Economics

Powell Says 'Time Has Come' for Fed to Cut Interest Rates

- Fed chief more confident inflation on sustainable path to 2%
- Says Fed doesn't seek, welcome further cooling in labor market

Fed's Powell Says 'Time Has Come' for Policy to Adjust

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Chair Jerome Powell said the time has come for the Federal Reserve to cut its key policy rate, affirming expectations that officials will begin lowering borrowing costs next month and making clear his intention to prevent further cooling in the labor market.

"The time has come for policy to adjust," Powell said Friday in the text of a speech at the Kansas City's Fed's annual conference in Jackson Hole, Wyoming. "The direction of travel is clear, and the timing and pace of rate cuts will depend on incoming data, the evolving outlook and the balance of risks."

The Fed chief acknowledged recent progress on inflation, which has resumed moderating in recent months after stalling earlier in the year: "My confidence has grown that inflation is on a sustainable path back to 2%," he said, referring to the central bank's inflation target.

Treasury yields fell and the S&P 500 index of US stocks rose while the dollar declined.

Swaps traders held roughly steady in their pricing, with the total rate cuts they foresee through the end of 2024 at about 102 basis points. Odds also remained steady for a quarter-point cut in September, and the probability of a 50-point cut rising slightly to 24%.

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While the remarks provided some clarity for financial markets in the near term, they offered few clues as to how the Fed might proceed after its September gathering.

Still, the speech confirmed the Fed is on the cusp of a key turning point in its two-year battle against inflation. For most of that time, the labor market proved surprisingly sturdy, giving officials room to focus doggedly on lowering inflation toward the central bank's 2% target.

The Fed has held its benchmark rate in a range of 5.25%-5.5% – its highest level in more than two decades – for the last year in support of that goal, propping up borrowing costs across the economy.

Yet just as inflation has neared its target, cracks have appeared on the employment front, prompting several Fed officials to worry that high rates now pose a threat to the economy's continued strength. Warning signals included a disappointing July jobs report that rattled financial markets.

"We do not seek or welcome further cooling in labor market conditions." Powell said, adding that the slowdown in the labor market was "unmistakable."

Powell added that he believes the Fed has the ammunition needed to counter a more rapid deterioration.

"The current level of our policy rate gives us ample room to respond to any risks we may face, including the risk of unwelcome further weakening in labor market conditions," he said.

Policy Pivot

"It was a very definitive turn away from the singular inflation focus the Fed had," said Derek Tang, an economist at LH Meyer/Monetary Policy Analytics, of Powell's speech. "I think it's actually now tilting more fully towards defending the expansion against recession. It really seems the inflation worry has faded into the background."

After being late to raise rates in response to an inflation surge during the Covid-19 pandemic, Powell's remarks underscore how Fed officials are hoping to avoid another policy error now that price growth is easing. Their success or failure will determine whether there's a so-called soft landing, the rare feat of smothering a burst of inflation without tipping the economy into recession.

"Our objective has been to restore price stability while maintaining a strong labor market, avoiding the sharp increases in unemployment that characterized earlier disinflationary episodes when inflation expectations were less well anchored," Powell said. "While the task is not complete, we have made a good deal of progress toward that outcome."

At their last gathering in July, the "vast majority" of Fed officials felt it would likely be appropriate to cut rates in September if economic data continued to come in as expected.

While inflation remains above the Fed's goal, it has retreated markedly from its recent peak of 7.1% in 2022. The central bank's preferred inflation gauge, the personal consumption expenditures price index, rose 2.5% in June from a year earlier. A separate measure of underlying consumer inflation cooled in July for a fourth straight month. Meanwhile, the unemployment rate ticked up last month, also for a fourth straight time, reaching 4.3%, and employers pulled back on the pace of hiring.

Path Ahead

Powell's comments will likely be well-received by Americans contending with high interest rates attached to mortgages, autos, credit cards and other borrowing. Investors are widely anticipating a quarter-point cut when when the Federal Open Market Committee next meets Sept. 17-18.

Questions remain about the Fed's path forward and Powell provided no additional clarity.

Investors are weighing whether another negative jobs report would compel the Fed to cut rates by a larger-than-usual 50 basis points in September. Another key matter is how policymakers might proceed with the pace and size of rate cuts in subsequent months.

Powell said policymakers "will do everything we can to support a strong labor market as we make further progress toward price stability."

"He wants to preserve optionality," said Jan Hatzius, chief economist at Goldman Sachs. "My interpretation is he thinks it's data dependent. If he pre-judges it, then that raises the hurdle for making up your mind when the data becomes available."

One additional jobs report and two inflation reports are set to be released ahead of officials' September meeting.

Boston Fed President Susan Collins and Philadelphia Fed chief Patrick Harker said this week the central bank should begin lowering rates soon and that the pace of cuts should be "gradual" and "methodical."

"Right now they just probably don't need to go 50 basis points," Jim Bullard, a former St. Louis Fed president, told Bloomberg TV on Friday. "I think that would trigger expectations about a really rapid pace of rate decline. They probably don't need to do that."

At their gathering next month, Fed officials will release fresh set of economic projections and indicate where they anticipate their policy rate will be at the end of each year through 2026.

(Updates with economists' comments from 13th paragraph.)