August 5, 2024

Will They or Won't They? July Federal Open Market Committee Statement Falls Short of Committing to September Rate Cut

Economic
INSIGHT

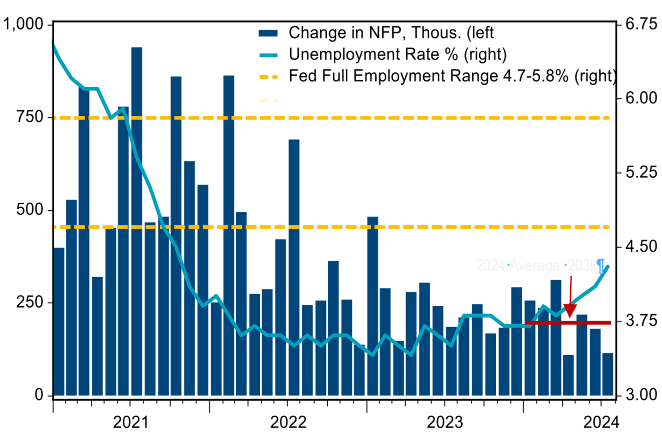
As expected, last week the Federal Reserve (Fed) opted to keep rates unchanged — currently in a range of 5.25-5.50% — for the eighth consecutive meeting. However, the Committee's forward-looking guidance did fall shy of expectations; while policy makers kept the prospect of a September rate cut alive, they stopped short of committing to it. Reiterating a focus on the data, they were clear that further confidence is needed in the underlying trend of inflation before it would deem it appropriate to cut rates. At the very least, the Fed's noncommittal rhetoric lessens the certainty of a rate reduction in the near term, as each incoming data point plays an increasingly key role in tipping the scales in one direction or another.

"*Now we've made a lot of progress and the labor market, I think unemployment was in the threes, mid-threes, so it's a different economy and I think it's time, it's coming to be time to adjust that so that we support this continued process.*"

– Fed Chairman Jerome Powell July 31 Federal Open Market Committee (FOMC) Press Conference

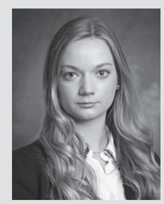
LABOR MARKET CONDITIONS CONTINUE TO NORMALIZE

In the July FOMC statement, the Fed noted that job gains have "*moderated*," and while there has been a "rise" in the unemployment rate, the level of joblessness remains "*low*." During the press conference, Powell underscored the "*solid*" nature of the consumer thanks in good part to decent gains in the labor market and decent gains in wages. While the Fed remains ready to respond to unexpected weakness, Powell was clear that policy makers see labor market conditions as simply "*normalizing*," as opposed to cooling to a point of signaling weakness. While the latest July employment



Source: Bureau of Labor Statistics/Haver Analytic

Lindsey M. Piegza, Ph.D.
Chief Economist
piegzal@stifel.com



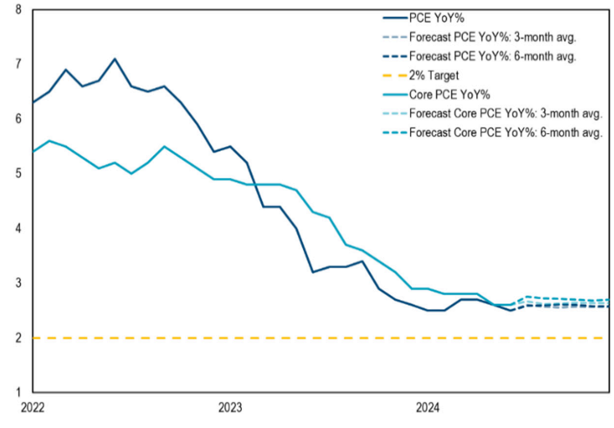
Lauren G. Henderson
Economist
hendersonla@stifel.com

report showed a more muted increase of 114,000 and a rise in the unemployment rate to 4.3%, the average pace of hiring remains still solid, with the rate of joblessness firmly below the lower bound of the Fed's full-employment range.

"Overall, a broad set of indicators suggests that conditions in the labor market have returned to about where they stood on the eve of the pandemic—strong but not overheated."

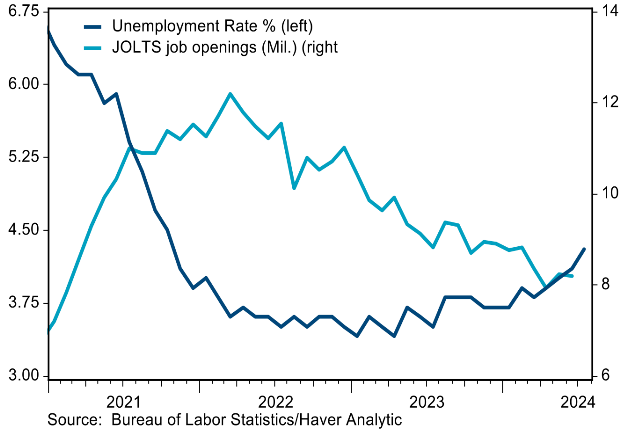
– Fed Chairman Jerome Powell July 31 FOMC Press Conference

INFLATION CONTINUES TO IMPROVE BUT REMAINS ELEVATED



Source: Bureau of Economic Analysis/Federal Reserve/Haver Analytics

On the inflation front, policy makers indicated an improved assessment in the directional momentum of price pressures, at least somewhat. "*In recent months*," the July FOMC statement stated, "*there has been* ***some*** *further progress towards the Committees 2% objective*," but inflation still remains "*somewhat elevated*." After a number of head fakes at the start of the year, inflation remains increasingly bumpy and uneven with just two months of downward momentum in the headline Personal Consumption Expenditures, and further sideways movement in the core, which is unchanged at 2.6% for the second consecutive month. While down from recent peak levels, amid a painfully slow pace of improvement, inflation remains stubbornly above the Committee's target.



Source: Bureau of Labor Statistics/Haver Analytic

THE BALANCE OF RISKS CONTINUES TO MOVE TOWARDS BETTER BALANCE

The statement noted the risk profile between its employment and inflation goals "*continue to move into better balance*." The July FOMC statement, however, stopped short of indicating such a balance has been met. As such, rather than focusing solely on one side of the Fed's directive, the Committee says it will be "*attentive to the risks on both sides of its dual mandate*." In other words, while the Fed acknowledges inflation risks remain, the Committee is increasingly aware of risks on the employment side, with labor market conditions notably less tight than they were at the start of the year. The divide between labor demand and labor supply persists with 8.1 million current job vacancies as of June; however, there has been a welcomed narrowing of that gap from a peak of 12.2 million in March 2022 with the ratio of openings to unemployed subsiding back to the pre-pandemic level.

THE FED IS STILL STRUGGLING TO GAIN CONFIDENCE IN DISINFLATION

Arguably, the most important component of the July FOMC statement was the ongoing

GLOSSARY

FOMC – Federal Open Market Committee

JOLTS – Job Openings and Labor Turnover Survey

PCE – Personal Consumption Expenditures

UST – U.S. Treasury

YoY – Year over Year

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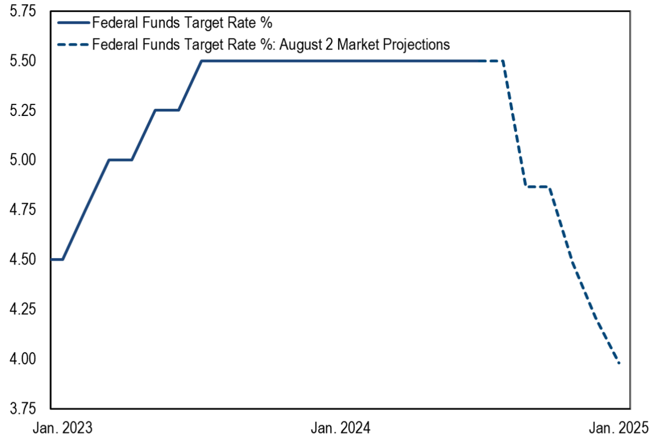
forward guidance reiterating a hesitancy to adjust policy without further evidence of a sustained disinflationary path. "*The Committee does not expect it will be appropriate to reduce the target range until it has gained* ***greater confidence*** *that inflation is moving sustainably toward 2 percent.*" Inflation has made meaningful progress particularly in the aftermath of the trend reversal at the start of the year, but with only a few data points of improvement falling well short of the Fed's bar of "*many*" months of improving data, Fed officials are cautious to commit to a rate reduction in just 47 days' time. During the press conference, Powell noted multiple times that a September rate cut is "on the table," but equally highlighted the need for the "*totality of the data*" to support such a move.

"*If that test is met, a reduction in our policy rate could be on the table as soon as the next meeting in September.*"

– Federal Reserve Chairman Jerome Powell July 31 FOMC Press Conference

INVESTORS CONTINUE TO PUSH THE FED TO ACCOMMODATE A NEED FOR RELIEF

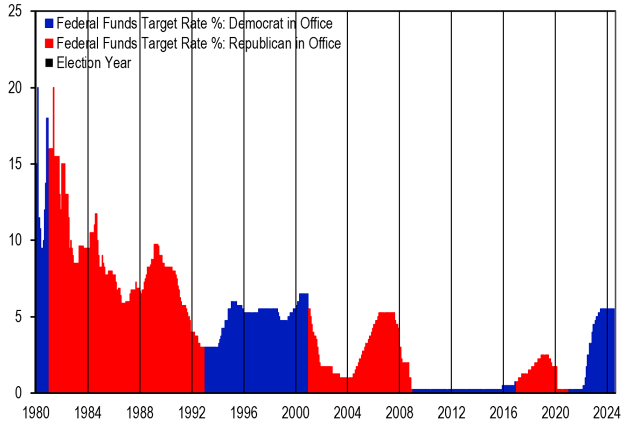


Source: Federal Reserve Board/Bloomberg

Despite a lack of commitment in the July FOMC statement, and from Powell during the Q&A portion of the press conference, investors remain optimistic the Fed will provide the relief they have been desperately anticipating for the better part of the past two years. While down from a peak of six to seven rate cuts expected at the start of the year, the market is seeking at least three cuts by year-end. The probability of a September rate cut is priced in at near certainty with the market pricing in over 150 basis points (bps) in rate cuts by the end of January. Meanwhile, with the prospect of the Fed easing sooner than later, the 10-year U.S. Treasury yield continues to wane, dropping 117 bps from a recent high of 4.99% on October 19 to 3.82% as of this morning at 11:55 a.m. Eastern, the lowest since December.

POLITICS WILL NOT DICTATE FED POLICY

With the Presidential election top of mind, the market is cautious of the Fed's ability to navigate policy adjustments in the remaining five months of the year. When pressed on whether, or how much, the implications of the Presidential election will direct policy decisions, Chair Powell was clear that the Committee has a legal mandate of instilling price stability and full employment, and in no way does Washington, D.C. or the political agenda of the administration in power impact or detract from the



Source: Federal Reserve Board/Bloomberg

Fed's focus on achieving said mandates. "*This is my fourth presidential election at the Fed, I can tell you this is how we think about it. This is what we do. So anything that we do before, during, or after the election will be based on the data, the outlook, and the balance of risks and not on anything else,*" Powell said. Supporting his apolitical claim, the Fed has historically been willing to raise and cut rates during an election year with both an incumbent Republican and an incumbent Democrat. The Fed, however, has never engaged in a policy pivot directly ahead of a presidential election.

TEMPERED APPROACH TO POLICY DECISIONS

While the Fed is actively considering a near-term rate cut, potentially as soon as next month, the pace of reductions is likely to be slow and tempered, perpetuating the expectation of relatively higher rates for longer and well above neural into 2025, if not beyond. When questioned about the prospect of a larger 50 bp cut in September, Powell responded a more sizeable reduction is "*not something were thinking about right now.*"

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BOTTOM LINE: SEPTEMBER RATE CUT ON THE TABLE, BUT THE FED REMAINS DATA DEPENDENT

The July FOMC statement offered no guarantee of a September rate cut, disappointing investors' expectations for a commitment to policy easing in the next six and a half weeks. While a September rate cut is still a possibility and very much "*on the table,*" the statement suggests the Fed remains data dependent and that policy makers are not yet convinced price pressures will continue to moderate or that labor market conditions have cooled enough.

Progress has been made, but the Committee is looking for additional indications of sustainable inflationary progress back towards the 2% objective. That's not to say the Fed needs to, or will, wait until 2% is met, but the trajectory of inflation remains uncertain. Thus, while desperate to provide relief, as well as perpetuate and support current conditions, policymakers will continue to put a heightened level of importance on the incoming data between now and the September 18 FOMC meeting. "*We're getting closer to the point at which it'll be appropriate to reduce our policy rate, but we're not quite at that point,*" Powell said.

That being said, the onus is on the data to convince policymakers not to make a move in September. In other words, coupled with a cooler July employment report, any minimal improvement in price pressures will likely be enough to prompt the proverbial green light to cut rates. Of course, even if the Fed did opt to open the door to rate cuts as early as Q3, they will likely fall short of the market's desire to return to neutral, let alone revert back to an accommodative stance anytime soon. Meaning, even under the more favorable inflation scenario of ongoing – albeit minimal – easing in price pressures, perhaps the Fed can eke out one or two rate reductions in the near term, followed by a second-round extended pause.

Lindsey Piegza
Ph.D., Chief Economist
piegzal@stifel.com

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