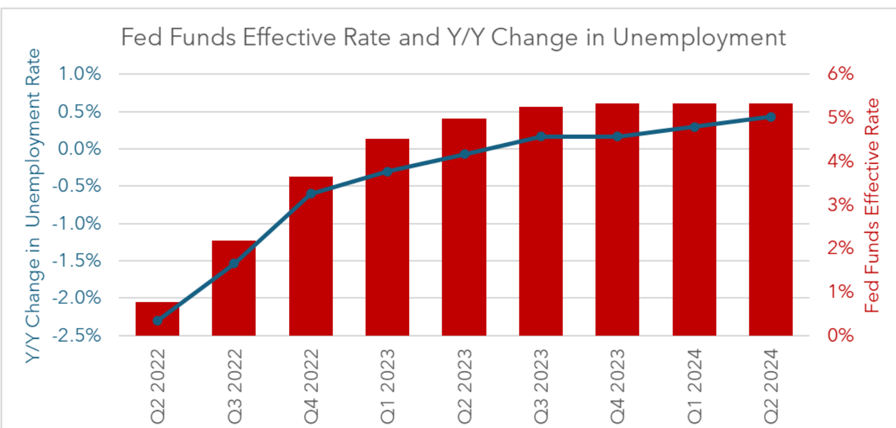
Thursday, August 1, 2024

😊 Last Thursday, the Bureau of Economic Analysis (BEA) announced real GDP grew an estimated +2.8 percent at the seasonally adjusted annual rate (SAAR) during Q2 – twice the Q1 growth rate
😬 On Friday, BEA announced core inflation was +2.6 percent in June – about the same as May
😕 Yesterday, the Fed's Open Market Committee (FOMC) announced they will maintain their current policy rate target at 5.25 to 5.5 percent – right where it's been for the last year

Did they do it? Avoid overcorrecting and achieve a soft landing for once? Sadly, almost definitely not ☹️

The Fed's current disinflation campaign has been faster and more effective than it's seemed. Yes, it's taken a long time for inflation to come down. After 28 long, painful months, core inflation has only fallen from +5.6 percent to +2.6 percent. One major reason it's taken so long is the expansionary pressure of the post-COVID rebound, which has partly masked the effects of the Fed's restrictive policy. The effect was still there.



The graph at left shows the fed funds effective rate and changes in the unemployment rate following the start of the Fed's current campaign. Rising interest rates always suppress hiring and investment, and reduced hiring normally manifests as increased unemployment. This time, as the graph shows, unemployment didn't increase right away. Instead, its decline slowed for the first five quarters of the Fed's interest hikes.

Moreover, the effects of tightening the money supply started right away but were clouded by the post-COVID recovery, thus greatly increasing the risk the Fed would overcorrect and wait too long to cut interest rates. At this point, the unemployment rate has increased year-over-year for four consecutive quarters. Historically, when that's happened, it's immediately followed by explosive unemployment and recession.

As of this writing, based on financial market behavior, the Chicago Mercantile Exchange (CME) estimates a 74 percent the Fed cuts rates by a quarter point in September, 26 percent chance of a half point, and a **ZERO** chance rates stay the same again. But if literally *everyone* agrees it's time for a cut, isn't it too late? 🤔

Until next week,

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