First Trust
ECONOMIC RESEARCH REPORT
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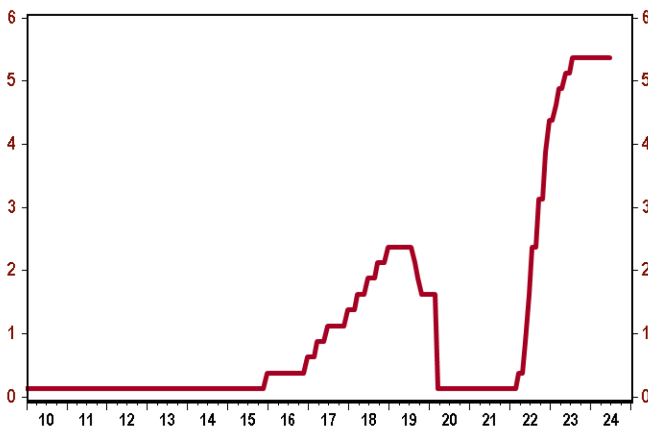
Reality Check

Today, the Fed made it clear there'd be fewer rate cuts in 2024, most likely one or two, with a start more likely after the election than before. Meanwhile, the Fed made a mess out of explaining its logic for their new path forward.

The Fed's statement was a virtual non-event, with only one notable wording change – a "lack of further progress" on inflation has become "modest further progress" – a nod to this morning's CPI release.



Source: Federal Reserve Board/Haver Analytics

From there, things start to get a bit confusing. The committee's economic projections showed no change in its expectations for GDP growth and the unemployment rate for year-end, and minimal change in the inflation outlook, yet the committee changed its expectation for the appropriate pace of rate cuts in 2024 from three down to one. More confusing is that their forecasts for year-end readings on "core" inflation (which excludes the volatile food and energy components) and the unemployment rate – proxies for their dual mandate of price stability and maximum employment – reflect absolutely no change from current readings. You read that right, the Fed forecasts that "core" PCE inflation will end the year at the exact same twelve-month rate that we have witnessed through April, and the unemployment rate won't rise or decline between now and the end of December.

In other words, conditions today don't warrant a rate cut, but if conditions don't improve between now and year-end, the Fed will then have the confidence that it's time to start cutting rates. Likewise, with little to no change in their forecasts for growth or inflation in 2025 and 2026, they have bumped up their expected pace of rate cuts in each year by one so, despite the slower pace of rate cuts in 2024, we see rates end in the exact same spot as previously forecast by the time we reach year-end 2026.

What would we take away from today's report? The Fed is at a loss for why progress on inflation has stalled and where they will go from here. They believe they have done enough to bring inflation in check, but they aren't seeing results. In our view, they have been following the wrong signals since the start; ignoring the growth in the M2 money supply in favor of blaming supply changes, which resulted in targeting a symptom rather than the disease. They flooded the system with excess reserves, muting their ability to manage economic activity through monetary policy and putting themselves in the awkward position of running large losses. They find themselves reacting to stubbornly high inflation they told us would be transitory, and constantly trying to explain away why their forecasts have been off base. Confidence is justifiably waning.

We do expect that the Fed will cut rates once later this year, likely after the elections, but we see cuts coming as economic weakness leads to higher unemployment and modest progress on inflation. The morphine is wearing off and the aftereffects of money printing, excessive and misguided spending from Washington, and companies getting a bit over their skis in terms of hiring will lead to a more turbulent back half of 2024.

Brian S. Wesbury, *Chief Economist*
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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. Job gains have remained strong, and the unemployment rate has remained low. Inflation has eased over the past year but remains elevated. In recent months, there has been modest further progress toward the Committee's 2 percent inflation objective.

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 have moved toward better balance over the past year. 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. 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.

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