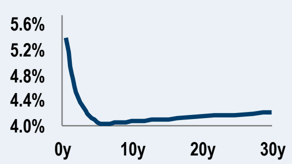
Dec 13, 2023

ONCE A GRINCH, FOREVER CHANGED

- Fed policymakers held overnight interest rates unchanged at 5.25% - 5.50%, the fourth consecutive hold after 18 months of hikes
- It appears that inflation has settled into a tolerable range, with 3-month and 6-month core PCE trending at a 2.3% - 2.4% annual rate
- Short term markets have been running ahead of Fed rhetoric, though FOMC members are clearly leaning towards possible cuts
- Dot plot accompanying today's FOMC is net dovish relative to September, though dispersion of rate expectations is very wide

Treas.	Now	1.45PM	Chg.
3mo	5.38	5.39	-(0.01)
2yr	4.55	4.67	-(0.12)
5yr	4.07	4.17	-(0.11)
10yr	4.08	4.15	-(0.06)
30yr	4.23	4.27	-(0.04)
3m/2s	(84)	(72)	-(11)
2s/10s	(46)	(52)	+6
2s/30s	(32)	(40)	+8



Source: Bloomberg

The Federal Reserve Open Market Committee left its target for overnight interest rates unchanged at a range of 5.25% - 5.50%, their fourth unchanged decision after more than a year of unusually rapid hikes. December FOMCs always seem to bring to mind the 2018 meeting at which Fed Chair Jay Powell donned his Grinch hat, uttered the words "autopilot," and tanked the financial markets just in time for the holidays. Powell probably remembers that experience and the subsequent walk back too well to repeat it again. More recently, Powell noted that the risks are roughly balanced for the Fed's next move, and financial markets took that statement as a cue to begin pricing in interest rate cuts in 2024—100 bps of them at present. We would caution against taking that pricing as gospel, and even Fed officials have highlighted that we're a long way from cuts. But momentum-based trading programs are exaggerating the market-implied probabilities of rate cuts by bidding up short-term interest rate futures, and few are brave enough to fight back against that trend this close to year-end. A mid-year "normalization" rate cut is certainly possible, and today's FOMC results would suggest several are coming.

Data since the FOMC met in early-November has been generally weaker, both on growth and inflation. After 3Q's blockbuster GDP expansion, 4Q seems to include slower consumption growth. Personal spending was up only +0.2% in October, and expectations for the holiday retail season are modest. The Atlanta Fed's GDP now tracker has data registering a +1.3% growth rate so far in the quarter, though that could change considerably when we see retail sales results tomorrow morning. While the inflation "crisis" ended last spring, the recent inflation readings are just about normal. This week's CPI result noted the lowest core YoY inflation rate in about two years, and next week's PCE inflation is likely to continue the moderating trend. Even prior to that reading, on a 3-month and 6-month basis, the core PCE is running at 2.3% – 2.4%. That's close enough that policy doesn't need to do any more heavy lifting. Unless Powell and colleagues get especially nervous about inflation falling below the 2% target, however, it is hard for them to advocate for rate cuts without more evidence of slowing.

The FOMC statement accompanying today's announcement was little changed, as the Fed maintained its pattern of adjusting the statement only in months when they do not release economic projections. Economic growth "has slowed from its strong pace," a sort of market-to-market of aforementioned data, and inflation "has eased" which is a slight qualitative downgrade in inflation concerns. As this is one of the quarterly meetings, the FOMC also released summary economic projections and the vaunted dot plot. Going into the meeting, markets were pricing in a very divergent course of policy relative to the dots, which would seem to make the change in the dots more significant than their absolute median. The median forecast for 2024 fell to 4.625% (3 cuts) from 5.125% (1 cut) at the September FOMC meeting. The range of expectations remains very wide, however, with some officials still expecting no change and some expecting as many as 100 bps of rate cuts; expectations for 2025 and 2026 were largely unchanged.

Immediate market response to the FOMC statement had the curve bull steepening, with front end yields falling 12 bps from pre-FOMC levels. The 2s/10s spread increased about 6.5 bps, though the curve remains deeply inverted. Fixed income markets have taken a dovish FOMC release and interpreted it in the most optimistic possible way.

FEDERAL RESERVE press release

• Growth "has slowed" and inflation "has eased"

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.

• No change in any other language in the statement from November's

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.

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 was unanimous

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Michael S. Barr; Michelle W. Bowman; Lisa D. Cook; Austan D. Goolsbee; Patrick Harker; Philip N. Jefferson; Neel Kashkari; Adriana D. Kugler; Lorie K. Logan; and Christopher J. Waller.

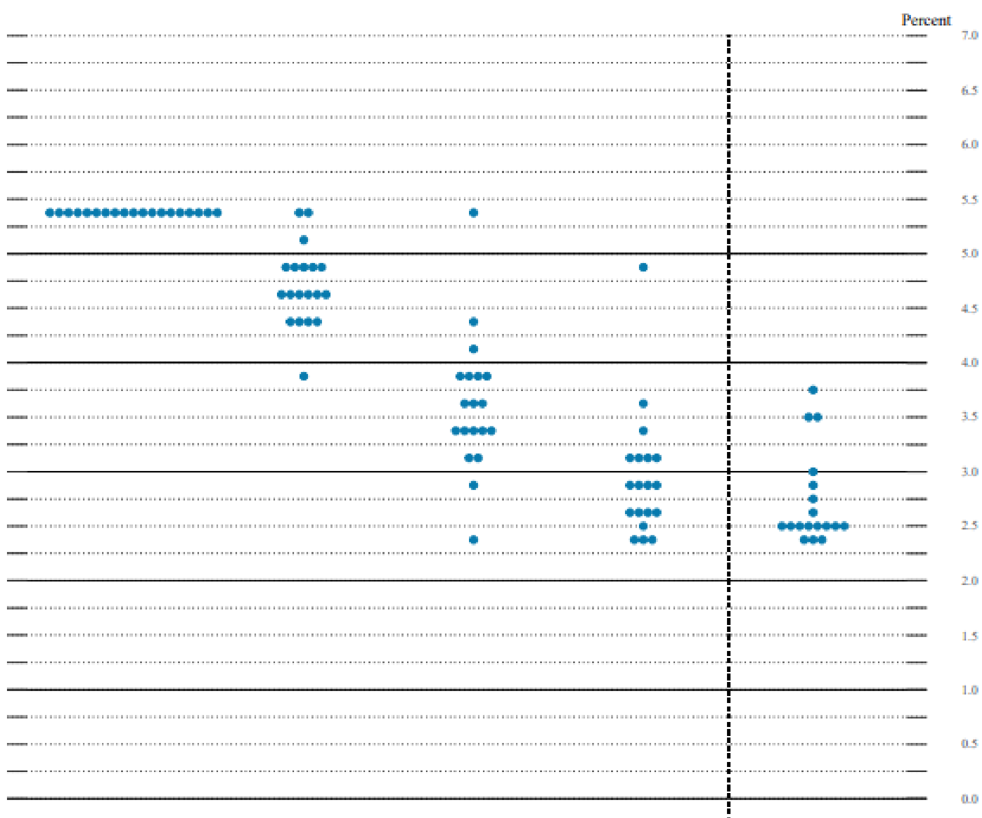
- Median GDP growth slightly downgraded for 2024, but PCE inflation exp. also cut
- Fed officials continue to forecast the softest of landings
- Median expectation is for 75 bps of rate cuts in 2024, though there's no obvious consensus
- More subtly, the dots exclude one hike in 2023 (Sep dots had one more hike), which makes the change in dots vs. prior iteration look larger on paper than they are in reality

Table 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy, December 2023

Percent

Variable	Median[1]					Central Tendency[2]					Range[3]				
	2023	2024	2025	2026	Longer run	2023	2024	2025	2026	Longer run	2023	2024	2025	2026	Longer run
Change in real GDP	2.6	1.4	1.8	1.9	1.8	2.5–2.7	1.2–1.7	1.5–2.0	1.8–2.0	1.7–2.0	2.5–2.7	0.8–2.5	1.4–2.5	1.6–2.5	1.6–2.5
September projection	2.1	1.5	1.8	1.8	1.8	1.9–2.2	1.2–1.8	1.6–2.0	1.7–2.0	1.7–2.0	1.8–2.6	0.4–2.5	1.4–2.5	1.6–2.5	1.6–2.5
Unemployment rate	3.8	4.1	4.1	4.1	4.1	3.8	4.0–4.2	4.0–4.2	3.9–4.3	3.8–4.3	3.7–4.0	3.9–4.5	3.8–4.7	3.8–4.7	3.5–4.3
September projection	3.8	4.1	4.1	4.0	4.0	3.7–3.9	3.9–4.4	3.9–4.3	3.8–4.3	3.8–4.3	3.7–4.0	3.7–4.5	3.7–4.7	3.7–4.5	3.5–4.3
PCE inflation	2.8	2.4	2.1	2.0	2.0	2.7–2.9	2.2–2.5	2.0–2.2	2.0	2.0	2.7–3.2	2.1–2.7	2.0–2.5	2.0–2.3	2.0
September projection	3.3	2.5	2.2	2.0	2.0	3.2–3.4	2.3–2.7	2.0–2.3	2.0–2.2	2.0	3.1–3.8	2.1–3.5	2.0–2.9	2.0–2.7	2.0
Core PCE inflation[4]	3.2	2.4	2.2	2.0		3.2–3.3	2.4–2.7	2.0–2.2	2.0–2.1		3.2–3.7	2.3–3.0	2.0–2.6	2.0–2.3	
September projection	3.7	2.6	2.3	2.0		3.6–3.9	2.5–2.8	2.0–2.4	2.0–2.3		3.5–4.2	2.3–3.6	2.0–3.0	2.0–2.9	
Memo: Projected appropriate policy path															
Federal funds rate	5.4	4.6	3.6	2.9	2.5	5.4	4.4–4.9	3.1–3.9	2.5–3.1	2.5–3.0	5.4	3.9–5.4	2.4–5.4	2.4–4.9	2.4–3.8
September projection	5.6	5.1	3.9	2.9	2.5	5.4–5.6	4.6–5.4	3.4–4.9	2.5–4.1	2.5–3.3	5.4–5.6	4.4–6.1	2.6–5.6	2.4–4.9	2.4–3.8

Figure 2. FOMC participants' assessments of appropriate monetary policy: Midpoint of target range or target level for the federal funds rate



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