Fed Unfiltered, Transcript
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Gina:

I feel like I kind of don't need to introduce Neel Kashkari. You all know who he is. He is president of the Minneapolis Fed, a job he has held for several years. Previously was at Treasury, under Hank Paulson during the financial crisis, helped with TARP. One of the thought leaders behind TARP, as well. Before that, at Goldman Sachs. Originally an aerospace engineer, if I remember correctly.

Neel Kashkari:

That's right.

Gina:

Yeah, so quite a resume. Doesn't need a ton of introduction. I'll go ahead and jump right in to questions, here. I will take a couple of audience questions at the end. Not a ton, probably. I've got a lot to get to. But before I even get started, actually, do you want to go ahead and deliver your remark?

Neel Kashkari:

Sure. Thanks, Gina. Thanks to the organizers for inviting me. It's great to be with you. My name's Neel Kashkari, as Gina said. I thought I'd just spend, because this is... I know we're going to cover a lot of different topics, which I'm excited about. I wanted just spend a couple minutes on financial regulation and what should be our first priority in financial regulation, in my opinion. If we want to help Americans of all stripes have better economic outcomes, first and foremost, we need a stable financial system. One of the things that we've learned is that when there are financial crises, financial crises disproportionately hurt lower income folks, disproportionately hurt people of color and people who are marginally attached to the economy. The '08 financial crisis was devastating and it took 10 years to rebuild the labor market after that crisis.

Neel Kashkari:

And so since I've been at the Minneapolis Fed for six and a half years, I have strongly argued that the big banks in America need more capital, that we've done the analysis, a lot of others have done the analysis that if the largest banks in America had substantially higher levels of capital, there's a cost-benefit test that is beneficial to society overall, and especially to lower income groups who suffer the most in these financial crises. The kind of capital requirements I'm talking about would likely require an act of Congress, so I'm realistic about that, but there are steps where we can take in the near term.

Neel Kashkari:

One step, as an example is the Fed can activate the countercyclical capital buffer. When it was created, it was intended to be turned on a third of the time. It's never been turned on. My staff tells me that by the end of next year, 18 countries across Europe will have activated their countercyclical capital buffers. High time that we use our tool to its full potential. And this is not trivial. It's another one, 1.2% I think is the average of the other countries of risk-weighted assets. It's a meaningful amount of capital. Not enough by itself, but it's meaningful.

Neel Kashkari:

And then the stress test. The stress test is a very important tool. It has gradually been somewhat weakened over time. I'll give you a specific example. Something happened in Q1 of this year. Interest rates started going up across financial markets in anticipation of the FOMC acting, and the large custody

banks, State Street and Bank of New York, had big losses. And it was interesting, if you look at the size of the actual losses that they printed in Q1, they were on the same order of magnitude or as big as the losses that they were expected to see in their prior year stress test. Can you imagine that? The stress test is supposed to be a crisis and here in Q1, they lost as much, roughly as much as they would've lost in their prior year stress test. What's going on?

Neel Kashkari:

Well, right now, the Fed does one scenario when it looks at the stress test, and you have to guess the scenario correctly. And that scenario was not a rapidly rising interest rate environment, where it turned out they have a lot of exposure. And so kind of re-engineering or doubling down on the stress test, running different complementary tough scenarios can be a way of making it stronger to make sure that the banks can withstand the next crisis, which the one thing we are all guaranteed of is we're not going to see it coming. It's not going to be where we think it comes from. So we need to run a bunch of different scenarios.

Neel Kashkari:

So those are a few things. We at the Minneapolis Fed have created a tool from publicly available data where you can run your own stress test. You can go to our website, you can adjust different interest rate profiles. You can adjust GDP, you can adjust unemployment and you can see what type of losses the banking sector faces with different policy responses. And so we would just encourage anybody who's interested in financial regulation, run your own stress test, run your own analyses and scenarios and see if you think that the biggest banks in America are resilient enough without the taxpayer stepping in to support them. So, anyway, I wanted to give you that overview because fundamentally, I think having a financial system and an economy with a strong foundation is a necessary precondition to helping Americans of all stripes reach their full economic potential. And that's why I talk about it a lot. So thank you. Gina.

Gina:

As you mentioned, you talk about this a lot, so the responses to you are well tread. And one that you often get, and particularly the Bank Policy Institute will often post something saying this right after you post something saying what you just said, is that this is a balancing act. And to the extent that you have higher capital requirements, you could potentially discourage lending and we could sort of be shooting ourselves in the foot and choking people out of the financial system in the process of trying to make financial system safer. And I wonder what your response to that is.

Neel Kashkari:

I mean, if you take that argument to its logical extent, we should just have zero capital requirements. Of course that's absurd. And again, I go back to what happened in '08. Who was devastated by '08? Generally it was not people in this room. It was lower income folks, marginally attached to the economy, people with a lot of debt. And for many of those folks, if they recovered, it took many, many years for them to recover, if they were ever, ever able to fully recover economically speaking. And so this is like a speed limit. Somebody can say to you, "Well, there are costs to having a 65 mile an hour speed limit. Make it 75." Why not make it 85? Why not make it 150? Why have a speed limit at all?

Neel Kashkari:

There are trade offs, and we've done the analysis, cost-benefit analysis. There are costs to society of marginally higher lending costs, and there are benefits of avoiding devastating financial crises. So we would encourage researchers to look at our website. We call it the Minneapolis Plan. You can examine our analysis, run your own analysis. A number of independent researchers have also concluded. They may not get as high as I'm arguing, but they argue that the biggest banks need meaningfully more capital than they have today.

Gina:

Interesting. And on the countercyclical capital buffer, obviously former Vice Chair Quarles talked about the CCYB all the time when you were talking about the CCYB all the time. One of the things he would frequently say is that this is something meant to lean against really extreme periods of irrational exuberant. And we have very high capital, and so it's sort of always on, the countercyclical capital buffer. And I wonder what your response to that is.

Neel Kashkari:

And he also, my dear friend, the former vice chair, also argued that it wouldn't be effective to raise it, but it would be effective to lower it. It's like you can come up with arguments that the banks and their advocates come up with very creative ways to argue for lower capital requirements. It'll be good for low income folks. It'll be good for the economy. What it is good for are their share prices. So let's not make any mistakes about what the arguments here. The arguments are about banks want higher stock prices and they get that with more leverage. That's what's going on here. And so the Banking Policy Institute, I appreciate that they're actively retweeting our analysis. We appreciate the promotion. I don't find their arguments particularly persuasive. It's pretty easy to look through them.

Gina:

I do guess, I'd love to push you on this a little bit, because it does seem like the one very clear data point they can point to is 2020. Obviously the banks made it through 2020 without major incident, and I wonder what your reaction to that is.

Neel Kashkari:

Well that, thank you Gina, for asking that. You're right. The banks say, "Look, the heroes of COVID were not the scientists, the doctors, or the nurses. It was the banks," because they kept up lending through the terrible COVID shock. Well, Congress spent trillions of dollars supporting bank borrowers. It's called American families and American businesses, and that's what enabled them not to face credit losses. We've done analysis of Minneapolis Fed on our website where you can look at an unemployment shock and what losses typically hit the banking sector when there's a massive unemployment shock. And you can look at banks own provisioning for loan losses, the losses they expected to have. They didn't face anywhere near that. Why? Because we didn't anticipate and the banks didn't anticipate that Congress would step in with multi-trillion dollars to support the American people. I applaud Congress for doing it, but let's not kid ourselves. This was a bank bailout in other names and with other intentions. The banks absolutely benefited from it. I could never work at one of these places where I just have to make up these arguments that they're the heroes of the COVID crisis.

Gina:

One of the things that the Fed did during the COVID crisis is kind of, I think maybe a little bit like what you were suggesting with the stress test, in that it realized pretty early on that the stress test scenario

that it had come up with was way too easy relative to what we were actually seeing in the COVID shock. It ran several scenario analyses and kind of churned out results that were never actually applied to individual banks. It was all anonymized, but nevertheless, we did do some sort of scenario analysis. I wonder if A, that's what you're talking about and B, whether you think that's something we could sustainably do year after year, because I remember at the time that that was a big stress internally on the Fed's resources.

Neel Kashkari:

Well, I think we can staff up for it and just make that this is going to be the expectation that we're going to run multiple different scenarios, very different scenarios, different types of crises, and we're going to hold the banks to be able to withstand the worst of all of them. Just depending on their portfolio, some shocks are going to hit certain banks more than other shocks. I think there's no reason that the Fed could not staff up for that and there's no reason that the bank should not be able to capitalize themselves well enough to endure it.

Gina:

Interesting. You also mentioned that the stress tests have actually gotten a little bit easier. I assume that's a reference to the stress capital buffer?

Neel Kashkari:

Well, no, it's a reference to the fact that we're only running one scenario now as opposed to multiple scenarios, and it's also a reference to the fact that we used to give failing grades. Now, nobody can fail the stress test. Banks don't like it when they get a failing grade from the Federal Reserve, big surprise. And so there have been small ways when I think it has been made less of an onerous, it's been made less stringent or less onerous on the banks, and I think that this is an opportunity with the new vice chair coming in, Michael Barr, to potentially go in a different direction.

Gina:

Interesting. One of the big things that Vice Chair Quarles emphasized when he was in his position, and I think he didn't quite accomplish as much along these lines as he wanted to, was that supervision should be much less discretionary. Obviously it's been a big topic of conversation today, and I wonder where you fall on that sort of discretionary versus clear lines supervision question.

Neel Kashkari:

If you're too transparent, they'll say, "Well, we want to know exactly what the stress scenario is. We want to know in advance all the details of it." We see it in their public reports, of how banks adjust their balance sheets depending on the time of year and depending on the stress scenario and whatnot. This just reminds me of Volkswagen. They knew what the fuel economy test was. When they were running a test, they changed their engine parameters to get better fuel efficiency. And when the test was over, they started polluting again. If you give maximum transparency in the vein of political legitimacy, you are also opening yourself as a regulator to be gamed by the entity that you are seeking to regulate. And so I think we need to be very careful about that.

Gina:

Interesting. And I wonder, obviously when we talk about scenario analyses and adding them to the stress test, that often comes up re: climate change. There's a big conversation about, should we be

doing climate change scenario analysis? That seems to be the direction that that is leaning in. Should we be doing even more stringent actual climate stress tests? And I wonder where you fall on that spectrum.

Neel Kashkari:

To me, the issue of climate change as it relates to banks and stress tests, this is just basic credit analysis. I mean, we're supposed to be monitoring banks for how they assess the credit risk that they're taking, and if a bank, a small bank or a big bank has a highly concentrated portfolio in one sector of the country that's prone to flooding, as bank supervisors we're going to look at that and say, "Hey, that doesn't make sense. You're taking more risk than you appreciate." So to me, looking at banks' lending exposure to California, or to forests or to areas prone to flood, I just think that's actually bread and butter supervision. and I actually don't think that should be controversial.

Gina:

I guess I'm going to push you on that a little bit. One thing that Lael Brainard, Vice Chair Lael Brainard, when she was governor, recently gave a speech on climate scenario analysis, and she kind of laid out some of the challenges there. And one of them is these are events that might interact with one another that we haven't seen before that we think are plausible, but we don't actually know how they would play out in the real world and we don't know what the probabilities around them are. I'm obviously summarizing. And so I guess I wonder, how do you design a scenario or a stress test around something that is so uncertain?

Neel Kashkari:

I think it's very difficult and I think we're all learning and we're learning from other central banks around the world that are trying to do something similar. And I think we need to keep an open mind, be humble. As the prior panel said, we're going to get some things wrong, admit when we're wrong and improve going forward.

Gina:

Are you far enough along in that regard? Obviously some of the other central banks globally, particularly the Bank of England has been a little bit more ahead of the curve on this one.

Neel Kashkari:

Yeah. I think there are a number of researchers across the Federal Reserve and at the Federal Reserve banks that are very interested in this topic and are doing serious work. Like in a lot of things, we don't necessarily have to be first, but we want to do our best to get it right. We're not going to be perfect, but we do want to do our best to get it right. And if we can learn from what other central banks are doing, that's great.

Gina:

In the vein of not having to be first, central bank digital currency. Do you think that that is something that you all should be looking into seriously? To what degree should you be looking into it seriously? What are your thoughts on CBDC?

Neel Kashkari:

I mean, as my colleagues at the Federal Reserve have talked about, we are examining it. I'll tell you my personal bias is I'm pretty skeptical. I keep asking anybody at the Fed or outside of the Fed to explain to me what problem this is solving. I can send anybody in this room $5 with Venmo right now. No, seriously. So what is it that a CBDC could do that Venmo can't do? All I get is a bunch of hand waving. I get, "Well, maybe it's better for financial inclusion. Maybe it's better for cross-border remittances." Maybe. Is there any evidence that it is?

Neel Kashkari:

They say, "Well, what about China? China is doing it." Well, I can see why China would do it. If they want to monitor every one of your transactions, you could do that with the central bank digital currency. You can't do that with Venmo. If you want to impose negative interest rates, you could do that with a central bank digital currency. You can't do that with Venmo. And if you want to directly tax customer accounts, you could do that with the central bank digital currency. You can't do that with Venmo. So I get why China would be interested. Why would the American people be for that? So anyway, I've said, I think the crypto space broadly is 95% noise, hype and confusion. I'm leaving open the 5% possibility that something useful could come from it. I'm still waiting.

Gina:

To push you a little further on that, obviously one of the big moments I think in the Fed's thinking about central bank digital currency came when the Libra Project was announced. And just this idea that you could have a platform that large pioneering a technology potentially this disruptive did seem to be something that scared some of your colleagues. And I do, I wonder, or maybe not scared is the wrong word, motivated some of your colleagues to look into this topic. And I wonder if you think that the thing at the cusp of the technological research here is important. I wonder if you could talk about the use case versus the technology?

Neel Kashkari:

No, fair point, and some of my colleagues will say this, though. We don't know what these early seeds of the technology are going to lead to in 10 years or 20 years. And we ought to pay attention. And I absolutely believe that. I mean, I agree with that. I graduated from Wharton 20 years ago, and I remember, I think I remember this case study. There's probably going to be a professor here who's going to tell me I got it wrong, but I think I remember a case study about Motorola and cell phones. The case study that I remember is their analog phones were cutting edge and there was a push for digital, and nobody could articulate the use case for digital. And Motorola said, "Oh, we don't need that. We're going to stick with our analog phones," and then obviously digital technology exploded and then Motorola lost the handset war. As much as I may dump on crypto, the 5% of me is saying, "Okay, maybe something important could come from this in the future, and so let's at least pay attention to it so that we don't fall behind."

Gina:

Yeah. Interesting. I guess both the central bank digital currency and the climate question kind of feed into this broader question that I think has been up for debate today, which is what role is the Fed supposed to be playing in 21st century America? Because it does seem like the mandate has shifted a bit. Obviously the mandate itself has technically not shifted, but it seems like you all are taking more expansive views sometimes. I wonder where you see the Fed fitting into the broader governance system here in the US?

Neel Kashkari:

Well, I've only been at the Fed for six and a half years, so I can't tell you I know exactly what the individual regional banks were doing 20 or 30 years ago. But when I read history, and I read a lot of American history, the Fed was created with this really unique structure on purpose, that they wanted the different regions of the country to have a voice in policy making and to have a real understanding of what's happening in their regions. And so you do see different regional banks that are more out in front on some issues rather than others.

Neel Kashkari:

So for example, the San Francisco Fed is probably the most engaged in issues around climate change because California's burning. It's in drought. When I talked to Mary Daley about it, she said, "If I'm not looking at climate change, my constituents are asking me, what am I doing?" This is such a pressing issue that they are facing. In Minneapolis, we have been very outspoken, but not alone on issues of racial equity. George Floyd was killed down the street a mile or so from our bank and this is a very real issue in our city, the racism in Minneapolis and the economic disparities. It's for our community, it's also for our employees. We live there, we are members of our community, and so we look at these issues.

Neel Kashkari:

Soon after I started, we created something we call the Opportunity and Inclusive Growth Institute. It's a research institute focused on harnessing the Federal Reserve's extraordinary research power to try to understand issues of economic disparities. And even if we can't address them with monetary policy, if our researchers can do research on them in a nonpartisan way and just lay out the facts and lay out the analysis, we think that's a contribution for us to make. And so each reserve bank can decide for itself what are the relevant issues in their district, but I think that that heterogeneity and the richness of the different research that's going on, I think it's a strength.

Gina:

Chair Powell will often say that the Fed has this precious independence, and one of the reasons it has this precious independence is because it stays in its lane or it sticks to its netting. He kind of changes his metaphors up. And I wonder if you think that sort of this more expansive set of issues that you're becoming involved in, if that comes at a risk of overstepping that lane or getting out of that lane and inviting politicization.

Neel Kashkari:

Maybe. I've had people say to me, "How could you not look at these issues? You're supposed to go after maximum employment." It's not full employment, it's maximum employment. As many Americans possible working, participating in the economy. For the first four or five years I was at the Fed prior to the pandemic, I was usually a lonely voice arguing against interest rate increases. Oftentimes when I was a voter, the only dissenter saying no. And I said no because we were undershooting our inflation target. I'd go around to communities across my district and there are still people who are looking for work. And I said, "Well, if we're undershooting our inflation target, and there seems like there's still slack in the economy, why are we raising interest rates?"

Neel Kashkari:

To me, understanding economic disparities and racial disparities actually is really important to getting maximum employment right. You actually know when we have reached not max, full employment,

when we have reached maximum employment. I think we did not have a good understanding of maximum employment in the last expansion. And so to me, understanding these disparities is actually important to even our dual mandate itself.

Gina:

You brought up the I word, so I guess we have to move onto that. Obviously you guys were very hesitant to repeat the mistakes of the 2015, 2018 cycle. You didn't want to choke off the expansion too early by raising rates too much and now we have very high inflation. And I wonder if you think you moved too slowly in 2021 because of the experience of that prior cycle.

Neel Kashkari:

I mean, I think so. Yes. And I was strongly in the camp of, "Well, I think this is going to be transitory." We had fiscal stimulus, which we can model how long it would take to flow through the economy. We had workers that we were expecting to return, some of whom did return, but some of whom have not returned. So for a bunch of reasons, it seemed logical that this inflation shock would be temporary. It might end up still being transitory, but a lot longer than I expected at the time and longer than we can tolerate. And certainly, I mean, for me, at least, I'm not going to speak for my colleagues. For me, the experience of 2016 through 2020 did shape how I looked at the economy because I kept seeing us misread the labor market before, where we kept making that mistake over and over again. I don't want to repeat that mistake again.

Neel Kashkari:

Now having said that, as Rich said, if you look at private sector forecasters, now, maybe they're all just following our lead, which is possible, but even the advanced economy central banks who started tightening policy before us, look at where their inflation is. There's still a massive inflation shock going on all around the world. So could I tell you where would inflation be right now if we had moved three months earlier? I mean, would it be 8% into the 9%, 7%? I don't know. We'd still have an inflation shock. That's not an excuse, it's just saying there are big forces going on in the global economy and we are responding very aggressively.

Gina:

You just mentioned that you think it still might be transitory. I wonder how what we're seeing in housing and court services and some of sort the underlying moves up we're seeing within these inflation indices, how does that sort of shape your view of the path back towards 2%?

Neel Kashkari:

Well, it makes it more concerning. The longer inflation is high and the more it spreads out across sectors of the economy, the more likely it is going to be embedded in the fabric of the economy, and then the more work we have to do to push it back down to 2%. And one example of this is wages. I mean, typically when we think about the dual mandate, the way I think about it, typically I think about a wage-driven inflation story where businesses compete to find workers, the unemployment rate drops, wages go up. That eventually then leads to inflation as those costs get passed on to consumers. That's not what we are yet seeing.

Neel Kashkari:

We are seeing an inflation story, in my opinions, that is dragging wages up rather than the other way around, and businesses are saying, "Oh my gosh, we've got these cost increases." It's being caused by supply chains and other factors, not a wage-driven story yet, but wages are climbing. And the risk is that this goes from being a supply-driven inflation story to a wage-driven inflation story, and it becomes more embedded, and then it becomes harder for us to break it and bring it back down. So it's concerning that it's spreading across the economy and it just means that we do have to continue to act with urgency.

Gina:

Interesting. Obviously some of this has reversed itself within markets over the last day, but after the meeting last week, you heard a lot of investors basically saying the Fed's going meeting-by-meeting now. We think that by sometime this fall, we're going to have signs that we are headed pretty clearly into a recession, and the Fed going meeting-by-meeting is going to see those recession signs and stop hiking. And I wonder if you think that it's with your understanding of the world, if you guys saw recession signs materializing, would you stop lifting interest rates?

Neel Kashkari:

I can only speak for myself. I think we are... Hey guys, can we focus here? I think we are laser focused on getting inflation down, and whether we are technically in a recession right now or not, it doesn't change my analysis. I'm focused on inflation and where inflation is likely going, and that, to me, my opinion is what we have to focus on right now. If you look at financial markets, some financial markets are indicating that they expect us to cut interest rates next year. I don't want to say it's impossible, but it seems like that's a very unlikely scenario right now, given what I know about the underlying inflation dynamic. So more likely scenario is we would continue raising and then we would sit there until we have a lot of confidence that inflation is well on its way back down to 2% before we would start to cut. So I think markets, I said this over the weekend, I'm not sure what markets you're looking at.

Gina:

Obviously you have two mandates, full employment and stable prices. It sounds like you're pretty solidly focused on the price stability portion of that mandate right now. I wonder if you really saw unemployment shooting a lot higher, would that give you pause in making rate increases?

Neel Kashkari:

Sure. We've said that if these two things are in tension, then we would take a balanced approach looking at these two sides of our dual mandate. Right now we, by almost any measure, have a very strong labor market and we have very high inflation. So there's not a trade off right now. And by the way, back prior to the pandemic, in my judgment, there was also not a trade off because we were undershooting our inflation target and we still had some slack in the labor market. So at some point there will come attention and then we will have to make trade offs, but we're a long way away from that right now.

Gina:

Do you think a soft landing is still possible?

Neel Kashkari:

I think it's possible, but I don't know how likely it is. We'll do everything we can to try to achieve it, but we have to get inflation back down. And I think, I can't remember, as Don or Rich said, and I believe this. The American people benefited tremendously, in my opinion for decades, because the Fed got control of inflation and managed to anchor inflation expectations. So the people didn't have to think about inflation. There were tremendous benefits to the American people across all parts of the American economy. That is a necessary precondition to have the kind of inclusive growth that I certainly want to have for our economy. And so I think we have to get back to that.

Gina:

Do you think that inflation expectations are well anchored right now? I feel like that's been sort of, well anchored is the buzzword, but is it still true?

Neel Kashkari:

I forget the gentleman's name here, the investor who was speaking earlier. I mean, I look at the same market data that he looks at. Now again, if we and financial market participants are all totally wrong about the outlook for inflation, then the economy may look very, very different, but all of those market indicators are saying that market participants who pay close attention are expecting inflation to fall quite rapidly over the next few years. So those are the best measures I have. Even if you look at survey measures of inflation expectations, they have come up somewhat, but they've not come up by a lot, at least over the medium- and longer-term horizon, and so the best data we have says that inflation expectations are still well anchored, and now it's our job to meet those expectations and to bring inflation back down so that those views are vindicated.

Gina:

Which inflation expectations do you actually think matter? Which ones do you care about when you are thinking about policy?

Neel Kashkari:

I mean, we look at all the different measures we can, both survey measures as well as market-based measures. Each of them have their strengths and each of them have their deficiencies, and so I think if they were telling us wildly different stories, that would give me pause, but I don't think they're telling wildly different stories right now.

Gina:

Okay, great. And I'm going to open it up to questions after one or two more, so think about your questions and maybe find a microphone. But I guess one of the things that I think is really interesting and that we're all kind of wondering is how long is it going to take inflation to come back down at this point? Obviously track record of forecasting inflation recently has not been great, but I wonder if you feel like you have any confidence over how long it's going to take to get back to 2%.

Neel Kashkari:

It's a good question. I don't know. I think it's probably going to take several years. If some people who are forecasting a recession are right, then maybe it'll happen more quickly than that. I don't know.

Gina:

Do you need to get inflation back to 2% as an absolute goal if supply chains remain messed up? If the reason we have higher inflation is because supply is constrained, is it necessary to wrestle it the whole way back down to that 2% average target?

Neel Kashkari:

It'll be a good debate to have. I think the answer's yes, because I think about the economy has certain supply potential and our job is to get maximum employment and stable prices, 2% inflation in that economy's potential. And so if the economy's potential is smaller than we thought it was, we still have to get to our dual mandate goals in that economy. We can't simply say, "Well, now we're going to go for 3 or 4% inflation because the economy is smaller than we thought." At least that's how I view it.

Gina:

Okay, interesting. Does anybody... we have... go ahead. Make sure you use a microphone. Kate, would you have it? Oh, there we go.

Speaker 3:

[inaudible 00:30:10] as opposed to, say, unemployment [inaudible 00:30:25] benefit more from? [inaudible 00:30:29] the unemployment [inaudible 00:30:32]. I'm just wondering, why would maximum unemployment for [inaudible 00:30:41] 5% [inaudible 00:30:41] and why would it 75% [inaudible 00:30:54] and less than?

Neel Kashkari:

Well, excuse me, a lot of different reasons. The second part of your question answers the first part of your question. In 19... what was the first year?

Speaker 3:

19-

Neel Kashkari:

'67. I mean, the percentage of women that were working was much lower than the percentage of women working today, and so there are plenty of households in America where the woman works and the husband stays home, as an example. There are demographers who know this data much better than I do. And then there are other factors such as availability of childcare and whatnot that are affecting labor supply. From my perspective, in terms of whether the economy is overheating or not, we kept looking at data such as labor force participation, such as the unemployment rate, we, the Fed broadly, in 2016, '17 and '18, and we kept thinking, "Oh my gosh, we're out of workers. Everybody able-bodied who wants to work is gainfully employed." And then miraculously, the next month, the economy created a bunch of jobs in excess of population growth. We were bringing people back in.

Neel Kashkari:

And so these are hard things to estimate, to know exactly what labor market is exactly consistent with maximum employment and consistent with 2% inflation, but we need to keep an open mind because one of the things that I've learned over the last five or six years is the vast majority of people want to work. If given the chance to have a decent job at a decent wage, the vast majority of people want to work and we should give them the chance.

Speaker 4:

Actually, I wanted to ask about a somewhat separate topic of master accounts. So there are many different types of institutions, novelly chartered institutions that have sought to be able to open master accounts with the Federal Reserve banks, especially in recent years. None of those applications have yet been approved and some of those are crypto-related. There's of course the narrow bank, which is somewhat a precursor to that. I think one can debate each of those particular applicants on the merits, but I think it would also be a fair statement that there should be clearer, more transparent rules around who actually should be able to get a master account in the first place. So I was hoping A, would you mind speaking to that question of what types of institutions you think should be able to plug into the Fed's payment systems and have a master account? And also, if you wouldn't mind speaking to even the fact that this is ostensibly a decision that has been delegated to the Federal Reserve banks themselves, as opposed to one that's made by the board in DC, to the extent you see a diversity perspectives across the Federal Reserve system, if you could speak to that?

Neel Kashkari:

Well, I'll just say, I think it's important that we have consistency across the 12 Federal Reserve banks that Neel doesn't just make it up. "I like you so I'm going to give you an account. I don't like you, so I'm not." I think there should be consistency across. And by the way, I'm not suggesting that there isn't, but I think it's worthwhile. We're doing extra work as these new types of entities are approaching us to make sure that they're all being treated in a fair and consistent manner. I also think it's related to the broader question of regulation. I mean, if you're going to allow an entity to plug into the financial system of the United States, that there be appropriate regulations and you're not mistakenly plugging something in that could ultimately be disruptive or destabilizing to the system.

Neel Kashkari:

So I know Congress is debating, just take crypto as an example, different regulatory frameworks for crypto. I think those debates are important to have, and I would anticipate that who gets access to a master account may well be affected by who is overseen. If you're overseen by a federal regulator, then maybe that makes it easier and gives us more confidence that you meet basic requirements to be able to get access to the Federal Reserve system. Honestly, I don't have more to it than that right now.

Speaker 5:

Thank you very much. You referred in your comments back that Congress would try to [inaudible 00:35:02]. What are [inaudible 00:35:14]?

Neel Kashkari:

Yeah. It's a great question. I've been thinking about that a lot. I just read Ben Bernanke's new book, which is a very nice summary of the current stance of monetary policy, and it was a reminder after the '08 crisis, first of all, the Fed, Treasury, learned a ton in the '08 crisis. We benefited in the 2020 crisis from having had that experience so recently, that we were able to move much faster and more aggressively having the confidence of some of the programs from '08. I still think there are lessons to be learned from 2020, and we need to carve out the time to do that work to reflect on that. Right now, it's like all hands on deck on inflation. So we went from one crisis to a very different crisis, but we need to find the time to reflect on that.

Neel Kashkari:

So some examples, the Main Street Program didn't work, by and large, which is a lending program to mid-size businesses. And it was kind of clear at the front end it wasn't going to work, because when I talked to mid-size businesses in my region about ideas, they said, "We don't need a loan. We don't know when we're going to be able to reopen our business. We can't take on more debt because we have no idea if we're going to be able to pay it back." The innovation, for example, of the PPP program, the paycheck protection program, was it was basically a grant program.

Neel Kashkari:

Now, with the benefit of hindsight, people will look at it and say a bunch of people got PPP who didn't need it and I'm no doubt there were some fraud, but it also got a lot of money out to a lot of small businesses across the country very quickly. And so if you just contrast those two programs, one was structured effectively like a grant program, one was structured like a lending program at a time when businesses said, "We can't take on more debt because we're too afraid." So I don't know what the specific lessons from that are, but those are two things that would be interesting to analyze and contrast how effective they were.

Gina:

I'm going to take my prerogative as a moderator and ask a followup to that. I wonder whether you think if there are any places where we created moral hazard with the 2020 facilities, because obviously that was such a big subject of conversation after 2008, and I feel like we really haven't heard as much of it this time.

Neel Kashkari:

It's always a risk. So go back to my example about the banks. Now the banks are saying, "Look, we were the heroes of the crisis," because Congress was so aggressive and the Fed was so aggressive in supporting the financial system. Maybe if they actually had to bear those losses, they'd be better capitalized for the next one. But of course there would've been big cost for the American people, too. This was less of a moral hazard issue because this was the... what was the pandemic? It was a natural disaster. Instead of a hurricane hitting the Gulf Coast, this was a hurricane hitting the entire US economy all at once. That's why this pandemic was so profound. In addition to the million people who died, I'm talking about the economic cost. A weather event like this or natural disaster like this, it's hard for me to see the direct moral hazard, but undoubtedly there are some. But not like '08. '08 was clearly bad lending, people making loans they should not have, people taking out mortgages they should not have. It's much easier to connect the dots or moral hazard in '08 than in 2020.

Speaker 6:

[inaudible 00:38:32]

Neel Kashkari:

Yeah. I mean, I think banks returning capital. It'd be great to use that capital to make them stronger before they go back and return capital. And again, it goes back to, they want to get their share prices higher. And so one way to do that is reduce your share count. So, I mean, I think-

Speaker 7:

[inaudible 00:38:56]

Neel Kashkari:

And I agree. I agree.

Gina:

John?

John:

Thanks for this. I was surprised to hear your concern about wage growth, and maybe we can distinguish between inflation driven by wage growth and just sort of wage growth, because I think one way to think about... a story you could tell about the economy since the Volcker era is that we had an economy before then where the returns from the economy were divided between capital and labor. And then you have the Volcker shock. You have price stability, but you also have wage stagnation so that you have increases in productivity, but no increases in wages. And so when you said that you were really concerned about wage-driven price increases, what I heard is you were concerned about workers having more power in the economy, which would then ultimately be to their benefit and to the disadvantage of capital. I think critics of the Fed might worry that the way that you think about inflation often advantages investors and owners of capital as against workers who would like to see rising wages, whatever the inflationary consequences.

Neel Kashkari:

Yeah. Well, thanks for asking me for that clarification. I definitely am in favor of wage growth, of real wage growth, but I'm in favor of real wage growth that is consistent with 2% inflation. And I'll give you an example of an anecdote that I shared at the FOMC. I'm allowed to share my anecdote to you, because I'm the one who said it. There's a convenience store near my house, a gas station that I go and I buy Cherry Coke Zeroes, among other things there, and I was asking... this is maybe nine months ago. I was asking the owner. He's had a help wanted sign up on the door. I said, "What's going on?" He's like, "Oh my gosh, I've got five convenience stores all around the Twin Cities. I have never seen a labor market like this in 25 years. This is just crazy. We cannot get workers."

Neel Kashkari:

And I said, "Well, what is it normally like?" He said, "Normally, I put a help wanted sign up and that day, I have a line of workers out my door that I get to pick from." So what occurred to me when he said that was, why is that what we define as normal? Why is that a normal labor market, when there is a line of workers up to get a job at a gas station? Another example, in 2016 or 2017, I was doing a round table of small businesses in North Dakota who were going on and on and on about the historic worker shortage. Whenever businesses can't find workers at wages they're used to paying, they declare a worker shortage. And I asked them, I said, "When was the last time there was a good labor market?" And they thought about it and they said, "2009 was a pretty good labor market."

Neel Kashkari:

That's our mindset. That is what is normal. And so I'm with you spiritually that I think that the pendulum has swung for too long, too far in one direction. But I think we can allow the pendulum to swing back, but in a manner that is fundamentally consistent with 2% inflation. I don't think that long-term there are going to be benefits to workers if we just say, "Okay, well, 3%'s our inflation target, or 4%." I actually don't think long-term that that would accrue to workers' benefit, but we could have that debate.

John:

But I think it's interesting that you learn that by talking to employers, not by talking [inaudible 00:42:25]

Neel Kashkari:

No. I talk to a lot of workers. We talk to a lot of labor groups. If you actually look at our beige book, we actually inserted sections in our beige book on worker feedback, on what workers are experiencing for that very reason. So those are just anecdotes, the two anecdotes that I shared with you, but we talk to a lot of workers. Especially I find beneficial is talking to frontline workers who are cleaning hotel rooms and bagging groceries and cleaning office buildings and whatnot. You learn a lot. Thanks.

Gina:

Jeremy?

Jeremy:

Two quick questions on bank capital. You started with the countercyclical buffer. What do you think about automating the buffer, tying it mechanistically to macroeconomic indicators like credited GDP growth to take away regulatory discretion? Second, Nicola had a question earlier about the supplementary leverage ratio. Was excluding treasuries and reserves the right call in spring of 2020, and what would you do with the SLR today?

Neel Kashkari:

Well, it's an interesting concept to tie the CCYB to... we have it in, the stress capital buffer has some elements of this, which is if under certain conditions it limits their ability to pay out, to buy back shares and to pay dividends and whatnot in more of a mechanistic way. I'm open minded to it. I mean, if we're never going to turn it on through discretion, then we bet might as well go to something that's a little bit more rules-based, even though I'm generally speaking, not a fan of rigid rules because the economy throws too many curve balls. But I'm sympathetic with looking at that.

Neel Kashkari:

I would've preferred in March, April of 2020 that the big banks just raised more capital. I mean, that's another way of solving the problem. Absent that, doing whatever we could do to stabilize the financial system I was in favor of. I mean, I just can't believe it, having lived through 2008, but 2008 is burned into me. The idea that 12 years later we had another financial crisis where the financial system was on verge of collapse, that is just shocking to me. It's outrageous that our financial system is that vulnerable, absent the Fed stepping in with massive programs to keep financial markets running. And so all of you who are in the regulatory, financial regulatory arena, we have a lot of work to do.

Speaker 10:

[inaudible 00:44:42]

Neel Kashkari:

We need more capital today.

Speaker 11:

Ask you a couple of questions about the Treasury and the Treasury/Fed relationship. You, like a number of other high-ranking Fed officials, started their political careers in the Treasury Department. Do you think that has implications for central bank independence? And also, as the Treasury and the Fed are working more and more closely during financial crises, do you think there's any constraint on what Treasury can use the ESF for? Could it set up a facility with the Fed's reduced commodity prices right now?

Neel Kashkari:

To the latter question, I don't know. I know that Congress put some constraints on the exchange stabilization fund in the Dodd-Frank Act, and off the top of my head, I don't know what those constraints, how constraining those would be. I think the Fed and Treasury working well together during crisis is something we should be happy about and proud of. They worked very well under Paulson and Bernanke and then Geitner and Burnett, and they worked well again in the COVID crisis. I think that that's very effective. I don't know. I don't think the fact that I started out at Treasure, I think the fact that I started out at Treasury gave me a good understanding of financial crises and financial markets, and that I've benefited in my role as a policy maker at the Fed. So, I mean, it's a fair question to ask, but I don't see it as a concern.

Gina:

Nathan?

Nathan:

If [inaudible 00:46:25] notes on the crises. I wanted to ask just a more technical question about the countercyclical capital buffer and how it interacts with monetary policy more generally. If you were to convince your colleagues to activate the countercyclical capital buffer, do you think that that should have an impact on what interest rate policy decision you're making? For example, would you consider, say there was a meeting where you were planning to hike 50 basis points, would you say maybe we shouldn't hike that at all because we're activating the countercyclical capital buffer?

Neel Kashkari:

It's hard for me to respond to this specific example that you gave, but I do think on the margin, if people had more confidence that the various regulatory tools that we had were being fully utilized to make sure the banking system was safe, then there would be less sympathy with, "Well, we might need to use monetary policy to keep financial markets from getting into excess." Sometimes I'll hear people say, "Well, this market is frothy. Therefore, maybe we should use monetary policy." I mean, it sounds attractive until I stop and think about it and I actually walk through the analysis and it ends up being, "Oh my gosh, you're imposing these huge costs on society to deal with this one market over here."

Neel Kashkari:

So an example is Alan Greenspan declaring irrational exuberance. I look at that and say if the Fed had tried to use monetary policy to stop the stock market from climbing through the tech bubble, they would've caused much more damage than the recession that followed when the tech bubble burst. So wrong tool for that. So I think on the margin, if the countercyclical capital buffer were effective, then there would be even less consideration that monetary policy might be the right job to deal with either real estate prices that were high or stock prices that are high. Right now, I don't think we're making decisions using interest rates to try to deal with those markets, but I think we just have more comfort

that the financial system was strong, and then we could really use monetary policy for the dual mandate.

Speaker 13:

In the issue of stress tests and the difficulty of knowing what the next crisis shock will be, a lot of entities in the private sector for Citibank and others are hiring futurists at a very high level to predict the unpredictable or prepare for it. So, any thoughts on the Federal Reserve integrating futurists for their stress tests? That's the first part. And the second part is, what future crises or the possibility of a future crisis kind of keeps you up at night that we might not all be aware of?

Neel Kashkari:

Well, I'm thinking about when you said the Fed hiring futurists, I thought about the prior conversation about Fed credibility. I'm not sure how well that message would be received by the public. We do bring in outside speakers all the time who have wildly different perspectives and they challenge us to think about things we might not be thinking about. May be best if the futurist is out here and then come in and visit us every once in a while. In terms of what shock, none of this is going to be new. So you're going to say, "Gee, Neel, you're not telling us anything we're not already thinking about," but just the geopolitical tensions.

Neel Kashkari:

I read a lot of history, and the situation in Ukraine is obviously devastating for the Ukrainian people. There's a lot of history that it could expand beyond just Ukraine, and what are the implications for the world economy and for the world? That's something that, again, you're well aware of that, too.

Gina:

I think we are pretty much out of time, but I wonder before, I always ask, is there anything we're not asking you?

Neel Kashkari:

Yeah, is there anything you don't want us to ask you? That's my favorite question. No, I just think this is a great conference. I really appreciate you inviting me to participate in it. As you can tell, I like to speak candidly. Not everybody appreciates that, but hopefully you appreciated it. So thank you for having me.

Speaker 14:

Please jump right into [inaudible 00:50:49]