Julie Hyman:

The Federal Reserve finds itself in an increasingly tough environment as it looks to fight inflation, navigates slowing job growth, and preserve overall financial stability. The March Jobs Report offered the latest glimpse into the state of the labor market while traders are anxiously awaiting tomorrow's inflation data for more clues on the Federal Reserve's path ahead. Let's get over to Yahoo Finances' Jennifer Schonberger. She's sitting down for an exclusive interview with the New York Federal Reserve President John Williams. Jen, take it away.

Jennifer Schonberger:

Good morning. I am indeed here live at the New York Federal Reserve with the president of the New York Fed and Vice Chair of the Federal Open Market Committee, John Williams. President Williams, thank you so much for sitting down with me and for having me here at the New York Fed.

John Williams:

Well, it's great to be here and welcome here to the bank.

Jennifer Schonberger:

Thank you so much. I want to kick off the conversation with your reaction to the March Jobs Report. We saw the nonfarm payroll number cool off a bit from those blowout numbers back in January and February. At the same time, temp jobs went down by 11,000, and job openings have fallen to the lowest level in two years. While still strong, it doesn't give you any assurance that the job market is starting to come back into balance.

John Williams:

Well, we definitely see some slowing in the demand for labor as you just pointed out. Job openings have come down gradually, but they're very high still relative to history. Unemployment of course is very low at 3.5% and job growth is still quite strong. And in fact, when you do look closely at the data from the past few months, we had unusual weather patterns. I guess when I look at that, it seems like job growth is actually quite strong still even in the latest data. So yes, we are seeing some slowing in the demand for labor, but the demand for labor is still very strong. Labor market is still very strong.

Jennifer Schonberger:

How much do you think of this is structural given some of the trends we've seen from the pandemic?

John Williams:

Well, I think some of it I think is still related to the pandemic. The labor market and the economy have had to adjust to the shifts in demand and supply that we've seen over the last few years. And I would add to that the Russia's war and Ukraine. So a lot of factors have affected the US economy and the labor market. In terms of structural, I think one of the things we are still watching for is a lot of people who retired earlier than unusual. Will they come back in the labor force or is there some change in their decisions that they've made going forward? Other than that, I don't really see that this is really fundamentally being structural, but more just a reflection of the highly unusual patterns we've seen in the economy last couple years

Jennifer Schonberger:

So then given your assessment of the job market and new developments we've seen with OPEC cutting back on oil production, how does that inform your outlook for inflation?

John Williams:

Well, inflation has started to come down. It peaked for the last year around 7% on the Personal Consumption Expenditures Price Index that we follow at the Fed. It's at about 5% and still way above our 2% goal. We're seeing inflation come down mostly now in the commodities and the goods prices, and I think that does reflect some of the pandemic effects fading. We're seeing supply chains opening up much more globally. So those things are all good to bring down those factors of inflation. We're also seeing some signs that demand for housing is slowing. We're seeing that in the housing data. We're also seeing that in the rent data for the new rents that people are signing their new leases on. So we're seeing signs of inflation slowing, but inflation is still very high. And I would just mention that some of this core services inflation excluding housing, that hasn't bunched yet, so still got our work cut out for us to get inflation back to 2%.

Jennifer Schonberger:

So you've got inflation risk. On the other side, there's still reverberations now from the bank failures last month. So what are you seeing in terms of credit conditions? Any sense of whether credit conditions have tightened further since those bank failures and whether banks are cutting back or may soon come back on lending?

John Williams:

Well, this is something I and many others are watching very closely. So right now it's still pretty early days in terms of seeing clear signs of changes in credit conditions and credit availability. I'll be watching that closely to see those signs and then see any broader effects on consumer spending, business spending at other parts of our economy. So right now we are not seeing any strong signs of those effects happening, but it's something I'm very much watching for. I would say it's in the context of an economy that's actually growing pretty well. First quarter growth, we don't have the official numbers, but it looks like the first quarter growth is well above 2% at an annual rate. Labor market, as we've talked about, is still growing. It's still very strong. So we're starting from a place of a pretty strong beginning to the year. It's just a question of do credit conditions tighten somewhat and how much of effect does that have on the outlook. Still a little uncertain.

Jennifer Schonberger:

So given that, how do you view financial conditions now?

John Williams:

Yeah, so I think it's important to separate some of the credit availability from banks because the issues we've seen are really in a few banks from broader financial conditions. I mean, we've seen financial conditions tighten since the Fed has been tightening monetary policy. And I would highlight that central banks around the world have been tightening monetary policy. So I think that financial conditions broadly have tightened in the way you pretty much expect given monetary policy moving from very accommodative to now somewhat restrictive.

Jennifer Schonberger:

So then given that, how does that inform your thinking for the policy path and ultimately the peak on the Fed funds rate?

John Williams:

Well, so right now I think we've gotten monetary policy into a restrictive stance. Underlying inflation is probably in the low 4%. Obviously we've raised the target Fed funds range above that. I think the question for us is to really watch the data, we got a lot of data coming obviously on the retail sales and CPI and a lot of other indicators, and see what are we seeing in terms of the trends in demand both in the economy and in the labor market and what we're seeing in the inflation data. I go back to our economic projections in March. Clearly, if you look at the median dot, if you will, people expect maybe one more rate increase. I think depending on conditions, we'll see what we need to do. I think really it's going to be a period of also just learning along the way, are we really getting to the sufficiently restrictive policy to make sure that we bring inflation down 2%? We need to get that done the next couple years, so we need to get policy right for that.

Jennifer Schonberger:

How restrictive would you say we are right now?

John Williams:

Well, I would say we're somewhat restrictive. I mean, I would get out my thesaurus maybe and come up with a more creative word, but I think somewhat restrictive. My view of the longer run, neutral real interest rate is about half a percentage point. So I think we're somewhat above that. So the real question to me is, we've gotten to restrictive, what's it going to take to be sufficiently restrictive? Do we need to do somewhat more to get there and obviously be driven by the data and the outlook?

Jennifer Schonberger:

Did your estimate for the peak on the Fed funds rate change at all given the bank failures?

John Williams:

Well, I think that we all have to take you into account a lot of different factors in thinking about the economic outlook and the risks to the outlook. We've seen the data come in pretty consistently strong. At the same time, inflation has been very high. At the same time, I think the economy is going to grow at a pretty modest rate this year. That hasn't fundamentally changed. So I do think that the bank failures add to uncertainty about the outlook and we'll have to take what actually happens into account. But fundamentally, my view is we have an economy that will grow modestly this year. Unemployment will probably edge up over the next year, somewhat inflation will come down.

Jennifer Schonberger:

So then is it fair to say that you still see, given the SEP that you brought up, the Fed funds rate peaking around the range of 5 to 5.25, and then pausing?

John Williams:

Well, that's a reasonable starting place. I mean, that's the median we saw from my colleagues. Again, it have to be driven by the data. I will say that one thing that you have paying attention to is the financial or the credit conditions, but also really do we really see signs of this underlying inflation coming down.

Jennifer Schonberger:

So let's say we get to the fall. If you do intend to stick with 5 to 5.25 and then pause, let's say we get to the fall and inflation's still high, it's not coming down, what is the prospect of needing to resume rate hikes after you pause? Would that be on the table?

John Williams:

Absolutely. We need to do what we need to do in order to make sure we bring the inflation down to 2% over the next few years. So if inflation ends up being higher than I expect or stickier as you said, then we'll have to adjust policy appropriately. We've been doing that. We've been learning along the way over the last past year and a half. Clearly, the peak funds rate and the path for the funds rate have changed as the data have informed kind of the views of where inflation and employment are likely to be and we'll just need to stay in that data dependent mode and really focused on achieving our maximum employment and priceability goals.

Jennifer Schonberger:

So the market right now is pricing in rate cuts later this year, I know that's not in your projections. But from what you're saying and how you're characterizing things, would you say it's safe to say there's more upside risk to the path for Fed funds rate versus cuts?

John Williams:

Well, I think it really depends on what happens in the data. When I look at market projections or path for the Federal funds rate, I think a lot of people in the private sector have somewhat slower economic growth or maybe even a recession in their outlook. They also, a lot of them, have inflation coming down much faster. So it could be that part of the reason that people expect the funds rate to come down more quickly than we have in our projections, it's just a different view on how the economy's going to evolve. Again, we need to be data dependent. If inflation comes down faster than we expect, that'd be great news and that would obviously inform the path for policy. So I don't see that that difference between how maybe the markets or commentators expect the funds rate to come down faster than our projections is a problem. It's I think more of a, we'll see how the economy evolves and obviously we'll just be focused on achieving our goals.

Jennifer Schonberger:

What would it take for you to cut rates? Does it have to be that severe recession scenario? Or if you feel like credit conditions end up tightening more than perhaps thought, are you able to snip a bit off the top and still have real positive rates, if you will, still be restrictive adjusting for inflation?

John Williams:

Well, I think the real issue is if inflation comes down, we're going to need eventually, not soon, but if inflation comes down, we'll need to lower the interest rates because otherwise real or inflation adjusted

interest rates will go up. So if you look in the economic projections that we put out in March, at least the median dot has the funds rate going down in next year and the year after. I think that's really primarily driven by the fact that inflation is coming down and we'll be moving monetary policy to a more normal stance. So I think that's an important driver of interest rates eventually coming down. Obviously other factors, how the economy's doing and how this all fits together would be relevant as well.

Jennifer Schonberger:

I want to ask you about risks to the economy. A lot of folks are saying commercial real estate could be the next shoe to drop. Of course we heard that back in 2009 after the financial crisis didn't come to fruition. Nevertheless, what are you seeing? You're here in New York on commercial real estate.

John Williams:

Well clearly, commercial real estate, especially office space, there's a lot of open questions about what's going to happen there with a hybrid model and fully remote work. Companies are using office space differently. The demand for office space will be changing. I think that does affect the market price of a lot of those buildings both here in New York, but in other big cities. So that's clearly something that will have to be resolved over time. It's not something that happens on one day. You know mentioned in the past we've seen typically the borrowers and the lenders work things out in a way that's not disruptive. But that said, it is definitely something very much on my radar, both in terms of the New York City economy, but also broader conditions.

Jennifer Schonberger:

On credit conditions, I know you say you're not seeing too much of a tightening right there. Of course we'll see what happens as time plays out. But given these bank failures and the question mark of the magnitude of that, how much does that raise the odds for a recession?

John Williams:

Well, I think that, again, we're in a situation where even before, this growth was going to be relatively modest. And so it's hard to predict recessions. If you ask economists, they like to predict them, but the track record's not very good on that. I do think it's a factor that could influence confidence, consumer and business confidence, and it could affect the available credit. So we'll have to watch that. It's clearly could be a negative shock to the economy and cause the economy to slow further. But right now we're not seeing those effects. And actually, the banking system is really stabilized. And so it's pretty much focused on the two banks that failed. So I guess right now I'm not thinking that it would be such a big negative on the outlook, but we're going to have to watch the data carefully.

Jennifer Schonberger:

Yeah. To your point, we are going to see slower growth you project this year. Maybe not a recession, but slower growth. If inflation remains persistent and interest rates need to remain high as a result of that, what is the prospect for a stagflation scenario?

John Williams:

Well, I really don't see that. One of the things we have actually seen in the labor market, and we started with the labor market so I'll come back to that, is as labor demand has come down, we've seen the job openings data come down, we've seen wage growth come down, but we haven't seen unemployment

go up at least so far. So I think if we can get this nice balance of supply and demand in the economy where demand comes back in a way consistent with supply, we don't need to have such a negative effect on the economy and at the same time reduce the inflationary pressure. So I think we've got some things that we've already talked about that are helping us bring inflation down. Some of the pandemic effects and supply chain issues are now fading. It's really a matter of just getting supply and demand back into balance. Demand is... so far it's exceeding supply. And that's what monetary policy can do, is get that balance.

Jennifer Schonberger:

So it sounds like you're not too worried at this point about ripple effects from the bank failures and credit tightening. I know you said we're going to watch and see, but I'm curious if that could have any implications for your quantitative tightening program if we were to see credit conditions tighten further?

John Williams:

Well, I really think that the shrinking of our balance sheet, the QT as you mentioned, is obviously something that has been going on for quite some time, it's going very smoothly. I don't see that as the main area of focus for thinking about monetary policy. Really, the primary instrument of monetary policy is the federal funds target and we can adjust what we do with that to best achieve our goals. Again, I think bringing the size of our balance sheet down is working really well. It's not something that I would see as something we would need to adjust anytime soon.

Jennifer Schonberger:

Given your outlook for inflation and that you're not seeing too many signs right now of the credit tightening impacting the economy, how quickly do you think you need to move to get to the peak on the Fed funds? Do you need to move really fast or do you want to give it some time to see all things settle out and maybe do it later in the summer? What are you thinking?

John Williams:

Well, again, we're going to learn a lot from the data we get. We'll figure that out. You'll look at all the briefing books and have that discussion at the meeting and other future meeting. So we'll figure that out as we can to best achieve our goals. I mean, clearly we're in a situation that at least according to our current projections, we're not that far from that peak rate. So it's not something that a year ago where the problem was we understood that the peak rate was quite a ways off, we didn't know exactly what it was, but we needed to move quickly to get that. We're not in that situation right now. So I think we can adjust as needed obviously and continue to watch the data and continue to be data dependent.

Jennifer Schonberger:

So you say we're not in that situation, meaning you could wait potentially to go another 25 basis points or better to go in May?

John Williams:

Well, we-

Jennifer Schonberger:

I know your data dependent. I know.

John Williams:

Well, we'll see. I don't think it would be a problem to do one or the other. I think that the main point I'm making is we just need to get that the analysis of data, clearly make a clear decision and move forward from that. I will go back to the fact that right now the labor market remains out of balance. Demand is still much stronger than supply, inflation is still very high. So we have to always keep that in mind, that's where we're starting from, and then think about what are the various risks and different things that can happen in the future.

Jennifer Schonberger:

President Williams, thank you so much for your insight. I so appreciate it. I hope to speak with you again soon.

John Williams:

Great. Thank you.