First Trust
Monday Morning OUTLOOK

Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – *Dep. Chief Economist*
Strider Elass – *Senior Economist*
Andrew Opdyke, CFA – *Senior Economist*
Bryce Gill – *Economist*
Nate Gerze, CFA – *Economic Analyst*

630-517-7756 • www.ftportfolios.com April 14, 2025

Time to Cut Rates

Quantitative Easing was different during COVID than during the Financial Panic of 2008. During COVID, M2 growth soared, while it was held back during the Financial Panic by much tighter liquidity controls on banks. That's why we were among the first and very few who predicted much higher inflation due to COVID policies.

After that, we remained wary of loosening monetary policy too aggressively because we feared that, in spite of a drop in inflation, inflation remained above the Federal Reserve's 2.0% target and the embers of higher inflation could be rekindled quickly if the Fed were too hasty.

But recent inflation reports suggest some *modest* room for loosening monetary policy, including a reduction in short-term interest rates. In spite of some new tariffs, consumer prices declined 0.1% in March, the largest decline for any month since the early days of COVID. As a result, consumer prices were up only 2.4% in March versus a year ago and it looks like the Fed's preferred measure (PCE prices) is up about 2.2% in March compared to a year ago, which is very close to the 2.0% target.

Yes, we are still above 2.0%, but monetary policy operates with long and variable lags. So, if we maintain a monetary policy tight enough to bring inflation down to 2.0%, and if we also wait until inflation hits 2.0% before ending that tighter monetary regime, then we are almost guaranteeing that inflation will fall short of that 2.0% target for some period of time and could raise medium-term recession risk.

The same M2 measure of money that signaled high inflation several years ago is only up 3.9% in the past year. By contrast, M2 grew at about a 6.0% annual rate in the ten years before COVID, and that was during a period when PCE inflation averaged 1.5% per year. In other words, there's a case to be made that monetary policy should be looser so that M2 could grow faster than it has in the past year.

Unlike some other analysts and investors, we are not concerned that tariffs will lead to much higher inflation, as inflation ultimately depends on monetary policy, not tariff or tax rates. Yes, tariffs could increase the price of the particular items being tariffed. But that means less money would be left over to buy other goods and services, so demand – and prices – typically fall, leaving the overall price level roughly the same as it would be in the absence of tariffs.

However, tariffs could temporarily depress economic growth as they leave consumers and businesses with less to spend on domestically produced goods and services. In theory, tariffs mean producers should shift some of their output toward being made in the US, but in the short-term businesses may balk at such a shift if they think the tariffs will just be repealed soon anyhow. In other words, if we are going to impose tariffs, it's better to impose a tariff system that's sustainable than one that changes year to year, much less week to week or day to day.

On balance, that suggests some modest room for the Fed to cut short-term rates when it meets in May, although we think the Fed will probably kick the can down the road and make the decision in June.

Don't get us wrong; we are not changing our view that inflation remains a long-term problem that the Fed must be prepared to fight. We expect inflation to average 2.5%+ in the next ten years, not the 1.5% like it did pre-COVID. But short-term risks are to the downside, and we think the Fed should temporarily focus on that.

We also think it's important for the Fed to move gradually. The US dollar has weakened lately, and, as a result, there is little case for a *drastic* loosening of monetary policy. The Fed could let up somewhat on bank regulations and capital requirements, which would help the struggling bond market. And one or two rate cuts would not be excessive.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
4-15 / 7:30 am	Empire State Mfg Survey – Apr	-12.0	**-2.7**		-20.0
7:30 am	Import Prices – Mar	0.0%	**0.0%**		+0.4%
7:30 am	Export Prices – Mar	0.0%	**+0.3%**		+0.1%
4-16 / 7:30 am	Retail Sales – Mar	+1.4%	**+1.5%**		+0.2%
7:30 am	Retail Sales Ex-Auto – Mar	+0.4%	**+0.4%**		+0.3%
8:15 am	Industrial Production – Mar	-0.2%	**-0.2%**		+0.7%
8:15 am	Capacity Utilization – Mar	78.0%	**77.9%**		78.2%
9:00 am	Business Inventories – Feb	+0.2%	**+0.2%**		+0.3%
4-18 / 7:30 am	Initial Claims – Apr 12	225K	**223K**		223K
7:30 am	Housing Starts – Mar	1.416 Mil	**1.414 Mil**		1.501 Mil
7:30 am	Philly Fed Survey – Apr	5.0	**10.9**		12.5