mni

All Signal, No Noise

MARKET ANALYSIS

MNI Fed Preview: June 2022

Meeting Dates: Tue-Wed, 14-15 June
Decision/Statement/Summary of Econ Proj: Wed 15 June at 1400ET / 1900BST
Press Conference/Q&A: Wed 15 June at 1430ET / 1930BST

Minutes: Wed 6 July

Links (likely URLs based on previous meetings):
Statement: https://www.federalreserve.gov/newsevents/pressreleases/monetary20220615a.htm
Summary of Econ Proj: https://www.federalreserve.gov/monetarypolicy/fomcprojtabl20220615.htm
Implementation note (if applicable):
https://www.federalreserve.gov/newsevents/pressreleases/monetary20220615a1.htm
Press Conference: https://www.federalreserve.gov/monetarypolicy/fomcpresconf20220615.htm

MNI Review of Previous FOMC (May): https://roar-assets-auto.rbl.ms/documents/15790/FedReviewMay2022.pdf

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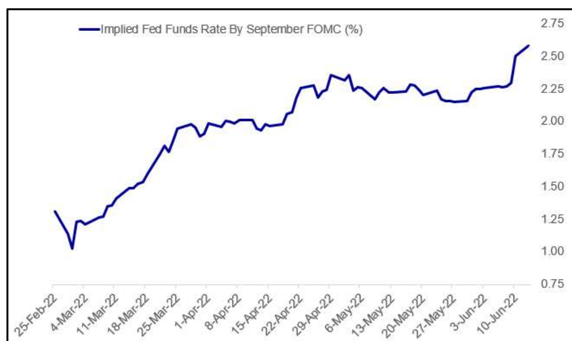
MNI POV (Point Of View): Higher Pressure, Higher Dots

By Tim Cooper

- *June's FOMC meeting is likely to deliver the previously-promised 50bp hike, but the market reaction to May's inflation report significantly raised the bar to a hawkish meeting outcome.*
- *The Dot Plot will signal a more hawkish rate path than had been expected a few weeks ago, but it would be surprising if it came close to confirming market rate hike pricing.*
- *Backed by the Dot Plot, Chair Powell is likely to signal that 50bp hikes are the base case in July and September, but is unlikely to pre-commit beyond that.*

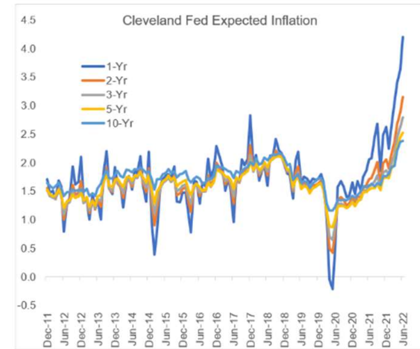
The Fed's messaging on near-term rate hikes had been unusually clear and basically unanimous prior to the pre-June FOMC blackout period: 50bp hikes would be delivered in both June and July, with incoming data determining whether further 50bp hikes would be required in September and beyond. There was even a nascent debate as to whether the Fed could pause its hiking cycle in September. And then incoming data arrived: June 10th's May CPI report saw both headline and core inflation again exceed expectations, with the monthly core rate accelerating to the fastest since June 2021 led by shelter costs (*see "Macro and Financial Developments Since The May 3-4 FOMC"* below for more on the details).



Normally a single data point wouldn't elicit such dramatic market repricing, but **May's report seems to have changed the overall narrative.** Rate futures are now pricing in an end-2022 funds rate of 3.4% (250bps above the current 0.875% rate), with 175bp of hikes between June and September (vs 146bp the day before the CPI data), and a terminal rate in late 2023 nearing 4% (vs closer to 3.3% pre-CPI). Sell-side analysts have scrambled to update their hiking profiles (**see our Analyst Summaries section**) and there is speculation the Fed could hike by 75bp or even 100bp this week. The reaction was exacerbated by the fact that the data came during the blackout period, meaning Wednesday's decision will be the first time we'll get Fed members' reactions.

That's a very significant market move a single data point, and it's unclear whether the FOMC can hurdle the higher bar to a hawkish outcome implied by the huge shift in market expectations in the last couple of sessions. That said, having spoken admiringly of the inflation-crushing Volcker Fed, the current FOMC's leadership will want to send a strong message that it is taking the inflation threat seriously:

- **Inflation hasn't peaked.** Chair Powell's key criterion for slowing/pausing rate hikes is "clear and convincing evidence" that inflation is slowing. If anything, May's inflation report provided clear and convincing evidence that inflation hadn't peaked in March/April as many had expected. If anything, inflation appears to be broadening out across price categories, and even if not accelerating, is proving persistent.
- **Inflation expectations have started advancing again from already-elevated levels.** Fed officials have consistently emphasized that while they are of course looking for evidence that inflation is set to cool as they expect and forecast, they are paying at least as much attention to inflation expectations. It appeared earlier in 2022 that such expectations may have been in the process of peaking, but many indicators are hitting fresh cycle highs (see the accompanying chart of the Cleveland Fed's Inflation Expectations metric, based on a broad set of both market- and survey-based data; also see our inter-meeting data review below).
- **And that's happening despite higher rates being priced.** While markets see the Fed delivering more hikes, they don't yet expect that to translate into substantially lower inflation going forward. There will be questions this week of Powell of whether the Fed will have to run faster just to stand still. The prospect of the Fed needing to tighten increasingly aggressively to get back ahead of the curve also helps explain why markets are increasingly implying recession fears.



However, can a hawkish Fed out-hawk very aggressive market pricing? The new terminal Fed pricing nearing 4% is far above even the highest "dot" expectation for the longer-run rate, with a March median of 2.4% and a range of 2 to 3%. While most analysts expect the Dot Plot to signal an end-2023 rate above 3%, it's unlikely that many FOMC members would signal at this stage that they see rates going close to 4% (ie, 100-200bp above the perceived neutral rate). The table below shows where various FOMC participants have signalled they regard the neutral rate to be, how quickly they want the Fed to get there, and whether they see the need to get rates above neutral.

Member	Position	Neutral	Latest	Latest additional comments
Powell	Chair	2-3% (FOMC)	May 4	May 17: Won't hesitate to raise above neutral if needed, not a stopping or looking-around point
Brainard	V.Chair			Apr 12: Move to neutral gives FOMC optionality. Combined effect with QT brings to neutral late'22
Williams	Gov	2-2.5%	Apr 14	May 10: Really hard to know where neutral is, don't know if have to raise above
Bowman	Gov			
Waller	Gov	2-2.25%	Mar 18	May 30: Supports above neutral by year-end, wants several 50bp hikes
Bullard	2022	2%	Jun 1	Jun 1: Sees a lot of unanimity for moving to neutral. Personally wants 3.5% by year-end
George	2022	2.5%	Mar 30	May 19: Unclear where level lies, favors watching for signs that inflation cooling
Mester	2022	~2.5%	Apr 22	Jun 2: Need to get to neutral as soon as possible, probably need to go above neutral
Evans	2023	2.25-2.5%	May 17	May 18: Favors getting to neutral by year-end, inflation curbed with a few hikes beyond
Harker	2023	2.5%	Apr 6	Apr 6: Can hike to neutral without recession
Kashkari	2023	2%	May 6	May 6: Probably need to raise moderately above neutral
Barkin	2024	2-3%	May 10	May 10: Hike rates to neutral, then evaluate. Sensitive to our inability to understand where it is
Bostic	2024	2-2.5%	May 9	May 11: Backs 50bp moves until at neutral level, will support moving rates more if inflation persists
Daly	2024	~2.5%	Jun 1	Jun 1: Will look to see what more needs doing once at neutral

Omits incoming Governors Cook & Jefferson, Boston Fed Collins (starting July, '22 voter), Dallas Fed Logan (Aug, '23 voter) and expected to be confirmed VC Banking Supervision Barr

Source: Bloomberg, MNI

The end-2022 futures implied rate of 3.4% would require over 250bp of hiking the rest of the year, with 50bp in each of Jun/July/Sep/Nov/Dec, or a 75bp hike or two. That's certainly possible, but it's unlikely the Dot Plot would communicate such an outcome. As the table above shows, most members seem to want to move to neutral in the coming months (mid 2%s) and see where things go from there. **We summarize our expectations for the Dot Plot on page 4.**

As for the rate decision itself: there's about a 25% probability implied of a 75bp hike at this meeting. A 50bp raise could thus ensure a knee-jerk dovish market reaction before the rest of the materials are digested. Far more likely than a 50bp hike would be the suggestion that such an option would be open to the FOMC at the July meeting, but this would probably have to wait for Powell's press conference. Overall though the FOMC may prefer to guide to more consecutive 50bp hikes, rather than signal the need for bigger hikes (and that could provide some immediate relief to the very short end of the rates curve, which is fully pricing a 75bp hike by September).

Statement: Watching Guidance

(**Link to May FOMC statement**)

There are two areas of focus for the Statement, each of which lean in a hawkish direction, though each will probably take a back seat in importance to the rate decision, Dot Plot, and press conference.

- **The characterization of inflation pressures:** The May statement included*: "Inflation remains elevated, reflecting supply and demand imbalances related to the pandemic, higher energy prices, and broader price pressures."* If this is recharacterized, it's most likely to be in a hawkish direction, perhaps by eliminating the reference to the imbalances being related to the pandemic.
- **Forward rate guidance:** The May guidance reiterated that following the rate hike at that meeting, the FOMC *"anticipates that ongoing increases in the target range will be appropriate".* There are some expectations – particularly given the outsized May inflation figure – that this language will go further by implying sizeable (eg 50bp) hikes further into the year beyond July. The word "expediently" could be added, or the FOMC could codify Chair Powell's conditionality for pausing rate hikes: namely, "we need to see inflation coming down in a clear and convincing way". Powell would probably have to elaborate on any such changes in the press conference.

Below is a general idea of how the statement could look:

June 15, 2022

Federal Reserve issues FOMC statement

For release at 2:00 p.m. EDT

Information received since the Federal Open Market Committee met in May indicates that job gains remain robust, while inflation remains elevated, reflecting supply and demand imbalances related to the pandemic, higher energy prices, and broader price pressures.

The invasion of Ukraine by Russia continues to cause tremendous human and economic hardship. The invasion and related events are creating additional upward pressure on inflation and are likely to weigh on economic activity. In addition, COVID-related lockdowns in China are exacerbating supply chain disruptions. The Committee is highly attentive to inflation risks.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. With appropriate firming in the stance of monetary policy, the Committee expects inflation to return to its 2 percent objective and the labor market to remain strong. In support of these goals, the Committee decided to raise the target range for the federal funds rate to 1-1/4 to 1-1/2 percent and anticipates that ongoing increases in the target range will be appropriate.

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

The balance sheet normalization program was initiated on June 1, as described in the Plans for Reducing the Size of the Federal Reserve's Balance Sheet that was issued in conjunction with the May meeting statement.

Voting for the monetary policy action were Jerome H. Powell, Chair; Lael Brainard, Vice Chair; John C. Williams, Vice Chair; Michelle W. Bowman; James Bullard; Lisa D. Cook; Esther L. George; Patrick Harker; Philip N. Jefferson; Loretta J. Mester; and Christopher J. Waller. Patrick Harker voted as an alternate member at this meeting.

We might also see a dissent or two in either direction depending on if there is a surprise outcome (possibly on the dovish end if the FOMC surprises and goes 75bp; possibly a hawkish dissent by, say, Bullard to a 50bp hike, although he's said previously he wasn't seeking a 75bp raise). **Our Instant Answers for this meeting look for any dissents to the rate decision and in which direction.**

Summary of Economic Projections / Dot Plot: Focus On 2022

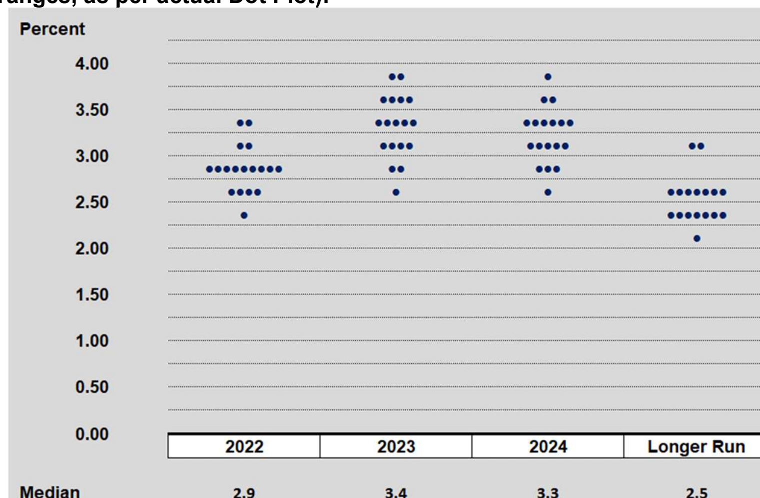
Any analysis of the June SEP's implications should be prefaced with the caveat that we don't really know to what degree Friday's CPI report will be reflected in the final projections. The Fed notes that "initial projections are due by the end of the day on the Friday before the FOMC meeting" but "policymakers may revise their projections at any time until the evening of the first day of the meeting." We assume that the final projections will take May's CPI reading into account. That having been said (and keeping in mind that there will be 18 submissions to the SEP, vs 16 previously, with Govs Cook and Jefferson joining since March):

Rate Dot Plot:

Our **Instant Answers** focus on the Dot Plot (eyeing the medians for 2022/23/24/L-R), but also the number of 2022 dots above 2.875% and 3.125%, as well as the number of 2023 dots above 3.375%. Overall it's hard to ascertain where consensus currently lies for the Dot Plot, given that several previews came out before the May CPI data. We would have considered our own base case (see below) as hawkish prior to last week, but now it's probably largely in line with the emerging consensus.

- **2022 (March median was 1.9% rounded):** This is probably the most consequential dot in the path, as it will signal how many 50bp hikes lie ahead beyond the July meeting. Sell-side previews written ahead of May's CPI release generally expected the end-2022 dot to come in at 2.50-2.75%, which would imply 50bp hikes in June and July, downshifting to 25bp in Sep, Nov, and Dec for 175bp of further tightening this year (including 50bp in June). The benchmark post-CPI seems to be 2.75-3.00%, which would imply the FOMC median seeing a 50bp hike in September, then downshifting to 25bps hikes. Given current market pricing, we would expect a dovish reaction to a median below 2.9%, or a hawkish reaction to a median above it.
- **2023 (March median was 2.8% rounded):** Assuming the 2022 Dots come out at 2.875%, the 2023 median dot should be somewhere above 3.00%. 3.375% is the rough consensus, implying two further 25bp 2023 hikes before pausing, but there are more analysts who see a median below that than expect a number above. If June's edition shows just one 2023 hike (3.1%), it would be seen as a dovish concession and a sign that FOMC members don't (yet) see the need to go far past neutral to tame inflation. Above 3.4% would be unexpectedly hawkish.
- **2024 (March median was 2.8% rounded):** March's dots implied at least two FOMC members pencilled in rate cuts by the end of 2024. It's likely that will be the central case for even more members this time, given the increasing amount of rate hike front-loading. There is general consensus that the median 2024 dot will reflect members' expectation (hope?) that having brought rates well above neutral by 2023, they can ease off the brakes by 2024. Since this would also reflect current market pricing for a 2024 cut, a 3.1% median wouldn't be much of a surprise. Steady at 3.4%, or a cut below 3%, would be mildly hawkish/significantly dovish, respectively.
- **Longer-Run (March median was 2.4% rounded):** If this changes from March's 2.375%, it could move in either direction, as we don't know the longer-run dot expectations of the 2 new incoming governors (Cook and Jefferson). We've seen sell-side expectations for both 2.25% and 2.50%. We wouldn't expect many of the existing dots to change, and we wouldn't see a shift as market-moving as most would interpret as being due to the altered composition of the FOMC rather than a fundamental reappraisal.

Here is MNI's general outlook for June's Dot Plot (note the Longer-Run dots are depicted as midpoints but represent the lower end of those ranges, as per actual Dot Plot):



Note a likely consensus around 2.75-3.00% rates by end-2022, ie the high end of the neutral range. 2023 sees more dispersion but 15 of 18 members see rates rising above neutral, with a 3.375% median. Then in 2024, some of those higher dots coming down, with voters evenly split between 3.125% and 3.375% for a 3.3% median. The longer-run dot shifts one-tenth higher vs March, but it's just as likely to come in at 2.25%, and we wouldn't read much into that.

Economic Projections:

MNI is pencilling in the following for the June SEP projections:

Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents under their individual assessments of projected appropriate monetary policy, June 2022

Percent

Variable	Median 2022	2023	2024	Longer Run
Change in real GDP	2.0	1.9	2.0	1.8
Mar projection	2.8	2.2	2.0	1.8
Unemployment rate	3.5	3.7	3.8	4.0
Mar projection	3.5	3.5	3.6	4.0
PCE inflation	5.4	2.8	2.2	2.0
Mar projection	4.3	2.7	2.3	2.0
Core PCE inflation	4.4	2.7	2.2	
Mar projection	4.1	2.6	2.3	
Federal funds rate	2.9	3.4	3.3	2.5
Mar projection	1.9	2.8	2.8	2.4

- For 2022, it's widely expected that the June SEP will significantly downgrade GDP growth, while also upgrading inflation expectations and leaving the unemployment median unchanged.
- Further out it gets more interesting, particularly in conjunction with the rate path. Our expectation is that participants will expect and signal an aggressive front-loaded rate hike path, so inflation and growth could be projected lower and unemployment higher in 2023 and 2024 as the FOMC is willing to apply significant pressure on demand in favor of suppressing inflation.
- We wouldn't be surprised to see GDP growth forecast at/near or even just below the 1.8% longer-run rate, with the unemployment rate (a lagging indicator) close to 4% than to 3% by 2024. In turn, PCE inflation would ebb slightly more quickly in 2024 than was forecast in March, though still slightly above 2%.

Press Conference: Clear And Convincing?

Powell's already provided significant guidance, both in the last press conference, and in a May 17 interview. His comments in the latter are worth repeating here as they will likely be repeated in some way in June's press conference:

> *"We need to see inflation coming down in a clear and convincing way. We are going to keep pushing until we see that...the way I'm thinking about it is right now, we are raising rates expeditiously to what we have been seeing to a more normal level, which is something that we will reach may in the fourth quarter. But it is not a stopping point. It is not a looking around point. We don't know with any confidence where neutral is. We don't know where tightening is. We just know in this market, higher inflation, very strong growth. What we are going to be looking at, meeting by meeting, data reading by data reading, is what is happening in the financial conditions, what is happening with the economy .... convincing evidence that inflation is coming down. That is what we really need to see. We are watching for that. If that involves moving past levels of neutral, we will not hesitate to do that. We won't. Honestly, we will go until we feel like we are at a place where we can say yes, financial conditions are at an appropriate place, we see inflation coming down. We will go to that point and there will not be any hesitation about that."*

A few key questions:

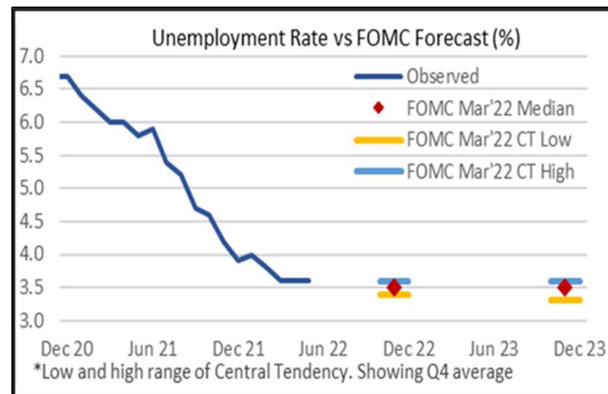
- Will Powell cement expectations for a 50bp hike in September?
- Will Powell rule out a 75bp hike in future? (Previously he said it wasn't actively considered by the FOMC; this time he may suggest that such an option is plausible if the data warrants.)

- Is the prevailing belief on the FOMC that rates will have to move above neutral?
- Does the FOMC believe that inflation expectations have become less anchored since the May meeting?
- Has Powell's assessment of the likelihood of a "soft landing" decreased since the May meeting?
- Did the FOMC discuss an acceleration of balance sheet runoff / MBS sales?
- How much more tightening of financial conditions does the FOMC believe is required to achieve the inflation mandate?

Macro and Financial Developments Since The May 3-4 FOMC

By Chris Harrison

The labor market consolidated recent tightening



There have been two payrolls reports since the FOMC last met for a 50bp hike, with jobs growth on balance stronger than expected but wage growth and the unemployment rate both disappointing somewhat. That does compare with heady analyst expectations though, with the trend still very strong. Payrolls growth has clearly moderated over the three months to May, with the three-month average of 408k vs 602k in the prior three months but still more than twice pre-pandemic trends as it quickly narrows the gap to pre-pandemic employment to just 0.5% or 822k jobs below.

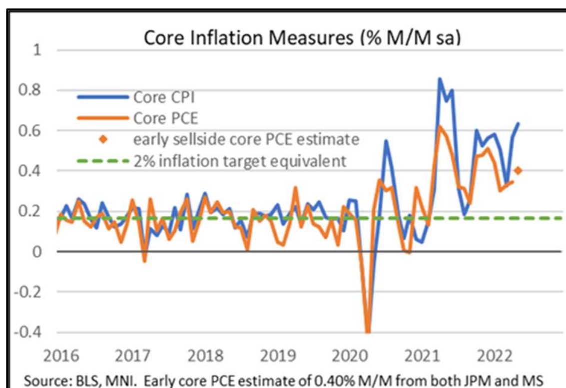
A combination of softer household employment growth and a stalling in the recovery of the overall participation rate (prime-age participation continued to close the pre-pandemic gap) has seen the previously rapid decline in the unemployment rate level off at 3.6%. Whilst technically higher than consensus, it's only a tenth above both the pre-pandemic low and where the median FOMC member saw it ending both 2022 and 2023 back in the March SEP.

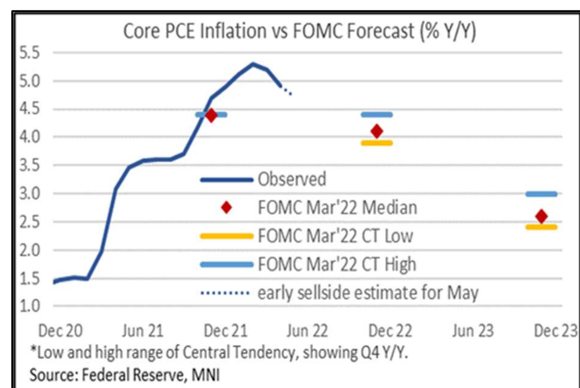
Average hourly earnings have also been softer than expected at 0.31% M/M for the past two months. There have been arguments for these being biased lower first by the timing of Good Friday and then potentially missing bi-monthly pay in May, but the three-month rate is still at 4.5% annualized despite cooling. Pay for the bottom 80% of earners is faster, with the non-supervisory measure running at 5.5% annualized. These run rates may have cooled but require sizeable productivity growth to be compatible with the Fed's 2% inflation target. Coupled with just shy of 2 job vacancies per unemployed and quits just off record highs, excess labour demand remains clearly evident.

…But CPI inflation surged even more than expected

Two surprise beats have seen headline CPI inflation hit 8.6% Y/Y in May after what was widely expected to have been the peak of 8.5% in March. Energy prices bounced in May as pump prices and gas surged whilst food inflation saw the highest of the pandemic recovery after what's already been an extremely hot run – areas that are most visible from consumers on a day-to-day basis.

Core CPI inflation in May meanwhile surprisingly hit the fastest since Jun'21 with +0.63% M/M. If there's a caveat it's that airfares have been an unexpectedly large driver, although only a caveat if prices do indeed fall back at some point. They have increased almost 50% in three months as jet fuels surge at the same time as travel demand rebounds and added an average 0.1ppts to monthly core CPI inflation over those three months.





More importantly, typically 'sticky' shelter price inflation has accelerated, with a significant breakout in OER to multi-decade high of 0.60% M/M after an extremely stable 0.41-0.45% range to the prior eight months, and actual rents of primary residence even faster at 0.63%. Rampant shelter inflation, and the growing breadth of inflationary pressures – evidenced by the Cleveland Fed median hitting a new cycle high of 0.58% M/M – helped drive a substantial sell-off in Treasuries.

If there's any consolation for the FOMC it's that the measures driving core CPI have smaller weights in core PCE, or in the case of airfares are measured by PPI which saw a markedly softer increase in April. These differences have re-opened a large wedge between core CPI and core PCE, with sell side analyst currently estimating +0.40% M/M for core PCE prior to Tuesday's PPI release. That should be of scant comfort though, still rising more than twice the rate equivalent to the 2% inflation target and a re-acceleration after two months that had appeared to see a moderation in pressures.

Further, and possibly a result of continued rapid inflation in items that consumers feel the most, U.Mich consumer long-term inflation expectations surprisingly jumped 0.3ptps to 3.3% in the preliminary June survey. It had seemingly plateaued at 3.0% after a then-peak of 3.1% in January but instead has increased to the highest since mid-2008 and prior to that 1994.

	Levels		Change since		
	Latest		May 4	Mar 16	
UST 2Y	3.06	%	42	113	bp
UST 10Y	3.16	%	22	97	bp
2s10s	9	bp	-20	-15	bp
Fed Funds Jun'22	57	bp	4	-10	bp
Fed Funds Jul'22	115	bp	14	22	bp
Fed Funds Dec'22	242	bp	50	82	bp
5Y breakeven	3.16	%	-8	-25	bp
5Y5Y infl swap	2.74	%	3	18	bp
S&P500	3901		-9	-10	%
DXY	104.1		2	6	%
WTI	120.7	$	12	27	%
VIX	27.8		9	4	%

FOMC-dated Fed Funds show implied change in effective rate
Source: Bloomberg, MNI - as of 10 Jun 2022 close

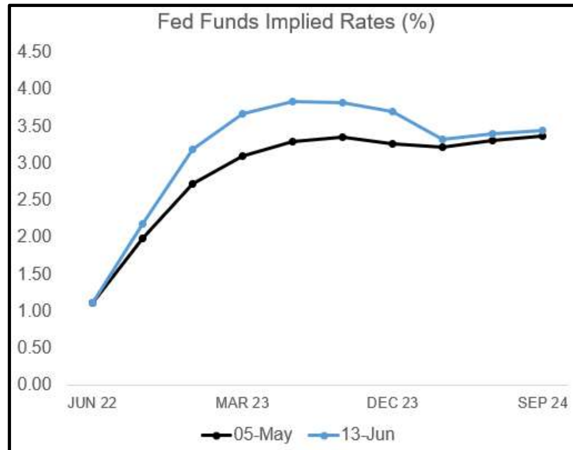
MNI Instant Answers:

The questions that we have selected for this meeting are:

- Federal Funds Rate Range Maximum
- Total Dissenters
- Number of dissenters favoring a smaller rate hike
- Number of dissenters favoring a larger rate hike
- Median Projection of Fed Funds Rate at End of 2022 %
- Median Projection of Fed Funds Rate at End of 2023 %
- Median Projection of Fed Funds Rate at End of 2024 %
- Median Projection of Longer Run Fed Funds Rate %
- Number of 2022 dots > 2.875%
- Number of 2022 dots > 3.125%
- Number of 2023 dots > 3.375%

(Formerly Human Readable Algo) The markets team have selected a subsection of questions we think could be most market moving and will publish the answer to all of these questions within a few seconds of the Fed statement being released. These questions are subject to change; clients will be informed of any changes via our Edge and Bullets services. **A comprehensive list of questions is available on the MNI Monitor (available via the website here:** https://www.marketnews.com/realdisplay?product=AFM

Market-Implied Rate Outlook



Source: Bloomberg, MNI Market News. Updated Jun 13, 2022

- Markets are pricing in around an additional 50bp hiking in 2022 versus where markets were priced following the May FOMC meeting, which has also boosted bring the 'terminal' rate to nearly 4% by Q3 2023 (vs a previous peak rate expectation of around 3.4%). ***Updated Jun 13, 2022***

mni Central Bank Watch - FED

MNI FED Data Watch List

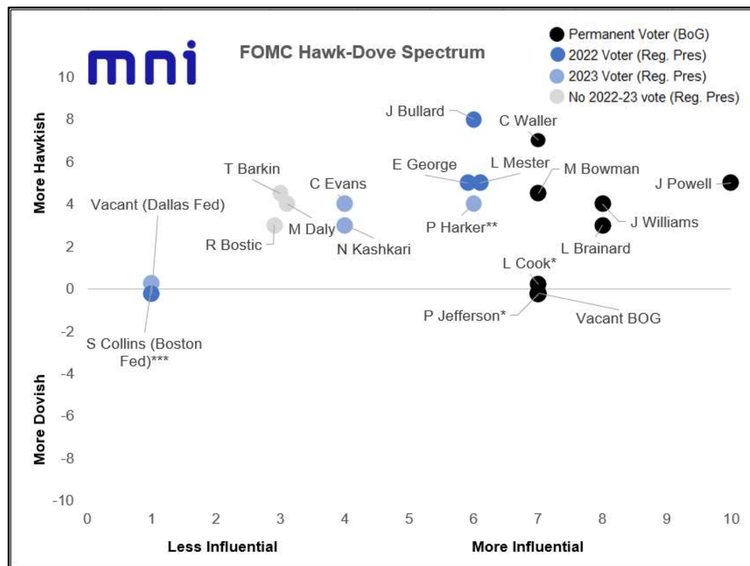
Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
CPI	% y/y	8.6	7.9	↑	6.8	↑					1.48
PCE Deflator	% y/y	6.3	6.0	↑	5.1	↑					0.74
UoM 1-Yr Inflation Exp	% y/y	5.4	5.4	→	4.8	↑					1.01
Inflation Swap 5y/5y	%	2.74	2.55	↑	2.49	↑					0.82
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
ISM	Index	56.1	58.6	↓	60.6	↓					-0.91
Industrial Production	% m/m	1.08	0.84	↑	1.39	↓					0.61
Factory Orders	% m/m	0.3	2.3	↓	1.8	↓					-0.74
Housing Starts	K	1724	1666	↑	1563	↑					0.44
Monetary Analysis		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Corporate Spreads BBB/Baa	bps	1.82	1.56	↑	1.25	↑					2.04
Chicago Fed Financial Con	Index	-0.26	-0.45	↑	-0.59	↑					1.39
Consumer Credit Net Chg	$bn	38.1	15.3	↑	21.2	↑					0.83
New Home Sales	K	591	831	↓	671	↓					-1.78
Consumer / Labour Market		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Retail Sales	% m/m	0.9	2.7	↓	1.6	↓					-0.29
Consumer Confidence	Index	106.4	105.7	↑	111.9	↓					-1.04
Nonfarm Payrolls Net Chg	K	390	714	↓	647	↓					-1.19
Average Hourly Earnings	% y/y	5.2	5.2	→	5.3	↓					-0.52
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Equity Market	Index	3901	4374	↓	4567	↓					0.19
US 10-Year Yield	%	3.16	1.83	↓	1.44	↑					1.36
US Yield Curve (2s-10s)	bps	9.2	39.3	↓	87.9	↓					-0.66
USD TWI	Index	90.82	92.70	↓	91.63	↓					-0.80

- Inflation readings continue to set new highs on a Y/Y basis, but financial conditions have tightened since the May FOMC meeting. **(*Updated Jun 10, 2022*)**

Key Inter-Meeting FedSpeak – June 2022

Since Chair Powell said at the May FOMC press conference that "50 basis point increases [were] on the table at the next two meetings", that viewpoint has been basically unanimous among participants.

- No participants stated that they were favor of a hike bigger than 50bp in June. However, an unexpectedly high inflation print for May was released in the FOMC blackout period, so we do not have any participants' reaction to the data or views on its implications.
- Beyond June and July's meetings, there is a divergence of opinion.
- Powell's criteria for more aggressive tightening (vs market pricing as of mid-May) is lack of "clear and convincing evidence" of inflation pressures abating, as "if we don't see that then we will have to consider to be more resolute". Likewise, Vice Chair Brainard said it was "very hard to see the case" for a rate hike pause, and would have to see "a string of decelerating data" to pull back on tightening.
- Conversely, Bostic said outright he would consider a pause in September.
- There was no discernable support to a hike greater than 50bp in magnitude.
- Most desired a return of rates to "neutral" by year-end and then reassessing the path forward, with the consensus being that the Fed would move above neutral if necessary; others including Bullard want rates to rise well above neutral by year-end.



Our matrix uses the following methodology based on the MNI Markets Team`s subjective analysis.* ***Hawkish/Dovish scores*** *indicate MNI`s subjective assessment of each member`s stance on monetary policy. -10 implies member believes aggressive easing warranted; +10 is most hawkish, implies member believes aggressive tightening warranted. Scores around -2 to +2 considered relatively neutral. On ***Influence****, the x-axis runs from 0 ('least influential') to 10 ('most influential'). Voters in the current year receive a minimum score of 6; the Chair receives a 10 and Board of Governors members receive at least 7. Those who are not voters in the current year are limited to a score of 4; among them, those due to vote next year receive higher influence scores (rising towards end of current year), and vice-versa. * Recently appointed to Board of Governors; monetary policy bias assumed for now to be neutral. ** Harker expected to vote at June 2022 FOMC in place of interim Boston Fed President. *** Collins assumes Boston Fed presidency on July 1.*

Member	Role	Voter		Monetary Policy Commentary Since May FOMC
		'22	'23	
J Powell	BOG, Chair	X	X	**On rate hikes:** "There's a broad sense on the committee that additional 50 basis increases should be on the table for the next couple of meetings…if we see what we expect to see, we would have 50 basis point increases on the table at the next two meetings" **– May FOMC press conference** "Restoring price stability is an unconditional need. It is something we have to do. There could be some pain involved…We need to see inflation coming down in a clear and convincing way. We are going to keep pushing until we see that...the way I'm thinking about it is right now, we are raising rates expeditiously to what we have been seeing to a more normal level, which is something that we will reach maybe in the fourth quarter. But it is

Member	Role	Voter		Monetary Policy Commentary Since May FOMC
		'22	'23	
				not a stopping point. It is not a looking around point…. If that involves moving past broadly understood levels of 'neutral,' we won't hesitate at all to do that." **– May 17** **On a 75bp hike:** "I said we weren't actively considering [that]. **– May 12**
J Williams	NY Fed, V Chair	**X**	**X**	**On rate hikes:** "We do need to move - again, the word is expeditiously - to more normal rates this year, and we're on our way to do that. But we also need to watch, and we need to monitor what's happening in the economy. Job number one is to bring inflation down. The risk that I'm most focused on is what happens if inflation stays higher than expected." **– May 16** **On hiking above neutral:** "If it's needed to raise real rates above neutral to get inflation down, I have absolutely no reluctance to do so." **– May 10**
L Brainard	BOG, V Chair	**X**	**X**	**On rate hikes:** "From where I sit today, market pricing for 50 basis points, potentially in June and July, from the data we have in hand today, seems like a reasonable path. It is very hard to see the case for a pause [in September], we've still got a lot of work to do to get inflation down to our 2% target. If we don't see the kind of deceleration in monthly inflation prints, if we don't see some of that really hot demand starting to cool a little bit, then it might well be appropriate to have another meeting where we proceed at the same pace. If we are seeing a deceleration in the monthly prints, it might make sense to be proceeding at a slightly slower pace." **– Jun 3**
M Bowman	BOG	**X**	**X**	**No commentary on current monetary policy since May meeting**
C Waller	BOG	**X**	**X**	**On rate hikes:** "I support tightening policy by another 50 basis points for several meetings. In particular, I am not taking 50 basis point hikes off the table until I see inflation coming down closer to our 2% target. And, by the end of this year, I support having the policy rate at a level above neutral so that it is reducing demand for products and labor, bringing it more in line with supply and thus helping rein in inflation. This is my projection today, given where we stand and how I expect the economy to evolve. Of course, my future decisions will depend on incoming data. Over a longer period, we will learn more about how monetary policy is affecting demand and how supply constraints are evolving. If the data suggest that inflation is stubbornly high, I am prepared to do more." **– May 30**
L Cook	BOG	**X**	**X**	**No commentary on current monetary policy since May meeting (was sworn in to BoG on May 23)**
P Jefferson	BOG	**X**	**X**	**No commentary on current monetary policy since May meeting (was sworn in to BoG on May 23)**
Vacant	BOG	**X**	**X**	**Unoccupied, Michael Barr nomination pending**
L Mester	Clev. Fed	**X**		**On rate hikes:** "The longer the inflation readings stay up, the more chance is that longer term expectations can move higher than levels consistent with our 2% goal, and that'll make it much more costly to bring inflation down...Two more 50s sounds like a plausible strategy, and then we'll have more information to see how the economy is evolving. Perhaps inflation is coming back down better even than we thought, and we can adjust the pace. Or if it hasn't moved in the right direction, and some of the upside risks have manifested themselves, then we may have to be a little more aggressive." **– MNI Interview, May 16** **On hiking above neutral:** "With inflation as high as it is, and with expectations for inflation above 2%, you need to take into account that -- at least on the short end -- we're still at an accommodative stance of policy. And even if we get up to 2.5%, depending on what's happening on the inflation and expected inflation, we may still be accommodative...When you're assessing the stance of policy, you have to be also looking at real rates because that's really what matters for the economy…I would like the fed funds rate to be at neutral certainly by the end of the year, but we have to continue to assess that and see how the economy is evolving…I do think we'll have to go above neutral myself, but I can't really tell you today how much above neutral we'll have to go." **- MNI Interview, May 16** **On inflation:** "I'm not convinced we've hit the peak…The April report was more mixed. I want to see a string of these reports before I conclude that it's coming down. I haven't seen compelling evidence that it's moved down...I think there's upside risks to inflation. We have to be particularly attuned to not wanting to declare victory too quickly." **- MNI Interview, May 16**
E George	K.C. Fed	**X**		**On rate hikes:** "I think we are good at 50 basis points. I would have to see something very different to say we need to go further than that." **– May 19** "Fed policymakers have emphasized a commitment to act expeditiously to restore price stability, and I expect that further rate increases could put the federal funds rate in the neighbourhood of 2% by August, a significant pace of change in policy settings. Evidence that inflation is clearly decelerating will inform judgments about further tightening. The evolution of [Fed] efforts alongside other factors will affect the course of monetary policy, requiring continuous and careful monitoring." **-May 23**
J Bullard	St. Louis Fed	**X**		**On inflation expectations:** "I think we're on the precipice of losing control of inflation expectations. That's why it is important for the Fed to take action today that's credible, that will keep inflation expectations low and stable. **– Jun 1** **On rate hikes:** "I think we have a good plan for now. This 50-basis point per meeting increase is twice the normal pace that the committee has used in recent years which shows that there's a lot of unanimity around expeditiously moving to neutral in this high-inflation environment that we're in." **– Jun 1** **On a 75bp hike:** "Not my base case." **– May 11** **On hiking above neutral:** "I have also said we should get to 3.5% by the end of the year, which is higher than some of my colleagues… the more we can front-load..the better off we will be. In out years, 2023 and 2024, we could be lowering the policy rate because we got inflation under control." **– May 20**
Vacant	Bos. Fed	**X**		**Susan M. Collins will assume the Boston Fed presidency on July 1. No monetary policy commentary from interim President Kenneth C. Montgomery, First VP And COO Of Boston Fed**

Member	Role	Voter		Monetary Policy Commentary Since May FOMC
		'22	**'23**	
P Harker	Phil Fed	**	**X**	**On rate hikes:** "If there are no significant changes in the data in the coming weeks, I expect two additional 50-basis-point rate hikes in June and July. After that, I anticipate a sequence of increases in the funds rate at a measured pace until we are confident that inflation is moving toward the Committee's inflation target." **– May 18**
N Kashkari	Minn. Fed		**X**	**On rate hikes:** "The question right now that I'm asking myself, and that I'm asking my economists that I work with is, do we just have to follow through on what we've promised - is that going to be enough - or are we going to have to do even more. And I don't know the answer to that. My colleagues and I are going to do what we need to do to bring the economy back into balance. What I don't know is how much are we going to need to do ... if we get some help on the supply side, then we won't have to do as much; if we don't get any help on the supply side, we are going to have to do more." – May 17
Vacant	Dall. Fed		**X**	**Dallas Fed Pres Kaplan announced his resignation Sep 27. To be replaced by NY Fed's Lorie Logan on Aug 22, 2022. No monetary policy commentary from interim President Meredith Black, First VP And COO Of Dallas Fed**
C Evans	Chic. Fed		**X**	**On rate hikes: "**Inflation is clearly much too high and monetary policy must be repositioned to address this. The exact path for policy will depend on the evolution of the economy. But from where we sit now, I support returning the federal funds rate to neutral expeditiously." **– May 17** "We did 50 at our last meeting and it's extremely likely that we do 50 at the next meeting and probably thereafter. Once we get to a good setting for the funds rate we can, after that, do a more measured pace of increases, say 25bp at each meeting after that." **– May 18** **On hiking above neutral:** "My current assessment of neutral is in the range of 2-1/4 to 2-1/2 percent. And it may be necessary to bring rates somewhat above neutral for a time to return inflation to the Federal Open Market Committee's (FOMC) 2 percent average inflation target. **– May 17** "Something like neutral by the end of the year, whether you get there sooner or earlier is not that critical. It's being well positioned to address the problems that we expect to face in 2023 that's my first concern." **– May 18**
T Barkin	Rich. Fed			**On rate hikes:** [Raising rates by 50bp is] "pretty straightforward...In my mind, were conditions to stay the same which of course is a pretty big if, I think let's normalize as fast as we can feasibly get there." **- MNI Interview, May 6** **On a 75bp hike:** "I think anything would be on the table...I think you've been around me long enough to know I never rule anything out...I'll just say our pace is pretty accelerated right now. If you started seeing signs, as imperfect as inflation expectation assessments are, but if you started convincing yourself that inflation expectations have started to move, that to me is the strongest case to try to move faster...I think it's going to take us a while to get inflation under control and that's one of the reasons why I'm supportive of that accelerated rate increase path." **- MNI Interview, May 6** **On hiking above neutral:** "I'll say I'm sensitive to our inability to understand exactly where neutral is...As you enter the intersection, you might be more inclined to slow down and look around...We're still well under neutral...People certainly worry that the path to control inflation will require the Fed going into restrictive territory, and that that could cause a recession. I'll just remind everybody that the Fed hasn't been that restrictive in a very long time." **- MNI Interview, May 6**
R Bostic	Atl. Fed			**On rate hikes:** "As we expeditiously return monetary policy to a more neutral stance to get inflation closer to our 2 percent target, I plan to proceed with intention and without recklessness. We have seen throughout the pandemic that events and market shifts can happen quickly and in ways that dramatically alter the prevailing economic dynamic, in both good ways (the rapid rebound in employment right after the initial lockdown) and bad (the rapid rise of the delta and omicron variants). We all must be ready for the unexpected to occur, assess how risks have changed when it does, and stay aware of shifts in the strength of the economy. I have got a baseline view where for me I think a pause in September might make sense." **– May 24**
M Daly	S.F. Fed			**On rate hikes:** "I see a couple of 50 basis point hikes immediately in the next couple of meetings. [After that] we need to look around and see what else is going on. I really think these inflation numbers have been going on too long, and consumers, businesses and everyday Americans are depending on us to get inflation back down and bridling it." – **Jun 1** **On hiking past neutral:** "We need to get the rate up to neutral, which I put about 2.5% in nominal terms. We need to do that expeditiously. I'm looking for both supply to recover somewhat and demand to come back down a little bit. If neither of those things cooperate, then we need to go into restrictive territory." – **Jun 1**

Analyst Views – Fed Outlook

Most analysts expect the Fed to hike by 50bp at the June meeting.

- A couple of analysts (Barclays and BNY Mellon) see a 75bp hike; we haven't seen Nomura's preview but for the past few months they have been expecting 75bp hikes at both the June and July meetings.
- The magnitude of eventual rate hikes varies widely: consensus is that the Fed will stop after 225 or 250bps of hikes, but estimates range from 150bp to 325bp.
- A few analysts are beginning to pencil in rate cuts in 2023 and 2024 amid economic weakness.

Table sorted high-to-low by Fed funds "terminal" rate in cycle, where this could be ascertained by analyst's June FOMC meeting preview. Where MNI hasn't seen a preview for this meeting, we have left them out of the table.

Analyst	Expected Rate Path	Total Hikes (bps)
Deutsche	50bps Jun, Jul, Sep, Nov, then 25bps to 4.00-4.25% by mid-2023	325
ABNAMRO	50bps Jun, Sep, Nov, Dec, early 2023 to 3.75-4.00%. Then 25bp cuts to 2.75-3% by end-2023	300
ANZ	50bps Jun, end-2022 2.75%, mid-2023 3.75%	275
Commerzbank	50bps Jun, Jul, Sep, then 25bps to spring 2023 to 3.25-3.50%	250
Goldman Sachs	50bps Jun, Jul, Sep, Nov, then 25bps to early 2023 to 3.25-3.50%	250
SEB	50bps Jun, Jul, Sep, then 25bps to 3.25-3.50% by mid-2023	250
TD	50bps Jun, Jul, Sep, Nov, then 25bps to 3.25-3.50% by early 2023. Then 50bp in cuts in 2024	250
Barclays	75bps Jun, 50bps Jul, then 25bps to early 2023 to 3.00-3.25%	225
BNPParibas	50bps Jun, Jul, Sep, then 25bps to early 2023 to 3.00-3.25%	225
ING	50bps Jun, Jul, then 25bps to 3.00% in 1Q 2023	225
NatWest	50bps Jun, Jul, then 25bps to early 2023 to 3.00-3.25%	225
Swedbank	50bps Jun, Jul, then 25bps to 3.00-3.25% in 2023	225
Rabobank	50bps Jun, Jul, Sep, then 25bps in Nov and Dec	200
UBS	50bps Jun, Jul, Sep, then 25bps in Nov and Dec to 2.75-3.00%	200
Standard Chartered	50bps Jun, Jul, Sep, then 25bps Nov to 2.50-2.75%	175
Unicredit	50bps Jun, Jul, then 25bps in Sep and Nov to 2.25-2.50%	150

Analysts' Key Comments

Note summaries in alphabetical order of institution.

ABN Amro: Aggressive Hikes, Then Cuts

ABN Amro sees a 50bp hike at the June FOMC, with rates continuing to rise sharply by early 2023 before cuts begin in H2 2023.

- **Future action:** 50bp hikes at each meeting to Feb 2023 to 3.75-4.00% terminal rate.
- Then cutting in 25bp increments in H2 2023, back down to 2.75-3.00% by the end of 2023.
- "While an unusual profile compared to recent rate cycles, this is more consistent with the kind of cycles we saw in previous high inflation episodes of the 1970s and 1980s, and reflects the fact that the nominal neutral rate moves up and down in line with inflation"

ANZ: Aggressive Hikes, Then Cuts

ANZ expects a 50bp hike at the June meeting, with the FOMC open to raising rates by 50bp in September.

- **SEP/Dot Plot:** Slightly higher Dots vs March. Seemingly unanimous FOMC support for getting rates to neutral (2.5%) before the end of the year.
- 2022 GDP revised down, inflation up.
- **Press conference:** Powell to keep the possibility of a 50bp Sept hike if the summer data warrants.
- **Future action:** end-2022 rates at 2.75%, mid-2023 at 3.75%.

Barclays: 75bp Hike

Barclays revised up its June FOMC hike call to 75bp from 50bp following the May CPI data, though it's a "close call" of 75bp being deferred to July: "With little indication that [price pressures] have peaked, and greater risk of a self-reinforcing inflation dynamic taking shape, we think that the FOMC will want to reinforce its credibility".

- **Future action:** 50bp hike in July, then 25bp per meeting through Feb 2023 to 3.00-3.25%.

BNP Paribas: Powell To Lean In On 50 In Sept

BNP sees a 50bp hike at the June meeting, with the main focus the degree to which additional 50bp hikes are signalled beyond July.

- **SEP/Dot Plot:** 2022 Dot at 2.8%; 2023 at 3.1%; 2024 at 3.1%.
- Given persistent inflation overshoot in SEP, unlikely many participants will forecast rate cuts.
- GDP growth revised down 2022-24; only other change is to 2022 headline PCE (to 5.2% from 4.3%).
- **Press conference:** Powell to signal a low bar to a 50bp hike in September; to tie the rate path to inflation coming down in a "clear and convincing" way.
- **Future action:** 50bp hikes in Jul and Sep, then 3 further 25bp hikes, to 3.00-3.25% by Feb 2023.

BNY Mellon: 75bp Hike Incoming

BNY Mellon now looking for a 75bp hike from the Fed this week, following Friday's CPI report. Previously they'd seen 50bp hikes in June and July, then slowing to 25bp for the rest of 2022.

- They are still looking for 50bp in July and a downshift in hiking pace to 25bp in September, but "we caution that data between now and the end of July could upend these expectations and motivate us move in favor of larger increases for the post-June meetings." (Their full preview will be out Tuesday.)

CIBC: 75bp Possible

CIBC sees a 50bp hike at the June FOMC meeting, though: "there's even a chance that it opts for a 75-basis point hike…given how far the funds rate is from where they expect to take it, although that risks an overreaction in financial markets".

- **Future action:** 3 more 50bp hikes after June to bring the Funds range to 2.75-3%.

Citi: Rising Likelihood Of 50s Beyond Sept

Citi continues to see a 50bp hike at the June meeting following the May CPI print.

- **Future action:** 50bp hikes in July and Sept, with a rising likelihood of 50bp pace continuing thereafter, or still possibly larger hikes.

Commerzbank: Pause Discussion Unrealistic

Commerzbank sees a 50bp hike at June's meeting, with a hiking pause discussion "unrealistic due to the persistent inflation problems".

- **Press conference:** Powell to keep the further course of action open and not provide any food for speculation about an interest rate pause in the near future.
- **Future action:** 50bp hikes in Jul and Sep, 25bp thereafter to 3.50% in spring 2023.

Credit Suisse: Powell Likely To Note Sept Pause Not Likely

Credit Suisse sees a 50bp hike in June, though their preview was written before the May CPI report which they acknowledge "a significant surprise…could affect the dot plot".

- **SEP/Dot Plot:** 2022 median Dot at 2.625%, 2023 at 3.125% (higher dot than this would be hawkish given market is pricing cuts in H2 2023). 2024 to suggest no more hikes, risk skewed to a shift down as some participants have suggested a possible cut. L-R dot could rise to 2.5%.
- **Statement:** To acknowledge that economic activity has picked up in the second quarter but the housing sector has slowed; should repeat that FOMC is highly attentive to inflation risks. Could mention elevated job openings (hawkish) or easing of COVID lockdowns (dovish) but not base case.
- **Press conference:** Powell likely to note he doesn't see a September pause as likely; don't expect him to say confidently that inflation has peaked.

Danske: Risks Skewed Toward More 50bp Hikes

Danske expects a 50bp hike at the June FOMC, with at least one more 50bp hike to be signalled (in July).

- Risks are skewed toward signalling that more 50bp hikes are needed.

Deutsche: Fall Forecast For 50s

Deutsche expects a 50bp hike at the June FOMC meeting, with the strong May CPI data "meaningfully" lowering the probability of a downshift in the hiking pace to 25bp at the Sep meeting.

- **SEP/Dot Plot:** 2022 Dot at 2.8%, 2023 at 3.3%, 2024 at 3.3%, L-R at 2.4%.
- 2022 and 2023 core PCE revised up (2022 to 4.4%, 2023 to 3.0%). Unemp revised up, GDP down.
- **Statement:** Minor changes to description of the econ environment.
- **Press conference**: Powell to reiterate 50bp July hike expectation but to leave all options open beyond July; to echo "expeditiously" comments and at minimum indicate that policy is more likely to move beyond neutral at some point. Risk he opens the door to a 75bp hike In July.
- **Future action:** 50bp hikes in Jul, Sep, Nov, 25bp thereafter. 3.125% rate at end-2022, 4.125% mid-23.

Goldman Sachs: 50bp Hikes To Extend To November

Following the upside surprise to May CPI, Goldman added one 50bp hike to its Fed rate path outlook (to September) but in its full June meeting preview it adds yet another 50bp to November meeting. GS still sees 50bp raises in June and July.

- The FOMC will respond to the inflation data and rising long-term expectations with a "resolutely hawkish message" across the statement, projections, and Dot Plot.
- Why not 75bp? While possible, "the FOMC appears to prefer to tighten more aggressively by adding more 50bp hikes instead. This strategy has successfully tightened financial conditions quickly and forcefully so far, so we expect the Committee to stick with it for now."
- **SEP/Dot Plot:** End-2022 dot at 2.875%; 2023 at 3.625%; 2024 at 3.375%.
- GDP likely below potential in 2022 and probably 2023; unemp to increase to 3.8%; core inflation projections steady for 2023-24.

- **Statement:** To revise forward guidance to say the FOMC "anticipates that raising the target range expeditiously will be appropriate until it sees clear and convincing evidence that inflation is moderating" – implying a high bar for reverting to 25bp hikes.
- **Future action:** 50bps in Sep and Nov (25bp previously), in addition to the 50bp hikes in June and July it has previously called for, 25bp pace in Dec and Jan, reaching a terminal rate of 3.25-3.50%.

ING: Inflation To Cool In H2 2023

The FOMC will hike by another 50bp in June and confirm that 50bp in July remains on the cards, writes ING.

- **SEP/Dot Plot:** 2022 Dot at 2.6%; 2023 at 3.0%; 2024 at 2.8%.
- **Future action:** 50bp hike in July, but downshift to 25bp hikes thereafter to 3.00% in 1Q 2023.
- But inflation to cool in H2 2023, which could pave the way to move back toward neutral in late 2023.

JPMorgan: Powell To Downplay Likelihood Of September Pause

The FOMC will hike by 50bp at the June meeting, JPMorgan writes, but "the more interesting development will be what the updated interest rate forecast "dots" say about the path beyond June."

- **SEP/Dot Plot:** 2022 dot at 2.625%; 2023 and 2024 at 3.125%. Risks aren't too large of a higher 2022 dot.
- Less GDP growth, more headline inflation, little changes to core inflation/unemp rates.
- **Statement:** Continue to be upbeat on econ activity; same factors putting upward pressure on inflation, but China / Ukraine language could get slimmed down.
- **Press conference:** Powell to reiterate high likelihood of another 50bp hike in July, to downplay the likelihood of a September pause.

Lloyds: Signalling Far From Done By September

Lloyds sees the Fed hiking by 50bp in June, then again in July. The overall message will be that the FOMC expects to be far from done with raising rates by September.

- **SEP/Dot Plot:** 2022 Dot at 2.875%, further increases in 2023.

Morgan Stanley: Eyeing The Terminal Rate

Morgan Stanley sees a 50bp hike at the June FOMC and is eyeing the Fed's terminal rate: they see potential for a higher repricing following the May inflation data.

- They think the terminal rate can go to 3.5-4.0% (similar to overshooting "neutral" in the mid-1990s by 100-150bps); or if like the 1980s, terminal rates can reach 4.5-5.0% (200-250bp above neutral)
- **SEP/Dot Plot:** Note that the medians have surprised to the upside in each of the last 3 SEP meetings. End-2022 Dot at 2.875%.
- A median Dot above 3% at end-2022 plus at least 3 hikes in 2023 would be hawkish; below 2.875% would be dovish.

NatWest: Powell Hawkish But Not More Than Previously

NatWest sees a 50bp hike at the June meeting, with modest increases in the Dot Plot profile, and the takeaway from Powell's presser still tilting hawkish, "but probably not any more than what has been previously advertised by Fed officials".

- **SEP/Dot Plot:** 2022 dot at 2.625%, 2023 at 2.625%, 2024 at 2.625%, L-R at 2.375%.
- 2022 GDP revised down to 2.1%, 2023 to 1.9%; no noteworthy changes to core PCE.
- **Statement**: Mild tweaking. Tone positive in a few areas (consumer spending), perhaps acknowledging a little slowing in other respects (housing). Job growth could be downgraded to "strong" from "robust".
- **Press conference:** Powell to emphasize Fed's focus is on inflation; likely to signal urgency on the expected size of near-term hikes; continue to use term "expeditious" re rate hikes.
- **Future action:** 50bp hike in July, stepping down to 25bp in Sep, Nov and Dec, 2 more in early 2023 with a 3.125% terminal rate.

Nordea: 50bp Hike

Nordea sees a 50bp hike at the June FOMC meeting, with a further 50bp hike coming in July, and a high likelihood of more beyond that (it may take until November to get "clear and convincing evidence" of inflation subsiding).

- Why not 75bps? "Our general thinking is that the FOMC appears to prefer tightening more aggressively by adding more 50bp interest rate hikes and a higher end point. So far, this has resulted in a successful and fast tightening of financial conditions and we do not see the FOMC risking the current forward guidance. Hiking too fast, ignites the risk of flattening the curve too much without getting the move higher in longer term rates which is needed to dampen the real economy."
- **SEP/Dot Plot:** 2022 Dot at 2.875%; 2023 at 3.625%; 2024 at 3.125%; longer-run 2.625%.

Rabobank: Peak Inflation Is The New Transitory

The May CPI data suggest that in addition to 50bp hikes in June and July, that 50bp is the most likely outcome in September, writes Rabobank.

- The peak of inflation is less relevant than its persistence – it's the latter that will determine how high the Fed will have to go and for how long. The FOMC may be looking for M/M inflation rates below 0.2% as evidence that inflation is moving lower.
- **Press conference:** Powell may give a more detailed description of what the FOMC is looking for in the data to decide on the rate moves in September and beyond.
- **Future action:** 50bps in Jul and Sep, 25bp in Nov and Dec.

RBC: 50bp Hike

RBC sees a 50bp hike at the June FOMC, with a further 50bp raise in July, with the target range rising to 2.75-3% by year-end.

Scotiabank: A Steeper Climb

Scotiabank sees a 50bp hike at the June meeting, with the FOMC hawks "running the show" given "there is no credible evidence that inflationary pressures are easing".

- The FOMC might hike by 75bp this week "but the risk to doing so is that this would make a dumpster fire out of the Fed's approach to meeting-by-meeting guidance and risk fully losing control of the narrative into each individual meeting". There could be some dissenters.
- The FOMC could provide explicit guidance toward 75bp being actively considered for July; extend guidance on 50bp hikes to at least Sep and perhaps Oct; raise the median dot to at least 3% by end-2022 and above the 2-3% neutral range in 2023.
- **SEP/Dot Plot:** Hawkish surprise would entail an upward revision of the longer-run rate.
- **Press conference:** Powell may strengthen language to indicate the FOMC will raise rates above neutral.

SEB: To Leave September Hike Size Open

SEB expects the Fed to hike by 50bp at the June meeting, while keeping the door open to a 50bp hike in September.

- **SEP/Dot Plot:** 2022 dot to rise to at least 2.4%; 2023 and 2024 at 3.4%.
- **Future action:** 50bp hikes in Jul and Sep, 25bp hike pace afterward, to 2.75-3.00% by end-2022, 3.25-3.50% by mid-2023.

SocGen: High Odds Of Terminal Rate Dot Above 3%

The Fed will hike by 50bp at the June meeting, with the main question ahead being the magnitude of hikes starting in September, writes Societe Generale.

- **SEP/Dot Plot:** 2022 Dot at 2.6%. High odds of terminal rate shown above 3% (most likely 3.1%).
- **Modest downward revisions for GDP in 2023-**24; for 2022 to 1.0-1.5%. Large upward revisions to PCE for 2022 (5.6% headline, 4.7% core).

Swedbank: Continuing To Hike Expeditiously

Swedbank expects a 50bp hike in June, with all focus being on the Dot Plot.

- **SEP/Dot Plot:** 2022 median Dot revised up; 2023 to show further hikes; 2024 to imply cuts vs 2023.
- **Future action:** Fed to hike by 50bp in Jul, then by 25bp in Sep/Nov/Dec and 2x in 2023.

Standard Chartered: Outside Chance Of 100bp

Standard Chartered sees 100bp Fed hike possible on Weds (base case is 50bp though):

- "We do not preclude 75bps and even see an outside chance of 100bps at the 15 June meeting...Our outside chance of a 100bps move reflects a risk that the FOMC sees the need for a 'Volcker moment', but we do not think the FOMC sees itself at that point yet and we do not see the need for such a dramatic move."
- **Future action:** 50bp hikes in July and September, 25bp in November, terminal rate of 2.75%.

TD: One Of The Most Relevant Dot Plots In Recent Years

TD sees a 50bp hike at the June meeting, though the FOMC "could possibly consider a larger increase following May's strong inflation data".

- But the Fed's inclination "is to maintain its tightening pace at 50bp per meeting until the monthly rate of inflation tells them otherwise".
- **SEP/Dot Plot:** One of the most relevant Dot Plots in recent years. As neutral rates are passed before end-2022, divergences in the dot plot path will become evident.
- End-2022 Dot at 2.875%; end-2023 at 3.375%; end-2024 at 3.125% (reflecting a rate cut). L-R 2.50%.
- Statement: Few changes.
- **Press conference:** Powell to reiterate the message that the FOMC is determined to adopt the necessary measures to achieve price stability even if that means hiking meaningfully above neutral.
- Powell likely to commit to an additional 50bp hike in September and perhaps further, and if asked, will leave the option of a 75bp hike on the table.
- **Future action:** 50bps hikes through Nov FOMC, then 25bp thereafter until 3.25-3.50% by Feb 2023.
- 50bp in rate cuts in 2024.

UBS: Hint Of 50 For September

UBS expects a 50bp hike in June, and note that the outsized May CPI rise will push most FOMC participants toward assuming a 50bp hike in September would be appropriate/

- **SEP/Dot Plot:** 2022 dot at 2.875%; 2023 at 3.375%; 2024 below 2023 (3.125%).
- Longer-run dot could slip to 2.25% due to new governors.
- Core PCE will probably move higher (4.3-4.4% for 2022) though not aas much as in previous revisions, and the 2024 projection could revise down slightly.
- **Statement:** Hawkish risk if no longer mentions pandemic-related supply and demand imbalances as a cause of inflation.
- **Press conference:** Powell to put another 50bp hike for Sept on the table.
- **Future action:** 50bp hikes in Jul and Sep, returning to 25bp in Nov and Dec, pause in 2023 (at 2.75-3%).

Unicredit: Hikes To Stop After November

Unicredit sees it as "very likely" the Fed will hike by 50bp in June,

- **SEP/Dot Plot:** 2022 Dot at 2.6-2.9% (the higher end of this would be hawkish), 2023 at 3.1-3.4%.
- Headline PCE to be revised above 5% for 2022; GDP down. Little change beyond this year.
- **Future action:** Fed to slow to 25bp in Sep and stop hiking after hitting 2.25-2.50% in Nov.

Wells Fargo: Hawkish Risks From Dot Plot

Wells Fargo writes that with a 50bp hike already assured and priced in, focus will be on the latest Dot Plot.

- **SEP/Dot Plot:** It's "all but assured" the Dot Plot will shift upward: markets are priced for a 2.75-3.00% end-2022 rate (vs 1.875% median in the March Dot Plot). While Wells Fargo expects the new median dot will match that market outlook, they see risks the median will be above that level, which would see a hawkish rate market reaction.
- Likewise, they see hawkish risks from any signal of additional tightening throughout 2023. Wells Fargo sees the 2023 median dot at 3.375% (vs 2.75% in the March Dot Plot, and 2.75-3.00% market pricing). "This would signal more tightening at the margin while also striking a balance between some of the more hawkish and dovish FOMC participants."
- For 2024, the median is set to be largely unchanged from March's 2.75%, suggesting the FOMC will head back toward neutral amid cooling inflation.

- **Press conference:** Powell is set to take a "balanced" tone, reflecting a mix of FOMC views from those who are on board with taking rates significantly above neutral this year, and those who want a more measured approach.

Wrightson ICAP: 75bp Hike In July

Wrightson ICAP is looking for a 50bp Fed hike this week, but they're now looking for a 75bp hike in July followed by 50bp in September (after which a return to a 25bp hiking pace "might be possible", dependent on data).

- "The burden of proof" on inflation shifted after Friday's CPI data, and some favorable surprises would be necessary to justify not moving 75bp in July.
- Why 75bp in July and not in June? "On paper, that would not be an unreasonable response to Friday's data, which underscored the need to move away from the Fed's easy-money policy stance “expeditiously”. However, a 75-basis-point move would be the largest rate hike in nearly 30 years and could lead to unexpected disruptions. Cementing investor expectations of a steeper rate trajectory would tighten financial conditions quite effectively in the short run without running the implementation risks associated with a last-minute deviation from existing guidance. The Fed seems more likely to lay the groundwork for the possibility of a 75 bp move next month than to announce one after this week's meeting."
- The dots could show a another drop in the longer-run rate to 2.25% (with two new governors submitting projections for the first time).
- Interpreting the economic projections will be more challenging than usual, given that it's a modal forecast, and uncertainties/variance are high.

MNI Policy Team Insights

MNI INTERVIEW: Fed May Need To Raise Rates To 5% -Lacker (Pub Jun 10, 2022)

By Pedro Nicolaci da Costa

WASHINGTON (MNI) - The Federal Reserve may have to push interest rates much higher than markets expect in order to contain an inflation problem that it allowed to get out of hand, former Richmond Fed President Jeffrey Lacker told MNI.

Fighting inflation from behind means the Fed will need to do more than it would have otherwise to ensure policy is actually restrictive enough to tamp down demand.

“My sense is they have to go to 5% before they can really think they’re at neutral,” said Lacker in an interview with MNI’s FedSpeak podcast. Even at the aggressive current pace of 50 bps per meeting, “they’re not going to hit that until the middle of next year.”

Fed officials have said they would like to push official rates, currently in a 0.75% to 1% range, to more neutral levels “expeditiously.” But policymakers have defined neutral in nominal terms on an assumption that the inflation rate eventually returns to the Fed’s 2% target. That’s a big assumption, said Lacker.

“Three percent is fine as a neutral rate if inflation already is 2%. But if not, then 3% isn’t neutral. What is neutral depends on what the current inflation rate is, what the going rate is, what it’s expected to be in the next couple of quarters.”

(See MNI: Wary Fed Will Test Neutral From Below–Ex Staffers)

SIX MONTHS BEHIND

Lacker said the Fed is six months behind the curve on interest rate policy and should have started tightening back in September, when it first became obvious that inflation was more than a passing phenomenon.

Instead, Fed Chair Jerome Powell and his colleagues delayed rate rises until the end of a lengthy tapering process for asset purchases, which Lacker argued was needless and costly.

“By the September meeting the data was very clear that they needed to move. But they were hamstrung by their forward guidance and by this commitment to taper asset purchases. That’s what held them up to March,” he said.

“I think they’re six months behind the curve. They’re making up for it with speed and haste. But it’s not an immediate offset because you can’t take back the fact that expectations have seeped into markets, wage rates accelerated over the winter and firms have become accustomed to pricing in cost increases, passing them on as price increases.”

RECESSION CHANCES

Waiting too long means the Fed has increased the chances of a policy error that leads to recession and rising unemployment, said Lacker.

“I’m somewhat pessimistic about their ability to bring inflation down without causing a recession. It strikes me as highly unlikely that they’re going to be able to do that,” he said.

"The signs of inflation coming off its peak are extremely tentative, nothing to take to the bank. It seems very unlikely that they're going to get inflation down to what their forecast was at the last meeting before the beginning of next year.

Indeed, CPI jumped 8.6% in the year to May, dashing hopes that inflation had peaked in March. In that context, Lacker added, "The fall is way too soon to talk about a pause" in rate increases.

MNI INTERVIEW: Fed Set For Three 50BP Rate Hikes – Kroszner
(Pub Jun 9, 2022)

By Pedro Nicolaci da Costa

WASHINGTON (MNI) - The Federal Reserve will probably raise interest rates by half a percentage point in the next three meetings in order to tame a surge in inflation and ensure longer-run price expectations don't take off, former Fed board governor Randall Kroszner told MNI.

"They're on a path to raise rates most likely for the next three meetings in 50-basis-point chunks and then it's maybe time to reassess," he said in an interview. "They want to make sure that inflation expectations don't become unanchored. They have the opportunity now relatively quickly to make sure they don't."

Recent comments pushing back against the prospect of a pause in rate hikes from Lael Brainard, the Fed's new vice chair, clearly cemented that prospect, Kroszner said. "This is a clear pivot from Lael who had been more dovish. That was not an accident. It's really about expectations management."

The Fed needs to act aggressively to catch up with an inflation rate that, at 8.3% in April, is near its highest levels since the 1980s, said Kroszner, who left the Fed in 2009 and is now deputy dean and professor of economics at the University of Chicago's Booth School of Business.

"Short-run inflation expectations are certainly quite high but if you look at the intermediate expectations five- to ten-years out, they're not much different than the upper ranges of where they've been over the last decade," he said. "They have the luxury of being able to raise rates significantly while the unemployment rate is still below 4% and inflation expectations haven't become unanchored."

75BPS A STEP TOO FAR

Still, Kroszner argued that moving by 75-basis-points as some market participants have speculated the Fed might would be a step too far.

"They've set expectations up to be 50 basis points per meeting," he said, adding that this puts the central bank on a sufficiently fast path toward its goal of getting to neutral levels or a bit higher.

"If you look at the infamous dot plot, getting in that range of 2-½ to 3 is where all the members think is neutral or slightly above neutral. They're on a clear path to get to basically to the mid-2s by September and probably 3 by the end of this year." (See: MNI INTERVIEW: Fed Should Slow Hikes As Neutral Nears--Wright)

TIMES HAVE CHANGED

Kroszner said the Fed needs to act promptly to send a clear message to a generation of Americans who have not experienced high inflation – or even an aggressively restrictive central bank.

"In the old days people understood that the Fed needed to take the punchbowl away. For the last 25 to 30 years the perception of the Fed's job is to prevent downside risks," he said. "The challenge is that you've got a generation of policymakers and politicians, market participants and just the general population that doesn't understand that that's part of the Fed's role."

Kroszner said the Fed was aware of the risk of market volatility as it tightens policy, even though it would try to avoid significant disruption by clearly telegraphing its short-run policy path.

“They need to move boldly without causing tumult in the markets, but they’re willing to tolerate that tumult in the markets if they can get to what they think is a soft of softish landing. And I think that really requires them to move quickly so they don’t have to raise rates as much as if they waited and then inflation expectations become entrenched.”

Fed June Dots To Show Further Hawkish Shift -Ex-Officials (Pub Jun 7, 2022)

By Pedro Nicolaci da Costa and Evan Ryser

WASHINGTON (MNI) - Federal Reserve officials are likely to pencil in more aggressive rate hikes in their June forecasts because high inflation is proving even more persistent and widespread than policymakers believed, former Fed policymakers and staff economists told MNI.

Those shifts since the last official set of economic projections in March will likely be accompanied by a mix of higher inflation and lower growth estimates to balance out the policy message.

“You’ve got a number of people who are definitely arguing we should be at least at 3% by the end of the year, so I think you’re going to see a significant jump up,” from a median of 1.9% by year-end 2022 in the March dot plot, said Randall Kroszner, former Fed governor, in an interview.

Fed officials have said they would like to get the fed funds rate to more neutral levels expeditiously. “If you look at 2.5% to 3%, that’s where pretty much all members of the FOMC think neutral or slightly above neutral. Getting to roughly neutral relatively quickly without causing too much tumult is their goal," Kroszner said.

INFLATION STAYS HIGH

Joseph Gagnon, a former Fed board economist now at the Peterson Institute for International Economics, said the Fed will likely acknowledge inflation is more persistent and broad-based than believed even just three months ago, when policymakers forecasted year-end PCE inflation of 4.3% for 2022 and 2.7% for 2023.

“They will have to raise the inflation projection,” he said. “They will probably will raise the dots at least half a point and possibly more. I doubt they will forecast a recession, and yet they may not want to show inflation overshooting much in 2024.”

PCE inflation registered 6.3% in the year to April, a modest downtick from a March reading of 6.6% but oil prices have since picked up again as the war in Ukraine rages on and Chinese cities locked down for weeks to stop the spread of Covid-19, straining supply chains.

PEAK IN 2023

Officials have signaled 50-bp rate hikes in June and July, taking the fed funds rate to a 1.75%-2% range. A step back to quarter-point increases in each of the three remaining meetings of the year would take the rate to 2.5%-2.75% by December, but policymakers have said they need to see a consistent string of inflation declines before they are convinced a deceleration in the pace of tightening might be in order.

Ellen Meade, a former senior adviser at the Fed board, thinks the fed funds rate will peak around 3.25%-3.5% in this cycle. “That could mean ending the year around 2.50%-3% and that would mean switching over to 25s either in September or November,” she said.

U.S. elections a week after the November FOMC meeting make it awkward for the Fed to downshift to zero in September, Meade added. "What's much more likely is that in September they do 50 or 25 and they put in place forward guidance that takes you to the end of the year."

NO RECESSION TALK

The Fed will likely move cautiously after rates hit 2.5% because of the uncertainty associated with determining just when monetary policy has become restrictive, MNI reported last week. (See: MNI: Wary Fed To Test Neutral Rate From Below–Ex-Staffers).

Next week, the FOMC will likely acknowledge the growth outlook is softening even as it shies away from even hinting at the prospect of recession.

"They should show real GDP falling below its longer-run trend, in order to be realistic," said Selva Demiralp, also an ex-Fed board economist. "They started an aggressive tightening cycle. It is hard to imagine that this will not have a toll on GDP."

In March, the Fed saw fourth quarter economic growth averaging 2.8% this year, 2.2% next year, and 2% in 2024 as the fed funds rate stays at a peak of 2.8% through 2024.

Low Immigration To Keep Lid on Labor Supply -Fed Staffers (Pub Jun 3, 2022)

By Jean Yung

WASHINGTON (MNI) - A dramatic slowdown in immigration over the past few years is exacerbating the U.S. worker shortage, contributing to wage pressures and likely constraining growth for some time, Federal Reserve economists told MNI.

The loss of older workers and women from the workforce during the Covid-19 pandemic have been cited as top reasons for the lack of labor supply. But the decline in immigration is also playing a significant role, and the trend isn't likely to improve soon due to massive backlogs and Fed tightening that may weaken growth prospects, the economists said.

"The lack of immigration inflow in 2020 and 2021 created a shortfall of anywhere from 800,000 to 2 million workers," Dallas Fed economist Pia Orrenius said in an interview. "In a normal year, immigrant workers account for a third to half of the growth in the workforce. So it's very obvious that the lack of immigration has aggravated labor market tightness, difficulty in hiring and some of the wage inflation we've seen."

MISSING MILLIONS

U.S. immigration has been declining for several years prior to the pandemic but net flows flatlined at almost zero during 2020 and 2021. Current flows are still a fraction of pre-pandemic trends.

Estimates of how many fewer working-age immigrants there are in the U.S. as a result of the pandemic vary due to high nonresponse rates in Census data. Giovanni Peri, a labor economist at University of California, Davis, estimated using the Labor Department's monthly Current Population Survey that about 2 million foreign-born workers are "missing" today than had the trend over the decade prior to the pandemic continued. Fed Governor Christopher Waller has cited a 1.5 million figure.

"Immigration plays a role that differs by industry, but it's not negligible in the current labor shortage, with so many jobs open right now" San Francisco Fed economist Nicolas Petrosky-Nadeau told MNI.

BACKLOGS

As the economy recovered and wages rose, many service sector workers quit their low-paid jobs to work in e-commerce, leaving a slew of vacancies in restaurants and hospitality that have typically been filled by immigrants. That dynamic helped drive service sector wages higher, Orrenius said.

Record numbers of undocumented migrants, attracted by the wage hikes, have flooded in to take those jobs, but political opposition to President Joe Biden's handling of illegal border crossings has also sapped momentum on legal immigration reform.

The U.S. Citizenship and Immigration Services said in March it was reviewing more than 9.5 million pending applications, a 66% increase from the end of fiscal year 2019.

"It'll continue to be a challenge even with an administration that's more accepting of immigrants, especially of asylum seekers and refugees, we still have a lot of barriers to the immigration system because of its archaic nature, backlogs and staffing shortages at USCIS," Orrenius said.

CYCLICAL BOOST TO END

The Fed is hoping to ease the demand-supply imbalance in the labor market by tightening financial conditions, and that means the cyclical boost to labor force participation could run out by the end of the year. Add to that the retirement of baby boomers and an aging population, immigration plays an even larger role in workforce growth going forward.

The University of Texas at Austin professor Aysegul Sahin, who also advises several regional Fed banks, said participation lags improvements in the unemployment rate by about nine months on average, which means it could top out at 62.5% to 63% by year-end, close to its 2019 average. The rate was 62.3% in May, according to jobs figures released Friday that slowed a moderation of job growth to a still unusually strong 390,000 for the month.

"Generally, participation rises late in the cycle if labor demand is strong and continued. Anything that serves to dampen labor demand should slow down the process of people staying in the labor force," Petrosky-Nadeau said.

A recovery in immigration "would make a sizeable contribution to alleviating the pressures."

Wary Fed Will Test Neutral Rate From Below -- Ex-Staffers (Pub Jun 3, 2022)

By Evan Ryser, Pedro Nicolaci da Costa and Jean Yung

WASHINGTON (MNI) - Federal Reserve officials will likely turn cautious as interest rates approach a level they consider neutral, potentially slowing the pace of rate hikes because they fear shocking the economy into recession if financial conditions tighten more quickly than anticipated, former central bank staffers told MNI.

Moreover, ex-staff said the Fed will target a neutral policy rate using a lower trend measure despite recent energy and commodity price spikes, presuming underlying inflation pressures are still under control because much of the recent inflation is driven by short-term supply shocks.

"Neutral should be defined in inflation adjusted terms, but the adjustment should be long-run expected inflation, which has not really moved yet," said Joseph Gagnon, a former Fed board economist now at the Peterson Institute.

While the Fed plans to get to the very bottom of that long-run neutral range in coming months and says it may move to a "restrictive" stance, policymakers have downplayed the need to raise the short-rate above inflation, instead shifting the focus to focus on broader financial conditions and arguing that longer-run rates are already higher.

“Their current trajectory is still maybe barely getting us to neutral if that," said Ken Kuttner, a former assistant vice president at the New York Fed. “Their projected trajectory is still really at the low end just to get to neutral and then if you think the economy is overheating to the point where you need to get contractionary, then there is still a ways to go."

Minneapolis Fed Research Director Mark Wright told MNI last week the Fed might consider slowing the pace of rate increases as rates approach a neutral level.

"The way they'll implement their strategy is to move in steps, and use the observed responses in inflation and unemployment to gauge whether or not they've reached 'neutral,'" said former Richmond Fed staffer Peter Ireland.

'RESTRICTIVE'

FOMC members estimate the long-run neutral borrowing rate is somewhere around 2.4%, when growth is close to potential, inflation is around 2% and employment is near sustainable maximum potential.

Ireland said talk about the neutral rate is mainly a reflection of the central bank's underlying dilemma: "How much of the increase in measured inflation is coming from the supply side versus how much is due to excessive monetary accommodation?"

CPI inflation has jumped to 8.3% in the year to April and the PCE measure has hit 6.3%, and standard guidelines suggest raising the policy rate more than one-for-one to inflation.

“History tells us is if you want to reduce inflation, you have to have the policy rate above the inflation rate," said Michael Bordo, a former Fed and Bank of England researcher, who sees the need for a more aggressive path for the short-rate. “This concept of a neutral rate is kind of misleading, because if you're feeling something that isn't there, then there always assumptions that are going into that.”

FILTERING NOISE

These 'Taylor rule' guidelines recommend raising rates relative to inflation that is not caused by temporary factors. The Dallas Fed's trimmed mean measure is at 3.8% over the last year. Evan Koenig, a former principle policy adviser at the Dallas Fed, told MNI the key measure of trend inflation is likely to average about 4% between now and the first quarter of 2023.

"For the Taylor rule and similar policy guides, it makes sense that you want an inflation gauge that is relatively uncontaminated by 'noise' but which includes inflation’s trend and cyclical components. Trimmed-mean inflation fits the bill very nicely," Koenig said, suggesting a 4.5% neutral policy stance.

While some ex-staff suggested the tightening of financial conditions in recent weeks could reflect a lower neutral rate for the economy, there is broad agreement that a restrictive policy is still needed, with a terminal fed funds rate of at least 3.25%.

Guidance from Fed Chair Jerome Powell has pointed to 50 basis point increases in June and July. Cleveland Fed President Loretta Mester Thursday said "it could be that the relatively swift tightening in financial conditions means that monetary policy will transmit throughout the economy faster than in past cycles and that demand will moderate more quickly."

MNI INTERVIEW: US, UK Recessions May Be Deeper Than GFC Slump (Pub Jun 1, 2022)

By Pedro Nicolaci da Costa

MNI (WASHINGTON) - The U.S. and UK economies are already in a recession that may well prove even deeper than the sharp contraction linked to the 2008 financial crisis as consumer confidence collapses, former Bank of England Monetary Policy Committee member David Blanchflower told MNI.

Policymakers are too focused on inflation pressures that will likely subside within a few months and not enough on leading indicators like plunging lumber prices and shipping activity that show an economy already flirting with a significant slowdown, he said.

“My suspicion is this recession will be longer-lasting and deeper” than that seen in 2007-2009, said Blanchflower, now a professor at Dartmouth College, in an interview.

That applies to both the United States, where the economy shrank by a post-war record of 4.3% from peak to trough during the course of the global financial crisis, and the United Kingdom, which saw a 6% drop, he said.

LESS ROOM TO CUT

One reason things could be worse this time is policymakers are a lot more worried that high inflation will become embedded in consumer psychology, which will make it harder for them to pivot to an easier monetary policy stance. Moreover, there is less room for central bankers to cut rates and fiscal policy is unlikely to provide substantial support, Blanchflower said.

“The ability of the central bank to cut rates from 500 to zero then is not true today” said Blanchflower, also a former visiting scholar at the Boston Fed. “The unemployment rate in the U.S. got to 10%. I see no reason why it shouldn’t do so again."

Minneapolis Fed Research Director Mark Wright told MNI last week the Fed is cognizant of recession risks but he does not foresee one in the near-term. (See: MNI INTERVIEW: Fed Tightening Already Having Effect–Wright)

The U.S. economy shrank at a 1.5% annualized rate in the first quarter, but most economists dismissed the decline as a blip. Blanchflower disagrees.

“The numbers are going to get worse because the revisions are going to go down,” he said. “The likelihood is that in a year’s time the NBER will call recession as having started in Q1 of 2022. My call is that the recession probably started in the U.S. in the first quarter of 2022.”

AMERICAN EXCEPTIONALISM

Blanchflower said the Fed’s policy approach suffers from being too insular and domestically focused, which makes it miss risks to U.S. growth from overseas.

“You never hear Fed officials talking about global things, they never talk about what’s happening to Europe, what’s happening to Japan. If there’s a global slowing, it’s going to cause the U.S. to slow,” he said. “In Q1 2022, 12 OECD countries have gone negative. What you’ve seen is collapsing consumer confidence. There’s a global recession coming.”

As growth turns into contraction, Blanchflower said inflation figures will start to moderate quickly, and may actually turn negative by next year, as they did during the global financial crisis.

Blanchflower published a paper in October 2021 arguing tanking consumer expectations suggested the economy was already on the verge of recession. Since then, Wall Street recession concerns have risen sharply. He was also one of few central bankers who in April 2008 was predicting a recession when others believed one could be avoided despite the U.S. housing and banking crash.

Inflation Seen Staying High, Making Fed Rate Pause Harder

(Pub May 27, 2022)

By Jean Yung and Pedro Nicolaci da Costa

WASHINGTON (MNI) - A deceleration in inflation the Federal Reserve hopes could allow it to slow or pause rate hikes in the fall may not materialize, with current and former Fed staff economists telling MNI supply shocks and strong domestic demand are likely to keep prices rising more than expected for months longer.

The full inflationary impact of the war in Ukraine and China's zero-Covid policy is only starting to be felt, the economists said. Meanwhile, continued reopening after pandemic restrictions could further fuel demand for services, a sector already experiencing acute staffing shortages and wage pressures. Housing costs are also headed higher still.

While war has already sent energy prices soaring, the inability of Russia and Ukraine to export wheat and key fertilizer components like ammonia, natural gas and potash are just beginning to make their way into the production process and could hit food prices later this year, said Robert Rich, director of the Center for Inflation Research at the Cleveland Fed.

"Fertilizer prices are three to four times higher compared to 2020. How this will potentially show up in terms of production hasn't played out," he said in an interview. In response to higher costs, some farmers may use less nutrients, which would reduce crop yields. "There's a lot of uncertainty because we don’t know what the reaction will be in the farming community right now. Prices are high and could potentially go even higher."

SUPPLY DISRUPTIONS

Prolonged Covid lockdowns in China are forming other supply shocks. "There's a direct effect on global supply chains, but an important question is how are firms responding to the ongoing supply chain issues," Rich said, adding that a wave of reshoring could see more expensive local production substitute for imports. "The anticipation is this could extend the surge of elevated inflation readings."

The Fed's preferred PCE inflation measure fell several tenths to 6.3% in the 12 months ended April, while CPI eased to 8.3% over the same period. Fed officials have penciled in larger-than-usual 50 bp rate hikes for June and July to take the fed funds rate target close to 2.0%, the low end of estimates of neutral, and are looking for a deceleration in month-to-month inflation readings to decide whether to slow the pace of tightening in September.

But Joseph Haslag, a former Dallas Fed economist now at the University of Missouri, told MNI he's losing hope that inflation will fall to 4%-5% by year-end. "I think inflation is at its peak, but suspect the peak will be pretty flat because of Ukraine, China and other fears," he said. "Inflation seems to be entrenched in the data in a way that I have not seen in previous data."

SHIFTING TO SERVICES

Policymakers had hoped a pivot by U.S. consumers back to buying services instead of physical goods as the economy normalizes would also relieve price pressures, slowing goods inflation to zero or even slightly negative while any services inflation pick-up is contained by Fed tightening. But that's far from assured.

While core CPI goods inflation has slowed over the past three months, the three-month annualized growth in core services prices accelerated to 7.7% through April. Rents are still climbing, and a surge in demand for restaurants and hotels could create the conditions for a wage-price spiral.

Given the relative weighting of services versus goods in the basket, even if services inflation stayed constant and goods prices fell over the next year, inflation would remain uncomfortably high, the economists noted.

MNI INTERVIEW 1: Fed Should Slow Hikes As Neutral Nears-Wright

(Pub May 26, 2022)

By Pedro Nicolaci da Costa

WASHINGTON (MNI) - Federal Reserve policymakers may consider slowing the pace of interest rate hikes as they approach a neutral rate of interest, although officials have divergent views as to where that key juncture lies, Minneapolis Fed Research Director Mark Wright told MNI.

“The real calculation that a lot of people will be making is do we need to go above the neutral rate, and what do you think the neutral rate is,” Wright said in an interview. His comments came just after Fed minutes released Wednesday showed the FOMC believes policy may have to become restrictive in order to rein in inflation, meaning the fed funds rates would be above the level considered neutral.

“It would make sense to slow down as we approach that number. But people’s ideas of where that number is will vary and they might disagree in their assessment as to just how far above that number they have to go.”

Wright expects inflation to ease over the course of this year but concedes upside risk to that forecast based on overseas developments like the war in Ukraine and China’s Covid shutdowns. (See also: MNI: Fed’s Mester Sees Upside Risk To Inflation)

“If you look at our core measures of PCE, we’d like to see those monthly numbers drop down to 0.2% and then a little bit below 0.2% over the course of the year,” said Wright, who advises Minneapolis Fed President Neel Kashkari and attends FOMC meetings.

“I think some of the moderation in demand that we’re producing by tightening policy will help with that. But some of those oil price fluctuations will make it into core.”

U.S. CPI inflation jumped to 8.5% in the year to April, while the Fed's preferred PCE measure climbed 6.6% in the year to March, both well above the central bank's 2% goal. In response to the surge in prices, the Fed has raised interest rates by 75bps and indicated another 50bp rate hikes are likely at the next couple of policy meetings, in June and July.

“Although what we’ve done so far in terms of raising interest rates is pretty modest, and only a step on the path we’re walking, the forward guidance we’ve given about what’s coming has clearly shown up in much tighter financial conditions and much tighter mortgage rates, which is one of the primary ways in which Fed policy affects the economy,” said Wright, noting that the Fed would also allow its balance sheet to contract.

THE SEARCH FOR NEUTRAL

The high degree of uncertainty surrounding the path of inflation means the Fed should remain flexible in its policy direction as rates near the 2% level that marks the lower end of estimates of the long-run neutral rate, he said.

“If the data is clear that the economy is slowing and slowing quickly in September then I imagine there’ll be a move to not raise further – maybe even begin to think about not just pausing but eventually it might be necessary to lower them,” Wright said. “On the other hand if inflation is still high and potentially getting higher then at that point we might go ahead with further increases.”

Wright said the central bank cannot rule out the larger, 75-basis-point rate hikes that have already become a focus of market speculation, but added that they are not under active consideration under current circumstances.

“I think in the back of everyone’s mind people know that’s a possibility if necessary. The committee will do whatever it takes to get inflation under control,” he said. “That would include (75bp moves) if necessary but I don’t think that’s something that’s at the front of everyone’s mind right now.”

MNI INTERVIEW 2: Fed Tightening Already Having Effect-Wright (Pub May 26, 2022)

By Pedro Nicolaci da Costa

WASHINGTON (MNI) - U.S. businesses and consumers are still confident inflation will come down over a longer horizon despite the recent surge in prices across the economy, in part because they are already feeling the pinch of tighter financial conditions arising from Fed rate hikes, Minneapolis Fed Research Director Mark Wright told MNI.

Business investment decisions tend to be made over a seven- to ten-year period, while households looking to get a mortgage opt most commonly for a 30-year loan, he said in an interview. In both cases, rates have moved sharply higher not just because of the Fed's monetary tightening to date but also expectations of further rate increases.

“The fed funds rate or overnight rate can have a negative real interest rate, but the interest rates people care about which are over seven, ten, thirty years, those real interest rates can be positive and those are the ones that we’re paying a lot of attention to," Wright said in an interview. (See also MNI INTERVIEW: Fed Should Slow Hikes As Neutral Nears-Wright)

"Financial conditions as a whole have tightened very significantly. Thirty-year mortgage interest rates are about 5-¼% now and it’s not so long ago that they were under 3%," he said.

NO WAGE-PRICE SPIRAL

At the same time, he said, fears of a wage-price spiral have thus far not been born out.

"We’re only seeing wage increases picking up in a relatively small number of occupations in a small number of places. A lot of the deals we’re seeing being negotiated through unions make some kind of adjustment but they’re not locking in lots of wage increases in the future,” he said.

“I think that’s because they’re very concerned that if they do that will lead to negative employment effects once the inflation rate comes down. I take that as being consistent with the belief that inflation will stabilize, so that’s comforting.”

However, Wright added this was no reason for complacency in the face of high inflation that has far surpassed official expectations.

“The Federal Reserve Act doesn’t give us a mulligan if it’s caused by supply issues – we’re supposed to get stable prices regardless of where it’s coming from,” he said, “If we don’t get inflation down real soon there's a very real risk that people will begin to think it’s entrenched and start acting accordingly."

CAN’T IGNORE RECESSION RISKS

Wright said the Fed is mindful of recession risks as it tightens monetary policy and as overseas economies slow, with Europe facing a hit from the war in Ukraine and its effect on energy prices while China copes with Covid lockdowns.

“We have a mandate to pursue both stable prices and maximum employment, so we can’t ignore concerns that we might induce a recession,” Wright said.

“We’re well aware of the danger, and we’d certainly rather avoid a recession, but I think we’re prepared for a little bit of risk of that if it helps us get our stable prices objective back under control,” he said. “I don’t think we’re in incipient territory by any means but it’s something we’ll be paying very close attention to.”

Wright said job market conditions could sour if economic conditions deteriorate, despite the labor market tightness that has characterized the rebound from the Covid recession and a historically low jobless rate of 3.6%.

"It's possible that could begin to change quite quickly. We're starting to see some major corporations saying that they'll be looking to reduce their staffing levels, particularly in retail," he said. "We could start to see that show up in the data soon, hopefully it shows up in a steady not dramatic way."

Fed Seen Taking Bumpy Road to Avoid Wage-Price Spiral

(**Pub. May 19, 2022**)

By Jean Yung

MNI (WASHINGTON) - The Fed is determined to head off a potential wage-price spiral with aggressive monetary tightening, even at the cost of larger-than-desired losses to growth and jobs, former Federal Reserve economists told MNI.

Persistently elevated inflation has renewed fears of a wage-price spiral as employers compete for a limited labor pool and workers look for pay increases to keep up with inflation. Surging prices, initially caused by broken supply chains, could become everlasting if they start feeding into wage demands.

"The goal is to return the labor market to a more sustainable position where wage increases are consistent with the 2% inflation objective. That's the key indicator and it's too high at the moment," former Fed Board research director David Wilcox told MNI.

How that gets accomplished is likely to be bumpy, he said. "It may land with broken crockery, but one important message we've heard is Chair Powell is determined to control the inflation rate. They hope to avoid recession, but if it's necessary to pay that price, that's what they'll do."

(See MNI: Fed Sees 'Growth Recession' As Best Case—Ex-Officials)

WAGE WORRIES

Some measures of wage growth have stabilized in recent months but remain at historically high levels, where they could stay as long as hiring continues at its current pace of around half a million jobs a month, the ex-Fed economists said.

Unit labor costs surged 7.2% in the first quarter after averaging no more than 2.5% for several decades before the pandemic.

"I don't think we've seen much evidence to date of a wage-price spiral, but going forward I'm much more concerned about that," former Fed Board staffer Stephanie Aaronson told MNI. "A year or so ago people didn't have very strong expectations that inflation would be so persistent. Now it's really on everyone's mind. That matters for businesses."

If demand for services surges this summer, employers could lift wages as they try to hire quickly in a very competitive market, Aaronson said. Hourly earnings rose by 5.5% in the year through April but failed to keep up with CPI inflation, which jumped 8.3% in the same month.

"That's the bad scenario in which it would take much more of an effort on the part of the Fed to get inflation under control," Aaronson added.

SLOWING POACHING

The first signs of a labor market slowdown will likely come in the form of a rebound in the weekly initial jobless claims figures, followed by a backing off of the quits rate, the ratio of job vacancies to the unemployed, falling or even negative monthly payrolls, and finally a decline in wage growth.

If all goes well, a soft landing is possible, said former New York Fed economist Aysegul Sahin, who currently consults for several regional Fed banks. She argues wage growth has been high in part because during the pandemic firms have had to poach workers from other firms.

As financial conditions tighten, employers may wait to hire new graduates or people who have voluntarily quit their old jobs, and pay a bit less for them. Job-to-job transitions data will be a key indicator. "Given how strong the job market is, firms can slow poaching, and there's a long way to go before they start letting people go," Sahin said. "The Fed could calibrate this to slow down without getting unemployment above 4%."

The jobless rate isn't likely to rise to 5% without a recession, she said.

But there’s often a "nonlinearity" in dynamics when a contraction takes hold, said Wilcox, currently an economist with the Peterson Institute for International Economics and Bloomberg Economics. Increases in unemployment tend to be much sharper than the recovery. "It’s not well understood, and once in process, it's difficult or impossible to stop."

MNI INTERVIEW: Lagging Fed May Need 75BP Hikes To Catch Up
(Pub May 18, 2022)

By Pedro Nicolaci da Costa

WASHINGTON (MNI) - U.S. inflation has gotten so far out of the Federal Reserve’s reach that more extreme steps like interest rate increases of 75 basis points and pushing the federal funds rate above levels currently considered neutral may become necessary, Ricardo Reis, an academic consultant to the Fed system, told MNI’s FedSpeak Podcast.

Price expectations are at serious risk of becoming unanchored as businesses and workers start to factor inflation prospects over longer-term horizons, said Reis, a professor at the London School of Economics who also advises the Bank of England and the Riksbank.

After hiking rates by 0.75 percentage point over the last two policy meetings, the Fed has signaled at least another two 50bp rate hikes in June and July. Markets are pricing in a fed funds rate that will end the year around 3%.

“More likely than not it seems not to be enough and there will be further tightening by which I mean not just delivering on the increases that have already been announced but probably having to do somewhat more,” said Reis in the podcast.

“That implies some 50-basis-point increases in several meetings and even, why not, 75 basis points. Especially because if we see that inflation starts being ingrained that will be a sign that the words of the last few months are not enough and if so then actions and big hammers have to be taken and that is indeed shock measures such as increases of 75 basis points.”

Reis said it’s unclear whether inflation pressures have peaked, echoing comments Cleveland Fed President Loretta Mester made to MNI in an interview Monday. (See MNI: Fed's Mester Sees Upside Risk To Inflation)

CREDIBILITY TEST

He saw the next few months as crucial to figuring out how entrenched inflation expectations have become given how prices are rising far more quickly than even the most extreme estimates by Fed officials. U.S. consumer prices jumped 8.5% in the year to April.

“Even if one looks at any generous interpretation of what the Federal Reserve thought was tolerable or admissible, we are many percentage points above that in terms of the inflation we’ve achieved,” said Reis.

"I like to point to a speech by Charlie Evans of the Federal Reserve Bank of Chicago given in 2011 when he said imagine having the inflation rate above 5% for several months, any self-respecting central banker would have their hair on fire. We are talking at the point in which every member of the FOMC has their hair on fire, and they should, it is that bad."

Reis said the rest of this year will be a decisive test for the ability of the Fed, by words and action, to curb the spike in inflation to 40-year highs.

"Over the next seven months of months, it's going to crucial (to gauge) the extent to which the credibility of monetary policy has indeed been harmed insofar as we will see firms setting prices with the expectation of high and continuous inflation, and workers asking for wages with the expectation that inflation will remain very high throughout 2023," Reis said.

"We are now at that second-round stage where inflation either becomes entrenched in prices and wages in U.S. society and economy or not. We will see that over the next few months. I think the Fed realizes that and this is why I think we see, rightfully, such a strong reaction."

MNI INTERVIEW: Fed's Mester: Rates Likely Headed Above Neutral (Pub May 16, 2022)

By Jean Yung

MNI (WASHINGTON) - The Federal Reserve likely needs to move monetary policy to a restrictive stance to contain inflation, Cleveland Fed President Loretta Mester told MNI Monday, warning that the Fed's estimate of the nominal longer run fed funds rate of 2% to 3% might still leave policy too accommodative.

"With inflation as high as it is, and with expectations for inflation above 2%, you need to take into account that -- at least on the short end -- we're still at an accommodative stance of policy. And even if we get up to 2.5%, depending on what's happening on the inflation and expected inflation, we may still be accommodative," she said in an interview.

"When you're assessing the stance of policy, you have to be also looking at real rates because that's really what matters for the economy."

She reiterated her support for two more 50 basis point rate increases in June and July before reassessing whether a "more aggressive" pace will be required to tame price rises.

"I would like the fed funds rate to be at neutral certainly by the end of the year, but we have to continue to assess that and see how the economy is evolving," she said. "I do think we'll have to go above neutral myself, but I can't really tell you today how much above neutral we'll have to go."

'MORE AGGRESSIVE' IF NEEDED

The policy path will depend critically on whether the Fed's recalibration of borrowing costs is bringing demand and supply into balance to help alleviate underlying price pressures, Mester said.

The war in Ukraine and Covid-19 lockdowns in China have increased the upside risk to inflation on the supply side. Meanwhile, firms' inability to find workers have led to "pretty sizeable wage increases" that aren't sustainable, she said.

A risk management approach requires the central bank to consider not only the probability of a bad outcome but also the potential cost of one.

"The longer the inflation readings stay up, the more chance is that longer term expectations can move higher than levels consistent with our 2% goal, and that'll make it much more costly to bring inflation down," Mester said.

"Two more 50s sounds like a plausible strategy, and then we'll have more information to see how the economy is evolving. Perhaps inflation is coming back down better even than we thought, and we can adjust the pace. Or if it hasn't moved in the right direction, and some of the upside risks have manifested themselves, then we may have to be a little more aggressive."

MNI INTERVIEW2: Fed's Mester Sees Upside Risk to Inflation (Pub May 16, 2022)

By Jean Yung

MNI (WASHINGTON) - Cleveland Fed President Loretta Mester cautioned against concluding that U.S. inflation has peaked after CPI moderated for the first time in eight months in April, saying risks are still to the upside.

"I'm not convinced we've hit the peak," she said in an interview Monday. "The April report was more mixed. I want to see a string of these reports before I conclude that it's coming down. I haven't seen compelling evidence that it's moved down."

Shelter inflation is up and takes a while to feed through to inflation measures, she said. The war in Ukraine and continued coronavirus lockdowns in China can leave supply chains kinked for longer, she said.

"I think there's upside risks to inflation. We have to be particularly attuned to not wanting to declare victory too quickly," she said.

The evolution of consumer inflation is key to whether the Fed will need to speed up its interest rate increases by September and how far officials need to push policy into restrictive territory, she said. With rates headed above 2% by fall, she forecasts PCE inflation to end the year at 4.5% to 5% and take a couple years to fall back to target.

The PCE jumped 6.6% in the year to April while the more prominent consumer price index surged 8.3% over the same period, both around 40-year highs.

'HEROIC' HIRING EFFORTS

Firms in the Cleveland Fed district had thought supply chain issues would ease this year, but "that's all been pushed out," Mester said. "Whenever one thing gets resolved, there seems to be another issue. People have been calling it whack-a-mole."

Meanwhile, employers are finding it incredibly difficult to find workers, even to the extent that some hesitate to invest in new capacity due to uncertainty on staffing.

"There's been heroic efforts to try to find workers and that includes pretty sizeable wage increases, and firms tell us they're questioning how much longer they can do this because at some point they're not going to be able to increase wages further," she said. "Those conditions are making it very hard to maintain a workforce. I don't see right now that the wage increases we're seeing are sustainable."

Some firms have been pondering longer run changes to their supply chains to avoid such problems in the future, Mester said. A reversal of the decades-long trend of globalization could affect the inflation rate going forward, she said.

"I don't think anyone can tell you today what that will look like," she said. But "as a policymaker, this experience makes you very attuned not only to the downside forces but potential upside forces, and that'll have to be incorporated into how we think about calibrating the economy as it emerges out of Covid."

MNI INTERVIEW: Treasury Market Reform Efforts To Ramp Up-Liang
(**Pub. May 13, 2022**)

By Evan Ryser

MNI (WASHINGTON) - The U.S. Treasury Department is bolstering its efforts this year to reform the USD23 trillion Treasury market, pushing for more transparency and data and adding that central clearing appears promising for some changes, Treasury Under Secretary for Domestic Finance Nellie Liang told MNI.

"The Treasury market is an urgent area because it is important that it function well even in a stressful time," she said. "The Treasury market is the most liquid, deep market in the world and we want to keep it that way."

Liang suggested reform efforts will not be so strict to solve for previous shocks that could overburden markets in more normal times. "We're not trying to only prevent the last global financial crisis, or only March 2020, but to the extent both of those events told us something about how the system doesn't work well under stress, you should fix it."

"We are on our own schedule," Liang said, when asked if the Federal Reserve's speedy runoff of assets from its balance sheet urges a faster schedule for reforms. Efforts are being made to push reforms "all at once" even if there is a natural sequence to having rules released for comment or having multiple government agencies working together, she said in an interview earlier this week at an Atlanta Fed conference.

MARGINAL IMPROVEMENTS

As pandemic fears gripped investors in March 2020, Treasury market liquidity rapidly deteriorated to 2008 crisis levels, prompting the Federal Reserve to buy USD1.6 trillion of Treasuries to increase stability.

The Inter-Agency Working Group for Treasury Market Surveillance, led by the Treasury and comprising the Fed and market regulators, has been exploring overhauling the market to improve its resilience in times of stress and have flagged five areas for consideration.

Liang acknowledged the improvements would be incremental considering the rapid increase in the size of the Treasury market and big dealers' constrained ability to intermediate.

"There are a number of places on the margins where improvements can be made, whether it is because trading practices have changed or because of technology, and the regulations have not kept up," said Liang, who was also the first director of the Fed's Division of Financial Stability from 2010 to 2017.

Other proposed changes include tweaking the supplementary leverage ratio, which banks say constrains their ability to hold and deal in Treasuries. That push could gain momentum if President Biden's pick for Fed vice chair for supervision, Michael Barr, is confirmed relatively quickly.

With a focus on off-the-runs, steps to be taken include improving data quality and availability, evaluating expanded central clearing, and enhancing trading venue transparency and oversight, Liang said, not expecting much need for Congress to pass legislation to help the process.

Treasury intends to issue a request for information (RFI) that could come around June, she said, also pointing to efforts by the OFR to fill data gaps for uncleared bilateral repos and SEC proposals to update the definition of a government securities dealer.

(See: MNI: Fed Repo Facility Seen As 1st Step To Address Market Clogs)

MARKET VOLATILITY

Recent lower liquidity has been largely due to elevated volatility as a result of uncertainty, she said. "There's no question that standard measures of liquidity such as bid-asks have been rising, and depth has been falling, but it is in line with the higher volatility," she said. "Not really a lot of concern but something to watch."

Liang said in-house studies show central clearing could be promising, also pointing to an IAWG meeting in November. "That's an area where the authorities lie with the SEC and I think it's promising for some changes," she said. The New York Fed has argued central clearing would have lowered dealers' daily gross settlement obligations by roughly 60% in the weeks around the market disruptions of March 2020.

Acknowledging that central clearing could concentrate risk in a central counterparty, the Treasury official suggested reforms. "Everyone should be concerned about concentrating more risks at individual institutions, but regulations for CCPs can be improved and my guess is there will be a lot of work to do that," she said.

Fed Sees ‘Growth Recession’ As Best Case—Ex-Officials (Pub May 13, 2022)

By Pedro Nicolaci da Costa

WASHINGTON (MNI) - The Federal Reserve has started to acknowledge that an economic soft landing may be hard to pull off, hoping instead for a “growth recession” where the pace of expansion slows down significantly with only a modest rise in the jobless rate, former central bank officials told MNI.

Fed Chair Jerome Powell appeared to curb his own optimism on the recovery in his latest press conference as he referenced a “softish” landing that doesn’t “materially” boost unemployment.

“A growth recession is what they’re shooting for,” said William Dudley, ex-president of the New York Fed. “The problem is that they have never been able to pull that off when they’ve had to push up the unemployment rate more than marginally.”

While recent labor market strength has underpinned the Fed’s view that it can raise interest rates fairly aggressively without knocking the economy into the recession increasingly feared by investors, officials’ optimism has nonetheless dimmed from only a few weeks ago, when Powell spoke of how soft landings were more frequent than generally believed. (See: MNI: Fed’s Barkin–Tamping Inflation Will Take Time)

“It might require a bit of a growth recession, that is a bit of an increase in the unemployment rate with growth continuing, no real recession, but much softer to relieve some of this pressure on the labor market,” Dohn Kohn, former Fed vice chair, told MNI. “It could well take a bit of a low trend growth and higher unemployment rate to dampen demand.”

A growth recession, generally defined as a period of expansion so slow that it leads to a loss of jobs rather than gains, would ease price pressures associated with an unemployment rate currently at a historic low of 3.6%. Fed officials point to other measures of labor market tightness potentially contributing to high inflation, which has quickly become the central bank’s top priority as consumer prices shot more than 8% higher on a yearly basis.

Powell and his colleagues are placing great emphasis on the job-to-vacancy ratio, which is at a record high of 1.9. They seem to believe they can pull some of the slack out of the labor market by denting vacancies without a large increase in the ranks of jobless workers.

60s GROOVE

Jeffrey Lacker, former president of the Richmond Fed said policymakers may be shooting for a scenario like that which transpired in the mid-1960s.

"When the Fed raised rates, they got a slowdown, they backed off and there was a growth pause – growth slowed but not enough to make it a technical recession," Lacker said in an interview. "That is about the best scenario I think they can hope for because they're not going to slow inflation much, given the momentum it has now, without materially affecting demand."

In the event that things don't go as planned and the best-case scenario does not materialize, ex-officials said policymakers would cross their fingers for a mild recession.

Powell hinted at this prospect when he said the Fed should be able to bring down inflation without "a severe downturn."

"The broader question of 'is the Fed willing to engineer a recession to get inflation under control'? I think that they are," said Luke Tilley, a former Philadelphia Fed policy advisor now at Wilmington Trust.

"It's because of those long-term inflation expectations that they need to get under control. A technical recession that would slow the economy down – that would be a possibility that the Fed would be willing to have that happen."

Fed QT May Have Deeper Tightening Effect - Ex-Officials (Pub May 12, 2022)

By Jean Yung, Pedro Nicolaci da Costa and Evan Ryser

MNI (WASHINGTON) - The Federal Reserve's unprecedented effort to whittle down a record USD9 trillion balance sheet could have a much larger than expected impact on financial conditions if markets become disorderly, ex-Fed officials told MNI, casting doubt on the chances that the asset reduction plans will run quietly in the background as current policymakers hope.

The Fed's second go at shrinking its balance sheet, which it calculates will be equivalent in impact to just one rate hike a year, is expected by officials to proceed more smoothly than its first attempt in 2018 when key lessons were learned about banking system reserve requirements. But pandemic-era QT is twice as aggressive and comes at a time of rapidly rising yields. If markets turn bumpy, ex-officials fear the tightening effect from the Fed's bond runoffs could be multiplied several times over.

"There certainly is potential for financial market tumult," former Richmond Fed President Jeffrey Lacker said in an interview. "This is another looming possibility for the Fed to have to face, which is a scenario in which the inflation fight has not yet been won and yet financial markets exhibit some volatility, some asset price declines, some credit spreads widening, which is what you'd expect if growth slows down."

If forced to decide between halting runoffs and loosening policy in response to market downturns and widening credit spreads, and keeping policy tight to tame inflation, "it's going to be a tough choice, and speculation about that choice is going to likely roil financial markets by itself," Lacker said.

REPO VOLATILITY

When it reduces its balance sheet, the Fed in essence asks the private sector to hold more Treasuries and MBS, putting upward pressure on those rates and potentially also leading to more activity in repo markets as levered investors seek to fund their positions. That raises the possibility that repo rates could one day rise in a disorderly way, resulting in stresses that could exacerbate existing structural weaknesses within the Treasury market, ex-officials said.

In 2018 and 2019, QT contributed to spikes in repo rates, forcing the Fed to reverse course and add liquidity through market operations.

This time, to ensure a smooth transition, the FOMC will first slow then stop runoffs when reserve balances are "somewhat above the level it judges to be consistent with ample reserves," it said when announcing QT this month.

"No one at the Fed has a clear understanding of what the rolloff will do to financial markets and the economy," said Rick Roberts, a former New York Fed staffer and ex-adviser to the Kansas City Fed. Hopefully QT will run in the background without a shock to markets or the economy, but the process will likely slow or stop "if the Fed identifies a meaningful disruption that can be tied to the rolloff," he added.

REPO FACILITIES

Current and former officials have pointed to massive inflows into the Fed's reverse repo facility as a sign the banking system has an abundance of cash this time.

Money market funds have deposited as much as USD2 trillion in the facility, "suggesting the Fed can reduce the balance sheet by that much and nothing would happen," former New York Fed research director Stephen Cecchetti told MNI. The FOMC has signaled it intends to allow its portfolio to decline by roughly USD3 trillion over three years to about 20% of GDP from 36% now.

"It’s hard to find evidence large scale asset purchases do a lot when financial institutions are operating normally," he said. "The first 2 trillion are really easy, they got that back already in the overnight reverse repo facility. The next trillion maybe might do something, and if they sell MBS, which is a thinner market than Treasuries, then maybe something will happen."

The new standing repo facility could offer an early warning of strains in money markets, current and former officials said. Usage of that borrowing channel could be a more valuable signal that the Fed is approaching the end of QT than any survey or model-based estimate.

MNI INTERVIEW: Fed's Barkin Says Hikes Not On Set 50BP Course
(**Pub. May 6, 2022**)

By Evan Ryser and Pedro Nicolaci da Costa

MNI (WASHINGTON) - Federal Reserve Bank of Richmond President Tom Barkin told an MNI podcast Friday interest rate increases are not on a preset course and he would like to see interest rates on a path to normal that is as fast as feasible, backing this week's historic FOMC decision to raise the fed funds rate 50bps, while not ruling out the potential for a supersized 75bp increase if needed.

Given that inflation remains uncomfortably high, broad-based, and persistent and with demand extremely strong, raising rates by 50bps was "pretty straightforward," Barkin said in his first public comments after the FOMC meeting, backing the Committee's move.

Asked whether he'd back two more consecutive 50bp moves, he said: "In my mind, were conditions to stay the same which of course is a pretty big if, I think let's normalize as fast as we can feasibly get there."

But whether the U.S. central bank needs to continue to move beyond estimates of neutral is uncertain, he said. While currently demand and inflation both are pointing in the direction for a relatively quick rise in rates, he said, it's going to depend on the state of the economy and "the time to reassess is when inflation starts to come down or when underlying demand starts to come down, and we'll see what happens then."

NOT RULING OUT 75BP

The Richmond Fed president did not completely rule out a larger 75bp move. "I think anything would be on the table," he said. "I think you've been around me long enough to know I never rule anything out."

"I'll just say our pace is pretty accelerated right now," he added. "If you started seeing signs, as imperfect as inflation expectation assessments are, but if you started convincing yourself that inflation expectations have started to move, that to me is the strongest case to try to move faster."

Chair Jerome Powell earlier this week said a "75 basis point increase is not something the Committee is actively considering."

As to when the Fed would likely need to downshift and begin to hike rates in smaller 25bp increments, Barkin stressed the ambiguity of assessments of neutral. "I'll say I'm sensitive to our inability to understand exactly where neutral is," he said. "As you enter the intersection, you might be more inclined to slow down and look around."

LONG WAY ON QT

And as the central bank is set to begin shrinking its balance sheet June 1, Barkin said markets and the Fed do have a better sense of how quantitative tightening works but acknowledged there is still a learning process. "I remind myself this is only the second time we've done this," he said.

Barkin expressed more confidence that markets can handle QT in its first steps. "It seems odd to me to imagine that there's going to be too much stress removing, taking our balance sheet from USD9 trillion to USD8 trillion. We're at very elevated levels," he said. "We're a long way from the point of what ought to be causing market stress."

"We should and are always concerned about whether there's enough liquidity in the market, whether the markets are going to function in the right way," he said. "To suggest that we know exactly how it's going to play out I think is a little aggressive."

MNI INTERVIEW2: Fed's Barkin-Tamping Inflation Will Take Time

(**Pub. May 6, 2022**)

By Pedro Nicolaci da Costa and Evan Ryser

MNI (WASHINGTON) - Bringing high U.S. inflation down to more acceptable levels will take time because the economy is still booming, employment is robust and supply chain issues are taking longer than expected to get resolved, Richmond Fed President Thomas Barkin told MNI.

“I think it's going to take us a while to get inflation under control and that's one of the reasons why I'm supportive of that accelerated rate increase path that we talked about,” Barkin told MNI’s FedSpeak podcast, saying he would not rule out a larger 75 basis point rate hike if inflation expectations look to be getting out of hand.

“Demand is still extremely strong,” he said. “I don't see any quieting in that yet.”

Barkin said business contacts in the Fed’s 5th district expect inflation pressures to persist. "People would like the supply chain stuff to to get solved but it's just taking longer and longer and longer and it's sort of like whack-a-mole, the latest issues of course being the Ukraine and being the shutdown in China."

BROAD-BASED

One the difficulties with tamping inflation, which has surged to a 40-year high of 8.5%, is that price pressures have broadened as supply chain issues clashed with increased demand due to fiscal and monetary support following the pandemic.

“A lot of us thought a year ago that this was about getting chips in cars, and as soon as we got chips in cars inflation would ease,” Barkin said. “What we've seen, of course, is that it's much broader than that. And the longer

that you have elevated inflation, the higher the risk that firms and consumers are going to think that inflation is going to stay elevated. That informs my forward-leaning, look on normalizing rates."

Still, he’s encouraged that business managers' price setting habits do not yet reveal a deeper inflationary psychology.

“You ask them, what kind of pricing power do you think you're going to have a year from now? They have not yet convinced themselves that this pricing power is continuous or long lasting,” he said. “They do not see this as a long-term regime change. They see this as a shorter term thing that we're gonna get to the other side of at this point.”

NO RECESSION

He pointed to the April employment report, which showed a larger-than-expected gain of 428,000 jobs, as a further sign that labor market conditions are very tight. Even some of the labor shortages that have characterized much of the pandemic might be easing for some sectors as parts of the economy return to normalcy, he said.

“The amount of noise I hear from businesses is less today than it was five or six months ago,” he said. “It was almost desperation five or six months ago, and today it has eased up. I think it's that you have seen a big rise in participation, particularly in the lower end of the workforce. And so the hospitality sector is one that I'm hearing a lot less noise from.”

Barkin said he’s surprised by all the chatter about recession risks in financial markets and in the business community, attributing the worries to understandable concerns about the high levels of uncertainty associated with a period of higher inflation and the Fed’s efforts to rein it in.

“We've got a long time before we do something that throws us into a recession but I understand why people are concerned about it,” he said. "We're still well under neutral."

“People certainly worry that the path to control inflation will require the Fed going into restrictive territory, and that that could cause a recession. I'll just remind everybody that the Fed hasn't been that restrictive in a very long time.”