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GLOBAL ECONOMICS

## SCOTIA FLASH

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# Powell Rules Out a March Cut, Sets Up QT Reassessment

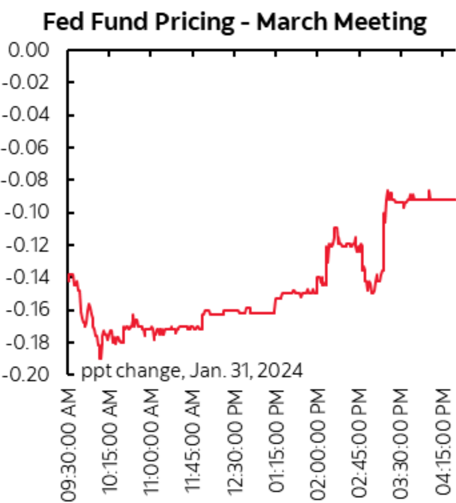
- **Powell said a March cut is "not the most likely case."**
- **The Fed's perfectly understandable confidence problem**
- **Powell wisely rejects a rules-based approach**
- **A QT discussion was held and a fuller discussion was promised for March...**
- **...which probably sets up a likely announcement to reduce Quantitative Tightening**
- **All nearer-term FOMC meeting dates trimmed cut pricing**

It took sixty minutes to get there and after premature headlines and comments about what was delivered, but eventually Chair Powell's prime message was to explicitly rule out a cut by March and to set up a potential announcement on adjusting Quantitative Tightening at the next meeting. No policy changes were delivered. In all, the communications met my expectations.

Everything else about the statement and the rest of the press conference is of relatively little consequence. The biggest unanswered question is why it took so long to deliver the punchline today! That begs the question whether Powell was giving his own opinions after the statement and first sixty minutes of the press conference and going off-script.

What follows is a full account that summarizes my instant real-time views provided to our markets clients.

**Chart 1**




Sources: Scotiabank Economics, Bloomberg.

### MARCH CUT? FUHGGEDDABOUDIT!

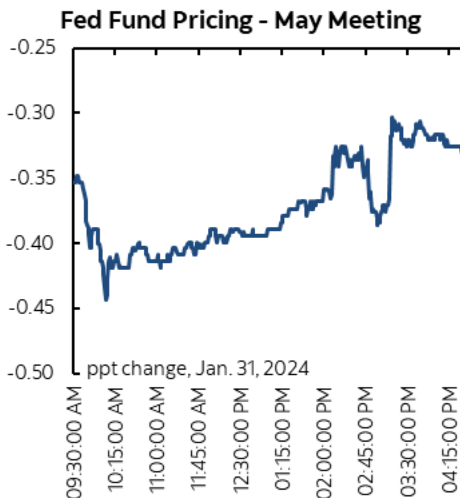
Chair Powell delivered his strongest rejection to date of market pricing for a rate cut at the March meeting. When asked whether it is premature to think that rate cuts are right around the corner, he said:

> "We said in the statement we will move carefully. I don't think it's likely that the Committee will reach a level of confidence to begin easing by the March meeting. That's probably not the most likely case."

That trimmed market pricing for easing over coming meetings (charts 1, 2 and 3). Charts 4–7 show the intraday moves across other market measures.

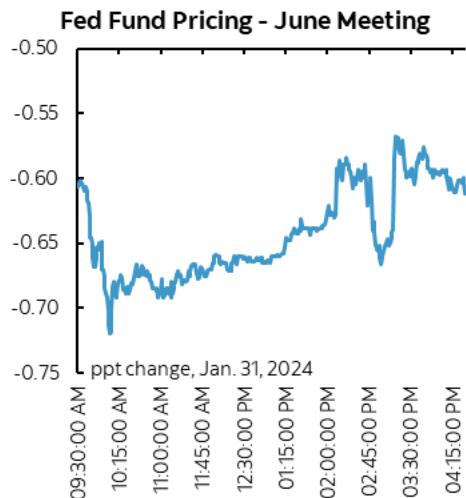
Powell has the data line-up to back him up on that comment. The Committee will only get one more PCE print by March and two more payrolls/wages reports. It's doubtful that one

**Chart 2**




Sources: Scotiabank Economics, Bloomberg.

**Chart 3**




Sources: Scotiabank Economics, Bloomberg.

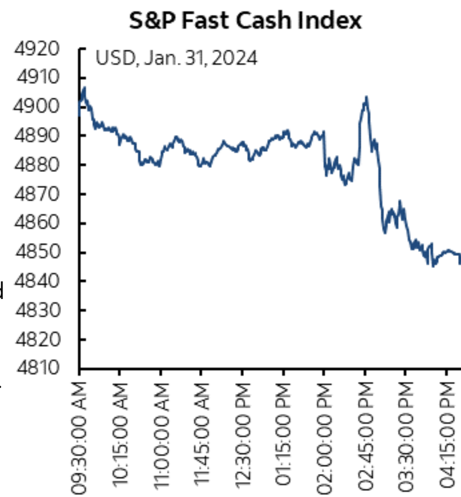
or two more data points on each would give them the required confidence to take this to the next level and begin easing.

When asked whether a first cut would start a cycle of cuts or be a one-off, he sloped off the question by saying "It's going to depend on the data." Good answer.

When asked whether there was variation among FOMC members on the confidence to cut rates and how quickly to get there, Powell flat out said

> "There was no discussion on cutting rates. We're not at that stage. We're not at a place of working out those details because we were not actively considering moving the funds rate down."

Chart 4




Sources: Scotiabank Economics, Bloomberg.

Chart 5

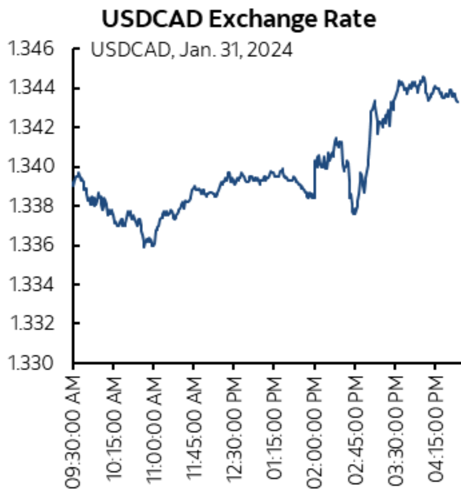
Sources: Scotiabank Economics, Bloomberg.

## NO DATE STAMPS

When asked how many months he thinks he might need to see lower inflation to have more confidence to ease, Powell said: "I'm not going to put a number on it."

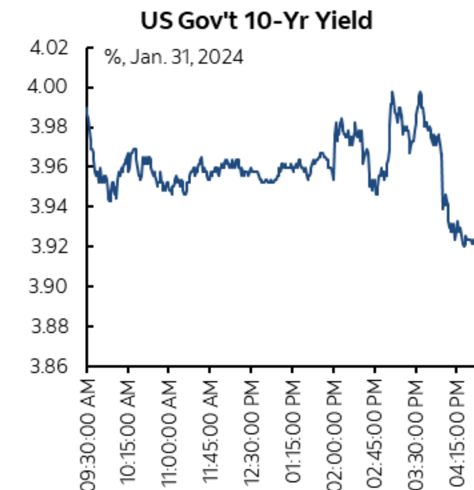
Good for you, we all know the perils to trying to outguess developments in this environment. Powell knows full well that projections have a nano-second shelf life.

Chart 6




Sources: Scotiabank Economics, Bloomberg.

Chart 7




Sources: Scotiabank Economics, Bloomberg.

## QUANTITATIVE TIGHTENING CHANGES AFOOT

Toward the end of the press conference, Chair Powell was asked whether the Committee discussed slowing the pace of balance sheet run-off in the months ahead. He said that balance sheet run-off has gone well so far, and that:

> "We did have some discussion on the balance sheet. We're planning to have more in-depth discussion in March."

That translates into a need to watch the FOMC meeting minutes three weeks from now for more about the range of the discussion at this meeting.

It also potentially tees up an announcement on changing QT parameters at that meeting.

When asked whether they would want to cut and moderate balance sheet run-off in tandem, Powell said "We see those as separate tools. It's not something we're planning but it could happen."

When asked what he needs to see when considering whether to taper Quantitative Tightening and whether that includes seeing the overnight repo facility go to zero, Powell said:

> "That's what we'll be talking about at the March meeting. I wouldn't say that's what we're targeting. We'll be looking at a variety of things over the next year or so."

That 'over the next year or so" may be reference to the kind of timeline they have in mind for ending QT. It might imply rejection of a sudden ending of QT or a more compressed timeline.

### STATEMENT CHANGES

Please see the accompanying statement comparison at the back of this note for changes that were made to this statement relative to the prior one on December 13th. There were more changes than anticipated.

The growth reference in the opening sentence was upgraded from 'slowed' to 'a solid pace' which is roughly what was expected.

The second paragraph was a total re-write. It eliminated reference to the banking system, how tighter financial and credit conditions would weigh on economic activity, hiring and inflation with uncertain effects.

In place of that prior wording, they now reference how dual mandate risks are “moving into better balance.”

Key, however, were the changes to the third paragraph. They struck out reference to ‘any additional policy firming that may be appropriate’ and replaced it with “in considering any adjustments” while pushing back against nearer term easing by saying:

> “The Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent.”

The decision was unanimous.

On balance, the statement made it fairly clear that it doesn't sound like they're in a rush to ease.

### THE FED’S CONFIDENCE PROBLEM

The statement-codified need to have greater confidence is the key here. When asked point blank what it would take to give the Fed confidence to ease, Powell said this:

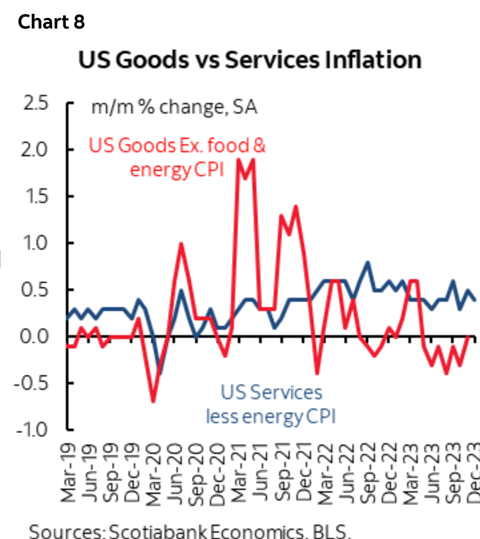
> “We have confidence. We're looking for greater confidence. Implicitly our confidence has been gaining. We want to see more data, a continuation of the good inflation data. Is the 6 months of good inflation data a signal we're on a sustainable path toward achieving 2% sustainably? The data is low enough. But can we take it as sustainable, that's what we're talking about. We're looking for inflation to continue coming down as it has for the past six month.”

When probed further with the question being “Is there anything that makes you doubt that it will be sustainable?” Powell said:

> “It's a good story but we need more confidence. Over time, goods inflation will flatten out and so disinflation will require services inflation to contribute more.”

This last point is key. Powell returned to it more than once as a key uncertainty. Goods disinflation has been dragging down inflation while services inflation remains hot (chart 8). There are multiple scenarios going forward, but Powell is implicitly asking what if goods disinflation stalls and services inflation does not?

**Chart 8**




Sources: Scotiabank Economics, BLS.

Powell also noted that "Ongoing progress in bringing it down is not assured" in reference to inflation.

Powell further responded with “No I wouldn’t say that” when asked if the goldilocks soft landing has been achieved. He said “Core inflation is still too high. We’re not declaring victory at this point. We still have a ways to go.”

The Chair also noted that this key quote:

> “The greater risk is that inflation stabilizes at a level above 2% rather than accelerates. We would have to respond if inflation moves back up again and both of those scenarios are risks. You've had 6 very good months for inflation but are the last six months durable?”

On the other hand, Powell sounded worried that ultimately the picture could rapidly shift toward exposing greater vulnerabilities. He said this in the context of dismissing worries about rapid economic growth challenging achievement of the dual mandate:

> “A lot of this disinflation has come through healing of supply chains. Relative to the neutral rate we can't identify with precision how tight policy is. The supply side has been recovering in the middle of this. A lot of the growth we are seeing is driven by easing supply chains and labour markets and when that wanes, we'll see more of the tightening effects.”

The Fed's confidence problem also extends to the other part of its dual mandate. When asked whether the labour market is back to normal, Powell said:

> "The labour market by many measures is at or nearing normal but not totally back to normal. Job openings and wage increases are not totally back to where they were. The economy is broadly normalizing. Wage setting will take a couple of years to get all of the way back [to pre-pandemic]."

Powell also responded affirmatively in response to whether the FOMC will be watching CPI revisions on February 9th and duly noted that "Last year was a surprise" and not a good one.

### NO MECHANICAL RULES PLEASE!

Powell was asked why they wouldn't be easing as a Taylor Rule would indicate given expectations for falling inflation. Powell responded by saying:

> "We consult a number of Taylor rules but we've never been in a place where we've made policy on the basis of the Taylor rule. If real rates go up as inflation comes down we cannot mechanically adjust the policy rate because we look at more than just the fed funds rate and we don't know where the neutral rate of interest is at any given time but we also can't wait until the economy turns down. We're in a risk management framework trading off the risk of too early and too late but the timing requires confidence toward sustainable 2% inflation."

Powell might have also said that easing in anticipation of falling future inflation is a tad farcical given how poorly models and central banks forecast inflation throughout the whole pandemic era (and before…). If you ease because you expect durably cooler inflation but you know everyone sucks at forecasting inflation, then why would you ease on this basis? Powell's been around long enough to know the answer.

### RISK TO THE OTHER HALF OF THE DUAL MANDATE

When asked whether a weaker employment picture would motivate easing, Powell basically said yes:

> "We're not looking for that. If we saw an unexpected weakening in the labour market that would certainly weigh in favour of cutting sooner. If inflation is stickier that would support cutting later. In the base case, the SEP shows we think we can and should be careful about when to begin to dial back."

Onto Friday payrolls next!

### UNANSWERED QUESTIONS

I'm a bit surprised that no one in the press conference asked why the FOMC removed the comments in the statement about how the banking system is sound and resilient and the reference to tighter financial and credit conditions that are likely to weigh on economic activity, hiring and inflation and how the effects are uncertain. Are they less concerned about these factors?

The statement referenced "any adjustments to the target range"' instead of "any additional policy firming" in the prior statement. That sounds ambiguous in a way that leaves tightening and easing on the table, yet Powell said during his presser that "We believe that the policy rate is at its peak" and that "dialing back" will become appropriate at some point this year. That's not new; in fact the dot plot has shown 2024 easing for years now and Powell said it again at the December press conference.

**RELEASE DATE: January 31, 2024**

***Recent indicators suggest that economic activity has been expanding at a solid pace***. Job gains have moderated since early last year but remain strong, and the unemployment rate has remained low. Inflation has eased over the past year but remains elevated.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. ***The Committee judges that the risks to achieving its employment and inflation goals are moving into better balance.*** The economic outlook is uncertain, and the Committee remains highly attentive to inflation risks.

In support of its goals, the Committee decided to maintain the target range for the federal funds rate at 5-1/4 to 5-1/2 percent. ***In considering any adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks. The Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent.*** In addition, the Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities, as described in its previously announced plans. The Committee is strongly committed to returning inflation to its 2 percent objective.

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Thomas I. Barkin; Michael S. Barr; Raphael W. Bostic; Michelle W. Bowman; Lisa D. Cook; Mary C. Daly; Philip N. Jefferson; Adriana D. Kugler; Loretta J. Mester; and Christopher J. Waller.

**RELEASE DATE: December 13, 2023**

***Recent indicators suggest that growth of economic activity has slowed from its strong pace in the third quarter***. Job gains have moderated since earlier in the year but remain strong, and the unemployment rate has remained low. Inflation has eased over the past year but remains elevated.

***The U.S. banking system is sound and resilient. Tighter financial and credit conditions for households and businesses are likely to weigh on economic activity, hiring, and inflation. The extent of these effects remains uncertain.***

The Committee remains highly attentive to inflation risks. The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. In support of these goals, the Committee decided to maintain the target range for the federal funds rate at 5-1/4 to 5-1/2 percent. ***The Committee will continue to assess additional information and its implications for monetary policy. In determining the extent of any additional policy firming that may be appropriate to return inflation to 2 percent over time, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments.*** In addition, the Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities, as described in its previously announced plans. The Committee is strongly committed to returning inflation to its 2 percent objective.

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