

# CHART OF THE WEEK

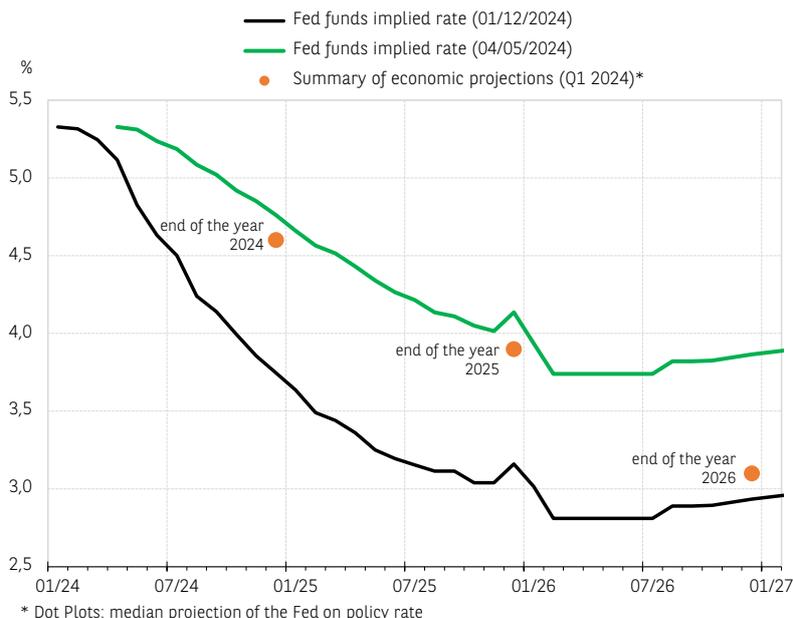


10 April 2024

## DON'T FIGHT THE FED!

Anis Bensaidani

US Fed funds rate: don't fight the Fed!



Source: Bloomberg, BNP Paribas

The Federal Reserve releases the Summary of Economic Projections (SEP) following the last meeting of the quarter. These forecasts are closely scrutinized as they include the “dot plots”, i.e. the median trajectory of the medium-term policy rate by the members of the Committee. The Q4 2023 projections included three rate cuts (of 25 bps each) in 2024, for a rate target of 4.6% at year-end. At the same time, the Fed Chair, Jerome Powell, noted progress on the inflation front (CPI at +3.2% y/y in Q4 2023, v. +7.1% y/y a year earlier), but refused to declare victory.

The prospect of rate cuts has brought a wave of optimism to markets. According to the Fed Funds Implied Rate, derived from futures contracts traded on federal funds, as of 12th January 2024, markets were pricing six to seven rate cuts in 2024 (dark line on the chart), with the first one occurring as early as the March FOMC meeting. Meanwhile, Fed officials attempted to dampen this optimism during their public appearances.

However, inflation data released thereafter surprised on the upside, reporting a monthly acceleration in January (+0.3% m/m) and February 2024 (+0.4% m/m)<sup>1</sup>, a pace inconsistent with the 2% target. In February, headline and core inflation were still too high for comfort, at +3.2% y/y and +3.9% y/y respectively (CPI measure by the BLS). This has led to a significant cooling of rate cuts expectations by the markets, which have, eventually, gradually aligned with those from the SEP. In the meantime, the US economy has continued to prove robust too, while the rebalancing of the labour market does not constitute to date a deterioration likely to call for a monetary policy response (with respect to the objective of full employment in the Fed’s dual mandate).

The SEP from March 2024 does not contain any change related to the 2024 number of rate cuts according to the headline figure. The median remains at 4.6%, while Powell expressed confidence about the disinflation trajectory despite the mixed progress seen in the latest data. However, FOMC members look less confident regarding the number of rate cuts they are forecasting. The group of those anticipating fewer than three cuts expanded by one member (9 out of 19 compared with 8 before) and the group of those planning more has only one member left (previously 5). As for markets expectations, they now appear to be slightly more pessimistic than the FOMC projections, with a 4.7% target rate at the end of 2024 (between two and three cuts, green line on the chart), and a probability only slightly above 50% that the first cut will occur in June.

<sup>1</sup> Seasonally adjusted data.

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