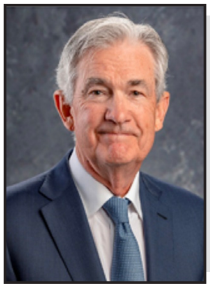
March 25, 2024

Key Takeaways from the March Federal Open Market Committee Rate Decision

Economic INSIGHT



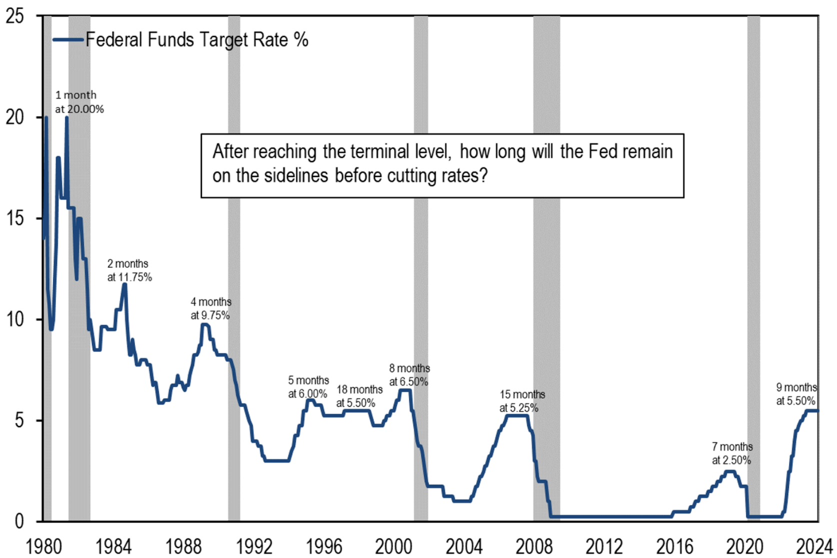
> *"We're looking for data that confim the low readings that we had last year ... And give us a higher degree of confidence that what we saw was really inflation moving sustainably down to 2."*
>
> **Federal Reserve Chairman Jerome Powell, FOMC Press Conference March 20, 2024**

Ahead of the Federal Reserve (Fed)'s March rate decision, Fed Chairman Jerome Powell headed to Washington to testify before Congress on the current state of policy and expectations for rates going forward. Without convincing proof of inflation retreating, the Committee, he said, is in no rush to initiate rate cuts, setting the stage for a prolonged position on the sidelines.

Following January's hotter-than-expected consumer price report, officials – and investors alike – were hopeful February would offer some needed relief, and evidence to reopen the door for a near-term change in policy, but to no avail. Instead, the continued acceleration in monthly price pressures resulting in a flattening – rather than improving – trend simply affirms the notion of higher rates for potentially much – much – longer than previously expected.

RATE DECISION

As expected, the Federal Open Market Committee (FOMC) opted to leave rates unchanged in a range of 5.25% to 5.50% for the fifth consecutive meeting. The last adjustment was back in July, when the Committee hiked the upper bound of the federal funds rate from 5.25% to 5.50%, the 11th consecutive increase, and totaling 525 basis points of policy firming since liftoff in March 2022. Currently at nine months, this is the Fed's third longest period of time before initiating rate reductions after reaching a presumed terminal rate. The longest was in 2006-07, when the Fed opted to keep rates steady at 5.25% for 15 months (10 meetings) before the first rate cut.[1]



Source: Federal Reserve Board/Bloomberg

[1] Technically, the span between 1998-1999 was the longest. After holding rates steady at 5.50% for 18 consecutive months, the Fed then cut rates to 5.25%. However, the following month the Fed raised rates back up to 5.50% before cutting again to 4.75% just one month later.

Lindsey M. Piegza, Ph.D.
Chief Economist
piegzal@stifel.com

Lauren G. Henderson
Economist
hendersonla@stifel.com

ASSESSMENT OF THE ECONOMY

The Fed's assessment of the economy was virtually unchanged from January. Describing economic activity as *"solid,"* Fed Chairman Jerome Powell noted that end of the year GDP accelerated beyond earlier expectations thanks in good part to strong consumer demand and an easing of supply chain constraints. Removing a previous notion of moderation, the statement noted job gains have remained *"strong,"* along with a *"low"* unemployment rate still well below what the Committee designates as the full-employment range. While there remains a sizable disconnect between labor demand and labor supply, Powell highlighted several reasons to be optimistic in terms of labor market conditions, including moderating wage growth to a more sustainable level and improvements in labor participation.

BALANCE OF RISKS

The March FOMC statement also repeated that policy makers would consider incoming data, the evolving outlook, and the balance of risks in making adjustments to policy. It also noted that a reduction would not be appropriate until the Committee has gained more confidence that inflation is moving sustainably towards the Fed's 2% goal.

In the aftermath of accelerating inflation data, the Fed remains understandably concerned about the lack of improvement in price pressures. While Powell was clear the Committee would not *"overreact"* to the last two months of hotter-than-expected price pressures, he was equally clear, the Committee *"could not ignore them."*

"We're looking for data that confirm the low readings that we had last year," Powell said. *"And give us a higher degree of confidence that what we saw was really inflation moving sustainably down to 2%."*

SUMMARY OF ECONOMIC PROJECTIONS FORECAST

Despite elevated inflation data, the majority of Fed officials still anticipate it will be appropriate to reduce rates – several times – later this year. According to an updated March dot plot, the consensus remains for three rate reductions in 2024; however, the Committee did reduce its forecast for additional rate cuts in 2025 from four to three.

The updated Summary of Economic Projections (SEP) also indicated policy makers expect a slightly higher rate of inflation and economic growth in the near term. Raising projections for cost pressures in 2024 from 2.4% to 2.6%, the Committee also expects the economy to grow more substantially at 2.1% versus a previous forecast of 1.4%. The Committee furthermore lowered its projection for the unemployment rate slightly from 4.1% to 4.0%.

Source: Federal Reserve • Dec. 13 FOMC Projection • Mar 20 FOMC Projection

GLOSSARY

FOMC – Federal Open Market Committee

OER – Gross Domestic Product

QT – Quantitative Tightening

SEP – Summary of Economic Projections

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BALANCE SHEET REDUCTION

The March FOMC statement also reiterated the Fed's intention to continue reducing its balance sheet by as much as $95 billion per month. In January, the Fed opened up the conversation to balance sheet management, suggesting a potential reduction in the current pace of roll off in the coming months. However, while central bankers have made a push to begin at least discussing an end to Quantitative Tightening (QT) and Committee members appear increasingly open to an adjustment near term, the Fed did not announce a timeline for tapering quantitative tightening this month.

During the press conference, Powell said the focus is on determining the appropriate *"timing"* for adjustments to the current pace of roll off, which he defined loosely as *"fairly soon,"* in order to avoid *"turbulence"* in the marketplace. As the January meeting minutes showed, *"most"* Committee members have been in agreement that an exit strategy would be composed *"well before"* initiation, suggesting from a timing standpoint, an end strategy will likely be discussed in further detail in May. With that being said, moving away from QT may still be some months away.

DISSENT

There were no dissenting votes to the March FOMC statement or policy announcement.

BOTTOM LINE

The disinflationary trend of 2023 appears to have been disrupted, with the latest inflation data uneven at best, stabilizing nearer 4%, double the Fed's intended target. Despite the hotter-than-expected inflation data, the Committee remains confident it will be appropriate to begin reducing policy firming at some point later this year. That being said, such an optimistic outlook remains contingent on the forecast that the near-term acceleration in price pressures will abate and inflation will once again retreat towards 2% on a sustained basis.

Of course, if these expectations fail to materialize, the Fed remains flexible and willing to adjust its current forecast for rate reductions. As the Fed has reiterated time and time again, SEP projections are not a predetermined path, and individual forecasts will expectedly change based on the incoming data.

Committee members have been clear they need more confidence in the underlying inflation data before taking the first step to reduce the policy firming put in place over the past two years. Thus, while still hopeful the recent uptick will prove short-lived, an ongoing lack of improvement in the inflation data, or worse, a sizable reversal in last year's declining trend could force the Fed to more permanently shelve the notion of rate cuts, or even consider additional rate hikes.

The Fed has been hyper-focused on achieving the utopic scenario of a soft landing whereby the Committee raises rates to a sufficiently restrictive level to *eventually* reinstate price stability without sending the economy into negative territory. However, with attention on maintaining positive growth, the Committee may have inadvertently failed to raise rates high enough to quell price pressures.

Lindsey Piegza
Ph.D., Chief Economist
piegzal@stifel.com

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