Loretta Mester:

And here I'm reminded of the words of former Fed Chair Paul Volcker when he fought inflation in the 1980s. Chair Volcker said, "Failure to carry through now in the fight on inflation will only make any subsequent effort more difficult at much greater risk to the economy." Thank you.

Pam:

Dr. Mester, thank you so much for being here and for helping us to understand the changes in the economic and financial realm. Our speaker, as I said before, has graciously agreed to respond to questions. And fellow Akron Roundtable board member Ed Markey will moderate the Q&A. If you have note cards, please hold them up.

Ed Markey:

Thank you Pam, and thank you for your willingness to take questions. Point of clarification, the questions have been coming in digitally and I've been taking a look at them while I'm sitting here. That's the reason I have my phone on my lap, as far as you know. Dr. Mester, has the Fed considered pausing interest rate hikes to determine how the previous hikes will impact the economy and would it make sense to focus efforts on reducing the balance sheet?

Loretta Mester:

So of course, as we've been raising interest rates, and we do this all the time leading up to FOMC meetings, and in the meetings we're always assessing what the stance of monetary policy is and whether it's sufficiently restrictive to get us back to 2% inflation to make sure that we get a sustainable maximum employment, which are two monetary policy goals. So as we've gotten closer and we've seen some progress, we're always debating that kind of decision about how much farther to go and how much less farther to go. So my own view is that we've come a long way and we're much closer to the end than the beginning, and we're going to have a meeting in two weeks or so where we're going to basically be talking about what the next decision [inaudible 00:02:13] be.

That's what we're part of what we're doing at FOMC meetings is really determining whether we want to do that. In terms of the balance sheet, by allowing assets to run off the balance sheet, that also, right, is tightening financial conditions.

So we're seeing the effects of both the tightening of the Fed funds rate, the increase in interest rates and that reduction in the balance sheet on the economy. And that also figures into our policy goals, but our active tool is the Fed funds rate, that policy rate. We set in motion, last year, that reduction in the balance sheet according to a plan, and we're continuing to follow that plan. And as assets run off, of course, the balance sheet is reduced and we get that tightening effect. But that isn't really the active tool. We're having that run sort of in the background and then using our policy tool as the tool, active tool, in monetary policy.

Ed Markey:

Thank you. We have a lot of questions, very, very, very thoughtful questions as well. We won't be able to get to them mall. We'll get to as many as we can. You talked about this recent stress on the banking industry. Do you believe the Fed will be more accommodating of bank mergers allowing bigger, stronger banks to grow?

Loretta Mester:

So I'll separate out the bank stress from the way we manage merger and acquisitions. I mean, we have a whole process that takes into account concentration of the banking and the regionally aspect of banking. And that's a process that has some limits on sort of how concentrated the industry should be. The stresses that arose were really a classic bank run, if you will, depositors withdrew money. Silicon Valley Bank found themself have to having to sell assets at a loss and that continued to then spook other depositors and then they withdrew.

So that's what caused that. We're prepared to take actions as necessary to make sure that the overall financial system remains stable. The new lending facility that we set up, which is a 13 (3) facility under exigent circumstances with a backstop from the treasury, and the combination of that and discount window lending has eased some of that stress because we're basically allowing banks to borrow on very sound collateral, right?

It's treasuries and agency securities and that collateral is posted and then they can borrow from the Fed, and that has calmed things down. So the stresses that arose were in a few banks. The potential contagion was what drove the actions on the part of the Fed to set up the new facility and the we're continuing to monitor what actions will be necessary... Or not what actions, but we're continuing to monitoring the credit conditions and the credit standards that banks are now evaluating.

We already had seen some tightening in those credit standards because of interest rate increases and now we're assessing whether the stresses in the banking industry have increased the desire of banks to look at their portfolios and tighten credit standards even more than they would've without the bank stress. And that's what figures into assessing what the next steps on monetary policy will be.

Ed Markey:

Thank you. We have several questions on the theme of the US dollar. So what level of concern do you have about the US dollar losing its singular position as the global reserve currency and what defensive efforts are being taken to preserve the US dollar as the global reserve currency? In addition, any other thoughts you might care to share regarding US dollar vis-a-vis foreign currencies?

Loretta Mester:

So of course, the Fed is not the entity that is in charge of the US dollar. Of course the treasury is the entity that really has concern for, or has the purview, for looking after the dollar. The value of the dollar does feed into monetary policy considerations because it's one of those financial conditions, but we take it as a given and then we think about financial conditions. I mean, I think in general the US dollar is still the reserve currency of the world, and while it's very good to be thinking longer term of some of these issues, especially in a world of digitalization and other things going on that's not my concern., high level concern right now maybe because I'm taking the Fed monetary policy perspective as a policy maker. My concern now is that we get back to price stability and continue to have a very strong economy here. And that can do a lot, I think, to continue our predominant role as a world global economy. And that's where I'm kind of focused right now.

Ed Markey:

As long as you brought up digitalization, any thoughts you have on non-traditional currencies and the impact they may have going forward?

Loretta Mester:

Well, it's certainly some things that are happening now in terms of technological advances have allowed some of the currencies to come on board. A lot of those are not really payments methods. So the Fed has a role in payments of course, as you know. And in fact we're going to be launching in July a new payment service FedNow, which is an instant payment service. And I think sometimes there's confusion between what the Fed is doing in that space and digital currencies. Those are two separate things. And as Chair Powell said, there's no move at the Fed to do a central bank digital currency. That would have to come from Congress telling the Fed that that's the direction they want us to go in. And that has not happened yet. So again, they're separate things. Right now, I think that the authorings of the Fed and payments are the ones that are the traditional ones or very good in terms of payments. And then if you think about cryptocurrencies and other currencies, I think of them more as not a payments method, although a new asset that people can hold.

Ed Markey:

The headlines today and over recent days concerned the debt ceiling, and we'd like to hear your perspective on Congress's decision to either raise the debt ceiling or failure to do so and the effect that may have on the economy.

Loretta Mester:

This is something that needs to be taken care of. If it's not taken care of, it will stress our economy, our financial markets. It's got to get done and I think it will.

Ed Markey:

One of our audience members heard you speaking of hearing from business owners and other community and bureaucratic leaders, how often does your office hear from and take action based on community feedback from everyday people?

Loretta Mester:

So we actually pride ourselves on talking to a broad, broad spectrum of people in our district. It's something that we've worked hard on. And a way to kind of demonstrate that is if you look at the Beige Book, which is the book that we put out, the whole Federal Reserve system puts out a couple of weeks before an FOMC meeting. What you'll see is a new section that many of the reserve banks, and I'm proud that Cleveland is putting it in called Community Views. And that, our community development division within our bank has been instrumental in getting those views. That includes views from individuals who we've contacted, but also a lot of the community development organizations within our district who are very much in touch with some of the challenges in low and moderate income areas and neighborhoods.

That does influence how we look at how is the economy doing and how is it fairing? And we really are aiming to have an economy that works for everybody and that's a strong US economy in all neighborhoods, in all places and for all people. And that's kind of a goal that we're striving for. And of course with monetary policy, it's measured by price stability and maximum employment.

Ed Markey:

Something else we've been reading and hearing about is the concept of a soft landing versus a hard landing coming out of a recession and interest rate increases. Could you walk us through that a little bit? Explain the concept of the landings and what we can expect?

Loretta Mester:

I think there's concern about when you think about a hard landing, what does that mean? I think the concern is about we will have a recession and that we will see sharp rises in unemployment and people losing their jobs. That would be a hard landing and perhaps some more in civilian financial markets and assets, values going down. The soft landing of course is what we're aiming for, which is we get inflation on a sustainable downward path of 2%. And I like to explain to people, that doesn't mean we keep raising interest rates until inflation gets back to 2% because we know that our policy actions affect the economy. It takes time for them to feed through. But we do need to get to a point where we're convinced that inflation is moving back down to 2%. In this environment, I do think we're going to have very slow growth.

I think growth will be well below 1%, which is what we had last year. And that right is part of that readjusting of balancing supply and demand. When you're in such a low growth, it doesn't take much of a shock. Think of anything that we're not incorporating to send growth below zero. But the economy has been very resilient and the labor market has been very strong. So my anticipation would be even if that were to happen, it wouldn't be a sharp downturn, which is the hard landing and that we will get inflation meaningfully down this year and continuing to fall over the next couple of years. We probably will see some rise in the unemployment rate, but it's very, very low now and unsustainable low when you think about where we need to get back to have that healthy balance in the economy.

Ed Markey:

One of the other effects of the pandemic related to more folks working from home than ever, a following effect of that was a lot of commercial real estate now being largely vacant. How do banks respond to this type of a situation where, is commercial construction still going on? Are existing commercial buildings now being repurposed? How do banks look at that relative to helping fund new development?

Loretta Mester:

So you're right. I mean, we have seen sort of the structural change. I would think that COVID and reaction to working at home is a big structural change. At the same time, we have rising interest rates. Both of those factors of course affect the real estate industry quite a bit. And what you have seen is banks really looking at their portfolios, some of those loans are going to re-price over the next several years. And with rising interest rates that'll matter in terms of the value of those assets. So banks are very much looking at their real estate portfolios and rebalancing those portfolios and making sure they have enough capital and liquidity because of what the future holds for some of those assets. But on the other hand, if you look at housing, there's a structural deficit in terms of the supply of housing.

And so if you think about multi-family housing as another asset class in terms of real estate, right there, you would've thought with the rise in interest rates we've seen so far, you'd have house prices coming down quite a bit. That hasn't happened because supply is constrained. So again, there are multiple factors that feed into the pricing of those assets, which then feed into how banks will respond to those. We have seen in our region banks reassessing how much they want to have their portfolio in commercial real estate going forward given the interest rate environment and giving the other trends that you're talking about.

Ed Markey:

The individual experience we have at banks now is much different than it used to be, which kind of prompts this question. Do you think the efficiencies gained from banks utilizing AI technologies could potentially help stabilize the economy? And additionally, what potential risks do you see associated with artificial intelligence?

Loretta Mester:

Okay, so I believe in technology. I am a positive on technology and I think AI is already being used in several areas and I see great potential in AI. But with all technology, you have to know how to use it. And I think that's something that we have to think hard about. Any institution that's implementing some technology, you better learn how to use it before you implement and know what the benefits are and what some of the caveats are that you'd have to be aware of. So again, I see that it has great potential, but I also think we have to really understand what we're implementing when we're implementing a new technology. And that's true of AI in all new technology. I think sometimes we forget that it's not just having the technology, it's also being able to utilize it in the most productive and effective way possible.

Ed Markey:

Thank you. We have time for about two more questions. Janet Yellen is on record saying that, "Depositors at national banks big enough to be systematically important to the national financial system will be made whole." But what about local regional banks in Ohio?

Loretta Mester:

So we have it a deposit insurance system, and of course if you're below the 250,000 in your account, your deposit is safe. It's backed by that deposit insurance system. What happened when Silicon Valley Bank failed was it was deemed to be a systemically important, or a systemically important potentially exigent circumstance, that it could contain... And that's why the actions were taken by the FDIC, the treasury and the Fed to try to make sure that there wasn't contagion there, and my understanding of course is that the FDIC is going to assess the banks to pay for that action. Going forward, I don't speak for the treasury, but we're going to make sure that we... I think what we need to aim for is an equitable, financially stable financial system, banking system. And so policy makers who are in the FDIC and the treasury will make decisions about what the right thing to do is.

But we need a system that basically prevents us from having to take those actions. My goal always is let's make sure that we're making the right decisions and having the right framework, and that includes not only regulation but the rules to implement the right banking regulations and also the supervision of institutions so that we can prevent ourselves from getting into a situation where hard decisions have to be made that then have repercussions going forward. And so by doing that, we have a much more stable banking and financial system. And then that also is beneficial for us when we're doing monetary policy because we can then focus monetary policy on the goals that Congress gave us and we can focus our prudential and micro prudential regulations and supervision of financial institutions to ensure that the financial institutions stay stable.

Ed Markey:

Thank you. You spoke earlier about reduction of population in the Cleveland area affecting the workforce, et cetera. What's the economic condition of the Cleveland District in general and what's the condition in relation to other Fed districts in the national landscape?

Loretta Mester:

I mean, in terms of the population, we are getting some population growth in portions of our district. Columbus is doing better than Cleveland. Cleveland's losing population. Columbus is gaining. Cincinnati, last time I looked, is stable. But that's important because workforce is driven by... Population growth is a really important component of that. And as you get more jobs within a labor market when the economy picks up, you want to be able to have well-trained labor force ready to take on those jobs. It makes everyone better. The people who can get those jobs end up being better off. Their families get to be better off. So that's kind of what we're aiming for. Other parts of the country, of course, are gaining population. The south in particular, and the west, they gained a lot of population. Texas is gaining population and they have stronger economies as a result because they have more people that can go to work.

So again, I think the reason population growth is important is because it feeds into labor force growth, which then feeds into productivity and just a healthier economy. And that's something we're going to have to address because we want to keep growing jobs, which I think we all do. And to grow the economy, we're going to have to be able to have people to take those jobs. That doesn't just necessarily mean bringing people in from outside, but also training, better training and education, so that people are well-equipped to take on not the job today, but the job of the future. Because we know the economy is very dynamic and changing all the time. We want people to be able to understand what their work is today, but also to have the capability to take on jobs of the future.

Ed Markey:

To finish on an uplifting note with our last question, what sectors of the economy do you see as still being strong or growing even in such challenging conditions?

Loretta Mester:

Well, the parts of the economy that are in the service sector, so personal and professional services, business services, they've been strong, which is also why inflation of those parts of the economy have been strong. The parts that are not strong, but they're... It's pretty amazing that we've been through so much, and the economy is just a resilient economy. The US economy is incredibly resilient. Think about back when we first had COVID hit, just think about how dire some of the predictions were about how we would fare. I mean, it was a incredibly dire period. There was uncertainty everywhere., and yet, we were able to get to the point where we are now and things didn't get as bad. Now, a lot of actions were taken to prevent the bad, right? So we mitigated the downside, but even when we were taking those actions, it wasn't clear that that would be enough.

So that just tells you that the underlying economy, of the US economy, it's an economy that's worth keeping, right? We have great things going on in the economy in terms of its resilience and strength. We do have problems. I'm not trying to undermine the problems, but I think it's easy to focus on the problems and not to really understand that we have a good economy. We have more jobs than we've had. We have a very strong labor market, and now we're going to do what it takes to get us to that soft landing that you mentioned before.

Pam:

Dr. Mester, thank you so much for being with us today. On behalf of the Akron Round table, it's my pleasure to present to you a contemplative sun. This work of art was designed exclusively for Akron Roundtable by Akron artist Don Drum.

Today's program will be broadcast on Thursday, April 27th at 8:00 PM on WWKSU 89.7 FM. You may also listen to Akron Roundtable programs on our website or on our podcast channel. Thank you to the University of Akron and its Excel Center for Experiential Learning for sponsoring our podcast series. Please mark your calendars now for May 18th, 2023. For our next speaker, Cindy Hole, Treasurer of the Freedom to Read Foundation and newly elected President of the American Library Association for her presentation, Ohio Unbanned: Librarians Protect Your Rights to Read and View Against Censorship. Thank you for being with us today and we look forward to seeing you next month. Have a great day.

Ed Markey:

Thank you so much for your generosity to all those questions. [inaudible 00:25:23].