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**JOE KERNEN, CNBC:**

Now to the Fed, Steve Liesman joins us on set this morning with a special guest, which I'm excited about.

**STEVE LIESMAN, CNBC:**

This is huge.

**KERNEN:**

We talk about it all the time and he's going to defend these things, not that they need defending.

**LIESMAN:**

That’s not what’s hugo about this. For the first time post-pandemic we have five people around the table. It’s the first interview I believe by the former Vice Chairman of the Federal Reserve since leaving office.

**RICH CLARIDA, PIMCO:**

It is.

**LIESMAN:**

Now are you excited?

**KERNEN:**

I was already excited

**LIESMAN:**

And now it's like double excited.

**KERNEN:**

It is.

**LIESMAN:**

Richard, thank you for joining us.

**CLARIDA:**

It’s a thrill to be here. It’s been too long.

**LIESMAN:**

A little history in the making for cable television. Richard, I want to ask you this. I think there's only one thing that really matters when it comes to the investment proposition relative to the Federal Reserve. Do you believe them or not? And it seems like on days when we're in the green, it's a day not to believe the Fed. And days when we're in the red, we believe the Fed.

So give us some guidance about whether or not to believe these guys when they say they're going do what they say they're going to do

**CLARIDA:**

I think you got to believe the Fed, in particular after the Chair's very Effective speech at J.H. The message I got is very clear; failure is not an option to Jay Powell. So I think the uncertainty is how high will rates have to go and how long will they have to stay there to bring inflation down into the twos. But you got to believe the Fed now. I think they've made that very clear, and I've been surprised how unified the messaging is among other members of the committee on this point. So you got to believe the Fed.

**LIESMAN:**

My understanding is they're not really coordinating this. They're just sort of speaking from the same book here when it comes to — I always said you wake up in the morning, if you're a central banker, you hate inflation. You may be a dove or a hawk but you're against inflation. But let me turn you to another question because on the one hand the Fed says they're data dependent. On the other hand we hear these numbers like 4% and they're kind of guiding us to this number. Is this data dependent, or are they going to 4%, come hell or high water?

**CLARIDA:**

Well, I think they're going to 4% hell or high water if I had to put it into two boxes. They are data dependent, but that's why they're going to 4%. Steep inflation is way too high. Inflation was way too high last year. The Fed had a lot of company and I was part of it in getting the inflation forecast wrong. But job one really of the Fed right now — until inflation comes down a lot, the Fed's really a single mandate central bank. The chair made clear the Fed knows that if you squander price stability, it's very hard to achieve and sustain maximum employment. So I think that they are data dependent and the data's inflation is too high. So I think they're going to at least 4%

**KERNEN:**

They already squandered it. That's the problem.

**CLARIDA:**

Okay. Well, we can agree to disagree on that

**KERNEN:**

But that's the thing that gets me. It's almost like we're in the soup now. We're in this mess, so I guess there's no reason to talk about how we got in the mess. But it's just unfortunate that we need to do things that are counterintuitive or counterproductive. We need to raise unemployment. We need to slow the economy. We need to cut off this great recovery. We need to make barley costs higher for entrepreneurs and people that are trying to build businesses that hire people. We're in this mess of cutting off our nose for some reason and the answer that we're giving — what's that got to do with Putin's price hike? What's that got to do with inflation that's all around the place caused by other things? So our people here in this country got to take it on the chin to lower inflation. It's not a great way to do this.

**CLARIDA:**

Well, no, Joe. And I think if it were just Putin and it were just energy I think your point would be one hundred percent correct. The problem is that the shock the economy took globally with the shutdown and the pandemic and the reopening was an enormous shock. It was almost a warlike shock. So there's been a lot of dislocation and unfortunately a piece of that is the economy got out of balance last year in part because of policy and in part because of other measures and I think chair Powell is correct that over the long haul you can't prosper in the economy as we saw in the 70s. You and I remember the 70s with high and variable inflation. So I agree it's not a great place to be and if it were just Putin you would be right. But unfortunately the economy is out of balance now and the Fed needs to bring demand back to meet supply.

**KERNEN:**

Interest rates seem too low and you can't have people taking risks because sure you can't spawn stupid decisions by keeping rates low. I see how we need to get back to a more normal level, sure. But would you agree that the Fed enabled fiscal policy to run amok?

**CLARIDA:**

Well, here’s what I'll say about that because I was obviously Vice Chair during 2020 and 2021. As I said, 22 million jobs were lost in the spring of 2020, a 30% decline of GDP. The Fed was all in. I have no apologies for that. I think given the shock the Fed needed to be all in. I was not unhappy when the CARES Act passed at the end of March, which was $2.5 trillion. I think what you can say is that as we went through 2021, it became clear, maybe sooner to others than to others, that demand, in part supported by that policy, was out of balance with supply.

**KERNEN:**

You don't date it back to ‘09? Other people say you've been in an emergency for longer.

**CLARIDA:**

Well, I'll only talk about the three and a half years I was there.

**LIESMAN:**

I kind of disagree a little bit with Joe on a fine point, which is this one. I think it matters to go back and figure out how and why they got it wrong. What troubles me about it, and I understand why you were saying it in the context of your request to do it now.

**KERNEN:**

But don't we need to not do it next time?

**LIESMAN:**

Rich, was there groupthink on the Fed in that period of 2021? I'm surprised. You guys like Larry Summers. Okay, you could disagree with Larry and he makes some bold statements, euphemistically bold, but you could say that there was concern that policy was too wide open. Why wasn't there more dissent on the Fed? Why weren't there more people coming forward and saying we need to put the brakes on this? We were talking yesterday. In March of 2022, rates were zero, and we were already six or seven months into this inflation run. How did it go wrong and what needs to be fixed on the Fed? That's what I care about, that it doesn't go wrong again.

**CLARIDA:**

Okay, so let's talk about 2021. Remember in 2020 the pandemic was disinflationary. Inflation fell in 2020. Unemployment was high. The Fed thought we had access capacity in the economy and I would say if you look at the real-time data that we got through about May or June, it was consistent with that view: underlying broad inflation, DOW was running about two —

**LIESMAN:**

You were four or five percent on the headline, but —

**CLARIDA:**

Wage gains were running right in line with our inflation objective, but you are correct. Through the summer there was an inflection point in the data and basically everything went hockey stick by September: wages, broader measures of inflation. So I think the Fed did get the potential supply of the economy wrong. I'm sure folks will go back and look at how that occurred. What I will also say, Steve, is in August of 2021, and I know you know because you covered it, I gave a speech at Peterson reflecting my own views, which was that the combination of monetary and fiscal policy in place in August 2021 was going to push average inflation, which you know is our new framework, at or above two. So I think on the average inflation metric, we check that box in August. So I think the reality is that the members of the committee did begin to realize during the summer it was time to pivot and then the committee did pivot in November to begin shrinking the balance sheet. But it is a fair question how long it took to do the taper and then how long it took to raise rates.

**REBECCA QUICK, CNBC:**

Hey, Rich, yesterday I listened to Chairman Powell's speech or the interview that he was giving with a lot of interest. It was this whole idea of the dual mandate where you want to lower inflation but you also have the mandate of making sure you're dealing with full employment. He was pretty pained in saying yeah, he thinks the dual mandate is right and by the way Congress is the one that sets it. You have to listen to what they say. But it strikes me that we could run into an issue where Congress gets more and more vocal about one mandate being chosen over the other because everyone acknowledges that in order to bring inflation down we are going to have to deal with higher inflation. There was just a piece yesterday from Jason Furman suggesting we could be looking at 6.5 percent of inflation for two years before you get back to 2-3 percent inflation. Is there a point where you have to recognize at least for the short to medium term that one of those mandates, inflation, is going to take center stage and deal with potential pushback from elected officials who aren't going to like that?

**CLARIDA:**

Well, Becky. I think both are correct. I think from what I read, like all of you at Jackson Hole, my interpretation of that very crisp speech was failure's not an option. Keep at it until the job is done. And I think in effect with the “some pain” reference, what that means is for some time the Fed is in essence in single mandate mode. And the way Chair Powell and others explain that is that over the long run you cannot have and sustain maximum employment with high and skyrocketing inflation. So I think that's the way I interpret and will interpret the Fed going forward. But I think the second part of your question is also accurate in the sense that it may well trigger some pushback certainly. In my youth I followed Paul Volcker and Paul received a lot of pushback back in 1980 and ‘81. I'm not saying the situations are comparable. Volcker inherited 14 percent inflation. But nonetheless, I think that the mission here is going to generate some pain as the Chair said and that could generate some pushback

**LIESMAN:**

Richard I need to interrupt here because I don't want to take credit for the phrase that you used for me from the outside, which is that you said the Fed is now off of this concept of immaculate disinflation.

**CLARIDA:**

Yeah, well, I think in fairness the March SEP, which showed that inflation was going to fall next year with unemployment really not rising and without going below potential, yes, that that could have happened. But that would not have been my baseline. And so you saw the committee pivot more hawkishly in the June SEP with a rise in unemployment and a slowdown in growth. And I think we'll see more of that in the SEP we get in two weeks and thus the “some pain” reference in the Jackson Hole remarks.

**KERNEN:**

This is what I've been thinking about since you mentioned Volcker. There's a new school of thought that the economy is and could be inherently stable if the Fed somehow would stay out of things and even back then it would have equilibrated. And actually with the new prime minister in England there are certain people saying what she's saying. Yeah, there's going to be some pain initially but we're going to cut regulation. We're not going to raise corporate taxes. We're going to increase the supply of the economy. We're not going to try to raise rates to lower the supply of the economy, but we're going to just try and stimulate the private sector and then the inflation sort of takes care of itself and we don't need you raising rates when there's inflation, lowering rates when it's this. There's an equilibrium. Does that make any sense at all that the economy could be self-corrected?

**CLARIDA:**

That is a long standing issue of discussion and research in macroeconomics. Those debates go back at least to Milton Friedman and Paul Samuelson in the 1960s. They had dueling newsweek columns on exactly that point: does monetary policy destabilize the economy by attempting to fine tune interest rates in the money supply? The broad consensus beginning in the 1990s is that there is a role for monetary policy and raising/lowering rates to keep inflation around a low and stable level, but I guess economic historians are going to come back and look at this for the next 70 years. I think what they may conclude is that this was a warlike shock. You shut down the global economy, you reopen it, there’s dislocation. And my hope is that what we’ll be saying in two or three years is we got through this and inflation came down. It was basically a spike in supply and demand. But certainly the alternative hypothesis which you put forward, which is that monetary policy has been part of the problem, I'm sure we'll see a lot of attention. I don't agree with it.

**ANDREW SORKIN, CNBC:**

You think it just comes down if we did nothing?

**KERNEN:**

It's weird because if it's a supply chain issue And you're raising rates to make it hard–

**LIESMAN:**

Joe, let me put you in the hot seat on that. Okay, so let's say you're in charge of the Fed and a 30-year U.S. bond is not clearing in the market. Are you just going to sit there and say, “oh, it'll take care of itself. I'm sure”--

**KERNEN:**

So you mean you got to raise rates?

**LIESMAN:**

No, not raise rates. In that case you liquify the market. If you're ready to sit there and let it clear, and a 30-year U.S. bond is not is not clearing–

**QUICK:**

But that's letting the balance sheet continue to grow or not run off as quickly versus raising rates, right? If you want to make sure you've got liquidity in the market.

**CLARIDA:**

If I could just rewind the tape a little bit, I don't think we wanted to miss- it's very easy now to say, “Oh, yeah Of course we knew in March of 2020 that the 22 million jobs we lost when we come back in two years. And of course we knew that the 30% decline in the economy which is faster than the great depression would do a U-turn.” I guess the Fed and fiscal authorities could have taken that risk and sat on the sidelines and let it all work out, but I think you can't look at where we are now. You have to look at both the employment side and the output side as well as the inflation side and look at the nature of the shock and the policy.

**KERNEN:**

So did the growth of M2 cause this inflation?

**CLARIDA:**

Not reliably!

**KERNEN:**

No, what I just wondered was it the Fed's fault or was it not the Fed's fault for printing too much?

**CLARIDA:**

The rate of inflation we got is a function of the fact that the amount of demand and the economy supported by policy, and the supply and the economy were out of balance and prices were too high. I think the data is very clear that there is a pretty big supply–

**KERNEN:**

Then why would you want to keep rates low, so supply goes up so that there's no longer- so that you can satisfy the demand we want instead of cutting down the demand for the lowered supply?

**CLARIDA:**

I think Joe, in real terms rates are still quite low, right? I mean bond yields are below inflation so the other thing Milton Friedman taught us is to look at that, Andrew.

**SORKIN:**

I want to ask a completely different question.

**CLARIDA:**

Good.

**SORKIN:**

A personal question to delicate one, because it's about, really the credibility of the Fed in a different way. Which is that when you step down one of the big issues was stock trading, and I just wanted to get your sense and your thoughts on that issue, and you can talk about it and talk about sort of whether you think that affects the credibility of the Fed. What you the whether you think that what the Fed is doing that should be applied to, by the way other parts of government, if you will?

**CLARIDA:**

Well, what I was simply saying is that you know the Fed has put in place some new rules and regulations which I think make a lot of sense and I think those are fine, those are fine efforts.

**SORKIN:**

But just on a personal basis, do you say to yourself that it affects the credibility of the Fed? Do you think that it affects the kind of people that will want to take this job? I mean that was always you know one of the arguments about whether people should be able to trade or not trade or this or that, is that they're going to be you know people either who are fabulously wealthy who want to stay fabulously wealthy, and want to invest their money. You're not going to be able to capture their expertise, because you're not going to want these roles. I mean there's lots of debates about all of this in the context both of the Fed and more broadly.

**CLARIDA:**

Well, I'll simply say that for me it was the honor of my career to serve at the Fed. And I can't imagine anyone who would be capable of doing it would say no to the position based upon the rules that are now in place.

**SORKIN:**

So the rules are not going to impact that issue.

**CLARIDA:**

I don't think so.

**SORKIN:**

And you think that's true also for people in kind- do you think that those rules should also be applied to conduct?

**CLARIDA:**

I can't weigh into that. I don't know what they are.

**SORKIN:**

But you must have a view now that you've experienced this whole situation.

**CLARIDA:**

Yeah, as I say I think that the rules in place now make a lot of sense and as I said, I don't think it will dissuade good people from serving in the Fed. I'll leave it at that.

**KERNEN:**

How about overall rules, like actual rules. Because you can, “Oh we had the Greenspan Fed, and then there was the Yellen Fed, and well the Bernanke Fed…” And I mean, it's really the personality and the temperament of the person. Is that the way this should be done? Shouldn't there be like something, like standardized for how we react when you got the world's biggest economy and it's so many people are dependent on what happens? And it could be, “Oh well the guy we had then, he was thinking this, and the lady we had then she was thinking this, which is the opposite of what the guy thought.” And the economy’s going, you know all over the place. I mean, is that a way to run a federal reserve?

**CLARIDA:**

Well the short answer is no if that was the way it was run. I think you'd have to argue Joe, that the 25 years from say the early 90s till the pandemic, you know inflation was low and stable, there were big shocks. They're legitimate questions about whether or not the Fed should have seen the mortgage crisis coming. But I think the conduct of monetary policy holds up quite well in those 25 years.

**KERNEN:**

Could you do it Steve? Could you write an objective set of rules?

**LIESMAN:**

Let me tell you, Joe I've been to several seminars and by experts, put on about rules. There's a great monetary policy expert, Orphanides who was head of the Bank of Cyprus and worked at the Federal Reserve. He put up a list of countries with rules, and showed how they break them. And then he put up a list of rules and showed how they didn't work. So if there were a rule that was perfect, I think everybody would glom on to it. I think there are- the Fed could maybe do more to sort of lay out the rules that guide it. But if I just get to another issue, which I don't want to let you leave Richard, without talking about the trade-offs that have to happen. We talked about this at the beginning. Where does unemployment have to go? There's this idea that Becky brought up from Jason Furman; six and a half percent to bring it back under control. And then there's this idea from Jay Powell who says, “You know what, we can get rid of job openings, and not necessarily get rid of jobs.” Where do you stand on that?

**CLARIDA:**

Well as Jay and the committee has indicated and I agree with, if you look at wage dynamics and other indicators, vacancies, unemployment; there is an imbalance in the labor market and so in order to bring it into balance three things have to happen. You need to have some increase in participation. You need to have some reduction in vacancies and you're probably gonna have to have some rise in unemployment. The amount of rise in unemployment that the Fed will need in order to get inflation down will depend on how much we get on participation. And how much we get on just firms reducing the number of vacancies. And there's no there's no crisp or definitive answer to that question, but I do suspect that we're going to need to see a rise in unemployment, north of what the Fed is currently marking down, which is about half a percentage point. I would point out that in mild recessions in the past, and you know Here's the “R-word”, but if we do go into a recession, in mild recessions in the past the unemployment rate has risen by less than two percent. So I think one issue about the “R-word” right now is the last two recessions in ‘08 and the pandemic were the two worst ones in 75 years. But we could have a downturn in the US with just a sharp slowdown in growth and a modest rise in unemployment. I think it's too soon to tell what will be required. But I do think it will be more of a rise than we've seen in the projections.

**LIESMAN:**

Is the recession your base case here?

**CLARIDA:**

I think that it may take a while for our friends at the NBER to call a recession, as you know. But I think it's probably about a coin flip right now.

**LIESMAN:**

50-50?

**CLARIDA:**

Yeah.

**LIESMAN:**

One other thing and a place where I dramatically agree with Joe, is this issue; the idea of bringing back labor. We can't provide the supply that we provided before If we don't have the workers providing the work to provide the supply. And the market looks at strong job growth as inflationary and looks at weak job growth as disinflationary. I just I'm missing a chip somewhere Richard, and I think that putting people back to work is disinflationary

**CLARIDA:**

Well, and and I think any fair reading of the 39 speeches I gave as Vice-Chair will show that I made I made repeatedly, including at my first speech at Peterson in October 2018, where I said, “The Fed is not against wages going up. We want wages to go up. We just don't want it to be inflationary.” And we had an incredibly good labor market before the pandemic, a low unemployment rate, real wages were rising, more at the bottom end of the wage distribution. One of the reasons that we cut rates; we adjusted rates down in 2019, was to support a strong labor market. So I and I believe my former colleagues are entirely with you on that point. Unfortunately now, given the nature of the pandemic shock, there's a different challenge in the labor market right now. But longer term, I think Fed policy is entirely consistent with trying to achieve that goal.

**LIESMAN:**

Okay, Richard. A real pleasure to have you join us. Thank you very much.

**KERNEN:**

That's when people are at work and being productive instead of at home like screwing around with computer games You know while they’re pretending to actually be working.

**QUICK:**

You don’t think that happens in the office?

**KERNEN:**

No, not nearly as much because someone might come up and go “you're fired!” At home it's like, “no one around, do do do. Oh, I gotta go to the bathroom.”

**LIESMAN:**

Joe, did you ever try to sit in the CNBC newsroom and try to read a monetary policy speech on equal our monetary equilibrium?

**QUICK:**

Doesn't happen.

**LIESMAN:**

I read a lot better at home by myself. It's a lot. Hey, I can't talk now, Becky.

**SORKIN:**

I don't know whether that matters.

**QUICK:**

Rich, thanks for coming.

**CLARIDA:**

Well, thank you.

**LIESMAN:**

I'm much more productive.

**KERNEN:**

You're more productive at home?

**LIESMAN:**

Way more productive.

**KERNEN:**

Well, you know, hopefully you're not building homes or you know, actually out in the real world doing things that matter to everyone and you know, you're at home like thinking. That's not going to get us anywhere.

**QUICK:**

Yeah, stop thinking!

**LIESMAN:**

Intellectual property, Joe, where have you been the last 20 years?

**KERNEN:**

I like the real economy.

**QUICK:**

Rich, thank you.