Mark:

Okay. Greetings. Could I have your attention? Okay. Welcome. We want to get this show rolling. Now they'd asked me to push a button up here to make sure the mic was on. Can you hear me okay? There's a couple buttons, and what I was worried about was pushing the one that would make interest rates go up. Please check that as well.

To begin, today's the 10th luncheon of the '22-'23 season of the Boston Economic Club. Before we make formal introductions, I wanted to first alert you to two big events coming up as well. On February 22nd, we have Stéphane Bancel, who is the chairman of Moderna. He's going to speak specifically about the challenge of COVID and what that company has done to try to help. That should be actually a very interesting get-together. Then on February 28th, we have Paul Tucker, who is, of course, the former governor of the Bank of England who's speaking on his new book, which is called Global Discord: Values and Power in a Fractured World, which is a very timely book. I think you'll enjoy both of those events.

To kick off the fireside chat, I want to introduce President Collins. But first, I'd like to say this, that we're just so happy to be back here. President Collins is the 14th president of the Boston Fed. Importantly, she was born in Scotland, raised in New York City, but was Boston-bound, and I'll get to that in a little bit. Prior to her role at the Boston Fed, and actually just a year ago, last year, many of you probably remember the announcement when she was appointed to be the Fed head here.

Sure, she has been here only for a year. She's been the dean and also she's been a provost at University of Michigan. She's been at the Brookings Institute, IMF, a Georgetown professor, and served 10 years as a director for the Chicago Fed. But most importantly, during her formative years, that's 16 years here in the Boston area, whether she was a student at Harvard or whether she received her PhD in particular at MIT, or actually became a professor at Harvard itself, these were the years in which that her research and scholarship was forged.

To us, we think of her as being here for a very long time. One year ago, a month, her intellectual curiosity brought her back to Boston, and as a result, Boston community in particular and this club is better for it. Without further ado, on behalf of the Boston Economic Club, I'd like to give you a warm welcome.

Susan M. Collins:

Mark, thank you so much. I really appreciate it and I am absolutely thrilled to be here with all of you today, both those of you who are in the room, and I know we have some folks who are watching remotely, and also to be here back in Boston. I'll be really brief. I do want to just make a few remarks, introduce our distinguished guests, and get as quickly as we can to I know what we're all looking for, which is what will be a really engaged discussion.

It really does mean a lot to us here at the Fed to have the club back here. We're all just delighted to see everyone. I have to say when I walked into the room, the buzz was just palpable and delighted to be able to welcome everybody back. Of course, seven months in, the announcement was almost exactly a year ago, a year ago tomorrow, but I started July 1, and so I'm also delighted that this is the first event that I'm able to attend and I look forward certainly to many more.

We really resonate with the club's ongoing interests, which is really just a frank exchange of views on important topics, leveraging rigorous data analysis and thinking about ways to have an impact and really further a shared mission. We very much support that and look forward to continued partnerships. It fits squarely in the Boston Fed and the Federal Reserve's mission and focus, which is really policies and services to foster a vibrant, inclusive economy that works for all. That's something we're all hard at work on. I suspect some of the pieces of that will come up in our conversation today.

It is absolutely true that I'm also delighted to be back here in Boston. I did spend 16 years here. It's a bit of a homecoming for me, and it's wonderful to see the vibrancy and also the fabulous talent in so many different areas and commitment to really leveraging opportunities and making this an even better place than it already is. Just delighted to be back.

Now it's just my pleasure to say some brief words of introduction for Neel Kashkari and Roger Lowenstein. Now I know that you are each able to access the bios, and so I'm going to be brief again to get us to the discussion. I'm not going to repeat that, but I do want to just give a few highlights. Roger, as I suspect you all know, has a very distinguished record as a reporter, author, exploring nuances of the economy and the financial system, and the latest of his seven books was recently named a finalist for the Lincoln Prize. Just delighted to have you here as part of the conversation.

Turning to Neel, again, a very distinguished, varied career before joining the Minneapolis Fed as president in 2016. While he's been really proactive and creative there, and I'll just highlight the opportunity in Inclusive Growth Institute and a number of other initiatives too numerous to mention, it's been wonderful to have him as a colleague more broadly. I really appreciate the extent to which, like all of my FOMC colleagues, he really values public service, public opportunities, and well-being for our economy and for all of the people who participate in it, and finding ways to broaden and spread that out.

Actually, some similarities between Neel and Roger. They're both incredibly productive, thoughtful, active, engaged thinkers. They're also willing to provide candid insights and opinions, and whether or not you agree on all fronts, they foster substantive, engaged dialogue that we can all learn from on topics that matter. I want to commend both of them for that. As a lifelong student researcher and educator myself, I really appreciate willingness to engage actively to analyze and then to offer views and opinions in a way that engages with others.

I'll conclude my remarks by, again, just a very warm welcome to Neel, to Roger, to all of you who are here in the room, to everyone watching online, and just to say, again, how absolutely thrilled we are to have the Economic Club event back in our space. With that, I'm sure that we are in for a very lively, active conversation. With no further ado, I turn it over to Neel and Roger.

Neel Kashkari:

Hi. Good afternoon. Thank you. Thanks for having me, first of all. I'm just going to say a few thank-yous. I'm going to turn it over to Roger to kick off our discussion. Can you all hear me okay? Great. I'm president of Minneapolis Fed, but maybe more relevant for today is I'm on the Board of Directors of the Economic Club of Minnesota. I think these economic clubs provide really valuable service, bringing in experts from around the country, around the world to talk about important issues in a non-political manner.

I was honored to get your invitation, Mark. Thank you for inviting me. It's great to be here. Thank you to Susan and my colleagues at the Boston Fed for hosting us. Of course, thank you to Roger. I'm a huge fan. When this opportunity came up, I actually want to interview him. I'm hoping that we can have a little bit of back and forth as we go forward. But I really appreciate you being here, Roger. Thank you all for being here as well.

Roger Lowenstein:

Hi. Neel, it's a pleasure. Susan, thank you very much for that lovely, gracious, and generous introduction. Thank you to Mark at the Economic Club. Is the sound okay? I just... No?

Neel Kashkari:

You might need to move it up a little higher. Move this one up higher. This one up higher.

Roger Lowenstein:

There you go. How's that? How's that now? Any better? The green light is on. Okay. There we go. Okay. I want to say what an honor it is for me to be at the Fed. It means an awful lot as an institution. Partly, I guess, because one of my books is about the Fed. It was formed... As some of you may know, the inspiring intellectual author of it was an immigrant named Paul Warburg who had a dream. We're in the presence today of two Federal Reserve Bank presidents. One of them is an immigrant from Scotland. One is the child of immigrants from India. I think they are carrying on the tradition that Warburg said he hoped would be carried on, that the Fed would be, he said, like the churches of old Europe, a great institution in the United States.

Neel, I don't have to ask you what you've been up to lately. We all saw the bad news last week. Rates went up by another 25 bips. What's next? I think that's the question asked itself. You've even partly answered it because you've hinted at a very precise number, 5.4%. I wondered, is that... I know there are 10 commandments and certain numbers come down from... But where does 5.4 come from? We're, by the way, in a range now of 4.5 to 4.75.

Neel Kashkari:

Correct. Once every three months, each FOMC, Federal Open Market Committee, participant needs to submit essentially a forecast of what we think optimal monetary policy will be and how the economy will respond. It's a tough thing. Once every three months, we have to write something down. We have, I'm sure Susan does this with her colleagues, a lot of deliberation with my economists at the Minneapolis Fed on what do we think the underlying trends are for inflation, how responsive do we think the economy is going to be to our rate hikes, how long does monetary policy take to work its way through the economy.

There's a lot of judgment and art in addition to attempts at science to try to put down something. Basically, last year, I concluded, and I think many of my colleagues concluded, that the traditional economic models that we rely on to understand inflationary dynamics have really failed in the reopening of the economy. Just to be blunt, we did not see the giant inflation coming, and we did not expect it to last as long as it did. As you might recall, many of us said we thought it would be transitory. But what we ended up having does not feel like transitory.

Once I concluded that, hey, these models are not working, we still have to make decisions. How do you make decisions if your fundamental tool is not working? We have to let the inflation guide us. It's raising rates aggressively to try to get real interest rates positive. It's unlikely that negative real interest rates would be restraining the economy. We need to get real positive interest rates across the yield curve, get there as fast as we can, and then watch inflation and see how inflation responds.

So far, headline inflation has come down because oil and food prices in many cases have come down. Core inflation has come down because goods prices have fallen. But the services side of the economy is still hot. We know housing inflation is a big part of that, but we can actually analyze and forecast housing pretty well. If you look at new leases that get signed, it takes a year or two for them to work their way through the official inflation statistics.

If you strip out housing, you're left with this part of the economy called core services ex-housing. Think about the services economy, the wages that people are paying and people are earning. We haven't seen any movement there. There's some hopeful signs, but there's not yet much evidence in my judgment

that the rate hikes that we've done so far are having much effect on the labor market. We need to bring the labor market into balance. That tells me we need to do more. How much more? I don't know for sure.

Roger Lowenstein:

You stress two things you're looking at. One is inflation itself by whichever or various measures, core, the headline number, and so on, but how much are prices going up. I mean, that's the object, right?

Neel Kashkari:

Correct.

Roger Lowenstein:

That's why you guys, men and women, are raising rates now, because inflation's too high. But you're not just looking at inflation, you're also looking at the labor market, which is... and Larry Summers has been spoofed for saying Larry Summers wants to destroy a million jobs or something. But obviously, neither he nor those of you who are on the Fed, your goal isn't to destroy jobs. Which will be dispositive? Is it going to take lower inflation or is it going to take... We had a huge jobs number, 517,000. Is it going to take lower than 200, lower than 100? When does the bell ring so that at least Neel Kashkari can say, "Okay, we've got this under control"?

Neel Kashkari:

One, there's a bridge you could think between jobs and inflation. One of those bridges, a pit stop on that bridge is wages. What's happening to wage growth? You would think if wages are climbing fast, and wages are a big part of the services economy, if wages are climbing really fast, then that probably means inflation's going to stay high. Typically, the way we think this works, if we have a 2% inflation target, and prior to the pandemic, we were running at about 1% productivity growth, you could think wage growth of 3% is consistent with inflation at 2%, assuming productivity is unchanged.

Right now, depending on your measure, wage growth is somewhere between 4% and 5%. Wage growth right now is too hot to support a 2% inflation environment. Nobody at the Fed wants to destroy jobs. One of our goals is maximum employment. We want as many Americans as possible gainfully employed and enjoying higher wages, but we want that environment to be sustainable. We want it to be a healthy job market consistent with 2% inflation. That, to me, says we need to get wage growth around 3%.

What's tough is we saw this job report that came out on Friday. 500,000 jobs. Big surprise to all of us that it was so high. Now it's one reading. Sometimes things are hot, sometimes they're cold. Don't overreact to one reading. But it's hard to imagine a real moderation in wages if the economy is creating jobs at anywhere close to that level.

Roger Lowenstein:

This is the all good news is bad news. A lot of jobs, but it's got this bad news, not a silver lining. Would you be willing, you and your colleagues, to take actions on interest rates that could tip the economy into recession if you felt those actions were necessary to stop inflation? For the laypeople here, in a sense, we're all laypeople, we're all people in our ordinary lives, why is that a good trade to make?

Neel Kashkari:

Sure. If you go back in history, not all the way back to your book, but we're going to get there, if you go back in more recent history, one of the big errors that the Federal Reserve made was in the late 1960s or 1970s in letting inflation get out of control. Some of you will remember a time when you had double-digit mortgage rates, double-digit interest rates, and inflation was the number one economic issue on the minds of the American people because there was no way to escape it. Ultimately, it took a new Fed chairman, Paul Volcker, coming in and with his colleagues, raising rates dramatically to crush inflation and to anchor inflation expectations. Now, in doing so, he ended up causing... they caused a very deep recession, a very deep recession-

Roger Lowenstein:

Two.

Neel Kashkari:

... that was necessary, but that then set us up for 30-plus years of very positive economic environment. Muted inflation, decent growth, mild recessions that ended up following. I think most of my colleagues agree with me that keeping inflation expectations anchored at 2% is absolutely foundational to achieving the thriving economic environment that we all hope for and that we all can achieve. But you must first build the foundation, and that foundation is anchored inflation expectations that the Volcker Fed managed to achieve. We do not want to cause a recession, but we know we have a job to do, to get inflation back down to 2% and to keep inflation expectations anchored. I don't think we're going to have to do anywhere near what the Volcker Fed had to do because we entered this period with inflation expectations.

Roger Lowenstein:

You don't see a 19% federal funds rate?

Neel Kashkari:

No, I do not see that.

Roger Lowenstein:

All right. That's good news.

Neel Kashkari:

We can make news there.

Roger Lowenstein:

Good news. That's right. That's right.

Neel Kashkari:

They know.

Roger Lowenstein:

But has the horse left the barn on not letting it get out of control? Does anyone really believe that inflation's going to go back to 2% or as it was? For much of the 21st century up to the pandemic, the Fed had to work hard to get it up to 2%. Do you see us going back there or have these last some years, which are still going on, sort of changed the psychology where it's going to be back to 3%, 3.5% is normal, sometimes 4%, sometimes 2.75%? The great moderation was the name-

Neel Kashkari:

Correct.

Roger Lowenstein:

... for the period of extremely low and stable rates. Is that history?

Neel Kashkari:

I don't think so. I don't see any reason to think that it would be history. I'll say a couple of things. First of all, if you look at financial market indicators, financial markets and the bond market and inflation expectations that you can pull out of the bond market are showing great confidence, actually more confidence than we have, that inflation's going to fall very quickly back down to our 2% target over the course of this year and some into next year. I hope they're right, but at least financial markets are saying no, the scenario you painted is not correct. Then if you look at what were the jobs-

Roger Lowenstein:

Did you buy a long-term bond?

Neel Kashkari:

We're not allowed to buy individual securities. I invest only in index funds, widely distributed.

Roger Lowenstein:

Okay.

Neel Kashkari:

You can see my financial disclosures for all the information.

Roger Lowenstein:

We'll take it off faith.

Neel Kashkari:

Yeah, thank you. The dominant macroeconomic trends leading up to the pandemic were things like the aging of our society, a lot of savings, rather low investment leading to low neutral interest rates. The central bank is not actually independently setting interest rates. We are responding to these macroeconomic forces. There's some interest rate that represents neutral. We don't set where neutral is. The macroeconomy does, the demographics of society, savings, investment, et cetera. We are adjusting interest rates around that neutral.

I have not seen anything that suggests to me that we're in a fundamentally new world going forward. If anything, the demographics have gotten worse. Societies continue to age. People have retired. Early immigration has really took a dip as a result of the pandemic. All of these things have effects on the economic environment in a way.

Roger Lowenstein:

The savings glut, the things that Bernanke used to worry about, that could come back-

Neel Kashkari:

It absolutely could come back.

Roger Lowenstein:

... and force rates down?

Neel Kashkari:

It's certainly possible. I've not seen anyone make a strong case why that will not be the case where we return to once we get through this transition period.

Roger Lowenstein:

What about the missing worker and the pressure on wages?

Neel Kashkari:

That's a serious issue. I mean, a lot of people retire early because of the pandemic. Don't forget, more than a million Americans died from COVID. Each one is a human tragedy. It's also a lot of lost potential output for the economy. Then we have dried up immigration as well. It's all having an effect on our economy's potential. But that, to me, doesn't affect how I think about inflation. It just affects how big the economy will be. I would like it to be bigger, us being able to produce more goods and services, but we need more workers to be able to do that.

Roger Lowenstein:

A little bit more in the future, and then I want to get to what led to this point. If we could go back, and you're hopeful, I won't say confident, that we can get back to 2%, would that imply, you talked about real rates have to be positive, a 5% Fed funds rate or something? I mean, if we-

Neel Kashkari:

There's the transition period that we're going through right now, which is where most of my colleagues, I think, have said they expect the federal funds rate to get above 5% at some point this year. Could it go higher than that? Certainly possible, it could go higher than that. We will all respond to the data that we see in the inflation. Then the expectation is at some point, we will end up holding rates, pausing for some period of time, probably a long period of time, while that tighten policy works its way through the economy, and then assess, do we need to go higher from there or do we need to go lower from there. It's going to be determined by how quickly inflation starts falling back towards our target.

The one thing I'll say to you, we have a lot of different views around the FOMC, a lot of different backgrounds, but we are all totally united in our commitment to getting inflation back down to our 2%

target. We have a range of views on what it's going to take to get there, but the commitment does not deviate around the committee.

Roger Lowenstein:

Do you lean on the hawkish side, the more worried side, the less convinced side that the job has been done [inaudible 00:32:24]-

Neel Kashkari:

Correct. Yes. If you just look at our individual rate forecast, I'm on the hawkish end of things, just because it seems like underlying inflation, the job market, wage growth is quite robust right now.

Roger Lowenstein:

Would you say it's important, if you have two risks, one is obviously the risk that Fed actions could cause a recession, a new problem, but the other risk is that the problem we already have, inflation, isn't cured, that the first responsibility is to cure the problem we already have?

Neel Kashkari:

Yeah. I mean, it is [inaudible 00:32:57].

Roger Lowenstein:

We're actually back here three years later and say, "We didn't really beat inflation," which happened in the '70s.

Neel Kashkari:

This is exactly right. We are acutely aware of the mistakes that were made in the 1970s when the committee thought they'd done it, they backed off, and then inflation got more entrenched, flared back up again, and then they had to go even higher to ultimately bring it back down. That's a mistake we cannot make.

Roger Lowenstein:

Let's talk about the mistakes, not in the '70s but in the recent period. What happened to the Fed? Why were those signals missed? Some prominent economists got them. Obviously, plenty of prominent economists were wrong, and those same economists who were right this time may have been wrong some other time. That's a hindsight bias, but still, you guys are sitting in the chairs. Why did the Fed miss it, particularly when prices were moving up month after month after month?

Neel Kashkari:

We always talk about our dual mandate, stable prices and maximum employment. Prior to the pandemic, we learned that the unemployment rate could get as low as 3.5% and not trigger high inflation. That's what we saw right before the pandemic. In May of 2021, core inflation first crossed the 2% mark. At that moment, the unemployment rate was 5.9%. We see a little bit of inflation, okay, we're crossing 2%, but, boy, there's still millions of available workers on the sidelines that represent a lot of output, potential output. Should we be raising rates at that point when there's still so many workers out there waiting to find work?

Roger Lowenstein:

Right then was zero.

Neel Kashkari:

Right then, yes, we were still at zero. Correct. Basically, we took about six months from that moment that we finally crossed 2% before we said by November of 2021, "Okay, we need to do something different. We need to accelerate our plans." That's when we started signaling to the markets that tightening is coming, and they started response in financial markets. They started adjusting then. With the benefit of hindsight, I absolutely wish we had started tightening sooner. But knowing what we knew at the time, I actually think the call that we made was eminently reasonable based on the facts that were in front of us. Then we took about six months to say, "Okay, the models are not working, we need to get moving."

Roger Lowenstein:

We spoke at lunch a little bit about the toolkit the Fed used in 2008. In 2008, lowered rates to zero, bought up all kinds of credit, hadn't bought before, built up the balance sheet, kept rates low, and it worked because even if the economy didn't recover quickly, it recovered despite these forecasts of runaway inflation. They were all over the press, those advertisements you remember being taken out.

None of that happened because, basically, the American household was slowly, slowly, slowly rebuilding its personal balance sheet, and they weren't spending, and there was no inflation. Was that same set of tools used to a different situation this time? Because this time, it wasn't a mortgage crisis, it was a virus. Once we had the virus under control, the economy was ready to roll. Did you apply those proper lessons for 2008 to the wrong war this time?

Neel Kashkari:

A very good question. I would say we fought two distinct wars in COVID. The first war was in March of 2020 when the virus first hit and governments were shutting down, sending stay-at-home orders, et cetera. I'm not sure if you even remember this, a lot of people won't remember it, the financial markets were on the precipice of complete collapse. In '08, what's interesting is in '08, when investors got scared, they fled to treasury bonds as a place of safety.

In 2020, when the pandemic hit, the pandemic was so unlike any of us have lived through anything like this that people just wanted cash. They didn't even want treasury bonds, so they fled treasury bonds, too. Then you had the fundamental plumbing of our financial system on the verge of collapse. In my district, we have a lot of big companies, including big food companies, like General Mills, Cheerios. General Mills and companies like that did really well because the supermarket stayed open. People couldn't go to restaurants, so they went to grocery stores.

But if companies like General Mills whose business was sound could not access the financial markets because the markets were collapsing, then this virus, which has infected people and targeted the services economy, spreads over to the entire economy, including the goods economy, and so in March of 2020, under Chair Powell's leadership, the Fed acted very aggressively to go in to stabilize financial markets and to keep the plumbing of the financial system working. In that case, we applied the lessons of '08 even more powerfully and effectively to get the financial system going.

Roger Lowenstein:

You're suggesting appropriately?

Neel Kashkari:

Appropriately. Now once we get through that acute period, now we've still got very high unemployment, great uncertainty about what the fiscal response is going to be. The best health experts in the world were saying, "We don't know if a vaccine is even possible, and how many years it's going to take, how long is this virus going to be with us." Then we moved into we need to provide as much economic support to get the economy going again, not just the acute financial stability situation that we had in March 2020. I think there, we could have a debate on did we end up doing too much, was it the wrong medicine or not necessarily tailored the right way, because the dynamics of the pandemic shutdown and reopenings were just so unlike anything we've ever seen before.

Roger Lowenstein:

Now you've written up a fascinating analogy to the run-up in prices, which is to the Uber, Lyft economy, surge pricing. Everybody knows that if it costs $10 to get from your home to work, if you go there on a rainy day, it's going to cost not $12, it's going to cost $18 or $25 or something. But could you tell us, in hindsight, as you've explored this last period, how does that apply, the surge pricing dynamic, through the US economy?

Neel Kashkari:

We've been seeing these wildly mixed signals that are really hard to understand from the economy. For example, businesses across my region, I'm guessing it's true here, too, number one complaint is they can't find the workers they need and they're having to pay up a lot. Unemployment, very low. Yet, if you look at labor share of income, so the US economy produces so much income, some of it goes to the owners of capital, some of it goes to workers, labor share of income is going down. How is that? You would think in a tight labor market with a lot of bargaining power, labor share of income would be going up. Is this really a tight labor market or not? This is where we came up with the surge pricing analogy.

Imagine in my analogy that Uber owns all the cars and the drivers are their employees. The rainstorm hits, Uber says to all of their drivers, "We'll pay you time-and-a-half, get out and drive," and the price skyrockets by way more than time-and-a-half. Uber's profits go through the roof. What's going on here? What's going on here is worker incomes are up, all the workers are fully employed, profits have soared, and labor share of income has gone down.

Roger Lowenstein:

But only for as long as it rains.

Neel Kashkari:

Correct. Only for as long as it rains. This dynamic actually kind of describes the economy that we've been experiencing in recent year, in the recent period. The hope is that when it stops raining, that prices will very quickly revert back down to what we've been used to. I was just trying to understand and reconcile these various signals that we're seeing. The surge pricing analogy, at least for me, actually does a pretty good job, it's a simple analogy, but a pretty good job of explaining the situation.

Roger Lowenstein:

It's a cause for hope because the rain of the supply chain problems is abating and so on. I mean, that's-

Neel Kashkari:

That's right.

Roger Lowenstein:

We're not going to be in a rainstorm forever. What lessons can you take away... When I say next, hopefully, we'll never deal with another pandemic like this, but we'll deal with something, and it might be the first something of that sort just as the pandemic was the first of that sort. Every crisis is different, that's why they're crises, but are there any lessons you can take from this for the next time, whenever the next time and whatever the next time is?

Neel Kashkari:

I think it's have a lot of diverse voices around the table to offer differing opinions so you can test each other and see if you're missing something. I mean, somebody asked me yesterday why... There were a few prominent economists who were very critical of saying, "Hey, this inflation's not transitory." They asked me, "Why didn't you listen to those?" My answer was this, because they couldn't explain how it would work. Basically, they were saying, "This is my judgment based on my experience that this is going to be a big problem." We would say, "Okay, explain to us the mechanism. Explain to us how you're going to have very high inflation with 5.9% unemployment. What is the mechanism by which you get from here to there?"

It's a tough issue because we are constantly being called by experts saying radically different things. Like there are some experts who used to like me when I call for low rates, who now think I've abandoned them and that "What are you looking at?" They're really mad and they're calling us saying, "These rate hikes are crazy, you shouldn't be doing this." Then there are other people who are calling and saying, "Oh, my gosh, you're not being nearly aggressive enough." How do you make decisions? How do you make sense in the noise, the cacophony of loud voices? It's challenging. You have to go back to some fundamental principles to look at the data, to let the data guide you, to use the models and then imply your own judgment. I mean, we need to study this period before I'm going to be able to... I need your help to go back and document it.

Roger Lowenstein:

Serious question, is the Fed's forecasting ability any better than anybody else's?

Neel Kashkari:

I'll say I don't think my forecasting ability is better than... I don't want to-

Roger Lowenstein:

Is there a case for just saying to the Fed, "Let's get out of the forecasting business, let's not try and anticipate anything because it's the future, we don't know what's going to happen, and when we see the inflation, we'll jack up rates, when we see the unemployment, we'll ease, and let's just admit we're good economists, we're good responders, but we don't know what's going to happen"?

Neel Kashkari:

I'm sympathetic with that view. We've created a process where every five years, we're going to take a comprehensive look at how we conduct monetary policy and what we can learn from our own

experience and other central banks. In a few years, we're going to kick off that process again. I think that's a very thoughtful question that we should ask.

Roger Lowenstein:

Now I think this discussion, by inference, has given the Fed too much credit, because you're not alone to blame for the inflation. A lot of people think the deficit, and therefore, the Congress and the administrations, the two of them, had a lot to do with it. What do you think about that? These record deficits, both in the full COVID period and the aftermath, how much have they had to do with the inflation, and how much do the seemingly continuing deficits for as far as the eye can see worry you?

Neel Kashkari:

I definitely think the fiscal support during the pandemic and following the pandemic was part of it. Remember, go back to vaccines, the biggest shock of the COVID pandemic once it started was how quick these highly effective vaccines came online. A lot of the pandemic responses were not designed knowing that we would have highly effective vaccines by the end of 2020 and into 2021. Again, with the benefit of hindsight, were some of these programs oversized? I think probably.

You can look at it. I mentioned some of the bank CEOs that we talked to report about the checking account balances of their customers, that somebody who used to have $100,000 in their checking account before the pandemic, at the peak, had $7,000 in their checking account. I mean, huge multiples because of a lot of the government support. That definitely affected buying behavior. It definitely affected the choices people made about which jobs to go back to when they wanted to come back to work. It definitely had some effect. I think all of this, we should reflect on and learn from it. I do think Congress learned from '08, and they acted very aggressively. Remember in '08, when we went to Congress to ask for the TARP authority, Congress first turned us down.

Roger Lowenstein:

That's right.

Neel Kashkari:

All right. Then the Dow plummeted and then-

Roger Lowenstein:

700 points.

Neel Kashkari:

Correct. Then a few days later, they ended up voting for it. I think that as a country, we are capable of learning from prior experiences and doing better in the future.

Roger Lowenstein:

If you strip away the sort of blackmail aspect of what's going on with the debt ceiling now, because obviously, the money's already been appropriated, so we're going to have to borrow to be able to spend the money we've already legislated. But if you strip that aspect out, are the Republicans right to be worried about the deficits? By the way, I should say that I'm speaking to a former candidate for governor who has played both sides of both the political and the monetary fence.

Neel Kashkari:

Long term, I mean, I do think deficits do matter, but it's a curious... There's not a clean answer of knowing exactly how much is too much. Look, Japan has more than twice as much debt-to-GDP as America, and yet they have rock-bottom interest rates and very low inflation. Why is that? You go ask 10 economists that question, you're going to get 10 curious looks on their faces, because nobody can really explain that. How much-

Roger Lowenstein:

I thought they matter whenever the other part is impactful.

Neel Kashkari:

That's certainly true. That's certainly true. But that's the tough part. How much is too much? You do know, you've many examples in world history, when a country gets over-indebted, people lose confidence and then, all of a sudden, they can't pay their bills anymore. We don't want to push it, right? We want people to maintain confidence in the US economy, in our fiscal situation and our economic competitiveness. How far is too much? I don't know. But anything we can do to enhance our economic competitiveness will accrue to our long-term interest.

Roger Lowenstein:

We were talking at lunch about some of the economic problems the country faces outside of the Fed. One of them, which I think we both have an interest in, is immigration. Immigration, particularly in the context of the missing worker, but perhaps also in the context of the addition of creativity and openness and everything that immigrants bring, [inaudible 00:48:06] exhibit A, but just for an open society and for productive growing society, are missing immigrants part of the story of the missing worker? How serious is the labor shortage to you right now?

Neel Kashkari:

Missing immigrants are a big part of the current story, but they're a huge part of our future economic competitiveness, whether we are thoughtful about embracing immigration as we have in American history or not take. I've mentioned Japan. Japan's demographics are worse than America's. Their society is aging even more, and they have fewer young people, but they're also very closed off to immigration. It's not a tool available to them. This is a tool. We're not perfect at it, but, man, we're pretty darn good at it. This is a tool available to us if we want to economically compete and win and run circles around any of our adversaries. Immigration is a tool that we have available to us, because so many immigrants from around the world want to come here.

We're talking high-skilled immigrants. We're talking lower-skilled immigrants, folks working on farms or factories or doctors and everything in between. Every business that I meet with across my region, I'm guessing this district is not that different, talks about the need to find workers. It's a structural issue. It's not simply an issue of today. It's an issue of the next 5 years and the next 10 years. I talked to all of the elected representatives, members of Congress, and the Senate from my part of the country, Republican and Democrat, 100% of them understand this. Actually, 100% of them agree with the need for immigration to feed our economy. The challenge is when the cameras come on and the politics gets in the way. I say to them, I say, "Do you all agree? You shouldn't be able to do something if you all agree."

Roger Lowenstein:

Will there be another campaign?

Neel Kashkari:

Not for me. Not for me.

Roger Lowenstein:

Not to mention the addition that immigrants give to the retirement systems-

Neel Kashkari:

Absolutely.

Roger Lowenstein:

... creating much more of a bulge below instead of having just a few younger generation members supporting all of us gray beards, which is insoluble without people.

Neel Kashkari:

Exactly.

Roger Lowenstein:

You just can't do it. We have a crypto expert at the table, a central bank crypto expert. I wanted to ask you, there's a lot of talk about central bank digital currencies. Is there a problem which these things are supposed to solve? I'll tell you frankly, in the private sector, I don't see the problem, except when they go bust, journalists get to write about them. But is this something that central banks, our central bank, the Federal Reserve needs?

Neel Kashkari:

That's the question I'm asking, which is what problem does this solve. Whether it's a central bank digital currency or Bitcoin or any of these other flavors, what actual problem? I've been asking this question now for several years, and to my mind, no one's been able to answer it. Usually, I get back, "Well, there's a problem in America of financial inclusion, and maybe this will be better for financial inclusion." Is there any evidence that it's better for financial inclusion? Maybe. That's kind of the quality of the answer I've gotten back so far. I'm reserving judgment. We've got colleagues at the Boston Fed who are studying this, who are working hard. I think that's great to study it and analyze it. But I think we need to explain.

I'll give you an example. I can send $5 right now instantly to anybody in this room with Venmo or PayPal or Zelle or someday FedNow. Okay? What is it that a CBDC can do that Venmo can't do? The only speculation I've been able to come up with, because everyone says, "Well, if China's doing it, therefore we need to do it." You know what you could do with the central bank digital currency that you can't do with Venmo? You could charge negative interest rates. Can't do that with Venmo. You could directly tax customer accounts. Can't do that with Venmo. You could monitor every one of your transactions. Can't do that with Venmo. I get why the Chinese government is doing it.

Roger Lowenstein:

You're saying in the hands of the government, this is a more intrusive... The ideology of the private crypto world grew up with, "Hey, we'll be far from government. This will be liberation. We won't have the heavy hand of the state, the Federal Reserve on our money." But you're saying that in a central bank context, it's the opposite.

Neel Kashkari:

Let me say you this. None of my colleagues at the Federal Reserve who are interested in this want to do any of the things I just said, right? That is not what's motivating us. But those are the only use cases I've been able to come up with that you could achieve with a central bank digital currency that you cannot achieve through other means.

Roger Lowenstein:

Can you Venmo money to people over borders?

Neel Kashkari:

I don't know. But the challenge is central bank digital currency, like with Bitcoin, they say, "Oh, Bitcoin's great, cross-border transactions." My in-laws live in the Philippines. If I want to send my father-in-law $100 to buy groceries, I send him $100 in Bitcoin. Great. How did he buy groceries?

Roger Lowenstein:

Sam Bankman-Fried said he wanted to give away the bulk of his money, and I think he proved it's a very effective [inaudible 00:53:24]. I think I'm supposed to break for questions.

Neel Kashkari:

Okay. But before we do, I'm kind of a history junkie and this book that Roger just wrote, Ways and Means, is about how Lincoln financed the Civil War. I've read a lot on the Civil War. Maybe 15 or 20 books before I read Roger's book. When I heard that he wrote a book on the Civil War, I thought, "All due respect, what's left to write?" Roger pulled on this thread and this whole world of the foundation of economic policy, monetary policy, fiscal policy is right there. I just have to ask you, where did you come up with this idea and the inspiration for writing this book? Because I loved it. I was sad when I finished reading it.

Roger Lowenstein:

Thank you very much. I came up with it right here in a sense. The previous book was the book I wrote about the Fed. It was a book about the history of the Fed. The Fed was formed in 1913. I learned a little bit in the course of that about the system it replaced, which was the National Banking System, which has formed the Civil War. The architect of that was Salmon Chase, the Treasury Secretary. I was intrigued that with everything else going on in the Civil War, like fighting the Civil War, they had designed this very complicated but quite effective and enduring, 50 years is not bad, financial system.

Then when I looked a little more, I saw that they did all sorts of things then. They created a currency. They created the forerunner of the IRS. They created the first income tax. We had the first fiat money and the Homestead Act and the railroads and the land-grant college. They really created a federal government role in the economy, both financially and economically, in very much sort of a way that FDR had extended the role of the federal government, because everyone knew about FDR. I had known

about it. The premise was, people don't really know about this side of Lincoln and the Civil War. Thank you for asking.

Neel Kashkari:

Yeah. Necessity is the mother of invention. I mean, it's just unbelievable. I'm not sure if I'm allowed to give endorsements, but-

Roger Lowenstein:

Thank you.

Neel Kashkari:

Wink, wink. Ways and Means is a heck of a book.

Roger Lowenstein:

Thank you.

Neel Kashkari:

I guess we've got mics up and hands up. If you want to ask Roger questions, I won't be offended.

Speaker 1:

Hi. Thank you. Very interesting.

Roger Lowenstein:

He's got the answers.

Speaker 1:

The Fed's work could be made easier or more difficult because of fiscal policy. Can you talk about the Fed's influence or lack of influence on shaping fiscal policy? What do you think would be helpful to the Fed's mission right now in terms of fiscal policy? Thank you.

Neel Kashkari:

Yeah. We try to stay out of fiscal policy, and the kind of handshake agreement is then hopefully the elected leaders give us space to do our jobs to achieve our dual mandate, subject to their oversight. We try not to give advice on specific fiscal measures. There are times when we're in crisis when there can be coordination, but generally speaking, we want to be left alone and we try to leave Congress alone to do their jobs. I'll give you just one thing right now that's percolating fiscally that is on my mind. A lot of states are flush. My state, Minnesota, typically has $50 billion state budget. They're expecting a $17 billion surplus.

Roger Lowenstein:

Wow.

Neel Kashkari:

Montana, $7 billion budget, 2.5 surplus. Wisconsin, similar. About a 30% surplus in these states. Some of them are considering tax rebates to their families, which I understand. But that's more stimulus. It's more money in people's pockets. I want them to have their money back. It also means that people have more money to spend on goods and services or take more time before re-entering the job market. On the margin, it's probably a little bit inflationary and makes our jobs on the margin a little bit harder. Those are the types of things that I'm aware of. Our colleagues are always analyzing whatever packages Congress puts out, to analyze what does it do to the economy, and then we just simply take that as an input into our policy deliberations.

Speaker 2:

Just continuing the question on fiscal versus what you guys are working on. If you look at the stimulus that happened in the deficits that grew, they were done under very low interest rates. As the federal government tries to roll that debt, it's somewhat going to be beholden to whether you're successful in inflation. Can you spend a second how you think about what you need to target for inflation rates and the market interest rates as it relates to the federal government trying to roll this debt? Because they're going from, I think, sub-2% to, if they rolled it now, 4%. Thank you.

Neel Kashkari:

We don't think about and talk about what do our interest rate policies mean for the federal government. It's Treasury's job and Congress' job to finance the government. It's our job to meet the dual mandate of stable prices and maximum employment. The best thing we can do for the society is get inflation back down to 2%. If we were to lose control of inflation expectations, and instead of having expectations at 2%, they were at 4% or 5%, eventually, that would then, of course, express itself in much higher rates for the government to go and borrow at. I think everybody's interests are aligned. We have to get inflation back down to 2%. That's not why we're doing it. We're doing it because that's our job, but on the margin, that would make Treasury's job easier if we keep inflation expectations anchored. Gentleman here. The mic's coming to you, sir. This one.

Speaker 3:

The gross domestic product was growing at 0% in the first half of last year. You guys raised rates from zero to something like 4.5% over the course of the year, and the real GDP growth rate accelerated to 3% in the second half of the year. Why did that happen?

Neel Kashkari:

Yeah. This is another example of the mixed signals that we're getting from the economy. Typically, economists will say, "Well, if you have two quarters in a row of negative GDP growth, that typically signals a recession." But typically, in a recession, you have a lot of job losses. In those first six months of the year, you had very, very strong job growth. That's why many of us said, "It doesn't look like we're really in a recession."

I don't have a great answer. There were some measurement issues between gross domestic product and gross domestic income. Those two are supposed to be the same. They had big deviations during that period, and then they reverted back towards each other over time. We're expecting, as policy is tight, tighter, the economy will grow much more slowly this year over the course of this year than last. Most forecasts, I think, are for us to avoid a recession, but I think it's going to depend on some of the

dynamics that we've been talking about here today. I don't have a good answer for you, sir. It's a lot of mixed signals coming out of the economy and the reopening.

Speaker 4:

It's often been pointed out that financial crises are frequently associated with rising rate environments. I'd be interested in your views on the current state of financial conditions, and more specifically, the growth of credit outside of the banking system in what used to be called, I guess, the shadow banking system.

Neel Kashkari:

Actually, after the financial crisis, the Board of Governors created a team of economists who are charged to study financial stability risks. They, with colleagues around the system, are constantly surveying different markets, looking for signs of excess. Typically, it's excess leverage that gets built up. Then you're in a higher rate environment, they can't roll over those debts, and that leads to some kind of a downturn. Right now, we're not seeing evidence. Like households, which was a big challenge in the '06, '07, '08 crisis, households, generally speaking, have very strong balance sheets. People have a lot of equity in their homes.

You look around a lot of businesses. Generally speaking, we are not seeing signs of massive over-leverage, which suggests some type of systemic risk. But as Roger said, crises always come from where you're not expecting them. Could it be that in the continuing increasing rate environment, we see other areas of pressure? It is certainly possible. But right now, we're not seeing anything that's jumping out of the traditional things that we look at that says that there's a problem around the corner. But we're watching.

We're getting the signal that we're at our time. Roger, I'll leave you any last thoughts or questions.

Roger Lowenstein:

Just if you're a betting man, are we going to have a recession or not?

Neel Kashkari:

I'm going to answer a different question. I'm a betting man in the sense that I bet that the Federal Reserve is going to get inflation back down to 2%.

Roger Lowenstein:

Okay.

Neel Kashkari:

We're committed to it. Thank you for having me. Really appreciate it.

Roger Lowenstein:

This was really fun. Really fun.