Fed stays its hand on interest rate cuts

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The US Federal Reserve has signalled it intends to cut interest rates this year but that the cuts will come later than markets have been calling for.

In response to a question at his press conference following the Fed meeting yesterday chair Jerome Powell all but ruled out a March rate cut stating that, based on its discussions, it was not the "base case." Wall Street indexes moved down on his remarks.

The benchmark S&P 500 index dropped 1.6 percent on the back of the decision, after it had reached a record high on Monday, in its biggest fall since September.

In its statement on the decision, the Federal Open Market Committee (FOMC) said the economic outlook was uncertain and it remained "highly attentive to inflation risks" even as the latest data show the inflation rate is coming down and that it was not yet prepared to move.

"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 his prepared remarks, Powell said the Fed believed its policy rate was "likely at its peak for this tightening cycle and that, if the economy evolves broadly as expected, it will likely be appropriate to begin dialing back policy restraint at some point this year."

But he warned that the economy had surprised forecasters in many ways since the pandemic and "ongoing progress towards our 2 percent inflation objective is not assured."

Given the FOMC statement's insistence on the need for "greater confidence" the press conference opened with questions on what it would take to provide it.

Powell was not explicit, but his remarks indicated that the Fed is chiefly focused, as it has been throughout, on the issue of wages.

In his opening remarks he noted that as "labour market tightness" had eased, progress on inflation had continued, and the risks to achieving inflation and employment goals had moved into "better balance."

In the question-and-answer session Powell said that goods inflation was coming down and pointed to the question of inflation in the services sector. On previous occasions, he has said that the key issue here is wages.

The latest data from the US Bureau of Labor Statistics shows that wages rose by 4.2 percent over the course of the year, down from 4.4 percent in September and clearly insufficient to compensate workers for the hit to their living standards.

But the Fed wants to see a further decline in wages before it is ready to state that inflationary expectations have become anchored around its 2 percent target.

Andrew Hunter, deputy chief economist at the research firm Capital Economics, put his finger on the issue in comments to the *Financial Times*.

"The further slowdown in wage growth evident in the fourth quarter employment cost index illustrates that easing labour market conditions are helping to push inflation down," he said, and that the latest data would help "reassure" the Fed that it was on course for its 2 percent target.

Overall, there seems to be a growing bifurcation on the state of the US economy. Pointing to the official data in his opening remarks, Powell said economic activity had been expanding at a "solid pace" with gross domestic product growth coming in at 3.3 percent in the fourth quarter and at 3.1 percent for the year as a whole.

The experience for workers on the ground is very different. Rather than a "goldilocks economy" – growth on the rise, inflation coming down and unemployment at a historic low – they are confronting a wave of layoffs.

This week's announcement by UPS that it plans to lay off 12,000 workers across its global operation comes in the wake of the destruction of thousands of jobs in the auto industry in the past month.

Tech industry jobs are likewise being slashed with 25,000 eliminated in the first month of this year following loss of more than a quarter of a million in 2023.

The worsening employment situation was highlighted in a *Wall Street Journal* report on the fall in the quit rate, indicating growing job insecurity. Last year the number quitting their jobs was down by 6.1 million compared to 2022, a decline of 12 percent and the lowest level in three years.

In comments to the Journal, Brett Ryan, senior US economist at Deutsche Bank, indicated the economic situation was not as it appeared.

"On the surface things look really good and robust but when you dig deeper it's a labour market that is being driven by a narrower set of industries and is showing signs of substantial slowing," he said, noting that employment in just three industries—leisure and hospitality, government and health care accounted for most of the job creation last year.

The official unemployment rate is just 3.7 percent, the lowest in 50 years. But as a commentator on the business channel CNBC pointed out some 85 percent of the states are reporting higher unemployment.

One of the reasons for the fall on Wall Street was the ongoing factor of sheer greed—disappointment that finance was not going to get its hands on cheaper money as fast as it had hoped.

But another is the fear that if interest rates remain too long at their present levels this will have a major impact on areas such as commercial real estate which have become dependent on lower rates.

Those concerns assumed material form yesterday when shares of New York Community Bancorp, which bought the failed Signature Bank in last year's banking crisis, plunged by as much as 46 percent at one point after it reported a major loss.

The bank said it had lost $260 million in the final three months of 2023, down from a profit of $164 million in the same quarter of 2022 and was cutting its dividend in order to comply with regulations resulting from the takeover of Signature.

The bank attributed the sharp fall to a rise in loan losses many of which were tied to office buildings—a situation which confronts many regional banks in the US which are heavily involved in commercial real estate.

NYCB chief executive Thomas Cangemi said the bank had looked at "the general office weakness throughout the country" and that it had thought through the "payment shock and interest rate shock given the rise of interest rates that we've experienced over the past few quarters."

If such developments deepen and extend more broadly, then the clamour on Wall Street for the Fed to start cutting interest rates will intensify.