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Observations on the Economy, and the Vibrancy of Smaller Cities

Remarks at the Worcester Regional Research Bureau's 39th Annual Meeting

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The views expressed today are my own, not necessarily those of my colleagues on the Federal Reserve Board of Governors or the Federal Open Market Committee.

Key Takeaways

1. **Collins said the U.S. economy is in a good place overall.**

   Activity continues to grow at a solid pace. Collins anticipates "that inflation will return to the Fed's 2 percent target in a timely way – and crucially, amid a healthy labor market."

2. **On monetary policy, she said given the disinflation progress to date, further adjustments in the policy rate will likely be needed after the September initial rate cut.**

   "My confidence in the disinflation trajectory has increased – but so have the risks of the economy slowing beyond what is needed to restore price stability." Collins will remain highly attentive to both price stability and maximum employment, the two parts of the Fed's Congressional mandate.

3. **Collins said labor-market conditions are no longer too hot, nor too cold – softening from the unsustainably tight job-market conditions a year ago.**

   The unemployment rate remains low by historical standards. Job growth has slowed on balance in recent months but remains relatively solid. We continue to see a low level of initial claims for unemployment insurance, as well as muted levels of continuing claims. "A labor market with supply and demand in better balance is a key reason for disinflation becoming more broad-based" said Collins, adding that the goal is not further cooling in the labor market.

4. **Inflation's components show services prices (excluding housing) expanding at a rate more consistent with 2 percent overall inflation, while housing inflation has moderated some recently – but is the most "sticky."**

   Housing inflation "remains above its pre-pandemic average despite some recent improvements. However, there are good reasons to think that this stickiness in current shelter inflation reflects existing rents still catching up to new market rents," she said.

5. **Current, elevated wage growth reflects robust gains in worker productivity and therefore, should not necessarily lead to additional price pressures.**

   While nominal wage growth has exceeded inflation for the past year, this follows a period when inflation outpaced wage growth – so wages are in part catching up to past price increases. Also, real wage growth over this recovery has yet to match measured productivity gains; Collins noted Boston Fed research that concludes nominal wage growth could continue to exceed inflation for a while but remain consistent with the on-going disinflation process.

6. **Finding economic resurgence in the face of long-term challenges often involves local people willing to collaborate across sectors on shared goals and strategies. Collins noted the growing "playbook" of effective local strategies that New Englanders are deploying.**

   "Some locales have focused on business retention and recruitment and strengthening neighborhoods. In others, local leaders have decided to focus on reducing impediments to participation in the labor force – addressing tangible problems like job readiness, childcare, and transportation. In others, people are focusing on entrepreneurship support." Collaborative leadership across sectors can be "easy to say, difficult to do" – but is vital.

Thank you for your warm welcome, and for the invitation to be with you this evening. I especially want to thank Paul Matthews, Executive Director and CEO of the Worcester Regional Research Bureau, for helping this wonderful event come together.

It is great to be in New England's second-largest city, incorporated 302 years ago – and as the Bureau points out, growing in population since 1980.

It is also my pleasure to congratulate the Bureau on its 39 years of service to the public good – through impartial, empirical, nonpartisan research, convening, and educating. I appreciate the Bureau's focus, prominently displayed in your materials, on "Turning Data Into Insight."[1] This underlines a kindred spirit with the Federal Reserve Bank of Boston, where we rigorously use data and models to shape our policymaking – and complement that analytical approach by listening to people's experiences of challenges and opportunities in the economy. My congratulations to all of you here tonight, for your engagement and commitment to this region's advancement, and prosperity.

I will cover two things this evening. First, most of my remarks will focus on my economic outlook and monetary policy views, including a look at some of the analysis we do at the Boston Fed, as we contribute to U.S. monetary policy.

Starting with a national context will provide a frame for my second topic – the economies of New England, Massachusetts, and Greater Worcester. I will briefly share some perspectives on the economic contributions of smaller cities and the areas that surround them – and some thoughts based on the Boston Fed's efforts to support opportunities for everyone to participate in our economy, regardless of their background or geographic location.

[1] www.wrrb.org

The Economy and Monetary Policy

I'll begin with the national economy. As always, my comments reflect my own views; I do not speak for my colleagues at the other Reserve Banks or the Board of Governors.

I like to share my "bottom line" up front, and will do so by saying that, overall, the U.S. economy is in a good place, which monetary policymakers are working to maintain. Recent developments have increased my confidence that inflation will return to the Federal Open Market Committee's (FOMC's) 2 percent target in a timely way – and crucially, amid a healthy labor market. Looking ahead, preserving the current favorable economic conditions will require additional adjustment to the stance of monetary policy, so as to not place unnecessary restraint on demand. A careful, data-based approach to normalizing policy will be appropriate as we balance the two-sided risks and remain highly attentive to both the price stability and the maximum employment parts of our Congressional mandate. I'll say a bit more about these points, referencing a few charts along the way.

Some Historical Context

Figure 1 provides some historical context on price stability and maximum employment. The left-hand panel shows the Fed's preferred measure of inflation, calculated using the PCE price index[2]. The blue line shows that total (or headline) inflation is moving back towards the FOMC's 2 percent target, shown by the green line. The red line is core inflation, which excludes the volatile, though obviously important, categories of food and energy. And the grey bars show recessions. In the right-hand panel, the unemployment rate path highlights how unusual this post-pandemic recovery

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[2] The Personal Consumption Expenditures Price Index (https://www.bea.gov/data/personal-consumption-expenditures-price-index)

has been. Instead of the typical gradual decline, unemployment fell very quickly after spiking, this time around.

As I've discussed in other talks,[3] a variety of factors led to demand outstripping supply, including in the labor market; and these unsustainably tight conditions contributed to price and wage pressures that fueled the surge in inflation. High inflation affects all of us, and is particularly challenging for those with lower incomes. Indeed, I continue to hear about the challenges from inflation and high price levels as I speak with people in communities across New England.

Inflation

Figure 2 focuses on *core* inflation, which tends to capture more reliably the underlying inflation trend. In particular, the darker line shows that the 12-month measure has declined, but remains elevated. Also shown is a three-month measure, reflecting more recent data but also more volatility (or "noise"). It highlights the unexpectedly large jump in inflation at the beginning of this year, after the encouraging progress at the end of 2023. The good news is that this disinflation process has resumed, and I see it as driven by economic developments that are broader and more solidly in place than at the end of last year – increasing my confidence that inflation is firmly on a trajectory to the FOMC's 2 percent target.

I'll explain by breaking core inflation into its three components, which have behaved quite differently, as shown in **Figure 3**. In the second half of 2023, disinflation was largely due to a quite rapid deceleration in *core goods* prices, shown in the first panel. Since then, the contribution of core goods prices to the overall disinflation process has moderated, though inflation developments in this area continue to be favorable and in line with pre-pandemic trends.

[3] For example, see my May 8, 2024 remarks at M.I.T.: "Reflections on Uncertainty and Patience in Monetary Policymaking" (bostonfed.org).

The contribution of *services* inflation to the overall disinflation process has resumed, although services inflation is still somewhat elevated. The far right-hand panel shows that, after a big jump in early 2024, *core services prices excluding housing* has been expanding at a rate that is more consistent with 2 percent overall inflation.

The middle panel shows that *housing* inflation has also moderated more recently. This component of inflation is the most "sticky," and remains above its pre-pandemic average despite some recent improvements. However, there are good reasons to think that this stickiness in current shelter inflation reflects *existing* rents still catching up to *new* market rents. In fact, rent growth for newly signed leases has been at or below its pre-pandemic range for many months, as shown in the right-hand panel of **Figure 4**. (The left-had panel in the figure shows PCE housing inflation again, for convenience). While the data do not suggest emergence of new inflationary pressures, it is difficult to predict how long this rent catch-up process may take.

The moderation in new rent growth also reflects a labor market that is normalizing and reducing price pressures in the services sector more generally. Labor costs are a main driver of services inflation, and a labor market with supply and demand in better balance is a key reason for disinflation becoming more broad-based, and for my increased confidence that inflation is on a sustained path back to 2 percent.

The Labor Market

In the labor market, the constellation of data point to notable softening from the unsustainably tight conditions a year ago. As Chair Powell noted in his August remarks at Jackson Hole,[4] the goal is not further cooling in the labor market. And the recent

[4] See https://www.federalreserve.gov/newsevents/speech/powell20240823a.htm where Chair Powell noted that we do not seek or welcome further cooling in labor market conditions. Also see Sept. 30 remarks where he said "We do not believe that we need to see further cooling in labor market conditions to achieve 2 percent inflation" (https://www.federalreserve.gov/newsevents/speech/powell20240930a.htm).

data, including September's unexpectedly robust jobs report, bolster my assessment that the labor market remains in a good place overall – neither too hot nor too cold.

Figure 5 shows just three of the many indicators that I and my team review when assessing labor market health. First, the unemployment rate rose from very low levels over the past year – but has recently ticked back down, and remains low by historical standards. Second, although the middle panel shows that job growth slowed notably in recent months, it remains relatively solid. Here, I'll note that recent job growth has been somewhat concentrated in a few sectors, which is one factor I continue to monitor.[5] Finally, the third panel highlights the low level of initial claims for unemployment insurance, indicating a quite-healthy labor market, as well as muted levels of continuing U.I. claims, suggesting that unemployed workers can find jobs relatively quickly.

I mentioned previously that this has been a highly unusual economic cycle, and I'd like to spend a moment on one dimension. **Figure 6** compares the evolution of the employment-to-population ratio in this cycle (the blue lines) with the average pattern from the past three recession cycles (the red lines). Clearly, the employment drop was much more sudden and steeper this time. While that is true across age groups, there are notable differences in the employment patterns during this recovery. For workers aged 25-54, the middle panel, the employment-to-population ratio returned to the pre-crisis level more rapidly than in prior episodes. In contrast, a persistently lower share of people aged 55 and older are working post-pandemic (the right-hand panel), which accounts for the total employment-to-population ratio (in the left-hand panel) still being somewhat below its pre-pandemic peak.

This pattern is quite different from prior cycles, and points to a set of issues of particular relevance for New England, the U.S. region with the oldest population. Figure

[5] Furthermore, data revisions combined with uncertainties about labor supply growth add to the difficulty of estimating the breakeven level of job creation: [2024 Preliminary Benchmark Revision: U.S. Bureau of Labor Statistics (bls.gov)].

6 is also a reminder that aggregate data mask what are often significant differences in experience across demographic groups, sectors, and locations.

With the cooling of the labor market, wage growth is also moderating – but remains above its pre-pandemic pace. However, I want to emphasize that the current, still-elevated wage growth also reflects robust gains in worker productivity and therefore, should *not* necessarily lead to additional price pressures.

Recent analysis by Boston researchers makes this point in some detail. **Figure 7** shows that nominal wage growth (measured by ECI, the employment cost index, the blue line) has exceeded PCE inflation (the red line) for the past year. However, this follows a period during which inflation outpaced wage growth, so that wages are in part catching up to past price increases.

Furthermore, real wages (or wages adjusted for inflation) should track growth in worker productivity over the medium to longer run, and real wage growth over this recovery has yet to match measured productivity gains. Given the developments in prices, wages and productivity to date, the "projections" part of the chart illustrates how nominal wage growth could continue to exceed inflation for a while and still remain consistent with the on-going disinflation process.[6] In fact, recent data revisions that raise the level of GDP and point to lower employment suggest that productivity may be understated by current measures.

Demand

Going forward, it will be vitally important to preserve healthy labor market conditions. In my view, this will require economic activity continuing to grow close to trend, which is my baseline outlook.

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[6] For more details on the projected non-inflationary ECI range, see "Is Post-pandemic Wage Growth Fueling Inflation?" (bostonfed.org). For additional analysis on this topic, see "Productivity Improvements and Markup Normalization Can Support Further Wage Gains without Inflationary Pressures" (bostonfed.org).

In this respect, recent data show activity continuing to grow at a solid pace overall. Importantly, the fundamentals underpinning consumer spending remain favorable, including job opportunities and the gradual recovery of real wages. However, I call myself a "realistic optimist" and that includes recognizing that there are risks on both sides of this outlook.

Figure 8 shows two demand-related indicators. On the one hand, household net worth remains quite elevated by historical standards, as shown on the left, which could contribute to a faster-than-expected pace of growth in consumer spending. At the same time, strains are starting to emerge, especially at the lower end of the income distribution. For example, credit card delinquencies, shown in the right-hand panel, have risen to above pre-pandemic levels, although they are still low by recent historical standards.

Monetary Policy

The next phase of monetary policy must focus on preserving current favorable economic conditions. A sustainable return of inflation to target, and a strong labor market, are both critically important.

A restrictive monetary policy stance played a key role in the disinflation progress so far, and recent data on spending and production indicate that the effects of restrictive policy are being felt, especially in interest-sensitive sectors of the economy. With the labor market cooling, and economic growth reverting to a more normal pace, the economy is somewhat more vulnerable to adverse shocks. My confidence in the disinflation trajectory has increased – but so have the risks of the economy slowing beyond what is needed to restore price stability.

For these reasons, the FOMC began easing the policy stance at its meeting last month (see **Figure 9**). I saw an initial 50 basis point rate reduction as prudent in this context, recognizing that monetary policy remains in restrictive territory.

Further adjustments will likely be needed. Indeed, the median projection from the FOMC participants' *Summary of Economic Projections,*[7] released at the end of last month's meeting, includes an additional 50 basis points of cuts in the federal funds rate this year. But I will stress that policy is not on a pre-set path and will remain data-dependent, adjusting as the economy evolves.

Smaller cities and Central Massachusetts

With the national economy as context, I'll now offer some brief perspective on smaller cities and the areas that surround them – including a few observations about Central Mass. and Greater Worcester. Like the Bureau, the Federal Reserve serves the public – *all* the public. So while "superstar" cities get a lot of well-deserved buzz, we care deeply about smaller cities and rural areas, and the economic experience for people in them. In fact, a large portion of the Massachusetts population – more than a third – lives outside the Boston metro area. And about a third of *that* population live in Worcester County.

People are of course fundamental to economic activity, and **Figure 10** shows population trends since 2000. As you likely know, population growth in Worcester County has exceeded the state average, fueled in part by rapid population growth in the city of Worcester – quite a bit faster than Boston in the period since 2010.

New England's smaller cities have of course been buffeted by the crosscurrents of economic history, often driven by technological change. Certainly, the decline in manufacturing sector's share of employment over time has been a powerful current affecting Worcester, the Commonwealth, and the entire U.S., as shown in **Figure 11**.

[7] September 18, 2024: FOMC Projections materials, accessible version (federalreserve.gov)

While the share of employment concentrated in manufacturing declined nationwide, Worcester was particularly hard hit, given the previous importance of the sector here.[8]

Still, Worcester's population growth speaks to its more recent and ongoing revitalization, leveraging assets such as location, local leadership, and developing an important mix of sectors. Particularly notable over the last decade has been very rapid employment growth in professional and business services, more than double the pace of growth in Massachusetts and the U.S.[9]

Resurgence and Vibrancy

I'd like to share some thoughts on how smaller cities and rural areas around the country, and in New England, find economic resurgence in the face of long-term challenges like the loss of manufacturing jobs. Over the last 10 to 15 years the Boston Fed, motivated by our mandate to support maximum employment, has learned and shared a great deal.[10] Our research and experience shows that an essential element is local leaders willing to collaborate across sectors on shared goals strategies. (Easy to say, difficult to do!).

[8] An extensive literature examines many dimensions of the steep decline in manufacturing employment. For an interesting recent exploration, with references to the prior literature, see "New Perspectives on the Decline of US Manufacturing Employment," by Teresa C. Fort, Justin R. Pierce, and Peter K. Schott, in the *Journal of Economic Perspectives*, Volume 32, Number 2; Spring 2018; Pages 47–72 [https://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.32.2.47]

[9] Professional and Business Services employment grew rapidly from 2013 to 2023. In Worcester County the growth was 33 percent. In the City of Worcester the growth was 57 percent, over that time. This compares to 23 percent for the U.S. as a whole, and 25 percent for Massachusetts. *Sources:* Bureau of Labor Statistics, Quarterly Workforce Indicators, and the Massachusetts Executive Office of Labor and Workforce Development ES-202.

[10] One can learn more about the Bank's work to support growth in smaller cities and rural areas at https://www.bostonfed.org/community-development/supporting-growth-in-smaller-industrial-cities.aspx. Our mandate and our concern for a vibrant, inclusive economy bring our focus to the challenges that prevent people from participating in the economy or the workforce – issues like childcare, housing, transportation, and broadband. Studying factors that limit people from participating, and disparities for groups and places, can help strengthen overall economic growth and competitiveness.

Thoughtful experimentation can lead to new approaches that support economic vibrancy. Within our Working Places initiatives, I would highlight the effort we called "LELE" or Leaders for Equitable Local Economies – an 18-month experiment beginning in 2021, which had great success in Worcester.[11]

The "Reimaging Civic Engagement in Worcester, MA" LELE team worked with the city to implement a participatory process for distribution of funds from the American Rescue Plan Act of 2021 intended to support communities hit hardest by COVID-19.[12] Ultimately, the group helped bump Worcester's allocation from $10 million to $50 million – a good example of building civic infrastructure that engages and includes all.

More generally, we and our partners are exploring ways people can grow the "playbook" of effective local strategies. For instance, some locales have focused on business retention and recruitment, and strengthening neighborhoods. In others, local leaders have decided to focus on reducing impediments to participation in the labor force – addressing tangible problems like job readiness, childcare, and transportation. In still others, people are focusing on entrepreneurship support, and access to information about jobs being available where people go every day – like their kids' schools. Again, a key is local people coming together from various sectors to determine and then work on shared objectives.

Looking Ahead

In concluding, I hope it is evident that our focus at the Boston Fed is on a vibrant economy that works for everyone, not just for some. That spirit motivates me to study

[11] One can learn more about Working Places initiatives and LELE at https://www.bostonfed.org/workingplaces.aspx

[12] The Worcester team was led by Casey Burns, Gina Plata-Nino, and Etel Haxhiaj. Under their LELE umbrella, five resident committees helped review and prioritize grant applications. Grant writing sessions were held to support applicants from small, new, and diverse organizations. Resident ambassadors engaged more fully with the Worcester Housing Authority.

and analyze the economic data and contribute in a rigorous manner to monetary policymaking.

It also motivates me to travel the region, hearing from stakeholders across our economy – as shown in **Figure 12**. That's why I gathered with some Worcester leaders earlier this afternoon, and why I'm headed to Vermont this evening for a series of meetings tomorrow. Hearing from New Englanders with diverse perspectives about the challenges and opportunities they see in the economy helps me fulfil my responsibilities as a policymaker – and is a truly wonderful part of my job.

In addition to our monetary policy work, the Federal Reserve supports Main Street economies in a variety of ways – often quietly and behind the scenes. Our support includes financial stability, most directly through safety and soundness supervision; providing payments and financial services infrastructure such as through the FedNow instant payments service;[13] conducting objective research and analysis; and convening experts and community members around key topics.

There are no shortages of challenges in our economy, but myriad opportunities as well. I believe we have real opportunities to see central Mass., all of Mass., indeed all of New England thrive. The keys are engagement, cross-sector collaboration, analysis, innovation, and commitment. I know you have those things in Worcester and Central Mass. I look forward to continued partnerships, and wish you continued great success.

Thank you.

[13] https://www.bostonfed.org/payments-innovation/fednow-service.aspx