CIBC CAPITAL MARKETS

Economics
ECONOMIC FLASH!

economics.cibccm.com

May 1, 2024

Fed announcement: Jay-P's data state of mind

Ali Jaffery ali.jaffery@cibc.com

The FOMC kept interest rates unchanged today as expected in May. The statement added a sentence on the lack of inflation progress but that was balanced by an acknowledgement of the progress made to date. The Fed also announced it will slow the pace of balance sheet run off in June, with Treasury runoff slowing from 60bn to 25bn while the MBS cap would stay at 35bn.

The main takeaway from today's meeting is that the Fed expects the elevated inflation readings we saw in Q1 to pass, and implicitly still see a path to cutting rates this year. Powell was clear that he has less confidence in that outcome now than he did previously and acknowledged the likelihood of holding rates for longer. But he carefully dismissed the idea that policy was not restrictive enough, arguing that "over time" it likely would be. He went further to point out the progress achieved in slowing the labor market, wage growth and inflation over the past few years. On growth, he straddled between his past view of the strength in the economy being the result of stronger supply and it showing some signs of a very modest slowdown. The undertone of this view is not something new, as the FOMC clearly believes the link between slack and inflation as not being very powerful and know that the US economy is far less interest rate sensitive than it was in the past. They want to see more evidence that (1) the economy is truly overheating and (2) that overheating is translating into price pressures. The reporters, rather than Powell, seemed more frustrated about the trajectory of the economy and the risks of not achieving price stability.

Powell is clearly very data dependent and very patient. Over the past nine months, he saw six consecutive great months, and then three not-so-great inflation reports in a row, so he is reluctant to jump to a new narrative so quickly. What today's meeting shows us is that they are comfortable with a slow pace of progress, with tolerance for some bumps and even some large potholes on the way. The catch however, is the Fed will calibrate policy changes at the same pace and risk of holding rates where they are is undoubtedly higher. Bringing inflation back to 2% is a must, but the Fed has not set a hard deadline for itself because it does not want to stoke further stress in the labor market now that inflation is now below 3% as Powell noted. The 3%-threshold is likely based on the idea that inflation above this level could cause inflation expectations to be at greater risk of being unanchored.

All of this seems very sensible to us. It has not been easy to disentangle the forces driving the US economy in the post-COVID period, for the Fed or for forecasters. Potential output could be much higher, as he alluded to, and the labor market could also be structurally tighter because of demographic forces and immigration. A shift in attitudes seems to be driving Americans to spend more on durable goods and save less. These structural changes make it difficult for the Fed to get a read on how much or how little demand there is in the economy at any point in time. Added to this challenge, the underlying recent strength in inflation is also tricky to figure out. It has elements that also appear not so long-lasting, and driven by sector-specific forces like the rise in car insurance premiums, rather than the broader forces of supply and demand in the economy as a whole. Powell's data state of mind and patience is a wise strategy and he has time on his hand with the labor market steady -- neither cooling a lot, nor heating up materially. We think that while the last set of inflation reports have been discouraging, they will turn a corner as these idiosyncratic factors fade and a path to policy easing will emerge later this year giving the Fed the chance to ease twice in 2024.

This report is issued and approved for distribution by (a) in Canada, CIBC World Markets Inc., a member of the Investment Industry Regulatory Organization of Canada, the Toronto Stock Exchange, the TSX Venture Exchange and a Member of the Canadian Investor Protection Fund, (b) in the United Kingdom, CIBC World Markets plc, which is regulated by the Financial Services Authority, and (c) in Australia, CIBC Australia Limited, a member of the Australian Stock Exchange and regulated by the ASIC (collectively, "CIBC") and (d) in the United States either by (i) CIBC World Markets Inc. for distribution only to U.S. Major Institutional Investors ("MII") (as such term is defined in SEC Rule 15a-6) or (ii) CIBC World Markets Corp., a member of the Financial Industry Regulatory Authority. U.S. MIIs receiving this report from CIBC World Markets Inc. (the Canadian broker-dealer) are required to effect transactions (other than negotiating their terms) in securities discussed in the report through CIBC World Markets Corp. (the U.S. broker-dealer).

This report is provided, for informational purposes only, to institutional investor and retail clients of CIBC World Markets Inc. in Canada, and does not constitute an offer or solicitation to buy or sell any securities discussed herein in any jurisdiction where such offer or solicitation would be prohibited. This document and any of the products and information contained herein are not intended for the use of private investors in the United Kingdom. Such investors will not be able to enter into agreements or purchase products mentioned herein from CIBC World Markets plc. The comments and views expressed in this document are meant for the general interests of wholesale clients of CIBC Australia Limited.

This report does not take into account the investment objectives, financial situation or specific needs of any particular client of CIBC. Before making an investment decision on the basis of any information contained in this report, the recipient should consider whether such information is appropriate given the recipient's particular investment needs, objectives and financial circumstances. CIBC suggests that, prior to acting on any information contained herein, you contact one of our client advisers in your jurisdiction to discuss your particular circumstances. Since the levels and bases of taxation can change, any reference in this report to the impact of taxation should not be construed as offering tax advice; as with any transaction having potential tax implications, clients should consult with their own tax advisors. Past performance is not a guarantee of future results.

The information and any statistical data contained herein were obtained from sources that we believe to be reliable, but we do not represent that they are accurate or complete, and they should not be relied upon as such. All estimates and opinions expressed herein constitute judgments as of the date of this report and are subject to change without notice.

This report may provide addresses of, or contain hyperlinks to, Internet web sites. CIBC has not reviewed the linked Internet web site of any third party and takes no responsibility for the contents thereof. Each such address or hyperlink is provided solely for the recipient's convenience and information, and the content of linked third-party web sites is not in any way incorporated into this document. Recipients who choose to access such third-party web sites or follow such hyperlinks do so at their own risk.

© 2024 CIBC World Markets Inc. All rights reserved. Unauthorized use, distribution, duplication or disclosure without the prior written permission of CIBC World Markets Inc. is prohibited by law and may result in prosecution.

The CIBC logo and "CIBC Capital Markets" are trademarks of CIBC, used under license.