The Economic Club of New York

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The Economic Club of New York

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John C. Williams
President and Chief Executive Officer
Federal Reserve Bank of New York

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Moderator: Sara Eisen
Co-Anchor
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Introduction

President Barbara Van Allen

Good afternoon and welcome to actually the 706th meeting of The Economic Club of New York in our second century. I'm Barbara Van Allen, President and CEO of the Club. As many of you know, The Economic Club of New York is recognized as the nation's leading nonpartisan forum for discussions on social, economic, and political issues, and we've had more than 1,000 prominent guests appear before our Club, and the tradition of excellence continues right through to today.

I want to extend a warm welcome to students from Columbia Business School, Mercy College, George Washington University, and the Gabelli School of Business who are joining us virtually today as well as members of our largest-ever Class of ECNY Fellows. The 2023 class actually numbers over 71 and it is a diverse, rising, next-gen group of business thought leaders, and we are just so proud, the impact that program has had on our membership over the last five years since it was created.

Today, I'm honored to welcome our special guest and, of course, Economic Club of New York Chair, John Williams. John is the President and Chief Executive Officer of the Federal Reserve Bank of New York. In that capacity, he serves as Vice Chair and a permanent member of the Federal Open Market Committee. From 2011 to 2018, John

was the President and Chief Executive Officer of the Federal Reserve Bank of San Francisco. Prior to that, he was the Executive Vice President and Director of Research at the San Francisco Fed, which he joined in 2002.

John began his career in 1994 as an economist at the Board of Governors of the Federal Reserve System. In addition, he served as a senior economist at the White House Council of Economic Advisers and as a lecturer at Stanford University's Graduate School of Business. He holds a Ph.D. in Economics from Stanford University, an M.S. degree from the London School of Economics, and an A.B. from the University of California at Berkeley.

John will begin with some brief opening remarks which will be followed by a conversation in which we're delighted to have Club member and co-anchor of CNBC's Squawk on the Street, Sara Eisen, doing the honors of moderating. As a reminder, this conversation is on the record. We do have a lot of media actually in the room as well as participating virtually. And many thanks to those members who submitted questions in advance. They were shared with Sara, and we do intend to take a few questions from those in the room toward the end of the event. So, John, if you're ready, the mike is yours, sir.

Opening remarks by John C. Williams

Thank you, Barbara. You know I've done so many of these introductions myself, I was speaking along with you as you spoke. But thanks again, Barbara, for the kind introduction. And as Chair of The Economic Club of New York, I often have the honor of introducing speakers to our forum so it's really a special privilege today for me to speak with you.

I'm also pleased to be here during my favorite month of the year. The weather is warmer, baseball season is well underway, and the games are a lot shorter, thankfully. And it's the month when people around the world celebrate Star Wars, one of the all-time great franchises. I'm often asked – you may be surprised to hear this – but I'm often asked whether I'm a fan of Star Trek or Star Wars, and my definitive answer is, yes.

So now, I promise I won't spend my time talking about the weather or baseball. What I want to talk about today is inflation. Inflation remains too high. High inflation is hardest on those who can least afford to pay high prices for food, shelter, and transportation. And we, at the Federal Reserve, are committed to bringing inflation down. As the Mandalorian would say, "Price stability. This is the way."

Before I continue, I need to give the standard Fed disclaimer that the views I express today are mine alone and do not necessarily reflect those of the Federal Open Market Committee or others in the Federal Reserve System.

So the FOMC is mandated by Congress to promote maximum employment and price stability. The goals of our dual mandate are intrinsically linked. Specifically, price stability is essential for the economy to reach its full potential and to sustain maximum employment over the long term. Since the pandemic, imbalances between demand and supply have persisted throughout the economy, leading to high inflation and a tight labor market. Although we've seen some signs of a gradual cooling in the demand for labor, as well as for some goods and commodities, overall demand continues to exceed supply.

Now, first let's discuss what this means for employment. At the national level, job growth has been robust with monthly job gains averaging about 220,000 over the past three months. Other indicators show that labor demand is gradually slowing, yet remains very strong. For example, job openings have come down from their peak back in March of last year. Still, the ratio of job openings to unemployed far exceeds the levels prevailing before the pandemic, when the labor market at that time was also very strong. Similarly, quit rates have been gradually declining, but are above pre-pandemic levels.

In addition, the unemployment rate is at a historically low level of 3.4%. And in April, the employment-to-population ratio for those between the ages of 25 and 54 reached the highest level since 2001. So the strength of the labor market is evident in parts of the Federal Reserve's Second District as well. And Fairfield County, in Connecticut, has fully recovered from the pandemic. Northern New Jersey is above where it was back in 2019. And New York City has also shown remarkable progress, with employment closing in on pre-Covid levels.

Nationally, we're also seeing improvements on the supply side of the labor market. As you'll recall, when businesses reopened after the 2020 pandemic shutdown, many faced a dire shortage of workers. Since then, we've seen a rebound in labor force participation, with the 25- to 54-year-old age group slightly above pre-pandemic levels. And although overall participation is below where it was before Covid, economists at the New York Fed have found that this shortfall is more than fully accounted for by the aging – or what I prefer to call the "maturing"– of the workforce.

Now, this increase in labor force participation has helped alleviate some of the imbalances that we've seen in the labor market. But with baby boomers increasingly reaching retirement age, population aging will continue to put downward pressure on participation in the medium term. Increases in the labor force from immigration, which has picked up from the pandemic lows, can partially offset this, but it's unlikely to fully

undo the impact.

So achieving, turning to inflation, achieving balance on the inflation side of our mandate has been more challenging. Last June, inflation spiked to a 40-year high of 7%, as measured by the personal consumption expenditures price index. Since then, inflation has moderated to 4.2%, in large part due to a decline in energy prices. Now, that's much better than 7%, but still more than double the FOMC's longer-run goal of 2% inflation.

This inflation target is an important bedrock principle for the FOMC. It provides a "North Star" for our policy decisions and helps improve the public's understanding of our goals and our actions. It has also helped to keep various measures of longer-run inflation expectations remarkably well anchored at levels consistent with our 2% longer-run goal.

Although short- and medium-term inflation expectations rose during the pandemic, these measures have since come down. Indeed, based on the latest reading from the New York Fed's Survey of Consumer Expectations, three-year-ahead expectations have returned to a level nearly identical to the average between 2014 and 2020. And although one-year-ahead inflation expectations in the survey remain elevated, they have declined considerably from the peak level reached back in June of 2022.

So, to understand why inflation remains so high, it's instructive to examine inflation developments in various sectors of the economy. So far, inflation has declined in many categories of commodities and goods, which tend to be more sensitive to higher interest rates. In addition, supply chains, which were severely constrained after the pandemic's onset, have improved considerably. This is something I hear from business leaders from around the district, but also the New York Fed's Global Supply Chain Pressure Index has declined to a level that indicates supply chain pressures are now actually somewhat lower than normal, lower than the pre-pandemic levels.

At the same time, the March price data indicates some moderation in overall rent inflation. And rents for new leases have been showing slower rates of increases, which should help bring inflation, shelter inflation, down in coming months. Now this is really important because shelter inflation has been a significant driver of the high inflation that we've seen over the past year.

But the most persistent area of inflation is what is referred to as core services excluding housing, and that's been running about 4½% since last August. This is driven by a continued imbalance between overall supply and demand, and it's going to take the longest to bring down.

Now, in The Rise of Skywalker, Anakin urged Rey to bring back the balance. And that's

what the FOMC has been doing in taking strong actions to accomplish that. Last week, the FOMC raised the target range for the federal funds rate to 5 to 5-1/4%. That's our tenth consecutive rate increase. In our post-meeting statement, the FOMC indicated that "in determining the extent to which additional policy firming may be appropriate to return inflation to 2% over time – you cannot actually read this whole sentence without taking a breath somewhere – the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments."

In addition, the FOMC indicated it will continue to reduce its holdings of Treasury securities and agency debt and agency mortgage-backed securities, according to the framework that was announced a year ago. The FOMC also said that the "Committee will closely monitor incoming information and assess the implications for monetary policy." I will be particularly focused on assessing the evolution of credit conditions and their effects on the outlook for growth, employment, and inflation.

Now, because of the lag between monetary policy actions and their effects, it will take time for the FOMC's actions to restore balance to the economy and to return inflation back to our 2% target. In terms of my forecast, I expect inflation to decline to around 3-1/4% this year, before returning to our longer-run goal of 2% over the next two years. As tighter monetary policy continues to take effect, I expect real GDP to grow only

modestly this year, with growth then picking up somewhat next year. And I anticipate the slow growth will continue to cool the labor market, with unemployment gradually rising to about 4 to 4 ½% over the next year.

Now, I'm confident that we're on the path to restoring price stability. And as always, I'll be monitoring the totality of the data and what it implies for the achievement of our goals. And to paraphrase the wise philosopher Yoda, "A little more knowledge lights our way." Thank you.

Conversation with John C. Williams

SARA EISEN: I think we learned a few things there. Inflation is too high and you're such a Star Wars fan.

CHAIRMAN JOHN C. WILLIAMS: Well, it is May.

SARA EISEN: Did you dress up last Thursday?

CHAIRMAN JOHN C. WILLIAMS: I, I mean I dress up like an economist.

SARA EISEN: So my kids brought light sabers to school. You didn't bring them to the

Fed?

CHAIRMAN JOHN C. WILLIAMS: I didn't. I did not.

SARA EISEN: Inflation is too high for you. That was the take-away. Was that the right take-away from your speech?

CHAIRMAN JOHN C. WILLIAMS: Absolutely. Inflation is too high.

SARA EISEN: But aren't you guys done raising rates?

CHAIRMAN JOHN C. WILLIAMS: So, first of all, we haven't said that we're done raising rates. We made the decision at our May meeting to raise the federal funds target range, as I said. And we didn't make a decision of what we're going to do in our future meetings or, you know, how the economy is going to evolve will obviously affect our decisions. I do think that we've made incredible progress over the past year or so bringing interest rates from close to zero to a little over 5%. I think that brings real interest rates or inflation-adjusted rates to a stance that should help bring inflation down.

I think what we're going to need to do, as we always do, is be data-dependent. Continuously, on an ongoing basis, reassess what the data are telling us. Like I said,

I'm very focused on what's happening with the credit conditions, but also what's happening with inflation data, what's happening with employment data, and then make the decisions based on what the data is telling us. I think I always go back to we need to make sure that we bring inflation back to 2% on a sustained basis.

SARA EISEN: But here's the thing. In the last statement, last week, you guys took out a very key phrase, some additional policy firming – I don't know, some Fed-speak that indicated that you were still raising rates – went away.

CHAIRMAN JOHN C. WILLIAMS: It's a very artful Fed-speak...

SARA EISEN: Did you write it?

CHAIRMAN JOHN C. WILLIAMS: It's a committee document. But, yes, we did change the statement. That is an important...

SARA EISEN: But wasn't that a signal that you're pausing?

CHAIRMAN JOHN C. WILLIAMS: A signal in our earlier language was clearly, before, that we saw the need, that it was going to be appropriate to continue to raise rates. Now what we've said is, is we're not signaling that we're going to raise rates at the next

couple of meetings. What we're signaling is we're going to make sure that we achieve our goals and we're going to assess what's happening in the economy and make the decisions based on that data. And if additional policy firming is appropriate, then we'll do that. But if you think about this language of forward guidance, we're moving definitely back from very explicit directed forward guidance, here's what we're planning to do, to one of we're going to be watching the data and making the decisions on a meeting-by-meeting basis.

SARA EISEN: So is June on the table for you for a rate hike?

CHAIRMAN JOHN C. WILLIAMS: Well, my view is we're going to get a lot of data between now and our June meeting and we'll get more data as the year progresses.
SARA EISEN: But so far? We've had some data. We had a good jobs report. That was a surprise.

CHAIRMAN JOHN C. WILLIAMS: So I think for me it's really assessing, again speaking for myself, it's really, one of the things that I'm very focused on is how are we seeing the tightening of credit conditions. We've seen this tightening of credit conditions. So one question is how big is that? How big of an effect does it have on jobs, on the economy, and on inflation? So that's one question I have, but let's watch all the data. Again, I used the phrase totality of the data, and when we get, between now and the June meeting

we'll have more information, and we'll make a decision at that point. And then we'll meet again six weeks after that.

SARA EISEN: The market thinks you're done and thinks that you're going to be cutting rates this year, which I know Chair Powell always gets the question and he says, no, we're not looking to cut rates this year. Do you see any scenario where you would be cutting rates this year?

CHAIRMAN JOHN C. WILLIAMS: Well, in my baseline scenario I see the economy continue to grow. I see inflation coming down gradually. So in my forecast we need to keep a restrictive stance of policy in place for quite some time to make sure we really bring inflation down from the, you know, over 4% it is now all the way to 2%. So I do not see in my baseline forecast any reason to cut interest rates this year. And I will say that, you know, at some point further out in the future, of course, if my forecast comes true and inflation is moving back to 2% and the economy is performing as expected, then of course at some point we do need to move interest rates back to more normal levels. But I don't see that happening this year.

SARA EISEN: Do you see it as a problem that the Fed and the market are on different pages?

CHAIRMAN JOHN C. WILLIAMS: Well, I don't know if the Fed or the market, maybe this is a good topic for some of the questions from this group, but I'm not so sure whether the Fed and the market are on different pages. First of all, the market is made up of literally, you know, millions of people who are investors and involved in decisions and so there isn't one voice of the market. So we talk to market participants at the New York Fed, you know, on a regular basis, so it's a range of views, what's going to happen on interest rates. And there's a range of views on what's going to happen with the economy.

So if you look at our, if you look at the surveys of economists or market participants in the past, that can be very different than, I think, what most people look at when they hear what does the market expect, which is this market-implied path of interest rates. And typically the market-implied path of interest rates from futures markets does show a steeper decline. And that probably reflects some uncertainty and risks that investors see or market participants see. I think that the modal outlook doesn't have the same path of interest rate declines that you see kind of in some of the market-implied rates.

But I don't see this as a problem. We're making our policy decisions to achieve our maximum employment and price stability goals. I think we've communicated pretty well why we're doing those. And we're committed to achieving those goals and so we'll just, you know, communicate as effectively as we can depending on how the economy

evolves. I mean I think market participants and others will understand that those expectations may change depending on how circumstances change.

SARA EISEN: You mentioned the high inflation rate, higher than you'd like, higher than comfortable. But a lot of people say, look, the inflation expectations are low and have come down, so the Fed shouldn't really be too worried about inflation, and so chill out a little bit on raising rates.

CHAIRMAN JOHN C. WILLIAMS: I view myself as pretty chill.

SARA EISEN: You're chill today. You won't confirm a pause though.

CHAIRMAN JOHN C. WILLIAMS: I mean, okay, so on the issue of inflation expectations, this has been something that I think is really important. You know, we've learned from the 60s and 70s in the U.S. and in other countries, when the public doubts what the Fed is trying to do or a central bank is trying to do, inflation expectations become unanchored. That makes inflation, it actually pushes inflation higher and you get that kind of wage price spiral that we've seen at times. We're not seeing that today.

So the inflation expectations being well anchored is a very positive thing. But that's not all we need. We actually need to get our economy back into balance. We need supply

and demand to be in balance and we need to actually get inflation back to 2%, not just be kind of satisfied with the fact that people expect it to eventually get back. So we need to take our actions to support that outcome.

SARA EISEN: Right. In other words, you don't want to take it for granted that those inflation expectations are lower. Are you surprised at how sticky some of the parts of inflation have proven to be? I mean, milk prices are down more than 30% from the cycle highs and yet food inflation is stubbornly high. Why?

CHAIRMAN JOHN C. WILLIAMS: Well, again I think, you know, one of the things that's happened, that has been a surprise, and it continues to be surprised is I think the effects of the pandemic, and not just the direct effects of Covid, but all the effects it had on behavior and the decisions that people made, businesses have made, the changes in what we buy and do, have just continued to have kind of effects on supply and demand in our economy. And as that changes you see some sectors suddenly have a lot more inflation, others actually have deflation as you indicated. So there's just a lot of churn, if you will, going on in supply and demand, and so it's not a business-as-usual macroeconomy right now.

So it is a surprise. I mean, and exactly how this played out, I think many of us – including myself – expected more of a pivot from goods to services earlier. But what we

actually saw was, you know, people continued to buy goods at a high rate and were buying services. So that's what led to demand exceeding supply. So what's the lesson to me on this is first of all, it's still a very unusual set of circumstances. We have to be nimble. We have to watch all the data in all of its different ways and, you know, again make the best decisions we can.

SARA EISEN: And nothing should be called transitory, is the other lesson.

CHAIRMAN JOHN C. WILLIAMS: Well, you know, one of the things you learn, I've learned in Fed communication, is whatever word we use, and this goes back decades, once you've used the word a few times, it gains a permanent meaning. And so you always have to, you realize that these words carry, like we had the "measured pace" if you go way back. And if you look up the word measured, it means, you know, thoughtful, well-reasoned, well-considered. But if you use the word "measured" now in a central banks, it means a very specific thing. So you learn that that's kind of the power of some of our communications, that they end up kind of having a very strong meaning.

SARA EISEN: Yes, I mean there was one. It was not even thinking about, thinking about, that was another one, raising rates.

CHAIRMAN JOHN C. WILLIAMS: So I think, you know, and the situation we've dealt

with, and going back to what happened last year, I mean clearly '21, inflation moved very rapidly. It moved up. And it not only moved rapidly but also much more persistently. And to me, the lesson from that is, you know, basically don't make assumptions that this is how everything is going to work. Don't think this is going to be the same as one episode or another, but really have an open mind and recognize that you may need to change your mind and make decisions appropriately. I think we did that very effectively last year.

SARA EISEN: So which part of the inflation numbers are you most worried about, are you seeing as most sticky, that you really want to see come down?

CHAIRMAN JOHN C. WILLIAMS: Well, I think, you know, we're seeing on the goods inflation, which is like, you know, cars and appliances and things like that, those have come way down. But they still haven't come down as much as I expected because I think demand is still strong. The shelter costs, the rents, I think that's moving. I think the piece that is proving highly persistent so far is core services excluding housing, which is a lot. It's a lot of the consumption basket. And that is, I think, very closely related to the fact that demand is still very strong relative to supply and there's still that imbalance there. But I would say even in goods prices, demand is still strong relative to supply so it's a general issue that our economy is still out of balance but moving in the right direction.

SARA EISEN: Alright, I'll ask it another way. How much more does inflation have to come down before you'd be comfortable pausing?

CHAIRMAN JOHN C. WILLIAMS: Well, I think, again, you know, I'm going to answer with you have to look at all the pieces of this. Inflation can come down for different reasons. Like even on the, you know, I said that overall inflation is 4.2%. If you look over the last six months, it's even lower. But a lot of that is energy price declines. And, you know, when you talk about our phrases, we don't want to say we look through energy price movements, but we want to understand we're not going to see energy prices likely to decline year after year. So it's not just about what happens with inflation. I think it's more about seeing are the underlying trends or the movements, you know, in the right direction, and there's the whole set of kind of data points.

SARA EISEN: Some people think, and this came from one of the member questions, thank you, that inflation is not going to go all the way down to 2% because deglobalization, we're onshoring supply chains. We're investing in environmentally-friendly technologies. All of that is just going to make things permanently more expensive and a higher inflation range. Do you buy that?

CHAIRMAN JOHN C. WILLIAMS: I don't, because it's our job to make sure at the Fed, and that would be true of other central banks, to make sure that inflation is low and

stable. So we can do that even in a world, you know, as you mentioned, with deglobalization or friendshoring or other aspects of that or, you know, the other things that you mentioned.

I go back to my experience, you go back to whether the 80s or 90s or 2000s, we had a lot of those kinds of changes. We had globalization. We had productivity, a very slow productivity for a long period. We had high productivity. We had a lot of different things happening with the labor force. Our economy has had a lot of structural change over the last 30 years. But, you know, the Fed has been able, through that, to on average keep inflation low and stable. Other countries have proven that they were able to do it too.

It does change, maybe what interest rate it takes to achieve that lower inflation. Maybe it changes some other factors in the economy. But those are things that we need to be able to adjust to. If we're in a global economy that is growing more slowly or different things are happening, we just need to be able to adjust to that and make sure we deliver that lower inflation.

So I'll just say one phrase I don't like is "structural inflation." We can have structural change in the labor market, in the product market, in trade, or other policies. Those are things that influence the environment that we operate in, but they don't dictate what the inflation rate is over long periods of time. And again, you can look at inflation in the U.S.

and other countries and see that it is possible and achievable to have low and stable inflation in a lot of different kinds of macro environments.

SARA EISEN: So what about the economic outlook? Demand has held up relatively well during this entire period of tightening. But some people are worried that we're looking at a sort of perfect storm, that the lag impact of more than 500 basis points of tightening in a short period of time, the stimulus, and there was a lot of it, is starting to run out, and you have these bank problems, tightening credit. If all that happens, isn't that a worrisome outlook?

CHAIRMAN JOHN C. WILLIAMS: Well, you know, I think that the FOMC statement, which I had to take a breath to read that one sentence, it listed a lot of these factors in the statement, and I mentioned them myself. So I think we do have to think about, there are, as Milton Friedman said, long and variable lags in monetary policy, and we do understand that. We have models. We have statistical or economic analysis that helps us understand what that means. We've done analysis trying to understand, to the extent that we've seen some tightening in credit conditions, what kind of effect will that have on GDP and employment.

And we obviously have to take into account the fact that we've tightened monetary policy, as you said, but also central banks around the world have been tightening

monetary policy over the last year or so. And so we incorporate that in our analysis. We include that in the forecast. As I said, my forecast is for pretty modest growth this year.

SARA EISEN: But no recession?

CHAIRMAN JOHN C. WILLIAMS: Not a recession in my baseline forecast. We incorporate that. But let me get to your question. I mean things may not play out the way we expect. I see there really are two-sided risks to the growth outlook. And if I go back to February, before the issues in the banks, with Silicon Valley Bank in March, my forecast, I was revising my forecast quite a bit for 2023, because, you know, the data were convincingly strong on all fronts. It was looking like the underlying momentum in this economy was much stronger. Then we have the events of March, we had new data, some revisions to data, and you take all that into account. And that's where I come out today. But I think there is a possibility that, you know, this economy has got a lot more underlying strength, it could grow stronger than I'm saying, and that's where we might find ourselves later in this year.

Similarly, there is this risk that credit tightening or other factors will slow the economy down more than we expect and we need to take that into account. So I do see the risks to this outlook as being to both sides, both on inflation and on unemployment.

SARA EISEN: What are you seeing so far on the credit conditions? Because you said a few weeks ago, you made a lot of news saying you're not seeing a lot of evidence of that.

CHAIRMAN JOHN C. WILLIAMS: Well, I think what we're seeing mostly is anecdotal right now, including survey and discussing with BIS contacts and what we're hearing from banks. Clearly, you know, the monetary policy tightening itself that we've been doing for a little over a year will tend to tighten, will raise the cost of credit, but also tend to tighten credit conditions as part of the monetary policy transmission. So we saw that even before March.

Since then, I think we're seeing more signs, especially maybe in the regional bank or that kind of range of banks, of some signs of further tightening of credit. Quantifying that in terms of how big this is compared to other episodes is still pretty challenging because we haven't gotten a lot of real data. But clearly, it's going to have an impact. I mean we are, you know, I have in my baseline a view that credit is going to be tighter, more expensive. And that will be one of the factors, if you go back to what I said earlier, in February I had this pretty positive view that the economy was going to grow much stronger. That's now offset by a view that we're going to see some slowing in credit. But we're going to have to watch the data. We don't have a lot yet.

SARA EISEN: Yes, some people are trying to figure out, is it equal to a 25-basis point hike, a 50-basis point hike, a 100 basis? Do you have any clue?

CHAIRMAN JOHN C. WILLIAMS: So I think, okay, so my answer to this is, that's a really hard question to answer. I think it's, so when we look at, neither do I have any clue. I'll leave that...

SARA EISEN: You know what I mean.

CHAIRMAN JOHN C. WILLIAMS: But I think that a lot of the analysis is the effect on lending. And I think that if you think about the data that we have between, you know, tightening of credit standards maybe in past experiences, like where for whatever reason there was a tightening of credit, that affects lending. So that's a little bit more direct. Then there's an effect of lending on economic activity, businesses, investment, employment, and things like that. And then there's the question that you're asking, okay, well, with all those different things happening, does that mean you're going to need to raise rates by less, by a certain amount? And I think that's harder, even harder to answer because you're just making a lot of different connections.

And my view, it's directionally. It does mean that the economy is going to grow somewhat slower. Directionally, that means we don't need as high interest rates.

Exactly what that is, is going to depend on, again I go back to what's happening with inflation, what's happening actually with employment and GDP and other indicators. I think one thing that I bring up in this context is this is an economy that started the year, not only very strong, but with actually very good momentum. And now you're getting a shock, if you will, that's going to slow that. But we're not starting out with an economy that was weak and got a shock and took it further down. So I think that that, in a way, it may slow the economy but I don't necessarily see it completely knocking the economy off course.

SARA EISEN: Hence, the no recession.

CHAIRMAN JOHN C. WILLIAMS: Hence, the no recession.

SARA EISEN: But Fed staff expect a recession.

CHAIRMAN JOHN C. WILLIAMS: Well, you know, the Fed, so all of us have to look at all the data and try to figure out what does it mean, how do I come up with, what we call the baseline or modal forecast, and then recognize as soon as you write down that forecast, there is now 50 scenarios around that forecast. Things could go better or worse in all the different things, both here and around the world. And so the board staff does an independent judgment. They come up with a baseline forecast. They come up

with lots of scenarios of how things can be different. It's really valuable.
They are outstanding staff, think through all of these different issues very carefully and they come to their own judgment about what that baseline is. I come to my own judgment on that. But I think the basic underlying story is very similar. It's one of an economy that is slowing. It's a labor market that is, you know, gradually, I think, cooling somewhat over time, and then inflation coming down.

SARA EISEN: But the labor market has been remarkably strong, I mean that wage number on Friday. Did that surprise you? It's not really supposed to be going up right now, is it?

CHAIRMAN JOHN C. WILLIAMS: Well, I do think you have to be careful about looking at each data point in isolation. I think the overall trajectory of all the wage numbers has been one, including the ECI, that wage growth had slowed quite a bit for a while but it's now stabilized in the something like 4½ to 5% range, which is still pretty high. So that' s how I see that. To me, what that's telling me is the labor market is still very strong. I mentioned the job openings, the vacancies to unemployed, because that's a nice indicator of the excess demand. And so that's come down quite a bit. But to use a technical term, we're kind of on that vertical part of that curve where we've seen vacancies come down, quit rates come down, but the number of unemployed actually not. But as we move forward, I think that, you know, my own forecast is we're going to

continue to see vacancies come down, but we actually will see some increase in the unemployment rate just as the economy continues to...

SARA EISEN: Because it feels like we report on layoffs every single day. I know a lot of them are tech firms. But how do you make sense of the fact that it hasn't filtered through to the economy and the data?

CHAIRMAN JOHN C. WILLIAMS: I think a lot of those people are getting jobs. I mean, I think that's what we're seeing in the economy is that the labor demand is really strong. The number of vacancies is strong. Clearly some companies, as you point out, are in different places on that, but the overall demand for labor still is stronger. But again, it is moving. I mean it's still a strong labor market but we're seeing signs that the balance that we're moving towards, is restoring the balance.

SARA EISEN: I guess what I'm wondering is can inflation meaningfully come down if unemployment is still at a historically low level of 3.4%?

CHAIRMAN JOHN C. WILLIAMS: Well, so I think it gets back to your earlier question about what's the thing that's going to be hardest to get inflation down. So I definitely think on commodity prices, goods prices, car prices, probably even getting into the rental prices and house prices, we can see them come down even with the economy

where it is today. Because a lot of that was driven by pandemic-related demands and supply chain issues and a lot of those have been resolved.

I think this underlying imbalance between supply and demand is really manifesting itself in this core services excluding housing. That's the piece that we will not get that to come down until we restore the balance in the economy.

SARA EISEN: Back to the banks, because it's obviously front and center still. We talked about the credit impact. What about just the stress level right now in the banking system?

CHAIRMAN JOHN C. WILLIAMS: I think that has actually calmed down significantly. You know the banking system is sound and resilient. There were a few banks, as we all know, that have failed and have gone through resolution, but overall, the banking system is quite strong. And what we're seeing is that during March and after that, you know, we saw huge outflows of money from deposits, out of the banking system, into money market funds and other places and also between banks. That has really slowed down and we're not seeing that kind of dynamic that was so concerning back in March. I think the strong actions by various agencies, including the Federal Reserve, the FDIC, and the U.S. Treasury and everyone working together, I think, helped really bring that situation under control. So I feel that, if you will, that acute phase of March is behind us.

I do think there are still these issues around credit tightening. I think that, you know, even banks that are very healthy and strong are seeing the costs of their funding go up. I'm sure that there are banks who are thinking, well, given what happened, I'm going to be more conservative. I'm going to maybe hunker down and be cautious and make sure that, you know, I'm very strong for any other event that happens. And I think that's how that can spill over into the availability of credit. So the issue here is, I think, one of more just the adjustment in our economy to somewhat tighter credit.

SARA EISEN: So as a bank regulator, do you expect more banks to fail?

CHAIRMAN JOHN C. WILLIAMS: You know, I don't want to speculate on any specific kind of issue like that. Obviously, what we learned from Silicon Valley Bank especially, and it came out in Vice Chair Barr's report, is that institution had very significant challenges and decisions that were made that made it much more exposed to these kinds of risks. And so I think that especially those three firms, you know, really stood out in terms of the problems they had and the issues that they were dealing with. And that's not a more general issue in our banking system. So that's how I see it.

SARA EISEN: Do you have any lessons? I mean they're supposed to be supervised, right, by the Federal Reserve? Are there lessons for you on how to do that better going forward?

CHAIRMAN JOHN C. WILLIAMS: Well, I will point people to Vice Chair Barr's report, which I think is a very honest appraisal of shortcomings at the Federal Reserve and also lessons learned. Obviously, shortcomings about Silicon Valley Bank, of the management of the bank and the decisions that were made there. So I won't repeat any of that.

From my perch, I would say the one, a couple of lessons that I would highlight beyond having very strong and effective regulation, supervision, all those things, is the speed at which those events developed, the speed at which depositors fled Silicon Valley Bank, we saw a similar dynamic in Signature. We actually, you know, I think the speed and magnitude of how people pull money away from banks out of fear or concerns of the solvency, which is dramatically different, I don't think it's just social media or the particulars of the client base of Silicon Valley Bank.

I mean those maybe, you know, relevant, but I think it's really more that we have – as regulators and supervisors, all of us, not just the Fed, but others – have to make sure that banks are able to access liquidity, make sure that they have the liquidity they need if an event like this happens. And that kind of speed and, again, magnitude of the withdrawal of deposits was really unprecedented.

SARA EISEN: I want to open it up to the room, but one more from me, which is – and

maybe I should have started here but I got caught up in Star Wars and inflation – which is what happens if we default on our debt, if Congress can't raise the debt ceiling on June 1st? I know the Fed, Chair Powell has said the Fed can't save us, but you must have a contingency plan if that happens.

CHAIRMAN JOHN C. WILLIAMS: Well, I think the plan for that is for Congress and the administration to raise the debt ceiling and do it very soon. That's the only plan that's assured to work. Because I think that, you know, that's a decision of Congress and the administration. They need to take responsibility for doing that. And you said it well, Chair Powell already said it, but I'll say it too. There's nothing the Fed can do that would mitigate the types of affects you would get out of a default or something like that. Also, going back to the unknown unknowns, this is not something we have experience with, over 200 years. So this is not something that you can plan for every contingency or think through. This is really, you know, my answer really is that's for Congress to do.

SARA EISEN: What would that do to your outlook? That's something you can answer.

CHAIRMAN JOHN C. WILLIAMS: I'll say this is really uncharted territory to consider that.

SARA EISEN: A question from the audience, and we have mikes going around.

QUESTION: Great. First of all, thank you for the discussion, always interesting. The 2% inflation target seems to be somewhat arbitrary. Can you explain to us why that's the right level of inflation? And then as an adjunct to that, and I think Sara asked it in a slightly different way, how much pain is the Fed willing to inflict on the labor market over the medium term to get down to that 2% level?

CHAIRMAN JOHN C. WILLIAMS: So, the 2% target I don't view as arbitrary. I view it as, in our case where we've thought about this, really going back to the 90s, that we have a dual mandate by Congress, we have maximum employment and price stability. And one of the things we realized from both, you know, experience in the U.S. and around the world, is that high and variable inflation undermines the ability to achieve maximum employment and the economy's potential over time. Countries that have high and variable inflation do worse in terms of economic performance. So the two are connected.

At the same time, we know that if we try to drive inflation down to zero or extremely low levels, and we understood this before – the financial crisis – that would mean that you would need to be bringing interest rates down to zero very frequently, so the zero lower bound problem. And again, this is just, if you have inflation on average at zero or 0% inflation, you are just going to find that during a downturn the Fed is going to be having to cut rates to zero, maybe using QE and other things.

So there was a recognition that for those factors and quite a few others, that you don't want the inflation target to be too low because that would interfere with achieving price stability – I'm sorry, maximum employment. You don't want the inflation target to be too high because that would interfere with achieving the economy's potential and maximum employment. And similarly, we want a maximum employment definition that's consistent with inflation averaging 2% over time. So that was the analysis that went into that. I, myself, wrote some papers way back around those issues, so it's not arbitrary. Most central banks in advanced economies have chosen inflation targets of 2 or 3% for that reason.

So let me get to the question about the pain. You know, my baseline forecast is that inflation will come down quite a bit this year without the unemployment rate rising a lot. I do have a forecast, which is similar to the median in the March economic projections of the committee, of unemployment reaching about 4½%. That's not that much higher than our estimate of the long-run unemployment rate. I think that the way that I think about your question, the second question, is we know that inflation, high inflation affects different groups in different ways. It does undermine our ability to achieve a maximum employment.

So it's really important that we, over time, bring inflation back to 2%. So obviously with the dual mandate we wanted to do it in a way that balances our two objectives, but in

doing so makes sure that we achieve the 2% inflation. You know, some people ask the question, well, why not choose another inflation target? I think that would undermine, first of all, I don't think it would be consistent with the dual mandate and the connection between them. But also, you know, going back to the earlier comment that, you know, having well anchored inflation expectations, avoiding wage price spiral type of dynamics in the 70s has actually been very beneficial here and other countries. So I think it's very important for us to carry out our commitment.

SARA EISEN: I think we have one here...

QUESTION: Gerald Di Chiara from Ameriprise. So Professor Segal has made a lot of this shelter component which makes up about a third of the number, driving the number higher than it should be. And a big part of that would probably be owners' equivalent rent. He's kind of even used the words that once the real-time data starts to more properly reflect in that number, I think he's used the word it's going to act like a sledgehammer on the CPI number. I wonder if you could comment on that and when you think that will happen and how much impact I guess?

CHAIRMAN JOHN C. WILLIAMS: Yes, you know, I think the basic point, which I made a passing reference here earlier, is right. I mean we are seeing, you know, this is the data that shows us what are people, when they sign up for a new 12-month lease, what are they agreeing to on the rent versus the previous on the same unit? And so we're seeing

those rents come, well, either the rate of inflation comes down or actually in some cases the rents come down. And we have the ability like, you know, a lot of people, I think it takes a spreadsheet, is convert that to what the shelter inflation rates will be over the next 12 months.

And there's no question, especially on the CPI where the weight of shelter is very high, as you mentioned, that that's going to bring the core CPI and the overall CPI down very sharply. I think we have to be careful here to, so we've got that in our analysis, if you look at my own forecast where inflation is going from the current level of say roughly 4-1/4 down to 3-1/4 by the end of the year. That's part of the driver of bringing that inflation down. Now, we're not going to get that disinflation every year, year after year. We're not going to see inflation for rents go from, you know, whatever, 5 to 2 to -1, right? You have to be careful about, this is probably a reflection of an adjustment process. But that's in our forecast.

It's probably one of the reasons that we could see CPI inflation and PCE inflation kind of separate a little bit over time. But I think this is one of the things that's easier to understand. We have the data. We have the analytics to see how that translates. It's a little bit of a communication thing because we have to, you know, like you had to live through today. I have to go through core services excluding housing because it's the piece that isn't affected by that. But I think it is a major factor.

We're tracking it very closely and it's part of our forecast. I think the real question I have is how far will this process go? Like right now, the data on new rents is still, you know, very small increases. Six months from now, you know, we'll see whether that stays low. And if it does, that's a very good sign. If it starts picking up again, just more information that we'll have to take into account.

SARA EISEN: I think we have one back there...

QUESTION: Hi. This is Raana Khan from Joseph Stone Capital. Thanks for your talk. I have two questions. The first is, you know, there was no warning or anything right before Silicon Valley issue. We hadn't read any report or felt that there was a signal that there's a crisis coming from regional banking. So how come Fed got it so wrong? Now you're saying the banking system is resilient. It's hard to believe because you got it wrong the first time. And the second question, connected with the first one, the issue wasn't regional banks or small banks, the issue was commercial real estate. That issue is still there, commercial real estate. And what is the Fed doing? And is there a contingency plan? Thank you.

SARA EISEN: He's tougher than me.

CHAIRMAN JOHN C. WILLIAMS: I was about to say the first question was a statement,

but I'll take it as a, do you agree? So I think there is a lesson in that. I think that's one of the lessons. There was a recognition that banks, especially we understand the interest rate risk of banks. And in banks like Silicon Valley Bank, who held a lot of fixed-income, you know, Treasuries and MBS, had taken on a lot of interest rate risk. And I think that's one of the key lessons from a supervisory point of view is to make sure there's timely action when there's those kinds of risks, both by the firm but also from the supervision side.

So I think there are lessons. Those risks were understood to exist. I think that the surprise in March was it went from people saying, yes, there's interest rate risk and especially in some of these banks that are, like Silicon Valley, more exposed to this, given the decisions they made, to seeing a, like massive run on that bank of the uninsured deposits. It happened over a period of hours. So I think that that is the real lesson of this. Obviously, the lesson is, as I said, we need to make sure that we're nimble and managing, you know, supervising these institutions well.

In terms of your second question, I think that, you know, this is pretty public information about, given the reporting from the banks, these were pretty extreme outliers. Silicon Valley Bank, in terms of the uninsured deposits, in terms of both sides of its balance sheet, the asset and the liability side. And we saw similar issues at Signature Bank. So these are pretty far outliers in terms of their vulnerabilities there.

But, you know, if I go back and think through both of your questions, the lesson is one of humility of understanding, you know, how are things going to develop in the future, evolve in the future when there is a shift in sentiment, in markets or around the fundamental soundness of a specific institution. And the fact that this can move very quickly and move in a profound way and then have potentially contagion to other institutions that really don't have these same problems is clearly a lesson that we need to take into account.

SARA EISEN: What about the commercial real estate question? Because I know a lot of people have that, are you worried about souring loans? Bad loans on commercial real estate?

CHAIRMAN JOHN C. WILLIAMS: Just to be clear, I mean CRE was not the issue at Silicon Valley Bank in terms of the problems there. But commercial real estate is clearly something that we're very focused on at the Fed, both on the supervision side but also in watching the economy and understanding potential risks there. So we are definitely both monitoring that and analyzing it but also paying very close attention in the supervision space around banks' commercial real estate risk. This is primarily focused in the office space. That's where you see some of the potential declines in values as businesses have seen people go to work from home or remote, the demand for office space has gone down in places like New York and San Francisco and other places.

So, you know, that is an area definitely we're focused on. That's where, you know, banks or other institutions that have more CRE risk, especially in office space, you know, we're paying close attention to that. So I think that from my perspective, this is just, kind of the thing that's right in front of us, that we understand what the issues are, we just need to pay very close attention.

SARA EISEN: We have one here...

QUESTION: Just on the banks again, not to beat a dead horse, we don't want to talk about them the whole afternoon. But last week, TD walked away from purchasing First Horizon. And for me, covering banks, very rarely that you see a bank walk away from a deal unless something is wrong. So publicly, First Horizon came out and supported their company, their stock. TD was very clear. We don't know when there's going to be approval, and it's been dragged out for some time now, that deal. The question for you is wouldn't we want more consolidation in bank land? Shouldn't these regulators actually encourage it?

Partially, a lot of these ___ have never experienced a rising rate environment. So I think Silicon Valley, Signature, First Republic, we could argue are unique. I don't think so personally. But I think one of the things we do need is more consolidation in our system to actually get rid of, not bad actors, but weak players. And why wouldn't that have been

one of the mandates last week? Because when TD came out and said that, that really put a damper in anybody's thought process around having any consolidation, before receivership.

CHAIRMAN JOHN C. WILLIAMS: So I won't speak to any specific institution, but I don't think there's, in my view, we don't need to see blanket more consolidation or less consolidation. I think our banking system is, you know, with the community banks, with mid-sized banks, with the larger banks, having all of that be healthy and strong actually serves the public, the businesses, households effectively. So I don't think we need to have one or the other. I do think what we need is to have healthy, strong institutions. And I do think it was actually important where the FDIC, you know, handled the three banks through receivership and those activities of those banks are being taken on by other banks. So I think that's an important part because that's where you, if you don't have, I mean you might have a hole in our kind of financial system about providing credit to areas, but my view is, especially, we don't have a desire to more consolidation or not, it's really more making sure we have a strong, a strong banking system at all the different levels that I think are important for our economy.

SARA EISEN: I think we have one more here...

QUESTION: It's ____. Thank you, John. It's ___ that innovation of every, in the last

three months, every other conversation, you start with ChatGPT and with Chat in between. So how then current ____ member agencies are, their direction toward the innovation. Are we applying the brakes? Or are every ___ member agencies are taking the lead on that?

CHAIRMAN JOHN C. WILLIAMS: You know, I can't speak for other agencies on this. But I do think that innovation in the financial system is for real. I mean I know that, you know, earlier in my career a lot of people in the financial system were no, no, no, that's for tech companies and Silicon Valley. But we're definitely seeing innovation, both in terms of AI. We're seeing that in terms of various different digital assets and things like that.

So I think what's really important for agencies or the official sector is to stay focused on our mandate. Like we have to protect financial stability, we obviously need to protect the safety and soundness of our financial system and the success of our economy. And so that, to me, I think innovation is not good or bad or we should be for it or against. It's really making sure that that innovation is being harnessed to improve the delivery and the cost effectiveness of financial services or other things. And I think that's where a lot of the focus really is the way we think about some of the areas of innovation.

I think artificial intelligence is really a huge thing. We've been talking about it. It's around

the corner, it's around the corner. Well, suddenly, it's not around the corner. It's right there. And so again, we just need to be nimble. We need to keep up with the technology. We need to understand it. And again, be driven by our public mission in deciding how we approach it.

SARA EISEN: Do you use ChatGPT?

CHAIRMAN JOHN C. WILLIAMS: I do not, although I've had some friends make suggestions to me.

SARA EISEN: I bet it could do a killer Fed statement.

CHAIRMAN JOHN C. WILLIAMS: Sara, that was so easy. You could have said, I thought ChatGPT wrote the last Fed statement. It did not. It was actually human beings.

SARA EISEN: Alright, thank goodness, God only knows. Thank you so much for the time today.

PRESIDENT BARBARA VAN ALLEN: Terrific conversation. And Sara, thank you also. Really wonderful. So I just want to give a little peek into the upcoming schedule in terms of major events. It's probably pretty well known that we're going to host Henry Kissinger,

the Chairman of Kissinger Associates, Former Secretary of State, for a Signature Luncheon on May 23rd. And that is proving to be a very popular event, so if you're interested, please let us know. We'll be celebrating, by the way, his 100th birthday. And I did have a couple of people say, is he going to be in the room? Yes, he's going to be in the room. He's going to do actually a fireside chat with Marie-Josee Kravis, our Chair Emeritus. And I don't want to overlook the virtual event we, by the way, have May 17th, where we will host the Ukrainian Ambassador to the United States. So that should be a good conversation. We'll focus a little bit on the rebuilding of Ukraine after the war. On May 23rd, the Club will have another complimentary One Member-One Candidate Reception, inviting all members to bring your prospective member candidates. And this is an invitation-only event, and we hope to see some of you there with potential candidates. And June is shaping up to be actually another great month. Marc Rowan, the CEO of Apollo Global Management, will be joining us. And Karen Karniol-Tambour, the Co-Chief Investment Officer at Bridgewater, will be also joining us in June. And there are more surprises in store that we not yet announced. So continue to watch our website.

I'd also like to just take a moment, as we always do, to recognize our 361 members of the Centennial Society, whose contributions help to provide the financial backbone for the programming here at the Club. So thank you to all who are attending virtually today. We have a crowd bigger than this attending virtually. So thank you. We're going to say

goodbye. And for everyone in the room, enjoy your lunch, and we'll see everyone again, I hope, soon. Thank you.