ECONOMICS

FED CHAIRMAN POWELL WITHSTANDS POLITICAL PRESSURE

Dr Jörn Quitzau, 07 May 2025

- **The US Federal Reserve leaves the Fed Funds Rate unchanged at 4.25-4.50%.**
- **In recent weeks, Fed Chairman Jerome Powell has come under massive pressure from US President Donald Trump to ease monetary policy more quickly. Powell has resisted this pressure.**
- **Politically independent central banks are an important prerequisite for price stability.**

The Fed made its interest rate decision in May after a truly historic month of April. It was the first monetary policy decision by the US central bank after Donald Trump drastically tightened tariff policy on April 2 and later attacked the Fed's independence. The attacks on the central bank were aimed in particular at its chairman Jerome Powell ("Mr. Too Late"). Powell withstood the pressure to cut interest rates more quickly and left the key interest rate unchanged at 4.25-4.50%.

The Fed Chairman justified the interest rate decision in his usual fact-based manner with the available macroeconomic data. He emphasized that the current US economic policy is a threat to both central bank objectives (price stability and maximum employment). Inflation has recently fallen slightly further towards the Fed's target of 2%. The consumer price index was only 2.4% higher in March than in March 2024 (core rate +2.8%). PCE inflation, which is important for the Fed, fell from 2.6% to 2.3% (core rate: 2.6%). Inflation is therefore on the right track, but is still somewhat too high. In addition, there is uncertainty about the extent to which tariffs will boost inflation, as while tariffs drive up prices, the foreseeable slowdown in the economy will curb price increases. The net effect can therefore not be clearly determined. On the positive side for the Fed, market-based longer-term inflation rates remain well anchored at just a bit over 2%.

The economic outlook is currently exceptionally uncertain. Or as the Fed writes: "Uncertainty about the economic outlook has increased further." So far, the US economy has remained resilient. Although GDP fell slightly in the first quarter, this was partly due to one-off effects. The labor market remained robust in March. The unemployment rate remains at a low 4.2%. In view of the good employment situation, consumer spending also remains quite stable. However, the economy is likely to weaken noticeably as the year progresses if customs policy and the associated uncertainty take full hold. In anticipation of weaker economic data, the Fed is likely to cut the key interest rate by 25 basis points in June (June 18) or July (July 30) at the latest.

The independence of central banks: Internationally, central bank independence was not the norm until the early 1990s. It was only when empirical studies showed that the independence of a central bank had a positive effect on price stability that the Deutsche Bundesbank model became established and the independence of central banks became the standard. This prevented – or at least made it more difficult – for politicians to involve their own central bank in the financing of government spending. The result has been pleasingly low inflation rates in recent decades (until the major wave of inflation from 2021). At the same time, however, it should be noted that the globalization of the economy picked up speed from 1990 onwards and the low-wage countries were integrated into international production chains. This put pressure on production costs and product prices. Therefore, the long period of low inflation cannot be explained by the work of the independent central banks alone.

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