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Chief Economist

13 JUNE 2024

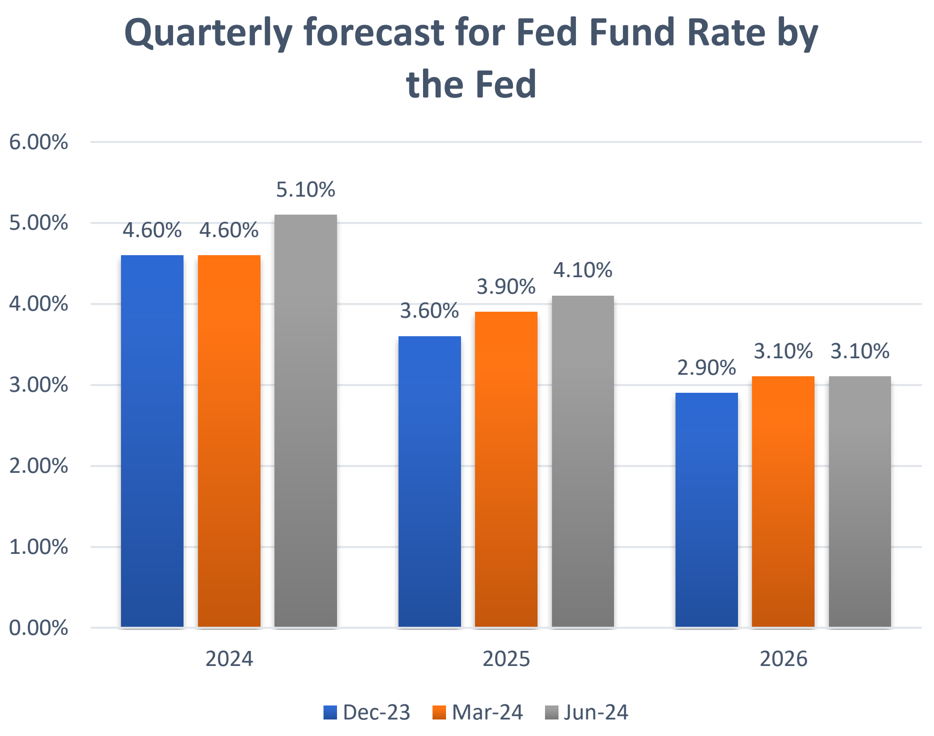
US Federal Fund Rate

A Tug of War between the Fed and Markets

The US Federal Open Market Committee (FOMC) concluded its meeting on June 12, 2024, maintaining the Federal Funds Rate at 5.25% to 5.50%. This outcome, expected by economists, shifts the focus to when the first rate reduction might occur as inflation continues to moderate, gradually approaching the 2.00% policy target.

The latest FOMC statement maintains a hawkish tone, as committee members believe that progress towards the 2.00% inflation target has been modest. This suggests that the Fed may need to keep interest rates unchanged to ensure that the monetary policy stance remains restrictive for an extended period.

The Federal Funds Rate (FFR) has held steady since last July, following a 25 basis point hike by the Fed. Since then, speculation about a potential rate cut has persisted. The latest FFR projection from Fed staff suggests one rate cut this year, a departure from the previous forecast of three cuts. In this environment, market sentiment is likely to be cautious but may incline towards anticipating monetary easing, considering the Fed's history of sudden policy changes.



Source: Bloomberg

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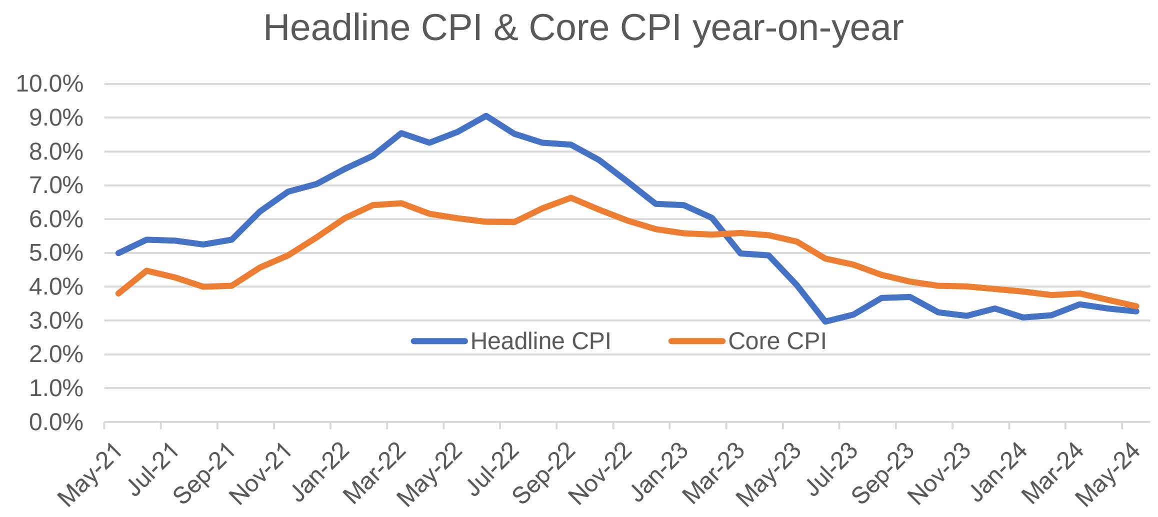
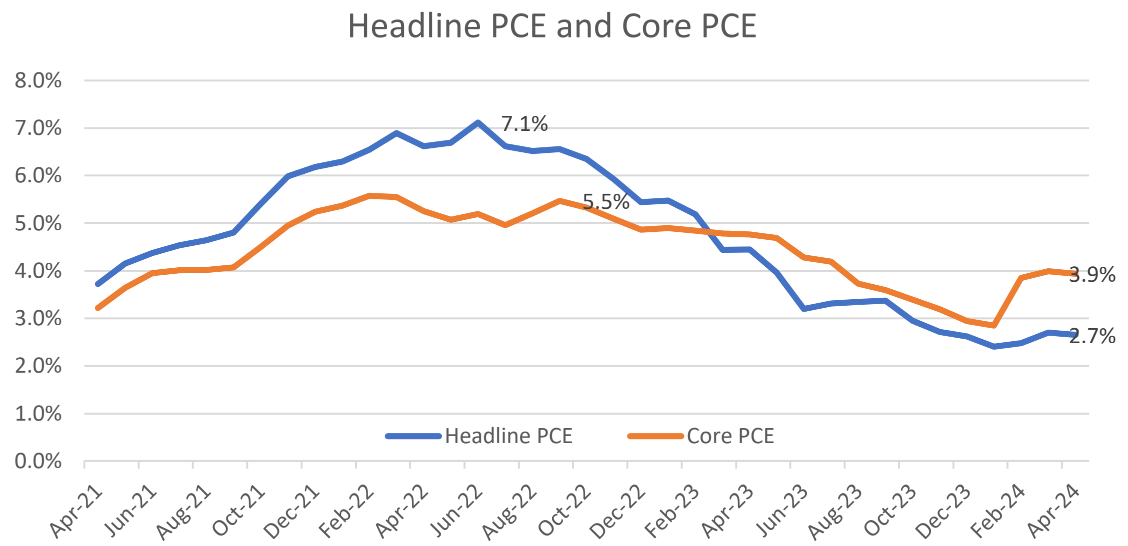
US inflation rate has moderated and the market bets for two rate this year.





Despite the Fed's maintained restrictive posture, the markets remain skeptical, particularly as inflation continues to moderate. Recent data revealed that the Consumer Price Index (CPI) inflation was lower than expected at 3.3% in May (April 2024: 3.4%), against a consensus estimate of 3.4%. According to interest rate derivatives contracts, the probabilities for a rate cut in September and December have increased from 47.8% and 53.8% to 60.0% and 74.6%, respectively. This highlights a discrepancy between the Fed's outlook and market expectations.

Probability of FFR cut based on interest rate derivatives

FOMC meeting dates	12-Apr-24	13-May-24	13-Jun-24
31-Jul-24	35.7%	22.0%	8.0%
18-Sep-24	**48.0%**	**47.8%**	**60.0%**
07-Nov-24	22.8%	34.2%	35.2%
18-Dec-24	**49.9%**	**53.8%**	**74.6%**
29-Jan-25	31.3%	38.3%	50.2%

Sources: Bloomberg & CEIC

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US Beige Book Report

Reporting month	Overall assessment in Beige Book
January 2024	Overall, most Districts indicated that expectations of their firms for **future growth were positive**, had improved, or both.
February 2024	The outlook for future economic growth remained generally positive, with contacts noting **expectations for stronger demand** and less restrictive financial conditions over the next 6 to 12 months.
April 2024	In contrast, nonresidential construction was flat, and commercial real estate leasing fell slightly. **The economic outlook among contacts was cautiously optimistic, on balance.**
May 2024 .	Overall outlooks grew somewhat **more pessimistic** amid reports of **rising uncertainty** and **greater downside risks.**

The Beige Book is a Fed publication that reports on current economic conditions across the 12 Federal Reserve Bank districts, including Boston, New York, Philadelphia, and Cleveland. Each Federal Reserve Bank collects information from its branches and conducts interviews and online surveys with businesses, community organizations, economists, market experts, and other sources.

The overall assessment indicates a shift towards greater uncertainty and growing pessimism among respondents. Additionally, it was reported that employers have gained more bargaining power and employee turnover has decreased, suggesting a buyer's (employer's) market.

This suggests that employers may have more influence over wage levels, while employees are less inclined to switch jobs due to decreased confidence in securing new employment. This trend is reflected in the Quit Rate, which has stabilized around 2.2% from December 2023 to April 2024, down from a peak of 3.0% in April 2022.

Consequently, demand conditions may soften, potentially leading to lower inflation in the coming months.

Source: US Federal Reserve

Markets vs. Fed – who will win?

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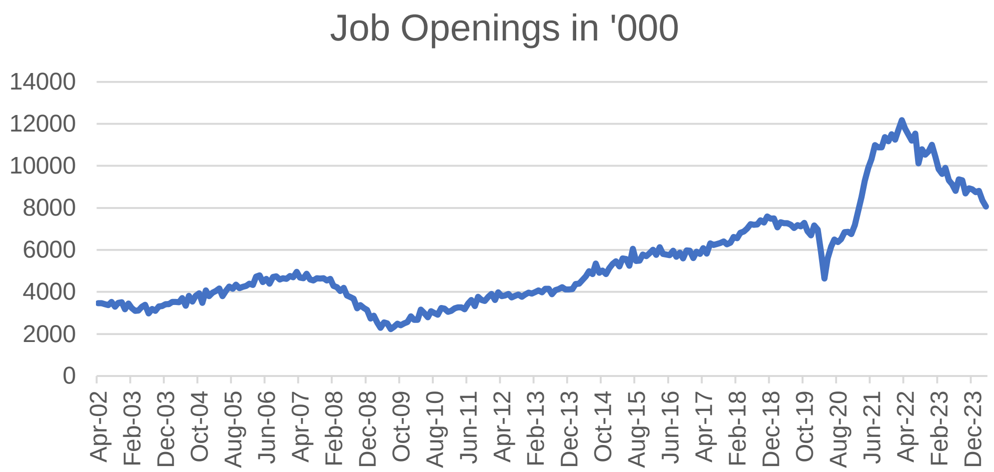
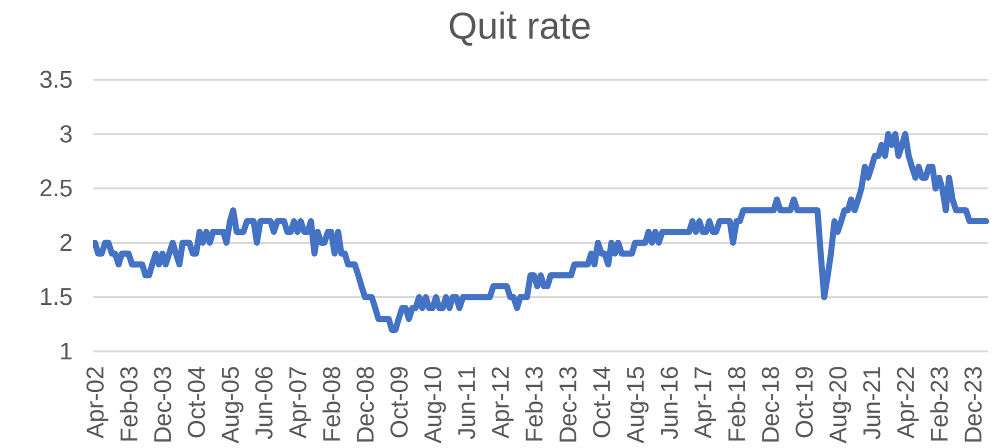
This question is complex. On one hand, the Fed is responsible for monetary policy and is equipped with the tools and skilled personnel needed to make robust economic estimates, aiding the FOMC in their decision-making process. On the other hand, the Fed underestimated the rising inflation in 2021 and 2022, initially describing the high inflationary pressures as "transitory" back in 2021.

We are not discrediting the Fed, as predicting the future is inherently uncertain. However, signs of a weakening labor market have emerged, and the current monetary policy is highly restrictive. The Fed has set the long-term FFR at 2.80%, while the prevailing level is 5.50%, indicating that the policy stance has been in the restrictive zone for quite some time. Given the lag in the effects of monetary policy, an economic slowdown is likely to become evident soon.

Given this context, the markets have a basis to anticipate lower rates in the future. Therefore, we expect the Fed to begin monetary easing in September and December, reducing the FFR by 50 basis points, bringing it down to 4.75% to 5.00% by the year's end.





Sources: US Bureau of Labor Statistics & CEIC