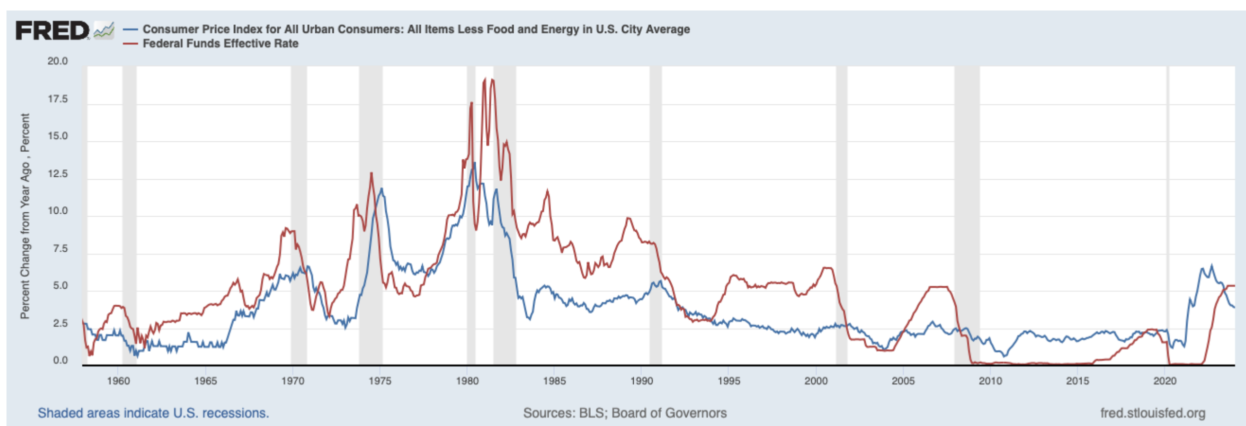
Some perspective on growth, inflation and the Fed funds rate …

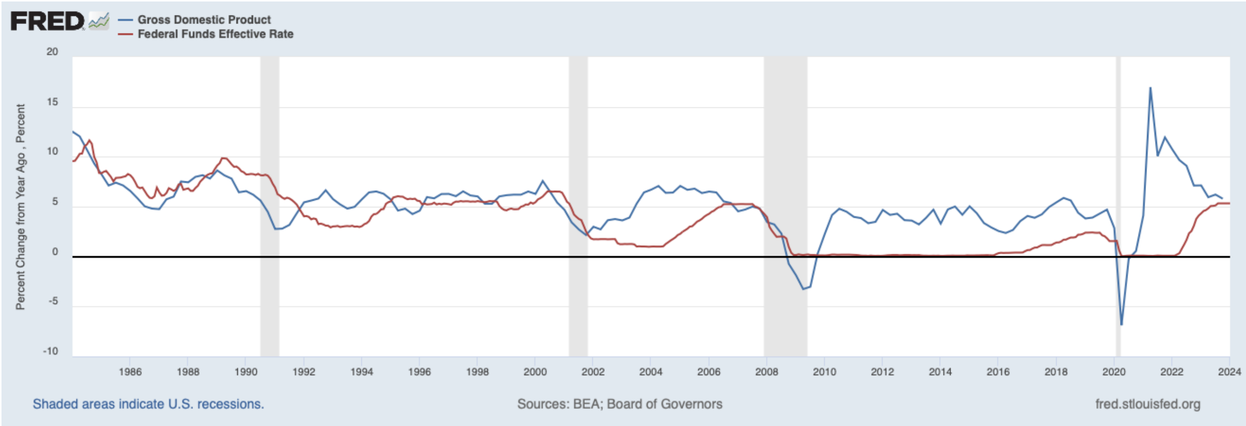
In January 2024, the consumer price index, excluding food and energy – a measure of so-called "core" inflation – was 3.87 percent higher that it was 12 months ago (blue line below). The current Fed funds interest rate, the Federal Reserve's primary policy interest rate, was (and still is) 5.33 percent (red line below). The difference between these two numbers is 1.46 percentage points, or 146 basis points. Is 146 basis points a lot, or a little?

Some folks argue that it is a lot and believe the Federal Reserve should begin lowering the Fed funds rate very soon. But if we ignore most of the ten years following "the great financial crisis" of 2008 & 2009 (GFC) and the early years of Covid-19, two time periods characterized by an extraordinarily low Fed funds rate that was purposefully held well below the inflation rate in America, 146 basis points does not look high, it looks low.

For the 50 years prior to 2008, the Fed funds rate (red line, below) was, on average, 184 basis points above "core" CPI 12-month inflation. If we just look at the 1960s, a period of strong productivity growth and low inflation, the Fed funds rate, on average, was 172 bps above core CPI inflation. In the 1990s, another decade of low inflation and pretty good productivity growth, the Fed funds rate was 193 basis points, on average, above core CPI inflation. So, using these various reference points, the current Fed funds rate looks low, not high, relative to the current pace of 12-month core inflation in the United States.



Another relevant point of reference is growth of current dollar Gross Domestic Product (GDP), (blue line below). GDP growth, versus the same quarter a year ago, was 5.8 percent in the final quarter of 2023. During the past 40 years – apart from the Covid lockdown - the Federal Reserve has only lowered the Fed funds rate (red line below) when current dollar GDP growth has moved below the existing Federal funds rate.



Based on the most recent growth and inflation data, it seems we may be waiting a while for the Fed to cut their target interest rate, and it could be the case that the next move in the Funds rate is up, not down. Especially if the price of crude oil – the most systemically important commodity price in America – continues to move higher.

Douglas Cliggott | 13 February 2024

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