

September's rate cut debate still (rightfully) rages on

By Taylor Schleich

It's rare to have any material uncertainty going into a Fed meeting, at least as it relates to the headline rate decision. However, that's the position we find ourselves in today as investors contemplate whether the Fed will begin its easing cycle with a 25 or 50 basis point rate reduction. Since 2022, OIS markets correctly predicted the outcome of all 21 meetings and as of the day before the decision, have never priced in more than 5 bps of 'uncertainty' (i.e., market-implied rate change was always within 5 bps of actual rate change). Canadian investors are well aware this has not been the BoC experience, especially in 2022.

However, we are *not* less than 24 hours from decision time. Even though the Fed is in blackout and even though there's no material market moving data left to be released (retail sales shouldn't be the deciding factor), we may still get convergence. And there's a chance it still could be towards a 50 bp cut.

Let's go back a couple of years to the Fed's tightening cycle. In June 2022, hikes were starting to ramp up and the Fed was coming off a 50 bp hike, Powell signalling there were more 50s to come. The May 2022 CPI report, released on the Friday before the Fed decision, showed prices accelerating a whopping 1% m/m, well above consensus expectations. Despite this, OIS markets discounted 'just' 56 bps for the

next week's meeting (less than one in four odds of a 75 bp hike). The Bloomberg consensus leaned towards 50 bps too. Then on Monday, major financial media outlets (WSJ, Bloomberg) **reported** that the FOMC was contemplating a 75 bp hike. Market pricing quickly moved towards 75 bps and ultimately, that's what materialized two days later.

Today's situation isn't perfectly analogous but there are obvious similarities. Nick Timiraos' (of the WSJ) **recent article** revived bets on a 50 bp cut, although it wasn't as suggestive as the June 2022 market mover was. For now, we're still tempted to lean towards 25 bps for next week. After all, the Fed had the labour market report in hand before the blackout period and post-jobs Fed speakers didn't seriously push for a larger cut. Inflation data, while taking a backseat now, also lean 25 bps for what it's worth. Ultimately though, the Fed call should remain fluid. While they're constrained by their blackout, off-the-record dialogue with respected journalists can deliver the message and lessen the shock on Wednesday if they did want to go big. So, keep a close eye on your news feeds this weekend. Bigger picture, even if the Fed does start 'small', we expect 50 bp moves to remain front and centre in the policy debate. We believe the Fed will (and should) deliver at least one large cut this year. See our **Fixed Income Monitor** for our fresh rate outlook.

Table: The Fed doesn't like to deliver surprises

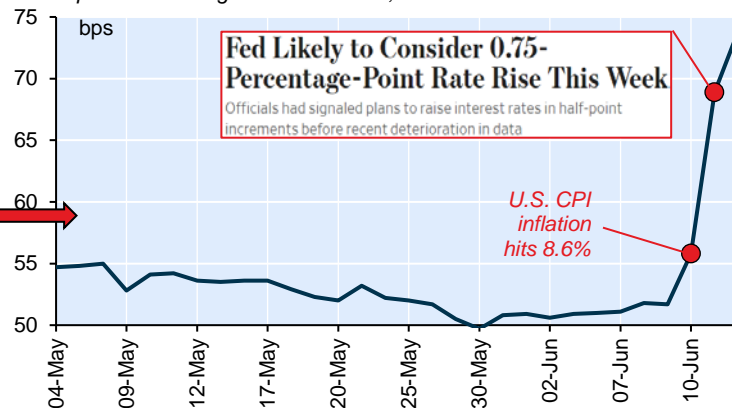
OIS-implied rate change (day before decision) vs. actual change since 2022

Meeting	Implied rate change, bps	Most likely decision	Actual decision	As expected?
26-Jan-22	1	Hold	Hold	Yes
16-Mar-22	28	25 bp hike	25 bp hike	Yes
04-May-22	52	50 bp hike	50 bp hike	Yes
15-Jun-22	74	75 bp hike	75 bp hike	Yes
27-Jul-22	78	75 bp hike	75 bp hike	Yes
21-Sep-22	80	75 bp hike	75 bp hike	Yes
02-Nov-22	75	75 bp hike	75 bp hike	Yes
14-Dec-22	51	50 bp hike	50 bp hike	Yes
01-Feb-23	26	25 bp hike	25 bp hike	Yes
22-Mar-23	21	25 bp hike	25 bp hike	Yes
03-May-23	21	25 bp hike	25 bp hike	Yes
14-Jun-23	2	Hold	Hold	Yes
26-Jul-23	24	25 bp hike	25 bp hike	Yes
20-Sep-23	0	Hold	Hold	Yes
01-Nov-23	0	Hold	Hold	Yes
13-Dec-23	0	Hold	Hold	Yes
31-Jan-24	-1	Hold	Hold	Yes
20-Mar-24	0	Hold	Hold	Yes
01-May-24	0	Hold	Hold	Yes
12-Jun-24	-1	Hold	Hold	Yes
31-Jul-24	-1	Hold	Hold	Yes
18-Sep-24	-34	25 bp cut	?	?

Source: NBC, Bloomberg, FRB | Note: Most likely decision = implied rate change rounded to the nearest 25 bp increment.

Chart 1: The WSJ teed up a 75 bp hike in June 2022

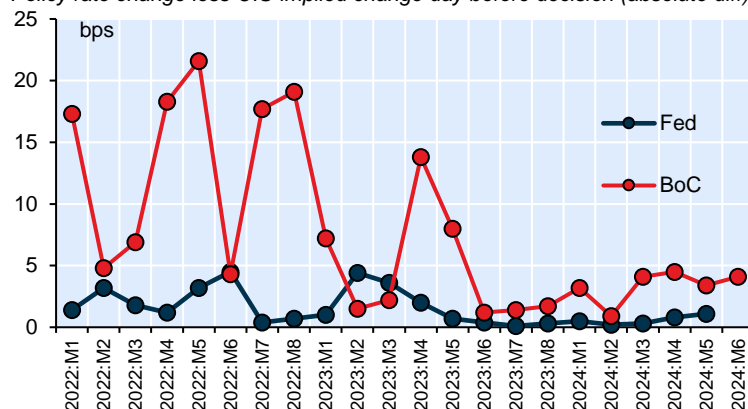
OIS-implied rate change for the June 15, 2022 interest rate decision



Source: NBC, Bloomberg, WSJ

Chart 2: Canadians are used to more decision uncertainty

Policy rate change less OIS-implied change day before decision (absolute diff)



Source: NBC, Bloomberg | Note: M(#) refers to meeting number of the year



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