Powell's Not-Dovish Dovish Speech

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- Fed Chair Powell's speech (here) prompted a rally in risk assets and Treasuries while the USD sold off. Some of that first response is being reined in as this note is being sent. While the initial market reaction may reflect short covering by market participants that expected a more obviously hawkish slant, there was nothing 'dovish' per se in this speech. That turns the attention to the FOMC minutes tomorrow at 2pmET and we'll see if dovish market positioning into the minutes holds up afterward.

- What may have caught some attention is possible misinterpretation of Powell's reference to rates being 'just below' neutral. If one unwisely subscribes to precise estimates of neutral rates then that may infer that the Chair is saying they are very close to being done hiking if they are 'just below' such an estimate. That would be incorrect. The Chair referenced the *range* of neutral rate estimates that FOMC participants suggested lies between 2 ½% to 3½% in the September dot plot. I doubt that materially changes in December's dots. With the upper end of the Fed funds target range now at 2.25%, it's a mere truism that this rate lies just beneath the 2.5–3.5% neutral range but the Fed is always saying they don't know where neutral really sits and so that could ambiguously imply either little by way of additional rate hikes or 125bps to get to neutral.

- Further, there may be a tendency to confuse 'neutral' as a cyclical end point for rate hikes. That is not the meaning of the concept. It is the long run guidepost. It is not to be confused with a cyclical peak in rates. In fact, the dot plot from September showed a significant cyclical overshoot of the long run neutral rate. Recall the FOMC's last dot plot in September had neutral at 3% but their projected rate was 3.1% at the end of 2019 and 3.4% in 2020. That we are just below the bottom end of the neutral rate range is entirely consistent with still being on track for a cyclical overshoot so there isn't anything necessarily being signalled here. In fairness, what we don't know is where Chair Powell's presently implied cyclical peak sits relative to the FOMC committee but my point is not to misinterpret his neutral references.

- Other core messages are largely preserved. Powell is continuing with unchanged messages like 'gradual' hikes and balanced risks of hiking too fast or too slow, they don't know where neutral is but they're getting closer to the range of estimates, they're not terribly fussed by stability issues etc. None of this is new info versus attempting to make a story.

- And on speculation that Powell is signalling a pause in rate hike plans partly through referencing uncertain effects of monetary policy adjustments that could take a year or longer to assess, I'd just note that we too have a prolonged pause—at 3.25% after Q3 next year.

- Interestingly, a strong signal that the Fed is not worried about asset valuations came with this remark: "We see no major asset class, however, where valuations appear far in excess of standard benchmarks as some did, for example, in the late 1990s dot-com boom or the pre-crisis credit boom." Pair that with "....overall financial stability vulnerabilities are at a moderate level." Taken together, this implies that stability considerations are being monitored with two tail risks—note the discussion on Brexit for example—but that the bar is set fairly high on developments to date mattering much to the Fed as it charts its course forward.

- So now it's onto the minutes. If there is a hint in Powell's speech, then it lies in the rejected opportunity to talk about the balance sheet plans and link that back to stability considerations. That suggests the minutes may not discuss balance sheet management and the full discussion may be deferred to the December FOMC but we'll find out soon enough.
- Again, watch for 'soon' reference to reaffirm a December hike, what the overall committee thinks of the broad macro conditions and markets etc.