comes to pass, then it will be important to ensure inflation expectations remain well anchored while assessing the likely magnitude and persistence of the misses to each side of our dual mandate goals. In terms of inflation, it is certainly possible that increases in tariffs could have only a short-lived effect. But coming after an extended period of elevated inflation, consumers and businesses may respond differently to this event than might otherwise have been the case. When clarity is hard to come by, waiting for additional data will help inform the path ahead.

But other scenarios are certainly possible, and instead of focusing on a modal outlook, I am considering a range of possible outcomes. If the economy should falter and inflation decline, then it may be appropriate to ease policy by lowering the federal funds rate from its current level, perhaps even quickly. If the labor market remains healthy and inflation moves up persistently, then monetary policy may need to follow a more restrictive trajectory.

We will simply have to see how events unfold. I would rather be slow and move in the right direction than move quickly in the wrong direction. Fortunately, with policy at its current modestly restrictive level, I think we are in position to assess the incoming data, the risks to the outlook, and the appropriate policy response to achieve our longer-term objectives.

Concluding Topics

Let me conclude with three sets of big-picture topics that I have noted in other venues and that are worth repeating here.

The first topic is r-star. There is considerable uncertainty over a fundamental concept for policymakers: how restrictive—or accommodative—is monetary policy.[6] My view that monetary policy is only modestly restrictive is based on my assessment that the economy has been resilient, the labor market has been healthy, and inflation has come down only slowly under the current setting. Figuring out the neutral rate is always complicated. There is evidence that the neutral rate changes over time, with some models and estimates pointing to long-running structural factors and others capturing a role for shorter-term forces. Fiscal deficits, productivity growth, and the structure of the Fed's balance sheet are just a few such factors. Recent and prospective changes in government policies could also affect r-star. This is a topic that bears watching.

---

[6] See Beth M. Hammack. 2024. "Lake Effect: Views from the Fourth District on the Economy and Monetary Policy." Speech given at the City Club of Cleveland, Friday Forum, Cleveland, Ohio, December 6, 2024. clevelandfed.org/collections/speeches/2024/sp-20241206-views-from-fourth-district-on-economic-and-monetary-policy.

My second topic is the Federal Reserve's plan for the balance sheet.[7] Tools, tradeoffs, and assessments of the level for ample reserves will all be relevant in the near to medium term, but we also need to think over a longer horizon. What does a "neutral" balance sheet look like, especially on the asset side? Should we align assets and liabilities, and, if so, how? How much volatility should we be willing to accept in overnight markets? Ultimately, there may be tradeoffs between the variability in short rates and the size of the balance sheet. Could there be benefits from separating market-functioning balance sheet actions from all other actions? I see these questions about the steady state for the balance sheet as worthy of discussion by the FOMC. My takeaway is that rapidly expanding the balance sheet is easy, but shrinking it with minimal market impact is harder and takes more time, especially after purchasing a lot of long-dated assets.

My final topic is the growth of the private-credit market.[8] This market fills a financing gap for relatively higher-risk, middle-market borrowers. There are some financial-stability benefits of the growth in this market, but there are also some risks. Some of these risks include the market's relative opacity, the growing exposure of pension funds and life insurers, and interconnections between private credit and the banking system. As the rapid growth in private-credit investments compresses returns, these funds may employ more leverage. In fact, while the level of private-credit fund leverage appears moderate, it has been notably increasing over the past several years, particularly at business-development companies. As a Federal Reserve policymaker, I am attuned to the potential financial stability risks from this fast-growing market.

---

[7] See Beth M. Hammack. 2025. "The Federal Reserve's Balance Sheet: Some Major League Questions." Speech given at the Money Marketeers of New York University, Inc., New York, New York, April 23, 2025. clevelandfed.org/collections/speeches/sp-20250423-federal-reserve-balance-sheet.

[8] See Beth M. Hammack. 2025. "Trading Places: My New View from Inside the Federal Reserve." Speech given at Columbia University School of International and Public Affairs and the Bank Policy Institute, 9th Annual SIPA/BPI Bank Regulation Research Conference, New York, New York, February 27, 2025. clevelandfed.org/collections/speeches/2025/sp-20250227-trading-places-my-new-view-from-inside-the-federal-reserve.

And with that, I thank you for your attention. I look forward to the upcoming discussion.