(Shutterstock)

Cooling US inflation supports case for Fed cuts

02 April 2024, 4:30 pm CEST, written by UBS Editorial Team

Inflation data continues to cool, providing comfort to the Fed and helping the case for Fed cuts this year.

The personal consumption expenditures (PCE) price index, which is the Federal Reserve's favorite gauge for inflation, showed price pressures eased during February. Fed Chair Jerome Powell described the data within Friday's PCE report as being "along the lines of what we would like to see." The core PCE index, which excludes volatile food and energy prices, rose 0.3% on the month, down from 0.5% in January.

Within the PCE inflation data, wage income showed a strong 0.8% growth, and spending on services rose the most since July 2021, at 0.6%. However, the latest set of data remains consistent with our view of a gradual cooling of inflation, which would help the case for Fed cuts this year.

More favorable inflation data is expected ahead. While the headline figures showed less of a slowdown than last year, the modest growth in core services should be encouraging to the US central bank. During an appearance at the San Francisco Fed on Friday, Powell said the data is what the Fed was expecting. This followed his remarks after the Fed's policy meeting last month, when he pointed out that higher-than-expected CPI prints in January and February had not changed the central bank's expectations that price rises would keep falling this year, in line with our view.

Consumer spending should slow amid cooling labor market. The rise in wage income was the most since the start of last year, and spending was stronger than expected, pointing to a still-resilient economy. But with the savings rate falling to around half the pre-pandemic level, consumer spending should continue to slow to a more sustainable pace amid a combination of high prices and high interest rates. A cooling labor market, marked by rising unemployment rate, should also give the Fed some comfort.

The US economy remains headed for a soft landing. The US economy 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. With the current level of rates well into restrictive territory, growth should continue to soften to below trend.

So, while the Fed is likely to seek further reassurance that inflation is heading sustainably back to its 2% annual target before embarking on rate cuts, our base case remains that easing should start at the June policy meeting, with 75 basis points of cuts for the year. Against this backdrop, we advise investors to limit cash balances, which will likely become less attractive as the year progresses. Now is the time to lock in high fixed rates on cash as well as yields on quality bonds.

Contributors: Brian Rose, Senior US Economist, CIO America, UBS Financial Services, Inc., Daisy Tseng, Strategist, UBS AG Singapore Branch

Important information
As a firm providing wealth management services to clients, UBS Financial Services, Inc is registered with the U.S. Securities and Exchange Commission (SEC) as an investment adviser and a broker-dealer, offering both investment advisory and brokerage services. Advisory services and brokerage services are separate and distinct, differ in material ways and are governed by different laws and separate contracts. It is important that you carefully read the agreements and disclosures UBS provides to you about the products or services offered. For more information, please visit our website at www.ubs.com/workingwithus.
© UBS 2023. All rights reserved. UBS Financial Services Inc. is a subsidiary of UBS AG. Member FINRA/SIPC.
There are two sources of UBS research. Reports from the first source, UBS CIO Global Wealth Management, are designed for individual investors and are produced by UBS Global Wealth Management (which includes UBS Financial Services Inc. and UBS International Inc.). The second research source is UBS Group Research, whose primary business focus is institutional investors. The two sources operate independently and may therefore have different recommendations. The various research content provided does not take into account the unique investment objectives, financial situation or particular needs of any specific individual investor. If you have any questions, please consult your Financial Advisor. UBS Financial Services Inc. is a subsidiary of UBS AG and an affiliate of UBS International Inc.