FMG QuickTake: July 2024 US Rate Policy Decision

August 1st, 2024

Summary:

- The Federal Reserve kept rates unchanged at 5.25% - 5.50%
- The accompanying statement delivered more balanced overtones
- Opening the door for the potential to cut rates soon
- Then Chair Powell spoke
- And delivered all that the market wanted to hear..........

Important Takeaways -

- **Where will rates go from here?**
  Down
- **Will the Federal Reserve cut in September?**
  The market is 120% priced in. So they'd better
  So what could the rest of 2024 look like for cuts?
  The market thinks 3 cuts in 2024. That doesn't sit with the Dot Plot projections that we saw 6 weeks ago - but the market thinks the Fed has overcooked this pie and will pivot once again

Observations -

The statement was not that much changed from the June 12th version, but did offer up the following encouragement for those that believe that rates need to be/can be lowered

- "*Inflation continues to move towards better balance*"
- "***The committee is* (now) *attentive to the risks of its dual mandate"*** (inflation and full employment)

Chair Powell then held the usual press conference and inked the deal for a September cut and more (in the eyes of the market)

- He did try to provide some context on where the broad balance of opinion on September sits when he said that no decision had been made and that the data in the time between now and September 18th is crucial. However, he revealed his particular opinion when he said:
- Speaking of the need for inflation to keep cooling, he said *"If that test is met,* ***a reduction in our policy rate could be on the table as soon as the next meeting in September"***
- ***"I don't think of the labor market in its current state as a likely source of significant inflationary pressures. So I would not like to see material further cooling in the labor market"***

Conclusions -

The Fed is a large and complex body. Everything is done with due process and preferably all decisions are unanimous. The statement following the decision is always forensically curated to achieve that broad consensus. At the June meeting, half the members of the FOMC decision making board removed a cut from 2024 in their projections - lowering their opinion to a mere single. And so producing a dovish statement no was always a tall ask. However;

- TGo essentially say that they are looking at growth and employment with equal diligence as inflation is an admission that they are *way* more comfortable with the latter at this point.
- The market knew this and Powell confirmed that understanding with his comments on the labour market. If it is no longer considered a source of inflationary pressures - and the unemployment rate is creeping higher (like Canada, immigration is putting strain on the economy to create more jobs) - then there can only be one conclusion;
- ***Absent another inflation shock - The Fed are about to start cutting rates***

Essentially, what the Fed has delivered is a more complicated and nuanced version of the Bank of Canada's (BoC) messaging of the past 2 months. The level of restriction in policy is now inappropriate and can be reduced. The BoC has moved to further dovishness -but it is unclear that the Fedd will, or indeed needs to do that in September. Given the broad spectrum of opinions on the FOMC, a cut and guidance towards some further rebalancing of policy to be less restrictive feels like all that are capable of delivering.

Market Reaction -

Rates are lower across every tenor. The curve has barely changed - all tenors are aggressively lower.

- 2 year yields down 20 bps
- 5 year yields down 20 bps
- 10 year yields down 18 bps

What Next? -

Data . As much as the market wants to believe in the brave new world where rates can be cut steadily from here, there are many members of the Fed board that will not support a September cut if **inflation** does not print in their comfort zone before the next meeting. We will **also need to pay attention to employment reports now** (and we have 2 of those before the next meeting) - since Powell has highlighted that weakness will be seen as more of a bug in the economy than a feature on reducing inflation from here.

The bond market will be hard to keep down following yesterday's events. Only a bout of disappointment via irrefutably strong data or a plethora of Fed members dialing back Powell's dovish overtones will stop the trend lower in yields. **There is an awful lot priced in now** - 4 straight cuts between now and January and the low for policy in the curve is now 3.255 by 2026 (ie 200 bps of cuts and a policy that reflects 2.5% steady inflation) - but the market is more than capable of continuing this party for a while yet.

US Treasury Bond Yield Summary							8/1/2024
		Last	1w chg (bps)	YTD chg (bps)	3m High	3m Low	% Rank of Current Yld to 3m Range
UST Bond Yields	2y	4.204	-22.70	-67.30	4.976	4.204	0%
	5y	3.868	-26.28	-36.90	4.633	3.868	0%
	10y	3.999	-24.18	-7.86	4.612	3.999	0%
	30y	4.296	-18.76	12.07	4.733	4.296	0%
Curves	2s10s	-20.48	-148.00	59.44	-14.69	-49.48	95%
	5s30s	42.75	752.00	48.97	42.75	4.23	100%

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