South Korean Edaily newspaper interview with
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1. Like the "Greenspan Conundrum" in the past, there are many questions about why U.S. government bond yields have been going down so much recently. What do you think is the reason? What is the implication of this for the current U.S. economy?

Long-term treasury yields reflect the market's expectations of the future path of the short-term policy rate set by the Federal Reserve. Ten-year treasury yields are currently around 1.3%, which suggests that market participants expect that, in attempting to achieve its 2% inflation target, the Fed will need to keep the federal funds rate quite low for the foreseeable future. In turn, that suggests that, despite the current inflation "scare," market participants have a benign inflation outlook. The Fed's monetary policy stance, and how it is reflected in the yield curve, is driven by economic conditions, so the interesting question is: what is it about the structure and behavior of the economy that is producing an environment of low inflation and low nominal interest rates? My hunch is that it reflects the secular process of digital technologies disrupting and transforming the economy, leading to more (desired) savings than investment. Rather than putting upward pressure on inflation and interest rates, large budget deficits help absorb these excess savings and, by supplying a safe asset, allow purchasing power to be transferred into the future.

2. The Federal Reserve maintains its "temporary" stance on inflation in the U.S. However, there are many concerns that inflation may be structural, given the recent rate of wage increases in the U.S. How do you see it?

The current spike in consumer price inflation (5.4% year-on-year in June and July) is almost certainly a temporary phenomenon, associated with the economy recovering from, and adapting to, its biggest ever short-term hit to activity. Inflation is set to moderate over the course of 2022 as unfavorable base effects fade or reverse and supply bottlenecks ease. If inflationary pressures look like becoming structural because the economy is

pushing up against its supply constraints and the public's inflation expectations threaten to become unanchored, the Fed will move to counter that by tightening monetary policy.

3. If you agree with the Fed, why do you think the market is misjudging? On the contrary, if the Fed is misjudging, what do you think is the problem? If so, do you think the Fed's policy response to the inflation could be a failure?

It is not the market, but economic forecasters and commentators who are worrying about inflation breaking out on the upside. Market measures of inflation expectations such as yields on nominal treasury yields and inflation-indexed securities, and break-even inflation rates remain well-behaved, suggesting that the market is aligned with the Fed rather than with inflation worrywarts. Pundits get rewarded with headlines; investors put their money on the line. What the pundits miss is that, for high inflation to become structural, the Fed has to let it. Under its post-August 2019 average inflation targeting framework, the Fed is aiming for inflation to run a little above its 2% target for a while. So far, so good, but if inflation remains high the Fed will move to rein it in, and it has the tools and the political independence to do so.

4. There is a view that the recovery of the U.S. economy has peaked. It could be because of the delta mutation virus or because of normalization of monetary policy. What do you think? Also, do you think that the infrastructure bill discussed in Congress recently will affect the economy?

The US recovery has peaked in terms of the growth rate: real GDP in Q3 of last year bounced back by 7.5% (non-annualized) after falling 8.9% in Q1, and such a high number cannot be expected again. The real question, however, is how close is the economy to full employment, after which the Fed's job is to try to keep it growing at its potential growth rate (reckoned to be around 2%), and how long will it take to get to that point? Real GDP is now 0.8% above its pre-Covid (Q4 2019) level, but is about 2% below where it likely would have been had the pandemic not happened. The latest unemployment rate, at 5.4%, is almost 2 percentage points above its pre-Covid level (of 3.5%) and a wider measure of under/unemployment, at 9.2%, is 2.4pp above its pre-Covid trough. Payrolls are still 5.7 million below their pre-Covid level (and further below their trend), and the

labor force participation rate is 1.6pp below its pre-Covid level and more than 4pp below its pre-financial crisis level. These data suggest that, despite the record high level of job openings, the economy is still some ways from hitting its full employment speed limit.

5. Some say that Chairman Jerome Powell will not mention tapering at the Jackson Hall meeting in August. When do you expect the Fed's tapering? And how about rate hikes?

The Fed has set a lower bar on when it would begin tapering than that on starting to raise the federal funds rate, namely that "substantial further progress [has to be made] toward its maximum employment and price stability goals." At its July FOMC meeting, the Fed gave a heads-up that tapering of its treasury securities and MBS purchases is now on the horizon by noting that "progress [has been made]". The Fed rarely breaks any new policy ground at the Jackson Hole meeting, so Chair Powell is unlikely to go beyond reiterating the existing message that the Fed will continue to monitor progress at upcoming meetings. If the August employment report is another strong one, the Fed is likely to signal at its September FOMC meeting its intention to begin tapering at its November of December meeting. I do not expect the Fed to begin hiking rates until early 2023, given the higher bar it has set for doing that, namely the achievement of full employment and (PCE) inflation being on track to exceed 2% for some time.

6. There is a lot of concern about asset bubbles. Do you think the current stock, real estate and high-risk asset markets are in a bubble area?

"Bubble" is a big word. An asset price bubble occurs when prices become detached from underlying fundamentals and rise, driven by expectations that they will keep on rising. I don't think stock and risk asset markets are in a bubble in that strict sense, but valuations are rich. Monetary policy works largely through its effect on asset prices, and asset prices, by discounting future cash flows, reflect the positive effects on the future trajectory of the economy that monetary and fiscal policies aim to have. It is important to distinguish between asset prices rising in response to monetary and fiscal policies doing their job and asset price bubbles, that by definition are bound to burst and are likely to leave significant economic damage in their wake.

7. Cryptocurrencies were soaring in the middle of the year and are showing adjustment due to regulations. Do you agree with the U.S. authorities' position that cryptocurrencies have no intrinsic value and are an extremely speculative asset? The interest of institutional investors is growing; do you think that cryptocurrency has a role as a means of storing value?

Bitcoin and other cryptocurrencies represent a significant technological, payments system, and monetary development. Blockchain is a transformative technology, which transcends cryptocurrency applications. Cryptocurrencies are “disrupting” central banks and other payments systems providers, and is forcing them to innovate, notably by spurring the development of Centra Bank Digital Currencies. It is very unlikely that cryptocurrencies will seriously challenge, let alone displace, sovereign money because their very selling point – no central authority controls them – is their blind-spot: nobody can vouch for their inflation rate. A cryptocurrency like Bitcoin can be a store of value, in that it can serve to transfer purchasing power through time, but, being a risky speculative asset, it makes for a poor one. Like fine wine, collector’s art, and gold, the winners in the cryptocurrency competitive race are likely to find a niche in the ecosystem of monetary assets, but hardly dominate it.

8. Conflicts between the U.S. and China have intensified since the inauguration of the Joe Biden administration. What is the nature of the confrontation between the two powers and what aspects do you expect to see in the future?

The rapid and sustained economic development of China in the past four decades, and the scope for it to continue, has upended the economic, political and security balance in the world, and a new one has yet to be forged. The US and China need to find a way of mutually accommodating each other, as challenging and uncomfortable as that may be. The US needs to recognize that it can no longer call the global shots and China that with global power comes global responsibilities. The risk of falling into a dreaded Thucydides Trap is heightened by the two countries having political systems that are inimical to one another. The US would be well advised to go easy on the preaching of values and China to develop a thicker skin.

9. South Korea is sandwiched between two major powers, the United States and China. There is also an opportunity factor, but it is accepted as a crisis. How do you think Korea's strategy should be in the meantime?

Rather than being sandwiched, South Korea can try to build a bridge. Geographically, historically, economically, and geopolitically, the country is in a unique position to play a constructive role in helping to mediate and shape US-China relations. To do so, it would need to mend fences and join forces with Japan, work towards some kind of rapprochement with North Korea, and build significant diplomatic capacity, buttressed by soft and hard power.

10. While Korea's economic growth rate is predicted to be 4 percent this year, there is also controversy over the timing of a rate hike in Korea. What kind of monetary and fiscal policies do you think should be implemented in the current situation, such as Korea, which is sandwiched between developed and developing countries?

The global economy is still operating in the shadow of the devastating negative economic shock of Covid-19, and South Korea is no exception. This calls for both monetary and fiscal policies to be mobilized aggressively to support a return to full employment while helping the economy adjust to a shifting pattern of post-Covid demand. South Korea is the tenth (nominal GDP basis) or fourteenth (purchasing power parity basis) largest economy in the world, and its per capita income has significant potential to rise; it can now claim the mantle of a developed economy.

11. There are many concerns in Korea that the national debt has increased too quickly since the Pandemic. Is it your view that a preemptive rate hike or debt reduction is not necessary in Korea? (answer provided August 14, 2021)

Budget deficits and debt levels have shot up in all major economies as part of a necessary economic and policy response to the negative shock from the pandemic. Fiscal policy should serve the needs of the economy, not the other way around.

The level of real GDP in Q2 2021 in South Korea was just 1.3% above its pre-Covid (Q4 2019) level and about 3% below where it would have been had the pandemic not happened. Consumer price inflation in July was 2.6% year-on-year, above the Bank of Korea's 2% inflation target, but that elevated reading reflects a distorting base effect from last year's Covid shock: compared to two years ago, on an annualized basis, inflation is 1.7% year-on-year. Rather than being preemptive, monetary and fiscal policy in South Korea, as in other major economies, should be patient, and supportive of a full and strong recovery.