JSB Capital Management, LLC

Pro-active Wealth Management

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Today the Federal Reserve Chairman, Jerome Powell, testified before the Senate Banking Committee during the first of two days of required congressional testimony. He indicated a subtle but important shift today that potentially moved the central bank closer to lowering interest rates sometime this year. He emphasized that a further cooling in the labor market could be undesirable when contemplating the timing of an interest rate reduction.

“Elevated inflation is not the only risk we face,” Powell said, “We’ve seen that the labor market has cooled really significantly across so many measures.…It’s not a source of broad inflationary pressures for the economy now.” Mr. Powell conceded that he might not have arrived at this judgment as recently as two months ago as evidenced by his more measured comments made at a conference in Portugal just last week.

That assessment is notable because Fed officials have long cited an overheated labor market as a primary risk to bringing inflation back down.

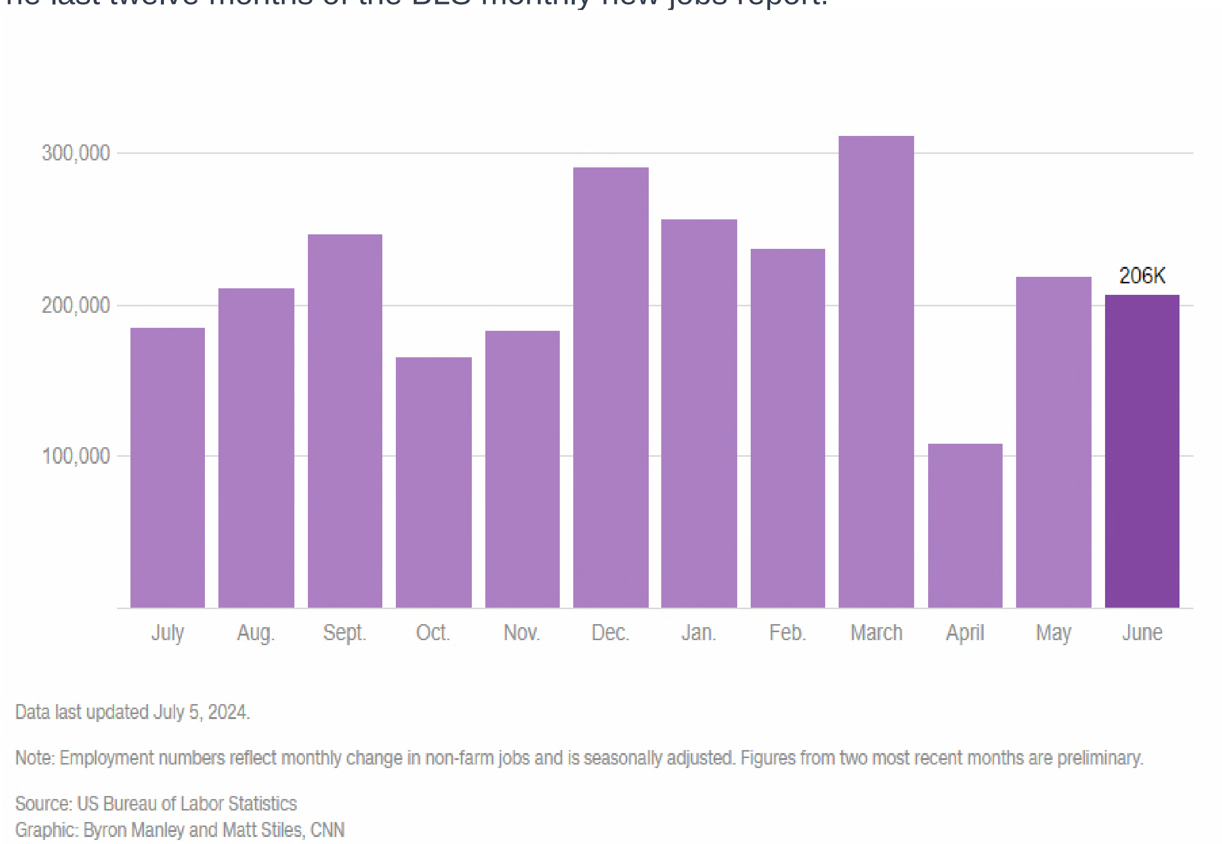
Federal Reserve Chair Mr. Powell

Labor Market Data Input to the Interest Rtae Decision

The U.S. economy apparently has added an average of 200,000 jobs per month this year (according to the Bureau of Labor Statistics (BLS), which is infamous for its consistent downward revisions a month later). As evidence of the curious BLS jobs added number, the unemployment rate has inched up to 4.1% in June from 3.7% in December, despite the growth rate in jobs. Today Mr. Powell described the job market as “roughly back to conditions seen before the pandemic hit, when it was strong, but not overheated.”

In addition, the shifting outlook in labor-market data showing a slowdown in hiring and a mild but steady increase in the share of Americans looking for work, amid an increase in the workforce (due partly to more immigration), suggests a real downward trend in the inflationary effects of a previously robust labor market.

The last twelve months of the BLS monthly new jobs report:



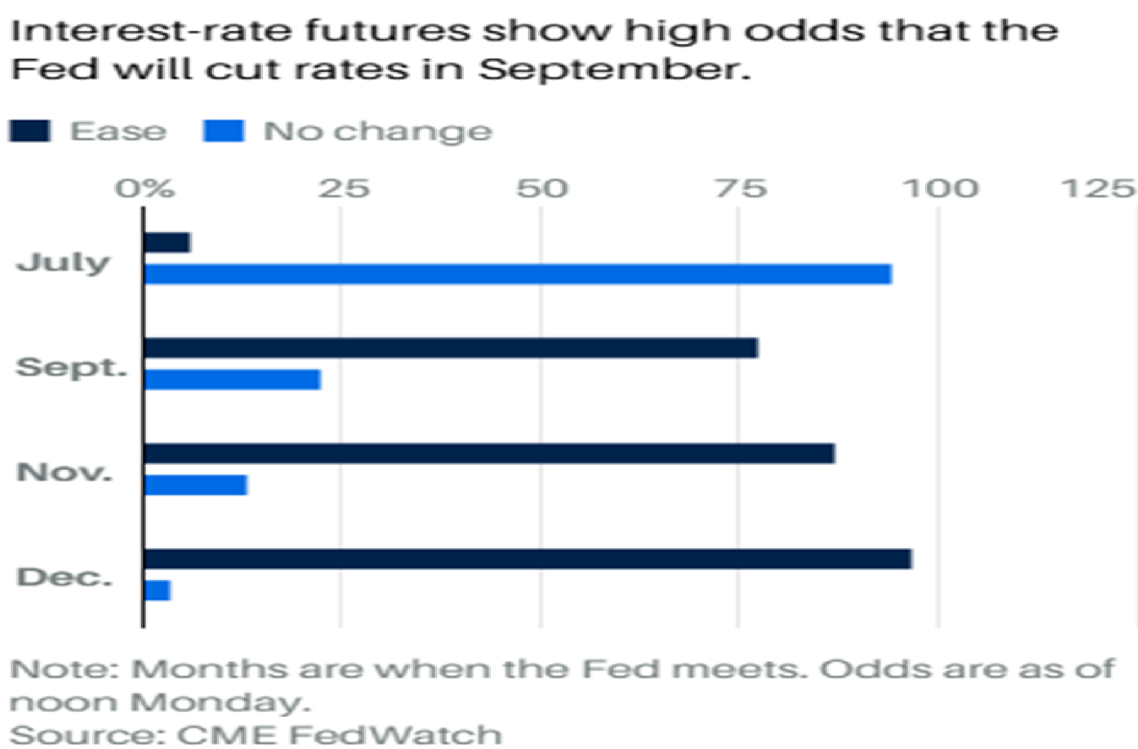
Inflation Data Forecasts Rate Cuts

Through last year, Fed officials were laser focused on elevated inflation statistics. They haven't had to worry too much about trade-offs between fighting inflation with higher rates and an increase in joblessness because businesses were scrambling to fill open jobs amid the reopening from the pandemic. The Fed raised rates at the fastest pace in 40 years in 2022 and 2023 to combat inflation that also rose to a four-decade high. Officials have held their benchmark rate in a range between 5.25% and 5.5%, their highest level in more than two decades, since last July.

Inflation as measured by the Consumer Price Index (CPI) fell to 2.6% in May, according to the Fed's preferred gauge which was down from 4% one year earlier but still above the Fed's 2% target.

"We had quite a lot of good inflation data in the last seven months of last year," Powell said on Tuesday. "Then we had a bump in inflation in the first quarter, and now we've had one good and one very good inflation reading. We need more good data so that we can be confident that what we're seeing is really that inflation is going back down toward 2%."

The inflation data irregularity has left the Federal Reserve governors in an intermediate holding pattern. Fed policymakers are hoping for either: (1) several more months of convincingly benign inflation readings or (2) evidence of meaningful weakness in hiring and economic activity before actively considering lowering rates. Owing to the current inflation and labor data Fed officials seek to balance the risk of moving too slowly to reduce interest rates with the risk of moving too soon.



Bottom Line

While almost all of Mr. Powell’s commentary suggested it was a matter of when not if the Federal Reserve Bank would cut their administered rates, he repeatedly spurned efforts by members of the Senate Banking Committee to pin him down on the exact timing. “I’m not going to be sending any signals about the timing of future actions,” he said.

When pressed over whether he had greater concerns about larger increases in unemployment, Powell said, “Absolutely I do. Even more so than in March, when we were here.”

The FOMC next meets on July 30-31. As indicated in the chart above, interest-rate futures pricing implied a less than 5% chance that the committee will reduce the fed-funds rate by a quarter of a percentage point at that time. However, interest rate futures were pricing in about 75% odds of a cut at the Fed’s next meeting in September.

With that optimistic rate background, the domestic stock and bond markets will likely remain slightly “bullish” over the next several months in anticipation of a September rate cut.