First Trust
ECONOMIC RESEARCH REPORT

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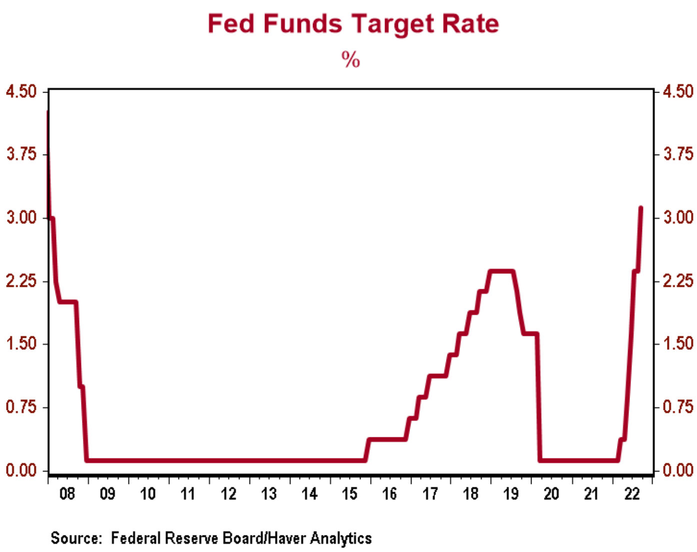
Another 75… With More to Come

The Federal Reserve once again voted unanimously to raise rates by three-quarters of a percentage point - 75 basis points (bps) - today, bringing the target for the federal funds rate to 3.00 – 3.25%, and signaled expectations for continued hikes ahead. Today's statement was also accompanied by updated forecasts from the Fed (the infamous dot plots), which show a more aggressive path of rate hikes through 2023.

The forecasts, however, were a very different story, with changes across the board. From an economic perspective, the Fed now sees growth slower, unemployment rising faster, and inflation running slightly higher through the remainder of 2022 and throughout 2023. This forces the Fed to make a choice, do they focus on supporting the weakening economic outlook, or prioritize the fight against inflation that stands at levels last seen nearly 40 years ago?



Today's dot plots show a notable shift higher in the expected path of rate hikes moving forward, with the Federal Funds Rate now forecast to end 2022 around 4.4%, a full percent above the June forecast of 3.4%. That suggests another 75-basis point hike is the most likely scenario at their next meeting in November, followed by a 50-point hike in December. And the Fed expects a single 25-point hike in 2023 – likely to start the year - before starting to ease policy in 2024.

While we much prefer Chair Powell to channel Paul Volcker rather than Arthur Burns, we have our reservations on the Fed's dealings. 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 Powell was questioned on the topic at a recent conference by the Cato Institute, he brushed the idea off and continued to push the same tired model of inflation drivers that have left the Fed well behind the curve and constantly revising forecasts higher.

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 the tools they have to tame inflation are like using a drill to hammer a nail. Follow the growth of M2 – which has thankfully slowed and must remain low for the foreseeable future – for guidance on the path forward from here.

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Text of the Federal Reserve's Statement:

Recent indicators point to modest growth in spending and production. 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 3 to 3-1/4 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.