Powell revives talk of 'Fed put'

Hint at rate cut shakes up Chicago summit

by Darrell Delamaide in Washington

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It was supposed to be a quiet, semi-academic review of monetary policy strategy, without generating any market-moving news. But Federal Reserve policy-makers don't always get to pick their moments, and Fed Chair Jerome Powell moved markets with just a few words when he spoke at their early June gathering.

In brief opening remarks at the Chicago meeting on strategy, Powell noted trade negotiations and other matters that could negatively impact the economy.

'We are closely monitoring the implications of these developments for the US economic outlook,' he said. 'As always, we will act as appropriate to sustain the expansion, with a strong labour market and inflation near our symmetric 2% objective.'

It was St. Louis Fed Chief James Bullard who supplied the context for this remark. Weak inflation, US bond yields and the negative impact of trade tensions mean 'a downward policy rate adjustment may be warranted soon,' Bullard said.

The acknowledgment was the first from a Fed official departing from the mantra of patience espoused by Powell. So, when Powell stepped up the next day and talked about 'appropriate' actions, markets took that as meaning a rate cut. Equities soared, and Treasury yields fell. Later in the day, Vice-Chair Richard Clarida said the Fed would do whatever is needed to keep the economy in a 'good place'. This could include an insurance, or pre-emptive, rate cut.

The belated acknowledgment from the top two Fed officials came as Fed futures priced in one or two rate cuts this year despite the protestations from Powell and others that policy was on hold. Powell has changed course often enough that investors felt confident ignoring his words, in the assumption that he would change course once again.

They were not disappointed. The pivot came so quickly that some conspiracy theorists thought President Donald Trump may be pushing tariffs to bend the Fed to his will and get them to lower rates. Others wondered whether Powell has turned into Trump's 'lackey'.

The purpose of the strategy review, capped by the conference in Chicago with experts from the Fed and elsewhere, was largely lost on investors. Questions about how to redefine inflation targets or measure price increases or what exactly constitutes full employment are as theoretical as counting angels dancing on the head of a pin. What markets want is a pragmatic Fed that practices what it preaches, paying attention to data and flexibly adapting its policies.

New York Fed Chief John Williams conceded as much ahead of the Chicago meeting. He acknowledged market expectations of a rate cut without endorsing them. But he added that policy-makers 'need to be prepared to adjust our views of what's happening in the economy and where the economy is likely to go'.

The plunge in long-term Treasury yields has inverted the yield curve once again, with the higher three-month yield indicating short-term rates may be too high. 'It's a pretty strong signal in the markets that they think rates are going to be lower in the future,' Williams acknowledged.

Robert Kaplan, president of the Dallas Fed, tapped on the brakes, however. He said trade tensions increased downside risk but 'it would make sense to let this situation breathe a bit'. But he added, 'Some of these decisions can change. We may see a new announcement and new decisions in the next four or five weeks.'

Chicago Fed Chief Charles Evans said 'the market sees something that I haven't yet seen in the national data' as it prices a Fed rate cut into the futures market. Evans thinks the economy 'continues to be solid'. He is 'a little nervous' that inflation is running below the Fed's 2% target, but is 'pretty comfortable' with the Fed's current monetary stance. (His remarks came before the weak jobs report for May, however.)

The situation did breathe as Trump called off the tariff threat to Mexico at the end of the first week of June. But labour market figures showed a much weaker than expected increase in jobs, leaving Fed policy-makers to ponder the implications.

Odds are still against a rate cut at the June meeting, but attention is focused on July. Market participants will be scrutinising the statements and projection materials in the June 18-19 meeting, as well as Powell's remarks at the press conference, for clues about the next summit.

Powell's concession in Chicago revived talk of a 'Fed put' – that the Fed would cut rates to prevent any substantial decline in the stock market. His remarks boosted equities to their best week so far this year.

Fed Governor Lael Brainard virtually defined the put when she echoed Powell's remarks that the Fed would be 'prepared to adjust policy to sustain the expansion'.

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