

Chairman's Views

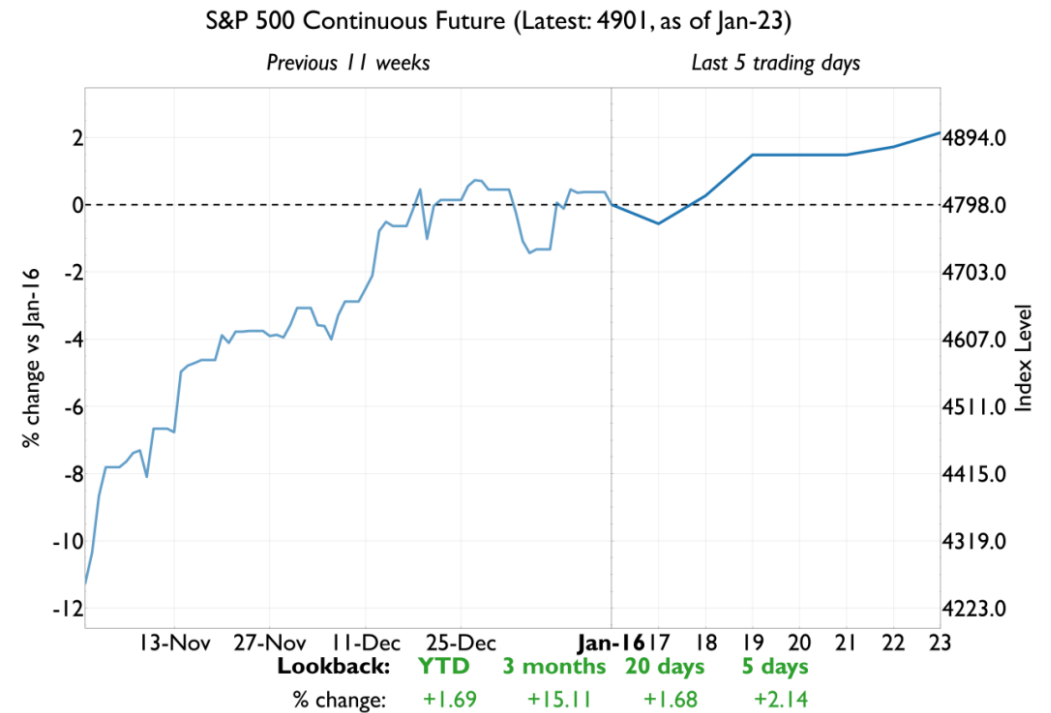
24 January 2024



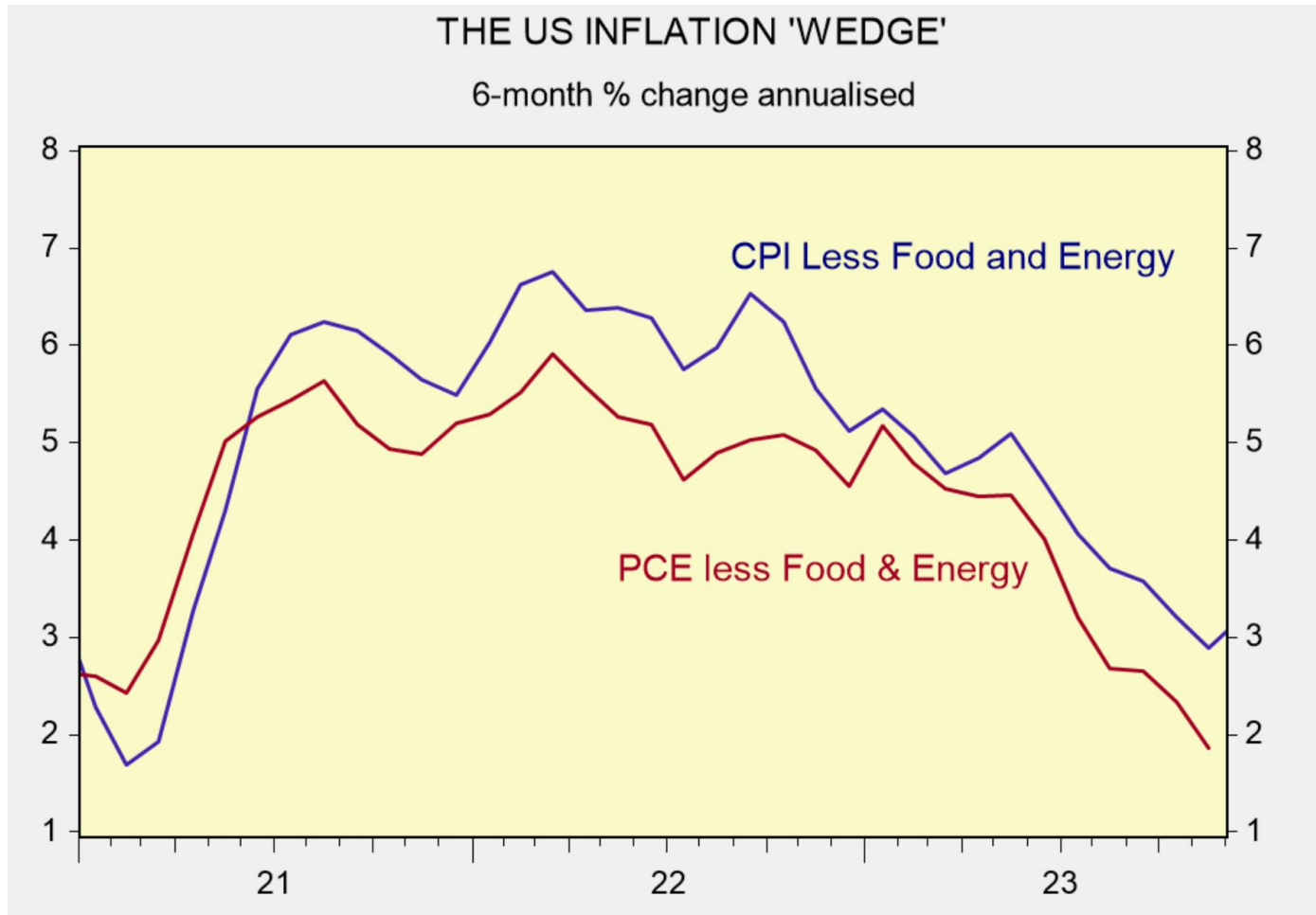
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Macro foundations

Markets have tilted a bit further towards a no landing scenario in the past week, but the big picture in the economic data and the markets still favours a soft landing this year



- ▶ Waller captured the mood last week with a mild push back against early and large rate cuts. “No rush” was the phrase of the week
- ▶ A repeating theme from FOMC speeches has been increased confidence about low inflation but warnings that the Fed **must not** risk needing to reverse course once rate cuts have started – Daly, Williams, Bostic, Logan etc have all supported the 3 dots FOMC median forecast and have been a tad less dovish than Powell
- ▶ Logan specifically warned about the easing in the financial conditions index (FCI), while Waller specifically denied that it is important
- ▶ Several have mentioned or hinted that an **easing in the labour market is needed** to indicate that lower inflation is needed to indicate that inflation will not rise again
- ▶ There is also a lot of focus on **upcoming inflation numbers**, including the consumer price index (CPI)

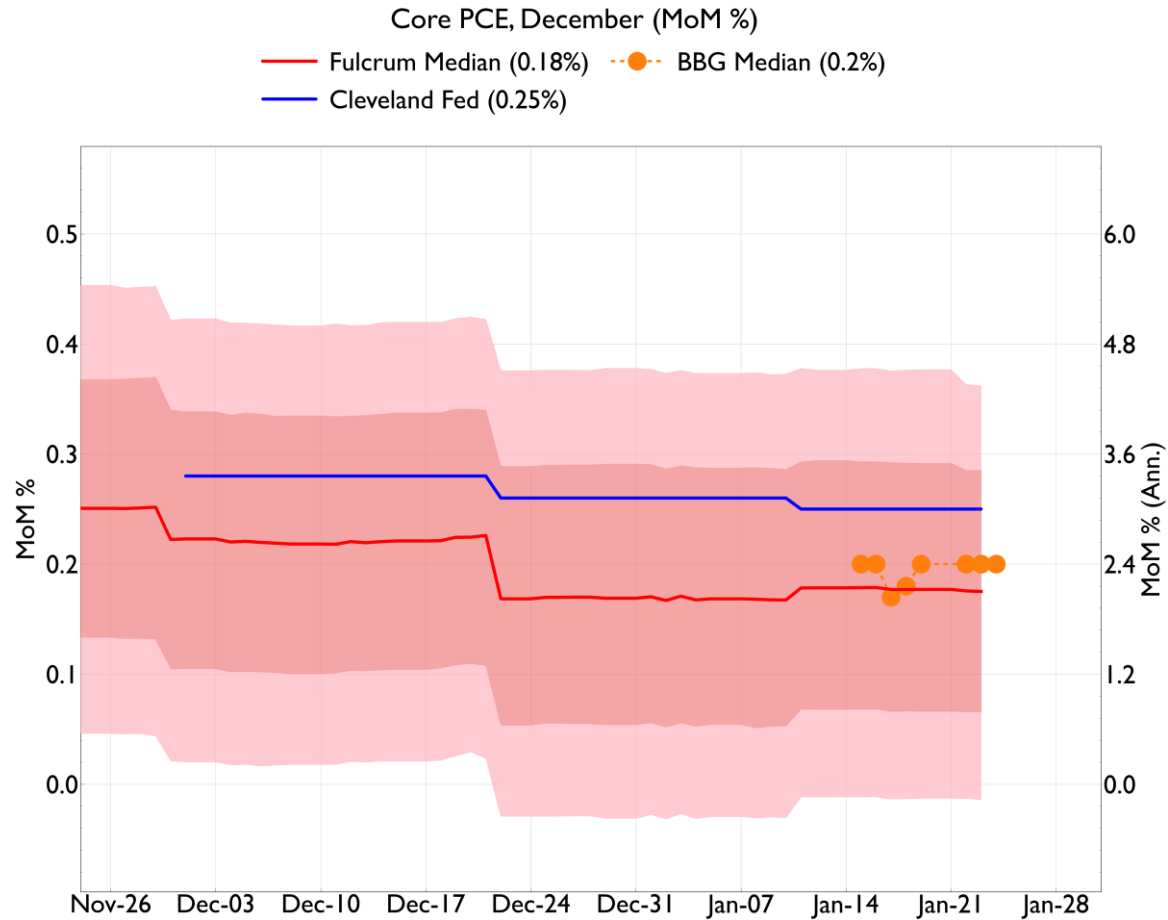


The wedge is mainly about shelter, especially rent and owner’s equivalent rent (OER).

As shelter inflation continues to fall this year, CPI inflation would decline more than PCE inflation.

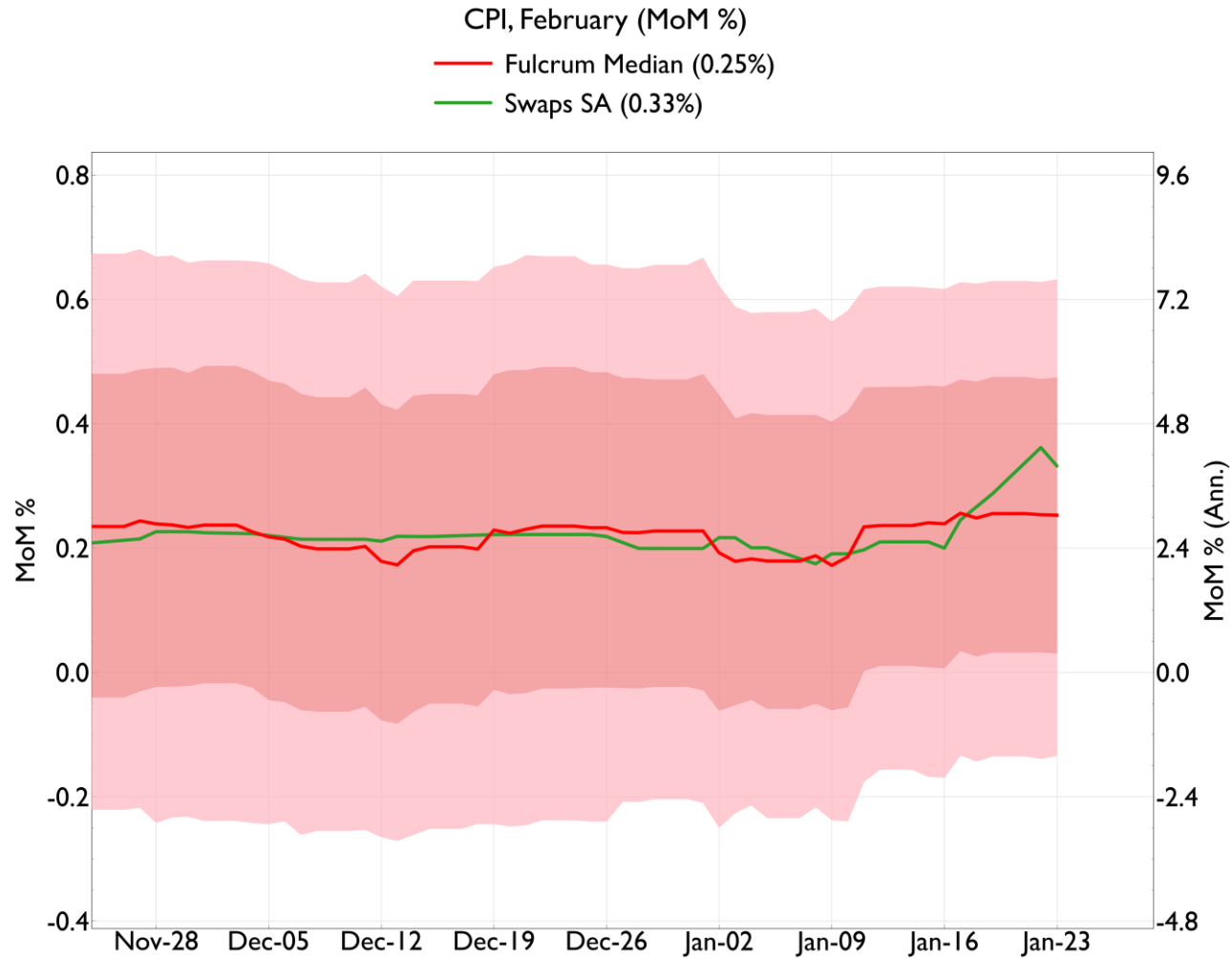
Dec-23 (6m % Ann.)	Core CPI	Core PCE (Est.)	CPI - PCE
Core goods	-0.64	-0.66	0.02
Apparel	-0.11	-0.11	0.0
New autos	0.06	0.03	0.04
Used autos	-0.27	-0.12	-0.15
Alcohol	0.03	--	0.03
Medical goods	0.06	0.11	-0.05
Core goods other	-0.41	-0.56	0.15
Shelter	2.31	0.98	1.33
Rent	0.54	0.22	0.32
OER	1.83	0.75	1.08
Accommodations	-0.08	--	-0.08
Shelter other	0.03	0.01	0.02
Medical services	0.26	0.44	-0.18
Doctors’ services	0.0	0.07	-0.07
Hospital services	0.17	0.21	-0.04
Medical services other	0.09	0.16	-0.07
Transport services	0.75	0.22	0.53
Car maintenance	0.07	0.07	-0.0
Car insurance	0.7	0.01	0.69
Airline fares	-0.05	0.14	-0.19
Transport services other	0.03	-0.0	0.04
Accommodations	--	-0.05	0.05
Food (away)	--	0.29	-0.29
Core services other	0.47	0.57	-0.1
Unclassified	0.07	0.04	0.03
Total	3.21	1.82	1.39

Market consensus has been hovering around 0.2%. Fulcrum's best guess is slightly below that number.



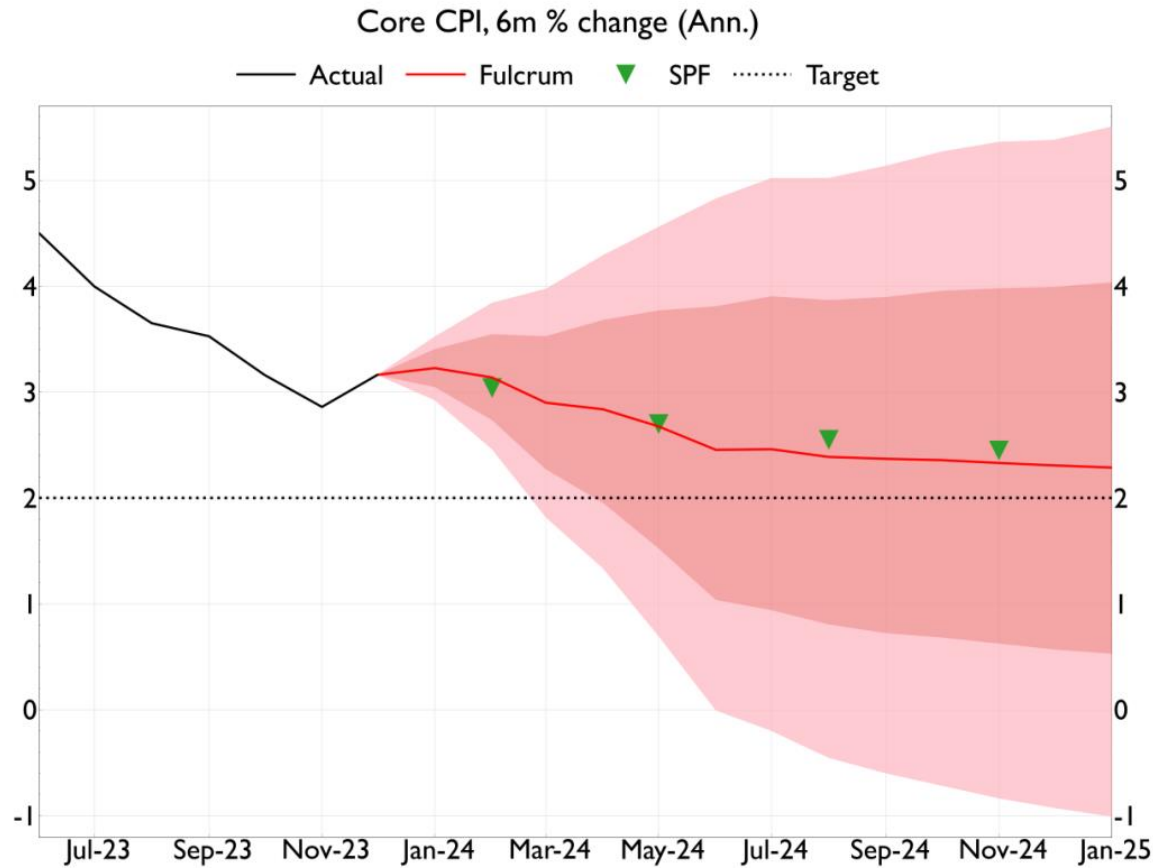
The dark and light red shaded areas represent the 68% and 90% forecast of the model respectively. For illustrative purposes only. Source: Fulcrum Asset Management, Haver Analytics, Bloomberg.

There have been concerns about a jump in headline CPI inflation in the February data. This seems to be mainly about energy prices and is not very worrying.



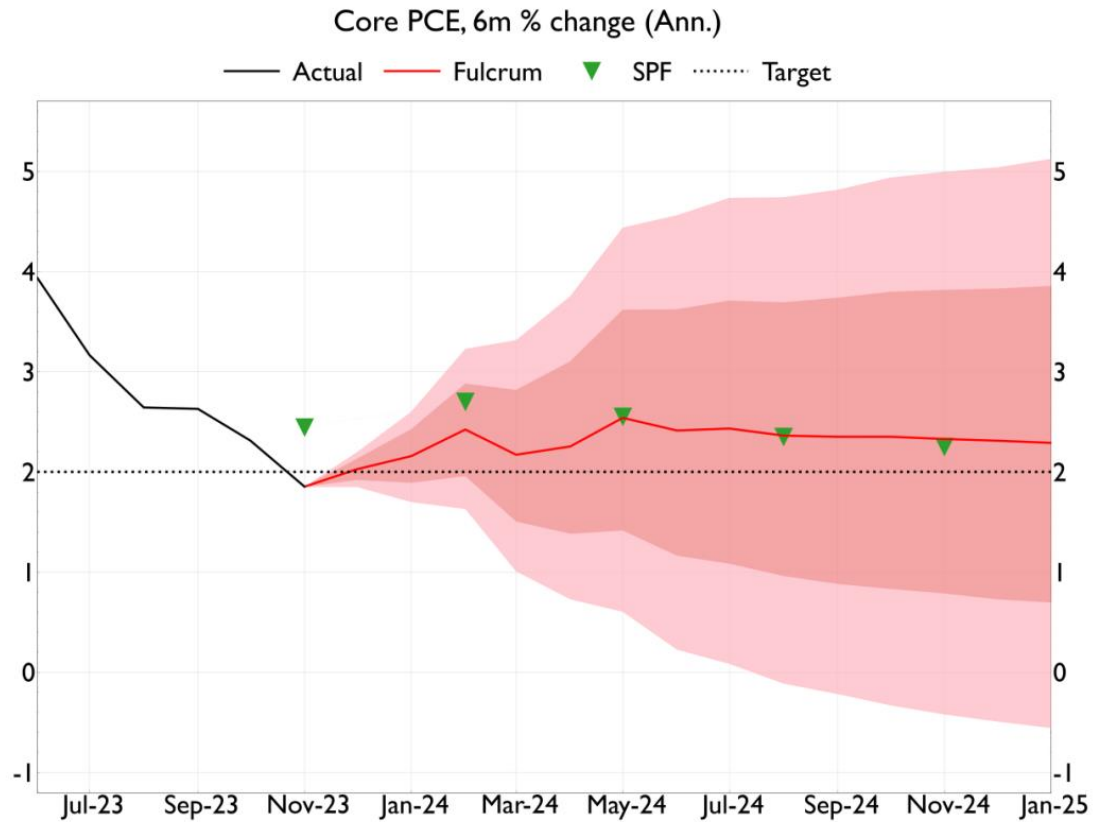
The dark and light red shaded areas represent the 68% and 90% forecast of the model respectively. For illustrative purposes only. Source: Fulcrum Asset Management LLP, JP Morgan.

Core CPI run rate will fall towards 2% as shelter inflation subsides.



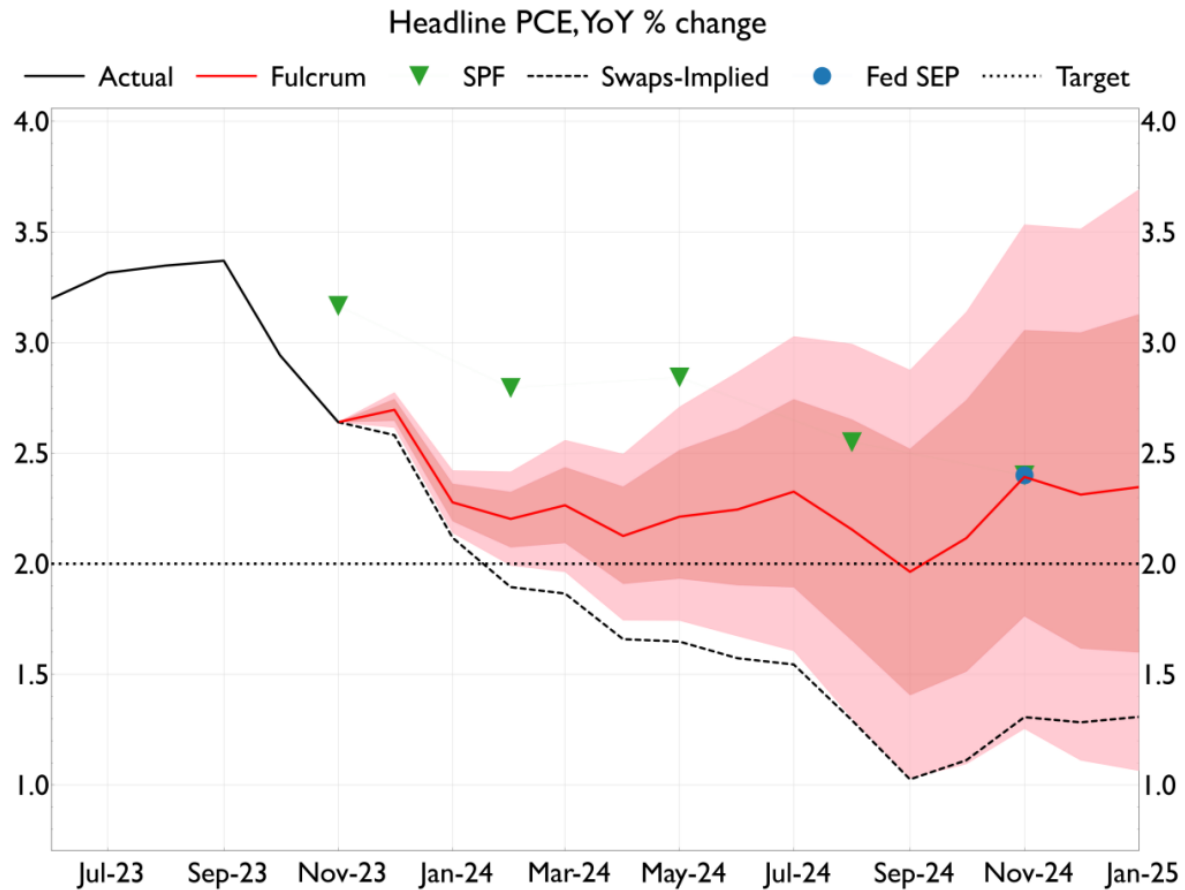
Source: Fulcrum Asset Management LLP, Haver Analytics. The dark red and light red areas represent the 68% and 90% confidence interval for the forecast, respectively, and the red line represents the median forecast. SPF stands for Survey of Professional Forecasts. For illustrative purposes only.

Core PCE 6 month run rate dipped below 2% in November but may hover a little above 2% from now on.



Source: Fulcrum Asset Management LLP, Haver Analytics. The dark red and light red areas represent the 68% and 90% confidence interval for the forecast, respectively, and the red line represents the median forecast. SPF stands for Survey of Professional Forecasts. For illustrative purposes only.

12 month headline PCE inflation (the target variable) may fall further but could probably remain above target and market swaps.

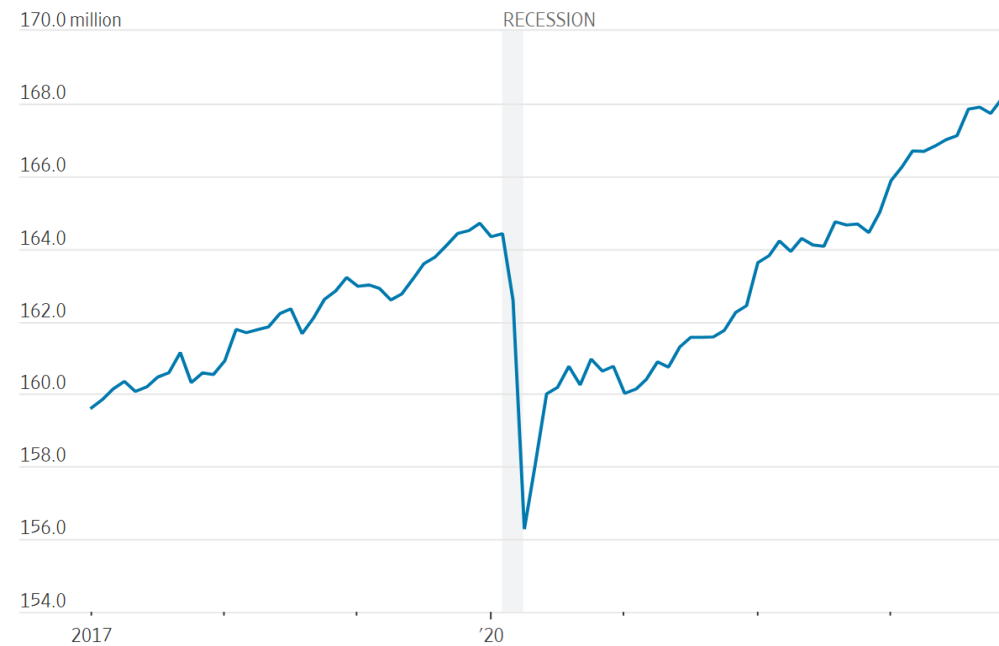


Source: Fulcrum Asset Management LLP, Haver Analytics. The dark red and light red areas represent the 68% and 90% confidence interval for the forecast, respectively, and the red line represents the median forecast. SPF stands for Survey of Professional Forecasts. For illustrative purposes only.

An excerpt from the Wall Street Journal:

Fed policymakers are considering the question of how much more supply the economy has to offer. Several “assessed that healing in supply chains and labor supply was largely complete, and therefore that continued progress in reducing inflation may need to come mainly from further softening in product and labor demand,” [according to minutes](#) of their December policy meeting. (A few officials assessed there is still room for additional supply gains.)

U.S. labor force

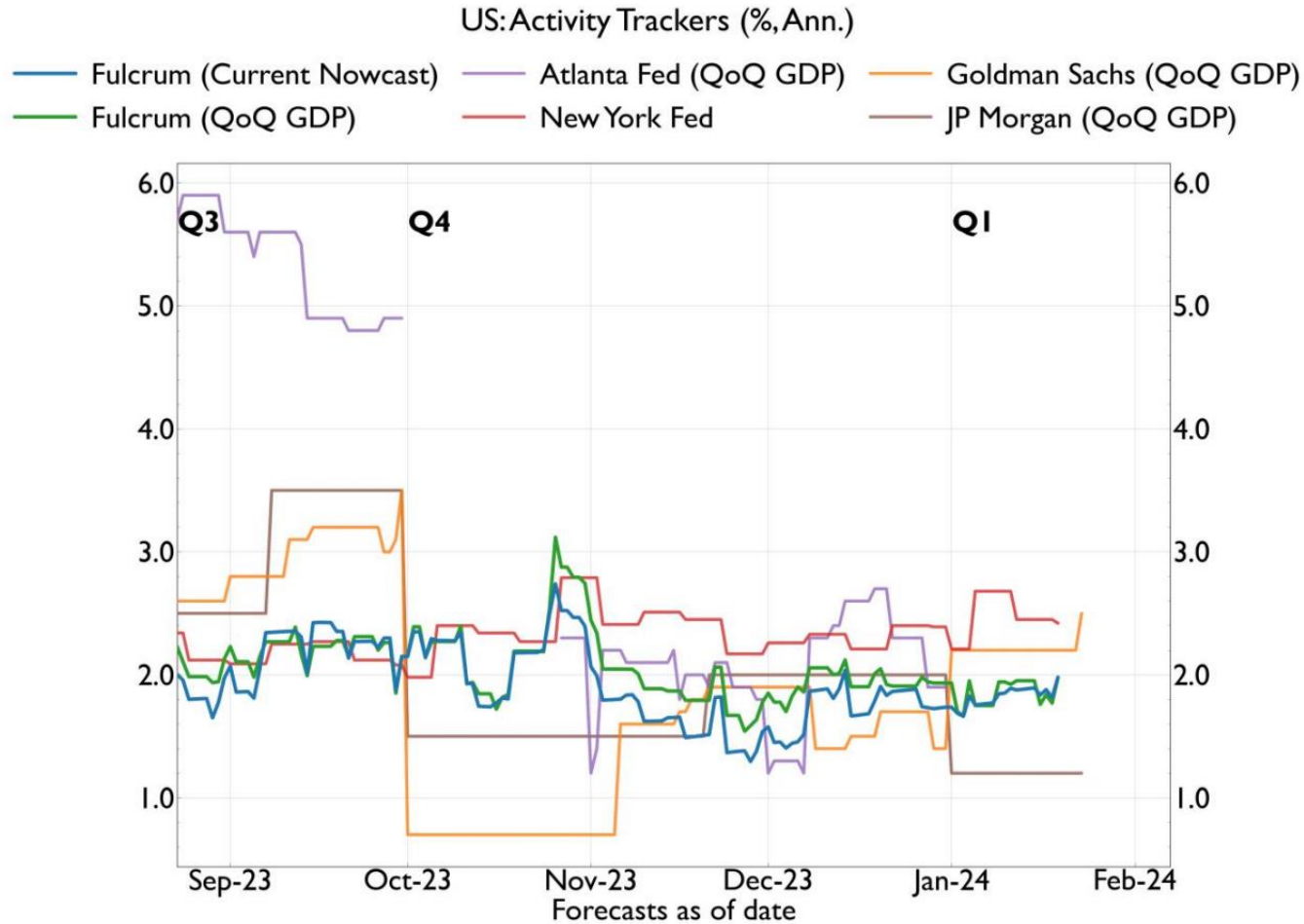


Note: Seasonally adjusted.

Source: Labor Department via St. Louis Fed

Fulcrum activity nowcasts for the US remain stable at close to 2% which is in the middle of a tight range.

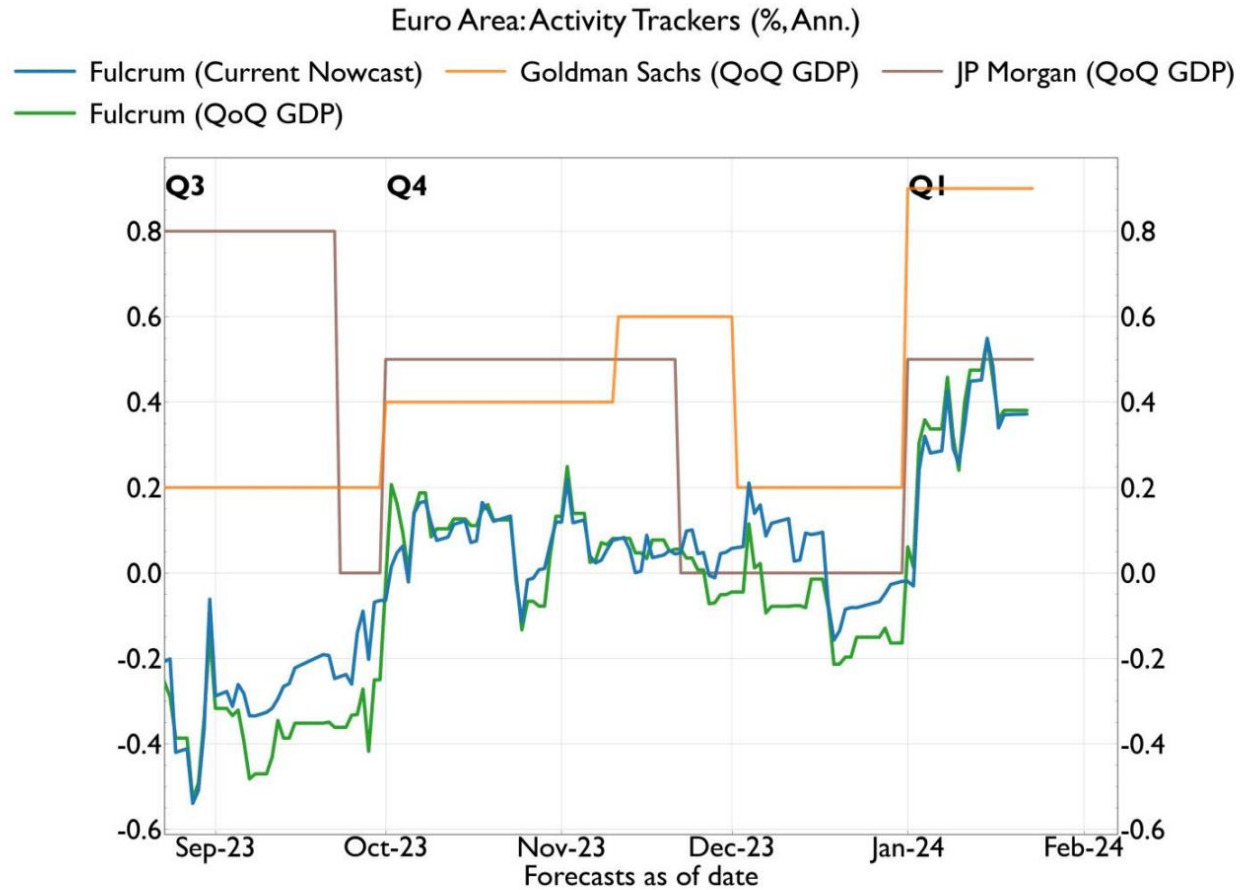
Advance GDP for Q4 is released tomorrow – GDP may be around 2% but final domestic sales could be at 3%.



Source: Fulcrum Asset Management LLP, Haver Analytics, Goldman Sachs, JP Morgan.

- ▶ Main forecasts still suggest a soft landing is very probable
- ▶ We now attach a 60% subjective probability to this outcome, down from 65%
- ▶ Given recent data and forecasts, we increase the probability of “no landing” from 20% to 25%
- ▶ This means that the probability of a hard landing remains at 15%
- ▶ These probabilities as usual refer to changes in market perceptions in the coming 3-6 months, not the eventual outcome for 2024
- ▶ A March cut by the Fed seems unlikely unless inflation falls further AND the labour market eases. We do not expect definite Fed guidance on this in January
- ▶ May or June seem highly probable start dates for rate cuts
- ▶ The market now expects 5 cuts this year, compared to 6 two weeks ago and compared to 3 in the FOMC median dots
- ▶ It would be surprising to see the market pricing more than 5 cuts for the year, or less than 4 in coming weeks

The Fulcrum nowcast is now validating economic forecasts that show slightly positive GDP growth in 2024 Q1.

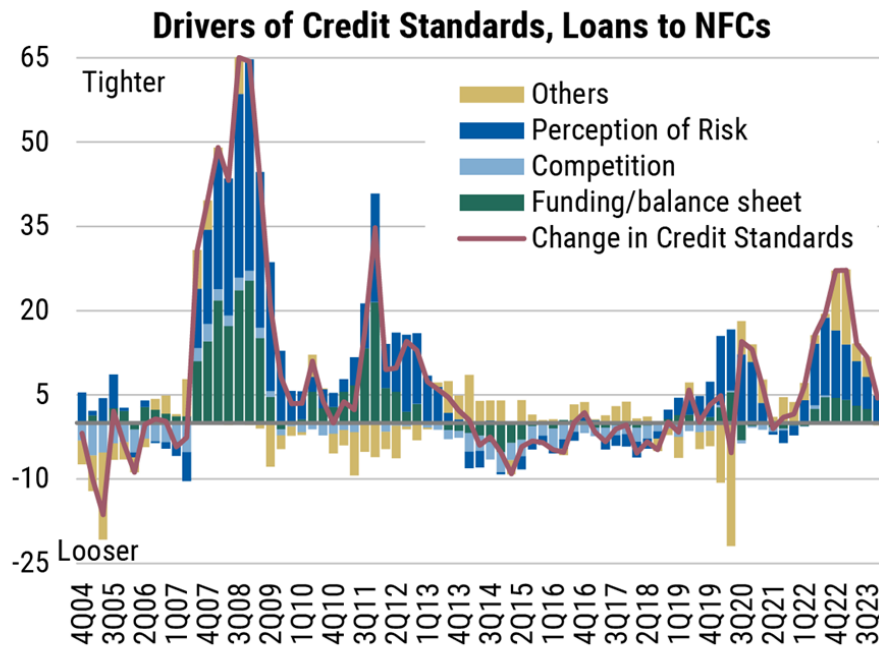


Source: Fulcrum Asset Management LLP, Goldman Sachs, JP Morgan.

ECB survey of bank lending standards has eased, taking the MCI into less tight territory.

Excerpt below from Morgan Stanley, with thanks....

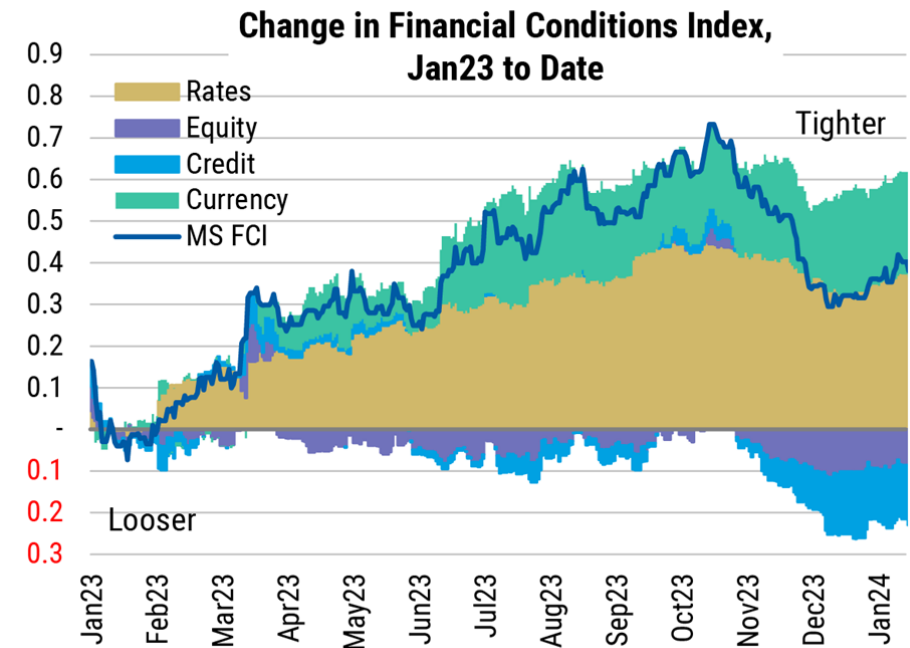
Pace of tightening in credit standards for enterprises moderated meaningfully...



Source: ECB, Morgan Stanley Research Calculations

...and the same was true for loans (mortgages and consumer credit) to households

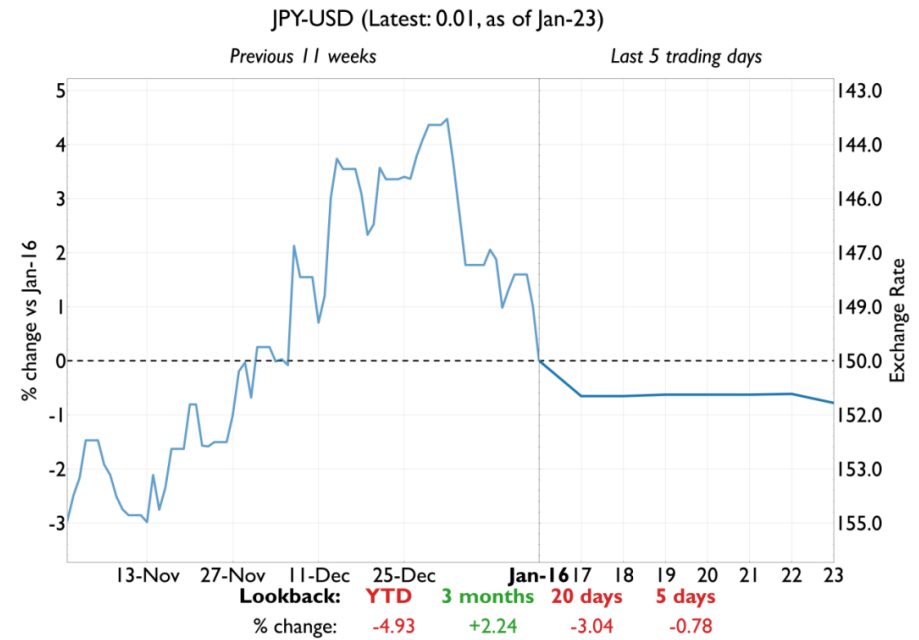
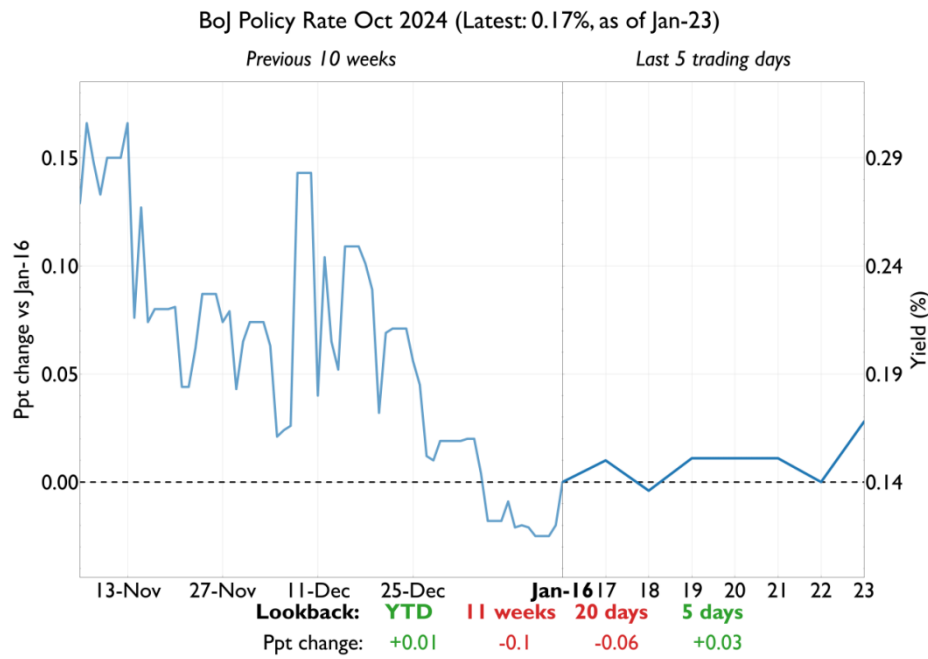
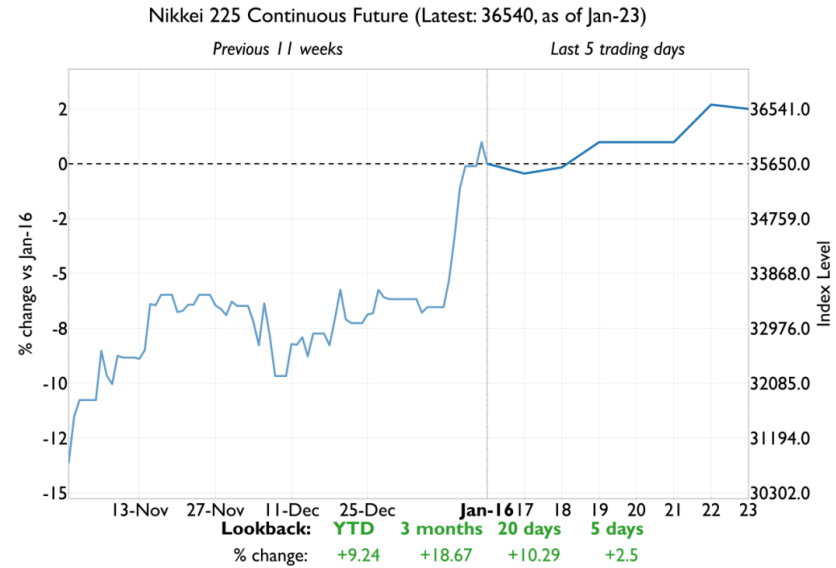
Financial conditions are now looser than 3 months ago



Source: Bloomberg, Morgan Stanley Research

- ▶ A key comment from Lagarde at Davos suggested that a rate cut around mid year was a reasonable expectation
- ▶ Important hawks Nagel (Bundesbank) and Holzmann (Austria) have also suggested that rate cuts in the second half of 2024 are possible or likely
- ▶ Phillip Lane has said that full wage data will not be available before the April ECB meeting
- ▶ A few doves have suggested that earlier rate cuts are still possible
- ▶ Recent signs of recovery in the real economy and the shift towards easier bank lending standards and financial conditions may reassure the ECB that a deep recession is less likely than they thought in December

The January BoJ meeting increased forward policy rates slightly but did not disturb the yen or the equity market.



Source: Fulcrum Asset Management LLP, Bloomberg.

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