

Cutting conditions

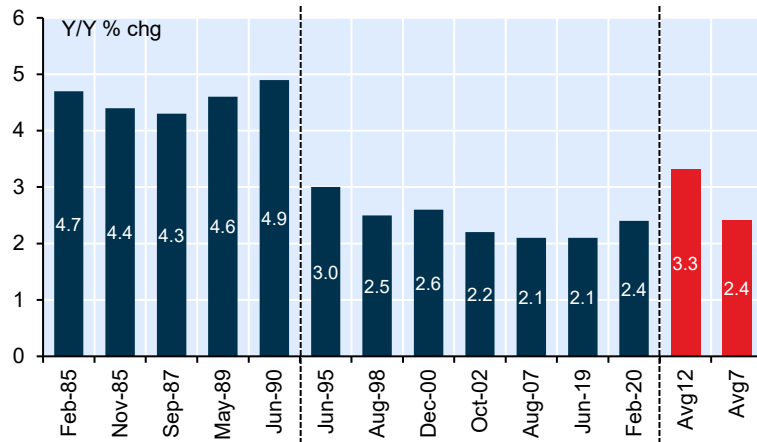
By Warren Lovely & Taylor Schleich

Full disclosure: We're roughly 48 hours ahead of what is almost certainly to be the FOMC's 10th consecutive policy interest rate hike, Wednesday's prospective 25 bp increase due to bring cumulative tightening to 500 bps in under 14 months. Much will be made of the forward guidance, with Powell and Co. likely (in our view) to push back against market expectations of a near-term pivot to less restrictive policy. While current conditions are clearly incompatible with cuts, it's worth asking what type of backdrop has prevailed at the start of prior easing cycles. Indeed, we've been fielding this question with growing frequency/intensity. Here we offer a high-level retrospective on inflation and labour market health at the onset of rate cuts. While leveraging the historical record, our sample size is obviously modest. Moreover, given that the current tightening cycle has deviated notably from perceived norms, the eventual approach to easing could likewise buck historical trends.

In the more contemporary period (i.e., since the mid-1990s when 2% inflation has been the goal), U.S. headline and core inflation averaged 2.3–2.4% at the time of the first FOMC rate cut. The U.S. jobless rate had averaged 4½% at the onset of easing. With headline CPI inflation currently 5.0%, core CPI inflation an even steamier 5.6% and the unemployment rate a very tight 3.5%, the U.S. economy seemingly has way to travel before traditional 'cutting conditions' are in place. (It's a similar story if you prefer to focus on PCE inflation.) If anything, more recent inflation news has been less than soothing; we're thinking of Friday's ECI release or this morning's ISM prices paid print. Nonetheless, our baseline forecast for the U.S.—compiled by our Economics and Strategy colleagues—embeds material CPI inflation relief from here, both for the headline and the core. Meantime, a slower pace of hiring (which could commence as soon as this Friday's non-farm report) could gradually release tightness in labour markets, nudging the jobless rate progressively higher. As it happens, our current U.S. forecast sees the proverbial 'line in the sand', for both core CPI inflation and the jobless rate, being crossed in/around the turn of the year. Not coincidentally, that jives with our broad expectations for FOMC policy. Market-implied expectations, while fluid, have embraced a fairly rapid shift to less restrictive policy at the FOMC. For our part, we've tended to view December as the earliest timeframe for a pivot to lower rates and concede that even that will require quite rapid underlying inflation relief and much-less-ebullient conditions in America's heretofore resilient labour market.

Chart 1: Where has inflation been when FOMC first cuts?

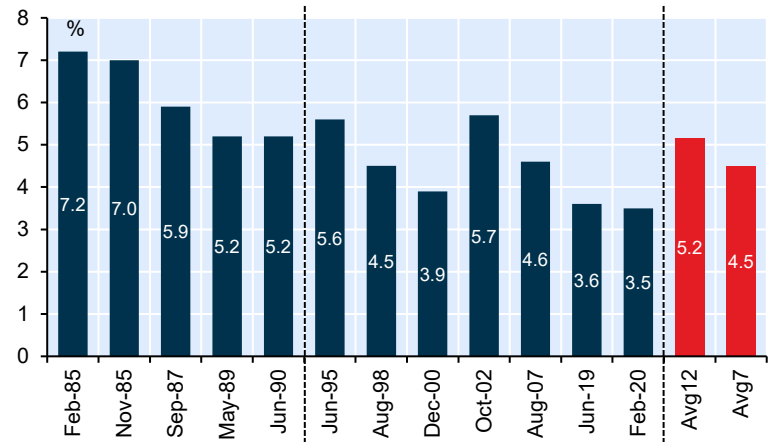
U.S. core CPI inflation at time of first FOMC ease



Source: NBF, FRB, Bloomberg | Note: 'Avg12' based on 12 episodes since 1985; 'Avg7' is subset for post-1995 era; reference month for data is 1M prior to first FOMC ease

Chart 2: What about the U.S. jobless rate?

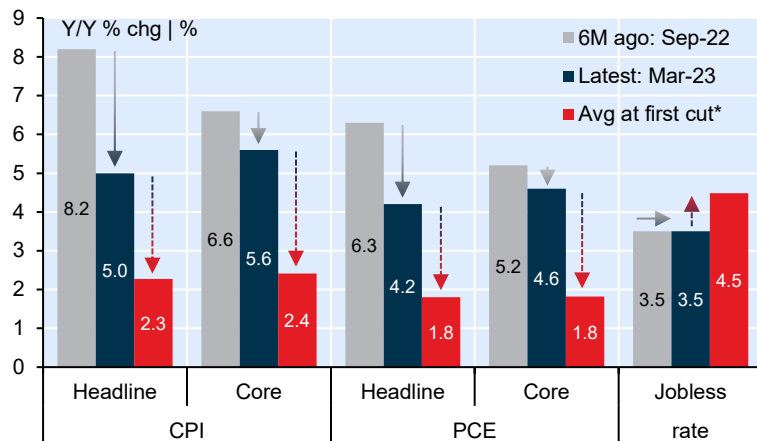
U.S. U3 unemployment rate at time of first FOMC ease



Source: NBF, FRB, Bloomberg | Note: 'Avg12' based on 12 episodes since 1985; 'Avg7' is subset for post-1995 era; reference month for data is 1M prior to first FOMC ease

Chart 3: Still some way to go before FOMC can cut...

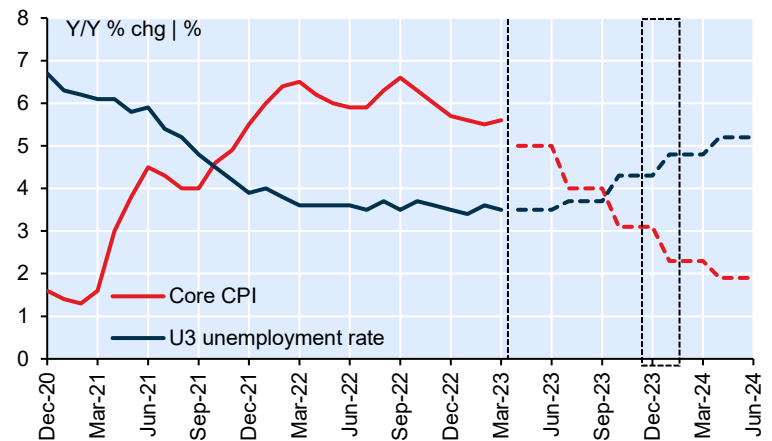
Key U.S. indicators: Past & current reading vs. average at first FOMC ease



Source: NBF, FRB, Bloomberg | Note: 'Avg at first cut' based on 7 episodes in post-1995 era; reference month for data is 1M prior to first FOMC ease

Chart 4: ... but conditions could be met around turn of year

U.S. core CPI inflation & jobless rate: Actual + NBF baseline forecast



Source: NBF, Bloomberg | Note: Dotted red/blue lines reflect NBF forecast (quarterly averages) as per latest Monthly Economic Monitor ([link](#))



Economics and Strategy

Montreal Office

514-879-2529

Stéfane Marion

Chief Economist and Strategist
stefane.marion@nbc.ca

Kyle Dahms

Economist
kyle.dahms@nbc.ca

Alexandra Ducharme

Economist
alexandra.ducharme@nbc.ca

Matthieu Arseneau

Deputy Chief Economist
matthieu.arseneau@nbc.ca

Daren King, CFA

Economist
daren.king@nbc.ca

Angelo Katsoras

Geopolitical Analyst
angelo.katsoras@nbc.ca

Jocelyn Paquet

Economist
jocelyn.paquet@nbc.ca

Toronto Office

416-869-8598

Warren Lovely

Chief Rates and Public Sector Strategist
warren.lovely@nbc.ca

Taylor Schleich

Rates Strategist
taylor.schleich@nbc.ca

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