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FED SHADOW

The Most Annoying Fed Chair Ever

Thursday, January 10, 2019
Donald Luskin

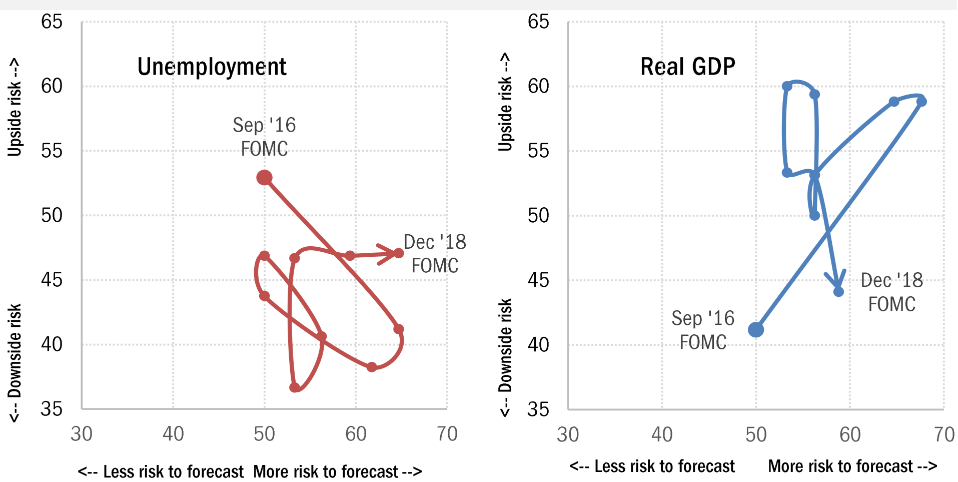
He's on a tight leash. But he's still way over his head, ignorant, arrogant and tone-deaf.

Anyone with any doubts about our call that Fed Chair Jerome Powell has cut a deal with the Trump administration to save his job and his reputation (see "Did Powell Just Cut a Deal?" December 23, 2018) needs look no further for proof than yesterday's minutes of the December FOMC. His remarks today in Washington prove it too, but the interview format gave him plenty of opportunity to show his fundamental and irremediable weakness as Fed chair.

In client conversations this week – since Powell clearly put himself into rehab with Friday's joint interview with former chairs Yellen and Bernanke (see "On Powell in Rehab" January 4, 1018) – we've been asked several times whether he really reached an agreement with the administration, or whether he was simply chastened by markets. *We say it's a deal. Remember, the Q4 bear market in equities was two-thirds done before the FOMC even met* – *and it wasn't enough to get Powell's attention*. What changed everything were media reports swirling over the pre-Christmas weekend that President Donald J. Trump was about to fire him. But *it doesn't matter. He's got the message. It makes little difference whether the message was delivered by Mr. Market or Mr. Mnuchin.*

- We're not going to say the FOMC minutes lie, exactly, about what

Diffusion indices of FOMC participants Summary of Economic Projections



Source: Federal Reserve, TrendMacro calculations

Update to strategic view

US FED: Yesterday's minutes of the December FOMC offer an alternate history designed to make up for Powell's grievous communications mis-steps. The broken covenant with markets for new statement language indicating strong data-dependency is rationalized away with arguments about the precise meaning of "expects," "judges" and "some." The cavalier characterization of balance sheet normalization being "on auto-pilot" is cleansed with a robust discussion about potentially maintaining higher than usual reserves, and non-reserve assets. In remarks today, he repeated his new buzz-words "patient" and "flexible," and tried to show some humility in certain ways. He remains arrogant and tone deaf, bragging that he has "had lots of time to learn monetary economics." He muffed a critical question about balance sheet normalization, mouthing easy platitudes and showing utter ignorance of the innovative policy discussions about it that occurred just three weeks ago at the FOMC. He's on a leash now – but he's still an incompetent.

[Strategy dashboard]

was discussed at the December meeting (see "On the December FOMC" December 19, 2018). Let's just say they are slanted to accentuate the positive, which is to say, to make it seem that the FOMC actually did the right thing all along, but somehow the markets just misunderstood.

- *The minutes are always a forward-looking communications tool as much as they are an historical record. In this case, it's a good thing for Powell to sign off on this alternate history, because it points forward to a future in which he knows what he did wrong, and learned from the experience. At the same time, it lays bare just how terribly he mismanaged the meeting's statement and the subsequent press conference* (see "It's Not 'Quantitative Tightening' – It's Powell" December 20, 2018).
- As always following March, June, September and December FOMCs, the minutes revealed the suspected direction of forecast error, and the degree of uncertainty, in the participants' Summary of Economic Projections – the same exercise that produces the "dot plots."
- *We see clearly that, compared to the September meeting, the FOMC had become much more uncertain about its unemployment and GDP forecasts* (please see the charts on the first page). *For GDP, the rising uncertainty accompanied increased downside risk to the forecast.* Yet none of that caution was revealed in Powell's chirpy up-beat characterizations in the December post-meeting presser.
- In that presser, Powell also cavalierly dismissed questions about the possible tightening effect of balance sheet normalization by saying it was "on auto-pilot." But *yesterday's minutes reveal an extensive conversation by the committee on the possible long-term posture of the balance sheet, including several detailed scenarios involving maintaining unusually high levels of reserves, or encouraging the accretion of non-reserve assets, including from entities who normally don't deal directly with the Fed* (see "Data Insights: FOMC Minutes" January 9, 2019). Assuming this discussion actually took place, how simple it would have been for Powell to say so. The dismissive "auto-pilot" remark was something between a missed opportunity and a material mis-statement.
- And yesterday's minutes offer a groveling rationale for why December's post-meeting statement didn't contain more forceful language concerning the flexibility of the FOMC's rate hike expectations in light of possibly deteriorating incoming data. Such cautious language was promised in the minutes of the November meeting (see "Data Insights: FOMC Minutes" November 29, 2018) – so failing to follow through was not only a policy error (given recent weak data) but worse, a broken covenant with markets.
- Here's what yesterday's December minutes say about that – and as you read it, *remember that Powell is a lawyer, not an economist*:

  "With regard to the postmeeting statement, members agreed to modify the phrase 'the Committee expects that further gradual increases' to read 'the Committee judges that some further gradual increases.' The use of the word 'judges' in the revised phrase was

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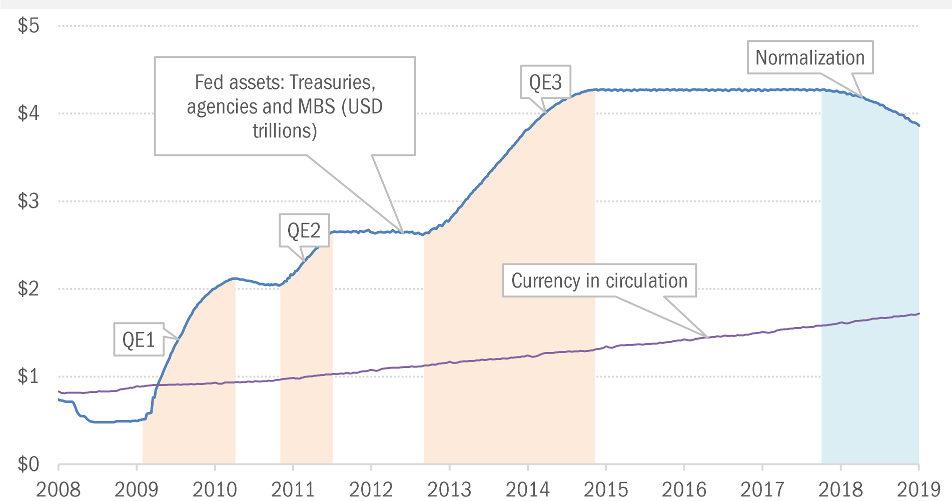
intended to better convey the data-dependency of the Committee's decisions regarding the future stance of policy; the reference to 'some' further gradual increases was viewed as helping indicate that, based on current information, the Committee judged that a relatively limited amount of additional tightening likely would be appropriate.

- Only a lawyer would dare tell you, with a straight face, that the verb "judges" is less decisive than the verb "expects" – or that the compound adjective "some further" really suggests any different number of rate hikes than the simple adjective "further."
- *But what's important here is that Powell and the whole FOMC – all of whom approve the minutes before they are made public – now understand they made a policy error, and broke a covenant with markets, and are doing whatever it takes – including re-writing history a bit – to make amends.*

Today's remarks at the Economics Club of Washington DC, again in the interview format, didn't add much new information. *But that's good. We just want to see Powell staying on the wagon, now that he's put himself into rehab.*

- Powell started out repeating the buzz-words from his remarks last Friday that got the most traction as symbolic of his new-found policy caution – "patient" and "flexible."
- At the outset he humbly joked that it's a lot different to be Fed chairman, as opposed to a mere Board governor – as a way of admitting he's been chastened, and is learning on the job (without losing his dignity, of course).
- *But he's still the most annoying person ever to be Fed chair – arrogant, tone-deaf, oblivious.* When asked what it was like to be a non-economist in charge of the Fed, following MIT-credentialed Bernanke and Yale-credentialed Yellen, he bragged, "I've had lots

Fed quantitative easing: accumulation and normalization USD trillions



Source: Federal Reserve Board, TrendMacro calculations of time to learn monetary economics." The live audience was kind enough not to laugh.

- *But his ignorance was on display, unfortunately, when his interlocutor asked him at what level of normalization the Fed's balance sheet would be sufficient for the efficient conduct of monetary policy.* Without a word about the sophisticated policy discussion from the FOMC, to which we alluded at the outset, he said, "That will depend on the public's appetite for our liabilities. For example, there's a great appetite for currency, which we treat as a liability."
- He went on to note that currency in circulation was below $1 trillion before any of the quantitative easing program began, and is now "close to" $2 trillion (please see the chart on the previous page). A natural implication is that he sees some future then-current level of currency in circulation as a target for the level of the balance sheet. In fact, currency in circulation is well below $2 trillion (it's about $1.71 trillion), and at historical rates it won't grow to $2 trillion for 5-plus years. At the present rate of maturity-driven run-off, the balance sheet would converge with currency in circulation at about that level, in about that time-frame.
- That's not necessarily the wrong level for the balance sheet to settle at – indeed, it's probably the canonical norm that anyone casually acquainted with monetary economics would grab first as the default outcome. *But the Fed chair is supposed to think more deeply than the default answer – especially when the market has demonstrated its intense concern with this issue (the stock market visibly ticked down at this moment in the interview). And all the more so when the FOMC just three weeks ago conducted a thoroughgoing discussion of the matter, in which novel configurations reflecting the new needs of today's economy were adduced. But no. Powell just blathered the easy answer – because, in reality, he hasn't really "had lots of time to learn monetary economics."*

The good news in all this is that Powell is now on a very short leash. In today's interview he mentioned, indeed, that he has breakfast every week with Treasury Secretary Steven Mnuchin (the man who holds the leash). The bad news is that he's still Jerome Powell, a lawyer and politico who finds himself running the most important financial institution in the world. We do hope that the deal we're sure he has cut with the administration involves, after some dignified amount of time has passed, his graceful resignation so that he can "spend more time with his family" or some such.

Bottom line

Yesterday's minutes of the December FOMC offer an alternate history designed to make up for Powell's grievous communications mis-steps. The broken covenant with markets for new statement language indicating strong data-dependency is rationalized away with arguments about the precise meaning of "expects," "judges" and "some." The cavalier characterization of balance sheet normalization being "on auto-pilot" is cleansed with a robust discussion about potentially maintaining higher than usual reserves, and non-reserve assets. In remarks today, he repeated his new buzz-words “patient” and “flexible,” and tried to show some humility in certain ways. He remains arrogant and tone deaf, bragging that he has “had lots of time to learn monetary economics.” He muffed a critical question about balance sheet normalization, mouthing easy platitudes and showing utter ignorance of the innovative policy discussions about it that occurred just three weeks ago at the FOMC. He’s on a leash now – but he’s still an incompetent.