

MNI Fed Preview: June 2023

Meeting Dates: Tue-Wed, Jun 13-14

Decision/Statement/Summ Of Econ Projections: Wed 14 Jun at 1400ET / 1900UK

Press Conference/Q&A: Wed 14 Jun at 1430ET / 1930GMT

Minutes: Wed 5 Jul

Links (likely URLs based on previous meetings):

Statement: <https://www.federalreserve.gov/newsevents/pressreleases/monetary20230614a.htm>

Summ of Econ Proj: <https://www.federalreserve.gov/monetarypolicy/fomcprojtabl20230614.htm>

Implement. note: <https://www.federalreserve.gov/newsevents/pressreleases/monetary20230614a1.htm>

Press Conference: <https://www.federalreserve.gov/monetarypolicy/fomcpresconf20230614.htm>

MNI Review of Previous FOMC (May): <https://roar-assets-auto.rbl.ms/files/52765/FedReviewMay2023.pdf>

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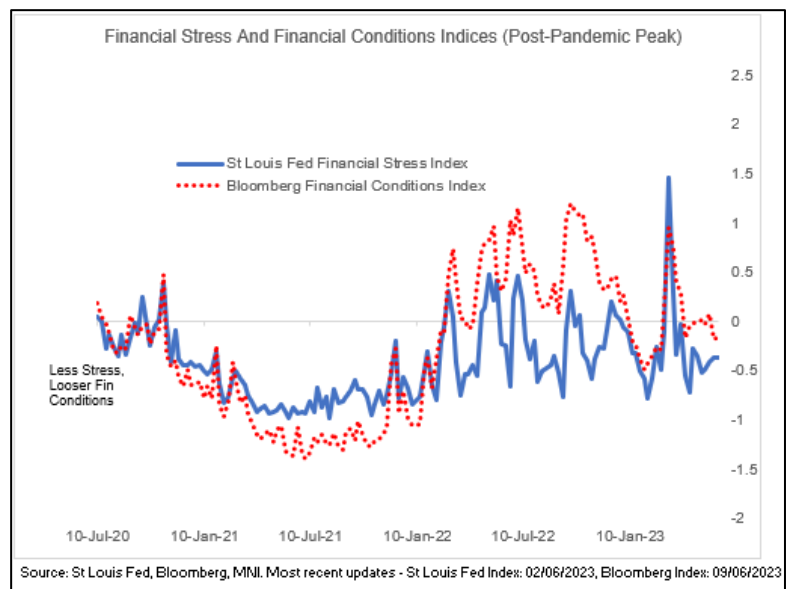
MNI POV (Point Of View): How To Communicate A Hawkish Hold

By Tim Cooper

- *The FOMC's tightening cycle is likely to "skip" June's meeting, with the Committee holding rates at 5.00-5.25% while signalling that it currently expects to hike at the following meeting in July.*
- *While data and events since early May have on balance probably justified another 25bp hike, some data have left room for doubt, and the FOMC has set a fairly high bar to further tightening.*
- *In an effort to maintain a hiking bias, the Statement's forward rate guidance is likely to remain unchanged, with the updated economic projections showing that an additional rate hike is expected by year-end.*
- *The main reason to galvanize communications around a bias of future hikes is not just to placate the hawks, but to ensure that expectations of a cut don't rise with any hint that the FOMC is implying the next move will be down.*

Notwithstanding an extraordinary surprise in the May CPI reading due June 13th, the most likely outcome for the June 13-14 FOMC meeting is the rate hold that was hinted by Chair Powell and the Committee at the May meeting.

Data and events since early May have - on balance - actually leaned to a hike decision, in our view. That includes stubborn core ex-housing services PCE prices (with some Fed officials suggesting that concerns over housing inflation are resurfacing, [see our note here](#)) and still-strong jobs growth. Economic surprises have tilted to the upside overall, particularly the "hard" data including nonfarm payrolls. The two biggest lingering uncertainties - the Federal debt ceiling impasse and banking crisis - have respectively been resolved / have abated (*see chart at right of financial condition stress pulling back*). Pricing still remains for a decent chance of a 25bp June 14 hike (around 25% probability).



But other data have left room for doubt (see our *Macro Developments* section starting page 6), and we can't help but notice that the more dovish readings of late have seemingly had a more outsized reaction vs the hawkish data. The unheralded downward revision in Unit Labor Costs eclipsed the very strong ADP private payrolls data for example, while an initial jobless claims miss on Jun 8 also brought a strong dovish reaction. Most notably the strong headline May jobs figure, while arguably in the context of a mixed report as a whole, had only fleeting impact on market hike pricing.

The Last Meeting Set A High Bar For A Hike

The main reason for expecting a hike vs a hold in June, though, is Fed communications. The most prominent was soon-to-be-Vice Chair Jefferson's call for a "skip" (joined by Philadelphia Fed Pres Harker), an important development from which June hike pricing never really recovered. And as we noted in the May FOMC review, the bar to a June hike was set pretty high by Powell and co, and if there was any ambiguity ahead of the meeting, the default decision would be a hold as the Fed bides time to get more information about the trajectory of the economy. That's both because most FOMC members, including the very senior leadership, genuinely believes that in its modal scenario it has caught up with the inflation tide, and the risks are more finely balanced between over- and under-tightening. There's also a hint of hoping for a "soft landing" while inflation drifts back toward target.

Several officials disagree: we'd eye Mester, Bullard, Kashkari, Logan, Bowman, and Waller as the most likely candidates to back a June hike. (Ironically, Logan was one of the first - [back in February](#) - to signal she could support a "skip".) But that's a minority of 6 out of 17 active participants (noting the vacant seat for Brainard and, effectively, the KC Fed), and while we think Powell is genuinely willing to listen to arguments, he has seemed amenable to "skip" a meeting. Williams and Jefferson are also on board with a hold, and as it stands they will have support from others including Harker, Daly, Cook, Goolsbee, Bostic, and Collins.

Barkin sounds uncomfortable with the inflation outlook (see our interview with him in the Policy Team section later in this preview) but we'd guess he's agnostic about whether a hike is necessary this month or can wait until July. Barr is neutral but will go with the Chair's decision - as our Policy Team noted in their [recent article on the divisions](#) within the FOMC on the June decision, the Fed hasn't seen a governor dissent since 2005 - which is why soon-to-be Vice Chair Jefferson's call for a "skip" was an important development.

How To Communicate A Hawkish Hold

With a sizeable divide on a hike vs hold likely, the June FOMC meeting will be about keeping rates steady but communicating that the Fed isn't necessarily done hiking yet. The "skip" approach that appears to have gained ground just prior to the pre-meeting blackout period is a compromise underlining that the burden of evidence as - since the May meeting - shifted to those who see further tightening as necessary. Those on the FOMC who see the job as not yet done will expect to see further evidence to that effect over the subsequent six weeks. But they can be persuaded. Likewise, the doves expect their approach to be vindicated by further disinflation progress. Indeed, the main choice at June's meeting is whether to 1) hold rates while retaining a hiking bias into July or 2) hike 25bp with less of a hiking bias.

The main reason to galvanize communications around a bias of future hiking is not just to placate the hawks, but to ensure that expectations of a cut don't increase with any hint that the next move is implicitly seen by the FOMC to be downward. The Statement will reflect this caution, probably by maintaining the current language intact ("*In determining the extent to which additional policy firming may be appropriate...*") The dots will serve a similar purpose, probably shifting up by 25bp per year in 2023-24, though there is some possibility of a schism within the distribution of hawks and doves that bears watching.

And Powell will keep the door clearly open to a July hike pending the data. Back at February's FOMC press conference, when asked whether the Committee had considered the idea of taking a meeting off and then resuming rates: "In principle, though, you know, we used to-the thing we used to do was go every other meeting, if you remember, 25 basis points, and that was considered a fast pace. So I think a lot of options are available. And I mean, you saw what the Bank of Canada did and, you know, they left it that they're willing to raise rates after pausing." He could note that a pause and a data-dependent subsequent hike is hardly a dovish development, particularly given that policy is either regarded to be at or very near "sufficiently restrictive" territory. And perhaps it was fateful that the Bank of Canada unexpectedly resumed hikes on June 7. Powell could namecheck the BoC again as an example of how it's possible for a central bank to follow through on a hike after a "conditional pause".

Statement: Skip Won't Change Tightening Bias

([Link to May FOMC statement](#))

Assuming the FOMC opts for a "skip" in June with an eye to giving serious consideration to a hike in July, it's unlikely that the June Statement will change much from the previous edition in May. In particular, the forward guidance will be eyed, but it's unlikely we see much change there as the existing language encompasses a hiking bias.

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

Economic activity expanded at a modest pace in the first quarter. Job gains have been robust in recent months, and the unemployment rate has remained low. Inflation remains elevated. The U.S. banking system is sound and resilient. Tighter credit conditions for households and businesses are likely to weigh on economic activity, hiring, and inflation. The extent of these effects remains uncertain. The Committee remains highly attentive to inflation risks.

- **No substantial changes to the description of economic dynamics are likely, though as usual for the June statement the timeframe will be changed to reflect that the 1st quarter GDP data are in:** "Economic activity appears to have remained steady after expanding at a modest pace in the first quarter."
- **Nor would we expect any changes to the paragraph introduced in March's meeting amid banking turmoil,** as it captures the FOMC's expectation of tighter banking conditions – though with a highly uncertain magnitude.

*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 5 to 5-1/4 percent.** The Committee will closely monitor incoming information and assess the implications for monetary policy. In determining the extent to which **additional policy firming may be appropriate to return inflation to 2 percent over time, 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 its previously announced plans. The Committee is strongly committed to returning inflation to its 2 percent objective.*

- **The policy decision will be the most impactful part of the decision** – MNI expects a hold at current levels, with the sentence reading "decided to keep the target range for the federal funds rate at 5 to 5-1/4 percent".
- **The forward guidance could change** for one of two main reasons:
 - **The FOMC wants to accompany a hold with language that explains its decision** as intended to gain more time to gather more data to determine the extent to which further tightening may be appropriate. In a more hawkish version of this it could also tweak language to more forcefully suggest that it intends to hike at least once more.
 - **Or less likely: the FOMC wants to shift toward a neutral stance by modifying or eliminating the hiking bias** ("additional firming may be appropriate"). This would of course be interpreted dovishly though such a change would probably only happen were the Fed to hike at this meeting. In this case the Statement would probably add language emphasizing that the FOMC intends to hold rates at the new level for an extended period of time.
- MNI expects the existing guidance to remain largely as-is, as it already signals the Committee's tightening bias, likely complemented by an upward shift in the median projections "dot" profile.
- Additionally, changes to the language on QT are very unlikely.

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 labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

- **No changes to this paragraph are likely.**
- **In the Implementation Note,** we expect all of the main administered rates to remain unchanged.
- **No dissents are expected.** Though as our Policy team noted in their Jun 1 story ("MNI POLICY: Fed Most Divided Since Start Of Hikes, More Loom", the most likely dissenting voters if any would be Kashkari/Logan (dissenting against a hold) or Harker/Goolsbee (dissenting against a hike).

Summary of Economic Projections: Dots To Nudge Higher

[\(Link to March SEP\)](#)

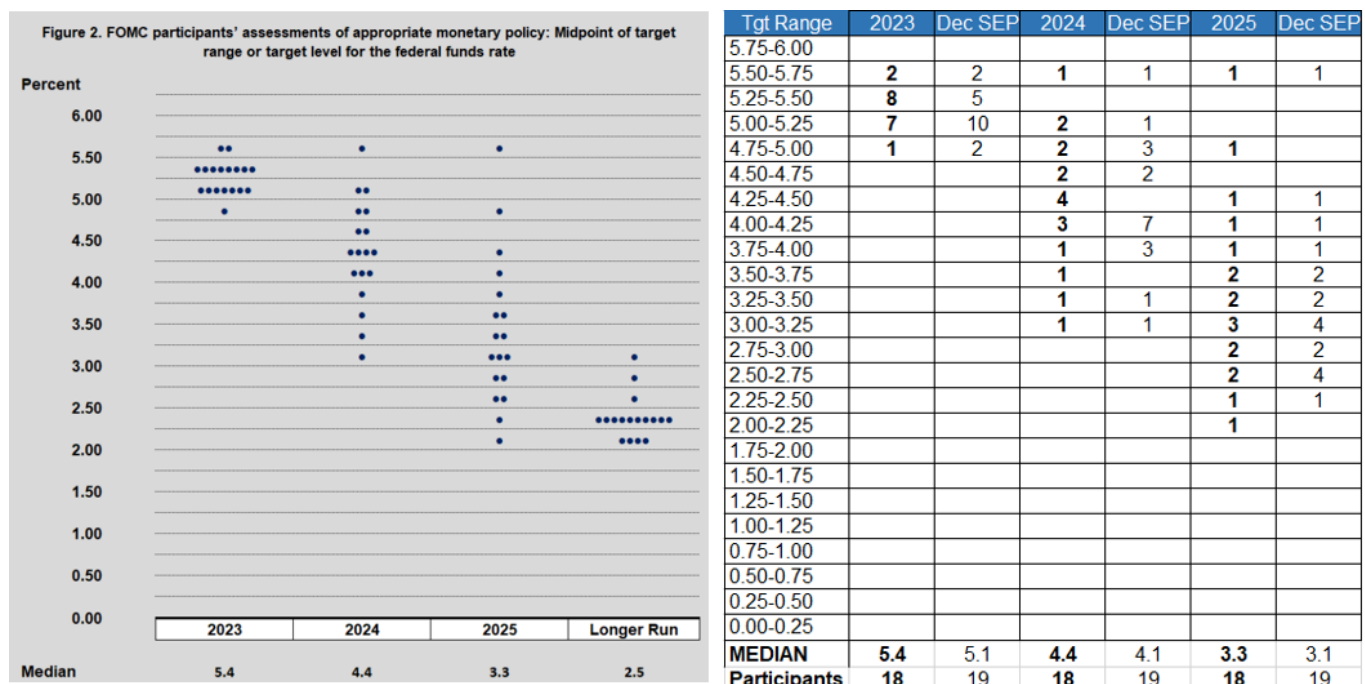
It's very likely the FOMC retains its hiking bias in the June meeting communications, but it's debatable whether we end up with a higher median 2023 end-year rate Dot which would clearly emphasize that the Committee intends to hike at least one more time. Of course, a surprise 25bp hike at this meeting would mechanically force a 25bp shift higher to 5.4% from 5.1% (where it has been for the last 2 updates), but apart from that, the numbers on the Committee make it tricky to see a shift much higher.

The previous SEP in March showed 7 dots above the 5.1% that was eventually reached in May. A solid 10 of 18 were right at 5.1% (1 at 4.75-5.00% suggested someone thought March's would be the last hike). Recall that these projections were made in the midst of the banking crisis, and when a hold was considered. Even with this backdrop, there was some analyst expectation that the median would rise to 5.4%.

2023: MNI thinks June's SEP will see a rise to 5.4% for 2023: the most hawkish 7 of the 18 will remain above 5.1%, and they need to be joined by 2 others to move the dot higher (by 1/8 percentage point to 5.25%, splitting 5.125 and 5.375). 8 of them could be Mester, Bullard, Kashkari, Logan, Bowman, Waller, Barkin, and the KC Fed stand-in. Getting to 9 let alone 10 may prove dependent on the June 13 CPI reading. In this way we could see the data influencing a hawkish message delivered through the Dots signaling a lean toward a July hike, but not necessarily a hike itself. If there is only limited support for a 5.4% end-year rate (i.e. 6-7 still see no further hikes), that could be dovish on the margin. If there are 6+ members looking for rates above 5.4% by year-end, that could be interpreted hawkishly.

2024/2025/L-R: While almost all attention will be on the 2023 dot, we note our expectation that if it's raised 25bp, we'd expect the 2024 and 2025 medians to be raised as well. This would be in keeping with the previous revisions, and raising the 2023 dot while keeping 2024 steady would imply more aggressive cuts next year (87.5bp cuts currently implied; would rise to 115bp if 2023 goes to 5.375% while 4.25% is retained). By the same token, though, the "split" median of 4.25% for 2023 means there shouldn't be much read into a 12.5bp increase in the median for that year. Our assumption is that at least one of the 9 2024 dots at or below 4.1% migrates to above 4.1% which would raise the median to 4.4%, but the bar to a 4.6% median appears high. We expect 2025's dot to rise 25bp to 3.4% (3.375%), while we don't expect any changes to the longer-run dot at 2.5%.

Below are our expectations for the June Dot Plot:



Changes To Macro Projections: Outside of the Fed funds rate medians, we don't expect many changes in the projected SEP macro variables in the June edition.

There could be an uptick in the GDP growth rate for 2023 based on recent activity data tracking through Q2, and perhaps a modest tweak to PCE inflation projections, but the biggest change is likely to be to the 2023 unemployment rate. Even with the 0.3pp uptick in May, at 3.7% the unemployment rate would have to rise a fairly rapid 0.8pp in the final 7 months of the year to

reach the FOMC's 4.5% March projection. We think the FOMC median will split the difference and revise the end-2023 unemployment rate down a few percentage points though we've seen sell-side expectations as low as 4.0%.

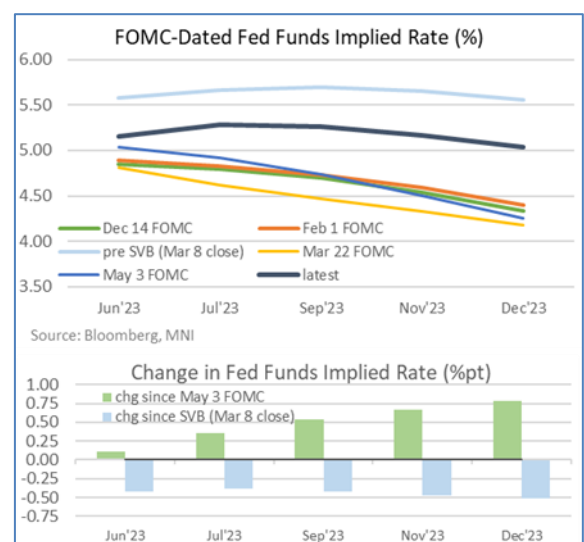
Expectations below:

Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents under their individual assessments of projected appropriate monetary policy, June 2023

Percent				
Variable	2023	2024	2025	Longer Run
Change in real GDP	0.6	1.2	1.9	1.8
Mar projection	0.4	1.2	1.9	1.8
Unemployment rate	4.2	4.5	4.6	4.0
Mar projection	4.5	4.6	4.6	4.0
PCE inflation	3.3	2.5	2.1	2.0
Mar projection	3.3	2.5	2.1	2.0
Core PCE inflation	3.7	2.6	2.1	-
Mar projection	3.6	2.6	2.1	-
Federal funds rate	5.4	4.4	3.4	2.5
Mar projection	5.1	4.3	3.1	2.5

Current Rate Expectations

Data may have been mixed but there have been enough strong aspects within them, along with no further escalation of banking issues, to push the rate path significantly higher since the March FOMC, even if the moves only really began in the second half of May. These increases slowed abruptly however after Governor, and Vice Chair nominee, Jefferson put forward the June skip narrative in late May in rhetoric that has guided markets ever since. At typing, there is just +7bps priced for Wednesday's decision followed by a cumulative +20bps to a terminal effective rate of 5.28% in July. With the increases since the March FOMC particularly loaded later in the year for a sizeable trimming of rate cuts (the Dec'23 rate is some 75bps higher than at the last meeting), Fed Funds now price only 25bp of cuts from terminal to year-end for an implied rate just 4bps lower than the current effective. The regional banking woes from mid-March cast a long shadow though, with July terminal rate still almost 40bps below pre-SVB highs and the year-end rate a little more than 50bps below.



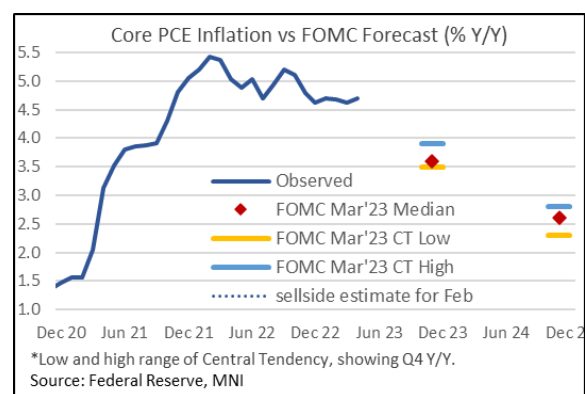
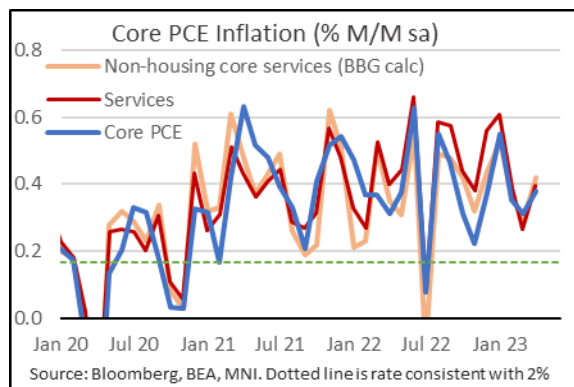
Macro Developments Since The May 2-3 FOMC

By Chris Harrison

The single CPI report since the last FOMC saw core CPI inflation come in slightly stronger than expected in April as it nudged up from 0.38% to 0.41% M/M, considering consensus only just tipped from 0.3 to 0.4 on the day of the release. Details were mixed though as the main upside driver came from an even larger than flagged increase in used cars (accounting for a hefty 0.17pps of the change in M/M rates) with the surprise mostly offset by softer volatile items. Perhaps most importantly, key core service ex housing measures moderated to differing extents, but the Fed's preferred measure excluding just owner equivalent rents and primary rents eased from 0.40% to 0.11% M/M for its softest since July and before that Sep'2021. Some

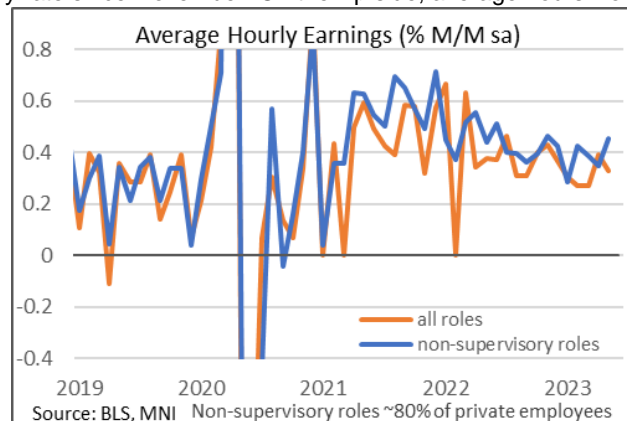
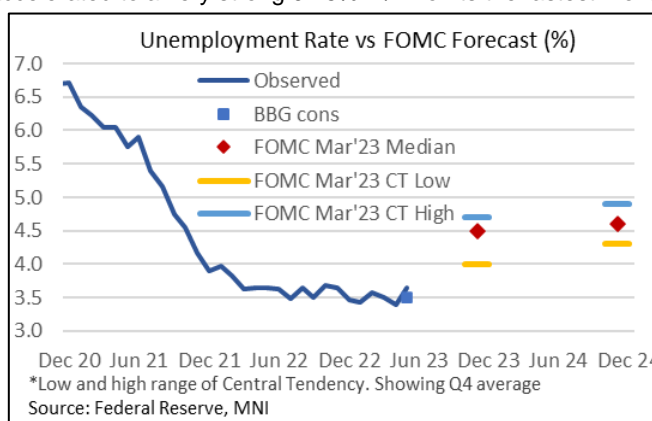
softer details and a surprisingly large normalisation in dispersion measures aside, core CPI continued to grow at a fast pace in April with its fifth consecutive rounded 0.4% M/M print.

However, if core CPI offered the notion of some softer underlying pockets of inflation, then core PCE dispelled that two weeks later. Core PCE inflation was stronger than expected in April at 0.380% M/M (cons 0.3) after a stronger skew to Q1 revisions meant higher figures in February and March with the partial offset lower back in in January. Of note, it was led by core non-housing services. Bloomberg's calculation accelerated to 0.42% M/M from an upward revised 0.29% in Mar (initial 0.24%) and 0.37% in Feb (initial 0.35%). It's the fastest pace since January's 0.53% M/M and follows the Q1 average of 0.40% M/M, for zero sign of moderation. It was followed by U.Mich consumer long-term inflation expectations pushing to highs since 2011 even that was subsequently revised down to 3.1% for the top of its recent range. However, nuance continues here as the New York Fed's Multivariate Core Trend, released later using the same April PCE data, saw a further moderation to 3.4% after a sharp revision lower in March growth rates to 3.6% (initially 4.5%). Further, there could be some renewed goods disinflation on the cards with the NY Fed's Global Supply Chain Pressure Index slumping to its lowest on record for a series starting in 1997, along with sharp falls in prices paid components of latest ISM surveys.



The two payrolls reports since the last FOMC have been decidedly mixed, first coming in stronger than expected across the board but offset by particularly heavy downward revisions before the latest data for May had massively conflicting details between the establishment and household surveys. Taking the most recent figures, payrolls increased 339k for a 144k beat to consensus which was further compounded by a +93k net upward revision over the prior two-months. It left a three-month average of 283k, almost exactly the same as at end-2022 for no sign of moderation from a pace that is nearly three times what Powell has previously deemed a long-term sustainable level. Caveating this was employment in the separate household survey falling -310k for the largest gap to nonfarm payrolls since Apr'20. It meant the unemployment rate increased from 3.4% to 3.65% (cons 3.5) for the first rounded 3.7% figure since Oct'22 and having last been higher in Feb'22. The first more significant increase in the rate in recent months after a string of downward surprises, the unemployment rate nevertheless remains far off the FOMC median of 4.5% for Q423 as from the March SEP (in a central tendency range of 4.0-4.7%).

Further details were also mixed. Average hourly earnings saw a downward revision but its non-supervisory component accelerated to a very strong 0.45% M/M for its the fastest monthly rate since November. On the flip side, average hours worked



surprisingly fell further and are approaching pre-pandemic lows, an exacerbated version of the trend decline nearer pre-pandemic averages seen in separate JOLTS quit rates. Landing on Jun 2, the mixed payrolls report didn't alter the recently adopted skip narrative for the Jun 13-14 FOMC, yet the sheer strength of payrolls trimmed rate cuts and Tsys bear flattened.

MNI Instant Answers:

The questions that we have selected for this meeting are:

- Federal Funds Rate Range Maximum
- Does the FOMC change the phrase "in determining the extent to which additional policy firming may be appropriate"?
- If yes, does the FOMC remove the reference to additional firming?
- Does the FOMC refer to future "adjustments" in interest rates?
- 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 > 5.125%
- Number of 2023 dots > 5.375%
- Number of dissenters

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.**

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	4.9	6.4	↓	7.7	↓					-1.45
PCE Deflator	% y/y	4.4	5.4	↓	6.1	↓					-1.23
UoM 1-Yr Inflation Exp	% y/y	4.2	4.1	↑	4.9	↓					-0.28
Inflation Swap 5y/5y	%	2.58	2.58	→	2.64	↓					-0.72
Economic Activity		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
ISM	Index	46.9	47.7	↓	49.0	↓					-1.36
Industrial Production	% m/m	0.48	1.01	↓	-0.11	↑					0.68
Factory Orders	% m/m	0.4	0.0	↑	0.9	↓					0.43
Housing Starts	K	1401	1340	↑	1432	↓					-0.05
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	1.88	1.80	↑	1.93	↓					0.61
Chicago Fed Financial Con	Index	-0.23	-0.27	↑	-0.19	↓					-0.23
Consumer Credit Net Chg	\$bn	23.0	20.1	↑	35.0	↓					-0.06
New Home Sales	K	683	649	↑	577	↑					1.43
Consumer / Labour Market		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
Retail Sales	% m/m	0.4	2.8	↓	1.0	↓					-0.02
Consumer Confidence	Index	102.3	103.4	↓	101.4	↑					-0.69
Nonfarm Payrolls Net Chg	K	339	248	↑	290	↑					0.45
Average Hourly Earnings	% y/y	4.3	4.7	↓	5.0	↓					-1.06
Markets		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
Equity Market	Index	4268	3970	↑	4080	↑					-0.08
US 10-Year Yield	%	3.81	3.92	↓	3.61	↑					-0.19
US Yield Curve (2s-10s)	bps	-76.2	-89.6	↑	-70.5	↓					-0.78
USD TWI	Index	120.30	120.32	↓	124.81	↓					-0.69

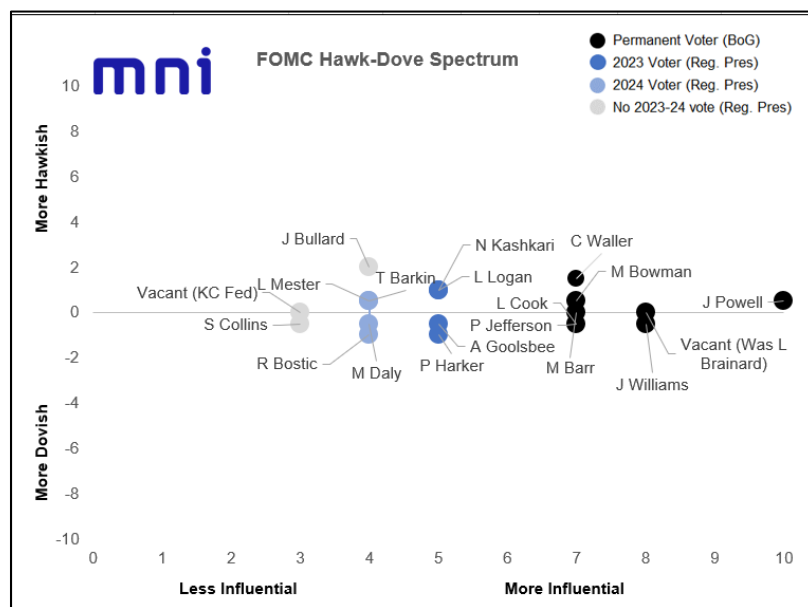
Source: MNI, Bloomberg

(Updated Jun 8, 2023)

Key Inter-Meeting FedSpeak – June 2023

Divides within the FOMC on the rate path forward are becoming more pronounced, though notwithstanding the impact of the May employment report on Jun 2 and the corresponding CPI print on Jun 13, a majority appears to support a “skip” at the June meeting.

- Some FOMC participants are leaning toward at least one further increase in the Funds rate. **Most likely to support a hike in June** are Mester, Bullard, Kashkari, Logan, Bowman, and Waller.
- They are likely in the minority on the FOMC. Bostic, Harker, Williams and Jefferson appear **on board with a “skip” in June**, and they will likely have support from others including Daly, Cook, Goolsbee, and Collins.
- **A couple may be persuadable in either direction, depending on the data**, including Barkin and Cook, though neither seems dogmatic about a June hike/skip (we haven't heard from Cook since the May FOMC, but she is likely to lean dovish).
- **Chair Powell is of course the key participant** (along whose opinion the Board will vote, including Barr who hasn't expressed a view) and seems genuinely willing to listen to arguments from either camp, but appears amenable to “skip” a meeting.
- **As we appear to be at or near the top of the rate hike cycle, our Hawk-Dove Spectrum has been recalibrated lower since our May FOMC preview**, with FOMC participants clustered around the neutral mark as nobody seems to view either significant tightening or easing as warranted.



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.

Member	Role	Voter		Monetary Policy Commentary Since May FOMC
		'23	'24	
J Powell	BOG, Chair	X	X	<p>"We've come a long way in policy tightening and the stance of policy is restrictive and we face uncertainty about the lagged effects of our tightening so far and about the extent of credit tightening from recent banking stresses...having come this far, we can afford to look at the data and the evolving outlook to make careful assessments." – May 19</p> <p>"While the financial stability tools helped to calm conditions in the banking sector, developments there on the other hand are contributing to tighter credit conditions and are likely to weigh on economic growth, hiring and inflation...as a result our policy rate may not need to rise as much as it would have otherwise to achieve our goals. Of course, the extent of that is highly uncertain." – May 19</p>
J Williams	NY Fed, V	X	X	<p>"We want to see inflation come down, and we've taken strong actions to make that happen...we know it takes a while for our decisions to fully affect the economy...we've got to make our decisions and then watch what</p>

Member	Role	Voter		Monetary Policy Commentary Since May FOMC
		'23	'24	
	Chair			happens, get that feedback, see how the economy's behaving." – May 16
Vacant	BOG, V Chair	X	X	Previously occupied by L Brainard who left following the February FOMC
M Barr	BOG, V Chair	X	X	No commentary on current monetary policy since the May meeting
M Bowman	BOG	X	X	"While we expect lower rents will eventually be reflected in inflation data as new leases make their way into the calculations, the residential real estate market appears to be rebounding, with home prices leveling out recently, which has implications for our fight to lower inflation." – May 31 "Should inflation remain high and the labor market remain tight, additional monetary policy tightening will likely be appropriate to attain a sufficiently restrictive stance of monetary policy...I also expect that our policy rate will need to remain sufficiently restrictive for some time to bring inflation down and create conditions that will support a sustainably strong labor market." – May 12
L Cook	BOG	X	X	No commentary on current monetary policy since the May meeting
P Jefferson	BOG	X	X	"A decision to hold our policy rate constant at a coming meeting should not be interpreted to mean that we have reached the peak rate for this cycle. Indeed, skipping a rate hike at a coming meeting would allow the Committee to see more data before making decisions about the extent of additional policy firming." – May 31 "Inflation is too high, and we have not yet made sufficient progress on reducing it...history shows that monetary policy works with long and variable lags, and that a year is not a long enough period for demand to feel the full effect of higher interest rates." – May 18
C Waller	BOG	X	X	"I do not support stopping rate hikes unless we get clear evidence that inflation is moving down towards our 2% objective...but whether we should hike or skip at the June meeting will depend on how the data come in over the next three weeks... We still have some major data releases coming up in the next three weeks and I'll also be learning more about evolving credit conditions, both factors which will inform me on the best course of action. Between now and then, we need to maintain flexibility on the best decision to take in June...if [bank] lending does slow, this can obviate the need for at least some monetary policy tightening." – May 24
P Harker	Phil Fed	X		"I think we should pause [at the June meeting], because pause says we're going to hold for a while — and we might...we should at least skip this meeting in terms of an increase. We can let some of these things resolve themselves, at least to the extent they can, before we consider — at all — another increase... I do believe that we are close to the point where we can hold rates in place and let monetary policy do its work to bring inflation back to the target in a timely manner." – Jun 1 "I think we can take a bit of a skip for a meeting...I am definitely in the camp of thinking about skipping any increase at this meeting...if we're going to go into a period where we need to do more tightening, we can do that every other meeting. We don't have to do it every meeting." – May 31
N Kashkari	Minn. Fed	X		"We may have to go higher from here, but we may not raise rates quite as aggressively and as quickly as we have over the course of the past year. Let us get a little more information while we determine do we need to go higher and how much higher we need to go...right now it's a close call either way, versus raising another time in June or skipping...some of my colleagues have talked about skipping. Important to me is not signalling that we're done. If we did, if we were to skip in June, that does not mean we're done with our tightening cycle. It means to me we're getting more information." – May 22
L Logan	Dall. Fed	X		"I'm keeping an open mind and a close watch on economic developments as we head toward the next meeting in mid-June. As of today, though, I remain concerned about whether inflation is falling fast enough...after raising the target range for the federal funds rate at each of the last 10 FOMC meetings, we have made some progress...the data in coming weeks could yet show that it is appropriate to skip a meeting. As of today, though, we aren't there yet." – May 18
A Goolsbee	Chic. Fed	X		"There's still a lot of the impact of the 500 basis points we did in the last year that's still to come...[voting for May's hike was] "a close call". – May 15 "I think it's far too premature to be talking about rate cuts and premature to be saying — even for the next meeting — are we going to pause? Are we going to raise? Are we going to cut...I haven't committed or decided anything. I think it's a mistake for us to commit our decisions weeks before the meeting when we're still going to get a lot more information...we've got to look at a lot more measures than just unemployment, inflation and wages in the kind of the conventional box of numbers that we looked at in the past...the fundamental question is, is there a reason to think that the financial conditions are tighter than just what the interest rate says." – May 16
T Barkin	Rich. Fed		X	"I'm looking to be convinced that demand is in fact coming down, and that that will then start to bring inflation down." – May 30 "There's a story out there that's quite plausible: The lagged effect of rate moves combined with credit tightening in the economy combined with the erosion of pandemic-era stimulus will bring demand down and inflation down relatively quickly. But I still want to be convinced...If inflation doesn't seem to be coming down as expected, I'm very open to more tightening. On the other hand, if things play out in a way that gives me comfort that inflation is moving in the right direction toward our target, then I'm very comfortable waiting...[I'm] pretty comfortable with data dependence as opposed to the forward guidance model." – MNI Interview, May 12 "I do want to learn more about what's happening with all these lagged effects. But I also want to reduce inflation...and if more increases are what's necessary to do that I'm comfortable doing that." – May 16 "I'm not going to prejudge June...I'd like to be convinced of [Fed tightening + credit conditions leading to lower demand/inflation] and I'm still looking to be convinced of that." – May 22

Member	Role	Voter		Monetary Policy Commentary Since May FOMC
		'23	'24	
R Bostic	Atl. Fed		X	<p>"We're going to let the data guide us, and we don't want to be locked into any particular movement." – May 24</p> <p>"We haven't gotten to the hard part yet [if the Fed was unable to bring down inflation without much higher unemployment]...we are going to have to be super strong and detached." – May 17</p> <p>"Our policy works with a lag. And we're just at the very beginning of this time when that lag is starting to play out and you're starting to see tightness emerge....right now, absent a big change, I think I will be comfortable saying, let's just look and see how things play out." – May 22</p>
M Daly	S.F. Fed		X	<p>"I really think at this point in our tightening cycle, it is prudent to resist the temptation to say what we're going to do for the rest of the year... [tighter bank credit] could be worth as much as a couple of rate hikes...[the best Fed policy] "is about extreme data dependence and policy optionality." – May 22</p>
L Mester	Clev. Fed		X	<p>"I don't really see a compelling reason to pause [in June] — meaning wait until you get more evidence to decide what to do... I would see more of a compelling case for bringing [rates] up . . . and then holding for a while until you get less uncertain about where the economy is going." – May 31</p> <p>"At this point, based on the data I have so far, given how stubborn inflation has been, I can't say that I'm at a level of the fed funds rate where it's equally probable that the next move could be an increase or a decrease...there's four weeks ago before the June meeting. And so I want to take into account all the data, including the banking data," – May 16</p>
J Bullard	St. Louis Fed			<p>"[Rates are] "at the low end of what is arguably sufficiently restrictive given current macroeconomic conditions... where within the sufficiently restrictive zone should the policy rate be? And are there other factors to consider (e.g., financial stability)? Such assessments could be reflected in judgments by the FOMC going forward...monetary policy is in much better shape today with the policy rate at a more appropriate level than it was a year ago... "The prospects for continued disinflation are good but not guaranteed, and continued vigilance is required". – Jun 1</p> <p>I think we're going to have to grind higher with the policy rate in order to put enough downward pressure on inflation and to return inflation to target in a timely manner...I'm thinking two more moves this year – exactly where those would be this year I don't know – but I've often advocated sooner rather than later."-May 22</p>
S Collins	Bos. Fed			<p>"While inflation is still too high, there are some promising signs of moderation...I believe we may be at, or near, the point where monetary policy can pause raising interest rates." – May 25</p>
Vacant	K.C. Fed			

MNI Policy Team Insights

MNI INTERVIEW: Policy Lags Argue For Fed Pause, Blinder Says (Pub Jun 8, 2023)

By Jean Yung

(MNI) WASHINGTON – The FOMC is likely to leave its benchmark interest rates unchanged next week, but a "really bad looking" CPI report could still prompt a surprise quarter-point increase, former Federal Reserve Vice Chair Alan Blinder told MNI, adding he would urge policymakers not to raise rates any further.

"The FOMC is beginning to divide into dovish and hawkish factions, and the worse the CPI report, the more it strengthens the hawks' hands. The better the report the more it strengthens the doves' hands. Chair Powell is right in the middle," he said in an interview. (See: [MNI POLICY: Fed Most Divided Since Start of Hikes, More Loom](#))

"When the Fed started on this quest to push the inflation rate down, everybody on the Fed knew they were late getting started and they'd have to go quite a bit higher," he said. "But now where they are, there are lots of live questions over whether and why to go higher or to stop right here."

The FOMC has lifted its fed funds rate to a 5%-5.25% target range in little over a year and is set to update its three-year projections at its June meeting. Futures traders expect just a 28% chance of a quarter-point move next week, though the peak rate is priced slightly higher at 5.285% by August.

POLICY LAGS

Prices are still growing too fast, but waiting for inflation to fall to 2% to stop raising rates would result in deflation, Blinder said. The PCE price index rose 4.4% in April or 4.7% excluding food and energy prices.

"What we learned from decades and decades of data before the pandemic is that the effect on inflation came after the effect on real growth," Blinder said. "It's the lags argument, and the weak evidence that the economy is showing signs of slowing, that wages and prices are showing signs of moderation -- certainly not enough yet on prices, but some signs."

Conventional central banking wisdom says it takes 18 to 24 months for inflation to normalize after tightening policy, and Blinder said he's not yet convinced that the pandemic has changed that.

"To the extent that the present is like the past -- and that is of course a big question -- we really wouldn't expect the effect of tighter money on inflation to be showing through very much now," he said.

WAGE GROWTH DECELERATING

To judge the outlook for inflation, the Fed is looking at real growth and the amount of slack in the labor market and wage behavior.

The May jobs report was "mixed" with employers adding over 300,000 workers while households reported a fall in employment, but a drop in self-employment -- a volatile category -- appeared to account for a significant part of the discrepancy, Blinder noted.

That various measures of wage growth are showing signs of deceleration is a more persuasive signal of disinflation in the pipeline, he said. "Wage growth is trending down quite mildly, but it's there."

MEETING BY MEETING

With a sharply divided committee, Powell will likely say as little as possible about the outlook for the policy rate next week, despite speculation that the hawks on the committee will push for a July hike, Blinder said.

"I wouldn't expect prose suggesting that they're on pause for a period of time, though they may be," he said. "It's especially smart for Powell to maintain maximum optionality and not give a statement that leans strongly either in the direction of a good chance of tightening in July or very little chance. I don't think they'll come out either way."

MNI INTERVIEW: Fed Likely To Hike 50-100BPS More, Gagnon Says (Pub Jun 8, 2023)

By Pedro Nicolaci da Costa

(MNI) WASHINGTON – Federal Reserve officials could take a breather from interest rate hikes at next week's meeting, but that won't stop them from tightening monetary policy by at least another half and possibly a full percentage point, Joseph Gagnon, a former senior economist at the Fed Board of Governors, told MNI Thursday.

Inflation has been more stubborn than expected, and while it should let up enough by year-end to give policymakers comfort, recent strong data will keep the Fed on track for additional rate increases.

"The data over the past few months has gradually pointed towards maybe a few more hikes, maybe 50 basis points or so, I wouldn't rule out 100 basis points," Gagnon told [MNI's FedSpeak podcast](#).

"There's no rush and they can afford to take their time. But based on the data at hand I might personally support a 25 basis point hike now. Of course there will be CPI data and that could change things."

HAWKISH PAUSE

CPI figures for May are due on the first of the Fed's two-day meeting on June 13-14, but market participants still see a high bar for a June hike after top officials like vice-chair-nominee Philip Jefferson hinted strongly at a desire to skip a meeting.

"A pause is certainly possible, but I think if they pause they're going to indicate a very significant chance that they would hike at the next meeting, so it's not going to be signaling a stop," said Gagnon.

FOMC members' interest rate projections, which accompany the quarterly Summary of Economic Projections, could also point to higher rates down the line.

"The dot plot reflects the outcome of individual people's perceptions so they don't have any joint control. I think it would drift up but with a lot of dispersion," Gagnon said. "In March there was a huge majority all lined up for the peak being where they are now, but almost all the people that didn't agree with that were on the high side. So it wouldn't take much, only two people I think, to raise the median."

RISING CHANCE OF DISSENTS

The chances of a Fed dissent, which has not occurred in almost two years, are rising now that the policy calculus is becoming more difficult, he said. (See [MNI POLICY: Fed Most Divided Since Start of Hikes, More Loom](#))

"We're really in an area where there could likely begin to be dissents just because it's not so clear how to read the data, and they have been surprisingly unified so far," he said.

Still, despite some possible bumps along the way, Gagnon is optimistic that inflation will come down substantially by year-end – especially when measured on a three- or six-month basis – and do so without a major spike in unemployment.

"I think that they don't need much of a rise in unemployment, maybe half a percent to 4% or the low fours and that's all they need. If they can get unemployment in the range of 4%-4.5% then wage inflation will go down a tick more next year and we'll be on a glide path to something they could live with. That would definitely be a soft landing."

HIGHER INFLATION TARGET

Gagnon said he still supports the idea of eventually raising the Fed's inflation target to 3%.

"Already inflation in the news is way down from where it was a year ago. And it's still above 4.5%. That says to me that by the time we get to 3% it's just not going to be an issue with the public anymore, and that encourages me to think that a target of 3% would not be a problem," he said. ([See MNI POLICY: Fed To Consider Shift to Inflation Target Band](#))

**MNI INTERVIEW: Fed Done Hiking, Inflation To Drop: Ex-Staffer
(Pub Jun 6, 2023)**

By Pedro Nicolaci da Costa

(MNI) WASHINGTON – The Federal Reserve has finished hiking interest rates and will probably cut before year-end, ex-Philadelphia Fed economist Luke Tilley told MNI, a view counter to policymaker hints that a June pause might be followed with more tightening.

"My outlook is for inflation to slow appreciably through the year," Tilley, now chief U.S. economist at Wilmington Trust, said in an interview. Inflation will slide to 3.5% in the next couple of months, end the year just above 3% and fall to around the Fed's 2% target by spring of 2024, he said.

"When you get to the back half of the year and inflation has come down significantly and the economy is slow and long-term inflation expectations are very much in check, it doesn't make any sense at all to have the fed funds rate at 5%. I think they'll have to let off the brake a little bit." (See [MNI INTERVIEW: Fed Likely Done, Cuts Possible Before Year-End](#))

Hawkish Fed signals are more of an effort to tamp down market expectations for rate cuts than genuine fears of an inflation rebound, Tilley said. (See: [MNI POLICY: Fed Most Divided Since Start Of Hikes, More Loom](#)) Ten-year Treasury bonds traded at a yield of 3.71% Monday afternoon, less than the 4.51% yield on securities due in two years.

HOUSING AND WAGES

"When you ask Powell about financial conditions, the only thing he's talked about in very specific terms is the real rate curve," he said. "They must be encouraged by what they're seeing there. They're not going to be as optimistic as they're feeling because they don't want markets to price in cuts."

Tilley also pointed to moderation in housing, services and wage costs as evidence inflation will slip this year.

Housing costs should continue to fade as lags between home values and owner-equivalent rent calculations used by the Bureau of Labor Statistics narrow, he said. "We're finally starting to see the shelter numbers come down and they should keep coming down," he said.

The slowdown in consumer spending on services is also a good sign especially since it's come without major damage to employment, Tilley said.

'THIS IS THEIR BABY'

"Inflation adjusted spending on services -- down to 1.7% three-month annualized over the past three months -- that's a very normal rate of spending," he said. The ISM's latest services index for May fell to 50.3, the lowest since December.

Wage growth has slowed even with continued strong hiring including May's new 339,000 positions, he said. "Strong job growth is disinflationary as strong as the wages are not too high. I'm all for strong hiring."

The Fed behind the scenes is likely concerned about more damage from recent problems in regional banks, he said. Tilley noted the Fed was created in 1917 to halt banking panics and that the rate-setting Federal Open Market Committee wasn't created until the 1930s.

"I don't know that there's an appreciation about how worried the Fed is about the regional bank situation. They have to say everything is ok. This is their baby – If they break it, it's entirely on them."

MNI POLICY: Fed To Consider Shift To Inflation Target Band (Pub Jun 6, 2023)

By Pedro Nicolaci da Costa and Evan Ryser

(MNI) WASHINGTON – The Federal Reserve is likely to consider moving away from a singular inflation target of 2% and toward a band system possibly ranging from 1.5% to 2.5%, that allows for a wider, more realistic set of outcomes.

The next framework review is slated for 2025 but top policymakers have signaled they are already thinking about possible changes.

"I haven't heard anything or seen anything that would make me think that 2% is the wrong target. But whenever we next talk about policy I'd certainly be open to talking about a range as a concept," Richmond Fed President Thomas Barkin told reporters earlier this year.

Still stung by the rapidity of the rise in post-pandemic inflation pressures, which officials initially argued were transitory, U.S. central bankers are looking back on their pre-Covid concerns about undershooting the 2% inflation goal by a couple of tenths of a percentage point as relatively quaint.

A shift toward a target band would be in line with the practice of many central banks around the world, including the Bank of Canada and the Reserve Bank of Australia. (See [MNI: Fed Able To Tolerate Above-2% Inflation, To Keep Target](#))

FRAMEWORK UNDER SCRUTINY

The outcome of the last framework review in 2020, which calls for the Fed to make up for periods of shortfall by overshooting the inflation target, has come under fire from critics who say it prompted policymakers to wait too long before reacting to the inflation surge that began in mid-2021 and peaked in the summer of 2022.

Formulated after years of inflation hovering below the 2% inflation goal during the sluggish recovery that followed the Great Recession of 2007-2009, the new framework means the Fed would "apparently would not make up for overshoots of the target. The new framework did not seem even to contemplate the possibility of persistent strong inflation pressures," according to ex-Fed vice chair Donald Kohn in a 2022 essay.

The Fed's current forecasts for inflation to end 2023 around 3.3%, and not fully reach the 2% target until 2025, are a tacit admission that the goalposts of achievability have since shifted dramatically.

LESSONS LEARNED

Minneapolis Fed economist Abigail Wozniak told [MNI's FedSpeak podcast](#) said the inflation experience of the last two years will certainly inform the next round of discussions inside the central bank, which while officially 1-½ years out are already effectively taking place.

"There will be some consideration given to what we just learned over the last two or three years about how an episode like this can work through the economy. There probably will be some rethinking about the underlying assumptions that contributed to that overhaul," she said.

"But the spirit of the overhaul, of trying to make sure that we are allowing enough growth to happen in way that benefits the broadest set of folks who are trying to engage with the economy through work, that is a spirit that I think the Fed will carry forward and continues to be very much a part of the discussion."

Allowing a little more inflation in exchange for a little more employment might be one way of doing that, and a rate target band could accomplish that.

Ex-Fed Vice Chair Richard Clarida, who oversaw the 2020 framework review, said the idea of a target range [was contemplated](#) but rejected at the time. But he said conditions have changed so much since then that the idea should be reconsidered.

"The Committee chose not to go down that road given the initial conditions because the concern was if the Committee were to define a range of 1.5 to 2.5[%] that could reinforce the view inflation would never get to 2 and then reinforce the challenge of inflation expectations sagging," he told a Brookings conference in May. "But the initial conditions will be much different in 2024 and 2025 and I would hope the merits of seriously considering a range could be entertained."

MNI INTERVIEW: US Bank Stress Not Very Disinflationary-KC Fed (Pub Jun 5, 2023)

By Evan Ryser

(MNI) WASHINGTON – The U.S. regional bank turmoil in March will put a smaller dent on inflation than traditional monetary tightening, Kansas City Fed economist A. Lee Smith told MNI.

His comments are based on new research that cautions against counting on tighter credit conditions to work as a substitute for additional interest rate increases.

"The stress and the banking turmoil we experienced may not be all that disinflationary," Smith said in an interview Friday, before the pre-meeting blackout period began. "Financial stress is really very different than financial conditions."

Historical evidence suggests tighter credit conditions emanating from financial shocks generate only modest disinflationary effects compared to the kind of increase in the unemployment rate that comes from higher official interest rates, according to the recent analysis from Lee and co-authors.

"To the extent you're going to cut off some of that credit and you're going to see less of that expansion from firms, either startups or expansions from existing firms, it has this echoing effect on the economy's productive capacity going forward," Smith said.

ADVERSE SUPPLY EFFECT

"That is going to act very much like an adverse supply effect that will counteract some of the disinflation from just a pure demand shock. These credit shocks can have significant real effects but may not lower inflation all that much," he added. (See [MNI POLICY: Fed Most Divided Since Start Of Hikes, More Loom](#))

The analysis by Smith, Brent Bundick and Johannes Matschke shows that financial stress is about half as disinflationary as Federal Reserve monetary tightening. A one standard deviation increase in financial stress measured by the [Kansas City Fed's Financial Stress Index](#) typically portends an increase in the unemployment rate of 0.7ppts and a fall in CPI by about 0.4ppts in the first year, compared to 0.65ppts following monetary tightening, the analysis shows.

Some Fed policymakers have argued that the credit stresses and banking issues in March might dampen inflation like monetary policy tightening, perhaps reducing the need for additional rate hikes.

"We're arguing that that may not be the case and certainly historical evidence cautions against that interpretation," said Smith, though he declined to comment on the current rate outlook.

That is because of a persistently lower path of investment spending following a financial stress episode could adversely affect the economy's future productive capacity.

"The fact that investment is more responsive for a similar size movement in the unemployment rate, and we see a bigger fall in investment, it's an indication to us that there's this credit supply effect that transmits to the economy in a way that reduces the ability in the economy to produce in the future," he said.

"The March episode could affect not just the pricing of credit, but really the provision, the flows and the quantities of credit."

MNI INTERVIEW: US Dollar Leadership Eroding-Ex-IMF adviser (Pub Jun 2, 2023)

By Pedro Nicolaci da Costa

(MNI) WASHINGTON - A combination of rising political risk, fear of economic sanctions and new financial technologies will gradually erode the U.S. dollar's supremacy in global capital markets and trade in coming decades, ex-IMF adviser Josh Lipsky.

Protracted debt ceiling negotiations, while ultimately successful at avoiding default, add to the impression that the U.S. is not as trustworthy a partner as it was in the past, said Lipsky, also a former State Department official and now senior director of the Atlantic Council's GeoEconomics Center.

"Just because there's no alternative doesn't mean the rest of the world is not deeply frustrated. The world is increasingly exasperated by this," he said in an interview.

"For Biden to have to go the G7 and have to hear from the other leaders about the biggest threat to the global economy coming from inside the house – for the U.S. – is hugely problematic long term for U.S. leadership, maybe not short term because of the lack of viable alternatives." (See [MNI INTERVIEW: U.S. Fiscal Trajectory Deviating From AAA Peers-Fitch](#))

The G7's decision last year led by the United States to freeze Russian central bank assets has led to trepidation among other major countries, he said, though he added that he viewed the move as morally justified following the invasion of Ukraine.

"There were ripple effects, and significant ones from the G7 sanctions on Russia, specifically the freezing of the assets, the USD300 billion," said Lipsky. "That made a lot of countries, not just China and Russia – India, Indonesia, think about their dollar holdings, their inability to access dollars if they were to be on the wrong side of the U.S. in a particular situation."

SLOWLY BUT SURELY

Lipsky said the dollar's status as the world's reserve currency is not under immediate threat, but will likely be chipped away incrementally over time.

"None of that can change overnight for all the obvious incumbency reasons. But it does mean countries are looking and we should take that signal seriously," he said. "The dollar's reserve status in a ten- to 20-year period is not under threat in a significant way, it just may be slightly eroded with a few other currencies – yuan, euro, etc. growing. The dollar is still dominant – just not as dominant as it once was in 10 to 15 years."

Advances in financial technologies that allow for more rapid, seamless transactions between banks in different countries also risk leaving the U.S. behind, especially because many nations have taken discussions about creating a central bank digital currency more seriously.

"It's the wholesale CBDCs, the bank-to-bank CBDCs. China, Thailand. We see a doubling of interest in wholesale central bank digital currency in the past year since the sanctions. And I think the sanctions are a factor in that," said Lipsky. "Now you go through the dollar because that's how the systems are built, because it's a stable intermediary, but if you can settle more quickly and you have enough liquidity, you don't actually need the dollar to do that."

MNI INTERVIEW: Fed Needs Limit On Reverse Repo - McAndrews (Pub May 26, 2023)

By Evan Ryser

(MNI) WASHINGTON – The Federal Reserve needs to put a growth limit on the overnight reverse-repo facility as it would remove the destabilizing fear that a run into it is a possibility, James McAndrews, former head of research at the Federal Reserve Bank of New York, told MNI.

"This concern by market participants that the RRP could be a vehicle into which people run does pose a risk to the economy," he said in an interview. "And there's a very straightforward solution to damp down that concern, which is to implement a growth limit."

While there is a per-participant cap of USD160 billion and an absolute limit to the size of the facility now that the Fed enacted several years ago, that number is so large given the program's nearly 150 participants that it far exceeds the amount of securities that the Federal Reserve holds. Consequently, the current absolute limit is ineffective, McAndrews said.

A growth limit would allow participants to increase their investments in the reverse-repo facility, supporting financial stability and monetary policy as intended, while disallowing outsized jumps in investments into it that could be destabilizing now. Such a cap could constrain inflows to the overnight reverse repo facility beyond some percentage relative to a prior base week or month, McAndrews said, also noting other options discussed in a 2015 Fed staff [paper](#).

RUN RISK

Bank depositors are questioning the safety of their deposits following the sudden failures of Silicon Valley Bank, First Republic Bank and others, he said. But it is usual for bank deposits to be withdrawn whenever the Fed raises rates, as banks pay depositors far less than what they can earn at money market mutual funds. (See: [MNI INTERVIEW: Deposits To Continue To Leave US Banks-Schnabl](#))

What's different is the Fed's overnight reverse-repurchase agreement (ON RRP) facility, launched in 2014, which allows select money market mutual funds, broker-dealers and government-sponsored agencies to place funds directly with the Fed overnight and, in exchange, to receive Treasury securities as collateral. With a rate of 5.05%, far above the 0.07% rate the average depositor earns on interest checking accounts, the facility has grown from about USD1 trillion in mid-2021 to around USD2.2 trillion recently.

"It wasn't unforeseen that it would be large, that it would be by and large stabilizing to the financial economy, and that it would support monetary policy implementation," McAndrews said, noting the facility helped preclude runs that might otherwise have occurred during the more recent financial storm.

Fed officials have said the ON RRP facility continues to support effective policy implementation and control over the federal funds rate, providing a strong floor for money market rates.

"I'm not advocating a change in the spread between the interest on reserve balances and the overnight RRP rate," McAndrew said, addressing some recent proposals, because the reverse repo rate helps to support and implement monetary policy appropriately and lowering the rate would essentially be a rate cut.

RESPONSIBLE CAPS

But the fear of a run into the reverse-repo facility is itself a risk, McAndrews said. "If people hold that belief, it would be rational for them to protect themselves from that risk by preemptively withdrawing deposits from banks and that's the concern. Banks could be harmed by the very presence of this concern."

This is crucial during the current period of bank failures and the federal debt ceiling uncertainty, said McAndrews who served for 28 years in the Fed system. As a result, at present the reverse-repo facility confounds the Fed's efforts to bolster the safety of the banking system, he said.

MNI INTERVIEW: Companies' Contribution To US Inflation Falling (Pub May 26, 2023)

By Jean Yung

(MNI) WASHINGTON – Corporations' profit margins contributed little to U.S. inflation in the first quarter and will be an even smaller driver of price pressures going forward as inflation eases, Federal Reserve Bank of Kansas City economists Andrew Glover and Jose Mustre-del-Rio said in an interview.

Firms' mark-ups spiked in early 2021 when costs were actually falling, and profit margins rose at higher rates than inflation. But by the end of 2021, as inflation started picking up, profit growth was already a falling share of price pressures and contributed less than 20% of overall inflation in 2022, according to a [recent paper](#) by the economists.

That trend accelerated in the first quarter. According to Commerce Department data released Thursday, corporate profits slipped 5.1% in the first three months of the year and contributed only 0.2 percentage point to the 5.3% GDP deflator inflation rate, Glover told MNI. Due to data limitations, the economists use GDP deflator as their inflation rate; it has been running slightly hotter than the Fed's preferred PCE inflation measure since the pandemic.

"In past recoveries, we see this type of trend happen pretty consistently. Early in the recovery, profits contribute a lot to inflation. That falls as the recovery continues and eventually profits contribute very little," Glover said. As expansions mature, "the contribution of profits turns disinflationary, masked by inflationary pressures of labor and other nonlabor costs," Mustre-del-Rio added.

STICKY PRICES

Macroeconomists at the Fed have been generally dismissive of the argument that increased corporate power has driven pandemic-era inflation. Glover and Mustre-del-Rio's paper notes data going back to the 1940s that shows inflation from corporate profits climbs sharply in the first few quarters after the end of a recession then descends as recoveries continue.

The Kansas City Fed economists found inflation would have averaged 3.4% in 2021 based solely on growth in profit margins, but because costs actually fell over the period, average inflation registered just 2.7%. "In 2021 wages weren't growing yet, but if you're a firm you saw the writing on the wall -- it was harder to find workers," Glover said.

Firms anticipating higher replacement costs for inventory and rising labor costs preemptively set higher prices, while their actual costs take time to catch up. Pay freezes for example typically are lifted only gradually as contracts are renegotiated or new workers hired, Mustre-del-Rio noted.

Over the 2021-2022 period, corporate profits contributed 41% to inflation, "more or less the same" as the the historical average of 59%, Glover said.

EXPECTATIONS NORMALIZING

Signs that firms' inflation expectations are moving toward pre-pandemic averages bode well for the prices businesses will charge customers and for inflation overall, Glover and Mustre-del-Rio said.

The Cleveland Fed's national [Survey of Firms' Inflation Expectations](#) show expected CPI inflation over the next 12 months has declined to 5.0% in April from a pandemic high of 7.3% in October. The Atlanta Fed's [Business Inflation Expectations](#) survey of firms in its district has also fallen to 2.9% from a high of 3.8% last year.

"Expectations of firms are contributing less to inflation now than last quarter," Glover said. "It's still higher than what would get us to target, but it's moving down."

Still, worries remain that the labor and nonlabor costs now driving inflation won't ease so quickly. Former Fed Chair Ben Bernanke and former IMF chief economist Olivier Blanchard said in a [paper this week](#) "a very tight labor market has begun to exert increasing pressure on inflation" and can only be reversed by "policy actions that bring labor demand and supply into better balance."

MNI INTERVIEW: Deposits To Continue To Leave US Banks-Schnabl (Pub May 25, 2023)

By Evan Ryser

(MNI) WASHINGTON – Deposits at U.S. commercial banks will continue to slip lower as the Federal Reserve leaves rates high and the March bank crisis lifted funding costs for banks permanently, said New York University Stern School of Business Professor Philipp Schnabl in an interview.

"I would expect more outflows. As long as we have higher rates we tend to see that this will continue," said Schnabl, a former New York Fed visiting scholar.

So far the core deposit outflows are roughly in line with past estimates, he said, pointing to his 2016 [paper](#) with co-authors.

Given the average deposit spread beta of 0.61, a 100 bp increase in the fed funds rate is expected to induce a 365 bps outflow of deposits and a 249 bps reduction in lending. These estimates imply that a typical 400 bps Fed hiking cycle induces a 1,458 bps reduction in deposits and a 995 bps reduction in lending relative to keeping rates unchanged, he said.

"It remains to be seen how this will play out over the entire hiking cycle," said Schnabl, who presented on banks, nonbanks, and interest rates at a recent Atlanta Fed conference. Based on 2014 figures, these numbers translate into over USD1.3 trillion reduction in deposits and nearly USD800 billion less in lending.

The Fed in early May raised borrowing costs by another 25 basis points to a range of 5% to 5.25%. Officials have appeared divided on a June [hike](#) or [pause](#) while others have suggested a potential [skip to a July hike](#). (See: [MNI INTERVIEW: Fed Seen Pausing In June, Could Restart-Acharya](#))

FUNDAMENTAL RESET

Fed officials have said conditions in the banking sector had broadly improved since early March, with the initial deposit outflows experienced by some regional and smaller banks moderating substantially over subsequent weeks.

Around USD980 billion in deposits have left banks since the Fed began to raise interest rates, the biggest outflow on record, with over USD670 billion of inflows into money market funds during this Fed hiking cycle about half of that since SVB failed. Deposits have stabilized since late March, but the sector is still stressed as evidenced by still-high Fed loans to banks, weak bank lending, and declines in the share prices of US regional banks.

To some degree, there has been a fundamental reset with a subset of depositors who have left banks and moved to money market funds and large banks, Schnabl said. "Chances are they are not going back to the regional banks and there will be a bit of a reset in terms of thinking about these banks' business model."

Ongoing funding pressures on U.S. banks are visible in still-heavy lending to banks by the Federal Reserve, currently totaling USD305 billion or around 1.5% of US GDP. This includes all lending facilities such as the discount window and the new bank term funding program. The Fed lending has edged down from its March peak but is still around half the level seen at the peak of the global financial crisis.

MNI INTERVIEW: Wages Minor Part Of US Inflation-Fed's Wozniak **(Pub May 25, 2023)**

By Pedro Nicolaci da Costa

(MNI) WASHINGTON – A hot post-pandemic job market complicates the Federal Reserve's job of bringing down inflation but wages are only a small contributor to price pressures thus far, meaning policymakers can still pull off a soft landing, Minneapolis Fed Vice President Abigail Wozniak told MNI.

"The early evidence suggests that wages are only part of the story and probably a smallish part of the story of the ongoing inflation that we are experiencing – or certainly the inflation that we've experienced to date," she said.

That means the central bank can still rein in inflation without a major spike in a jobless rate still hovering around 50-year lows, she told [MNI's FedSpeak Podcast](#).

"This certainly means that it is a possibility. There's still a path for that," said Wozniak, who serves as director of the Minneapolis Fed's Opportunity and Inclusive Growth Institute.

Wozniak, a labor economist, said it's encouraging strong hiring conditions have benefited lowest-paid workers the most in this recovery.

"A huge change that we've seen is a lot of pressure for the part of the labor market that employs our lowest-earning workers. Those workers have seen real wage gains," she said. "That's been pretty dramatic. It hasn't been sufficient to reverse the decline in those relative earnings that has happened since the 1980s but it has made a measurable dent in that."

And the rise in inflation has not hit those lower down the scale disproportionately harder relative to their incomes, as might have occurred in an economic downturn with high joblessness.

"The overall impact on household budgets, relatively speaking, is somewhat modest. That means inflation has an impact on household bottom lines that's relatively equal across the distribution, as compared to some other things we might experience – the other big thing I'm thinking of is a recession which is going to have massive disproportionate effects," she said.

INFLATION PERSISTENCE

Wozniak said it's prudent to worry that the recent decline in inflation will not persist in a totally linear fashion, noting high levels of uncertainty.

"It's right to be concerned that the correction that we've seen so far could be different for that subsequent remainder of the correction that we need to see. That possibility is worrisome and I don't think we have a good handle on that," she said. (See [MNI INTERVIEW: Sticky Prices Could Require More Hikes-Fed Econ](#))

A rebound in immigration into the United States should help moderate wage pressures, said Wozniak.

"It may have the effect of removing some of that pressure in the lower earnings part of the labor market," she said. "But I still think the fundamentals are suggesting that we're going to be in a somewhat different place going forward than we were over the last four decades, of just seeing continued erosion of relative earnings for those lowest earnings workers."

MNI INTERVIEW: Fed Needs Better QE Guardrails- Fed Adviser (Pub May 25, 2023)

By Greg Quinn

(MNI) OTTAWA - The Federal Reserve needs clear guardrails around how it uses quantitative easing in future amid heightened scrutiny over the limits of its legal powers and recent policy errors, Christina Skinner, who has advised the Fed and the Bank of England, told MNI.

With large-scale asset purchases becoming a more regular feature of monetary policy, Skinner said it would be a good idea to provide the same kind of framework that the Fed has given for meeting its inflation goal. The QE framework could cover things such as the potential stock and flow of asset purchases, the duration of any program and financial metrics for shifting to QT, she said.

"It seems easy to grow the balance sheet, very difficult to shrink it, and so if that in fact is true then QE is a little bit of a troubling one-way ratchet. That's definitely something that central banks need to think about and explain," said [Skinner](#), assistant professor at the Wharton business school at the University of Pennsylvania.

More rules-based monetary policy could help the Fed deal with challenges to its legitimacy such as the risk of fiscal dominance, she said. While Chair Jerome Powell has come through former President Donald Trump's threat to fire him and persistent massive deficits, the Fed has been blamed for overdoing stimulus, misreading inflation as transitory and by some in Congress for the collapse of Silicon Valley Bank.

ACCOUNTABILITY DIAL WAY UP

"There are basically two reasons why Congress and the public sit up and pay attention to the central bank: either the central bank has made a mistake or they have done something that seems to push the limits of their authority and power, and both of those things are happening or have been happening at various intervals in the past three years," Skinner said. "The accountability dial is turned up pretty high right now because the Fed and other central banks too are having to do a lot of self-reflection and explanation."

Officials must also study whether they suffered from "groupthink" or economic modeling problems that caused a misreading of demand-side forces pushing inflation to its fastest rate in decades, Skinner said. "This is something that central banks need to explain across the board, and why I hope there will be more conversations about groupthink, diversity of viewpoint, and thinking through a broader array of modeling."

The Fed's embrace of rapid interest-rate hikes is evidence that fiscal dominance never really took hold, she said. But dangers around political pressure are evident in calls for central banks to focus more on climate change or use balance sheets to underwrite other political pet projects. (See: [MNI INTERVIEW: Fed Must Hike Rates To 6%, Maybe 7%-Ex-Staffer](#))

"That could eventually erode the legitimacy of the institution if people wake up one day and say we didn't actually ask the central bank to allocate credit to green companies," she said.

FINANCIAL STABILITY TRADEOFF

"What we had during Covid was fiscal-monetary coordination that got very close to fiscal accommodation. And if we had continued down that path then we might have flipped back into a world of fiscal dominance," Skinner said. "The Fed's actions over the past year in terms of raising rates is challenging for the government's debt service burden. That is a show of independence."

Higher borrowing costs create new tradeoffs around financial stability, another reason QE guardrails would help. The Fed's current "floor" model of controlling short-term rates is another area pointing to dangers from unchecked balance sheet expansion, Skinner said, echoing [criticism](#) from the BIS.

"The Fed has raised rates in the face of known financial stability, but it could be helpful if it articulated about how it thinks about the relationship between monetary stability and financial stability."

**MNI INTERVIEW: Fed Must Hike Rates To 6%, Maybe 7%-Ex-Staffer
(Pub May 23, 2023)**

By Pedro Nicolaci da Costa

(MNI) WASHINGTON - Federal Reserve officials must hike interest rates to 6% and perhaps even to 7% to tame inflation even if they pause in June to assess the speed of recent tightening, ex-Philadelphia Fed economist Dean Cruoshore told MNI.

Cruoshore disagreed with Jerome Powell's description of monetary policy as "tight" in his May press conference, especially in light of inflation that has been subsiding but remains far above the 2% target. The Fed chair hinted at a pause on Friday when he said turmoil in U.S. regional banks likely meant interest rates wouldn't rise as much.

"Policy is not really tight and we see that in the stubbornness of core inflation. I'm thinking they need to get the fed funds rate to at least 6% before they are done, and possibly as high as 7%," said Cruoshore. He spent 14 years at the Philadelphia Fed and his research was cited in a recent speech by Fed Governor and Vice Chair nominee Philip Jefferson.

"Core inflation is likely to remain high and that they will need to tighten more in subsequent meetings," Cruoshore said. Inflation has been coming down since a summer 2022 peak but core CPI remained stubbornly hot at 5.5% as of April.

Many Fed officials have hinted that a pause in rate hikes does not necessarily mean the end of the tightening cycle, with St. Louis Fed President James Bullard saying he sees at least another 50 basis points of increases.

JUNE PAUSE NOT A PEAK

Cruoshore said given the speed of monetary tightening beginning in March of last year, it makes sense for the central bank to pause and assess the cumulative effect.

"A pause in June would be quite reasonable. The Fed has actually tightened more than I thought they would from March 2022 to today," he said.

The Fed has raised rates 500 basis points to a range of 5%-5.25% since March of last year. Top policymakers including Powell have voiced concern about repeating what they see as the mistakes of the 1960s and 70s – including a start-stop approach to monetary tightening.

The Fed's June meeting will include a new Summary of Economic Projections, which might allow the central bank to deliver a "hawkish pause" that maintains a tightening bias and thus leaves the door open to additional increases.

"Because of the aftermath of COVID messing up all of our macroeconomic data, the degree of uncertainty around all forecasts is huge," Cruoshore added.

MNI INTERVIEW: US Consumption Decline Could Play Out Slowly (Pub May 18, 2023)

By Jean Yung

(MNI) WASHINGTON – The Federal Reserve's inflation goal could remain out of reach for some time as consumers continue to draw down excess savings to make up for lost spending during the pandemic, even as the pieces fall into place for a gradual easing of price increases, St. Louis Fed economist Fernando Martin told MNI.

Higher interest rates should incentivize consumers to save more and spend less, but with excess savings of roughly USD372 billion still at their disposal and USD721 billion in missed spending during the pandemic, consumption is likely to continue to boost growth at least through the summer, Martin said in an interview.

"Households still have some excess income from the fiscal packages. That's slowly dying off, and until it does, people are still spending that. So despite the fact the Fed has been raising rates and creating an incentive to save more, that effect of excess savings hasn't completely disappeared yet," he said.

The amount of estimated excess savings represents about half a month of consumption and is likely to be spent down over the summer as people travel and move homes, Martin said. But, "we are still behind in total consumption. The privations during the pandemic have not been made up. Maybe I forwent a vacation as planned, and this is perhaps the time to go and maybe I'll splurge on that."

GOODS INFLATION HIGH

How quickly demand will deflate and pull down inflation is a key topic of debate for the Fed as it [prepares to pause](#) rate hikes. Real U.S. consumption has been persistently elevated after bouncing back from a precipitous drop at the start of the pandemic. It returned to the pre-pandemic trend of 2.4% annual growth in March 2021, the same month that inflation crossed 2% and has exceeded trend ever since. (See: [MNI INTERVIEW: Fed's Barkin 'Very Open' To More Tightening](#))

A first-quarter jump of 3.7% in consumer spending, which accounts for more than two-thirds of U.S. economic activity, contributed 2.5pp to GDP growth, the most since the second quarter of 2021. But there are signs of softening.

Martin expects overall consumption to weaken though he emphasized the large degree of uncertainty on the post-pandemic new normal. Households are still buying more goods and fewer services than before 2020, keeping core goods PCE inflation above 3% compared to -0.6% in the 2016-2019 period.

"We should be patient with the data trends. The price of goods seems to have stabilized -- the demand for them is elevated but hasn't been growing much. But it used to decline on average, so we still need to wait for that to happen. We're not even close to that. That may take a while."

END OF THE YEAR

Core services prices excluding housing costs, an aggregate that Fed Chair Jerome Powell noted is important for understanding how inflation will evolve, are also showing persistence, and make up half of all expenditures.

"This measure moves very slowly because a lot of the contracts embedded in the prices don't get updated very frequently and so sometimes reflect the past. But the steady trend tells you there's persistence in prices and it won't come down to 2% super fast. By the end of the year we'll have a cleaner picture of where we are," Martin said.

The housing market is a "big unknown" and may be a good barometer of the return to normal, he added. Housing services inflation saw a significant acceleration in 2022 and is just beginning to come off its peak, lagging real-time rent data. Employers are also still figuring out remote work policies, which will affect people's choice of living arrangements.

A recession is not preordained to moderate demand, Martin said. "There's a scenario under which activity slows down and you see layoffs but we don't see the unemployment rate go up, so we won't have a recession. Or if we do, it's going to be mild. If things persist the way they are, a recession is not really necessary for this mechanism to operate."

MNI INTERVIEW: Fed Seen Pausing In June, Could Restart-Acharya (Pub May 17, 2023)

By Evan Ryser

AMELIA ISLAND, FL (MNI) - The Federal Reserve is nearing a pause in its interest rate increases at the June meeting, but compared to past tightening cycles there remains a heightened chance the central bank will have to hike again, possibly later in the year, former Reserve Bank of India deputy governor Viral Acharya told MNI.

"Depending on how the next two or three quarters pan out, there might have to be potential for a hike," he said. "We are heading in the right direction of the inflation trajectory but it doesn't mean that you can give up on the inflation target."

While the central bank may refrain from an eleventh straight hike in June, the Fed will keep a hawkish bias, said Acharya this week at an Atlanta Fed conference, suggesting that bias could be signaled in the Summary of Economic Projections. There are some, he said, "who think the Fed lost a little bit of credibility through this inflation cycle and I think they've got to restore it because you can't allow an unanchoring of long-term market expectations." (See [MNI INTERVIEW: Fed's Barkin 'Very Open' To More Tightening](#))

BANKS IMPACT OUTLOOK

"We can't rule out one or two, maybe even more rate hikes," he said, also noting downside risks emanating from financial fragility that could put rate cuts on the table.

"It doesn't look to me terribly good both in terms of macro and the financial situation for these regional and mid-sized banks."

"To me, that's the main risk that so far they've had interest rate risk, but I think credit risk is lurking in the background and will manifest soon in terms of the [commercial real estate] losses," he said. "If collectively they all have to tighten credit, the economy will approach a recession faster and that could dent consumer confidence and reduce the demand for credit as well further squeezing margins."

But Acharya downplayed how much additional Fed hikes would add to financial stability risks should the central bank need to double up on its inflation fight.

"If the Fed has to go ahead with another 25bp hike or two, I don't think that's going to be shifting the needle as far as the stability of banks is concerned," he said. "We know that the bulk of the rate hikes we are likely to see have already happened."

QT ON AUTOPILOT

Acharya added that the Fed's program to roll off USD95 billion per month in Treasury and mortgage-backed securities from its USD8.5 trillion balance sheet is "almost on an autopilot at some level." Fed Presidents Raphael Bostic and Austan Goolsbee said Tuesday the bar is a "[little high](#)" to make adjustments to QT.

But along the way certain parts of the short end of the yield curve have steepened, with implications for banks and depositors seeking higher yields, said Acharya, who [presented a paper](#) at the Kansas City Fed's Jackson Hole conference last year warning that QT could lead to [disruptions in the banking sector](#).

"I think SVB is an extreme version, but it is a microcosm of what happened to the entire banking system, which is that its balance sheet grew very fast in a short period of time, on the back of uninsured deposits and that is a consequence of quantitative easing," he said.

"My sense is QT has gone fine for what it is but I very much doubt the Fed can do the completion of that exercise given the scale of QE that was undertaken," said Acharya, now a professor at New York University's Stern School of Business.

MNI INTERVIEW: Fed's Barkin 'Very Open' To More Tightening
(Pub May 12, 2023)

By Jean Yung

(MNI) WASHINGTON – Nascent signs of cooling consumer demand may already be pulling down price pressures, meaning the Federal Reserve can hold interest rates where they are, but Richmond Fed President Thomas Barkin is "very open" to supporting more rate rises should the data tell a different story, he said in an interview late Friday.

The Fed's rate hikes over the past year are having an effect on consumer spending and the labor market with more to come, and the recent banking turmoil is prompting lenders to tighten credit standards, all of which should help tame inflation, Barkin said.

"There's a story out there that's quite plausible: The lagged effect of rate moves combined with credit tightening in the economy combined with the erosion of pandemic-era stimulus will bring demand down and inflation down relatively quickly. But I still want to be convinced," he said.

"For me it will depend on what I learn about how much does demand cool and how much does that demand cooling bring down inflation. If inflation doesn't seem to be coming down as expected, I'm very open to more tightening. On the other hand, if things play out in a way that gives me comfort that inflation is moving in the right direction toward our target, then I'm very comfortable waiting."

PRICING POWER

Federal Reserve Chair Jerome Powell this month signaled the central bank may hold off on further hikes after raising their benchmark overnight rate to a range of 5% to 5.25%, but a [couple FOMC officials](#) have already expressed doubt that inflation is under control, warning that tighter policy may be needed.

Barkin said he is "pretty comfortable with data dependence as opposed to the forward guidance model," given the uncertainty of the impact of policy lags and credit conditions as well as external factors like the debt ceiling showdown in Washington.

Measures of underlying inflation remain elevated at the "high 4s," and the monthly core inflation readings are "not consistent with what I want them to be," Barkin said. (See [MNI INTERVIEW: Sticky Prices Could Require More Hikes-Fed Econ](#))

The past two years of high inflation "has led firms to believe that pricing is more of a lever than they thought three or four years ago." Consumer facing firms are reporting price growth of 12% to 13% plus volume growth, he said.

"You're really looking for those folks who are selling directly to consumers to reach the point where they go, 'I don't think I can raise price anymore.' And I did not pick that up" in annual reports over the past few week, Barkin said. "Again, there's a very plausible story that they will pull back relatively soon. It could be happening now, as demand is cooling."

A LITTLE LESS LENDING

Consumer spending data has been "flattish" in February and March after being quite elevated in January, and real-time data on credit card transactions have "definitely cooled" in April. People are spending down their excess savings while some fiscal supports have ceased, and credit tightening will help slow demand further, Barkin said.

The Richmond Fed district is home to some of the largest U.S. lenders like Bank of America and Capital One but also a number of smaller banks, which have told supervisors that deposit flows are stable and they've invested in building the liquidity they need, he said.

Credit conditions were already tightening before Silicon Valley Bank failed, and the Fed's survey of lending released several weeks after SVB "looked like a modest additional tightening but not something outsized," Barkin said. Given rising funding costs, banks "on the margin are making sure they're absolutely comfortable with each credit they issue. What I hear people say is: We're just taking a second look at marginal credit. The natural implication of that is you do a little less lending."

Businesses in the Richmond Fed district continue to complain that they're short of workers, Barkin said, in line with labor market indicators pointing to a cooling "from red hot to merely hot." Secondary indicators like job openings, quits rates and jobless claims are moving in the right direction, but "it's hard to ignore a 3.4% unemployment rate, the lowest since May 1969," and still high wage growth figures, he said.

MNI INTERVIEW: Sticky Prices Could Require More Hikes-Fed Econ (Pub May 10, 2023)

By Pedro Nicolaci da Costa

(MNI) WASHINGTON - There is a significant risk U.S. inflation will not come down as quickly as the Federal Reserve expects this year, forcing the central bank to raise rates further despite strong market expectations for a pause in June followed by rate cuts not long after, senior Dallas Fed research economist Enrique Martinez-Garcia told MNI.

"There's a nontrivial risk that things could get more difficult and more challenging for the Fed to manage. Policymakers might have to consider whether or not the current path is sufficient to keep inflation on track," he told [MNI's FedSpeak podcast](#).

Such an outcome would raise the chances of a recession, as well as heightening the prospect of additional financial stresses following a number of sizable U.S. bank failures since March,

"If it turns out that inflation is indeed stickier than we are anticipating right now and that requires monetary policy to become even tighter, then the financial and labor market stresses are likely to be higher and I would expect the chances of a harder landing to be higher," he said. (See [MNI INTERVIEW: Fed Pause Could Make Inflation More Entrenched](#))

One major impediment to the Fed's ability to bring inflation back down to its 2% inflation target in timely manner is a labor market that is still ultra-tight despite some modest loosening around the edges, Martinez-Garcia said. That post-Covid dynamic is keeping wages too lofty to be consistent with price stability and increases the risk that inflation expectations could become unanchored.

TOO MUCH OF A GOOD THING

U.S. employers added 253,000 jobs in April, beating Wall Street expectations for some 12 months in a row, while the unemployment rate sank to match a 50-year low of 3.4% again and wage growth picked up.

"The fairly robust growth in wages which has continued, is not accelerating but is still very high and quite persistent," Martinez-Garcia said. "This is particularly relevant for the sectors that are labor intensive and in particular for industries in the service sector that are heavily dependent on labor and the wage scale is going to be a very important part of their cost structure."

Fed Chair Jerome Powell has emphasized the importance of seeing a decline in service costs outside of the housing sector, which he argued in his post-meeting press conference last week "really hasn't moved much."

The Dallas Fed researcher argued that "if we are going to see moderation in headline inflation consistent with expectations of the central bank we should expect to start seeing signs of service inflation slowing down sooner rather than later, otherwise mechanically it's just going to be difficult."

HOUSING FACTORS

Martinez-Garcia, an expert on housing, said dynamics in a sector that reached bubble-like conditions during the pandemic, will also be key to how fast inflation can come down.

"The cooling of a housing market and housing trends is also going to be mechanically key for the Fed to achieve its stated goal of bringing inflation closer in line to its target by the end of the year, beginning of next year," he said.

U.S. CPI extended its decline in April, dipping to 4.9% on the year. But the core measure remained quite elevated at 5.5%. Shelter prices were the largest contributor to headline inflation.

While long-term inflation expectations are still well-anchored, Martinez-Garcia said that should not be reason for complacency because the longer prices stay high, the more workers and businesses will start to build in higher inflation expectations into their wage negotiations and pricing structure.

"The big lesson that policymakers learned from the 60s and 70s is that if you let those cost-push pressures go without responding you run the risk that while temporary, they might be persistent enough that they start changing the way agents react to inflation," he said.

The Fed raised interest rates last week to a 5%-5.25% range and opened the door to a possible pause in June, although officials have certainly not yet committed to stopping hikes for now.

MNI INTERVIEW: Fed Likely Done, Cuts Possible Before Year-End (Pub May 5, 2023)

By Pedro Nicolaci da Costa

(MNI) WASHINGTON - The Federal Reserve is most likely finished raising interest rates and it could be prompted to cut them before year-end if inflation falls sharply as it may well do, former Boston Fed research director Jeff Fuhrer told MNI.

"We're probably getting to the end of rate hikes. I'd be surprised if they continue raising next time," Fuhrer said in an interview. "Inflation has already started coming down – that has little to do with the Fed's actions so far, it's too soon."

The Fed raised interest rates to a 5%-5.25% range and Fed Chair Jerome Powell hinted at a possible pause in hikes as early as the June meeting.

Fuhrer said that elevated but lagging shelter costs are adding about 2 percentage points to CPI, and once those pressures ebb the true pace of inflation will prove much more subdued than the 5.9% April reading.

"If shelter were doing something more normal, and there's good reason to believe they will be, then the underlying rate of inflation is already in the 2.5% maybe 3% range," Fuhrer said. (See [MNI INTERVIEW: Services Peaking As Fed Hikes Gain Traction-ISM](#))

OVERCOOKED

If his expectation is correct that inflation will fall even more rapidly as the lagged effects of accumulated tightening are more directly felt on prices and the job market, then Fed policy is arguably already too tight, Fuhrer said.

"There's a significant risk that they've raised rates too much. They've really raised the risk of a slowdown," he said.

That said, the economy could still skirt recession given a labor market that shows few signs of slowing significantly – with a larger-than-expected gain of 253,000 new jobs last month.

"It risks having a slightly less soft landing. I think they've misread the way inflation has worked in this cycle especially at the current juncture so they've probably already overdone it."

RATE CUTS PLAUSIBLE

Despite assurances from Powell that the Fed does not expect to reverse course and start reducing interest rates any time soon, financial markets continue to predict as many as three cuts this year, starting as early as July.

Fuhrer said the bar for cuts is high given the Fed's rhetoric about keeping rates higher for longer – but not insurmountable if inflation data move in the right direction.

"If they see that inflation really is coming down and we are really seeing signs of softness, I would not be deeply surprised if they decided to recalibrate with some cuts in rates," he said.

"Powell's saying their read is inflation is still going to be a little bit sticky and if that's right it wouldn't be appropriate for them to be easing in the next six to nine months. But if some of these signs that inflation is coming down quickly are ratified, month after month, and it looks like it's coming down to the 2% to 3% range, then they might say how much more steam do they need to take out of the economy?"

MNI INTERVIEW: Fed Pause Could Make Inflation More Entrenched **(Pub May 4, 2023)**

By Pedro Nicolaci da Costa

(MNI) WASHINGTON - A possible pause in interest rate hikes from the Federal Reserve in June, seen as more likely after this week's FOMC decision and an accompanying statement that was more equivocal about future increases, could lead to more deeply embedded inflation pressures that might require even tighter policy down the line, a former top Fed staffer told MNI.

Andrew Levin, who spent two decades as a Fed board economist, said Fed Chair Powell's dovish hints that a pause could be forthcoming, including the argument that real interest rates are already substantially positive, fail to take into account still-elevated short-run inflation expectations of consumers and businesses.

"There's a very substantial possibility that inflation is going to remain elevated as far as the eye can see," he said. Levin pointed to the Cleveland Fed's ["indirect" measure of consumer inflation expectations](#) over the next 12 months at 5.4%.

"Probably at the end of this year and into next year these deep underlying measures of inflation are still going to be running in a range of 4-5%. What are they going to do to bring inflation down below 4%? A federal funds rate of 5% is probably not going to be enough to make much of a difference."

The Fed this week hiked interest rates to a range of 5-5.25%. Chair Powell argued monetary policy is tight because comparing market-based expectations of inflation one-year out of around 3% versus the fed funds rate yields a real rate of around 2%. "That's meaningfully above what many people would assess as the neutral rate," he said.

CONFLICTING SIGNALS

Levin, a former aide to Fed Chair Janet Yellen, said Powell's reasoning makes sense only if you believe market based expectations – but he sees reason for skepticism.

"We're getting conflicting signals. The 3% is the Federal Reserve itself and professional forecasters and former Fed economists who are now chief economists at a lot of private sector firms that all have very similar views – they've been wrong for two consecutive years, wrong about how fast inflation would come down," he said.

"Consumers just don't see it the same way. If the consumer is proven yet again to be right, then a 5% federal funds rate is not tight, it's neutral," he said. Consumer surveys from the University of Michigan and the New York Fed both showed year-ahead inflation expectations surging in April.

Levin says that by even hinting at a pause the Fed has limited how much further room it has to raise rates further without significantly disrupting markets. Barring a significant worsening of the regional banking crisis and a substantial recession, he said, the Fed might still be forced to deliver one or two more hikes later in the year. (See [MNI INTERVIEW: Fed To Resume Hikes Later If Inflation Lingers](#))

"If inflation stayed high and the economy is still growing moderately, then I think the communications they've been making lately could leave the door open to making a couple more quarter point hikes. Maybe they get up to 5.5% or 5.75% this year. That's still not a very tight monetary policy if inflation is still at 5%."

"The problem will get harder and harder for the Fed. Next year is a presidential election year so it would be hard for the Fed to take decisive action," he said.

STAGFLATION, NOT RECESSION

In part because of the Fed's timidity in fighting inflation in the face of financial instability, Levin still thinks the economy could skirt a recession.

"There are some strains from the bank failures [and] those might affect the lending behavior of banks, those might have other spillover effects from credit markets. But the signs we got from the services PMI and probably in the employment report tomorrow, the economy is doing ok," he said. "Probably the better description is something like stagflation."