First Trust ECONOMIC RESEARCH REPORT

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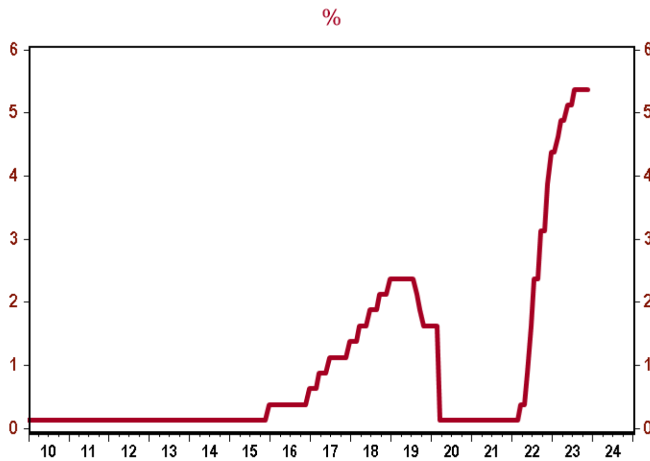
On Pause…For Now

The Fed kept rates unchanged at today's meeting, but whether they are done with rate hikes or simply at a pause is yet to be determined.

Today's Fed statement itself was mostly a copy/paste of September, with some minor wording changes noting that the economy is growing at a "strong" rather than "solid" pace, and employment gains have "moderated" rather than "slowed". The only new information came with the addition of "financial" conditions to previously noted credit conditions as factors weighing on household and business activity.

At the press conference, Chairman Powell noted two primary factors that seem to be weighing on Fed decision making. The first is the tightening in financial conditions, as higher rates on everything from mortgages to corporate borrowing will have an impact on activity moving forward. The second – and related – factor is that the Fed thinks the full effects of policy actions to-date have yet to be fully felt.



In our view, the Fed is watching the wrong metrics. It should be paying more attention to the money supply, which is signaling that it is already tight. The M2 measure has declined in eleven of the last fourteen months, has contracted 3.6% in the past year, and is down 4.4% off the peak in July of last year. Meanwhile, bank credit at commercial banks as well as their commercial and industrial loans are both flat to down. If this isn't tight, we're not sure what tight means.

It remains to be seen how quickly the reductions in the money supply will translate into inflation getting back to the Fed's 2.0% target, but the Fed has gained some traction against the inflation problem. Given time, the mission can be accomplished, but the Fed must remain patient. One of the biggest risks in the year ahead is the Fed jumping the gun on cuts should economic conditions deteriorate.

For now, each FOMC meeting remains "active," meaning the Fed is ready to raise rates further if the data suggests more work to be done. But without a clear path forward the looming geopolitical tensions, resumption of student loan payments, slowing economic and employment growth, and higher oil prices could make the Fed's path bumpy. History may show that the Fed finished rate hikes in July, but it will still be a while before they can call their mission complete.

Brian S. Wesbury, *Chief Economist*
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Text of the Federal Reserve's Statement:

Recent indicators suggest that economic activity expanded at a strong pace in the third quarter. Job gains have moderated since earlier in the year but remain strong, and the unemployment rate has remained low. Inflation remains elevated.

The U.S. banking system is sound and resilient. Tighter financial and credit conditions for households and businesses are likely to weigh on economic activity, hiring, and inflation. The extent of these effects remains uncertain. The Committee remains 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 maintain the target range for the federal funds rate at 5-1/4 to 5-1/2 percent. The Committee will continue to assess additional information and its implications for monetary policy. In determining the extent of additional policy firming that may be appropriate to return inflation to 2 percent over time, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments. In addition, the Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities, as described in its previously announced plans. 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 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; Lisa D. Cook; Austan D. Goolsbee; Patrick Harker; Philip N. Jefferson; Neel Kashkari; Adriana D. Kugler; Lorie K. Logan; and Christopher J. Waller

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