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On Jerome Powell's Testimony

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Donald Luskin

After last week's "further" bungle, the rookie chair delivers further incoherency.

We're surprise that markets haven't reacted more negatively to new Fed chair Jerome Powell's first Congressional testimony this morning. It was his chance to rehabilitate his reputation after the release of the January FOMC minutes last week (see "Chairman Powell, You Have Just Been Hazed" February 22, 2018), in which he utterly failed to explain the alarming use of the word "further" in characterizing future rate hike prospects (see "On the January FOMC" January 31, 2018). *His prepared remarks were a train-wreck of incoherent econobabble. Mercifully, it was at least brief.*

- *Of the most potential significance to us, he completely omitted key analysis that former chair Janet Yellen had included in every one of her last four semi-annual appearances before Congress – that is, the explanation that the funds rate would evolve in harmony with the recovery of the natural rate of interest, also known as the neutral rate of interest, or r-star.*
- In its place was a cavalcade of cringe-worthy clichés, characterizing the Fed's basic policy as "to strike a balance between avoiding an overheated economy and bringing PCE price inflation to 2 percent."
- There was an ominous allusion to "financial conditions in the United States" having "reversed some" of their "easing." He went on to say, "At this point, we do not see these developments" – whatever they even are – "as weighing heavily on the outlook for economic activity." Perhaps markets are taking some kind of comfort from what can be seen as a cautious outlook, although it would be nice to know what he was talking about.
- Finally, his concluding paragraph was an odd *non sequitur*, seemingly intended to throw a bone to Republicans in Congress who would have preferred John Taylor for chair – assuring them that he finds policy rules "helpful." Is that important at this point?

How can markets be so calm in the face of two back-to-back pieces of evidence that the new Fed chair is a dunce? We suspect the answer is that markets have confidence that he is more puppet than dunce, and that the Trump administration will pull his strings in such a way as to not let him make a horrible growth-killing mistake.

Update to strategic view

US FED: Powell's first Congressional testimony was a train-wreck of econobabble and clichés. Regrettably, it omitted key language used consistently over the last two years by Yellen, elevating the natural rate of interest to the key policy variable. Yesterday Quarles, the other Trump appointee on the Fed, gave the most robust statement ever – that the Fed has no desire to slow the economy, and sees gradual rate hikes only as indexing to the rising natural rate of interest.

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- We happily point to a speech made yesterday by Randal Quarles, the other Trump/Mnuchin appointee to the Federal Reserve Board of Governors. As the vice-chair for bank supervision, it was slightly unusual for him to speak about the economy and monetary policy, but he did – and as far as we're concerned, *Quarles said precisely what Powell should have said*:

  "…a sustained increase in growth could be associated with an increase in the natural rate of interest, a concept that has developed a prominent position in the lexicon of central banking in recent years. …As the natural rate moves up, any given level of the policy rate would be more accommodative, so the policy rate would also have to move up... It is important to point out that this higher policy path would be motivated by sustained stronger growth and improved economic conditions, not a greater desire to slow the economy."

Note Quarles' last phrase – "not a greater desire to slow the economy." That's Quarles doing what should have been done in last week's minutes and in Powell's testimony this morning: being clear about what that pesky word "further" – introduced at the January FOMC – *doesn't* mean.

This is the statement of total policy continuity from the Yellen/Fischer years. We have argued that former chair Janet Yellen and former vice-chair Stanley Fischer resurrected Knut Wicksell's 119-year old concept of the natural rate as a modern policy rule (see, among many, "Yellen Gives Conservatives Something to Cheer" February 17, 2017). *Critically, as we anticipate the Fed's policy response to an accelerating global economy, this rule is substantially free from the growth-killing illogic of the Phillips Curve. For Powell to be a safe pair of hands, all he had to do was indicate he was on board with rule. He didn't. But Quarles already had, and perhaps that's enough.*

To that we add Treasury Secretary Steven Mnuchin's statement on Friday:

> "There are a lot of ways to have the economy grow…You can have wage inflation and not necessarily have inflation concerns in general."

We have said all along that Powell is not an original economic thinker, and that policy continuity would be his default position. (see "Warsh the Reformer, Powell the Plodder" October 3, 2017) And if the Trump administration had wanted someone more hawkish, it certainly had the opportunity to choose someone else (see "The Trouble with Taylor" October 24, 2017). Clearly, the administration got a puppet. Now we just have to make sure that it keeps its hands firmly on the strings.

Bottom line

Powell's first Congressional testimony was a train-wreck of econobabble and clichés. Regrettably, it omitted key language used consistently over

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