Joe Santos:

All right. Well good evening everyone. My name is Joe Santos and I direct the Ness School for Management and Economics. And our event this evening is being sponsored by our very own Dykhouse program, our speakers program for money, finance and banking. The former governor of the Bank of England, Mervyn King, famously equipped that monetary policy should be boring. And by that, he meant it should recede into the background where nobody notices it. And a free enterprise economy should simply operate on its own.

Judging from the house this evening, monetary policy is not boring. And so tonight, I have the pleasure of welcoming to the Dykhouse Speaker Series, Neel Kashkari, who all of you know is the president and CEO of the Federal Reserve Bank of Minneapolis. President Kashkari began his career as an aerospace engineer. Later, after earning a graduate degree in business, President Kashkari joined Goldman Sachs in San Francisco, where he worked several years.

His career in public service began in 2006 when he joined the U.S. Treasury under then Treasury Secretary Hank Paulson. In 2008, he became Assistant Secretary of Treasury overseeing the Troubled Asset Relief Program during the financial crisis. And you've never gotten a Christmas card since. President Kashkari assumed his current role as Federal Reserve Bank of Minneapolis President and CEO at the start of 2016. So Neel Kashkari, welcome to South Dakota State University.

Neel Kashkari:

Thank you. And thank you, Joe, for having me. Thank you all. What a great turnout. Really appreciate it. And do me a favor and call me Neel. It'll be more comfortable for everybody.

Joe Santos:

So before we get going, I'll lay out the ground rules in just a moment. And the rules are mostly that there are no rules. I want to hand you the floor. Perhaps you have some opening remarks, some comments you'd like to make. So go for it.

Neel Kashkari:

Well, thank you. I want to just start and spend a couple minutes tell you why I'm here and what the Minneapolis Fed does. And let me also just mention that we're live streaming this onto the internet. So when we get to Q&A, I'm really interested in hearing from you. This might be your chance to be famous. So just think about that. But in all seriousness, the Federal Reserve is our national central bank. We were created by the United States Congress in 1913. Think of it this way, to try to manage the ups and down to the U.S. economy.

And Congress did something unique in 1913. They said, "We don't want the Central Bank simply housed in Washington, D.C. We want it spread out around the country so that different regions of the country have a direct voice in policy making. And one of the challenges facing the country in the late 1800s, leading up to the creation of the Federal Reserve, was that the ag community, farmers, couldn't get credit to either plant their crops or to harvest. The money was being sucked into New York City.

And so a lot of farmers said, "Hey, we need credit for our farm operations." And that was part of the motivation for creating the Federal Reserve system. So there's the Board of Governors in Washington, D.C. You've probably heard of way back when Alan Greenspan and then Ben Bernanke and Janet Yellen and our current chairman Jerome Powell, the governors sit in Washington. They're appointed by the President of United States, confirmed by the United States Senate. So Jerome Powell was originally

appointed by President Trump and was recently reappointed by President Biden, again, confirmed by the Senate.

But then they created 12 independent Federal Reserve banks, the ninth of which is the Minneapolis Fed. And our jobs are to represent this region, that's Minnesota, North and South Dakota, Montana, part of Michigan, part of Wisconsin. So a big part of my job is to travel around this region with my colleagues to understand what is happening in our regional economy. And then I go back to Washington, D.C. every six weeks when we have Federal Open Market Committee meetings, when we meet and we talk about the national economy.

And part of what I'm doing in those meetings is I'm representing all of you. Now, we cannot set a different interest rate for South Dakota and for California because we all use the same currency, we all use the same dollar. So we have to pick an interest rate, a monetary policy that's right for the country as a whole. But part of my job is to make sure that you are represented in that deliberative process so we can come up with the best monetary policy for the nation as a whole.

And so meetings like this are really important for me. It's an important chance for me to share with you what I'm seeing in the economy, but also to hear from you. That's why we're going to have a lot of time for Q&A when hopefully you will ask me questions, but also share to me what's happening here in the regional economy so I can include that in my understanding of our region's economy when I then go back to Washington, D.C. in mid-December for our next Federal Open Market Committee meeting.

So thank you for inviting me. Thank you for being here. I'm very much looking forward to our discussion.

Joe Santos:

Thank you. And as Neel said, we're going to have Q&A here, and we've got folks, Caden, Victoria, if you guys can grab the mics from the folks who have the microphones out over in the back. And these good students, who are now my favorite students, will run up and down the aisles when you raise your hand to ask a question. And while that gets started, I just want to ask my own question here if I may. And that is, Congress has mandated that the Federal Reserve have a so-called dual mandate to maintain low and stable inflation, price stability and full employment.

To a macroeconomic student, that might strike them as a little bit contradictory in the short run. So why is that mandate important? And then how is it essentially used to inform or to operationalize monetary policy, week-to-week, FOMC meeting to FOMC meeting?

Neel Kashkari:

So the dual mandate gets a lot of attention even outside of a period right now of high inflation. So as Joe said, we've got maximum employment and stable prices. The way we think about it is we typically say those two goals are like size of a seesaw. So when the economy gets strong and the unemployment rate drops, people find jobs, which is a really good thing. Businesses then have to compete to find workers. They end up having to pay more wages, and then that leads to more inflation.

So the unemployment rate goes down, you could think the inflation rate goes up on the other side of the seesaw. In that environment, the Federal Reserve would tend to raise interest rates to cool the economy down and bring it back into balance. That's how we think about it typically working. That is not what has happened in the past couple years. Right now, the unemployment rate in the country is very low by history standards, but we're seeing very, very high inflation. But the inflation that we are experiencing is not being driven by wages.

So the normal mechanism by which inflation gets triggered is not what has happened in the last year or two, what has caused this inflation. It has been things like supply chains that were screwed up that

continue to be somewhat screwed up because of COVID all around the world. They're getting better, but they're not perfect yet. I visited a company here, a large company and a large employer here today that was talking to me about the supply chain challenges that they continue to face. It happened because there was also a lot of stimulus put in the economy in response to the pandemic. It happened because Russia invented Ukraine. And so you saw oil prices and commodity prices skyrocket.

So a bunch of different factors hit the economy outside of the normal channel that we think about, which is through the labor market. And so you are seeing wages climb in the country, but those wages are trying to catch up to inflation rather than what is actually driving inflation. And so this is a challenge for us because our traditional models for analyzing the economy are not working very well right now because the source of inflation are these other sources rather than the primary source that we think about associated with our dual mandate. Sorry, you asked me a question, I drove right into it. And anyway, you asked the question.

Joe Santos:

So quick follow up, if I may. Maximum employment, of course, we're talking about some percentage of the labor force, but then there's the labor force percentage of the population. That labor force participation rate has gone down. It's persistently done so. Should that somehow be incorporated into the maximum employment piece of the dual mandate?

Neel Kashkari:

It is, absolutely. So we look at a lot of different measures to try to understand what is our economy's potential. The more Americans we have that are gainfully employed and contributing to our economy, the bigger our economy's potential. So as Joe was saying, one measure you hear a lot about is the unemployment rate. Well, the unemployment rate only counts people who are looking for a job. If you have retired or you've given up looking, or for some other reason you're not in the job market, you're not counted as unemployed.

So we look at those measures too. What percentage of adults are working, what percentage of adults of a working age are working? We look at a lot of different slices. And one of the things that you hit on that in the pandemic, we lost a bunch of workers from our economy, and we're surprised that more of them have not come back yet. Now, first of all, remember, a million Americans died from COVID. Now it's skewed older, no question. But some of those folks were workers. So obviously they're human tragedies. They're also not coming back to our economy.

We also saw a bunch of folks who were near retirement age, who would've kept working had the pandemic not hit, choose to retire early because they could. Now, retirement tends to be sticky. Once somebody retires, they tend to stay retired. But it's not always sticky. People can unretire. People can come back part-time. That hasn't happened that much yet. I hope more of them come back. We also know that people have had to deal with childcare issues, have had to care for family members. There have been a lot of frictions and complexities and challenges associated with that.

And of course, COVID is still spreading around the country. And thankfully, it's not killing nearly as many people, but it is still infecting people and it is still affecting people's ability to go back to work. Maybe they're out of work for a week or two while they're getting better. So there's a lot going on, but there's no question our economy's potential is lower today than we thought it would be because of the pandemic. And we have to factor that in when we think about... So let me go back to inflation. Where does inflation come from? It comes from more demand for goods and services than there is supply of goods and services.

And because we're missing all these workers, our economy's potential to supply goods and services is lower than it otherwise would've been. And so our job at the Federal Reserve is to bring that demand down to balance with that lower level of supply.

Joe Santos:

So again, this is way too much fun. You've got to try it. So we're going to turn house lights on and hand this over to you if you so wish. And again, we've got some folks with microphones. So all you need to do is raise your hand and someone will come to you with a hot mic. And could we lighten it up just a little bit so we can see folks hands coming up?

Neel Kashkari:

There's a hand up here.

Joe Santos:

There's a hand here.

Neel Kashkari:

Couple hands. Mic is coming to you. And do me a favor, just tell us who you are.

Zach Zuber:

Do you want me to stand or... Okay.

Neel Kashkari:

Whatever you'd like.

Joe Santos:

What would you like? Okay. No.

Zach Zuber:

Okay. My name is Zach Zuber. I'm from Williamsburg, Iowa. Anyways...

Joe Santos:

I think your mic is off.

Neel Kashkari:

Yeah, just slide it up.

Joe Santos:

Because the folks streaming it won't be able to hear you.

Zach Zuber:

Okay.

Neel Kashkari:

I'll repeat your question. Now all the mics are off.

Zach Zuber:

You just want me to talk through it? Okay. During the Ford administration, inflation got up to its peak, and then during the Carter administration, interest rates got to, I believe, 16.63%. Back then, land prices were fairly high for the time reaching 2,000, 3,000 an acre, specifically where I'm from. Now, land prices we're seeing are anywhere from $10,000 to $15,000 to $20,000 an acre. Do you see that ever going down to below 10,000 on average in an area like Iowa or Southern Minnesota?

Neel Kashkari:

I'm going to try. Can you all hear me? No. So none of the mics are working now. Let's just give it a second. Hey Chris, is there any hope for getting the mics turned back on?

Speaker 4:

Yeah, one second. It's great now.

Neel Kashkari:

Can you guys... All right. Great. Thank you. So the gentleman's question is, land prices have really skyrocketed over the last several decades. Gentleman said they are over $10,000 an acre in part of the country he's talking about. And is there any hope that they're going to go back down in the future? I don't know. I mean, to be honest with you, you would know much better than me about the fundamentals. I know that when I travel around and I meet with a lot of farmers in our region, we talk about a lot of things. We talk about their input costs going up, we talk about their labor costs going up, we talk about they can't find labor a lot of times are some of the challenges that farmers are facing.

But remarkably, land prices have held up very well. And the explanations that I hear are a bunch of different explanations, including major ag companies buying land, including investors, the investor class, so to speak, coming in and buying land. So I don't have any better insight into where land prices are heading from where you are. One would imagine in a high interest rate environment that asset prices would be lower. You're discounting these cash flows at a higher interest rate, you're going to end up with a lower valuation.

Right now, we're in a higher interest rate environment to try to bring inflation back down. Financial markets seem to believe that inflation should fall back down towards our 2% target over the next couple years. I hope they're right. I know that we're going to do what we need to do to bring inflation back down. And once we get inflation back down, I would expect interest rates at that point to more normalize to lower levels. So how long that process takes, I don't know exactly. But certainly, asset prices do get affected by the interest rate environment.

Unfortunately, I probably can't shed any more light than that. Thanks for asking the first question. Why don't you speak up and we'll repeat your question until the mic comes.

Jeff:

[Inaudible 00:19:35].

Neel Kashkari:

Hi Jeff, good to see you. Here's the mic right behind you.

Jeff:

So a few years ago, you conducted a town hall or listening session in Aberdeen, South Dakota, and a lot of the discussion at that time was farm based. I know you did some listening to the main street businessmen people as well. But as I recall, there was a lot of discussion about rising input costs in the ag economy and rising costs for some of the other sectors represented. And you made some comments at that time about productivity and how we need to boost productivity gains that will offset a lot of this rising cost.

So fast forward to today, given the whole we have in our labor market due to COVID... And a couple weeks ago, I also listened to your talk with Beth Ford and some of the others. Great discussion. And I know the topic came up about H-2A and pulling in a different labor force to try to fill that void. But my question specifically tonight is, how can we account for increased productivity gains, farm or non-farm, in a world where we've got quiet, quitting, a transient labor force, all those things? Curious about your thoughts. And thank you for coming to our fine university, by the way.

Neel Kashkari:

Yeah, thank you. Productivity. How do livelihoods get better? Part of the way livelihoods get better is we just become more productive in producing things. Economic growth comes from more workers to produce things, and it comes from more productivity, so those workers are more productive and can do more with less. Now, we're having fewer children than prior generations, and that's a real challenge for us. And we've been able to supplement our growth with immigration throughout our history. And the question is whether we are willing to embrace that going forward. For one, I hope we are because it's a very powerful way to continue driving our economy.

But productivity growth is what you're asking about. That's the other half of the equation. And we need productivity growth. In the first half of this year, we saw a lot of hiring, but we saw negative GDP growth. If you combine those two, more workers are producing less. The math of that suggests negative productivity growth. Now, I don't actually believe that we are forgetting how to produce things. I don't believe that we're getting dumber in how to produce things. There's a lot of mix signals coming out of the economy right now.

But we are seeing in a tight labor market that companies are embracing technology because they have to. Whether it's hotels that are saying, "Well, you can check yourself in through a kiosk." Or you go to a McDonald's where you can order yourself through a kiosk and then someone will just bring you the food. I was at a gas station recently, which this was quite alarming to me. I was at a gas station and they had replaced all of the doors, the clear glass doors, on all the coolers around the gas station, they replaced them with giant computer screens. And I didn't understand this.

I asked to manager, "What is the point of these giant computer screens?" On the screen, they just have a digital image of the soft drinks that are in the cooler. So I said, "I don't understand what is the point of this?" And the manager said, "This is not for our customer's benefit, this is for our benefit." And I said, "How is this for your benefit?" And he explained. He said, before, when they wanted to raise prices, they had to go into all the coolers and change all the tags by all the soft drinks. And it took somebody all day. But they're short staffed.

Now, the prices are digitally on the computer screens. So they just have to push a button. Now as a central banker whose job it is to get 2% inflation, that was like a punch in the gut when he told me that, right? I was not expecting that explanation. But that's an example of people adopting technology to try to solve labor scarcity issues. So we're going to get inflation back down. I heard that story. Trust me, we're going to get inflation back down. That story is quite concerning to me.

But there may be little things, benefits that come from this experience. Think about this. Think about Zoom and online learning. I don't think it's the end all be all. I don't think it's a perfect substitute. But I think we are all learning that we can be productive remotely in ways that I certainly didn't appreciate. So those are all optimistic nuggets. Then maybe there will be some productivity enhancements coming forward. Sorry, long answer to your question.

Other questions. Over here in the front. Oh, somebody in the back. Okay.

Nash Colberg:

My name is Nash Colberg. The Fed, in my opinion, has been doing very well with raising interest rates at a steady pace. I feel like there's some skepticism out there that a soft landing isn't obtainable anymore. I just wanted to know what your opinion was if you think a soft landing is obtainable, and what point do we have to get to if it's not?

Neel Kashkari:

All right. So thanks for the question. So the whole idea of a soft landing. Traditionally, when the Federal Reserve raises interest rates, we do that to tap the brakes in the economy. But historically, when a central bank raises rates a lot to tap the brakes in the economy, oftentimes, you end up slamming the brakes and you end up tipping the economy into recession. So what we would like to achieve is slowing down a little bit of demand in the economy, bringing inflation back down, but hopefully avoiding a recession and certainly avoiding a deep recession. That's what I think we would generally call a soft landing.

There's a lot of uncertainty around that. I talked about it a few minutes ago that inflation comes from a mismatch between supply and demand, and that supply is depressed because of the pandemic and related factors, missing workers, and we have to bring demand down. Well, we're hoping that we get some more help on the supply side, right? We are getting some help on the supply side. I do know that supply chains generally are getting better. That makes it easier for companies to meet the needs of their customers. So if we get more help on the supply side, then that increases our chances of achieving that soft landing that we are trying to achieve.

If we don't get any help on the supply side, then we have to do all of the work by bringing demand down, and that increases the chances of having a hard landing, so to speak. Either way, we know we have a job to do to get inflation back down and we're committed to doing what we need to do, but we are going to do everything we can to try to achieve a soft landing while getting inflation back down. But it's not entirely up to us.

Joe Santos:

Just a quick follow up while the next hand goes up. Hindsight is 2020, but that's where the fun is. Should the Fed have tightened sooner?

Neel Kashkari:

Yes. With the benefit of hindsight, yes. So a year ago, maybe a little more than a year ago, I was in the camp that said, "Hey, this high inflation that we're starting to see looks transitory. That was the term that we used. And the reason that I thought it was transitory was, we knew that a bunch of workers were missing, and we knew that Congress had given very generous unemployment benefits. And a lot of businesses said, "Hey, these workers aren't coming back while they're getting more money paid to stay home."

So I concluded from that, well, when those unemployment benefits expire, you're probably going to see a wave of workers come. We also knew that a lot of schools were closed in America, and that when the schools reopened in person learning, that would make it easier for families with young children to go back to work, and other things like that. Well, the unemployment benefits expired, we didn't see a wave of workers. The schools reopened, we didn't see a wave of workers. And as the unemployment rate started to fall, that's when we started to see more of the inflation.

And as I said earlier, the inflation was not being driven by wages, it was being driven by these other factors. And of course, we also had multiple new waves of COVID which we didn't know in the summer of 2021. So knowing what I know now, absolutely, I wish we had gone back and started tightening policy sooner. Now, I'm also realistic about that. Even if we had, there are some countries whose central banks started tightening months in advance of the Federal Reserve, six months in advance of the Federal Reserve. They also have a very similar inflation challenge today.

So even if we had started tightening earlier, we would still have very high inflation today. But frankly, we would be taking away one of the talking points, people who are saying, "Oh, it's all the Fed's fault." I mean, I wish we could take credit for it. Some things have been out of our control.

Joe Santos:

Thank you. Go ahead. Someone else from the audience. Another hand? Here we go.

Barry Sackett:

Thank you. Barry Sackett with the South Dakota Blockchain Institute. Just wondering how you and the Fed are looking at digital assets and how that'll affect your ability in looking at monetary policy now into the future.

Neel Kashkari:

First of all, thank you for asking the question. Whenever I go to a college campus, I'm always asked at least once about Bitcoin or digital currencies. I've been vocally quite skeptical for several years. When I first heard about Bitcoin and other things, I was curious. And the more I studied it, the more I couldn't make sense of it. And here's the thing. Why do government backed currencies play this vital role in our economies? Because the government has a legal monopoly on printing that currency.

If you go back in American history just before the Civil War, banks, each had their own currency, states had their own currency, and it was chaos. Even if your bank was really safe, but there was hundreds of other currencies out there and people got confused like, "Which was the safe? Was it your currency that was safe? Or was it yours that was safe?" It was chaos. And that's the fatal flaw in cryptocurrencies is that Bitcoin can claim there're only going to be X million Bitcoins ever mined. But nothing stops me from creating Neel Coin and Joe from creating Joe Coin.

And there have been thousands of these coins that have now been created that are hard to distinguish. And so it's wild wild west and chaos all rolled into one. So I'm not ruling out the possibility that something useful could come out of this sector, but so far, I haven't seen it. And for several years, I've been saying it's 95% noise, hype and confusion. And I think that 95% might be generous. It might be 99% noise, hype and confusion based on what's going on right now. So we'll see if anything useful comes of it.

Some central banks have said that they're going to look at a central bank backed digital currency. Some of my colleagues at the Fed are examining it. But as yet, nobody's been able to explain to me what problem this is solving. And I'm waiting. So count me as deeply skeptical at this point. So far, all the

questions have been from men. I have observed in my experience, sometimes women ask even better questions. And so, I would encourage any of our female colleagues to not be shy.

Joe Santos:

You can put your hand back up, Young. It didn't mean you couldn't ask.

Neel Kashkari:

I didn't mean for you to put yours down. Sorry about that.

Speaker 8:

Fed used the QE, quantitative easing, for the first time in year 2008. And that time, it worked pretty well without causing inflation. But Fed is using QE for the second time in history. For some reason, it end up causing very severe record high inflation. And I would like to know what made such difference. That is the first question. And the second question is, do you think Fed can use QE sometime in the future? It seems like it's just causing inflation without making really big difference.

Neel Kashkari:

Well, this is where it goes back to my prior comment. You're giving us too much credit. I don't agree that QE is what's causing inflation. QE, a lot of stimulus. So there's monetary stimulus, QE is part of that, a lot of fiscal stimulus, coinciding with multiple COVID waves, coinciding with supply chains disrupted, coinciding with some number of millions of workers who are no longer in the job market for a variety of reasons that we already discussed. And then of course, Russia invading Ukraine. So there's a constellation of factors that appear to all be working together to drive inflation higher right now. I don't agree that this is QE driven inflation. I don't think QE is that powerful by itself.

And so we are shrinking our balance sheet. We're shrinking it roughly twice the rate that we shrank it after the last financial crisis, in the last time we use QE. And I think that QE is actually quite powerful as a tool of monetary policy, but monetary policy has limits into what it can do by itself. And so for me, I don't conclude from this that we should never use QE again in the future. I think it's the constellation of factors that have led to the high inflation.

Joe Santos:

One here.

Charlie Stevenson:

Hi, Neel. I'm Charlie Stevenson. I'm an ag banker in town. You spoke earlier to Joe's question and you sided on the supply side of the supply-demand equation in terms of how do we get here with inflation. Is that really where you think we're at? It was a supply problem, it wasn't a demand problem. And is there any dissent in the FOMC meetings about where that is? And then I guess, my last question is, does the answer to my question matter?

Joe Santos:

It's a good question. It's a really good question.

Neel Kashkari:

Well, it doesn't matter in terms of we know what we have to do. Okay? So we have to bring demand down into balance with supply to get inflation down, and we're committed to doing that. In terms of the first part of your question, I would repeat your question this way. I think you're asking, if we had to attribute the sources of this high inflation, how much your supply versus how much your demand? I've seen different economists try to do this. I've seen some say two-thirds supply, one-third demand. I think there's a lot of uncertainty on this analysis. And people will probably be studying this for a long time.

Just think of it this way. Imagine that you had massive stimulus hitting the economy. You would think that how would that lead to inflation? It would lead to people trying to consume goods and services. It would lead to the unemployment rate falling. It would lead to wages soaring. And that would lead to high prices and high inflation. There's something really curious going on right now in the economy. There's this notion... Sorry, this is a long answer. It's a very complicated question you asked.

There's this notion of labor share of income. So the U.S. economy produces this much income in a given year, and some of that income goes to workers and some of that income goes to owners of businesses. Labor share of income has been declining over the last 30 years, fairly gradually. Well now, we apparently have a very tight labor market. Businesses are having to compete to find workers. And you know what's happening? Labor share of income is going down.

I would've thought, if we have this historically tight labor market, that workers would've more bargaining power now and labor share of income would be going up. So the reason I tell you that is there's a bunch of weird stuff happening in the economy right now that is hard to neatly say this is purely supply, this is purely demand. It ends up, these things are getting lumped together. But to your last part of your question, at the end of the day, it doesn't matter. We have our work to do and we know we have to do it. But thanks for asking the question.

Joe Santos:

Oh, David.

David Davis:

Hi. I am David Davis. I'm a professor here at the university. I'm a micro economist, so I'm going to try to not ask a stupid macro question. So you talked about quantitative easing and you talked about the Fed shrinking its balance sheet. I've heard also it called unwinding its position. Can you just talk a little bit about the nuts and the bolts of how that works? My initial thought was, this is a bad time to be selling bonds because they're very low priced. But I don't think that's exactly what is meant by reducing the balance sheet. Is that right?

Neel Kashkari:

You are correct. I'm going to give you the quick answer to your question. Then I'm going to give some more background for everybody's benefit. The quick answer to your question is we've got this $8 trillion portfolio, mostly of treasury bonds and Fannie and Freddie mortgage backed securities. And every single day, some of those are maturing. And so what we're simply doing is letting those mature and we're shrinking our balance sheet by those maturing. Then the treasury department pays us back the principle and then our balance sheet shrinks that way. So we're not actually going out and selling bonds.

We have the ability to go out and sell bonds. We don't think we need to at this point. We think that this runoff, this natural runoff is actually quite rapid, and that's how we're able to shrink the portfolio without capitalizing those losses, so to speak, that you're talking about. Let me just give you a little bit of background on what this QE thing is, because not everybody will necessarily get it.

So traditionally, when we want to boost the economy, we cut something called the federal funds rate, that we lower it as an interest rate, and we can lower it to zero basically. And this interest rate is an overnight interest rate that banks charge each other. Well, why do you care about an overnight interest rate? Who pays an overnight interest rate? Well, the reason we care about it is because by lowering overnight interest rates, it has an effect on long-term interest rates.

So if you go to get a mortgage to go buy a house, a 10 year mortgage, a 20 or a 30 year mortgage, if we've cut the federal funds rate, chances are your mortgage is going to end up being a lower interest rate and your payment will be lower. So it'll be easier for you to afford a house. So then the question was in the '08 eight crisis, once we cut that overnight interest rate to zero, are we out of ammunition? And the answer is no. We went into quantitative easing by buying long-term bonds, five year bonds, 10 year bonds, 30 year bonds. We are able to drive long-term interest rates down as well.

And then, that then dragged down mortgage rates and car, auto loan rates, et cetera, as a way to boost the economy. So as we're unwinding this, the best way to see how this works is mortgage rates, at the beginning of this year, 30 year mortgage rate was around 3%. Now it's over 7%. And that is because of the actions that the Federal Reserve has taken, raising our federal funds rate, but also beginning to shrink our balance sheet. All of that is working together to drive these long-term interest rates up, which makes it more expensive to buy a house, more expensive to buy a car, and that then taps the brakes on the economy.

Joe Santos:

Yeah, right here.

Zach Zuber:

All right. I was told to ask this question. You have a lot of students here. Generally, most of might here for extra credit. President Biden was saying, he's going to pay off federal student loans. That was a big thing that students were curious about. How would that affect almost anything that you cover, whether that be the Federal Reserve, whether that be economy or interest rates? What is the general effect of that? I mean, you're talking millions of dollars.

Neel Kashkari:

From my perspective in trying to read the economy, then trying to read supply and demand and inflation, it's probably not going to have a big effect. And I'll tell you why. On one hand, if you cut whatever debt I have or whatever debt you have, that makes it a little easier for us to go out and spend on other things. So on the margin, it should be net [inaudible 00:41:06]. Having said that, if you look at who actually has student loan debt in America, the lowest income Americans, if you give them an extra dollar, they will spend the dollar because they got to put food on the table and they're trying to put a roof on their head and clothes for their kids, et cetera.

So if you give an extra dollar to the lowest income Americans, they will tend to spend it. If you give an extra dollar to a very wealthy person, they will tend not to spend it because they're already covering their basic needs. And along the middle, some of it'll get spent, some of it'll get saved. Well, if you look at who has student loan debt in America, it's not the wealthiest Americans, but it's also not the lowest income Americans, because the lowest income Americans, by and large, don't get the opportunity to go to college.

So it ends up being folks in the middle who, by and large, are going to spend some of it, but are going to save a lot of that money that they get back from the government, so to speak. So if you look at that, on that lend, it's a little bit of a regressive policy rather than a progressive policy. And the curious thing is,

the more regressive it is, the less inflationary it is because that money's going to end up not getting spent.

So I actually don't think it's going to make a big deal in terms of our analysis of what the economy is going to do. I think it raises long term questions about, what about the next set of students to come? The students that are here four years from now, are they going to get a similar deal? We have to educate more and more and more people in our country, give them access to really high quality education, and we need to find a way to do that affordably. Is this program a model for the future? I don't know. That'll be up to our elected leaders to decide. But those are some of the questions that it raises in my mind.

Joe Santos:

Right across.

Speaker 11:

Back to productivity for a moment. You talked about technology being helping boost productivity, the convenience store example and so forth. Over the last 20 years, there's been a big gain in productivity through lean manufacturing and lean methods, especially in inventory reduction just in time. With the supply chain problems throwing that completely out of whack, would you see businesses overreacting and start to hold much more inventory having had this bad experience of being short?

Neel Kashkari:

I'm skeptical that some of the changes that you're seeing right now are going to last. I think once we get through the pandemic, the pressures from investors end up becoming quite high and saying, well, you hear a lot of stories about, well we're going to reshore, we're going to onshore, we're going to friend shore, pick your clever name. Most of those mean we're going to spend more money, we're going to have higher costs. And so I'm skeptical that these changes are really going to last because in my experience, the pressure from investors two years from now, five years from now, when this is in our rear view mirror, they're going to say, "Hey, go out and find the lowest cost way of manufacturing this."

So I hope we have some lasting lessons from this. I'll give you an example. So '08, we had this terrible housing downturn, terrible financial crisis. And if you remember going into '08, we had a housing bubble, we had people taking out no doc loans, you had home flipping. Well, just a few years ago, some major companies were launching home flipping businesses. And I just couldn't understand how somebody who was born before 2008 could think that a home flipping business is an actual legitimate, scalable, sustainable business.

I mean, it works on the way up. And then what happens when there's a downturn? And so it's a long answer to say we have frustratingly short memories. And so my guess is, the lessons from the pandemic and the supply vulnerabilities that we're now experiencing, my guess is those lessons are not going to be long lived.

Joe Santos:

Go ahead.

Dan Nelson:

Yeah, Neel, Dan Nelson. Welcome to Brookings. Pleasure listening to you. The last time the Fed was able to combat this hive of inflation was back in the 1970s, early eighties. And at that time, we obviously

didn't have 30 trillion in debt. And my question is, with a fed funds rate of, at this point, over 5%, is the Fed concerned that maintaining that high of an interest rate is going to cause problems in servicing 30 trillion in debt? And is the pivot less about reaching a 2% inflation target and more about an inability to service that debt?

Neel Kashkari:

Good question. It is the Treasury's job and the Congress's job to decide how to finance the government, how much they want to tax, how much they want to issue debt, how much they want to spend and what they want to spend on. That's not our responsibility. Our responsibility is to achieve our dual mandate goals. So I can tell you, we do not contemplate what our interest rate decisions mean for the U.S. Treasury or for Congress and their fiscal spending plans. We view our job as to achieve our dual mandate goals.

So I think people say, what might drive the pivot at some point in the future? At some point, the unemployment rate... So we have two sides of our dual mandate. Inflation and maximum employment. At some point, they will come into attention. So let's say if I thought that the lowest unemployment rate, I think it's lower than this, but let's just say I thought it was 4%. Imagine a rough way of looking at this. If we were missing our unemployment target by 50%, we'd have a 6% unemployment rate relative to four.

And if we were missing our inflation target by 50%, we'd have a 3% inflation rate relative to two. So at some point, these two goals are going to come in attention. We are a long, long, long way away from that right now. So that's why any talk of a pivot is entirely premature right now. But at some point, we'll have to factor in these two goals. That in my view is what would be a reasonable way to think about, hey, when should we start normalizing policy? It is not, what does this mean for the fiscal authority? That simply doesn't come into my thinking.

Speaker 13:

So based on your personal experience and your study of history, what are two or three decisions that we can make that will make five years from now a success?

Neel Kashkari:

Individually or as a country?

Speaker 13:

As business leaders?

Neel Kashkari:

Well, something we talked about earlier. If you look at all the economic challenges we have as a country, not all of them, but many of them are made easier if we have more workers in our country. Think about Social Security, Medicare, a lot of these entitlement programs are funded by current workers paying for current retirees. And as our society is aging, that ratio is getting imbalanced and these programs run into challenge. Or think about the overall growing and the growth potential of the U.S. economy. Think about servicing the debt.

So individually, I can't give you advice on how you run your business, but when I think about the one thing that we could do as a country that could really boost our economic competitiveness, it is fixing our immigration system so that we have an immigration system that meets the needs of our economy. And

it's there if we have the political will to do it. I understand that it's politically challenging, but that is the single biggest thing that I'm aware of that's within our control that could really move the needle on our economy's potential.

Speaker 14:

Thank you for being here. As you can tell, I'm not of the current generations that are through school, but I observe it a lot. I'm a CPA, involved in banking and businesses. I'm curious what your perspective is on this, but what I'm seeing is, we're competing with firms from South Carolina, New York City. They're hiring our workers to work remotely, which is a great impact from COVID accelerating cloud-based business and remote working.

But I'm also sensing, and I credit young people for this, the desire for a better work-life balance. So they're demanding I want to work from home, they're demanding that I want to work three days a week. And so we're having to compete on a local level with national firms. Some of the businesses I'm involved in, we can't hire enough people. So we have trucks that sit. And so I'm curious how you see that translating into increasing productivity. My sense is, my feeling is there's going to be a moderation of productivity attitudes among workers. Thank you.

Neel Kashkari:

Yeah. I'll say this. I think every generation thinks that the generation that follows them is lazy. Well, you're talking about attitudes and attitude changing. I think that people have a lot of desires and a lot of goals, and then economic reality starts to hit them, right? They get married, they start to have families, and all of a sudden these other things become important to them. I'm optimistic. In our region, our region is quite rural. And one of the biggest challenges when I would go to small towns all around our region is they would say to me, "All of our young people are leaving, and we want them to come back but our town is dying."

And now because there's been a lot of money that's being allocated for broadband, which I think is a great thing, now all of a sudden, some of those young people can come back. And maybe they're not working for the local company, maybe they are working for somebody in another part of the country. But that's a heck of a revitalization engine that didn't exist five years ago or 10 years ago. And so look, there's going to be a lot of changes to come. And I also know we do have a tight labor market right now. And a year from now, or two years from now, if the labor market is softer, people are not going to be, they're not going to be able to be quite as picky as they're able to be right now.

So this pendulum is going to swing back and forth and it's going to lead a lot to changes. But I think this is an example of some of the benefits of technology, accessing workers who we couldn't have previously access, accessing housing. Another challenge that has not come up here yet today, affordable housing is a challenge almost anywhere you go. Well now, all of a sudden, if you don't have to be clustered at the heart of the city, which is very expensive, and you can live more in a rural community and have a high quality of life, all of a sudden, that relieves pressure on some of our housing needs as well.

So I'm not glossing over that there're going to be challenges for individual firms and challenges for our society as a whole, but I actually think there are going to be some good things that come of this.

Joe Santos:

Yeah. We have time for one or two more. Chris, up here.

Speaker 15:

Maybe. Okay. So you mentioned housing. And I was curious, what are your thoughts are or if there's been conversation around how to treat rent in the CPI? There's been some conversation around that. You see market rent nationally, at least pretty flat now, and in many cases, even going down, although everyone expects rent because it's based upon currently paid rent, which might have been from leases 12 months ago, being a significant component of inflation, having high inflation going forward. Just curious to see what your thoughts are and what others are on how to factor in where market rents might be flatter going down, but will be a big component of inflation expected for the next few months.

Neel Kashkari:

So thanks for that. We are acutely aware of the math associated with, just to the gentleman's question. So we get these inflation readings that you read about in the paper. Consumer price index is one that gets a lot of attention. And shelter is a big portion of that, of what a family pays every month. The way that is calculated, we can forecast where it's going based on what's happening to new rents. Because if you sign a new lease today, the people who've been in that same apartment building six months ago, they've got older data. And so as those leases turnover, it takes a couple years for those new leases to work their way through the actual calculation.

So just as the gentleman said, we know that the new leases are flattening out and yet there's a lot of inflation in the pipeline yet to come. So we study that. We're aware of that. And we factor that in our assessment of where we think inflation is going. Having said that, as mechanical as that process is, we have been repeatedly surprised to the upside. And so it's not quite a perfectly tight link the way one might think it is. There are still sources of surprise. So we factor that in, we're paying attention to it, and we try to do our own forecast of where we think inflation is headed, and we try to account for some of those effects.

So thanks for asking the question. I would note, when I suggested was there not a question from any women in the audience, I just reminded myself that your governor is a woman. And I don't think that she would be pleased if we only called on men in this. So let me just ask, if we have question time for one or two more, any women in the audience have a question? Oh, over there. I see hands pointing this way. There we go.

Speaker 16:

So I'm in [inaudible 00:55:43] business class, and he mentioned that you didn't vote in this last meeting that you guys had because it wasn't your rotation or whatnot. But you did get to say your piece to represent this part of the nation. And my question or two questions is, did you expect the rate to be set where it was at, or did you expect a different setting of the rate? And if you had monitor a monopoly power, where would you set it and why?

Joe Santos:

They are better.

Neel Kashkari:

Thank you. See? Good questions. So let me just explain how we vote. There are 12 reserve banks. And it's complicated, but basically we rotate, we take turns. So I'm a voter next year. I was not a voter this year or the prior year. But we all go to all the meetings, we all make our recommendations, we all participate in the deliberations. But in the last 30 seconds of a two day meeting, when they take the vote, certain names are called out and not others. So you're right, I was not a voter.

I was not surprised because there's a lot of work in preparation that goes into these meetings. The chairman of the Fed, so Jerome Powell, sends us some options in advance of the meeting so we know what the menu is, what's being deliberated upon, and we talk about it in advance individually. I talk about it with my economist as I prepare for those meetings. So I was pretty certain I knew where we were going to end up in this meeting. And a lot of times, the deliberation in this meeting is really about laying the groundwork for where we're likely going to be at the next meeting.

So at the next meeting, which is mid-December, I don't know what we're going to do. There's a lot of talk in the public about might we raise rates by 50 basis points? Might we raise rates by 75 basis points? Those are certainly going to be on the table, but could it be something beyond that? It's possible too. So I don't know exactly. I think we're on a good path right now in terms of what I would do if I was king. I think we're on a good path right now. I think we are united in our commitment to getting inflation back down to 2%.

But monetary policy operates with a lag. So some people have said, "Well, why don't you just go one move? Go up three percentage points in one move." And the answer is, monetary policy takes time to work its way through the economy. And by moving aggressively but taking a few steps, we get to see how the economy evolves, we get to see what's happening with supply chains, and that reduces the risk that we're going to overshoot our mark. And so I think we're on a good path right now. Thank you.

Joe Santos:

So we spent 57 minutes or so talking about monetary policy, but it's not everything the Fed does. And so in the final three, you've been an ardent supporter of racial and social justice. What's the Fed's role there? It's a very different topic.

Neel Kashkari:

Yeah. Up into the pandemic, I was for, several years, arguably what they call the most dovish member of the Federal Open Market Committee. I was arguing for low interest rates. And the reason I was is that, every time we thought we were at maximum employment, the economy created all these new jobs. We thought we were out of workers, and then all these workers came back. And inflation stayed below our 2% mark. And I would go into low income communities and minority communities and businesses would tell me... In fact, it might have been in South Dakota.

I did a round table of businesses a few years ago and said, "My gosh, there are no workers left." And then the next round table I did was with non-profits helping low income communities. And they said, "We don't have enough jobs." And there was a big disconnect between business and between those communities. And so the more conversations I had like that, the more I realized that if we just look at the national unemployment rate, it's missing a lot of important people below the surface. And so our work on this is really about understanding what is our economy's potential? Who is out there? Who wants to work? Who can work? And the better we understand that, and by the way, the better we reach them, the greater our economy's potential.

So to me, it's absolutely about understanding part of our dual mandate, which is maximum employment. And that means understanding our economy's true potential. Not just its superficial potential, but its true potential. And its true potential is if everybody who's interested in working is actually able to participate and contribute to our economy. So we're a long way from that right now.

Joe Santos:

Thank you. And we are very nearly done with our program. So I thought maybe just a final thought for all these students, aerospace engineer, Goldman Sachs, TARP, federal reserve bank president, any career advice?

Neel Kashkari:

Well, there has been no plan, as you could probably tell, in my career. I pursue things that I think are really interesting and challenging and important. And I find for me, if I'm interested in it and I'm challenged by it, and I think it's important, that really motivates me that I'm going to do my best. And if I do my best, I'm more likely to be successful at it. And so I would just say, life is long. You're going to be very focused when you're graduating on your first job. Your first job is not the end all be all. It's your first job. And you can do different things and be willing to take risks.

I mean, I don't think I've taken careless risks. I've taken thoughtful risks, but I have been willing to take risks. And I found that that has been... Whatever job I have, whatever company I'm working for, most people are nervous about taking risks. So you're in a job, you want to get to the next level, you want to get promoted. I was willing to say, "Yeah, that's all fine, but I'm going to go try something totally different." And that has actually enabled me to go out and try to do different things. And so life is long. Figure out what is important to you, and go for it.

Joe Santos:

Well, Neel, on behalf of the Ness School of Management and Economics, South Dakota State University and all of its stakeholders, thank you.

Neel Kashkari:

Thank you for having me. I really appreciate it.