Economic Update

August 23, 2024

Powell Calls for Rate Cuts; "We Do Not Seek or Welcome Further Cooling in Labor Market Conditions"

- **In his Jackson Hole speech Fed Chair Powell called for near-term cuts to the federal funds rate, citing the softening labor market. Powell said that the FOMC does not want a further cooling in the labor market.**
- **Powell said he expects inflation to slow further in the near term toward the Fed's 2% objective.**
- **PNC expects multiple fed funds rate cuts in 2024 and 2025, starting at the next FOMC meeting.**

In his speech this morning at the Jackson Hole monetary policy conference Fed Chair Jerome Powell explicitly called for cuts in the federal funds rate as inflation as moving toward the central bank's 2% objective and the labor market is softening. Powell called for a shift in monetary policy toward cuts in the federal funds rate, saying "the timing and pace of rate cuts will depend on incoming data, the evolving outlook, and the balance of risks."

Powell in particular noted the ongoing slowing in the labor market, saying that "the cooling in labor market conditions is unmistakable," citing lower job vacancies and slowing wage growth. He added that "it seems unlikely that the labor market will be a source of elevated inflationary pressures anytime soon." Perhaps most importantly, he said that the labor market is where it needs to be: "We do not seek or welcome further cooling in labor market conditions." He also said that the "downside risks to employment have increased" since the Federal Open Market Committee began to raise the federal funds rate in 2022.

Powell's speech is consistent with PNC's baseline forecast for cuts in the federal funds rate starting at the FOMC's next meeting, on September 18. PNC expects a cut in the fed funds rate of 25 basis points at that meeting, with additional 25 basis point cuts at the FOMC's remaining 2024 meetings, in early November and mid-December. That would bring the fed funds rate to a range of 4.50% to 4.75% at the end of this year, down from 5.25% to 5.50% currently. PNC then expects additional rate cuts in the first half of 2025, with the fed funds rate down to around 3.5% at the middle of next year.

Powell expressed optimism about the outlook for inflation, saying that "my confidence has growth that inflation is on a sustainable path back to 2%," the FOMC's inflation objective. He attributed the slowing in inflation over the past couple of years to an improved balance between aggregate supply and demand, in part because of restrictive monetary policy. He also said that "the upside risks to inflation have diminished."

At the same time Powell also said that "the downside risks to employment have increased." This indicates that the FOMC would not hesitate to cut the fed funds rate aggressively if it appears that the labor market is deteriorating further. He also said that the current range of the fed funds rate "gives us ample room to respond to any risks we may face, including the risk of unwelcome further weakening in labor market conditions."

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Market reaction was positive to Powell's remarks. The fed funds futures market is pricing in a 68% probability of a 25 basis point cut in the fed funds rate on September 18, with a 32% probability of a 50 basis point cut. The S&P 500 is up 0.6% since it opened this morning. The yield on the 10-year Treasury note is down 6 basis points to 3.80%. The dollar weakened against a basket of currencies. The price of a barrel of West Texas Intermediate crude oil is up more than 2% on the day, to around $74.60.

Powell also discussed the path of inflation since the pandemic. He attributed the acceleration in inflation in 2021 and 2022 to strong demand, especially for goods, as a result of stimulus aid, low interest rates, and an inability to spend on services. He also noted supply constraints in the wake of the pandemic, coming from supply-chain disruptions, especially in regards to China, and a reduced supply of labor. But a better balance between supply and demand in 2023 and so far in 2024 has led to slower inflation without a significant slowing in economic growth. This rebalancing has occurred through tight monetary policy that has weighed on demand, a rebalancing in demand from goods to service, and a reduction in supply-chain problems. He also noted that keeping inflation expectations well anchored contributed to slower inflation, citing the Fed's commitment to fighting inflation.

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