THE FED AT JACKSON HOLE SEPTEMBER 23, 2024 – A RECAP

US Federal Reserve Chairman Jerome Powell prepares the stock market for an imminent interest rate cut (Friday , 23rd Sept 2024)

In a much-noticed speech at the central bank meeting in Jackson Hole, the Fed chairman came close to announcing victory over inflation. This was very well received by the markets. However, Powell also admitted that he had initially greatly underestimated inflation.

She waited a long time, but now it is likely to be the case: The US Federal Reserve will probably decide to cut interest rates for the first time in four and a half years in September. Fed Chairman Jerome Powell gave clear indications on Friday, during his traditional speech at the central bank meeting in Jackson Hole, that an interest rate decision is imminent. "The time for an adjustment has come", he said.

An adjustment in September was expected. However, in previous appearances Powell had always left the door open to postpone a rate cut if the economic data so required.

Recently, however, the Fed has given increasingly clear smoke signals. Fed representatives had already indicated at the symposium in Wyoming on Thursday that "gradual" and "methodical" interest rate cuts were imminent. In this respect, it is still to be expected that the Fed will only lower the key interest rate by 0.25 percentage points in September for the time being and will not aim for a "double move”.

Recently, however, the Fed has been sending out increasingly clear signals. Fed representatives had already indicated at the symposium in Wyoming on Thursday that "gradual" and "methodical" interest rate cuts were imminent. In this respect, it is still to be expected that the Fed will only lower the key interest rate by 0.25 percentage points in September for the time being and will not aim for a "double move".

Boosted stock markets

This closes the circle for the Fed in Jackson Hole. Two years ago, when inflation in the USA and Europe was threatening to spiral out of control, Powell swore the world to a consistent fight against inflation in the same place. At the time, he said that a recession would be accepted if necessary in order to bring inflation back down to two percent.

Powell's current appearance was almost a victory speech. Although the Fed Chairman refrained from triumphalism, he did hint that, from the Fed's point of view, a new monetary policy era had dawned.

The financial market had been waiting for such confirmation and reacted strongly to Powell's speech. The value of US government bonds rose significantly and the leading US index, the S&P 500, also rose rapidly by around one percent. The Russell 2000, which includes many SMEs that react very sensitively to changes in interest rates, initially rose by as much as 2%.

The currency markets also reacted, with the dollar weakening against the euro and the yen.

Kazuo Ueda, the head of the Japanese central bank, had announced a few hours before Powell's speech at a hearing in the Japanese parliament that he would stick to his stricter monetary policy as long as inflation and growth remained on track. However, Ueda also indirectly conceded that the Bank of Japan would keep an eye on the reaction of the stock markets when making its decision.

A stronger yen, combined with weaker economic data from the USA, contributed significantly to the turbulence on the stock markets at the beginning of August. Many investors who had bet on a weak yen had to liquidate large bets very quickly, which sent the Japanese stock market tumbling and unsettled investors around the globe.

A repeat of this does not appear to be on the cards at present: Japan's benchmark Nikkei-225 index rose in after-hours trading.

Clarity for the markets

Macroeconomic indicators in the USA have not given a clear picture recently. The labor market has weakened somewhat; recent estimates of how many jobs have been created this year have been revised downwards significantly. The unemployment rate has risen slightly but gradually to 4.3% recently. However, this is still a good figure. There are also signs that part of the recent rise was weather-related, for example due to a hurricane in Texas in early summer.

The ambiguous data has recently unsettled the financial market. It has been on a rollercoaster ride in recent weeks. Concerns that a recession could be imminent in the US after all have been reinforced by doubts about the plans of major tech companies to use artificial intelligence to help the economy become more productive. Powell's words should now help to calm the markets.

An extraordinary time

Powell also used his speech in Wyoming to defend the Fed's policy of recent years. He once again explained the reasons why the central bank had initially assumed that the surge in inflation in 2021 was merely temporary: inflation was initially heavily concentrated on goods that were in short supply due to the pandemic. Inflation expectations also remained well anchored - which made a wage-price spiral less likely.

In reality, however, the labor market remained tight for a longer period of time and inflation became entrenched. The year 2022 brought further price shocks, for example due to the war in Ukraine, which made oil, natural gas and wheat more expensive. In China, the fight against Covid-19 also lasted a very long time, which continued to affect supply chains and the supply of goods.

Equally extraordinary, however, was how inflation in the US was brought back under control without triggering a recession and a sharp rise in unemployment. Powell said that this time the necessary cooling of the labor market was not achieved by more layoffs and a sharp increase in unemployment, but by a decline in job offers and new hires.
Inflation expectations remained well anchored, thanks in part to the Fed's sharp interest rate hikes in recent years. This was by no means assured, Powell said, as these expectations had never been seriously tested since the 2000s.

Powell said that the pandemic and the surge in inflation over the past three years would keep monetary policy researchers busy for a long time to come. The Fed would soon begin a fundamental review of this "extraordinary period". Powell promised modesty and openness to criticism.

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