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March 20, 2024

Fed announcement: Easy Does It

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What's the big takeaway from today's FOMC decision? The Fed is a patient creature. They neither want to overreact to a few upside inflation surprises nor to abandon the emphasis they have put on keeping the labor market in a good place. That is why they are signalling an "Easy Does It" approach to rate cuts by penciling in three cuts in each year of their projection horizon, amounting to one less rate cut than they had in the December projection (removing one cut from 2025). At the same time, they revised up GDP over the projection horizon materially and core inflation modestly higher in 2024 while keeping their view on the labor market mostly unchanged. The median view on the long-run fed funds rate or the closest we get to the committee's view on the neutral rate rose a smidge to 2.6 from 2.5 and will likely continue to drift up.

Powell provided a lot of color on the Fed's view on the bumpy January and February inflation reports, attributing January to seasonal effects and February as a bit higher than they would have liked. He also remarked that inflation in the first half of the year tended to be stronger than the second half, implicitly casting more doubt about the seasonality of the data more broadly. The view was clear though, the Fed is not overly worried about these reports upending the trend of disinflation and the path to 2% inflation, while bumpy, still seems achievable. Powell also continues to retain confidence that some combination of slower shelter inflation and non-housing services is within reach but wisely wants to give it time. The slightly more restrictive monetary policy over the course of the next few years seems to be the Fed's response to tame any excessive persistence in core inflation.

The supply-side of the economy remains very much in Powell's head and for good reason. He attributed part of the upward revision in GDP to more supply-side growth and later elaborated that demand fed from an increased in the population or workers was ultimately not going to prove inflationary. That is how one can square the large upward revision in GDP (both in level and growth terms), a still tame inflation path and monetary policy just slightly more restrictive. Recent research from the CBO showing that that population growth could be somewhat understated given a flux in immigrants who are mostly undocumented, provides some support to the Fed's labor supply-side story in 2023 but not necessarily going forward.

Today's decision and projections put a bit of pressure on our Fed call for four rate cuts this year. But four is not very far from three. It's actually pretty close and as Powell alluded to, the data flow will make all the difference. Before today, a good number of people believed the Fed was more likely to remove one cut in 2024 than in 2025, but clearly Powell remains cautious of keeping policy too restrictive this year because it could hurt the labor market. Also, the boost to growth from labor supply may not be as enduring in 2024 as it was in 2023 if the flow in immigration slows. Labor demand is certainly slowing across a range of indicators and Powell showed a little bit of concern when talking about the low hiring rate possibly translating into more layoffs in the future. The last two retail reports, while somewhat clouded by bad weather and seasonality, could show early signs of a consumer who is a bit fatigued after pulling forward a lot of goods consumption. That is especially true if no small part of that consumption is from newcomers. And perhaps most important, if Powell is right that the recent uptick in core inflation is just a "bump" and partly due to seasonality, more easing will very quickly become vogue again. So while we are not that far off from Jay, we remain somewhat skeptical. Our eyes will be on inflation and the labor market to see whether Powell's story bears true.

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