

## On Deck – Chair Jerome Powell and the Fed

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The Federal Reserve Open Market Committee (FOMC) has their next scheduled meeting on September 17-18. Chair Jerome Powell and the Fed's Board of Governors have been objects of President Trump's criticism for not lowering rates enough. As several analysts have pointed out, politicians never call for an increase in interest rates.

The CME Group estimates the probability of changes in Federal Reserve target rates based upon Fed Funds futures prices. As of August 28, the "FedWatch Tool" is showing an 85.1% probability of a Fed funds target rate cut of 25 basis points from the current range of 4.25-4.50% and a 14.9% probability of no change in rates at the conclusion of the FOMC meeting on September 18.

On August 22, Chair Powell gave a speech at the Jackson Hole annual economic symposium. The Federal Reserve publishes transcripts of significant speeches by Fed Governors. Chair Powell highlighted the changes since his prior speech at Jackson Hole a year ago when the Fed funds target rate was 1.0% higher.

- A year ago, the restrictive policy stance was appropriate to bring down inflation.
- Inflation has since moved closer to the Fed's objective (2% in the long run).
- The labor market has "cooled from its formerly overheated state."
- The unemployment rate has increased by almost a full percentage point.
- The labor market has remained in balance near maximum employment over the past year.

Chair Powell then described current economic challenges and the Fed's limitations in dealing with "structural changes."

Significantly higher tariffs across our trading partners are remaking the global trading system. Tighter immigration policy has led to an abrupt slowdown in labor force growth. Over the longer run, changes in tax, spending, and regulatory policies may also have important implications for economic growth and productivity. There is significant uncertainty about where all of these policies will eventually settle and what their lasting effects on the economy will be.

Changes in trade and immigration policies are affecting both demand and supply. In this environment, distinguishing cyclical developments from trends or structural developments is difficult. This distinction is critical because monetary policy can work to stabilize cyclical fluctuations but can do little to alter structural changes.

Chair Powell described the state of the current US economy.

- The labor market appears to be in “a curious kind of balance that results from a marked slowing in both the supply and demand for workers.”
- GDP growth has slowed from last year to 1.2% for the first half of the year.
- Higher tariffs have begun to push up prices in some categories of goods.
- Housing services inflation remains on a downward trend.
- The base case for the effects of tariffs on inflation is relatively short lived - a one-time shift in the price level as they work their way through the supply chain and distribution networks.
- It is possible, however, that tariffs “could spur a more lasting inflation dynamic.”
- “In the near term, risks to inflation are tilted to the upside, and risks to employment to the downside.”

His comments were considered by many to support a cut in the Fed funds target range at the next FOMC meeting. Chair Powell, however, cautioned his audience that “monetary Policy is not on a preset course.” Perhaps to push back against political pressure, he said, “FOMC members will make these decisions, based solely on their assessment of the data and its implications for the economic outlook and the balance of risks. We will never deviate from that approach.”

The Federal Reserve is limited in their ability to control all interest rates. During the last year, the interest rate on 1-month Treasury bills, which is most affected by the Fed funds rate, has declined by 0.95% to 4.32%. In contrast, the interest rate on all US Treasury bonds with maturities longer than 5 years have increased. The interest rate on the 30-year US Treasury bond has increased by 0.73% during the last year to 4.93%. So, based on financial market prices, investors expect higher inflation and/or a higher probability of a credit default.

If you have any questions or comments, please contact me.

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