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The Fed's Three Strike Policy Mistake



The Federal Reserve kept rates unchanged in the last meeting, downgrading growth estimates and raising inflation expectations.

The Fed **expects** inflation at 2.7% at the end of 2025, up from the 2.5% they estimated in December. In terms of real Gross Domestic Product (GDP), they **expect** a 1.7% increase in 2025, slightly below the previous guidance of 2.1%. Thus, the benchmark interest rate remains in the 4.25 to 4.5% range.

The Federal Reserve's problem is that it does not seem to pay attention to monetary aggregates. Therefore, policy mistakes have become a norm.

The Fed's most alarming policy mistake was to consider inflation "transitory" when the money supply increased at the fastest pace in decades and agreeing to keep negative real rates in a recovery where prices were rising at an abnormal speed.

Printing money and rising government spending led to a burst in inflation that remains to this day. Even Fed officials recognise that they should have raised rates and normalised policies earlier.

Instead, they kept an ultra-loose policy until 2022 despite the abnormally high inflation, repeating that inflation was transitory. It was not.

The Fed began increasing rates in March 2022, marking the start of a significant tightening **cycle**. Chairman Jerome Powell mentioned rates would stay "higher for longer."

Policy mistakes

However, the "higher for longer" policy lasted less than 16 months. In July 2023, the Fed **paused** rate increases, maintaining the 5.25%–5.50% range until September 2024, when it began cutting rates.

In June 2024, the Fed panicked and decided to delay its normalisation of the balance sheet, signalling a dovish stance designed to appease

bond markets as Treasury yields started to rise significantly. The rate **cuts** of September 2024 exacerbated this dovish mistake.

The Fed's new loose policy mistake came despite evidence that inflation was only declining due to the volatile energy component and in the middle of an election, just as government spending soared and money supply growth accelerated.

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The Fed's first policy mistake was to maintain extremely aggressive easing policies in the middle of a strong recovery with abnormally high inflation. The second was to abandon the tightening cycle in the middle of an election, thus igniting a new inflationary burst.

The third strike in this trend of policy mistakes is to keep rates unnecessarily elevated, despite the evidence of an economic slowdown after four years of government excess and elevated deficit spending.

The consequences of monetary policy mistakes

These Fed policy mistakes have been extremely damaging for families and small businesses. The productive fabric of America suffered the high inflation created by uncontrolled federal spending and monetary excess only to bear the entire burden of policy normalisation with rising interest rates.

Citizens and small businesses have been impoverished by high inflation followed by rising borrowing costs, leaving families and small businesses exhausted by the end of 2024.

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However, in the same period, government size in the economy has continued to rise regardless. The government kept borrowing and spending as if nothing had happened.

The Federal Reserve faces enormous criticism because it has been perceived as taking political decisions and cutting rates too fast and too soon in the middle of an election.

Now that the productive private economy is asphyxiated, it keeps rates unchanged because inflation is persistent. However, the only reason why inflation is persistent is because the Fed eased too early and too fast in an election year, and government spending was already indicating a risk of persistent price pressures as money supply growth accelerated.

Policy encouraged government indebtedness

Now, the Fed may create a recession by keeping rates at an abnormally high level. The easing cycle they started in 2024 should be happening now.

These policy errors result in periods of economic ups and downs. Markets soared in 2024, expecting more rate cuts and easing policies. A risk-off took place when the Fed changed the message to a hawkish tone less than six months after signalling a potent easing cycle of six to eight rate cuts.



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The Fed should start paying attention to what monetary aggregates are telling us. Money supply and the velocity of money are showing that the current policy is too restrictive considering the imbalances built by the federal government and the slowdown in the productive sector, which has been evident for seven months.

Consumer confidence, capital expenditure, and credit growth have been showing a weakening trend since mid-2024.

The Fed seems too concerned about maintaining the government debt bubble. It has delayed its normalisation path again, although the balance sheet has not been reduced to 2019 levels.

By delaying normalisation and keeping rates untouched, the Fed is passing again the entire burden of monetary policy impact to the private sector, especially families.

The Fed should have given a strong signal to the government to stop spending without control. It did the opposite. Policy encouraged government indebtedness while hurting families.

If the United States enters a recession, it will not be due to the current administration's policies. It will be the fault of a monetary policy that seems designed to maintain the inherited government imbalances disguised at the expense of families and businesses.