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**SONALI BASAK, BLOOMBERG:**

Let's discuss this further with PIMCO economist Tiffany Wilding. When you think about what we saw today and the mixed signals, what did you make of it?

**TIFFANY WILDING, PIMCO:**

Yeah, I couldn't agree with Mohamed (El-Erian) more. I thought today's report was very mixed; mixed signals in the sense that you had a very strong and continued strong gains in the headline payroll, monthly payroll gains, but of course the so-called household survey, which is the basis for the unemployment rate, was weaker, and you have the unemployment rate moving up. Now what I would say is that taking a step back and smoothing through the monthly noise, the concern that we have had is that the U.S. economy has been growing at a very, very strong pace. Over 3% last year growth is higher, we would argue, than underlying potential. And when you have growth that's running higher than potential, what that usually means is that the unemployment rate should be falling, not rising, and you have payroll growth, which is potentially re-accelerating. And I think that's what we're concerned about. Obviously, we didn't see that on the unemployment rate side with today's report, but I think more broadly, that's our concern. I think that's also the Federal Reserve's concern when they're saying they need to get more confidence before cutting that inflation is going back to their target.

**BASAK:**

Well, when you look at even the inflation print next week, what will you be looking for? And will it lend a little bit of an all-clear if there is improving data? Do you think the Fed will have to need to wait a little longer for maybe not that first rate cut, but for that second one?

**WILDING:**

Well, so our view is that overall, the data and what we hear from the Fed is probably more consistent with a mid-year first cut than a March first cut, regardless of what the CPI report produces. Now, as we're mentioning with the payroll report, there's a lot of noise in any given data report. In January, you also had some kind of noisy-looking increase in inflation that was related to the shelter categories. So we think that probably moderates, but nevertheless, what we would say is that our forecast for inflation this year is a bit stickier than what the Fed is currently projecting. So core PCE, we think, ends the year closer to three than two, the Fed's target. And, of course, Fed officials are currently projecting at 2.4. So I think there's the potential for some upside surprise as we move throughout the year on the inflation side, especially if we don't get labor market cooling, but nevertheless, I think there's also this question around how much above-target inflation the Fed's willing to tolerate. Maybe if it's still running at two, two-point something, they're okay with that. They continue and they get going on rate cuts and you see a sequence of cuts throughout this year.

**BASAK:**

It's interesting. Fed futures still point to at least three rate cuts this year, and say they do not materialize, Tiffany. Say you get two or even one. What else starts to soften? And what does that path look like in terms of those higher interest rates rolling into the economy?

**WILDING:**

I think just given the strong growth trends that I mentioned, the strong growth that we're seeing in the United States, and by the way, you're not seeing that anywhere else in the developed markets. We've even seen some technical recessions in some markets, including Germany, UK, and Japan. The U.S. continues to be a standout region for growth. I think you need tighter financial conditions in order to cool that growth off. And so maybe that's exactly what the economy needs. Now, having said that, we do think there's some what we call hot spots or places that we are monitoring very closely. As everybody knows, the commercial real estate sector in the United States is going through a recession right now. How much that spills over into the broader economy is still a key question. Regional banks have a lot of exposure to that on their balance sheet. We think some of those smaller regional banks are probably under-reserved for the type of risk that's sitting on their balance sheet. So there's probably going to be some volatility in these sectors. But again, maybe that volatility and some more tightening and credit conditions is exactly what the U.S. economy needs here in order to get that last mile of inflation behind us.

**BASAK:**

You think about the last mile. You think about the last mile of inflation rates still staying a little higher as well. And do you still have any worries about this economy? If you see the data start to soften, we all know that the market can be like walking on a razor’s edge sometimes. So what are you looking out for in terms of any clues that perhaps things are softening too quickly, even if you're seeing decent data today?

**WILDING:**

I think the consumer sector is clearly the one that you have to watch. And even there, actually, I would say under the surface, things are bifurcated. I hate to use the term two-speed economy, but I definitely think it's relevant. When we look under the surface at households and consumers, although average consumption has been quite robust, consumers on the middle to lower end of the income spectrum haven't been doing as well. If you look at credit card data, you have seen delinquencies start to rise. Subprime, obviously, is seeing more of that, but nevertheless, on the higher income spectrum side, that's where you still had a lot of excess savings sloshing around and pretty strong consumption trends as well. So the thing that we'll be looking for is obviously the consumer. The unemployment rate in the labor market will be a key input into that. The other thing, obviously, is just corporate profits. As you have consumers that are spending down their excess savings, that should put some downward pressure on corporate profits. We're not seeing it in the magnificent seven, I guess. But certainly that would be another indicator that things are slowing a little more quickly here.

**BASAK:**

Tiffany, when you saw Jerome Powell really take to Congress this week, he did get a number of questions on the balance sheet reduction. How do you argue that this is still not an economy or a market that's on life support when the Fed's balance sheet is still as bloated as it is?

**WILDING:**

Yeah, exactly. Ultimately, our view is that the Federal Reserve can continue to shrink its balance sheet. The one thing I would just note here is although it has been reducing the size of its asset holdings over the past year or more, it has not actually tightened liquidity conditions as you would expect. We still have very similar amounts of bank reserves in the system, and that's because most of the decline is coming out of the RRP, the Fed's reverse repo facility. So the Fed, what it's done so far on QT, hasn't really quantitatively tightened anything, if you will. And as a result of that, we think there's probably more room to run. I think it's reasonable for the Fed to reduce the pace at which it's letting assets roll off, just in terms of prudence and things like that, but nevertheless, we think they can go for a while here, and get the balance sheet down further. Certainly, we think they can continue QT through the end of 2024, if not into 2025 here.

**BASAK:**

In some ways, Tiffany, it's looser for longer. That is PIMCO economist Tiffany Wilding. Thank you so much for your time on such a busy week and another busy week ahead.