

This week's edition of "Three on Thursday" looks at where short-term interest rates in the U.S. could be heading in 2024. Inflation has continued to trend down, while unemployment has remained low and the economy has continued to grow, meaning rate hikes are a thing of the past. Chairman Powell, in the January U.S. Federal Reserve (Fed) press conference, mentioned that the incoming data aligns with the Fed's criteria to initiate rate cuts. However, the Fed remains cautious, desiring an extended period of lower inflation to bolster confidence in achieving their 2% inflation target. With Chairman Powell all but ruling out a March rate cut, attention now shifts to when the Fed will commence cuts and how many cuts will unfold throughout the year. There exists a significant gap between the market's expectations and the Fed's projections for the number of cuts. To gain a little more context, we present the three tables and charts below.

### FOMC Participants' Economic Projections (%)

	Median		Central Tendency*		Range**	
	2024	2025	2024	2025	2024	2025
Change in real GDP	1.4	1.8	1.2–1.7	1.5–2.0	0.8–2.5	1.4–2.5
Unemployment rate	4.1	4.1	4.0–4.2	4.0–4.2	3.9–4.5	3.8–4.7
PCE inflation	2.4	2.1	2.2–2.5	2.0–2.2	2.1–2.7	2.0–2.5
Core PCE inflation	2.4	2.2	2.4–2.7	2.0–2.2	2.3–3.0	2.0–2.6

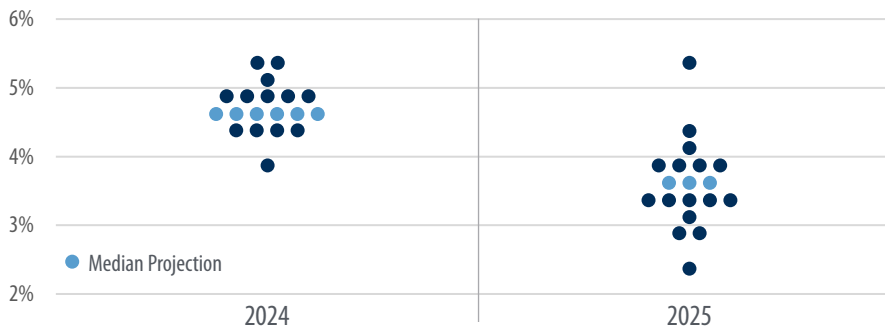
Source: Federal Reserve, First Trust Advisors. Estimates as of 12/13/23.

\*The central tendency excludes the three highest and three lowest projections for each variable in each year.

\*\*The range for a variable in a given year includes all participants' projections for that variable, from lowest to highest.

The Federal Open Market Committee (FOMC) convenes at eight scheduled meetings annually. During four of these meetings (March, June, September, and December), they release their Summary of Economic Projections (SEP). In this report, participants submit their projections for real GDP growth, unemployment, and inflation. The latest available SEP, from the December 2023 meeting, indicates a median forecast for real GDP growth at 1.4% from Q4 2023 to Q4 2024. Both "core" Personal Consumption Expenditures (PCE) inflation (excluding food and energy) and overall PCE inflation are projected to be 2.4% over the same period. Unemployment is expected to average 4.1% in the fourth quarter of 2024. These forecasts collectively suggest sustained growth with a trend towards lower inflation.

### FOMC Participants' Assessments of Appropriate Monetary Policy: "Dot Plot"



Source: Federal Reserve, First Trust Advisors. Estimates represent midpoint of target range or target level for the Fed Funds rate. Estimates as of 12/13/23.

Additionally, within the SEP, FOMC participants evaluate their expectations for the appropriate monetary policy in the upcoming year, outlining where they anticipate the Fed Funds rate to conclude each year. Based on the most recent data available as of the December meeting, the median forecast suggests three rate cuts by the end of 2024. This would bring the Fed Funds rate down to a range of 4.5% to 4.75% from its current range of 5.25% to 5.50%. Projections for year-end vary, ranging from two participants foreseeing no change in rates in 2024 to one participant anticipating a substantial six rate cuts.

### Market Implied Probabilities for Federal Funds

FOMC Meeting Dates	Federal Funds Range (bps)								Implied Meeting Outcome
	350-375	375-400	400-425	425-450	450-475	475-500	500-525	525-550	
3/20/2024	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	16.50%	<b>83.50%</b>	Stay
5/1/2024	0.00%	0.00%	0.00%	0.00%	0.00%	9.60%	<b>55.40%</b>	35.10%	Cut
6/12/2024	0.00%	0.00%	0.00%	0.00%	8.20%	<b>48.60%</b>	38.10%	5.20%	Cut
7/31/2024	0.00%	0.00%	0.00%	6.90%	<b>42.40%</b>	39.70%	10.20%	0.80%	Cut
9/18/2024	0.00%	0.00%	6.20%	38.90%	<b>39.90%</b>	13.10%	1.70%	0.10%	Stay
11/7/2024	0.00%	3.80%	26.10%	<b>39.50%</b>	23.60%	6.20%	0.70%	0.00%	Cut
12/18/2024	2.60%	19.20%	<b>35.40%</b>	28.60%	11.60%	2.40%	0.20%	0.00%	Cut

Source: CME Group, First Trust Advisors. Probabilities implied by 30-Day Fed Funds futures pricing data. Estimates as 2/8/24. Orange highlighted cell represents projected Federal Funds Rate at that meeting date

In our view, the FOMC's median projection of three rate cuts in 2024 aligns with their overall economic outlook, indicating a trajectory toward a soft landing without a recession. However, the market has also embraced this soft-landing scenario, but anticipates five rate cuts this year. Notably, just before Chairman Powell's press conference last week, the market anticipated six cuts with the first starting in March. Current expectations point to the first rate cut in May. If the economy remains healthy and keeps growing, it is very hard to imagine the Fed cutting short-term interest rates by the 125 basis points the market expects. We believe the Fed will cut interest rates six times this year, but due to a (mild) recession while inflation continues to decline.

There is no guarantee that past trends will continue, or projections will be realized.

This report was prepared by First Trust Advisors L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.