

EDITORIAL

3

WHAT MADE POWELL BLINK?

In his much-awaited speech at the annual Jackson Hole central bankers' symposium, his last as Chair of the Federal Reserve (Fed), Jerome Powell delivered a dovish surprise by opening the door wide to a rate cut at the FOMC's upcoming meeting, his tone a long way away from his hawkish press conference following the July 30 FOMC meeting, and its hawkish minutes, published just days before the speech. Markets cheered, with both stocks and bonds rallying. Were they right to? Much depends on what caused the shift. Was it relief from inflation developments? Heightened fears of recession? Giving in to political pressure? Chair Powell himself assigned it to a "shifting balance of risks". But what does this actually mean? We see four layers of explanations: the data; the reaction function; the casting; and the politics.

THE DATA

The August 1 employment report drew the spotlight by revealing that job creations had been much lower than expected not just in July but also in the prior two months, leaving employment barely higher at end July than in April. Nonetheless, the unemployment rate edged up only slightly to 4.2%, still an historically low level. But data on the inflation side of the Fed's dual mandate also moved away from the Fed's target, with both retail and wholesale price inflation accelerating in July to exceed 3%. Moreover, industry surveys confirm that most firms intend to pass through to consumers the price increases they face owing to tariffs, and several measures of inflation expectations also rose in August¹.

This tension between the two sides of the Fed's mandate is unfortunate to be sure, but was in fact anticipated by the FOMC at its July meeting. Plausibly, what wasn't was the scale of the slowdown in the pace of job creations.

THE REACTION FUNCTION

Speaking on the heels of the last FOMC meeting, Chair Powell emphasized that the relevant metric of achievement of the Fed's "maximum employment" mandate was the unemployment rate. He waved off concerns about slowing jobs growth on the grounds that both the demand and supply sides of the labour market appeared to moderate at the same pace, leaving the market broadly in balance.

While this dynamic is still very much at play, Chair Powell in Jackson Hole acknowledged this was "a curious kind of balance", seemingly ditching his earlier analysis in favour of the less benign one promoted for some time by Governor Waller (who voted for a cut at the July meeting). This argues instead that downside risks are rising and the observed balance could quickly give way to sharply higher layoffs and unemployment.

Gone is the previous emphasis on the greater distance of inflation from its target and hence the need to address this risk first. Instead, Chair Powell noted that while a risk existed that the impact on prices of tariffs passthrough would not be short-lived, this did "not seem likely", again rallying to the long-held Waller view. But why now, when the minutes of the July FOMC meeting make clear that this was a minority view then?

THE CASTING

In early August, Governor Adriana Kugler unexpectedly announced her resignation from the Fed's Board. She didn't attend the July FOMC meeting and had been expected to serve until January 2026.

Still, her resignation opened up a seat for which President Trump has nominated Stephan Miran, currently chair of his Council of Economic Advisers. If confirmed by the Senate ahead of September 16-17, Mr. Miran will support a cut of at least a 25 bps rate cut in September (he is on the record favouring a 50 bps cut). More recently, allegations of mortgage fraud have surfaced against Governor Lisa Cook, leading President Trump to demand her resignation. This may enable him to appoint another like-minded Fed Board member ahead of the September FOMC meeting, further tilting the likely lean of the FOMC's majority. It would also give Trump appointees a majority on the Fed's Board.

Monetary policy decisions are made by the FOMC, not the Fed's Board. However, the Fed's Board has important powers including, potentially, that of terminating at will the mandate of regional Fed Chairs (who comprise the remainder of the FOMC membership)². Throughout his term, Powell has been a consensus builder. This is an art that requires anticipating where the common denominator is likely to lie ahead.

POLITICS

In recent months, the Fed's independence from the Executive Branch has been challenged to a degree unheard of since the Nixon White House, and then the brunt of the pressure happened behind closed doors.

Nowadays, it is being exercised on social media and TV screens on a weekly basis, with clear intent to test, or find ways around, the boundaries of the laws that protect Fed Chairs and Governors from dismissal.

Beyond the President's verbal assaults on the Fed Chair, there is a broader undercurrent among the President's allies challenging the Fed's current governance model in a fundamental way and calling for drastic reforms. These include the latest nominee to the Fed Board and one of the leading candidates to succeed Chair Powell³.

¹ Notably, the University of Michigan and the New York Fed surveys of inflation expectations released in mid-August both registered an increase in household inflation expectations (both near term and long term ones) in July, with U. Mich ones nearing 4% over the long term and NY Fed survey ones around 3%.

² See *Who has to leave the Federal Reserve next?* Brookings, David Wessel, August 8, 2024, for more on this point.

³ See Stephan Miran, *Reform the Federal Reserve's Governance to Deliver Better Monetary Outcomes?* Manhattan Institute and Kevin Warsh, "Central Banking at a Crossroads", G30 Spring Lecture 2025, available on YouTube.



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EDITORIAL

4

Central bank independence cannot exist in a vacuum. Unless there is a broad political and societal consensus in its favour, it is bound to wither. This context puts the balance of risk in a wholly different perspective: defuse political pressure on Fed independence by showing open-mindedness to a shift in monetary policy stance, at a limited risk to the Fed's inflation-fighting credibility, or risk unleashing the destruction of the whole institutional framework that underpins it.

It is against this backdrop that Chair Powell felt it necessary to state that "FOMC members will make [monetary policy] decisions based solely on their assessment of the data and its implications for the economic outlook and the balance of risks. We will never deviate from this approach." But who does "we" stand for here, beyond the current FOMC with its short lifespan? And how reassuring is a commitment to "never deviate" that *de facto* cannot bind future FOMCs?

Only Chair Powell knows the relative weight of these different considerations; but if there is a reason to cheer here, it is to welcome a move to bend in order to avoid breaking. Unless the September 5 payrolls report delivers extremely positive surprises, the Fed should announce a 25 bps rate cut on September 17, and signal great prudence ahead. The time of maximum danger for inflationary dynamics to take hold is now and in the next few quarters.

Defusing a frontal clash with the White House, and thereby reducing the risks of an FOMC that would pursue overly stimulative monetary policy during that window, is the best way to entrench the soft landing Powell's Fed has so far delivered.

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