First Trust
ECONOMIC RESEARCH REPORT

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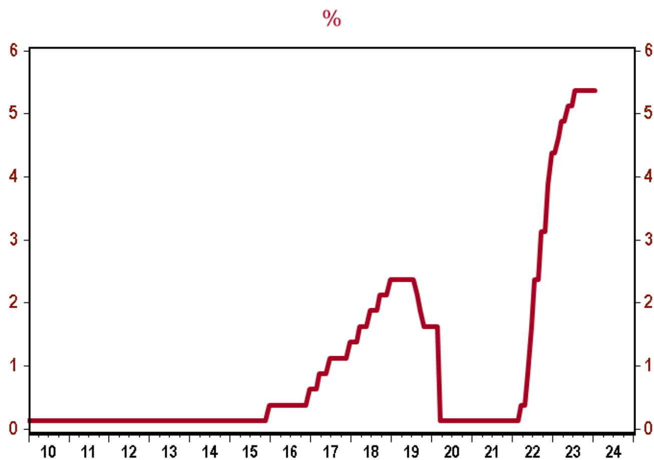
May Day

Rate hikes are in the rearview mirror, now the issue is when the Federal Reserve starts to cut.

The Fed didn't change short-term interest rates today, nor did it alter the pace of Quantitative Tightening, but it did use both the statement and Chair Powell's press conference to guide expectations for the path of normalization in the year ahead.

Starting with today's statement, there were a number of changes from December, including the removal of text about tight financial and credit conditions being likely to weigh on economic activity, and the addition of new text that the "Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent." And while inflation remains the central focus, the Fed highlighted that the balance of risks between the inflation and employment goals are coming into better balance.



This is understandable, given that inflation is trending down. The Consumer Price Index rose 3.4% in 2023, versus a 6.5% rise in 2022, while unemployment has slowly crept higher. But much of the improvement in last year's inflation readings was due to energy, which has declined 2.0% in the past twelve months. The Core CPI is still up a worrisome 3.9% from a year ago compared to 5.7% in 2022, and we believe the Fed is likely to have more trouble getting broad measures of inflation, like the CPI, through the final stretch than it has had in bringing inflation down over the past year.

That said, Powell comments during today's press conference sang a more confident tune. He stated that incoming data has been in-line with what the Fed wants to see to start the rate cut process, and they don't have reason to expect the positive progression of inflation data will shift in the months ahead. The Fed's reason for remaining on pause is that they simply want to see the trend continue for a longer period to build "greater confidence" they will hit – and sustain – their 2.0% inflation target. When asked if that confidence could come by the next meeting in March, Powell responded that he doesn't think the committee will have broad confidence that soon, suggesting May is very likely to be the start of the cut cycle.

In our opinion. the Fed's primary focus should be on not cutting rates too aggressively or prematurely, which could re-ignite the inflation problem like the Fed did on multiple occasions under Chairman Arthur Burns in the 1970s. The economy is still growing, but we think it falls into recession before the year is out and that real GDP growth significantly lags the predictions of the FOMC members. Given that the Fed has now signaled 75 bps in rate cuts even in an environment of moderate growth, if we are right about slower growth, it will be very difficult for the Fed to resist generating higher inflation in 2025 and beyond.

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Text of the Federal Reserve's Statement:

Recent indicators suggest that economic activity has been expanding at a solid pace. Job gains have moderated since early last year but remain strong, and the unemployment rate has remained low. Inflation has eased over the past year but remains elevated.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. The Committee judges that the risks to achieving its employment and inflation goals are moving into better balance. The economic outlook is uncertain, and the Committee remains highly attentive to inflation risks.

In support of its goals, the Committee decided to maintain the target range for the federal funds rate at 5-1/4 to 5-1/2 percent. In considering any adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks. The Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent. In addition, the Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities, as described in its previously announced plans. The Committee is strongly committed to returning inflation to its 2 percent objective.

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Thomas I. Barkin; Michael S. Barr; Raphael W. Bostic; Michelle W. Bowman; Lisa D. Cook; Mary C. Daly; Philip N. Jefferson; Adriana D. Kugler; Loretta J. Mester; and Christopher J. Waller.

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