First Trust ECONOMIC RESEARCH REPORT

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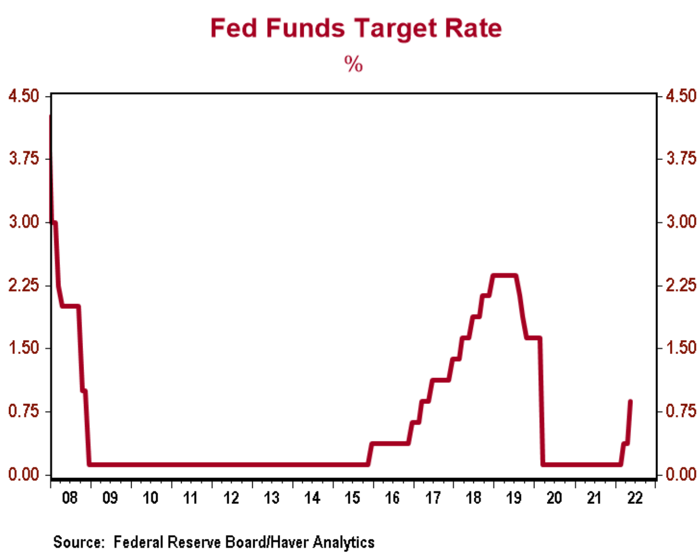
Jerome ~~Powell~~ Volcker

"Transitory" is out, "expeditious" is in. As most investors expected, the Fed raised short-term interest rates by half a percentage point (50 basis points) earlier today, leaving the range for the federal funds rate at 0.75 – 1.00%. The 50 bp rate hike was the largest at any one time since May 2000, near the peak of the first internet boom. And at least two more 50 bp hikes are likely at the meetings in June and July.

Prior to the meeting we had anticipated a half percentage point rate hike today, another half point in June, and at least an additional one percentage point in hikes spread over the four meetings in the second half of the 2022, with more to come in 2023. Chair Powell's press conference reinforced this view, noting that the Fed expects to have 50 basis point increases on the table for at least the next two meetings. However, when asked if a 75 basis point increase could be in the cards, Chair Powell said that is not something that the Fed is actively considering. Taken as a whole, we expect the path forward will bring the Feds Fund rate to at least 2.5% by year-end.



With regards to quantitative tightening, the Fed announced that reductions to the balance sheet will begin on June 1 at a pace of $47.5 billion per month, broken down to $30 billion per month of Treasury securities and $17.5 billion of mortgage-backed securities. On September 1 the pace of tightening will double to $95 billion per month, broken down to $60 billion in Treasuries and $35 billion of mortgage-backed securities, with the pace maintained for the foreseeable future.

Many have questioned if the Fed would flinch on hikes due to the Russia/Ukraine conflict, due to slower activity out of China, or due to last week's weak report on first quarter economic growth. Powell squashed those concerns repeatedly, stating the Fed has the resolve that it will take to bring inflation back down and the fundamentals to support action now. In a direct address to the American people, Powell said that inflation is far too high, demand is strong, unemployment is low, and households and business are in good financial strength. From their vantagepoint, interest rates are far from neutral, and need to be raised to address inflation.

While the Fed plans to act expeditiously and today's actions were a notable step forward, the Fed remains well behind the inflation curve. The Consumer price Index is up 8.5% from a year ago and the PCE Deflator – the Fed's preferred measure of inflation – is up 6.6% from a year ago, both the largest increases since the early 1980s. Yes, some of the rapid pace of inflation is due to volatile food and energy prices, but "core" inflation is also running unusually hot and rapid housing rent increases should keep inflation elevated the next few years even as the Fed becomes less loose and, eventually, tight.

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Text of the Federal Reserve's Statement:

Although overall economic activity edged down in the first quarter, household spending and business fixed investment remained strong. Job gains have been robust in recent months, and the unemployment rate has declined substantially. Inflation remains elevated, reflecting supply and demand imbalances related to the pandemic, higher energy prices, and broader price pressures.

The invasion of Ukraine by Russia is causing tremendous human and economic hardship. The implications for the U.S. economy are highly uncertain. The invasion and related events are creating additional upward pressure on inflation and are likely to weigh on economic activity. In addition, COVID-related lockdowns in China are likely to exacerbate supply chain disruptions. The Committee is highly attentive to inflation risks.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. With appropriate firming in the stance of monetary policy, the Committee expects inflation to return to its 2 percent objective and the labor market to remain strong. In support of these goals, the Committee decided to raise the target range for the federal funds rate to 3/4 to 1 percent and anticipates that ongoing increases in the target range will be appropriate. In addition, the Committee decided to begin *reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities on June 1, as described in the Plans for Reducing the Size of the Federal Reserve's Balance Sheet that were issued in conjunction with this statement.*

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; Michelle W. Bowman; Lael Brainard; James Bullard; Esther L. George; Patrick Harker; Loretta J. Mester; and Christopher J. Waller. Patrick Harker voted as an alternate member 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.