

8 June 2023

Research US

Fed preview - On hold

- We expect the Fed to maintain rates unchanged next week, markets price in a modest 25% probability of a 25bp hike.
- Focus will be on communication around potential hike in July & the updated dots. The Fed is unlikely to close the door for hikes, but we doubt they will materialize.
- We see downside risks to consensus expectations for May CPI, and forecast +0.2% m/m (4.2% y/y) for headline & +0.3% m/m (5.2% y/y) for core.

Markets have focused on the renewed uptick in macro momentum, which has resurfaced fears of inflation turning more persistent. But we doubt the rise in leading indicators will be sustained, and see evidence of underlying inflation continuing to gradually ease.

While the May NFP surprised markedly to the upside, the underlying details were much weaker. Employment growth is heavily concentrated on sectors such as leisure & hospitality, which have for a long time suffered from labour shortages. As labour force participation is recovering, employment rises even if broader labour demand is weakening. But importantly, supply-driven employment growth is not inflationary, rather the opposite.

The number of employed workers declined by 310k, which together with labour force growth of 130k suggests that slack is finally forming into labour markets. As such, wage sum growth remains on a downtrend, and our preferred measure of underlying inflation, core services CPI & ex. housing & health care, has also stabilized in the last two releases.

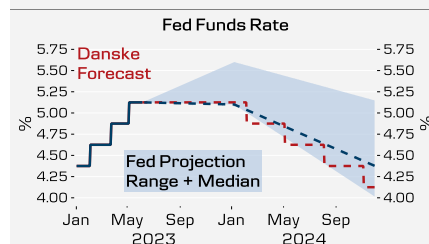
We expect the May CPI, released just ahead of the FOMC meeting, to slow down to 0.2% m/m (4.2% y/y) driven by negative contribution from energy prices. We also forecast Core CPI to continue cooling to 0.3% m/m (5.2% y/y). Manufacturing PMI price indices and used car prices suggest that the April uptick in core goods CPI will not be sustained, while we also look for continuing gradual slowdown in core services and shelter components.

Markets are pricing in a larger (75-80%) probability for a hike in July. Notably, it would only require two individual FOMC participants to shift their 2023 rate projections higher to lift the median 'dot' to 5.25-5.50%, which could spark a hawkish initial reaction in the markets. **We still think the bar for restarting hikes in July will be high** unless inflation pressures clearly accelerate over summer, which we consider unlikely. Private consumption has so far remained markedly resilient compared to the plunge in real disposable income, but with excess savings soon depleted, we think growth backdrop will remain weak.

Negative signals from longer-lead monetary indicators combined with the risk of tightening liquidity conditions over summer will further discourage rate hikes when inflation has already turned lower. Consumers' inflation expectations have continued declining, and currently hover around 4-5%, suggesting that holding nominal rates at 5% will maintain monetary policy stance sufficiently restrictive.

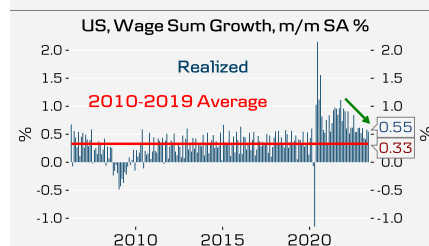
We make no changes to our forecasts, and expect the Fed to maintain rates at the current level for the remainder of the year. A pause could pose near-term upside risks to EUR/USD, but we still maintain a bearish view on the cross towards H2.

Distribution of individual Fed forecasts was tilted to the upside of median already back in March



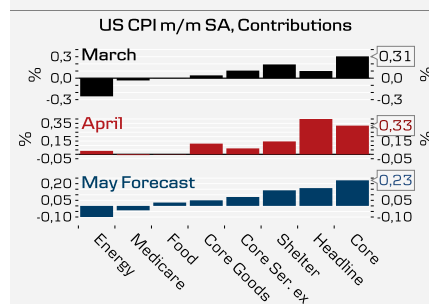
Sources: The Fed, Danske Bank

Labour markets are gradually cooling



Sources: Macrobond Financial, U. S. BLS

The inflation boost from core goods prices is unlikely to last



Sources: U. S. BLS, Danske Bank

Analyst

Antti Ilvonen
+358 445 180 297
antti.ilvonen@danskebank.com

Director

Jens Nærvig Pedersen
+45 45 14 14 95
jenpe@danskebank.dk

Disclosures

This research report has been prepared by Danske Bank A/S ('Danske Bank'). The authors of this research report are Antti Ilvonen, Analyst and Jens Nærvig Pedersen, Director

Analyst certification

Each research analyst responsible for the content of this research report certifies that the views expressed in the research report accurately reflect the research analyst's personal view about the financial instruments and issuers covered by the research report. Each responsible research analyst further certifies that no part of the compensation of the research analyst was, is or will be, directly or indirectly, related to the specific recommendations expressed in the research report.

Regulation

Danske Bank is authorised and regulated by the Danish Financial Services Authority (Finanstilsynet). Danske Bank is authorised by the Prudential Regulation Authority in the UK. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

Danske Bank's research reports are prepared in accordance with the recommendations of Capital Market Denmark.

Conflicts of interest

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high-quality research based on research objectivity and independence. These procedures are documented in Danske Bank's research policies. Employees within Danske Bank's Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and the Compliance Department. Danske Bank's Research Departments are organised independently from, and do not report to, other business areas within Danske Bank.

Research analysts are remunerated in part based on the overall profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

Financial models and/or methodology used in this research report

Calculations and presentations in this research report are based on standard econometric tools and methodology as well as publicly available statistics for each individual security, issuer and/or country. Documentation can be obtained from the authors on request.

Risk warning

Major risks connected with recommendations or opinions in this research report, including as sensitivity analysis of relevant assumptions, are stated throughout the text.

Expected updates

Ad hoc

Date of first publication

See the front page of this research report for the date of first publication.

General disclaimer

This research has been prepared by Danske Bank A/S. It is provided for informational purposes only and should not be considered investment, legal or tax advice. It does not constitute or form part of, and shall under no circumstances be considered as, an offer to sell or a solicitation of an offer to purchase or sell any relevant financial instruments (i.e. financial instruments mentioned herein or other financial instruments of any issuer mentioned herein and/or options, warrants, rights or other interests with respect to any such financial instruments) ('Relevant Financial Instruments').

This research report has been prepared independently and solely on the basis of publicly available information that Danske Bank A/S considers to be reliable but Danske Bank A/S has not independently verified the contents hereof. While reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation or warranty, express or implied, is made as to, and no reliance should be placed on, the fairness, accuracy, completeness or reasonableness of the information, opinions and projections contained in this research report and Danske Bank A/S, its affiliates and subsidiaries accept no liability whatsoever for any direct or consequential loss, including without limitation any loss of profits, arising from reliance on this research report.

The opinions expressed herein are the opinions of the research analysts and reflect their opinion as of the date hereof. These opinions are subject to change and Danske Bank A/S does not undertake to notify any recipient of this research report of any such change nor of any other changes related to the information provided in this research report.

This research report is not intended for, and may not be redistributed to, retail customers in the United Kingdom (see separate disclaimer below) and retail customers in the European Economic Area as defined by Directive 2014/65/EU.

This research report is protected by copyright and is intended solely for the designated addressee. It may not be reproduced or distributed, in whole or in part, by any recipient for any purpose without Danske Bank A/S's prior written consent.

Disclaimer related to distribution in the United States

This research report was created by Danske Bank A/S and is distributed in the United States by Danske Markets Inc., a U.S. registered broker-dealer and subsidiary of Danske Bank A/S, pursuant to SEC Rule 15a-6 and related interpretations issued by the U.S. Securities and Exchange Commission. The research report is intended for distribution in the United States solely to 'U.S. institutional investors' as defined in SEC Rule 15a-6. Danske Markets Inc. accepts responsibility for this research report in connection with distribution in the United States solely to 'U.S. institutional investors'.

Danske Bank A/S is not subject to U.S. rules with regard to the preparation of research reports and the independence of research analysts. In addition, the research analysts of Danske Bank A/S who have prepared this research report are not registered or qualified as research analysts with the New York Stock Exchange or Financial Industry Regulatory Authority but satisfy the applicable requirements of a non-U.S. jurisdiction.

Any U.S. investor recipient of this research report who wishes to purchase or sell any Relevant Financial Instrument may do so only by contacting Danske Markets Inc. directly and should be aware that investing in non-U.S. financial instruments may entail certain risks. Financial instruments of non-U.S. issuers may not be registered with the U.S. Securities and Exchange Commission and may not be subject to the reporting and auditing standards of the U.S. Securities and Exchange Commission.

Disclaimer related to distribution in the United Kingdom

In the United Kingdom, this document is for distribution only to (I) persons who have professional experience in matters relating to investments falling within article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the 'Order'); (II) high net worth entities falling within article 49(2)(a) to (d) of the Order; or (III) persons who are an elective professional client or a per se professional client under Chapter 3 of the FCA Conduct of Business Sourcebook (all such persons together being referred to as 'Relevant Persons'). In the United Kingdom, this document is directed only at Relevant Persons, and other persons should not act or rely on this document or any of its contents.

Disclaimer related to distribution in the European Economic Area

This document is being distributed to and is directed only at persons in member states of the European Economic Area ('EEA') who are 'Qualified Investors' within the meaning of Article 2(e) of the Prospectus Regulation (Regulation (EU) 2017/1129) ('Qualified Investors'). Any person in the EEA who receives this document will be deemed to have represented and agreed that it is a Qualified Investor. Any such recipient will also be deemed to have represented and agreed that it has not received this document on behalf of persons in the EEA other than Qualified Investors or persons in the UK and member states (where equivalent legislation exists) for whom the investor has authority to make decisions on a wholly discretionary basis. Danske Bank A/S will rely on the truth and accuracy of the foregoing representations and agreements. Any person in the EEA who is not a Qualified Investor should not act or rely on this document or any of its contents.

Report completed: 8 June 2023, 14:45 CET

Report first disseminated: 8 June 2023, 15:00 CET