BNY MELLON
iFlow
SHORT THOUGHTS

February 6, 2024

First Fed Rate Cut Now Expected May 1

Focus on what Fed will do, not on what it should or could do

- We move our expectation for initial Fed rate cut from March 20 to May 1
- We don't see strong growth data a problem for Fed, just not enough inflation data yet
- Foreigners sell out of US Treasuries between December and January

March Into May

In light of the very impressive US jobs data reported last week, along with additional statements from Federal Reserve Chairman Powell, we are dropping our call for a March rate cut, and instead now expect the first reduction in the policy rate to come at the conclusion of the April 30-May 1 FOMC meeting, some six weeks (and one meeting cycle) later than we previously expected. While we still think it would be appropriate for the Fed to cut rates in March, the exceptionally strong January jobs data and Powell's statements – both at the FOMC press conference as well as Sunday night on a widely watched television interview – that a move in March is "not likely" have swayed us to change our call.

We continue to believe that inflation – especially the Fed's preferred core PCE measure – will behave well and keep decelerating, providing the Fed with, as its January meeting statement says, "greater certainty that inflation is moving sustainably towards 2 percent." For us, it's simply a matter of needing additional data to confirm what we have seen so far. Annual core PCE inflation has fallen for 11 straight months, and in 14 of 15 months. This, plus what we expect to be another encouraging PCE print at the end of February (for the January reference month), to our mind should be enough for a rate cut in March. However, the Fed has apparently decided it needs more than that to be comfortable with easing policy.

Last week, after the FOMC meeting and press conference, we defended our March cut view on the grounds that the data were already providing – and would continue to – sufficient evidence that inflation was going in the right direction, toward target. However, Friday's jobs

data probably were surprising enough to give the Fed pause. Recall, we're trying to pin down what the Fed WILL do (and when), rather than what it should and could do.

Considering the hot jobs data and a number of strong prints in other data series relating to the real economy and demand, we acknowledge that it's running strong so far in 2024. However, we believe that these stronger data shouldn't, by themselves, make the Fed more hawkish than it otherwise would have been. As Powell himself responded during his presser on Jan. 31 when asked about the impact of strong economic data, he dismissed this as not particularly relevant to inflation progress, and by implication the policy path.

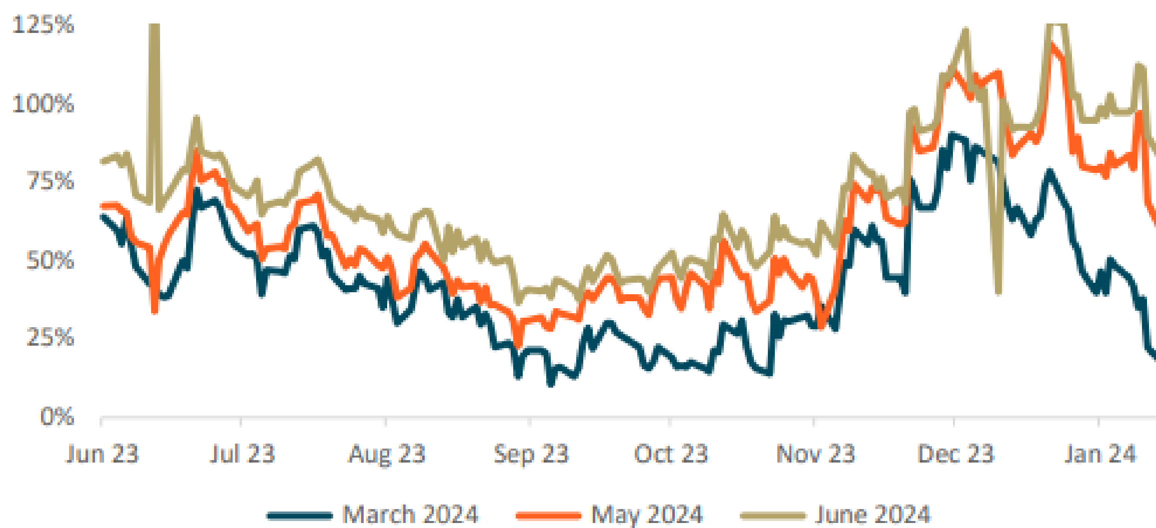
To quote (emphasis ours): "...***if you take a step back, we've had strong growth, very strong growth last year, going right into the fourth quarter. And yet, we've had a very strong labor market, and we've had inflation coming down****. So I think, whereas a year ago, we were thinking that we needed to see some softening in economic activity, that hasn't been the case. So, I think we look at stronger growth.* ***We don't look at it as a problem. I think, at this point, we want to see strong growth. We want to see a strong labor market. We're not looking for a weaker labor market****.*"

So, while we concede that a March cut is highly unlikely at this point, we don't think that hotter data, if accompanied by further cooling inflation, would make the Fed more hawkish. In September 2022, core PCE peaked at over 5.5%. Even though the economy has grown impressively since and labor markets remain quite robust, core PCE fell to 2.9% last December. Stronger growth by itself does not mean inflation progress will be reversed. This is a change from the Fed's view from a year ago, which presumed the need for the economy to slow to below-trend growth as the price to pay for the required disinflation.

Markets have been quick to price out a March cut. Federal-funds futures at this writing imply just a 16.5% chance of a rate move then – down from 76% in mid-January (see chart). A May cut currently enjoys market-implied odds of 59%, and we think that will move around during the next several weeks. We do expect inflation data to come in lower and lower – presumably enough disinflation to see a change in Fed rhetoric well before the May meeting.

Note that during the recent tightening cycle, the Fed repeatedly stated that it would not wait until core PCE actually reaches 2% to begin easing policy, a sentiment Powell reiterated in Sunday night's media appearance: "*I've said that we wouldn't wait to get to 2% to cut rates*". By our simple calculations, if we assume 0.15% per month inflation in core PCE, then by June inflation will be below 2%. It would be a massive volte face for the Fed to wait until then. Instead, May 1 should arrive with sufficient data having been published to allow the first of what we think will be four cuts by the end of the year.

Pricing Out March, Focusing On May



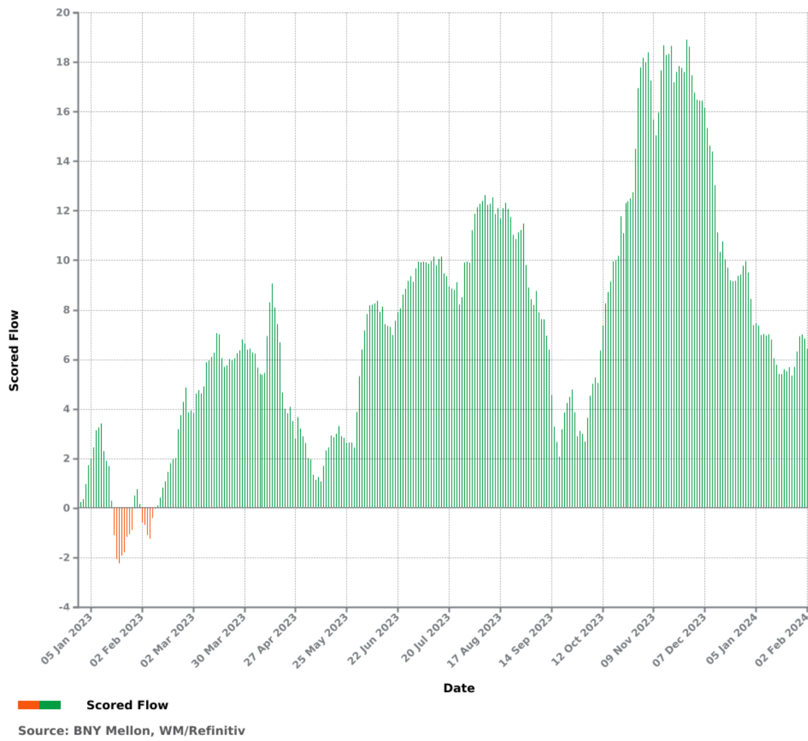
Source: BNY Mellon Markets, Bloomberg

Cross-Border Bond Selling

Shifting gears, this week we take an updated look at overseas flows and US sovereign debt. iFlow allows us to examine these cross-border flows on a daily basis. As the chart below shows, since early December we've observed significant shedding of Treasuries across the curve, only stabilizing recently. We don't have a full accounting of why this happened, but we have been worried about significant Treasury issuance not being able to meet sufficient demand at current prices. The potential absence of – and indeed, the selling by – foreign investors is one element driving our broader concern.

Offsetting that worry, however, we do observe ongoing demand from domestic real money accounts. This has assuaged some of our fears of a buyers' strike. But on the margin, a retreat from the market by overseas investors could push yields higher.

Sell In December & January



FI

SUBCLASS
SOVEREIGN BONDS

Scored Flow

INVESTOR BASE	DATE TAG
CROSS BORDER	TOTAL

United States	Cumulative Sum
DATE RANGE: 12.30.2022 —	02.02.2024
MEAN	+7.32
STANDARD DEVIATION	+4.90

Source: BNY Mellon Markets, iFlow

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

John Velis
AMERICAS MACRO STRATEGIST

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.