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John C. Williams
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Webinar

Moderator: Catherine Rampell
Columnist, The Washington Post

Introduction

President Barbara Van Allen

Good afternoon and welcome to the 624th meeting of The Economic Club of New York in our 114th year. I'm Barbara Van Allen, President and CEO of the Club. As many of you know, The Economic Club of New York is the nation's leading nonpartisan forum for open discussions on timely economic, social and political issues, and we feel our mission today is as important as ever as we bring people together as a catalyst for civil conversation and innovation. A special welcome to members of the ECNY 2021 Class of Fellows – a select group of diverse, rising, next-gen business thought leaders sponsored by members as well as students from the CUNY Graduate Center, Columbia Business School, Rutgers University, and the Gabelli School of Business at Fordham.

It's a pleasure for me to now introduce our Club Chair, John Williams, who also serves, most importantly, as President and CEO of the Federal Reserve Bank of New York. In that capacity, he serves as the Vice Chairman and a permanent member of the Federal Open Market Committee. From 2011 to mid-June of 2018, John was President and CEO 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 for the Federal Reserve System. In addition, he served as a senior economist in the White House Council of Economic Advisers and as a lecturer at Stanford University's Graduate School of Business. John holds a PhD in economics from Stanford, an MS degree from the London School of Economics, and a AB from the University of California at Berkeley.

Today's event will begin with opening remarks by John. After his remarks, he'll be joined by Catherine Rampell, Columnist at *The Washington Post* – thank you for being here, Catherine – whom we are fortunate to have as our moderator. Today we will also have the chat box open during the event, so you can pose questions directly for Catherine and John to potentially use in the conversation. In addition, any questions that were submitted in advance to the Club on the online portal were shared in advance with Catherine and may also be addressed during the conversation. We're going to end promptly at 1. As a reminder, this conversation is on the record and we have plenty of media on the line today. So without further ado, John, the mike is yours.

Opening remarks by John C. Williams

Well, thank you for that kind introduction, Barbara. It's a great honor for me to be addressing members of The Economic Club of New York today, and this is the first time

I'm doing so since becoming the Club's Chair.

Today's event was scheduled to take place in person, and we were at the Club. We were really looking forward to the opportunity for us to be able to come together. But predicting the future is nearly impossible and here we are meeting virtually. Now, I say it's nearly impossible to predict the future because I plan to share my outlook for the U.S. economy with you over the next few minutes.

Now we're not the only ones that expected business to be more like usual at this point in time. But the direct and indirect effects of the virus continue to shape the way we live our lives, do our work, and come together with others. On top of that, signs of the Delta variant's impact are showing up in the data, contributing to more uncertainty about the future. Business, in fact, is unusual in many ways, and continues to reflect the extraordinary nature of the pandemic.

In my remarks today, I'll share more about how these effects relate to the economic outlook for the nation and right here in New York. I'll also go into some detail about the outlook for inflation. And finally, I'll discuss what this means for monetary policy and the road ahead. 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.

I'll start by saying that the headline of our economic story is good news. The recovery continues to show solid momentum. But the subheading is that we'll need to be patient. Even with the strong pace of growth we experienced much of this year, a full recovery from the pandemic will take time to complete. The adjustment to rapidly changing circumstances, along with a resurgence in Covid-19 cases, is affecting consumer spending and jobs, sustaining supply bottlenecks in sectors such as autos, and delaying a full reopening of the service sector.

So, to continue with the news analogy, here's the lede. I expect gross domestic product, or GDP, to increase around 5 ½ to 6% this year. My current forecast accounts for strong growth in the first half of 2021, but also balances some slowing of growth in the remainder of the year relative to the first half.

Now I'll turn to employment, something I know many of you as business leaders watch closely. Job gains, by and large, have been strong in recent months. On average, 750,000 jobs were added per month over the three months through August, and the unemployment rate now stands at 5.2%.

At the same time, we're seeing indications that the labor market recovery is being impaired by the recent Covid surge. Job gains slowed noticeably in August, with the weakening concentrated in sectors most sensitive to the pandemic, including leisure and hospitality. Health concerns, early retirements, and childcare challenges continue to weigh on labor supply. Anecdotally, a lack of immigration and work visas is affecting labor supply as well.

Another storyline that's taken hold is the cycle of hires and quits in the labor market. Clearly, demand for workers is very high. We see this in an elevated number of job postings and hires. At the same time, people are leaving their jobs in large numbers, either to look for new work or exit the labor force altogether. These conditions reflect the extraordinary nature of the pandemic, and also illustrate that we still have a long way to go until we achieve the Federal Reserve's maximum employment goal. In fact, there are over 5 million fewer jobs today than before the pandemic, and the unemployment rate is still far above levels reached early last year.

When tracking progress toward maximum employment, it's important to take two points into consideration. First, even if job postings are at a record high, job postings are not jobs. These vacancies won't be filled instantly. It takes time for employers to find the right workers. And second, a full recovery means a recovery in employment, not just lower unemployment.

Employment dynamics are driven by both the unemployment cycle and the labor force participation cycle. Because employed workers are more likely to remain attached to the labor force, these cycles are closely interrelated, as lower unemployment raises participation by reducing labor force exits. And this relationship also means that the participation cycle typically lags behind the unemployment cycle, and this is an important feature to keep in mind in assessing the state of the labor market.

Even with this in mind, demand for workers and progress on hiring remains strong, and I expect some pandemic-related factors to diminish as progress is made on containing the virus both here and abroad. Therefore, I am confident that we will continue to see meaningful job gains and continued progress toward maximum employment.

The last aspect of the outlook that I'll speak about is inflation. Core Personal Consumption Expenditure inflation, which excludes volatile food and energy prices, has averaged about 2-3/4% since the start of the pandemic. This is above the Federal Reserve's 2% longer-run goal.

We saw some very high monthly inflation readings in the second quarter of this year, reflecting pandemic-related supply bottlenecks and imbalances, but more recent data have shown that the inflation rate is moderating. The earlier spike in inflation largely reflects the effects of the rapid reopening of the economy, which pushed supply and demand in extreme ways.

In fact, we are now seeing some of the pandemic-related spikes retrace, including prices for lumber, used vehicles, and rental cars. This process of adjustment may take another year or so to complete as the pandemic-related swings in supply and demand gradually recede. As the economy gets through these highly unusual dynamics, I expect inflation to come back down to around 2% next year. One reason I expect inflation to moderate is that measures of underlying inflation and longer-term inflation expectations have been relatively stable during this period of otherwise volatile inflation readings.

There are two aspects of longer-term inflation expectations, or two important aspects of longer-term inflation expectations: their level and their sensitivity to economic conditions, in particular, to inflation. In terms of the level of inflation expectations, survey and market-based measures of longer-term inflation expectations have reversed the declines that we saw in the past several years and are now around levels seen seven or eight years ago. And they currently appear to be well aligned with our 2% long-run inflation goal.

The second issue is how well anchored inflation expectations are, and whether there's a risk that they could drift higher in response to the elevated rates of inflation that we've been experiencing. A group of economists at the New York Fed took a closer look at recent behavior of inflation expectations using the New York Fed's Survey of Consumer Expectations. In particular, they looked at longer-term inflation expectations and found that expectations of inflation five years in the future have barely budged over the past two years.

This evidence is reassuring that, despite the highly unusual swings in inflation over the past year and a half, inflation expectations are still well anchored. In addition, measures of underlying inflation that are not overly influenced by the effects of the pandemic have remained stable. So with underlying inflation and inflation expectations running at levels consistent with our 2% longer-run goal, I expect inflation to decline to about 2% next year as the pandemic-related effects on prices subside. Still, there is a great deal of uncertainty about the inflation outlook, and I'll be watching the data on inflation and inflation expectations closely.

These numbers tell the story of the economic outlook on a national level. But the New York economy faces unique challenges, and they may be more serious relative to other parts of the country. New York State's unemployment rate is well above the nationwide rate, and New York City's is almost double the national figure. Private sector employment in the state is down nearly 10%, with the hard-hit leisure and hospitality sector down 27%. Now that said, the most recent data shows signs of improvement. Employment across the state grew at roughly double the nationwide pace in August, with outsized growth in New York City. Looking ahead, I expect the New York economy to continue to strengthen along with the national economy over the next few years.

So this brings me to the Fed's policy response. In its December 2020 statement, the Federal Open Market Committee, or FOMC, said it would continue asset purchases at the current pace until it sees substantial further progress toward our maximum employment and price stability goals.

Given what I've said, I think it's clear that we have made substantial further progress on achieving our inflation goal. There has also been very good progress towards maximum employment. Now, assuming the economy continues to improve as I anticipate, a moderation in the pace of asset purchases may soon be warranted.

It's important to remember that even after the asset purchases end, the stance of monetary policy will continue to support a strong and full economic recovery and sustained attainment of 2% average inflation. Particularly, the FOMC has indicated that it will continue to hold the target range for the federal funds rate at its current level until the economy reaches conditions consistent with its assessments of maximum employment, and inflation has reached 2% and is on track to moderately exceed 2% for some time. There is still a long way to go before reaching maximum employment, and over time it should become clearer whether we reach 2% inflation on a sustained basis.

I began by saying that it's nearly impossible to predict the future. The economy remains tied to the extraordinary and unpredictable nature of the pandemic. But with continued progress on the economic recovery and a reversal of some of the pandemic's unusual dynamics, I anticipate that we will soon reach a time when business will be more like usual.

I look forward to the question-and-answer portion of today's program, and very much look forward to seeing many of you when we are able to be together in person. Thank you.

Conversation with John C. Williams

CATHERINE RAMPELL: Thanks so much, President Williams. A very informative and thorough talk, and I'd love to dig into many of the particulars that you addressed when talking about the macro-outlook and monetary policy. So one thing that you mentioned was supply chain issues, which continue to be a major problem for inputs like chips, for production, for shipping, other logistics. You know that lumber prices have fallen back to earth, but elsewhere bottlenecks have persisted for much longer than many people expected, I think you included perhaps.

Even if the forces behind these bottlenecks are transitory, turn out to be transitory, is there a risk that if they stick around for long enough, inflation expectations will change and firms will preemptively begin raising prices, causing inflation to become more self-sustaining?

JOHN C. WILLIAMS: Well, you know, that is something that I'm very focused on. As I said, you know, we need to watch or measure inflation expectations, look at other indicators of more, kind of broad-based sustained inflationary dynamics. So that, to my mind, would be looking perhaps not so much focused on the price of motor vehicles or specific goods that are affected directly by the bottlenecks and shortages that you mentioned, but looking at the broader indicators of underlying inflation. And those tend to be, you know, core services, looking at wage developments and again looking at inflation expectations.

So definitely keeping a very close eye on the pandemic, the sectors that are most affected by the pandemic but also making sure keeping track of those other indicators of more persistent inflationary pressures. So, as I said in my prepared remarks, I'm not seeing worrying signs of inflation yet there, but something definitely to be very much watching closely.

CATHERINE RAMPELL: What about rising shelter costs, including owner equivalent rent? How confident can you be that inflation will be transitory with shelter prices likely to rise in sort of a lagged response to the current home price surge? You know, especially given that nominal wages are rising rapidly as well.

JOHN C. WILLIAMS: Yes, sure, and you know, that is an important part of the dynamic of an economic recovery. We saw the prices of shelters, including owner-occupied rent, owner equivalent rent, and in other measures, you know, slow quite a bit during the downturn. And now we're starting to see some signs that, you know, they're going to pick up. But that's what you normally would see in an economic recovery. We've gone from a period last year where the economy was really, was hit hard by the pandemic, but now we're seeing very strong growth and unemployment come down, income is growing. So it's not surprising to me that some of these measures of shelter costs are starting to rise and, as you pointed out, house prices have risen quite a bit.
So I see that as part of the dynamic that would come from a strength in the economy. And one of the reasons I expect, you know, looking for that to happen, for inflation to be, you know, consistent with a sustained achievement of 2% inflation, if you look at the period right before the pandemic, if you looked at the inflation rate, what was happening was that service prices, which includes shelter, were growing on a CPI basis, you know, roughly around 3%. Goods prices tend to grow much, much slower because there's more technological change in advancement and productivity growth in the goods sector, the durable goods sector. So you typically see shelter prices rising more than the average inflation rate.

So what we've seen is the shelter prices grow more slowly. I would expect them to come, that growth rate to get back up to levels consistent with 2% inflation overall, and at the same time, to see some of the durable goods prices that were such a big part of the story over the last year and a half, those inflation rates to come back to more fundamental. So it's definitely, the big story here is basically a shift, you know, initially into durable goods, into buying cars and appliances and things like that, and then as the economy is improved, we're going to see it back to services. Again, I see that as part of the story of how we're going to end up with 2% inflation rate or a little bit above that over the next few years. But again, that's what I would be looking for, to see a sustained achievement of 2% inflation.

CATHERINE RAMPELL: On housing prices, why is the Fed buying mortgage-backed securities when home prices are booming?

JOHN C. WILLIAMS: Well, you know, the way I see that is our asset purchases, which, you know, are currently a combination of $80 billion of U.S. Treasury securities plus the $40 billion of MBS, mortgage-backed securities, this is really to provide financial conditions in support of a strong and full economic recovery and achievement of our goals of maximum employment and 2% inflation on average.

So, to me, that's how these two tools that we use – the asset purchases, both of

Treasuries and mortgage-backed securities – really work together to provide very accommodative financial conditions that support a strong and full recovery. Based on the research that I've seen and the analyses I've seen, sure, buying mortgage-backed securities may have a small extra effect in reducing mortgage rates, but that's a very small effect compared to the overall effect it has on financial conditions much more broadly, that affect the overall economy.

Now, you know, my view is that these tools have been extremely effective, both in the prior economic recovery and expansion and this time. But, you know, as we've discussed, we're using them to support a strong overall economy, not trying to target a particular sector.

CATHERINE RAMPELL: So let's talk a little bit about the Fed's new framework and how it fits into your remarks today. What do you say to people who are worried that the new framework fosters an environment where the changing reaction function gives these kinds of supply side spikes in inflation that we were talking about given supply chain problems, etc., more persistence than might have been otherwise the case?

JOHN C. WILLIAMS: Well, I really don't think the change in our framework from last year, which I fully supported and I think it's an absolutely great improvement in our monetary policy strategy, really is the story here. What we're dealing with, whether it was with the old framework from before or the new one, we're dealing with this extraordinary period of supply and demand shifts from the pandemic, from fiscal policy, from a global pandemic. And obviously the supply shortages that we talk about, and the bottlenecks, many of them, these are occurring in other countries and affecting us.

So, to my mind, it's not really about the framework. You know, the difference which, you know, the real change there was making sure that we were focused on maximum employment and achieving inflation of 2% on average, really is the change that matters so much for the pandemic. Right now what we're dealing with are big swings in supply and demand that are pushing up inflation. No question. But we're just dealing with that as you would deal with it in any circumstance so we're trying to balance the achievement of both of our goals and bring our economy over the next couple of years to achieve both maximum employment and 2% inflation.

So I don't see the framework as being the story here in terms of creating greater risks of higher inflation. It's really about, if you read our consensus statement, as we call it, it's all about anchoring inflation at 2%. And we want long-run inflation to average, over the long run, inflation average at 2%. The problem we had earlier was it was running on average below 2%, but today, again, I would just reiterate the framework is really about assuring that we have and having a policy to make sure that we anchor inflation expectations and inflation at 2%.

CATHERINE RAMPELL: Your colleague, Chicago Fed President Charles Evans, also spoke earlier today, talked about the framework, and suggested that the Fed needs to aim for a stronger inflation overshoot than what is currently in the projections, which released last week showed that no FOMC member expects over, I think it was 2.3% inflation in 2023. Evans said, "I feel we need to go beyond trying to thread the needle by a couple of tenths in order to be assured of a sustainable, moderate overshoot." Do you agree with that assessment? Are there advantages to substantially overshooting your inflation targets or to so-called catch-up inflation?

JOHN C. WILLIAMS: Well, my, again I'm going to sound like I'm saying the same thing as last time, but my view is the test here really is about are we really anchoring inflation expectations and actual inflation, both of those, at 2%? So it's not so much about, you know, are my forecasting 2.1 or 2.2 or 2.3% inflation, but the test here, which is completely driven by the data and the experiences, making sure that we come out of this episode with a very firm foundation where the public expects inflation on average over the medium term to be 2%, and we're delivering a notion of inflation on average of 2%. And with that, it improves our ability to respond to any change in economic conditions that we may see.

So, you know, when I look at the forecast right now, there's just so much uncertainty. There are so many things that we, you know, it's very hard to predict. And you mentioned some of those already, the bottlenecks and some of the supply chain issues have lasted longer and been more severe than many people expected. So we need to just be data-driven. We need to be focused on achieving the goals that we set out, and which our FOMC statement has, I think very clearly described now for about a year in terms of the liftoff conditions. And really just make sure that we're achieving that goal of getting the inflation anchored as close to 2% over the longer-term as we can.

CATHERINE RAMPELL: So speaking about being data-driven, with some notable exceptions, Fed officials generally don't give advice on what fiscal policy should look like, but to what extent do you consider what fiscal policymakers are actually doing when you are forecasting macro indicators or setting monetary policy? For example, when Congress passed a $2 trillion fiscal stimulus this past spring, did that affect your inflation forecasts? Do the plans that are currently on offer right now in Congress for infrastructure spending and otherwise, are those taken into account in your own forecasts for inflation, growth, employment next year?

JOHN C. WILLIAMS: Well, absolutely. I mean, you know, as a forecaster for the U.S. economy, I think there are two things that are really important to think about. There's a lot of developments in terms of fiscal policy, understanding how that's affecting the economy, both here and over the next several years. International developments are equally important. You know, what's happening around the world has huge effects on the U.S. economy. So whenever I and the team think about what's the baseline outlook for the economy, we have to analyze how past fiscal policy actions are affecting the economic outlook and also think through the various scenarios of proposed fiscal policy actions that still haven't passed through Congress.

So, sure, that is definitely one of the environmental fiscal policies, one of the important environmental factors you have to think about in terms of the economic outlook, in terms of the inflation outlook. But I would just put that on a list of things when we go through the analysis and also the scenario analysis, that what are the various sources of uncertainty, I would include fiscal policy on that list but there's a lot of other things. Covid clearly, huge uncertainty out there to factor on the economic outlook, and then what's happening around the world.

CATHERINE RAMPELL: So does that mean you think that fiscal policy in recent months has been contributing to the above trend inflation that we have seen so far?

JOHN C. WILLIAMS: Well, you know, I think the way I think about this is I go back to just the extraordinary nature of the pandemic. And, you know, the vast majority of the fiscal actions that started back in March of last year with early action with the CARES Act and with various other actions that have taken place, you know, the vast majority of those were providing a bridge to get families, small businesses, state and local governments and others to get us through, as a country, a period of huge declines in income and jobs because of the pandemic, because of the shutdown of the economy, and because of all the repercussions of Covid.

And so, you know, it's not the usual fiscal policy. It's really about income support for Americans across the country in different ways. And so that's very different than fiscal policy that maybe we talk about in the textbook where we tend to think about the government spending more money on building a bridge or military expenditures and things like that. And so I think from my point of view, that's been just critically important to help minimize the long-term scarring and damage to the American economy and American households. So that's how I view this. I don't see that as primarily fiscal policy in terms of stimulus.

Now, it's true, clearly, that providing more income to American families, to businesses and others and state and local governments has allowed them to spend more, and that's where we've seen this show up very clearly in the data. People, you know, when the stimulus checks had gone out, people increased their spending on goods. That has, I think, been one of the factors along with just the pandemic moving a lot of people out of cities into maybe more suburban or rural areas, that's driven the demand for cars and driven the demand for a lot of things that have been in short supply. So, yes, that's part of that dynamic about the supply and demand imbalances.

Honestly, though, I would still put most of that responsibility of those imbalances on the supply side itself because with the pandemic has come, you know, shutdowns of factories or ports or challenges in getting the ships around the world to the right places because of the pandemic and these imbalances.

Now the good news is these are pretty localized. I mean they are, it's pretty clear what's causing these imbalances. It may take, like I said, a year or more to work all this out. If you think of the semiconductor chips in auto production, that's probably a great example of that. But, you know, we'll get through that. And then the real question is where are we afterwards? And a lot of those, kind of special factors in terms of supply and demand that caused the spike in inflation, are those still factors that are going to be driving people to, you know, want to buy more cars and buy more, kind of goods?

Or will people be doing what I think we started seeing this summer, you know, where people said, no, no, I bought the goods that I want, now I want to go back and travel and go to restaurants and stay at hotels? So that's what I'm expecting to see is more of a shift or back-away from buying goods, back to the service sector where there is clearly a lot of capacity out there and ability to meet that demand over time.

CATHERINE RAMPELL: Well, you mentioned that these are global phenomena that we're seeing, these supply chain problems driving inflation. But inflation has been rising higher in the U.S. than in other OECD countries. No? So what's different about what we’re experiencing here than in other countries?

JOHN C. WILLIAMS: Well, we are starting to see some of the similar kind of dynamics in the U.K. and in some other countries. So, it’s true, the experience is different across different countries. We’re not seeing as much in Japan. I think we’re seeing some of it in Europe. But I think again it’s this kind of unique confluence of factors – relatively large stimulus coming in to support families and small businesses and others. At the same time, running into some pretty specific supply chain bottlenecks and shortages that have really affected certain goods.

Now, I know that, you know, I don’t want to just focus on used cars, but it’s hard not to. The increase in used car prices over the pandemic period actually explains a big part of the rise in the CPI. And if you look at new car prices, you see that too. So when you break it out, I know that, you know, I’m not trying to say it doesn’t matter. It obviously matters if you’re trying to buy a car, prices are higher. That is true. But when you look at kind of the causation of where the inflation has been really high in the U.S. than, again, compared to other countries, it can be narrowly identified with specific, some specific sectors, and motor vehicles is clearly one of them.

CATHERINE RAMPELL: Do you worry about calculations suggesting that there will be a negative fiscal impulse, close to three percentage points or so, next year and whether this complicates the prospect for a monetary policy exit?

JOHN C. WILLIAMS: Well, that's definitely part of the calculation. And again, you know, there were different estimates of the fiscal impulse, both for 2020, '21, '22, '23. But I completely agree with the premise that fiscal policy was providing a huge boost to household income and businesses, like I said. And, you know, with a lot of these programs now coming to an end, kind of that boost to the economy is disappearing. So that's definitely something I factored in to my forecast. I don't expect growth to be nearly as strong next year as this year. It's still a strong economy. It's still moving, you know, on the way to maximum employment. I still think that's the main outlook. But it will be slower because of some of the fiscal support that was so valuable in the past is and will be coming to an end. So that's definitely one of the factors.

I think, again, as Covid hopefully, we get further, you know, we get further and further progress in terms of dealing with Covid through vaccinations and everything, that we'll see the service sector, the sectors that are still way below where they were a year and a half, or before the pandemic, leisure and hospitality and others like that. As you know, in New York City, the restaurants and the bustle of tourism and all those things that are missing right now, when those are fully coming back, those will give us an additional boost to the economy. Kind of like the reopening of the domestic economy did earlier. So that's how I get to a point where I expect above-trend growth next year.

Some drag from fiscal policy in terms of growth rates and that counterbalanced by further reopening and broadening of the reopening of our economy. It is, again, one of the risks, though, that dynamic could actually be more negative than we expect. I mean one thing that gives me some optimism is households are sitting on a lot of savings built up during the fiscal support of the pandemic so we know that household savings is very high now and that hopefully will be another factor supporting consumer spending growth over the next year or two.

CATHERINE RAMPELL: So let's talk a little bit more about labor markets which you addressed in your remarks. Noting that labor supply challenges remain even after the end of a number of federal unemployment insurance programs that I think many business owners and economists and others anticipated would ease some of the labor shortages, but still vacancies are going begging. Why do you think it is that so many people aren't returning to their jobs or even the labor force? And what can be done about it if the problem is primarily some of the factors you mentioned in your remarks? Retirements, lower levels of immigration, childcare. Can Fed policy and relatively loose monetary policy in particular actually do very much to promote employment growth?

JOHN C. WILLIAMS: Well, I think we don't know the answer to the first part of your question, is what is it that's holding back labor supply right now? I think we all can, I think, agree to a list. I mentioned some of them. There's still hesitancy about coming back into jobs where you are at risk of being around people who might have Covid. So there's, I think, a lot of factors.

The unemployment insurance issue was definitely one of the factors that obviously is no longer at play. The inability of childcare is something I hear about a lot. You also have this kind of issue of reattaching people to the labor force, which is, you know, really what I was getting at about the dynamics of a recovery. We saw a really fast rehiring of the temporary layoffs. You know, people who were laid off for a few months, they got hired back to their original employers. But now we're having to re...not, rematch, but match people with different employers, often different jobs, maybe different locations. So I think that's another factor.

So I see a lot of hiring going on. The numbers of people being hired every month, the gross numbers, is very high. But we're also seeing a lot of people switching jobs and doing, maybe even leaving the labor force as you said. So I don't think we know the answer to this. I guess I'm trying to be a bit humble about this and say we're going to have to watch and see. I am not in the camp that thinks we're going to see this huge surge of labor supply in, you know, September or October as the schools reopen and everything. I think that's one of the factors. But we're going to really have to watch and it may take quite a bit longer for the labor supply to come fully back. I do think it will.

One of the lessons of the last expansions was that with patience, eventually, because, you know, when all these stories happened back in the middle of the last recovery, you know, labor participation is really low and it's not going to come back. But what we learned is a sustained, strong economy, a robust economy year after year really did not only lower unemployment, but it also strengthened the participation rate and really got us to a very healthy level of employment that I think it's really what our maximum employment goal is.

So my answer is not very, kind of maybe satisfactory in the sense I don't have the clear answer to it, but I do think my vision about, like what do I think about maximum employment when the labor market is not what's happening right now because there's just so much churn and so much change happening, but really thinking 12 months, 24 months in the future, what's good going to look like then? And I think that's going to be a labor market that's very strong and we're going to get through a lot of the challenges we're seeing now hopefully.

CATHERINE RAMPELL: Would it be appropriate to lift interest rates off of zero before the unemployment rate returns to its pre-pandemic level, which I think was around 3 ½%, and if so, why?

JOHN C. WILLIAMS: Well, you know, our FOMC statement has consistently said that, you know, one of the very stringent tests for the liftoff of the federal funds rate from its current level would be seeing employment at levels consistent with maximum employment. So, you know, I think that was really a good way of describing what we're waiting to see. I think that will set us up well, you know, to achieve a durable and strong economic recovery and achievement of sustained 2% inflation on average. So I think that's the right way to think about it and that continues to be the FOMC's statement on that.

So I don't see a need, given the outlook, to have a different view than that. I think, you know, one of the things that sometimes comes up is, well, don't you want to get ahead of, do you want to get ahead of it? The economy is getting stronger and stronger, don't you want to start raising rates before that goes too far? One of the lessons of the past recovery was that we really, by acting too early and maybe preempting a full and strong recovery, we didn't really see inflation achieve our 2% goal on a sustained basis in the last recovery.

And that's one of the important things of the framework is we really want to be focused on the maximum employment in a broad, inclusive way, but also to achieve that sustained 2% inflation. That's still well off in the future. Right now we're still in the pandemic stage. But that's how I'm thinking about what are the, you know, our statement language explains the conditions for liftoff, and I think those are really good to help us really get a very strong, full recovery and achieve our inflation goals.

CATHERINE RAMPELL: On the language about inclusive growth, I think there's been lot of confusion about what that specifically means. Are there particular benchmarks you're looking for, for specific demographic subgroups? Is the threshold when the Black unemployment rate meets X percent or the gap between the Black-White unemployment rate, you know, narrows to a certain number of percentage points? What does that mean? I mean I think that it sounds nice, inclusive growth, but there's a lot of confusion about what, in practice, that represents.

JOHN C. WILLIAMS: Yes, it's a fair point, because it is a very general statement. In my view, it does not mean having different targets or goals for unemployment rates for different groups or employment levels for different groups. I think the words together – broad and inclusive – are actually important, working together. So I think from my own kind of reflection on this, is we do get caught up in what's the unemployment rate, the standard unemployment rate, the number I mentioned in my speech, the 5.2% rate.

And there are so many other indicators in the labor market. First of all, there's U4, 5, and 6, which are much broader and I think in many ways more inclusive measures of underemployment because they talk about people who are working part-time who want to work full-time. They talk about people who are on the margins of the labor market who want a job but they don't get counted as unemployed. So that's part of that broader, and I would say more inclusive definition.

Obviously, it also is reflecting our society and being inclusive across different ethnic and racial groups and across different sectors and really getting the big picture of the economy. So again, it's not about, to me it's not about having specific goals for each group, but really thinking holistically about what is a really strong economy like and what does maximum employment mean? So going back to thinking, well, the natural rate of unemployment is 4% or 5%, whatever we talked about in the past, it's getting past that and like really looking and saying is this truly what we see in maximum employment.

And one of the gains, I mean one of the benefits of the last experience is we kind of went past where we thought maximum employment or the natural rate of unemployment was and we realized there was a lot more labor supply out there. The labor supply was much more lasting in 2018, '19 and into 2020 than people had originally thought and understood. So allowing that economy to kind of fully reach its potential is what I think of as broad and inclusive. It's inclusive but across all parts of, segments of our society, but it's not getting kind of caught into, you know, the mentality, well, I've got one summary statistic that tells me the state of the labor market. I've got to look at all the data and come to a judgment.

CATHERINE RAMPELL: Let’s talk about some other risks to the more immediate outlook right now. The federal government is coming close to running out of money to finance its obligations. We’ve already technically hit the debt limit and Treasury is engaging in extraordinary measures to keep us afloat. Even coming close to a debt default could and has caused some disruptions in the Treasury market that could cause broader market stress. How worried are you about this right now? And what measures, if any, could the Fed take to limit the possible fallout from defaulting on our debt?

JOHN C. WILLIAMS: Well, let me answer the second part first and then I’ll get back to the first. Clearly, you know, we have, we, at the Federal Reserve, cannot undo the potential damage to the financial system or the economy if the U.S. government were to not meet its obligations. So regardless of what you think we could or would do, it would not be able to undo what the potential damage of a default would be in the sense of not paying on its obligations.

So I think this is absolutely critically important that the elected officials, obviously in Congress, and the executive branch, that this get resolved in a timely manner. It creates uncertainty in the markets now, but we’ve been through that before. But, to me, you know, when you think about – what did I say earlier in my remarks – I said it’s impossible or it’s very hard to predict the future, I mean I think we should all be humble that the federal government not being able to pay its bills would clearly have huge negative effects on the American economy.

CATHERINE RAMPELL: And I apologize. Your video feed has been cutting out periodically for me so I don't know if you addressed this, but in a March 2013 Fed call transcript you had seemed open to some actions to deal with the damage from a possible default, that some of your fellow FOMC colleagues...(are you still there?)

JOHN C. WILLIAMS: You froze.

CATHERINE RAMPELL: I froze. Oh, okay.

JOHN C. WILLIAMS: You were asking about the 2013...

CATHERINE RAMPELL: In 2013, in a Fed call, according to the...

PRESIDENT BARBARA VAN ALLEN: John, Catherine...

CATHERINE RAMPELL: I'm here...

PRESIDENT BARBARA VAN ALLEN: I was going to jump in with the chat box questions but you're here, so please proceed.

JOHN C. WILLIAMS: Yes, I've been frozen for the last, about 50 seconds.

CATHERINE RAMPELL: Okay, I will try a third time if you didn't hear my question before. You had endorsed or seemed open to endorsing some actions in 2013 when there was another debt limit showdown, including outright purchases and CUSIP swaps. Some of your colleagues at the time referred to them as loathsome or beyond the pale. Would you still remain open to those kinds of measures if we faced a default?

JOHN C. WILLIAMS: Well, you know, I'm not going to speculate on what we would or would not do in a situation like that in terms of our ability. I expect, you know, again going back to my first point, I don't know if you were able to hear it, is that regardless of what we do tactically or operationally in terms of our own procedures, that would not fundamentally change the damage that the federal government not paying its bills would do. So again, I'm not going to speculate on particular actions that we could take, but again, you know, those would be, they wouldn't be able anywhere near to address the kind of damage that the federal government not being able to pay its bills would create.

CATHERINE RAMPELL: Can anyone hear me? Oh, you're back. Okay. Sorry, I don't know what the technical difficulty issue is.

JOHN C. WILLIAMS: It shouldn't be from me. I checked my computer and it's running fine.

CATHERINE RAMPELL: So another potentially controversial question for you, I guess, but what should the Fed's role be in assessing the risks from, or even mitigating, climate change?

JOHN C. WILLIAMS: Well, now I'm just going to ask, Catherine, can you hear me?

CATHERINE RAMPELL: Yes.

JOHN C. WILLIAMS: Okay, good. You know, I do think that climate change is one of the very important factors that's going to grow in importance for understanding the economic conditions, financial conditions, and obviously the health of the financial and economic system we're in. So I think from the Federal Reserve's point of view and from my perspective, it's really important that we have the expertise, the knowledge and understanding of how climate affects our local economy, our national economy, the global economy, how it creates risks or changes for the banking system, the financial system. So I think these are right at the core of what we do as a central bank, at the Fed. You know, we have responsibility to our monetary policy around regulatory and supervisory responsibility and responsibilities to make sure, you know, around our community development and economic development.

So, to me, understanding, studying and being an expert at the climate-related issues is core to all of that. We don't make climate policy at the Federal Reserve. That's for the elected officials. But understanding this, understanding these issues, and incorporating that in our analysis and our thinking, I think are just, to me, the way I say it to my colleagues is we need to be as good at understanding how the climate is affecting the economy and the financial system as we are into anything else that we study when we say consumer behavior or changes in the financial system or international developments. This is just a core part of understanding the economy and the financial system going forward.

CATHERINE RAMPELL: Do you worry at all about whether paying attention to climate risk could jeopardize bipartisan support for the Fed's independence? There have been criticisms from Republican senators in particular that the Fed shouldn't be even thinking about climate risks.

JOHN C. WILLIAMS: Well, you know, I understand, again the people don't want the Fed doing our climate policy and I agree with that. So we obviously want to focus on our mission, our responsibilities around monetary policy and economic outlook or regulatory/supervisory responsibilities. So I think as long, at least from my perspective, as long as we are focused on the job that Congress has given us in terms of our critically important responsibilities and do those as well as we can and be prepared to do those in a world where climate and many other things, like technology are changing, that's what we need to be able to do. We need to be able to carry out our mission in a changing world.

I have the exact same answer about how do I think about changes in technology in the financial system. We need to be expert at that. We need to understand that and we need to be prepared to act effectively for a changing environment in different ways. So I think as long as we stay focused on our mission and our important role in society and the economy, and really just show that we're doing this so that we can carry that out, I hope that, you know, that wouldn't be subject to criticism.

CATHERINE RAMPELL: On another question related to perceptions of the Fed's independence, support for the Fed's independence, do you think central bankers should be allowed to trade securities?

JOHN C. WILLIAMS: Well, this is clearly an issue that is being reviewed for the Federal Reserve. I understand the context of the question. And, you know, Chair Powell has, I think, stated very clearly that we do absolutely need to have, to operate successfully as the Federal Reserve, we need to have the public's trust. We need to hold ourselves to the highest ethical standards and I completely agree with that. We do have strict policies in place around restrictions and on disclosures. That said, as Chair Powell, has indicated and I totally support, these need to be reviewed in the context of are these the best policies? Could they be improved in ways?

Now, that work, I think, is just starting, underway at the Board of Governors. I'm looking forward to seeing what conclusions they draw and obviously at the New York Fed, you know, we stand ready to adopt any changes around financial rules or disclosure or anything like that, that they adopt into our own code of conduct. I always go back to, what's so important and when you work in the Fed, you understand this, is that we need to make sure that people understand that we're working all the time in the interest of the public and we need to have policies and restrictions that support that. So that's how I see this.

CATHERINE RAMPELL: There's been a lot of interest in whether the Fed will develop a central bank digital currency and, if so, what some of the design considerations might look like. If the Fed does come out with a digital currency, do you think it would be important or useful to develop one that preserves anonymity in transactions, similar to cash?

JOHN C. WILLIAMS: Wow, there's a lot "ifs" there. That's a huge question. It's an important question. And, you know, clearly we're seeing technological innovation in the financial system that we hadn't seen in decades. It started with the fin-techs and everything. We're now moving with stablecoin, with discussions with cryptocurrencies and lots of other innovation in the financial system. And one of the things obviously that comes around that is central bank digital currencies.

I'll start by saying that the Federal Reserve is currently undertaking a very big, important innovation with our FedNow system, which is a real-time growth settlement system for payments. It's going to be done in the near future. And I think that's actually going to address a number of the shortcomings in our current payments landscape. We still use a lot of checks here and, you know, obviously currency, paper currency has advantages and disadvantages. But I think the new FedNow system will really make it easier, and very importantly, safer to transact for consumer payments in the future. So I think that's a big innovation that's already happening. I know it's not the bright shiny object of CBDCs, but it is, I think, really important to address having an efficient, strong payment system.

In terms of CBDCs, I think that's an open question. Obviously, some other jurisdictions are moving on that and around the world there's a really good conversation, a lot of analysis being done. And here at the Federal Reserve, there's a lot of study of central bank digital currencies, the technology, how would it work, what would it achieve, what would be the risks. And the Board of Governors, I know, is working on that. They have a white paper analyzing the public policy issues around this in terms of, you know, is this something, what are the advantages and potential disadvantages. Other countries, other central banks have issued studies like that or are in the process of preparing those. I think this is a really important international conversation.

I think, to my mind, the anonymity question and some of these others are really, kind of at the core of this. Like if you really think about central bank digital currency, you know, not only what problems are you trying to solve but how do you do this in a way that improves the efficiency of the payment system, makes it more inclusive in terms of people who don't have bank accounts or sending international payments, which can be very expensive. How is it addressing those? But how is it also making sure that we're protecting our society from money laundering or terrorism finance or other things that we want to control. So I think there's a lot of really big policy questions around that, at least, that haven't been answered yet, and I'm looking forward to seeing that conversation continue. What's interesting is we obviously can watch and learn from other jurisdictions as they also are looking to all of these issues.

CATHERINE RAMPELL: I'm pulling one of the questions submitted from the audience here, and I've gotten other questions about this as well. Do you have any comment, thoughts on the ideas presented in the recently released Fed Board paper about inflation expectations suggesting that maybe we should not be thinking so much about inflation expectations in developing policy? And, you know, others have commented that the new framework de-emphasizes one unobserved variable, the natural rate of unemployment, and transfers a bigger burden unto another one, inflation expectations, which the economic profession maybe doesn't understand so well what drives them. So what do you think about the paper? How do you regard the risk of a bigger policy error if, for example, expectations just lag actual inflation?

JOHN C. WILLIAMS: Well, you know, I do think this is a topic that we, in the economics profession, have been debating for as long as I've been, you know, I got out of grad school in '94. So this has been a topic throughout my career, and I've actually written quite a bit about the different models of how do we understand how people form inflation expectations. Like many things, we don't know the answer. And I don't think we are going to ever know the answer.

What we need to do is understand as best we can different ways of organizing, like how do inflation expectations appear to behave? How do they relate to actual inflation? And really also kind of not be overly fixated on one particular model or another, but really look at a range of different explanations. I think there's been some pretty strong research that shows inflation expectations are related to actual inflation experience. I think that's part of the story. There's also the financial markets. We tend to look forward and think, like, well, what's inflation like if you're going to invest for ten years? What's inflation likely going to be ten years ahead? And that's, the TIPS market is obviously very closely related to that.

So I think, you know, again, I think inflation expectations are a great indicator to me. Do we have the well anchored, nominal anchor you want as a central banker? There are important measures that we can consult and analyze. I think that that is true, even if we don't have a perfect model to explain how they behave. I think our survey that we do at the New York Fed is a great addition to all the other data and analysis that has happened. Again, I don't see this as about one person has the right model, another person has the wrong model. I really think it's like taking all the information we have and bringing it together. At the end of the day, my view is, you know, the test is – I think I said this earlier – the test for our 2% longer-run goal is that we do have inflation expectations anchored at 2%, but we also deliver 2% on average over time. And those are complementary answers, so it's not one or the other. It's really deliver the 2%.

CATHERINE RAMPELL: I think we are running short on time, but one last question from me, which is what are your expectations for trend productivity growth in the coming cycle? And is it likely to be higher than it was following the 2008 crash? Because presumably that gives the Fed a little more headroom to allow faster wage growth without pushing up inflation. So I'm just curious. What are your expectations?

JOHN C. WILLIAMS: I'm happy to answer that very quickly. I know what Barbara is doing. She's telling us that we've got to wrap it up. I've seen that many times. So I appreciate both the question and Barbara's call. And so I do think that's a great question. I'm open-minded that we could see, you know, we've seen great productivity growth during the pandemic. Some of that's composition between goods and services, but some of it seems to be a change in how we're doing business. So it's definitely open-minded about, you know, what's the new normal look like for productivity, for labor supply and things like that? Right now, I'm not coming to any conclusion but it's definitely going to be an area of, I think, very avid interest and study as we come out of this period.

PRESIDENT BARBARA VAN ALLEN: Many thanks, John, for sharing your time with us today. Just terrific conversation. Catherine, thank you for doing the honors.

I'm pleased to report that we have many more impressive speakers in the lineup this fall. And as always, we encourage you to invite guests to our events. On Wednesday, the 29th, this week, we will welcome Shivani Siroya. She's the Founder and CEO of Tala, and she'll be discussing accelerating financial health for underserved populations. Charlotte St. Martin, who is the President of The Broadway League, will be with us on September 30th, and she's going to talk about the return of Broadway. And she'll be interviewed by Rachel Moore, our board member, who is also CEO of the Los Angeles Performing Arts Center. We have a Member-Only Discussion scheduled for October

18th. That will be led by Bob Hormats, and we'll be talking about global foreign policy developments with a focus on developments in China, Afghanistan, and Australia, and there's certainly plenty to talk about. We'll have The Honorable Gina Raimondo, the Secretary of Commerce, on October 21st. That will be followed by The Honorable Christopher Wray, the Director of the FBI on October 28th. And then we'll have Bob Sulentic, who is the President and CEO of the real estate giant, CBRE with Mason Morfit, the Partner, CEO, and CIO of ValueAct Capital on November 4th.

I'd like to also just take a closing moment to thank those of our 338 members of the Centennial Society for joining us today as their contributions continue to provide a financial backbone for the work we do at the Club and help enable us to offer our programming now and into the future. So thank you again everyone for joining us. Please stay healthy and safe. And we hope to see you at our next webinar and look forward to in-person events, as John said, hopefully in the coming weeks. Thank you.