May 20, 2024

The Federal Reserve Continues to Recommend Patience amid Uncertain Inflationary Pressures

Lindsey M. Piegza, Ph.D.
Chief Economist
piegzal@stifel.com

Lauren G. Henderson
Economist
hendersonla@stifel.com

Patience.

4 Out of 5 Fed members surveyed recommend patience.

Opting to keep rates on hold for the sixth consecutive meeting earlier this month, Federal Reserve (Fed) Chairman Jerome Powell reiterated a message of continued patience for policy easing – eventually – as the Committee awaits further evidence inflation is on a sustained downward trajectory toward 2%. However, given the economy and, more specifically, inflation have failed to evolve as expected, "*eventually*" may prove to be a 2025 occurrence. In other words, if inflation remains at current levels or even pushes slightly higher, which remains our base case forecast, the Fed may have little, if any, wiggle room to provide relief, potentially keeping rates at today's relatively elevated level though the entirety of the current year, or at least as long as it takes for inflation to begin to again recede.

In the aftermath of the May rate announcement, a number of Fed officials echoed Powell's position, voicing conviction that the current level of policy is appropriate to restrict growth and result in slower inflation – again *eventually*. One such speaker was Chicago Federal Reserve President Austan Goolsbee. In a somewhat unusual interview last week, which included a reference to the 1994 film *The Shawshank Redemption*, a historical antidote regarding the first rotary phone and a firm declaration against categorizing Fed members as varying forms of poultry, Goolsbee offered further and detailed insight into his assessment of current inflationary conditions, as well as his expectations for Fed policy going forward.

A DISCUSSION OF POLICY AND DIRECTIVES

Last Friday, I had the distinct pleasure of attending an in-person event with Chicago Fed President Austan Goolsbee. Interviewed by CNBC's Steve Liesman at a luncheon event hosted by the Economic Club of Minneapolis, Goolsbee expanded beyond the Fed's headline message of "*patience*" for eventual policy easing.

"*Are you concerned about inflation?*" Liesman asked Goolsbee out of the gate. "Yes, of course," he responded. He continued to say that "as monetary policy figures, Fed members are constantly concerned about inflation, and despite three months of rising price pressures, there's "*not much evidence*" that inflation is stalling out at 3%. We don't yet know," Goolsbee added, "if the rise at the start of the year was more of an anomaly or simply a reflection of inadequate seasonal adjustments, or indicative of a larger trend."

Since the start of the year, inflation has not only arrested an earlier disinflationary trend, but also by most metrics, entirely reversed course, pushing higher and further

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away from the Committee's 2% target. Chairman Powell has been clear the Committee won't overreact to a few months of bad data, nor however, can several unfavorable data points be ignored. Goolsbee noted he was in agreement with such sentiment that one month does not make a trend, but three months is a "*real month*" worth considering.

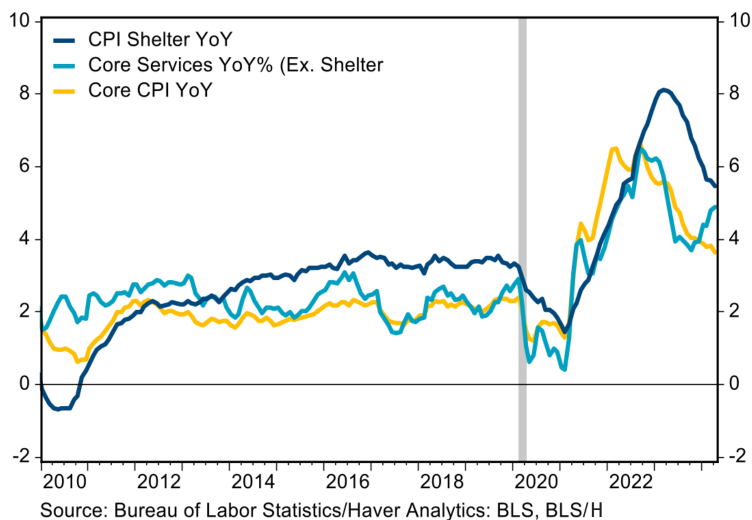
That being said, Goolsbee encouraged the Fed's message of patience, emphasizing a wait-and-see approach to inflation and subsequent policy response. Denying classification as either a Dove or a Hawk, Goolsbee insisted he was in a third camp: the "*data-dog camp*." And being a data-dog, he explained, means you need to "*know when to walk and know when to sniff. And we've moved from walking time to sniffing time.*" In other words, he said, he has changed his view from expecting a near-term reduction in rates to … "*we need to wait and see.*"

"*When can we expect at least some policy relief?*" Liesman asked, looking for more details. While stopping short, as one would expect, of quantifying or committing to a specific timeline, Goolsbee noted first, his assessment of the current level of policy, which he described as "*relatively restrictive*," suggesting at 5.5%, the Fed is still actively slowing growth prospects. But from here, Goolsbee was clear, rate cuts "*are dependent on confidence that inflation is on a pathway back to 2%.*" If we are confident, he said, then as the Federal Open Market Committee (FOMC) statement implies, then and only then will the Fed take action to reduce rates. But we don't yet have that confidence, Goolsbee remarked.

An earlier Fed forecast painted expectations for a more accommodative policy pathway in the near term. The March FOMC dot plot, for example, implied the majority of officials saw three rate reductions as a reasonable forecast for 2024. Such an outlook or expectations for future rate cuts – again eventually, Goolsbee clarified, are based on a "*theory of the economy and predictions of conditions … improving.*"

At this point, the reversal in inflation or lack of disinflation does not appear to be signs of an overheating economy. "*We aren't seeing more negatives*," Goolsbee said optimistically, noting ongoing positive supply-side developments as well as a larger population than previously expected driven by robust immigration flows contributing to the sticky nature of elevated prices. That being said, "*If it begins to look like overheating and not a supply quantity issue … if we're overheating, we will take action and get inflation back down to 2%*," Goolsbee noted.

Still, for the majority of Fed members, policy easing appears to be a question of when, not if. Yet, with inflation moving higher since January, it's reasonable to wonder whether or not the Committee is considering the scenario whereby inflation fails to improve or worse, continues to push higher? Clearly sharing such a concern,



Source: Bureau of Labor Statistics/Haver Analytics: BLS, BLS/H

GLOSSARY

AI – Artificial Intelligence

CPI – Consumer Price Index

YoY – Year over Year

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the moderator made reference to the Fed's unwavering focus on policy easing. Like geology, Liesman said, it takes pressure and time. "But how will you know," he asked Goolsbee, "if and when you need to introduce further pressure?"

"*Geology is the study of pressure and time. That's all it takes really … pressure … and time …*" - The Shawshank Redemption

"First, we need to understand," Goolsbee responded, "if we are "*hung up*" at a higher level of inflation or if this is just a bump in the road." If inflation fails to move toward the 2% target then we will need to act. But he offered, inflation "*is coming down*." Goolsbee went on to clarify his expectations for further reprieve in cost pressures, particularly in the rental component of housing. Although, while down from an earlier peak of 8.1%, shelter costs remains elevated at 5.5%, complicating the Fed's ability to slow broader measures of inflation given housing remains a sizable component of the price index calculation.

"*When do you expect such relief?*" Leisman followed up. "*What is the time period?*"

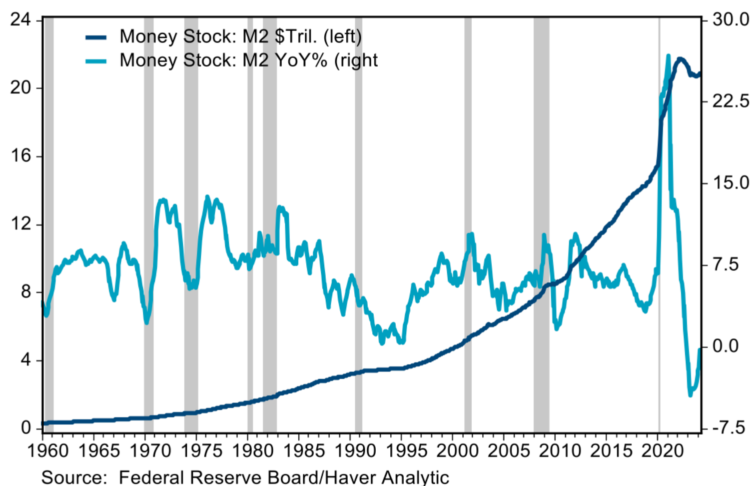
"*Reasonable*," Goolsbee responded. "*Reasonable*."

But if it takes *more* than a reasonable time, would the Fed be willing to move the goalpost for inflation as opposed to further firming policy? Leisman inquired. Instead of 2%, perhaps a 3% target? With a lighthearted tone, Goolsbee shook off the notion of raising the bar for inflation given the potential surge in inflation expectations, which would likely feed back into the realized inflation calculation, potentially then driving the real measure of prices even higher. Remember, despite near double-digit inflation at an earlier peak, Goolsbee reminded the audience, inflation expectations have been well anchored as the market remains convinced the Fed will reinstate price stability … eventually. If we move the goalpost, it's like the Trident dentists, Goolsbee remarked, "*Once you make a recommendation, you're married to it. It's done.*"

OUTSIDE INFLUENCES

Rounding out the interview with questions from the audience, Goolsbee was asked about the fiscal contribution to inflation. As expected, there were few takeaways on the subject as the Chicago Fed President drew the proverbial line in the sand between monetary and fiscal policy, the latter of which the former does not comment or make judgements on. We simply react to the conditions created by the government, Goolsbee said, rather than comment on the "*creation*" of such conditions.

Well-articulated deflections aside, deficits do matter, and a massive expansion of the government's balance sheet will continue to reshape expectations for longer-term rates, and further insight inflationary implications keeping pressure on the Fed



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to be a sizable buyer of Treasuries. Goolsbee dismissed concerns, however, of the rising size of the Fed's balance sheet, noting current financial market conditions necessitate a larger size than was ever necessary previously. "*We can shrink it from where it was,*" he said, "*but it will never go back to levels it was prior to the financial crisis.*"

Goolsbee furthermore dismissed concerns of recent policy initiatives taken during the pandemic era with nearly $6 trillion in stimulus resulting in a 36% expansion in the money supply. "I don't put a lot of credence," he said, "on money aggregates given the definitions of money have become *"outdated.*""

Finally, regarding the impact of Artificial Intelligence (AI) on the balance of growth, Goolsbee noted that it will depend on how fast the implementation and change filters into the labor market and broader economy. Noting that by the age of 40 most Americans have had 11 different jobs, he emphasized the mobility and flexibility of the U.S. labor force. However, if overnight 8 million truck drivers are displaced by self-driving vehicles as opposed to a slowly adopted spread, for example, that has more of an "*apocalyptic feel.*"

Lindsey Piegza, Ph.D.
Chief Economist
piegzal@stifel.com

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