Tomorrow's Affairs
Analysis of today
Assessment of tomorrow

By: Daniel Lacalle

The Fed Must Cut Rates, as Leading Indicators Suggest

Jerome Powell's decision to reject any rate cut is a dangerous gamble. Furthermore, it is another adverse decision that hurts the productive fabric of the economy.

The Federal Reserve's policy mistakes since 2020 are too many to ignore. Moreover, all its policy decisions have erred on the side of bloating the size of government in the economy while hurting families and small businesses.

Since 2020, all the Fed seems to care about is supporting rising government spending. The Fed's unwarranted ultra-dovish stance, especially during the 2024 election period, indicated a rapid decline in interest rates and continuous liquidity injections.

Why would the Fed decrease the pace of normalising the balance sheet in 2024? Was it logical to announce massive rate cuts and a dovish stance when inflation was already persistent in September 2024? Obviously not.

However, when the election process ended and the weakness of the economy became evident, the Fed decided to turn hawkish.

Inflationary burst

In 2020, the Federal Reserve's exaggerated response to the COVID-19 crisis incentivised the government to boost expenditure and borrowing well into the recovery.

As MIT and Borio conclude, the enormous inflationary burst that has asphyxiated citizens in the United States was created by massive money supply growth led by out-of-control government spending.

In March 2021, when inflation soared after the historic increase in government spending and money supply, Powell announced that inflation was transitory and kept easing. Negative real rates and enormous asset purchases fuelled inflation.

The Fed did not stop its money printing until March 2022 and then decided to hike rates at the fastest pace in history

From June 2020 to October 2021, the Fed was purchasing $80 billion in Treasury securities and $40 billion in mortgage-backed securities (MBS) each month.

By November 2021, he only announced a modest "tapering" of asset purchases, reducing the pace by $10 billion in Treasuries and $5 billion in MBS each month. This was happening as inflation soared to a whopping 6.8% annualised rate.

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A destructive inflationary spiral

The Federal Reserve's policy under Powell since 2020 has damaged families and small businesses by easing too much too fast and destroying the purchasing power of the currency with inflationism and damaged families and businesses further with a drastic rate hike that crippled the finances of the productive fabric of the United States.

In 2024, in the middle of an election, Powell announced a surprising slowdown in the normalisation of the Fed's balance sheet and, afterwards, in September, an even more shocking pace of large rate cuts despite persistent inflation.

> Powell and the Fed have ignored monetary aggregates consistently since 2024

The latest announcement of no rate cuts is even more damaging when all the signs of economic slowdown have been evident since October.

It is basically choking the productive sector again based on a ridiculous assessment of inflation risk when the latest Truflation figure shows a 1.4% inflation annualised rate, oil is down, most other commodities are down, and egg and food prices are stable.

Powell and the Fed have ignored monetary aggregates consistently since 2024, and this has created a destructive inflationary spiral followed by an incorrect rate policy.

The Fed keeps damaging the productive sector

The solution is to stop manipulating the price and quantity of money. The Fed is not following its mandate and keeps damaging the productive sector.

The bond market is telling the Federal Reserve that its policy rates are too high. Leading economic indicators are also showing it. If rates floated freely, they would probably be one hundred basis points below the current level.

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All of this demonstrates that the Federal Reserve acts too late and radically, placing the entire impact of its mistakes on families and businesses, while the government debt continues to rise.

The Fed's mess could have been avoided if it had monitored monetary aggregates. It would have been more prudent with asset purchases and rate cuts in 2020; it would have ended the easing cycle in mid-2021, and the path of rate hikes would have been slower, leading to a softer economic impact. How do we know that? Are we unfairly criticising based on hindsight? No.

Economists like Steve Hanke or Tim Congdon and many others have warned of the excessive easing and abrupt rate cuts and hikes since 2020.

The Trump administration's criticisms

The Fed was drowning the economy with liquidity when it was not needed and is now choking the economy for no reason— or only because it is using lagging indicators to inform its policy.

Powell may feel that the Trump administration's criticisms of his work are unfair, but unfortunately the Fed does not have a stellar track record of following its mandate.

The Fed's mistake of keeping rates untouched is a direct attack on the productive sector - Daniel Lacalle

It has created and perpetuated inflation along with an irresponsible administration, and it is asphyxiating the productive economy today by stubbornly stating that the Fed will not support markets.

Powell made the market slump when he stated, "I'd say, 'No,' with an exclamation point," when asked about the Fed having a backstop for the stock market."

This statement is particularly damaging because the Fed's actions have fuelled a liquidity bubble since 2020, leading to an immediate slump in markets that affects families' financing and business credit.

The Fed consistently generates detrimental boom and bust cycles by disregarding monetary aggregates. Choosing to ignore that the US economy has been slowing down rapidly since October will add to the mistakes outlined earlier.

The bond market, true inflation figures, and leading macroeconomic indicators show that rates would be significantly lower today if they were free-floating. The Fed's mistake of keeping rates untouched is a direct attack on the productive sector.