

WEEKLY

Economic Commentary

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The Federal Reserve took center stage this week, as the rate-setting committee met amid a swirl of speculation over the outcome. For sure, there was little suspense regarding an actual move. To no one's surprise, the key policy rate was kept unchanged in the 5.25-5.50 percent range that has been in place since last July. What the markets keenly wanted to know was where the Fed stood regarding future moves. Here too, the committee provided few surprises, which it turns out was just what investors wanted to hear. Stock prices raced to new records and bond yields eased a bit.

Simply put, the Fed still intends to cut interest rates three times this year, sticking to the plan it outlined in December. The big change since then has been in market expectations. Recall that back in December, few traders agreed with the Fed, believing that a much sharper pivot away from the rate-hiking campaign in effect between March 2022 and July 2023 was warranted. After all, inflation had tumbled dramatically over the second half of 2023, with the annual increases in the Fed's preferred price gauges, the personal consumption deflators, cut in half between June and December. At the time of the policy meeting on December 12-13, market participants were firmly convinced that the Fed's 2 percent inflation target was well within reach and that the Fed was credibly on the way towards achieving that goal without sending the economy into a recession.

However, they also believed that the soft landing would need some rate relief imminently to stave off a recession. Hence, the financial markets had priced in as many as 6 rate cuts in 2024, beginning in March, as well as giving high odds that the economy was poised for a downturn if rates remained higher for longer, as the Fed intended. The wide chasm between market expectations and the Fed's plans lasted for the better part of December and January. But with the hotter-than-expected reports on consumer prices and job growth over the first two months of the year, the markets have gradually come around to the Fed's way of thinking. By this week's policy meeting, any difference between the Fed's plans and market expectations had vanished.

To be sure, investors were encouraged that the Fed did not use the upside surprises in recent data as an excuse to sound a more hawkish tone. As much as anything, that fueled the rally in stocks and helped reverse the recent runup in bond yields. The bellwether 10-year Treasury yield ended the week at 4.21 percent, down about 10 basis points from its nearby peak hit just before the Fed meeting. Earlier this month, just prior to the latest data on jobs and inflation, the yield had hovered just over 4.0 percent. Meanwhile, by retaining its plans to cut rates later this year, the Fed breathed more life into the stock market rally, spurring expectations of sustained growth in revenues and profits. Despite a modest setback on Friday, the S&P 500 gained more than 2 percent on the week, hitting record highs along the way.

Indeed, the updated projections of the Fed now sees growth considerably higher in 2024 than was the case in December, with GDP increasing by 2.1 percent compared to the earlier prediction of a 1.4 percent increase. Importantly, that steep upgrade included only a mild uptick in expected inflation, from 2.4 percent to 2.6 percent in the core personal consumption deflator, which is the Fed's preferred inflation gauge. The modest uptick reflects the stronger CPI and producer price data for January and February; the personal consumption deflator will be reported next week, and that too is expected to come in somewhat hotter than the Fed would like. Importantly, the Fed's inflation outlook for 2025 remained unchanged, despite the stronger growth expected in GDP. From our lens, that combination is a sign that the Fed expects productivity and more supply to drive a noninflationary growth increase next year.

Federal Reserve Projections				
Percent				
Variable	Median ¹			
	2024	2025	2026	Longer run
Change in real GDP	2.1	2.0	2.0	1.8
December projection	1.4	1.8	1.9	1.8
Unemployment rate	4.0	4.1	4.0	4.1
December projection	4.1	4.1	4.1	4.1
PCE inflation	2.4	2.2	2.0	2.0
December projection	2.4	2.1	2.0	2.0
Core PCE inflation ⁴	2.6	2.2	2.0	
December projection	2.4	2.2	2.0	
Memo: Projected appropriate policy path				
Federal funds rate	4.6	3.9	3.1	2.6
December projection	4.6	3.6	2.9	2.5

All this is positive news for the financial markets, stoking the celebratory mood that has prevailed since the

meeting. We caution, however, that investors may be reading too much of a dovish sentiment into the Fed's updated projections. While the median forecast of the 19 members of the policy-setting committee (FOMC) was for three quarter-point rate cuts before the end of the year, lowering it to 4.6 percent by year-end, the so-called dot plots that represents each member's prediction came awfully close to signaling only two cuts. In fact, if one member raised the dot for this year, it would have been enough to shift the median forecast to only two cuts. That, in turn, would likely have resulted in a much different market reaction than the celebratory one it struck.

Fortunately, the calendar of economic data was extremely light this week, so there was nothing new on the economic or inflation fronts that would derail the positive market response to the Federal Reserve meeting. That said, amid this light calendar one sector did take the spotlight – housing. Paradoxically, it is also the most rate-sensitive sector of the economy, which enhances the significance of the Fed's meeting. Clearly, rate cuts that would eventually bleed into lower mortgage rates would be of enormous help to the housing market. That said, housing activity has lately been holding up quite well, as all the data surprised on the upside for the latest month. The index of homebuilder sentiment turned positive in March for the first time since July 2023. February housing starts came in stronger than expected, and building permits data point to further momentum for starts, particularly in the single-family sector. Existing home sales also beat expectations in



February, and the inventory of homes for sale registered a solid increase. More timely data from the National Association of Realtors (NAR) indicates a healthy increase in inventory is likely in March, reflecting increases in new and ongoing listings. The recent gains in inventory suggest some sellers are moving off the sidelines despite relatively high mortgage rates. If the trend toward more supply continues, we think it will translate into more home sales. Supply overall remains historically tight, however, so we don't expect much downward pressure on home prices.

Speaking of prices, it's too soon to determine the impact of the settlement related to real estate commissions on the housing market. In the wake of the settlement, real estate agents for home sellers will no longer be required to offer a share of their commission to agents for home buyers. Prior to the settlement, the standard for most, but not all, existing home sales was a 6% commission split between agents. The settlement could put some downward pressure on prices: sellers may reduce their prices knowing they will pay a lower commission; they might also be willing to sell in an environment of higher mortgage rates knowing that their selling costs would be reduced. There could be some offsetting factors, however. Some agents may still be willing to offer buyers' agents some share, albeit reduced, of their commission if it helps with a sale of a home. On balance, our initial take is that the change will weigh on home prices, but only at the margin, and will also result in lower commissions, which will reduce residential investment in GDP, all else equal.



KEY FINANCIAL INDICATORS

INTEREST RATES	March 22	Week Ago	Month Ago	Year Ago
3-month Treasury bill	5.37%	5.38%	5.41%	4.57%
6-month Treasury bill	5.30	5.34	5.36	4.56
2-year Treasury note	4.60	4.74	4.68	3.76
5-year Treasury note	4.20	4.33	4.28	3.41
10-year Treasury note	4.21	4.32	4.25	3.38
30-year Treasury bond	4.39	4.43	4.37	3.64
30-year fixed mortgage rate	6.87	6.74	6.90	6.42
15-year fixed mortgage rate	6.21	6.16	6.29	5.68
STOCK MARKET				
Dow Jones Industrial Index	39475.90	38714.77	39131.53	32237.53
S&P 500	5234.18	5117.09	5088.80	3970.99
NASDAQ	16428.82	15973.17	15996.82	11823.96
COMMODITIES				
Gold (\$ per troy ounce)	80.82	2159.40	2046.40	2034.50
Oil (\$ per barrel) - Crude Futures (WTI)	2165.10	81.01	150.48	69.33

KEY ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
Housing Starts (February) - 000s	1521	1374	1566	1451
Building Permits (February) - 000s	1518	1489	1493	1489
Existing Home Sales (February) - mlns of units	4.38	4.00	3.88	4.00

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