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Weekly Commentary

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Inflation rises

In the Federal Open Market Committee meeting last week, Chair Jerome Powell said that the risks to the outcome he is hoping for are balanced between employment and inflation. On Friday, the latter might have added more weight on the scale. The growth rate of Personal Consumption Expenditures Index rose both monthly from November and year-over-year: from 0.1% to 0.3% and from 2.5% to 2.6%, respectively. The "core" PCE version, which strips out volatile energy and food prices, also had a higher rate from November but not for the annualized number: 0.1% to 0.2% and 2.8%, respectively.

The uptick fits the trend of inflation's reacceleration in recent months and is concerning to the Fed. Enough so that they held the target fed funds rate at 4.25-4.5% at the meeting, keeping monetary policy restrictive. Powell and company would love to push inflation to, or close to, their long-held PCE target of 2% without slowing the US economy meaningfully down. But the latter might be inevitable if they must hold rates higher-for-longer to achieve that goal. If some of the tariffs that President Trump is considering are inflationary—and that is not a guarantee—we might see rates elevated for much longer than the markets previously envisioned. We think the Fed will still cut rates as much as a half-percentage point this year, but even that should keep liquidity products in a good place as higher rates typically meant higher yields.

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