



Insigneo Weekly Dispatch

# Balancing the Economy Between a Cold and a Heart Attack

Our thoughts on the Federal Reserve's meeting this past Wednesday as it attempts to balance inflation and the labor market.

**By Mauricio Viaud**

Senior Investment Strategist and PM  
Insigneo

## Balancing the Economy Between a Cold and a Heart Attack

As a kid, I remember building towers with dominoes, stacking them up one on top of the other, until I reached the last domino at the top, carefully placing it so as not to topple the whole structure. That was no easy feat. That last domino had to be placed perfectly centered at the top. A little too much one way or the other and the whole tower would collapse. That is what I equate the Federal Reserve's predicament to be right now: if they cut rates too soon, inflation could rise, but if they wait too long, the labor market could collapse, possibly leading to recession. That last domino has to be placed perfectly at the top of the tower. Much like a doctor dealing with an ill patient, sometimes there is not a lot of room for error.

While the markets appeared focused on inflation, we have been very vocal about the fact the labor market, based on the strength of the consumer, was what truly kept us up at night. Inflation is certainly important and part of the Fed's dual mandate of price stability and maximum employment. Inflation, however, is more easily identified. Using a medical analogy, inflation is like having a cold. There are ups and downs and it can be extremely disruptive, but it is more easily diagnosed. We have a general idea about the progression of its trend, but it is more reactive to the correct medicine, in this case monetary policy. Do not get me wrong, left unchecked a cold can easily become pneumonia, just like rampant

inflation can cause chaos in the economy. But since symptoms tend to be more prevalent, whether in the body or the economy, both a cold and inflation tend to receive more immediate attention. However, a weak labor market that leads to recession is like a heart condition that can lead to a heart attack. It is a silent killer that can sneak up on anyone, displaying little to no symptoms until it is too late. Like a heart attack, there are some markers that could indicate a higher risk of the unthinkable happening. In the case of the labor market, weak consumer spending and decreasing payroll numbers could be these markers. But the labor market is backwards looking, appearing to be strong, until it is not. But just like a heart attack, there can be warning signs. If caught on time, a doctor and a patient can react swiftly to try to minimize the chances of anything happening. Left unchecked though, the consequences could be fatal.

Jerome Powell and the Fed find themselves in a similar position right now, trying to balance between a cold and a heart attack. The focus of the Fed has been on fighting inflation, keeping rates elevated for longer than expected. Case in point, the Fed once again left rates unchanged after its meeting this week in an attempt to wrestle inflation back to its long-term target of 2%. In that sense, not much changed during the Fed's July meeting. However, some things did change, meaningfully. Namely the Fed's indication that it is open to start cutting interest rates as early as September, as well as its acknowledgment of the risks of labor market deterioration. A renewed monetary policy easing cycle is, however, dependent on what Powell called "the totality of the data", with the Fed's investment

committee noting, for the first time, that it is "attentive to the risks to both sides of its dual mandate." Before this meeting, the majority of the committee's focus had been on taming inflation. At the same time Powell recognized that unemployment had moved higher, and job openings decreased, stating that "downside risks to the labor market are real now". As a matter of reference, the unemployment rate currently stands at 4.3%, its highest level since 2020, when the covid-19 pandemic was in full swing. Unsurprisingly though, Powell also stated that it would be appropriate for the Fed to lower interest rates only after it had gained "greater confidence" that inflation was on the right track. With this last statement, the Fed is attempting to maintain a degree of flexibility, and rightly so.

Wall Street has been highly reactionary though, so as could be expected, it was quick to price in three rate cuts this year, starting with a 25-basis point in September. In fact, the market is assigning over a 100% probability of a rate cut next month, indicating that some on the Street expect as much as two cuts in September. Powell tried to leave his outlook rather vague, arguing that for the remainder of the year, he "could imagine a scenario in which there would be everywhere from zero to several cuts, depending on how the economy evolves." However, the Fed is finally acknowledging the fact that weakness in the labor market could be a real issue, leaving investors to consider a scenario where the Fed has to cut fast and hard to stave off a labor market collapse that could lead to recession. The economy's "cold" merits treatment so it does not turn into pneumonia, but its "heart condition" begs more importance than it has been afforded.

The shift in focus towards the importance of the labor market does not come as a surprise to us. We have been and continue to remain vocal and attuned to the importance of the consumer and the labor market for the economy and the markets in general. It is encouraging to see that other investors are starting to catch wind of this latent danger as well.

The Federal Reserve was not the only show in town this week, as the central banks of England, Japan, Brazil and Chile also announced changes, or the lack thereof, in their monetary policy stances. Brazil and Chile left interest rates unchanged, with Brazil hitting the breaks on its monetary easing cycle, and Chile likely bringing its cycle to a complete halt. Across the Atlantic, the Bank of England, or BOE, cut rates for the first time since 2020, reducing rates by 25 basis points to 5%. Andrew Bailey, Governor of the BOE, stated that there are likely more rate cuts on the horizon, but that they would take a cautious approach to the easing cycle and would avoid cutting too much to avoid fueling inflation. On the other side of the world, the Bank of Japan, or BOJ, stole the show by moving in the opposite direction to most central banks, hiking interest rates by 15 basis points and reducing its bond purchases by half. This hike was much needed in Japan, as interest rates in this country had lagged most developed markets. Although this move should strengthen the Japanese Yen, the effects on its stock market are still uncertain. On one hand, a higher Yen might deter foreign investors from investing in the country's equity markets. On the other hand, higher rates over time

could cause Japanese citizens who had invested their assets outside of the country, to repatriate these assets and invest in the local market. The jury is still out on Japanese equities, but the Yen should be the clear winner in this scenario.

Unlike Japan, we do not think that the Fed is going to raise rates. We do think that it will try to maintain the delicate balance between cutting rates too soon and waiting too long to cut. If inflation trends lower and the labor market continues to cool at a healthy rate, the Fed could take the same cautious approach as the Bank of England. This would be positive for equity markets. However, if the labor market deteriorates faster than anticipated and the Fed has to cut hard and fast to avoid a recession, this could create turmoil for the markets. We believe that the Fed will begin reducing rates this year. However, the reason behind the cuts is going to be crucial for the markets. The focus has been on fighting the economy's pressing "cold", but the realization that its "heart condition" can no longer be left unchecked is coming to the forefront. The Fed does not want the market to develop pneumonia, but it certainly does not want it to be the victim of a heart attack. It is a very delicate balance between a cold and a heart attack; I do not envy Dr. Powell's predicament.



Click or scan this code to access more insights at [insigneo.com/insights](https://insigneo.com/insights)

## Important Legal Disclaimer

Insigneo Financial Group, LLC comprises a number of operating businesses engaged in the offering of brokerage and advisory products and services in various jurisdictions, principally in Latin America. Brokerage products and services are offered through Insigneo International Financial Services, LLC, headquartered in Puerto Rico, and through Insigneo Securities, LLC, headquartered in Miami. Both are members of the Financial Industry Regulatory Authority (FINRA) and Securities Investors Protection Corporation (SIPC) <https://www.sipc.org/>. Investment advisory products and services are offered through Insigneo Advisory Services, LLC, an investment adviser registered with the Securities and Exchange Commission. In Uruguay, advisory services are offered through Insigneo Asesor Internacional S.A, Insigneo Gestor Internacional S.A, Insigneo Asesores de Inversion Latam, SRL, and Insigneo Asesores de Inversion de Uruguay, SRL, in Argentina through Insigneo Argentina, SAU, and in Chile through Insigneo Asesorías Financieras, SPA. Collectively, these nine operating businesses make up the Insigneo Financial Group. To learn more about the Broker Dealers including their conflicts of interest and compensation practices, please go to <https://insigneo.com/disclosures/> or via [www.finra.org](http://www.finra.org). To learn about Insigneo Advisory Services, LLC and any conflicts related to its advisory services, please see its Form ADV and brochure which can be found at Investment Advisor Public Disclosure website <https://adviserinfo.sec.gov/>

### FOR AFFILIATES LOCATED IN CHILE

Insigneo Asesorías Financieras SPA se encuentra inscrito en Chile, en el Registro de Prestadores de Servicios Financieros de la Comisión para el Mercado Financiero. Este informe fue efectuado por área de Research & Strategy de Insigneo Securities LLC, o sus proveedores, en base a la información disponible a la fecha de emisión de este. Para evitar cualquier conflicto de interés, Insigneo Securities LLC dispone que ningún integrante del equipo de Research & Strategy tenga su remuneración asociada directa o indirectamente con una recomendación o reporte específico o con el resultado de una cartera. Aunque los antecedentes sobre los cuales ha sido elaborado este informe fueron obtenidos de fuentes consideradas confiables, no podemos garantizar la completa exactitud e integridad de estos, no asumiendo responsabilidad alguna al respecto Insigneo Securities LLC, Insigneo Asesorías Financieras SPA ni ninguna de sus empresas relacionadas.

Este material está destinado únicamente a facilitar el debate general y no pretende ser fuente de ninguna recomendación específica para una persona concreta. Por favor, consulte con su ejecutivo de cuentas o con su asesor financiero si alguna de las recomendaciones específicas que se hacen en este documento es adecuada para usted. Este documento no constituye una oferta o solicitud de compra o venta de ningún valor en ninguna jurisdicción en la que dicha oferta o solicitud no esté autorizada o a ninguna persona a la que sea ilegal hacer dicha oferta o solicitud. Las inversiones en cuentas de corretaje y de asesoramiento de inversiones están sujetas al riesgo de mercado, incluida la pérdida de capital.

La información base del presente informe puede sufrir cambios, no teniendo Insigneo Securities LLC ni Insigneo Asesorías Financieras SPA

la obligación de actualizar el presente informe ni de comunicar a sus destinatarios sobre la ocurrencia de tales cambios. Cualquier opinión, expresión, estimación y/o recomendación contenida en este informe constituyen el juicio o visión de área de Research & Strategy de Insigneo Securities LLC, o sus proveedores, a la fecha de su publicación y pueden ser modificadas sin previo aviso.

### FOR AFFILIATES LOCATED IN URUGUAY

En Uruguay, los valores están siendo ofrecidos en forma privada de acuerdo al artículo 2 de la ley 18.627 y sus modificaciones. Los valores no han sido ni serán registrados ante el Banco Central del Uruguay para oferta pública.

### FOR AFFILIATES LOCATED IN ARGENTINA

Insigneo Argentina S.A.U. Agente Asesor Global de Inversión se encuentra registrado bajo el N° 1053 de la Comisión Nacional de Valores (CNV) e inscripto ante la Inspección General de Justicia (IGJ) bajo el N° 12.278 del Libro 90, Tomo -, de Sociedades por Acciones. Este informe fue efectuado por área de Research & Strategy de Insigneo Securities LLC, o sus proveedores, en base a la información disponible a la fecha de su emisión. Para evitar cualquier conflicto de interés, Insigneo Securities LLC dispone que ningún integrante del equipo de Research & Strategy tenga su remuneración asociada directa o indirectamente con una recomendación o reporte específico o con el resultado de una cartera. Aunque los antecedentes sobre los cuales ha sido elaborado este informe fueron obtenidos de fuentes consideradas confiables, no podemos garantizar la completa exactitud e integridad de estos, no asumiendo responsabilidad alguna al respecto Insigneo Securities LLC, Insigneo Argentina S.A.U. ni ninguna de sus empresas relacionadas. La información base del presente informe puede sufrir cambios, no teniendo Insigneo Argentina S.A.U. la obligación de actualizar el presente informe ni de comunicar a sus destinatarios sobre la ocurrencia de tales cambios.

Este material está destinado únicamente a facilitar el debate general y no pretende ser fuente de ninguna recomendación específica para una persona concreta. Por favor, consulte con su ejecutivo de cuentas o con su asesor financiero si alguna de las recomendaciones específicas que se hacen en este documento es adecuada para usted. Este documento no constituye una oferta, recomendación o solicitud de compra o venta de ningún valor negociable en ninguna jurisdicción en la que dicha oferta o solicitud no esté autorizada o a ninguna persona a la que sea ilegal hacer dicha oferta o solicitud. Las inversiones en valores negociables están sujetas al riesgo de mercado, incluida la pérdida parcial o total del capital invertido. Cualquier opinión, expresión, estimación y/o recomendación contenida en este informe constituyen el juicio o visión de área de Research & Strategy de Insigneo Securities LLC, o sus proveedores, a la fecha de su publicación y pueden ser modificadas sin previo aviso.