

## US Macroeconomics

June 12, 2023

Joseph Lavorgna, Chief US Economist | 212.893.1528 | joseph.lavorgna@smbcnikko-si.com

### Fed to Hibernate Bond Bulls

The Fed will refrain from another rate hike when the FOMC meeting concludes on Wednesday afternoon. **Chair Powell raised the bar to what would be the 11th rate hike in a row** when he said last month that “We haven’t made any decisions about the extent to which additional policy funding will be appropriate. But given how far we’ve come we can afford to look at the data and the evolving outlook.” Unless the May consumer price data, released tomorrow, are exceedingly hot, a June rate pause is likely.

The futures market is discounting only a 25% chance of a June rate hike, but a slightly higher than 50% chance of a July rate hike. The market then starts to build in a small probability of a 25 basis point November 1st rate cut and is split 50/50 on the chance of a December 13th rate cut. The FOMC’s updated economic and financial projections are set to reinforce fixed income investors’ near-term bearish slant.

In March, the central tendency on 2023 real GDP growth was 0.0 to 0.8%. But since the economy is up 1.6% over the last four quarters, **the central tendency on output is likely to be lifted**. Our best guess is that we will see something in the vicinity of 0.5 to 1.5%. The central unemployment rate is likely to be lowered in part because of the better than earlier anticipated GDP performance but also because the rate has not increased much from where it was when the March forecasts came out (3.6%).

The central tendency on 2023 unemployment was 4.0 to 4.7%. Our best guess that we will see something in the vicinity of 3.9 to 4.5%, which is enough of a tweak to keep the Fed’s estimates of the core PCE deflator uncomfortably high, especially given the fact there has been no improvement in reducing core inflation thus far in 2023.

In March, the central tendency on 2023 core PCE inflation was 3.5 to 3.9%, and core inflation was running 4.7% year-over-year at the time. In the three months since, **core inflation has been stubbornly stuck at a 4.7% annual pace** so we should see its predicted range increase to somewhere around 3.8 to 4.3%. In response, the “dot plot” should show a higher terminal fed funds rate.

Our best guess is that **the 2023 median dot will be increased 25 bps to 5.4% as this would only require two members to lift their estimates of the funds rate**. This expected change is likely to spill over into 2024, which should show fewer rate cuts as only one member needs to change. This is consistent with the Fed’s ongoing message of keeping interest rates ‘higher for longer’ to dampen aggregate demand and quell inflationary pressures. Consequently, we expect to see the median 2024 fed funds fund dot go from 4.3% to 4.4%.

Our forecasts differ from the Fed’s in one important regard — the need for further interest rate hikes. **Our economic projections are consistent with a further weakening in the labor market, which is already evident from declining hours and rising jobless claims**. While core inflation may remain sticky, headline prices are declining quickly, right in line with the historical record. This means that inflation expectations will remain anchored.

When the unemployment rate rises significantly further from its current reading, we expect policymakers to pivot from worrying about high inflation to worrying about recession, especially with the 2024 Presidential Election looming. At that time, the Fed will remind us that unemployment is a leading indicator and inflation is a lagging indicator.

## Disclaimers

This document is provided by SMBC Nikko Securities America, Inc. (“SMBC Nikko”), the US-registered broker-dealer affiliate of Sumitomo Mitsui Banking Corporation, for informational purposes only. This document was prepared by SMBC Nikko’s economist(s). The views, statements, assumptions and forecasts expressed herein are those of the author(s) and do not reflect the judgment of any other person or of SMBC Nikko, it does not constitute an offer, or solicitation of the sale or purchase, of securities or other investments. The information contained herein is obtained or derived from sources believed to be reliable, but SMBC Nikko and the author(s) make no representations as to its accuracy or completeness. In some cases, such information may be incomplete or summarized. This document has been prepared based on assumptions and parameters determined by the economist(s) in good faith. The assumptions and parameters used are not the only ones that could have been selected, and therefore no guarantee is given as to the accuracy, completeness, or reasonableness of any such quotations, disclosures, or analyses. Past performance is not a reliable indicator of any future results.

This document has been prepared for and is directed at institutional investors and other market professionals and is not intended for use by retail customers. It does not take into account any specific investment objective, financial situation, or particular need of any recipient. The information contained herein should, for whatever purpose, be used solely at the discretion and responsibility of the recipient. SMBC Nikko and its affiliates do not accept any liability or responsibility for any results in connection with the use of such information. Recipients are responsible for making final investment decisions and should do so at their own discretion after conducting a careful examination of all documentation delivered prior to execution, explanatory documents pertaining to listed securities, prospectuses, and other relevant documents, and their own independent analysis and assessment of the merits of any transaction. The financial instruments discussed may be speculative and may involve risks to principal and interest.

## Conflicts of Interest Disclosures

The views, statements, assumptions and forecasts expressed herein may differ from those expressed in globally branded research produced by SMBC Nikko or its affiliates. The trading desks of SMBC Nikko and its affiliates trade or may trade as principal in the financial instruments that are the subject of this material, and the author(s) of this document may have consulted with the trading desks while preparing this document. The proprietary interests of SMBC Nikko and its affiliates may conflict with those of the recipient. SMBC Nikko and its affiliates may seek to do business with the companies mentioned in this material and the trading desks may have accumulated, be in the process of accumulating, or accumulate long or short positions in the financial instruments mentioned and may have acquired them at prices no longer available. The trading desks may also have or take positions inconsistent with the views expressed in this document or may have already traded on those views.

This material is not a research report, and neither this material nor its author(s) is subject to SMBC Nikko policies and procedures that apply to the globally branded research reports and research analysts of SMBC Nikko and its affiliates or to legal requirements designed to promote the independence of investment research. It is not subject to any prohibition on dealing ahead of the dissemination of investment research. This means that on the date of this document, SMBC Nikko, its affiliates, and their respective directors, representatives, or employees, may have a long or short position in any of the instruments mentioned in this document and may make a market or trade in instruments economically related to the securities, derivatives or other underlying assets mentioned herein, in each case either as principal or as agent.

No part of the author(s) compensation was, is, or will be, directly or indirectly related to the specific recommendations or views expressed herein. The personal views of authors may differ from one another.

Distribution, possession or delivery of this document in, to or from certain jurisdictions may be restricted or prohibited by law. Recipients of this document are required to inform themselves of and comply with all such restrictions or prohibitions.