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GLOBAL ECONOMICS

SCOTIA FLASH

March 20, 2024

Contributors

Derek Holt
VP & Head of Capital Markets Economics
Scotiabank Economics
416.863.7707
derek.holt@scotiabank.com

The FOMC Still Needs More Confidence

- **The FOMC stands by 75bps of cuts this year, but largely ruled out more…**
- **…while slightly reducing next year's cuts**
- **Uncertainty about when to cut as the FOMC debates how to view recent inflation**
- **Tapering quantitative tightening is afoot, perhaps by June…**
- **…with no modalities offered and no decisions made yet**
- **Growth and core PCE were revised up, the unemployment rate down**
- **The neutral rate edged up, but the core Committee estimate probably did not**

The FOMC delivered the goods that made equity and bond holders a little richer than they thought going into the communications. By the time the dust settled, the S&P500 rallied by another 1%, the USD depreciated with USDCAD moving about half a penny lower, and the US Treasury curve bull steepened in 2s10s as the two-year yield fell by about 6-7bps with the 10s yield little changed.

The statement is **here** and the Summary of Economic Projections including the revised 'dot plot' is available **here**.

Here is what they did.

75BPS OF CUTS THIS YEAR, BUT DOING MORE WAS LARGELY RULED OUT

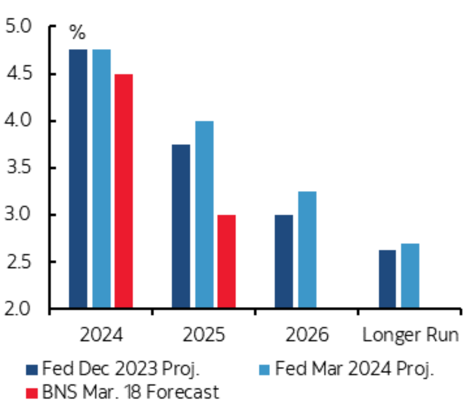
The dot plot continued to guide 75bps of cuts this year (chart 1). One reason why markets liked the communications is that the Committee did not reduce the projected number of rate cuts this year which they could very well have done given recent upside surprises to inflation.

Still, confidence to ease this year arguably diminished across the whole Committee's opinions. There are more dots in the 75bps camp this time versus last time (9 versus 6), but the rest of the distribution is more skewed toward fewer cuts on net. Instead of five who previously thought the policy rate could be cut by 100 (4) or 150bps (1), only one is calling for more than 75bps this year at –100bps. The rest of the dots pivoted toward fewer cuts. Two now think no cuts will be delivered (from 1), 1 thinks one cut (from two), and an unchanged 5 think that only 50bps of cuts will be delivered.

The distribution matters is the point and it is shown in chart 2.

Chart 1

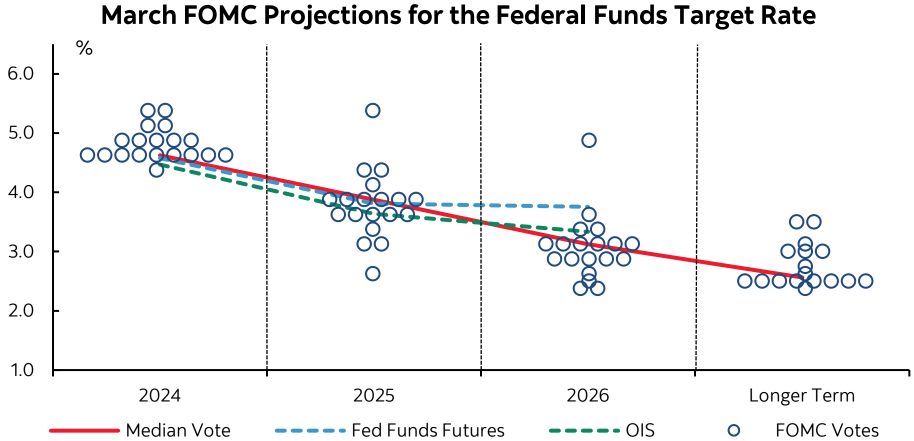
Fed Policy Rate Forecast Comparison



Sources: Scotiabank Economics, Federal Reserve Summary of Economic Proj. (Mar. 20, 2024).

Chart 2

March FOMC Projections for the Federal Funds Target Rate



Note: OIS & Fed Fund Futures as of Mar. 20, 2024.
Sources: Scotiabank Economics, US Federal Reserve.

Chair Powell dodged questions on timing a first cut during his press conference. He simply said they require more confidence which doesn't tee up May given the Chair's preference for more explicitly guiding next moves. June is 'live' but not necessarily when a first reduction may be delivered. Given six meetings from June to the end of the year, 75bps of cuts would imply probably skipping a couple—or starting later.

In fact, Powell extra did not sound like he was in a rush to cut. He started his press conference by repeating that "inflation is still too high, ongoing progress is not assured, and the path forward is uncertain." During his presser, he said that January core inflation may have been higher due to seasonal distortions, but also said it was dangerous to remove select elements and ignore data that one doesn't like. He said point blank that the Committee was unsure whether the recent reacceleration of month-over-month core inflation "is a bump on the road or something more." They're not going to cut until they have a stronger answer.

ONE LESS CUT IN 2025

The Committee removed one 25bps cut from 2025 and carried that through to 2026. Markets ignored that perhaps because they treat the nearer term dots more seriously than the guesswork further out in time and especially for such a small change.

NOT MUCH CONFIDENCE BEHIND A HIGHER NEUTRAL RATE

The longer-run neutral rate was raised by a tenth to 2.6% but it did not sound like Chair Powell was convinced that carried any significance. In fact, the reasoning behind the change in the median projection was pretty weak. What drove it was that three participants who previously thought that neutral was lower than 2.5% were reduced to one as the other two moved higher. The strongest tendency remains around a neutral rate of 2.5% according to an unchanged number of eight Committee members.

Those eight members likely include the most influential participants. Anyway, the neutral rate is the biggest total guess out of the whole set of guesses.

QT CHANGES ARE AFOOT "FAIRLY SOON" BUT ZERO DETAILS WERE OFFERED

Changes to the amount of maturing Treasuries (US$60B/month) and MBS ($35B/mth) that are allowed to roll-off the Fed's balance sheet are in the works but nothing was announced. That was expected by most. No targets or timelines or other details were offered. Further discussion and a decision "fairly soon" will be offered. From my recollection, 'soon' leans toward the next meeting, so 'fairly soon' would sound like within the next couple of meetings and hence perhaps by the June FOMC.

I'm not sure that we'll learn much more in the meeting minutes three weeks from now with respect to QT plans. Maybe they'll discuss ranges for the first taper, ranges for end targets and ranges for timelines. That could inform the breadth of possibilities, but Powell said they decided nothing whatsoever today. That suggests that further discussion on the modalities will occur at the May/June meetings with an announcement.

LITTLE CHANGE TO THE STATEMENT ITSELF

Please see the accompanying comparison of the current and prior statements. The one statement change was largely inconsequential. All they did was to flag that job gains "remained strong" instead of the previous reference to running at a "solid pace." Everything else in the statement was left unchanged as illustrated by the accompanying statement comparison.

What was not changed is more meaningful. They did not make the reference to target rate changes less ambiguous in terms of direction and instead chose to repeat reference to "In considering any adjustments to the target range for the federal funds rate…"

They also left intact reference to how "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." Clearly they are not there yet.

The statement references to inflation and growth were unchanged.

The statement was unanimously supported with no dissenters.

The statement repeated that "the Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities..."

FED ECONOMISTS' ESTIMATE FOR NEXT WEEK'S CORE PCE

Chair Powell said during the press conference that "for the February numbers core PCE we have well below 0.3% m/m." What 'well below' means is uncertain, but presumably it's something at or above 0.25% m/m that rounds up. Otherwise, he might have said 0.2% or a lower number. Expect most folks to coalesce around this estimate in consensus surveys once they are complete. I had previously submitted 0.3% for my estimate.

FORECAST CHANGES

Charts 3-6 show what changed in the FOMC's projections relative to the Scotia Economics house forecasts.

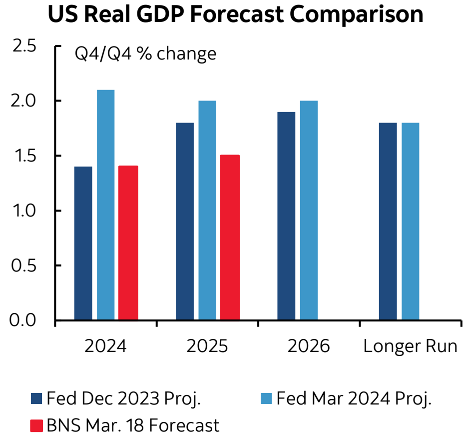
GDP growth was revised up from 1.4% this year on the standard Q4/Q4 basis to 2.1%, from 1.8% to 2.0% next year and from 1.9% to 2% in 2026. The longer-run potential growth rate was left unchanged at 1.8%.

The unemployment rate forecast was revised down a tick to 4% this year, left at 4.1% next year, down a tick to 4% in 2026 and left at 4.1% in the longer-run estimate of the natural rate.

The headline PCE inflation forecast was left at 2.4% this year, raised a tenth to 2.2% in 2025, and left at 2% in 2026.

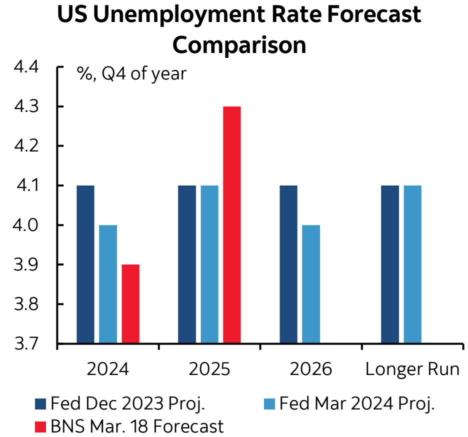
The core PCE inflation forecast was raised two-tenths to 2.6% this year and left unchanged at 2.2% and 2.0% in the next two years.

Chart 3



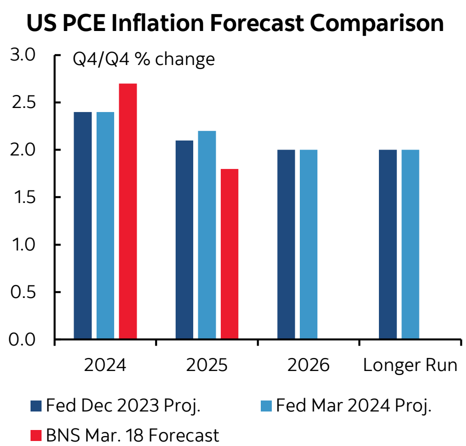
Sources: Scotiabank Economics, Federal Reserve Summary of Economic Proj. (Mar. 20, 2024).

Chart 4



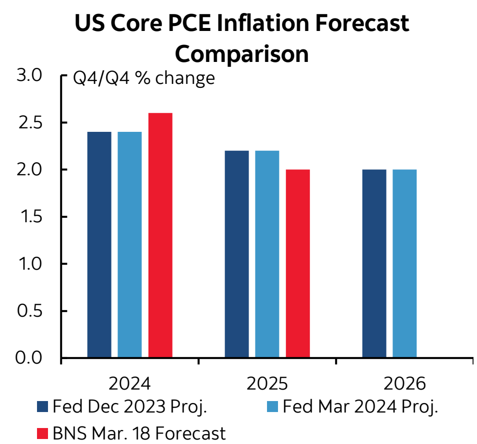
Sources: Scotiabank Economics, Federal Reserve Summary of Economic Proj. (Mar. 20, 2024).

Chart 5



Sources: Scotiabank Economics, Federal Reserve Summary of Economic Proj. (Mar. 20, 2024).

Chart 6



Sources: Scotiabank Economics, Federal Reserve Summary of Economic Proj. (Mar. 20, 2024).

RELEASE DATE: March 20, 2024

Recent indicators suggest that economic activity has been expanding at a solid pace. ***Job gains have remained 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: 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.

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