The Economic Club of New York

491st Meeting
111th Year

Randal K. Quarles
Vice Chairman for Supervision
Federal Reserve System

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Interviewer: Greg Ip
Chief Economics Commentator
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Introduction

President Barbara Van Allen

Welcome everyone, to the 491st meeting of the Economic Club of New York in our 111th year. I'm Barbara Van Allen, President of the Economic Club, and I'll be presiding today as our Chairman, Marie-Josee Kravis is traveling overseas. As many of you know, the Economic Club of New York is the leading nonpartisan platform for speeches and conversations on economic, social, and political issues. More than 1,000 prominent guest speakers have appeared before the Club over the last century and have established a strong tradition of excellence.

I'd like to take a brief moment to recognize the, now 271, members of the Centennial Society, each of whom has made a donation of $10,000 or more to the Centennial Fund. This fund serves as the financial backbone of the Club. Several of them are seated at the head table and other tables in the front of the room. We also have joining us today members of the 2018 Class of Fellows. This program enables the Club to introduce the next generation of business leaders to our Club. Applications for the 2019 Class of Fellows are now available online on the Club's website, and we encourage you to consider nominating a talented professional colleague from your organization to participate in this special customized program. More information about the Fellows Program and other Club programs are on each of the tables in the room.

It is a pleasure for me to introduce our distinguished guest speaker today, Randy Quarles, who

took office as a member of the Board of Governors of the Federal Reserve System on October 13, 2017 to fill an unexpired term ending on January 31, 2018. He was reappointed to the board and sworn in on July 23, 2018 for a term ending January 31, 2032. He was sworn in as Vice Chairman for Supervision on October 23, 2017 and his term as Vice Chairman for Supervision ends October 13, 2021.

Prior to his appointment to the board, Randy was a Founder and Managing Director at The Cynosure Group, a Utah-based investment firm. And before founding that group, he was a partner at the Carlyle Group, a private equity firm based in Washington, DC. From September 2005 to November 2006, Randy served as Under-Secretary of the Treasury for Domestic Finance. Prior to that, from April 2002 to August 2005, he was Assistant Secretary of the Treasury for International Affairs. During his tenure, he served as Policy Chair of the Committee on Foreign Investment and prior to joining the Treasury Department, he served from August 2001 to April 2002 as the U.S. Director of the International Monetary Fund. From January 1991 to January 1993, he served in the Treasury Department as a Special Assistant to the Secretary for Banking Legislation and as Deputy Assistant Secretary of the Treasury for financial institutions. Prior to that, and in between his service at the Department of the Treasury, he was a partner at Davis Polk & Wardwell serving in the New York and London offices. Randy received his BA in philosophy and economics summa cum laude from Columbia and earned a law degree from Yale Law School.

Randy will be giving us some initial remarks and afterwards we will move to the conversation segment of our program. As Randy comes forward to take the podium, I'd like to remind everyone that this event is on-the-record. It actually is being broadcast Live and we do have plenty of media in the room. Randy, the podium is yours. (Applause)

Randal K. Quarles

Vice Chairman for Supervision

Federal Reserve System

Thank you. Thanks very much. It's an honor to be here and I'm very grateful for the invitation to speak to this group. And I'm looking forward to the conversation later with Greg Ip. It's now almost exactly a year since my appointment as the Vice Chairman for Supervision at the Fed. And in that time I have, as you would probably expect, spoken most frequently about matters related to the financial sector supervision and regulation. But that's not all I do at the Federal Reserve. So I'm particularly grateful for this opportunity to speak to this group about another part of my day job, which is a member of the Federal Open Market Committee.

Today, I'd like to offer my take on the economic outlook, which is optimistic, and explain how I view my optimism as consistent with the continued gradual pace of policy tightening that many Committee participants have projected. In particular, I'll explain how my views on potential growth help shape my outlook, both for the economy and for the appropriate path of monetary

policy. Relatedly, I'll discuss the uncertainties that arise when a central element of the outlook – in this case, the potential capacity of the economy – is unknown and largely unobservable. Such uncertainty can complicate policymaking in even what appears to be a very healthy economy, providing a further argument for gradualism.

So, where are we now? In previous remarks on the economic outlook that I delivered at the National Association for Business Economics in February, I characterized the U.S. economy as being in a good spot and asked if the economy had reached a positive turning point following an extended period of post-crisis slow growth. I argued that while it might be too soon to call a turning point, there was a definite possibility of an upside surprise.

So now that we're fairly deep into 2018, where do we stand overall? My view has not changed all that much from February. While many other forecasters had to revise up their forecasts over the course of the year, my own outlook is basically unchanged, because the economy is evolving essentially as I expected at the outset of the year. We remain in a good spot. Gross domestic product increased a robust 3-1/4% in the first half of the year and indicators suggest continued strong growth throughout the summer. Economic conditions are as close to meeting the Federal Reserve's dual mandate for monetary policy – maximum sustainable employment and price stability – as they have been in a long time. Inflation is in line with the Committee's 2% objective, and the unemployment rate is at nearly a 50-year low.

Now, how long can this strong growth be sustained? Well, obviously the answer depends largely on what form growth takes. Growth that's supported by increases in the productive capacity of the economy should be durable. On the other hand, if growth primarily reflects demand that stretches production beyond its sustainable capacity, the economy will run into constraints that will result in slower growth, higher prices, or a potentially destabilizing buildup of financial imbalances. So, which is it? Well, it's hard to tell. So, I'll come back to that question shortly.

But fundamentally, I see many reasons to be optimistic about the growth of the potential capacity of the economy over the next few years. In part, my optimism is rooted in the view that many of the factors that have been weighing down potential growth since the financial crisis could be lifting. Have we reached the turning point? While that issue is still unresolved, the recent evidence is encouraging.

Why am I optimistic about the economy's supply potential ? The growth of potential can, at the most basic level, be broken down into two factors: the supply of labor and the productivity of labor. Productivity, in turn, is importantly affected by changes in the stock of capital – that is, machines and factories – as well as technological advances and improved production methods. I see reasons to be hopeful about both of these factors.

So, let's start with labor. For some time, the contribution of the labor force to potential growth has been held down by the predictable drag of baby boomers moving into retirement. But the

decline in labor force participation following the financial crisis exceeded even what might be expected given this long-standing downward trend – in particular, as the participation of prime-age workers, those between the ages of 25 and 54, fell and teenagers exited the workforce in droves. The reasons behind the fall in participation among non-retirement age workers have been the subject of much debate. But fundamentally, I see little reason to assume that this will be permanent, and we've already seen some signs of a turnaround. So I think there's potential for labor force participation to move up, perhaps as workers respond to the incentives of plentiful job opportunities, higher wages, and thereby adding to the productive capacity of the economy and pushing back on the constraints on growth.

Some recent labor force trends have been promising. For example, the two-decade long trend increase in the population that's not in the labor force on account of disability peaked in 2014 and has started to move down again quite rapidly – again, for reasons that defy easy explanation but may reflect the general improvement in labor market opportunities.

So, now let's turn to productivity. Labor productivity has averaged an annual growth rate of only 3/4 of a percent since 2011, far below the 2-1/4% pace that prevailed in the two decades before the financial crisis. Although there are competing theories, the productivity decline isn't well understood, and a consensus explanation has yet to emerge. As a consequence, since we don't really understand what's caused it, the slowdown could reverse unpredictably as well. The most recent data have been moving in the right direction, although only haltingly, with labor

productivity increasing about 1-1/4% over the past year.

But there are reasons that productivity growth could shake off some of its recent torpidity. I'd like to start with the capital stock. After a few years of abysmal business sector investment spending, it appears as though the drought has broken. After picking up in 2017, business fixed investment climbed a robust 10% at an annual rate in the first half of this year, likely supported by lower corporate tax rates and other incentives in last year's tax bill. Also, indicators for investment, including orders and shipments of non-defense capital goods, point toward continued strength, and survey evidence points to high business optimism and solid capital expenditure plans. More capital should allow labor to be more productive.

I'm also a bit of a techno-enthusiast. We are in the early stages of a more widespread application of a wave of new technologies, such as 5G communications, artificial intelligence and machine learning, 3-D printing. It might be that the productivity gains associated with these and other new technologies are embodied in new capital equipment and will only now start to become apparent as the investment drought of recent years comes to an end. A tighter economy could also create incentives for firms to revamp their production methods to save on scarce labor resources.

So, to summarize, the economy has been doing very well. Whether this performance is sustained will be importantly determined by whether growth is supported by increases in the economy's potential. I am hopeful that potential growth, and particularly productivity, could accelerate from

its relatively anemic pace of late, sustaining growth without overheating the economy. The more the economy's potential growth increases, the more gradual we can be in our removal of monetary policy accommodation. Thus, an assessment of the pace of potential growth will be an important input into what I view as the appropriate path of policy to achieve our objectives of maximum sustainable employment and price stability.

Now, the tricky thing, as I mentioned earlier, is that potential output is unobserved and can only be inferred from the behavior of other measured economic indicators. Traditionally, as taught in Econ 101, inflation provides a signal on whether the economy is operating above or below its potential level. If inflation moves up in a sustained manner, not just because of temporary shocks, then the economy is likely operating above its productive capacity, as firms have the leeway to raise prices given the strength of demand. Likewise, if inflation moves down persistently, then the economy is likely operating with some slack, as firms restrain prices to sell their products in the face of weak demand.

But, if inflation is the primary indicator of the economy's position relative to its potential, how confident can we be in the quality of the signal? It's been noted – quite frequently, I might add – that the relationship between inflation and the tightness of the economy has gotten weaker, which is to say that inflation appears to be less affected by movements in economic slack or tightness, traditionally measured by the unemployment rate, than in the past. As the role of slack in explaining inflation has diminished, inflation expectations have assumed greater importance.

But it's reasonable to ask, if inflation is, in fact, now largely a reflection of inflation expectations, is current inflation still a good indicator of the cyclical state of the economy? Or, more directly, can we count on the current inflation rate to warn us in time if the economy is overheating?

To be a little controversial – well, controversial in a very nerdy sort of way – perhaps what we're witnessing with inflation is an application of what has been called Goodhart's law, after Charles Goodhart, the distinguished scholar of central banking at the London School of Economics. The law can be summarized as the idea that if an indicator becomes a target of policy, that indicator loses its value as a gauge of the state of the economy. Rather, the indicator becomes a signal of the public's belief in the competence and commitment of the government agency that's targeting the indicator.

Something along these lines could be happening to inflation, especially given the important role of expected inflation in the behavior of actual inflation. Perhaps inflation is just sending a signal of people's trust in the Fed's ability to meet its inflation objective. Well, if so, no complaints from me. That's a good thing. But a problem does arise if the Fed remains reliant on inflation as our only gauge of the economy's position relative to its potential. There are risks in pushing the economy into a place it doesn't want to go if we limit ourselves to navigating by what may be a faulty indicator. Anchored inflation expectations might mask the inflation signal coming from an overheated economy for a period, but I have no doubt that prices would eventually move up in

response to resource constraints. The ultimate price, from the perspective of our dual mandate, would be an un-anchoring of inflation expectations.

Of course, I view this more as a risk than a baseline expectation. As I've said, I am optimistic about our potential growth. I expect that even relatively strong growth can be met without running into economic constraints. But I also think we should pay attention to other indicators of tightness and overheating in addition to inflation. There are other signs of potential besides inflation, including, but not limited to, direct measures of labor utilization or indications of shortages and bottlenecks in production.

Now, how should these thoughts affect monetary policy? I began my remarks by noting that there may be reason to think that the productive capacity of our economy could be accelerating, which would allow a more gradual withdrawal of accommodation without overheating. But I have noted as well that there may be reason to think that resource constraints could be more binding than current inflation measures would traditionally indicate, which would call for a more athletic response.

Moreover, there is today a higher degree of uncertainty about many of these factors – measures of labor slack, the relation between labor slack and inflation, the sensitivity of current inflation measures to actual resource constraints, and the future growth of productivity – to name a few, than there has been for many years. In such an environment, some have argued that this greater

uncertainly leaves policymakers without a clear guide and market participants without a firm anchor, meaning policy itself could drift – perhaps dangerously.

I don't think that's the case at all. Instead, I think this situation reinforces and supports the importance of a clear, steady strategy and a gradual, predictable approach to the removal of accommodation, as we continue to monitor the data. The analogy I frequently use – President Williams is here and he will now grimace – is the old pilot's adage of "don't chase the needles." Now, what does that mean? The control panel of an airplane – as all of you who are pilots know – has an instrument to guide your course: a circular gauge with a vertical bar that runs through it, or a needle right through the center of it. If the bar moves sideways to the left, you're drifting off course and should change course to the left until the bar comes back into the center. If it moves to the right, you change course to the right. Today, these instruments get their input from the plane's GPS system. They're fairly sensitive and accurate. But decades ago, , when I was a young man first learning to fly in the clouds, they got their information from radio beacons that were stationed on the ground and they were very squirrelly. The bar could wander from side to side for a while for any of a number of reasons – your distance from the beacon, the angle you were approaching it from, interference from other instruments on the panel, sunspots, rain – and because of this uncertainty, the first rule that we were taught as young pilots was don't chase the needle.

Precisely because of the uncertainty around the course inputs, the right strategy was to set a

course based on your knowledge of the destination, winds, and performance of your plane, communicate that course clearly to air traffic control so everyone knew what you were doing, and then stick to that course steadily even as the course needle might waver from side to side across your instrument. If the needle moved to one side substantially and stayed there pretty consistently, then you would make a small, firm correction – but even then, only gradually and with clear communication about what you were doing. In a world where you had great confidence in the sensitivity of your instrument, such as in today's GPS-based avionics, you could respond immediately to moment-to-moment changes in your course readings, but in the world of radio beacons and sunspots, chasing the needles would at best lead to inefficient fishtailing across the sky, and at worst to a substantial deviation from your destination.

Today, uncertainty around many of the macroeconomic inputs to monetary policy decisions argues for just the same approach to navigation. Rather than meaning that policy will drift because of this uncertainty, it means that policymakers should chart a course that is stable, gradual, and predictable, communicate it clearly, and then follow that course through the temporarily shifting and sometimes conflicting signs from the economy unless some strong and steady signal requires a firm but moderate correction.

Given that the economy has performed fundamentally as I expected at the outset of this year, in my view the right strategy is to maintain the gradual course that I have thought appropriate for some time now. Put another way, while I think that there is enough – while I believe that there is

enough reason to think that the productive capacity of our economy might be increasing so that we should not feel compelled to accelerate our pace, I also believe that there is enough doubt about current inflation as an infallibly reliable measure of current resource constraints that the continued gradual removal of accommodation is appropriate. Like pilots back in the days of radio beacons, we should not chase the needles. Thank you very much for that opportunity. I'm looking forward to now talking with Greg. (Applause)

President Barbara Van Allen: Thank you, Randy, for those insights. We'll now move to the question and answer portion of the program. And I'd like to introduce our interviewer, Greg Ip, who is one of the country's best-known economic journalists. He's currently Chief Economics Commentator of *The Wall Street Journal* and writes about U.S. and global economic developments and policy each week in the Capital Account column and on Real Time Economics, *The Wall Street Journal's* economic blog. He regularly appears on radio and television, including NPR and the PBS News Hour and on CNBC. Gentlemen, let the conversation begin.

Conversation with Randal K. Quarles

Vice Chairman for Supervision

Federal Reserve System

GREG IP: Thanks very much Barbara. And thank you, Randy, for being here today. You know

Harry Truman used to complain about two-handed economists who were basically simultaneously optimistic and pessimistic, so I'm glad to see that you are admirably one-handedly optimistic in your speech today. But I want to press you a little bit on specifically how optimistic you are. So, the median projection for your colleagues on the Federal Open Market Committee is a long-run growth about 1.8%. That's historically slow. It's also similar to what the Congressional Budget Office and the private sector thinks. Is that number too low in your view?

RANDAL K. QUARLES: I think that, my base case is that our long-term growth potential will be higher than that. I'm not going to specify it to the decimal point because I think that's very difficult to do. But I do think that we are, that the next wave of technology that is rolled out will be different than the last wave of technology, that the platforms, the Facebooks and the What's Apps of the world have definitely created value. But I think that the potential for something like 5G communication, 3-D printing, the new Quantum computing chips, all of this that we could expect to see roll out over the course of the next decade, will be much more significant for increasing our productive capacity.

GREG IP: So if you think the number is more likely to be, growth is likely to be better than the consensus thinks rather than worse, how do you, as a policymaker, build that into the actual decisions you make. Monetary policy works with legs and potential growth is a very slow-moving thing and it takes a lot of data to know whether it's moved up. How do you decide today whether that, you said in your speech, I think, that if potential is better that gives you more room

to be gradual in normalizing policy, and so I would presume you would err on the side of a more gradual path. But how do you decide today whether such an approach is merited given that you may not know for years and by the time you find out, it may be too late if you've made a mistake?

RANDAL K. QUARLES: So, that's why I think you've got to weigh the risks against each other. So, by the same token, I talked in the second part of my speech around the uncertainty as to whether inflation is currently an infallibly reliable indicator of resource constraints. We could, in fact, have an economy that is more constrained than our spot measures of inflation would indicate. And so you need to chart a course that is between those two possibilities because there is uncertainty around both of them.

GREG IP: But if it turns out that you're right that we can do better, would that basically argue in favor of a more gradual path?

RANDAL K. QUARLES: Absolutely. Absolutely. And my preferred path for policy is more gradual than I think many other people's because of my optimistic assessment of the growth potential in the economy.

GREG IP: If you think potential is better, does that change your endpoint? There's a lot of economic models that suggest that the higher the economy's long-run growth, the higher the

equilibrium interest rate that it can sustain. Do you see a higher terminal rate for interest rates?

RANDAL K. QUARLES: I think that over time that you could see, you can see that. If you assume that the potential of the economy is increasing, then that would argue for that but over a longer period of time. As you say, that takes a long time to roll out.

GREG IP: So you can imagine a scenario where the path is more gradual but the endpoint is further away?

RANDAL K. QUARLES: You could imagine that. I wouldn't commit to that.

GREG IP: Sure. So, you've made a compelling case, put together a number of elements why potential growth could do quite well. Now, the economy did grow 3% in the last year. That's a very good rate. Do you think that's sustainable over the long run?

RANDAL K. QUARLES: The U.S. has gone through significant periods in its history where it has grown at 3%, so I do think that that is potentially a sustainable rate, yes.

GREG IP: Still, in the last year, not only did we have 3% growth – and I'm just using estimates, by the way, of the third quarter – we also had the unemployment rate drop by ½ a percentage point. Now if you use, like an old rule of thumb like Okun's law, that suggests that we're using

up slack in order to do that. So 3% probably overstates the long-run growth rate, you know, that would point to potential of around 2%. So the question is, it strikes me that combination is not sustainable. If we keep growing at 3% and we keep dropping the unemployment rate at that rate – you know, eight years ago it was negative – it's already at a 49-year low. It's lower than most of the estimates that you and your colleagues have put out there of the long-run natural rate of unemployment. So what do you do about that? Doesn't this suggest that at some point the Federal Reserve must act to stop unemployment from going further to avoid overheating?

RANDAL K. QUARLES: So I think there are a few interesting things about that, about various measures of labor slack. So, let's take the unemployment rate first before we turn to the labor force participation rate. I think there's a significant reason to have questions around whether the traditional level at which one has set the natural rate of unemployment, whether those still obtain. We have had – even over the course of the last 20 years, for example – a significant evolution in the sort of educational composition of the workforce. If you had, you know, if you had asked me maybe five years ago to describe changes in the educational composition of the U.S. workforce, I would have said, well, GI bill, after World War II, lots more people got a college education, but that process was probably largely finished by the 70s at the time that I was in high school. When I was in high school, most people I knew, most adults that I knew had college educations. So that probably was the period when it happened. It was not really the case at all. I mean in 1960 when I was learning to ride a bike, most workers in the United States had not even graduated from high school. The majority of U.S. workers had not graduated from high

school. This evolution has continued through our lifetimes, and even over the course of the last 20 years, there's been a material increase in the percentage of the U.S. population that has a college education. Why is that significant for this point? Well, traditionally the natural unemployment rate for college-educated workers is much lower than for workers overall. It's in the 2-percentage point range. And so you would expect that the natural rate of unemployment for the U.S. workforce would shrink, would lower as the educational composition increases. And that process has been ongoing, a significant portion of it masked by the financial crisis even as there has been a continuing increase in the percentage of the U.S. population that has graduated from college. So, that's just one reason why I think that there is significant, I have significant doubt – not that I'm saying that it is, I'm certain that it's wrong – but there is significant doubt around the traditional level at which we have set the non-inflationary rate of unemployment. In addition to that, you have the fact that we have very low labor force participation rate in this country, particularly among prime-age workers, but we've seen that begin to turn around. There is significant room for us to satisfy some of the demand for labor in the economy, from bringing people back into the workforce who weren't even being counted in the unemployment rate. And we've seen evidence that that is beginning to happen. The long-term trend downward in the labor force participation rate that was being driven by the retiring of the baby boomers has leveled out, notwithstanding that you still have baby boomers retiring. That can only be because we are pulling people back into the workforce for a variety of reasons we don't understand. Some of them are probably policy incentives. Some of them are probably the pure strength of the economy. Some of them may be progress in the opioid crisis. I mean we don't fully understand

why that is, but for both of those reasons, both questions as to whether the 4-1/2% which is where the average of the Federal Open Market Committee's assessment of the natural rate of unemployment are, plus what's happening with the return from workers in the labor force participation rate, I think that there are reasons to question whether the current unemployment rate would argue for increasing the rate of policy.

GREG IP: So obviously that brings me to my next question, which is if you look at the projections of your colleagues, most of them see the unemployment rate actually slipping further from the current level and remaining below their estimates of the natural rate of unemployment for a number of years. Now, typically that requires a restrictive stance of policy to bring it back to sort of a safe, non-inflationary level. What's your review? Do you think policy likely will have to be restrictive at some point?

RANDAL K. QUARLES: Well, so at one level that's a bit of a metaphysical question because it depends, whether a policy is restrictive depends on what you think is happening to potential and potential is unobserved, right? Now, given my view, which I've expressed today, because I'm optimistic about the potential of the economy, I do think that we'll be able to follow a gradually increasing path for a period of time without actually moving into restrictive territory. But, you know, what the practical implications of that are as to are we restrictive, are we not restrictive, that's mostly a function again of one's optimism about the potential of the economy.

GREG IP: Interesting. Let's talk a little bit about the other part of your job, the regulatory side. Now, we've talked somewhat about your responsibility as a monetary policymaker to keep the economy from either slipping back or overheating. What about on the regulatory side? Now, Congress gave you a tool called the countercyclical buffer, which basically says if you're worried about the economy or the financial system overheating, you can raise this capital buffer. And some of your colleagues have already actually said now is the time to act. The economy is looking pretty good, on the verge of overheating. As the markets look buoyant, this is the time to activate the countercyclical buffer. What's your view?

RANDAL K. QUARLES: So I think that's interesting. The international agreement around the countercyclical capital buffer was that this would be a financial stability tool, that the countercyclical capital buffer would be turned on – that is to say that there would be an addition to banks' capital requirements when financial stability risks were elevated. Now, at the Fed, we have a very comprehensive and unanimously agreed framework for evaluating financial stability risks. We review that at the board regularly. And currently we view the financial stability risks as moderate. They would not argue for turning on the countercyclical capital buffer given that framework, which again is quite methodical and unanimously agreed. Now, some of the calls for turning on the countercyclical capital buffer now seem to be more a reflection of where we are in the business cycle as opposed to financial stability risks.

GREG IP: Almost using it the way they use monetary policy.

RANDAL K. QUARLES: Almost using it the way that you would use monetary policy. The phrases such as, if not now, when? We're at this point in the business cycle, shouldn't we turn on the countercyclical capital buffer? That's not how our current framework works. That's not part of the internationally agreed approach. I mean there are interesting international examples, however. Britain seems to have evolved their use of the countercyclical capital buffer into more of a business cycle tool. They now say that they expect the countercyclical capital buffer to, in most cases, be on at, at least a moderate level so that they can turn it down in the event of a business downturn. They can do that, in part, because their standard required capital levels are lower than ours. That would be, you know, we have extremely high capital levels in this country. Our banks are very well capitalized. That's part of the strength of our system. But our banks are more highly capitalized than most other jurisdictions even with their countercyclical capital buffers on. So there wouldn't, we wouldn't really have the headroom without some costs in supporting economic growth to add an additional capital layer on top of this for business cycle reasons. You'd have to imagine a significant readjustment of the capital structure in which the countercyclical capital buffer would play a more continual role without further raising our capital levels, which has, you know, which creates systemic distortions if we were to do that. That's not currently contemplated. We're sticking with the, again, the internationally agreed use of this as a financial stability rather than a business cycle tool. And we have certainly gone through many business cycles in this country that have not raised financial stability concerns. And currently we do not see financial stability concerns as elevated and there's not a reason to turn on this, or at

least I should say, I do. I'm not going to speak for everyone who is involved. But that is our agreed framework and so I don't see a reason to turn on the countercyclical capital buffer.

GREG IP: That said, do you think that it might be, given that some of your colleagues, both on the board and among the Reserve Bank presidents who do not have a direct responsibility for this as a regulatory matter, given that they are beginning to sort of, like argue, that there are business cycle reasons why it might be a wise tool and a more surgical one than monetary policy, is that a conversation that you and your colleagues ought to be having? Would you support that conversation to revisit the purpose of the buffer?

RANDAL K. QUARLES: So, I think that's a, I think it would require – as I said – you'd have to, that would be a significant rethinking of our overall capital framework. Because we have turned the dials in our capital system up to the highest level in general, whenever there's a choice given the international framework, and because the capital levels in our banks are basically the highest in the world, that is a source of strength but it also means that turning on the countercyclical capital buffer, we're clearly in a region of capital in the system where additions to capital would come at a cost in the ability of the system to provide credit. So I think you'd have to think very carefully about that. I'm always willing to listen to intelligent cases that are made, but those are the factors that I think that would be relevant.

GREG IP: Speaking to listening, as a Federal Reserve official, you get to listen to lots of

unsolicited advice on how to do your job. One of the people offering that advice lives in the White House. President Trump recently described the Fed as crazy, loco, and out of control for raising interest rates amid a low inflation environment. Now, I've covered four different Fed chairmen, and crazy, loco, and out of control are not in the Top 10 adjectives I would use to describe any of them. That said, how do these comments affect how you do your job, if at all?

RANDAL K. QUARLES: (Laughter) Well, we've stayed pretty focused on the facts about the economy. It is, it is not unprecedented for a president to have views about Federal Reserve policy. While some recent presidents have not commented, over the course of the Republic and over the course of the life of the Fed, most presidents have, in fact, commented on Federal Reserve policy. And the job of the Fed is to remain focused on the facts of the economy and to be independent from the administration. The Fed is set up to do that and there has not been any effort to undermine that independence. So we're focused on just doing our jobs.

GREG IP: All else equal, did you like that previous custom of presidents not commenting on the Fed?

RANDAL K. QUARLES: I think we can do our jobs in any event.

GREG IP: So, I understand from...your wife's family, you're actually related to Marriner Eccles, who had a pretty important role in Fed independence back in the day when they were trying to

escape the Fed Treasury Accord. What do you draw from that episode, the importance of independence and how you go about your work?

RANDAL K. QUARLES: I mean for monetary policy to be independent of political considerations is, you know, I think history shows – and both our own history and the history of the world – shows that that's a very important policy factor. And certainly we will remain independent currently.

GREG IP: I would note that Marriner Eccles did lose his job as chairman but he stayed on as governor to make sure the right thing had to be done. So I'll just leave that out there for you and your other chairman, the Vice Chairman of the FOMC who is sitting right here, to keep in mind about what you might be called upon...you don't need to comment on that. So, let me finish off with a question, going back in history. In the last 200 years, we've never had a business expansion that lasted at least ten years, and yet by next year, this could be the first. But history tells us that even though economists claim business expansions don't die of old age, that they certainly become more susceptible to pre-existing conditions. And right now I look around, I see a Federal Reserve that's tightening monetary policy. I see an unemployment rate below 5%, before 4% indeed. And I see things like interest-sensitive sectors like housing is starting to weaken. And I can't help but notice all these things were precursors to recessions. Randy, is it different this time?

RANDAL K. QUARLES: I think that you, at any particular moment in evaluating the economy, you need to look at the state of the economy at that moment, as opposed to how long a particular expansion may have existed. And all the indicators currently are for a strong economy for a significant period into the future. If you were to identify, is there, you know, where is a source of current weakness, it would be hard to identify them. There are risks, as there are always risks around any economic projection, but this still remains quite a strong economy.

GREG IP: Well, you began on an optimistic note and you end on an optimistic note. Thank you very much, Randy. We appreciate it. (Applause)

RANDAL K. QUARLES: Thanks. (Applause)

PRESIDENT BARBARA VAN ALLEN: Thank you very much, Randy and Greg, for really a fascinating conversation. We hope you both enjoyed it as much as we did listening. As a reminder, our upcoming schedule continues tomorrow with a signature luncheon with Mark Carney, the Governor of the Bank of England. We do still have some tables available. On October 23, next week, we will have the Class of 2018 Fellows face off in a debate, which should be exciting, at Bloomberg. And on October 29, we have Charlie Cook here. He'll be interviewed by Bob Rubin, former Secretary of the Treasury, on the upcoming midterms and what we might look for in 2020. And on October 30, we'll have Margaret Keane, the CEO of Synchrony. Again, many thanks and enjoy your lunch.