First Trust

ECONOMIC RESEARCH REPORT

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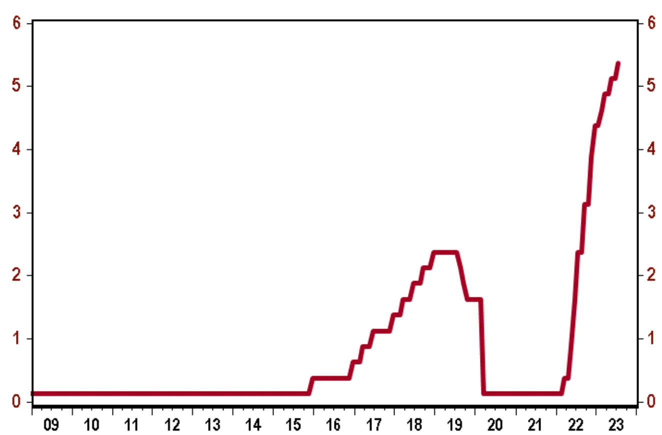
Time Will Tell

Anyone hoping for excitement from today's Fed statement was severely disappointed. As expected, the federal funds rate was lifted 25 basis points (bps) to a range of 5.25 to 5.50%. With the exception of the rate hike and slight wording changes – the "modest" pace of economic growth strengthened slightly to "moderate" – today's statement was a virtual carbon copy of the mid-June release.

It's worth noting that, while the Fed did not release new economic forecasts today, the economy has progressed largely in-line with what the Fed projected back in June. At that meeting, the Fed forecast it would be appropriate to raise rates two more times before year end. The first of those two hikes came today, and there is little reason to believe their view on the path forward has shifted.



During today's press conference, Chair Powell faced a barrage of questions trying to get a hint on the timing for the next rate move or guidance on when the job will be done, but Powell stuck firm to the Fed's data dependent mantra. Powell said that between now and the Fed's next meeting in September there will be two more employment reports, two more CPI reports, and a report on employment costs. Markets will be watching them closely to figure out whether the Fed will raise rates again in September.

If the Federal Reserve were paying close attention to the money supply, it would know that monetary policy is already tight. While M2 rose modestly in May and June following nine consecutive months of decline, the money supply has contracted 3.6% in the past year. Meanwhile, bank credit at commercial banks as well as their commercial and industrial loans are both 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. And yet, once again, the Fed uttered not one peep about the money supply in its policy statement, nor did any journalist broach the topic.

It's like the Fed has been operating in a fog without the appropriate tools to guide their way. Focus on supply chain disruptions, the level of the federal funds rate, consumer and business surveys, and inflation expectations had the Fed late to act and constantly adjusting course since. Having abandoned its long tradition of implementing monetary policy through scarce reserves and imposing a new policy based on abundant reserves following the financial crisis, they made their mistakes harder to correct. Whether they can cross the inflation finish line before the economy goes into recession will depend on how quickly the reductions in the money supply effects the economy later this year. They have their work cut out for them.

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Text of the Federal Reserve's Statement:

Recent indicators suggest that economic activity has been expanding at a moderate pace. Job gains have been robust in recent months, and the unemployment rate has remained low. Inflation remains elevated.

The U.S. banking system is sound and resilient. Tighter 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 raise the target range for the federal funds rate to 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; Lorie K. Logan; and Christopher J. Waller.

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