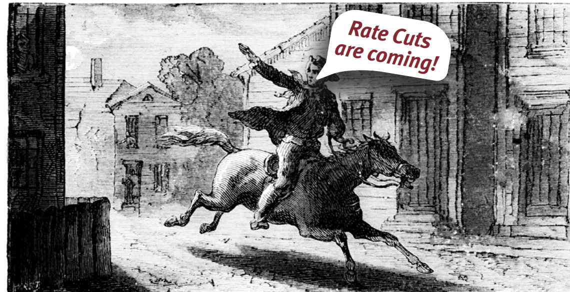
September 9, 2024

The Time Has Come: Chair Powell Concedes to Policy Pivot

Economic INSIGHT



According to Federal Reserve (Fed) Chairman Jerome Powell, the time for rate cuts is upon us. While devoid of specifics in terms of the expected timing and speed of future policy adjustments, he gave a clear nod to the market when speaking at the annual Jackson Hole symposium on August 23, that amid cooling conditions it was now appropriate to adjust policy off of a 23-year high.

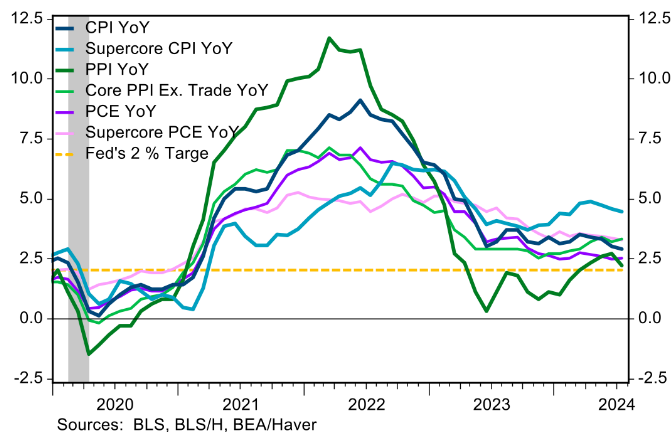
"*The time has come for policy to adjust. The direction of travel is clear, and the timing and pace of rate cuts will depend on incoming data, the evolving outlook, and the balance of risks.*"

- Federal Reserve Chairman Jerome Powell, Jackson Hole, August 23, 2024

FIGHTING INFLATION

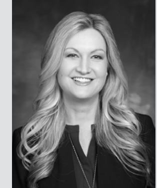
Since 2022, the focus of the Powell-led Fed has been on raising rates from crisis-level accommodation as price pressures surged to a 40-year high. While inflation remains stubbornly above the Fed's 2% target, the nominal progress from earlier peak levels since April has seemingly met the Committee's threshold of instilling enough confidence for continued and sustained improvement back towards price stability. As such, the Fed's focus has now shifted to the labor market.

The latest read on Personal Consumption Expenditures (PCE), the Fed's preferred measure of inflation, came in somewhat better than expected. The core PCE, which excludes food and energy, rose 0.2% in July and held steady at 2.6% year-over-year, a tenth of a percentage point less than forecasted, albeit still more than half a percentage point above the Fed's target. There was also a lack of improvement in both the headline and the supercore PCE – core services excluding shelter – holding steady at 2.5% and 3.3% in July, respectively. Nevertheless, with further disinflationary progress in the July Consumer Price Index (CPI) and Producer Price Index (PPI), the Chairman and company view the goal of price stability within reach.



Sources: BLS, BLS/H, BEA/Haver

"*Four and a half years after COVID-19's arrival, the worst of the pandemic-related*



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economic distortions are fading. Inflation has declined significantly."

"*Our objective has been to restore price stability while maintaining a strong labor market, avoiding the sharp increases in unemployment that characterized earlier disinflationary episodes when inflation expectations were less well anchored. While the task is not complete, we have made a good deal of progress toward that outcome.*"

- Federal Reserve Chairman Jerome Powell, Jackson Hole, August 23, 2024

TURNING THE FOCUS TO A WEAKENING LABOR MARKET

In his remarks at Jackson Hole, Powell noted the Committee's growing focus on the U.S. labor market amid the changing and softening of conditions with the balance of risk between the dual mandates of price stability and maximum employment moving into better balance.

JOLTS: Hires Rate (left
JOLTS: Quits Rate (right
Source: Bureau of Labor Statistics/Haver Analytic

"*The labor market is no longer overheated, and conditions are now less tight than those that prevailed before the pandemic. Supply constraints have normalized. And the balance of the risks to our two mandates has changed.*"

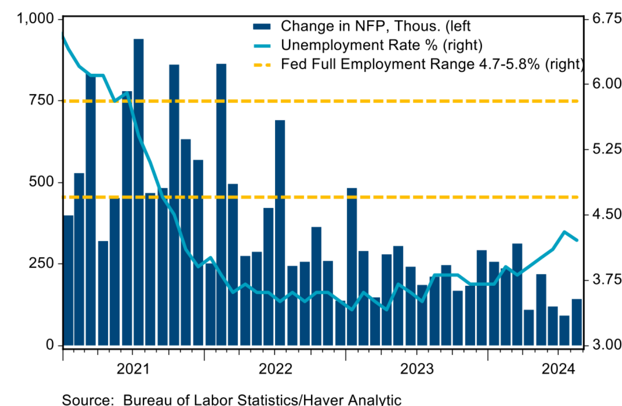
- Federal Reserve Chairman Jerome Powell, Jackson Hole, August 23, 2024

Citing a rising unemployment rate and the accompanying slowdown in payroll growth, Powell highlighted the more recent decline in job vacancies, falling to 7.7 million in July from 12.2 million two years prior along with the ratio of job openings to unemployed people slowing from 1.4 at the start of the year to 1.1, now below the pre-pandemic level. Furthermore, both the hiring and quits rates have dropped well below pre-pandemic levels; the hiring rate currently stands at 3.5%, notably less than the 3.9% average in 2019, with the quits rate at 2.1% as of July, 20 basis points (bps) below the 2.3% average leading into the pandemic.

"*It seems unlikely that the labor market will be a source of elevated inflationary pressures anytime soon. We do not seek or welcome further cooling in labor market conditions.*"

- Federal Reserve Chairman Jerome Powell, Jackson Hole, August 23, 2024

The latest August nonfarm payroll report also reinforces the Fed's notion of further cooling in the labor market. Albeit the still-positive pace of hiring and relatively low level of unemployment, coupled with a weak pace of jobless claims, underscores conditions are far from a state of outright weakness.



Source: Bureau of Labor Statistics/Haver Analytic

Nonfarm payrolls rose by 142,000 in August, falling short of the 165,000 gain expected. The

GLOSSARY

CPI – Consumer Price Index

FOMC – Federal Open Market Committee

JOLTS – Job Openings and Labor Turnover Survey

PCE – Personal Consumption Expenditures

PPI – Producer Price Index

NFP – Nonfarm Payrolls

YoY – Year over Year

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three-month average, meanwhile, declined from 141,000 to 116,000. July payrolls were revised down from an 114,000 gain to just an 89,000 increase. With additional revisions to previous months, the overall change in nonfarm payrolls (August data + net revisions) was just 56,000, the weakest pace since December 2020. Meanwhile, the unemployment rate ticked down from 4.3% to 4.2% in August, as expected and marking a two-month low, while wage gains picked up from 3.6% to 3.8%.

In addition, jobless claims fell 5,000 from 232,000 to 227,000 in the week ending August 31, the second consecutive weekly decline and a one-month low, pulling the four-week average down from 232,000 to 230,000. Continuing claims, or those claiming ongoing unemployment, also fell, dropping from 1.86 million to 1.84 million in the week ending August 24, the lowest since mid-June.

APPEASING INVESTORS, BUT NOT EVERYONE

At this point, the Fed has seemingly committed to a rate reduction in less than two weeks and possibly additional cuts by year-end — a joyous message for anxious investors desperate for relief. That being said, even as the Fed initiates a reduction in rates, market players are still likely to be somewhat disappointed by the realized policy pathway. After all, acquiescing to the market's demand for a near-term pivot is not a commitment to a particular size or speed of subsequent cuts.

Investors continue to anticipate a reduction in rates at all three remaining meetings of the year with the potential for at least one 50 bp cut, totaling at least 110 bps in easing by year-end. Powell, however, has indicated the pathway forward is not predetermined and will remain data-dependent. He indicated a larger 50 bp reduction is not something the Committee is "thinking about right now." Thus, barring a significantly weaker read or deteriorating expectations regarding inflation or employment conditions, policy makers are likely to support a relatively tempered approach both in terms of size and speed of reductions.

Atlanta's Raphael Bostic said he may support more than one rate cut this year, suggesting he's not only coming from a base case of a single 25 bp reduction in 2024 but would unlikely support three or more reductions as investors are hoping for in the remaining four months of the year. "I don't want us to be in a situation where we cut, and then we have to raise rates again: that would be a very bad," Bostic said at Stanford event in Atlanta on August 26.

Philadelphia Fed President Patrick Harker also voiced support for a more tempered approach. Rate cuts should absolutely be on a more controlled and methodical pathway, he said, translating into a maximum of 75 bps in cuts this year with neutral "somewhere around 3%." Speaking to reporters on the sidelines of the Jackson Hole conference, Harker indicated support for the process to begin in September as well as optimism of labor market conditions normalizing as opposed to continuing to weaken.

Federal Reserve Bank of New York President John Williams also chimed in with optimism regarding the progression of the economy moving towards a state of equilibrium. Noting it is now appropriate for the central bank to reduce interest rates, Williams said there had been "significant progress" toward the Fed's dual goals of maintaining stable prices and maximum employment and furthermore, that the risks to achieving both have moved into "equipoise," or a state of equilibrium.

San Francisco Fed President Mary Daly similarly voiced support for a near-term adjustment in rates as policy becomes increasingly restrictive. "The time is upon us"

to cut rates, she said on Bloomberg TV on August 26. “Remember, every time inflation comes down, the policy gets more restrictive. And I think that’s a recipe, if you will, for overtightening and injuring the labor market and growth.”

Of course, not everyone is on board for a more patient approach to policy adjustment. Also speaking on the sidelines of Jackson Hole, Chicago Fed President Austan Goolsbee indicated a more heightened level of concern regarding mounting weakness in labor market measures. “We want to be careful, as Chair Powell said, about the employment side of the mandate, too,” he said. As such, Goolsbee offered support to ease rates on a more expedited basis, as policy, he said, is tighter now than in prior points in the cycle given the decline in inflation, which has resulted in higher “real rates.”

More recently, speaking with MarketWatch, Goolsbee underscored his support for a more aggressive pathway. “It is pretty clear that the path is not just rate cuts soon,” but rather there will be multiple cuts over the next year.

Finally, speaking earlier today at the University of Notre Dame, Fed Governor Christopher Waller said he is “open-minded” regarding a larger rate cut at the September 18 meeting, and noted “the current batch of data no longer requires patience, it requires action.”

FED PIVOT

In July, the Fed assumed a somewhat disappointing position — at least relative to market expectations — insisting further evidence was needed before supporting the notion of a rate cut. Since then, while not all the latest data points towards a green light for a September cut, enough seemingly do. As such, Powell has acquiesced that the time for a rate reduction is now, essentially securing a first-round rate cut on September 18.

That being said, a still-solid labor market coupled with inflation lingering above the Fed’s target of 2% suggests the need for a slow and tempered pace of reductions, falling shy of the more rapid easing pathway anticipated by investors. As such, with the market pricing in weaker-than-expected data and a somewhat more aggressive monetary response, even amid a Fed pivot this month, a more favorable economic reality and softer policy response will likely offer support for longer-term yields. Will it be enough to force a reversal back near recent highs? Likely, no. But the differential between market expectations and the more probable reality leaves room for at least some retrenchment of the recent drop in longer-term yields.

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