U.S. FOMC Review

- Powell: it is the Fed's job to return inflation to two percent; inflation still "too high"
- FOMC to "proceed carefully," but could raise rates further "if appropriate"

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Powell at Jackson Hole

- This morning Fed Chair Jerome Powell delivered the keynote address at the 2023 Jackson Hole Economic Symposium. In his speech, *Inflation: Progress and the Path Ahead*, Mr. Powell reaffirmed the Fed's goal of returning inflation to its two-percent objective and assessed progress made regarding the mandate since last year's conference, concluding bluntly that while inflation has moderated from its peak, it remains "too high." Thus, in the near term, the FOMC could raise the target range for the federal funds rate (currently 5.25 percent to 5.50 percent) "if appropriate" and/or "hold policy at a restrictive level until…confident that inflation is moving substantially down toward our objective." No mention was made of a pivot to a less restrictive policy setting.

- Although the Chair's remarks tilted hawkish, his tone was less urgent than it was last year when he referenced Paul Volker, and the FOMC was in the midst of four 75-basis-point hikes in an attempt to calibrate policy with rapid inflation. (The headline price index for personal consumption expenditures at that time, from June 2022, peaked at 7.0 percent, year-over-year.) Currently, Chair Powell indicated that Fed officials are well-positioned to "proceed carefully as we assess the incoming data and the evolving outlook and risks," a sentiment predicated on the current restrictive policy setting which has pushed the real two-year yield and real longer-term yield approximately 250 basis points and 150 basis points higher, respectively, since last year's symposium.

- Proceeding with caution is likely warranted in an environment where risks to the outlook have become more balanced. In his address, Chair Powell likened the conduct of monetary policy to "navigating by the stars under cloudy skies." The maritime imagery emphasized the difficulty of making real-time decisions with imperfect information: monetary policy works with long and variable lags and the neutral rate of interest cannot be identified with certainty. Given the response of the economy to monetary policy thus far, it is reasonable to conclude that restrictive policy is weighing on activity. However, the Committee still runs the chance of either doing too little, thereby allowing "above-target inflation to become entrenched," or doing too much and causing unnecessary harm to the labor market and broader economy.

- While Chair Powell mentioned the balance of risks and argued that upcoming policy decisions will be dictated by the totality of the data, we were struck by his discussion of inflation, which occupied the majority of his speech and painted a picture that we view as somewhat at odds with market participants' perceptions. While Mr. Powell noted that realignment of pandemic-related "demand and supply distortions" and restrictive monetary policy were slowing inflation, he argued that "the process still has a long way to go, even with the more favorable recent readings," and that two months of good data (June and July) "are only the beginning of what it will take" for officials to declare inflation vanquished. To measure additional progress, Chair Powell indicated that we should watch closely core inflation. As with other recent presentations, he broke core into three broad categories: goods, shelter, and non-housing services. Regarding core goods prices, Mr. Powell noted that unwinding of pandemic-related supply and demand imbalances and tightening in monetary policy have led to sharp cooling. However, he contended that in the aggregate, core goods prices remain "well above" pre-pandemic levels and that restrictive monetary policy is required for further progress. As for shelter inflation, Chair Powell ratified the widely held perception that cooling rents are "in the pipeline" and will filter through to slower shelter appreciation over the next year, but he also seemingly implied that a return of housing services inflation to the pre-pandemic trend was not locked in and risks remained.

Finally, he noted that non-shelter service inflation, which composes more than half of core, has moved sideways since the initiation of policy tightening. Components of non-shelter services (healthcare, food services, transportation, etc.) were not directly affected by pandemic-related disruptions and appear to be less interest-sensitive than housing and goods. They rely heavily on labor, and tight labor-market conditions are still creating significant wage pressure. To moderate wage growth to a rate consistent with two-percent inflation, the labor market needs to adjust further.

- In conclusion, we view the Fed Chair as signaling that the target federal funds rate is approaching its peak, and that any further adjustments will be dependent on the incoming data. However, as inflation is still broadly inconsistent with the Fed's price stability mandate, he continues to favor restrictive policy for some time.