First Trust
ECONOMIC RESEARCH REPORT
Andrew Opdyke, CFA – *Senior Economist*
Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – *Dep. Chief Economist*
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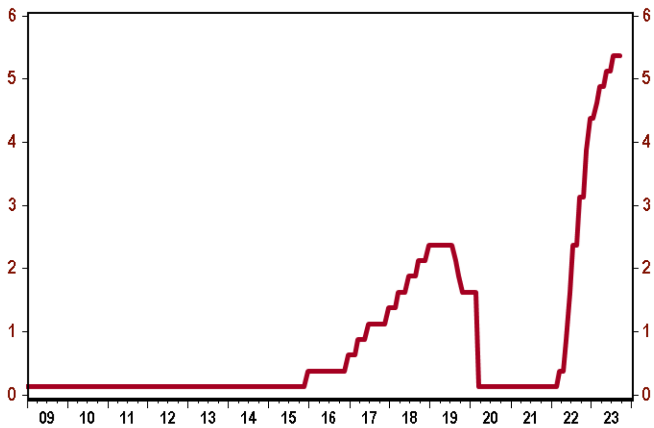
You Know It When You See It

While the Fed kept rates unchanged at today's meeting, between the press conference and forecast updates, Powell and Co. gave plenty of ammo to keep the financial press busy speculating about what may come at the next FOMC meeting this Fall.

Today's Fed statement itself was a non-event, with minor wording changes noting that the economy is growing at a "solid" rather than "moderate" rate, and employment gains have "slowed" but "remain strong". It's in the updated economic projections (the "dot plots") – which give a peek at how the Fed expects the economic and rate landscape to evolve moving forward – that things got interesting.

Fed Funds Target Rate

%



Source: Federal Reserve Board/Haver Analytics

The Fed upped its economic growth forecasts for this year and next to 2.1% and 1.5%, respectively, compared to June estimates of 1.0% and 1.1%. Along with stronger growth, the Fed projects a more modest rise in the unemployment rate to 3.8% (prior forecast of 4.1%) and slightly higher inflation of 3.3% (prior forecast of 3.2%). Interestingly, they lowered their forecasts for "core" inflation – which strips out the volatile food and energy components – to 3.7% for year-end 2023, and they have core inflation sitting at 2.6% by the end of 2024. We would take the over on that bet.

What do these outlook changes mean for the path of rates? One more rate hike is anticipated by the majority of policymakers before the end of the year, just as they forecasted in June, but they now believe that rates will then need to remain higher for longer. June projections showed a total of one hundred basis points (bps) of rate cuts anticipated by FOMC members in 2024, but that has now been revised to expected cuts of 50 bps. On balance the dot plots showed a more hawkish outlook.

During the press conference, questions revolved around how the Fed will determine if/when rates have become sufficiently restrictive and no further hikes are expected. Powell here channeled former Supreme Court Justice Potter Stewart's classic line that he will "know it when he sees it." In other words, the Fed does not have a high degree of confidence on when exactly the rate hike/cut process will be accomplished. They – by their own admission – have had a very difficult time forecasting how inflation and rates would unfold, and their models still aren't up to the task.

What makes this so frustrating is that the Fed – and the financial media who have the opportunity to ask questions during the Q&A session – refuse to even discuss the impacts of the money supply on the inflation ills of the past few years. If the Federal Reserve were paying close attention to the money supply, it would know that monetary policy is already tight. While M2 has risen modestly since April following nine-consecutive months of decline, the money supply has contracted 3.7% 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. Given time, the mission can be accomplished, but the Fed must remain patient. They waited far too long to start rate hikes; they shouldn't jump the gun on cuts.

For now, each FOMC meeting should be considered "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 government shutdown, resumption of student loan payments, slowing employment growth, and higher oil prices could cloud the Fed's vision as 2023 comes to a close. Where's the finish line? Nobody knows for sure, but we aren't there yet.

Brian S. Wesbury, *Chief Economist*
Robert Stein, *Deputy Chief Economist*

Text of the Federal Reserve's Statement:

Recent indicators suggest that economic activity has been expanding at a solid pace. Job gains have slowed in recent months but remain strong, 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 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.