

Dan Hamilton
February 20, 2025

Brief Policy Update

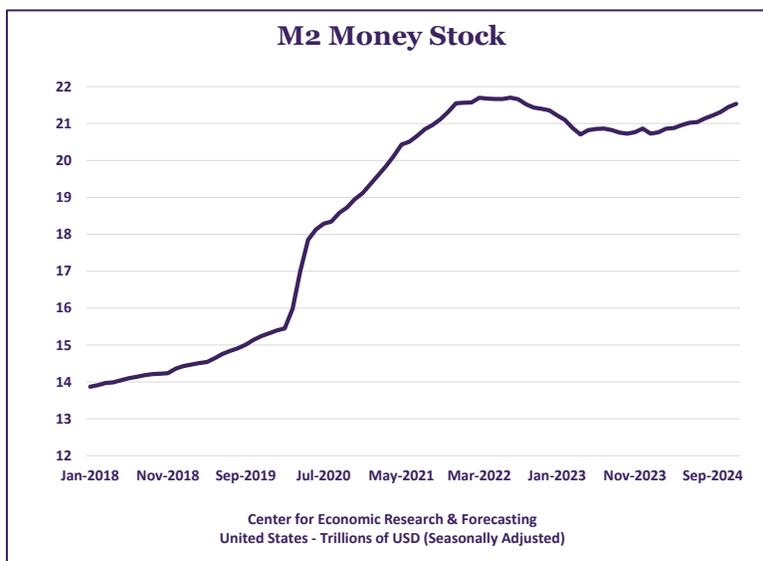
U.S. macroeconomic policy-making continues to sink to ever lower depths of poor policy.

A recent and heavily abbreviated timeline of Washington DC's poor macroeconomic management might start in late 2008. With the U.S. economy in contraction, the Fed embarked on a new set of monetary policy tools that were then, and still now, unconventional, untested, and not recommended by economic theory. When the 2020 pandemic era began, the Fed added more misguided tools to its arsenal,¹ and yet with ongoing hubris, poured an ever greater volume of money into the economy.

The monetary policies referred to above include too-low for too-long interest rates, interest on reserves, and never-ending quantitative-easing (QE-infinity). These policies distort prices, they subsidize risk-seeking, inflate bubbles and create other distortions that pose difficult to manage risks to the overall macro-economy. These policies also reduce financial intermediation, the process of savings and deposits being lent out to those who need credit for their business operations, which reduces investment and current economic growth, as well as future productive capacity.

The expansion of the money supply in 2020 and 2021 is likely to be unprecedented in U.S. history. In April 2020, the money supply exploded by 110 percent annualized, and it remained at double-digit annual growth rates for 24 months beginning in March of 2020, see Figure 1.

Figure 1: U.S. Money and GDP



¹ Average inflation targeting, yield curve control, and corporate bond purchases.

Washington DC embarked on a sequence of misguided fiscal policy expansions with the Pandemic in 2020. After multiple multi-trillion dollar fiscal spending deals during the 2020 through 2024 period, largely supported by both Democrats and Republicans, the U.S. is now one of the world's top ten countries in debt to GDP, not a good group in which to be a member.

Economic research shows that high debt provides detrimental impacts. It raises bond yields and reduces capital investment which in turn reduces current GDP growth as well as future productive capacity. The evidence is strongest for this effect when the debt to GDP ratio exceeds 90 percent (Reinhart & Rogoff 2010). The U.S. debt to GDP ratio has averaged more than 120 percent for four and a half years now, see Figure 2.

Figure 2: U.S. Debt to GDP

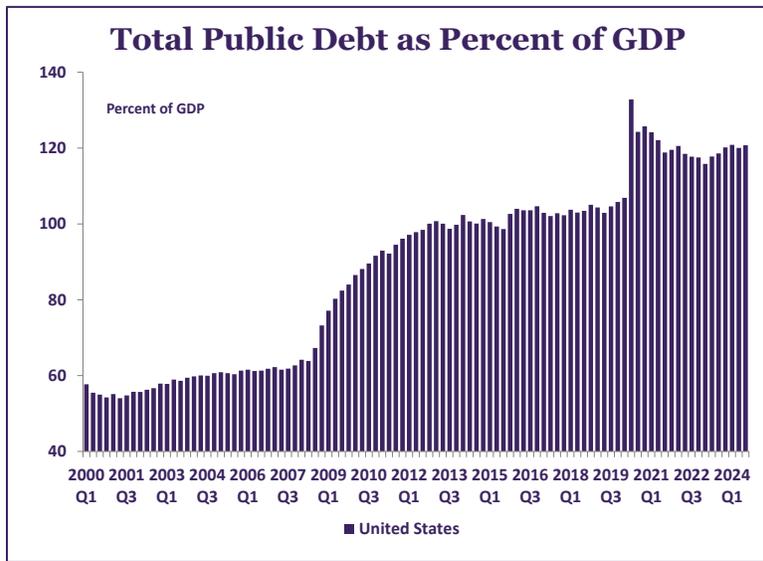


Figure 3: U.S. Consumer Price Index Inflation

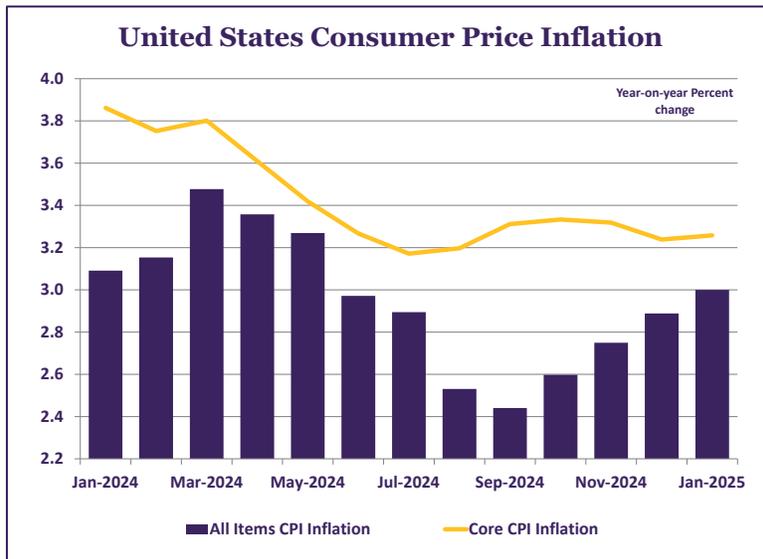


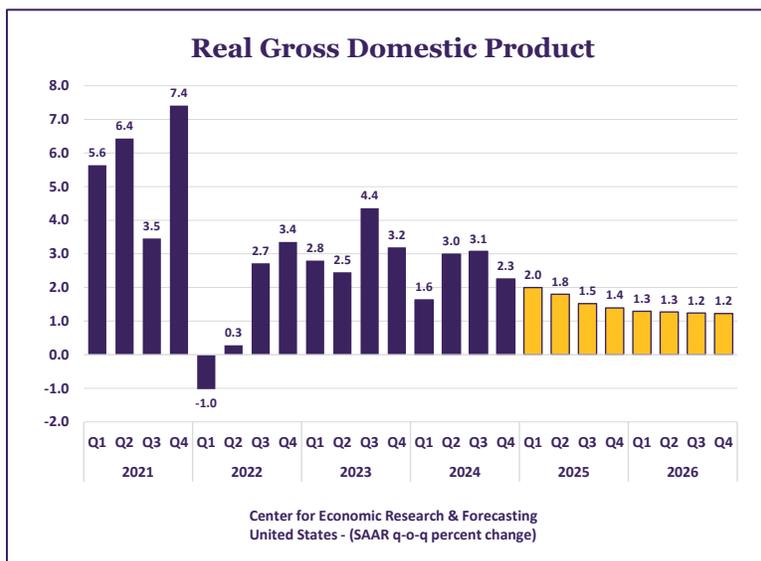
Figure 3, above, shows that CPI inflation has strengthened in every month since September 2024 and Core inflation (excluding food and energy) remains above 3.2 percent and appears poised for greater acceleration. I remind our clients that the Fed did not achieve a soft-landing, as some have claimed, the hypothesis where they engineer a reduction of inflation down to their two percent target without inducing an economic contraction.²

Current Executive Office policymaking has not progressed far enough along for CERF to calculate macroeconomic impacts. However, as we have described before, we note that policy uncertainty can depress investment that has a payoff some years later. This would depress current and future GDP. Certain categories of 2024 investment spending reversed direction from growth in quarter 3 to contraction in quarter 4, which could partially be driven by macro-economic uncertainty.

The Forecast

CERF’s forecast embodies the maintained assumption that poor macroeconomic management will prevail for the next two years. We forecast that economic growth will slow to a particularly low rate in 2026 as the negative impacts of poor policy-making eventually take hold, see Figure 4.

Figure 4: CERF U.S. Economic Growth Forecast



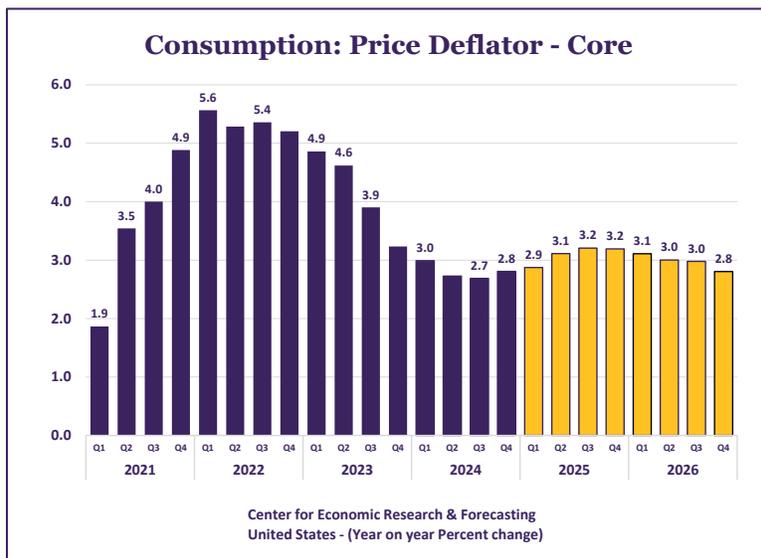
The factors that contribute to inflation appear likely to remain in force for the next two years. This includes the historically large size of the money stock, the ongoing monetary policies that include a policy rate that is still set at a stimulative level, a still too-large balance sheet (\$6.8 trillion dollars), and the Fed desire to cut rates any time they can, which impacts inflation expectations as well as actual inflation.³

² Wall Street Journal “JP Morgan Calls It: The U.S. Economy has Made a Soft Landing” Oct. 11, 2024.

³ Wall Street Journal “Fed’s Waller: Policy Uncertainty Shouldn’t Dissuade Rate Cuts” Feb. 18, 2025.

Our inflation forecast, showing inflation here as the Fed’s preferred measure rather than the CPI, calls for a gradual strengthening of inflation through the end of the year, then a gradual cooling throughout 2026, ending that year at a rate well above the Fed’s two percent target, see Figure 5.

Figure 5: CERF U.S. Inflation Forecast

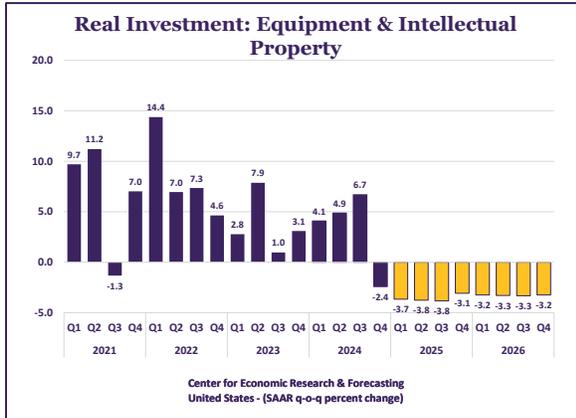


This forecast of the U.S. economy embodies a tension. The economic harm that will occur due to policy will occur (and has been occurring for some time now). But this is offset by the salient underlying strengths of the U.S. economy. While we forecast that the U.S. economy will begin to slow by end of 2025 and that this slowdown will be fully manifested in 2026, the risk exists that the U.S. economy will press on with a strength that, to an extent, pushes past the harmful policies. To be clear, even if this does occur, U.S. economic growth will still be under potential.

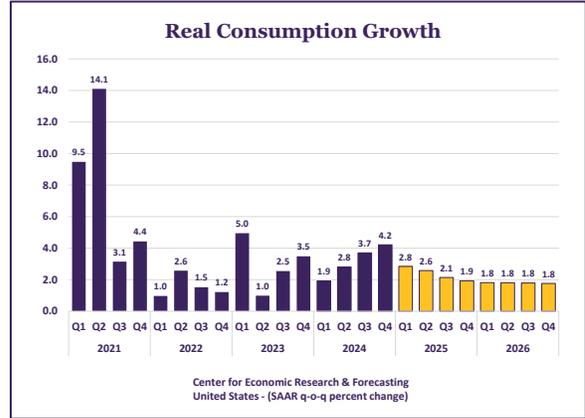
In the spirit of Milton Friedman’s encouragement to economists to recommend better government policy despite low odds of such policies’ political popularity, I call on the Fed, Congress, and the President to engage in thoughtful, rules-based, and longer-run oriented economic policy-making.

Forecast charts are provided on the next page.

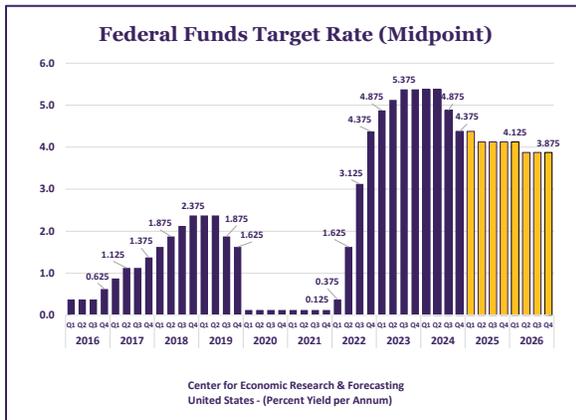
Forecast Charts



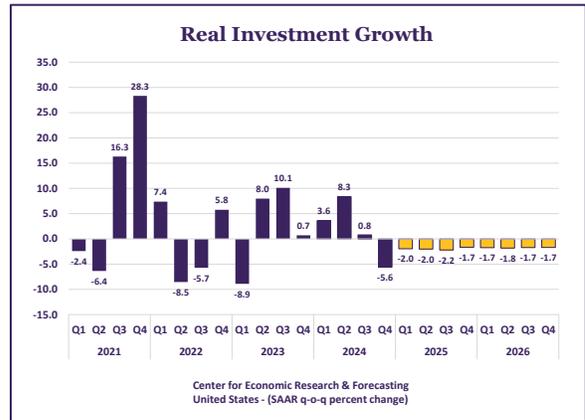
Sources: U.S. Bureau of Economic Analysis, CLU-CERF



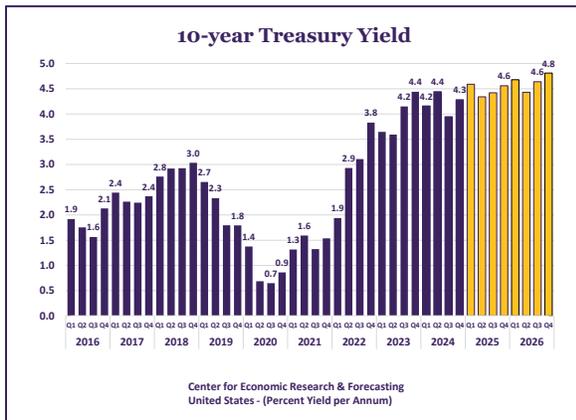
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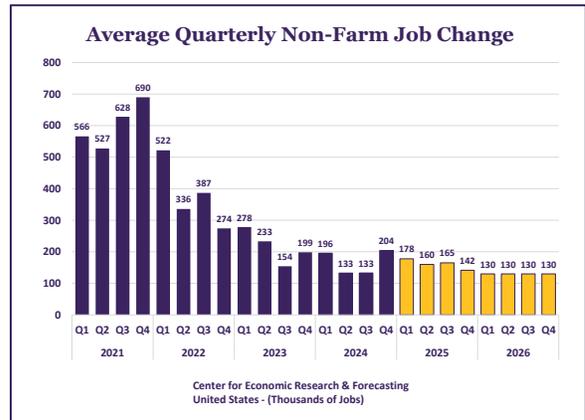
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