First Trust
ECONOMIC RESEARCH REPORT

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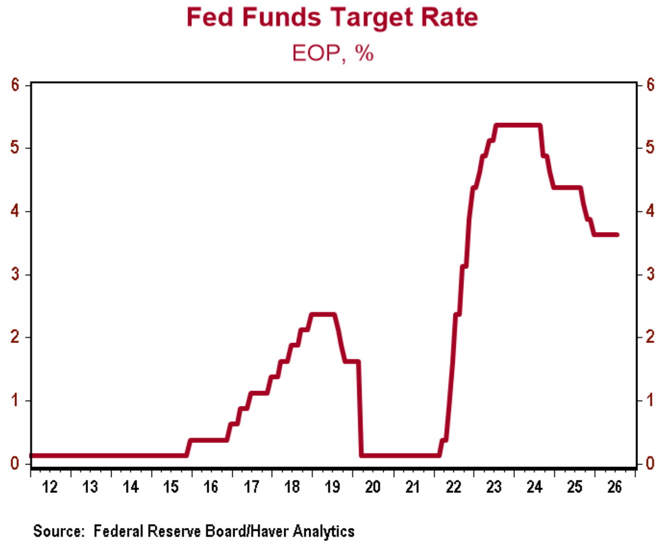
Fed on the Case

Kevin Warsh's second meeting as Fed Chair saw no change in rates and minimal edits to the Fed Statement, but included a press conference giving insight into what the Fed is focused on. In an economy where Warsh described output as solid, capex and productivity as strong, and the employment market as steady, he views the answer to recent inflation problems as anything but straight forward, while making clear that the Fed is on the case.

In terms of the Fed Statement there was one key change, which is that three bank presidents previously approved by Jerome Powell dissented in favor of raising rates today, making it clear there is sentiment at the Fed to raise rates if the inflation picture doesn't improve. At the press conference, Warsh made clear that the Fed is committed to achieving the 2% inflation target.



Futures markets entered today's meeting pricing in a near 100% chance of a rate hike coming by September. Those odds are now closer to 50/50 for September with a hike now expected by October or December. Warsh reminded the markets that the Fed has tools beyond rates to work on inflation (for example, shrinking the Fed's balance sheet), and appears to be winning the fight against the policy hawks. The 10-year Treasury yield jumped to 4.69% today and appears to agree with this assessment. We believe he would prefer to hold off on rate hikes for the foreseeable future, but is battling the Powell faction – led by the former Fed Chair who remains on the board and as a member of the FOMC – and is working to gain the broader support of voting members to play the long game.

It's true that inflation measures remain above the Fed's 2% target, and higher energy costs have shown in readings over recent months, but the M2 measure of money has been growing below the historical trend pace over recent years, and higher energy prices are likely to be offset by consumers eventually pulling back in other areas, which will see those other prices eventually decline. We aren't advocating for rate cuts any time soon, but we are fully on board with the Fed asking itself hard questions while they wait for more clarity on their dual mandate. We look forward to what answers those hard questions bring.

Brian S. Wesbury, ***Chief Economist***
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Text of the Federal Reserve's Statement:

The Federal Open Market Committee approved the following statement for release by a 9 – 3 vote:

The Committee decided to maintain the target range for the federal funds rate at 3-1/2 to 3-3/4 percent, in support of the Federal Reserve's dual mandate. The Committee is continuing its policy of maintaining ample reserves in the banking system.

Economic activity is expanding at a solid pace despite elevated uncertainty that owes, in part, to the conflict in the Middle East. Productivity growth and capital investment are strong. Job gains have kept pace with the workforce, and the unemployment rate has changed little.

Inflation remains elevated relative to the Committee's 2 percent goal, in part reflecting supply shocks that have driven price increases in certain sectors, including energy. The Committee will deliver price stability.

Voting against the monetary policy action were Beth M. Hammack, Neel Kashkari, and Lorie K. Logan, who preferred to raise the target range for the federal funds rate by 1/4 percentage point at this meeting.