November 26, 2024

A Slower Pace of Federal Reserve Action, Higher Longer-Dated Yields Amid Elevated Inflation, Stronger Growth, and Bloated Deficits

Economic INSIGHT

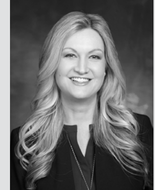
Despite some early, emerging weaknesses in housing, construction, and manufacturing, the storyline of a solid economy remains intact. The backdrop of ongoing consumer resilience and positive business investment, resulting in a broader growth rate of nearly 3% – at least in hindsight from July to September – coupled with a stellar jobs report in September, underscores the persistent strength of domestic activity. Such conditions not only perpetuate expectations for a soft landing, but the need for a more tempered approach to monetary policy going forward, as this is clearly not an ailing economy in need of policy support. While adjusting conditions do warrant a less restrictive level of rates, and thus further cuts from here, given policy remains in "firm" territory, the data does not indicate any sense of emerging weakness that should prompt the Federal Reserve (Fed) to act with a sense of urgency or immediacy.

While the Fed opted to move forward with a second-round rate cut in November, the Committee maintained a relatively positive assessment of current conditions. This was a very reasonable and accurate assessment, as the data was incredibly solid throughout October. Although, if the Fed was truly data dependent, it can be argued there was little need, if any, for a second-round cut. However, bypassing November, just one meeting after an outsized rate cut in September, would have likely been interpreted as an admission of a policy error or an excessive policy move. Thus, the Fed had little option but to move forward with an additional rate cut, albeit a lesser 25 basis point (bp) move, particularly given the cover provided by the recent hurricane-related weakness in the October jobs report.

Going forward, if the data remains as solid as it has and inflation stays as stubbornly sticky as it has, there is ample support and justification to potentially hold policy steady at the start of next year or even as early as the December meeting. After all, the Committee is in no rush to lower rates as the economy is "remarkably good," with Federal Reserve Chairman Jerome Powell unwilling to rule out the potential for a near-term pause, or even a rate hike in the coming year. At the very least, policy is not on a predetermined path, and while changing conditions do likely warrant a further reduction in policy firming back towards neutral as the data normalizes and inflation moves slowly back towards the Committee's goal of 2%, adjustments are likely to be very measured and tempered, with a structurally higher r* potentially resulting in a longer-run neutral rate substantially above central bank predictions.

For the market, despite the recent pivot in monetary policy, resulting in 75 bps of rate cuts in three months, longer-dated yields are on the rise. Reflecting elevated expectations for domestic growth and ongoing heightened inflation amid a lack of disinflationary momentum with price pressures posting little improvement in four months, market pressures are moving the floor higher for longer-term rates. Additionally, mounting concerns over a bloated government balance sheet are likely to limit the downside potential for further policy easing.

Going forward, with deficits as a percentage of GDP already doubling over the past 15 years, coupled with further apprehensions over growing budget deficits post-



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

Lauren G. Henderson
Economist
hendersonla@stifel.com

STIFEL

election (a legitimate concern under the scenario of either an incoming Trump or Harris administration), investors will expectedly continue to reshape expectations for higher longer-term rates. Real rates, furthermore, will expectedly remain stubbornly elevated and push higher over time, resulting in a more normal shaped curve as we look out further into the new year.

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

DISCLAIMER

This material is prepared by the Fixed Income Strategy Department of Stifel, Nicolaus & Company, Incorporated ("Stifel"). This material is for informational purposes only and is not an offer or solicitation to purchase or sell any security or instrument or to participate in any trading strategy discussed herein. The information contained is taken from sources believed to be reliable, but is not guaranteed by Stifel as to accuracy or completeness. The opinions expressed are those of the Fixed Income Strategy Department and may differ from those of the Fixed Income Research Department or other departments that produce similar material and are current as of the date of this publication and are subject to change without notice. Past performance is not necessarily a guide to future performance. Stifel does not provide accounting; tax or legal advice and clients are advised to consult with their accounting, tax or legal advisors prior to making any investment decision. Additional Information Available Upon Request.

Stifel, Nicolaus & Company, Incorporated is a broker-dealer registered with the United States Securities and Exchange Commission and is a member FINRA, NYSE & SIPC. © 2023

ADDITIONAL INFORMATION AVAILABLE UPON REQUEST.

Stifel, Nicolaus & Company, Incorporated | Member SIPC & NYSE | www.stifel.com

1124.7376987.1

STIFEL

											Annual Rate 2022 – 2025				End of Q2 2026
	Q1 2024	Q2 2024	Q3 2024	Q4 2024	Q1 2025	Q2 2025	Q3 2025	Q4 2025	Q1 2026	Q2 2026	2022	2023	2024	2025	2026
Growth Indicators															
GDP, QoQ%	1.6%	3.0%	2.8%	2.2%	2.3%	3.1%	2.2%	2.8%	2.3%	2.5%	1.6%	3.0%	2.8%	2.2%	2.3%
Consumer Spending, %	1.9%	2.8%	3.7%	2.5%	2.5%	3.0%	2.2%	2.6%	2.5%	2.0%	1.9%	2.8%	3.7%	2.5%	2.5%
Fixed Investment, %	6.5%	2.3%	1.3%	2.7%	3.0%	3.8%	4.0%	3.8%	4.5%	4.5%	6.5%	2.3%	1.3%	2.7%	3.0%
Housing Starts, k, end of quarter, yr end	1,299	1,329	1,354	1,430	1,475	1,500	1,510	1,525	1,550	1,600	1,299	1,329	1,354	1,430	1,475
Unemployment Rate, %, qtr avg, ann avg	3.8%	4.0%	4.2%	4.4%	4.5%	4.5%	4.4%	4.4%	4.3%	4.3%	3.8%	4.0%	4.2%	4.4%	4.5%
Nonfarm Payrolls, k, qtr avg, ann avg	310	118	254	170	160	175	180	175	175	175	310	118	254	170	160
Inflation Indicators, YoY%, yr end															
PCE	2.8%	2.4%	2.1%	2.4%	2.5%	2.3%	2.3%	2.4%	2.3%	2.3%	5.3%	2.6%	2.4%	2.4%	2.3%
Core PCE	3.0%	2.6%	2.7%	2.8%	2.5%	2.4%	2.4%	2.3%	2.3%	2.3%	4.6%	2.9%	2.8%	2.3%	2.3%
PPI	2.0%	2.9%	1.8%	2.9%	1.5%	1.8%	2.1%	2.1%	2.0%	2.0%	6.4%	1.1%	2.9%	2.1%	2.0%
Interest Rate, %, end of quarter, yr end															
FF	**5.50**	**5.50**	**5.00**	**4.50**	**4.25**	**4.00**	**3.75**	**3.75**	**3.75**	**3.75**	**4.50**	**5.50**	**4.50**	**3.75**	**3.75**
3 month U.S. T-Bills	5.37	5.36	4.36	4.50	4.45	4.25	4.05	3.90	3.80	3.85	4.37	5.34	4.50	3.90	3.85
2 year U.S. T-Notes	4.62	4.76	3.64	4.25	4.28	4.35	4.25	4.28	4.30	4.35	4.43	4.25	4.25	4.28	4.35
5 year U.S. T-Notes	4.21	4.38	3.56	4.30	4.40	4.55	4.45	4.50	4.55	4.65	4.01	3.85	4.30	4.50	4.65
10 year U.S. T-Notes	**4.20**	**4.40**	**3.78**	**4.45**	**4.50**	**4.65**	**4.55**	**4.60**	**4.65**	**4.75**	**3.88**	**3.88**	**4.45**	**4.60**	**4.75**
30 year U.S. T-Bonds	4.34	4.56	4.12	4.60	4.65	4.80	4.70	4.75	4.80	4.90	3.97	4.03	4.60	4.75	4.90
3 month to 2 year spread bps	-75	-60	-99	-25	-17	10	20	38	50	50	6	-109	-25	38	50
3 month to 10 year spread bps	-117	-96	-85	-5	5	40	50	70	85	90	-50	-146	-5	70	90
2s to 10 year spread bps	-42	-36	14	20	22	30	30	32	35	40	-55	-37	20	32	40

Actual date in red (Source: Bloomberg) | GDP figures shown as annual change

STIFEL