Comerica Economic Alert

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Fed's March Decision Was As-Expected; A Rate Cut Is Likely Around Mid-Year

- **The Fed held the target for the fed funds rate unchanged as expected in March and signaled that they are likely to start reducing rates later this year.**
- **In their quarterly projections for economic growth and inflation ("Dot Plot"), the Fed held unchanged the projection for the federal funds rate at year-end, implying three rate cuts of a quarter percent each over the rest of 2024.**
- **The Fed also said "it will be appropriate to slow the pace" of their balance sheet reductions "fairly soon."**
- **Comerica maintains unchanged our forecast for the Fed to cut the federal funds rate by a quarter percent at their June decision, and to make subsequent quarterly cuts of a quarter percentage point again in September and December.**

As was universally expected, the Fed held the federal funds target steady at a range of 5.25% to 5.50% at the March 20 monetary policy decision, extending the pause on rate changes that followed their last hike in July 2023. The March decision was unanimous. The key phrase in the monetary policy statement was that the risks to the Fed "achieving its employment and inflation goals are moving into better balance," meaning that they are becoming more confident that inflation is returning to their 2% target. However, they also repeated from their prior statement made January 31st 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."

The Fed's quarterly "Dot Plot" (Projections for the economy and the fed funds rate) held unchanged the projection for how much Fed policymakers think it will be appropriate to cut the federal funds rate this year. The median Fed policymaker thinks it will be appropriate to lower the fed funds rate to a range of 4.50% to 4.75% by the end of the year, three quarters of a percent below the current level.

The median dot on the Dot Plot also upgraded projections for real GDP growth in 2024, nudged lower the forecast for the unemployment rate at year-end, and raised the projection for core PCE inflation a bit. In reaction to this, the median dot raised the projection for the year-end fed funds rate in 2025 and 2026 by a quarter percentage point, to 3.9% and 3.1%, respectively.

The Fed's March policy statement held their assessment of recent economic data essentially unchanged from the January statement, saying economic activity and job growth are "strong," and that inflation "has eased over the past year but remains elevated."

Chair Powell was asked directly at the press conference following the March decision about how much more data would be needed to make the committee "confident" enough that inflation is "moving sustainably toward 2 percent" before they start cutting, and he essentially said he wasn't sure. Powell loves to speak plainly, but precisely, and his response was anything but. That implies FOMC policymakers hold a range of views about what the threshold for rate cuts should be. Chair Powell stated in the press conference that the FOMC is "a consensus-oriented organization and we do try to achieve consensus and ideally, unanimity." That messaging is essentially unchanged from the Fed's prior decision in January.

In short, the March Fed decision indicates that the Fed sees the economy largely on course with their projections released last December, implying that an initial rate cut will likely be appropriate around mid-year.

Comerica maintains unchanged our forecast for the Fed to make an initial federal funds rate cut of a quarter percentage point at the June 2024 decision, followed by subsequent quarter percentage point cuts in September and December.

Separate from interest rates, Chair Powell stated at the March press conference that "the general sense of the [FOMC] is that it will be appropriate to slow the pace of run-off fairly soon." 'Run-off' refers to the Fed's policy of reducing the size of their balance sheet, a.k.a. Quantitative Tightening or "QT." QT unwinds the Fed's massive purchases of Treasury bonds and government-backed securities made during the pandemic and its aftermath to support the economy's recovery. The Fed is likely to slow QT shortly after they begin cutting interest rates in mid-2024, and to end QT late this year or in early 2025. Financial markets will likely see the end of QT as favorable for risky assets, like stocks and corporate bonds, since the Fed will be directing less of private investors' money into the risk-free assets that the Fed had been taking off their balance sheet.

While Comerica's outlook for monetary policy in 2024 is unchanged from the last time the Fed met in January, the balance of risks to that outlook has shifted. Inflation came in a bit hotter than expected in January and February, and in particular, service prices excluding energy services and shelter services—which tend to track with inflation's underlying trend—rose rapidly after running cool in the second half of 2023. Momentum has built up in inflation over recent years, and in early 2024 that showed up in high increases of health care service charges, car and truck rental rates, and other labor-intensive services whose prices change relatively infrequently.

At the same time, the unemployment rate rose to 3.9% in February, the highest since early 2022, indicating a modest margin of slack has returned to the labor market. While job growth was solid through February, growth of the labor force has picked up over the last year as people who stepped away from the labor force during the pandemic re-enter it, and as increased immigration swells the number of jobseekers.

With higher-than-expected inflation, but also an uptick in unemployment, the risks to Comerica's forecast for monetary policy look balanced. In plain English, that means that if our forecast misses the mark, the Fed looks equally likely to cut rates less than projected as they are to cut them by more than projected.