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**JONATHAN FERRO, BLOOMBERG:**

I'm pleased to say that we're blessed with the presence of the former Fed Vice Chair, Richard Clarida. Rich, it's good to see you.

**RICHARD CLARIDA, PIMCO:**

And I'm blessed to be here.

**FERRO:**

Thank you very much. I've been singing your praises for the last week because I was thinking back to the secular outlook from PIMCO in the middle of last year. Where you and the team wrote down this Fed will accept “two-point-something”. Can you describe what you were looking for back then, what you saw and whether it's starting to come your way?

**CLARIDA:**

Well, Jon, I think it has played out. Look, I think Chair Powell and the committee deserves enormous credit. Inflation got up to 5.5% or 6% maybe 10% on headline. It's now running in the twos. Our view then was “two-point-something” would be the point at which the Powell Fed would start to pivot towards easing. I think they think they're done. I think they're signaling that they're going to be cutting starting this year. I think it's important to remember the goal is to get to 2%, but they're going to start cutting before they get to 2 based upon their view that financial conditions are tight. So we'll see how it plays out. But I think so far that's played out like we thought.

**FERRO:**

A phrase you've used is, “opportunistic disinflation”. Can you help me explain the difference between what you see and maybe what others see when they start to say things like, and I was talking about it on this program, “a higher tolerance for inflation”. What's the difference?

**CLARIDA:**

I don't think there's tolerance. “Opportunistic inflation”, actually is something that folks thought the Greenspan Fed did 30 plus years ago. That is, you tighten policy, you get inflation close to where you want it. But for that last mile, you just wait till the next recession to get it done. And that could well be what we end up in this cycle. That is the rate cuts will start before you get to the long run goal of 2%. And at some point there'll be a downturn. Inflation can fall further than. The tricky thing is, of course, the Fed wants to avoid the downturn in the first place, which means that at minimum, Chair Powell will have some communication challenges ahead, I think.

**LISA ABRAMOWICZ, BLOOMBERG:**

Well, there's a lot to impact there. Just let's start on the first issue, which is something that Andrew Hollenhorst was talking about earlier this week that essentially, you cannot get down to 2% without a recession. Do you agree?

**CLARIDA:**

Well, I think historically that's what you would say. But look, the progress has been remarkable. You mentioned Governor Waller. I'm a big fan of Chris’s. I've worked with him. Chris has been making the point, “You can get back to 2%, without a lot of unemployment, if vacancies are cut”. So I don't want to say that you can't get there, but it could be a heavy lift, yeah.

**ABRAMOWICZ:**

Well, the other part of what you said is really important. The Fed doesn't seem to want that weakness. And they even said that they would cut rates in response to a weakening labor market.

**CLARIDA:**

I noticed that, yeah.

**ABRAMOWICZ:**

What does this mean for the longer term inflation rate? Does it mean that “two-point-something” is the floor? And kind of could we see sort of bouts of volatility in inflation in the upcoming years?

**CLARIDA:**

I think that is a risk case. I think the progress on disinflation is remarkable. But inflation is still above where they want it to be. And there's some evidence that it may be more sticky and stubborn than folks were thinking. Again, I'll let the data speak for itself. I hope the Powell Fed really is data dependent. I think they need to be open to the possibility that inflation is sticky. And I think that changes their communication and the rate path.

**FERRO:**

Can you help us understand the inconsistency that we struggled with last week? And again, on the program this morning, we caught up with Bruce Kasman, of JP Morgan, who’s brilliant. And acknowledge the difficulty in explaining the following: When the Fed is asked if we're sufficiently restrictive, Chairman Powell will often speak and point to the labor market, then simultaneously embrace and confirm that a lot of the improvement came from the supply side. Now, I'm trying to understand whether you can really point to the labor market as a sign you're sufficiently restrictive and also acknowledge that a lot of the improvements come from the supply side. Can you do those two things at once?

**CLARIDA:**

You can. I think, look, there has been improvement in the labor market. Wage inflation has stepped down from five and a half down to around 4%. But that's still a little bit hot compared to where they want to get. But the Chair is right. There's been important supply side benefits, in particular labor supply productivity has also picked up. I actually think, Jon, if I could, I think maybe a little bit more of a disconnect is on the financial conditions predicate itself. If you just look nearly at the federal funds rate, it's well above inflation. That looks very tight historically. But of course, very few people, including banks, borrow at the federal funds rate. If you look at mortgage rates and you look at other things, they've come down and credit spreads are tight. Bloomberg- financial conditions indexes, including Bloomberg’s, are easing. And so he got that question last week about financial conditions. And he says, “We think they're tight”. Well, they could be, but they're certainly easier than they were in November, so.

**FERRO:**

What do you think he's pointing to when he says, “We think they're tight”? What is he pointing to?

**CLARIDA:**

Well, absolute borrowing cost. If you want to get a car loan, if you want, if you want to get a mortgage rate, so traditional indicators of the cost of borrowing are elevated, but obviously other indicators are moving in the other direction. So as usual with the data, it's probably a mixed picture.

**ABRAMOWICZ:**

Do you think that it's clear that it is truly a sufficiently restrictive rate currently at the Federal Reserve?

**CLARIDA:**

That would be my base case, but there is a risk that it's not. And I think importantly, the focus on the baseline, of course, is re-insuring. We want to know what's going to happen, but I think there is a risk management case here where it may not be restrictive enough. I think the Fed's view, if we- I don't think people care what I think, I think the Fed's view is if inflation is stickier and more stubborn than they want, they'll just keep rates at the current level longer or they'll reduce the pace of rate cuts. I don't really think the Powell Fed is thinking about hiking anymore right now. I think they think they're done.

**ABRAMOWICZ:**

You said, “if the Fed really is data dependent”, and I don't think you're necessarily casting doubt on whether they look at the data, but what data matters most, if what we're looking at right now, is inflation data that is coming in hotter and frankly goods disinflation, it seems to have ended?

**CLARIDA:**

Certainly, the January and February data, if the PCE comes in, that would be the risk. There is some evidence, I think, that the Chair is the correct seasonality. That's always been tricky in recent years. Most of the bad news and inflation has been in the first four or five months. So I don't think we want to remove that possibility. I just think that a sticky inflation scenario is maybe not a baseline, but it's a very realistic case. And I think investors and people looking at the economy need to start thinking about it.

**FERRO:**

How do you perceive the balance of risks, holding too long or cutting too soon? What is the bigger risk for you?

**CLARIDA:**

Well, I'm no longer there, so it probably doesn't matter. I think given that the last three years, inflation has substantially overshot that target, look, I was the charter member of “Team Transitory”. It's looking better now than it did a year ago. But I think there is path dependence and history dependence in monetary policy. And so I think the risk management I would be doing if I were there would say, “There is a real- we want to avoid; I don't think it's, we want to avoid having inflation shoot up again and having the credibility challenged”.. So I would be leaning more in a hawkish balance of risk mode than just hugging the baseline right now.

**ABRAMOWICZ:**

To put sort of a bow on that point, if you think about how much more investors have to consider the idea of sticky inflation and Fed officials themselves, can you give us a sense of how much that possibility has increased in your view in the past month or two based on the loosening of financial conditions? And frankly, the Fed's response to it.

**CLARIDA:**

It has increased, certainly. Look, we got really, we got five out of six months of really, really good, surprisingly good inflation data. And for good reasons, both supply and demand. In some ways, I think there's actually now compared to where we were maybe in January, a better alignment between markets in the Fed in the sense that after the December meeting, the markets are priced in six or seven cuts, which was a disconnect with what I thought the Powell Fed would deliver. So on that end, I don't think there's too much of a disconnect. Now, I think markets understand they think they're done. The margin that they're going to play with is when to cut and how much to cut, but not to hike. So I don't think there's that much of a disconnect right now.

**FERRO:**

One final question: Can we do the show again in Newport Beach, California? Can we do that in June?

**CLARIDA:**

Well, you know, it's above my pay grade, but I'll treat you to a burger like I did. Actually, you treated me or no one treated each other.

**FERRO:**

No, I think we treated each other.

**CLARIDA:**

We treated each other, OK.

**FERRO:**

I think Manny and Mike exchanged cards or something like that. Rich is good to see you. Thank you, sir. Thank you very much.

**CLARIDA:**

Thank you.

**FERRO:**

The former Fed vice chair, Richard Clarida.