

March 20, 2023

Fed's monetary policy: We expect a terminal rate of 2% for the easing cycle

- Following today's monetary policy statement, in which Fed maintained the reference rate between 5.25% and 5.5%, our model suggests that the terminal rate of the Fed's easing cycle (upper range) could stand at 2%
- In the previous tightening cycle, the model approximated in a very timely manner the upper bound of the terminal rate (5.5% vs the 5.25% anticipated by the model)
- We expect that the Fed will make its first 25bps rate cut in June

Fed's topics classification using NLP and ML techniques. In July 2022 we published a research note where we described a model using natural language processing (NLP) techniques that classify and interpret the FOMC statements. In addition, it also **provides a methodology to confirm whether the communication made by the Central Bank is consistent with the monetary policy implemented** (refer to: [Welcome to the Machine \(Learning\): An NLP framework for analyzing the Fed's monetary policy statements](#)).

The relationship between the Fed funds rate and the semantic classification obtained was also analyzed. In this regard, the most important finding in our research note was the degree of strength in the relationship between the Fed funds rate and the semantic classification obtained, given that the latter can explain 9 out of 10 rate movements. The model also defines the range of variation of the terminal reference rate (refer to Chart 1).

The Fed's semantics allude to a terminal rate of 2% for the easing cycle. Although the Fed maintained the funds rate at 5.5% (upper bound) and showed a marginally less hawkish tone in its written communication, the model continue to rank the semantics of the statement with the central topic alluding to the tightening monetary cycle of 2023 (Topic 8 in Chart 2). We highlight that this topic has been the dominant one since the Fed began implementing its current tightening monetary cycle in March 2022.

In this regard, the same topic can give us an estimate of the terminal rate for Fed's easing cycle. Taking the 1st quartile for the monetary policy rates included within this topic, we forecast that the upper bound for the terminal rate will stand at 2% (refer to Chart 2).

We expect that the Fed will make its first 25bps rate cut in June. We highlight that in today's press conference, Powell was less hawkish than in January's meeting. Speaking to reporters after today's FOMC's decision, Powell mentioned several times that the committee would pay close attention to May's economic data. In this regard, we believe that the downward trend in inflation, coupled with lower pressures coming from the labor market will allow the Fed to make its first 25bps rate cut on the 12th of June.



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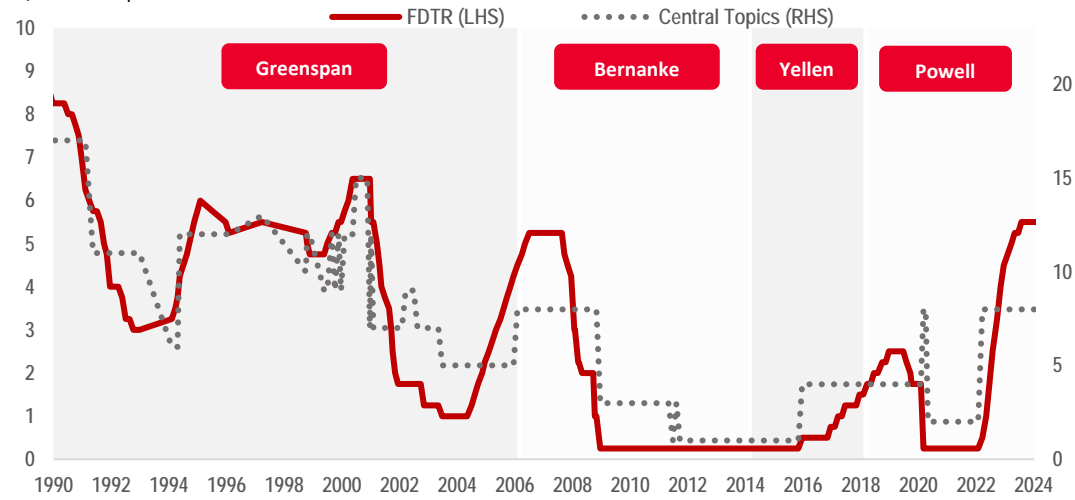


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Chart 1: Banorte's Fed Topic Index vs Fed Funds (upper range)

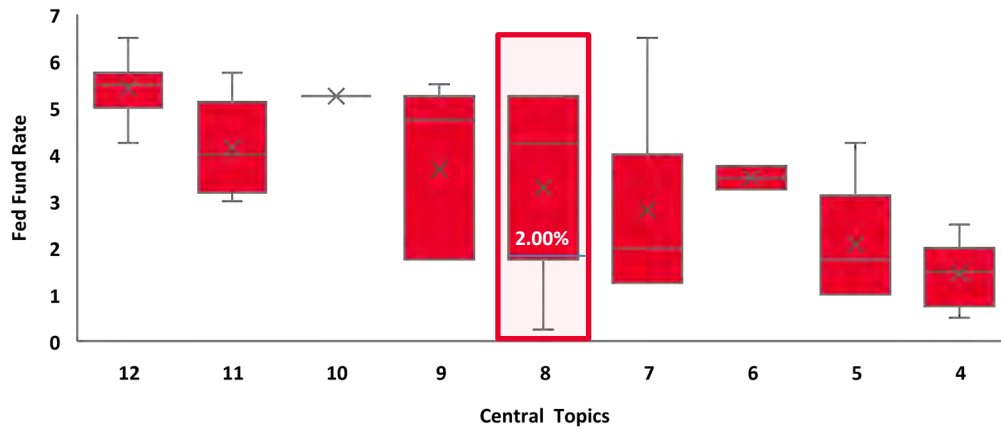
%; Central Topics



Source: Banorte, Federal Reserve

Chart 2: Range of Fed Funds Rate by Topic

Central Topics



Source: Banorte, Federal Reserve

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