John C Williams: Achieving balance amid uncertainty

Remarks by Mr John C Williams, President and Chief Executive Officer of the Federal Reserve Bank of New York, at the Housatonic Community College, Bridgeport, Connecticut, 31 March 2023.

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As prepared for delivery

Thank you. It's great to be here at Housatonic Community College today. Fairfield County in Connecticut is part of the Federal Reserve's Second District, which also encompasses New York State, Northern New Jersey, Puerto Rico, and the U.S. Virgin Islands.

An important, and enjoyable, aspect of my job is to meet with members of the community-students, educators, and business and civic leaders-from throughout the Second District, so I can hear firsthand about their experiences on issues like the economy, housing, and, of course, inflation.

High inflation hurts everyone, but it's hardest on those who can least afford to pay more for groceries, rent, and gas. Persistently high inflation also undermines the ability of our economy to reach its full potential.

Today, I'm going to talk about inflation, which remains a top concern. I'll also give my views on the economic outlook and monetary policy.

Before I go any further, I need to give the standard Fed disclaimer that the views I express today are mine alone and do not necessarily reflect those of the Federal Open Market Committee-what we call the "FOMC"-or others in the Federal Reserve System.

A Series of Events

Over the past three years, our economy has endured a remarkable series of events that have added to economic uncertainty. First came the pandemic, which caused huge and prolonged imbalances between demand and supply that are still with us today. Then Russia's war on Ukraine fueled higher global energy and food prices.

More recently, stresses in parts of the banking system are likely to result in a tightening of credit conditions that will in turn reduce spending by businesses and households. The magnitude and duration of these effects, however, is still uncertain.

The FOMC is responsible for setting monetary policy. We are mandated by Congress to promote maximum employment and price stability. On the employment side, the U.S. labor market has been extremely resilient. Job growth has been strong, job vacancies are plentiful, and at 3.6 percent, the national unemployment rate is near half-century lows. I should also note that Connecticut's unemployment rate has fallen to a low level of 4 percent.

Inflation is another story. The FOMC defines price stability as 2 percent inflation, as measured by the personal consumption expenditures (PCE) price index.[1] Our commitment to 2 percent inflation is an important bedrock principle, providing a "North Star" for policy decisions and helping to improve the public's understanding of our goals and actions.

Inflation reached a 40-year high of 7 percent this past June. While it has since moderated to 5 percent, it is still well above our longer-run goal. Without price stability, we cannot achieve maximum employment on a sustained basis. That is why it's so important for the FOMC to use its monetary policy tools to bring inflation down.

The Inflation Gears

Our most important policy tool is the setting of the target range for the federal funds rate, which influences demand for goods and services by affecting borrowing costs.

To show how this is helping to reduce inflation, I've been using an analogy of a mechanism, such as a watch, that is powered by gears.

The watch represents the economy, and its gears are different sectors. To keep time accurately, the gears need to turn at the right speed. But the ones that drive inflation have been spinning at different rates.

The first inflation gear relates to globally traded commodities, such as lumber, steel, and grains. Thanks in part to tighter monetary policy here and abroad, demand has eased, and commodity prices have moderated.

The second gear, which represents goods such as cars, appliances, and furniture, is turning nearer where it needs to be, as higher interest rates have helped curb demand. Supply-chain bottlenecks that plagued the economy earlier in the pandemic have receded, which is also helping bring goods price inflation down.[2]

The gear that's having the most trouble turning represents non-energy services excluding housing. It's influenced by the balance of overall supply and demand for these services and labor, and it will likely take the longest to bring inflation in this sector down fully.

Well-Anchored Expectations

One aspect of inflation that's important for achieving and sustaining price stability is the anchoring of inflation expectations. Various measures of longer-run inflation expectations have remained well anchored at levels consistent with our 2 percent goal.[3]

Inflation expectations for the next few years, which increased as inflation was rising, have come down in recent months. The New York Fed's monthly Survey of Consumer Expectations showed that three-year-ahead inflation expectations are back to where they were in early 2021, and one-year-ahead expectations have decreased sharply.[4]

FOMC Actions

With all this in mind, last week, the FOMC raised the target range for the federal funds rate to 4-3/4 to 5 percent, its ninth consecutive increase. The FOMC said it "will closely monitor incoming information and assess the implications for monetary policy." It also said it "anticipates that some additional policy firming may be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent over time." [5], [6]

I will be particularly focused on assessing the evolution of credit conditions and their effects on the outlook for growth, employment, and inflation.

Economic Outlook

While the FOMC has taken decisive steps to bring inflation down, lags exist between policy actions and their effects. It will take time for all of our inflation gears to move at a pace that takes us to our 2 percent target. I expect inflation to decline to around 3-1/4 percent this year, before moving closer to our longer-run goal in the next two years.

I expect real GDP to grow modestly this year and for growth to pick up somewhat next year. Slower growth and tighter monetary policy will likely lead to some softening in the labor market. So, I anticipate unemployment gradually rising to about 4-1/2 percent over the next year.

Conclusion

The economic outlook is uncertain, and our policy decisions will be driven by the data and the achievement of our maximum employment and price stability mandates. I am confident that our actions will bring inflation down to our 2 percent longer-run goal.

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[1] Board of Governors of the Federal Reserve System, Statement on Longer-Run Goals and Monetary Policy Strategy, adopted effective January 24, 2012; as reaffirmed effective January 31, 2023.

[2] Federal Reserve Bank of New York, Global Supply Chain Pressure Index.

[3] John C. Williams, A Steady Anchor in a Stormy Sea, remarks at SNB-FRB-BIS High-Level Conference on Global Risk, Uncertainty, and Volatility, Zurich, Switzerland, November 9, 2022.

[4] Federal Reserve Bank of New York, Survey of Consumer Expectations.

[5] Board of Governors of the Federal Reserve System, Federal Reserve issues FOMC statement, March 22, 2023.

[6] In addition, the Committee said it will continue to reduce its holdings of Treasury securities and agency debt and agency mortgage-backed securities, according to the Board of Governors of the Federal Reserve System, Plans for Reducing the Size of the Federal Reserve's Balance Sheet, May 4, 2022.