**Fed Unfiltered, Transcript**
**8/26/22 – Loretta Mester, Interview: Bloomberg TV**

Speaker 1:

You were in the room. Did he give from your perspective, the way you look at the markets, did he give the message that you felt needed to be given?

Loretta Mester:

I think that was a very strong message and I'm certainly aligned with that. This is not a short campaign here. It's going to take time and more Fed work and more Fed attention to get inflation on a trajectory down to our 2% goal when we're all in and we're going to be resolute about it. So, I thought the message was strong and right.

Speaker 1:

Resolute, from your point of view, what does that mean?

Loretta Mester:

Resolute means that this is not a quick fix. We're going to have to bring rates up from their current levels and continue doing that until we see compelling evidence that inflation is moving back down towards 2%. And until it does, we're going to have to just be very resolute in that being our goal. The July inflation report was welcome news, but we really can't let wishful thinking substitute for compelling evidence. So, we need to see a lot more data. I personally need to see a lot more convincing evidence than inflation is moving back down.

Speaker 1:

Do you have a feeling about September 21st? You get more evidence of the jobs report and the CPI report before then, but are you leaning one way or another at this point?

Loretta Mester:

I mean, I want to wait until the data comes in. I mean, as the markets assume it's going to be 50 or to 75, that's where my head is. It's going to be one of those two, but I do think that we're going to have to move interest rates up from current levels. So, I want to see that data, I'll assess it, look at the decompositions of the inflation data more carefully, and also the inflation expectations data I think is very important as well.

Speaker 1:

We had good news on that front today, the Michigan numbers come down, obviously gasoline, but they're still elevated. Do you still have any concerns at this point that we have seen any kind of expectations get built in?

Loretta Mester:

Well, I do think we're at the upper of the range of being longer term inflation expectations, being consistent with 2% inflation. I don't think they're over that range yet, but I think we have to take it very seriously when we see those levels being elevated and sustained elevated because if inflation expectations were to move above levels consistent with 2% or long run 2% inflation goal, then getting inflation back down will be that much harder and that much more painful. And so, that's why I'm very focused on that as well, as well as the other data on inflation to be able to assess how much demand moderation is happening, how much supply change is happening because we really have an imbalance in demand and supply. Of course, the Fed tools work on the demand side supply, so-

Speaker 1:

We thank you for lowering gasoline prices. That's the one thing you can't control here. And that is obviously a danger going forward, you don't know what's going to happen.

Loretta Mester:

Well, but there are upside risks there, right? Because we know that the European situation with Ukraine and the Russian supply of oil, those numbers are coming out or that environment means that probably gasoline prices may not be sustained at lower levels. So again, I don't think this is a time to declare victory over inflation. There's a lot going on in the economy that will affect inflation going forward and we just have to be very resolute. If you look at services inflation, rents are still very elevated and rents flow through into those underlying inflation numbers with a lag. And so, again I think there's reasons to be cautious on declaring that inflation is peaked and cautious in thinking that it's on a trajectory moving down and that's the approach I'm taking. I really need to see convincing evidence of that before I would say that we can ease off of our need to raise interest rates.

Speaker 1:

Chairman said that the goal is to get rates to a slightly restrictive stance, which he said, you look at the summary of economic projections from June and it was around 3.4%, 3.5%, but he caveated that by saying "September 21st, you have a new set of projections." Have you changed your view on where you think the terminal rate needs to be?

Loretta Mester:

So, there's a lot of confusion out there about what that 3.4, that's a long run. There's a long run neutral and a short run neutral. And if you think about where inflation expectations are and you think about what's a real rate, a neutral real rate, that's like about a half a percent. We're still a negative real rates. So, we haven't even gotten to a neutral in that sense, Fed funds rate. So, we're going to have to move rates up. I mean, I think we're going to have to move them up and this is based on just my current rate of the data above 4% and probably need to hold them there next year. So, in other words, move them up to slightly above 4% sometime early next year and then just keep them there in order to get this inflation under control and back down to 2%.

Speaker 1:

The markets looked at what the Fed has been saying about that and say, we don't think they can do that, that we're going to see recession going forward. Are you willing to go into recession to maintain rates at that level?

Loretta Mester:

Well, I think we're going to have to assess demand versus supply, right? The imbalance there. But I do think we have to see inflation coming back down because even if growth and I do think growth will be slow. I'm not projecting a recession, but I do think we're going to have below trend growth this year and into next year. But I think that's necessary in order to get inflation under control. And we'll see increasing in the unemployment rate unfortunately, but I don't think excessively deep in terms of either a pullback and growth or labor markets being totally disruptive because the labor market is so strong right now. It's still very tight. We have labor demand really outpacing labor supply.

Loretta Mester:

So again, there's reason to think that yes, we're going to see a slowing. In fact, our policy is intended to work on that demand side, but there's also reason to think that it may not be prolonged or deep slow down. It could very well be that we have to have some slow down, but it won't be one that's really a painful one in terms of the longevity or deepness in it that said, we're going to have that. I mean, and if we don't have that, I don't think we're going to get inflation moving back down and that'll create more problems. It'll be very painful. We won't be able to get the strong labor market conditions we had in the last expansion unless we get this inflation down.

Speaker 1:

We're speaking with Loretta Mester, the President of the Cleveland Federal Reserve Bank who was in the room as Chairman J. Powell spoke today. Some of your colleagues argue for a go slower approach in terms of raising rates to that restrictive level because they're concerned about long run lags. And some of the others we've talked to say, that's not really an issue because policy lags are much shorter these days. And so, we don't have to worry that a year from now we're going to be choking the economy. Where do you fall on that spectrum?

Loretta Mester:

Well, I do think that because of the forward guidance that the Fed gave when it pivoted, you saw the financial markets react probably sooner and more sharply than typically. But that doesn't necessarily mean that the real economy is going to the effect of the policy changes on the real economy are going to happen faster. So, I think I'm agnostic on that. And even when we say long and very relaxed, it's the long and variable part. So, six months to 18 months is still a long time. So, that isn't really a frame that I'm using to sort of determine where I think appropriate policy is. Rather I'm going to be looking at the data and what it's informing me about the outlook.

Loretta Mester:

So, I know a lot of people say, "Well, why are you looking at data talking about the past and not looking forward?" I am looking forward, but the data helps inform my outlook for the economy and assess the risk to that outlook. And so, I'm looking forward and I think we have to with policy. So for example, I don't believe it would be appropriate to continue raising rates until inflation is down to 2%. We're going to at some point have to pause, keep rates probably at an elevated level for some time and then make sure that inflation is on that downward trajectory.

Speaker 1:

What do you see or what are people telling you in your district, both businesses and consumers, about how they feel about the economy? Because there's a potential self-creating problem there.

Loretta Mester:

I think there's a lot of concern about the future. If you talked to businesses now, a lot of them say things are still really good. I still have orders. I have a backlog of orders. The manufacturers will say, so I think that activity will stay relatively strong this year. It's about the future. It's about what's going to happen next year and going forward, and same on the consumer side when you talk to households, they're struggling with this inflation. I mean the inflation is very painful and that's why it's so imperative that the Fed do this action to get that inflation under control. But again, most of it's not about necessarily the current situation, it's really what is the future going to bring? And that's why it's very important for the Fed to be doing actions now, so that the future can be a better future.