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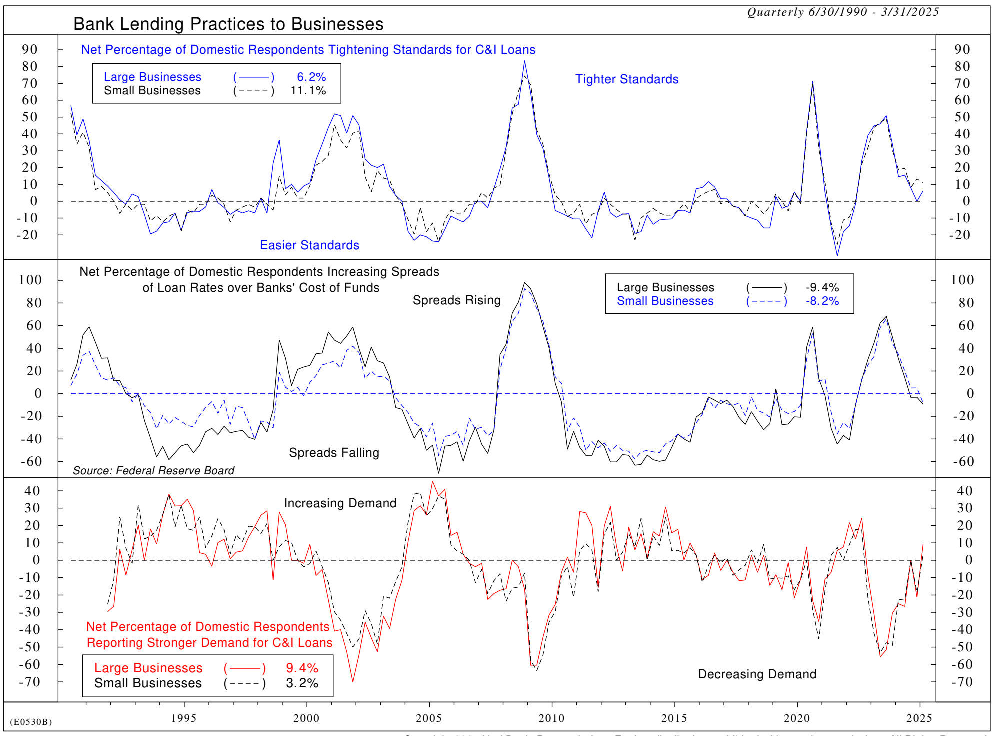
Is Fed policy meaningfully restrictive?

Key Takeaways

- Powell views policy as meaningfully restrictive. Real rates remain above neutral.
- Banks continue to tighten lending standards, but financial conditions remain easy.
- These conditions won't last forever. Rolling over maturing loans at higher rates is restrictive. We should see more of that this year.

Tighter standards for business loans



In last week's press conference, Fed Chair Powell still described monetary policy as "meaningfully restrictive." He pointed to the effect of high rates on interest sensitive spending such as housing. He also noted the progress toward achieving the goal variables of 2% inflation and maximum employment.

We generally use the level of real rates to determine the degree of restrictiveness. At 1.8%, **the** real rate **is 80 bp above the Fed's longer run median estimate**.

Tighter standards

The FOMC, however, had access to one additional data set that we did not have last week. The Senior Loan Officer Opinion Survey showed that banks continued to tighten lending standards. Banks reported modestly tighter standards on balance for business loans, amid stronger demand (chart above). Banks also tightened standards at a slower pace for commercial real estate loans.

In the household sector, standards tightened for credit cards and were basically unchanged for other types of loans.

Banks expect standards to be flat to easier over the course of 2025 amid stronger demand. Respondents expect business loan quality to improve but consumer loan quality to deteriorate or show little change.

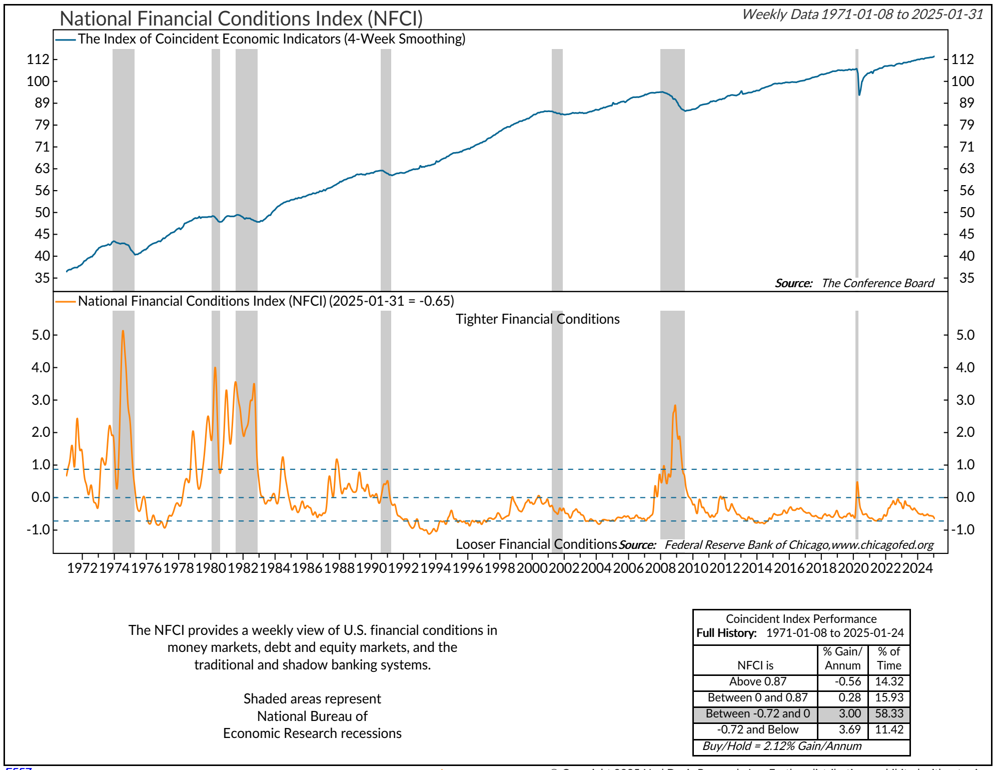
Those who say Fed policy is NOT meaningfully restrictive point to accommodative financial conditions, such as the one produced by the Chicago Fed. At -0.65, the index is well below the neutral zero reading (page 2, top chart).

Our own Credit Conditions Index (CCI), which measures the cost and availability of credit to the real economy, remains squarely in positive territory at 70.5% (page 2, bottom chart). Business conditions remain near record highs, while the consumer sector has stabilized. The CCI consistently called for above-trend growth last year.

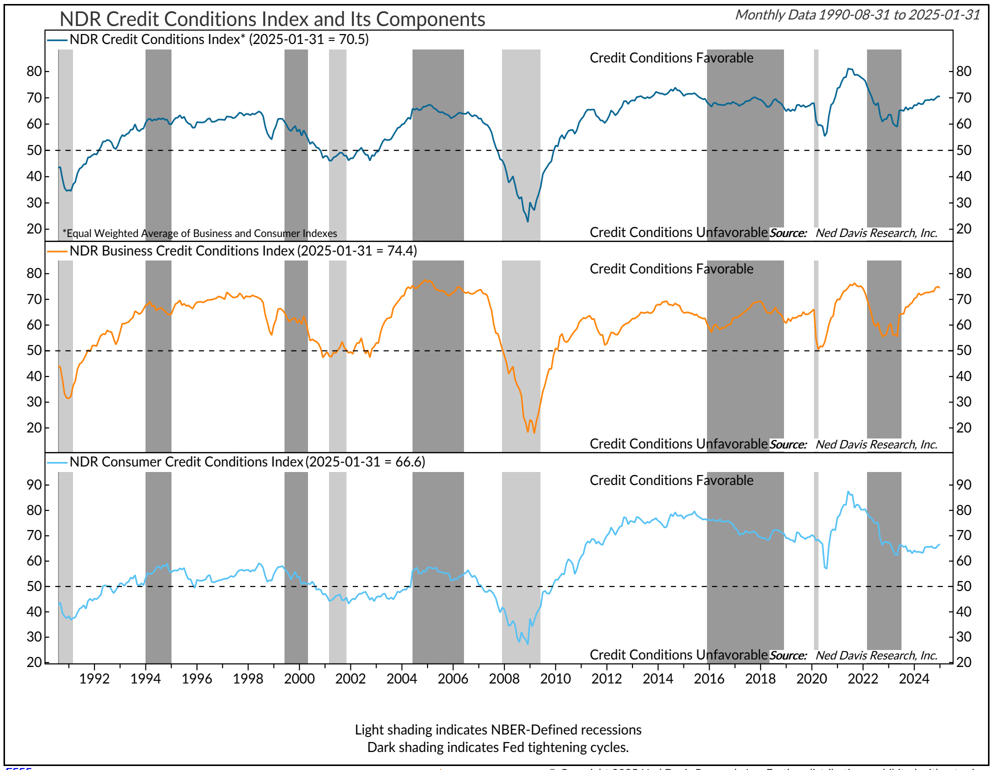
The debate

The battle between real rates and the impact on interest sensitive sectors on one hand and easy financial conditions on the other has sowed confusion among market participants about the direction of policy. We view this as **another distortion from the pandemic**. The impact of higher rates only affected those who had floating rate loans or those who wanted to take out new loans. Those with fixed rate debt weren't impacted or were positively impacted by the higher rates they were getting on their cash.

NFCI shows easy financial conditions



CCI remains positive



But those conditions won't last forever. Typical business loans taken out during the pandemic have a term of five to ten years. Rolling over maturing loans at higher rates is restrictive. It's just that we haven't seen much of that impact yet. That should start to change this year.

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NDR HOUSE VIEWS (Updated February 4, 2025)

For global asset allocation, NDR recommends an overweight allocation to stocks, marketweight allocation to cash, and an underweight allocation to bonds. Our recommendations are in line with our Global Balanced Account Model.

Equity Allocation

U.S. | Our U.S. asset allocation recommendation is 70% stocks (15% overweight), 25% bonds (10% underweight), and 5% cash (5% underweight). On an absolute basis, we are overweight the S&P 500 (year-end 2025 target of 6600). We are neutral on small-caps versus large-caps (implicit overweight to mid-caps) and neutral on Growth versus Value.

INTERNATIONAL | We are overweight the United States, Canada, and Pacific ex-Japan; underweight Emerging Markets, the U.K., and Japan; and makeweight Europe ex. U.K.

Macro

ECONOMY | The global economy has shown notable resilience, with recession chances waning. Risks include monetary and fiscal policy uncertainty, sticky inflation, and easing Chinese growth.

FIXED INCOME | We remain 100% of benchmark duration, and are neutral on the yield curve. We are overweight MBS and underweight CMBS and ABS. We are marketweight everything else.

GOLD | We are currently bullish.

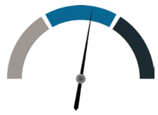
CURRENCIES | We are neutral on the U.S. dollar, euro, yen and the U.K. pound.

Economic Summary

February 3, 2025

Near term activity: ● Accelerating ● Neutral ● Decelerating

Global Economy
(3.1%)



U.S. Economy
(1.5% - 2.0%)

U.S. Inflation
(2.75% - 3.25%)

Economic gauges reflect changes in near-term economic activity. Numbers in parenthesis refer to NDR 2024 forecasts.

Global Asset Allocation

● Overweight ● Marketweight ● Underweight

- ● Stocks (70%)
- ● Cash (10%)
- ● Bonds (20%)

Benchmark: Stocks (55%), Bonds (35%), Cash (10%)

Equities — Regional Relative Allocation

- ● United States 69% | Canada (5%) | Pacific ex. Japan (4%)
- ● Europe ex. U.K. (13%)
- ● Emerging Markets (5%) | U.K. (2%) | Japan (2%)

Benchmark – U.S. (64.0%), Europe ex. U.K. (11.7%), Emerging Markets (10.2%), Japan (5.3%), U.K. (3.4%), Pacific ex. Japan (2.5%), Canada (2.8%)

Global Bond Allocation

- ● Europe (35%)
- ● U.S. (56%) | U.K. (4%)
- ● Japan (5%)

Benchmark: U.S. (57%), Europe (27%), Japan (12%), U.K. (5%)

U.S. Allocation

- ● Stocks (70%) | Mid-Cap
- ● Small-Cap | Large-Cap | Growth | Value
- ● Bonds (25%) | Cash (5%)

Benchmark: Stocks (55%), Bonds (35%), Cash (10%)

Sectors

- ● Financials (16%) | Consumer Discretionary (14%)
- ● Materials (1%) | Health Care (10%)

Benchmark: Technology (30.1%), Health Care (12.1%), Financials (12.6%), Communication Services (9.2%), Consumer Discretionary (10.6%), Consumer Staples (6.5%), Industrials (8.5%), Energy (3.9%), Utilities (2.3%), Real Estate (2.3%), Materials (2.3%)

U.S. Bonds — 100% of Benchmark Duration

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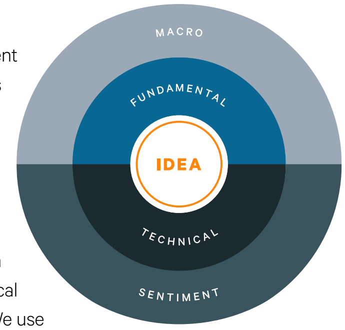
See the Signals.™



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