Fed's Powell says higher rates may be needed, will move 'carefully'

Howard Schneider, Ann Saphir

JACKSON HOLE, Wyoming, Aug 25 (Reuters) - The Federal Reserve may need to raise interest rates further to ensure inflation is contained, Fed Chair Jerome Powell said on Friday, nodding both to easing price pressures and the surprising overperformance of the U.S. economy and promising to move "carefully" at upcoming meetings.

Powell said Fed policymakers would proceed with care as they "decide whether to tighten further," but also made clear that the central bank has not yet concluded that its benchmark interest rate is high enough to be sure that inflation returns to the 2% target.

"It is the Fed's job to bring inflation down to our 2% goal, and we will do so," Powell said in a keynote address to the Jackson Hole Economic Policy Symposium. "We have tightened policy significantly over the past year. Although inflation has moved down from its peak - a welcome development - it remains too high. We are prepared to raise rates further if appropriate, and intend to hold policy at a restrictive level until we are confident that inflation is moving sustainably down toward our objective."

In that context, recent data has raised a new concern, he said.

"We are attentive to signs that the economy may not be cooling as expected," with consumer spending "especially robust" and the housing sector possibly rebounding, Powell said.

The economy continues to grow above trend, Powell said, and if that continues "it could put further progress on inflation at risk and could warrant further tightening of monetary policy."

His remarks showed the Fed wrestling with conflicting signals from an economy where inflation has by some readings slowed a lot without much cost to the economy - a good outcome, but one that has raised the possibility that Fed policy is not restrictive enough to complete the job.

Unlike in last year's speech at the closely watched annual conference hosted by the Federal Reserve Bank of Kansas City - a terse warning of more tightening to come - Powell did not warn households of coming "pain" from further policy tightening. But neither did he signal that rate cuts were anywhere close, or nod as some policymakers have done to the need to adjust rates downward once inflation cools more sustainably.

'FINGER ON THE TRIGGER'

Markets reacted by continuing to price in only a modest chance of a rate hike next month - less than 20%, based on rate futures pricing - but an increasing likelihood of a rate hike at one of the Fed's following two meetings - on Oct. 31-Nov. 1 and Dec. 12-13 - with prices indicating a better-than-50% chance of the policy rate ending the year in a 5.5%-5.75% range.

[1/3] Federal Reserve Board Chairman Jerome Powell speaks during a press conference following a closed two-day meeting of the Federal Open Market Committee on interest rate policy in Washington, U.S., July 26, 2023. REUTERS/Elizabeth Frantz

"My main takeaway is that when it comes to another rate hike, the chair still very much has his finger on the trigger, even if it's a bit less itchy than it was last year," said Inflation Insights' Omair Sharif.

It was difficult, Powell said, to know with precision the degree to which the Fed's current 5.25% to 5.5% benchmark interest rate had cleared the "neutral" rate of interest needed to slow the economy, and therefore hard to assess just where policy stands.

Powell repeated what has become a standard Fed diagnosis of inflation progress - with a pandemic-era jump in goods inflation easing and a decline in housing inflation "in the pipeline," but concern that continued consumer spending on a broad array of services and a tight labor market may make a return to 2% difficult.

Recent declines in measures of underlying inflation, stripped of food and energy prices, "were welcome, but two months of good data are only the beginning of what it will take to build confidence that inflation is moving down sustainably," Powell said.

"Given the size" of the broader services sector, excluding housing, "some further progress will be essential," the Fed chief said, and it will likely require an economic slowdown to deliver it.

"Restrictive monetary policy will likely play an increasingly important role. Getting inflation sustainably back down to 2% is expected to require a period of below-trend economic growth as well as some softening in labor market conditions," Powell said.

While Powell's tone was not as stern as last year, when in a very abrupt set of remarks he disabused market notions that the Fed was then nearing the end of its rate-hike cycle and would cut rates through this year. Still, it was clear he did not want to set aside any options.

"Powell continues to walk a tightrope," said Michael Arone, chief investment strategist at State Street Global Advisors. "This year I think he is demonstrating that he is pleased with how far monetary policy has come and how inflation has been reduced. But he is still holding on tightly to this notion that they are watching it carefully and they still have work to do."

The Fed chair also indicated he is not open to entertaining a discussion about changing the Fed's 2% target for inflation as some economists have suggested may be warranted in an environment with growth that is persistently above trend.

"Two percent is and will remain our inflation target," Powell said. "We are committed to achieving and sustaining a stance of monetary policy that is sufficiently restrictive to bring inflation down to that level over time."

Powell ended his speech on Friday with nearly the same line he finished with last year at Jackson Hole: "We will keep at it until the job is done."

Reporting by Howard Schneider and Ann Saphir, Additional reporting by Lewis Krauskopf; Editing by Andrea Ricci

Covers the U.S. Federal Reserve, monetary policy and the economy, a graduate of the University of Maryland and Johns Hopkins University with previous experience as a foreign correspondent, economics reporter and on the local staff of the Washington Post.

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