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On Powell's Debut at Jackson Hole

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A clarion call for humility, caution and skepticism from our non-economist Fed chair.

The media Fed-watcher industry tried its best to make you expect that today's Jackson Hole keynote by new chair Jerome Powell would be a market-moving sensation – a cage-match between the Phillips Curve and the yield curve – a rousing cry of independence in the face of President Trump's dovish interference – or a call for bold policy action, not caution, in the face of uncertain economic indicators. *Thankfully it was none of that. Powell's keynote this morning is by far the best public statement he's ever made in both form and substance. It is a reasoned call for humility and agnosticism by monetary policy-makers in an ever-changing world of uncertainty, and gradualism in the face of that uncertainty until and unless an obvious emergency emerges.*

- *Good job, Jay! We didn't think you had it in you.*
- *Maybe this healthy dose of skepticism is the pay-off for having a non-economist at the helm of the Fed for the first time since 1979.*
- *This should go a long way to relieving lingering fears that the Powell Fed is a hatchery of GOP hawkishness, which in turn should encourage healthier inflation expectations, which in turn should boost the 10-year Treasury yield, which in turn should keep the yield-curve from inverting.*
- *The bond market's initial minor reaction to Powell – a 3 bp pull-back in the 10-year yield – is the typical mistaken algo response to a dovish message. From the starting point of today's still-low yields and inflation expectations, dovishness logically points to nothing but higher yields.*

We're going to avert our eyes from politicized narratives that suggest the absence from Jackson Hole this year of the European Central Bank's Mario Draghi and the Bank of Japan's Haruhiko Kuroda represents some kind of diminution of America's leadership role in the world, under Trump. If their absence suggests anything at all other than that they had competing vacation plans, perhaps it suggests that they expected it would be uninteresting to attend *a symposium at which they would be told by the Fed chair that all their cherished economic nostrums are basically worthless.*

- Yet surely they actually *are* worthless, because they depend on the observation of the unobservable – as Powell points out – critically,

Update to strategic view

US FED, US BONDS: Powell disappointed Fed-watchers expecting a bold and hawkish policy message in his first speech at Jackson Hole, perhaps in part to assert independence in the face of dovish interference from Trump. But he surprised and delighted us with his best-ever public statement, a clarion call for humility, skepticism and gradualism in policy. This is a dovish message that should improve inflation expectations and lead to higher 10-year yields, and a steeper curve. The longer-term problem is Powell leaves the markets without much of an idea of the basis, if any, on which he will make future policy decisions. The default would seem to be some form of inflation-targeting.

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in the case of the natural rate of unemployment (u* or u-star) and the natural interest rate (r* or r-star). *He likens these to celestial stars used for navigation, but notes that unlike the celestial stars, these move all the time. He could have gone further, as we would, and say that they not only move, but are unobservable anyway.*

- Our stronger version of this theme was hinted at in the minutes of the August FOMC meeting, released Wednesday (see "Data Insights: FOMC Minutes" August 22, 2018):

  "Many participants noted that…the statement's language that "the stance of monetary policy remains accommodative" would, at some point fairly soon, no longer be appropriate. …A number of participants emphasized the considerable uncertainty in estimates of the neutral rate of interest, stemming from sources such as fiscal policy and large-scale asset purchase programs. Against this background, continuing to provide an explicit assessment of the federal funds rate relative to its neutral level could convey a false sense of precision."

- This verges on advancing the skeptical to the nihilistic. It is saying, in essence, that the Fed has no way of knowing at any point in time whether its policy stance is accommodative, neutral or tight.
- *This points to a downside in Powell's agnosticism – markets are going to have a hard time figuring out on what basis he will make policy decisions. This is something he has yet to articulate, and it will be a real challenge for him.*
- There is one way – the way put forward 120 years ago by economist Knut Wicksell, and resurrected for the consideration of policy-makers two years ago in a speech by then-vice chair Stanley Fischer. *You simply observe the rate of inflation. If it's above-target, you are too accommodative. If it's below target, you are too tight.*
- After all – the one thing a central bank knows for sure is what its inflation-target is – π* or pi-star – which Powell this morning mistakenly lumped in with his other ever-shifting stars. To be sure, a central bank doesn't know if its inflation-target is the ideal one. And it doesn't necessarily know how to measure inflation to begin with. But if the target and the measurement are based on the same metrics, you're half-way home.
- The only problem is that the Fed's mandate is not just to deliver stable prices, but also maximum employment. Former chair and inflation-targeting advocate Ben Bernanke had a finesse for that – articulated in 2006 in his inaugural speech as chair – the view that the inflation rate is the one thing a central bank actually has a chance of controlling effectively, and if it succeeds, it will have done the best it can to set the stage for maximum employment.

Bottom line

Powell disappointed Fed-watchers expecting a bold and hawkish policy message in his first speech at Jackson Hole, perhaps in part to assert independence in the face of dovish interference from Trump. But he surprised and delighted us with his best-ever public statement, a clarion call for humility, skepticism and gradualism in policy. This is a dovish message that should improve inflation expectations and lead to higher 10-year yields, and a steeper curve. The longer-term problem is Powell leaves the markets without much of an idea of the basis, if any, on which he will make future policy decisions. The default would seem to be some form of inflation-targeting.