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Four in a row

Jackson Hole Preview August 2024

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Summary

- At Jackson Hole, Fed Chair Powell is likely to signal a 25 bps rate cut for September.
- The recent deterioration in economic data has raised our confidence that the US economy is sliding into a recession or at least a significant slowdown in the second half of the year.
- Therefore, we have decided to cluster the four rate cuts we forecasted from September 2024 through June 2025 in the upcoming four scheduled FOMC meetings: September, November, December and January.

Forward guidance at Jackson Hole

On Friday, August 23, Fed Chair Powell is scheduled to talk about the economic outlook at the Jackson Hole symposium. Less than four weeks before the next FOMC meeting, on September 17-18, this is a convenient time to give his assessment of the unsettling economic and market developments in August and what this means for the Fed's rate policy. In particular, he could give a clear signal that the FOMC is likely to discuss a 25 bps rate cut in September. However, there are some limitations to the forward guidance Powell can provide. There will effectively be a full round of data between Jackson Hole and the September meeting of the FOMC with the PCE for July (Aug 30), the Employment Report for August (Sept 6) and the CPI for August (Sept 11). Given the Fed's data-dependent meeting-by-meeting approach, Powell would not like to overcommit. Also, there is no Q&A, only a prepared speech, which also restricts his ability to provide nuance and detail.

So what room does he have? Powell could indicate that he has gained greater confidence that inflation is moving sustainably toward 2% due to recent inflation data. The FOMC was not ready yet to alter its formal statement in July to reflect this, but Powell certainly was at the press conference, both in his prepared statement and during the Q&A. He said that the last couple of (inflation) readings had added to confidence and that more good data would cause the FOMC to gain more confidence. Given the encouraging inflation data since then, Powell could confirm this.

Meanwhile, Powell could stress the weakness in labor market data as a second – and in our view more urgent – argument for rate cuts. In the July statement, the FOMC already said that it is attentive to the risks to *both* sides of its dual mandate. Until June, the statement was that the Committee remained highly attentive to inflation risks. Since March, Powell has repeated that an unexpected weakening of the labor market could also be a reason to cut (in addition to progress on inflation).

Finally, with a full round of data between Jackson Hole and the September meeting, it would be premature for Powell to signal the exact size of the rate cut. However, he could indicate whether the baseline is 25 or 50 bps. By expressing confidence in market stability and by indicating that the Fed is not behind the curve, he could indicate that 25 bps is the baseline scenario for September, rather than the 50 bps that some in the market want.

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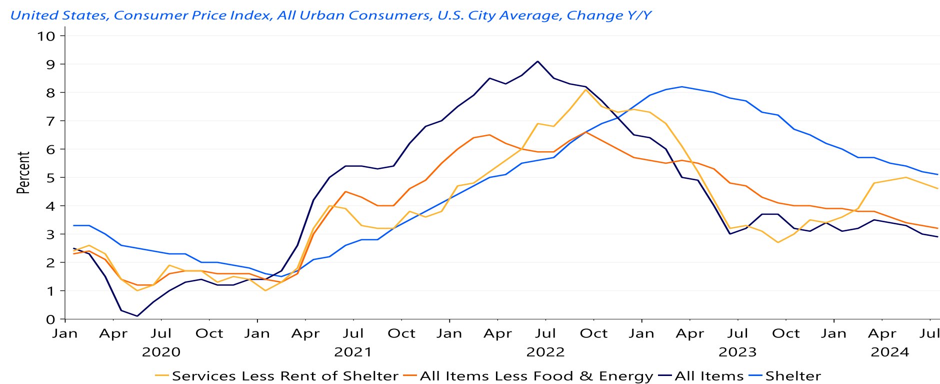
Soft landing unlikely

At the previous FOMC meeting, on July 30-31, the Committee decided to keep the target range for the federal funds rate unchanged at 5.25-5.50% and to continue reducing its holdings of Treasury securities, agency debt and agency MBS at $60 billion per month. The FOMC statement was tweaked to lay the groundwork for a rate cut, but the Committee was careful not to commit to anything. In contrast, during the press conference Powell clearly put the September rate cut on display. At Jackson Hole, he could take it a step further. After all, recent inflation data have been encouraging and the deterioration in the labor market data suggests that the FOMC cannot afford to wait much longer.

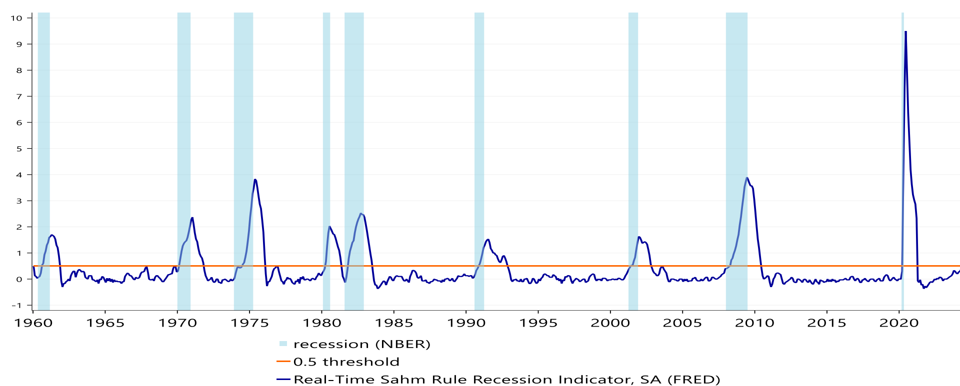
Figure 1: Recent inflation data have been encouraging



Source: Macrobond

We were one of the first banks to forecast a US recession and remain one of the last to keep a recession in our forecast. The reason is that we thought it unlikely that the Fed would be able to squeeze inflation out of the economy without doing any damage, i.e. a recession or at least a significant slowdown. When the recession did not occur at the widely expected time, most banks abandoned their recession call. In fact, they subscribed to the Fed's narrative of a soft landing. To us, that seemed premature. Sequences in the economy are rarely characterized by fixed lags, instead lags can vary a great deal. Nevertheless, the underlying mechanisms often lead to certain sequences. In our view, those had not changed. Therefore, we kept our doubts about a soft landing. In fact, the excess pandemic savings that sustained consumer spending for longer than widely anticipated were getting depleted and credit card data revealed increasing financial stress. What's more, while nominal policy rates had risen substantially, real rates had not been restrictive for very long.

Figure 2: Sahm-rule signals start of recession



Source: Macrobond

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To illustrate the optimism of the soft landing narrative, take a look at the FOMC's unemployment rate forecasts made in June (Table 1): they expected 4.0% in the final quarter of 2024 and a peak of only 4.2% in the final quarter of 2025. We found that unrealistic and our own forecast was 4.5% for 2024Q4, which would trigger the Sahm rule. In reality, unemployment climbed faster than expected by the Fed and reached 4.3% in July. The pace at which the unemployment rate is rising already triggered the Sahm-rule, signaling that a recession had started in July! While this is a one dimensional rule that may be too simple to apply this time – although it always has so far –, the logic of the Sahm rule still applies: once unemployment starts to accelerate, an adverse feedback loop may have started that could lead to a recession. In other words, perhaps the 0.5 ppt threshold is too tight for this unusual post-COVID cycle, but a worrisome loop may have started already. Sooner or later, rising unemployment is going to undermine consumer spending and when the latter slows down, this will lead to further layoffs. So while we do not necessarily take the Sahm rule literally, we do interpret the rapid rise in the unemployment rate as an indication that the economy is sliding into a recession or at least a significant slowdown in the second half of the year.

Table 1: Median projections of FOMC participants, June 2024

Variable	*2024*	*2025*	*2026*	*Longer run*
GDP growth	2.1 (2.1)	2.0 (2.0)	2.0 (2.0)	1.8 (1.8)
Unemployment	4.0 (4.0)	4.2 (4.1)	4.1 (4.0)	4.2 (4.1)
PCE inflation	2.6 (2.4)	2.3 (2.2)	2.0	2.0 (2.0)
Core PCE inflation	2.8 (2.6)	2.3 (2.2)	2.0 (2.0)	
Federal funds rate	5.1 (4.6)	4.1 (3.9)	3.1 (3.1)	2.8 (2.6)

Source: FOMC, June 12, 2024 (March 20, 2024)

From 'one per quarter' to 'four in a row'

Since April when a June cut was derailed by disappointing inflation data we have had four rate cuts of 25 bps each in our forecasts, starting in September 2024 and ending in June 2025. The large distance between the rate cuts also reflected our uncertainty about the exact timing of the recession or slowdown. To get some robustness in our policy rate forecasts, we spread out the cuts over a wide confidence interval in which we expected the recession or slowdown to occur with a high probability. However, the recent labor market data give us reason to shrink this confidence interval, concentrating our rate cut forecasts to four in a row: September, November, December and January. If the rise in the unemployment rate continues, we expect the FOMC to cut by 25 bps at each meeting through January. Note that the June dot plot of the FOMC was based on unemployment rising to only 4.0% in 2024Q4. The September dot plot will no doubt imply more than one rate cut in 2024.

It is important to note that we do not add rate cuts to our forecasts, i.e. we still get to a target range of 4.25%-4.50% in the remainder of 2025. This is because we only expect a mild recession

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or a significant slowdown, not the extraordinary recessions of the *Global Financial Crisis* or the *COVID crisis* that led to the Fed rapidly slashing rates to the zero bound. What's more, if Trump wins the presidential election, the universal tariff that he cannot stop talking about – recently even suggesting he could raise it to 20% instead of 10% – is likely to lead to a rebound in inflation that should stop the Fed's cutting cycle in its tracks. Of course, Harris is doing well in the polls right now, but as we discussed in our Monthly Outlook: it remains to be seen whether see can sustain this advantage. What's more, although we still know little detail about her economic agenda, some of her plans could give housing inflation a boost and that would also make the Fed hesitant to cut further.

Conclusion

At Jackson Hole, Powell is likely to signal a 25 bps rate cut at the next FOMC meeting in September. Since recent economic data have increased the probability that the economy is sliding into a recession or a significant slowdown in the second half of the year, we have changed our forecasts for Fed policy rate cuts in September 2024, December 2024, March 2025, and June 2025 to the four consecutive scheduled meetings in September 2024, November 2024, December 2024 and January 2025 (Table 2).

Table 2: Rabobank forecasts of target range for federal funds rate in 2024 and 2025

FOMC meeting	*Size of rate change (bps)*	*Target range (%)*
January 30-31, 2024	0	5.25-5.50
March 19-20	0	5.25-5.50
April 30-May 1	0	5.25-5.50
June 11-12	0	5.25-5.50
July 30-31	0	5.25-5.50
September 17-18	-25	5.00-5.25
November 6-7	-25	4.75-5.00
December 17-18	-25	4.50-4.75
January 28-29, 2025	-25	4.25-4.50
March 18-19	0	4.25-4.50
May 6-7	0	4.25-4.50
June 17-18	0	4.25-4.50
July 29-30	0	4.25-4.50
September 16-17	0	4.25-4.50
October 28-29	0	4.25-4.50
December 9-10	0	4.25-4.50

Source: Rabobank

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