Economic Update

May 1, 2024

FOMC Keeps Fed Funds Rate Unchanged, Maintains Loosening Bias; Will Slow Pace of Quantitative Tightening

The Federal Open Market Committee kept the fed funds rate unchanged in a range between 5.25% and 5.50% in its policy statement this afternoon. The FOMC maintained a loosening bias, but rate cuts do not appear imminent; the statement says that "the Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2%."

The statement also provided an update on the process of balance sheet reduction, or quantitative tightening (QT). In the aftermath of the pandemic the Fed created money electronically and used the proceeds to purchase longer-term Treasurys and mortgage-backed securities (MBS). Then, with a strong recovery and elevated inflation, the Fed let some of these securities mature and roll off the balance sheet, reducing the size of the central bank's balance sheet; this has been putting upward pressure on long-term interest rates. Starting in June the Fed will let $25 billion of Treasurys roll off per month, down from $60 billion currently. The Fed will still allow up to $35 billion of MBS to roll off per month; the central bank wants to move its portfolio back to mostly Treasury securities. The Fed is unsure of the proper size of the balance sheet long run; slowing the pace of QT will give the central bank more flexibility in calibrating the optimal size.

In discussing the current outlook, the statement noted solid economic growth, strong job growth, and a low unemployment rate. The statement noted an easing in inflation over the past year, but also that it remains elevated. In addition, the statement said that "in recent months, there has been a lack of further progress toward the Committee's 2% inflation objective." In addition, the statement said that "the Committee remains highly attentive to inflation risks."

Today's FOMC statement was largely as expected. The committee still wants to cut the fed funds rate, but is holding off for now until it is sure that the reacceleration in inflation will reverse. This is consistent with PNC's baseline forecast for 25 basis point reductions in the fed funds rate at the July and November FOMC meetings, which would take the rate to 4.75% to 5.00% at the end of 2024. PNC then expects a few additional rate cuts in 2025 as inflation further slows.

The announcement on QT was also largely as expected. The Fed has made it clear that it wants to slow the process so as to avoid upsetting financial markets, and also that it wants to reduce its MBS holdings.

Market reaction was muted, with the S&P 500 increasing and then giving back its gains. The yield on the 10-year Treasury note is down by a few basis points, with shorter-term yields little changed. The price of a barrel of West Texas Intermediate crude oil has fallen below $79. The dollar has fallen slightly against a basket of currencies.

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