

THE ECONOMY & STRATEGIES

# Stephens Economic Quick Take

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The Federal Reserve deserves credit for navigating the economy toward a soft landing, in which growth will be weak but positive over the next several quarters, without triggering the hyperinflation some market participants feared.

After nearly a decade of missteps, the Fed started doing the right thing in April 2022, when it raised interest rates in an aggressive, yet prudent, manner, from 0.00%-0.25% to the 5.25%-5.50% range in July 2023.[i]

But the Fed's mistakes were not limited to interest rates. In recent years, the Fed purchased huge amounts of Treasuries, so called 'Quantitative Easing', prolonging an artificially low to zero-rate environment. Then it further blundered by allowing public discourse to embrace so-called "transitory inflation."

These factors, and the aftermath of the government's response to the COVID-19 pandemic, led the U.S. to experience more than full employment, as evidenced by unemployment at 3.7% in December.[ii] The Fed has signaled rate cuts given the downward trend of inflation, but it has also signaled that it wants to see higher unemployment before cutting rates to avoid the return of inflation. If the Fed strives for lower employment, monetary policy must remain restrictive.

Meanwhile, service prices have improved, but not nearly enough for overall inflation to stabilize at 2%. The cost of airline tickets, auto and homeowners' insurance, hair styling fees, housing, childcare, and other services continued to increase at an annual rate of 5.5% through November.[iii]

The Fed's preferred inflation measure – Personal Consumption Expenditures Price Index, Excluding Food and Energy (core PCE) – fell from 4.2% to 3.2% between July and November, still well above target.[iv]

Finally, the central bank made yet another mistake when it pointed to three rate cuts in 2024. Fortunately, the talk among many market participants in the early days of January 2024 is that those rate cut bets were premature given the strength of the economy in early 2024.

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[i] Effective Federal Funds Rate

[ii] Bureau Of Labor Statistics The Employment Situation — December 2023

[iii] Bureau of Labor Statistics Consumer Price Index Summary

[iv] Personal Income and Outlays, November 2023

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