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**GUY JOHNSON, BLOOMBERG:**

OK, let's return to our question of the day. How are you feeling? What's going on? If you were to talk about an overriding emotion right now, is it fear or is it greed? Let's ask that question now to Richard Clarida, PIMCO Global Economic Advisor and, of course, former Federal Reserve Vice Chair. Rich, great to see how you're feeling. What's the overriding emotion right now? Fear or greed?

**RICHARD CLARIDA, PIMCO:**

Well, let me talk about the market. I think there's certainly an element of fear. And as always, there's greed. As you're thinking about this sell-off, I think there are four potential factors. As always, there's the Fed. There's the macro data. There is fiscal, potentially, and there are technicals. Most of this sell-off really since the Fed has really not been on Fed news. I think it's been a reflection of concerns about fiscal, a higher term premia. And, of course, fiscal dysfunction in Washington never ceases to disappoint. So I think there's a lot going on here.

**ALIX STEEL, BLOOMBERG:**

Does this mean a higher neutral rate, Rich, and the echoes of that?

**CLARIDA:**

Well, it could, Alix. I think at PIMCO, we try to distinguish between a neutral bond yield on a 10-year and the neutral federal funds rate. We do think we're going to be in a world eventually of steeper yield curves, but there's no doubt that in a world where government debts north of 100% are GDP, we really do not have a consistent fiscal policy in the U.S. We're going to probably be in a world of steeper curves, for sure.

**JOHNSON:**

The neutral rate, always interesting to try and see it with hindsight. Rich, what we can certainly observe right now is a very fast move. Do you think the Fed's going to be comfortable with the speed of the move that we're seeing in the bond market?

**CLARIDA:**

Well, so far, Fed officials have had a chance at various appearances, and they've not really taken that opportunity to push back against this. My own sense is that, to the extent this move really does reflect higher bond yields because of so much treasury issuance, it's not something the Fed would necessarily want to lean against. It actually does some of the Fed's job for it, but obviously, if moves get extreme or persistent, it could get the Fed engaged, but we haven't seen that yet.

**STEEL:**

Yeah, I think Alan Ruskin in Deutsche Bank was saying that the recent 85 bips in the 10 year is like 150 bips worth of tightening for the Fed. So, okay, not the worst thing in the world. What looks unruly? What would worry Rich, if you were still at the Fed?

**CLARIDA:**

Good question. What I'd be looking at, Alix and Guy, is I'd be looking at the extent to which this sell-off reflects a big move up in inflation expectations. The Powell Fed wants to anchor inflation expectations. So far, most of the move has been in real rates, not in inflation, but if I were still back at the Eccles or the Martin building, I'd be looking to see that the Fed's credibility is still in place, which it currently is.

**JOHNSON:**

Yeah, the Fed would certainly like to maintain its credibility, and if things get disorderly, maybe it would have the opportunity to step in. Rich, do you have any idea, do you have any clarity on what the current strike price of the Fed put is, were things to get disorderly?

**CLARIDA:**

Well, I think that's a tricky concept in general of the Fed put. What I do think we do know, Guy and Alix, is the Fed understands that the liquidity of the treasury market is essential to achieving its mission. And certainly, in my time at the Fed, we had disruptions, for example, in the repo markets in 2019. So there can be sufficient or significant disruptions where the Fed steps in. We saw from the Bank of England exactly a year ago. But I don't have a particular level that I would mention right now.

**STEEL:**

Do you think that the bond market is functioning well? We talk about liquidity risks, the hedge fund basis trade, all that stuff. Is the bond market giving us a real read, or are there just a lot of distortions? And what do we do with that?

**CLARIDA:**

Alix, a good point, because I alluded to that a moment ago, I do think there are market technicals at play here. Essentially, what I mean by market technicals, tendencies for prices to move or overshoot in response to fundamental news. I'll give you a good example. Just intraday, if you look at your Bloomberg screen, you'll see that the yield on the 10-year treasury moved up about 15 basis points, and then moved down roughly that amount on the ADP data. So those are very big, big moves in response to one report. So that's telling me that there is a technical element here.

**JOHNSON:**

Yeah, you've also alluded to the fact that the Fed's probably comfortable with what it's seeing. To a certain extent, this is doing the job that the Fed may need to do further down the road. Rich, do you still believe that the Fed has further to go? I'm wondering what the right question to ask is right now. Is it still, how high do they go, or is it now, how long do they stay there? Are we at the top of the mountain horn? Are we at the top of table mountain? If you were to pick a mountain, where are we?

**CLARIDA:**

Well, if you had asked me this a month ago, and I think I was on Bloomberg around that time, I was in the camp going into the September meeting that we would likely get one more hike in this cycle if really just for precautionary reasons. And certainly the dots at the September meeting had 12 of the 19 participants indicating one more hike. I'm less of that view now. I think given that, as I said, the bond market can do some of the Fed's job for it, if even some of this recent increase were to stick, I think the Fed could well be done.

**STEEL:**

If the Fed is done, first of all, thank you for breaking news with us. We appreciate it. If the Fed is done, what about 2024? It looked like the dots were looking at two cuts. Do you see that being real?

**CLARIDA:**

Alex and Guy, the thing about market pricing is that it's reflecting a probability weighted average of a lot of scenarios. Two cuts looks about right to me, but I think there's certainly a chance that we don't get any cuts next year. Or conversely, if inflation falls more rapidly than I and the Fed expect, they could be cutting more. So I think the way to look at those numbers is that they're averaging across a range of outcomes, but that doesn't look unrealistic to me. What I will say is back in May, when the markets were pricing in six cuts, including starting this year, I thought that that was out of line with Fed reality.

**JOHNSON:**

Rich, when we get into a rate cutting cycle, what does that cycle look like, do you think? How low do we go? Catherine Mann was talking the other day. She was talking about rates being permanently higher. Do you agree with her?

**CLARIDA:**

Well, I think in the case of the UK, and my good friend Catherine Mann's done a great job there, I think that is right. As you remember, they barely got rates above zero before the pandemic during my time at the Fed. We got the fund rate all the way up to 2.5%. What I do think, however, is central banks do have some room to cut now, and so they're further away from the zero bound. Not to sound boring, but I think central banks are going to be data dependent. I think an important difference in this cycle, leaning in Catherine's direction, is this is the first rate hike cycle, at least in the US, in 40 years, in which the goal of policy has been to reduce inflation, not just to keep inflation from going up. So I think there probably will be something of a bias in this cycle as well.

**STEEL:**

Oh, that's interesting. And it also goes back to the neutral rate, right? Still definitely unclear in that sense. So, Richard, I'm just wondering then, what you think about the labor market. What happens if we get a super hot number on Friday? What happens if we get a nice, cool number? How are you thinking about it?

**CLARIDA:**

Well, there's no doubt that the Fed wants the labor market to slow. It's hoping it can engineer that soft landing. But, 180-200,000 jobs a month is probably about 100,000 more than the economy can sustain without upward pressure on wages. So, I think that our analysis indicates that we're going to continue to see a slowdown in gains and payroll growth. It'd be interesting tomorrow, if for a change, the ADP report is indicating something. If we got an ADK print tomorrow, that would certainly be downshifting into the range the Fed thinks is consistent. But I do think that the Fed is looking not just at the price inflation data, but also wage and compensation costs. They're still running high relative to the Fed's long run inflation target.

**JOHNSON:**

Yeah, the ISM services data are certainly pointing us in that direction. We got that at the top of last hour. So Rich, put it all together for me. Jamie Dimon's warning of the risk of potentially going to 7% on the 10 year. We've got others making similar noises, some are even saying higher. What kind of trajectory are we currently on? Do I want to be buying the 10 year at this point? Do you think that's going to be a better entry point further down the road?

**CLARIDA:**

Well, what I'd say about that is we think that we're in a world, and we've said this in our publications, that we do think the Fed has credibility, will get inflation to two, and starting yields for patient investors are attractive. There are a lot of opportunities in the bond market and spread and mortgages and globally. So I wouldn't necessarily highlight just an interest rate level at this point. But yes, the bond market is adjusting, as I said, to technicals, to macro data, to fiscal dysfunction, and prices will find a level consistent with that data.

**STEEL:**

Rich, always good to get your perspective. Next time, with me in studio. We miss you in person, Rich Clarida, PIMCO Global Economic Advisor and former Federal Reserve Vice Chair, great to get your perspective. I always learn a lot.