Fed Watch

Fed is done if conditions allow them to be done

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Powell could have been more hawkish given strong economic data, but instead started to pave the way for a dovish shift soon

- **The FOMC unanimously decided to hold the fed funds rate steady at its current 5.25-5.50% 22-year-high target range for a second consecutive meeting.** The statement continued to point that "inflation remains elevated," but the fact that the wording for the inflation assessment remained unchanged compared to September's statement suggests a likely widespread opinion among FOMC officials that inflation has continued to ease broadly in line with the expectations outlined in the latest SEP. However, the surprisingly 4.9% GDP growth rate for 3Q23 released last week did drive the Committee to upgrade the recent pace of economic activity to "strong" instead of "solid". While they continued to acknowledge the gradual supply-demand rebalancing in the labor market, they also slightly upgraded job gains to have "moderated" instead of "slowed."

- **The Fed remains attentive to the implications of the recent spike of long-term yields, but refused from ceding control of financial conditions to market shifts that might not prove to persist.** Considering that GDP was well above expectations in 3Q23 and job gains in September were double the expectation, the hawkish tweaks to the statement were partially offset by the addition of "tighter financial conditions" as another factor that, together with "tighter credit conditions", are "likely to weigh on economic activity, hiring, and inflation," which is most likely a reaction to the recent developments in the Treasury yield curve. While Chair Powell was asked several times about an estimation on how the recent surge in long-term interest rates translates into rate hikes, he refused to give an answer and instead said that it is not clear yet how "persistent [is this development] going to be," and that the important thing is rather looking at higher long-term rates as part of a "broader picture" in which they have contributed to a tightening of broader financial conditions, which "would need to be persistent" as only then they could implications for the path of monetary policy.

- **Doors were left wide open to the possibility of another rate hike.** Powell conveyed the idea that the FOMC is certain that the current "monetary policy stance is restrictive", but also reiterated a couple of times that the first question at hand[1] is still how high should the fed funds rate go to achieve a policy stance that is sufficiently restrictive to bring inflation back down to 2%. Chair Powell argued that the Fed is still "not confident that policy is sufficiently restrictive", but also that "tight policy is putting downward pressure on inflation", and that the "full effects of tightening have yet to be felt" considering the lags with which monetary policy affects economic activity and inflation. For now, the FOMC will continue with a "meeting-by-meeting" strategy until they are confident that they have achieved a stance of policy that is sufficiently restrictive to bring inflation down to 2% over time.

- **Overall, we think the Fed started to pave the way for a gradual change of tone in the following meetings in which a definitive pause will be effectively signaled and the debate will shift toward the length of the pause.** Our view is that several conditions and headwinds (e.g., lower disposable income on the resumption of

[1] The second being -once the first is known-, for how long the Fed should hold rates steady.

student loan payments last month, depleted savings, and higher financial costs) are biased so that in the coming weeks and months, economic data will likely concentrate on the side of evidence supporting an easing of real economic activity, allowing the Fed to have confidence that inflation will continue its course towards target in the absence of inflation risks stemming from an overheated economy. We continue to expect no more rate hikes and a rate cut cycle to start next year with a 25bp rate cut in late-2Q24 followed by two more 25bp rate cuts in 2H24.

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