Liquid Insight

Jackson Hole FAQ: late summer guide

17 August 2023

Rates and Currencies Research
Global

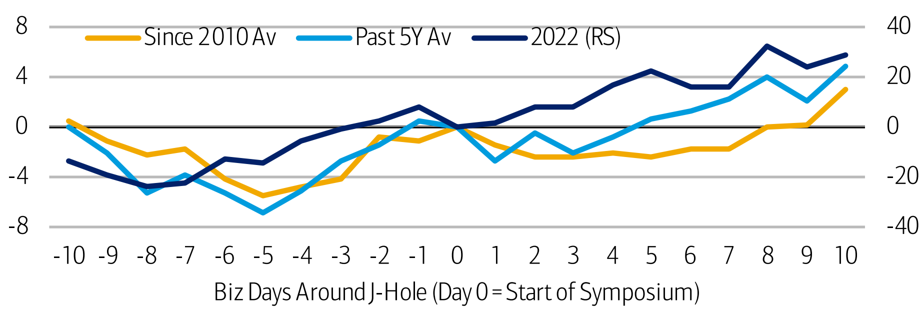
Key takeaways

- Fed Jackson Hole is next week, we offer thoughts in FAQ format
- Fed to reiterate 2%, stress inflation work to do, sound less balanced b/c strong data
- Markets: rates = Fed may sound hawkish; stay underweight front end; FX = no strong signal, neutral rate focus to be hawkish

By Aditya Bhave, Mark Cabana, & Alex Cohen

Exhibit 1: 10Y UST yield change around prior Jackson Hole symposiums (bps)

Rates historically rose into event, held week after, & increased further into Sept



Source: Bloomberg

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Jackson Hole FAQ: you ask, we answer

Market attention will be focused on Fed Jackson Hole (JH) Symposium next week (Aug 24-26). We offer our expectations for Jackson Hole (JH) in FAQ format. Key Q & As:

When is it & what is topic? August24-26, "Structural Shifts in the Global Economy"

Why does market care? Fed Chairs often speak, and other officials attend. Major policy changes have been signaled, and it is often during a long intermeeting period.

When is JH agenda released? Typically in the afternoon / evening of first day (Aug 24)

Will Powell speak? Likely but still unconfirmed. Fed Chairs almost always participate but they can skip; Yellen skipped in '15, and Bernanke skipped in '13

What do we expect at JH? Fed to reiterate 2% objective, stress more inflation work to do, sound less balanced vs July presser or FOMC minutes due to recent strong data.

What is market JH reaction? Rates = less balanced Fed guidance will be hawkish; stay underweight front end. FX = no strong signal likely, neutral rate focus likely hawkish.

What is historic JH reaction? Rates = sell off into JH, sideways week after, sell off into Sept; curve flatter (Exhibit 1); FX = sideways, 2022 was outlier

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What and when is Jackson Hole?

The Jackson Hole Economic Policy Symposium is a late summer event hosted by the Federal Reserve Bank of Kansas City in Jackson Hole, Wyoming. It is attended by central bankers, policymakers, academics, economists, financial market participants and media from around the world. Every year, 120 people are selected to attend the symposium based on that year's agenda, with consideration to diversity in region, background and industry. The 46th edition of the symposium will be held this year from August 24-26, with a welcome dinner the evening of August 24 and the actual proceedings of the conference the following two days.

What is the Jackson Hole topic?

The symposium topic will be "Structural Shifts in the Global Economy". The papers that will be presented on this topic will be posted online at the time of the presentation. Potential topics could include subjects such as the changing structure of where people work, whether unobservable variables like r*—the natural rate of interest— and underlying inflation have changed since the pandemic, higher fiscal deficit impact on global economies & markets, and the relation of artificial intelligence on productivity.

Why does the market care about Jackson Hole?

The market typically cares about Jackson Hole for three reasons: (1) The Fed chair typically addresses the audience to start the conference's proceedings, and the Chair's address has, at times, been a chance to signal a policy change. (2) In addition to the Fed Chair's address, many other Fed participants attend and speak to the media. (3) The symposium often occurs in between the longest intermeeting period and happens at a time when the market is generally quiet due to summer holidays and limited events.

Most FOMC inter-meeting periods throughout the year are six-to-seven weeks long. The length of time between the July/August and September meetings is often eight weeks. The longer inter-meeting period means that Jackson Hole has been treated as a "mini-meeting" by the market, where the Fed can provide updated monetary policy guidance weeks ahead of the September meeting.

Fed Chairs have also historically used Jackson Hole to signal upcoming policy changes at the September FOMC meeting. For example, the market interpreted Powell's Last July's FOMC press conference as implying a potential deceleration in the pace of rate hikes & more dovish policy stance; Powell's Jackson Hole comments allowed for a course correction towards a more aggressive policy stance. Other examples include 2020 when Powell launched the Fed's Flexible Average Inflation Targeting (FAIT) framework at the (virtual) Jackson Hole conference and 2011 when Chair Bernanke in 2011 signaled a maturity extension program (i.e. "Twist") at the September meeting.

Other FOMC participants typically also conduct media interviews around the conference, often expressing their views on the path of monetary policy.

When is the Jackson Hole schedule released?

The symposium schedule should be released the afternoon or evening of August 24. It is expected that Chair Powell will speak the morning of August 25, probably at 10am Eastern Time (8am MT). Since 2016, the Fed Chair has spoken at this time on the first morning of the symposium every year except 2020, when Powell's speech was a little earlier. However, Powell's appearance has not yet been confirmed.

Do Fed Chairs always speak at Jackson Hole?

Fed Chairs almost always speak at Jackson Hole. In fact, the symposium typically starts with an address by the Fed Chair on the morning of the first day, which is the only broadcasted event of the conference. Since 1998, Fed chairs have spoken except for two instances: Yellen in 2015 and Bernanke in 2013. The 2015 symposium was right ahead of the Fed starting its hiking cycle in December of that year. Though Fed Chair Yellen did not speak, Bill Dudley, the New York Fed President at the time, did signal shortly before the meeting that a rate hike in September was unlikely, which led markets to quickly price out the hike. Therefore, Chair Yellen may have not seen the need to speak that year after a strong message had already been sent.

What do we expect from Fed communications?
If Chair Powell does speak at Jackson Hole this year, we expect him to reiterate the Fed's commitment to its 2 percent inflation target. He will likely note that although there has been progress on the inflation front, there is still a lot more work to be done. Therefore, policy will remain restrictive for an extended period.

At the July press conference, Powell noted that risks around the impact of Fed policy were becoming more balanced and, given the lagged effect of monetary policy on the economy, the Fed would likely start cutting rates before inflation reaches 2%. We think the tone could be less balanced at Jackson Hole given the robust data flow since the July FOMC meeting. In particular, 2Q GDP came in well above expectations at 2.4%, and July retail sales ex-autos surged by 1.0% (see: US Watch: In a word, remarkable). While the Fed would prefer not to short-circuit the business cycle, policymakers are probably becoming increasingly concerned about a re-acceleration in inflation, driven by strong aggregate demand. Therefore, we expect Powell to push back— implicitly or explicitly— against the degree of rate hikes that markets are pricing for next year.

Meanwhile, in terms of the extent and timing of additional hikes, Powell is likely to emphasize that the Fed is data-dependent and every meeting is live. If Powell were to comment that he is comfortable with the current pace of hikes for now, markets would view that as guidance towards a pause in September and a possible hike in November.

Market participants have recently speculated that Jackson Hole will be used as a venue to highlight upcoming shifts in Fed communication around the neutral rate. Market focus has recently increased on the neutral rate due to underlying economic resilience in the face of elevated policy rates & re-pricing of global 3y1y rates (for detail see: Liquid Insight: Finding a higher "neutral" ground).

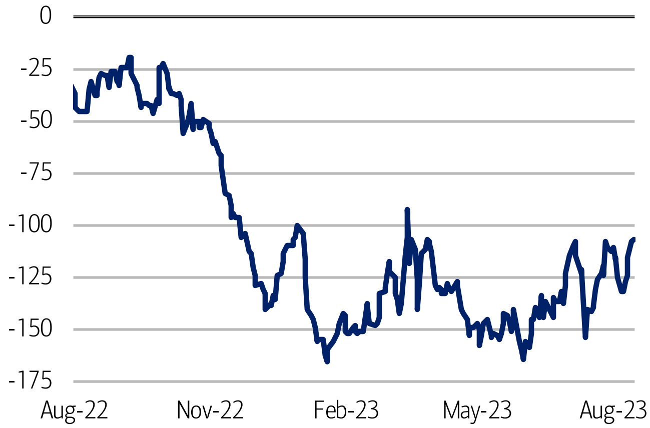
We would be surprised to see any large shift in Fed communications around the neutral rate at Jackson Hole, given that there is significant uncertainty around estimates of this rate. If the Fed were to signal expectations for a higher neutral rate it would likely be interpreted by the market as hawkish since it implies higher overnight rates to slow the economy.

What is expected rates & FX market reaction around Jackson Hole?
US rates: Fed communications that sound less balanced vs the July FOMC minutes risk being interpreted as hawkish by the market. This could result in greater pricing of hikes at the Sept & Nov meetings, which cumulatively price 11.5bps of further tightening. We would not be surprised to see this pricing shift to 15bps if more balanced Fed rhetoric is adjusted due to recent strong data in favor of a clearer tightening bias.

Hawkish Fed rhetoric risks & increased hikes will reinforce our core view for clients to remain underweight the UST front end. We have recommended clients position in Dec '23 – Mar '24 FOMC steepeners, which should benefit from a more hawkish Fed message and / or reiteration of higher for longer message. We also expect a further reduction in the extent of rate cuts priced in '24. Cuts in '24 have been reduced by 25bps since last Monday; we see risks these cuts are reduced further (Exhibit 2). A further reduction of rate cuts will likely result in a bear flattening of the UST curve.

In the unlikely event Powell skips Jackson Hole we expect lower volatility across market & limited impact on UST rates / curve. The driver of lower volatility across markets is clear: the market would assign a lower potential market impact from the symposium. The rates market would likely interpret a Powell skipping of Jackson Hole as indicating the Fed seems comfortable with current market pricing of the expected policy path.

Exhibit 2: Fed rate cuts priced in '24 (bps)
The market has been trimming extent of Fed cuts in '24 with strong data



Source: Bloomberg
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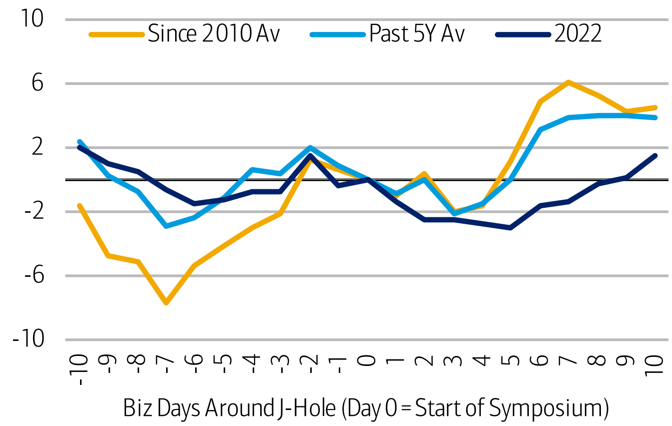
Exhibit 3: 2s10s curve around JH (bps)
Curve has steepened into event, held week after, & re-steepened into Sept



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FX: This year's Jackson Hole conference occurs amid a relatively choppy and rangy FX market. The dollar has been rallying over the past month mainly on relative U.S. growth outperformance and the rise in both nominal and real yields. (FX Watch: The USD's road trip 16 August 2023) However, this has been occurring amid a broader disinflationary trend in the U.S., as well as expectations that several other major central banks could keep rates higher-for-longer than the Fed to bring core inflation down. While we do not anticipate any overtly strong policy signals from Jackson Hole this year (as noted above), any overt suggestion of a higher-than-expected neutral policy rate could serve as a fresh catalyst for another leg of dollar appreciation. Conversely, should the topic of eventual rate cuts receive prominence, the dollar could move back into the lower-half of the year's range.

What are the historic rates & FX reaction around Jackson Hole?
Rates: US rates have recently sold off into Jackson Hole, held the moves during the week after, and sold off more meaningfully into September (Exhibit 1). Since 2010 the US 10Y has declined 2+bps in the symposium aftermath but increased 3+bps in the 10D after. Over recent years the yield declines have been smaller & sell-off larger. The largest sell-off in recent years was 2022 due to Powell's hawkish remarks on inflation.

The UST curve has tended to flatten modestly in immediate response to Jackson Hole (Exhibit 3). However, the curve has historically steepened in the 10D after the event. Powell's 2022 Jackson Hole speech resulted in a curve steepening in the 10D after the event despite the more hawkish message & large rate sell-off at the front end.

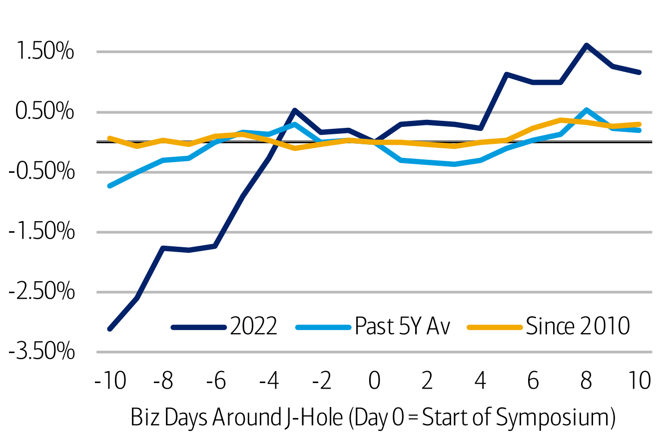
Overall, recent years have seen the UST curve bear steepen in response to Jackson Hole.

FX: The dollar has traded within a modest +/- 0.5% range in the 10 days before and after Jackson Hole on average (Exhibit 4). FX volatility has similarly been subdued around the event (Exhibit 5). However, 2022 was a bit of an aberration. Last year, the USD appreciated about 3% in the 2 weeks leading up to Jackson Hole and continued another 1% in the weeks after.

While Chair Powell's hawkish remarks added to the dollar's ascent in 2022, it's uptrend was well entrenched prior to the event. Indeed, 2022 was a noteworthy year for the dollar, as the DXY index reached a new 20-year high that September. Drivers for the dollar's appreciation at the time included: the Fed's aggressive tightening campaign, recession fears across the globe, energy shocks in Europe and elsewhere, and China's zero-covid policies.

Exhibit 4: DXY index around JH (%)

Dollar historically little changed around event; rallied in 2022



Source: Bloomberg; BofA Global Research

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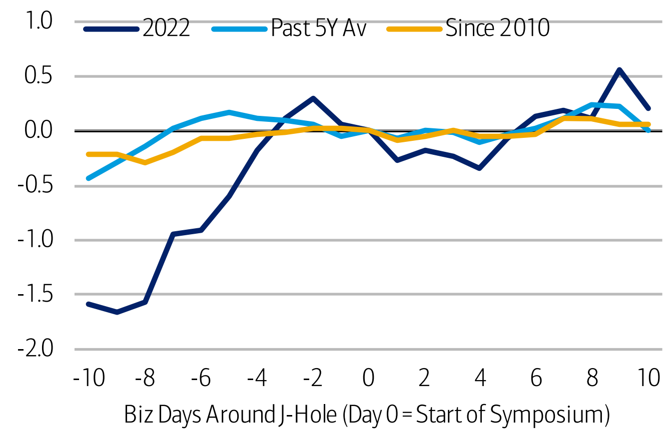
Exhibit 5: CVIX index around JH (ppt)

FX vol generally subdued into event; 2022 was an aberration



Source: Bloomberg; BofA Global Research

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Notable Rates and FX Research

- **Global Rates, FX & EM Year Ahead 2023 –** Year Ahead 2023: Pivot ≠ Peak, 20 Nov 2022
- Miracle on Main Street **Global FX Weekly**, 11 Aug 2023
- R*s be our guide **Global Rates Weekly**, 11 Aug 2023
- The market bias against the USD, **Liquid Cross Border Flows**, 7 August 2023

Rates, FX & EM trades for 2023

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Global FX Weekly: Miracle on Main Street 11 August 2023

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