PREVIEW: Jackson Hole 2020

PREVIEW: Fed's Jackson Hole (virtual) Economic Symposium, 27-28th August

SCHEDULE: The full schedule will be released at 20:00 EDT on 26th August (01:00 BST 27th August), and the research papers will be available at that time on the Kansas City Fed's website (here); but the main event will be remarks from Fed chair Powell at 09:10 EDT/14:10 BST on Thursday. The entire event will be streamed on the Kansas City Fed's YouTube page (here). Other notable attendees that will be delivering remarks include BOE governor Bailey (09:05 EDT/14:05 BST on Friday); BOC governor Macklem and the ECB's chief economist Lane will speak on a panel (11:15 EDT/16:15 BST on Thursday).

FRAMEWORK REVIEW: The Fed's review of monetary policy strategy, tools, and communications began in November 2018, and is aimed at reviewing the Fed's dual mandate of maximum employment and price stability. Whether the Fed chooses to release the full conclusions of its study remains to be seen, although analysts at Goldman Sachs think the central bank might reveal excerpts from a revised version of the 'Statement on Longer-Run Goals and Monetary Policy Strategy', which it expects the FOMC to release at its 16th September meeting. For markets, the review will help shape expectations on how long the Fed will keep rates at zero, and how it will use tools like asset purchases to achieve its objectives.

SPECIFICS: There is an argument that the Fed will be deliberately vague about its framework review, according to Capital Economics. and the consultancy does not expect mechanical rules with actual numbers. It says providing actual numbers will be hard to formulate, since if the Fed is targeting average inflation over a cycle, it requires an estimate of when the cycle began and when it might end. On the other hand, a numerical rule would also entail specifying how quickly officials want any inflation undershoot to be made up. And additionally, CapEco does not think that Powell will get into any specifics about how the new strategy warrants additional monetary stimulus.

AVERAGE INFLATION TARGET: The consensus expects that the Fed will ultimately shift to an average inflation targeting (AIT) regime. UBS is expecting only modest changes to the Fed's 'Statement on Longer-Run Goals and Monetary Policy Strategy'. UBS thinks the FOMC will target 2% inflation "on average, over time", and that overshooting the 2% target is a desirable outcome when inflation expectations have been dragged lower. "The statement will have to be explicit that their full employment mandate is critical," UBS writes, but notes that in 2012, "the FOMC provided a specific numeric threshold for unemployment, 6.5%, and later unemployment reached 3.5% with no overshooting of inflation -- we believe strongly the Fed learns from history."

SEPTEMBER FOMC: The July FOMC did not really 'set the foundation' to future policy tweaks, like enhanced forward guidance or yield curve targeting. Accordingly, we expect the Fed will use the Jackson Hole conference to shed light on these themes. However, that of course depends on whether the FOMC can engineer a consensus on the stance of policy. In terms of what the strategy review might entail for that September meeting, UBS reckons there will be guidance about keeping the funds rate at zero for as long as is necessary to ensure full employment and an overshoot of inflation, but thinks the Fed will only give a numerical trigger for inflation. "The FOMC could commit to keep the federal funds rate at zero until realized inflation is at 2% and the one-year ahead forecast is at or above 2¼%," UBS speculates, noting that the recent meeting minutes showed officials wanted to communicate QE more in terms of easing financial conditions, rather than supporting market functioning. "Because the Fed's internal modelling of QE relies on the extraction of duration to push down longer-term yields, purchases of short-term paper may ease market frictions but do not ease the stance of policy," the bank explains. "Of the USD 80bln per month of Treasuries that the Fed is buying, only USD 36bln has maturity of 5 years or longer," and since the Fed has already leaned-back on taking rates negative, leaving QE as its main policy instrument; UBS says this logic leads them to purchases at maturities of 5 years or longer.

MARKET REACTION: Goldman Sachs does not think that the framework review will come as a large surprise to financial markets, especially since the Fed has appeared to be leaning towards AIT since early 2019, and has also cooled on yield curve targeting. "At this point, the key issues are likely fairly well understood in markets," GS says, "some investors might be disappointed if they expect an explicit make-up policy or the immediate deployment of yield caps and targets, though we suspect only a minority of investors hold those expectations."