Fed Unfiltered, Transcript
9/27/22 – Charles Evans, Interview: CNBC

Speaker 1:

Are we closer to the end here than to the beginning in terms of how many more hikes need to come in your opinion?

Charles Evans:

Well, I mean, you're exactly right. We had a thorough open market committee last week and the consensus is really very strong that inflation is high. Getting inflation under control in the US is a job one, and so increasing our policy rate is very important. We have certainly increased our federal funds rate target range expeditiously already. We're at 3 to 3.25%. And the consensus median view for the end of this year is that the federal funds rate will be in the 4.25 to 4.5%. So there's still a ways to go this year and a little bit more next year according to the summary of economic projections that my colleagues and I put together.

Speaker 1:

The pound has been an extraordinary story over the last 24 hours, as has the gilt market, as has the Swedish krona, as has the Korean won, evidence it seems that what the Fed is doing is having global repercussions on other countries' currencies and asset classes. Is the Fed going to break the market, do you think, by tightening as aggressively as it has been at this point? This seems to be the fastest we've seen any Fed move in recent history. And we know that in those other occasions, we had a 2008 crisis with Lehman Brothers. We had obviously a meltdown in 2000 with the technology sector. We had an Asian currency crisis in 1997. Is the Fed now creating another global currency crisis or a further crisis in financial markets?

Charles Evans:

This has been a very rapid increase in our short-term policy rate in the US. If you go back to 1994 and '95, the Fed increased interest rates by 300 basis points over the course of a year. We've done that in seven months already and we still have a ways to go. Inflation is very high, and globally, inflation is very high. In the US, there's been a lot of commentary about how the strong fiscal support for the economy and a number of different tranches has led to very strong aggregate demand at a time when supply has been held back. So, demand has outstripped supply in a number of areas, especially goods production. So, it's been a very challenging time. Prices have gone up. Relative prices gone up. Cars, durable goods in the US, and many segments, but now it's broader and that's, I think, the concern sort of globally. This is a global inflationary environment with high energy prices and a concern that it spreads more broadly throughout every economy is one that central bankers are going to have their eye on. And so, I think this type of brain environment is here for a while.

Speaker 3:

Charles, a decade ago, Reinhardt and Rogoff told us that 90% was the key benchmark. It's been challenged a lot as well, but global debt has surged past it at a state level, at a state enterprise level, at a corporate level, and, of course, at a household level as well. Did we forget that debt actually matters and now it's come back to bite us?

Charles Evans:

Well, it's certainly the case that fiscal responsibility is very important. We've been in a very difficult period obviously, going through the pandemic and COVID, and I think the fiscal support that

governments around the world provided their citizens and households is exactly what governments are there for, and so that leads to higher deficits, higher debt. It is a challenge obviously, when you use up your fiscal capacity and it's hard to do more there. It is the case that many financial investors really have a strong desire for safe assets and good quality fiscal debt is really quite safe, but there can be limits and nobody knows exactly where they are and they depend on so many different features of each economy. Strong economies very important increasing growth rates, trend growth rates, and supporting the structure of your economy is very important helpful determinant for how you might weather that.

Speaker 3:

And it's a delicate balance. And as you say, there are limits, a delicate balance between fiscal responsibility and largesse. And again, a lot of the latter been going on recently and indeed monetary policy as well. Has the UK government overstepped the mark, overstepped the limit and broken that delicate balance?

Charles Evans:

Well, I'm here to talk about my views on the US economy and US monetary policy. I think this is just a very challenging period. We have an aging population around the world. Growth rates are not nearly as strong as everybody would like them to be. Increasing growth of labor input is important. And technology, putting in place the infrastructure that helps support more technological growth, capital investment by businesses and all of that. It's got to be done in a very responsible manner so that investors have confidence in that. But it's very challenging.

Speaker 1:

Yeah, but-

Speaker 3:

A very conservative answer, sir.

Speaker 1:

I mean, basically you set the global interest rate and because you are tightening them for the American economy, everybody else is having to suffer the consequences of that. Back in the '90s, Alan Greenspan acknowledged that the Fed had some responsibility for the global economy. Are we not in that situation again? Don't you have some responsibility for the global economy and if you break the pound then you do some serious damage?

Charles Evans:

We obviously pay attention to global financial conditions. They're an important determinant for our own economic stability and for our growth possibilities. Globally advanced economies are suffering through a very high inflation period right now, and every central bank, every government is keeping their eye on where inflation is, and we know that low and stable inflation is a very important fundamental for strong growth going forward. And so in the US, Chair Jay Powell has been very clear that getting inflation under control is very important to support stronger future growth. I think every advanced economy has their same eye on that and I think that's very important.

Charles Evans:

Are there risks? Yes, of course there are risks because we're having to increase rates much higher than they've been increased in quite some time. Federal funds rate, my judgment, next spring is going to have a real rate of about 1.5%. We just had a long period of zero and negative real interest rate, so it is a challenge. It's not outsized relative to past performance, but on the other hand, we're in a different world where we have lower trend growth, so it's tough.

Speaker 1:

Rent oil has fallen $20 since August. We are seeing energy prices come down very rapidly. In what sense is that shifting your appreciation or belief in your own inflation forecasts at the Fed? I mean, should you be adjusting down more rapidly?

Charles Evans:

So oil prices have come down that's for sure. They're still high. If you ask people in the US, you can just hear, gas prices are lower. They're still high, higher than people in the US would like. That's something that we just have to appreciate and set policy accordingly. The hard part, in my judgment, is that coming out of COVID, we've seen a strong recovery. We've seen a huge emphasis on goods production, not in-person services provision, and that's really distorted prices. We've had strong relative price increases, and that, by itself, I mean it leads to measure inflation that's higher. Need not lead to future inflation because that's really monetary. But when households, businesses, labor become accustomed to inflations going up, wages need to go up just to catch up, not to get ahead but just to catch up, that's the type of transmission mechanism that has every central banker concerned. So we want to make sure that we stay on top of the inflation situation. Certainly, I'm speaking in the US, our situation, and I think that by the spring of next year, we're going to get to a funds rate that we can sort sit and watch how things are behaving and if inflation starts to come down, things will be more restrictive and we would want to adjust downward those interest rates.

Speaker 3:

The tone is in labor market, all kinds of barometers. You look at them all as well. I pour over them all as well, and look at the JOLTS, for instance as well. And even if we take the JOLTS with a pinch of salt about the intentions of companies to hire as well, it still looks extraordinary, somewhere in the region of two jobs for every person looking for employment or perhaps slightly less than that now as well. How much does it worry you about the heat in the employment market and what that could do to wages? And actually, from what you were just saying, actually, you want to see wages increase to actually offset the cost of living crisis, but obviously, there is a finite level of where it gets too hot.

Charles Evans:

Certainly households would, at a minimum, want to keep up with inflation and so having their labor income keep up with inflation.

Speaker 3:

8, 9% in the past.

Charles Evans:

Well, that's very stiff, obviously. Wages have gone up in some segments, more. I'm hopeful that inflation's going to come down while wage growth can continue at a good level so that households can

keep up. But we need to keep our eye on the ball of higher productivity, better business outcomes so that labor can enjoy the fruits of that. It's certainly the case that labor is strong in the US, as you mentioned, vacancies are almost twice the pool of unemployed. I think the aging demographics, certainly in the US, are real challenge, and around the country at the moment, demand is outs stripping supply in many areas where the labor situation for years and years and years has worked. But if you've got an unemployment rate in 2%, like some states in my district, things are working just exactly right, and if there's something that goes off kilter just a little bit, oh, that causes disruptions, and I think it's even more than that right now. So I think that's a challenge, especially for goods-producing sectors.

Speaker 1:

In terms of the next move then, does the market still need to see the fed's teeth? Does it need to be a 75 or 100 basis point move?

Charles Evans:

I think we've been very clear in our communications, and I'm a strong proponent of our summary of economic rejections and the fact that we indicate where we think the path of the funds rate ought to go to justify our projections. The exact timing of that path to me is less important than the fact that we continue to get to the point where we think we ought to be. So whether or not it's a larger increase at the next meeting or continued increases to get there. Before very long, if you just look at everybody's projections, we pretty much all got the same spot by March.

Speaker 3:

But what outlook-

Speaker 1:

No, I was just going to, I'll ask you about the financial markets and how they feed back into decision-making because we know the Fed does keep an eye on what's going on, and clearly, volatility has picked up here. And if you had a 60/40 portfolio, which a lot of retirees do in the United States, you'd be down 20% year to date because of the declines we've seen in both equities and bonds at this stage. You could argue yesterday was the first real evidence we've seen of disorderly selling in the gilt market. To what extent are financial market issues going to feedback into decision-making or should they at this next meeting?

Charles Evans:

Well, I mean, I worry, my colleagues worry a lot about financial instability risks. I think at the moment we're in a moment where in many different markets, investors are trying to figure out exactly where things are going. I think in the US we may have started off slow, but we've been expeditious in increasing rates, and so I think we're on a path where we ought to be. And so I think markets in the US have a better idea. They may think that, well, it certainly is the case of higher borrowing and lending costs are going to impact their ability to take on certain investment opportunities. I think that's just the way things are going to have to proceed until we have inflation under control, the quicker we get inflation under control, the better we can get borrowing costs back to where they support stronger, continued and confident growth.

Speaker 3:

Yeah, not for the first time, I was going to ask you almost an identical question as my colleague there. We've been working together too long, sir. But in terms of the risks that Jamie Dimon others were talking about when they were before the politicians in the last week or so as well, where do you identify the greatest risks for the financial markets? We know they like to overshoot to the upside and overshoot to the downside in terms of irrational exuberance and pessimism as well, but where do you see the greatest risk for the financial markets? Some in the financial markets might argue it's what you, sir, do in the FOMC and the rest of your colleagues as well, but I presume you'd beg to differ.

Charles Evans:

Well, I think having a strong economy is an important fundamental for financial markets to allocate capital to its best uses, and so I think that's very important. Getting on top of inflation is very important in the US and around the world. Having the supply channel improve, I believe that it's already improving. There's a certain aspect too. It took time because COVID hit Malaysian and Indonesian plants with semiconductors and you haven't been able to finish cars in the US and around the world because of that. That's getting better. But now we're finding part shortages owing to short labor in certain other areas. And so getting the economy back on track, getting supply in line with demand, and getting inflation to come down, I think that financial markets will benefit just like everybody in the country.

Speaker 3:

And ultimately, there's a cleansing process. There was the dotcom bubble bursting. There was at the great financial crisis. And I'm wondering now how you feel about some of these? The more extreme models we see of allocation of finance and capital in markets, whether it be in the SPAC market, whether it be in some of these growth stocks, whether it be in business models that you and I, where deep down we know haven't got a chance of making profitability on a regular basis as well. Do you feel the cleansing process in financial markets is working again this time around?

Charles Evans:

Well, I think we've definitely moved to a higher interest rate environment where there has to be more the most discipline of all investors as opposed to perhaps at earlier times where things may have been fraught. Maybe real rates really weren't that low, but they still were challenged in all of that. But I think we moved to a period where you get that type of behavior that you're talking about. Now, most importantly, I'm still optimistic that the US economy has a narrow path but can navigate its way to unemployment not rising about 5%. We're at about 3.7% now, and so obviously, that would mean more people unemployed, but still, 4.5% unemployment would be a very good outcome. I think that would provide strong fundamentals for the US economy, that would provide strong fundamentals for financial markets and allocating capital to its best uses, to its most productive uses. I'm always looking for investments that are leading to more physical business investment that improve infrastructure for everybody and stronger competition. And so to the extent we get more of that, that would be healthy.

Speaker 1:

Yeah, that's interesting. So you continue to stick to the line that recession can be avoided here, even though, I think, there are a lot of people that are worrying that monetary policy comes with a lag and you're not really waiting or pausing to see what the impact of the moves that have been taken already are going to be.

Charles Evans:

Well, I'm a little nervous about exactly that. There are lags in monetary policy and we've moved very expeditiously. And so when we've done three 75 basis point increases in a row and there's talk of more to get to that 4.25 to 4.5 by the end of the year, you're not leaving much time to look at each monthly release. Again, I still believe that our consensus, the median forecaster to get to the peak funds rate, assuming by March, assuming there are no further adverse shocks, and if things get better, then we could perhaps do less. But I think we're headed for that peak funds rate, and that offers a path for employment stabilizing at something that still is not a recession. But there could be shocks, there could be other difficulties. Goodness knows, every time I've sort of thought the supply chains were going to improve, that we're going to get auto production up and used car prices down, and housing and all of that, something has happened, so cautiously optimistic.

Speaker 4:

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