BNY MELLON
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SHORT THOUGHTS

**March 19, 2024**

# FOMC Preview - March Toward Cuts?

- No rate move Wednesday, dots to reflect stronger growth and inflation
- Median dot for end-2024 federal-funds rate could be nudged higher
- Quantitative tightening will be discussed at meeting, but nothing announced

## Dots To Signal Stronger Economy, Higher Inflation – And Rates?

We expect no action Wednesday from the Federal Reserve's Open Market Committee, but that doesn't mean there won't be plenty to digest, including a new set of dots with the March Summary of Economic Projections (SEP). The Committee will discuss the future of quantitative tightening behind closed doors. At his post-meeting press conference, Chair Powell is likely to field questions about the new SEP, the outlooks for inflation and the economy, the soundness of the banking system, and the future policy path.

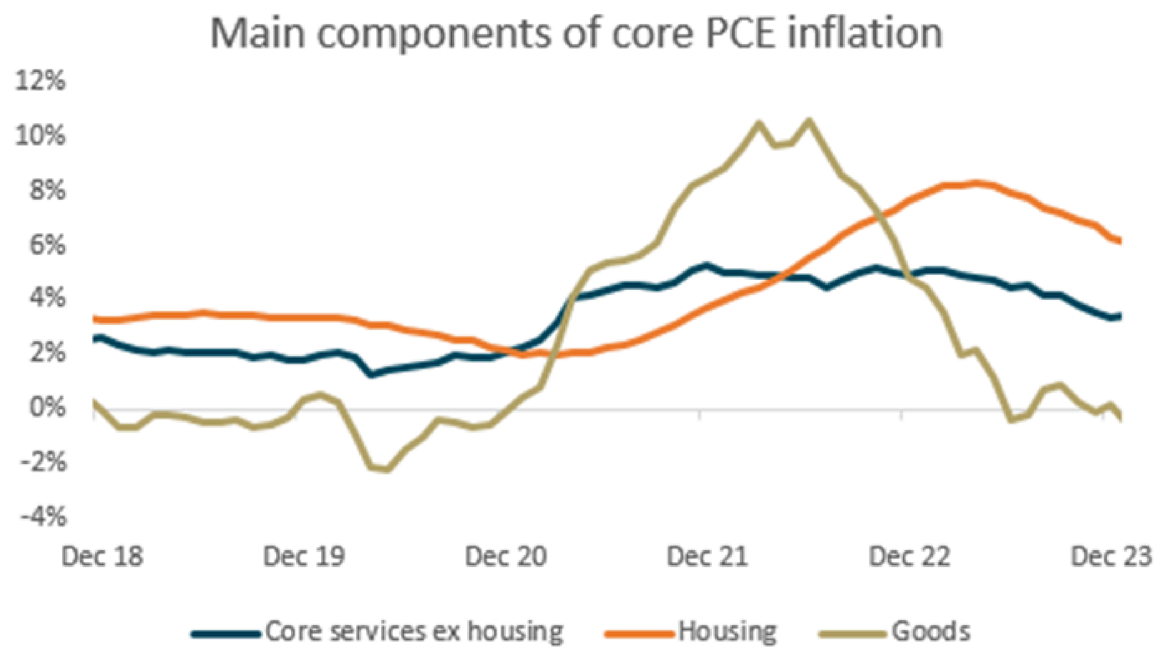
While we began 2024 with a view that the Fed would begin lowering policy rates at this meeting, January inflation data, released in February, has moved our expectation in favor of a June start. Furthermore, February data so far indicate that while cooler than in January, the almost straight-line progress of decelerating price increases observed in the second half of last year has attenuated. The most important piece of inflation data, core PCE, will not be available before the rate decision at this meeting, however. We feel more comfortable about slow and steady progress resuming in core PCE, but expect the Fed to continue to argue for greater confidence that this measure is cooling before launching the rate-cut cycle.

The median dot for the end-2024 federal-funds rate in the December SEP, at 4.6%, foresaw three 25bp rate cuts this year. Will that dot be nudged higher, indicating more FOMC members and participants now see fewer cuts? We still think three cuts will be appropriate this year, with the upper band of the funds rate down to 4.75% at year-end. This time, however, officials might be inclined to be more hawkish than that. Furthermore, we think the dots for end-2024 GDP growth (1.4% in December) and core PCE inflation (2.4%) could also be increased slightly. We note that even with end-2024 core PCE expected to be above the

2% target, Fed officials in December saw three rate cuts. This underscores the Fed's (particularly Chair Powell's) expressed preference not to wait until inflation hits target before initiating rate cuts. The question, then, is if the 2024 inflation view via the dots is bumped up, does that mean rate cuts will be slower and/or later. This will be key to interpreting the relative hawkishness or dovishness of this meeting and the accompanying SEP.

Our view is that the economy is slowing towards its trend rate of growth – around 2%. We also think the labor market is slowing, or as the Fed would put it, "coming back into better balance between supply and demand." Thus, the true target is inflation, specifically core PCE. For our June rate-cut view to be validated, we need to see progress on this variable. There are three elements in core PCE: goods, services ex housing, and housing. As the chart below shows, goods inflation has petered out to around 0% y/y. Housing remains quite elevated but is following rental prices on the street lower, albeit with a lag. The real sticking point is core services ex-housing. There's been some progress on this sub-aggregate but we need to see more. We expect Chair Powell to reiterate this message.

**Three Components Of Core PCE Slowing – But Is It Enough**




Source: BNY Mellon Markets, Bureau of Economic Analysis

The minutes of the January 30-31 FOMC meeting indicated that the Fed would commence a detailed discussion about potentially slowing the pace of balance-sheet shrinkage. We don't expect that to lead to any announcement at this meeting, but instead likely at the April 30-May 1 meeting, with any changes to begin in June. We have been of the view that if the Fed wants quantitative tightening to run longer, it needs to go slower. Once the excess liquidity parked at the Fed's reverse repo facility (RRP) drains completely, or close to it, reserves will come under pressure to fall as well, and we could see strains in funding and repo markets. Thus, slowing the pace of QT will be one mechanism to help forestall that from happening. Even though there will be no announcement this time, we also expect questions about this at the press conference. Powell isn't likely to give too much away, however.

We think the market is probably ready for a change in the dots in the manner which we describe above – higher expectations for growth and inflation, and potentially fewer cuts by the end of the year, perhaps something closer to just two and a half, with the median policy rate closer to 4.8%. Thus, we don't think such outcomes would surprise the market too much. Still, there is a lot in play for the SEP and the press conference. Stay tuned.

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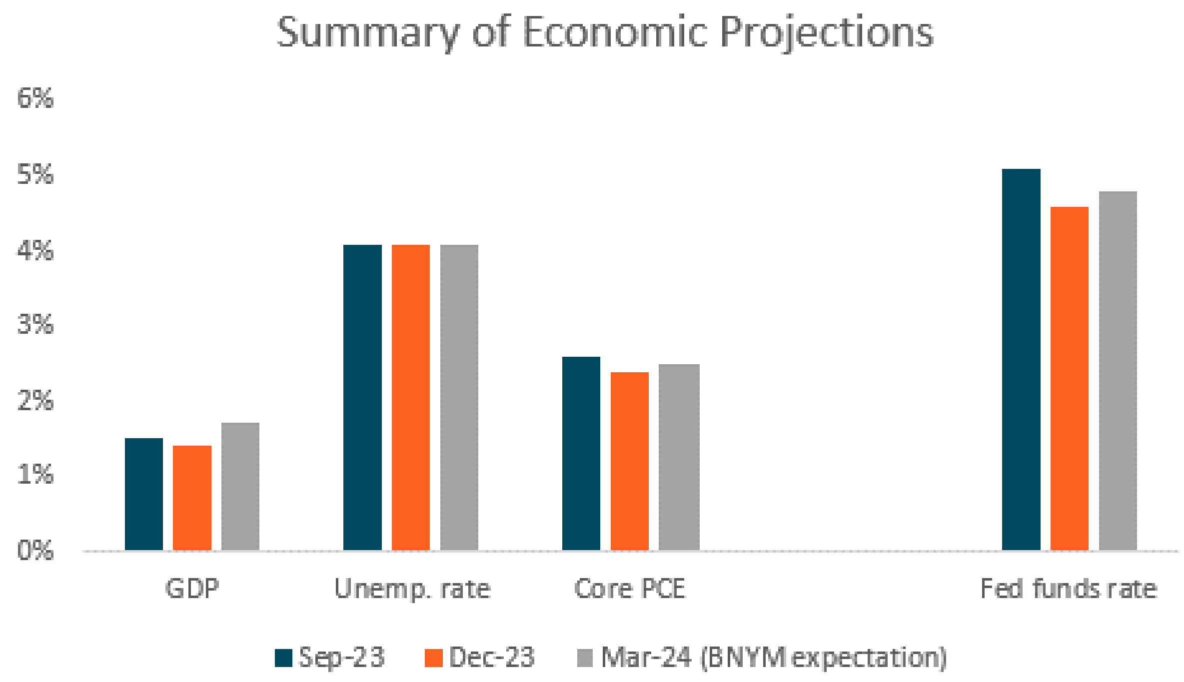
**Dots To Be Dissected**




Source: BNY Mellon Markets, Board of Governors of the Federal Reserve System

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