A Fourth District Groundhog in London’s Financial District

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Introduction

Thanks to the organizers for inviting me to speak on this distinguished panel. I know that many of you in the audience are familiar with the Federal Reserve's responsibility for setting monetary policy in the United States. Less well known is how the Federal Reserve System is structured to carry out *all* of its responsibilities to support the economy and financial system. So before I share my views on the outlook for the US economy, let me give you a brief Fed primer. As always, 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 Fed is a decentralized, public–private system uniquely capable of serving the United States' economic and financial interests free from short-term political pressures. Monetary policy actions are undertaken by the Federal Open Market Committee, or FOMC, which is made up of the 12 presidents of the Reserve Banks and the seven governors at the Board of Governors in Washington DC. The 12 Reserve Bank presidents rotate voting years, apart from the president of the New York Fed, who is a permanent voting member and vice chair of the committee. Whether voting or not, all 19 of us speak, listen, and learn from each other at every meeting.

Besides setting monetary policy, the Fed's main functions are promoting financial stability, bank supervision and regulation, consumer protection and community development, and supporting the US payments system. A quick note about our payments work: the Cleveland Fed is one of several Reserve Banks that supports the government's payments services. This includes collecting customs duties, among other duties, taxes, and fees on behalf of the US government.[2]

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[1] I am grateful to Willem Van Zandweghe, Kurt Lunsford, Edward Knotek, Dani Carlson, and Doug Campbell for assistance with these remarks.

[2] The US Department of the Treasury provides data on customs duties in the Monthly Treasury Statement, fiscaldata.treasury.gov/datasets/monthly-treasury-statement/receipts-of-the-u-s-government.

Congress has given the FOMC a dual mandate to achieve maximum employment and stable prices. To do this, the Committee considers a wide range of information to assess how close or how far we are from these goals and how likely the economy is to reach them. The Fed's decentralized structure allows each Reserve Bank president to bring their District's unique regional perspective and on-the-ground insights into the nation's monetary policy-setting process. These insights are particularly important to me right now as I try to extract the signal from the noise in economic and financial data.

I spend a lot of time traveling the Fourth District to gather these insights. The Cleveland Fed's region encompasses all of Ohio and parts of Pennsylvania, Kentucky, and West Virginia. It is historically part of the nation's industrial heartland, with a strong manufacturing footprint. I was recently in Pittsburgh, a major steel producing area, where the topic of steel tariffs is at the center of many conversations.

Not far from Pittsburgh in the Fourth District is Punxsutawney, Pennsylvania, famous for its annual Groundhog Day celebration. Lately, I've been feeling a bit like Bill Murray's character in the movie Groundhog Day. For Phil Connors—Bill Murray's character—every day begins with his alarm going off to the song "I Got You Babe," Ned Ryerson inevitably tries to sell him life insurance, a blizzard forces him to spend the night, and he wakes up, once again, on February 2nd. Now, if you're a frequent follower of Fed commentary, you, too, may begin to experience a sort of déjà vu. For me, most conversations I have with business contacts seem to hinge on the theme of elevated uncertainty, and each day I scan the economic releases for clarity in the data. So, let me turn to what I'm seeing and not seeing in the data and what I'm hearing from my contacts.

Economic Outlook

In many ways, the US economy is maintaining solid momentum as we approach the middle of the year. Real gross domestic product edged down in the first quarter, but the combination of consumer spending and business fixed investment grew at a solid rate. The positive tone of the hard data contrasts with a notable downshift in soft data since early in the year. Survey measures of consumer and business sentiment have declined, and many respondents have cited policy uncertainty.

Looking at our maximum employment goal, the US labor market remains healthy. Job gains have been solid on average through the first five months of the year, enough to keep the unemployment rate steady, at 4.2 percent in May. That low level is similar to readings over the last 12 months. The hires rate has also been steady over the last 12 months, and the layoffs rate remains low.

On inflation, we've made good progress, but we have some distance to go before we sustainably reach our 2 percent inflation objective. Headline PCE inflation was 2.1 percent through April, and estimates from the Cleveland Fed suggest that PCE inflation stepped up to 2.3 percent in May.[3] Core PCE inflation, which excludes the volatile food and energy sectors, has been running somewhat higher. The Cleveland Fed calculates several alternative inflation measures that help 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 still running above levels consistent with our inflation objective, as they have for the past four years. While the recent inflation data have been encouraging, they are backward-looking and may not capture very recent developments.

The tariffs that have been put in place have clouded the future paths of employment and inflation. Although I include government policies holistically in my forecast, trade policy is the main focus area for many business leaders. The ultimate extent and size of the tariffs are uncertain, but current information indicates that the average tariff rate will be the highest it's been in nearly a century. It will take some time for their overall economic effects to become clearer in the hard data. That's one reason why I am relying

[3] See clevelandfed.org/indicators-and-data/inflation-nowcasting.

heavily on the feedback from regional business and community leaders in the Fourth District.[4] In general, our contacts report subdued economic activity. In their comments to us, many indicate that they have paused some spending in light of increased uncertainty surrounding government policies, including those on tariffs, immigration, and federal spending. While low consumer sentiment has not yet shown up in the spending data, Fourth District retailers expect that customers will pull back when prices rise from the tariffs.

In addition to the feedback from District contacts, I am considering a variety of data beyond the usual monthly and quarterly indicators to inform my views on growth, inflation, and the labor market in this dynamic environment. Regarding consumer prices, some high-frequency retail price data indicate that the response to tariffs has been modest so far.[5] However, recent Fed research finds that tariffs on goods from China affect prices fairly quickly, with substantial variation in the degree of pass-through across products.[6]

In developing my views on the outlook, I find it useful to think about specific goods given variation in tariff rates across products and countries of origin. For example, a 25 percent tariff on steel and aluminum was in effect starting in mid-March before it increased to 50 percent earlier this month. Between February and May, the producer price index of steel mill products increased 21 percent, suggesting that pass-through can take at least a few months and that further price increases could be in the pipeline.

As I noted, the Fourth District has historically been a major steel-producing region. To assess the impact

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[4] 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.

[5] Cavallo, Alberto, Paola Llamas, and Franco Vazquez. 2025. “Tracking the Short-Run Price Impact of US Tariffs.” Working Paper, June 3, 2025. pricinglab-rw7gfm.s3.us-east-1.amazonaws.com/tariffs/TrackingTariffs_Cavallo_Llamas_Vazquez.pdf.

[6] Minton, Robert, and Mariano Somale. 2025. “Detecting Tariff Effects on Consumer Prices in Real Time.” FEDS Notes. Washington: Board of Governors of the Federal Reserve System, May 09, 2025. doi.org/10.17016/2380-7172.3786.

of this specific tariff, I have been speaking more frequently with our business contacts in the steel industry. Recently, contacts have noted that demand for domestic steel has been soft. They have pointed to a number of factors for that softness, including tariff uncertainty, concerns about the economic outlook, and a pullback in orders after a surge in steel imports earlier in the year. With the new tariffs in place, there is some discussion of whether businesses will need to rethink their import orders, and many clients are placing orders no more than a week ahead. As this one item illustrates, even known tariffs can impact businesses in dynamic ways.

I also keep a close eye on layoff measures, which provide near-real-time information. These are broadly stable of late. Initial unemployment claims have been edging up since April but remain low. Staff at the Cleveland Fed compile data from advance layoff notices filed under the Worker Adjustment and Retraining Notification Act, or WARN Act, that are a leading indicator for layoffs.[7] This indicator moved up in May but remains near its historical average. Unlike Phil Connors, who yearned for *anything* to change in his continuous day, I have to say that I welcome the consistency and resilience of the US labor market.

Finally, I monitor financial conditions to assess their impact on households and businesses. Here, I've been struck by the disconnect between financial markets' apparent optimism on government policy developments and the more cautious sentiments expressed by many business contacts in the Fourth District. Major equity indices have retraced their declines following the partial reversal or postponement of tariff announcements. Similarly, long-term interest rates increased sharply after the initial announcements but are now only modestly above levels from late March. Differentials between US Treasury yields and sovereign bond yields abroad have widened as some central banks continue to ease

[7] 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.

policy, yet the dollar has depreciated against a basket of foreign currencies. Geopolitical events have recently put upward pressure on oil prices, which bear watching. While the expansion of oil production in the United States means that the economy is less exposed on net to oil price fluctuations than it once was, there is plenty of evidence that the pain of large increases in energy prices still weighs on consumer spending.

As investors weigh the implications of changes in government policies, policy uncertainty, and geopolitical events, I am watching financial market developments through the lens of a policymaker and looking for impacts on the real economy and inflation. If long-term rates stay elevated, it means higher borrowing costs for households and firms. If the weakening in the dollar persists, it can add pressure on consumer prices on top of the direct effects of the tariffs. Rising oil prices could affect inflation and growth prospects.

Monetary Policy

Taking on board all of the recent data and developments, I supported last week’s decision to hold the federal funds rate steady. In my view, the current policy stance is only modestly restrictive: the labor market has been healthy, and inflation has come down only slowly under the current setting. This feels to me like policy is already close to neutral. Given the resilience of the economy thus far, the risks from maintaining the current policy setting appear low, and I don’t see a weakening in the economy that would merit imminent rate cuts, though I remain attentive to that possibility. Looking ahead, if both sides of our mandate come under pressure, then holding the policy rate steady for some time 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. Additionally, recent increases in oil prices pose an upside risk to the stability of inflation expectations, given the typical relationship between increases in gasoline prices and inflation expectations in the United States. When clarity is hard to come by, waiting for additional data will help inform the path ahead. It may well be the case that policy remains on hold for quite some time before the Committee initiates very modest cuts to return policy to a neutral setting.

An important role for monetary policy is to promote economic stability. In times of great uncertainty, promoting stability might mean moving slowly. But when there is clarity in the data, promoting stability could mean moving with speed. Consider a scenario in which the economy falters and inflation declines; in this case, it may be appropriate to ease policy by lowering the federal funds rate from its current level, perhaps even quickly. In another scenario, the labor market could remain healthy, with inflation moving up persistently; in that case, the federal funds rate may need to be higher than expected to put continued downward pressure on inflation.

Fortunately, with the fed funds rate at its current modestly restrictive level, I think we're in position to carefully assess the incoming data, the risks to the outlook, and the appropriate policy response to achieve our longer-term objectives. I would rather be slow and move in the right direction than move quickly in the wrong one.

Conclusion

Unlike in an American rom-com, I see no neat and tidy way for monetary policy to make a 93-minute exit from its current holding pattern. Until we get to that moment, I appreciate that hearing me repeatedly say that we need to wait for more data must feel like your own version of Groundhog Day. Though my words may sound the same to you, like Phil Connors, I am living each day differently, scrutinizing the data and learning how regional leaders are changing behavior in this uncertain environment. I am confident that one day, though it may not be soon, we will wake up to find more confidence in the outlook, clarifying the path forward. When we do reach that point, know that I am ready to move decisively to ensure the FOMC delivers on its dual mandate of maximum employment and price stability.