



DB CoTD: The Fed Dilemma

*** Yesterday we launched our latest global market survey, which we're doing on a quarterly basis now. We ask simple questions to tease out your thoughts on tariffs, Germany, US vs. European equities, etc. We would very much appreciate all responses. They are all anonymous. The link to fill it in is [here](#). ***

As we see the start of the latest two-day FOMC meeting, our economists anticipate a relatively quiet affair, with the Fed still in wait-and-see mode. See their preview [here](#).

Meanwhile, data like that shown in today's CoTD highlights a dilemma the Fed may face in the coming months. The latest University of Michigan survey (released last Friday) revealed that consumers' real income expectations over the next one to two years reached the lowest point in the survey's 47-year history. Given that nominal income expectations have held up better, it's clear that the perception of impending inflation is the primary cause. This is also reflected in the inflation expectation series. Currently, these inflation expectations are highly polarised by political affiliation, suggesting that at least half the electorate will ultimately be proven wrong regarding future inflation. However, the risk is that, in aggregate, these expectations will begin to influence behaviour.

Therefore, if expectations of future real incomes are at these all-time lows due to inflation expectations, cutting rates in the future to offset declining consumer confidence becomes more complex. The Fed likely hopes that a significant portion of the population will soon feel more optimistic and less concerned about inflation.

Thanks to Steve Caprio (head of Credit Strategy) on my team for this graph. It's included in his latest report, which highlights why the risk/reward profile still favours wider spreads. Steve's team was among the few to predict wider spreads this year and European outperformance of US markets. Regarding the latter prediction, the report explains why they have now closed out their European credit overweight, given the increasing difficulty of further spread compression upside. See their note [here](#) for more.

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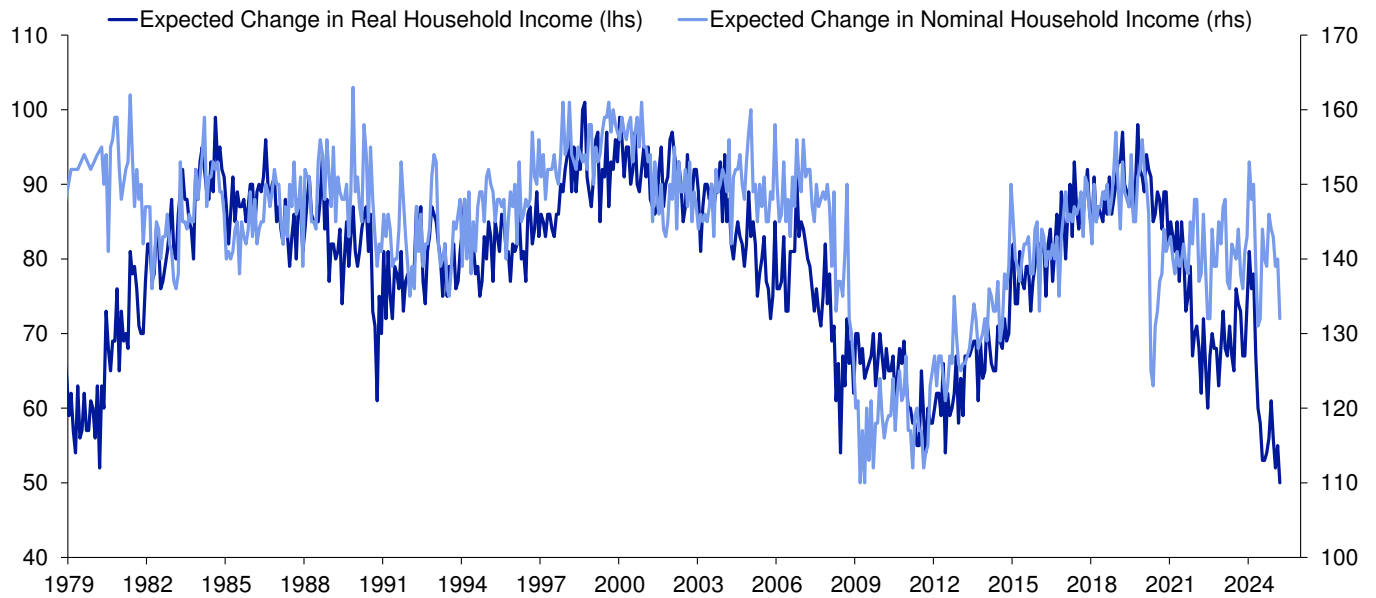
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Figure 1: It will be more challenging than usual for the Fed to cut rates if consumer confidence continues to fall as much of the decline is due to expectations of falls in real income due to the perception of higher upcoming inflation.



Source : Deutsche Bank, Bloomberg Finance LP



Appendix 1

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