Instant Insights – CPI Release Keeps Rate Cuts in Sights

The Federal Reserve (the "Fed") adjusted its "dot plot" projections to reflect just one cut in 2024, down from its previous projection of three, but it penciled a steeper course of four rate cuts to follow in 2025. We believe one or two cuts remains a sensible base case this year. Meanwhile, the latest Consumer Price Index (CPI) release offered encouraging signs that disinflationary trends remain in place.

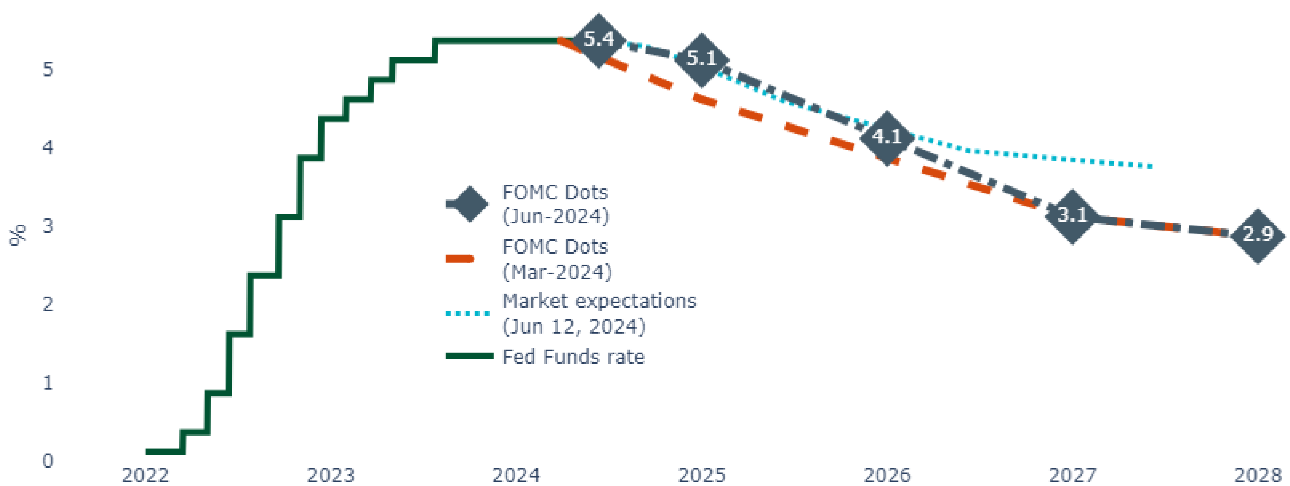
FOMC projects one rate cut in 2024, but four cuts in 2025

As expected, the Federal Open Market Committee (FOMC) held the federal funds rate at 5.25% to 5.5% and left monetary policy unchanged.

The committee made only one modest change to its official statement, changing a reference to a "lack of progress" on inflation to "modest progress." Elsewhere, the Fed left its economic projections largely unchanged, save for very slight increases in its unemployment, Personal Consumption Expenditures (PCE) and core PCE forecasts for 2025.

It adjusted its "dot plot" to reflect a median expectation of one rate cut in 2024, down from its last projection of three. Notably a larger number of committee members voted for two cuts rather than one, and Chair Jerome Powell indicated either scenario remains "plausible." The committee also notably projected a steeper course of four rate cuts in 2025, up from three. This moves the "dots" in line with the latest market expectations for the next two years (Figure 1).

Figure 1: The FOMC projects one cut by the end of the year, down from three [1]



Charts are provided for illustrative purposes only.

CPI eases pressure on the Fed

Ahead of the FOMC meeting, the CPI report showed some positive momentum after a string of disappointing prints earlier in the year. Chair Powell noted it was a "better report than most anyone expected."

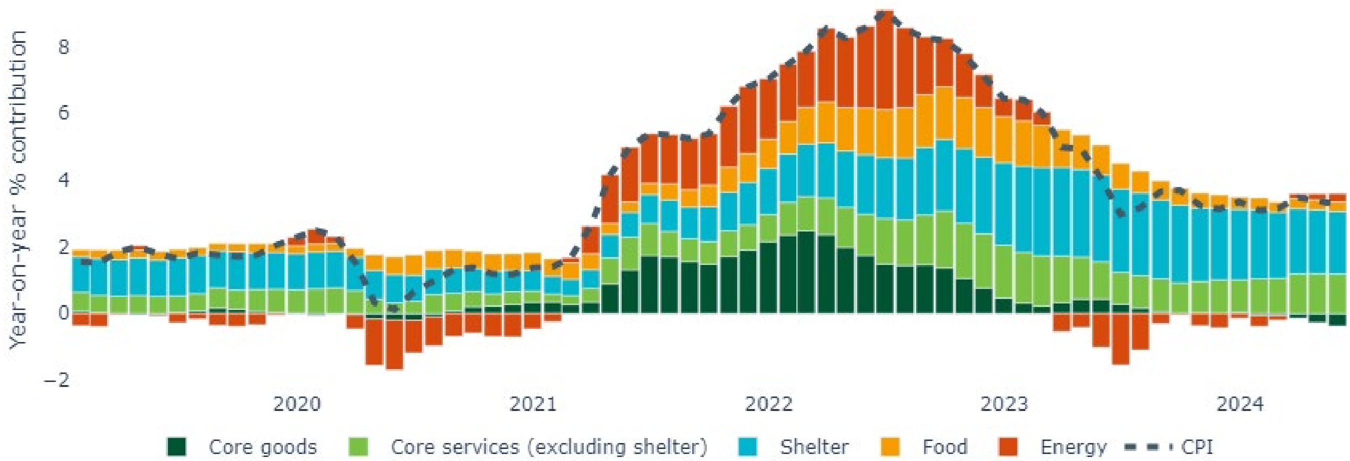
[1] Federal Reserve, Bloomberg, June 2024

Headline prices were flat in May, down from 0.3% in April. This brought the headline inflation rate from 3.4% to 3.3%. The slowdown in the headline index was driven by a 2% drop in energy prices, while food prices were up modestly by 0.1%.

Excluding food and energy, core prices rose 0.2% in May, the slowest monthly pace since August 2021, and lowered the annual rate from 3.6% to 3.4%.

From a category perspective, core goods moved deeper into negative territory year-on-year, falling from -1.3% to -1.7%, the lowest since 2004. New vehicle prices were down 0.5% for the second consecutive month. Used car prices rose 0.6% but are more than 9% below last year's levels.

Figure 2: Core goods categories reached their lowest year-on-year level since 2004[2]



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There were also positive takeaways in the "sticky" core services sectors (which we are watching closely for clues on long-term trends).

Encouragingly, the "supercore" services sector (which excludes shelter) eased from 4.9% to 4.8% year-on-year after two strong months. Transportation services fell, with motor insurance prices notably falling -0.1% in May after two hot prints.

Shelter continued to slow on a year-on-year basis, edging down from 5.5% to 5.4%, though progress there remains glacial. We do expect this measure to continue slowing gradually over the next few months, given a continued slowing in the rental markets (which tend to directionally lead the CPI rental category by ~12 months).

Figure 3: Core services see some mild relief from shelter and "supercore" inflation[2]

	Jun 2023	Jul 2023	Aug 2023	Sep 2023	Oct 2023	Nov 2023	Dec 2023	Jan 2024	Feb 2024	Mar 2024	Apr 2024	May 2024
CPI	3	3.2	3.7	3.7	3.2	3.1	3.4	3.1	3.2	3.5	3.4	3.3
Food	5.7	4.9	4.3	3.7	3.3	2.9	2.7	2.6	2.2	2.2	2.2	2.1
Energy	−16.7	−12.5	−3.6	−0.5	−4.5	−5.4	−2	−4.6	−1.9	2.1	2.6	3.7
Core CPI	4.8	4.7	4.3	4.1	4	4	3.9	3.9	3.8	3.8	3.6	3.4
Core Goods	1.3	0.8	0.2	0	0.1	0	0.2	−0.3	−0.3	−0.7	−1.3	−1.7
Shelter	7.8	7.7	7.3	7.2	6.7	6.5	6.2	6	5.7	5.7	5.5	5.4
Transport Services	8.2	9	10.3	9.1	9.2	10.1	9.7	9.5	9.9	10.7	11.2	10.5
Medical Services	−0.8	−1.5	−2.1	−2.6	−2	−0.9	−0.5	0.6	1.1	2.1	2.7	3.1
"Supercore" CPI	4	4.2	4	3.9	3.8	3.9	3.9	4.3	4.3	4.8	4.9	4.8

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[2] Bureau of Labor Statistics, Macrobond, Bloomberg, June 2024

We believe September remains in play for a rate cut

We believe a rate cut in September remains a sensible base case, with the Fed then leaving a second cut a possibility by the end of the year. After a tough start to the year, another helpful CPI print offered some relief. Although it may need to see more prints like this over the coming months before becoming comfortable about cutting rates, we believe disinflationary trends remain in place.

In our view, with rate cuts still in sight, considering potential allocation to fixed income ahead of the rate cutting cycle may remain an attractive opportunity.

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Core CPI excludes the more volatile food and energy categories. **Supercore** inflation equals the inflation of a basket of goods and services, minus the food and energy inflation, and minus the housing inflation. The **Consumer Price Index (CPI)** measures the monthly change in prices paid by U.S. consumers. The Bureau of Labor Statistics (BLS) calculates the CPI as a weighted average of prices for a basket of goods and services representative of aggregate U.S. consumer spending. **Federal Open Market Committee** is a committee within the Federal Reserve System that oversees the nation's open market operations and determines the direction of monetary policy. **Sticky** is resistant to change.

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