MNI Fed Preview: December 2022

***Note to readers:** MNI's Fed Preview is published the week prior to the FOMC meeting, with a separate preview of sell-side analyst summaries to follow in the week of the meeting.*

Meeting Dates: Tue-Wed, 13-14 December
Decision/Statement/Econ Projections: Wed 14 December at 1400ET / 1900GMT
Press Conference/Q&A: Wed 14 December at 1430ET / 1930GMT

Minutes: Wed 4 Jan

Links (likely URLs based on previous meetings):
Statement: https://www.federalreserve.gov/newsevents/pressreleases/monetary20221214a.htm
Summary of Econ Proj: https://www.federalreserve.gov/monetarypolicy/fomcprojtabl20221214.htm
Implement. note: https://www.federalreserve.gov/newsevents/pressreleases/monetary20221214a1.htm
Press Conference: https://www.federalreserve.gov/monetarypolicy/fomcpresconf20221214.htm

MNI Review of Previous FOMC (Nov): https://roar-assets-auto.rbl.ms/documents/20044/FedReviewNov2022.pdf

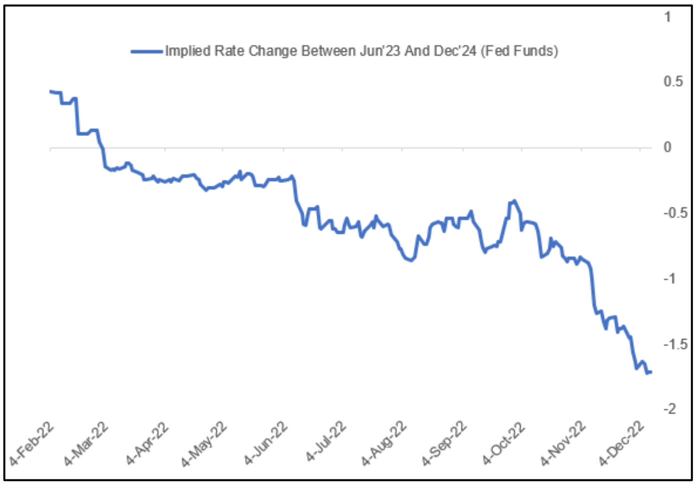
Contents

MNI POV (Point Of View): Forecasting The End

By Tim Cooper

- *The FOMC will step down the pace of rate hikes to 50bp at the December meeting.*
- *But it will likely signal via the Dot Plot that it intends to tighten by a further 75bp to a terminal rate above 5% in 2023.*
- *Chair Powell's Nov 30 speech has recession-minded market participants eyeing substantial rate cuts in 2023-24.*
- *This offers scope for Powell to push back against easier financial conditions at the post-meeting press conference.*

The FOMC will hike rates by 50bp at the Dec 13-14 meeting, with Chair Powell having cemented the step-down from a 75bp hike pace in his Nov 30 speech ("the time for moderating the pace of rate increases may come as soon as the December meeting"). This puts attention squarely on December's updated Summary of Economic Projections/Dot Plot, and in particular the 2023 rate hike outlook. Our expectations for the Statement and the new projections (including a 5.1% median 2023 Dot) are in separate sections below.



Return Of The Forecasters

The context for the December meeting is that Fed leadership sees inflation having already peaked and likely to keep decelerating, with monetary tightening working with a lag and economic growth remaining below trend. Chair Powell laid out a case in a Nov 30 speech – which will no doubt be reiterated at the December press conference – that while inflation remained high, the Fed was cautiously optimistic that core goods and housing services prices are set to see significant disinflation in 2023. This outlook helps underpin a step-down in the size of rate hikes from 75bp to 50bp, "as we approach the level of restraint that will be sufficient to bring inflation down". (Notably, Gov. Cook also made an optimistic appraisal of the inflation outlook on Nov 30.)

But "the timing of that moderation is far less significant than the questions of how much further we will need to raise rates to control inflation, and the length of time it will be necessary to hold policy at a restrictive level. It is likely that restoring price stability will require holding policy at a restrictive level for some time." This was the next step in the FOMC's change in focus which began at the November meeting, when Powell posed three questions for FOMC policy: "how fast to tighten policy", "how high to raise our policy rate", and "how long to remain at a restrictive level".

With these communications and a soft October inflation print in mind, the market has become less focused on the size of future hikes, and is even getting desensitized to estimates of the ultimate target. Markets have basically taken the first two questions as a combo: the downshift to 50bp in Dec as a prelude to the end of the hiking cycle not long thereafter, with potentially a further 50 to 75bp to follow in early 2023. Seemingly with Powell's blessing, and the FOMC's increased emphasis on the duration of time rates will spend at a soon-to-be-reached restrictive level, markets are now concerned largely with the third question, "how long to remain at a restrictive level". Pricing suggests that the expected answer is: "not very long". Treasury yield / swaps curves have inverted aggressively, while rate futures are implying a peak in rates below 5% by mid-2023 with 50bp in cuts the rest of the year. There are over 160bp in cuts priced by end-2024.

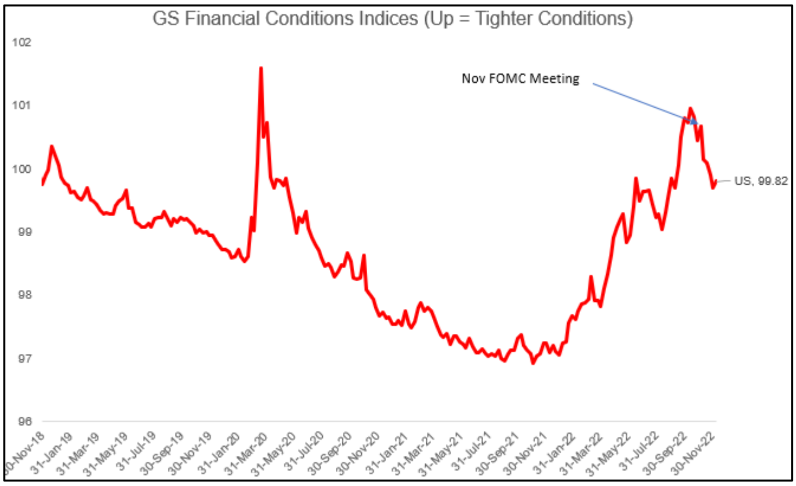
From The Guidance Phase To The Forecasting Phase

In this sense, we have moved beyond the guidance phase of the tightening cycle, to the forecasting phase. Part of the reason markets are now less concerned about a substantially higher terminal rate is that Powell highlighted the expectation that overall PCE inflation would abate next year as core goods prices continue to moderate, and housing inflation moderates (on the basis of private rental measures, which usually pass through to price indices with a long lag). While core goods prices had long been anticipated to come back to earth after a post-pandemic spike, one of the big reasons to expect the Fed to "overtighten" was that shelter prices were set to remain high through early 2023 at least. So if the Fed had continued to make policy based on incoming data, there would be good reason to expect hikes to continue well into next year. Indeed consider a counterfactual in which Powell signalled the Fed was looking for progress on incoming housing inflation data before softening its stance – terminal rate expectations would likely have crept well above 5%, rather than falling below 5% as they did.

Going from Powell's need for "clear and convincing" evidence with "a series of declining monthly readings for inflation" before slowing/stopping hikes, back to a regime of using forecasts as their main guide to policy, has both merits and drawbacks. It makes sense as the Fed reaches the top of the hike cycle, as the rapid tightening is yet to be fully felt, and with signs inflation is turning over, there is room to wait and see what happens. Over-tightening on the basis of lagging indicators is a recipe for a hard economic landing. But the drawback of relying on forecats is clear: part of Powell's stated reasoning for focusing on historic data was because previous forecasts underestimated the persistence and acceleration of post-pandemic inflation. Once again, on the basis of forecasts, the current high rates of inflation are seen as "transitory".

Will Powell Push Back?

Assuming Powell and the Fed are right on the goods and shelter inflation outlook (a big assumption), the major area of uncertainty is the labor market, which was the focus of the Chair's Nov 30 speech ("Inflation and the Labor Market"). The labor market is, in turn, the key to ex-housing services core inflation, which Powell has alighted on as the key to the outlook ("may be the most important category for understanding the future evolution of core inflation. Because wages make up the largest cost in delivering these services, the labor market holds the key to understanding inflation in this category.").



As we discuss in the economic developments section below, labor market conditions remain too tight for the Fed's comfort, with declining participation and accelerating wages. Employment is historically a lagging indicator, so it may be well into 2023 before Powell sees the kind of progress he is looking for (he cited 100k job gains as consistent w labor force growth, for example, less than half of November's pace).

The market pricing incorporates an expectation that the US economy will enter recession in the next year (consensus is over 60% probability, while yield curves are too inverted to suggest any other outcome), and that this will force the Fed to ease. Those expectations in turn are easing financial conditions, potentially to a degree that the FOMC will begin to find uncomfortable. The Fed will likely revise down its GDP growth forecasts and up its unemployment expectations for 2023 in December, but probably to something short of full-blown recessionary numbers.

How much will the Fed push back on market expectations at this meeting? Markets reacted to the Nov 30 Powell speech in a very dovish manner. Powell almost certainly knew what he was doing by implicitly condoning the easing in financial conditions since the November FOMC and October inflation print. Analysts had expected Powell to push back – he didn't. At the December meeting, there is likely to be a more forceful pushback in the press conference, particularly against the notion that the Fed is set to cut rates later in 2023. Whether the market will take such warnings seriously is another question, given that they've already heard those warnings before.

One way Powell can push back is merely by sounding less relaxed about the inflation outlook than he did in his Nov 30 speech and Q&A. He may re-emphasize the need for incoming data as important to confirm the disinflationary narrative, and remind that forecasts – particularly on the labor market – are uncertain. A more foreceful pushback would be a pledge that goes beyond maintaining policy at a restrictive level for "some time", perhaps by citing a foreseen need to do so for a "considerable" time for example (though that's probably unlikely to be pledged until they are near/at the terminal rate). At the very least, expect him to affirm that the FOMC has a "ways to go" and do not intend to cut rates by end-2023.

Statement: "Ongoing" Going Out?

(Link to November FOMC statement)

The forward guidance in the Statement underwent an unexpected revision in November, and will be eyed again in December for any more shifts.

Going paragraph by paragraph through the Nov statement in italics, with some potential changes highlighted:

"Recent indicators point to modest growth in spending and production. 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."

- **These paragraphs were unchanged in November** and are unlikely to be revised substantially in December.
- The first sentence of the statement is often tweaked to reflect incoming activity data, but it didn't change last time, and any amendments here (potentially reflecting slowing growth, in line with the most recent Beige Book) are unlikely to have market impact.
- **The inflation phrasing has been the same for several meetings and there is no obvious change required.** There is an outside risk they could dovishly acknowledge the slower pace of price growth while remaining elevated, perhaps with a nod to Powell's description of core goods prices heading lower but services inflation remaining high – but this will probably be reserved for the press conference where it can be given the nuance required.
- **At some point the reference to the Russia-Ukraine war will be removed** or included in a broader phrasing referring to global conditions impacting growth/activity – it's largely irrelevant to the overall message of the statement though.

"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 3-3/4 to 4 percent. The Committee anticipates that ongoing increases in the target range will be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent over time. In determining the pace of future increases in the target range, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments. 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."

- **The statement will reflect the rate hike to 4-1/4 to 4-1/2 percent.**
- **"Ongoing increases" is probably the most contentious potential change.** It entered the statement in March when the hiking cycle began, and its inclusion signalled an indefinite number of (multiple) future hikes.
- **Therefore, it's hard to see how this would be changed in a more hawkish direction.** But with the downshift in hike pace, and another 50bp to 75bp in total tightening likely to be signalled to the dots, it is possible this could be changed to "some further" increases, or even "further" increases.
- **Dovish possibilities include** "at least one" or "a" future increase or eliminating the sentence altogether (unlikely as it would suggest the immediate end of the rate hike cycle).
- **We are also looking for a potential enshrinement of what FOMC members have been saying about keeping rates in restrictive territory "for some time"** – Powell's Nov 30 speech contained potential language in this regard: "It is likely that restoring price stability will require holding policy at a restrictive level for some time."

- **This is particularly the case since the language inserted in November refers specifically to "determining the pace of future" hikes,** an aspect of policy that is actively being played down by the FOMC at this stage and doesn't really cover the next phase of policy (getting to terminal and holding). This probably needs to change, if not at this meeting, then by February, as the last few hikes are in sight.
- The FOMC won't change balance sheet policy anytime soon, so the latter half of the paragraph will remain intact.

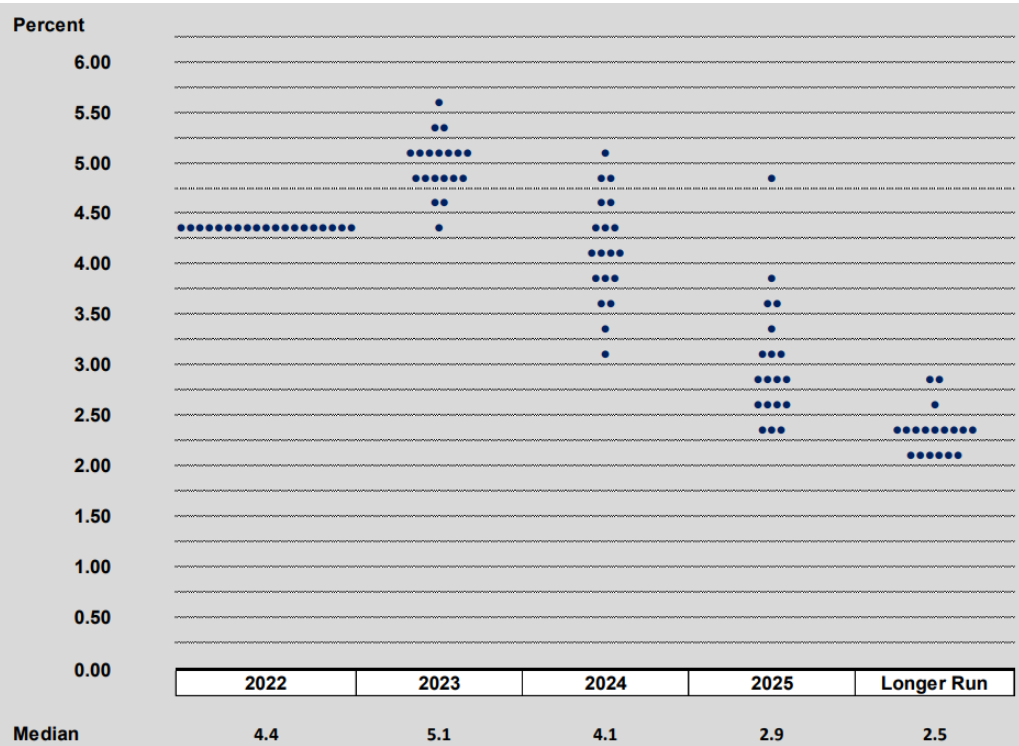
> *"In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment 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."*

- **No changes to this paragraph are expected**. At some point the references to "readings on public health" will be removed, as Covid infections are no longer a key driver of the outlook.
- **Dissents to the rate decision look unlikely**, with none of the voting members appearing to be in opposition to a step-down to 50bp.
- **In the Implementation Note,** we expect a parallel 50bp shift in all of the main administered rates, with IORB rising to 4.40% and ON RRP rising to 4.30%.

Dot Plot: How Much Is "Somewhat"?

The 2023 median will be the focus on the Dot Plot, as it will be taken as the FOMC's central expectation for the terminal rate (even though it's the end-year rate, so entries could theoretically reflect higher mid-year rates and end-year rate cuts). Since whatever that rate is, is expected to be reached by May, it's also likely to be a strong guide to how the FOMC currently views the next two decisions (Feb and Mar). The 2024 and 2025 Dots are of secondary importance, though will be eyed for how the FOMC views the scope for cuts once inflation subsides.

Our expectation is for the 2023 median to be raised 50bp to 5.1%, with 2024 up 25bp to 4.1%, and 2025 steady at 2.9%. **See chart below.**



The 2023 median is a close call. Sell-side analysts are almost evenly divided on whether the median will come out above or below 5% (which itself is the market-priced terminal rate). With Powell and the Nov Minutes pointing out that the estimate for the terminal rate has increased "somewhat" since the September projections, this depends partly on the meaning of that word. We think it suggests 25bp or 50bp, but probably not 75bp or more.

- **The hawks will be looking for at least 125bp more hikes, to a 5.00-5.25% range**, so 75bp beyond the Dec FOMC's 50. Bullard said based on the Taylor Rule, his minimum level is 5-5.25%. Waller eyed a possible "sequence" of 50bps hikes into 2023; Kashkari said his terminal rate was higher than the 4.75-5.00% he had expected in September. **On the more dovish end**, Bostic saw 75 to 100bp more tightening required (4.50-4.75% or 4.75-5.00%); Daly's terminal rate was "somewhere between 4.75-5.25%". Harker cited 4.50%.

- **Particularly given the strong labor market data since Powell's speech, we think there will be sufficient support for another 50bp in Feb and a further 25bp projected in March to warrant a 5.1% median projection.** The tie-breaker for us is that the FOMC medians have continually surprised consensus to the upside during this hiking cycle. Our projected Dot Plot has 10 above 5% and 9 below 5%, for a median of 5.1%, so even one participant switching to below 5% would flip the balance to a 4.9% median. A 4.9% median would probably be seen as dovish, with 5.1% taken hawkish. But the number of dots at the median may prove at least as important as the median itself in determining market reaction, as reflected in our Instant Answers.

The 2024 projection is seen as less meaningful than 2023's. But if the FOMC wants to reinforce a "higher for longer" attitude, they could point to fewer than 100bp in cuts (the last projections pointed to 75bp of cuts, albeit from 4.6% to 3.9%). We are pencilling in 100bp cuts to a 4.1% median, which is less cutting than the market is pricing**.**

For 2025, we would expect FOMC participants to see the funds rate remaining above the longer-run rate, with 2.9% likely unchanged from the September projections. For the Longer-Run Dot, no change from 2.5% is expected in this round of projections.

Here is how those expected dots compare to the September edition, with medians bolded (Longer Run dots mostly represent top of 25bp range in table; median is 2.50%):

Tgt Range	2022	Sept	2023	Sept	2024	Sept	2025	Sept	L-R	Sept
5.75-6.00										
5.50-5.75			1							
5.25-5.50			2							
5.00-5.25			**7**		1					
4.75-5.00			6	6	2		1			
4.50-4.75		1	2	**6**	2	2		1		
4.25-4.50	**19**	**9**	1	6	3	2				
4.00-4.25		8			**4**	2				
3.75-4.00		1		1	3	**4**	1			
3.50-3.75					2	3	2	2		
3.25-3.50					1	3	1	2		
3.00-3.25					1	1	3	4		
2.75-3.00						1	**4**	**3**	2	2
2.50-2.75						1	4	3	1	1
2.25-2.50							3	4	**9**	**9**
2.00-2.25									6	6
1.75-2.00										
1.50-1.75										
1.25-1.50										
1.00-1.25										
0.75-1.00										
0.50-0.75										
0.25-0.50										
0.00-0.25										

The major changes in the macroeconomic projections are likely to be:

- GDP growth upgraded for 2022 but downgraded for 2023.
- The unemployment rate forecast for 2022 might be nudged slightly lower, but tick higher for 2023-2024. (The longer-run unemployment rate is worth watching in this and future projections for any signs the FOMC is shifting toward seeing a higher NAIRU).
- 2022 core PCE is likely seen higher than it was in September, but we see potential for 2023 to remain flat/a tick lower, though could remain stubbornly high through 2024.
- MNI's expectations are below:

Percent

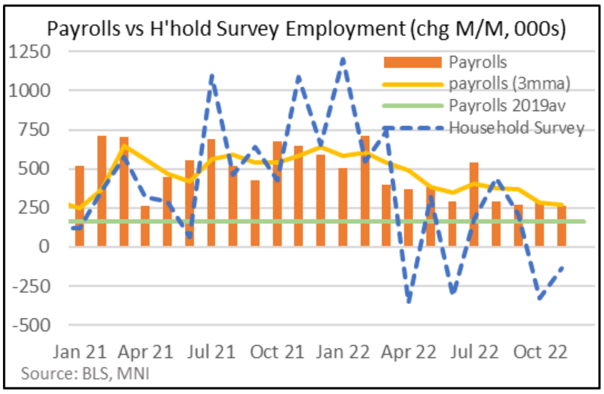
Variable	Median				
	2022	2023	2024	2025	Longer Run
Change in real GDP	0.4	0.6	1.6	1.8	1.8
Sep projection	0.2	1.2	1.7	1.8	1.8
Unemployment rate	3.7	4.5	4.5	4.3	4.0
Sep projection	3.8	4.4	4.4	4.3	4.0
PCE inflation	5.6	2.9	2.4	2.0	2.0
Sep projection	5.4	2.8	2.3	2.0	2.0
Core PCE inflation	4.8	3.0	2.3	2.1	-
Sep projection	4.5	3.1	2.3	2.1	-
Federal funds rate	4.4	5.1	4.1	2.9	2.5
Sep projection	4.4	4.6	3.9	2.9	2.5

Macro and Financial Developments Since The November FOMC

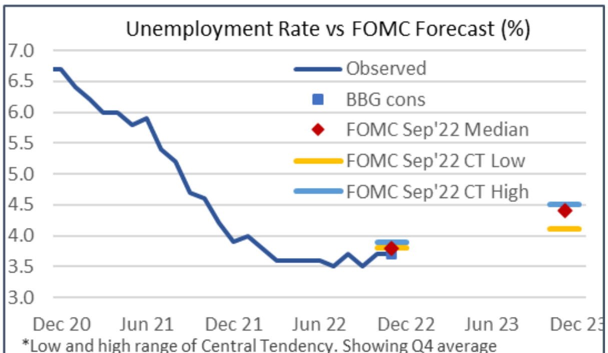
By Chris Harrison

The two payrolls reports since the last FOMC meeting have shown jobs growth continuing to moderate but at a pace that is too slow for the Fed's liking. That was made particularly clear by Chair Powell offering 100k as an equilibrium growth rate on Nov 30 before the November report beat expectations of 200k with 263k the following week. There is a caveat in that the separate household survey measure of employment has fallen in those two months and could be a sign that smaller non-payrolls businesses are under greater pressure, but the data are also typically more volatile and enjoyed a much stronger period through 2H21.

The still strong payrolls figures are more in keeping with the strength in average hourly earnings and their newfound upward trajectory after sizeable revisions in the November report. Average hourly earnings growth is now seen to have accelerated for the past three months, hitting 0.55% M/M for the fastest pace since January and non-supervisory employee wage growth faster still. There are as always compositional issues with AHEs whilst the latest Atlanta Fed Wage Growth Tracker held at 6.4% for three-month moving average of median wage growth. The next Employment Cost Index for Q4 is unfortunately not released until Jan 31 but further upward pressures could have increasingly hawkish implications. Either way, the strong rate of wage growth is in keeping with an unemployment rate of 3.7% holding close to historical lows and the recovery in participation stalling further.

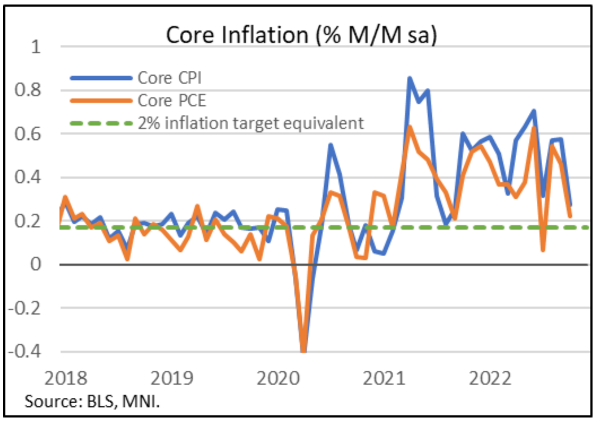


Source: BLS, MNI

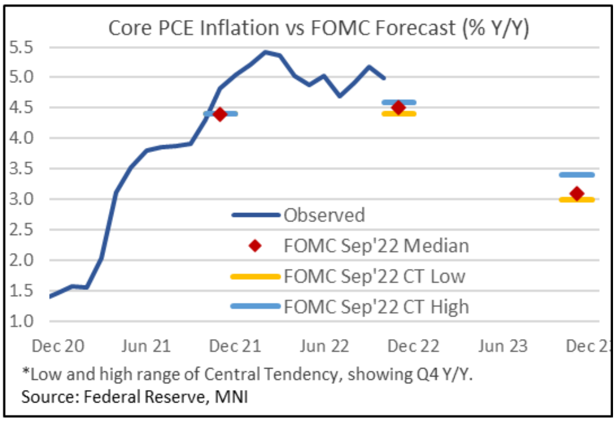


*Low and high range of Central Tendency. Showing Q4 average
Source: Federal Reserve, MNI

Falling between the labour reports and offering a relatively more dovish tilt was a significant miss for CPI inflation, compounded recently with an additional miss for core PCE inflation. Core CPI inflation slowed from 0.58% to 0.27% M/M. Contributions came from goods and services alike, the latter importantly from slightly larger than expected cooling in rents but also an idiosyncratic factor in health insurance. It saw markets view a 50bp hike on Dec 14 as locked in (from 57bps priced beforehand) and the terminal rate slid 15bps to 4.9%. It was however obviously just one release and FOMC members have both in the past and since warned about wanting to see multiple months of slowing sequential inflation, helping at the time push the terminal rate back above 5% in the following week. More recently, the CPI rise ended up translating to a 0.22% M/M increase in core PCE (consensus 0.3), getting closer to a monthly rate consistent with the Fed's 2% target but keeping July as the only month since Feb-2021 to have achieved that. The November release is due on the first day of the 2-day Fed meeting, but is unlikely to sway the decision and won't affect the projections.



Source: BLS, MNI.



*Low and high range of Central Tendency, showing Q4 Y/Y.
Source: Federal Reserve, MNI

Growth measures have been less eye-catching but have seen modest upward GDP growth revisions and surprising resilience in service surveys. Real GDP was slightly stronger than first thought at 2.9% annualized in Q3 (initially 2.6) thanks to upward revisions across final domestic demand components but at still subdued growth rates. It maintains a bounce back from the average -1.1% contraction through 1H22 and with the Atlanta Fed GDP nowcast pointing to a continued acceleration to circa 3.5% in Q4. At the margin but of note to some of the more hawkish FOMC members, Gross Domestic Income was surprisingly revised lower again and is seen increasing just 0.3% annualized in Q3. In more timely measures, the ISM services has been the most recent upside surprise, rising 2pts to 56.5 and showing no sign of the continued relative weakness in manufacturing (49.0). Details were more nuanced though, painting a picture of domestic strength vs foreign weakness as business activity, production and import indices surged but new export orders extremely weak at levels last seen in the depths of the GFC and pandemic.

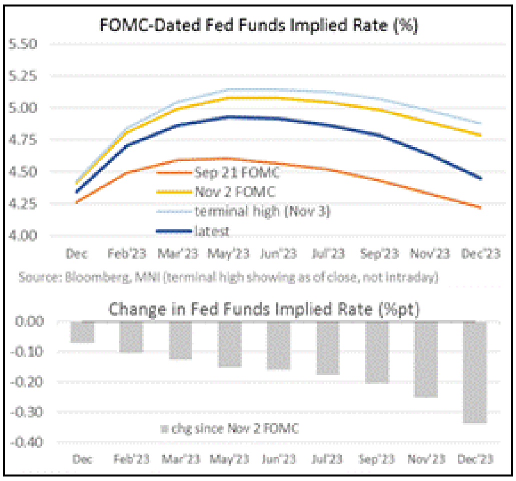
MNI Instant Answers:

The questions that we have selected for this meeting are:

- Federal Funds Rate Range Maximum
- Median Projection of Fed Funds Rate at End of 2023
- Median Projection of Fed Funds Rate at End of 2024
- Median Projection of Fed Funds Rate at End of 2025
- Median Longer Run Projection of Fed Funds Rate
- Number of 2023 dots > 4.875%
- Number of 2023 dots > 5.125%
- Number of 2023 dots > 5.375%
- Does the FOMC change the phrase "anticipates that ongoing increases in the target range will be appropriate"?
- Does the FOMC add policy will likely remain restrictive "for some time"?

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

The market continues to see a 50bp Dec hike as largely locked in (51bps) whilst being torn between a 25bp or 50bp hike to follow on Feb 1 (cumulative 88bp priced). Terminal Fed pricing has continued to fluctuate but currently sits at 4.95% (a cumulative 111bp of hikes) with perhaps the most eye-catching aspect for the Fed then cuts to 4.5% by end-2023. ***Updated Dec 7, 2022***

mni Central Bank Watch - FED

MNI FED Data Watch List

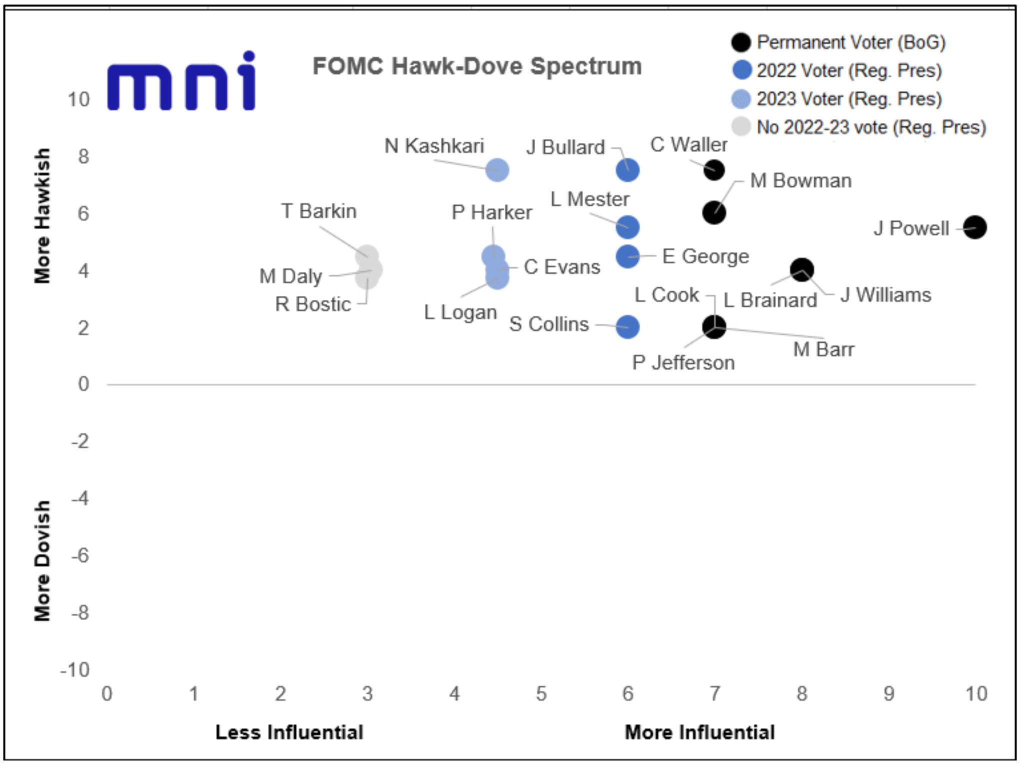
Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
CPI	% y/y	7.7	8.5	↓	8.3	↓					0.69
PCE Deflator	% y/y	6.0	6.4	↓	6.4	↓					-1.40
UoM 1-Yr Inflation Exp	% y/y	4.9	4.8	↑	5.3	↓					-0.67
Inflation Swap 5y/5y	%	2.55	2.54	↑	2.65	↓					0.43
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
ISM	Index	49.0	52.8	↓	56.1	↓					-2.10
Industrial Production	% m/m	-0.11	0.65	↓	0.68	↓					-0.87
Factory Orders	% m/m	1.0	-1.0	↑	0.7	↑					0.18
Housing Starts	K	1425	1377	↑	1805	↓					-0.92
Monetary Analysis		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Corporate Spreads BBB/Baa	bps	1.93	2.07	↓	1.82	↑					1.07
Chicago Fed Financial Con	Index	-0.21	-0.21	↓	-0.23	↑					-0.34
Consumer Credit Net Chg	$bn	27.1	24.3	↑	31.3	↓					-0.57
New Home Sales	K	632	543	↑	619	↑					0.24
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	1.3	-0.4	↑	0.7	↑					0.11
Consumer Confidence	Index	100.2	103.6	↓	103.2	↓					-0.49
Nonfarm Payrolls Net Chg	K	263	292	↓	386	↓					-0.79
Average Hourly Earnings	% y/y	5.1	5.2	↓	5.3	↓					-0.51
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Equity Market	Index	3964	3955	↑	4132	↓					-0.29
US 10-Year Yield	%	3.47	3.19	↑	2.84	↑					0.68
US Yield Curve (2s-10s)	bps	-80.7	-30.0	↓	28.8	↓					-1.45
USD TWI	Index	122.13	122.43	↓	119.84	↑					0.70

Source: MNI, Bloomberg

- Data have been mixed over the past 3 months: activity indicators and inflation have subsided, while financial conditions have mostly eased as the Fed is increasingly seen to be near the end of its hiking cycle. **(*Updated Dec 8, 2022*)**

Key Inter-Meeting FedSpeak – Dec 2022

- **Fed Chair Powell gave the most important inter-meeting comments** with his speech on Nov 30 on “Inflation and the Labor Market” (**full text here**).
- **Powell signalled that a stepdown in the hike pace to 50bp rather than 75bp hike was imminent** (“the time for moderating the pace of rate increases may come as soon as the December meeting”), while he echoed the November meeting minutes in saying “It seems to me likely that the ultimate level of rates will need to be somewhat higher than thought at the time of the September meeting and Summary of Economic Projections.”
- We've put together a **transcript of Powell's Q&A after that speech at Brookings** - worth reading in full.
- **Most other FOMC participants echoed the message** that it would soon be appropriate to downshift to a slower pace of hikes, but that there remained uncertainty about how high the ultimate level of rates would be and how long they would need to remain there.
- **The consensus appears clearly in favor of a 50bp hike in December. A few participants gave updates of their terminal rate outlooks,** with the general message that this would be higher than had been expected at the time of the last round of Dot Plot projections in September.
- **The hawks will be looking for at least 125bp more hikes, to a 5.00-5.25% range.** Bullard said based on the Taylor Rule, his minimum level is 5-5.25%. Waller eyed a possible "sequence" of 50bps hikes into 2023; Kashkari said his terminal rate was higher than the 4.75-5.00% he had expected in September.
- **On the more dovish end,** Bostic saw 75 to 100bp more tightening required (4.50-4.75% or 4.75-5.00%); Daly's terminal rate was "somewhere between 4.75-5.25%". Harker cited 4.50%.
- **Some personnel changes are ahead:** Chicago’s Charles Evans and Kansas City’s Esther George will be retiring in January. Evans’ successor will be Austan Goolsbee (an economics professor at the University of Chicago) and will become a voter immediately upon arrival, while George’s replacement is still not yet known.



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 November FOMC
		'22	'23	
J Powell	BOG, Chair	**X**	**X**	**On rate hikes and the terminal rate:** "It seems to me likely that the ultimate level of rates will need to be somewhat higher than thought at the time of the September meeting and Summary of Economic Projections… Monetary policy affects the economy and inflation with uncertain lags, and the full effects of our rapid tightening so far are yet to be felt. Thus, it makes sense to moderate the pace of our rate increases as we approach the level of restraint that will be sufficient to bring inflation down. The time for moderating the pace of rate increases may come as soon as the December meeting. Given our progress in tightening policy, the timing of that moderation is far less significant than the questions of how much further we will need to raise rates to control inflation, and the length of time it will be necessary to hold policy at a restrictive level. It is likely that restoring price stability will require holding policy at a restrictive level for some time. History cautions strongly against prematurely loosening policy. We will stay the course until the job is done.…" **– Nov 30** **On inflation:** "Core services other than housing… may be the most important category for understanding the future evolution of core inflation. Because wages make up the largest cost in delivering these services, the labor market holds the key to understanding inflation in this category…It will take substantially more evidence to give comfort that inflation is actually declining…the truth is that the path ahead for inflation remains highly uncertain." **– Nov 30**
J Williams	NY Fed, V Chair	**X**	**X**	**On rate hikes and the terminal rate:** "I still think we have a ways to go in terms of where the fed funds target is and where we need to get it to next year in order to get to a sufficiently restrictive stance…My view is we need to get the federal funds rate above the inflation rate, and sufficiently above the inflation rate to basically bring downward pressure on inflation." **-Dec 1** **On rate cuts:** "I do think we're going to need to keep restrictive policy in place for some time. I would expect that to continue through - at least through - next year…at some point, nominal interest rates will need to come down. Otherwise real interest rates will be going up and that would just be tightening policy further and further in terms of its effects on the economy… I do see a point, probably in 2024, that we'll start bringing down nominal interest rates because inflation is coming down and we would want to have real interest rates appropriately positioned." **– Nov 28** **On the Dot Plot:** "Stronger demand for labor, stronger demand in the economy than I previously thought, and then somewhat higher underlying inflation suggest a modestly higher path for policy relative to September…not a massive change, but somewhat higher." **– Nov 29** **On inflation:** ""We're seeing some forward-looking indicators that inflation is turning…we're moving now, and into next year, with a lower inflationary trend." **– Dec 1**
L Brainard	BOG, V Chair	**X**	**X**	**On rate hikes:** "It will probably be appropriate soon to move to a slower pace of increases…but I think what's really important to emphasize, we've done a lot, but we have additional work to do… By moving at a more deliberate pace we'll actually be able to see how that cumulative tightening is playing out…exactly what that path looks like I think is really hard to say right now."" **– Nov 14** **On inflation:** "The most recent CPI inflation print suggests that maybe the core PCE measure that we really focus on might be also showing a little bit of a reduction. That would be welcome." **– Nov 14** **On risk management in setting rates**: "In the presence of a protracted series of supply shocks and high inflation, it is important for monetary policy to take a risk-management posture to avoid the risk of inflation expectations drifting above target." **-Nov 28**
M Barr	BOG, V Chair	**X**	**X**	**On rate hikes and the terminal rate:** "We're in restrictive territory. The question we're working on is: is it sufficiently restrictive? How much more restrictive do we need to be in order to see the kinds of changes in the economy that will eventually lead to a reduction in inflation…"I think that we have some work still to do on that. So we're not done…I think that the rate is going to have to stay high for a long period of time," he said. "We're not thinking about loosening. We're still very much 100% focused on getting to a sufficiently restrictive rate and staying at a restrictive rate for a long-enough time to bring inflation down to 2%."**– Dec 1**
M Bowman	BOG	**X**	**X**	**On rate hikes and the terminal rate:** ""As we approach a sufficiently restrictive level of the federal funds rate, it will become appropriate for us to slow the pace of rate increases as we determine how high we need to raise the target range… until I see our actions actually having some impact that would lower the rate of inflation, I think that my expectation would be that we would have a slightly higher rate than I had anticipated in September." **– Dec 1**
L Cook	BOG	**X**	**X**	**On rate hikes and the terminal rate:** "What policy rate is sufficiently restrictive we will only learn over time by watching how the economy evolves. Given the tightening already in the pipeline, I am mindful that monetary policy works with long lags…thus, as we get closer to that uncertain destination, it would be prudent to move in smaller steps…how far we go, and how long we keep rates restrictive, will depend on observed progress in bringing down inflation. But rest assured, we will keep at it until the job is done." **– Nov 30**
P Jefferson	BOG	**X**	**X**	**No commentary on current monetary policy since the November FOMC meeting**
C Waller	BOG	**X**	**X**	**On rate hikes and the terminal rate:** "The data of the past few weeks have made me more comfortable considering stepping down to a 50-basis-point hike. But I won't be making a judgment about that until I see more data… I expect that getting inflation to fall meaningfully and persistently toward our 2% target will require increases in the federal funds rate into next year…we still have a ways to go… [incoming data could warrant a stepdown to 25bp hikes in 2023] or maybe it could be necessary to continue climbing a little longer to a higher final attitude by implementing a sequence of 50 basis point hikes." **– Nov 16** **On inflation:** "It's good finally that we saw some evidence of inflation starting to come down…we're going to need to see a continued run of this kind of behavior on inflation slowly starting to come down before we really start thinking about taking our foot off the brakes here… 7.7% CPI inflation is enormous…It's really not so much about the pace any more, it's where we're going end up. And where we end is going to be driven solely by what

Member	Role	Voter		Monetary Policy Commentary Since November FOMC
		'22	'23	
				happens with inflation." **– Nov 13**
L Mester	Clev. Fed	**X**		**On rate hikes and the terminal rate:** "I think we can slow down from the 75 at the next meeting, I don't have a problem with that." **– Nov 21** "Given we're beginning to move into restrictive territory, we have the opportunity to slow the pace of increases and evaluate the effects…I don't think we're near a pause." **– Nov 28** **On inflation:** "We had one good October CPI report. I would need to see several more of those and more moderation and perhaps even a reduction in core services prices. And we also have to see better balance in the labour market…it's very easy to be caught out by the good news, but we don't want wishful thinking to take [the place of] really compelling evidence. The costs of stopping too early are high. We want to be very diligent about this." **- Nov 28**
E George	K.C. Fed	**X**		**On rate hikes and the terminal rate:** "A more measured approached to rate increases may be particularly useful as policymakers judge the economy's response to higher rates…with a firm commitment to return inflation to target, the pace of hikes is less important than the strength and communication of this commitment… I continue to see several advantages for a steady and deliberate approach to raising." **– Nov 10** "I don't think we will be able to say we've arrived until we see that inflation coming down as a signal that our policy has really been sufficiently restrictive to bring that down….for me, the more important question for this committee, looking out over next year, is being careful not to stop too soon…This was the lesson of the 1970s and '80s, is thinking, 'Oh, we've got it now, we can stop,' and then you find that inflation really re-emerges in some way." **– Nov 16** **On inflation and growth:** "When I think about inflation today, we've kind of turned the tide of supply-chain, production-side shortages. Now, we're really looking at labor as the driver here…I'm looking at a labor market that is so tight, I don't know how you continue to bring this level of inflation down without having some real slowing, and maybe we even have contraction in the economy to get there." **– Nov 16** **On the dot plot:** "Well, when I think back to my own forecast in March and June, and [estimates of the potential terminal rate] have pushed up. I think I have probably been on the high end anyway of thinking where a terminal rate would be, just give the persistence of that inflation. So I don't know that that is a signal that I'd keep going higher as I look ahead." – Nov 16
J Bullard	St. Louis Fed	**X**		**On rate hikes and the terminal rate:** "The policy rate has not yet reached a level that could be considered sufficiently restrictive…the policy rate will eventually reach a level the FOMC judges sufficient to put meaningful downward pressure on inflation. From there, the FOMC can adjust the policy rate up or down depending on incoming data without first having to get it from near zero up to a level considered appropriate for the inflation environment." **– Nov 29** "In the past I have said 4.75%-5%...based on [Taylor Rule analysis], I would say 5%-5.25%. That's a minimum level. According to this analysis that would at least get us in the zone…it's easy to make arguments that before this is all over you'd have to go to much higher levels of the policy rate [than 5.25%]. But for now I'd be happy to get to the minimal level and that's why I think the committee is going to have to do more." **– Nov 17**
S Collins	Bos. Fed	**X**		**On rate hikes and the terminal rate:** "I'm not at a place where I think it's helpful to give a specific number [for peak rates]…I do think we're going to need to raise rates further." **– Nov 11** "I expect [meeting the inflation mandate] will require additional increases in the federal funds rate, followed by a period of holding rates at a sufficiently restrictive level for some time…Historically, 50 was viewed as a large increase…but 75 still is on the table, I think it's important to say that as well….“from my perspective it is a different phase [now vs earlier in the cycle]. And I really am focused on how high [rates will go]…as rates get higher, the concerns that we might go too high do increase." **– Nov 18** **On inflation:** "The latest data have not reduced my sense of what sufficiently restrictive may mean, nor my resolve." **- Nov 18**
P Harker	Phil Fed		**X**	**On rate hikes and the terminal rate:** "I am in the camp of wanting to get to what would clearly be a restrictive stance, somewhere north of four-ish, you know, four and a half percent, and then I would be okay with taking a brief pause, seeing how things are moving. And then if we have to, we can continue to tighten." **– Nov 10** "In the upcoming months, in light of the cumulative tightening we have achieved, I expect we will slow the pace of our rate hikes as we approach a sufficiently restrictive stance… [some time in 2023] I expect we will hold at a restrictive rate for a while to let monetary policy do its work." **– Nov 15**
N Kashkari	Minn. Fed		**X**	**On rate hikes and the terminal rate:** "I had interest rates in September peaking at around 4.9% in the March-April kind of time frame…given what I know right now, I would expect to go higher than that. How much higher than that, I don't know." **– Nov 4** [saying either 50bp or 75bp hikes on the table in Dec, and not ruling out other options]: "by moving aggressively but by taking a few steps, we get to see how the economy evolves… and that reduces the risk we're going to overshoot our mark… we are a long, long, long way away from [meeting dual mandate goals] right now, so that's why any talk of a pivot is entirely premature." **– Nov 10**
L Logan	Dall. Fed		**X**	**On rate hikes and the terminal rate:** "While I believe it may soon be appropriate to slow the pace of rate increases so we can better assess how financial and economic conditions are evolving, I also believe a slower pace should not be taken to represent easier policy." **– Nov 10** **On inflation:** "This morning's CPI data [for October] were a welcome relief, but there is still a long way to go." – **Nov 10**
C Evans	Chic. Fed		**X**	**On rate hikes and the terminal rate**: "I do think there's benefits to adjusting the pace as soon as we can." **– Nov 9** "We probably are going to have a slightly high peak rate of the funds rate, even as we likely will step down the pace of increases." **– Dec 2**
T Barkin	Rich. Fed			**On rate hikes and the terminal rate**: "It is entirely conceivable to me we would end up over 5…but to me, that's not a plan - that would be an output of our efforts to try to keep inflation under control." **– Nov 4** "I'm very supportive of a path that is slower, probably longer and potentially higher than where we were before…It is helpful to be somewhat more cautious as you are in restrictive territory…it is a better risk-management approach." [Peak rates will] "certainly" [be above what he expected in September]. **– Nov 29**

Member	Role	Voter		Monetary Policy Commentary Since November FOMC
		'22	'23	
R Bostic	Atl. Fed			**On rate hikes and the terminal rate:** ""In terms of pacing, assuming the economy evolves as I expect in the coming weeks, I would be comfortable starting the move away from 75-basis-point increases at the next meeting… if the economy proceeds as I expect, I believe that 75 to 100 basis points of additional tightening will be warranted…it's clear that more is needed, and I believe this level of the policy rate will be sufficient to rein in inflation over a reasonable time horizon." **– Nov 19** **On inflation:** "There are glimmers of hope… I will need to see indicators of broad-based easing of inflation." **– Nov 15** "I do not think we should continue raising rates until the inflation level has gotten down to 2%. Because of the lag dynamics I discussed earlier, this would guarantee an overshoot and a deep recession... If it turns out that that policy is not sufficiently restrictive to rein in inflation, then additional policy tightening actions may be appropriate." **– Nov 19**
M Daly	S.F. Fed			**On rate hikes and the terminal rate:** "As we work to bring policy to a sufficiently restrictive stance - the level required to bring inflation down and restore price stability - we will need to be mindful…adjusting too little will leave inflation too high. Adjusting too much could lead to an unnecessarily painful downturn." **– Nov 21** "Somewhere between 4.75 - 5.25% seems a reasonable place to think about as we go into the next meeting…and so that does put it in the line of sight that we would get to a point where we would raise and hold…Pausing is off the table right now, it's not even part of the discussion…Right now the discussion is, rightly, in slowing the pace." **– Nov 16** **On market pricing:** "While the funds rate is between 3.75 and 4%, financial markets are acting like it is around 6%...as we make decisions about further rate adjustments, it will be important to remain conscious of this gap between the federal funds rate and the tightening in financial markets…ignoring it raises the chances of tightening too much." **– Nov 21** **On inflation:** "One month of data [the Oct CPI] does not a victory make, but those were some positive signs…these things getting better are encouraging, as is a slower labor market. But we need to get more of that to be sure and confident that inflation will come down to our price stability goal in any reasonable amount of time." **– Nov 16**

MNI Policy Team Insights

MNI INTERVIEW: US Wage Pressures Likely To Be Longer Lasting (Pub Dec 7, 2022)

By Pedro Nicolaci da Costa

(MNI) WASHINGTON – Federal Reserve Chair Jerome Powell's dovish commentary on inflation last week indicated the FOMC may be returning to a more forecast-based monetary policy, lessening the risk that interest rates will peak much above market expectations around 5%, ex-Fed board economist Jonathan Pingle told MNI.

Powell surprised investors by changing his tune from his recent public pronouncements, including the last two press conferences and his Jackson Hole speech. While he had previously said it was too soon to argue inflation had peaked, Powell offered a more nuanced view of prices in remarks at the Brookings Institution which suggested he believes the high point has passed.

"I was surprised at how forecastey the comments were on Wednesday, reinforced by the fact that Gov. Lisa Cook had spoken just before with kind of a similar shift," said Pingle, who spent four years at the board and is now chief U.S. economist at UBS.

Powell's comments "took out some of the upside risks about how high they will go, how much they would think they need to really hammer the economy in order to accomplish what they need to accomplish," said Pingle.

In particular, Powell highlighted the need to see "core services" inflation outside of housing come down while signaling that he expected a drop in the cost of new rental leases, a key driver of core prices that affects CPI with a long lag. (See MNI INTERVIEW-U.S. Inflation Likely At Turning Point--SF Fed)

"I get a fair amount of questions about what if rates are going to 6%? St. Louis Fed President James Bullard had laid out policy rules where he had one option that went to 7," Pingle said. "What we heard from Powell was not someone who feels like rates need to be marched up to 6.25%."

FORECAST-BASED POLICY

Indeed, a return to forecast-based policy would indicate a significant shift in thinking at the central bank as interest rates rise to levels policymakers consider restrictive. Officials until recently emphasized the need to see actual declines in headline inflation rather than focusing on forecasts, previously proven premature, that inflation was set to fall.

FOMC members have said they will likely ease the pace of rate increases from a recent string of outsized 75-basis-point hikes to 50 basis points in December, in part so they can take stock of the cumulative and lagged effects of tightening to date.

"It seemed to me something of a shift from the backward looking, we need to see it in the inflation data to believe and back toward forecast-based monetary policy," Pingle said. "That matters for how we want to think about policy next year. If they're going to go back to putting more weight on where they think inflation is headed then they might react a little less to where inflation is now."

Pingle thinks market expectations for rates to peak around 5% are likely correct given the recent path of the data and official pronouncements from the Fed.

"We're expecting them to do 50 in December then we expect another 50 bps in February. If you told me they were going to do another 25 after that I don't have a strong conviction one way or the other," he said.

"My basic premise is that they have in mind a terminal rate of 5%, plus or minus. They're going to want to fulfill that to some extent even if inflation slows, because they're probably going to interpret what's unfolding as what they priced into their forward communications but they'll be reluctant to fall too far short of that."

MNI INTERVIEW: US Wage Pressures Likely To Be Longer Lasting (Pub Nov 29, 2022)

By Jean Yung

(MNI) WASHINGTON – The U.S. is likely to see continued strong wage pressures even if an economic slowdown raises unemployment over the next year, barring a recovery in labor force participation closer to pre-Covid levels, Yale University professor and visiting scholar at the Federal Reserve Bank of Philadelphia Giuseppe Moscarini told MNI.

Labor flow trends show the fraction of workers who move from job to job every month is falling, while the job-finding rate for the unemployed remains elevated, according to Moscarini. That indicates a shrinking supply of labor from those looking to switch jobs -- and continued upward pressure on labor costs and inflation, he said in an interview.

Perversely, high labor demand also suppresses labor supply, because people feel they can wait to rejoin without missing the boat, he said. At 62.2%, workforce participation is still a full percentage point below its pre-pandemic level, enough to raise the unemployment rate by a third if all the missing workers joined at once.

"Bottom line, I expect no moderation in wage growth in the short run. Real wages lost a lot of ground," Moscarini said. "Once the non-participants rejoin, pulled by higher wages or pushed by low stock returns, we could see an effect."

SHRINKING SLACK

Wage growth is predicted much more accurately by labor market flows, not stocks like the unemployment rate, Moscarini said.

Coming out of the pandemic in 2021, as employees reflected on their priorities, quit their jobs or changed sectors, both the job-finding and job-switching rates rose, indicating a high degree of mismatch in the workforce. Wage pressure was contained as workers moved to better-fitting jobs.

Job openings are still abundant this year, but the job-switching rate has fallen as workers became happy to remain where they are. A number of current vacancies are likely replacement hiring as people quit, and those are less likely to be suppressed by weak demand, Moscarini noted. (See: MNI INTERVIEW: Fed Can Cool Economy With Modest Job Losses)

With labor supply shrinking, wage growth took off. The employment cost index, a measure of wages and benefits, hit its fastest annual pace in decades in the second quarter of 2022, and cooled just slightly in the third quarter.

"Presumably in 2021 there was a lot of post-pandemic mismatch. In 2022, this reallocation had happened and we started digging into shrinking slack," Moscarini said.

STEEPER PHILLIPS CURVE

Moscarini's research also constructs a wage Phillips curve relating measures of labor market flows -- rather than unemployment -- to wage inflation and finds the flows data outperforms the unemployment rate as a source of wage pressure.

"Labor market theory in macroeconomics has been about flows for at least 40 years. Empirical support for this view is enormous. Media and, partially, the Fed are stuck in the 1970s," he said. "The unemployment rate is only a part of the picture, and the less interesting one."

MNI INTERVIEW:US Inflation Likely At Turning Point-SF Fed Econ (Pub Nov 17, 2022)

By Evan Ryser

(MNI) WASHINGTON - The U.S. economy may be shifting into an environment where sky-high inflation is finally poised to turn lower, led by softening core goods prices, San Francisco Fed economist Adam Shapiro told MNI.

"There's a good probability based on my read that we're at a turning point right now in terms of where the inflation numbers are going and where the economy is headed. We're not seeing it at all in the labor market but we know from past experience that the labor market can just turn on a dime," he said in an interview.

While stressing current "indicators are all showing that inflation is still high," Shapiro said that despite some remaining kinks supply chain bottlenecks have come down a lot. "It certainly looks like the supply chain pressures that were very, very strong last year are behind us now," he said.

The Labor Department last week reported a softer-than-expected 0.4% headline CPI increase over the month of October with core prices increasing less than expected. The headline producer price index rose 0.2% last month, below expectations, and core PPI, at a 0.0% change month-over-month in October, was at the lowest level since November 2020.

"Based on our current trends over the last two or three months, it looks like there's a signal of softening happening in the goods market," said Shapiro, a vice president in the San Francisco Fed's research department.

SPOT RENTS

"When you look under the hood, what's actually driving most of the CPI now are the service categories, and then within that it's rent inflation," Shapiro said.

Core CPI eased to 6.3% in the year to October from its peak of 6.6% the previous month, its highest since 1982. Rent has soared 7.5% over the year and owners' equivalent rent increased by 6.9% and are likely to worsen before starting to improve due to BLS methodology, he said.

"It can actually take up to two years for this whole process to actually filter its way through into the CPI stock of rents," he said, pointing to his research with San Francisco colleagues. "The fact that new lease price inflation was really, really high last year is still feeding through to the service Price Index of CPI and PCE now."

"New lease prices take time to filter through to the stocks," he said. (See: MNI INTERVIEW: US CPI Rent Costs To Gain Momentum - Fed Economist)

Shapiro pointed to an analysis from former Council of Economic Advisors chair Jason Furman that updates core CPI by swapping in spot rents on new leases for all rent on existing leases and shows core CPI at a 2.8% annual rate over the last three months versus 5.8% for the official BLS measure.

"If you want to get an accurate picture of what is the inflationary pressure right now and what's causing that then there are certain indicators that you might want to look at over and above others," Shapiro said. But a tight labor market and elevated wage growth will likely prevent pressure on core services prices from evaporating entirely, he said.

If "I start to see core goods inflation continue to go down and then I see the spot readings on rent really start falling more then I'll say, 'Okay, this is looking like it's really coming off now,' he said. "By next year, if I see that rent inflation is still high, but everything else is low, I'll say, 'Okay, I think we're at a point now where inflation is where we want to be.'"

MNI INTERVIEW: Fed Can Cool Economy With Modest Job Losses (Pub Nov 17, 2022)

By Jean Yung

(MNI) WASHINGTON - The Federal Reserve can cool the economy without putting millions out of work because the overwhelming majority of post-pandemic job openings aim to poach workers rather than hire from the pool of jobless, so even a large overall decline in vacancies as interest rates increase would add only modestly to unemployment, St. Louis Fed economist Paulina Restrepo-Echavarria told MNI.

In new research with co-author Dallas Fed economist Anton Cheremukhin, Restrepo-Echavarria argues the response of unemployment to a slowdown in demand for workers has likely decreased in recent years, because poaching vacancies have outpaced job openings with the potential to determine the unemployment rate.

Vacancies for the employed have risen steadily since 2015 and accelerated since Covid-19 to more than three-quarters of all posted openings from roughly half in the decade prior, they estimate, while monetary policy is thought to have an equal effect on both.

"Monetary tightening could lead to a relatively large decline in job openings, but a drop in vacancies for the already-employed has no bearing on the Beveridge curve -- it doesn't generate unemployment," she said in an interview. "We might not see a big effect of tighter policy on unemployment. So the idea of a soft landing may actually be possible." (See MNI INTERVIEW: Fed Cheers Cooling Labor Demand As Openings Dip)

DUAL BEVERIDGE CURVE

Since Covid-19, the behavior of the Beveridge curve, which plots the relationship between the vacancy and unemployment rates, has been strikingly different from past recessionary episodes, puzzling economists. Some have attributed the breakdown to shifts in hiring to different sectors, while others have blamed a larger retiree pool.

But by dividing vacancies into the two group, the Fed economists come up with dual Beveridge curves, of which the one for unemployed workers closely resembles Beveridge curves of the past.

"That unusual pattern is all due to vacancies for the employed. Once you remove that, it looks the same as it always looked," Restrepo-Echavarria said.

Though it's difficult to discern from a job ad whether an employer wants to hire an unemployed worker, therefore making it impossible to prove their theory, Restrepo-Echavarria added that recruiters say firms often make that decision at the outset.

MNI INTERVIEW: Cooldown in Oct CPI Overstated -Fed's Meyer (Pub Nov 11, 2022)

By Jean Yung

(MNI) WASHINGTON - An unexpectedly softer U.S. CPI report for October paints a rosier picture of moderating inflation than is likely the case, Atlanta Fed economist Brent Meyer told MNI.

Roughly 60% of the CPI basket is still rising at rates above 5%, and alternative measures of underlying inflation remain "very elevated, reflecting broad-based price pressure," he said.

The Median, 16% Trimmed-Mean and Sticky CPI measures all posted increases in the 5% to 7% range, well above core CPI reading of 0.3% for the month or 3.3% on an annualized basis.

“This is a better report than we’ve seen over the past several months, but only slightly. The topline numbers are overstating the improvement in underlying inflation,” Meyer said.

CORE SERVICES

Economists have been waiting some time to see the consumer rotation from goods spending back to services show up in prices, and "we’re finally starting to see that play out," Meyer said, calling the trend the best part of the report. Core goods prices fell 0.4% in the month, the first decline since March.

But core CPI and especially core services inflation were pulled down by a very sharp decline in health insurance prices due to the Labor Department's backward-looking methodology, he said. That technical factor will continue to be a drag on CPI in the coming months but won't affect the Fed's preferred PCE inflation measure, which estimates health care prices using different source data.

Meanwhile, a tight labor market and fast wage growth will likely prevent pressure on core services prices from evaporating very quickly, he said.

Richmond Fed President Thomas Barkin told MNI this week interest rates may peak higher than the Fed has anticipated until now if inflation doesn't slow and the labor market remains tight. (See MNI INTERVIEW: Fed's Barkin-Prices May Force Higher Rates Peak)

MNI INTERVIEW: Thin Liquidity Complicates Fed Plans To Tighten (Pub Nov 10, 2022)

By Pedro Nicolaci da Costa

(MNI) WASHINGTON - Deteriorating liquidity in the USD24 trillion U.S. Treasury market presents a major risk to global financial stability that could force the Federal Reserve to end quantitative tightening before 2024 and complicate its efforts to tamp down inflation, Priya Misra, a member of the Fed’s Treasury Market Practices Group, told MNI.

The Fed is not only raising interest rates at one of the fastest clips in its history, it is also shrinking its balance sheet, which peaked at almost USD9 trillion in April and has since declined to USD8.6 trillion.

“Treasury market liquidity is always important, but it’s more important if you’re dealing with some sort of shock,” said Misra, managing director and head of global rates strategy at TD Securities. “And the shock right now is an unprecedented hiking cycle, which is unprecedented in its speed and the global nature of it.”

Treasury market liquidity has remained poor by many measures, prompting renewed calls for reforms of various sorts, including possible adjustments to the supplementary leverage ratio. Misra is concerned things might deteriorate if the Fed is forced to tighten even more than in the already-hawkish scenario of a 5% peak rate priced in by markets. (See MNI INTERVIEW: Fed’s QT Could Trigger Liquidity Crunch-Rajan)

“We all think the Fed ends hikes sometime in the first half of next year. What if inflation is so sticky that they’re hiking to the end of next year, to a higher level? Does that result in any financial institution or some part of the market (cracking)?” she said.

“It’s not something that is a slow burn, it’s actually something that could become very meaningful in a shock event. If there’s any sort of financial stability issue it could spiral out of control really quickly now.”

HIDING IN PLAIN SIGHT

The UK pension fund debacle is a perfect example of how large, unexpected pockets of vulnerability can hide in plain sight.

“LDIs are an example. I would be shocked if anyone said they saw this coming in this particular sector. It’s a pretty well-regulated industry, they actually did everything right in terms of duration matching and yet they had a problem there,” she said. “People wanted cash but they didn’t have enough cash, all they had was gilts, it wasn’t enough.

“It highlights that vulnerabilities get amplified if liquidity is poor. And you have a shock that we’re all living through. If we had a liquidity problem with the Fed on hold or doing QE we could afford to ignore it.”

Instead, the Fed is doing QT, which Misra thinks it will have to abandon by the time 2023 draws to a close.

“I think QT stops by the end of next year either because we get reserve scarcity or the Fed starts to cut rates,” she said.

Fed staffers say they expect tightening liquidity to be eventually alleviated by a fall in usage of its reverse repo facility, and by a recalibration of bank capital requirements.

But Misra said she’s advising clients who are not able to park their money at the Fed that they need to make sure they have enough liquidity to withstand losses on other holdings.

“If you have corporate bonds or mortgages you might want to also hold some liquid assets. Your liquidity needs are higher because the products you thought might give you liquidity may not,” she said. “Maybe it’s not even Treasuries. Maybe you need to have a higher cash buffer because you can’t even rely on the Treasury market. But if Treasury market liquidity goes down, what happens to the mortgage market, and credit?”

MNI INTERVIEW: Fed's Barkin-Prices May Force Higher Rates Peak (Pub Nov 9, 2022)

By Jean Yung

(MNI) WASHINGTON – U.S. interest rates "may well” peak higher than the Fed has anticipated until now if inflation doesn't slow and the labor market remains tight, even as officials shift to smaller hikes to minimize the risk of overtightening, Federal Reserve Bank of Richmond President Thomas Barkin said in an interview Wednesday.

Now that real rates are credibly positive across the curve, the time is ripe for a different reaction function -- one that is more deliberate, less about speed and more about direction, he told MNI.

"Precision is an impossible standard here. Our tools work with long and variable lags, and the data are influenced by many things in addition to our tools," he said. "That’s why I like the idea of going slower for longer to a potentially higher place, because it will give you time to read the data and what you're learning from contacts and react appropriately."

Doing what it takes to curb inflation will determine the ultimate peak for interest rates, and that means borrowing costs could continue rising amid a lack of progress. "We have a choice depending on how inflation comes in, whether we pause or whether we continue to react to elevated inflation readings," he said. "If we don't get inflation under control, we may well have to keep the peak higher."

DECEMBER DOWNSHIFT

Barkin is watching for signs of cutbacks in consumer spending and capital investment -- which would presumably precede any slowdown in inflation – ahead of a decision on whether to end the string of outsized 75-basis-point hikes as soon as the Fed's next meeting in December. (See MNI INTERVIEW-Fed Set For 'Lively Debate' On Size Of Dec. Hike)

"I'll be looking for signals that demand is starting to soften, and it will be wonderful to get signals that inflation is starting to soften," he said.

There are encouraging signs that some price pressures are easing, he noted. Used car prices are falling, ports are opening up and transportation costs normalizing. The October CPI report due Thursday is expected to show inflation over the past 12 months decelerating to 7.9% from an earlier peak of 9.1%, though the Fed's preferred PCE inflation measure remains near 40-year highs at 6.2%, or 5.1% excluding food and energy costs.

Yet higher interest rates have yet to have a palpable impact on prices in even the most interest-sensitive sector, Barkin said. Housing prices are "barely down" despite mortgage rates having more than doubled since the Fed began raising rates. "It takes a while for monetary policy to affect demand and a while for demand to affect prices," he said.

POST-PANDEMIC CHALLENGES

Intelligence from local businesses also points to unique post-pandemic challenges, Barkin noted. Firms in the Richmond Fed district are both reluctant to shed workers who were hard to find in the first place, and to give ground on hard-fought price increases as costs continue to rise.

"They're on Page One of the downturn playbook. They may well be cutting advertising but they're not yet in a mood to cut labor," Barkin said. "For the last 20 to 30 years, firms had a hard time raising prices. In the midst of Covid, they had the courage to raise prices and many did. They're not going to back off cost increases until they're forced to."

Short of older workers and new immigrants, the U.S. workforce may also be entering an era where labor is structurally short, he said, adding, "I do sense some real reluctance" to let go of workers.

As labor demand proves harder to temper, "the Fed may well have to do more," he said.

MNI INTERVIEW: US CPI Rent Costs To Gain Momentum-Fed Economist (Pub Nov 9, 2022)

By Evan Ryser

(MNI) WASHINGTON - The boost to CPI inflation from housing is likely to accelerate further before reversing course even though the rental market from which such measures are computed has started to soften, Cleveland Fed economist Randal Verbrugge told MNI.

"I expect CPI rent to have a bit of momentum because it's just much more slow moving. I sort of expect CPI rent to grow a little bit more and then start to slowly decelerate," he said in an interview. "New tenant rents are probably going to decelerate back to kind of a normal level and slowly average rents will fall back to that."

The CPI's measure of rents was up 0.8% in September, the largest monthly increase in over three decades, and 7.2% over the year. Verbugge, along with the Cleveland Fed's Lara Loewenstein and BLS coauthors Brian Adams and Hugh Montag, show in a recent paper rent inflation for new tenants leads the official BLS rent inflation by roughly 12 months.

NEW TENANTS

"The top takeaway is the reason that outside rent measures differ from official CPI rent is that they're tracking new tenant rents rather than the rent facing a typical renter," Verbugge said about the paper. The authors conclude that taking a broader measure of rents, as the CPI does, is the right way to understand price growth.

The CPI attempts to measure contract rents, also known as in-place rents, and those are an attempt to measure what households actually pay, whereas most private-sector sources measure the asking rent only for a new lease. The BLS said earlier this year it has plans to publish research on a rent index focused on new tenants and is exploring alternative data sources.

The Zillow Observed Rent Index (ZORI) began to decelerate in year-over-year terms last March, suggesting a deceleration would first be visible in the March 2023 CPI data, to be released in mid-April.

GIVE OR TAKE

Verbugge said the statistics suggesting a year difference between inflation for new tenants and official BLS rents are not the final word and the lag could be shorter or longer.

"A correlation is not a final word on anything I wouldn't think, especially because any statistic like a correlation is going to be really pulled a lot by any extreme observations," he said. "Maybe it's 13 months, maybe it's 11 and maybe it'll take longer when things are quiescent. I can imagine that happening."

At the same time, Verbugge said, increased use of pricing software among property managers and landlords could lead to a more rapid fall in rent inflation if market conditions were to sour further.

""That is going to make rents more responsive than they used to be to market conditions. We might see rents fall much more rapidly if we enter a recession, let's say, then we would have about 10 years ago when people weren't using this kind of software and that could change inflation dynamics," he said.

MNI INTERVIEW-Fed Set For ‘Lively Debate’ On Size Of Dec. Hike (Pub Nov 4, 2022)

By Pedro Nicolaci da Costa

(MNI) WASHINGTON - Federal Reserve officials may clash at the December meeting over whether to slow the pace of interest rate hikes despite persistently high readings for key inflation measures and a strong job market, former Richmond Fed research director John Weinberg told MNI.

“That’s going to be a lively discussion in December,” he said in an interview with MNI’s FedSpeak podcast following this week’s FOMC decision to raise interest rates by 75 basis points for a fourth consecutive meeting.

“There’s likely to be a number of committee members who think that even with the picture that we have now, as long as rates continue going up and are moving toward a sufficiently restrictive stance, that they can afford to slow the pace. So I wouldn’t be surprised to see them do that.”

Fed Chair Jerome Powell in his press conference this week emphasized that while the Fed is considering slowing the pace of hikes in the next meeting or two, that will likely mean a higher terminal rate than the 4.6% priced into the September SEP.

The FOMC also emphasized the need to make monetary policy “sufficiently restrictive” to bring inflation down from near 40-year highs back to the Fed’s 2% target.

"The real policy rate needs to be positive, it's not now," said Weinberg. "Inflation is falling more slowly than the committee had hoped, which means that by the time they get up to a nominal rate of say 4-½%, if inflation hasn't cooled as much as they had expected, then the stance of policy is not going to be perhaps restrictive at all and maybe not sufficiently restrictive."

He said that given current conditions rates are likely to peak around 5% as markets expect but the range of outcomes is wider than usual. (See [MNI: Ex-Officials Now See Fed Rate Peak At 5% Or Higher])

UNDERLYING MOMENTUM

Echoing arguments from some Fed officials that the economy is strong enough to withstand the central bank's aggressive tightening campaign, Weinberg said a recession may yet be avoided, and, if there is one, it would not be particularly deep.

"Even if monetary policy gets restrictive enough to contribute to some actual contraction in the economy, the economy is positioned to weather a policy shock like that and perhaps other typical real shocks," he said.

"Household financials are in reasonably good condition, there's still some fiscal impetus in the pipeline, and all of these things should mitigate any recessionary effects on the economy. So I think if there is a recession in the next couple of years it will be pretty mild."

The October jobs report out Friday corroborated that momentum, with the economy generating a stronger-than-expected 261,000 new jobs.

Still, Weinberg conceded that high uncertainty around prices means the Fed may yet face the challenge of entering a recession while inflation is still well above target.

"If we actually get recessionary forces emerging in the real economy, whether it's caused by monetary policy or some other shock then the problem gets a lot trickier, because the committee's tendency will be to want to provide accommodation in the face of significantly rising unemployment," Weinberg said. "And if inflation hasn't fallen sufficiently by then you could get into a ratchet problem which everyone wants to avoid."