

June 12, 2024

## Fed's monetary policy: We expect the first rate cut in December

- 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 December

**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 correlation 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), Powell maintained a more hawkish bias in his speech following the monetary policy announcement. Nevertheless, the model continues 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 1<sup>st</sup> 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 December.** We highlight that in Today's press conference, Powell was more hawkish than in May's meeting. Speaking to reporters after FOMC's decision, Powell mentioned several times that the committee would pay close attention to economic data coming in the rest of the year. In this regard, we believe that the downward trend in inflation, coupled with lower pressures coming from the labor market in 4Q24 will allow the Fed to make its first 25bps rate cut on the 18<sup>th</sup> of December.



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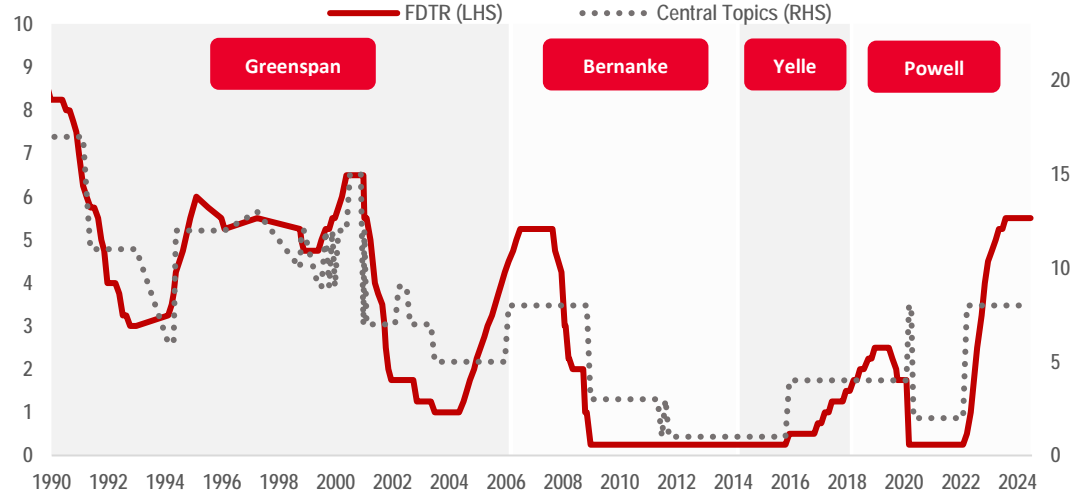


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**Chart 1: Banorte's Fed Topic Index vs Fed Funds (upper range)**

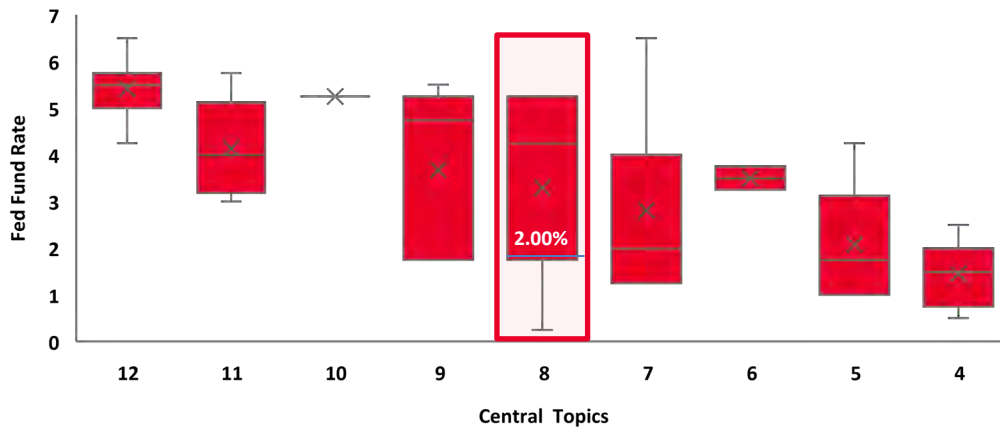
%; Central Topics



Source: Banorte, Federal Reserve

**Chart 2: Range of Fed Funds Rate by Topic**

Central Topics



Source: Banorte

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We, Alejandro Padilla Santana, Juan Carlos Alderete Macal, Alejandro Cervantes Llamas, Marissa Garza Ostos, Katia Celina Goya Ostos, Francisco José Flores Serrano, José Luis García Casales, Santiago Leal Singer, Víctor Hugo Cortes Castro, José Itzamna Espitia Hernández, Leslie Thalía Orozco Vélez, Hugo Armando Gómez Solís, Carlos Hernández García, Yazmín Selene Pérez Enríquez, Cintia Gisela Nava Roa, Miguel Alejandro Calvo Domínguez, José De Jesús Ramírez Martínez, Daniel Sebastián Sosa Aguilar, Gerardo Daniel Valle Trujillo, Luis Leopoldo López Salinas, Marcos Saúl García Hernández, Juan Carlos Mercado Garduño, Ana Gabriela Martínez Mosqueda, Jazmín Daniela Cautencos Mora, Andrea Muñoz Sánchez and Paula Lozoya Valadez, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V for the provision of our services.

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