Economic
INSIGHT

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# Call for Patience Likely to Delay Inevitable Further Federal Reserve Action

*"There is nothing that is saying we need to do anything imminent anytime soon…We can just sit there and wait for the data."*

Federal Reserve Governor Christopher Waller Speaking to CNBC

September 5, 2023

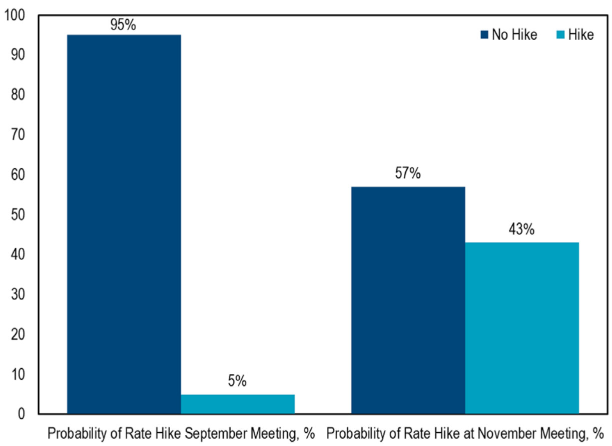
Federal Reserve (Fed) Chairman Jerome Powell did not parse words late last month at the annual Jackson Hole Symposium in Wyoming, when he sent an extremely hawkish message to the market that there was more policy work to be done, and soon. But while Powell reiterated the relatively disappointing improvement in inflation and cautioned against reading too much into a few good data points, other Fed officials are not as convinced further policy action is necessary, at least not yet.

Given the *relative* improvements in the data, some Fed officials are speaking out in the name of patience, dismissing the need for a 12th round rate hike later this month. Investors are also on board for a pause, as market expectations for a September hike are virtually nonexistent. Of course, while the recent cooling in the labor market and broad-based trend of disinflation have been encouraging, market forecasts have been wrong before, and the painful consequences of not sufficiently raising the interest rate target high enough to maintain a downward inflationary trajectory is certainly on the minds of policy makers

**WALLER, AMOUNT OTHERS, URGES PATIENCE**

According to Federal Reserve Governor Christopher Waller, policy makers can "*proceed carefully*" with interest rate increases given recent data showing inflation continuing to ease and labor market conditions cooling.

Speaking on CNBC last week, Waller insisted there is nothing in the data indicating a need for immediate action. "*There is nothing that is saying we need to do anything imminent anytime soon,*" he said, suggesting policy makers could hold rates steady at the upcoming September meeting. "*We can just sit there and wait for the data.*"




Source: CME FedWatch Tool
As of 9/8/2023

Speaking to business leaders in Boston on Wednesday, Boston Fed President Susan Collins also indicated a need for a patient policy approach and a "*holistic data assessment.*" "*While we may be near, or even at, the peak for policy rates, further tightening could be warranted, depending on the incoming data,*" Collins said.

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Additionally, speaking with the foreign press on Tuesday, Cleveland Fed President Loretta Mester, who remains in favor of at least some additional policy action, also conceded the Fed could take its time and fully assess incoming data. "*I can well imagine, from what I see so far,*" she explained, "*that we might have to go a bit higher, that we might have to raise the policy rate a bit more.*" She added, "*But there is still a lot of time before our next decision in September and we will get a lot of data and information by then.*"

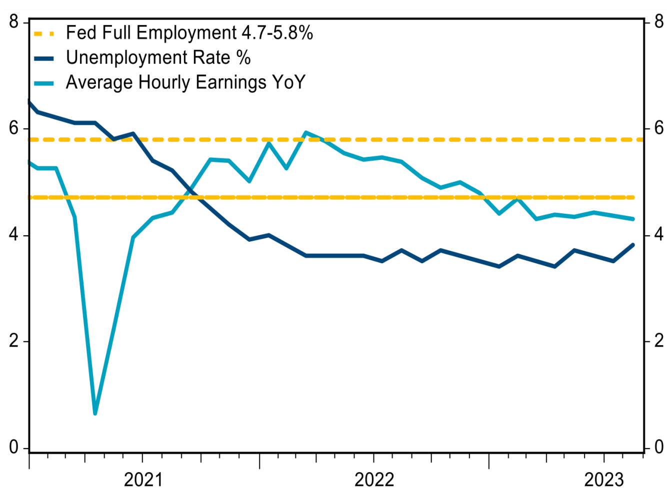
Later, New York Fed President John Williams, Chicago Fed President Austan Goolsbee, and Dallas Fed President Lorie Logan were also among those suggesting the need for a patient approach as policy may be rapidly approaching the terminal level. Although, Logan specifically warned that a temporary pause in September would likely be just that, temporary. Speaking to the Dallas Business Club, Logan was clear "*skipping does not imply stopping.*"

Investors as well have embraced the notion of a second-round pause sooner than later. The market is currently pricing in a September rate hike at just 5% and remain on the fence for a November rate hike at less than 50%. Of course, investors have been prematurely calling an end to Fed tightening throughout the year, instead betting on rate cuts which have not materialized.

## DATA IMPROVEMENT, DATA SHORTCOMINGS

While data is modestly moving in the right direction, contrary to Fed commentary, it is hardly making the case that patience is the best course of action. It is true that the pace of hiring has slowed and the number of job openings is considerably reduced from peak levels, but this suggests that the labor market is only cooling somewhat and not slowing sharply (or as sharply as needed to have a more significant impact on prices). Additionally, an unexpected rise in the August unemployment rate from 3.5% to 3.8% reflects a welcome surge of new participants in the market that, if sustained, should help to alleviate wage pressures, but those benefits would not be immediate.

For now, wages remain stubbornly above 4% as they have since July 2021, with the Employment Cost Index (ECI) rising an additional 1.0% in the second quarter. That far exceeds the desired level of labor costs from the Fed's perspective. Furthermore, the broader pace of disinflation in the economy has slowed more recently with core Personal Consumption Expenditures (PCE) index price pressures reversing course in July from 4.1% to 4.2%, along with the headline Consumer Price Index (CPI) and Producer Price Index (PPI) pushing higher from 3.0% to 3.2% and 0.2% to 0.8%, respectively.




Source: Bureau of Labor Statistics/Haver Analytic

Additionally, as Saudi Arabia and Russia extend voluntary oil production cuts through year end, which have sent crude oil prices as high as $90 a barrel earlier this week,

**GLOSSARY**

**CPI** – Consumer Price Index

**ECI** – Employment Cost Index

**PCE** – Personal Comsumption Expenditures

**PPI** – Producer Price Index

**SA** – Seasonally Adjusted

**YoY** – Year over Year



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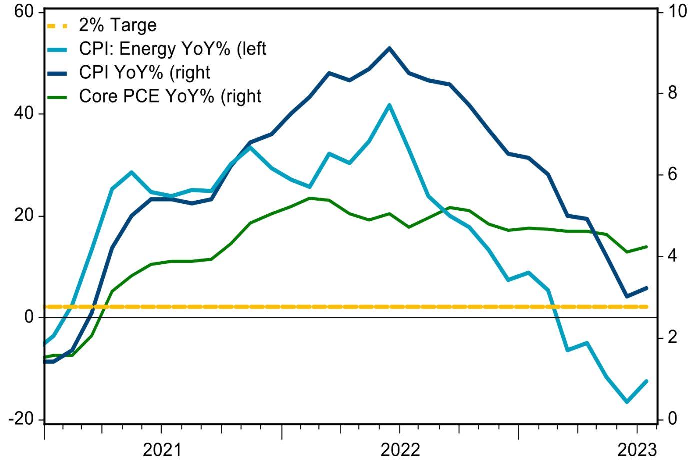
coupled with ongoing uncertainty surrounding the Black Sea grain deal between Russian and Ukraine, energy and commodity price pressures remain a significant upside risk to broader inflationary pressures.

## SEPTEMBER POLICY OUTLOOK

Despite a far-from-definitive indication of ongoing or sustained improvement in inflationary pressures, the latest cooler-than-expected employment report and further improvement in some inflation metrics *does* give the Fed enough cover to pause later this month. However, with the pace of disinflation disrupted as of late and price pressures still elevated nominally, the Committee would arguably be well advised to move forward preemptively with further policy firming actions sooner than later.

In fact, not only is an additional rate hike(s) likely necessary to reach a sufficiently restrictive level to tame price pressures, but it is also needed for the Fed to maintain credibility with investors that it will continue to adjust policy until its goal of reinstating stable prices has been achieved. As Powell said, "*We will keep at it until the job is done.*"




Sources: BEA, BLS/Haver

The Fed was unfashionably late to the inflation-taming party as it held on to the "*transitory*" notion of price pressures well beyond what was appropriate. The Committee does not want to commit another policy error by stopping short of achieving its policy goals or by losing resolve so close to the finish line.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