JSB Capital Management, LLC

Pro-active Wealth Management

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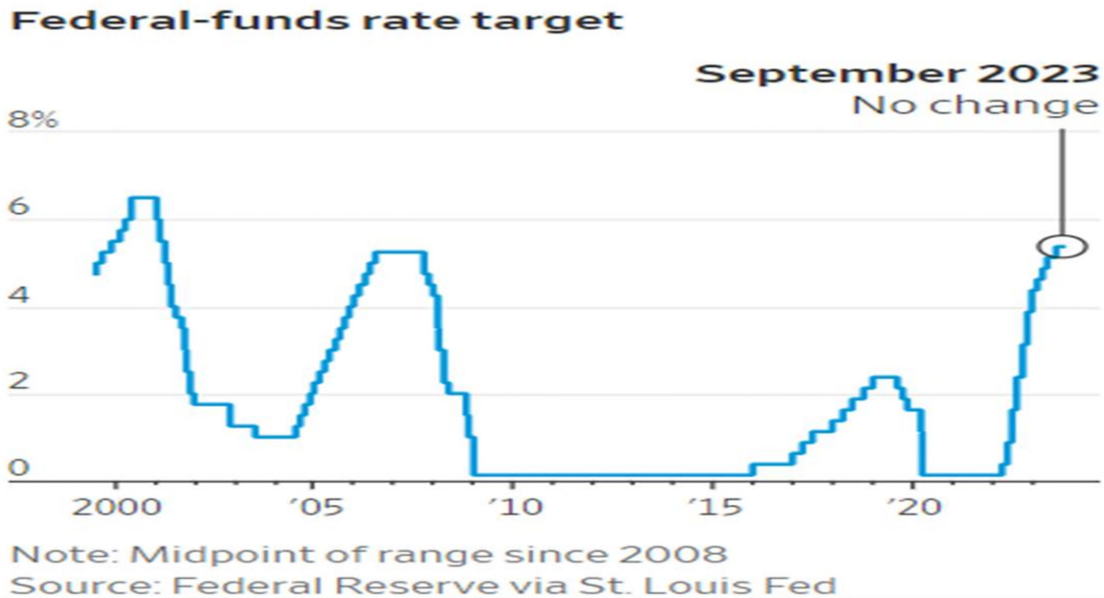
As expected by everyone who follows economic events, the Federal Open Market Committee (FOMC), the interest rate setting body of the Federal Reserve Bank, concluded their two-day meeting today and they announced that interest rates would stay right where they are for now.

The FOMC held its target range for the federal funds rate at 5.25% to 5.5%, while quarterly projections (known as the SEP or Summary of Economic Projections) showed 12 of 19 officials favored another rate hike in 2023. This fact may have startled the markets a bit as all market indicators slumped significantly right after the Fed Chairman completed his press conference.

The Federal Reserve Bank building, Washington, D.C.

In a post-meeting statement released Wednesday, the FOMC repeated language saying officials will determine the “extent of additional policy firming that may be appropriate.”

After a historically rapid tightening that took the federal funds rate from nearly zero in March 2022 to above 5.25% in July of this year, the central bank has in recent months pivoted to a slower pace of increases.



This relatively new strategy allows for incoming data to direct the short-term peak level for interest rates as inflation decelerates toward the Fed’s intractable 2% target. The Fed’s preferred index of prices, the Personal Consumption Expenditures or PCE, excluding food and energy, rose 4.2% in the 12 months through July.

“We want to see convincing evidence, really, that we have reached the appropriate level,” Powell told reporters on Wednesday. “We've seen progress, and we welcome that—but you know, we need to see more progress before we would be willing to reach that conclusion.”

The evidence the FOMC seeks lies in the data published since the Fed’s last meeting at the end of July. This data has generally shown that the labor market and consumer spending remain resilient despite the rise in rates, while core inflation (Core PCE) has slightly improved.

Of the many headwinds that policymakers must deal with, the shocking spike in oil prices, which have surged 30% since June, represents the highest near-term threat to the most important inflation indicators and might impact tighter interest rate policy. Additionally, the resumption of student-loan payments next month will take more discretionary spending power out of consumers' hands by a considerable amount. Not to be dismissed right now, a possible government shutdown at the end of this month is also looming over the outlook and threatens to deprive policymakers of key data on employment and prices produced by federal agencies heading into the next Fed meeting Oct. 31-Nov. 1.

The Fed Chairman's Press Conference

Federal Reserve Chair Jerome Powell frowned noticeably when he told reporters that consumer spending remains "particularly robust," but he said, "central bank officials aren't hoping that Americans pull back on shopping". "It's a good thing that the economy is strong. It's a good thing that the economy has been able to hold up under the tightening that we've done. It's a good thing that the labor market is strong," Powell said. "The only concern is it just means that if the economy comes in stronger than expected, that just means we will have to do more in terms of monetary policy to get back to 2%."

Yet Powell acknowledged that a decline in consumer spending could contribute to an economic slowdown or even a recession. "That's always a concern," he said, but added that the Fed's No. 1 concern is restoring price stability. "We will assess our progress based on the totality of the data and the evolving outlook and risks," Powell said in Aug. 25 remarks in Jackson Hole, Wyoming. "We will proceed carefully as we decide whether to tighten further or, instead, to hold the policy rate constant and await further data."

Mr. Powell emphasized: "That's something we have to do so that we can have the kind of economy we really want, which is one with a sustained period of tight labor market conditions that benefit all." Adding, "Given how far we've come with our rate hikes and how quickly we've gotten here, we do have the ability to be careful as we move forward because of that consideration."

For now, the FOMC has directed progress in bringing down inflation without a big increase in unemployment, a surprising trend that Fed officials optimistically expect will continue. But Mr. Powell warned that what happens next may be affected by factors outside the central bank's control and that could cause unemployment to rise more than anticipated.

The Number One question on Everyone's Mind

When asked if a soft landing was now a baseline expectation, Mr. Powell said he wouldn't go that far: "A soft landing is a primary objective, that's what we've been trying to achieve for all this time." But the Chairman warned that the absolutely worst thing the Fed can do is to fail to restore price stability.

"The record is clear on that—if you don't restore price stability, inflation comes back," he said. It would be "miserable" to have inflation constantly coming back and the Fed needing to tighten rates again and again. "So, the best thing we can do for everyone, we believe, is to restore price stability," Powell said.

The Immediate Future

The overall tone of today's announcement was that the FOMC remains prepared to raise short-term interest rates further "if appropriate." The majority of the voting members of the FOMC have essentially "penciled in" another rate hike before the year is out. Powell reminded everyone at his press conference that policy makers would be holding interest rate policy at a restrictive level "until we're confident that inflation is moving down sustainably toward our objectives." The primary reason why rates might have further to go is stronger economic activity and consumer spending, Mr. Powell said, rather than persistent inflation. "Broadly, stronger economic activity means we have to do more with rates," he said.

Given the lags in the economic effect of dramatically higher short-term interest rates, the FOMC will be data dependent and will likely move carefully for the next several meetings.

Therefore, our investment strategy, in part, will be to continue to buy short-term U.S. Treasury bills which currently yield around 5.5% and lock in those very attractive, risk-free rates for as long as possible. For the near-term, the stock market is likely to be propped up by the "soft landing" scenario that Mr. Powell seeks.

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