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GLOBAL ECONOMICS

SCOTIA FLASH

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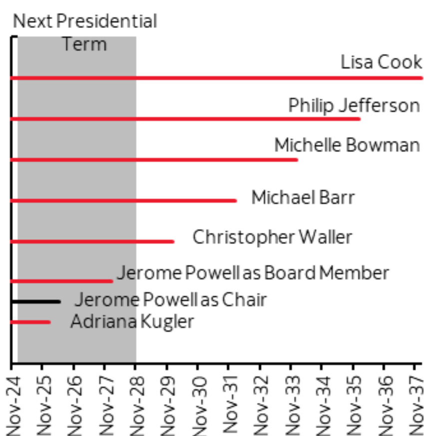
Chart 1



Sources: Scotiabank Economics, Brookings.

FOMC Cuts and Buys Time

- **The policy rate was lowered by 25bps to 4.75% as expected**
- **There was very little market reaction**
- **There were few meaningful statement changes**
- **Powell & Co are on watch for policy changes and will incorporate when they arrive…**
- **…by which point they risk being too late again**
- **Powell made clear he has job security—at least until his term is up**

The Federal Reserve's policy rate range was cut by 25bps as widely expected. The duck-and-weave tone of most of the press conference basically made it clear that the FOMC is in some awkward limbo as it waits to see how other macroeconomic policies could change in the wake of the US election. Overall, however, I don't think we learned much by way of nearer term perspectives today and the path to the December meeting remains data dependent with a significant bias toward another quarter point cut.

A discussion around a handful of statement changes is offered below along with an attempt at a full transcript of the Q&A during the press conference.

That main points from the Q&A emphasized how the Committee won't pre-judge other potential policy actions and will incorporate them when known, and the Chair made it very clear to the world that he has job security as the change of administration unfolds—at least until Powell's term is up in 2026 as chair (May 2026) and, probably less likely, as Governor (January 2028). He and other Governors are shown in chart 1; the only other expiring term during the new administration's term is Kugler's.

While I think Powell didn't have much choice today, you can see how central banks stumble into challenges. If (!) he truly believes what he said, then they only react to changes in other policies (fiscal, trade, immigration) and other developments after they're known and passed and then they model them and then they start to see the effects. In other words, when it's too late, as we saw when inflation was let out of the bag and the struggle to put it back in then ensued. Hence central banks over/under shoot and are the source of much of the volatility that we get over time imo. This serves as a reminder of the differences between the investing world and the policy world.

Statement Changes

The statement tweaked the language in a couple of spots which seemed somewhat material, only for Powell to say in the press conference that they were not. See the appendix for the statement comparison.

The prior statement's reference to how "The Committee has gained greater confidence that inflation is moving sustainably toward 2 percent" was struck out. On the surface, this raised uncertainty over why they did that. Did they do so because they have less confidence now and in light of recent inflation data and perhaps the US election? Or did they mean that they simply have reached a new equilibrium of improved confidence but not incrementally greater?

And so Powell was asked about whether there was any policy substance in the changed inflation language and whether it is meant to open the door to a December pause and he said:

"Not really, no. The test for gaining greater confidence was our test for that first rate cut in September. If you leave it in, then it's new forward guidance. We have gained confidence

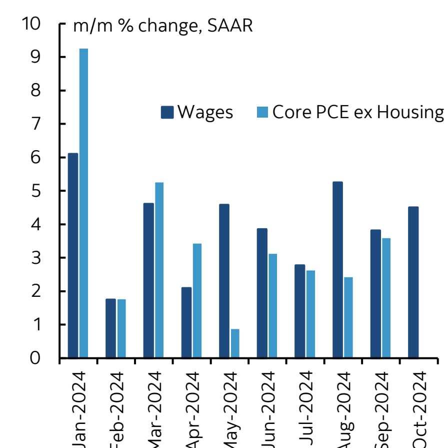
that we are on a path to 2%. We don't think it's a good time to be doing a lot of forward guidance. There is a fair amount of uncertainty. We are on the path to our destination but we don't know the exact destination and the pace."

This could be challenged by also noting that the statement removed reference to "In light of the progress on inflation" that led off the third paragraph in the prior statement. I'm not sure I buy his insouciance toward the matter.

One reason for why I say that is that core inflation has been trending back up of late (chart 2). Another reason is that the US economy's ongoing strength is persistently maintaining capacity pressures to the US economy that remains in excess aggregate demand. Another reason is that they have got to be incrementally more uncertain about the path toward sustainably achieving 2% inflation given the potential mixture of other policy changes on trade policy, immigration policy and fiscal policy that probably lie ahead.

The final statement change was the minor wording change around the state of the job market in the opening paragraph. I don't find that to be significant. Saying "labour market conditions have generally eased" is not meaningfully different than "job gains have slowed."

Chart 2



Sources: Scotiabank Economics, BLS, BEA.

Questions That Were Not Asked

Before turning to the ones that were asked, one question that should have been asked is why do Powell & Co believe that the balance of risks to dual mandate goals is the same now (post-election) that it was in September and could you elaborate? It might have been better to say they don't know. Expect this to be revisited in subsequent meetings as the administration changes hands.

Press Conference Q&A

Here is a Q&A format of what was asked during the roughly 40 minute presser.

Q1. Do you see any potential policy shifts stemming from the US election?

A1. In the near-term, the election will have no effect. We don't know what the timing and effects of policy changes may be. We don't guess, we don't speculate and we don't assume.

Q2. Are the growth risks presented by higher Treasury yields now different than a year ago when yields were higher?

A2. Long bond rates are nowhere near that level. We're watching that and want to see where they settle. It appears that the moves are not principally about higher inflation expectations and more about stronger growth and less downside risks.

Q3. Do the September FOMC projections still seem relevant now?

A3. We're in between cycles now and I wouldn't want to comment. Since those forecasts we have seen stronger growth and some of the downside risks including revisions have diminished. We would factor that in. At the same time we got one inflation report that wasn't terrible but that was higher. By the December meeting we'll have more data.

Q4. What will you be looking at specifically in December? Do you still think the dot plot from September for next year is still valid?

A4. We don't fill out a forecast at this meeting so I can't speak to that. In December we'll have another forecast. We are down 75bps now and we're asking ourselves is that where we want to be? We want to be on a middle path by maintaining strength in the job market but still progressing toward our 2% inflation target. I think that's where we are but we'll see.

Q5. Is a full percentage point of cuts in 2025 still expected?

A5. I can't answer that. We're on a path to a more neutral stance. We have six weeks until the December meeting. I'm not ruling it out or in.

Q7. Are higher deficits behind higher yields?

A7. We don't comment on fiscal policy and I don't have more to say on bond yields. We would wait to model the outcome of possible tax code changes. It goes into the model when it actually passes along with other changes. It's a process that takes some time. We would look at the net effect of all policy changes that we do with every administration. There is nothing to model right now.

Q8. Do you feel you need to lean against current rates or do you take it as a signal that you should do less?

A8. We need sustainability. Remember that the surge in the long bond yield was temporary. We're doing the decompositions of yield movements and reading others but right now it's not a major factor in how we look at things.

Q9. Why do many cuts at all in this backdrop of strong recent data?

A9. Our mandate is maximum employment and price stability. We think policy is still restrictive. Our goal variables are improving. We don't need further labour market cooling to achieve that part of our mandate. The job is not done on inflation but there is progress.

Q10. What might cause you to pause in December?

A10. We haven't made any decision about that at all. We're in the process of moving our policy rate lower. We are prepared to adjust our assessment of the appropriate pace and destination as appropriate. As we move closer to neutral it may turn out to be appropriate to dial back the pace. We reach a point when we slow the pace much like an airplane slowing into an airport

Q11. Core inflation is at 2.7% and has been there since July. Why doesn't that give reason to pause at this meeting?

A11. The 3- and 6-month readings are around 2.3%. That's telling us we really have made significant progress. Non housing services and goods are back to the levels when we had sustained 2% inflation in the early 2000s. What's not is housing services. Market rents are experiencing very low inflation. Leases that are turning over are taking several years to catch up to this which reflects past inflationary pressures. Look at the labour market, it's not a source of inflationary pressures. You see catch-up inflation in areas like auto insurance and other areas. We see a path that expects inflation to be bumpy but along a path toward 2% over the next couple of years

Q12. Are you quickly seeking to get to neutral?

A12. Nothing in the data says we should be in a rush. The right way to find neutral is carefully and patiently.

Q13. Did you learn anything about what Americans think about the economy from the election results?

A13. I won't answer a question on the election.

Q14. When do we reach a point at which the labour market is cooling too much. The UR has been at 4% or higher and the broadest measure is up a half point from a year ago and the quits rate is falling. You said at Jackson Hole that any further cooling would be unwelcome.

A14. We have seen an upward change in unemployment. I wouldn't say that the labour market has fully stabilized as it has gradually cooled, but we want to keep it in a great place. Wages are still running just a bit above where they would need to be to keep inflation at 2% unless productivity remains strong. Wage gains are now consistent with 2% inflation given productivity readings. [ed. less so after this morning's numbers and revisions]. [ed. He should have flagged population expansion and a higher labour force participation rate over the past couple of years as being behind a higher UR in part.]

Q15. If Trump asked you to leave would you go?

A14. No.

Q15. Are you legally required to leave?

A15. No.

Q16. If there were black clouds on the horizon then what would they be?

A16. Geopolitical risks are elevated but they have had relatively little effect on the US economy. The US economy has been very good. [ed. didn't answer…]

Q17. Your predecessors spoke up loudly when they thought fiscal policy created imbalances. Will you do that?

A17. I have said many times, no more or less than predecessors, that the US government's fiscal path is unsustainable. The level is not unsustainable but the path is unsustainable. There is a very large deficit at full employment. It is a threat to the economy.

Q18. Does the President have the power to fire or demote you or Governors?

A18. Not permitted under the law. [ed. A follow up question could have been can he change the law…]

Q19. Longer-term inflation expectations do seem to have risen including a half point rise since when you cut in September. Do you have concerns that inflation expectations are unanchoring or anchoring at a higher level?

A19. I looked at the 5y5y that we look at a lot and it's not moving much. [ed. has increased quarter point since Sept while inflation breakevens from the TIPS market have moved up by more].

Q21. Any concern about Trump's influence on the Fed?

A21. I'm not going to get into any political issues here today.

Q22. Can you rule out an interest rate hike next year?

A22. No I wouldn't rule anything out but that is not our view.

Q23. Would it be appropriate for the Fed to undershoot 2% inflation for a while to offset previously higher inflation?

A23. No that's not part of our framework and it's not something we're going to be looking at in our framework review. [ed. that was a price level targeting Q and CBs have generally rejected that option]

RELEASE DATE: November 7, 2024

Recent indicators suggest that economic activity has continued to expand at a solid pace. ***Since earlier in the year, labor market conditions have generally eased,*** and the unemployment rate has moved up but remains low. Inflation has made progress toward the Committee's 2 percent objective but remains somewhat elevated.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. The Committee judges that the risks to achieving its employment and inflation goals are roughly in balance. The economic outlook is uncertain, and the Committee is attentive to the risks to both sides of its dual mandate.

In support of its goals, the Committee decided to lower the target range for the federal funds rate by 1/4 percentage point to 4-1/2 to 4-3/4 percent. In considering additional adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks. The Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities. The Committee is strongly committed to supporting maximum employment and returning inflation to its 2 percent objective.

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Thomas I. Barkin; Michael S. Barr; Raphael W. Bostic; Michelle W. Bowman; Lisa D. Cook; Mary C. Daly; Beth M. Hammack; Philip N. Jefferson; Adriana D. Kugler; and Christopher J. Waller.

RELEASE DATE: September 18, 2024

Recent indicators suggest that economic activity has continued to expand at a solid pace. ***Job gains have slowed***, and the unemployment rate has moved up but remains low. ***Inflation has made further progress toward the Committee's 2 percent objective but remains somewhat elevated.*** The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run.

The Committee has gained greater confidence that inflation is moving sustainably toward 2 percent, ***and judges that the risks to achieving its employment and inflation goals are roughly in balance.*** The economic outlook is uncertain, and the Committee is attentive to the risks to both sides of its dual mandate.

In light of the progress on inflation and the balance of risks, the Committee decided to lower the target range for the federal funds rate by 1/2 percentage point to 4-3/4 to 5 percent. In considering ***additional*** adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks. The Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities. The Committee is strongly committed to supporting maximum employment and returning inflation to its 2 percent objective.

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