

The Fed Pretends to Listen

Central bankers insist on promoting inflation. What we've got here is failure to communicate.

By Donald L. Luskin

It isn't every day that representatives of elite bureaucratic institutions walk among the ordinary people they govern and ask: "What do you really think of us?" The Federal Reserve did just that last year, through 13 "Fed Listens" events, in Washington and at each of the 12 regional reserve banks around the country. Boy, did they get an earful. But having listened, the Fed evidently didn't hear a thing.

Speakers at the events included representatives of constituencies the central bank doesn't regularly hear from, including retirees, small business and what the Fed calls "underserved communities" and "select demographic groups." Unlike the professional economists the Fed usually listens to, according to the notes from the sessions posted on the Fed's website, these people don't agree when Chairman Jerome Powell and other officials say that the economy is "at or near full employment," and can't imagine why they say monetary policy must drive inflation higher "to the target rate of 2%."

To be sure, in the "Fed Listens" events there was solid recognition of the happy fact that in the 11th year of America's longest-ever economic expansion, minority unemployment is at an all-time low, and wage gains among the lowest earners and the least educated are starting to pick up. But from the perspective of minority and low-income participants in the economy, it's way too early to declare "mission accomplished" on full employment.

In Chicago, participants in a community panel said that while today's unemployment is "among the lowest these communities have known . . . these levels would be considered catastrophic for the country as a whole." One participant said that "in some neighborhoods, 'it's always a recession.'" A community panelist in Philadelphia asked, "Does a 10% unemployment rate in the . . . Latino or African community obligate the Fed to act as it did during the financial crisis?"

In New York, economists on one of the panels threw up their hands and admitted that even from their perspective, "the definition of . . . 'full employment' is unclear." That's quite an admission, considering that achieving it is one half of the Fed's dual mandate from Congress.

The other half of the Fed's mandate—stable prices, which it defines as inflation at the target rate of 2%—also got a drubbing in the "Fed Listens" events. It seems that ordinary people don't think there should be any inflation at all—and they certainly don't see why it should be higher. In Richmond, Va., after Lael Brainard, a Fed governor in from Washington, had complained that it is "difficult to boost inflation up to the Fed's 2% objective," a panelist had to remind her that even "a slight increase in prices makes a difference" to low- to moderate-income households. In Dallas, a spokesman for seniors said stable prices are "crucial."

How will the Fed respond to this feedback? It was discussed at the December meeting of the policy-setting Federal Open Market Committee and was written up in the minutes of the meeting released to the public this month.

The Fed heard one thing loud and clear: “Aggregate statistics mask significant heterogeneity in the labor market outcomes.” In simpler language, full employment isn’t. This reinforces what the Fed calls “the importance of sustaining the economic expansion so that the effects of a persistently strong job market reach more of those who, in the past, had experienced difficulty finding employment.”

That suggests the Fed will be less likely to repeat its error of late 2018, hiking rates to “cool” an economy it believed was “over-heating” simply because more people have jobs.

But when it comes to inflation, the Fed doesn’t seem to have heard that Americans want less of it, not more. Instead, the Fed says it heard participants suggest “that the Federal Reserve could better communicate its reasons” for wanting higher inflation. In reality, the only panelists who said any such thing were those at the event in Washington—and only when they were specifically asked about it.

It seems the Fed is determined to stick to its higher-inflation policy—and trying to “communicate its reasons” using an absurd social-justice rationale. According to the December minutes, “simulations from a specific macroeconomic model” tell the Fed staff the obvious: Recessions hit minorities and the poor the hardest. But the model, they claim, further shows that this disparate impact is “especially large” when interest rates are zero. So for the sake of minorities and the poor, the Fed should cause inflation to be higher so that interest rates can be higher. That way the Fed can cut those high interest rates to prevent a recession, without risking getting all the way down to zero. Never mind that those same high interest rates would slow the economy, impede job creation for minorities and the poor, and perhaps trigger the recession that subsequently lower interest rates would then cushion.

The good news is that inflation world-wide is continuing at historically very low levels, where it has been for more than a decade, despite the massive efforts of every central bank in the world to push it upward. As long as the Fed seeks higher inflation, and even if the Fed can’t explain it—it will keep interest rates low, and high rates won’t impede continued expansion.

What the Fed should have learned from its listening exercise is, strangely enough, the same thing it should have learned from President Trump’s hectoring tweets on monetary policy: Keep rates low so the expansion can keep trickling down to every American, and enjoy the happy circumstance that inflation is so benign. Perhaps it would have been institutionally unseemly for the Fed to have taken the president’s top-down commands. But it’s now hearing all the same ideas from the citizens it is—presumably—here to serve.

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