US Economic Weekly

The Fed has a communication problem

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Weekly viewpoint

At the January FOMC meeting press conference, Chair Powell significantly raised the bar for a March cut. He said that the Fed needs "greater confidence" in the inflation outlook before it starts normalizing its policy stance. After Powell all but ruled out a March cut (twice!), our best guess is that in order to cut, the Fed wants to see more evidence that services inflation is consistent with 2% outcomes and a further slowing in wage growth to 3.5%. In line with that, we now look for the rate cut cycle to begin in June and expect 25bp rate cuts in June, September, and December 2024 followed by 100bps of cuts in 2025. Overall, the Fed managed to push back against the timing of the first cut but not the pace of cuts. Markets are pricing roughly six cuts this year. Additionally, we also pushed out the timing of our expected QT slowdown announcement from the March FOMC meeting to the May FOMC meeting.

Data preview: CPI revisions unlikely to impact Fed policy

CPI seasonal factors will be revised on February 9 resulting in revisions to seasonally adjusted inflation data. We find that revisions are typically small in nature. Over our ten-year sample, the absolute average of the monthly revision was just 2.6bps. Meanwhile, last year's revisions to the monthly profile in 4Q 2022 were by far the largest in our sample. In our view, this suggests last year was an outlier. Moreover, the revisions were driven primarily by revisions to new and used autos, which were likely a result of methodology changes more than changing seasonal patterns. Therefore, we do not expect the revisions to affect our or the market's outlook for the fed funds rate path. (See CPI Inflation Watch: CPI revisions unlikely to impact Fed policy)

Data preview: ISM Services to continue increasing

We expect ISM services to print at 51.5 in January from 50.4 in December, continuing to signal expanding activity in the sector. Healthy consumer spending has continued to support the service sector as evidenced by the solid employment growth seen in the sector over the past several months. That said, the services sector experienced a slowdown in the rate of growth in December, largely due to weaker growth in new orders and employment contracted for the first time since May. We expect services to have remained in the expansionary territory but a higher for longer interest rate environment, geopolitical events and labor constraints may act as potential headwinds.

PCE: Personal Consumption Expenditures

CPI: Consumer Price Index

GDP: Gross Domestic Product

BTFP: Bank Term Funding Program

SLOOS: Senior Loan Officer Opinion Survey

QT: Quantitative Tightening

The Fed has a communication problem

- Chair Powell stated that a March rate cut is unlikely because the Fed probably won't be sufficiently confident that inflation is returning to target.

- We think the Fed has created considerable ambiguity about its reaction function. Still, we take Powell's message on board: we now expect cuts to start in June.

- The Fed managed to push back against the timing of the first cut but not the pace of cuts. Markets are pricing a policy error: roughly six cuts this year.

(Greater) confidence is everything

The January FOMC statement leaned slightly hawkish. The forward guidance language was shifted from a hiking bias to more neutral language, as we had expected. However, markets focused on the addition of the following language to the statement: "[t]he 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".

Unsurprisingly, the first part of Chair Powell's press conference focused on the interpretation of "greater confidence". Powell stated that the Fed is already confident that it can start cutting rates this year after six months of encouraging inflation data, but it wanted to see more good data (though not necessarily better data). He also said that weaker growth is not a prerequisite for rate cuts.

March is no longer the base case: for cuts or QT tapering

All of this was in line with our view going into the meeting that the Fed would start cutting rates in March. Given favorable base effects, core PCE inflation might well be running below 2.5% y/y by February. The Fed would have a read on this by the March meeting. With the three- and six-month rates also expected to be close to target, we thought this would be enough evidence for the Fed to start normalizing rates in March.

But then Powell dropped a surprise on us and the markets, saying that "[b]ased on the meeting today, I would tell you that I don't think it is likely that the committee will reach a level of confidence by the time of the March meeting to identify March at as the time to do that" (begin cutting rates). While this statement does not rule out a March cut in theory, we think it means the bar to cut rates in March is now very high. Economic fundamentals would have to weaken significantly and/or core PCE inflation would have to slow to perhaps 0.1% per month, driven by disinflation in services.

These outcomes are not our base case, so we no longer expect rate cuts to start in March. We now think the Fed will start cutting at a quarterly cadence in June. Based on Powell's comment that the Fed would start "in-depth" discussions about the balance sheet in March, we also push out the start of QT tapering from March to May. We now expect a reduction in the Treasury redemption cap from $60b/m to $30b/m and for this to remain open-ended. Our view is that tapering could continue until year-end.

Lack of clarity about the reaction function

Powell's ruling out a March cut (twice!) is inconsistent with the Fed's emphasis on data dependence and a meeting-by-meeting decision process. It also seems at odds with other statements Powell has made recently. Namely, i) the Fed will start cutting rates before inflation falls to 2%, ii) the Fed can cut rates based on the inflation data alone, and iii) the Fed is focused on inflation aggregates – the headline and the core – and does not want to nitpick on specific components.

After yesterday's press conference, our best guess is that in order to cut, the Fed wants to see i) more evidence that services inflation is consistent with 2% outcomes in the event that goods price declines stop, and ii) a further slowing in wage growth to 3.5%. An unexpected slowdown in economic activity, or a financial shock if recent news on banking sector stress gets meaningfully worse, could also precipitate a rate cut.

That said, recent Fed communication has left us with more questions than answers about the reaction function. This ambiguity compounds the usual uncertainty about the data flow. As discussed above, a cut in March is still on the table. We would place the odds of a March cut at around 30-40%. The Fed could also start cutting rates at the May meeting, by which time it will have all the key economic indicators through March.

Our base case is that the Fed would prefer to start cutting in June, when it can provide additional guidance with the Summary of Economic Projections. There are also two jobs and CPI reports between the May and June meetings. But it is now incumbent on the Fed, in our view, to shed light on the path forward.

Markets are pricing a policy mistake

Going into the January meeting, we thought it was more important for the Fed to push back against market pricing of the speed of rate cuts rather than the timing of the first cut. Yet the Fed achieved the exact opposite. Powell's strong statement about March lowered pricing of a March cut, but markets are still pricing about six cuts over the course of this year. This suggests to us that they are pricing in a policy error.

Markets apparently don't agree with a gradual pace of rate cuts once the Fed starts. For what it's worth, we do not think a three-month delay in the cutting cycle poses meaningful downside risks to the economy. But if the Fed wants to cut rates at a quarterly pace, it has a lot of work to do in terms of moving market pricing, and it runs the risk of inducing meaningful financial tightening.

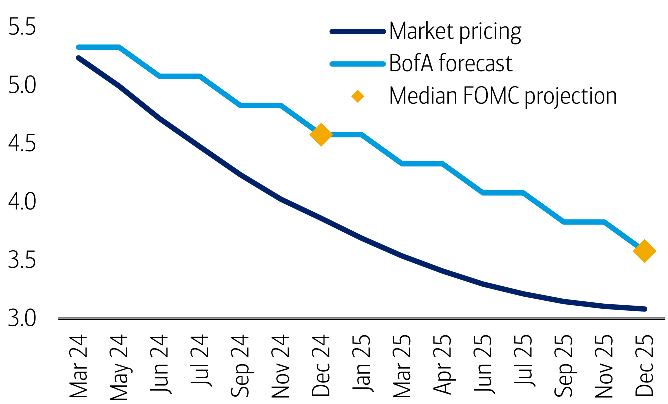
Mixed data flow this week

Turning attention to this week's data flow, it has been a mixed bag, although the big event is obviously Friday's jobs report. The manufacturing ISM came into focus after a string of large misses in the regional PMIs. But the index surprised to the upside in January, increasing two points to 49.1, the highest level since 2022. The increase was driven by new orders and production, both of which entered expansionary territory.

Meanwhile, construction spending surged by 0.9% in December, while November was also revised up to 0.9% m/m, boosting 4Q GDP tracking. On the downside, auto sales came in well below consensus expectations at 15.0mn. We attribute the slowdown to two idiosyncratic factors: i) widespread weather disruptions, and ii) an unfavorable seasonal adjustment. Indeed, auto sales were above their January 2023 level on a NSA basis, but below on a SA basis. We expect both factors to weigh substantially on the retail sales and overall consumer spending data for January. It will be interesting to see if the Fed is as willing to look through this potential soft patch in the economy as we are.

Exhibit 1: Market pricing of Fed policy rates vs. BofA forecasts and dot plot projections

Markets are pricing roughly six rate cuts this year



Source: BofA Global Research, Bloomberg, Tullett Prebon

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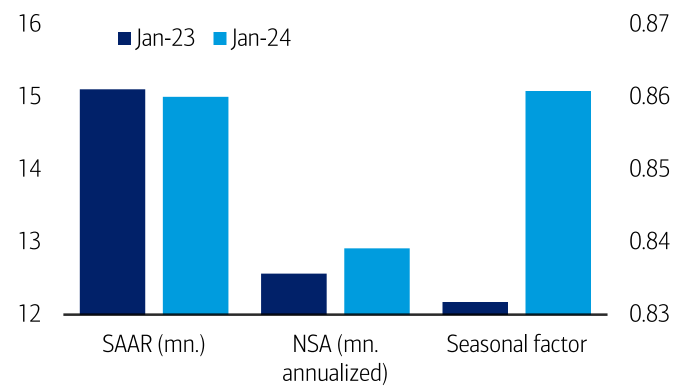
Exhibit 2: Auto sales for the month of January

An unfavorable (i.e., higher) seasonal factor weighed on auto sales in Jan 2024



Source: Wards Auto, BofA Global Research

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US GDP Tracking

4Q GDP tracking up two-tenths to 3.5% q/q saar

Construction spending in December came in higher than expected at 0.9% m/m. November was also revised up to 0.9% m/m. Residential construction spending printed at a strong 1.4% m/m with both single family construction and home improvement coming in higher than expected. Public construction also surprised to the upside at 1.3%, largely on the back on non-residential construction. This led to an increase in our 4Q tracking estimates for residential investment, structures and government spending.

Overall, this increased our 4Q US GDP tracking estimate from 3.3% q/q saar in the advance estimate print to 3.5% q/q saar. Next week, December trade balance, wholesale inventories and CPI revisions will impact 4Q GDP tracking.

Exhibit 4: BofA US GDP tracking estimate (% q/q saar)

4Q US GDP tracking is up two-tenths to 3.5% q/q saar largely due to the higher-than-expected construction spending print in December along with the upward revision to November

Date	Data release	GDP	Final Sales	PCE	Res. Inv.	Struct	Equip	IPP	Gov.	Exports	Imports	Net exports (level)	CIPI (level)
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**	2.1	2.0	**0.6**	3.5	2.5	2.5	2.3	2.4	1.8	-930.8	26.3
1/25/24	4Q (A) GDP	**3.3**	**2.7**	**2.8**	**1.1**	**3.2**	**1.0**	**2.1**	**3.3**	**6.3**	**1.9**	**-908.2**	**82.7**
2/1/24	Construction Spending	**3.5**	**3.0**	2.8	**1.5**	**5.8**	1.0	2.1	**4.1**	6.3	1.9	-908.2	82.7
	GDP tracking	3.5	3.0	2.8	1.5	5.8	1.0	2.1	4.1	6.3	1.9	-908.2	82.7
	Contribution to GDP growth (pp)			1.9	0.1	0.2	0.1	0.1	0.7			0.4	0.1
	BofA official GDP forecast	1.5	2.5	2.0	1.0	3.5	2.5	2.5	2.0	2.5	2.0	-929.0	29.5

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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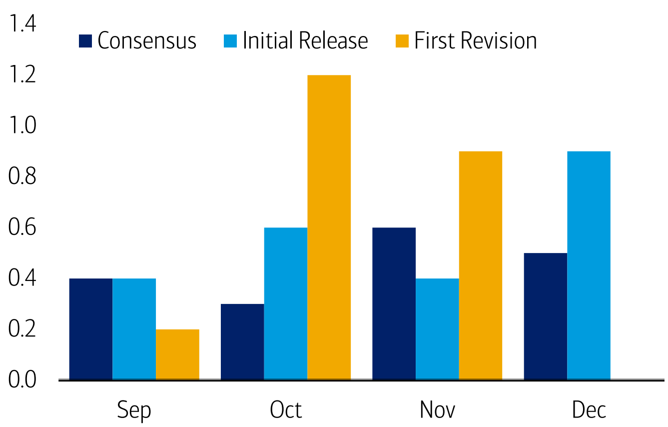
Exhibit 4: Construction Spending m/m % change)

December construction spending came in higher than expected along with an upward revision to November



Source: Bloomberg

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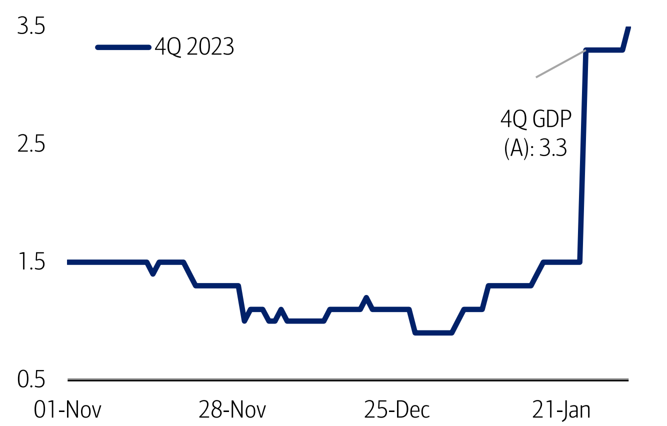
Exhibit 5: GDP tracking evolution (% q/q, SAAR)

4Q GDP tracking is up two-tenths to 3.5% q/q saar



Source: BofA Global Research

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Data in the past week

January 29th – February 2nd

This week the focus was on the FOMC rate decision

Date	Time	Indicator	Period	Actual	Consensus	Previous
1/30/24	9:00	Case-Shiller HPI (yoy)	Nov	5.1%	—	4.9
1/30/24	10:00	Consumer Confidence	Jan	114.8	114.8	108.0
1/30/24	10:00	JOLTS Job Openings	Dec	9026k	8750k	8925k
1/31/24	7:00	MBA Mortgage Applications	Jan 26	-7.2%	—	3.7%
1/31/24	8:15	ADP Employment	Jan	107k	150k	158k
1/31/24	8:30	Employment Cost Index	4Q	0.9%	1.0%	1.1%
1/31/24	9:45	Chicago Purchasing Managers	Jan	46.0	48.0	47.2
1/31/24	**14:00**	**FOMC Rate Decision (mid-point)**	**Jan 31**	**5.375%**	**5.375%**	**5.375%**
2/01/24	8:30	Initial Jobless Claims	Jan 27	224k	212k	215k
2/01/24	8:30	Nonfarm Productivity	4Q P	3.2%	2.5%	4.9%
2/01/24	8:30	Unit Labor Costs	4Q P	0.5%	1.2%	-1.1%
2/01/24	9:45	S&P Global US manufacturing PMI	Jan F	50.7	50.3	50.3
2/01/24	10:00	Construction Spending (mom)	Dec	0.9%	0.5%	0.9%
2/01/24	10:00	ISM Manufacturing	Jan	49.1	47.2	47.1
2/01/24	All day	Total Vehicle Sales	Jan	15.0M	15.7M	15.8M
2/02/24	8:30	Change in Nonfarm Payrolls	Jan	NR	185k	216k
2/02/24	8:30	Private Payrolls	Jan	NR	170k	164k
2/02/24	8:30	Unemployment Rate	Jan	NR	3.8%	3.7%
2/02/24	8:30	Average Hourly Earnings mom	Jan	NR	0.3%	0.4%
2/02/24	8:30	Average Weekly Hours	Jan	NR	34.3	34.3
2/02/24	10:00	U. of Michigan Sentiment	Jan F	NR	78.9	78.8
2/02/24	10:00	Factory Orders	Dec	NR	0.2%	2.6%

Source: Bloomberg, BofA Global Research. NR= Not Released

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Data in the week ahead

February 5th – February 9th

Next week the focus will be on ISM Services, SLOOS, CPI Revisions

Date	Time	Indicator	Period	BofA Estimate	Consensus	Previous
2/05/24	9:45	S&P Global US services PMI	Jan F	—	—	52.9
2/05/24	10:00	ISM Services	Jan	51.5	52.1	50.5
2/05/24	14:00	SLOOS results	—	—	—	—
2/07/24	7:00	MBA Mortgage Applications	Feb 2	—	—	-7.2%
2/07/24	8:30	Trade Balance	Dec	-$61.8bn	-$62.3b	-$63.2b
2/07/24	15:00	Consumer Credit	Dec	—	$16.5b	$23.8b
2/08/24	8:30	Initial Jobless Claims	Feb 03	220k	—	224k
2/08/24	10:00	Wholesale Inventories	Dec F	—	—	0.4%
2/09/2024	—	CPI Revisions	—	—	—	—

Source: Bloomberg, BofA Global Research

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Federal Reserve Speakers

Exhibit 7: Upcoming policy speakers

Key speaking engagements and news events*

Date	Time	Speaker
Feb 5	14:00	Fed's Bostic (voter) gives welcoming remarks
Feb 5	14:00	Senior Loan Officer Opinion Survey (SLOOS) on bank lending practices
Feb 6	12:00	Fed's Mester (voter) speaks on economic outlook
Feb 6	13:00	Fed's Kashkari participates in moderated discussion
Feb 6	14:00	Fed's Collins delivers opening remarks at labor market conference
Feb 6	19:00	Fed's Harker speaks on Fed's role in the economy
Feb 7	11:00	Fed's Kugler (voter) speaks at Brookings event
Feb 7	11:30	Fed's Collins speaks at Boston Economic Club
Feb 7	12:30	Fed's Barkin (voter) speaks on outlook and regional economy
Feb 8	12:05	Fed's Barkin (voter) speaks at Economic Club of New York

Source: Bloomberg

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Exhibit 8: Summary of Fed speak in the previous week

Below is a summary of key quotes from Fed speakers over the past weeks

Speaker	Date	Quote
Powell (Chair)	31-Jan	"Based on the meeting today, I would tell you that I don't think it's likely that the committee will reach a level of confidence by the time of the March meeting." "We believe that our policy rate is likely at its peak for this tightening cycle and that, if the economy evolves broadly as expected, it will likely be appropriate to begin dialing back policy restraint at some point this year." "We are prepared to maintain the current target range for the federal funds rate for longer, if appropriate."
Waller (Governor)	16-Jan	"As long as inflation doesn't rebound and stay elevated, I believe the FOMC will be able to lower the target range for the federal funds rate this year." "When the time is right to begin lowering rates, I believe it can and should be lowered methodically and carefully."
Mester (Cleveland)	11-Jan	"I think March is probably too early in my estimation for a rate decline because I think we need to see some more evidence." "I think the December CPI report just shows there's more work to do, and that work is going to take restrictive monetary policy."
Williams (NY fed)	10-Jan	"My base case is that the current restrictive stance of monetary policy will continue to restore balance and bring inflation back to our 2% longer-run goal." "The timing of when [interest rates come down] that happens and the speed at which that happens will depend on how inflation evolves, how the economy evolves." "[FOMC] Intends to slow and then stop the decline in the size of the balance sheet when reserve balances are somewhat above the level it judges to be consistent with ample reserves. So far, we don't seem to be close to that point"
Barr (Vice Chair of Supervision)	9-Jan	Signals BTFP will end on March 11, when it expires
Bowman	8-Jan	"Should inflation continue to fall closer to our 2% goal over time, it will eventually become appropriate to begin the process of lowering our policy rate to prevent policy from becoming overly restrictive." "I will remain cautious in my approach to considering future changes in the stance of policy,"
Bostic (Atlanta)	8-Jan	"We are in a restrictive stance and I'm comfortable with that, and I just want to see the economy continue to evolve with us in that stance and hopefully see inflation continue to get to our 2% level Expects 2 rate cuts this year starting in 3Q "Open question" if and when the Fed should alter B/S reduction pace
Logan (Dallas)	7-Jan	"In my view, we should slow the pace of runoff as ON RRP balances approach a low level" "In light of the easing in financial conditions in recent months, we shouldn't take the possibility of another rate increase off the table just yet."

Source: Bloomberg

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Exhibit 9: BofA US Economics Dove-Hawk chart

This year the regional presidents voting on the FOMC (Federal Open Market Committee) will be Daly, Mester, Bostic and Barkin

		Dove	Dovish	Centrist	Hawkish	Hawk
Governors & permanent voters			Cook Kugler	Powell (Chair) Waller Jefferson (Vice Chair) Barr (Vice Chair supervision) Williams (NY)		Bowman
Regional Presidents on Rotation	2024			Daly (San Francisco) Mester (Cleveland)	Bostic (Atlanta) Barkin (Richmond)	
	2025		Collins (Boston) Goolsbee (Chicago)		Schmid (Kansas City)	Musalem (St. Louis)*
	2026		Harker (Philadelphia)	Mester (Cleveland)	Kashkari (Minneapolis) Logan (Dallas)	

Source: BofA Global Research

*Musalem was recently announced as President of the St. Louis Fed. We have yet to hear him comment on monetary policy. Therefore, this is a preliminary placement.

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Federal Reserve Balance Sheet

The balance sheet fell by $51.1bn in the past four weeks

The Fed continues to let up to $60bn of maturing Treasury securities roll off its balance sheet each month, while also reducing holdings of agency mortgage-backed securities by up to $35bn. In the week ending January 31, the Fed's balance sheet decreased by $47.8bn (H.4.1 Exhibit 10). In the past four weeks, the balance sheet has shrunk by $51.1bn. Balance sheet runoff continues to reduce take-up in the overnight reverse repo facility (ON RRP), which has fallen by $108.4bn over the past four weeks.

Lending through the BTFP decreased by $2.5bn to $165.2bn. That BTFP balances declined as of January 31 is a postive sign in light of recent troubles at New York Community Bancorp. The Fed officially announced the BTFP will end on March 11, in line with our expectations (see BTFP to expire on schedule) and raised the rate for new BTFP loans which will now be equal to the interest rate on reserve balances at the time of the new loan.

Exhibit 10: The balance sheet of the Federal Reserve ($bn, Wednesday, end of period values)
Factors affecting reserve balances of depository institutions (H.4.1 Table 1)

$bn, Wednesday, end of period values	31 Jan	7-day chg	4 week chg	Chg since June 1, 2022
Supplying reserve funds (Federal Reserve assets)				
Reserve Bank credit outstanding	7593.1	-47.8	-51.1	-1285.5
Securities held outright	7112.2	-41.1	-75.2	-1368.3
US Treasuries	4692.7	-29.6	-60.6	-1078.1
Federal Agency	2.3	0.0	0.0	0.0
Mortgage-backed securities	2417.2	-11.5	-14.6	-290.3
Unamortized premiums on securities held outright	276.1	-0.8	-2.6	-61.1
Unamortized discounts on securities held outright	-25.5	0.0	0.3	-1.0
Repurchase agreements	0.0	0.0	0.0	0.0
Foreign official (FIMA repo facility)	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0
Loans	171.7	-2.1	24.9	151.1
of which:				
Discount window (primary and secondary credit)	3.2	0.4	1.0	2.3
Paycheck protection program (PPPLF)	3.3	0.0	-0.1	-16.5
Bank Term Funding Program (BTFP)	165.2	-2.5	24.0	165.2
Other credit extensions	0.0	0.0	0.0	0.0
Other factors supplying reserve funds	58.5	-3.8	1.5	-6.2
Total factors supplying reserve funds	7680.2	-47.8	-51.1	-1284.1
Absorbing reserve funds (Federal Reserve liabilities)				
Currency in circulation	2327.0	-2.5	-21.3	47.0
Reverse repo agreements	977.6	-2.5	-108.4	-1252.9
Foreign official accounts	362.2	21.7	-3.9	96.7
Others	615.4	-24.2	-104.5	-1349.6
Treasury cash holdings	0.4	0.0	0.0	0.3
Other deposits with Federal Reserve Banks	1050.6	42.8	136.7	22.1
of which:				
Treasury General Account	865.5	50.3	122.0	84.9
Treasury contributions to credit facilities	7.4	0.0	0.0	-10.5
Other Federal Reserve liabilities and capital	-94.4	-7.6	-10.5	-144.4
Factors absorbing reserves, other than reserves	4268.5	30.2	-3.5	-1338.5
Reserve balances with Federal Reserve banks	3411.7	-78.0	-47.7	54.3

Source: Federal Reserve, Haver Analytics, BofA Global Research. Note: Quantitative tightening began on June 1, 2022.

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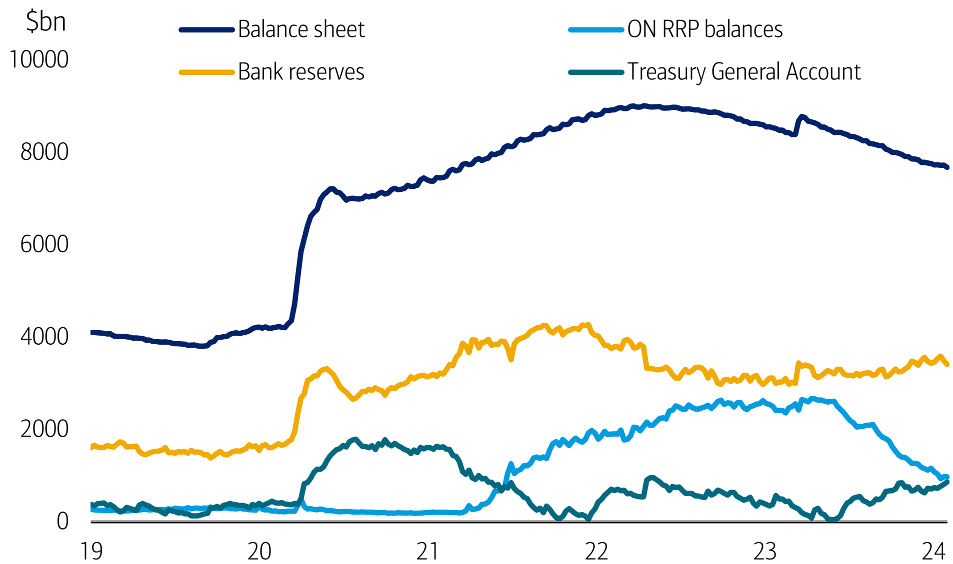
Exhibit 10: The balance sheet, ON RRP balances, bank reserves, and Treasury General Account ($bn)
Nearly all the drain in liquidity from balance sheet runoff has shown up in lower ON RRP balances while bank reserves have been largely stable



Source: Federal Reserve, Haver Analytics, BofA Global Research

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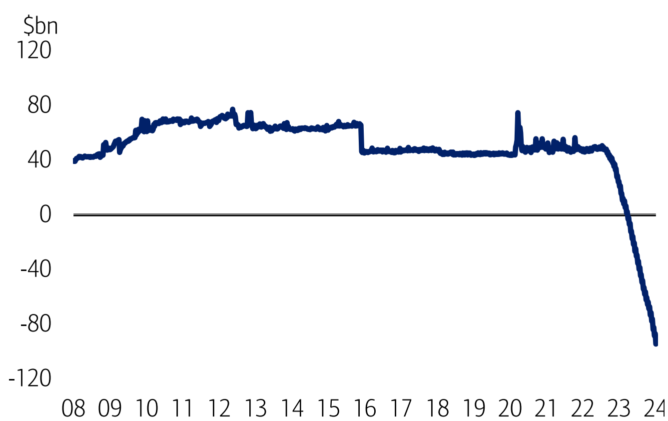
Losses on the Fed's balance sheet: The Fed continues to pay more in interest on reserves than it earns on its securities holdings. Earnings that are retained to cover this loss are booked as a negative liability on the balance sheet under "interest on Federal Reserve Notes due to the US Treasury" in the line item "other Federal Reserve liabilities and capital". The cumulative value of the shortfall in earnings (the "deferred asset") is $94.4bn.

Exhibit 11: Other Federal Reserve Liabilities and Capital ($bn)
Federal Reserve losses are mounting



Source: Federal Reserve, Haver Analytics, BofA Global Research

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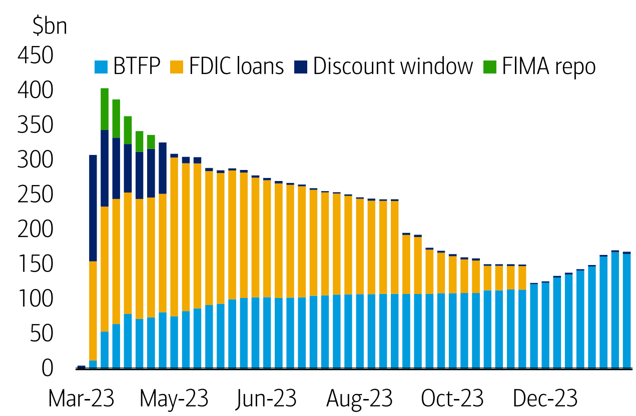
Exhibit 12: Federal Reserve Emergency Lending Facilities ($bn)
Lending through the BTFP saw its first decline since late Nov



Source: Federal Reserve, Haver Analytics, BofA Global Research

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Core views

Growth: Soft landing

- After the higher-than-expected 4Q advance GDP print, we continue to expect a soft landing for the US economy. Earlier, we had marked up our forecast for growth in private consumption while maintaining a slowdown in non-consumer related components like residential investment, nonresidential investment, and government spending. We continue to expect growth in real US GDP of 1.2% 4Q/4Q in 2024, up 0.6pp, and 2.0% in 2025 (See report: Sticking the landing).

Inflation: Moving in the right direction, but sticky

- PCE inflation falls to 2.0% y/y in 3Q25. Core PCE will now likely fall below 3% y/y by 1Q24. But the road to 2% will likely be slower due to sticky core services ex-housing inflation. We expect core PCE to fall to a slightly above target 2.4% y/y by 4Q24.

Federal Reserve policy rates: Need for "greater confidence" to start easing

- At the January FOMC meeting press conference, Chair Powell significantly raised the bar for a March cut by saying, "I don't think it is likely that the committee will reach a level of confidence by the time of the March meeting". He also said that the Fed has confidence in the outlook but needs "greater confidence" before it starts normalizing its policy stance. We now look for the rate cut cycle to begin in June and expect 25bp rate cuts in June, September, and December This would mean 75bp of rate cuts this year and we retain our view of 100bp of rate cuts in 2025 (See report: US Watch: January FOMC: March is no longer the base case).

Federal Reserve balance sheet: May start of taper

- After the January FOMC meeting, we push out the timing of our expected QT (Quantitative Tightening) slowdown announcement from the March FOMC meeting to the May FOMC meeting. In addition to altering the timing of tapering, we also adjust the path of QT slowdown. We no longer expect a $15b/m taper in the US Treasury redemption cap at each FOMC meeting. Instead, we now expect a reduction in the Treasury redemption cap from $60b/m to $30b/m and for this to remain open-ended. Our view is that it can remain at this level until end '24. (See report: US Watch: January FOMC: March is no longer the base case).

Structurally higher US interest rates? Think again.

- Our estimate of the neutral real policy rate is hovering around 40bp. During the decade following the global financial crisis, our estimate of the real neutral rate was negative or close to zero. If the post-pandemic surge in participation proves short lived and productivity does not accelerate, then any rise in the neutral rate of interest in the US economy is likely to be modest at best and could prove temporary. This would mean the zero lower bound remains a constraint on monetary policy and the terminal rate in any easing cycle could be lower than we expect (See report: Structurally higher US interest rates? Think again).

Labor markets: The virtuous cycle continues

- The post-pandemic surge in labor force participation has led to a surge in total hours, and supported growth in disposable income, helping to keep consumer spending elevated despite higher interest rates. We think this has some further room to run in 2024 but foresee the participation rate drifting down toward its underlying demographic trend in 2025 and beyond (See report: Structurally higher US interest rates? Think again).

Fiscal policy: Caution: drag ahead

- Fiscal policy bills and other idiosyncratic factors contributed to resiliency of the economy in 2023. However, the impulse to growth should turn negative in 2024. Fiscal sustainability is an ongoing concern that could be exacerbated by higher interest rates (See report: Fiscal impulse: running out of steam).

Economic forecast summary

Exhibit 14: BofA US economic outlook

We continue to expect a soft landing for the US economy

	1Q 23	2Q 23	3Q 23	4Q 23	1Q 24	2Q 24	3Q 24	4Q 24	1Q 25	2Q 25	3Q 25	4Q 25	2022	2023	2024	2025
Real Economic Activity, % SAAR																
Real GDP	2.2	2.1	4.9	3.3	1.0	1.0	1.5	1.5	2.0	2.0	2.0	2.0	1.9	2.5	2.1	1.8
% Change, Year Ago	1.7	2.4	2.9	3.1	2.8	2.5	1.7	1.2	1.5	1.7	1.9	2.0				
Final Sales	4.6	2.1	3.6	3.2	1.5	1.0	1.5	1.5	2.0	2.0	1.5	1.5	1.3	2.9	2.0	1.6
Domestic Demand	3.8	2.0	3.5	2.8	1.5	1.0	1.5	1.5	2.0	2.0	2.0	2.0	1.7	2.2	1.9	1.7
Consumer Spending	3.8	0.8	3.1	2.8	1.5	1.5	1.5	1.5	2.0	2.0	2.0	2.0	2.5	2.2	1.9	1.8
Residential Investment	-5.3	-2.2	6.7	1.2	-0.5	-0.5	1.5	2.0	2.5	2.5	2.5	2.5	-9.0	-10.7	1.0	2.2
Nonresidential Investment	5.7	7.4	1.5	1.9	1.0	1.0	2.0	2.0	2.0	2.0	2.0	2.0	5.2	4.4	1.8	2.0
Structures	30.3	16.1	11.2	3.7	-1.0	-1.0	1.0	1.0	1.5	1.5	2.0	2.0	-2.1	12.7	2.6	1.4
Equipment	-4.1	7.7	-4.4	2.7	1.0	1.0	1.5	1.5	2.0	2.0	2.0	2.0	5.2	-0.1	0.8	1.9
Intellectual Property	3.8	2.7	1.8	2.7	2.0	2.0	2.0	2.5	2.5	2.5	3.0	3.0	9.1	4.3	2.2	2.5
Government	4.8	3.3	5.8	3.3	1.0	0.5	0.5	1.0	1.0	1.0	1.0	1.0	-0.9	4.0	2.0	0.8
Exports	6.8	-9.3	5.4	2.7	1.0	1.0	1.5	1.5	2.0	2.0	2.5	2.5	7.0	2.7	2.0	1.8
Imports	1.3	-7.6	4.2	1.8	1.5	1.5	1.5	1.5	2.0	2.0	2.0	2.0	8.6	-1.7	1.2	1.7
Net Exports (Bil 12$)	-935	-928	-931	-908	-912	-917	-919	-922	-926	-930	-933	-936	-1051	-926	-917	-931
Contribution to growth (ppts)	0.6	0.0	0.0	0.4	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	-0.5	0.5	0.1	0.0
Inventory Accumulation (Bil 12$)	27.2	14.9	77.8	82.7	67.5	60.5	57.5	64.5	73.5	82.5	97.5	112.5	128.1	50.7	62.7	91.7
Contribution to growth (ppts)	-2.2	0.0	1.3	0.1	-0.3	-0.1	-0.1	0.1	0.2	0.1	0.2	0.2	0.6	-0.4	0.1	0.1
Nominal GDP (Bil $, SAAR)	26814	27063	27610	27939	28175	28419	28712	28984	29314	29629	29938	30255	25744	27356	28573	29784
% SAAR	6.2	3.8	8.4	4.9	3.4	3.5	4.2	3.8	4.6	4.4	4.2	4.3	9.1	6.3	4.4	4.2
Key Indicators																
Fed Funds Rate (midpoint, % EOP)	4.875	5.125	5.375	5.375	5.375	5.125	4.875	4.625	4.375	4.125	3.875	3.625	4.375	5.375	4.625	3.625
Industrial Production (% SAAR)	-0.3	0.8	1.7	-2.9	-0.5	0.5	0.0	0.5	1.0	1.5	1.5	1.5	3.4	0.2	-0.3	0.8
Capacity Utilization (%)	79.5	79.4	79.5	78.6	78.5	78.5	78.5	78.5	79.0	79.0	79.0	79.5	80.3	79.3	78.6	79.0
Nonfarm Payrolls (Avg mom ch, 000s)	312	201	221	165	100	75	75	100	100	125	125	150	399	225	88	125
Civilian Unemployment Rate (%)	3.5	3.6	3.7	3.8	3.8	4.0	4.1	4.2	4.2	4.2	4.1	4.1	3.6	3.6	4.0	4.2
Civilian Participation Rate (%)	62.5	62.6	62.7	62.6	62.8	62.8	62.8	62.8	62.8	62.8	62.7	62.7	62.2	62.6	62.8	62.8
Productivity (% SAAR)	-0.8	3.5	5.0	3.0	0.0	1.0	1.5	1.5	1.5	1.5	1.0	1.0	-1.9	2.7	1.0	1.3
Personal Saving Rate (%)	4.8	5.1	4.2	4.0	4.4	4.6	4.7	4.9	5.1	5.2	5.4	5.6	3.5	4.5	4.7	5.3
Light Vehicle Sales (Millions SAAR)	15.0	15.8	15.7	15.6	16.0	16.2	16.4	16.5	16.8	17.1	17.5	17.9	13.8	15.5	16.3	17.3
Housing Starts (Thous. SAAR)	1385	1450	1370	1455	1450	1440	1505	1555	1555	1575	1585	1595	1551	1415	1490	1580
Current Account (% of GDP)													-3.7	-3.6	-3.4	-3.3
US Budget Balance ($bn, Fiscal Year)													-1375	-1695	-1800	-1900
Inflation																
GDP Price Index (% SAAR)	3.9	1.7	3.3	1.5	2.4	2.5	2.7	2.3	2.6	2.3	2.2	2.3	7.1	3.6	2.3	2.4
% Change, Year Ago	5.3	3.5	3.2	2.6	2.2	2.4	2.3	2.5	2.5	2.5	2.4	2.3				
PCE Chain Prices (% SAAR)	4.2	2.5	2.6	1.7	2.1	2.3	2.3	2.0	2.4	2.0	1.8	1.9	6.5	3.7	2.2	2.1
% Change, Year Ago	5.0	3.9	3.3	2.7	2.2	2.2	2.1	2.2	2.2	2.2	2.0	2.0				
Core PCE Chain Prices (% SAAR)	5.0	3.7	2.0	2.0	2.5	2.5	2.5	2.3	2.5	2.2	2.0	2.0	5.2	4.1	2.4	2.3
% Change, Year Ago	4.8	4.6	3.8	3.2	2.5	2.2	2.3	2.4	2.4	2.4	2.2	2.2				
CPI, Consumer Prices (% SAAR)	3.8	2.7	3.6	2.8	2.6	2.7	2.5	1.9	2.4	2.0	2.8	2.4	8.0	4.1	2.7	2.3
% Change, Year Ago	5.8	4.0	3.6	3.2	2.9	2.9	2.6	2.4	2.4	2.2	2.3	2.4				
CPI ex Food & Energy (% SAAR)	5.0	4.7	2.8	3.4	3.3	3.1	2.9	2.7	2.6	2.6	2.5	2.4	6.1	4.8	3.2	2.7
% Change, Year Ago	5.6	5.2	4.4	4.0	3.6	3.1	3.2	3.0	2.8	2.7	2.6	2.5				

Source: BofA Global Research

BofA GLOBAL RESEARCH

Rates and dollar forecast

Table 1: Rates and dollar forecast

We think the Fed is done hiking and will start cutting in June

	Spot	24-Mar	24-Jun	24-Sep	24-Dec	25-Mar	25-Jun	25-Sep	25-Dec
Interest rates									
Fed Funds	5.33	5.25-5.50	5.00-5.25	4.75-5.00	4.50-4.75	4.25-4.50	4.00-4.25	3.75-4.00	3.50-3.75
Fed Effective Rate	5.33	5.38	5.13	4.88	4.63	4.38	4.13	3.88	3.63
2-Year T-Note	4.20	4.75	4.50	4.25	4.00	-	-	-	3.75
5-Year T-Note	3.81	4.50	4.40	4.25	4.15	-	-	-	4.00
10-Year T-Note	3.88	4.40	4.30	4.25	4.25	-	-	-	4.25
30-Year T-Bond	4.12	4.70	4.65	4.65	4.75	-	-	-	4.75
Dollar									
EUR-USD	1.09	1.07	1.10	1.15	1.15	1.16	1.17	1.18	1.20
USD-JPY	146	145	143	142	142	140	138	136	136
USD-CAD	1.34	1.35	1.34	1.32	1.30	1.30	1.30	1.30	1.30
AUD-USD	0.66	0.66	0.68	0.71	0.71	0.71	0.71	0.71	0.71
NZD-USD	0.61	0.60	0.62	0.63	0.63	0.63	0.63	0.63	0.63
GBP-USD	1.27	1.23	1.26	1.31	1.31	1.33	1.34	1.37	1.40
USD-CHF	0.86	0.90	0.87	0.84	0.84	0.84	0.84	0.84	0.83
USD-SEK	10.40	10.93	10.36	9.74	9.65	9.57	9.40	9.24	9.00
USD-NOK	10.44	10.84	10.27	9.57	9.48	9.40	9.23	9.07	8.83
USD-CNY	7.18	7.45	7.40	7.10	6.90	6.90	6.80	6.80	6.70
USD-MXN	17.09	17.80	17.90	18.30	18.50	18.70	18.90	19.10	19.50

Source: BofA Global Research

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Rolling calendar of business indicators

Key economic data over the next three weeks

Next week the focus will be on ISM Services and SLOOS

Monday	Tuesday	Wednesday	Thursday	Friday
Feb 5	**Feb 6**	**Feb 7**	**Feb 8**	**Feb 9**
9:45 am: S&P Global US Services PMI – Jan F 10:00 am: ISM services– Jan 2:00 pm: Senior Loan Officer Survey (SLOOS)		7:00 am: MBA Mortgage Applications – week ending 2/2/2024 8:30 am: Trade Balance – Dec	8:30 am: Initial Jobless Claims – week ending 2/3/2024 10:00 am: Wholesale Inventories – Dec F	CPI revisions
Feb 12	**Feb 13**	**Feb 14**	**Feb 15**	**Feb 16**
2:00 pm: Monthly Budget Statement - Jan	6:00 am: NFIB Small Bus. Optimism – Jan 8:30 am: Consumer Price Index – Jan	7:00 am: MBA Mortgage Applications – week ending 2/9/2024	8:30 am: Initial Jobless Claims – week ending 2/10/2024 8:30 am: Advance Retail Sales – Jan 8:30 am: Import Price Index – Jan 8:30 am: Empire Manufacturing – Feb 8:30 am: Philly Fed – Feb 9:15 am: Industrial Production – Jan 10:00 am: NAHB Housing Index – Feb 10:00 am: Business Inventories - - Dec	8:30 am: Housing Starts & Permits – Jan 8:30 am: Producer Price Index – Jan 10:00 am: U. of Mich Sentiment – Feb (P)
Feb 19	**Feb 20**	**Feb 21**	**Feb 22**	**Feb 23**
President's Day		7:00 am: MBA Mortgage Applications – week ending 2/16/2024 2:00 pm: FOMC Minutes	8:30 am: Initial Jobless Claims – week ending 2/17/2024 9:45 am: S&P Global US Manufacturing and Services PMI – Feb (P) 10:00 am: Existing Home Sales – Jan	

*Projections- subject to revision as additional data become available. P - preliminary reading , S - second reading, T - third reading, F - final reading

Source: Bloomberg

BofA GLOBAL RESEARCH

CPI Forecast table

Exhibit 15: CPI monthly forecast table

We expect CPI inflation to moderate over the course of our forecast horizon given our expectations for restrictive monetary policy and a soft landing

	Non-seasonally Adjusted						Seasonally Adjusted									
	Headline CPI			Energy			Headline CPI					Core CPI				
	Level	m/m	y/y	Level	m/m	y/y	Level	m/m	y/y	q/q saar	y/y (quarterly)	Level	m/m	y/y	q/q saar	y/y (quarterly)
2022: Jan	281.15	0.8	7.5	260.65	1.7	27.0	282.60	0.6	7.6			286.79	0.6	6.1		
2022: Feb	283.72	0.9	7.9	267.77	2.7	25.6	284.61	0.7	8.0			288.15	0.5	6.4		
2022: Mar	287.50	1.3	8.5	298.25	11.4	32.0	287.47	1.0	8.5	9.2	8.0	289.05	0.3	6.5	6.7	6.3
2022: Apr	289.11	0.6	8.3	298.47	0.1	30.3	288.61	0.4	8.2			290.41	0.5	6.1		
2022: May	292.30	1.1	8.6	316.76	6.1	34.6	291.27	0.9	8.5			292.25	0.6	6.0		
2022: Jun	296.31	1.4	9.1	340.92	7.6	41.6	294.73	1.2	8.9	9.7	8.6	294.02	0.6	5.9	6.0	6.0
2022: Jul	296.28	0.0	8.5	325.41	-4.5	32.9	294.63	0.0	8.4			294.93	0.3	5.9		
2022: Aug	296.17	0.0	8.3	305.37	-6.2	23.8	295.32	0.2	8.2			296.64	0.6	6.3		
2022: Sep	296.81	0.2	8.2	297.34	-2.6	19.8	296.54	0.4	8.2	5.5	8.3	298.34	0.6	6.6	6.2	6.3
2022: Oct	298.01	0.4	7.7	300.36	1.0	17.6	297.99	0.5	7.8			299.33	0.3	6.3		
2022: Nov	297.71	-0.1	7.1	292.95	-2.5	13.1	298.60	0.2	7.1			300.26	0.3	6.0		
2022: Dec	296.80	-0.3	6.5	274.94	-6.1	7.3	298.99	0.1	6.4	4.2	7.1	301.46	0.4	5.7	5.1	6.0
2023: Jan	299.17	0.8	6.4	283.33	3.1	8.7	300.54	0.5	6.3			302.70	0.4	5.5		
2023: Feb	300.84	0.6	6.0	281.67	-0.6	5.2	301.65	0.4	6.0			304.07	0.5	5.5		
2023: Mar	301.84	0.3	5.0	279.08	-0.9	-6.4	301.81	0.1	5.0	3.8	5.8	305.24	0.4	5.6	5.0	5.6
2023: Apr	303.36	0.5	4.9	283.35	1.5	-5.1	302.92	0.4	5.0			306.49	0.4	5.5		
2023: May	304.13	0.3	4.0	279.82	-1.2	-11.7	303.29	0.1	4.1			307.82	0.4	5.3		
2023: Jun	305.11	0.3	3.0	283.85	1.4	-16.7	303.84	0.2	3.1	2.7	4.1	308.31	0.2	4.9	4.7	5.2
2023: Jul	305.69	0.2	3.2	284.83	0.3	-12.5	304.35	0.2	3.3			308.80	0.2	4.7		
2023: Aug	307.03	0.4	3.7	294.33	3.3	-3.6	306.27	0.6	3.7			309.66	0.3	4.4		
2023: Sep	307.79	0.2	3.7	296.00	0.6	-0.5	307.48	0.4	3.7	3.6	3.6	310.66	0.3	4.1	2.8	4.4
2023: Oct	307.67	0.0	3.2	286.75	-3.1	-4.5	307.62	0.0	3.2			311.37	0.2	4.0		
2023: Nov	307.05	-0.2	3.1	277.03	-3.4	-5.4	307.92	0.1	3.1			312.25	0.3	4.0		
2023: Dec	306.75	-0.1	3.4	269.38	-2.8	-2.0	308.85	0.3	3.3	2.8	3.2	313.22	0.3	3.9	3.4	4.0
2024: Jan	308.02	0.4	3.0	270.35	0.4	-4.6	309.37	0.2	2.9			313.99	0.2	3.7		
2024: Feb	309.29	0.4	2.8	270.54	0.1	-4.0	310.05	0.2	2.8			314.79	0.3	3.5		
2024: Mar	310.88	0.5	3.0	278.15	2.8	-0.3	310.84	0.3	3.0	2.6	2.9	315.63	0.3	3.4	3.3	3.6
2024: Apr	312.09	0.4	2.9	282.32	1.5	-0.4	311.57	0.2	2.9			316.42	0.2	3.2		
2024: May	312.86	0.2	2.9	285.31	1.1	2.0	311.92	0.1	2.8			317.21	0.2	3.0		
2024: Jun	314.33	0.5	3.0	292.00	2.3	2.9	312.90	0.3	3.0	2.7	2.9	318.00	0.2	3.1	3.1	3.1
2024: Jul	314.78	0.1	3.0	288.49	-1.2	1.3	313.27	0.1	2.9			318.79	0.2	3.2		
2024: Aug	315.21	0.1	2.7	288.78	0.1	-1.9	314.33	0.3	2.6			319.52	0.2	3.2		
2024: Sep	315.04	-0.1	2.4	283.04	-2.0	-4.4	314.66	0.1	2.3	2.5	2.6	320.24	0.2	3.1	2.9	3.2
2024: Oct	315.10	0.0	2.4	277.78	-1.9	-3.1	314.98	0.1	2.4			320.94	0.2	3.1		
2024: Nov	314.56	-0.2	2.4	272.75	-1.8	-1.5	315.38	0.1	2.4			321.65	0.2	3.0		
2024: Dec	314.24	-0.1	2.4	269.61	-1.2	0.1	316.39	0.3	2.4	1.9	2.4	322.35	0.2	2.9	2.7	3.0
2025: Jan	315.65	0.4	2.5	273.32	1.4	1.1	317.04	0.2	2.5			323.05	0.2	2.9		
2025: Feb	316.65	0.3	2.4	271.42	-0.7	0.3	317.44	0.1	2.4			323.74	0.2	2.8		
2025: Mar	318.00	0.4	2.3	277.35	2.2	-0.3	317.93	0.2	2.3	2.4	2.4	324.44	0.2	2.8	2.6	2.8
2025: Apr	319.09	0.3	2.2	281.16	1.4	-0.4	318.53	0.2	2.2			325.12	0.2	2.7		
2025: May	319.81	0.2	2.2	285.00	1.4	-0.1	318.84	0.1	2.2			325.80	0.2	2.7		
2025: Jun	321.33	0.5	2.2	293.35	2.9	0.5	319.84	0.3	2.2	2.0	2.2	326.48	0.2	2.7	2.6	2.7
2025: Jul	321.86	0.2	2.3	292.67	-0.2	1.4	320.30	0.1	2.2			327.15	0.2	2.6		
2025: Aug	322.49	0.2	2.3	296.11	1.2	2.5	321.57	0.4	2.3			327.82	0.2	2.6		
2025: Sep	322.45	0.0	2.4	293.01	-1.0	3.5	322.06	0.1	2.4	2.8	2.3	328.49	0.2	2.6	2.5	2.6
2025: Oct	322.61	0.0	2.4	289.68	-1.1	4.3	322.48	0.1	2.4			329.15	0.2	2.6		
2025: Nov	322.16	-0.1	2.4	286.60	-1.1	5.1	323.00	0.2	2.4			329.81	0.2	2.5		
2025: Dec	321.93	-0.1	2.4	285.10	-0.5	5.7	324.14	0.4	2.4	2.4	2.4	330.47	0.2	2.5	2.4	2.5

Source: Bureau of Labor Statistics, BofA Global Research

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