Speaker 1:

Is absolutely my pleasure and my privilege to introduce to you Mr. Neel Kashkari.

Neel Kashkari:

Thank you, Casey. Thank you President. Thank you Dean. Thanks everyone for hosting us every time we get to visit Montana, it's great fun, always learn a lot. It's obviously a huge state, a very diverse geography, a lot of different centers of the economy represented here and it's obviously beautiful, so it's always a great pleasure for us to get to come here. I also want to thank our board of directors. We have a board of directors that's focused on Montana, the Helena Board of Directors, and then we also have a board of directors of the Minneapolis Fed overall. We have the whole hell on the board here and we have a few members of our Minnesota board here, so we're just grateful for all of your service. Casey talked about the region that we represent. Our job is to represent all of you. Our job is to understand what's happening here now in local economy, and then when I go back to Washington, DC every six weeks and we set interest rates for the nation, part of what I'm doing in those meetings is I'm talking about what's happening across our regional economy.

And the way we get that information, a lot of different ways, one way our events like this go out. I'm spending a couple days in Montana meeting with leaders across the state, hearing firsthand what businesses, what workers, what local leaders are experiencing. But then our boards of directors also are a critical conduit in reaching out and giving us insight into what's happening in the regional economy and so I appreciate everybody who's here tonight, appreciate our board service. It really is service and the spirit of public service, and that's what our mission is ultimately.

Now, what are we trying to do with the Federal Reserve? First of all, we were created by the United States Congress in 1913. Congress created us and they've given us our assignments. We always talk about two goals.

One goal is stable prices and that means inflation that we've defined at 2%. My guess is you know that inflation is not currently at 2%, and I'm sure we're going to talk about that here today. The other goal is maximum employment. As many Americans as possible gainfully employed and contributing to our economy. We normally think these two sides of our mandate are connected like sides to the seesaw, that when the economy gets hot and businesses have to compete to find workers, the unemployment rate goes down. That's a good thing. More Americans are working, but then they have to pay more to keep those workers and that leads to inflation. In that situation where the economy looks like it's overheating, the central bank will raise interest rates, make things more expensive to borrow, and then to try to level off the economy and they'll do the opposite if we're into a recession, and I know with the dean we're going to talk about this here in a minute.

Coming out of the pandemic, we had a very unusual economic environment. You had a couple million Americans who were missing from the workforce, and that was a surprise to us. Where did they go? Some people retired early, A million Americans died from Covid. That's significant. I mean, obviously significant personal loss, but also significant lost labor. We had a lot of people who were struggling with childcare issues and healthcare issues, taking care of family members, a bunch of different things, and we had depressed immigration, all of that conspiring to keep workers who we had been counting on out of the economy. And at the same time, you had a whole lot of fiscal stimulus hit the economy, so there there's a lot of demand. So you had depressed supply and a lot of demand. You also had monetary stimulus from the Fed. All of those conspire into this big spike in prices.

Now, I thought a year and a half ago, two years ago that this uptick in inflation would be temporary. We called it transitory, that you'd see workers come back in, you'd see the fiscal stimulus fade away, but then the pandemic took a lot longer. We had different ways of COVID hit, which extended the pandemic. We then had Russia launching the war against Ukraine, which shot commodity prices straight up. All of those things conspired and ended up making the inflation a lot stickier than we expected, and that meant that we had our job to do, which is raising interest rates to bring demand down into balance with supply, hoping we'd get some help from supply while we brought demand down, and we've been raising rates quite aggressively over the course of the last year to bring the economy back down into balance.

So that's just some context. I know we're going to talk about a lot of more recent events, and so why don't I just stop there and turn it over to Dean who's has a bunch of questions for me. It's like I'm back in school again.

Dean:

Yeah, so let's talk about the format quickly here. This is a town hall format, so that means you all have the opportunity to interact. I have some questions to interject here and there that came from some of our students and some of our faculty. And so there will be two mics roaming the room. And so please, we can start taking those. I'm going to give the first question here, try and keep your conversation to a reasonable time so everybody gets a chance to ask their question.

Neel Kashkari:

By the way, one thing, just so you know, we're live streaming this as I try to do for all of my events so that people in the public can see what we're talking about. I'm not coming to Montana and sharing FOMC secrets. I'm telling you what I tell everybody, but just so you know, when you ask your question, the world will get to hear you.

Dean:

All right, so first question. In terms of recent events, various market watchers are worried about the continuing impact of low interest rates on asset and liability decisions of bankers, which came to a head with the Silicon Valley Bank failure. So maybe you could comment on why that bank failed and some people think it was a mistake to increase the bar for heightened regulatory oversight from 50 billion to 250 billion in 2018 in the height in light of heightened risk. And do you think the outcome might have been different if that hadn't happened?

Neel Kashkari:

Okay, there's a lot there.

Dean:

We have smart students.

Neel Kashkari:

I know, I understand. It's a lot there for me to get my head around. I'm not worrying about your ability to receive it. Let's just start with what happened at Silicon Valley Bank. And let me just start by saying the Minneapolis Fed does not have a role in overseeing Silicon Valley Bank, so I'm not sharing any confidential information. This is all based on public information. When you go to the bank and you deposit money in the bank, you deposit your paycheck, the bank has to turn around and do something with that money. Traditionally, banks will take that money and turn around and make loans to other customers. Let's say to go buy a house. Well, Silicon Valley Bank and a number of other banks saw a huge uptick in deposits in the past few years and could not turn around and make new traditional loans with it.

So what do they do with that cash? All this money came in as deposits. What do they do with that cash? They said, well, let's earn a higher return by buying US treasury bonds, long-dated bonds that had a pretty attractive yield and mortgage backed securities guaranteed by Fannie and Freddie, among other things. But let's just keep it simple. That's what they turned around and do. It seems like a pretty safe thing to do except if interest rates go up, the value of those securities go down. And so that's what ended up happening. They were counting on interest rates not going up, counting on the Fed not needing to raise interest rates. When interest rates went up a lot, the value of those securities went down. So now all of a sudden they owed money back to their depositors, they owed more money back to their depositors, then those securities ended up being worth.

And when people started to look at this and figure that out, depositors started to get scared and said, "Hey, I think I'm going to take my money out." And the thing about banking is if everybody gets scared at the same time, no matter what the fundamentals are of the bank, if everybody gets scared at the same time the bank will collapse. And so if you look at Silicon Valley Bank and you measure it on how much of these unhedged risks do they were off the charts. We can look at it across the banking sector, they were the overachievers in unhedged risks that they were taking. And they also had a lot of deposits that were large, so beyond the deposit guarantees of the FDIC. So if you had to rank order all the banks in America say, who seems to be the most vulnerable in this environment, they would've been number one.

Now, they're not the only one. There've been some others too that came under similar pressures, but they were the most extreme in that case. So then the depositors got spooked, 40 or so billion dollars fled the bank in one day, which is huge numbers. And then ultimately the bank had to be taken over by the FDIC and then the Federal Reserve announced an emergency lending facility to help banks that have otherwise good collateral like treasury bonds and mortgage backed securities, they could bring it to the Fed and we can lend against that. Let me back up for one second.

The Central Bank's first reason for being, the reason we were created, was to support the banking system. If there's a banking panic, remember any bank in the world, if everybody gets scared, will collapse. So in those moments of quote, unquote panic, they can turn to the central bank for money to lend against them so that their depositors will be okay.

So no, the Federal Reserve was acting in our traditional capacity in supporting the banking sector. And I think between the actions of the Fed and the FDIC, it has provided some reassurance and some calm. I would just say I was at the front line of the 2008 financial crisis. Every time we thought in '08 okay, we've done enough, it's over, things flared back up again and they got worse. And so I'm not ready to declare all clear, but there are hopeful signs that these risks are now better understood and calm is being restored. Okay, thank you.

Dean:

Let's get some audience questions here

Neel Kashkari:

Way in the back.

Speaker 5:

Well, thank you for being here. Playing that thread out, to what extent do you think it's a good idea for bank accounting practices to change so that their bond positions should be market to market as opposed to being carried at face value?

Neel Kashkari:

I don't know. In '08, this is always a topic of debate. Whenever there's any kind of stress, and let's say... in '08, there were a bunch of banks that had whole loans, so loans that they made to homeowners or apartment buildings that people really doubted were money good, but they had the virtue of holding those to maturity. They didn't have to market to market. So some people said you ought to market those to market. And then other people said... I mean it's a very complicated thing. It depends on what perspective you have.

Depending on circumstances, one of these measures looks worse, another one looks better. And I think the best I've been able to see is you need banks to be honest, are these really intended to be held in maturity or not? By the way, so the Fed, we're lending a hundred cents on the dollar in our new facility against treasury bonds and Fannie and Freddie mortgage backed securities because they carry no credit risk. And we have the luxury that if we needed to own these bonds, we can own them the maturity and there's no mark to market risk for the Federal Reserve. And so it just ends up being a complicated question that I don't think there's a perfect answer to that's simply changing the accounting treatment would change the fundamental health of one of these institutions. Sorry, it's not a very satisfying answer, but it's a subtlety there.

Dean:

Other questions?

Neel Kashkari:

Right behind that one.

Speaker 6:

Hello. Hi. I was curious about what you were saying about how if everyone gets scared, a bank will fail. It seems that now we live in a time where paranoia seems to spread very rapidly. Do you feel that now in the time when information spreads very quickly that banks are particularly vulnerable?

Neel Kashkari:

It's a concern. I mean a lot of people have talked about the fact that part of this bank run was precipitated on social media. That didn't exist in 2008, so that's a new phenomenon. The analogy is kind of like, I mean I hate to use it in this crowded room, shouting fire in a crowded theater, right? That's terrifying, if you were in a crowded movie theater and it's dark and somebody yells fire and everybody panics, people are going to get hurt.

Somehow we've managed to live with that risk of some crackpot shouting fire in crowded theaters. And so I'm hopeful that we will find a way of, people are going to get used to... At this point, people kind of know when you turn on Twitter, a lot of the stuff you're going to look at is just nonsense and you get desensitized to the nonsense because there's so much nonsense on social media. I'm hoping that we are going to get used to this kind of noise and become a little bit desensitized to it. But it's a good question and I don't have an easy answer for you.

Speaker 6:

Sure, thank you.

Neel Kashkari:

Thanks.

Who's got the mic there?

Dean:

Right there.

Neel Kashkari:

Can you stand up for us so we can see you?

Speaker 7:

Thank you for being here. I recently bought some six month bonds from you yielding about [inaudible 00:14:13]-

Neel Kashkari:

Not from me, from the US Treasury Department, which is separate. Go ahead.

Speaker 7:

Treasury direct, but risk-free return, 5%. I'm spending more than ever and I'm not concerned about inflation because I'm getting that premium. Would tax increases be a better way to moderate the economy? I feel like if my taxes were raised, I might slow down.

Neel Kashkari:

You're always free to send more money to the Treasury Department. It's a good question. There are different ways of tamping down demand. You're right, if you increase taxes on something, you're going to get less of that activity, whatever that activity is. It's hard to move tax policy very quickly. And so what democracies have done is they've set up the central bank to say, hey, we're going to set you up. We're going to keep you independent of the political process, at least the short term political process, and give you the freedom to move interest rates up and down as necessary to try to achieve the goals that we've given you. In America's case, it's stable prices and maximum employment.

I think it's challenging for Congress to say we're going to move fiscal policy very quickly in response to these short term fiscal changes and fiscal challenges that we have.

I'll say this, our political system is much better at deciding, hey, we should spend more money than it is to get together to say we should spend less money. And it's a tougher thing for our democracy to... They can do it, but it's a tougher thing for our democracy to handle certainly in the short term. And you can see every few years there's a debt ceiling negotiation that ends up being quite drawn out that's evidence of how hard it is to read some of these agreements. So I mean, I think in theory you're right, it could work. I think it's hard to pull off in our democracy.

Dean:

All right. While we're setting up the next audience question right now here I have another student question.

Neel Kashkari:

Sure, go ahead.

Dean:

So Ben, one of our finance students from Bozeman, kind of getting at some of your opening remarks relative to the 2% interest rate that the Fed sets as the target. In 2012, the United States adopted the 2% target inflation policy. With the massive changes in global economy since then, do you feel the target rate should be adjusted?

Neel Kashkari:

And the short answer is no. Most advanced economy central banks have agreed that 2% is the right [inaudible 00:16:42]. And let me first of all say why. Deflation is really bad. Some people say to me, well, why is shouldn't it be zero? Why shouldn't the inflation rate that you aim for be zero? Deflation is really bad, because if you take out a mortgage on a house and the price of your house drops, but your debt stays fixed, your equity gets wiped out and the debt just gets bigger and bigger and bigger. So most people can understand, okay, deflation is really bad. Well, for the eight or so years before the pandemic hit, we were not actually able to hit our 2% inflation. We hit about 1.5 or 1.6. So if our target had been zero, we would've been in deflation. So the way I described 2% is we want a very low inflation rate, but something that gives us a little bit of margin for error in case we can't quite get there.

And that's why 2% is a low inflation rate, but something a little bit about zero. Now, why not change it? The way we think this works is if everybody starts to believe, okay, the Fed is serious about 2% and the ECB is serious about 2%, and the Bank of England is serious about 2%, it starts to get woven in the fabric of our everyday decision making even though we don't realize it. I'll give you an example. So we meet with labor unions quite regularly to understand what are their union workers experiencing and how are their wage and negotiations going? Unions tend to negotiate multi-year agreements, and when we talk to them about what their wage rate, they're negotiating, it's very comforting for us because embedded in their negotiation is an assumption that inflation's going to go back down and that we're going to get back down to 2%.

You can see it in the way they negotiate. So we don't realize it ends up woven into the fabric of our everyday decision making. If we all of a sudden change it and say, well, inflation's really high right now, it's around 5%, so let's just stop at three and a half and call it good. All of a sudden people are like, wait a second. They told me two. Now you're going to stop at three and a half? Well, maybe next time you're going to stop at four and then you're going to stop at five. And then maybe I just don't believe anything you're saying to me. And so there's a reasonable argument one could make in the long term, should it be two, should it be two and a half or something different? We could have that debate, but there's no way we can adjust this when we're missing our target right now because we would do enormous harm to the credibility of the institution.

Speaker 8:

Hello. Thanks again for coming to Montana. We have a lot of small regional banks here in Montana, and with a lot of the things going on with the Silicon Valley Bank and other smaller banks, are our smaller banks here in Montana at risk with what's been going on lately? Thank you.

Neel Kashkari:

Well, I'd say a few things. We supervise, the Minneapolis Fed supervisors a lot of banks in our region, they're not all banks. Some banks are supervised by state banking supervisors. We and the state banking supervisors are very focused on what are the risks that pressure Silicon Valley Bank and do other banks have similar risks and similar exposures? By and large, when we look across our region, banks seem very healthy that they did not take the same kind of risk that Silicon Valley Bank took. And importantly, that their depositors, if you look at most community banks, the vast majority of their depositors are fully guaranteed by the FDIC. So the FDIC has a guaranteed limit of $250,000. Silicon Valley Bank had a huge percentage of its deposits that were non guaranteed because they were in bigger accounts.

Most community banks in our region, the bulk of their deposits fall within the deposit guarantee. So that's another source of safety. So I'm not going to promise you that there are no more banks in our region or in Montana that could come under pressure. But I can say when we look across the banking sector as a whole, we do not see the kind of build up and risks that Silicon Valley Bank had. And the last thing I'll say is the Treasury, the FDIC and the Federal Reserve through their actions have indicated, have said, we are going to stand behind the banking system. We're going to use our full resources to stand behind the banking system to make sure that the economy is safe. And you should take that seriously.

Dean:

And so next question. We have some of our very good friends from Montana Banks here in the front row, and so we'll take one.

Neel Kashkari:

I hope you're not going to call me a liar.

Speaker 9:

I'm going to ask you two questions. Thank you for being here. First off, did Silicon Valley and the Signature Bank, did they have access to the Fed or to the Federal Home Loan Bank to borrow funds by pledging some of their real estate loans? Is That would've helped them? That's question one. Question two is how long's it going to take to get to 2%?

Neel Kashkari:

They did have it. So the home loan banks is a source of liquidity for a lot of banks across America. Banks make loans, home loans, they take those loans to the home loan banks and are able to get funding. But the home loan banks also have some provisions looking at their tangible equity. And while the market to market equity was shrinking, all of a sudden there was risk that they were going to get cut off from the home loan banks. And then many times banks will obviously turn to the Federal Reserve, the discount window to get lending.

My understanding of the Silicon Valley bank cases, they did have collateral, but the deposit outflow was so fast that it overwhelmed their ability to tap these other sources of liquidity. And that's why the

Federal Reserve stood up this emergency facility to say, here's yet another even more generous source of liquidity to make sure that other banks could meet their deposit needs.

Get back down to 2%. If you believe the bond market, it's going to happen pretty fast. Like the bond market is indicating that over the second half of this year, inflation should fall quite quickly. So much so that the Federal Reserve would then go and start cutting interest rates. I'm not as optimistic as the bond market. I would see us getting somewhere in the middle threes, I hope by the end of this year, but on a nice solid path back down to 2% sometime hopefully over the course of the following year. But I don't know yet. And there's a lot of uncertainty. The bond market, people love to say, oh, the bond market is so wise, they didn't see inflation coming. They did not see the high inflation coming. Neither did we. So we both missed it. And right now the bond market is optimistic that inflation's going to fall quickly. I'm less optimistic than they are.

Dean:

Okay. Let's take one more student question here, and this is from Dean and he's from Forest Lake, Minnesota, but it's Montana question since we're sort of moving in that way. I'm from Forest Lake, Minnesota. What impact has the Federal Reserve District nine had on Fed policies over the last two years? And I think he was interested in a regional aspect.

Neel Kashkari:

Well, we cannot set a different interest rate or a different monetary policy for Montana and for California and for New York because we all use the same dollar, so it's one monetary policy for the nation. But what our jobs are is to make sure that this region is represented in that deliberative process so that when we make a decision for the country as a whole, hey, we were part of that process, and it's not going to be perfect. It's not going to be exactly what Montana exactly needs, but it's going to be right overall, we hope for the country as a whole, and then Montana will benefit as part of that. So we've been very actively part of that process.

For example, when COVID hit and the Congress created the PPP program, this is the paycheck protection program, that small businesses accessed money from the government to help them meet payroll during the pandemic when a lot of their businesses were shut.

Well, the Minneapolis Fed launched with our colleagues across the Federal Reserve system, a lending program to get money out to community banks all across the country so that they can then turn around and lend money to their small businesses that was run out of the Minneapolis Fed in coordination with our colleagues around the Federal Reserve system. So that's a tangible thing that we did in the Minneapolis Fed that would've affected a lot of businesses and therefore different employees in Montana and all across the region and all across the country.

Dean:

Okay, thank you. Did we have one?

Speaker 19:

Okay. Yeah. Thank you for being here. And I think for all of us educators, we really admire the clarity of your presentation. So thank you. I have a naive question. So the observation is that we are having fewer banks in America as years go by and they're getting bigger. Is that a good thing or should we be trying to have more banks started? Should our students be thinking about forming a new bank?

Neel Kashkari:

It's been going on for decades and decades. I don't know. I'm going to get the number wrong. And the 1930s, it was like 30,000 banks, and 10 years ago it was 8,000 banks and now it's 5,000 banks. And in the consolidation, it's been a one-way street throughout most of our country's history. And why is it happening? It's happening for a few reasons. One reason is technology is improving. So we expect and want to do more, use our, for example, our mobile devices. That technology is also expensive and it becomes harder for community banks to try to offer all the latest services that a large bank can offer. So technology is part of this. Then you also have regulatory issues where the biggest banks in America generally, believe it or not, have lower levels of capital, that's the buffer against mistakes, the bad things happening than community banks.

It's the opposite of the way it should be, right? The big banks are the risky ones, and yet they have much lower levels of capital than community banks. So there's an unlevel playing field. Now, the Silicon Valley Bank episode, depending on what Congress decides to do in the wake of it, is probably going to accelerate this trend because one of the dynamics that happened, when Silicon Valley Bank and Signature Bank got into trouble, customers and other banks of similar size said, hey, that's kind of scary. Maybe we ought move our money to a giant bank, because implicitly people knew that the giant banks are too big to fail. And implicitly they understood that those giant banks have unlimited deposit insurance. So if you have effectively unlimited deposit insurance in a few banks and limited deposited insurance for everybody else, that creates an unlevel playing field that leads to more assets.

So I don't think it's a good thing if we end up having more and more consolidation. I think Canada has five or six giant banks, and that's it. I'll tell you this one more thing, it's a long answer to your question. In the 2020 pandemic, I talked about the PPP program. I heard from a lot of small businesses in our region who said they had long-standing relationships with giant banks, and when they called the giant bank up and said, "I need to help getting a PPP loan," they got nowhere and they got no help. And then they had to go establish a new relationship with a local bank who was able to get them access. So that was proof for me that there is a role that community banks play in our communities that is very hard for the giant banks to replicate, especially in these times of financial stress. So I think we definitely need community banks in our country, but we need some fundamental regulatory reform to make that possible.

Dean:

Our senior level finance class is submitted a question, I think it's a good follow along to this, and they ask, will community banks be required to pay increased FDIC insurance rates because of the regional bank activities and the Fed policy of covering them?

Neel Kashkari:

That's a good question. I mean, all banks pay into the FDIC, the deposit insurance fund, which is that buffer that the FDIC has to pay for some of these losses. I know there have been talk about, and I just don't know the details, increasing that fee to make up for the losses of a Silicon Valley Bank and Signature Bank. I've also heard some proposals that it wouldn't be an increase across the board, that it would be skewed towards the bigger banks. I don't know where that stands right now. So it's possible that community banks would've to pay more, but I just don't know the details of where that will go.

Speaker 10:

I have a short question or a question with a yes or no answer. I think 26 years-

Neel Kashkari:

Okay, now I'm on my guard. Go ahead. Usually it's a trick.

Speaker 10:

26 years ago, I had the pleasure of touring the Federal Reserve Bank in Helena. It was open one day a year, I think, or one evening. Can a person still do that? It was fascinating. And then one of the things they were showing was the art collection, which was living local artists. Is the Fed still collecting art?

Neel Kashkari:

Okay, so I know our tours were reopened in Minneapolis at the Minneapolis Fed. Yes, you can.

Speaker 11:

Yes.

Neel Kashkari:

Yes, you can tour. What about the art?

Speaker 11:

I don't know that we're actively collecting across the system or in our bank, but yeah, we have a beautiful collection.

Neel Kashkari:

It seems like it's static. It may not be constantly being refreshed, but there is, in Helena and the Minneapolis, the head office, there's a lot of art from local artists that we're very proud of. So if you visit with Shannon afterwards, we'd love to have you come visit or come to Minnesota and visit the Minneapolis one as well. Thank you.

Dean:

Question up there.

Speaker 12:

Hey, thank you. Appreciate your time today. So with the rollout of Fed Now planned for later this summer or 2023 and that whole digital currency discussion, how far away do you think a centralized bank digital currency would be for America and or global partners as well?

Neel Kashkari:

So Central Bank digital currency, I think is quite a ways away from the US. First of all, our Fed chairman, Jerome Powell, has stated very clearly that we would need Congress to act and decide this is something that they wanted the Central Bank to do, first of all. And I think there's a long way away from that. Number two, now I'm going to give you my own take on this. Nobody has been able to articulate to me, and I've been asking this question for years, what problem this would actually solve in society. You get a bunch of word salad answers of vague promises and speculation with no actual evidence of what it could do. And I'll give you a very simple example. I can send anybody in this room right now, $5 with Venmo right now. It'll show up in your account just like this.

So what could a central bank digital currency do that Venmo can't do? And I get crickets in terms of answers. Now, then they say, well, wait a second. China's doing it. Well, that means we need to go do it because China's doing it. Well, you know what a central bank digital currency could do in theory? You could monitor every one of your transactions. Sounds pretty good to China. You could directly tax customer accounts. Can't do that with Venmo. Sounds pretty good to the Chinese government and you could impose negative interest rates. Can't do that with Venmo, but you could do that with the Central Bank digital currency. All right. I get why China would do it.

I do not understand why the American people would be for that, and I would not be for that. And by the way, those three things, negative interest rates, taxing your accounts, monitoring your transactions, nobody at the Federal Reserve wants to do that. So until somebody can make the argument for what this thing actually achieves that is not achievable with current technology, I don't think there's any case for it.

Speaker 13:

Thank you for coming. My question, since you brought up China, revolves around a more worldly look at things and you look at what's going on in Ukraine and Russia and then you bring China into the mix and India and the British nations, I'm curious what role the Fed has in helping assist the US dollar to remain the world's reserve currency and what the Fed is doing in that role.

Neel Kashkari:

The US dollar is the world's reserve currency because investors around the world have more confidence in the US economy than in any other major economy in the world. So what leads people to have that confidence? We have a rule of law that's not perfect, but that's basically better than anywhere else. We have a political system that seems like it's acrimonious at times, but you know what? It kind of works over the long term and works better than a lot of other political systems. We have a central bank that is independent, that has the freedom to raise interest rates if we need to bring inflation back down. So the role that we play at the Federal Reserve in preserving confidence in the dollar is achieving our dual mandate goals. That's our part. We get inflation back down to 2%. We help the American people achieve maximum employment.

We've made a big contribution to investors around the world saying, that's where I want to invest. Now, what could change that? One is if we screw up things at home, another is imagine if China really gets their [inaudible 00:34:34] that's like they're disarming themselves economically. That's good for us. Europe has its own set of challenges, so I would not bet against America in terms of being the preeminent economy in the world because of these fundamental things. So we can't take it for granted, but I think our competitive position is very good for where we are right now.

Speaker 14:

All right. I'm live. Thank you. Thank you for coming. I appreciate coming to these meetings and I wanted to thank Bobcat Nation for showing us a welcome. We appreciate that very much. So there's a couple things that I been sitting here, I was asked to ask a question, and one of the things that I noticed was people will ask two questions. I only have two. And the first observation that I've got is there must be a record number of people that have said, "Boy, I didn't see that coming." And so that's the situation that we're at. Specifically, my question, there was a op-ed in the Friday Wall Street Journal by Mark Steinberg, and he talked about, first he talked about Silicon Valley Bank and how terrible it was. And then he went on to say that since 2008, the number of banks in the world credit system has gone from over 50% to less than 40% and that vacuum has been filled by non-bank. That's one term that he used.

I've also heard these referred to as shadow banks, and I won't claim to say that I know what they do, who they are, but I bet you have more thoughts on that. And I'm wondering if you can share your thoughts on this situation that Steinberg described, if it is in fact correct. And then my second question, if I may-

Neel Kashkari:

Okay, sorry. So there was an observation and two questions. Go ahead.

Speaker 14:

Okay. All right, thank you. The second question is, I'm down here skiing, I'm retired, but I've got a retirement plan and I have a lot of bank stock in my retirement plan. And I would bet everybody in the room here that's got a retirement plan and a regular portfolio has bank stock. And so with Silicon Valley Bank and the impact on the financial system in America, the question is now what do we do? And the problem with that question, it always gets asked, but the easiest answer is always not to do anything. Well, not doing anything is a decision. And my question for you, my second question is that a good decision in this situation?

Neel Kashkari:

Well, your second question's easy for me to answer, which is I'm not allowed to give investment advice.

Dean:

Well, that's too bad because we have some coming from [inaudible 00:37:43].

Neel Kashkari:

And by the way, if you go to the Minneapolis Fed website, you can see I have very detailed financial disclosures, just what I invest in. I have widely dispersed index funds and I don't touch them. They're on autopilot and I don't trade, I don't do anything in and out of markets, in and out of sectors. S and P, international index funds as wide as you can do. I'm not giving you investment advice, I'm just saying that's what I, you can see that for myself. Now I lost your first question. Tell me again. Shadow Banks, thank you. Shadow Banks. Yeah, shadow banks. So what are shadow banks? A lot of different things where traditionally it'd be a bank making a loan to a company.

This is somebody else providing that funding that makes its way to that company. So insurance companies end up making some loans to companies. For example, in commercial real estate, insurance companies have a lot of premiums that get paid to them. They need to invest those premiums somewhere. They end up turning around and participating, for example, in the commercial real estate market. You also have pension plans that invest in different funds that are focused on loans to industrial companies that are focused on real estate loans, et cetera. So if you have a pension, your pension plan may be funneling some of your savings into the shadow banking sector in the various vehicles and various structures. Your insurance company might be participating. Those are a couple mutual funds as an example, may also be buying things like there's something called a collateralized loan obligation. You may have heard of a CDO back in '08, collateralized debt obligation where you pool a bunch of loans to industrial companies together, chop them up into individual securities and then mutual funds can buy them.

So it may well be that in your retirement plan, you are participating in the shadow banking sector, not realizing that your money is waterfall out to some of these underlying uses. It's not nefarious, it's just a different source of capital than through the traditional banking system. Now some people say, and I don't know if this is all true, depending on the vehicle, that banks are more highly leveraged than some shadow banks. So if a bank has 10% equity, they may have 90% debt against the assets. The shadow bank may have less leverage than that depending on the kind of vehicle. So it ends up being getting very complicated very, very quickly. Something we try to monitor, we have less visibility into all of these different sectors in the shadow banking sector than we have into the banking sector.

That makes us a little bit nervous because we have less visibility into it, but it's also less concentrated. So if something goes bad in the shadow banking sector, it's less likely to ripple through the entire shadow banking sector as opposed to what we just saw with Silicon Valley Bank where you have a lot of banks that have these mortgage backed securities and these treasury bonds, maybe they all face similar risks and that's what caused people to get scared about a month ago. Sorry, long answer to your question.

Speaker 14:

Thank you. That was very good.

Neel Kashkari:

All right.

Speaker 15:

Thank you. Yeah, I'll echo the prior comment that layman's terms very intelligent answers and that we can digest. So I appreciate that. Thank you. Also, appreciate you making a plug for credit unions and local banks that we should all have checking and savings accounts there. My question is this, the price stability used to be 50 years ago was the goal was zero. And so this idea of 2%, which you laid out a very good explanation of why that's such a better target has probably been only the last 30 years, and yet our target for unemployment is still zero for this dual mandate. Is it worthwhile to maybe give that one a buffer and say, hey, maybe goal for unemployment shouldn't be zero.

If we have this dual mandate, maybe it should be, that should be two 3%. What are your thoughts on that?

Neel Kashkari:

Thank you. So you're right. The law says that we are supposed to achieve maximum employment as many Americans as possible working, consistent though with our 2% inflation target. We've tried to estimate what does maximum employment look like and it's somewhere in the three and a half to four, four and a half percent range, we think is about as low as you're going to drive the unemployment rate in normal times in a manner that's consistent with our 2% inflation target. So we're not actually aiming for zero, we're aiming for as low as we can consist with that 2% inflation target. But I'll tell you, there's a lot of uncertainty about what is maximum employment and when are we there.

So prior to the pandemic, at first we thought 6% was maximum employment and then the unemployment rate fell, then it fell to five and we, okay, now we're there inflation's about to take off and it didn't take off. Then it fell to four and inflation still didn't take off. Then it fell to three and a half and inflation still didn't take off. So there's a lot of uncertainty about what is maximum employment. And in recent years, up until this current period, we were always overestimating, meaning we thought it was 5% when it was really lower than now, we thought it was 4% really lower than that. And so we're not aiming for zero. We know it's going to be some amount because of their frictions in the labor market. People aren't changing jobs, but we want as many Americans as possible to be gainfully employed and achieve our 2% inflation target and that's what we're trying to achieve.

Dean:

I'll throw a student question in here real quick. So in the introduction, your role in the 2008 financial crisis was noted and the student noted it too. So during the 2008 financial crisis, you played a major role in the Treasury Department's response on several fronts which helped the country avoid an economic disaster. Could you tell us how close we came to a meltdown and how similar is that situation to the recent banking panic?

Neel Kashkari:

We were very close to a true meltdown in '08. In oh eight, it felt like we were... I mean, I've never served in the military, but it felt like as close as I could imagine it being in economic war where every night we went to... And I was working 18 hours a day sleeping on my couch in my office seven days a week, months, months, months with a lot of other people. It wasn't just me. And there were times where we didn't know if we'd wake up in the morning if the banking system would've collapsed and you would've seen thousands of bank failures across the country. And then you might recall we had to go to Congress to ask for the authority to intervene, ask for the tarp authority. And when we went to Congress, they first voted it down, and I was sitting in the gallery over the house floor.

So this is where the Washington State of the Union address, it's in the House of Representatives room and there's a gallery up there. And so I was seated there and I couldn't believe they voted it down. And we walked out of that room and I just thought to myself, well, at least history will show that we asked. We tried. But then thankfully, well that afternoon, the next day, the Dow Jones Industrial Average dropped 777 points. And then a few days later, Congress got back together and they ended up passing. So it's all you equity investors out there, thank you for the support. But even after it passed, it went on for months and months and months, and we just didn't know... There were times, so the tarp was $700 billion of tax square money to support the banking system. There were times when I thought we were going to burn through that and we'd have to go back to Congress to ask for 700 billion more.

So the fact that we got through it and got most of that money paid back is a miracle relative to what it felt like when we were in the moment. In the moment,. We were taking our best shot, trying everything we could think of to stabilize, to save us from falling into the abyss. And we didn't know if it was going to work. Thankfully it did work, but it was quite scary at the time. And then more recently, no, it's not been like that at all. I mean, one thing is a lot of the emergency programs that were created in '08 were brand new and never been tried before by the Fed. We had the benefit of that experience. So when COVID hit, the Federal Reserve acted very aggressively to take some of those programs off the shelf, deploy them even more aggressively, and to my colleagues were able to stand up this emergency program for the banks in the weekend that was very powerful after Silicon Valley Bank collapsed. So we really benefited of having fought those prior battles.

Dean:

All right. Thank you. We have a question.

Speaker 16:

I'm a selfish person as every other person in this room is, and so I'm wondering, based on the fact that the six-month government bonds have a higher interest rate than any long term bonds two year, five year, 10 year, 30 year, which is usually a forecast for economic times of hardship in the future, how are you guys going to help ensure that I have a job here in a year after graduation? I'm sure you guys look into this a lot more than a 19-year-old college kid, or at least I'm hoping so.

Neel Kashkari:

Well, so you're right. The gentleman was referencing the inverted yield curve that you may hear about in the financial press where short-term interest rates are higher than long-term interest rates. And that happens because investors in those longer term securities are assuming that interest rates will going to fall. Usually that means because they think that there's going to be some type of a downturn coming, that inflation will fall, there'll be a recession, and interest rates will go back down. And that's why you get this funny shape of the yield curve. We need to get inflation down and we have to get inflation back down to our 2% target because if we were to fail to do that, then your job prospects would be really harmed. You're right. It could be that our monetary policy actions and the tightening of credit conditions because of this banking stress leads to an economic downturn.

That might even lead to a recession. It's possible that that would lead to recession, and that would probably make your job search a little bit harder if you're searching for a job in a recessionary period. As hard as that, that would be, and I'm not hoping for that, but as hard as that would be, it would be unambiguously worse if we failed to get inflation back down and people lose confidence that the Federal Reserve is going to do its job. For the 40 years before the pandemic hit, we all benefited from actions that the Federal Reserve took in the early 1980s to bring inflation down and to demonstrate that they were serious about keeping inflation in check. That was like a foundation for us to then have a strong competitive economy. We need to defend that foundation for your benefit and for the folks that come after you.

Dean:

All right. We have another student question. I know you were not wanting to give investment advice, so I'll try and spin it, but that's basically what it is. I'm a new investor and have been following various economic trends that pertain to the stock market, like the banking crisis, the fight against inflation, macro economic data reports and so on. With the additional economic concerns, or what additional economic concerns do you think I should be aware of for 2023 as a new investor? So it's not investment advice, but what would you be looking for?

Neel Kashkari:

Just go back to my prior comments, which is if you look at my public disclosures of where I invest, I just give an example. I have two children. I have a two-year-old and four-year-old. And when my children were born, my wife and I set up a 5 29 college savings plan for each of our children. And every month, a little money comes out of my checking account and goes into an index fund in each of my children's names. Every month, no matter what's happening, good economy, bad economy, it's on autopilot. That's how I manage my own investments, and again, that's all publicly available.

Dean:

Great. Brett.

Speaker 20:

You've talked about the teeter-totter and the interest rates on one side of the teeter-totter and full employment and mostly referred to the unemployment rate. Could you comment on labor participation rate, labor supply, immigration rate, and those sorts of things that affect the other end of that teeter totter?

Neel Kashkari:

Yeah, thanks. You're right. There are a lot of different measures of labor market that we look at. The unemployment rate is one measure, but it's an incomplete measure. The labor force participation rate. So if you're not looking for a job, maybe because you're retired or because you're in school or some other reason, you're not counted as unemployed. So we look at how many people are in the labor force, meaning I want a job whether I have one or not, I want one. I'm in the labor force. That's another measure that we look at. So the labor force participation rate took a big hit when COVID hit, a lot of people left. The labor market said, I'm not looking for a variety of reasons. That's been a positive surprise recently that it has ticked back up again. That's good news. If we can see the labor for participation rate drive up, that means more Americans are in the job market, want to participate.

That's good news in terms of the potential output of our economy. Then you have just the number of potential workers, that's our population, and this is a challenge for dance economies all around the world, that we're having fewer children than prior generations, and fewer children means fewer workers to produce things in the future, fewer consumers to buy things in the future. And this is just math. So I always say to audiences, this is the math. What are our choices?

We can either accept slower growth, we can do what Japan is trying to do and subsidize fertility to try to bribe families to have more babies, by the way, it doesn't work. Or you can embrace immigration. That's it. Those are the three choices you have. And immigration has been a very powerful economic force in our country for economic growth and innovation, and it's starting to tick up again. And so that's starting to show up in the numbers, which is also helping us in terms of our labor supply. But long term, we've got this big demographic challenge and long term, the only answer to that big demographic challenge is immigration, and somehow we have to reach political consensus around that.

Dean:

I think we have time for one more. One more question.

Neel Kashkari:

Right there in the middle, Shannon.

Speaker 17:

Yeah. Just quick one. Do you think in some ways the reaction to Silicone Valley Bank and all the money that was given to them and even those uninsured deposits getting back, is that in some ways rewarding bad behavior?

Neel Kashkari:

Absolutely, it is. No question. But the challenge is what do you do about it and how do you avoid doing the opposite? So the terminology is called moral hazard, where, hey, if you got bailed out in Silicon Valley Bank, then maybe I'm going to get bailed out in my bank. And so now I don't need to care if my bank is taking risks or not, and that's a legit thing. I mean, moral hazard is real, absolutely, but what do you do? Let the should, should the FDIC and the treasure and the Federal Reserve just said, you know what? We're going to let this fire sweep through the regional banking system and let this panic sweep through. That would've caused real hardship for the country. I'll give you another example. I compare big banks, big banks hate it when I do this, but I'd compare them to nuclear reactors.

And here's what I mean by that. When a nuclear reactor melts down, you could say, "Well, let's let it melt down. Let's punish those shareholders." Of course, society pays huge swaths of society pay if you let the nuclear reactor melt down. So in that time of crisis, governments will spend unlimited money to try to stabilize the reactor because the consequences to society are so profound. That's this vexing thing about banking bailouts. You could have let the fire spread, and yet the shareholders will be hurt, but a lot of other people would be hurt too. So what do you do? You don't ban nuclear power. You regulate it like crazy to try to minimize the chances for that meltdown happening. And so that's why I hope that we are willing to have a fundamental re-look at our banking regulations in our country so that we can really manage these risks better than we have to date.

Dean:

All right. Well, I want to thank everyone for coming. I want to thank Neil for coming all the way out.