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**LISA ABRAMOWICZ, BLOOMBERG:**

This is a conversation that to me caps off one of the most fascinating periods of Fed history and economic history that I've ever seen, Rich Clarida Former Fed Vice Chair, as well as Columbia University Professor and PIMCO Global Economic Advisor, as well as a renowned singer. Rich Clarida, thank you so much for being here in person. I just want to start with what you make of the past week, Fed Chair Powell's comments and the markets reaction.

**RICHARD CLARIDA, PIMCO:**

Well, the Chair's comments took me by surprise and he had a difficult mission because it's the last meeting of the year, so it's natural to look ahead. But yes, I thought both the press conference and the FOMC statement were more dovish than I expected. There is a soft landing base case. We're all hoping for it. And I think the markets are really focused on that. He didn't say “Mission: Accomplished”. I'm not sure if he thinks “Mission: Accomplished”, but that's being interpreted that way. And of course, as you've mentioned on air, we've had a little bit of pushback recently. So we're all now trying to assess what message they would like to deliver.

**ABRAMOWICZ:**

Well, that's exactly what I wanted to ask you. What do you make of the pushback?

**CLARIDA:**

Well, I think the delicate challenge, and we've discussed this on the show in the past, is a tug of war between their guidance and market pricing. Part of the reason Lisa, inflation is expected to come down next year to “two point something” is because financial conditions have tightened. As the markets think “Mission:Accomplished” in rate cuts, six cuts are coming in next year, that will ease conditions. That makes it less likely that inflation comes down. So it's a tricky point right now for the Fed.

**ABRAMOWICZ:**

Do you think that Fed Chair Powell made a mistake?

**CLARIDA:**

I don't think so. I think he was reflecting his committee. And I think in the press conference, sometimes Chairs can sort of distance themselves. And I think he was embracing the baseline view. But there is a risk case as well. And I think perhaps some of the pushback is to remind folks about those other scenarios.

**ABRAMOWICZ:**

Mary Daly, in a Wall Street Journal discussion yesterday came out and said even if the Fed cuts rates by three times next year, that the Fed's benchmark rate will still be quite restrictive, even if in that scenario. And then she went on to say that, “we have to be forward looking and make sure that we don't give people price stability that but that away jobs”. Is this a new emphasis for the Fed?

**CLARIDA:**

Well, Lisa, I think at the margin it is because I think inflation was so high for so long, I think the Fed effectively had a single mandate for a couple of years, “We got to get inflation lower”. The Fed of course has a dual mandate. But I do think, and I of course work closely with Mary and with big fans of hers, I do think the issue here is that the committee itself emphasizes financial conditions. Indeed financial conditions made an appearance in the November statement and reappeared in December, it is true that one element is the real funds rate. But other financial conditions are easing, which as we said, makes it less likely that inflation does come down.

**ABRAMOWICZ:**

Which raises this question about whether you are right. The “two point something” view of inflation is kind of what the Fed is embracing right now in order not to jeopardize the labor market. Is that what your sense is?

**CLARIDA:**

Well, I've always thought that “two point something”, would be the point at which they start to think about cutting. So that is playing out in their projection. I do believe down to the individual, there are 19 of them, they all want inflation to get to two. And I do agree with them that if they hold off cutting rates at all until inflation gets to two, they're probably going to overshoot. But the timing is delicate. And I think there is a risk case on both sides. But I do think they are emphasizing now the dual mandate more than they have been.

**ABRAMOWICZ:**

Do you think it's because they're seeing something that other people aren't? Or they're at least emphasizing in their own data, some of the weakness, that maybe is overlooked by people who are piling into the market?

**CLARIDA:**

I'm not really sure of that. I think it's important for them- The Fed was criticized a lot in 2021 and 2022 for being behind the curve. I think it's appropriate to step back and acknowledge the progress in disinflation. And I think they're seeing that. But I think there's still a ways to go. And I think in particular, the labor market may require more adjustment than their factoring in. (COUGHS) Sorry.

**ABRAMOWICZ:**

No, it's all right. I'll let you catch your breath.. It's a confusing moment for all of us. And I'm wondering if you think it helps or hurts the cause to see the Fed come out, Fed Chair, Jay Powell with one message. And then Austan Goolsbee saying, “you guys, I'm surprised by your reaction.” And hearing from John Williams saying, “we're not really talking about rate cuts”.

**CLARIDA:**

That's not something you'd like to see coming out of a meeting. I think the market reaction, easing financial conditions is something that they are trying to push back against. I don't know how successful they can be, however.

**ABRAMOWICZ:**

Do you think that easing in financial conditions does ultimately have an inflationary impact right now?

**CLARIDA:**

Well, to the same extent that if you're tight in financial conditions, it lowers inflation. If they're eased on a sustainable basis, credits, threads are tight, borrowing costs are lower, valuations are up. At the margin, it supports demand. And if you think there's a demand piece to inflation, then, yes.

**ABRAMOWICZ:**

So right now, do you think that it is potentially concerning and counter to what the Fed is looking for given the all-in feeling? And frankly, I mean, we just heard this morning, the Fed “shot the bears”. The Fed wants to make people happy. I was bearish, but now I'm really bullish. I mean, is this a positive thing?

**CLARIDA:**

Well, I look, I'm very convinced that the Powell-Fed will do what it takes. I think that the communications challenges, which were substantial in 2023, maybe even more substantial in 2024.

**ABRAMOWICZ:**

There's been speculation from a number of guests that there is a political element to this, that the calendar is tricky for the Federal Reserve, considering that heading into November, everything is going to be really politicized. Do you buy any of that argument that that would encourage them to make a move earlier in the year?

**CLARIDA:**

Look, the history shows, in fact, I checked before I came on air; The Fed has actually adjusted rates in most presidential election years. In fact, they cut rates in ‘92 and cut rates in ‘08, although for other reasons. And they've hiked rates as well in election years. So, historically, the Fed doesn't let the political calendar dictate the outcome. At the margin, could it influence timing, say, between a June move and a September move? I'm not sure, but I think the number of rate adjustments we get next year will be the adjustments that the committee thinks is appropriate given the economy.

**ABRAMOWICZ:**

Given that we are talking about the politicization, do you think that this jeopardizes some of the credibility of the Fed, given that so many people have come on here and speculated? And we don't have any ability to basically know or not know, but is there some other consequence of just that speculation?

**CLARIDA:**

I really don't think so, Lisa. In the end, the Fed will be judged by returning to price stability and ideally doing so at minimal cost to the labor market. And so, I think the Fed's credibility in the end will rise and fall with delivering price stability.

**ABRAMOWICZ:**

When you talk about the potential for a re-acceleration of inflation and a stickiness, do you see that coming through the services sector in a material way? Which areas of the economy could we see a more material re-ignition?

**CLARIDA:**

Yeah. So, I think exactly. So, I think goods prices are now falling. So, we've had goods disinflation, deflation. The service sector typically lags behind. I would also say, I think the real- where the rubber will hit the road, Lisa, is in the labor market. So, we've had a substantial adjustment in the labor market without any rise in unemployment. And that is great. I will say my good friend and former colleague Chris Waller nailed that back in the summer of 2022. So, that's wonderful. I do think, however, that you cannot have a two percent price inflation target of wages going up four or five percent, which is where we are now. So, I think, if I were there, I'd be looking at the labor market adjustment as well as the services sector, as well. You know, one of the measures, which is core services ex-housing, has basically not adjusted at all in the last several months. So, it's still elevated.

**ABRAMOWICZ:**

A lot of people are talking about how the economic data has been really positive and how the Fed has been doing a good job. And how we have seen unemployment stay low, even with inflation coming down. Why do you think people feel so bad?

**CLARIDA:**

Well, I think there's a distinction, and it's certainly one I've thought about and written about, economists tend to focus on inflation. That's the change in prices. But individuals in the economy tend to think about the level of prices. So, even if inflation returns to 2 percent, the level of things like going to the grocery store, going to the movies, renting your apartment, those numbers are all a lot higher than they were four years ago. So, I think when inflation is low and stable, we tend to ignore that. But when you've had a big move in the level of prices, I think it does create more concern among households than you may infer just by looking at the inflation data.

**ABRAMOWICZ:**

I want to ask you, though, also about the housing market. And rents are higher. We just got housing starts and building permits came in higher than expected. We do see some of the treasury rally pairback, which is what you would expect. Does the high price of homes, in addition to the lack of any volumes, also create some sort of real dampening effect to sentiment?

**CLARIDA:**

Well, I think the high valuation for homes obviously makes the people of their own homes happier. But there's a distributional consequence, especially for younger parts of the population, folks in their 20s and 30s, who have not yet acquired that first home, and whatever they thought about the cost of ownership three or four years ago, it's a lot higher. But there's a huge wealth effect, positive wealth effect for folks who own homes. Presumably, they're happy about that.

**ABRAMOWICZ:**

Well, but it raises this question about what this does longer term to the inflation dynamic, but also to sentiment, particularly for younger individuals who haven't gotten in.

**CLARIDA:**

Yeah. Well, it does. And I think that this is an unusual period, Lisa, in the sense that because so many folks refinanced into low rate mortgages in the prior decade, the Fed, including when I was there, was doing QE to support the mortgage market. And because these are 15 and 30 or fixed rate mortgages, it is having this effect on supply that may be with us for a while.

**ABRAMOWICZ:**

We're here with Richard Clarida of PIMCO, formerly Fed Vice Chair. We are going to be having a conversation with my colleague David Weston with Brian Moynihan of Bank of America. And I do want to get your take, Rich, on whether you are seeing the stability in banks as one reason why a soft landing can materialize, right? Is that sort of one tailwind to a lot of this rally that was not there, say in March?

**CLARIDA:**

Lisa, absolutely. The Global Financial Crisis triggered a major rethink of the way that we regulate, and supervise banks in the U.S. As a whole, if you look at all the banks, they have lots of capital, lots of liquidity. And indeed, in 2020, when we were going through the dark days of the pandemic, you know, banks were a source of stability and increasing lending. So absolutely, I do think it's an important reason to think of the banking system as supporting the economy and not being a headwind.

**ABRAMOWICZ:**

Rich Clarida, thank you so much for taking the time as always.

**CLARIDA:**

Thank you, Lisa.

**ABRAMOWICZ:**

Wonderful to get your insights.