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GLOBAL ECONOMICS

SCOTIA FLASH

May 1, 2024

Neither Powell Nor Macklem Are in a Big Rush to Ease

- **FOMC confirmed it is in no rush to ease...**
- **...but that the next move remains likely to be lower...**
- **...as Powell leaned against hike risk**
- **Quantitative tightening flows will be tapered in June**
- **Markets generally liked what they heard**
- **BoC Governor Macklem also doesn't sound like he's thinking of a June cut**

The FOMC smartly executed an overall set of communications that struck a balance between ruling out nearer term easing, sticking to the line that the most likely next move is down, while pouring cool—not ice cold—water on the risk of rate hikes. The result was taken reasonably well by markets and broadly met my expectations for Powell & Co not sounding more hawkish than what was already priced going in. Grade 'A' in my view.

MARKETS SEE-SAWED BUT GENERALLY LIKED IT

Fed funds futures pricing for cumulative easing this year increased by a few basis points compared to just before the 2pmET statement (chart 1). Markets moved closer to being on the fence between one and two quarter point rate cuts by year-end. The S&P initially gained over 1%, 2s rallied by about 4bps, 10s rallied a touch, and the dollar weakened by about half a penny to CAD, but each of these measures gave back most of those moves into the close (charts 2–5).

OVERALL SUMMARY

Statement changes (see appendix) were devoid of hawkish signals relative to pricing and leaned in the other direction by shifting to a past tense reference to dual mandate goals that "have moved toward better balance." They announced a QT taper of the pace of roll-off of maturing securities held on their balance sheet to be implemented in June which was broadly in line with expectations. Powell's press conference laid out a baseline expectation for lower inflation over the duration of the year and that rate cuts may still be in store later in the year but that they lack the required "greater" confidence to do so in the nearer term with all meetings to evaluate incoming data. Stocks climbed by over 1%, the dollar weakened and market pricing for cumulative cuts by year-end increased by about 6–7bps to now being on the fence between one and two quarter point cuts. He also did not slam the door on hiking but generally poured cool water on it.

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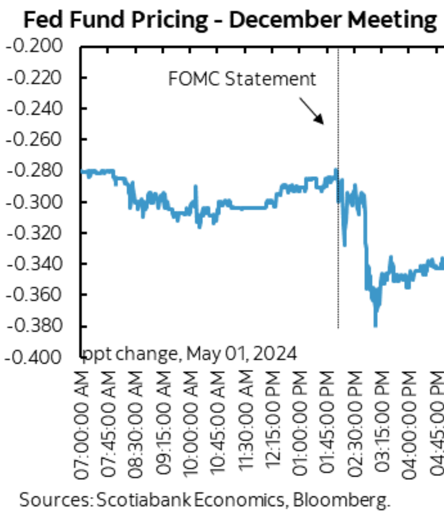
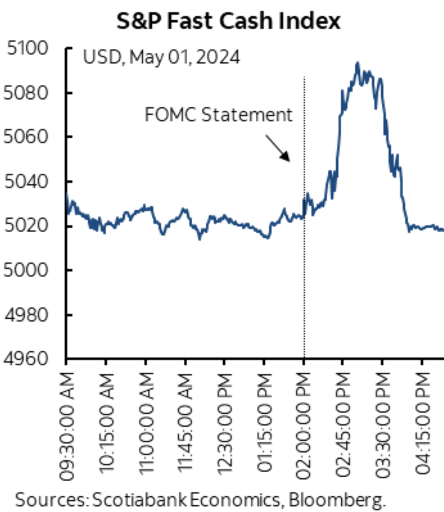
Chart 1



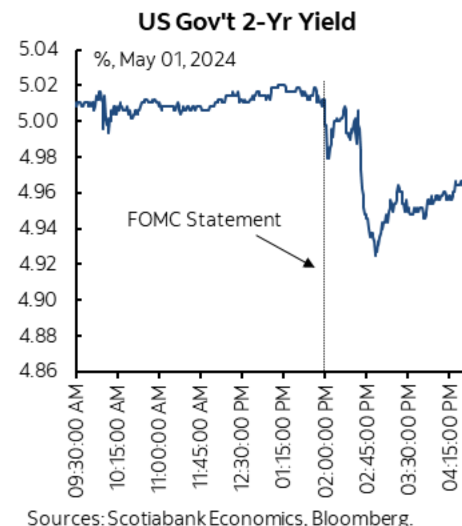
Sources: Scotiabank Economics, Bloomberg.

Chart 2



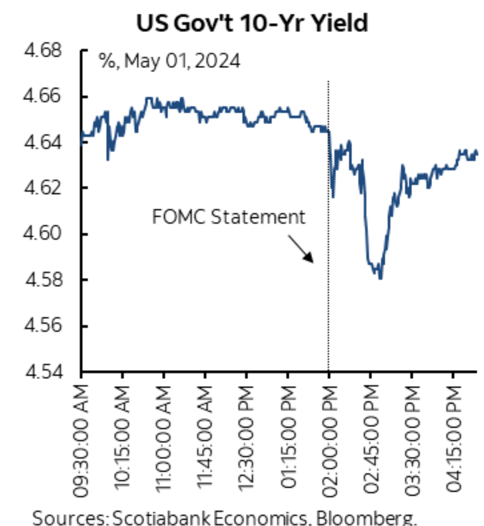
Sources: Scotiabank Economics, Bloomberg.

Chart 3



Sources: Scotiabank Economics, Bloomberg.

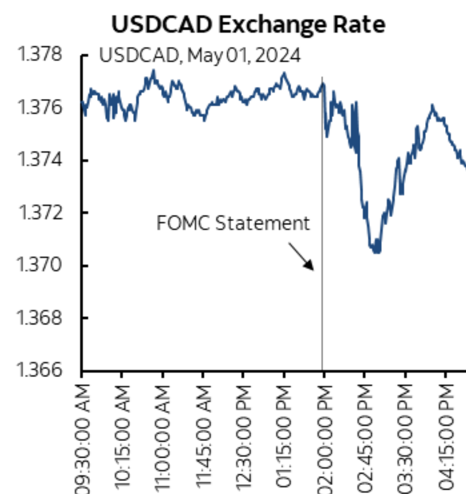
Chart 4



Sources: Scotiabank Economics, Bloomberg.

I think Powell also teed up a move toward projecting fewer cuts in the June dot plot. It would take only one of the 9 votes in the -75bps line in the March dot plot to move to -50bps in order to swing the median down to -50bps assuming no one else changed, just to highlight how close of a call it was even in March. It's almost a certainty that the median projection will move lower in June. It's unlikely they go as low as –25 which would take a lot of vote changes. It's even more unlikely that the median drops any cuts.

Chart 5



Sources: Scotiabank Economics, Bloomberg.

Further elaboration follows.

QT PLANS—REDUCED ROLL-OFF STARTING IN JUNE

The statement and **this** implementation note from the New York Federal Reserve announced a tapering of quantitative tightening flows that will be implemented next month.

> "Beginning in June, the Committee will slow the pace of decline of its securities holdings by reducing the monthly redemption cap on Treasury securities from $60 billion to $25 billion. The Committee will maintain the monthly redemption cap on agency debt and agency mortgage-backed securities at $35 billion and will reinvest any principal payments in excess of this cap into Treasury securities."

The purpose of taking this step is to not withdraw liquidity and tighten funding market conditions to the point of raising strains on the financial system as maturing bonds roll off the Fed's balance sheet. Further important details are contained in the NY Fed's release and the FAQs.

STATEMENT CHANGES—FEWER RISKS TO ACHIEVING GOALS

Other than the QT announcement there were a few other significant statement changes. Not that this was expected, but markets might have feared a hawkish pivot on the forward guidance that might have sounded more open to additional tightening. That was not the case.

The biggest change was the shift to this:

> "The Committee judges that the risks to achieving its employment and inflation goals have moved toward better balance over the past year."

Compared to this in the March statement:

> "The Committee judges that the risks to achieving its employment and inflation goals are moving into better balance."

That might seem like a subtle shift in tense, which it is, but it's a powerful message in that the Committee is indicating more confidence that risks to the dual mandate goals of full employment and stable 2% inflation have come closer into balance. That still signals they are short of mission accomplished but to say "have" moved, instead of "are moving" is signalling that their look at the whole suite of readings has them not giving up achieving their goals and on the next rate move being down, not up.

Another key in the statement was the reference to how progress on inflation has stalled out which is their way of statement-codifying reference to not being in a rush to ease:

> "In recent months, there has been a lack of further progress toward the Committee's 2 percent inflation objective."

The opening paragraph also shifted the tense on economic activity expanding at a solid pace.

Forward guidance was left unchanged. It remains data dependent and generic by repeating how "the Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge."

There were no dissenters.

IN NO RUSH TO CUT

Powell's opening comments in his press conference had him coming out swinging by noting "considerable progress" toward dual mandate goals and "that's very good news" but inflation remains too high. He continued to argue that supply and demand conditions in the labour market have come in to better balance, that there continues to be strong job growth but also strong immigration and a higher participation

rate to aid a rebalancing of the labour market as wage growth has ebbed but that labour demand still exceeds supply. He also noted that longer term measures of inflation expectations remain well anchored across a broad array of measures. None of that sounded like a guy thinking of further tightening—or abandoning and hope of easing.

Chair Powell's press conference made it clear that the Committee is in no rush to cut. He did this by saying the following:

- "so far this year the data have not given us that confidence" that dual mandate goals have been achieved.
- "it is likely that further progress will take longer than expected"
- "We've seen enough data and should take some signal and we are taking signal and the signal we are taking is that it is likely to take longer to gain confidence that we are on a sustainable path to 2% inflation."
- he repeated that they will make decisions meeting by meeting, conditional on data

…BUT THE BASE CASE REMAINS IN FAVOUR OF LOWER EXPECTED INFLATION…

Powell made his own base case outlook very clear when he said:

> "My forecast is that we will see inflation come back down over the course of the year"

He elaborated upon this by flagging the argument that lower market rent rates should show up in lower shelter inflation but with uncertain lags.

…AND AN ONGOING EASING BIAS WITH VERY LITTLE APPETITE FOR MORE HIKES

When asked during the press conference "Is the current policy rate sufficiently restrictive?" Chair Powell said:

> "I do think the current policy rate is restrictive and weighing on demand. You can see that in the labour market. You saw that in the JOLTS report this morning. The same is true of quits and hiring rates that have normalized. Consumers and businesses are indicating that the supply and demand of jobs has come back down. We believe it is restrictive and over time will be sufficiently restrictive."
>
> "We believe our policy is in a good place. We believe it is restrictive. You see it in the labour market. You see it in interest sensitive spending."

Now while that doesn't explicitly rule out hikes, any sensible person would have heard that it's very unlikely.

Powell went on to state more deliberately in response to further questioning that

> "It's unlikely that the next policy move will be a hike. Our policy focus is upon how long it would take to remain restrictive. We would look at the totality of the data. If we were to come to that conclusion that policy is not tight enough due to a totality of evidence then that's what it would take to take that step" [ie: hike].

Apparently that either wasn't enough, or journalists in the presser were ticked someone else had already asked their favourite question, so they tried again by asking if he has dropped his easing bias to which he answered:

> "Our decisions will depend upon incoming data, the totality of the data. We think policy is well positioned to address different paths that the economy might take. If we did have a path where inflation proves more resilient and the job market is still strong but inflation is moving strong then that would be a path to hold off on rate cuts. Inflation moving sustainably down could give us confidence to begin cutting rates. So could an unexpected weakening in the labour market. The data will have to answer the question for us in terms of peak rate."

A better question was whether the Committee felt it still had time to cut three times this year as per the March dot plot and given the meeting calendar. Powell said:

> "I don't think of it that way. We need more time. We didn't see progress in the first quarter. It's going to take longer to reach that point of confidence. I don't know how much longer it will take. When we get that confidence then rate cuts will be in scope."

Where Powell's delivery stumbled somewhat was in response to whether there was any discussion about a rate hike in today's meeting and whether he is satisfied with 3% for the rest of the year to which he replied:

> “Of course we're not satisfied with 3% inflation. We think our policy stance is appropriate to achieve that. The policy focus has really been on holding the current level of restriction. That's where the discussion was focused."

Maybe it was dragging on and he was getting a tad frustrated with the same repeated line of inquiry, but I didn’t like the stammering and shifty body language that made Powell seem uneasy while answering that last question.

A PREDICTABLE ANSWER ON THE ELECTION’S EFFECTS

Powell was asked “Is the bar for rate changes higher closer to an election?” and his answer was delivered in a somewhat terse manner, yet a thoroughly predictable one.

> “We are always going to do what we think is the right thing to do for the economy. That's hard enough to do and taking in other things reduces our chance of doing the right thing for the economy.”

When asked in another way about whether there is a difference in cutting in September versus December, he flippantly said:

> “There's a significant difference between an institution that takes into account political events and one that doesn't. Read all the transcripts around past elections and you won't see any discussion around elections.”

BANK OF CANADA GOVERNOR ALSO SOUNDED IN NO RUSH TO EASE

After the dust had settled on what the Fed has done, Bank of Canada Governor Macklem and Senior Deputy Governor Rogers began testimony before a parliamentary committee. The opening statement (**here**) did not sound amenable to cutting the policy rate as soon as the June meeting to me. That reinforces our expectation for easing no earlier than the July or September meetings, though we are aware of the need to evaluate incoming data.

Key in this regard are the following passages toward the end:

> “Overall, the data since January have increased our confidence that inflation will continue to come down gradually even as economic activity strengthens. Our key indicators of inflation have all moved in the right direction and recent data point to a pickup in economic growth.”

> “I realize that what most Canadians want to know is when we will lower our policy interest rate. What do we need to see to be convinced it’s time to cut? The short answer is we are getting closer. We are seeing what we need to see, but we need to see it for longer to be confident that progress toward price stability will be sustained.”

> “In the months ahead, we will be closely watching the evolution of core inflation. We remain focused on the balance between demand and supply in the economy, inflation expectations, wage growth and corporate pricing behaviour as indicators of where inflation is headed.”

> “To conclude, we’ve come a long way in the fight against inflation, and recent progress is encouraging. We want to see this progress sustained.”

On timing rate cuts, key here is that “we need to see it for longer,” and “in the months ahead,” and “we want to see this progress sustained.”

We get one more inflation report before the June meeting, but the “months ahead” reference seems to me like they are setting a high bar against this being sufficient.

RELEASE DATE: May 1, 2024

Recent indicators suggest that economic activity ***has continued to expand*** 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. ***In recent months, there has been a lack of further progress toward the Committee's 2 percent inflation objective.***

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 ***have moved toward better balance over the past year.*** 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. ***Beginning in June, the Committee will slow the pace of decline of its securities holdings by reducing the monthly redemption cap on Treasury securities from $60 billion to $25 billion. The Committee will maintain the monthly redemption cap on agency debt and agency mortgage-backed securities at $35 billion and will reinvest any principal payments in excess of this cap into Treasury securities.*** 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: 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.

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