

WEEKLY COMMENTARY

With Sticky Inflation and a Strong Economy, What's the Case for Fed Rate Cuts?

By Royce Mendes, Managing Director and Head of Macro Strategy

According to Jerome Powell, the US central bank is “not far” from cutting interest rates. Monetary easing is typically used to combat a weak economy and a resultant slowdown in inflation. But there’s no hint of either in the current data. The US economy continues to outperform its peers by a wide margin and inflation has proved to be somewhat stickier than expected.

This cycle is fundamentally different. From the first pandemic-related rate cuts back in 2020 to the aggressive rate hikes in 2022 and 2023, nothing about this business cycle has been textbook. The Fed’s rate cuts won’t be predicated on below-target inflation or a recession in this cycle.

The goal now is to calibrate policy to achieve the vaunted soft landing. Bringing inflation down gradually while keeping the unemployment rate low seems possible with just the right touch.

The target for the fed funds rate is currently set at 5.375%, well above the central bank’s long-term neutral rate estimate of 2.50%. Even if policymakers decide to raise that estimate next week, the implications are the same: Rates need to come down before they get anywhere close to the neutral rate.

The difference between a typical rate-cutting cycle and the forthcoming one will not only come from the impetus to ease policy. The Fed is also likely to take a much more cautious approach than usual once it begins cutting rates. Without a severe recession or financial crisis on their hands, US policymakers can take their time delivering rate cuts.

That will come in some contrast to their peers at other central banks. The Bank of Canada, European Central Bank and Bank of England will likely begin easing monetary policy in June, the

same time we expect the Fed to start cutting rates. However, Canada, the eurozone and the UK are all on the verge of recession.

As a result, rate cuts in those jurisdictions could be deeper. We expect the Bank of Canada to deliver more monetary easing than the Fed this year and next to combat the sluggishness in the domestic economy.

While borrowers in places like Canada will benefit from the extent of rate cuts, they’ll be disappointed to see how the local currency reacts. The US dollar is likely to remain strong against the Canadian dollar, assuming the rate-cutting cycle is less pronounced in America.

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What to Watch For

By Randall Bartlett, Senior Director of Canadian Economics, Tiago Figueiredo, Macro Strategist, Marc Desormeaux, Principal Economist, Marc-Antoine Dumont, Senior Economist, and Francis Généreux, Principal Economist

TUESDAY March 19 - 8:30

February	ann. rate
Consensus	1,428,000
Desjardins	1,450,000
January	1,331,000

WEDNESDAY March 20 - 14:00

March	
Consensus	5.50%
Desjardins	5.50%
January 31	5.50%

THURSDAY March 21 - 10:00

February	m/m
Consensus	-0.2%
Desjardins	0.0%
January	-0.4%

THURSDAY March 21 - 10:00

February	ann. rate
Consensus	3,920,000
Desjardins	4,000,000
January	4,000,000

MONDAY March 18 - 9:00

February	m/m
Consensus	n/a
Desjardins	0.0%
January	3.7%

UNITED STATES

Housing starts (February) – With the weather taking a sharp turn for the worse in January, housing starts plummeted, resulting in the steepest monthly decline since 2015 (excluding the start of the pandemic). But the return of better weather in February suggests that the numbers have probably rebounded substantially. This is supported by the fact that hours worked across the construction sector jumped 1.9%—the biggest increase in a year—and the number of building permits issued in January were much higher than the number of housing starts. We expect February housing starts to come in at around 1,450,000 units, though building permits likely edged down over the same period.

Federal Reserve Board Meeting (March) – We definitely don't expect the Fed to adjust the federal funds target rate at their upcoming meeting. However, the Fed's recent communications, including testimony by Jerome Powell before two separate congressional committees, seem to be setting the stage for future rate cuts. Inflation is still too high to justify immediate cuts, but the Fed is signalling that lower rates are on the horizon. The press release issued with the Fed's decision will likely be very similar to January's statement, but we may get a better sense of where things are going from Mr. Powell's tone at the press conference and the information included in the Fed's new forecasts.

Leading indicator (February) – There hasn't been a month-over-month increase in the Conference Board's Leading Economic Index since February 2022. In fact, the 0.4% contraction recorded in January marked the 23rd consecutive month of decline. However, the downward trend may have finally ended in February. Positive contributions from hours worked, the stock market and the subcomponent tracking changes in credit conditions likely offset the drag created by interest rates, consumer confidence, the ISM index and building permits. As a result, we believe the leading indicator flatlined in February.

Existing home sales (February) – Existing home sales jumped 3.1% month-over-month in January, marking the sharpest upturn since February 2023. The gains helped pull sales back up from the low point recorded last fall. Existing home sales sunk to just 3,850,000 units in October, a low not seen since 2010. But the signals for February have been mixed. On the one hand, pending home sales fell in January. This would normally be a major negative signal for February's existing home sales, but in this case it could just be another consequence of the cold snap that hit the country at the start of the year. On the other hand, preliminary regional data point to an uptick in home resales in February. Consequently, we expect existing home sales to stagnate at 4,000,000 units.

CANADA

Existing home sales (February) – February 2024 will be an interesting month for the Canadian housing market. We're penciling in zero growth in sales at the national level for the data release this coming Monday. Early information from local real estate boards suggests purchasing activity took a bit of a breather in many major cities following broad-based jumps in December and January. That could be a response to the pickup in Canadian interest rates seen in the second half of January and early February, which followed stronger-than-anticipated economic data. New listings, which rose nationally in January for the first time since August 2023, could also tell us something about market sentiment. The uptick in new listings last month likely prevented sharper sale price gains but also probably increased sales in an environment of still-tight supply.

TUESDAY March 19 - 8:30

February	m/m
Consensus	0.6%
Desjardins	0.6%
January	0.0%

Consumer Price Index (February) – Headline consumer price growth likely accelerated to 3.1% on an annual basis, a two-tick increase relative to January. While most of that advance can be explained by energy prices—in particular gasoline prices, which rose 5% over the month—we also expect a rebound in several other categories that posted weak price growth in January. That should see inflation excluding food and energy go up to 3.3% from 3.2% in January. The Bank of Canada’s core measures are expected to have moved higher as well, although our recent research suggests that these indicators are overestimating the stickiness of inflation. Governor Macklem explicitly noted that he wanted to see further declines in the number of components with inflation greater than 3%. While we’re unlikely to see substantial progress on that front, we do expect to see incremental moves in the right direction.

FRIDAY March 22 - 8:30

January	m/m
Consensus	-0.4%
Desjardins	-0.2%
December	0.9%

Retail sales (January) – Retail sales likely edged down 0.2% in January. This is marginally higher than Statistics Canada’s flash estimate of a 0.4% drop. We expect that higher volumes month-over-month drove seasonally adjusted nominal auto sales upwards, despite softening prices. Lower prices at the pump likely fuelled demand, pushing up volumes and sales at gasoline stations on a seasonally adjusted basis. We anticipate core retail sales to post a slight negative in January. For February’s flash estimate, we expect the print to be only modestly above 0%, with auto sales and core retail sales likely remaining close to flat and gasoline edging up.

OVERSEAS
TUESDAY March 19

March	
Consensus	-0.10%
Desjardins	-0.10%
January 23	-0.10%

Japan: Bank of Japan meeting (March) – The Bank of Japan (BoJ) seems poised to end its negative interest rate policy. So far, the BoJ has held off on making a move due to concerns that inflation could slip back below its medium-term target. Before changing its monetary policy, the central bank wants confirmation that wages will continue to rise, as this would help keep inflation around 2%. More key data on wage growth will be released by next month. The BoJ will probably raise interest rates slightly after that. In the meantime, the yen may remain quite volatile.

THURSDAY March 21 - 5:00

March	
Consensus	49.7
February	49.2

Eurozone: Purchasing Managers’ Index (March, preliminary) – Eurozone PMIs seem to be picking up momentum. Of course, at 49.2 the eurozone composite index still sits below 50, the dividing line between economic growth and contraction, but it’s still much better than the low of 46.5 reached in October. February’s 1.3-point gain was mainly attributable to the services component, which rose above 50 for the first time since July 2023. It will be interesting to see if the eurozone’s composite PMI will be able to continue on this modest upswing.


THURSDAY March 21 - 8:00


March	
Consensus	5.25%
Desjardins	5.25%
February 1	5.25%

United Kingdom: Bank of England meeting (March) – With UK inflation having eased appreciably, the Bank of England (BoE) may be able to justify rate cuts in the near future. Like other central banks, it will probably remain cautious in the short term and wait for clearer signals that inflation will fall enough to converge to its target. That said, it will nonetheless be interesting to analyze the BoE’s tone in its official press release. Investors will be watching for indications of imminent rate cuts. We’ll also be keeping a close eye on how the bank’s officials vote. Last time, two officials were still in favour of raising rates, while another was more inclined to lower them. As things stand, we expect the first rate cut to be announced at the June 20 meeting of the Monetary Policy Committee.

Economic Indicators

Week of March 18 to 22, 2024

Date	Time	Indicator	Period	Consensus		Previous reading
UNITED STATES						
MONDAY 18	10:00	NAHB housing market index	March	48	n/a	48
TUESDAY 19	8:30	Housing starts (ann. rate)	Feb.	1,428,000	1,450,000	1,331,000
	8:30	Building permits (ann. rate)	Feb.	1,500,000	1,450,000	1,489,000
	16:00	Net foreign securities purchases (US\$B)	Jan.	n/a	n/a	160.2
WEDNESDAY 20	14:00	Federal Reserve meeting	March	5.50%	5.50%	5.50%
	14:30	Speech by Federal Reserve Chair J. Powell				
THURSDAY 21	8:30	Initial unemployment claims	March 11–15	215,000	215,000	209,000
	8:30	Current account (US\$B)	Q4	-209.0	-210.0	-200.3
	8:30	Philadelphia Fed index	March	0.0	0.0	5.2
	10:00	Leading indicator (m/m)	Feb.	-0.2%	0.0%	-0.4%
	10:00	Existing home sales (ann. rate)	Feb.	3,920,000	4,000,000	4,000,000
FRIDAY 22	16:00	Speech by Federal Reserve Bank of Atlanta President R. Bostic				
CANADA						
MONDAY 18	8:30	Industrial product price index (m/m)	Feb.	n/a	0.2%	-0.1%
	8:30	Raw materials price index (m/m)	Feb.	n/a	0.3%	1.2%
	9:00	Existing home sales (m/m)	Feb.	n/a	0.0%	3.7%
TUESDAY 19	---	2024 New Brunswick Budget				
	8:30	Consumer price index				
		Total (m/m)	Feb.	0.6%	0.6%	0.0%
	Total (y/y)	Feb.	3.1%	3.1%	2.9%	
WEDNESDAY 20	---	2024 Saskatchewan Budget				
	---	2024 Newfoundland and Labrador Budget				
	13:30	Release of the Bank of Canada Summary of Deliberations				
THURSDAY 21	8:45	Speech by Bank of Canada Deputy Governor T. Gravelle				
FRIDAY 22	8:30	Retail sales				
		Total (m/m)	Jan.	-0.4%	-0.2%	0.9%
		Excluding automobiles (m/m)	Jan.	-0.5%	-0.4%	0.6%

NOTE: Each week, Desjardins Economic Studies takes part in the Bloomberg survey for Canada and the United States. Approximately 15 economists are consulted for the Canadian survey and a hundred or so for the United States. The abbreviations m/m, q/q and y/y correspond to month-over-month, quarter-over-quarter and year-over-year change respectively. Following the quarter, the abbreviations f, s and t correspond to first estimate, second estimate and third estimate respectively. Times shown are Eastern Daylight Time (GMT - 4 hours).  Desjardins Economic Studies forecast.

Economic Indicators

Week of March 18 to 22, 2024

Country	Time	Indicator	Period	Consensus		Previous reading		
				m/m (q/q)	y/y	m/m (q/q)	y/y	
OVERSEAS								
SUNDAY 17								
China	22:00	Industrial production	Feb.		5.3%		6.8%	
China	22:00	Retail sales	Feb.		5.6%		7.4%	
MONDAY 18								
Eurozone	6:00	Trade balance (€B)	March	n/a		13.0		
Eurozone	6:00	Consumer price index – final	Feb.	0.6%	2.6%	0.6%	2.8%	
Australia	23:30	Reserve Bank of Australia meeting	March	4.35%		4.35%		
TUESDAY 19								
Japan	---	Bank of Japan meeting	March	-0.10%		-0.10%		
Germany	6:00	ZEW Current Conditions Survey	March	-82.4		-81.7		
Germany	6:00	ZEW Expectations Survey	March	20.5		19.9		
WEDNESDAY 20								
United Kingdom	3:00	Consumer price index	Feb.	0.7%	3.5%	-0.6%	4.0%	
Eurozone	11:00	Consumer confidence – preliminary	March	-15.0		-15.5		
Brazil	17:30	Central Bank of Brazil meeting	March	10.75%		11.25%		
Japan	19:50	Trade balance (¥B)	Feb.	-850.3		235.3		
THURSDAY 21								
France	4:15	Composite PMI – preliminary	March	48.6		48.1		
France	4:15	Manufacturing PMI – preliminary	March	47.3		47.1		
France	4:15	Services PMI – preliminary	March	48.6		48.4		
Switzerland	4:30	Swiss National Bank meeting	March	1.75%		1.75%		
Germany	4:30	Composite PMI – preliminary	March	46.9		46.3		
Germany	4:30	Manufacturing PMI – preliminary	March	43.5		42.5		
Germany	4:30	Services PMI – preliminary	March	48.8		48.3		
Norway	5:00	Bank of Norway meeting	March	4.50%		4.50%		
Eurozone	5:00	Composite PMI – preliminary	March	49.7		49.2		
Eurozone	5:00	Manufacturing PMI – preliminary	March	47.0		46.5		
Eurozone	5:00	Services PMI – preliminary	March	50.5		50.2		
United Kingdom	5:30	Composite PMI – preliminary	March	53.2		53.0		
United Kingdom	5:30	Manufacturing PMI – preliminary	March	47.8		47.5		
United Kingdom	5:30	Services PMI – preliminary	March	53.8		53.8		
United Kingdom	8:00	Bank of England meeting	March	5.25%		5.25%		
Mexico	15:00	Bank of Mexico meeting	March	11.25%		11.25%		
United Kingdom	20:01	Consumer confidence	March	-20		-21		
FRIDAY 22								
United Kingdom	3:00	Retail sales	Feb.	-0.3%	-0.8%	3.4%	0.7%	
Germany	5:00	ifo Business Climate Index	March	86.0		85.5		
Germany	5:00	ifo Current Assessment Index	March	86.8		86.9		
Germany	5:00	ifo Expectations Index	March	84.8		84.1		
Japan	19:30	Consumer price index	Feb.		2.9%		2.2%	

Note: Unlike release times for US and Canadian economic data, release times for overseas economic data are approximate. Publication dates are provided for information only. The abbreviations m/m, q/q and y/y correspond to month-over-month, quarter-over-quarter and year-over-year change respectively. Times shown are Eastern Daylight Time (GMT - 4 hours).