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The Carlyle Compass

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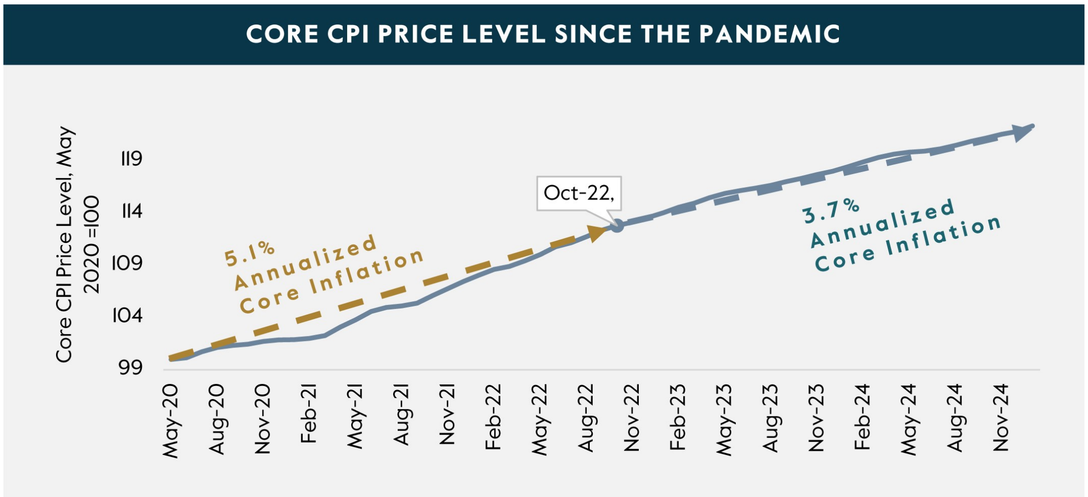
Soft Landing's Illusory Victory

In 2022, many analysts contended that it would not be possible to bring inflation back to target without a recession. This was the "hard landing" hypothesis. Many have since assumed it's been invalidated, but that's not true. Yes, the U.S. economy has thus far escaped recession, but inflation hasn't returned to the Fed's target either.

Economics deals in "if…then" statements; not prophecy, but conditional likelihoods. "Hard landers" weren't necessarily predicting an outright contraction in economic activity. They were simply saying that IF 2% inflation were to be achieved, THEN a recession would be necessary.

Between Q2-2020 and Q3-2022, core CPI inflation in the U.S. averaged 5.1%. Embarrassed by its insistence that inflation was "transitory," the Fed responded with four consecutive 75bps rate increases. By October 2022, an inflection point had been reached. Inflation finally started falling, but not to target; since then, annualized core CPI inflation has averaged 3.7% (Figure 1). *If* we'd all known that the Fed would be willing to accept annualized price growth more than 1% above its professed target, *then* there would have been ample reason to doubt a recession would materialize.

Figure 1: Underwhelming Disinflation



Source: Carlyle Analysis; Federal Reserve, February 2025. There is no guarantee any trends will continue.

We don't have a dog in this fight. At the time the "hard" versus "soft" landing debate was raging, we focused on signs that real interest rates—the economy-wide cost of capital—had adjusted upward. As we wrote in 2023, "the question facing investors" was not "whether the economy must endure a recession before inflation and interest rates inevitably return to prior levels, but whether those prior levels are still realistic endpoints." We argued they weren't, which made all of the "landing" talk silly.

The FOMC never officially raised its inflation target, but actions speak louder than words, starting with the 50bps rate cut in September 2024 with annual core PCE inflation closer to 3% than 2%. We agreed that a cut was merited at the time, but doubted the Fed could cut more than 100bp before inflation would reemerge as a constraint. The constraint we had in mind wasn't the 2% target, but price trends that made clear that inflation was moving further away from it, as seems apparent in the most recent data.

At this stage of the game, it seems hard not to concede the hard landers' point. By prudently deciding that the risks of maintaining base rates at 5.35% outweighed the rewards, the Fed effectively pushed the "landing" debate to that other favorite realm of the economics profession: the counterfactual. What *would have* been required to get annual inflation to 2% was left to the speculation of academicians…

…But probably a recession.

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