

US Macroeconomics

October 15, 2024

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Elevator Economics

There have been many twists and turns in monetary policy decision-making of late. Given the persistence of conflicting economic signals, we do not expect this situation to dissipate any time soon. Let us review developments over the past year.

The Fed pivoted toward 75 basis points in rate cuts last December (i.e. the median dot) and kept that projected easing in place when updated forecasts were next provided this past March. However, the FOMC reduced the amount of expected 2024 easing in June to just a single 25 bp rate cut by yearend. Within three months, the Fed went from three (25 bp) cuts to just one! But sentiment would soon shift again.

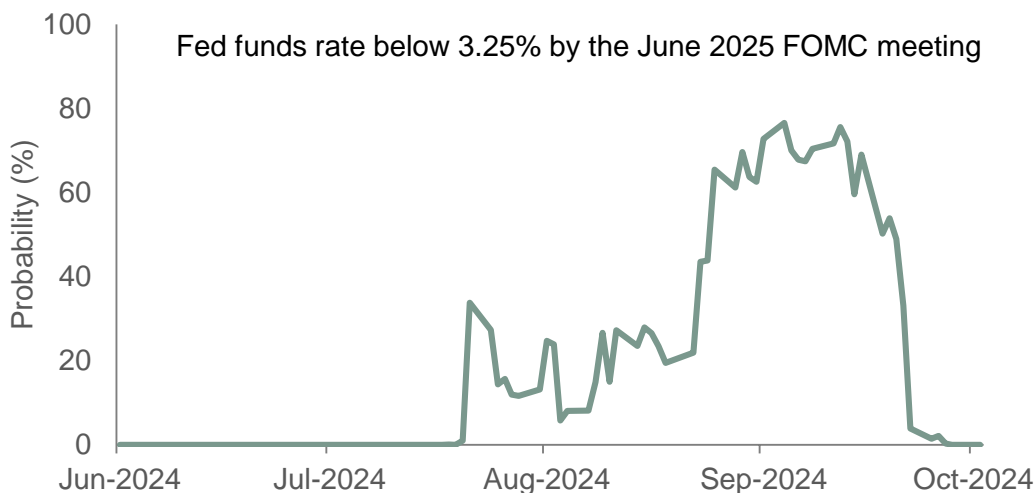
While the Fed stood pat in July meeting, the minutes stated that “several [members] observed that the recent progress on inflation and increases in the unemployment rate had provided a plausible case for reducing the target range 25 basis points.” That is a remarkable turnaround. Then the Fed surprised the financial markets (not us) by cutting 50 bps in September and projecting another 50 bps by yearend. But now, **another dramatic shift in Fed policy expectations may soon be underway.** Could the markets be in for a surprise yet again?

Following substantial upward revisions to National Income, a much stronger than expected September employment and a troublingly elevated reading on the core consumer price index, the bond market has repriced the Fed. But the repricing is for the terminal rate, not the near-term trajectory of the fed funds. We believe this is a mistake.

Market participants have raised their expectation of the terminal rate. They expect the funds rate to trough at around 3.25% compared to 2.75% previously. However, the future market is still discounting 25 bp rate cuts at the upcoming November and December FOMC meeting. This does not make sense to us given the recent spate of data.

The economy has proven to be stronger than monetary policymakers expected. And the rise in stock prices has further eased financial conditions. **If the Fed cuts more in the near-term, aggregate financial conditions are poised to ease further,** thus adding more monetary accommodation to an economy that may have grown over 3% accounting to the latest Atlanta Fed GDP Now estimate.

Positive economic momentum should continue for at least a while longer. Consequently, **we expect the Fed to skip easing at the November 7 FOMC meeting** and reengage rate cutting in December when it becomes obvious again the labor market is in a fragile state. Therefore, the up and down volatile nature of Fed policymaker is likely to persist.



Source: CME, SMBC Nikko

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