Fed Unfiltered,
Charles Evans, Interview Transcript, Greater Des Moines Partnership and Drake University's Moderated Q&A, 8/10/22

Charlie:

Sure. I'll just be brief. I mean, at the Federal Reserve Bank of Chicago monetary policy we have dual mandate to provide financial and monetary support, to promote maximum employment and price stability for the United States economy. So each of those are kind of interesting to talk about and a little bit challenged as well.

Charlie:

In terms of the economy, maximum employment, the labor market continues to be quite vibrant even though the national state of business is measured by the gross domestic product, was slightly negative in the first half of this year. That has lead to a lot of commentary as to whether or not two quarters of negative growth, however small that negative is, is at a recession.

Charlie:

And the employment numbers continue to just be so strong, over 500,000 jobs were created by business establishments last month and the unemployment rate is 3.5%. This is just a sign of a still-strong economy, with good fundamentals, with households being able to find jobs, earn good incomes. So I'm optimistic that the economy will continue to grow after this, and the second half of this year I think will be quite positive.

Charlie:

We are at a point where the Federal Reserve is raising interest rates from very low levels, and that's because inflation is very high. Inflation is unacceptably high. Just this morning, the Consumer Price Index came out and it was reported over the last 12 months inflation was 8.5%.

Charlie:

Now I have to go into, it's a little complicated at this point one thing is 8.5% is just huge. That's a big number, so nobody can be happy about that. It's better than the report last month and the month before. So we're getting the first positive report that at the headline level prices were flat. That's because energy prices, gas prices, have gone down. Gas prices are still high. So we're going to run through a period where even if I start pointing to falling gas prices, it's like, "They're very high. I'm still spending a lot to fill my 2007 Toyota Corolla, and that's a small car." So that's going to hurt people. Shelter prices are going up.

Charlie:

And so, the Federal Reserve, we've tightened monetary policy quite a lot very quickly and short-term policy interest rate now is at the 2.25% to 2.5% range, that's the Federal Funds rate. And I expect that we will be increasing rates the rest of this year and into next year in order to make sure that inflation gets back down to our 2% objective before too long.

Charlie:

Having said that, I'm optimistically forecasting that next year the core rate of PCE inflation is going to be something closer to 2.5%. That'll be above our 2% objective but it'll be substantially lower than where we are now. So why don't I stop there and let you ask some questions.

Robert:

Yeah, thank you for those re-

Speaker 3:

I want to ask you guys a quick question. [inaudible 00:03:08]. Your report also.

Charlie:

I think anybody who knows me, that's probably because my loud voice, right, John? So this is actually more-

Robert:

I don't know. This, oh, wow, this is really... Okay, all right.

Charlie:

If these shut off my voice will still project. I'll just repeat what your comments are.

Robert:

All right. Well, thank you for those remarks. And I think we're actually going to dig deeper into a couple of those points you made today. Let's start with talking about the current situation and the outlook.

Robert:

The unemployment rate is quite low, which you mentioned. We discussed earlier that in Iowa it's actually lower than many parts of the country and low for the Midwest. I think the last statistic I read was around 2.6%, which is comparable to a pre-pandemic unemployment rate in the state of Iowa.

Robert:

By many measures the job market remains very tight, as we've discussed. Employers are having trouble finding employees. Yet activity in both the first and second quarters shrunk last year, which under some definitions of a recession, under some common definitions that is a recession, although that's not the official technical recession title. Are we already in a recession? And if not, do you anticipate us being in a recession within the next year or two?

Charlie:

Right, so like I was saying earlier I think it's... I'm not looking for the economy to turn down in a significant fashion anytime soon. So I'm not looking for a recession. I think that the second half of this year we should see positive growth.

Charlie:

We have seen cooling household spending, retail sales have been slowing, the housing market has turned down. We've increased interest rates and markets have been expecting further increases in interest rates. So mortgage rates which had been very attractive only a year or two ago, now are much, much higher. And so, buying a house is a much more costly proposition. If you can find a house that hasn't already just sold it's a very difficult time in most communities. Part of this must have been a response to COVID; people figuring, "Well, I'm going to be spending a lot more time in my house and maybe I need a bigger or a better-sized property," and things like that.

Charlie:

Business fixed investment has been recently too. And so, there's a lot of uncertainty that businesses are navigating. When that's the case they're usually cautious in terms of expanding their operations. And so, I think that some of the reasons why the first half of the year growth was flat to negative. But I don't think that's indicative of a recession.

Charlie:

Recessions are usually things that are a surprise: something happens and then all of a sudden the economy turns down. Almost surely the case that the economy is a little more fragile at this point. We've been raising interest rates, we've had supply shocks and things like that. But I think it would take something adverse to kick us into a downturn. The fundamentals continue to be pretty good.

Charlie:

The 2.5% unemployment rate in Iowa and in other states in our district, I think Wisconsin, Indiana have low unemployment rates too. I think Michigan and Illinois tend to have higher interest rates. It's a marvel that labor markets work as well and businesses are able to find workers under normal conditions. I think under the current situation where, I mean, it's hard to find lifeguards in my local village pool. And it's like, "Wow, where did they go?" So I think this has just challenged many, many business models when it's harder to find workers.

Robert:

Certainly. And you touched a little bit on the remainder of 2022. But where do you see the economy, and I know it's an imperfect science, but where do you see the economy heading beyond 2022?

Charlie:

Well, I think we're almost surely looking at growth, which a good outcome would be sort of trend growth. And trend growth isn't nearly as strong as what a lot of people probably think.

Charlie:

When you look at the state of labor force participation, the aging of the population, trend growth is going to be defined by what sustainable growth and labor input is, plus sustainable growth and labor productivity.

Charlie:

With the aging of the population labor force growth is much, much weaker than it was, say, in the seventies and the eighties. Back then, we had 3.5% trend growth. But now we're looking at something much closer to 1.75%, so that would be an average rate of growth that the national economy could be expected to repeat year after year after year. And we've just gone through a period of rapid growth after the big downturn from the COVID shutdown. And we've also had a lot of fiscal support. We've had a lot of consumer spending.

Charlie:

And so, we're expecting that we're going to overshoot a little bit, and I would expect growth to be at trend or below that. So that would be growth rates in the order of 1.5%, 2% next year, that type of thing. Those are good rates. I mean, the way you get 3% is if you had prior years that were below that to sort of catch up. Unless all of a sudden we had a huge explosion in labor force and productivity.

Robert:

Well, looking forward into the future it would be an understatement to say that there's a lot going on in the world, with the continuing effects of COVID-19, on global supply chains, the situation in Ukraine, the emerging situation in China. Many central banks around the world, including the Fed, are moving to a more restrictive policy stance. What do you see the biggest risk to growth over the next year or two being?

Charlie:

Well, I think supply chain issues continue to challenge everybody; businesses. Whether or not you're components are going to show up, I think we're going to continue to struggle with that for longer than I would like. I think there's been some improvement. I expect improvements will continue. But we're at the point now where it's not semi-conductor ship shortages per se that are the problem, but it's another component. It seems like the just-in-time production inventory model just doesn't seem to be working as well, under current conditions, as it did for a long period of time. And for businesses to have towards having more of a buffer stock of inventories I think is more challenging, more costly, and you got to set that up. So I think that could be a challenge for the future.

Charlie:

I mean, in terms of risks that I'm concerned about obviously the Russian aggression invading Ukraine, outright war and the horrible atrocities there, that effects food prices. Ukraine is the breadbasket of Europe historically, and the lack of their ability to do the harvest and to ship out the wheat, that's challenging global food stocks. There's been some improvement there. There are also supply side chains in Ukraine to Germany also.

Charlie:

So I think that affects Europe negatively as well. I think the attitude of geopolitical risk just around the world is something of a concern. And closer to home in the US, I think labor force issues are going to be a continuing concern. Are folks going to want to come back to work in the numbers that businesses need? Where are they going to choose to work? Are they going to work here on-site? Are they going to work more remotely? How are businesses going to navigate that? I think that's going to be a challenge for a lot of folks.

Charlie:

I know that every business person I talk to, that's a subject that comes up. Are people coming back to the office? What are hybrid meetings like? Anybody had a good hybrid meeting lately?

Robert:

Probably some of the same technology concerns that...

Charlie:

I mean, you can have the best tech... Yeah, it's... We get a lot of work done. It's just the experience is different and it sort of depends on the nature of the meeting. Where it's information exchange and we know what we're doing, it's easy. Where you're really trying to grapple with issues that you're trying to get your arms around, it's probably harder to do that in a hybrid situation. Some people are going to be a lot better at it than others.

Robert:

Yeah. We also hear a lot of comments about corporate culture and then cohesion of workforce, especially when people are trying to attract and retain, what impacts those have on being able to attract and retain.

Charlie:

Yeah, we had a nice meeting this morning, business folks, and hearing concerns, challenges, that they're facing. We talked a lot about a workforce, labor issues. And it does seem like, I mean, I just had a lot of thoughts that we didn't have time to talk about.

Charlie:

Remote work can be very positive and it can be great for large numbers of people. And I think that business enterprises can find a way to make some of that work in their organization, maybe quite a lot. But I haven't quite figured out myself how leadership development, employee development, takes place in that model.

Charlie:

I know that we have been successful at the Chicago Fed in maintaining our business responsibilities when we were 100% remote except for essential staff on-site. And that's because we had an effective culture. We knew what we were doing. We were drawing down every month from that good culture as we brought 200 people into our organization over 18 to 24 months who had never been in the building. And it's just getting them integrated in a way that we can continue to move forward is a challenge.

Charlie:

And now, if you roll that forward five years or something, I think leadership development and culture are big issues. And I think we're all going to have solve that one way or another.

Robert:

Yeah. Let's dig a little bit deeper into labor. We know that there are many more open positions than we have individuals or unemployed workers who can fill them. Workers are also, at least we hear, quitting in high numbers, but nominal wage growth is strong. So with this activity showing signs of slowing how do you expect the labor market to evolve over the rest of 2022 and beyond?

Charlie:

There's a tremendous number of vacancies that have been posted. I mean, once businesses found out that there are labor shortages I think job ads exploded, and maybe people put up multiple job ads for the same job. I always wonder how that number gets controlled for multiple advertising and whatnot, but there's millions and millions more vacancies out there than available unemployed workers, people who can come back and take that.

Charlie:

The question that comes to mind to economists is how do you reduce that number of vacancies without the unemployment rate going up a lot? Because it's usually the case that what transpires after this is the fundamentals for the economy go down, you go towards a recession and in a recession vacancies go down, separations go up and unemployment goes up, employment numbers go down.

Charlie:

We are in a very unusual situation. COVID hit, we had a sharp downturn, we had a sharp recovery. That's not normal monetary policy business cycle analysis. And so, we have to figure out how normal statistical relationships, combinations, continue to work and others which are just, no, this is just very, very different.

Charlie:

So I think it's quite possible that we'll be able to tighten monetary policy enough so it will put pressure on the economy so that inflation will be more manageable, it will come back down to our 2% objective and unemployment will almost surely go up, but it will only go up towards what we think of as a more sustainable number, which nationally is probably close to 4.25.

Charlie:

I tend to be agnostic about that. I mean, it could be lower. And most of the time throughout the last 15 years that I've been on the Federal Open Market Committee it hasn't been a question. It's like unemployment is too high and inflation was too low. But when you get to the point where you kind of say, "Gee, unemployment's kind of low. Shouldn't we knock it back up?" And it's kind of like, "Well, what's inflation doing? If inflation's low, no, because the economy's doing well. Why would anybody want to get in the way of the economy when American households are doing well?"

Charlie:

But when inflation is high, then that's a problem. And then, all of a sudden inflation leapt up over the course of 12 months from 1.7% to 7.9%. So other things are at work, and vacancies are just part of this. I think that adjustment process could likely be just very different than anything else we've experienced. It could be that people just wipe away those vacancies. It's like, "No, I don't need [inaudible 00:16:22]. I'm already getting people to show up and hiring, and then I'm losing some people." So it could work out okay.

Robert:

That's part of the question, is whether or not... I mean, you've mentioned workers leading the work field during the pandemic and for other changes. Do you see there being room to increase the labor market, or is that something that much of the readjustment will need to occur on the demand side?

Charlie:

Well, I think there are probably people sitting on the sidelines who haven't come back from the period of the COVID shutdown. It could be that there are childcare, adult care issues, the availability of staff to help households so that both parts of the household, everybody can be working. I think that can be still a challenge.

Charlie:

I hear more about adult care and it's kind of like the aging of the population. We're kind of living through, I'm getting older so, of course, I know more people who it's kind of like their parents are getting older and they're kind of going back and forth to help out, or whatnot. But because baby boomers are such a large part of the population I think this is just more experiences and I think this is part of what colors the job market today.

Charlie:

Ultimately, the aging of the population and demographics are going to put constraints on how many workers are going to be coming back or growing business, enterprises, and things like that. And especially in communities outside of extremely large metropolitan areas, I mean, a city like Chicago has its own challenges with people leaving the metropolitan area and some coming in, but net outflows and things like that.

Charlie:

But Iowa, various communities here, obviously with the aging of the population and children who go to Big 10 universities or wherever, Iowa, do they come back or do they go somewhere else? So there's a natural ebb and flow. I think the aging of the population though kind of makes that more challenging throughout.

Charlie:

So I think every community that I've visited over the last many years the question of how do we think about workforce development, how do we think about bringing people to our communities so that we can... I've got businesses that have great ideas and they just need workers. And it's like are they going to locate here? Are they going to go somewhere else? Everybody knows that their community needs that pool of labor with the skills that are necessary for that continue to thrive and expand.

Robert:

Yeah, that's it. You describe it as evergreen issues, and that's certainly one we've had here in the state of Iowa, which is the brain drain and the youth drain; both of those leaving the state.

Charlie:

Yeah.

Robert:

As we look at some of these high-level words, workforce is one I'm sure you hear many, many times per day.

Charlie:

Right.

Robert:

Recession is one. But I want to turn to inflation if we can now.

Charlie:

Yeah.

Robert:

In June of this year inflation measured by the CPI came in at what can be described as a jaw-dropping 9.1%. Certainly higher than, I think, any of us have ever heard of and maybe even expected.

Robert:

Just this morning we received another CPI report for July. I know that may have had some improvement but certainly didn't show the best news. How do you interpret this morning's inflation report? I know you've had limited time to digest it, but what can you tell us? And should we paying attention to the headline number or the core measure?

Charlie:

Yeah. So inflation is very high. That's the first thing everybody's going to say. And it's been higher for longer than certainly I thought it would be.

Charlie:

There were a lot of reasons initially to kind of think, "Oh, gosh, the car companies can't get semi-conductor chips and the plants are shut down in Malaysia and Indonesia. Well, when they fix that in a few weeks then they're going to start making chips. They'll come back, and then they can make cars and they don't have to be really expensive."

Charlie:

The way this really shows up is in used car prices, because you can't buy a new car. They're not on the dealers lots. So you buy a used car. And used car prices, I mean, they went up 40% in one year, 40% in one year. And it's a small component in the CPI but 40% is a big number contributing to that.

Charlie:

So yeah, I mean, inflation just leapt up and it stayed there, and the supply chain continued to be a problem, labor force issues, people continued to stay back, be shy, businesses were struggling with that. Workers were quitting. God, just some eye-opening, eye-popping charts where it's like if you chart quits against the employment compensation index wages they're very highly correlated. People quit to get more money. And when quits are really high they're finding other jobs and finding better incomes. And so, then that's a challenge for businesses obviously.

Charlie:

It's a great thing for the workers. My son actually got a little raise, more than a little raise, when he switched jobs. His former boss called him and said, "Hey, you can do the same thing over here," and that's good. So those are big challenges.

Charlie:

In the early days of the high inflation numbers last year, last fall, I was optimistic that they would come down more quickly. And then, we realized, no, that was naïve. And so, the Fed was a bit behind the curve, so to speak, in terms of raising rates. Probably in hindsight, we probably should have raised interest rates somewhat, changed our plans, maybe six months ahead of time. That's with hindsight. At the moment, at that time I didn't see it quite that way.

Charlie:

We have very quickly adjusted our stance of monetary policy. We started using the phrase we are going to make policy rate changes expeditiously, and then we started moving. Within four meetings, we had increased our policy rate by 2.25 percentage points. That's extraordinary, as extraordinary as the high inflation numbers.

Charlie:

We do not expect that we are finished. We report in our quarterly summary of economic rejections where we think our policy rate will be at the end of the year. And it's north of where it is today. I expect at the end of this year the Federal Funds range will be 3.25% to 3.5%. At that point, it's restrictive. I think we'll raise rates a few more times next year, so that we at the end of next year... I don't see a reason to change this estimate. I think it'll be 3.75% to 4%. So sort of a 4% top funds rate at the end of next year is what I'm thinking about. Associated borrowing rates, mortgage rates, they'll be affected.

Charlie:

That's assuming we continue to have a vibrant labor market that is only deteriorating a little bit with the unemployment rate going up. Businesses are still looking to fill jobs. If things didn't turn out quite so cheery there, that would probably reduce the inflationary pressures a bit more and maybe that would alter the funds rate path. But those are some of the kinds of things that I'm thinking about there.

Robert:

I want to ask you, but [inaudible 00:23:39] a little touch on something you mentioned. The Federal Open Market Committee, it seems that you maybe acknowledge, I don't want to put words in your mouth, but maybe could have reacted more quickly in addressing this.

Charlie:

Yeah.

Robert:

The Federal Open Market Committee is, in its own words now, and you just use the word expeditiously, removing accommodations by simultaneously increasing the Federal Funds rate while also reducing the size of the balance sheet.

Charlie:

Right.

Robert:

Can you tell us what you mean by the word expeditiously? And why are the rates needing to rise expeditiously at this time?

Charlie:

Yeah. I mean, we were behind the curve so we just needed to raise rates very quickly. And so, it had been a long time since the Federal Reserve had increased interest rates at one meeting by .75% of a percentage point, 75 basis points. That was extraordinary. We did it in November of 1994 and I don't think we've done it since then. We just did two of those, and that's sort of we got to get up to neutral as quickly as possible, so that then we can make things a little bit more restrictive.

Charlie:

So I think we've done that. Yeah, like I said, in retrospect it would have been better if we had been a little more perceptive and seen the persistence of the inflationary pressures. But you look around the world and other central banks are catching up to what we have done. So I feel like we're in a good place and we can pivot to being more restrictive if inflation gets out of hand, more than what I'm thinking about, or the economy is stronger and that's going to be more inflationary. I don't think that's the case. I don't think the most recent employment report indicates that per se, but we need more data on that. But also if things get better more quickly we can not raise rates quite as much as I've just indicated, and that would be good too.

Charlie:

So I think we're well positioned now for a couple of different turns of the data over the next few months. And so, we'll be paying attention.

Robert:

Experience teaches us everything. So the next time around we have a global pandemic that impacts the market in this way, you'll be really prepared, correct?

Charlie:

Yeah. No, that's right, that's right. We are so much better off than we were in March of 2020, and we have life-saving vaccines and boosters. They're going to get better at this. If you want to get this, it's available. And we have better therapeutics too if you come down with this.

Charlie:

However, the virus has been better at mutating a little bit. Now so far it's mutated towards the more contagious not as deadly, still dangerous though. And so, maybe it continues to do that so that it's like a virulent flu or something, something that comes around all the day. But I don't know. I went down to Indiana last week and I met up with a group that I had spoken to December 2019. And we'd had a lovely event there. And when I saw the person in your chair who'd done the event with us, I said to her, "Yeah, we didn't talk about COVID back then, did we? Yeah, we didn't see that coming." It's hard to look into the future, right?

Robert:

Yes, it is. We are going to get to our audience questions. I want to touch on one more area here, to touch on kind of the social awareness of the Fed. Because one of the goals here today is to provide information from you, but also to provide information to people who may not normally be focusing on the Fed, which I think that there's arguably more broad awareness in the Fed and its actions than there has been in the past.

Robert:

Now, whether this is due to the rise in social media, like Twitter and Reddit, whether it's the important role that the Fed has played which is very, very public over the past couple of years, or it's these highly-publicized rate hikes that we've seen recently, how does this heightened awareness of the Fed, both from the public and from policy leaders, impact the actions or decisions that the Federal Reserve may make?

Charlie:

Yeah. I've been with the Federal Reserve for 31 years now. I came to the Chicago Fed as an economist to do research. I'd been at a university and you can teach and do research. With the Fed I could do research and do policy analysis and it was a very good fit for me, and I really enjoyed it.

Charlie:

Early years when I was contributing to policy analysis I came to the viewpoint, Chair Greenspan was running things and it was kind of like the economy does really well, the Fed does really well when we're in the background. We're letting businesses do the best that they can, private enterprise, good government, fiscal policy and the economy runs well and we try not to let inflation to get too high or too low, and things like that.

Charlie:

Then you run into certain severe periods where we had the dot.com stock market crash and 9/11, and we end up having to do a bit more than normal. Maybe it's more front page than it was. Interest rates get down to zero, and then all of a sudden it's like, "Oh, there's more to do," and Congress and the President weren't doing it with fiscal policy after the great financial crisis.

Charlie:

And so, in order to meet our dual mandate objectives and support the economy and get inflation up, we just had to do extraordinary things. And so, when you get to zero we had to do more and we started buying assets. And that became more complicated and we were criticized for it, which is totally fair. We should all understand what we're trying to do, but we were on the front page all the time much more. And that ends up you're in the crosshairs of a lot of people.

Charlie:

I would like to go back to stepping back, being in the background, letting the US economy do what it does so well. But when you need to take action to support maximum employment and price stability, I think that's what you need to do.

Charlie:

The pandemic was just totally unexpected and different. I mean, it had elements of the same features; inflation was extremely low and all of a sudden airlines couldn't fly, hotels couldn't be filled. Do you remember there was, early on, if you were going to deliver oil or gas at some hub you had to pay somebody for them to take the delivery because there was such a glut of oil at the refineries, and whatnot? That was very brief. Now we're totally put the other side.

Charlie:

So just been a lot of different changes in all of this. But we've just basically had to take actions to support the economy. And we're doing that now, and it's going to be more challenging to get inflation down. You just got to do what's right.

Robert:

There's some really great memes on Reddit of Powell. But I haven't seen yours yet. I will email them to you if I find them.

Charlie:

Okay... So yeah, I don't know.

Robert:

We have reached the part of our show where we will-

Charlie:

So do you know how to create memes?

Robert:

I wish I did.

Charlie:

[inaudible 00:30:47]

Robert:

I find some good ones and then I send them. I've got some friends in the audience who could tell you that I send the same ones repeatedly-

Charlie:

Yeah, no, I see. Yeah, no, I...

Robert:

I don't have a wide breadth of them. We'll go ahead and turn to the audience now. If you have a question that you'd like to ask, go ahead and raise your hands and we will go ahead, and I believe John is right there and we'll get a microphone to you. We're going to make sure that one's turned on appropriately.

Speaker 3:

Right here.

Speaker 4:

I didn't really want to be the first cab off the rank. Back in the days when you were working as an economist and probably I was too, they used to report inflation in terms of seasonally adjusted annual rate. There were always problems with the seasonal adjustment, but when you look at the 8.7 that was announced it seems very high, but it's looking at inflation that was built in over the last year. Whereas a seasonally adjusted number would give you a sense of the forward momentum. I don't know what the number is for today. Why do they not report seasonally adjusted inflation anymore?

Charlie:

Well, they do seasonal adjustment for certain parts of the report. I think the 12 month change that they report isn't seasonally adjusted but that's because it's 12 months. And so, when you think of the season as a 12 months then you don't need to do that.

Charlie:

More generally, you're reminding me that back when in the early nineties when I started getting involved in this I was informed that there was a seasonal problem with inflation. The first half of the year inflation was higher than the second half of the year. Inflation was generally higher than everybody thought it should be. It was running 4% or 3.5%. It's before we got it down to 2%.

Charlie:

But it was one of those things where it's like, "Oh my god, the first year inflation really looks bad. We're going to have to do something." And my boss would kind of go, "That's because the seasonals haven't been fixed." And that whole seasonal adjustment process is just really complicated.

Charlie:

COVID has changed the seasonals in ways, and it takes about six years for the filter to kind of catch things. So yeah, you want to clarify?

Speaker 4:

The question to me is if the number that had been reported today was a seasonally adjusted number, my suspicion is it would be much lower than 8.7%, and it would be much more supportive of the notion that we're going to get to 2.5% over the next 12 months.

Charlie:

That may well be right. I think the bigger challenge really, I feel a little on the back foot when last year I was kind of saying, "I think inflation's going to be transitory, the high numbers," and it wasn't transitory, it was here, right? So I'm going to be skeptical or more careful, and whatnot, and I guess my response is 8.5%'s a big number. I don't care if it's seasonally adjusted or not. If I see more over the next few months and longer, and then we sort of see seasonals say one thing or another then that would be helpful as well. So we do a lot [inaudible 00:34:02]

Speaker 5:

Hi. Thank you for taking my question. What you said today is pretty much in line with all the Fed members that [inaudible 00:34:10] about you're determined to bring inflation down.

Charlie:

Right. I'm sorry, can you slow down? My hearing's not so good.

Speaker 5:

Sorry.

Charlie:

Yeah.

Robert:

We've got an echo up here that I don't think [inaudible 00:34:19]

Charlie:

Yeah, sorry.

Speaker 5:

I was just saying that what you said today is in line with all the Fed members, what they've said, [inaudible 00:34:26], they said that you guys are determined to bring inflation down.

Speaker 5:

Yet it looks like markets are not believing what you're saying because if you look at financial conditions, they haven't tightened the way they should given how fast and how aggressive you've been, if you look at whether it's credit spreads. They're not widening, they're tightening. Even the most risky parts of markets have rallied.

Speaker 5:

For the last 40 years markets have been very focused on asset prices and it looks like markets don't believe that the Fed can really kind of let asset prices go and focus on the real economy. Do you worry that there's a risk of a loss of credibility for the Fed?

Charlie:

No, I'm not. I'm not quite sure... So financial markets, there's a number of different pieces to that. Over the years people have sort of said, "Wow, look at the stock price go up. When asset prices go up, that's inflationary. Why don't you put assets into your inflation measures?" And I don't subscribe to that at all, because it's really cost of living is what a consumer basket is, and then there's investments and things like that. So I tend to separate those out. I don't think anything about the equity markets is telling us about inflation.

Charlie:

Now when you look at the Treasury Fixed Income Markets, then I pay a lot of attention to that because any investor that's going to put their money out for 10 years at some Fixed coupon rate and it's kind of like, "Inflation's going to kill me if it's a lot higher than what I've got priced in there," so there's a tremendous amount of research, finance research, models with lots of differing assumptions so that we try to tease out what the market has for inflation expectations.

Charlie:

And as you look at these, and then there's special markets: there's the TIPS market that gives some measure of inflation expectations and you tease out some things with models and you get more. Those are largely saying... So if you look at the next year inflation expectation it's high, and that's because inflation is high. But if look at something beyond the first year, so it's like you take out that first year and then you go after that, those have been coming down. They've been coming down quite a lot actually. In that sense, markets truly do believe that inflation's going to come down and maybe they're concerned because the 10-year rate now it's inverted against the two-year rate. So why is that? Well, one reason is the two-year rate's going to average all of the monetary policy tightening that I just described, and so it has to average to a higher number than what it is. But 10 years out, the market's trying to think, "Well, is inflation going to be lower? Is there going to be a recession or a downturn that that's also going to reduce rates," and all those things.

Charlie:

So that's a cause for some nervousness in terms of how longer rates go down. I saw just this morning that the German bond 10-year rate, which had been negative for quite some time before because people were very worried about Europe and COVID and low inflation. And then inflation went up, and it was up to 1.9%, which is pretty high for them, and now it's at nine-tenths. So that's gone down too.

Charlie:

So long-term interest rates have gone down a lot. And I think markets are pricing in either enough credibility for monetary policy, or worries that with that credibility central banks are going to go too far and then cause a downturn, or something. So they're trying to think through that, but so far I've been impressed that inflation expectations have stayed closer to where they could have been with these current high inflation rates.

Speaker 6:

There has been a lot of talk lately from the Fed about equity issues and a renewed interest in driving some of those benefits to the bottom of the economic ladder. The folks at that level are the first to feel the pain from Fed activity and the last to get the pain from Fed activity. So what other tools does the Fed have in order to drive that? Instead of the benefits going to the top, as it often does in our society, to drive that down so it can be more equal for everyone?

Charlie:

Right. I don't think I've ever had this reaction but I had a flashback to Star Trek where the medical doctor Bones goes, "I'm just a country doctor."

Charlie:

So the Federal Reserve has been called upon to do a lot, or we've taken it upon ourselves to answer a call whether we've been called upon or not. I talked earlier about how in the nineties if we can be in the background and let the US economy do what it does best, that would be great. And then, we find ourselves in situations where the unemployment rate's 10% and inflation's very low and we had to do things.

Charlie:

Over a long period of time, I'd been president for a long time, I've struggled with... It always seemed like we had to do an awful lot to provide the amount of accommodation that I thought that the national economy needed. Different communities are in different places, but the national economies continued to have high unemployment, growth wasn't enough and inflation was low.

Charlie:

And very well-trained colleagues, economists, my research staff would kind of look at models and go, "Yeah, but I see inflation going up." And I'd kind of go, "Yeah, but we've had those models say that before." And so, I kind of wanted to see it, the whites of your eyes see the inflation, and things like that.

Charlie:

And I was completely in agreement with the adjustment in our strategy where it was kind of like, "Let's make sure that we see everybody get as much of the employment gains as we can. Let's not unnecessarily cause a recession on the belief that inflation's going to go up unless we saw inflation go up."

Charlie:

And so we used language where we said, "We're trying to promote maximum and an inclusive employment." And I think that's right. I think about it very broadly. You can think about in terms of demographics and racial demographics that Black unemployment often is 50% or double what white unemployment is; college-educated, high school educated. But more broadly it's not just racial. It's all kinds of demographics.

Charlie:

But one that really hits me is median household income. Income inequities increased dramatically over the last 20 and more years. And so, median household income nationally for a family of four, a couple of years ago that's the latest data, was about $65,000. That's median. Now if you take average, so average is putting in those really big incomes, average is $97,000 for a family of four nationally. So median is the 50th percentile. This average ends up being about the 65th percentile.

Charlie:

So with all of our emphasis on national aggregates, aggregates are more like averages, we find ourselves focusing more on higher income, better outcomes. And it just seems to me part of inclusiveness is if focusing on the 65th percentile of income is an interesting idea, it ought to also be interesting to focus on the 35th percentile.

Charlie:

And so, I think that as much as we can we should look broadly at how our policies are affecting everybody, and we should be a little bit cautious not to provoke an unnecessary economic restraint unless it's really essential to maintain price stability.

Charlie:

And we're in a current situation where 8.5% inflation, we really need to get on top of that. So I think we should do it in a measured, appropriate way but we have to make sure that we can re-establish price stability before too long.

Charlie:

But throughout all of this, and monetary policy's really only got one tool, so if I had five tools I might be able to hit a particular income distribution a little bit more or not. Can't do that. So we need other policies, other policy makers to all come together and think about what would be good for the economy, US households in general.

Robert:

I think we've got about time for two more questions. We'll go over here, and then if we have one right over... Or one or two, we'll see.

Speaker 7:

Real simple question: a question about cyber security with what's going on, Ukraine, Russia. Tell us about what the Fed is doing in the realm of cyber security in keeping our banking systems safe.

Charlie:

Oh, cyber security, is that what...

Speaker 7:

Yes, cyber security.

Charlie:

See, I'm about to retire because I'm turning 65. I thought you said social security. Okay... Cyber security.

Charlie:

Cyber security is unbelievably important. We are using digital technologies, computers, the internet so much, we're doing work remotely. And the idea that somebody can get into any enterprises' system and cause havoc and bring you down, ransomware, things like that, it's just we need to be very careful. Everybody does. This is individual hygiene at the business enterprise level.

Charlie:

When it comes to banks and supervising banks part of that bank examination process is just working with banks, understanding, having regulations. And it's kind of like if you are going to maintain a safe and sound bank obviously you have to make sure that you're protected against cyber intrusion and things like that.

Charlie:

It's natural for any business, where it's like, "I've got revenues and I've got costs. And things that are cost center, well, you know? Do we really need to spend that much money?" Where do you play that risk management aspect?

Charlie:

We have to have continued conversations, dialogue about how important cyber security is. Sharing information when there are penetrations, it's also human nature for any enterprise where it's kind of like, "I've got a little problem over here, but I think I'm working it and it's not really a challenge," and then two weeks later it's like, "Oh, I can't solve this." And oh no, wish we'd all known about that faster.

Charlie:

So there are whole bunch of things at work. It's fascinating. There's a lot of work to do. And things like ransomware just make it really, really hard, right? Somebody gets into your computers. They shut it down and they want to be paid in crypto. If you didn't have that crypto I don't think you'd have the same thing because it would have to play out like, "Okay, we just shut down your computers. I want you to go to the Central Park and put half-a-million dollars in the trash can by the statue. And don't tell anybody." That just doesn't work.

Robert:

There's some people in the room that might not realize that's how Bitcoin started, was it was hand exchanged. We've got time for another question over here.

Speaker 8:

I wonder if the attention that the Fed gets, not just publicly or in the press, but from Congress during the occasional hearings, that reinforces our faith, our kind of post-Volker orthodoxy that the Fed's monetary policy is the primary way in which the US government can control inflation and manage employment. I wonder if that view and that emphasis is providing cover, wittingly or unwittingly, to politicians who therefore feel like they don't need to have their hands on fiscal policy, if it gives them an out on tax policy and other kinds of economic policies that are more difficult and more unpopular in some cases and so let's just let the Fed do it? And if that's the case, if the answer to that question is yes, is there any way of putting the ball back into the policy court, the legislative policy court and fiscal policy, to address some of these kind of bigger macro issues?

Charlie:

One thing, at the Federal Reserve is we have a conversation about how we interact with Congress and the President and what our strategy and mandates are, we've got a mandate to support maximum employment and price stability, so there's a scorecard. You can hold us accountable and the Chair goes to Congress on a regular basis, and they can comment, criticize and things like that.

Charlie:

And certainly when Allan Greenspan was chair he was lording over everybody because he had good outcomes after the first few years and a lot of prestige and all of that. But then something bad happens, and then tables are turned. So he had a good urn but when the tables get turned then everybody's unhappy about that.

Charlie:

I think what... I don't love this term but I use it: it's important that the Federal Reserve maintain its independence, independence from political pressure. We have to be, and we are, accountable to democratically-elected officials and that's why the Federal Reserve and the Chair goes to Congress and reports out.

Charlie:

I think this is good for Congress because it's like, "Okay, you Fed, you're responsible for keeping inflation in check because if we get involved it's hard for anybody to kind of say, 'We need to promote restrictive financial conditions which are likely going to harm a lot of businesses and harm a lot of households, and it's probably going to put a lot of people out of work.'"

Charlie:

What Paul Volker had to do to break the back of double-digit inflation was to create 10% unemployment. And then, it came down pretty quickly. But it was very painful and nobody wants to go back and do that again.

Charlie:

And so, an independent monetary authority should make those hard calls, and when they make them and maintain credibility not have to do that very often. And then Congress can go about doing their own business.

Charlie:

It also allows Congress to criticize the Fed, and I take that as just that's the way this works. If we're independent they can criticize us. That's fair game. I think they should be fair about it, but that's in the eye of the beholder.

Charlie:

If anybody wants to use this as an excuse not to do what they should do in their own line of work and legislating fiscal policy, I think we have to count on the voters to hold people accountable. It's not our job to... We're going about doing the best that we can. We're trying to share information. We're trying to get the best information from people up on the Hill and the President and others, and go about doing the job that we need to do. And Congress has to do that and the President has to do that too.

Robert:

Charlie, I could do this all day but Cathy won't let me.

Charlie:

No, [inaudible 00:50:52]

Robert:

Lots of people wouldn't let us either. I just want to tell you thank you [inaudible 00:50:55]

Charlie:

Yeah, the crowd is always respectful for the first 58 minutes.

Robert:

And the questions are tame too, right?

Charlie:

Yes, that's right.

Robert:

On behalf of Drake, on behalf of the Des Moines Partnership, myself and everyone else, thank you so much for taking the time to come here to Iowa and to speak to us today. This is a very, very important topic and you're certainly... When we speak of experts, you're not only the foremost expert. I mean, you're the guy, to steal a line from Hamilton, in the room where it happens. So we really appreciate it.

Charlie:

Well, I really appreciate that. It's great to be here, Robert. You did a great job. I never had any doubts and it's a great event. Thanks for the hospitality here at Drake and Des Moines. It is always great when I am able to get out of the office or get out of my home office and visit around our five-state district. I just learn a lot and I take it back and I share it with everybody who has to listen to me when I go to Washington, and whatnot. So thanks very much. I really appreciate it.

Robert:

Thanks to all of you for attending.