Fed Unfiltered, Transcript
5/18/22 – Charles Evans, Interview: Bloomberg TV

Michael McKee:

A lot of people questioning now whether the Fed is going to be debating monetary policy or whether we're locked in for the rest of the year. The Fed has said, and Jay Powell has said, 50 basis points at the next couple of meetings. Would you anticipate something like that running through December?

Charles Evans:

Well, we've been discussing the state of the economy and inflationary pressures for quite some time, and the committee has definitely coalesced around moving off the effect of lower bound. We've already begun doing that, and, as Chair Powell said, we're going to be moving expeditiously towards something much more like a neutral fed funds rate. My own assessment of neutral is in the 2.25% To 2.5% range for the federal funds rate. As the chair has said, we just did 50 and 50s are on the table for some period of time. I would expect, by the end of this year, it could be quite likely that we were at a neutral setting, and I think we would be very well positioned to address the future inflationary pressures of 2023. I'm expecting things to improve from the very high inflation that we're having, but I do think that it's going to take us some time to take care of this.

Michael McKee:

Do you see any probability or possibility or reason to that a 75 basis point move would come to the table?

Charles Evans:

Well, I think it's very useful to front load our policy settings, at the moment. We did 50 at our last meeting and it's extremely likely that 50 at the next meeting, and probably thereafter. Once we get to a good setting for the funds rate, when we can after that do a more measured pace of increases, say 25 basis points at each meeting after that, I think that would be a nice shallow path that would give us time to assess the incoming data and know exactly what we're facing. If we do a little bit more sooner, then we can get to that point where we can do the shallow path or maybe we take 50s a little bit longer, but, like I say, I think something like neutral by the end of the year, whether or not you get there sooner or earlier is not that critical. It's being well positioned to address the problems that we expect to face in 2023. That's my first concern.

Michael McKee:

How far above neutral do you think you may have to go, to get the results you want?

Charles Evans:

It's a hard question. Nobody reports what the neutral setting of the Fed funds rate is. It moves around over time. It depends on whether or not we've got tailwinds at our back or headwinds that we're facing. I think we're going to be feeling our way around that. Like I say, I've got a benchmark of what I think, so if we go beyond that, if we go 50 basis points beyond that, 75 basis points beyond that, then, that restrictive setting of policy should be working to bring inflation down. We don't have to constantly increase the funds rate to be restrictive. We can get to a restrictive setting and sit there for a while. Maybe we sit there longer at a less restrictive setting and it takes a little bit longer for inflation to come down, but there are many special factors that have led to the very, very high inflation rate that we're facing. I'm hopeful that in 2023 we're going to be facing core PCE under 3%.

Michael McKee:

Wall Street would like to know whether if the economy slows, you're willing to slow the pace of rate increases to try to keep the economy from falling down, to keep us out of recession, or whether you will continue to be aggressive if inflation remains high. And I suppose that begs the question of whether you see a recession or not, so I'll leave those two questions for you then.

Charles Evans:

Well, we have to dual a mandate. We are trying to set the monetary and financial conditions to support maximum employment and price stability. At the moment, the price stability objective is the one that's most critical, because, at 8.3% CPI, that's much too high. I think it's going to be coming down. The labor market is doing extremely well. There's tremendous demand for workers and I'm hopeful that labor force participation will increase, but, basically, we have a vibrant labor market.

Charles Evans:

The first order of business is getting inflation under control. Now, as we get to a restrictive setting the monetary policy, I do expect that the economy's going to cool a little bit. By cooling, I mean we're still going to be having growth. I think the growth at trend levels, 1.75% to 2%, trend is 1.75%, but I'm looking for 2.2%, as we continue to have a neutral to restrictive setting. That's consistent with growth. If we see something that's weaker than that, we'll have to see what that means for inflation. If inflation, the trajectory, looks like it's confidently coming down and we're going to hit our 2% objective or be close enough to it, then we'd have a little more latitude, but, at the moment, we really need to be focusing on inflation.

Michael McKee:

What's your forecast for inflation, over the next quarters and year? I ask that in the context of what you're hearing from the CEOs in your district about whether they're still feeling price pressures, whether they still feel they have pricing power.

Charles Evans:

When I talk to businesses, C-suite individuals or small businesses, they're facing a lot of cost pressures, and, to the extent that they've been able to do it, they have passed along many of those cost pressures. I think the days of how long they're going to be able to pass that along are probably numbered. I think consumers are getting fed up with high prices and they can respond by shifting their expenditures, but businesses are facing those pressures. They've raised wages. And, in many cases, where six months, nine months ago, we heard that there were intense wage pressures, when wages have gone up that has actually satisfied and improved the labor setting in those manufacturing plants. Higher wages, it doesn't necessarily mean they have to keep going up each quarter each month.

Charles Evans:

I feel confident that businesses are going to get on top of their labor costs and pricing behavior will be more in line with what I think price stability is. I can't reel off what inflation's going to be three months from now or six months from now, because there are a lot of real factors that could play out in different ways. That's part of what we're going to be looking for. If we get to a neutral setting by the end of this year, we're going to have many, many more months of data to see is a trajectory coming down or do we still have a real problem on our hands and we need to be much more restrictive?

Michael McKee:

We are talking with Chicago Fed President Charles Evans. Let me follow that up with a question, not from me, the professional economist markets watcher, but from the average American, when am I going to feel like my paycheck is keeping up with inflation?

Charles Evans:

It's been very difficult for households, obviously. Gas prices have been extremely high, food prices are high. I think worldwide factors are an enormous part of that. Energy supplies. The Russian invasion of Ukraine is hitting gas prices, agricultural prices. A lot of weed is produced in Ukraine, and that has global implications in all of that. We have very strong demand, so it makes sense. It's what everybody's dealing with. Higher prices. Shortages, you can't necessarily get exactly the product that you want and it's a lot higher.

Charles Evans:

I'm hopeful that, as inflation comes down, hopefully some of those prices will revert and they'll come down. Food prices often can round trip and energy prices too, but gas prices are high and that's always a negative thing for consumer confidence. If we can get that in better shape, but that's not monetary policy that supply conditions. Wages have gone up, so I think incomes have gone up. The labor market is good, people who want a job can get a job. That's good for household income. If we can get labor force participation up and some childcare to adult care issues resolved, keep everybody in schools, that'll be beneficial for the economy.

Michael McKee:

Have you been surprised by the strength of ongoing consumer spending, that people are still buying a lot of stuff, basically?

Charles Evans:

It has been strong, hasn't it? Some of that, I think, is the fiscal support was very helpful for many households that otherwise would be in very difficult situations. I think that the growth of the economy, many people are doing extremely well, even if it's unequally shared. Sometimes those retail sales come from a skewed distribution of consumers. It's nice that the fiscal support packages and the strong labor market, which has helped lower income workers get jobs at better wages and also at better schedules, probably more full time, that's been beneficial. I think that's contributed to the strength in retail, and I hope that it continues.

Michael McKee:

When you think about going forward, how much confidence do you have in your ability to bring inflation down, given that you've mentioned COVID and Ukraine and all of the other things that are going on that are supply side problems and the Fed works on the demand side?

Charles Evans:

Oh, that's right. That's right. On one level, I'm extremely confident that we can bring inflation down. Inflation is the ever increasing prices of all goods, and that's a monetary phenomenon. The setting of the federal funds rate, the policy rate, can address that. What I'm not confident about is we can't bring down gas prices. Gas prices are going to be very high, because of real factors. Low inflation is going to be, well, they're high but they're not continuing to go up, but those are real factors. It's another set of public policies that need to deal with that. Food prices are the same way. I'm confident that the setting of monetary policy can keep them from ever increasing. They could stay high on a relative basis, compared to other prices, for longer than most people would like, but we can get inflation down. It probably would take a more restrictive setting of monetary policy, if those special factors continue to be high.

Michael McKee:

Before we let you go, let me ask you about the balance sheet, because that's the other side of your monetary policy that has to play out. What do you anticipate happening, when you start lowering the balance sheet? Should we see rise in interest rates at the long end, because it was designed to push them down at the long end, and, if so, by how much?

Charles Evans:

That's right. We've increased our balance sheet dramatically, and we've announced that we're going to let maturing assets roll off. We chose among the most aggressive roll off paths that we could, so I think we're going to get our balance sheet down to a more normal level before very long. That will have a restrictive effect on financial markets that sometimes is measured, I think, for what we're looking at it maybe. It's the same as if we'd increase the federal funds rate by 50 basis points on top of what we're actually doing, so we do have that restrictive setting. I tend to think that markets are forward looking, they are, and they price this in pretty much when they know what it is. I think that effect is already working its way through financial markets, and we've seen long rates go up some. We've seen borrowing rates, auto rates, mortgage rates go up. I think it's having that effect that's helped somewhat with the front loading of restrictive monetary policies. We're probably better positioned to be bringing inflation down, because of that. I think that's working pretty much as we were hoping.