Fed Unfiltered, Transcript
8/11/22 - Mary Daly, Interview: Bloomberg News

Kathleen Jays:

The CPI, Consumer Price Index for July, the headline broke pretty significantly. Then the very next day producer prices, which is usually the kind of secondary report wholesale prices was negative on the month. The first time since the pandemic, when you look at these numbers, how significant to you are these latest results?

Mary Daly:

Well, they're significant in that they're saying we're seeing some improvement, but they're not victory because remember that the headline CPI number is still 8.5%. I want to say it again, 8.5% on a 12 month basis. And that means the consumers are paying 8.5% more this month than they were last year for the same goods and services. And that's too high. Inflation is too high, but it is always important to start seeing it come down a little bit.

Kathleen Jays:

So if I were to ask you to think of a little scale. Have one thing on one side and on the other side, so one has 50 basis points for the September meeting, the other one has 75 basis points. After you've seen these numbers, and anything else that's come out lately like jobs, I guess. How do those scales wait now, does Mary Daly feel that 50 basis point rate hike a little bit more or 75?

Mary Daly:

Well, maybe the first thing I'll start with is the scale 50, 75. Doesn't just depend on a data point, even an important one like the CPI. I like to say that we're data dependent. We're not data point dependent. And so really how I think of whether it's going to be 50 or 75 is I look at a lot of things coming in. So we have inflation numbers coming in. We have employment numbers coming in. We actually spend a lot of time. I know I do. And my colleagues do talking to businesses, households, community groups, people in stores. What are you feeling? And are you seeing signs that the economy is slowing?

Mary Daly:

So all of those things, when I put them together, global risks, global growth, I have a baseline case going into September that is 50 basis points. That's where I've been since the last meeting, but I have an open mind about whether 75 is going to be necessary. And a lot of that will depend on the labor market, inflation. And whether we see those things slow enough to say, wow, we've got the momentum we need to really fight inflation.

Kathleen Jays:

But the 50 or 75, isn't about pivoting. It's not about ending this rate hike path. So I'm still kind of curious if you just were looking at those numbers, what would you say? Do they support your baseline, for example?

Mary Daly:

So 50 or 75? Yeah. I think 50 supports the baseline. Think where we need to be at the end of year.

Kathleen Jays:

I mean the numbers we just got.

Mary Daly:

The numbers, we just got the numbers. We just got, say that we have enough uncertainty about the path of inflation. It looks a little bit of improvement, but we don't want to be head fake. So we want to wait for the next report. We have a grade inflation report and unemployment report coming out before the next meeting. It really behooves us to stay data dependent and not call it. But for today with those numbers in hand, I still think 50 basis points is the case, but I am open to 75 should the data evolve differently.

Kathleen Jays:

Okay. So we've got another inflation report in other jobs, probably big ones. Now I want to ask you, I want to hit some of the big points first. And the other one is there's in terms of recession and recession risk. There seems to be frequently a sense in markets that once there're signs up a recession, if the risks are rising, the Fed will pull back. So is the Fed, are you willing to let those risk materialize? If you have to risk a recession, if that's what it's in the end takes to get the inflation rate down.

Mary Daly:

I'd like to start with this. We are a long way from evaluating those risks right now. Look at the employment report, the people in the labor market, whether they're a firm trying to find a worker or worker trying to find a job, do not feel like it's a recession. Right now jobs are plentiful. The main marker for consumers about a recession is are they having a hard time finding jobs? Is it hard to get a job and are their incomes falling? You really don't see that right now, so I don't see the risks of inflation as our preeminent risk. I see the most important risk we face in the economy is inflation that is too high and has been too high for too long. And we need to bring that down. So when I'm balancing the risks, I'm really balancing how quickly can we bring inflation down without tipping the labor market over? And that's why 50 basis points make sense to me right now.

Speaker 3:

Mary does the stock market bullishness right now, is that challenging to the Federal Reserve, given that of course that could relax financial conditions, which is not what the Fed wants to see at this moment.

Mary Daly:

So we look at a broad range of financial conditions and the stock market is simply one of them. I'm also looking at mortgage interest rates and borrowing rates for businesses and consumers for a variety of things. And I really do want those to remain tight and tight and tightening as we go. Because we don't want financial conditions to relax. We want them to remain tight so that we can continue to bridle the economy, somewhat take the accommodation out. Remember financial conditions have been so loose in part because we were adding a lot of accommodation to get us through the pandemic. Now we want to pull that back and we want the economy to slow, bring demand and supply back in balance and deliver a sustainable growth path that delivers on price stability and full employment. This is achievable, but it takes some time to work its way through.

Speaker 4:

Mary, it's not the ideal scenario, but would you ultimately be comfortable or okay with triggering a recession, even if it's a mild one in order to get over inflation?

Mary Daly:

Well, let me just say, what is true is that I think about what I want to achieve, what Americans really are expecting us to achieve. And that is a smoother transition that doesn't require a recession, actually delivers on a slower economy that is still giving people the jobs they need and the price stability they deserve. That's what I'm looking for, and that's what I'm focused on 100%.

Kathleen Jays:

So Mary, I wanted to ask you about a story we just ran. Senators suggesting that the Reserve banks need to provide information under Freedom of Information Act. They're mainly concerned about some of what they consider trading irregularities over the last year. Is there something that the Reserve banks are holding back? Is there any reason why you would, is there something that is being miscommunicated here?

Mary Daly:

So let me start with the idea the first acknowledging we did receive a letter from Senator Warren today, all the Reserve banks did and the board of governors. And we're thinking about that, we're looking over that letter. We just received it this morning, but here's the most important message for listeners. The Fed is dedicated to being transparent because transparency is how we build trust and trust is our most important tool. And so us being transparent about how we run our businesses, how we have our finances, and most importantly about what we're doing with policy, because inflation is high, is how we assure every American that they can depend on us to do the jobs we've asked to do. Which is price stability, full employment.

Kathleen Jays:

In terms of the labor market, how are you assessing its strength? And I'm guessing what is the reaction function? Right now the labor market is strong, and you're suggesting that's one of the reasons you guys will get a soft landing. What are the triggers? What are the signals from the labor market that would make you rethink that would make you have a shift in policy, or just maybe worry more about getting a soft landing?

Mary Daly:

Sure, I really appreciate that question because the labor market has, we have a range of data, an entire dashboard of data. So it is too simplistic to simply look at the unemployment rate, although that's an important measure. But I look at quit rate, how many workers are quitting? How many job openings do we have? Right now we see job openings coming down, that's not the same as laid off workers. So when I start to see workers maybe getting laid off and those workers struggling to find jobs, then I would worry more. But right now I'm not seeing that. Right now I'm seeing many workers finding jobs, very few getting laid off and mostly people feeling that the labor market has a lot of opportunities for them. Firms think that it's very hard to find workers and everyone tells me, literally everyone, that the salient risk, the most important risk in the economy is high inflation.

Speaker 4:

There's a lot of criticism that through Fed policy, we've seen a lot of distortions in the housing market that will have some level of longevity, even as policy changes. Do you sort of address that? Because what we are seeing is the stickiest parts of inflation is really in housing, in shelter, in rental costs.

Mary Daly:

So I think it's useful to start prior to the pandemic. We have had an imbalance in supply and demand for housing for a long time. Housing units just haven't been keeping up after the great recession, the financial crisis, which was an important housing market crisis. So it was already where we were prior to the pandemic. And then the pandemic just made it worse, because people were trying to move out, buy homes, they had cash to do it, interest rates were low. As we changed the economy and we raise interest rates. The first thing we've seen is that the housing market is slowed, that will slow home price appreciation. And then that with a lag filters through to rental price inflation. So it will take some time for all of this to work through the economy, but we are seeing the signs that it is working,

Speaker 3:

Given those challenges in the economy, Mary, we have seen really Congress and the white house step up with new legislation, whether it's a CHIPS Act or the Inflation Reduction Act, when will those sort of filter through to the economy? And do you really think of those measures right now as the Fed considers where to go in the next couple of years?

Mary Daly:

So we take all the factors into account, including legislation. But the most important thing that people should know about the Fed is we work with the economy we have. And that is right now, something that a variety of circumstances are creating high inflation. So if there are factors that reduce inflation, whether that's legislation that gets passed or slower global growth, or the removal of supply chain barriers, we're prepared to adjust policy to accommodate those. But right now I think the unequivocal answer that everyone would have is inflation is too high. And we still have a lot of work to do.

Kathleen Jays:

Well speaking of inflation too high, I want to come back to the CPI report. Core services are continuing to rise, that's one issue. In the productivity report on Friday, big drop in productivity, big jump in unit labor costs. In terms of your inflation outlook, is that one of the factors that suggest sure, we saw a break in the CPI headline, but some of the underlying forces are still going to push upward on inflation, like shelter costs and other services.

Mary Daly:

So when we look at the inflation projections that we get from this report, this is one of the reasons I take it's good news that the inflation came down. It's certainly some relief for consumers, but really I'm looking at the longer run. And the longer run is driven by things like core services. Remember service is a lot of what we buy and if those prices are continuing to rise at a rapid clip, then we still have a lot of work to do. The shelter inflation, part of what I see there is the prices will stay elevated. That price appreciation will fall off gradually, so that's more anticipated. The core services I'm watching very carefully because we don't want inflation pressures to spread. And importantly, we want inflation expectations of consumers to remain well anchored, which they currently are.

Kathleen Jays:

Have to ask you about the yield curve. It's inverted. It's been a very powerful signal in the past. How concerned are you about that? What are the signals you see?

Mary Daly:

So it won't be surprising to anyone that I watch all signals, and the yield curve is one signal of financial conditions. But what I see right now is that we're in an uncertain time, and there's not just uncertainty about what the Fed will do, because I know there's a lot of conversation. What exactly will we do in September? But people pretty much know the path that we're on, and our commitment to bring inflation down. What is uncertain is what's going to happen in the global economy? I think it shouldn't be overlooked that central banks across the globe are tightening policy, so that synchronized tightening of policy is tightening global financial conditions and growth is slowing globally. And investors and market participants are trying to figure that out and trying to figure out how the Fed's going to react, but how central banks across the globe will react and how the economy will fare.

Kathleen Jays:

Seems that a message coming with the fed, including you, is that you expect about another a hundred basis points of hikes this year, and then possibly more next year. Some people are more convinced you're going to get to 4%. So is that sort of the consensus that the data at matter? But currently the view is that right now where we are, where inflation is we have to get too restrictive. And we have to get at least a hundred basis points, if not 150 or more to get, not just to some kind of near term neutral, but to a restrictive stance that will bring down inflation.

Mary Daly:

Well, let me talk about my own view. I see 3.4, which is what was in the summary of economic projections, which we put out four times a year. That was the June number that's about right for the end of this year. So another a hundred basis points of the increase between now and the end of the year. That seems right to me. If you think of the neutral rate of interest is roughly around three. That means we're already in restrictive space by the end of the year. And then I do see us going up more next year, be more restrictive to fully bring inflation down. Another important feature that markets didn't come in with is that I don't see this hump shaped part where we raise interest rates to really high rates and then bring them down. I think of raising them to a level that we know is going to be appropriate and then holding them there for a while so that we can continue to bring inflation down until we're well and truly done. Until we've restored price stability.