FEBRUARY 2024

The Fed should be more patient

Key messages

- January's better-than-expected figures may delay the convergence towards the medium-term inflation target of 2% but that it will not contradict the disinflation path.
- We now look for the Fed to start cutting rates in June, and we expect 100bps of rate cuts this year.
- No changes to our 12-month bond yield and EUR/USD FX rate forecasts.

Macro

US CPI inflation rose more than expected in January. This was especially true for so-called "core services", which have shown some stickiness in recent months. They remain the main source of uncertainty around the normalisation of inflation and are thus key for the central bank. Strength was broad-based, with medical care services, transportation services and other personal services all accelerating. Note, however, that some of the CPI services components that rose the most, such as medical services and airfares, are not feeding into core PCE, the favourite measure of the Federal Reserve. For the core PCE these items are taken from the Producer Price Index (PPI). The latest PPI release on 16 February confirmed the pressure on the medical services and airfares components. It also suggests that the core PCE for January should see a rebound. It will be released on 29 February.

It is important to note that the month of January is usually influenced by start-of-the-year price increases, with seasonal adjustments also playing a role. This generates additional volatility. Last year for example, the January and February CPI inflation data saw a sharp rise that was reversed later. This year, we think that January's figures may delay the convergence towards the medium-term inflation target of 2% but that it will not contradict the disinflation path.

Central banks

The American central bank's rate-cutting cycle is therefore not questionable. It could, however, be delayed because of the recent stronger-than-expected macroeconomic data. We now look for the Fed to start cutting rates in June, instead of May, allowing policymakers to gather more data and base their decision on the staff's economic projections. More importantly, we think the rate-cutting cycle will take more time, as we expect 100bps of rate cuts this year (150bps previously), 100bps next year and we forecast the neutral rate at about 2.75% in 2026.

As for the ECB, policymakers are divided between those who fear that premature rate cuts will force the central bank to make a hasty monetary policy reversal, and those who think that rates are too restrictive and dampen growth too much. In any case, both "camps" want to be reassured about the evolution of salaries and corporate profits, and these data will only be available after the April policy meeting. As a result, we continue to anticipate 75bps in rate cuts this year, with the first one in June. We also expect 75bps in rate cuts in 2025 with a deposit rate of 2.5% by end-2025.

Rates

The rate-cutting cycle is not fundamentally changed in the US. We think it will de delayed by a month and will end in early 2026 rather than end 2025. Bond yields may find some support in the very short term, but we do expect them to drop in Q2 and Q3. Our 12-month targets for 10-year yields remain 4% in the US and 2.25% in Germany. We think investors should seize the opportunity of the current rebound in bond yields to lock in higher yields in their bond portfolios.

EURUSD

Our EURUSD scenario remains unchanged. Indeed, despite our outlook change for central banks, the Fed should still cut rates more than the ECB in the coming two years and could continue in 2026. The Dollar remains overvalued with regards to the purchasing power parity estimate. Indeed, the OECD measures it around 1.33 (the value of one euro). We maintain our EURUSD 3-month target at 1.06 and our 12-month target at 1.15.

	Fed			ECB		
	Market pricing 15 February	BNPP WM Previous forecasts	BNPP WM Updated forecasts	Market pricing 15 February	BNPP WM Previous forecasts	BNPP WM Updated forecasts
Date of first rate cut	June 2024	May 2024	June 2024	June 2024	June 2024	June 2024
Expected rate cuts in 2024	95 bps	150 bps	100 bps	115 bps	75 bps	75 bps
Expected rate cuts in 2025	69 bps	100 bps	100 bps	50 bps	75 bps	75 bps

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