Pallas Perspective

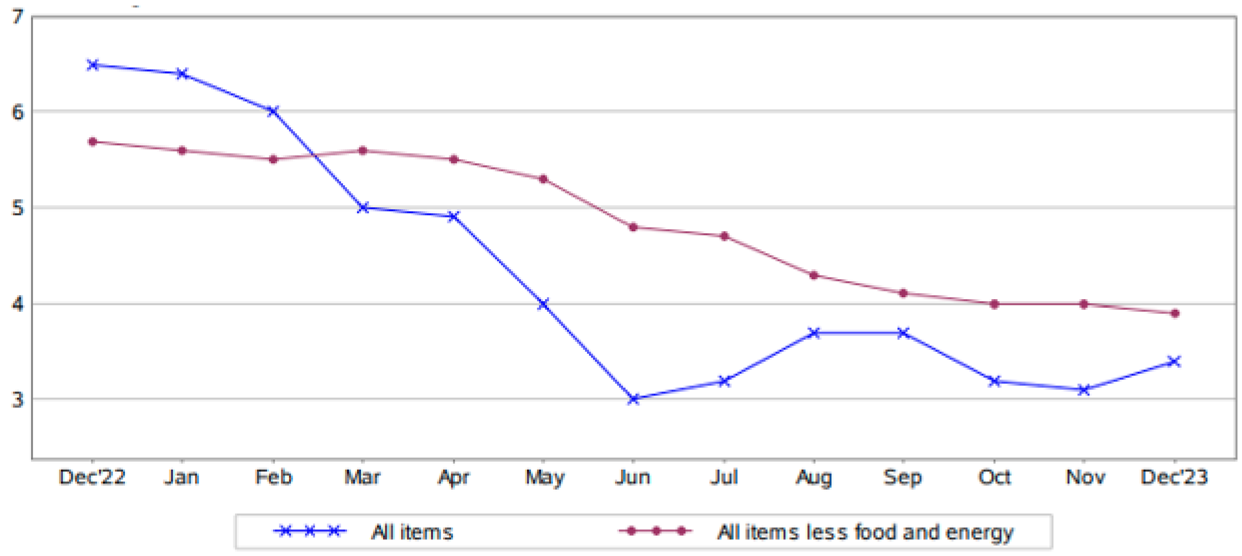
January 12, 2024

Inflation Data declining Year Over Year Yet Stabilizing Near Term

The strong rally in markets in November and December was largely due to the release of lower inflation data and the Federal Reserve's pivot toward a projection of peak interest rates being in place with expected cuts in 2024. However, the rate of disinflation, which represents the expectation that inflation will decrease, is likely to face challenges compared to market expectations during the first half of the year.

On Thursday of this week, the December data for the Consumer Price Index (CPI) was released and showed an increase of 0.3% month over month, a tick firmer than expected, lifting the year-ago increase to 3.4% from 3.1% in November. The data confirms the broad trend that inflation is continuing to moderate from a very strong pace a year ago but flattening in the near term.

12-Month Percent Change in U.S. CPI



Source: U.S. Bureau of Labor Statistics

While core inflation is continuing to trend in the right direction, we don't see the Fed in a rush to cut rates. With all the key data now in hand, it is hard to see how the January Federal Open Market Committee meeting would result in guidance to ease at the subsequent meeting in March (as markets apparently still expect). Perhaps the Committee could soften the guidance toward a neutral bias, but that would be more consistent with easing further on in the year.

For financial markets, the rally in equities and bonds may be held in check, or at least subside from the rapid pace in late 2023. Lower rates help expand valuation multiples and that catalyst may now take a back seat to economic growth and corporate earnings. Fourth-quarter corporate earnings reports and a discussion on guidance for 2024 will be the next near-term catalyst for markets.