Kyla:

Hey everybody, my name is Kyla. Welcome to my channel where I talk about the stock market and the economy, amongst other things. I had the incredible opportunity to interview Mary Daly, the President and CEO of the San Francisco Federal Reserve. As we all know, inflation is not where anybody wants it to be, the Fed is very, very focused on getting inflation down to 2% with their very blunt toolkit, raising rates, shrinking the balance sheet, talking.

And as we all know, and as I've talked about extensively on this channel, people are the economy and it's really important to keep people in mind when making policy decisions. So, we discuss all that and more in this interview. The evolution of the labor market, worker power, profit margins, homeowners, and the fixed rate mortgage and how that prevents some elements of monetary policy transmission, the Fed's toolkit, their pretty blunt hammer, and artificial intelligence.

Hey Mary, thanks so much for coming back on to chat about the economy. I'm so excited to talk to you today.

Mary Daly:

My pleasure, I'm delighted to be here.

Kyla:

I want to talk about a wide range of things, the labor market, inflation, your thoughts on AI, but I think the first question that I want to get into is, for the past couple of years our world has been dominated by tech, but now there's these tech layoffs that are almost forcing us to revert to the physical world again. And so I'm curious your thoughts on the evolution of the labor market, specifically in this niche of the evolution of maybe favoring blue collar work or the need for blue collar work over white collar work as it's been for the past couple decades?

Mary Daly:

So, I think it's a really good time to try to do something that we do in economics all the time, which is separate what's going on currently from what the underlying trend is. So, if you think about your term of blue collar, white collar, that is really something that people are focused on right now. And they say, is there a re-imagining of, really what they're talking about is low and moderate wage workers who work in the services industry or do retail, landscaping, things of that sort, are those individuals getting a better deal?

And I would say that right now those workers are in short supply and high demand, and so they're getting higher wages. But if you ask yourself, is that going to be a replacement for getting the skills that are durable throughout one's career, I would say no. Because right now, even though those workers are getting rapid wage growth, they are not always keeping up with inflation.

In fact, when I'm out there talking to individuals who are starting out or middle career, they're just on a treadmill trying to keep up, trying to make ends meet. And if you think about tech, the tech workers that are being laid off in a big firm that's announced massive layoffs are turning around and finding jobs in all kinds of places that have been short of tech workers to do the cool things that are anything from manufacturing to new ideas in financial services to just running the business lines better at any institution. So, I don't think that this is a sea change in the labor market.

What I think of this is a good job market for a wide range of workers, including those who don't always get a break and yet skills pay. And those workers hopefully are finding an opportunity once we get inflation down, to go back in and get whatever skills they want to have to build their career. Right now it's a frenzied world out there to try to earn enough to keep up with inflation. That's why the Fed is so focused on inflation.

Kyla:

On inflation. The labor market aspect is so interesting too, because you know have these workers who their wages are, everybody's wages are being eaten away by inflation. It's pretty much unavoidable, but for the first time it does almost feel like the worker is able to have a choice. We have such a tight labor market, so how does the Fed think about that trade off where we have somewhat of a healthy labor market, low unemployment, but then people are able to turn around and get those jobs, especially in tech, versus battling inflation, then unemployment rate is probably going to have to tick up?

Mary Daly:

Well, the inflation rate and the labor market, they're all related. So, I'm going to go back to 2019, that's what I would call a really healthy labor market. We had low inflation and people were able to get multiple job opportunities. People who had been sidelined, people had sort of said, "Well, you're probably not going to work again." They were coming back in. People had career mobility, they were accumulating income and wealth. That was a really solid economy that delivered a strong labor market and low inflation price stability.

Now we have an unbalanced economy, and while it feels good at the moment for a particular worker to get a particular wage gain, you said this and I totally agree, that it's being eroded every single day by inflation. That's not what I call a strong place for the economy to be in, because we need sustainable growth. The thing the Fed's working on and the best thing we can do for Americans is provide a sustainable path of growth that does exactly what we're able to do in terms of the labor market, gives people opportunities to change jobs, to find the career that matches their interest, to grow their careers over time, but then to bring that paycheck home week after week and be able to afford things that they afforded last week.

And right now we can't do that. So, I think that's the point of balancing the economy. You balance the economy to give people a full slate of options, not just a positive here and a takeback there.

Kyla:

I think that makes a lot of sense, having this balanced economy. And I think one aspect that has raised a lot of eyebrows recently is companies and profit margins and raising prices like Campbell's soup raised prices by 16% last quarter. And of course it's certain aspect you're like, "Well, they kind of have to raise prices in order to pay these workers and get this ball rolling again." But I know that the Fed is in between this top-down look at the economy, how far the economy is operating above capacity. The bottoms up look, prices and wages, but how do you think about that trade off between higher costs for consumers from companies raising prices like this and companies maintaining profit margins?

Mary Daly:

We have only one tool, the interest rate. And then we have two goals, full employment, price stability. And so what we're really doing is we're asking how can we get those two things to go together at the same time? So, prices are rising for a whole bunch of reasons. Supply chains, demand has outstrip supply because demand is strong, stronger than it normally is at this point in the economy. And then people don't necessarily want to do the jobs that they once wanted to do. So, labor supply is short and firms are trying to manage this.

We have less global competition, less global interaction than we did prior to the pandemic. You've heard about reshoring, nearshoring, all of these things are happening at the same time and all of that's contributing to profit margins or revenues or sales or prices. And so unpacking that is something you can usually do historically, but it's very hard to do it in real time. And in real time we can all agree on this thing, inflation's rising too fast, faster than our goal, but faster than people can really keep up.

And so the job of the Fed, whatever the cause of that high inflation is, is to bring inflation back down to 2% using the tools we have and do so as gently as we can so that we don't leave the labor market worse off for no reason at all. So, the things on the top of my mind, and this is up and down the generational spectrum across all my communities that I serve, is how do I deliver the easiest path for the economy that puts inflation back on track and keeps the labor market as strong as it possibly can be?

Kyla:

I think that that is the right goal and it's a tough one for sure. I think as a renting member of the younger generation where I rent, I don't own a home, a lot of people around my age are like, "I don't know if I'm ever going to own a home." I'm curious how the Fed is thinking about that disparity, so between renters and homeowner. Homeowners are a little bit more insulated from monetary policy transmission hypothetically, because they have this 30 year fixed rate mortgage and a lot of people got in at 2%. So, they maybe don't feel the Fed's toolkit as heavily as somebody who doesn't own a home.

Mary Daly:

So, when I think about it, here's how I think about it and here's how it works with monetary policy. So, we have, just to say it again, we have one tool, it's a blunt tool, so we raise the interest rate, it affects the economy, it affects housing first, one of the first sectors it affects, because it's an interest sensitive sector. The mortgage interest rate rises, demand for ownership of homes falls because it's more expensive to get the loan.

That eventually slows the price of home price growth, and then eventually trickles into rental price growth. That eventually is a really important word because it takes some time. So, if you're a younger person and you're thinking, "Well, I'd like to start buying a home," what you see right now is you see home prices coming down or the gross growth being less rapid, at the same time that the cost of borrowing goes up and you think, "Well, I'm not going to get a chance now either, because now I can afford the price but I can't afford the loan."

And what I'm going to offer here is that the way we do our job well for all of you in the younger generation who's thinking about this, is to get inflation back down to 2% so that the price of the homes can come down to a sustainable level, a sustainable rate of growth, and we can move the interest rate back down to neutral so that it's lower and you can both afford the price of the home, you're not in a 10 person deep line paying cash or using their equity in their previous home to buy a home and competing you out.

We also recognize that without inflation going down, you can't even save money out of your paycheck because you're just paying for basic necessities. So, that's why I really do think of inflation as the toxin that pulls away at the foundation of the economy. And if we can fix the toxin and get it back down to 2%, then you can save more, you have more ability to get the homes you want and deserve and you have more ability to afford the loan because we can put interest rates back in their neutral position. So, it takes time.

I feel for that part of it, I feel for every American who has to go through this transition, but this is one of those things where if we fail to make the transition, the world would be far worse than if we make the transition well and smoothly.

Kyla:

It's definitely tough, because as you know, when you speak to people in the younger generation, there's a lot of frustration. This concept of financial nihilism is really big where it's like, "Well, I can't have that 'white pick fence, American dream,' so why would I ever try?" If you could say something, and I know that you do say things to the younger generation, how would you approach that concept of financial nihilism where you see people giving up almost on their financial future?

Mary Daly:

Well, the first thing I would say is don't give up. I mean you've been given one of those historical draws, which no one wishes, that you are coming of age, coming out and moving into the economy at a time when we had a pandemic, and then following the pandemic we have high inflation, and then it looks like the economy needs to cool to fight inflation. So, that creates anxiety about, "Okay, how much is it going to cool and where am I going to be?"

And then the things that you've put your goals and dreams on about home ownership or whatever your goals and dreams are, feel less able to grasp. And the thing I will offer is the thing that I had to tell myself when I was back in a similar thing, it was in your position in the Volcker disinflation and all I saw was high inflation made everything unaffordable, followed by a deep recession that made everything unavailable.

And that is what I'm trying to avoid as a policymaker, is not doing that. And so what I would say is hang in there, hang on, don't give up, but be ready to move when moving is possible, not moving physically, but be ready to act on your dreams when it feels more favorable by continuing to save what you can, continuing to plan for your future. But if you give up, then you've let basically a pandemic and an economy with high inflation get the upper hand. And I refused to do that as a policy maker, and so the thing I'd ask of you is hang in there with me.

I mean I hate to be so direct and I don't mean to be pollyannaish, but I mean what other choice do we have? We have to hang in there and get through this and be ready to go next time.

Kyla:

There was something I was reading the other day, things will always be okay eventually. And I think what you said earlier, eventually it does a lot of legwork there, but I think that's true and it's always a good reminder that things will normalize over time ideally.

Mary Daly:

Can I say one more thing about that?

Kyla:

Yeah, of course.

Mary Daly:

I don't want to interrupt you.

Kyla:

No, please.

Mary Daly:

But that saying, things will work out eventually, always feels like we're not actors until eventually comes. But what I'm offering when you said is there's something I want to say is that you can participate in your future even when you can't execute on every goal and dream you have. And so I wouldn't be passive bystanders on that. It's more get out there and think about, okay, what do I need to do to be ready so that it just doesn't feel like we're waiting on behalf of eventually, we're actually actively participating so that we're ready for when a different situation emerges. That's my thought on that. It's what I tell myself.

Kyla:

No, I think it's really good. Action begets action. You have to be out there doing the things, finding the opportunities, and that's a big part, I think. Be actually curious to hear a little bit more of your time growing up in the Volcker environment. Did you find that you had to be pretty active doing and finding things out there?

Mary Daly:

Absolutely. I mean I think one of the things I really appreciate about the younger generation of your listeners and you is that you're scrappy. And I think being scrappy is a really good quality in an economy that is dynamic. I mean even if we just abstract from inflation right now, we have a very dynamic economy. I mean you mentioned it, that the labor market seems to change and some things that were really hot six months ago seem less hot now. And you have to be able to be resilient to navigating what is an ever-changing economy and one that's going to continue to change at a rapid pace.

So, I really think of my growing up as one where I found opportunities where I could and I got help where I needed it and I pieced together something that in retrospect to many looks like a path I would have plotted, but in reality was the crooked path of being opportunistic, being out there looking for the opportunities that I knew built my own future. And I know it's over said, but it's really this economy is no reason to feel like you're being pushed around. Yes, inflation is higher than we want it to be. That is absolutely true.

Yes, it can feel like a treadmill. Absolutely true. You're still able to captain your own destiny by putting your jobs together and doing the things that are important to you and keep planning for your future. And that's ultimately what I think is you already have as a generation, look how much you've already gone through. But it's about activating that and kind of marching forward. And all I can say to you as a policy maker is you're top of mind when I get up in the morning about how I think about why are we doing policy, why is this so important? It's really to deliver an economy for all of you that you deserve and that works better on behalf of everyone.

Kyla:

Just making sure that things are okay for future generations, because they're kind of all that you have to a certain degree. And I'm curious your thoughts on rolling recessions. So, there's this idea that the whole economy might not go into recession, but pockets of the economy, maybe manufacturing for example, will go into a recession and the Fed does have this really blunt toolkit. Is there any ideas around maybe more nuanced targeting of monetary policies or really just like, "Well, this is kind of the domino that we have to tip in order to get things rolling?"

Mary Daly:

Let me go back to your first point about rolling. I think we actually overuse the R word, if I may say.

Kyla:

The recession word?

Mary Daly:

Yeah, I call it the R word. Definitely overuse it. And so then the question is what are people responding to? And I think what really there's a lot of response to what I would think of as natural dynamism in the economy. I mean the economy's always moving, that's the way it is. Everything's firing on all cylinders and sectors are going to be rebalancing and other sectors are going to be coming up. Some sectors say, "Oh, we should have been growing faster, now we're going to really ramp up." Other ones say, "We probably got over our skis a little bit," I just went skiing so, "We probably got over our skis a little bit, so let's pull back and let's rebalance."

So, if I can do this, I'd like to replace your R word with a new R word, rebalancing. The economy is in a period of rebalancing, and that can feel a little bit anxiety provoking, but it can also be the place where we grow into something that really delivers different kinds of benefits to everyone. We have new opportunities for people who have all different kinds of skills to get the kind of career mobility they've been wanting their whole lives. So, I think of the economy as a hopeful place where there's a lot going on, but I'm going to keep coming back to this. None of this works, literally nothing I just talked about works unless we get inflation back down to 2%.

Because that is the thing right now that makes us the most vulnerable in our economy, is that inflation is so high it's unsustainable, and we have to get it back down to 2% so that we can have a really sustainable, stable, resilient path forward.

Kyla:

And are there any pockets of inflation, like specific sectors of the economy, that you're worried about? I know recent inflation prints haven't been great. Are there any specific spots that you're paying attention to?

Mary Daly:

Inflation's going to move around and there are going to be areas that pop up, as you said, and areas that come down. But if I was going to unpack overall inflation and tell you how I look at it, what dashboard I'd look at, I'd say I'd look at overall inflation of course. And then I look at if I take food and energy out, because those tend to be volatile and the Fed doesn't have a lot of direct, I mean our interest rate controls demand, which is really going to affect core inflation. And so then there's core goods and there's core services.

So, we know core goods prices are coming down as the supply chains get improved or repair, and as all of us decide that we're going to go out and do things as opposed to buy things. So, that's a good thing. And then the other one is core services, and that has two components. And I say this because it's really important to separate the two components. One is housing, we've already talked about it. And the other one is really if someone could come up with a better name, you should send it in. But core services ex-housing, which really just means core services, take the housing out, see what you have.

And that one's been a little stickier. And that's about all those things we mentioned. Restaurant meals, haircuts, business services, those have been stickier. And that's an area where my focus is really on I'm, I'm really focused on that because that also needs to slow down. Inflation needs to come down for us to really be confident that we're moving towards our price stability goal. So, that's what has to happen, that's what I'm looking at. But a little bit of up and down in inflation readings, I wouldn't be too worried about because transitions are always a little bumpy and the data being bumpy doesn't mean we're not on the right path.

Kyla:

Yeah, exactly. And on a three-month basis it looks decent. So, month to month it's a little choppy for sure. But I think that's a good point. And this will be my final question, because I know we're almost out of time. I am curious for your thoughts on artificial intelligence, whether that be like how it's impacting the labor force, if you see it impacting the labor force, or just your general thoughts on it?

Mary Daly:

One great thing about being long-lived is that you've seen a lot of things, but also I read a lot of history, and one of the things you see time and time again historically, and even in my lifetime, is that every time a new tool comes out or a new machine, a process, a technology, then there's always a lot of concern that it will replace all labor and that we won't have anything to do. And it never happens, because one machine takes the place of some tasks that we used to do and then that frees up our bandwidth to think about new things we could do.

But the responsibility of the economy, if you will, is to ensure that those people who used to do the tasks that now a technology or a machine or a process does, actually have a place to go in the new economy. And that's why it's, again, sustainable expansion. You keep hearing me say sustainable expansion. I'm not worried that AI is going to replace all humans. What I'm thoughtful about though is as AI starts to be something that takes certain tasks away, how is the economy positioned in a sustainable place so that it can absorb the workers who want different jobs because they no longer have to do the ones that technology can do effectively.

So, the economy is constantly growing, it's constantly dynamic, but the job is always as a pop Fed policy maker, maintain that sustainable path of growth. And when we get off of it, get back on it so that all of this can be smoother and that people like yourself and all the generations out there have an opportunity to reengage and fully participate.

Kyla:

Yeah, absolutely. Well, thank you so much. This has been great. And thank you.

Mary Daly:

Always a pleasure. Thank you.

Kyla:

So, that was Mary Daly, President and CEO of the San Francisco Federal Reserve. What an honor, and what a great conversation. I think the main thing is that the Fed is really focused on that 2% number, like super, super focused in order to rebalance the economy, right? That new R word that she mentioned. As Mary said, none of this works unless they get inflation down to 2%. The Feds' toolkit is really blunt, and it has a blunt impact, like a sledgehammer almost, and they're taking that to the economy and things are getting better, but the path is long and bumpy, as we talked about.

Wage stability in context of inflation is probably more important than wage growth, and we have a strong labor market, but it could be stronger if inflation was more stable. But of course, policy impacts are wide, they're varied and they are unequal. But the goal, as Mary said, is to balance the economy to give people a full slate of options, not just a positive here and a takeback there. I hope that you enjoyed the interview. Please leave any thoughts, questions, comments below.

The transcript is on my substack. It's also on podcast format if you want to listen on the go. And I'm on TikTok, Instagram, everywhere, and I hope y'all are doing well. I'll talk to you very soon.