Fed Unfiltered, Transcript
4/5/22 – Esther George, Interview: Bloomberg TV

Michael McKee:

You've called for the Fed to be measured and cautious in its policy moves. Does that mean that you would be against larger moves for the time being? Would you dissent against 50 basis points on May 4th?

Esther George:

So I think the way I think about removing accommodation is we have two instruments here. We've got short term policy rates and we have a very large balance sheet that are affecting the amount of accommodation in the economy. So it will take thinking about both of those things, I think as we come to our main meeting to decide what is the appropriate pace? What's the appropriate amount of a policy decision at that meeting?

Michael McKee:

Well, there are a lot of people on Wall Street who say the Fed's behind the curve and you've got to go 50 because you're going to lose control of inflation if you don't.

Esther George:

So we know that this policy is as accommodative as at any time when we have inflation this high, when we have labor markets this tight. So there's no question that policy has to be removed, but I think you have to do that in the context of having highly negative real rates, a $9 trillion balance sheet, and thinking about how that combination is going to flow through to the economy. So yes, we have to be very deliberate and intentional as we remove this accommodation.

Michael McKee:

Well let me rephrase the first question. Would you support 50 if that's what the majority wants to do?

Esther George:

I think 50 basis points is going to be an option that we'll have to consider along with other things. And again, I'm very focused on thinking about how the balance sheet moves in conjunction with policy rate increases.

Michael McKee:

Well, let's talk about that Lael Brainard who's in line to be vice chair of the Fed said this morning that she expects the balance sheet to shrink more rapidly than in the previous recovery with significantly larger caps and a much shorter period to phase in the maximum caps. Does that summarize where the Fed is going?

Esther George:

So I think when you compare this cycle to where we were the last time we were reducing the balance sheet and we didn't go very far because of the need for reserves and the decision around that. When you look today at where the balance sheet is and the conditions in which we'll be doing that I think it easily argues for going faster and moving along at a quicker pace than we did before. We have a ways to go to get this accommodation out of the economy.

Michael McKee:

Monthly caps of a hundred billion sound realistic.

Esther George:

So I think we're still talking about what the right approach would be relative to last time. And again, we're doing that in the context of looking at the size of the balance sheet and the conditions in the economy today, which will likely warrant doing more and going faster than before.

Michael McKee:

What's your anticipated impact of reducing the balance sheet in terms of a rough equivalent to basis points in a rate move.

Esther George:

So I think it's an important question because we often focus so much on the benefits going in terms of how it pulls duration out of the market. It boost asset values. I've been looking at some of the estimates that go all the way to 150 basis points effect of that balance sheet on longer term rates. So wherever that is I think there is clearly going to be some adjustment that takes place both in asset markets, as well as long term rates and I think when I look at the yield curve I'm looking at that issue relative to that balance sheet and what effect it's having on longer term rates, less so around some of the conversation on whether it's predicting a recession.

Michael McKee:

Well, because you're looking at it in terms of the Fed pushing down on the longer rate end.

Esther George:

Right. And I think that exists today. I mean we have $9 trillion sitting there. It is having a downward pressure on those longer term rates.

Michael McKee:

Well, what do you think the outlook for the economy is because a lot of people are saying given the war that's underway, given the possibility of COVID coming back and then the Fed removing accommodation and maybe becoming tight that the economy is likely to go into recession and there are the people who say the Fed's going to do something until they break something. How do you respond to that?

Esther George:

So I think right now when we look at the outlook for the economy, obviously I think we're going to see GDP step down just because fiscal policy is waning relative to the money that went out during the pandemic. Rates are going to be rising in that sense, but if you look at how household balance sheets are positioned right now, if you look at consumer demand, it remains pretty strong and one of the jobs of monetary policy will be to try to bring that demand and supply into better balance as we go forward.

Michael McKee:

Well, to get demand down you raise interest rates and then demand falls, production falls, and unemployment rises. How far are you willing to let unemployment rise to bring down inflation?

Esther George:

So I think that's one of the things we're going to have to watch. So we talk a lot about the neutral rate, but for me watching how economic activity unfolds. So as we begin to raise rates and lower that balance sheet those are going to move through the economy with a lag. And what you want to watch is to see how much traction are you getting with those rate increases. So when I think about today, how consumption has skewed toward durables, you might say higher interest rates will get more traction. On the other hand we have a lot of liquidity out there. We have households that have capacity to spend because of their excess savings. Maybe it will take more rate increases. So I think as we go through that it's going to be a function of making sure that inflation comes down and the accommodation comes out.

Michael McKee:

Lael Brainard said today that she expects the accommodation of rate moves and the balance sheet would take you to neutral by the end of the year. Do you get that high by the end of the year do you think? Do you need to go above neutral in order to bring inflation down?

Esther George:

So I think if you just look at where we are today you might say, we'll have to go above neutral to bring inflation down, but there's a long time between now and the end of the year to see how the economy unfolds. And so that's why I've argued for being deliberate to monitor how the economy is unfolding so that we are able to see what impact we are having as we go through this process as opposed to racing toward some particular number that we think we need to get to.

Michael McKee:

In terms of the balance sheet, you're the banking person, does the supplementary leverage ratio rule have to change in order to make that work so that banks can take on more on their balance sheets?

Esther George:

Well, I wouldn't argue for that because the supplemental leverage ratio is designed to be a strengthening factor that positions these very large global institutions to withstand shocks. That was the design of this. We went through a period in 2008 and nine where the economy suffered because we didn't have the kind of capital strength. So I would not argue for a reduction in the supplemental leverage ratio.

Michael McKee:

All right, let's talk a little bit about your district and what CEOs are telling you. The story has been so far, we can't find workers. We have to pay up and we have pricing power. Are they telling you any of that is starting to change?

Esther George:

So we're still hearing that. We heard it as recently as our March board meeting and in some of the advisory councils we have. Supply chains are still a big problem for them. And in some cases not getting better, maybe getting worse as we've seen through some of the problems with the war in Ukraine, some of the issues with China and their zero COVID policy. So that continues to be a pain point. They still are able to pass along their cost at this point. So I haven't seen a lot of improvement yet in that. They are adjusting though and I think that's an important thing to think about. Firms figure out how to adjust to the circumstances they're in so they're deploying more technology. They're finding more innovative ways to get to meet the demand that they have today

Michael McKee:

Well, one thing that Fed wants to do is break a cycle of ongoing price increases. Are CEOs telling you that they think they're going to continue to raise prices? Are you going to have to do some work there?

Esther George:

So I think right now they see the ability to pass on those prices. I think longer term they are looking to see some of the same factors that I've mentioned, whether those supply chains eventually ease up, whether demand comes down in a way that allows those supply disruptions to work their way through. So I think we are watching carefully because we know from looking at consumer sentiment right now, people hate high inflation and that has its own effects on the economies.

Michael McKee:

Today I'm told as your 40th anniversary at the Federal Reserve, which meant you come in when Paul Volcker was there and I'm wondering how you would compare that period to today in terms of the uncertainty about monetary policy and how the economy is developing and the pressure the Fed is under.

Esther George:

Yeah. So remarkably when I started at the Kansas City Fed 40 years ago we had very similar inflation rates. Of course, they were coming off a long period of inflation expectations being high and problems with wage price spirals in that sense. Today I view as different in this sense only that we've had a different kind of shock. It's been a year. We have a commitment to get back to an inflation target that I hope reassures the public of our resolve to do that. And that, in that sense I think a bit different. The pain that you feel today around high inflation, not much different.

Michael McKee:

What about the pain Fed officials feel about trying to deal with it?

Esther George:

It's a big issue. I mean I don't think anyone underestimates the task ahead of us to try to bring inflation back to our target. That's our mandate. To do that and to ensure that there's a steady expansion in the economy, that's how we achieve our full employment mandate. That's how having low prices will help assure that for the economy.

Michael McKee:

Okay. Last question I have to ask you is, do you have a message for Tom Barkin today, the Richmond Fed Bank president whose district includes the University of North Carolina?

Esther George:

Well, it was a great game. I'm glad it turned the way it did. It was a great comeback here and congratulations to both teams for how hard they play.

Michael McKee:

Does it improve the economy here to have the winning team?

Esther George:

I think it certainly improves sentiment here so people are pretty happy about the win.