John C Williams: No man is an island

Remarks by Mr John C Williams, President and Chief Executive Officer of the Federal Reserve Bank of New York, at the 2019 Asia Economic Policy Conference, Federal Reserve Bank of San Francisco, San Francisco, California, 14 November 2019.

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As prepared for delivery

“No man is an island entire of itself,” wrote the poet John Donne in 1624. Almost four centuries later, his words still ring true. And they are particularly salient when it comes to the financial fortunes of the global economy.

Today I’m going to explore the commonalities and interconnectedness of the global economy, and what that means for the outlook in the United States.

But before I delve into these ideas, I want to say what a pleasure it is to be back at the San Francisco Fed, among so many friendly faces. The Asia Economic Policy Conference is always a fascinating day, and I’d like to thank Mary Daly for the invitation to speak, and Zheng Liu and Mark Spiegel for putting together an outstanding program.

I knew I was back in San Francisco when this morning I spent 20 minutes in line, waiting to spend five dollars on a cup of coffee. This is one thing for which inflation appears to be alive and well.

Before I explore issues like inflation in any greater depth, I should 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 or others in the Federal Reserve System.

The U.S. Economy

If monetary policy represents a set of scales, on one side we have a strong U.S. economy with unemployment near a 50-year low, and on the other, a more challenging and uncertain landscape.

GDP looks to grow around 2 percent this year, and unemployment has stayed at or near historically low levels, boosted by solid job growth. At the same time, the Federal Open Market Committee (FOMC) has moved to cut rates three times. What’s going on?

There are three trends I’ll explore today, which all demonstrate the commonalities and the interconnectedness of the global economy.

The first is the low neutral rate of interest, or r-star, the second is slowing global growth, and the third is rising geopolitical tensions. All are critically important to the long-term prospects of the U.S. economy, and each tells an important story about the conditions we’re experiencing today.

Low R-star

Those of you who know me won’t be surprised that I’m starting with low r-star! The neutral rate of interest—the rate that prevails when monetary policy is neither restrictive nor accommodative—has been an area of study, and a personal passion, for the past two decades.

I could talk about r-star at great length, but you may be relieved to hear that for the purpose of this speech, there’s just one point I want to make: r-star has fallen, not only in the U.S., but around the world.

Fundamental shifts have been occurring in the two main drivers of r-star over the past two decades: demographics and productivity growth. Lower fertility rates and aging populations, as well as slower productivity growth, have pushed down r-star by as much as two percentage points in a number of developed nations.

These structural shifts are having fundamental effects on real interest rates, growth, and inflation. A number of advanced economies have inflation below desired levels and longer-term interest rates that are well below where they were a decade ago.

There are, of course, a few outliers, but the commonalities between the world's developed economies are becoming more and more apparent.

There's no doubt that the U.S. is experiencing first-hand the effects of the structural shifts in demographics and productivity growth. But the fact that these changes are a common experience for so many developed economies creates challenges to our economic prospects at home.

Slowing Global Growth

Which brings me to the second trend I highlighted: slowing global growth. This story—of low interest rates, low inflation, and slow growth—is showing up in the data.

The latest numbers from the International Monetary Fund (IMF) follow the recent trend of steady downward revisions of growth estimates. Their forecast for global growth for 2019 is now 3 percent, which is the lowest since 2008–09, and it's not hard to think of scenarios in which growth slows even further.[1]

In the old days, central bankers used to worry about inflationary pressures being too great. Old habits die hard, and I'm always on the lookout for signs that inflation is rising too fast. But in the current climate it's inflation that's too low that's of greater concern.

You see, my five-dollar cup of coffee masks an inconvenient truth: inflation in the United States is below target and has been for some time.

Beyond sluggish inflation, we're starting to see signs of slower global growth playing out in the U.S. data. While consumer spending is holding up, other parts of the economy—including manufacturing, exports, and business investment—have seen growth stall or experienced outright declines.

Geopolitical Tensions

The third and final issue I want to discuss—the rising geopolitical tensions around the globe—further complicates an already complex picture.

When it comes to the economic outlook, the word of the day—and probably the year—is "uncertainty."

Trade negotiations, civil unrest, and tensions in a number of corners of the world are driving many businesses to take a wait-and-see approach to investment, thus putting a further dampener on growth prospects.

It's notable that later in the same poem I used to open my speech, John Donne writes, "if a clod be washed away by the sea, Europe is the less."

The ongoing uncertainty around Brexit and its eventual outcome is a cause of concern not just for the UK economy, but many of its European trading partners. It's impossible to predict what the spillover effects will be when Brexit finally reaches a conclusion.

We face similar uncertainty on our own shores regarding trade tensions. I frequently hear from my business contacts that they're holding off on making investments until the landscape is clearer.

And the *ongoing* uncertainty in both of these situations, rather than the day to day ups and downs, has become a key driver of business decisions.

Trade negotiations and Brexit are top of mind when it comes to uncertainty. But geopolitical risks and political upheaval are affecting regions across the globe.

It's striking that in almost every corner of the world geopolitical tensions are threatening to put the brakes on growth. Even if the outcomes of current negotiations are ultimately positive—be they between the U.S. and China, or the UK and the European Union (EU)—the uncertainty created by current events is no doubt having a lasting effect on the economic conditions we're experiencing today.

Furthermore, the interconnectedness of our economies means that literally, no man is an island. If one economy starts to struggle, the spillover effects onto others can take hold rapidly.

The common thread of geopolitical tensions is that while they're difficult to predict, they're also impossible to ignore. On a backdrop of low r-star and slowing global growth, they drive businesses to be more cautious, more vigilant, and more conservative in their approach.

Data Dependent, Not Data-Point Dependent

The long-term factors driving low r-star and slowing global growth, as well as the more near-term geopolitical tensions, are afflictions from which we all suffer.

So what's the solution? Where do we as policymakers, researchers, and regulators go from here?

At press conferences I'm often asked: if growth slows by X percent, or unemployment increases by Y percent, will that mean that the FOMC is going to do Z at its next meeting?

If the Fed had a motto, it would probably be "data dependent." When asked about this, it's important to clarify that while I'm data dependent, I'm not data-*point* dependent.

It's not about being guided by one single data point—GDP or job growth—but by all of the data and information that tell us where the economy is, and where the economy is heading. Importantly, it's not about looking at things merely as they are—it's about trying to read how the economy is likely to evolve over the next couple of years, and what risks lie ahead, based on a broad range of evidence.

Monetary policy is a long game. The policy decisions we've made this year will continue to have a ripple effect years into the future. As policymakers, we need to take in how far-reaching those ripples are going to be.

Monetary Policy

The adjustments to monetary policy we made this year were designed to balance maintaining a strong U.S. economy with slowing global growth, and provide insurance against ongoing and potential future risks.

And that's what they've done. The economy is in a good place, and monetary policy is as well. My forecast is for moderate GDP growth, the labor market remaining strong, and inflation moving back to our symmetric 2 percent target. Of course, things can change. Data dependency remains our motto, and if there were a material change to this outlook, we would adjust monetary policy in support of our goals of maximum employment and price stability.

Conclusion

I'll conclude with this. John Donne's words are perhaps more relevant in 2019 than they were in 1624. No man is an island, and no economy can insulate itself—for better or worse—from the fortunes of its neighbors.

At the same time, all economies are having a common experience as a result of longer-term structural changes.

Shifts in demographics and productivity growth point clearly in the direction of low neutral interest rates and slowing growth. We're seeing the reality of these changes in the form of sluggish inflation and interest rates much lower than in previous decades.

Central banks and policymakers around the world need to prepare for economies that are more connected than ever before.

I'll now take your questions.

Addendum

'No Man is an Island'
No man is an island entire of itself; every man
is a piece of the continent, a part of the main;
if a clod be washed away by the sea, Europe
is the less, as well as if a promontory were, as
well as any manner of thy friends or of thine
own were; any man's death diminishes me,
because I am involved in mankind.
And therefore never send to know for whom
the bell tolls; it tolls for thee.

John Donne

[1] International Monetary Fund, *World Economic Outlook: Global Manufacturing Downturn, Rising Trade Barriers*, Washington, D.C., October 2019.