Powell's Incrementally Cautious Testimony

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- **Fed Chair Powell's opening statement and ongoing Congressional testimony has succeeded in avoiding significant market surprises thus far but is incrementally dovish by my read.** Markets are ignoring it so far with the 2 year Treasury yield and the USD on a DXY basis completely unchanged post-communications. There are nevertheless two reasons for putting a more cautious angle on his testimony. Powell's testimony is ongoing but at an advanced stage now and will be repeated before the House Financial Services Committee tomorrow at 10amET.
- First, Powell's opening remarks (here) inserted more doubt into the outlook for Fed policy:

  > "With a strong job market, inflation close to our objective, and the risks to the outlook roughly balanced, the FOMC believes that—for now—the best way forward is to keep gradually raising the federal funds rate."

- Second, the rest of that same "for now" paragraph gives the risks of going too fast versus too slow and openness to changing forecasts if needed but not yet:

  > "As always, our actions will depend on the economic outlook, which may change as we receive new data."

- **None of this is necessarily surprising given data dependency, but "for now" and "may change" could be taken as indicating somewhat less confidence in their forecasts.**
- The combined insertion of "for now" and "may change" is done with emphasis by setting the references apart from the surrounding paragraph in pointed fashion but it does raise the usual risk of over-interpreting Fed communications. I think the effort is deliberate and rooted in the Fed's awareness of the importance of communications derived from its subcommittee focused upon effectively portraying subtle shifts in risks to the outlook. That said, there are at least three possible interpretations. One is that perhaps the references are meaningless and just a statement of the obvious in a data dependent world for Fed policy. Another is that perhaps they could be twisted to infer the Fed won't raise rates gradually and will instead expedite hikes if not anchored in any further understanding of the context and when read literally. To counter this interpretation, Powell largely dismissed it by stating "gradually raising rates is the way for us to extend this cycle". The third possible interpretation is where I lean in that, on net, my judgement is that it probably leans slightly in the opposite direction as a neutral-dovish piece of incremental information.
- **The reason is that I can't seriously think that the FOMC is skewed toward upward forecast revisions to growth and sustainable core inflation**, given escalating trade and geopolitical tensions, the debate over flat yield curve signals that Powell takes as primarily indicative of the market's assumptions on the neutral rate, investment uncertainty "put on ice" to use Powell's reference and that is showing up in their minutes and discussions with businesses, plus evidence that inflation may be stalling out (here) with USD strength setting a possible cap on future inflation risk. Judgement weighed against the literal interpretation would suggest the Fed wouldn't add to the air of uncertainty governing the global business climate by expediting hikes compared to its existing projections.

- As such, relative to our house forecast for another 100bps in fed funds tightening to 3% by the end of next year that markets continue to undercut, I would continue to skew the risks somewhat more toward fewer hikes than more.
- On trade policy, Powell generally dodged questioning and there is only one single “trade” reference in his statement. Powell reiterates that he is focused upon "staying in our lane and our lane is the economy." One could counter that trade policy does of course relate to the economy and it lies well within the Fed’s mandate to assess related risks. He goes on to note that "... it is difficult to predict the ultimate outcome of current discussions over trade policy as well as the size and timing of the economic effects of the recent changes in fiscal policy. Overall, we see the risk of the economy unexpectedly weakening as roughly balanced with the possibility of the economy growing faster than we currently anticipate. " Powell also noted that the effects of tariff changes could go in both directions when he stated “If it results in lower tariffs for everyone, that will be a good thing for the economy.” One can’t argue with that except by pointing to the broad direction of retaliation across all of America’s major trading partners as heavily skewed in the opposite fashion.
- **Overall, I would have preferred to hear the Fed Chair weigh in more directly on the one-sided risks to global and US growth from rising protectionism and the uncertainty over the extent to which fiscal policy may juice growth this year and in future.**