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Forget about March

FOMC Post-Meeting Comment January 2024

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Summary

- As widely expected, the FOMC kept the target range for the federal funds rate unchanged at 5.25-5.50% today. The decision was unanimous.
- The FOMC statement opened the door to rate cuts, but at the same time indicated that March is too early. During the press conference, Powell confirmed this.
- Powell said that the Committee needs greater confidence that inflation is falling back to 2% sustainably and this requires more data.
- We continue to pencil in the first rate cut in June. Once started, we expect the Fed to continue with one cut of 25 bps per quarter.
- With the next FOMC meeting scheduled for March 19-20, we think that an extension of the Bank Term Funding Program would be a more effective measure to alleviate stress in small banks than a rate cut.
- The FOMC is going to have an in depth discussion about the pace of balance sheet reduction at the March meeting.

Introduction

As widely expected, the FOMC kept the target range for the federal funds rate unchanged at 5.25-5.50% today. The decision was unanimous. There was no update of the economic and rate projections. The FOMC statement confirmed our view that rate cuts are coming this year, and that March is too early. Fed Chair Powell said that a March rate cut was not the most likely outcome.

Statement

The FOMC statement opened the door to rate cuts, but at the same indicated that they are not imminent. The door was opened by the removal *of "In determining the extent of <u>any additional policy firming</u> that may be appropriate to return inflation to 2 percent over time, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments."* and the addition of *"In considering <u>any adjustments</u> to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks."* However, the FOMC immediately indicated that rate cuts are not imminent: *"The Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent."* This reduces the probability of a March rate cut, which explains the rise in Treasury yields after the release of the statement.

On the economy, the statement upgraded its assessment of the economic activity to *"has been expanding at a solid pace"* from *"has slowed from its strong pace in the third quarter."* Note that GDP growth was 4.9% in Q3 and 3.3% in Q4, outpacing Q1 (2.2%) and Q2 (2.1%).

Press conference

In his prepared statement, Powell said that inflation is still too high and that the FOMC will need to see continued progress to achieve confidence. He repeated that the Committee is strongly committed to get inflation back to 2%. The policy rate is well into restrictive territory. He said that the policy rate is likely at its peak and that the FOMC is likely to reduce it this year.

During the Q&A, Powell finally pushed back against market expectations of an early rate cut. Echoing the need for greater confidence that inflation is moving sustainably toward 2% in the FOMC statement, Powell said that he did not think it is likely to achieve confidence by March to cut rates. Regarding the PCE projections, Powell said that they might be lower in March based on recent data.

Powell did not want to declare victory on a soft landing and said that the FOMC still expects GDP growth to moderate. However, he said that if they see an unexpected weakening in the labor market they would cut faster. At the same time, if inflation remains sticky, they would cut later. Powell said that the FOMC was in a risk management mode not to cut too fast and not too late.

Regarding the balance sheet, Powell said that they had some discussion, but there will be an in depth discussion at the March meeting. When asked whether he was interested in a possible third term as Fed Chair, Powell said he has no stance on that. Note that his current term ends on May 15, 2026.

Table 1: Median projections of FOMC participants (December 2023)

Variable	*2023*	*2024*	*2025*	*2026*	*Longer run*
GDP growth	2.6 (2.1)	1.4 (1.5)	1.8 (1.8)	1.9 (1.8)	1.8 (1.8)
Unemployment	3.8 (3.8)	4.1 (4.1)	4.1 (4.1)	4.1 (4.0)	4.1 (4.0)
PCE inflation	2.8 (3.3)	2.4 (2.5)	2.1 (2.2)	2.0	2.0 (2.0)
Core PCE inflation	3.2 (3.7)	2.4 (2.6)	2.2 (2.3)	2.0 (2.0)	
Federal funds rate	5.4 (5.6)	4.6 (5.1)	3.6 (3.9)	2.9 (2.9)	2.5 (2.5)

Source: FOMC, December 13, 2023 (September 20, 2023)

Meanwhile in regional banking…

Only a week after the Fed's Board of Governors announced that it would terminate the Bank Term Funding Program (BTFP) on March 11 as scheduled, another regional bank managed to get itself in trouble. New York Community Bancorp decided to raise its loan-loss provision to $552 million, more than 10 times analysts' estimates. The link between small banks and commercial real estate that we have warned about repeatedly was clearly visible here as the bank said it wanted to build up loan-loss reserves to be better in line with its other banks of its size and get ahead of potential weakness in the office and multifamily property sectors. As the bank put it: "Given the impact of recent credit deterioration within the office portfolio, we determined it prudent to increase the allowance for credit losses coverage ratio." We did anticipate a return of The Bank Term Funding Program in our FOMC Preview, but it may come earlier in the form of an extension of the March 11 termination date. With the next FOMC meeting scheduled for March 19-20, we think an extension of the BTFP would be a more effective measure to alleviate stress in small banks than a rate cut.

Conclusion

We continue to pencil in the first rate cut in June. Once started, we expect the Fed to continue with one cut of 25 bps per quarter. In our forecasts this would imply September and December, bringing the total amount to 3 in 2024. The severity of the recession that we still expect to occur due to the lagged effects of the hiking cycle, could force the FOMC to cut more than 75 bps this year. At the same time, threats to supply chains remain an upside risk to inflation and could keep the Fed on hold for even longer than we now expect.

Table 2: Rabobank forecasts of target range for federal funds rate in 2024

FOMC meeting	*Size of rate change (bps)*	*Target range (%)*
Dec 12-13, 2023	0	5.25-5.50
Jan 30-31, 2024	0	5.25-5.50
March 19-20	0	5.25-5.50
April 30-May 1	0	5.25-5.50
June 11-2	-25	5.00-5.25
July 30-31	0	5.00-5.25
September 17-18	-25	4.75-5.00
November 6-7	0	4.75-5.00
December 17-18	-25	4.50-4.75

Source: Rabobank

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