First Trust
ECONOMIC RESEARCH REPORT

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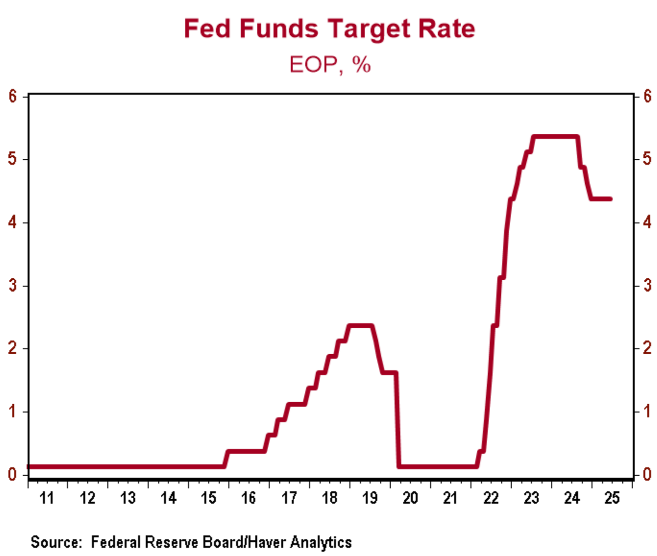
Slower Growth, Higher Unemployment, Still Two Cuts

The Federal Reserve held rates steady today, while also projecting slow economic growth, higher unemployment, and higher inflation. And while the Fed signaled that two further rate cuts are still their base-case for the remainder of 2025, the timing of those cuts remains up in the air.

Starting with the survey of economic projections, the Fed's view on the remainder of 2025 has weakened since the latest forecasts in March. "Real" – inflation adjusted – growth for 2025 has been downgraded to 1.4% from the 1.7% anticipated back in March, while growth expectations for 2026 were reduced to 1.6% from 1.8%. Other estimates moved higher, but not in the categories you would hope. Consistent with slower economic growth, the unemployment rate (currently at 4.2%) is now expected to rise to 4.5% by year-end and remain there through 2026, while prior forecasts anticipated the unemployment rate to hit 4.4% this year before declining next year. Inflation expectations for this year likewise rose to 3.0% for PCE prices (the Fed's preferred inflation metric) from a prior estimate of 2.7%, while next year is now anticipated at 2.4% versus a prior estimate of 2.2%.



With slower expected growth, and higher unemployment, the Fed continues to anticipate that two rate cuts will be appropriate before year-end, but tariff inflation concerns now have them anticipating that rate cuts will progress at a slower pace over the following two years. We believe that the Fed's concern over higher and more persistent inflation related to tariffs is misguided. Yes, tariffs can raise prices for the tariffed items, but they leave less money left over for other goods and services. They shuffle the deckchairs on the inflation ship, but don't change how high or low the ship sits in the water. That's up to the money supply, which is barely higher today than it was in April 2022. We believe this relative monetary tightness is why inflation has slowed recently, with CPI up at a 1.0% annualized rate in the last three months.

Changes in today's Fed statement were less dramatic. Today's statement included text that previously noted the unemployment rate had "stabilized at low levels" now simply stating that the unemployment rate "remains low." Meanwhile text around the level of uncertainty in the outlook softened to say uncertainty has "diminished but remains elevated". Along with that change, the Fed removed previous language that "risks of higher unemployment and higher inflation have risen." A bit odd, considering that they raised inflation and unemployment rate forecasts at the same time.

The press conference brought little new information, with Powell reiterating that the economic environment justifies a continued pause while we wait and see the impacts from changes out of Washington. Powell waived off concerns surrounding Middle East conflict and the threat of higher oil prices, but did acknowledge that the global landscapes are changing as immigration, trade, and geopolitics are in the spotlight. This – he rightly states – is the purview of Congress, not the Fed, but real change is happening in the world around us.

We admit this is an incredibly difficult time to forecast, with soft sentiment data moving in a negative direction alongside weakness in some hard data such as housing, while many other measures of activity continue to progress. How the economy will progress in the short term if true progress is made in cutting deficit spending and signing new trade deals is still to be seen. The era of easy everything is over, and while that may not be a welcome transition for many, it's a necessary transition.

Much could happen between now and the next Fed announcement scheduled for July 30th. There will be two more readings on PCE inflation, another employment report, potential progress on the tax bill, and a whole lot of tweets. Throughout this period of increased uncertainty, we are working harder than ever to dive into the data and identify the trends that we believe are critical to navigating the current environment. From the Monday Morning Outlook, Three on Thursday, Data Watches, and Wesbury 101 videos, our goal is to help bring you clarity on the numbers that matter most.

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Text of the Federal Reserve's Statement:

Although swings in net exports have affected the data, recent indicators suggest that economic activity has continued to expand at a solid pace. The unemployment rate remains low, and labor market conditions remain solid. Inflation remains somewhat elevated.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. Uncertainty about the economic outlook has diminished but remains elevated. The Committee is attentive to the risks to both sides of its dual mandate.

In support of its goals, the Committee decided to maintain the target range for the federal funds rate at 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; Michael S. Barr; Michelle W. Bowman; Susan M. Collins; Lisa D. Cook; Austan D. Goolsbee; Philip N. Jefferson; Adriana D. Kugler; Alberto G. Musalem; Jeffrey R. Schmid; and Christopher J. Waller.