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Weekly Commentary

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Markets can't bully the Fed

If there's one thing Federal Reserve officials detest, it's seeming to be kowtowing to the markets. That does happen from time to time, but you won't find many policymakers willing to admit it. It's not so much ego-driven as foundational to implementing monetary policy. Markets trade on expectations. The Fed can't force banks and other financial institutions to adjust rates, and the impact of its action can only influence the Treasury yield curve. Officials need the financial system to follow their actions, not the other way around.

But ever since Chair Jerome Powell's dovish keynote address at the Fed's central bank symposium in Jackson Hole, Wyo., the fed funds futures market has priced in more cuts than policymakers indicated in June and have implied in recent speeches. Notably, some traders are betting the Fed will cut rates by 50 basis points in its September Federal Open Market Committee meeting, rather than the odds-on expectation of a quarter-point reduction. We think that the labor market continues to be solid, if weakening, and that inflation remains sticky. So, we project the Fed will only move by 25 basis points.

Last Friday's release of July's Personal Consumption Expenditures Index was in line with expectations, throwing neither gasoline nor water on the notion of a quarter-point cut. Remember, the Fed was willing to force a recession if necessary to tame inflation. Powell doesn't think they will need to, but rest assured, he will do so if inflation pauses or re-accelerates. In other words, he is in no hurry to ease. The markets might be in for a beating if they continue to fight the Fed.

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