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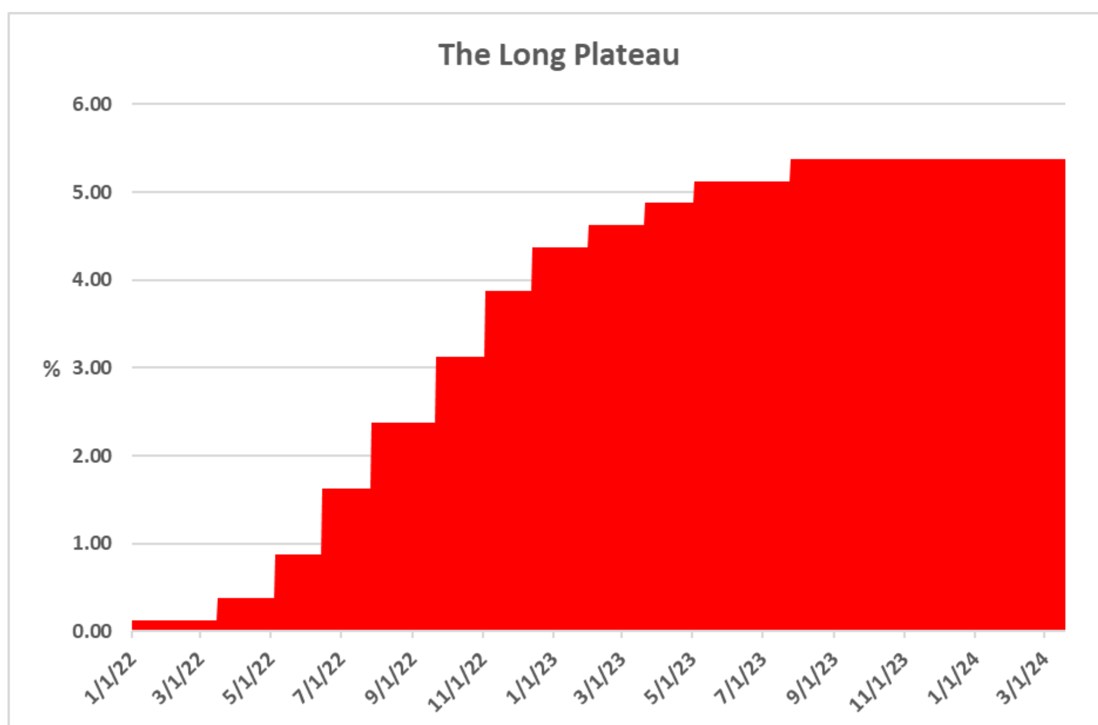
US interest rates - the fed stays put for a fifth consecutive meeting

Synopsis: For the fifth consecutive meeting, the US Federal Reserve has held the Fed Funds rate unchanged. However, what mattered was not the rate announcement, but the accompanying 'dot plot'.

Date published: 21.03.2024



Last night, to the surprise of nobody, the US Federal Reserve once again left its Fed Funds Rate at 5.25%-5.50%, the level it has been since 26 July 2023. The market's focus was not on the rate, but on...

- The Fed's accompanying press release;
- The 'dot plot' accompanying the press release, showing the views on the path of interest rates held by the members of the Fed's Open Market Committee; and
- What the Fed Chairman, Jay Powell, said in the subsequent press conference

Back in December, when the last dot plot was issued, the market perceived a Powell pivot to lower rates, reinforced by a dot plot that suggested there would be three rate cuts in 2024. That was not enough for the market, which ended 2023 anticipating six or even seven cuts in 2024, with the first perhaps as early as March. Such a difference in perception was never going to last.

By the time the Fed met this week, the market had rowed back in line with the Fed's December dot plot and had reduced the odds of a first cut in June to under 50%.

Arguably there were two main reasons for fading of hope from the market. Inflation is proving to be stickier than expected.

The November 2023 CPI reading was 3.1%, while February's was 3.2%. The February reading for the Fed's preferred index, Core PCE, has not yet emerged (it is due out on 29 March – January's reading was 2.8% and February's is projected to be unchanged). While the Fed waits, Core CPI, which fell from 4.0% in November to 3.8% in February, points to a slow decline.

The other reason is the strength of the US economy. Despite ticking up in recent months, unemployment remains low (3.9% in February) and the latest GDP numbers show an annualised growth rate of 3.2% for Q4 2023. The US does not look like an economy that is being constrained by high interest rates.

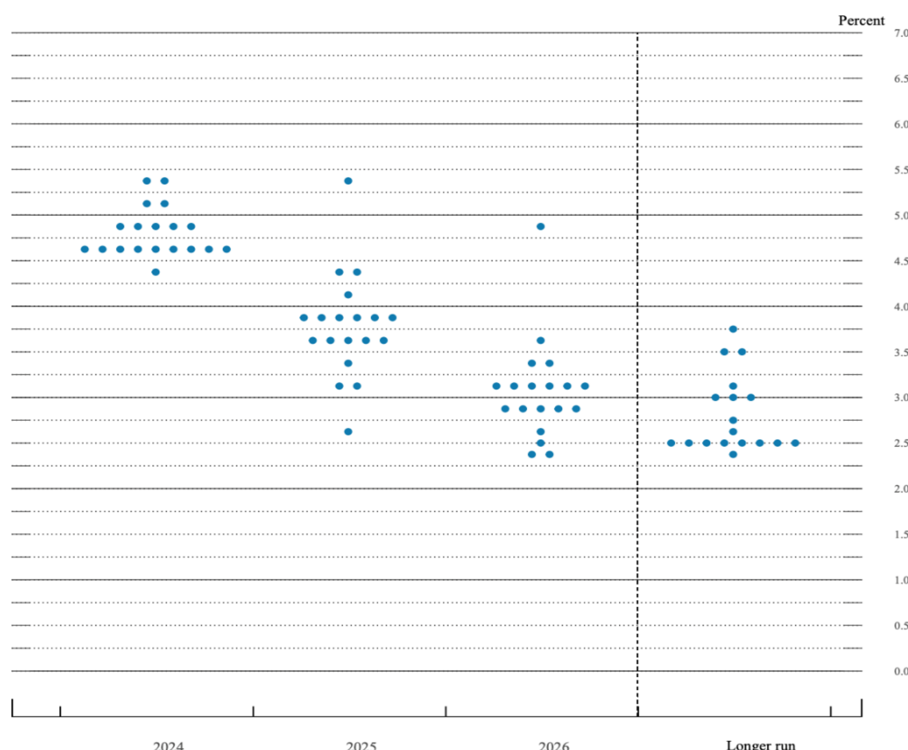
The Fed's press release reflected the continued healthy state of US Inc, repeating the opening of January's press release that 'Recent indicators suggest that economic activity has been expanding at a solid pace.' Indeed, the March press release was virtually identical to its immediate predecessor.

The accompanying dot-plot, which sets out Fed's members individual estimates of interest rates (and other economic data) over the next few years, pointed to a slightly more hawkish view.

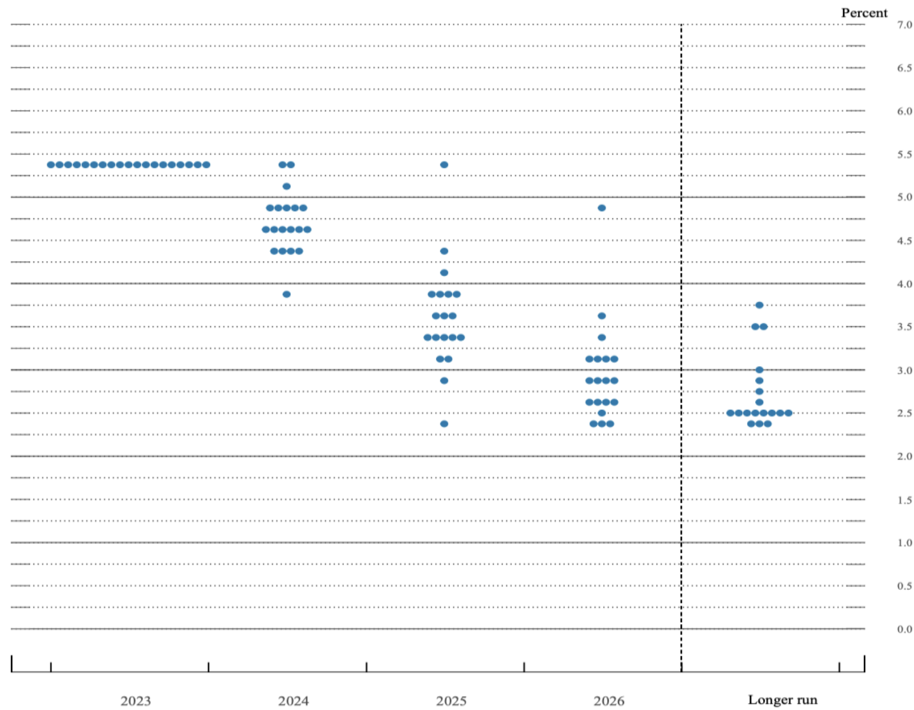
While the dots still coalesced around three rate cuts by the end of 2024, the spread of opinion was narrower.

Here are March's and December's interest rate plots...

March 2024



December 2023



The median figure for the end of 2024 is the same 4.6% as in December, although the mean figure (which the Fed does not publish) rose 0.11% to 4.81%.

The median number suggests three rate cuts of 0.25% over the remaining six meetings this year, although the presidential election on 5 November makes timing awkward. The Fed will want to be seen as neutral and not offering Biden any political favours.

There are two Fed meetings due after the election, the first of which starts on 6 November. The dot plot also pushed up the end 2025 median rate by 0.3% to 3.9% end 2026 by 0.2% and, for good measure added 0.1% to the longer term rate.

The marginally hawkish dots message was not reflected in the comments of Jay Powell, the Fed chair, at the post announcement press conference.

He said, "As labour market tightness has eased and progress on inflation has continued . . . we believe that our policy rate is likely at its peak for this tightening cycle, and that if the economy evolves broadly as expected, it will probably be appropriate to begin dialling back policy restraint at some point this year."

When asked whether he wanted to counter the stock market induced easing of financial conditions, he did not take the bait. According to Bloomberg's US Financial Conditions Index, things are as slack as they were in mid-2021, before interest rates started to rise.

The markets read Powell as a green light to keep up the buying spree...

- The 2-year Treasury bond yield fell 0.2% on the day to 4.59%.

- The yield on the 10-year Treasury bond, a widely used benchmark, was virtually unchanged at 4.27%.
- The S&P 500 rose 0.84% to a new all-time high and the NASDAQ added 1.25%.
- The US dollar index fell about 0.5% as investors turned to currencies where interest rates appeared less likely to fall rapidly.
- Gold, which traditionally benefits from lower interest rates and a weakening dollar, rose $50 to $2,210 an ounce, a new high.

Comment

The odds are now 80% that the Fed will cut in June. If it does not, markets could react sharply.

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