FED WATCH: AT THE MIDWAY POINT

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06/12/2024

Once again, the Fed kept rates unchanged at the June FOMC meeting. As a result, the Fed Funds trading range remains in the 5.25%–5.50% band that was introduced in July last year, and still resides at a more than 20-year high-water mark. For those keeping track, this represents the seventh consecutive FOMC meeting where the policy makers decided to take no action on the rate front. For calendar year 2024, we have now hit the midway point in terms of the number of annual FOMC meetings.

Despite economic and inflation data that has challenged prior rate cut expectations, Powell & Co. still seem to agree that a rate cut will more than likely occur sometime later this year. However, what this potential rate cutting episode could eventually look like is still up for debate. This point was underscored by the revision in the Fed's own Federal Funds Rate forecast, known in market parlance as the dot plot.

Four times a year, the policy makers provide their Summary of Economic Projections (SEP), along with their usual FOMC meeting policy statement. Within the SEP lies the aforementioned dot plot, and the June meeting entails an updated forecast. Up until now, the Fed had been projecting three rate cuts for this year, but in their revised outlook, that number has now been reduced to one easing move, a bit less than money and bond market expectations. Based on recent Fed-speak, some reduction was arguably well telegraphed by the policy makers.

With half of the Fed's regularly scheduled FOMC meetings for 2024 now in the books, investors are left trying to ascertain what exactly Powell & Co. will do at the remaining four policy convocations this year. Obviously, the policy makers' data dependence remains on full display, and arguably one could characterize it as heightened at this point. And, if the Fed is in heightened data dependence mode, that means so is the U.S. Treasury (UST) market, elevating the volatility quotient, accordingly.

Presently, monthly inflation reports appear to be the primary driver for Fed policy decision-making, with the labor market data following close behind. As we've seen, both these inputs have not only provided the Fed with no urgency to consider easing monetary policy anytime soon, but they have also played an integral role behind rate cut expectations being scaled back in a visible fashion. As a result, the voting members apparently feel right now they can just sit back and be patient, as the last mile toward their 2% inflation goal has proven to be more challenging than initially envisioned.

In my opinion, renewed consistent progress on inflation is a necessary ingredient to getting the Fed to feel comfortable enough to begin the rate cutting process. In addition, unless the labor market shows signs of falling off the cliff, the course of monetary policy easing could be a choppy one as Powell & Co. await fresh data for their next move. That could mean rate cuts may not come with each subsequent FOMC meeting.

The Bottom Line

At this point, I believe two rate cuts is still a reasonable case scenario for 2024. However, don't be surprised when the UST market begins to entertain the prospects for 2025 monetary policy.

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