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Fed not quite ready to cut

Blog

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At today's policy meeting, the FOMC statement was changed to remove the tightening bias, opening the door to rate cuts. However, the statement said that "[t]he Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent."

At the post-meeting press conference, Federal Reserve Chair Jerome Powell confirmed that this language means that the first rate cut would likely *not* be made at their next meeting on 19–20 March. Powell said that "almost all" of the FOMC participants believe that it will be appropriate for the Fed to start cutting rates this year. He noted that the inflation data has been favorable over the past six months, with core PCE running below a 2% pace, but in year-over-year terms inflation is at 2.9%, which is still well above their target. Powell also seemed content to let the economy grow at a robust pace as long as inflation continues to make progress toward their target.

Market pricing on the probability of a March rate cut was around 40% as of yesterday's close, moved above 70% this morning, and then fell back to 36% after Powell's comments.

The bottom line: Following today's meeting, CIO's base case remains that the Fed will cut rates by 100 basis points in 2024, with the first cut in May, and that the US economy remains on course for a soft landing. The actual path of rate cuts will depend mainly on the inflation data, but the labor data will also be important, including Friday's payroll report. As demonstrated by today's market action, uncertainty over future policy moves by the Fed and other central banks around the world may result in choppy markets in the months ahead. Even after the Fed starts to cut rates, they will remain highly data-dependent, with policy decisions likely to be made on a meeting-by-meeting basis. Geopolitics is another potential driver of volatility in 2024. We should also keep in mind that, despite the recent favorable developments on both growth and inflation, downside risks remain.

The CIO investment outlook remains unchanged after the FOMC meeting. We continue to favor quality bonds and stocks as the best way to navigate this macroeconomic uncertainty, while still expecting positive returns for bonds and equities through year-end. The recent data has been consistent with our upside Goldilocks scenario, in which small-cap stocks should do especially well.

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