

TRENDMACRO LIVE!

On Powell at Jackson Hole

Friday, August 25, 2023

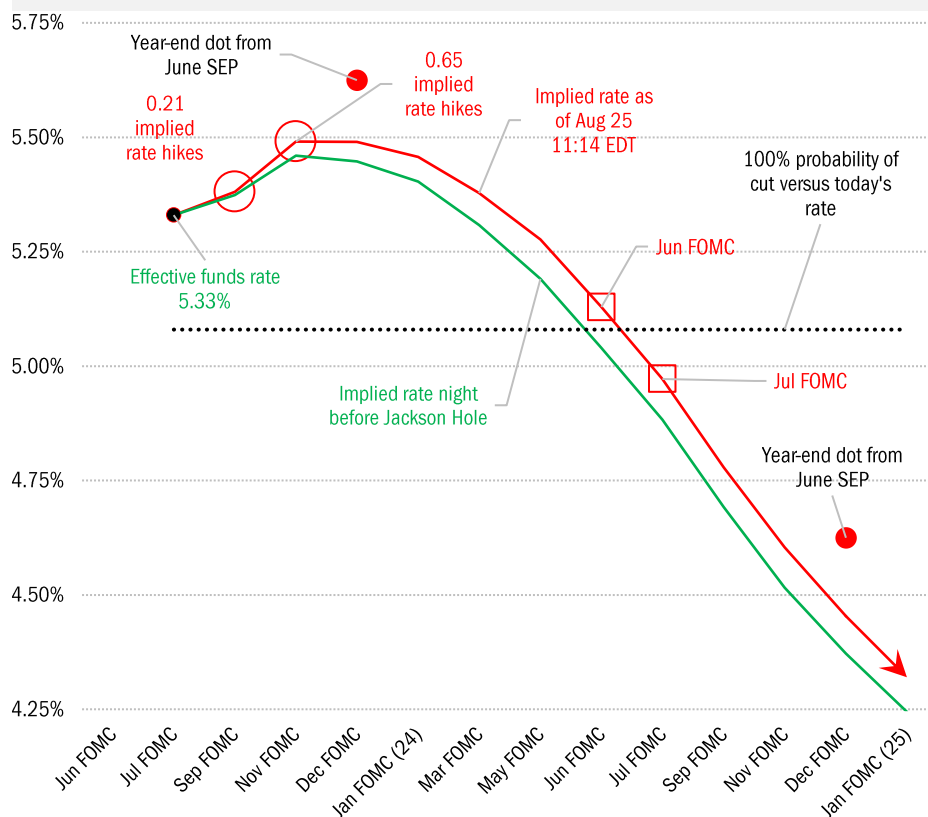
Donald Luskin

Ugh. We are making “progress” against inflation except we’re not. Classic Powell.

[Fed Chair Jay Powell's Jackson Hole speech this morning](#) underwent a sudden and instructive name change. The [Fed's event calendar](#) had billed it as “Economic Outlook.” As delivered, the name was changed to “Inflation: Progress and the Path Ahead.” We love to see that word “progress” as the first word – it means Powell is acknowledging fully that there has been some. Of course he said “the process still has a long way to go,” and the speech’s final words were: “We will keep at it until the job is done.”

- As of this writing, markets are taking the speech as slightly hawkish (please see the chart below). There’s still no real probability of a

Futures-implied path of fed funds rate



Source: Bloomberg, TrendMacro calculations

Update to strategic view

FEDERAL RESERVE, US MACRO: The title of Powell’s speech was changed at the last minute to emphasize “progress” on inflation, but the bulk of the speech was about how there has been too little progress. This is basically a boilerplate holding statement containing no new information. As of this writing markets are upping their cumulative implied probability of a hike by the November FOMC to 65%, for the first time above 50-50. And the full implied probability of a cut has been pushed out to July 2024. This is probably the reaction Powell wants, thinking he can help conquer inflation, through the expectations channel somehow, by keep markets afraid. But in the meantime, the “progress” Powell is nevertheless acknowledging is real, and is about to turn into evidence of downright deflation. We’ve seen the last rate hike. The first cut should come in the first quarter of next year.

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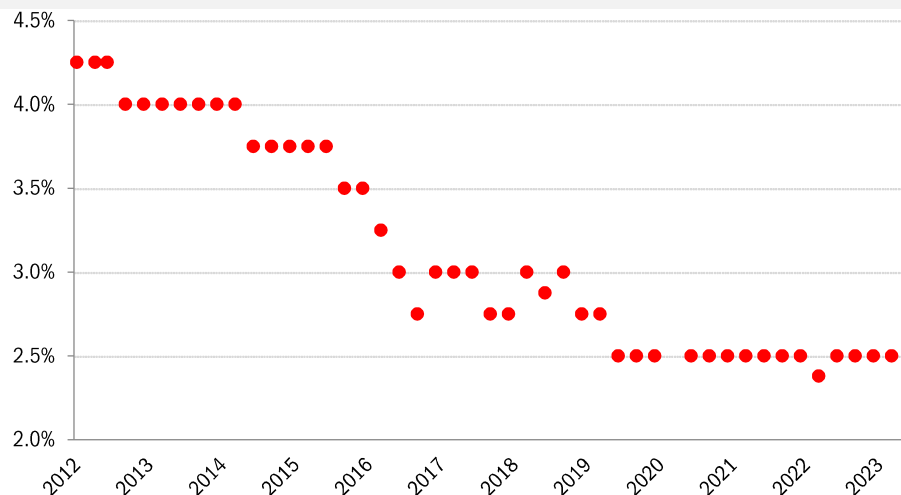
2024 (again, please see the chart on the first page).

- We shouldn't read anything new into boilerplate that is not new, such as Powell's statement in the first paragraph, "We are prepared to raise rates further if appropriate, and intend to hold policy at a restrictive level until we are confident that inflation is moving sustainably down toward our objective."
- All told this is basically a holding statement that should not be seen as significantly changing the policy outlook.

Powell disappointed Fed-watchers who had expected something imaginative or dramatic here.

- He didn't speculate on secularly raising the Fed's estimate of the neutral interest rate (R-star), which the Fed has left unchanged at an historic low since before the pandemic (please see the chart below). Indeed, he said "real interest rates are now positive and well above mainstream estimates of the neutral policy rate."

R* "Longer-term" "assessment of appropriate monetary policy," mid-point funds rate target



Source: FRB [Summary of Economic Projections](#), TrendMacro calculations

- He didn't announce that the Fed intends to raise its inflation target.
- He didn't elaborate on the discussion that emerged in the July FOMC about continuing balance sheet runoff even after rate cuts eventually commence (see ["Data Insights: FOMC Minutes"](#) August 16, 2023)

It seems to us Powell believes that encouraging the markets to see an early end to this tightening cycle will itself risk raising or sustaining inflation, somehow, through the expectations channel. So while giving "progress" pride of place, the bulk of the speech is about how it isn't enough progress.

- The market would appear, as of this writing, to be taking this all a little too seriously. However Powell may choose to slice and dice the inflation data, it is becoming increasingly apparent to any

neutral observer that there has indeed been much “progress.” We are confident that with each coming data release, “progress” will start looking more and more obviously like downright deflation (see, among many, [“Inflation Has Peaked -- Get Ready for Deflation”](#) May 24, 2023).

- *We continue to think the July rate hike will prove to have been the last. And when outright deflation becomes unmistakable, the rate cuts will likely start in the first quarter of the coming year.*

Bottom line

The title of Powell’s speech was changed at the last minute to emphasize “progress” on inflation, but the bulk of the speech was about how there has been too little progress. This is basically a boilerplate holding statement containing no new information. As of this writing markets are upping their cumulative implied probability of a hike by the November FOMC to 65%, for the first time above 50-50. And the full implied probability of a cut has been pushed out to July 2024. This is probably the reaction Powell wants, thinking he can help conquer inflation, through the expectations channel somehow, by keep markets afraid. But in the meantime, the “progress” Powell is nevertheless acknowledging is real, and is about to turn into evidence of downright deflation. We’ve seen the last rate hike. The first cut should come in the first quarter of next year. ▶