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TRENDMACRO LIVE!

On Powell at Jackson Hole

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Powell is willfully blind to the fact that inflation has peaked, and has no idea why.

"I'm from the government, and I'm here to hurt you – for your own good." Or as Fed Chair Jerome Powell put it at Jackson Hole this morning:

> "While higher interest rates, slower growth, and softer labor market conditions will bring down inflation, they will also bring some pain to households and businesses. These are the unfortunate costs of reducing inflation."

In terms of the path for the funds rate:

> "In current circumstances, with inflation running far above 2 percent and the labor market extremely tight, estimates of longer-run neutral are not a place to stop or pause… At some point, as the stance of monetary policy tightens further, it likely will become appropriate to slow the pace of increases. Restoring price stability will likely require maintaining a restrictive policy stance for some time."

There is nothing in this that is new.

Indeed, with nothing new to say, it seems Powell considered not speaking at Jackson Hole this year. The speech wasn't even put on the Fed's calendar until last Saturday morning, and the prior week, in response to our repeated inquiries, the Fed's communications staff would neither confirm nor deny he would speak.

- *Early this morning, future markets had been implying a 72% probability of a 75 bp hike at the September FOMC. Then July Personal Consumption Expenditures inflation data was released, matching the July Consumer Price Index with a month of deflation, and sequential drops in year-on-year headline and core readings – all well below expectations. So before Powell took to the podium, markets had revised that probability down to 51%.*
- *Powell specifically referred to the earlier data release by dismissing it out of hand:*

> "While the lower inflation readings for July are welcome, a single month's improvement falls far short of what the Committee will

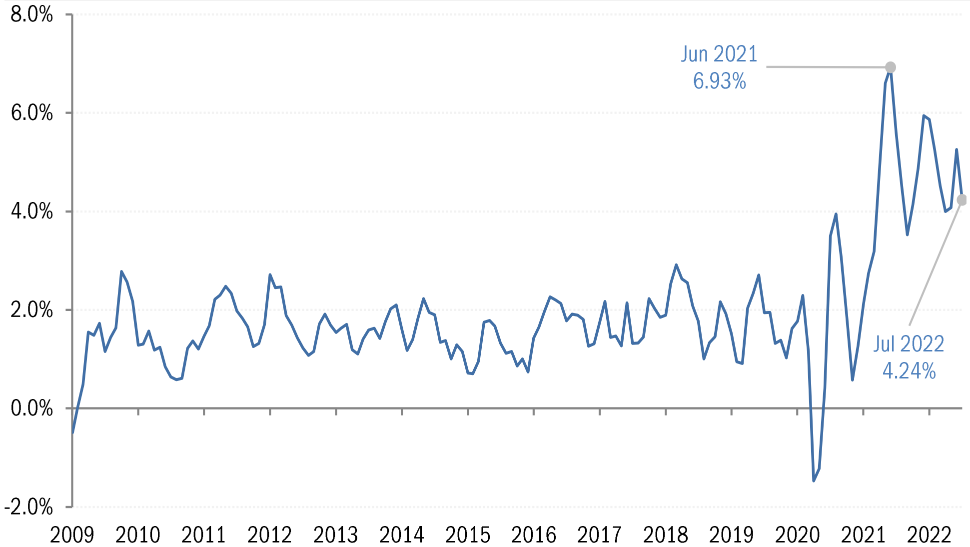
Update to strategic view

FEDERAL RESERVE, US MACRO: Nothing new in Powell's long-awaited speech, which he almost didn't give. Bigger news is this morning's reported July deflation in the headline PCE Index, a sequential drop in year-over-year core, and another month of consumer dis-savings. Powell overtly dismissed that in his speech, insisting a "restrictive policy stance for some time" is required. Market-implied expectations for the September FOMC fell on the good inflation news, and didn't come all the way back with Powell's speech. The implied funds rate for February is still below its high-water mark just before the June FOMC, though the year-end implied funds rate rose slightly. Powell failed to mention a NY Fed study this week showing that 60% of present inflation is due to expansionary fiscal policy. Such policy ended long ago, and inflation is subsiding with an expectable lag. Today's risk-off reaction in markets is not due to anything new or more hawkish that Powell said – but rather his continued willful blindness, and his seeming ignorance of the dynamics underlying inflation.

need to see before we are confident that inflation is moving down."

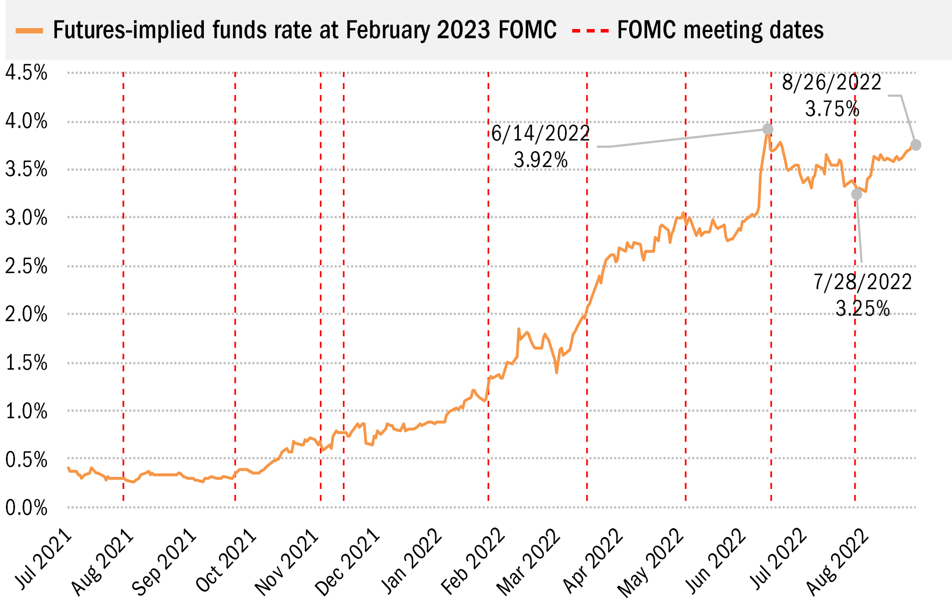
- Fair enough, but he is dismissing the reality that quarter-over-quarter core PCE inflation peaked in June 2021 – yes, a full 13 months ago (please see the chart below)!

Core Personal Consumption Inflation (quarter-over-quarter, annual rate)



Source: Bloomberg, TrendMacro calculations

- And before the next FOMC on September 21, August CPI data will be released, and there is simply no way it won't be the second back-to-back month of outright deflation. Gasoline alone will do it – down 11% month-over-month, compared to down 6% in July (and the August seasonal adjustment is bigger).
- *<u>We continue to think this can't fail to influence the September FOMC, making a 75 bp hike highly unlikely, indeed opening the</u>*



Source: Bloomberg, TrendMacro calculations

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door to a mere 25 bp hike (see "On Inflation, If You Don't Study History…" June 13, 2022).

- *Indeed, as of this writing, futures-implied expectations for the September FOMC have partially bounced back to a 63% probability of a 75 bp hike – higher now that Powell has spoken, but still lower than before the PCE inflation data was released.*
- *For that matter, the implied funds rate for February 2022, at 2.76% is still lower than it was before the June FOMC. However alarming the risk-off reaction in markets this morning may be, the reality is that by many measures, even after this speech, the Fed is less hawkish now that it was thought to be in mid-June – which, by no coincidence, is when the stock market bottomed* (please see the chart on the previous page).
- *One possible explanation for the reaction is the 3 bp rise in the implied cycle peak in March 2023 – from 3.78% to 3.81%, and the 6 bp rise in the implied funds rate for November 2022 – from 3.50% to 3.56% – suggesting that the hiking regime will have a slightly higher and longer-lasting plateau – consistent with Powell's statement that "Restoring price stability will likely require maintaining a restrictive policy stance for some time."*

The broader problem is that the Fed seems to be in a state of willful and selective blindness – taking on board all bad news on inflation, and ignoring anything good. Our hopes for a sensible reaction in September to August CPI have to come to terms with the fact that in the minutes of the July FOMC, the committee waved away falling gasoline prices, saying "these prices could quickly rebound" (see "Data Insights: FOMC Minutes" August 17, 2022). On the way up, they never said "these prices will fall back" – as indeed they have.

Similarly, in this morning's speech, Powell laid out "three important lessons" for inflation-fighting, the second of which was that "the public's expectations about future inflation can play an important role in setting the path of inflation over time."

- *He admitted that "expectations appear to remain well anchored," but warned "that is not grounds for complacency." In other words, even though this element that "plays an important role" is giving no cause for alarm whatsoever, the Fed needs to deliberately slow the economy and throw people out of work – just in case.*
- And never mind that even inflamed expectations – which we don't have now – can't possibly lead to inflation, no matter how bad they are, without an expanding money supply that funds the marginal purchases that would be made based on those expectations. And money supply growth has been flat for five months, its year-over-year rate of change has been falling for 18 months, and we are now in the sixth month in a row of household dis-savings. *Expectations are anchored – but it wouldn't matter if they weren't.*

Most deeply disturbing, none of Powell's "lessons" – and nothing else in his speech – even touches on a thoroughgoing explanation of the inflation we are experiencing now – without which, it seems pointless to talk about *solutions to it, and without which markets can't have confidence that the Fed will behave rationally.*

- Powell could easily have referred to the ideas in [Wednesday's study] released by the Federal Reserve Bank of New York calculating that 60% of today's inflation is explained by "expansionary fiscal policy."
- That result is very good news for inflation. As we've been saying for months (see, among many, ["Video: What you're not hearing about what caused today's inflation, and where it's going"] June 9, 2022), such policy reached its zenith 18 months ago and has returned to pre-pandemic norms already – which is why year-over-year core CPI inflation peaked in March, exhibiting the 13-month policy-lag we have estimated.

So now the long-awaited Jackson Hole moment has come and gone, and we pretty much don't know anything more about the Fed's policy outlook than we did before. *That's good news, we suppose – it didn't get worse.*

But the best news is that even if the Fed makes a contractionary policy error here – an error because inflation has already peaked, and will surely head lower no matter what the Fed does or doesn't do – *at least inflation has already peaked, and will surely head lower no matter what the Fed does or doesn't do.*

It would be very bad news if we had the intractable inflation problem Powell thinks we have. The good news is that we don't (we just have to deal with the fact that he thinks we do).

Bottom line

Nothing new in Powell's long-awaited speech, which he almost didn't give. Bigger news is this morning's reported July deflation in the headline PCE Index, a sequential drop in year-over-year core, and another month of consumer dis-savings. Powell overtly dismissed that in his speech, insisting a "restrictive policy stance for some time" is required. Market-implied expectations for the September FOMC fell on the good inflation news, and didn't come all the way back with Powell's speech. The implied funds rate for February is still below its high-water mark just before the June FOMC, though the year-end implied funds rate rose slightly. Powell failed to mention a NY Fed study this week showing that 60% of present inflation is due to expansionary fiscal policy. Such policy ended long ago, and inflation is subsiding with an expectable lag. Today's risk-off reaction in markets is not due to anything new or more hawkish that Powell said – but rather his continued willful blindness, and his seeming ignorance of the dynamics underlying inflation.