Economic Alert

Global Research
12 December 2022

FOMC – Hiking delayed, hiking denied?

- **50bps seems pretty much a done deal given recent Fed comments**
- **We see 4.75-5.00% as slightly more likely than 5.00-5.25% for the end-2023 FFTR**
- **Market reaction to 5.00-5.25% is likely to be benign as long as hikes are spread over 2023**

If you won't let me call him changeable, I'll call him consolable

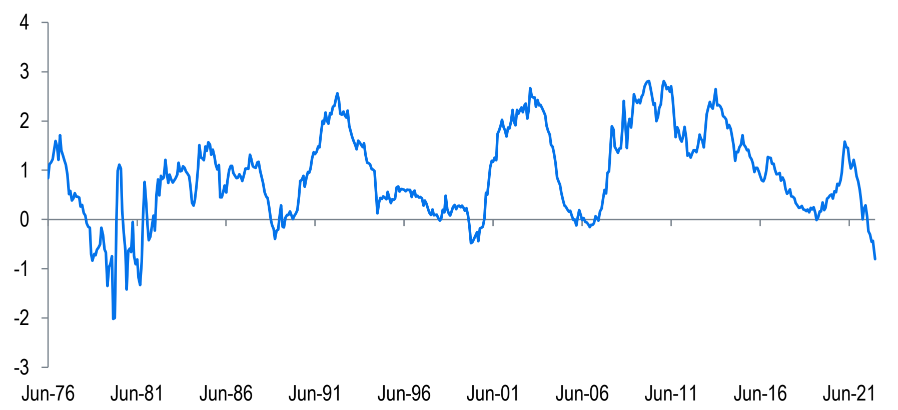
Steve Englander
+1 212 667 0564
Steve.Englander@sc.com
Head, Global G10 FX Research and North America Macro Strategy
Standard Chartered Bank NY Branch

The battleground at the 14 December FOMC meeting is not the fed funds target rate (FFTR) move, which is universally expected to be 50bps, but the hikes at the 1 February meeting and beyond. We have two CPI (one released 13 December) and two PCE releases before the 1 February meeting, so 2023 pricing is very fluid. The focus on 14 December will be on the signals that the FOMC sends on the FFTR peak.

Currently the market is pricing in 4.96% as the peak. We think this reflects an almost 50-50 view on whether the peak FFTR range will be 4.75-5.00% or 5.00-5.25%, although there is more tail to the upside than to the downside. The FOMC's Survey of Economic Projections (SEP) now has the median end-2023 FFTR range as 4.50-4.75%, but with six participants already seeing end-2023 rates above this range, it is not a big leap for the end-2023 median to go to 4.75-5.00% or 5.00-5.25%, although we see the first as more likely. The Fed has pushed back strongly against the idea of 2023 cuts so it is likely that the end-2023 FFTR in the SEP will be seen as the high.

If the FOMC moves to a 4.75-5.00% range on Wednesday, we expect asset markets to rally and the USD to fall. A neutral range would be 5.00-5.25%, with the FOMC acknowledging downside policy rates risk if the economy falters or inflation begins to decelerate. A moderately hawkish move would be 5.00-5.25%, with measured reference to upside rates risk if inflation does not cooperate. An even higher median range or heavy emphasis on the upside risk to policy rates if inflation does not subside would be very hawkish. Indicating that hikes will likely be spread across the year would be somewhat dovish, as in our view, the market sees a 2023 slowdown that will impede hiking as the year progresses.

Figure 1: The market, but not the Fed, sees curve inversion as recession signal
% (10Y UST yield minus 2Y UST yield)



Source: Bloomberg, Standard Chartered Research

If you are in scope for MiFID II and want to opt out of our Research services, please *contact us*.

Issuer of Report: Standard Chartered Bank NY Branch

Important disclosures and analyst certifications can be found in the Disclosures Appendix

We see a pause after a 25bps February hike

Our forecast is for a 50bps policy hike on 14 December, a further 25bps on 1 February then a pause. We think the US economy would have to melt down in January for the FOMC to stay flat at the 1 February meeting. There is risk that the FOMC will hike 50bps at both the December and February meetings, but we think it is more likely that it will stick to 50bps and 25bps respectively, and pause afterward, with the proviso that it could resume hiking if inflation does not retreat.

The market will pay close attention to the end-2023 FFTR dots in the SEP. In September there were already six participants who saw 4.75-5.00%; an upward shift of four dots of the six at 4.50-4.75% would be needed to get the higher range. Given the uniformity of commentary on the need for an upward adjustment (with most saying modest), the median at 25bps higher than in September seems readily attainable.

We see the SEP pointing to 4.75-5.0% as the peak

We think getting to 5.00-5.25% is a harder slog. We assume that all six who were already at 4.75-5.00% will move up (although this is not guaranteed). But to get to 5.00-5.25% would require four of the remaining 13 to move up by 50bps or more. For the six at 4.50-4.75%, this would require a 50bps move and for the remaining seven a 75bps move or more. We do not think that data since September, as mixed as it has been, justifies such big moves to those not leaning hawkishly already.

It is a close call, but we think that 25bps is more likely as the upward adjustment to the projected terminal policy rate than 50bps. The market would likely see this as somewhat dovish even with uncertainty about the ultimate peaks.

Two caveats: (1) Tuesday's CPI release could change the tone. If the core reading comes in at 0.2% or 0.3% m/m, the market view may be that a new lower range has been established. There may be more downside than upside risks to upcoming CPI prints, but with uncertain timing. (2) Fed Chair Powell's press conference spin matters, at least until disproved by data. If he expresses disappointment with data, investors may see a hint that he is leaning to further hikes beyond any pause.

A pause gives the FOMC time to reach consensus

It is well understood that a pause in hiking could be a prelude to subsequent easing, hiking or nothing. The purpose of the pause would be to give the economy more time to indicate whether tightening to date has been adequate. The FOMC has often delayed action by a meeting or two (or more) to get consensus on required moves. If the economy and inflation have not reacted by May or June, even those with dovish tendencies will see a need for moves beyond currently contemplated ranges.

Hiking delayed, hiking denied

The market sees hikes as off the table once a clear downturn begins

If the FOMC statement or Powell at the press conference indicates that 2023 hikes will likely be spread over the year, the market will see this as dovish, in our view. The deeply inverted yield curve signals expectation of a recession (Figure 1), even if not an extremely deep one. With this viewpoint the market is likely to discount projected hikes in Q2-2023 and beyond, because those hikes are likely to be derailed by upcoming weak data. So if the projections point to, say 75bps of hikes in 2023, it will make a difference to the market reaction whether the hikes are expected to be concentrated in Q1 or later in the year. In reacting to this week's FOMC meeting, the market will likely see later hikes as less probable than hikes earlier in the year.

The importance of recession

The Fed needs a slump to be convinced that tightening has taken hold

We think a slump is a necessary and sufficient condition for a pause in Fed policy rate hikes because a slump will tell the FOMC that the tightening has finally taken hold. Until this happens, much policy making is seat of the pants.

Physics has a Standard Model that explains almost everything with great precision. Economics has a standard model that explains little and misses quite a bit. However, the Phillips curve and Taylor rule framework remain the workhorses of most Fed officials. The major principles: (1) The sustainable decline in inflation is proportionate to the cumulative time that unemployment is above its equilibrium level – or roughly the cumulative shortfall of GDP below potential; (2) once policy rates and the unemployment rate are high enough to slow inflation, inflation will fall as long as the policy rates and the unemployment rate stay above the equilibrium level; and (3) a crucial implied equation links real interest rates and GDP growth, but with very uncertain dynamics.

The absence of inflation response may mean long lags or insufficient tightening

At present it is difficult to tell whether the absence of clear activity and inflation response is due to long lags (the dovish view) or the insufficiency of tightening to date (the hawkish view). Doves worry that not enough time has been given for the dynamics of (3) to work through, while hawks worry that we are underestimating how much tightening is needed for (2) to be achieved.

When the unemployment rate begins to rise, it is an unambiguous signal that tightening has been enough to get demand growth below supply growth, ultimately leading to lower inflation. Once the slowdown is clear, it means that the disinflationary cycle is in place and all that is needed is patience in moving policy rates back to neutral as the inflation target is back in sight. Until then, much of policy is conjecture.

Disclosures appendix

Analyst Certification Disclosure: The research analyst or analysts responsible for the content of this research report certify that: (1) the views expressed and attributed to the research analyst or analysts in the research report accurately reflect their personal opinion(s) about the subject securities and issuers and/or other subject matter as appropriate; and, (2) no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendations or views contained in this research report. On a general basis, the efficacy of recommendations is a factor in the performance appraisals of analysts.

Global Disclaimer: Standard Chartered Bank and/or its affiliates ("SCB") makes no representation or warranty of any kind, express, implied or statutory regarding this document or any information contained or referred to in the document (including market data or statistical information). The information in this document, current at the date of publication, is provided for information and discussion purposes only. It does not constitute any offer, recommendation or solicitation to any person to enter into any transaction or adopt any hedging, trading or investment strategy, nor does it constitute any prediction of likely future movements in rates or prices, or represent that any such future movements will not exceed those shown in any illustration. The stated price of the securities mentioned herein, if any, is as of the date indicated and is not any representation that any transaction can be effected at this price. SCB does not represent or warrant that this information is accurate or complete. While this research is based on current public information that we have obtained from publicly available sources, believed to be reliable, but we do not represent it is accurate or complete, no responsibility or liability is accepted for errors of fact or for any opinion expressed herein. This document does not purport to contain all the information an investor may require and the contents of this document may not be suitable for all investors as it has not been prepared with regard to the specific investment objectives or financial situation of any particular person. Any investments discussed may not be suitable for all investors. Users of this document should seek professional advice regarding the appropriateness of investing in any securities, financial instruments or investment strategies referred to in this document and should understand that statements regarding future prospects may not be realised. Opinions, forecasts, assumptions, estimates, derived valuations, projections and price target(s), if any, contained in this document are as of the date indicated and are subject to change at any time without prior notice. Our recommendations are under constant review. The value and income of any of the securities or financial instruments mentioned in this document can fall as well as rise and an investor may get back less than invested. Future returns are not guaranteed, and a loss of original capital may be incurred. Foreign-currency denominated securities and financial instruments are subject to fluctuation in exchange rates that could have a positive or adverse effect on the value, price or income of such securities and financial instruments. Past performance is not indicative of comparable future results and no representation or warranty is made regarding future performance. While we endeavour to update on a reasonable basis the information and opinions contained herein, we are under no obligation to do so and there may be regulatory, compliance or other reasons that prevent us from doing so. Accordingly, information may be available to us which is not reflected in this document, and we may have acted upon or used the information prior to or immediately following its publication. SCB is acting on a principal-to-principal basis and not acting as your advisor, agent or in any fiduciary capacity to you. SCB is not a legal, regulatory, business, investment, financial and accounting and/or tax adviser, and is not purporting to provide any such advice. Independent legal, regulatory, business, investment, financial and accounting and/or tax advice should be sought for any such queries in respect of any investment. SCB and/or its affiliates may have a position in any of the securities, instruments or currencies mentioned in this document. SCB and/or its affiliates or its respective officers, directors, employee benefit programmes or employees, including persons involved in the preparation or issuance of this document may at any time, to the extent permitted by applicable law and/or regulation, be long or short any securities or financial instruments referred to in this document and on the SCB Research website or have a material interest in any such securities or related investments, or may be the only market maker in relation to such investments, or provide, or have provided advice, investment banking or other services, to issuers of such investments and may have received compensation for these services. SCB has in place policies and procedures and physical information walls between its Research Department and differing public and private business functions to help ensure confidential information, including 'inside' information is not disclosed unless in line with its policies and procedures and the rules of its regulators. Data, opinions and other information appearing herein may have been obtained from public sources. SCB expressly disclaims responsibility and makes no representation or warranty as to the accuracy or completeness of such information obtained from public sources. SCB also makes no representation or warranty as to the accuracy nor accepts any responsibility for any information or data contained in any third party's website. You are advised to make your own independent judgment (with the advice of your professional advisers as necessary) with respect to any matter contained herein and not rely on this document as the basis for making any trading, hedging or investment decision. SCB accepts no liability and will not be liable for any loss or damage arising directly or indirectly (including special, incidental, consequential, punitive or exemplary damages) from the use of this document, howsoever arising, and including any loss, damage or expense arising from, but not limited to, any defect, error, imperfection, fault, mistake or inaccuracy with this document, its contents or associated services, or due to any unavailability of the document or any part thereof or any contents or associated services. This document is for the use of intended recipients only. In any jurisdiction in which distribution to private/retail customers would require registration or licensing of the distributor which the distributor does not currently have, this document is intended solely for distribution to professional and institutional investors. This communication is subject to the terms and conditions of the SCB Research Disclosure Website available at https://research.sc.com/Portal/Public/TermsConditions. The disclaimers set out at the above web link applies to this communication and you are advised to read such terms and conditions / disclaimers before continuing. Additional information, including analyst certification and full research disclosures with respect to any securities referred to herein, will be available upon request by directing such enquiries to scgr@sc.com or clicking on the relevant SCB research report web link(s) referenced herein. MiFID II research and inducement rules apply. You are advised to determine the applicability and adherence to such rules as it relates to yourself.

Market-Specific Disclosures – This document is not for distribution to any person or to any jurisdiction in which its distribution would be prohibited. If you are receiving this document in any of the market listed below, please note the following:

Australia: The Australian Financial Services Licence for Standard Chartered Bank is Licence No: 246833 with the following Australian Registered Body Number (ARBN: 097571778). Australian investors should note that this communication was prepared for “wholesale clients” only and is not directed at persons who are “retail clients” as those terms are defined in sections 761G and 761GA of the Corporations Act 2001 (Cth). **Bangladesh:** This research has not been produced in Bangladesh. The report has been prepared by the research analyst(s) in an autonomous and independent way, including in relation to SCB. THE SECURITIES MENTIONED IN THIS REPORT HAVE NOT BEEN AND WILL NOT BE REGISTERED IN BANGLADESH AND MAY NOT BE OFFERED OR SOLD IN BANGLADESH WITHOUT PRIOR APPROVAL OF THE REGULATORY AUTHORITIES IN BANGLADESH. Any subsequent action(s) of the Recipient of these research reports in this area should be subject to compliance with all relevant law & regulations of Bangladesh; especially the prevailing foreign exchange control regulations. **Botswana:** This document is being distributed in Botswana by, and is attributable to, Standard Chartered Bank Botswana Limited, which is a financial institution licensed by Bank of Botswana under Section 6 of the Banking Act CAP 46.04 and is listed on the Botswana Stock Exchange. **Brazil:** SCB disclosures pursuant to the Securities Exchange Commission of Brazil (“CVM”) Instruction 598/18: This research has not been produced in Brazil. The report has been prepared by the research analyst(s) in an autonomous and independent way, including in relation to SCB. THE SECURITIES MENTIONED IN THIS REPORT HAVE NOT BEEN AND WILL NOT BE REGISTERED PURSUANT TO THE REQUIREMENTS OF THE SECURITIES AND EXCHANGE COMMISSION OF BRAZIL AND MAY NOT BE OFFERED OR SOLD IN BRAZIL EXCEPT PURSUANT TO AN APPLICABLE EXEMPTION FROM THE REGISTRATION REQUIREMENTS AND IN COMPLIANCE WITH THE SECURITIES LAWS OF BRAZIL. **China:** This document is being distributed in China by, and is attributable to, Standard Chartered Bank (China) Limited which is mainly regulated by China Banking and Insurance Regulatory Commission (CBIRC), State Administration of Foreign Exchange (SAFE), and People’s Bank of China (PBoC). **European Economic Area:** In Germany, Standard Chartered Bank AG, a subsidiary of Standard Chartered Bank, is authorised by the European Central Bank and supervised by the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht-“BaFin”) and the German Federal Bank (Deutsche Bundesbank). This communication is directed at persons Standard Chartered Bank AG can categorise as Eligible Counterparties or Professional Clients (such persons constituting the target market of this communication following Standard Chartered Bank AG’s target market assessment) as defined by the Markets in Financial Instruments Directive II (Directive 2014/65/EU) (“MiFID II”) and the German Securities Trading Act (“WpHG”). No other person should rely upon it. In particular, this is not directed at Retail Clients (as defined by MiFID II and WpHG) in the European Economic Area. Nothing in this communication constitutes a personal recommendation or investment advice as defined by MiFID II and WpHG. **Hong Kong:** This document is being distributed in Hong Kong by, and any part hereof authored by an analyst licensed in Hong Kong is attributable to, Standard Chartered Bank (Hong Kong) Limited 渣打銀行（香港）有限公司 which is regulated by the Hong Kong Monetary Authority. **India:** This document is being distributed in India by Standard Chartered Bank, India Branch (“SCB India”). SCB India is a branch of SCB, UK and is licensed by the Reserve Bank of India to carry on banking business in India. SCB India is also registered with Securities and Exchange Board of India in its capacity as Merchant Banker, Depository Participant, Bankers to an Issue, Custodian, etc. For details on group companies operating in India, please visit https://www.sc.com/in/important-information/india-result/. The RBI had advised that entities under their regulations shall not deal in virtual currencies ("VCs") or provide services for facilitating any person or entity to deal with or settle VCs; however, the Supreme Court overturned the ban on cryptocurrency payments. A proposed law which may prohibit dealing in cryptocurrencies is under discussion, according to media reports. **Indonesia:** Standard Chartered Bank, Jakarta Branch is a banking institution duly licensed and supervised by the Indonesian Financial Service Authority. The information in this document is provided for information purposes only. It does not constitute any offer, recommendation or solicitation to any person to enter into any transaction or adopt any hedging, trading or investment strategy, nor does it constitute any prediction of likely future movements in rates or prices or represent that any such future movements will not exceed those shown in any illustration. Future changes in such laws, rules, regulations, etc., could affect the information in this document, but SCB is under no obligation to keep this information current or to update it. Expressions of opinion are those of SCB only and are subject to change without notice. **Japan:** This document is being distributed to Specified Investors, as defined by the Financial Instruments and Exchange Act of Japan (Act No.25 of 1948, known as “FIEA”), for information only and not for the purpose of soliciting any Financial Instruments Transactions as defined by the FIEA or any Specified Deposits, etc. as defined by the Banking Act of Japan (Act No.59 of 1981). **Kenya:** Standard Chartered Bank Kenya Limited is regulated by the Central Bank of Kenya. The information in this document is provided for information purposes only. The document is intended for use only by Professional Clients and should not be relied upon by or be distributed to Retail Clients. **Korea:** This document is being distributed in Korea by, and is attributable to, Standard Chartered Bank Korea Limited which is regulated by the Financial Supervisory Service and Financial Services Commission. **Macau:** This document is being distributed in Macau Special Administrative Region of the Peoples' Republic of China, and is attributable to, Standard Chartered Bank (Macau Branch) which is regulated by Macau Monetary Authority. **Malaysia**: This document is being distributed in Malaysia by Standard Chartered Bank Malaysia Berhad only to institutional investors or corporate customers. Recipients in Malaysia should contact Standard Chartered Bank Malaysia Berhad in relation to any matters arising from, or in connection with, this document. **Mauritius:** Standard Chartered Bank (Mauritius) Limited is regulated by both the Bank of Mauritius and the Financial Services Commission in Mauritius. This document should not be construed as investment advice or solicitation to enter into securities transactions in Mauritius as per the Securities Act 2005. **New Zealand:** New Zealand Investors should note that this document was prepared for “wholesale clients” only within the meaning of section 5C of the Financial Advisers Act 2008. This document is not directed at persons who are “retail clients” as defined in the Financial Advisers Act 2008. NOTE THAT STANDARD CHARTERED BANK (incorporated in England) IS NOT A “REGISTERED BANK” IN NEW ZEALAND UNDER THE RESERVE BANK OF NEW ZEALAND ACT 1989, and it is not therefore regulated or supervised by the Reserve Bank of New Zealand. **Pakistan:** The securities mentioned in this report have not been, and will not be, registered in Pakistan, and may not be offered or sold in Pakistan, without prior approval of the regulatory authorities and/or relevant governmental statutory body(ies) in Pakistan. **Philippines:** This document may be distributed in the Philippines by Standard Chartered Bank (Philippines) (“SCB PH”) to Qualified Buyers as defined under Section 10.1 (L) of Republic Act No.

Document approved by
Sarah Hewin
Head of Research, Europe and Americas

Document is released at
17:12 GMT 12 December 2022