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Monetary policy is a tool meant to smooth-out economic cycles, while keeping inflationary pressures in check.(UBS)

Expecting a Fed cut in June, not May

22 February 2024, 8:40 pm EST, written by US Editorial Team

At the UBS Chief Investment Office (CIO), we now think thew Fed will be on hold for a bit longer than we previously expected – we forecast the first 25bps rate cut will be in June, rather than May. Our US Economist Brian Rose stated that "our base case calls for one rate cut per quarter after that until the Fed Funds target range reaches 3.25~3.5%, in line with our estimate of the longer-run neutral rate."

As such, we now foresee total cumulative cuts of 75bps in 2024, in line the most recent FOMC's projections and roughly similar to the market's current pricing. Note that, just a few weeks ago, the market went so far as to price ~170bps of cumulative cuts for this year; the stark repricing is the reason why the US Treasury yields curve on average has increased about 40bps year-to-date.

What have we heard from policymakers?
Following the most recent monetary policy announcement, Fed Chair Jerome Powell stressed that there's no rush to cut, and minutes from the meeting verified that this view is widely shared.

More specifically, Powell said : "we just want some more confidence before we take that very important step of beginning to cut interest rates." As per our analyses, the confidence will not be in place until June.

A reminder on monetary policy
Monetary policy is a tool meant to smooth-out economic cycles, while keeping inflationary pressures in check. When the economy faces growth problems, looser financial conditions are generally warranted. In turn, when activity is strong and risks on upward price pressures mount, monetary tightening is the prescribed policy.

Factors that drive the Fed's current cautiousness

1. The upside surprise in January's CPI figures. The data may have noisiness due to seasonal factors, but the fact of the matter is that it dampened the expectations of a swift and clean disinflation process.
2. Non-farm payrolls data showed that 353,000 jobs were created in January. The figure surpassed even the most optimistic expectations. Moreover, there were upward data revisions to previous months, proving that the labor market has been even hotter than we initially thought.
3. Additionally, real GDP figures for 4Q23 came in also much stronger than expected, after an already whopping performance in 3Q23. All the while, GDP nowcasts for 1Q24 show that economic activity continues resilient and above trend.

In the current context of a strong economy and still present upside risks to inflation, the Fed has the room to wait before loosening financial conditions. There's no urgency. Sometimes, the best thing you can do is to have a little patience.

How to position yourself?
On the back of our updated Fed call, we revised up by 25bps our short-term 10-year Treasury range to 4%– 4.5%, while maintaining our expectations of a 3.5% level by year-end. Seeing the market push toward a 10Y yield of 4.5% wouldn't surprise us, particularly since February is historically a seasonally bearish month. Hence, we continue to recommend locking in high yields, as we think rates will trend lower in the second half of the year.

Main contributor: Alberto Rojas

For more, see the recent report, **Strong data may delay rate cuts**.

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