First Trust
ECONOMIC RESEARCH REPORT
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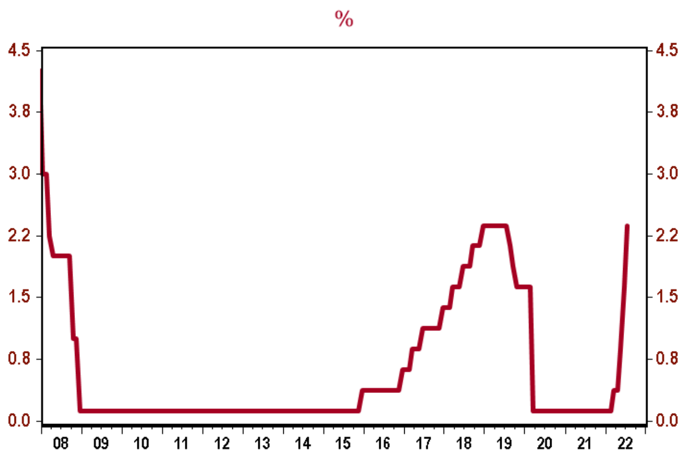
What Wasn't Said

The Federal Reserve unanimously voted to raise rates by three-quarters of a percentage point - 75 basis points (bps) - today, bringing the target for the federal funds rate to 2.25 – 2.50%, and signaled expectations for continued hikes in the months ahead. While today's meeting was not accompanied by updated forecasts from the Fed (the infamous dot plots), there were some notable comments on how Powell and Co. view the current outlook.

Starting with the Fed statement, there was a softening of language around economic activity. Should this be considered a sign that the Fed believes the economy is in (or on the verge of) a recession? Not so fast. Powell explicitly stated during his press conference that he "does not think the U.S. is currently in a recession." Why? Performance is simply too strong in too many areas. Employment is robust, the unemployment rate stands near a 50-year low, and industrial production continues to expand. So while tomorrow's GDP release may show a negative print for a second consecutive quarter – the rule of thumb definition of a recession but not the official determinant – Powell is taking the release with a grain of salt. Given the tendency for GDP reports to be revised as more/better data is collected, we wouldn't put much weight on tomorrow's data either.



Source: Federal Reserve Board/Haver Analytics

Our biggest concern over today's Fed activities has nothing to do with what they published or said, but rather what they continue to ignore. The M2 money supply is and has been the biggest factor on inflation, yet Powell and the committee statement didn't mention it once, nor did any reporter ask a question on the topic. While the Fed meets again in late September, we care far more about the next release of M2 data on August 23rd. Thankfully, M2 growth has moderated through the first half of 2022, up at a modest 1.7% annual rate after double digit increases to start both 2020 and 2021, but the fact that the Fed hasn't made a slowdown in M2 growth their top priority heightens the risk that their tightening of monetary policy misses the mark and they continue to battle from behind the curve.

The bottom line is that it's good the Fed has prioritized the fight against inflation, but it remains overly optimistic in how quickly it will get inflation back under control, especially as they use a drill to hammer a nail. We expect a continuation of rate hikes through the remainder of this year, even if that pace moderates. The market is pricing in rate cuts early in 2023. Without clear signs of recession, that's unlikely to happen

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Text of the Federal Reserve's Statement:

Recent indicators of spending and production have softened. Nonetheless, job gains have been robust in recent months, and the unemployment rate has remained low. Inflation remains elevated, reflecting supply and demand imbalances related to the pandemic, higher food and energy prices, and broader price pressures.

Russia's war against Ukraine is causing tremendous human and economic hardship. The war and related events are creating additional upward pressure on inflation and are weighing on global economic activity. 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. In support of these goals, the Committee decided to raise the target range for the federal funds rate to 2-1/4 to 2-1/2 percent and anticipates that ongoing increases in the target range will be appropriate. In addition, the Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities, as described in the Plans for Reducing the Size of the Federal Reserve's Balance Sheet that were issued in May. 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 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; Michael S. Barr; Michelle W. Bowman; Lael Brainard; James Bullard; Susan M. Collins; Lisa D. Cook; Esther L. George; Philip N. Jefferson; Loretta J. Mester; and Christopher J. Waller.

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