Speaker 1:

Let's start with the meeting this week, and what came out of it, because we got the move up to the restrictive rate, that was even more restrictive than people thought. Inflation has stayed high. It's proved hard to get down, probably harder than you thought it would-

John Williams:

Yeah.

Speaker 1:

... just a few months ago. With these dots, with this position now, do you think you've finally caught up to where you need to be?

John Williams:

Well, I think we're well on our way there, and I think when you look at the central tendency of the dots, my colleagues expect the Fed funds rate to get to, say, 5% to 5.5% next year. I think that gets us into that hopefully sufficiently restrictive stance of policy that will bring inflation back to 2%. So, I am getting increasingly confident that we're getting closer to that point, but obviously we have to watch the data. The inflation and other data have surprised us, and we need to be on the lookout for that, but I do feel we're getting to a better place.

Speaker 1:

Now, just about two weeks ago, you said that the Fed funds rate has to get above the inflation rate-

John Williams:

Yep.

Speaker 1:

... to bring down inflation. How far above inflation does it have to get?

John Williams:

Well, that's the question, in a way. We talk about this in terms of sufficiently restrictive to bring inflation back to 2%. So, to me, it's really about getting it high enough and of course, keeping it high for a while, for enough time to really see clear signs inflation is moving back down on the way to 2%. My view is you have to think about real interest rates, as you said.

If you look at, again, the median dots, if you will, in the economic projections we just put out, you see the real Fed funds rate, say the Fed funds rate minus the core PC inflation, around 1.5%. I think that's a reasonable view of 'restrictive'. Again, whether it's sufficiently restrictive, we'll have to watch the data and see, but I think that's, to me, basically where I'm thinking right now.

Speaker 1:

Now, there's many top economists, former Fed officials even, who are saying it's looking more and more like you are going to have to go higher, even than where you are now. Maybe something like six, maybe something heading towards 7%. Could you see that happening, and what circumstances, what would be happening for that, you have to go ahead like that?

John Williams:

Well, that's definitely not my baseline, as I just indicated. I don't think we'll need to get real interest rates that high. But of course, things could happen differently than we expect and we'd have to... especially around inflation, but also how strong is the economy even with higher interest rates? Do we still have these imbalances between supply and demand right now?

PC inflation is 6% over the last 12 months, and we have clear signs that demand exceeds supply in our economy and our labor market. So to me, the question of how high we have to get to is really going to depend on what we see in inflation, and the supply-and-demand imbalance. Again, my base case is we don't have to get that high. I think we have some favorable developments underway, things that we've been talking about for a long time.

Supply chains definitely are getting better around the world. We're seeing that in a lot of different data, and we're also seeing some of the goods prices and import prices come down, a reversal of some of those pandemic era things that pushed up inflation. So, we've got a few factors, I think, are going to bring inflation down to 3% to 3.5% next year. But then, the real issue is, how do we get it all the way to two?

Speaker 1:

Right, of course it is, but right there though, is the message from Wednesday that... and this ties in with maybe we might have to go higher... is the message that if it's not coming down as we expect, then we are clearly open to going higher, taking the next step?

John Williams:

Well, we're going to have to do what's necessary. Again, sufficiently restrictive to bring inflation down to 2%, and it could be higher than what we've written down, and we have had to increase our interest rate projections as the data have come in. Inflation has been stubbornly high, as many people have said, and we've seen the economy remain very resilient to higher interest rates. Remember, the unemployment rate is 3.7%. Some signs of slowing demand for labor, but still a very, very strong imbalance between supply and demand right now.

Speaker 1:

There were two surprisingly good CPI reports going into this meeting, and so a lot of people thought, "Well, good news for the Fed. You know, maybe they're not going to be quite as aggressive." But at the same time, what happened? 2023 inflation forecast, boom, goes up. How did this happen? What's guiding your view on inflation? Again, two good surprises on CPI, and yet the PC core and PC overall still expected to rise.

John Williams:

Right. Again, relative to, say, our earlier projections in September. I think that you really have to think about what's happening in the inflation data. We are seeing good news. I like good news on inflation reports. A lot of that's in the goods areas, so some of the areas we've been long expecting those inflation rates to come down.

That's something that we've been expecting to see as part of the baseline forecast. Where inflation is still high is in these core services areas, the areas that are probably going to be more persistent, and really reflect the imbalance between supply and demand in the labor market and in our overall economy. So, sure, we are seeing some good signs on goods and some other categories.

I'm also seeing some good signs in the rents for new leases of apartments and houses. So, that inflation should eventually start coming down later, in the latter part of next year. But again, in these other core services, that inflation rate is still high, and that really gets to how strong the labor market is. So, sure, some good news, but the underlying issue of core services inflation is still very much there.

Speaker 1:

Well, your forecast for unemployment next year is a big jump.

John Williams:

Mm-hmm.

Speaker 1:

You see it much weaker, up to almost a full percentage point from what you were looking at in September, to 4.6%.

John Williams:

Mm-hmm.

Speaker 1:

You're looking for GDP to be much weaker than you thought three months ago, down to 0.5%. Is this the kind of forecast that is consistent with a soft landing? Is it consistent with something maybe not quite that good?

John Williams:

Well, I think it is an economy that's continued to grow. As you pointed out, the median dot is around half a percent growth for this year, and for next year. So, it's an economy that's growing. It's an economy where the unemployment rate is rising somewhat. As you mentioned, the median would be at 4.6% at the end of next year. So, I don't see this as a recession. We're clearly not in a recession right now, based on the data. It is an economy that is growing, but only modestly, and I think it's an economy that's really seeing the imbalance issues between supply and demand diminishing, and inflation coming down.

Speaker 1:

The retail sales were weak across the board, pretty much. Is this a canary in the coal mine for where the economy is heading, in a part of the economy? You want to get final demand down.

John Williams:

Right.

Speaker 1:

Is this maybe an early sign that you're succeeding?

John Williams:

Well, we have to look at all the data on that. Obviously, where we're seeing the signs of the economy slowing is in the housing sector, and now in manufacturing. Consumer spending has been jumping around a bit month and month, quarter to quarter. It's actually been more up until this latest data, more resilient perhaps than I was expecting. So, we just have to go through all that data, and really see the underlying strength in the economy. That data doesn't change my basic view that we're going to have an economy growing modestly over the next year.

Speaker 1:

You're talking about the services ex-housing, right? Core services ex-housing, seems like it's the key indicator now. We have to see that coming down for the Fed to be convinced that inflation's moving in the right direction.

John Williams:

Well, I think it is most closely related in many ways to the state of the labor market and domestic price pressures. At least some of these other categories... which of course are part of the inflation index, we don't ignore any of them... but they really are about the special factors.

Speaker 1:

Right.

John Williams:

Car prices that skyrocketed.

Speaker 1:

Sure.

John Williams:

Transportation costs and things like that. Then, I think the housing market, we're already seeing some good indicators eventually-

Speaker 1:

Right.

John Williams:

... of that coming down. This is the area that's not coming down, and we definitely needed to see it coming down to get to that 2% inflation call.

Speaker 1:

So, a lot of focus on labor, and wages in that part of it. Right? That's what's important, that's what Chair Powell pointed out this week. So, do you think that there are signs of a wage-price spiral right now? Is that one of your concerns? Again, and when you look at CPI's coming down, that's good news, but boy oh boy, the trend is still too much up for us.

John Williams:

Yeah. I don't see any signs of a wage-price spiral of the kind that we saw in the 70s. A couple of data points I'd point to. One is inflation expectations have been coming down. They've been really well anchored for longer-run expectations, but we've also seen in our New York Fed survey and in the Michigan survey, shorter-term inflation expectations coming down. So, I think that we're not seeing that dynamic kick in of people expecting higher inflation, demanding higher... or wage increases because of that. The other is, I really see wages as kind of the barometer, one of the barometers of the strength of the labor market, about demand and supply.

Speaker 1:

Right.

John Williams:

I think wage growth has been very high because labor demand has been really strong relative to available supply. As labor demand and supply get better, in better balance, I think the wage gains will be more consistent with longer-term trends and our 2%.

Speaker 1:

What do you make of the Southwest Airlines contract that was just signed? They're going to get a 24% increase in wages over the next, what is it, five years? Four years, excuse me. Is that a concern?

John Williams:

Well, we're seeing a lot of adjustment in wages around the country. I'm not going to point to any specific one. Again, wage increases right now, given where inflation has been, given where the labor market is, are still quite high. So, we're watching those indicators. To me, it's really about tracking how the economy does over the next year. Labor demand and supply, and wages.

Speaker 1:

[inaudible 00:09:40] focus on financial conditions.

John Williams:

Yeah.

Speaker 1:

Chair Powell noting that the markets and the Fed seem to be working at cross purposes a lot of the time lately. Are you concerned about this push-pull between the Fed and where it's trying to lead, and where the markets want to go?

John Williams:

Well, I think we need to be... and we are being clear on what we're trying to, what we're going to achieve, and how we're going to achieve it. I think the economic projections and the dot plot we put out provided a nice roadmap of how we're seeing the economy and monetary policy over the next couple of years. Obviously, financial conditions depend on a lot of other things than just monetary policy.

So, I always look at a broad set of monetary policy... sorry, financial conditions, understand how that feeds into our outlook. Right now, I know that a lot of... some market participants clearly are more

optimistic about inflation coming down. I look at the real interest rates implied by that. I think pretty much everyone understands that real interest rates need to get restrictive and stay there for a while.

Speaker 1:

Is that an issue for the Fed, though? When you're trying to move policy in a certain direction, you want to tighten, and if the markets rally and then financial conditions soften for whatever interpretation markets are taking, is that an issue? Does that make the job harder?

John Williams:

It doesn't make the job harder, but it's just another one of those factors. Like what's happening to the global economy, a lot of things that have to feed into our view of where the economy's going, and then what we need to do. Clearly, to the extent that financial conditions have tightened quite a bit over the past year, consistent with our moving to a restrictive stance of policy, that's an important part of the transmission of monetary policy in the economy.

Speaker 1:

In keeping with that, I want to ask you one last question, because we are hearing this a lot. That the Fed let inflation get out of control for whatever reason, and that this may have eroded the credibility of the Fed with the markets. How do you respond to that?

John Williams:

Well, we are absolutely committed to getting inflation back to our 2% goal, and we're acting in that way. I think we're communicating in that way. So, I don't think we've lost the credibility, of course, at all. I do think that we are completely united in our focus on getting inflation back to 2%. We've taken extraordinarily strong policy actions over the past year, and as we've shown, we're going to continue to take the actions that are needed to get inflation back to 2%. Price stability is absolutely essential for a strong economy in the long run. We need to get that done, and we will.