

iFlow

SHORT THOUGHTS

JOHN VELIS
FX AND MACRO STRATEGIST FOR THE AMERICAS



July 25, 2023

July Hike Should End This Fed Rate Cycle

One Last Move

We expect a 25bp rate hike Wednesday from the Federal Open Market Committee (FOMC), a view shared by most market participants. We don't expect much more news or market-moving information from what we think will be a rather straightforward meeting. The irony is that this meeting will likely wind up being noteworthy in that we think – despite anticipating a fairly hawkish Chair Powell – there will be no subsequent hikes in the current cycle. The Fed, however, may not believe it's done just yet. Indeed, in keeping with officials' median expectation for a 5.6% federal-funds rate at the end of 2023, the Committee may judge that skipping in September but hiking in November would fulfill its projection.

Chair Powell has spoken recently about “speed, level, and time” as the three facets of the policy path going forward. The *speed* has certainly slowed, with rate moves going from 50bp at a clip to 25bp per clip, to skipping in June and likely hiking in July. If the same speed is to be maintained, then November would be – in the Fed's mind – the likely last hike. However, we don't think conditions then will warrant any more hikes. That means the *level* of the upper limit of the policy rate will likely settle at 5.5%. The amount of *time* it stays there is an open question. We don't expect rate cuts until well into 2024, probably no sooner than Q2.

Market pricing has +25bp Wednesday nearly nailed on – a 97% chance priced into the federal-funds futures market as of this writing. As for subsequent hikes, pricing for Sept.

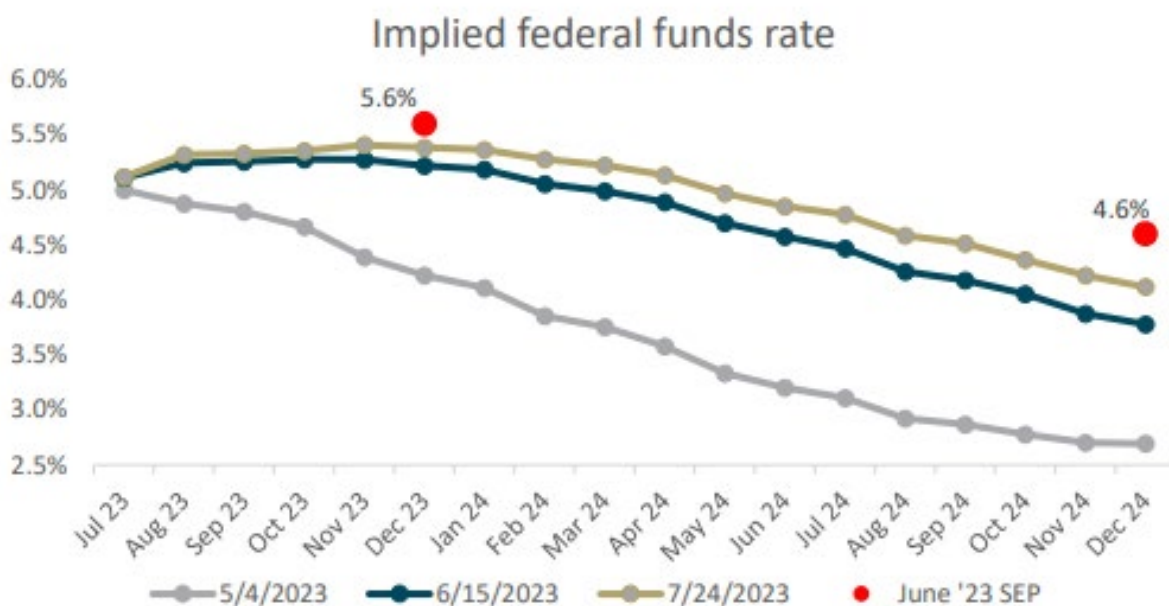
20 only implies a 17% chance and for Nov. 1 a 25% probability. This last fact could reflect the possibility of an “every other” cadence after July, but we note that when combined, September and November pricing only anticipates a 40% chance of a hike occurring at either meeting. The market is skeptical of that second additional hike, as are we.

We disagree with the market regarding 2024 policy and the timing and quantity of rate cuts after the peak is reached. Market-implied rates see cuts as soon as this December (see chart below) while – as stated above – we think it will be much later than that.

Furthermore, even though the market has moved its rates expectations through the end of next year a tad higher, it anticipates nearly 150bp in cuts over that time horizon. This is 50bp lower than where the Fed’s June Summary of Economic Projections has end-2024 rates (4.6%).

While the Fed may currently foresee two more hikes this year, we think it’ll be done Wednesday. We also see the Kansas City Fed’s annual Jackson Hole Economic Symposium at the end of August offering Powell a chance to redirect market expectations and hint that the end of the cycle was indeed reached on July 26.

Fed Pricing About Right For 2023, Too Dovish for 2024



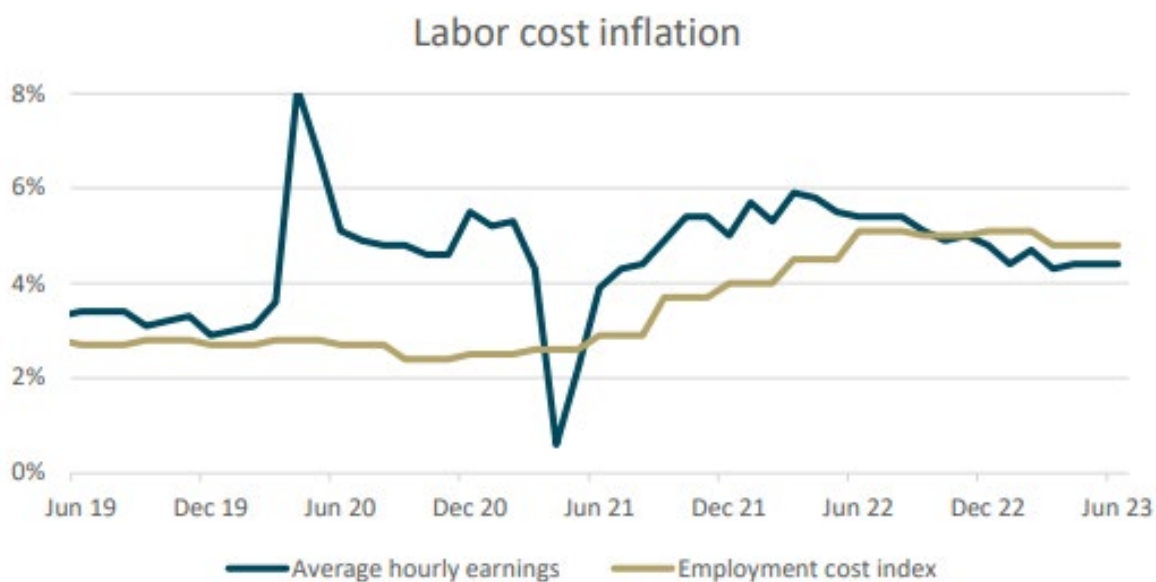
Source: BNY Mellon Markets, Bloomberg, Federal Reserve Board of Governors

Still Skeptical On Inflation

While last month’s CPI print was encouraging in that it suggested a significant

deceleration in inflation, we don't think this will be sufficient for Chair Powell to be especially sanguine on the inflation outlook. Other measures of inflation are still elevated. For example, wages in the form of average hourly earnings – which we wrote about a few weeks ago (see [here](#)) – are still well above 4% y/y, far above the approximate 3% that the Fed reckons is consistent with 2% core PCE inflation. Furthermore, the PCE price index is not behaving as favorably as CPI, and we remind readers that the Fed's inflation target refers to the former measure, not the latter. Somewhat uncooperatively for the Fed and the markets, both the employment cost index for Q2 (a quarterly comprehensive measure of labor costs) and PCE inflation for June will be released this Friday, two days after the meeting.

Labor Costs Need To Fall



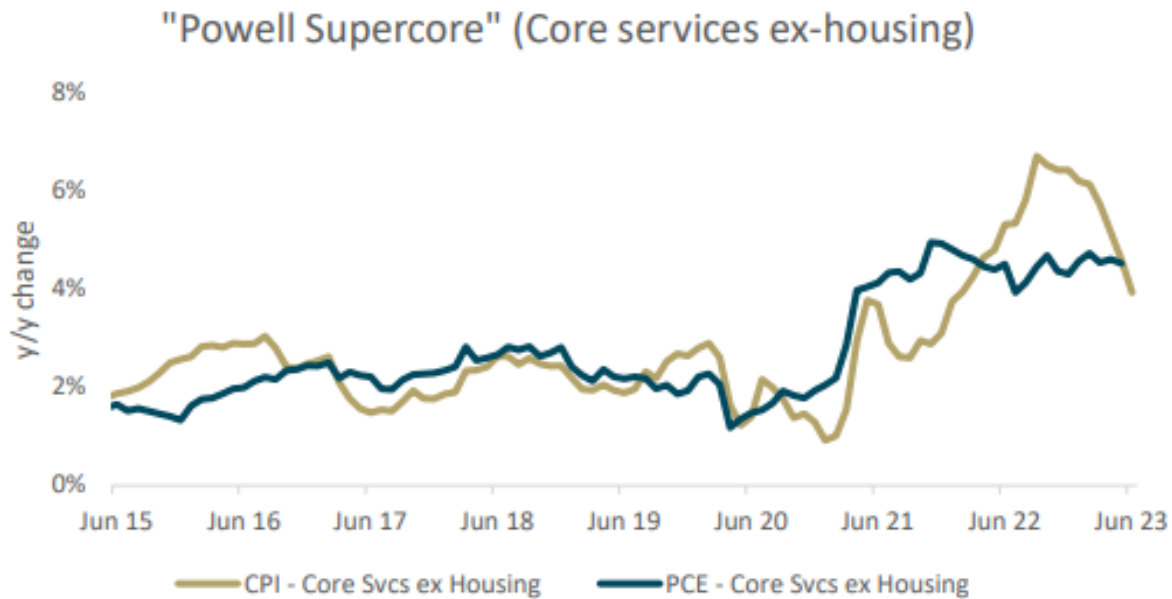
Source: BNY Mellon Markets, Bureau of Labor Statistics

In PCE terms, core inflation in May was running at 4.6% annually. Market consensus for June is a big drop in that yearly rate to 4.2%. If accurate, that would be the biggest monthly deceleration in core PCE since the pandemic. Yet, it would still be well above the 2% that is the Fed's goal, a goal the June SEP doesn't see reached until sometime in 2025.

Expect Chair Powell to point out that the annual rate of PCE inflation for core services ex rent, a concept that is increasingly referred to as the "Powell supercore", has been averaging around 4.5% for over a year – and has not shown signs of relenting (see chart

below). Powell cites this measure as being a good indicator of underlying price pressures in the services sector, and it's one that will be scrutinized when released on Friday. Furthermore, housing costs, which had stabilized in recent months, look set to inch up again, thanks to paltry supply in the market. The impact (and timing of such) this will have on the overall core PCE is still to be seen, but we still expect a general drop in inflation over the next few months to remain slow – slow enough to prevent quick rate cuts.

Supercore: PCE vs CPI Measures



Source: BNY Mellon Markets, Bureau of Labor Statistics, Bureau of Economic Analysis

Please direct questions or comments to: iFlow@BNYMellon.com



John Velis
FX AND MACRO STRATEGIST FOR THE AMERICAS

CONTACT JOHN



bnymellon.com

BNY Mellon is the corporate brand of The Bank of New York Mellon Corporation and may be used as a generic term to reference the corporation as a whole and/or its various subsidiaries generally. This material and any products and services may be issued or provided under various brand names in various countries by duly authorized and regulated subsidiaries, affiliates, and joint ventures of BNY Mellon, which may include any of the following. The Bank of New York Mellon, at 225 Liberty St, NY, NY USA, 10286, a banking corporation organized pursuant to the laws of the State of New York, and operating in England through its branch at One Canada Square, London E14 5AL, UK, registered in England and Wales with numbers FC005522 and BR000818. The Bank of New York Mellon is supervised and regulated by the New York State Department of Financial Services and the US Federal Reserve and authorized by the Prudential Regulation Authority. The Bank of New York Mellon, London Branch is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. The Bank of New York Mellon SA/NV, a Belgian public limited liability company, with company number 0806.743.159, whose registered office is at 46 Rue Montoyerstraat, B-1000 Brussels, Belgium, authorized and regulated as a significant credit institution by the European Central Bank (ECB), under the prudential supervision of the National Bank of Belgium (NBB) and under the supervision of the Belgian Financial Services and Markets Authority (FSMA) for conduct of business rules, and a subsidiary of The Bank of New York Mellon. The Bank of New York Mellon SA/NV operates in England through its branch at 160 Queen Victoria Street, London EC4V 4LA, UK, registered in England and Wales with numbers FC029379 and BR014361. The Bank of New York Mellon SA/NV (London Branch) is authorized by the ECB and subject to limited regulation by the Financial Conduct Authority and the Prudential Regulation Authority. Details about the extent of our regulation by the Financial Conduct Authority and Prudential Regulation Authority are available from us on request. The Bank of New York Mellon SA/NV operating in Ireland through its branch at 4th Floor Hanover Building, Windmill Lane, Dublin 2, Ireland trading as The Bank of New York Mellon SA/NV, Dublin Branch, is authorised by the ECB and is registered with the Companies Registration Office in Ireland No. 907126 & with VAT No. IE 9578054E. The Bank of New York Mellon, Singapore Branch, subject to regulation by the Monetary Authority of Singapore. The Bank of New York Mellon, Hong Kong Branch, subject to regulation by the Hong Kong Monetary Authority and the Securities & Futures Commission of Hong Kong. If this material is distributed in Japan, it is distributed by The Bank of New York Mellon Securities Company Japan Ltd, as intermediary for The Bank of New York Mellon. If this material is distributed in, or from, the Dubai International Financial Centre ("DIFC"), it is communicated by The Bank of New York Mellon, DIFC Branch, regulated by the DFSA and located at DIFC, The Exchange Building 5 North, Level 6, Room 601, P.O. Box 506723, Dubai, UAE, on behalf of The Bank of New York Mellon, which is a wholly-owned subsidiary of The Bank of New York Mellon Corporation. This material is intended for Professional Clients only and no other person should act upon it. Not all products and services are offered in all countries.

The information contained in this material is intended for use by wholesale/professional clients or the equivalent only and is not intended for use by retail clients. If distributed in the UK, this material is a financial promotion.

This material, which may be considered advertising, is for general information purposes only and is not intended to provide legal, tax, accounting, investment, financial or other professional advice on any matter. This material does not constitute a recommendation by BNY Mellon of any kind. Use of our products and services is subject to various regulations and regulatory oversight. You should discuss this material with appropriate advisors in the context of your circumstances before acting in any manner on this material or agreeing to use any of the referenced products or services and make your own independent assessment (based on such advice) as to whether the referenced products or services are appropriate or suitable for you. This material may not be comprehensive or up to date and there is no undertaking as to the accuracy, timeliness, completeness or fitness for a particular purpose of information given. BNY Mellon will not be responsible for updating any information contained within this material and opinions and information contained herein are subject to change without notice. BNY Mellon assumes no direct or consequential liability for any errors in or reliance upon this material.

This material may not be distributed or used for the purpose of providing any referenced products or services or making any offers or solicitations in any jurisdiction or in any circumstances in which such products, services, offers or solicitations are unlawful or not authorized, or where there would be, by virtue of such distribution, new or additional registration requirements.

The terms of any products or services provided by BNY Mellon to a client, including without limitation any administrative, valuation, trade execution or other services shall be solely determined by the definitive agreement relating to such products or services. Any products or services provided by BNY Mellon shall not be deemed to have been provided as fiduciary or adviser except as expressly provided in such definitive agreement. BNY Mellon may enter into a foreign exchange transaction, derivative transaction or collateral arrangement as a counterparty to a client, and its rights as counterparty or secured party under the applicable transactional agreement or collateral arrangement shall take precedence over any obligation it may have as fiduciary or adviser or as service provider under any other agreement.

Pursuant to Title VII of The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and the applicable rules thereunder, The Bank of New York Mellon is provisionally registered as a swap dealer with the Commodity Futures Trading Commission ("CFTC") and is a swap dealer member of the National Futures Association (NFA ID 0420990).

BNY Mellon (including its broker-dealer affiliates) may have long or short positions in any currency, derivative or instrument discussed herein. BNY Mellon has included data in this material from information generally available to the public from sources believed to be reliable. Any price or other data used for illustrative purposes may not reflect actual current conditions. No representations or warranties are made, and BNY Mellon assumes no liability, as to the suitability of any products and services described herein for any particular purpose or the accuracy or completeness of any information or data contained in this material. Price and other data are subject to change at any time without notice.

Rates: neither BNY Mellon nor any other third party provider shall be liable for any errors in or delays in providing or making available the data (including rates, WM/Reuters Intra-Day Spot Rates and WM/Reuters Intra-Day Forward Rates) contained within this service or for any actions taken in reliance on the same, except to the extent that the same is directly caused by its or its employees' negligence. The WM/Reuters Intra-Day Spot Rates and WM/Reuters Intra-Day Forward Rates are provided by The World Markets Company plc ("WM") in conjunction with Reuters. WM shall not be liable for any errors in or delays in providing or making available the data contained within this service or for any actions taken in reliance on the same, except to the extent that the same is directly caused by its or its employees' negligence.

The products and services described herein may contain or include certain "forecast" statements that may reflect possible future events based on current expectations. Forecast statements are neither historical facts nor assurances of future performance. Forecast statements typically include, and are not limited to, words such as "anticipate", "believe", "estimate", "expect", "future", "intend", "likely", "may", "plan", "project", "should", "will", or other similar terminology and should NOT be relied upon as accurate indications of future performance or events. Because forecast statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict. iFlow® is a registered trademark of The Bank of New York Mellon Corporation under the laws of the United States of America and other countries.

This document is intended for private circulation. Persons accessing, or reading, this material are required to inform themselves about and to observe any restrictions that apply to the distribution of this information in their jurisdiction.

Currency Administration is provided under and subject to the terms of a definitive agreement between BNY Mellon and the client. BNY Mellon exercises no investment discretion thereunder, but acts solely pursuant to the instructions in such agreement or otherwise provided by the client. Unless provided by definitive agreement, BNY Mellon is not an agent or fiduciary thereunder, and acts solely as principal in connection with related foreign exchange transactions.

All references to dollars are in US dollars unless specified otherwise.

This material may not be reproduced or disseminated in any form without the prior written permission of BNY Mellon. Trademarks, logos and other intellectual property marks belong to their respective owners.

The Bank of New York Mellon, member FDIC.

© 2020 The Bank of New York Mellon Corporation. All rights reserved.