WHERE ARE RATES GOING? A CONVERSATION WITH TOM BARKIN, RICHMOND FED PRESIDENT

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Last week, I had the opportunity to interview Tom Barkin, president of the Federal Reserve Bank of Richmond, for our "Behind the Markets" podcast. Barkin was a featured keynote speaker at the Global Interdependence Center's (GIC) Rocky Mountain Economic Summit in Victor, Idaho.[1]

Barkin's prepared remarks delivered at the summit emphasize how companies see pricing power and how that feeds the economy's overall inflation dynamics. Barkin said:

> Most companies in most industries have settled pricing routines that are slow to change. These routines begin with inflation expectations and are also grounded in what firms anticipate about their competitors' and customers' reactions. A variety of factors might be limiting fims' ability and willingness to raise prices.
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> In my view, with inflation muted, there isn't much case for stepping on the brakes. At the same time, I don't see the current levels of inflation or inflation expectations as a trigger for additional accommodation. The potential to use rate changes to alter firms' settled routines is small, and the potential cost of overreaching feels real. It's also hard to make a case for stepping on the gas with unemployment so low and consumer spending so healthy.

Federal Reserve (Fed) Chairman Jerome Powell's testimony has generally been interpreted by the markets as dovish, indicating a likely interest rate cut at the upcoming July Fed meeting, and many are debating whether it should be 25 or 50 basis points (bps).

Barkin emphasized the importance of properly reading the Fed's memo, which for many years had a strong forward guidance component to keeping rates low. The current memo has no forward guidance in it whatsoever.

While Barkin sees risks pointed to the downside, without any forward guidance, the Fed has not explicitly communicated where it is going or what it is planning to do just yet. There will be more inflation indicators, GDP readings and consumer confidence data points that will come in before Barkin makes a call on what rate actions are appropriate at the July meeting.

Below are some of key areas from our podcast discussion:

The Good

Barkin points to consumer spending being 70% of the economy, and consistently strong at that. Likewise, Barkin's discussions with CFOs and CEOs of businesses are all very optimistic. With unemployment at 3.7% and wages up 3.1% year-over-year, the labor market is also very strong.

The Bad

Barkin's main worry about the economy is business confidence and business investment due to international weakness and trade issues. He does not see business leaning backward but it is not leaning forward as much as he would like.

Afraid of Yield Curve Prediction?

On our program, Wharton Professor Jeremy Siegel has been adamant the Fed should cut interest rates 50 bps to reduce the yield curve inversion, even though he does not believe it is likely that the Fed would follow suit.

Barkin emphasized a few points on the yield curve inversion. He is focused on the relationship between the 2- and 10-Year yield, and that yield curve spread has not inverted yet. The 2/10-Year spread is an indicator that Barkin cites as having *some* predictive power with upcoming recessions, even though it is not perfect. Likewise, this recession indicator has been much less reliable in international economies and only worked about 50% of the time.

Barkin emphasized a number of factors, like the 10-Year bond yield and term premiums being "shockingly low," while people are paying money to tie up their cash for 10 years. Barkin sees the unique strength of the U.S. as a bastion of stability and higher growth, higher rates and confidence in the currency that brings money to flow to U.S. Treasuries, which has consequently pushed yields down.

Zero Lower Bound Questions

If the Fed does determine it needs to stimulate the economy, given that we only have 2.25% of cuts that can be made before we get to zero, there is less ammunition to cut rates compared with the last rate-cutting cycle. Barkin is open conceptually to anything, but he is skeptical that negative rates would be the path to embrace.

Small Business Optimism

At the GIC conference, the chief economist for the National Federation of Independent Business (NFIB) showed a series of charts for 30 million small businesses, which signaled robust optimism and hiring demand.

Barkin confirmed from his talks with small businesses and small business benefit-providers that their pipelines are strong, signaling healthy operations all around. Small businesses are less exposed to international trade conflicts, which provides a more security. But Barkin sees a big difference for global firms, and even larger business that are U.S.-centric, as they are more susceptible to the negative impacts from ongoing trade disputes.

Central Bank Independence and Inequality

At the GIC conference, economist Paul McCulley made a speech highlighting how he believes the Fed mandate may (or should, in his view) change to add not just a focus on "stable prices, maximum employment and moderate interest rates" but a focus on inequality and wealth dispersion.

Barkin countered that Congress actually should be quite pleased with how the Fed is fulfilling its mandate with 3.7% unemployment and very stable prices.

Barkin sees educational performance being one of key factors in the rise of inequality, and he sees U.S. educational performance currently plateauing in a way that other countries have not, which limits upward mobility and pervades it even further.

Student Debt: A Problem?

Barkin does not see the total amount of consumer debt outstanding as a primary risk for the banking system. But on the consumer side, Barkin recently learned that 40% of students who begin college do not finish. On the podcast, Barkin was not ready to say fewer people should go to college, but he did say that we need to help students get through college.

It was a great opportunity to speak to Barkin ahead of a very important Fed meeting coming up in July. Please follow the link below to listen to the entire discussion.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

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DEFINITIONS

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Inflation : Characterized by rising price levels.

Dovish : Description used when stimulation of economic growth is the primary concern in setting monetary policy decisions.

Interest rates : The rate at which interest is paid by a borrower for the use of money.

Basis point : 1/100th of 1 percent.

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.

Yield curve : Graphical Depiction of interest rates on government bonds, with the current yield on the vertical axis and the years to maturity on the horizontal axis.

2-Year Treasury : a debt obligation of the U.S. government with an original maturity of two years.

10- Year Treasury : a debt obligation of the U.S. government with an original maturity of ten years.

Term premium : The term premium represents the incremental yield that investors require to hold a longer-term bond, as opposed to a combination of shorter-maturity bonds.