WEEKLY MARKET COMMENTS – MAY 7, 2024

There were two events last week which sort of calmed the market in terms of taking away the fear that some investors had regarding the possibility of interest rates actually being raised this year, instead of the more commonly held perception that some sort of rate reductions are still possible in 2024.

The Federal Reserve last Wednesday emphasized that inflation has remained stubbornly high in recent months and said it doesn't plan to cut interest rates until it has "greater confidence" that price increases are slowing sustainably to its 2% target.

The Fed issued its decision in a statement after its latest meeting, at which it kept its key rate at a two-decade high of roughly 5.3%. Several hotter-than-expected reports on prices and economic growth have recently undercut the Fed's belief that inflation was steadily easing. The combination of high interest rates and persistent inflation has also emerged as a potential threat to President Joe Biden's re-election bid.

"In recent months," Chair Jerome Powell said at a news conference, "inflation has shown a lack of further progress toward our 2% objective."

"It is likely that gaining greater confidence," he added, "will take longer than previously expected."

Powell did strike a note of optimism about inflation. Despite the recent setbacks, he said, "My expectation is that over the course of this year, we will see inflation move back down."

Investors initially cheered the prospect that the Fed will cut rates at some point this year as well as Powell's comment that the Fed isn't considering reverting to rate increases to attack inflation.

"I think it's unlikely that the next policy rate move will be a hike," he said.

Later, though, stock prices erased their gains and finished the day essentially unchanged from where they were before Powell's news conference.

Still, Powell sketched out a series of potential scenarios for the months ahead. He said that if hiring stayed strong and "inflation is moving sideways," that "would be a case in which it would be appropriate to hold off on rate cuts."

But if inflation continued to cool or if unemployment rose unexpectedly Powell said the Fed would likely be able to reduce its benchmark rate. Cuts would, over time, bring down the cost of mortgages, auto loans, and other consumer and business borrowing.

Those comments were a signal that the Fed is a lot less confident that they know how policies are going to unfold over the course of this year and investors were hoping for an update on the committee's path forward. And instead what we got was, 'We're really not confident enough to tell you what our path forward is going to be.' "

The central bank's overarching message Wednesday — that more evidence is needed that inflation is slowing to the Fed's target level before the policymakers would begin cutting rates — reflects an abrupt shift. As recently as their last meeting on March 20, the officials had projected three rate reductions in 2024, likely starting in June.

But given the persistence of elevated inflation, financial markets now expect just one rate cut this year, in November, according to futures prices tracked by CME Fed Watch.

The Fed's warier outlook stems from three months of data that pointed to chronic inflation pressures and robust consumer spending. Inflation has cooled from a peak of 7.1%, according to the Fed's preferred measure, to 2.7%, as supply chains have eased and the cost of some goods has actually declined.

Average prices, though, remain well above their pre-pandemic levels, and the costs of services ranging from apartment rents and health care to restaurant meals and auto insurance continue to surge. With the presidential election six months away, many Americans have expressed discontent with the economy, notably over the pace of price increases.

On Wednesday, the Fed announced that it would slow the pace at which it is unwinding one of its biggest COVID-era policies: Its purchase of several trillion dollars in Treasury securities and mortgage-backed bonds, an effort to stabilize financial markets and keep longer-term rates low.

The Fed is now allowing $95 billion of those securities to mature each month, without replacing them. Its holdings have fallen to about $7.4 trillion, down from $8.9 trillion in June 2022, when it began reducing them. On Wednesday, the Fed said it would, in June, reduce its holdings at a slower pace.

Instead of allowing $60 billion in Treasuries to roll off each month, it will allow just $25 billion. At the same time, it will continue letting $35 billion in mortgage-backed bonds mature each month.

By cutting back its holdings, the Fed could contribute to keeping longer-term rates, including mortgage rates, higher than they would be otherwise. That's because as it reduces its bond holdings, other buyers will have to buy the securities instead, and rates might have to rise to attract the needed buyers.

The U.S. economy is healthier and hiring stronger than most economists thought it would be at this point. The unemployment rate has remained below 4% for more than two years which is the longest such streak since the 1960s. And while economic growth reached just a 1.6% annual pace in the first three months of this year, consumer spending grew at a robust pace, a sign that the economy will keep expanding.

He also downplayed any concerns that the economy might be at risk of sliding into "stagflation" — a toxic combination of weak growth, high unemployment and elevated inflation that afflicted the United States during the 1970s.

"I was around for stagflation," Powell said, "and it was 10% unemployment, it was high-single-digit inflation. And very slow growth. Right now, we have 3% growth which is pretty solid growth, I would say, by any measure. And we have inflation running under 3%. ...I don't see the 'stag' or the 'flation,' actually."

On Friday, the April non-farm payrolls report show that the nation's employers pulled back on their hiring last month but still added a decent 175,000 jobs in a sign that persistently high interest rates may be starting to slow the robust U.S. job market.

This report showed that last month's hiring gain was down sharply from the blockbuster increase of 315,000 in March. And it was well below the 233,000 gain that economists had predicted.

Yet the moderation in the pace of hiring, along with a slowdown last month in wage growth, will likely be welcomed by the Federal Reserve, which has kept interest rates at a two-decade high to fight persistently elevated inflation. Hourly wages rose a less-than-expected 0.2% from March and 3.9% from a year earlier, the smallest annual gain since June 2021.

The Fed has been delaying any consideration of interest rate cuts until it gains more confidence that inflation is steadily slowing toward its 2% target. Rate cuts by the central bank would, over time, reduce the cost of mortgages, auto loans and other consumer and business borrowing.

As a result of this report, stock prices rose sharply and bond yields fell on Friday on hopes that rate cuts might now be more likely sometime in the coming months.

The state of the economy is weighing on voters' minds as the November presidential campaign intensifies. Despite the strength of the job market, Americans remain generally exasperated by high prices, and many of them assign blame to President Joe Biden.

Even with the April hiring slowdown, last month's job growth amounted to a solid increase, though it was the lowest monthly gain since October. With the nation's households continuing their steady spending, many employers have had to keep hiring to meet their customer demand.

Though the unemployment rate ticked up from 3.8% to 3.9% in April, it was the 27th straight month in which the rate has remained below 4%, tying the longest such streak since the 1960s.

Last month’s hiring was led by healthcare companies, which added 56,000 jobs. Warehouse and transportation companies added 22,000 and retailers 20,000. Government at all levels, which had been hiring aggressively, added just 8,000 jobs in April, the lowest monthly total since December 2022 and this was because state and local government revenue has recently slumped.

Temporary help jobs fell by more than 16,000. These positions are often seen as a potential indicator of where the job market is headed because companies sometimes try out temps before committing to full-time hires.

The labor force participation rate which includes the share of the adult population that either has a job or is looking for one was unchanged at 62.7%, well below pre-pandemic levels.

America’s job market has repeatedly proved more robust than almost anyone had predicted. When the Fed began aggressively raising rates two years ago to fight a punishing inflation surge, most economists expected the resulting jump in borrowing costs to cause a recession and drive unemployment to painfully high levels.

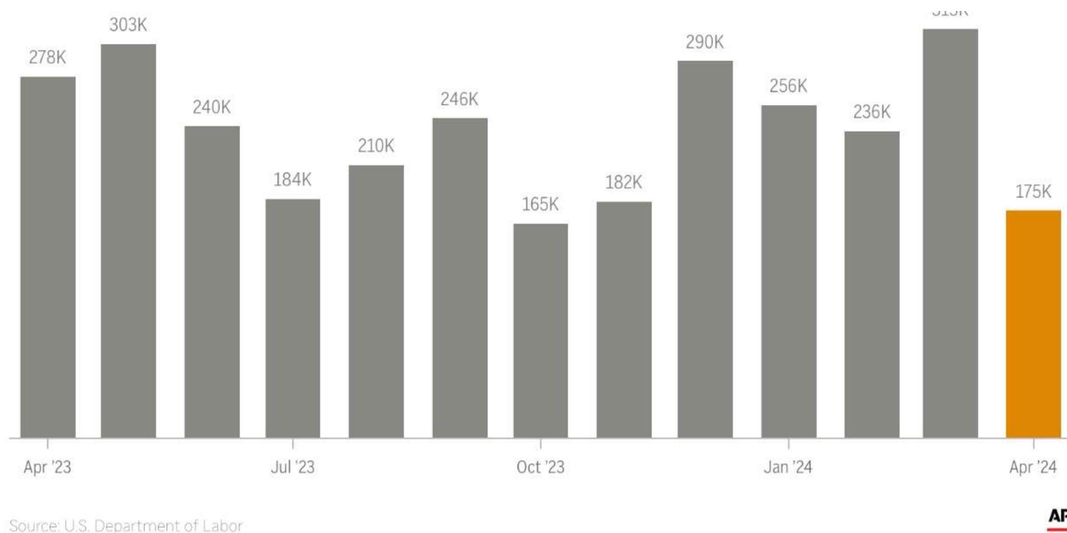
The Fed raised its benchmark rate 11 times from March 2022 to July 2023, taking it to the highest level since 2001. Inflation did steadily cool as it was supposed to, from a year-over-year peak of 9.1% in June 2022 to 3.5% in March.

Yet the resilient strength of the job market and the overall economy, fueled by steady consumer spending, has kept inflation persistently above the Fed’s 2% target.

The job market has been showing other signs of eventually slowing. This week, for example, the government reported that job openings fell in March to around 8.5 million which was the fewest in more than three years. Still, that is a large number of vacancies: Before 2021, monthly job openings had never topped 8 million, a threshold they have now exceeded every month since March 2021.

On a month-over-month basis, consumer inflation hasn’t declined since October. The 3.5% year-over-year inflation rate for March was still running well above the Fed’s 2% target.

There is some evidence that the pressure to raise wages has eased. But there is some companies that are focusing more on offering flexibility in shifts for workers who are increasingly juggling multiple jobs to pay their bills in the face of still stubborn inflation.



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