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**KAREN TSO, CNBC:**

Let's get to Richard Clarida, who is a Global Economic Adviser at PIMCO and Former Fed Vice Chairman. Richard, thank you very much for joining us today, in what is a huge day for markets, and we appreciate you weighing in with your expertise. You were a Vice Chair over the Fed until January 2022. So very much in charge while we were talking about ZIRP for markets, the Fed took off in March 2022, a couple months later after you left. Now we are looking at a Fed that is pivoting. Were you surprised, like other market participants, that the signaling came so early?

**RICHARD CLARIDA, PIMCO:**

Well, thank you for having me on. I thought it was a close call whether or not the dots would show two or three cuts, and it was. But the change to the statement, although appearing to be modest, was significant, and the press conference reaffirmed the Fed thinks they're done, and moreover, they are confident that they are done. Two weeks ago, the chair was discussing that it was premature to start talking about rate cuts, and then yesterday he revealed they are talking about rate cuts. So yes, the totality of the communication yesterday did surprise me. That's for sure.

**TSO:**

Richard, before the market gets too excited at this point, carrying on with the pricing and rate cuts and positioning on risk on assets. What would you say about the caveats here for the Fed that's still dealing with inflation? We can see it in the cost of services still. That was unchanged in November, as it was in October. Does the market need to be cautious around rate cuts, and just how quickly they will materialize next year?

**CLARIDA:**

Well, you know, I would have said that 24 hours ago, but after yesterday, I think the Fed thinks that the inflation is on the way to 2%, it's what I've called the “two-point-something destination”, and they're going to start cutting. Yes, of course, there is inflation data that could move them away from this, but I think that the thinking has got to be that rate cuts will be beginning probably in the spring or early summer.

**STEVE SEDGWICK, CNBC:**

Richard, lovely to see you, sir. Why didn't the Fed break something in this raising cycle? I could not move for experts on CNBC over the last two years who were astounded that the Fed was moving so aggressively because they said the Fed would break something. At the moment, all I can hear is about Goldilocks, rather than broken chairs and bowls of porridge. Why hasn't the Fed broken anything?

**CLARIDA:**

I think there are a couple of points here, and it's a good question. The first is, although the number of rate hikes is very significant, most of those hikes in 2022 were just about getting the policy rate above inflation, and so really, policy has just been restrictive for maybe a little more than a year. I think the major point, and I should confess, I was a charter member of “Team Transitory” back at the Fed in the spring of 2021, and part of the Goldilocks story is simply that it's looking now, like not only a lot of the inflation surge, but a lot of the disinflation is reflecting transitory supply factors that are normalizing and that's a very good thing. That means the Fed needs to have a less restrictive policy than if it was entirely an excess demand story. So I think that's so part of it.

**SEDGWICK:**

Richard, we all know that on both sides of the Atlantic, here in the UK and obviously in the United States, it's where the consumer is. It's the services side, which is absolutely pivotal. Is the consumer, and I'm talking about your average, there isn't an average consumer, but I'm talking about most Americans, rather than the rich Americans. Are they struggling? Because I look at warnings from the likes of Target and Walmart, and I saw some horrible stuff from Hasbro in the last couple of days, and one could argue when you look at the extra-use of revolving credit that actually the US consumer is creaking a little bit. What is the picture as far as you see it?

**CLARIDA:**

Well, I think there are a couple of issues here. First is that sometimes it's useful to look at the median consumer, not the average, because the average is pushed up by the top. As of last year, median household income in the US was actually down in real terms. I think this year it will be up, but yes, I think for the median right in the middle household, it was a challenging period in terms of prices. Of course, employment is strong. I think the other issue, of course, is the consumer did hold up, and was the source of resilience in 2023, because the fiscal checks that were sent out during the pandemic were saved, and that was a source of substantial cushion that consumers drew down. So I think it's a mixed picture. Employment is very strong. Price level is higher than most folks are accustomed to, and the economy is adjusting for sure.

**TSO:**

Richard, you just said, “employment is very strong”. We had a reminder yesterday from Jay Powell that both mandates are important. We're getting to that point, inflation and unemployment. Now, the unemployment rate we just got last week, it dropped. It didn't stay steady. It didn't go up. It dropped to this point of the cycle. How unusual is that?

**CLARIDA:**

Well, it's very unusual to have a booming job market and a substantial decline in underlying inflation. Inflation can move around because of oil prices and the like, but when the Fed started hiking in March of 2022, headline inflation was 9%, and it's now under 3%. Underlying inflation has probably fallen from 5.5% down to 3% or below. So, in traditional economic models, to get underlying inflation to decline, that rapidly and that significantly, you usually see some slack in the labor market. But again, this reinforces, I think, the view that a lot of the inflation and now the disinflation reflects the winding and unwinding of supply disturbances from really what was a once-in-a-century shock, which was the pandemic.

**TSO:**

So, Richard, back to the earlier point, where you said that you hadn't really changed your view here, that we've still got some weakness cropping up in various different points of the economy it seems. So, how do we think about that stubbornness around the labor market? I mean, isn't that going to foil the Fed this year going into next year?

**CLARIDA:**

Well, you have to acknowledge that so far, the labor market has been able to adjust through vacancies, job posting and quits and not through employment. And, you know, obviously, I hope that can continue. But as I said, it has been a very unusual three years. And so far, the Fed has been able to engineer a substantial decline in inflation. What I would say, however, is that it is not “mission accomplished”. It may be “mission accomplished" in the forecast, but right now, inflation is still running about a point above the Fed's target. And I think what I would say is what we heard from the committee yesterday in the Chair's press conference is not only do they believe they are done, they are confident they are done. They're not really trying to hold out very much optionality. And so I wish them well, but there is some uncertainty, I think you have to acknowledge.

**SEDGWICK:**

Richard, in terms of other beneficiaries of low rates, the US government is one potentially as well with its extraordinary deficits at the moment. And you would have seen better than me the Congressional Budget Office estimates going forward. It doesn't look pretty. How does this benefit all kinds of lenders out there, including the government and its balance sheet?

**CLARIDA:**

Well, it is very straightforward. Anybody who borrows benefits if rates are lower and that includes the federal government. What's interesting, of course, is as you understand, in the US, because of the way our mortgage market is set up, most households who own their home have a fixed rate mortgage. But most of the rest of the economy rates do rise and fall with the level of rates. So corporate borrowing, auto loans, credit cards and all the rest. And so it definitely is a benefit to borrowers for sure.

**SEDGWICK:**

Absolutely. And I guess another side of things that the Fed is doing at the moment, we're focusing very much on interest rates, Richard. But I want to know what your thoughts are on quantitative tightening going forward and what that could do to the US economy. Because while rates are clearly falling aggressively across the curve now as well, potentially we get the 75 base points plus next year as well. We've still got quantitative tightening going on. Is that other issue going to be a major influence?

**CLARIDA:**

Well, quantitative tightening is sort of going on in the background. The committee doesn't want to adjust it meeting by meeting. I think when I served on the Fed, we were also doing QT and we stopped QT in July of 2019 when we cut rates. And what's interesting now is what the committee is saying and the chair has confirmed that they are considering that when they do start to cut rates, they could continue QT. And so I think QT will be with us for a while. What's uncertain is how long the Fed will do QT because that depends on some technical factors in the money markets. But yes, QT will be with us for some time, it looks like.

**TSO:**

Can I ask you about some commentary around the market, Richard, because we had DoubleLine Capital’s Jeffrey Gundlach, warning of a turbulent 2024. We've had a fairly strong reaction to the Fed overnight. Do you think we are setting up for a turbulent year for markets next year?

**CLARIDA:**

Well, of course, there's always a risk of turbulence. But, you know, 2022 was pretty turbulent with Russia's invasion of Ukraine and a lot of volatility and 2023. So I guess there's a lot of turbulence you can't anticipate. But what I would say is that, you know, Fed raising rates looks like it's not going to be contributing to turbulence. That's for sure.

**TSO:**

And what do you make of the movement we already had in yields? I mean, we're talking this morning about longer duration could be set to fall further on some of the yields given what we're now hearing from the Fed. How should we be thinking about the Treasury curve stateside for next year?

**CLARIDA:**

Well, there have been a lot of moves in treasuries this year. And recently as October, the ten-year treasury yield was above five. And now it's below four. That's a big move. It was on my screen. It looked like a 20 basis point move in one day. Those are unusual. And we've had several of them this year. And yesterday was another one. You know, to not sound boring or simplistic, but yesterday tells you, “don't fight the Fed”. And with the Fed saying the message is, “We think we're done. We're confident we're done. We're going to adjust policy even with inflation in the twos”. That is definitely shifting down the entire level of rates. That's for sure.

**TSO:**

Richard, you've just gone there on the messaging from the Fed. So let me squeeze in a final question to you. What sort of communication does the Fed now need to deliver to markets next year? How does it need to think about carefully massaging its message?

**CLARIDA:**

Well, I think the one risk that is perhaps underappreciated is it is too soon to declare “mission accomplished”. Inflation can rise and fall for a number of reasons. I think the progress is real. But the reality is there is some chance that inflation proves to be sticky and stubborn. And then that creates a challenge for the Fed, not only in communication, but in policy decisions. Now, I'm convinced the Powell-Fed will do what it takes in the end to get inflation down towards target. But there is a risk that inflation does not cooperate with the forecast next year.

**SEDGWICK:**

Lovely to see you today, sir and taking all our questions. We really appreciate it. It's good to get your expert view on such an important day. Thank you, Richard Clarida, who is the Global Economic Advisor at PIMCO and, of course, Former Fed Vice Chair.