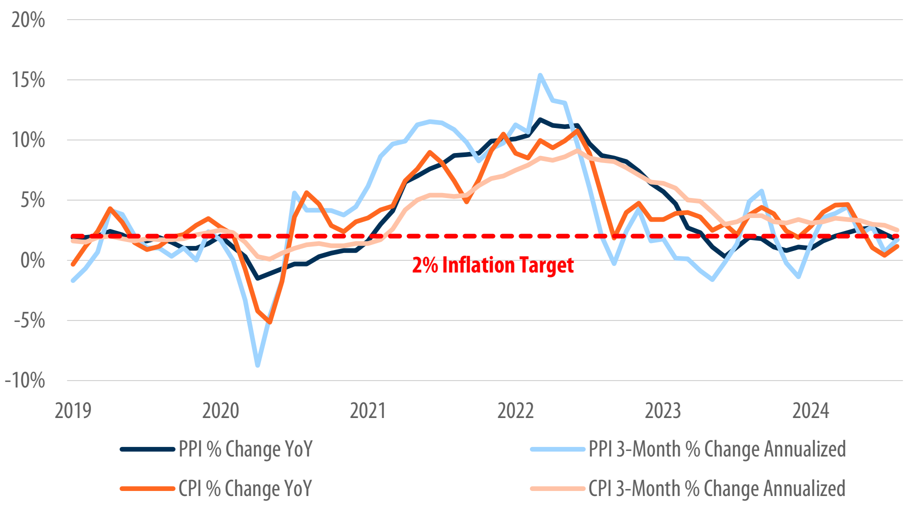
September 12, 2024

In this week's "Three on Thursday," we turn our attention to the Federal Reserve's ("the Fed") upcoming meeting and the anticipated outcome. With signs of a softening labor market, yesterday's consensus-expected 0.2% CPI report, and today's more moderate report on producer prices, it is all but certain the Fed will cut interest rates next week. The key question remains: by how much—25 or 50 basis points? While we believe that monetary policy has been sufficiently tight for some time, providing the Fed with room to make some cuts, we urge caution in their approach. Inflation, though easing, has yet to reach the Fed's 2% target. History reminds us that inflation can surge back if policy is loosened too quickly. To offer deeper insight, we've included the following charts and table below.

Inflation vs. the Federal Reserve's Target



Source: Bureau of Labor Statistics, First Trust Advisors. Monthly data 1/2019 - 8/2024.

With the latest inflation data from both the Consumer Price Index (CPI) and the Producer Price Index (PPI), the Fed will see this as further confirmation that it's time to lower interest rates. In August, the CPI rose by 0.2%, marking a year-over-year("YoY") increase of 2.5%—the slowest pace since February 2021. Over the past three months, inflation has climbed just 1.1% on an annualized basis. Similarly, although today's PPI report showed a slightly higher monthly increase than expected of 0.2%, the YoY rise remained only 1.7%, and 1.7% annualized over the past three months.

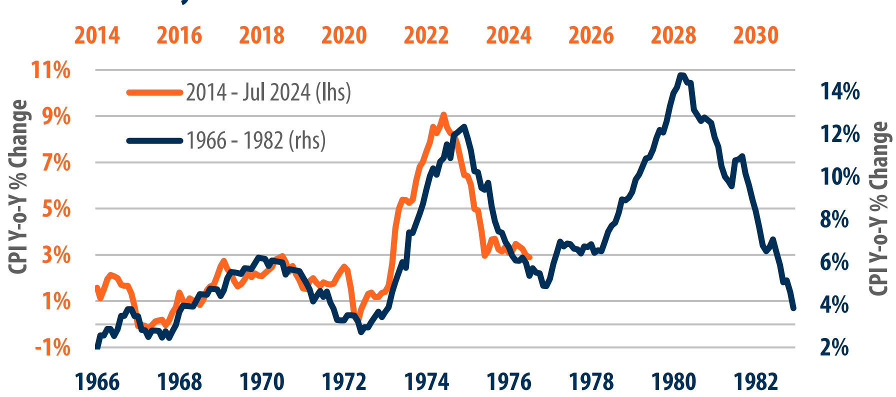
Market Implied Probabilities for Federal Funds Rate

	Federal Funds Rate Range (bps)							
FOMC Meeting Dates	350-375	375-400	400-425	425-450	450-475	475-500	500-525	Implied Meeting Outcome
9/18/2024	0.00%	0.00%	0.00%	0.00%	0.00%	15.0%	**85.0%**	25 bp cut
11/7/2024	0.00%	0.00%	0.00%	6.10%	43.30%	**50.60%**	0.00%	25 bp cut
12/18/2024	0.00%	3.70%	28.80%	**47.80%**	19.70%	0.00%	0.00%	50 bp cut

Source: CME Group, First Trust Advisors. Probabilities implied by 30-Day Fed Funds futures pricing data. Estimates as of 9/12/24. Orange highlighted cell represents projected Federal Funds Rate at that meeting date.

The CME FedWatch Tool is a widely utilized resource that offers insights into market expectations for changes in U.S. monetary policy, particularly regarding the Fed's target interest rate. This tool calculates the probability of Federal Open Market Committee (FOMC) rate changes for upcoming meetings by analyzing pricing data from 30-Day Fed Funds futures contracts traded on the Chicago Mercantile Exchange (CME). As of this morning, the market anticipates three rate cuts totaling 100 basis points (bps) by the end of the year, starting with a 25 bp cut at the Fed's meeting next week followed by another 25 bp cut in November, and 50 bp in December.

Inflation Today vs. the 1970s



Source: Bureau of Labor Statistics, First Trust Advisors. Monthly data for time periods: (1/1966 - 12/1982) and (1/2014 - 7/2024).

The current inflation trend is strikingly like the 1970s, the last time the Federal Reserve faced a major inflation crisis. Back then, under political pressure, Fed Chairman Arthur Burns prematurely eased monetary policy to avoid a downturn, leading to a renewed surge in inflation. To avoid repeating this mistake, today's Fed must resist the urge to loosen policy too aggressively. It took a steadfast leader like Paul Volcker, coming in as the Fed chair in 1979, determined to extinguish inflation completely, even at the risk of a recession. Despite skepticism from many around him, Fed Chairman Volcker's resolve paid off, and he is now remembered as the hero who ultimately defeated inflation.