

Economic & Market Watch Intelligence Brief

Briefing

- Prior to 2008, the Federal Reserve adjusted interest rates mostly by buying and selling Treasuries (open market operations). This injected money into the economy, driving rates down. In 2008, as part of its emergency response to the financial crisis, the Fed began paying banks interest on the reserves they hold at the Fed (a floor system). A higher rate makes it more attractive for banks to hold reserves instead of expanding loans. The Fed formally adopted the floor system as its permanent operating framework in 2019.
- Using open market operations, the Fed can directly influence short- and long-term rates by buying short-term and long-term Treasuries. Prior to 2019, long-term rates would change, on average, 71 basis points (bp) for each 100 bp change in the effective Fed funds rate (**Figure 1**).
- Using the floor system, the Fed can only directly influence short-term rates. Since 2020, long-term rates change, on average, only 58 bp for each 100 bp change in the effective Fed funds rate (**Figure 2**).
- The switch has shifted the impact of Fed policy away from long-term rates toward short-term rates. On average, short-term rates changed 85 bp prior to 2020, but 100 bp since 2020, for each 100 bp change in the effective Fed funds rate (**Figure 3**).

Chart of the Week: Deficits Force Fed To Choose

Who Owns Treasuries	Why They Bought Treasuries	Amount Owned (Trillions)
Markets	Investment.	\$26.4
Intragovernmentals (e.g., Social Security)	Legal requirement.	\$7.5
Federal Reserve	Consequence of monetary policy.	\$4.2

Fed Slows Money Growth

Markets fully finance the deficit.



Fed Accelerates Money Growth

Fed partially finances the deficit.



Commentary

Nominal interest rates measure interest in terms of dollars. These are the rates we hear quoted in the news. But real interest rates are what matter. These measure interest in terms of purchasing power.

When the Fed cuts nominal rates, it loosens financial conditions with the intent of putting downward pressure on real interest rates. Lower real rates encourages borrowing, which stimulates economic growth. But the increased growth typically puts upward pressure on prices, presenting the Fed with a tradeoff: applying downward pressure to real interest rates can yield both economic growth and inflation. Which is greater depends on conditions.

Federal deficits add a third factor to the mix (**Chart of the Week**). To fund its deficits, the government borrows from markets. The increased demand for financing puts upward pressure on interest rates, making it more expensive for everyone else to borrow. That slows economic growth.

The Fed can offset some of this by cutting nominal interest rates, but doing so risks adding to inflation pressures if demand is already strong. In the end, we pay for deficits either in the form of higher real interest rates or higher inflation. Which we get depends on how the Fed and markets react.

Snapshots

Figure 1. Long-Term Rate Response to Fed Funds Rate (1962–2019, Monthly)

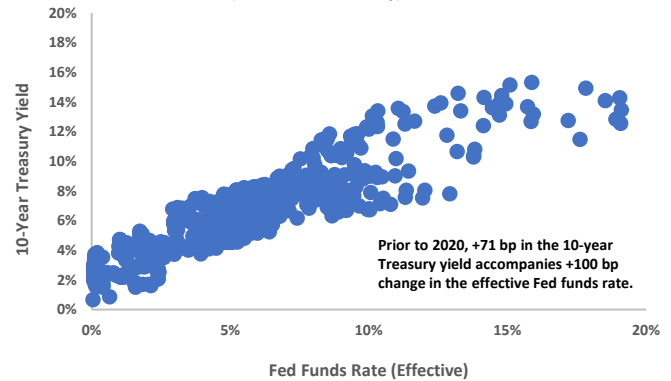


Figure 2. Long-Term Rate Response to Fed Funds Rate (2020–2025, Monthly)

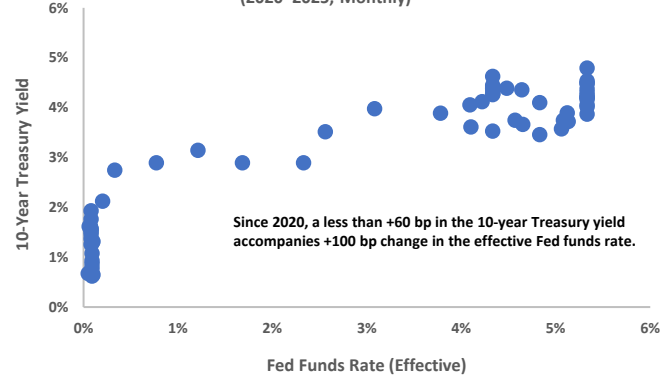
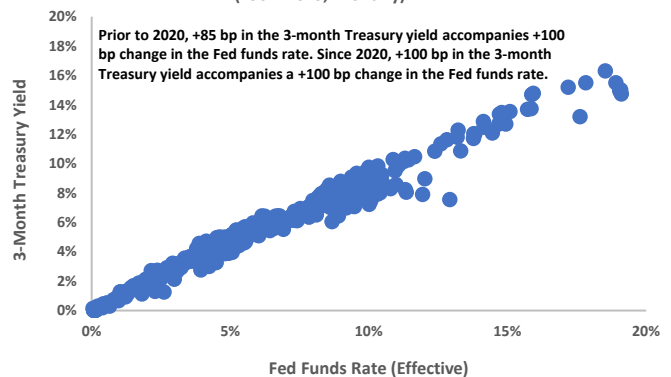


Figure 3. Short-Term Rate Response to Fed Funds Rate (1962–2019, Monthly)



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Economic & Market Watch Dashboard

Key Indicators

INTEREST RATES¹

2025

2026

	Current	Q4	Q1	Q2	Q3	Q4
Fed Funds Target ² (%)	4.00	3.75	3.75	3.50	3.25	3.25
SOFR (%)	3.93	3.54	3.33	3.19	3.11	3.06
2Y UST (%)	3.57	3.40	3.34	3.31	3.29	3.27
5Y UST (%)	3.69	3.59	3.57	3.57	3.57	3.56
10Y UST (%)	4.10	4.08	4.07	4.08	4.08	4.07
30Y UST (%)	4.70	4.61	4.60	4.60	4.58	4.55

ECONOMY

2025

2026

	Current	Q4	Q1	Q2	Q3	Q4
PCE Inflation (YoY %)	2.7	3.0	2.7	2.4	2.3	2.3
CPI Inflation (YoY %)	3.0	3.1	2.9	3.1	2.9	2.6
Real GDP (QoQ %)	3.8	1.2	1.7	1.9	2	1.2
Unemployment (%)	4.3	4.5	4.6	4.6	4.5	4.5
Consumer Spending (QoQ %)	2.5	1.2	1.5	1.9	1.9	2
Industrial Production (YoY %)	0.9	1.4	0.9	1.0	1.2	1.5

Equities & Currency

	Current	Year ago
DJIA	47,135	43,989
Nasdaq	23,463	19,287
S&P 500	6,803	5,996
US Dollar Index	\$1,219.18	\$1,267.77

Commodities

	Current	Year ago
Crude Oil (Per Barrel)	\$59.75	\$70.38
Natural Gas (Per MMBtu)	\$4.28	\$2.67
Coal (Per Short Ton)	\$14.90	\$14.10
Gold (Per Ounce)	\$4,098.00	\$2,694.80
Corn (Per Bushel)	\$4.28	\$4.31
Soybean (Per Bushel)	\$11.11	\$10.17

Industry

	Current	Year ago
Natural Gas Storage (Billion Cubic Feet)	3,915	3,972
U.S. Daily Power Consumption (MWh)	10,619,752	10,601,103
World Container Index (Per 40ft)	\$1,959	\$3,444

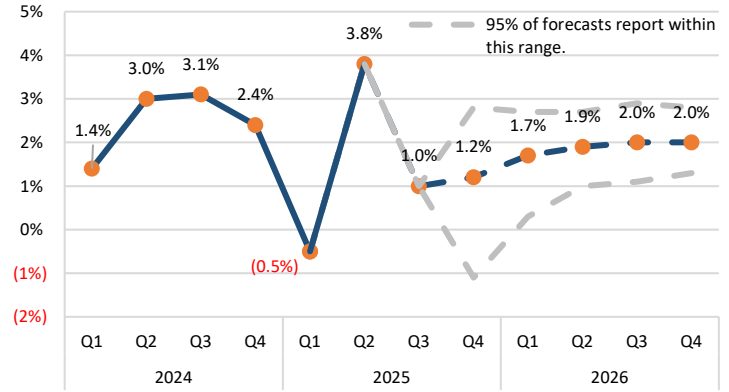
¹ Unless otherwise indicated, forecasts are from the Blue Chip Professional Forecasters.² Target rate forecast is based on futures market contracts.

Source: Blue Chip Financial Forecasts, Trading Economics, Moody's Analytics, Statista, Trading Economics, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, U.S. Energy Information Administration, U.S. Treasury Department, Federal Reserve Bank of Atlanta, Federal Reserve Bank of New York, Federal Reserve Bank of St. Louis, International Monetary Fund, World Bank, University of Michigan, The Conference Board.

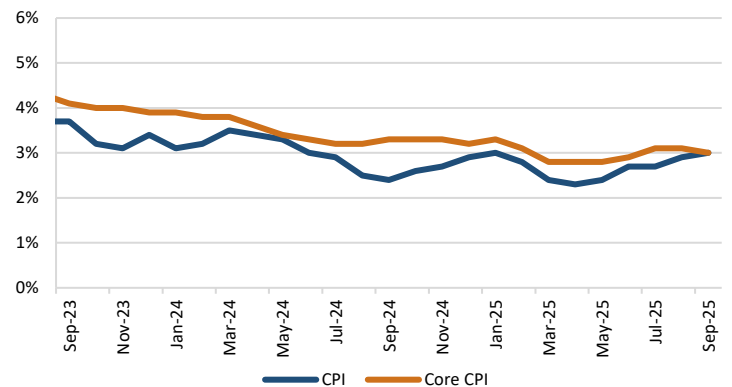
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Forecasts

Real GDP Growth Trend



Headline vs. Core Inflation



10-Year US Treasury vs. Fed Funds Trend

