Fed’s Powell signals a willingness to cut rates, but more progress is required

Progress appears to being made on the Fed's aspiration of moving the economy into better balance and thus bringing inflation down towards the 2% target. Two-way risks are also increasingly being acknowledged and if the data moves in the direction we expect the potential of a September interest rate cut in the US will build further

Economy remains robust, but some progress has been made

In Federal Reserve Chair Jerome Powell's written testimony on monetary policy to the US Senate, he talks a little more of two-way risk, but while the Fed is open to the possibility of rate cuts at some point, he emphasises that the data needs to be there to justify it.

He acknowledges that first quarter data did not give them great confidence inflation was returning to target, but that "the most recent inflation readings, however, have shown some modest further progress, and more good data would strengthen our confidence that inflation is moving sustainably toward 2 percent". Regarding growth he recognises that “growth appears to have moderated in the first half of this year following impressive strength in the second half of last year”, primarily due to ”slower but still-solid increases in consumer spending”. As for the jobs market, his description is “strong, but not overheated” with the higher unemployment rate resulting from increased labour supply rather than weakness in payrolls growth.

Two-way risks emerging

The monetary policy stance is described as “restrictive” and that is helping to bring the economy into better balance and is putting downward pressure on inflation. He states that “reducing policy restraint too soon or too much could stall” progress on inflation, but at the same time he suggests that "elevated inflation is not the only risk we face. Reducing policy restraint too late or too little could unduly weaken economic activity and employment." As such it appears that they are open to the idea of loosening monetary policy, but it has to be backed up by the data.

Jackson Hole could firm up expectations of a September cut

Our position is that the Fed doesn’t want to cause a recession if they can avoid it and if the data allows we expect the Federal Reserve to start moving monetary policy from “restrictive” territory to “slightly less” restrictive policy from September.

To deliver this we look for three things.

1. **Core inflation to continue coming in at 0.2% month-on-month or below** – the run rate required to bring annual inflation to the 2% target.
2. **The unemployment rate**, which has already risen from 3.4% to 4.1%, to push higher towards 4.3%.
3. **Consumer spending growth**, which has slowed from a 3%+ annualised rate in 2H 2023 to 1.6% in 1H 2024, to decelerate further.

Such outcomes should give the Fed confidence that the economy is on the path for a “soft landing” and they can start to move their policy stance closer to neutral. If we are right and the data comes in as we project, we suspect that the Jackson Hole symposium in late August will be used as the venue to give the market the clearest indication on impending policy loosening.

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