Fed Unfiltered, Transcript
8/25/22 – Esther George, Interview: CNBC

Steve:

We kick off our Jackson Hole coverage of the Federal Reserve Conference, as we always do, with an interview with Kansas City Fed President, Esther George. This is her 10th Jackson Hole conference as Fed President and unfortunately, the last one we understand.

Esther George:

Yes, it is.

Steve:

Well, thanks for joining us as always and agreeing to sit down. I want to start off where I think the market is most interested, has been an aggressive series of rate hikes, and maybe you could shed some light on perhaps how much more there is to go.

Esther George:

So I think when we look at the economy today, Steve, we still see imbalances. Imbalances between demand and supply, and that's putting high inflation in play, so we still have high inflation. We saw some easing in the July numbers, but I think it remains broad-based, so there's more work to be done.

Steve:

Some of your colleagues have said they see a terminal rate of 3.75 to 4%. Others have set above 4%. Which camp do you put yourself in or neither?

Esther George:

Well, I think for this year, we have three more meetings. We know we still have more progress to make. What I'm really looking for is to say, when do we see the turning point in inflation? When can we begin to see where that terminal rate might rest because I don't think we know yet where that may have to settle out, but it will be higher than it is today, for sure.

Steve:

How will you know it when you see it?

Esther George:

So I think you'll see a pretty convincing deceleration in inflation. I think for me, I will be hearing it in the region. So one of the early indicators for me is always talking to our business contacts, to people in the community to get a sense of what they are experiencing and where they see that over the next six months.

Steve:

Do I take it you're not hearing it now?

Esther George:

I am not hearing it now.

Steve:

What are you hearing?

Esther George:

So right now we continue to hear number one concern is a tight labor market, difficulty finding people to work and that price pressures are still there. They've seen some easing, I think, on supply constraints, but not enough that they can look ahead over the next year and think that isn't still going to be an issue for them.

Steve:

Is it three months in a row of good numbers like we had in July? Is it four months in a row that will give you some confidence?

Esther George:

Well, ultimately, it's getting back to our target. I think to see a convincing trend, you'd want to at least see three consistent months of data to know where things are, but of course always doing that in the context of what's going on in the rest of the world. What else is unfolding in our domestic economy at the same time?

Steve:

The market gets obsessed about things like 50 or 75. Do you want to weigh in on what your preference would be for September?

Esther George:

No.

Steve:

Great, but what is the difference in your mind? If you did 50, what are you signaling? If you do 75, what are you trying to accomplish? How do you understand the differences between the two?

Esther George:

Yeah, I think that's hard to explain. Obviously, doing 75 in June and July sets a pace that I think the public is looking for, what changes that would cause you to step down. I think certainly at some point, getting to a steadier more sustainable pace is going to be important, so I think it's too soon to say what should we expect in September because we have some important data that's coming up and always for me an important conversation around that table about what other people are seeing.

Steve:

Could it be more than 75 in your mind or less than 50?

Esther George:

Well, I think after we saw July, I think the real question is July inflation numbers beginning of seeing other easing that will come in months to come, but far from clear given how broad-based inflation is right now.

Steve:

You dissented on a recent vote for a very specific reason. It had to do with the relationship between interest rates and the balance sheet and the effort to reduce the balance sheet. Can you explain that? Do you still have those concerns?

Esther George:

So when I think about the process of removing accommodation and beginning to tighten policy, obviously the short-term interest rate has been our primary focus, but we also have a very large balance sheet, and our commitment has been to bring that balance sheet down. Of course, we will be doing that in a much more volatile environment, more uncertain environment than we did in 2017, the last time we did this. So, as I looked at the path of rates and thinking about the intertwined effects of a balance sheet, it makes me just watch things a little more closely to see how the markets respond, to see how financial conditions respond to that.

Steve:

Do you still have concerns that raising rates by 75 base point increments could endanger the effort to reduce the balance sheet?

Esther George:

Well, we certainly have done a lot of interest rate increase in a short amount of time, nothing I've seen in my time on the FOMC. I think we should still expect that some of that policy will work with a lag. So, we've seen it hit the housing market pretty quickly, but I think its full effects may not be seen for some time, so keeping that in mind as we move forward with this very expeditious path of rate increases is particularly important to me.

Steve:

The balance sheet is not rolling off quite according to a schedule. I know there are things that make it go up and down and not be perfect, but are you concerned at all? I see there's 116 billion dollar reduction since you began in June or so, and it should be 150 billion by the end of this month. Is that close enough, or is there some problem that we're having, that you're having in terms of reducing the balance sheet?

Esther George:

So, remember the caps are being implemented, phased in if you will, so they will hit their full effect in September in terms of bringing down the balance sheet. It is a faster pace than we've done before. It is a larger balance sheet than we've had before, but I think we'll have to see how the market adjusts to that.

Steve:

It's not just the market, but it's the actual pace of the decline. Should it be hitting a certain amount every month or is it going to be plus or minus because of different idiosyncratic elements?

Esther George:

Yeah. That'll be a function of the maturities as they roll off. Of course, we've made a commitment to a significant reduction in that balance sheet and getting back to a mostly treasuries portfolio, so there's work to be done on the balance sheet for sure.

Steve:

How about selling assets? Is that something that you favor?

Esther George:

I think it's going to be necessary at some point. Particularly given that we're in a higher rate environment, to get back to a treasuries only portfolio may require making some adjustments there at some point.

Steve:

I want to talk a little about the inflation process. How do you expect it to cool? Do you think, is it housing that comes down or the housing price that comes down? Is it consumer spending that comes down and eases off the pressure on consumer prices? What's the process in your mind?

Esther George:

So I think the process we've seen a little bit of already, so we've seen in the housing, some cooling beginning at that point, I guess when I look at the inflation dynamics right now, though, we have a fundamental imbalance still between supply and demand. It is very broad-based when we look at the drivers of inflation right now. So what we saw in July, we saw some airfares coming off there. We saw hotel accommodations, car rentals, those kinds of things, but those were pretty specific categories. I think we're going to have to see something more broad-based to begin to know that inflation is coming off its highs.

Steve:

Does the unemployment rate need to rise to bring down inflation?

Esther George:

So the labor market is very tight and I suspect to get some loosening in that labor market, you will see higher unemployment.

Steve:

That leads to the next important area here. It's really a three-part question. I'll give you the first two parts now. Is it already a recession or will it be a recession?

Esther George:

Yeah, so it's an interesting question that comes up because, again, when I talk to contacts in my region, the things I hear would not be consistent with what you might hear during a recession. Difficulty finding labor, a tight labor market, wages rising, adding jobs every chance they get. So, that dynamic is not clear yet despite the fact that we had two quarters of negative GDP and added three million jobs, so it is an unprecedented situation when you think about recession dynamics.

Steve:

What does Esther George, the Kansas City Fed President say? Is it a recession?

Esther George:

I think what we see right now is demand is cooling, and I'm going to be watching that data very carefully to see how much it brings this imbalance back to something to get inflation down.

Steve:

If it is a recession ... This is the third part of the question ... how does that change policy or does it?

Esther George:

Well, I think there are always factors that are going to influence our policy that we can't anticipate. For right now, given the dynamics we see in the economy, our charge is pretty clear and that is to bring inflation back to our target. That remains the focus even as we watch what's going on around it, and right now that seems pretty clear on the path ahead.

Steve:

So just to understand that sequence, if it seems like it's a recession and the growth is negative and unemployment rate is rising, that wouldn't necessarily change policy if you're still above target.

Esther George:

Well, when you say, for example, unemployment rising, we're at 3.5%. If we think about a natural rate of unemployment, if we think about what I might have penciled in my own forecast, it is well below that number. So, you could see unemployment rise and begin to provide some easing there along with other dynamics in the economy, and it's just hard to predict which one of those will end up being the stronger factors in bringing inflation down.

Steve:

The title of the conference is Constraints on the Economy. Can you give a preview of what kind of topics that leads to the discussion?

Esther George:

I'm looking forward to this conference because we're going to talk about reassessing constraints in terms of how we've thought about it over the past couple of decades. So, over the past few decades, as you know, the issue has really been, do we have enough demand in the economy? We had relatively low inflation. We now are focusing more on supply and what a supply shock has done, the inflation that's accompanied that, the kinds of policies that have come along in the past two years. So I think it's a good time to revisit those constraints as we've talked about them in the past and see what it means in the current environment.

Steve:

When we talk about those constraints, you talked about some of them already. One of them is labor. Another is supply and that's globalization. Is it possible we're entering a period here of higher inflation because the things that kept it down in the past have gone away?

Esther George:

Well, I don't know if they've gone away. I think the question will be, we've talked a long time about demographics and what effect they've had on long-term growth in the economy. So I think the question is what else is going on maybe that we weren't thinking about? What other factors? I think that's what will be interesting in this conference is to hear perspectives on what's changed. What have we not paid attention to that we should pay more attention to now, and what role has policy played in any of this that might change how we thought about it?

Steve:

I want to get to that in just a second, which is really important, but if it is a world of more constraints, more constraints on supply, more constraints on the supply of labor, the supply of goods, does that mean a world of higher federal funds rates?

Esther George:

It could mean higher funds rates. Right now we're looking at inflation and trying to decide how sticky is inflation. It's so broad-based now, what will it take to bring that down? I think for the near-term anyway, thinking about higher interest rates seems reasonable to me. Whether in the long run, again, I hope this conference shed some light on that.

Steve:

You talked about policies. The Fed Chair, others have acknowledged there were mistakes made along the way. I don't think we need to go over that ground. I guess the question I have is if mistakes were made, is there an examination process of how to fix it such that they're not made again in the future?

Esther George:

I think that's always important for the Central Bank. As you know, Steve, we've had a process that created the framework that was put in place a few years ago. The idea of periodically taking a look at how we set policy, how those strategies are fulfilling our mandates and doing that, so I suspect over the next few years, that's going to be an important component to look at.

Steve:

It's unfortunate that one of the things that's blamed for the mistakes that were made is the new framework. The idea of waiting until inflation was obvious before you acted. Is that seen as a mistake, something that needs to be looked at again?

Esther George:

I don't think the frame. I wouldn't put the burden on the framework. I would put the burden on the experience we've had the last two years. This was an unprecedented shock to the economy. We didn't have a playbook around pandemics. We also saw fiscal policy responding in an extraordinary way, so I think there certainly will be things we need to learn from that experience in thinking about the role of policy, how we judged inflation dynamics over that period, but I wouldn't lay it at the feet of the framework per se, given the nature of what we've been through.

Steve:

One thing that seems a little troubling is throughout the process from the beginning of the easing through the extended easing while inflation was going on, most of the votes were unanimous for policy. Those unanimous votes, in retrospect, where mistakes. Is there a danger of a groupthink that needs to be examined at the Federal Reserve?

Esther George:

Well, I think it's very important, and the committee process provides for the ability to bring different views to the table. You also know there's not a vote of the entire committee, so the voices that are at that committee, whether they're voting members or not can affect how the public views whether the consensus was there, but I will tell you. Being one that values having the diversity of views, the opportunity to dissent is an important component of how this committee makes decisions.

Steve:

It didn't happen. It didn't happen.

Esther George:

It did not happen, and you'd have to talk to everyone because it's a very individual decision how you come out on those. I will say it was a time of high uncertainty. Again, going back to, I don't want to overuse the word unprecedented, but it was, in terms of judging what was happening in the economy, whether this supply shock would be met, whether the demand would be met in some way, so a lot of retrospection to think about there.

Steve:

Okay, so your 10th Jackson Hole conference as President and you've been coming since 2005, which I think that's 17 years. What stands out in your mind in memories?

Esther George:

Well, every one of these conferences is unique in some way, but I think the thread that I always walk away from is the opportunity to bring really intellectual rigor to some of these topics that are of importance to global central banks, to have that debate in the room. Then the opportunity in this beautiful setting to be able to continue that conversation throughout the conference. So that is, I think, always the highlight for me is listening to that debate, listening to how people think about these issues and coming away, I think, with a better understanding, hopefully.

Steve:

All right, I'll give you mine. Okay?

Esther George:

Great.

Steve:

I'll tell you two that I remember. I remember complaining bitterly about the Demographics Conference and using the information for many years to come and still today. The other one I remember from that same conference was when Allen Greenspan said, "We don't know a lot that's definite about economics. We have no given constants, but we do know the vast number of people who are 35 years old now in 30 years will be 65." That was one of my favorite clips. That one, he told me to look at productivity. Anything, a particular anecdote that stands out for you?

Esther George:

This is our 45th symposium. When you think over that span of time, about how many things have changed. We had the Asian financial crisis. We had the Eastern European block beginning to come to the conference and raising issues about how they would think about monetary policy. So, I think any number of those. 2007, we talked about housing finance, and a lot of people at that time said, "What kind of a topic is that for central bankers to talk about?"

Steve:

Didn't somebody stand up and make a warning in 2007 that was dismissed at this conference?

Esther George:

Yes, there was. There were questions about financial stability that actually came a few years earlier and actually turned out to be pretty prescient.

Steve:

Anything else, Esther, that you want to add? Did we get everything?

Esther George:

No. I'm delighted we're back here in Jackson Hole again and the chance to engage in this topic.

Steve:

Thanks so much, Esther.

Esther George:

All right.

Steve:

Great. Bye-bye.