Daily Blog – 18 April 2024

My analysis of the Fed inflation fight has been correct. Chairman Jay Powell is now turning hawkish. In a speech last night, he said that the inflation fight is not done, and we should not expect any rate cuts this year. What the hell? At Christmas, the whole world thought he was going to slash rates 4 times in 2024. But those of you reading this blog have been warned. I have always thought that the guy is a lousy policy maker. “Watch the data, he said...” Now this is what you get.

Bond yields are closing in on the high levels reached before bulls got the inflation fight by the Fed wrong late last year. The 10 year bond is at 4.65 basis points which is at record highs The two year bond is at 5%.. How did this happen, when just three months ago, everybody was thinking the Fed will cut interest rates three or four times in 2024.

Powell Dials Back Expectations on Rate Cuts

By

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April 16, 2024 4:05 pm ET

Inflation and hiring have been firmer than expected this year, weakening the case for pre-emptive rate reductions

Federal Reserve Chair Jerome Powell signaled that first-quarter inflation data has raised uncertainty over when and if lower interest rates would come later this year. Photo: Samuel Corum/Bloomberg News

Firm inflation during the first quarter has called into question whether the Federal Reserve will be able to lower interest rates this year without signs of an unexpected economic slowdown, Chair Jerome Powell said Tuesday.

His remarks indicated a clear shift in the Fed’s outlook following a third consecutive month of stronger-than-anticipated inflation readings, which derailed hopes that the central bank might be able to deliver pre-emptive rate cuts this summer. Officials had previously said they were looking for greater confidence that inflation was returning to their target and were optimistic another month or two of data might meet that standard.

“The recent data have clearly not given us greater confidence and instead indicate that it is likely to take longer than expected to achieve that confidence,” Powell said at a moderated question-and-answer session in Washington. The remarks were his first public comments since an inflation report last week sent stocks sliding as investors recalibrated their rate-cut expectations.

The S&P 500 fell slightly after Powell spoke, and investors sold Treasurys, sending up yields. The 2-year Treasury note yield briefly hit 5% for the first time since November.

Powell indicated Tuesday the Fed wasn't considering rate increases, either. Instead, Powell said officials would leave rates at their current level "as long as needed" if inflation proved more stubborn. He also said the Fed would be prepared to cut rates if the economy was slowing sharply. Officials raised rates last summer to a 23-year high and have held them there since July.

"We think policy is well positioned to handle the risks that we face," Powell said. "Right now, given the strength of the labor market and progress on inflation so far, it's appropriate to allow restrictive policy further time to work."

Central bank officials started the year with guarded optimism that they would be able to cut interest rates several times beginning around midyear after inflation dropped faster than they had anticipated at the end of 2023.

In December, Powell had pivoted from focusing on whether the Fed would need to raise rates again to when the central bank might be in a position to lower them. Market participants raced ahead and began anticipating a string of six or seven rate cuts, puzzling Fed leaders who didn't think such exuberant expectations were aligned with their own outlook.

Still, Fed leaders, including Powell, maintained up through early this month that rate cuts were likely to be appropriate, even after economic activity and hiring had proven more resilient than expected. That kept front-and-center the possibility that officials would take back some of last year's rate increases and shore up the prospects of a so- called economic soft landing.

Even President Biden, who had mostly avoided commenting on the Fed, joined in on the rate-cut guessing game, declaring shortly after his State of the Union address in March that the "little outfit" that sets rates might be lowering them soon. At their meeting in March, most Fed officials projected two or three rate cuts this year would be appropriate, with a narrow majority penciling in at least three cuts.

But reality has dealt the Fed and the White House a different hand, at least so far. Powell's comments suggest the central bank will now need to see several more monthly inflation readings to regain the confidence that they had been looking for, effectively delaying rate cuts until later in the year and underscoring the difficulty of achieving a so-called soft landing.

While the Fed could cut rates sooner if the economy slows sharply and unexpectedly, typically rate cuts aren't able to prevent a downturn once it has begun.

The consumer-price index, released last week by the Labor Department, showed core inflation in March was 3.8% over the past 12 months. That broke a yearlong streak in which the 12-month change had declined in each month. Core inflation excludes volatile food and energy prices, and economists treat it as a better gauge of underlying price pressures.

The Fed's preferred gauge, which will be released next week by the Commerce Department, is likely to show core prices rose 2.8% in March from a year earlier, the same as in February, according to estimates by Fed economists. But Powell said three- and six-month annualized inflation rates were now running above that level, underscoring how recent data have gone in the wrong direction. The Fed targets 2% inflation over time.

After last week's CPI report, most analysts on Wall Street changed their forecasts, scrapping expectations of a June rate cut. They see the Fed waiting until July, September or December to start lowering rates, and they expect just one or two cuts this year.

The Fed raised rates aggressively over the last two years to combat inflation, which soared to a 40-year high. But Powell in recent months has approvingly cited signs that labor market imbalances are easing. By maintaining that message on Tuesday, Powell suggested the Fed was only partially resetting its outlook.

A continued slowdown in wage growth is a likely requirement for policymakers to remain confident that inflation will improve over time. Wage pressures "continue to moderate, albeit gradually," Powell said.

Write to Nick Timiraos at Nick.Timiraos@wsj.com (Sorry folks, there will be no rate cuts this year.)

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