



The Daily Dish

The Case to Cut

DOUGLAS HOLTZ-EAKIN | SEPTEMBER 18, 2024

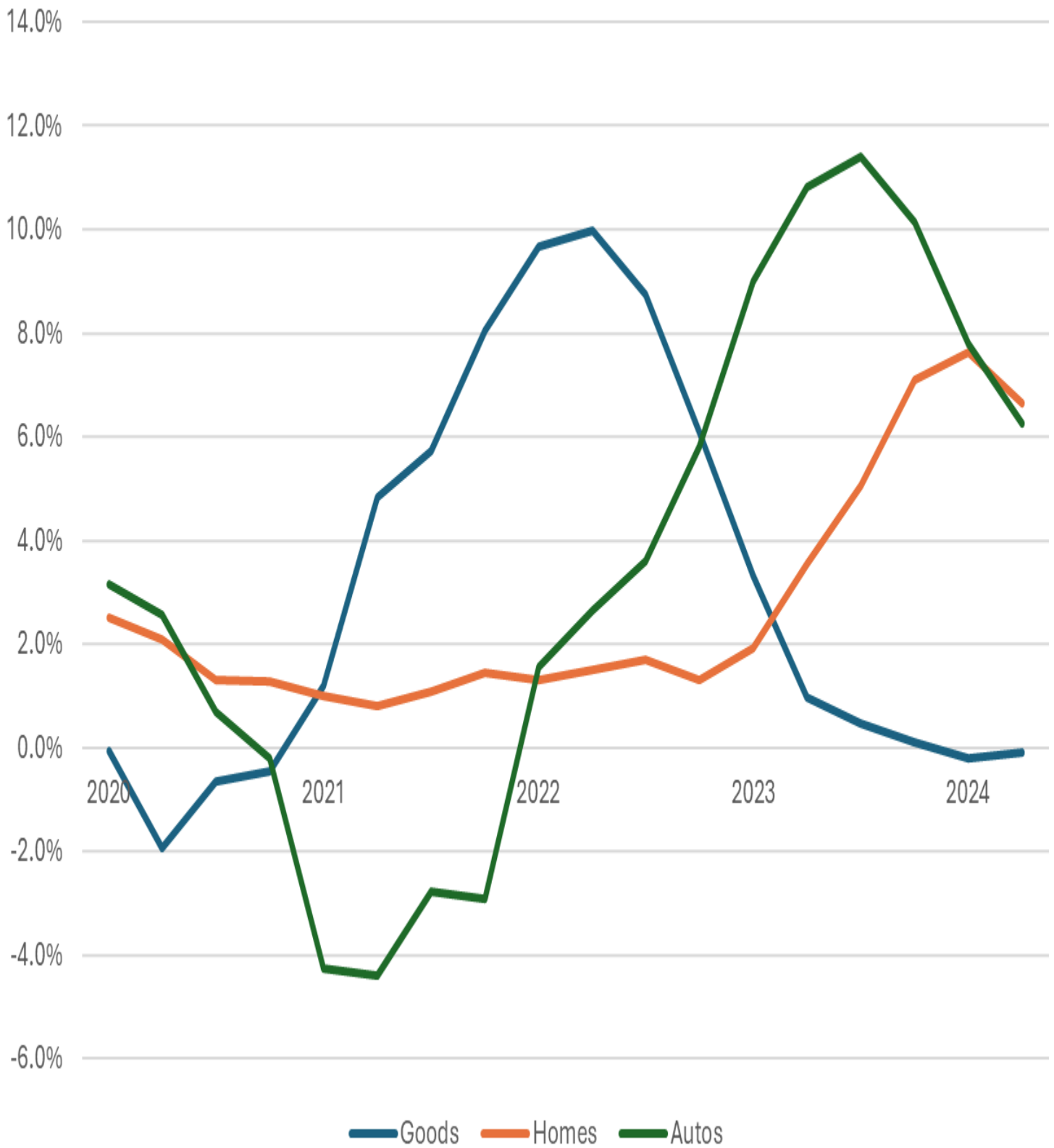
The Federal Reserve is widely expected to cut its target range for the federal funds rate (the policy rate) by 25 to 50 basis points at the conclusion of today's Federal Open Market Committee meeting. This easing of monetary policy comes despite the fact that the latest Consumer Price Index (CPI) report showed inflation at 2.5 percent and core CPI at 3.2 percent. Similarly, the personal consumption expenditures price index was at 2.6 percent in the most recent report. Its core was also 2.6 percent.

None of those numbers is 2 percent, so it raises the obvious question: What gives?

The criteria that have been repeatedly given by Chairman Powell are that the Fed must be confident that inflation would return to, and remain at, the 2 percent target. In past meetings, the FOMC has disappointed the easy-money crowd by remaining unchanged even as actual inflation eased. Its confidence in further declines must be higher now.

It is easy to see the case for further declines. One of the notable areas of upward pressure has come from insurance, especially auto and homeowners (see graph). But as the graph also shows, when goods price inflation heated up, insurance premium inflation remained low for a time.

PCE Inflation: Goods and Insurance



But this had to end because insurance simply covers the cost of replacing goods (cars, etc.), so insurance costs

had to go up. Sure enough, they did. The lag represents the time needed to reassess insurers' exposure, reprice policies, and get them approved by state insurance commissioners. (Notice the regulated nature of insurance precludes the evil "greedflation" from rearing its ugly head.). Now that goods price inflation is tamed, it is sensible to expect insurance inflation to fall in the future.

A similar argument applies to the shelter component of services inflation. As Eakinomics readers know, this is one-third of the CPI and has remained stubbornly high. It had been expected that each month as new leases were signed, their inflation component would ease and, over a year, this would filter into the overall shelter component. This process got held up either by the absence of new supply or the arrival of new demand. With residential construction off its recent lows and the immigration surge abating, the Fed must see the original dynamics playing out.

Or, the Fed could be wrong, in which case it will have repeated the error of the Volcker Fed and eased prematurely. This would be ironic since it is the one mistake Chairman Powell vowed not to make when the Fed launched this tightening cycle in 2023.