John C Williams: 'E' is for equipoise

Remarks by Mr John C Williams, President and Chief Executive Officer of the Federal Reserve Bank of New York, at the Council on Foreign Relations, New York City, 6 September 2024.

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As prepared for delivery

Introduction

Good morning. I always appreciate the opportunity to speak before members of the Council on Foreign Relations.[1]

Before I get started, let me 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 (FOMC) or others in the Federal Reserve System.

Just as you'd expect, I'll be speaking today about the "e" word-by which, of course, I mean the economy. I'll talk about where it's headed, and the process of getting supply and demand in better balance and bringing inflation back down to the FOMC's 2 percent longer-run goal. I'll also discuss the progress made toward the Federal Reserve's dual mandate goals of maximum employment and price stability, as well as the path ahead for monetary policy.

The Fed's Dual Mandate

I'll start by discussing where the economy stands right now, broadly speaking.

Since it's back-to-school season, I'll throw out another "e" word that you may find on a middle school vocabulary list. This word is a little less commonly used-at least in my own conversations. And that word is "equipoise."

The definition, according to Merriam-Webster, is "a state of equilibrium." If I were asked to use it in a sentence, spelling bee-style, I'd say: "The significant progress we have seen toward our objectives of price stability and maximum employment means that the risks to the two sides of our dual mandate have moved into equipoise."

This is because supply and demand imbalances have dissipated, labor market conditions have eased from being exceptionally tight, and inflation has come down significantly. Many factors have contributed to this favorable set of circumstances, including the Federal Reserve's strong actions to restore price stability.

The Inflation Onion Is Back

Now let me delve deeper into the two sides of our dual mandate that have moved into equipoise: inflation and the labor market.

We'll go in alphabetical order, so let's start with inflation.

I've been using the analogy of peeling an onion's layers to describe inflation-both how it rose and how it has since moderated.[2] In my "inflation onion," there are three layers. Each layer represents a major category of inflation: prices of globally traded commodities; prices of products or durable goods like appliances, furniture, and cars; and prices of core services.

The sharp rise in inflation that we saw in 2021 and 2022 was in large part due to aftereffects of the pandemic, as well as Russia's war on Ukraine and consequent actions. Once those effects began to dissipate, the layers of the onion started to adjust in turn. While each inflation layer normalized at a different speed, they all moved in the right direction. This broad-based downward movement has brought the overall inflation rate back down closer to our 2 percent longer-run goal.

This disinflation process shows up clearly in the data. The 12-month percent change in the personal consumption expenditures (PCE) price index has declined from its 40-year high of just above 7 percent in mid-2022 to 2.5 percent in July. Measures of underlying inflation, like core PCE inflation and the New York Fed's Multivariate Core Trend inflation, similarly show a sizable decline over the past two years to around 2-1/2 percent today.[3] The decrease in inflation has benefited from a moderation in demand and improvements in supply that together have reduced supply-demand imbalances, both here in the U.S. and internationally.

Equally reassuringly, inflation expectations remain well anchored. The New York Fed's Survey of Consumer Expectations (SCE) shows that inflation expectations have remained in their pre-Covid ranges at all horizons in recent months.[4] Other measures of inflation expectations, both survey- and market-based, give a similar signal. And the Atlanta Fed's measure of business inflation expectations, which reflects the thinking of businesses in setting prices, has similarly returned to levels near its average over the 2012-2019 period.[5]

The disinflation phenomenon is not unique to the United States. Canada, the United Kingdom, and most European economies experienced historically high inflation over the past few years and have similarly seen rapid declines. The global supply disruptions experienced following the pandemic and war in Ukraine amplified the rise in inflation, and the restoration of supply and demand balance has accelerated its decline.

Labor Market

Now let me turn to the labor market. Even as the economy has grown at a solid pace, a wide range of indicators have pointed to a continued normalization in the labor market following the red-hot period in 2021 and 2022. Today, most of these measures have moved from the tightest they've been in over two decades to levels more consistent with the good labor market that existed in the period before the pandemic.

One measure that understandably gets a lot of attention is the unemployment rate, which has risen by nearly a percentage point from its very low reading in early 2023. Still, it remains relatively low by historical standards, and some of this increase reflects

a cool-down in the labor market from an overheated state. In addition, the increase in unemployment has occurred in the context of a strong increase in labor supply, rather than from elevated layoffs.

To get the full picture of the labor market and what it means for monetary policy, it's important to monitor a wide range of data in addition to the unemployment rate. For example, I take the temperature of the labor market by looking at surveys of both households and businesses; the rates of quits, hiring, and job vacancies; and the job-to-job transition rates and flows between unemployment and employment states.

Taken together, these data indicate that the labor market is now roughly in balance and therefore unlikely to be a source of inflationary pressures going forward.

Monetary Policy

What does this mean for monetary policy?

In its July statement, the FOMC said it "judges that the risks to achieving its employment and inflation goals continue to move into better balance", and that it is "attentive to the risks to both sides of its dual mandate."[6] Regarding the path of policy going forward, the Committee said it "will carefully assess incoming data, the evolving outlook, and the balance of risks" and that it "does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent."

The accumulated evidence has increased my confidence that inflation is moving sustainably toward 2 percent. The current restrictive stance of monetary policy has been effective in restoring balance to the economy and bringing inflation down. With the economy now in equipoise and inflation on a path to 2 percent, it is now appropriate to dial down the degree of restrictiveness in the stance of policy by reducing the target range for the federal funds rate. This is the natural next step in executing our strategy to achieve our dual mandate goals. Looking ahead, with inflation moving toward the target and the economy in balance, the stance of monetary policy can be moved to a more a neutral setting over time depending on the evolution of the data, the outlook, and the risks to achieving our objectives.

In terms of the Fed's balance sheet, the Committee began to slow the pace of decline of our securities holdings in June. That process is going smoothly and as planned, and the level of reserves remains well above ample.

The Economic Outlook

Before I close, I'll share my forecast for the other "e," the economy. I expect GDP growth this year to be around 2 to 2-1/2 percent. I expect the unemployment rate at the end of this year to be around 4-1/4 percent, and thereafter to move gradually down to my estimate of its longer-run level of 3-3/4 percent. With the labor market in balance, I expect the process of disinflation to continue. Specifically, I expect overall PCE inflation to moderate to around 2-1/4 percent this year and to be near 2 percent next year.

That's my base case. But it's important to emphasize that the outlook remains uncertain, and I am attentive to signs of a shift in economic conditions. Three areas are particularly in focus. One is the possibility of a significant further weakening in the U.S. labor market. The second is a sharp slowdown in global growth that could spill over onto our shores. And third, the experience of the past year shows that the process of disinflation is not always smooth and can surprise both to the upside and downside.

Conclusion

We've come a long way from the unacceptably high inflation and overheated labor market that we experienced two years ago. Monetary policy has been unequivocally focused on returning inflation to our 2 percent longer-run target. The risks to our two goals are now in better balance, and policy needs to adjust to reflect that balance. Of course, one clear lesson of the past several years is that the future is highly uncertain. Therefore, our decisions will be data-dependent, with a keen eye on the achievement of our maximum employment and price stability goals.

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[1] These remarks were prepared based on data available as of September 5, 2024.

[2] John C. Williams, A Bedrock Commitment to Price Stability, remarks at the 2022 U.S. Hispanic Chamber of Commerce National Conference, Phoenix, Arizona, October 3, 2022; John C. Williams, Peeling the Inflation Onion, remarks at the Economic Club of New York (delivered via videoconference), November 28, 2022; John C. Williams, "Peeling the Inflation Onion, Revisited," Federal Reserve Bank of New York, *The Teller Window*, September 29, 2023.

[3] Federal Reserve Bank of New York, Multivariate Core Trend Inflation.

[4] Federal Reserve Bank of New York, Survey of Consumer Expectations (July 2024 Survey).

[5] Federal Reserve Bank of Atlanta, Business Inflation Expectations, August 2024.

[6] Board of Governors of the Federal Reserve System, Federal Reserve issues FOMC statement, July 31, 2024.