Fed Unfiltered, Transcript
3/1/22 – Charles Evans, Interview: Lake Forest – Lake Bluff Rotary Club

Speaker 1:

Good morning, sir. It's always great to have you here.

Charles Evans:

It's great to be here. I really appreciate it. I just tell everybody at the office, I have done this event on a number of occasions. Back in January of 2012, on very short notice, Chairman Ben Bernanke asked me and my colleague Charlie Plosser at the Philadelphia Fed, if we'd schedule a public event quickly so that we could talk about the benefits of our new inflation objective that we were about to publish that time. And so this group was able to do that very quickly. My colleague, Cathy Lemieux, has a special connection and it's just been wonderful, and I feel a special appreciation from them. So I'm happy to be here.

Speaker 1:

Well, it's our distinct honor to have you here, and thank you again to Cathy for supplying that initial connection. Thank you very much. Not that there's anything interesting in the economy and what do they refer to the economics as the dismal science, but obviously there's lots going on. So when we get right into it. Charlie, the economy's come a long way over the past two years, GDP is back to pre-pandemic levels. Unemployment is down to 4% and job markets are the hottest in years. At the same time, inflation is at 40 year highs. Where do you see the economy heading in the first quarter and the rest of 2022?

Charles Evans:

Yeah. Thanks so much for that. And if you've attended these events in the past, you'll notice that the situation is entirely different than when I've been here before. I've spent the bulk of my time telling you that inflation is too low and we need to get inflation up to our inflation objective. All of a sudden, inflation is extremely high. Core CPI is 7.5% on an annualized basis. And so that's something that needs to be addressed by monetary policy for sure.

Charles Evans:

That being said, the economy in the United States is on a pretty good footing at the moment. We've had very strong growth. That's been a recovery from the pandemic, the economic shutdown that occurred in the spring of 2020 in order to keep us safe, and then bring people back as best we could. Although so many people worked remotely, we're still largely working remotely at the Federal Reserve Bank of Chicago and quite successfully as well, and manufacturers have learned how to produce safely very quickly.

Charles Evans:

And so the economy rebounded quickly, but it took a while to get back up to the level that we had pre-pandemic. So we're really in a very good situation there, and the labor market has improved dramatically. The unemployment rate is down to 4%. So that's really quite good. I'm sure during the commentary question and answer, we can talk more about there have been labor shortages, there continue to be labor shortages, many employers, it's difficult to find workers. On the terms that they have found attractive in the past with the hours and all of that, and I think there's sort of a sea change going on for a lot of business models because of that.

Charles Evans:

So there are tremendous challenges ahead of us, but there are ones that are being addressed from a position of strength in the US economy. So I think GDP has been good. I think the first quarter might be a little bit softer. It'll still be good and I think we're going to continue to see strong improvement in labor markets. And so really the attention, except for the international situation which is quite grave, I think at the moment, there are no obvious spillovers to the US economy, but of course it's still early days and it's hard to know how everything will play out.

Charles Evans:

Obviously, oil prices have gone up quite a lot. The supply of oil is going to be reduced. Russia supplies quite a lot of oil to the world market, and President Biden announced, listening to him yesterday that global authorities are going to release quite a lot of oil from strategic reserves in order to try to deal with that. But it's still the case that oil price is going to be high. Gas prices are high, prices of a lot of things that you really think of as dear to you are very high. And so inflation 7.5%, and we're going to have to adjust monetary policy to deal with that. So why don't we keep going with the questions?

Speaker 1:

Sure. With all that's going on in the world with the lingering effects of Omicron and Ukraine, what do you perceive the biggest risks to growth in the coming year?

Charles Evans:

Well, I do think that the inflation situation is quite a risk. And so wages have been going up. Business profits have been quite high in successful industries. I think the in-person service sector has been challenged throughout COVID. And so that'll be a continuing challenge and high prices, ever increasing prices are really difficult for businesses, especially if you can't pass those price increases along. If you can, then of course it's the end user, consumer that has to deal with that and do incomes keep up, traditionally they lag.

Charles Evans:

But wages have been going up. What we need to do is get a handle on the rising inflationary pressures and adjust monetary policy. Monetary policy has been set at zero, basically the funds rate plus our large balance sheet because of the pandemic and we needed to get the economy going. But at the moment, we need to readjust that so that it's moving towards neutral. I think that the inflation situation is going to improve, in part because it's driven a lot by real factors. Back in January of 2021, just last year, inflation was under 2%.

Charles Evans:

If you think about the 1970s, everybody goes, "This is a repeat of the 1970s." 1970s was a period where inflation started to gradually increase from the 60s, monetary policy was too easy, it got higher, you had a supply shock, it went up, but then it came down, but it kept getting higher and we never dealt with it. This just leaped from under 2% to 7.5% in a year. And a lot of this has to do with supply chain issues, semiconductor chips that aren't available to auto producers. So auto producers haven't been producing cars. Used car prices went up 10% in one month, first month and they just can't continue to do that forever.

Charles Evans:

Although they have continued to go up and that's really been the surprise to me. So there's just been a number of categories of prices that have gone up a lot, anything auto related, durable goods related. There's been a tremendous demand for goods in the US economy. When you can't do in-person services, go out to restaurants and enjoy that, you substitute goods. So much of that activity that used to be in services has moved over to goods, and we just didn't have the capacity to deliver all of those goods and then getting them from the warehouse. Have you seen Amazon trucks in your street?

Charles Evans:

I think my residential street is more of an alley sometimes with all of the vans that are there all the time. I've learned since I work at home too, that the Amazon driver likes to park in front of my driveway at least twice a day as he delivers packages to everybody. I mean, the entire delivery system is different. That's had resource implications for supply chains, and so the prices have gone up. I expect many of those prices to start coming down or at least stay at the same level. If they stay at the same level, they're not going to keep going up and inflation is ever increasing prices. And so there's a natural reducing factor for inflation that is on the way.

Charles Evans:

It's taking longer than I expected. It's going to continue into next year. And as we increase the Federal Funds rate and take away so much accommodation for monetary policy, we're going to have restrictiveness coming in play for monetary policy, the fiscal support's going to start withdrawing, and then we're going to have the supply chain improve. I expect that that's going to lead to inflation much closer to 2%. Not this year, not at all, even next year it's probably going to be closer to 2.5% than 2. But by 2024, I think we'll be back closer to 2%.

Speaker 1:

There's been a exodus from the workforce recently and it's affected all small business people. For instance, in the field I'm in which is divorce line, this is not a commercial, but it has been a growth industry strangely enough. But you can't find professionals wanting to fill those lower levels and come in. And the stories I'm hearing anecdotally from clients with small businesses, they can't find people to fill up the rigs and how is that affecting us?

Charles Evans:

I've heard stories like that for quite a long time. I started hearing stories like that before I expected to hear the manufacturers outside of large metropolitan areas, either in exurb or more rural areas in Iowa, "I'm having trouble finding manufacturing workers in my plant." You push a little bit and it's like they're trying to add a third shift. It's unusual to have a third shift because the demand for their product is so much. And in this town, they have a long history of knowing that there's a cyclical factor here, so that third shift work won't necessarily stick around. And so workers are kind of thinking that one through and going, "I don't know if that's where I want to be working."

Charles Evans:

Some of it is because there's been tremendous demand and businesses are trying to do things they haven't done in the past. That's wonderful, but it's not obvious that it can take place smoothly. Then you've got a lot of workers who are kind of reevaluating. It's like that job was a lot harder, and in the current environment given... I mean, imagine a close in-person service type of work or restaurant or something like that. Not only do you have to do the tough job that you're doing, but you have to deal with people who don't want to wear masks, don't want to be compliant or whatever the situation is. Maybe they're just grumpy and that's always part of this.

Charles Evans:

But sort of the better parts of those jobs, maybe there aren't as many. And so I think that might be one part of it. Child care, adult care, care issues are much more important in the COVID environment. It's very difficult to find a child care service. They got hit very hard and so care issues are very difficult. Then you've got people who are employed and working in offices, but they're not working in offices. They're working at home and they like to stay working at home. But they're employed. That's not really the issue that you're talking about so much, but the labor market is just a fascinating complex set of issues that it's going to take us a while to think through.

Charles Evans:

Plus, I mean, if I'm a business person I'm kind of going, "I can't find workers at the price that I want to pay them." As an economist and Economics 101, it's like there's supply, there's demand, there's a price where you want... I've heard just casually people kind of go, "I'm hearing..." I mean, just in a hotel setting listening to people talking about, "Well, they just can't find workers." I'm kind of going, "At the price they want to pay, you kind of think there ought to be a price." And sometimes it's not just the price, it might be benefits too.

Charles Evans:

And then the Wall Street Journal had a great story the other day with a bunch of anecdotes and you kind of go, "Man, they're offering signing bonuses at a sandwich place." I mean, that's how unusual things are, $300 as the story went, if you stay for three months. But they didn't get the hours that they wanted. It's like, "You didn't get 40 hours. Maybe you only got 10 hours." That's the job where if I take that job, they need so many hours. I'm going for 30, 35, 40 hours and I only get 12. So people move around and then the person stayed for three months, asked for their bonus. And I guess the story they got back was, "It's not just three months, but you had to work enough hours, which we didn't give you."

Charles Evans:

It's a lot of complicated issues and businesses are challenged by that. There's no doubt about it. There's just a whole bunch of business models where it's like, "I've worked very hard. I put the capital in this business. I'm providing a product, customers like it, and I have a value proposition for my employees, but now it's harder, the price is higher. And I was only barely... Kind of my margins were thin anyway." And so it's entirely possible that business models that were successful in previous environment might not work in a current environment. And that's very difficult and unfortunate.

Speaker 1:

All right. Well, let me move on. The government responded overwhelmingly to support the economy in the early days of the pandemic. Congress applied over 5 trillion of relief funds, while the Fed committed a large amount of support from supporting the flow of credit to accommodative interest rates and asset purchase policies. How important has fiscal policy been to the economic recovery?

Charles Evans:

So strong fiscal support has been fundamental to the success of the US economy throughout the pandemic, from the early stages to where we are now. We have strong demand for goods in part largely because we've had fiscal support. It's been very generous in fact. And in fact, not many people might say it's been too generous, but it's been very generous. And so people across the income spectrum have been able to maintain nutrition levels by and large, they've been able to demand goods to replace services and they've sort of kept the economy going and increasing.

Charles Evans:

Haven't dug into exactly the composition of auto demand. But historically, lower income workers are challenged in order to get an automobile, to get to their place of work and public transportation's important in the current environment. You might think that they're more able to get a car, because there's a little more income support or they didn't take a big hit, except that car prices are very high. So there's a lot going on there. But I think fiscal support has been very strong, to the point where it's stretched our supply chain and our capacity more than we thought.

Charles Evans:

Well, we thought it was possible to meet this capacity. And in fact, we haven't. When you read about the backups in the West Coast ports, there's more imports coming in than we had before. There's a dysfunctionality at work in terms of getting the goods onto the dock, onto the truck, into the warehouse and all of that, because there aren't enough truck drivers for the capacity that they have. But the amount that's coming in has been really high. And so it's been a good story in the sense that we've had this replacement for services that we weren't able to enjoy, but it is stressed the supply chain, it's caused higher prices.

Charles Evans:

And then you have the special stories like semiconductors, which is like, I never would've guessed that the auto companies were the low margin semiconductor business. And so when they delayed taking their orders back in 2020, because they didn't know what auto demand would be, then it came back up, they lost their place in line. The East Asian producers of semiconductors all of a sudden they had demand for consumer electronics, games, videos, high margin chips. What do you do? You produce for high margin or low margin? Swapped into high margin, auto sector couldn't get their semiconductors, which were also a generation vintage behind the others. And so it took time to build that up.

Charles Evans:

Plus those economies, Malaysia, Indonesia, Vietnam, all of the lower cost producers, they got hit by COVID because they weren't able to support, prevent that in their countries as well as we did in the US. And so then those went down, then there's a fire in Japan at a plant. I mean, you just get these add-on stories. And so you don't have the semiconductors. Plus, rented a car recently? A year ago, you could rent a car on vacation for three weeks for $300. Today it's $2,000. It was cheap because they were getting rid of their cars, it was an older car. Now they have to replace those. And so the backlog of the demand is high.

Charles Evans:

Auto companies are still trying to get everything in line. And so you just put that all together and there's just tremendous challenges that we've all been facing, they translate into very high prices, it's a much better positive situation to be dealing. Unemployment is low. Incomes are high until the recent Russian invasion of Ukraine, stock market was high, all kinds of things. So we've weathered this in a very good fashion. Fiscal support has been very important for that.

Speaker 1:

At the January Federal Open Market Committee meeting, the committee indicated that it would soon be appropriate to raise the Fed funds rate, citing both inflation above target and a strong labor market. Will we see that happen at the upcoming March meeting? And if so, will that increase be one quarter percent or more?

Charles Evans:

Let's see. I used to tell an old story, like they make you go to school for two weeks in order not to answer a question about where interest rates are going to go. But we started talking about forward guidance on interest rate policies long time ago. At a particular meeting, we usually don't talk about it, except this is the most talked about subject I believe that chair Powell, I know he is doing testimony this morning. I think I saw a news item already indicating what, he said that we're going to raise rights at the next meeting, Cathy? Did he say that?

Cathy:

He said the committee has said [inaudible 00:18:49] conditions are right, there's no reason-

Charles Evans:

Conditions are right, so there's no reason not to. Yeah. Well, that's a very clever way to say that. And I deal with very clever bosses, so that's good. As I say, if you've attended this event in the past, President Evans as well known for saying that we need more policy accommodation, because inflation is too low and we need to get inflation up. Inflation is too high. It rose because relative prices increased a lot and it's broadened out, so that's a problem and it's going to take a while for it to come down.

Charles Evans:

I'm not a big soccer fan, but I get the idea that we're wrong-footed, the ball's on the wrong foot, we can't get it in the right place. Monetary policy needs to make an adjustment upwards towards neutrality. I think the question is how quickly we're going to get... We're going to get moving. We're going to get moving pretty quickly. We're going to get moving towards neutrality. I think a complication is the current global environment, but of course, it's kind of an inflationary environment with the reduction in oil supplies. And so I think we're going to get going early next meeting, next several meetings for sure.

Charles Evans:

And then before we get to the end of the year, we're going to have a chance to see more data on inflation, how things are playing out, how the economy's doing, and we can take stock and maybe we just keep going. By some accounts, some financial market analysts are expecting as many as 725 basis point increases this year. Our summary of economic projections of the FOMC had a median I believe of three increases. But that was in December and in December we didn't expect things to be as inflationary as today. And so, I mean, we're obviously going to make an adjustment. We're wrong-footed and we need to get moving. It's going to take us at the current expectation, still some amount of time to get to neutral. And we're going to find out more information, and know if that's exactly what we need to do or we need to do more.

Speaker 1:

So do you think we're going to be experiencing this high inflation through the rest of this year?

Charles Evans:

I think that inflation at the end of 2022, I think the median SEP in December was like two and three quarters percent for core PCE. PCE runs a little bit lower than CPI. Most recent inflation data were more negative than that. It's going to be over 3% for this year, and I mean, it could be... I don't think it'll be as much as 4, but I think it could be somewhere in the 3 to 3.5% range. I need more data. We haven't really sharpened our focus on that. I could be changing my tune within a couple of weeks.

Speaker 1:

So at the earliest 2023 to tame it.

Charles Evans:

Again, this is sort of the waning of the supply effects, improving logistics, more semiconductors, auto companies getting... I mean, you got to understand, used car prices in the spring, they went up 10% in one month. One month. That's not annualized. That's one month and you go, "Whoa." Then the next month it went up 7% and you go, "Whoa, this can't keep going." Next month it was 10%, three months in a row, really high. It's just like a big relative... I got a 2007 Toyota Corolla, but the battery was dead a couple of weeks ago. I'm not selling that car. I bought a new battery for it because it's hard to buy a used car.

Charles Evans:

We have a whole bunch of these things that are going, once you get new cars coming in at scale used car prices, aren't going to be as high. They will come down. Rents are going up. Rents are probably going to stay up. There's a whole bunch... It's broadening out and wages are going up. And how businesses are able to spread that out, do they have pricing power to spread that out? It's also the case that sort of historically or at least in the last 15 years, it's been tough for businesses, you could tell me more, it's tough to raise prices. "I can't just raise prices. I don't have that kind of market power."

Charles Evans:

And if I tell people wage costs are going up, nobody really believes that in a normal environment. If oil prices go up and you've got an energy component in your business, that's easy to identify and you can raise that price. You can pass that along. Commodity prices, food prices, things like that. But normally it's hard. Current environment, "Oh, it's the supply chain." I mean, there are ready excuses for this, whether it's a supply chain or not. And so I think in the current environment, we probably are going to have a little bit more of prices, cost being passed along.

Charles Evans:

And then next year, how is competition going to maybe erode that? Or maybe the inflationary pressures will be more intense than that. That's part of what I'll be looking for. Competition's very important. We get to a situation where people are doing better and it's like, "Come eat at my restaurant, come buy my product." That's good for the economy. We need that type of competition.

Speaker 1:

Well, let me try to put you on the spot further. Do you think the Fed is behind the curve in terms of its current monetary policy stance? And if so, how can the Fed catch up?

Charles Evans:

Well, I mean, it is fair to say. I've said that policy at the moment is wrong-footed. Things change very quickly. From January, 2021 to April, 2021, it was a sea change. Like I say, it was under 2%. Next thing I know, it's used car prices through the roof and everything else. And so it changed very quickly. It would've been a massive change in policy to get to something closer to neutral already, and the economy didn't seem like that was the right move. Plus it still seems like there's a good relative price component to this. And so given that I'm expecting improvement, but look, I've been wrong before. I thought it was going to be more transitory than this and it's taking longer. So that's what we have to assess.

Charles Evans:

I think there's still time given the current situation. We're making a move up. And if we see that things are continuing to deteriorate on the inflationary front more than we're thinking, we can increase rates more quickly and things like that. We're going to address the balance sheet, being large and reducing that before too long. And so we're going to put a lot of things in play. Financial markets are going to be responding too. Fed doesn't always have to in the moment do everything financial markets, look at what we're going to do, and start increasing interest rates and reducing the credit that's available. That's the channel for monetary policy to have this effect.

Charles Evans:

By the way, let's not forget, when we say that monetary policy needs to respond to get inflation down, this isn't just prices magically come down. It's the economy reacts and we end up not stressing the supply chain the same way. And historically, that's a time when employment is more challenged, more businesses are more challenged. And so it ends up being a much more difficult business environment for everybody. We don't want to do that unnecessarily. Nobody would want to do that unnecessarily. That's why we're going to be careful and assess the situation, but we're at zero. We need to be somewhere north of that by quite a bit. We're going to get going on this pretty soon.

Speaker 1:

Well, along those lines, with the Fed's dual mandate, the other side being the labor market, what are currently the Fed's definition? Are we currently at the Fed's definition of full employment?

Charles Evans:

So that's always a very difficult question, because the inflationary situation for the US and cost pressures, when do cost pressures kick in? Back in the 80s, the employment regulatory environment was such that probably the natural rate of unemployment, it would be... We're at 4% now. In the 80s, 4% would be on fire inflationary pressures. Certainly we thought that. Because we kind of thought that the natural rate of unemployment back in the 80s, we learned was closer to 6%. Now it's not clear what it is.

Charles Evans:

We've gone down to 4% and had very low inflation. At the moment, we're at 4%, we've got high inflation, but that's not the monetary policy story. You don't go from January, 2021 under 2 to April, '21 going up except for special factors and things like that. So we got to figure that out. The key point for full employment in our most recent adjustment of our long-run framework, is we want to make sure that we're not facing employment shortfalls. When the economy's not doing well, when the labor market's not vibrant, we don't want to mess with that unless it's crucial that we deal with inflation.

Charles Evans:

And so I expected before the relative price shocks that we'd be sort of dealing with an up creep of inflation above 2, and that would be okay as we tested the waters for how vibrant the labor market could be before we sort out inflation. Now we're at a point where we see 7.5% inflation. We have to adjust that. Labor markets are vibrant. I anticipate with the relatively measured... Measured, I shouldn't use that word because it meant something in 2004 that's different than now.

Charles Evans:

But with the adjustment path for monetary policy that I'm anticipating, I think that the labor market ought to be able to maintain quite a lot of vibrancy. At the end of that, are we at full employment? I just think that we don't want to unnecessarily put stress on labor markets and small businesses. But we have higher inflation and so we have to make adjustments now.

Speaker 1:

All right. Thank you. In addition to interest rates, there's been a lot of talk about the Fed's balance sheet. Can you explain how the balance sheet has been used to aid the economic recovery and conversely, what role would it play in helping to rein in inflation?

Charles Evans:

Yeah, one of the challenges for monetary policy in the last 15 years, has been that we've been in a low interest rate environment around the world. And when interest rates are low and you go into a recession, monetary policy doesn't have a lot of capacity to cut rates. Cutting rates in order to get the economy moving forward is basically how we deal with recessions. And if you started at 2% for the Federal Funds rate, you can only cut it to 0. Historically, we've needed 5 percentage points of reductions in order to get the economy going.

Charles Evans:

And so this effective, lower bound, we can't go below 0 has been a problem. Because of that, under Chairman Bernanke and other foreign central banks had done this too, we started buying assets. We grew our balance sheet, which is sort of as close to the textbook increasing the money supply, that you might have heard about back in college or high school or things like that. And so we've increased our balance sheet in order to add on to the accommodation. And that seemed appropriate in the early days of the pandemic, because we were worried about market functioning, and bank reserves actually weren't large enough to handle all of the financial market volatility that capital markets were dealing with. Then we got past that.

Charles Evans:

Then we got to the point where it was useful to support the economy with continued asset purchases. Then we really had substantial fiscal support and that was unexpected. Back in 2011 when we could have had more fiscal support that would've improved employment, we didn't get it. Because that came out online, it was unexpected, we really pushed the demand for goods. And now we're just in a situation where we need to start winding that back, and I anticipate that we'll be doing that by the middle of this year probably. We'll start a roll off. We'll have to decide the pace of the roll off, doing it in some regular fashion so that markets can understand that we don't inject more volatility into financial market valuations is useful. But we'll want to start reducing the size of our balance sheet, because it's very large.

Speaker 1:

Going back to your comments earlier about supply chain issues as a major driver of inflation. Are you seeing any signs or the supply chain issues are beginning to improve?

Charles Evans:

Yeah. I think the answer is yes, but it's really hard to tell. I mean, you can start to look at numbers, and I believe that the ships that are waiting at port on the West Coast ports has been coming down. On the other hand, earlier on they were coming down. But in part that was because they told them to wait further out. And when you wait further out, it doesn't get counted. Now, I mean, there was a reason for it because they were coming in too close and bunching, and so you wanted to do that. But the reporting, you got to look at this pretty carefully. And so it's kind of hard to see.

Charles Evans:

The auto companies, when you talk to auto company analysts, people in the industry, they're getting access to semiconductor chips. They're getting, sometimes you hear this fair share. So I think they've figured out how to allocate these across the different companies. Everybody's building this up. I think the rental car companies are trying to rebuild. They are trying to rebuild their stock. And so it's going to take a while and I think you've got, the industry always wants to make adjustments. And so they think they probably got their own tensions between dealerships, and whether or not you got cars on the lot, or whether or not you order them online and what the financing is for that.

Charles Evans:

I mean, it could be that we get caught up in some of these longer term secular adjustments too, but I'm expecting that the flow of those cars is going to improve. I think durable goods are along the same line. Logistics issues, you hear about truck drivers, there aren't enough truck drivers. Been hearing that for 10, 15 years. If you talk to somebody in the trucking industry, there's never been enough truck drivers. And so it's like welders, there were never enough welders either. Something sort of got to change in that. Plus you got the Amazon effect. How many of those truck drivers went from long haul to something different, which is local and vans and things like that?

Charles Evans:

I mean, it could be that we're just in the midst of this sort of generational shift. Digital is big. We're buying differently. The trucks aren't necessarily going to the jewel and your local grocery store, but they're coming out and parking in front of my driveway and whatnot. So it's just hard to know how to assess.

Speaker 1:

You've got the feature of autonomous vehicles entering. And I've seen stories recently about autonomous trucks out on the West Coast being used. So that's another impact to look forward to.

Charles Evans:

Yeah. There's all this head scratching where people get very excited. See, this is the truck driver problem. I mean, I've talked to people in the industry and they kind of go, "I can't find truck drivers. I pay them all kinds of money, signing bonuses, they just won't come. We really need more truck drivers. Oh, by the way, in five years, I will not need truck drivers because there will be autonomous trucks." And I kind of go, "You think the truck drivers don't hear that side of the story too? You make this investment and then you're not going to have a job for them." So there's a lot going on.

Charles Evans:

Now, the infrastructure for autonomous vehicles, I mean, they're going to have to drive side by side with people like me, and my wife says I don't drive fast enough. And maybe I move in.... I don't know. I don't know how the autonomous vehicles figure out that one day, they're driving next to Charlie Evans. The next day, they're driving next to Ann Evans, we drive differently. They have to obey the speed limits. What was it? Tesla or somebody was programming that they didn't have to stop at the stop sign. They could roll through. That's [inaudible 00:35:41] not compliant. That doesn't sound right.

Charles Evans:

There are just so many issues here. It's hard to know how that will play out. But the additional infrastructure, it's like the bike lanes in downtown Chicago or anywhere, you take away part of the road for a different vehicle and there's more congestion. I don't know how that's going to play out.

Speaker 1:

Well, I do cross country motorcycling and with autonomous vehicles, my wife said, "More life insurance Carl."

Charles Evans:

When did she ever say less?

Speaker 1:

Yeah, that's right. You can never have enough, like ammo. All right. On a lighter note, Charlie, what role-

Charles Evans:

I'm just trying to keep up with Larry. I mean, [inaudible 00:36:30].

Speaker 1:

What role will inclusivity play in monetary policy discussions? Much has been set of making the Fed's labor market goals more inclusive. What does that mean in practice?

Charles Evans:

So this is back to the full employment question and it's really, what do we mean by full employment? And we think that everybody should enjoy the benefits of full employment, that we should have a vibrant labor market. And it shouldn't just be for certain slices of the labor market, like the high skill professional side. But it should be everybody. Everybody should enjoy in the benefits of vibrancy and a strong economy. Monetary policy is very special. I mean, we've really only got one tool. We can do interest rates, we can do balance sheet, but it's really monetary.

Charles Evans:

There's one aspect to this. And we are already trying to do a lot in order to support maximum employment and price stability. So that's two goals, one tool. Oftentimes they're not in conflict, so that's okay. But we do have to be careful. We're not going to be able to solve all of the issues. And so the fact that Black unemployment rates tend to be higher than white unemployment rates, Hispanic unemployment rate's higher too. We'd love to have conversion to that, everybody the same, not seeing differences like that. And it's broader than just demographics too.

Charles Evans:

Look at the income distribution. I mean, there's been quite a bit of income skewness over the last 20 years. Here's an example of that median. Because in economics with macro, we sort of focus on central tendencies, averages. Median household income, family of four, $67,000 a year, 67, median, 50% below, 50% above. Average household income, 97,000 per year. There's skewness between the median and the mean. Now, this 97,000 is about the 65th percentile of the distribution. So from 50th percentile to 65th. And a question that I would ask is, if the 65th percentile is an interesting object to study, focus on care about, shouldn't we count on the 35th percentile too?

Charles Evans:

While averages sort of point to in a particular direction, we should be more broad-minded in this. And before we take restrictive action, which is necessary when it's necessary to cool down inflation, we should at least think and make sure we're not doing this unnecessarily. We want to make sure we can continue with this much vibrancy of the economy, and labor markets, and small businesses as possible. But when we have to tighten policy to get inflation back in line, we have to do that. But we don't want to do it unnecessarily. That's how I sort of think about that.

Speaker 1:

I just have another couple of points and then we're going to open this up to the audience for questions. The recovery from the pandemic recession has been much quicker than from the Great Recession, in part due to monetary and fiscal policy, but also due to fundamental differences between the two periods. Yet still the unemployment rate today is 4% after the financial crisis that took more than eight years to reach that point. What did we learn from the previous crisis and how will monetary policy be different this time around?

Charles Evans:

Well, I think it's public policy, writ large. So monetary policy can't do everything. After the great financial crisis, we were called upon to do way more than we could achieve because fiscal policy was at logger heads in 2011, over the debt ceiling, over austerity. The kind of fiscal support that would've improved demand dramatically and made for a more vibrant labor market wasn't on the table. And so monetary policy was faced with inflation woefully below our objective and employment shortfalls.

Charles Evans:

And so we were just constantly having the Federal Funds rate at zero, bankers were challenged by that. The yield curve was flat and all of that, but that's what we had to do in order to try to support the economy. When you've got more aligned public policy support as we did during and after the pandemic with more fiscal support, well, we've seen more vibrancy, quicker return to pre-pandemic levels of employment, of activity, and supply chain that we didn't really understand. So that was stressed. And so that's unfortunate.

Charles Evans:

And also the pandemic affects globally, which we didn't really have any ability to affect unless we'd done way more vaccines globally, everywhere, but even then you have to take up and all that. So it just ended up being complicated. I think it's been a much better environment in order to have people back to work, higher incomes, enjoying goods as best they can. But it hasn't been all rainbows in your unicorns and we need to do more to get inflation under control.

Speaker 1:

All right. I think we'll open this up to questions from the audience. And Larry, how do you want to arrange for that? Is there someone with a microphone that can be-

Charles Evans:

Putting more pressure on Larry, wow.

Speaker 4:

[inaudible 00:41:52].

Charles Evans:

Guys out there with microphones, hopefully.

Speaker 1:

Are they still there? Oh, there they are. Okay.

Charles Evans:

I don't know why you described this as so stressful, Larry. This is just so easy and enjoyable. Carl and I are having a wonderful time.

Speaker 1:

Yes. We're going to continue on this discussion in the afternoon, if you'd like to join us at the [inaudible 00:42:10]. It's a little hard to see from here, but I've got a arm waving over there. Carol, go ahead.

Carol:

Oh my gosh. Over the past many decades, our US manufacturing has been hollowed out and we've surrendered our US manufacturing jobs to China and including vital industries, which is pharmaceuticals, weaponry, the parts for weapons. Given the geopolitical situation with China, do you think that US manufacturing will return anytime soon, what role regulation will play in that, and just give us your forecast.

Charles Evans:

Yeah, no, it does seem to be the case that many parts of manufacturing and the labor force have been hollowed out over the time period that you're talking about. Now, the environment was one where foreign markets were opening up and trade agreements were being signed, NAFTA in the early '90s and more broader trade agreements. Corporations jumped all over this in order to lower their costs. So on the one hand you can look at the outcome and kind of go, "Yeah, manufacturing's been hollowed out." On the other hand, capitalism in the corporate sector were like, "Supply chains. This is really lower costs, benefits to consumers." Well, if you've got a good job that pays wages, then prices are lower. If you had one of these higher wage manufacturing jobs, well, you might have lost that because the hollowing out effect that you're talking about. So this has been a topic of discussion and great disagreement for quite some period of time.

Charles Evans:

Now in economics, where most economists will go, "Trade's great. Free trade is great," and the argument goes, there are those people who you're talking about who had good jobs, high wages, they lost those through competition, but that's okay, they can be compensated because the gains are so large, all those benefits you can compensate losers. Now the part that gets lost is that last part never takes place. It doesn't take place at scale that the theory would kind of say, "Everybody will agree this is a good idea." So when you had a good manufacturing job at a high wage with good benefits, and then that job went overseas, that was a loss.

Charles Evans:

Now in the current environment competition with China, China's very big, so they're going to have a lot of weight in this. I was slow to understand the real strategy behind the TPP, which is the US getting together with a large number of countries that trade with China so that this large voice could negotiate from power against China. If instead you go, the one country against another, the big country wins. So I think that's a challenge. And then moving manufacturing jobs back to the US, it's certainly the case that supply chains have been stressed, and so Fukushima 2011, floods in Thailand. A lot of corporations did realize that supply chains were too far and they needed to bring them back, but they haven't been brought back all the way to the US.

Charles Evans:

And the current labor environment is one with higher wages, so it's totally unclear how that gets sorted out. But this is what competition and capitalism is all about, trying to figure out where to build these. And as the State of the Union, President Biden mentioned the other day, and Governor of Ohio and all of that intel is committed to a big plant in Ohio and you have more of those. It could be more of the world that I think you're pointing to, but we'll have to see how this plays out. I think those would be good outcomes, I mean, don't get me wrong, I'll just say I don't how it's going to proceed.

Speaker 6:

[inaudible 00:46:22]. Good monetary policy is really challenged if it's up against really bad fiscal policy. You heard the president at the State of the Union last night. Did you get any sense of where we're going in terms of fiscal policy and overall expenditures relative to the economy and what that's going to mean as our debt levels and all the rest continue on?

Charles Evans:

Well, I think anybody who reads the newspapers, listens to media, reads a balanced account of all of these things, I heard things from the president that I had read about in terms of what their intentions are, what they've asked Congress to do. We've all heard about how, is the Senate going to take this up or not? So that's our democratic system at work. And it back in 2011 got stymied in terms of, if you look at it in terms of the public policy that would best advance employment, I think more fiscal support back then would've been incredibly helpful. But there's also the larger question of how you're going to pay for it and things like that, and there are strong disagreements about funding the IRS, collecting taxes, tax rates, and things like that. I don't know how that'll play out, but yeah, I mean, if you've got good fiscal policy thinking, good monetary policy thinking, good regulatory policy, I mean, that's a good world.

Speaker 1:

Other questions for the audience. Mr. Mebs, can we get our microphone over to...

Speaker 7:

Thank you. The Fed early on in the pandemic changed monetary aggregate one and monetary aggregate two eliminating reserves and also eliminating any restrictions on withdrawals from other deposit accounts. Why was that done?

Charles Evans:

I'm not really familiar with that. I mean, I'm not doubting what you're saying, but in terms of, there was a time where the monetary aggregates were something that we looked at very carefully and they were almost an instrument of monetary policy, now they're just sort of a financial report and things like that. So the distinction between M1, M0, and M2 and things like that, it's like reporting. And most of what I'm focused on is the economic data, the financial implications, capital markets, and the narrow aggregates like you talk about just don't come into play nearly as much as they did back in, perhaps in the '70s and '80s. Financial innovation has just sort of changed that game so much.

Speaker 1:

Okay. There's another question at that table.

Speaker 8:

Charlie, outside of the Fed, who are some particularly influential academics, politicians or others who have influenced Fed policy?

Charles Evans:

Sorry?

Speaker 8:

Are there outside forces that directly affect Fed policy besides the Fed itself?

Charles Evans:

I mean, we talked to a wide range of experts, academics, people in industry, trying to get the best thinking on how they see the data proceeding, how they see different issues like monetary aggregates, is that important? Is that something we miss something by not focusing on that? Or with interest rates, another one that is sort of long-term interest rates aren't as high as you might have thought they would be in a world where the Fed says they're going to start raising the short-term interest rate. If you think that we're going to raise by some accounts, an expectation of seven increases this year, which would take us to just under 2%, and then you think about the expectations theory for long-term interest rates and you kind of go, "Well, the 10-year rate ought to be much higher than where it is now. Why not?"

Charles Evans:

Well, we do have a large balance sheet, so that's part of it. If we roll off the assets that should reduce term premia so that those rates would be up. But back in 2005, Alan Greenspan said it was a conundrum that the 10-year rate wasn't going up at a time when we were raising short-term interest rates. And this is what was early signs of this low interest rate environment globally. And so there's a lot of questions like that. Talking to financial experts on how they think about that, how you tease out different estimates of term premium. There's still a lot going on.

Speaker 1:

Closer to home, specifically in the Chicago area, we're dealing with our own economic issues. They may be similar to some other metropolitan areas in the country, but certainly there are some idiosyncratic issues we are dealing with. Is Chicago Fed's role to focus specifically on the immediate locale and to investigate what's happening here, and then you use that to interplay with the other Fed presidents?

Charles Evans:

We've got 12 reserve banks spread around the country, not evenly, they're most east of the Mississippi, because it was created in 1913 when more economic activity was there. But we do pay attention to our five state district, Illinois, Indiana, Michigan, Wisconsin, and Iowa, large cities, also rural areas. We're looking for signs of economic development, how are things proceeding? I mean, the argument is that we're always trying to monitor the national environment, and if we sort of add up our local five state region and understand things that are happening, that informs the national environment, gives a double-check on the national data, which sometimes is slower to pick up on changing trends, like what we've talked about. So there's always a very good reason for us to be doing economic intelligence, talking to people in our areas.

Charles Evans:

Understanding state governments, debt issues, financing, tax issues. Is Chicago a wonderful place for corporations to come and headquarter themselves, or are they nervous about future tax liabilities and how that's going to be paid for and things like that? Those are issues that could be other large metropolitan areas would face too. So we have an interest in understanding that, we talk to people at the local level, the city level, the state level, the regional level, and all kinds of things like that. But we do this in sort of, we're trying to understand, we're trying to learn. We'll convene experts so that everybody can understand some of the unusual better policy prescriptions perhaps, or at least to have a discussion on that. So it's very much in a collaborative, we're just trying to understand everything that's going on.

Speaker 1:

And moving from the local area or the regional area to more worldwide, is there interplay with the Federal Reserve and the European Central Bank, as far as any policy coordination? Or are they too autonomous and there's no communication?

Charles Evans:

There's tremendous sharing of information, sharing of insight. I mean, every central bank has their own job to do, and that's what they do, but they talk together. Sometimes in public conferences we have those, but also at the Bank for International Settlements in Basel, Switzerland, many central bankers will get together on a regular basis and share all the things that are going on, the challenges that everybody is facing. The international banking regulators will get together in similar types of venues and share issues like that.

Charles Evans:

It's the kind of thing that corporations do, business round table and others, small business groups and things like that. So there's a tremendous amount of discussion, sharing of insights and things like that. It's not coordination except under the most extreme financial circumstances. Like the financial crisis in 2008, there were a number of coordinated announcements where it's like four, five, six central banks agreed to do this action for their own countries, which were aligned with what needed to be done.

Speaker 1:

All right. We are getting close to the end and I think we've got another question and we're encouraging it.

Speaker 9:

See, we haven't had a Bitcoin question yet.

Speaker 1:

There was somebody talking about it earlier, but go ahead, sir.

Speaker 10:

Charlie, you have access to some of the best data in the world in terms of what's going on with the economy. Things are obviously moving fast and you kind of indicated that inflation has come on quickly. What are some of the real-time indicators that you're focused on as we're kind of moving forward and thinking about monetary policy?

Charles Evans:

It's interesting you say I have access to a lot of data and we do. Some of this is data that we pay for just like the private sector. It's very rare that I have a unique source of data that I get for free. Now we do have quite an opportunity to call people or have a routine nature of sharing of contacts among businesses or community groups and things like that, so that is very important. During the pandemic, I was amazed that my staff did such a good job of getting some of these mobility data indicators, and of course businesses had to do that too. So if I could remember the names of the vendors that provided the mobility data, you'd kind of go, "Yeah, I know about that because that's like GPS data and or point of sale data and everybody's using..." And then the credit card companies have their own insights or Venmo and whatnot.

Charles Evans:

And if they packaged that, because data is powerful and valuable. So as these companies find ways to take the value in their data, package it and sell it to people like us or other businesses, that takes place too. The mobility data was very useful in the first two months for sure of the pandemic, when you knew that people were hunkering down, you weren't quite sure what people were doing. Were people comfortable going to grocery stores at all? Were they doing Instacart and the like for deliveries? I did that a little bit. After a while you did and you stopped wiping down the grocery bags and the boxes too. You did it at first, but there's just a whole bunch of things that we did. But I mean the New York financial markets group take actions on behalf of the entire Federal Reserve, Federal Open Market Committee, they get a lot of data.

Charles Evans:

They talk to people in the markets. That information gets shared at a higher level with us, and so it is an amazing amount of data that we have access to. Now when I read financial news and things like that, that's when I kind of go, "Oh yeah, they see that stuff too." Or we all see different slices of it, and we kind of like certain parts better than other parts too. Like the M1, the M2, I can't give up on that because you're right, there's this data it's released weekly and all of that. And when we change how it's collected, then it sort of changes what other people have been able to figure out from that. That's a challenge.

Speaker 1:

Any other questions in the audience? Here we go.

Speaker 11:

Hi, you spoke briefly about shifting in business models, and I was just wondering if you all have seen any patterns that might impact business models in the next two to five years.

Charles Evans:

The issue that I keep coming back to, which probably isn't exactly responsive to what you're thinking... But anyway it's sort of like labor and remote work. And I know that in the Federal Reserve, I think so on the one hand during the pandemic, everybody's worried like my brother who's older sells furniture, La-Z-Boy Furniture in Columbus, Georgia. And he is very worried when it first started because you got your whole business there. Couple of weeks in you kind of go, "Wait a minute. This is good because people are buying furniture because they're going to be hunkering down." So it's been great for him, but not for others in service, restaurant.

Charles Evans:

For those of us professionals who figured out how to work remotely and maintain our business requirements, it's been great. We've been very successful. But of course they can work from their house for the Federal Reserve Bank of Chicago or they could work from their house for Google because Google wants remote people too. And so I think there's a lot of competition for workers, people who only want remote work. That's one question that everybody, the recruiters keep saying, everybody asks at some point, "Can I work remotely?" And the answer to that question is very important for whether or not the conversation continues. That's an important one.

Charles Evans:

I was talking to somebody the other day, who's in a more rural environment, a small town, and this person mentioned, "Historically, we've got a workforce, we've got activities and it all works because this is where they live. They're the source of employment and we know how to make it work." Now, all of a sudden more people are working remotely and they're working in California here. And so all of a sudden what you thought of as a compared advantage, once you had the workers in place, isn't the same strength. That's a big challenge. I think that's one that a lot of people will be facing.

Charles Evans:

I think in terms of... I mean there's just a whole host of issues and it really comes down to the business. One that I keep thinking about is the in-person service, the restaurants or something, and the businesses that for the longest time have been able to go, "Yeah, I got a workforce, and when I don't need them, I send them home." And so they might only get 17 hours this week, next week they get 25 or something. And you always knew that the worker wanted more hours and they didn't want to work two jobs. And it's like now more businesses are having to deal with that.

Charles Evans:

Maybe they have to pay for more hours. Maybe you have to pay more. If you have to pay $17 an hour and you used to pay 12, do you give them 40 hours or are you even more careful to only keep them in place? So I don't know how that's going to play out between the workers and how much negotiating power they have and businesses where it's like, "I've got very thin margins. I can make this shop work, but I can't make it work at that." That one.

Speaker 1:

Sounds like a good time for business and organizational consultants to start gearing up.

Charles Evans:

Consultants are always the answer, aren't they?

Speaker 1:

When in doubt become a consultant. I think we are at the end and I will invite Mr. Cool to come up, or maybe not come up. Are you going to do it from down there?

Speaker 12:

I'm coming up.

Speaker 1:

Okay.

Charles Evans:

Am I coming down?

Speaker 12:

Come on down.

Charles Evans:

All right. Excellent. Thank you. Thank you so much.