First Trust Portfolios Canada
Monday Morning OUTLOOK

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Inflation, Tariffs, and the Fed

The Federal Reserve made it clear on Wednesday that it's not about to cut short-term interest rates again anytime soon, which is good news if you'd like to see the Fed live up to its goal of bringing inflation down to 2.0%.

After all, progress toward that 2.0% goal has stalled. PCE prices, the Fed's favorite measure of inflation, increased 2.6% in 2024, barely better than the 2.7% climb in the twelve months ending December 2023. Core prices, which exclude food and energy, climbed 2.8% last year, slightly above overall inflation.

Meanwhile, SuperCore prices, which exclude food and energy, but also all other goods and housing rents, rose 3.5% in 2024 versus a 3.4% climb in the year ending in December 2023. That's right…SuperCore inflation was worse in 2024 than in 2023!

We like to pay attention to this measure not because *we* think it's a great inflation measure but because a few years ago *the Fed* was telling investors and the general public to watch it, but then mysteriously stopped talking about it when SuperCore stopped telling the story of rapid inflation reduction the Fed wanted to tell.

Now tariffs are coming, with the Trump Administration raising them on imports from Canada, Mexico, and China. Each of these countries is saying some retaliatory tariffs are likely on the way, as well. How this will affect inflation, however, is often misunderstood.

Yes, tariffs will put upward pressure on prices for any items being tariffed. But ultimately inflation is a monetary phenomenon and as long as the new tariffs are not accompanied by a looser monetary policy – and it doesn't look like they will be – then higher prices for those products means consumers have less money to spend on other goods and services, putting offsetting downward pressure elsewhere.

In the meantime, expect the Fed to use the tariffs as a reason to hold the line on short-term interest rates. Especially with the press focusing on the prices that do go up because of those tariffs.

The Fed is probably happy that it has something else to blame for inflation and will be less reactive to incoming data than it normally is. Keep this in mind when you see the onslaught of economic reports over the next two weeks, including employment, retail sales, industrial production, and inflation.

If, as we expect, economic data begin to show signs of a slowdown, the Fed (and the market) will not immediately price in rate cuts. On the other hand, if the Fed does react to a slowdown in the economy and starts to increase the money supply too much, then stagflation becomes a problem. Either way, the equity market faces some serious headwinds. The era of easy everything is coming to an end.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
2-3 / 9:00 am	ISM Index – Jan	50.0	**49.7**	50.9	49.2
9:00 am	Construction Spending – Dec	+0.2%	**+0.5%**	+0.5%	0.0%
afternoon	Total Car/Truck Sales – Jan	16.0 Mil	**16.0 Mil**		16.8 Mil
afternoon	Domestic Car/Truck Sales – Jan	12.2 Mil	**12.3 Mil**		12.9 Mil
2-4 / 9:00 am	Factory Order – Dec	-0.7%	**-1.1%**		-0.4%
2-5 / 7:30 am	Int'l Trade Balance – Dec	-$96.8 Bil	**-$97.4**		-$78.2 Bil
9:00 am	ISM Non Mfg Index – Jan	54.1	**54.4**		54.0
2-6 / 7:30 am	Initial Claims – Feb 1	213K	**210K**		207K
7:30 am	Q4 Non-Farm Productivity	+1.4%	**+1.8%**		+2.2%
7:30 am	Q4 Unit Labor Costs	+3.4%	**+3.6%**		+0.8%
2-7 / 7:30 am	Non-Farm Payrolls - Jan	170K	**165K**		256K
7:30 am	Private Payrolls – Jan	141K	**140K**		223K
7:30 am	Manufacturing Payrolls – Jan	-2K	**-10K**		-13K
7:30 am	Unemployment Rate – Jan	4.1%	**4.1%**		4.1%
7:30 am	Average Hourly Earnings – Jan	+0.3%	**+0.3%**		+0.3%
7:30 am	Average Weekly Hours – Jan	34.3	**34.3**		34.3
2:00 pm	Consumer Credit– Dec	$14.5 Bil	**$7.2 Bil**		-$7.5 Bil