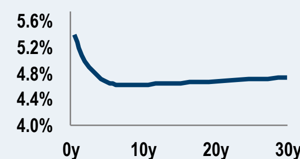
May 1, 2024

HIGHER-ISH FOR A LITTLE LONGER-ISH

- The Federal Reserve held unchanged its target for overnight interest rates at 5.25% - 5.50%, the sixth consecutive hold
- Stubbornly high inflation readings have delayed the expected start to Fed cuts, with the core PCE running at a 4.4% 3-month annualized pace
- FOMC statement struck a slightly more hawkish tone, highlighting the lack of progress on inflation in recent months
- Powell and friends released plans to slow the pace of balance sheet shrinkage over the coming several months

Treas.	Now	1.45PM	Chg.
3mo	5.40	5.41	-(0.01)
2yr	4.98	5.02	-(0.04)
5yr	4.66	4.70	-(0.04)
10yr	4.63	4.65	-(0.02)
30yr	4.74	4.75	-(0.01)
3m/2s	(41)	(39)	-(2)
2s/10s	(35)	(37)	+1
2s/30s	(25)	(27)	+2



Source: Bloomberg

The Federal Open Market Committee (FOMC) held its target for overnight interest rates steady at 5.25% - 5.50% for the sixth consecutive meeting. While markets had, once upon a time, expected rate cuts to commence as early as this spring, persistent upside inflation surprises through early 2024 have caused the Fed to delay the start of an easing cycle. Policymakers are clearly feeling handcuffed by stubbornly high inflation, preventing them from providing the widely anticipated monetary accommodation. For markets that had gotten out over their skis in pricing imminent rate cuts, this FOMC meeting amounts to a hawkish re-set of expectations. As our tongue-in-cheek title suggests, common market parlance has dubbed this re-set "higher or longer," but higher than what and for longer than what? We are, in all probability, at peak overnight interest rates, and current pricing has those rates holding through almost year-end.

Economic data since the March FOMC meeting has been characterized by solid growth but disturbingly firm inflation. Core 1Q Gross Domestic Product (real final sales to domestic purchasers) ran at a 3.0% pace, with resilient consumer spending offsetting continued weakness in rate-sensitive sectors like housing. The employment backdrop remains very firm, with the unemployment rate holding below 4% and job openings still exceeding available workers by a wide margin. Incoming inflation figures, however, have been persistently higher than expected across a wide range of categories. The PCE inflation metrics accelerated marginally in 1Q, with the core PCE clocking a 4.4% 3-month annualized pace. Most of that is a seemingly anomalous January reading of 0.5%, but the point remains. Services inflation, in particular, has re-accelerated in recent months. While the Fed had been anticipating a faster moderation in inflation, allowing it to cut rates, the higher run rate has caused officials to tap the brakes on policy easing for now. As we are fond of saying, inflation is a process that is only meaningful over time, and so focusing on month-to-month results is not a great way to measure general prices. The PCE results were noisily low in late 2023 and they've been noisily high in early 2024, with the trend somewhere in the middle. But the bar for policymakers to act is simply too high for Powell and colleagues to assume away this noise.

The FOMC statement struck a slightly more hawkish tone compared to the previous few meetings but was well within the range of expectations. On inflation, the statement highlighted that "there has been a lack of further progress towards the Committee's 2 percent inflation objective." On the growth side, policymakers noted that recent indicators "suggest economic activity has continued to expand." In addition to the statement, the FOMC published plans to slow the pace of balance sheet shrinkage, or Quantitative Tightening (QT), to maintain sufficient banking reserves. We estimate that the banking system needs $2.8 trillion - $3.0 trillion of reserves to settle daily payments versus about $3.2 trillion today. Starting in June, the FOMC will cut $45 billion off the maximum pace of monthly balance sheet shrinkage. Although there will be oodles of conspiracy theories about the Fed providing stimulus by slowing QT, this announcement is just the natural conclusion of a process that started more than two years ago.

Initial market reaction was modestly positive, with interest rates across the curve dropping by 1 - 4 bps, and equities as marked by the S&P 500 flipping from small losses on the day to small gains. The dollar fell by about 0.2% versus the currency of major trading partners. Initial trading was choppy, however, without any particularly strong directional impulse.

FEDERAL RESERVE press release

• Economic growth remains "solid," but now we have a note of caution on lack of inflation progress

Recent indicators suggest that economic activity has continued to expand at a solid pace. Job gains have remained strong, and the unemployment rate has remained low. Inflation has eased over the past year but remains elevated. In recent months, there has been a lack of further progress toward the Committee's 2 percent inflation objective.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. The Committee judges that the risks to achieving its employment and inflation goals have moved toward better balance over the past year. The economic outlook is uncertain, and the Committee remains highly attentive to inflation risks.

• Guidance language unchanged again

•Fed's Treasury portfolio will now shrink by no more than $25 billion per month, much slower pace of QT

In support of its goals, the Committee decided to maintain the target range for the federal funds rate at 5-1/4 to 5-1/2 percent. In considering any adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks. The Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent. In addition, the Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities. Beginning in June, the Committee will slow the pace of decline of its securities holdings by reducing the monthly redemption cap on Treasury securities from $60 billion to $25 billion. The Committee will maintain the monthly redemption cap on agency debt and agency mortgage-backed securities at $35 billion and will reinvest any principal payments in excess of this cap into Treasury securities. The Committee is strongly committed to returning inflation to its 2 percent objective.

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

• Voting unanimous

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Thomas I. Barkin; Michael S. Barr; Raphael W. Bostic; Michelle W. Bowman; Lisa D. Cook; Mary C. Daly; Philip N. Jefferson; Adriana D. Kugler; Loretta J. Mester; and Christopher J. Waller.

Implementation Note issued May 1, 2024

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