US Fed guides rates higher for longer

We are in the midst of the April-May round of central bank meetings. Last week, saw the US Federal Reserve gathering take centre stage. To no great surprise, the central bank left its key funds rate in a target range of 5.25%-5.50%, a 22-year high.

This marked the sixth straight meeting that US rates have been left on hold. From a markets viewpoint, with no expectation of any rate change, attention was centred on what guidance would be forthcoming on the Fed's outlook regarding interest rates.

Assessing the meeting statement and Chair Powell's press conference, the Fed is guiding that official US interest rates will remain at their current level for longer than previously envisaged. The reason for this is that the downward trajectory in US inflation has stalled. As a result, the Fed does not have sufficient data to show that inflation is on a sustained move lower to its 2% objective and therefore, it does not have confidence that now is the right time to consider cutting interest rates.

The Fed acknowledged the recent stickiness to inflation in its meeting statement. It commented that "in recent months there has been a lack of further progress toward" its 2% inflation target. Meanwhile, in the post meeting press conference, Chair Powell's emphasised that the Fed is committed to "retaining our current restrictive stance of policy for as long as is appropriate".

When questioned on whether the Fed would contemplate hiking rates, Chair Powell was quite clear that "its unlikely that the next policy move will be a hike". Instead, the focus within the Fed is on "how long to keep policy restrictive".

Amid higher than expected inflation, on-going strength in the labour market and less dovish soundings coming from FOMC members over recent weeks, market expectations for US rate cuts have been scaled back significantly. However, the extent and timing of any rate cuts will be very much data

dependent. Chair Powell has outlined potential paths to policy easing for the Fed. Rate cuts could occur if the Fed has greater confidence that "inflation is moving sustainably down to 2%" or an "unexpected weakening in the labour market".

To note, at the start of the year, futures contracts were anticipating around 150bps of policy easing in 2024. The market had moved to price in around 40bps of rate cuts by end year, with the first 25bps rate cut not expected until the November meeting at the earliest. Following last Friday's payroll data for April though, which saw jobs growth print below expectations, the market moved, in the immediate aftermath of the release, to anticipate 50bps of rate cuts by year end.

While the US economy has continued to perform well over recent months, aside from the April labour market data, there have been other signs of a loss of momentum in activity levels. Therefore, if US data disappoints over the coming months, especially in relation to the labour market and/or there is a resumption of the downtrend in inflation, then this would set the scene for rate cuts later this year.

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