Mizuho Brief: US

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MIZUHO

Jackson Hole Take-Aways

- There are five key points that stuck after **Fed Chair Powell**'s speech **at Jackson Hole**, which despite being **notably dovish**, but .
- All of which highlight **greater uncertainty over the timing** and **depth of rate cuts**. ***But*** the ***need for***, and likelihood of, ***cuts is underscored***.
- First, **do not expect a déjà vu 50bp September rate cut** this time, despite dovish concessions. Not ***as the base line***.
- Point being, **2024 was an exceptional "inflection point"**. Whereby **downside jobs risks had risen acutely** as inflation had cooled significantly, **warranting an abrupt 100bp calibration** over three consecutive meetings (Sep, Nov, Dec).
- In contrast, ***inflation*** **has** in fact **edged up** amid tariffs bleeding into prices this time whereas the ***job market conditions have held broadly steady***, even if marginally softer. Ostensibly then, **the case for an upsized cut is diminished**.
- Second, the **policy challenges** are **greater** and arguably **unfamiliar** resulting in *further fragmentation with FOMC views* and *greater volatility (and fluidity) in Fed Futures pricing*.
- This, as a *conspiracy of unusual trade, immigration, fiscal and regulatory impacts* **simultaneously unleash opposing demand and supply risks**.
- Third, the **inability to confidently discern between cyclical and structural/trend in the wake of unprecedented geo-economic and immigration shocks** *complicate the Fed's calculus*.
- To be sure, the **baseline is for one-off price impact from tariffs**. And the **job market** is deemed to be **broadly in balance**.
- But **inflation uncertainty is heightened** by *complex and unpredictable supply-chain/distribution/wage-price dynamics* in a new construct.
- Equally, and **at the opposing end**, the **"curious" job market balance,** *with distinctly less demand buffer*, **warns of potentially sharp downside risks masked.**
- Inevitably then, both *policy dilemma* and *ambiguity* are heightened in the interim, and as geoeconomic policies evolve.
- Nonetheless (and fourth), the **shifting balance of risks** (to jobs) *in the context of* "**policy in restrictive territory**" *graduated/phased rate cuts, starting with a 25bp cut in September*, is *the likely game plan* for now.
- Especially given the baseline for one-off price shocks (as wage-price risks are mitigated by softer underlying conditions)
- Finally, the **balance of risks** is tilted to **more cuts sooner**.
- Notably if the **initial restraint** guided by the need "*to balance … dual mandate*" amid conflicting supply-demand risks is **overtaken by the urgency for compensatory easing** if the seams give way on confidence.

- In fact, **at some point in the future** the **Fed could also deem fit to imbue more "insurance cuts"** ***in view of accentuated jobs risks*** amid *"curious" job market balance with exceptionally skimpy buffer*.

Key Excerpts from Jackson Hole in Fed Powell's Own Words

1. High Bar for Repeating the 50bp (Sep) Cut in 2024

a. "one year ago, the economy was at an inflection point."
b. "Policy rate had stood at 5-1/4 to 5-1/2 percent for more than a year"
c. "Upside risks to inflation had diminished. But the unemployment rate had increased by almost a full percentage point, a development that historically has not occurred outside of recessions."
d. "… (since then) labor market (this year) … remain(s) in balance near maximum employment".

2. New Challenges of Both Demand & Supply Shock

a. "Changes in trade and immigration policies are affecting both demand and supply."
b. "… significant uncertainty about where all of these (trade, immigration, tax, spending, regulatory) polices will eventually settle and what their lasting effects on the economy will be."
c. " … distinguishing cyclical developments from trend, or structural, developments is difficult."

3. Sharp Jobs Slowdown Without Evidence of Attendant/Proportionate Slack

a. "slowdown (in jobs) is much larger than assessed …
b. "But (no) large margin of slack in the labor market … unemployment rate, while edging up … historically low (at 4.2%) … (o)ther … labor market conditions … also little changed or have softened only modestly …"
c. "Labor supply has softened in line with demand, sharply lowering the "breakeven" rate of job creation needed…"

4. Could Warn of Concealed Downside Rising Jobs Risks

a. "…labor market … (in) a curious kind of balance … marked slowing in both the supply … and demand"
b. "… suggests … downside (jobs) risks … rising … can … quickly (result) in sharply higher layoffs and rising unemployment."

5. Tariff-Induced Inflation Emerging & Highly Uncertain

a. "Effects of tariffs on consumer prices are now clearly visible … expect(ed) to accumulate over coming months, with high uncertainty about timing and amounts."

6. Mostly Benign, Albeit Highly Variable amid Evolving Tariffs

a. " A reasonable base case is that the effects will be relatively short lived … one-time shift in the price level …"
b. "(But) "one-time" does not mean "all at once." … will … take time … to work … through supply chains and distribution networks."
c. "Moreover, tariff rates continue to evolve, potentially prolonging the adjustment process."

7. Inflation Spiral Risks Possible, But Mitigated

a. "however, … the upward pressure on prices from tariffs could spur a more lasting inflation dynamic, and that is a risk to be assessed and managed"
b. "workers … (may) demand and get higher wages … setting off adverse wage–price dynamics … (but) (g)iven that the labor market is not particularly tight and faces increasing downside risks, that outcome does not seem likely
c. "Another possibility is that inflation expectations could move up, dragging actual inflation (higher)" "Inflation has been above our target for more than four years and remains a prominent concern for households and businesses."

8. Although Complacency Not an Option

a. "… cannot take the stability of inflation expectations for granted. Come what may, we will not allow a one-time increase in the price level to become an ongoing inflation problem."

9. Dilemma Requiring "Balance" & Caution

a. "…risks to inflation are tilted to the upside, and risks to employment to the downside—a challenging situation."
b. "When our goals are in tension like this, our framework calls for us to balance both sides of our dual mandate"
c. "100 basis points closer to neutral than it was a year ago, and the stability of the unemployment rate and other labor market measures allows us to proceed carefully"

10. But Bias is to Ease Albeit Guided by Evidence

a. "Nonetheless, with policy in restrictive territory, the baseline outlook and the shifting balance of risks may warrant adjusting our policy stance."
b. "Monetary policy is not on a preset course … based solely on … assessment of the data … (economic) implications … balance of risks."

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