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Macro Roundup Article

Headline: The Fed Prepares for Rate Cuts. But Why?

Article Link: https://theovershoot.co/p/the-fed-prepares-for-rate-cuts-but

Author(s)	Matt Klein
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Tweet: .@M_C_Klein argues that rate cuts could be "unnecessarily stimulative" risking above-target inflation, given the ongoing rise in asset prices, continued wage growth, and strong private sector balance sheets.

Summary: Beyond asset prices, the quantities of consumer borrowing and bank lending have also shown signs of stabilizing (or modest acceleration) in the second half of 2023. None of this is what one would expect if policy were actually “restrictive”. The argument from Fed officials is that none of this matters. As Governor Chris Waller put it recently, “if inflation goes down, you would lower policy the rate”. But the inflation data are telling us only what has already happened, while interest rates are supposed to be forward-looking. Setting the future price of money based on last year’s price increases is nonsensical. As it happens, inflation had always been expected to slow, which is why breakevens never went above 4%. Moreover, these market-implied inflation premiums have not budged in over a year. The danger is that they may instead be shifting from “neutral” to “unnecessarily stimulative” because they are calibrating policy with a faulty backward-looking model.

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Primary Topic: Business Cycle

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