■ Bill Adams ■ Waran Bhahirethan

January 31, 2024

Fed Decision Indicates a Rate Cut in March Is Possible But Not Likely; Fed Will Wait to See the Whites of 2% Inflation's Eyes Before Pulling the Trigger

- **The Fed held the target rate unchanged as expected at the January decision, and continues to shrink their balance sheet.**
- **The Fed's policy statement indicates some members think a rate cut might be appropriate as early as March, their next scheduled decision, but a critical mass lean toward waiting longer.**
- **Chair Powell is a member of the latter group, saying at the press conference following the January decision that a cut in March "Is probably not the most likely case."**
- **A cut at the Fed's March decision can't be ruled out, but they are more likely to wait until one of the following two decisions in May or June to begin reducing rates.**
- **Comerica's baseline forecast anticipates the Fed waiting until June to begin reducing rates, and cutting them by a cumulative three quarters of a percent by December.**
- **But if the Fed doesn't follow that course in 2024, they are more likely to start cutting interest rates earlier than forecasted, and to cut them by more than forecasted.**

As universally expected, the Fed held the Federal Funds target steady at a range of 5.25% to 5.50% at the January 31 monetary policy decision. The decision was unanimous. The key phrase in the monetary policy statement was that "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."

It is easy to imagine that phrase rankling Chair Powell, who prefers to state things as clearly and simply as possible. In the press conference following the decision, he explained that "inflation is still too high, ongoing progress toward bringing it down is not assured, and the path forward is uncertain." He added that the FOMC needs "to see continuing evidence [that is, good data releases] to build confidence that inflation is moving down sustainably toward our goal." Okay. Fine. How much evidence?! A reporter asked Chair Powell to clarify in the press conference but he declined to answer.

The FOMC will have two more months of CPI and jobs reports in hand when they meet next in March. The January policy statement implies that a critical mass of FOMC members are skeptical that will be enough data to convince them that inflation is on a sustainable downward trajectory. Chair Powell seems sympathetic to this point of view, saying at the January press conference that a March cut "is probably not the most likely case." Also, some FOMC members likely believe that even if inflation is on its way back to target, the Fed should keep talking tough about fighting inflation to push back against buoyant financial market conditions like high stock market prices, narrow credit spreads in the bond market, and a less-strong exchange rate, which are making the Fed's high policy rate less restrictive to growth than it otherwise would be.

On the other hand, some FOMC members seem concerned that the Fed risks holding rates too high for too long, which could "unduly weaken economic activity and employment," as Powell put it in the opening statement to the press conference.

The Fed will wait to pull the trigger on rate cuts until they see the whites of 2% inflation's eyes. The Fed was badly burned in late 2021 and 2022 when they thought high inflation would be transitory, then got caught by surprise when it rose more and persisted longer than expected. They want to avoid making the same mistake twice. A rate cut in March is possible but by no means assured. Rate cuts are more likely to start in the second quarter of 2024. It's (sigh) data-dependent.

The Fed also made no adjustments to their balance sheet runoff policy (commonly called quantitative tightening) at the January decision. They continue to allow up to $95 billion in maturing Treasury bonds and mortgage-backed securities to roll off of their balance sheet as they mature. Chair Powell stated that the Fed is "planning to begin in-depth discussions of balance sheet issues at our next meeting in March." That implies that the Fed is unlikely to slow the pace of balance sheet reduction before June. Comerica forecasts for the Fed to slow their balance sheet run-off in the second half of 2024, and likely end it in late 2024 or the first half of 2025.

Comerica's January forecast anticipates the Fed waiting until June to start reducing the target rate, and cutting it by a cumulative three quarters of a percent by the end of 2024. But if the Fed doesn't follow that course in 2024, they are more likely to start cutting interest rates earlier than anticipated, and cut them by more than anticipated.