



CIO believes the Fed will balance strong recent economic data with the lagged effects of high rates and potential financial stability risks to maintain an overall bias toward easing policy. (UBS)

Trimming our forecast for Fed rate cuts this year

11 April 2024, 2:35 pm CEST, written by UBS Editorial Team

A third consecutive month of stronger-than-expected US inflation data saw markets quickly reprice expectations on the Federal Reserve's path to cut interest rates this year. The March US consumer price index (CPI) report showed monthly headline and core (excluding food and energy) CPI both increased 0.4% from February, versus expectations for a 0.3% month-over-month rise.

By the end of December, investors are now penciling in only 42 basis points of Fed rate reductions, compared with 67 basis points before the release of the March CPI and around 150 basis points in early January.

With the prices of core services excluding shelter still elevated, we have trimmed our forecast for Fed rate cuts this year. We now look for the first cut in September, with a reduction of 50 basis points by year-end. We still expect one 25-basis-point rate cut per quarter subsequently into next year.

But a likely delay to the start of the Fed's rate cuts does not change our view on the overall macro and investment backdrop. We continue to see a benign environment that benefits quality bonds and equities.

Inflation remains likely to fall. We still expect inflation to trend lower over time, as the current level of US interest rates is high enough to eventually push growth below trend. While the economy remains resilient, growth has been slowing, and consumer spending should cool down. More US households have used up the excess savings built up during the pandemic, with credit card rates at a record high and more people carrying debt. This, to us, implies spending will have to slow at some point, while wage increases are already moderating.

The Fed's easing bias remains intact. The upward surprises in the recent inflation data, combined with the strong pace of job growth, imply that future prints must be softer in order for the Fed to cut rates. That said, the Fed has made it clear that hitting 2% inflation is not a hard-and-fast rule. The Fed's objective is to guide the economy to full employment and stable inflation. The US central bank has begun emphasizing its employment mandate in recent weeks, accepting it may take time to get inflation back to target. The minutes from the March FOMC meeting also showed that policymakers anticipated "some unevenness in monthly inflation readings as inflation returned to target." We believe the Fed will balance strong recent economic data with the lagged effects of high rates and potential financial stability risks to maintain an overall bias toward easing policy. We think it remains unlikely that the Fed would be forced to raise rates further.

So, we retain our preference for quality bonds and quality stocks. We think the current high yields on quality bonds provide investors an attractive source of regular portfolio income, and within equities, we maintain our positive view on semiconductors and software for the broader AI theme.

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Original report - [Macro backdrop remains benign despite reduced Fed rate-cut expectations, 11 April 2024.](#)

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