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GLOBAL ECONOMICS

SCOTIA FLASH

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Median Versus Mode on the FOMC

- **Policy was left unchanged as widely expected**
- **The median participant only sees one cut this year, but the mode is –50bps**
- **The neutral rate was revised a little higher**
- **Growth and inflation were revised up**
- **This was not Powell's strongest presser and that contributed to the market reaction**

Markets took back about half of this morning's post-CPI rally (recap **here**) as the full set of FOMC communications worked through. Some of that cheapening occurred in response to the updated projections including the fresh dot plot, but more of it happened during the press conference. I think a reason for the latter effect is that this wasn't Powell's strongest press conference.

WHAT MARKETS DIDN'T LIKE

One key is that the Committee lowered its projection for rate cuts by more than most expected for this year (chart 1). The median projection is for only one quarter point rate cut this year and 100bps next year. I'll nevertheless come back to why there is more to this than meets the eye.

Another key is that they raised inflation forecasts and are above our views, even though Powell gave short shrift to the higher forecast (chart 2).

DOT PLOT—25 OR 50BPS OF CUTS

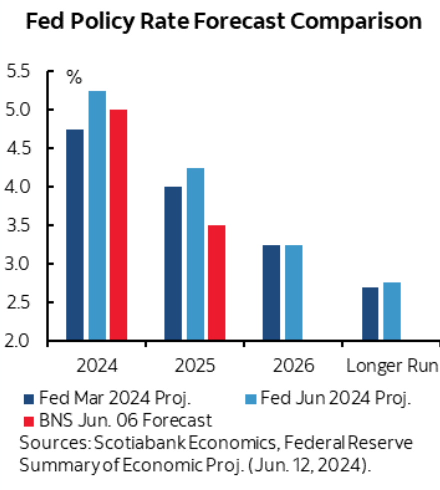
The median Committee projection now expects one single quarter point rate cut this year compared to –75bps in March, followed by 100bps of cuts next year instead of 75bps of cuts in the last projection, and another 100bps of cuts in 2026 to an unchanged 3.25%.

Having said that, the downgrade to -25bps this year masks a very close call between -25 and -50bps. The Committee's mode is 8 participants who now expect -50bps of cuts this year versus 7 who expect -25 with 4 expecting no cut. In other words, data could very easily swing that tight balance between –25bps and –50bps in the next dot plot come September but it needs a fair amount to go right by then for that to happen.

HIGHER NEUTRAL RATE

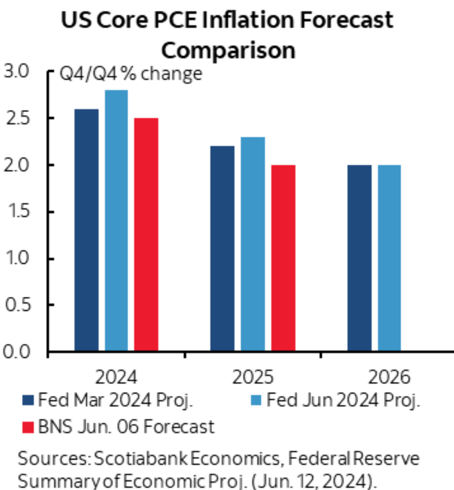
The Committee also raised its median longer-run fed funds forecast to 2.75% from 2.6%. Many would take that as a sign that the Committee may feel policy is slightly less restrictive now relative to a long-run guidepost than it previously thought. That also fed some of the rise in bond yields.

Chart 1



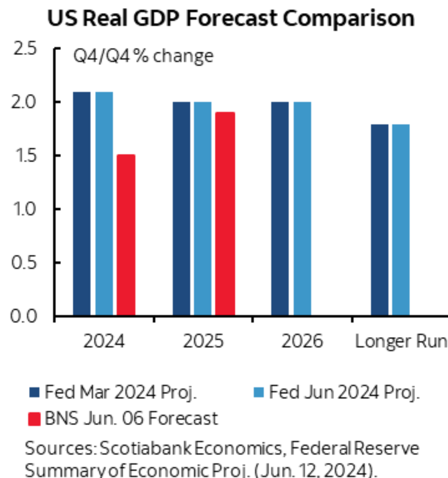
Sources: Scotiabank Economics, Federal Reserve Summary of Economic Proj. (Jun. 12, 2024).

Chart 2



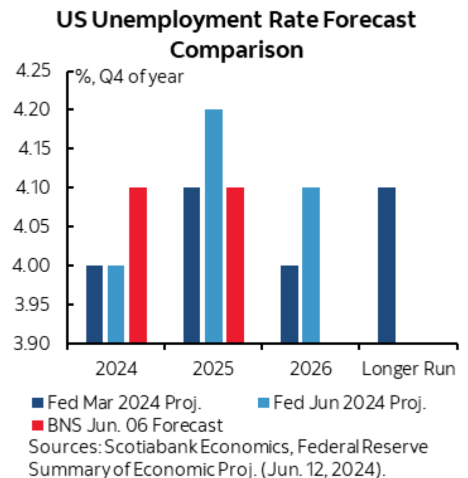
Sources: Scotiabank Economics, Federal Reserve Summary of Economic Proj. (Jun. 12, 2024).

Chart 3



Sources: Scotiabank Economics, Federal Reserve Summary of Economic Proj. (Jun. 12, 2024).

Chart 4



Sources: Scotiabank Economics, Federal Reserve Summary of Economic Proj. (Jun. 12, 2024).

Chair Powell was asked in his press conference whether a higher neutral rate was indeed a sign that the Committee believes policy is not as restrictive as previously indicated and he said:

"The long-run neutral rate is a theoretical construct. It is the equilibrium rate years into the future when there are no shocks. That doesn't apply to today. The concept of r* is important but doesn't get you where you need to be in the nearer term. People have been gradually writing it up because they have been coming around to the view that rates won't go back to pre-pandemic levels."

In other words, he tried to tell folks to ignore it, perhaps without enough market success. Personally, I think it should be taken with a mountain of salt because estimating the neutral rate is very difficult, more likely to be revealed in retrospect by observing what happens to the economy and inflation, and does not speak to the near- and medium-term path toward arriving at a more neutral policy stance. In other words, raising neutral doesn't tell us much of anything about whether they cut soon and by exactly how much.

FORECASTS

The Committee raised its projection for core PCE inflation by two-tenths to 2.8% this year, one-tenth to 2.3% in 2025, and left 2026 at 2%. That is higher than our forecast.

One reason for the Committee being higher than us on core PCE is that the Committee left GDP growth unchanged throughout the projection horizon. The median participant's projection is for 2.1% Q4/Q4 GDP growth this year, 2% in each of the next two years, and the long-run potential growth estimate was left unchanged at 1.8%. This is above our forecast especially for this year (chart 3).

The Committee sees a little more demand pressure on prices from GDP growth this year than we do.

Unemployment rate projections were little changed as this year was left at 4%, but the rest of the projection horizon was raised by one-tenth to 4.2% next year, 4.1% in 2026 and 4.2% in the long run (chart 4). Markets didn't appear to acknowledge slightly more labour slack.

TINY STATEMENT CHANGES

Please see the appendix for a statement comparison. Only one single word changed through the insertion of 'modest' further progress toward 2% inflation. Other than that, the only other change was just to put the QT changes in the present context after they announced them in the prior statement.

WHERE POWELL COULD HAVE BEEN CLEARER

Powell Should Have Been Clearer on Internal Forecast Consistency

The oddest point in the presser was when a few reporters repeatedly asked in slightly different ways why the Committee would be showing rate cuts at all given its forecasts for solid growth and persistent inflation. Powell kind of flubbed the answer in my opinion by dancing around the issue saying that they expect fewer supply side problems, tighter monetary policy to continue working and for there to be less and less excess demand for labour.

What he should have said is that the Committee's projections for growth and inflation incorporate their estimates for rate cuts. In other words, without such cuts, growth and inflation would presumably be weaker throughout the forecast horizon. That would have been a more directly dovish signa; in other words, absent, say, 125bps of cuts this year and next, the economy and inflation would be weaker.

Instead, his weak answer may have been an added reason why bond yields rose somewhat in the press conference as opposed to bluntly saying that the Committee thinks rate cuts will be needed in order to deliver their soft landing macro projections.

Stale on Arrival?

Where I also thought Powell's performance could have been better was when he was asked in the press conference whether Committee participants changed their rate projections after this morning's CPI print. He was evasive and that didn't help.

What he did say is that when there is an important data print they make sure that participants can update their forecasts and most people don't. He left me with the impression that he was trying to say that the forecasts fully incorporated this morning's CPI. The way he answered it and his body language didn't convince me.

Where does this all leave us? Back to watching the data, or picking petals off daisies as argued in my Global Week Ahead.

RELEASE DATE: June 12, 2024

Recent indicators suggest that economic activity has continued to expand at a solid pace. Job gains have remained strong, and the unemployment rate has remained low. Inflation has eased over the past year but remains elevated. In recent months, there has been ***modest*** further progress toward the Committee's 2 percent inflation objective.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. The Committee judges that the risks to achieving its employment and inflation goals have moved toward better balance over the past year. The economic outlook is uncertain, and the Committee remains highly attentive to inflation risks.

In support of its goals, the Committee decided to maintain the target range for the federal funds rate at 5-1/4 to 5-1/2 percent. In considering any adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks. The Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent. ***In addition, the Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities.*** The Committee is strongly committed to returning inflation to its 2 percent objective.

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Thomas I. Barkin; Michael S. Barr; Raphael W. Bostic; Michelle W. Bowman; Lisa D. Cook; Mary C. Daly; Philip N. Jefferson; Adriana D. Kugler; Loretta J. Mester; and Christopher J. Waller.

RELEASE DATE: May 1, 2024

Recent indicators suggest that economic activity has continued to expand at a solid pace. Job gains have remained strong, and the unemployment rate has remained low. Inflation has eased over the past year but remains elevated. In recent months, there has been a lack of further progress toward the Committee's 2 percent inflation objective.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. The Committee judges that the risks to achieving its employment and inflation goals have moved toward better balance over the past year. The economic outlook is uncertain, and the Committee remains highly attentive to inflation risks.

In support of its goals, the Committee decided to maintain the target range for the federal funds rate at 5-1/4 to 5-1/2 percent. In considering any adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks. The Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent. In addition, the Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities. ***Beginning in June, the Committee will slow the pace of decline of its securities holdings by reducing the monthly redemption cap on Treasury securities from $60 billion to $25 billion. The Committee will maintain the monthly redemption cap on agency debt and agency mortgage-backed securities at $35 billion and will reinvest any principal payments in excess of this cap into Treasury securities.*** The Committee is strongly committed to returning inflation to its 2 percent objective.

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

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