

Economic Outlook:

A New Federal Reserve Strategy to Tame Inflation: *Skip and Reengage*

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STIFEL

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Fed Chair Jerome Powell

“Nearly all FOMC [Federal Open Market Committee] participants expect that it will be appropriate to raise interest rates somewhat further by the end of the year. But at last week's meeting, considering how far and how fast we have moved, we judged it prudent to hold the target range steady to allow the Committee to assess additional information and its implications for monetary policy.”

- Federal Reserve (Fed) Chairman Jerome Powell Semi-Annual Policy Testimony to Congress, June 21, 2023

Some Fed Officials Voiced Support for Pause, Further Future Action



Fed Governor Philip Jefferson, Voting

*“A decision to hold our policy rate constant at a coming meeting **should not be interpreted to mean that we have reached the peak rate for this cycle.** Indeed, skipping a rate hike at a coming meeting would allow the Committee to see more data before making decisions about the extent of additional policy firming.”*

- Fed Governor Philip Jefferson, Conference on Policy Challenges for the Financial Sector, May 31, 2023



Philadelphia Fed President Patrick Harker, Voting

*“I am in the camp increasingly coming into this meeting thinking that we really **should skip, not pause, but skip an increase.**”*

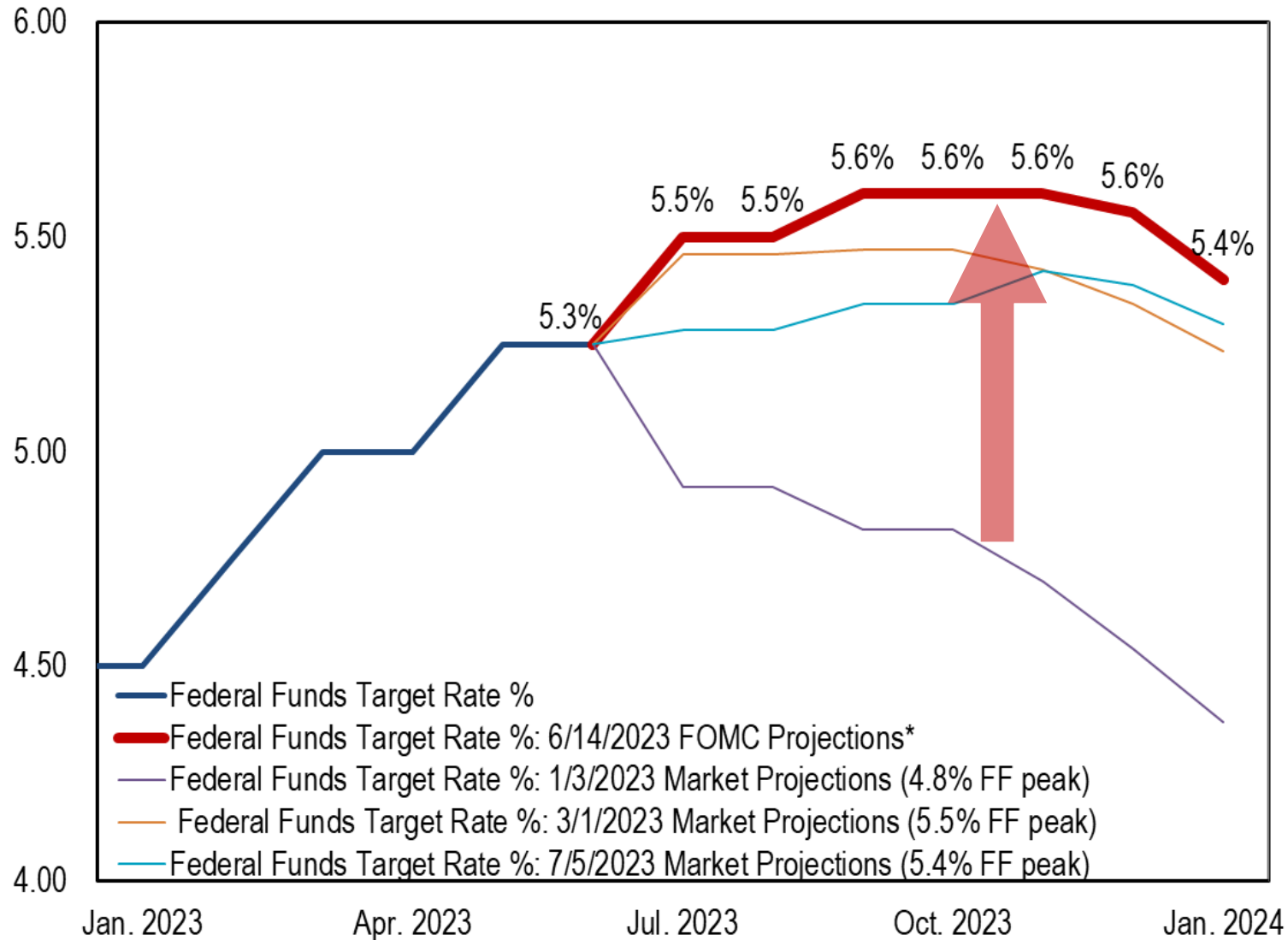
- Philadelphia Fed President Patrick Harker, Official Monetary and Financial Institutions Forum Economic and Monetary Policy Institute Event, May 31, 2023

June FOMC Statement Language Adjusted to Suggest Further Rate Hikes

*“In determining the **extent of additional policy firming that may be appropriate** to return inflation to 2 percent over time, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments.”*

- June 14 FOMC Statement

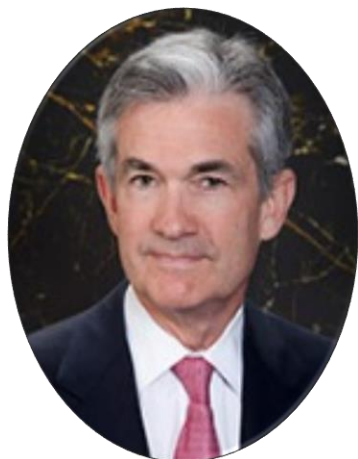
Market Expectations Rising for Fed Funds Rate



Source: Federal Reserve Board/Bloomberg

*Projections assumed from the figures in June 14 FOMC SEP

Powell Signals More Tightening is on the Way, Pace Uncertain



Fed Chair Jerome Powell

*“Although policy is restrictive it may not be restrictive enough and it has not been restrictive for long enough...**I wouldn’t take moving at consecutive meetings off the table.**”*

-Federal Reserve Chairman Jerome Powell
European Central Bank’s Annual Policy Summit, June 28, 2023

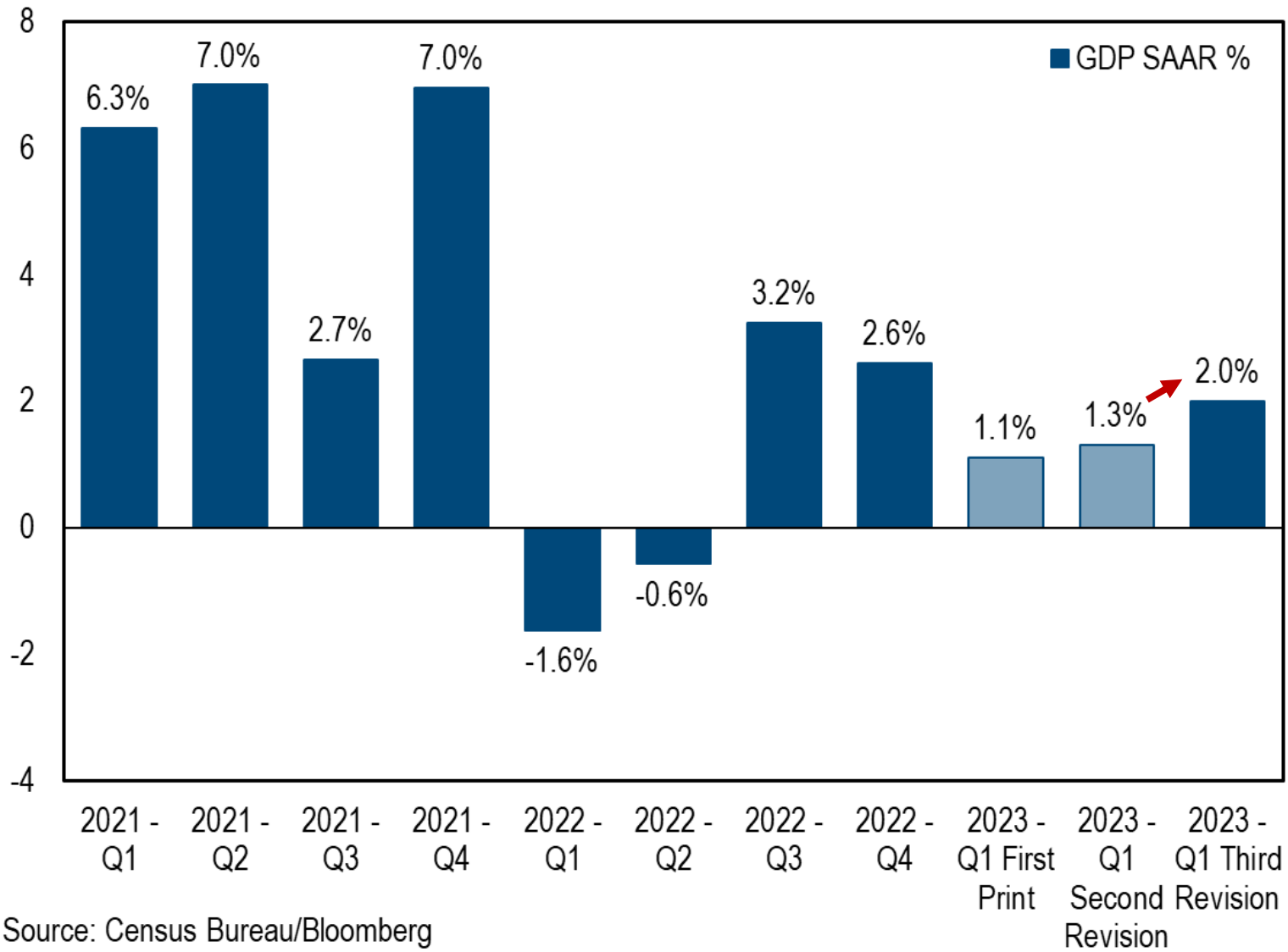
*“Given how far we’ve come, it **may make sense to move rates higher but to do so at a more moderate pace.**”*

-Federal Reserve Chairman Jerome Powell
Semi-Annual Policy Testimony to Congress, June 21, 2023

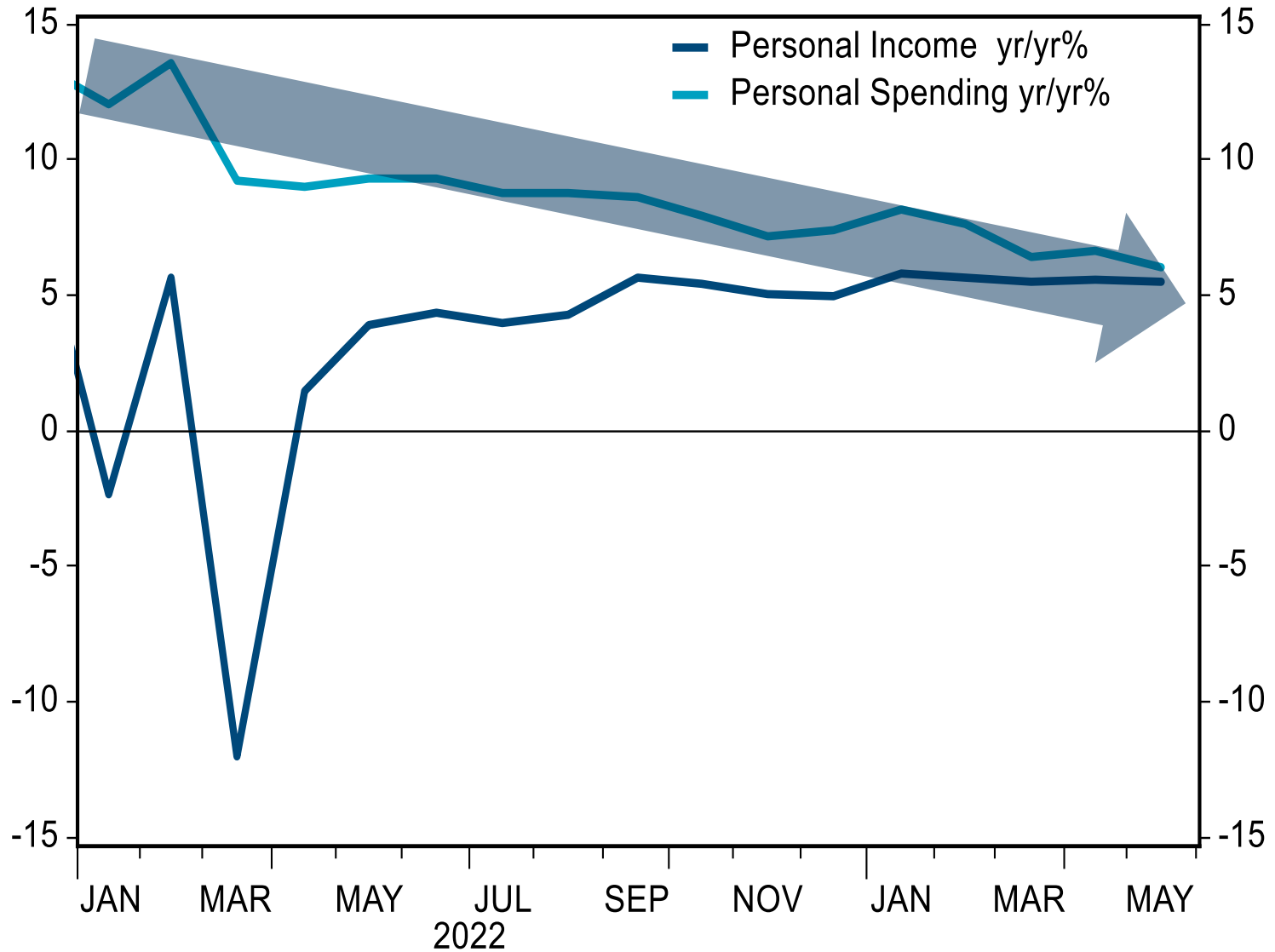
*“Economic activity has continued to expand at a **modest pace. Job gains have been robust** in recent months, and the unemployment rate has remained low. **Inflation remains elevated.**”*

- June 14 FOMC Statement

GDP Revised Higher at the Start of the Year

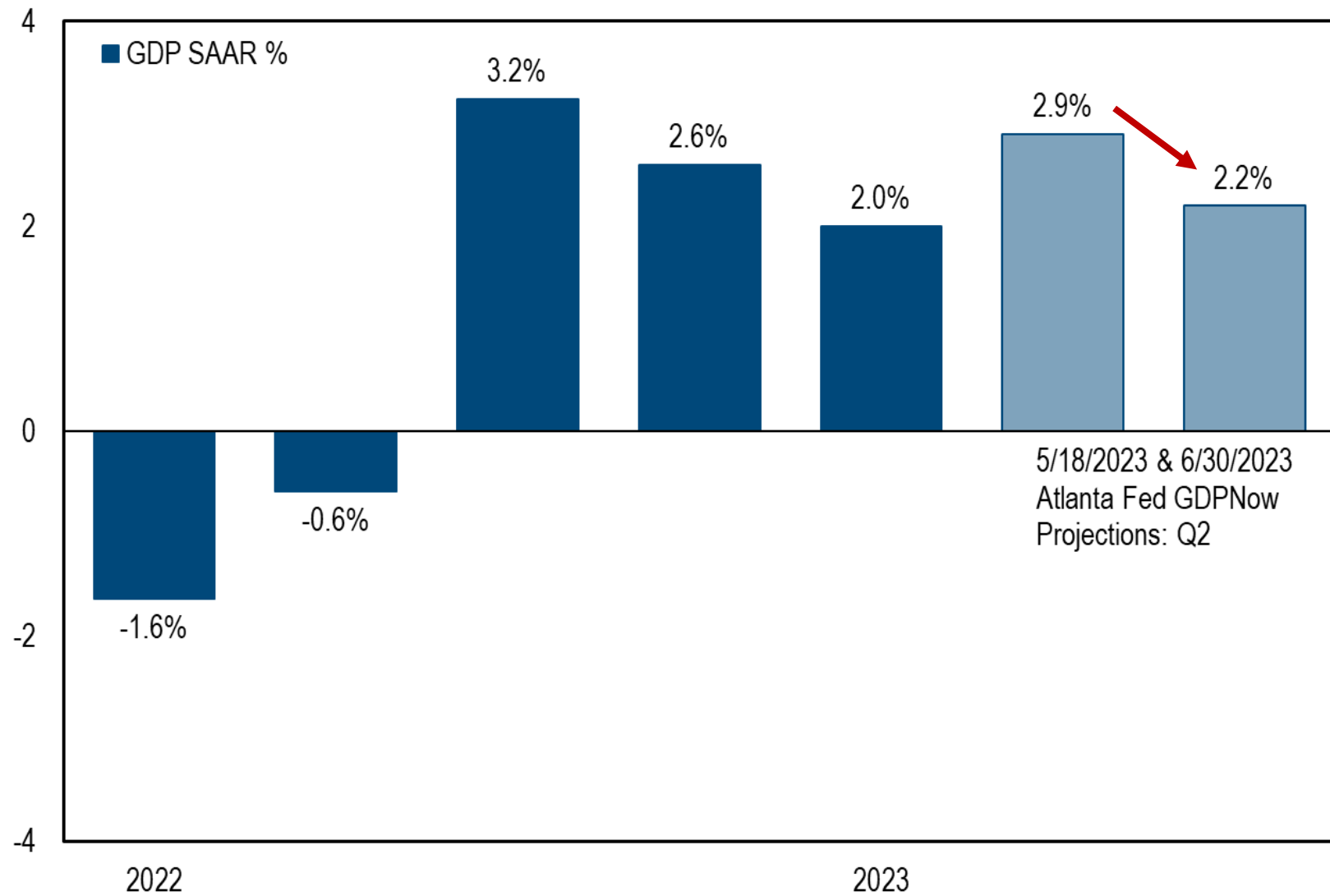


Consumption Cools in April/May



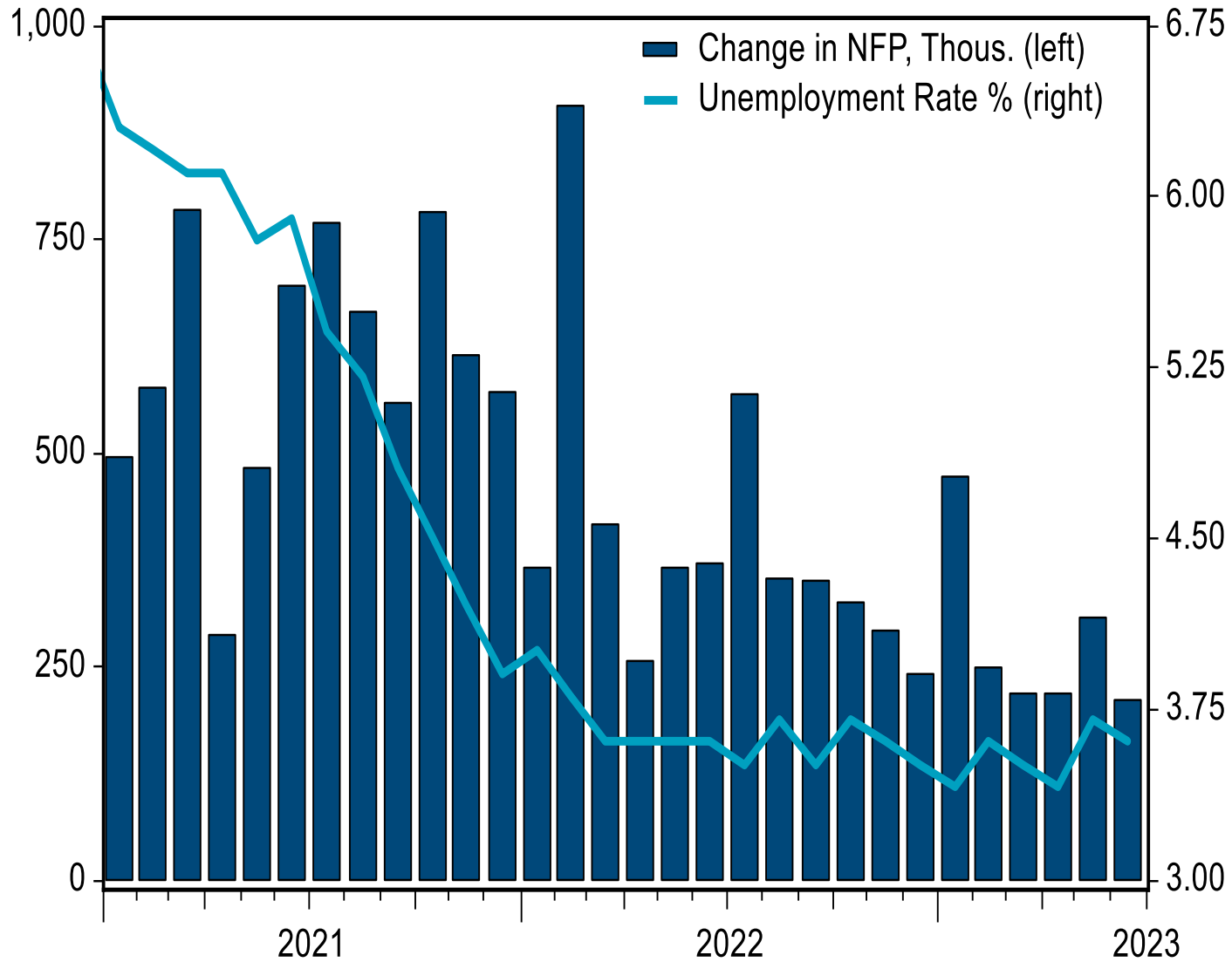
Source: Bureau of Economic Analysis/Haver Analytics

A Weaker Consumer Lowers Q2 GDP Projections



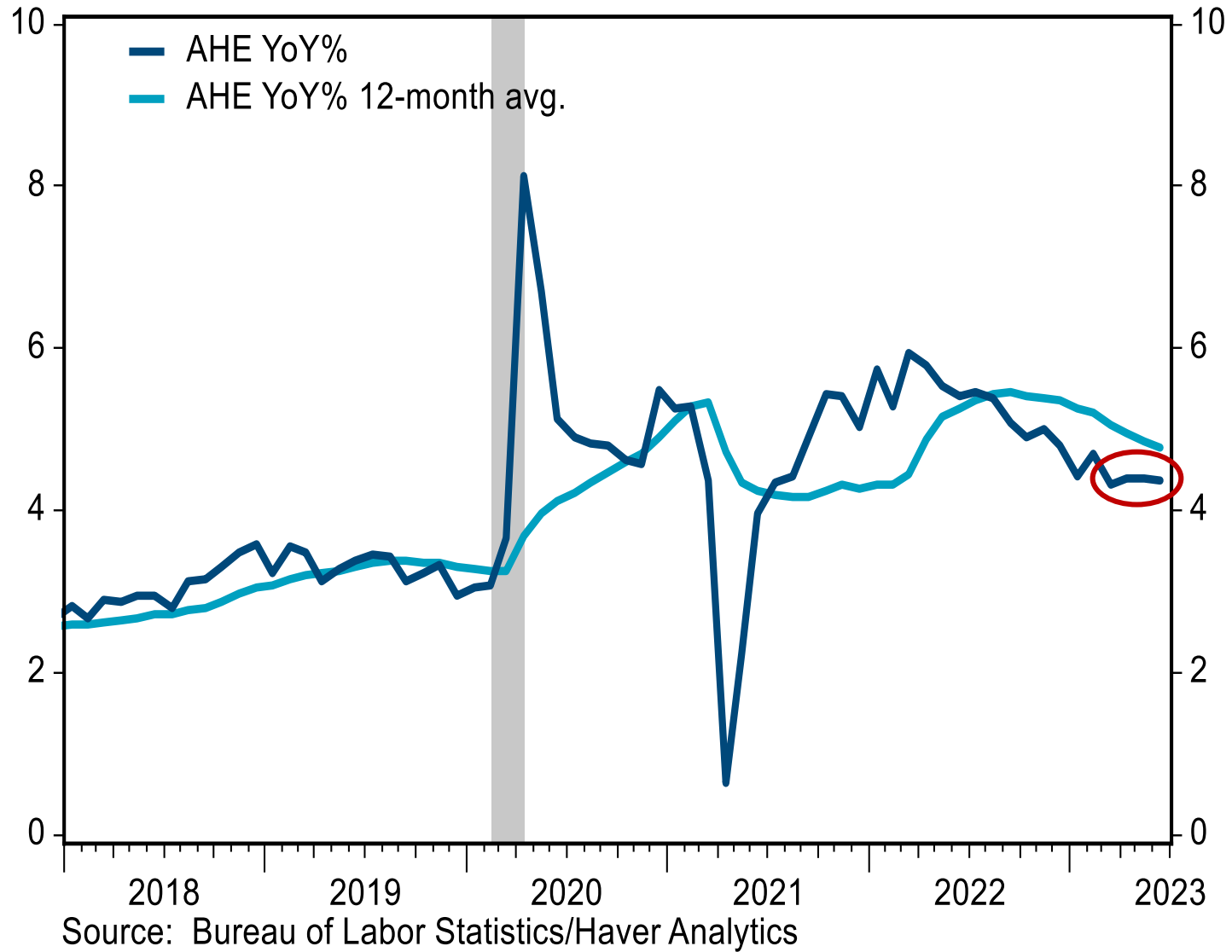
Source: Census Bureau/Atlanta Fed/Bloomberg

Strong Job Growth, Low Unemployment Signals Tight Labor Market

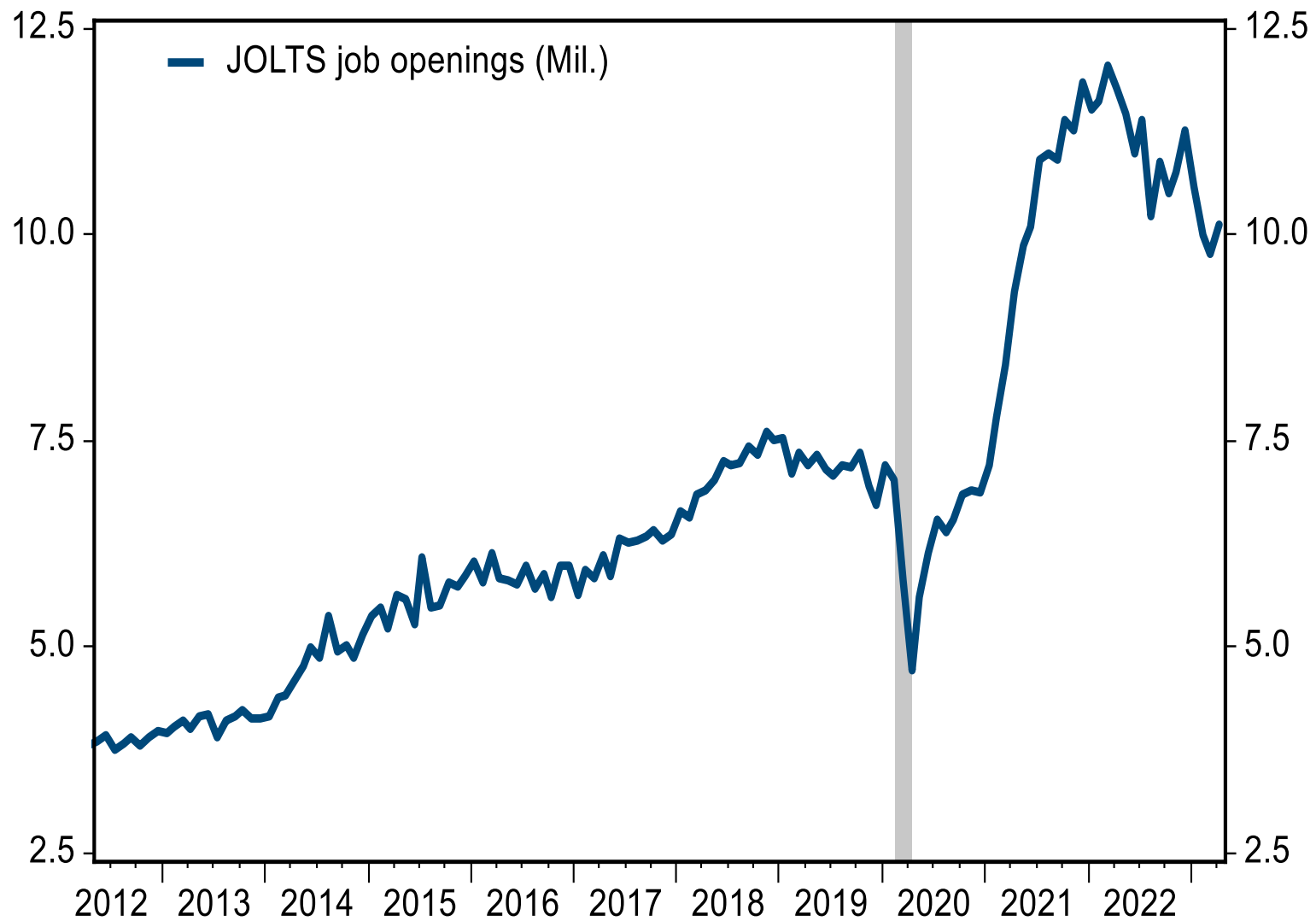


Source: Bureau of Labor Statistics/Haver Analytics

Wage Pressures Remain Elevated

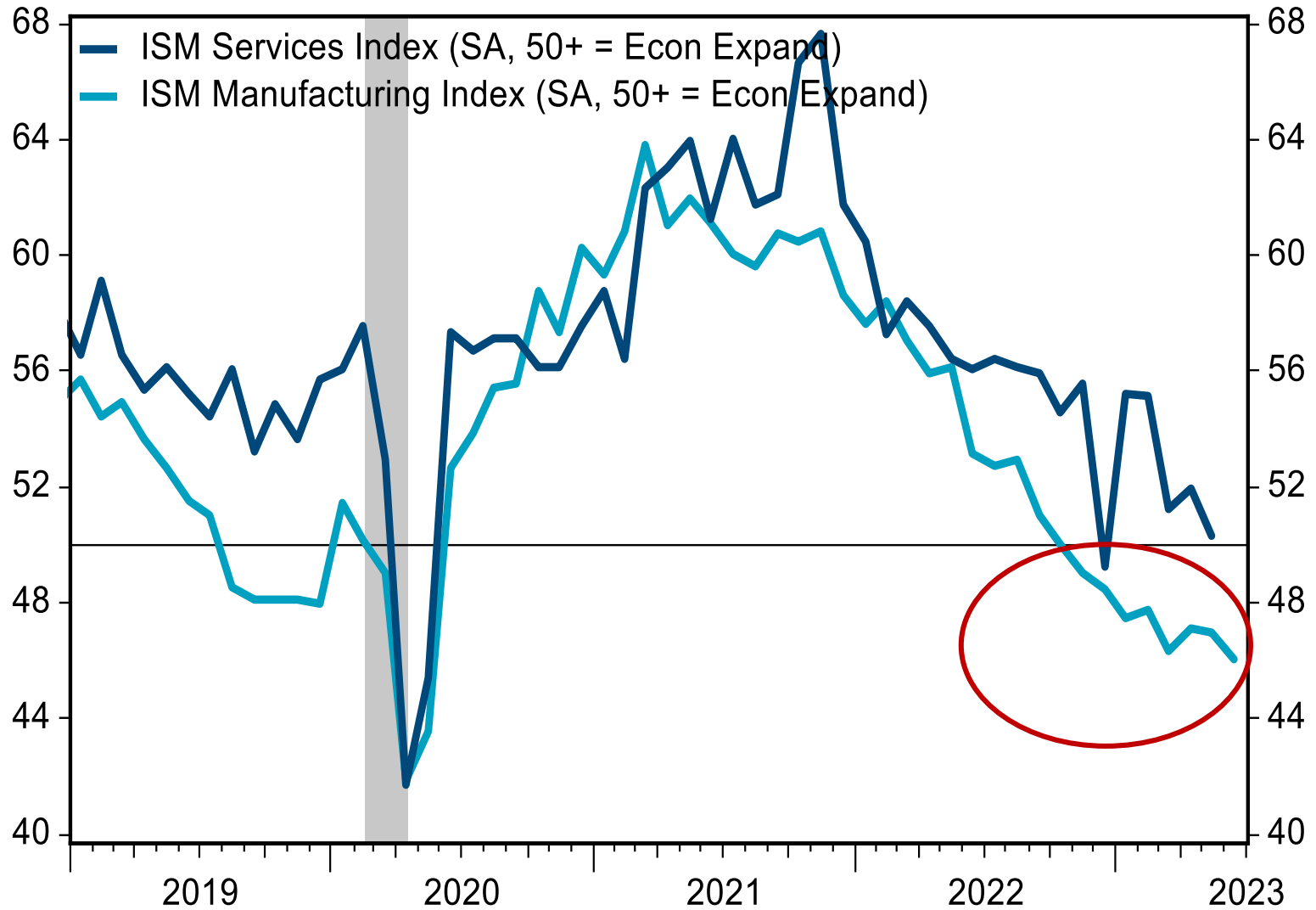


Job Vacancies Remain Elevated, Signal Tight Labor Market



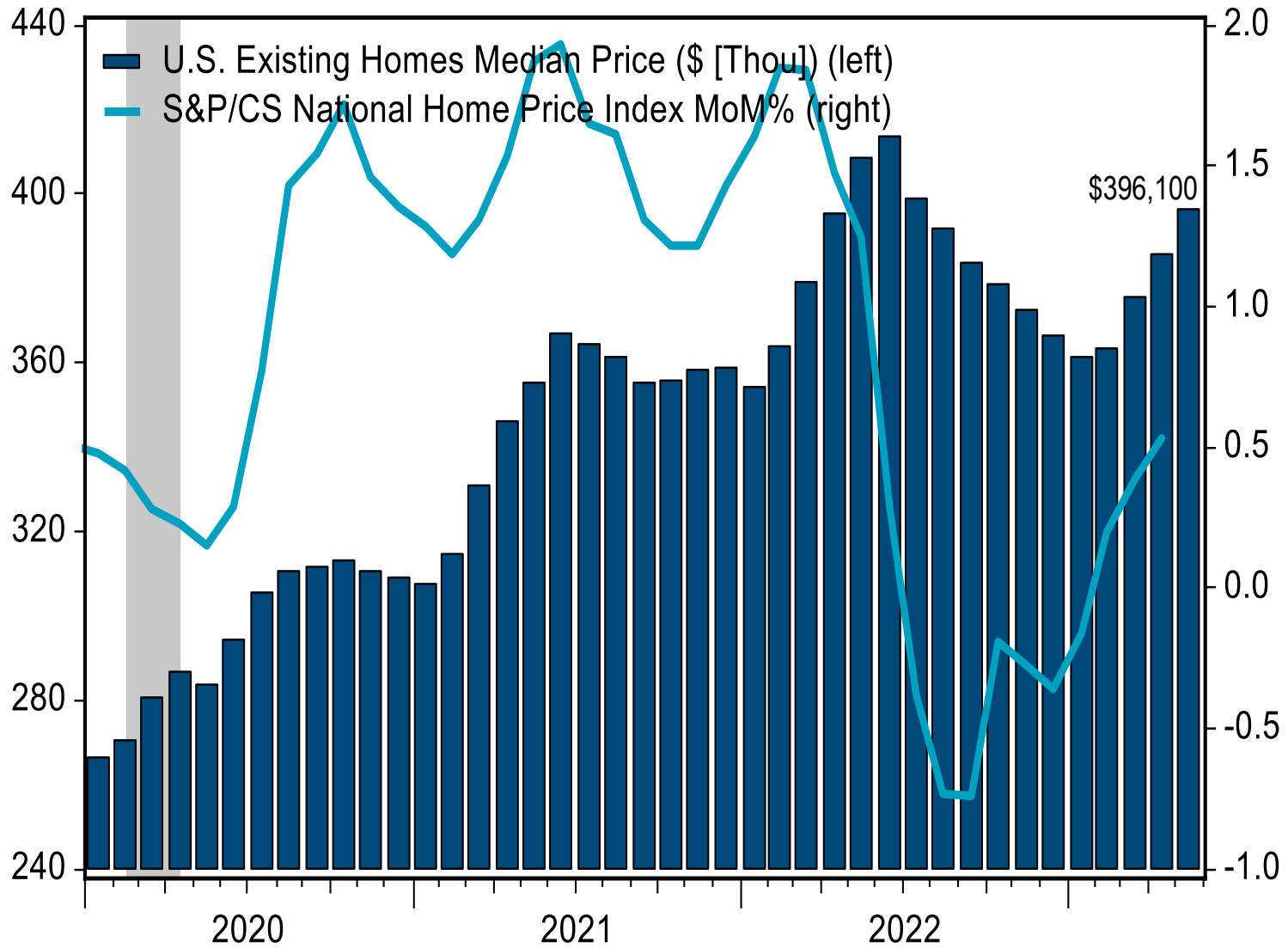
Source: Bureau of Labor Statistics/Haver Analytics

Manufacturing Activity Remains in Contractionary Territory, Service Sector Positive but Slowing



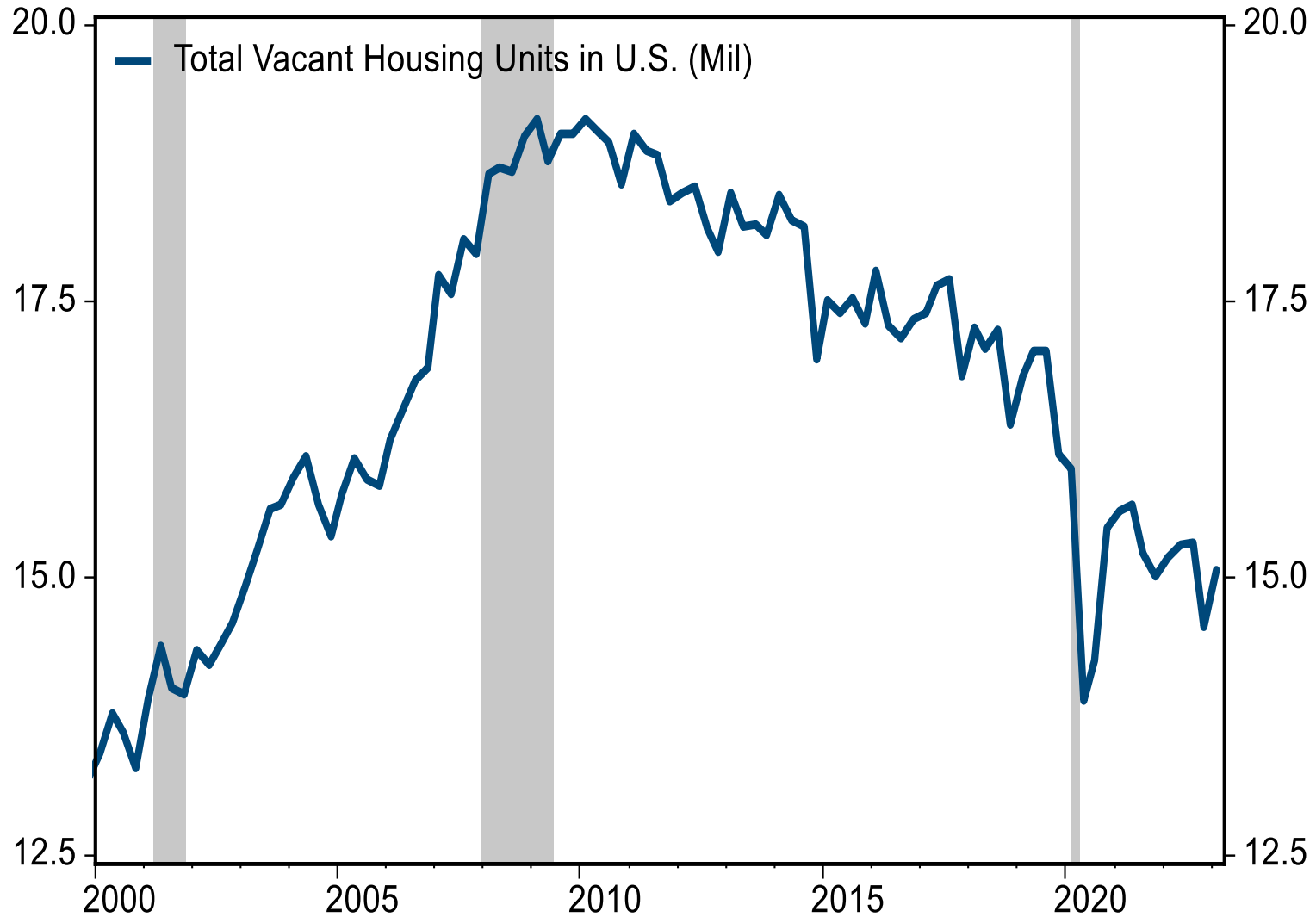
Source: Institute for Supply Management/Haver Analytics

Prices Push Back into Positive Territory



Sources: NAR, S&P/Haver

Housing Inventory Low Relative to Demand/Population



Source: Census Bureau/Haver Analytics

Inflation Still Top Concern for Policy Makers, Consumers Alike

% Who Say Each of the Following is a Very Big Problem in U.S. Today	
Inflation	65
Affordability of health care	64
Ability of Dems/Reps to work together	62
Drug addiction	61
Gun violence	60
Violent crime	59
Federal budget deficit	56
State of moral values	54
Illegal immigration	47
Quality of public K-12 schools	47
Climate change	39
Racism	35
Condition of roads, bridges and other infrastructure	34
Domestic terrorism	34
International terrorism	30
Unemployment	24

Source: Pew Research Center Survey of U.S. adults conducted June 5-11, 2023

“A Few Banks” Should Not Deter the Fed from Fighting Inflation



Fed Governor
Christopher Waller

*“Let me state unequivocally: The Fed’s job is to use monetary policy to achieve its dual mandate, and right now that means raising rates to fight inflation...**I do not support altering the stance of monetary policy over worries of ineffectual management at a few banks.**”*

- Fed Governor Christopher Waller, Norges Bank and the International Monetary Fund Event, June 16, 2023

Not All Fed Officials are Calling for a Blanket Increase in Requirements



Fed Governor
Michelle Bowman

*“In particular, as the United States moves forward with implementing new international capital standards, **I am concerned that new capital requirements could unnecessarily hinder bank lending and diminish competition. We need to consider whether examiners have the appropriate tools and support to identify important issues and demand prompt remediation. Increasing capital requirements simply does not get at this underlying concern about the effectiveness of supervision.**”*

-Fed Governor Michelle Bowman, Financial Seminar in Salzburg, June 25, 2023

Federal Reserve Conducts Annual Stress Test on Banks

- The 23 largest U.S. banks met the minimum capital requirements and could weather a “*severe global recession*”
- In the 2023 tests, the Fed hypothesized a scenario with a recession, a 40% decline in commercial real estate prices and a substantial increase in office vacancies, as well as a 38% decline in home prices
- Additionally, under the Fed’s worst scenario, the unemployment rate would rise to 10%
- During this hypothetical recession, the group would endure a collective loss of \$541 billion and saw their total capital levels drop from 12.4% to 10.1%

Risks to Individual Financial Institutions and Broader Banking Sector Remain

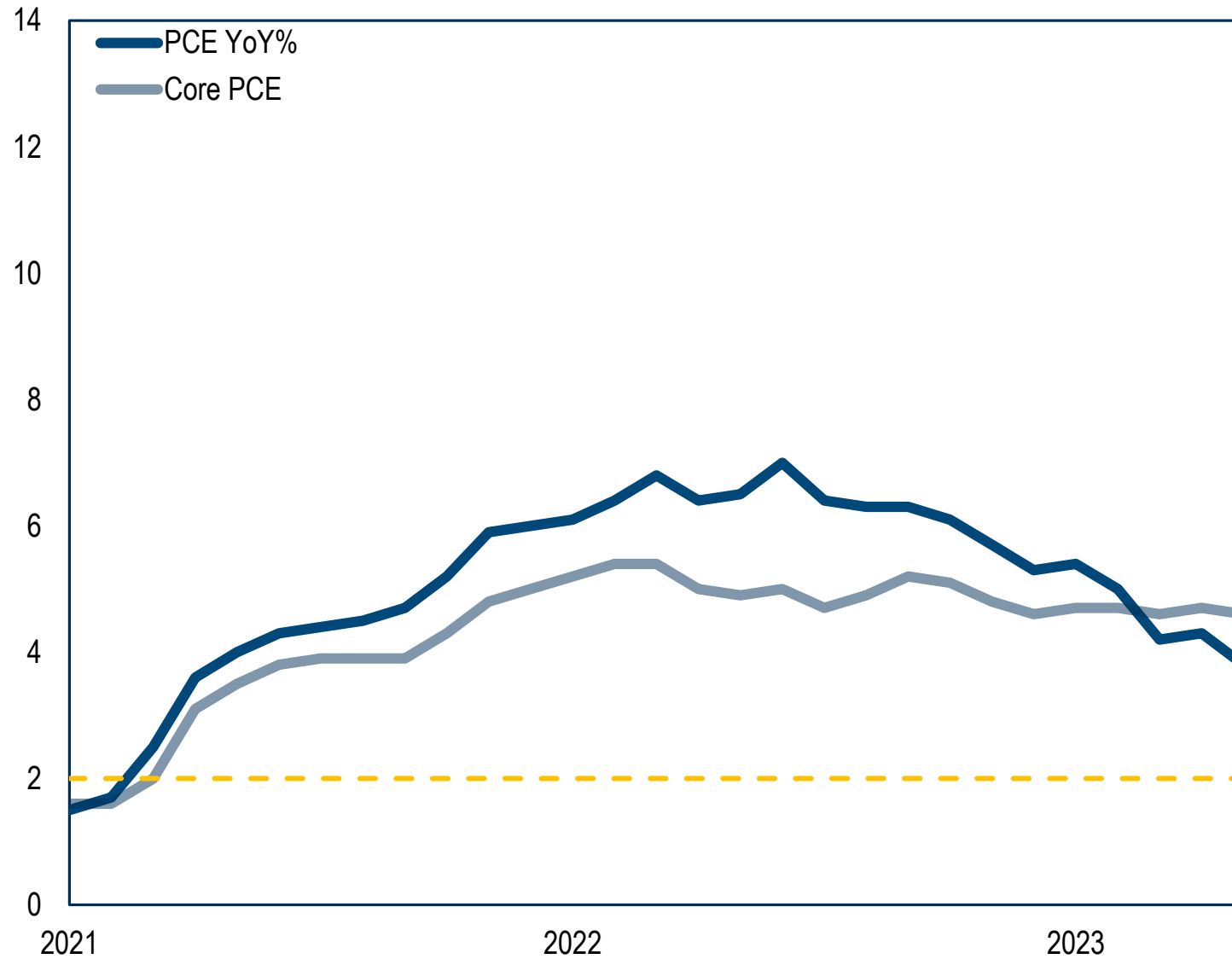


Fed Vice Chair for
Supervision Michael Barr

*“Today's results confirm that the banking system remains strong and resilient...At the same time, this stress test is only one way to measure that strength. **We should remain humble about how risks can arise and continue our work to ensure that banks are resilient to a range of economic scenarios, market shocks, and other stresses.**”*

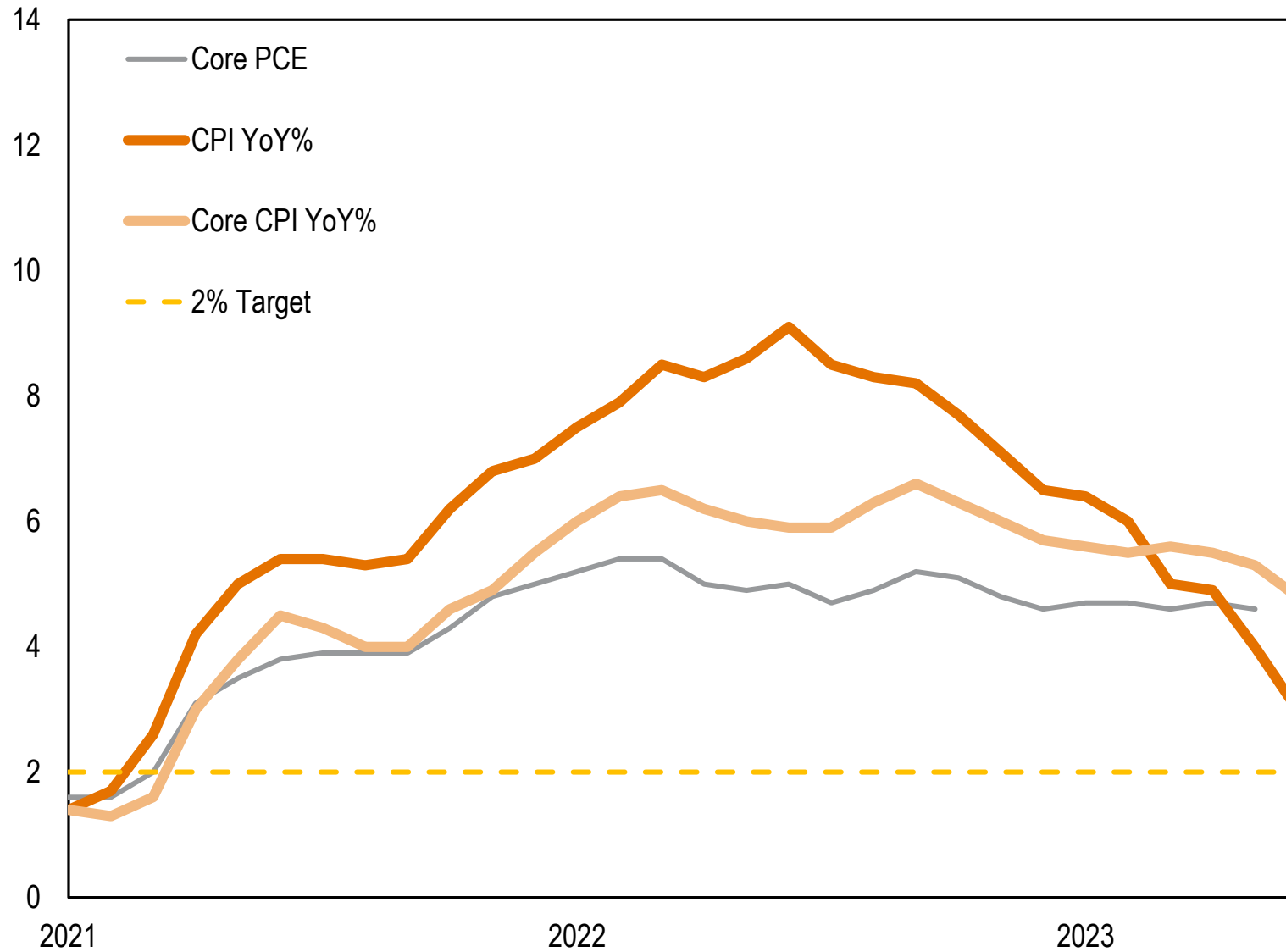
- Fed Vice Chair for Supervision Michael Barr, Statement on Stress Tests, June 28, 2023

Inflation Remains Elevated – Personal Consumption Expenditures (PCE)



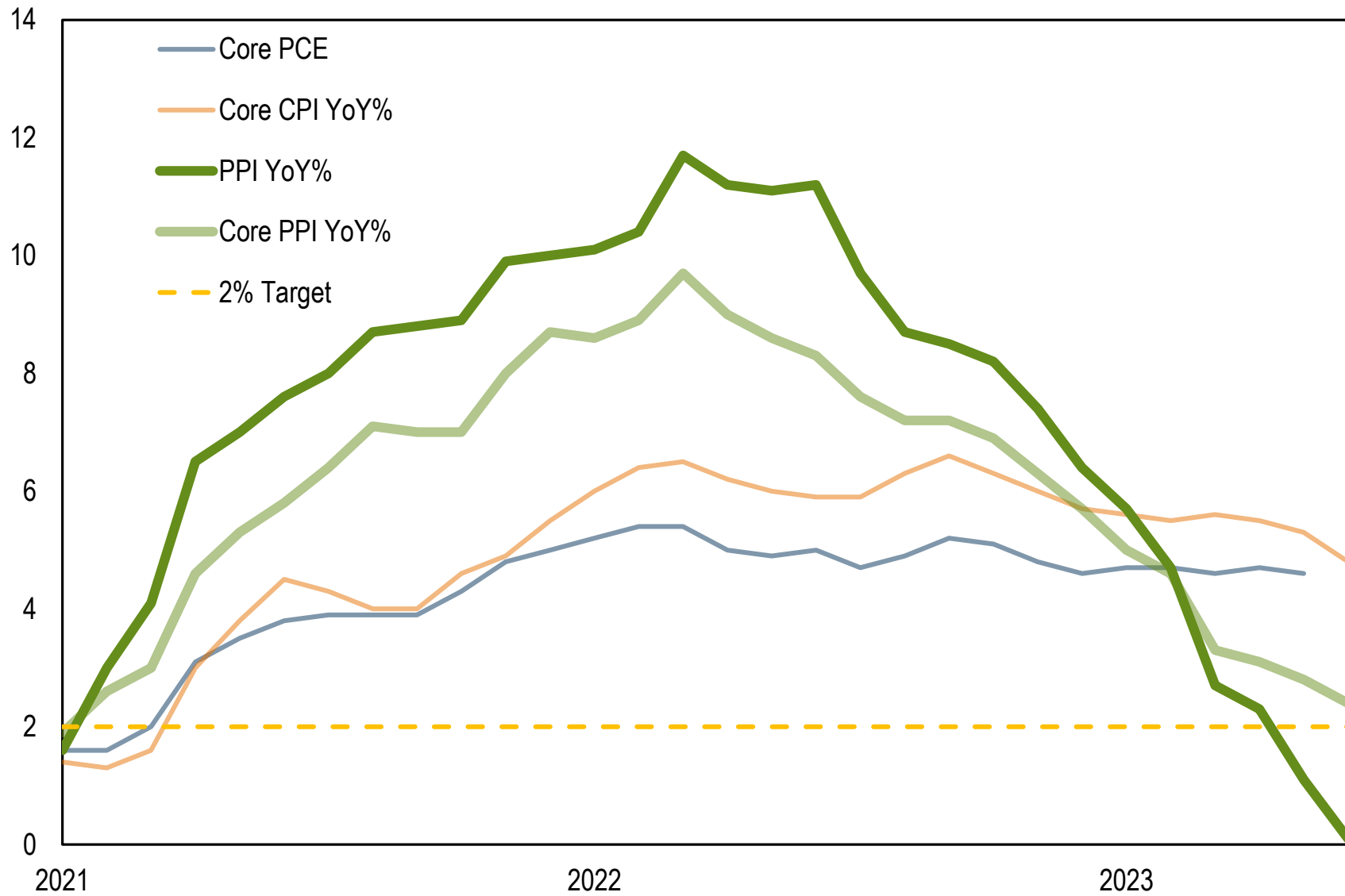
Source: Bureau of Labor Statistics/Haver Analytics

Inflation Cooling, But Remains Elevated – Consumer Price Index (CPI)



Source: Bureau of Labor Statistics/Haver Analytics

Inflation Shows Improvement – Producer Price Index



Source: Bureau of Labor Statistics/Haver Analytics

QUESTION: Why pause rate hikes in June, even if only for one month?

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ANSWER:

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- June 14 FOMC Statement

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QUESTION: Why hasn't Fed policy had a more meaningful impact on price pressures?

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ANSWER:

1. Presumed lag in policy
2. Organic nature of inflation

Transparency Actions

- Summary of Economic Projections (SEP) four times a year (began in April 2011)
- Press conference at every meeting (began in January 2019)
- Ample Fed-Speak

Types of Inflation

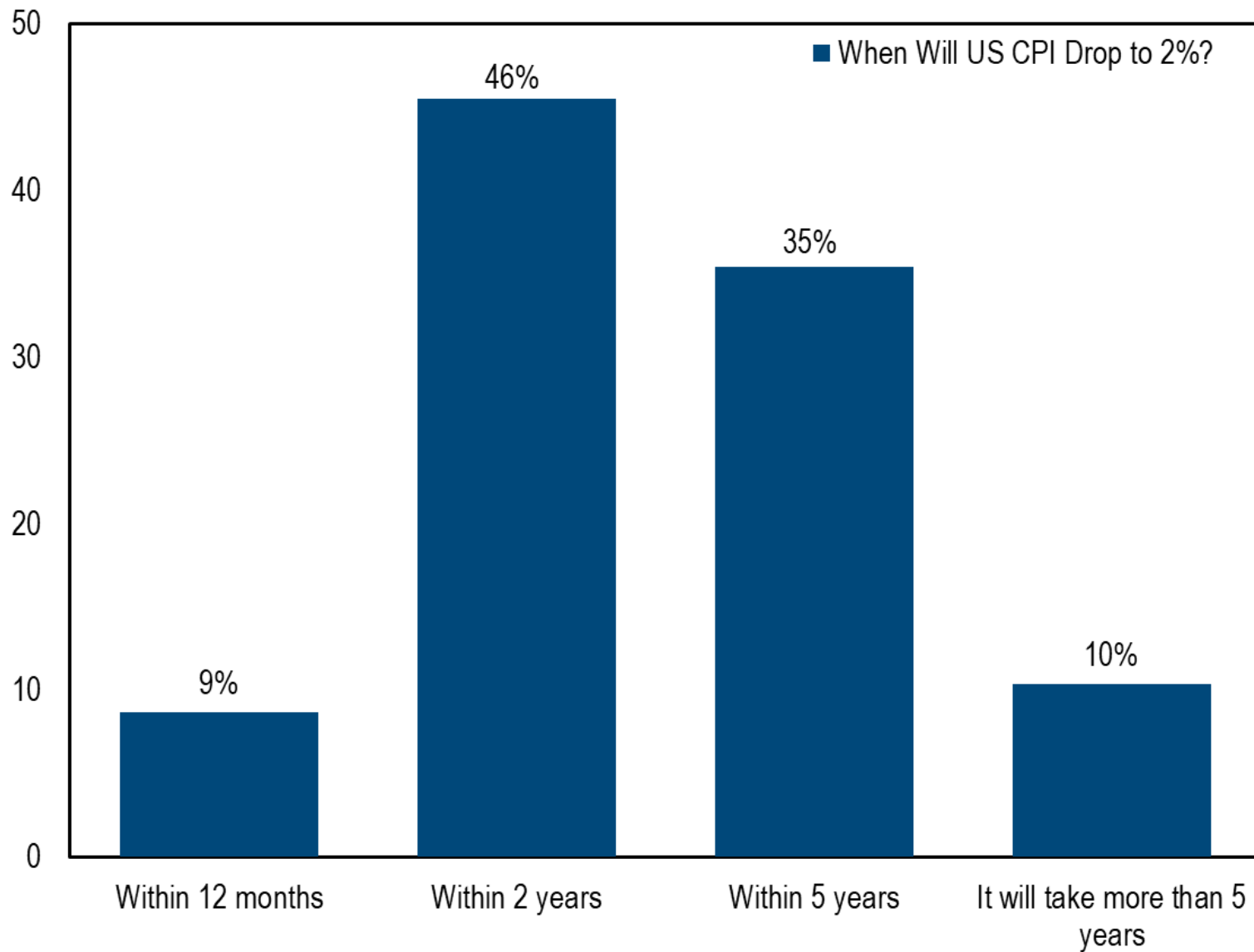
- Supply-side inflation: price increases in the energy and food sectors or shortages in certain industries (such as shortages of semiconductor chips) can cause shifts in the demand patterns in other industries (such as automobiles)
- Wage-push inflation: an overall rise in the cost of goods that results from a rise in wages
- Demand-side inflation: when demand for goods or services rises faster than the supply of those goods and services
- Greedflation: a price rise introduced by companies to take advantage of inflation and boost profit margin

Fed Pauses Rate Hikes in June, Indicates Willingness to Raise Again Soon



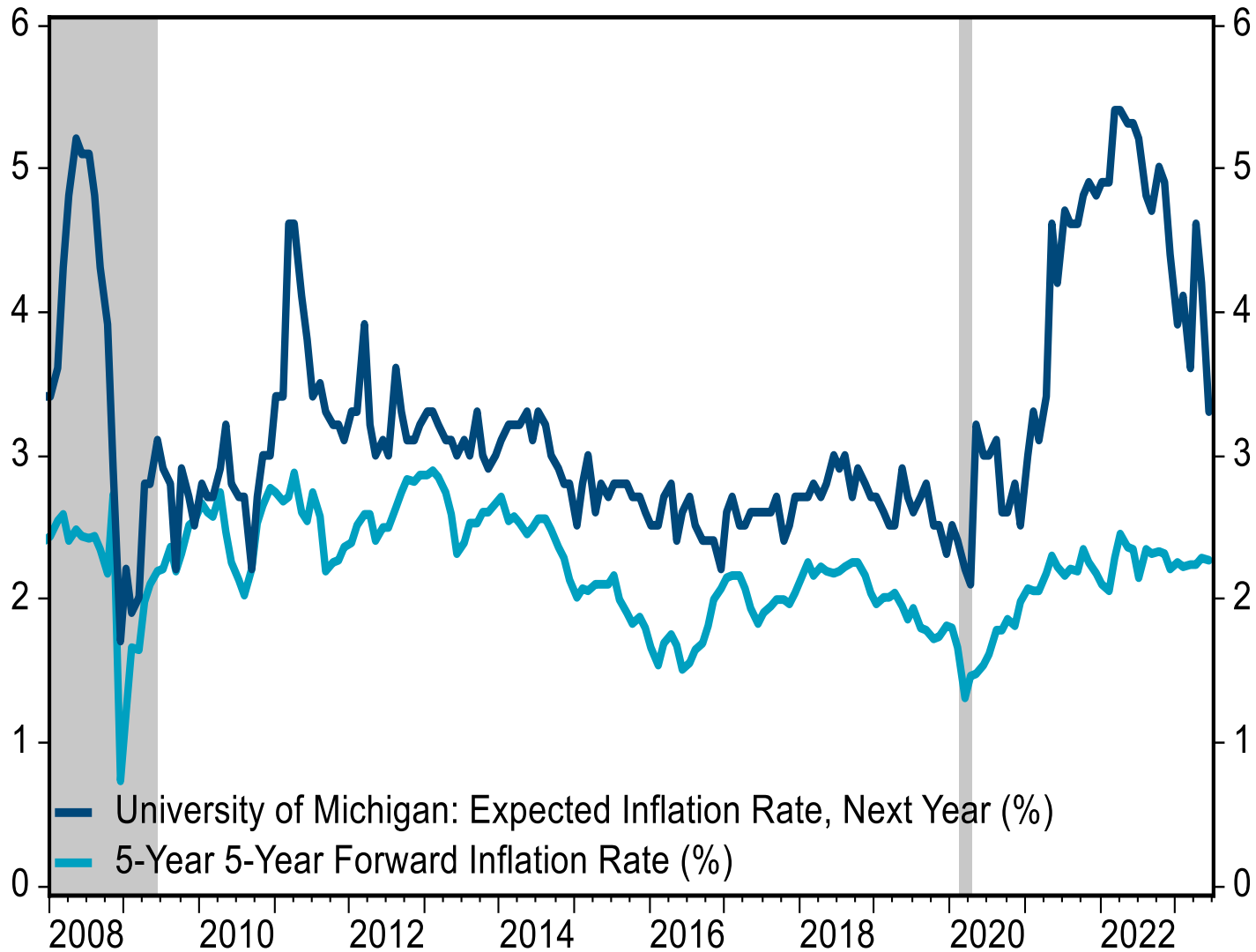
Source: Bureau of Economic Analysis/Federal Reserve Board

Price Stability Not Likely in Near Term



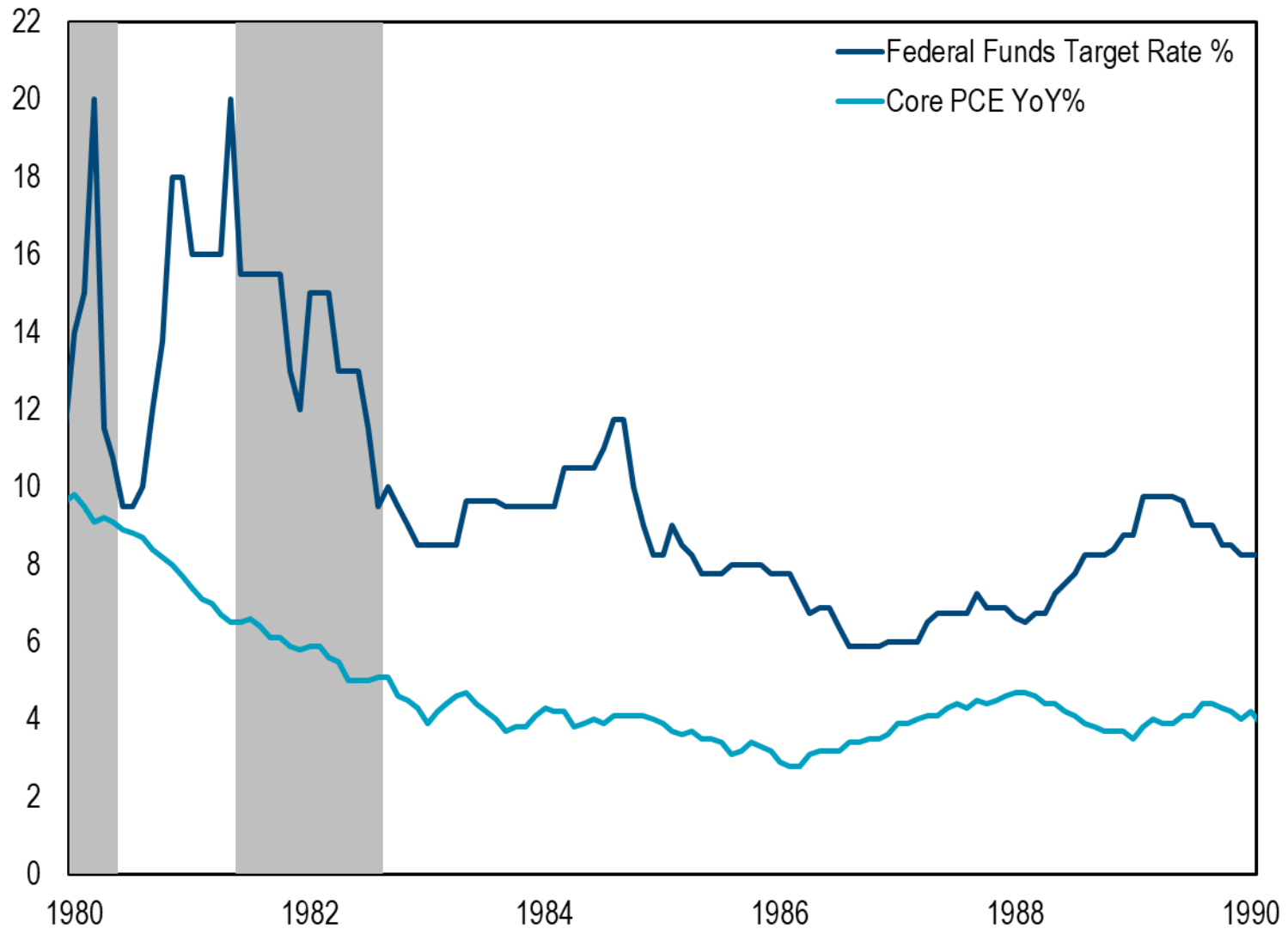
Source: Bloomberg MLIV Pulse Survey

Inflation Expectations Anchored but Rising?



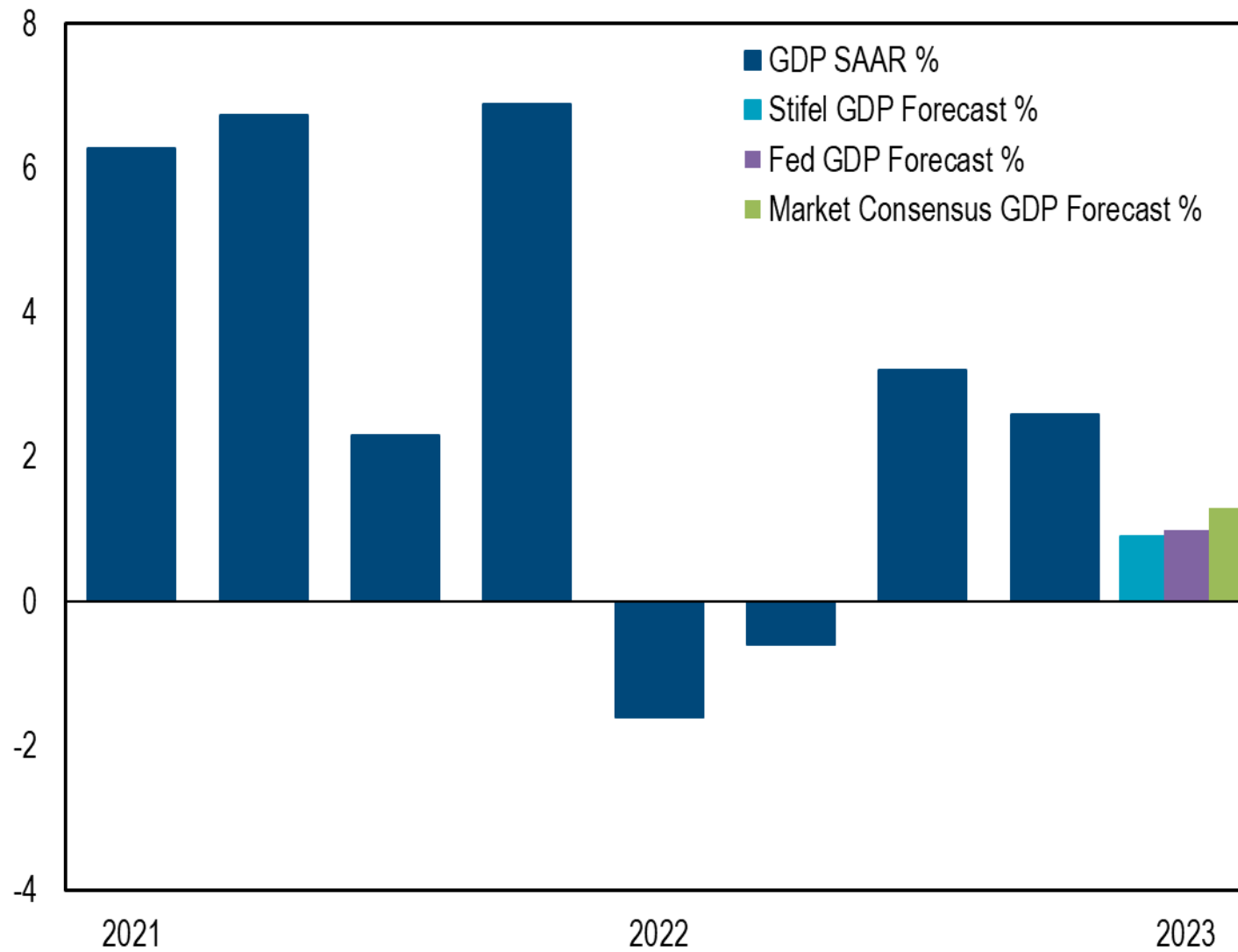
Sources: University of Michigan, Federal Reserve Board/Haver Analytics

Federal Funds Rate & Inflation in the 1980s



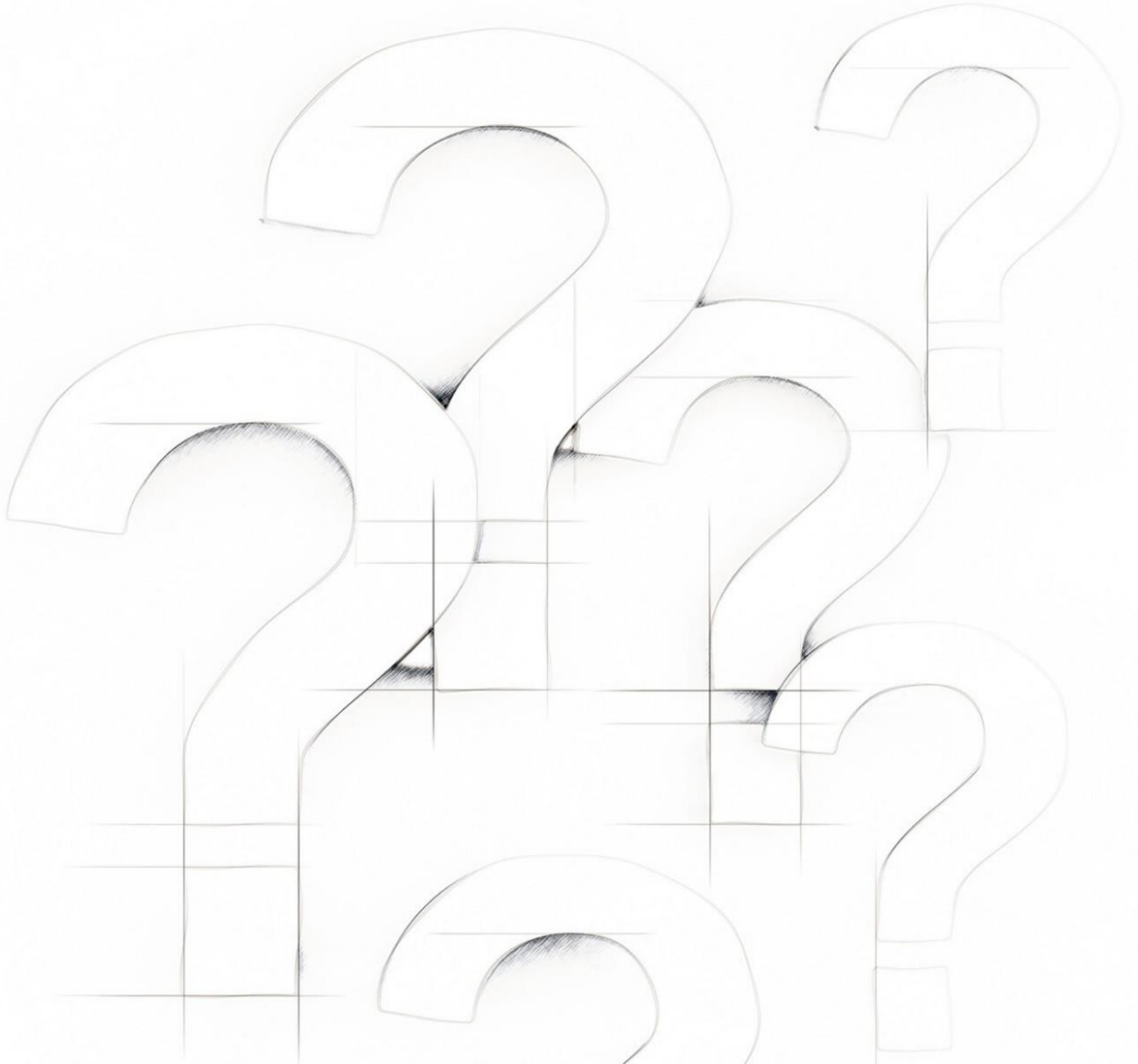
Source: BEA/Haver

GDP Expectations Include Possible Recession by Year-End



Source: Bloomberg/Stifel

Q&A



Thank you

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Market perform - For credit specific recommendations we expect the identified credit to perform approximately in line with its sector specific peers over the next six months.

Underperform - For credit specific recommendations we expect the identified credit to underperform its sector specific peers over the next six months.

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