Economic INSIGHT

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"Patient, Careful, Methodical, and Deliberative:" Rate Cuts Delayed Amid Ongoing Inflation Concerns

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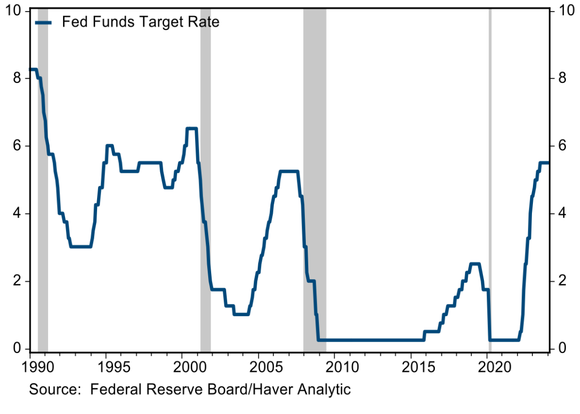
Since reaching a presumed terminal level of 5.50% in July of last year, the Federal Reserve (Fed) has offered a consistent message of *"patience"* when it comes to the next stage of policy adjustment. While willing to include the notion of an eventual rate cut(s) into the conversation, Fed officials have been clear they will take a tempered approach towards a removal of accommodation. With an uneven trajectory in price pressures and lingering risks to the upside, the Fed's monetary policy committee wants to see further evidence of a sustained return of price stability before moving to unwind the policy firming of the past two years. The market continues to anticipate a near-term initiation to rate cuts, as well as a more expedited pathway lower, but without meaningful improvement in the inflation data, investors are poised for disappointment in both the timing and *pace* of rate reductions

A MESSAGE OF PATIENCE

According to the January Federal Open Market Committee (FOMC) meeting minutes, most Fed officials agree that rate cuts will prove appropriate at some point later this year. Current conditions, however, do not yet warrant a change in policy. Noting that the risks of achieving both inflation and unemployment goals are moving into better balance, the Committee remains *"highly attentive"* to inflation risks. Furthermore, with growth accelerating beyond expectations through the end of the year, a solid consumer, and a strong labor market, most officials highlighted the *"risks of moving too quickly to ease the stance of policy."*



Source: Federal Reserve Board/Haver Analytic

In the aftermath of the Fed's January policy decision to hold rates steady for the fourth consecutive meeting and the more hawkish tone of the meeting minutes, several FOMC members in recent months reiterated the Fed's cautious approach to future rate cuts on separate occasions. At the start of the year, Fed Governor Christopher Waller and New York Fed President John Williams urged patience against the backdrop of a hotter-than-excepted read on consumer and producer prices. *"The strength of the economy and the recent data suggest it's appropriate to be patient, careful, methodical, and deliberative,"* Waller said, adding there is simply no rush to cut rates. Williams asserted that *"we still have a ways to go on the journey to sustained 2% inflation,"* with *"bumps"* along the way.

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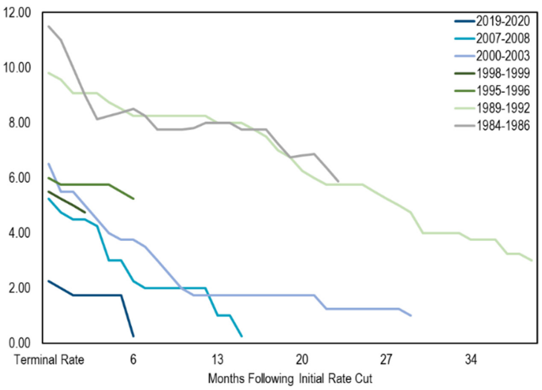
Philadelphia Fed President Patrick Harker warned against initiating rate cuts prematurely. *"As progress can be bumpy – and uneven at times,"* he said, the Fed can take its time *"to get this right."* Fed Governor Lisa Cook stated she would like to continue to see more progress and have more confidence in the inflation data before implementing the first rate cut, while Atlanta Fed President Raphael Bostic suggested the pathway to reaching the Committee's 2% target is still likely a ways off and will not be a *"fast march."*

Aside from the timing of the initial reduction in rates and a current lack of confidence in the (dis)inflationary data, Fed officials have also set the tone for a more tempered and potentially less mechanical pace of subsequent cuts than in cycles past. Unlike in 2007-2008 when the Fed lowered rates for seven consecutive meetings before hitting pause, the Powell Fed is likely to be more in line with former Fed Chairman Alan Greenspan during the mid-1990s. After first cutting rates in July 1995, the federal funds rate was held steady at 5.75% for the next three meetings.



Source: Federal Reserve/Haver Analytics

To that end, according to Boston Fed President Susan Collins, the best course of action appears to be a strategically slow reduction in policy. Speaking to the Boston Economic Club on February 7, Collins said she favors a *"methodical, forward-looking strategy that eases policy gradually."* Meanwhile, Philadelphia Fed President Patrick Harker also voiced support for a *"steady, slow reduction,"* suggesting once a quarter or every other meeting may be an appropriate pace of reduction, while Cleveland Fed President Loretta Mester was clear the timing of rate reductions does not need to be systematic, orderly or correspond to the quarterly Summary of Economic Projections (SEP). *"I don't think tying when we move to the SEP is necessary, as long as we're communicating well,"* Mester said.

INFLATION IMPROVEMENT

As expected, the January FOMC meeting minutes showed ongoing concern about inflation, a message of unease conveyed by Fed officials themselves particularly in the aftermath of an unexpected acceleration in prices at the start of the year. While price pressures have clearly declined from peak levels, the lack of meaningful improvement, or at least the uneven and painfully slow pace of descent, has policy makers still questioning their ability to reach the 2% inflation target on a sustained basis.

The Consumer Price Index (CPI), for example, rose 0.3% in January, a larger-than-expected rise and following a more muted 0.2% gain in December. Year-over-year, consumer prices rose 3.1%. While down from the 3.4% pace in December and a two-month low, according to the median forecast, the CPI was expected to rise just 2.9% over the past 12 months. Excluding food and energy costs, the core CPI, meanwhile, rose 0.4% in January, also more than expected after a 0.3% increase the month prior. Year-over-year, the core CPI increased 3.9%, unchanged from the prior month and falling well short of an expected slowdown to 3.7%. Additionally, the all-important supercore, which excludes food and energy as well as housing, rose 0.9% in January, the largest monthly gain since April 2022. Year-over-year, the supercore rose 4.4%, a sizable reversal from the 3.9% gain in December and now marking the fastest pace since May.

GLOSSARY

CPI – Consumer Price Index

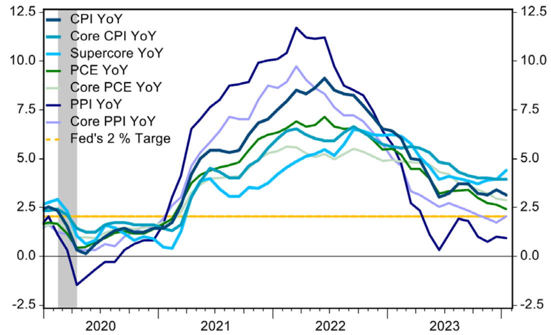
PCE – Personal Consumption Expenditures

PPI – Producer Price Index

QT – Quantitative Tightening

YoY – Year over Year

Producer prices, as measured by the Producers Price Index (PPI), rose 0.3% in January, also significantly more than expected, and resulting in a 0.9% increase year-over-year. Excluding food and energy costs, the core PPI jumped 0.5% at the start of the year, more than double expectations, and 2.0% over the past 12 months, reversing course from a 1.7% pace in December.



Sources: BLS, BLS/H, BEA/Haver

And finally, the Personal Consumption Expenditure (PCE), the Fed's preferred measure of inflation, rose 0.3% in January. While in line with expectations, the monthly gain at the start of the year was triple the December rise. Year-over-year, headline inflation increased 2.4%, also as expected, and down from the 2.6% annual gain in December. Excluding food and energy, the core PCE rose 0.4% in January, the largest monthly increase in a year. Over the past 12 months, core inflation increased 2.8%. While in line with forecasts and the slowest annual pace of ascent since March of 2021, January's 2.8% is a minimal one-tenth of a percentage point improvement from a 2.9% annual gain in December.

CONCLUSION

While Fed officials have begun the conversation of eventual rate reductions – and even a contemplation of unraveling quantitative tightening (QT) – the pathway to removing policy firming will be slow and tempered, and furthermore, based on the evolution of the inflation data. Down from earlier peak levels, the latest uneven trajectory of price pressures has been far from a convincing disinflationary trend back to 2% with a trifecta of acceleration at the start of the year. As the Committee continues to see upside risks to inflation, which may not result in the need for additional rate hikes, fears of a premature initiation of rate cuts, at the very least, reinforces the need for the Fed to remain on hold for some time longer. Thus, with the likelihood of inflation continuing to fall short of expectations, the delayed timing of the initial rate reduction, as well as the more tempered pace of subsequent cuts are likely to disappoint investors.

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"It will likely become appropriate to begin easing policy later this year… When this happens, a methodical, forward-looking approach to reducing rates gradually should provide the necessary flexibility to manage risks, while promoting stable prices and maximum employment."

Boston Fed President Susan Collins speaking to the Boston Economic Club
February 7, 2024

"It would be a mistake to move rates down too soon or too quickly without sufficient evidence that inflation was on a sustainable and timely path back to 2% … I don't think tying when we move to the SEP is necessary, as long as we're communicating well."

Cleveland Fed President Loretta Mester speaking on a call with reporters
February 7, 2024

"The strength of the economy and the recent data we have received on inflation mean it is appropriate to be patient, careful, methodical, deliberative – pick your favorite synonym…Whatever word you pick, they all translate to one idea: What's the rush."

Fed Governor Christopher Waller speaking at the
University of St. Thomas Minneapolis Campus
February 7, 2024

"We have time to get this right, as we must … As progress can be bumpy — and uneven at times — it is important that we see more evidence, allowing us to look past the vagaries of monthly data and ensure we continue on the right path."

Philadelphia Fed President Patrick Harker speaking in Newark, Delaware
February 22, 2024

"I would like to have greater confidence that inflation is converging to 2% before beginning to cut the policy rate… We should continue to move carefully as we receive more data, maintaining the degree of policy restriction needed to sustainably restore price stability while keeping the economy on a good path."

Fed Governor Lisa Cook speaking at Princeton University
February 22, 2024

"While the economy has come a long way toward achieving better balance and reaching our 2% inflation goal, we are not there yet," Williams said, adding, "I am committed to fully restoring price stability in the context of a strong economy and labor market."

New York Fed President John Williams speaking in Garden City, New York
February 28, 2024

"I still see signs that suggest that this is not going to be a fast march to 2% … As long as we are going to get there and we are not seeing bad things happen on the side I am comfortable being patient."

Atlanta Fed President Raphael Bostic speaking in Roswell, Georgia
February 28, 2024

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