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**SCOTT WAPNER, CNBC:**

Stocks in the red across the board after the latest Fed Minutes showed officials are concerned about “significant upside risks to inflation”. FOMC is also warning more rate hikes could be necessary. Let's bring in former Fed Vice Chair Richard Clarida. Mr. Clarida, welcome back. It's nice to see you.

**RICHARD CLARIDA, PIMCO:**

Good to be here.

**WAPNER:**

All right, so they're concerned about inflation remaining sticky if not ticking back up and possibly having to raise rates even more. What are your own expectations? How many more hikes do you think are in the cards?

**CLARIDA:**

Well, I do think the Powell Fed is data dependent right now, but I've also thought, and after reading the minutes today, continue to think that the risks are that we do get in one more hike this fall. At the June meeting, the SEP dots indicated that most folks thought that a July hike and one more would be required. And I'm leaning in that direction.. Now they could get data that are sufficiently positive for them that they could be done, but these minutes read like a committee that is worried not just about the baseline, but about the risk. And as your quote indicated, the risks are to the upside on inflation.

**WAPNER:**

Wow. So I was wondering whether you were going to suggest that even more than one was potentially necessary. Is that all you see? Because I feel like the market would take that as a big W.

**CLARIDA:**

Well, it could. Right now, the pricing, as I look at my screen, is under a 40 percent chance of getting in that additional hike this year. So it's certainly not priced in. I agree. I think they're close to done. They've hiked a lot. They're in restrictive territory. I think the debate does turn at some point to how long to keep rates in restrictive levels. But on your specific question, I do lean in the direction that there is one more hike in the pipeline this year.

**WAPNER:**

I'm curious as to your reaction to the Atlanta Fed and their GDP now. It's not a forecast. It's now 5.8 percent, still got a lot of eyebrows going up, right? So, if they're even close to correct, the implication obviously is that the economy's pretty darn strong. What's that going to mean for your prediction and what the Fed might end up doing?

**CLARIDA:**

I think right now, of course, the Atlanta Fed's getting the attention and they do good work there. Other indicators that we look at do indicate that certainly the economy entered the third quarter with good momentum. The economy has surprised me. It has surprised on the upside this year. I think, Scott, they're probably more focused on the labor market because we do have near a 50-year low unemployment. The statement itself today, the minutes itself, emphasize that the wage gains, wage inflation is still running hot compared to the long-run inflation target. So I think probably more of the focus will be on the labor market, I would guess.

**WAPNER:**

How would you assess this as to whether the worst case scenario, so to speak, for the Fed is one in which wages remain elevated, prices paid, we just learned today, we're up in August. At the same time, the economy remains stronger than they expected. Is that a worst-case scenario for not only them because it really puts them in a box and for the markets?

**CLARIDA:**

Well, yes, so I think our baseline view is that the economy next year does downshift with inflation running in the twos, with perhaps some modest rise in unemployment in that scenario. But there is a risk case. It's not the most likely case. There is a risk case that inflation and the labor market is just very, very sticky in the case of inflation, resilient in the case of the labor market. And if they're sitting there next spring with 4% inflation and 4% or below unemployment, they're in a tough situation.

**WAPNER:**

Do you feel like we're done talking about the possibilities of a recession? Now it's the debate of either soft landing or no landing, or do you feel like it's still a risk that needs to be taken seriously?

**CLARIDA:**

Oh, yes, I think that recessions are in the eye of the National Bureau of Economic Research, but historically, we've never had a period when the unemployment rate has risen by more than half a point that has not been an NBER recession. And even the Fed itself and its projections in June saw the unemployment rate rising by about a percentage point. So if recent history is any guide, even a pretty softish landing could well be designated at least as a technical recession. So no, I don't think we should rule out that potential recession at all.

**WAPNER:**

I guess with this week, that leads me to the idea of when the Fed's going to first cut rates with projections by some firms here on Wall Street that it'll come in the second quarter of 2024. Now do you think inflation needs to be back at target before the first cut or not?

**CLARIDA:**

No, I take the Fed at its word and we had interesting comments from New York Fed President Williams not so long ago. And this is a point others have made on the committee, including Chris Waller, which is that if the committee does succeed in getting inflation into the twos next year, then it could, and I think would, start to consider rate cuts simply because if he keeps rates at current levels as inflation falls, that means real interest rates adjusted for inflation are going up, which is actually tightening financial conditions. And so I do think we can get easing or at least a reduction in rates from current levels next year if inflation does demonstrably fall into the twos.

**WAPNER:**

So into the twos, not two percent, right? There's a significant difference between getting all the way back to target versus at least confident or some degree of confidence that we're well on our way.

**CLARIDA:**

And I think to me that is a likely scenario, that inflation is in the twos and the Fed is adjusting rates next year, not all the way back to the long run destination, but easing rates in the context of inflation that's fallen a lot and that's within striking distance of the long run two percent goal.

**WAPNER:**

The other thing is the election obviously factoring into next year and I'm curious as to what you think and how that will factor in, if at all, in the way that policy moves forward, how it could influence it in any way.

**CLARIDA:**

Well, let me just stay bluntly upfront. The Powell Fed is going to do what it needs to do to keep at it until the job is done and get inflation going back to two. I do think that the calendar is set up and their guidance is set up for them to get in the rate hikes they think will get the job done, get those in place this year. But I also think that if they're wrong and inflation is stubborn and sticky next year, I think they'll do what it takes to get it back down to two percent over time. So I don't think the Fed wants to be the focus of attention in an election year, but in the end, I think they'll do what they need to do to get the job done.

**WAPNER:**

Sure, but Powell must know, or at least he's got to be thinking about it somewhere in his being that you would expect perhaps the current president of the United States to be talking more often about the idea of cutting rates as you get closer to an election which we already know is going to be highly contentious.

**CLARIDA:**

Well, again, I'll simply say, I think the Fed's communication and projections indicate that they think they're going to get rate hikes that they need in place, get them done this year. Next year is a long way away. I would say that past Feds have hiked in presidential election years. Volcker hiked in 1984. Greenspan hiked in 2004.. So if the Fed needs, the Fed will do what it needs to do as an institution and I'm sure that it will do that.

**WAPNER:**

Are we going to get it more than eight minutes from Mr. Powell next week at Jackson Hole?

**CLARIDA:**

Well, I'm certainly not talking to him about his speech. I don't know. I was at Jackson Hole last year. I thought it was a very effective eight minutes. It was very clearly in his voice. And so I'm looking forward to seeing what he has to say.

**WAPNER:**

You'll be there again, I suspect?

**CLARIDA:**

No, I'm going to be with my family on some well-deserved vacation, so I will not be at Jackson Hole.

**WAPNER:**

Alright. I appreciate it nonetheless. We'll talk to you in the weeks ahead. I'm sure. Mr. Clarida, thanks so much. That’s Richard Clarida, the former Fed Vice Chair, joining us.