April 15, 2024

Weekly Commentary

Fed Rate Cuts - Not So Fast!

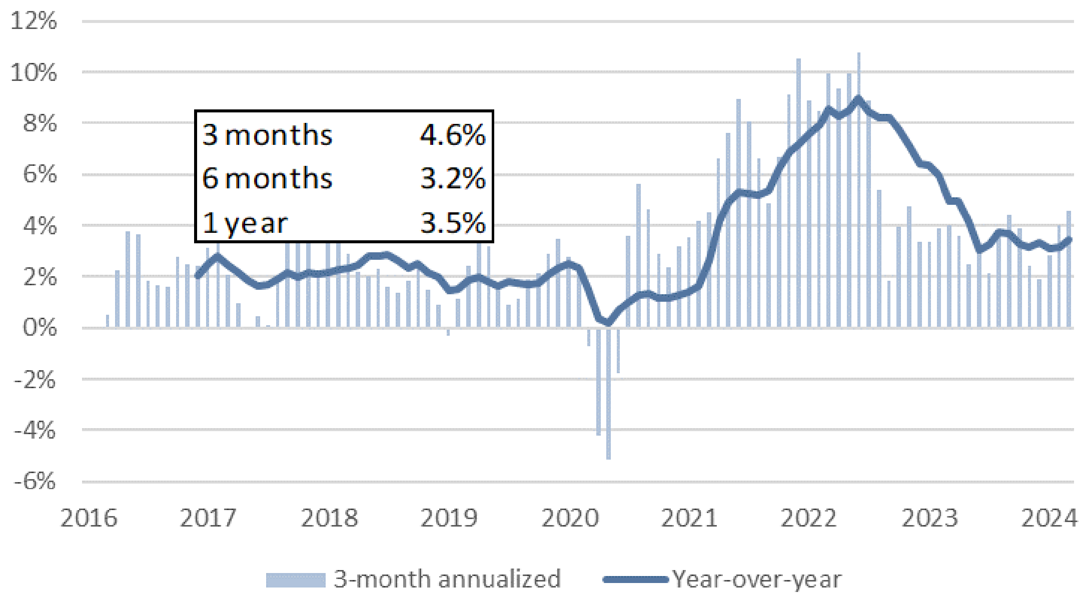
As measured by the consumer price index (CPI), inflation continues to remain stubbornly above the Federal Reserve's 2% year-over-year target. The March CPI report released last week indicates that the cost of living rose 3.5% over the last 12 months and shows some signs of accelerating.

The inflation apologists continue to point to nuances around how the Bureau of Labor Statistics measures shelter prices as the reason inflation has remained sticky. They argue that rents, as measured by CPI, are lagged and that real-time measures show that rent growth has stalled across the US. Using real-time rents in CPI then results in a much lower CPI reading. It's a fair critique of measuring rents, but CPI also doesn't pick up the rising cost of owning a home due to higher home prices and borrowing rates. CPI is an imperfect measure, but it's not obviously biased in one direction or the other.

Focusing on the components of inflation is missing the forest for the trees. In 2021, Fed Chair Powell pointed everyone toward "Supercore" inflation (CPI excluding goods and housing) when goods prices were rising rapidly. But now that Supercore inflation has surged to over 8% over the last three months, the Fed doesn't talk about it much anymore.

Too-high inflation is a demand story (immigration, a balance sheet effect driving consumption, continued large fiscal deficits, etc). Aggregate demand (nominal GDP) is increasing 6% per year versus a 4.5% trend pre-COVID. If the US economy can only grow at perhaps 2.5% in real terms the rest of the excess demand will increase inflation. A 6% NGDP growth is commensurate with 2.5% real GDP growth and 3.5% inflation, which is exactly what we have today.

Fig. 1: Consumer Price Index (CPI)



Source: Bloomberg, Mill Creek.

Last Week…

- **The March headline Consumer Price Index (CPI) exceeded expectations,** coming in at 0.4% compared to the consensus forecast of 0.3%. The annualized headline CPI rose to 3.5%, up from the previous month's 3.2% and surpassing the forecast of 3.4%.

- **US equities concluded Wednesday's trading session with losses,** although they recovered from earlier lows triggered by the CPI report. The Dow Jones, S&P500, and Nasdaq closed by 1.09%, 0.95%, and 0.84%, respectively.

- **Market expectations for a rate cut in June fell to under 30% from nearly 60%** before the release of the CPI data.

- **FOMC minutes indicate the policy rate is at its peak,** with policymakers favoring a slowdown in the pace of bond sales by around half.

- **March headline Producer Price Index (PPI) registered at 0.2%,** slightly below the consensus of 0.3% and February's figure of 0.6%.

News and Insights

- About The Sense and Nonsense of Open-ended Funds - Christoph Junge, Head of Alternative Investments at Velliv, argues that despite risks, investing in open-ended funds offers benefits like diversification, transparency, strategy alignment, and favorable fee structures, making them appealing to sophisticated investors, especially for income-oriented strategies.

- Brooklyn's Super-tall 'Sauron' Tower in Clouds of Uncertainty - Brooklyn's iconic 'Sauron' tower, now faces foreclosure due to default on a $235 million loan, highlighting the broader impact of rising interest rates on real estate projects. Despite its architectural acclaim, the tower's financial struggles reflect challenges in New York's real estate market, affecting luxury buyers and investors.

- Jamie Dimon Warns Rates Could Stay High as Market Mood Shifts - JPMorgan CEO Jamie Dimon warns that US inflation and interest rates could remain higher than expected due to substantial government spending and the need for increased investments in various sectors. Dimon's remarks coincide with a shift in market sentiment and highlight potential risks in private credit markets.

- Fed's Kashkari Floats Possibility of No Rate Cuts This Year - Neel Kashkari, President of the Federal Reserve Bank of Minneapolis, suggested that interest-rate cuts might not be necessary this year if progress on inflation stalls, particularly if the economy maintains its strength. Kashkari noted that while he initially considered two rate cuts in response to falling inflation, if inflation remains stable, he may reconsider the need for those cuts altogether.

- Wall Street Reclaims $16 Billion of Deals Lost to Private Credit - Borrowers are opting for cheaper public loans over direct lenders, shifting approximately $16 billion of debt from private funds to syndicated loan and bond markets this year, driven by favorable conditions in credit markets. Thryv Holdings Inc. and Encora Digital are among the latest companies to make this switch.

This week's contributor: Michael Crook, CAIA

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