Uneasy Calm at Fed's Jackson Hole Conference

Adam S. Posen says the mood at the annual Economic Policy Symposium sponsored by the Federal Reserve Bank of Kansas City at Jackson Hole, Wyoming, which he attended in late August, reflected widespread concern about the Fed's ability to fight the next economic downturn. The Fed chair, Janet Yellen, sought to calm nerves at the conference but left many participants uneasy about continued slow growth in the United States.

Unedited transcript of interview recorded August 31, 2016. © Peterson Institute for International Economics.

Pedro da Costa: Hi, I'm Pedro da Costa, Editorial Fellow here at the Peterson Institute for International Economics. I'm joined by Adam Posen, President the Institute. Thank you for joining me.

Adam Posen: Thanks, Pedro.

Pedro da Costa: So you've just come back from the Kansas City Fed's Annual Jackson Hole Symposium. And I wanted to get your sense of the general mood of the conference and what you took away from the gathering.

Adam Posen: It's interesting, Pedro. I've been lucky to get to go in the last four years. And it's gotten to be a really good conference in the sense that Fed Kansas City Esther George, the President, essentially pushed out a lot of the markets people. There's essentially no markets people. It's all Central Bankers, ex-Central Bankers, academics, a few other officials.

And so, the discussions get to be pretty serious and people aren't really talking their focus. They would if they were at a market interest. This year was a little funny because the last couple of years had just been a really clear theme. So, two years ago, it was taper tantrum and how the emerging markets were going to react and the surprise that a lot of emerging markets were actually wanting Fed to hike. Last year, the theme was about should the Fed hike, shouldn't the Fed hike, a lot about unemployment.

This year was more muddled. The Kansas City said, well, we want to worry about what they called resilience, which is the ability of the Fed to respond if there is another problem now. And that's a really serious issue. But it ended up being a lot of maybe two academic papers. And the Chair, Janet Yellen, gave a speech at the start that was very calm. Now, to be fair, she wasn't the only calm one. There was much more calm at the Central Bankers than I've seen for some time.

Pedro da Costa: Yeah. And so, one of the things as you mentioned, the theme was designing resilient frameworks for monetary policy. But Yellen's speech seemed to, at least for the moment, write off any other advances in monetary policy thinking and pretty much stuck to the script that we're an inflation-targeting Central Bank, right? That just it's aiming for 2 percent and we expect that we're headed that way. And, therefore, we're thinking about raising rates. So there was no kind of different policy message from that. Is that fair enough?

Adam Posen: I think you're right. I think that's a very fair assessment. The Chair's speech, first third was basically saying the economy is on the path. I think the famous quote is something like the case for tightening is stronger. It's gained strength over the last few months. It's a very clear, mildly hawkish as the statement goes message.

And the larger third of the speech were focused on some recent research by the Fed, which obviously the Chair had stimulated saying, "Okay. If something terrible were to happen to the US economy right now, could we respond as the Fed?" And their answer was a pretty calm yes. We could do a lot more QE, which our colleague here at Peterson, Joseph Gagnon, has argued would still work. And I think he's largely right.

But as you said, Pedro, they dismissed or the Chair dismissed some things. So Fed Chicago President, Charles Evans, had spoken about, well, maybe we should wait until inflation rises before we act. Fed San Francisco President, John Williams, had spoken about maybe we should have a higher inflation target so there'll be more room to cut next cycle. There are a lot of people including me obviously who were talking about negative rates as a tool.

And the Chair very quickly dismissed all of those. I mean some of them she clearly thought had a decent argument. But she just said they're just not relevant right now. We're not going to talk about them.

Pedro da Costa: Yeah. That was interesting. So, do you think that the Fed sounded overly confident in the end? Because the sense in the markets really is that Central Bank as much as they like to say that they have lots of ammunition left. That they've done a lot and they are reaching perhaps the outer bounds of what their policy arsenal has to offer, do you think there was a little—do you get a sense of complacency by the Central Bank?

Adam Posen: I'm not sure your complacency. It is difficult because you don't really want the Central Bank publicly saying, "Yeah, sorry. Whatever happens, happens," unless that really is the case. And I think there's good reason I think that's not really the case.

But there was, I think, in the Chair' speech and in all the conversations around it, I think there was too much—what was it? How would I put it?

If we have to cut rates but we don't go below zero and we do some QE it will be fine. If you're ruling out negative rates, if you recognize that unfortunately Congress has restricted the Fed on what it can buy in ways the other Central Banks aren't, then there's reason to be a little nervous.

A second thing, not to belabor this, is the Chair didn't make a very realistic statement that a number of colleagues has made that what they call r-star and y-star, trend rate of growth y star meaning productivity and r-star what's sort of the neutral interest rate, what the interest rate you'd end the tightening cycle. Both have come down. And that's a recognition of the reality that we're not growing as fast and we're not likely to grow as fast for a while.

Pedro da Costa: That's the more dovish side of her remarks in the sense that even if she might be talking about the case strengthening for near-term hike she's suggesting that in the long run they're not going to go that far. Is that correct?

Adam Posen: Well, I don't recall dovish. You're right in what she is saying as Fed New York President, Dudley, said a couple of weeks before. We're only going to raise rates only so high, not up to the 400 basis points the way we usually do, maybe 300 [inaudible 0:05:20].

But it's not dovish because as Stanley Fischer, the Vice-Chair, said just a few weeks before also, "If this is as fast as the economy can grow, then we feel we have to raise rates now because we don't want to go too fast and get inflation because it's not going to be sustainable."

And that was actually one of the surprises of Yellen's speech is that she pretty much agreed with that point of view. And it's a pretty legitimate point of view. But there's starting to be people both inside the FOMC and outside like Larry Summers, Paul Krugman, and others [inaudible 0:05:55] who are arguing they're sort of what you could call positive hysteresis. If you run the economy hot, you may actually be able to raise the growth rate, not just temporarily increase productivity—

Pedro da Costa: Including by, perhaps, bringing some of the people who have fallen out of the labor force back in and things like that.

Adam Posen: Exactly. And the Chair presumably speaking in her role as Chair of the Committee, not necessarily her own personal view, pretty much ruled that out at present.

Pedro da Costa: And do you get a sense given these limitations in monetary policy that Central Bankers are more inclined to discuss the need for greater fiscal policy action? And if so, which countries do you think are either inclined or that should be doing?

Adam Posen: Yeah. I mean this is something which as you know we've talked about at a number of events here, not just you and I, past Peterson Perspectives you've conducted here at the Institute. Essentially, all the logic for fiscal expansion is there if you're not Greece, if you're not Argentina.

The interest rates are incredibly low. Nobody is panicking in the rich countries. There's huge amounts of public and private investments that had been foregone in recent years. Central banks are able to keep rates low. So why not spend? Why not do this?

And then there are people getting like Krugman and Summers and Brad Delong and others who go further and say, "You actually crowd in private investments." So there's a whole really solid set of arguments why you would want to do this. And repeated G7 and G20 community case keeps saying, "Yeah, everybody is doing fiscal stimulus instead of monetary. Too much monetary causes, inflation causes, asset bubbles, it's bad. Let's do fiscal."

So, anyway, what you said is right that there was a pretty strong message not just from Chair Yellen, but from a number of the other Central Bank Governors at the meeting that we really wish fiscal policy would take over. We really fiscal policy would do its part. Of course, the flipside being an independent Central Bank is you don't set fiscal policy. It's elected parliaments who do that.

Pedro da Costa: And you're shy about even proposing that because it's not your mandate.

Adam Posen: Yeah. That's why you're absolutely right to raise it because it was striking how much the Central Bankers did this. And to the Fed Kansas City's credit, they set it up so the meeting the luncheon speaker was Chris Sims, Princeton, who was a Nobel laureate. And he actually used the occasion to make, for my taste, a very theoretical, but anyway, argument for why in the end you need fiscal policy not monetary policy.

Pedro da Costa: Interesting. And as far as the sense from overseas, of course, one of the factors that's kept the Fed from raising rates is not just a domestic outlook really. It's primarily actually risk from overseas. First, it was China. And then they became worried about Brexit. What was your sense from the overseas Central Bankers and speakers at the conference since this is, of course, a very international event?

Adam Posen: Yeah. I don't remember the number, but there's several dozens of foreign Central Bankers including from Latin America, Africa, East Asia, South Asia, Australia, as well as Europe. I think they're much calmer than they've been.

Adam Posen: Now, again, that doesn't mean everything is wonderful. And it was worth noting that the Chinese government for the second year in a row did not send a senior official from the People's Bank. They're the only ones not to from the last few years. So maybe that's a signal. But among the Latin American Governors she spoke to. The Asian Governors she spoke to. Even the European Governors she spoke to. There was a sense, yeah, things aren't that bad.

Now, that's a relative state. So Agustin Carstens, a very distinguished Governor of the Bank of Mexico, Central Bank of Mexico was one of the closing speakers. And he said, "Well, you guys have ignored the emerging markets these last few days too much. And we at Mexico are able to weather the storm that's because we take tough measures."

Pedro da Costa: And even they have had a quarter of negative [overlapping conversation 0:09:46].

Adam Posen: Oh yeah, yeah, yeah. It's not something easy. And Governor Kuroda of the Bank of Japan made it very clear that he intends to do more and push more. But there definitely wasn't the sense of anxiety or pressure that one saw at Central Bank meetings over the last several years.

Pedro da Costa: Sure. I guess the further away you move from the crisis epicenter of 2008, the calmer it gets.

Adam Posen: Absolutely.

Pedro da Costa: Thank you so much, Adam. I appreciate the update.

Adam Posen: Thank you, Pedro.