Fed Unfiltered, Transcript
9/29/22 – Loretta Mester, Interview: CNBC

Joe:

... [inaudible 00:00:00]. Thanks for being here. There are some people, I've seen it posited that the Fed, if it were to blink or pause, it's not going to be because of economic conditions, but because of something, I don't know, scary, something similar that we saw yesterday, maybe some type of dislocation.

Joe:

I wonder, how do you try to anticipate that? The piece in the journal today says, "We're fortunate to have King Dollar so that we don't have the same type of ... It was easier for that to happen over in the UK, and it won't happen here." But we've got our own issues with debt ratios and everything else, with some of the stuff we're seeing from the Biden administration. Do you know for sure that there's not something under the surface, if you continue to raise rates sharply, that would cause you to pause because of disorderly market conditions or pensions or whatever you want to use?

Loretta Mester:

Right. Yeah. Joe, you're right that no one knows for sure, and what we saw at the beginning of the pandemic, of course, was dysfunction in that all important treasury market. There have been steps to try to make that a more robust market and more resilient market. So, no one knows for sure. So far, we haven't seen the kind of market dysfunction, even through what's happening in the global markets right now. We haven't seen that in the US markets.

Loretta Mester:

But we've got to always be attuned to the possibility and be able to react appropriately should something like that happen, and that's how we're balancing what we need to do on the monetary policy side, knowing that market dysfunction is not helpful for us to achieve our monetary policy goals. So, I take your point that we need to be cognizant of that, but right now, I don't see that in the market functioning that we're looking at.

Joe:

He has so many expressions. Sometimes, I get tired myself. But this is not your father's labor market either, and I'm now switching to economic numbers that are coming in and whether we can trust those to give us an accurate picture. If there are parts of the economy where inflation really is moderating, but we have this new hybrid workforce, and we have a low participation rate, and we've got new ideas about how we actually want to approach labor, what if that's why we have this inflation? But it's moderating everywhere else, and you kill the patient when it didn't need to be killed because you were misinterpreting what the labor market's telling us.

Loretta Mester:

Right. Yeah. So, all the indicators we have from businesses that we talk to is that the labor market demand is still outpacing supply. The firms we talk to in manufacturing and the service sector still are trying to hire, and they're still trying to find labor force. I think the things you're talking about are important when you're thinking about will labor force participation move up from levels where they currently are? And I take the fact that we're basically back to trend on the labor force participation rate, given demographics, so I'm not expecting this big influx of workers. I think we'll get some relief there. I think some people will be drawn back in, but I'm not expecting that.

Loretta Mester:

So then we have to ask, okay, we've got to moderate both the labor market and product markets, if we're going to get inflation back down. At some point, once we get real rates up, and we see more of that moderation demand, you're exactly right. Then there's some trade offs, and then you need to be concerned, have you gone too far, or is this a good place to stop? We're not at that point yet. Inflation is still a 40-year high, so right now, the conversation has to be, we have to do what we must do to get back to price stability because we can't have a healthy economy, we can't have good labor markets over time, unless we get back to price stability.

Speaker 3:

Let me follow up on that, which is, you've done three 75 basis point rate hikes in a row, which is historic by itself. They say that monetary policy acts with long and variable lag, so you have no idea when what you've done to the economy is going to hit. Given the rapid rise in rates, why isn't there an argument for a pause sometime, even if you're still going higher, to see what kind of effects you've had on the economy?

Loretta Mester:

Yeah. Yeah. We can have that conversation, but we're still not even in restricted territory on the funds rate. So you're right, we've moved the funds rate up 300 basis points, this year, but look how high inflation is. So it has to be relative-

Speaker 3:

Give me the number. When you say four and a half, what's restrictive about four and a half? What inflation number are you using to plug in there?

Loretta Mester:

Right, so if inflation is at three and a half, next year, or even lower, which is what the median CPI or the-

Speaker 3:

Right. SEP.

Loretta Mester:

... SEP says, then that would be a positive real rate.

Speaker 3:

You'd use that number.

Loretta Mester:

Right, so-

Speaker 3:

You'd have to get to four and a half of a 1% positive rate.

Loretta Mester:

Right, you have to calibrate. The other thing to understand, though, as inflation comes down, even holding the funds rate at a particular level is a more restrictive policy, so that's going to be the calibration exercise.