

Federal Reserve Watch

“A little more evidence” to cut

“A little more evidence” on inflation is needed to cut

In his testimony to Congress as part of the Monetary Policy Report, Fed Chair Powell stuck to the script when it came to the outlook for monetary policy. Conditional on the economy evolving in line with Fed expectations, Powell said it would be appropriate to reduce policy rates later this year. The Fed retains its optimism about the ability of the economy to expand while maintaining low unemployment and falling inflation.

He said that significant progress has been made on reducing inflation and the Fed has “some confidence” that inflation will converge to 2%. He said that “a little” more data is needed to give them more confidence and that Inflation data need not get better for the Fed to cut. It simply needed to be more of the same.

In response to a different question, Powell said “a little more evidence” that inflation was sustainably returning to the Fed’s target was all that was needed for the committee to cut rates. He also said the Fed would not wait until inflation had reached 2% but would act in advance of inflation getting to this point.

A June cut remains a reasonable base case

Overall, we would not call Powell’s remarks dovish, but if his word choice was intentional then the bar to reducing rates does not appear exceptionally high. In our view, it is reasonable to keep June as the base case for the first policy rate cut.

Powell could have been more hawkish and emphasized concerns about a re-acceleration in the economy and inflation, which would have reduced the likelihood of a June start to the easing cycle. About as far as he would go in this direction was to say that the strength in the economy required “careful” assessment before policy is eased.

Immigration has helped boost labor supply

When asked about immigration, Powell said it was a “notable factor” supporting the economy in 2022 and 2023. Our analysis points to the same conclusion. We estimate that potential growth is currently running at 2.2%, up from 1.7-1.8% prior to the pandemic. We find that the rise in potential growth can be traced entirely to faster growth in total hours (which is a function of employment, participation, and the work week). We do not find that trend productivity has picked up, though we certainly acknowledge that it can over time. Whether immigration policies change for 2025 and beyond is yet to be seen – and Powell refrained from commenting on specific policy proposals – but, for now, immigration remains an important factor in helping the economy grow faster without generating overheating effects.

Changes to Basel III are likely, but what will be is unclear

Members of Congress repeatedly pressed Powell on Basel III rules. While not offering any specifics, Powell’s comments made it clear that the Fed was considering changes. What these changes may be is unclear, but Powell would not rule out re-submission.

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