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A dovish Jackson Hole

The Fed is prepared to cut rates as soon as September, barring a surprise in the August employment and CPI reports.

Key Takeaways

- "With policy in restrictive territory, the baseline outlook and the shifting balance of risks may warrant adjusting our policy stance."
- Powell saw the last payrolls data raising downside risks for the labor market and reducing upside risks for inflation.
- For the labor market: "if those risks materialize, they can do so quickly in the form of sharply higher layoffs and rising unemployment."
- Chances of a September cut have increased.
- The framework review was largely as expected: The Fed moves away from zero-lower-bound thinking and the restrictions it places on monetary policy.

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Powell says new risks may warrant adjusting policy

The key sentence in Fed Chair Powell's Jackson Hole speech: "with policy in restrictive territory, the baseline outlook and the shifting balance of risks may warrant adjusting our policy stance."

This was a new, more dovish skew. It does not definitively say the Fed will cut in September, but it comes about as close as it can given the data between now and then.

For Powell, the balance of risks has shifted in the direction of a weaker labor market. Yes, he explains the curious balance in the labor market from immigration, but he is taking on board signal from July payrolls, whereas before he was highlighting upside risks to inflation.

The slowdown in payrolls "is much larger than assessed just a month ago", increasing his concern about downside risks to the labor market. "if those risks materialize, they can do so quickly in the form of sharply higher layoffs and rising unemployment."

For the inflation side of the Fed's mandate, there is less risk of the "more lasting inflation dynamic" from tariffs because the labor market is "not particularly tight" and "faces increasing downside risks." In a weakening labor market, it is less likely that tariff-related price gains spill into wage rates and spill into "adverse wage-price dynamics." The increased risk to the labor targets lessens the risk to the Fed's inflation target.

On net, this suggests a low bar for rate cuts. Powell sees policy as still "above neutral" even after 100 bps of cuts. The Fed may want to take the policy rate lower to a more neutral setting to balance the evolving risks. Today's talk suggests an altered reaction function, one that perhaps again skews a little more towards labor market risks.

On the Fed's Framework Review

Chair Powell also presented the 2025 Statement on the Longer-Run Goals and Monetary Policy Strategy at his Jackson Hole address. The changes are largely as expected; the Fed is moving away from Effective Lower Bound (ELB) and the restrictions it placed on monetary policy.

There were five points outlined. First, the 2025 statement de-emphasizes the ELB, in that the ELB is no longer described as a defining feature of the economic landscape. The revised statement states that monetary policy is designed to promote maximum employment and stable prices across a broad range of conditions. Second, the framework has returned to flexible inflation targeting. The Fed eliminated the “makeup” strategy introduced in 2020, and the revised framework acknowledges that the inflation overshoot post-2020 was neither intentional nor moderate. Third, there was a clarification about the language around employment. In the 2020 review, the adopted policy was to "make up for persistent shortfalls from the inflation target", and policy decisions would be about assessments of “shortfalls” rather than “deviations” from maximum employment. (This was a one-sided assessment of labor market strains.) In the 2025 statement, the "shortfalls" reference has been removed and the statement now recognizes that employment may exceed real-time assessments of maximum employment without necessarily threatening price stability. Fourth, the statement notes the balanced approach to the dual mandate: when employment and inflation goals diverge, the Fed will weigh the extent and timing of each deviation. This approach aligns more closely with the original 2012 language and guides policy decisions when trade-offs arise. Lastly, the Fed reaffirmed its commitment to act forcefully to keep long-term inflation expectations well anchored, and price stability was emphasized as essential for a sound economy and broad-based well-being.

The rest of the statement aligns with the previous ones. The statement reaffirms the 2% inflation target, which remains central to the Fed's dual mandate. And the Fed will continue to conduct public reviews of its framework approximately every five years, allowing for reassessment and public engagement.

Overall, the move away from the ELB was expected, as that restriction drove the shortfalls and overshoot language of the 2020 statement. We think that the Fed not returning to the "deviations" language is appropriate: "employment may at times run above real-time assessments of maximum employment without necessarily creating risks to price stability". In a sense this is still shortfalls language, but it says the Fed will only take steps to counter low unemployment if it comes with price pressures.

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