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The Carlyle Compass

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Welcome back to ***The Carlyle Compass****, your weekly newsletter that brings together the latest research and market insights from our global team.*

In September, Chicago Fed President Austan Goolsbee elegantly melded two metaphors that have defined the macro discourse over the past two years: "If you're going to have a soft landing, you can't be behind the curve."

What landing? Which curve? It didn't matter. If you consume financial news media, you knew exactly what he meant and may have even found yourself nodding along.

"Thought," psychologist Lev Vygotsky wrote, "is not merely expressed in words; it comes into existence through them." Philosophers, linguists, and literary theorists have all expressed the same idea: the words, idioms, and lingo we use to describe something shape how we think about it.

The "landing" in this case was the conclusion of the narrative arc set in motion by the Fed's hiking cycle. The premise of the story was that rates would return to "normal" as inflation declined. The question was whether that would occur in the context of a recession—a "hard landing"—or through a benign deceleration in growth—the "soft landing."

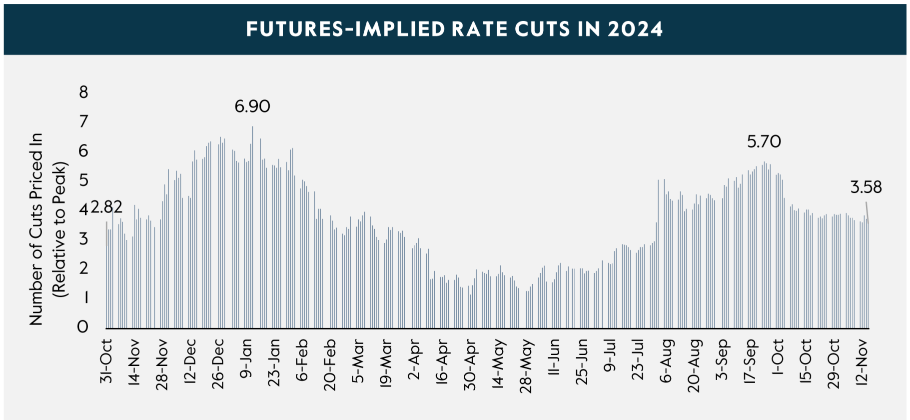
Problems with this framing were two-fold. First, "landings" are generally scheduled for some fixed point in time, as for a plane departing LAX *en route* to JFK. We're now 482 days since the Fed's last rate hike and many still talk about the "landing" as they had a year ago. To what extent has the temporal dimension of this framing prevented us from considering the possibility that rates will remain well above pre-pandemic levels?

Secondly, the lack of clear lines of demarcation between these two conceptual categories meant that data one analyst would consider to be consistent with a "soft landing" could be construed as signs of a "hard landing" by another. This became especially evident in late summer, when labor market data that one would think to be the quintessence of a "soft landing" set off panic among some investors (Compass, August 6).

That panic manifested semiotically as the "curve" that the Fed somehow found itself behind. In January, many forecasters had been expecting seven or more rate cuts this year, starting in

March (Figure 1). When the Fed failed to deliver on their predictions—which would have required preemptive easing in the face of 3% annual rates of GDP growth and core inflation (!)—these forecasters insisted the Fed had courted disaster.

Figure 1: How Long Until the "Soft Landing"?



Source: Carlyle Analysis; Bloomberg, November 2024. There is no guarantee any trends will continue.

And this brings us to Goolsbee's metaphoric conjunction. If you want lower rates absent a recession (a "soft landing") you need to cut rates in advance of a recession (stay "ahead of the curve"). After cancelling out the "recession" terms on both sides of the logical operator, you end up with a statement that essentially says that if you want lower interest rates, you need to cut interest rates.

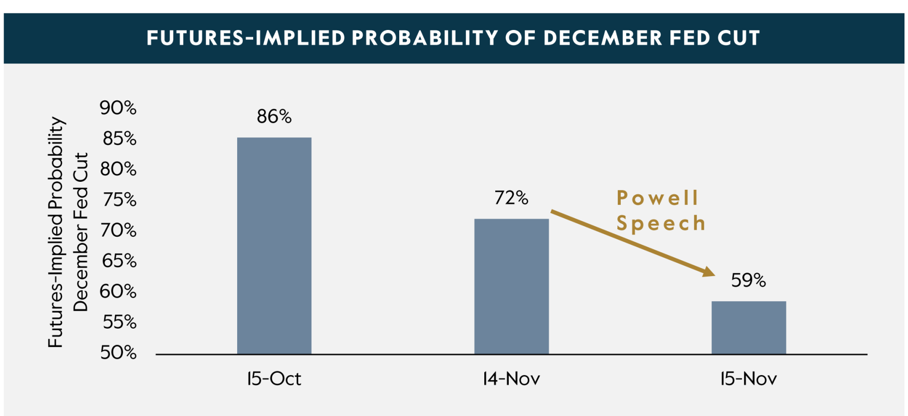
Who could argue with that?

When the Fed cut by 50 basis points in September, in accordance with Goolsbee's wishes, many observers thought this marked the start of an aggressive easing cycle. But, as we noted at the time, the Fed's plan may have been to exploit this sentiment. By "leaning into market repricing," an aggressive cut at the start might ease financial conditions to an extent that would create "optionality" for the Fed to deliver *fewer cuts in the future* (Compass, September 24).

Last Thursday, Chair Powell implied things may be playing out this way. He explained that the Fed is in the process of moving interest rates to "a more neutral setting" but "the economy is not sending any signals that we need to be in a hurry to lower rates."

In other words, the Fed is no longer perceived as being "behind the curve" so the captain has decided to circle the airport a bit before bringing the plane in for its "soft landing." Futures markets now view a December cut as roughly a coin-flip proposition, down from an 85% likelihood a month ago (Figure 2).

Figure 2: Fed No Longer "Behind the Curve"



Source: Carlyle Analysis; CME, November 2024. There is no guarantee any trends will continue.

Economics is unique in that the discipline has largely avoided the obsession with language that's infected much of the rest of the social sciences. That may not be the blessing it seems, but instead a sign of "physics envy" that presumes human activity can be reduced to mathematical equations.

Recent experience validates Robert Shiller's admonition that economists should "grapple with issues that have troubled literary theorists." Stories, symbols, narrative, contagion in phraseology. What he calls "narrative economics" paves the way for a fuller understanding of economic and market fluctuations than could be delivered through virtually any other methodological advance.

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