

# Fed Monitor

## Why the Fed may soon move in a dovish direction

Although the coronavirus has spread to more countries and equities are now more than 7% down, the Fed has yet to move in a more dovish direction. On Tuesday, Fed vice chair Clarida may have opened the door slightly for a change in direction in the near future if the situation deteriorates further, as he said the Fed is looking at monetary policy on a meeting-to-meeting basis. The question is how much will it take for the Fed to react? **We compare the current situation with the Fed's U-turn in early June 2019 when Fed chair Powell said that the Fed will 'act as appropriate to sustain the expansion'** at the 'Fed listens' event, which eventually led to the first insurance cut in July.

**Our key takeaway is that looking at nearly all metrics, the economy is in worse shape than in June 2019 (see table below and charts next page). This means we should expect the Fed to shift soon in a more dovish direction and investors are right in pricing in cuts, in our view.** The Fed's blackout period ahead of the 17-18 March meeting begins on 7 March and since none of the most important FOMC members (as of today) is scheduled to speak before, the dovish shift may not occur until the meeting (in the statement or at the press conference). Otherwise we believe a shift will occur after the March meeting, mirroring the radical U-turn the Fed made in early January 2019 after the hawkish meeting in December 2018 amid a longer risk-off period. **Our base case is still a rate cut in April.**

### Things are looking worse than when Fed chair Powell changed direction in June

Indicator	Change	Current level		Level before Powell speech 4 June 2019	
		Level	Date	Level	Date
Recession probability 10s3m	Worse	55.9%	26-Feb-20	57.6%	03-Jun-19
Recession probability 10s2s	Worse	37.0%	26-Feb-20	33.6%	03-Jun-19
S&P500 decline since last peak	Worse	-7.6%	26-Feb-20	-6.8%	03-Jun-19
10yr breakeven inflation expectations	Worse	1.5%	26-Feb-20	1.7%	03-Jun-19
ISM manufacturing	Worse	50.9	Jan-20	52.3	May-19
ISM non-manufacturing	Worse	55.5	Jan-20	56.3	May-19
PMI manufacturing	Better	50.8	Feb-20	50.6	Jun-19
PMI services	Worse	49.4	Feb-20	51.5	Jun-19
Monthly chg in nonfarm payrolls (first estimate, 3-month avg.)	Better	212	Jan-20	160	Apr-19
Avg. hourly earnings % y/y	Worse	3.1%	Jan-20	3.3%	Apr-19
PCE core inflation	Neutral	1.6%	Dec-20	1.6%	Apr-19
Consumer confidence (conference board)	Neutral	130.7	Feb-20	131.3	May-19
Retail sales growth % 3m/3m	Worse	-0.2%	Jan-20	1.0%	Apr-19
Trade policy uncertainty	Better	632	Jan-20	787	May-19

Source: BEA, BLS, Conference Board, Policy Uncertainty Index, IHS Markit, ISM, Bloomberg, Macrobond Financial, Danske Bank

### Recent Fed monitors

- *Fed Monitor: Fed considers introducing a temporary asymmetric operational inflation target range*, 20 February
- *Fed Monitor: Monitoring, not reacting to, the coronavirus*, 12 February

### Calendar ahead of the FOMC meeting

Date	Fed speeches	Data
27-Feb	Evans and Mester	Core capex
28-Feb	Bullard	PCE core
03-Mar	Mester	ISM manufacturing
04-Mar	Evans; Beige Book	ISM non-manufacturing
05-Mar	Bullard	
06-Mar	Kaplan, Williams, Evans, Mester, Bullard & George	Jobs report
07-Mar	Blackout period starts	
11-Mar		CPI core
13-Mar		Consumer confidence
17-Mar		Retail sales & manufacturing production
18-Mar	<b>Fed policy announcement</b>	

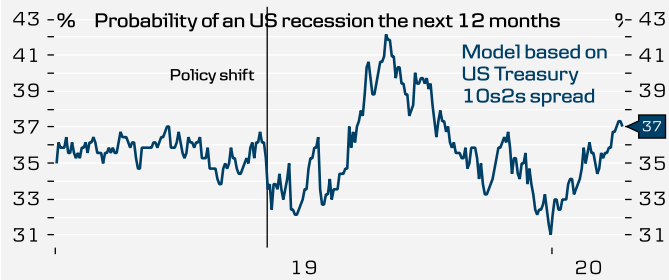
Source: Bloomberg

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## Current situation versus early June 2019

### Slightly higher recession probability according to investors



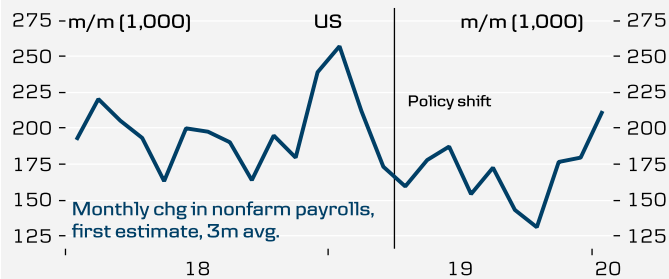
Source: Bloomberg, Macrobond Financial, Danske Bank calculations

### Both ISM indices are lower



Source: ISM, Macrobond Financial

### Jobs growth has accelerated



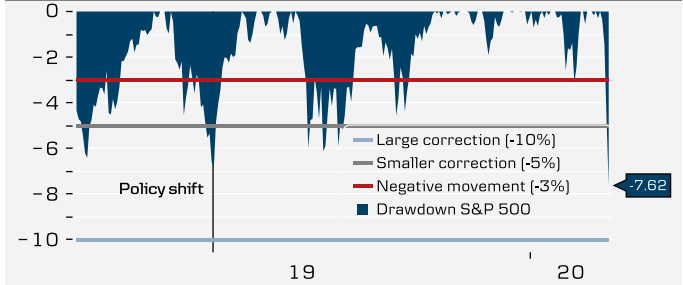
Source: BLS, Macrobond Financial

### Negative retail sales growth



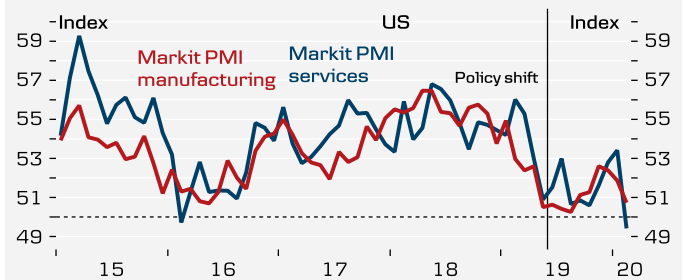
Source: Census Bureau, Macrobond Financial

### Larger S&P500 drawdown



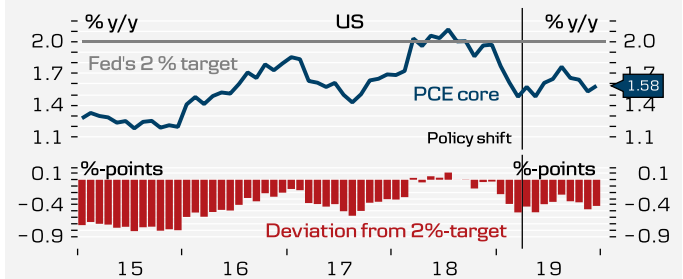
Source: Bloomberg, Macrobond Financial, Danske Bank

### Markit PMI service is below the 50 threshold



Source: IHS Markit, Macrobond Financial

### PCE core inflation remains below 2%



Source: IBEA, Macrobond Financial

### Consumer confidence basically unchanged



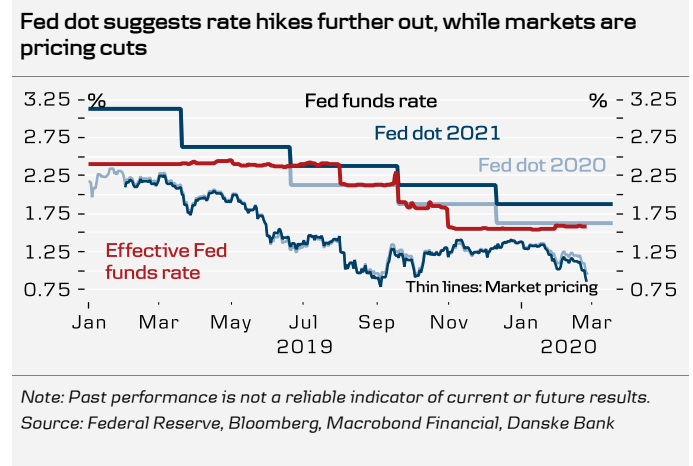
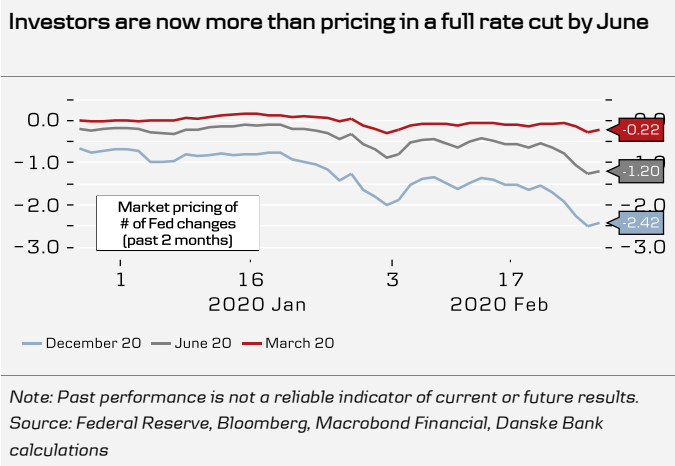
Source: Conference Board, Macrobond Financial

Fed charts

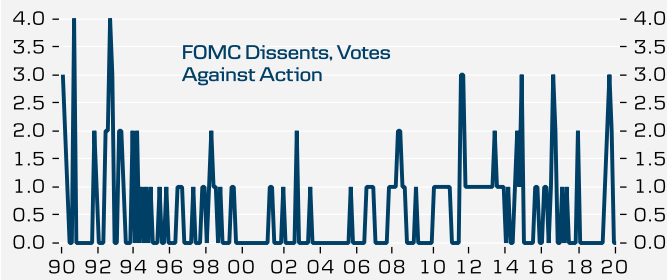
Recent Fed quotes

2020		Recent quotes
Hawkish	George Kansas city	Coronavirus "incorporated as a downside risk"
	Rosengren Boston	
	Mester Cleveland	
Neutral	Harker Philadelphia	"Too early to say what impact the coronavirus will have on the global economy"
	Barkin Richmond	Coronavirus makes it very difficult to do forecasting "The disruption (in China) could spill over to the rest of the global economy" "I expect China to have a couple of quarters of weaker growth and then bounce back" "Closely monitoring the coronavirus"; "it is too early to say" "Pays to be patient" with respect to coronavirus and rate cuts
	Quarles Board	
	Bowman (B) Board	
	Bostic Atlanta	
	Clarida (B) Vice Chair	
	Williams New York	
	Daly San Francisco	
	Evans Chicago	
	Powell (B) Fed Chair	
Brainard (B) Board		
Kaplan Dallas		
Dovish	Kashkari Minneapolis	Coronavirus "clearly is a downside risk for China"; "could affect" monetary policy
	Bullard St. Louis	"If you think the virus is going to dissapate [...] we don't have to lower rates in that scenario"
	Vacant Board	
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	<b>Voting member</b> (B) Board Member	

Source: Federal Reserve, Bloomberg, Danske Bank

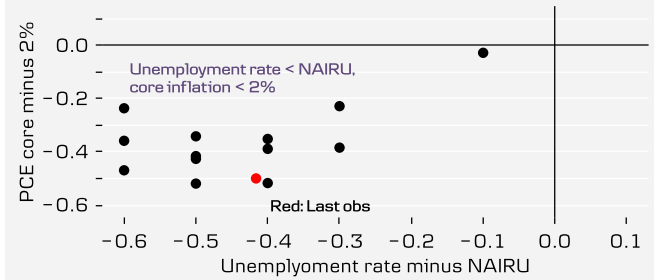


Fed prefers to work by consensus



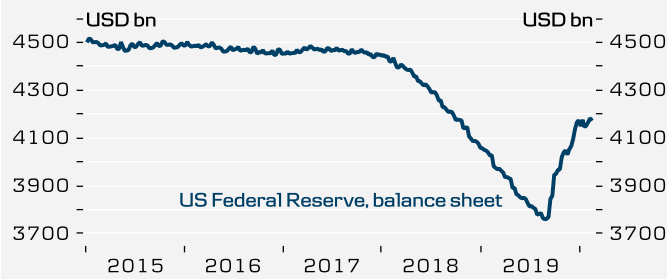
Source: St Louis Fed, Macrobond Financial, Danske Bank

Fed thinks it has fulfilled its maximum employment objective but inflation remains below 2%



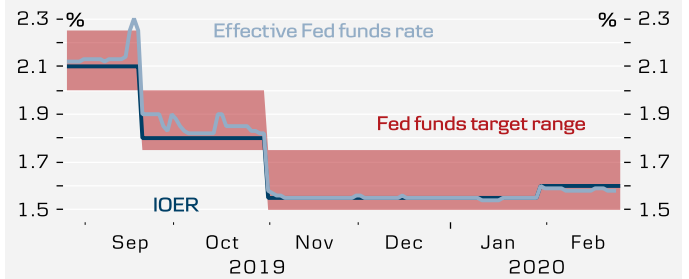
Source: Federal Reserve, BEA, BLS, Macrobond Financial, Danske Bank

Balance sheet is increasing



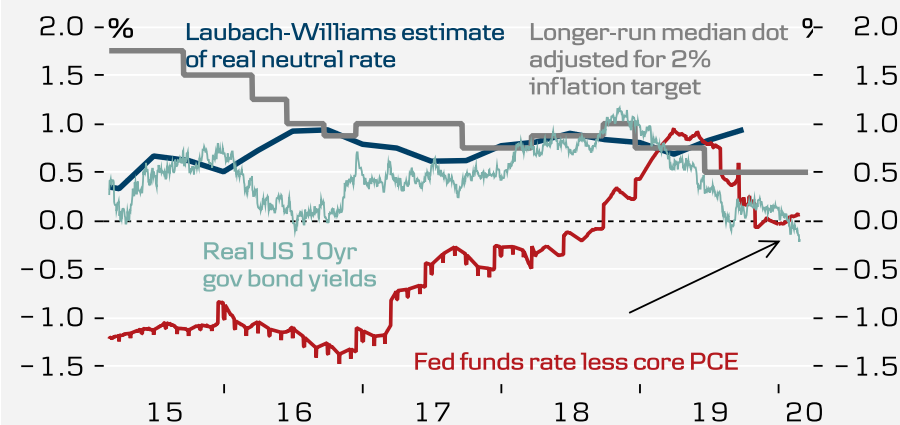
Source: Federal Reserve, Macrobond Financial, Danske Bank

Effective Fed funds rate remains below the IOER



Note: Past performance is not a reliable indicator of current or future results. Source: Federal Reserve, Macrobond Financial, Danske Bank

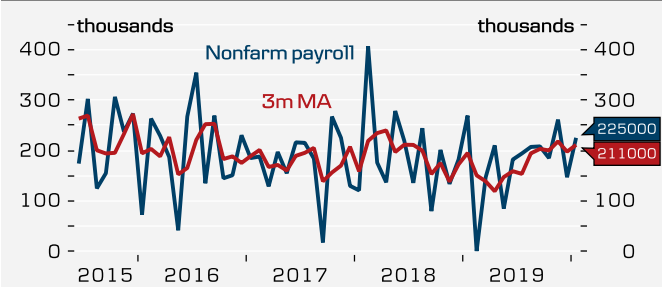
US monetary policy is not accommodative compared to market rates



Note: Past performance is not a reliable indicator of current or future results. Source: Federal Reserve, Bloomberg, NY Fed, BEA, Macrobond Financial, Danske Bank

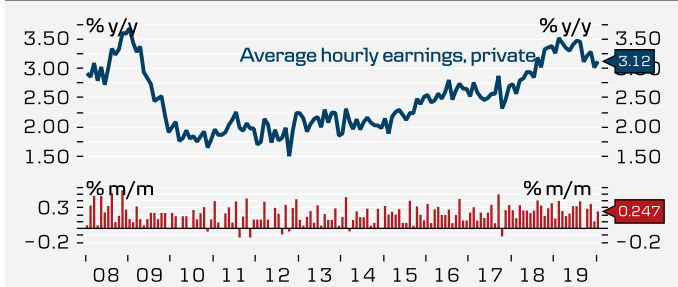
Macro charts

Employment growth is solid



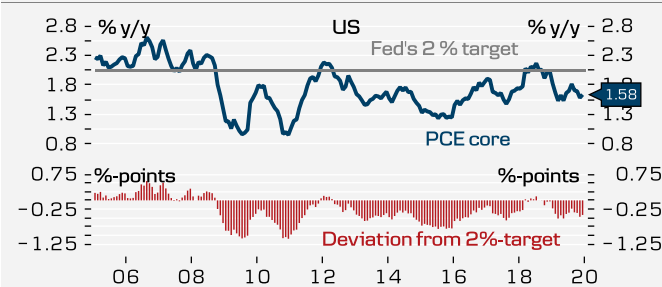
Source: BLS, Macrobond Financial, Danske Bank

Wage growth is not as high as previously but still decent



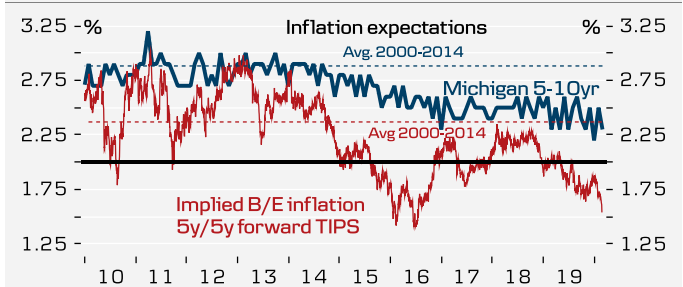
Source: BLS, Macrobond Financial, Danske Bank

PCE core inflation continues to run below the 2% target



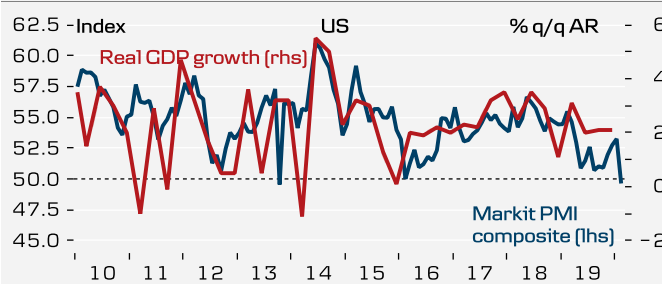
Source: BEA, Macrobond Financial, Danske Bank

Inflation expectations remain below historical average



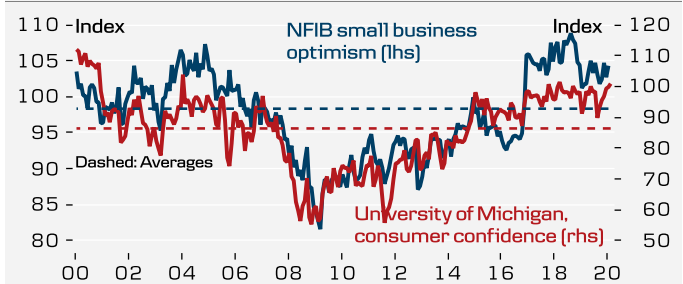
Source: Michigan, Bloomberg, Macrobond Financial, Danske Bank

Markit PMI service was extremely weak in February signalling 0% growth in Q1



Source: BEA, IHS Markit, Macrobond Financial, Danske Bank

Optimism remains high among consumers and small businesses amid coronavirus fears



Source: NFIB, University of Michigan, Macrobond Financial, Danske Bank

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