

## US Watch

## Jackson Hole: a Rorschach test

## Key takeaways

- Fed Chair Powell's speech at Jackson Hole was somewhat balanced, with hawkish and dovish elements.
- Markets took the comments as slightly hawkish, moving closer to our call for a 25bp hike in Nov & only 75bp of cuts in 2024.
- We continue to think that fading cuts in 2024 is the best way to trade front end.

## Bottom line: a balanced assessment

Fed Chair Powell delivered what we thought was a balanced assessment of the economic and monetary policy outlook at Jackson Hole today. As expected, he gave little forward guidance on policy, instead emphasizing data dependence.

## Something for the hawks...

There were a few hawkish elements in Powell's speech. First, he mentioned that the Fed is vigilant to the risk that the economy is not slowing as expected, particularly given the recent robust data. Therefore, further tightening could be warranted. Second, Powell reiterated the Fed's view that a period of below-trend growth and a softer labor market would be needed to get inflation back to 2%. In other words, the Fed does not believe in immaculate disinflation. We don't either. Third, he argued that although real rates are well above "mainstream estimates" of the neutral real rate ( $r^*$ ), there is uncertainty about the level of this rate and therefore the extent of monetary restraint at the moment. So Powell is open to the possibility that  $r^*$  has increased, but he does not have conviction on this question.

## ... And something for the doves

However, Powell's comments also included some dovish tones. He noted that there could be significant further drags from the 525bp of hikes that the Fed has already carried out, given the uncertainty around the lags with which monetary policy affects the economy. Powell also delivered a more balanced assessment of the risks of tightening too much versus tightening too little. This stands in contrast to his prior statements that the risk of under-tightening is greater. Third, in his concluding remarks, Powell did not commit to delivering on the dot plot, which calls for one more hike. Instead, he said that the Fed will "proceed carefully" and be guided by the data in terms of whether to tighten further.

## Markets move towards our forecast

We remain comfortable with our call for one more 25bp hike in November and 75bp of cuts next year, starting in June and proceeding at a quarterly cadence. Markets moved toward our forecast after Powell's speech. At the time of this writing, they are pricing about a 70% chance of a hike by November, compared to 60% before his remarks. Pricing of cuts in 2024 has decreased by 5bp to around 110bp. (Continued on next page)

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Macro  
United States

**Aditya Bhawe**  
US Economist  
BofAS  
+1 646 855 9929  
[aditya.bhave@bofa.com](mailto:aditya.bhave@bofa.com)

**Meghan Swiber, CFA**  
Rates Strategist  
BofAS  
+1 646 855 9877  
[meghan.swiber@bofa.com](mailto:meghan.swiber@bofa.com)

**Howard Du, CFA**  
G10 FX Strategist  
BofAS  
+1 646 855 6586  
[yuhao.du@bofa.com](mailto:yuhao.du@bofa.com)

**US Economics**  
BofAS

**Global Economics Rates & FX**  
BofAS

[See Team Page for List of Analysts](#)

## **Rates: balance of risks = higher for longer**

Powell was not definitive on whether or when the Fed will hike rates again, sending a less hawkish signal than we anticipated. FOMC overnight indexed swap (OIS) in mid-2024 has been most volatile, consistent with a higher for longer message. Powell was focused on the risks around the inflation outlook, leading the market to contemplate timing of cuts in 2024. Rather than just the inflation data near term, the broader suite of data will need to indicate more balanced risks around the inflation outlook. We continue to think that fading cuts in 2024 is the best way to trade front end. Cuts by mid-2024 have been priced out by around 6bps. The market has also shifted the peak in policy rate from November to December, opening door for adjustments at a later meeting.

## **FX – initial USD weakness but quick reversal**

Into the Jackson Hole event, the month-to-date USD rally had been quite persistent. Relative to the market's expectation of a hawkish tone, Chair Powell's speech turned out to be more balanced, causing an initial knee-jerk move lower for the USD. However, the USD weakness quickly reversed by end of the speech. As we discussed in the report, [FX implications of a Fed September hold and November hike](#) last week, market expectation converging to a near-term Fed rate hold decision for September would likely alleviate some pressure for the market. As a result, the USD could see some short-term pullback towards the 200-day simple moving average (SMA) after having had a good run in August. For rest of the year, we maintain a cautious view on FX and continue to see EURUSD at 1.05 as the year-end forecast (see the report, [World at a Glance: 23 August 2023](#)).

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# Research Analysts

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## US Economics

### Michael Gapen

US Economist  
BofA  
+1 646 855 3270  
[michael.gapen@bofa.com](mailto:michael.gapen@bofa.com)

### Aditya Bhawe

US and Global Economist  
BofA  
+1 646 855 9929  
[aditya.bhawe@bofa.com](mailto:aditya.bhawe@bofa.com)

### Stephen Juneau

US Economist  
BofA  
+1 646 855 7254  
[stephen.juneau@bofa.com](mailto:stephen.juneau@bofa.com)

### Shruti Mishra

US and Global Economist  
BofA  
+1 646 855 1040  
[smishra44@bofa.com](mailto:smishra44@bofa.com)

### Jeseo Park

US and Global Economist  
BofA  
+1 646 855 8688  
[jeseo.park@bofa.com](mailto:jeseo.park@bofa.com)

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