

Morning Market Tidbits

Postcard from the West Coast: it's all about the Fed

In focus

Last week we met with several institutional and corporate clients on the West Coast. As expected, the biggest focus of our conversations was the Fed. Most clients felt that the Fed would start cutting rates in May or June. They argued that, since the December meeting, several Fed speakers have pushed back against imminent rate cuts. This suggests that the Fed prefers to err on the side of caution, especially given that robust activity data do not create an urgency to cut.

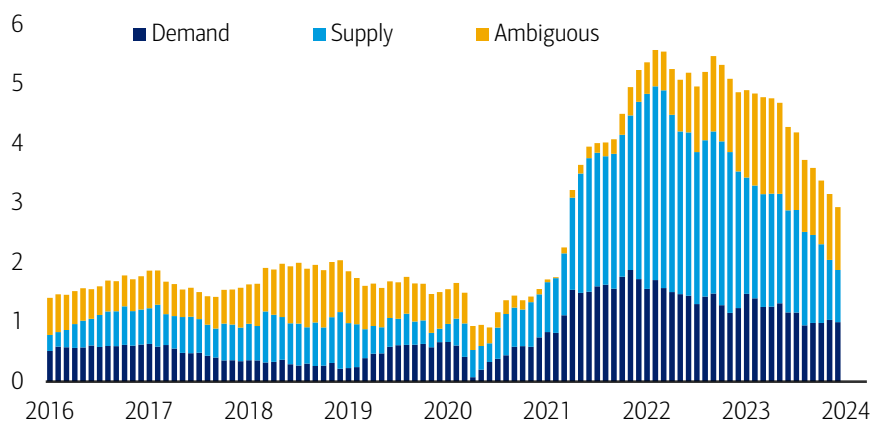
We think this is a reasonable view and we cannot quibble much with current market pricing – about a 40% chance of a March cut – because there are two jobs reports, two batches of inflation data and revisions to both jobs and inflation between the January and March Fed meetings.

We nonetheless maintain our call for a March cut for three reasons. First, Chair Powell's comments at the December press conference suggest that the Fed has embraced "immaculate disinflation", i.e. the notion that disinflation can continue despite resilient economic activity, due to supply-side improvements.

Second, core PCE inflation is already running below 2% on a three- and six-month annualized basis. And the year-over-year (y/y) rate is likely to fall sharply in the next two months due to favorable base effects. Nearly 90bp of the 2.9% y/y core PCE inflation rate will roll off in January and February, so the y/y rate could be below 2.5% by February. Note that although the February core PCE data will not be available at the time of the March Fed meeting (March 19-20), the CPI and PPI reports will be released before the meeting. So the Fed will have a good read on February PCE inflation.

Exhibit 1: Contributions of supply and demand to y/y core PCE inflation (percentage points (pp))

Supply-side improvements have contributed to much of the decline in core PCE inflation



Source: BofA Global Research, Federal Reserve Bank of San Francisco, BEA

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(Continued on next page)

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PCE: Personal Consumption
Expenditures

CPI: Consumer Price Index

Third, we think the recent strength in consumer spending is overstated. We found that clients were generally on board with our soft landing forecast, but were concerned about the risk of re-acceleration in inflation due to above-trend growth. It makes sense to focus on this risk because markets have largely priced it out. And there are plausible ways it could play out, including a large supply shock due to disruptions in the Red Sea.

Yet we do not think re-acceleration should be the base case yet. We have argued that seasonal factors boosted spending in December, but will be a drag in January (see [Retail sales: December giveth, January taketh away](#)). If we also consider the widespread winter weather disruptions this month, the risk is that the consumption data for January will be very soft. This would not reflect weak consumer fundamentals, but it would take some of the shine off the 4Q GDP beat and allay fears that the economy is overheating.

In summary, March is a close call and our forecast of a cut is out of consensus based on our client conversations. Meanwhile, we got little pushback on our call that the Fed will start tapering QT in March and end QT by June. Both the timing of rate cuts and the path of QT will likely be discussed at length at the January meeting (see [January FOMC preview: Playing for time](#)). That leaves plenty of scope for market surprises, even if the Fed does not make a decision on either issue this week, as we expect.

Market Action

The Asian equity markets that we cover closed mostly negative overnight. Looking at individual markets, the Hang Seng, the Shanghai Composite, the Indian Sensex and the Korean Kospi fell 2.3%, 1.8%, 1.1% and 0.1% respectively. On the flipside, the Nikkei added 0.1%.

As of 7:00 am ET, aggregate European stocks are up 0.2% and S&P500 futures are down 0.1%. In the bond markets, 10-year Treasury yields are down 1bp to 4.06% and German Bund yields are up 1bp to 2.25%. The dollar index is down \$0.18 to \$103.43. WTI crude oil prices are \$0.05 lower at \$76.73/bbl, and gold prices are at \$2034.41/oz.

Data previews

January 30th

Case-Shiller HPI, Consumer Confidence

Date	Time	Indicator	Period	BofA Estimate	Consensus	Previous
1/30/24	9:00	Case-Shiller HPI (yoy)	Nov	5.5%	—	4.8%
1/30/24	10:00	Consumer Confidence	Jan	115.0	114.5	110.7
1/30/24	10:00	JOLTS Job Openings	Dec	—	8750k	8790k

Source: Bloomberg, BofA Global Research

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US GDP Tracking

Exhibit 2: BofA US GDP tracking estimate (% q/q saar)

The advance print of 4Q US GDP came in at 3.3% q/q saar. The main differences from our tracker were largely in the higher-than-expected rise in consumption and in the volatile net exports and inventory component.

Date	Data release	GDP	Final Sales	PCE	Res. Inv.	Struct	Equip	IPP	Gov.	Exports	Imports	Net exports (level)	CIPI (level)
1/11/24	CPI	1.3	2.0	1.9	-0.2	3.3	2.8	2.5	2.3	2.2	2.2	-935.5	26.5
1/12/24	PPI	1.3	2.0	1.9	-0.2	3.6	2.8	2.5	2.3	2.2	2.2	-935.5	27.0
1/17/24	Retail Sales	1.4	2.1	2.0	0.2	3.6	2.8	2.5	2.3	2.2	2.2	-935.5	27.0
1/17/24	Industrial Production, Business Inventories	1.3	2.1	2.0	0.2	3.5	2.5	2.5	2.3	2.2	2.2	-935.5	26.3
1/17/24	Import and Export Prices	1.4	2.1	2.0	0.2	3.5	2.5	2.5	2.3	2.4	1.8	-930.8	26.3
1/18/24	Housing Starts and Permits	1.5	2.2	2.0	0.6	3.5	2.5	2.5	2.3	2.4	1.8	-930.8	26.3
1/25/24	4Q US GDP Advance Print	3.3	2.7	2.8	1.0	3.2	1.1	2.1	3.3	6.3	1.9	-908.0	82.7
	GDP tracking	3.3	2.7	2.8	1.0	3.2	1.1	2.1	3.3	6.3	1.9	-908.0	82.7
	Contribution to GDP growth (pp)				1.9	0.0	0.1	0.1	0.6			0.4	0.1

Source: BofA Global Research. Our GDP tracking estimate reflects the mechanical aggregation of incoming data that directly informs the BEA's GDP calculations. The process is distinct from our official published GDP forecast. Boldface cells indicate where data have implications for tracking estimates.

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