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Remarks on the Economic Outlook and Financial Inclusion

by

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at the

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Good morning. It is really a pleasure to join you here in Alaska.[1] Getting outside of Washington, D.C. and hearing about the unique issues that affect Alaskans provides valuable insights that inform my work at the Federal Reserve. A part of the mission of the Federal Reserve is to support an economy that works for everyone. Consumers and communities are more successful when they have access to financial products and services that meet their needs. While many of these products and services are available online, as Alaskans know better than most Americans, geography and location are also important. This access often looks very different in places with many remote and rural communities. Today, I will discuss the Federal Reserve's work to promote a more inclusive financial system, including our work on financial inclusion for Indigenous communities. Before diving into those topics, I will share my current views on the economy and monetary policy.

Economic and Monetary Policy Outlook

Over the past two years, the Federal Open Market Committee (FOMC) has significantly tightened the stance of monetary policy to address high inflation. At our July meeting, the FOMC voted to continue to hold the federal funds rate target range at 5¼ to 5½ percent and to continue to reduce the Federal Reserve's securities holdings.

After seeing considerable progress last year, in recent months we have seen some further progress on lowering inflation. The 12-month measures of total and core personal consumption expenditures (PCE) inflation, which I prefer to the more volatile higher-frequency readings, have moved down since April, although they have remained somewhat elevated at 2.5 percent and 2.6 percent in June, respectively. In addition, the latest consumer and producer price index reports

[1] The views expressed here are my own and not necessarily those of my colleagues on the Federal Open Market Committee or the Board of Governors.

indicate that 12-month core PCE inflation likely remained a bit above 2.5 percent in July. The progress in lowering inflation since April is a welcome development, but inflation is still uncomfortably above the Committee's 2 percent goal.

Prices continue to be much higher than before the pandemic, which continues to weigh on consumer sentiment. Inflation has hit lower-income households hardest, since food, energy, and housing services price increases far outpaced overall inflation over the past few years.

Economic activity moderated in the first half of this year after increasing at a strong pace last year. Private domestic final purchases (PDFP) growth was solid and slowed much less than gross domestic product (GDP), as the slowdown in GDP growth was partly driven by volatile categories such as net exports, suggesting that underlying economic growth was stronger than GDP indicated. Unusually strong consumer goods spending last year softened in the first quarter of this year, largely accounting for the step-down in PDFP growth. Goods spending rebounded in the second quarter and retail sales continued to rise at a solid pace in July.

Consumers appear to be pulling back on discretionary items and expenses, as evidenced in part by a decline in restaurant spending since late last year. Low- and moderate-income consumers no longer have savings to support this type of spending, and we've seen a normalization of loan delinquency rates as they have risen from historically low levels during the pandemic.

The labor market continues to loosen, as the number of available workers has increased and the number of available jobs has declined—signs that illustrate the labor market is coming into better balance. After slowing in the second quarter, payroll employment gains eased to a more modest pace in July, even as job openings are being filled by the increased immigrant labor supply. The latest labor market report shows that the unemployment rate stood at 4.3 percent in

July. Although notably higher than a year ago, this is still a historically low unemployment rate. In addition, the ratio of job vacancies to unemployed workers has declined to its pre-pandemic level. We are also seeing a slowing in wage growth, which now stands at just under 4 percent as measured by the employment cost index. However, given trend productivity, wage gains remain above the pace consistent with our inflation goal.

My baseline outlook is that inflation will decline further with the current stance of monetary policy. Should the incoming data continue to show that inflation is moving sustainably toward our 2 percent goal, it will become appropriate to gradually lower the federal funds rate to prevent monetary policy from becoming overly restrictive on economic activity and employment. But we need to be patient and avoid undermining continued progress on lowering inflation by overreacting to any single data point. Instead, we must view the data in their totality as the risks to the Committee's employment and price-stability mandates continue to move into better balance. That said, I still see some upside risks to inflation as supply conditions have now largely normalized and any further improvements to supply seem less likely to offset price pressures arising from increasing geopolitical tensions, additional fiscal stimulus, and increased demand for housing due to immigration.

There are also risks that the labor market has not been as strong as the payroll data have been indicating, and it appears that the recent rise in unemployment may be exaggerating the degree of cooling in labor markets. The Q4 Quarterly Census of Employment and Wages (QCEW) report suggests that job gains have been consistently overstated in the establishment survey since March of last year, while the household survey unemployment data have become less accurate as response rates have appreciably declined since the pandemic.[2] The rise in the unemployment rate this year largely reflects weaker hiring, as job searchers entering the labor force are taking longer to find work, and layoffs remain low. It is also likely that some temporary factors contributed to the soft July employment report. The rise in the unemployment rate in July was largely accounted for by workers who are experiencing a temporary layoff and are more likely to be rehired in coming months. Hurricane Beryl also likely contributed to weaker job gains, as the number of workers not working due to bad weather increased significantly last month.

In light of upside risks to inflation and uncertainty regarding labor market conditions and the economic outlook, I will continue to watch the data closely as I assess the appropriate path of monetary policy. Increased measurement challenges and the frequency and extent of data revisions over the past few years make the task of assessing the current state of the economy and predicting how it will evolve even more challenging. I will remain cautious in my approach to considering adjustments to the current stance of policy.

It is important to note that monetary policy is not on a preset course. In my view, we should consider a range of possible scenarios that could unfold when assessing how the FOMC's monetary policy decisions may evolve. My colleagues and I will make our decisions at each FOMC meeting based on the incoming data and the implications for and risks to the outlook and guided by the Fed's dual-mandate goals of maximum employment and stable prices. By the time of our September meeting, we will have seen additional economic data and information,

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[2] The Q4 Quarterly Census of Employment and Wages (QCEW) administrative data show employment gains that are about 110,000 per month lower than what the Current Employment Statistics (CES) survey reported from March 2023 to December 2023. Although the Bureau of Labor Statistics benchmarks CES payroll employment based on the Q1 QCEW, to be released on August 21, the Q4 QCEW data point to a substantial downward revision to CES employment gains last year.

including one employment and one inflation report. We will also monitor how developments in broader financial conditions might influence the economic outlook.

I will continue to closely watch the data and visit with a broad range of contacts as I assess economic conditions and the appropriateness of our monetary policy stance. As I noted earlier, I continue to view inflation as somewhat elevated. And with some upside risks to inflation, I still see the need to pay close attention to the price-stability side of our mandate while watching for risks of a material weakening in the labor market. My view continues to be that restoring price stability is essential for achieving maximum employment over the longer run.

Focus on Financial Inclusion

I will turn now to discuss our work to promote financial inclusion. An inclusive financial system enables access to financial services that enhance the financial well-being of consumers and businesses. Consumers come from a wide range of economic circumstances, with varied perceptions of and experiences with the banking system and different financial needs. All consumers should have access to the financial services and products they need.

The U.S. economy benefits when more households achieve financial stability. Yet, while we have made significant progress in expanding access to financial services and deposit accounts in the United States, the remaining challenges often include geographic location, products that meet specific customer needs, the absence of financial literacy education, lack of access to technology and reliable internet, and in some cases, language. These challenges are even more acute in providing access to financial services to Indigenous populations like those here in Alaska. It is impressive to see that many financial services providers, including banks and Community Development Financial Institutions (CDFIs), are working to address these challenges and making significant inroads.

Importance of banks in furthering financial inclusion

The U.S. financial system is uniquely positioned to bring consumers into the financial mainstream by providing innovative solutions to meet the credit needs of their communities. Banks and other depository institutions assist consumers and small businesses by providing financial products and services that are safe, fair, and responsive. In doing so, they serve a critical role in connecting consumers to the financial system and to the economy.

Smaller banks, including community banks, are indispensable in providing access to financial products and services, especially in more remote or rural areas. Here, in Alaska, your banks are the front-line providers for your communities. As you know well, community banks support small businesses through credit and technical assistance and targeted support specific to customers in their communities. As a former community banker, I know firsthand that smaller banks deeply understand their communities because they live in the local economy and know their customers well.

This was especially apparent during the COVID pandemic. Community banks rose to the challenge and continued to support the needs of their customers and communities. One of the programs first made available in response to the pandemic was the Paycheck Protection Program (PPP), which was geared to small businesses and was necessarily dependent on community banks. The PPP was timely and effective in helping millions of businesses weather the initial phase of the pandemic, and community banks were absolutely essential to the success of the program.[3]

This successful outcome is probably not surprising to this audience, because when it comes to lending to small businesses, community banks have always been an outsized source of credit, relative to their size in the banking system. Before the pandemic, community banks accounted for over 40 percent of all small business lending, while they only accounted for roughly 15 percent of total assets in the banking system.[4] This trend has continued. An analysis of June 2023 call report data showed that community banks had larger shares of small-business loans relative to their total assets than larger institutions.[5]

Community banks know their customers, and they know their communities. During that challenging time, community bank CEOs told me that early in the pandemic they directly contacted every single one of their business and consumer loan customers. They took the time to check in with each one to see how they were doing, and what they needed. They encouraged customers to keep in touch with the bank, and they noted the available opportunities for payment deferrals and other options that customers might not have been aware of. Because of this

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[3] Allen N. Berger, Maryann P. Feldman, W. Scott Langford, and Raluca A. Roman, "Let Us Put Our Moneys Together: Minority-Owned Banks and Resilience to Crises," WP-2313 (Federal Reserve Bank of Philadelphia, June 2023), https://www.philadelphiafed.org/-/media/frbp/assets/working-papers/2023/wp23-13.pdf.

[4] Governor Michelle W. Bowman, "Community Banks Rise to the Challenge" (speech at the Community Banking in the 21st Century Research Conference, St. Louis, MO, September 30, 2020), https://www.federalreserve.gov/newsevents/speech/bowman20200930a.htm

[5] See Eldar Beiseitov, "Small Banks, Big Impact: Community Banks and Their Role in Small Business Lending," October 20, 2023, https://www.stlouisfed.org/publications/regional-economist/2023/oct/small-banks-big-impact-community-banks-small-business-lending.

relationship banking model, small banks were and continue to be able to provide more tailored financial products and services that are designed to meet the specific needs of their customers.[6]

We all recognize the important role of small banks in the functioning of the U.S. economy by supporting the financial needs of their customers and communities. The Federal Reserve relies on insights from community banks and created a mechanism to formalize the views and feedback from community banks on a regular basis through our Reserve Bank and Board Community Depository Institutions Advisory Councils (CDIAC). The Board CDIAC includes a representative from each of the local advisory councils at the 12 Reserve Banks. CDIAC members are bankers from community banks, thrifts, and credit unions who provide insight and information about the economy, lending conditions, and other issues that they see firsthand in their communities.

This perspective helps us gain insights into economic activity and the impact of our policies on rural and underserved communities.

Central Bank Network for Indigenous Inclusion

I will turn now to highlight our efforts in providing broader access to financial services. In 2021, the Federal Reserve became a member of the Central Bank Network for Indigenous Inclusion (CBNII).[7] This group brings together the central banks of the United States, Canada, New Zealand, and Australia. The network enabled us to initiate an ongoing international dialogue to raise awareness of economic and financial issues in Indigenous populations. This

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[6] Governor Michelle W. Bowman, "The Role of Research, Data, and Analysis in Banking Reforms" (speech at the 2023 Community Banking Research Conference, St. Louis, MO, October 4, 2023), https://www.federalreserve.gov/newsevents/speech/bowman20231004a.htm

[7] Board of Governors of the Federal Reserve System, "Federal Reserve Board Announces It Has Joined the Central Bank Network for Indigenous Inclusion, Which Will Foster Ongoing Dialogue, Research, and Education to Raise Awareness of Economic and Financial Issues and Opportunities around Indigenous Economies," news release, October 13, 2021, https://www.federalreserve.gov/newsevents/pressreleases/other20211013a.htm

allows us to share knowledge and best practices, promote engagement and education, and work together with Indigenous communities.

As the Federal Reserve's representative to the network, I have prioritized expanding our outreach and engagement efforts to include all U.S. Native populations, Native Alaskan, Native Hawaiian, and Native American. Coming here to Alaska is a key part of this role to ensure that the Federal Reserve continues to expand our firsthand knowledge and understanding of the issues and barriers that may prevent full engagement in the economy. I take these responsibilities seriously and have made meeting with and learning from Indigenous groups and leaders a priority in my work.

In October 2021, I met with Native American leaders in South Dakota and on the Pine Ridge Reservation. These tribal leaders highlighted the importance of building understanding by meeting with people in their communities to enhance our knowledge of their social and economic circumstances. Earlier this year and last year, I met with members of the Native Hawaiian community and a range of community organizations to learn about the issues and challenges they face, in addition to the recovery efforts following the devastating wildfire in Lahaina. And yesterday, I met with Native Alaskan leaders to learn about Alaska Native corporations and other initiatives here in Alaska. These convenings and conversations help to inform our work at the Federal Reserve to ensure that the financial system is accessible to everyone, including Indigenous communities.

The Fed's work in this area is supported by many of our Reserve Bank teams, including the San Francisco Reserve Bank, the Minneapolis Center for Indian Country Development, and the St. Louis Native Economic and Financial Education Empowerment program. Together, these teams and programs support Indigenous organizations and tribal nations by providing actionable data and research, economic and personal finance education, and other resources to advance opportunities for prosperity in Indigenous communities.

We know that the economic well-being of all Americans is an important aspect of the Federal Reserve's goal to increase economic inclusion, and it is one of the reasons we began participating in the CBNII. Even with all of its tools, the Federal Reserve cannot fully succeed until all Americans, including our Native populations and those existing on the margins of the economy, have the opportunity to fully participate. Engagement in these learning opportunities, including these meetings, will help to advance this goal.

Mission-driven organizations

Finally, I would like to briefly address the Federal Reserve's efforts to build the institutional capacity of another set of key stakeholders: Minority Depository Institutions, Women-Owned Depository Institutions, and CDFIs, whose missions are to reach historically underserved populations. Providing support for these institutions is an important part of the Federal Reserve's responsibility to provide a safe, sound, and accessible banking system that protects consumers.[8]

These mission-driven banks and CDFIs are often vital sources of capital to many underrepresented small businesses. CDFIs generally target specific underserved markets. For example, there are many Native CDFIs, including several here in Alaska, that support Native communities by providing access to credit, capital, and financial services.[9] While there has been some significant growth in Native CDFIs,[10] they cannot singlehandedly resolve the credit needs of this population. This effort will require partnerships with banks, state and local governments,

[8] See the Federal Reserve's Partnership for Progress website at https://www.fedpartnership.gov.

[9] See https://www.cdfifund.gov/programs-training/programs/native-initiatives.

[10] See https://www.minneapolisfed.org/article/2024/native-cdfis-connect-indian-country-to-credit-and-capital.

and community stakeholders. As an example, the Federal Reserve convened a small business lending working group that brought together local, state, and federal partners to address challenges with access to capital for Alaskan small businesses, especially those owned by Native Alaskans.[11] This group has helped connect local Native CDFIs to banks and state and federal partners for funding and technical assistance.

Finally, I will close with a brief note on the revisions to the CDFI Certification Application recently released by the Treasury's CDFI Fund.[12] There are significant benefits to being a certified CDFI, including access to federal, state, and local governmental funds, philanthropic support, and private sector investment. While the certification process is overseen by the CDFI Fund, I encourage CDFI banks to review the new certification application and share feedback on whether the requirements are attainable and remain compatible with the bank's existing business model.

Closing Thoughts

In closing, thank you again for welcoming me here today. I am very pleased to have the opportunity to learn from your experiences and incorporate these lessons into our work. The unique challenges that you face here in Alaska will help to inform and expand the Federal Reserve's understanding of how we can make the financial system more inclusive. Our meetings over the past few days with state government officials, Native Alaskan leaders, small business owners, and financial institutions provide many different perspectives to help inform our work to achieve an economy that works for everyone.

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[11] Governor Michelle W. Bowman, panel remarks at the 2023 Symposium on Indigenous Inclusion, Te Pūtea Matua, Auckland, New Zealand, September 27, 2023, https://www.federalreserve.gov/newsevents/speech/bowman20230927a.htm.

[12] See https://www.cdfifund.gov/news/553.