First Trust
ECONOMIC RESEARCH REPORT
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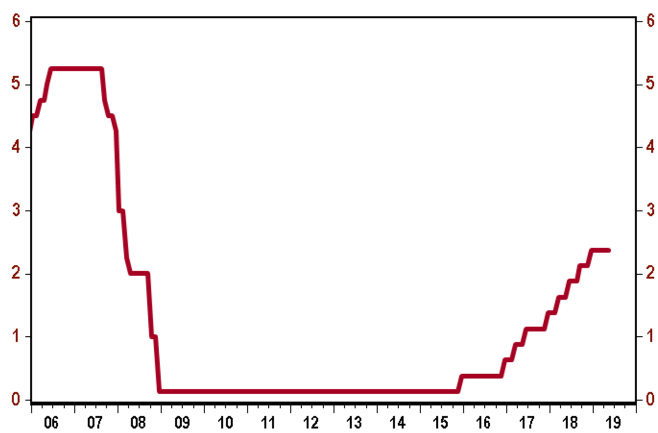
No Cut in Sight

Hold off on the Fed statement for a moment, Chair Powell's press conference was the real news today. He noted that both GDP and employment came in above expectations while inflation surprised to the downside. Inflation has become a recent bellwether for those trying to justify a rate cut. Powell addressed this head-on, stating that lower inflation appears due to transitory factors, and the Fed expects inflation to return towards the 2% target moving forward.



Source: Federal Reserve Board/Haver Analytics

There was little change to the Fed statement itself, on net, with stronger language on economic activity and weaker language on inflation. Arguably the most dovish change came in noting that household spending and business fixed investment have slowed since the Fed last met. But here, too, Powell stated that signs already suggest this will move higher in the quarters ahead. In part, this improved forecasts comes from the global outlook, where growth prospects are improving, China trade negotiations appear nearly complete, and concerns about Brexit have been put on hold with the delayed deadline date. With virtually every comment, Powell tilted decidedly hawkish.

There were two other items of note from outside the statement. First, as was previously announced, starting tomorrow the Fed will begin to pare back the pace at which they let Treasuries roll off the balance sheet. As of April, the Fed was reducing the size of the balance sheet by $50 billion per month, of which $30 billion came from Treasury securities and $20 billion from mortgage securities. Moving forward, reductions in Treasury securities will be cut in half to $15 billion a month. Mortgage securities will continue to be reduced at a rate of $20 billion per month. This will continue until October, at which point the Fed will stop balance sheet reductions. Mortgage securities will continue to roll off at a pace of $20 billion per month, but those proceeds will be invested into Treasury securities, keeping the balance sheet size the same and simply changing the composition of assets.

The second item of note was the announcement that the Fed is reducing the rate of interest paid on excess reserves (IOER) to 2.35% from 2.40%. Before the press conference began, the financial media was pointing to this change as a sign the Fed is preparing for a rate cut. Cue Powell once again, stating that the change to the IOER rate is in no way representative of a change in policy stance. In December of last year, the Fed increased the Fed funds rate 25 basis points but only moved the IOER higher by 20 points, essentially making the same 5 point cut announced today. These are simply tweaks as the Fed learns how best to manage rates with large excess reserves in the system.

We don't anticipate a rate hike (and certainly not a rate cut) at the June meeting, but we will be eagerly awaiting the Fed's updated economic projections – the so called "dot plots." Any change in rate expectations should be towards higher rates. And remember, the March Fed forecasts showed eleven members expecting rates to remain unchanged this year, four members expected one hike before year-end, while two members expected two hikes in 2019. In sharp contrast, the markets – even after today's statement and the press conference – are pricing in a 50%+ chance of a cut this year, with zero chance of a hike. That is absurd.

The data continue to show an economy that warrants further hikes. And if the 10-year Treasury rate moves above 3%, we expect we will get one. That's not to say the pouting pundits will change their tone (or ever admit they were wrong), but those who zone them out are likely to be rewarded. Just as they have been these past ten years.

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Text of the Federal Reserve's Statement:

Information received since the Federal Open Market Committee met in March indicates that the labor market remains strong and that economic activity rose at a solid rate. Job gains have been solid, on average, in recent months, and the unemployment rate has remained low. Growth of household spending and business fixed investment slowed in *the first quarter. On a 12-month basis, overall inflation and inflation for items other than food and energy have declined and are running below 2 percent. On balance, market-based measures of inflation compensation have remained low in recent months, and survey-based measures of longer-term inflation expectations are little changed.*

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. In support of these goals, the Committee decided to maintain the target range for the federal funds rate at 2-1/4 to 2-1/2 percent. The Committee continues to view sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective as the most likely outcomes. In light of global economic and financial developments and muted inflation pressures, the Committee will be patient as it determines what future adjustments to the target range for the federal funds rate may be appropriate to support these outcomes.

In determining the timing and size of future adjustments to the target range for the federal funds rate, the Committee will assess realized and expected economic conditions relative to its maximum employment objective and its symmetric 2 percent inflation objective. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments.

Voting for the FOMC monetary policy action were: Jerome H. Powell, Chair; John C. Williams, Vice Chair; Michelle W. Bowman; Lael Brainard; James Bullard; Richard H. Clarida; Charles L. Evans; Esther L. George; Randal K. Quarles; and Eric S. Rosengren.