Goldman Sachs Exchanges
Stagflation and the Fed's next move
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Allison Nathan: As the US economy faces a stagflationary shock, how will the Fed navigate this tricky environment? I'm Allison Nathan and this is Goldman Sachs Exchanges.

My guest today is Rob Kaplan, the vice chairman of Goldman Sachs and the former president of the Dallas Fed. Rob, welcome back to the program.

Rob Kaplan: Good to see you, Allison.

Allison Nathan: So, Rob, there is so much to talk about today. But of course, there is a lot of concern that the US is headed for a stagflation shock which is notoriously difficult for monetary policymakers to deal with. So, first of all, let's just get your view. Do you think that we are facing stagflation ahead?

Rob Kaplan: We are facing most likely slower growth and stickier prices, so I guess that might be the definition of stagflation. And there are several reasons why, not just tariffs. We're right now in the middle of an effort to cut government spending and lower deficits. There's a question mark how effective it's going. But that would normally slow growth.

You've got a regulatory review in every industry. That should help growth, but it might take a year or two. You've got immigration flows due to deportations, immigration and flow of workforce is decelerating, is declining. Workforce growth helps growth. We're accustomed to 1 to 2 million workers per year over the last eight years, including in the first Trump Administration. It looks like it could be in the low hundreds of thousands this year. That makes growth lower. Makes the job force in the service sector stickier.

And then you've got tariffs, which should slow growth and provide a cost shock. But we don't know how much of a cost shock because we don't know what the tariff levels are.

So, if you wrap it all together, it makes sense that growth is going to slow, and prices are likely to be stickier. We just don't know how much.

Allison Nathan: So, how does the Fed weigh these risks of slower growth but higher inflation? We have an FOMC meeting coming up. What will the conversation be like in the Eccles Building?

Rob Kaplan: So, the smartest thing the Fed could do, and if I were in my former seat, agree what you know and acknowledge what you don't know. And right now, the things you don't know are significant. I don't know what the tariff levels are going to be. We haven't announced any of these trade levels yet. I do know that immigration growth is slowed, and workforce growth is slower. And I know what they're trying to do with the government.

So, what I would say is the soft data, I know that's weaker. But so far, other than travel, leisure, shipping, those are clearly soft. But the hard data or otherwise is kind of hanging in there. And inflation at the moment is kind of hanging around in the mid twos. But I know we're about to get a cost shock.

And so, the smartest thing you do with this amount of uncertainty is kick the can. They won't be prepared to act in May. And then they'll take with a clean sheet of paper for June. And then figure out as they get into the June meeting, so what's the puzzle look like now? And so, don't try to prejudge. Don't be rigid. Don't be predetermined. And realize there's a puzzle. But you don't know what the pieces are yet.

And so, I'd be careful about making public comments on what you will or won't look through because you don't know. And I'd be careful about talking about dates like June meeting versus July meeting. I would be aware of that.

And then the last thing they have to do is realize inflation expectations in the surveys are getting unanchored. Okay? And so, you need to at least jawbone a little tougher and remind people you haven't given up your fight on inflation. And that's why you've heard Jay Powell in his speech in Chicago a couple of weeks ago sound a little tougher. It's not that he's not prepared to lower rates down the road. But he doesn't want inflation expectations to become unanchored.

Allison Nathan: So, you basically think the Fed sits tight here?

Rob Kaplan: In May.

Allison Nathan: In May. Watches. Waits. And that's the message they've been giving. I mean, they basically said we will wait to see how this evolves and how the data evolves. And we'll go from there. So, they could not cut at all this year. Or they could cut by a lot.

Rob Kaplan: Yeah. And what Jay's going to try to do, his big opportunity is in the press conference then. I think he'll try to sound balanced, even handed. But also, keep their options open. And be clear that they're still very focused on not just worrying about higher unemployment, but also fighting inflation. I think you'll hear that from him in the press conference.

Allison Nathan: So, I'm going to pivot here, Rob. The last time we spoke, we had discussed concerns about Fed independence. You were the head of the Dallas Fed during Trump's term. And when I asked you, first term, and when I asked you about that originally, you said, look, on the supervisory side, yes, you can feel some political pressure. But on the operational side in terms of interest rates and how they're managing monetary policy decisions, you didn't feel that during Trump 1.0.

Obviously, this rhetoric around Fed independence has ramped up.

Rob Kaplan: Yeah.

Allison Nathan: Have your views at all evolved since we last spoke about this?

Rob Kaplan: So, between now and the end of Jay Powell's term, I think the Fed will fight and strive around the table to be making decisions that are divorced from political pressures and political considerations. I think the issue will be whoever the new head of the Fed is going to be, I think it's very important for that person, whoever he or she is, to be seen to not have made any precommitments to the administration about what they will or won't do.

And I think there's probably some creeping skepticism out there whether that will be the case. That will be a challenge for the next Fed chair. But I think as long as Jay Powell is in the seat and with this cast of folks around this FOMC table, I think you may hear from one or two some comments that I think would be wiser not to make. But with the exception of that, I think they're going to strive to make whatever they think is the best decision to create full employment and price stability without regard to political pressures.

Allison Nathan: And it's an important point you just made there that I think sometimes gets unappreciated, which is it's around the table. You know? There are many members of the FOMC. And Chair Powell and the chair, in general, has one vote. So, how does that work if we think about the potential scenarios, how much influence can a chair have relative to everyone around the table?

Rob Kaplan: So, in a typical meeting, remember, there are seven governors. And then you have a rotating group of presidents who vote. And so, normally a Fed chair doesn't want more than a couple of dissents. Maybe you could live with three dissents. So, you need to keep a consensus around the table.

There has been a tendency historically for the governors to not dissent. Although, we've had a couple this year. But yeah, Jay has to build a consensus of the group and get people on the same page. And so, part of his job is to assess the group, give his own views. But he can't cut rates or raise rates or act by himself. He has to get the view of the group.

And so, this is part of the reason, there are two reasons why I think you didn't see any action recently. One, I think there's already some concern around the world about the institutional framework of the United States and willingness to invest in the dollar and buy duration. I think replacing the Fed chair before his or her term are over would undermine some of that confidence. That's one reason not to do it.

And then the second point is, even if Jay Powell weren't there, the remaining people around the FOMC table are going to strive to be true to what they believe and operate without regard to political pressure or influence. And I think you'll get the same results whether he's chair or not.

Allison Nathan: Right. Interesting. So, it just wouldn't be that effective in achieving the administration's goals?

Rob Kaplan: I don't think so.

Allison Nathan: Interesting. Okay. So, a lot of uncertainty. We don't know what the Fed will do because we don't know what tariffs and other policies are going to do. You know, what do you say to investors who are asking you, "What does this mean and how should I respond and react and navigate all this?"

Rob Kaplan: So, we go through a couple of things. One, I talk about the broad framework of all the structural changes that are going on. The other thing I talk about is how this affects the US, but how it affects outside the US. And this is where there's a divergence.

You've got to remember, for most countries around the world, they're fighting a trade war with only one country. So, the United States is fighting a trade war broadly. It means our companies are struggling to figure out how to realign their supply chains and logistics. And they're somewhat hesitant to domicile more in the United States unless they think it will be globally competitive.

And so, outside the US, this tariff change is likely a growth shock. Might, in fact, be disinflationary in that we have over capacity in goods around the world, just not in the United States with these tariffs. But we will in other countries. And so, it might in fact be clearer for their central banks, they may have more latitude to cut rates. Maybe do fiscal stimulus.

The United States is a little bit, not the only country, but kind of unique in that we're likely to have an issue with supply of goods and we may have some issues with supply of workers because of what we're doing on immigration. So, we're the one country that will have a growth shock potentially negative. But also, a cost shock.

Other countries around the world may have a little more clarity and latitude on how to manage this since that's another thing we talk with global investors about.

Allison Nathan: Right. So, are you essentially saying, you know, look abroad? Look abroad in a way that we haven't been looking because the US has performed so well and outperformed substantially?

Rob Kaplan: I still think the US exceptionalism thesis, it's got a few chinks in it, and in particular the chinks come from people questioning does our institutional framework of the US, is it still in place? That includes terrific companies, very innovative companies, higher education, innovation, science research was part of that bedrock, rule of law, free speech. There are maybe a few questions being asked. I think today as you and I are sitting here, Meta and Microsoft just announced earnings last night, I think that's a reminder to people around the world, you know, the US exceptionalism thesis, that's a key part of it. And you'll notice today, dollar strengthening, gold selling off, ten year actually rallying a little bit. It kind of reminds people, okay, that's the reason why, you know, I was so heavily allocated to dollar denominated assets.

So, those kinds of things help. And my big hope is as we come out of these two or three years, you want to come out of this period with US exceptionalism thesis intact. We don't do everything perfectly. But our institutional framework is intact. Our global competitiveness is intact. Our great, innovative, superb companies are intact. And that's my hope for the next few years.

But in the near term, there have been a few chinks in it that have caused people to, on the margin, allocate a little more away from the dollar.

Allison Nathan: Right. Which you think is warranted. But we'll see. I share your hope.

Rob Kaplan: Yeah. It's warranted. But it's not a wholesale reallocation. So, we're fortunate. There are stages to park outside the US. But at the moment, from what I've observed, it feels more like parking than high conviction investing. Whereas when people are investing in the US, I think it was more high conviction investing because a lot of these exceptional attributes, that pull is not gone. I think we have to make sure to preserve it.

Allison Nathan: I think everyone would agree that it's very hard to have high conviction today. Thanks again, Rob, for joining us.

Rob Kaplan: Thanks, Allison. Good to talk to you.

Allison Nathan: This episode of Goldman Sachs

Exchanges was recorded on Thursday, May 1st, 2025. I'm Allison Nathan. Thank you for listening.

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