WEEKLY MARKET COMMENTS – FEBRUARY 1, 2024

The hope that interest rate cuts are coming in March were eliminated in yesterday's Fed interest rate announcement yesterday.

The Federal Reserve delivered that message, first in a policy statement and then in a news conference at which Chair Jerome Powell reinforced it.

The Fed did signal that it is nearing a long-awaited shift toward cutting rates, evidence that its officials have grown confident that they are close to fully taming inflation, but no longer does its policy statement say it is still considering further rate hikes.

Yet the officials made clear that the first rate cut is likely months away. Their statement said they don't think it would be time to cut rates "until it has gained greater confidence that inflation is moving sustainably" to their 2% target.

Some investors and economists had been holding out the possibility that the Fed might cut as early as its next meeting in March, but that now appears off the table.

"I don't think it's likely that the committee will reach a level of confidence by the time of the March meeting" to start cutting rates, Powell said at his news conference.

The central bank kept its key rate unchanged at about 5.4%, a 22-year high. But the changes to its statement — compared with its last meeting in December — show that it has moved toward considering rate reductions while still maintaining flexibility.

In December, the Fed's policymakers had indicated that they expected to implement three rate cuts of one-quarter point this year. Yet they have since said little about when those cuts might begin, and some senior officials stressed that the Fed will proceed cautiously.

On Wednesday, Powell said the Fed doesn't need to see significant changes in the inflation data for it to cut rates. It just needs to see the inflation slowdown continue. Prices have increased at just a 2% annual rate over the past six months, according to the Fed's preferred measure. (PCE, or Personal Consumption Expenditures).

"It's not that we're looking for better data — it's just that we're looking for a continuation of the good data that we've been getting," he said. "We just need to see more."

The central bank's message Wednesday that it is edging closer to cutting rates but not planning to do so anytime soon disappointed traders as losses in the stock market accelerated after Powell’s news conference began. As a result, the S&P put in its worst performance since September.

The change in the Fed’s stance comes as the economy is showing surprising durability after a series of 11 rate hikes helped drastically slow inflation, which had hit a four-decade high 18 months ago. Growth remains healthy: In the final three months of last year, the economy rose at a 3.3% annual rate, the government said last week.

The Fed is assessing inflation and the economy at a time when the intensifying presidential campaign is pivoting in no small part on voters’ perceptions of President Joe Biden’s economic stewardship. Republicans in Congress have attacked Biden over the high inflation that gripped the nation beginning in 2021 as the economy emerged from recession. But the latest economic data, ranging from steady consumer spending to solid job growth to the slowdown in inflation, has been helping consumer confidence..

At his news conference, Powell said the Fed welcomes signs of economic strength.

“We want to see strong growth and a strong labor market,” the Fed chair said. “We’re looking for inflation to come down, as it has been coming down for the last six months.”

Most economists now say that they expect the Fed to start cutting its benchmark rate in May or June. Rate cuts would eventually lead to lower borrowing costs for America’s consumers and businesses, including for mortgages, auto loans and credit cards.

A year ago, many analysts were predicting that widespread layoffs and sharply higher unemployment would be needed to cool the economy and curb inflation. Yet job growth has been steady. The unemployment rate, at 3.7%, isn’t far above a half-century low.

Labor costs are easing, too. On Wednesday, the government reported that pay and benefits for America’s workers, which accelerated in 2022, grew in the final three months of 2023 at the slowest pace in 2.5 years and that slowdown reduces pressure on companies to raise prices to cover higher labor costs.

The Fed appears on the verge of achieving a rare “soft landing,” in which it manages to conquer high inflation without causing a recession. Should the pace of economic growth strengthen, though, it could complicate the challenge for the Fed.

Powell said that faster growth could potentially cause inflation to stall at a rate above 2%, which could complicate the Fed’s timetable for rate cuts. For now, with the economy performing well, he said, the Fed doesn’t need to rush to reduce borrowing costs.

“If we saw an unexpected weakening in the labor market, that would certainly weigh on cutting sooner,” Powell said.

Asked whether he thought the Fed has already achieved a soft landing, Powell suggested it would be premature to say so.

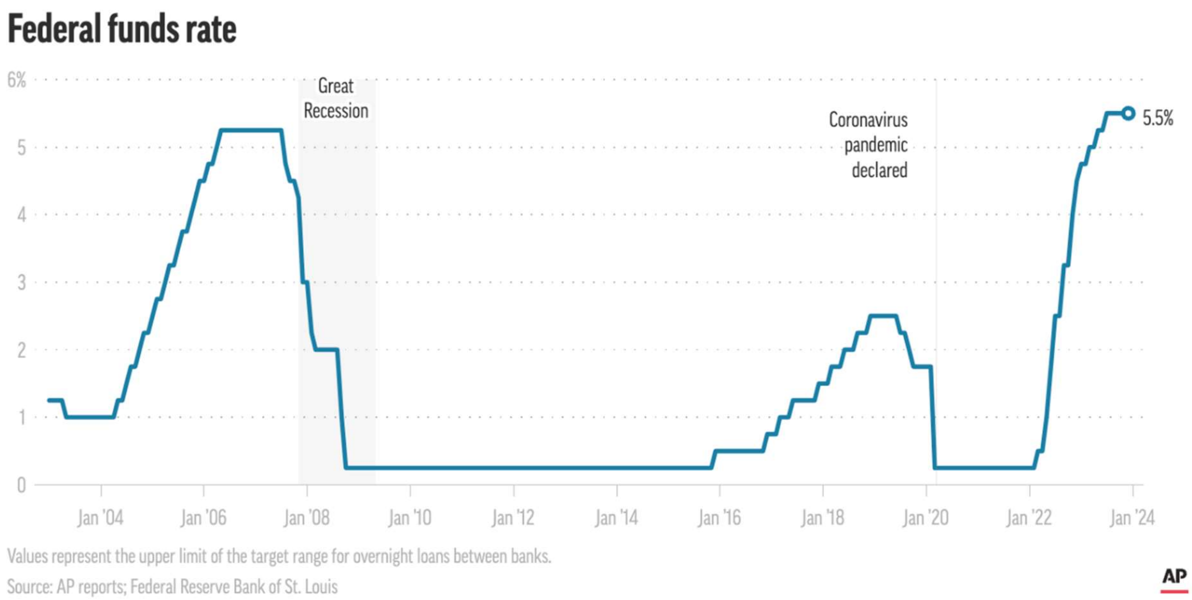
“We have a ways to go,” he said. “Core inflation is still well above target on a 12-month basis. Certainly, I’m encouraged and we’re encouraged by the progress, but we’re not declaring victory at this point. We think we have a ways to go.”

Some cracks in the job market have begun to emerge and, if they worsen, could spur the Fed to cut rates quickly. For several months, most of the nation’s job growth has occurred in just a few sectors — health care, government and hotels, restaurants and entertainment. Any weakening in those areas of the economy could threaten hiring and the overall expansion.

A report Tuesday showed that the number of workers who quit in December reached its lowest level in three years. That suggested that fewer Americans are being recruited for new, higher-paying jobs or are willing to search for and take new positions. Though quits remain at a level consistent with a solid job market, they have fallen about one-third from their peak in mid-2022.

Still, the U.S. economy is outdoing its counterparts overseas. During the October-December quarter, the 20 countries that share the euro currency barely avoided a recession, posting essentially no growth.

Still, as in the United States, unemployment is very low in the euro area, and inflation has slowed to a 2.9% annual rate. Though the European Central Bank could cut rates as soon as April, many economists think that might not happen until June.



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