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Ahead of the March FOMC: Our Monetary Forecasts

We participate in the NY Fed's Survey of Primary Dealers, which collects expectations about monetary policy and economic indicators in advance of each FOMC meeting. In this note we provide a snapshot of our responses to the survey.

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A First Look at Our Expectations for the March FOMC Statement & Press Conference

FOMC policy statement

Current conditions - we look for little change.

> "Recent indicators suggest that economic activity continues to expand ~~has been expanding~~ at a solid pace. Job gains ~~have moderated since early last year but~~ remain strong, and the unemployment rate has remained low. Inflation has eased over the past year but remains elevated."

GDP continues to growth at a "solid pace". Since the January meeting, the BEA revealed that 4Q23 real GDP grew at an annualized pace of 3.2% (full year 3.1% 4Q/4Q). Into the blackout period around the March FOMC meeting we are tracking real GDP growth in 1Q24 at 2.3% vs Atlanta Fed's GDPNow at 2.5% and NY Fed Nowcast at 2.1%.

Job gains remain strong, and have not moderated as much as previously thought. Since the January meeting we have received two employment reports. First, annual benchmark revisions interrupted the previous slowing trend in payrolls as well as the trend in downward back revisions. Then, February payrolls came in higher than expected at 275k, but was offset by a return to sizable downward back revisions. In all, through February the 3MMA (265k) has accelerated in the past four months and the 6MMA (231K) has moved sideways for about six months.

Core PCE inflation in January showed a further tick down to 2.8%Y from 2.9%Y in December, pointing to some further progress, though still elevated readings over the past year. In Chair powell's semiannual testimony Chair Powell stressed inflation does not need to be at 2% before cutting, but the Fed needs "a bit more evidence". We think core PCE at 2.5%Y is a good level to signal a June cut, and first expect to hit that level in March, which will be in hand for the May FOMC meeting. That's a good time for the Fed to communicate it will "soon be appropriate" to adjust the policy rate.

Forward guidance - no need to alter.

We think there is no need to alter any of the language around the policy stance. For example, we expect the Committee remains "highly attentive" to inflation risks, and expect no change to the Fed's balance sheet normalization plans.

Press conference

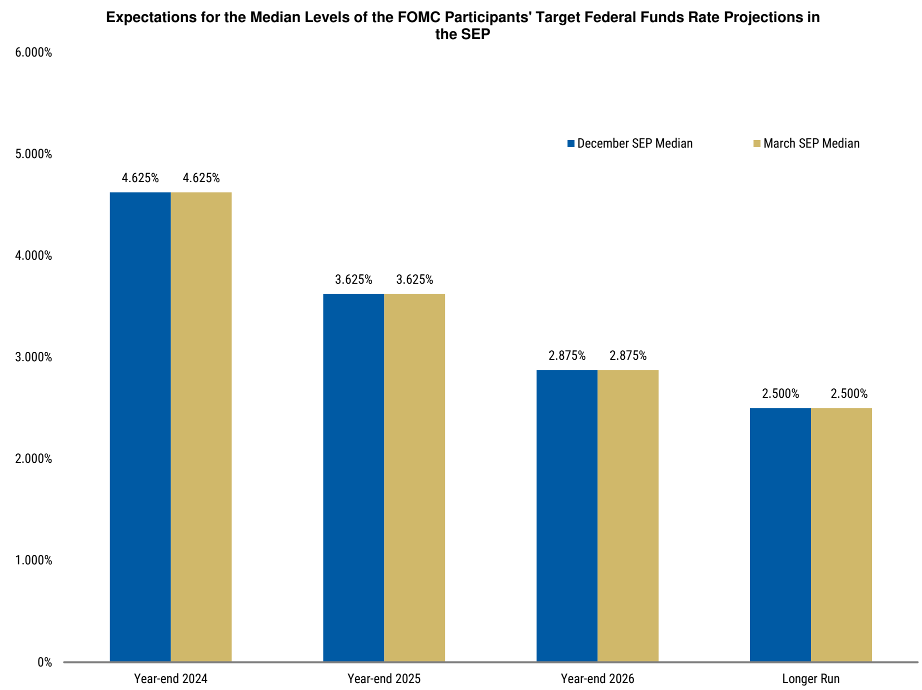
Chair Powell is fresh off Capitol Hill sharing the Committee's views on the economy and monetary policy - it is unlikely his message strays far from the views he expressed. In testimony he stressed patience as the Committee gains "a bit" more confidence that inflation is headed toward the 2% goal. The Fed remains on track to cut "at some point" this year. **On balance, Fedspeak suggests there will be no change in the median expectation for 75bp in rate cuts this year.**

Though we expect no change to balance sheet guidance in the statement, Fed communication has put QT in the spotlight and the Fed is slated to have in-depth discussions on the balance sheet at the March meeting. **Powell is likely to share broad strokes of those discussions when asked in the Q&A. We look for a June start to taper.**

Our Expectations

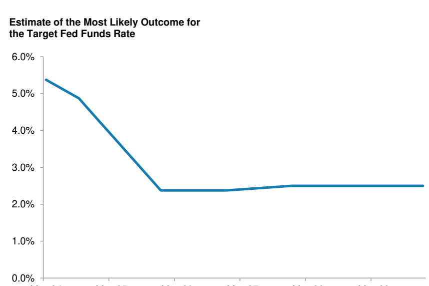
Exhibit 1, Exhibit 2, Exhibit 3, Exhibit 4, and Exhibit 5 depict our modal expectation for the policy rate. Our baseline views are indicated through 2025 (see 2024 US Economics Outlook: Slowing Growth, Easing Policy (12 Nov 2023). We provide guidelines for probabilities of longer-term outcomes as well.

Exhibit 1: Expectations for the Median Levels of the FOMC Participants' Target Federal Funds Rate Projections in the SEP



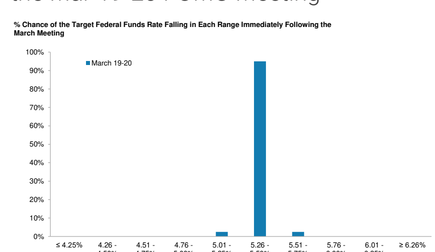
Source: Federal Reserve Board, Morgan Stanley Research

Exhibit 2: Modal Expected Path for the Fed Funds Rate



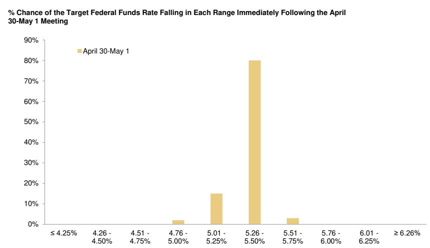
Source: Morgan Stanley Research forecasts

Exhibit 3: Estimates of Likely Outcomes for the Federal Funds Rate for the Mar 19-20 FOMC Meeting



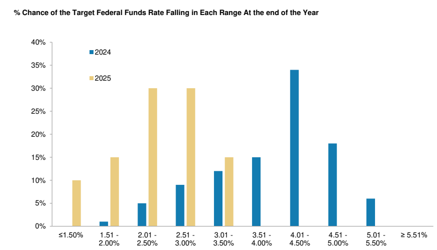
Source: Morgan Stanley Research forecasts

Exhibit 4: Estimates of Likely Outcomes for the Federal Funds Rate for the April 30 -May 1 FOMC Meeting



Source: Morgan Stanley Research forecasts

Exhibit 5: Estimates of Likely Outcomes for the Federal Funds Rate by end 2024 and 2025

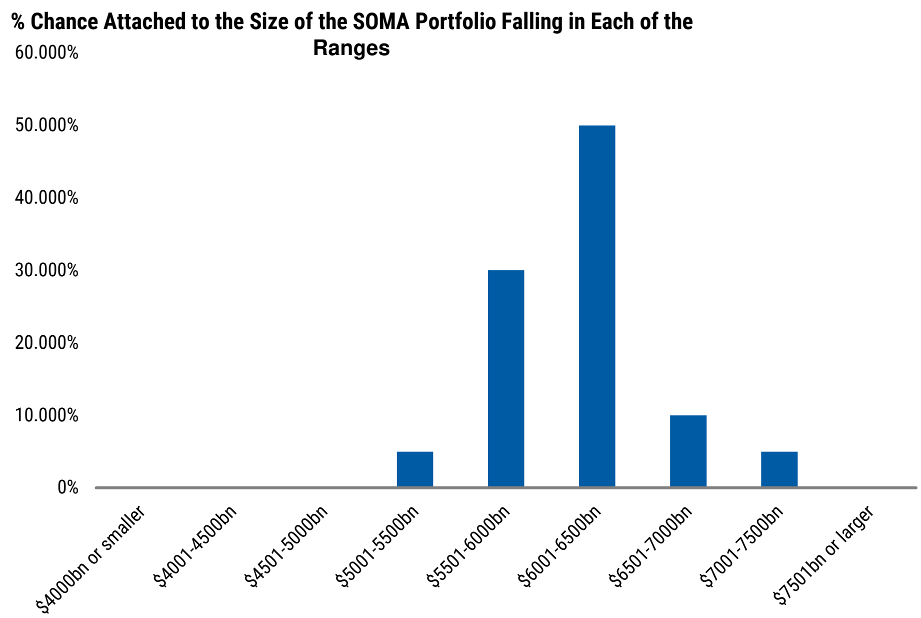


Source: Morgan Stanley Research forecasts

Expectations for the SOMA Portfolio

Exhibit 6 shows our modal expectations for the Fed's SOMA portfolio. ***For a detailed review of the Fed's balance sheet, see:*** **Global Macro Strategy, US Economics, US Large Cap Banks: A $6.5tr SOMA Portfolio (22 Apr 2022)*, and*** **Global Economics and Macro Strategy: Earlier Start, Slower Taper (19 Jan 2024)**

Exhibit 6: Estimates of the SOMA Portfolio

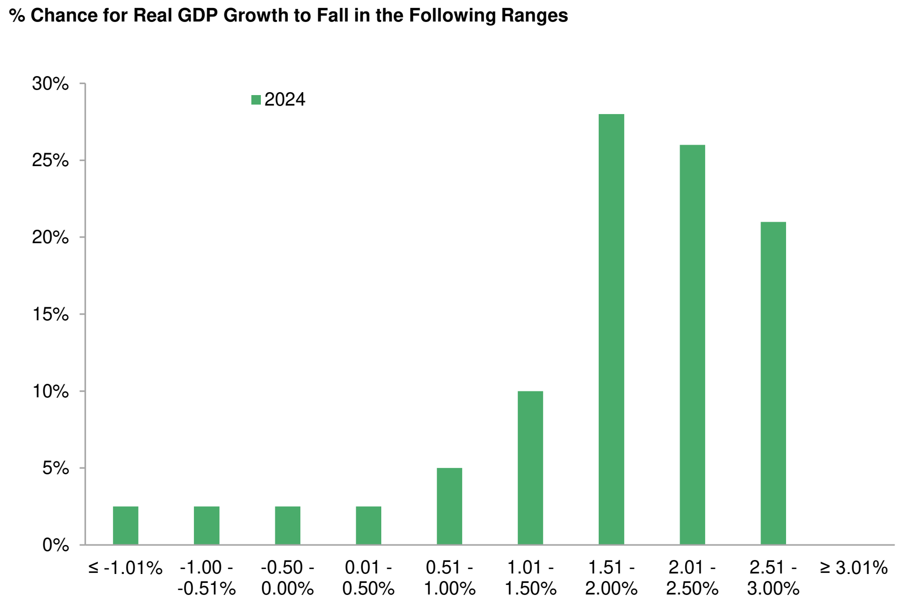


Source: Morgan Stanley Research forecasts

Expectations for Growth and Inflation

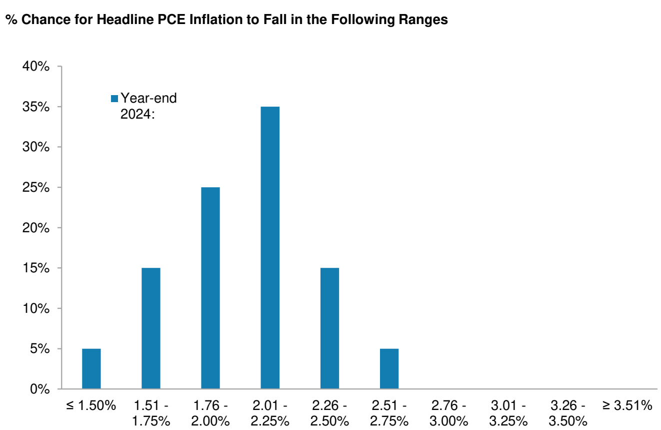
Exhibit 7, Exhibit 8, Exhibit 9, Exhibit 10, and Exhibit 11 show our modal expectations for growth and inflation, as well as an assessment of how policy might respond to changes in the labor market and inflation. **For a detailed review of our year-ahead growth and inflation forecasts, see: 2024 US Economics Outlook: Slowing Growth, Easing Policy (12 Nov 2023)., and US Economics: Inflation Update: Role of the CPI/PCE Wedge (12 Jan 2024).**

Exhibit 7: Percent Chance of Real GDP Growth (4Q/4Q) Falling in the Following Ranges



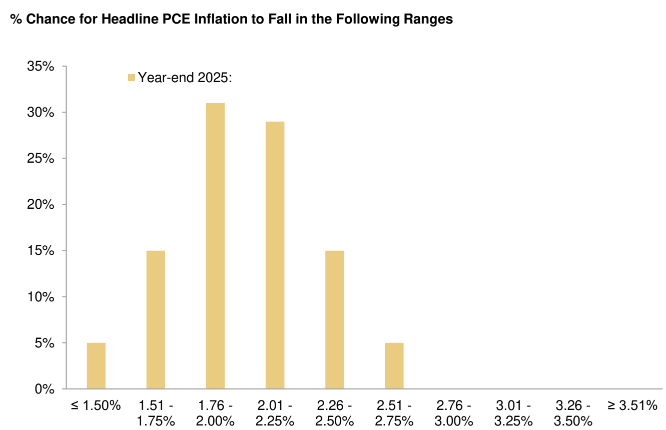
Source: Morgan Stanley Research forecasts

Exhibit 8: Percent Chance of PCE Inflation (4Q/4Q) Falling in the Following Ranges by end 2024



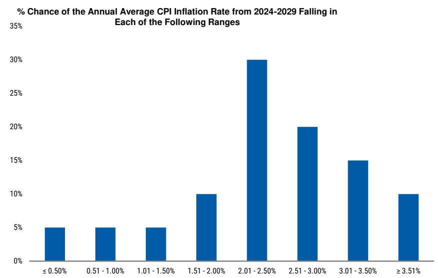
Source: Morgan Stanley Research forecasts

Exhibit 9: Percent Chance of PCE Inflation (4Q/4Q) Falling in the Following Ranges by end 2025



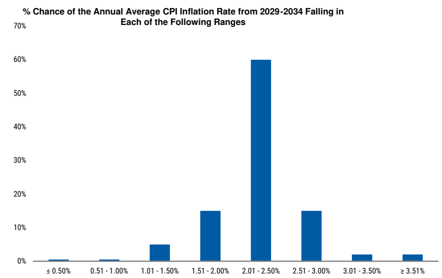
Source: Morgan Stanley Research forecasts

Exhibit 10: Probabilities of Average Annual CPI Inflation Falling in the Following Ranges, 2024-2029



Source: Morgan Stanley Research forecasts

Exhibit 11: Probabilities of Average Annual CPI Inflation Falling in the Following Ranges, 2029-2034

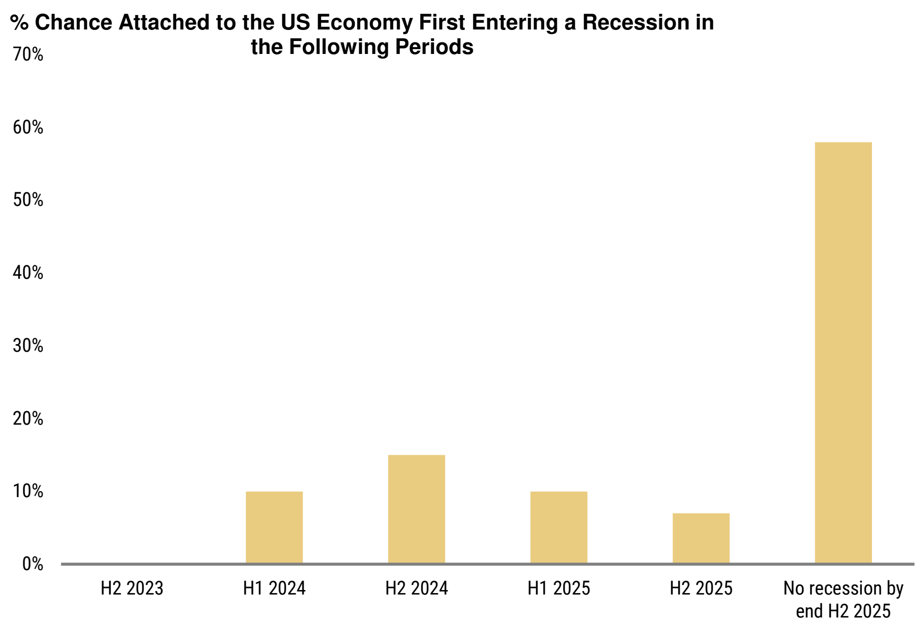


Source: Morgan Stanley Research forecasts

How We See Recession Probabilities

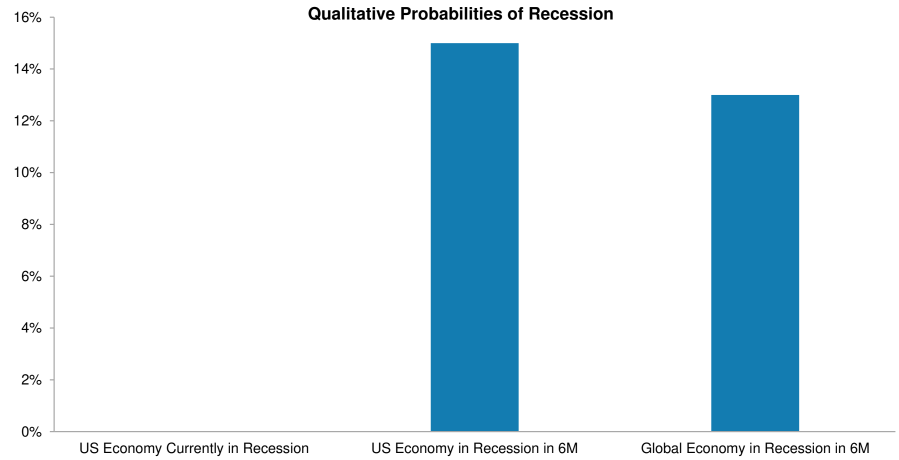
Exhibit 12 and Exhibit 13 show our recession probabilities for the US economy.

Exhibit 12: Probabilities of the US Economy First Entering a Recession in the Following Periods



Source: Morgan Stanley Research forecasts

Exhibit 13: Probabilities of Recession



Source: Morgan Stanley Research forecasts

The probabilities shown are only illustrative. They do not forecast a precise series of events and do not account for all possible outcomes but instead illustrate our sense of the relative plausibility of selected scenarios, based on our underlying recession probability index for the US.

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