

Burns or Volcker?

We get a big bunch of data reports this week: GDP revisions and economy-wide corporate profits for the first quarter; durable goods, new home sales, personal income, and consumer spending for May; home prices for April. Throw in some regional manufacturing reports for June by various Federal Reserve Banks. In other words, by the end of the week, we should know more about the recent underlying trends in the economy.

But the one report we will be following the most is the one that might get the least media and investor attention: the Fed's report on Tuesday about the money supply. No matter how you slice – M1, M2, or M3 – the key measures of the money supply have all been falling lately.

In turn, this means the Fed has been tight. It remains to be seen how quickly this tightness can get inflation back down to the Fed's 2.0% target, but that's where it would ultimately head if these measures of money remain in decline. Hence our focus on Tuesday's report, where we will see whether monetary policy has stayed as tight as it's been the past few months.

Meanwhile, for those still focused on short-term interest rates, back on June 14 the Fed tried to have its cake and eat it, too, when policymakers decided to refrain from raising rates but, at the same time, signaled two more quarter-point rate hikes later this year.

The most absurd part of all this is that the decision was unanimous; literally not one policymaker dissented from this "split the baby" tactic. We say it's absurd because have you ever known even just two economists or policymakers to agree on everything? And yet the Fed is trying to represent itself as an organization with no alternative thoughts or narratives, as if it were part of the government of North Korea or the old Soviet Union.

Either way, while we recognize the absurdity of the Fed unanimously supporting skipping a rate hike while signaling two more later on this year, we think the Fed is likely to follow through on its projections of two more rate hikes. We are forecasting that when all is said and done that the economy ends up a little weaker than the Fed expects this year, but inflation stays higher than the Fed thinks. Combined, if we are right, that should keep the Fed on track to raise rates as it recently projected.

Another factor that might get the Fed back to raising rates in July is that the UK inflation problem remains acute. The UK version of the consumer price index was still up 8.7% in the year ending in May, which has and will continue to keep the Bank of England in hiking mode, even if it leads to a major recession.

Ultimately Fed Chairman Powell has a decision to make: would he prefer to be remembered like Arthur Burns or Paul Volcker? Burns kept monetary policy too loose and let inflation reignite; he was respected at the time but now his name is Monetary Mudd. Paul Volcker tightened monetary policy to what was then considered excruciating levels in the early 1980s. Despised by many at the time, he's now considered a great leader at the Fed, the slayer of the inflation dragon that Burns let loose.

Making the decision even harder for Powell is that we are on the cusp of a presidential election year, which means all the moves the Fed makes (or refrains from making) will be seen through the prism of him trying to help one political side or the other. A recession in 2024 could tempt Powell to turn into Burns, but maybe, just maybe, he will be Volcker, instead.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
6-27 / 7:30 am	Durable Goods – May	-0.8%	0.0%		+1.1%
7:30 am	Durable Goods (Ex-Trans) – May	0.0%	+0.2%		-0.3%
9:00 am	New Home Sales – May	0.675 Mil	0.702 Mil		0.683 Mil
6-29 / 7:30 am	Initial Claims – Jun 24	265K	260K		264K
7:30 am	Q1 GDP Final Report	+1.4%	+1.5%		+1.3%
7:30 am	Q1 GDP Chain Price Index	+4.2%	+4.2%		+4.2%
6-30 / 7:30 am	Personal Income – May	+0.3%	+0.4%		+0.4%
7:30 am	Personal Spending – May	+0.2%	+0.2%		+0.8%
8:45 am	Chicago PMI – Jun	43.5	42.1		40.4
9:00 am	U. Mich Consumer Sentiment – Jun	63.9	63.9		63.9