Fed Unfiltered, Transcript
2/9/22 – Loretta Mester, Interview: CNN

Speaker 1:

Loretta Mester is the president of the Federal Reserve Bank of Cleveland and a voting member of the FOMC. I've taken away my balls and tubes, which will set the interest rates. But you do set the interest rates in the United States. Let me start the discussion. I will say it before you do, the decisions will be data dependent and the Fed will be watching the data coming in and making decisions in accordance with that data. So as they say, all protocols observed. Now, we can get to it. The reality is you've said three in the past, you've come out openly and said three rate rises. Being data dependent from where we sit now, do you think it's likely to be more this year?

Loretta Mester:

Well, we're in the process of constructing new summary of economic projections for the March meeting. But the inflation data continue to move up. So I could imagine that I'm going to pencil in more than three. But I really do believe that we need to really look at the data and how it informs. It's economic and financial developments and how they affect the outlook, then the risks around the outlook. That'll determine kind of what the ultimate path will be. I think I'm supportive of moving the rate up in March. I think over the next couple of months, we're going to need to see further rate increases. Then by mid-year, if I don't see indications that inflation is on a downward trajectory, which I'm expecting in my forecast, then we might have to speed up the removal of accommodation. But if we see inflation moving down in accordance to my forecast, then we might be able to slow down the removal of accommodation.

Speaker 1:

The problem of course now is that we're into these issues of monetary lag and the difference between acting now and when you're going to see the response, which can be many months. So, this is the hardest part of monetary policy now, isn't it? It is anticipating a move now and seeing the reaction in 8, 9, 10 months time.

Loretta Mester:

Yeah. You have to be forward looking. Monetary policy affects the economy with the lag, long and variable lags. You don't know exactly when. But we should be able to start seeing the monthly increases in inflation moving down. Some of that will be dependent on monetary policy, some of it will be because supply conditions and those constraints from the bottlenecks and the other constraints on supply probably will ease this year. Certainly the businesses we talk to, many of them think that it'll ease in the second half of this year, or some think it'll be next year. But they all expect that some easing in that, and that also will lead to lower inflation rates. So I think it's going to be a combination, which is why I think inflation will be moving down this year. But it'll remain above 2%. So I think the job one for us now is to remove emergency accommodation in a way that it'll control inflation and maintain the expansion in healthy labor markets. That's what's going to determine our path. It's always looking at our dual mandate goals and that's our guide.

Speaker 1:

Do you regret the persistent use of the word transitory to describe inflation, which lulled many into believing that the Fed was not going to act consequently, those who say that the Fed is now behind the curve and should have taken some measures, maybe not dramatic, earlier.

Loretta Mester:

Yeah. I was never a fan of using transitory as long as we did, and I've said that publicly. I think what the word was meant to convey was that a lot of the factors affecting the inflation readings were supply constraint factors, rather than something that would be lasting and that monetary policy could address. But it gave the impression, just as anybody would reasonably think, that inflation readings would come down quickly. That was unfortunate. I think now our language is better that we got rid of calling it transitory, but pointing out that some of what's happening in inflation is supply side, some of it is robust demand.

Speaker 1:

If that's the case, and I know you are not fine tuning a Swiss clock, I realize that, but the higher rates are designed to slow consumer or can slow the demand side of the equation. So how much would you be comfortable seeing the economy slow as a result of these rate increases?

Loretta Mester:

Yeah. There's no doubt, the economy, there's a lot of demand momentum. The issue is, is that demand is out of balance with supply because supply is constrained. So we need to take out accommodation. Yeah, I do expect by doing that, financial conditions will get a little less accommodated and we'll see demand moved out. But remember, GDP growth last year was 5.5%. That's a really, really high rate. We haven't seen that rate since 1984. So again, and labor market's the same thing. Labor markets, by many measures, are very tight. That's a case where the real economy can support raising interest rates to bring demand into better balance with constraint supply.

Speaker 1:

Lets go just slightly deeper into the weeds, but I think fascinating regardless. The ballooning of the balance sheet, the Fed's balance sheet, which now has to be addressed. Now, if we look at the Bank of England, they've pretty much made it clear that reducing the balance sheet is one of the priorities, providing it can be done without upsetting money markets and the financial plumbing. I read the recent paper by the Fed on this, how you are going to do it. It's tricky, isn't it? As we saw once before, when you tried to reduce the balance sheet.

Loretta Mester:

Well, we put out the principles in January about how we're going to go about doing it. In there, we made a clear statement that the Fed funds rate is our primary tool of monetary policy. So we are working on what the exact actual implementation plan will look like in accordance with those principles. But my view is that we should start sooner and go faster than we did last time, because the balance sheet is so large and the economy is in such a stronger position and inflation is much higher.

Loretta Mester:

I still think that should be in the background, it's not going to be our primary tool. But we'll set up a plan, we'll announce it in advance so that markets know what the plan is. Then our main tool of policy will be that Fed funds rate. So that's how I imagine it going, but we're still talking within the committee about what the particulars will be. We have announced that it'll primarily be reduced and reduced significantly through runoff. My own view is that I could see us at some point during the process selling some of our mortgage-backed security portfolio, because one of the other principles we put out is that over the longer run, we want to move the portfolio back to primarily treasuries.

Speaker 1:

You have been through several cycles, I suppose, any of us who've been doing this long enough have been through several interest rate cycles, in both directions. Does this feel any different to you to in the 2000s, time in 2008? Does this feel different what we are facing and the decisions that the committee has to make?

Loretta Mester:

So in a lot of respects, it feels different because of the nature of the shock. The pandemic was something we hadn't experienced before, and the effects on the economy and our reaction in terms of what we had to do to the economy because of the pandemic, is very different than things we experienced before. On the other hand, we have the experience of having used emergency tools before. So that actually we were in a good position, because we had done that before. We'd been in the position of having to move our balance sheet back down. So, that's good. That's information that's very helpful to us. We've been in this position before of having to navigate an economy where there's risk and uncertainty. So in that respect, we know what we have to do in terms of reducing emergency accommodation, getting inflation under control, which is so important because we want a sustainable and inclusive expansion. The best thing we can do at this point is get inflation under control so that the expansion will continue and labor markets will remain healthy.

Speaker 1:

President Mester, I'm very grateful ma'am for your time today. Thank you.

Loretta Mester:

Thanks.