MNI Fed Preview: September 2022

Meeting Dates: Tue-Wed, 20-21 September
Decision/Statement/Summary Of Econ Projections: Wed 21 September at 1400ET / 1900BST
Press Conference/Q&A: Wed 21 September at 1430ET / 1930BST

Minutes: Wed 12 Oct

Links (likely URLs based on previous meetings):
Statement: https://www.federalreserve.gov/newsevents/pressreleases/monetary20220921a.htm
Implementation note:
https://www.federalreserve.gov/newsevents/pressreleases/monetary20220921a1.htm
Summary Of Econ Proj: https://www.federalreserve.gov/monetarypolicy/fomcprojtabl20220921.htm
Press Conference: https://www.federalreserve.gov/monetarypolicy/fomcpresconf20220921.htm

MNI Review of Previous FOMC (July): https://roar-assets-auto.rbl.ms/documents/17498/FedReviewJul2022.pdf

Contents

- **Page 1-7:** MNI POV (Point of View)
- **Page 7:** MNI Instant Answers
- **Page 8:** Market Implied Rates / MNI Central Bank Data Watch
- **Page 9-11:** Key FOMC Communications / MNI Hawk-Dove Spectrum
- **Page 12-17**: Analyst Meeting Outlook / Individual Sell-Side Analyst Views
- **Page 18-44:** MNI Policy Team Insights

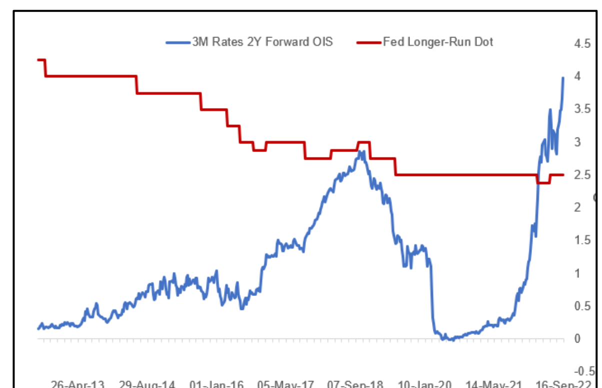
MNI POV (Point Of View): Terminal Vision

By Tim Cooper

- *Along with a 75bp hike at the September meeting, the FOMC will attempt to cement "higher for longer" rate pricing.*
- *With changes to the statement likely to be limited, immediate focus will be on the Dot Plot's end-2022 median rate forecast and the 2023 "terminal" rate, for which sell-side expectations center on 3.9% and 4.2%, respectively.*
- *MNI sees a flatter Fed funds rate "Dot Plot" than consensus, though risks to the 2023 Dot lie to the upside of 4.1%.*

The FOMC is very likely to hike by 75bp for the third consecutive meeting in September, while emphasizing that it intends to keep rates in restrictive territory for "some time" in order to bring inflation back down toward 2%. The FOMC's mission this week will be to cement **Chair Powell's message from the Jackson Hole symposium** that the Fed is not yet done tightening, and that when it is, it will maintain rates higher for longer than the market had previously expected. His August 26 speech was relatively brief and to the point, and bears reading again as several of its themes are sure to be repeated at this week's meeting:

- *"without price stability, we will not achieve a sustained period of strong labor market conditions"*
- *"Restoring price stability will take some time and requires using our tools forcefully to bring demand and supply into better balance"*
- *"We are moving our policy stance purposefully to a level that will be sufficiently restrictive to return inflation to 2 percent… with inflation running far above 2 percent and the labor market extremely tight, estimates of longer-run neutral are not a place to stop or pause"*
- *"At some point, as the stance of monetary policy tightens further, it likely will become appropriate to slow the pace of increases"*
- *"Restoring price stability will likely require maintaining a restrictive policy stance for some time. The historical record cautions strongly against prematurely loosening policy"*



Of course, the market has by now received this message – so this meeting will aim to underline the market's newly-priced expectations. From an expected 3.00-3.25% after September's 75bp hike, the terminal rate is now seen at nearly 4.5% for the Mar'23 meeting, 110bps higher than after the July FOMC. And while the market is still pricing in cuts by the end of 2023, rates are still seen north of 4% going into 2024. In the inter-meeting period, FOMC participants' anticipated eventual targets for the Fed funds rate ranged from "a little bit above 3 [in 2022], and a little bit more above 3 [in 2023] (Daly), to 4-5% (Kashkari). Several appeared to eye a level of around 3.75-4.00%, with the 3.4% June SEP median for 2022 now seen as too low. Altogether, though, a level above 4% appears widely regarded on the FOMC as meeting the standard of "restrictive".

Incoming inflation data is obviously alarming, but medium-term inflation expectations have remained anchored, largely reflecting the economic impact of more hawkish market repricing. And with the FOMC well aware that monetary policy works with a lag (**note especially VC Brainard's Sept 7 speech which mentioned overtightening risks**), they may be largely happy with the status quo in terms of market pricing. By the same token, the FOMC won't want to hint at a pivot coming soon. The dovish reaction to the July meeting led to pared-back hike expectations, rising calls for cuts in 2023, and overall looser financial conditions – which as evidenced by more recent communications, was unwelcomed by the FOMC.

While a 100bp hike is not out of the question this week, several factors suggest that the FOMC will opt for "only" 75bp. First and foremost, a 100bp raise hasn't been floated as an option (and unlike June, participants this time had a post-CPI and pre-blackout opportunity to talk up 100bp). The surprisingly high August CPI reading (see our Data section below) merely cemented a 75bp hike as opposed to a 50bp hike, in our view. At this point, the FOMC probably won't see a benefit or need to accelerate the pace of tightening. A 75bp raise would mean 325bp of hikes in just 7 months, and by almost all expectations would leave the funds rate well over halfway to its eventual destination in this cycle. Market pricing provides plenty of scope for further tightening this year, with a further 100bp of hikes priced in over Nov and Dec – and the FOMC has shown that they are willing to go further should the data warrant.

As such we expect the Fed won't want to deviate much from recent messaging at this meeting. But some potential dovish and hawkish outcomes from the release, as discussed in the sections below, include:

- **Dovish:** Sub-4% end-2022 median Fed funds dot; change in Statement forward guidance to suggest that a slowdown in the pace of increases is nearing
- **Hawkish:** Statement emphasizes labor market tightness and / or broadening inflationary pressures; End-2022 median Fed funds dot above 4.1%; End-2023 median Fed funds dot above 4.4%; no / one cut in 2024; Powell pushes back heavily against the market's rate-cut narrative, and invokes the Volcker Fed

Statement: Still Watching Forward Guidance

(**Link to July FOMC statement**)

Judging from sell-side analysts' previews, there is little expectation for any substantive changes to the September statement compared with July's. But as always there are several areas of the statement that bear attention:

- **The most closely-watched part of the statement is the forward guidance on rates,** namely that having hiked at this meeting (presumably by 75bp), the Committee "anticipates that ongoing increases in the target range will be appropriate." That language will probably remain unchanged for yet another meeting. Just as last time, it points to further hikes at the next two meetings at least. And suggests that yet again, the debate in November is expected at this point to be between 50bp and 75bp.
- **If there is an addition to this guidance, it would probably be lifted almost verbatim from Powell's Jackson Hole speech** -which while recognizing that the 75bp hike pace will not go on indefinitely, the FOMC intends to keep rates "restrictive" "for some time". Synthesizing Powell's comments, we could see something like:
  - *"At some point, as the stance of monetary policy tightens further, it likely will become appropriate to slow the pace of increases. However, restoring price stability will likely require maintaining a restrictive policy stance for some time."*
- **In a close call, we don't expect the statement language to change in this regard** – the Committee may prefer to communicate these sentiments in the Powell press conference and the meeting minutes.
- It would be surprising to receive any more specifics in the statement on what the FOMC's criteria are for slowing the hike pace – that's probably going to be left up to Powell in the press conference, though he's unlikely to divulge much more than he has previously.
- **Elsewhere, a hawkish lean to the Statement's 1st paragraph description of the current state of the economy** could add more detail on the Fed's interpretation of the most recent inflation data, with potential mentions of uncomfortably high broad metrics of CPI (incl median), and/or accelerating rent/services inflation offsetting the "progress" in energy prices and some goods.
- Also along hawkish lines, it could also emphasize the view that supply and demand in the economy, particularly in the labor market, remains unbalanced (Powell at Jackson Hole called the labor market "clearly out of balance").
- **The 2nd paragraph on Ukraine-Russia looks ripe for an update** – if so it could more broadly mention global factors and restate that the FOMC "is highly attentive to inflation risks".

- **Dissents to the rate decision look unlikely.** If there are any to a 75bp hike, it's more likely to be KC Fed Pres George again in favor of 50bp, as opposed to St Louis Fed Pres Bullard dissenting in favor of 100bp.

Below is a general idea of how the statement could change.

July FOMC:

July 27, 2022

Federal Reserve issues FOMC statement

For release at 2:00 p.m. EDT

Recent indicators of spending and production have softened. Nonetheless, job gains have been robust in recent months, and the unemployment rate has remained low. Inflation remains elevated, reflecting supply and demand imbalances related to the pandemic, higher food and energy prices, and broader price pressures.

Russia's war against Ukraine is causing tremendous human and economic hardship. The war and related events are creating additional upward pressure on inflation and are weighing on global economic activity. 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. In support of these goals, the Committee decided to raise the target range for the federal funds rate to 2-1/4 to 2-1/2 percent and anticipates that ongoing increases in the target range will be appropriate. In addition, the Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities, as described in the Plans for Reducing the Size of the Federal Reserve's Balance Sheet that were issued in May. The Committee is strongly committed to returning inflation to its 2 percent objective.

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 readings on public health, labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Michael S. Barr; Michelle W. Bowman; Lael Brainard; James Bullard; Susan M. Collins; Lisa D. Cook; Esther L. George; Philip N. Jefferson; Loretta J. Mester; and Christopher J. Waller.

September FOMC:

September 21, 2022

Federal Reserve issues FOMC statement

For release at 2:00 p.m. EDT

While the latest economic data have been mixed, the economy continues to show strong underlying momentum. Job gains have been robust in recent months, and the unemployment rate has remained low. Inflation remains elevated, reflecting supply and demand imbalances, higher food and energy prices, and broader price pressures.

Russia's war against Ukraine is causing tremendous human and economic hardship. The war and related events are creating additional upward pressure on inflation and are weighing on global economic activity. 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. In support of these goals, the Committee decided to raise the target range for the federal funds rate to 3 to 3-1/4 percent and anticipates that ongoing increases in the target range will be appropriate. In addition, the Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities, as described in the Plans for Reducing the Size of the Federal Reserve's Balance Sheet that were issued in May. The Committee is strongly committed to returning inflation to its 2 percent objective.

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 readings on public health, labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Michael S. Barr; Michelle W. Bowman; Lael Brainard; James Bullard; Susan M. Collins; Lisa D. Cook; Esther L. George; Philip N. Jefferson; Loretta J. Mester; and Christopher J. Waller.

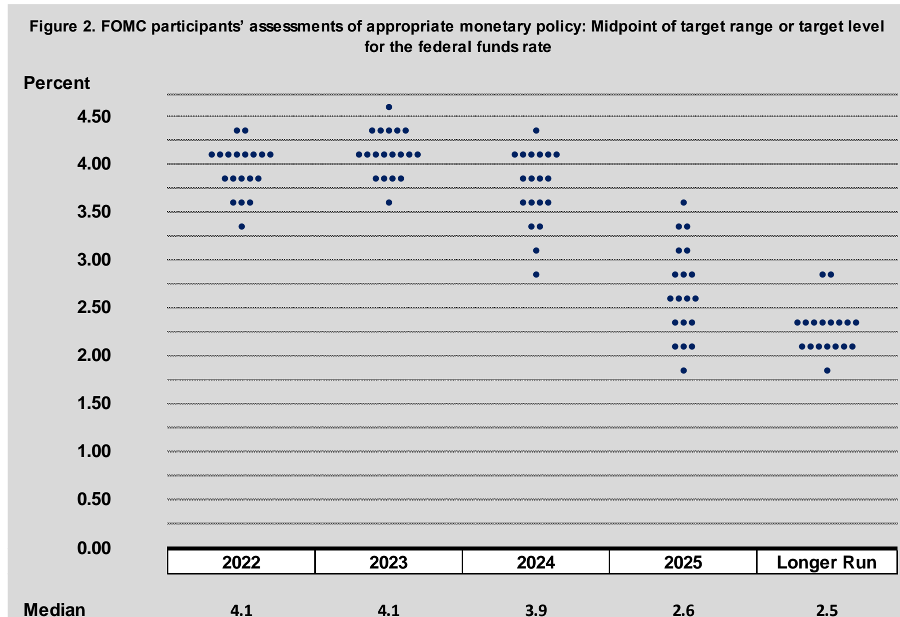
Summary of Economic Projections / Dot Plot: Terminal Vision

There will be two focal points to the September Dot Plot update – the end-2022 forecast (which will form clear expectations of what to expect at the next two meetings), and the 2023 terminal rate.

While keeping in mind that the Dots do not represent a central FOMC forecast, June's version appears to have been at least somewhat choreographed, and September's should likewise be regarded seriously if not literally.

- **Powell's comments on the June SEP dots in his Jackson Hole speech clearly point to an upgrade in September's editions, with restrictive policy "for some time" to be signalled:** *"Restoring price stability will likely require maintaining a restrictive policy stance for some time. The historical record cautions strongly against prematurely loosening policy. Committee participants' most recent individual projections from the June SEP showed the median federal funds rate running slightly below 4 percent through the end of 2023. Participants will update their projections at the September meeting."*

At right is MNI's general outlook for September'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):



- **2022: 4.1%.** That would be 100bp of increases in total across Nov and Dec. This would be a leap from June's projections given that no participant then saw a rate above 4% this year, but anything less would suggest the FOMC clearly intends to slow hiking sequentially in Nov (50bp) and Dec (25bp) and that may not be a message participants want to send at this stage. Between September and November, the FOMC will see just one inflation print and one employment report – which probably won't present enough

evidence to conclusively expect a smaller hike.

- **2023: again, 4.1%, with risks of 4.4%.** While below market pricing of a nearly 4.5% peak, it should be kept in mind that this would be consistent with the "higher for longer" rate strategy after front-loading hikes in 2022 and into territory that most FOMC members would probably regard as restrictive. And because this is a year-end forecast, some members' contributions may pencil in slight easing of rates toward end-2023 vs a mid-year "terminal" peak, biasing the median to the downside. This is a close call though: we could easily see a 4.4% median, and the number of dots above 4.1% will be closely eyed in any case.
- **2024-25: 3.9%, and 2.9%.** Given that the June SEP showed a clear inclination to rate cuts in 2024 as projected inflation begins to subside, we'd expect similar this time, though perhaps less pronounced – and still in "restrictive" territory. The newly-included 2025 projections are effectively longer-run forecasts, so we would expect the FOMC to expect rates to be falling back toward the longer-run neutral rate (2.00-2.50%) by that point.

MNI is pencilling in the following for the September SEP projections – reflecting weaker growth and higher inflation (especially in 2022-23), with the unemployment rate picking up further from historically low levels.

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

Percent

Variable	Median				
	2022	2023	2024	2025	Longer Run
Change in real GDP	0.5	1.4	1.7	1.8	1.8
Jun projection	1.7	1.7	1.9		1.8
Unemployment rate	3.7	4.3	4.6	4.3	4.0
Jun projection	3.7	3.9	4.1		4.0
PCE inflation	5.4	2.8	2.2	2.0	2.0
Jun projection	5.2	2.6	2.2		2.0
Core PCE inflation	4.3	2.9	2.3	2.0	
Jun projection	4.3	2.7	2.3		
Federal funds rate	4.1	4.1	3.9	2.6	2.5
Jun projection	3.4	3.8	3.4		2.5

Sell-side analysts are finely split on their expectations for the September FOMC meeting's update to the "Dot Plot".

- The number expecting a 3.9% vs 4.1% 2022 Fed funds median dot is almost evenly split (vs the 3.4% median in the June projections).
- Likewise, there is a nearly even divide between 4.1% and 4.4% for end-2023 (vs 3.8% seen in the June forecasts).
- Almost all see the FOMC pencilling in rate cuts in 2024 (expected 3.8% median vs 3.4% in June).
- The 2025 projections are newly introduced in this round.

Sell-Side Analyst Expectations For Median Fed Funds "Dots" In September SEP

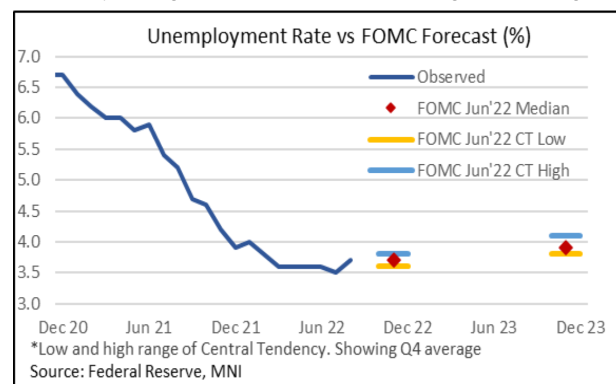
	2022	2023	2024	2025
UBS	4.1	4.6	4.1	2.9
Citi	4.1	4.4		
Credit Suisse	4.1	4.4	4.1	3.6
Deutsche	4.1	4.4	3.9	3.4
Goldman Sachs	4.1	4.4	4.1	3.6
TD	4.1	4.4	3.6	2.9
ANZ	3.9	4.4		
Credit Agricole	3.9	4.4		
ING	4.1	4.3	3.8	2.5
BMO	3.9	4.1		
Barclays	4.1	4.1	3.4	2.6
BNPParibas	3.9	4.1	4.1	2.9
BofA	3.9	4.1	3.9	2.6
Morgan Stanley	3.9	4.1	3.6	3.2
Societe Generale	3.9	4.1		
Unicredit	3.9	4.1	3.4	2.5
Wells Fargo	3.9	4.1	3.4	2.5
SEB	3.8	4.1	3.6	
Median Sell-Side Expectations For September SEP	3.9	4.2	3.8	2.9
Actual June SEP	3.4	3.8	3.4	NA

Sorted by 2023 high-to-low. All analyst forecasts seen by MNI saw 2.5% for the Longer Run Rate

Macro and Financial Developments Since The July FOMC

By Chris Harrison

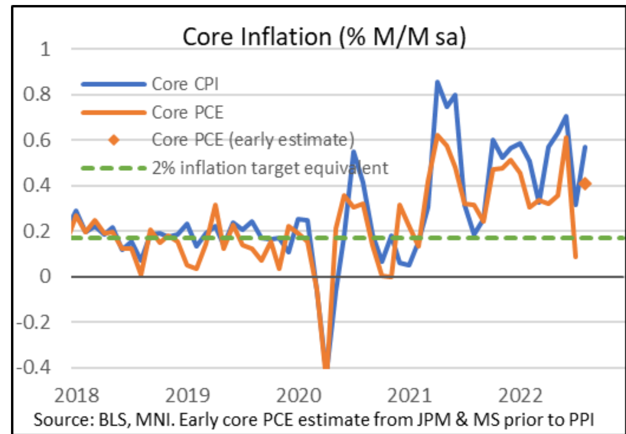
There have been two CPI and payrolls reports since the July FOMC, allowing for sizeable fluctuations in rate expectations over the eight-week gap between meetings. The most impactful came most recently though, with CPI inflation in August bucking what had looked like the start of a cooling in pressures after July's miss.



*Low and high range of Central Tendency. Showing Q4 average
Source: Federal Reserve, MNI

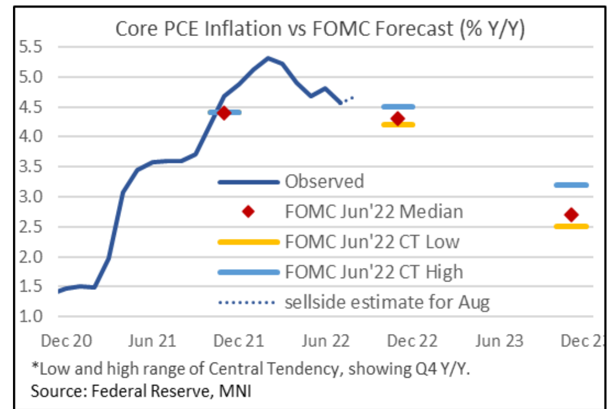
The combination of the two payrolls reports left an open debate between a 50bp and 75bp hike for this week's meeting: not strong enough to warrant 75bp in their own right but equally too solid to justify a more dovish pivot (Aug released Sep 2). Strong payrolls growth lent support to evidence that the US isn't already in a recession, adding a rapid 841k jobs in two months and closing the gap to pre-pandemic levels of employment, albeit still notably below in population-adjusted terms. However, after signs of a stalling in the recovery of labor supply, including in the July report, participation surged higher in August from year-to-date lows to highs, in turn pushing the unemployment rate for a surprisingly two tenths increase to 3.7%. It wasn't a drastic move, coming off joint record lows and where the median FOMC member expects the rate to sit at in Q4, but a larger increase in underemployment and a further drift higher in socio-demographic unemployment rate gaps pointed to a modest easing in labor market tightness despite a record 2 job openings for every unemployed. Similarly, there was a modest cooling in average hourly earnings growth to a still strong 0.3%

M/M, although the Fed is probably more focused on metrics with fewer compositional issues such as the ECI the latter most recently at 1.3% non-annualized in Q2 after 1.4% in Q1 (but Q3 not released until Oct 28 just prior to Nov 2 FOMC decision).

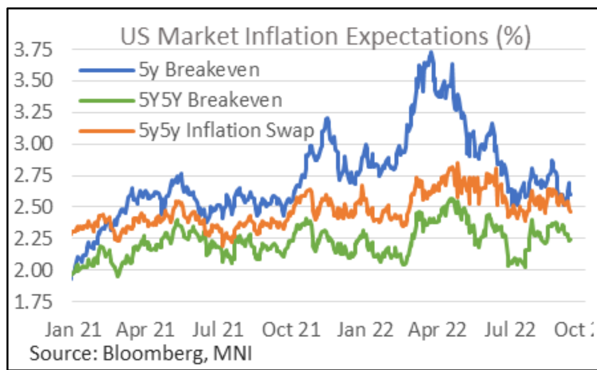


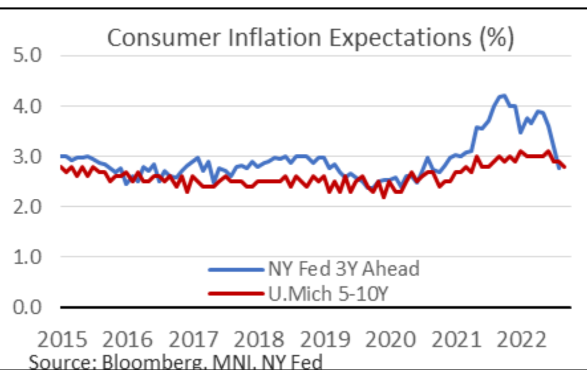
The opposite is true for CPI inflation, with core CPI first surprisingly soft in July before ripping higher in August (released Sep 13), seen as locking in a 75bp hike this week and forcing a substantial re-pricing of higher terminal and 2023 rates generally. Sequential core CPI inflation bounced from July's soft 0.31% M/M to 0.57% M/M, sharply unwinding hopes of cooling price pressures with a two-pronged acceleration in goods (limited sign of impact from supply chain easing) and services (both sticky and wage-sensitive alike), with the breadth of pressures driving a new high in monthly median CPI. Core goods defied expectations of a cooling on squeezed margins as the rate doubled, while core services saw surprising strength in shelter – a yet new multi-decade high for OER M/M inflation – but also in other wage-sensitive categories such as medical care. Having been preceded closely by VC Brainard on wanting to see "several" months of lower inflation and Governor Waller implying perhaps even longer, it essentially reset the clock on how soon the Fed might look to stop aggressively tightening monetary policy.

Early indicators suggested core PCE bounced to at least 0.41% M/M in August (potentially higher after the PPI details), a quick reversal after July saw the first monthly rate since Mar-2021 below that consistent with the 2% inflation target. A similar M/M rise would temporarily buck the downward trend in the Y/Y since the Feb-2022 peak of 5.3%, with the median FOMC member in the June SEP expecting this to hit 4.3% in Q4, which Bloomberg consensus still surprisingly shows despite the latest CPI strength.



There does however continue to be (mild) grounds for Fed optimism in declining/stable inflation expectations. Short-term inflation expectations are cooling on lower commodity prices, notably so in the case of 1Y and 2Y breakevens, whilst more significantly for the FOMC, long term survey measures have started to trend lower (U.Mich 5-10Y at 2.8% in preliminary September print) whilst 5Y and 5Y5Y breakevens are little changed from levels at the time of the last FOMC suggesting a reasonable anchoring in expectations.





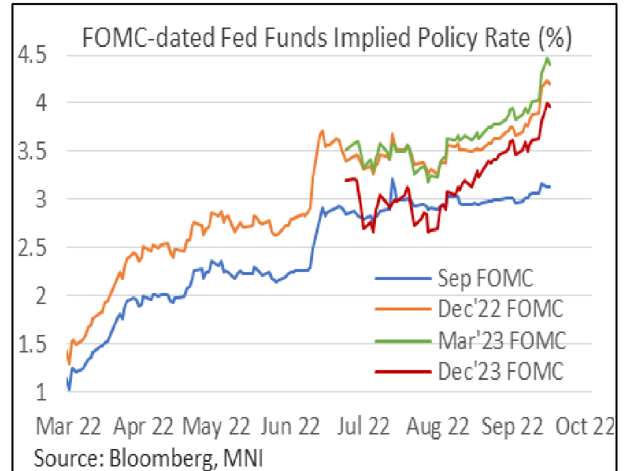
The moderation in the U.Mich inflation components helped see a cooling in Fed rate hike pricing on Friday from latest highs but the curve remains steep. We head towards Wednesday's decision with 80bp of hikes priced and just shy of 2x75bp hikes fully priced as of the November FOMC, in what would be the fourth consecutive 75bp hike if it were to materialize. Beyond that, the terminal rate is now seen at 4.4% for the Mar'23 meeting, a huge 40bp increase since August CPI and 110bps higher than after the July FOMC, whilst a concerted push from the Fed on the need to see higher rates for longer has seen the implied effective rate hit 4% for the Dec'23 meeting. The result of this has been a 2Y Treasury yield touching fresh highs since 2007 of 3.92%, pushing the 2s10s spread to circa -40bps although it remains off lows of closer to -50bps in a potential nod to inflation being seen as more structural.

Changes in financial markets since previous FOMC meetings

	Levels		Change since		
	Latest		Jul 27	Jun 15	
UST 2Y	3.87	%	*87*	*68*	bp
UST 10Y	3.45	%	*66*	*17*	bp
2s10s	-42	bp	*-21*	*-51*	bp
Fed Funds Sep'22	80	bp	*20*	*30*	bp
Fed Funds Dec'22	4.19	%	*87*	*64*	bp
Fed Funds Mar'23	4.40	%	*111*		bp
5Y breakeven	2.53	%	*-16*	*-45*	bp
5Y5Y infl swap	2.50	%	*-3*	*-31*	bp
S&P500	3873		*-4*	*2*	%
DXY	109.6		*3*	*4*	%
WTI	85.1	$	*-12*	*-26*	%
VIX	26.3		*13*	*-11*	%

FOMC-dated Fed Funds show implied change in effective rate

Source: Bloomberg, MNI - as of 16 Sep 2022



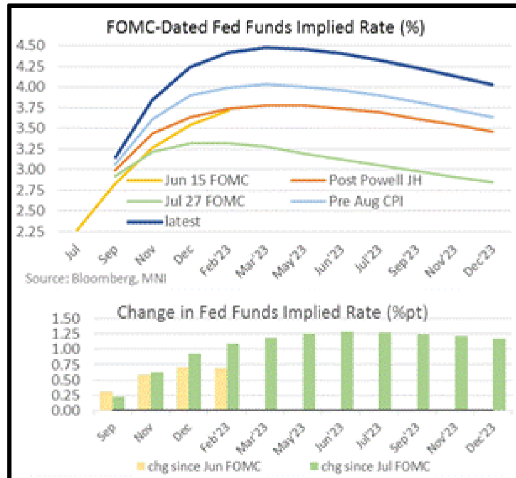
MNI Instant Answers:

The questions that we have selected for this meeting are:

- Federal Funds Rate Range Maximum
- Interest Rate Paid on Reserve Balances (IORB)
- Offering rate on reverse repurchase agreement operations (ON RRP)
- 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 %
- Longer Run Projection of Fed Funds Rate %
- Number of 2022 dots > 3.875%
- Number of 2022 dots > 4.125%
- Number of 2023 dots > 4.625%
- Does the FOMC say it needs to see "clear and convincing evidence"/"compelling evidence" that inflation is easing?
- Does the FOMC describe future policy as needing to be "restrictive”?
- Does the FOMC say it will be "patient" in determining future rates adjustments?
- Does the FOMC indicate it will accelerate balance sheet reduction above what was announced in May?

The markets team has 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 Chat and Bullets services.

Market-Implied Rate Outlook



Source: Bloomberg, MNI Market News

- Markets are pricing in a probability of under 20% for a 100bp hike at the September FOMC, with 75bp fully priced in. There are just shy of 150bp in total hikes fully priced by the November FOMC. The terminal rate is now seen at 4.4% for the Mar'23 meeting, a huge 40bp increase since August CPI and 110bps higher than after the July FOMC. ***Updated Sep 16, 2022***

mni Central Bank Watch - FED

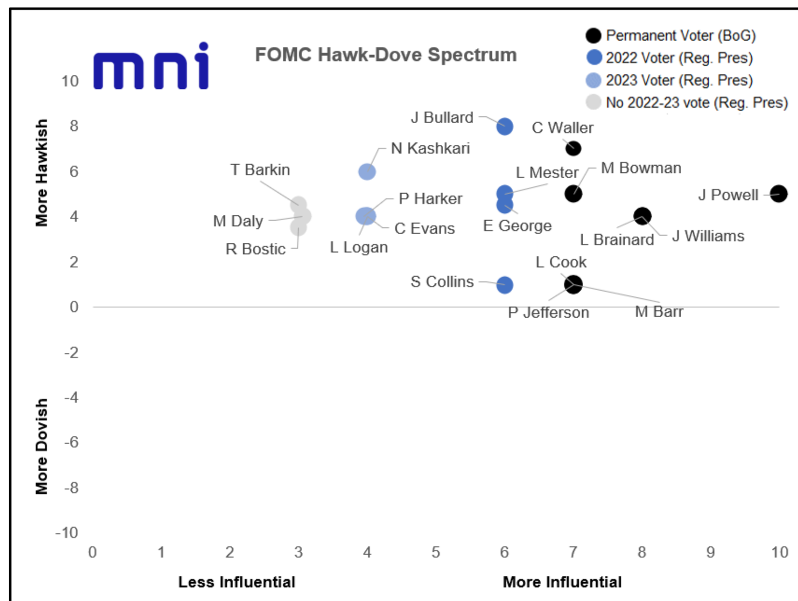
MNI FED Data Watch List

Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
CPI	% y/y	8.3	8.6	↓	7.9	↑					1.05
PCE Deflator	% y/y	6.3	6.3	→	6.0	↑					0.00
UoM 1-Yr Inflation Exp	% y/y	4.6	5.3	↓	5.4	↓					-1.68
Inflation Swap 5y/5y	%	2.50	2.65	↓	2.55	↓					-0.46
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
ISM	Index	52.8	56.1	↓	58.6	↓					-1.92
Industrial Production	% m/m	-0.20	-0.07	↓	0.74	↓					-1.43
Factory Orders	% m/m	-1.0	0.7	↓	2.3	↓					-1.84
Housing Starts	K	1446	1805	↓	1666	↓					-1.78
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	2.07	1.82	↑	1.56	↑					1.96
Chicago Fed Financial Con	Index	-0.22	-0.25	↑	-0.45	↑					0.68
Consumer Credit Net Chg	$bn	23.8	33.7	↓	14.4	↑					-0.56
New Home Sales	K	511	619	↓	831	↓					-1.46
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	0.3	0.4	↓	1.7	↓					-0.27
Consumer Confidence	Index	103.2	103.2	→	105.7	↓					-0.18
Nonfarm Payrolls Net Chg	K	315	386	↓	714	↓					-0.89
Average Hourly Earnings	% y/y	5.2	5.3	↓	5.2	→					-0.79
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Equity Market	Index	3845	4132	↓	4374	↓					-0.42
US 10-Year Yield	%	3.44	2.84	↑	1.83	↑					1.15
US Yield Curve (2s-10s)	bps	-42.6	28.8	↓	39.3	↓					-1.39
USD TWI	Index	90.82	92.70	↓	91.63	↓					-0.80

- Most indicators of activity have flatlined or shown signs of slowing over the past few months, alongside tightening financial conditions and moderating inflation expectations. Incoming inflation and labor market data has continued to surprise to the upside, however. (***Updated Sep 16, 2022***)

Key Inter-Meeting FedSpeak – Sept 2022

- Chair Powell set the tone for the September FOMC with his keynote speech at the Jackson Hole symposium.
- Three comments he made about the monetary policy path stood out:
  - *“July’s increase in the target range was the second 75 basis point increase in as many meetings, and I said then that another unusually large increase could be appropriate at our next meeting”*
  - *“At some point, as the stance of monetary policy tightens further, it likely will become appropriate to slow the pace of increases”*
  - *“We are moving our policy stance purposefully to a level that will be sufficiently restrictive to return inflation to 2 percent… Restoring price stability will likely require maintaining a restrictive policy stance for some time. The historical record cautions strongly against prematurely loosening policy”*
- Other senior Fed officials (including Brainard and Waller) echoed these comments, with many nodding to Powell’s resolve not to allow the FOMC to make similar mistakes to the Fed of the 1970s.
- There appeared to be no opposition to a 75bp September hike in the inter-meeting period by any FOMC participant. Some reiterated their preference for a front-loaded rate hike cycle.
- FOMC participants’ anticipated eventual targets for the Fed funds rate ranged from “a little bit above 3 [in 2022], and a little bit more above 3 [in 2023] (Daly), to 4-5% (Kashkari). Several appeared to eye a level of around 3.75-4.00%, with the 3.4% June SEP median for 2022 now seen as too low.



*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. Recent appointees’ monetary policy bias assumed for now to be slightly hawkish.*

Member	Role	Voter		Monetary Policy Commentary Since July FOMC
		‘22	‘23	
J Powell	BOG, Chair	X	X	**On inflation and the labor market:** "The U.S. economy is clearly slowing from the historically high growth rates of 2021, which reflected the reopening of the economy following the pandemic recession. While the latest economic data have been mixed, in my view our economy continues to show strong underlying momentum. The

Member	Role	Voter		Monetary Policy Commentary Since July FOMC
		'22	'23	
				labor market is particularly strong, but it is clearly out of balance, with demand for workers substantially exceeding the supply of available workers. Inflation is running well above 2 percent, and high inflation has continued to spread through the economy. While the lower inflation readings for July are welcome, a single month's improvement falls far short of what the Committee will need to see before we are confident that inflation is moving down." **– Aug 26 Jackson Hole Speech** **On the impact of monetary tightening:** "Reducing inflation is likely to require a sustained period of below-trend growth. Moreover, there will very likely be some softening of labor market conditions. While higher interest rates, slower growth, and softer labor market conditions will bring down inflation, they will also bring some pain to households and businesses. These are the unfortunate costs of reducing inflation. But a failure to restore price stability would mean far greater pain." **– Aug 26 Jackson Hole Speech** **On rate guidance:** "At some point, as the stance of monetary policy tightens further, it likely will become appropriate to slow the pace of increases. Restoring price stability will likely require maintaining a restrictive policy stance for some time. The historical record cautions strongly against prematurely loosening policy. Committee participants' most recent individual projections from the June SEP showed the median federal funds rate running slightly below 4 percent through the end of 2023. " **– Aug 26 Jackson Hole Speech** "It is very much our view, and my view, that we need to act now forthrightly, strongly, as we have been doing, and we need to keep at it until the job is done." **– Sep 8**
J Williams	NY Fed, V Chair	**X**	**X**	**On rate hikes:** "We need to have somewhat restrictive policy to slow demand and we're not there yet…. This is not something that we're going to do for a very short period of time." "I do think that there will be a time where the policy actions will change because the conditions -- first of all, where we've got the policy rate in terms of a real interest rate, in terms of versus neutral, will be different than it is today because interest rates are still much lower than I think where they're going to need to be… There's going to be a period in the future at some point where you're adjusting probably in smaller steps." **– Aug 30**
L Brainard	BOG, V Chair	**X**	**X**	**On rate hikes:** "So far, we have expeditiously raised the policy rate to the peak of the previous cycle, and the policy rate will need to rise further…We are in this for as long as it takes to get inflation down… Monetary policy will need to be restrictive for some time to provide confidence that inflation is moving down to target…At some point in the tightening cycle, the risks will become more two-sided. The rapidity of the tightening cycle and its global nature, as well as the uncertainty around the pace at which the effects of tighter financial conditions are working their way through aggregate demand, create risks associated with overtightening." **– Sep 7**
M Barr	BOG, V Chair	**X**	**X**	**No comments on current monetary policy since July FOMC**
M Bowman	BOG	**X**	**X**	**On rate hikes:** "I also support the committee's view that 'ongoing increases' would be appropriate at coming meetings. My view is that similarly-sized increases [referring to 75bps] should be on the table until we see inflation declining in a consistent, meaningful, and lasting way." **– Aug 6**
L Cook	BOG	**X**	**X**	**No comments on current monetary policy since July FOMC**
P Jefferson	BOG	**X**	**X**	**No comments on current monetary policy since July FOMC**
C Waller	BOG	**X**	**X**	**On rate hikes:** "…data confirm that the Fed is hitting its full employment mandate, so all my attention is on bringing inflation down." Say, for example, that inflation follows the path laid out in the June SEP, which has core PCE inflation falling to 4.3 percent in the fourth quarter of 2022 and then moving toward 2 percent over 2023 and 2024. In that case, I would support our policy rate peaking near 4 percent." "This long-run rate is effectively where participants think the policy rate would settle when the economy is growing at its potential and inflation is at our 2 percent target. This is a good definition of success when employment and inflation are near our goals and no help is needed from monetary policy. But that isn't the case now; inflation is far from our goal, so more action is needed. The policy rate will have to move meaningfully above this neutral level to further restrain aggregate demand and put more downward pressure on prices." "The (FOMC) is committed to undertake actions to bring inflation back down to our 2 percent target. This is a fight we cannot, and will not, walk away from.. I support continued increases in the FOMC's policy rate and, based on what I know today, I support a significant increase at our next meeting on September 20 and 21 to get the policy rate to a setting that is clearly restricting demand." **– Sep 9**
L Mester	Clev. Fed	**X**		**On rate hikes:** "As I said, I think going a little bit above 4% by early next year and then holding it there is what my policy path is, based on the current information I have." **- Sep 9, MNI Event** **On QT:** "We should be contemplating selling the MBS part of our portfolio...at some point it probably makes sense to think about doing that so that we get the composition back to primarily Treasuries, which was one of our principles that we put out." **- Sep 9, MNI Event**
E George	K.C. Fed	**X**		**On rate hikes:** "Given the likely lags in the passthrough of tighter monetary policy to real economic conditions, this argues for steadiness and purposefulness over speed." Weighing in on the peak policy rate is likely just speculation at this point. The often-discussed neutral rate of interest is an unobserved and potentially unstable benchmark, potentially undermining its value as either a guide for policy or public communication." **- Sep 9** **On QT:** "Successfully shrinking the balance sheet will lessen the Federal Reserve's footprint in financial markets. In particular, the large balance sheet is distorting the price of duration and artificially flattening the yield curve in a way that could promote a reach for yield by investors with potential implications for financial stability." **– Sep 9**
J Bullard	St. Louis Fed	**X**		**On rate hikes**: "I've said 3.75-4 by the end of this year. I would like to get to that level." **– Aug 26** "I would lean toward the 75 basis points at this point. Again, I think we've got relatively good reads on the economy, and we've got very high inflation, so I think it would make sense to continue to get the policy rate higher and into restrictive territory." **– Aug 18**

Member	Role	Voter		Monetary Policy Commentary Since July FOMC
		‘22	‘23	
				"I was a bit hoping that we could get (rates) to 3.75% to 4% this year and then sort of see what was happening during the winter, in the first quarter of next year, and make a judgment at that point about whether more rate increases were needed...if we do get inflation slowing down, then we may be able to hold the rate at that higher rate for that period of time." “I think the destination is a little bit higher than what I would have thought even a couple months ago because inflation has continued to broaden out and doesn't look like it's turning the corner at least based on the evidence we have today.” **- Aug 9, MNI Interview**
S Collins	Bos. Fed	**X**		**On rate hikes**: "Restoring price stability is job one … it's really premature right now to be too specific about exactly what the right policy move will be in September." **– Sep 7**
P Harker	Phil Fed		**X**	**On rate hikes**: "I'd like to see us get to a clearly restrictive stance by the end of the year - north of 3.4%, which was the median in the last SEP - and then maybe continue to increase depending on the data, or just sit there for a while… we often think now because of the 75s that a 50 is not impactful," he said. But "a 50 basis point move is still very substantial." **– Aug 25, MNI Interview**
N Kashkari	Minn. Fed		**X**	**On rate hikes**: "4% to 5% is probably where I would guess right now the level of restriction needs to be given what we and what financial markets believe about inflation over the next few years." **– Aug 31** “Where I am today and there's more data to come in between now and the September meeting, nothing has really changed that would dramatically change my rate path outlook, but again, I don't want to prejudge it. But from the data I've seen, it doesn't imply a big change to my rate path. **– Aug 29**
L Logan	Dall. Fed		**X**	"Our number one priority has to be to restore price stability." **– Aug 31**
C Evans	Chic. Fed		**X**	**On rate hikes**: “I think that we’ve got a good plan in place. We could very well do 75 in September… I think our Summary of Economic Projections have been pretty clear that we’re likely to be headed for about 4% before too long, next year.” **– Sep 8**
T Barkin	Rich. Fed			**On rate hikes:** “I have a bias in general towards moving more quickly, rather than more slowly, as long as you don’t inadvertently break something along the way.” “The destination is real rates in positive territory and my intent would be to maintain them there until such time as we really are convinced that we put inflation to bed.” **– Sep 7** "We're committed to returning inflation to our 2% target and we'll do what it takes to get there...I don't expect inflation to come down immediately or suddenly or even predictably." **– Aug 30**
R Bostic	Atl. Fed			**On rate hikes:** “For me, restrictive is somewhere in the 3.5 – 3.75% range. I’m hopeful that we can get there by the end of the year.” **– Aug 26** "I'm really in that 50-to-75-basis-point range [for September], and thinking about where -- I mean, at this point I'd toss a coin between the two. But fortunately, I have time to get more information and get a better read on where things are." **– Aug 25**
M Daly	S.F. Fed			**On rate hikes:** "But ultimately, we need to get the rate up beyond - up to neutral at least, which is around 3%. But likely to restrictive territory, a little bit above 3 this year, and a little bit more above 3 next year. That's just the kind of interest rate path … the tightness of financial conditions we need to bridle back the economy a bit and slow the pace of inflation." **– Aug 18**

Analyst Views – Fed Outlook

All but one sell-side bank analyst expects the Fed to hike by 75bp at the September meeting, per the 30 notes we read for this preview.

- **Nomura expects a 100bp hike** at the September FOMC, as of last week (we haven't seen an update to this or their full meeting preview).
- **Most see the rate hike cycle peaking/concluding in December,** with a few seeing the hiking cycle carrying through into early 2023.
- **Most expect a 50bp hike in November**, though some see a 75bp raise, and one or two 25bp.
- **The expected peak/ terminal rate varies** from 3.50-3.75% (BNP Paribas) to 5.00% (ANZ, Deutsche, Natwest, Rabobank), with the most common expectation 4.25% (i.e. another 100bp of total hikes after the September FOMC) but no particular consensus.
- **Several analysts are already pencilling in** rate cuts.
- **Sell-side expectations for the September SEP Dot Plot** are in the MNI View earlier in this preview.

Table sorted high-to-low by Fed funds "terminal" rate in cycle, where this could be ascertained by analyst's September FOMC meeting preview. Where MNI hasn't seen an updated rate view since early September, we have left them out of the table. For further details see analyst note summaries in following section.

	Rates (levels refer to top of Fed funds range)	Total Hikes In This Cycle	Cuts Coming?
ANZ	Terminal rate of 5%	500	
Deutsche	75bp Nov, 50bp Dec, 25bp in Feb and March to 5% terminal rate. 100bp of cuts in Q4 2023	500	Yes
NatWest	75bp in Nov, 50bp in Dec, 25bp in Mar, 25bp in Jun to 5.00%	500	
Rabobank	75bp Nov, 50bp Dec, 25bp Feb, 25bp Mar to 5.00% terminal rate	500	
Nomura	50bp Nov, 50bp Dec, 25bp Feb, 4.75% terminal before cuts starting Sep '23; 25bp/meeting to 2%.	475	Yes
Citi	50bp Nov and Dec, 25bp Jan to terminal 4.5%	450	
Credit Suisse	4.25-4.5% terminal rate in 2023 (including a 25bp hike in Q1 23)	450	
Danske	125bp hikes total Nov and Dec	450	
Nordea	4.0% end-2022 rate, 4.5% by March 2022, 50bp cuts in 2024.	450	Yes
TD	75bp Nov, 50bp in Dec to a 4.50% terminal rate for most of 2023.	450	
BofA	Terminal 4.25% funds rate early 2023; recession to open door to cuts starting 2023.	425	Yes
Credit Agricole	50bp in Nov, 25bp in Dec and Feb to 4.25% terminal	425	
Goldman Sachs	50bp Nov and Dec to 4.25% year-end	425	
JPMorgan	50bp Nov, 25bp in Dec, 25bp in Jan-Feb to a terminal 4.00-4.25%.	425	
Societe Generale	50bp hike Nov, 25bp Dec, 25bp in Q123 to terminal rate above 4%, pausing by spring through end-2023. Rec	425	
UBS	50bp Nov, 50bp in Dec (previously 25bp), to 4.25%. Then cuts to a "still-restrictive" 3.5% in 2023.	425	Yes
ABNAMRO	50bp Nov, 25bp in Dec to terminal 4% rate. 2023 cuts to 3%.	400	Yes
Barclays	50bp Nov, 25bp Dec to terminal 4.0%; cuts starting in Q3 2023	400	Yes
ING	50bp Nov, 25bp Dec to 4% terminal, rate cuts in H2 2023.	400	Yes
Morgan Stanley	50bp Nov, 25bp Dec - rates peak at 4.00% by end-2022, steady to Dec 2023	400	
SEB	50bp hike November, 25bp in Dec to terminal 4.00%. Cuts by end-2023 to 3.50%.	400	Yes
Unicredit	50bp hike in Nov, 25bp in Dec to peak 4% by year-end; cut likely in late 2023	400	Yes
BNPParibas	25bp in each of Nov and Dec, 3.75% terminal rate held through 2024.	375	

Analysts' Key Comments

All analysts expect a 75bp hike at the September FOMC unless specifically mentioned. Note summaries in alphabetical order of institution.

ABN Amro: 4% Terminal Rate; Cuts In 2023

- **Future action:** 50bp in Nov, 25bp in Dec to terminal 4% rate. 2023 cuts to 3%.

ANZ: 5% Terminal Rate As FOMC Reinforces Hawkish Guidance

ANZ sees the FOMC reinforcing overtly hawkish guidance at the September FOMC, alongside a 75bp hike.

- **SEP/Dot Plot:** 3.9% 2022 median dot; 4.4% 2023; cuts in 2024.
- **Press conference:** Powell to reconvey his hawkish Jackson Hole message. At some point it may be appropriate to slow tightening pace, and Powell may give guidance on that, but for now decisions are data dependent. Powell likely to reinforce that a restrictive stance is likely to be needed for some time.
- **Future action:** Terminal rate of 5%.

Barclays: A Much Bumpier Landing Forecast

Barclays expects the September FOMC to include Dot Plot-provided clues on the latest thinking about the pace of upcoming meeting hikes, the terminal rate, and "its resolve to hold rates higher for longer".

- **Statement:** Little change in forward guidance. The reference to "ongoing increases" will likely be replaced with "additional increases" as the end of the hiking campaign nears.
- Could elaborate on the rationale for ongoing hikes, such as the need to bring demand and supply into better balance.
- **SEP/Dot Plot:** Median dots - 2022 4.1%; 2023 4.1%; descending in 2022 and 2023 to just above 2.5%.
- Much bumpier economic landing in 2022 and 2023 vs prior forecasts, unemp rising to 4.5% by end-2023; core PCE seen falling from 4.5% 2022 to 2.8% 2023 and 2% 2025.
- **Press conference:** Powell won't offer specific guidance on Nov; though discussion will likely signal a data-dependent decision between 50 or 75.
- **Future action:** 50bp Nov, 25bp Dec to terminal 4.0%; cuts starting in Q3 2023.

BNP Paribas: Powell's Ticking Clock Races Against Policy Lag

BNP sees a hawkishly delivered 75bp hike as more likely than a 100bp raise at the September FOMC, though recent data point to upside risk to consensus estimates of the terminal rate.

- **SEP/Dot Plot:** Lower GDP growth, higher unemployment and core PCE estimates.
- Median dots: 3.9% 2022, 4.1% 2023, 4.1% 2024, 2.9% 2025.
- **Press conference:** Powell may provide some guidance around the terminal rate but emphasize that the ultimate level will be subject to the behavior of economic data.
- **Future action:** 25bp in each of Nov and Dec, 3.75% terminal rate held through 2024.

BofA: Higher For Longer

BofA sees the main message from the September meeting as being a "higher for longer" policy stance.

- **SEP/Dot Plot:** 2022 median of 3.9%; 2023 4.1%; 2024 3.9% ; 2025 2.6%; L-R 2.5%.
- Overall, less growth, higher unemployment, and a higher terminal rate, but inflation largely unchanged.
- **Statement:** To add the line "The Committee anticipates that restoring price stability will likely require maintaining a restrictive policy stance for some time."
- **Press conference:** Powell to continue to emphasize the path for policy is data dependent; to downplay fwd guidance from the dot plot.
- **Future action:** Terminal 4.25% funds rate early 2023; recession to open door to cuts starting 2023.

CIBC: Case Can Be Made For 100bp, But Probably Not On The Drawing Board Now

CIBC sees "the least" the Fed can do is hike by 75bp at the September meeting and pledge that more is coming, though "the case could easily be made" for 100bp. But "the fact that the Fed declined to do 100 bps when rates were at a much lower level suggests that it's probably not on the drawing board now."

Citi: Slowing Hikes Will Require At Least 2 Additional Months Of Softer Data

With inflation not slowing as quickly as expected, Citi thinks FOMC officials will need at least 2 additional months of softer inflation data to meet the criterion of "several" months of slower increases, which makes at least a 75bp hike at the September meeting assured.

- **SEP/Dot Plot:** 2022 median to reflect at least 75bp, more likely 100bp of hikes in Nov and Dec; 2023 likely to be higher than in 2022, could come in around 4.5%.
- **Press conference:** Powell sounds similar to his speech at Jackson Hole, though hawkish risks he could respond more strongly given August CPI data.
- **Future action:** 50bp in Nov and Dec, 25bp Jan to terminal 4.5%

Commerzbank: Tightening To Trigger Recession

Commerzbank sees Fed tightening triggering a moderate recession in early 2023.

- **Future action:** Rates to reach 4% by end-2022, with the Fed refraining from further hikes in 2023 amid waning inflation.

Credit Agricole: Totality Will Lead To 75bp Hike

Barring a "press leak hinting at such an outcome", Credit Agricole sees a 100bp hike as doubtful at the Sept FOMC, with a 75bp hike instead.

- "The guidance in the statement and press conference should remain non-committal in terms of the exact size of future moves, putting the dot plot in the spotlight."
- **SEP/Dot Plot:** 3.9% 2022, 4.4% 2023, easing afterward but above median.
- **Future action:** 50bp in Nov, 25bp in Dec and Feb to 4.25% terminal.

Credit Suisse: Powell To Push Back Against 2023 Cut Pricing

Credit Suisse sees a 100bp hike as unlikely, with a broad range of inflation indicators continuing to point to some moderation despite August's reading - but their analysts still see a hawkish overall message at the meeting.

- **Statement:** To note small pickup in spending/production, and robust job gains. Could upgrade language on inflation risks from being "highly attentive" to something more urgent.
- **SEP/Dot Plot:** Medians of 4.1% 2022, 4.4% 2023, 4.1% 2024, 3.6% 2025. GDP substantially lower in 2022-23, unemployment up slightly above 4% in 2023, core PCE could reach 3.0% in 2023.
- **Press conference:** Powell likely to deliver a hawkish message similar to Jackson Hole, and likely to push back against market pricing for cuts next year.
- **Future action:** 4.25-4.5% terminal rate in 2023 (including a 25bp hike in Q1 23); rate cuts unlikely in 2023.

Danske: Terminal Rate Above 4% Likely

Danske analysts doubt the Fed hikes 100bp in September, with 75bp in Sep/Nov/Dec and a terminal rate well above 4% more likely.

- **Future action**: Currently forecasting 125bp hikes in Nov and Dec, but Danske to review its forecast after the meeting.

Deutsche: No 100bp, But Powell Won't Rule That Out At Some Point

The FOMC will refrain from hiking by 100bp in September, Deutsche believes. That's in part because it would create a larger "increment baseline" increasing the difficulty of downshifting, and accelerating further would seem to disregard Brainard / Powell's comments about the lagged impact of tightening.

- **Statement:** Few changes; will almost certainly maintain existing rate guidance.
- **SEP/Dot Plot:** 2022 dot median 4.1%, 2023 4.4%, 2024 3.9%, 2025 3.4%, L-R 2.5%.

- GDP revised down, upward inflation (core to 3.0% in 2023 before infl falls back to 2.1% by 2025) and unemployment (to 4.4% 2024).
- **Statement:** Powell likely careful not to curtail optionality and rule out 100bp at some point.
- Powell likely to emphasize that there is considerable uncertainty around peak funds rate during this cycle.
- His main message on inflation: "it is clearly too high and with history showing that risks of an unanchoring of inflation expectations rise with the duration of the spike, the Committee is committed to acting "forthrightly" in taming inflation."
- **Future action:** 75bp Nov, 50bp Dec, 25bp in Feb and March to 5% terminal rate. 100bp of cuts in Q4 2023, returning to neutral over time.

Goldman Sachs: FOMC Looking For Quicker Progress Toward Inflation Goals

While a 75bp hike in September would be a "reversal from the plan" set out by Powell in July, Goldman believes "Fed officials now appear to want somewhat quicker and more consistent progress toward reversing overheating, and some might have reevaluated the short-term neutral rate."

- **SEP/Dot Plot:** To show GDP growth more materially below potential in 2022/2023, with a slightly larger increase in the unemp rate and a bit more inflation.
- Median dots: 4.1% 2022, 4.4% 2023, 4.1% 2024, 3.6% 2025, 2.5% L-R.
- **Press conference:** Powell to acknowledge that the dots call for slowing the pace of tightening and to reiterate that he thinks this will likely be appropriate at some point for the reasons he cited in July.
- **Future action:** 50bp Nov and Dec to 4.25% year-end.

ING: Cuts Coming In H2 2023

ING expects a 75bp hike in September to be received by markets as seeing the FOMC taking a "level-headed, data-dependent approach".

- **SEP/Dot Plot:** 4.1% 2022, 4.3% 2023, 3.8% 2024, 2.5% Longer-Run
- **Future action:** 50bp Nov, 25bp Dec to 4% terminal. Rate cuts in H2 2023

JPMorgan: Powell To Emphasize That Rates Will Go Up And Stay Up

Beyond the expected 75bp hike in September, JPMorgan has raised their Fed hiking path view (see below), believing "the Fed will need to continue tightening policy until they are confident that some slack is coming back into the labor market".

- **Statement:** Path of least resistance is to leave guidance unchanged. Can and should be modified though that the Committee expects it will maintain restrictive policy for some time.
- **SEP/Dot Plot:** 4.25% median 2022 dot; at least another hike in 2023; 4.0% in 2024, 3.5% 2025.
- **Press conference:** Powell to downplay dots showing 2024-25 rates coming down, emphasizing that over the 6-12 month horizon, rates are likely to go up and stay up.
- **Future action:** 50bp in Nov (was 25); 25bp in Dec (unch) but now expect 25bp in Jan-Feb to a terminal 4.00-4.25%. Balance sheet on autopilot.

Morgan Stanley: The Path Forward

Morgan Stanley believes that with a 75bp hike likely at the September meeting, "more important than the policy action at this meeting will be the path forward"

- **Statement:** A hawkish nod to an acceleration in core services inflation or calling out rents directly is possible. Will note risks to global economic activity. Would seem ill-timed to directly address the conditions necessary to begin slowing hikes.
- **SEP/Dot Plot:** 3.9% 2022 median, 4.1% 2023, 3.6% 2024, 3.2% 2025, 2.5% L-R.
- Near-term inflation forecasts higher; unemployment rising slightly; 2022 growth slashed.
- **Press conference:** Powell to expand on the FOMC's view that at some point slowing hike pace will be appropriate. "We need to know the mile markers that get us there."
- **Future action:** 50bp Nov, 25bp Dec - rates peak at 4.00% by end-2022, steady to Dec 2023.

NatWest: 5.00% Terminal Rate

- **Future action:** 75bp in Nov, 50bp in Dec, 25bp in Mar, 25bp in Jun to 5.00%.

Nomura: 100bp Hike

Nomura stands basically alone in expecting a 100bp hike at the September FOMC, writing after the August CPI report: "While the Fed did not raise rates by 100bp at the July meeting, contrary to our expectations, we think recent data will encourage policymakers to revisit whether they should increase the pace of rate hikes, considering the Fed's commitment to data dependence."

- **Future action:** 50bp Nov, 50bp Dec, 25bp Feb, 4.75% terminal before cuts starting Sept 25/meeting to 2%. Balance sheet runoff ends after September 2023; no outright sales expected.

Nordea: Slim Chance Of Pivot Any Time Soon

In addition to another 75bp hike in September, Nordea expects the Fed to get into restrictive territory by early 2023 and "to stay there for as long as it takes to get the job done on inflation…our take is that this will require a long long period of high rates and we see slim chances of a Fed pivot anytime soon."

- **Future action:** 4.0% end-2022 rate, 4.5% by March 2022, 50bp cuts in 2024.

Rabobank: 5.00% Rates Ahead Amid Wage-Price Spiral

With the August CPI report confirming that a wage-price spiral is taking place in the US, Rabobank expects the FOMC to hike to 5.00% by early 2023. There is an upside risk of a 100bp hike in September.

- **Future action:** 75bp Nov, 50bp Dec, 25bp Feb, 25bp Mar to 5.00% terminal rate.

Scotiabank: Dots Unlikely To Guide To 2023 Rate Cuts

Scotiabank analysts see too high a bar to a 100bp hike at the September meeting, or indeed to "undershooting" with a 50bp raise.

- **SEP/Dot Plot:** Median dots above 4% in 2023 and kept at this peak through 2023; unlikely to guide to rate cuts in 2023.
- Inflation forecasts up for this year at a minimum but may not majorly adjust core PCE.

SEB: Powell To Keep Door Open To Continued Rapid Hikes

SEB writes they would "have to shift our views" on a 75bp September hike if the June media leak to hike more aggressively is repeated.

- **SEP/Dot Plot:** 2023 GDP closer to 1%; unemp at least around 4.5% by end-2023. Core PCE forecasts in line w consensus but some upside risks for the 2022 estimate.
- 3.8% median dot in 2022; slightly above 4% in 2023; 3.4% 2024.
- **Press conference:** Powell likely to keep the door open for continued rapid hikes by repeating guidance that another "unusually large" increase could be appropriate depending on data.
- Slowing hike pace "at some point" likely to be repeated (from July and at Jackson Hole) unless FOMC members have started to see the need for a much higher terminal rate.
- **Future action:** 50bp hike in November, 25bp in Dec to terminal 4.00%. Cuts by end-2023 to 3.50%.

SocGen: No New Pressures To Hike 100bp

SocGen sees the FOMC refraining from a 100bp hike in September, having been unwilling to take that step before and no "new pressures to take it now".

- **SEP/Dot Plot:** Downward GDP in 2022; modest upward inflation for 2023.
- Median dot to 3.9% in 2022; 4.1% in 2023; to push out cuts vs June projections.
- **Future action:** 50bp hike Nov, 25bp Dec, 25bp in Q123 to terminal rate above 4%, pausing by spring through end-2023. Recession and rate cuts in 2024.

TD: 75bp A Given

The Fed "cannot afford not to deliver" on the market's 75bp hike expectation at the September meeting, writes TD, making it a "given".

- **Statement:** Tone on growth/labor market likely to stay mostly unchanged. May flag that labor market imbalances are showing only modest signs of improvement.
- **SEP/Dot Plot:** 4.1% 2022 dot median; 4.4% 2023; 3.6% 2024.

- **Press conference:** Powell likely to deliver similar hawkish remarks to Jackson Hole's; to signal the Fed "anticipates that ongoing increases in the target range will be appropriate"; to leave door open to additional, unusually large rate increases if inflation data don't evolve as anticipated.
- **Future action:** 75bp hike in Nov, 50bp in Dec to a 4.50% terminal rate for most of 2023.

UBS: Jackson Hole Redux

UBS expects the Fed not just to hike by 75bp in September (and are "very skeptical" of a 100bp raise), but to communicate that the future debate "likely keeps additional outsized rate hikes on the table". They expect emphasis on where the SEP sees rates at end-2023.

- **Statement:** Minimal changes; eliminating 2nd para language on Ukraine-Russia war but keeping "Committee is highly attentive to inflation risks". Some chance George or Bullard dissents.
- **SEP/Dot Plot:** Median 2022 dot to 4.1%, 2023 to 4.6, 2024 to 4.1%, 2025 2.9%. 2.5% Longer Run but some risks of a downward revision as Collins, Logan, and Barr submit dots for the first time.
- Growth expectations marked down severely; core PCE up a bit to 2022 and 2023.
- **Press conference:** Powell to re-emphasize seeing the job of fighting inflation through to the end.
- To explain that at some point it will likely become appropriate to slow hikes; to say the debate going forward will be 50 vs 75 at the November meeting as well.
- A new phase is approaching of rates rising "purposefully" vs "expeditiously".
- **Future action:** 50bp in Nov, 50bp in Dec (previously 25bp), to 4.25%. Then cuts to a "still-restrictive" 3.5% in 2023.

Unicredit: 100bp Hike Chances Are "Low"

Unicredit analysts see the chance of a 100bp hike at the September meeting as "low" given "no Fed official mentioned it as a possibility prior to the blackout period, and a larger hike could send a problematic signal to markets."

- **SEP/Dot Plot:** 2023 median dot 3.9%; 2023 4.1% (with upside risks); 2024 3.4%, 2025 2.5%.
- GDP revised down for 2022-23; core inflation could be revised up for 2023.
- **Future action:** 50bp hike in Nov, 25bp in Dec to peak 4% by year-end; cut likely in late 2023. The bar for ending QT earlier than expected is high.

Wells Fargo: Big Rate Cuts Coming In 2023-24

Alongside an expected 75bp September hike, Wells Fargo sees a dot plot signalling no cuts in 2023.

- **SEP/Dot Plot:** 2022 median dot 3.9%; 2023 4.1%; 2024 and 2025 easing back.
- Weaker GDP growth and higher unemployment for 2023. No sweeping changes to inflation.
- **Press conference:** Similar message to Jackson Hole, that the fight against inflation is far from finished.
- **Future action:** A further 100bp in hikes to early 2023, then 175bp in cuts between H2 2023 and 1H 2024.

Westpac: 100bp Unnecessary

Westpac sees a 100bp increase at the September meeting as "unnecessary and potentially risky".

- They see risks that the new FOMC projections are sanguine in their growth forecasts, which could lead market pricing to turn more hawkish.

MNI Policy Team Insights

MNI: Fed Sept Projections To Show Higher Rate, Inflation Peaks (Pub Sep 16, 2022)

By Jean Yung, Pedro Nicolaci da Costa and Evan Ryser

Federal Reserve officials next week are set to boost their projected interest rate path for this year and next, and the revision may not be their last after an unexpected acceleration in CPI renewed fears that the fight against inflation will take longer than anticipated, former officials and staffers told MNI.

The Fed's quarterly update to its Summary of Economic Projections is likely to show rates rising to 4% or above by year-end and peaking at around 4.5% in 2023, the former officials said, though many believe rates will ultimately need to rise to 5% or higher, more than futures markets are pricing. Fed funds implied rates peak in March 2023 at 4.48%, just a tad above 4.25% in December.

"It's quite plausible we get to 4% by year-end, and I would not rule out a decision to go higher than 4%," former Atlanta Fed president Dennis Lockhart said. "A negative scenario that sober observers have to consider is one in which there's no tangible progress in taming inflation over the coming months and past year-end."

Both headline and core CPI accelerated in August as food prices surged and owners' equivalent rent notched its largest increase since 1986, giving the Fed no reason to dial back the pace of interest rate hikes. A third straight 75-basis-point rate increase next week will take the fed funds rate to a 3%-3.25% target range for the first time since 2008.

NOT QUITE RESTRICTIVE

The 3.8% peak in rates seen in the Fed's June economic projections "was predicated on inflation coming down at under 3%, and that looks really dubious at this point," said former Richmond Fed president Jeffrey Lacker, who expects to see a more hawkish rates path accompanied by higher inflation forecasts next week.

"If inflation expectations remain about where they are at 5% or 6%, they're going to have to go up above 6%. Maybe on their march there by the time they get there expected inflation will ease off a little bit. But it seems unlikely it will ease off enough to warrant stopping before 5%."

Former Dallas Fed principal policy adviser Evan Koenig agreed there was nothing in the August CPI report to suggest that underlying inflation pressures are easing. Core CPI seems to be stabilizing at around 6% rather than heading lower, he noted, while the Dallas Fed's Trimmed Mean PCE inflation gauge estimates the underlying trend for the Fed's preferred price measure to be somewhere between 4.25% and 4.5%.

"Roughly speaking, we're halfway to where we need to be to get the real funds rates to restrictive territory," he said. Unless the fed funds rate is above that trend inflation rate, "policy still isn't in clearly restrictive territory, and until that happens, we're not likely to see a slowing in nominal spending growth, much less in core inflation."

GRIMMER REALITY

The FOMC will likely also take this opportunity to admit that tighter monetary policy will work by driving up unemployment a little bit, though GDP forecasts aren't likely to dip below 1% so as to avoid signaling a recession, said Jonathan Wright, a former economist at the Fed board of governors.

"Tighter policy, a higher peak, lower GDP growth and higher unemployment" is a story that fits together, he said. "They'll probably put down something in the mid-4s, maybe 4.5% for unemployment, but I think that is the best case scenario. I would think that a reasonable best guess of what kind of unemployment rate you're going to take to get inflation under control would be about 5% and it could be higher."

With strong consumer demand and a Fed that has "dilly-dallied for the past year," former Philadelphia Fed economist and University of Richmond professor Dean Croushore worries inflation will gather more momentum, forcing policymakers to hike more and faster next spring.

"If they tighten sooner rather than later, the fed funds rate may not need to be much above 5%. But if they slow down and take their time, then inflation will rise more, and they will need to get up to 6% or more by mid-year next year."

MNI INTERVIEW: Easing Price Expectations Little Comfort-UMich (Pub Sep 16, 2022)

By Evan Ryser

Consumer expectations for inflation have shown tentative signs they may turned down but the easing provides little comfort since the moves are from volatile energy prices, the head of the University of Michigan's Survey of Consumers told MNI.

The University of Michigan survey's inflation expectation measures declined in the preliminary September report with the median expected year-ahead inflation rate moving down to 4.6%, the lowest reading since last September, and the median long run inflation expectation rate easing to 2.8%, the first time since July 2021 below the 2.9%-3.1% range.

"If today's state of the world continues this could very well be sustained but if the war in Ukraine causes gas prices to increase then this could change on a dime again," she said in an interview. "If we had five more months like August then I would expect them to keep going down but we can't know for sure."

Hsu emphasized that the movements "are not large" and added that the downward movement in median five-year-ahead inflation expectations is "typical wiggle." Hsu said she is "pushing back on the idea that they are rolling over," adding "there is so much uncertainty."

It is "too early to tell" whether it has peaked, she said.

INTERQUARTILE RANGE

But Hsu suggested the downward movement in median long run inflation expectations could be more than just drops in the bottom of the distribution of respondents. "We are seeing reductions in the 25th and 75th percentiles," said Hsu, a former principal economist at the Fed board's division of research and statistics.

"Incorporating that gas prices have come down but core inflation is holding steady, there are conflicting signals," she added. "Consumers remain very uncertain particularly about the trajectory of inflation."

Both headline and core CPI accelerated in August as food prices surged and owners' equivalent rent notched its largest increase since 1986, giving the Federal Reserve no reason to dial back the pace of interest rate hikes. A third straight 75-basis-point rate increase next week is expected take the fed funds rate to a 3%-3.25% target range for the first time since 2008. (See: MNI: Fed Sept Projections To Show Higher Rate, Inflation Peaks)

High inflation remains a major reason Americans feel much worse about the economy than they even did at the start of the pandemic.

"Respondents are not changing how they feel about inflation. They continue to speak spontaneously about how inflation is eroding their living standards," the Michigan survey chief said.

And while consumers continue to have little faith in the government to tackle lingering price pressures, in September respondents showed a little more confidence. "There is a slight increase in those that think that the government is doing a good job, with 17% in August and then 21% now."

Consumer sentiment was essentially unchanged in September, just 1.3 index points above August. The one-year economic outlook continued lifting from the extremely low readings earlier in the summer.

MNI INTERVIEW-Fed's Anti-Inflation Drive Risks Overtightening (Pub Sep 16, 2022)

By Pedro Nicolaci da Costa

The Federal Reserve's aggressive effort to raise interest rates to fight inflation near 40-year highs raises the risk that policymakers will overdo it and push the economy into recession, driving a steep global downturn, ex-Fed board economist Julia Coronado told MNI.

Coronado does not believe a recession is inevitable, but says the window for avoiding one is narrowing after the August CPI report showed worrisome and broad-based inflation pressures still percolating.

"If the risk management lean is toward preventing inflation from taking hold then, yes the risk is tilted toward overtightening," she told MNI's FedSpeak podcast. "I don't think they're trying to overtighten but that's where the predominant risk lies right now."

Now president of MacroPolicy perspectives, Coronado said it's hard to pinpoint where the fed funds rate will peak in this cycle given the unpredictability of inflation. But she added the September Summary of Economic Projections will offer clues into how policymakers are currently foreseeing the policy path.

"We're expecting a 75-basis-point rate hike that will take us to 3.25% for the top of the range," she said. That would be the third such move in as many meetings, an extremely rapid clip by historical standards.

"Most officials willing to say what their baseline is are talking about getting to around 4% by the end of the year. That's quite doable – either another 75 in November and decide what to do in December or you could go 50 in November and 50 in December."

Deciding when to slow the pace of hikes from a historic run of ¾-point moves will be difficult because the Fed will only get one more month's worth of data between the September and November meetings.

RESTRAINING PASS-THROUGH

Whether the economy can avoid recession will depend in part on how quickly demand begins to wane in response to the Fed's tightening, Coronado said.

"It does seem like a close call at this stage," she said. "We may need to tighten the screws more to shake out that inflationary passthrough behavior." (See MNI: Fed's Mester: Wages May Be Stabilizing, Need More Hikes)

Coronado said firms have taken advantage of the unusual pricing power they achieved during the pandemic, a combination of product scarcity and strong consumer balance sheets, to widen their margins.

"It's quite possible that we actually do need to see a break in the current conditions, a really weak environment where consumers are more cautious, more price sensitive, because the job picture has weakened, because incomes are getting squeezed," she said.

A U.S. recession would be especially troubling for the global economy because the country's growth has been a driver of strength. "If the U.S. goes into recession we really are looking at a pretty significant global downturn," she said.

The giant U.S. mortgage market, which has already taken a huge hit from the Fed's tightening campaign amid a surge in rates above 6%, bears close watching.

"The mortgage market is going through not just a cyclical tightening but structural changes, you are now in a world where neither the GSEs nor the Fed are buyers of mortgages and that's something we haven't seen in a very long time," she said.

"More than doubling mortgage borrowing costs is radical. So the market is functioning, but bid-ask spreads are wide, the liquidity is poor. Do you get some kind of a seizing up on some kind of event? it's possible. It feels like that's a vulnerable market."

MNI INTERVIEW: Fed Has 'Long Way To Go' On Hikes-Acharya (Pub Sep 15, 2022)

By Pedro Nicolaci da Costa

The Federal Reserve is nowhere near finished raising interest rates and financial markets are not prepared for how tight monetary policy will need to get in order to bring down inflation, former Reserve Bank of India deputy governor Viral Acharya told MNI.

Investors may also be ignoring risks to the financial system posed by the process of reducing the central bank's USD8.8 trillion balance sheet, said Acharya, who presented a paper on QT at the Fed's Jackson Hole conference this year.

"The Fed rate hike cycle has a long way to go," said Acharya, now a professor at New York University's Stern School of Business, in an interview. "Even the professional investors have not yet internalized the full scale of rate hikes and tightening that will be needed if inflation doesn't come down that quickly. And I think it's not coming down that quickly."

Acharya said that while market expectations for inflation remain relatively contained, household expectations of inflation have already drifted dangerously higher.

"Household expectations are not anchored – they are very adaptive they are based on realized inflation. The Fed needs to hike rates more precisely to bring expectations more in line with their policy path," he said. (See MNI INTERVIEW: Fed Will Need To Hike Past 5% – Buiter)

Acharya did not specify a level for the terminal fed funds rate, but he suggested Fed talk of rates peaking at 4% was still far too optimistic.

"They will probably wait for a sustained three-to-six month period of declining inflation before they can really think about at what point do we slow down the pace of tightening," he said, adding it's too soon to say inflation has peaked.

"If the prints remain in the range of 8% they will have to keep up the pace of 75 basis points" per meeting, especially given the lagged effects of monetary policy.

LIQUIDITY MISMATCH

Acharya also pushed back against the dominant view within the Fed that the process of winding down the balance sheet will carry on in the background without major market disruptions.

"The Fed may have to strike a delicate balance as it embarks on this because the financial system also creates leverage, especially of the short-term type, in periods of easy money," he said.

"Now when you contract liquidity, if these claims don't contract at the same pace or more gracefully then you could have a bad intersection of declining liquidity assets and a large residue or stock of claims on liquid assets."

These risks can materialize through three channels, Acharya said: commercial banks, shadow banks or a mix of both.

“The most problematic is the interaction of these two – if corporates have become reliant on bond markets and if they are not able to roll over costs that are very large, then they draw down on credit lines from banks,” he said.

“Some of the credit lines are in fact sold to asset managers, central counterparties, as well. So the drawdown on credit lines may not just be from nonfinancial corporations, they can even be from financial corporations, utilities, which also get stressed in a time of aggregate uncertainty.”

MNI INTERVIEW: Fed Will Need To Hike Past 5% - Buiter (Pub Sep 14, 2022)

By Pedro Nicolaci da Costa

The Federal Reserve will need to raise interest rates substantially more than investors or policymakers believe, pushing borrowing costs above 5%, in order to bring down inflation, economist and former Bank of England Monetary Policy Committee member Willem Buiter told MNI.

A stronger-than-expected 8.3% jump in CPI in the year to August cemented expectations for further aggressive hikes from the central bank, sending stock markets lower and bond yields higher. It also raised the prospect that the Fed’s new “higher for longer” mantra may mean more tightening than is currently priced in.

“They’re still quite far behind the curve. Inflation is way above target even if you just look at core inflation,” said Buiter in an interview. “Real economic activity is at or above full capacity utilization, the unemployment rate is still at cyclical lows, so monetary policy should be materially restrictive.”

That means the policy rate should be well above the neutral rate when in reality the Fed is just now “edging above the neutral level,” said Buiter, who also served as global chief economist at Citigroup as well as in a series of academic positions.

Core inflation jumped 0.6% last month, double expectations for a 0.3% gain and leaving the year-on-year reading at 6.3%--more than three times the Fed’s 2% target for headline inflation.

As for how high the Fed will need to boost the Fed funds rate in order to bring inflation back to target, Buiter said: “No less than 5% would be my guess. If they did that for a year or so it would probably get inflation out of the system.”

Well-anchored expectations mean the Fed can still bring down inflation without inflicting too much economic harm, said Buiter.

“Inflation expectations very encouragingly have not become unhinged yet,” said Buiter, citing both market measures and consumer surveys like the one published by the New York Fed. “The damage can still be contained but they have to get more serious than they are currently. They talk tough but they’re really still wearing short pants.” (See MNI INTERVIEW: Powell Channels Volcker To Head Off '80s Redux)

TOO LATE FOR A FULL POINT?

Still, Buiter said it was unlikely the Fed would opt for a full point rate hike at next week’s meeting despite some market speculation to that effect following the surprise CPI gains.

“If they were going to do 100 basis points they would have done so already. I wouldn’t completely rule it out, but I’d be very surprised because that is not what any member of either the board or the regional presidents has been hinting at,” he said.

That doesn't mean that the latest data, and other indicators of both hot inflation and a strong labor market, won't sway the Fed to be even more aggressive. Buiter thinks they will hike by 75 basis points for the next two meetings, then go down to 50bps in December and persist with further 50bp or 25 bp hikes early next year.

"If they do so it will slow down the economy and could create a mild recession," he said.

But such actions are necessary in Buiter's view in order to get inflation back under control.

"There's enough inflation built in, inflation expectations in the short run are coming down but they're not 2%, so we are going to see through the labor market, through wage inflation, through the service sector and through other parts of the economy where there is still probably excess demand – certainly labor scarcity – you're going to see upward pressure on inflation," he said.

"Core and headline inflation will converge, with headline coming down faster than core inflation for the foreseeable future."

MNI INTERVIEW: Cleveland Fed Sees Higher Aug CPI Than Market (Pub Sep 9, 2022)

By Jean Yung

The Cleveland Fed's inflation Nowcast sees August CPI coming in two-tenths higher on the month than market expectations, associate research director Ed Knotek told MNI, using a model that's outperforming professional forecasters through the pandemic.

The Nowcast estimates August CPI rising 0.1% on the month and 8.2% on the year, in a report due out Tuesday. Core CPI is seen increasing 0.5% on the month and 6.3% from a year earlier. Market forecasts have -0.1% for headline CPI and 0.3% for core.

More upside misses suggest even tighter monetary policy, and Cleveland Fed President Loretta Mester said on an MNI webcast this week it's far too soon to conclude inflation has peaked. Surging prices as the economy re-opened following Covid shutdowns surprised Fed officials and are one reason the FOMC embraced outsized rate hikes.

"When we look at how the model has performed compared with surveys of professional forecasters, either through the Philly Fed Survey of Professional Forecasters, or the Blue Chip consensus, the model has actually been performing pretty well," Knotek said. "It tends to outperform predictions from either of those two surveys, which are aggregating across many individuals."

GETTING THE NEXT ONE

The Nowcast predicts three separate components of inflation. The energy component leverages high frequency data on oil and gas prices, similar to what other forecasters use, while food and core inflation are time-series models that extrapolate from recent price moves.

While forecasters can look at a suite of models, news headlines and their best judgment on what weight to put on different factors from month to month, the Nowcast model has been fairly consistent since its conception eight years ago.

"It's fair to say the forecast errors of the model's predictions have increased since before the pandemic but that's been true across forecasters in general," Knotek said.

Combined with the bank's Median CPI and Trimmed Mean CPI, which have been "somewhat elevated" at 6.3% and 7% respectively in July, they give policymakers a more robust view on where inflation is headed, Knotek said. "The benefit of the Nowcast is getting the very next reading right," he said.

MNI INTERVIEW: Fed's QT Could Trigger Liquidity Crunch-Rajan (Pub Sep 9, 2022)

By Pedro Nicolaci da Costa

The Federal Reserve's plan to reduce its USD8.8 trillion balance sheet carries significant risks, including a possible liquidity crunch in financial markets that would have broad repercussions for corporate credit, former Reserve Bank of India Governor Raghuram Rajan told MNI.

Rajan, who co-authored a paper on the subject presented at this year's Jackson Hole conference, said in an interview the Fed is too complacent about the prospect that Treasury market liquidity will vanish in times of stress, as it did with the onset of Covid in March 2020.

"When you talk to Fed officials, there's generally a sense that we solved that problem with these liquidity coverage ratios – this may have been yesterday's problem, it's not today's problem," said Rajan, a professor at the University of Chicago's Booth School.

"Whenever I hear that I get worried because it does mean you put a lot of faith in your regulations dealing with the problem."

Rajan said officials often blame episodes when liquidity dried up to minor regulatory issues when in fact they are more systemic and a direct result of the build-up of reserves that accompanied the central bank's massive QE program.

"Demand deposits have gone up hugely in the system and if you look at credit lines, even various forms of guarantees of what corporations do, what hedge funds do, what other financial firms do, have gone up," he said.

This could be a recipe for trouble if the economy enters a serious slump where concerns about the solvency of financial firms or other large corporations come into play.

"What we worry about is some combination of a real downturn when you start worrying about credit risks across the banking system, across the nonfinancial system, and liquidity being relatively scarce compared to the very increased demand for liquidity," he said. "When these two come together you can get fairly unpleasant outcomes."

He added that liquidity coverage ratios that are supposed to create a buffer against crises are not especially reliable.

"The liquidity coverage ratio ensures we have enough liquid assets to cover 30 days of runoff. But what is 30 days of run off? If they all run in one day that might be really problematic," he said. (See MNI INTERVIEW: Fed's Mester Focused on QT Impact on Liquidity)

HARD LANDING RISKS

Turning to the Fed's aggressive interest rate hikes this year, Rajan said the central bank still has a chance to ensure higher expectations of inflation do not become entrenched among businesses and consumers, but added the window is closing rapidly.

"The question is at what point do people say I just can't make ends meet without a further increase in wages or compensation," he said. "I don't think we've reached that time yet, so in that sense expectations are still anchored. But if we stay with 8 to 9% for a substantial period of time, people will start saying those 3, 4, 5% wage increases are simply insufficient."

Rajan said markets are likely underestimating not only how high interest rates need to go but also how long they need to stay high – and how much pain that will entail – in order to bring inflation that registered an 8.5% yearly gain in July back toward the Fed's 2% target.

"I don't think cutting interest rates is on the minds of any Fed policymakers and that was clearly indicated at Jackson Hole," he said.

"They're seared by the memory of the 70s – the Fed cut interest rates only to see inflation come back up. You have to wait to see that you've killed the beast, and that would mean inflation coming down significantly, even below the Fed policy rate by some amount."

The most optimistic outcome, he said, would be for the Fed to hike rates somewhat above 4% and then wait for signs that inflation is coming down and the labor market is softening before a long pause, which would last at least through the end of 2023. And that could mean a much bigger hit to employment than officials – and inventors – currently expect.

"If you take the old view and you compute elasticities, sacrifice ratios, the numbers that come out are pretty alarming," Rajan said. "To bring inflation down from these levels, even under optimistic scenarios, would require an unemployment rate of 2.5% more than we have now for a sustained period of two to three years."

MNI INTERVIEW: Fed's Mester Focused on QT Impact on Liquidity (Pub Sep 9, 2022)

By Pedro Nicolaci da Costa and Jean Yung

Federal Reserve Bank of Cleveland President Loretta Mester told MNI Wednesday she's more concerned about the potential for quantitative tightening to constrain market liquidity than its effect on financial conditions, and she favors letting the USD95 billion-a-month asset run-off program continue on autopilot.

"I'm more focused on whether it's going to have an impact on liquidity in the markets than I am on how much the equivalent is on a fed funds rate," she said in an MNI webcast. "We're monitoring to make sure it's not disrupting anything. So far, so good."

Some investors and a former regulator have warned recently that QT could have a much larger tightening effect than the Fed expects, especially if growth slows dramatically. Fed researchers also anticipate a potential amplification of its effects should the Treasury market experience high turbulence. (See: MNI INTERVIEW: Market Strains Could Ramp Up QT Effect)

Ahead of the FOMC's announcing its QT plan in May, policymakers discussed an approach that would set a pace for reducing the Fed's USD9 trillion balance sheet with a high bar for further adjustments once it was set running. "I'm persuaded by that," Mester said. "We have less experience with balance sheet reduction," she added. "There's a lot of interesting research out there about whether QT is symmetric with QE, and there's various reasons to think that it may not be."

MBS SALES

Even as she favors leaving the speed of QT untouched, Mester argued for more active management of the composition of the Fed's asset portfolio.

As Treasury assets mature faster than MBS, "we should be contemplating selling the MBS part of our portfolio," she said. "At some point it probably makes sense to think about doing that so that we get the composition back to primarily Treasuries, which was one of our principles that we put out."

Most FOMC officials are in agreement on making such a move when rate hikes are "well underway," according to the minutes of Fed meetings earlier in the year.

Mester, a voter on rates this year, reiterated in her prepared remarks her view that the fed funds rate should rise above 4% by early next year and stay there. The dollar has continued to rise as investors anticipate further rate hikes. Fed funds futures traders are pricing in 67 bps of tightening later this month, close to last week's levels before Friday's jobs report for August, and rates are expected to peak at 3.91%. They are currently in a target range of 2.25% to 2.5%.

MNI INSIGHT: OFR Nears Proposing Rule To Fill Repo Data Gap (Pub Sep 6, 2022)

By Evan Ryser

The U.S. Office of Financial Research plans soon to ask for public comment on its plan to collect data on the opaque non-centrally cleared bilateral repo market, MNI understands, in what would be a step toward better understanding the risk that hedge funds' growing presence in short-term funding markets poses to the financial system.

The OFR, an arm of the Treasury Department created by the 2010 Dodd-Frank Act to promote financial stability, would be filling in a key gap in data in the largest segment of the repo market that also contains a greater share of riskier collateral. OFR estimates that primary dealers' exposure to non-centrally cleared bilateral repos doubled in 2022 from previous years to more than USD2 trillion.

The data collection moves are part of a wider effort by regulators to better identify emerging risks in short-term funding markets, particularly after the March 2020 Treasury market meltdown highlighted the previously-unknown extent of hedge fund leverage in repos.

The OFR has already gathered some repo data from nine volunteer institutions for three days in June. Now the agency is hammering out the final details of its advance notice of proposed rulemaking on reporting exposures, hoping to minimize bureaucratic burdens, MNI understands. It is unclear how long it would take to issue a final rule, after a multi-step process including gathering comments from investors and the general public.

TREASURY MARKET REFORM

In 2021, FSOC reestablished its Hedge Fund Working Group, an interagency staff-level working group, that recommended the OFR consider ways to obtain better data on uncleared bilateral repurchase agreements, an important source of leverage for hedge funds.

The Treasury Department also recently solicited public comment on ways to increase transparency in the USD24 trillion Treasury market. (See: MNI INTERVIEW: Treasury Market Reform Efforts To Ramp Up - Liang)

Market participants and legislators generally encouraged the Treasury Department to continue efforts to promote post-trade transparency, but some investors cautioned of potential risks to the ability to trade both larger sizes and less liquid issues.

Federal Reserve Vice Chair for Supervision Michael Barr is set to give his first public remarks in his position later this week, which are likely to be closely watched for clues on his approach to the supplementary leverage ratio and his assessment of market capital and liquidity.

MNI INTERVIEW: Fed May Pause When Core Prices Fall Under 3.5% (Pub Sep 1, 2022)

By Evan Ryser

The Federal Reserve could pause interest rate increases once trailing 6-month annualized core inflation falls below 3.5%, which could come around March if not earlier, a former senior Fed Board researcher told MNI.

John Roberts, a former deputy associate director at the Fed Board in Washington who oversaw its domestic economic modeling efforts, said looking at two-quarter changes in core PCE prices provides a good balance between timeliness and noise reduction.

In his model simulations, he found that the Fed could pause once six-month core inflation falls below 3.5% and still meet its inflation goals. “But they won’t look only at core PCE inflation,” he explained. “They will also look at alternative measures of core inflation, like the Dallas Fed’s trimmed mean. And they will want to see key measures of wage inflation moving down as well.” The Dallas Fed's trimmed mean 6-month annualized measure was 4.3% in July.

SLOPING UNEMPLOYMENT

The Fed has raised rates aggressively this year to combat high price pressures and at its June and July policy meetings, raising the federal-funds target rate range by 0.75-percentage-point increments, a historically aggressive action. It is next scheduled to meet September 20-21 where it will issue fresh forecasts in its Summary of Economic Projections including for the year 2025.

Noting recent work by Fed staffer Andrew Figura and Fed governor Chris Waller that suggested the unemployment rate may need to rise to 4.5% to return the labor market to better balance, Roberts thought it possible the next SEP could show higher unemployment. “You might see the unemployment path through 2024 a bit more upward sloping than in June," he said. (See: MNI INTERVIEW: Fed Sept SEP Must Reflect Rate Hike Pain - Dudley)

“That may mean tighter policy than in the June projections,” with the funds rate path running higher, “perhaps by 25 basis points or so," said Roberts, a former special adviser to then-Fed Governor Lael Brainard from 2017 to 2019. The June SEP showed the fed funds rate ending the year at 3.4% and 2023 at 3.8%, before moving down to 3.4% in 2024.

Roberts’s model simulations, which were based on the June SEP, suggested that the peak in the funds rate could be reached at the March meeting. But recent statements by policy makers suggest the Fed might move more aggressively than that, so that the peak could be moved forward to December or January, he said.

"Then you might see in the SEP it would be holding relatively flat between the end of 2022 and the end of 2023, or maybe just up another quarter point in 2023," said Roberts, who served at the Fed Board for more than 35 years.

RATE CUTS

Roberts pointed out that the June SEP, which Chair Powell last week suggested was still a good guide to Fed thinking, had the funds rate moving down in 2024. His simulations suggested that those outright cuts likely wouldn’t happen until six-month core inflation was below 2.5%.

“When they put out their 2025 projections in September, inflation will likely be within striking distance of the Fed’s 2% target, and the funds rate will be headed down towards its long-run neutral rate of 2.5%," said Roberts, who once oversaw the staff production of alternative scenarios and model-based monetary policy analysis that were presented to the FOMC as part of their meeting preparations.

With interest rates coming down, it’s possible the SEP will show an outright decline in the unemployment rate, he added.

MNI INTERVIEW: Self-Employed Could Keep US Joblessness Low
(Pub Sep 1, 2022)

By Jean Yung

The share of self-employed workers is rising rapidly in the U.S. economy as people embrace more flexible work arrangements post-Covid, and the trend could put downward pressure on the unemployment rate even as hiring slows, Federal Reserve Bank of St. Louis economist Victoria Gregory told MNI.

The self-employed , or those who report earning most of their income from self-employment, made up almost 11% of the 157 million employed workers in the U.S. at the start of the year, according to Gregory's analysis of detailed BLS household survey data, roughly a percentage point higher than 2019.

Self-employment was less susceptible to initial employment declines at the start of the Covid-19 pandemic and also recovered more quickly to pre-pandemic levels by the summer of 2020. It dipped again during the winter of 2021 but has since recovered from that as well.

"To get an accurate understanding of the labor market you need to look at many different variables. The household survey can measure non-traditional types of employment, and that's where the unemployment rate comes from," Gregory said in an interview. "If the trend continues, it's going to be more important for policymakers to pay attention to the household survey."

FLEXIBILITY KEY

The rise of entrepreneurship and gig work since 2020 is the opposite of what happened during the Great Recession, when the share of self employment fell, and has contributed to current U.S. labor market strength, Gregory said. (See: MNI INTERVIEW: Fed May Pause When Core Prices Fall Under 3.5%)

The industry mix among self-employed workers has stayed relatively constant during Covid, led by construction and professional services. The real estate and transportation sectors have become more popular, which can be traced to the housing boom and growth in demand for delivery services, Gregory said.

More women chose self employment in the past two years than the pre-pandemic trend, which "may suggest that the burden of home and child care placed on women in 2020 made self employment a more attractive option," she said.

"I was trying to see whether people switched into industries that were less affected by the Covid recession or had less layoffs in order to avoid that risk in the future, and I didn't find that. People are switching to being self employed based on other characteristics of the job," like flexible hours, higher earnings or a better skills fit.

PAYROLLS SURVEY

Self-employment is not counted in the BLS establishment survey -- one of two major factors accounting for the discrepancies between the household and the establishment surveys, the other being that multiple job holders are counted only once in the household survey but more in the establishment survey.

The household survey has shown notably weaker job creation in recent months, even as the unemployment rate sank to a 50-year low of 3.5% in July, Federal Reserve Chair Jerome Powell noted at his last press conference.

Economists are unsure why the two surveys have diverged in recent months but say the differences are likely temporary.

MNI INTERVIEW: Fed Likely To Hike Another 75BPs In Sept-Haslag (Pub Aug 31, 2022)

By Pedro Nicolaci da Costa

The Federal Reserve is likely to deliver another aggressive 75 basis point rate hike in September to catch up with an inflation problem that officials failed to foresee, ex-Dallas Fed economist Joseph Haslag told MNI's FedSpeak podcast.

That kind of move is needed "just to get to the path that almost everybody agrees they're going have to get to," Haslag said. "So why hold off – that's going to be the essential driving force around the table."
(See MNI INTERVIEW: Fed's Harker Wants Rates Above 3.4% By Year-End)

"Fifty basis points is a possibility – I wouldn't rule it out completely – I'd just put less probability on that than I do on 75 at this stage. I think it's cooked in, I think the markets are ready for it and the past couple weeks have reflected that painful updating process."

Chair Jerome Powell delivered hawkish remarks at Jackson Hole last week that drove stock prices lower and bond yields higher. Wall Street was looking for a possible dovish pivot but instead got the shortest ever Wyoming speech that signaled a focus on restoring price stability even at the cost of increasing economic pain.
(See MNI INTERVIEW: Fed's Bullard Says Rates Could Be 'Higher For Longer)

INFLATION NOT SO BAKED IN

Powell made clear he's trying to ensure inflation doesn't become entrenched in business and consumer expectations, avoiding the need to act even more aggressively later, Haslag said.

While inflation of the 1970s is similar to today's because of supply shocks, Haslag said Powell benefits from the Fed's credibility dating back to the Volcker shock. That's why the fed funds rate is likely to peak around 4% or a little bit below as the Fed has predicted, he said.

"Inflation is starting to be baked in a little bit but it's not so baked in that we're risking double-digit inflation," said Haslag.

While the Fed's characterization of "transitory" inflation was ridiculed and later abandoned, Haslag sees the big price gains as temporary, just over a longer period. Trimmed mean measures "are all coming in somewhere between 3.5% and 5%. That seems to be a pretty good gauge of what's going to happen, what we're looking at by the end of the year," for headline inflation, he said.

CALMING MARKET SIGNALS

Market measures of inflation expectations also give the Fed some relief. "They're telling us there's not a lot of great fear that inflation is going to be persistent," Haslag said.

The inverted yield curve is another market signal that's not as worrisome as some economists have suggested, he said. "Yield curve inversions have predicted way more recessions than we've actually experienced."

While Haslaq doesn't see a recession as inevitable, it wouldn't take much to tip the economy into a short contraction. "We're dealing with an economy that could be headed for a recession," he said. "The whole soft landing business is really about fairly fine tuning points about whether we're above zero or below zero."

MNI INTERVIEW: Fed To Stay On Hold After Rates Peak -Blinder (Pub Aug 29, 2022)

By Pedro Nicolaci da Costa

The Federal Reserve is unlikely to cut interest rates shortly after it stops raising them as many in financial markets still seem to think, ex-Fed Vice Chair Alan Blinder told MNI on the sidelines of this year's Jackson Hole conference.

The Fed may also need to push interest rates somewhat higher than the central bank's median projection of 3.8%, Blinder said in an interview with MNI's FedSpeak podcast.

"I never believed that and I think Powell never believed that, and part of his exclamation point was to basically shout at the markets, stop believing that because it's not going to be over that fast," said Blinder, also a former member of the White House Council of Economic Advisers and a Princeton University professor.

That's partly because U.S. inflation pressures are "nearly unprecedented," as inflation has never been this high or broad in the post-war era, except during the Great Inflation of the late 1970s and early 1980s.

U.S. PCE inflation registered a 6.3% rise in the year to July while core inflation rose 4.6%. Both readings were softer than a June peak but still too elevated for the FOMC's comfort.

"The core inflation rate is still way too high. It's more than double the Fed's 2% target," Blinder said. "What you worry about is whether it's getting into wages and via that you have secondary effects where it gets into everything. And the potential lasting effects, which don't seem to be there yet, on inflationary expectations."

Fed Chair Powell's remarks, which knocked stock prices sharply lower as markets interpreted them hawkishly, included a warning that history suggests premature loosening of policy would be misguided. But many investors still think the Fed chief was just jawboning markets in the short term.

"He's feeling the frustration that all Fed chairs feel at some point: What does it take to drum this into the heads of traders?," said Blinder

As for the Fed's interest rate forecast of a peak slightly below 4%, Blinder said: "If anything you probably want to nudge it higher, I don't mean 5.8%, but probably a little bit higher." (See: MNI INTERVIEW: Fed Sept SEP Must Reflect Rate Hike Pain–Dudley)

TOO MUCH BLAME ON FISCAL

Blinder said a large fiscal U.S. response to the Covid crisis gets excessive blame for causing the inflation problem the country is now experiencing.

"The few people who were 'right' about inflation were right for the wrong reasons. Overstimulus of the economy from fiscal and monetary policy together played some role, but from what we know about the sensitivity of inflation to GDP gaps, the unemployment rate, it wouldn't be a lot," he said.

"So they got the direction right but exaggerated the magnitude, but they're getting tremendous credit for a food shock and an energy shock both of which emanated at least in part and maybe in large part from the Russian invasion of Ukraine."

Blinder said another reason inflation pressures have not been transitory as the Fed first predicted is because supply chain issues have been far more protracted than many could foresee.

"The other part that made Team Transitory miss -- and by the way I was a member of Team Transitory and I've done many mea culpas -- was the slowness of market capitalism to fix these supply chain problems," he said. "I've often characterized this as a way overestimate of the efficiency of global capitalism."

MNI INTERVIEW: Fed Sept SEP Must Reflect Rate Hike Pain-Dudley (Pub Aug 26, 2022)

By Pedro Nicolaci da Costa

The Federal Reserve's next round of economic projections in September are likely to show more persistent inflation and higher unemployment to reflect the greater pain that will result from the central bank's aggressive monetary tightening campaign, former NY Fed President William Dudley told MNI.

"This is a different message about how we have to be restrictive and we're going to need to be restrictive for some time and there's going to be some pain and the unemployment rate is going to have to go up," Dudley said. "The interesting thing is will you be able to see this in the Summary of Economic Projections for September because the June projections were still quite optimistic."

Fed Chair Powell delivered a strong and succinct message at this year's Jackson Hole conference: interest rates will have to rise to restrictive levels and then stay there for longer. Markets reacted swiftly, with the Dow Jones industrial average diving 1,000 points with two-year bond yields rising to 3.4%, the highest level since June and edging closer to highs not seen since the global financial crisis of 2008.

And that was exactly the point, Dudley said in an interview on the sidelines of the conference.

"The more that the market internalizes the correct message from the Fed, the more financial conditions tighten and early and then the Fed has somewhat less to do," he said. (See MNI INTERVIEW: Fed's Harker Wants Rates Above 3.4% By Year-End)

SO LONG, SOFT LANDING

Dudley, echoing Powell's comments, said the FOMC hasn't made up its mind about whether the central bank should hike interest rates by 75 or 50 basis points when it meets in September.

But the June FOMC's median view that rates will peak at 3.8% sometime in 2023 was still overly sanguine, he added. "My view is, 3.8% is certainly possible but I think the risks are on the higher side of that," he said.

Additionally, the median unemployment rate in those projections went up to 4.1% which is only just slightly above FOMC officials' view of full employment, he said, suggesting the need for more slack in the economy to fight inflation.

"And yet inflation went magically down close to 2%. So it was a very benign forecast, there was virtually no pain in that forecast," Dudley said.

"The September forecast needs to be more realistic about the pain involved and I think it needs to be more realistic about how this is going to take longer."

Dudley said one key aspect of Powell's remarks was that he did not try to sugarcoat possible economic outcomes.

"There was no discussion about how things could turn out to be more benign. He didn't quite use the r-word but he talked about pain," he said. "And that's one of the first times he's talking about that. Before he'd emphasized a soft landing is still possible, there's still a path, [and] there was none of that this time."

MNI INTERVIEW: Fed's Harker Wants Rates Above 3.4% By Year-End (Pub Aug 25, 2022)

By Pedro Nicolaci da Costa and Jean Yung

Philadelphia Fed President Patrick Harker on Thursday told MNI the U.S. central bank should raise its benchmark interest rate above 3.4% by December to combat soaring inflation, adding that rates could continue rising next year or hold at that level for some time.

The Fed has moved aggressively this year to lift the fed funds rate to a 2.25% to 2.5% range, with another 50 basis point or 75 basis point hike expected next month as its preferred PCE inflation gauge climbed to 6.8% in June, a four-decade high.

"I'd like to see us get to a clearly restrictive stance by the end of the year -- north of 3.4%, which was the median in the last SEP -- and then maybe continue to increase depending on the data, or just sit there for a while," Harker told MNI's FedSpeak podcast on the sidelines of the Kansas City Fed's annual Jackson Hole Symposium.

As for the size of the September rate increase, Harker said he's reserving opinion until all the data are in hand. "We often think now because of the 75s that a 50 is not impactful," he said. But "a 50 basis point move is still very substantial."

SIT AT RESTRICTIVE

The current level of rates is likely in the "long-run or medium-term neutral range," Harker said, but "because of where inflation is, we have to rise above that."

Once rates get to a restrictive stance, Harker said he wants to give monetary policy time to work through the economy. "I'd like us to get up to a restrictive stance and then sit there for a while before we consider cutting rates to let this work." (See MNI INTERVIEW: Fed's Bullard-Rates Could Be 'Higher For Longer')

Monetary policy can put a lid on demand, even as supply chain bottlenecks limit the Fed's ability to bring inflation down, Harker said. Labor markets remain tight with a record number of job openings.

As rates rise, the unemployment rate "will rise, but I don't see it rising to where some people have said, say, 5%. That's always possible but I don't think it's probable at this point."

GLIMMERS OF HOPE

Harker expects headline PCE inflation to end the year at 5.5% and core inflation to stay above 3.5% this year and next.

The July CPI report offered "glimmers of hope" as price rises eased to 8.5% from 9.1% a month earlier, Harker said. "We still have a long way to go to get inflation under control."

Harker wants to see continued decreases in the pace of inflation as well as a steady decline in the number of product categories registering above-5% inflation. "We'll see how the data evolves over the next two months, three months, four months," he said. "This is going to take some time."

MNI INTERVIEW: Kohn Sees Upside Risks To Fed Funds Rate Peak (Pub Aug 23, 2022)

By Pedro Nicolaci da Costa

WASHINGTON (MNI) – Federal Reserve policymakers could be forced to raise interest rates more than their own forecasts and market expectations suggest because of persistent inflation pressures and a strong labor market, former Fed Vice Chair Donald Kohn told MNI.

Fed officials in June said rates were likely to peak around 3.8% and investors now see them topping out at 3.75% in March of 2023. Kohn told MNI’s FedSpeak podcast that “sticky” inflation pressures raised the chances that fed funds might need to go even higher.

“There are upside risks on inflation relative to what the market has and relative to what the Fed had. So there are upside risks to the funds rate relative to what the Fed saw in the June meeting,” Kohn said. (See MNI INTERVIEW: Fed's Bullard-Rates May Be 'Higher For Longer')

His concern about lingering inflation pressures hinges on the strength of the labor market, which saw employment growth surge by another 528,000 jobs in July while the jobless rate fell to 3.5%, matching a 50-year low.

“My concern is inflation will be sticky because labor market tightness will be sticky,” Kohn said. “The labor market remains extremely tight, vacancies are still very high, the unemployment rate is below most estimates of the natural rate. Wages are increasing rapidly, much more rapidly than is consistent with the 2% inflation goal.” (See MNI INTERVIEW: Wages Hotter Than Labor Dept Data-Atlanta Fed)

Kohn said the Fed would be “lucky” to get PCE inflation, which climbed to another 40-year high of 6.8% in June, down to between 4% and 5% by year-end.

“The real issue is whether it’s going to go all the way back to 2% over the next couple of years without a fairly substantial increase in the unemployment rate putting some slack into the economy,” he said.

JACKSON HOLE

Kohn said investors expecting some kind of firm signal on the direction of policy from Fed Chair Jerome Powell’s keynote speech at this week’s Annual Jackson Hole Symposium would be disappointed.

“He will deliberately stay away from anything that looks like a dovish pivot," he said. “He’ll emphasize again their determination to get inflation back to 2% and to do whatever it takes to get there. He doesn’t want any doubt in the minds of consumers, business people, market participants, that the Fed is determined to get inflation down.”

Powell would also not likely tip his hand on whether the Fed will slow the pace of rate hikes in September down to 50 basis points from 75 basis points in its last two meetings.

“At some point they need to step down those increases to a more sustainable pace -- 150 basis points in the last couple of meetings is outside my experience, at least post-1982,” said Kohn, who spent 40 years at the central bank and is now a senior fellow at the Brookings Institution. “But whether that’s going to be September or not I think the incoming data will let them know.”

RECESSION CHANCES

Kohn said that while the unemployment rate clearly needs to rise in order to get inflation down to the Fed’s 2% target, this might still be accomplished without driving the economy into a full-fledged contraction.

“They can make this happen without a recession but it will require slow growth and a rise in unemployment to take pressure off the labor markets,” he said. “That gets to be a very delicate balancing act. Very slow growth can tip into recession because of developments not only in monetary policy in the U.S. but global developments on the supply side.”

MNI: Inflation Expectations Drop On Gas Little Comfort For Fed (Pub Aug 22, 2022)

By Evan Ryser

WASHINGTON (MNI) - Consumer expectations for inflation have shown tentative signs they may turned down from peaks reached earlier this summer but the easing provides little comfort since the moves are primarily due to a fall in gas prices that may still prove volatile, regional Fed bank economists and outside advisers told MNI.

"It seems like there may be some evidence that we're past a peak, but in an absolute sense, these short term inflation expectations measures are still very high," said Ed Knotek, a senior vice president and associate research director at the Cleveland Fed.

As households' expectations about future inflation can influence realized inflation, the turn in survey respondents' price expectations in the Indirect Consumer Inflation Expectations measure, the University of Michigan's Survey of Consumers, and the New York Fed's Survey of Consumer Expectations from very high levels is positive, even if predicated heavily on gas prices.

"I view the decline that we've seen there recently as really reflecting the moves in gasoline prices," said Knotek. "And in some sense, I wouldn't be surprised if that helped push down some of those longer term inflation expectations measures too."

ELEVATED DISAGREEMENT

Consumer surveys comprise thousands of responses, and policymakers have historically put focus on the median household response, but surveys are also now showing historically elevated disagreement.

The Michigan survey shows the 25th and 75th percentile of longer-term inflation expectations is the widest it's been since the late 1980s and the New York Fed's consumer survey is realizing a similar phenomenon.

The current and former Fed economists expressed little surprise by the increased dispersion, and pointed to uncertainty around the forecast mean.

"The dispersion can be due to many things and you do notice that it rose much earlier before any tightening had started" from the Fed, said Raphael Schoenle, former deputy director of the Cleveland Fed's Center for Inflation Research. "This reflects huge uncertainty and how persistent that is."

Michael Weber, an outside adviser to the Cleveland Fed, said mean expectations might be less interpretable now and might be worse as an indicator relative to the signals from the wider array of responses. "Looking at the uncertainty and understanding where it comes from, it's certainly still very useful for the Fed," he said.

NEED A TREND

The University of Michigan and New York Fed surveys also show more respondents viewing deflation on the horizon, primarily due to an uncertain outlook while a minority of economists pointed to elevated recession risks. (See: MNI INTERVIEW: U.S. Consumers' Price Expectations Soften - UMich)

Uncertainty around inflation, supply chains, the pandemic domestically and internationally all can contribute to the idea that there will be deflation, a New York Fed economist who's studying the issue told MNI. About a quarter of respondents in the NY Fed survey see deflation three years ahead.

Still, the economists said they'd like to see a more persistent fall in inflation expectations and it's "reasonable" to expect the dispersion to decrease as inflation prints begin to fall toward the Fed's 2% goal.

"Just relying on the situation that gas prices have come down somewhat is no indication to me at all that you should actually relax and lean back and can conclude victory," said Weber. "You want to see a broad-based decrease and a sustained decrease in the end."

Schoenle agreed preliminary indications are going in the right direction for policymakers. "But you want to see more of a trend," he added.

MNI INTERVIEW: Banks Face Mounting Risks As Fed Hikes -Hoenig (Pub Aug 19, 2022)

By Pedro Nicolaci da Costa

WASHINGTON (MNI) - U.S. bank balance sheets could come under rising pressure as the Federal Reserve lifts interest rates and asset values decline because lenders are not as well capitalized as regulators maintain, former Kansas City Fed President Thomas Hoenig told MNI.

Hoenig, also ex-vice chair of the FDIC, said in the latest episode of MNI's FedSpeak podcast that improvements to bank capital regulation since the last financial crisis were not enough to make him comfortable about the state of the banking system.

"If the Federal Reserve raises rates sufficiently, to or above 4% by the end of the year and they stick to quantitative tightening, then I think you will have downward pressures on asset values of all kinds. I think that's where the banks will feel the effects," he said.

"It's not just in the shadow banks because the largest commercial banks and some of the largest regional banks fund the shadow banking sector and that will come back on their balance sheet."

QT RISKS

He said financial markets have not yet fully appreciated the effects of the Fed's quantitative tightening program, which aims to reduce the USD9 trillion balance sheet fairly rapidly. (See MNI: Recession Could Force Fed To End QT Early-Ex Officials)

"I know the regulators say the largest banks are so much better capitalized. When you look at their leverage ratio and you think about liquidity tightness and you think about asset quality, their leverage ratio is 6%. That's not an overly impressive leverage ratio," adding that he would prefer to see a ratio around 8% or 9%.

Hoenig acknowledged risk-weighted capital ratios are closer to 13% but added that these could not be relied upon as a long-run measure of financial strength.

"As we learned in the financial crisis, risk-weighted capital becomes secondary in a crisis. Only leverage matters and the leverage ratio matters, and I think 6% is marginal," he said. "It will I think be tested if the economy runs into confidence issues, if the rates rise sufficiently that it does begin to pressure down asset values, then I think the test of adequate capital would be forthcoming."

HIGH RISK OF RECESSION

Hoenig said he sees the strong likelihood of a U.S. recession next year if the Fed is serious about bringing down inflation, which slipped to 8.5% in July but remains close to a 40-year high. (See MNI INTERVIEW: Fed's Bullard-Rates Could Be 'Higher For Longer')

"I haven't really witnessed too many adjustments coming down from 8.5% to 2% without a recession," he said. "I think the probabilities of a recession are fairly high." He thinks inflation will end the year around 6% to 6.5%.

Hoenig, who as head of the Kansas City Fed hosted the annual Jackson Hole Symposium for 20 years, said he doubts Fed Chair Powell will commit to a 50bp or 75bp rate hike at the September meeting given that there will still be additional data on inflation and jobs before then.

"I just can't imagine they've made up their mind at this point," he said.

The easing of financial conditions seen since the softer-than-expected CPI print last week makes policymakers' jobs harder, Hoenig said, adding that's partly the Fed's fault because it previously flinched in the face of modest economic weakness and financial distress.

"It's a statement in the sense of the Fed's perceived credibility with the market. The Fed is saying inflation is the No. 1 goal and they're going to bring it back to 2%, and yet there's this view that they will reverse fairly quickly," he said.

The minutes also showed some concern about overtightening, which prompts investors to start pricing in the prospect of rate cuts rather quickly after interest rates peak, he said.

"When you give mixed messages the market is going to read it favorably, and that's because the Fed has changed directions fairly consistently," he said, citing the repo scare of 2019 and the 2018 pause in hikes.

MNI INTERVIEW: US Labor Force 'Missing' 2.5M Workers - KC Fed (Pub Aug 17, 2022)

By Evan Ryser

WASHINGTON (MNI) - Around 2.5 million workers are "missing" from the U.S. labor force, a figure that's increased half a million since May, Federal Reserve Bank of Kansas City senior economist Didem Tuzemen told MNI.

"We have lost people from the labor force since March," she said. The decline in the size of the labor force has been driven by "missing" workers, who may yet return, rather than demographic factors such as slower population growth and an aging population, she said in an interview.

Using data from the U.S. Census Bureau's Current Population Survey, Tuzemen estimates the size of the U.S. labor force if it had continued to grow at its 2015–19 trend during the pandemic then discounts both slower population growth and the aging of the population. She estimates that as of July the missing labor force is now around 2.5 million.

"If we had stayed in the 2015-2019 labor force trend or population growth trends, and also if there was no aging, then we would have around half a million more people in the labor force," she said. "Slower population growth and aging of the labor force or the population means that 1.5 million people would not be in the labor force regardless."

Weaker population growth is also related to slowing immigration, she said, citing work by University of California, Davis's Giovanni Peri showing that about 2 million foreign-born workers are "missing" today. (See: MNI: Low Immigration To Keep Lid on Labor Supply -Fed Staffers)

LABOR SUPPLY

Currently, individuals age 65 and older make up the majority of the missing labor force as their labor force participation rate has remained persistently below pre-pandemic levels throughout the recovery, she said. "It's still the older individuals that make up the majority of the missing labor force."

Increases in the size of the aggregate labor force in the near term will depend on the pace of recovery in the labor force participation rates of these older groups and further increases in the prime-age labor force participation rate, which had been on an increasing trend in the 2015–19 period. The labor force participation rate has fallen 0.3 percentage points since March to 62.1% today, from 63.4% before the pandemic.

"The main reason why the labor force is now below the pre pandemic is because labor force participation rates of different demographic groups are below their pre pandemic levels," she said. "We really need all age groups for people to participate more in the labor force to get somewhere close to the pre pandemic levels."

Goldman Sachs economists say some cyclical recovery in prime-age labor force participation over the next year could contribute about a third of a percentage point to the overall labor force participation rate. But over the long run they expect the rate to decline in line with demographic trends, mostly due to population aging, slipping to 62.0% by the end of 2024, and 61.8% at the end of 2025.

Tuzemen declined to offer forecasts on the participation rate and on what millions of missing workers could mean for wage pressures going forward, noting the need to see how labor demand fares. An update to the Kansas City Fed's Labor Market Conditions Indicators index released last week showed momentum in the labor market continuing to ease but remaining above its longer-run average.

MNI INTERVIEW: Fed To Hike More Than Markets Expect–Goodhart (Pub Aug 16, 2022)

By Pedro Nicolaci da Costa

(MNI) - The Federal Reserve will likely raise interest rates substantially more than markets are pricing in because inflation will prove stubborn even amid slowing economic activity, former long-time Bank of England member and adviser Charles Goodhart told MNI.

Wall Street is betting the fed funds rate will peak around 3.6%, while Fed officials have signaled rates will end the cycle around 3.8%.

“The problem is that you won’t get inflation back to target unless you get wage growth back to a consistent level,” Goodhart said in an interview. “And it will take quite a lot more to get wage growth down, which is one of the reasons that a recession is likely to be deeper than the Fed indicates.”

The U.S. inflation surge seen over the past year took a breather in July on the back of lower energy prices with annual CPI dipping to 8.5% from a 40-year high of 9.1%. Price pressures are sufficiently widespread and persistent that inflation will likely end the year around 6% to 7% – more than three times the Fed’s 2% target, Goodhart said.

Official rates will have to go “a lot higher than appears to be the case at the moment in market expectations. Take market expectations and you add on something like 1.5% to 2%,” he said. (See MNI INTERVIEW: Fed’s Bullard-Rates Could Be ‘Higher For Longer’)

MISGUIDED EMPLOYMENT ASSUMPTIONS

The Fed’s hope for a soft landing appear misguided given that tamping down wage growth requires a higher jobless rate of at least 4.5% or 5%, he said. The unemployment rate fell in July to 3.5%, matching a 50-year low.

“The rate of growth of real output has been slowing down, partly as a result of the hikes in interest rates, but the labor market remains fairly tight,” said Goodhart. “The Fed is making weird, wild assumptions about the steepness of the Beveridge curve, which are unlikely to be realized.”

Goodhart, author of an influential recent book arguing reduced global labor supply will lead to higher cost pressures, cited the debate between Fed economists and outsiders including former IMF chief economist Olivier Blanchard and former Treasury Secretary Larry Summers.

“When it comes to discussing macroeconomics, trying to go against Blanchard and Summers is not a very sensible idea,” he said. “One of the questions is when is the Fed going to realize that it’s going to take more in the way of (slowing) which will require further interest-rate increases to turn the labor market around significantly.”

QT OPTIMISM RISKS

Reducing the Fed’s USD9 trillion balance sheet might also be rougher than officials hope, Goodhart said. (See MNI INTERVIEW: Market Strains Could Ramp Up QT Effect)

“The spat or worse between China and the U.S. being on the rise, the Chinese are beginning to worry about their vast holding of Treasuries,” he said. “If you’ve got a combination of QT and some of the foreigners withdrawing funds, you could at some point get a break in the T-bond market. It hasn’t happened yet. I find markets still excessively optimistic.”

MNI INTERVIEW: Wages Hotter Than Labor Dept Data- Atlanta Fed (Pub Aug 12, 2022)

By Jean Yung

WASHINGTON (MNI) - U.S. wages rose even more rapidly last month than the Labor Department's average hourly earnings metric would suggest, as workers remained in short supply, Federal Reserve Bank of Atlanta economist John Robertson said in an interview.

The Atlanta Fed Wage Growth Tracker, which monitors people who have stayed in their job for at least a year, was steady at 6.7% in July, a gain well in excess of the 5.2% increase in average hourly earnings indicated by Labor Department data. The tracker showed that people who took new jobs last month won an increase of 8.5%, up from 7.9% in June, and much higher than July’s 5.9% rise for stayers.

"The overall level of growth stabilized in July, but is still very strong and rising for job switchers," Robertson told MNI.

“The biggest story is still on the supply side. The labor force participation rate is still stuck at a lower level than pre-Covid, even among prime-age workers," he said. "The labor market still seems very tight."

SUPPLY OF WORKERS

The Atlanta tracker has rocketed higher since May 2021, when it was at the pandemic low of 3.0%. It is now seeing the fastest rate of increase since data began in the early 1980s. The Labor Department's Employment Cost Index, which controls for changes in labor composition by looking at a set basket of jobs every quarter, showed private sector wages picking up to 5.7% in the second quarter, the fastest since 1982.

Demand for workers is very high but it's where it should be had the five-year trend prior to Covid continued, Robertson said. "The thing that’s created the gap is the supply side. It hasn’t recovered at all. And every month that it doesn't recover makes you think maybe it won’t recover in the way we thought."

"The longer it goes on, the more permanent it looks," he added. "The Fed needs to put more weight on easing the demand side to give supply time to catch up."

MUDDLED PICTURE

Rapid wage growth is one part of the labor market story, but the overall picture is more complicated, Robertson said.

"You have wage growth still strong, but you do see from JOLTS data that the number of vacancies is starting to come down, which suggest excess demand is easing for workers. That would be consistent with some softening in wage pressure," he said. "But payrolls coming in at over 500,000 last week, which would be consistent with demand being very strong, and the unemployment rate moving to 3.5%, an all time low."

"Right now it’s a very muddled picture of the labor market," he said. "We have to keep monitoring the data very closely to find a balance where demand starts to ease enough."

Initial jobless claims have drifted higher over the past several weeks, but JOLTS layoffs figures haven't budged from low levels. At the same time, the JOLTS quits rate has stabilized, consistent with some easing in labor market conditions, Robertson noted.

"It's hard to draw any strong conclusion about the state of the labor market. The data are not speaking with one voice." (See MNI: U.S. Staffing Firms Say Job Openings Data Inflated)

MNI INTERVIEW:Fed's Bullard-Rates Could Be 'Higher For Longer' (Pub Aug 9, 2022)

By Pedro Nicolaci da Costa and Jean Yung

WASHINGTON (MNI) - The Fed will be prepared to hold interest rates "higher for longer" should inflation continue to surprise to the upside, and market pricing will need to adjust accordingly, Federal Reserve Bank of St. Louis President James Bullard told MNI Tuesday.

"I was a bit hoping that we could get (rates) to 3.75% to 4% this year and then sort of see what was happening during the winter, in the first quarter of next year, and make a judgment at that point about whether more rate increases were needed," he told the MNI FedSpeak podcast. "If we do get inflation slowing down, then we may be able to hold the rate at that higher rate for that period of time."

But with inflation topping forecasts time and time again, "It's certainly possible we could continue to get surprised to the upside here. And if that's the case, we'll have to be higher for longer, and the market has to price that in."

U.S. CPI soared 9.1% in June, several tenths above market expectations and marking a fresh four-decade high. July data, due Wednesday, is expected to ebb after energy prices have retreated. (See MNI: CPI Shortens Odds Of 75BP Hike In Sept.-Ex-Fed Staffers)

“It’s too early to make the claim" that inflation has peaked, he said, adding it's "disconcerting to not see equal amounts of betting on either side." Investors overwhelmingly believe that inflation will come down in short order, but "if you look at the track record over the last year, that has been a bad bet."

FRONTLOADING

Whether the Fed lifts rates by another unusually steep 75 basis points or in September is "a tactical decision" to be made with more CPI and jobs reports in hand, Bullard said.

"I have liked frontloading rate hikes, and I continue to think that we'll have to get to 3.75% to 4% by the end of this year. Whether we want to do more in the September meeting and less in later meetings or spread it out evenly is a tactical decision," he said.

“I think the destination is a little bit higher than what I would have thought even a couple months ago because inflation has continued to broaden out and doesn't look like it's turning the corner at least based on the evidence we have today.”

A good indicator of underlying inflation, the Dallas Fed Trimmed Mean gauge, has risen "straight up" since the fourth quarter and now sits at 4.3%. "We need to put downward pressure so that a measure like that is turning around in a convincing way and moving lower toward our target or 2%," he said. "I'd like to see that stabilize or come lower by the time we get to the end of this year."

Headline inflation numbers will continue to be important to watch, as well as anecdotal reports from firms, Bullard said. "I'd especially like to see firms worried that if they increase prices, they're going to lose market share, perhaps permanently, or even ruin their business by increasing prices too far."

NO RECESSION

The U.S. is not in a recession now, predictors of future recession chances may not be straightforward, Bullard said.

The economy added 2.7 million jobs in the first half of the year and unemployment has been falling. That employers added 528,000 jobs in July was above anyone's expectations, including his own. "The jobs data is wildly at variance with the idea that we're in recession," he said.
“So these are just not recession numbers as far as the labor market is concerned."

The inverted yield curve, which some say could predict a slowdown, may be due to the idea that markets think inflation will be high a year or two from now but fall further out, Bullard said.

MNI INTERVIEW: Fed Funds May Need To Reach 7% Or More-Levin (Pub Aug 8, 2022)

By Pedro Nicolaci da Costa

WASHINGTON (MNI) - High and persistent inflation will force Federal Reserve policymakers to raise interest rates much more than they are currently projecting, perhaps nearly twice as much, ex-Fed board economist Andrew Levin told MNI.

Fed Chair Jerome Powell said in his July press conference that the June Summary of Economic Projections, which shows the federal funds rate peaking at 3.8%, was still the best guide available for where official interest rates are headed.

But that view is too sanguine because it is unclear that inflation has peaked and, even if it has, any decline will likely be choppy and slow, said Levin, a former Fed board economist for two decades until 2012, including two years as a special adviser on monetary policy strategy and communications.

“The more likely scenario is that core inflation continues running in the neighborhood of 5, 6, 7%, and really to bring inflation down the Fed is going to have to raise the federal funds rate up to 5, 6, 7% or more,” he said in an interview. “The longer this goes on the harder it’s going to get because the more entrenched the expectations are in the wage- and price-setting behavior.” (See MNI: CPI Shortens Odds Of 75-BP Hike In Sept-Ex Fed Staffers)

One of the problems, Levin said, is that the Fed sees itself as already having raised rates to an effectively neutral level, even though rates are deeply negative when adjusted for inflation.

“If inflation is running at 7 to 8% then they want cost of living increases of 7 to 8%, and then it’s very hard for firms to raise their prices by much less than 7 to 8% and you just get the same cycle that we had in the 60s and 70s,” he said. “What that means is the markets are probably totally wrong and that probably by this fall it will be clear the Fed still has a long way to go.”

Levin said the Fed is not being straight with markets, which raises its own set of dangers.

“There’s a chance here that the markets are going to totally lose confidence in the Fed and that will make things go even more haywire,” he said.

LABOR MARKET PAIN

Making matters worse, despite real rates still at negative levels, Levin said that it’s not accurate to say the labor market is too tight despite stronger-than-expected monthly job growth such as that registered in July. He said the Fed seems to have forgotten about its new framework language focused on “broad and inclusive” employment, adding that workers are set to pay much of the price of the hikes to come.

“We’re not really at maximum employment, it’s not accurate to say the labor market is overheated,” Levin said, noting that wage increases are not keeping up with inflation.

“It’s true that the unemployment rate is low on average, but just like in the past it hasn’t fully reached some groups within the economy and there are still people out of the workforce where if things continue to improve hopefully

labor force participation would continue to recover," he said. "If the labor market were overheated we'd see wages growing faster than inflation, that's definitely not what we're seeing."

By claiming the job market is too hot, the Fed is effectively asking workers to make sacrifices, Levin added.

"They should hold down on their wage increases and that's how we're going to manage to reduce inflation, by having workers hold back on their cost-of-living increase," he said.

"We're probably in for a tough period ahead. We might have to have shortfalls from maximum employment for a while in order to get inflation down. I'm not arguing against that," he said. "But like a good doctor, they have to be honest with the patient's family."

MNI: Recession Could Force Fed To End QT Early - Ex Officials (Pub Aug 4, 2022)

By Jean Yung and Evan Ryser

MNI (WASHINGTON) - A recession next year would force the Federal Reserve to consider slowing or stopping the run-down of its massive asset portfolio long before bank reserves approach their equilibrium level, though any decision to alter course would not be made lightly, former Fed officials and ex-staffers told MNI.

"Conceivably sometime in 2023 they'll need to cut rates, so it's quite plausible that economic circumstances could also raise questions about what to do with the QT program," former Atlanta Fed President Dennis Lockhart said in an interview.

"They're reluctant to pause that normalization process or reverse it prematurely if that can be avoided," he said. "The first principle for rates and balance sheet policy is to avoid inconsistency."

RECESSION PREDICTIONS

Markets are pricing in a first quarter-point cut for the Fed's benchmark overnight rate by July 2023 after it peaks at 3.4% in February, and a second cut by December 2023. The fed funds rate is currently trading in a 2.25%-2.5% target range.

"The Fed's QT program could end by late next year, and it would easily be in the cards if the economy slows enough, even if the Fed isn't reducing the funds rate," Ellen Meade, a former senior adviser at the Fed board now at Duke University told MNI.

But she added that a pause in bond runoffs would create the expectation that a rate cut is on the table. "The FOMC would be blowing up ordering and messaging it took great pains to create, although that doesn't mean it couldn't happen."

But if the economy were to slow below-trend without entering recession, "they're more likely to leave rates unchanged. And if they're doing that, their inclination would be to continue QT," said Bill Nelson, chief economist with the Bank Policy Institute and a former deputy director of monetary affairs at the Fed Board.

He judged that even in a mild recession the Fed could just hold rates steady and allow QT to continue.

TREASURY MARKET

A 2023 conclusion to QT would leave the Fed with a much larger balance sheet than desired, shaving just a little over USD500 billion from the current USD3.3 trillion of bank reserves, according to the New York Fed's May projections.

That's significantly above estimates of the minimum comfortable level of cash needed in the banking system, but investors and former policymakers worry that QT could still prompt periods of disruptions in funding markets amid concerns over worsening bond market liquidity.

"If market conditions really deteriorated a lot, I could imagine they could say okay, we're going to throttle back on QT, but I think it would take a lot," said William English, former director of monetary affairs at the Fed Board and secretary to the FOMC.

"The Fed would like very much to not have QT on the agenda and have to talk about it and make ongoing adjustments and so on."

MNI INTERVIEW: Tantrum Risk Rises As Fed Resets- Ex-Researcher (Pub Aug 4, 2022)

By Greg Quinn

MNI - The Federal Reserve will face a greater risk of sparking market volatility as it continues to tighten policy to fight inflation even as the economy slows, former Fed visiting scholar and MIT professor Ricardo Caballero told MNI.

That danger runs against recent clarity from policymakers playing catch-up against big price gains according to Caballero, who has done research at the Fed's main board and the Boston branch of the central bank.

"Tantrum risk will rise substantially once the tradeoff between activity and inflation becomes more balanced," Caballero said. "Stay tuned."

The MIT economics professor is studying mismatches between Fed and market outlooks, arguing that ideally the FOMC incorporates some investor views and gradualism into its actions to blunt any miscalculations.

"They were doing a great job early on, both during the worst of the Covid shock and the early stages of the recovery," he said by email. "The Fed was constantly communicating its plans to the market. The problem was of a different nature: they just fell behind the curve, so they could no longer afford that gradualism."

STOCK MARKET DISAPPOINTMENT

Debate has shifted to a potential recession as the FOMC upped rate hikes to 75 basis points at the last two meetings. Officials say they could tighten another 75 at the next meeting, one of the steepest tightening campaigns in decades.

But slowing inflation from around 9% now may lift record low unemployment and bring questions about meeting the Fed's maximum employment goal. The job market could also be weaker than officials expect based on what could be misleading vacancies data, ex-Bank of England MPC member David Blanchflower has told MNI. (See MNI INTERVIEW:US Jobless Rate Masks Slack – Blanchflower)

"We are going through a very complex scenario, where there is much more scope for disagreements than we are used to," Caballero said. "One lesson from our papers is that by becoming very data-dependent, the Fed implicitly tells the market that if they make a mistake, it won't last for very long. This stabilizes the impact of potential mistakes."

Bond investors are still pricing in tame longer-term views of inflation, with 10-year Treasuries yielding 2.79% Wednesday morning. Economists at ING argued Tuesday the Fed will find it hard to keep hiking its fed funds target rate, now at 2.25%-2.5%, and "there is no modern example" of continually taking it higher than the 10-year bond yield.

Stock investors may also be in for an unpleasant surprise, Caballero suggested. "The equity market seems to be taking the news from the bond market as good news, without pausing to think about what the Fed may have to do

to the economy," he said. "Unless we get lucky with commodity prices and supply chain bottlenecks, which may well happen, inflation may be a lot harder to tame than the equity market is assuming."

MNI INTERVIEW: US Jobless Rate Masks Slack -Blanchflower Paper (Pub Jul 29, 2022)

By Pedro Nicolaci da Costa

WASHINGTON (MNI) - The U.S. job market is weaker than Federal Reserve policymakers believe because officials are focused on historically-low unemployment and a high vacancy rate, but neither is correlated with wage growth, according to forthcoming research ex-Bank of England MPC member David Blanchflower shared with MNI.

Fed Chair Jerome Powell told reporters this week that the labor market is “extremely tight,” pointing to rapid employment growth, a 3.6% jobless rate and a large number of job openings. He and other officials say this strength suggests the economy can avoid a recession despite rapidly rising interest rates.

“The labor market is not tight. The vacancy to unemployment ratio is negatively correlated with wage growth,” said Blanchflower, now a professor of economics at Dartmouth College and also a former visiting scholar at the Boston Fed. (See: MNI: U.S. Staffing Firms Say Job Openings Data Inflated)

The paper, set for publication by the NBER, argues that the low-cost nature of posting new jobs makes it “unclear there is any information in these data.”

“Vacancies tell us little about the number of hours under offer in the jobs, where they are and in what occupations,” the paper notes. “No information is available on the pay under offer in any vacancy. We have no idea where they are and in which occupations and how much of a mismatch there is with the unemployed.”

MEEK WAGE GROWTH

Blanchflower said his findings help explain why wage growth remained tame over a prolonged period of strong U.S. job growth, and why even recent gains have not kept up with inflation.

“Real wages are falling rapidly at present and, prior to that, real wages had been stagnant for quite some time,” he argues, adding that the unemployment rate “is not key to understanding wage formation in the USA and hasn’t been since the Great Recession.”

The unemployment rate is “irrelevant in the face of other variables which show you lots of slack,” he said, citing the nonemployment rate and the underemployment rate.

“The nonemployment rate is 4.6 percentage points below where we were in 2000 and the underemployment rate hasn’t mean reverted either, so two non-mean reverting variables explain wage growth,” the former policymaker said.

DEEP RECESSION

Blanchflower’s past work argued back in August 2021 that the U.S. economy would enter recession in January 2022 based on plunging consumer expectations about the future, well before there were any hints that GDP would register two quarters of contraction in the first half of the year.

He told MNI’s FedSpeak podcast last month that much of the world economy is already in recession.

He still thinks the downturn which he believes the United States has already entered could be deeper than the Great Recession, with unemployment rising into the double-digits in part because of lessened policy ammunition both on the monetary and fiscal fronts.

“The Fed can’t cut rates from 5% to zero. There are limits on what they can do on QE. What could Biden get through Congress on the fiscal side?” Blanchflower said. “The worry to me is that if you look at the decline in confidence it’s broadly comparable to what you saw in 2008 and the ability of the authorities to fix it is more limited.”