MNI Jackson Hole Preview – Aug 2022

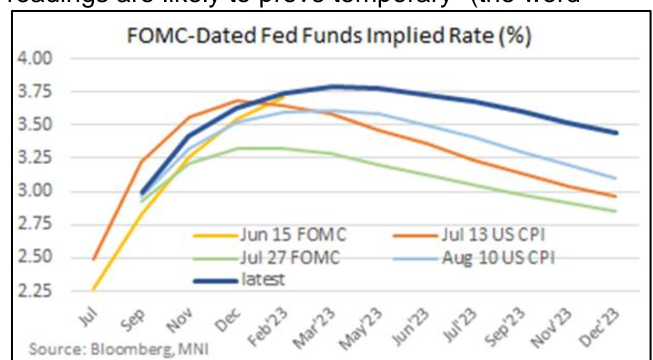
MNI View: Premature To Pivot

By Tim Cooper and Chris Harrison

- *Fed Chair Powell is unlikely to signal a major policy "pivot" in his 2022 Jackson Hole speech.*
- *He could reiterate that slower hikes will likely be appropriate "at some point", but is very unlikely to endorse market pricing for 2023 cuts, or to provide concrete guidance for future decisions.*
- *Recent rate repricing raises risks that expectations have gotten too hawkish in the run-up to Jackson Hole.*

Fed Chair Powell's keynote speech on "Economic Outlook" at the 2022 Jackson Hole symposium (1000ET / 1500 UK) could prove to be almost the complete opposite of last year's edition, which was delivered amid very different conditions than the Fed finds itself confronting today.

The following phrases from his 2021 Jackson Hole speech certainly won't appear this time: "the absence so far of broad-based inflation pressures", "little evidence of wage increases that might threaten excessive inflation", "a number of factors that suggest that these elevated [inflation] readings are likely to prove temporary" (the word "transitory" appears in the text four times), and "while the underlying global disinflationary factors are likely to evolve over time, there is little reason to think that they have suddenly reversed or abated. It seems more likely that they will continue to weigh on inflation as the pandemic passes into history". **A year and 225bp in hikes later, with inflation at multi-decade highs, Powell will take a very different tack this time.**



General consensus for Powell's speech is that he will deliver a largely hawkish message, in a similar vein to that conveyed by several regional Fed presidents in the past few weeks (*see Analysts' Key Comments section below*). Powell will have to balance a commitment to bringing inflation down with an acknowledgment that rate hikes will slow "at some point", as he did at the July press conference. This would be tied to both the front-loaded nature of the hike cycle and the lagged impact of tightening (as noted in the July minutes). Concrete guidance for future decisions may not be forthcoming, however. And a more emphatic "pivot", with an eye on recession risks, looks premature at this stage, with key data yet to come before the next policy meeting, and inconsistent with much of the FOMC messaging of recent weeks.

Developments in Fed Funds Rate Expectations

Rising anticipation of a hawkish speech – with some expecting Powell to actively push against the notion of a pivot - has helped boost implied market rate hike pricing. Since the July FOMC, market expectations have ranged from a 55-70bp hike for the next meeting in September, currently sitting at 67bps judging by FOMC-dated Fed Funds futures. They started at the low end of this range following a data dependent stance at the July meeting before beginning to climb with SF Fed's Daly ('24 voter) saying the Fed is nowhere near done yet before a chain of similar Fed commentary. In the interim there was a large beat for payrolls, pushing that 70bps priced for September, before retracing the moves with a CPI miss as core CPI surprisingly slowed to 0.3% M/M. This did little to halt hawkish Fed rhetoric though, with talk of the need for higher rates for longer and railing against market pricing of rate cuts.

The result has been a terminal rate pushed both higher and further out, currently seen reaching 3.78% at the Mar-2023 meeting with cuts to end-2023 being reduced from almost 60bps to 35bps at present. This repricing raises the risks that expectations have gotten a little too hawkish in the run-up to Jackson Hole.

Some areas to watch in Powell's speech are:

- **Does Powell give any signal of the size of the September hike?** He's very unlikely to commit to a particular magnitude (50bp or 75bp being the most likely), and it would almost be a shock if he didn't

reiterate that future moves would be data-dependent (particularly since he emphasized in July that the FOMC is moving to a meeting-by-meeting approach and not providing "clear guidance"). A dovish risk is that he reiterates his comment that 75bp hikes are unlikely to be common; on the hawkish end, he could signal that any size hike is on the table, implying that 100bp is not out of the question.

- **Does Powell reinforce the hiking path from the June Dot Plot, or signal that the FOMC may now be eyeing a steeper and more sustained tightening?** Analysts expect that if he addresses rate pricing, he will point to the June Dot Plot, which has a 3.4% median Funds rate for end-2023 and 3.8% for end-2023 (vs 2.25-2.50% currently), and which he basically re-endorsed at the July press conference. Some expect he could signal that the FOMC will be eyeing an upside revision to that outlook. In another possibility, he could be more forceful than his July comment that Fed policy "needs to be at least moderately restrictive".
- **How hard does Powell push back against 2023 rate cut pricing, if at all?** Powell is very unlikely to signal cuts at this juncture. The hawkish risk is that he pushes back harder against the easing narrative by underlining the Fed intends to take - in BofA's words - a "higher for longer" (vs "lower for longer") approach.
- **What's the threshold for a reduction in the magnitude of hikes, or a pause?** Powell could reiterate that he is looking for "clear and convincing evidence" of a slowdown in inflation. But the FOMC's criteria have been somewhat nebulous on this front, and Jackson Hole provides an opportunity to present a more holistic explanation of what they are looking for.
- **Does Powell acknowledge recession risks?** Like the July FOMC press conference, it's doubtful he'll do so outright, but he may again say that the path to a soft landing is challenging and narrow.

Jackson Hole Analysis From MNI's Policy Team

- For more, see our Key MNI Policy Articles at the end of this preview, and listen to our FedSpeak Jackson Hole preview podcasts with ex-Fed officials (**link to podcasts here**):
- **Former Fed Vice Chair Donald Kohn says Powell** "will deliberately stay away from anything that looks like a dovish pivot" in his keynote speech at Jackson Hole.
- **Former KC Fed President Thomas Hoenig tells MNI** he expects wide-ranging discussion of macroeconomic and policy constraints at Jackson Hole. Hoenig doesn't think Powell will show his cards on whether the Fed will hike 50 bps or 75 bps in September.

Jackson Hole Schedule

The main publicly-known events on the Jackson Hole schedule so far are Chair Powell's speech "Economic Outlook" at 1000ET Friday the 26th, and ECB's Schnabel appearing on a panel on Saturday the 27th.

- The theme of the symposium, which begins at a private dinner Thursday evening and features speeches/panels Friday and Saturday, is "Reassessing Constraints on the Economy and Policy".
- The full schedule will be released Thursday at 2000ET (0100UK time early Friday morning), which will include the various academic paper presentations.
- There will be the usual FOMC President interviews on the sidelines. We don't know of any confirmed appearances but if previous years are any guide, we will get some TV appearances Thursday and Friday.
- Reports suggest several international policymakers will be in attendance, including BOE's Bailey, BOJ's Kuroda, BoC's Macklem, and ECB's Schnabel and Nagel (BBG reports "about half of the ECB's 25 rate setters" will be in attendance though not Pres Lagarde). Several senior EM central bankers will also be in attendance. However, not all attendees will be presenting / giving media appearances.
- The full Symposium website is here (which will include links to papers, livestreams, and schedule): https://www.kansascityfed.org/research/jackson-hole-economic-symposium/

Thursday Aug 25:
- 2000ET Full Jackson Hole Agenda Released

Friday Aug 26:
- 1000ET Chair Powell Speaks On "Economic Outlook" (livestreamed; text released; no Q&A)

Saturday Aug 27:
- 1225ET ECB's Schnabel in panel discussion "Outlook for Policy Post-Pandemic"

Analysts' Key Comments

Barclays: Risk Management Theme To Be Prominent At Jackson Hole

Looking ahead at the Jackson Hole symposium, Barclays notes that they saw the July Fed minutes' tone as hawkish, with "FOMC participants [] more concerned about weakness in activity data leading into the meeting than was communicated in the statement and press conference, which brushed aside these signals showing a strong labor market and robust inflation. What emerged was a more subtle "risk management" justification for continuing to push rates into restrictive territory, despite downside risks".

- Barclays saw the FOMC as having set a "high bar" for "whether it has seen sufficient evidence of a sustained deceleration in prices to step down from aggressive hikes".
- They expect "such risk-management rhetoric will be prominent" at Jackson Hole - "we suspect that the Chair will use the opportunity to sketch out the committee's strategy as it attempts to guide policy to a "moderately restrictive" position in coming meetings, with risk management and data dependence likely to be key themes."

BMO: Could Affirm 75bp Hikes Are Not Expected To Be Common

BMO notes as a backdrop to Jackson Hole that "most Fed officials have warned that they are far from calling a truce in the inflation battle and that market expectations of rate cuts next year are premature", with the minutes confirming that future hikes are data dependent "though they also noted (for the first time) that policymakers are starting to worry about overtightening".

- BMO eyes a 50bp September hike, so "we'll see if [Powell] affirms" the point that he doesn't expect 75bp hikes to be common.

BNY Mellon: More Inflation Talk Than Policy Guidance At Jackson Hole

BNY Mellon expects "more talk about inflation, rather than explicit policy guidance" from Chair Powell at Jackson Hole.

- Despite mounting hike pricing in the past week on speculation Powell will push back against the "pivot" narrative and deliver a hawkish message, BNY Mellon thinks that the terminal rate now priced in is still too low and the expected cuts thereafter won't materialize.
- "What will finally take market expectations higher? We think it will be the realization that inflation is indeed not going down quickly enough, that the labor market will remain tight, and that the Fed is serious is its commitment to lower the former and slow down the latter. We expect Powell will point this out in his speech, and let the implications be inferred from his concern over inflation and the Fed's resolve to get it turned around."
- But BNY Mellon doesn't expect Powell to give explicit rate guidance this week, "because we think the Fed has gotten out of the guidance business" per Powell's July press conference "meeting-by-meeting" comment.
- Powell will "make it clear that the Fed won't relent on tightening policy until it sees" compelling evidence of inflation moving down - "concentrating on inflation rather than guidance on rates will still get the hawkish message across, and not box Powell into any specific rate path."
- BNY Mellon still sees a 75bp hike in September, and "would be surprised if Powell's comments steer those expectations further one way or another. To us, the key data releases are more important."

BofA: Powell To Send "Higher For Longer" Message At JH

BofA thinks Powell is likely to use his Jackson Hole speech to say the pace of hikes could slow 'at some point' while emphasizing restrictive policy ("a slower pace of hikes does not imply the Fed has changed its view on the appropriate terminal rate of the current hiking cycle").

- BofA expects the Fed "to push back against any notion of a quick pivot to rate cuts", with Powell "likely to repeat that the Fed will keep policy restrictive until it has clear and convincing evidence that PCE inflation is on a path to average 2% over time."
- That message could be characterized as "higher for longer" vs the prior cycle's "lower for longer".

- BofA continues to expect a 50bp hike in September. Another 50bp in Nov and 25bp in Dec will bring rates to 3.50-3.75%, but "risks to our outlook are in the direction of a longer expansion and more hikes."

Deutsche: Powell Could Skew Comments In Hawkish Direction

Deutsche sees the Jackson Hole symposium arriving at a "critical juncture for monetary policy" - they "hope/expect" participants will address: "framing the Fed's reaction function; the role of labor supply constraints in achieving its dual mandate; the case for responding to supply-driven inflation; and risk management considerations in a high-inflation environment."

- Powell will re-state the Fed's “unconditional commitment” to bringing inflation back to target, "including that the June SEP – which shows a higher terminal rate than the market -- remains a decent guide for policy and that officials anticipate holding policy at a restrictive stance for some time.
- "We also expect Powell to emphasize that moving from 75bp to 50bp in no way signals the Fed's inflation fight is over, and that the Fed could well still deliver a sequence of 50bp increases at coming meetings if the incoming data dictate it. Having incorrectly taken his July comments as dovish, the Chair is likely to skew his comments in a hawkish direction in an effort to ensure the Fed's inflation fighting credentials are not questioned again."
- Powell should likely reiterate the Fed's hopes around achieving a soft landing in the labor market by reducing labor demand with less movement in the unemployment rate." though Deutsche adds "while a soft landing is plausible, it remains unlikely in our view".
- "More interesting will be if Powell discusses conditions under which the Fed should break from the traditional reaction of “looking through” supply shocks and actually respond to higher inflation, irrespective of its causes...Powell could note that a sequence of supply shocks could threaten an unanchoring of inflation expectations which could ultimately make inflation more persistent."
- "It will be important to see whether Powell adopts this risk management approach [which "argue in favor of risking being too hawkish"] espoused by some of his hawkish-leaning colleagues.

JPM: Powell To Push Back Against Pivot

While JPMorgan sees the data since the July meeting pointing "in the direction of" a 75bp September hike, they don't expect Powell at Jackson Hole "to tip his hand on the size of the next move, which will depend on upcoming releases."

- JPM expects Powell to note "that activity indicators have been mixed but the labor market remains exceptionally tight and inflationary pressures are still building. In so doing, we believe he will push back against the idea that a dovish policy pivot is coming anytime soon. Instead, we expect he will remain steadfast that "ongoing" rate increases are needed to regain price stability."

TD: Powell Could Note Fin Conditions May Need To Re-Tighten

TD notes that in the buildup to 2022's Jackson Hole symposium, Fed officials have signalled since the July meeting that the June Dot Plot is "still valid policy guidance for the near term".

- In other words, "the Committee is in broad agreement to hike rates to at least the 3.25%-3.50% range before the end of the year" and TD is "of the view that the terminal rate is still above that level."
- Powell's speech "won't ... bring a significant departure from his recent statements, likely emphasizing the Fed's data dependence and the need to hike further to bring inflation under control."
- TD expects Powell to emphasize the recent easing of financial conditions and "suggest that the Fed may need to tighten policy further if financial conditions remain insufficiently restrictive."

UBS: Powell Could Favor 50bp Sept Hike, But Point To High Terminal Rate

UBS thinks Fed Chair Powell may use his speech at Jackson Hole in part to "defend the institution's policy response to the pandemic".

- Current policy-wise, he may reiterate that - addressing the symposium's theme of "reassessing constraints on the economy and policy" - the FOMC needs to bring inflation back to 2% "even if the labor market must slow and growth runs below potential, in order to achieve better economic outcomes in the long run".
- If Powell does signal intentions for the September FOMC, "we think he will favor 50 bp, at least gently, without removing the possibility of a 75bp increment."

- UBS' core view is for a 50bp September raise; they point out though that Powell "will likely argue that this lower pace of hikes does not imply a capitulation on inflation but a move to further ongoing toughening. This could still be meaning fully restrictive policy but at a pace that allows for more evaluation of how inflation and the real economy respond. At this juncture Chair Powell likely won't want to ease financial conditions and could use the opportunity to suggest the terminal rate is higher than expectations."

Recent FOMC Communications

Pertinent FOMC member commentary since the Jul 27 FOMC decision

Date	Member	Voter	Comment
Aug 2	Daly	2024	Our work is far from done, so we are still resolute and completely united on achieving price stability. I don't see a labor market that's in a recession.
Aug 2	Mester	2022	Prices only cooling if you squint, fears service inflation will be more persistent. Can't cry victory too early, inflation has been stubborn and haven't even seen peak yet.
Aug 3	Bullard	2022	Sticks to call of wanting 3.75-4% by year-end. Q2 economic slowdown more concerning than Q1 but doesn't see US in recession with jobs market so strong.
Aug 3	Daly	2024	Markets ahead of themselves expecting cuts next year, won't bring rates down in just a few months. We're not even up to neutral right now, with neutral estimated circa 3.1%.
Aug 3	Kashkari	2023	Market bets on Fed rate cut is very unlikely, inflation fight is bigger priority than recession
Aug 4	Mester	2022	75bp hike in Sept not unreasonable, sees rates peaking little above 4% next year
Aug 5			PAYROLLS REPORT BEATS ESTIMATES
Aug 9	Bullard	2022	Fed prepared to hold rates higher for longer should inflation continue to surprise to the upside, and market pricing will need to adjust accordingly
Aug 10			CPI REPORT MISSES ESTIMATES
Aug 10	Evans	2023	Keeps to rate projections, wanting 3.25-3.5% by year-end and 3.75-4% by end-23.
Aug 10	Kashkari	2023	CPI report doesn't change his rate path of 3.9% year-end, 4.4% end-23. Fed to raise rates and sit there until inflation eases. Idea of cuts unrealistic whilst CPI high.
Aug 11	Daly	2024	Far too early to declare victory on inflation. Keeps to baseline of 50bp hike in Sept, doesn't rule out 75bp but sees increased support for a slowdown in the pace of rate hikes.
Aug 18	Daly	2024	50bp or 75bp hike in Sept reasonable, favors hiking to a little above 3% by year-end (from 3.4% prior). May need to go higher than that, depends on data.
Aug 18	Bullard	2022	Too soon to say the inflation surge has peaked. It isn't clear that financial conditions have actually eased as stock prices can distort some measures.
Aug 18	George	2022	July CPI encouraging but too soon for victory lap. It's not clear where the stopping point for rates will be, but the Fed will need to be "completely convinced" inflation is coming down.
Aug 19	Barkin	2024	Fed will do what it takes to lower inflation to 2%, very seriously focused on it. Expect yields to rise, tighter financial conditions as b/sheet shrinks.

Key MNI Policy Articles

MNI INTERVIEW: Upside Risks To Fed Funds Rate Peak- Kohn

(**Pub. Aug 23, 2022**)

By Pedro Nicolaci da Costa

MNI (WASHINGTON) - Federal Reserve policymakers could be forced to raise interest rates more than their own forecasts and market expectations suggest because of persistent inflation pressures and a strong labor market, former Fed Vice Chair Donald Kohn told MNI.

Fed officials in June said rates were likely to peak around 3.8% and investors now see them topping out at 3.75% in March of 2023. Kohn told MNI's FedSpeak podcast that "sticky" inflation pressures raised the chances that fed funds might need to go even higher.

"There are upside risks on inflation relative to what the market has and relative to what the Fed had. So there are upside risks to the funds rate relative to what the Fed saw in the June meeting," Kohn said. (See MNI INTERVIEW: Fed's Bullard-Rates May Be 'Higher For Longer')

His concern about lingering inflation pressures hinges on the strength of the labor market, which saw employment growth surge by another 528,000 jobs in July while the jobless rate fell to 3.5%, matching a 50-year low.

"My concern is inflation will be sticky because labor market tightness will be sticky," Kohn said. "The labor market remains extremely tight, vacancies are still very high, the unemployment rate is below most estimates of the natural rate. Wages are increasing rapidly, much more rapidly than is consistent with the 2% inflation goal." (See MNI INTERVIEW: Wages Hotter Than Labor Dept Data-Atlanta Fed)

Kohn said the Fed would be "lucky" to get PCE inflation, which climbed to another 40-year high of 6.8% in June, down to between 4% and 5% by year-end.

"The real issue is whether it's going to go all the way back to 2% over the next couple of years without a fairly substantial increase in the unemployment rate putting some slack into the economy," he said.

JACKSON HOLE

Kohn said investors expecting some kind of firm signal on the direction of policy from Fed Chair Jerome Powell's keynote speech at this week's Annual Jackson Hole Symposium would be disappointed.

"He will deliberately stay away from anything that looks like a dovish pivot," he said. "He'll emphasize again their determination to get inflation back to 2% and to do whatever it takes to get there. He doesn't want any doubt in the minds of consumers, business people, market participants, that the Fed is determined to get inflation down."

Powell would also not likely tip his hand on whether the Fed will slow the pace of rate hikes in September down to 50 basis points from 75 basis points in its last two meetings.

"At some point they need to step down those increases to a more sustainable pace -- 150 basis points in the last couple of meetings is outside my experience, at least post-1982," said Kohn, who spent 40 years at the central bank and is now a senior fellow at the Brookings Institution. "But whether that's going to be September or not I think the incoming data will let them know."

RECESSION CHANCES

Kohn said that while the unemployment rate clearly needs to rise in order to get inflation down to the Fed's 2% target, this might still be accomplished without driving the economy into a full-fledged contraction.

"They can make this happen without a recession but it will require slow growth and a rise in unemployment to take pressure off the labor markets," he said. "That gets to be a very delicate balancing act. Very slow growth can tip into recession because of developments not only in monetary policy in the U.S. but global developments on the supply side."

MNI INTERVIEW: Banks Face Mounting Risks As Fed Hikes -Hoenig

(**Pub. Aug 19, 2022**)

By Pedro Nicolaci da Costa

MNI (WASHINGTON) - U.S. bank balance sheets could come under rising pressure as the Federal Reserve lifts interest rates and asset values decline because lenders are not as well capitalized as regulators maintain, former Kansas City Fed President Thomas Hoenig told MNI.

Hoenig, also ex-vice chair of the FDIC, said in the latest episode of MNI's FedSpeak podcast that improvements to bank capital regulation since the last financial crisis were not enough to make him comfortable about the state of the banking system.

"If the Federal Reserve raises rates sufficiently, to or above 4% by the end of the year and they stick to quantitative tightening, then I think you will have downward pressures on asset values of all kinds. I think that's where the banks will feel the effects," he said.

"It's not just in the shadow banks because the largest commercial banks and some of the largest regional banks fund the shadow banking sector and that will come back on their balance sheet."

QT RISKS

He said financial markets have not yet fully appreciated the effects of the Fed's quantitative tightening program, which aims to reduce the USD9 trillion balance sheet fairly rapidly. (See MNI: Recession Could Force Fed To End QT Early-Ex Officials)

"I know the regulators say the largest banks are so much better capitalized. When you look at their leverage ratio and you think about liquidity tightness and you think about asset quality, their leverage ratio is 6%. That's not an overly impressive leverage ratio," adding that he would prefer to see a ratio around 8% or 9%.

Hoenig acknowledged risk-weighted capital ratios are closer to 13% but added that these could not be relied upon as a long-run measure of financial strength.

"As we learned in the financial crisis, risk-weighted capital becomes secondary in a crisis. Only leverage matters and the leverage ratio matters, and I think 6% is marginal," he said. "It will I think be tested if the economy runs into confidence issues, if the rates rise sufficiently that it does begin to pressure down asset values, then I think the test of adequate capital would be forthcoming."

HIGH RISK OF RECESSION

Hoenig said he sees the strong likelihood of a U.S. recession next year if the Fed is serious about bringing down inflation, which slipped to 8.5% in July but remains close to a 40-year high. (See MNI INTERVIEW: Fed's Bullard-Rates Could Be 'Higher For Longer')

"I haven't really witnessed too many adjustments coming down from 8.5% to 2% without a recession," he said. "I think the probabilities of a recession are fairly high." He thinks inflation will end the year around 6% to 6.5%.

Hoenig, who as head of the Kansas City Fed hosted the annual Jackson Hole Symposium for 20 years, said he doubts Fed Chair Powell will commit to a 50bp or 75bp rate hike at the September meeting given that there will still be additional data on inflation and jobs before then.

"I just can't imagine they've made up their mind at this point," he said.

The easing of financial conditions seen since the softer-than-expected CPI print last week makes policymakers' jobs harder, Hoenig said, adding that's partly the Fed's fault because it previously flinched in the face of modest economic weakness and financial distress.

"It's a statement in the sense of the Fed's perceived credibility with the market. The Fed is saying inflation is the No. 1 goal and they're going to bring it back to 2%, and yet there's this view that they will reverse fairly quickly," he said.

The minutes also showed some concern about overtightening, which prompts investors to start pricing in the prospect of rate cuts rather quickly after interest rates peak, he said.

"When you give mixed messages the market is going to read it favorably, and that's because the Fed has changed directions fairly consistently," he said, citing the repo scare of 2019 and the 2018 pause in hikes.