First Trust ECONOMIC RESEARCH REPORT
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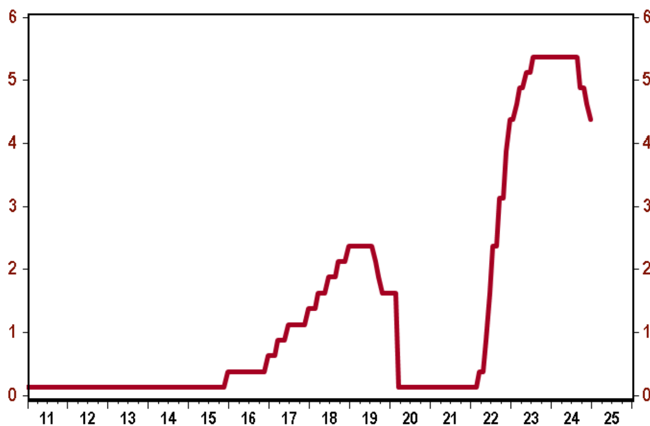
Where to From Here?

The Federal Reserve cut interest rates for the third time this year but signaled the path forward will likely be more gradual – and less certain – than previously forecast. The Fed cut by a quarter percentage point today, following on the half point cut in September and a quarter in November.

Today's statement saw very few alterations from the November meeting. Language was added that the Fed will consider "the extent and timing" of additional adjustments to interest rates, which Powell later clarified was meant to signal a slower pace of cuts moving forward. It is also worth noting that Cleveland Fed President Beth Hammack voted against today's rate cut, preferring instead to keep rates unchanged.

The Fed also released an updated Survey of Economic Projections (the "Dot Plots") showing their expectations on GDP, employment, inflation, and rates in the years ahead. Fed members paired back cut expectations in 2025, from four cuts forecast when projections were last released in September, to a more modest two cuts for 2025 projected today.



Justification for the slower pace of easing comes in the form of higher inflation expectations for 2025, with PCE prices now forecast to end this year at 2.4% and then rise in 2025 to 2.5% (back in September, the Fed forecast inflation to decline to 2.1% in 2025). Along with higher inflation expectations, the Fed is forecasting 2025 to see a slightly lower unemployment rate (now 4.3% from 4.4% in September) and slightly faster inflation-adjusted GDP growth (up to 2.1% from 2.0%).

Given the Fed has prioritized headline PCE prices as the best measure of inflation experienced by consumers – and with their forecasts today that these prices will rise, not fall, in the year ahead – it begs the question why the Fed believes that further rate cuts are warranted in 2025. The cooling labor market has brought the employment side of the Fed dual mandate into balance with inflation risks, and the Fed may be forced to choose if rising inflation trumps weaker jobs growth if (or when) push comes to shove.

During the press conference Powell was once again peppered with questions around how the election results and potential policy changes ahead have impacted their forecasts. In short, Powell stated that the election results have little impact on their short-term views. The Fed does not know what – or when – policy changes will be implemented under the new administration and has no plans to speculate.

What Powell didn't get much of in today's press conference was real pushback on the hard questions. Why has the Fed abandoned the "SuperCore" inflation metric they prioritized two years ago? Why has the Fed continued to ignore the money supply in their analysis when it outperformed virtually any other measure in predicting the inflation the Fed said would never occur? How is the Fed running operating losses of more than $100 billion per year and still paying for non-monetary research? We didn't expect any reporters to step up to the plate and press Powell, but these are questions that need answers.

The stage is set for an epic battle in Washington over the year ahead. Tax cuts and deregulation stand to boost businesses, while a clamping down on government excess could slow the outsized deficit spending that has propped up economic growth. What will we be watching? If M2 growth remains modest, both inflation and economic growth will slow, but the Fed will have room to continue cuts. If, however, rate cuts lead to a rapid rise in M2 growth, the Fed has shown an active neglect of the warning signs that would have preempted this inflation debacle to begin with.

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Text of the Federal Reserve's Statement:

Recent indicators suggest that economic activity has continued to expand at a solid pace. Since earlier in the year, labor market conditions have generally eased, and the unemployment rate has moved up but remains low. Inflation has made progress toward the Committee's 2 percent objective but remains somewhat elevated.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. The

Committee judges that the risks to achieving its employment and inflation goals are roughly in balance. The economic outlook is uncertain, and the Committee is attentive to the risks to both sides of its dual mandate.

In support of its goals, the Committee decided to lower the target range for the federal funds rate by 1/4 percentage point to 4-1/4 to 4-1/2 percent. In considering the extent and timing of additional adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks. The Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities. The Committee is strongly committed to supporting maximum employment and 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; Thomas I. Barkin; Michael S. Barr; Raphael W. Bostic; Michelle W. Bowman; Lisa D. Cook; Mary C. Daly; Philip N. Jefferson; Adriana D. Kugler; and Christopher J. Waller. Voting against the action was Beth M. Hammack, who preferred to maintain the target range for the federal funds rate at 4-1/2 to 4-3/4 percent.

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