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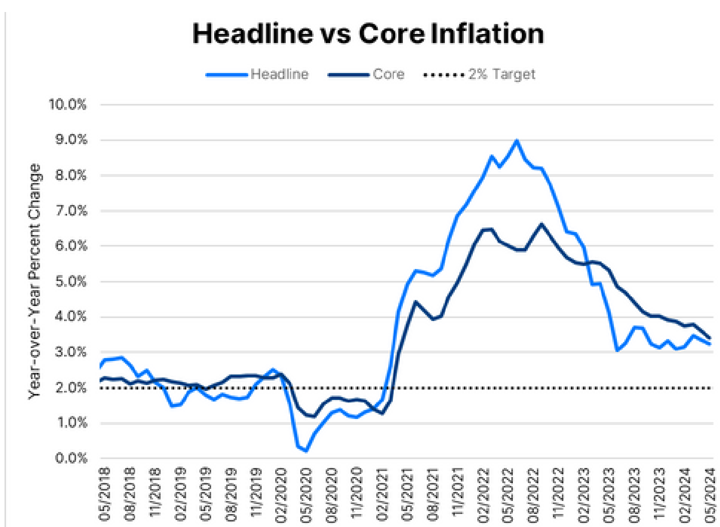
# June 2024 Economic Outlook: Disinflation Celebration and the Fed's Rate Cut Hesitation

## Key takeaways:

- **The latest CPI report showed inflation slowing to 3.3% in May. This was a much-needed positive development, as the first several months of 2024 showed persistent inflation that reignited fears of stagflation.**
- **However, the unexpected pickup in wage growth, coupled with strong job creation, continues to fuel concerns about resurgent inflationary pressures, complicating the Fed's policy decisions.**
- **The Fed's higher interest rate stance directly impacts businesses' profitability through increased operating and borrowing costs, necessitating proactive strategies around cost controls, pricing, and capital allocation to maintain competitiveness.**

The latest Consumer Price Index (CPI) report showed inflation slowing to 3.3% year-over-year in May, down from 3.4% in April. This was a much-needed positive development, as the first several months of 2024 showed persistent inflation and reignited fears of a 1970s stagflation environment.





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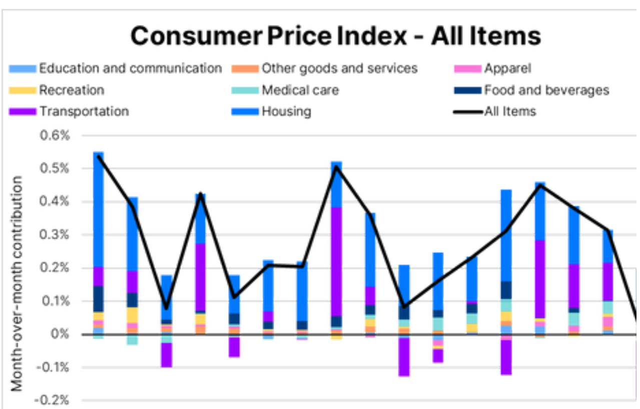
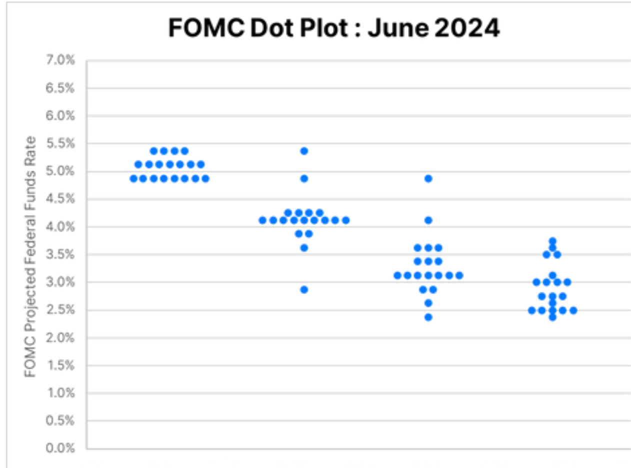
The key drivers behind the slowdown in CPI in May were housed in the transportation component, which declined 2% due to a drop in gasoline prices. While the easing of energy prices provided relief, shelter costs continued to rise at a concerning 0.4% monthly and 5.4% annually, acting as a persistent inflationary force.

The outlook for continued disinflation hinges on whether the factors that tempered inflation in May, such as lower commodity prices and easing supply chain pressures, prove durable, while the stickiness of shelter inflation remains a key risk as the Fed seeks to bring inflation back to its 2% target:




While there are significant risks heading into the second half of the year, the latest two inflation releases signal that the Federal Reserve's higher for longer stance is having the intended effect in cooling price pressures. So, why was the market rally following the CPI release immediately tapered by the Federal Reserve bringing expectations crashing back to reality with an updated Dot Plot, which signaled one rate cut, rather than three this year?




While the easing of price pressures is a positive development, policymakers remain concerned about the stickiness of core inflation, particularly in the services sector which is partially being driven by resilient wage growth. The employment release indicated that the US economy added 272,000 jobs in May, surpassing expectations and signaling continued economic resilience.

Significantly, the report showed wage growth reaccelerating, with average hourly earnings rising 4.1% year-over-year, exceeding the 3.0%-3.5% range considered consistent with the Fed's 2% inflation target.

This unexpected pickup in wage growth, coupled with strong job creation, continues to fuel concerns about resurgent inflationary pressures, and complicates the Fed's policy decisions. It also signals that although we have received two positive CPI reports in a row, the battle against inflation is still far from over. By signaling a shallower path of rate cuts, the Fed aims to keep borrowing costs higher for longer and firmly anchor inflation expectations and prevent an unwarranted easing of financial conditions that could undermine its hard-won progress in taming price pressures.

At Prevedere, we anticipate continued disinflation throughout the year, but it will continue to be an uneven downward trajectory as certain components remain troublesome for the Federal Reserve. This will continue to fuel their higher for longer stance through the end of 2024.

This directly impacts operating costs, borrowing expenses, and overall profitability for businesses operating in the US as the higher cost of debt financing means borrowing for investments or expansions will remain significantly more expensive than two years ago. The Fed's commitment to keeping rates elevated until inflation is firmly under control signals that these challenges will persist in the near term. Businesses need to proactively manage these headwinds through prudent cost controls, pricing strategies, and capital allocation to maintain competitiveness and shareholder value in an economic environment that continues to prove challenging.

# Thank you

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