THE ECONOMIC CLUB

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Executive Conversation

Tom Barkin

Speaker

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JODIE MCLEAN: Tom is the eighth president and chief executive officer of the Federal Reserve Bank of Richmond, where he has been for six years. In that role, his responsibility is the bank's monetary policy, bank supervision and regulation, and payment services, as well as oversight of the Federal Reserve system's information technology organization. So, in addition, he serves on the Federal Reserve's chief monetary policy body, the FOMC.[1] Tom hails from Tampa, Florida, originally.

He has more degrees than I understand from Harvard – [laughter] – but he does have three degrees from Harvard. But I think one of all of our secret weapons with Tom is that Tom has 30 years' experience in the business world prior to coming to the Fed. He served at McKinsey, where he oversaw the southeast part of the country, but he was also the CFO and, I think, the chief risk officer prior to joining the Fed. Additionally, he has background in the Fed before joining, where he served on the Atlanta Fed board from 2009 to 2014, and chaired that board from '13 to '14. So, Tom, thank you. Thank you for joining us here today.

And I think it is interesting. I guess we just had an FOMC meeting, January 30 to 31. Did you vote?

TOM BARKIN: I did. I did, yeah.

MS. MCLEAN: You did vote. Your vote –

MR. BARKIN: It would have been a little awkward to not have – not have exercised the right.

MS. MCLEAN: Can you give us a little bit of inside how does that work? Who votes? How does the voting work? Tell us a little bit about that.

MR. BARKIN: OK. So there are 19 members of the FOMC. And for some arcane reasons that are built into the statute, 12 of the members vote at every meeting. So the seven governors all vote, and then the presidents vote in a rotating order. I'll say, I'd really don't think it matters. We haven't had a one-vote margin in at least 40 years. It's a consensus-oriented organization. And maybe most importantly, during the times I've voted and the times I haven't voted, I've felt equal ability to try to have influence on what's happening in policy. So we go to the meeting. There's often presentations by the staff. There'll be a go-around on economic conditions. There'll be a briefing on – discussion on policy. There'll be a go-around on policy in the memo.

And then when it's all over, there's a secretary who'll call the roll and vote. So, you know, Jay[2] will vote, then they go in alphabetical order after that. So as a Barkin, I feel that my vote counts – [laughter] – at least somewhat more than others.

MS. MCLEAN: How many people who are voting have a deep business background, like yours?

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[1] The Federal Open Market Committee (FOMC) is a committee within the Federal Reserve System that oversees the nation's open market operations and makes key decisions about interest rates and the growth of the U.S. money supply.
[2] Jerome (Jay) Powell, chairman of the Federal Reserve.

MR. BARKIN: Well, it's a mix of people with a mix of skills. I'd have to think about it. Most of the – almost all of the members of the committee have backgrounds in policy or in economics. There's a zillion Ph.D. economists. I think Jeff Schmid, who's in Kansas City, was a banker. And then me, my background. I think that's about it.

MS. MCLEAN: So do you think it distinguishes you in the room?

MR. BARKIN: Oh, that's what I tell people outside. [Laughter.] But I think there's value to diversity. And I think there's value to having a different perspective in the room. I'm a competitive person and so, you know, when I joined the committee I tried to ask myself: What am I going to say that's going to be useful, different? And I do think I had the opportunity to work with companies as they decided whether to hire people or fire people, to raise price or occasionally to lower price, you know, to invest in capital expenditures or other big investments for the future, or not. And so I think as we're testing the economy and trying to ask questions of what's actually happening, I would like to think I've got something to add there.

I also think, having been, you know, at McKinsey, where there's lots of very smart people, you know, building models, and you're always trying to test them, I also try to bring some amount of critical thinking to the question of, you know, the models that we're looking at, how valid are they or not? You get into interesting questions. For example, rate increases famously work, as Milton Friedman said, with long and variable lags. But if you ask people how long the lags are, they're actually pretty long and pretty variable. And so the confidence interval on a lot of these things is so wide as to ask the question how you making policy against them. And I like to try to do some of that stuff, bring some business judgment, if you will, to some of these academic questions.

MS. MCLEAN: One of the things I've noticed, we have a national platform. I feel like I'm on the road a good bit traveling. I don't think that I hold a candle to your schedule. One of the things that Tom is really well known for is the work that he does at least two or three weeks a year out on the road, going and talking directly to businesses. Talk a little bit about how you gather, and why. Why do you do that?

MR. BARKIN: Two or three weeks a month, not a year? Yeah.

MS. MCLEAN: Yeah, a month, sorry.

MR. BARKIN: Well, so, I mean, I was in western Carolina – so, my district is South and North Carolina, Virginia, D.C., Maryland, and almost all of West Virginia. And I try every week to be out. So I was – Monday, Tuesday – I was in Asheville Monday. Booming, booming city. I was in western Carolina Tuesday. Actually, the Cherokee Indians have a casino there and a whole operation. And trying to understand the part of Appalachia that's also in my district. And when I'm there, I will always try to find whatever the most important businesses are there and try to understand how they're seeing the economy, whether it's, like I said, you know, how they're doing pricing, what their demand looks like. I'm trying to get real-time signals there.

I'm trying to understand what's happening in the towns. Like I said, Asheville is a lot different than western Carolina. D.C. is a lot different than South Carolina. And trying to understand my district as best as I possibly can. And then almost always there are issues going on that I can learn from, whether that be you know, childcare, or housing, or any of those sorts of things that are happening.

A couple of interesting things I saw in Haywood County, North Carolina yesterday. A paper plant closed, 1,100 people laid off in a county of 17,000 people. One year later, the unemployment rate in Haywood County was actually down at 2.9 percent. So how could that be? And I think it just speaks to this issue we're having with the labor market – not issue – the positive of the labor market, which is: How does unemployment stay so low? And the answer is, there's a lot of people still looking for workers. And in Haywood County, there were a lot of people still looking for manufacturing workers. Many more open positions than the number of people laid off. And so people got repotted.

There's this question of reprioritization of spend. You know, when does the consumer spending surge slow down? I was talking to the casino. The casino's got every bit as many visitors as they had a year or two ago, but the average spend is down almost half. What's going on there? I think it's people aren't at the $25 table. They're at the $10 table – for anyone listening, I don't really do a lot of gambling, but I'm assuming that's what the tables are. [Laughter.] And when you're – when you're looking at reprioritization of spend, you start saying, OK, now I get it. You know, people have only this much money. They're spending more here, or they're spending less there. You just – I think you understand the economy much more fully if you're on the ground in Haywood County than if you're not.

MS. MCLEAN: It is, sorry, two to three weeks a month. It's remarkable how much information you collect. Talk a little bit also about the board – the board of Richmond, you also have an advisory board in Baltimore, you have an advisory board in Charlotte. We get together eight times a year to give you really a roundtable. Discuss sort of the motive behind that and how you think about your board.

MR. BARKIN: Yeah. So, first of all, thank you for your service, and, Barbara, for yours, and Alice is here, and Cecilia I saw. And I'm probably missing somebody that I apologize for if I did. You guys are nice enough to give your time to us. And what we do is eight times a year we basically tap your brains on what's happening in the economy. And I try to construct boards that have a diverse view of what's happening in the economy. During COVID, we had the CEO of a health care system on our board. And he was very useful for understanding, you know, what was happening in terms of – whether it was vaccine rollouts or, you know, shutdowns in the economy.

Jodie's got a dual hat, because she's in real estate which is very useful, but also retail real estate. And so understanding what's happening in the consumer side, which is 70 percent of the economy. Barbara brings a lot on the industrial side. So we're getting, I think, a broad-based view of what happens in the economy. And, if you will, every six weeks, I get to both tap their thinking on what's happening in the economy and test my thinking about what I'm saying. And quite frequently – and I was on the Atlanta board, as Jodie said the beginning, so I had this

experience. You know, quite frequently I walk out with my views deepened, shaped, or changed. And I really like the opportunity to test my synthesis from six weeks out in the market every six weeks with a bunch of people who, you know, have a broad-based – a broad-based view.

MS. MCLEAN: All right. So inflation data, it's looking very good. As somebody who's in commercial real estate, I'm highly interested in when we're going to get about this, and landing the plane. Where are we in landing the plane?

MR. BARKIN: Well, the airport's right there. [Laughter.] But we're still up in the air. And so there's some room between where we are in the runway. And you definitely want to land on the right runway and not the wrong runway. More seriously, I just say the data that has been coming in over the last couple of months has been remarkable. Just to give you a feel for some of it, GDP came in in the fourth quarter at 3.3 percent growth. Normal would probably be two or a little bit under. GDP year over year, fourth quarter to fourth quarter, 3.1 percent growth. So demand's still very healthy.

Now, unemployment 3.7 percent. We added 353,000 jobs last month. This is still a tight labor market. And I should say, we haven't had two years of under 4 percent unemployment in over 50 years. And so a very strong labor market. And inflation, which at the beginning of last year was still quite elevated, the last seven months have actually been basically right at our target. So the 12-month numbers are 2.6 percent, core would be 2.9 percent. But the last seven months, 1.9 percent. So, you know, inflation down, while demand is still healthy. That's why the drumbeat you hear is the soft landing drumbeat.

I'd say the challenges on inflation, it's not that broad. It's really been disinflation in goods. A lot of goods prices increased with all the supply chain issues. Some of them started coming back down. Apparel would be a good example. Used cars would be another good example. And services and rent inflation have both stayed more elevated. And so inflation overall is down. The mix of it is not as broad based as, you know, you might hope. And so we'll just have to see whether it's going to stay sustainably down, which would be terrific, or if there's still more inflationary pressure to come.

MS. MCLEAN: What could drive that inflationary pressure?

MR. BARKIN: So you want me to go dark here? [Laughter.] No one wants to hear that. Well, I mean, wages are still – wage growth is strong. And that's not a negative, especially if you're a worker. But to the extent that productivity doesn't come along, that runs the risk of, you know, creating increases on the services side, especially. Housing is still tight. And so while there are a lot of people forecasting that rents will come down, it's also the case that houses are still selling very quickly and prices and rents are still increasing. And there is this question in my mind about whether the drop we've seen in goods prices is sustainable or whether this is just a rollover from COVID, and in the end we're going to have a different lens.

So you could well have pressure on prices. I'll even say more broadly, you know, we had 20 years before COVID where businesses knew they had no pricing power. And consumers

knew that prices never went up. And so if businesses thought about raising prices, consumers would switch to private label or something else. Or intermediaries, you know, retailers would say: Don't bring that price increase into my shop. I think you've had two years of significant price increases. And so I do think businesses feel they have a little more pricing power than they used to, or at least price is on the list of levers to use in a way that it wasn't before.

And so I do have this question, and for the economists you could put it in the realm of inflationary expectations, whether the expectations of businesses and consumers, which had converged so neatly into a very narrow range, haven't just widened a bit, and whether that wouldn't create more ability and confidence in price setters to increase prices and for price receivers, like you and me, to actually accept it. So that's not a prediction or a forecast. I'm not saying that's going to happen. But that's the risk. And that's one of the risks I think I'm trying to navigate against.

MS. MCLEAN: So do you have a sense about this consumer? Because consumer has held up remarkably well. They really have. They don't seem to have fear for their jobs. But do you see them continuing to grow in strength? Or do you think they're going to slow down a little bit?

MS. MCLEAN: Well, so there's this – so the story a year ago was the combination of stimulus and suppressed spending during COVID meant that consumers had all this excess savings in their pocket and that excess savings was getting spent down month after month after month, and eventually they would run out, and then spending would slow. That was the story a year, a year and a half ago. And I think if you look at what's happened, it is the case that when you talk to people who sell to lower-income consumers, and even middle-income consumers, that those consumers seem to have hit some limit. They're reprioritizing. They're stretching. People who sell to higher-income consumers don't tell me that at all. I mean, there's still – you and – you and I are still spending like drunken sailors.

But I think now when you reflect on what's happened the last year, you have to ask a different set of questions. And I think about it like this: For the last year, year and a half, unemployment very low – 3.7 percent. Wages are up. And wages are up faster than inflation over the last year, year and a half, not the two years before that. And so people have more spending power. At the same time, the equity markets have been very strong, home values have been very high. And so people with assets have more wealth. And so the combination of those two seems to have encouraged people to spend more freely than they otherwise would. And the indicator for that is the savings rate.

The savings rate, which is the percent of your income that you save, before the Great Recession was sort of in the 4-5 percent range. After the Great Recession, it went up to the 7-8 percent range. And so people were saving a lot more, maybe home values were down, people were saving for retirement regardless. For the last two years, it's been back in the 4 percent range. So people are spending more out of their earnings than they were or than they did over the over the prior 10 years. And I think that's because they've got jobs, wages are up, they've got more wealth. And so they've got more confidence. And maybe there's even a, you know, post-COVID what was I saving it for kind of emotion going on there.

And as long as that continues, I think you'll see a healthy consumer spending environment. You know, recessions – I don't want to use the R-word – but there's a lot of talk about how they come, you know, rates and all that stuff. Most of them come suddenly. And something happens – think the pandemic, think Lehman Brothers, think 9/11 – that causes consumers and businesses to pull back strongly in unison. That's really the most likely scenario for when things go south. And you can't really forecast that. So my forecast doesn't have that happening, but that's the thing you always worry about, is something that causes people to pull back. And that would be the risk on the spending side.

MS. MCLEAN: External shocks.

MR. BARKIN: A confidence shock of some sort, which could come from external or any other source.

MS. MCLEAN: So are you telling us that the 2.6 or the 2.9 is not enough to say we're done, we just call it a day?

MR. BARKIN: Declaring victory is very enticing. But you're never going to hear me do that. I think our target is 2 percent. And we'd like to get inflation down to 2 percent. It it's not a – it's not difficult to stay focused on that when you've got an employment market that continues to be as strong as it is. And I said something about that earlier. I mean, we have an unemployment – I mean, we have a labor market that is at historic levels of strength. Job gains, unemployment, job openings, initial jobless claims, all these metrics are very strong. And inflation's coming down. And so I'm very supportive of being patient, you know, to get to where we need to get. I say at this point the trade off, which is, you know, coming into better balance, is still being in favor of continuing to work on inflation.

MS. MCLEAN: So are you aware of $2 trillion of commercial real estate loans coming due? About $660 billion that will mature in 2024 alone? I think about 20 percent, maybe just under 20 percent of that, is in office. Does that raise concern for you, and that coming? And how does the Federal Reserve think about that?

MR. BARKIN: Well, I'll talk about how I think about it. Which is, commercial real estate's a big sector. Probably better – you know, retail, your sector, is doing well. And industrial datacenters –

MS. MCLEAN: We could still take lower rates.

MR. BARKIN: You'd still like that? [Laughs.] The hotels, there's lots of parts of real estate. They're really talking about office, commercial office, and really inner city, you know, downtown commercial office, maybe even B- and C-quality. And that is a troubled sector. It's troubled, in part, by rates. But it's in trouble in large part by work from home. And in D.C. in particular, you guys know, it's a particularly difficult market. So it wouldn't surprise me to have, you know, real issues in the commercial real estate office segment coming. And some have already hit. And I'm sure there'll be more to hit.

Where you worry the most about it – I don't want to be cavalier about it – is less the individual investors in those entities and more the banks and other financial institutions that stand behind them. And the challenge is whether those losses come back to the banks, and whether they're banks with exposures significant enough to then, you know, cause them to have contagion into other parts of the financial system. That's really the risk. That's not a new risk. We've had real estate issues before – '08, '74-'75, '91. And my hope and trust is that banks have – are well aware of those segments. And I've stressed that that doesn't mean you're never going to have a bank that's going to get, you know, wrong-footed on commercial real estate, but that the sector as a whole has taken the precautions.

One of the interesting things about the risks that we face today is that two years ago if I had been here, or last year when I did, you know, do a video with this group, the world was absolutely convinced we were going to have a recession. Absolutely convinced. And so when you're absolutely convinced you're going to have a recession, what do you do? You cut back on hiring. You, you know, maybe slim down your overhead or your capital expenditures. If you're a bank, you tighten your credit. And so I think this – we're all a lot less over our skis than we were on all these recessions that happened with a sudden jerk from left field. And so my hope and expectation is a lot of this tightening and care and write offs and management has already gotten out in front of some of the issues that are undoubtedly in front of us.

MS. MCLEAN: Undoubtedly, because I think there's also this conversion of tightening up of reserves, and that more and more capital reserves it feels like there's less liquidity for the commercial real estate that's coming through. Can we talk a little bit about housing? Housing affordability is a growing concern. Have you seen any promising housing solutions during your travel in the fifth district?

MR. BARKIN: Well, it's pretty interesting. And I gave a speech on this in Virginia in November. So, first of all, housing has been under-built for a generation. Demand has escalated. As you work from home, the one thing you realize is that you don't like your home very much. And so you need a better home, or a bigger home. S you have a lot of demand and not enough supply. The solution has got to be about supply. You know, subsidizing more demand is only going to create bigger problems in terms of pricing. So you got to create more supply.

And it's been very interesting as I've traveled, because – and the Post had a really good article on this a month or two ago. There are a bunch of cities in my district – Raleigh would be a good example – where you can really build if not 360, you know, 320 around Raleigh. If you go to the exurbs around Raleigh, you will see the national homebuilders there in – you know, in force. And there's house after house after house, subdivision after subdivision going up. And the prices are $250-$300,000 a house. So they would fit the category of sort of affordable for a middle-income worker. They're an hour outside of Raleigh. And so the commute five years ago would have been a problem. But if you're only in the office two days a week or three days a week, maybe that commute's not that bad.

There's a lot of – they figured out how to attract developers there, through whatever combination of permitting or land availability. But I think this notion of buildable land in a 360

around a city is huge. It's not – I mean, you know Charleston well. Charleston's not even 180. And it's not that affordable. So that's a different set of issues. But if you go into the surrounding Raleigh, surround Charlotte, surround Greenville, of all of those places that's where the national homebuilders are. And they're building in force. That's not the case here. And, you know, you could argue how much that is land availability, land price, demand. But it's a lot harder to do – nimbyism. It's a lot harder to do it here. But in other parts of my district, they're really building housing at remarkable scale.

MS. MCLEAN: We are seeing that throughout South Carolina, that's for sure. Economic conditions, you touched on this earlier, but quickly – they can change really quickly. How do you update your understanding of the economy when you don't have real-time data?

MR. BARKIN: Well, one of the things we all got better at during COVID was real-time data. So one of the things I look at, for example, is credit card spending every week, and what it looks like. And, you know, for those who are looking for events, there was a lot of bad weather in January. So it doesn't look nearly as good in January as it looked in December or November. We'll see how that plays out. But for me, I get it on the streets. And so, you know, I described my day in Haywood County yesterday. But that's what I'm trying to do, is to do roundtables with businesses across sectors and try to understand what they're seeing in terms of real-time demand, how they're feeling about their prospects for hiring, or whether they're preparing for layoffs, and how they think about pricing today, versus – you know, yesterday versus tomorrow.

And I think that gives a ton of insight, which you have to be careful about. You can't – just because one business is good and one business is bad, it might be the business not the sector. So you need enough data points that you can kind of aggregate. You need to control for what sector you're in and what competitive situation people are in. But again, I feel I can do that. And, you know, test those insights, then, more and more as I travel around the district. That's where I think I'm getting my best information.

MS. MCLEAN: All right, one more question and then we'll open it up to the floor. So if I've sat here and I've listened to you, it seems like the economy generally seems to be in a good spot. Inflation is slowing. The labor market, though, seems very solid. Are you concerned – and if we listen to 60 Minutes, if we listen to Jay Powell, it sounds like there will be some inevitable lowering at the end of the year. I don't know if that's right or not. Are you concerned right now that this could just be a head fake, and there's really more inflation? Or do you really feel like you can see the airport, as you said earlier, and we're going to land this plane this year?

MR. BARKIN: Well, I said we can see the airport. I didn't say anything about where the plane was going. [Laughter.]

MS. MCLEAN: I'm trying.

MR. BARKIN: There were four or five tries in that question to get me to say something.

MS. MCLEAN: I'm trying so hard. [Laughter.]

MR. BARKIN: So, first of all, and I want to say this clearly, if you had given me a year ago or 18 months ago 3.7% unemployment, 2.6% inflation, and a 3.3% GDP growth rate, I would have taken it and gone on vacation. So that's clear. You should feel good about where the numbers are in the economy and where it sits. That is a good thing.

I think there's still a reasonable amount of uncertainty in what we're seeing. I talked about inflation. Is this goods? That would be temporary. That would be your head fake. Goods are kind of going to be a head fake, but – and then we're going to be stuck with this elevated rent and services inflation. That's one level. Or, you know, have expectations, and the Fed's actions, and supply chains opening up, and labor force increasing all done its work and brought inflation back to where we were before COVID? That's one big uncertainty. And I'm waiting to get more clarity on that before declaring anything more in terms of what we do on the policy side.

I'd say there's also demand uncertainty too. You've got – rates should have had more impact in theory than they've had. Maybe it's just being delayed and we'll see more of it, like you described, on the commercial real estate side. Banks have cut back. You know, maybe that'll have more impact. On the other hand, the long rate is down almost 100 basis points from November and consumer sentiment is up. So maybe we'll have more demand. That's another uncertainty.

On the labor market, I don't think – I didn't expect 353,000 jobs. And I don't know anyone who did. And so is that real, or, and all of a sudden people are hiring again? Or is it more what I'm hearing, which is that people aren't hiring as many but they're also not firing either because they're worried about how they're going to replace those. Those are three pretty big questions about what's happening in the economy. And that's, you know, why I make the case for not being in any particular hurry. Let's see what we learn and, you know, make policy appropriately.

MS. MCLEAN: All right. Are there questions?

Q: Thank you. Gary Shapiro, Consumer Technology Association.

And thank you. You sound so data-driven to me, and I love that, but you're also out in the field, and I appreciate that. I'm just curious since you rely so much on these numbers and that's all you've been talking about if there was a number that you really trust totally and you think it reflects reality, which one would it be? And which number would you like to have that you don't have, that you would like to be better at? For example, the unemployment rate, relying on people still looking for a job for a year, or the cashless economy which seems to be growing? What number could you – would you like to see improved?

MR. BARKIN: Hmm. So these numbers are – they do get revised. And it is also a fact that a lot of the survey response rates for these numbers have gone down. And so, you know, you get wary of, you know, declaring too much love for any particular number or any particular read. And you've heard me on the – first, so, for example, I've mentioned this 353,000 jobs last month. I'm going to give you some numbers that are in the zone of right, but not perfect. It's January. In a typical January, people cut jobs because you've added retail jobs for Christmas.

So the normal January would be a loss of 2.6 million jobs. This January, we lost, I'll make up a number, of 2.5 million jobs. Seasonally adjusted, it added up of an increase to 353,000. Now how confident do you feel about that number? Right? Not very. So I think in the end, you sort of take everything as it is. It's the best metric we've got, you know, but it's not perfect.

On a regular basis, as I said, I do look at weekly credit card spending because those are real numbers and I know what to do with them. I have to adjust them, but I kind of know what to do with them. And I look at initial unemployment claims, because by and large when people get fired they file for unemployment. So that tells you something about the job market. But a lot of these other things, I think – I'm not negative on them. I started thinking all these numbers were worthless – like inflation, that number can't be right. Yeah, they're pretty good. I think the people who did them did as thoughtful a job as you could possibly do, recognizing that nothing's perfect.

MS. MCLEAN: I hear you talk about the trimmed mean, though. You might want to talk just a little bit about that.

MR. BARKIN: Yeah. So, on inflation I gave you a couple of numbers early. One was that 12-month inflation, 2.6%. The second was that 12-month core inflation was 2.9%. That's excluding, you know, food and energy. By the way, people actually consume food and energy, but it shouldn't matter. The thing I've worried about is the breadth of inflation coming down. If oil prices go up and then oil prices go down, that'll make the headline number look good but you could have a bunch of other things that don't look as good.

And so the Dallas Fed tracks something called the trimmed mean. And to oversimplify what they do, is they cut out the 25% of the items in the basket that have the biggest price increase. They cut out the 25 that have the lowest price increase or price decrease. And they leave you with the 50% in the middle. And that's probably more reflective of where reality is. That, for the last 12 months, is 3.3%. Doesn't mean it's terrible, but – and it's come down, but it hasn't come down as much as some of these other measures because oil prices have come down a lot, used cars have come down a lot. And those are out weighting the other numbers in the metric.

Q: Tom, Roberta Liss with Cushman & Wakefield. Great to see you again.

MR. BARKIN: Hey, great to see you again.

Q: Thank you for all the comments. Jodie, great job.

So, Tom, two questions. First, when you were at Harvard did they have some kind of sale where if you, like, by two degrees, you get a third one for free, or anything? [Laughter.]

MR. BARKIN: I don't remember that. Not at all.

Q: OK. [Laughs.]

MR. BARKIN: I will say, in the '70s the degrees were a lot cheaper than they are today.

Q: [Laughs.] For us all. My question's about AI. With all of the data, I agree, that you just do a phenomenal job of speaking to all the businesses and understanding what's happening on the ground, and then marrying that with the tremendous amount of data. How does the Federal Reserve use AI for any predictive measures, or legislations, or acts that we might be making?

MR. BARKIN: Well, it's a place we're investing. And, you know, there's sort of I and there's AI, and there's on your way to AI. So, you know, but the simplest way to describe it is, first of all, we have an awesome forecasting model that tries to forecast the economy. And it is a model of historic proportions that tries to actually model out the entire economy and bring out a forecast. It's called FRB/US, for Federal Reserve Bank U.S., I guess. And that's an example of bringing modeling and technology to the question of forecasting the economy. We've got lots of models like that, that try to forecast the economy. So in macroeconomic policy, we've got forecasting models.

In bank oversight, you know, which is another thing we do, we actually have models that try to identify those banks with the biggest risks. And so you've got people building models and trying to leverage artificial intelligence to say: How do we go through all the data that exists, and that we have, to sort of find the places where we need to be upping our supervision, and places where, you know, we can tailor appropriately because the risk is lower? You know, both of those are at least intelligence, and whether they're artificial intelligence we'll have to get better.

You know, we're very – we're still on early days with the generative AI. In part because, you know, the tools that are used to create it actually take note of where the information is coming from. So, for example, if the Fed started saying we need to do a lot of stuff on, you know, when do you lower interest rates, that would somehow show up in the artificial intelligence. That would be information that you wouldn't want to get out. So we're still trying to figure out the security side of that. So we've got some controlled experimentation, but the generative stuff I think is still on the come.

Q: Hey. Anne Kress, president of Northern Virginia Community College.

So I want you to talk a little bit about the actual availability of workforce, right? Because the unemployment rate isn't necessarily a marker of that, because there are a lot of folks – and multiple Feds have done a lot of great research on people who effectively have taken themselves out of the labor market. And the U.S. Chamber refers to this region as having a severe labor shortage, which is going to compromise some ability to grow. And that's not just affecting here. But can you talk a little bit about the challenges that are really facing the labor market?

MR. BARKIN: Mmm hmm. So a couple of metrics. I've talked about unemployment rate, which is very low and that – a simple way to think about that is, you know, people looking for a job, what percentage of them can get a job? OK. A broader measure that I kind of like is employment to population, which is for relevant sectors – say, prime-age people – what percent

are actually working versus not working. And just to give you the national economy, employment to population is a little over 60%. And so there's a lot of people not working.

Now, I'm not saying that's a bad thing. I mean, some are in school, some are taking care of parents or kids, some are happily retired. But there's a lot of folks in that mix who aren't in the workforce. And if we want to grow our workforce that's a very interesting thing to think about. In my district, you know, what you see is that D.C., West Virginia, and – I'm sorry, D.C., Virginia, and Maryland have actually very high participation rates on a national scale. South Carolina and West Virginia have very low participation rates on a national scale. And some of that is demographics. You know, to the extent you've got an older population, that will be part of it. But there's a lot more to it than demographics. There's a piece which is education, preparedness. Opioids, you know, show up in there sometimes.

And so, but I think for us as a country we got to live in the '90s through a period where we were a long workforce. That was the baby boom getting its prime years, that was women more fully participating, that was people being healthier and living longer and working longer, that was even access to offshore labor. And I think we sort of assumed that would last forever. And a bunch of businesses did things like stop training programs because you could find enough trained people on the street. And I think what COVID has exposed, as participation of 60-up has dropped significantly and, you know, I guess with the questions on immigration – is, we may well be at the verge of a decade or two where labor isn't long, labor is short.

And so questions like how to get people off the sidelines become a pretty big deal. So some – we're not the first country to have this problem. You know, Japan is very interesting. I don't aspire to be Japan, but Japan is very interesting. Their labor force participation of people 60 and up is 17 percentage points higher than ours. Ours is, like, 36. Theirs is, like, 53. That's a crazy, interesting difference. Now, older people in Japan are healthier. But there are also incentives to work. They've worked hard on job design. But if you don't have enough workers, you're going to work on how to get more advantage of workers?

Canada is another interesting one. Women's labor force participation in the U.S. and Canada's labor force participation of women were both the highest in the world in the year 2000. And since 2000, ours has basically flatlined and theirs has increased another five percentage points. And there's lots of theories of the answer. One that intrigues me is Canada taxes second incomes just like they tax first incomes. So, in other words, you know, the first X is non-taxed in the U.S. In the U.S., if you have a second earner the first dollar is taxed. In Canada, it's not taxed that way. So that's interesting. So are there tax policy and other policy changes you can come up with? Childcare someone will bring up. Absolutely. You know, that that could be relevant to how one gets higher participation.

And those are just big segments. I haven't talked about in South Carolina and West Virginia, for example, the people who are, you know, undereducated, and feeling hopeless, and not, you know, participating in the economy, and what one can do to get theirs. And you didn't ask me for this, Anne, but I believe community colleges might be part of the answer. But you know, I think this may well be the business problem that we have for the next decade or two. I

don't think it's an unsolvable problem or an un-addressable problem, but it is a very important one for us to get working on.

Q: Hey, Tom. Caleb with FORVIS. We're a public accounting firm.

And, first of all, thanks for coming here. I've heard you speak several times and I really appreciate how you're able to take very complex ideas and distill them down to understandable levels.

MR. BARKIN: That's usually what someone says before they ask a really complicated question. [Laughter.]

Q: So as much as I want to ask you about your Mountain Dew, I'll save that for another time. [Laughter.] But my question is around, how does the national debt, the consideration of our debt obligations, rising interest rates – some feel like it's unsustainable. How does that impact the discussions around the Fed and your outlook? Or is it just too nebulous to really affect your decision-making today?

MR. BARKIN: Our decision-making is very focused on our mandate, which is unemployment, and inflation. And if I could massively oversimplify a complicated discussion, is inflation at our target, or headed toward our target? Is – you know, where are we on – against the maximum employment part of our mandate? There's a lot of other stuff out there – you know, how much money is being spent fiscally, what are the risks in Taiwan – that are all important to understand as part of the context, but they're not actually our mandate. Our mandate is inflation and unemployment. We're very focused on that.

And you have to take – I'll call it these tailwinds or headwinds – you just have to take them as environmental and make policy against them, as opposed to sort of say – you know, one of the mistakes of the '60s famously was William McChesney Martin saying: You know, we're not going to do a rate increase if you'll do a tax increase, you know, to Lyndon Johnson. Well, that never ends well. And that's not the business we're in. We're in the business of the environment's the environment we're in. Let's see what we can do about inflation, in a way with the least damage to unemployment.

Q: Hi, Tom. Chris Bruch with Donohoe.

First thing I want to do is thank you for your leadership. You know, during the darkest days of COVID, we had many conversations. One of our business lines is hotels and we were in a crisis situation in the hotel industry. And having a regional board president contacting ground-level troops to find out what's really going on in real-time gave us a lot of confidence that, you know, there was interest and people were listening. So really appreciate that. I don't think all board presidents get to that level.

My question pertains to the 2% target. So, the 2% target, I think, has been around 40 years, or more. And we're in a very different world today than we were 40 years ago. Just think about technology. Think about AI, all the advancements we have in technology, the global

economy, the debt-to-GDP ratio. Everything is so incredibly different than it was when whoever it was on the Fed said 2% is the magical, sacrosanct number. Is it? What's wrong with 2.5 [percent]? And will the Fed – is there a time the Fed needs to revisit this target, because it's a very different world today than it was then?

MR. BARKIN: For a second, I thought you were sending me to a lower target, you know, when you started talking about productivity and artificial intelligence. So just historically, there was a huge debate in the '90s about what the target ought to be. Interestingly, the debate was between two or something lower. Greenspan famously said, you know, stable prices mean zero. And there are other people who were arguing for, you know, 1.5 to 2 [percent]. Every central bank in the world is basically at 2 [percent]. Some are up to 2 [percent], some are 1.5 to 2 ½ [percent], but they're all basically at 2 [percent].

And I want to say, 2 [percent] is not some magical, mythical creature that no one's ever seen. We've been at it for, I'll make up numbers, you know, 28 of the last 30 years, right? The last – and, by the way, we're pretty close to it now, having been at 1.9% for the last seven months. And so, you know, our target is 2 [percent]. The biggest weapon we have is credibility. I think, you know, we absolutely ought to go – head to 2%. And I don't think we're talking about massive damage has to be done to hit our target, or we've created some unattainable target. That's the first point.

We do on a regular basis, you know, reassess monetary policy and our framework. We do it about every five years. The most recent one was in 2020. And when we look at it again, I'm sure we'll look at everything, including, you know, how we articulate our objectives. And I don't know what will change. I'm not saying anything will change or not change. But if we haven't learned something from the last five years, I'll be disappointed, because I think, you know, we've learned a lot.

For me, what I've learned is not that 2% is unattainable. [Laughter.] Actually, you know, those of you who think we're about soft landing and we out to lower rates tomorrow are basically saying it's attainable. And I just don't think throwing away your credibility – if you said stop, I've just changed my mind, the target's 3 [percent], well, then who would believe you're actually going to hit 3 [percent]?

MS. MCLEAN: Any other questions? I want to make sure – we have one here.

Q: Hi. Eric Maggio with Donohoe.

Tom, with growth, unemployment, and inflation all in a good spot and generally trending better, you know, this question gets asked a lot, why is the consumer not on board? Consumer sentiment is still low. I think the last poll, it was a little better. But what is it going to take to get that consumer to get this disconnect between how good the economy is doing and how badly the consumer feels?

MR. BARKIN: Great question. And, you know, five years ago, I actually did a speech making the case sentiment mattered a ton in terms of consumer spending and the like. But what we've

seen in the last two years has been very different from the history, which is that consumer sentiment has been very negative, but spending has been very strong. And that's not what you normally see. And I attribute it 110% to inflation. It turns out that everybody hates inflation. And consumers really hate inflation. And so when inflation's elevated, you can say everything you want about employment or whatever, but they really don't like it. And that brings them down. And it's especially when the inflation is on items that they buy all the time. You know, stuff in the grocery store, gasoline. You're just sort of hit every day with this realization that everything's gotten more expensive. And, if you will, the world has gotten more difficult.

There is no mental ledger, by the way, that says my wages went up 5% and my prices went up 5%, and that's fair. That's not how – Jim Davis is here. Took me to a place – thank you, Jim – we did a series with a whole bunch of construction workers. And I was trying to get them to say your wages are up 10%, why are you so unhappy about prices being 5%? And they just don't go there. I mean, it's two different ledgers. One ledger is wages, which is finally my boss recognizes how valuable I am. And the other ledger is prices, which is somebody's screwing me. [Laughter.] And that's how people think.

And so they're unhappy about inflation. Even today with inflation down, I think they're unhappy about relative prices. In other words, they don't just look at it on a one-year basis, like we do; they look at it on a three- or four-year basis. And they still remember when, you know, my Diet Mountain Dew was half the price that it is today. That's how they think. And there's obviously some tail to it. So the last month or two the sentiment has actually bumped up a ton. Maybe the most recent numbers are making people more optimistic. Who knows? But I think it's absolutely inflation.

And it's why, you know, we're so serious – I'm so serious about this notion of doing what we need to do on inflation. Because I think we've learned the economy is not working for anybody when prices are as volatile and as high as they were two years ago. And I'm not saying it was good, but it's helpful to relearn that I think, again, and do what you need to do about it.

MS. MCLEAN: All right. One last question.

Q: Hi. OK. Yeah. OK, no worries.

MS. MCLEAN: No, that's perfect.

Q: OK. Well, good afternoon, everybody. And welcome, Tom.

Just wanted to get your perspective on U.S. global competitiveness, and in particular China. And maybe get your perspective on whether it's decoupling or de-risking.

MR. BARKIN: Well, so, I mean, one thing we just ought to feel good about is the competitiveness of this economy. And it was true after 2008 and it's doubly true today. I mean, we came back faster. You know, our growth has been stronger, our employment has been better, and our prices have come down faster than really any of the other developed countries. I'm not

talking about China. I'll get there in a second. But, you know, that's been a huge strength of ours. And it's all the stuff you know about in terms of the vibrancy of the U.S. economy.

I do think that over the last five years, there's been an increasing focus and understanding by businesses that the simplistic view of globalization just wasn't going to work the way it did before. Whether that be supply chain outages, you know, Fukushima, you know, with the nuclear incident in Japan, or the tariff issues with China, or even geopolitics. And so I do talk to businesses that are diversifying their supply chain, you know, quite significantly.

You'd like to think that there was a lot of onshoring, and there's a little onshoring. I think people are struggling to find workers. There's a lot more movement to Mexico or Vietnam than there is moving back to the U.S. But regardless, if your supply chain is entirely dependent on one country now, China or another, I think that just feels like a very dangerous supply chain choice, given, you know, what we know geopolitically and what we've seen from the supply chain side. So I definitely think people are doing that. And that is de-risking.

Decoupling, that's a whole 'nother scenario. And there's a bunch of politics on that, that I'm no expert on. But you can see the risks.

MS. MCLEAN: OK. One last question. We have one more here.

Q: Hi, Tom. Andy Navarrete from Capital One. Thank you for everything you're doing for the system.

I'm tempted to ask a bunch of questions around bank supervision, but I'll refrain. Try to keep it more general.

MR. BARKIN: Thank you.

Q: Yeah. [Laughs.] One of the – you know, one of the elements of – or, consequences of rate increases, of course, making certain things more expensive, and so as society sort of grapples with issues like affordable housing or even adoption of EVs, if you're raising rates or keeping rates as a sustained level, EVs are more expensive, housing is more expensive. Does that actually enter into the calculus at all or the conversation at the FOMC? Or Are you sort of required to be agnostic to those kinds of, you know, broader concerns?

MR. BARKIN: Well, inflation, unemployment, we're trying to think about the whole economy – inflation, unemployment. It is absolutely the case, and it's an unfortunate part of the case, that interest rate increases hit certain sectors earlier than other sectors. Commercial real estate, you know, being a classic example, housing being another example. The logic isn't to raise rates, to raise costs, to raise prices. The average is to raise rates, to lower demand, to lower costs, to lower prices. And so maybe the best way that I've come to think about it is short-term versus long-term, right?

What we're trying to do is to get prices down in the long term. That might require a certain set of costs – segments that interest costs are a big part of their costs, like banking or real

estate – have to have some short-term increase in costs so that the economy broadly brings down prices, and therefore costs come down. I think it's a horizon issue, you know, solves your question. But I don't think anyone thinks if you took rates up as high as you want to in some way, you're creating more inflation. I think what you're doing is you're actually doing something to lower inflation. I hope you think we're proving that now. But that doesn't mean in every sector and every cost structure it works out equally.

MS. MCLEAN: Well, one last one is. [Laughter.] This really is the last one. And then –

Q: [Inaudible.] I'm with PayPal.

I'm curious if you have an explanation for the productivity numbers, the relatively unprecedented productivity numbers, over the last couple of quarters. Is it entirely labor? Is it technological innovation? Is it something else? And where do you potentially see that trend going forward?

MR. BARKIN: Yeah, so productivity is a tough one. For those who don't follow the numbers, for the 10 years before COVID it was about 1.4% a year labor productivity. Then it spiked in 2020 because a bunch of service workers left the economy and they're lower productivity, the way the numbers work. And so productivity increased, but it was really a mix issue. In 2021 and '22, productivity plummeted. Same issue in reverse. They're coming back in, mix issue. And you could also say some of that was couldn't find labor, wrong person for the job, didn't have the skills. Over the last three quarters, four quarters, productivity has been quite strong.

So I honestly don't know what to make of it, because you had this trendline. And then you had spike, plummet, spike. And so the way I look at is I just look at the four years. I want to go over all the spikes. And where we are is the last four years productivity has been 1.6%. That's modestly, a hint higher than the 1.4% pre-COVID. But I don't think it's high enough for me to conclude that we've gone to some different productivity paradigm. But if we have a few more quarters that are like the last few quarters, you know, I'll change my mind on that.

You know, I do think – I guess a couple of other things on productivity. I do think when labor is short there is a big incentive for employers to think hard about alternatives to hiring, like automation, or AI, or whatever. And so I think the incentive's there to invest in labor productivity. The second thing I'd point out is that if you go to a restaurant and the service isn't very good because they're running short-staffed, that shows up in the productivity stat but it's not actual productivity. It's just poor service not measured as productivity. So, you have to be a little careful during times when we have sectors that are still short-staffed as to where we're actually landing this. But the 1.6% versus 1.4% is how I think about it. And I'm just going to watch the next year or so and see what trajectory we're on.

MS. MCLEAN: And, with that, Tom, thank you. Thank you for joining us today.

MR. BARKIN: No, great being back with you all. [Applause.] Thanks.

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Tom Barkin is the president and CEO of the Federal Reserve Bank of Richmond. He has held this position since 2018.

Tom serves on the Fed's chief monetary policy body, the Federal Open Market Committee, and is also responsible for bank supervision and the Federal Reserve's technology organization. He is "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.

Prior to joining the Richmond Fed, Tom was a senior partner and CFO at McKinsey & Company, a worldwide management consulting firm, where he also oversaw McKinsey's offices in the southern United States.

Tom earned his bachelor's, MBA and law degrees from Harvard University.