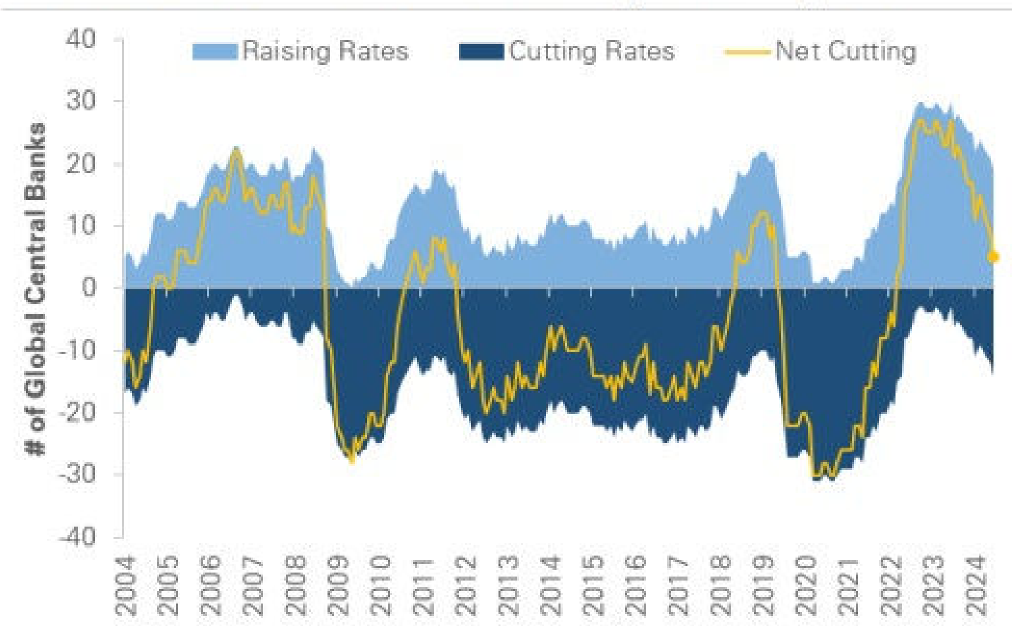
MOORE INSIGHTS

Key Updates on the Economy & Markets

The topic of interest rate cuts continues to dominate the financial markets. Investors are focused on when the Federal Reserve will lower rates, all while keeping a close eye on corporate earnings and valuations. Economists are analyzing inflation and labor market data to determine their impact on the probability and timing of rate cuts. Speeches by Fed members and minutes of recent Fed meetings have received greater scrutiny as investors search for clues about the central bank's next steps. This letter recaps the second quarter, discusses investors' focus on the Federal Reserve, and looks ahead to the remainder of 2024.

Global Central Banks are Starting to Cut Rates

While the Federal Reserve waits for more confirmation that U.S. inflation will return to target, the trend among global central banks has shifted decisively away from tightening. Figure1 categorizes over 30 of the largest central banks based on whether their last policy action was a rate hike or a rate cut. The line shows the net number of central banks tightening versus easing. When the line is positive, it indicates more banks are raising interest rates. When it's negative, it indicates more banks are cutting interest rates.



Central banks cut interest rates early in the pandemic to protect against unknown risks associated with shutting down the economy. When the economy reopened and inflation soared to multi-decade highs, they reversed course and raised interest rates with the goal of easing inflation.

Central bankers kept interest rates high over the past few years while waiting for inflation to slow, as shown in the plateau from 2022 into 2023.

Today, central banks are starting to cut interest rates as inflation slows around the world. More than 10 central banks have cut rates, including Canada, Switzerland, and the European Central Bank. The monetary policy environment is shifting from rate hikes to rate cuts, and investors expect this trend to strengthen in the coming quarters as more banks cut interest rates. However, this easing cycle is likely to be more staggered than previous cycles, with central banks cutting interest rates at varying speeds based on their unique inflation and economic growth conditions.

Analyzing Economic Trends & Surprises From 2Q24

A big theme from the past few years has been the U.S. economy's strength compared to the rest of the world. U.S. homeowners locked in low mortgage rates during the pandemic, which has protected them from the immediate impact of higher rates. However, mortgage

rates reset more frequently in some countries outside the U.S., with those borrowers feeling the impact of higher rates sooner.

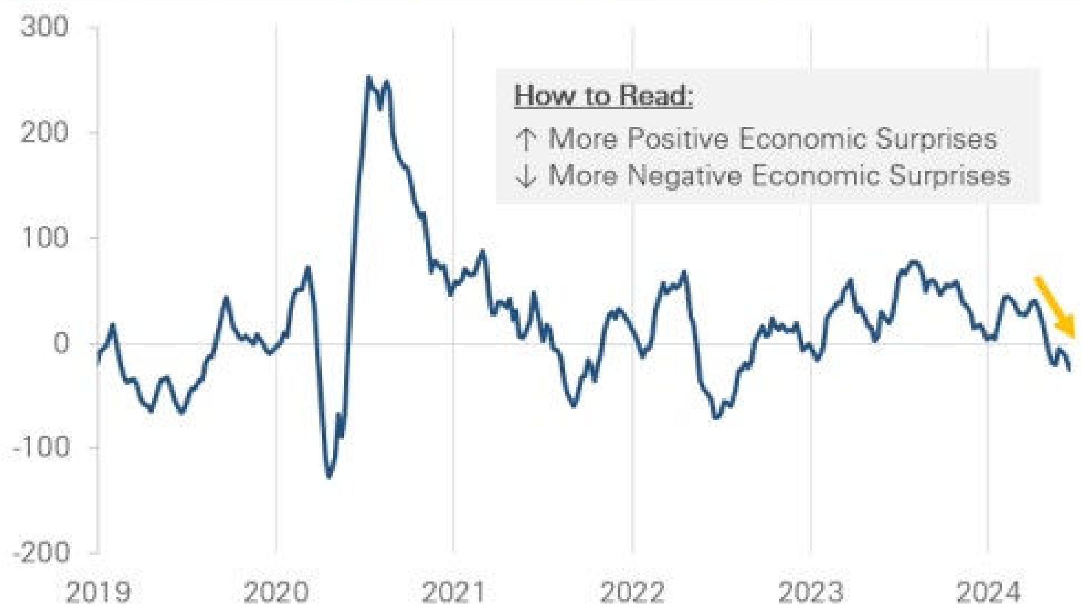


Figure 2 shows the Citi Economic Surprise Index, which compares economic data releases against Wall Street's estimates. A positive reading indicates economic data is stronger than anticipated (positive surprises), while a negative reading signals more negative surprises. In March 2022, the index turned negative as the Federal Reserve

started to raise interest rates. The increase in negative surprises signaled a slowdown in response to early rate hikes. During the past two years, the index stayed mostly positive as the economy remained resilient, with most economic data points surpassing expectations.

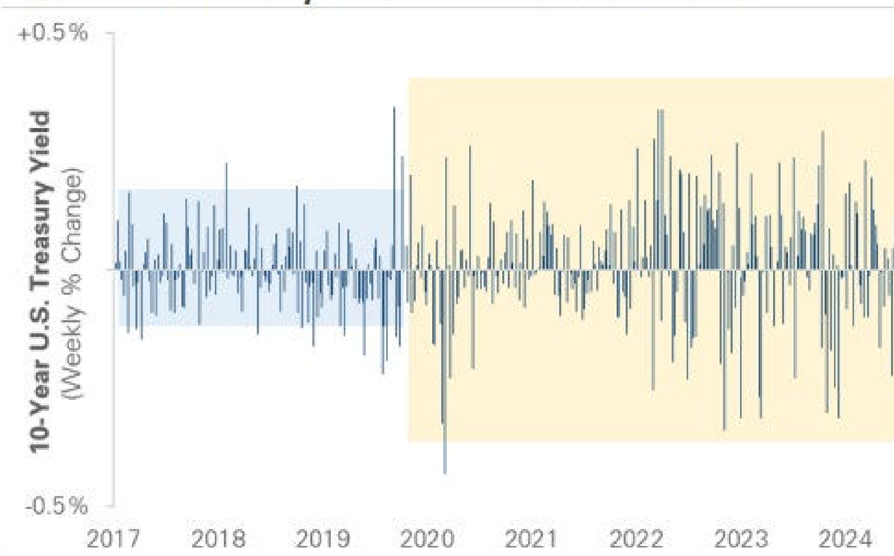
In Q2, there was an increase in the number of negative economic surprises as the U.S. economy underperformed expectations. Job growth slowed in April, and the unemployment rate rose to 4% in May. Retail sales declined in April, raising concerns about the U.S. consumer's strength and potential stress for lower-income households. May manufacturing survey data signaled a slowdown, and the U.S. Census Bureau reported the economy grew more slowly in the first quarter than initially estimated.

Investors are debating what the recent negative surprises indicate. Are they the start of a new trend toward slower economic growth? If so, how much could the economy slow? Markets will closely monitor economic data in the third quarter. However, there isn't a clear relationship between negative surprises and the rate of economic growth. Instead, the index is more of a reflection of how the economy is performing relative to investor expectations.

The more appropriate question may be whether the U.S. economy is returning to its pre-pandemic trend after growing at an above-average rate over the past few years. If so, investors may need to adjust their expectations to match the economy's new equilibrium.

Investors Remain Intently Focused on the Federal Reserve's Next Interest Rate Decision

The market remained focused on the Fed's policy guidance in the second quarter as inflation eased and economic data softened. However, there was no major shift in expectations, and investors still expect a rate cut later this year. While the market is closely monitoring the Fed, it's not receiving much actual guidance. On one hand, members of the Fed have advocated for patience. They want more confirmation that inflation is moving toward the 2% target. At the same time, those members, including Chair Powell, have said there is a high bar for additional rate hikes. Due to the unclear commentary, the market is left to speculate about the Fed's next step. Investors are using monthly economic data to form their opinions. However, those data points can be noisy from month to month, as they are adjusted to account for seasonal economic effects like summer vacations and holiday shopping.



Bond yield movements show the data's volatility and the market's indecisiveness. Figure 3 graphs the weekly changes in the 10-year Treasury bond yield over the past eight years. From 2016 to 2020, the 10-year yield's movements were relatively small. The large drops near the

middle of the chart mark the onset of the COVID pandemic and the Fed's decision to slash interest rates to near zero. The right side of the chart shows that yields have been more volatile in both directions since the Fed began raising interest rates in March 2022. Today, Treasury yields are the most volatile they have been in eight years as the market navigates a complex transition from rate hikes to rate cuts.

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