The Fed is biased toward easing policy this year. (UBS)

Fed in 'no rush' to cut ahead of inflation data

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Federal Reserve Governor Christopher Waller has indicated that recent data pointing to higher-than-expected inflation have reinforced the case for delaying the start of the rate-cutting cycle.

Speaking at an Economic Club of New York gathering on Wednesday, Waller said “there is no rush to cut the policy rate” right now, and that “it is prudent to hold this rate at its current restrictive stance perhaps for longer than previously thought to help keep inflation on a sustainable trajectory toward 2%.”

Following the comments, markets scaled back expectations for easing this year by around 5 basis points, to 75 basis points. Investors' attention will now turn to the release of the Fed’s preferred measure for inflation, the core personal consumption expenditures index, on Friday, when markets will be closed for a public holiday.

The latest Fed commentary change our view that the central bank remains on track to cut rates this year, starting at its June policy meeting.

The Fed is biased toward easing policy this year. Despite his caution on inflation, Waller noted in his speech that rate cuts are not off the table, adding that further expected progress on lowering inflation “will make it appropriate” for the central bank to begin cutting rates this year. The Fed’s latest dot plot indicated that the median forecast from policymakers was still for three rate cuts by the end of this year, in line with our view.

Inflation should trend lower in the coming months. We believe that higher-than-expected releases in January and February were partly driven by temporary factors, including seasonal price hikes at the start of the year, and we expect the decline in inflation to resume in the coming months. In fact, given the modest increase in rents for new tenant leases, which

lead shelter prices in the consumer price index by around 12 months, we remain confident that the biggest component of the index will continue to slow.

Growth shows signs of moderating, and the labor market appears to be cooling off. With retail sales showing signs of cooling, US growth is expected to moderate from an unsustainable pace. It was running at an annualized 4% rate in the second half of last year, but the Atlanta Fed's GDPNow model is tracking growth of a much lower rate of 2.1% for the first quarter of this year. Recent trends in the labor market should also give the Fed some comfort, as the unemployment rate rose to the highest level in two years, and growth in average hourly earnings slowed to just 0.1% month-over-month in February.

So, we maintain the view that by the time of the June meeting, conditions should be right for the Fed to trim rates. This backdrop means that investors should proactively manage their liquidity via a combination of fixed-term deposits, bond ladders, and certain structured investments, and lock in still-elevated yields in quality bonds.

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