John C Williams: The “new normal” for growth

Remarks by Mr John C Williams, President and Chief Executive Officer of the Federal Reserve Bank of New York, at the Community Bankers Conference, hosted by the Federal Reserve Bank of New York, New York City, 4 April 2019.

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As prepared for delivery

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Introduction

Good morning, everyone. It’s a pleasure to be hosting this conference, and I’d like to start by welcoming you all to the New York Fed. I know there’s an opportunity to tour the gold vault later, and I definitely recommend it. There’s something very exciting about our more traditional approach to storing money… even though the gold bars pose certain logistical and practical challenges. If you drop one on your foot you’ll definitely know about it.

Community Banks

I’m going to start today by talking a bit about community banks. Aside from a short period running a pizza restaurant, I’ve spent all of my career in the Federal Reserve System. And I’ve had the opportunity to travel extensively throughout the United States. When you visit communities in more rural or remote parts of the country, away from big urban centers like New York and San Francisco, you really see the value of community banks. In many places you’re the only game in town when it comes to banking services and credit. You know the customers in your community because you are an integral part of the community.

You represent an essential part of our financial system and economy. But I know you didn’t come here today to hear me tell you what an important job you do. What I hope is that I can give you some insights that will be useful going forward.

I know interest rates play a vital role in your businesses, so I’d like to spend a bit of time talking about the outlook and what that means for monetary policy. But before I do, I need to 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.

Where Things Stand

For the last decade we’ve all had our focus on recovery from the Great Recession. The path to getting back on track has been a long one, and there is a sense that the economy has now fully recovered. GDP growth came in at 3 percent in 2018 and I expect it to be around 2 percent this year.

The difference between last year’s numbers and this year’s forecast has caused some concern, and that’s where I’m going to keep my focus. Many people are hoping for GDP growth of 3 or 4 percent, similar to what we saw in the late 1990s. Less optimistic forecasts for 2019 growth are therefore, understandably, a source of worry.

But it’s key to remember that this GDP growth is taking place on a backdrop of historically low unemployment, and low, stable inflation. Unemployment is at 3.8 percent and inflation continues to run just under 2 percent.

The Fed is tasked with two goals: Low and stable inflation and maximum employment. From the perspective of monetary policy things are going very well. And the economic fundamentals indicate that slower growth is—far from a sign of doom and gloom—what we should expect.

The Economic Fundamentals

The 3 percent growth of 2018 was boosted by a number of tailwinds. Strong global growth, fiscal stimulus, and accommodative financial conditions all helped drive GDP growth and a tight labor market.

These tailwinds have calmed, and in fact reversed in some cases. Three developments contribute to this view: a downturn in global growth, heightened geopolitical uncertainty, and the effects of tighter financial conditions.

If you strip away these factors you're left with the underlying drivers of potential growth, which are demographics and productivity growth. Both of these have slowed significantly. Baby boomers are retiring and fertility rates have come down, which has significantly slowed labor force growth relative to past decades. Productivity growth has also fallen considerably from the boom years of the late 1990s and early 2000s.

I put the potential growth rate of the U.S. economy at about 2 percent, which is in line with the forecasts we're seeing for this year.

Of course, a number of different scenarios could play out. Geopolitical uncertainty and other factors holding back growth may recede, and the U.S. economy could resume the robust trajectory of last year. Or GDP growth could continue closer to trend, which is my own forecast. Finally, there's always a chance that downside risks could knock GDP growth off course.

But what the data's telling us is that this period of slow growth isn't an aberration—it's the "new normal" we should expect for the foreseeable future.

Monetary Policy

So what does all this mean for interest rates?

With the economy running close to our dual mandate goals, monetary policy is in the right place.

Looking ahead, the Fed will watch the data and use monetary policy to keep the expansion on track. When growth is well above trend, raising interest rates to keep the economy on a sustainable path is the right decision. Equally, when faced with a crisis like the Great Recession, it's incumbent upon policy makers to use every tool at their disposal to get the economy back on course.

It's important to remember the change in the long-run economic fundamentals means that interest rates are likely to be lower than what we saw in the 1990s, for example. In addition, the slope of the yield curve is unlikely to return to levels typically seen in the past. This "new normal" clearly has implications for banks, large and small.

Conclusion

In conclusion, the outlook is positive. GDP growth is on track, unemployment remains low, and there are no signs of inflationary pressures building. And while many of you will miss the heady days of the 1990s when growth rates were at 4 percent, the economic fundamentals indicate that these are *fundamentally* different times. But I'm optimistic for bankers like you because of your relationships with customers and the role you play in your communities.

Please enjoy the conference. I look forward to joining you later for the luncheon.