Global Economic, Debt and Central Bank Dynamics

Dr. Stanley Fischer and Terrence Keeley

This interview with Dr. Stanley Fischer[1] took place on Sept. 22, 2020 at a BlackRock Educational Academy session – an event that drew more than 250 institutions and financial professionals from 42 countries.

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TK: Dr. Fischer, thanks for joining us, albeit virtually. Jay Powell is testifying before Congress today. What do you think is front of mind right now for Chairman Powell and his colleagues?

STANLEY FISCHER: Front of mind for Chairman Powell is trying to make sure that, beyond the general outline he gave on the Fed's migration of fixed inflation targeting to more variable inflation targeting, that they have a viable policy framework in which that can be done – that's a top concern. I think there will be some difficulties around turning points, when the private sector must guess whether the Fed is going to start raising the interest rate, if that's what it needs to do, and by how much. I think they have introduced a bit more flexibility into the target inflation rate in a way that will complicate investor decisions in the short and longer runs. They need to make that new framework work. That must be foremost in Jay Powell's mind, and for the whole committee, as well as their various views on who is going to take which positions publicly.

TK: When I was a student, I was told that inflation always and everywhere is a monetary phenomenon. What confidence do you have that the Federal Reserve – and other central banks around the world – can engineer higher inflation? Are we going into a period where inflation will be higher in the years immediately ahead?

STANLEY FISCHER: I think that's a big question. It's not as if the Fed was trying to keep inflation *below* targets for the last ten years, but that's what happened. And sometimes, as I listen to the conversations about, we must raise the target, well, we didn't raise the target, but we were nevertheless below the target. I think the change in which the Fed will try to compensate for lost non-inflation is a healthy one. It's been tried by some people. Australia is a country that has used that framework – not exactly, but reasonably. Will it work? Well, it has worked in some places. And it probably can work if the central bank has got the ability and the guts to try and go beat the old target of two percent.

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[1] **IMPORTANT DISCLOSURES:** ***Dr. Stanley Fischer*** *is a renowned economist, former Vice Chairman of the Federal Reserve, former Governor of the Bank of Israel and former First Managing Director of the IMF. During his tenure at the Fed, Dr. Fischer headed the Financial Stability Committee. Dr. Fischer has been a Senior Advisor to BlackRock since January 2019.* ***Terrence Keeley*** *is a Managing Director at BlackRock, responsible for overseeing the relationships and services BlackRock provides to central bank, sovereign wealth fund, finance ministry and supra-national clients. Mr. Keeley also runs the BlackRock Educational Academy, the firm's primary client learning and knowledge transfer initiative. The views expressed are those of Dr. Fischer alone; they do not reflect official positions of BlackRock. Other disclosures appear at the end of this document.*

TK: One of the tools that some central banks have been utilizing to engineer those outcomes have been negative interest rates. What is your view on negative rates as a monetary policy tool? Does it comport with the goal of seeking higher inflation, or is it counterproductive? There are powerful arguments on both sides.

STANLEY FISCHER: Well, in theory, negative rates are consistent with generating higher inflation. Nonetheless, if you look at the fact that the Swedes came off their negative interest rate policy – and one doesn't know quite what Switzerland will do, its problem having been mainly large inflows of currency and using the negative rate as a way of dealing particularly with the capital account in Switzerland – it's an open question. My view is the United States is not a country in which people will say, "hmm, negative interest rates, now that is interesting, let's see how we can make money off that!" Instead, they will yell and scream for quite some time about how this is impossible, how it never worked anywhere, et cetera. But it can work – and it would work if it's implemented well.

When I was in the Fed, I had a sense that my colleagues were concerned about how they would deal with the public response to negative interest rates. I was too. I think the average American is probably not quite the same as the average Swiss or Swede.

TK: We're speaking about the importance of monetary policy – but we live at a time when the coordination of monetary and fiscal policies is even more determinative; the success of one seems to depend on the other. You co-authored an important piece with Philip Hildebrand and other BII colleagues about how combining fiscal policy with monetary policy has become essential. How would you generally rate global fiscal policy responses to date?

STANLEY FISCHER: Well, I think at this moment, the argument that if the Fed does more, fiscal will do less, probably has got some weight behind it. Fiscal policy, at least in my mind, could have been more active in the US and elsewhere, more positive, and it can still become more active and more positive. That would help monetary policy. I think what is alarming some people – the belief that debt to GDP levels are too high and unsustainable – that argument is not well founded. We should be looking at the burden of the interest payments in the budget. That tells you a very different story about how sustainable fiscal policy now is.

TK: So your point is – even though high debt levels of debt to GDP might scare some, the fact that the carrying costs of those debt loads at these levels of interest rates are low should make us less concerned about our fiscal burdens and trajectories. Did I state that properly?

STANLEY FISCHER: You did.

TK: Equity markets now seem to be romancing a V-shaped recovery. Indeed, the recovery of equity markets in the last few months has exceeded every reasonable expectation. How do you see economic recovery going into 2021? Scott Thiel just mentioned we're seeing a good recovery in manufacturing, but the services sector is lagging. What are your forecasts for 2021 growth?

STANLEY FISCHER: Well it depends on what policies are going to be in place in 2021, and we don't know those. In the United States in particular, it depends on the election results. That is going to be a major factor. Assuming a Republican victory, I would not expect much of a change. Assuming a Democratic victory, there will be major changes - and if that happens, we may get a push to growth, and a push to inflation.

TK: I often speak to my 90-year old Swiss father-in-law. He doesn't understand anything that's going on in modern monetary policies. This notion of quantitative easing, "printing money" – he thinks it is just crazy. Now he is Swiss, so you can forgive him that. But quantitative easing is no longer a phenomenon reserved just to developed central banks and countries. Several central banks in developing countries - including Indonesia, India, South African, Turkey, Mexico, Columbia, Poland, to name a few - have followed their developed country central bank counterparts in buying domestic government mortgage and/or bank bonds. Now, this "crazy thing" [i.e., QE] is becoming a common phenomenon the globe over! Should markets welcome this global extension of unconventional monetary techniques? Do you think ubiquitous QE poses more risks or more opportunities?

STANLEY FISCHER: The basic difference between emerging market central banks and developed market central banks is the amount of trust that the public in the country and outside the country has in the ability of that central bank to deliver its targeted variables, namely inflation and growth. Looking at the names of the countries you've mentioned, some of those have tough central banks and some of them don't. For those that are going to be pushed around by their government, QE could be a negative factor.

But those countries with central banks that are willing to stay tough while going along with the belief that they need more steam in the engine - those will be okay. But watch extremely closely because these dynamics can change very quickly.

TK: Let's stay on emerging markets. Over the years, you've been a hero for so many, advocating effective growth policies. It turns out that many developing countries - especially those that rely on tourism, oil exports or low skilled labor - these are particularly vulnerable in the current environment. The IMF has reported that, without more concerted efforts, several low-income developing countries like Bangladesh, face a lost decade – their words, mind you, "a lost decade". Do you agree with this sober assessment? If so, what can be done about it?

STANLEY FISCHER: Look, any country can have a lost decade if it screws up sufficiently. That's something we've just got to be wise about. You must always watch what the central bank is doing. When a central bank is acting sensibly – even a strong central bank in a country with a relatively weak economy, like South Africa, for instance, where the economy hasn't done that well but the central bank is a very powerful institution with a very good governor - in those cases, I wouldn't be too concerned about quantitative easing. But I would be very worried about what happens if a new government changes the governor or something like that to change course. In emerging market countries, you've got to watch more closely than you would with a Bank of England or the Fed, or some institution that's been around for centuries. The Fed just made it over a century. History makes a difference on how much confidence you should have in a central bank. And of course, we've gotten this far into the discussion without talking about what is going to happen with the Coronavirus vaccine. That's a new, uncertain factor.

Pandemics are not totally new, of course, but they're new enough. The last time a plague was as important in the developed world was exactly 100 years, in 1918-20, after World War I. This is a factor which we've got to keep watching and hoping that the vaccine comes on board relatively quickly, and that it is effective. That will have a big impact on demand. It's something that doesn't exist yet. When and how it happens will have a powerful influence on expectations, short term but also for the next decade.

TK: The health authority that I follow most closely in the US is Scott Gottlieb. Dr. Gottlieb said yesterday that there is no chance for an effective, population-wide immunization program in the US until after the second quarter of 2021, at the earliest. So – we appear to have a long slog ahead of us.

There are multiple questions coming in for you, Stan – from Sweden, Saskatchewan, Indiana. Let's start with Saskatoon. Why is the Federal Reserve targeting two percent inflation? Is there something magical about two percent? Given technology's pervasive effect on dampening inflation, shouldn't we be comfortable with a target below two percent?

STANLEY FISCHER: Well, that is a discussion that's gone on for a long time, and two percent was chosen initially by the New Zealanders in the early-90s. What you wanted was a low enough number to allow relative prices to change, but not a high enough number that would generate inflation. Serious inflation, I mean. Do you remember Alan Greenspan's definition of what the target inflation rate should be? He said the rate of inflation should be such that people don't take it into account in thinking about the future. That means it better be pretty low. And I think that's right. When I was Governor of the Bank of Israel, trade union leaders came and spoke to me about, if the rate ever gets to four percent we are changing our behavior, we will have to go back to indexation – meaning they would need go back to all the bad things Israel had when we were a high inflation country. That had an impact on the governor of the central bank.

TK: This inflation question had two parts. The first is *why* two percent - but the second is, can we even *measure* inflation? Are the measurements that we're utilizing robust enough to say "two percent" vs. "three percent"? Perhaps that is consistent with what Alan Greenspan said as well.

STANLEY FISCHER: I often say we really don't know how accurately we measure inflation, but we do know it's not perfect. It's wise to have what a few central banks have, which is a range for the inflation rate, typically something between one and three percent, and then move the target rate around within that area. Why not go to five percent? That is very clear: running an economy with five percent inflation is a big pain in whatever part of the economy experiences that pain. You don't want to be in that position, because then you start spending a lot of time making bets about inflation and so forth. You're not getting anything useful out of that.

TK: Rick Rieder often points out our phones today are no longer just our phones; they're also our cameras, our health devices, our tracking devices - and yet they are still measured as a cost of a phone. Same can be said about cars. Inflation components fail to account for technological advances.

Here's another question for you. Given the design of some crisis stimulus packages, there are growing concerns about central bank independence. Should we be concerned about central bank independence? Could perceived interdependence become a challenge for some countries going forward?

STANLEY FISCHER: Independence is important. And it will be a challenge in some countries. When you write down these governance models, you can easily say that the Central Bank X cooperates with the government of X. Well, that would be nice, but frequently it isn't. When that happens, you're going to have a harder time keeping the economy under control and being able to predict what is going to happen. Too often there is a political fight involving a central bank, which will get support from certain parts of the public, but not from the rest of the public, which probably cares less about inflation.

TK: The next question relates to China and globalization. A good portion of what has dominated global growth and policy responses over the last three decades has been the integration of China into the global economy in a relatively organic way. Now China's relationship with the world, and certainly with the United States, is more contentious. How are you thinking about China's future relationships with international policymaking bodies? How do you see globalization trends in the years to come?

STANLEY FISCHER: Well, China will be a major factor in the global economy. It already is, and it will be for a very long time. And they're running themselves very well at the moment. So they're there, and we're going to have to take them into account. We're also going to have to realize that throwing our weight around is not necessarily going to be successful over any long period, particularly if China continues to outperform the Western World. Tensions are typical as formerly low-income countries make their way into the higher-income category, which is what China is doing, and what Korea did, and quite a few others, did. When that happens, you must deal with friction. The best way to deal with it would be to try and find mutually beneficial policies and programs. But as capital flows increase - which they will if China stays at two and a half, three percent on its real interest rate while we're somewhere around one percent - we will have to accept that. Especially if capital is to remain flexible, as we would prefer.

TK: Stan, as usual, your insights are appreciated by all of us. I'm going to ask you a final question. It's more of an investor question. This is an advanced fixed income seminar. Virtually every insurance company, bank, many private portfolios, and all retiree portfolios rely on income. And there are so few sources of reliable income in the world today. What advice do you have for investors who are looking to have some type of income return in their portfolios?

STANLEY FISCHER: Well the thing that seems obvious is - buy Chinese government bonds. But even that's something that must be done very, very carefully. Capital markets work, though not necessarily instantaneously. If a country has three to four percent real returns, there's usually some reason for that.

Before you buy those instruments, you better be very certain that those three to four percent real rates are well based. We've seen President Trump's efforts to influence China's policies – but so far, I think the Chinese have done pretty well in not losing very much in those contests. You need to be fairly confident about the long-term behavior of a country in which you're putting a lot of money. And there is a reason why you should always diversify – because almost every country has the capacity to blow up.

TK: So this has just flashed across the tape: *Stan Fischer says every country has the capacity to blow up*. You're making news even on this broadcast!

STANLEY FISCHER: Thanks. I feel like I finally made it.

TK: Dr. Stanley Fischer. What a privilege and an honor to hear from you!

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