First Trust
ECONOMIC RESEARCH REPORT
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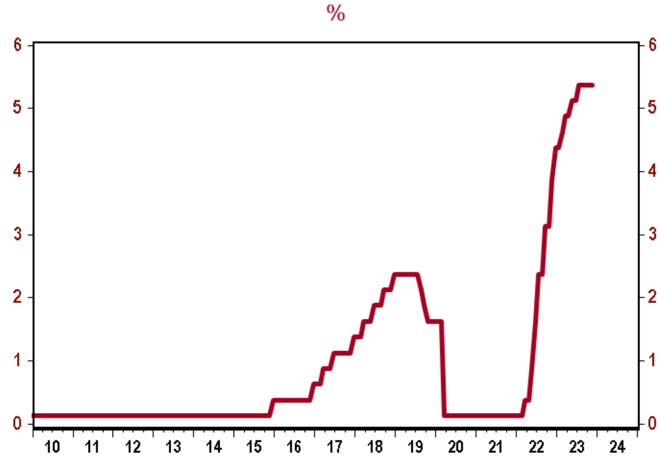
Fed Declares Mission Accomplished

The Federal Reserve declared victory today, projecting a soft landing as its base case in the years ahead, with more cuts in short-term rates, and with inflation gradually getting back to its 2.0% goal without a recession. Unfortunately, we think the Fed is declaring mission accomplished too early.

The Fed didn't change short-term interest rates today, nor did it alter the pace of Quantitative Tightening, but it made major changes to its projections for short-term interest rates. Not one policymaker on the Federal Open Market Committee thinks the short-term interest rate target will be higher a year from now than it is today, which is 5.375%. And while the median forecast from policymakers in September was one rate cut of 25 basis points in 2024, now the median projection is 75 bps. In turn, the median policymaker projects another 100 bps in rate cuts in 2025 and then another 75 bps in 2026.

Fed Funds Target Rate



Source: Federal Reserve Board/Haver Analytics

True, inflation is trending down. The Consumer Price Index is up 3.1% from a year ago versus a 7.1% in the year ending in November 2022. But much of the improvement is due to energy, which is down 5.4% in the past twelve months. The Core CPI is still up a worrisome 4.0% from a year ago compared to 6.0% in November 2022. In other words, the Fed is likely to have more trouble getting broad measures of inflation, like the CPI, back down to its goal than it has bringing it down in the past year or so.

Moreover, the Fed should be focused on not cutting rates too aggressively and prematurely, which could re-ignite the inflation problem like the Fed did on multiple occasions under Chairman Arthur Burns in the 1970s. The economy is still growing for now, but we think it falls into recession in 2024 and that real GDP growth significantly lags the 1.4% predicted by the FOMC. Given that the Fed has now signaled 75 bps in rate cuts even in an environment of moderate growth, if we are right about economic growth it will be very difficult for the Fed to resist generating higher inflation in 2025 and beyond.

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Text of the Federal Reserve's Statement:

Recent indicators suggest that growth of economic activity has slowed from its 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 has eased over the past year but 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 any 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.