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The Reappearance of the Upper Tail

Comment on FOMC Minutes May 2024

RaboResearch
Global Economics & Markets
mr.rabobank.com

Philip Marey
Senior US Strategist
+31 6 138 929 58

Summary

- The minutes of the FOMC meeting on April 30-May 1 show that various FOMC participants are willing to hike if necessary.
- This stands in sharp contrast to Powell's remarks during the post-meeting press conference, indicating that the Committee was not thinking about hiking.
- Once again this shows that Powell is pushing for rate cuts, while some of his fellow FOMC participants are more hesitant.

Introduction

In the television series *Manifest*, the tailfin of Flight 828 has the habit of disappearing and reappearing. The same now seems to be happening with the upper tail of the Fed's policy rate distribution. Three weeks ago, during the post-meeting press conference, Powell assured us that the FOMC was not thinking about hiking. However, today the minutes of the April 30-May 1 meeting revealed that various participants were willing to hike if needed. This underlines the contrast between Powell's agenda and the discussions in the FOMC.

Disappointed about inflation

On May 1, the FOMC kept the target range for the federal funds rate unchanged at 5.25-5.50%. According to the minutes, participants observed that while inflation had eased over the past year, in recent months there had been a lack of further progress toward the 2% target. This was also mentioned in the formal statement after the meeting. In fact, participants noted that the recent monthly data had showed significant increases in components of both goods and services price inflation. In particular, inflation for core services excluding housing had moved up in the first quarter compared with the fourth quarter of last year, and prices of core goods posted their first three-month increase in several months. In addition, housing services inflation had slowed less than had been anticipated based on the smaller increases in measures of market rents over the past year.

Despite the recent disappointments, participants continued to expect that inflation would return to 2% over the medium term. However, participants generally noted their uncertainty about the persistence of inflation and agreed that recent data had *not increased their confidence* in progress toward 2%. Accordingly, they had suggested that the disinflation process would likely take longer than previously thought. Several participants stated that core nonhousing services price inflation could resume its decline as wage growth slows further with labor demand and supply moving into better balance, aided by higher labor force participation and strong immigration flows.

On hold, cuts, or hikes?

In their discussion on policy rates, participants noted disappointing readings on inflation over the first quarter and indicators pointing to strong economic momentum, and assessed that it would take longer than previously anticipated for them to gain greater confidence that inflation was moving sustainably toward 2 percent. Members agreed that they did not expect that it would be appropriate to reduce the target range until they have gained greater confidence that inflation is moving sustainably toward 2 percent.

The FOMC is not only uncertain about inflation, but also on the restrictiveness of the current policy rate. Although monetary policy was seen as restrictive, many participants commented on their uncertainty about the degree of restrictiveness. These participants saw this uncertainty as coming from the possibility that high interest rates may be having smaller effects than in the past, that longer-run equilibrium interest rates may be higher than previously thought, or that the level of potential output may be lower than estimated.

It came as no surprise that the minutes mentioned that participants discussed maintaining the current restrictive policy stance for longer should inflation not show signs of moving sustainably toward 2 percent or reducing policy restraint in the event of an unexpected weakening in labor market conditions. However, the minutes revealed that various participants mentioned a willingness to tighten policy further should risks to inflation materialize in a way that such an action became appropriate. During his press conference three weeks ago, when asked if a hike was discussed, Powell said that the focus of the FOMC discussion was on remaining on hold rather than raising the policy rate. This shows that Powell was trying to hide this part of the discussion in the FOMC and instead continued to push his own dovish agenda.

Table 1: Median projections of FOMC participants (March 2024)

Variable	*2024*	*2025*	*2026*	*Longer run*
GDP growth	2.1 (1.4)	2.0 (1.8)	2.0 (1.9)	1.8 (1.8)
Unemployment	4.0 (4.1)	4.1 (4.1)	4.0 (4.1)	4.1 (4.1)
PCE inflation	2.4 (2.4)	2.2 (2.1)	2.0	2.0 (2.0)
Core PCE inflation	2.6 (2.4)	2.2 (2.2)	2.0 (2.0)	
Federal funds rate	4.6 (4.6)	3.9 (3.6)	3.1 (2.9)	2.6 (2.5)

Source: FOMC, March 20, 2024 (December 13, 2023)

The pace of balance sheet runoff

On May 1, the FOMC announced a reduction in the pace of balance sheet reduction, starting in June, by reducing the monthly redemption cap on Treasury securities from $60 billion to $25 billion, maintaining the monthly redemption cap on agency debt and agency mortgage-backed securities (MBS) at $35 billion, and reinvesting any principal payments in excess of the $35 billion cap into Treasury securities. According to the minutes almost all participants expressed support for this decision. However, a few participants indicated that they could have supported a continuation of the current pace of balance sheet runoff at this time or a slightly higher redemption cap on Treasury securities than was decided upon.

Conclusion

If we compare the minutes released today and Powell's post-meeting press conference three weeks ago, it becomes very clear once again that Powell is eager to start cutting rates, while some other FOMC participants are more hesitant. During the Q&A Powell said it is unlikely that the next move is a hike. When asked if a hike was discussed, Powell said that the focus of the FOMC discussion was on remaining on hold rather than raising the policy rate. However, the minutes show that there is support in the FOMC for resuming the hiking cycle if necessary. We addressed Powell's personal incentive to cut before Election Day earlier in our FOMC Post-Meeting Comment. It may not be what Powell had in mind, but if the persistence in inflation is not accompanied by an economic slowdown, keeping rates unchanged may not be enough to get inflation toward 2%. The upper tail of the policy rate distribution should not be ignored, even if Powell is trying to obscure it.

Meanwhile, the FOMC is giving the current restrictive rate more time to work through the economy and monetary policy is data-dependent. There are two paths to rate cuts: progress on inflation or an unexpected weakening of the labor market. We don't expect the FOMC to cut rates because of progress on the inflation front. Instead, we think it is more likely that a weaker labor market in the second half of the year is going to do the trick. Our view is that the US economy is heading toward stagflation, from the current situation of persistent inflation and GDP growth slowdown. Anyway, the window of opportunity for rate cuts is narrow. If Trump returns as US President – which is our current baseline scenario based on the opinion polls – we are likely to see a new inflationary impulse from a universal tariff in 2025. This should stop the Fed's cutting cycle in its tracks.

Table 2: Rabobank forecasts of target range for federal funds rate in 2024 and 2025

FOMC meeting	*Size of rate change (bps)*	*Target range (%)*
January 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 11-12	0	5.25-5.50
July 30-31	0	5.25-5.50
September 17-18	-25	5.00-5.25
November 6-7	0	5.00-5.25
December 17-18	-25	4.75-5.00
January 28-29, 2025	0	4.75-5.00
March	-25	4.50-4.75
April-May	0	4.50-4.75
June	-25	4.25-4.50
July	0	4.25-4.50
September	0	4.25-4.50
November	0	4.25-4.50
December	0	4.25-4.50

Source: Rabobank

RaboResearch
Global Economics & Markets
mr.rabobank.com

Global Head

Jan Lambregts
+44 20 7664 9669
Jan.Lambregts@Rabobank.com

Macro Strategy

Global

Michael Every
Senior Macro Strategist
Michael.Every@Rabobank.com

Europe

Elwin de Groot
Head Macro Strategy
Eurozone, ECB
+31 30 712 1322
Elwin.de.Groot@Rabobank.com

Bas van Geffen
Senior Macro Strategist
ECB, Eurozone
+31 30 712 1046
Bas.van.Geffen@Rabobank.com

Stefan Koopman
Senior Macro Strategist
UK, Eurozone
+31 30 712 1328
Stefan.Koopman@Rabobank.com

Erik-Jan van Harn
Macro Strategist
Germany, France
+31 6 300 20 936
Erik-Jan.van.Harn@Rabobank.nl

Maartje Wijffelaars
Senior Economist
Italy, Spain, Portugal, Greece
+31 88 721 8329
Maartje.Wijffelaars@Rabobank.nl

Wim Boonstra
Senior Advisor
+31 30 216 2666
Wim.Boonstra@Rabobank.nl

Americas

Philip Marey
Senior Macro Strategist
United States, Fed
+31 30 712 1437
Philip.Marey@Rabobank.com

Christian Lawrence
Senior Cross-Asset Strategist
Canada, Mexico
+1 212 808 6923
Christian.Lawrence@Rabobank.com

Mauricio Une
Senior Macro Strategist
Brazil, Chile, Peru
+55 11 5503 7347
Mauricio.Une@Rabobank.com

Renan Alves
Macro Strategist
Brazil
+55 11 5503 7288
Renan.Alves@Rabobank.com

Asia, Australia & New Zealand

Teeuwe Mevissen
Senior Macro Strategist
China
+31 30 712 1509
Teeuwe.Mevissen@Rabobank.com

Benjamin Picton
Senior Macro Strategist
Australia, New Zealand
+61 2 8115 3123
Benjamin.Picton@Rabobank.com

FX Strategy

Jane Foley
Head FX Strategy
G10 FX
+44 20 7809 4776
Jane.Foley@Rabobank.com

Rates Strategy

Richard McGuire
Head Rates Strategy
+44 20 7664 9730
Richard.McGuire@Rabobank.com

Lyn Graham-Taylor
Senior Rates Strategist
+44 20 7664 9732
Lyn.Graham-Taylor@Rabobank.com

Credit Strategy & Regulation

Matt Cairns
Head Credit Strategy & Regulation
Covered Bonds, SSAs
+44 20 7664 9502
Matt.Cairns@Rabobank.com

Bas van Zanden
Senior Analyst
Pension funds, Regulation
+31 30 712 1869
Bas.van.Zanden@Rabobank.com

Paul van der Westhuizen
Senior Analyst
Financials
+31 88 721 7374
Paul.van.der.Westhuizen@Rabobank.com

Cas Bonsema
Senior Analyst
ABS, Covered Bonds
+31 6 127 66 642
Cas.Bonsema@Rabobank.com

Agri Commodity Markets

Carlos Mera
Head of ACMR
+44 20 7664 9512
Carlos.Mera@Rabobank.com

Michael Magdovitz
Senior Commodity Analyst
+44 20 7664 9969
Michael.Magdovitz@Rabobank.com

Paul Joules
Commodity Analyst
+44 20 7887 824436
Paul.Joules@Rabobank.com

Energy Markets

Joe DeLaura
Senior Energy Strategist
+1 212 916 7874
Joe.DeLaura@Rabobank.com

Client coverage

Wholesale Corporate Clients

Martijn Sorber	Global Head	+31 30 712 3578	Martijn.Sorber@Rabobank.com
Hans Deusing	Europe	+31 30 216 9045	Hans.Deusing@Rabobank.com
Neil Williamson	North America	+1 212 808 6966	Neil.Williamson@Rabobank.com
Adam Vanderstelt	Australia, New Zealand	+61 2 8115 3102	Adam.Vanderstelt@rabobank.com
Ethan Sheng	Asia	+852 2103 2688	Ethan.Sheng@Rabobank.com
Ricardo Rosa	Brazil	+55 11 5503 7150	Ricardo.Rosa@Rabobank.com

Financial Institutions

Short-term Interest Rates

Marcel de Bever	Global Head	+31 30 216 9740	Marcel.de.Bever@Rabobank.com

Bonds & Interest Rate Derivatives

Henk Rozendaal	Global Head Fixed Income	+31 30 216 9423	Henk.Rozendaal@Rabobank.com

Solutions

Sjoerd van Peer	Global Head	+31 30 216 9072	Sjoerd.van.Peer@Rabobank.com

Relationship Management

Rogier Everwijn	Global Head	+31 30 712 2440	Rogier.Everwijn@Rabobank.com
Rob Eilering	Banks	+31 30 712 2162	Rob.Eilering@Rabobank.com
Petra Schuchard	Insurers		Petra.Schuchard@Rabobank.com
Frank Dekkers	Asset Managers		Frank.Dekkers@Rabobank.com
Javier Alvarez de Eerens	MDB	+31 30 712 1015	Javier.Alvarez@Rabobank.com
Christel Kleinhaarhuis	Fintech		Christel.Klein.Haarhuis@Rabobank.com

Capital Markets

Laura Bijl	Global Head	+31 88 726 3254	Laura.Bijl@Rabobank.com
Christopher Hartofilis	Capital Markets USA	+1 212 808 6890	Christopher.Hartofilis@Rabobank.com
Ian Baggott	Capital Markets Asia	+852 2103 2629	Ian.Baggott@Rabobank.com
Willem Kröner	Global Head ECM	+31 30 712 4783	Willem.Kroner@Rabobank.com
Harman Dhami	DCM Syndicate	+44 20 7664 9738	Harman.Dhami@Rabobank.com
Crispijn Kooijmans	DCM FIs & SSAs	+31 30 216 9028	Crispijn.Kooijmans@Rabobank.com
Bjorn Alink	DCM Securitisation & Covered Bonds	+31 30 216 9393	Bjorn.Alink@Rabobank.com
Othmar ter Waarbeek	DCM Corporate Bonds	+31 30 216 9022	Othmar.ter.Waarbeek@Rabobank.com
Joris Reijnders	DCM Corporate Loans	+31 30 216 9510	Joris.Reijnders@Rabobank.com
Brian Percival	DCM Leveraged Finance	+44 20 7809 3156	Brian.Percival@Rabobank.com

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