Fed Unfiltered, Transcript
2/24/22 – Mary Daly, Interview: Los Angeles World Affairs Council & Town Hall

Kim McCleary:

Welcome. I'm Kim McCleary, President, and CEO of the Los Angeles World Affairs Council & Town Hall. Today, we are very pleased to present today's live stream from the beautiful California Club in Downtown Los Angeles. We are thrilled and honored to welcome our speaker today, Mary C. Daly, who is President and chief executive officer of the Federal Reserve Bank San Francisco. We thank our live stream viewing audience today for joining us for this one-hour program. I would also like to extend a very special thank you to our Board Chair Lynda Boone Fetter whose invaluable contribution to today's program is so appreciated. I just have a couple of notes on today's program. Number one, President Daly will be coming to the podium to make her remarks. After that, KABC radio broadcast journalist and host of Mottek on Money, Frank Mottek, will be joining her on stage for a conversation that will include questions from our live stream audience.

Kim McCleary:

We are so delighted to welcome back, President Daly to the Los Angeles World Affairs Council & Town Hall. She leads the Federal Reserve System's 12th District, which is the largest and most diverse in the Federal Reserve System. Besides California, the 12th District also includes Alaska, Arizona, Hawaii, Idaho, Nevada, Oregon, Utah, and Washington. Today, two years into the COVID-19 pandemic, the US economy is remarkably strong though there are economic conditions that cause Americans concern. So today, President Daly will offer her views and perspectives on, This Time is Different... Because We Are. Please join me in welcoming President Mary Daly.

Mary Daly:

The very first thing I wanted to say is good afternoon. Thank you so much for the introduction. It is simply terrific to be here in Los Angeles, doing a hybrid event, which is the first one I've done. It's my first trip since COVID and I wanted it to be here since I had had such a delightful time here in 2019. And I really think this is a terrific way to get started on my new post-COVID adventures. It actually makes me feel like progress is starting to take hold.

Mary Daly:

Now, when I think about this, it's almost hard to believe that it's been two years since COVID-19 hit our shores. And while it's not fully behind us, we've come a really long way, especially in the economy. Growth is up, unemployment is down, and people are getting their lives back. But for anyone who has shopped, bought gas, or paid rent lately, everyone knows inflation is high. Higher than it has been in nearly four decades.

Mary Daly:

And for some, this is a sign that price stability is at risk, that absent aggressive action by the Fed the economy will be propelled into a 1970s-style Great Inflation. Like many of you, I live through that time. I remember my parents' daily complaints about rising prices and rising bills. And the hours-long waits at gas stations in the very hot Missouri sun stuck to the vinyl seats of our station wagon. High and rising inflation makes life harder. And then there was no end in sight.

Mary Daly:

But the picture today looks quite a bit different. And so does the Federal Reserve. We've evolved as an institution and our understanding and our tools have evolved as well. And I'll spend my time today talking about how this evolution makes us better. Better prepared to meet our dual mandate goals of price stability and full employment even in these challenging times.

Mary Daly:

Now first, before I get too far along, I'd like to remind everyone here, that the views I will express today are my own and do not necessarily reflect anyone else in the Federal Reserve System.

Mary Daly:

Before I talk about how this time is different, I want to talk about what exactly happened during the Great Inflation. What was it like? Well, from about the mid-1960s through the early 1980s, American households faced nonrelenting rise in prices. And the worst of it came in the 1970s when the cost of living for the average family more than doubled. The stress in our nation during that time was palpable. Businesses and families lost confidence and many struggled to simply make ends meet. And people collectively wondered, how did this happen? The answer of course is complicated. But I want to focus on a few factors that I think are particularly relevant for today's discussion.

Mary Daly:

The first has to do with fundamental economic changes and our inability back then to measure and understand them in real-time. For example, after decades of rapid post-war GDP growth led by booming technological advancements and rising labor productivity, US productivity growth had started to slow. And this meant that the capacity of the economy to expand without spurring inflation was far more limited than it had been in previous decades. And at the same time, the labor market was changing. Young baby boomers were joining the labor force in very large numbers and altering the age composition and the dynamics of the workforce. In particular, they were taking longer to find jobs and turning through more opportunities as they found their preferred path, their very right path. And this behavior, which is completely natural for young people, increased the study state rate of unemployment, a benchmark policymakers used to judge how close the economy was to full employment and full capacity.

Mary Daly:

Looking back, with the advantage of hindsight, it's clear that policymakers missed some critical shifts. Without the data, the tools, and the focus on real-time monitoring, they and macro forecasters more broadly, expected the economy to behave exactly like it had before and for inflation to fall as the economy and the labor force grew. And these views, in part, kept the Fed from acting forcefully to offset rising inflation. But the story doesn't end there. The Fed's policy misses were amplified and perpetuated by institutional factors and by its own communication strategy.

Mary Daly:

Let me start with institutional factors. At the time, there was a very tight link between wages and prices. Many employment contracts included automatic cost-of-living adjustments or COLAs, which meant that when prices went up, wages immediately followed. And firms then passed on these increased labor costs to prices. And so it went, again and again, in what became a self-perpetuating upward inflation spiral.

Mary Daly:

When two oil price shocks created even higher inflation, prices and wages grew in near lockstep. And here is where the Fed's own communication practices exacerbated things. The Federal Reserve and many central banks at the time held the view that transparency and communication were more costly than beneficial. Central bankers, actively avoided sharing information, believing that such communication might constrain their ability to nimbly adjust policy or even it could dilute its impact.

Mary Daly:

And because of this, the Fed operated largely behind closed doors. The public became aware of Fed policy actions by watching how markets reacted following the Federal Open Market or FMC Committee meetings. And the main source of information that market participants, households, and businesses had about the Fed's commitment to price stability was what they could glean from incoming inflation data.

Mary Daly:

The result was actually quite predictable. And I'll direct your attention to the slide. The more inflation rose, the more consumers and businesses expected to rise. And you can see this in the green and blue lines which show two measures of price inflation, and the red line which shows inflation expectations. As inflation moved up, so did inflation expectations. And these expectations of future inflation were then built into wage and price contracts. And before long, inflation dynamics and future inflation were deeply intertwined with inflation psychology. And with the Federal Reserve offering very little guidance or reassurance that it would do something about it, the situation snowballed. And it wasn't until the Fed implemented a series of steep interest rate hikes, under then-Chairman Paul Volcker, then inflation finally started to recede.

Mary Daly:

Now, shifting back to today, inflation is high again. And many are concerned that we could soon be facing another long and painful period followed by another long and painful correction. But that's actually not what I see, and I'd like to explain. You've heard many, including me, talk about how inflation itself is different this time. It's been pushed up by pandemic-related imbalances between policy-supported demand, which is made quite robust and COVID-disrupted supply, which has been very, very slow to recover.

Mary Daly:

And both of these factors should recede as the pandemic weakens its grip, lowering some of the inflation pressure that we see. The economy or the context for this inflation is also different. There are weaker links between wage and price inflation. There's greater global price competition. And there's also a number of longer-term structural factors, including an aging population that's globally aging that will exert downward pressure on growth and inflation once the pandemic is behind us.

Mary Daly:

But these are not the differences that matter most. The main reason I'm confident we are not heading for another 1970s Great Inflation is that the Federal Reserve is different. And I'm not referring to the people of the Fed who clearly have changed but to the practices and beliefs which have changed even more.

Mary Daly:

One major evolution that separates today's Federal Reserve from the Federal Reserve 50 years ago is a deep understanding that inflation expectations influence future inflation. If people expect inflation to persist, then it does. And this understanding led the Fed and economist more broadly to a critical insight. In order to manage actual inflation, policymakers also have to manage inflation psychology. The Fed has to enlist the help of households, businesses, and market participants in the job of fighting inflation by communicating with them about its commitment to price stability and its plan to achieve it.

Mary Daly:

Acting on this insight required a radical transformation. The Fed had to break open its black box of decision-making and embrace transparency. And to understand the magnitude of this transformation, you have to recall that for most of its history, the Fed was uncommunicative by design. And again, I'll direct your attention to the slide. You can see that there's a big flat line that goes all the way back to 1913, although I didn't show it on the slide. And so the first time that the Fed engaged in this communication revolution was in the 1990s. And the first step in this communication revolution came in 1994. When the Fed began releasing post-FOMC meeting statements. In the mid-2000s, the Fed went further, publishing the Summary of Economic Projections to provide the public with information about the expected path of economy and interest rates. In 2012, the Fed announced its first-ever explicit inflation target, 2%.

Mary Daly:

And in 2020, just a couple of years ago, we introduced a new monetary policy framework, which outlined principles for managing our inflation and employment mandates in a variety of economic conditions. As the figure illustrates, the Fed went from being mostly silent, for much of its history, to explicitly and intentionally transparent. And the effects of these efforts can be seen in the data. And I'll refer one more time to that inflation chart. With greater transparency came more stable inflation expectations, which since the late 1990s have remained well-anchored, around 2%, despite spikes or drops in inflation.

Mary Daly:

And even today, when inflation is at a 40-year high, long-run inflation expectations of businesses have remained quite stable, and financial market expectations have also been well anchored, as evidenced by long-term interest rates staying low despite the current inflation shock. And this tells us, these data, and this response tells us that businesses and markets are listening. They're hearing the Fed's communications and believe that we will act on our commitments.

Mary Daly:

In practice, greater transparency, better communication, and the era of well-anchored inflation expectations build Fed credibility. And this credibility provides an important insurance to the economy. It makes the economy more resilient and less vulnerable to painful periods like the ones we experienced in the 1970s. And it gives all economic agents, not just the Fed, a role to play in helping the economy smooth through inflation and other shocks, which ultimately makes it more resilient to whatever changes are on the horizon.

Mary Daly:

Most importantly, and I can't highlight this enough, greater transparency and a strong commitment to achieving our goals, assures Americans, wherever they are, that periods of high inflation or unemployment will not last forever, and that there is an end in sight.

Mary Daly:

But transparency is not a destination. It's a practice. And it requires ongoing communication if we are going to keep the credibility that we still value alive. And in that spirit, let me tell you about how I see the economy today and the policy adjustments that we will need to be making to move us to a sustainable path.

Mary Daly:

Let's start with the economy. By almost any measure that we look at in a large dashboard that measured, is doing well. GDP growth, consumer spending, and business investment are all up. And the labor market continues to post solid job gains, low unemployment, and strong wage growth.

Mary Daly:

And notably, importantly, labor market gains have been broad-based, occurring for a wide range of groups, including those who are traditionally disadvantaged. African Americans, Hispanics, and people with less than a college education to name a few.

Mary Daly:

Of course, as everyone knows, and many people feel, inflation is too high and inflation pressures have begun to spread outside the sectors that were most directly affected by the pandemic. But most vividly, average Americans, like my parents five decades ago, are worrying about rising prices and rising bills. And this means it's time to move away from the extraordinary support that the Fed has been providing during the pandemic and bring the monetary policy in line with the challenges we face. So absent any significant negative surprises, I see our next meeting of the FOMC, which will be held in March, as the appropriate time to begin this adjustment.

Mary Daly:

The timing and magnitude of future funds rate adjustments and balance sheet adjustments will depend on how the economy and the data evolve. And this will depend on how well we transition from pandemic to endemic, not just here in the United States, but globally. I'm watching how quickly supply chains recover, how rapidly workers sidelined by health, family care, or other COVID-related barriers return to the labor force, and how quickly the fiscal boost which helps so many people get through the pandemic, how quickly that fades now that the pandemic is moving behind us. We will be closely watching all of these developments, and let the data determine the appropriate path of policy.

Mary Daly:

And as we adjust policy and move into a post-pandemic world, we will also have to keep in mind that many of the challenges that existed prior to the pandemic will likely still be with us. And notable for policy, our slower global growth, less monetary and fiscal policy space, and the associated downward pressure on inflation that those two things bring.

Mary Daly:

Against this backdrop, the next few years will require what I call focused awareness. Focus on bringing inflation back down to levels consistent with price stability, and delivering a labor market that works for everyone, and awareness of the uncertainty that lies ahead and the challenges that are surely before us.

Mary Daly:

Let me conclude by telling you what I see as the main lesson of the Great Inflation. For me, it's really not about the Fed. It's not even really about economics. It's about humility. It's about knowing that ours is an economy in constant transition, and that none of us knows for sure what the future holds. We need to move forward with confidence. The confidence in our policies, our tools, and then the credibility the Fed has built. But we also have to remember that evolution is not static. And to meet the needs of a constantly changing economy, we have to be constantly changing ourselves. Today's Federal Reserve looks different than it did 50 years ago. And I suspect it will look different again in 50 more. And that will be a good thing. It will mean the evolution continued, and that next time will also be different. Thank you.

Frank Mottek:

Thank you, Mary Daly, for your speech. And now, it's an honor to ask you a few questions here and some questions from our global audience as well. Thank you so very, very much for making this possible today.

Mary Daly:

Thank you.

Frank Mottek:

Madam President reminded me that my father had a 1966 Impala with the vinyl seats as well. And I remember his conversations with neighbors in the '79s and he called it, not the prime rate, but the crime rate went up to 21.5%. What is your outlook for interest rates this year?

Mary Daly:

My outlook for interest rates is that they will be moving up off the extraordinary accommodation that the Federal Reserve rightly provided during the pandemic. They'll be moving up to a level that's more consistent with where the economy is. As I mentioned in the speech, I expect our first movement in that place to be in March at our first meeting. And then, to have subsequent increases in the rate as we go forward through the year.

Mary Daly:

The endpoint at the end of this year, it's too early to call because we have so much uncertainty. Will we fully move from pandemic to endemic? How much will the fiscal roll-off temper spending? What's going to happen to the supply chains? And now, we have additional geopolitical risks. So the endpoint is not completely certain but the path towards a economy with tighter monetary policy that is right-sized for the fact that the economy is growing on its own, it's sustaining itself, and we have to be mindful of that so that we can get inflation down and supply and demand back in balance.

Frank Mottek:

I know you're on Face the Nation recently, things have been changing so quickly, and you did have something to say about your expectation for that rate hike in March which you're expecting. And now that you're facing the World Affairs Council Los Angeles & Town Hall, can you give us an update on your expectation and what do you think should be appropriate for the hike in March?

Mary Daly:

Sure. When you look at what's out there, the world is filled with uncertainty, but we don't have anything that is a negative surprise, that is so deep that we wouldn't want to move the policy rate up. So I still expect borrowing any negative surprises that come between now and our March meeting, that we would lift off, from the Zero Lower Bound, we would move the policy rate up, and then we would start a process of subsequent increases that would get us closer to neutral. But exactly how close to neutral we'll get depends on all of these uncertainties that you meant. You're right. The news is fast-breaking, and so that's why the Fed is committed to data dependence. If we're data dependent, then we're looking out and seeing the data, and that is the right way to respond to so much uncertainty.

Frank Mottek:

And speaking of the news, it looks like inflation is off the front page here with the Russian-Ukraine crisis very much in focus. So will this situation dissuade the Fed from raising rates next month?

Mary Daly:

Well, geopolitical risk, whatever it is, whether it's this situation or previous situations creates quite a bit of uncertainty in the economy even when it hasn't materially affected the economy. And I will be watching the data closely, but I don't see anything right now that would disrupt our plans to move the rate up off the Zero Lower Bound because the economy has already got pressures on inflation. Inflation's too high. I think everyone sees that. We need to get that in control, and we need to get demand and supply back in balance. So I see the geopolitical situation unless it would deteriorate substantially, as part of the larger uncertainty that we face in the United States and our US economy. And we'll have to navigate that as we go forward, but I don't see it today, disrupting our plans to lift off.

Frank Mottek:

What is your view on how many rate hikes there will be this year, and to what extent we've seen various predictions? Two, three, four, five, six, seven, eight, nine?

Mary Daly:

No, it's really running the entire numerical distribution at this point. And I think what that tells you, and I think this is a really important point that I'd like to highlight. What that tells you is that everyone looking at it is looking at the uncertainty we face. And then trying to figure out, "Okay, with that uncertainty, what would be the appropriate path of policy?"

Mary Daly:

Here's where I am today. But again, reassuring everyone, reemphasizing for everyone that I'm very data-dependent on this. What I see today is that inflation is well above our price stability goal. And that the lesson from the 1970s is we need to demonstrate to the American people that we're committed to having that, not be a perpetuating spiral. And clearly, we have more accommodation in the system with interest rates in extraordinarily low levels than we need for an economy that's adding jobs and growing like this one is.

Mary Daly:

I mean, here in LA, it's booming out here. So people are ready to get back out and participate. So with that in mind, then raising rates, at least four times would be my preference. But it most likely will mean more than that unless of course, we get the Ukraine and Russia situation pulling back demand, we get the fiscal roll-off being more... Consumers being more sensitive than I currently forecast, or the supply chains recover more quickly. But I'm committed to getting inflation to be coming down and getting demand and supply in balance.

Frank Mottek:

As far as the potential jolt to the economy, I know, for example, the prominent economist Dr. Muhammad El-Erian has expressed concern about a possible jolt, slamming the brakes possibly next month and maybe ending up in stagflation or even a recession. How do you address those concerns?

Mary Daly:

Those are not the things I see happening. I think the economy is really well positioned. I mean, I see it when I look at the numbers, but I actually see it when I just go out and visit with businesses and community members. There's a lot of economic activity. People are interested in getting back to their lives and people are optimistic. Cautious and uncertain, of course, but optimistic about the future of the economy. And with that in mind, then the economy is self-sustaining. It's getting on its own two feet. And so raising the rate isn't slamming on the brakes on an economy, it's actually withdrawing the support that the economy no longer needs, which eases the inflation pressures, eases the supply and demand imbalances, and allows the important thing to develop that the economy's on a sustainable path.

Mary Daly:

The last thing you want is an economy that's going too fast, overruns what's possible, and then, you do have to bridle it back. But that's not where we're at. We're at a place where we're doing the handoff from intense COVID-related support to gradually moving the policy rate up and getting this policy accommodation right-sized for the economy we have.

Frank Mottek:

Coming off the Great Recession, and before the pandemic, there was a lot of talk about unwinding the Fed's extraordinary programs from the Great Recession, and that was supposed to be looking like paint drying. Now that the balance sheet is even bigger, how do you expect this to be unwound at some point?

Mary Daly:

My expectation would be... And let me put it this way so that everybody knows. So I am informing my views, but one of the things we do at the FOMC meeting is we deliberate. We think about these things and we'll be having discussions. Sir Paul mentioned this at his press conference last time. We're going to be having discussions at the next several meetings about what exactly to do with the balance sheet, how to do it. But there's a broad agreement, and this maybe is something that is worth noting. There is broad agreement. You can see it from looking at any FOMC participant that inflation is too high and that the policy rate is too low. And then we need to move the policy rate up. The Fed's funds rate, this policy rate is our primary tool. It is the one we have the most experience with. It is the one. We know how it works in the economy. That's our primary tool.

Mary Daly:

But the balance sheet is also a tool and we need to adjust it as well. So when I look out, you do a rate increase, another rate increase, and then you start thinking about reducing the balance sheet. You see how much that tightens policy, and then you can take more rate increases. So whether it'll be two rate increases in the balance sheet, three rate increases in the balance sheet, my colleagues and I will be deliberating this. But clearly, we want to bring all of our tools back into balance so that they're right-sized with the economy we have.

Frank Mottek:

And as far as the Main Street economy is concerned, part of the extraordinary measures that we saw during the pandemic was the Fed coming to the rescue of the Main Street economy with that lending program. Can you comment about what the Fed has done to help the Main Street economy over the past couple of years?

Mary Daly:

Sure. So as many people might remember, in the pandemic, the fiscal agents actually said, "We need to provide more support to businesses, small businesses, but also medium-sized businesses, as well as households." And so that funding came through, extended unemployment insurance and all the stimulus checks, et cetera, which we don't really call stimulus, we call support because it was a very terrible time. But businesses needed help, and so that came through the funds that went into the Main Street Lending facility, and also through the PPP or the Paycheck Protection Program lending facility that we ran.

Mary Daly:

The critical thing to know about those facilities is we have lending powers but we do not have spending powers. So we get funds from Congress, they appropriate funds, and then we help intermediate them to the groups that need them. And so when those funds are gone and Congress decides that fiscal stimulus is not needed, that fiscal support is not needed, then we close our facilities. And so, at this point, we've moved away from those facilities. We've closed them. And so we're left still with this balance sheet that we will bring down to more normal levels, but that's where we are in the scheme of those types of things. And that's really what you want. You want to use your emergency tools when there's an emergency. And then you want to pull away from emergency tools and get to a more normal state of affairs as the emergency passes.

Frank Mottek:

And there was quite a word salad of programs that were created during the pandemic. And prior to that, during the Great Recession, you had tarp and ham, and I think you had barf. And when I told that to Treasury Secretary Paulson, he said, "That's what I did." Believe it or not, that's what he said. But tell us about those extraordinary programs that came together largely through the experience of the Great Recession. And was it fortunate that you had some of those other programs in place and that experience to get through this situation?

Mary Daly:

Well, experience even if hard-earned and sad... I mean the financial crisis is nothing to celebrate about, but we did learn a lot from having to do extraordinary things then. And I think that's what you... And in my speech, I talked about evolution. Right? We live in a world now that looks different than 50 years ago. And we realize the importance of, and always have about, the Fed is a lender of last resort. It's meant to step in when markets break. Because if markets break or they dislocate, which they did in the early part of the pandemic, the treasury market, which never really suffered, and so the Fed goes in. But the Fed doesn't just work for Wall Street. It's actually working to help intermediate congressionally appropriate funds to all parts of the country. And that's our role is to help that intermediation. And we learned from the Great Recession. We all learned a lot from our pandemic support. And then we'll go forward and be ready for the next crisis, whatever that is. Hopefully, not for a long time.

Mary Daly:

The critical thing though, for everyone to understand, is that those are emergency packages. Those are emergency programs. They work and they're appropriate in the most dire of our circumstances for the economy. And then we go back to things that people normally expect from the Fed, and our toolkit really is the Fed funds rate. We move that and other interest rates follow. And then our other really priority tool is communication. Whether you call it forward guidance about what we're going to do, or just transparency and communication, the idea that we're going to be out there and talking about where the path is headed, to me, my mind, or when I talk to contacts business leaders and households, that's what they want to know. They want to know we're on it. We're going to get inflation under control, get the economy in a balance, and also what's going to happen to my interest rate. Those are the two things that really help economic agents more broadly, fully participate in the economy.

Frank Mottek:

And of course, in the '70s, this kind of an exchange was unthinkable. And we really appreciate your clarity on these important issues. I remember having a conversation with my great mentor, Paul Kangas, on the Nightly Business Report when Alan Greenspan was the Fed chair and trying to decipher what he said. We jokingly said we needed a Greenspan-ish dictionary to figure out what was being said, so we really appreciate this chance to speak directly to you. And of course, the Fed is not only concerned about inflation but also the job picture and a lot of interesting things happening on the labor front with the Great Resignation happening. It's getting a lot of attention. What are your thoughts about where we are with the job picture at the moment?

Mary Daly:

Sure. So the job picture is... Let's start with the things that are really good about the job picture. We are adding jobs. The labor market was very hard hit as you remember when COVID came and we went back. And the service sector was in a particular hard hit because there's a lot of in-person contact that was prohibited. And then, firms don't hire. They let go of those workers. They say, "We can't afford those workers. We're just barely going to be able to make our rent and get through this." Right? And so that was a very challenging time. So if you look at the labor market now, it's remarkable that we've made so much progress. And this Great Resignation, I want to say a few things about this Great Resignation because we've done a lot of work on this. My colleagues at the San Francisco Fed have, and here's what we learned.

Mary Daly:

It's less about epiphanies and lifestyle choices and feeling like maybe it's not even what you want to do to work. And it's much more about people leaving because they have to take care of kids. They have to think about their lifestyles. They have to think about maybe I want to reposition, maybe I want to move, maybe I want to do other things. So the great resignation is also about the fact that lots of people got thrown out of their jobs when the service sector collapsed. And now, every service provider in the country seems to want a lot of workers all at the same time. And it's created an auction environment for those workers which is good for those workers. That's not usually their livelihood but it's also created a lot of extraordinary quits, hard to find people, hard to keep people, and it gets misconstrued almost as a great epiphany. But for lower-wage workers, low and moderate-wage workers, it's less about epiphanies and more about prospects for their income and wage growth going forward.

Frank Mottek:

What is your outlook for the unemployment rate this year?

Mary Daly:

I would expect it to continue to come down and how much it comes down depends on that mention I made in my talk, which is if we can get really to endemic if schools can stay into a place where kids who get exposed to COVID or have a symptom don't have to take the whole class home. The number of moms and dads, who, in my group, in my company, the Federal Reserve, or who I hear about who just literally you're working. And then suddenly you have to be home because you have to pick up your kid because one guy got exposed. I have a friend who has three kids and she was on a three-week spiral of, this kid got exposed and was home for a week. Then the next kid got exposed, home for a week. They're in different classes. This is extraordinarily disruptive to the lives of people.

Mary Daly:

When that subsides, then I would expect us to see labor supply recover. As we get our lives back, I would expect people to get more comfortable being out and see our lives recover. So if that should happen, if people start coming back, then the unemployment rate might just stay at a low level but study out. But if people don't come back, then I would expect the robust job growth to move the unemployment rate lower. And that's why we have to be data-dependent because we actually don't know what the future is going to bring even a future that's only two quarters ahead.

Frank Mottek:

We thought we could take the word supply chain out of our vocabulary by the end of last year, but that is still an issue. What are your thoughts about the important supply chain issue? You've probably seen the videos of the ships backed up here at the ports of LA and Long Beach and probably there in the Bay Area as well. Give us your view. What's going on with the supply chain?

Mary Daly:

Well, there's no doubt that the supply chain continues to struggle. There are improvements in the supply chain. I like to do data collection myself, just casual data collection, I guess. So I'd like to drive by where all the car dealerships are in Oakland. And in December, they had no cars. Literally, no cars. The cars of the employees were parked in the lot. But now, they have cars coming on. So the supply chains are... Lots are getting full. Supply chains are improving. But we're a long way if you just look at the port backup and things from coming to full equilibrium.

Mary Daly:

Importantly, and I think this is another thing that I've had to really learn about is that this isn't really about US supply chains, it's about global supply chains. So if China, let's just take China. China gets the Omicron, gets that. They don't have the vaccination capacity. They don't have the vaccination rate. Their vaccine is efficacious, whatever the word is. I'm not-

Frank Mottek:

You got it.

Mary Daly:

I need a health professional here.

Frank Mottek:

That's the word.

Mary Daly:

Perfect. I found it. It's rattling around in there. So then, they have to do lockdowns. So then, this factory closes. This block closes. Well, that will happen, and then we'll feel it for three, four, five, six months down the supply chain. So really we are in a global economy. Supply chains are global. And it's going to be a while before these are fully repaired. But I think there are, in Fed speak, we would call this green shoots, just seeing some cars on the lots and seeing people buy cars and seeing things happen, that's a green shoot. How many green shoots we're going to get before the end of the year? I'm hopeful it'll be a whole garden. But I'd have to be mindful that we are not the only players in this game. It really depends on global developments.

Frank Mottek:

We have a number of car people in the audience, Mr. Dickerson, for example, and we've seen the used car prices, especially spike like 40% over the last year. And people are paying, I believe about a hundred thousand over sticker, I heard from one of the luxury brands. Give us your reaction to that.

Mary Daly:

That's a lot of money over sticker, that's my reaction.

Frank Mottek:

It is, yeah.

Mary Daly:

I guess it's a good time to be a car dealer. But I'm going to talk about more modest car prices. And that probably really are, the kind that my parents or many families would have to deal with. You need a car. You maybe don't feel as comfortable on public transportation or it's not available. So you need a car. The used cars are in high demand because there aren't as many new cars, and now you're paying more for that car. And those are just additional things that put burdens on people's finances. But importantly, and this is one of the reasons I talk about things that will recede as COVID recedes.

Mary Daly:

Importantly, I don't expect used car prices to continue to rise at double-digit rates. It's really just a transition. It's a longer transition than anyone thought. But it's a transition because new cars aren't available, everybody's buying, trying to compete for the same used cars, and there's been this demand shock of wanting cars because you maybe don't feel as safe on public transportation or you've moved farther out and need an automobile. So all of those factors will wind themselves out to a more steady equilibrium down the road. But how long that will take is still unclear. Although the new cars on the lot are a good sign.

Frank Mottek:

For a while there, I believe it was now Treasury Secretary Janet Yellen, when she was Fed chair, referred to the mystery of inflation for years. Inflation was officially quite low. What are your thoughts about how inflation is measured? And we're getting a question here from our global audience now. This one. Are the basket of goods used to measure inflation the same today as they were in the 1970s?

Mary Daly:

They adjust the basket... I'll take that one first. So there's a basket of goods and that concept is the same. But the basket gets adjusted regularly so that we are accurately reflecting the pain or well, in this case, the pain, that the American households are feeling. And so, it's a regularly adjusted basket. It wouldn't look the same as it did in the 1970s. For instance, energy price, energy consumption is lower now than it was in the 1970s. And so it would be a smaller portion of total household spending than it was back then. But the same elements are there. The main things that people feel the most pain on are eating, putting gas in their car, and paying their rent or buying a house. Those are the things we all need and they're things which are not as discretionary, so they are the things that cause the most difficulty. They're still in the basket.

Mary Daly:

You asked me about the mystery of inflation. So one of the mysteries of inflation really isn't a mystery anymore. We've done a lot of work on this. We know what is happening. And it's one of the contexts I mentioned in terms of what we're going to have to be watching for. So in the decade of the expansion after the Great Recession, we were never able to get inflation up to our 2% goal, never. And many other countries faced the same challenge. We couldn't get inflation up to 2% no matter how hot the economy seemed to be. And so when you go back in and think about that, part of it is that we don't... Everyone knows that we're constrained by the Zero Lower Bound. There's only so much we can do to boost the economy when it gets a negative shock. And the fiscal policy was constrained as well because many countries had looming debt problems that they were trying to deal with.

Mary Daly:

That pushes inflation down because the way inflation stays at 2% is, when there's a negative shock, the Fed can step in, fiscal agents can step in, central banks across the globe can step in, and then you can get inflation to go back up because you can get the economy to improve. So that is still with us. We've got slower global growth. We're going to have the Zero Lower Bound be more of a constraint. We've got a low neutral rate of interest. For anyone who's in banking, you remember the days when the neutral rate of interest was say three, four, 5%. Now it's 2.5. That's the nominal neutral. Well, that's with inflation, which means the real neutral is 0.5. That's a really low number. And so you're very susceptible to being pushed to zero. And then we have run out of policy space.

Mary Daly:

And I think one of the lessons that comes out of the pandemic though, is that we might not have as much policy space on the funds' rate, but we have a lot of tools that we can bring to bear. And those tools have been successful at spurring the economy forward. And we can adjust now to bring that policy rate back down, or push it back up and get inflation under control. So the mystery of inflation, as Janet said, our Treasury Secretary Yellen. She's a friend of mine, so I always say Janet, but that's okay. But Treasury Secretary Yellen, "It's no longer a mystery but it still is a factor." And we have to be mindful of that because we don't want to be back in a situation where inflation gets below 2% again, and then it's harder for us to get it back up. Japan still suffers from that tragedy of having inflation that never moves.

Frank Mottek:

Right. And the word transitory was removed from the Fed vocabulary. It seems as it relates to inflation. Can you give us some insight on the discussion about that?

Mary Daly:

Only after the fact that you realize words are not going to be as durable as you intend them to be. So transitory... So the factors... What I meant by transitory... So let me speak for myself. How I thought about transitory is not expected to persist once the pandemic is beyond us. The myth that all of us had was, we thought the pandemic would go away faster. We didn't think we'd be... I did not think in March of 2020 that I would be bringing employees back to the Federal Reserve in March of 2022. That's two years. I mean, maybe all of you were greater predictors than me, but I didn't think we would be in a two-year pandemic that would literally keep us in these sort of away from each other places.

Mary Daly:

When you think about transitory, it will be likely to recede as the pandemic recedes or loosens its grip, but that has been a much longer period of time than anyone thought. And as a consequence, it doesn't seem appropriate to use the word transitory because it doesn't ring true for people. It's like, "This is never going to end." But the good news in my mind is, "The pandemic is." We are improving. We're here. We haven't done this for two years. So we're here. We're putting our toes in the water. We hopefully are moving from pandemic to endemic. And as we get those things, then those will actually start helping supply and demand get more in balance and be one of the factors along with the Fed, and along with the other things we've talked about, that will temper inflation as we go forward.

Frank Mottek:

One area of concern at the beginning, and there were some ominous predictions about this was commercial real estate, and obviously, there are a lot of big changes in that world still, with the slow return to the office and all of that. And then on the residential side, we've seen the record high prices fueled by record-low mortgage rates as rates begin to come up. Madam President, what do you see ahead for real estate?

Mary Daly:

Let's back up for a moment. We were just talking at the lunch before the event that for commercial real estate people, March 2020 was, there were white-knuckled. They were, "Oh my gosh, what's going to happen?" And what I saw, and I saw this in all the different capacities I talked to is that people are pretty entrepreneurial. They're getting out there. They're figuring out, "Okay, I've got this space. I'm making a prediction. It's unlikely people are going to come and occupy this space. So what can I be doing? How do I repurpose space? How do I get into other building opportunities, other rental opportunities where I can take advantage of where the economy's going, not where it's been? So is there more transposition to be taken?" Are there going to be repositioning on commercial real estate? Sure. Surely. Absolutely. But residential has been stronger than I think anybody noted, anybody thought, and it hasn't just been low-mortgage interest rates. It's been a demand shock to housing.

Mary Daly:

People want different kinds of houses than they want just two years ago, and they want more space and they want to live further out from the city. And what I'm very interested in is are we going to be like 1918? So the last pandemic we had was 1918, the Spanish flu as it's called. And if you read the headlines back then, which you can do. You see that everybody thought the death of cities was upon us. That we will never have another US city, like the cities that were there when 1918 happened, when the Spanish flu happened. And you know what happened? We had the roaring '20s and the rebirth of the US city.

Mary Daly:

And so, that's why I said, we can't know today what the future holds, but we have to be positioned to respond to whatever it is. And a key message that's come through the pandemic, and I'm not trying to be too optimistic. I am an optimist by nature. But I see it with my own eyes and hear it from my contacts. People are entrepreneurial. They're flexible. I mean, we all went home and still did our work. And now we're going to come back and try hybrid. And I'm confident that even in this transition, the economy's going to figure out what's next and figure out how to work that out.

Frank Mottek:

Another question from our webinar audience, our global audience here, on the crypto, certainly our vocabulary has expanded since the 1970s. Bitcoin, Ethereum, Shiba Inu, Dogecoin, and now the Fed may be getting into crypto too. What's your view on the crypto space?

Mary Daly:

The first thing I'll say is that there's a lot of confusion. You think transitory was a confusing word. Crypto, so there's so much... That your word is used to describe a whole bunch of things. So Bitcoin is not the same thing as a digital currency. It's nothing like a currency. It's an asset. It doesn't expand as the economy grows. It's got a fixed limit. Its price fluctuates. Right? So that's an asset and is a kind of investment tool, and you can also use it for a medium exchange, but it's still an asset like a stock. So then there's these stablecoins, but they're not all that potentially stable. And so I think that's another oxymoronic little twist of a phrase. But they're a new thing, and they actually solve problems that many people would like to solve. The efficiency of exchange, the ability to have something that can go across border.

Mary Daly:

What I see when the Fed issued this white paper, what I see when I think about digital currency or the evolution of digital exchange, it's really what are the use cases that people need. And then let's stack those against the risks that are there, like having a single ledger that has everybody's number in it for exchange or importantly, thinking about fraud or criminal activity, you have to think about all of these things, privacy. So you end up with a time period where absolutely the world is changing. Absolutely, we're thinking about all these and the Fed is actively studying these issues. But this is a place where going slow allows you to go fast, and going fast can be extremely disruptive. So how I think of it right now is, it's really important for us to start using very precise language about what these different aspects under crypto mean and start then thinking about regulatory issues, risk issues, and where and when central banks should be involved.

Frank Mottek:

And certainly, in the financial world, Bitcoin and other cryptos have tremendous fans and huge critics. Maybe you can give us some insight on the discussion at the Fed, is that the same situation there among Fed policymakers, big fans, and big critics?

Mary Daly:

Well, central bankers are actually really boring. We don't tend to be fans or critics. We tend to be students and geeks and we're studying. And so it really goes back to... Our teams are working on, what's the taxonomy. What's Bitcoin? What does it look like? What are the risks associated with it? What's stablecoins, and what are the use cases, and what are some of the concerns? So for instance, in stablecoins, something that we think about a lot is stablecoin promised dollar-for-dollar exchange, but they're not always keeping... They're not always backing those. And so what if there's a run on that, what happens? And so, I would look at these things from a financial stability perspective. What's going to happen? Is there a systemic risk? Right now, it's a small part of overall financial markets, but those are the things that we need to watch.

Mary Daly:

And you brought up the financial crisis. I was working at the Fed during the financial crisis as an economist, the big lesson from the financial crisis. Since we're talking about lessons from history here is that we need to be looking ahead and studying things that might have a very small impact on the market today. But actually, as they grow could be a vulnerability that we need to be incredibly knowledgeable about. So things that are helpful, financial intermediation, the innovation in the financial system, that's critical. Every history book will tell you this, every research paper will tell you, "You have to have it in order to continue to help the economy grow." But if you're not mindful of the risks that it brings and your students of that, and you think about how to manage it, then you can find yourself in situations like the financial crisis, where looking back, it seems easy, but we didn't see it going forward. And I think that's where my mind is on crypto, stablecoins, Bitcoin, digital currencies is, what are the use cases? What are the risks, and how do we manage it as we go forward?

Frank Mottek:

What are your thoughts about the underlying of blockchain? Unlike the internet, which everyone was eager to get on, are we seeing people eager to get on the blockchain? I don't know too many people that are actually using it, but what are your thoughts about blockchain, that technology that everyone's talking about?

Mary Daly:

Well, that's another thing that I think... I mean, I will just use self-reflection. I had to really work to study all of these things because people often use blockchain, crypto, stablecoin, and all these things, Bitcoin in the same sentence as if they're the same things. Blockchain's a technology. There's going to be... It's a technology and there's going to be all kinds of things that it can be used for. And those use cases are being developed right now. But I would separate that as a technology. And then, think of it, the use cases being these financial assets or these financial classes that we're talking about.

Mary Daly:

I think that's really important. So my answer to all of these questions is this is a period of intense and should be in a period of intense study, not just by the Federal Reserve, but by all regulatory bodies, and by the average consumer who is dipping toes into those waters. And really, there's got to be a high level of education so that people know what they're getting into.

Frank Mottek:

What's your reaction to El Salvador adopting Bitcoin as a legal tender? And closer to home, Rick Caruso, for example, accepting rent in Bitcoin and others now adopting Bitcoin and becoming more mainstream. But what are your thoughts about that?

Mary Daly:

This is an answer that I don't have to usually give but I'm going to give it, which is, I really make a point of not opining on things that are not in my purview to make any decisions about, at least in my public life. My point at home all the time, but seriously, what a sovereign nation decides to do is that sovereign nation's responsibility and what an individual entrepreneur or CEO decides to do is the responsibility of that person.

Mary Daly:

My focus really is a hundred percent on the financial stability issues in the economy. The use cases that people are asking for when they want these types of products and whether the Federal Reserve needs to be involved in thinking about solving for some of those use cases while managing the privacy and risk aspects and criminal fraud and other things, criminal issues that we do. Our job is to have... Think of one of... Our core responsibilities are a safe and sound payment system, a safe and sound financial system with other regulators, and a stable economy that promotes price stability and full employment. So I'm a hundred percent on that payment, that people want a safe and sound payment system and that's where my energy is being spent.

Frank Mottek:

The financial crisis, as was famously told by President Bush in his book, Decision Points. He said that it started when the Treasure Secretary Paulson and Ben Bernanke came to him and said, "Mr. President, we have a problem with the TED spread," which is an obscure, measurable liquidity in the financial market. First of all, how is the TED spread looking? And is there anything on the horizon that perhaps we're not seeing at the moment that you're watching, please?

Mary Daly:

This is another thing about the Fed people might know is that those terms, while they make history books, don't actually stay with us all the time. So here's how I'm thinking about the economy. Here's what I'm looking at. I'm looking at the dashboard of indicators on growth, the dashboard of indicators on the labor market, the dashboard of indicators on inflation, and I'm looking at financial markets more broadly. And what I see when I look at financial markets are several things. Let me focus on them. That financial conditions are accommodated right now and more accommodated than we would like them to be for the economy we have, which is why we've raised the interest rate and for our... Think about raising the interest rate, we haven't done it yet, but why we're talking about it.

Mary Daly:

And that just brings me to my second point about financial markets. We started talking about raising the interest rate and we tapered our asset purchases more quickly than we said we would. And financial conditions started to tighten because financial markets listen to us and they look forward. It is not the case any longer that we go behind closed doors, we make a decision, and then we do Federal... We do open-market activities and then people look for smoke coming out of the chimney and to decide what we're doing. We're very transparent not only about what we've done, but about what we will be doing, and that tightens financial conditions already and has already started to reposition things.

Mary Daly:

And then the third thing in financial markets is that right now they're reacting to a variety of things including geopolitical risk, including how's the pandemic going to end, and including what's the future going to look like. And what I feel good about in all of those things is that financial market participants and entrepreneurs and businesses are repositioning themselves. They know the rate the environment is going to change. They know it in enough time that they can reposition themselves and find themselves in a situation where they're not cut short. And that's what you really want because you want a smooth landing for workers, for households, for businesses, and for markets. And that's what we're trying to accomplish. And that's one of the reasons I'm here.

Frank Mottek:

And thank you very much for being here. On behalf of the entire Los Angeles World Affairs Council & Town Hall and President and CEO, Kim McCleary, and the global audience on the web today, and all of us here at the California Club, I look forward to our next conversation on Mottek on Money as well. And thank you very, very much, Mary Daly, the President of the San Francisco Federal Reserve. Thank you very much for making this possible.

Mary Daly:

Thank you.

Frank Mottek:

Thank you.