2022 College Fed Challenge Winning Team Q&A Session
Federal Reserve Board

ROBIN CAPPETTO. Welcome to the 2022 Virtual College Fit Challenge Competition. First, we're going to read your team I.D. Please confirm that this is the team I.D., you have, students and judges. 202200200332. Is that correct?

SHIRLEY REN. Yeah.

ROBIN CAPPETTO. Great. All right, advisors and spectators, please mute and do not show yourself on video. I believe we're already doing that. Team, are all your presenters present and ready to go?

(Nonverbal affirmations from presenters)

ROBIN CAPPETTO. Great. Please. I don't see this as the case, but I'm just going to say it. Please do not have any school identifiers in your Webex or your presentation today. A few rules before we get started. If you're not presenting, please mute your lines and do not show video when you are not speaking. It's a good idea to mute so sound is clear. We are going to be recording today's session for Final Judging. You may have your slides up that were used during your presentations submitted in October. You could not have updated. The data within the economy is essentially locked in when you submitted that video. If you verbally reference updated data, it will not help your team or hurt a team score that does not do the same. In a few minutes, we're going to start a timer. Jean will state two minutes and end verbally. This may interrupt your sentence, but please allow it. Jose, can you verify we are recording? You're on mute, Jose.

JOSE ACOSTA. Sorry about that. Recording is confirmed.

ROBIN CAPPETTO. Great. Thank you. Judges, can you verify that you have the two common questions?

BOHAN WANG. Yes.

SAM JEROW. Yes.

ROBIN CAPPETTO. Great. And can you please introduce yourself? Quickly, judges.

BOHAN WANG. Sure. Hi. My name is Bohon, Bohon Wang. I work in the Division of Financial Stability

SAM JEROW. And hi, I'm Sam Jerow. I'm also in the Division of Financial Stability.

ROBIN CAPPETTO. Great. Thank you. And thank you again for your time. If we're ready to get started. We will start the timer when the first question gets asked. Everyone ready?

(Nonverbal affirmations from presenters)

ROBIN CAPPETTO. Great.

BOHAN WANG. Okay, so let's dove right into it. Our first question is explain your view about the future trajectory of labor force participation. What are the implications of this view for your assessment of appropriate monetary policy?

RICHARD ZHU. So, I'd just like to start off by saying that labor market is unprecedentedly tight at the moment. We've seen U3 numbers and Ethereum U6 numbers at 3.7 and 6.8 percent respectively in the most recent reports. And so, before that, in the September reports at 3.5 and 6.7 percent. We've seen an imbalance between supply and demand.

Specifically on the demand side, we see nonfarm payrolls gaining currently 261,000 in the most recent report. That's up from three. That's down from 315,000 in September. So, it's a slowing rate that's still positive and came in above expectations. On the supply side, we've seen a huge glut in supply. On the LFPR (Labor Force Participation Rate) front, we see it's down 1.2 percent from the pre-pandemic levels driven primarily by long term trends that have been accelerated by COVID. That includes early retirements as well as sort of trends, broader trends among prime age men and as well as long- COVID, which has resulted in 15 percent of unfilled jobs. Lastly, we also see a decrease in immigration and foreign workers, which sort of additionally hits this labor supply. We also see it within prime-age LFPR. We've seen a near full recovery that has driven sort of some of the partial recovery of LFPR at 82.5 percent.

LAUREN FAHLBERG. Kind of to touch upon my colleague's points regarding the decrease in LFPR over recent months in the COVID era recovery. One of the things I'd like to point out is the fact that the vacancy to unemployment ratio still remains extremely elevated, hovering around 1.7 to 1.8 per worker. One thing that I'd like to point out that is very important to the Fed is the fact that the vacancy to unemployment ratio does lead to; unelevated vacancy to unemployment ratio, does lead to increased worker bargaining power for further salaries and wages. And although it's not necessarily one of the largest contributing factors to inflation, we still would like to keep in mind the fact that wage inflation is a sentiment aspect of inflation.

SHIRLEY REN. So just to address some of the monetary policy implications of LFPR and the overall labor market dynamics, as we know, monetary policy tools are aimed at addressing demand and not necessarily the supply side drivers. However, there is first off, significant room for demand to cool. And in addition, given these supply side constraints, that means that monetary policy tools would have to act pretty aggressively at the moment in order to restore that demand to really better align with supply. So, as we monitor some of the near term, as well as long term pressures on the supply side from pandemic era disruptions, as well as this broader demographic shift, it's really important to rethink about how to conduct monetary policy, given the constraints on the supply side and restore those balances in the economy.

SAM JEROW. Thank you. I'll ask the next question. The current cycle of monetary policy tightening is taking place in an environment where real estate prices are extraordinarily high. Does this suggest to you that monetary policy tightening is likely to have an outsized effect on this sector and through it, a larger than usual effect on the economy? If so, how should monetary policymakers take this into consideration?

NOAH HARRIGAN. Yeah, it's certainly very important to consider the path of monetary policy transmission throughout the economy when you're considering these sectoral impacts of monetary policy. For example, in response to the rate hikes that we've already seen thus far, we saw that the Q3 numbers for residential fixed investment fell by 26 percent, in Q3. So, you are seeing that these interest rate sensitive spending sectors are certainly responding not only quickly to our rate hikes, but in a very strong way. So, in some ways, yes, you do see this strong response that you're talking about, but it's also important to note that this is the kind of response we'd like to see, given that inflation is considerably high right now. We also have returned to positive growth and we're seeing a very tight labor market. This is overall indicative that these changes in the interest rate sensitive sectors will kind of spread out to the rest of the real economy and hopefully these tightening financial conditions will contribute to a slowdown in inflation and a slight cooling of what some might call an overly tight labor market.

SHIVANI PRUSTY. I'd just like to reiterate my colleague's point about the path of monetary policy transmission of where we first hit financial conditions. Financial conditions tighten, which then effects the real economy, which then affects inflation. And so given how tight monetary policy has been, we've seen financial conditions react accordingly, especially in these very interest rate sensitive sectors, such as residential and business fixed investment. And so that's natural given our policy, and that is what we expect. On the side of is housing a current concern to our policy? I would say not necessarily. I don't think that we face the risk of overshooting or being too tight, given how healthy balance sheets are. We see like low credit risk, low delinquency risk. So even though housing prices are on the rise, it is important that we continue with this aggressive policy in order to align, in order to keep up with our commitment to align demand with supply and bring overall inflation down.

SHIRLEY REN. And just to reiterate my colleague's points on the importance of the housing market, it is definitely important from a financial stability point of view as well as the overall inflation story. And that's because households spend a very sizable portion of their budget on housing in general. It contributes to a significant portion of core PCE (Personal Consumption Expenditures Index) specifically. And so far, we've seen this surge in housing prices, given the surge in demand during the economy's recovery from COVID, as well as supply side constraints. We're now seeing some of this demand cooling as well as supply, as well as supply increasing. So, creating some of that excess inventory. But housing prices will likely not slow down in the coming month, given how sticky they are. Some of the rents locked in will not be able to be revised. And that's a part of what Governor Waller has mentioned earlier last month when he talked about the economic outlook with respect to the housing market. So, while we will continue to monitor some of the trends in the housing market, it's really important to acknowledge that our commitment to fighting inflation right now and in addressing that part of our dual mandate, is a core focus of monetary policy. And we will also continue to monitor the stability risks as we conduct this risk management-based framework.

BOHAN WANG. Okay. I'll ask the next question. What sort of coordination between the Federal Reserve System and other international central banks is necessary and prudent given the current economic conditions?

LAUREN FAHLBERG. Well, one of the things that I'd like to point out is the fact that the Fed's dual mandate does not explicitly entail that it leads to coordination with other international central banks. However, obviously, the Fed's policymaking does, of course, have several implications, not only on other central bankers’ decision making, but also on international currency exchange rates, as well as interest rates worldwide. One of the other things that I'd like to point out is the fact that a U.S. Federal Reserve interest rates rate hikes do, of course, affect other central banks tightening cycles as well.

SHIVANI PRUSTY. I'd also just like to add that currently we've seen the effect of our policy has strengthened the dollar. And that is important in the context of the global economy, because the dollar is used as the foreign, is used as the global reserve currency. And all of this policy has been done in order to bring U.S. inflation down, which will have broader benefits. However, it is important to note that there are a lot of foreign, there are a lot of foreign countries that have debt in U.S. dollars. So, for example, a lot of Latin American countries. So, as we tighten our policy, it is important to consider the risk of Latin American economies defaulting on their loans the way that we saw during the Volcker era. So that is something to consider as we engage in this policy.

SHIRLEY REN. Yes, definitely. And lastly, just to around us out. Overall, we see global central banks engaging in this tightening cycle and that's going to amplify the tightening that the Federal Reserve is pursuing in the US. by dampening foreign demand for U.S. goods. And as well as overall tightening financial conditions. And as my colleagues have mentioned, the U.S. is definitely interconnected with international economies in every front, and there is a lot of uncertainty both in terms of the financial and economic systems, but also the geopolitical landscape. So, it's really important to consider how this is driving supply and demand at home, as well as putting it in context of financial stability. As we have seen in past episodes, we've definitely had both regional as well as global financial contagion effects that have had a real effect on the economy.

SAM JEROW. Okay. Thank you. So, kind of, you mentioned this a couple of times, but more explicitly, can you explain what is the relationship between monetary policy and financial stability? And are there any financial stability concerns you find particularly salient at the moment?

LAUREN FAHLBERG. As my colleagues have mentioned before, monetary policy has a strict effect on specifically interest rate sensitive spending, which directly translates into financial markets. Right now, we still do see relatively stable financial markets as well as stable balance sheets. So that shouldn't necessarily be a huge concern for the Fed. Currently, and we believe that the Fed should stick to its guns in continuing an aggressive policy response.

SHIVANI PRUSTY. I'd also just like to add to that how one of the roles of the Fed is to be a supervisor for financial institutions. So, part of that includes being a lender of the last resort during the COVID era pandemic. We saw how they created all these Section 13(3) lending facilities in order to backstop liquidity in markets and to make sure that there were still financial stability. And this is really important. This is really important because of historical precedents. We've seen how in 2008, when there was with mortgage-backed securities and all that subprime lending, how weak financial markets then translated into the real economy and had that risk there. So that was definitely very true back then. And is reason for monetary policy to be concerned about financial stability also in the case of the efficacy of monetary policy transmission. And turning to some risks right now, I don't believe that we really see many financial stability risks, as mentioned before, household balance sheets and business balance sheets are quite healthy. That is a consequence of -

JEAN DURR. 2 minutes.

SHIVANI PRUSTY. Thank you. That's a consequence of the pandemic era and how that's a consequence of the pandemic.

RICHARD ZHU. I completely agree with my colleagues, and I think that though there's nothing that's very major in our minds at the moment. One thing that is beginning to peek over the horizon is sort of the illiquidity in the longer-term treasuries as a result of the Fed's sort of large-scale quantitative easing over the past decade or so. It's resulted in sort of a huge accumulation of securities. And as they begin to offload, as they begin to tighten quantitatively, it has resulted in sort of this trend that some traders are beginning to see.

SHIRLEY REN. And just to bring it home. Right now, we see in the November Financial Stability Report participants citing persistent inflation and higher than expected monetary policy tightening as the biggest risks. Which means that in order for these macroprudential risks to stay low, it's really important that the Fed remains committed to fighting inflation, and that is what monetary policy tools are designed for. So, as we continue to monitor these other risks, for example, associated with balance sheets, with credit quality, etc., it's also really important for the Fed to continue to deliver data dependent and condition of forward guidance, to be really clear and communicate in its policy path and to pursue appropriate policy in order to bring inflation down.

NOAH HARRIGAN. Chair Powell also noted that, you know, he wants to see positive real interest rates across the yield curve before we really considering, you know, stopping tightening. And so, this is important to note that we still don't see positive real interest rates across the yield curve. So that means that while financial conditions are tightening, they certainly could not be considered anything near like that, you know, extraordinarily tight yet. We also see that consumer credit delinquency rates are still at 1.7 percent, which is a very.

JEAN DURR. Time is up. Sorry times is up.

ROBIN CAPPETTO. Thank you, Jean. Sorry, guys, for the interrupt. Thank you again for your time today and your participation in this year's Virtual College Challenge. You will receive an invitation to the winner announcement that's going to take place on November 18th at 2:30 p.m. We're going to have programing from 2:30 to 3 and then we'll deliver the winning teams after that. A press release will also announce the winners that day. The winning video presentation and Q&A sessions will be uploaded to the board's website after the announcement. After that time, we will also be in touch about supplying your video Q&A sessions. On behalf of the Board Economic Education team, thank you for competing in the Virtual College Board Challenge. Have a great remainder of your school year and holiday season. And again, judges, thank you for your time.

LAUREN FAHLBERG. Thank you so, so much.

JEAN DURR. Thank you.