CENTRAL BANKS

Fed's Williams: Time For Central Bankers to Weigh New Policy Toolkit

San Francisco Fed president says Fed may need to look at price level targeting

President and Chief Executive Officer of the Federal Reserve Bank of San Francisco, John Williams in Zurich in September.
PHOTO: ARND WIEGMANN/REUTERS

By Michael S. Derby
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Federal Reserve Bank of San Francisco President John Williams called again on Thursday for policy makers to rethink how they conduct monetary policy in a changed economic and financial landscape.

Mr. Williams didn't comment on the near-term monetary policy outlook in a speech prepared for delivery before a conference at his bank. Instead, he pressed forward with advocating for policy makers to adapt their tools to a world where interest rates are lower than they used to be.

Changes in the economy suggest the Fed will not be able to raise rates as high as it did in the past, he said. And because rates are unlikely to go up all that much, the Fed will have less room to lower them when the inevitable next economic downturn arrives, Mr. Williams said.

The Fed's current overnight target rate range now stands at 1% and 1.25%. Officials are widely expected to raise rates again at their December policy meeting. Mr. Williams, who isn't a voting member of the rate-setting Federal Open Market Committee, has generally been supportive of pushing rates higher. In the speech, he said 2% to 3% could be where short-term rates stand when they are at a neutral level.

If rates again are lowered to the near zero levels that persisted between the end of 2008 and 2015, the Fed could have to resort to the unorthodox policy tools it used during the financial crisis and its aftermath, Mr. Williams said. That could mean long-term bond buying and guidance about the future of low rates could all be back on the table. It could also change its inflation target, now set at 2%. Or it might mean a new strategy is needed, he said.

"We're finally seeing the sustained rebound in global growth that we've long been hoping for," Mr. Williams said. Around the world, "central banks are pivoting towards unwinding monetary stimulus. From a monetary policy perspective, the world is starting to look more 'normal.'"

But, 'history teaches us that a recession will come at some point, and prudence demands that we use this time of relative economic calm to plan for the storms ahead," Mr. William said. "It's prudent to spend this period examining our monetary policy framework and considering how to make ourselves more resilient," he said.

Ideally, some sort of fiscal policy actions would help lift the economy out of its current low-interest rate environment, Mr. Williams said. “I fear that those changes may not arrive soon enough,” he said.

Mr. Williams said one option for central banks is to adopt a strategy called price level targeting. This regime keeps short-term rates ultra low in order to help overall price levels move back toward a path central bankers deem appropriate.

That said, new and unorthodox strategies can bring new risks. “The major problem with some of these approaches such as price level targeting is that no one’s tried it yet! And experiments where the safety of the world’s financial system is at stake are high risk, to say the very least.”

The idea the Fed may have to rejigger its toolkit has been gaining steam among some policy makers. The idea of a change comes amid changes in Fed leadership, which could help open the door to new approaches to policy in new economic landscape.

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