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ASSET MANAGEMENT

MARKET COMMENTARY

Fed's confidence in a soft landing grows.

Paolo Zanghieri

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- **In sticking to its expectations of three rate cuts this year, the Fed revised up its growth forecast until 2026. Positive supply side developments, the FOMC believes, have made the economy more resilient to higher rates, allowing the Fed to remain patient on monetary easing.**
- **The FOMC turned more tolerant on inflation, raising its YE forecast by 0.2pp to 2.6% but dismissed concerns about the recent data. The projected policy rate for YE 2025 has been raised by 25 bps, but the 2024 dot still envisages 75bp cuts this year despite more sluggish disinflation . The median expectation for the long-term rate is also up, by 10 bps, consistent with better trend growth and higher debt.**
- **Powell strongly hinted that the Fed will soon slow the pace of Quantitative Tightening, but this does not imply a higher equilibrium value for the stock of asset holds, he added.**
- **We stick to our view of three rate cuts this year, starting from June. Markets cheered the unchanged 2024 dot and overall dovish tone of the meeting, with the S&P closing at a new high and the 2 year rate losing 10bps**

The Fed has got more confident that it can deliver a very soft landing, and that there is no need to compress growth below potential to bring back inflation to target. It raised its Q4 2024 GDP forecast to 2.1%yoy (from 1.4%), some 0.3pp above its trend estimate. Moreover, the balance of risks to growth has moved from negative to slightly positive, while worries about unemployment continued to recede, with the projection still foreseeing only a 0.2pp increase in the unemployment rate. The strengthening in labour supply was cited as a key factor behind the mild inflationary impact of strong labour demand. Yet, the decline in the hiring rate leaves the market exposed to a sudden reversal if layoffs climb from the current very low rate.

Importantly the central projections signalled that it will tolerate stickier than expected inflation. It raised the year end forecast for inflation to 2.6% (from 2.4%), but without changing the median policy rate. Consensus around a 75bps indeed increased: the number of FOMC members indicating three rate cuts this year has increased from six to nine. However, some hawkish bias remains: nine members (out of 19) thinks that less than three cuts are needed.

Inflation risks remain front and centre, even though Powell in the press conference said that the FOMC tends to think that the latest disappointing figures are temporary bumps that prove that disinflation will not be smooth. The Committee remains confident that the strong disinflation in rents will at some point show up in shelter prices, but the timing is very uncertain. Of course, he added that further progress on this front is needed before the Fed is confident enough to start cutting rate. This supports our view that of the first of the three rate cuts for this year will begin in June, which markets have converged to. July remains a possibility, especially if the February PCE data (due on March 29), show a slower than expected disinflation in core, ex-housing services.

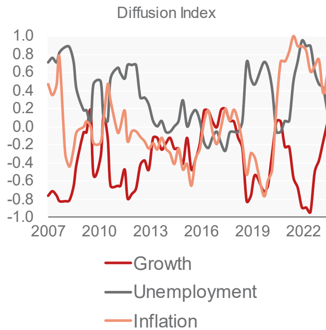
The recent easing in financial conditions is not a concern for the FOMC: they remain in Powell's view tight enough to compress labour demand, and anyway in 2023 inflation went down even though financial conditions fluctuated a lot, so the relationship between the two appears weak.

As usual Powell did not commit to a path for monetary easing and opted not to rule out a rate cut in May, which seems to us very unlikely as one more inflation print would not be enough to ease concerns and demand does not seem in need of help. Longer term, the upward drift in the expectation for the neutral rate, eventually raised its estimate by 10bps, to 2.6%. Powell downplayed the shift, citing the vary large uncertainty surrounding the estimated of the neutral rates, but he signalled that he does not think that the policy rate will not return to the ultra-low level seen after the pandemic.

Finally, a deep discussion on QT within the FOMC has started but has not yet dealt with the duration and composition of the Fed's asset holdings. An announcement of the slowing in the pace of asset runoff is forthcoming, but this does not mean that the process will stop soon. More details should be in the minutes, and we expect an announcement in May (at the latest June) followed by a slowdown of QT, which we expect to end around the turn of the year.

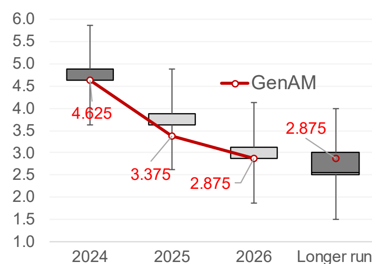
The renewed commitment to cut rates and the optimistic picture of the economy pained by the Fed pushed the S&P to a new high, while the 2-year yield lost around 10 bps.

FOMC projections: Balance of risks
Diffusion Index



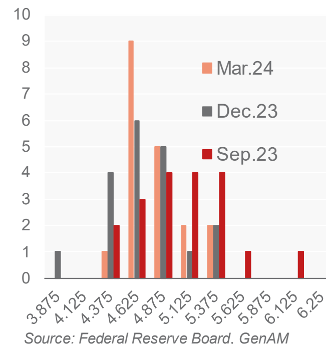
Source:Federal Reserve Board, GIAM

FOMC "dots"
Middle of the range.
Year-end, median, quartiles and extremes of the distribution



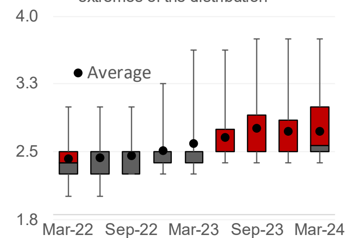
Source: Fed. Reserve Board, Refinitiv, GIAM

Distribution of the YE 2024 dots



Source: Federal Reserve Board, GenAM

Distribution of the longer term rate estimates
Average, Median, quartiles and extremes of the distribution



Source:Federal Reserve Board, GIAM

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