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TRENDMACRO LIVE!

On Powell at Jackson Hole (Virtually)

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Donald Luskin

A bit of a hawkish surprise on taper timing, but also two very dovish consolation prizes.

Fed Chair Jerome Powell's long-awaited speech this morning at the annual Jackson Hole conference sharpened the outlook for tapering asset purchases versus the mish-mash of conflicting signals given just last week in the minutes of the July FOMC (see "Video What you aren't hearing about the Fed's taper talk" August 19, 2021 and "Data Insights: FOMC Minutes" August 18, 2021). *We have to say that Powell's clarifications were more in the direction of tapering sooner rather than later, that is, more hawkish, than we expected*:

> "At the FOMC's recent July meeting, I was of the view, as were most participants, that if the economy evolved broadly as anticipated, it could be appropriate to start reducing the pace of asset purchases this year."

That is: not just announce, but actually start reducing. *This brings forward the announcement from the December FOMC, as we had expected, to probably November* (September's meeting, just 26 days away, feels too soon for the economy to have "evolved" decisively).

As of this writing, markets don't seem to be throwing any tantrums – as we had expected they would not (see "Video: Three things you aren't hearing about the coming taper tantrum" June 7, 2021). *That may be because Powell softened the hawkish blow with two very dovish pieces of forward guidance*:

> "Even after our asset purchases end, our elevated holdings of longer-term securities will continue to support accommodative financial conditions."

That is: *just because new purchases cease, the Fed won't be "normalizing" its holdings – selling assets, or letting them run off by failing to reinvest coupons and maturities*, In other words, the Fed will stop de-risking the market by taking duration risk, prepayment risk and credit risk out of the private sector's aggregate portfolio – but it won't re-risk the market by requiring the private sector to take back risk from the Fed's portfolio.

And very critically, we think, early in the speech Powell recommitted the Fed to the strategic shift he announced last year at Jackson Hole: the

Update to strategic view

FEDERAL RESERVE, US MACRO: Powell's Jackson Hole speech was hawkish relative to expectations set in the minutes of the July FOMC in that it brings forward in time the likely onset of starting to taper asset purchases, from the December meeting to November. Powell cushioned the blow by saying that, at the conclusion of tapering, the Fed's portfolio would not be reduced. Most important, he set a very high bar for lift-off from near-zero policy rates, and effectively recommitted to last years' policy shift to abandon the Phillips Curve. This confirms market expectations that, as with the tapering of QE3, lift-off would come something like two years after announcement of tapering.

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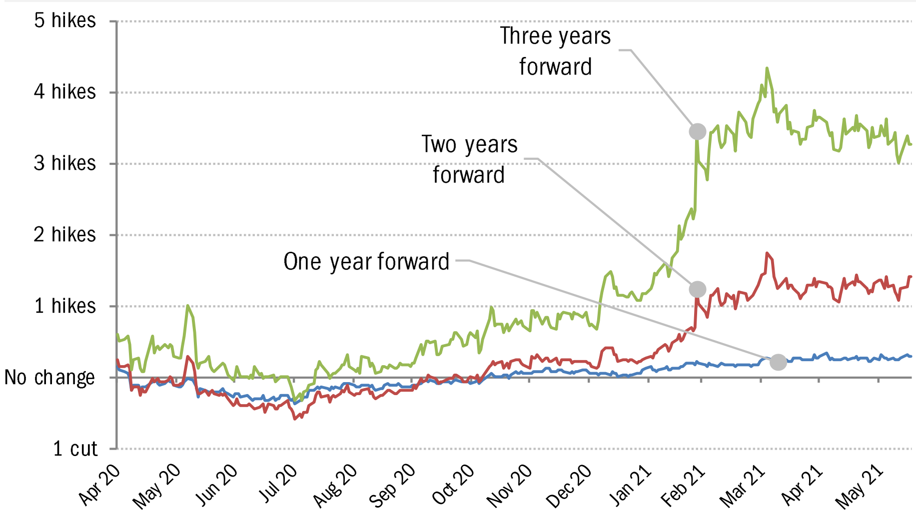
official abandonment of the false and toxic Phillips Curve belief that low unemployment represents an inflation threat that the Fed must act against. (see "Regime Change for the Equity Risk Premium?" April 19, 2021):

> "…responding may do more harm than good, particularly in an era where policy rates are much closer to the effective lower bound even in good times. …Today, with substantial slack remaining in the labor market and the pandemic continuing, such a mistake could be particularly harmful. We know that extended periods of unemployment can mean lasting harm to workers and to the productive capacity of the economy."

The dovish policy implication is that, asset purchases aside, this sets a very high bar for lift-off from near-zero policy interest rates:

> "We have said that we will continue to hold the target range for the federal funds rate at its current level until the economy reaches conditions consistent with maximum employment, and inflation has reached 2 percent and is on track to moderately exceed 2 percent for some time. We have much ground to cover to reach maximum employment, and time will tell whether we have reached 2 percent inflation on a sustainable basis."

Market-implied forward number of 25 bp rate hikes



Source: Bloomberg, TrendMacro calculations

Coming into Jackson Hole, money markets have been expecting no hikes within a year, and only one within two years (please see the chart above). Those expectations have been in place since February. They are broadly consistent with the pattern set in the tapering of QE3 – that lift-off happens two years after the onset of tapering. We think today's speech does nothing to bring those expectations forward in time.

Bottom line

Powell's Jackson Hole speech was hawkish relative to expectations set in

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