March 21st, 2024

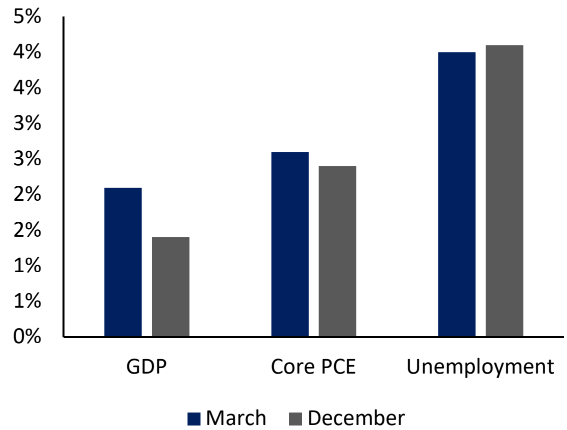
Fed rate cut around the corner!!!

In one of the most anticipated meeting the Fed finally hints to cut rates this year after keeping rates unchanged in the last five meeting. And this will be one of the first rate cut after raising rates steeply in 2022-23 by 500 bps and as rates rose to the highest level in 40 years. The main reason for raising rates was inflation and now the reasoning for cutting rates too is stable price rise. The dollar retraced from the recent highs of 105 and currently is trading around 103 levels, after the dot plot suggest that the Fed could be looking to cut rates thrice this year.

Was the Fed dovish or hawkish?

The question now arises is the Fed dovish or hawkish? What could be the implications of the same on the dollar in the near future? So it seems that the market currently is bewildered from the Fed Chairman's commentary. Growth is projected to inch higher to about 2.1% from earlier projection of 1.4%, suggesting stability in the economy. On the other hand, price rise is expected to remain stick and core PCE is projected at 2.6% compared from earlier projection of 2.4%. As far as the dot plot goes officials suggest that median rate for the year could be at 4.6%, thereby pricing in three rate cuts for this year. The Fed governor signalled that path of soft landing could be complicated than anticipated earlier. Overall, commentary is 'anticipated' to be dovish primarily as previously the market was discounting a couple of rate cuts and now are pricing in three rate cuts. On the contrary, a revision of GDP and inflation forecast is likely to be anticipated as hawkish and that could restrict sharp downside for the dollar.

Fed Future Projections

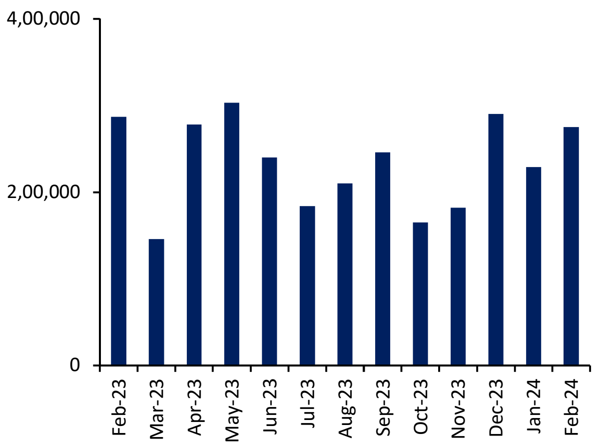


Source: fed.gov

Path to Rate Cuts

The Fed Chairman has noted in the past that cutting rates too soon could spark a resurgence in inflation, thereby causing pain to consumers and businesses. The economy in a broad sense seems to be quite stable and currently we can't find any reason that could push the Fed to cut rates soon. Borrowing cost is expected to remain high and is likely to impact everything from credit card rates to loan purchases for auto or home. So despite raising concerns over inflation, growth prospects remaining strong; the major trigger for cutting rates is higher borrowing cost and that is getting reflected in slower in slower retail sales growth in the last few months.

US NonFarm Payrolls



Source: Reuters

It is interesting to see that the Fed mentioned about *easing the balance sheet run off,* which has fallen from ~$9tln to ~$7.5tln, the M2 money supply that has also fallen significantly, suggests a tight squeeze of liquidity in the market. It is important to pre-emptively scrutinize the market liquidity as, historically whenever M2 money supply has shrunk by at least 2%, a depression combined with double-digit unemployment rates has followed. Currently, M2 has fallen by more than 4% from the peak, which means that less cash is available for individuals and business and some action is required in the same.

Fed officials were continuously preparing the market for a delay in rate cuts, as they were not convinced that inflation has eased down enough and to add-on, the labour market has also been strong justifying their soft landing dialogue. We are seeing something similar once again, wherein market participants are discounting a rate cut three months from now, but Fed officials and economic data points are suggesting the opposite.

Outlook

Now that the Fed has taken its neck out and the officials are hinting towards announcing rate cuts this year the dollar rally could remained capped from here on. With major crosses getting support at lower levels primarily on back of weakness in the greenback. Projection suggest that state of the economy remains stable but any shift from three to two rate cuts during the year, could also support the dollar at lower levels. We expect that the recent retracement in the dollar could keep a floor to prices in the near term.

Gold and silver started this year on a steady note, however since mid-Feb both the metals have picked up significant pace. Gold continuously is marking all-time high levels while silver is also catching the pace and inching higher. Market participants are discounting a rate cut since the start of this year and that sentiment is keeping the prices elevated. It is important to understand that economic data, inflation and growth forecasts are on higher side hence, some profit booking could be seen in both, but till the rate cut expectations continue to exist, the bias will be on higher side. US currently is also facing severe Debt related concerns, which could also keep the price supported, similarly for silver recent boost in industrial metals and pick up in Chinese economy could further add gains.

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