

The Fed's Challenge

The Federal Reserve cut short-term rates by a quarter percentage point last week, like pretty much everyone expected. In addition, the Fed didn't push back hard against market expectations of another quarter-point cut in mid-December, so unless the economic or financial news changes dramatically by then, expect a repeat at the next meeting.

It's not hard to see why the Fed has been cutting rates. The consumer price index is up 2.4% in the past year versus a 3.7% gain in the year-ending in September 2023. Meanwhile, the PCE deflator, which the Fed uses for its official 2.0% inflation target, is only up 2.1% in the past year while it was up 3.4% in the year ending in September 2023.

However, in spite of getting into the Red Zone versus inflation, the Fed isn't yet in the End Zone, and it looks like progress has recently stalled. According to the Atlanta Fed, the CPI is projected to be up 2.7% in the year ending this November while PCE prices should be up 2.5%.

It's also important to recognize that a few years ago the Fed itself devised a measure it called Supercore inflation, which excludes food, energy, all other goods, and housing. That measure of prices is still up 4.3% versus a year ago, which is probably why the Fed has stopped talking about it.

Moreover, it's important to recognize that there's a huge gulf between the policy implications of the Fed reaching its 2.0% inflation goal and the public's perception of inflation no longer being a problem. Right or wrong, for now, the public seems to think that for inflation to no longer be a problem prices would have to go back down to where they were pre-COVID.

But that's not going to happen. The federal government spent like drunken sailors during COVID and the Fed helped accommodate that spending by allowing the M2 measure of the money supply to soar. M2 is off the peak it hit in early 2022, but it would take a much greater reduction than so far experienced to restore prices as they were almost five years ago.

Instead, getting to 2.0% inflation means eventually accepting not only that prices aren't going back to where they were but they're going to keep rising, albeit at a slower pace.

And remember, even that goal has so far remained elusive. The embers of inflation continue burning. And since we have yet to see a significant or prolonged slowdown in growth, much less a recession, it remains to be seen whether inflation will reach 2.0% or less on a consistent basis.

The bottom line is that the Fed's inflation goal remains elusive. In turn, that means don't be surprised if the Fed pauses rate cuts early next year.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
11-13 / 7:30 am	CPI – Oct	+0.2%	+0.2%		+0.2%
7:30 am	“Core” CPI – Oct	+0.3%	+0.3%		+0.3%
11-14 / 7:30 am	Initial Claims – Nov 9	220K	224K		221K
7:30 am	PPI – Oct	+0.2%	+0.2%		0.0%
7:30 am	“Core” PPI – Oct	+0.3%	+0.3%		+0.2%
11-15 / 7:30 am	Retail Sales – Oct	+0.3%	+0.3%		+0.4%
7:30 am	Retail Sales Ex-Auto – Oct	+0.3%	0.0%		+0.5%
7:30 am	Empire State Mfg Survey – Nov	0.0	-5.5		-11.9
7:30 am	Import Prices – Oct	-0.1%	0.0%		-0.4%
7:30 am	Export Prices – Oct	-0.1%	-0.1%		-0.7%
8:15 am	Industrial Production – Oct	-0.3%	-0.1%		-0.3%
8:15 am	Capacity Utilization – Oct	77.1%	77.3%		77.5%
9:00 am	Business Inventories – Sep	+0.1%	+0.1%		+0.3%

Consensus forecasts come from Bloomberg. This report was prepared by First Trust Advisors L.P. and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward-looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security. Such statements are generally identifiable by the terminology used, such as “plan”, “anticipate”, “intend”, “expect”, “estimate”, or other similar wording. These forward-looking statements are subject to known and unknown risks and uncertainties and other factors that are beyond the control of the Funds, FT Portfolios Canada Co. and its affiliates, and First Trust Advisors L.P. and which may cause actual results, levels of activity and achievements to differ materially from those expressed or implied by such statements. Such factors include, but are not limited to general economic, market and business conditions; fluctuations in securities prices, fluctuation in interest rates and foreign currency exchange rates; and actions by governmental authorities. Future events and their effects on a fund may not be those anticipated by us. Actual results may differ materially from the results anticipated in these forward-looking statements. We do not undertake, and specifically disclaim, any obligation to update or revise any forward-looking information, whether as a result of new information, future developments or otherwise. This information does not constitute a solicitation or an offer to buy or sell any security. Commissions, management fees and expenses all may be associated with ETF investments. Read the prospectus before investing. ETFs are not guaranteed, their values change frequently, and past performance may not be repeated.