USA: Governor Waller Says FOMC Will Need to Consider Raising Rates If Core Inflation Is Hot This Week

Jan Hatzius
+1(212)902-0394 | jan.hatzius@gs.com
Goldman Sachs & Co. LLC

David Mericle
+1(212)357-2619 | david.mericle@gs.com
Goldman Sachs & Co. LLC

Alec Phillips
+1(202)637-3746 | alec.phillips@gs.com
Goldman Sachs & Co. LLC

Ronnie Walker
+1(917)343-4543 | ronnie.walker@gs.com
Goldman Sachs & Co. LLC

Manuel Abecasis
+1(212)902-8357 | manuel.abecasis@gs.com
Goldman Sachs & Co. LLC

Elsie Peng
+1(212)357-3137 | elsie.peng@gs.com
Goldman Sachs & Co. LLC

Pierfrancesco Mei
+1(212)902-8809 | pierfrancesco.mei@gs.com
Goldman Sachs & Co. LLC

Jessica Rindels
+1(972)368-1516 | jessica.rindels@gs.com
Goldman Sachs & Co. LLC

BOTTOM LINE: In a speech at the New York Association for Business Economics, Fed Governor Christopher Waller emphasized the importance of upcoming inflation readings for the near-term policy outlook. Waller said that "the FOMC will need to consider tightening monetary policy in the near-term" if "we get another hot reading on core inflation this week." At the same time, Waller said that he would "need to see several months of lower readings to feel that inflation is moving in the right direction…[and] hold the policy rate at its current target range," but that he thinks that is "still a reasonable outcome." Waller's comments today and the minutes to the FOMC's June meeting released last Wednesday suggest that the Committee has become increasingly open to the possibility of rate hikes to combat inflation.

MAIN POINTS:

1. In a speech at the New York Association for Business Economics, Fed Governor Christopher Waller emphasized the importance of upcoming inflation readings for the near-term policy outlook. Waller said that "the FOMC will need to consider tightening monetary policy in the near-term" if "we get another hot reading on core inflation this week." He said that he would "need to see several months of lower readings to feel that inflation is moving in the right direction…[and] hold the policy rate at its current target range," but that he thinks that is "still a reasonable outcome."

2. We expect the next few inflation prints—starting with tomorrow's CPI reading—to look meaningfully better than the last five months. We expect core CPI inflation to average just 0.18% in the next three months as airfares decline on the back of lower jet fuel prices, hotel rates—which are measured at the time of booking—drop from their World Cup highs, and rent inflation continues to slow. Core PCE inflation is likely to remain slightly more stubborn (we forecast 0.23% on average over the next three months), in part because of ongoing upward pressure on imputed financial services prices from the equity market rally and price increases in software/accessories whose weight in core PCE is 30 times larger than in core CPI.

3. Waller noted that "data in recent months support the idea that the labor market is stable and balanced." He said he "believe[s] employment is close to its maximum sustainable level" and that unless he sees evidence of a significantly weakening labor market, his "focus will be on inflation."

4. Waller said he "expect[s] solid consumer spending growth to continue, helped by energy prices that have recently fallen from their April highs." We believe that the recent resilience in spending largely reflects an outsized boost from tax cuts stemming from last year's fiscal package, and expect that spending headwinds from

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higher inflation will weigh on spending growth for the rest of the year.

5. In Q&A, Waller opined on several topics that the new task forces will tackle. On communications, Waller said that he has “been a skeptic of the dots for a long time,” and that he would make a few changes to the SEP, including switching from forecasts for calendar years to a rolling horizon (“a six-, twelve-, eighteen-month rolling thing”) and releasing the projections the day after the meeting. On inflation, Waller said that he would prefer an inflation range to a point target but that he likes “the way we do things now” with a “very clear price index that we use” and “a numerical target which we hold ourselves accountable to.” On balance sheet policy, Waller said that he doesn’t “have any problems with shrinking the balance sheet” if “you can figure out ways where banks don’t need as [many] reserves” but that “it’s not obvious that our balance sheet is causing huge financial problems or market functioning problems.”

6. Waller’s comments today and the minutes to the FOMC’s June meeting released last Wednesday suggest that the Committee has become increasingly open to the possibility of rate hikes to combat inflation.

