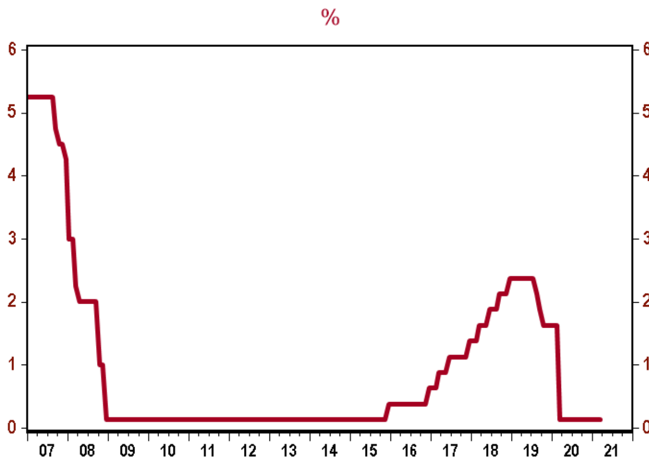
First Trust
ECONOMIC RESEARCH REPORT
Brian S. Wesbury – Chief Economist
Robert Stein, CFA – Dep. Chief Economist
Strider Elass – Senior Economist
Andrew Opdyke, CFA – Senior Economist

March 17, 2021 • 630.517.7756 • www.ftportfolios.com

The Fed Speaks Softly, But Carries Some Big Numbers

At its most recent meeting the Federal Reserve made no changes to monetary policy and minimal changes to its statement, simply acknowledging that some economic indicators have "turned up" recently while also noting that inflation remains below 2.0%.

Instead, the "action" from the Fed was in changes to its projections, including changes to the economic forecast as well as the number of policymakers who think the Fed will lift short-term interest rates in either 2022 or 2023. In particular, the Fed raised its forecast for real GDP growth this year to 6.5% versus a prior forecast of 4.2%, largely the result of the recently-enacted $1.9 trillion "stimulus" plan. In turn, higher real GDP translates into lower unemployment rate projections, including 4.5% at the end of 2021 (was 5.0%), 3.9% at the end of 2022 (was 4.2%), and 3.5% at the end of 2023 (was 3.7%). In addition, the Fed raised its forecast for PCE inflation this year to 2.4% versus a prior estimate of 1.8%.



As you'd expect, a forecast that includes faster real growth, lower unemployment, and faster inflation also includes more policymakers who foresee an earlier start to rate hikes. Back in December, only one policymaker thought the Fed would raise rates in 2022; now, four of eighteen officials think they'll raise rates at least once next year. Back in December, only five policymakers thought rates would be higher by the end of 2023; now, seven of eighteen foresee at least on rate hike by the end of that year.

Yes, that means a majority of monetary officials still think the first rate hike will be in 2024 or beyond. And now that the Fed has lifted its economic projections, the data have a higher hurdle to clear before the Fed will consider them worth changing the expected path of short-term interest rates.

However, there is still plenty of time for the Fed to change its mind and bring forward a first rate hike into 2023. The key issue will be inflation. The Fed expects 2.4% PCE inflation this year but then a decline to 2.0% in 2022. If, instead, inflation continues to rise in 2022, a rate hike in 2023 would be possible, maybe even a rate hike by the end of 2022.

Our view is that the Fed's new inflation forecast for 2021 is correct, but it will be surprised in 2022 by inflation's staying power. The M2 measure of the money supply has never grown as fast as it has in the past year and the federal government has helped keep incomes very high relative to production levels. Combined, these will push inflation higher than the Fed expects. The Fed still says no rate hikes until 2024. We think it's more likely sooner than that versus later.

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

Text of the Federal Reserve's Statement:

The Federal Reserve is committed to using its full range of tools to support the U.S. economy in this challenging time, thereby promoting its maximum employment and price stability goals.

The COVID-19 pandemic is causing tremendous human and economic hardship across the United States and around the world. Following a moderation in the pace of the recovery, indicators of economic activity and employment have turned up recently, although the sectors most adversely affected by the pandemic remain weak. Inflation continues to run below 2 percent. Overall financial conditions remain accommodative, in part reflecting policy measures to support the economy and the flow of credit to U.S. households and businesses.

The path of the economy will depend significantly on the course of the virus, including progress on vaccinations. The ongoing public health crisis continues to weigh on economic activity, employment, and inflation, and poses considerable risks to the economic outlook.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. With inflation running persistently below this longer-run goal, the Committee will aim to achieve inflation moderately above 2 percent for some time so that inflation averages 2 percent over time and longer-term inflation expectations remain well anchored at 2 percent. The Committee expects to maintain an accommodative stance of monetary policy until these

outcomes are achieved. The Committee decided to keep the target range for the federal funds rate at 0 to 1/4 percent and expects it will be appropriate to maintain this target range until labor market conditions have reached levels consistent with the Committee's assessments of maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time. In addition, the Federal Reserve will continue to increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage-backed securities by at least $40 billion per month until substantial further progress has been made toward the Committee's maximum employment and price stability goals. These asset purchases help foster smooth market functioning and accommodative financial conditions, thereby supporting the flow of credit to households and businesses.

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 public health, 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; Raphael W. Bostic; Michelle W. Bowman; Lael Brainard; Richard H. Clarida; Mary C. Daly; Charles L. Evans; Randal K. Quarles; and Christopher J. Waller.

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.