USA: Fed Governor Waller Says He Anticipates "Additional Hikes"

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BOTTOM LINE: Fed Governor Christopher Waller suggested that he likely expects two additional rate hikes to be appropriate. He said that "If the economic data continue to come in as expected, I anticipate additional hikes to support a timelier return of inflation to our 2 percent goal. But there is some flexibility about when those hikes will occur. The hikes do not need to come at consecutive meetings, but they should be in place in an acceptable period of time." Waller said that the lack of a resolution to the Middle East conflict, signs that the artificial intelligence buildout is raising consumer prices for technology goods, and the risk of new tariffs had undermined his faith that inflation is progressing toward the 2% target. We continue to expect one additional 25bp rate hike in December and have lowered our probability that the FOMC could pass on a December hike because Waller's speech represents a hawkish shift relative to his emphasis in previous comments on the three-month annualized rate of core PCE inflation, which is now just 2.0%.

MAIN POINTS:

1. Governor Waller's comments suggested that he likely expects two additional rate hikes to be appropriate, which would raise the funds rate to 4.25-4.50%. He said that "If the economic data continue to come in as expected, I anticipate additional hikes to support a timelier return of inflation to our 2% goal. But there is some flexibility about when those hikes will occur. The hikes do not need to come at consecutive meetings, but they should be in place in an acceptable period of time." Waller highlighted that in the September dot plot, "eight participants expect that rates will be 50 basis points higher at the end of 2027 than they are today," and added that "markets have interpreted that the Committee is likely to raise the policy rate 50 basis points in the coming months." He also gave an example in which policymakers deliver three 25bp hikes in total.

2. Waller said his view on raising the funds rate had changed in response to "a preponderance of evidence over several months that the risks for monetary policy had shifted, reflecting a strengthened labor market and a range of persistent inflationary forces." He said that core inflation is "not showing sufficient progress" and highlighted three forces that have undermined his faith that inflation is still progressing toward the 2% target: 1) the lack of a resolution to the Middle East conflict, 2) signs "that the artificial intelligence buildout was significantly driving up high-tech consumer prices," and 3) the risk of new tariffs.

3. Separately, Waller also endorsed the Fed's current approach to communicating its likely policy path, both through officials' public remarks and through the dot plot in the Summary of Economic Projections (SEP), as a "way of communicating ... that has the flavor of forward guidance but isn't forward guidance." The Fed's approach to

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communication is one of the topics under review by the task forces, and Waller's comment suggests that he would likely oppose eliminating the SEP.

4. We continue to expect one additional 25bp rate hike in December, which would raise the funds rate to 4-4.25%. Waller's message is in line with comments last week from President Williams and Vice Chair Jefferson that pointed toward skipping a hike in October. We have lowered our probability that the FOMC could pass on a December hike because Waller's speech represents a hawkish shift relative to his emphasis in previous comments on the three-month annualized rate of core PCE inflation, which is now just 2.0%. We continue to think that by March—the next meeting after December where a hike might be under consideration on an every-other-meeting schedule—the inflation data will have improved enough to convince most of the FOMC that additional hikes are unnecessary.