WEEKLY MARKET COMMENTS – MARCH 26, 2024

Federal Reserve officials signaled last Wednesday that they still expect to cut their key interest rate three times in 2024, fueling a rally that ended in records for the Dow, S&P and Nasdaq, despite signs that inflation remained elevated at the start of the year.

For now, the officials kept their benchmark rate unchanged for a fifth straight time.

Speaking at a news conference, Chair Jerome Powell said the surprising pickup in inflation in January and February hadn't fundamentally changed the Fed's picture of the economy, namely that the central bank still expects inflation to continue to cool, though more gradually than it thought three months ago.

The recent high inflation readings followed six months of steady slowdowns in price increases. Economists and investors were looking for some clarification Wednesday about how the latest inflation reports were viewed at the Fed.

The January and February data, Powell said, "haven't really changed the overall story, which is that of inflation moving down gradually on a sometimes bumpy road towards 2%," the Fed's target.

In new quarterly projections they issued, the policymakers forecast that stronger growth and inflation above their 2% target level would persist into next year. Overall, the forecasts suggest that the Fed still expects an unusual combination: A healthy job market and economy in tandem with inflation that continues to cool, which is just more gradually than they had predicted three months ago.

For this year, the Fed projected that the economy would expand by 2.1%, a big increase from its December forecast of just 1.4%. Yet at the same time, it still expects inflation to keep declining, though slowly.

The Fed's updated projections suggest that it expects improvements in supply chains and the availability of workers to continue, allowing the economy to grow even as inflation slows to the Fed's target. Rising immigration, for example, has made it easier for businesses to hire without having to rapidly raise pay.

Rate cuts would, over time, lead to lower costs for home and auto loans, credit card borrowing and business loans. They might also aid President Biden's re-election bid, which is facing widespread public unhappiness over higher prices and could benefit from an economic jolt stemming from lower borrowing rates.

The financial markets cheered the message Wednesday from Powell and the Fed, with traders sending the Dow Jones industrial average surging 1%, to another all-time high.

“Inflation has come way down, and that gives us the ability to approach this question carefully and feel more confident that inflation is moving down sustainably,” Powell said. “It is still likely that we will see that confidence and that there will be rate cuts.”

The Fed’s policymakers did make some small adjustments in their outlook: Their projections showed that in 2025, they now foresee only three rate cuts, down from the four they envisioned in their December forecasts.

One reason may be that they expect “core” inflation, which excludes volatile food and energy costs, to still be 2.6% by the end of 2024, up from their previous projection of 2.4%. In January, core inflation was 2.8%, according to the Fed’s preferred measure.

Most economists have pegged the Fed’s June meeting as the most likely time for it to announce its first rate cut, which would begin to reverse the 11 hikes it imposed beginning two years ago. The Fed’s hikes have helped lower annual inflation from a peak of 9.1% in June 2022 to 3.2%. But they have also made borrowing much costlier for businesses and households.

Though consumer inflation has tumbled since mid-2022, it has remained stuck above 3%. And in the first two months of 2024, the cost of services, like rents, hotels and hospital stays, remained elevated. That suggested that high borrowing rates weren’t sufficiently slowing inflation in the economy’s vast service sector.

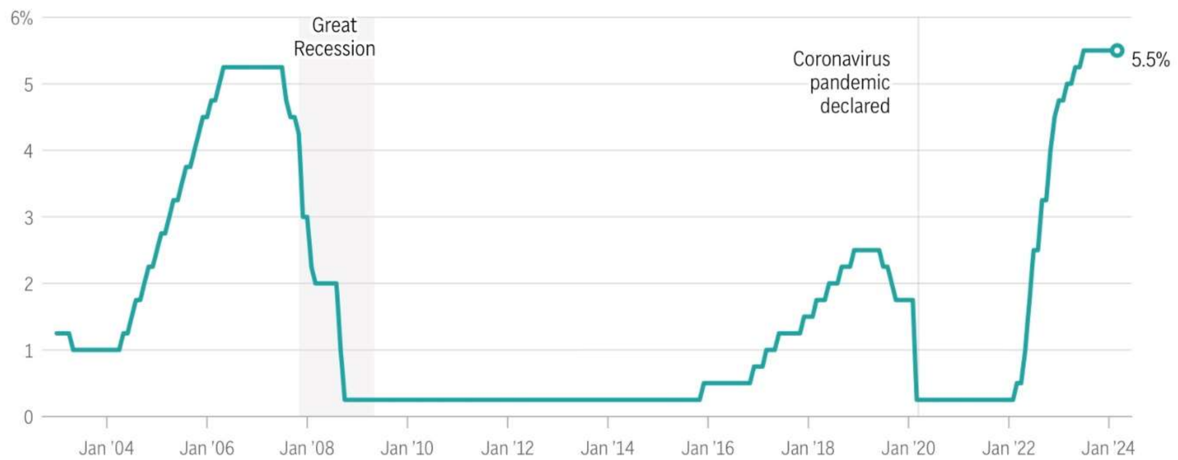
While the Fed’s rate hikes typically make borrowing more expensive for homes, cars, appliances and other costly goods, they have much less effect on services spending, which doesn’t usually involve loans. With the economy still healthy, there is no compelling reason for the Fed to cut rates until it feels inflation is sustainably under control.

In most respects, the U.S. economy remains heathy as employers keep hiring, unemployment remains low and the stock market is hovering around record highs. Yet average consumer prices remain much higher than they were before the pandemic, which is a source of unhappiness for many Americans for which Republicans have sought to pin blame on Biden.

And there are signs that the economy could weaken in the coming months. Americans slowed their spending at retailers in January and February, for example. The unemployment rate has reached 3.9%, still a healthy level, but up from a half-century low last year of 3.4%. And much of the hiring in recent months has occurred in government, health care and private education, with many other industries barely adding any jobs.

Other major central banks are also keeping rates high to ensure that they have a firm handle on consumer price spikes. In Europe, pressure is building to lower borrowing costs as inflation drops and economic growth stalls. The European Central Bank hinted

this month that a possible rate cut could come in June, while the Bank of England isn't expected to open the door to any imminent cut at the present time.



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