

FED FOCUS

Confidence in US rate cuts rise as inflation lands within expectations**Thursday, May 16, 2024 7:59 AM CT**By Brian Scheid and Umer Khan
Market Intelligence

The latest US inflation reading is driving expectations of up to three cuts to benchmark interest rates before the end of 2024 as price hikes stood mostly within projections.

Prices rose 3.4% year over year in April, a slowdown from 3.5% in March, according to the market-preferred consumer price index data released May 15. Not counting volatile food and energy prices, the closely watched core inflation figure rose 3.6%, the smallest annual growth in three years, according to US Bureau of Labor Statistics data.

While the slowdown in annual price growth was relatively small from March to April with just a 10-basis-point drop, the latest inflation reading fell within economists' forecasts. It also stands in contrast with [hotter-than-expected price data](#) earlier this year that shrank the market outlook from as many as six rate cuts in 2024 [to one or none](#). The outlook for cuts now looks more promising as inflation shows more signs of receding closer to the Federal Reserve's 2% target.

"The Fed's goal is to see moderation in the economy and inflation — and that's what these figures indicate," said Kathy Jones, chief fixed income strategist for the Schwab Center for Financial Research. "Markets are happy with better-than-expected inflation data. After three months of disappointment, this raises hopes that it will come down longer term."

Consumer price index all items YOY change (%)

January 1970-April 2024



Data accessed May 15, 2024.

Based on data released May 15, 2024.

Data includes year-over-year change in non-seasonally adjusted consumer price index for all items.

Source: US Bureau of Labor Statistics.

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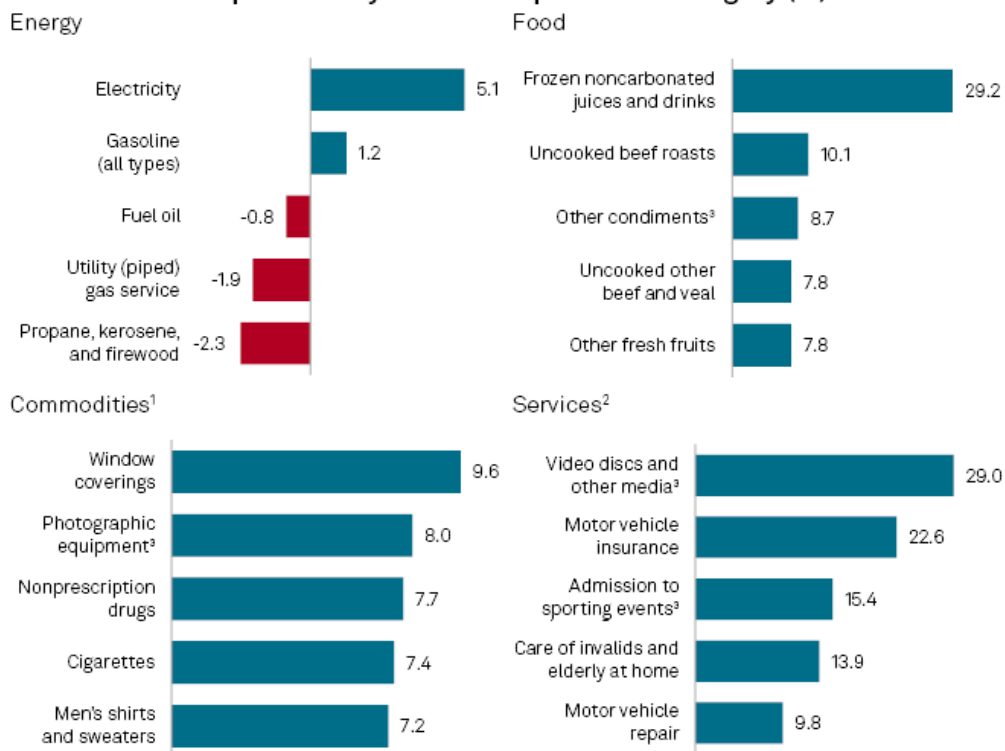
More cuts in view

The latest inflation report increases the likelihood that the Fed will cut more than once before the year ends, potentially approving as many as three cuts by December, said Bret Kenwell, a US investment analyst at eToro.

The odds of three cuts by the end of the year was about 25% on May 15, according to the CME FedWatch Tool, which measures the futures market probabilities of Fed rate moves. The odds were about 20% a month earlier.

For the Fed to cut three times, bringing the central bank's federal funds rate target down as low as 4.5%, inflation will need to show further progress toward the 2% goal, or the economy needs to show further weakness, Kenwell said.

YOY inflation in April 2024 by detailed expenditure category (%)



Data accessed May 15, 2024.
 Based on data released May 15, 2024.
 Data includes year-over-year change in non-seasonally adjusted consumer price indexes.
¹ Excludes food and energy commodities.
² Excludes energy services.
³ Special index based on a substantially smaller sample.
 Source: US Bureau of Labor Statistics.
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Such movement "could nudge that conversation toward three cuts," Kenwell said. "Just because it becomes a conversation — like when investors were [talking about a rate hike](#) — doesn't mean it will become consensus."

One major impediment to three cuts this year is time, with just five Fed meetings left before the end of the year and most Fed watchers not expecting a cut until September when just three meetings will remain.

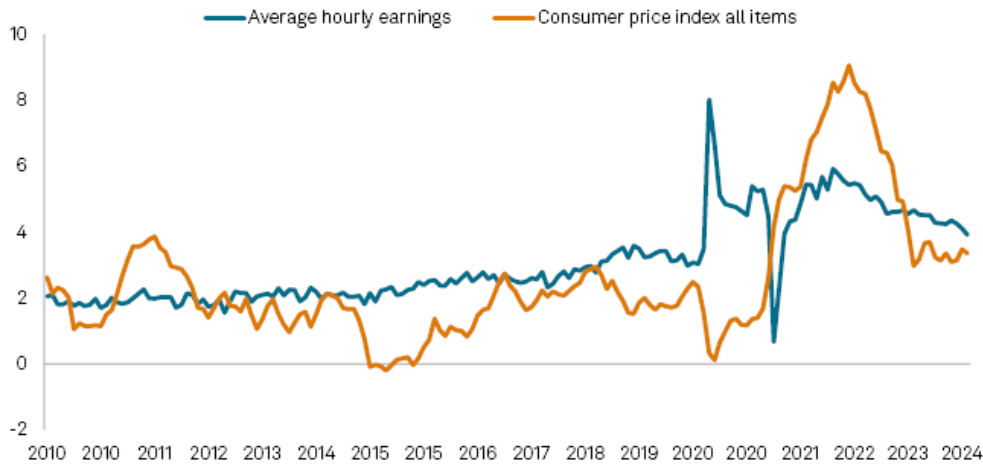
"And the Fed is going to need something more than one in-line inflation report before justifying a rate cut," Kenwell said.

The September question

The consumer price index data, along with this week's producer price index — which showed wholesale inflation increased 2.2% in a year — and advance estimates of US retail and food services sales — which showed an increase of 3% over the past year — may be enough to get the Fed "moving toward" a cut, said Jones with the Schwab Center.

Wages growing faster than consumer prices (%)

YOY change: January 2010-April 2024



Data accessed May 15, 2024.

Based on data released May 3, and May 15, 2024.

Consumer price index includes year-over-year change in non-seasonally adjusted consumer price index for all items, while average hourly earnings includes seasonally adjusted data.

Source: US Bureau of Labor Statistics.

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The first cut will likely not happen until September, Jones said, and the Fed will need a few more months of data showing that inflation is approaching that 2% goal. Jones, expects two cuts this year and said the Fed may consider a cut earlier if the labor market shows signs of moderation or weakening.

The Fed will likely need two or three additional months of cooler inflation readings to gain confidence that inflation is returning to its 2% target, said Josh Jamner, an investment strategy analyst at ClearBridge Investments.

"In our view, the criteria for the Fed to cut is less about a specific barometer and more about a general tone where both the internals of and recent trends in inflation point to a reasonable expectation of continued cooling in the inflationary data," Jamner said.

Umer Khan contributed to this article.

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