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TRENDMACRO LIVE!

On Powell at Jackson Hole

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Donald Luskin

Rate cut expectations were deep before he even started talking. Then they got deeper.

There was no first-order risk in this morning's speech by Fed Chair Jerome Powell at the Jackson Hole Economic Symposium that he would do anything but reaffirm the first rate cut for the September FOMC. It was already clear from the July FOMC (see "On the July FOMC" July 31, 2024), and even more so in Wednesday's minutes of that meeting (see "Data Insights: FOMC Minutes" August 21, 2024). Indeed, this morning Powell said early in his speech,

> "The time has come for policy to adjust."

- *The risk was second-order – that Powell would disappoint market expectations for a rapid and aggressive easing cycle.* Coming into this morning's speech, markets were expecting 100 bp in rate cuts by the December FOMC, while the "dot plot" from the June FOMC Summary of Economic Projections called for only 25 bp (please see the chart below). Markets were expecting 225 bp in cuts by the December *2025* FOMC, with the "dot plot" indicating only 125 bp.
- But those expectations reflect a blend of the market's expectations for the business cycle and how the market expects the Fed to respond if those expectations eventuate. Those expectations, it

Update to strategic view

FEDERAL RESERVE, US MACRO: Powell didn't disappoint. Affirming what was already obvious from the July FOMC and its minutes, he said "The time has come for policy to adjust." He said nothing to affirm the rapid and deep rate cut expectations embedded in markets, but reassured that he does not welcome any further weakening in labor markets, and will act if it nevertheless happens. So to the extent that market expectations for the funds rate are in fact a…

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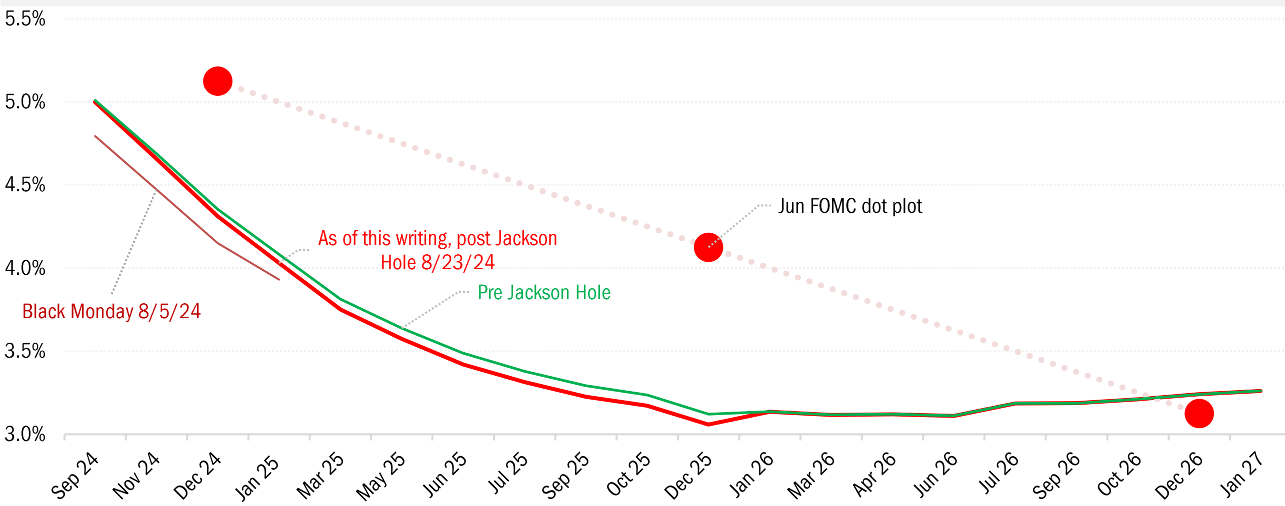
Futures-implied effective fed funds rate at future FOMC meetings, compared to FOMC "dot plots"



Source: Bloomberg, SEP, TrendMacro calculations seems to us, clearly reflect expectations for a recession and an emergency Fed response. Powell doesn't share those expectations, saying in the next sentence:

> "The direction of travel is clear, and the timing and pace of rate cuts will depend on incoming data, the evolving outlook, and the balance of risks."

- Later in the speech he was clear that a "Powell put" is in place in case market expectations for a recession turn out to be right:

> "We do not seek or welcome further cooling in labor market conditions… We will do everything we can to support a strong labor market as we make further progress toward price stability. With an appropriate dialing back of policy restraint, there is good reason to think that the economy will get back to 2 percent inflation while maintaining a strong labor market."

- Apparently that was more than enough, because as of this writing market expectations for rapid and deep rate cuts have only gotten deeper (again, please see the chart on the previous page).
- Still, those expectations are less frantically worried than they were on "Black Monday," August 5, when markets were implying 125 bp in cuts by December 2024, with the first coming as an inter-meeting emergency move in August (again, please see the chart on the previous page, and "It's a Recession! Well, Maybe It's Just a Correction" August 5, 2024). But the recession expectations linger.

We think everything about the market's rate expectations is wrong. There will be no recession. The Fed won't have to support the labor market with aggressive rate cuts. This easing cycle will just be a normalization to the neutral rate. And the neutral rate is higher than the market thinks, or else the Fed would have already caused a recession.

Here's Powell's intellectual evolution on the subject so far:

- Powell in testimony to the Senate Banking Committee, March 7, 2024:

> Interest rates right now are well into restrictive territory. They're well above neutral. … We're far from neutral now.

- Powell at the July FOMC post-meeting press conference, three months later, July 31, 2024:

> I wouldn't say it's extremely restrictive…

Our call is that there will be a 25 bp rate cut at the September FOMC, and a series of once-per-meeting 25 bp cuts until we get to something like 4%, which we think is an appropriate neutral rate for what will be then be a neutral world.

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… recession forecast, he has pledged to deploy a "Powell put." Rate cut expectations have deepened from already aggressive levels as of this writing. He was silent on the recession-free terminal rate in this easing cycle, in light of his evolving awareness that the neutral rate must be higher than previously thought. Our call is no recession. So we call for a 25 bp cut in September, and another at each FOMC meeting until 4% is attained in May.

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Bottom line

Powell didn't disappoint. Affirming what was already obvious from the July FOMC and its minutes, he said "The time has come for policy to adjust." He said nothing to affirm the rapid and deep rate cut expectations embedded in markets, but reassured that he does not welcome any further weakening in labor markets, and will act if it nevertheless happens. So to the extent that market expectations for the funds rate are in fact a recession forecast, he has pledged to deploy a "Powell put." Rate cut expectations have deepened from already aggressive levels as of this writing. He was silent on the recession-free terminal rate in this easing cycle, in light of his evolving awareness that the neutral rate must be higher than previously thought. Our call is no recession. So we call for a 25 bp cut in September, and another at each FOMC meeting until 4% is attained in May.