First Trust
ECONOMIC RESEARCH REPORT

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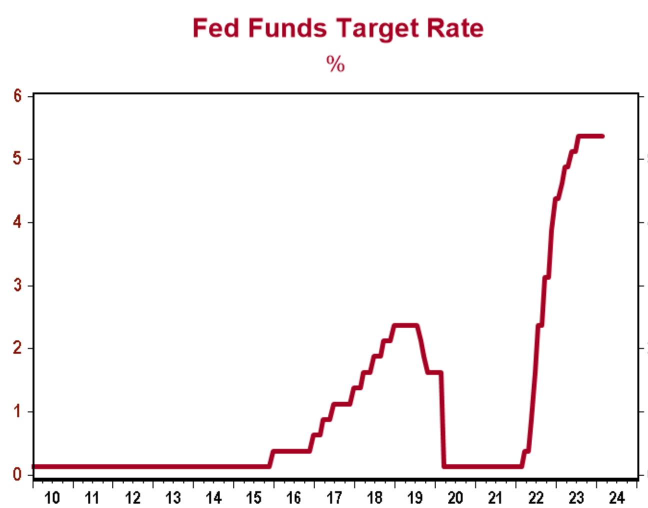
Rate Expectations

There was zero chance the Fed was going to cut rates today; instead it was all about what today's meeting, the dot plot, and the press conference meant for the timing and pace of rate cuts in the months ahead.

Starting with today's statement, there was only one change from January, and it was a minor one. While prior language stated that job gains "have moderated since early last year but remain strong" today's statement removed language concerning moderation and simply stated that "job gains have remained strong." That – along with a slight adjustment lower to the unemployment rate forecast for 2024 –suggest that a stronger than anticipated job market has weakened Fed confidence that inflation will trend sustainably towards 2.0%.



Source: Federal Reserve Board/Haver Analytics

The survey of economic projections provided more clarity. Forecasts for real (inflation-adjusted) GDP growth in 2024 rose to 2.1% from 1.4% in December. And with that outlook for stronger growth, their unemployment rate expectation shifted down to 4.0% from 4.1% while core inflation expectations rose to 2.6% from 2.4%. It's worth noting that with unemployment at 3.9% and core inflation at 2.8%, this suggests the FOMC members see very little movement in either category over the remaining nine months of the year.

While the combination of faster growth, higher inflation, and a stronger job market didn't shift the Fed's expectation for the equivalent of three 25 basis point cuts between now and year end, the distribution of forecasts shows that only one FOMC participant now expects more than three rate cuts will be appropriate this year, down from five members at the December meeting. And rate cut expectations for 2025 shifted to three cuts from four.

Beyond rate cuts, markets have been wondering when the Fed will start to taper back the pace of quantitative tightening (QT). During today's press conference, Powell wouldn't confirm or deny that the process could begin as soon as the next Fed statement on May 1st, but he did say that it would be appropriate to start "fairly soon" with plans to gradually cut the pace of roll-offs. In other words, May looks to be on the table.

We expect the Fed will start cutting rates in June. That said, the Fed should take a cautious approach once the process begins, with a primary focus on not cutting rates too aggressively or prematurely, which could re-ignite the inflation problem like the Fed did on multiple occasions under Chairman Arthur Burns in the 1970s. The economy is still growing, but we think it falls into recession before the year is out and that real GDP growth significantly lags the predictions of the FOMC members. This, in turn, heightens the risk that the Fed takes a more aggressive path on rate cuts in response to economic weakness, bringing the threat of re-accelerating inflation to the forefront in the years ahead.

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Text of the Federal Reserve's Statement:

Recent indicators suggest that economic activity has been expanding at a solid pace. Job gains have remained strong, and the unemployment rate has remained low. Inflation has eased over the past year but remains 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 moving into better balance. The economic outlook is uncertain, and the Committee remains highly attentive to inflation risks.

In support of its goals, the Committee decided to maintain the target range for the federal funds rate at 5-1/4 to 5-1/2 percent. In considering any 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 does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent. 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; Thomas I. Barkin; Michael S. Barr; Raphael W. Bostic; Michelle W. Bowman; Lisa D. Cook; Mary C. Daly; Philip N. Jefferson; Adriana D. Kugler; Loretta J. Mester; and Christopher J. Waller.