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Feasibility Analysis of the U.S. Federal Reserve Achieving Soft Landing

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Abstract: At present, the United States is witnessing an unprecedented level of inflation, which has not been observed in the past 40 years. To navigate the economy, the US Federal Reserve has opted to raise interest rates. This paper provides an in-depth analysis of the potential impacts of the Federal Reserve's policy, drawing upon a wide range of forecasts from economists across various fields and perspectives to present a comprehensive picture of the situation. The central question is whether the US economy will be able to achieve a "soft landing", as anticipated by the Federal Reserve, or whether it will ultimately enter into a recession. In the event of a recession, the paper delves into the severity and duration of the potential downturn, providing insight into what Americans may expect. Given the United States' critical role in the global economy, the Federal Reserve's policy decisions have far-reaching effects. Therefore, comprehending the possible results and consequences of the current interest rate hikes is vital for policymakers and ordinary citizens alike.

Keywords: Inflation, Interest rates, US. Federal Reserve, Soft landing, Recession

1. Introduction

The U.S. Federal Reserve's decision to increase interest rates in order to lower inflation back to pre-crisis levels has sparked debates on whether this will actually be effective, and whether the resulting decline in consumer spending and investment will cause a recession. The Federal Reserve's goal is to achieve a "soft landing" for the economy, but some experts believe that it is more likely to be a "hard landing" for the economy. Additionally, there is disagreement on the severity of the recession that may occur. One potential outcome is that the Federal Reserve's policy will be effective in reducing inflation back to pre-crisis levels. As inflation decreases, real wages will increase, leading to an increase in consumption. While the economy may experience a slowdown, it is predicted that a recession will be avoided. However, there are concerns that the Federal Reserve's policy may have negative consequences, such as a decline in consumer spending and investment, which could lead to a recession. The severity of the recession may be influenced by factors such as the degree of decline in consumer output and investment, as well as external economic factors. To better understand the feasibility of the US Federal Reserve achieving a soft landing, this paper explores both the arguments for and against it. It is important to note that the US economy's impact is global in today's open markets, making this issue relevant to the world as a whole. The potential for a recession in the US has implications for economies around the world, and could lead to widespread economic instability. Therefore, this issue is not only relevant to Americans but also to people around the globe. Ultimately, this paper will shed light on the potential outcomes of the Federal Reserve's current policy and provide valuable insights into the future of the global economy [1].

2. Team Soft Landing

Guy Berger, the principal economist at LinkedIn, is one of the proponents. He believes that although it is impossible to bring inflation down without slowing down the economy, it is possible to avoid triggering a recession, and he offers his reasons from two aspects: (1) the most intuitive one is the data comparison between September and October of 2022 on the personal consumption expenditure price index used to measure inflation, which shows that the growth of data in October has decreased compared to September; (2) the growth of jobs while interest rates increasing proves that labor market's resilience to rate hikes. But what he sees as a possible future risk is that the Fed will further increase the interest rate due to wage growth unless there is a substantial increase in the unemployment rate or a decrease in job openings [2]. The reason is that Powell believes wage growth is the major driver of inflation, and, at present, hourly earning is increasing.

Jeremy Zirin, senior portfolio manager and head of private client US equalities at UBS Asset Management, agrees that while there are some potential risk factors, the chances of implementing a soft landing are greater than people thought. On the one hand, the Fed has made two future plans clear: one is that there will not be more aggressive tightening; another is that, according to Chair Powell, the uncertainty in the market will be reduced and Fed will be very clear, which could reduce investors' concerns about policy mistakes and unpredictable market. On the other hand, Zirin predicted that inflation would peak in these few months, and people would see a decline in inflation in the second half of the year. The government can take this opportunity to reduce the hike [3].

Although there are many uncertainties as to whether Fed can finally accomplish a soft landing, many economists predict that it is achievable through the fairy-tale-like economic data released in early November. The reason they give is: average hourly earnings and retail sales data in November reveal that the retail and consumer level inflation has gradually faded away. The call to ultimately achieve a soft landing depends on the government's ability to keep consumer spending stable. While previous experience tells peope that an increased interest will lower the demand, this time it may be different: the general retail purchase in November was higher than economists expected. Meanwhile, economists have also pointed out several potential problems and constraints: (1) the rise in retail sales mainly comes from online and non-store retailers, but the sales data from physical retailers are not as good as online retailers; (2) the data of Comsumer Price Index (CPI) in November alone does not form the trend of reducing inflation. Plus, the CPI may also look better than the actual situation for various reasons; (3) because of the "long and variable lags" of monetary policy, regardless of the changes in inflation, monetary policy would likely lead to a recession; (4) Fed may enter a recession while waiting for confirmation of the elimination of inflation. However, in general, these economists are optimistic about the arrival of a soft landing [4,5].

3. Team Hard Landing

The economists who believe Fed is tightening into a hard landing also provide compelling reasons. Barry Sternlicht, Starwood Capital Group's CEO, Jeremy Siegel, a renowned finance professor from the Wharton School of the University of Pennsylvania, and Adam Strauss, Co-CEO of Pekin Hardy Strauss Wealth Management argue that the government has not paid attention to the economy's response to the interest hike that has enacted. With energy and housing prices, rent, and CPI all having fallen from the beginning of the year, the Federal should have eased the pressure, but instead, they continued to raise interest rates aggressively when the economy was rapidly slowing down. Three economists suggested several possible explanations for this move: (1) Powell put too much weight

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on the wrong lagging indicator CPI without considering the leading indicator and the housing market; (2) the US. intended to reduce Russia's profits in producing energy by lowering oil demand and prices; (3) US Federal was using the excuse of lowering inflation to raise interest rates to boost bank profits; (4) Powell wanted to protect his legacy. But regardless of the reason, they think Powell will continue to hike rates [6].

The statement by the United Nations Conference on Trade and Development suggests that a soft landing would be an imprudent gamble. It could have very severe consequences on emerging economies, including a debt crisis. The United Nations Conference on Trade and Development (UNCTAD) Secretary-General Rebeca Grynspan has proposed better ways to reduce inflation, such as a windfall profits tax on businesses. And UNCTAD explicitly states that trying to reduce inflation by only raising interest rates is only likely to slow the world economy and end with a recession, for which UNCTAD has lowered its expectations on global economic growth [7].

CNBC conducted a survey with economists, fund managers, and strategists on whether they think the Federal Reserve's policy is going to end in recession, and the results show that most think so, and they expect the average starting time to be in August 2023. These economists expect the average start time to be in August 2023, and yet they all have different ideas on the severity of the coming recession. For instance, Robert Fry, chief economist of Robert Fry Economics LLC, is on the side that the upcoming recession will be mild, and argues that while the recession is inevitable in the process of reaching lower inflation, the likelihood of that recession being severe has decreased due to a recent increase in market interest rates. Contrarily, Joel Naroff of Naroff Economics believes that there is a greater chance that events may turn out worse and linger longer than predicted by most models [8].

Steven Maria, Amber wave partner co-founder and portfolio manager, believes that the recession will start at the end of this year and early next year, based on the historical context, the market was priced by median330 basis points to enter the recession, but now it has already been priced by 450 basis points plus Fed will continue to buy bonds in March, its total expected price is roughly 700 basis points, well above the historical data. The depth of the recession can also be reflected by the massive reduction in housing demand. On the other hand, Steve believes that inflation cannot be attributed entirely to the supply side, but also to policies. As the US Federal has been encouraging speculation and gambling, and the crazy rise in crypto and stock prices as a result of the policies have made people seek to make money through unproductive behavior—trading crypto and stock—rather than finding actual jobs. Once the supply chain from countries like China is disrupted, it will lead to higher volatility on the supply side. As for the investors, they have been used to the government pushing volatility down to bail them out through monetary and fiscal policies, but for the first time in 20 or 30 years, the policies are now pushing volatility up. They are having a hard time adjusting to this shift. The government should not have failed to reduce euphoria in the markets and among consumers ahead of time in response to the policy change [9].

4. Discussion

Based on the analysis of a large number of economists, a harding landing seems more likely to happen. This is because the economists who support a soft landing are mainly looking at one to two months of data to derive a desired scenario. Regardless of whether one to two months of data can represent a trend of a better economy or a decline in inflation, not only do economists who support a hard landing suggest that Powell may be over-valuing the wrong index, but even economists who support a soft landing have concerns about whether the index is falsely overestimated. The proponents of a hard landing are more comprehensive in their considerations. Besides, the Team Soft Landing may have mixed their personal will into their analysis, and look at potential downturns and risk factors in the most optimistic way. On the other hand, they may intend to stabilize the people's minds so that they will not fall into the worry of recession and curtail household consumption and housing demand, which will make the economy become even worse. More importantly, Jerome Powell, the Federal Reserve Chairman who has been claiming that a soft landing is possible, has changed his position in an interview. He publicly admitted that a soft landing is very challenging and affirmed the possibility of a hard landing. He should have been firmer to inspire the public confidence, but he seems to have lost his confidence. This change of stance is very much like a preventative measure in advance for the public to accept the recession in order to fight inflation, so that people will not be shocked when the recession really comes in the future [10].

5. Conclusion

In conclusion, the complex and multifaceted issue of achieving a soft landing for the economy through the U.S. Federal Reserve's attempt to increase interest rates to lower inflation has led to a debate between economists who support a soft landing and those who support a hard landing. The former mainly analyzes the better trend of several data after the policy implementation, while the latter raises concerns about the current situation of goods, housing, and labor markets, as well as the possible negative results. Despite the ongoing pandemic and its economic fallout, economists on both sides of the argument have valid explanations and reasonable analyses to support their stance and maintain cautious optimism. The hope is that the US Federal Reserve will be successful in achieving a soft landing, allowing inflation and the economy to return to pre-pandemic levels. However, there are no guarantees in economics, and anything is possible until the last minute. Therefore, it is crucial to continue monitoring economic indicators and making informed decisions based on the available data. It is also important that people do not cut back on spending and reduce economic activity for fear of a recession as this would worsen the economic predicament. As such, the debate over the feasibility of the US Federal Reserve achieving a soft landing will likely continue, and economists must continue to assess the available data and update their analyses to ensure that they make informed decisions.

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