

Don't doubt the (2024) dots

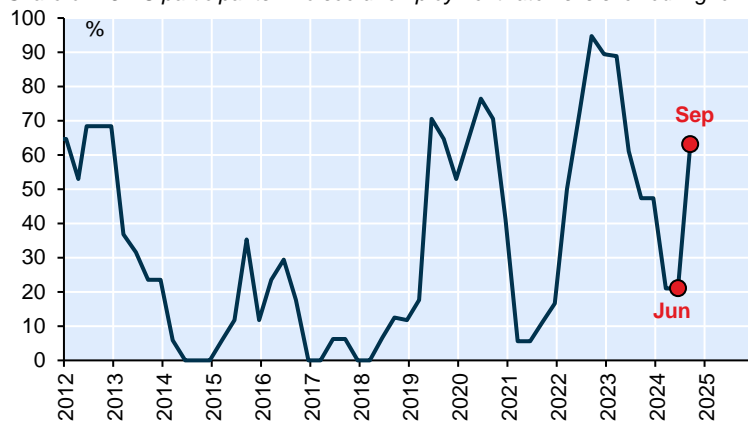
By Taylor Schleich

Despite starting the cycle with a 50 bp rate cut, Chair Powell was anything but alarmist. He stressed that the economy is still solid, the labour market is in good shape and the rationale for starting off with a “strong” move was to keep conditions as such and not out of fear of imminent and acute weakness. Investors therefore shouldn't assume that this will be the pace of the easing cycle going forward, according to Powell. Should we believe him? While it may be appropriate to discount some chance of additional 50s this year given the balance of risks in the labour market, we're inclined to trust the Chair when he says large cuts won't be the norm... at least for the next couple of meetings.

The FOMC isn't naïve. They're aware of labour market risks. They may have downplayed them before (and some may still be to an extent), but the SEP makes clear that more officials are worried about the jobless rate. Moreover, the median forecast entails further softening in the near term. A 0.2%-pt rise in the unemployment rate is an entirely reasonable forecast for the last four reports of 2024 (only three of which will be published before December's decision) and one that's consistent with our own outlook and the broader consensus. Yet even with the marginal increase expected and upside risks identified, all but one participant sees the easing pace slowing down. We wouldn't fight that.

Chart 1: The Fed knows that labour market risks are rising

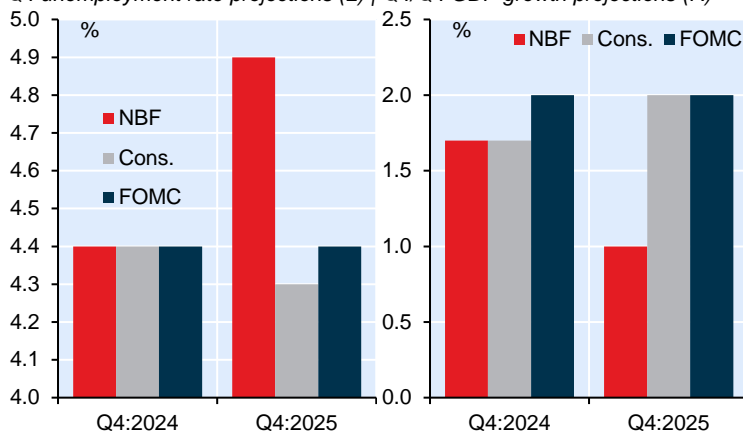
Share of FOMC participants who see unemployment rate risks skewed higher



Source: NBC, FRBx

Chart 3: The Fed (and consensus) is too optimistic

Q4 unemployment rate projections (L) | Q4/Q4 GDP growth projections (R)



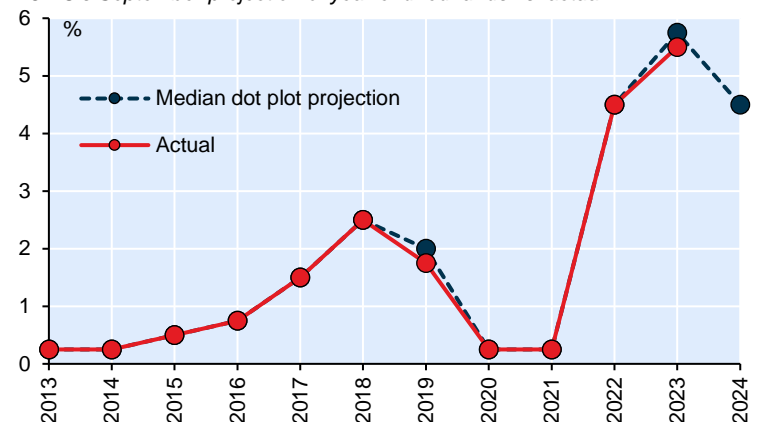
Source: NBC, FRB, Bloomberg

The historical record is also on the Fed's side. Eight of the past ten years, the median projection in the September dot plot came to pass. The only exceptions came last year when a final hike never materialized and in 2019 when repo market turmoil warranted a faster 'mid-cycle adjustment'.

Beyond 2024 however, we largely disregard what the Fed is signalling, and there's evidence to back this indifference up. Comparing the FOMC's year-ahead rate projection from September to where policy ends up doesn't offer a shining endorsement of their forecasting ability. Just twice in the past decade has the collective projection materialized and their median error is 100 bps (their September 2023 projection of 5.25% upper will also prove way off). We won't pretend to hold the economy's crystal ball, but we don't think it's a stretch to say the FOMC's economic outlook is far on the right tail of the distribution. Their expectation for growth to continue at potential and for the job market to quickly stabilize is not consistent with past cycles and we don't think this cycle will be an outlier. So, rather than slowly progress back to a neutral policy stance through 2025 and into 2026, we could see a return to 50 bp moves early next year, neutral potentially being hit by the summer. To express this view, we'd look to sell SFRU4 to buy SFRM5.

Chart 2: It's tough to bet against the Fed on a 3M horizon

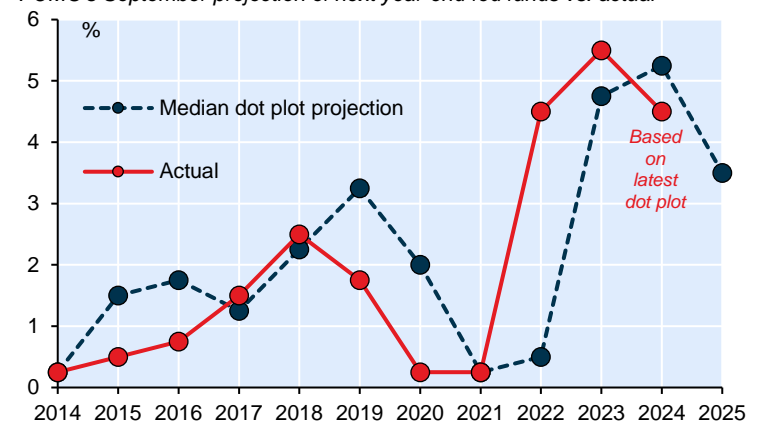
FOMC's September projection of year-end fed funds vs. actual



Source: NBC, FRB | Note: Adjusted to FF upper. E.g., 2013 dot = proj. of Dec-13 from Sep-13

Chart 4: The Fed's rate forecasting ability isn't impressive

FOMC's September projection of next year-end fed funds vs. actual



Source: NBC, FRB | Note: Adjusted to FF upper. E.g., 2014 dot = proj. of Dec-14 from Sep-13



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