LHM MONETARY POLICY ANALYTICS

August 24, 2018

Comfortable With Current Outlook, Powell Doesn't Rock the Boat

In his first speech at Jackson Hole, Chairman Powell reiterated his longstanding key themes without rocking the boat. This suggests that he is comfortable with the outlook for the economy and monetary policy for now and thinks the public has a good understanding of the FOMC's thinking. He was heartened by the lack of warning signs of elevated overheating risks or inflation accelerating above 2 percent, but added that such a benign condition "results in part from the ongoing normalization process." While major questions about the structure of the economy remain, the FOMC's current policy plans—gradual rate hikes for another couple quarters, barring unanticipated shocks—is appropriate given those uncertainties. The big question is how exactly the FOMC will proceed after nearing neutral, and in our view Powell did not provide new insight into that issue.

The term "risk management"—which in this expansion we have often associated with being more cautious in removing accommodation—came up again and again. But his advocacy of a risk management approach in the face of uncertainty should not be taken as him supporting more dovish policy than otherwise: Powell used the phrase in a broader, more symmetric sense. He essentially used it to mean that monetary policy should take into account risks in any direction. But of course that is the case.

He also made clear that a risk management approach does not mean being averse to changing policy. He cited a couple examples in which managing risks would imply adjusting monetary policy more sharply: In the face of negative shocks, when policy is at risk of being constrained by the zero lower bound, and when the stability of inflation expectations are threatened in either direction. He said, "I am confident that the FOMC would resolutely 'do whatever it takes' should inflation expectations drift materially up or down or should crisis again threaten." We see this as generic reassuring Fed-Chair-speak.

On the topic of imbalances, Powell again made the case that the Fed should be wary of financial markets imbalances, not just price inflation: "Whatever the cause, in the run-up to the past two recessions, destabilizing excesses appeared mainly in financial markets rather than in inflation. Thus, risk management suggests looking beyond inflation for signs of excesses." In his view, both the unemployment rate and inflation can be misleading indicators of the cyclical state of the economy. No news here, but this reinforces that Powell's FOMC is more focused than ever on taking a holistic approach to assessing imbalances in the economy.

Powell also cited the just-released Fed staff paper.[1] One takeaway from the speech and the paper that is relevant to policy is the idea that inflation will be slower to respond to changes in resource utilization, is less responsive to such changes than before (flat Phillips curve), and is affected by many shocks that can obscure underlying price pressures. He quoted its argument that "When following a standard Taylor rule and facing a

[1] Erceg, Christopher, James Hebden, Michael Kiley, David López-Salido, and Robert Tetlow (2018). "Some Implications of Uncertainty and Misperception for Monetary Policy," Finance and Economics Discussion Series 2018-059. Washington: Board of Governors of the Federal Reserve System, August, https://dx.doi.org/10.17016/FEDS.2018.059.

Larry Meyer	**202-794-7358**	**larry@lhmeyer.com**
Kevin Burgett	**202-794-7352**	**kevin@lhmeyer.com**
Derek Tang, CFA	**215-806-3154**	**derek@lhmeyer.com**

very flat Phillips curve, for example, it is not always good advice to lower the weight on the gap between unemployment and u* and to raise the weight on inflation in making policy.″ His main takeaway from that paper was that ″no single, simple approach″ is appropriate across a broad range of scenarios. But there′s a lot to get in to with respect to this paper, and we will follow up with a further discussion of it as it relates to the Powell Fed.

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Larry Meyer
202-794-7358
larry@lhmeyer.com

Jacqueline Dolson
202-794-7357
jacqueline@lhmeyer.com

Matt Peterson
703-965-6568
matt@lhmeyer.com

lhmeyer.com

Monetary Policy Analytics Macro Team
Larry Meyer
David Stockton
Kevin Burgett
Derek Tang, CFA