Essentials of Monetary Policy

The Fed's Next Move Will Be a Rate Cut, but It Won't Come Right Away

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According to the Federal Reserve (Fed)

- The Committee decided to maintain the target for the federal funds rate in a range of 5.25% to 5.50%.
- Recent indicators suggest that economic activity has been expanding at a solid pace. Job gains have moderated since early last year but remain strong, and the unemployment rate has remained low. Inflation has eased over the past year but remains elevated.
- The Committee judges that the risks to achieving its employment and inflation goals are moving into better balance.
- In considering any 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 does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent.

Comments

The Fed is firmly in wait-and-see mode. This is no surprise given the latest economic data. Today's decision to hold for the fourth straight meeting was an easy one, with all

106 forecasters surveyed by Bloomberg calling it correctly.

The statement accompanying the Fed's decision didn't open the door very wide to an imminent shift in monetary policy. The language surrounding additional rate hikes was removed from the statement, and Jerome Powell said during his press conference that rates are likely at their cyclical peak.

With the Fed seeing risks coming into better balance, it's pretty clear the next move will be a rate cut. In fact, it was the only path forward discussed in the statement. So it's no longer a matter of what will happen next, but when. We knew as much from the projections released in December, which showed that the next moves would be interest rate cuts later this year. But the Fed is now saying it wants greater confidence that inflation is moving sustainably toward its 2% target before lowering rates. That means US monetary policy now hinges on the Fed's confidence level.

Growth, employment and inflation (especially as measured by the PCE price index) are all moving in the right direction. That means the Fed is in no rush to cut. As Jerome Powell said, it can wait for "more good data" to be sure inflation will continue to cool. The Fed will want to see services inflation come down further, and would love to see slower wage growth as well. Bottom line? "The Committee intends to move carefully as we consider when to dial back the restrictive stance that we have in place."

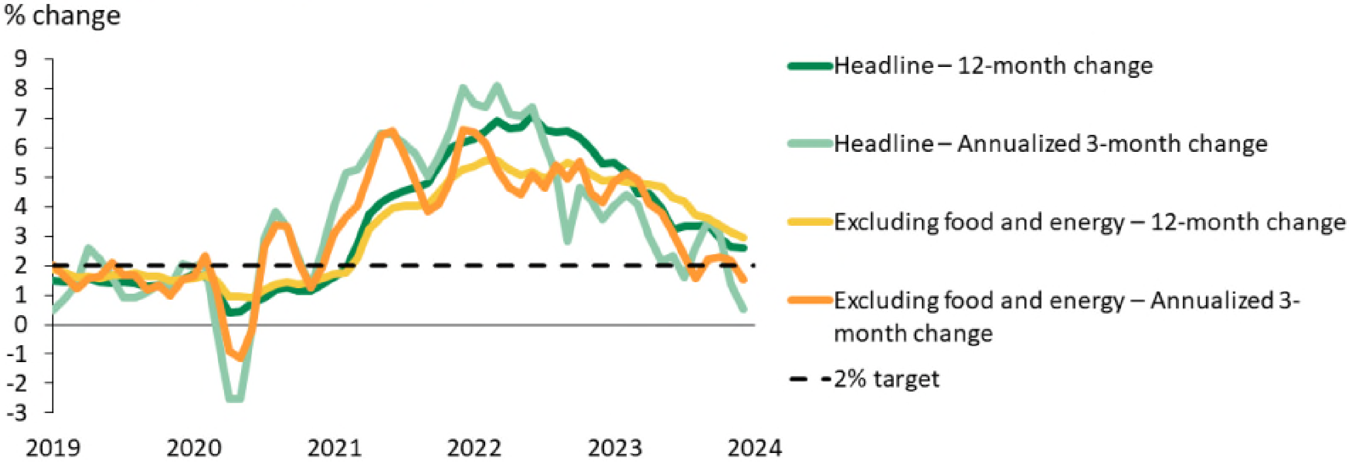
Implications

As expected, the Fed left rates unchanged today. Its next move will likely be a rate cut, though it probably won't come at the next meeting in March. If inflation continues to come down, the Fed could lower rates this spring or summer.

Graph

The Personal Consumption Expenditures Price Index Is Nearing Fed Targets

United States – PCE price index



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