

MARKET COMMENTARY

The Fed needs more data before cutting

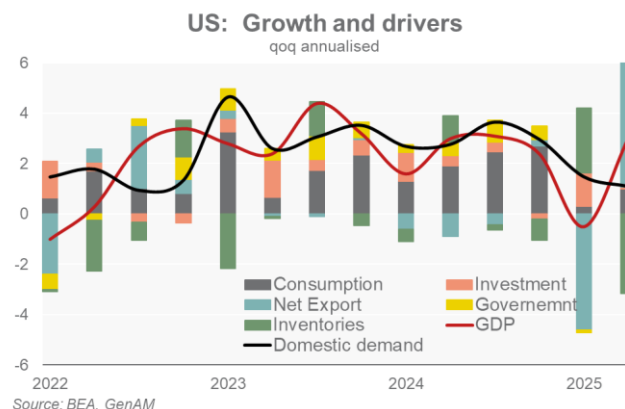
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- The Fed meeting dampened expectations of a quick restart of policy easing. The FOMC acknowledged the visible signs of a growth slowdown but remains focussed on the upside risks to inflation due to tariffs.
- Chair Powell stressed that “modestly restrictive” stance remains appropriate. Two members dissented from the decision not to cut in July, but most of the committee remains strongly in favour of waiting and seeing.
- Given the large gap between the July and the September meeting the Fed will have two months of employment data before deciding and then next price figures will be very informative on the impact on tariffs. T
- The speech at the Jackson Hole meeting (Aug. 21) will prove once again critical. The odds of a rate cut in September (our baseline so far) have reduced to just above 50-50, and we will review our call with the July employment data. But we still see a terminal rate in the 3.25%-3.5% range.

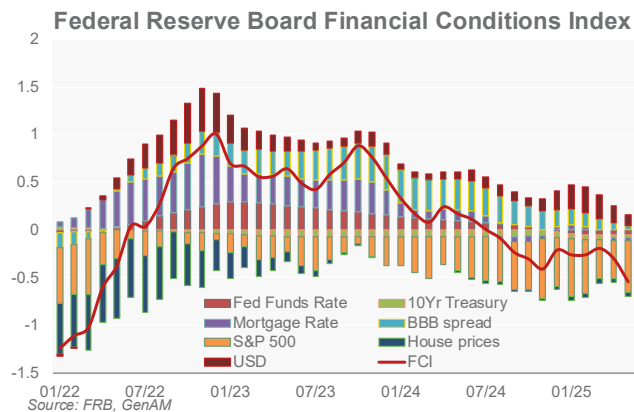
Faced with huge uncertainty in the economic impact of the tariffs and despite unprecedentedly high political pressures for delivering rate cuts, at the July meeting stressed again the need to wait for clarity, given that the economy remains on a relatively strong footing. The decision not to cut was expected, the number of dissenters (two) was the highest since 1993 but that too was well anticipated and has not apparently affected the strong consensus around the need for more data before acting.

The press release was shorter than usual and focussed on the uncertainty on trade and that despite the volatility in economic data activity has “moderated” but the labour market remains solid. Indeed, behind the solid showing of Q2 GDP (+3% qoq ann.) sales to domestic purchases slowed down materially. When asked about that, Powell preferred to note that the labour market remains in balance with quits, job openings and the unemployment rate at roughly the same level as one year ago. The unemployment rate remains the key variable the FOMC looks at and it seems to have stabilised as slower labour force growth is matching weakening demand. Yet, it is important to highlight that job creation looks increasingly fragile, as employment growth comes from a shrinking number of industries. Looking at the 6-month change only 52% of sector post higher employment.



Inflation was where Powell sounded hawkish, probably in attempt to defuse more clearly any hint that the Fed might bow to political pressure. It is true that tariffs are a price level shock, and a central bank should look though it but, in a significant off-script take, Powell stated that the FOMC was “looking through goods inflation by not raising rates”.

Powell also clarified that current policy is not overly restrictive, as most of the committee believe economic performance does not indicate excessive restraint. He also noted that financial conditions remain accommodative and recent fiscal changes may boost demand. Overall, since the economy is not reacting as though rates are far from neutral, there is little justification for the Fed to cut rates simply to reach an uncertain neutral level.



The next meeting will be held on September 16-17 and by then the FOMC will have two more CPI and employment reports, in which the impact of tariffs on activity and tariffs should be more evident. Moreover, as it has often happened in recent years, chair Powell’s speech at the Jackson Hole conference will provide him an opportunity to deliver a clear message on the short-term outlook for monetary policy.

If the aim of the hawkish tome was to dampen hopes of a September rate cut, the FOMC was successful. Markets reduced the priced size of accommodation to 35 bps from 45bp before the meeting. The odds of two rate cuts this year, beginning in September (our baseline so far) have decreased to just above 50-50. We are still confident that the Fed will eventually bring the policy rate in the 3.25%-3.5% range, we will reassess the timing of the first move with the July employment data due this Friday.

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