Speaker 1:

Think we'll start off this morning with a question about the CPI report that came out last week. It showed that inflation is slowing a bit, and so I'm wondering how strong now do you think the case is for downshifting at the December meeting to something more like a 50 basis point cut?

Lael Brainard:

Yeah. I think the most recent CPI inflation print suggests that maybe the core PCE measure that we really focus on might be also showing a little bit of a reduction when we get those October numbers later this month, maybe from about 0.5 monthly, month over month, in August and September, maybe down to 0.3, and that would be welcome. I think the inflation data was reassuring preliminarily just in terms of showing a slowing in categories that I had been anticipating.

If you pull it apart, obviously food and energy that reflects the war, Mr. Putin, and some weather issues. We really are focused on those core numbers. Within core, we're finally starting to see goods inflation starting to turn over and that is consistent with the data that we've seen on lower shipping times, more availability of automotive semiconductors, for instance, wholesale prices on used cars turning over and just generally starting to see those goods prices turning down.

That's a really important trend that'll need to continue over the next year if we're going to see overall disinflation. Within services though, core services, housing remains quite strong. It's going to take probably well until next year until we start to see those new lease numbers starting to filter through to the average housing services. Then on non-housing core services, that's where you're seeing people moving their demand, which had been very strongly in goods over to leisure and hospitality, restaurants, hotels.

Their wages are going to be more important over time and that's where the labor demand-supply imbalances have been the greatest. There too, we are starting to see the wage series, whether you look at the ECI or average hourly earnings on a quarter by quarter, they are stepping down, but that's going to take time. I'm happy to turn next to what that means for policy. Is that-

Speaker 1:

Yes, exactly. Do you think the downshift is coming?

Lael Brainard:

Yeah. I think it will probably be appropriate soon to move to a slower pace of increases, but I think what's really important to emphasize, we've done a lot, but we have additional work to do both on raising rates and sustaining restraint to bring inflation down to 2% over time. We have raised rates very rapidly by nearly four percentage points over about nine months and we've been reducing the balance sheet.

You can see that in financial conditions. You can see it in inflation expectations, which are quite well anchored. You can see it in interest rate sensitive sectors, but as we said last meeting, there are likely to be lags and it's going to take some time for that cumulative tightening to flow through. So it makes sense to move to a more deliberate and a more data dependent pace as we continue to make sure that there's restraint that will bring inflation down over time.

Speaker 1:

We were just talking about the size of the interest rate hikes that you've been doing, but another thing that Fed chair, Powell, brought up in his latest press conference was where we'll end up that peak. He

was essentially saying that he thinks we'll end up at a higher peak than people may have originally thought. Do you agree with that? If we end up at a higher peak, does it mean that we'll hold there for a shorter amount of time?

Lael Brainard:

Yeah. These are issues that are questions that are very much going to be informed by the flow of data. Even for just the December meetings decision, we still will have additional data in hand by the time that members of the committee will be submitting their new projections. Of course those projections are going to reflect that data both on inflation as well as on the labor market activity more generally.

But it is the case that we do have additional work to do on raising rates and that by moving forward at a pace that's more deliberate, we'll be able to assess more data and be better able to adjust the path of rates to bring inflation down.

Speaker 1:

So much of what we wrote about here at Bloomberg during the pandemic and elsewhere, I know other journalists too, was about people getting back into the labor market and getting jobs, but now it seems like because inflation is so high, we're now starting to talk about potentially people losing their jobs and moving into a recessionary period. We've been seeing headlines even just this morning about job losses in tech for example.

Bloomberg Economics actually is forecasting 100% chance of a recession in the next 12 months. What is your forecast for where we end up in terms of unemployment by the end of next year?

Lael Brainard:

Yeah. I think it's very difficult to give firm projections because this is a very unusual labor market. The pandemic led to a lot of departures from in-person services in particular and if you look at hiring data, you can still see pretty healthy hiring in some of those in-person services where some businesses are still trying to catch up to levels of employment that may be appropriate for the run rate that they're seeing.

It is the case that as rates move further into restrictive territory and financial conditions remain tight, that does exert some restraint on demand to bring demand into better alignment with supply. So you will see some reallocation.

Now, vacancies are unusually high relative to unemployment and that does suggest for the reasons that we were just talking about, this catch-up hiring, there's some chance that we'll see more of a diminution in those vacancies rather than putting as much emphasis on layoffs, but it's likely there'll be a combination of both. So we'll just be watching the labor market as well as inflation very carefully as we go forward.

Speaker 1:

I want to turn to another big story that we've been covering, which is the implosion of another firm in the crypto market, FTX and Sam Bankman-Fried's empire there. In a speech in July, you were looking at the crypto market and at that time thought that there weren't signs that there was so much interconnectivity yet between crypto firms and the broader financial market to imply a systemic risk. How has your view changed given what's happened in the past week?

Lael Brainard:

Yeah. I don't think my view has fundamentally changed. First of all, it is really concerning to see that retail investors are really getting hurt by these losses. It is also the case that despite a lot of hype, you heard a lot about how decentralized these markets are and how innovative and different. It turns out they're highly concentrated, highly interconnected, and you're just seeing a domino effect. Failures from one platform or one firm spilling over elsewhere.

It reinforces, I think, this need to make sure that crypto finance, because it is no different than traditional finance in the risks that it exposes investors to, needs to be under the regulatory perimeter. It's precisely these issues of interconnectedness, leverage, liquidity, that our traditional financial risks and consumer protection, retail protection, we really need to make sure that that environment has the appropriate regulatory guardrails, whether that means bringing some into compliance with existing rules or in some cases expanding that regulatory perimeter.

In order for the innovation that is in some of those platforms to actually make a positive contribution, there need to be strong regulatory guardrails that assure that like risks are subject to like disclosures and like regulatory outcomes.

Speaker 1:

You were just talking a lot about risk. Turning from risk in something more narrow, even though interconnected like the crypto market going way broad in terms of the world risks, you worked at treasury before the Fed with a focus on international affairs. We're seeing a lot of fracturing right now between countries like China, Russia, the U.S. and West, lots of pressure on food prices and energy prices for people around the world and the strength of the dollar is pressuring particularly some developing countries.

How much of a risk do you think there is that that pressure, that strength of the dollar and those forces could boomerang back to something that hurts the U.S. economically?

Lael Brainard:

Yeah. I think there are clearly complicated geostrategic risks. There are risks associated with very high inflation around most of the world economy and the need for rapid tightening to address that. That creates spillovers between different economies and you're seeing that in financial market reaction. In a highly uncertain environment with high volatility, it leads to the need for rapid adjustments.

That can sometimes strain liquidity in core funding markets and that can also sometimes reveal pockets of hidden leverage that maybe were not so apparent to other market participants, or even in some cases to regulators. We are very focused on potential spillovers. I think we're highly cognizant that in a world where many large central banks or central banks in large jurisdictions are tightening at the same time, that that is greater than the sum of its parts.

In the case of the U.S., it reinforces the tightening that we're doing here because not only do we see it in terms of reduced demand for our products abroad ultimately, but we also see it through spillovers of tighter financial conditions and through the dollar.

For other countries, spillovers may also create some real risks, for instance, those as you were mentioning, who might be commodity importers or those subject to exchange rate risk, both in their trade balance but also in the mismatch between assets and liabilities. We're on the lookout, very vigilant about potential global risks.

Speaker 1:

We have corporate earnings starting to roll in again, even this week. We have the holidays coming up with large retailers. A lot of people have been focused, and you mentioned, about wages rising and wage inflation, but my colleague, Craig Torres, actually pointed out to me that you've also been looking at and noted in some of your speeches the issue of corporate profits, markups that firms have done and how much wiggle room there is for a reduction there.

What are you seeing in the data in terms of inventory stock-ups, like potential for markups to actually bring some of this inflation down?

Lael Brainard:

Yeah. I think the data is not comprehensive, but certainly in retail sectors you can look at retail margins relative to how much wages have been growing in that retail activity. You can look at that markup and how it compares with inventory to sales ratios. Normally as inventory to sales ratios increase, you'd actually expect more competitive pressure to start bringing those markups down. That's particularly true when consumers are price-sensitive.

That process has led to first of all, very high retail markups, in some cases, many times the increase in the average hourly earnings in that sector. Now that inventory sales ratios are improving and getting back to pre-pandemic levels, in some cases even above them, it's been slow to see that markup coming back down, but it's a process that you would expect at this point in the cycle so I'm certainly looking at that closely and of course that would contribute to disinflation in those sectors.

Speaker 1:

I want to turn for a moment to the Fed as an institution itself. There's been a lot of questions of late in terms of whether or not the Fed was too late in turning to inflation. That's why we're in the situation that we are now. But we've also seen some questions about trading among some of the Fed policymakers from their personal accounts. How much damage do you think has been done to the Fed's credibility over the past few years?

Lael Brainard:

Yeah. Look, I think that first of all, in those cases where our rules were not clear enough or where there were inconsistencies with stronger rules at the board than at the reserve banks, even though we're all FOMC members, that we've taken very rapid action to bring those rules into conformity. We also have put in place ethics processes at the reserve banks that will better catch those issues sooner and lead to self-identification and stronger compliance with those rules.

Critically important, we understand that we serve the American public, that we have to build trust with the American public and that we had some work to do following those breaches and we're very committed to continuing to strengthen the trust placed in the Federal Reserve and I think that's across both are rules, but also our policymaking.

Speaker 1:

Just staying on the issue of the Fed's mandates for a bit, in August 2020, the Fed came out with a new framework, and I know you were very influential and including in that framework the phrase broad and inclusive. That that's the type of maximum employment that we want to see. Not just one group driving that unemployment rate down, but that it's broad. Then of course we saw so many people lose their jobs in the pandemic.

How difficult do you think it will be to stay with that broad and inclusive new mandate given that there's so much pressure on the Fed right now just to get inflation down?

Lael Brainard:

Yeah. I think the focus on broad and inclusive employment is really core to our work and so if you look right now at the recovery in employment, what you'll see is that unemployment's actually back around the level that was in place prior to the pandemic.

Unemployment outcomes for demographic groups, racial and ethnic groups, are actually quite similar to where they were pre-pandemic and of course they had improved for Black workers and Hispanic workers in particular, a great deal over the course of this very long recovery. In terms of going forward, I'd like to continue to see gains among those groups. Those disparities that we saw right prior to the pandemic are again evident today.

Again, that was after some really important improvement had taken place. The other things that we're seeing is there was a lot of people who left leisure and hospitality, as I noted earlier, the in-person services arena continues to be an area where I think it's harder to attract people back. Early retirees is a huge new phenomenon. We're missing a very large number of people from the workforce that would've been projected to be working. We're very focused on that.

Our mandate, our framework, our approach is very much around the keeping inflation expectations anchored at 2% and I think you've seen that we've worked hard at that and that in fact inflation expectations have been anchored, very important we stone very strong resolve to get inflation down. I think we'll continue to take the necessary steps while also being very mindful of the labor market.

Speaker 1:

Do you think those early retirees will come back in any notable way? It was a debate last year.

Lael Brainard:

I don't think I have any better insights than most people. It does seem to be somewhat correlated among different demographic groups. You see some of those early retirements being more concentrated among white workers and among college-educated workers. I don't know if that really tells us very much about whether they're likely to come back or not.

Certainly as we think about resolving imbalances, one of the important imbalances is labor demand and labor supply, particularly in some of those in-person services areas. So it would be great to see a return of workers that of course would be the best outcome if we don't see that. Obviously you need restraint on the demand side to bring demand into alignment with that reduced supply.

Speaker 1:

When you look ahead to next year, would you be surprised if the Fed actually reverse course and cut rates at some point next year as some people on Wall Street think might happen?

Lael Brainard:

I think what we talked about in the last meeting, which is taking into account the cumulative amount of tightening that is in place and the lags with which tightening and financial conditions flows through to activity and to inflation. I think by moving at a more deliberate pace, we'll actually be able to see how that cumulative tightening is playing out and how much additional tightening.

As we get into restrictive territory or further into restrictive territory, risks become more two-sided and in that environment it's really valuable to be able to take into account the data as we go. So that should enable us to move to a restrictive level that is appropriate for bringing inflation down over some period of time. So exactly what that path looks like I think is really hard to say right now, but I think it will be very much better at balancing those risks by virtue of being able to take on board more data.

Speaker 1:

I want to leave some time for questions from the great group in the room, but I did want to ask you one question about the way you see your job. You've been vice chair since May, and obviously were at the Fed through the pandemic. We saw so many people around the country and world change what they wanted from work, how they worked, what they wanted to do for work over the course of the pandemic. How did the pandemic change you?

Lael Brainard:

Yeah. Look, I think the pandemic brought a lot of tragedy and heartache to families and workers around the country, really around the world, and we're still seeing some of that both in terms of people's willingness to go back to some of the jobs that were so hard being on the front lines during the pandemic. You think about healthcare in-person services generally, those were really taxing and stressful jobs.

The flip side of that is we also learned that we can do a tremendous number of things in a way that's enabled by technology remotely and effectively and productively and so we did all of our operations remotely, which is a remarkable thing. I think if you had asked me six months beforehand, would that be something that you would feel confident about? I would've said absolutely not. But we were able to do that and with companies all over the world.

I think there is some positive implications for the economy. It may take a while, but for people's ability to work in ways that they are more productive and more satisfied, and also for the economy, I think to be more productive and hopefully more resilient into the future, I mean, I think between the pandemic and the war, there's probably some rethinking of cost savings versus resilience.

Companies are reconfiguring supply chains to take those things into account, so I'm hopeful that some of these changes will actually lead to a more flexible economy going forward.

Speaker 1:

Great. Well, I do want to open it up to questions. Does anyone from the audience have one? Would you mind giving your name and affiliation when you ask the question just so vice chair can know?

Chris Rugaber:

Sure. Hi Chris... Oh, thanks. Chris Rugaber at Associated Press. You mentioned the potential for catch-up hiring in areas like leisure and hospitality and there's also been plenty of anecdotes, I think including in the Beige Book about potential labor hoarding if there is a slowdown. Do those two combine potentially to create more labor demand than you might want to see going forward, therefore perhaps more wage pressure even if the economy were to slow a bit?

Lael Brainard:

The stories about catch-up hiring and labor hoarding, if you look at some of the recent hiring data, it does look actually like the strongest hiring has been in those catch-up areas, so it's really a sectoral story

rather than an aggregate demand overall story. Which of course, taking a look at wages, if you look at the employment compensation index, which is probably the broadest measure, it's stepped down quite a bit actually from about 6% in the first half of the year to about 4.3% in the third quarter.

That is a similar kind of movement that we've seen in average hourly earnings there. I think it's stepped down from about 4.7 the first half of the year to about 3.9 in the three months leading up to October. That does suggest cooling on aggregate and lessening wage pressures. I think it's important to remember that wages have actually not kept up with inflation.

Real incomes have actually on aggregate fallen even though wages are higher than what would be consistent with the run rate associated with 2% inflation. They're really in the middle there and they are coming down.

Speaker 1:

Great. Craig Torres from Bloomberg.

Craig Torres:

[inaudible 00:25:35].

Speaker 1:

I'll come to you next, Rachel.

Craig Torres:

Vice chair, when inflation starts to fall and if unemployment starts to rise, what kind of patience... Inflation's a lagging indicator. How much patience will you show to get inflation back to two if it's trending around three, if the labor market is in distress?

Lael Brainard:

We have a 2% inflation target and that is what our monetary policy is designed to achieve, along with also a maximum employment objective. So as we go forward, obviously risks are going to be more two-sided as we get into more restrictive or further into restrictive territory. We'll be balancing those considerations but we are very much focused on achieving our 2% inflation goal.

It's very important to keep inflation expectations anchored around that goal and so we'll just have to make judgments like that as we go forward. What is the appropriate level of restraint on a sustained basis that's going to be necessary to make that balance?

Speaker 1:

Rachel, as promised, to you.

Rachel Siegel:

Thank you. Hi, Vice Chair Brainard, Rachel Siegel from The Washington Post. To follow-up on what you were saying about lag effects, can you walk us through what that timeline looks like over the coming year? When you talk about cumulative tightening, how much of that is just from the federal funds rate versus tightening from other central banks around the world too?

Lael Brainard:

Yeah. Different people are going to think about those things differently. When I think about cumulative tightening, I really think about financial conditions because it's financial conditions that transmit that to decision-making by firms who might be borrowing or by households. The cleanest read perhaps is on the treasury yield curve. If you just look at that, essentially we've seen the entire curve from one to 10 years move above 1% in real terms.

That's a big shift in a nine-month period and that's one way of thinking about cumulative tightening. Of course that does take into account not only our actions here at home, but potential spillovers of financial conditions abroad. In terms of thinking about lags, so there are a variety of different estimates that the research uses different methodologies, so some research methodologies leave you with many quarters of lags and some suggest that that transmission is somewhat shorter.

You might be thinking maybe two to three quarters rather than the longer estimates of lags that come from the historical literature. But even with that, that suggests that it takes some time for that cumulative tightening to really be visible. If you think about the housing sector for instance, that's where we can see it right away. Residential investment has come down extremely rapidly in response to much higher interest rates.

But if you think about some of the other decisions that households are making that are perhaps less interest rate sensitive, it may take quite a bit more time. So it's really going to be a, again, exercise of watching the data carefully and trying to assess how much restraint there is and how much additional restraint is going to be necessary and sustained for how long? Those are the kinds of judgments that lie ahead for us.

Speaker 1:

I think we probably have time for one or two more questions. This side of the room? Howard.

Howard Schneider:

Howard Schneider with Reuters. Thanks for being here and taking the questions. With one exception, the Fed has turned on this record-setting shift in monetary policy with only one dissent. I'm wondering, do you think that's a strength of the system that there hasn't been more public discussion about this, that the language is so fully aligned behind the statements of the chair and how hard has that been to achieve?

Lael Brainard:

Well, I do think that there is very strong agreement among committee members on the need to show resolve, the need to keep inflation expectations anchored at 2% and to stop high inflation from getting entrenched. So I think that is reflected in this really strong support for the rapid cumulative tightening that has taken place so far, again, of almost four percentage points of tightening in a period of about nine months at the same time that the balance sheet is being reduced.

We do have... And I think this is really important, we do have very full discussions among committee members taking into account all the complicated judgment calls that we've been talking about here, how much restraint for how long? What data do we look at given that a lot of data is looking in the rear-view mirror? I think there's healthy discussions and I do believe that it's going to be very important to have those different perspectives informing our policy deliberations.

Speaker 1:

I think we have time for just one last. Ed?

Ed:

Yes. You were talking about rear-view mirror data and one thing in particular I was thinking about is housing, because when you think about real incomes, that's one of the places where people are very stressed over the price level changes. There's anecdotal evidence that price level changes in rentals are coming down, but that's not necessarily reflected in the data that we see in CPI, for example. How do you look at that in terms of thinking about going forward in terms of the lag of the effect of monetary tightening?

Lael Brainard:

Yeah. Housing services is really important. It's particularly important in CPI, but it's also important in PCE inflation and it's really important in terms of how much money an average household spends each month on housing services. It really is a big expenditure, usually the single biggest expenditure item for many households and it's very salient.

In terms of the data, the cumulative tightening that's taken place has really shown up in very large increases in mortgage rates in a very short period of time. You can see that reflected in house prices, house prices across the country had been rising very rapidly. Most indicators now suggest that it best they're flattening out and in some cases actually falling and of course in some parts of the country house prices are now falling.

How does that translate into rental pricing? If you look at new rents on new leases, that's where I think you're referring to. We're actually seeing those indices coming down, but for continuing leases, they may actually still be catching up to the market. So what do we see in the inflation metrics? It's really the aggregate of different housing services. We're tracking those sub-components very closely because they'll give us a sense of when that component is likely to peak.

Again, I would say well into next year, taking into account those offsetting forces. Housing services in the inflation series isn't likely to peak until well into next year, so that's one of those persistent categories where continued restraint is going to be important to bring inflation down to 2% over time.