At Passage Wealth, it is important that you are well-informed about what is happening in the markets. Here are a few of the key topics of conversation that deserve the most attention this month. If you have any questions or would like to continue the conversation, please reach out.

Year-over-year inflation has improved in each of the last 11 months. While prices are still increasing faster than the Fed is comfortable with, as headline prices rose 4.0% over the last year through May, the rate of those increases continues to come down[1]. Core inflation, which excludes the volatile food and energy components, rose by 5.3%, marking the slowest rate since December 2021. Although the significant improvement in headline inflation provides some flexibility for the Federal Reserve, stubborn core inflation may significantly push out any easing the Fed may have been previously debating. While the progress is positive, persistently higher prices will continue to exert pressure on both the economy and consumers.

A day after the release of the inflation report, the Federal Reserve held interest rates steady, the first time doing so after 10 consecutive rate hikes. The bigger news came from the Fed's comments and dot plot, which indicate a more hawkish stance on interest rates than previously anticipated. Earlier this year, market discussions revolved around when the Fed would begin easing its policy stance and cutting rates in the second half of the year. However, Fed Chair Powell stated during the press conference that rate cuts are "a couple years out." Additionally, the dot plot reveals that a majority of the committee expects at least two more 25 basis point rate hikes this year[2], contrary to last month's indication that the Fed was finished with rate hikes. Despite these comments, the Fed Fund futures market still assigns significant probabilities to rate cuts early next year[3].

The bottom line: Recent comments and data releases from the Federal Reserve indicate their intention to reshape market expectations for the remainder of this year and into 2024. However, it's not clear that the market fully believes the Fed and is still placing significant odds that rates will be lower, by this time next year, than they are today[3]. If the Fed is indeed going to be in a more aggressive stance for longer, that can create headwinds for the overall economy. However, if the market is right and the Fed begins to ease next year, it may increase the odds of a soft landing. Regardless, the changing expectations surrounding the Fed can introduce volatility in capital markets, making upcoming inflation reports crucial in assessing how the Fed will adjust or maintain its current tone.

Sources:

1. Bureau of Labor Statistics, https://www.bls.gov/news.release/cpi.nr0.htm
2. The Federal Reserve Summary of Economic Projections,
https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20230614.pdf
3. CME FedWatch Tool as of June 14, 2023

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The CME FedWatch Tool is a tool created by the CME Group (Chicago Mercantile Exchange Group) to act as a barometer for the market’s expectation of potential changes to the fed funds target rate while assessing potential Fed movements around Federal Open Market Committee (FOMC) meetings.