BNY iFlow SHORT THOUGHTS

November 5, 2024

FOMC Preview – Straightforward

Election Week Means FOMC Is a Second-Tier Event

- We expect a straightforward 25bp cut this week and for market reaction to be muted
- This week should be dominated by post-election developments
- Going into the election, iFlow shows a clear bear steepening trade

We expect the FOMC to cut the federal funds rate by 25bp on Thursday this week. Beyond that move – which is 91% priced in – we don't foresee much in the way of forward guidance, and instead expect Chair Powell's press conference to reaffirm the Fed's data dependence with respect to future monetary policy. The setup going into the meeting is such that market movements on the Fed's announcement will likely be dwarfed by post-election market trends.

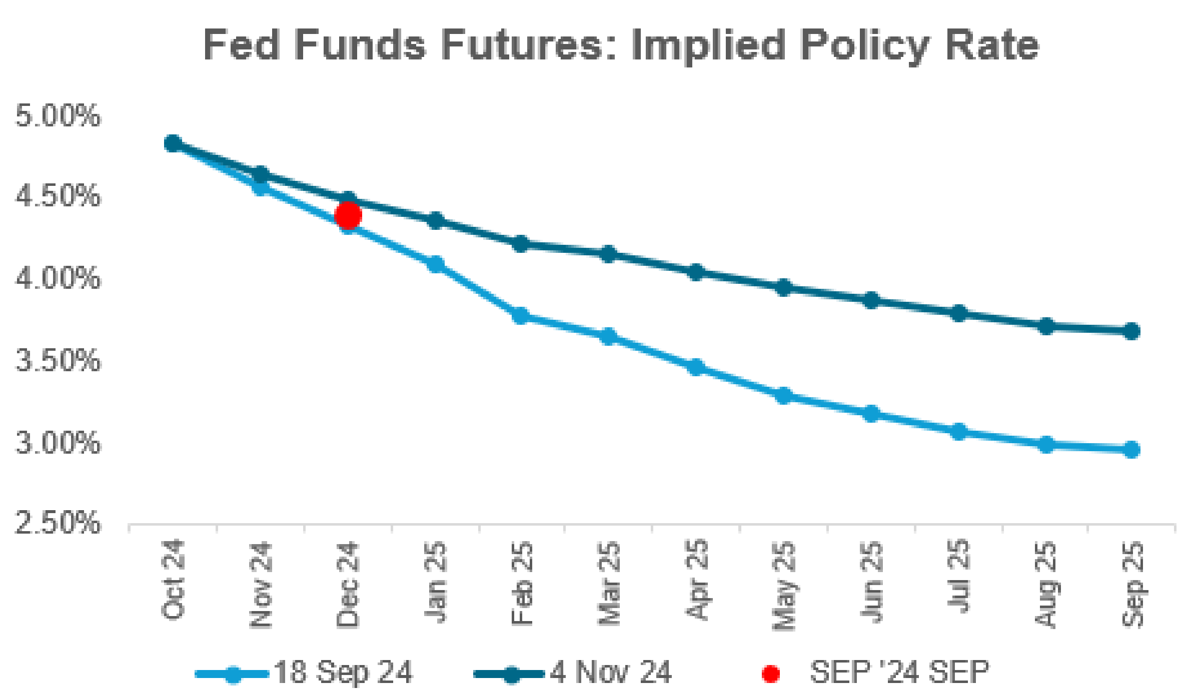
It seems off-key to be looking ahead to the Fed meeting, with the US election just two days beforehand and the results looking too close to call going into the vote. But the calendar is set, and we expect more investors to spend the midweek analyzing and digesting electoral outcomes (or lack thereof) than parsing Chair Powell's press conference. The setup going into the FOMC is so straightforward, and our expectations are high for a relatively uncontroversial meeting, so we don't expect a significant post-meeting reaction in markets.

It's remarkable to consider just how much – and how quickly – Fed pricing has changed since the September 18 meeting, repricing from a very aggressive and swift cutting path in the days after the jumbo cut to a much shallower path. Exhibit #1 shows the implied federal funds rate going out to next September. We compare Monday's pricing, three days before the meeting, to that on the day after the FOMC six weeks later. Note how much expectations have shifted in just over one month.

Exhibit #2 shows the expected probabilities of a 25bp rate cut for every FOMC meeting out to next September. We show these probabilities as they were on September 19, the day after the FOMC; November 4, as we write; and October 4, one month ago. Note that a probability of over 100% implies that one cut is fully priced, and the remainder is the chance that rates would move by 50bp. After the FOMC in September, the market was not only sure of four consecutive rate cuts through March 2025, but each of those months also featured a nontrivial probability of a move larger than just a quarter point. By October 4, just a few weeks later, not only were the odds of 50bp cuts over the next several months lower, but in some cases, there was a less than 100% chance of any rate cuts at all. These probabilities have only shortened since then.

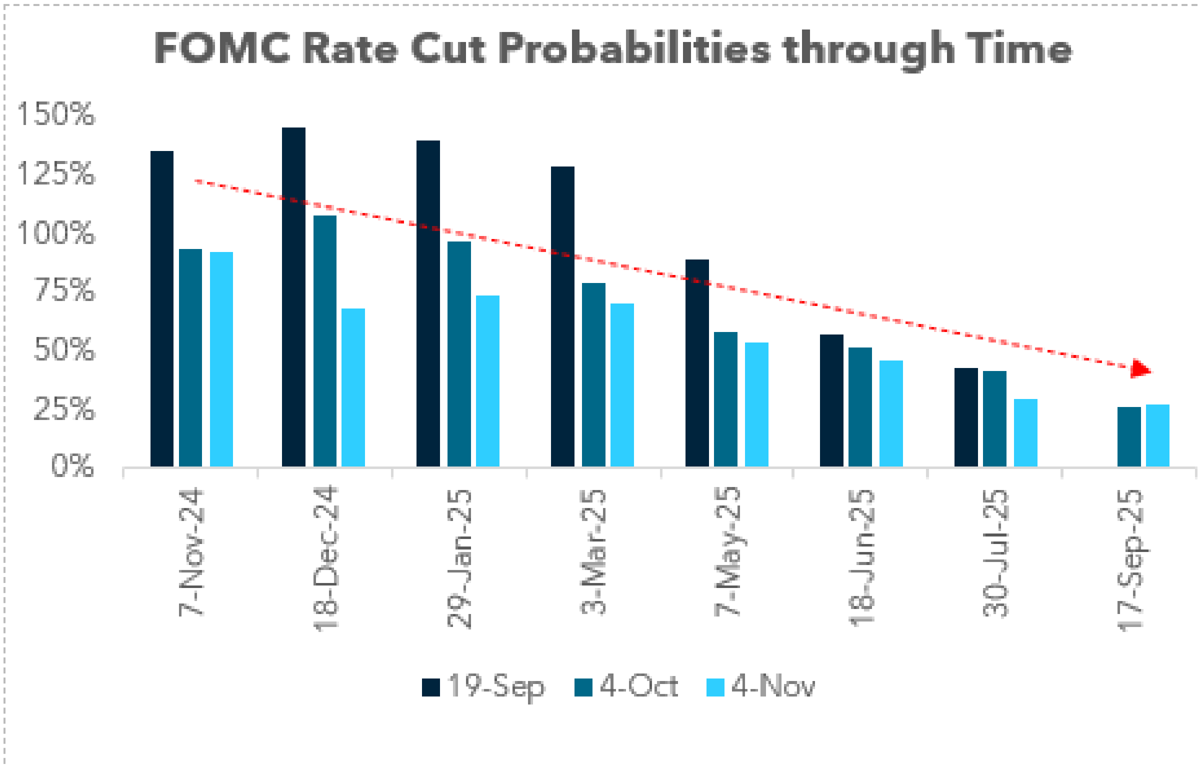
After last week's job market report was published, we wrote (see here) that we see – even with the difficulty of interpreting the data due to hurricanes and strikes – a gradually weakening labor market, one that keeps the Fed cutting rates in December (also by 25bp, in our view). Into 2025, the outlook is murkier. The Fed's most recent Summary of Economic Projections (SEP) sees rates down to 4.5% this year, matching our own expectation. For 2025, the dots coalesce around 100bp of cuts, and we agree – fully cognizant of the uncertainties still in front of us. We see four cuts of 25bp at each of the SEP meetings (March, June, September, December) next year. Economic and political developments are still unknown, so our view for 2025 is admittedly not an especially high conviction forecast.

Exhibit #1: Curve Shift



Source: BNY Markets, Bloomberg

Exhibit #2: Declining Probabilities



Source: BNY Markets, Bloomberg

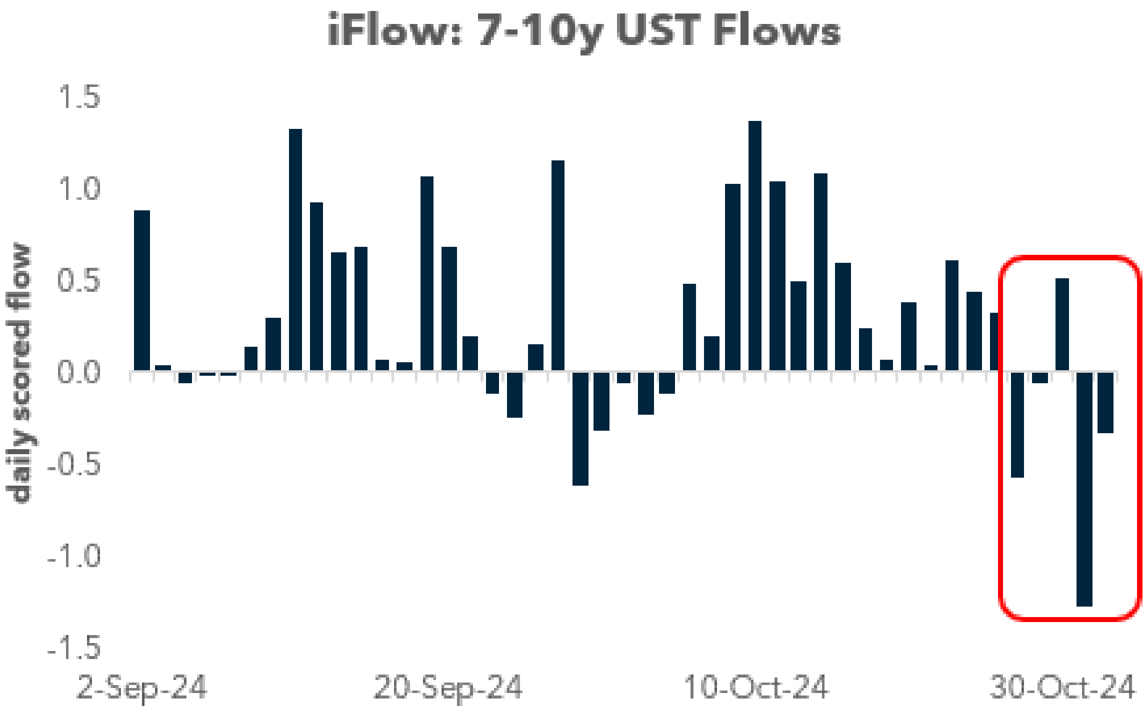
Going into the election, we noticed that in recent days the bond market has seen some interesting flows. We wrote recently in Short Thoughts about the linkages between rising bond yields of late and election risk (see here). At the time, we discussed the relationship between the US Treasury term premium, bond yields, and their connection to rising bets that Donald Trump would win the upcoming election.

In the two charts below, we display what our custody clients – via our iFlow data program – have been doing recently at both the long and short ends of the yield curve. Exhibit #3 shows daily flows into the 7-10y portion of the yield curve. In Exhibit #4, we show flows into the 0-1y maturity bucket as well as into cash and other short-term assets (CAST). In the former case, we have seen significant selling in recent days while in the latter case we see strong buying over the same period.

We infer that investors are retreating into cash and cash-like assets at the expense of long-term bonds. De-risking going into the election seems to be in play as well as the likelihood of further bear steepening in the event of a Trump win. Interestingly, over this past weekend, yields have fallen as these electoral expectations have moderated. We would expect that

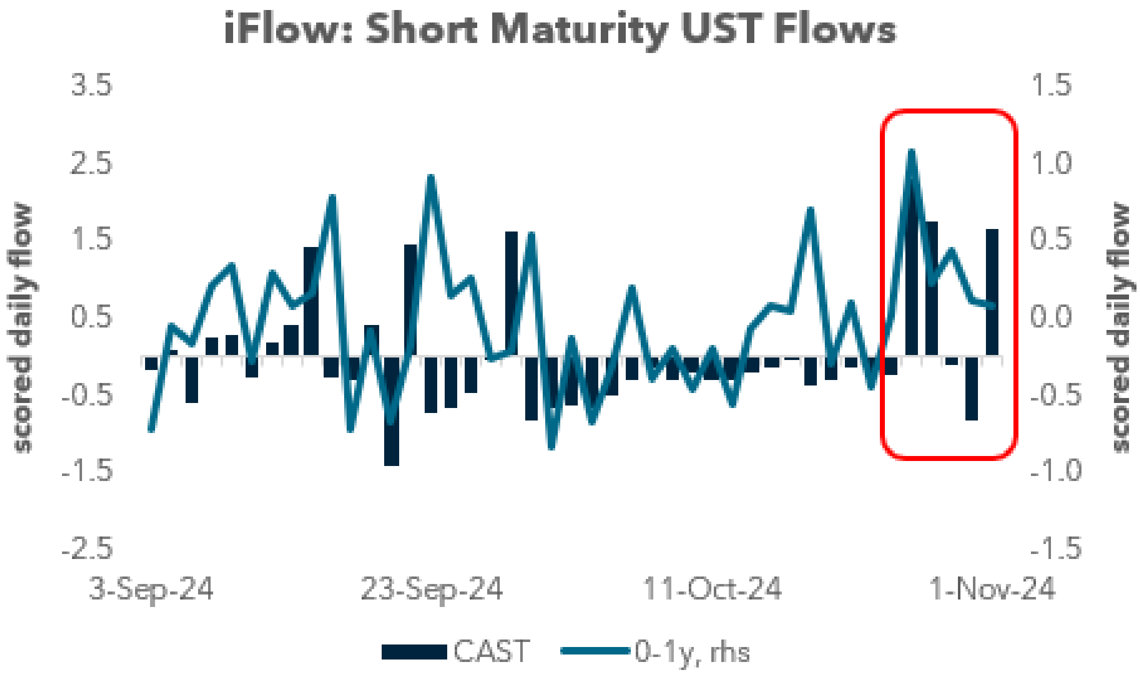
Monday’s iFlow data will show a reversal in this pattern of long- and short-term flows, given the post-weekend adjustment in prices, but we still think most of the market events will not kick off until at least Wednesday.

Exhibit #3: Selling 7-10y USTs



Source: BNY Markets, iFlow

Exhibit #4: Buying Short Maturities and Cash



Source: BNY Markets, iFlow

Please direct questions or comments to: iFlow@BNY.com

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