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A CONVERSATION WITH FENDERAL RESERVE GOVERNOR ADRIANA KUGLER

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KEYNOTE REMARKS:

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Cecilia Rouse Good morning. Welcome to Brookings. I'm Cecilia Rouse and I'm the new president here. And it is my absolute honor and privilege to introduce today's talk. So on behalf of the institution and the Hutchins Center on Fiscal and Monetary Policy, I'm so pleased for Brookings to host today's speech on monetary policy by Federal Reserve Governor Adriana Kugler. Her first since joining the Fed in September of 2023. I'd also like to extend a special welcome to her parents and her brother. Thank you for joining us today.

So today's event is an example of how the Hutchins Center, whose mission is to improve the quality and efficacy of fiscal monetary policies and the public's understanding of them, achieves its mission. Today's speaker embodies the best of today's policymakers, who are bringing substantial expertise to the table to address some of our most important policy challenges. Adriana Kugler is a Berkeley PhD economist with research interests that range from labor markets to policy evaluation in developing economies. She's been a professor of public policy and economics and vice provost at Georgetown, where she is on leave, and most recently was U.S. executive director of the World Bank. And in September, as I noted, she was confirmed as the newest member of the Federal Reserve Board. Now, as you all well know, the Fed has a dual mandate. Its job is to ensure price stability while also maintaining full employment. So that's not an easy balancing act, especially given that, at least according to traditional models they suggest that there's a trade off between the two when the economy's red hot and there is low unemployment, there's a potential for inflation and vice versa.

So these past 2 to 3 years have been rather challenging for the Fed. The economy and the labor market rather specifically, has been remarkably strong as we've navigated our way through the pandemic. This and other disruptions related to the pandemic led to a period of relatively high inflation. And so the task before the Fed has been how to bring down the inflation without causing the economy to crash.

This brings me back to Adriana. Not only is she an established academic economist, but she also spent two years as chief economist at the Bureau of Labor Statistics, at the Labor Department, during which she worked closely with the bills on measurement of labor markets. Read for the full employment part and on prices where we get our consumer price index, read the price stability part. This is all to say that she's truly the right person for the job, which gives me all the more confidence that the Fed will pull off this seemingly impossible soft landing. And now I'm going to do the obligatory knock on wood. Following her remarks, Governor Kugler will be joined on stage by our own Don Kohn, the Robert Roosa Chair in International Economics at the Hutchins Center and former vice chair of the Federal Reserve Board. Don will ask some questions of his own and then turn the audience for yours. Please join me in welcoming Adriana Kugler to the podium.

Adriana Kugler Well, thank you so very much, Ceci, for that generous introduction. And let me just say what an honor it is to be introduced by Ceci Rouse. Selfishly, I'm very happy we have her back in town leading this great institution. So let me now start with my prepared remarks. I am very pleased to be speaking here at the Brookings, one of the country's premier centers for policy discussion and analysis. As you all know, the Federal Open Market Committee, or FOMC, has been working really hard at lowering inflation in the context of achieving our dual mandate of maximum employment and price stability. Today, I will discuss recent developments in the economics area here in the U.S., talk about how I approach our dual mandate and explain how I view the current stance on monetary policy.

So I know Ceci did a great job and she was very generous in introducing me. But by way of introducing myself, my career in both academia and in public service has included a focus on labor markets and inflation. In my academic work, I have explored various aspects of labor markets, including the effects of labor market policies, as well as the role of educational attainment, among other topics, as well as detailed measurement in terms of productivity and prices. As Ceci said, as the chief economist at the U.S. Department of Labor, I engage regularly with the Bureau of Labor Statistics, which produces data on both employment and inflation. I have approached these topics through both a rigorous focus on measurement considerations, as well as a broader view of the real world experiences of the people who underlie that headline data. And believe me, I will continue to do that as a member of the FOMC as well. With that background, I will now turn to recent economic developments and outlook for this year.

The pace of inflation continues to slow. 12 month inflation, as measured by the personal consumption expenditures or the PC index, was 2.6% in December, down from a peak of 7.1% in June of 2022. And the six month rate for PC inflation was even lower at 2%. While the FOMC use PC inflation for our 2% target, we also look to core PC inflation, which excludes more volatile food and energy prices as an indication of the underlying inflation trend. Core PC inflation was 2.9% in December, also down from a high of 5.6% back in February 22. Core PC inflation on a six month basis was even lower. I'd 1.9% in December. So we have made great progress. Indeed, the slowing in total on core PC inflation that we have seen over the last year or so is the most dramatic we have seen since the early 1980s, even though you see progress may be uneven from month to month.

I like to look under the hood of the inflation numbers for clues about the inflation outlook. A lot of the disinflation we have seen has come from the goods sector, where many prices have actually fallen as the demand has cooled and supply chains have mostly healed. Price declines in the goods sector have been helpful, though the core goods category constitutes less than one quarter of the total PC index. We have seen less, though I would say still meaningful progress on service as inflation. But there are reasons for optimism. Measures of housing services inflation are naturally persistent. Tentent rents move slowly because of the prevalence of year long lease agreements, and estimates of owner occupied housing costs are computed based in large part using those tandem rents. So this measures react only gradually to data that comes on newly signed rental agreements, and such data do suggest continued rental continued declines in terms of housing services inflation, a category that accounts for about 15% of the total PC index.

That leaves us with the important category, of course services, excluding housing. This category saw a 12 month inflation of 3.3% in December, down from a peak of 5.2% in December 21. Continued overall disinflation will depend heavily on core services, excluding housing, which accounts for roughly half of the total PC index. While the inflation rate for these categories is still elevated, there is reason to expect improvement, as I will now discuss.

So I see three factors as likely to contribute to continued disinflation, especially in this category of core services, excluding housing. Continued moderation of wage growth. Normalization of price setting behavior by firms, and anchored inflation expectations.

Speaker 3 First the disinflation process is being held by wage growth moderation associated with the ongoing cooling of the labor market. The pace of payroll gains has slowed considerably over the past couple of years. The three month average of payroll

gains surge above 700,000 in May 2021, and then trended down through 22 and 23. Of course, last week's payroll report was quite strong, and the three month average gain jumped to nearly 300,000. But the broader trend has been one of moderating gains. These moderation in payroll growth largely reflects cooling demand. And actually hiring and hiring plans have actually [unintelligable] as he cementing the job openings and labor turnover survey or JOLTS data in other surveys as well we see the same trend. So job openings have also declined, such that the ratio of openings to unemployment has come down to 1.5 from a peak of two, and is now closer to a pre-pandemic ratio of 1.2. I am pleased that this cooling of the labor market has been accomplished without a marked rise in layoffs, which would impose hardships and difficult transitions for individuals, families and communities.

At the same time, labor supply has improved significantly. Returning to pre-pandemic levels. Labor force participation has risen for prime age workers since early in the pandemic, particularly among women who last year reached the highest participation rate on record. And we have seen an increase in immigration. A source of workers that is particularly important in certain sectors. For example, in the construction sector, about a quarter of all workers are non-native in leisure and hospitality this year is about one fifth. With decent labor demand and robust labor supply, we have seen a slowing trend for wage growth. Of course, as a general matter, I prefer to see robust growth of workers wages. But for a wage growth to be sustainable, it must be consistent with 2% inflation. Far higher wage growth is slowing, is likely to be important for ongoing disinflation, particularly in the labor intensive services industries. For private services, overall, 12 month growth of average hourly earnings was 4.4% in January, down from a peak of 6.1% in March of 22. More specifically in leisure and hospitality. Earnings growth was 4.4% in January, down from a peak of almost 14% in late 2021. In education and health, earnings rose 3.7% in January versus a peak of almost 7% in late 2021. Some of these sectors did see a pickup in wage growth in January, but overall, the broader trend is one of cooling. I mentioned these sectors because they exemplify just how labor intensive the services sector can be. For example, labor costs are roughly 60% of value added in leisure and hospitality and more than 80% of value added in health and education. An easing of labor cost growth in these and other labor intensive sectors is likely to be passed on to consumers as lower wages and to help reduce inflationary pressures.

Let me now turn to the second factor that I mentioned before. The second factor that is likely to contribute to continued disinflation has to do with how frequently individual prices are adjusted by firms. Research by Federal Reserve Board staff and others has found that the rise in inflation during 21 and 22 year mostly reflected firms changing prices very frequently, rather than firms making very large adjustments when they did change prices. In particular, before the pandemic, the median price lasted more than ten months, but by early 2022, the median price was lasting less than five months. Encouragingly, the frequency of price adjustments has declined, and since then, the median price duration is moving up to seven months. I am looking for a return to pre-pandemic price adjustment patterns in the services industries, in particular as cost pressures ease and as the [unintelligable] to support a return to price stability continue to affect consumer and firm behavior.

There are some signs that businesses may be more wary of the responses by consumers to higher prices, and may already be responding by raising prices less frequently. For example, mentions of consumer price sensitivity have become more common in the Fed's recent Facebook, which reports economic conditions across our 12 districts from various market participants.

The third factor that is going to favor continued disinflation, in my view, is one that is related to the other two factors that I have been talking about, and that's the stability of inflation expectations. Inflation expectations can feed into wage demands and negotiations, as well as into price setting decisions. To understand why this matters going forward, let me first look back. Over the past couple of years. Some workers have demanded large pay increases to catch up with higher than normal growth in the cost of living, resulting from various pandemic related shocks. Some of these wage gains, in turn, likely pass through higher prices as part of firms frequent price adjustments. If expectations for future inflation had become unanchored or persistently higher than workers might have continued to demand higher than normal wage increases going forward, and firms might have continued to pass on these costs to consumers. But inflation expectations have stayed reasonably well anchored, as inflation expectations to stay anchored and in tune with inflation is slowing farther in the future, employees, many of whose wages have recently been rising faster than inflation, are less likely to continue demanding very large wage and salary increases. Similarly, as businesses expect the prices of labor and other inputs to rise more slowly, or for some inputs even to fall, they will be less likely to plan to significantly increase their own prices throughout the year, which in turn helps to reduce inflation.

Survey data from the Richmond Fed show a close relationship between the firms expectations for overall price inflation and those firms on price setting plans. In particular, as inflation comes down, firms become less reactive and inflation expectations play less of a role in firms price adjustments. Several data sources support the idea that expectations are indeed well anchored. One closely watched source is the Michigan survey, in which expectations for inflation during the next 5 to 10 years have remained fairly flat recently, near levels seen for much of the past decade, and expectations for inflation in the year ahead have come down a third after peaking in 2022. Expected inflation in the New York Fed survey of consumer expectation shows a similar pattern. With both one year and three year expectations close to the pre-pandemic norms. Expectations also appear well anchored in service of forecasters and market based measures of future inflation. This information suggests that firms, workers and investors understand that price and wage setting behaviors are likely to return to pre-pandemic norms, which will help us to return to prices stability that we enjoyed before the pandemic.

So I have noted three reasons I expect for continued progress towards FOMC 2% target for inflation, and I believe monetary policy has played a key role in driving these factors.

An open question moving forward is how spending momentum will evolve this year, which may either help or hinder this disinflationary process. I expect consumer spending to grow more slowly this year than last, which would help with this inflation. Large balances of excess savings accumulated early in the pandemic have supported household spending during the past few years. By now, these extra savings are likely exhausted, at least for the lower half of the income distribution. And we have begun to see signs that some households have come under increased stress, such as rising delinquency rates in credit card and auto loans. Just two days ago, the Federal Reserve released its January survey of senior loan officers and that survey showed continued tightening of credit card lending standards, the latest in a string of such surveys documenting tighter conditions for a variety of consumer lending. These signs of tight financial conditions point to slower consumer spending. Business spending growth is also likely to be a bit slower this year, since the widely discussed boom in factory construction may level off, albeit at a higher level. Eventually, equipment investment should rise to fill those newly built factories with

machines, but the process will likely be gradual. And I closely watched developments in broader financial conditions as well. Some measures of financial conditions have become a bit less restrictive in recent months, but remain relatively tight. Indeed, the FCI-G, a measure of financial conditions published by the Fed, and other indicators suggest that overall financial conditions are consistent with continued progress on our inflation mandate.

So I am pleased with these inflationary progress does far unexpected to contain. I must emphasize, however, that the committee's job is not done yet. Consumer spending was surprisingly strong last year. Gross domestic product grew at a nearly 5% rate in the third quarter, led by consumption. And even though spending and output growth moderated some in the fourth quarter. Consumption contributed nearly two percentage points to fourth quarter GDP growth. So consumers could surprise us again this year and that could slow progress on inflation. Last week's employment report was also surprisingly strong amid a broader cooling trend. It is important that supply and demand in both public and labor markets broadly continue well, meaning to better balance. I am also paying close attention to some upside rates to inflation posed by geopolitical developments. Russia's ongoing war in Ukraine and the widening of the conflict in the Middle East could contribute to higher commodity prices and disrupt global trade, in turn pushing goods inflation up in the U.S. When I worked at the World Bank, I followed these issues on international supply chains and commodity prices closely, and I certainly will continue to do so now.

I will remain focused on the inflation side of our dual mandate until I am confident that inflation is returning durably to our 2% target. I am keenly aware that high inflation vastly complicates business decision making and, importantly, creates serious hardships for our most vulnerable individuals and households. Having lived in Columbia during periods of high and volatile inflation, I know firsthand how destructive it can be. It is critical that inflation returns to 2%, as that is indeed the pace the committee has deemed to be consistent with prices stability. Of course, I am mindful of our employment mandate and I am closely tracking labor market developments. While historically we have sometimes seen a tradeoff between inflation and employment, as Ceci pointed out, the recent experience of this inflation has been sustained without a significant rise in unemployment. I do expect job growth to continue. However, history has shown that labor market conditions can change very quickly sometimes before we see strong signals in a spending data. Thus, I am watching very closely the totality of the data, with risks on both sides of the mandate in mind.

I am also cognizant of international risks to our employment mandate. For example, a broader slowdown in Europe or China two of the engines of global growth could become a drag on the U.S. economy. For now, I see the risks to our dual mandate as roughly balanced. Our policy stance is restrictive. But the target range for the Federal funds rate has been steady for some time now, and the most recent summary of economic projections by FOMC participants suggests that the rate is at its peak now if the economy evolves as expected. At some point the continued cooling of inflation, and labor markets, may make it appropriate to reduce the target range for the Federal funds rate. On the other hand, you progress on the inflation. For some reason it stalls. It may be appropriate to hold the target range to steady at its current level for longer to ensure continued progress on our dual mandate. In summary, I am pleased by the progress on inflation and optimistic it will continue. But I will be watching the economic data closely to verify the continuation of this progress. This approach is the surest path to achieving and maintaining both of the FOMC economic objectives, and promoting an economy that benefits all Americans. Thank you.

Don Kohn Well, thank you very much, Governor Kugler. I think you lived up to Ceci's billing. You had a lot of information there on inflation, labor markets. You made your views very clear. So we're honored that you chose, Brookings for your first speech. And and it was it was a good one.

Adriana Kugler Thank you. Don.

Don Kohn So I think let's see if we can dig in a little bit here. You've emphasized that the committee's job is not done, that your eyes are on inflation, and the primary emphasis right now, anyhow, is hitting that price stability part of the dual, the dual mandate. So what would you be looking for? I mean, we've heard Jay Powell and others say they're looking for some more good data. I'm not sure exactly what that is. Could you spell out a little bit more what you would like to see before you decided that it was time to begin easing those interest rates, so that you could be confident that you were getting to the 2%.

Adriana Kugler So, that's a great question, Don. I don't want to speak for the chair, but I will speak for myself.

Don Kohn Right. And I remember having to say that all the time. With Ben, in the audience, I had to say it.

Adriana Kugler But, what would we have seen obviously, as I said, is, rapid disinflation in particular in the second half of last year. And if you look at some of these six month and even three month measures, we're already hitting the 2% or even below the 2%, right? So people are wondering, well, what else? Right? So the issue for me is if you look at these three categories of inflation that I mentioned, goods, housing, and services except housing, they're very telling. Goods inflation started falling all they way back at the beginning of 22. Housing inflation, as I said, because of the way that it is measured mostly is pretty persistent, but we expect it to continue coming down given market rents, information that we have and better data on your rents. So that will continue coming down. But that only started in 2023, maybe around mid 23. Housing services. Services x housing, on the other hand, only started coming down in the second half of 23. It had been very, very persistent, very stubborn. And that, as I mentioned, accounts for 50% of the PC index. So that's the element, one of the elements, I should say, because there are many other elements to that I'll be watching for. But that's one of the elements that I'll be watching to see continued and sustained declines in. Right. I will be watching for the services x housing to continue showing us this inflation, because that is a key component. Indeed. Of course, there are other components such as wage growth, moderation. That's key because as I explained in my speech, right? That feeds into services housing inflation. So there are a number of elements, but that is certainly one of the elements that for me is important. And it's not that we haven't made good progress. We have indeed, we made very rapid progress. It's about saying that it's sustainable and that is durable. And that is very important to all of us.

Don Kohn To clarify that inflation doesn't, the services x housing inflation by itself doesn't need to get down to two in order to, but it does need to be low enough that a lower level of goods inflation would then you would average to two is I.

Adriana Kugler Absolutely I mean goods inflation. We have seen deflation in terms of goods prices. Right? I mean, we have seen a decline in prices in many goods categories across the board. So that is happening already. So that may level off some. So it may work

in the opposite direction. That's about a quarter of the total PC index. And we see some of these pressures from the broadening of the conflict in the Middle East that could contribute for some of that goods inflation to also come down, the lower levels of water in the Panama Canal because of the El Nino. Right? I mean, we we have it coming all ways, right? We think about all sorts of issues that could push up maybe a little bit goods inflation, which means we need to compensate. Also, as you said, with this other aspect, which before had been very stubborn, but it's certainly moving in the right direction. And we want to see that continue. I want to see that continue for sure.

Don Kohn So let's, turn to the labor market. You mentioned wages and declining, wage growth. So do you think some people have said that if productivity is one and a half ish, then wages have to be, wage growth has to be three and a half ish. So are you waiting until wage growth gets down there. Is that one of the key factors or, how are you judging, you said labor markets are nearly in balance, but not quite in balance. What would you be looking at to see those, whether those labor markets are in balance and how what how does how do wage growth factor into that discussion?

Adriana Kugler Thank you. Thank you for that question. I definitely think demand and supply for labor coming more into balance. We have seen some moderation of of demand for labor. We have seen job postings come down by about 25% since their height, and we're seeing a little bit less hiring. As I said, the good news is that we haven't seen that lower demand for labor show up as layoffs at least. I mean, I know there's some people in the media here, technology sector, there's some spotty layoffs in a few parts of the economy, but it's not showing up in the aggregate data. Right? So it's not coming up in big numbers. So that's one side we're continuing to see that there's some moderation in labor demand. Labor supply has really helped, I would say in the last year. As you know, during the pandemic, people withdrew out of the labor force in big numbers. And that has really changed with some excess retirements during that time. So many of those people will not be coming back. The good news is prime age workers, some labor participation of prime age workers is had pre-pandemic levels or above. Even in the case of prime age women, we hit record levels on labor force participation from prime age women back last June, and those numbers are still close to record levels, to be honest. So that's really helping.

The immigration stories also helping. Immigrants entering the labor force really helps, especially in some sectors. As I mentioned in construction, they make up a quarter of the labor force. In leisure and hospitality they make up 20% of the labor force, so they really make a difference in certain sectors. And according to census, so back in December, census just released new numbers and population growth and labor force growth, they tell us that about 1 million people enter between June of 22 and June of 2023.

The CBO has released numbers, which tells us that those numbers are even bigger. All right. So those numbers are probably helping in terms of labor force participation. And maybe some of those immigrants haven't even fully come in to participate in the labor force. So maybe we're still to see some some impetus in labor force participation, from that side. So that's helping. And again, that brings us more into balance. Another aspect which I would say is usually unappreciated. But, you know, as a labor economist, I pay attention to these things is, improvements in match quality, match quality and the speed of matches. That's essentially, an increase in effective labor force participation. There is evidence of that. So that that's another additional impetus on labor force, on the labor force side, that really helps to bring this into balance. Now, as to your question, we do need wage moderation. We have been seeing it, especially in the services sector, as I mentioned, from 5.2 to 4.4. All of the data, whether you use ECI, whether used an average hourly

earnings, no matter what data you use, show you that trend down, has been happening. And in some sectors, as I mentioned leisure and hospitality, they came down from 14% to 4.4%. So that that's happening, it's very real and it's making its way through. Right? In terms of filtering through prices to lower prices. Now, where do we need it to be exactly? That's not so clear, right. I wouldn't pin it to a number. I do want to see that continued trend. But it depends on productivity. It depends on markups. It depends on many other factors. So I would say roughly we think it needs to still come down some more. And we're not quite there yet, but it's definitely moving in the right direction.

Don Kohn So I was about to ask you about productivity. You just brought it up. We've had two big quarters of productivity growth. Do you think productivity is in the process of picking up or is that just make up for earlier misses? I think from 2019 or so we're still about one seven or so, something like that. So how are you looking for that productivity.

Adriana Kugler So the way we usually measure productivity says as productivity per worker. Right? So naturally as there's some moderation in labor demand that's going to pick up that that's one factor that is contributing to that. And if that continues that will continue to happen. But the other parties is technical change, which everybody's talking about. Right? AI and an actual technical change and, and productivity changes that are here to stay. And I think it's too early to tell. Right. And we need to see if generative AI is in fact going to, to be here, to stay, to make a difference. Across the board in many industries.

Don Kohn Okay. Yeah, I agree, for what it's worth. Some of the factors you cited. So the increase in labor force participation, maybe even the degree of immigration, the unwinding of the Covid, Covid supply chain issues, so the remarkable performance of the U.S. economy is, importantly, as you've emphasized, a result of increases in supply as well as the Feds damping of demand, is there a risk that that those increases in supply won't continue would make, would make your job somewhat harder, to, continue that progress toward inflation? So that's one of the things you'll be watching.

Adriana Kugler Absolutely. I, I think your characterization is, is right that the, the situation we're in now is related to both what has happened from our side at the Fed on, on the demand side and the increase, restrictive stance of policy as well as the supply side. Right? I mean, we see supply side, issues as winding down, as I mentioned in my speech, they have been healing, but I do not think they're fully healed. I think there's still room. There's still room to go on the supply side, both in goods and in terms of labor. I. Mentioned extensively where I think we can still potentially make some increased progress in terms of the labor supply side, in terms of the good side. I would say there are many measures on supply disruptions and how much, they have gone away or not. They instituted for, for supply management, for example, has some measures. They showed, delays in deliveries, backlogs, all of those seem to have gone away. But on the other hand, if you ask people in manufacturing about whether they have full access to work at capacity, they tell you they're still seeing shortages in materials. There is about 20% of companies that are still seeing shortages in materials, in production, in manufacturing. That did come down from 45% by 21. But but there's still some substantial, right, disruptions that are, that are still there that kind of still continue to, to work their way through and help us.

Don Kohn So some of the goods disinflation could be, pardon my language, transitory. I said that you didn't say that. But some of it may not persist. Right? I mean that's a that that's something to keep looking at.

Adriana Kugler As I said, there has been a whole lot of good disinflation since, since early 2022.

Don Kohn Right.

Adriana Kugler And and right now we're seeing deflation. Yeah, we're seeing a reduction in in prices of many goods. Okay.

Don Kohn So let me ask a little bit about where, we've discussed a little bit about what you'll be looking at for when to begin easing off policy. Let's talk a little bit about where the ultimate destination would be. So in the Federal Reserve's, quarterly forecast, the median projection by FOMC participants is for interest rates to settle out. Nominal interest rates are 2.5%. But there are a lot of people who think that there are upward pressures on those longer term interest rates or increase deficits. They're building supply side resilience, or things like that. So how are you thinking about once the path begins? Where is it going to, is it going to portend a bit higher, or star a bit higher final settling place for or for interest rates?

Adriana Kugler So, as you know, there is a lot of uncertainty in measuring the near-term rate of interest. So deficits come in persistence of, of demand, persistence of these, dissolution of supply side disruptions, but even technology and population. Right? So there is a whole lot of uncertainty. So I don't think anyone is about to find out what are stories today. Right. But but we do think about these issues, right. I think more important than thinking where exactly we're going to end up is what that path will be. And thinking about the different factors that will be relevant in determining where we need to go next. So as I said before, I think this inflation is clearly happening and it's happening at a good pace. It's continuing. We see reasons, as I mentioned, to see that it would continue. I think, growth and employment have been resilient. So we see that side of our mandate also as us moving so far in the right direction. Now the job is not done yet, so we will certainly move forward in terms of the Federal funds rate. And that path will depend on how we get, and how we start seeing our movement towards our target. So we're targeting inflation, so that will be critical. Having said that, I do think and I am watching closely because historically we have seen incidents where unemployment rises suddenly without much warning. So we're watching that also closely. And that will also determine our path. But I would say the path is what is most important than the ultimate end goal, which which we won't know until we're done with it.

Don Kohn All right. Thank you. Let me ask one more question before we turn to the audience. Financial stability issues. So very prominent, in the news today are concerns about commercial real estate exposures at regional banks. Their equity, their share prices are down sharply. Do you see the CRE problems, office buildings and some retail as a real threat to financial stability? How do you judge how how well is the bank? Will the banking system cope with this, oncoming repricing of, of commercial real estate?

Adriana Kugler Yeah. Let let me just generally say that that there, there's significant sources of resilience in terms of financial stability. For example, the balance sheets of households and businesses seem to be solid. The banking sector, despite the events last March, as seems to be sound, generally sound, though we continue to monitor closely. I do. I do pay a lot of attention to CRE as a source of vulnerability. I think it is, something we need to continue to monitor. Valuations appear to be much higher than than the actual fundamentals. And the supplies in particular for, office space. And I think, you know, we

have seen changes in return to office, policies in people working from home, all sorts of things that that change the need for office space. So there seems to be some issues, with valuation, which I haven't fully realized because there have been very few transactions in the recent past in those properties. So we don't know exactly, but we're certainly watching very closely that side as well as non-banking sector institutions as well.

Don Kohn So but overall, you would say the regional banks, the banking sector itself is well capitalized and liquid. There may be. I mean, how are you, have you done a particular analysis of some of these regional banks that have the exposures?

Adriana Kugler I actually do serving in a subcommittee for small and regional banks. And so that that's something we pay attention to. Right? We pay attention to exposure to commercial real estate. We pay attention to how well capitalized banks are. So we're definitely keeping a close eye on those issues.

Don Kohn Okay. Thank you. So let's turn to the audience. Yes. And make let's make sure these are questions.

Audience member Thank you. Yes. You've presented and discussed a lot of very favorable macroeconomic data, but a person who cares about who the next president is well aware of the fact that, at a micro level, people don't think the administration is doing a very good job on the economy. So what has to happen for the macro developments to be reflected in micro developments?

Adriana Kugler So, I'm not going to speak for the administration because as you know, the Federal Reserve is an independent and nonpolitical agency. So I'm going to I kind of speak for how I see, right, that that potential disparity between the macro data and how people are feeling that data in their real lives. Right? So I, I mentioned I care about this, right? I don't just care about. Right, the aggregate numbers and the average numbers. I realize when we talk to a lot of people as members of the board, we talk to a lot of people from across the country, from different communities to hear their stories as well. So I think there's a notion right? The data only sees the average. And we do realize, there are differences between different groups. For example, as I said, household balance sheets are in pretty good shape, but we're seeing some weakening of household balance sheets for those in the lower half of things. Tuition, increased pressures in terms of excess savings disappearing right after some of the help that they received during the pandemic or, they need to start repaying student loans again, or they're very high prices of auto insurance. Right? Things that affect like Day-To-Day, right? Your bills and how you see things. I think that's where you see some of these parting. I think also it's important to remember, right? Prices have gone up, the level of prices have gone up. And that's something that people see every day. Right? The price of gas, the price of eggs, milk, bread, what you consume every day, every week when you go to the supermarket and when you go to to the gas station. Right? This is kind of how you you view things. So those prices have gone up, but wages have also gone up and they have gone up by more than prices. So I think people will realize that real wages have gone up at some point. They started seeing that the two things are coming to balance and that is, I think, in part why maybe sometimes people are not feeling that progress, in their daily lives and they're not seeing the improvement necessarily.

Don Kohn Yes. Introduce yourself please.

Audience member Well done. Thanks. Rich Miller at Bloomberg. Thank you very much for doing this. Appreciate it. The Fed seems to have set a fairly high bar for the first rate cut. Chair Powell said it would be a highly consequential decision. Governor Waller says the worst thing a big mistake would be to cut and then have to reverse. And and the FOMC itself says you need greater confidence. Does that suggest that once you clear that bar, you can move with some alacrity to reduce this, amount of restriction that we see? Thank you.

Adriana Kugler Thank you for your question, Rich. I, I think it is, something that we're paying attention to. I would say. That we we don't. We don't actually know. Right? Because even from now until March, right? We're going to get two new reports on inflation. We're going to get one new report on jobs. We're going to get another new report on ECI. So compensation right. We get a lot of new data even between FOMC meetings. So I would say we we kind of say oh yeah we'll once we card we'll go gradually or we'll cut right away. It will depend on many factors. I don't think we can call it out now.

Don Kohn Were you part of the median 75 basis point cut in December?

Adriana Kugler You know, I've been at the FOMC for the past four meetings. Yeah. So that tells you, right?

Don Kohn Okay, perfect. More questions from the audience before I stick my foot in my mouth. Louise, I I'm there.

Adriana Kugler Right? I mean, I mean, all those meanings that I mean, they said for for the past two cycles that have included a sub. Yeah.

Audience member I'm Louise Sheiner from the Hutchins Center. Hi. How are you? So you mentioned sort of thinking about inflation in three buckets, which is how I think about it. We've got housing, we've got goods, and we've got, services x housing. Are you worried about the possibility or how would the Fed look at it, that you actually go below target next year? Because with those pieces, with deflation on goods being higher than it is normally, it seems quite possible that you might say that underlying inflation is still not quite a target, but the actual measure, inflation is well below. And would that be a communications difficulty for you? How would you look at that.

Adriana Kugler So as I said, I think there may be a little bit of a reversal on the good side, we we don't actually know, but there's some factors that could create upward pressures and goods inflation. I think the issue is how it averages out. Right? We are thinking, as you mentioned, about what's measured in what to measure, for example, in housing inflation, we definitely think it is lower than what it looks like right now, because if you even look at these research series that the BLS has put out on new tenant rents index, right, that shows you plus market rents that we made using open sources showed that that's probably lower than it looks like right now. So we're taking account of all of that. We're definitely looking at, you know, not only what's measured but what we where we actually expect it to be.

Audience member I'm just saying if because deflation continues at the rate it's been, you could get an inflation number of, you know, one and a half next year and you might still say, we're not done. And I'm just wondering about that kind of difficulty of that could arise.

Adriana Kugler We're definitely thinking of that. Yeah. But you know, we I think the whole issue is that that averages out and they're still reasons why we may expect upside

surprises due to inflation, as well as downside surprises on employment. The risks are roughly balanced, so we don't know where it will go.

Don Kohn Another question. Yes. The back of the room. Thanks.

Audience member Thank you. Pedro de Costa MNI. So to follow up on Rich's question. You mentioned we get a lot of data between now and March. Is March a live meeting in your view? And then secondly, why do you think it's taking so long for shelter inflation to ebb, given how long? New rental, new lease rentals have been falling.

Adriana Kugler So let me start with this second one. As I mentioned there, these Year-Long lease agreements. So the way the BLS collects the data on housing inflation, which feeds both in the CPI and PC, is by by looking at a sample of of renters, they they interview people every six months. And six of the sample is interviewed every six months. And then they slowly add people to each of those six of these samples. So it's very slow moving. That's why they created that other series that I mentioned, the new Tenant Rent Index, to capture only new renters. So that's that helps to kind of look at actual changes in prices of this same property, holding everything else constant. Right? So that's one of the reasons, right, when we look at that new research series that they're creating, when we look at, market brands that come from other sources, we see something different. We see a faster decline in housing prices. It's just not coming through the data yet. We think that's already starting to happen more quickly than it shows up. So can you can you repeat your first question now?

Audience member [unintelligable]

Adriana Kugler So look, every meeting is life itself. That's the way it goes. We don't make decisions. So close the door because we will get new information. We have to react to new conditions. We have to react to information that is coming. And as we are not going to make a decision now, for a decision for something that is going to be made in seven weeks from now, certainly March, May, June, every meeting from now until the end of the year and moving forward will be live. Every meeting is live. Okay.

Don Kohn All right. Yes.

Audience member Okay. Hi. Bryson with [unintelligable]. I'm curious for your thoughts on the role that wages play inflation. And is it perhaps time to deemphasize how much of that is a trigger for any potential concerns about the inflation rate? Of the wage price spiral. And should we? Some would argue that this issue between the Great Recession and now wages will sort of lagging behind. And then we had the pandemic and you saw this acceleration in wage growth. But it seemed that inflation was caused by other factors outside of wages. So do we need to be as concerned about people getting higher wages.

Adriana Kugler So first let me say that real wages are up. No matter what metric you use, right? Real wages are increasing at 1% if you use ECI. They're increasing at 1.5% and you use the average hourly earnings. So they're going up. That that is the reason why I mentioned. Right. If people see that they're going to start demanding lower wages because they can't keep up with the cost of living. That's really important. So that will that will continue to plain until we're more into balance, right? Of course there are other factors. I would say we have not seen a wage prices spiral. I would say we have not seen that type of dynamic. And I described that in my speech. I just don't think that actually happening that way this time around. And that was managed through, inflation expectations.

Precisely. Right. Both. Firms businesses are realizing, well, they cannot keep posting prices at that level because consumers will push back. And by the same token, workers are realizing, well, my salary is now above what it was to sustain my cost of living, my usual cost of living. And so that's that's something that, you know, makes me think that I can. Not butch, but it's this much pressure in terms of of increasing, asking for higher salaries and wages and that that is happening. And we hear stories like that.

Don Kohn All right. I think that we're about out of time. So thank you, Governor Kugler. Thank you very much. Thank you Don. Feel free to come back anytime. We do. Happy to welcome you again. Thank you. Thank.