Fed put. Growth vs Inflation
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Fed day tomorrow. Starting with a quote from Powell press conference on the 29th of January.

*I think if we look back over the past , **we can see that policy is restrictive.** Now, policy is meaningfully less restrictive than it was before we began to cut. It's 100 basis points less restrictive. And for that reason, we're going to be focusing on real progress on inflation or, alternatively, some weakness in the labor market before we—before we consider making adjustments. (Source: here)*

The starting point and the assumption here is that policy continues to be restrictive. what follows from here are 6 key point into the Fed tomorrow.

1. **Fed's Stance:** Fed expected to maintain "optionality," - it will keep flexibility on the policy path. However, with core PCE tracking higher, there could be upward pressure on the dot plot.

2. **Market Reaction:**

- **Relief Rally:** Positive for risk parity. Equities and FI could see a bounce as volatility declines.
- **Pain Trade:** One rate cut and no changes to QT. This leads to a bull-flattening and risk-off move
- **Positioning:** Limited directional bets, indicating that this Fed is not seen as a game-changer.

3. **Expectations on Dots & QT:**

- **SEP/Dots:** The median dot is expected to signal two rate cuts, which aligns with market expectations.
- **QT :** Market pricing suggests a 60% chance of a pause, with two possible scenarios
- 1. **Soft Pause:** Reducing runoff from $10B to $20B.
- 2. **Stronger Pause:** Reinvesting MBS runoff into Treasuries.

QT is More Important Than Dots: The Fed's primary goal seems to be controlling volatility, suggesting QT adjustments may take precedence over rate cut projections.

Curve & Sector Implications:

- Yield Curve: If the Fed avoids a one-cut scenario, the reaction is a steepening in US 2s10s.
- Cyclical vs Defensive Stocks: A strong QT pause + two dot cuts would likely favor cyclical stocks.
- Risk Assets: Market positioning favors a rally in risk assets with continued demand for USD and SPX.

5. Market Psychology & Bias:

- Many investors expect to buy the dip on a hawkish surprise, assuming
- A. The market is more focused on growth than near-term inflation.
- B. Hawkish surprise might trigger a rates sell-off but could be short-lived due to still-fragile risk markets.

The central case is a modest relief rally and lower volatility, but pain trades could arise if: 1) QT expectations disappoint 2) The median dot signals only one cut, triggering a risk-off move with a bull flattening.

6. Flows & Positioning:

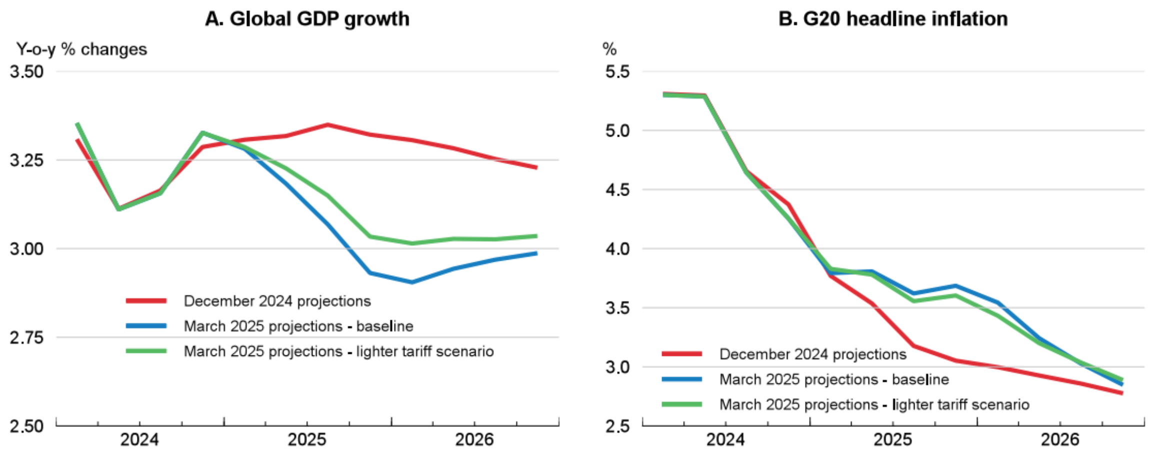
- Investors have been selling the front end of the curve, with better buying further out.
- The market is currently in wait-and-see mode, particularly after the recent growth scare premium.
- Risk Assets- Equity cash volumes are down 20% vs recent avg. Risk better for sale across all client types today.

Bottom Line: The Fed objective is to control volatility given this level of economic uncertainty.

- The base case is a mildly dovish Fed (QT soft pause + two dots), which supports risk assets.
- Biggest risk: A one-cut scenario or underwhelming QT adjustments.
- Positioning suggests a relief rally, but risks remain if the Fed leans more hawkish than expected.

OECD latest projections: Global growth is expected to soften and inflation to remain high: (Source: here)

Figure 7. Global growth is projected to weaken



Note: The global and G20 aggregates use moving GDP weights at purchasing power parities. See main text for details of the baseline and lighter tariff scenario.

Source: OECD Interim Economic Outlook 117 database; OECD Economic Outlook 116 database; and OECD calculations.