Speaker 1:

Welcome back. Markets falling today despite the pace of inflation easing. Investors are hoping for a jobs number that is just right tomorrow. Then with the Fed, a slow rate hikes, but they don't want to see signs of a recession. Edward Lawrence at the New York Federal Reserve with an exclusive interview with the Federal Reserve Bank of New York president John Williams. Edward, take it away.

Edward Lawrence:

And Cheryl, yeah, we are in the museum part of the New York Federal Reserve. And joining me now is that very special guest we talked about is John Williams, the president of the New York Federal Reserve. Thank you first of all for being here. I want to jump right in with inflation. You had said earlier this week that inflation, it would take a long time to get to that 2% target. How long are we talking?

John Williams:

Well, first of all, welcome to the New York Fed and welcome to our museum here. It's great to be here with you. So inflation, first of all, is the number one problem we're facing in terms of the monetary policy. It is far too high. Today, the latest reading showed the PCE inflation rate. The one that we're focused on is at 6.0% and we want it to be 2%. So to answer your question, we need to get from six to two. Honestly, I think this is going to take a couple years. My hope is that we will be at our 2% inflation goal by 2025. But importantly, I expect to see a pretty significant decline in inflation next year as supply chain issues improve as we see the slowing economy, the economy getting better and balance bringing inflation... start bringing inflation down actually over the next year. But it's going to take a couple years to get all the way to 2%.

Edward Lawrence:

So at the end of 2025. So the Federal Reserve chairman yesterday said that with all of the tightening that the Federal Reserve has done, he's surprised basically that the inflation rate hasn't come down more than it has, it's moved sideways, at least in the core rate. Is it entrenched and how entrenched is it?

John Williams:

So I don't think it's entrenched. I think what we're seeing is a wide variety of factors influencing inflation. One way... one point I would make is high inflation is true in almost all countries. We're seeing in Europe, the America's, Asia, around the world. So there are global factors that have driven inflation up partly due to the pandemic, partly Russia's war in Ukraine. So I think there are a wide variety of factors that have affected that. Inflation expectations based on surveys, based on market measures, other things that we look at seem to be really well anchored at our 2% goal. So I think our job is just to get supply, demand back in line with supply and bring inflation back down to 2% so that it doesn't become entrenched.

Edward Lawrence:

You talked about this PCE number, which is at 6%. Has it peaked? Has inflation peaked now and are we on the downside?

John Williams:

Well, the overall inflation number, I'm not going to get... I don't know if it's peaked because that depends on some volatile prices like food and energy, which have been affected by global developments. I do think we're starting to see some signs on inflation measures that are moving in the right direction. Commodity prices have come down, we're finally seeing some used car prices come down. We're seeing some other indicators on rents, new lease rents. So we're some forward looking indicators. The inflation is turning. Of course, it's hard to predict the future and there's a lot of factors that affect inflation. But I do see we're moving now and into next year with a lower inflationary trend.

Edward Lawrence:

The Fed Reserve chairman also made the point about the labor market causing inflation. He said this and I'm going to read it. So this is a great labor market in that sense. It is too great in a way because it's going to be adding to inflation. Are we seeing a wage price spiral here then starting?

John Williams:

I don't think we're seeing a wage price spiral so much. What we definitely are seeing signs of is a very, very strong demand, excess demand, if you will, very strong demand for labor. So we're seeing huge number of job openings, people quitting jobs and very high wage growth. To me, those are indicators that demand is just far exceeding supply. We need to get demand and supply back into equilibrium, and then wage growth will come down to being consistent with our 2% inflation goal. So I'm not seeing a spiral so much, it's just really a lot of signs that the labor market still is not only very strong, but the demand just is far greater than available supply.

Edward Lawrence:

So is labor then pushing inflation a little bit? The labor demand?

John Williams:

I think the very strong economy, demand for goods and services, demand for labor, these are all connected, of course, these are all driving the broad based high inflation we've seen. We get the economy better in balance and that means tighter monetary policy as part of that, to get demand more in balance means that we'll see inflation come down.

Edward Lawrence:

What about government spending? What kind of headwind is government spending? And one of the reasons I say is in the PCE report today, it's at an increase in current dollar personal income in October. Primary reflected increases in compensation and government social benefits. Much of a headwind is government spending to what you're trying to do.

John Williams:

So I think right now the government spending is not a big part of the inflation going forward. Clearly the support for households and businesses was a big part of getting through the pandemic, big part of the big economic picture. But right now I don't see that as the primary issue. I see really as an issue of the global factors influencing commodity prices and demand, the supply chain issues which are getting better. And then this fundamental fact that demand is exceeding supply. But we know how to deal with that and that's what we're dealing with.

Edward Lawrence:

But what about going into next year? I mean, you've got $4 trillion basically with the American Rescue Plan, bipartisan infrastructure, CHIPS Act inflation reduction, and that money is going to continue to come working against what you guys are trying to do.

John Williams:

Well, I think that obviously fiscal policy, other things are kind of in the background of the factors that are influencing the economy. Our job is really just to focus on given the economic outlook, given the strength in the economy and in the inflation outlook. What do we need to do to get basically monetary policy to a sufficiently restrictive stance to bring inflation back to 2%? That's what we've been doing through this year and that's what we're going to need to continue to do in order to bring inflation under control and bring it back down.

Edward Lawrence:

And on that six rate hikes this year so far, you talked about... or the Federal Reserve chairman talked about moderation. So are we looking at 50 basis points then in December or maybe 25 basis points?

John Williams:

Well, we've been doing 75 basis point increases, which by historical standards are very large increases. We needed to get the stance of monetary policy moving very quickly towards a restrictive stance. When I think of slowing that pace, I think it's taking a step down in that pace. I still think we have a ways to go in terms of where the Fed funds target is and where we need to get it to next year in order to get the sufficiently restrictive stance. So to my mind, if we're, at least in the near term, slowing the pace means maybe stepping down one step in terms of that pace.

Edward Lawrence:

And you talk about where is the neutral rate. Where do you think the federal funds rate needs to be to get in front of inflation?

John Williams:

Well, I always think about this in terms of inflation adjusted interest rates. You can't think of the Federal funds rate alone. You have to think about in the context of what's happening with inflation. So my view is we need to get the Federal funds rate above the inflation rate and it's sufficiently above the inflation rate to basically putting downward pressure on inflation.

Edward Lawrence:

Is that 5%?

John Williams:

It will depend on how the economy performs, how inflation performs next year. But I definitely see us needing to get... we still have further work to do to get from where we are.

Edward Lawrence:

And one last quick question I wanted to ask you about, interest rate hikes next year. Do you believe... we're hearing about moderation, you're hearing a step down you're saying in December. So then are we looking at a January rate hike? Are we looking into February, March, April?

John Williams:

So if you look at the projections that we made at the FOMC in September, and I think the data flow that we've seen since then, we still have ways to go beyond whatever we'll do in our upcoming meeting this month in order to get to that sufficiently restrictive stance. Exactly what that number means, it's going to depend on the data. This is a mantra I've been saying for a long time. We have to be data dependent. We have to be really driven by how the economy's performing and how do we best get to that 2% inflation goal.

Edward Lawrence:

So possibly more rate hikes in the future, maybe a step down in December. Cheryl, we'll send it back to you. You got a lot of news, a lot of things to chew on here... back there. Go back to you.

Speaker 1:

Good for you for asking. 25, 50, 75? Great question. Edward, thank you very much. All right.