Fed Unfiltered, Transcript
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Adam S. Posen:

So let's start out with the central bankers meat and potatoes. We see inflation in the US at a 40 year high. We see inflation rising in a number, if not all, remaining G20 countries. At the same time, long term government interest rates have moved only a little. People are noting that the tenure in the 30 year treasuries are up at levels they haven't been for a while, but by historical standards, they remain quite low, and especially in real terms. So how much faith should we put into this concept of anchored inflation expectations, both that we're measuring it properly and that it matters once inflation gets to this point?

Charles Evans:

Sure. That's a great question. And because you ended with the point about anchored inflations, this makes me think, the term itself makes you think about there's an anchor, or there's not an anchor that it's all or nothing. And really this comes down to, what are inflationary expectations? Are they consistent with the Federal Reserve's objectives, our dual mandate objectives and our 2% on average inflation over time objective, our new long run strategy that we implemented about 18 months ago. We are out to make sure that inflation expectations are consistent with 2% inflation on average over time, and we refer to that as anchoring. We're currently in an environment, as you just mentioned, where inflation is extremely high.

Charles Evans:

It leaped up to 7.9% last month on the total CPI, and most recently it was just reported at 8.5% for the CPI. We didn't get there slowly. February 2021, CPI was 1.7%. So this is a very different increase in inflation than we had tended to expect for the longest period of time. And in that sense, it is very unusual. So I think markets, the 10 year rate this morning was at 2.88%, and that's higher than it's been, but it doesn't seem to be screaming that high inflation is going to continue for quite some period of time. And so I think that's part of what's going on and I do think that inflation continues to be anchored near our inflation objective, but it's not the case that inflation this year or next year is going to be at 2%.

Adam S. Posen:

Well, just following up on that, Charlie, as you may have seen, my current PIIE colleagues, David Wilcox and David Reifschneider, who from their long service at the federal reserve board wrote a piece for us about a month ago in which they run various simulations and suggest that because inflation expectations are well anchored that will speed or ease the disinflation process this cycle. And then we had some published debate from even within Peterson about how applicable is that? Could you say a bit more about not necessarily their paper, if you haven't read it, but just the idea that the more anchored inflation expectations are, maybe you don't have to push as hard to disinflate, and whether that applies right now?

Charles Evans:

I haven't read their most recent contribution there, but I'm familiar with the previous things that they've written about and their long service at the federal reserve and it's consistent obviously with the way that the Fed puts together its forecasts. And yes, it's certainly the case that with stable inflation expectations, the Fed's task is a bit simpler to bring inflation down to perhaps let the economy grow a little faster, knowing that inflation's not going to get out of hand, not having to respond in a very urgent fashion against any early indications of inflationary pressures or Phantom inflationary pressures, because there is that credibility. So I do think that that is helpful, that makes our job more straightforward and we can address both sides of our mandate, the maximum and inclusive employment and also price stability.

Charles Evans:

I think that the current environment is just very different than anything we've experienced recently. If you look at how we got to, and I focus on the 7.9, because I paid a little more attention to the composition of the numbers back in the February CPI, 20% of the core CPI basket increased by 20%. That included vehicle prices, new vehicles and used vehicles. It included home furnishings and it included hotel and motel costs. Now that's 20%, now actually they rose by 20%. That's 15% of the basket. Now the other 85% of the basket, that was rising at 4.1%. Now that's a big number, that's an inflation rate that really is a challenge. And that's what I think monetary policy needs to be responding to. There's good reason to think that those special factors that I mentioned are going to retreat at least a little bit where they're going to stop going up.

Charles Evans:

If they stop going up, that's going to be helpful for inflation. If they retreat, that's going to be even more helpful for inflation, but we're still left with the broader basket, 85% that's at 4.1%. And I think that's the part that monetary policy needs to be responding to. I think because inflation expectations over the next couple of years are stable, anchored if you will, that's going to make the adjustment process that we have in mind, most of us have talked about for the Fed, in line with bringing that core basket down.

Adam S. Posen:

So Charlie, as we all know, forecasting is hard work, or at least difficult work. If we look at the dots, the various modal forecasts of committee members through the last couple of years, or we look even at the survey of professional forecasters, you all went through 2011, very reluctantly it seemed, to upgrade your inflation forecast. And our colleague, Jason Furman had pointed out at the time and subsequently that there seemed to be very little weight on a possible breadth of outcomes.

Adam S. Posen:

There also seemed to be relatively slow changes in those forecasts. Obviously you can't speak for everyone on the committee, let alone for the mistakes of the society of professional forecasters, but what was the thinking in your view that led you and perhaps others to be slow to say, hey, we are getting broad inflation? It wasn't just Jason. It was Olivia Blanchard, Larry Summers, myself, who were out there again, not that you have to listen to us, but just that it wasn't completely out of the blue, but the path of the official forecast made it look like it was.

Charles Evans:

Adam, that's certainly a fair comment. I think that one of the frustrations that I have felt in so much of this is that there's been a lot of very interesting and insightful commentary that has been made. There's been a relative dearth of details, analytical pieces of why inflation was going to go up. So those early comments that were, my memory of these are, well, we've got a lot of fiscal support. We've got infrastructure that's being proposed and with all the income support, and then on top of that infrastructure support, then while we could be seeing overheating of the economy.

Charles Evans:

And at that time, I'm pretty confident that there was nobody who was talking, there's a semiconductor chip shortage here, because part of that was COVID related with the shutdowns in Malaysia, Indonesia and Vietnam. The global pandemic, and the fact that the global economy has not been able to deal with it, at least as successfully as the US in terms of safeguarding manufacturing production.

Charles Evans:

That's one thing that businesses have done very well in the United States. And so on top of the fact that the auto companies got out of line for chips back in 2020, because they thought that auto demand was going to be down, Then it went back up and everybody went to consumer electronics and the margins are a lot higher in consumer electronics. And so there's a lot of microeconomics in industry explanations as to why demand flowed away from the vehicle manufacturers. And then you put the supply chain aspect. Now, maybe overheating, again, this is the dearth of analytical descriptions. If by overheating, it was meant that the private sector supply chain was much more fragile than we'd ever expected and the ports were going to be swamped, now that is good's demand, so that's a fair point that's overheating.

Charles Evans:

But I was listening to that and at that time it still seemed very plausible that the underlying explanation was one that there's some kind of resource scarceness, Phillips' curve, and we're going to see inflation come about that way. The history of that type of inflation evolution is the one from the '60s and the '70s where it grew slowly. But inflation leaped in February of 2022, and a lot of that was on the strength of these special factors. Now you talked to the auto companies and others, and there was early reason to believe that the chip shortage was, they're going to have a production geared up and they would fix that, but then COVID hit. Anyway, so it was more persistent. It came online, certainly did. A lot of COVID stuff, home prices are up and things like that.

Charles Evans:

So yeah, maybe I was slow to appreciate that, but if there had been more details about what people had in mind that we could think through then that would've been more helpful than just inflation's going to go up. We heard a lot of those types of forecasts over the last 10 years while I've been president when inflation was extremely low. And everybody said, well, in two years, it's going to be high and that didn't transpire. And so there's a little bit of path dependency there too, which is, you really had to be insightful about why this time was different, and it was more than just good old fashioned overheating. There were other special things that worked, it seemed, to me.

Adam S. Posen:

Thank you very much.

Charles Evans:

That's a lot of defensiveness.

Adam S. Posen:

No, no, it's not lot of defensiveness.

Charles Evans:

It is certainly the case that there continue to be an expectation that, okay, transitory might have been a strong word at times series, since there's transitory and there's permanent. I don't think there's permanent things. I think there's persistence, but that's a bunch of details that people don't like to talk about.

Adam S. Posen:

No, I appreciate, it's not defensive when you're being frank and open and talking about the process and I'm grateful as I'm sure our audience is for you to do that. I'm not trying to score points here, Charlie, but I just [crosstalk 00:11:52].

Charles Evans:

No, no. No, I know you're not.

Adam S. Posen:

I just want to be very clear in terms of being fair. Again, not that anybody should listen to me, but in our semi-annual global economic prospects, April 1st, last year, I wasn't certainly calling 8% inflation, but I was calling it, and some of us were saying just what you just said, Charlie, that there was this confusion between transitory in the time series sense that this is not affecting underlying trends and the general English usage.

Charles Evans:

Right.

Adam S. Posen:

That transitory means, no big deal, it'll be over.

Charles Evans:

Right. If I could just build on the way, I think about inflation a little bit more, might be helpful in how we talk going forward. I think there's a two step process that's likely to… as I think about the improvement in the inflation outlook over the next couple of years, I think they're going to be two distinct steps. And they're related to this bucketing of special factors that I was talking about. I think there's reason to believe even though the vehicle prices have been higher and home furnishes and others for longer than I was expecting.

Charles Evans:

There's reason to believe that they're going to plateau and then start coming down. And if that small part comes down a bit, and then if the remaining 85%, which is the larger part of it, I said it was 4.1% as of February 22, if that stepped down to three to three and a half, which is high number, that's a problem. But because you might get, if the other bucket went up 20%, if it retreats 5%, which I think is not an unreasonable number, you could get a 2023 CPI core of two and a quarter to two and a half.

Charles Evans:

Now that's a very special kind of… that's not a sustainable two and a quarter because part of it is this retreating and goods. You've still got the more devilish three to three and a half percent in that calculation that needs to be dealt with. That's the part that I think monetary policy is going to be working, focusing on as we ramp up. But that's the second step. And so that's why I think that the timing for how monetary policy is responding, can be sensible. Even though we are currently experiencing very high inflation, that seems to be the part that is puzzling to many people. Inflation's very high right now, why don't you move much more quickly? You need to be dealing with this. And it's really this underlying part that I think is going to take a little more work, but it's also the timing I think it can be okay.

Adam S. Posen:

No, thank you. That's great. So just digging a little further, and again, you may feel you've already answered this, but it's wonderful I have the opportunity to draw you out a bit. So Blanchard and Summers, for example, leave aside what they said a year ago, have in recent months increasingly explicitly said, you're not going to be able to control this inflation by simply getting up to neutral or a little above neutral. You have to get the positive real rates to get it under control. Now, if I read your remarks correctly yesterday, and please correct me if I'm wrong, but a simple version of something you said yesterday was we're going to get to neutral roughly, because we never know exactly where neutral is and then we'll see where we are and if we have to go forward beyond that.

Adam S. Posen:

So first, what do you think of the arguments that our priority we have to pull what I call a mini Volker and get the positive rates versus neutral? And second, if I'm right in characterizing in short form, your view, what will be the things to see where we are in say early 2023, or when we're at neutral, how will you make that assessment?

Charles Evans:

Sure. So right now the target federal funds rate range we increased by 25 basis points. So it's a quarter to a half a percentage point. Then so many people would like more communications about what we're going to do from the federal reserve, our summary of economic projections, which were published after our last meeting indicated what all of my participants are thinking about in terms of rate increases this year and next, and the year after. And the median participant expected a total of seven quarter point rate increases this year, which would take the federal funds target range to one and three quarters to 2%. Now, I think the neutral setting of the funds rate that's artful moves around over time probably, but a lot of people put it in the two and a quarter to two and half percent range.

Charles Evans:

So we're not far from neutral. We're probably not at neutral at that point. And now more recently more of my colleagues have said, and I've said I'm open to doing 50 basis point increases in order to front load this a little bit. I like to talk in terms of quarter point increments because it lines up with the dot chart. I think that would take us to nine quarter point rate increases this year if we did 50 at this meeting, 50 at the next meeting, and then thought that we were front loaded and we could do 25 the rest of the year. That would take us to two and a quarter to two and a half and that would be arguably neutral. Some people will actually find that that rate is actually a little above, right at neutral and others would say, you probably got to go a little bit more.

Charles Evans:

If we were going to a much higher rate increase, we have to go through neutral. This is just the continuity of we're going to do this slowly. By the way, Paul Volcker, let's remember what he did. He did not say what he was going to do with the funds rate. He did something, he said, we're going to target money and nobody knew what targeting money meant. They had to pull out non-borrowed reserves targeting to... They built up the entire framework when all they did was they immediately raised short term policy rates. Now, if somebody wants to have a conversation about why we don't immediately do a Paul Volcker, which is to take it next meeting to four or 5%, come on, we can talk about that, but that's not what anybody's talking about. We're talking about something that is relatively continuous, although it could be steeper.

Charles Evans:

And so I think that with nine of these increases by December, will be at neutral. And at that point we're going to have more information. If I read some of the most recent commentary from people who have said, we need to do really a lot and inflation was getting out of hand, I think they said, look, nobody ever said inflation was going to stay at 8%, right? It's going to come down, used car prices, they've come down a little bit. I'm not going to make too much of that, but at some point we do expect that that's going to have an effect. The goods preference of consumers at the moment over services has really had a big effect on these prices, and if we have a little transition back to more normal demand and that might help out a little bit, but by the end of the year, we should be at neutral.

Charles Evans:

Now at the last meeting, I actually was the median for this year. I had seven increases. Seven, nine, I also had two more by March. So then the question is, does it matter a lot if we get there in December or in March? How important is this? Remember we're counting on the monetary transmission mechanism, auto borrowing rates are going to be higher. Well, it's a four, five, six, seven year loan. Those have already got built into them, a path of increases. So the difference between December and March, isn't that much, it's the attitude and how you talk about it and the credibility that helps with the anchor. Mortgage rates, those have already got a path embodied in them. And if the long term tenure treasury rate doesn't have, if it's a 2.88, they're envisioning some toping now of these rate increases, that is not going to make a whole heck of a lot of difference between whether or not you get there within six months or whatnot.

Charles Evans:

I think the attitude is important. I think that the commentary has been helpful for reminding everybody, getting our attention. We were focused in, it's not a question of getting attention, but I think there's more alignment on getting monetary policy to a neutral, slightly restrictive stance, we'll probably end up with something that is more restrictive. But over the next year, we're going to be able to look at developments and what the employment market is doing and all kinds of things, and there are a lot of risks. And so I think the optionality of the path that has most recently been staked out is very high value.

Adam S. Posen:

That's great. Thank you so much, Charlie, for spelling out your thinking on that. And I think you were very fair to the commentators, including me as one of them. Just going a little further, you played a key role along with many other members of the committee, former vice chair [inaudible 00:21:46] of, how I refuse to call him chair [Pro Tempore 00:21:51], and we hope vice chair Lael Brainard in the so-called new framework, New York Fed president John Williams. Again, I'm not going to name check everybody. The new framework, which was announced in September of 2020. This is part of a global trend where a number of central banks have undertaken reviews of their inflation targeting framework in recent years, including the ECB, the reserve bank of Australia. So there is a lot of discussion about whether you all just had bad luck.

Adam S. Posen:

You had created a new framework that was appropriate for the years of inflation undershoots that got switched on to you because of COVID. There are also some more, let's say, aggressive interpretations that part of why there was so much inflation was because the Fed had decided to go too much for a hot economy, the new framework was productive. What does the experience in the last couple of years tell you about the new framework? Are you happy with where it is? Do you have things you have top of mind for the next review, which is scheduled for 2025 I think? How should we all be thinking about the new framework or was this all a side show, the new framework was really just a better explanation of what was already being done?

Charles Evans:

Well, I think that's a very fair statement of what the issues ahead of us are, and I'm open minded to the comments about how the environment could have changed relative to the way that I was thinking about things over the last 10 years. I still feel pretty confident with my expectation that trend growth rates are going to be on the low side. They're one and three quarters percent. They might be a little bit lower. What is trend going to be? Productivity innovation comes from time, good efforts and entrepreneurship and all of that. But it appears at various times, and it's very difficult to predict and labor input. And labor input is part of the aging demographics.

Charles Evans:

And if we have an attitude that is not favorable towards more immigration, then I think the labor input is not going to be growing for quite some time, unless there's some change. If you put low growth, one in three quarters percent into your calculation standard growth model, you're going to come out with a low real interest rates. So low R-star. So what is it about the current environment that has changed greatly that gives us less headroom from a monetary standpoint to deal with a downturn? And so it's those downturns where inflation goes below our objective and we really struggle to get it back up. So I'm not sure the environment is clearly moved away from that. I would not be willing to say that the effective lower bound risk has diminished in any way, but it is certainly the case that we're dealing with higher inflation and maybe things are moving around and expectations, so we should be open-minded.

Charles Evans:

What I think the committee and central banks struggle with a lot, and it's a good struggle in the sense that we've been successful, those who came before us, in bringing inflation down and we have a lower stable inflation environment. We don't want to lose that, but it has been low and central bankers are largely conservative ad so as soon as you say two percentage to your objective, I think a lot of central bankers go, okay, two. Certainly don't want to go beyond two. One and a half, we'll get up to two, but two. 2.1, ooh, that's a little… 2.2. And so I know that after the great financial crisis we struggled with, other than saying inflation objective was symmetric, we struggled with making it symmetric. And so I think that the improvement in the framework emphasized that we should average 2% over time on average and that inflation expectation should be clearly consistent with that 2%.

Charles Evans:

We had language that indicated it can be okay to overshoot. I think a lot of central banks have behaved as if 2% was a ceiling. And if anything, the new framework moves the ceiling. This is just a way of thinking about this, it moves the ceiling from two, and I hoped it was more than 2.2, but I doubt that it's as high as 2.5%. I think that most central bankers, even if you say your objective is 2%, get very nervous and squishy of inflations at two and a half, and I think that continues to be a challenge. So, if you believe that central banking should be preemptive against inflation concerns, if you tell me for sure that inflation's going up, yes, absolutely. But nothing is for sure when it comes to inflation and we fought a lot of phantom inflation increases and it's harmed many people in the American economy because of that.

Charles Evans:

So trying to balance that out. At the moment, the environment is just so different. Inflation's very high. As I said, taking out special factors, you're still looking at an underlying inflation rate on the order of 4% in the CPI and that needs to be addressed. And so this has been an unfortunate development in terms of the framework and how you think about it, and those are the things that the next committee is going to have to think through as they, just either decide to continue to ratify the framework or tweak it or change it.

Adam S. Posen:

Great. Thank you. Just to pick up on one piece of what you were saying. A few years back, as I recall, you did talk about the possibility of a higher inflation target, 3% inflation target, I believe instead of a 2%. Blanchard in our shop, as well as I, Joe Gallen, others have spoken about this because of the effect of lower bound and the issues of recession response and flexibility. Clearly it sounds like you're ruling out the idea that the Fed would declare victory at 3% now and de facto let the target go up. What is your current state of thinking on the idea of raising the inflation target? Again, I'm not asking you to speak for, or forecast other members, I'm asking what's your current take on that debate?

Charles Evans:

Well, I do think that if you were to do a dispassionate cold analysis on the basis of a variety, but certainly our best macroeconomic models or thoughts about what the cost of inflation are and the benefits of having monetary policy that can respond most easily with short term interest rate policies, then you could reasonably end up thinking that the inflation objective should be higher than 2%. That just the theoretical analysis could lead you to, there are more benefits than there are costs after all.

Charles Evans:

A lot of what we're talking about is what's the cost of steady inflation at a higher rate. What we certainly are dealing with at the moment is unexpected inflation. This is not steady inflation, this is unexpected inflation. It's coming from gas prices. You tell me gas prices go up. I will tell you the American people will be unhappy. That's just general, but that's not inflation per se, but it can lead to inflation. If you thought that and argued that higher average inflation led to greater inflation volatility, that's a cost and then you'd be more comfortable with the lower inflation objectives, but I've never seen good theoretical analysis that deliver that correlation. It seems to be empirical, but the explanation seems to allude most people. So I can imagine that a dispassionate analytical academic style analysis could lead to that.

Charles Evans:

I sense there's no appetite among central bankers though, for a higher inflation objective. And so I just think that this is a non-starter, which is why I have argued as aggressively as anyone. And I think that the committee members, the leadership has done a fantastic job of coming up with a framework that was endorsed by the entire committee. But even within that, I think you have to work very hard and somewhat ambitiously to probe the limits so that the inflation ceiling hasn't just been moved from 1.9 actually to 2.2, so that you can actually average 2%. And if we can pull off averaging 2%, and I'm not including these relative price increases, but they complicate things, that would be an improvement in policy.

Adam S. Posen:

Thanks very much.

Charles Evans:

That's a pretty minimal improvement relative to what the gains could be from different frameworks.

Adam S. Posen:

Thank you very much. In that context, again, going back to something I believe you've written about and spoken about in the past, before COVID a few years ago, there was a lot of discussion of the idea that if monetary policy, for whatever reason was going to keep running up against the effective lower bound on interest rates, maybe there should be some different thinking about fiscal monetary coordination. So we had Ben Bernanke, for example, with co-authors at a Peterson Institute conference with his proposal for automatic shift towards fiscal policy when you hit the lower bound.

Adam S. Posen:

We had Stanley Fischer and colleagues from BlackRock a few years ago have a proposal that again, to oversimplify, seem to be saying central bank should be able to force fiscal stimulus when you hit the effective lower bound in a bad way, or for a long period. Given the relatively strong, discretionary fiscal response to COVID, and some of the encouraging things that chair Powell said about the fiscal response early in the pandemic, what do you think about these arguments now? Is there a need or a use for having more formal arrangements to coordinate monetary fiscal policy? If we're going to keep running up against the effective lower bound, can it be done in an ad hoc fashion? Have we learned anything that tells us we should, or shouldn't rely more on fiscal policy?

Charles Evans:

Well, I think you've described exceptionally well what the potential benefits can be from a public policy response that looks at the challenges and damages that have been done to the American people from a variety of shocks and how a fiscal policy can improve things. This is all about stabilization policy and how that can benefit. For the longest time, central bankers, we don't coordinate with the fiscal authorities. We don't advocate fiscal policies in general, specifically, and we're always responding to the state of aggregate demand. And so the previous comments from Larry Summers, yourself, Olivia Blanchard about the dangers of overheating that come from too much fiscal support, that's fair game. That's totally sensible to have that discussion and then talk about that, or times when there's depression like events and having fiscal policy respond, especially when monetary policy by itself can't.

Charles Evans:

So I think there are benefits. I think that the slow recovery following the great financial crisis could have been faster if we hadn't gone into a period of a fiscal [inaudible 00:34:36] in 2011 over the debt ceiling and things like that. But that being what it is, the central bank responds as they do. So I think that from an economic orientation, theoretical, academic, there are a lot of reasons to believe that you could get better economic outcomes. But I will say that this is where I think economics by itself is inadequate. A lot of times the way I pose this is that's very interesting, but what's your theory of political economy? Because I think if you just have in the back of your mind, well, the fiscal and political authorities are going to do absolutely what is best for the largest American population, I think we need to question that and improve that and integrate that because what interested me as an undergraduate economics major was the fact that stabilization policy could improve outcomes.

Charles Evans:

You need to choose policies very carefully, and you can do danger and all of that. But I think the overall objective function for the larger number of decision makers is vastly different sometimes than what we have in mind as economists. That's a challenge to everybody.

Adam S. Posen:

That's a challenge I certainly recognize, thank you for raising it. Continuing to jump us back and forth in the discussions that you've been part of for the last several years on policy. One issue that we have to think about going forward is what do we do if God willing or politics willing, we get a sustained series of increases in carbon prices, if we get a sustained series of public investments in green technology, which it seems are necessary in order to address climate change? And this is separate from many issues of bank supervision, and whether you allow lending for fracking, I'm talking about the macroeconomic adjustment issues, which our colleague, Jean Pisani-Ferry has been writing about.

Adam S. Posen:

So from the point of view of a central banker, how should monetary policy be thinking about it if we're targeting core inflation of some sort, but say energy prices are just on a secular up trend for quite some time? Or how should central banks be thinking about it if governments are running bigger deficits, but maybe a bigger proportion of it is going into public green investment? Or can the central bank just say, I call it as I see it. I’m just reacting to two year forecast. I don't need to think about this. Assuming taking your point about political economy very seriously. You may not get this outcome, but assuming that this would be a good outcome, there's some hope of getting it, how should the central banks react? How should monetary policy react?

Charles Evans:

It's a very important question. I'm not 100% confident we thought through very carefully that very special type of scenario that you're talking about. In the sense that as you and I have discussed in the past, if you have an oil price increase or some kind of commodity price increase, and it's increasing the price level, monetary policy often would look through that first phase, and then you would look to see if it's more broadly getting into underlying inflation and that type of thing. It would be similar to if all of a sudden, a country decided to switch to a BAT tax system where all of a sudden retail prices would be higher, just because of the way those prices are collected.

Charles Evans:

And you would think that a central bank focused on the welfare of the average American citizen would try to look through the price level effect to the underlying inflationary consequences so that they didn't necessarily trigger a recession just to bring the price level down. That would be like Britain after World War I, going back on to gold at the wrong parody, and it's like bad things had to happen just to preserve a certain price and revert back.

Adam S. Posen:

That’s a very astute analogy, Charlie, one I don't think people have made before. I just want to note that. That's very good.

Charles Evans:

So I think that's an element of so many of these things, and that's why in the average inflation commentary, and I've argued in a different context back in 2010, that it's like, price level targeting with cheating isn't such a bad thing where it's like, when you want to get inflation up, you get up, you target the price level, but then once you get to that line, then you stop and you revert back to inflation targeting. And I think because of the effective lower bound risk, that can work. So to get to carbon pricing, carbon pricing would be an example of that. We would obviously be seeing changes in relative prices, and they would ultimately find their way into higher inflation numbers. And I think that the best practice central banking, there'd be a strong argument for trying to look through that. I think though that there would be a lot of different opinions on that among economists, also among democratically elected officials, and so I think that that would be challenging.

Adam S. Posen:

That's great. Thank you very much. That was a great fulsome reply, a lot to think about. So we are the Peterson Institute for International Economics. This is macro week part because the world's, like our policy makers, are gathering virtually and in person in Washington. Obviously there's some terrible things happening on the international scene. Not going to ask you to comment on sanctions or on the Russian invasion of Ukraine, but when you hosted the Fed Listens conference, and I believe it was summer of 2020 prior to the announcement of the new framework, our Peterson colleague, Maurice Obstfeld was featured doing a paper about how the rest of the world's impact on the US economy and how the Fed should think has been changing. And again, leaving aside geopolitical shocks, which obviously the Fed is not in the business of predicting.

Adam S. Posen:

How do you see the importance of the international sphere to Fed decision making now? What are the feedback loops? Until a few years ago, the fed always said we set our policy to achieve our domestic policy goals, which we understand, but additionally, there was an implicit, what happens abroad generally doesn't affect us very much unless there's a big US bank blowing up. Again, you would never say that, but just rough approximation. Has that changed in terms of your views and the FMCs views, do you think it's useful to be thinking more about international spillovers on the US economy than we used to, or is it still just second order and not worth thinking about much?

Charles Evans:

Well, I suspect that the framework continues to be the same, which is we have a mandate, we have a responsibility to be thinking about the US economy. Obviously anybody who thinks about that sees the international ramifications from trade financial flows. And so understanding what's impacting the rest of the world is critical and understanding the size composition of that should be important too. It's not just the largest economies that should matter. We should be paying attention around the world. But again, it does come down to what's the incidence of those influences on the US, and what's the impact of our actions on other economies too, in a feedback loop there.

Charles Evans:

I think you might find that there are different points in time where all of a sudden the magnitudes of the responses are much larger than they had been. So there could be heightened sensitivities from this, and we should be mindful of that. You could get to some critical junctures, non-linearities and things like that. So it would be very difficult to forecast that type of onlinear response, but we would have an intense interest in trying to understand it as best we can looking at the data, talking to everybody, sharing information the way that central banks bankers do in the G7 and G20 meetings as well.

Charles Evans:

So, I would say the framework, as I understand it probably hasn't changed that much, but the sensitivities could be heightened certainly in the current environment. And the other thing I do remember being reminded, I was going to say astounded, that's a bit strong, but reminded that four or five, six years ago at a presentation where at the end of it was, and of course when the ECB starts raising rates, and long term rates in Europe start going up, that's going to have an effect on the US too and ultimately in raising interest rates here, and it was like, hmm, hadn't been thinking about that recently or something. And so muscles that you haven't exercised in the past, all of a sudden might become more important. That could look like a different framework when in fact it's just heightened sensitivities.

Adam S. Posen:

No, I wasn't suggesting a different framework, but to get your insight into where the awareness of heightened sensitivities comes in is really helpful. Thank you.

Charles Evans:

And I think that the supply chain issues just take this to another place. We know back to 2011, the Fukushima tsunami event, and then floods in Thailand, and a lot of corporations that had gone to China with their supply chains and [inaudible 00:45:37], that's a little further than... I judged the risks. And so some of it came back and yet still they're really far. And now with COVID, so there's an intense interest in understanding global responses to the COVID pandemic and whether or not the Shanghai lockdown, because of COVID because of their strategy, impacts beyond the pain and suffering of the population there obviously, what that has to do with business and commerce and all that. So there are a lot of things to be keeping in mind, and they could argue for more cooperation [inaudible 00:46:19] dimensions.

Adam S. Posen:

And obviously we're very proud that at Peterson Institute, people like Chad Bown, Mary Lovely, and others here are leading the way on some of the research on unpacking those things. Let me just go one final step in the international direction. And again, this is about the broad perspective, not asking you to comment on exchange trades. One of the pundits obsessions the last few weeks, especially given the sanctions imposed on Russia for its aggression and the very, not unprecedented, but unusual measures to restrict even the central bank of Russia to access its reserves has been discussion of whether short term or long term, this affects the reserve role of the dollar. That arguably countries who see themselves potentially on the wrong side of the US government have an incentive to have a payment system or set of reserves that is less vulnerable to American action.

Adam S. Posen:

Fortunately we were grateful to have deputy treasury secretary Wally Adeyemo speak here a couple days ago about this issue. And of course I think rightly, but because he's deputy treasury secretary he said, nothing's going to happen to the dollar. Everything's fine. Again, not asking you to comment on the dollar's viability, but how do you and the Fed, you in particular, think about long term risks to US fiscal sustainability? And those are obviously caught up with the international position dollar ability to sell debt in our own currency, including to foreigners. Do you worry about long term fiscal risks? Do you worry about shifting reserve compositions? How do you think about these things or as with the ECBs interest rates, it generally doesn't interfere with what you're doing so you don't think about it very much?

Charles Evans:

It's a tough question. I would always worry about fiscal sustainability, I would always worry about the state of the world where all of a sudden, we couldn't fund ourselves in a fashion that is consistent with reasonable, relatively easy credit intermediation and all of that. So of course, the adverse outcome that would come about there, you need to be mindful of it. Now, the question is, well, what is the risk of that? And at the moment, I don't see the risk as especially high. Yes, we have definitely run very strong deficits and increased the national debt. I'm reminded that when COVID hit and back in probably April 2020, one of the first times I spoke to a group in Chicago and I said, we are going to be poor because of this as a country, because we're shutting down the economy for some period of time.

Charles Evans:

It's by definition, we must be poor. Now we've recovered so rapidly. And the stock market has done well and a large part of the economy… so it's hard to know exactly where, but it must be the national debt at some point, that is one indication of that if there is that continuing adverse impact. But it's also the case that our debt is a safe asset for so many investors, and around the world other countries have also increased their debt too. So it's hard to know on a relative basis, how things have changed all that much, but of course, with any curtailment of trading relations among substantial parts of the world that would change trade flows, and we have to be aware of that.

Charles Evans:

And complacency is a very bad thing. This is the other thing. I can go down the list and convince myself that we're still a very strong nation and very safe assets and I think that will continue, but you always have to be mindful of that. From a care monetary policy standpoint, we're typically focused on the medium term, three to five years, and it's hard to know how to put things into our forecast at a broader horizon, unless it's just horrific and has some meaningful possibility of occurring.

Adam S. Posen:

Thank you. Thank you very much, Charlie. We're coming towards the end of our time. You've been extremely gracious in sharing your thinking and explaining it so clearly. And I think our whole audience and everyone who will see this recording will benefit from it, as well as those obviously on the live stream right now. A final question if I may, which is a little less core monetary policy, but another point of buzz is central bank digital currencies, as well as alternative cyber and crypto private currencies.

Obviously the Fed came out with a white paper. There are other people on the FOC who were [inaudible 00:51:58] that particular charge, but could you give us any sense of how you think about the use case for central bank digital currencies? And does it matter if other monetary actors, whether it's China or the Euro area pursue them, even if the Fed effectively lags in that area? Is this something that deserves the amount of attention it's been getting, is what I'm asking?

Charles Evans:

Well, I think it definitely deserves the amount of attention that it's been getting. Obviously with private digital currencies evolving, there is an intense desire among many individuals, investors to have access to that means of payment or moving their wealth around Bitcoin, and things like that. There are transactions costs for international transactions, which have a substantial cost. And so trying to compete away costs like that is one incentive for trying to generate a market for your digital currency. Central banks are certainly looking at this and the federal reserve has been paying attention. We have a body of research. We have experts who've been in touch with central banks around the world and private firms as well.

Charles Evans:

I think we'll continue to do work so that we understand it. We have to understand it because it's going to be part of supervision crypto assets and things like that. We are doing work in financial services. We are going to be providing a Fed now product, which is going to be a real time growth settlement product that could be used for consumers through the banking system. If the desire is for instantaneous sure payments, which a digital currency could provide our Fed now product, we'll be able to deliver that. Now a question is going to be, if you had a central bank digital currency, what type of account, how would that change the financial system, the funding for banks and things like that. So I think there's a lot of study that has to take place.

Charles Evans:

There're going to be competing interests in whether or not that should be stood up. And I think there's going to be a, well, if everybody else is doing this, we could be behind the curve. So that's why we'll maintain our interests. We're studying it. And the federal reserve Bank of Boston has had a lot of work on their Hamilton project with MIT and they put together what will be an open source way of running a digital currency. That's actually going to have a lot of commonality with our real time growth settlement payments mechanism. So there's a lot of commonality we're going to maintain, our research interests and implementation through our vibrant financial services provision. And I think we'll stay close and ultimately, as the white paper indicates, I think you need higher authorities to allow more aggressive actions to be undertaken by the federal reserve.

Adam S. Posen:

Terrific. Well, again, thank you very much, Charlie. It's been a treat to get to talk with you and thank you for...

Charles Evans:

Thanks, Adam. This has been a tremendous conversation. It's always a good conversation at Peterson and with you, and I've really, really enjoyed it a lot.