The Economic Club of New York

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Tom Barkin
President and Chief Executive Officer
Federal Reserve Bank of Richmond

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Moderator: Michael Feroli
Chief U.S. Economist
J.P. Morgan

Introduction

President Barbara Van Allen

Good afternoon and welcome to the 743rd meeting of The Economic Club of New York. I'm Barbara Van Allen, President and CEO of the Club. Renowned as the premier nonpartisan forum in the nation, The Economic Club of New York stands as the leading platform for discussion on economic, social, and political matters. For more than a century, the Club has hosted over 1,000 preeminent guest speakers, contributing to our tradition of excellence.

I would like to extend a warm welcome to students who are joining us virtually from CUNY Graduate Center, Zicklin School of Business at Baruch College, and Mercy University. Congratulations and welcome to the new Class of Fellows who are joining us today for the first time. It is our largest and most diverse Class of Fellows to date. On behalf of myself, our Board of Trustees, and our Members, we look forward to being with you and enjoying this year's special programming and opportunities.

For today's program, we're honored to welcome back Tom Barkin. Tom is the President and CEO of the Federal Reserve Bank of Richmond. He's held the position since 2018. He serves as a voting member of the Fed's chief monetary committee, the Federal Open Market Committee. He's also responsible for bank supervision and the Federal

Reserve's technology organization. He's on the ground continually in the Fed's Fifth District, which covers South Carolina, North Carolina, Virginia, D.C., West Virginia, and Maryland. His engagement in the region has brought real attention to areas facing economic challenges.

He earned his MBA and law degrees from Harvard University. And prior to joining the Richmond Fed, he was a senior partner and CFO at McKinsey. He oversaw McKinsey's offices in the southern United States during his time there.

The format today will begin with prepared remarks from Tom followed by a conversation in which we're honored to have Club Member, Michael Feroli, as our moderator. Michael is Chief U.S. Economist at J.P. Morgan. We're going to end promptly at 1:00, and time permitting they will take questions from members and guests in the room. As a reminder, this conversation is on the record as we do have media on the line and in the room. So without further ado, please join me in welcoming Tom Barkin to the stage.

Opening Remarks by Tom Barkin

Thanks, Barbara. I'm going to be a lot more interesting, I think, on questions than I am on this speech. So I'll talk quickly for five or ten minutes about what's happening in the economy. I'm going to give you my views and not that of anybody else in the Federal

Reserve System and then Michael and I, I think, will have some fun with the Q&A.

So let me start just with the recent data, which I would just say has been remarkable. Twelve-month PCE inflation is now at 2.6%. Core is at 2.9%. Six-month, even seven-month inflation are even lower. Core inflation for the last seven months has been 1.9%. And these twelve-month numbers are absolutely going to get better over the next few months because we're lapping numbers from the beginning of last year that were pretty inflationary.

At the same time, contrary to most forecasts, and frankly contrary to my forecast, the progress on inflation has come while the economy has remained remarkably healthy. Unemployment rate, 3.7%. On Friday, we added another 353,000 jobs. GDP growth in the last quarter of 2023, 3.3%. And frankly, if you had told me a year ago that I could come here and speak to you at a time where inflation was 2.6% and unemployment was 3.7%, I would have accepted that offer.

Now, as some of you know, I don't just like to depend on the published data. I spend a lot of my time on the ground talking to businesses. And I'm hearing really good news from them too. Now, with the exception of some interest-sensitive sectors like banking, commercial real estate, the tone outside of that has shifted decisively away from talking about a recession. They may not be hiring as much but they're not firing either. And

while price setters continue to try, they seem more and more convinced that price increases are going to be smaller, less frequent, and less likely to stick. I take a lot of signal from the major consumer products manufacturers.

And if you look at their most recent earnings reports, I was happy to see that the realized price gains have gone from in the high double digits, high teens, mid-pandemic to low single digits today. So now it seems like every conversation we have is when we talk about a soft landing, a scenario where inflation returns to a 2% target while the economy stays healthy. And that could well happen. If it does happen, it's going to defy almost all predictions of what happens when the Fed raises interest rates so quickly to fight inflation. And it would be even more surprising given the challenges we faced last year – from the banking turmoil in the spring to the Gaza conflict in the fall.

Now, you can explain it. You can explain why inflation is settling so quickly without much disruption. The extraordinary levels of post-pandemic spending have been normalizing. The painful post-Covid supply chain shortages have been largely resolved. The rebound in prime-age labor force participation and immigration have helped alleviate labor market pressures. And most measures of inflation expectations have stayed remarkably stable suggesting that businesses and consumers have found the Fed and our inflation target credible. In other words, they likely understood the inflation surge was temporary, and that with the help of Fed action, it's now behind us.

So you might ask, why not declare victory and move rates back quickly to neutral levels? I assume in this room, there are many who are going to ask that question in multiple ways. So let me be clear that nothing would make me happier than a return to a pre-pandemic economy. But I'll give you two reasons for caution.

First, the airport is on the horizon, but the plane hasn't landed yet. And so for the nerds among us, I like the visual of an unfinished negative parabola, with the top being the peak of the pandemic recovery. And so just a few numbers – annual GDP growth before Covid, about 2%. It hit 5.8% in 2021. It was down to 2.5% in 2023 on an annual basis, closing in on its trend growth rate of about 2%.

Three-month average job growth, 214,000 before Covid, 727,000 in 2021. It's now 289,000, still above the replacement rate of about 100,000. And inflation, of course, which was just under 2% before Covid rose to 7.1% in 2022. It's now at 2.6% on the way back to 2%. And so you've got inflation, you've got demand, you've got employment all on a good path. All headed back toward normal, but there's no certainty where they're headed. And if you're a demand pessimist, you could point to monetary policy lags, credit tightening, the narrowness of job gains, the potential for geopolitical shocks, and you could worry about a downturn. Or if you're an inflation pessimist, you could point to continued strong wage growth and the recent drop in interest rates as fueling reacceleration.

The Fed is committed to returning inflation all the way back to 2%. And as I think about that commitment, I can't help but look for lessons in the past. History tells a lot of stories of inflation head-fakes. One I've been looking at lately is the end of the Volcker era. And for those of you who remember, in mid '86 inflation actually dropped to under 2%. The Fed reduced rates. Inflation then escalated again quickly the following year, and the Fed had to reverse course. And I'd just love to avoid that roller coaster if it's at all possible. So that's one reason for caution which is that the plane hasn't yet landed.

The second reason for caution is more fundamental. And there's an old saying that says no one returns from battle unchanged. And while our wars on Covid and our wars on inflation can't compare obviously to the horrors of an actual war, I'm still wondering how these experiences may have changed the economy, because disruptive events can have lasting consequences. For example, the trend line of GDP growth before the Great Recession, we never came back to that trend line afterwards.

So what changes worry me? I'll talk about the labor market. I'll talk about the housing market. And I'll talk about the global market. So first the labor market, which certainly has changed. Labor force participation is down. Employment is still over 4% under its pre-Covid growth trend. My generation, the baby boomers, is aging out of the workforce, participation has dropped as well. The market was tight before the pandemic and it's even tighter today. As evidence, wage growth – one measure is the Atlanta Fed's Wage

Growth Tracker – is still running at 5% annually versus 3.7% pre-pandemic. And this pressure on wages, and potentially prices, is likely to persist.

The second change is the housing market. We're short housing supply. That's a topic I talked about in a speech last year. We under constructed for a generation, and now the shortage of skilled trade workers and the recent increase in construction costs haven't helped. We've also seen demand increase. With interest rates low and work shifting partly to home, people look for new places to live. I mean after all nothing makes you more aware of the flaws of your current residence or your current roommate than spending every waking moment at home. Institutional investors added to demand. So did second-home purchasers. So housing prices shot up across the board. Now, the market has cooled a bit since, but with limited supply, prices remain high. And if housing supply continues to be short, that could mean further pressure on prices and rents in the coming years.

The third change could be deglobalization. Now Covid laid bare the vulnerabilities associated with global supply chains. Businesses and consumers became painfully aware that a series of unfortunate events – a severe winter storm, a fire in an overseas plant, or a blocked shipping lane could snowball into snarled supply chains, goods shortages, and a spike in costs. We're seeing countries rethink their trading relationships and firms redesigning their supply chains to privatize resiliency, not just

efficiency. These changes would suggest higher costs and less ability for intermediaries to drive year-over-year efficiencies. And these forces could well put renewed pressure on goods prices as well.

So looking forward, I'm hopeful, but still looking for more conviction that the slowing in inflation is broadening and sustainable. I talked about these three categories, in part, because most of the inflation drop so far has come from a partial reversal of pandemic-era goods price increases, which has more than offset continued higher than normal increases in shelter and other services.

Now, the Fed is not in the game of picking the correct makeup of inflation. Our target doesn't specify how the price of individual items should change. Just that the price index overall should increase by 2% over time. But the factors I discussed could hinder the continued deflation in goods and maintain pressure on shelter and services costs. A recent rebound in consumer sentiment, continued willingness of consumers to dip into savings, and a loosening of financial conditions could also introduce risk to the inflation outlook.

Now you could dismiss all these pressures as exerting only a fleeting impact on inflation in an otherwise stable environment, but I do worry about whether they could still influence expectations, which have been unsettled by the recent inflationary experience

of the last few years. The New York Fed's inflation uncertainty measure remains much higher, for example, than pre-pandemic levels.

So it's possible we'll return to the pre-pandemic economy pretty seamlessly. It's also possible that the landing might be somewhat bumpier, with continued inflation pressure or demand challenges that we'll need to counteract.

That's why I think it's smart for us to take our time. You likely saw in last week's meeting that we acknowledged that the risks to inflation and employment are moving into better balance, and we stated that we don't expect it to be appropriate to cut rates until we gain greater confidence that inflation is moving sustainably toward our 2% target. No one wants inflation to reemerge. And given robust demand and a historically strong labor market, we have time to build that confidence before we begin the process of toggling rates down.

So thanks for your time, and Michael and I are looking forward to a conversation.

Conversation with Tom Barkin

MICHAEL FEROLI: Thanks for that, Tom, very comprehensive remarks. I don't know where to begin. How about, you mentioned that it's easy to explain why inflation had

softened. How do you explain why growth hasn't remained as resilient as it was?

TOM BARKIN: Well, so a lot of us predicted, maybe you did – I did – that with rates being up as fast and as far as they would that we'd have a much softer economy. But I think you have to look at it now and say you've got 3.7% unemployment, so people are employed. They're spending. You've got, at least in the last year and a half, higher real wages, so people feel like they've got income they can spend. Asset values are up, whether that's houses or equity markets. And the net of all this is that the savings rate, which had been 4 or 5% before the Great Recession, which went up to 7 or 8% after the Great Recession, has been back down to levels, 4%. So I think people are spending, and I think that's really the core of it.

One fact I saw that I think is really interesting is that, in aggregate, corporate interest payments as a percentage of revenues or personal interest payments as a percentage of personal disposable income, both of those numbers are now only finally back to pre-Covid levels. So in aggregate, you might think on the margin that interest rates are affecting the economy, and for sure they are if you're in banking or real estate. But in aggregate, I don't think they've yet hit the economy the way you might think when you say, yeah, we went from 0% to 5%.

MICHAEL FEROLI: Yes, I guess it's the business side, the business sector that

surprises me a little more. I mean you would think the interest expense burden would have gone up in a way that a lot of people were predicting a lot of business bankruptcies at this point. And you talk to a lot of people in the Fifth District. Why haven't we seen that?

TOM BARKIN: Well, so people refinanced their loans, so the interest burden has come down, like I said. And then we do the CFO Survey, it's very interesting. You know, optimism about the economy is low, but optimism about their own business is actually still pretty high. And I just think everybody took the recession playbook out last year. A lot of people pulled the first couple levers, you know, maybe cutting back their hiring a little bit. But the next page in that playbook, which talks about reducing costs or cutting capital expenditures, they just can't get there while their business is still healthy.

And so month after month after month people see their business being healthy. And while, if you will, they're prepared for the downturn. They're just not seeing it, and they're not willing to cut back yet. That obviously puts some risk on the table, which is, you know, if something does happen that causes consumers and businesses to pull back in unison, that's how recessions happen. But you're just not seeing that kind of pullback yet.

MICHAEL FEROLI: One thing people threw out there as to why restrictive policy hasn't

impacted the economy is maybe it's not that restrictive. So a plug for the Richmond Fed research staff, they put out the Lubik-Matthes real neutral rate, which they estimate around 2%. I think that's probably a little high of what most people think is plausible. But where do you think, where do you think this conversation is going to be heading?

TOM BARKIN: Yes, so for those of you who aren't as deep into it, I say the center of the FOMC distribution in terms of what the real rate is would be about half a percent. Some of the people are now moving up to maybe it'll be in the range of 1%. There are three or four really big models in there, including one by John here that have very different answers. So the Lubik-Matthes is a higher number. I'm not sure if the number ought to be 2% or half a percent.

What I do pay attention to is the standard error, and unfortunately, it's 200 basis points. And so actually they may both be in the zone of right. And so I think it's hard to decide where to take rates over time by the models. I think you have to; you know, I used the word toggle in my speech. I think there's a test and learn process where, you know, you take rates toward the appropriate level and then you evaluate how the economy is reacting. And I do think this economy has not reacted to rates in the way that most forecasts would have said it would have.

MICHAEL FEROLI: So in your prepared remarks, you invited, essentially invited

questions about the first easing or the timing of when policy might...

TOM BARKIN: If I was dying for questions on that, I apologize, I wasn't. That wasn't my intention.

MICHAEL FEROLI: Maybe I misheard you...(Laughter). So talk about confidence, gaining greater confidence. Obviously, clearly lower CPIs, PCEs would do that. What outside of the inflation data itself would give you greater confidence about inflation going forward?

TOM BARKIN: So the last seven months, core PCE has been very good, 1.9%, as I said. So some sustaining of that would be helpful because the six months before that was 3.3%. That's one of those, do you believe this or do you believe that? The second thing I'd really love to see would be a broadening of inflation.

As I said, one thing that makes me a little nervous is it's really been driven by deflation in goods whose prices escalated given supply chain pressures during Covid. And I guess I always expected used car prices to come down. And I'm not sure how much signal I should take from used car prices coming down. We had no cars on lots. People bought used cars. They had to pay up. Now they don't. That feels to me like a very heavy thing to hang a conclusion on. And so I'd like to see a broadening.

The trimmed mean is another set of metrics that's obviously good for looking at broadening. It's running still over 3%. So, you know, if you sort of saw more in the rent. People have been predicting that the measures of rents would come down for some time. I'd like to see them actually start to come down. I'd like to see services settle. That's what I'm looking at. I don't think it's so much on the economy. But I will say that when the economy is as strong as it is, it's hard to feel urgency on taking rates down. I mean if you had a weakening economy and you felt like you were dealing with that backdrop, you might take a little bit more chance.

MICHAEL FEROLI: That's the tradeoff. So the strength of the economy adds a burden of proof to the...

TOM BARKIN: That's how I think about it.

MICHAEL FEROLI: Now, some policymakers have mentioned you don't need to get all the way to 2% before you ease policy. If the last seven months annualized are 1.9%, as you mentioned, March is, pushback against March, that would seem to suggest that you're looking at like, what, a two to four-month horizon in which you'd like to see inflation lower? Is that the right way to think about that?

TOM BARKIN: Well, the hard part with this question is that it assumes a set of data that

hasn't arrived yet. And so is your question, if we keep getting data that month after month after month looks like it's very consistent with 2% and broader, yes, let's start normalizing rates. What if the data bounces around in there? And so I think, similarly, you know, what are you going to see on the demand side? Are you going to see a dramatic weakening in the economy, as I've suggested the demand pessimists might see? Or are you going to see strength, 353,000 jobs a month like we apparently saw last month? Those are very different scenarios. And so in my mind, PCE inflation sustained at this level and broadening, that's my criteria. And I'm not focused on the month as much as I am focused on the criteria. And I could imagine scenarios where that happens relatively quickly, and I can imagine scenarios where that takes time.

MICHAEL FEROLI: You had mentioned in your remarks an aversion to having to reverse policy as Volcker did. Can you just get a little more into that? I mean a reversal in itself, if it doesn't affect, if you're still like attaining your inflation and employment objectives, why should policymakers care if that happens with policy being adjusted in different directions?

TOM BARKIN: I think it's more about the effects of uncertainty on the behaviors of businesses and consumers, particularly businesses. As I've talked to folks, so I've asked a lot of questions in the last three months about long rates, which escalated significantly in the third quarter and then have come, you know, nicely off in the fourth

quarter. Probably 80 or 90 basis points off their peak.

And when you ask questions about, well, how did long rates affect you or how does the drop start to affect you, you do get a feel of people waiting to pull the trigger, whatever that trigger is, until they kind of get more confidence on where things are actually going. And so I think there is a sense that if you were to lower rates that there's some amount of investment that's going to come online by people having confidence. And certainly there are industries like real estate and banking that are looking for that.

And so I just think there are some people who need enough stability in the situation to have the confidence to invest. And I have no objection to reversing course if that right answer is to reverse course, but just as a risk management thing, I think you'd love to avoid, you know, moving hard left and then moving hard right.

MICHAEL FEROLI: So if there's an added burden of proof on the first move, then should one, I would think one might gain more confidence that the following move would be in the same direction.

TOM BARKIN: I think that's right. That is right.

MICHAEL FEROLI: You know there's been a little bit of, I'd say, a mini-Renaissance

among academics of interest in leaning against the wind policies, I guess led by former policymaker Jeremy Stine. Do you ever see that entering your policy calculus if, I mean, look, if we do actually have a soft landing, HPA is looking pretty good right now. One might expect mortgage growth, etc. to pick up, would those factors enter into your calculus if we have an economy that looks like the SEP?

TOM BARKIN: The Richmond Fed actually did a lot of the early work on leaning against the wind and was very passionate on this topic. I think I can't wait to get to the other end of this inflation episode and declare whatever version of victory one does, in part because I think there's so much we're going to learn out of what happened. In the last framework review, we said, you know, we were suspicious enough that inflation could come along that we really wanted to see it before we'd start to, you know, lean against it based on forecasts. And that is what we did. And what's happened over the last two years has been the outcome of that.

Now, what's happened is the Fed can, with its credibility, increase rates and then inflation comes back to target and it stays stably back there, that will tell you something about whether that tactic works, if inflation comes that way. If it doesn't and inflation is more bouncier and it takes years to converge, not months to converge, then we'll learn something else.

And so, you know, I think we're going to learn a lot even in the next six months about how inflation settles after one of these episodes that will, therefore, be evidence in how nervous you have to be against the forecast-driven sense that demand is driving inflation that you have to lean against the wind on. I think a lot of that, we're closing in on some clarity, but I think it's still to come.

MICHAEL FEROLI: Okay. So that, I mean the way – and correct me if I'm wrong – is that when we get to 2% inflation in an environment of full employment, these factors would lead you to be biased higher relative to some estimate of neutral.

TOM BARKIN: I mean if we are actually able to deliver 2% inflation on a sustained basis in a relatively short order while demand stays at the levels that it's been recently, to me that makes the case that neutral is somewhat higher than previous projections. I mean you've raised rates and the economy hasn't been hurt in that way. I hope you noticed that in the statement I just made, there were about seven "ifs."

MICHAEL FEROLI: You know, in your remarks, I sense a little bit of ambiguity, which I've also sensed from other Fed officials in recent weeks about where we stand in the growth-inflation dynamic, the Phillips curve for lack of a better word. And to some degree, it sounds like, well, we're fine with whatever sort of real economic outcomes we get as long as inflation keeps doing what it does. On the other hand, you mentioned

wage inflation and the Atlanta Fed Measure running a little high. So maybe if you could just expand on how you're thinking about the Phillips curve relation between labor market slack and inflation.

TOM BARKIN: So, maybe I should start by saying a little bit how I've been thinking about the recent data, because the recent data, 353,000 jobs suggests an incredibly vibrant labor market. You know, January is always a tough month to try to make any business judgments based on. Just for those of you who aren't as deep in the numbers, normally we lose about 2.6 million jobs in January because the retailers who hire up for the Christmas season then lay the people off. It then gets seasonally adjusted up to the number you see.

So last month we only lost 2.5 million and so with the seasonal adjustment, it took it up to 353,000. So we don't have better numbers. The people who do those numbers are doing the best job they possibly can. But those are the numbers we see and those are the numbers you have to make policy off of. But I'm just a little cautious about deciding too much when you've got that big of, you've got a month with that big of a seasonal adjustment. It doesn't mean it's wrong. It just means I'd like to see a little more, I think a more rational thing when you see January.

And for those of you who remember last January, we saw massive retail sales growth.

We saw very significant inflation. We saw big numbers everywhere. It looked like we were in this huge reacceleration. And three months later it didn't look like that at all. So you just have to be careful with the numbers, first point.

The second point is the Phillips curve, which if you're like me you learned about in college and, of course, it has something to do with unemployment and wages and then we sort of extended it to say unemployment has actually something to do with prices. That last connection is a little attenuated. And certainly in 2019 and 2020, with very low unemployment rates, we didn't see inflation rear its ugly head despite a lot of forecasts. And so the short answer was the Phillips curve isn't flat.

Now, there's also no question that in 2021, with labor being even shorter, we saw wages really spike. And so there's some non-linearity there for sure. I think about it a little less model-based and a little bit more, you know, if an economy is running hot, in the way that at least the last six month's numbers would suggest we might be doing now, and I think in an environment where price setters have now had the experience of raising prices and maybe a little more confidence that they can do it, does that put inflation at risk? And that's how I would think about it. And I think that's a fair way to think about the risk of an economy that's too hot. Yes, you get into some of the non-linearities.

MICHAEL FEROLI: Okay, so it's more a matter of a very tight labor market. And what's your assessment of labor markets currently relative to where we've been?

TOM BARKIN: I think they're tight, but I don't think they're as tight as the numbers would have you show. And, in particular, I divide it into three segments. There's professionals, and I think that market today is at normal. It's not tight at all. It was tight a couple of years ago when the big tech companies started laying people off. People go, ah, okay, well, maybe I like this job, I'm going to be the last guy in and the first guy out. So I don't think the professional segment, it feels normal.

The frontline segment, which was way short after Covid, it's not all the way back to normal, but I think businesses have adjusted. And so your service is a little bit less good at a restaurant, your room is getting cleaned every other day at a hotel. But folks have figured out how to get by with the frontline labor.

The place that's still very tight is skilled trades – nurses, truck drivers, carpenters, plumbers, welders. I'd even put veterinary assistants in there. Those are all segments where you actually have to, if I could put it this way, manufacturer workers. And we were short pre-Covid and then demand in a lot of these segments spiked or retirements spiked, and we just don't have enough people. And there's still a wage ratchet going on in construction. There's still a wage ratchet going on in nurses, veterinary assistants, all

those folks. That's the place where I think it's still tight. And if you look at the job gains, excluding the most recent month, you do see it very much, increasingly in a narrow segment of occupations.

MICHAEL FEROLI: And that should be a relative price, relative wage matter rather than a broader macro concern. I'm going to ask you a question you can't answer. But it's one that I think comes up quite a bit. And you kind of alluded to it when you said, you know, aren't we like basically close enough? And I think there was a bit of, after the last framework review, a little unease, or however you want to put it, about the 2% flexible average inflation targeting. How flexible is flexible? And so, I mean certainly you don't need to be 2.0 to declare victory. Can you just shed a little light on whether you think it would help to have more specificity on that? Or do you think where we are now in terms of the framework and that ambiguity is constructive?

TOM BARKIN: So I get asked, another way to do it is I get asked a lot the question of are you going to change the target? And generally the question is, hey, you're already at 2.6 or 2.9, why not just declare victory and go? The Fed's only got one big lever and that's credibility. And I just don't think if you set a 2% target and you quit at 3% that anyone is going to have any credibility at 3%. And so you kind of have to hit your target to maintain your credibility.

And I'll also point out, it's not like 2% is some magical unicorn that nobody's ever seen. We lived in it for the last 30 years. We're inches away now. We've been there for the last six or seven months. The world has a 2% inflation target, and lots of good things happened with a 2% inflation target. So I don't think it's impossible to get there.

I have said before publicly that I'm very comfortable, when we get to the next framework review, debating the question of a range. You know, it's always felt to me a little strange that our target was 2%, and if we were at 2.1% or 1.9%, we were going to somehow beat ourselves up in a world where it's a basket of 180 goods that comes in month after...I just, that's felt like over-precision for me. I have to say, with full transparency, I lost that argument in the last framework review. So I don't know whether you should make policy over my arguing skills. But I do, a modest range around it where you do try to hit it. And there are other central banks that operate with a range.

MICHAEL FEROLI: Hopefully Rick Mishkin isn't going to be in that debate. Let me ask about, what are your thoughts, clearly I think around here there's some concern about the regional banking system. I think you briefly alluded to it in your remarks. Could you expand a little bit on how you see that as a risk for the outlook?

TOM BARKIN: Yes, so the Silicon Valley thing was very front and center back in the spring. You had three or four banks, idiosyncratic business models. But I think you

learned something about liquidity in particular. And they had the big mark-to-market losses and very low levels of uninsured deposits and that didn't work out all that well. The banks in my district, I'm talking to them all the time. I think everyone has taken on the lessons of that. And so access to liquidity facilities, more uninsured deposits, working on their mark-to-market losses. That seems to me like that was a last-year issue, not a this-year issue.

The issues, though, of this year are, I'll say two-fold. One is the cost of firming up deposits was higher cost deposits. And so the banks I'm talking to are struggling with shrunken margins. And so with thinner margins, that has implications both for your willingness to take on marginal credit as well as your focus on reducing costs. And there have been a number of announcements on cost reduction at various banks over the last few months and even a little M&A at least in my district.

In addition, you've got this commercial real estate risk that's out there. And, you know, I should say commercial real estate is this big, but data centers are doing fine and retail is doing fine and hotels are doing fine. And most people who are holding apartments are doing fine. Some of the buildings are having issues. So it's really, office is the big issue and particularly downtown B and C office. I was in D.C. yesterday where that entire downtown, you know, office complex is at high risk. And that is a risk for banks.

It's not an unknown risk. I mean '74-'75, '90-'91, '07-'08, I mean we've had commercial real estate office issues before. And I do believe that sector has that kind of trouble now. The hope and expectation is that the banks have a plan for that, whatever combination of appropriate reserves and capital. I'll say we've stress-tested the banks that we stress-test pretty hard on commercial real estate. And we published the results of that, which were relatively reassuring. But, you know, you don't know what you don't know in terms of whether there are banks out there that have exposure that isn't properly accounted for.

MICHAEL FEROLI: You know, D.C. really needs the federal workers back.

TOM BARKIN: Yes it's really striking. My district goes South Carolina through Maryland so I get to be in lots of markets. And if you're in Greenville or you're in Charleston, you don't feel like there's a downtown office space kind of issue. But if you're in D.C., and I met with a bunch of real estate folks in the morning yesterday, it's quite palpable, you know, just how low occupancy is and frankly how little hope they have to bring those buildings back.

MICHAEL FEROLI: One last from me and then I'll open it up to the audience. You had mentioned the structural, or the long-term, I should say, undersupply of housing right now. Is that a monetary policy issue or more of a societal issue?

TOM BARKIN: A big societal issue, a big societal issue. And I gave a speech on this in November because I really think there is a supply challenge. And again in my district I get to go, if you did an hour radius around Raleigh, you'll see the National Home Builders are there in force. And they're building $250,000, $300,000 houses in Clayton and Smithfield and Wilson and Siler City and all these places. But if you go to Maryland, there's still short housing. You can't find much of any building. So there's something about how do we get enough housing supply in markets? And it's not just about inflation or employment, it's about people's aspirations. And there's those who think that part of the decline in consumer sentiment is a sense that you can't have the life that your parents had and all that kind of stuff.

For us, as a policy, it gets to rents and occupancy costs. And shelter is a big part of these indices and it's a big part of people's cost of living. And so if you don't have enough supply and rents are going to continue to escalate, then that puts pressure on inflation. And so that's the policy part.

MICHAEL FEROLI: I think for Q&A this is a small enough room that people can just raise their hands and speak up. Or maybe there is mike, I guess, never mind, forget what I just said.

QUESTION: Thank you so much for joining us today. Would you be able to expand on

your comment that office B and C markets don't have much hope of coming back.

TOM BARKIN: No, I was just talking about the folks I talked to in D.C. I mean, look, a real interesting question, because these places have been hit by multiple things at the same time, but the new one is how much people work in an office. And so, as I walk around our district and I'm talking to developers what I'm hearing is that the trophy properties are actually doing fine because if you want to bring people back to the office, having a really nice office, that's doing well. The issue is the renewals they're getting in these less high quality, downtown. The suburban offices are also doing fine.

And it's a particular issue in D.C. because you don't have the government back and so much of the downtown office in D.C. is lobbyists and law firms and others who actually do their business with the government. So that, I was just talking about that. We'll see what happens to use of office space. There have been many efforts over the years, as you know, to take the amount of office space down, and then it sort of creeps its way back up, but we'll see about that. Re-purposing, I think, is very hard. But it's definitely a challenging segment right now. Again, not the first time we've had a commercial real estate challenge, and we get to the other side of these.

QUESTION: Overnight we saw there was quite a sharp drop in the inflation numbers from China. Do you see there's any risk of that spreading over here? Is there any sort of

follow-through effect to the U.S. market?

TOM BARKIN: Yes, so China has been very deflationary over the last year. To the extent that we import a lot of goods from China, that has actually played out nicely in our efforts to settle inflation here. You're asking me to now take my head off and say and I worried about deflation, and it's almost like taking my head off and thinking about something new. I guess there's always a risk there, but I'm not, you know, outside of a few goods categories, whose prices escalated during the pandemic, I'm not seeing much, if any, focus on prices coming down. Remember, our economy is heavily a services economy, heaving buoyed up by wages. It seems to me like it would have to be quite a situation to start bringing wages down. So I think the risk here is very different than the risk in China.

MICHAEL FEROLI: Can I ask...so you had mentioned, and this is related, the New York Fed Survey Measure shows increasing inflation dispersion. Basically, so they ask consumers their inflation expectation and it looks at how uncertain people are. And that has gone up. Where else do you see sort of a lasting imprint or something that will persist even as we get to the other side of this, or a risk of that persisting?

TOM BARKIN: On the inflation side?

MICHAEL FEROLI: On the inflation side, yes.

TOM BARKIN: Well, we do our own thing. In our last CFO survey, we asked sort of the same questions of businesses, which is your expectations for next year. Are you going to be raising prices at sort of pre-pandemic levels, higher than pre-pandemic levels, lower than pre-pandemic levels? And it was about 55% that were above pre-pandemic levels. Now, talk is cheap, and that was a November survey of what they expected to do this year. And some number of them will try and the customers will beat it back, and some numbers will change their mind.

But I just think if you're a price setter in this economy, for the prior 30 years the combination of globalization, e-commerce, the power of big box retailers just beat you into submission in terms of your inability to raise prices. Pricing was not a lever. Today, I think in every boardroom, as you're coming up with your plan and you're short at the last minute, someone is saying, well, maybe we should give price a try. And that doesn't mean it's going to stick, but I just think it's on the lever list in a way it wasn't really on the lever list five years ago.

MICHAEL FEROLI: Right, right, I agree. Interesting. There was, maybe right up front here...

QUESTION: So we know that the Fed is an apolitical body, but how do you factor in the dysfunction in Washington, particularly as we get closer and closer to the election?

TOM BARKIN: I don't know if you watched Jay on 60 minutes over the weekend, I might just defer to him. I thought he was brilliant. And the last question, for those who didn't see it, he said, you know, integrity is priceless and we're just not going to waste ours. You get to a meeting. The decisions are, I think, determined by the data you see. You're not trying to solve the world. You're trying to solve inflation, unemployment. That's the mandate. That's what you do. And I think you just keep your head down and you focus on that.

MICHAEL FEROLI: Maybe over here. I think we've not had anyone on this side of the room yet.

QUESTION: How much emphasis do you put on the views of the stock market and equity markets? We've been seeing a huge move. When you're formulating a decision, when you're sitting in a room, are the members, has it come up? I'd just like to know the thought process.

TOM BARKIN: Yes, I try not to pay a ton of attention to the equity markets, in part because they move up and they move down, and I don't really understand them. I mean

a more serious answer is if you think about consumer spending, it's certainly buoyed by a wealth effect. Not a massive effect. You know, and if equity values are up, that means people have more money. That means they're more likely to spend. So it has a consumer spending effect. And similarly, if you see big market drops, it often leads to consumer spending pullbacks. I think on the business side too, when your stock's up you're more confident. You're going to invest in the future. So there's some correlation there.

I spend a lot more time trying to think about the bond market. Actually because our policy goes to the economy much more directly through rates than asset values. And so I just think that's probably a more important thing. And if you read the minutes, you'll see it. At every meeting we're sitting there talking about what's happening, the minutes will show you we're not spending a lot of time talking about the equity markets. And again, the movements can be so volatile that it's, you know, you could get whiplash.

QUESTION: Hi. Thanks for your talk. Just a different question from the data. I just wanted to see your personal thoughts from the Richmond Fed point of view. How do you, what's your thoughts on the inclusive growth and income inequality and if that could play any role in that?

TOM BARKIN: Yes, so I mean income inequality is a huge issue for society, for this

country. Inclusive growth is as well. And we have a lot of very good researchers who do a lot of very interesting work on various elements of that because it does matter for the growth of the economy. I've struggled, though, with how to think about the Fed's role for that. Because we sort of have one tool and it's called interest rates, and they go up and they go down. And if you're in commercial real estate, you know, how that feels. But if you're interested in more inclusive growth, it's not actually easy to imagine how exactly we're going to change that with our one tool. It's just a blunt instrument for both of those questions. And I think both of those questions are best answered through means that are different than raise the interest rate 25 basis points or lower it 25 basis points.

QUESTION: Thanks, Tom. It was very helpful. So you talked about a lot of numbers, right? Low inflation, high employment, strong GDP growth. The average American still feels very down about the economy. How do you reconcile that? And also how do you take that confidence into account in policy setting?

TOM BARKIN: Yes, thanks. So one of the great paradoxes of the last few years is normally when consumer sentiment is down, consumer spending drops. And what we've seen over the last two years, as you rightly point out, is that consumer spending has plummeted...I'm sorry, consumer sentiment has plummeted while consumer spending has escalated. So what's going on there?

And I did a really interesting thing with a bunch of construction workers in Northern Virginia, where I asked them, you know, how do feel about inflation? And they go, hate it. And I said how do you feel about your wages? And they go, thank God, someone finally recognized my value. And I said, well, your wages are up more than your expenses, you must be happy. And they're like, no, I earned the wages. Someone is screwing me with the things.

And I really think, I think if you're a business, it's easy to have a mental ledger. It's called margin. And if your prices go up and your costs go up and your margins go up, you can kind of live with that. But if the margins go down, you can't. That's how businesses think. I don't think consumers have a mental ledger like that. I really do believe that wages are what you deserve or they need to be bigger to get what you deserve. And costs, prices, that's what someone is doing to you. And I just don't think they work that mental ledger.

And I think that sentiment about inflation is what's driving the sentiment overall. And I do think, it's not a good thing, I guess, that we learned it, but I do think we've relearned over the last two years just how much everybody hates inflation. I mean it's really been very reaffirming for what we try to do because I remember, you know, debates about how much does inflation really matter versus unemployment. People really, really, really hate inflation.

MICHAEL FEROLI: How will that inform the framework review, the upcoming framework review?

TOM BARKIN: I mean, it's every five years, so we'll see when we get there. But to me it's a little bit more around the question of how much risk are you willing to take on inflation? And some people call it the whites of your eyes part of the framework review, which is do you have to see it to do something about it? We talked about that earlier. That's where I think that would come up.

MICHAEL FEROLI: Maybe in the back. Maybe you first and then you after...

QUESTION: You spoke a lot about the housing market and, of course, about the lingering components of inflation that still have to come down, which is primarily rents. And, of course, we know that OER, it's not a cash flow. Right? Nobody pays that. And we've seen the strength in the economy. Is part of that maybe because we see this inflation but the vast majority of people, especially homeowners are obviously not experiencing the OER component of inflation? And then I'll just give maybe a little assist on the inequality question. I tend to think of inflation as very regressive, you know, the wealthiest folks don't experience it in the same way as less wealthy folks. And maybe perhaps that's why it's so important for you guys to be fighting inflation.

TOM BARKIN: I mean obviously unemployment is regressive too. And so the mandate is beautiful if you can get low inflation and high employment, you know, you do help with all kinds of things. And your first question was, well, I do think there's something to inflation as not being experienced by everyone the same. And when you look at spending and you talk to retailers, I do have a strong sense that the wealthy half of the economy has continued to spend, if you want to put it this way, like drunken sailors. You know, international trips, all that kind of stuff. More towards services than goods. But that part is very strong.

And when you talk to retailers who service the bottom half of the economy in terms of income, you know, what you hear is a lot about re-prioritizing and people being stretched and prices being up, even for folks whose real wages may have gone up because their entry-level jobs, the wages have increased. So I do think it's very different there. And so you may well be right that the people at the bottom are experiencing more of actual rent and less of imputed rent and that's part of it.

But I think it's also just wealth in general. The top half of the economy has the assets. And they've said that your house is worth 45% more and your equities are worth 40% more, you feel like you've got more money and you spend that.

QUESTION: So you mentioned a depleted savings rate and an aging population that's

also living longer. What are the consequences of the aging population that's also living longer on longer-term interest rates?

TOM BARKIN: I thought you were going to ask me to solve the question of them living longer, and I was trying to think about where I was going to go with that. Well, so what you're referring to is the theory of the neutral rate. It has a lot to do with the savings glut that a lot of people thought was created, and all the savings therefore bring rates down and all the rest of it. And so, you know, as people live longer and longer and they go into the era where you're no longer making any money, you're just spending money, won't savings come down? And doesn't that mean that long-term rates will go up? That's, I think, the premise you're putting down.

I do think that the combination of demographics globally and fiscal spending globally means that we may well see less demand for longer term bonds and, therefore, higher rates. We'll see. Many of you are in the markets and you know this stuff a lot better than I do. But that argument makes intuitive sense to me.

QUESTION: You talked a little bit about changes since the pandemic. One of the things that we've seen more recently is differences in the surveys, in different survey measures of things. Has it been harder, not that anybody is doing a poor job collecting the survey data, but has it been harder to get responses? And is that driving differences

in household versus business surveys? And how do you incorporate less data that might not be as good as it once was in your decision making?

TOM BARKIN: Well, I think everyone from pollsters to surveyors are finding lower response rates. And how much of that is cynicism or behavior and how much of that is hard to find people on their cell phone and they don't respond, I don't know. But that's clearly an issue. And that has to mean that the data you get month to month is less reliable. Right now they get more and more data, they revise it, and it's the best we've got. And your only good option is to make policy with the data you've got. But I do think you have to be aware that there's less reliability in that data than you might have hoped you would have.

And it's like the example I gave you of January labor numbers. And the seasonal adjustments have changed too because Covid was a roller coaster. So I think, yes, a little bit more caution is probably appropriate in a world where you might have less confidence in the data. The other thing that I try hard to do is to find alternative sources that might give you more information. You know, one thing that at least I didn't track before the pandemic that I now track every week is consumer credit card spending. It's not perfect. You can have makeshift in terms of payment vehicles. But it just gives you some amount of sense of what's actually happening versus just the data you get, and I think that's very useful.

MICHAEL FEROLI: I think we're good.

PRESIDENT BARBARA VAN ALLEN: Well, thank you all. This was a great conversation, very insightful. And, Tom, we appreciate you joining us. And Michael, thank you.

We have actually many great speakers coming up in February to look forward to. Next up is Kai-Fu Lee, the Chair and CEO of Sinovation Ventures. That will be on the 13th of February, next week. On the 21st, we have Melissa Kearney, the Neil Moskowitz Professor of Economics at the University of Maryland, who has written an important book about the role of family in the economy, and we look forward to that. February 22nd the Club is going to go on the road for the first time, heading down to Southern Florida, where we will host Seven-Time Super Bowl Champion, Tom Brady. And that event will be a dinner event in Miami. And it's proving to be pretty popular. There's still room for those that want to join us. And if you, as a member, are unable to attend, you're welcome to invite guests. On the 26th of February, we'll have Charlie Cook of the Cook Report, looking at Super Tuesday. So that will be fun. And to finish out the month, on the 27th, Eric Holder, Senior Counsel at Covington & Burling, and the 82nd Attorney General of the U.S.

Looking ahead to the spring, we're going to host David Ricks, the CEO of Eli Lilly.

Christopher Waller, Member of the Board of Governors of the Fed. Professor Jeremy Siegel of the Wharton School at the University of Pennsylvania. He'll be in a conversation with John Williams. Chairwoman Jessica Rosenworcel of the Federal Communications Commission. Susan Collins, President and CEO of the Boston Fed. Jamie Dimon of J.P. Morgan will be joining us. And John Williams, our Chair, will also be doing an event. So all of these are currently listed on our website. Please be sure to review the dates and add them to your calendar.

We always like to take a moment at the end of our events to thank the members of the Centennial Society that are joining us today as their financial contributions help to ensure our programming into the future. Thank you to everyone attending. To those watching digitally, which is over 150 folks, we'll say goodbye. And for those in the room, enjoy your lunch. Thank you.