Fed Unfiltered, Transcript

10/19/22 – Neel Kashkari, Interview: Q&A with Travelers Institute President Joan Woodward

Joan Woodward:

Good afternoon, and thank you so much for joining us. I'm Joan Woodward, Executive Vice President of Public Policy and president of the Travelers Institute, and I'm really thrilled to welcome you today to our special program. Today we're going to take a deep dive into the state of the US economy and the impacts that inflation, increasing interest rates, changes in the labor market and real estate markets could have on your business and personal lives. To help us navigate these topics, we're joined by Neel Kashkari, the president and CEO of the Federal Reserve Bank of Minneapolis. In his role at the Minneapolis Fed and as a member of the Federal Open Market Committee, Neel is intimately involved in the Federal Reserve's efforts to lower inflation now at a 40 year high.

We're very excited to have him join us today to provide us up and close personal perspectives on the status of the economy. The Fed's offered to bring down inflation rates and what we can expect in the coming months and years as consumers, business owners, employees, and all of us navigate these times. One quick note before we get started, I'd like to share our disclaimer about today's program. And now I'm really thrilled to introduce Neel Kashkari. Since joining the Minneapolis Fed in 2016, Neel has been instrumental in establishing the Opportunity & Inclusive Growth Institute, which aims to ensure that world class research helps to improve the economic wellbeing of all Americans.

Under Neel's leadership, the Minneapolis Fed also released an action plan on ending too big to fail, which calls for higher bank regulations and tighter bank regulations to avoid future taxpayer bailouts of large financial institutions. And prior to joining the Fed, Neel served in the public and private sectors, including several senior positions at the US Department of Treasury where he oversaw the Troubled Asset Relief Program or TARP during the 2009 financial crisis. We're really thrilled to have you here with us today, Neel, and we want to really get your insights. But first, why don't you tell us a bit about the Federal Reserve Regional Bank system, specifically about what's happening in Minneapolis and how you're navigating these really uncertain times. Neel, take it away.

Neel Kashkari:

Thank you Joan. It's great to be with you. Thank you for having me. It's great to be with all of you. I know we're speaking to a national audience, but I do want to start and just talk a little bit about the Federal Reserve system because a lot of people don't know a lot of details about it, nor would one expect you to. Congress created the Federal Reserve System in 1913. This was the nation's third attempt at creating a central bank. And in 1913 they said, we want to do something unique, we want all the regions of the country directly involved and represented in the policy process, not simply everything housed in Washington, D.C. So they created the Board of Governors, you've probably heard of the past chairman, Alan Greenspan, and then Ben Bernanke and Janet Yellen and their current chairman, Jerome Powell.

Well, the Board of Governors sits in Washington, D.C. They're appointed by the president of the United States and confirmed by the United States Senate. And then they created 12 independent Federal Reserve Banks and they carved up the United States into 12 different regions or districts. The idea is those reserve banks are meant to be independent and take an independent view of what's the appropriate policy, monetary policy for the nation. The Ninth Federal Reserve District is that where I sit here in Minneapolis, the Minneapolis Fed, and we represent Minnesota, North and South Dakota, Montana, the Upper Peninsula, Michigan and Northwestern Wisconsin.

A big part of our jobs, my colleagues and I, is to really know what's happening here on the ground in our regional economy. And then when I go back to Washington, D.C. every six weeks for Federal Open Market Committee meetings. Part of what I'm doing in those meetings is talking about what's happening in our regional economy so that those ideas are represented in that deliberative policy process. Now, importantly we cannot set a different interest rate for Minnesota and for California and New York, it's all the same dollar, so we have to set the right monetary policy for the nation as a whole. But the jobs of the regional presidents are to make sure that our regions are represented in that deliberative process.

And when I make a recommendation for monetary policy, I'm making recommendation, my best estimate of what's right for the country. But it is informed in part about what's happening in our region. In our region, our region looks a lot like the US economy. Our region is very diverse in terms of industry representation. All major industries of the US economy are represented here. That serves us well because some industries, some sectors may be doing better than others. So that diversity helps us and it also helps give me a lens into what's happening in the national economy. I'll say one thing and I know Joan, you and I are going to talk about current economic conditions a lot, so I'll save most of my comments for our discussion. But one thing we're paying a lot of attention to is, is the labor market softening?

And when I travel around my region here and I meet with businesses, I'm seeing very little evidence in my region that the labor market is softening. The number one issue I hear from businesses, small and large, is their struggles to find workers, how they're having to pay more wages to keep their employees and to attract employees. And the labor shortage is what I hear of more than anything else. When I talk to some of my colleagues from around the country, I am hearing evidence of in certain regions, in certain sectors, some softening of the labor market, but it's not showing up very much yet in the Ninth District. Another thing is different reserve banks will focus on different policy issues.

So five years ago at the Minneapolis Fed we launched a research center that you mentioned, the Opportunity & Inclusive Growth Institute to bring our research capabilities to understanding the barriers to economic inclusion. Why are some Americans left on the sidelines of an economic recovery? This is a long term research project that really tries to get at, how do we bring everybody into the labor market? How do we really achieve maximum employment? And that's just one example of focus that different reserve banks take on different issues. In Texas as an example, they do a lot of work in the Dallas Fed on the energy sector, we have energy in the Bakken and they have energy in the Permian Basin. That's been a focus for them.

So there are different focuses of different regional reserve banks. That's an overview of the Federal Reserve system. I'm thrilled to be here with you. Really look forward to getting into our discussions. So why don't I turn back over to you, Joan.

Joan Woodward:

Okay, terrific, Neel. Thank you for that overview. A lot of people don't understand and really have no really, as you say, need to understand how the regional banks work. I really appreciate that and bringing to perspective of the different regions is important, as you say to Washington to those FOMC meetings. Before I begin my discussion with Neel and get to some of the really important questions of the day, we're going to turn the tables on the audience and ask you a couple of polling questions. We want to get a sense and a pulse of what you're seeing in your daily lives. First question everyone just please click the answer there. Have climbing interest rates caused you to reconsider purchasing a home or a vehicle in the past few months?

Yes, it's caused me to postpone purchasing a home or vehicle. No, I'm still going to make that big purchase or I haven't really even thought about buying anything big recently. Let's see what our audience members. We had about 5,000 people register for this webinar today, so we're thrilled to have so many interested. Okay. It looks like the audience response here is about 40% of us says it's caused me to postpone a home or a car. About only 10% said that I was planning on purchasing but I'm still going through with it. Neel, what do you think of these results? We have about 40% of people who've changed their minds recently.

Neel Kashkari:

It's remarkable. Four times as many said that they're going to pause rather than go ahead with the purchase anyway. We know the way interest rates work, it affects certain sectors of the economy sooner than it affects the rest of the economy. These big ticket items that people generally have to borrow money for a house or a car, we know it affects those sectors right away. Mortgage rates have gone from around 3% for a 30 year mortgage to 7% more recently. That is having a profound effect on buyers who would go get a mortgage. And so it's interesting to hear those, get that anecdotal evidence. And I guess I'm not surprised by it, but four to one ratio, that's a big impact.

Joan Woodward:

This is all about consumer confidence, right? University of Michigan, the Conference Board, they come out every month with a consumer confidence number. Is that a leading economic indicator for you to look to it or is that a lagging economic indicator on consumer confidence?

Neel Kashkari:

It's a good question, it feels to me more like a real time indicator, thinking a sense of where people are feeling at the moment. And another one that we look at a lot are inflation expectations. How do people think inflation is going to be in the future? It's amazing how big mind share gasoline prices have in everybody's minds. Gasoline prices matter. You got to get to work, especially if you're in a rural community, you may have a long distance to drive and you see the price because you go and you fill up and you can see how it's draining your pocketbook every week or every month. And so gas prices actually have a big effect on how people are feeling about the economy and how they're feeling about the outlook for inflation.

I know that gas prices have been volatile, they were very high in the spring, they came down, now they've come back up somewhat and that has certainly affected people's purchasing power. It's a big deal for families.

Joan Woodward:

Okay, audience, we have one more question for you and then we're going to get to our discussion. So second question is, how likely is the US heading to a recession in the next six months let's say? How likely, not likely, somewhat or very likely? Let's get a sense of our audience here, Neel, before we move on. And it looks like results are coming in. On my end I see that about 60% of our audience say very likely and about 40% say somewhat likely and I only have 4% of the audience saying not likely. Obviously people are very worried here, likely or somewhat likely. What do you make of these results? Is that in line with what you're seeing out there in your region?

Neel Kashkari:

I would say those are probably more pessimistic than I personally am. We're still trying to work hard to engineer what we call a soft landing. And one of the dangerous things about economics is if everybody believes a recession is coming, then everybody will take effort to try to protect themselves and tighten their purse strings. And then that behavior makes it more likely that a recession happens because everybody pulls back at the same time, and it's getting a lot of attention. There's a lot of coverage in the news, in the financial press about is a recession coming and whatnot. And so there is the danger that we're going to talk ourselves into a recession even if the underlying fundamentals don't require it.

The first half of this year we had negative GDP growth and usually if you have two quarters in a row of negative GDP growth, people say you're in a recession. But normally if you're in a recession that negative GDP growth coincides with a lot of widespread job losses. Well, we had negative GDP growth and widespread job gains, so we were getting mixed signals out of the economy and there are a lot of different dimensions of the economy right now where we are getting these very mixed signals. It's hard to get an underlying read of what's the overall health of the economy. The strongest part of the economy this year has been the job market. It has slowed down somewhat in the last few months, but it has continued to create jobs at quite robust levels, larger levels than you need just to keep up with population growth.

By that dimension it seems like the fundamentals are still strong, but a lot of the surveys and a lot of the sentiment is quite negative and you look at what's happening around the world, it also gives us, it's setting up big caution signs that the global economy does appear to be slowing and facing big challenges, which I'm sure we'll talk about.

Joan Woodward:

Okay. Thank you for that. Consumer spending as you said, it's a mindset in terms of what our audience just answered that question. And so if the consumer is not fueling spending, isn't that juicing GDP growth? And so are you worried that some of our audience members who may have delayed that decision to buy something bigger may help to cause the continued negative growth? Are consumers key to keeping the economy going?

Neel Kashkari:

Absolutely. The consumers make up the bulk of the economy and there's some evidence that consumer spending is softened somewhat lately, but at the same time, and by the way you can see this in a bunch of places, you look at these retailers who had trouble stocking up because of the supply chain issues, then they stocked up and then all of a sudden they said, oh my gosh, consumers aren't buying as much as they were or they're shifting away from buying goods more towards buying services. But then you look at some of the bank, the large banks have reported earnings and talked about their consumers. Many banks have said, hey, our consumers are continuing to spend, our consumers continue to be flushed with cash. They're not spending down their additional savings.

So the underlying health of the consumer is another example where we're getting mixed signals on people are spending money, they're traveling, they're going out to restaurants, and yet retailers have a lot of inventory. And so part of it is a mix issue, they're changing what they're spending on. Part of it is uncertainty about the levels.

Joan Woodward:

Okay. So let's get to it. The big question of the day, what is your current outlook on inflation? Do you think it's peaked or we saw it today the UK just announced they have double digit inflation. What is your current view?

Neel Kashkari:

It's possible that headline inflation has peaked because gas prices, headline inflation includes everything. It includes gas prices and food prices, and those components matter a lot to families. But we also know they're quite volatile. Oftentimes we will look through those and say what do we think is happening with core inflation or underlying inflation? It's possible that headline inflation has peaked, but I have not seen evidence to give me comfort that the core inflation and the services inflation, the stickier parts of inflation that are less volatile, I've not yet seen much evidence that has yet peaked. And that's what I'm quite concerned about.

I want to see us have confidence that core inflation has peaked and then head it back down in the right direction. Financial markets are suggesting that inflation should fall rapidly next year and the year after. I certainly hope that they're right, but I have not yet seen evidence that that mechanism is in play.

Joan Woodward:

Okay. Let's talk about that for a minute, because obviously the Fed has generally aimed for an inflation rate of only 2%, which we've had for many, many years up until last year. Why has the 2% been a benchmark for the Fed and do you think we could get back there in the next couple of years?

Neel Kashkari:

2% was a compromise, which is we knew we had to be above zero for a bunch of different reasons. In part because deflation is really bad and you need to give yourself a little bit of margin of error. We actually weren't at 2%, we were at about 1.6% for the five or 10 years prior to the pandemic, which sounds like a small miss. But if our goal had been zero and we were at negative 0.4, negative 0.5, then we would've been in a deflationary environment, which is very problematic. I think central bankers around the world have agreed we want low stable inflation, but something a little bit above zero. And that's why 2% is where most central banks have converged around. And I do think, I have no reason to think we cannot get back to an economy.

We at the Federal Reserve are committed to doing our part to getting inflation back down to our 2% target. Some people have debated, hey, should it be higher, should it be a 3% target? And I've said I'm open to having those debates, but we need to first get back down to 2% because we said that is our goal. We're not going to move the goal post, we're going to get back, we're going to achieve our target. And then a fair game to have a deliberative process about what that target should be going forward.

Joan Woodward:

Okay. Let's talk about the underlying causes of inflation because obviously the Russian conflict in Ukraine, supply chain issues, obviously the wages have been rising, which is great for employees, getting more wages coming out of the pandemic. But let's describe the state of the supply chain, because supply chain issues to me, and we know President Biden just signed the bill to provide money for the chip makers, the semiconductor chip makers, the CHIPS Act, he called it, really to have more domestic production of semiconductors and chips for putting in cars and all electronics that we buy every day. Where do you think the supply chain shocks will look like in the future? Are we coming out of those shocks?

Neel Kashkari:

Well, this is again, we're getting mixed signals. I think there's some evidence that supply chains aren't getting better. And some businesses I talked to say, yes, they are getting better, they're not as acute as they were at the peak of the supply chain crises. And you can see this in shipping rates and whatnot that have come back down. Part of the supply chain issues were pandemic related, lost employees, shut downs in China, et cetera. Part of it was simply the demand outstripped the supply chain's potential to keep up even if there had been no disruptions. When the economy shut down, the services sector shut down, many people went home and then you started buying goods because you could buy goods, you couldn't get on airplanes, so people were buying more goods. So the good supply chain got overwhelmed just by the volumes that were at extreme levels.

Add to that you had COVID related and pandemic related issues that gummed up the work, so to speak. I think there's evidence that supply chains are getting better. I wish they get better faster. And the more help we can get on the supply side, the less that the Federal Reserve then has to do to bring demand down to get inflation back down to 2%. So where does inflation come from? It comes from a mismatch between demand and supply. And if supply can climb, then we don't have to bring demand down as far to get these things in the balance.

Joan Woodward:

Good. Well that's helpful in terms of your view of the supply chain maybe getting better. Let's talk about Europe a little bit because as we just mentioned, the UK just announced their inflation rate, but they have unique challenges with energy supply and certainly with Russian conflict in Ukraine, that's exacerbating their energy shortages. We're going into the winter season. Can you give us insight of how US policy makers different from maybe European central bank policy makers and how they think about where that target Feds funds rate should end up?

Neel Kashkari:

Well I would say first of almost all major advanced economy central banks are united in fighting this common shock of high inflation. And the sources of inflation are varied. In Europe, the tragedy Russia invading Ukraine and the energy shock, it's much more acute for European economies than it is for, it's affecting America don't get me wrong, but the pain is much more acute in Europe and in the UK because they're much more exposed to Russian natural gas and we're not here in the US largely, though these are global markets. And so the sources of their inflation are different. What are policy makers prepared to look through? Last year, a year ago I was in the camp where I said, boy, it seems like some of this high inflation we're seeing is likely to be transitory, it's probably going to fade, let's not overreact.

It obviously didn't work out that way, so we've had to pivot very aggressively. But I can understand central bankers in Europe might say, hey, if most of this is being driven by energy and we think energy's going to revert, they may be willing to look through some of that. Each central bank is going to take their local economic conditions and drivers into account as they decide the optimal policy for their economies.

Joan Woodward:

Okay. Let's move on because you mentioned wages and you mentioned the labor market and the labor market in your region, you had said early is still strong. I think a number of large companies like Travelers and other agent broker companies on the line here with us today, we're still looking for more workers. We have a lot of job openings in this market. And so for a lot of companies, the people that lost their jobs during COVID and decided to stay home, many millions of people did not come back into the workforce. So that labor participation rate, I want to get your thoughts on that. And then I also want to hear about wage pressures and if you think those will continue to rise.

Neel Kashkari:

A big part of the supply story and the missing supply is partially a story of missing workers. So where are those workers? And a lot of analysis has been done. First of all, never forget that a million Americans died from COVID. And yes, they were skewed older, but there were quite a few people who had been working before that are not, obviously they're not with us anymore. There's human tragedy associated with that. There's also lost economic potential, number one. Number two, a lot of Americans who were in a position to do so chose to retire early when the pandemic hit, they said, you know what, I don't know what this virus is, I'm just going to retire.

Now, retirement tends to be a sticky state, meaning when people retire, they tend to not unretire, it's not impossible and hopefully we can draw some of them back in because any amount they want to work will be good for the economy. We also have missing immigration. A bunch of folks that would've been coming to this country, contributing to our economy, the borders were largely shut during the pandemic. Those are missing workers. And then finally we have people who either continue to get COVID or they're dealing with childcare issues or they're taking care of a family member. COVID has now come ricocheting through my house twice and that disrupts our ability to work. Even though I can work remotely, that has an effect on how productive we are and whatnot.

And so this is still with us, the pandemic is still ricocheting around the economy and I think it is still affecting marginal labor supply coming back online so to speak. Those are all big drivers of where the workers are. In terms of wages, and this goes back to the root of inflation. So what caused this inflation? Traditionally we are very focused at the Fed on wage driven inflation. We always talk about our dual mandate, stable prices and maximum employment. We think of those two things as sides of a seesaw. When the economy heats up and the unemployment rate drops, businesses have to pay up to find workers. The unemployment rate goes down, inflation goes up, and they're linked like a seesaw. Well, what happened this time? In May of 2021 is when core inflation finally ticked above 2%, but unemployment rate was still 5.9%.

We still had a lot of labor slack on that side of the seesaw, but then this huge inflation wave hit us. It didn't come from the labor market. Where did it come from? It came from a lot of demand from fiscal stimulus, it came from supply chains that were screwed up. Then it came from Russia invading Ukraine leading to a commodity shock. It was not wage driven. And so wages are climbing, but most Americans real wages are declining. They're not climbing as fast as inflation and so wages are trying to catch up to the inflation rather than wages driving the inflation. So this is just a very different economic environment that we're in right now. Sorry I gave you a long answer to that question, but there's a lot underneath that.

Joan Woodward:

No, I actually think it's really important to understand that any single one of those factors that you talked about could cause core inflation to rise. But the confluence of the four of those you just mentioned are really going to be, it's a tough road ahead to tackle those four contributing factors versus just dealing with one. I want to talk about one you just mentioned, which is fiscal stimulus. And a lot of people know I worked on the hill for a long time. You worked at the Treasury Department. Policy makers do struggle with how much stimulus to inject into an economy when it's needed. Back in 2008, 2009, I know you were there on the ground working on stimulus bills with President Obama.

Trump signed three stimulus bills into law to help get us out of COVID. Biden signed one big stimulus, then we had the Build Back Better, then we had additional bills, the infrastructure law. A lot of this kind of, I would say deficit finance, fiscal policy. How much do you worry about that? Because I know that this last bill that Senator Mansion was worried about passing when inflation was already raging in the fall, how do you think about fiscal policy versus monetary policy as a lever to either hurt or help inflation?

Neel Kashkari:

Well, with the benefit of hindsight, one of the mistakes that policy makers made after the 08, 09 downturn, is in hindsight I think we were too timid. We could have been more aggressive. And as a result of that we had a 10 year recovery to rebuild the labor market. My message when the pandemic hit was, hey, air on doing too much rather than too little, go big. And we at the Federal Reserve were very aggressive in supporting the economy and Congress was very aggressive under both Presidents Trump and President Biden in supporting workers and small businesses especially. Now, then something happened, the best news of the pandemic was that you had this technology breakthrough of highly effective vaccines much sooner than people thought was possible.

I talked to some of the best health experts in the world who said we don't know if a COVID vaccine is possible. We don't know how many years it's going to take, you can't count on it. And by the end of the year we had multiple effective vaccines. So that was a miracle of technology that that happened so quickly. But that also meant that the downturn was shorter than it otherwise would've been and you could reopen the economy sooner than otherwise we could have. So with the benefit of hindsight now, boy it turns out that fiscal stimulus was probably more than was needed because the downturn ended up being shorter because these vaccines ended up being available and making people a lot safer and feeling confident.

It's a very complicated thing to do for Congress to look at a new type of crisis and say, at the beginning of it we know how long it's going to be, we know how deep it's going to be, let's size it just right. They did their best. I think everybody did their best. And then some things break different directions and you wish you could maybe tailor it a little bit differently if you could do it over again.

Joan Woodward:

I think you point out correctly that the financial crisis back in 2008, 2009 was a mortgage crisis, a housing crisis, a financial crisis. That took a lot longer to reset and get jobs back in the economy. But lessons learned, the cash for clunkers, did that work, was that the most efficient use of government policy versus the PPP loans directly to small businesses. I guess it's a learn as you're saying it's a learning curve and understanding what levers I guess fiscal policy may work. But do you take these lessons? Because COVID, this COVID induced recession, we came out of it so quickly from the labor market supply. Do you think policy makers understand what efficient use of tax dollars are in certain fiscal policy measures?

Neel Kashkari:

One of the things that I think we're all learning is economists talk a lot about, quote unquote, automatic stabilizers, things that kick in automatically where you don't have to go to Congress to ask for a new law. So such as the unemployment system, if certain things happen, people get unemployment checks. Well what ended up happening because their unemployment rates shocked, went up so high when the shutdowns happened, that some states unemployment systems were overwhelmed. Actually Minnesota's worked quite well, but that isn't true everywhere. One thing that policy makers at the state level and federal level could do is figure out what went wrong in some of those unemployment systems and correct them now, so that whenever there's a future recession, whether it's a year from now or 10 years from now, that those systems are there.

And by having systems that are highly effective in targeting the support to the people who need it, it really helps avoiding overdoing it. Because one of the challenges that Congress weighed this time is people knew that the unemployment systems were clunky. And so Congress said, well we need to do something more general as well to compliment those systems. If those systems were less clunky and the targeting was more effective then you wouldn't need as much widespread stimulus. You could just get the help the people who really needed it and then you'd have less of a risk of an overshoot or an inflation problem on the back end.

Joan Woodward:

Very well said. Thank you for that. Let's get back to credit and interest rates, I know it's on everyone's mind. We've got a ton of questions coming in on the Q&A, so please drop them in your Q&A there and we'll get to the audience questions shortly here. But Neel, how long do you think rates are really going to have to remain elevated to get inflation under control? What are the risks of raising rates too quickly, because it feels pretty quickly and it feels pretty big when you do the 75 basis points, but what about raising them too slowly? How do you think about that, weighing, raising them quickly and more deeply versus more slowly?

Neel Kashkari:

There are a lot of challenges. One of the biggest challenges we face is that we know that the full effects of monetary operates with a lag. It takes a year or two for the full effects of interest rate increases to work their way through the economy. So right away it hits the housing market through mortgage rates. But even on housing it takes a year or two for that effect to work its way through rents, because you may have signed a one year lease or maybe you signed a two year lease, and so it takes a while for all of that pricing to get re-priced in the new interest rate environment. And then other sectors, it takes even longer. We know we are using medicine that takes full effect with a lag.

The risk of really rapid increases is that you overdo it and by the time you realize that you've done enough, you already have all this additional medicine working its way through the economy and then that leads to a downturn. That's the risk of overdoing it. The risk of underdoing it, is that inflation expectations, people's confidence and belief that inflation will be in check becomes unanchored and then really people start changing their behavior and wage negotiations between employers and employees, labor union negotiations, all of that changes. And then you get this vicious spiral that we experience in the 1970s. And so to me the risk of underdoing it is a more serious risk than the risk of overdoing it. We have to get inflation back down to 2%, we're committed to doing so.And if you look at the recessions that have taken place in the past that were induced by the Federal Reserve, the biggest being in 1981 from by Paul Volcker, those recoveries can be very fast. Those do not suggest an 08 type recovery where it takes 10 years. Those bounce backs can be very, very quick. You get inflation down, then you normalize monetary policy and then the economy can boom again. And so there's a lot of uncertainty and the lags make those very complicated, but their cost of not tackling inflation in my mind that's an unacceptable cost.

Joan Woodward:

I think you said something really remarkable here that people really need to know, that by raising rates quickly you could shock the economy and the robust growth that occurs after that is really, really hopeful. I think for a lot of people who don't understand how fast, you just said there's a lag, we understand that, but how quickly the economy can turn on a dime and become robust growth. That's good to know. Let's stay on this topic for another minute and I want to want to talk about some other topics and get to some questions. Yesterday you made a little bit of a news saying that we might have to go above the 4.5, 0.75 benchmark policy rate next year. Tell us your thinking around making those comments. I assume it's similar to what you just said, you'd rather overdo it than underdo it.

Neel Kashkari:

I'm looking for evidence that the underlying inflation, think about wage growth, think about services inflation, core inflation, these things that are less volatile, that tend to be stickier. I'm looking for some evidence that those have in fact stopped climbing. I haven't seen that evidence yet. So until those stop climbing, I can't see how I would recommend pausing interest rate increases. I'm not saying we keep raising until inflation gets back down to 2%, but how do we pause until those have at least stopped climbing? Once we've got confidence that they've stopped climbing, then as one policy maker, I would be more comfortable to say, hey, let's let the medicine that we've injected work its way through the economy and let's see what happens before we start adjusting further.

But we need to at least get to that point and we're not even at that point yet. And so that's why my best guess right now is, yes, do I think inflation is going to level out over the next few months, the services, the core inflation and then that would position us sometime next year to potentially pause. That's my best guess right now, but we need to actually see what happens.

Joan Woodward:

Okay. We talked about inflation, interest rates, demand, supply. Let's talk about something worse, I think worse than inflation, which is stagflation. Many people understand that stagflation, which is lowering economic growth, which we've had for the last two quarters, rising inflation, which we obviously had for almost a year now. But the third piece is rising unemployment, which you talked about. We haven't seen evidence yet of unemployment rising. Those three ingredients coupled together are called stagflation. Talk to us about that scenario for a minute, and then I assume that means a recession.

Neel Kashkari:

Well, when I think about stagflation, and I think when most people think about it, talk about, it's an enduring state where you're in it for a long period of time and it's a very unhappy economic condition for the country and for the American people for the reasons that you said. The transition period that we're going through right now has elements of it, just like you said, we've got very high inflation, we've got low GDP growth. It's possible that as we go through this transition it will feel a lot more like stagflation. But I'm confident that we can get through that fairly quickly and then get to a robust economy that people can feel good about on the other side of that. What does that mean?

Think about the economy we had before the pandemic, we had very low unemployment, we had pretty good wage growth. In fact we had the best wage growth for the lowest income workers. We had overall decent GDP growth. That was a pretty good economy, wasn't the best economy but it was a pretty good economy in a lot of dimensions. That's where we're trying to get back to. And so yes, it may feel stagflationary through this transition period, but we go through this transition period so that we get to the other side and we have a good economy that people can feel good about.

Joan Woodward:

This is really helpful. This is good, Neel. Let's talk about the Fed's dual mandate, the unemployment, you're focused on unemployment, you're focused on prices. You mentioned this earlier, I want to get to it. What about the shorter term financial market reactions to when rates go up or when you get another nugget of good news in the labor market? Talk to us about how the Fed views the financial markets reacting to what you do, and does the financial market reactions influenced your decision making at the FOMC at all?

Neel Kashkari:

Well, we look at the financial markets because what we call financial conditions are one of the ways monetary policy works its way through the economy. And the best example of financial conditions are, and the tightness is the mortgage ready. Last November, the Federal Reserve, we pivoted the way we were forecasting the economy because inflation was not falling. And you saw long rates respond immediately through our forward guidance. We actually began tightening monetary policy toward the end of last year, even before we started raising our policy rate of the federal funds rate. And by doing that we began the process of normalizing monetary policy.

That's one way that financial conditions are a tool that we use to try to influence the economy. We pay a lot of attention to long term rates, mortgage rates, inflation expectations, we pay attention to the bond market, the stock market. All of these things go together to represent financial conditions. And so we pay attention. We're not targeting them directly, though we do pay attention to them as a mechanism of transmitting our policy stands into the broader economy.

Joan Woodward:

Great. I'm going to shift just a little bit because I want to talk about your personal story, because I think a lot of people on the line, public service, and you know I both know this, working in the government, there's something so special about public service and I truly believe in it as you do too. But you were in the White House when the financial meltdown happened in 2008, 2009. In fact, you and Hank Paulson, treasury secretary at that time were in charge of setting up this program, unprecedented program in the nation's financial history of the Troubled Asset Relief Program or TARP, really to keep the economy from descending into a Great Depression for many, many years, if not decades.

So what was that like trying to get Congress to agree to pass multi, hundreds of billion dollars to bail out the largest banks in the country and basically to save the economy like you did? Give us a behind the scenes on that.

Neel Kashkari:

Honestly it was terrifying. We didn't know how big the hole was that we were facing. Every time we thought, okay, maybe we're through it, it just got worse and got worse and got worse. And then we didn't know if our programs, even if Congress gave us the authority, if the authorities would be effective in stemming the crisis and would we be in another Great Depression. And so the way I describe it, I've never served in the military, so forgive the analogy, but it felt like 9/11, it felt like the economic equivalent of 9/11. That's how terrifying it was. I remember there were times when somebody would come into my office late at night, we were working night and day, I was sleeping on my couch, just somebody was crying, just saying the federal system is collapsing. What are we going to do?

And all we could do is put our programs together as quickly as we could and hope that it's enough. And when Congress voted the TARP down the first time, I remember sitting, I was in the House gallery overlooking the house floor when they voted it down. And I remember just thinking to myself, well at least history will show that we asked for help. And so if we're in the Great Depression then we're in the Great Depression. But we did ask for help. And then thankfully a few days later they came back together and then they passed it. And even when we got the authority we were taking our best shot, did not know if it would ultimately be enough. And fortunately it was enough.

But that experience really prepared I think us well for 2020. The Federal Reserve has tremendous institutional memory of the 08 crisis, and we were able to respond much more forcefully and at much bigger scale and faster because we had the institutional memory of having gone through 08 and we were able to reuse many of the tools that were developed in 08, we were able to use them in 2020 very effectively. And so that gave me confidence. We got through 08, we will get through this.

Joan Woodward:

Wonderful. We're grateful as a nation that you and Hank Paulson were at the helm steering with all this expertise you had for so many years working in the financial market. Thank you for that. I'm going to get to audience questions next, but I have one more question for you, Neel. So go back. If you were 25 years old, how would you change the trajectory of your career? Because working in financial markets like you did and then serving in government twice, the treasury and now of course running one of the largest federal reserve banks in the country. Give us some advice for someone who might want to go into public service or what would you go back and change in your career?

Neel Kashkari:

My career has been quite varied. I actually started out as an aerospace engineer, so I've done a lot of different things. I wouldn't change that. I actually think it's good advice to say you try different things, see what you like, see what resonates with you, take risks. I've done that. I wouldn't change that. I think the biggest thing I would go back and tell myself at 25, there's a bunch of stuff that you think is really important that you learn later is not that important. Just take a deep breath. Your first job's not the most important thing that's going to happen to you, even if it's not your perfect dream job to start out, you can do different things if you're willing to take a little bit of risk. The big things will reveal themselves over time. And the small things that you think really are a big deal right now are not a big deal.

In my role as a CEO, I think I heard Jeff Bezos say this once, that the job of a CEO is to make a small number of very important decisions. I actually think that that's right. The vast majority of decisions I can delegate to people. There are small number of decisions that I really take a strong view on and get personally very engaged in. Usually those are around people putting the right leaders in the right jobs. But a lot of small stuff don't sweat that, focus on the things that really matter. It takes time to have the experience to figure out what are the things that really matter. But that'll come.

Joan Woodward:

Okay. We are onto audience questions and there's a ton of them. We're going to try to do a rapid fire here. Nick Belsky asks us, or ask you, is there a particular dollar value where you see the Fed stopping in the short term with regards to unwinding of its balance sheets? I don't know if you want to comment on the value of the dollar, it's strength and weaknesses. Is there a particular value that you see?

Neel Kashkari:

I'm not sure if the person was actually asking about the value of the dollar or the dollar size of our balance sheet. Basically we're shrinking our balance sheet. We ballooned it in QE during the pandemic. We're now shrinking it. We're shrinking it at a rapid clip, about twice the rate that we shrank it after the last crisis. The balance sheet is shrinking now. What the ultimate final end state of the balance sheet is, I don't know. We know that the demand for physical currency for dollars continues to grow around the world and that means, just because of accounting, our balance sheet needs to be somewhat bigger and the demand for reserves and the banking system continues to grow, those will mean we're going to have a larger balance sheet than we had pre-crisis. I don't know what the final end point is of our balance sheet. We have ways to go on shrinking it and it's underway. I'll say that.

Joan Woodward:

Okay. This is an interesting one. Where do you see the biggest improvement with regard to how you measure the CPI correctly? This is coming in from Ryan Hupp. I actually worked on the CPI improvement commission with Senator Moynihan and Senator Roth with Michael Boskin, 25 years ago. Is the CPI currently correct in or is there a measurement tweak that can be done to the CPI?

Neel Kashkari:

Well, there are government economists who work very hard to collect this data and they're always looking for ways of improving it. So no doubt there are ways to continue to improve it. One area that we're very focused on is housing inflation and how it's calculated. Home prices have rocketed over the past few years. New rents have gone up quite a bit, but not as far as home prices, which suggest they may have some room to catch up. And then existing rents are even slower to adjust because I said earlier you may have a one year lease or a two year lease. We know for example, that there's a lot of embedded inflation in the housing market that is yet to work its way through the pipeline.

So one example of something that we're focused on is disentangling those different components to understand how much inflation and housing should we just expect to see, it's already done even though it's not yet showing up in that headline statistics. That's an example of an area where I think a richer set of information will help us understand. Because housing is a big part of the CPI, it's a bigger part of the CPI than the PCE, the other index that we look at. But it's a big part of expenses for families. So understanding underlying housing inflation is very important.

Joan Woodward:

Okay, thank you. Another question here, consumers are being asked to tighten our belts every day. What about reducing government spending, would that have a positive impact on inflation?

Neel Kashkari:

On the margin, yes. If you look at the Inflation Reduction Act that Congress passed, I think the CBO scored it as some net deficit reduction over 10 years. So on the margin, if it's deficit reducing, a good rule of thumb is on the margin it should be disinflationary, which is helpful. The challenge is programs like that tend to take a few years to work their way through the economy to really show up in what's happening in real economic activity, what's happening in inflation. I've said publicly and I've said it to members of Congress on both sides of the aisle, we'll take any help we can get on reducing inflation, helping on the supply side. All of that means we will have to do on the margin a little bit less in terms of reducing demand to get inflation into check.

Joan Woodward:

Okay. Couple questions coming in about, why are we changing the definition of a recession? Because historically as we learned in economics 101, at least I did, if you have two negative quarters, even after the three revisions, the revised three times as we all know. But if there's still two negative quarters back to back, why are we now saying that's not technically a recession? Good questions.

Neel Kashkari:

Because technically when you would have two negative quarters of GDP, you would also have widespread job losses. Those two things tend to go hand in hand. We had two negative quarters and widespread job gains. That's a weird situation to be in and it's hard to make sense of that. And that's why I don't think in the first half of this year at least, that we were in a recession, because the job market continued to hum. And so that's why I'm paying a lot of attention to what's actually happening to wages, what's happening to hiring, what's happening to people getting unemployment benefits, what's happening to layoffs to get a sense of what's really happening to the underlying economy.

Joan Woodward:

Okay. This is a good question and it's the definition of unemployment. Marjorie Carter asked, how does the real unemployment rate prior to COVID compared to the real unemployment rate after COVID? What I mean is that under employment is not real unemployment, I guess she's talking about the U-6 versus and what about those not pursuing. So if you're not pursuing a job right now, you're not actually counted as unemployed. Can you explain the difference of those two measures?

Neel Kashkari:

The way unemployment is calculated, the government researchers call up people and they say, do you have a job? Yes or no? No. Why don't you have a job? Are you looking for a job? And if you don't have a job and you're not looking, you're counted as not in the labor force. So you're not counted as unemployed because for whatever reason you don't want one. Maybe you're retired, maybe you're in school, maybe for other reasons. But the dankest thing happens even before the pandemic, they would call somebody up and that person would say, no, I don't have a job and I'm not looking for a job. I'm not in the labor force. And the next month that person would take a job. That's not supposed to work that way. The way it's supposed to work logically is you go from, I don't want a job, I'm not looking, to I'm now looking for a job and don't have a job. And then I do have a job.

But a lot of people go actually from the first state to the last state. It turns out I think many more people are actually in the labor force, but they may not realize it. They see their brother or sister gets a pretty good job or their neighbor. They're like, yeah, I can go do that job, I'm going to go get that. Those wages look pretty good. Another way we slice this is, what percentage of Americans are working? Just full stop. Who has a job? As a way of trying to get away from this psychological judgment column. Am I in the labor force or not? It's very fuzzy. We slice this a lot of different ways, but no matter which way we slice it, there are a bunch of people who are not working or not in the labor force who we thought would've been working had there been no pandemic.Now we talked about it earlier, some people died from COVID. We have missing immigrants, we have people who retired early. We have people dealing with childcare and healthcare issues. All of those things are going into whether somebody is working or not. It's a long answer, very complicated question, and we look at it as many different ways as we can to try to get insight into what's really happening.

Joan Woodward:

And Neel, isn't it also that the birth rate in the United States is down, people are getting married later in life, they're having less children than previous generations? I think the 2020 census showed that we only grew 7.5% in our population. So the birth rate too maybe also contributes. Is that possible?

Neel Kashkari:

For sure. This is happening in advanced economies all around the world as the economies are getting wealthier, families are choosing to have fewer children for the reasons that you said. But the one thing that has been different in America, unlike many countries, is immigration has been a very powerful tool to grow our workforce, to grow our consumer base. Where does economic growth come from? It comes from productivity growth and population growth. We've been able to supplement our declining birth rate by welcoming immigrants from around the world. And in full disclosure, that includes my parents, that includes my wife. The question is whether or not we're going to use that tool going forward to continue to drive economic growth. It's available to us if we choose to use it.

Joan Woodward:

Okay. Thank you. Another question coming in, this is regarding China. What is your reaction to the news that China is indefinitely delaying the release of their economic data domestically? And do you expect this to affect how western countries view that market?

Neel Kashkari:

I guess it's not that surprising. On one hand they say they want to be competitive in the global economy, in a knowledge economy and innovation. And then it seems like every other move they make politically is to clamp down on innovation and clamp down on exchanges of ideas and whatnot. And so this is just another example of that. I never took the official data releases from China that seriously anyway, because I think a lot of people call them into question. So the fact that they're delaying them, I don't is particularly surprising or particularly a big deal, but the more they clamp down on people having confidence in what's happening, the more they hurt that confidence, what's happening in the underlying economy, the less competitive they're going to be in the global economy as economic competitors to the US and Europe. I'm not wishing ill for China, but it only strengthens America's competitive position.

Joan Woodward:

Okay, thank you for that. Question coming in from Brian McDermott, and this is regarding, we used to be a energy exporter, oil and gas exporter a few years ago, now we're a net importer of that. What are your thoughts on the drawdown of the US strategic petroleum reserve to try to put more supply into the markets and do you think it's effective? Because I know it's millions of barrels, but in the grand scheme of thing, is it just a drop in the bucket or drop in the barrel I guess?

Neel Kashkari:

The challenge with the strategic petroleum reserve is as you said, it's only some 700 million barrels. And so it can help, it can be very powerful if, this goes back to our fiscal stimulus discussion, it can be very powerful if policy makers have a lot of confidence that the disruption is going to be finite. You're not going to just drain the whole SPR and then you're going to be back where you were anyway. And so that's where it's most powerful. And so I think it has been effective in lowering gas prices for families. I think it's been one of the tools. How long is it going to be effective? It really depends on what's going to happen now with the Russian invasion of Ukraine, what's going to happen with that war.

We've obviously seen Saudi Arabia announced that they're going to try to cut more supply from the market. These big geopolitical factors could end up being much more enduring than the strategic petroleum reserves capacity to counteract them. And so it's a complicated situation.

Joan Woodward:

Okay. This is a good question regarding income inequality by Maryanne Chance. She says, I've noticed more and more businesses are refusing to accept cash. Do you feel that this trend will continue to the point where paper money will no longer have value? Do you feel this trend will also penalize already marginalized people who are unable to attain a credit card? Very good question.

Neel Kashkari:

It's a good question. You definitely see that to save money and automation leads to more use of credit cards, et cetera, and digital currency types, digital dollars. That can lead to more efficiency, which is a good thing. But exactly as the questioner said, for people who are unbanked, that creates more hardships and more barriers to getting them included. We have a lot of work at the Federal Reserve to try to improve financial inclusion, making sure people have access to basic banking services, making sure that banks are reaching out across their communities to serve all of their constituents equally and fairly. And so it is a challenge.

And as we are designing at the Federal Reserve a real time payment system that we call FedNow, we are doing our very best to try to make sure that it's designed in a way that can be as inclusive as possible of all of these different communities that we are charged to represent. We're focused on it. It's not an easy problem to solve, but it's an important problem.

Joan Woodward:

Okay. Couple questions coming in. Explain why you think deflation is a bad thing? Is deflation worse than inflation? What we're in right now? First of all, define deflation for us and what effects on demand and supply within the economy, and do you think it's worse than inflation?

Neel Kashkari:

Yes, deflation is definitely worse than inflation, and here's why. You buy a house for however much you buy, you get out of mortgage, and then your home price continues to fall and fall and fall, and your mortgage relative to your home price gets bigger and bigger and bigger, and your equity gets wiped out. Deflation is devastating if you are a borrower, as many Americans are to buy a home or to buy a car, for example. And that's why it's so pernicious. Advanced economies all around the world that said we need to have low inflation, but positive inflation, so we can avoid that kind of a deflationary trap.

Joan Woodward:

Okay, this is a political question. You may or may choose to answer it. It is up to you, Neel. We have midterm elections coming up in just a few weeks. There's a lot of predictions, whether right or wrong, a lot of polling that the Republicans could take back the house for sure, and most likely the Senate or neither. But if the Republicans are able to take one chamber or the other, as you know basically in Washington when the White House is held by different party than Congress, you have gridlock and you have gridlock on most fiscal policy, which means you're probably not going to have a lot of new spending in the next two years.

How does the Fed think about if there is a split in a control of Congress in the White House and having gridlock in the policy arena? Is that good or bad for how you evaluate your decision making at the Fed, knowing that there won't be a lot of huge spending programs coming out of Congress?

Neel Kashkari:

It's neither good nor bad. Whatever Congress decides to do or decides not to do for whatever reason, we just take that as an input into our analysis of the economy. So if Congress says we're going to go pass a big stimulus, we put that into our models and then model the effects. Or if it says no, we're not going to do anything, then we will put that into our models and et cetera. Whatever Congress does for whatever political reason or otherwise, philosophical reason, we don't judge it. We just put it as an input into our analysis. And so we factor it in, but it's neither good nor bad from our perspective, it just is the context that matters.

Joan Woodward:

Okay. We only have a couple hundred more questions to get through, Neel. Let's try this one. Let's talk about, get your thoughts on switching to a central bank digital currency.

Neel Kashkari:

I for one, we're studying at the Federal Reserve, I'm quite skeptical. Digital currencies exist today. Joan, I could send you $5 with Venmo right now, that digital currency. What is it that this thing would solve? What problem would it solve? Nobody's been able to articulate it. People make these vague claims that it'll be better for financial inclusion and it'll be better for remittances. I've yet to see any evidence that that's actually true other than promises. Right now I'm quite skeptical, I'm keeping an open mind and let's see if people can make the case. But so far, as far as I'm concerned the case has not remotely been made that there's some benefit from this.

Joan Woodward:

Okay. So put yourself in a couple of 20 something year olds. I have a couple questions coming in from them. I'm 28, 29 years old, just getting married. I want to purchase my first home. Is this a good time? What advice would you give your 28 year old son or daughter?

Neel Kashkari:

I think the general advice on buying a home is if you're going to be in the home for an extended period of time, it probably makes economic sense if you can afford the mortgage, if you're buying something within your means. That's the test I would have is, hey, are you buying a house that you can really afford? You're not overextending yourself and you expect to be there for a long time. So really people regret home ownership is when they end up having to move in a couple years and there are big transaction costs and whatnot. If my children were older, that's what I would tell them, is if you expect to be there for a long time and you can really afford that house, then seems like why not, now is a good. You can always, by the way, the advantage of when rates eventually come lower is people can then go refi and so you can get out of the higher rates when rates fall back down.

Joan Woodward:

Okay, great. Neel, I can't get to the rest of these questions. So let me just tell you, this has been so, and you've been very optimistic. I think you've laid out all the scenarios that could happen for us over the next couple of years. A number of comments coming in, just saying how grateful people are that you are where you are, and that you're contributing to the dialogue within the Federal Open Market Committee discussions in Washington. Because you clearly have quite a handle on what's going on, and we are just appreciative of your public service. The number of comments have come in like that.

Neel Kashkari:

Well, thank you. Thanks for having me. I really appreciate it. Been a great discussion, Joan.

Joan Woodward:

Well, I really appreciate you as well, and I'm going to talk just for a minute in closing remarks about our upcoming programs. Thank you again, Neel. It's really helpful for a lot of our agents and brokers and customers to hear from you on these critical economic topics. We have a great lineup. So thank you, Neel. We'll let you go. We know you're very busy. We'll talk to you again. Hope to have you back. On October 26th we're going to talk about something really important to the economy, which is the real estate market outlook with the National Association of Realtors, Chief Economist, Lawrence Yun. Lawrence will join me on October 26th to talk about the economic outlook for the real estate, commercial and residential markets.

Then on November 2nd, we're going to turn to the trucking industry. We have a number of industry experts talking about what's going on in the trucking industry and what to expect for 2023. And then on November 9th, we're going to hear from author Susan McPherson about the lost art of connecting and how meaningful business relationships, especially during this pandemic, we can enforce and reinforce those business relationships. So drop us a line in the chat. We'd love to hear from you about today's program, suggest other topics or speakers you want me to interview on our Wednesday sessions, and we're really grateful that you joined us today. We'll see you next week and stay safe everyone.