



September 20th, 2023.

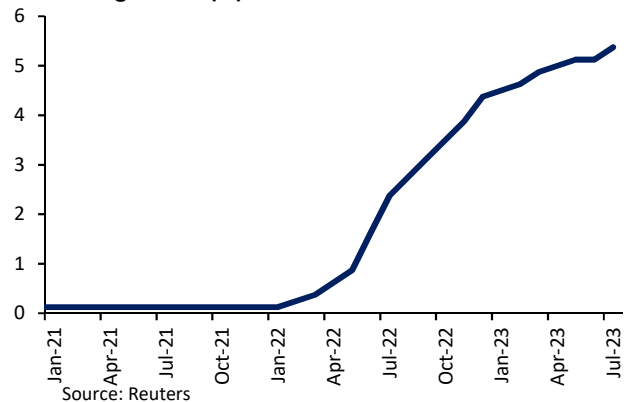
Fed likely to deliver a “Hawkish Pause”

In last couple of years, inflation has been the key measure to evaluate central bank action and focus on growth has taken a back seat. Inflation has retraced in last few months after hitting the highest in September 2022, but the question remains that will inflation recede further or will it turn around and continue to move higher?

Will focus shift to growth from inflation this time around?

In the upcoming meeting market participants have discounted that the central bank is expected to take a pause and is going to be narrative of the Fed governor that will drive a move in currencies, commodities and US treasuries. Before we answer all these questions, let us look at how is the overall state of US economy and what should we expect from today’s Fed meeting.

Fed's Target Rate (%)

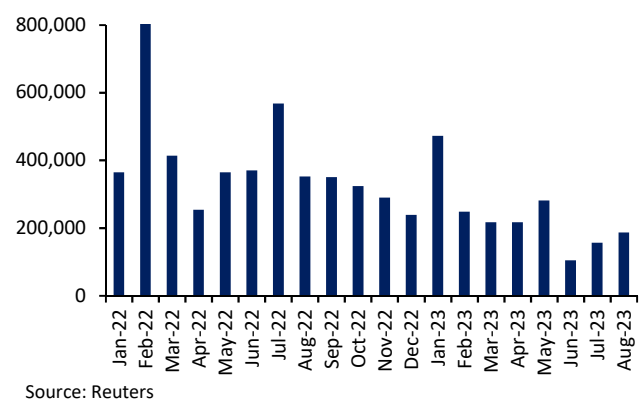


Moving towards ‘Soft-Landing’

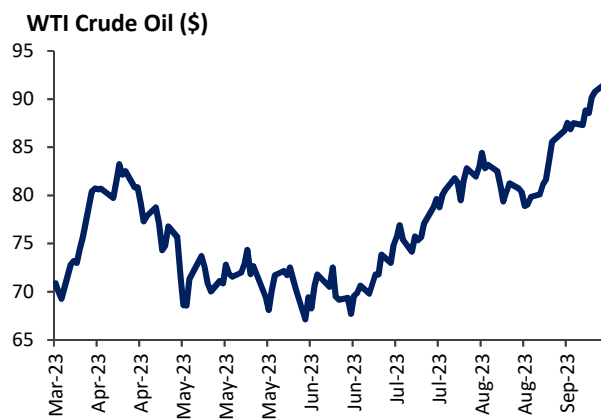
The U.S. economy has remained solid despite the Federal Reserve’s aggressive tightening in the last one and half year. Higher borrowing cost could lead to a situation like ‘hard-landing’; which currently looks out of sight as economic numbers have been beating estimates. Demand across the US economy remains firm and that remains one of the key reason to dodge a recession. Retail sales number in the last few months also suggest that there has been sustained recovery. Unfortunately, recent economic data is showing warning signs that higher interest rates may finally be starting to take a toll on the labor market. Latest jobs data reported that unemployment rate ticked up in August, while adding 187k jobs in August, thereby marking the latest evidence that the economy still remains resilient.

On the other hand, growth in consumer spending and other signs of economic resilience suggest that the Fed might have to restrict further money supply to bring back inflation to central bank’s target of 2%. Over the last one-year, interest rates across board has been on a rise and market participants are waiting for more signs to get clarity on whether we are moving towards a ‘Long-pause’ before Fed decides to cut rates. It is not only the Fed but also other major central banks whose focus has been to bring down inflation without sending the economy into recession i.e. Soft-Landing.

US Jobs Market



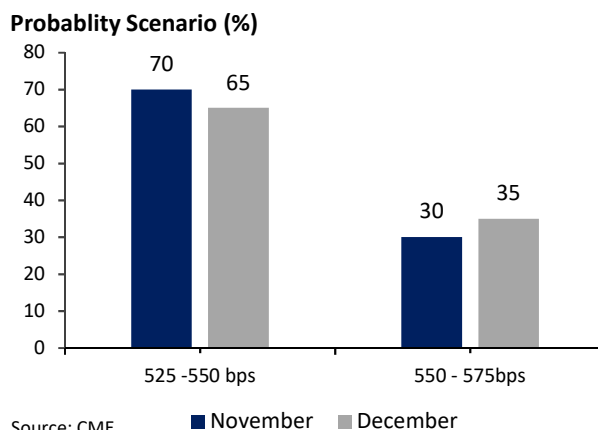
What could distort the overall inflation picture is rising energy prices. Recently, the IEA warned that oil markets were in a deficit and that could deepen further by the end of Q4. Higher crude prices were led by Saudi and Russian cuts that were extended until the end of the year. Many market participants fear that oil could breach the three figure mark in the weeks to come following strong demand, tight supplies and lack of tools available to the US administration to put a lid on prices. Fresh signs of higher inflation are fueling fears that any retracement in crude prices could be short-lived.



Source: Reuters

What to expect from the Fed?

The FOMC released its previous meeting minutes on 16th August, and the official’s language strongly implied that its path forward will be data-dependent. The Fed said inflation remains “unacceptably high” and noted “significant upside risks to inflation, which could require further tightening.” Today, the Federal Reserve is expected to keep rates unchanged and will continue to roll-off its \$8.1 trillion balance sheet. The central bank will continue to allow up to \$60 billion in Treasury securities and \$35 billion in agency mortgage-backed securities (MBS) to mature and roll off its balance sheet per month. The FOMC will also update its long-term economic growth projections, which include forecasts for GDP growth, unemployment rates, interest rates and inflation. The impact of Fed tightening is still having a negative effect on the economy and caution is warranted as growth is slowing. Investors are betting that the Fed could be nearing its rate-hiking cycle, assigning just a 30% chance to a November increase. If the chair does anything to disabuse the market of that sentiment, it would be meaningful. Fed officials are likely to signal one more quarter point interest rate increase when the central bank will publish its so-called ‘Dot-Plot’ of individual projections.



Source: CME

In this meeting we are expecting two scenarios to take shape and impact of the likely scenario is mentioned below:

Scenario	Likely Impact		
	Dollar Index	USDINR	Gold
Hawkish Pause	Green	Green	Red
Dovish Pause	Red	Red	Green

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