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Mary C. Daly
President and Chief Executive Officer
Federal Reserve Bank of San Francisco

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Moderator: Lisa Abramowicz
Co-Host, Bloomberg Surveillance
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Introduction

President Barbara Van Allen

Good afternoon and welcome to the 727th meeting of The Economic Club of New York. I'm Barbara Van Allen, President and CEO of the Club. The Economic Club is known as the nation's most prominent forum for nonpartisan discussions on social, economic, and political issues. More than 1,000 prominent guests have appeared before the Club over the last century and our record for excellence continues obviously up to, including today.

I want to extend a warm welcome to students from NYU Stern School of Business, the Gabelli School of Business over at Fordham, and Mercy University, who are joining us virtually as well. We also have members of our largest-ever Class of Fellows, which is a diverse, rising, next-gen group of business thought leaders. And now we're into October, the application for this annual program for 2024 is available online to our members.

Today, I'm really honored to welcome back Mary Daly. Mary leads the Federal Reserve Bank of San Francisco, the largest and most diverse Federal Reserve district, home to one-fifth of the nation's population. In this role, she charters a vision of the bank as a premier public service organization dedicated to promoting an economy that works for all Americans and supporting the nation's financial and payment systems. She is at the forefront of the Federal Reserve System's price stability and full employment mandates as a member of the Federal Open Market Committee.

Mary assumed leadership of the Fed in San Francisco in 2018, starting as an economist specializing in labor market dynamics and economic inequality, and subsequently served in many roles, including EVP and Director of Research. Her research advances understanding of the Federal Reserve's maximum employment and inflation mandates, most notably through her studies of wage rigidity and natural rate of unemployment. Her work has also highlighted the overall economic benefits of reducing wage and employment gaps among different demographic groups.

Through her speeches and public commentary, she helps demystify key issues faced by monetary policymakers, including topics such as inflation dynamics, financial stability, and the relationship between monetary policy and inequality. She is a Research Associate at the IZA Institute of Labor Economics and has held visiting research positions at CBO, Cornell University's School of Public Policy, and multiple universities and research institutes throughout California.

She also has served on numerous advisory boards, including the CBO, the Social Security Administration, the Office of Rehabilitation Research and Training, the Institute of Medicine, the Library of Congress, Syracuse University's Maxwell School of Citizenship and Public Affairs, and the Center for First-Generation Student Success. She currently serves on the Urban Institute's Board of Trustees.

So the format today will start with opening remarks by Mary followed by a conversation, and we're honored to have Co-Host of Bloomberg Surveillance at Bloomberg TV, Lisa Abramowicz, as our moderator. Time permitting, we will have questions from the room, again time permitting. As a reminder, this conversation is on the record, and we do have quite a bit of media on the line and a fair amount in the room. So without further ado, I would like to welcome Mary. Please join me.

Opening Remarks by Mary C. Daly

Well, thank you for that very kind introduction, and thank you all for being here. It's terrific to be here once again and speaking to The Economic Club of New York. I was here last on a virtual screen, that was also enjoyable. This is much, much better. I tell my employees that every day. It's much better together. So thank you very much for the invitation back, and I look forward to a great discussion.

Now, before we get started, I would like to take a few minutes to describe how I see the current economic environment and the uncertainties and the tradeoffs that we face as we calibrate policy. The key takeaway for today, in my opening remarks, is that the moment we're in calls for optionality. We must keep our minds open so that we can respond as conditions evolve. Vigilance and agility are paramount to finishing the job. And in case you're wondering, the job, of course, is to restore price stability as gently as we can.

Now, the good news is, at this point, we have time to get it right. The economy and policy are in a much better place than they were just a year ago. Growth and inflation are gradually slowing and the risks to the outlook are largely balanced. Monetary policy is restrictive and financial conditions are tight. So, we don't have to rush to make any additional decisions.

But progress isn't victory, and we must remain resolute to finish the job. A gradual return to 2% is in our sights, but it is not yet in our grasp, and that is the final mile. But before I go further and explain more in detail what I mean, I'd like to say that the views I express today are my own and do not necessarily reflect those of my colleagues or anyone else within the Federal Reserve System.

So, I mentioned just a moment ago that the economy and policy are in a better place. And so let me begin by taking stock of where we have been and how far we have come. Now, as all of you will recall, in March of 2022 – just 18 months ago – the FOMC had a problem. Headline and core inflation had risen to multi-decade highs and were projected to keep increasing. Inflation expectations, especially at the short end, were close behind. And there were concerns that this could generate a more worrisome increase in medium- and longer-run expected inflation. So, the FOMC began to tighten policy rapidly.

Since that time, we have raised the federal funds rate by 525 basis points to its highest level in 22 years. And these cumulative increases have moved policy well into restrictive territory. Indeed, the real federal funds rate – the one that we actually think is the part that tightens the economy – the real funds rate, as measured by the nominal funds rate less one-year-ahead inflation expectation, exceeds almost all measures of its neutral value.

We are seeing the effects of this tightening on the economy. Headline and core inflation have both declined significantly, bringing us much closer to our 2% goal. As my contacts in the Twelfth District – as Barbara said, it's a fifth of the United States and it's all of the western states – they tell me that this decline in inflation, and I'm sure you're seeing this here, is having an immediate positive effect on households, businesses, and communities who have been struggling on a treadmill of constantly rising prices and falling purchasing power. That relief that these consumers, businesses, and communities are feeling in their wallets is translating directly into more positive views on their part about future inflation. And we see that dynamic play out in the aggregate measures of short-run inflation expectations, which have been falling almost one for one with declines in published inflation.

But perhaps most encouragingly, and I really want to underline this, is that the welcomed decline in inflation we've all been waiting for has come without significant deterioration in economic growth or the labor market. The economy and the labor market are slowing, but not severely or abruptly. These developments have led market participants, businesses, and households to replace fears of recession with hopes for a soft landing. And that's a sea change from earlier this year.

I see what I've just described as unequivocally good news. But to ensure that we fully achieve the outcomes we want – sustainable price stability and a healthy and balanced labor market, a durable healthy and balanced labor market, we need to finish the work. And so the question is, what will this require?

And there is where I want to put two words – vigilance and agility.

So let me start with vigilance. We need to be vigilant in assessing the odds that the good data we've been seeing is actually setting a new trend, rather than just being a temporary relief that will stall out or plateau too early, leaving us short of our goals. And either is possible. Either we can just simply extrapolate from what we've been seeing and say that more good news is on the way, or we could say that this is just a partial re-balancing and we might stall out and we'll be well above what we need to be ultimately.

Now, I've discussed in some detail the recent positive data and how you might think that should continue. But I want to also talk about why these developments might plateau. The key reason that these developments could plateau is that the economy still has considerable momentum and we're a long way from 2% on inflation and a long way from a sustainable pace on job growth. So those things both are saying that we still have a ways to go and they could stall out because we have so much momentum.

And I think headline data really tell the story. I know all of you in this room pour over the headline data as we do. And in the labor market, for instance, even with the recent slowing we've seen, and we're all awaiting the jobs report tomorrow, but even with the recent slowing we've seen in these last several months, job growth remains well above what is needed to keep pace with overall labor force growth. And other indicators point to ongoing strength in the labor market. Inflation is similar. While overall inflation has fallen, it continues to be almost 2 percentage points higher than our target on a 12-month basis.

Now, as I said, it's possible that all the slowing we see actually just predicts, it will translate, it predicts and will translate into a steady march towards our goals. That this is something, this is a start of good and we'll continue to see it as we work through the coming months. But in the case of inflation, I think there are real risks to this projection and ones we have to carefully study.

Many components of inflation are coming down just as we would expect. Those are goods, housing, those are coming down, and we expect them to continue to slow. But non-housing core services, often called supercore, has been relatively sticky and remains far above its pre-pandemic level. And this type of inflation, this supercore, often lags recovery in the other sectors, so there's not a reason to worry yet. But we will need to see some progress in this category to be fully confident that we are on the path back to price stability.

So, what does all of this mean for policy? And this is where agility comes in. We need to be positioned and prepared for however the economy evolves, and we need to have options. If we continue to see a cooling labor market and inflation heading back to our target, we can hold interest rates steady and let the effects of policy continue to work. And it's important to recognize, and I know most of you – not all of you know – that even if we hold rates steady exactly where they are today, policy is going to grow increasingly more restrictive as inflation and inflation expectations fall because the real rate will rise. So, holding rates steady, even no change, is an active policy action on the part of the

FOMC.

I would say similarly, just like if the labor market continues to cool and inflation continues to slow, if financial conditions, which have tightened considerably in the past 90 days, if they should remain tight, well, then the need for us to take further action is diminished. Because the financial markets are already moving in that direction and they've done the work, we don't need to do it more.

But in contrast, and this is where you have to be optionality-oriented, because in contrast, if the deceleration of growth and inflation stall, activity begins to reaccelerate, or financial conditions reverse some of this tightening and loosen too much, we can react to those data and raise rates further until we are confident that monetary policy is sufficiently restrictive to complete the job. So, all this boils down to say this: rather than a prejudged path of what policy will be, we need to keep an open mind and have optionality.

So let me conclude with this. When I travel around my District and across the nation – I do spend a lot of time doing outreach and engagement – I see the progress we've made in the past year. And that is really worth acknowledging. We've done a lot in a short time and the economy is in a better place. But as I said at the start, progress alone is not victory. And it will take vigilance and agility to complete the final mile Thank you, and I look forward to our conversation.

Conversation with Mary C. Daly

LISA ABRAMOWICZ: That was a fantastic summary, and we all heard one line, which was, we all heard the whole thing, but I think that there's a burning question. We've talked about how this is quite an interesting time for us to be having this conversation because we've seen an incredible sell-off in the bond market. And suddenly, on a longer-term basis it seems as if the market is realizing higher for longer is for real. You said in your speech that financial conditions have tightened considerably over the past 90 days and if they remain tight "the need for us to take further action is diminished." Does that mean all things being equal, if bond yields stay where they are, the Fed doesn't need to hike again?

MARY C. DALY: Again, I'm going to remind everybody my views are my own, and I don't speak for anyone on the Committee. But that's exactly how I think about it. So, just instead of that, let's go back to June SEP where, if you remember, or maybe you don't, I will remind, in the June Summary of Economic Projections, there were two more rate hikes projected for this year. Then in July, we took one of those rate hikes and another one in the September SEP was the median outlook.

But the bond market has tightened quite considerably, about 36 basis points since we met in September. Well, that is equivalent to about a rate hike, right? And so then the need to do tightening additionally is not there. So, from my own perspective, that's what I look at. My job, as I see it, our job as I see it is not to tighten, just do our part, it's to watch financial conditions. Because monetary policy works, we raise the funds rate and it moves through all the other interest rates. If financial conditions are sufficiently tight, our work is not necessary because we don't need to boost them more. Does that make sense?

LISA ABRAMOWICZ: Absolutely. And Rich Clarida said today that the rising yield actually does the Fed's job for it. Would you agree with that? Would you sympathize with that kind of sentiment?

MARY C. DALY: That is actually how it works, right? If financial conditions tighten, I mean one of the things that's happened in the last 90 days and certainly in the last few weeks is that financial markets have collectively seemed to take onboard a variety of things. But one of the things that I heard from many commentators in many of the market outreach I do is that they have a general understanding now that we are committed at the FOMC to keeping rates higher for longer in an effort to bring inflation fully back down to 2%.

And that recognition along with all the other factors we could put in that list about why bond yields have risen are affecting certainly the financial conditions and the tightening. And see that as a positive outcome that we would have tighter financial conditions because then we can really get the job done of putting inflation back to rest.

LISA ABRAMOWICZ: When is a sell-off something that's welcome from a perspective of finally the market is coming to terms with what the Fed has been saying? And when is it disorderly, disruptive on a level that causes concern?

MARY C. DALY: So, you always want an orderly repricing over a disorderly repricing. And so far what I see is this, and this is why we watch it so carefully. But here's how I'm seeing it is that what is happening is financial markets are actually trying to find their footing and the right price for things, and they've got to digest a lot of information. One is the supply and demand changes in the Treasury space, right? So supply is going up and demand is going down, especially from foreign buyers, so that is one factor to digest.

Another factor to digest is Fed policy and forward guidance in the SEP. A third factor to digest is this increasing conversation people are having about whether the real neutral rate of interest has actually risen. So we came into the pandemic with it at about .5, which means nominal neutral about 2.5. And when people say, oh, the neutral rate might have risen for a variety of factors, I'm hearing everything from maybe it's 5 to something that I would see more likely, which is between 2.5 and 3 for the nominal neutral. We don't know if it's risen. Frankly, I don't think anybody really knows, but certainly we should have those conversations. But then the markets try to price that in.

So all of those factors, and then there's just lots of uncertainty in the economy and geopolitical risk and our own fiscal risk. And so that's what markets do, they digest a lot of information and try to find their footing on it, and I think that's what we're seeing. But so far it hasn't spilled over into disorderly. So far, even today when the jobs claims came out and it was sort of, I don't know what to make of it, right? That's how the markets sort of read it. You didn't see things shaking up in a wild or disorderly fashion. So, so far, so good.

LISA ABRAMOWICZ: Your bond quote of the day, 4.70 on the 10-year, I just checked. So it seems like yields are coming in as we speak, to your point about it not being disorderly. Back in March, when there was this concern about the banking situation, yields were, at the low of March, were about 150 basis points lower than where they are now. Are you seeing the same type of financial distress today that you did back then, even on the peripheries? How do you rationalize why it hasn't materialized in the same kind of way?

MARY C. DALY: So, March was a unique situation, and we want to learn from that unique situation. But it was a unique situation in this way. We had a bank run, a very, you know, old-fashioned, but a true bank run where the bank's liquidity was completely squeezed and it went, it dissolved in a period that was very, it was short, a rapid period of dissolution. And then that spilled over to two other banks, and that was the extent.

Now, one of the things that I always remind people of is we have over 4,000 banks in the country and three failed. And other banks that even felt the stresses, and there were a large number that felt stresses because they were near-neighbors in sort of size and balance sheet distribution, composition, they felt stresses but they managed those stresses because, in part, they had been a little more effective at hedging their risks. And then the Fed, with the Treasury's support, came in with the BTFP, and that produced a lot of calmness in the water.

So, since that time banking stresses have really not been something that, when you ask people in the community or the business leaders what are the top of your worries, that is not something they list. They list inflation, uncertainty, etc. So I think one of the reasons that we are seeing this yield rising, not spilling back over, is that essentially we know what's going on in the banking sector. Investor letters have been published for months saying here's what this balance sheet looks like. Here's what this balance sheet looks like. So there's not a surprise.

And the second is because the banking system is safe, sound, and resilient, and we have remedies in place that solved parts of the crisis and the stresses. So I think we're coming in, it's the same thing when you have the rising yields, we're doing it against a strong economy. We're doing it against a strong, a solid banking system. So that just means that the ripple effects are not going to be tipping things over. The fragility is not there, right? It's a sound system. And then you have this, and so then you have it able to absorb the tension points.

LISA ABRAMOWICZ: One thing that there's been a huge debate around is the long and variable lags. And this really speaks to this question of all of a sudden if you think that 10-year yields are at 5% rather than 4% or 3.5%, that changes what implication there is into different business models. How much does it change the business model of commercial real estate owners, of different residential real estate owners, of some of the constituents who you speak to on a regular basis?

MARY C. DALY: So I'm going to separate – that's a terrific question, but I'm going to unpack it into two parts, if you don't mind – the long and variable lags and how are people reacting to that. And I just met with a variety of commercial real estate CEOs with national footprints on Monday so I could bring some of that to this conversation.

But let me start with the long and variable lags part. So definitely, there's always a debate. If you really want to get into a debate, get a PhD in economics and you'll spend a lot of time, if you're in macro, debating long and variable lags in monetary policy. So here's what we can all agree on. There are lags and they're variable. And then people even debate about long, how long are they? But I go with long and variable lags. And the question is we know that the Fed's communications to financial markets went quickly, and then the question is how long does it take to get through the economy?

I'm of the view that we're still seeing the effects of that. We saw it initially in housing. Then we started seeing it in investment. Now we're starting to see it in the labor market and inflation, etc. And so it's absolutely happening and we want to continue to watch that because with the risks more balanced on the economy, we could as easily, I think at this point, overcorrect than undercorrect. And that's why taking the time to do it right is sort of where I think we need to be.

Now, what I'm hearing in this rise in yields, they're less concerned about, they have been less concerned – at least my commercial real estate roundtable – less concerned about the lags in monetary policy as much as this. There is this time when the people were in, one person described it as sort of a, it's almost like a footrace, right? But it's not really, it's really just like a, I have to see if the Fed will cut rates before I have to refinance my properties. And so you're in a look-ahead and you're saying, well, if the Fed cuts rates like the market suggests they will – the market suggested six months ago

– early in 2024 or at least by the middle of 2024, then I can, by the time I refinance, I'm golden. But that equation changes if we're higher for longer, to get inflation down, or if the yields are just going to be higher. Well, then projects that penciled out at near zero interest rates, or something much lower, they don't pencil out at 5.

And so I think one of the things that we think a lot about is what's the switch point for commercial real estate? Because you really want that to be an orderly repricing, and so far it has been, rather than a disorderly one. But I think that's something, that's a risk worth watching is that these higher yields change the psychology of what's possible for people and they start making those adjustments immediately as opposed to in a timeline that goes with the refi schedule.

LISA ABRAMOWICZ: Just to build on that, this idea of 5% or 4.8% or 4.7% of long-term rates that's being increasingly priced into markets, how much does that imply a significantly greater degree of distress in some of these areas, like real estate, commercial real estate that rely on this idea of refinancing five, ten years down the line?

MARY C. DALY: You know, I think we have to, and this one of the things we're going to have to do just as a nation, is if we are in a higher interest rate environment in general, and I don't think we should jump to the conclusion that that's where we are. I think we should a have a conversation, the low interest rate environment, are we going to have a nominal neutral of 2.5 or is it going to be something higher? Are we going to be fighting inflation from above our target now for a persistent amount of time or is it going to go back to fighting it from below our target? We don't know the answers yet. So I think what is really important is commercial real estate owners and purchasers and things, they have to be willing to play the longer game, right? What's the longer game look like and how do I get to the longer game?

And I'm hearing this in the San Francisco CEO Roundtable. Now, again these folks have a national footprint, but I'll share what I learned is that, you know, they're already traunching their properties. If you've got really high-quality stuff, you're putting all your work in terms of leasing into that property. And there are deals to be had so people with income to use, they're buying those properties up because, you know, property ultimately, and buildings are valuable down the road.

If you have property that you think isn't just, in the world of higher interest rates and lower...(Audio Issue)...well, okay, I'm going to go back to the land value, and I'm going to not try to spend a lot of time leasing that property or wait it out because, and I think that's the repricing we're going to need to see. We are just going to need to digest some of those losses and position for the new world.

The yields going up, I think it's just, it doesn't change that dynamic. It just brings people's awareness sharply to the problem, right? You could have seen the problem coming, and I think many did, which is why I'm not, I don't have alarm bells ringing. Commercial real estate people, they just tell me this all the time, and I have learned to believe them, you really have to have a strong constitution to be in commercial real estate because it goes through cycles.

And the way the successful ones persist is they recognize that the down point isn't forever, nor is the high point. So they get used to it and they stockpile and they refi early. When they see interest rates going up, they were trying to put stuff into longer maturities so that they cannot have to refi at the higher interest rates right away. So I think that's going on but that is a sector to watch as all of us know. And this will be just another piece, the higher bond yields will be another piece that makes the scrutiny have to be more intense.

LISA ABRAMOWICZ: To connect that to the idea of financial distress, people talk about a Fed put. How high is the bar for the Fed put? How high is the bar for financial distress, for the Federal Reserve to come in and to cut rates and to take actions to add liquidity to the system? How much higher is the bar at a time where inflation is still running at the levels that it's running?

MARY C. DALY: I'm going to separate these two things. I think they get pushed together all the time in a way that I don't think about them, so I want to separate them. So there's monetary policy that's about the two goals that Congress gave us – full employment, price stability. And we raise and lower the funds rate to do those types, that work, and because it's, this all gets conflated more easily because we have a balance sheet policy. So we use the asset purchases for two functions – market dysfunction and quantitative easing, right? To put additional policy accommodation in when we hit the ZLB. So we have both. But they can't actually persist separately.

So let's take the BTFP. The BTFP didn't change monetary policy. We went in, we saw some stress in the banking sector, with the backstop from the Treasury, opened the BTFP facility, helped calm the banking stresses, and monetary policy went on. And I think that's the way you should think about it. So I unpack those things. I hear a lot about the Fed put and this. What I really would do is we have tools that can be used. And the tools we use for financial dislocation are different than the tools we use for monetary policy. And both can occur.

So we shouldn't have to give up our promise to the American people, our commitment to achieve our mandated goals and bring inflation back down and price stability because we have some dysfunction in the market. But I, right now, don't see dysfunction. What I see is prices have gone up for...prices have gone down; yields have gone up for bonds. The 10-year now and other rates look similar to what, you know, we might have penciled in, in the SEP, for how much we were going to hold rates higher for longer because of the inflation. And I think they'll respond as the data come in to, I think markets have a better sense now, although I can't be sure of this. I don't want to say things that I don't have certainty about. But it seems there's more of an understanding about the Fed's reaction function now.

And a big part of the reaction function understanding that seemed to be missing was that we want to get inflation down to 2%. And in our forecast, we don't see it coming down to 2% like that. And in order to keep it coming down to 2% we have to keep rates restrictive in order to bring the economy more into balance, the labor market into balance, and inflation down to 2%.

LISA ABRAMOWICZ: You talked about vigilance and you talked about agility. And with respect to agility, you wanted to be able to treat policy according to what you're seeing in markets. And one thing that people have been speculating, and I'm sure this is sort of one of these theoreticals that make you roll your eyes...

MARY C. DALY: I never roll my eyes.

LISA ABRAMOWICZ: I will say when people talk about what you said in your speech, which is that as inflation falls and as growth slows, that the policy rate, even by not moving, by keeping it steady, is a policy action. It is actually tightening policy. At that point, how agile should the Fed be to make adjustments to the rate so that the restrictive level is the same? That might be lowering rates but not because of financial distress, not because of some sort of recession, not because of weakness.

MARY C. DALY: So, that's a terrific question. And I would argue that we're now entering into the hardest phases of policymaking, right? The hardest part. So I think Phase I is the one we just completed, we completed it earlier this year. Rates are too low; inflation is too high. There's only one direction. North. So everybody can agree, nobody's confused. It's just a matter of how quickly can you get to restrictive territory without causing any concerning disruptions. So we've accomplished that, Phase 1. Phase 1 was the easy phase. You just have to communicate we're going that way; inflation will come down.

The biggest concern that I had during that Phase 1, well, I had two. How fast can we go without, you know, distressing things? And two, how will we communicate that we're doing that. Those were the two things I was worried about. How fast can we go? And how can we communicate that so that we don't lose credibility? Because I was worried about the inflation expectations. So that's down.

Phase 2 is fine-tuning where we maintain the peak rate. And then Phase 3 is trying to bring it down to 2%. And so right now, the way it's penciled in, in the SEP, if the inflation forecast holds and the inflation forecast you see more generally, policy is growing more restrictive. So you might ask, well, why? Well, I think it's because it's challenging to get that supercore inflation down. We've got the easy ones behind us, right? Goods inflation has already come down a lot. Housing inflation is in train. We have to keep watching it. But that supercore is going to need persistent work.

But if we saw, and the labor market is strong, we're doing this against a very strong labor market. We'll see tomorrow if that persists, but so far pretty strong, solid labor market, good consumer spending, good GDP growth. I mean there's nothing about the economy that's faltering. But if that should change, well, then of course we could adjust rates so that we keep the level of restriction right for the economy we have. I don't really want to try to tell you what that's going to be because honestly that's what the whole speech is about. We have to tolerate our uncertainty of not knowing what it's going to do next year, but to know what elements we have and how will we react to whatever situation unfolds. Ultimately, humans hate this, and markets hate it more. Nobody likes uncertainty. They want to know; we all want to know exactly what's going to happen.

But I think right now projecting too confidently what will happen is actually a policy mistake because then you end up with surprising people and things. So I think it's really important that we stick to conveying our reaction function, conveying how we trade off and balance things, how we approach the uncertainties. And then as we get more information, as everybody does, then we'll, of course, see what to do next.

LISA ABRAMOWICZ: With respect to the actual economy and what's going on and what you see going on there, you talk about the labor market and how strong the labor market is. And I know you've done an incredible amount of research in economic inequality and the worker and the labor market. Through that lens, how do you view some of the labor strikes? What's going on in Detroit? What's going on with respect to the Kaiser Health Systems? What's going on with just the Hollywood strikes, which are sort of resolved, but maybe not.

MARY C. DALY: So I think, you know, the picture of the labor market is broader than just the strikes. I think the strikes get a lot of, because they're big labor actions, but in general we've seen a re-balancing of the labor relationships with firms. That is a very common occurrence in an extremely tight labor market, right? The demand for workers has outstripped supply of workers. That means that workers would have more power to say I want to live here, do this, have this other thing. So workers who aren't in unions and don't have regularly scheduled negotiated contracts, well, they can make those adjustments more continuously.

So a lot, I'm sure you've experienced this too, but if you were an employer in '22, and even late ‘21, you really saw wage demands rise, special circumstances. I want to live here and work there, and I don’t want to come back to the office. A lot of changes in how workers were relating to their employers. And there was also a relative demand shock for low wage workers that, you know, moved restaurant workers and hotel workers to delivery drivers and other things. So that whole work situation was changed.

I see the labor actions that have been taken recently, as they’re on regularly negotiated contract schedules, and those schedules came up, and they said, well, we’ve got to, a lot has changed since we negotiated the last contract. Pandemic, wage rates have risen. We have not been in continuous negotiations with you and we want to get in a better negotiation with you to ensure that we have some shared responsibility for the rapidly rising inflation and rapidly rising changes in the contours of the labor market.

So to answer your question, I think this is completely predictable given the imbalance we’ve had between demand and supply for workers. And there are going to be some renegotiations either in continuous space, like we have been seeing, or when contracts come up for negotiation, you have to renegotiate the terms of employment.

LISA ABRAMOWICZ: What’s the difference between renegotiating the terms of your employment and a wage-price spiral?

MARY C. DALY: Oh, that's a huge difference. So let me, I love that kind of question. Fantastic. Okay, so labor renegotiations are, I'm looking at, you know, what I've had to deal with as an employee. A lot of it is I've got this wage and inflation is going up so my real wage is falling. That's something that was commonly happening in '22 in the United States. Real wages were falling for many, many groups of workers, many tiers of wages. And that's something people, workers recognized. They recognized when their real wages are falling. They're losing purchasing power. They're falling behind even though they're earning. So that is what a labor negotiation is. It also could be, like in healthcare and things, hours worked, terms of trade, you know, schedules, etc.

A wage-price spiral is that people get wage growth and then producers, I mean, you know, firms selling pass that along to consumers. That causes inflation to go up. And then they see that inflation and they ask for wage growth. And you see this high correlation. A fact that's worth looking at, it's a very cool plot because it tells you why we're not in a wage-price spiral right now, is prior to '85, the correlation between wage growth and price growth was like .85. That broke down after the Volcker disinflation and it really is now like .25, .3, etc. So you don't have that one-for-one pass-through of wages to prices, prices to wages. It just doesn't work that way. And even now you see wage growth moderating.

And I also look at short-run inflation expectations. Short-run inflation expectations are coming down. As they come down, research out of the San Francisco Fed has shown, and others have confirmed this, that short-run inflation expectations are what people are using when they go in to negotiate wages. And so as those come down, you get release of wage pressure. So the worries about wage-price spiral, you know, people were worried about it in '22 and really we took that very seriously. We asked how that was going. At this point, those have really abated. And now we're really at a point about getting the wage growth rate to be balanced in the economy, bringing the labor market into balance, you know, we need about 100,000 jobs per month to keep pace with the labor force growth. At the last call, we were at 150,000.

So tomorrow's labor market report will tell us whether we've made more progress on that space or just sort of in the same place we've been in. But that's how it's different. They're completely different. One keeps me up at night. One is just a natural part of an economy.

LISA ABRAMOWICZ: So I love that when we were speaking ahead of this, we were talking about anecdotal data. And I said, you know, I love that you study the sociology of markets and anecdotes are really important. And you said, I don't view them as anecdotes, they're qualitative data.

MARY C. DALY: I think I said it that way.

LISA ABRAMOWICZ: You did, and you corrected me. You said absolutely not. I wouldn't call it anecdotes. It is qualitative data. What is the qualitative data or the anecdotes that...

MARY C. DALY: Here's why I don't call them anecdotes, because anecdotes are like I talked to Bob in the grocery store and now I know everything. You know, people trade anecdotes all the time because they heard one person, two people, four people at a party say it. At the Fed, the regional Fed presidents in particular, I think it's one of the big benefits of having a regional Fed. When the folks who set this up set it up, I think they thought this would happen, and it does happen. The regional Fed presidents and the entire regional Fed teams, we're in our districts collecting qualitative information by talking to many people like you, having roundtables, etc. but then we write it up.

And so the difference in an anecdote and qualitative information is we quantify the qualitative information. If one person says it, it does not mean it's the thing we should take on as fact, but if 50 people say the same thing, well, that's an early warning sign or some flavor that helps us flush out what the aggregate data are telling us. And what the qualitative data are telling me – there's many things, but I'll tell you a few. So at the beginning of this year, I'd say most of my conversations, when I asked them what's your biggest concern, they said recession. Then it switched to stagflation. They thought we were going to have high inflation forever, or just slow growth, like we did before the pandemic.

And now I say what's your biggest worry, and this is really remarkable. They say, well, I'm really worried about generative AI and how it changes my business in ten years. I'm really worried we're not educating our population enough to keep pace with the jobs we are creating. So why am I focusing on those? Because those are longer-term concerns, which means the anxiety they have about their short-term business has gone down and it's being replaced with the things that really should keep business leaders up at night. How is this going to transform my business? Do I have the workforce I need, not today, but five years from now, ten years from now? What do I need to do in my communities to ensure that we're durable? So that has been a sea change.

And then when you drill down, like with commercial real estate leaders, of course, they're thinking hard about, okay, I've got this property, what's the future? But their attitude was really interesting, across the board, it doesn't matter what position they're holding. They say there are going to be losses, but there are going to be opportunities. And what I'm trying to do in my business, when I went around to each of them, is say I'm trying to minimize the losses and maximize my ability to see and take the opportunities.

So I see that as a positive change in the environment we're in, and it's why, you know, I said in the speech that the recession fears are being replaced by soft landing. Soft landing is, just in their description, something that happens that doesn't break the economy and bring all their attention to how do I manage through a significant downturn. And I am not seeing that in there, when I take the temperature on that. I'm seeing instead they're talking about these longer-term issues that they're grappling with.

LISA ABRAMOWICZ: Does that mean that they're hoarding labor, reluctant to cut jobs? Because they do have this expectation that even if there is some sort of slowdown, there is going to be a brighter future ahead with not as many qualified employees available to do the jobs that need to get done.

MARY C. DALY: So I have the benefit of having done this work for a while. I was at the Fed long before I became the President, and I've been a labor economist my whole career. So I would like to broaden that part out just a tad. So, it is very common when employers go through big shocks that that carries over into their behavior. So let's go to the fact that in the Financial Crisis, employers had to cut nominal wages. They hate cutting nominal wages because it demoralizes employees, etc. So that had a long tail. They had to fire a lot of workers, they had to let go.

And, you know, for a lot of employers, if you're not the very largest employers in our country, you're letting go of people, you know each and every member of your team, and you had to let those workers go. And then you had to cut nominal wages. It's extremely painful. So then they hired extraordinarily slowly and kept working people overtime and other things just so they didn't have to be in a situation where they would have to let go of workers should another shock come.

So now what I'm seeing is the opposite of this. In the pandemic, people lost workers because they were afraid to come to work or they just, they decided to take early retirement, or they moved away. And so now employers are like, oh gosh, I'd better keep people. So I think we have to put a certain amount of this behavior we're seeing to that.

But the other part is, and this another benefit of doing this for a while, I think, another part is that the way it works in most cycles is that the very first thing that happens is hiring slows. The second thing that happens is layoffs occur. You don't have a lot of firms laying people off before they slowed their hiring. So when I'm looking at metrics for what I think is happening to the labor market, I'm looking at hiring statistics, job filling rates. You might have postings out there, but you're not filling. And what I'm seeing is a general slowdown, but not a cliff.

But, you know, obviously if there was a significant downturn, then businesses have to resize. But we're not seeing that yet. Even the layoffs we've seen have come in the tech sector where they got a little bit ahead of themselves on growth and then how to re-balance their workforce to meet the actual growth they were going to have. So I don't see anything out there that is ringing an alarm bell about the workforce.

And people say labor hoarding, I kind of think of it as we're just always fighting the last war. And you fight the last war of, we had to lay off a lot of people, you don't want anybody new. You fight the last war of, oh, my gosh, I lost a lot of people, you hang on tight. We're also in a very tight labor market from the employers' perspective. You know, it's loosening, but from an employers' perspective, they still have to spend a lot of their time finding workers to replace workers who leave, or if they want to open a new slot. That's expensive. So they definitely want to hang on to as many people as possible.

LISA ABRAMOWICZ: I have to open it up to questions in a second, but I do want to just ask you this before I do that. What do you think right now is the biggest misconception about the Fed and how they're operating policy?

MARY C. DALY: Well, I don't know if it's the biggest misconception. I would love to hear what you all think the biggest conception is so that I can, you know, tell you whether it's an actual misconception or true. But I think one thing that I've seen people say is, and it's just interesting, so we always have vigorous debates. I mean that's what you should expect from us, that we vigorously debate and discuss, people are bringing, we all come from different backgrounds. We use different lenses. We have different information. We talk to different people. We have different research teams. So, of course, we're all bringing it in, but we're all working towards the same goal, which is what's the best policy we can make today that will serve the goals of achieving price stability and full employment? That's what we're doing.

When we were in the pandemic, if you look at the dot plots and things, it looked like there was a ton of agreement. Well, of course, there's a ton of agreement. The only thing we could do was lend support to the economy. When inflation is 7%, there's a ton of agreement about what we should do with rates. Not surprisingly. Inflation is way off our goal, we have to raise rates. Now we're going to start to see a little more dispersion in the dots, but that is not because we suddenly started debating and suddenly started disagreeing with one another. It's because the situations around us changed.

And we always debate and discuss and things like that, but now the policy projections changed because people have a different projection about how they see the economy unfolding. And yet we all come together eight times a year and make a policy decision. And I see that as the real strength of the FOMC. It's one of the reasons I've worked at the Fed as long as I have, is because when you close that door to the meeting, there's no politics. There's no ego. There's just, let's try to figure out what we're going to do that's best for the American people and how do we do this well, and how do we stay vigilant and agile?

LISA ABRAMOWICZ: Mary Daly, thank you so much. I'm now going to open it up to questions. I believe there will be someone going around with a microphone.

QUESTION: Thank you so much. Constance Hunter at MacroPolicy Perspectives. So, Mary, you talked about supercore. And in August, PCE supercore was up about 0.144%. If we continue with this pace, by the time we get to March, it's going to go from about 3.7% three-month annualized to let's call it 2.2, 2.3. If we get there and we're at 2.3% annualized on supercore, what would stop the Fed from raising rates, or lowering rates rather at that point?

MARY C. DALY: So one thing that, you know, we'll have if we keep on the pace of that coming down, so, you know, we waited and waited and waited for goods to come down, and now they finally have. We waited and waited and waited for shelter prices to come down and now they have. And we have waited and waited and waited for supercore to come down and now it is, well, then that would, I am almost positive, be reflected in the December and the March SEP. The September SEP, which is what we're all pricing on, is one where supercore is still elevated, yes, directionally okay, but still elevated. So then it's about do you extrapolate from the direction of change or do you think about the level? So I'm thinking about the level and the direction of change. I'm keeping an open mind.

And so I guess what I'm saying is that when you hear what we say we think we'll need to do today, that's conditional on the information we see today. And I personally think we need to risk manage on this situation. So risk management calls for not getting too excited to call victory and say, oh, I saw the PCE supercore go down in August so we're on train. I think that would be a mistake because we aren't there yet. So I want to see it in the data. I want to see that direction of change be repeated before I would say, okay, we can relax some of the restriction on policy that we've got projected out.

If that should happen, then, of course, we would re-balance the policy in order to not over-tighten on the economy. I mean the operating principle that I use, and if you read the commentary of my colleagues, I'm sure you will see it embedded in their commentary, is you have to calibrate policy in real time. You have to, if inflation comes down and not only is the policy rate then more restrictive, but we don't need to have it as tight as it is, then we would make those adjustments. But predicting we're going to have that glorious path doesn't really serve anyone because another thing we have to hang onto is the credibility that we will get the job done. And there's right now a lot of concern percolating out there – some are excited about it, some are concerned – that we'll stop short and leave it around 3%. That is not a positive outcome for the economy.

You know you can just do a simple calculation of what 3% versus 2% inflation looks like for the average consumer. Now eventually all things adjust, but that's eventually. The transition costs of moving from 2 to 3% is high. And so are we getting stuck at 3%, their high, so our commitment is to 2% and that's why risk management. Obviously we would adjust policy if the conditions warranted it. But if I say anything more specific than that, it gets written down and then that doesn't serve us. So that is really my commitment. We are going to keep going until we are confident that we are on the path to 2%, adjusting for all the other things in the environment. Not blindly on a fixed path, but actually taking in all the information with agility.

LISA ABRAMOWICZ: And vigilance.

MARY C. DALY: And vigilance. Vigilance and agility. We've got a question up front, I think, that you might have missed.

QUESTION: Thanks. Ian Sheperdson, Pantheon Macroeconomics. You talked a lot about policy being tight, restrictive. You've raised rates a long way. Inflation expectations have come down. And you're shrinking the balance sheet. Well, actually in dollars since the peak now and can't continue to do that. So I just wonder whether you agree that there might be a case for taking perhaps a slightly longer pause between the September SEP and keeping markets hanging on at every meeting thinking that you might be raising rates again.

You know, the quality of the data that we get, the macro data isn't great. The payroll numbers plus or minus is 140,000 every month in terms of revisions. So is there not a case for saying we can wait a bit longer than just until the next meeting to form a more considered opinion rather than having markets thinking, okay, they didn't do anything this time, but they might go next time?

MARY C. DALY: I see. So, you know, I would hope that what markets would be able to do is look at the reaction function elements, right? So, obviously I'm here today and I'm saying, speaking for myself, that, you know, when bond yields rise, well, obviously that's a factor in my thinking about how much we need to do, additional we need to do. If the data are coming in, slowing, as we anticipate or would like to see, like Constance just mentioned, we have the PCE coming down, well then markets would take that in and say that the need to raise is not as prevalent as it was when those things weren't doing what they're doing.

And I would say that the market probability, while we haven't given markets perhaps the certainty that they want, the market probabilities for both November and December right now don't look out of line with what the uncertainty in the data are. You know, the last I checked, the market probability in November was low and there was a little bit more positive, there was a little more probability on a December move, but not extraordinarily high. And to me, that's consistent with what we see, right? Bond yields have risen, and when bond yields rose, you saw the probability on the November meeting go down.

To me that says the markets are understanding how we think about things and they do have the reaction function in mind. And, you know, then hopefully the communication we do inter-meeting – I know the Chair comes out and speaks in between press conferences and things, and all of us do as well – hopefully we're adding some additional clarity to this idea.

But the reason I don't want to get too far ahead is because we could find ourselves with data that are really accelerating again and then I don't want to be in a position where we've said definitively we're not going to do X, and then X is needed. So that's why this tolerance of uncertainty is so important and the forward guidance doesn't go away, but it gets less precise on a meeting-by-meeting basis. It was really, for many years now because we had the pandemic and we had the tightening to get policy to restrictive, it's been pretty clear what we're doing meeting-to-meeting. Those probabilities were really close each time.

Now we're in a much more uncertain world about what is going to be needed. And so when you don't know exactly what will be needed, it's not actually a terrific idea to telegraph one thing over the other. It's better to do, I think, what we're doing, which is saying we're going to have to think about it and here are the factors we're looking at. But to your broader point, if I thought the probabilities were terribly out of alignment with the uncertainties we face, I might be more concerned, but they're not.

QUESTION: Hi, President Daly. You've talked about long and variable lags and forward guidance. It's been mentioned that forward guidance is a means to lessen the time of the long lag. Do you see any evidence that that's working? And how long will this forward guidance be needed to...(Audio Issue)...

MARY C. DALY: I like the idea that we have forward guidance. The most important tool is our funds rate. The second most important tool, to my mind, is forward guidance. And then the third tool we have is the balance sheet. And I put them in those rankings because we have a lot of experience with the funds rate. We have the next most experience with forward guidance, and then the third most experience with what I think of as the tanker ship, or the balance sheet. And we can adjust the other two with, like speedboat, and the third one, the balance sheet is like a tanker ship. It takes a long time to turn.

So those are how I stack-rank the tools. There are many uses of forward guidance. But one of the most important ones is that we can telegraph what we're doing so that people can plan, but it also accelerates how quickly markets adjust. What I'm not as clear on, and I've never been as clear on – I've said this publicly before – is forward guidance helps us go from what we want to do over the course of a year to financial markets.

And if you look back to when we even pivoted and said we would taper asset purchases faster in November of '21, then it already started to raise the mortgage interest rate. By March, you know, the mortgage interest rate was already up and refi had completely stopped. So that was forward guidance that got immediately into financial markets. That is very, very quick. But that's only half of the lag. So that part of the lag was shortened by a lot.

The second part of the lag, though, is from financial markets to real conditions. And that lag, our forward guidance helps a little bit maybe, but not that much because it's really, let's take commercial real estate. It all has to do with the schedule of refinancing. It all has to do with when you were thinking about doing projects. So if you're going to put a new project together, then whatever rate is there matters for you. But if you're just refi-ing or figuring out how you're going to roll over debt, etc., this won't affect you until those moments occur. And so that's why I think there's still a time for that real side to go.

And then, of course, this time around the long and variable lags have been, it's hard to distinguish – I will call these observationally equivalent theories right now. Because we don't have evidence yet that would say one versus the other. So right now, it's very hard to know whether the momentum in the economy has just been stronger than we thought. I mean consumers have been more resilient than I think any of us imagined they would be.

The second possibility is that the transmission mechanism is weaker or slower than we predicted. And the third one is that R-star is higher, right? The real neutral is higher. And those conversations about let's maybe think about raising the real neutral but ultimately you've got these other two things you have to manage. What I'm taking some comfort in is I think the lags are having an effect. We're starting to see housing, we're starting to see demand slow. We're starting to see, as Constance just mentioned, the PCE supercore came down. These are all pieces of evidence that policy is working and that is a good thing. If it hadn't worked yet, I would be more concerned.

But I think our forward guidance – I'll say one last thing and I know I have to leave – the forward guidance that we did with the SEP, I think part of that is being translated into bond yields. Not all of it, but part of the bond yield rise has to do with that forward guidance. So that's how it works.

PRESIDENT BARBARA VAN ALLEN: Well, many thanks to you both. That was just a terrific conversation. Thank you.

I'm pleased to report that we have many great speakers. I'm not going to outline all of them that are coming up. But let me just quickly do October. On October 12th, we have Mustafa Suleyman, the Author, and CEO of Inflection AI and Co-Founder of Google DeepMind, for a breakfast. And he'll be in a conversation actually with Marie-Josee Kravis, our former Chair. On October 17th, we'll host Pat Gelsinger, the CEO of Intel, for a luncheon. And, of course, on October 19th, we have Jay Powell joining us, the Chair of the Federal Reserve, also for a luncheon. And on October 25th, we have a webinar with the President and CEO of Northwell Health, Michael Dowling.

The only other thing I want to mention quickly is we have confirmed Bill Gates, for those of you that have not heard, on December 7th. We'll have a dinner honoring him as he will receive the Peter G. Peterson Leadership Excellence Award, which is the only award given by the Club, and we do give it annually.

And just a quick note that we have launched our first-ever podcast titled, The Forum, and that's hosted by Club Trustee Becky Quick. So you can tune in to all the streaming platforms and find that. We encourage you to do that.

And then finally, as we always like to do, we want to thank those members of our

Centennial Society joining us today for their contributions which continue to provide the financial backbone of support for the Club and our programming. So again, thank you to everyone joining us virtually. We'll see you later. For everyone in the room, please enjoy your lunch. We hope to see you all again soon. Thank you again.