Dallas Fed

Speech by President Lorie K. Logan

Opening Remarks for 'Energy and the Economy: The New Energy Landscape' Conference

Dallas Fed President Lorie Logan delivered this address to open the conference hosted by the Federal Reserve Banks of Dallas and Kansas City in Houston.

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Thank you for that introduction, Daron.

It's a pleasure to open today's event. This is the Dallas and Kansas City Feds' seventh joint conference on energy, and the topic is more vital than ever. As a newcomer to this region, where energy is so central to the economy, I'm eager to learn and delighted to participate in this conference for the first time.

I'd like to thank everyone who has worked so hard to bring this event together, and particularly thank Esther George, president of the Kansas City Fed, for her partnership on this effort over the years. President George has been an extraordinarily impactful leader across all aspects of the Federal Reserve's mission during 40 years of service. She is a wise voice in our monetary policy discussions; she has brought about a leap forward in our nation's payments system as executive sponsor of the forthcoming FedNow service; and she has been a strong advocate for effective and efficient regulation of banks, especially community banks, throughout her career. President George is retiring this January—but before that, she is going to do us the honor of giving today's keynote address. Esther, I'm so grateful for everything I've learned from you, and I know I'm not alone when I say we will miss you deeply.

Today's conference theme is "Energy and the Economy: The New Energy Landscape." I'd like to share a few thoughts on energy and on the economy to begin our discussions. As always, these views are mine and not necessarily those of my colleagues on the Federal Open Market Committee (FOMC).

Energy prices have been extremely volatile this year. The front-month futures price of West Texas Intermediate oil was up more than 52 percent at points during the year, though it has since retraced, while natural gas is up 20 percent since a year ago at the Henry Hub and 61 percent in continental Europe. Significant pressures and volatility in energy prices have stemmed from Russia's war against Ukraine and Russia's weaponization of energy exports. Although European nations have worked hard to build natural gas inventories and make plans to conserve energy, Europe still faces a difficult winter under even the best scenarios. This context provides daily reminders that energy plays a critical role in economic life and national security.

Energy is especially important here in the Tenth and Eleventh Federal Reserve Districts, which together produce almost half of the nation's energy. Texas leads the nation in the production of oil, natural gas and wind power, and is second in utility-scale solar installations. Our region also leads the nation in refinery capacity and petrochemical production. In Texas, oil and gas production is a significant employer and

makes up 11 percent of state GDP and almost half of exports. Adding in chemical products, the energy share of state exports rises to more than 60 percent.

The Dallas Fed is deeply committed to advancing the understanding of energy's influence on the regional, national and global economies. We do so through our public outreach and research, including our quarterly energy survey of 200 oil and gas firms in Texas, southern New Mexico and northern Louisiana. We are grateful to those of you who participate in the survey.

We also bring people together, at events like today's conference, our Energy Advisory Council meetings and other important gatherings, to work through the issues and identify constructive paths forward.

As Daron said, my years of experience in finance have given me a deep understanding of the criticality of energy markets and how events in these markets can reverberate through the broader financial system. But I am relatively new to the real side of the energy economy—namely, how energy is produced, distributed and consumed. So, although I'm fortunate to have an expert energy team at the Dallas Fed and have learned a great deal from visiting with some key energy leaders around the Eleventh District, I look forward to listening and learning more. I am particularly looking forward to today's discussions and to connecting with all of you.

A deep understanding of the energy ecosystem is critical so the Federal Reserve can best accomplish core elements of our mission: setting monetary policy to promote maximum employment and stable prices, promoting the stability and efficiency of the financial system, and supporting community development. Energy sector developments affect economic output, employment, inflation, investment and credit markets. In turn, the Federal Reserve's policies significantly affect the energy sector, through both changes in macroeconomic conditions and changes in financial conditions that influence investment.

Today's economic conditions are complex, but they can be summarized in five words: Inflation is much too high.

Not only is inflation far above the FOMC's 2 percent target, but with aggregate demand continuing to outstrip supply, inflation has repeatedly come in higher than forecasters expected. This morning's CPI [Consumer Price Index] data were a welcome relief, but there is still a long way to go.

Price stability is foundational for a healthy labor market and economy over time.

- When inflation is high, it is difficult for families and companies to plan for the future and difficult for financial markets to allocate capital to the most productive uses.
- High inflation leaves many workers falling further and further behind, as their wages fail to keep pace with the cost of food, gas and other necessities.
- High inflation makes the business cycle more volatile, undermining the long and stable expansions that particularly benefit the most vulnerable in society.

In short, high inflation is a drag on our economy. The longer it continues, the worse the drag gets, the greater the risk that high inflation becomes entrenched and the greater the cost that must be paid to bring inflation down. The Federal Reserve has a dual mandate for monetary policy—maximum employment and price stability—but to achieve the maximum employment part of the mandate in a sustainable way, I believe monetary policy must focus now on promptly restoring price stability.

The FOMC has raised its target range for the federal funds rate by 3.75 percentage points since the start of the year, including with historically large 75-basis-point hikes at each of the past four meetings. Financial markets are pricing in the expectation of substantial further increases, and the FOMC is also

removing monetary accommodation by reducing our asset holdings as described in the plans that the FOMC issued in May. As a result, broad financial conditions have tightened significantly. The 10-year Treasury yield has risen to more than 4 percent, compared with 1.51 percent at the start of the year, and option-adjusted yields have reached nearly 6 percent on investment-grade corporate debt and about 9 percent on high-yield debt. Thirty-year fixed mortgage rates have climbed to 7.32 percent from 3.27 percent. Importantly, real—or inflation-adjusted—interest rates, as measured by yields on Treasury Inflation-Protected Securities, are significantly above zero across the yield curve.

These tighter financial conditions are beginning to bring demand back into balance with supply, particularly in interest-rate-sensitive sectors such as housing.

Sufficient cooling of the economy will eventually bring inflation back to our target. But this process is just getting started. The labor market remains very tight, and wages continue to grow considerably faster than the rate that would be consistent with 2 percent inflation.

You may have heard debate about whether tighter policy will imperil the financial system. It's important to remember that higher interest rates should cause pressures. As you are likely well aware, some investments that had a positive net present value at last year's interest rates do not make sense at today's higher rates. Some projects will have to shut down. Financial markets, businesses and the economy will have to adjust after so many years of near-zero rates. Such adjustments are expected and appropriate to moderate demand and reduce inflation.

So far, I believe we are seeing a normal financial market response to tighter monetary policy. Although the cost of credit continues to rise and issuance continues to slow, credit markets remain open for most borrowers. And while liquidity conditions in key financial markets have been strained, those strains appear so far to result primarily from high economic uncertainty and volatility that raises the costs of market-making, rather than the other way around.

Although inflation poses hardships in the near term and damages the economy's long-run strength, falling house prices, a cooling labor market and tighter financial conditions create hardships of their own.

I believe that the FOMC must do everything we can to restore the price stability that will support a healthy economy in the long run, but we should also try, if we can, to avoid incurring costs that are higher than necessary.

In my career in financial markets, I've learned that financial conditions usually evolve smoothly but sometimes deteriorate abruptly, with severe consequences for the economic well-being of households and businesses. As financial conditions become more restrictive, I am attentive to the potential for nonlinear and unexpected responses to further policy tightening.

While I believe it may soon be appropriate to slow the pace of rate increases so we can better assess how financial and economic conditions are evolving, I also believe a slower pace should not be taken to represent easier policy. I don't see the decision about slowing the pace as being particularly closely related to the incoming data. The restrictiveness of policy comes from the entire policy strategy—not just how fast rates rise, but the level they reach, the time spent at that level, and, importantly, the factors that determine further increases or decreases. The FOMC can and should adjust other elements of policy to deliver appropriately tight conditions even as the pace slows. We must remain firmly committed to our 2 percent inflation goal.

I will look to a wide range of information to assess whether policy is sufficiently restrictive. For example, I'll be watching the evolution of the labor market and economy, as well as thinking about real yields and about the accuracy of inflation forecasts, among other factors. Real interest rates remaining significantly

above zero would contribute to the slowing of demand that I expect will reduce inflation. By contrast, inflation forecasts that consistently miss on the low side do not foster confidence that we understand the inflation process well enough to predict success.

That is a lot of words to explain a five-word economic situation. So let me sum up. Inflation is much too high. The FOMC must restore price stability—but must also proceed in a way that allows us to better assess how financial and economic conditions are evolving. That is how we can deliver the healthier economy, with stable prices and maximum employment, which is the Federal Reserve's responsibility.

Thank you. I look forward to learning from all of you today, and especially to hearing President George's keynote remarks over lunch.

About the Author

Lorie K. Logan is president and CEO of the Federal Reserve Bank of Dallas.

The views expressed are my own and do not necessarily reflect official positions of the Federal Reserve System.