PREVIEW: Fed's Powell & ECB's Lagarde due to speak at the Jackson Hole Symposium on Friday, 25th August 2023

Fed Chair Powell at 15:05BST/10:05ET

MARKET PRICING:

- Ahead of the symposium, money markets currently price in a 89% probability of rates being left unchanged in September, with just an 11% probability of a hike. However, looking to November, a further 10bps of tightening are priced in, implying a c. 40% probability of a hike at that meeting, with the terminal rate priced at 5.43%. With the Fed signalling cuts are likely to occur some time in 2024, markets are almost fully pricing in a cut in May, with a c. 30% probability of an earlier cut in March. Meanwhile, the latest Reuters economist poll says the Fed is to cut at least once by the end of Q2 24, with 48/95 analysts expecting the Fed to wait until at least March before cutting.

POLICY STEER:

- The US economy remains resilient, and according to a recent Reuters poll, the US economy is likely to skirt recession, with the probability judged to be around 40%, which Reuters said was the lowest in over a year. Analysts suggest that an economy chugging along at a decent pace will give the Fed scope to raise rates and keep rates at a higher level for longer, as it tries to battle rampant inflation pressures.
- The recent FOMC meeting minutes noted that inflation remains “unacceptably high” and officials continued to see significant upside risks to the inflation profile, keeping a hawkish slant on their policy stance. While some have been warning about the risks that the Committee could accidentally tighten too much, a number saw economic risks as becoming more balanced. Most officials noted the gradual slowdown in economic activity, but they still see below-trend growth and a softer labour market as necessary to restoring economic balance. Fed staff themselves no longer see the economy entering a mild recession this year, the minutes revealed, highlighting its resilience in the face of aggressive monetary tightening.
- Many do not think that Powell will provide us with any significant policy steer, instead backing the data-dependent approach to policy making. Analysts at Investec say “we are not convinced that Fed members will add that much to the current monetary policy conjuncture, given a fair amount of policy related comments recently, including those in the July meeting minutes,” but say the event itself should help guide markets how central bankers globally are thinking about medium-term economic issues.

POWELL TO EMPHASISE RESTRICTIVE POLICY:

- Analysts at Piper say the Fed Chair could underscore that the end of rate hikes, when it arrives, would not mean that the era of restrictive policy is over, adding that “even after the 100bps of rate cuts the June dot plot implies for 2024, the latest 4.625% median for that year remains well greater than their 2.5% ‘long-run’ projection,” and adds that “considering that so-called R-star is no robust lodestar, without careful wording there is some risk that this clarification on life after hikes mistakenly comes off dovish, as some sort of ‘pivot’.”
- Piper says Powell could take the opportunity to “disabuse investors that cuts are right around the corner, with ample retread on how far they still are from their price objective, peppered with his greatest hits on the scourges of inflation.”

R-STAR DEBATE:

- News reports have been highlighting that the subject of the R-star could be a key subject at the conference.
- R-star – the real interest rate where demand for investments and savings is at an equilibrium, a policy rate which is not contractionary or expansionary for growth or inflation – has been estimated at around 0.5% (2.5% long-run Federal Funds Rate target, less the 2.0% inflation target in the long-term).
- Analysts will be looking to Fed officials for any clue as to whether they think this R-star rate is rising (which would imply higher policy rates).
- SGH Macro’s Fedwatcher Tim Duy says that this suggests that there are two risk events at Jackson Hole with the potential to take rates higher.

POWELL’S BALANCING ACT:

- Duy says the Fed faces a clear messaging challenge at Jackson Hole. “Powell can follow the messaging of recent weeks, which includes the minutes and the June SEP; this messaging has been consistent with market pricing of roughly 10bps more of rate hikes before the Fed cuts rates 100bps in 2024, but that messaging relies on a forecast that is very clearly not working, and a data dependent Fed would respond accordingly.”
- SGH says that if the Fed were to follow the data, he would be highlighting that growth is well above trend, and would be gearing us up for another rate hike at the October or November policy meeting. “If he was really bold, he would note that a growth rate like that estimated by the Atlanta Fed should put a rate hike into play for September, but that feels like too much of a shift when the consensus at the Fed wants to wrap up the rate hike part of the cycle.”
- The upshot, SGH says, is that the data dependent approach would mean that pricing for the October and November meetings was too low. On the other hand, SGH says the Fed chair could lean into the recent messaging; “this path fights the growth numbers and emphasises the expected impacts of policy lags,” it explains, “Powell could also cite recent declines in near-term inflation expectations as a reason that policy will tighten further in real terms even if the Fed holds rates steady.” That approach, however, would suggest to SGH that inflation expectations are being priced too low. “Odds favour Powell highlighting growth, though by doing so he is raising the risk of recession.”

ECB's Lagarde at 20:00BST/15:00ET and on BBG TV at 21:00BST/16:00ET

OVERVIEW:

- With several weeks until the ECB announcement and the key August Flash HICP metrics Lagarde has very little to gain by pre-empting the 14th September and by extension 26th October gatherings, as such data-dependence, referring back to the July meeting and awaiting the September macroeconomic projections will likely underpin her speeches.

AREAS OF FOCUS:

- Data Dependence: Lagarde is very likely to stick to the script from the July meeting (full recap below) which very much underscored the ECB is data-dependent. On this, Lagarde will likely use the upcoming data schedule to avoid giving away any fresh details with Flash HICP (Aug 31st), among other points, due before the September gathering. Additionally, Lagarde will likely defer to the macroeconomic projections that accompany the September meeting as a key component of the decision making process.
- Hike: Market pricing currently has a 50% chance of a 25bp hike occurring, a view that is endorsed by the core July inflation data and the inflationary aspects of the PMIs. Though, given the data-dependent approach and her commentary in July, Lagarde is unlikely to cement a hike at this point.
- Skip: In July, Lagarde said “at this point, I would not say so” when asked if the ECB had more ground to cover. Given the bleak tone of recent data on the growth narrative and sources in the immediacy of that meeting suggesting that some ECB members were eyeing a September pause given recessionary concerns, Lagarde could choose to give a hat-tip to this narrative in light of the August PMIs. However, any such remark would undoubtedly be heavily caveated by the above data dependence point. While the growth data would, logically, be biased more towards an end to the tightening cycle rather than a pause and final hike in October, the inflationary components of the PMIs (see below) alongside the uptick in July’s core HICP keeps the argument for a skip alive.
- Higher for Longer: Alternatively, Lagarde could make the assessment that the bleak growth environment and the overall trend of the inflation data is sufficient to pause/stop tightening at this point at instead outline a longer vs. higher approach to rates. Currently, markets do not fully price in a rate cut until September 2024.

PRICING & DESK VIEWS:

- Market pricing is currently 50/50 between unchanged at 3.75% and a 25bp hike to 4.00%. Before the Flash August PMIs, there was a 63% chance 25bp hike while the initial knee-jerk reaction to the data saw a shift to a circa. 60% chance of unchanged.
- JPMorgan: Expect the ECB to pause in September and postpone their final 25bp hike forecast to October.
- Morgan Stanley: Believe the path to a September hike has “become much more narrow”, but the decision on whether a hike happens or not in September is dependent on the upcoming inflation release.
- MUFG: Barring a significant upside-surprise to core EZ inflation in August, they expect participants to be less confident in the ECB hiking in September.
- SGH Macro: Sceptical of the view that the ECB could pause in September and hike in October if, as expected, inflation numbers improve. Expect the ECB to leave rates unchanged at 3.75% in September with a longer vs. higher restrictive-rates argument.

- RTRS Poll (11th Aug): 37/70 economists expect the ECB to maintain the Deposit Rate at 3.75% in September.

DATA SINCE JULY:

- Flash PMIs (Aug): Showed the impact the tightening cycle is having on the blocs' economy and the marked downfall in services removed any prospect of that component propping up the pressured manufacturing sector and offsetting a recession. HCOB's GDP growth nowcast looks for readings of -0.3% and -1.0% in Q3 for the EZ and Germany respectively. For the ECB, the data is a point of concern particularly when considering that sources after the July meeting were using an expected recession as a reason to pause in September. However, the release has bad news on the inflationary front as HCOB believes Lagarde's feared scenario of higher wages and lower productivity fanning price pressures is "about to come to fruition, for services at least".
- HICP (Jul): A release that saw the headline dip but the core (Ex-Food & Energy) print above expectations (but still lower than previous) and as such can be utilised by those on both the hawkish and dovish side of the spectrum and has ultimately had no impact on market pricing. Reminder, August's Flash HICP is due on Thursday, 31st August.
- GDP (Q2): A more pronounced than expected return to growth for the EZ after a Q4 decline and a stagnation in Q1; however, the release's underlying details add a negative skew given marked upside in the very volatile Irish and Lithuania numbers while Germany's metric could well be subject to a negative revision. Additionally, the above PMIs very much take precedence in the current growth assessment. On Thursday, 7th September we received revisions to the Q2 data, where the German, Irish and Lithuanian numbers will be eyed; regarding Germany, detailed Q2 data will be presented on Friday, 25th August (before Lagarde's Jackson Hole speech). More timely German data for Q2 indicates that a negative revision to the 0.00% QQ reading is a possibility.

JULY'S MEETING & PRESS CONFERENCE:

- As expected, the ECB hiked its key rates by 25bp taking the Deposit Rate to 3.75%. Overall, the statement was largely as expected but did feature a notable language tweak in the sentence that the "Governing Council's future decisions will ensure that the key ECB interest rates will be set at sufficiently restrictive levels for as long as necessary to achieve a timely return of inflation to the 2% medium-term target." (prev. "Brought to"). Aside from that, the remuneration of minimum reserves level was cut to 0.0% (prev. matched the deposit rate), sparking marked pressure in EZ banking names.
- The subsequent press conference was more interesting. Within this, Lagarde reaffirmed that the ECB is data-dependent explicitly stating that data and their evaluation of it will inform the ECB of how much ground needs to be covered. While Lagarde did not explicitly say what she believes the outcome will be at September's gathering, when asked if the ECB has more ground to cover she said "at this point, I would not say so", reiterating the data-dependent line and when concluding her answer added that "it may vary from one month to the other".
- In the aftermath of the July meeting, Reuters sources reported that some policymakers were at that point in favour of a September hike while others "eye" a pause as they expect a recession to materialise.

SOURCES:

- Reuters reports (08:34BST/03:34 25th August) that momentum is growing for a pause in ECB rate hikes as recession fears increase, debate still open. Policymakers agree that any decision to pause would need to make clear the job is not done and future hikes could still be needed. Click here for full details. A release which sparked a modest dovish reaction.
- Overall, the Reuters sources piece does not significantly change the calculus heading into Lagarde's speech. As she is still likely to remain data-dependent in her commentary, though if there is a Q&A session she will undoubtedly be pressed on the report.
- On the hawkish side, the sources highlight that a meaningful decline in underlying inflation would be needed for a pause and pushback on the implications of recent survey data (Flash August PMIs) highlighting the divergence between soft and hard data.
- While the doves continue to view increasing recession risks as reason for a pause, a view that was presented in a sources piece in the hours after the July policy announcement. The update from the Reuters sources piece, and the driver behind the dovish reaction, is that "momentum is growing" behind the pause argument.
- Perhaps most pertinently, all sources agree that even if a pause occurs the ECB will need to make clear its job is not over and more tightening could occur - i.e. the bank is looking to keep its data-dependent and meeting-by-meeting approach intact, even if September sees an unchanged rate decision. Reminder, the likes of SGH Macro view the bar for the ECB to pause and then resuming tightening (i.e. a skip, as the Fed did) as very high, particularly if upcoming inflation readings continue to moderate.

OTHER COMMENTARY:

- Since the July gathering Lagarde has not provided any market-relevant commentary. However, in the weeks after the July meeting but before the August lull fully kicked in, we received limited commentary from both doves and hawks. The doves stuck to Lagarde’s language and were very much data dependent with the exception of Stournaras, who on 28th July said a September hike “looks difficult”. From the hawks, the most interesting remark stemmed from Kazimir around an hour after Stournaras’ above language, Kazimir acknowledged that the ECB is nearing the conclusion of tightening but believes they should still take a “firm step further”. Most recently, Kazaks on 17th August highlighted the recent inflation print but kept to a data-dependent stance and said any additional hikes would be small; the small language is unsurprising, given the ECB has already stepped down to 25bp increments, but the plural on “hikes” is perhaps of note.
- On the eve of the symposium, ECB's Nagel and Vujcic spoke. Nagel, said it is much too early to think about pausing rate-hikes and that they need to be stubborn on policy and more so on inflation. Commentary from Bundesbank head Nagel which is very much in-fitting with his hawkish bias, but interesting given the headwinds seen in the EZ and particularly for Germany. Vujcic, said the EZ is basically stagnating and inflation has most likely peaked, remarks which seemingly outline the case for a end to tightening or a pause; however, he then adds that it is to be seen of rates are restrictive enough - a line which leaves him with room to manoeuvre in his policy preference.