WEEKLY STRATEGY
Perspectives

BMO Private Wealth

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Michael Gregory, Deputy Chief Economist, BMO Capital Markets
Sal Guatieri, Senior Economist, BMO Capital Markets

Guest Feature – Fed Independence Under Fire?

"The phrase 'perception is reality' is overused generally. But perception can be reality in monetary policy. The bond market doesn't act merely on what it sees. It acts on what it expects of the Fed or the government."
– Amity Shlaes

The Through Line: Central banks play a key role in economies around the globe with their oversight and transmission of monetary policy. In carrying out those duties, it is critical for end users – businesses, investors and consumers – to believe that those functions are conducted from a stance of independent thought and freedom from political influence.

'You're (not) fired!'

In his trademark style, President Donald Trump recently said he has *"no intention"* of firing Fed Chair Jerome Powell only days after threatening to do just that. In a reprise of his first term, the President had assailed Mr. Powell for not cutting interest rates to support the economy's flagging momentum. In 2018, the Fed was tightening policy to curb inflationary pressures, while today's debate focuses more around when policy easing will resume. Tomorrow, the President could have a change of heart and resume calling for Powell's dismissal, which begs one question: **Can the President actually remove the Chair before his term ends in May 2026?**

Not easily is the short answer. Presidents do not have explicit legal authority to fire Federal Reserve Board members. As an independent agency, the Fed hires and fires its own personnel. However, the Federal Reserve Act stipulates that Fed Board members shall serve 14-year terms unless removed "for cause" by the President. While the act does not define "cause," it typically refers to misconduct or malfeasance – not disagreements over policy. Still, this leaves an opening for the President to challenge Mr. Powell's position in court. In fact, Mr. Trump has recently asked the Supreme Court to remove two members of federal labor boards – also independent agencies – arguing that the "for cause" restriction is unconstitutional. Should the Court rule in his favor, it could embolden him to attempt the same with Chair Powell or other Fed governors.

The benefits of independence

Independence from political influence is widely regarded as essential in order for the Fed to fulfill its dual mandate of price stability and maximum employment. This twin goal is inherently difficult to achieve and involves a delicate balancing act since policy changes often impact inflation and growth in opposite ways. Lowering interest rates boosts growth, for example, but could also feed inflation. Political influence, especially when driven by short-term goals such as stimulating the economy or reducing unemployment, can lead to overheating, which compromises the economy's long-term health. If the Fed is forced to abruptly tighten policy to arrest inflation, the economy could slip into recession, bringing negative implications for financial markets.

Central bank independence is critical for maintaining long-term stability of both inflation and growth. The Fed's credibility is easier to uphold when investors, businesses and consumers believe it is fully committed to price stability and insulated from political interference. Under these conditions, inflation expectations are more likely to remain anchored to the inflation target, reducing the need for aggressive actions.

The President's recent threats to fire the Chair might explain recent selling pressure in U.S. assets – including stocks, Treasuries and the dollar. At a minimum, uncertainty alone appears to have contributed to heightened market volatility. **Should the President move to replace Mr. Powell with a more compliant (i.e., dovish) successor, Treasuries could come under renewed pressure.** And lest we forget, U.S. monetary policy is decided by 12 members of the Federal Open Market Committee, including the Chair, six other Board members, the president of the New York Fed, plus four other rotating regional Fed presidents.

History lessons

Although Mr. Trump is the only president who has openly threatened to fire a Fed chair, **history offers a few precedents that raised similar concerns about central bank independence:**

- In the 1960s, President Lyndon B. Johnson reportedly pressured Fed Chair William McChesney Martin Jr. to lower interest rates to support economic growth during the Vietnam War. These lower rates may have contributed to a meaningful pickup in inflation in the mid-1960s and the subsequent need for tighter monetary policy.

- In the early 1970s, President Richard Nixon pushed Fed Chair Arthur Burns to ease policy ahead of the 1972 election. Many analysts believe this contributed to a prolonged era of stagflation – high inflation coupled with sluggish growth. Long-term inflation expectations surged, complicating the Fed's efforts to curb runaway prices.
- A more extreme case occurred in Argentina around the start of this century when a collapsing economy – real GDP shrank 28% over a four-year period – was accompanied by hyperinflation and currency devaluation. The crisis was likely exacerbated when the government dismissed the central bank head in 2001.
- A more recent example of where government interference with the central bank led to hyper-inflation was in Turkey. The central bank chief was replaced with another who slashed policy rates, sending the annual CPI rate to 86% in October 2022.

These episodes indicate that **compromising the Fed's credibility as an independent policymaker in order to achieve short-term political gains could be a costly mistake**.

The Fed's complicating dual mandate

Among G7 central banks, the Federal Reserve is the only one with a dual mandate, namely, to promote both price stability and maximum employment. The others (Bank of Canada, Bank of England, European Central Bank, and Bank of Japan) have a sole mandate: promote price stability. Note that in 2021, the Bank of Canada was charged with taking into account the deviation from maximum employment, but only as a secondary consideration; the primary focus is still on price stability. Among the world's other central banks, price stability is the most frequent monetary policy goal with financial stability being a common co-mandate. A much smaller set of global central banks has policy mandates with a second economic aim.

The reason that there's a smaller group of practitioners with dual economic mandates is that it's harder to craft and communicate monetary policy while pursuing two potentially conflicting objectives. It's an easier choice when inflation is persistently above target and the economy is close to full employment (a case for restrictive policy), or when inflation is persistently below target and there is lots of labor market slack (a case for accommodative policy).

The tougher decision is when the policy environment has elements of both extremes, such as during stagflation. The Fed's formal guidelines aid in crafting policy in these cases. They say: *"The Committee's employment and inflation objectives are generally complementary. However, under circumstances in which the Committee judges that the objectives are not complementary, it takes into account the employment shortfalls and inflation deviations and the potentially different time horizons over which employment and inflation are projected to return to levels judged consistent with its mandate."* Amid the unfolding stagflation shock from tariffs, **we reckon that compelling evidence showing that employment is dropping, or is on track to do so, will trump any inflation concerns because current policy is still on the restrictive side and prompt the Fed to resume rate cuts. But, short of this, the Fed's focus will likely tilt to tariffs' immediate inflation impulse, delaying rate cuts for a few more months.**

What should investors watch for in the months ahead?

U.S. import prices are poised to rise owing to tariffs. And we wouldn't be surprised to see the prices of (domestically produced) import-competing goods also increase – but to a noticeably lesser degree. Since inventories of imported items surged in anticipation of tariffs, these price impacts could be delayed until inventories are depleted. However, as the impacts unfold, in aggregate they will contribute to a one-time jump in the general price level. Measured by the change from a year earlier, this will show up as a meaningful increase in inflation from its pre-tariffs level for the next 12 months.

The main worry for the Fed is whether this one-time, tariff-induced jump in the price level will cause any second-round or feedback pressures (for example, if wage growth increases to make up for higher retail prices or businesses use the veil of tariffs to pad their profit margins). The Fed has an ally here. Economic growth is going to slow thanks to tariff-induced erosion of purchasing power and potential retaliatory measures, which should guard against second-round pressures. Moreover, the recent deep pullback in oil prices will also help contain headline inflation in the near term. Beyond a month or two of inflation reports, the Fed will be scouring the data for any indications of feedback pressures in the month-to-month moves. The Fed won't wait around until the initial influence of tariffs falls out of measured inflation. But no matter how long the Fed delays easing, it will still likely be too long for the Trump administration if recent events are any guide.

With Fed policy still on the restrictive side, we expect the FOMC will resume rate cuts before summer's end, presuming we get at least a couple of subdued month-to-month inflation readings after the immediate tariff lift. The wait will also be determined by whether economic and labor market performance softens materially, which we believe it will. Communicating rate cuts amid annual inflation rates running in the range of 3% to 4% will take some skill, particularly with the administration likely to take credit for causing the Fed to act.

In focus in North America

Carol Schleif, CFA, Chief Market Strategist
George Trapkov, CFA, VP and Portfolio Manager

This week

U.S. markets in search of a vibe change – Global capital markets remained highly sensitive to the news cycle, with U.S. stocks, bonds and the dollar declining in unison (a highly unusual anomaly) on several occasions. Investors were left wondering if the tarnishing of the U.S. exceptionalism crown was a lasting or interim phenomenon. It hasn't helped that the news flow began the week lopsided, with Congress out of town on its two-week Easter break (a.k.a. no constructive pro-growth headlines re tax policy, budget cuts or deregulation). On the other hand, Fed governors were out in force on the talk circuit before the quiet period that begins on Saturday ahead of the next FOMC meeting. Their commentary reinforced Chairman Powell's recent assertions that the Fed has ample reason to observe from the sidelines (versus rush to cut rates) until the impacts of trade policy become clearer.

President Trump's social media posts over the weekend expressing his displeasure with Fed Chair Powell helped spark declines in major averages on Monday. These declines reversed (with notable gains in risk assets) on Tuesday and Wednesday as President Trump told reporters during a Tuesday press conference that he never intended to fire Mr. Powell. He, along with other administration officials, also hinted that there is substantial room to bring down Chinese tariffs. **Bottom line: despite earnings season ramping up – with plenty of fundamental news to chew on – market participants and the risk on/off trade remain highly sensitive to social media posts and macro headlines as they search for evidence that enough of the potential risks are discounted in current prices.**

Updated world IMF growth estimates – Tariff, trade policy and global growth were on the agenda as global finance leaders met in Washington, D.C. this week for spring meetings of the International Monetary Fund and World Bank. Coincident with the start of the event, the IMF released its growth outlook, dropping both global and U.S. expected growth while nudging anticipated inflation numbers higher. For the U.S., the group now pegs 1.8% growth versus the prior expectation of 2.7% it listed in January. Simultaneously, the group expects inflation to reaccelerate in response to heightened global trade tensions.

"America first does not mean America alone" – U.S. Treasury Secretary Scott Bessent told attendees at the Institute for International Finance Forum in Washington, D.C., on Wednesday morning. This gathering, held in conjunction with meetings of the IMF and World Bank, helped reassure the global finance heads and central bankers in attendance who "breathed a sigh of relief" that the U.S. was not angling to pull out of its global leadership role. Mr. Bessant noted that both organizations played critical roles in global finance and the U.S. was looking forward to partnering with them – as long as they refocused their efforts back to their core mission: securing global economic and financial stability. Mr. Bessent's prepared remarks noted that an "America first" policy means the country wants to continue to play a role in engaging with and helping rebalance a distinctly imbalanced global trading system.

U.S. business activity on pause, awaiting policy clarity – The Fed's most recent Beige Book highlighted continued consternation relative to unclear tariff policy, rising costs and subdued hiring and expansion plans. Some regions reported price increases and/or plans to increase levies as the import duties already in place begin to bite. Business leaders noted efforts on a number of fronts to constrain costs and shore up margins as they wait for the picture to clear. Wednesday's release of the Purchasing Manager Indexes illustrated similar themes. The manufacturing index came in a bit above expectations, presumably as companies accelerated projects ahead of tariff implementation. The Services PMI was a bit softer than expected but remained in expansion territory at 51.4.

Canada's inflation should remain muted – The Canadian dollar has surged by 4% since the start of the month, now hovering close to levels from a year ago. Previously, the Bank of Canada viewed a weaker currency as a key driver of inflation in the context of a trade war. However, the broader U.S. trade battle is exerting downward pressure on the U.S. dollar. Energy prices continue to shape headline inflation, with Canada seeing additional relief from the removal of the consumer carbon tax. The BoC estimates that this policy change alone will reduce headline inflation by 0.7 percentage points for a year. Meanwhile, national gas prices have dropped 20% year over year. An interesting shift in travel-related costs also contributed to inflation relief as many Canadians avoided U.S. trips – a sign that trade tensions can have reciprocal effects on pricing. With inflation easing and the possibility of a weak second and third quarter, the BoC is positioned to lower interest rates. BMO Economics anticipates three rate cuts by the end of the year, bringing the overnight rate to 2.0%, slightly below the Bank's perceived neutral range of 2.25% to 3.25%.

Canadian elections next week – Canadians will head to the polls on Monday to vote in the federal election. The Conservatives are promising $34 billion in new spending and $75 billion in tax cuts over the next few years. They plan to fund the cuts with spending reductions and increased government revenues. Liberal leader and current Prime Minister Mark Carney released his election platform outlining a sizeable deficit and more than $28 billion in spending cuts over the next four years. The Liberals plan to spend over $130 billion during their term if they win. According to preliminary figures from Elections Canada, a record 7.3 million Canadians cast their ballots at advance polls. This is a 25% increase from the 5.8 million who voted early in the 2021 general election. The CBC's most recent poll tracker numbers suggest that the margin between the Liberals and Conservatives has narrowed, with Liberals still in the lead.

Next Week

It will be a data-rich week, with several key employment reports, an initial read on U.S. and Canadian GDP and the Fed's preferred inflation metric, the PCE, all due out. Congress is back from break and hopefully will get to work on spending cuts, business friendly tax policy and some regulatory reform. Fed officials are all in the quiet period ahead of the upcoming FOMC meeting. Earnings season rolls on.

- **Monday 4/28 –** Canada Wholesale sales
- **Tuesday 4/29 –** U.S. Inventories, Consumer confidence, JOLTS
- **Wednesday 4/30 –** U.S. ADP Employment, GDP, PCE | Canada GDP
- **Thursday 5/1 –** U.S. President Trump celebrates the 100th day of his administration, initial jobless claims, ISM Manufacturing | Canada Manufacturing PMI
- **Friday 5/2 –** U.S. Employment report and Factory orders

Data scorecard as of April 23, 2025

Equity Market Total Returns						
	4/23/2025 Level	WTD	YTD	2024	2023	2022
S&P 500	5,376	1.8%	-8.2%	25.0%	26.3%	-18.1%
NASDAQ	16,708	2.6%	-13.3%	29.6%	44.7%	-32.5%
DOW	39,607	1.2%	-6.4%	15.0%	16.2%	-6.9%
Russell 2000	1,919	2.1%	-13.6%	11.5%	16.9%	-20.5%
S&P/TSX	24,473	1.2%	-0.2%	21.7%	11.8%	-5.8%
MSCI EAFE	8,795	1.9%	8.8%	3.8%	18.2%	-14.5%
MSCI EM	589	2.6%	2.6%	7.5%	9.8%	-20.1%
Bond Market Total Returns						
		WTD	YTD	2024	2023	2022
Bloomberg U.S. Aggregate		-0.2%	1.8%	1.3%	5.5%	-13.0%
Bloomberg U.S. Treasury		-0.2%	2.2%	0.6%	4.1%	-12.5%
Bloomberg U.S. Corporate		-0.1%	0.9%	2.1%	8.5%	-15.8%
Bloomberg U.S. High Yield		0.7%	0.5%	8.2%	13.4%	-11.2%
Bloomberg 1-10 Year Munis		-0.1%	-0.4%	0.9%	4.5%	-4.7%
Bloomberg Canada Aggregate		-0.7%	0.1%	4.0%	6.5%	-11.3%
Bloomberg Canada Treasury		-0.7%	0.5%	2.9%	5.0%	-9.9%
Bloomberg Canada Corporate		-0.3%	0.4%	6.9%	8.2%	-9.5%
Government Bond Yields						
	4/23/2025	Last Month End	Last Quarter End	2024	2023	2022
U.S. 10-Year Treasury	4.38%	4.21%	4.21%	4.57%	3.88%	3.88%
Canada 10-Year Government	3.24%	2.97%	2.97%	3.23%	3.11%	3.30%
U.K. 10-Year Gilt	4.55%	4.67%	4.67%	4.56%	3.53%	3.66%
German 10-Year Bund	2.50%	2.74%	2.74%	2.36%	2.02%	2.57%
Japan 10-Year Government	1.33%	1.49%	1.49%	1.09%	0.61%	0.41%
Currencies & Real Assets						
	4/23/2025 Level	WTD	YTD	2024	2023	2022
USD Index	99.84	0.6%	-8.0%	7.1%	-2.1%	8.2%
CAD:USD	$0.72	-0.2%	3.6%	-7.9%	2.3%	-6.7%
Bitcoin	$93,686.03	10.9%	0.0%	120.5%	157.0%	-64.3%
Gold	$3,288.34	-1.2%	25.3%	27.2%	13.1%	-0.3%
Oil (WTI)	$62.27	-3.7%	-13.2%	0.1%	-10.7%	6.7%

**Benchmark data does not reflect actual investment performance but reflects benchmark results of the underlying indices referenced. You cannot invest directly in an index. Index definitions can be found at the end of this publication.*

Index Definitions

Equity indices

S&P 500® Index is an index of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

NASDAQ Composite Index is a market-cap weighted index of the more than 3,000 common equities listed on the Nasdaq stock exchange.

Dow Jones Industrial Average ("DOW") is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the Nasdaq.

Russell 2000® Index (Russell 2000®) is an unmanaged index that measures the performance of the smallest 2000 U.S. companies in the Russell 3000® Index.

S&P/TSX Index is a capitalization-weighted equity index that tracks the performance of the largest companies listed on Canada's primary stock exchange, the Toronto Stock Exchange (TSX).

MSCI EAFE Index (Developed Markets —Europe, Australasia, and Far East Index) is a standard unmanaged foreign securities index representing major non-U.S. stock markets, as monitored by Morgan Stanley Capital International. The index captures large and mid-cap representation across 21 developed markets countries around the world, excluding the U.S. and Canada.

MSCI Emerging Markets Index is a market capitalization weighted index representative of the market structure of the emerging markets countries in Europe, Latin America, Africa, Middle East and Asia. Prior to January 1, 2002, the returns of the MSCI Emerging Markets Index were presented before application of withholding taxes.

Fixed income indices

Bloomberg U.S. Aggregate Bond Index is an unmanaged index that covers the U.S. investment-grade fixed-rate bond market, including government and credit securities, agency mortgage pass-through securities, asset-backed securities and commercial mortgage-based securities.

Bloomberg U.S. Treasury Index is an unmanaged index that includes a broad range of U.S. Treasury obligations and is considered representative of U.S. Treasury bond performance overall.

Bloomberg U.S. Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by U.S. and non-U.S. industrial, utility and financial issuers.

Bloomberg U.S. Corporate High Yield Index is an unmanaged index that covers the USD-denominated, non-investment-grade, fixed-rate, taxable corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+ or below.

Bloomberg 1-10 Year Blend Municipal Bond Index is a market value-weighted index which covers the short and intermediate components of the Bloomberg Capital Municipal Bond Index — an unmanaged, market value-weighted index which covers the U.S. investment-grade tax-exempt bond market.

Bloomberg Canada Aggregate Bond Index measures the investment grade, Canadian dollar-denominated, fixed-rate, taxable bond market. It includes treasuries, government-related, and corporate issuers.

Bloomberg Canada Aggregate Bond Index - Treasury is the treasury sub-component of the Bloomberg Canada Aggregate Bond Index, which measures the investment grade, Canadian dollar-denominated, fixed-rate, taxable bond market.

Bloomberg Canada Aggregate Bond Index - Corporate is the Corporate sub-component of the Bloomberg Canada Aggregate Bond Index, which measures the investment grade, Canadian dollar-denominated, fixed-rate, taxable bond market.

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