First Trust
ECONOMIC RESEARCH REPORT
Andrew Opdyke, CFA – *Senior Economist*
Robert Stein, CFA – *Dep. Chief Economist*
Brian S. Wesbury – *Chief Economist*
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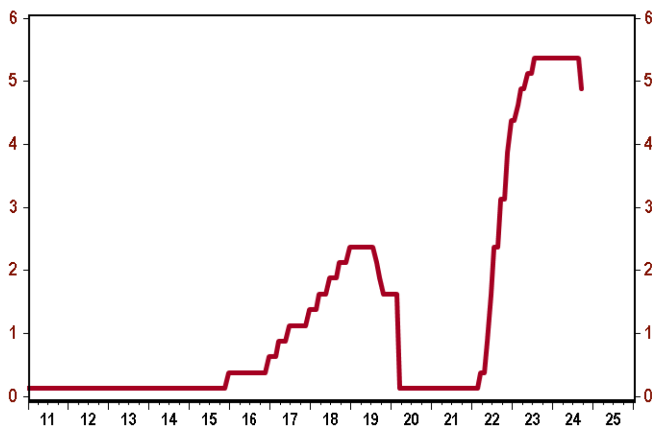
And We're Off!

The Fed began the process of rate cuts today, and they came out not with a whimper, but with a bang, cutting rates by 0.5% (50 basis points). Following the June meeting, Fed members forecast it would be appropriate to cut rates once – by 25 basis points (bps) – in 2024. Three months on, they have already surpassed those expectations, and forecast further cuts before the year is through.

So what has changed? Today's statement saw a number of alterations from the August meeting. Beyond the language surrounding today's rate cut, the Fed tempered language around the labor market and were intentional in highlighting that they view the balance of risks between inflation and employment as now roughly equal. Meanwhile the committee has gained "greater confidence" that inflation is moving steadily toward its 2.0% inflation target, justifying today's actions. It's notable that there was a dissent in today's vote – the first vote against a Fed action since 2005 – as Fed Board Governor Michelle Bowman preferred to cut rates today by 25 bps. That said, all nineteen voting members – including Bowman – forecast that rates should be cut to at least today's level by year end.



Today's statement was accompanied by updated economic projections from Fed members (the so-called "Dot Plots") which were consistent with rate cuts. The unemployment rate is now expected to end the year at 4.4% (in June Fed members were forecasting 4.0%), while PCE inflation expectations have fallen from 2.6% on a year-ago basis down to 2.3%. Weaker employment growth and a faster moderation in inflation add to a more robust reaction from the Fed.

When looking at the pace of anticipated rate cuts moving forward, today's accelerated start looks like a front-loading of cuts that were previously expected. Fed members signaled expectations for 50 bps of further cuts before this year is through, likely 25 bps at each of their two remaining meetings. For 2025, the Fed anticipates a total of 100 bps of cuts, the same number of cuts they signaled back in June. In 2026, the June forecast for another 100 bps of cuts is now down to 50bps. So more now, less later. On net, the Fed is signaling a steady pace of cuts from here, barring any substantive shift in the data.

During the press conference, Powell was peppered with questions related to the concerns over a slowing labor market, the Fed falling behind the curve, and what the Fed would need to see to be convinced 50 bp+ cuts should continue at future meetings. While Powell responded by reinforcing the Fed's data dependence and downplayed current labor market conditions as anything to be concerned about, we remain concerned that the Fed – and the markets – are watching the wrong data.

The money supply remains the most important indicator on the path forward. The M2 measure of money has been rising at a gradual pace after falling into contraction territory for much of 2022-23, and how M2 growth progresses from here will dictate if the Fed has room for further rate cuts or sees a re-acceleration of inflation as was seen when the Fed declared a premature victory on inflation back in the 1970's. If M2 growth remains modest, both inflation and economic growth will slow, but the Fed will have room to continue cuts. If, however, rate cuts lead to a rapid rise in M2 growth, the Fed has shown an active neglect of the warning signs that would have preempted this inflation debacle to begin with. We will continue to watch – and report – on the money supply, and the ongoing ramifications it has on the economy as a whole.

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 slowed, and the unemployment rate has moved up but remains low. Inflation has made further progress toward the Committee's 2 percent objective but remains somewhat elevated.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. The Committee has gained greater confidence that inflation is moving sustainably toward 2 percent, and judges that the risks to achieving its employment and inflation goals are

roughly in balance. The economic outlook is uncertain, and the Committee is attentive to the risks to both sides of its dual mandate.

In light of the progress on inflation and the balance of risks, the Committee decided to lower the target range for the federal funds rate by 1/2 percentage point to 4-3/4 to 5 percent. In considering additional 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 will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities. The Committee is strongly committed to supporting maximum employment and 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; Lisa D. Cook; Mary C. Daly; Beth M. Hammack; Philip N. Jefferson; Adriana D. Kugler; and Christopher J. Waller. Voting against this action was Michelle W. Bowman, who preferred to lower the target range for the federal funds rate by 1/4 percentage point at this meeting.

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.