Fed Unfiltered, Transcript
4/14/22 – John Williams, Interview: Bloomberg

Michael McKee:

We just got retail sales numbers. Inflation boosted sales up half a percent. What's your take on... I know you've looked a little bit at the numbers on this. Are we seeing any decline in demand?

John Williams:

Well, first of all, it's great to be here in person, Mike. It's nice to be able to do this today. We are seeing, I think, some early signs that consumers are shifting their purchasing patterns, coming out of the pandemic away from all the purchases of goods of the past few years and more to services. I won't respond too much to one month of data, but I do think that's a pattern I'm expecting to see continue during the year. And I think it's a very important part of this story is to see consumers, as we get past the pandemic, be able to move back to more normal patterns of spending. So we'll have to watch that data carefully, but that is a trend I am looking to see this year.

Michael McKee:

Well, it's been interesting over the last week or so. A number of your colleagues have seemed more concerned about the pace of inflation and have suggested they're changing their mind about how quickly you should do that. Are you still believing that you can do this at a measured, slow pace?

John Williams:

Well, I don't think we're going to do our policy adjustment in a measured, slow pace for sure. I do think, with very high inflation, we need to really focus on bringing inflation down to our 2% longer run goal and to do that over the next few years. So that is the number one focus and I say that because the economy is strong. The labor market is basically back to close to where it was before the pandemic, with the unemployment rate around three and a half percent and other indicators showing that we have very strong demand for labor. So I do think from a monetary policy point of view, it does make sense for us to move expeditiously towards more normal levels of the Federal Funds Rate and also to move forward on our balance sheet reduction plans.

Michael McKee:

If there was one phrase that sums up where your colleagues are, it's "Get to neutral by the end of the year." Would you be on board with that?

John Williams:

I do think we need to get back to a more neutral and normal level of the Federal Funds Rate, whether it's at the end of the year or... Exactly when that happens, will depend on the data. We will continue to be data-dependent. But given where the economy is, and especially given where inflation is, we really do need to reverse the policy actions that we put into place back in March of 2020, move that forward, and move the Federal Funds target to neutral. And again, whether it's by the end of the year or exactly when it happens, I think that will depend on the path of the economy. But yes, I agree with that.

Michael McKee:

So 50 basis points on May 4th.

John Williams:

Well, that's not a decision we made yet, but I do think that-

Michael McKee:

Well, you can make it right now.

John Williams:

That's not a decision we made yet, Mike. But I think that's a reasonable option. I think that for us, because the Federal Funds Rate is very low. We do need to move policy back to more neutral levels through this year. And I think that's a very reasonable option.

Michael McKee:

Speaking of neutral, what do you think neutral is these days? You were the guy who invented along with the late Tom Laubach, the R-star concept measurement, and that's the key indicator for what neutral might be.

John Williams:

So it's hard to know, as I always start any question on the neutral interest rate with it's an uncertain thing, it's something we don't measure directly. We have to infer it from other indicators. Coming into the pandemic, our estimates, most estimates of neutral were quite low. And I think that's consistent with my colleagues, the FOMC's view that a normal, nominal Federal Funds Rate probably around two and half percent.

John Williams:

So I think about, "Well, where is it today?" The economy is being pushed around to supply and demand dramatically by the pandemic, obviously, the invasion of Ukraine and other factors are moving the economy around. But then I go back to what are the longer run drivers of a neutral rate? And economists, I think, have studied this pretty carefully. They've identified demographics, productivity growth, global demand for the safe assets like the U.S. Dollar. I don't think those have fundamentally changed since before the pandemic.

John Williams:

So I guess my baseline assumption is a neutral, nominal Federal Funds Rate in the long run is probably still in the very low 2% to two and half percent range. So I don't think that's changed, but again, we have to have an open mind and see how we can follow the data.

Michael McKee:

How far above that do you think you might have to go to bring inflation down?

John Williams:

I think that's a really important question. As we get back to neutral, nominal neutral levels that we have to, I think to do two things. One is we have to keep focus on real interest rates. So it's not just a nominal interest rate of the Federal Funds Rate, but where's inflation. So I do think that we will need to get real interest rates meaning nominal interest rates, adjusted for inflation or expected inflation back to more normal levels by next year. And we may need to go a little bit above that depending on where inflation is. I think the economy right now has a lot of good momentum. I think the economy can withstand neutral or real interest rates or at neutral or a bit above, but the decision, those decisions will be made in the future, depending on how the economy evolves.

Michael McKee:

Well, where is inflation these days, the general consensus of analysts coming out of the CPI report this week was inflation has peaked.

John Williams:

Well, I'm not going to make a prediction about whether inflation has peaked because clearly food and energy prices have been quite volatile and affected by the situation in Ukraine. The oil prices could go back up. They're volatile. So I don't know about peaking. I do think that my view is with monetary policy, reducing the imbalance between supply and demand and the economy that's by bringing interest rates back to more normal levels. That's going to bring demand in the economy back to close to the supply with some of the supply chain issues gradually being resolved, and also this rebalancing between goods and services. I do think that the underlying trend in inflation is probably going to peak soon, hopefully, and start coming down later in this year.

Michael McKee:

The BlackRock analysts' world's largest asset manager say that you can't raise rates high enough to bring inflation down to 2% in the short run without an unacceptable level of unemployment. How high are you willing to go on unemployment? They also suggest you may just learn to live with 3% inflation instead of two.

John Williams:

Well, I'll start with the last part where I don't agree with that. We have a 2% longer run goal. We've discussed that thoroughly. That is our long run goal, and that's what we're going to stay with. So we're going to get inflation back to 2%. In terms of the unemployment and the risks there, clearly this is a period of great uncertainty. This is a challenging circumstances to conduct monetary policy, bringing inflation down while trying to keep the economy, the labor market strong. I think we have a couple of advantages over previous episodes. So one is where is the economy?the strongest? Where are we seeing the kind of demand exceeding supply? It's really in the interest sensitive sectors. It's in durable goods, in autos, in housing. And so as we brought up expectations of interest rates, as yields have moved up, mortgage rates have come up, that's going to help bring down that excess demand for that sector relative to supply.

John Williams:

So I think that our monetary policy tool, this time of interest rates is actually really well suited for the imbalance we have in the economy. So I think that's an important point to remember. The second is we have a very unique situation with the demand for labor, obviously much stronger than the supply, so the goal here would be to reduce that excess demand. We see it in the record number of job openings. For example, let's get the number of job openings down to a level that's consistent with maximum employment. So I don't think we have to decrease employment or raise unemployment so much is just take the froth if you will, out of the economy and get in on a more sustainable basis.

Michael McKee:

So you disagree with your predecessor at the New York FED, Bill Dudley, who said you can't achieve a soft landing?

John Williams:

I think we can achieve a soft landing. I think this is a unique set of circumstances, as we've talked about with the pandemic and with the Russian invasion, Ukraine creates a unique set of circumstances. Well, it's not going to be easy. I'm not going to pretend this is a monetary policy and this type of situation, everything goes exactly according to plan, but I think we are in a good place with monetary policy. We've seen a dramatic, significant movement in yields and financial conditions over the past several months. And that's already positioning, I think, policy well to get supply and demand kind of back into balance and to set us up for bringing inflation down over the next couple years.

Michael McKee:

I have to ask you about the balance sheet. Obviously you're going to make that decision, Lael Brainard suggested you announce it in May and it starts in June. Is that your anticipation?

John Williams:

Well, again, not a decision we made, but that is what I would expect. I think we should get the balance sheet reduction process underway. We've set out the principles around that. Those are, I think really important and we worked hard on coming up with a good plan for that. So yes, if we do make the decision at the main meeting, technically that process of reduction would start at the beginning of June, but it would obviously continue for quite some time as we get the balance sheet down to.

Michael McKee:

Two quick follows on that. One, what is your estimate of the impact on rates from reducing the balance sheet and two, what would trigger sales of mortgage backed securities? You said you might do that.

John Williams:

Yeah. So this question about what's... How do you convert balance sheet reduction into a, well, how big of a change in the federal funds target is that equal to? I think is really hard. I think the way I think to calculate that kind of number, given all the uncertainty and given that the balance sheet policies affect the economy in different ways than normal say moving the federal funds target. The way I think about it is that as we reduce the balance sheet is we've announced doing that. You're seeing basically upward pressure on longer term interest rates and the term premium. And we are seeing that in the data. If you look at a five year, five year four rates in the treasury yield curve, look at 10 year rates. Clearly we've seen over the past several months movements up in those rates, which I think reflect the market's expectation that we're going to conduct the balance sheet reduction.

John Williams:

So I see that as primarily the channel by which it affects things, it raises mortgage rates. It affects longer term yields, which affects borrowing costs. So we're seeing that happen. I think a lot of it has happened because it's through the expectation of our future action. That's in parallel, obviously with our short rate, the path of Federal Funds Rate, which is also removing monetary accommodations. So important point here, I think is both of these are happening at the same time. Financial conditions are being adjusted pretty significantly with both of these tools.

John Williams:

In terms of MBS sales right now, the first part of the plan is really doesn't incorporate sales. It's really about laying the balance sheet fall kind of organically, or be reduced through an organic process. And I think that's where we need to be focused. So to me, the first stage is really getting the size of the balance sheet down. There is this longer term issue. We got to also want to get the composition of the balance sheet to be primarily treasuries. So I see further down the road, once we've got the balance sheet reduction well underway, is a time where we can contemplate, "Well, do we want to add to the mix some sales to really get the long run composition, right?" But that's not a decision for now.