# Transcript

TAKE FIVE with Bill Emmons
FEDERAL RESERVE BANK of ST. LOUIS

## May 9, 2022

**Bill Emmons:** Hi. I'm Bill Emmons, and I'd like to talk about the FOMC meeting that took place May 3 and 4. At this meeting, the Fed's aggressive rate hikes began. The important takeaways from this meeting include 50 basis point increases in all of the Fed's interest rate targets, and the beginning of the Fed's portfolio reductions, sometimes called quantitative tightening, or QT. This will begin at a very modest pace of about 47.5billion dollars monthly, and that represents only 0.6% of the Fed's 8.5 trillion dollars securities portfolio. That will ramp up in the coming months. The Fed's generally optimistic economic outlook acknowledges inflationary pressures that are coming both from domestic supply demand imbalances and from oversea shocks from Ukraine and China, and I think this meeting really made clear the near-term outlook for policy.

The FOMC signaled further 50 basis point increases at several upcoming meetings. It outlined how quantitative tightening will begin slowly but then accelerate overtime, and, notably, Chairman Powell at the press conference dismissed speculation that there might be a 75 basis point increase at any upcoming meeting.

So, one of the notable developments over the last several months is the rapid increase in market expectations for where the fed funds rate will end up in 2022. So, if you go back to June of 2021, the median member of the FOMC saw no increase in the fed funds target off of its near-zero level through 2022. Then in September, there was a small increase to about 50 basis points at the upper end of the range. Then by December, a further move up to 1%. By March, up to 2%. And then, as we can see in the market reactions, just before the press conference of this meeting, market expectations were that that upper limit would be 3%. A lot of volatility on that day. That moved down to 2.5, but then early on May 5, it was all the way back up to 3.25%, so you can see a very large increase in where the market expects the funds rate to be at the end of '22.

This chart shows the likely path of the fed funds target range during 2022 according to the fed funds futures market at the Chicago Mercantile Exchange. Of course, two rate increases already have occurred, and the market now is looking for 75 basis points at the June meeting, contrary to what Chairman Powell suggested. Then, the market's looking for another 50 basis points in July, up 25 in

September, up another 50 in November, and finally up 25 basis points at the December meeting, bringing the target range to 3 to 3.25% at the end of this year.

So why is the Fed moving so fast? Well, clearly because price pressures are definitely widespread. So, this is a picture that shows a very wide range of indicators of prices all the way from asset prices, like stock prices, house prices, commodity prices, through producer prices, to consumer prices, and even labor costs. And I think you can see these are levels of these price indexes that there's been a very notable shift upward in that trajectory.

If you now look at these same series in terms of inflation (that is, the percent change from a year ago) the asset prices definitely showed through first. Stock prices, commodity prices, house prices were showing very strong inflationary pressures in 2021. And then, if you look only at those more broad measures of inflation (for example, the costs going into businesses and the cost of labor or broad consumer prices), these really are starting to show in late '21 and into early '22—well above the 2% level that the Fed's shooting for.

So, I think the implications for banks include now the consideration that inflation pressures are now pretty severe and quite widespread. It's also very clear short-term interest rates are headed up and possibly quite a bit, and consequently, the yield curve is likely to flatten. So the fed funds rate could exceed 3% by the end of this year, moving even higher in 2023, according to financial markets. Quantitative tightening will begin slowly, but will pick up pace, with uncertain effects on bond yields and on market liquidity. The economy looks strong at this point, but is projected to slow significantly this year.

So what should we expect? I think uncertainty about the Fed's upcoming monetary policy actions actually has declined, at least for now. And really, what we're all looking at is inflation and unemployment ratings, broader economic activity levels, to see whether the Fed needs to adjust that anticipated pace of tightening. And I would encourage you once again, keep listening to St. Louis Fed President Jim Bullard, who remains one of the more hawkish FOMC members and has proved to be a bellwether for future policy moves.

Thanks for listening, and we'll see you next time.

(END OF RECORDING)