Interview with Sandra Pianalto

Sandra Pianalto was named president and CEO of the Federal Reserve Bank of Cleveland in 2003. Today she has the most consecutive years of service among participants on the nation's monetary policymaking body, the Federal Open Market Committee. And in 2012, she has one of the 10 votes on the Committee.

Alan Greenspan was chairman of the Federal Reserve when Pianalto started her current job. Now, Ben Bernanke presides over a group that has navigated the financial crisis and Great Recession. The tools of monetary policy have changed over the past few years, and so has the sense of urgency in employing them. We asked Pianalto to talk with *Forefront* about a range of issues—how she develops her policy views; her current economic outlook; and the differences between Greenspan's Fed and Bernanke's. Mark Sniderman, executive vice president and chief policy officer of the Cleveland Fed, interviewed Pianalto on March 7, 2012.

Sniderman: ***You have been a participant on the Federal Open Market Committee since 2003. How has the FOMC changed since then?***

Pianalto: Probably the biggest change has been in the tools that we use to conduct monetary policy. Our country has been through the deepest recession since the Great Depression. We went through a financial crisis, and monetary policy responded very aggressively and creatively, with some new ways of accomplishing traditional objectives.

Also, we've changed the way we communicate. We've continued to look for ways to enhance our communication with the public. We've increased the number of times we share our economic projections with the public to four times a year. The chairman holds press briefings following those meetings where we release our projections.

In January, we took some truly historic steps in the way we communicate. We issued a statement on our longer-term goals and strategies for monetary policy and we also, for the very first time, shared with the public our forecast for the federal funds rate. I think these are tremendous strides in the way we communicate with the public.

Finally, I would note the change in chairmen since I joined the committee in 2003. Alan Greenspan was chairman then, and now Ben Bernanke is chair. And Ben has changed the way we conduct our meetings. You can read the transcripts—I'm not sharing anything that's confidential—but when Alan Greenspan was chair, he would usually go first in our policy go-round, when we take turns explaining our views. If you look at the transcripts, you'll see that oftentimes the conversation following his recommendation on policy would be, "I agree, Mr. Chairman," "I agree, Mr. Chairman," "I agree, Mr. Chairman." By contrast, Ben goes last on the policy go-round. That requires each one of us to give our views on appropriate monetary policy, and Ben listens to our views and then presents his own perspective. He then puts forward a recommendation that he believes best reflects the appropriate course for policy, consistent with the views of the Committee. We then act on that recommendation.

Sniderman: ***Let me follow up on something else you mentioned—the statement the Fed issued about its longer-term goals and strategies for monetary policy. I know this is a topic that you've been interested in for a while. Can you share some more thoughts about it?***

Pianalto: In that statement we, for the very first time, agreed on a numerical objective for inflation. We said that the Committee believes our mandate for stable prices translates into an objective for inflation of 2 percent over the longer term. I have been a longtime proponent of establishing a numerical objective for the Committee. It helps anchor inflation expectations. It provides more certainty around the types of actions and policies the Committee would deem appropriate to achieve that numerical objective of 2 percent for inflation.

Inflation is a monetary phenomenon. That's why we're actually able to set a numerical objective for it, and we should be held accountable for achieving it. Maximum employment, which is the other half of our dual mandate, is *not* primarily a monetary phenomenon. The maximum level of employment that our economy can achieve is determined by other factors, such as demographics, technology, and regulations. Therefore it's not appropriate for the central bank to set a numerical objective for maximum employment. The Federal Reserve can estimate the maximum level of employment given the economic circumstances we face and then set policy that's appropriate for achieving an unemployment rate that is consistent with maximum employment.

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Sniderman: ***Let me ask you about the way many people characterize FOMC members, labeling some people as hawks and others as doves. Do you think that's a handy, simple way for the public to understand policymakers' views? And where would you put yourself on that spectrum?***

Pianalto: I've been part of the Federal Reserve for a long time, more than 28 years. Those labels actually came into play when there wasn't agreement around an inflation objective. There were some members of the Committee who felt a higher rate of inflation was appropriate. Those individuals were dubbed doves. And there were some that felt that we needed a lower rate of inflation. In fact, one of my predecessors, Lee Hoskins, was focused on achieving zero inflation. And he was considered a hawk.

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Sandra Pianalto

Position
President and Chief Executive Officer,
Federal Reserve Bank of Cleveland

Former Positions
Economist, Federal Reserve Board of Governors
Economist, U.S. House of Representatives Budget Committee

Education
The University of Akron, BA in economics, 1976
The George Washington University, MA in economics, 1985

Select Civic Associations
Past Chair and Life Director, United Way of Greater Cleveland
Board Member, Cleveland Foundation
Board Member, Greater Cleveland Partnership

We now have agreement and a statement by the Committee that 2 percent is the appropriate level of inflation. So I don't think the titles of hawks and doves are useful when the Committee has stated that we have a 2 percent inflation goal.

If there are titles that people want to use, I would like to be labeled someone who is open-minded. Or someone who is pragmatic. We've been through some very unusual circumstances. We've had a lot of unexpected changes in economic circumstances that have required us to think differently about the appropriate path for monetary policy. So I tend to feel very comfortable being open-minded and not dogmatic or being an ideologue on appropriate policy. I've been open-minded to changes in policy as economic circumstances have changed.

Sniderman: ***Let's talk more directly about current circumstances. If inflation is near our goal right now, why not try to go faster and get that unemployment rate down sooner?***

Pianalto: We always have to stay focused on a balanced approach. I would be concerned that if we were to provide even more policy stimulus, given my current outlook, we could risk an unwelcome rise in inflation. On the other hand, if we were to remove our policy accommodation too quickly, I would be concerned that we would risk slowing the economy and causing an unwelcome disinflation. I think we have to strike a balance, and I think we have a good balance with our current policy.

Sniderman: ***It's clear the economy is growing and the unemployment rate is coming down, but the pace of improvement is still slow. You've said in speeches that you think the Fed's extraordinary actions have been successful. What gives you that confidence that the policy approach is actually making a difference?***

Pianalto: In more normal times, the main tool we use in conducting monetary policy is adjusting the federal funds rate, our target rate. Back in 2007, when the economy was entering into a recession, we began to lower the feds fund rate, and we continued to lower it until 2008 when we brought it down to near zero, where it stands today. We felt that the economy still needed further accommodation, so we used some new tools [such as long-term asset purchases, otherwise known as "quantitative easing"] in providing accommodation.

When we adjust the federal funds target rate, the rates at which consumers and businesses borrow are also affected. When we were bringing down the fed funds rate, medium-term and longer-term rates also came down. In using our new tools, we have the same objective of lowering rates at which consumers and businesses borrow.

When you ask how I can determine whether our policy accommodation has been effective, you can look at the path of medium- to longer-term interest rates, and they have been brought down significantly. On the mere announcement that we were going to be purchasing mortgage-backed securities, mortgage rates fell almost 100 basis points. Those are the rates at which consumers and businesses borrow. By bringing those rates down, we are providing stimulus to the economy by encouraging consumers and businesses to borrow money, and that translates into more spending.

Sniderman: ***Is there any way from history to try to get a sense of whether that was the right thing to do or not?***

Pianalto: I think we have a very good example of *not* having been accommodative at a time when the economy needed more accommodation. That was the Great Depression. It took us quite a bit of time, a lot of studying, to understand that the Federal Reserve was not providing enough policy accommodation during that time. The Federal Reserve's restrictive monetary policy contributed to making what might have been a severe recession into the prolonged, 10-year downturn that we now know as the Great Depression. That was a good lesson for us. And I think we learned from that episode, and we have responded more aggressively to the most recent severe recession.

Sniderman: ***You suggested that maybe it's not such a good idea to be pushing so hard on monetary policy because there's an inflation risk. But clearly the unemployment rate is very high. Are there some other factors at work keeping that unemployment rate up?***

Pianalto: I still believe that our current high unemployment is a cyclical problem and not a structural one. There's been a longstanding relationship between the amount of growth in the economy and the improvement that it translates into in terms of job creation. We've had a very weak recovery that hasn't created a lot of jobs. So the slow pace of this recovery is causing that unemployment rate to move down more slowly than we'd like.

I'm reassured that this issue is cyclical and not structural when I look at job openings. Prior to the recession, there were two individuals looking for every job that was open, so it was a 2-for-1 ratio. During this recession, that number has jumped to four people looking for every one job opening. So we just have a very slow pace of job openings, which, again, is cyclical, in my thinking.

But we're also finding that it's taking longer to match the skills that people have to the skills that are needed in available jobs. It may be that because these jobs require more training, more skills, more education, it is taking a little more time to make a match. That's another reason why it's taking longer to bring the unemployment rate down.

Sniderman: ***It is remarkable the number of employers who will tell you that the jobs they have open used to be filled by high school graduates. Now, at a minimum, those jobs require an associate degree or something like that.***

Pianalto: Yes, in fact, even the manufacturers I talk with say that for entry-level jobs, they're requiring at least two years of post-high school education; some additional training. The data show that where we've seen gains in manufacturing jobs, it's been in occupations that require a four-year college degree. And in occupations that require high school or less, jobs have actually declined. So yes, this is another important factor that's affecting our labor markets.

Sniderman: ***Let's turn attention to another place that's a notable headwind in the expansion, and that's the housing sector. Do you think it's appropriate for the Fed to be purchasing government-guaranteed, mortgage-backed securities to strengthen the housing sector? What are some other roles the Fed can play to try to get the housing sector to heal more quickly?***

Pianalto: In almost all previous recoveries, investment in housing has been positive and has helped the recovery. Unfortunately, in this recession, investment in residential construction has actually declined, so it's been a drag.

Monetary policy has helped the situation by bringing down mortgage rates, and that has made housing more affordable to many consumers. But we're in an unfortunate circumstance in that not everyone can take advantage of these lower interest rates. Because of depressed housing markets, we've had consumers lose a lot of wealth that was associated with housing. And because

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of the very challenging economic environment that we've been through, consumers have more difficulty obtaining credit. Their credit scores may have been lowered. So this transmission mechanism that monetary policy operates through has been blunted somewhat.

We have to look at other ways of addressing some of these issues. The Board of Governors recently sent Congress a white paper with some options about how we can address some of the challenges that we're facing in the housing market. The options range from some loan modification programs that might be available, to taking homes that are in foreclosure and now owned by banks and turning them into rental properties. I hope that Congress can have some debates around these various options and come to some policy decisions that will help the housing market.

My forecast for either economic growth or inflation would have to change for me to want to make a change in the stance of monetary policy.

Sniderman: ***Some of the most recent indicators show some signs of improvement in the pace of the expansion. Are you feeling more upbeat today than you were a year ago or even six months ago about the economy's prospects?***

Pianalto: I want to see more evidence that the good economic data that we're seeing is more than transitory, that it is sustained. We've seen two other episodes in this recovery—in early 2010 and then again in 2011—where we thought the economy was gaining some momentum only to be disappointed later on by additional factors, such as the European debt crisis, and issues around the tsunami in Japan that disrupted supply chains in the auto industry, and so forth. I'm being a little cautious about saying that this stronger economic data that we're seeing is going to be sustained. I'd like to see a little more evidence of that strength.

Having said that, one difference that I'm seeing this year from the two previous episodes where we started to see some strengthening in the economy is that the employment picture does look to be stronger. We've now had several months of good employment numbers. In conversations I've been having with businesspeople, they sound more optimistic. This time the optimism is being supported—it's not just a feeling; they're actually seeing stronger orders, and they are responding to those orders by doing more hiring. That's why I think we're seeing stronger numbers on the employment front.

Sniderman: ***If we get into the summer and begin to see another one of these patterns of the economy slowing down, do you think that would be the time to support further easing in policy and maybe be willing to take a little more risk on the inflation side of things in order to get the economy moving again?***

Pianalto: Right now my forecast is for the economy to grow a little more than 2.5 percent this year and 3 percent next year, with inflation staying close to 2 percent. My forecast for either economic growth or inflation would have to change for me to want to make a change in the stance of monetary policy. Given my current outlook for the economy, the current stance of monetary policy is appropriate. If my forecast were to change significantly, then I would want to look at the appropriate policy response, and perhaps make an adjustment to my monetary policy stance in response to a change in my forecast.

Sniderman: ***In that context, some people say the Committee is being maybe way too conservative about the inflation risk and that the emphasis on price stability is holding the economy back from getting this unemployment rate down. What is your view?***

Pianalto: I think it's important for us to maintain low and stable inflation in order for the economy to grow. I think our two objectives are complementary. We've learned over a long period of time that a low and stable inflation rate actually is necessary for longer-term economic growth. So I think it is appropriate for the Fed to stay focused on maintaining a low and stable inflation rate near our 2 percent objective in order to provide an environment for the economy to grow, and therefore for employment to grow, for jobs to be created.

Sniderman: ***Well, it's certainly been a challenging period for the Fed, as you've mentioned—unconventional actions, unconventional economic circumstances. And certainly the Federal Reserve has attracted its share of skeptics and critics, it seems, on a number of different dimensions. Policy is too tight, too easy, too much risk of inflation, not willing to take enough risk to get the unemployment rate down, and so on. How do you feel about all of the controversy surrounding you as a voting member this year?***

Pianalto: When you are in such unusual circumstances and you've been through the challenges we've been through as a country, it's not surprising that you're going to have diverse views on how to address these issues. As I mentioned earlier, I want to have an open mind about the appropriate policy approach, so I do read various people's views and opinions about our policy actions. I listen very carefully to my colleagues' views on appropriate policy responses given current economic circumstances and our current outlook. And then I make a judgment about what I believe should be the appropriate monetary policy response.

Sniderman: ***What are some of the things you've learned over time in terms of how you approach decision making?***

Pianalto: When you're part of the process that creates these new tools and implements them, you clearly are much more familiar with them. It's almost like, rather than going back and reading a textbook, you're actually writing the textbook. Therefore, because you're actually doing it, you feel much more knowledgeable about it—you're the expert.

Sniderman: ***Maybe it's the difference between someone handing you a tool and saying, "Here, use this," versus having a problem and then you have to create the tool to help you solve the problem?***

Pianalto: With the first couple of years on the Committee, I recall thinking about what other Committees did when they faced these types of circumstances. But in the past few years we have been facing a set of circumstances that very few previous Committees had to deal with. So I no longer had the luxury of thinking about what other Committees did. I turned my attention more towards creating the policy response to these circumstances.

It's a different approach. I spent less time thinking about, "what do I need to learn from others?" Rather, I had to focus on being helpful in creating the response. I'm sure that I've gained wisdom by going through this episode. That wisdom will be helpful, I'm sure, in responding to challenging circumstances in the future. ■

Watch video clips from this interview
www.clevelandfed.org/forefront

Recommended reading

Sandra Pianalto. 2011. "Price Stability: Why We Seek It and How Best to Achieve It." *Forefront*, Federal Reserve Bank of Cleveland (Spring).

Speech transcripts

For transcripts of President Pianalto's speeches, visit ***www.clevelandfed.org/For_the_Public/News_and_Media/Speeches***