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Focus On The Fed

In today's globally financially leveraged world, the level of interest rates matter. Which is perhaps why there is so much fascination with announcements from central banks, with none bigger than the US Federal Reserve. While its official task is to promote maximum employment and stable prices, the Fed's actions can often do more damage than good.

Central banks wield control over the money supply and the short-term price of money (i.e. interest rates). However, market dynamics, including debt levels, their rate of change, growth rates, investment opportunities etc. will ultimately "decide" where longer term rates should be.

As with all central command and control institutions that attempt to set a price, central banks grapple with incomplete information, with their market interventions frequently leading to unintended consequences. For instance, just back in December 2023 while they also kept rates unchanged, they signaled at least 3 cuts this year. Fast forward to today and current narrative has changed quite sharply.

This week's announcement by the Fed reflected the following observations:

1) Given the ***"lack of further progress"*** on inflation – i.e. it's still too high, they had no real choice but to keep short term interest rates unchanged for the 6th meeting in a row.

2) Addressing their 2% inflation target, they said that "***it will take longer than previously expected".***

The current effort by central banks to rein in inflation, and by definition the devaluation of purchasing power to a more acceptable level, can arguably be traced back to their policies following the 2008 financial crisis, further exacerbated in the 2020 pandemic. These measures included lowering the short-term rates to near zero and massively expanding the money supply, which sowed the seeds for the current inflationary environment.

During my recent four-week stay in the US, I saw firsthand the impact of high inflation on consumer goods. Comparing prices in grocery stores to those in South Africa and Europe, I observed substantial disparities, which I know can partly be attributable to higher labour costs.

In conclusion, there is a real possibility that central banks again find themselves lagging in their response to current economic challenges, particularly in their reluctance to lower short term interest rates. Despite ongoing inflationary pressures, there are signs of consumer strain, which will naturally impact the profitability of many consumer-focused companies.

This will however eventually result in the familiar tactic of the central bank being forced to "stimulate" the economy through monetary expansion and interest rate reduction. These measures will again be the tailwind for all real assets.

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If you have any questions about global asset classes or markets, please reach out to Ian and our team directly on global@seedinvestments.co.za.

We would love to hear from you.

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