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**JONATHAN FERRO, BLOOMBERG:**

Tiffany Wilding with, PIMCO Economist and Managing Director, Tiffany, we would love your reaction to the data. And if we can build on the conversation that Mike and I were having, I know that you've been focused on this in a big way. The difference between PCE and CPI, what’s your read of things?

**TIFFANY WILDING, PIMCO:**

Yeah, well, maybe just to start off by talking to what you guys were just focused on, I think that one of the key questions is how much additional improvement, supply side improvements can we get? And this gets back to how much additional normalization, post-pandemic should we expect? And where will the economy be? What is the underlying trend and inflation once all of those pandemic-related effects fade? And we don't know that yet. We can try to estimate it, but we're not really sure what it is and we're still kind of waiting to see that. And actually in our minds, that plus the fact that demand in the US economy still looks pretty strong, might be enough to keep the Fed on hold for a little bit longer than maybe the markets were pricing. And then there's the other issue of this court CPI versus PCE. As you guys suggested, the measures are calculated differently. CPI doesn't look as good, we;re at 4% still on a year-over-year basis, even though we've gotten down into that “two-point-something” range with PCE, there's a lot of non-market factors, non-market prices that go into the PCE as Michael McKee sort of suggested. And those are the things that are kind of contributing to the good news. So the Fed's kind of just getting lucky, frankly, on the PCE. We think the optics of the CPI, plus the fact that demand just continues to look so strong, probably will keep the Fed on hold a little bit longer here.

**LISA ABRAMOWICZ, BLOOMBERG:**

Yeah, I got to say, I was talking to Joe Davis of Vanguard and he was saying he's worried about this market, this economy, being something of a 1967 economy. Or basically, it looked like a soft landing. The Federal Reserve was able to cut rates and then inflation picked back up again in a rapid way. What are you looking at to make sure that's not the case? What's the most accurate gauge?

**WILDING:**

Yeah, well, I mean, I think that's the thing, right? Like, you have to estimate it. You can't really observe it in some sense right now. And it gets down to how much inflationary pressures is a tight labor market producing? And as I said, because we've gotten a lot of tailwinds to inflation as a result of these supply chain improvements, we're not really sure what that is. So the models, there's various models that have been devised since the pandemic to try to estimate this. Our look at all of them sort of suggest that inflation absent a weakening in the labor market may be running closer to two and a half to three on an underlying basis, which obviously is above the Fed's target. So those have been the basis of our reasoning that you probably do need some more weakening in the labor market. You need growth to slow for the Fed to really get back to 2% in a sustainable way. And we're just not seeing growth really slowing that much.

**ABRAMOWICZ:**

But in December, Jay Powell didn't seem to push back against market pricing. Didn't seem to push back against this idea. It seemed to, frankly, embrace the idea of a soft landing. Why do you think that's going to change, and they're going to be less likely to cut rates in March, given that if you look at a year-over-year comp, at least in the past six months, you are seeing it back in that 2% range. And a lot of people are saying, you've got it. You could take a victory lap as we were just hearing from Bob Michael.

**WILDING:**

Yeah. Yeah, I mean, certainly their preferred inflation measure is definitely going to give them cover if they did want a hike rate, or excuse me, if they did want to cut rates in March. We think it's going to be running at 2.7. They're going to be pretty sure it's running at 2.7 in that February data that we'll get right around that little after the meeting, but we'll probably know the details of it. So there definitely is cover for them to start to cut. And I think one of the questions here is- so we've done some historical analysis on central banks and when they tend to cut. And it basically suggests that central banks always tend to be too late. And they're not really cutting until their economies are already in recession and unemployment rates are up. So maybe knowing this kind of historical analysis, the Federal Reserve, instead of that kind of behavioral historical way, they want to actually push against that and say, you know what, maybe we're going to get going now, but we're going to go really slowly. It's certainly possible that they could do that. And I think Waller suggested that more recently. So we definitely wouldn't rule out March. It's a live meeting. I guess just for us, the balance of risks, still, it's become more balanced, but maybe still is a little bit more on the side of inflation risks re-accelerating, which suggests to us that maybe the mid-year cut is more reasonable. And by the way, that's what we think is in line with the median for when we look at the summary of economic projections from Fed officials.

**ABRAMOWICZ:**

Tiffany, what's the consequences of easier financial conditions? And I ask this because that's ultimately why it matters, right? Is that if they cut, it could potentially ease financial conditions to all the more with people pricing in another eight rate cuts, which seems to be the way that things go these days. So how much is that really contributing to your concern about inflation re-accelerating?

**WILDING:**

Yeah, I mean, so we have a housing shortage right now. And you have to keep in mind that higher interest rates do result in both supply and demand within the housing market, slowing. And we've seen that we've seen housing market activity really collapse. So I mean, one of the things is that as rates fall, you're going to see housing market activity re-accelerate. And that's going to provide a growth boost. And so the broader inflationary effects of that, I think you have to take those into account. We do think you're going to get some re-acceleration. So that's why even though the Fed does want to start to ease, they do see inflation down. The way they do it is they're still going to have to try to manage financial conditions. So they probably are going to tell us when they start easing. It's going to be very slow, very methodical, right? And we don't want financial conditions to ease too much. But of course, the markets will extrapolate as they always do.

**FERRO:**

I don't want to make this too circular, but just to go into this a little bit more. So if the Fed doesn't ease or cut interest rates any time soon, inflation keeps coming down. We had Matt Luzzetti of Deutsche Bank on with us recently, Tiffany. And he talked about that being passive tightening, just allowing real rates to increase. Is that offset by the broader easing of financial conditions that we've seen since October? Does one cancel out the other?

**WILDING:**

Well, I mean, so if what is priced into the bond market in terms of the path of the Fed funds rate, if that's not realized, because the Fed’s staying on hold longer, then that mechanically should tighten financial conditions. I guess the question is given how strong the economy looks, maybe financial conditions should be a little bit tighter. So in our minds, that's a little bit of a reason to wait a little longer here. I mean, you don't want to get that premature re-acceleration that could be inflationary.

**FERRO:**

Interesting. Tiffany, appreciate the update ahead of the Fed next week in reaction to that data and response to the data just moments ago, Tiffany Wilding there of PIMCO.