

Q&A: Fed at a crossroads — Independence, inflation, and investor implications

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Featured Guests: Gino Di Censo, Director of Global Fixed Income and
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Eight years of Federal Reserve (Fed) chairmanship by Jerome Powell is coming to an end in May 2026, with his replacement expected to be announced soon. While the Fed Chair is one voice among the Federal Open Market Committee (FOMC), rising political pressure is challenging Fed independence — a stalwart for financial markets.

While this is happening, the Fed is balancing between sticky inflation, a slowing economy and growing public debt. Some believe we're entering a new policy era of fiscal dominance, yield curve control and financial repression.

To explore what this means for investors, I'm joined by Gino Di Censo, Director of Global Fixed Income and Giuseppe Pietrantonio, Director of Currency and Multi Asset Solutions.

Mark Obrai (MO): Thank you both for joining. Throughout the Fed's history, it has periodically experienced significant pressure from the Whitehouse. Can you start by explaining why we should care about Fed independence?

Giuseppe Pietrantonio (GP): Central bank independence is a critical pillar for ensuring that monetary policy decisions are made with a focus on the long-term health and stability of the economy, rather than being influenced by short-term political considerations. When central banks operate independently from government influence, they are better positioned to pursue objectives such as price stability and full employment — core mandates of the U.S. Federal Reserve.

A key benefit of central bank independence is its role in controlling inflation. An independent central bank can prioritize stabilizing prices, which helps to moderate long-term interest rates and foster a predictable economic environment. In contrast, when governments exert control over central banks, there is a risk that monetary policy may be used to finance fiscal deficits, increasing the money supply by "printing money". This typically leads to runaway inflation and significant currency depreciation, as observed in several Latin American countries and other regions.

Recent market developments underscore the importance of central bank independence. For example, this year we've seen U.S. government bond yields rise significantly as market participants demand a higher risk premium to compensate for perceived fiscal and monetary risks. At the same time, the U.S. dollar has also been impacted, depreciating notably over the past year.

MO: The Whitehouse is once again attempting to assert more control by replacing key figures at the Fed. In the unlikely event Powell is replaced before his term ends in May 2026, how do you see markets reacting?

GP: This would be a major development — if the administration is actually looking to replace Powell or other key Fed officials with people more closely aligned with the Treasury, it raises some important questions about central bank independence, market stability, and political influence over monetary policy. While I still think the chances of Powell being removed are low, especially with his four-year term ending soon, if it were to happen, markets could initially rally on expectations of a more dovish Fed, particularly in risk assets like equities and emerging markets. The dollar would likely weaken as rate differentials narrow.

It's understandable that the administration and Treasury would want lower borrowing costs and more policy alignment heading into a sensitive period politically. But the danger is that undermining the Fed's independence could hurt long-term credibility, unsettle bond markets, and put pressure on the dollar.

MO: One could argue long bonds are reacting negatively to these developments. The curve is steepening, with long bond yields — 30 year US Treasury, 30 year Japanese Government Bonds — rising. Are markets anticipating greater inflation or pricing in sovereign risk?

Gino Di Censo (GD): Markets may be interpreting political influence over the Fed as a signal that monetary policy could become less independent and more accommodative. If investors expect looser policy, particularly in the face of large fiscal deficits, that would naturally push long-end yields higher as inflation risk rises.

From a sovereign risk perspective, while the U.S. still enjoys reserve currency status, there is a growing concern that persistent fiscal deficits, higher debt-to-GDP, and now questions about the Fed's independence could lead investors to demand a higher term premium for holding Treasuries.

MO: Can a fiscally dominant regime fund deficits while maintaining control over the yield curve and inflation? Are we potentially looking at negative real rates over the intermediate term?

GD: Short answer is yes, a fiscally dominant regime can fund deficits while maintaining control over the yield curve and inflation, but only temporarily. Over the long-term, both mechanisms can lead to higher inflationary pressure that undermines control. Near-term rate suppression can create future inflation.

In terms of real rates, they are currently negative and we are potentially looking at that to continue. Negative real rates can shrink debt effectively, but ultimately it negatively penalizes savers. A confluence of factors will ensure that real rates will remain negative over the intermediate term: deficits that stay large, curve management that keeps nominal yields contained relative to inflation and a policy mix that tolerates inflation at elevated levels.

MO: Does the 30yr Japanese Government Bond Yield (JGB) yield at all-time-highs (and rising) and USD depreciation complicate matters for the US?

GD: Yes it does. A breakout in the JGB long-term yields may signal that the world's largest foreign holder of U.S. Treasuries (Japan) may find U.S. bonds relatively less attractive. This could mean less foreign interest in U.S. bonds, putting upward pressure on U.S. nominal yields. Conversely however, if USD weakness fuels inflation or the Fed tolerates higher inflation to help fiscal dynamics, real yields could fall.

GP: Absolutely. While the U.S. government is seeking lower interest rates, a depreciating U.S. dollar can work against this objective. A weaker dollar tends to increase import prices, contributing to higher inflation. This dynamic could make it more difficult for the Fed to proceed with rate cuts aimed at stimulating growth.

MO: Looking at the next few months, we've got a Fed potentially easing into sticky inflation. The market rallied after Powell's Jackson Hole speech, interpreting concerns over employment as dovish. Fed Fund Futures are pricing high odds of a September 17th cut, yet core PCE remains at 2.8% at last read. How do you see this delicate balance playing out over the next few months?

GP: You're absolutely right — the Fed is navigating a complex environment as economic data continues to diverge from its policy stance. In the months ahead, I expect markets to shift between expectations for a near-term rate cut, prompted by softer labour data and weaker PPI, and ongoing concerns about stubborn inflation, with core PCE still hovering around 2.8–2.9%. A September rate cut is largely priced in, with the possibility of further reductions later in the year. While the path toward lower rates appears clear, persistent inflation will make the Fed's approach more challenging. As a result, we may see the Fed implement rate cuts followed by pauses to assess their impact on the economy and to determine whether inflationary pressures, including those from tariffs, remain persistent.

MO: How are you positioning across asset classes, sectors and currencies? Or what are you looking at to determine future positioning?

GP: Across broad asset classes, we remain relatively positive on select global equities. The weaker USD acts as a tailwind for non-U.S. markets where earnings benefit from currency translation and valuations appear more attractive compared to the U.S. That said, given potential risks ahead, we are mindful of our overall risk exposure and are maintaining a cautious approach.

We're still positioned against the USD because of rising fiscal risks, the Fed's tendency to ease even with sticky inflation, and stronger support for other currencies. A weaker dollar can help boost global liquidity and support risk assets, but it also makes imports more expensive, which could drive up inflation in the U.S. This might make things trickier for the Fed and could push long-term yields higher, which in turn could put some pressure on U.S. stock valuations over time.

GD: We are staying cautious on high yield and long-dated corporate given spread tightness. Investment grade is still supported by strong fundamentals, but spreads are historically tight. Selectivity matters.

MO: Thank you for your time.



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