

Federal Reserve Watch

Governor Waller: changes in policy to be “carefully calibrated and not rushed”

The economy is in an “unusual” place...

Federal Reserve Board Governor Christopher Waller delivered remarks at a Brookings Institution event in a speech titled, “Almost as Good as It Gets...But Will It Last?”

We read the key message from Waller’s remarks in the pace of any rate cut cycle over the timing of when the rate cut cycle may begin. In line with the title of his speech, his remarks were very favorable on the economy and the outlook for price stability. He noted that growth in activity was moderating, the labor market was coming into better balance, and PCE inflation was running close to 2% over the past six months. He said several times during his speech and the Q/A session that his confidence in bringing inflation to 2% while avoiding a recession has increased, even since his last speech in December. In fact, he said the data has come in “even better” since he last spoke.

Based on the evolution of the data, Waller said he thinks “the FOMC will be able to lower the target range for the federal funds rate this year.” That’s not exactly a surprise and is not a ringing endorsement for our expectation of a rate cut cycle that starts in March. However, he also said “I am becoming more confident that we are within striking distance of achieving a sustainable level of 2 percent PCE inflation. I think we are close...” This language suggests he favors starting sooner than later. We think the data will support a cut in March, but obviously the remaining data points on employment and inflation will be important in the committee’s assessment.

...which gives us a lot of “flexibility”

Where Waller was firmer was in views about the pace of rate cuts. He noted that historical episodes of fed cuts were recessionary in nature. Recessions are situations that require going fast on rate cuts. He said the current environment is “unusual” with the economy experiencing moderate rates of growth and disinflation, which, in his view, gives the Fed more “flexibility” to be methodical, assess the evolving economy, and reduce the policy rate early and gradually. Rather than easing policy to thwart a recession, he said the upcoming easing cycle is both about preserving a restrictive stance and guarding against overtightening.

While he did not specifically endorse quarterly rate cuts, we read his comments as being in line with the median participant in the Summary of Economic Projections once the easing cycle begins. This is consistent with our baseline outlook for 25bp rate cuts on a quarterly basis, for 100bp of cuts this year and 100bp in 2025.

On the balance sheet, Governor Waller’s views are more hawkish than Dallas Fed President Lorie Logan. Waller thinks more reserve drainage can be achieved before scarcity is reached (he targets a level of reserves at about 10-11% of GDP as an endpoint for QT). His views go against our expectation that tapering will start as early as March. That said, his views are in line with our own on Treasuries versus MBS: Tapering treasury caps is acceptable, but MBS redemption caps should remain unchanged.

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