

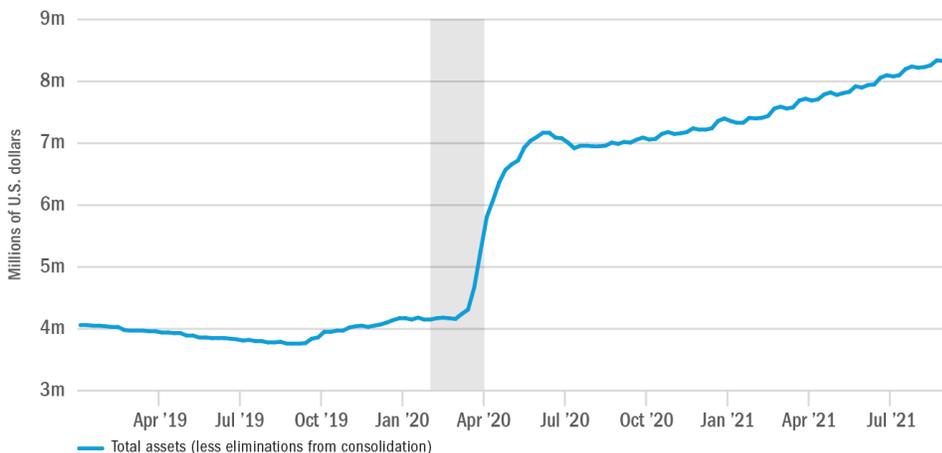
# Post-Jackson Hole: Stay focused and carry on

September 13, 2021

*The Fed issues a reassuring but cautious message against a fluid economic backdrop. But what's next for interest rates?*

Markets reacted positively to the much-anticipated speech by Fed Chair Jerome Powell at the annual Jackson Hole Economic Symposium. After more than a year of pumping liquidity into markets through ultra-low interest rates and massive asset purchases meant to prop up the economy during the worst of the pandemic, a lot of attention was focused on guidance the Fed chair might offer about monetary policy — particularly interest rates.

## ▶ The Federal Reserve's asset purchases increased substantially at the onset of the pandemic



Source: Board of Governors of the Federal Reserve System. Shaded area indicates recession period.

In his comments, Powell delivered a largely reassuring, albeit cautious, message. He reaffirmed the Fed's goals for inflation and employment, specifically recognizing that "substantial further progress" has been made toward the 2% inflation target and clear progress has been made toward maximum employment. Therefore, with the economy now on firmer footing, there was room for introducing a reduction in bond purchases — also known as tapering. He emphasized, however, that the timing and pace of the taper will not be intended to carry a direct signal regarding the timing of interest rate liftoff, for which the Fed has articulated a different and substantially more stringent test. There is a lot of ground to cover to reach maximum employment, and only time will tell whether we've reached 2% inflation on a sustainable basis.

On inflation, Powell confirmed that the Fed perceives the recent spike in inflation to be a result of "transitory" or temporary factors. He recognized that higher than expected [recent inflation was not broad-based](#). Higher prices were concentrated in specific areas, such as lumber and used cars, and these have recently come down. Most importantly, he said, wage growth — the stickiest and most concerning of inflation drivers — has been moderate. All-in-all long-term inflation expectations are anchored and are in line with the Fed's long-term goal.

As it relates to the labor market, while the recovery has been notable, six to eight million people remain unemployed. The good news is the pace of improvement in employment has been disconnected with a recent slowdown in growth. The [delta variant](#) poses a possible, but not probable, tail risk to continued improvement, which the Fed will be monitoring to ensure that a more equitable employment distribution remains in progress.

### **What does this mean for investors?**

While Powell provided a sense of direction, he was short on details. He attempted to draw a clear distinction between the timing of tapering and the interest rate hiking cycle. But he provided no clear guidance on the timing or pace of the taper, which we expect will come as early as next month's FOMC meeting, and a reduction in asset purchases potentially launching in December.

That said, the most important story isn't the taper. It will happen and will include some sort of mix across Agency RMBS and Treasuries, neither of which will materially impact interest rates on the long end. However, the Fed will need to walk a careful path to avoid a "taper-tantrum" similar to 2013. Given its commitment to supporting the economy in achieving a full recovery, investors should not expect any significant changes in the Fed's policy rate — at least in the foreseeable future, while allowing inflation risk premia to rise in the long end. In the longer run, we believe there are good odds that we end this cycle with a 10-year Treasury much lower than previous cycles, around 2%-2.5%, because the same secular and structural issues that we were facing prepandemic have not changed. The bottom line is that the economic landscape remains fluid as a return to normal or a new normal emerges, keeping investors on their toes.



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