

No Rate Cut Wednesday

The Fed meets on Wednesday to discuss the direction of monetary policy. With the futures market pricing the odds of “no change in rates” at 97.2%, no one should expect a rate cut at this meeting...or, we think, anytime soon.

Some, including the Trump Administration, might complain about steady short-term interest rates and say Fed Chief Jerome Powell is playing politics. The claim about playing politics may be true but for now, Powell has the data on his side. The economy looks solid and inflation remains stubbornly higher than the Fed’s 2% target.

Real GDP grew at a rapid 4.4% annual rate in the third quarter, the fastest quarterly pace in two years. We like to follow other key measures of economic activity and although they didn’t grow as rapidly, they don’t signal a problem with economic growth, either.

“Core GDP,” which includes consumer spending, business fixed investment, and home building, while excluding the more volatile categories like government purchases, inventories, and trade, grew at a respectable 2.9% annual rate in Q3. In the meantime, Real Gross Domestic Income, an alternative to Real GDP that is just as accurate over time, rose at a 2.4% rate in Q3. Not great, but not bad either. (Remember, the Federal Reserve thinks the long-term growth rate of the economy should average 1.8%, so even 2.4% is faster than that long-term average.)

More impressively, it looks like economic growth in the fourth quarter could come in even faster. At present, the Atlanta Fed’s GDP Now model suggests the economy grew at a 5.4% annual rate in the fourth quarter. Yes, much of this is related to a very favorable international trade report for October, which might reverse in November (new data to be released Thursday). But even if we exclude that by looking at Core GDP for Q4, the economy appears to have grown at about a 2.7% rate. Not bad.

The Fed is also looking at the labor market. While not as strong as the overall economy, the reports there are not showing clear stress, either. The unemployment rate finished 2025 at 4.4% versus 4.1% a year ago, but private-sector

payroll growth continues, in spite of a big drop in net immigration into the US. Yes, growth in private sector payrolls has been narrow and mostly confined to health care and social assistance, but we don’t think the Fed is focused on this issue for now. More importantly, the household survey, which contacts people directly rather than surveying employers, shows jobs up 2.4 million in the past twelve months.

Nor is inflation signaling a need for rate cuts. The Consumer Price Index rose 2.7% in 2025 (December/December), with core prices, which exclude food and energy, up 2.6%. And, just released with the GDP data, the GDP Deflator was up at a 3.8% annual rate in the third quarter.

There are reasons to believe inflation may decline in the next several months. One key reason is that the M2 measure of the money supply is up only 4.3% in the past year, slower than the pre-COVID trend of about 6.0% per year, which coincided with an average annual CPI inflation rate of less than 2.0%. As Milton Friedman taught us decades ago, inflation is always and everywhere a monetary phenomenon.

In addition, the way the government calculates the CPI may also lead to a drop in measured inflation. Zillow’s observed rent index tends to lead the CPI’s measure by about one year and Zillow’s measure of rent decelerated in 2025, suggesting the CPI’s measure of rents will decelerate this year. That’s a big deal because rent of shelter is about 35% of the overall CPI. This is also consistent with stricter enforcement of immigration law, right or wrong, putting downward pressure on rents nationwide.

Put it all together and we have a Fed that until Powell departs in May is not only politically inclined to reject rate cuts, but at least for the time being has the economic data to back up its case. If the Trump team really wants an easier monetary policy, it could drain the Treasury General Account, which currently holds almost \$900 billion at the Fed. By spending that money rather than hoarding it and issuing more debt, it could quickly boost M2 by about 4%.

| Date/Time (CST) | U.S. Economic Data | Consensus | First Trust | Actual | Previous |
|-----------------|--------------------------------|-------------|--------------|--------------|-------------|
| 1-26 / 7:30 am | Durable Goods – Nov | +4.0% | +3.3% | +5.3% | -2.2% |
| 7:30 am | Durable Goods (Ex-Trans) – Nov | +0.3% | +0.3% | +0.5% | +0.1% |
| 1-29 / 7:30 am | Initial Claims – Jan 24 | 205K | 202K | | 200K |
| 7:30 am | Int'l Trade Balance – Nov | -\$44.2 Bil | NA | | -\$29.4 Bil |
| 1-30 / 7:30 am | PPI – Dec | +0.2% | +0.2% | | +0.2% |
| 7:30 am | “Core” PPI – Dec | +0.3% | +0.2% | | 0.0% |
| 8:45 am | Chicago PMI – Jan | 43.5 | 40.9 | | 43.5 |

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