Betsy Schneider:

Hi, everyone. Hello? If you can hear my voice, clap once. If you can hear my voice, clap twice. There we go, it always works.

Betsy Schneider:

Hi, everyone. My name is Betsy Schneider and I'm the president of the Wharton Club of Minnesota. And on behalf of the entire club leadership team, we just want to thank everyone for coming out. This is an amazing turnout, and we hope that you all have time tonight to mix, mingle, connect and get to know one another a little bit better.

Betsy Schneider:

We're also very excited today to welcome Neel Kashkari, a Wharton alum from 2002 and currently president of the Minneapolis Fed, one of the federal reserve systems, 12 regional banks. He's held a variety of roles in public service and finance, most notably as assistant secretary of the Treasury during the 2008 financial crisis where he oversaw the Troubled Asset Relief Program or TARP.

Betsy Schneider:

We'll be going over a bit of ... Neel will be opening with some remarks today, and then we'll shortly get into the audience Q&A of it all. So without further ado, please join me in giving a very well warm welcome to Neel Kashkari.

Neel Kashkari:

Thank you. Thanks, Betsy. It's great to be here with all of you. A couple of things, just so you know, we're live streaming this event. So when we get to Q&A, just so you know, we're going to be broadcasting. Who knows who's watching? So if you could do me a favor, when you ask a question, if you ask a question, just identify yourself so we know who's asking the question, then I'd be happy to try to do my best to try to answer it.

Neel Kashkari:

I'm going to start, just give a few minutes about background in the Federal Reserve. This is a Wharton-affiliated group. So you probably know a lot of this background, but not everybody does. And I always like to talk about why I'm here. And then why I want to make this interactive, because the more I can hear from you and the more I can learn from you, the more I'm going to learn from this gathering. And that's valuable to me.

Neel Kashkari:

So 106 years ago, 1913, 105, 106 years ago, Congress created the Federal Reserve. And they did something unique. They said they didn't want the Central Bank simply housed in Washington, DC. They wanted it distributed around the country. So they created the board of governors, which is you probably heard of. They sit in Washington, DC. You've probably heard of Alan Greenspan, and then Ben Bernanke, Janet Yellen, and now our current chairman, Jerome Powell.

Neel Kashkari:

They're appointed by the President of the United States and then confirmed by the US Senate. And then they also created 12 independent Federal Reserve banks, the ninth of which is here, the Minneapolis

Fed. And our jobs are to represent this region in the nation's monetary policy process. So what is this region? This is The Ninth Federal Reserve District. It's 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 travel around this region and get to know what's happening in our regional economy. And then I go back to Washington, DC every six weeks when we have what we call FOMC meetings, meetings of the Federal Open Market Committee. And we debate, deliberate and ultimately set interest rates for the nation.

Neel Kashkari:

Something just happened to the mic. Can you all still hear me? Part of what I'm doing in those ... Can you hear me, Chris?

Chris:

No, let's take one off the table there.

Neel Kashkari:

Well, I'm going to have to sit to take one off the table there. All set? No. All right, this is all I get. I'm going to sit then.

Neel Kashkari:

So a big part of what I'm doing in those meetings is I'm talking about what's happening in our regional economy. Although we cannot set a different interest rate from Minnesota and for California, we have to come up with an average that we think makes sense for the country as a whole. But part of my job is to make sure what's happening here in our region is part of that deliberative process.

Neel Kashkari:

So it's important for me to be able to hear from people all across our economy on what's happening. So I've got a team of folks that work with me. We meet with labor groups, we meet with business groups. We meet with civic leaders, we meet with workers. The more two-way information we get, the better informed we're going to be and the better recommendations we can make. And so that's why when we get to Q&A, I'm very interested in hearing from you on what you're seeing in your sectors of the economy.

Neel Kashkari:

Obviously, inflation is top of mind. I'm going to talk about that here in a moment, but what are you seeing in terms of inflation? What are you seeing in terms of workforce? What are you seeing in terms of supply chains? All of this information will be very helpful to me and my colleagues. And by the way, I have a few colleagues with me. Andrea Raffo is seated right there. He's our brand new research director. So he oversees our team of terrific PhD economists that do economic research, both on the near term economic issues and long-term. Dominick in the back is assistant vice president in our public affairs area. And then Chris is manning the camera back there. So feel free to reach out to any of us if you've got questions or comments. And we'd love to hear from you.

Neel Kashkari:

So very briefly, obviously the pandemic hit. The economy was quite strong going into the pandemic. The unemployment rate was low. Inflation was low. Economic growth was pretty good. So overall, the economic fundamentals seemed quite positive. The few years leading up to the pandemic, we kept getting surprised at how much labor potential the US economy had.

Neel Kashkari:

Year after year after year, I would hear from businesses across our region who said, "It's a worker shortage. We can't find workers. It's impossible." And then the US economy would create hundreds of thousands of jobs again, month after month after month telling me, "Oh my gosh, there's more labor potential than we appreciated in the years leading up to the pandemic." So that was a good problem to have.

Neel Kashkari:

Then of course, the pandemic hits, the economy shuts down. We don't know when vaccines are going to be available. We don't know when therapeutics are going to be available. The miracle of the pandemic, I mean, it's devastating that a million Americans died, but the miracle of the pandemic were that highly effective vaccines were able to be developed much more so quickly.

Neel Kashkari:

I mean, the best health experts in the world told me they don't know if a vaccine was possible, how long it would take, how many years it would take. And for us to have multiple highly effective vaccines within a year is an absolutely remarkable scientific achievement. And then that ultimately positioned us for a very rapid recovery in terms of our economy.

Neel Kashkari:

Well, one shock, the COVID shock, the pandemic hitting us has now been replaced by a very different shock, which is very high inflation, something we have not experienced for 40 years. And obviously, the Federal Reserve's job is to keep inflation in check. We talk a lot about our dual mandate. One of which is stable prices that we defined as 2% inflation. The other side of that dual mandate is maximum employment, as many Americans as possible gainfully employed and contributing to our economy.

Neel Kashkari:

Typically, we think about these two sides of the mandate as a seesaw. As the economy strengthens and the unemployment rate goes down, businesses compete to find workers that leads to wages going up, that leads to high inflation. In that environment, we would tend to increase interest rates to bring the economy back into balance. For the five or six years leading up to the pandemic, we had an interesting problem. We had low inflation and more slack in the labor market. We were missing on both sides of our dual mandate. It's not supposed to happen that way.

Neel Kashkari:

So it made us think, "Okay, what's going on?" A lot of focus on this concept of secular stagnation. Pandemic hits. We put a lot of monetary stimulus into the economy. Congress really is aggressive in putting fiscal stimulus to support businesses and families who were suffering from the pandemic, who lost their jobs. But then the economy reopened much more quickly than we expected because the vaccines came online.

Neel Kashkari:

And so what we're seeing in this reopening, it's a good thing it's reopening. People have gone back to work by and large, but now we're seeing very, very high inflation, something we certainly did not expect. A year ago, I was solidly in the camp of transitory, which is, there are a bunch of factors that we think are temporary that's leading into this high inflation. I thought that they would subside fairly quickly. That has not been the case.

Neel Kashkari:

So the Federal Reserve moved very aggressively toward the end of last year to normalize monetary policy, to tap the brakes, to bring inflation back down. And so we've been undertaking that approach now for the last six to nine months. And you can see it manifesting itself in a bunch of different ways. You can see it because mortgage rates rocketed up in the first part of this year. That's tapping the brake on the housing market. You're seeing other durable good sectors come under pressure where we would expect.

Neel Kashkari:

When we raise interest rates, the first thing we think is going to happen is the housing is going to be affected. So the sectors that we would expect to see affected by our tightening monetary policy are in fact slowing down. And the question now is how long before inflation comes down, how much more are we going to have to do? And I'm sure we're going to get into that in our Q&A.

Neel Kashkari:

So I don't know, hopefully, that's a reasonable starting point for our discussion and maybe Betsy, I'll turn it over to you now.

Betsy Schneider:

Absolutely. We can begin with a couple of questions actually that were sent in by members who are here today. So thank you all for contributing your questions ahead of this and start thinking of the questions you have still. Thinking about the current inflationary environment, where do you see supply constraints as primary contributors to the current inflationary environment?

Neel Kashkari:

Well, there's a bunch of folks around the world have been trying to analyze what is causing the high inflation. And we know supply chains are a big part of it, an important part of it. I talk to a lot of global businesses that are headquartered in Minnesota, and the feedback that they've given me over the past year is that they've got 10 times as many supply.

Neel Kashkari:

These global companies always have some supply chain issue somewhere, but they have 10 times as much as normal, and it's whac-a-mole. They scramble. They put out one supply chain fire here, something emerges somewhere else in the global economy. So that's a big factor. The other thing that's important to note, almost all advanced economies are seeing very high inflation at the same time. So that means there must be common factors that are driving that shared experience, but on some dimensions we're seeing higher inflation.

Neel Kashkari:

So one way I look at it is some of these global factors like supply chains are leading to high inflation around the world. You've got the war, Russia invading Ukraine affecting energy prices, another global market affect and commodity prices, grain prices, et cetera. That's shared by people all around the world. On top of that, the US government did more in terms of fiscal stimulus. So as a very rough order of a magnitude, I would say half to two-thirds of the high inflation we're experiencing in America are driven by these supply side shocks, COVID-related, war in Ukraine.

Neel Kashkari:

Many advanced economies are experiencing that. Maybe the last third, I would say roughly speaking is explained by more fiscal stimulus in America and also an aggressive Federal Reserve supporting the economy. So as we would hope to see these supply chains, there is some evidence that supply chains are beginning to normalize long way from normal. And it's going to depend on the company, it's going to depend on the sector. But there is I think some positive news coming on the supply side that should relieve some of the pressure.

Neel Kashkari:

What's going to happen with the war in Ukraine and Russia, I don't know. Your guess is as good as mine. But we need to get some help on the supply side because ultimately where does inflation come from? It comes from a mismatch between supply and demand. If demand is exceeding supply, you're going to see higher inflation. If we get some help on the supply side, then we at the Federal Reserve have less to do in terms of bringing demand down in check.

Neel Kashkari:

By raising interest rates, we can bring demand down. Raising interest rates does not help bring more supply online. So we're trying to bring these two things into balance. And the more help we can get from the supply side, the less we have to do, the better for the economy in terms of avoiding a hard landing.

Betsy Schneider:

And I know one of those leading indicators that we often look to are oil prices. And with the recent easing of oil prices, does that suggest that the Federal Reserve will continue or change its trajectory on interest rates?

Neel Kashkari:

Because oil prices are so volatile, as are food prices, we tend to try to look through short term movements in oil and food. So you'll often hear in the press. There's something called the headline inflation, which includes everything that a typical American family would be buying. That includes food, of course. That includes energy. But then we will look at core inflation because energy and food tend to be so volatile. And we look at core inflation because it gives us some indication of where we think underlying inflation is heading over time.

Neel Kashkari:

So the fact that oil prices are pulled back somewhat, I mean, I'm happy about it. Less pain for American families in terms of gas prices and energy prices, but it probably doesn't change my underlying outlook. I'm really focused on where do I think the underlying inflationary trends of the economy are. And we need to make sure that those get back down to 2%, allowing the fact that some of these individual components are going to move up and down.

Betsy Schneider:

Makes sense. And last question before we'll open it up to the audience, how do you see environmental change as a risk to stability worldwide? And what role do you think financial markets should play in that?

Neel Kashkari:

There's been a lot of focus understandably, looking at what's happening around the world on climate change. I take it very seriously. I consider myself a person of science. If the best scientists in the world say this is a big risk, then I take it seriously as a big risk. In terms of what does it mean for my own outlook in terms of setting monetary policy, it's hard for me to see.

Neel Kashkari:

When I look ahead with our economists, we generally are looking ahead the next two, three, four years in terms of the horizon of when monetary policy affects the economy and when we need to forecast to try to adjust for that. Although there are extreme weather events happening every day, it's hard for me to see the cycle of monetary policy aligning very well with the cycle of climate change. So it isn't obvious to me that if you said, "Hey, it's definitive. This is how the planet is warming," that that changes my analysis for how we would set interest rates over the next two or three years. That doesn't mean it's not a serious risk.

Neel Kashkari:

So the place where it does show up is as we supervise banks. So when we supervise banks, we want to make sure that banks are analyzing their credit risk of their portfolios appropriately. So if you had a bank that is heavily concentrated in lending to the Gulf Coast and the Gulf Coast is vulnerable to hurricanes, we want to make sure that you are analyzing that risk appropriately.

Neel Kashkari:

Similarly, if you're a bank in California and you are lending into areas that are prone to forest fire, we want to make sure that you are analyzing the risk in your portfolio appropriately. So I think it directly affects bank supervision, and how we supervise banks to make sure that they understand the risk that they're taking. I don't yet see how it maps to monetary policy in the analysis that we do, but I'm open minded. I mean, people are studying this to try to figure out all the different ways it could affect the economy. And I think there's still a lot to learn.

Betsy Schneider:

Interesting, wonderful. So I think at this point we'll open it up to questions from the audience.

Neel Kashkari:

Now, are we going to have a mic for folks, Chris, or no?

Chris:

We're getting some batteries up. So if you could just-

Neel Kashkari:

Okay. Or I can repeat the question?

Chris:

Yes.

Neel Kashkari:

I'll repeat the question until we get new mics. So just raise your hand and I'll ... Go ahead, sir.

David:

So I graduated from Wharton 35 years ago with an economics degree, and I'm really interested in 35 years, what's changed in your ability to model the economy, what innovations have coming up? There's maybe a general perception that there's a lot of data based on past is prologue and that when there are inflections or changes in relationships, the Fed is a little slow to recognize that. So is there something you're doing in your process to not always be [inaudible 00:16:46] the data so much and be a little more creative about how things are going to change?

Neel Kashkari:

So David is saying, he graduated from Wharton 35 years ago, and a lot is ... I'm repeating this for the people who are watching. A lot has changed in the economy. What has changed about the way the Fed models the economy? It seems like when there are big inflection points in the economy, sometimes we're slow to react to that and recognize it because we are focused on recent events or recent data.

David:

Past is prologue.

Neel Kashkari:

Past is prologue. First of all, Andrea is in a much better position than I am to tell you about how the modeling has changed. People like Andrea and his colleagues do a ton of modeling of different scenarios, hitting the economy. And one of the thing is, and we're always looking for better models. We're always looking for ways to try to improve our models.

Neel Kashkari:

One of the curious features of the cutting edge of economic models, it's very hard to get them to generate a recession. A lot of the economy tends to be reverting back to trend. And so, yet we know recessions are real. So we know that these shocks happen. We know that there are non-linearities that are very hard to embed into an economic model.

Neel Kashkari:

And if you just look at the recent events, so we were very focused on the notion of secular stagnation, where we have slow growth, low inflation, low interest rates. And then a shock happens, COVID. Then there's a fiscal shock that happens, and now all of a sudden we're in a totally different regime. So it's funny, were we slow to recognize that?

Neel Kashkari:

In hindsight, sure. But in the moment, so I'll give you an example. We basically, for five years, had low inflation. And then core inflation finally ticked above 2% our target in May of 2021, so a little over a year ago. And at that time, the headline unemployment rate was 5.9%. Prior to the pandemic, it was 3.5%. So by that version, still a lot of slack in the economy. So we've got five years of secular stagnation and low inflation. Inflation ticks above 2%, and by most measures, there are still slack the economy.

Neel Kashkari:

At that moment, would you say we're in a new regime? I mean, I would say looking at that, I wouldn't be ready to conclude that. So we took several months, four or five months to say, "You know what? Maybe we are in a new regime." And by November, we started dramatically adjusting our outlook for monetary policies. So it's a long way of saying, I mean, we need to be self-reflective. We need to recognize that things can change, but things can change in infinite number of ways. And unless we are looking at the data, then we're just completely making stuff up.

Neel Kashkari:

And so I'm not sure. We have a lot to learn about what's happened and what we could have known, but simply saying, "Well, we need to be more creative." People can come up with all sorts of creative answers that don't make any sense. And so we're not perfect as you know, but we have a group of people who are dedicated to looking at the best data available, looking at the best analytical methods available and always trying to improve them so we can get better over time. That's the best answer I can give you.

David:

Do you think you've gotten better over time in 35 years?

Neel Kashkari:

Do we think we've gotten better over time in 35 years? I mean, I think if you look at the performance of the economy, even if you average in the 2008 crisis and the COVID shock, I mean, the last 40 years, economic performance on average has been pretty good. So I mean, I think overall, policy makers have done a pretty good job, but we didn't see the housing bubble and bust coming. We didn't see the pandemic coming, and now we didn't see the ...

Neel Kashkari:

Sorry, this is a long answer to one question. We run scenarios all the time of bad things that can happen. If we really think a bad thing is happening or going to happen, people are going to prepare for it and prevent the bad thing from happening. So generally speaking, the things that hit you are the things you do not see, or you did not think about. Just the nature of these things, unfortunately. Other question? Oh, we got a mic now. It's coming over there.

Akhmed:

Hi, my name is Akhmed. I'm actually a Yale graduate from the class of 2016. Thank you for coming tonight.

Neel Kashkari:

We won't hold that against you.

Akhmed:

I appreciate that, I snuck in. So I have a question that really, I'm curious for your insights on housing. I think it's perhaps a plurality of the core inflation number, and I was really interested in the way you talked about the Fed's ability to reduce aggregate demand, but not so much supply. And I think about that a lot in the sense of housing. There's a certain number of people, there's a certain number of places for them to live. It's unclear to me that reducing aggregate demand is really viable there.

Akhmed:

And yet increasing interest rates presumably would be an impediment to the housing stock. And I know we have a housing shortage in this country. So I'm curious how you think about that in the context of a pretty large component of the inflation measure and how you think the Fed can play a constructive role, or whether there's just other policy options and actors that need to be involved to work on that part of the inflation component.

Neel Kashkari:

Well, I think long run, there's no question, the Fed can't address that. Long run, it's all about regulations and regulatory policies to allow more homes to be built. And let me just go on a side note for a second. The reason that there's a housing shortage just about anywhere you go is because people like me, and many of you who own their own homes, don't want people building more homes in our neighborhoods. That's it.

Neel Kashkari:

So if you're wondering why there's an affordability problem, get the mirror out and look in the mirror is people like you and me who don't want us changing our neighborhoods. So we all say, "Not here, build over there." And then the people over there say, "Not here, build over there." And that's why home prices keep going up and up and up. But in terms of short run ... So that's a long run challenge, a structural challenge that we face.

Neel Kashkari:

Short run, we can affect housing demand. I mean, I'll give you an example. There are a lot of people who are well-to-do in America who own second homes, some own third homes. And you're seeing you go to Montana when I visit there, in part because of the pandemic, in part because of the show Yellowstone, which I've never seen. People, they're all flocking and buying second homes in Montana. Well, when we raise interest rates and we make it more expensive for folks, all of a sudden, the person's going to give a second thought to buying that second home.

Neel Kashkari:

And so there is a way that we can actually affect how much demand there is for units in America. It's not simply one for one with humans. It actually also affects people's choices to have roommates. It affects people's choices to have families living together or staying with their brother and sister moving together. Lots of decisions that people make can be affected by the affordability. And also, renting versus owning, people make different choices there. So I think we can have an effect on housing demand in the short run through our interest rate policy, which can then show up and translate into an underlying inflation.

Akhmed:

Thank you.

Ron Goldser:

Hi, I'm Ron Goldser, also Yale only in 1975, the other end of the spectrum. I'm interested in the supply side question that you started to discuss. One of the philosophies of the two main pillars is maximizing labor, labor force participation. I'm wondering what policies the Fed has to help facilitate maximizing labor force participation. In particular, I think about if I'm a small business and I have a line of credit and my interest rate goes up because interest rate policies have been changing and the interest rates have gone up, I can no longer afford to hire another employee, or I may even have to go so far as to lay employees off.

Ron Goldser:

I think about the fact that the labor force participation rate, to my knowledge, has not changed a whole lot over the last few years. It certainly hasn't gone up. If anything, it may have gone down so that there is room in the labor market, I would hope, for employees to come off the sidelines and get back involved. So how do you balance interest rates, the cost of money to businesses, small or large, to facilitate increasing employment? And if you've been around, you see We're Hiring signs in virtually every window in this town.

Neel Kashkari:

Yeah. So if our two goals are intention, so let's say we had a low unemployment rate and we had 2% inflation or maybe 2.5% inflation and you're trying to trade these two things off, we said, we will take a balanced approach. But right now, there's nothing remotely balanced about this. We have very low unemployment. And as you said, businesses all across the country are looking to hire. So by many, many measures, we are at maximum employment and we have very high inflation.

Neel Kashkari:

So this is a completely unbalanced situation, which means to me, it's very clear we need to tighten monetary policy to bring things into balance. At some point, a long way from where we are right now, we will have to have that debate. Okay, maybe we're getting to the place where we need to start trading off these two sides of it. Right now, there's no trade off. It's just completely uneven in terms of our dual mandate.

Neel Kashkari:

In terms of labor force participation, a bunch of workers are missing from the labor force that I thought would've come back by now. So what's the explanation? So one source of missing workers are folks who retired early because of the pandemic. They said, "I'm not sure I want to work from home. I'm not sure I want to get COVID. I'm in a position. I just want to retire." Question is will some of those folks come back? I hope so. Some are. I hope more of them come back.

Neel Kashkari:

Retirement tends to be somewhat of a sticky place to be. And people like it if they're retired. But hopefully, we can draw some of those folks back in. Let's also remember a million Americans died from COVID. Now, it's skewed older, but there were workers in that million that are lives lost. And it's also workforce that's lost as a result of that. Obviously, they're not coming back. We have folks who are taking care of family members, could be childcare issues, could be sick relative, could be something else. People are taking care of family members. That also puts challenges for them working.

Neel Kashkari:

And then the big slug of missing workers are immigrants. Immigration has been a huge engine of economic growth in this country throughout its history. Legal immigration has largely dried up in recent years in part due to Washington policy, in part due to the pandemic, and the desire to close borders to prevent COVID spread from coming across. Ultimately, economic growth comes from two things. It comes from productivity growth and it comes from population growth. And the fact of the matter is we're having fewer children than prior generations.

Neel Kashkari:

So our economy is going to grow more slowly unless we are effective in tapping into immigrants. And so that's a decision that we just have to make as a country. But if we don't do something with immigration, we're going to continue to have workforce shortages. And then ultimately all this means for us, we have to assess the economy's potential, its supply potential. And then we need to get demand to match that. And if the economy's supply potential is lower because we're not having children as much as prior generations, and we're not allowing immigrants to come in, then our economy's potential is going to be lower and it's going to be our job to bring demand down into balance with that.

Chris:

Okay, we're looking for a non-Yale person.

Neel Kashkari:

Maybe a Penn person even.

Randy Roland:

Good afternoon. My name is Randy Roland. I'm a Wharton grad from 1980 or something. First, I want to say, thanks for coming. Second, I'm going to say thank you to you and your organization, because whatever people say yes or no, you guys have stood in. And I think what you did during the pandemic, you kept the economy functioning. And I think that's huge.

Neel Kashkari:

Thank you.

Randy Roland:

I'm older. And I hear you talk about the tension between inflation and labor. And the tools you have are pretty sharp and they're pretty quick, but they don't go into effect immediately. And so I guess the question is how do you and your cohorts balance the time you think it's going to take for the actions that you've made? And they're pretty significant, by all counts. And how long that will take to come into the marketplace in effect, and how that affects the other actions you might consider taking?

Neel Kashkari:

Yeah, that's a really good question, and a really tough thing because famously, the monetary policy operates with the ... I can't remember whose quote it is, but long and variable lags, a very famous economist said it whose name is escaping me at the moment. And that's absolutely true. Now, some things happen right away. I'll give you an example. So we did not start raising the federal funds rate until March of this year, but we had already tightened financial conditions dramatically because in November we started changing the way we are talking about the future of monetary policies. So financial markets try to be forward looking, and so they end up adjusting very quickly based on our guidance of what we tell them is likely going to happen.

Neel Kashkari:

And so one way this shows up is if you look at mortgage rates back in 2020, when the pandemic hit, we went all in to support the financial system, ballooning our balance sheet, cutting the federal fund rate to zero. And you saw mortgage rates drop at a nice, gentle, pretty quick but still gentle path on the way down. This spring, winter and spring, they went almost vertical, ratcheting back up. So we tightened conditions in that dimension even faster than we loosen conditions when the pandemic hit, which is breathtaking speed.

Neel Kashkari:

So some things happen right away. Other things take more time to work their way into the economy. I would tell you, just speaking for myself, if inflation was high right now, and 4% when we want it to be 2%, I would be more willing to say, "You know what? Let's take our time, and let's gradually bring it back down and avoid the risk of overdoing it." But when inflation is 8% or 9%, we run the risk of un-anchoring inflation expectations and leading to very bad outcomes that would cause us to have to be very aggressive, Volckeresque to then re-anchor them. We definitely want to avoid allowing that situation to develop.

Neel Kashkari:

So with inflation this high, for me, I'm in the mode of we need to err on making sure we're getting inflation down, and only relax when we see compelling evidence that inflation is well on its way back down to 2%. So to me, missing two to four is very different than missing two to eight.

Andrew Felbinger:

Andrew Felbinger. I am a Wharton MBA grad from 2018. So the last decade plus, we've really had an unprecedented amount of quantitative easing. I'm very curious to hear your take on what your fears or concerns are that not only are we making this switch, but we're making this switch in an area where effectively no one has really ever been before. I'm curious kind of ...

Neel Kashkari:

What do you mean no one's been before?

Andrew Felbinger:

To the degree of which even talking about your response to your last answer of, we need to make quick changes to address inflation because it's at 8%, you have to move a little faster. The amount of quantitative easing we had over the last 10 years has really blown up the balance sheet, right? So I guess my question is no one has been in the point that we are today. Having to tighten now, what are the fears or concerns kind of heading into that?

Neel Kashkari:

I mean, the biggest fear is that if you look at financial market indicators of inflation and inflation expectations, financial markets believe that inflation is going to rapidly fall back down to 2% next year and the year after that. I hope they're right. The big fear that I have in the back of my mind is if we're wrong and markets are wrong and that this inflation is much more embedded at a much higher level than we appreciate or markets appreciate, then we're going to have to be more aggressive than I anticipate probably for longer to bring inflation back down. So that's probably my biggest fear.

Neel Kashkari:

The balance sheet itself is not the source of that fear. Part of the way the balance sheet works is through the last conversation we just had about signaling and about guidance, about where interest rates are likely to go. Just by us, we've barely shrunk the balance sheet so far. But we have laid out in very clear terms the path that the balance sheet is going to shrink as the bonds mature over the next several years. So much of that then gets priced in right away, and that gets expressed in these rates that have gone up over the last six months.

Neel Kashkari:

And so I actually think a lot of the balance sheet tightening effect, not all of it, but a lot of the tightening effect is already happening because of the guidance that we have provided. So the balance sheet itself is not my biggest source of concern. My biggest source of concern is just if we and financial markets are all collectively misreading the underlying inflation dynamics. Then it's going to take us a while probably to figure that out. And then we're going to have to be even more hawkish than I'm envisioning right now.

Chris:

More questions?

Speaker 9:

I'm not from Penn or Yale. But when he was new in his job, Paul Volcker came back to speak at my commencement. At that time, we used to think about full employment was 6%. I think our economy has done a fantastic job really of promoting the productivity and the growth that you spoke to and attributed correctly to the impact of immigrants and access to global markets, cheap labor.

Speaker 9:

So I have every confidence that the Fed will fulfill its primary mandate, as you described, and we'll get through this business cycle. But as an employer in the knowledge industry, I was elated to hear you talk about the need for immigrants. There's so much attention to illegal immigration, and I don't want to get distracted with that because I think that's the side show. That's not really the core issue that we face.

Speaker 9:

And so in light of that, I wanted to ask if it's not the Fed's job, who in the government is speaking on behalf of fixing this dearth of immigration? Is that a commerce department issue or who's the champion among your peers?

Neel Kashkari:

I mean, I think you would look at Commerce. I think you would look at Treasury, all of the economic agencies that are involved in regulating the economy or trying to drive economic growth. So Commerce and Treasury, I think would be two places to start. But ultimately, that's our political system and you all are participants in our political system. Hopefully, you are participating by voting and get involved and express your views.

Neel Kashkari:

I'm expressing, I travel around the district and I always say the same thing. We're having fewer children. So our economy is going to grow more slowly. So you've got three choices. You can either try to subsidize fertility, pay families to have more babies. Japan is trying that. It doesn't really work, by the way. Even if it does work, it takes 20 years to create a new worker, so it's a long solution. Two, you can embrace immigration, or three, you can accept slower growth. That's math. You decide which of those three you want. That's not my job. That's math.

Neel Kashkari:

Only one time I had somebody say, "You know, slow growth sounds pretty good to me." Usually, when people hear those choices, they say, "Wow, I didn't realize that's how it worked. I guess we need to embrace more immigration." And so I just think you got to get involved. I wish I had better recommendation for you than that. I don't. Not that I'm allowed to say. I'm supposed to stay out of politics.

John Vang:

Hi. John Vang here at the Luther Group. I have a two-part question about deglobalization. First, I would like to ask your view of deglobalization, are we going down the path of deglobalization in a secular way or is it just a temporary detour? And second, if we're really going down that path, how would you see the Fed policy evolve in response to that? Thank you.

Neel Kashkari:

So, I mean I talked to a lot of businesses that say that they're reassessing their supply chains and analyzing vulnerabilities they didn't realize that they had before. I know one company mentioned to me that they had no idea that they had some exposure to Ukraine. Turned out it was a supplier to a supplier to a supplier had an exposure to Ukraine. It took them a few weeks after the invasion to figure out that, "Oh my gosh, we've got this vulnerability."

Neel Kashkari:

So I think lots of companies are analyzing their supply chains and trying to build in more resilience. I'm somewhat skeptical that they're going to be lasting changes because it seems to me that the pressures from Wall Street on earnings are going to flare up again. And so, what do you mean you're going to have permanently increased cost? We want you to go for the low cost supplier. So, we'll see.

Neel Kashkari:

Maybe it means that they're not quite so concentrated on one supplier or two suppliers, or they spread their bets a little bit around a few more countries, so they're not potentially as vulnerable. So that to me is a story of deglobalization. Maybe it's the story of reglobalization or reordering, putting some of their chips in different places would be my guess.

Neel Kashkari:

And then in terms of what it affects us, I mean ultimately if we have a higher cost, if the economy has a higher cost of production, then that will go into our models or our analysis of what is the economy's potential and what monetary policy is appropriate given that economy's potential.

Speaker 11:

Good afternoon.

Neel Kashkari:

Good afternoon.

Speaker 11:

This is great to be here. Yes, I'm not from Harvard or Yale. I'm a guest of Steve Bear who's gracious enough to invite me. So thank you very much. And I'm also a friend of the Wharton. So what I'm curious about is what gets you up in the morning? What gives you that oomph to wake up and contribute to what you have to do to make the decisions?

Speaker 11:

And then the second part of my question is you talked about the productivity of the United States. And one thing I'd like to say is hearing the contribution of immigrants being highlighted has really touched me in a way because I'm originally from Kenya. I came here in my early twenties. And since then, all my contribution has been to the American economy. I have the young ones and essentially, they are Americans. So, all their contribution will be to the growth of the United States. So that messaging is really key.

Speaker 11:

So we have seen after the pandemic that a lot of our workers are staying at home, and they're preferring to work from home. So I'm curious to know, what do you see in the numbers the effect of that in the productivity of the overall US economy?

Neel Kashkari:

So, first of all, to your first question, why gets me up in the morning? One of the things ... So I spent three years and I think we're going to talk about it maybe if there's time. I spent three years in Washington, DC at the Treasury department, before and during the financial crisis. I learned firsthand there how important public policy is for the country. I always say to people, if you want to help a thousand people, donate to a charity, really important.

Neel Kashkari:

You want to help a million people or 10 million people or a hundred million people? The only way you can do that is by improving public policy. It's the only thing that works at scale. And I got hooked, so to speak, on trying to do things that are hopefully beneficial for society as a whole. That's why I ran for office in California to get back involved in public policy. That's why I jumped to the chance at joining the Minneapolis Fed.

Neel Kashkari:

One of the things you'd find is across the Federal Reserve system, the 12 banks, the board of governors, you got a lot of different people doing very different jobs. You've got economists, you've got bank supervisors, you have HR professionals, IT experts, people who work in law enforcement. The one thing that they all have in common is they have a belief in public service. That's the thing that motivates them for why they joined the Fed.

Neel Kashkari:

So that's what gets me up in the morning, which is unfortunately, the economy keeps throwing these wicked curve balls at us that we have to try to respond to, but try to do good, try to make the best decisions we can, to try to do as much good as we can for the people we are charged to work on their behalf. And that's everybody in the country.

Neel Kashkari:

Your second question was ...

Speaker 11:

In regards to the productivity of-

Neel Kashkari:

Productivity of work from home. So it was funny, the first two months of this year had negative GDP growth. But the economy is sending these mixed signals because we have negative GDP growth, which typically people will say, "Well, that means we're in a recession." But we've had a very strong labor market, hundreds of thousands of jobs being created. That is not signaling a recession. So those are conflicting signals.

Neel Kashkari:

Well, if you have negative GDP growth and a lot of hiring, if you just put that math together, you're going to have negative productivity or very low productivity. More workers producing less goods, that means you're going to have negative productivity. So it'll be very interesting to see how it plays out. Which one of these catches up? Does GDP catch up to the labor market or does the labor market catch up to GDP, or do they match somewhere in the middle?

Neel Kashkari:

I had one CEO of a very large company, I'm not going to name, not based in Minnesota, say to me, "You know why these productivity numbers stink? Because work-from-home stinks, and we're all just beginning to figure that out right now." My guess is that he's exaggerating, that it's not all work from home. But I also am personally quite skeptical that work from home is the miracle that it seemed for the first six months of the pandemic.

Neel Kashkari:

My personal view is in the first six to nine months of the pandemic, we'd all been working together. We all knew each other. We had relationships. We knew what we were doing. It's easier to transition home. We've now hired a lot of people who never met their colleagues. And when you're trying to onboard people who've never met their coworkers, it is different. And I am deeply skeptical that that is long term as successful as at least some form of hybrid.

Neel Kashkari:

So at the Minneapolis Fed, I'm back every day. Our leaders are back every day. But for most folks, they're back three days a week. That's our step. That's our starting point. Let's see how this goes. We may adjust to more, we may adjust to less. But we'll take it slow.

Linda Johnson:

Hi, Neel.

Neel Kashkari:

Hello.

Linda Johnson:

Last time when we met over at the Federal Reserve Bank, I asked, who can I talk to about the roses? And that you said-

Neel Kashkari:

About who?

Linda Johnson:

Dorothy Bridges, and then she retired. And I wanted to know who can I talk to about the roses.

Neel Kashkari:

I don't understand about the roses.

Linda Johnson:

Like say, community development people, to talk about the rose garden at Lyndale Park.

Neel Kashkari:

Oh, I see. So our new head of community development is Alene Tchourumoff. She's not so new. She's been with us now for three years or four years now, and she's in Dorothy's seat. And thankfully, Dorothy is still a good friend of the bank and doing great things, but I'd be pleased to put you in touch with Alene, who'd be happy to chat with you.

Linda Johnson:

Okay. Well, thank you.

Neel Kashkari:

Yeah. And Dominick, who's in the back, will find you afterwards and can connect you to Alene.

Linda Johnson:

And I'm for Princeton, Linda Johnson from Princeton University.

Neel Kashkari:

Thank you.

Stu:

Hi, Neel. Thanks for being here tonight. I'm Stu with the Alzheimer's Association. And so, while I'm a Wharton grad, I'm the oxymoronic Wharton grad in nonprofit. Kind of like you, not counting my days at Ford Motor Company by the way. So your prior answer talked about giving to nonprofit organizations. And my question is when you're doing your market research, are you talking to nonprofit organizations?

Stu:

It turns out that nonprofits are generally very dependent on philanthropy, and philanthropists are very much driven by the value of their investments when they make decisions about what they're going to do. And so there's clearly an impact on what the Fed is doing to how people feel about the value of their portfolios and therefore, the impact that they have on nonprofits. So I'd like to know if you include that in your conversations.

Neel Kashkari:

We do, for sure. And one of the things in addition to the community development group that Linda and I were just talking about has a lot of connections to nonprofits across the region and routinely meets with them and hears from them. We also, I skipped over the fact that each of the 12 reserve banks has a board of directors of local leaders. In many cases, they're business leaders, education leaders, labor leaders, and nonprofit leaders.

Neel Kashkari:

So for example, I was hired, the chair of our board of directors was MayKao Hang who was leading the Wilder Foundation. She's now at St. Thomas. And we also have on our board of directors now, Paul Williams, who runs Project for Pride in Living, a housing-oriented nonprofit. So we do have formal connections to nonprofits through our boards of directors, but also we have informal connections through our work in community development.

Neel Kashkari:

Why don't we turn them back to you, Betsy? You had some other questions?

Betsy Schneider:

Sure, I do. We'll jump back a little bit in time and space to 2008, 2009, and speak a little bit about the financial crisis. During that time, I was actually in my undergrad at Wharton taking international corporate finance. And they completely throughout the syllabus then said, "We're no longer doing that. We have the Financial Times, and that is our syllabus for the semester." And I imagine at the same time as we were throwing out our books, you were architecting the solutions for these problems and likely didn't have a whole lot of comparisons to look to in the past.

Betsy Schneider:

So my first question is, can you explain how TARP came together and specifically, how you got all these very disparate interests across the parties in Congress and the financial institutions to agree and align to a solution?

Neel Kashkari:

So when I reflect on the '08 crisis, I would say I was appointed by President Bush. I was a Bush appointee. I worked for the Treasury Secretary, Henry Paulson. And Ben Bernanke, the chairman of the Fed was also appointed by President Bush. We collectively, what I would say, were reluctant interveners. The idea of the government intervening in financial markets is something we did not like very much. Market, if you take a risk, you should deal with the consequences of your risk. The government should not come in to help you.

Neel Kashkari:

So at every step of the way, we were looking early on in the crisis. If we have to intervene, let's intervene as little as we need to so that markets can deal with this as much as they possibly can on their own. And I remember probably in January of 2008, the crisis started burning in the summer of '07. Some hedge funds blew up that were related in housing. In January of '08, I remember there was a conference call that the treasury secretary had with Alan Greenspan. And we were all hovering over the speakerphone because Alan Greenspan speaks quite quietly. And I remember he said, "This could be a one-in-a-hundred-year event."

Neel Kashkari:

And that was shocking. We were sitting here telling each other that, "Hey, this is a blip. Housing's going under some pressure. Some funds are blowing up. That's fine. Markets will get through this. It'll be fine." And here's Alan Greenspan saying, "This might be a one-in-a-hundred-year event." And then the Treasury Secretary said, "Okay, we need to come up with plans, not that we would implement right now." But if we really face this type of serious deep crisis, what would we actually do? What if we actually had to step in and bail out the financial system?

Neel Kashkari:

So a colleague of mine at Treasury, Phil Swagel, who now happens to be the director of the Congressional Budget Office, worked with staff to pull together just some contingency planning. What would we do if we really needed to step in to try to rescue financial markets? And the thing is we had our lawyers going back to statutes literally from the 1800s, looking for what authorities Treasury had.

Neel Kashkari:

Curious thing about the US government. The executive branch of the government can only do things that Congress has said, "You may do the following." As individual citizens, it's the opposite. We can do whatever we want, so long as what we want to do is not prohibited. So the presumption is with us. For the government, it's the opposite. The presumption is against the executive branch, unless Congress is authorized them to do something. So our lawyers had said, "You don't have these authorities. You would need to go to Congress."

Neel Kashkari:

So we presented this. It's not even a plan. We presented these bullets to both Secretary Paulson and Chairman Bernanke. And they both said, "Yes, this looks like a reasonable playbook. The question is when we could go to Congress to ask for this?" They don't want to go to Congress and say, "We need this unprecedented authority, if in fact the crisis is not that serious." And by the way, they're not going to give it to us if the crisis is not that serious. And by the way, we don't want to tell them we're so scared. That might trigger the crisis itself.

Neel Kashkari:

And so the key judgment was when to go to Congress. So we did that in January. In February, it went on the shelf. Bear Stearns was rescued, complicated situation. Lehman failed, and then financial markets cratered. And they said, "Now we have no choice but to go to Congress," and then they went to Congress. And then ultimately, Congress said no the first time, ultimately then Congress gave us the authority to set up the TARP. And then we used the TARP aggressively with the Fed and others, FDIC doing their part. And it effectively worked, which we didn't know if it was going to work at the time.

Betsy Schneider:

And as you talked about, these were unprecedented motions that you all were going through. And the process was widely contested on every side of the aisle and across within parties. Can you talk a little bit about the ... How did you prepare for the congressional hearings that went along with those?

Neel Kashkari:

That was something. So my job was to, once we got the authority passed, was to set up and run the TARP. And we had no idea how complicated this would end up becoming. In the six months that I was there until we got through the stress test and then I could step down, I hired about 140 people. It was a big startup in the middle of a crisis.

Neel Kashkari:

And I'd go up to testify in front of Congress, and it was funny. I mean, my longest hearing was six hours. 40 angry members of Congress, basically both sides of the aisle, I mean bipartisan basically, yelling at me for six hours because everybody was angry about the TARP and angry about the bailouts and angry about the financial crisis.

Neel Kashkari:

And I couldn't get mad. I had to try to answer their questions to the best of my ability and then go back to work, and try to get all of our programs up and running and hopefully, they'll be effective. So I had an index card that I brought with me because I was anticipating some contentious hearings. I had an index card that said, "The louder he yells, the calmer I shall be." And I just would look at that and read that to myself as a way to help me maintain my composure and ultimately try to get through it.

Neel Kashkari:

So when the 2020 crisis hit in COVID, even though the pandemic was completely different from the housing bubble bursting, I had the confidence of we've been through a massive crisis before. We will get through this. And I felt more at ease at that than I was in '08 because we had not been through '08. There was tremendous institutional knowledge, especially at the Federal Reserve, having done so much to support the financial system. And we benefited greatly from that collective institutional knowledge this time around.

Betsy Schneider:

That's amazing. And having come so close to seeing the collapse of the financial system, this once in a hundred year sort of event, how do you feel financial institutions have had to account for their actions from that time in a way that makes us more stable in the future?

Neel Kashkari:

Well, large banks have a lot more capital than they had going into the '08 crisis. I would argue and weave at the Minneapolis that have argued loudly not enough, they're definitely safer than they were going into the '08 crisis by virtue of that extra capital. But again, we would argue not enough. So we would do more, but ultimately again, it'll be our political system that'll decide how much risk we collectively want to take as a society in terms of financial crisis risk.

Betsy Schneider:

And then we have in the past had voices that provided some early stage alerts to some of these more systemic risks. Who do you feel today are the voices of reason or the voices that you listen to for commentary on the system?

Neel Kashkari:

Well, it's not Twitter. This is tough because people reach out all the time, predicting various doom and gloom scenarios all the time. And if you listen to all of them, I mean first of all, they're all giving you conflicting signals, right? So what would you do? You'd just be completely paralyzed. And so you try to listen to the ones and give their arguments a fair hearing in people that you've come to respect over time.

Neel Kashkari:

And you say, "Okay, this person has been really thoughtful in the past. Let me give this person a fair hearing," and then look at what they're arguing against the data that you're collecting and see, "Hey, does it match or does it not match?" And ultimately, you have to use judgment. But that judgment is not just making stuff up. It's listening to a wide range of voices.

Neel Kashkari:

So I'll give you an example, just a narrow example. For the five years leading up to the pandemic, I was arguably the most dovish member of the Federal Open Market Committee. I was voting against all of our interest rate increases because it seemed like there were still slack in the labor market. So if inflation is under 2% and there's still slack in the labor market, why are we raising interest rates?

Neel Kashkari:

It was a little lonely to be that lonely voice, because I'd say to myself, "Well wait, what do all my colleagues see that I'm missing?" Now, I benefited from the fact that I've got a really talented team of economists at the Minneapolis Fed, who are big, independent thinkers, and we would debate these issues every which way. So by the time I went to the Federal Open Market Committee meetings, I felt exceptionally well prepared. I was very rarely surprised by anything I had heard.

Neel Kashkari:

So at least I had the benefit of, "Hey, I've been challenged by some really smart people to test my assumptions to see what I might be getting wrong." We went through that. I'm still comfortable with my position. Then I'm going to take that position. I mean, I wish I had a better answer than that, but it's a little bit of art. It's a little bit of experience, and it's listening and hearing from a lot of different people to ultimately inform your judgment.

Betsy Schneider:

Wonderful. I think we probably have time for about one last question from the audience, if anyone has been sitting on one for a while.

Chris:

[inaudible 00:57:28] a second. Unless there's somebody else-

Neel Kashkari:

You can ask a second. Sure.

Chris:

Do we have a first? We have a first over there. [inaudible 00:57:37]

Harman:

Thank you. This is Harman. I work for Cargill. My question is one of the luxuries of this country is that the US dollar is a reserve currency of the world. So as we raise the interest rate, we will see a lot of countries that'll have burdens on their foreign currency reserves, and the commodities will be more expensive for them. And we'll see some debt defaults, et cetera. So I'm wondering, will that ever be a consideration for Fed in their decision to rate interest rates?

Neel Kashkari:

We have to make decisions for the US economy and for the American people. That's our mandate. That's our job. We do a lot of analysis on feedback loops from international markets and other countries around the world. And what happens in other countries affects the American economy. So in that context, it will get factored in. As we analyze these feedback loops of us raising rates, what does a strong dollar mean for inflation, that may then mean we have to do less because that may bring down the price of imports, et cetera. So it's definitely a factor that we consider, but we have to optimize monetary policy for the US economy because that is our job.

Betsy Schneider:

Wonderful. Well, I think, everyone, that concludes our time today. Thank you so much, Neel, for coming and thank you all for your wonderful and engaging questions. This has really been a highlight of my months. So thank you all so much.

Betsy Schneider:

A few quick thank you's as well to the Minneapolis Club. Ashten Fleck and Julia Hazen have been incredible in helping to put this together. The Wharton Club Leadership, we've got Paulina Alcántara, Steve Baer, Vito Quaglia and Brian Davis are all hanging around, if you want to say hi. And if you would love to get involved and help us plan our fall evening with the arts event, we would love to have you on the board as well.

Betsy Schneider:

And finally again, just a huge thank you to Neel and everyone in your office. From Meredith Lee, Dominick Washington, Chris Long, everyone has just been absolutely incredible. So thank you.

Neel Kashkari:

Thank you for having me. I appreciate it.