John C Williams: Monetary policy - a "data dependent" approach

Remarks by Mr John C Williams, President and Chief Executive Officer of the Federal Reserve Bank of New York, at the New Jersey Bankers Association's Economic Leadership Forum, Somerset, New Jersey, 18 January 2019.

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As prepared for delivery

Introduction

Good morning everyone. I wish every conference I went to had such an incredible opening—Joe's certainly a hard act to follow. I have a son who's a very talented artist, but he didn't get those genes from me. So I'm going to stick to what I know—monetary policy.

Today I'll talk about the economy, how I'm assessing the outlook, and what that means for monetary policy. It's early in the day, so I'll try and keep the recitation of facts and figures to a minimum. But I know there are a lot of bankers in the room and that the direction of interest rates plays a vital role in your business, so, rest assured, I won't skimp on that topic.

Given that I've promised to talk about interest rates, before I say another word I'll give the standard Fed disclaimer that the views I express are mine alone and do not necessarily reflect those of the Federal Open Market Committee or anyone else in the Federal Reserve System.

The Dual Mandate

I want to start this morning by reminding everyone what the goals of the Federal Reserve are. It's easy to think of the Fed as just setting interest rates, and of course that's a major part of what we do. But we do so in order to achieve two goals set by Congress: maximum employment and price stability. In Fed-speak it's called the dual mandate.

There are serious debates taking place amongst economists and policymakers about what maximum employment actually looks like, and they probably deserve another speech of their own. But I promised not to deluge you with numbers, so I'll focus on a few highlights.

The unemployment rate last year averaged just under 4 percent, the lowest such annual figure since 1969. The latest jobs numbers also showed very strong growth, with over 2.6 million jobs added last year. The ongoing strength in the labor market has led to encouraging gains in wages. No matter how you cut it, the labor market is strong, consistent with our maximum employment goal.

When we say price stability, our goal is to keep inflation around 2 percent.[1] Those of you who are of my generation will remember the runaway inflation of the 1970s and early 1980s. Obviously that's something we must avoid repeating. But the challenge of more recent years actually hasn't been *too high* inflation. Instead, it's been inflation that's persistently *too low*. Over the past decade, inflation has more often than not come in below our goal.

But things are looking better. Underlying measures of inflation have been running just below 2 percent over the past 12 months, and I expect them to be right at 2 percent this year. And I don't see any worrying signs of inflationary pressures building. So, from the perspective of the Fed's dual mandate as a whole, things are looking very good.

Of course, for this healthy jobs market and low and stable inflation to persist, we need solid growth in the economy. While GDP growth in 2018 looks to have been a robust 3 percent, we're hearing anxiety both in the markets and the commentary, about what's to come in 2019.

I wish I could now tell you with certainty what will happen to the economy, but anyone who promises they can see into the future is a charlatan. However, what I can do is provide you with some insight into how I assess the health of the economy and what that means for my view on the monetary policy decisions before us.

Data Dependent

I often say I'm data dependent, and I've talked about the major economic indicators, GDP growth, inflation, and employment. But these headline numbers aren't the only things that inform my view on monetary policy, or the economy more broadly. I'm looking at a whole raft of information about what's going on and where risks may be lurking.

Employment and unemployment numbers provide a useful summary measure of what's happening in the labor market. But "data" doesn't stop there. There are many sources of information on labor market conditions that I regularly consult. They range from very granular data that zero in on individuals' experiences in the labor market, to indices of job openings, how many people are quitting their jobs, and labor market participation, to name a few.

But it's not just these hard numbers that matter. I also find surveys of households and businesses provide valuable and timely perspectives about economic conditions. For example, there's a questionnaire that asks people whether jobs are "hard to get." It's helpful because it gives the perceptions of normal people (and not economists!) about whether there are a lot of open positions. This survey continues to report that it's relatively easy to find work, which is a very good sign about the strength of the economy.[2]

Beyond the economic data and surveys, financial market indicators are a critical source of up-to-the minute information on how investors view the economy. In addition, stock prices and interest rates affect the spending decisions of households and businesses, and the value of the dollar affects demand for exports and imports, so these are important factors shaping the economy's trajectory.

More broadly, I look at a wealth of data on international financial market developments and banking conditions, which feed into my understanding of the global outlook.

Finally, and perhaps least well known, I spend a great deal of time speaking with members of the public, at our Board and Advisory Group meetings, community and business leader forums, and events like today's. I get immense value from their insights, whether it's the challenges they face in filling positions, their plans for capital investments, or how global developments are influencing their decisions. These discussions provide a huge amount of detail and texture to the economic picture. One of the great strengths of the Federal Reserve System is our extensive networks of contacts in our communities, and we share what we learn from these conversations when we meet at the FOMC.

Being "data dependent" means taking this holistic view when thinking about the economy and monetary policy. Not all of these types of data draw headlines the way shifts in the stock market do, but together they provide a much richer and more complete depiction of what's happening. And they also tell me whether the signals we're getting from the markets are reflected in the economy as a whole.

2018 Tailwinds

In thinking about where the economy is heading, it's worth reflecting on where we were 12 months ago.

At the start of last year the message I was getting—from business leaders, economic data, and the markets—was one of overwhelming positivity. This reflected three tailwinds: strong global growth, fiscal stimulus, and quite accommodative financial conditions. Each of these was giving the economy an extra boost. Indeed, these tailwinds provided even more of a boost over most of 2018 than forecasters had anticipated.

Fast forward 12 months and indicators in Europe and Asia point to less optimism about global growth. The initial lift from the fiscal stimulus will likely wane over the course of this year. And financial conditions have become less accommodative over the past several months. In addition, we are now seeing some emerging headwinds to growth from the partial government shutdown in the United States and elevated geopolitical uncertainties abroad.

Other "data" confirm that the winds in our sails have calmed. The headlines have been about investors' concerns around growth, which have contributed to volatility in markets. This is also showing through in surveys of households and businesses, who say that they are somewhat less confident about future economic prospects. For example, the latest Empire State Manufacturing Survey and New York Fed Business Leaders Survey both point to slowing growth in the region. And there is no doubt that my colleagues and I are hearing the same thing directly from our business and financial market contacts, who are more focused on the possibility of a weaker economic outlook this year.[3]

But let me be clear: a softer economic outlook doesn't mean we should prepare for doom and gloom. On the contrary, it's likely we'll see GDP growth somewhere between 2 and 2½ percent this year. That's a step down from 2018, but still consistent with a healthy, growing economy.

Supporting a Strong Economy

So, how should the Fed respond to an outlook of slowing growth and one that's less certain than, say, this time last year? In a word: carefully.

At the start of 2018, when the economy was growing well above trend and interest rates still were still quite low, gradually raising rates was the obvious and necessary choice. Twelve months later, the tailwinds have lost their gust, interest rates are closer to normal levels, and inflation is tame. The approach we need is one of prudence, patience, and good judgment. The motto of "data dependence" is more relevant than ever.

If growth continues to come in well above sustainable levels, somewhat higher interest rates may well be called for at some point. However, if conditions turn out to be less robust, then I will adjust my policy views accordingly.

I assure you that I have my eyes wide open and my ear to the ground when it comes to thinking about how the economic outlook will unfold in the year ahead, and as ever I'll be guided by the data in all its forms.

The Balance Sheet

Aside from my views on interest rates, the other issue I get asked about is the normalization of the balance sheet. When we first announced our plans in June 2017, I was poised to expound on them in great detail.[4] But when I raised the topic I was sorely disappointed to be met with glazed eyes and general indifference. Sadly, nobody seemed to care!

Now that's changed, and I'm getting more interest on this topic.

It's important to remember why the Fed took unconventional monetary policy actions in the first place. Large-scale asset purchases, forward guidance on the future path of interest rates, and seven years where the federal funds rate hovered close to zero, were all measures necessary for the full recovery from the Great Recession.

A decade later and the FOMC has slowly but surely been moving monetary policy “back to normal.” We’ve moved interest rates closer to neutral, scaled back on forward guidance, and are over a year into the process of winding down the balance sheet.[5]

Our goals throughout the policy normalization process have been twofold. First and foremost, to support a strong, sustainable expansion of the economy. Second, to do this in a predictable and transparent way that creates as little disruption as possible.[6] So far, this plan has worked very well, with the economic expansion nearing record duration.

But it is important to stress that if circumstances change, I will reassess our choices regarding monetary policy, including the path of balance sheet normalization. Data dependence applies to all that we do. And, as always, if the outlook deteriorates in a material way, we stand prepared to deploy all our policy tools as appropriate in support of the economy.

Conclusion

I’d like to conclude where I began, with the dual mandate. There’s sometimes a view that Fed policymakers are fixated on two data points: inflation and employment. And the reason is that’s how we’re judged by Congress at doing our job.

But underpinning these is a strong economy, and ultimately that’s what we’re always using monetary policy to support. So, as the year unfolds I’ve got my eyes wide open, looking at the data and listening to experience—whether it’s coming from household surveys, market indicators, or from leaders in my District.

The economy *is* strong, the outlook *is* healthy, and my number one priority is using monetary policy to keep it that way. In short, I’m watching, listening, and prepared to adjust my views depending on the data.

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1 For more information on how the FOMC specifies its goals, see Statement on Longer-Run Goals and Monetary Policy Strategy, Board of Governors of the Federal Reserve System, amended January 30, 2018.

2 This question on whether jobs are “hard to get” is part of the survey conducted by Nielsen for the Conference Board that is used to calculate the Conference Board’s consumer confidence index. Information about the survey, including the latest press release of the index, is available at www.conference-board.org/data/consumerconfidence.cfm.

3 For example, the minutes of the December FOMC meeting stated that “Participants also reported hearing more frequent concerns about the global economic outlook from business contacts” (page 8). Later on the same page, the minutes said “However, contacts in a number of Districts appeared less upbeat than at the time of the November meeting, as concerns about a variety of factors—including trade policy, waning fiscal stimulus, slowing global economic growth, or financial market volatility—were reportedly beginning to weigh on business sentiment.” See Minutes of the Federal Open Market Committee: December 18–19, 2018, Board of Governors of the Federal Reserve System, January 9, 2019.

4 See FOMC issues addendum to the Policy Normalization Principles and Plans, Board of Governors of the Federal Reserve System, June 14, 2017.

5 See John C. Williams, 'Normal’ Monetary Policy in Words and Deeds, September 28, 2018.

6 See FOMC Communications related to Policy Normalization, Board of Governors of the Federal Reserve System, updated June 13, 2018.