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Weekly Commentary

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Fed shifts its focus

If anyone has ever said that the Federal Reserve's job is easy probably knows little about monetary policy. While most of the world's central banks focus only on price stability, the Fed must consider that and the health of the labor market. That complicates its decision-making substantially.

For about two years, this hasn't been much of an issue because only inflation needed attention. It had spiked to four-decade highs, prompting Chair Jerome Powell and company to hike rates to the present 5.25-5.5% range. But prices and costs have finally fallen. The Consumer Price Index has plummeted from a 41-year high of 9.1% in June 2022 to 2.5% last month, and the core Personal Consumption Expenditures Index—which strips out elements whose prices are volatile, such as those of food and energy—has declined from 5.6% in February 2022 to 2.6% last July.

Those downward moves put the employment situation in the hot seat, and it has been cooling. In its annual benchmark revision last month, the Labor Department lowered its previously announced number of added jobs within the period from April 2023 to last March by 818,000. On average, then, the economy actually added the fewest workers/positions since the pandemic. Also, the unemployment rate is rising, and other measures of the labor market show softening.

If the Fed wants to avoid pushing the U.S. into recession, it can't hold the fed funds target range at its elevated levels for long. Powell has essentially signaled the pivot to easing will come at the Federal Open Market Committee meeting this week. We think it will be a 25 basis-point cut but won't be surprised if it is 50.

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