John C Williams: Eclipse

Remarks by Mr John C Williams, President and Chief Executive Officer of the Federal Reserve Bank of New York, at the Federal Home Loan Bank of New York 2024 Member Symposium, New York City, 11 April 2024.

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As prepared for delivery

Introduction

Good morning. The Federal Home Loan Bank of New York and the New York Fed share a commitment to supporting economic strength in communities and households in our region. I look forward to speaking more about that in my discussion with President José González in a few minutes.

Before we get to that conversation, I'll spend some time focusing on how the Federal Reserve is working to achieve our goals of maximum employment and price stability. I'll also discuss the significant progress we've seen in restoring balance to the economy and bringing inflation back down to the Federal Open Market Committee's (FOMC's) 2 percent longer-run goal. Finally, I'll share more on the trajectory of the Fed's balance sheet as well as my view on where the economy is headed overall.

Now I need to provide the standard Fed disclaimer that the views I express today are mine alone and do not necessarily reflect those of the FOMC or others in the Federal Reserve System.

The Dual Mandate

I'll turn to the numbers in a minute. But first, by a show of hands, how many of you witnessed the solar eclipse earlier this week? I'll leave the complex explanations of cosmic phenomena to Dr. Massimino, who I expect will give a fascinating presentation later today. But simply stated, an eclipse happens when several things are perfectly aligned. Or, in the immortal words of Pink Floyd, when "everything under the sun is in tune."

Like Monday's eclipse, the Federal Reserve's dual mandate has two goals that need to be in tune with one another: maximum employment and price stability. Restoring price stability is essential to achieving a sustainably strong labor market that benefits all. The overarching objective of monetary policy now is to properly balance restoring price stability and maintaining maximum employment, and the FOMC remains strongly committed to bringing inflation down to 2 percent over time.

Strong Employment, Lower Inflation

The good news is that over the past year we have made considerable progress toward this objective. Demand-supply imbalances have diminished. Global supply chains, which were severely disrupted during the pandemic and early in the recovery, have

mostly returned to normal.[1] And the economy grew far faster than anyone expected last year. Labor supply has been boosted by an increase in labor force participation among individuals aged 25-54 years, as well as by increased immigration flows.

At the same time, the labor market has remained strong. The unemployment rate has been under 4 percent for more than two years, which is the longest stretch at that rate in over 50 years-even longer ago than the release of Pink Floyd's "Dark Side of the Moon."

Inflation has come down substantially, too. The 12-month percent change in the personal consumption expenditures (PCE) price index has continued to decline, falling from its 40-year high of above 7 percent in mid-2022 to 2-1/2 percent in the latest reading.

All in all, there has been tremendous progress toward better balance. But this episode is not yet over, and I am still very focused on ensuring we achieve both of our goals.

A Better-Balanced Labor Market

I'm going to delve further into the trends underlying both sides of our dual mandate, starting with employment.

When the U.S. economy recovered from the pandemic, the labor market turned red-hot. Demand for workers far exceeded supply, and that imbalance contributed to rapid wage growth and high inflation.

Now, the labor market has shown signs of returning to something closer to normal. Nationally, many indicators-such as quits rates and surveys of perceptions of availability of workers and jobs-have returned to ranges seen before the pandemic. The current unemployment rate of 3.8 percent equals my estimate for the unemployment rate that is likely to prevail over the longer run, and job growth continues to be solid.

The story in the Federal Reserve's Second District-an area with similar boundaries to that of the Federal Home Loan Bank of New York-is much like the national one. Our business contacts indicate that here, too, labor demand and supply are moving into better balance. In particular, we are hearing from businesses that it is becoming less difficult to find qualified workers.

Despite the progress in restoring balance, two important indicators point to lingering tightness in the labor market: job openings and wage growth. Job vacancies, which reached record highs in 2022, have trended lower since then, but are still quite elevated relative to pre-pandemic norms. And while we have seen measures of wage growth come down from their pandemic-era peaks, they remain above pre-Covid rates.

Inflation Over Time

On the price stability front, we've seen inflation decline significantly over the past year and a half. This drop has been broad-based, with all major categories of inflation-food, energy, goods, and services-all trending down. The decline in inflation has benefited from a reduction in demand and supply imbalances, both here in the U.S. and

internationally. The resolution of global supply-chain bottlenecks has been a key factor as well. The recent event at the Baltimore port is tragic and may have some local economic impact, but the overall outlook for supply chain issues is still broadly on a good path.

Importantly, inflation expectations in the New York Fed's Survey of Consumer Expectations are now again within their pre-Covid ranges at all horizons, consistent with other measures of inflation expectations.[2]

The Housing Market

One key area of the economy warrants more exploration. This audience knows all too well the unique situation that's playing out in the housing market right now. While restrictive monetary policy is having its usual restraining effects on housing demand, it is occurring amid a period where structural demand for housing has been especially strong. Remote work and other factors drove demand for housing in the aftermath of the pandemic, which in turn has pushed up home prices to elevated levels relative to historical norms. Even so, we're not seeing the types of risks in housing finance that we saw during the housing boom before the 2007-2008 financial crisis.

The strong structural housing demand also has had significant effects on rents, raising broad measures of rent inflation considerably in the aftermath of the pandemic. The restraining effects of restrictive monetary policy have begun to show in more moderate increases in these broad measures. Moreover, data on new rents suggest that rent inflation should moderate further in the coming months toward pre-pandemic norms.

While the residential housing market overall has remained strong, commercial real estate presents greater uncertainty and concern. The underlying value of many office buildings has become less clear, and I anticipate a bumpy process as buildings and investments come to market. In my view, this is not an immediate risk, but the situation will take time to resolve.

Monetary Policy and the Economic Outlook

So, the economy is strong, imbalances are diminishing, and inflation has come down but remains above our 2 percent longer-run target. What does that mean for monetary policy?

Over the past two years, the FOMC has put in place a restrictive stance of monetary policy with the aim of bringing inflation back to 2 percent on a sustained basis. Given the progress we have seen, the risks to achieving our maximum employment and price stability goals are moving into better balance.

At its March meeting, the FOMC kept the target range for the federal funds rate unchanged at 5-1/4 to 5-1/2 percent. In announcing that decision, the Committee said 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."[3] The

economic projections we issued at that time indicate that if the economy proceeds as expected, it will make sense to dial back the policy restraint gradually over time, starting this year.[4]

Taking into account the effects of restrictive monetary policy, I expect GDP growth to be about 2 percent this year, reflecting the continued resilience of the economy and further improvements on the supply side. I expect the unemployment rate to peak at 4 percent this year and move gradually down to its longer-run level of 3-3/4 percent thereafter. I expect inflation to continue its gradual return to 2 percent, although there will likely be bumps along the way, as we've seen in some recent inflation readings. I expect overall PCE inflation to be 2-1/4 to 2-1/2 percent this year, before moving closer to 2 percent next year.

As has been the case since the onset of the pandemic, the outlook ahead is uncertain, and we will need to remain data-dependent.

The Fed's Balance Sheet

I'll now spend just a moment mentioning the Fed's balance sheet.

In May of 2022, the FOMC laid out its plan for reducing the size of the balance sheet.[5] The execution of that plan is proceeding as we had envisioned, with securities holdings decreasing and take-up at the overnight reverse repurchase facility declining. Federal Reserve staff continue to monitor several indicators of abundance of reserves, and they all signal that the current level of reserves remains safely far above the level consistent with the FOMC's ample reserves regime.[6] We've so far reduced the size of our balance sheet by about $1.5 trillion. The next step in the execution of the plan will be to slow the pace of decline in our securities holdings.

While the Committee made no decision at our recent meeting, most FOMC participants said it would be appropriate to slow the pace of runoff fairly soon, consistent with the plans we previously discussed.[7] The decision to slow the pace is in no way indicating an imminent cessation of shrinking the balance sheet. Rather, by slowing the pace, we're better able to monitor conditions and facilitate a smooth transition to ample reserves.

Closing

I'll close by saying that price stability is the bedrock upon which our economic prosperity stands. The economy has come a long way toward achieving better balance and reaching our 2 percent inflation goal. But we have not seen the total alignment of our dual mandate quite yet. I am committed to achieving maximum employment and price stability over the long term.

Therefore, I will remain focused on the data, the economic outlook, and the risks as we evaluate the appropriate path for monetary policy to best achieve our goals.

Thank you.

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[1] Federal Reserve Bank of New York, Global Supply Chain Pressure Index.

[2] Federal Reserve Bank of New York, Inflation Expectations are Mixed; Consumers Express Concerns about Retaining and Finding Jobs, April 8, 2024.

[3] Board of Governors of the Federal Reserve System, Federal Reserve Issues FOMC Statement, March 20, 2024.

[4] Board of Governors of the Federal Reserve System, Summary of Economic Projections from the March 19-20 FOMC Meeting, March 20, 2024.

[5] Board of Governors of the Federal Reserve System, Plans for Reducing the Size of the Federal Reserve's Balance Sheet, May 4, 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.

[7] Board of Governors of the Federal Reserve System, Minutes of the Federal Open Market Committee, March 19–20, 2024; Board of Governors of the Federal Reserve System, Transcript of Chair Powell's Press Conference, March 20, 2024.