October FOMC preview: a hawkish hold

- **We expect the Fed to stay on hold in October, maintaining the target range at 3.75-4.00% following the 25bp hike delivered in September. A hold is widely expected at this point, with the BBG consensus close to unanimous and markets pricing less than a 10% chance of a hike.**
- **This does not mean we anticipate the September hike being a one and done, as we look for the Fed to come back with another 25bp hike in December and one more in March as well. Given this outlook, we continue to believe that hikes in consecutive meetings would be a better approach for the Fed to take, though several key FOMC members have indicated less urgency for further moves, so a more gradual approach may allow for broader buy-in on the Committee.**
- **While the September inflation data was not ideal for the Fed, recently implemented methodology changes for PCE improved the picture for PCE inflation more than anticipated. With YoY core PCE now on track to finish the year below what was pencilled in at the September SEP and three-month annualised core having shown clear improvement between February and August, this may be enough for a cohort of the FOMC to argue for a skip in October.**
- **We expect Chair Kevin Warsh to try and maintain the hawkish tone he offered in Jackson Hole and the September meeting, as that was clearly much better received than his July press conference. This would involve a continued emphasis on inflation as the Fed's "predominant focus", a reiteration of the view that he may be "hard-pressed" to call financial conditions restrictive, and once again stressing that the Fed will return inflation to target.**
- **However, the question would be how credible this approach is if the Fed does stay on hold as expected. Market pricing is consistent with the every-other-meeting approach for now, though clearly expects the Fed to deliver additional tightening, so if any questions were to arise about the Fed's resolve to hike further, then credibility concerns could rise to the forefront.**

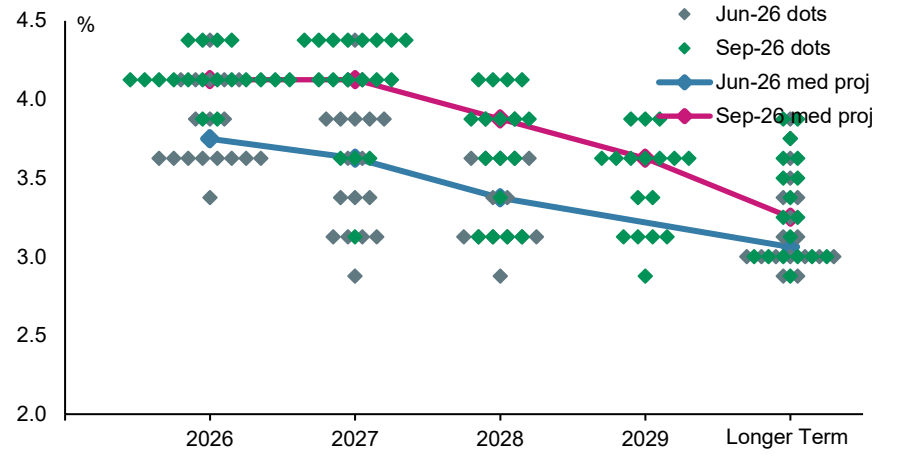


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Fig 1. September dot plot suggests additional tightening



Source: Federal Reserve, Crédit Agricole CIB

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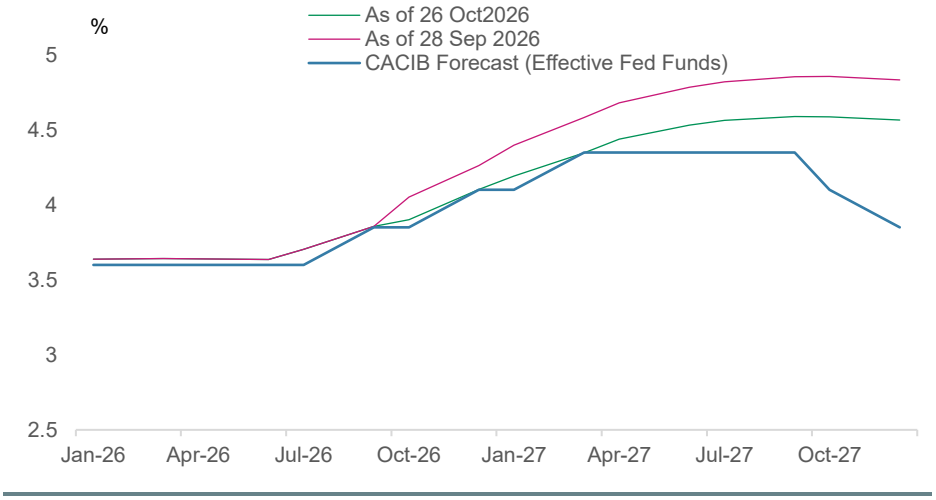
Fed to stay on hold, with some dissent

We expect the Fed to stay on hold in October, maintaining the target range at 3.75-4.00% following the 25bp hike delivered in September. A hold is widely expected at this point, with the BBG consensus close to unanimous and markets pricing less than a 10% chance of a hike.

This pricing even went down after upside surprises for both CPI and PPI in September, with October odds falling from just over 20% prior to the inflation reports and long-term Fed pricing still showing additional tightening but having softened as well over the past month or so (see Figure 2). While there are certainly other considerations outside of one single month of inflation data, we will admit we were surprised by the reaction. That said, **even if the Fed (or at the very least Chair Warsh) seems more open to live meetings than it used to be, tightening when pricing shows less than a 10% chance of a hike may be a step too far.**

If the Fed does stay on hold as expected, we would expect a number of dissents in favour of another hike given differing views on the Committee about the urgency of additional action. The likely dissents would include Cleveland Fed President Beth Hammack, Dallas Fed President Lorie Logan and Minneapolis Fed President Neel Kashkasi, all three of whom previously dissented in favour of a hike when the Fed stayed on hold in July.

Fig 2. Fed pricing has softened over the past month or so



Source: Bloomberg, Crédit Agricole CIB

But should it deliver consecutive hikes?

The base case of a hold in October does not mean we anticipated the September hike being a one and done, as we look for the Fed to come back with another 25bp hike in December, and one more in March as well. Essentially, this outlook would involve the Fed reversing the insurance cuts delivered in late 2025.

Given this view, we continue to believe that hikes in consecutive meetings would be a better approach for the Fed to take. The 25bp hike in September is not large enough on its own to have a material impact on the economy, and if the Fed knows (or at least has a high degree of confidence) that it will likely have to hike further in the future, then it should move sooner rather than later, in our view, as monetary policy impacts the economy with long and variable lags.

However, our job is to predict what we think the Fed will do, and not what we think it should do, and several key FOMC members have indicated less urgency for further moves. These would include:

- New York Fed President John Williams: "With the policy action we took at our September meeting, there is **no need for urgency, and we have time to gather more information".**
- Vice Chair Philip Jefferson: "My colleagues and I will need to come to our own judgment, which **may take more time.** I will continue to assess whether

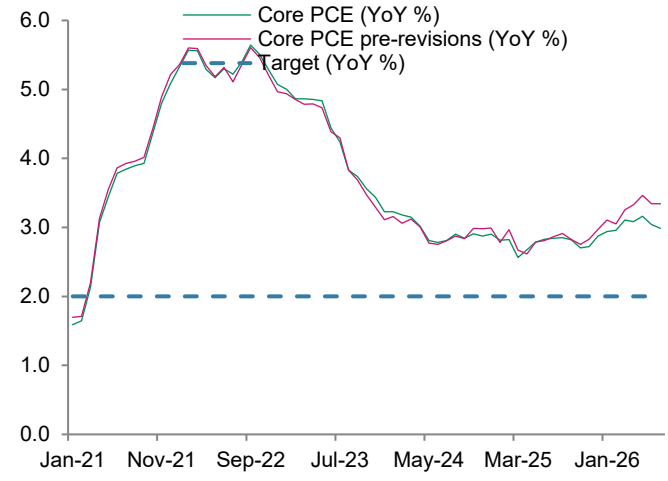
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underlying trends suggest that inflation will return to target with sufficient speed. With more data in hand, such trends may lend themselves to better discernment, as may the appropriate stance of monetary policy".

- Governor Christopher Waller: "I anticipate additional hikes to support a timelier return of inflation to our 2 percent goal. But **there is some flexibility about when those hikes will occur. The hikes do not need to come at consecutive meetings,** but they should be in place in an acceptable period of time".
- Vice Chair for Supervision Michelle Bowman: "We **have some time to wait and see** how financial conditions and the economy evolves before we decide that we need to take any more action. I **don't feel any urgency for taking further action at this point. We really need to take some time** and understand how things will evolve within the economy".

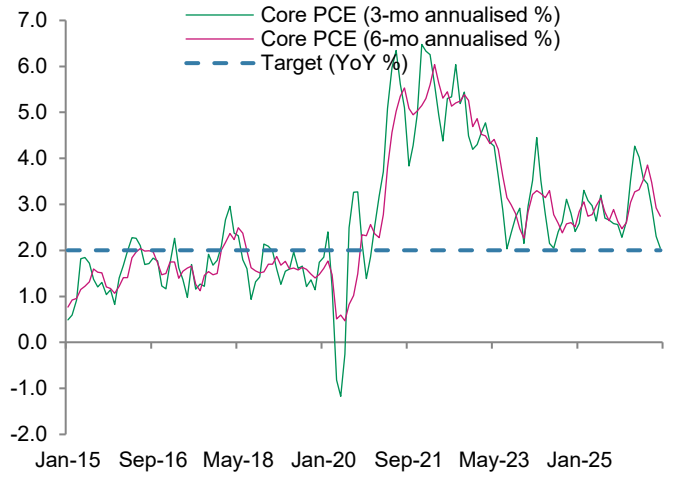
This is not a universal view, to be fair, but most of the FOMC members quoted above are fairly influential ones. Thus, it would be a clear surprise if the Fed were to end up hiking when people like Williams, Jefferson, and Waller were urging patience, so we maintain the view of a skip at this week's meeting as this more gradual approach could be a way to gain broader buy-in on an FOMC that is divided about the magnitude of additional tightening that will be needed.

Fig 3. Still not at target, but revisions improve PCE data



Source: Bloomberg, Crédit Agricole CIB

Fig 4. Three-month annualised core on a downward trend from February to August



Source: Bloomberg, Crédit Agricole CIB

Those supportive of a patient stance may point to the PCE inflation data for support. While the September data looks likely to come in on the firmer side given CPI and PPI inputs, with core expected at around 0.33% MoM with the YoY edging up to 3.1% from 3.0%, **recently implemented methodology changes improved the picture more than anticipated (see Figure 3).**

Taking these into account, YoY core PCE is now on track to finish the year below what was pencilled in at the September SEP and three-month annualised core has shown clear improvement between February and August. For the former, we are now tracking Q426 core PCE at about 3.1%, a full 0.3ppt below the 3.4% median projection in the SEP, while the latter has more than halved from 4.27% in February to 2.05% in August (see Figure 4). **This is certainly not enough to declare victory, and we do not think it will prevent further hikes but may be enough for a cohort of the FOMC to argue for a skip in October.**

Statement to be short and sweet once again

We look for limited changes to the statement, outside of the reference to the October decision and vote, with the statement remaining much shorter and more concise under Warsh than it has been in the past. Aside from the reference to the vote itself, however, we do not think the assessments of economic activity, productivity & investment, the labour market or inflation will change much, if at all, compared to the last meeting.

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Warsh to lean hawkish, but will he be credible?

In the press conference, we expect Chair Kevin Warsh to try and maintain the hawkish tone he offered in Jackson Hole and the September meeting, as that was clearly much better received than his July press conference. This would involve a continued emphasis on inflation as the Fed's "predominant focus", a reiteration of the view that he may be "hard-pressed" to call financial conditions restrictive, and once again stressing that the Fed will return inflation to target.

However, the question would be how credible this approach is if the Fed does stay on hold as expected. Market pricing is consistent with the every-other-meeting approach for now, though clearly expects the Fed to deliver additional tightening, so if any questions were to arise about the Fed's resolve to hike further, then credibility concerns could rise to the forefront.

Conclusion

Despite hotter-than-expected inflation data in September, the Fed is widely expected to remain on hold in October, as even if we continue to believe that additional hikes are likely, several key FOMC members have expressed less urgency in terms of the timing of additional moves. That said, we anticipate that the Fed will try to deliver a hawkish hold, though the question will be how credible the hawkish tone is if offered in conjunction with unchanged rates.

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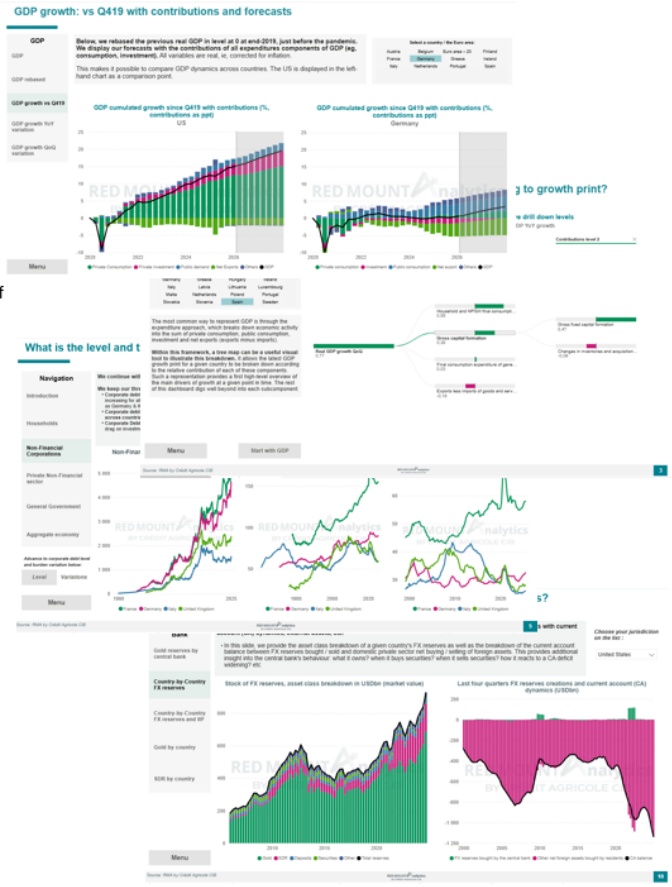
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