

Powell signals Fed to tread carefully, but that rates will stay high

Chair Powell acknowledges that monetary policy is “restrictive” and that policymakers will “proceed carefully” in determining whether to hike rates further. September is set for a pause, but robust growth means the door remains ajar for a further potential hike. Markets see a 50-50 chance of a final hike while we think rates have most probably peaked



US Federal Reserve
Chair Jerome Powell

2% remains the target with the Fed prepared to hike further

In his Jackson Hole address, Federal Reserve Chair Jerome Powell reaffirmed that the Fed remains focused on hitting the 2% inflation target and keeping it there. He spends a considerable amount of time breaking down inflation into different components and explaining the drivers, but as is usually the case, emphasises the non-energy, non-housing services. This remains the stickiest portion given relatively high labour input costs in a tight jobs market environment. Here, “some further progress... will be essential to restoring price stability”, but the expectation is that “restrictive monetary policy” will bring supply and demand into better balance and it will come down.

In fact, the description “restrictive” with regards to monetary policy is used on seven occasions in his speech with higher borrowing costs and tighter lending conditions acknowledged as factors that will act as a brake on the economy and slow inflation to 2% over time. But Powell is wary the recent strength in activity data mean that the “economy may not be cooling as expected”. In turn, this “could put further progress on inflation at risk and could warrant further tightening of monetary policy.”

As a result, the Fed "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".

Monetary policy signalled to stay tight

Nonetheless, he acknowledges that monetary policy assessment is “complicated by uncertainty about the duration of the lags” between implementation and the real world impact. With real interest rates “well above mainstream estimates for the neutral policy rate” there is clearly a concern that the Fed don’t want to tighten too much. This view point was echoed in the minutes to the July FOMC meeting that said “a number of participants judged that... it was important that the Committee's decisions balance the risk of an inadvertent overtightening of policy against the cost of an insufficient tightening”.

With Chair Powell concluding that “we will proceed carefully as we decide whether to tighten further or, instead, to hold the policy rate constant and await further data” we expect the Fed to leave the Fed funds target range unchanged at 5.25-5.5% at the September meeting. However, given the tight jobs market and strong third quarter activity the Fed will continue to signal the potential for one further rate rise before year-end in their forecast update, and will likely scale back the median forecast for 100bp of rate cuts in 2024 that it published in June.

We think rates have peaked and cuts will come in 2024

We don't think it will carry through with that final forecast hike though. The combination of higher borrowing costs, which is resulting in mortgage rates, credit card, auto loan and personal loan borrowing costs hitting two-decade plus highs, together with less credit availability, pandemic-era savings being run down and student loan repayments restarting should intensify the financial squeeze in the fourth quarter and beyond. So while the US economy may well expand at more than a 3% annualised rate in the current quarter, we expect to see a weaker performance in the fourth quarter together with further significant progress on inflation returning towards target. Our base case continues to be interest rate cuts through 2024 as monetary policy is relaxed to a more neutral footing.

Author

James Knightley

Chief International Economist, US

james.knightley@ing.com

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