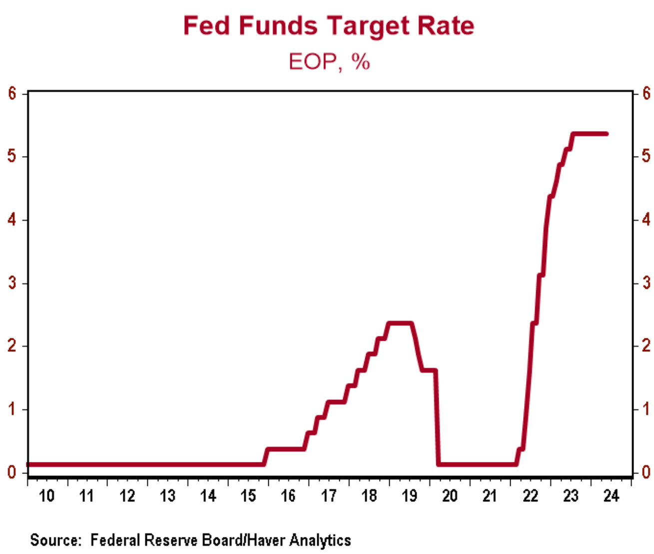
First Trust
ECONOMIC RESEARCH REPORT
Andrew Opdyke, CFA – *Senior Economist*
Robert Stein, CFA – *Dep. Chief Economist*
Brian S. Wesbury – *Chief Economist*
May 1, 2024 • 630.517.7756 • www.ftportfolios.com

A Lack of Confidence

No shortage of things to discuss after today's Fed statement and subsequent press conference. While the Fed did not cut rates – and nobody expected them to – today's focus was on how the Fed would respond to the turn higher in inflation to start 2024. But for all the questions, there was a distinct lack of clear answers.

Let's look first at today's Fed statement, which included more changes than usual. In particular, a new sentence was added noting that "there has been a lack of further progress towards the Committee's 2 percent inflation objective".



Meanwhile, although the Fed did not cut rates today – or even signal they are considering doing so any time soon – they did take what could be considered easing action in the form of an announced slowdown in the pace of quantitative tightening (QT). Starting in June, the Fed will reduce the monthly cap on Treasury redemptions from $60 billion per month down to $25 billion per month, while keeping the redemption cap of agency debt and agency mortgage-backed securities at $35 billion per month.

Why slow the pace of balance sheet normalization at the same time they state that progress toward lower inflation has stalled? During today's press conference Powell made clear that the Fed views rates as the Fed's primary tool in battling inflation, and the moderation in the pace of QT is meant to reduce financial market risks as they normalize their balance sheet (it should be noted – the Fed does NOT expect that their balance sheet will now end at a higher level with the reduced monthly roll-off, only that it will take them longer to get to "normal").

Throughout the press conference, Powell was peppered with questions on the chance further hikes could be needed. While not definitively ruling a hike out, Powell was very clear that the Fed believes that the current monetary policy is already tight enough to get inflation lower, and they anticipate the next move will be a cut. How long do we have to wait for that cut? Nobody – certainly not the Fed – knows. As it stands today, we would rule out June for a cut, barring a significant deterioration in the economy. July could also prove too soon for sufficient confidence to build. If that's the case, the Fed's path towards three rate cuts as projected in their March dot plots means cuts at each of the last three meetings in 2024. More likely – and unless economic weakness shows its head – the Fed will keep rates higher for longer than they have been forecasting for 2024.

Better a hawkish Fed than a dovish Fed until the inflation battle is won. The potential for reigniting inflation through action that is too early or too aggressive, as the Fed showed on multiple occasions under Chairman Arthur Burns in the 1970s, is not a risk they should be willing to take. The economy is still growing, and while we think the risk of recession is higher than market participants are currently pricing in, it is simply too soon for Fed action.

Brian S. Wesbury, *Chief Economist*
Robert Stein, *Deputy Chief Economist*

Text of the Federal Reserve's Statement:

Recent indicators suggest that economic activity has continued to expand at a solid pace. Job gains have remained strong, and the unemployment rate has remained low. Inflation has eased over the past year but remains elevated. In recent months, there has been a lack of further progress toward the Committee's 2 percent inflation objective.

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 have moved toward better balance over the past year. 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. Beginning in June, the Committee will slow the pace of decline of its securities holdings by reducing the monthly redemption cap on Treasury securities from $60 billion to $25 billion. The Committee will maintain the monthly redemption cap on agency debt and agency mortgage-backed securities at $35 billion and will reinvest any principal payments in excess of this cap into Treasury securities. 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.