First Trust
ECONOMIC RESEARCH REPORT
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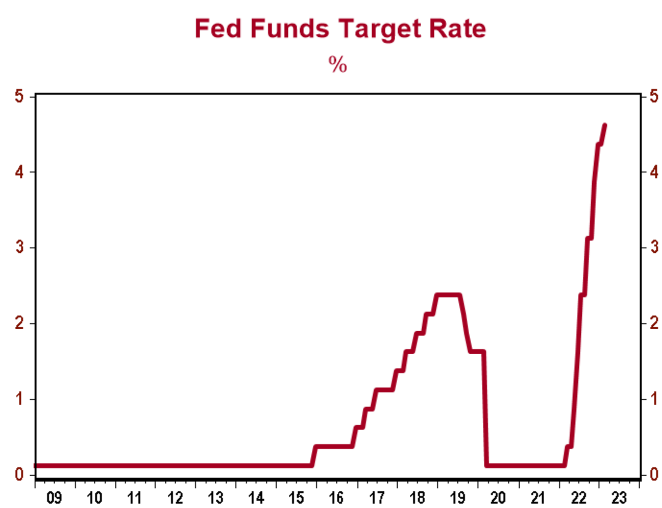
Slowing, Not Stopping

The Fed downshifted to a smaller rate hike to start 2023, but the job is far from done. As expected, the Fed raised rates by 25 basis points (bp) today, slowing from the 50bp hike in December, and the 75bp hikes at the four meetings before that. However, the Fed continued to reiterate that ongoing tightening is warranted and repeated the view that the risk to doing too little is greater than the risk of doing too much.

While we have to wait for March to get updated forecasts from the Fed (the dot plots), there were a number of changes to the Fed statement and Powell had plenty to talk about during his press conference.



Source: Federal Reserve Board/Haver Analytics

If you only saw today's statement announcing the Fed's move, the primary takeaway would be a shift toward a more dovish tone. Instead of focusing on the factors causing inflation to stay elevated, the Fed introduced new text that inflation pressures have started to ease. And gone is commentary about the ongoing Russian/Ukraine conflict contributing to inflationary pressures, which is now replaced with a note that the conflict is keeping global uncertainty elevated. Finally, with the size of today's rate hike down to 25bp, text was changed to shift the attention from the pace of hikes to the extent of future hikes. In other words, the Fed's focus is now on finding the finish line.

Then the press conference started. Chair Powell started dovish stating that it is "gratifying" to see disinflation starting to show in the data, and acknowledging that softening in wage pressures is a positive sign for future inflation, but he then tempered those remarks by reinforcing his belief that there is more work to be done. What has the Fed concerned is that non-housing service inflation remains unusually high. Until this metric turns, the Fed will not feel comfortable claiming victory and backing off.

Nick Timiraos – the Wall Street Journal's Fed reporter who many watch as an unofficial mouthpiece for Powell and Co. – asked the question that many have been thinking. Can the Fed simply pause at the current level of rates and watch to see how that flows through to inflation prints in the months ahead? Powell responded by saying the Fed thinks the greatest risk – and the most difficult situation for the Fed to manage – is in not doing enough and seeing inflation reaccelerate. If the Fed overshoots on tightening and inflation comes down faster and further than anticipated, the Fed has far more tools available to ease policy. Victory over inflation is priority #1.

It's good the Fed has prioritized the fight against inflation, but the necessary path to get there will likely bring volatility to the financial markets. While markets have rallied to start the year, we expect the party to end once they realize how much the economy will slow due to the decline in the M2 measure of the money supply since early last year. That economic medicine, while bitter, is part of the price we pay for the policy mistakes in 2020-21. And we are still amazed at how little attention the Fed and journalists give the money supply.

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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 has eased somewhat but remains elevated.

Russia's war against Ukraine is causing tremendous human and economic hardship and is contributing to elevated global uncertainty. 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 4-1/2 to 4-3/4 percent. The Committee anticipates that ongoing increases in the target range will be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent over time. In determining the extent of future increases in the target range, 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; Lael Brainard; Lisa D. Cook; Austan D. Goolsbee; Patrick Harker; Philip N. Jefferson; Neel Kashkari; Lorie K. Logan; and Christopher J. Waller.