Economic Analysis

United States: volatility will continue, but the easing cycle will start soon

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In recent weeks, financial variables in the United States and, therefore, in much of the world have shown very high levels of volatility. For example, while the yield on ten-year US Treasury bonds was at 4.2% in mid-March, in the first weeks of April, it reached 4.7% and is now at 4.3%. Likewise, stock markets fell 4% between March and the first days of April, then recovered and reached current levels that represent historical highs. What explains this volatility?

When the inflation data for March was released in April, which showed a slight rebound and, above all, that the disinflationary process that had been taking place last year stagnated during the first quarter of this year, the markets assumed that the Federal Reserve (the Fed) would no longer cut rates as sharply as previously thought. Some maintained that there would be no cuts in all of 2024. Some economists, such as Larry Summers, former Secretary of the Treasury, stated that the next move could even be an increase. This perception that the easing cycle would not be as marked as thought and that the Fed would likely not relax its stance throughout the year is what led to the decline in the stock markets and the increase in long-term bond yields.

However, data has subsequently been released that suggests that the economy is slowing, which may lead to the reactivation of the disinflationary process and the Fed starting an easing cycle this year.

Firstly, the president of the Fed, Jerome Powell, after announcing a few days ago the decision to continue with the monetary pause, stated that the possibility of a rate increase was very low.

Secondly, April job creation data showed an evident slowdown. While 300,000 places were created in March, only 175,500 were created in April. In the period between January and April of this year, 18% fewer jobs were created than in the same period of the previous year. A weaker labor market will reduce inflationary pressures.

Thirdly, demand for merchandises fell 0.4% in the first quarter, which also supports the idea that the economy is slowing down and that it will be difficult for prices to continue increasing at the same magnitude.

Fourth, a study by the San Francisco Federal Reserve shows that the excess savings that households accumulated in the post-pandemic period, which allowed families to maintain their consumption levels despite higher rates of interest, have finally run out.

Finally, inflation for the month of April was announced yesterday. The data shows that this fell again after the stagnation of the first quarter. It seems to me that the most likely scenario is that it will continue to fall in the coming months, both because of the slowdown that aggregate demand is beginning to show and because, to a large extent, the high inflation is explained by the owners equivalent rent component, which is estimated through surveys and is usually a lagging indicator. If we look at the behavior of observed rents, which is the leading indicator, we see that

they have fallen markedly, which allows us to assume that there is a high probability that owners equivalent rents will converge downwards in the coming months.

Because all of the above, the Fed will most likely begin reducing interest rates this year, possibly in September. This measure, which would be well received by the markets, would significantly reduce the possibility of observing a recession later.

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