1Q24 Economic Summary

The year started with investor expectations for Fed easing running far ahead of monetary reality. Market forecasts for rate cuts in 2024 had reached as high as seven, with the first ease predicted for the March FOMC meeting. However, U.S. economic resiliency and hotter-than-expected inflation data during the first three months of the year spurred a significant course correction. By the end of the first quarter, markets had scaled back the number of rate cuts in 2024 to three, realigning with the Fed's dot plot forecast. Fixed income markets sold off as easing exuberance faded, but equity markets shrugged off the rise in yields and continued to rally. All major U.S. stock indices ended the quarter at or near all-time highs as continued economic growth and robust corporate profits helped to offset disappointment over the forestalled rate cuts.

GDP growth came in softer than expected at 1.6% for the first quarter of 2024. However, if you look through the weaker headline number, domestic demand remained solid. Subtracting out the more volatile components of inventories and trade, final sales to domestic purchasers came in at a strong 2.8%. So, while the pace moderated from the red-hot growth experienced in the second half of 2023, economic activity remained above trend in the first quarter. Consumption cooled a bit but stayed firm as Americans dipped into savings and increased credit card balances to support their spending habits. Business activity picked up modestly, driven by investments in AI and outlays for equipment. After being a drag on growth for most of 2023, housing surged during the quarter. While existing home sales continued to be limited by low inventory and high prices, new home sales rose as construction of single-family houses increased, boosting supply. Buyers remained constrained by high mortgage rates and prices, but homebuilders helped ease the burden through incentives such as price reductions and mortgage-rate buydowns.

Labor market strength remained the primary driver of the economy's resiliency. The U.S. added a higher-than-expected 829 thousand jobs during the quarter, and the unemployment rate was a low 3.8% in March. Job growth was relatively widespread across most industries, with the biggest gains in hospitality and leisure, healthcare and government. Labor force participation increased due in part to an uptick in immigration. Job openings and quit rates remained high but leveled off during the quarter as the increase in available workers helped to bring labor supply and demand into better balance. Wage gains remained healthy, but the pace of earnings growth slowed. Chair Powell attributed some of the moderation to immigration as migrants typically fill lower-paying jobs, helping to tame aggregate wage inflation.

Despite the ease in wage pressures, inflation reaccelerated during the quarter as gas prices rose and core services prices remained sticky. Consumer prices as measured by the CPI came in hotter-than-expected in January, February and March, raising concerns that inflation is becoming entrenched. Stubbornly high shelter costs remain the primary driver of services inflation, but transportation, healthcare, and financial services prices were also on the rise during the quarter. Goods prices came down a bit primarily due to a decline in used car prices; however, as global manufacturing recovers, goods disinflation could begin to reverse. In addition, while the global supply chain improved in 2023, various factors including the recent bridge collapse in Baltimore, Houthi rebel attacks on vessels in the Red Sea and limited access to the Panama Canal due to drought, are all contributing to a rise in shipping costs that will likely be reflected in higher import prices in the coming months.

Mounting inflation pressures combined with strong underlying demand and low unemployment are making the Fed's quest to ease monetary policy more difficult. The Fed held the fed funds target range steady at 5.25%-5.50% at the March FOMC meeting, marking the fifth consecutive meeting with no change. While the Committee's median forecast continued to show three rate cuts in 2024, the dot plot skewed hawkish as the number of Fed officials expecting fewer cuts increased. The minutes to the meeting reinforced the hawkish tone as participants noted the "disappointing readings on inflation in recent months" and commented that they did not expect to reduce the fed funds rate until they "gained greater confidence that inflation was moving sustainably toward 2 percent." Post-meeting Fedspeak continued to promote the Committee's "higher for longer" stance, and market participants finally took heed. By the end of the quarter, traders had pushed back the timing and quantity of cuts priced into the fed funds futures market and yields rose across the curve.

The Fed started the year with a clear intent of cutting rates in 2024, but with a strong labor market and inflation going the wrong way, rate cuts are getting more difficult to justify. The question is rapidly moving from when and by how much the Fed will ease to will there be cuts at all in 2024. As long as jobs are plentiful and economic growth solid, the Fed has the flexibility to remain patient before easing policy. However, given that this is an election year, the longer the Fed waits, the less likely cuts become since moves close to an election are typically avoided.

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