All Signal, No Noise

MARKET ANALYSIS

Jackson Hole Preview – Aug 2020

Preliminary Schedule/Key Links

Thurs Aug 27

- **0910ET/1410BST:** Federal Reserve Chair Powell to speak on “Monetary Policy Framework Review” (text under embargo)
- **1115ET /1615BST :** Bank of Canada Gov Macklem and ECB Chief Econ Lane speak on panel

Fri Aug 28

- **0905ET/ 1405BST:** Bank of England Gov. Bailey

Full agenda released 2000ET/0100BST Wednesday (probable link):

https://www.kansascityfed.org/publications/research/escp

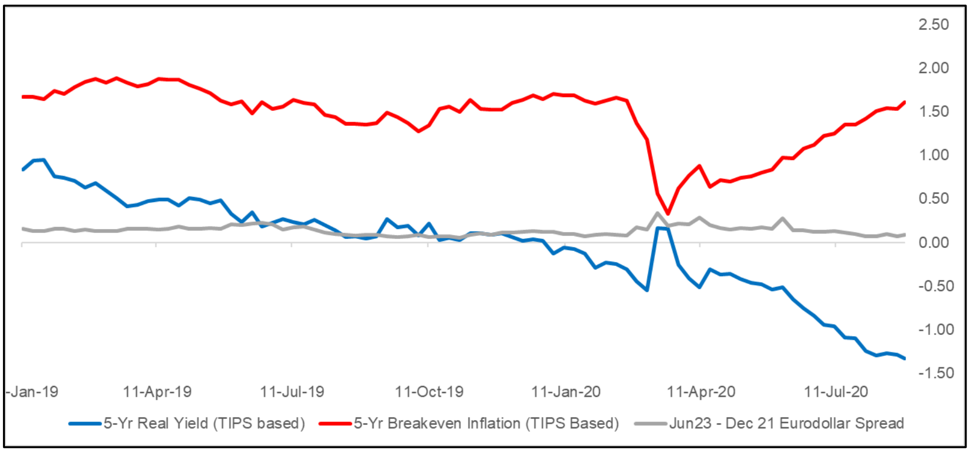
Livestreams (probable link):

https://www.youtube.com/user/KansasCityFed

MNI Point Of View: High And Low Expectations For Powell

The 44th annual Economic Policy Symposium hosted by the Kansas City Fed (an event known more widely as “Jackson Hole”) will be conducted online on Aug. 27 to Aug. 28. The full agenda for the event, entitled “Navigating the Decade Ahead: Implications for Monetary Policy,” is embargoed till the night before (approximately 2000ET/0100BST). The schedule will include multiple panels, research presentations, etc involving global policymakers/academics.

However, the undoubted highlight will be one of the few appearances announced in advance: Fed Chair Powell on Thursday at 0910ET/1410BST on the subject: “Monetary Policy Framework Review”. The title heavily implies **Powell is set to address the ongoing review of the Fed’s monetary policy strategy, tools, and communication practices, including changes to the Committee's Statement on Longer-Run Goals and Monetary Policy Strategy.** Based on sell-side analysts’ notes, expectations for the speech run both high and low.



High because **Powell is likely to at the very least strongly suggest what the conclusions of the long-running framework review will be, if not outright announce them** (the Fed is expected to formally unveil the new policy strategy at the September FOMC). By most indications, the Fed is set to take a major step by **adopting an average inflation targeting framework in which it would tolerate overshoots of the 2% target in order to compensate for prior misses below 2%.** The parade of Fed speakers early next week (Vice Chair Clarida first thing Monday morning, Gov Brainard Tuesday, NY’s Williams Wednesday) suggests a barrage of communication from the FOMC's heavy hitters in order to massage the message on the framework post-Powell speech ahead of the September meeting.

But expectations are also fairly low, with this **dovish change having been well-communicated in advance and largely priced in,** according to both sell-side assessments and market pricing (real yields near all-time lows, inflation breakevens bouncing back to near pre-COVID levels, Fed funds rate seen on hold through mid-2023 at least – *see chart above*).

And the changes were downplayed by Powell himself at the July FOMC as well (see communications section at the end for recent Fed comments)*: "to a very large extent the changes we'll make to the statement of longer run goals and monetary policy strategy are really codifying the way we're already acting with our policies to a large extent we're already doing the things that are in there. This is just a way of acknowledging that and putting them in the document."* So implying more of the same in terms of Fed policy, just putting it in writing. And more specific near-term policy measures to be taken to achieve the new target, like more specific forward guidance, are likely to be laid out separately, at either the Sep or Nov FOMC.

But other aspects could prove interesting. Surprises could include Powell mentioning:

- A specific time horizon for achieving 2% inflation on average / a more mechanical approach to inflation makeup, as opposed to a 'soft target'
- More specificity on maximum employment as a target
- Revisions to the Fed's communications strategy and dot plot. While most attention is squarely on the inflation targeting regime, some analysts point to possible changes to the economic projections (including more transparency on the economic assumptions underlying individual members' dot plots)
- **Yield Curve Control** as anything but a possible future tool in the toolkit would be dovish given that FOMC minutes/members have been clearly sceptical and expectations of adoption have been dialled back
- More specifics on **balance street options**, notably on extending duration, or tying this to fwd guidance

Analysts' Key Comments

Barclays:

- Expect Powell to indicate the Fed is prepared to introduce inflation averaging at the September FOMC, which would open the door to targeting modest overshoots of the 2% inflation target to compensate for periods of below-target inflation.
- But this will not come as news to financial participants who have expected this outcome for some time.
- In Sep (poss later): refine forward guidance (outcome-based tied to one/two year-ahead inflation forecasts), maintain current pace of purchases, with emphasis to change from market functioning to accommodation.

BNY Mellon:

- In addition to unveiling AIT, we will be listening for more clarity on the Fed's attitude towards yield curve control. If Powell remarks follow recent FOMC comments that do not indicate widespread support for YCC, this might be seen by the markets as hawkish.
- But Fed will eventually implement YCC, probably later this year, especially with the amount of issuance required from the US Treasury. If and when the Fed finally goes down the route of YCC, it would likely be wrapped up with additional quantitative easing should economic conditions warrant further accommodation in the fourth quarter of the year.

CIBC FICC:

- For the first time in years there could be serious market implications at Jackson Hole, with COVID seen as a deflationary shock, policy rates at historic lows, and skepticism about the long-term viability of tools to reach inflation targets.
- We could get a sense from Powell that policy is headed toward letting the economy run hot (inflation above target) for a period of time – leading to a makeup strategy for inflation.

- Markets are expecting this affirmation (based on real yields and breakevens). If not, could get position-squaring in USD.
- What's not expected (though still unlikely) is something more daring, like abandoning the inflation target and adopting something altogether different.

Citi:

- Powell's speech will be resolutely dovish, and point to the merits of supporting inflation expectations and tolerating inflation overshoots, following a period of undershoots, i.e., soft inflation averaging.

Deutsche:

- While it is possible that the policy review results are released along with Powell's appearance, it is more likely that he summarizes the key findings from this review and outlines the likely implications for the central bank moving forward.
- The review will codify the Fed's pivot to a soft avg inflation target that does not specify either the lookback period for computing the avg or the horizon over which to return to target. Instead, the new objective to be couched in terms of achieving 2% on average over the business cycle/medium-term.
- Fed to revise the language around maximum employment to emphasize the broad-based benefits of achieving a tight labor market.
- The review should re-emphasize that forward guidance and QE remain the primary tools when the fed funds rate reaches the effective lower bound.
- Within forward guidance, an outcome-based formulation is most likely to be preferred. While (front-end) yield curve control will remain a potential tool for the future, it was also clear from the July FOMC minutes that officials have all but ruled out its usage in the current environment with market pricing consistent with their expectations for the policy rate. Conversely, negative rates have been ruled out for the time being.
- Possible communications innovations include making the post-meeting statement less formulaic / more dynamic and enhancing the SEP by tying individual monetary policy expectations to economic forecasts.

Goldman Sachs:

- We do not think that the outcome of the framework review that we expect would be a large surprise to financial markets.
- On strategy: FOMC to adopt average inflation targeting, aiming for inflation somewhat above 2% when the economy is at or near full employment in order to offset inflation below 2% when the economy is depressed - do not expect an explicit make-up policy that formally tracks and commits to compensate for the cumulative below-target miss over some trailing window.
- If the FOMC instead decides to more formally track and respond to recent deviations from the inflation target, Powell might illustrate what this would look like in his speech.
- On tools: FOMC to reiterate that forward guidance and asset purchases are now standard tools and to note that front-end yield caps or targets could be useful in the future in certain circumstances, but without expressing any intention to actually implement anytime soon.
- On communications: FOMC might aim to tweak SEP to better convey the flexibility of the reaction function, addressing Powell's concern that "at times the dot plot has distracted attention from the more important topic of how the FOMC will react to unexpected economic developments." We are not sure exactly what this might involve, and we are less confident in this part of the review.
- Continue to expect changes to the forward guidance and asset purchase program to come at the November FOMC, but it has become a closer call versus September.

MUFG:

- Overall, it is likely that the Committee may seek to deliver, first, an updated Statement of Longer-Run Goals and Monetary Policy Strategy, and, second, a plan for the extension of the current Quantitative Easing programs prior to delivering a new, formal program to strengthen forward guidance.

NatWest:

- Expect clear guidance from Powell around rewriting of the longer-run statement.
- Likely to incorporate some form of average inflation targeting that opens the door to a make-up strategy on inflation to be announced at September FOMC. While the exact details remain unclear, officials may announce something along the lines of a temporary "asymmetric operational range" for inflation of 2-2.5%.

- As part of the MPR, the FOMC could make changes to the “dot plot” (e.g. more clarity on participants’ reaction function or perhaps provide some sort of alternative scenarios/forecasts) so that some revamping of the SEP could be announced.
- The language used in the July minutes about policy changes to forward guidance showed Fed wanted to retain as much flexibility about the details as possible. We still think the most logical order is to first complete the monetary policy review in September, then roll out policy changes with regard to forward guidance later this year.
- Expect little new information from Powell in regard to his current assessment of the economy relative to the July minutes.

SEB:

- Possibility for the Fed to shift to an average inflation target or at the least change its wording regarding inflation overshooting the target. Given that the Fed has not yet decided on the new framework there is a limit for how much Powell can reveal and we may have to wait until the September 16 meeting for details.

SocGen (Kit Juckes)

- The Fed is dovish by any measure, trying only to find the best way to signal that.
- Yield curve control has proponents but not a majority, negative rates ae unpopular, and while a weaker dollar would suit the Fed, they don't like talking about it.
- The danger at this point is, that the market is too heavily biased in favour of a degree of dovishness even Jay Powell can't deliver (yet). If that's the case, the long-term dollar decline will remain a theme of the next few years, not just months, but the need for a correction will be increasingly clear.

Standard Chartered:

- There is some room for dovishness at Jackson Hole but not a whole lot, as investors already anticipate inflation averaging over the cycle, some added use of asset purchases, and threshold levels for unemployment and inflation before policy rate hikes are considered.
- That said, there is no point for the Fed to introduce a new framework that surprises on the hawkish side.
- Powell to add market-friendly sentiment by being explicit on duration extension as stimulus to rates sensitive sectors, being open to YCC and added purchases of non-Treasury assets if needed, and referencing a narrower gap between minority and overall unemployment rates as a Fed goal.

TD:

- Expect Powell to effectively pre-announce the outcome of the review, which will lead to the formal adoption of some form of average inflation targeting.
- AIT adoption likely reflected in new Statement on Longer-Run Goals and Monetary Policy Strategy in Sep., with post-meeting statement to change forward guidance (inflation > 2% for a while to make up at least some of the shortfall in recent years).

Wrightson ICAP:

- Don’t expect a lot of fireworks in Powell’s speech; he has downplayed the likelihood of major surprises in the new version of the statement.
- Committee consensus appears to have gravitated toward a softer version of inflation averaging, in which the Fed would express a willingness to accept above-target price gains in the advanced stages of the business cycle without locking itself into a rigid policy of offsetting every shortfall with a subsequent overshoot (ie could target higher infl rates on tactical basis down the road).
- Perceived benefit of the more mechanical proposals under consideration at the start of the year was that a stronger commitment might halt the apparent erosion in inflation expectations but the upturn in most measures of inflation expectations makes that a less immediately pressing issue.
- Given existing credibility of dovishness it's not clear that the redesigned longer-run statement will have much impact on the transmission of policy one way or the other. Buttressing the central bank's political legitimacy, on the other hand, has become a more critical concern.

Relevant Comments From July FOMC

Powell Post-Meeting Press Conference

Before taking your questions, I'll provide an update on our review of our monetary policy framework. As a reminder we began this public review of our monetary strategy tools and communication processes, a first for the Federal Reserve, early last year. Our purpose has to take a comprehensive look how we can best meet our maximum employment and price stability objectives in the years ahead, particularly in light of the general lower level of interest rates around the world. As is evident in our current situation, the interest rates have reduced the scope for the committee to support the economy by cutting interest rates.

Our plans to conclude this review were, so like many things, were delayed by the pandemic. At this meeting my colleagues and I resumed our discussions. Our focus was on possible enhancements to our statement on longer run goals and monetary policy strategy. This document states our goals, articulates our approach to monetary policy, and serves as the foundation for our policy actions. While I do not have details to share today, I'm confident we will continue to make progress and will wrap up our deliberations in the near future.

In Q&A:

Q: *I wanted to ask about guidance. Do you see merits to tying your asset purchases to economic outcomes? And would you consider both inflation and labor market conditions as part of those outcomes? Specifically for the labor market, what conditions would you want to see before you think about pulling back stimulus?*
A: That's a great discussion. We've talked about that at past meetings and I imagine in future meetings. We haven't made decisions on that. You have a couple ways to go. You can tie them to dates. You can say we for a specific period of time we will keep rates at X level or we will keep them there until you achieve a certain macroeconomic goal. And it either be inflation or it can be an employment goal, as you pointed out.

I think there's attraction in all of those, depending on the situation. I think for obvious reasons, you can imagine situations where you would really want to be targeting macroeconomic outcomes. It's also the case that sometimes date-based guidance works too. I think it really is very fact specific. It's not something -- we haven't made any decisions on that, so I wouldn't be standing here telling you we're going to go this way or that way should the time come for us to change our forward guidance.
…

Q: *I wanted to ask how the framework review is working in tandem in your explicit afford guidance. Is the idea that you would announce the findings of the Fed review before committing to some explicit afford guidance or curve control policy? Thanks.*

A: So, I do think that completion of the review would -- first of all, it's something, it was a very high priority. We're really looking forward to completing it probably at the June meeting, but it might have been the meeting before that, we were right on track. Then we got distracted. We weren't expecting the pandemic, nobody was. The pandemic came in. I think it's important to go back and finish that. I think that will inform everything we do going forward. I would also tell you, though, that to a very large extent the changes we'll make to the statement of longer run goals and monetary policy strategy are really codifying the way we're already acting with our policies to a large extent we're already doing the things that are in there. This is just a way of acknowledging that and putting them in the document. I can't tell you what the exact timing of that will be. But I do think that's a sensible way to think about it.

July FOMC Minutes (Released August 19):

With regard to the outlook for monetary policy beyond this meeting, a number of participants noted that providing greater clarity regarding the likely path of the target range for the federal funds rate would be appropriate at some point. Concerning the possible form that revised policy communications might take, these participants commented on outcome-based forward guidance—under which the Committee would undertake to maintain the current target range for the federal funds rate at least until one or more specified economic outcomes was achieved—and also touched on calendar-based forward guidance—under which the current target range would be maintained at least until a particular calendar date. In the context of outcome-based forward guidance, various participants mentioned using thresholds calibrated to inflation outcomes, unemployment rate outcomes, or combinations of the two, as well as combinations with calendar-based guidance. In addition, many participants commented that it might become appropriate to frame communications regarding the Committee's ongoing asset purchases more in terms of their role in fostering accommodative financial conditions and supporting economic recovery. More broadly, in discussing the policy outlook, a number of participants observed that completing a revised Statement on Longer-Run Goals and Monetary Policy Strategy would be very helpful in providing an overarching framework that would help guide the Committee's future policy actions and communications.

A majority of participants commented on yield caps and targets—approaches that cap or target interest rates along the yield curve—as a monetary policy tool. Of those participants who discussed this option, most judged that yield caps and targets would likely provide only modest benefits in the current environment, as the Committee's forward guidance regarding the path of the federal funds rate already appeared highly credible and longer-term interest rates were already low. Many of these participants also pointed to potential costs associated with yield caps and targets. Among these costs, participants noted the possibility of an excessively rapid expansion of the balance sheet and difficulties in the design and communication of the conditions under which such a policy would be terminated, especially in conjunction with forward guidance regarding the policy rate. In light of these concerns, many participants judged that yield caps and targets were not warranted in the current environment but should remain an option that the Committee could reassess in the future if circumstances changed markedly. A couple of participants remarked on the value of yield caps and targets as a means of reinforcing forward guidance on asset purchases, thereby providing insurance against adverse movements in market expectations regarding the path of monetary policy, and as a tool that could help limit the amount of asset purchases that the Committee would need to make in pursuing its dual-mandate goals.

Current Statement on Longer-Run Goals And Monetary Policy Strategy:
https://www.federalreserve.gov/monetarypolicy/files/FOMC_LongerRunGoals.pdf

Analyst Fed Outlook (Post-July FOMC)

	Strengthened Forward Guidance	Yield Curve Control
ANZ	Yes, Outcome-Based, in September	Not likely soon
Barclays	Yes, Outcome-Based, in September	No view
BNP Paribas	Yes, Outcome-Based, in September	Perhaps eventually
Citi	Yes, Outcome-Based, in September	No view
Credit Suisse	Yes, Outcome-Based, in September or later	Yes, Australia-style, in September or later
Deutsche	Yes, in September or later	Yes
Goldman Sachs	Yes, Outcome-Based on BOTH Inflation and Employment, in November	Not soon
HSBC	Yes, Outcome-Based (could include employment?) in July or September	No view
ING	Yes, Outcome-Based, in Sep or Dec	No
JPMorgan	Yes, Outcome-Based, in September	No view
Morgan Stanley	Yes, Outcome-Based, in September	
NatWest	**Yes, Outcome-Based, in Nov [Prev said Sep]**	No view
Nomura	Yes, Outcome-Based, in September	No view
Nordea	Yes, Outcome-Based, in September or later	Yes, but later
Rabobank	Yes, Outcome-Based	Yes, 'down the road', potentially Q4
RBC	Yes, Outcome-Based (perhaps incl labor market), but no rush	
Societe Generale	Yes, Outcome-Based, "soon"	Yes, but contingent on market pricing hikes prematurely
TD	Yes, Outcome Based, in September	Yes, but by end-2020 may be too early
UBS	Yes, Outcome-Based AND Date-Based, in Sep	Yes, in September
Unicredit	Yes, in the fall	"Significantly less likely following June minutes"
Wells Fargo	Yes, in Sep or Nov	Under Consideration
Wrightson ICAP	Yes, Outcome-Based	Possible but not now

Bold indicates changed view vs pre-July FOMC. To the best of MNI`s knowledge as of Jul 30