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Friday Finish – US Economics | North America

Roadmap to a June Hike

We expect the Fed to pause, but there is still a path to a 25bp hike at the June FOMC meeting. On balance, FedSpeak this week has made clear it will come down to the next reading on inflation. Powell's comments and debt-ceiling headlines dampened market expectations for a June hike.

From the desk of the Chief US Economist

Just looking at the lineup of Fed speakers this week, I surmised on Monday that on balance FedSpeak would lean hawkish. That's not to say all the speakers were hawks, Governor Jefferson being one notable exception, but market pricing also translated the speeches into a hawkish tone and moved the probability of a 25bp June hike as high as 40%. Then came Chair Powell, who on Friday – alongside negative debt ceiling headlines – cut the probability in half. With strong conviction, we continue to expect policy to stay on hold in June, but we do see a path to a 25bp hike, and all else equal, the decision will come down to inflation.

This week was chock full of FedSpeak from seven regional bank Presidents and three Board Governors, capped off by Chair Powell in a discussion with former Fed Chair Ben Bernanke. **The consensus across the speakers was broadly that non-housing services inflation has shown no signs of significant improvement while the labor market has slackened only marginally, but views on how the Fed should react were less uniform.**

Minneapolis Fed President Kashkari, Cleveland Fed President Mester and Richmond Fed President Barkin went so far as to say explicitly that they believe tighter policy is needed. Chicago Fed President Goolsbee said it was too soon to talk about the June meeting, and Atlanta Fed President Bostic said he prefers to take a wait-and-see approach. **Governor Jefferson favors a forward-looking approach and acknowledged signs that the labor market and inflation are slowing and uncertainty is high – delivering what we feel was a more dovish message than the Fed Presidents.**

On net, during the course of the week investors interpreted the FedSpeak as leaning hawkish and market pricing for a 25bp rate hike in June moved up to ~40%. Then came Chair Powell. On Friday he delivered carefully scripted responses that avoided commenting on near-term policy, but nevertheless seemed to tilt away from the need to hike further. **In summary, Powell thinks that inflation remains sticky, the FOMC is committed to bringing it down, policy may not need to rise as much as previously thought, the financial markets are not misinterpreting the Fed's reaction function, and he no longer sees a risk of doing too little to tighten policy.**

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Chair Powell's remarks, to my ears, were meant to be balanced but **came across more sanguine compared to market expectations and the tone from the May Q&A**. Along with negative headlines suggesting a breakdown in debt ceiling negotiations, his comments pushed the market-based probability of a June hike down to ~18% to finish out the week. **We maintain a strong conviction that the Fed will choose to stay on hold at the June meeting**, but the market-based probability is likely to continue jumping around all the way up to the May CPI data release during the Fed's blackout period on June 19.

What if June is not the beginning of the pause? Resilience in the labor market has helped keep a June hike on the table, but **Fedspeak this week focused on inflation**. [Exhibit 1](#) shows our illustrative roadmap for near-term policy decisions. Reasonable thresholds for a June hike could be May payrolls greater than 150k and May core CPI greater than 0.35%M. Preliminarily, we forecast payrolls increased by 170k in May (140k private) and core CPI rose by 0.30%M. **We believe the May CPI print will show a slowdown in core services, which includes our expectation that the downward trend in housing (rents & OER) resumes**. Policymakers in particular will be focused on non-housing services inflation so as usual, the devil will be in the details.

Exhibit 1: Our Roadmap to the June Policy Decision

%M	Headline PCE	Core PCE	Headline CPI	Core CPI	Nominal Consumption	Real Consumption	NFP	UR	Assessment:
Jul-22	-0.09	0.08	-0.03	0.31	-0.23	-0.14	568	3.5	
Aug-22	0.27	0.55	0.23	0.58	0.92	0.65	352	3.7	
Sep-22	0.34	0.46	0.41	0.57	0.70	0.35	350	3.5	
Oct-22	0.42	0.31	0.49	0.33	0.59	0.17	324	3.7	
Nov-22	0.17	0.22	0.21	0.31	-0.42	-0.59	290	3.6	
Dec-22	0.20	0.37	0.13	0.40	0.25	0.05	239	3.5	
Jan-23	0.60	0.56	0.52	0.41	1.91	1.30	472	3.4	
Feb-23	0.30	0.35	0.37	0.45	-0.05	-0.35	248	3.6	
Mar-23	0.08	0.28	0.05	0.38	-0.02	-0.09	165	3.5	May FOMC: 25bp delivered.
Apr-23	0.33	0.35	0.37	0.41	0.19	-0.16	253	3.4	
May-23	0.20	0.33	0.12	0.30	0.23	0.02	170	3.4	June FOMC: 0bp expected. NFP>150k & Core CPI>0.35 -- 25bps
Jun-23	0.13	0.25	0.06	0.23	0.19	0.02	100	3.5	

Source: BLS, BEA, Morgan Stanley Research forecasts

Enjoy your weekend.

Incorporating the monthly data on retail sales, industrial production, housing starts and existing home sales on balance moved our 2Q23 real GDP tracking to +0.2% this week vs -0.2% last week.

Data I'm watching next week: [Key Data Watch Calendar](#).

New Home Sales (Tuesday, 10:00am): We forecast new home sales in April fell 3.0%M to a 663k annualized pace. This follows the 9.6%M increase that we saw in March. Data on housing starts, mortgage applications for purchase, building permits, and home buying consumer sentiment all remain weak, even as the correction in housing activity has bottomed.

Personal Income & Spending (Friday, 8:30am): We forecast personal income increased 0.36%M in April, a step up from 0.30% in March, reflecting stronger labor income. On softness in the underlying retail sales data, paired with better services spending, we forecast personal spending increased 0.19%M vs 0.0% prior. Real consumption contracts by 0.14%M

vs. flat in March.

We forecast for core PCE inflation at 0.35%M in April vs 0.28% in March, and headline at 0.33% vs 0.08% last month.

Weekend Reading/Listening:

- [Global Macro Strategy, Economics, Securitized Products, and IG Credit: 2023 Plan of Investors in Japan \(19 May 2023\)](#)
- [Global Economic Briefing: MSSCI: Supply-side easing continues \(18 May 2023\)](#)
- [Thematic Thursday: AI - Stockpicking in a Thematic Market \(18 May 2023\)](#)
- [Global Economics: Global Inflation Monitor \(17 May 2023\)](#)
- [Global Economics: Global Central Bank Monitor \(16 May 2023\)](#)
- [Global Economic Briefing: The Weekly Worldview: Breaking Into Pieces \(15 May 2023\)](#)

Past Friday Finish Commentary:

- [Friday Finish – US Economics: Sharper Focus on a Soft Landing \(12 May 2023\)](#)
- [Friday Finish – US Economics: No Cliff Diving Allowed \(5 May 2023\)](#)
- [Friday Finish – US Economics: More Support for a Soft Landing \(28 Apr 2023\)](#)
- [Friday Finish – US Economics: As Goes Housing, So Goes the Business Cycle \(21 Apr 2023\)](#)
- [Friday Finish – US Economics: Channeling the Fed \(14 Apr 2023\)](#)
- [Friday Finish – US Economics: The Substitution Effect \(31 Mar 2023\)](#)
- [Friday Finish – US Economics: Do the Data Matter Now? \(24 Mar 2023\)](#)

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