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Situation analysis July 31, 2024

Fed keeps interest rates steady; cuts starting in September remain the consensus expectation

Key takeaways

- The U.S. Federal Reserve (Fed) held interest rates steady in an elevated range of 5.25% to 5.50% today to bring down inflation.
- The Fed's statement placed greater emphasis on balancing inflation and employment goals, rather than primarily inflation, as the labor market gradually slows.
- The Fed's statement acknowledged "some further progress" toward its 2% inflation target after softer recent inflation and job opening data.

The Federal Reserve held its target federal funds interest rate steady in a range of 5.25% to 5.50% following its regularly scheduled two-day meeting, an outcome widely 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 official statement as well as Fed Chairman Jerome Powell's press conference repeatedly emphasized balancing the inflation mandate with the employment mandate as justification for holding rates steady right now and as the primary forward considerations for determining rate policy.

Investor expectations indicated by bond market prices are for two or three rate cuts this year, starting at the September meeting, remained consistent after the Fed's statement and press conference. The Fed's statement acknowledged elevated inflation and strong but gradually decelerating employment growth, stating inflation "has eased" but "remains somewhat elevated," while also noting that "job gains have moderated, the unemployment rate has moved up but remains low." Importantly, the statement said, "employment and inflation goals continue to move into better balance" and the committee remains attentive to the risks of both sides of the mandate" referring to inflation and labor market considerations. The statement carried a more balanced tone than recent communiques, which have emphasized problematic inflation.

Considerable policy tightening from a near-zero federal funds rate in early 2022 to the current 5.25% to 5.50% helped drive the Core Personal Consumption Expenditures Price Index (Core PCE), the Fed's preferred inflation gauge, from a peak above 5.5% in 2022 to 2.6% in June. Another inflation metric, the Core Consumer Price Index (CPI), fell to 3.3% in June due to differing calculation methodologies, and is also well off its 6.6% high in September 2022. Goods-related inflation remains well contained, and the most recent CPI report indicates decelerating but still-high service-related inflation.

The Fed is currently allowing to runoff, or mature without replacement, up to $25 billion per month in Treasuries and $35 billion per month of mortgage bonds it currently owns. This reflects a drop from the previous pace of $60 billion per month in Treasuries as of June 1, 2024. Slower balance sheet runoff improves market liquidity, which refers to the amount of money readily available to buy goods, services and financial assets in an economy. Shorter-term liquidity measures worsened in April when personal and corporate income tax payments were paid, but have since stabilized and rebounded, supporting riskier asset prices.

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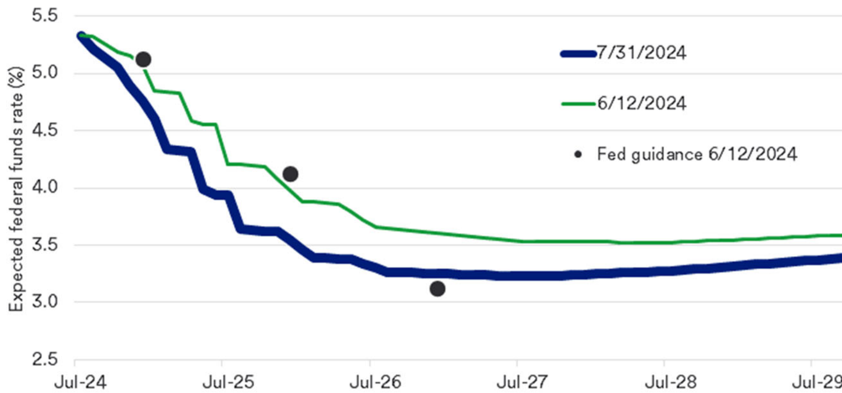
Market pricing of the expected path of the federal funds rate



Sources: U.S. Bank Asset Management Group Research, Federal Reserve, Bloomberg, 6/12/2024-7/31/2024.

Stock prices rose prior to the Fed's announcement today, with a sustained rally after the Fed's statement release and press conference met investors' expectations. Optimism for a September rate cut paired with Powell's constructive tone regarding the economy likely contributed to asset price moves. Treasury bond yields fell, and the S&P 500 finished the day up 1.58%. Companies with faster earnings growth and the Technology sector performed the best, though gains were broad based across markets. Ten-year Treasury bond yields fell 0.10% to 4.04% today, while two-year Treasury yields fell 0.09% to 4.27%.

Monetary policy, defined as central bank target interest rates, remains restrictive around the globe following aggressive rate hikes. However, global central bank rate cuts exceeded hikes starting in the fourth quarter of 2023 as inflation began trending lower. Investors anticipate modest rate cuts from other major central banks in addition to the Fed, with cuts expected in 2024 from the European Central Bank (ECB) and Bank of England (BoE).

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

Source: U.S. Bank Asset Management Group Research, Factset, 9/30/2006-7/31/2024.

So far, 2024 has been marked by solid performance of stocks (large U.S. stocks in particular). The relatively narrow growth-oriented rally in 2023 has broadened this year to include previously lagging sectors and smaller companies. However, large technology companies' year-to-date gains continue to tower above most other categories, helping to drive the S&P 500 near all-time highs.

We retain a glass-half full viewpoint regarding corporate profits while acknowledging the Fed's dilemma of inflation remaining elevated. Robust consumer and business activity has translated to stronger-than-expected economic data. In aggregate, consumer spending remains solid, driven primarily by wealthier cohorts. We remain attentive to some moderation in the labor market, which the Fed highlighted today. Economic strength continues contributing to sticky input costs and service-related inflation readings. However, moderating inflation trends remain clear despite stimulative fiscal policy in the form of deficit spending 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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