



Sandra Pianalto
President and Chief Executive Officer
Federal Reserve Bank of Cleveland

President's Letter

One of the Federal Reserve's mandates is maintaining stable prices. During my more than three decades in the Federal Reserve System, the focus has been primarily on avoiding high and variable inflation, and over most of that period, the Federal Reserve has successfully fulfilled its objective to keep inflation in check.

More recently, however, our attention has turned to a less familiar concern—persistently low inflation. While high inflation has well-known costs for economic performance, the problems posed by persistently low inflation can be equally harmful.

As its title promises, this year's annual report essay examines why inflation is low, and why it matters.

First, our researchers explore the relatively new phenomenon of low inflation. High inflation rates have been the focus of attention for the last several decades. It has been only in the aftermath of the most recent financial crisis that the Federal Reserve has had to look more carefully at how to guard against both overshooting *and* undershooting our inflation objective.

Our researchers explain why the US economy is currently experiencing a bout of sustained low inflation. Using a range of tools, our researchers have identified two main sources: slow economic growth, which has put very little upward pressure on prices and wages; and special, temporary forces that have held back some prices, such as the deceleration of medical care costs.

Finally, our researchers discuss appropriate monetary policy responses to persistently low inflation. Crucially, appropriate responses depend on the underlying forecast for inflation. Our current forecast is that steady economic growth should gradually push up inflation toward the Federal Open Market Committee's longer-run objective of 2 percent, particularly as some temporary forces that had been dampening inflation fade.

Over the past decade, the Bank's research staff has made tremendous contributions to our understanding of inflation. This year's annual report essay synthesizes and updates some of their most recent work, which we have also put on display in our new Inflation Central website at www.clevelandfed.org/inflation-central. I hope you will find that site a valuable source of information on all things inflation, and I am sure you will see why the Federal Reserve Bank of Cleveland has developed a well-deserved reputation for meaningful and impactful inflation research.



The Bank's inflation research is just one example of how we are fulfilling our mission to foster the stability, integrity, and efficiency of the nation's monetary, financial, and payments systems. In fact, based on our employees' wide range of expertise, we rolled out in 2013 a new strategic plan that capitalizes on their many talents. From bank supervision to payments innovation to stakeholder engagement, the Bank's 2014–2016 strategic plan is bold, aspirational, and focused on the future. First Vice President Greg Stefani talks more about the plan in his letter on page 26. I also invite you to review our Bank "By the Numbers" following Greg's letter, and see how we stacked up in 2013. I think you'll like what you see.



In 2013 as always, the Bank's boards of directors in Cleveland, Cincinnati, and Pittsburgh and its many advisory councils were vital in guiding and supporting our progress.

They provide the Federal Reserve with crucial, real-time information about business conditions on the ground, help us pick up trends before they are reflected in the data, and help us make connections with other business leaders in the region. Our directors also oversee many aspects of the Bank, and in 2013 they were instrumental in helping to set the Bank's strategic direction. I would like to say a special thank you to the four directors who completed their terms in office at the end of 2013 and to our retiring Federal Advisory Council member:

- Paul G. Greig, chairman, president, and CEO of FirstMerit Corporation, who served three years on the Cleveland board, and who will serve as the Bank's Federal Advisory Council representative in 2014
- Peter S. Strange, chairman of Messer, Inc., who served six years on the Cincinnati Branch board, the last two years as chairman
- Glenn R. Mahone, partner and attorney at law at Reed Smith LLP, who served six years on the Pittsburgh Branch board, the last two years as chairman
- Todd D. Brice, president and CEO of S&T Bancorp, Inc., who served on our Pittsburgh Branch board for six years
- James E. Rohr, executive chairman of PNC Financial Services Group, Inc., who served three years on our Cleveland Board and three years as the Fourth District's representative to the Federal Advisory Council, of which he served as chair in 2013



It has been 11 years since I participated in my first meeting of the Federal Open Market Committee as the incoming president and CEO of the Federal Reserve Bank of Cleveland. Little did I know back then what was in store for the nation's economy. The financial crisis, severe recession, and slow recovery have been a challenging and humbling experience, and it has been an honor to represent the Fourth Federal Reserve District during this extraordinary period in our country's economic history. The one constant during my entire tenure at the Bank has been the extraordinary dedication and professionalism of the employees of the Federal Reserve Bank of Cleveland. As I get ready to retire from the Bank, I know this fine organization is in good hands.

It also gives me great comfort to know that I do not have to say goodbye. We have a term for current and former employees, directors, and advisory council members—we are Fed Family. Once a member, always a member.

Sandra Pisanalto

Sandra Pisanalto
President and Chief Executive Officer