The Fed Says Best Not to Get Too Optimistic Right Now

As markets have become heady with anticipation of the Federal Reserve reducing rates, its minutes make clear how patient it plans to be.

By Erik Sherman

In the minutes of the last Federal Open Market Committee's meeting, held from October 31 to November 1, the overall take was, "Financial conditions continued to tighten, driven by higher yields on Treasury securities as well as by lower equity prices and a stronger dollar, which themselves partly reflected higher interest rates."

Labor market conditions did remain tight but were easing. Consumer inflation was "elevated but continued to show signs of slowing." Also, "Survey measures of consumers' short-run inflation expectations remained above their pre-pandemic levels. In contrast, survey measures of medium- to longer-term inflation expectations remained in the range seen in the decade before the pandemic."

However, since then, yields on Treasury securities have started to come down again. The S&P 500 is only 4.4% off its all-time high. The Fed's nominal broad dollar index, which had been climbing going into late October, in declining again.

Markets have been assuming that the Federal Reserve was pretty well done with raising rates — that things were on the mend. But the Fed keeps signaling that there are no quick fixes. On November 9, eight days past the end of the last FOMC meeting, Fed Chair Jerome Powell said in a speech at an International Monetary Fund-hosted conference, "U.S. inflation has come down over the past year but remains well above our 2 percent target. My colleagues and I are gratified by this progress but expect that the process of getting inflation sustainably down to 2 percent has a long way to go."

"For a market surge that has been predicated squarely on the belief that the Fed has completed its rate hike campaign, and that interest rate cuts are due early to mid-2024, the Fed minutes underscore the Fed's most recent messaging, that they are still not prepared to declare victory and that they have no intention thus far to cut rates in 2024," said Quincy Krosby, Chief Global Strategist for LPL Financial, in emailed remarks.

Markets believe that the Fed is done with any further rate hikes. If the economy continues to cool, that would seem a reasonable expectation. However, it is prudent to remember that conditions can change — already have to some degree — and that mixing some caution and scenario planning into strategy can be wise.