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Situation analysis May 1, 2024

Federal Reserve keeps rates steady, remains open to rate cuts later this year if data warrants

Key takeaways

- The U.S. Federal Reserve held interest rates steady in a range of 5.25% to 5.50% today as it maintains elevated rates to bring inflation down.
- The Fed cautioned of a "lack of further progress" on inflation recently, but noted current policy is "well positioned."
- Investors anticipate one to two 0.25% rate cuts in 2024 starting in the fall based on interest rate market pricing, a drastic change from six to seven cuts expected as recently as January.

The Federal Reserve (Fed) held its target federal funds interest rate steady in a range of 5.25% to 5.50% following its regularly scheduled two-day meeting, as expected by investors and economists. The Fed uses interest rate policy to carry out its maximum employment, price stability and moderate long-term interest rate mandates. The Fed left its official statement mostly unchanged, but added, "In recent months, there has been a lack of further progress toward the committee's 2% inflation goal." Chairman Jerome Powell echoed the sentiment during the subsequent press conference, stating that while he still believes policy is restrictive and positioned to thwart recent price increases, the committee needs to see more evidence that inflation is coming down before they are confident enough to cut rates.

Considerable policy tightening from a near-zero federal funds rate in early 2022 to the current 5.25% to 5.5% helped drive Core Personal Consumption Expenditures Price Index, the Fed's preferred inflation gauge, from a peak above 5.5% in 2022 to 2.8% in March. Other inflation metrics, like the Core Consumer Price Index, fell to 3.8% in March due to differing calculation methodologies, well off its high of 9.1% in June 2022. While goods-related inflation fell to near-zero levels, service-related inflation remained elevated and has reaccelerated when observing changes over shorter time frames such as three-months.

Investors dampened their expectations for aggressive rate cuts in 2024 due to sticky service inflation driven by robust job gains and the resulting resilience in consumer spending and economic activity. These changed expectations drove bond yields higher this year; investors now anticipate one to two rate cuts by year-end. Some prognosticators have even questioned whether the Fed's next move could be a rate *increase*, but Powell noted during the press conference, "It's unlikely that the next policy rate move will be a hike." He also reiterated the Fed remains data-dependent, and the data suggests policy remains well positioned for now.

Powell also announced a change to the Fed's balance sheet reduction strategy, known as quantitative tightening (QT). Presently, the Fed is allowing to mature without replacement up to $60 billion per month in Treasuries and $35 billion per month of mortgage bonds. Beginning in June, the monthly Treasury runoff cap will decline from $60 to $25 billion, which may help stabilize market liquidity — the amount of money readily available to buy goods, services and financial assets in an economy. Shorter-term measures of liquidity deteriorated in recent weeks, with April tax payments temporarily removing money from the economy.

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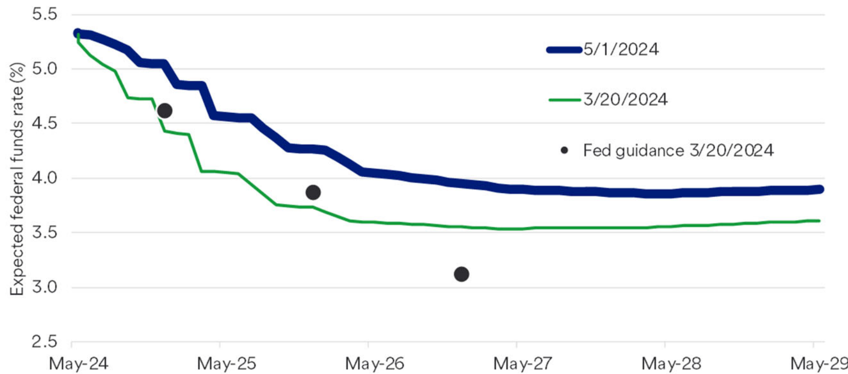
Market pricing of the expected path of the federal funds rate



Source: U.S. Bank Asset Management Group Research, Bloomberg; 3/20/2024-5/1/2024

Stock prices initially rallied, with investors viewing the Fed's press conference as less hawkish than feared, though ultimately finished the day weaker as the focus shifts to Friday's job report. The Fed's consistent message — that inflation remains too high, policy remains restrictive and more evidence is needed before cutting rates — prompted initial relief among those fearing discussion of a potential hike later this year. Treasury bond yields fell, and the S&P 500 finished the day down 0.34%. Smaller companies represented by the Russell 2000 Index, which can be more sensitive to financing costs, rose slightly as bond yields fell. Ten-year Treasury bond yields fell 0.05% to 4.63% today, while two-year Treasury yields fell 0.07% to 4.96%. Funds that track the Bloomberg Commodity Index fell 0.89% as crude oil inventories unexpectedly rose.

Monetary policy, defined as central bank interest rate target decisions, remains restrictive around the globe after aggressive rate hikes. However, there were more rate cuts in the past two quarters than rate hikes as inflation across the globe trended lower and some emerging economies began easing monetary policy. Investors anticipate modest rate cuts from other major central banks in addition to the Fed, with two to three cuts expected in 2024 from the European Central Bank (ECB) and two cuts from the Bank of England (BoE).

Global net central bank rate hikes (net hikes minus cuts), quarterly

Source: U.S. Bank Asset Management Group Research, Factset; 8/31/2004-5/1/2024

This year has been marked by solid performance of stocks (large U.S. stocks in particular) and inflation-sensitive assets like commodities, although gains have been trimmed in the past month. Smaller company stocks have lagged while bond prices have fallen and yields rose as investors price in fewer rate cuts. The relatively narrow rally in 2023 that boosted growth-oriented stocks began to broaden late last year and continued broadening into 2024. Currently, 10 of 11 sectors in the S&P 500 Index have posted gains year to date, with most index constituents participating in higher price trends.

We retain a glass-half full viewpoint regarding corporate profits and are also wary that inflation may be more persistent. Robust consumer and business activity has translated to stronger than expected economic data, while also contributing to gradually accelerating input costs and service-related inflation readings. Stimulative fiscal policy in the form of deficit spending has provided an additional tailwind to current conditions despite increasing government debt. We will keep you informed of our views as incremental data becomes available and as we update our assessment of market conditions.

As always, we value your trust and are here to help in any way we can. Please do not hesitate to let us know if we can help address your unique financial situation or be of assistance.

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Past performance is no guarantee of future results. All performance data, while obtained from sources deemed to be reliable, are not guaranteed for accuracy. Indexes shown are unmanaged and are not available for direct investment. The **S&P 500 Index** consists of 500 widely traded stocks that are considered to represent the performance of the U.S. stock market in general. The **Russell 2000 Index** measures the performance of the 2,000 smallest companies in the Russell 3000 Index and is representative of the U.S. small capitalization securities market. The **Bloomberg Commodity Index** tracks prices of futures contracts on physical commodities in the commodity markets and is designed to minimize concentration in any one commodity or sector. The **Personal Consumption Expenditures (PCE) Price Index** is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. It is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior. The **Consumer Price Index** is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. It is one of the most frequently used statistics for identifying periods of inflation or deflation.

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