newsquawk

PREVIEW: FOMC Rate Decision and Dot Plot due Wednesday 13th December at 19:00GMT/14:00EST; Powell Presser/Q&A at 19:30GMT/14:30EST

The Fed is all but certain to keep rates unchanged on Wednesday at 5.25-5.50% with focus on the accompanying SEPs ('Dot Plot') to gauge the magnitude of cuts in store for 2024 and beyond. The statement is expected to see minor tweaks but still maintain the optionality for further tightening. The SEPs will be the key focus, and there are expectations for a downward revision to the 2024 median Fed rate projection from the 5.1% seen in September on account of the faster progress than expected in the reduction of inflation and some signals of deteriorating economic growth, although the continued strength of the labour market will be capping the magnitude of any downward revision we may see. Chair Powell is expected to use his presser to push back against some of the recent aggressive pricing of rate cuts.

ON HOLD: A Reuters survey saw all but five of 102 economists surveyed suggest the Fed is done hiking interest rates. While Powell has refrained from determining that rates are "sufficiently restrictive", this is seen by many as keeping optionality on the table for a further hike/hikes in the case of a reacceleration of inflation (which appears increasingly unlikely), in addition to pushing back on the easing of financial conditions. Instead, the continued progress in reducing inflation to the 2% target - Core PCE in Oct fell to 3.5%, the lowest since April 2022 and down from the peak of 5.6% in Feb 2022 - alongside some of the deteriorating growth signals (Beige Book and business surveys have warned of softening labour demand, while job openings have been tumbling) is driving the conversation to how long rates will be held at current levels instead of how much higher they will climb.

STATEMENT: There are some expectations that there may be an adjustment to the statement line, "In determining the extent of additional policy firming that may be appropriate...", to something softer, such as "whether" additional firming. Some analysts have also warned that the line added in November about tighter financial conditions could be removed given the rally in Treasuries and stocks amid the market's dovish repricing of the Fed rate path. However, it's worth highlighting Governor Waller's comment from Nov 28th, "Long-term interest rates are still higher than they were before the middle of the year, and overall financial conditions are tighter...", while Powell highlighted the "substantial" tightening in financial conditions in his Spelman College appearance on Dec 1st, his last before the FOMC blackout period. Meanwhile, the growth description could be softened somewhat from "economic activity expanded at a strong pace", but the description that "job gains have moderated since earlier in the year but remain strong", will likely remain unchanged, as will "Inflation remains elevated."

CUTS: The market's key focus is on both where the Dot Plot says the Fed will cut rates to and any signals from Powell in his presser on when cuts may begin. Reuters' survey of economists had 52 of 102 forecasting no rate cuts until at least July, while 72 of 102 see 100bps of cuts or less next year. Markets have been more aggressive, with participants ramping up their cut pricing even further after Governor Waller said in a WSJ interview on Nov 28th, "there are certainly good economic arguments from any kind of standard Taylor rule that would tell you if we see this inflation continuing for several more months... you could then start lowering the policy rate just because inflation is lower." For such a high-ranking official on the FOMC to say that, and historically one of its most hawkish voices, was seen as indicative of a broader internal discussion being held on cuts at the Fed, one which has been at odds with the majority of the hawkish public commentary from policymakers. Powell pushed back on Waller's remarks at his Spelman College appearance, "It would be premature to conclude with confidence that we have achieved a sufficiently restrictive stance, or to speculate on when policy might ease." It's likely Powell will repeat that line on Wednesday.

LABOUR MARKET: The strong November payroll figures and the tumble in the unemployment rate are likely to embolden Powell's pushback against Waller. The report also tempered market expectations on Fed cuts better than Powell did (markets have been much more responsive to the data than hawkish Fed commentary as of late), with just over 100bps priced by the market through 2024 now vs extremes above 130bps seen last week before the data, whilst reducing the implied probability of March cut to 40% from c. 65%. A continued resilience of the labour market will reduce policymakers' appetite to rush forward with any 'technical' rate cuts, although some analysts are of the view that some of the softening leading indicators and growth headwinds could entice some on the Fed to get ahead of any growth slowdown to ensure a soft landing is secured, given that if you wait for payroll growth to slow down, or even turn negative, it's possibly too late to prevent a more meaningful slowdown.

DOT PLOT: The final 2023 rate dot is expected to be revised down to 5.4%, where rates currently are, from the 5.6% forecast in September. The 2024 rate dot is largely expected to see a downward reduction from 5.1% (which reflects just one 25bp cut), but it's unlikely the Fed will indicate anything as aggressive as market pricing suggests. The reduction in the rate dots will be reflective of the faster decline than expected in Core PCE, with the 2023 forecast expected to be moved down from the current 3.7% (vs Oct Y/Y printing at 3.5%), with that progress likely to carry over into the 2024 forecasts that many expect to see a downward revision to also. Meanwhile, it's worth keeping eyes on the longer run rate dot given the recent upward shift in estimates through 2023, where it would now take just two officials shifting from 2.500% to 2.625% to shift the median from 2.5% to 2.6%.

The September Dots for reference:

- FEDERAL FUNDS RATE: 5.6% in 2023 (unchanged vs. June), 5.1% in 2024 (prev. 4.6%), 3.9% in 2025 (prev. 3.4%), 2.9% in 2026, 2.5% in the longer run (unchanged)
- CHANGE IN REAL GDP: 2.1% in 2023 (prev. 1.0% in June), 1.5% in 2024 (prev. 1.1%), 1.8% in 2025 (unchanged), 1.8% in 2026, 1.8% in longer run (unchanged)
- UNEMPLOYMENT RATE: 3.8% in 2023 (prev. 4.1% in June), 4.1% in 2024 (prev. 4.5%), 4.1% in 2025 (prev. 4.5%), 4.0% in 2026, 4.0% in longer run (unchanged)
- PCE INFLATION: 3.3% in 2023 (prev. 3.2% in June), 2.5% in 2024 (unchanged), 2.2% in 2025 (prev. 2.1%), 2.0% in 2026, 2.0% in longer run (unchanged)
- CORE PCE INFLATION: 3.7% in 2023 (prev. 3.9% in June), 2.6% in 2024 (unchanged), 2.3% in 2025 (prev. 2.2%), 2.0% in 2026.