Fed Unfiltered, Transcript
1/4/22 – Neel Kashkari, Interview: Q&A with the Wisconsin Bankers Association (WBA)

Rose Oswald Poels:

Welcome, everyone, to the Midwest Economic Forecast Forum. My name is Rose Oswald Poels, and I am the president and CEO of the Wisconsin Bankers Association, and it is truly my honor to be the moderator today for two terrific economists that we will get to hear from and their outlook for 2022 here today. I want to welcome all of you. We're expecting over 500 people to today's program, which is outstanding, and coming from several different states. Joining the Wisconsin Bankers Association in hosting today's event are the Bankers Associations from the states of Illinois, Michigan, Minnesota, Montana and South Dakota, and we have bankers from across this Upper Midwest region joining us today. So again, welcome to all of you.

Rose Oswald Poels:

I also want to take a quick moment to thank our sponsors for today's program: BOK Financial Institutions Groups, Bankers' Bank and Wipfli LLP. Thank you all very much for sponsoring our program today.

Rose Oswald Poels:

It is my pleasure to introduce our first speaker, and I'll go through the format here. We're going to have some prepared remarks from him, and then I'll moderate a Q&A and then also encourage any of you to put questions in the chat, which I will, if time permits, get to those questions as well at the end of this session, and then we'll move to our second speaker for the second half of today's program.

Rose Oswald Poels:

So joining us first is President Kashkari, who is the Fed president for the Minneapolis Fed. He is the president and CEO, and he has served in that role since January 1st, 2016. He serves as a member on the Federal Open Market Committee, bringing the Ninth Federal Reserve District's perspective to monetary policy discussions in Washington, DC.

Rose Oswald Poels:

In addition to those responsibilities, President Kashkari oversees Minneapolis Fed operations and leads its many initiatives. Among them, he was instrumental in establishing the Opportunity & Inclusive Growth Institute, whose mission is to ensure that world class research helps to improve the economic well-being of all Americans. Most recently, he has joined with retired Minnesota Supreme Court Justice Alan Page to propose amending Minnesota's Constitution to make quality public education a fundamental right. This effort supports the Fed's mandate to achieve maximum employment, with education being a key to obtaining a good job.

Rose Oswald Poels:

Neel earned his Bachelor's and Master's degrees in mechanical engineering from the University of Illinois. He became an aerospace engineer, developing technology for NASA missions. Eventually turning to finance and public policy, he earned his MBA from the University of Pennsylvania's Wharton School, joined Goldman Sachs, and served in several senior positions at the US Department of the Treasury, including overseeing the Troubled Asset Relief Program, or TARP, during the financial crisis. Before joining the Minneapolis Fed, he ran for governor of California in 2014, on a platform focused on economic opportunity.

Rose Oswald Poels:

So please join me today in welcoming President Kashkari. I will turn it over to you for your remarks. Thank you very much for joining us.

Neel Kashkari:

Thank you, Rose. It is great to be with you and great to be with all of your members here today. I really appreciate the opportunity.

Neel Kashkari:

Let me just spend a few minutes and talk about, first of all, why I'm here and why I jumped at the chance to meet with you today. The Minneapolis Fed is the 9th of 12 Federal Reserve banks around the country. When the US Congress created the Federal Reserve back in 1913, they did something unique. They didn't want the central bank simply housed in the nation's capital. They wanted it distributed around the country, so that all of the regions of our country could have a voice in monetary policy making, so they created 12 independent reserve banks. The 9th is the Minneapolis Fed. Our Federal Reserve Bank represents Minnesota, North and South Dakota, Montana, the upper peninsula in Michigan and Northwestern Wisconsin.

Neel Kashkari:

So a big part of our jobs are to know what's happening across our regional economy, and what I just described is a large region with a lot of variability, to know what's happening across that economy. And then when I go back to Washington DC every six weeks, virtually right now, but hopefully back in person soon, part of what I'm doing in those Federal Open Market Committee meetings is talking about what's happening here in our regional economy. Now, we can't set a different monetary policy or a different interest rate for Wisconsin than for California. We all use the same dollar, that's our currency, so we have to pick one monetary policy, one interest rate for the nation as a whole. But we want to make sure that this region and what's happening here is part of that deliberative process.

Neel Kashkari:

So, meetings such as this are a great opportunity for me to, not only share my thoughts with all of you, but to hear from you, what's happening in your communities, to make me smarter, so that when I go back to Washington DC, in person or virtually, I'm able to represent Wisconsin and this region in that deliberative process. So thank you again, and I'm really looking forward to getting to our Q&A, so we can have the back and forth and I can hear from you what you're seeing, what challenges you face, and what's top of mind for you.

Neel Kashkari:

Now, prior to the pandemic, we had a strong economy. We had very low unemployment. We had a long expansion. While we were hearing from many businesses that they couldn't find workers, one of the really positive surprises was that, as the economy got stronger, as wages started to climb, we started to see more workers take jobs. And so it turns out, there was more labor supply out there than we appreciated, and that was really good, good for the economy's potential, good for our communities, and good for those workers who were able to get jobs, and of course their employers to put them to work. So things were looking quite good.

Neel Kashkari:

But we were also seeing, overall, a moderate growth environment. We were seeing low inflation, and we were seeing long-term low interest rates. This was a phenomenon that was taking place all around the world, that we think was driven by things like demographics and technology and trade. Central banks like the Federal Reserve can move interest rates up and down in the short term, but long-term interest rates are really driven by economic fundamentals, and we have to try to assess those fundamentals to determine what makes sense in the short run. But those fundamentals are driven by economic factors out of our control.

Neel Kashkari:

Well then, the COVID shock hit. COVID came out. Nobody was expecting it, I don't think. Certainly, we weren't. The economy went through a very rapid shutdown, partially by government mandate, but also just by individuals and families and businesses taking effort to protect themselves, and now the economy has been trying to reopen and recover from that. The recovery is uneven. On one hand, GDP has fully recovered. It's a very strong bounce back. But different sectors have been affected differently. And many workers have found jobs, which is great news. And while the unemployment rate has come down, we're still about 4 to 6 million workers short of where we should be, had there been no pandemic. And so, I think the economic recovery is well under way, but it's been uneven and there are still some big gaps.

Neel Kashkari:

One of the big surprises over the past six months to nine months has been the high inflation that we have seen in the economy. I have been strongly in the camp of, we think it's going to be transitory. What do I mean by that? We think that as the COVID shock passes, as the economy returns back to normal, there should not be a permanent change in the inflation rate that we've been seeing, that it should go back to the low inflation that we saw prior to the pandemic. But the truth is, inflation has been higher than I expected, and it has lasted longer than I had expected. And so, the key question is, is it so good to be transitory or none? How long is it going to last?

Neel Kashkari:

This morning, I published an essay on our website, in Minneapolis Fed that you can check out, that goes into this in a lot more depth. Basically, I see both demand side issues and supply side issues that are causing high inflation. On the demand side, the US government and many other governments around the world were very aggressive in supporting families and businesses to help them get through the pandemic. In fact, in the US, the fiscal stimulus far exceeded the income that was lost by families from the pandemic, and that led to a net stimulus for the economy. And at the same time, services sectors were closed, so families had to shift to spend more money on goods. So, because of these dynamics, we saw a big boost in demand in certain sectors of the economy. Well, that fiscal stimulus, we can map it out. We know that, what is currently a stimulus is rapidly going to become a fiscal drag, as that stimulus begins to fade. So, I have a lot of confidence that the demand boost is going to be temporary in nature.

Neel Kashkari:

What about the supply side? Well, we've been talking to a lot of large businesses that have global complex supply chains to understand, when is the supply side going to normalize? When are workers going to return? When are the kinks going to get worked out? And on that side, it's much less clearer how long it's going to take. Many large companies that I have spoken with have said, they don't see things getting better in the near term. They're global companies. They're always dealing with supply chain issues, but some companies said they're dealing with 10 times as many issues as they normally are, because of the COVID effects, because maybe it's a factory in Asia that shut down, or maybe there are not enough truck drivers. A lot of these different things are happening at the same time.

Neel Kashkari:

And as soon as they put out one small fire, something else flares up in another part of their global supply chain. And so when I asked them, "When do you expect your supply chain to get back to normal?", most could only venture a guess and say, not in 2022, maybe in 2023. And of course, with COVID ongoing, with new variants such as Omicron, it's really unclear to me now how long it's going to take for supply chains to normalize. And so, these are the things that I'm focused on. I have a lot more confidence that demand is going to normalize fairly quickly. I've got less confidence in how long supply is going to take. So what does this mean for the Federal Reserve, and what does this mean for monetary policy?

Neel Kashkari:

I see it as fundamentally as facing two different risks. One risk is that this high inflation that we're seeing leads to a change in long-term inflation expectations, so they go up. And if long-term inflation expectations go up, that could then lead to and become a self-fulfilling prophecy of high inflation in the future. That could be very costly to the economy and to families and communities. And I know, none of my colleagues at the Federal Reserve want to let that happen.

Neel Kashkari:

On the other hand, once the COVID shock passes and things start to go back to normal, and workers fully return and demand goes back to normal, I don't see any reason why the economy wouldn't revert back to the low inflation regime that we'd been in for 20 years, because things like trade, technology and demographics, it doesn't seem like those things have fundamentally changed. If anything, the demographics have gotten worse, which means that we're more likely to end up back in the low inflation regime. So I see these two very different risks that we at the Federal Reserve have to navigate, and it's going to be a tricky test to navigate these two possible different outcomes. And hopefully, we can monitor what's happening over the next six months, over the next year, both on the demand side and on the supply side, to determine what the right course is for monitoring policy.

Neel Kashkari:

I've explained all of this fairly quickly right now. I know, with Rose, we're going to get into Q&A. We can get into this in a lot more depth. And of course, there's a lot more detail on our website at minneapolisfed.org, where I laid all of this out in a detailed essay this morning. But, I thank you again for being here. Rose, I look forward to our conversation, and then our conversation with your members. Thank you.

Rose Oswald Poels:

Well, great comments, and yes, you're right. We're going to get into a little more detail on a lot of the points you just raised here. Why don't we start out with, first of all, how would you assess the overall conditions, either in the state of Wisconsin or across your district, since we have many members and bankers and business owners watching today from across the footprint of the 9th District, compared to the nation overall?

Neel Kashkari:

I think, overall, our region looks a lot like the nation. Our region is large. Our region is diverse. All the major sectors of the US economy are represented here in scale. There are differences. So, if you look at Wisconsin versus Minnesota, Wisconsin started recovering more quickly than Minnesota did. But then the recovery's been slower over the last six months to the last year. The ag sectors, obviously, agricultural markets are different across our region. Wisconsin was less affected by the drought than some other states in our region. So, I would say that Wisconsin is recovering more slowly than some parts of our region. But overall, our region as a whole looks a lot like the US economy.

Neel Kashkari:

And of course, what happens with the variants, what happens with COVID, is going to continue to have a big effect on the economic recovery. And I'm not talking about governments now mandating lockdowns. I'm talking about, if Omicron continues to spread as rapidly as it is, we're going to continue to see disruptions, just because workers are going to get sick, workers are going to have to stay home, and that's going to be a damper on economic activity.

Rose Oswald Poels:

Yeah. We certainly saw that over the holidays, with the airlines talking very publicly about that. And in Wisconsin, we've seen a lot of the larger metropolitan areas across the state delay school openings. Many were supposed to have kids come back yesterday, and they are waiting a whole nother week before they start school again. So, all types of disruptions we've had to manage and navigate through, for sure.

Rose Oswald Poels:

How would you characterize conditions in some of the state's more visible sectors, like manufacturing, ag and construction? Again, this spans across the footprint of the district.

Neel Kashkari:

I think, overall, quite well, but each has their own challenges. I mean, I think the manufacturing sector, because the goods sectors were less directly affected by the pandemic, we saw this shift from services to goods. Families couldn't go out to bars or restaurants or gyms, or they couldn't travel, so they ended up spending more money on goods. So generally speaking, manufacturers in the country and in our region did quite well. But they had their own challenges. They had supply chain issues. They had transportation bottlenecks. They had labor shortages as well. But relatively speaking, manufacturers have done quite well, and continue to do quite well.

Neel Kashkari:

Ag sector has been mixed across the region. The drought has been a big factor. But in Wisconsin, a lot of Wisconsin farmers have done pretty well because the drought has been less severe there. But of course, dairy producers have had their own challenges in Wisconsin, which has been a real challenge for those folks. So I would call that quite mixed, but overall, I think, quite optimistic in terms of where they're headed from here.

Neel Kashkari:

And then construction and the real estate market has been strong across the country. Again, there have been labor shortage complaints. There have been challenges with material prices. We saw lumber prices skyrocket. We saw lumber prices then fall. Now, they've come back up again. Obviously, that's good for the lumber mills, and Wisconsin has a lot of forestry products, which should be able to benefit from that. But if you're in the construction business, that obviously is affecting your bottom line and affecting affordability for your customers. So, overall, the real estate sector has done quite well. I think the analysis that I saw said that Wisconsin's real estate and housing market has not been as robust as some other markets, but overall, it has done pretty well.

Rose Oswald Poels:

Right. Right. And certainly, on the ag side, the federal stimulus that has occurred over the last 18 to 24 months has been helpful too, so.

Rose Oswald Poels:

Can you explain, maybe in some more detail, the Fed's dual mandate from Congress, you hinted at this earlier, the interplay of these two mandates, and how the Fed's thinking has evolved, in light of higher than expected and, as you noted, much longer in duration inflation?

Neel Kashkari:

So, our dual mandate that we talk about is stable prices, which we define as inflation at 2% per year, and we've said now that we want to try to average 2% over time, and maximum employment, as many Americans as possible gainfully employed and contributing to our economy. And we normally think of these two things as sides of the seesaw, where you're trading off these two. If the economy gets really strong, you would see businesses hire a lot of people. The unemployment rate would go down. Businesses would've to pay up to get their workers, which would lead to higher wages and higher inflation. And so, inflation would go up while the unemployment rate would go down. And then in that situation, you would traditionally raise interest rates to try to balance that out.

Neel Kashkari:

Now, in the many years before the pandemic hit, we saw a curious thing. The unemployment rate kept going down, but wages were staying low and inflation was still low, which suggested to me that there was still slack in the labor market, and it was not time to raise interest rates because we needed to absorb that slack. It was an easy position to take, because in a sense, it was a free lunch. We were undershooting on both sides of our mandate, so it's easy to say, "Hey, we ought to be more aggressive."

Neel Kashkari:

Well, it's more complicated now. Undeniably, we have high inflation, higher than our 2% target. And, by some measures, the labor market has recovered. I hear a lot of businesses say they can't find workers. There's a worker shortage. Businesses are always telling me there's a worker shortage, but I'm more sympathetic now, because by many measures, it actually looks like the demand for workers is exceeding the supply of workers. And the evidence is, wages are now climbing across the board, and they're climbing fastest for the lowest income workers. And at the same time, we have 4 to 6 million workers who are missing from the labor force.

Neel Kashkari:

So now, if we really are at a place of high inflation and maximum employment, then that would be a time for the Federal Reserve to say, "Okay. Now we may need to change the approach to monetary policy to start to reduce accommodation, or to start to tap the breaks." These are complicated judgments that the committee's going to have to make, but it definitely is a different environment than it was the four or five years prior to the pandemic hitting, when basically there was slack on both sides of our mandate.

Rose Oswald Poels:

Right. Right. Great point. So as you mentioned earlier, supply chains continue to be widely cited as a big factor for recent price increases. Why haven't the markets really managed to repair this more quickly than we might have expected?

Neel Kashkari:

It's a good question. I think that they are, individually. Certain supply chains get sorted out, but then new things are emerging. If you just think about 4 to 6 million workers effectively missing from the labor force, well, there's also a lot of reallocation going on. So if you look at it, when I talk to big companies, they say, "You know what? We actually have truck drivers to drive around locally. What we're struggling with is finding long haul truck drivers." And then I saw comments from some union leaders representing long haul truck drivers. And they said, "Stop complaining about long haul trucker shortages. These jobs stink. You're away from your family for a week at a time. These are really, really hard jobs." And so what I'm seeing is a reallocation of workers away from jobs, not that these are not important jobs, but away from jobs that are particularly challenging, to jobs that may offer similar wages and have a better quality of life.

Neel Kashkari:

So it seems like there's a reallocation going on right now. A lot of churn, as people say, "The job market is tight. I can go find a better job for me right now and for my family." And so those... Then that creates gaps in where they left, whether it's long haul trucking or it's healthcare workers. For example, in nursing homes or in childcare centers, there are a lot fewer jobs in childcare centers than there were prior to the pandemic.

Neel Kashkari:

Well, anyway, I could go on and on about this, but I see a reallocation that's going on. And as workers are reallocating, that is introducing new strains into the sectors that they are leaving, and challenging those jobs, those companies, to go try to adjust to that new reality that they're facing.

Rose Oswald Poels:

No, I think that's a great point. And, you're touching a little bit on the next question I have for you. You're right. Workers are making a lot of their decisions on quality of life. When I was growing up, my parents drove home the idea that you just go and work hard and do your thing. Be loyal to your company and don't ask a lot of questions, so. What have you learned about today's labor markets, and particularly labor supply during the pandemic, that maybe wasn't obvious before?

Neel Kashkari:

Well, one of the things that I learned before the pandemic was that, the vast majority of Americans want to work. Every time businesses told us, "We're out of workers," as wages started to climb, workers came back in. And that was resoundingly positive for everyone, for businesses, for communities, for the economy as a whole. I still believe that's true. I don't think people all of sudden say, "I'm never working again." But we have a lot of things that are going on right now that have created changes. On one hand, we've seen a lot of fiscal stimulus that's gone to the economy. And families across the income spectrum, their savings have gone up a lot, which is good. But that also means they have more options and they can take more time to find the job that suits them.

Neel Kashkari:

We also still have a lot of fear about the pandemic. We still have a lot of... I mean, Omicron is exploding with cases around the country. The good news is, the vaccines are quite effective in protecting us from serious health outcomes. But there are a lot of people who are still nervous about going back into the service sector, back into their old job, where they don't want to get COVID or they don't want to bring it home, if they have a family member at home who's particularly vulnerable. So, these things are... What I see is that, the demand for labor has recovered more quickly than the supply of labor, but I am not at all ready to write off that supply of labor. I do think it's going to come back. I just think it's going to take longer than we appreciated, than I appreciated certainly, for people to feel comfortable to go back into the job market. But we need them to come back into the job market for all of our sakes.

Rose Oswald Poels:

Yeah. That's very, very true.

Rose Oswald Poels:

So let's talk a little bit about the banking industry, specifically... The onset of the pandemic certainly presented unprecedented challenges for all types of businesses, including the banking industry. What is your impression of how the banks, particularly in your district, have managed through this unprecedented time?

Neel Kashkari:

I think the banks in our district, we have a few large banks, but mostly, we have mid-size and smaller banks, I think they've managed exceptionally well during the pandemic. And I got to tell you, since I joined the Minneapolis Fed six years ago, we always hear community banks talk about the role they play in their communities. And it always sounds good. And it's like, love community banks, right? You know what I'm talking about.

Rose Oswald Poels:

I do.

Neel Kashkari:

I think the pandemic hit and they actually did it, right? We saw this firsthand, when many businesses that I talked to said, "We had longstanding relationships with very large national global institutions." And, when they needed to call on them to get their PPP loan, they never heard back from their large institution, or their large institution was unable to help them. So they turned to then a community bank who was able to step up. And so I think we really saw community banks step up, very powerfully, to try to get support out to small businesses, mid-size businesses, even large businesses across their region. That was great to see, and I'm really appreciative of the fact that community banks could play that role.

Neel Kashkari:

In any type of crisis, whether it was the '08 crisis where I was at Treasury, or now this COVID crisis, there's almost no way for the government to set up a new program, the government being the Treasury, the small business administration, the Fed, to set up a new program and then directly reach thousands and tens of thousands of small businesses across the community. I mean, it's impossible to set up a new program in the middle of a crisis. You need to go through people who already have those relationships. And that was, we had to go through the community banks.

Neel Kashkari:

And so, at the Minneapolis Fed, we spearheaded the PPP Liquidity Facility, on behalf of the Federal Reserve System, working with all of our colleagues around the system. But that conduit was through small banks, largely, across the country. And so, I have nothing but admiration for the way the community banks, not only adjusted their own business practices to keep their employees safe and to continue to operate, but the role that they serve in getting relief and support out to their communities. We are all grateful for the role that community banks played.

Rose Oswald Poels:

Well, it is nice to hear you say that. Thank you. And, as you mentioned, the banking industry across the country did a phenomenal job, and jumping in, really, overnight to try to help stem the crisis. And, with the support of the government funding and the program, I think PPP proved. Largely, there's obviously aberrations here and there, but largely, was a huge success and did what it was supposed to do to really help people get through a tough time in a very short period of time.

Rose Oswald Poels:

So, during the crisis, banks were looked to, certainly, as advisors, a source of help, as we just talked about in the PPP context, and then, frankly, what they've always been known for, as a trusted, safe place for people's money. And so, we saw a huge influx of deposits into the banking industry, from extra money maybe people had from government stimulus programs, and just an overall flight to safety. While the increase in deposits has slowed, certainly, most bankers are still expecting these levels to remain high for, again, a longer period of time than, I think, we all initially thought as well. We're also dealing with, as a banking industry, shrinking net interest margins and much lower capital leverage ratios, given the surge and deposits. Do you have any insights on how this situation may play out, and how banks should be thinking about this situation as they look to deploy liquidity?

Neel Kashkari:

Well, I mean, I think banks have done a good job through the crisis, managing their risks. And, our supervisors are in close contact with the banks that we supervise to make sure that they've got appropriate risk management. And I would just say, continue to manage your risk appropriately. I mean, one of the things that I find funny when I travel around the region, certainly pre-pandemic, and I meet with small banks, they'd always say, "Oh my gosh. You should see what the banks in my neighborhood are doing. We're not taking those risks, but those guys are." Every bank I've met with says, "We're not taking these crazy risks, but you should see what our competitors are doing." I just think everybody needs to continue to manage their liquidity, manage their credit risk appropriately. Don't get over your skis, because as we've seen, shocks can happen when we're not expecting them. We were looking for what's the next shock to hit. Certainly, it wasn't going to be a pandemic. That was not on our radar screen.

Neel Kashkari:

But I do think there's a lot of institutional learning in the banking sector over the past 20 or 30 years. We've had ag downturns before. We've had farm challenges before. We've had real estate challenges. Obviously, the '08 crisis was a profound real estate challenge. I do think that there's a lot of learning that the banking sector has, especially among smaller institutions, from what they went through then and saying, "We're not going to let that happen again." So, I don't have any silver bullet here for you. I know these are challenging times, for the reasons that you said. But I just think, continue to manage your banks with an appropriate risk management lens, so that you can endure and succeed for the long term.

Rose Oswald Poels:

Right. Well, and that's a strong partnership between the Fed as a regulator and the banks says the regulated institutions. And as long as there's good, open communication, I think we can work through these challenges together.

Rose Oswald Poels:

Given the changing ways banks deliver products to consumers, and the continued economic disparities across different communities, can you provide us with status update on the Federal Reserve's efforts to modernize CRA?

Neel Kashkari:

Sure. So, the Federal Reserve put out what's called an ANPR, a notice of proposed rule making to get comments on modernization of CRA. CRA's been around for a long time. I think the view is, and I agree with this view, time is to modernize it, to make sure that it's meeting the needs of communities all across our district and all across the country that we are charged to serve.

Neel Kashkari:

So, a lot of comments have come in and our colleagues at the Board of Governors and around the Federal Reserve System are going through those comments. And importantly, they're also working with colleagues at the FDIC and the OCC, so that together, they can come out with one set of rules that all the banks across the country, no matter who their primary regulator is, can follow those rules.

Neel Kashkari:

And so that process is ongoing. I imagine you and your colleagues have submitted comments on that. Thank you, if you have done so. Continue to be engaged in that process. We want to get it right. We think that CRA is really important. We think modernizing it is important for communities, but also important for the banking sector. And we think doing it in partnership with the other banking regulators is the right way to go. And so, I think the right people are looking at it, taking it seriously, and I'm optimistic we're going to have a really constructive final rule that comes out.

Rose Oswald Poels:

Well, thank you, and I echo that sentiment. We'd like all the regulators to work together on this as well. So, thank you for that.

Rose Oswald Poels:

We will move into the questions that have come in through the chat here. The first one is probably not super surprising, but a topic we haven't talked about yet. What is the Fed's perspective on cryptocurrencies? Do you think this is going to be the future payment form?

Neel Kashkari:

Well, I'm not going to opine on the Fed's perspective. We have colleagues that are looking at this, and expect to issue a white paper, just laying it out, laying out what are some of the trade offs. I'll give you my perspective. I have yet to hear anybody articulate an actual benefit to consumers from cryptocurrency. I'll just give you an example. So, first of all, digital dollars exist today. I could send you $5 right now via Venmo instantly. And as far as you and I are concerned, that is a digital dollar. So what is it about crypto that would be somehow better than me just Venmo-ing you $5?

Neel Kashkari:

Well, some people have said... Look at it from the government's perspective. What could the government do with the crypto, a digital dollar or a crypto dollar? In theory, the government could tax our transaction directly. So if I send you $5, there's no way for the IRS to tax my transaction to you. But if it was a digital dollar, in theory, they could do that. Okay. That's a benefit to the government. If the government wanted to track our transaction, they could do that as if it were a central bank digital currency. You can't do that with Venmo. And, if the Fed wanted to impose negative interest rates with a fed dollar, in theory, you could impose negative interest rates. So those are three benefits to the government from a crypto Fed dollar. But those sound lousy from a consumer's perspective.

Neel Kashkari:

So now, some enthusiasts say, "No, you're missing the point. We want the seamlessness of Venmo, but we want the anonymity of physical cash." Some people think that's the benefit. Well, I don't know any government in the world that is going to support the seamlessness of Venmo and the anonymity of physical cash. So I'm still waiting for somebody to articulate, what is the actual use case of this thing, that is better for consumers and better for the government? I'm yet to hear that. Now, I'm not ruling out. It's possible somebody could come up with it, but I've been asking this question for a while. And as of yet, nobody has been able to articulate it. So, so far, I hear a lot of excitement. I hear a lot of hype. But I haven't seen much substance underneath it. But I'm keeping my mind open to learn.

Rose Oswald Poels:

Yeah, and I'm just old enough to not understand this at all. I prefer cash. I still write some checks. So, crypto is really foreign to me either. And, you're raising a great point. I mean, it's just hard to know what the true benefit is from a consumer standpoint here.

Rose Oswald Poels:

The next question, and there's several like this, at what point would you feel that it's appropriate to let the Feds balance sheet decline versus maintain the level after completion of the taper? Is there a preference to use some of the Feds tools more than others, such as balance sheet, interest on excessive reserves, Fed funds target rate?

Neel Kashkari:

Well, the federal funds rate is our primary policy tool, moving it up and down. And, the question was, once we got down to zero, is the Fed out of ammunition? And we learned in the '08 crisis, no, the Fed could use its balance sheet through quantitative easing to try to drive down long-term interest rates and provide more stimulus to the economy. I think that the strategy that the Fed undertook, when it normalized its balance sheet last time, worked quite well. So, they expanded their balance sheet. Then they held it. Then it tapered. And then at some point, they started lifting off the federal funds rate, and then they tapered it to the new size of the balance sheet.

Neel Kashkari:

We know our balance sheet's going to grow over time, because demand for dollars continues to grow all around the world. So our balance sheet has to continue to grow just to meet that demand. So it's not going to go down to where it was prior to the pandemic, but I would expect it to come down. But the sequencing and the timing, that's going to be for the Federal Open Market Committee to deliberate upon. But I think all of us are still committed to the fact that our primary policy tool is the federal funds rate, and we want to get back to a place where we can use that as our primary policy tool, and only use these other tools when we need to.

Rose Oswald Poels:

Okay. The next question asks, our labor market is quite complex. Can you help us peel back the labor issue more deeply? What are the biggest challenges contributing to the current problems, and what are the solutions?

Neel Kashkari:

Well, 6 to 9 months ago, I was asked this question and we were focused on a few things. One is, we were focused on enhanced unemployment benefits, especially low income workers were getting pretty attractive unemployment benefits. And it seemed like, "Well, why should I go take a job if I'm making nearly as much money or the same amount of money on unemployment benefits?" So we said, "Well, once those expire, that will be a catalyst to go back to work."

Neel Kashkari:

We also said that, while schools were closed in the spring, when schools reopen in the fall, then it'll be easier for families with young children to go back to work because their kids will be back in school. They won't have to be providing support. And of course, fears of the virus. Once people get vaccinated and people feel confident, they can then go back to work.

Neel Kashkari:

Well, unemployment benefits expired, and we saw almost no uptick in labor supply, as a result of the unemployment benefits expiring. Schools have largely reopened, though you mentioned that some schools are delaying their reopen because of the Omicron surge. But generally speaking, schools have gone back to something like normal, and that has not provided a big boost of labor supply.

Neel Kashkari:

So what I'm left with is, I'm left with, that there's still a lot of fear that people have of the virus, a lot of fear of going back out, getting exposed, maybe going back on a subway if they need to take a subway back to their old job, going back to that in-person service industry that they used to be in. And we also know that a lot of families have some excess savings built up that they're able to lean on right now. But our estimates are, especially for low income families, those savings are being fairly quickly spent down, and that's probably going to put pressure on them to go back into the workforce. So, it's a complicated picture. We do not have a clear one explanation or two explanations for what's going on here.

Neel Kashkari:

But I do know that we're missing 4 to 6 million workers who otherwise would have been there, had there not been the pandemic. And we know some people have retired. Older folks have retired. They said, "Hey, I don't want to work. I'm just going to retire." But that's not necessarily a one-way street. In the last expansion, there are a lot of people who retired, who then turned around and got jobs, because they were good jobs available at good wages. And so, I hope we can bring some of those recent retirees back into the workforce, because they still have a lot to contribute.

Rose Oswald Poels:

For sure. A related question on the Fed's balance sheet here, and it's a little long, so you'll have to bear with me here. The Fed's balance sheet doubled in the '08 recession, and again in the '20 COVID. Will this ever return to the early 2000 levels? Has this balance sheet growth the only thing that has supported the growth? With all the money from COVID support, is not the Fed concerned about just too much money in the system? Is that not what inflation really is, too much money chasing too few goods? It just seems all the COVID stimulus has put too much money into the system.

Neel Kashkari:

Well, there's a lot under that question. First of all, the balance sheet is not likely to return to the size it was 20 years ago, for a couple of reasons. One is, I just said that the demand for dollars, physical currency, all around the world continues to go up. So as much as you might hear people say, "Oh my gosh, the Feds..." Some people don't like the Feds monetary policy. The dollar is still the reserve currency of the world. People have more confidence in the dollar than they have in any other currency or any other economy in the world. The US economy is still the strongest, with the most confidence. So that's partially what's driving that demand for dollars all around the world. And the Fed's balance sheet is going to continue to grow, as those demand for dollars continue to grow.

Neel Kashkari:

In terms of too much stimulus, too many dollars chasing too few goods, I mean, you're right. That is the essence of inflation. If you just double the amount of dollars out there, chasing the same number of goods, you would expect the prices to go up proportion to that. But the question is, once that stimulus gets spent down, then what happens? Unless Congress continues to put out more stimulus, we know the path of this big fiscal stimulus, when it hits the economy, when it tapers off, and when it no longer is providing any support, what happens then? And so, that's the analysis that we're focused on, which is look at the demand side and that's the demand part of the story. But also look at the supply side, when do the supply chains get sorted out, and we can get back to something like normal.

Neel Kashkari:

So let me just go back in time, in pre-pandemic, let's say 2019, the Fed's balance sheet was much, much larger than it was in 2000. Yet we had low inflation. We had overall decent economic growth. We had low unemployment, and we had some wage growth. That was a pretty good economy, and yet we still had a very large balance sheet relative to 20 years ago. And so, I would focus less on that balance sheet comparison, than on these other things that we've been talking about.

Rose Oswald Poels:

And we have talked a lot about demographics. Any thoughts on the world aging population and declining birth rate, and the impact that's obviously having on the labor force?

Neel Kashkari:

It's a serious issue. It's a serious issue for our country. It's a serious issue for most advanced economies. And, this is one of the reasons why, when I think about, what's the risk that we end up in long-term high inflation regime versus going back to the low inflation regime, demographics are part of that analysis. The US has benefited tremendously over our history from immigration, bringing in more workers, bringing in more young people, who are both workers to produce things and consumers to buy things. That actually supports economic growth. While immigration has really slowed because of the pandemic, it had already been slower than history, but it had really slowed now because of the pandemic.

Neel Kashkari:

And so, if these demographic trends continue, I would expect we are going to continue to be in slow growth. We're going to continue to be in modest... Think about economic vibrancy overall. Demographics are a really, really key point. When I travel around our district, I always say to people, "This is math. You could either just accept slow growth. You can do what Japan tries to do and subsidize fertility, pay families to have more kids. Doesn't work, by the way. Or, you can embrace immigration. That's it. Those are your three choices, and that's just math." And so I hope that we can get our immigration system fixed, so that we can feed our economy and help go back to a very vibrant economic growth environment.

Rose Oswald Poels:

A couple of questions in the chat that are not surprising, coming from bankers, and an issue that I'm sure you've heard throughout your tenure so far. There's really two key areas where the banking industry struggles in its competition with credit unions. One is in the area of taxation, and one is in the area of CRA. So I'm kind of adlibbing and pulling these two questions together here, but do you ever see an opportunity for any CRA discussion that the banking regulators have to include credit unions? And at the same time, when we do talk about taxes and the need for revenue taxing a lot of, of course, legislative conversation about taxation as well, what do you think about the fairness and taxation as well between credit unions and the banking industry?

Neel Kashkari:

Well, I would broaden it beyond just credit unions and say FinTechs now. We have a whole new sector of entities that are getting involved in banking and banking-like services, that in some cases are not regulated or not subject to the same regulations. And that's a concern. I mean, that's a concern from fairness, which is the root of your question or the question that you just read. But it's also one of safety and soundness, and making sure that consumers are protected. And so, I think this is a really important discussion to continue to have. I know, banking associations across the country have been actively involved in this, but I think it does involve Congress. It does involve legislation saying, "Hey, let's create a system that's an even playing field, one set of rules for everybody, and making sure that consumers across the board are protected."

Neel Kashkari:

I mean, going back to crypto, just for a moment, one of the things I've been concerned about for a number of years is, they've been all of these so many initial coin offerings, which basically looked like securities offerings, where people have been fleeced out of billions and billions and billions of dollars. That's really concerning. I don't see it as a financial stability issue. It's a consumer protection issue. And the good news is, the SEC is taking it very seriously and cracking down on it. But I do think, whether it's crypto or it's FinTech, our regulatory system does need to have a level playing field, where there are not these big gaps. And I think that your engagement with your elected officials is going to be an important part of that.

Rose Oswald Poels:

Yeah, for sure, which we will certainly continue to do. A couple of questions in the chat on a fairly recent news announcement that I certainly, personally, it was very sad to see, and that is the resignation of FDIC Chair Jelena McWilliams. Do you have any perspective on the herd departure, and any concern that it might cause any kind of instability just among the banking regulators generally?

Neel Kashkari:

I don't have any comment. I mean, I've read these same articles you all have read. I don't have any insight or backstory information behind it. I'll just say this. During the financial crisis, I worked a lot with the FDIC, all the banking regulators. And I would just say, the professional staffs at the OCC, the FDIC, the Federal Reserve are very high quality. These are dedicated civil servants who care greatly about their mission and about operating in a serious non-political way. So I've got great confidence that these institutions are staffed by really high quality public servants. And I think that that will continue to serve us very well.

Rose Oswald Poels:

Thank you very much for that. And, we are out of time. A couple of people in the chat also wanted to say thank you to you as well for your comments, very thoughtful, very candid. I very much appreciate your time today in speaking to our large audience. So, again, thank you very much for your time. And, anything else you'd like to say in closing?

Neel Kashkari:

Well, just thank you for the opportunity. We really appreciate this to engage with you. And I very much look forward to getting back out in person and doing all these events, which are a lot of fun. But I appreciate doing this virtually today, so thank you.

Rose Oswald Poels:

Yeah, we look forward to that as well. Thank you again for your time.