John C Williams: A time of uncertainty

Remarks by Mr John C Williams, President and Chief Executive Officer of the Federal Reserve Bank of New York, at the Griswold Center for Economic Policy Studies 2022 Spring Symposium, Princeton, New Jersey, 2 April 2022.

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As prepared for delivery

Good afternoon, everyone. I'm so pleased to be here at Princeton University. It's great to be able to attend an event like this in person, and to see so many of my esteemed colleagues here today.

Whenever I visit a college campus, I am reminded that some of the concepts I learned as a student can become more meaningful over time, often in surprising ways. I've thought of that as I've reflected on the significant challenges we face today-the ongoing pandemic and the Russian invasion of Ukraine.

In addition to staggering human suffering, these events are imposing considerable economic and financial hardships around the world. If we think back on what many of us learned in statistics about factor analysis, the pandemic and the Russian invasion can be seen as factors that have common effects across countries. But there are also idiosyncratic components that have distinct effects for the U.S. economy.

I'll talk more about that today, as well as give you my views on inflation and the economic outlook. But I want to say at the outset that we at the Federal Reserve are committed to fulfilling our dual mandate of price stability and maximum employment. With inflation too high, we are focused on restoring price stability, while maintaining a strong labor market.

Before I go any further, I should give the standard Fed disclaimer that the views I express here are my own and do not necessarily reflect those of the Federal Open Market Committee (FOMC) or anyone else in the Federal Reserve System.

Shared Impacts

It's striking to think that just two years ago, the U.S. economy was reaching the trough of the COVID-19 recession. Back then, we were living through unprecedented lockdowns. And we had no way of knowing that this would be the shortest recession on record, or that the rebound would be so dramatic.

If we think about the global pandemic as a common factor, shutdowns, contractions, and rapid rebounds were the shared impacts across countries around the world. But so were supply-chain bottlenecks, shortages in semiconductors, and backlogs at ports-issues we grapple with today.

And just like the United States, other countries have experienced imbalances in demand. Since the initial lockdowns, people have spent more of their money on electronics, cars, and furniture-and less on entertainment, travel, and restaurants.

Many nations also showed considerable resilience of economic activity through the Omicron wave. But global risks remain. The BA.2 variant is now fueling a rise in cases in some countries, including China, Hong Kong, and the United Kingdom. Their experiences bear close monitoring. In addition, the war in Ukraine poses significant risks to food and energy prices, as well as to global economic growth.

Uniquely American

Going back to my analogy of factor analysis, there are idiosyncratic components to the pandemic. And I think it's important to note areas where we have had a uniquely American experience in the COVID-19 recovery.

First, the amount of direct fiscal support in the United States was larger than what most other countries provided.[1] This created a sizable cushion for many households, giving them the ability to maintain spending through the pandemic and as inflation started to rise.

In addition, the U.S. labor market has recovered strongly since the recession trough, and labor shortages here have become more acute than in many other countries.

Part of the reason for a shortage of labor is that the U.S. labor force participation rate is still about a percentage point below its level prior to the pandemic, in what has become known as the Great Resignation. A portion of this decline reflects longer-term trends related to the aging of the population. But some left the labor market because they needed to be home to care for young children or elderly relatives. Others didn't want to risk exposure to COVID at the workplace. And many simply chose early retirement.

Despite the challenges presented by the Omicron wave early this year, the unemployment rate fell to 3.6 percent in March, bringing it in line with the very low levels seen before the pandemic. With low unemployment, solid wage growth, and ample job openings, all indicators show that the strength of the labor market is at a level consistent with my view of maximum employment.

Inflationary Pressures

The other side of our mandate is price stability, and this is where our greatest challenge now lies. Inflation is far too high. In February, inflation-as measured by the personal consumption expenditures (PCE) price index-was nearly 6½ percent. And high inflation is a key concern in many countries around the world.

Even before Russia's invasion of Ukraine, the rapid global economic rebound had driven up prices for oil and many other commodities. Higher inflation is especially detrimental for those who are least able to meet the growing cost of essentials like food, housing, and transportation.

The war in Ukraine and the global response present even greater challenges and uncertainty. For example, Russia and Ukraine are large exporters of key materials, including neon, palladium, and platinum. Those materials are used in the production of a wide array of products, from auto parts to computer chips. Even before the war,

manufacturers were confronting shortages of important inputs. Further disruptions to these key products could create spillovers to economies across the globe.

But there are differences in the ways in which countries are experiencing inflation. In the United States, we are now seeing elevated inflation across many categories of goods and services. Meanwhile, in Europe, which is heavily dependent on Russia for energy, rising prices of oil and natural gas are the biggest concern. And in the Middle East, there are fears of a wheat shortage, given the region's reliance on wheat from Russia and Ukraine.

The one bright spot regarding inflation is that longer-run inflation expectations remain well anchored. This anchoring is seen in both market-based measures of expected inflation and in surveys of households and economists. For example, the New York Fed's Survey of Consumer Expectations has fielded special survey questions on five-year-ahead inflation expectations since 2019, and these expectations have hardly budged since the start of the pandemic.[2] In addition, the pass-through of inflation surprises to revisions in three-year-ahead inflation expectations is about half as large as it was before 2020. [3] That is, medium-term inflation expectations in this survey are less responsive to inflation shocks than they were before the pandemic.

Economic Outlook

Faced with rising inflation but otherwise strong economies, the Federal Reserve and other central banks have been moving away from the extraordinarily accommodative stances they took in early 2020. Last year, many emerging market central banks raised their policy rates. In December, the Bank of England followed suit, followed by the Bank of Canada this March.

Closer to home, the FOMC decided a little over two weeks ago to raise the target range for the federal funds rate by a quarter of a percentage point. The FOMC's decision to start the process of reducing monetary support for the economy reflected the strength and resilience the economy has displayed early this year, as well as the very high inflation readings of the past several months. In addition to the decision to raise the target range for the federal funds rate, the FOMC communicated two important messages about the likely future course of monetary policy.

First, the FOMC indicated that it expects that ongoing increases in the target range will be appropriate.[4] Although the FOMC did not make any decisions about future policy actions, its Summary of Economic Projections is informative regarding the thinking on the Committee at the time of the March meeting. The median assessment of the appropriate level of the federal funds rate at the end of next year is expected to be somewhat above the median assessment of its longer-run level.[5]

Of course, these are only forecasts. Uncertainty about the economic outlook remains extraordinarily high, and risks to the inflation outlook are particularly acute. One of the things we've learned from the pandemic is to expect the unexpected. The actual path for policy will depend on the evolution of economic conditions, the outlook, and risks to the achievement of our price stability and maximum employment goals.

Second, the FOMC indicated that it expects to decide at a coming meeting when to begin reducing its holdings of securities. This process will be based on the FOMC's "Principles for Reducing the Size of the Federal Reserve's Balance Sheet" released in January.[6] A key principle is to reduce the balance sheet in a predictable manner primarily by adjusting the amounts reinvested of principal payments received from securities held in the System Open Market Account. I expect that this process of reducing the size of the balance sheet can begin as soon as the May FOMC meeting.

Our monetary policy actions, combined with those of other countries, will help bring demand for labor and products in closer alignment with available supply. As this reduction in demand-induced price pressures takes effect and supply constraints gradually ease, I anticipate inflation readings will begin to decline later this year, although this process will take time to fully play out. For 2022 as a whole, I expect PCE inflation to be around 4 percent, then decline to about 2½ percent in 2023, before returning close to our 2 percent longer-run goal in 2024.

These actions should enable us to manage the proverbial soft landing in a way that maintains a sustained strong economy and labor market. Both are well positioned to withstand tighter monetary policy. In fact, I expect the economy to continue to grow this year and for the unemployment rate to remain close to its current level.

Conclusion

These are uncertain times, and the policy questions we face are challenging. But we have learned the lessons of high inflation from the past. Price stability is essential for sustained economic prosperity, and we are strongly committed to using our tools as needed to achieve our price stability and maximum employment goals.

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[1] International Monetary Fund, Database of Fiscal Policy Responses to COVID-19, October 2021.

[2] Olivier Armantier, Fatima Boumahdi, Leo Goldman, Gizem Koar, Jessica Lu, Giorgio Topa, and Wilbert van der Klaauw, "Have Consumers' Long-Run Inflation Expectations Become Un-Anchored?," Federal Reserve Bank of New York *Liberty Street Economics*, September 24, 2021; Olivier Armantier, Leo Goldman, Gizem Koar, Giorgio Topa, Wilbert van der Klaauw, and John C. Williams, "What Are Consumers' Inflation Expectations Telling Us Today?," Federal Reserve Bank of New York *Liberty Street Economics*, February 14, 2022.

[3] Olivier Armantier, Leo Goldman, Gizem Koar, Giorgio Topa, Wilbert van der Klaauw, and John C. Williams, "What Are Consumers' Inflation Expectations Telling Us Today?," Federal Reserve Bank of New York *Liberty Street Economics*, February 14, 2022.

[4] Board of Governors of the Federal Reserve System, Federal Reserve Issues FOMC Statement, March 16, 2022.

[5] Board of Governors of the Federal Reserve System, Summary of Economic Projections, March 16, 2022.

[6] Board of Governors of the Federal Reserve System, Principles for Reducing the Size of the Federal Reserve's Balance Sheet, January 26, 2022.