MNI
All Signal, No Noise
MARKET ANALYSIS

MNI Fed Preview: February 2023

***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, Jan 31-Feb 1
Decision/Statement: Wed 1 Feb at 1400ET / 1900GMT
Press Conference/Q&A: Wed 1 Feb at 1430ET / 1930GMT

Minutes: Wed 22 Feb

Links (likely URLs based on previous meetings):
Statement: https://www.federalreserve.gov/newsevents/pressreleases/monetary20230201a.htm
Implement. note: https://www.federalreserve.gov/newsevents/pressreleases/monetary20230201a1.htm
Press Conference: https://www.federalreserve.gov/monetarypolicy/fomcpresconf20230201.htm

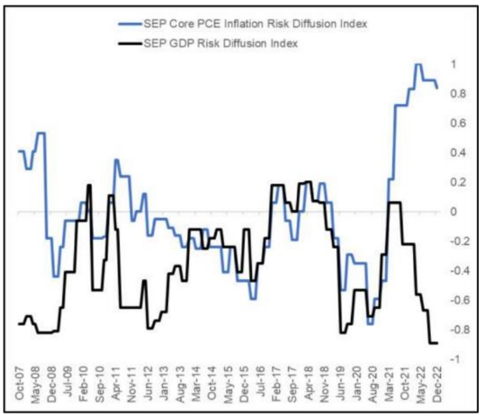
MNI Review of Previous FOMC (Dec): https://roar-assets-auto.rbl.ms/files/48990/FedReviewDec2022.pdf

Contents

MNI POV (Point Of View): Downshift, With "Ongoing" Concern

By Tim Cooper

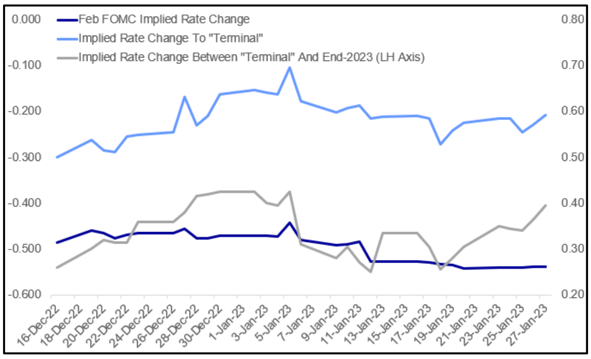
- *The Fed will downshift its rate hike pace in February for the second consecutive meeting, to 25bp from 50bp.*
- *The dovish risks to this meeting appear at least partly priced in, including some expectations of Statement language acknowledging decelerating inflation, or a clear signal that the end of the hiking cycle is near.*
- *However, there are many ways Powell could re-emphasize the FOMC's view that the job is not nearly done yet.*
- *Powell will again steer attention away from the pace of hikes and toward the terminal level (which the FOMC envisages as higher than the market does), while pushing back against rate cut pricing for H2 2023.*



The Jan 31-Feb 1 FOMC meeting will bring the Fed one 25bp step closer to the end of the hiking cycle, and just 50bp from its envisaged terminal rate range of 5.00-5.25%. Since the mid-December meeting, the FOMC's perception of the balance of risks to outlook has probably shifted very slightly away from that of undertightening to that of overtightening. At that time, the Diffusion Indices included with the forecasts showed almost all members saw risks to inflation lying almost entirely to the upside, with risks to growth to the downside (**see chart**). But as we explain in our Macro Developments section below (p4), inflation pressures continue to show signs of abating, the economic growth outlook looks increasingly mixed, and while job and labor cost growth remain strong, there has been evidence that demand for labor is waning and wages may be cooling.

Against this backdrop the FOMC will be thinking about pausing soon. But they will probably not even want to hint at that at this meeting, preferring to see more data and developments between now and the mid-March meeting. By that point, the FOMC will have had two more inflation reports and two more employment reports, and will be set to adjust their rate guidance accordingly (as Powell said in December of the March SEP Dot Plot terminal rate median, "if the inflation data come in worse, that could move up [from 5.1%]. And it could move down if inflation data are softer.") At this point, it's too early, and there is nothing to be gained by hinting at a more dovish approach. Inflation remains much too high, and the outlook overall remains extremely uncertain.

Markets meanwhile remain convinced the Fed will have to reverse course before long. As we come into the meeting week, the market-implied path of the fed funds rate is fairly close to where it was after the December decision. While incoming data and FOMC participants' communication has seen implied probability of a February 25bp vs 50bp hike from around 70% to 95+%, this has been offset by a rise in rates seeing being held at a slightly higher level through 2023. Terminal pricing is seen at 4.90% in June, with over 40bp of cuts priced by year-end. That terminal rate is below the 5.05% inter-meeting peak seen in early January, but is higher than the 4.80% terminal prior to the December FOMC, and the end-2023 implied rate is modestly higher than before that meeting.



Decision: The FOMC will raise the federal funds rate by 25bp to 4.50-4.75%. As has been the case for most of the hiking cycle, it's very unlikely that the FOMC will surprise with the actual rate-setting decision, with Chair Powell preferring to keep the market's focus on the meeting messaging instead. Consequently, market impact is unlikely: 26bp is priced going into the meeting week.

- At the December press conference, after which the FOMC hiked 50bp in a stepdown from the 75bp pace previously, Powell was seen as opening the door to another stepdown to 25bp on Feb 1: "I would say the most important question now is no longer the speed. And that applies to February as well. So I think we'll make the February decision based on the incoming data and where we see financial conditions, where we see the economy."
- Having played down the importance of "speed" and rather emphasizing the questions of "how high" to raise rates and "how long to remain at a restrictive level", the data (albeit limited) has duly cooperated since that meeting.
- Financial conditions have eased slightly since mid-Dec, but there hasn't really been FOMC pushback against that, with most on the FOMC more preoccupied with and seemingly relieved by progress on inflation.
- Several FOMC participants, from hawks to doves, expressed either openness to, or outright support for, a 25bp raise at this meeting (including Waller, Collins, Bostic, Logan, Daly, and Harker – see our FedSpeak section p5 for more detail). And the Fed leadership core did not take advantage of opportunities to push back against the 25bp messaging, including late pre-blackout appearances by Brainard and Williams.
- There have been no vocal proponents of another 50bp hike in recent weeks. While St Louis Fed Pres Bullard indicated he'd support a bigger-than-25bp hike in order to get to sufficiently restrictive territory as quickly as possible, his viewpoint looks quite isolated. And of course, he was a 2022 and not a 2023 voting member.

Forward Rate Guidance: No change. This is a closer call than the 25bp hike decision itself, with several sell-side analysts anticipating a change in the existing rate guidance that would point to only a limited number of further hikes ahead. There are two main reasons to expect them to maintain current language and guidance for now.

- Recall the Fed's reasoning for using the current "ongoing hikes" guidance language. Powell made this clear at the December press conference: "I would say it's our judgment today that we're not at a sufficiently restrictive policy stance yet, which is why we say that we would expect that ongoing hikes would be appropriate. And I would point you to the SEP again for our current assessment of what that peak level will be."
- Judging from those criteria, there is no sign that the FOMC yet sees policy in sufficiently restrictive territory. And there is likewise little reason to believe the FOMC has yet changed its collective mind on the terminal rate just yet.
- The anticipated 5.1% end-2023 December Dot Plot median implied one of two paths: either hikes of 50bp in Feb and 25bp in March before pausing, or 25bp at each of the first three meetings through May before pausing.
- Note that "ongoing" at that time would appear to have encompassed both those 2x hike and 3x hike scenarios. This will probably be true again in February, alongside a 25bp hike baseline for March and May.

Press conference: Expect Powell to maintain much of the rhetoric from the December meeting in February's press conference, with the overall message that the Fed will "stay the course until the job is done". It will be interesting to see how he answers the question of whether his perceived probability of a "soft landing" is increasing (he said in December: "lower inflation readings, if they persist, in time, could certainly make it more possible"). Overall though his talking points are likely to mostly lean hawkish, with Powell to:

- **Push back against market hike pricing once again.** First, Powell will point to the 5.1% terminal rate eyed by the Committee in December as still being the central case. Second, he will reiterate what he said at the December meeting: "we'll have to maintain a restrictive stance of policy for some time. Historical experience cautions strongly against prematurely loosening policy." Third, he will actively push back against rate cut pricing ("I wouldn't see us considering rate cuts until the Committee is confident that inflation is moving down to 2 percent in a sustained way…there are not rate cuts in the SEP for 2023"), though as usual, the market will probably take this in stride as mere posturing.

- **Re-highlight concerns about labor market strength offsetting inflation progress elsewhere.** Powell could again acknowledge that many areas of inflation are abating, but that there remain concerns over services ex-housing inflation – which in turn is "very fundamentally about the labor market and wages", in Powell's words. With Powell remaining relatively silent in the inter-meeting period, we heard from multiple senior Fed officials who both acknowledged relief over softening inflation prints, while eyeing strength in the labor market. NY Fed Pres Williams hinted that his assessment of risks included "encouraging" inflation readings offset by stronger-than-expected labor market numbers: "clearly some of the new inflation information has been encouraging, but the labor market has been coming in stronger than expected. I've been raising somewhat my forecast for growth and my view of the underlying strength of the labor market."

- **Note, if questioned, that a slowdown in the hike pace was compatible with an even higher terminal rate than currently envisaged.** Dallas Fed President Logan proposed in a January speech that a stepdown in rates would continue to provide flexibility to raise rates higher for longer: "A slower pace is just a way to ensure we make the best possible decisions. We can and, if necessary, should adjust our overall policy strategy to keep financial conditions restrictive even as the pace slows. For example, a slower pace could reduce near-term interest rate uncertainty, which would mechanically ease financial conditions. But if that happens, we can offset the effect by gradually raising rates to a higher level than previously expected."

Statement: Disinflation Characterization And "Ongoing" Concern
(Link to December FOMC statement)

The Statement was basically unchanged in December vs November, with no amendments to the closely-watched forward guidance, and the FOMC seemingly preferring the economic projections/dot plot to convey its outlook on future moves. MNI once again expects only limited changes to the statement.

Going paragraph by paragraph through the Dec 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 contributing to upward pressure on inflation and are weighing on global economic activity. The Committee is highly attentive to inflation risks.

- **These paragraphs were basically unchanged in December,** apart from a tweak in the language describing the impact of the Russia-Ukraine war as "contributing to" rather than "creating additional" upward pressure etc.
- **Most attention here will be paid to the characterization of inflationary dynamics.** The inflation phrasing has been the same for several meetings and could be due an update, acknowledging the slowing pace of price growth even as inflation remains elevated.
- Multiple FOMC speakers – from the hawkish (Waller) to the dovish (Brainard) -- sounded cautiously optimistic after the December CPI data that inflationary pressures were less worrisome.
- A more elaborate version could frame recent developments in light of the FOMC's new focus on the progress of core services ex-housing - but this will probably be reserved again for the press conference.
- The first sentence of the statement is often tweaked to reflect incoming activity data, and could be more nuanced if not downgraded outright. While market participants will be attentive to any major downgrade in the growth outlook, any amendments here are unlikely to have market impact.
- **It has been just under a year since the start of the Russia-Ukraine war, and at some point the reference to the will be removed** – though it's largely irrelevant to the overall message of the statement.
- **The commentary on "weighing on global economic activity"** looks increasingly dated with recent improvements in the Chinese and European economic outlooks, but it may be a meeting too soon for a change here.

"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 4-1/4 to 4-1/2 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."

- **Aside from the change in rates, MNI expects no change to this guidance, for reasons described above.**
- However if there are changes, they would almost certainly be in a more dovish direction. This could include changing "ongoing" to "additional / some further" increases to imply the end of the hiking cycle is approaching. Even more dovish would be deleting the sentence beginning "The Committee anticipates" altogether, which would

imply that the FOMC is no longer committed to further hikes; more dovish still would be signalling an outright pause ("no further increases").

- **The FOMC may want to cement its pledge to keep rates in sufficiently restrictive territory "for some time",** in order to push back against rate cut expectations. However, they have not included this language in prior statements even though participant after participant has underlined that they are not considering rate cuts.
- We've captured these possibilities in our Instant Answers.
- **The "in determining the pace of future increases" could be due an update with the downshift to 25bp.** While its inclusion again would probably be interpreted as the FOMC wanting to maintain the ability to upshift hike sizes again if warranted, it also runs slightly against Powell's emphasis on the terminal rate + holding in restrictive territory. This could instead lay out criteria which the FOMC will consider in assessing whether rates have reached sufficiently restrictive territory.
- No change is expected to balance sheet policy though Powell will probably be asked questions about a prospective slowdown or pause in QT later in the year for reserves management purposes.

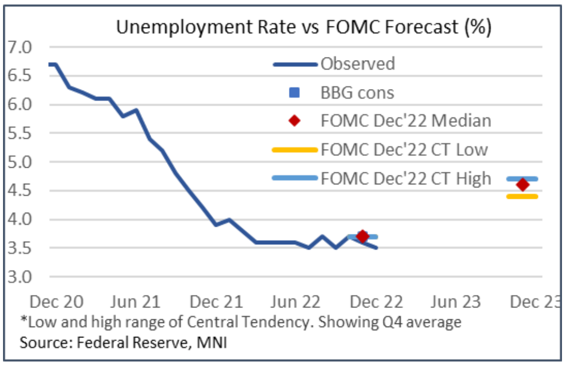
"In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of 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**. As we've written in previous previews, at some point the references to "readings on public health" will be deleted, as Covid infections are no longer a key driver of the outlook. This is not a market mover.
- **Dissents to the rate decision look unlikely**. None of the current voting members suggested opposition to a step-down to 25bp.
- **In the Implementation Note,** we expect a parallel 25bp shift in all of the main administered rates, with IORB rising to 4.65% and ON RRP rising to 4.55%.
- **There is some speculation that at some point this year the Fed could widen the IORB-ON RRP spread**, to dampen reserve repo facility use, but that's unlikely to occur at this meeting.

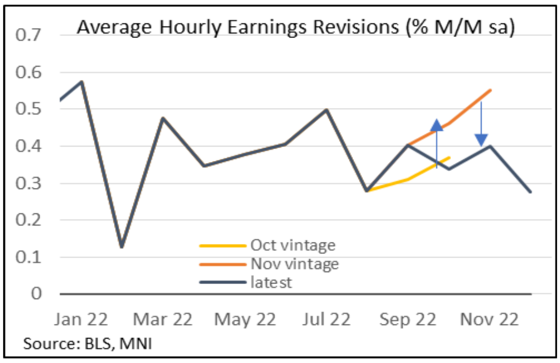
Macro Developments And Fed Pricing Since The Dec 13-14 FOMC

By Chris Harrison

After November's CPI report hit on day one of the two-day FOMC meeting, payrolls offered the first major release with broader strong details except for surprisingly weak average hourly earnings growth. Actual payrolls growth was broadly in line with expectations after revisions, continuing to run far hotter with a 3-month average of 247k than the ~100k that would allow for population changes as cited by Chair Powell late last year. What's more, a roaring back of employment in the separate, more volatile household survey saw the unemployment rate surprisingly falling to joint multi-decade low at 3.47% vs consensus for no change at 3.7%. This was all the more impressive after a larger than expected increase in participation on the month, and across both prime and non-prime age groups. However, both total and prime participation rates remain off post-pandemic highs seen in the summer, notably so in the case of prime age, and likely require further increases to more seriously allay Fed concerns of labour not returning to the workforce, including early retirees.



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

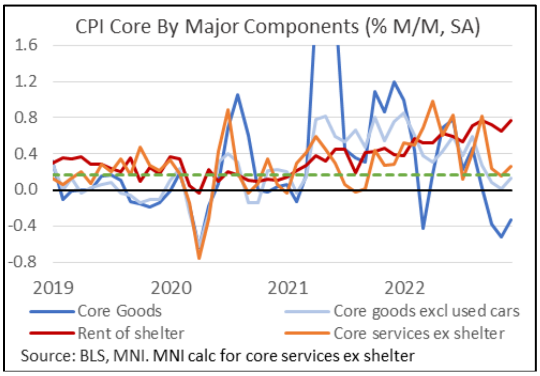


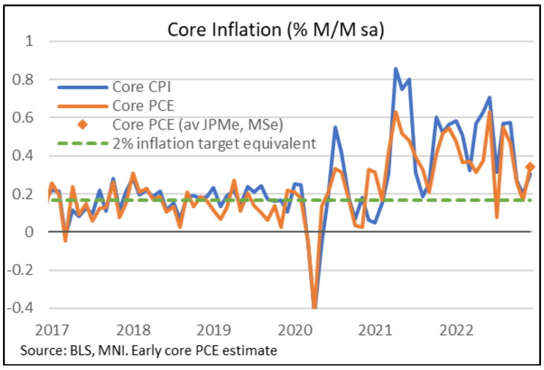
Source: BLS, MNI

Despite all those signs of labour market tightness, AHE took the headlines and increased the odds of a further downshift to a 25bp hike in February. Dovish market reaction at the time was amplified subsequently by the largest miss in ISM services since 2008, with the combination sparking a 25bp intraday rally in 2Y Treasury yields. The prior month's strong upward revision proved to be largely a head fake, with total AHE growth revised back down from 0.55% to 0.40% in Nov and slowing to 0.275% in Dec, the softest rate since Feb and before that Mar'21. Further, after an even stronger recent run, non-supervisory wage growth of 0.21% M/M (following a 0.43% revised down from 0.68%) was the softest since Jan'21. Importantly, compositional issues mean that just like we couldn't put too much weight on the prior upside, we equally can't get too carried away with this latest downside surprise. A far better test is yet to come with the Employment Cost Index for Q4 on Jan 31 (day 1 of the 2-day FOMC meeting). For now though, combined with average hours worked also falling towards the lower end of the pre-payrolls range, there are some marginal signs of labour demand moderation even if job openings remain historically elevated and weekly initial jobless claims trend lower at a rapid rate.

CPI inflation surprised in that it came in very much in line with expectations for once, with core CPI accelerating only modestly in M/M terms in December across major components. However, simply removing the possibility that inflation re-accelerated plus some more constructive details within the report helped see a 25bp hike on Feb 1 as almost locked in. Specifically, core CPI printed 0.30% M/M after November's 0.20% as all three major core components (shelter, non-shelter services and goods) accelerated. However, with standout strength in shelter expected to fade mechanically over time as weaker new leases feed through and the other two categories broadly kept to a recent softer trend. Digging even further into the details, an unusually strong increase in hospital services (the third strongest since at least 2000) likely temporarily biased non-shelter service inflation, a key segment for the Fed, higher. Further, there was sharper progress made on dispersion of inflation pressures, with MNI calculating that the share of the entire CPI basket seeing M/M inflation above 3% annualized in seasonally adjusted terms fell 7pps to 44%, the lowest since January 2021 and close to the 39% average through 2019.

The Fed is of course ultimately more focused on core PCE, which came in at 0.3% in December. That's nearly double the 0.17% M/M in November that had roughly been consistent with the 2% inflation target for the first time since July and before that February 2021. Nevertheless, the trend in core PCE inflation is at least moderating, from 4.7% annualized in Q3 to 3.9% in Q4.





Growth measures meanwhile have been a mixed bag, surprisingly strong at a headline level but rapidly cooling in some important components in the Q4 advance release. The real GDP beat (2.9% vs cons 2.6%) was heavily boosted by changes in inventories swinging from a -1.2 to +1.5pps contribution. Importantly, personal consumption confounded expectations of an acceleration as it surprisingly eased from 2.3% to 2.1% (cons 2.9%) whilst the drag from private investment intensified from -0.6pps to -1.2pps, its largest since the pandemic. The investment hit came as non-residential investment broadly paused after a strong Q3 whilst residential investment saw more of the same heavy declines (on its own dragging -1.3pps from quarterly GDP growth). The tepid non-residential investment outturn is all the more notable by the sharp slowdown in core durable goods orders, from 7.5% in Q3 to 0.1% annualized in Q4, suggesting little prospects of an uplift in the immediate months ahead. Tallying them up and final sales to domestic purchasers (aka final domestic demand) slowed from 1.5% to 0.8% annualized, whilst the private version of this measure of 0.2% annualized was the softest since the pandemic. Being just the advance release it is of course prone to revisions, but for now the net takeaway is that the year ended with a weak patch for underlying demand.

MNI Instant Answers:

The questions that we have selected for this meeting are:

- Federal Funds Rate Range Maximum
- Does the FOMC change the 1st paragraph to indicate an easing in price pressures in any category?
- Does the FOMC change the phrase "anticipates that ongoing increases in the target range will be appropriate"?
  - If yes, is the phrase deleted entirely and no other guidance on rates added?
  - If yes, does the FOMC say "further" or "additional" increases?
  - If yes, does the FOMC say it expects only one additional increase, e.g. "one further" or "an additional"?
- Does the FOMC say it expects to hold rates or will consider holding rates at their current level?
- 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.***

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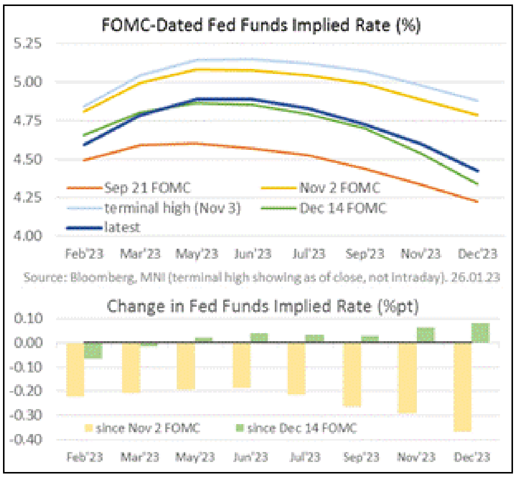
MARKET ANALYSIS

Market-Implied Rate Outlook



Source: Bloomberg, MNI Market News. Updated Jan 27, 2023

The market prices a 26bp Fed funds rate hike for Feb 1, a cumulative 45.5bps of hikes through the March meeting, 56bps of hikes to a peak of 4.89% for June, before 47bps of cuts to 4.42% at year-end. ***Updated Jan 26, 2023***

Central Bank Watch - FED

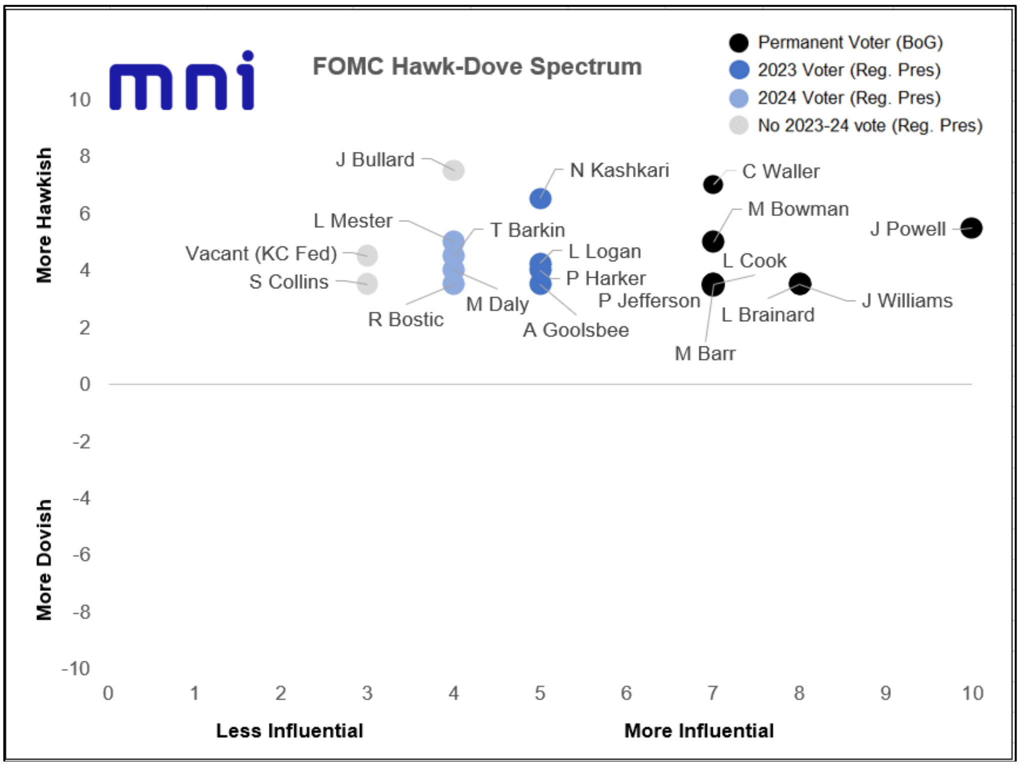
MNI FED Data Watch List

Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
CPI	% y/y	6.5	8.2	↓	9.1	↓					0.06
PCE Deflator	% y/y	5.5	6.3	↓	6.5	↓					-1.94
UoM 1-Yr Inflation Exp	% y/y	4.0	5.0	↓	5.2	↓					-1.85
Inflation Swap 5y/5y	%	2.58	2.16	↑	2.42	↑					0.19
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
ISM	Index	48.4	51.0	↓	53.1	↓					-1.95
Industrial Production	% m/m	-0.72	0.34	↓	-0.21	↓					-1.49
Factory Orders	% m/m	-1.8	0.2	↓	1.8	↓					-1.69
Housing Starts	K	1382	1465	↓	1575	↓					-1.01
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	1.86	2.24	↓	2.13	↓					0.84
Chicago Fed Financial Con	Index	-0.26	-0.04	↓	-0.13	↓					-1.29
Consumer Credit Net Chg	$bn	28.0	29.5	↓	26.9	↑					-0.24
New Home Sales	K	616	550	↑	571	↑					0.55
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	-1.1	-0.2	↓	1.0	↓					-0.78
Consumer Confidence	Index	108.3	107.8	↑	98.4	↑					1.32
Nonfarm Payrolls Net Chg	K	223	269	↓	293	↓					-0.91
Average Hourly Earnings	% y/y	4.6	5.1	↓	5.2	↓					-1.67
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Equity Market	Index	4060	3586	↑	3785	↑					-1.07
US 10-Year Yield	%	3.53	3.83	↓	3.01	↑					0.94
US Yield Curve (2s-10s)	bps	-66.2	-45.0	↓	6.0	↓					-0.80
USD TWI	Index	119.46	125.75	↓	120.16	↓					-0.34

- Both economic activity and price pressures have diminished over both 3- and 6-month periods, while financial conditions have clearly eased in recent months as well. Employment gains and wage growth have also softened. (***Updated Jan 26, 2023***)

Key Inter-Meeting FedSpeak – Feb 2023

- The annual rotation of voting regional presidents ushers in Chicago's Goolsbee, Philadelphia's Harker, Dallas' Logan, and Minneapolis' Kashkari as 2023 voters (a mostly dovish shift vs 2022's lineup of St Louis' Bullard, Cleveland's Mester, Boston's Collins, and KC's George).
- FOMC participants Waller, Collins, Bostic, Logan, and Harker each said their expectations was for a 25bp raise at the upcoming meeting. Others including Daly suggested openness to either a 25bp or 50bp hike.
- None explicitly endorsed another 50bp hike in February though Bullard's call for the FOMC to reach the terminal rate as quickly as possible implied another >25bp raise.
- **On the terminal rate:** Bullard, Kashkari and Mester ("little bit above the 5-5.25% median") said they pencilled in December Dot Plot end-2023 Fed funds expectations of 5.25-5.50%.
- In the 5.00-5.25% camp were Collins and Bostic.
- Barkin, Daly and Harker see rates rising above 5%, though weren't specific how much higher.
- The other members didn't state what their envisaged terminal rate was. (Recall in the December Dot Plot, 2 of 19 saw 2023 end-year rates of below 5.00-5.25%).
- All FOMC participants indicated that rates should be held at the peak for "some / a long" time.
- **Chair Powell's only appearance** was at an event in Stockholm in which he did not comment on current monetary policy (it was a panel on central bank independence; Powell said "restoring price stability when inflation is high can require measures that are not popular in the short term as we raise interest rates to slow the economy.")



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 December FOMC
		'23	'24	
J Powell	BOG, Chair	**X**	**X**	**No commentary on current monetary policy since December FOMC**
J Williams	NY Fed, V Chair	**X**	**X**	**On rate hikes:** "We're going to have to do what's necessary,.. it could be higher than what we've written down [in the December Dot Plot] …to me, the question of how high we have to get to is really going to depend on what we see in inflation and the supply-and-demand imbalance." **- Dec 16** **On inflation:** "I expect overall inflation to come back down to 2% in the next few years as further tightening of monetary policy realigns the balance between demand and supply…my view is that we're going to see a decline in inflation this year, driven primarily by things that were, you know, heavily dependent on commodities and some of the supply chain issues…We're committed to getting that overall inflation to 2%...that's going to require some further tightening of monetary policy to require slow growth in the economy to get there. But again, we're going to learn as we go". **– Jan 19** **On labor market:** "Clearly some of the new inflation information has been encouraging, but the labor market has been coming in stronger than expected. I've been raising somewhat my forecast for growth and my view of the underlying strength of the labor market." **– Jan 19**
L Brainard	BOG, V Chair	**X**	**X**	**On rate hikes:** "The FOMC moved policy into restrictive territory at a rapid pace and subsequently downshifted the pace of increases in the target range at its most recent meeting. This will enable us to assess more data as we move the policy rate closer to a sufficiently restrictive level, taking into account the risks around our dual-mandate goals." **– Jan 19** **On inflation:** "Even with the recent moderation, inflation remains high, and policy will need to be sufficiently restrictive for some time to make sure inflation returns to 2% on a sustained basis… the price trends in core goods and nonhousing services, the tentative indications of some deceleration in wages, the evidence of anchored expectations, and the scope for margin compression may provide some reassurance that we are not currently experiencing a 1970s-style wage–price spiral. For these reasons, it remains possible that a continued moderation in aggregate demand could facilitate continued easing in the labor market and reduction in inflation without a significant loss of employment. Nonetheless, substantial uncertainty remains". **– Jan 19** **On labor market:** "Recent declines in average weekly hours, temporary-help services, and monthly payrolls growth suggest tentative signs that labor demand is cooling....similarly, average weekly hours have declined...That said, labor supply appears likely to remain constrained. Despite constrained supply, wages do not appear to be driving inflation in a 1970s-style wage–price spiral...There are tentative signs that wage growth is moderating. I will be watching to see whether the employment cost index data at the end of this month show the deceleration from the third quarter continuing into the fourth quarter." **– Jan 19** **On monetary tightening lags:** "The lagged effects of earlier accommodation likely offset some of the initial effects of tightening over the course of 2022, and it is likely that the full effect on demand, employment, and inflation of the cumulative tightening that is in the pipeline still lies ahead." **– Jan 19**
M Barr	BOG, V Chair	**X**	**X**	**No commentary on current monetary policy since December FOMC**
M Bowman	BOG	**X**	**X**	**On rate hikes:** "I expect the FOMC will continue raising interest rates to tighten monetary policy, as we stated after our December meeting…my views on the appropriate size of future rate increases and on the ultimate level of the federal funds rate will continue to be guided by the incoming data and its implications for the outlook for inflation and economic activity…I will be looking for compelling signs that inflation has peaked and for more consistent indications that inflation is on a downward path, in determining both the appropriate size of future rate increases and the level at which the federal funds rate is sufficiently restrictive…Once we achieve a sufficiently restrictive federal funds rate, it will need to remain at that level for some time in order to restore price stability, which will in turn help to create conditions that support a sustainably strong labor market." **– Jan 10** **On labor market:** "So far, the job market has remained resilient despite higher interest rates and slower growth…unemployment has remained low as we have tightened monetary policy and made progress in lowering inflation. I take this as a hopeful sign that we can succeed in lowering inflation without a significant economic downturn. It is likely that as a part of this process, labor markets will soften somewhat before we bring inflation back to our 2 percent goal." **- Jan 10**
L Cook	BOG	**X**	**X**	**On inflation:** ""Inflation remains far too high, despite some encouraging signs lately, and is therefore of great concern. As a Fed policymaker, I am committed to bringing inflation back to our 2% goal…both figures are down a bit from the peaks reached in the first half of last year. However, monthly data are quite volatile, so I would caution against putting too much weight on the past few favorable monthly data reports,"**– Jan 6**
P Jefferson	BOG	**X**	**X**	**No commentary on current monetary policy since the December FOMC meeting**
C Waller	BOG	**X**	**X**	**On rate hikes:** "I currently favor a 25-basis point increase at the FOMC's next meeting at the end of this month. "Beyond that, we still have a considerable way to go toward our 2 percent inflation goal, and I expect to support continued tightening of monetary policy."**– Jan 20** **On inflation:** "Back in 2021, we saw three consecutive months of relatively low readings of core inflation before it jumped back up. We do not want to be head-faked. I will be looking for the recent improvement in headline and core inflation to continue."**– Jan 20** **On labor market:** "While the labor market is strong, it is also tight…wages, as I indicated earlier, are another stream of data that I will be watching for evidence of continued progress to help ease overall inflation. Though recent hourly earnings data are a positive development, I need to see more evidence of wage moderation to sustainable levels." **– Jan 20** **On financial conditions:** "If this loosening of conditions makes things looser in the sense that growth takes off, employment doesn't loosen and inflation starts to take off again then, yeah, we're going to have to do a lot more…the market has a very optimistic view that inflation is just going to melt away. We have a different view.

Member	Role	Voter '23	Voter '24	Monetary Policy Commentary Since December FOMC
				It's going to be a slower, harder slog to get inflation down and thus we have to keep rates higher for longer and not cut them before the end of the year." **– Jan 20** **On monetary tightening lags:** "I think it tends to be 9-12 months. So I think we are seeing a lot of the impact from monetary policy coming through in the next quarter or so." **– Jan 20**
P Harker	Phil Fed	X		**On rate hikes:** "I think we get north of 5 - again we can argue whether it's 5.25% or 5.5% - but we sit there for a while." **– Jan 18** "At some point this year, I expect that the policy rate will be restrictive enough that we will hold rates in place to let monetary policy do its work." **– Jan 20** **On labor market:** "GDP growth will be modest, but I'm not forecasting a recession. The labor markets are simply too hot to indicate a significant downturn at this point. **– Jan 18** **On the size of the hike at the next meeting:** "I expect that we will raise rates a few more times this year, though, to my mind, the days of us raising them 75 basis points at a time have surely passed…In my view, hikes of 25 basis points will be appropriate going forward". **– Jan 20**
N Kashkari	Minn. Fed	X		**On rate hikes:** "It will be appropriate to continue to raise rates at least at the next few meetings until we are confident inflation has peaked…I have us pausing at 5.4%, but wherever that end point is, we won't immediately know if it is high enough to bring inflation back down to 2% in a reasonable period of time…any sign of slow progress that keeps inflation elevated for longer will warrant, in my view, taking the policy rate potentially much higher." **– Jan 4**
L Logan	Dall. Fed	X		**On rate hikes:** "To put ourselves in the best position to manage the risks, I believe we shouldn't lock in on a peak interest rate. Rather, we need to continually and carefully assess what the incoming data imply about the economic outlook and adjust course accordingly… if you're on a road trip and you encounter foggy weather or a dangerous highway, it's a good idea to slow down. Likewise if you're a policymaker in today's complex economic and financial environment. That's why I supported the FOMC's decision last month to reduce the pace of rate increases. And the same considerations suggest slowing the pace further at the upcoming meeting." – **Jan 18** "We can and, if necessary, should adjust our overall policy strategy to keep financial conditions restrictive even as the pace slows. For example, a slower pace could reduce near-term interest rate uncertainty, which would mechanically ease financial conditions. But if that happens, we can offset the effect by gradually raising rates to a higher level than previously expected." **– Jan 18** **On inflation:** "It's hard to point to special circumstances that suggest services inflation will go away on its own. Rather, I see elevated services inflation as a symptom of an overheated economy, particularly a tight labor market, which will have to be brought into better balance for the overall inflation rate to return sustainably to 2 percent.**" – Jan 18** **On labor market:** "Some business contacts also tell me their hiring plans are slowing. In addition, wage pressures moderated in the latest national report on average hourly earnings. I'd need to see a lot more data, though, to be convinced the labor market is no longer overheated. To achieve better balance, labor supply will have to increase, or labor demand will have to decrease." **– Jan 18**
A Goolsbee	Chic. Fed	X		**New appointee, no commentary on current monetary policy since the December FOMC meeting**
T Barkin	Rich. Fed		X	**On rate hikes**: "Now, with forward-looking real rates positive across the curve and therefore our foot unequivocally on the brake, it makes sense to steer more deliberately as we work to bring inflation down." **– Jan 12** "I want to see inflation, and median and trimmed mean, compellingly headed back to our target…as long as inflation stays elevated, we need to continue to move the needle, to tighten if you will, ever more." **– Jan 17**
R Bostic	Atl. Fed		X	**On rate hikes:** "If the information I get from business leaders and others is consistent with [indications of slowing inflation, and the first signals we are getting is they are, I'll be comfortable moving at a slower rate, even 25 basis points, relative to what you saw us do through 2022."– **Jan 13** **On inflation:** "This report [December CPI] was really welcome news. It really suggests that inflation is moderating and it gives me some comfort that we might be able to move more slowly now that we are in restrictive territory." **– Jan 13**
M Daly	S.F. Fed		X	**On rate hikes and the terminal rate:** "I think something above 5 is absolutely, in my judgment, going to be likely. But when I say absolutely going to be likely, I still have uncertainty bands around that. But that's where I'm putting it right now. My own projection is we'll need to go above 5. How far above 5 we need to go, not completely clear. But importantly, we have a lot of data coming in and we have meetings in which we can debate this." **– Jan 9** Doing it in more gradual steps does give you the ability to respond to incoming information." **-Jan 9** **On the size of the hike at the next meeting:** "Heading into the next meeting I see those as both on the table, 25 or 50." – Jan 9
L Mester	Clev. Fed		X	**On rate hikes:** "We're not at 5% yet, we're not above 5%, which I think is going to be needed given where my projections are for the economy…I just think we need to keep going, and we'll discuss at the meeting how much to do… I was a bit higher than the median SEP projection for 2023." **– Jan 18** **On inflation:** "I think about what the most recent monthly numbers are telling us is that we can have some confidence or more confidence about the inflation projections, which do have inflation moving down this year…My own view is that it's going to take more policy action, to be assured that inflation is on a sustained downward path to 2% but I will — I do acknowledge that we've got some welcome news there." **– Jan 18** **On labor market:** "I'm anticipating we'll see some increase in the unemployment rate, but that it'll be less than one would typically see in an economic slowdown. I do have economic growth being well below trend. And that's going to temper the labor market, but it's just -- we're in a period where demand -- labor demand is still quite strong and quite a bit stronger than supply and so you can get that action of rebalancing on the demand side more than on the supply side." **– Jan 18**
J Bullard	St. Louis Fed			**On rate hikes:** "It now appears that the policy rate will move into the sufficiently restrictive zone during 2023. During 2023, actual inflation will likely follow inflation expectations to a lower level as the real economy normalizes…the policy rate is still a little bit below the sufficiently restrictive zone, so I think it would behoove the committee to get into that zone as soon as we can without ignoring the data." **– Jan 5** "I've liked the frontloading

Member	Role	Voter		Monetary Policy Commentary Since December FOMC
		'23	'24	
				policy, I think if we want to move to the low 5% level we should go ahead and get to that level so we get the disinflationary impact of that now,..the Fed is going to have to maintain rates at high enough levels to make sure inflation is moving down and staying down on a consistent basis." **– Jan 12 (post-CPI data) [On his 2023 Dot in the December Dot Plot]:** "We put in a dot for the end of 2023 at 5 1/4 or 5 1/2 percent. So I guess we're calling it 5 3/8ths. So that would be slightly higher than the median dot, although I would caution everyone that these kinds of things are a guess." **– Jan 18** **On being open to 50bp hike at the next meeting:** "Yes, why not go to where we are supposed to go, where we think the policy rate should be for the current situation?" **– Jan 18**
S Collins	Bos. Fed			**On rate hikes:** "I anticipate the need for further rate increases, likely to be just above 5%, and then holding rates at that level for some time…now that rates are in restrictive territory and we may (based on current indicators) be nearing the peak, I believe it is appropriate to have shifted from the initial expeditious pace of tightening to a slower pace – though appropriate policy will, of course, depend on a holistic review of available data. More measured rate adjustments in the current phase will better enable us to address the competing risks monetary policy now faces – the risk that our actions may be insufficient to restore price stability, versus the risk that our actions may cause unnecessary losses in real activity and employment." **– Jan 19** **On labor market:** "Bringing labor market conditions into better balance will therefore be critical to achieving our inflation target. While labor market activity has shown some signs of moderating, there is still a long way to go." **– Jan 19** **On the size of the hike at the next meeting**: "I think 25 or 50 would be reasonable; I'd lean at this stage to 25, but it's very data-dependent… adjusting slowly gives more time to assess the incoming data before we make each decision, as we get close to where we're going to hold. Smaller changes give us more flexibility." **– Jan 11**
Vacant	K.C. Fed			**Pres. Esther George is retiring and will not participate in the upcoming FOMC meeting. Her successor has not yet been named**

MNI Policy Team Insights

MNI: Strong Job Matching Aids Soft Landing Case-Fed Economist (Pub Jan 20, 2023)

By Pedro Nicolaci da Costa

(MNI) WASHINGTON – Minneapolis Fed economist Simon Mongey told MNI his research on job matching suggests that counter to the pessimism of some prominent economists, the high vacancy rate can still fall without a spike in unemployment, enhancing the chances of a soft landing.

Research from Olivier Blanchard and co-authors had indicated a jump in the jobless rate would likely result from a drop in vacancies due to the historical relationship between the two indicators. Mongey's findings suggest otherwise.

“Vacancies have been coming down steadily over the past eight few months” despite a 3.5% jobless rate matching 50-year lows, he said in a FedSpeak podcast interview.

“The large stock of vacancies – you can knock a few of them away without having a drastic effect on the number of matches formed in the labor market.”

That means the jobless rate doesn’t have to rise that much simply because vacancies are coming down, a trend thus far corroborated by the data.

STILL MATCHING

Mongey said the work of Olivier Blanchard and co-authors assumes there’s been a fundamental worsening in the job matching process because of the Covid shock.

“If you were to think this is a permanent change in the economy then as vacancies decline you would imagine unemployment would increase,” he said.

“What I find is that this measure of match-efficiency hasn’t deteriorated. You can lop off a lot of those leads without reducing the amount of matches, because you just have so much excess on one side of the market.”

Minneapolis Fed research director Andrea Raffo told MNI this week he thinks the economy can avoid a recession. (See MNI INTERVIEW: Fed’s Raffo Upbeat On Growth, Prices)

SUPER TIGHT

Vacancies data might even be understating job market tightness, Mongey said.

“We’ve got a very tight labor market which means that if you’re a firm and you’re trying to hire, it’s not enough to just open the position and have somebody walk into it, you’re also going to have to go out there and try to recruit as well,” he said.

He’s not worried about the level of labor force participation either, arguing that comparing it to the immediate pre-pandemic period can be deceiving.

“I find it kind of hard to see a drop-off in labor force participation relative to pre-pandemic. If you compare where we are to say mid-2018 … a lot of these participation rates are quite close to what they were before,” said Mongey.

Wage growth has picked up in part because of the large sector reallocation of employment following the onset of

Covid, Mongey said, but should subside once the process is complete and shifts from services spending to goods and then back normalize.

“With each of those reallocations workers are receiving wages compensating them for having switched jobs and switched sectors,” he said. “I’d imagine the allocation of employment across sectors at the end of the day is going to look the same. As the process of reallocation slows down, those wage pressures will subside.”

MNI INTERVIEW: Fed's Lags To Inflation Have Shortened - KC Fed

(Pub Jan 20, 2023)

By Evan Ryser

(MNI) WASHINGTON – The Federal Reserve's expanded toolkit over the years to include forward guidance and balance sheet policy means there's a shorter lag in policy transmitting to inflation, Kansas City Fed senior economist Taeyoung Doh told MNI, adding he expects a continuing deceleration in inflation.

"The peak impact on inflation is actually likely to happen right now in the first half of this year," he said, noting a significant jump in a proxy measure of the fed funds rate in the first half of last year and estimating a one-year time lag.

Still, it is likely less than half of the Fed's overall tightening has flowed into inflation so far, Doh said in an interview.

Recent research from Doh and San Francisco Fed coauthor Andrew T. Foerster suggests there may have been an acceleration in the maximum effect on inflation following the Fed's broader use of balance sheet and forward-guidance tools in 2009, reducing the time between policy moves and their peak impact from three years to as little as 12 months.

"It is not fully reflected yet," he said. "This [inflation] deceleration that we've seen recently has been driven by commodity price fluctuation and a lot of that depends on external conditions and not monetary policy conditions."

UNEMPLOYMENT UNCERTAINTY

The research from Doh and Foerster uses a proxy federal funds rate that incorporates public and private borrowing rates and spreads to measure the monetary policy stance and shows that monetary policy has been substantially tighter than the federal funds rate indicates.

The proxy rate peaked in the cycle in November at 6.44% before easing to 6.16% in December, declining for the first time since May 2021, due to a slide in mortgage rates and because of a continued fall in longer-dated Treasury yields. It could dip again for the month of January despite expectations for another fed funds rate increase February 1, Doh said.

Fed officials have recently taken to citing the KC Fed research to suggest monetary policy lags could be shorter. Fed Vice Chair Lael Brainard Thursday said "it is likely that the full effect on demand, employment, and inflation of the cumulative tightening that is in the pipeline still lies ahead."

But Doh said there is no statistically significant evidence that the unemployment response to policy tightening has changed in recent years.

"That huge uncertainty is driven by the factor that in the previous tightening we had very gradual tightening but the unemployment rate didn't move up," he said. "This seemed to suggest a very muted response of unemployment today as policymakers continue to raise rates but there is great uncertainty."

So far the KC Fed economist is cautiously optimistic there's a narrow chance for a soft landing in which inflation moderates and real growth remains positive and unemployment stays low. (See: MNI INTERVIEW: Minneapolis Fed's Raffo Upbeat On Prices, Growth)

"So far I don't see any contradiction in the data flow compared to the study."

MNI INTERVIEW:Minneapolis Fed's Raffo Upbeat On Prices, Growth (Pub Jan 19, 2023)

By Greg Quinn

(MNI) OTTAWA - U.S. inflation pressures are showing encouraging signs of softening and the country may avoid a deep recession and a more lasting era of stubbornly high price rises, Minneapolis Fed Research Director Andrea Raffo told MNI.

“The most recent readings on inflation not just in the United States but in several other economies are somewhat encouraging, in the sense that we do see a moderation,” he said in an FedSpeak podcast interview Wednesday.

Some commodity prices are returning to where they were before the Ukraine war, snags in global supply chains are easing and spending on goods is returning to normal after surging early in the pandemic, Raffo said.

“This is also a consequence of the strong actions taken by the FOMC and central banks around the world in raising rates, tightening financial conditions, and as a consequence reducing demand for some of these goods that tend to be also more interest sensitive,” said Raffo, who has also worked at the Fed's Board of Governors.

The Fed hiked rates from near zero last year to the highest since 2007 and investors see another quarter-point hike to 4.5%-4.75% after its Feb. 1 meeting. Consumer price inflation peaked at 9.1% in June and slowed to 6.5% in December. Fed officials project their preferred core PCE inflation measure at 3.5% this year and the economy basically stalling with growth of 0.5%.

WEAK LABOR SUPPLY

“Inflation remains uncomfortably high but the most recent months have shown some indication of moderation,” Raffo said. “I don’t want to share too much optimism but I think we are all hoping for a significant decline in inflation pressures over the course of 2023, and finally a return to more normal business conditions.”

Raffo joined the Minneapolis Fed last year, where President Neel Kashkari has moved to become one of the FOMC's most ardent supporters of hiking rates and holding at the peak until it's clear inflation is being crushed.

Weak labor supply remains a major concern for the U.S. economy, Raffo said, especially for services inflation. Labor force participation has stalled over the last year and rate increases mostly act on the demand side of the economy, he suggested.

“The key source of uncertainty is that unfortunately the legacy of the pandemic seems to be that the pool of workers in the United States has shrunk,” Raffo said. "We hope that the reduction in aggregate demand will be accompanied by a reduction in labor demand, and thus, fewer wage pressures, which would be a contributor to price pressures, especially in the service sector, which tends to be more sticky.”

The inversion of the Treasury yield curve has historically signaled a potential recession, Raffo said, but there's also a case to avoid that kind of downturn. The job market is very tight and reduced demand could cancel vacancies instead of forcing a surge of layoffs, he said.

TRADE CHUGGLING ALONG

“Especially in light of the most recent data on inflation, I think that the likelihood of a soft landing has somewhat increased, so we could experience a reduction in activity and below-trend growth this year, in line with the SEP projections, without necessarily going through a full-blown recession,” he said.

“The most recent developments have probably shifted the risks a little bit," he said. "They were clearly to the upside in terms of inflation and output, now they are probably starting to become a little more balanced.” (See: MNI: Fed Rates Likely Headed Above 5% Despite Cooling CPI)

Asked about the prospect of a new era of high global inflation triggered by aging populations or trade protectionism, Raffo again pointed to resilience. “I don’t see the damages coming from the actions taken over the past few years as having a long-lasting effect on global trade,” he said.

“As a matter of fact, as part of the shift of consumer demand away from services and toward goods, we’ve experienced one of the largest increases in trade during the Covid era," Raffo said. "It’s a reminder that actually trade remains a key engine of global growth."

MNI INTERVIEW: Atlanta Fed Tracker Shows Wage Growth Peaked (Pub Jan 13, 2023)

By Jean Yung

(MNI) WASHINGTON - U.S. wage growth has peaked since June and should help cool services inflation, Federal Reserve Bank of Atlanta economist John Robertson told MNI, though there is still some upward pressure coming from higher earners.

The three-month moving average of wage growth for the median earner has dipped to 6.1% from a high of 6.7% in June, though that's still quite a bit above the 3.5% to 4% range seen in 2019. The Atlanta Fed wage tracker uses microdata from the Bureau of Labor Statistics' monthly household survey comparing wages of the same person 12 months apart.

The figures indicate a cooling in the BLS's employment cost index for the fourth quarter, a closely watched gauge of wage growth by Fed officials. ECI data is due Jan. 31 as the FOMC begins deliberations on the size of its next rate hike.

"It does look pretty clear now that wage growth peaked in the middle of 2022," Robertson said in an interview. "That's consistent with some indications that maybe labor market tightness has loosened a little bit. Given the stubborn piece of inflation is likely to be the services component and that’s closely tied to wage growth, lower wage growth could feed into lower inflation."

Top Fed officials in recent weeks have pointed to stickier services inflation as they argue rates must climb above 5% and remain there this year. Some investors are betting the Fed will see compelling evidence inflation is moving back to 2% and cut interest rates late this year. (See: MNI: Fed Rates Likely Headed Above 5% Despite Cooling CPI)

JOB SWITCHING FOR RAISES

Higher-earning workers are still experiencing an upward trend in wage growth, Robertson said, perhaps as they demand some of the pay bumps won by lower-paid workers early in the pandemic.

"I'm starting to see a leveling off of wage growth for the lowest paid workers but continuing upward trends in the upper parts of the distribution," he said. "That moderates the overall level of decline in wage growth."

Many workers still lost purchasing power as wage gains lagged inflation, he said.

Median inflation-adjusted wages fell 0.9% in 2022 and 2.3% in 2021, compared to 1.6% growth in 2019. Roughly half of the Atlanta Fed's sample saw rising real wages and the winners tended to be lower-paid workers who won a bigger raise by switching jobs.

The Atlanta Fed wage tracker measures wage growth over a 12-month period and is "a bit of a lagging indicator," Robertson noted. Average hourly earnings data in the monthly jobs report offers a more near-term view -- albeit with compositional distortions -- and tells a similar story, slowing to 4.1% in December on a three-month average annualized basis compared to 6% last January, he said.

MNI INTERVIEW: CPI Rent Passthrough May Be Longer - Detmeister (Pub Jan 13, 2023)

By Evan Ryser

(MNI) WASHINGTON - Resilient shelter costs that surprised to the upside in December could make housing inflation more persistent, though a broad-based inflation slowdown that continued in the latest CPI report could foreshadow an earlier Federal Reserve pause in its interest rate increases, ex-Fed board economist Alan Detmeister told MNI.

"Rents were very strong and it's a bit of a concern for the next two or three months, maybe even into the early part of the summer," he said in an interview. "We're seeing inflation clearly slowing not only here but average hourly earnings is suggesting that as well and the Atlanta Fed wage tracker ticked down too."

Detmeister said CPI rents don't change the long run inflation outlook even though the passthrough from market rents to the CPI could be longer than previously anticipated.

"For the Fed in particular their monetary policy should not be driven by what they expect inflation to be over the next few months. It should be driven by what they expect inflation to be over the next two, three, four years," said Detmeister, former head of the Fed Board's wage and price section.

Rent prices "is an area where we have a strong view that inflation is going to fall but the exact timing is pretty difficult."

He's expecting a 29bp increase in core PCE and a 5bp rise in headline in December.

MAY PAUSE?

Prices for core services outside of housing rents, a component Fed Chair Jay Powell and his colleagues have highlighted, rose 25bp versus 12bp in November, but that was one of the smallest increases in the past couple of years.

Owners' equivalent rent and tenants' rent increases rebounded to 78 and 79bp increases after easing in the past couple of months. Market rent data continue to suggest a solid downtrend in rent increases over the next 12 months, he said.

Detmeister said he's expecting two more 25bp increases in the fed funds rate that would leave it in a range of 4.75% to 5%. He cited weakening growth prospects and a broad slowing in inflation, adding that much of last year's historic rate increases have yet to hit the economy.

Some former Fed officials see the Fed hewing more closely to a December SEP that showed 75bp of rate increases this year. (See: MNI: Fed Rates Likely Headed Above 5% Despite Cooling CPI)

"There's still a chance of a soft landing, but it's not the base case," said Detmeister, now at UBS.

"The expectations are that the biggest impact on the real side of the economy on GDP in the labor market move is 12 months after the change in interest rates. We're still not even a year from the first interest rate hike. You probably have not even seen half of the impact of the Fed hikes at this point."

MNI INTERVIEW-Fed Could Pause Hikes As Early As March–Sahm (Pub Jan 12, 2023)

By Pedro Nicolaci da Costa

(MNI) WASHINGTON - The Federal Reserve is likely to further reduce its rate hike pace to a quarter point at its Feb. 1 decision and could be on track to pause rate increases altogether after that as inflation shows further signs of softening, former Fed board economist Claudia Sham told MNI.

Sahm said the strength of the labor market means the Fed can still pull off a soft landing, but only if it backs off of the idea that it must significantly weaken employment conditions in order to reduce price pressures.

“I think there’s a path towards a 25 basis point increase at the coming meeting. And if the good news keeps coming in, they could pause,” she said in an interview with MNI’s FedSpeak podcast.

“In the press conference, Jay Powell laid the groundwork, he didn’t promise 25 but it did come out of his mouth and we’ve seen again Mary Daly recently. And Lael Brainard for months has been a voice saying ‘we shouldn’t go too fast.’”

HOUSING TO BECOME CPI DRAG

Sahm, also previously a senior economist at the White House Council of Economic Advisors, said signs of easing inflation pressures are coming not only from the unsnarling of supply chains and weak imports prices but also from a decline in rental costs that she says will soon be reflected in the CPI. (See MNI INTERVIEW: CPI Could Bring Forward Fed Pause-Ex-Staffer)

“On the market, rent prices are falling. We’re going to have housing services be a drag on inflation. By June, late spring, early summer, those prices could fall,” she said. “And housing services is a good bit of CPI. And we’re going to see other things turning over. Supply chains are healing, import prices look good. There’s a whole bunch of things that are looking good.”

Tomorrow’s CPI report is hard to predict but she said it the consensus about a better-than-expected reading could prove misguided.

“Yes, we’re seeing improvements but this is going to be a wild ride,” she said.

NO RATE CUTS THIS YEAR

Sahm said the prospect that growth will hold up nicely this year will mean that the Fed will follow through on its promise, thus far not believed by markets, not to cut interest rates in 2023.

"I take them at their word. I think the Fed is very serious about saying they're not going to cut even when unemployment goes up," she said. "They think 4% unemployment is sustainable for the economy, we're at 3.5%. The Fed would be happy, or comforted if we get another half a percentage point on unemployment."

Still, she said the idea of raising unemployment just enough to cool off inflation pressures is "playing with fire," particularly in light of her research, codified in something known as the Sahm rule, which suggests joblessness can take on self-fulfilling momentum.

"That's what my recession indicator shows – you get a half a percentage point increase relative to the low of the prior year and you're in the early months of a recession," she said.

"It could break this time, meaning you get a half a percentage point and you go up a little bit more but it stops. But not only has it happened historically, but there's a logic to, once unemployment gets going it keeps going. You start getting these feedback effects."

MNI: Fed Rates Likely Headed Above 5% Despite Cooling CPI (Pub Jan 12, 2023)

By Jean Yung and Pedro Nicolaci da Costa

(MNI) WASHINGTON - The Federal Reserve is likely to lift its benchmark interest rate above 5% to restrain inflation as long as the job market remains overheated, even with consumer prices falling in December for the first time since early 2020, former officials told MNI.

Markets are pricing another downshift in the pace of rate hikes to a quarter point next month and a rate peak around 4.9% after CPI cooled for a sixth straight month and several Fed officials said they would support a 25 bp move. Investors are also expecting a half-point rate cut by year-end, even with the latest FOMC dot plot calling for a 5.1% rate in December.

Encouraging inflation data isn't likely to shake Fed officials' resolve to raise rates above 5% and keep them there all year, the former officials said. That comes after CPI surged to 9.1% last summer, creating fears of embedded price gains.

"I expect them to step down to 25-bp steps. I think they'll do at least two and probably three," former New York Fed president William Dudley told MNI. "There is some risk of a pause and then a restart but not likely. They don't want that, and their preference would be just to keep rates elevated for longer."

TREND INFLATION STILL HIGH

Support for ratcheting down to a 25-bp move at the next meeting appears to be growing, former Atlanta Fed President Dennis Lockhart told MNI. That said, Fed Chair Jerome Powell "has been clear in past comments that the committee prefers overshooting somewhat to the error of undershooting."

Following Thursday's inflation report Philadelphia's Pat Harker said he favors a few more quarter-point moves while St. Louis President James Bullard said he wants to go faster to bring rates above 5%. Tom Barkin said in Richmond that while he favors going slow, rates could end up higher to curb price and wage inflation.

The FOMC is seeking a stopping point that gives them confidence disinflation will gain momentum. It's not yet clear that trend inflation is solidly on its way down, the former officials said.

The Cleveland Fed's median and trimmed mean CPIs were both up 0.4% for the month, rising 6.5% and 6.9%, respectively, from a year earlier. The trimmed mean PCE inflation from the Dallas Fed is still running over 4.5%, noted former New York Fed research director Stephen Cecchetti, now professor at Brandeis International Business School.

"The important thing for the FOMC is to make sure that the policy rate gets above trend inflation. This surely means going to 5% or higher," Cecchetti said. The fed funds rate was raised 50 bps in December to a 4.25%-4.5% target range.

LABOR MARKET PROBLEM

Powell has signaled he is looking for signs that the overheated labor market is losing steam as assurance inflation will fall toward 2%. Wage growth moderated in December but employers added another 223,000 jobs, twice as much as needed to absorb new workers, and the unemployment rate sank back to a 50-year low.

"To the extent that the labor market is the key focus driving policy, I don't think there has been enough movement toward supply-demand balance to justify a stepdown at the next meeting," Lockhart said, adding he still sees a case for a second straight 50-bp hike in February.

U.S. labor market strength remains key to policymaker deliberations, Dudley said. "Without considerable softening it will be hard to be confident that you will get back to 2% inflation."

MNI INTERVIEW: US Rent Inflation May Turn Negative - Apt List (Pub Jan 11, 2023)

By Evan Ryser

(MNI) WASHINGTON – Rent inflation is likely to ease in the December CPI report due Thursday and potentially turn negative by the second quarter of this year, online rental marketplace Apartment List's senior housing economist Chris Salviati told MNI.

Apartment List's national rent index has been declining for the past four months and is expected to slide further before turning higher again later in the spring. The index fell 0.8% in October, over 1% in November, and 0.8% in December, the three sharpest month-over-month declines in the history of the index going back to 2017, and is down 3% since its August peak.

"We're now starting to turn a corner after a period of really rapid rate growth where we're now starting to see a shift to a much cooler market," Salviati said in an interview. Rent in November and December rose by roughly 50bps less than in the same months in 2017 to 2019, according to Apartment List data.

That should drag down the rent component of CPI, which has hovered at around 0.8% for the past three months, said Salviati. "We've probably got at least a couple more months of positive month-over-month growth in the in the shelter component of CPI before it starts to peak, but I do think that we might start to see those monthly rates slowing if not turning negative potentially in the first quarter but certainly in the second quarter."

BARGAINING POWER

The Labor Department's CPI report Thursday is expected to show core inflation nudging up 0.3% in December after surprising lower with a 0.2% gain in November. Analysts expect the rate of price increases in the owners' equivalent rent and tenants' rents categories to dip by about a tenth compared to November.

CPI rent may take some time to catch up to other other measures of rent price growth, Salviati said, pointing to a recent Cleveland Fed report that launched new indexes tracking rental price changes for new and existing tenants and has shown a drop in rental prices. (See: MNI INTERVIEW:US CPI Rent Costs To Gain Momentum - Fed Economist)

The larger story in 2023 will be cooling demand colliding with increasing supply, driving a cool down in price appreciation. While a recession could push rents negative, Salviati's baseline is for the Apartment List's national rent index to rise between 0% and 3% this year, below its 3.8% gain in 2022 and a 17.6% jump in 2021.

Vacancy rates have normalized since bottoming in the second half of 2021 at 4.1%, reaching 5.9% in December, and there's potential it could move above 7%, he said. With a record number of multifamily apartment units under construction, "It's certainly possible that we could see kind of a bit of a glut in new supply at least temporarily," he added.

"Later this year we might be in a in a scenario where you've got properties competing for renters to fill their vacant units rather than the other way around."

MNI INTERVIEW: Fed Can Tame Inflation Without Slump-Andolfatto (Pub Dec 19, 2022)

By Pedro Nicolaci da Costa

(MNI) WASHINGTON - Falling inflationary pressures as supply shocks ease and fiscal stimulus is reduced should allow the Federal Reserve to conclude its tightening cycle before it prompts a recession and any big spike in unemployment, former St. Louis Fed economist David Andolfatto told MNI.

“You take a look at the most recent inflation prints, on a monthly basis they’ve come down quite a bit. Year-over-year it looks like you’re getting a nice hump-shaped pattern,” he said in an interview following the Fed’s decision to raise interest rates by another half percentage point last week.

“The Fed can bring inflation down more rapidly than it otherwise would fall, but the reason it’s falling is that fiscal policy has gotten its act together. Why do we need the Fed to spur a recession to bring inflation down more rapidly at the expense of unemployment? Just let inflation come down gradually without the social cost of putting a bunch of people out of work.”

Andolfatto said there is still a risk that the Fed take its monetary tightening campaign too far due to officials’ fear that inflation will prove more persistent than they expect.

“I’m little bit worried,” said Andolfatto, who left the St. Louis Fed six months ago after 13-1/2 years, and is now at the University of Miami.

“They want to see evidence that inflation is coming down persistently, they don’t trust the month-over-month figures, for one month, two months, three months, they might need four months, five months. They don’t want to be headfaked. That desire not to fall for the headfake” creates the danger of overtightening, Andolfatto said.

SO FAR SO GOOD

However, that is not his base case because he thinks policymakers, aware of their dual mandate of price stability and full employment, will remain cognizant of the danger of doing too much.

“As things are unfolding right now, the recent CPI, I’m looking at it with some satisfaction. Inflation is coming down, the unemployment rate is still low, it might tick up a little bit but the numbers still look okay,” he said. Andolfatto was one of the first Fed staffers to warn of the risk of post-pandemic inflation, and he also said in June that inflation had likely peaked when few others were willing to make that call.

These days, his prediction is looking rather prescient: the headline consumer price index has been falling steadily since June, when it hit a cycle peak of 9.1%, coming down to 7.7% in November. The Fed raised rates seven times this year to a range of 4.25%-4.5%.

LABOR MARKET NOT OVERLY STRONG

Andolfatto pushed back against the notion, proposed by many prominent economists and market participants, that a major spike in unemployment and a deep recession are needed to bring down inflation.

“There are forces in place that will move inflation back to target,” he said.

At the same time, he disagrees with the Fed’s argument that the labor market is somehow too strong, including Chair Powell’s assertion that wage growth is too robust to be consistent with price stability.

“Powell keeps on talking about the very strong labor market and demand for workers. How is it possible that the labor market is so strong when real wages are still going down? That position is very untenable,” he said.

“He says we see very rapid wage gains that are not consistent with 2% inflation and lower productivity. But if labor productivity is so low, why are firms screaming for workers?”

MNI INTERVIEW: Fed Will Resist Pressure To Cut In '23 -Blinder (Pub Dec 16, 2022)

By Jean Yung

(MNI) WASHINGTON - The Federal Reserve may avoid hiking interest rates beyond 5% if inflation keeps slowing while resisting pressure to cut for longer than investors expect, former vice chairman Alan Blinder told MNI.

Blinder sees continued tight policy even as he predicts most of the pain from rate hikes on the U.S. economy is still to come. That's because most of the inflation slowdown so far is from improving global supply chains rather than Fed action to create slack in the labor market, he said.

"The first few points of inflation reduction the Fed gets almost for free," he said. "The part that is slack in the economy -- bringing down wage increases and service prices -- is the harder part. It will come slowly and gradually."

"We haven’t seen hardly any of the pain yet," he said. "I don’t think they’ll be cutting soon. The bottom would have to fall out of the economy for that to happen. The question is how much higher they're going to go and at what pace."

SLACK NEEDED

While some longer-term bond yields have tumbled in recent weeks on bets the Fed will begin to trim rates next year, officials have pushed back in the comments around Wednesday's half-point hike and again on Friday at a talk by San Francisco President Mary Daly. The Fed's latest projections suggest a peak rate of about 5.1% by the end of next year.

The Fed has become more pessimistic about the rate hikes needed after its early inflation optimism was proven so wrong, Blinder said. But if better-than-expected inflation keeps up for another three or four months: "I don't think the Fed's going that high."

Still, Fed officials are glossing over how higher rates will be felt in the job market, Blinder suggested. The unemployment rate is likely to crest closer to 5% than the 4.6% projected by the FOMC this week, he estimates.

"What it's going to take is more slack. That’s what the Fed is trying to do without saying much about it," Blinder said.

WEAKENING HAS BEEN MODEST

The jobless rate and hiring numbers "haven’t moved much yet" in that kind of direction, he said. The unemployment rate at 3.7% remains below the Fed's estimated equilibrium level. Monthly payroll gains have come down to about 260,000 from half a million earlier this year but remain more than double the 100,000 needed to keep up with workforce growth.

Workers quitting at higher rates and striking for heftier raises across the country are also indicators of strength, he noted. Wages are showing little movement up or down, and that's reflected in elevated service prices, he said.

While the Fed may be willing to approach recession territory to meet its inflation goal, the stock-market sell-off on recession fears is unjustified, Blinder said. Disappointing retail sales and PMI data this week point to an economy that's weakening, but at a modest pace, he said.

"It doesn’t look to me that indicators are pointing to a recession more than a couple months ago," he said. Odds of a soft landing actually appear to be improving on the back of better inflation numbers and not-as-weak real growth numbers, he added.