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TRENDMACRO LIVE!

On Powell at Brookings

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Donald Luskin

The chair made two small but important (and dovish) concessions to reality.

Fed Chair Jerome Powell's speech today at the Brookings Institution was mostly just a repetition of his message at the November FOMC (see "On the November FOMC" November 2, 2022). He repeated the new emphasis on the lag between monetary policy and economic outcomes driving the need to slow down the hiking cycle (as reflected in the *written* November FOMC statement). But he also repeated the idea that the terminal rate in this cycle will likely be higher than expected, and last longer (as reflected in the *spoken* November FOMC press conference).

- We will point out two features of today's remarks that do at least hint at a change in his thinking.
- First: in his recapitulation of the lag concept, he said today "…the full effects of our rapid tightening so far are yet to be felt." *In other words, he does not attribute the rollover in virtually every inflation measure (headline and core CPI peaked in June; CPI ex-OER peaked in February; and core CPI peaked in September) to Fed policy. Implicitly, then, it has to be that he attributes it to something else, whether or not he knows what that something else is*. We, of course, know it is the rollover in the growth rate of the money supply as we move further and further in time from pandemic-era stimulus packages.
- Second: he made a detailed argument that owners' equivalent rent of residences is a very sticky inflation component, because leases turn over only glacially. He went on to highlight that contemporaneous measures of the growth of *new lease prices* has been falling sharply. *This validates that he is willing to look at inflation measures that exclude OER, just as we do. In other words, he wants to detect the signal in inflation data and throw out the noise – the most volatile and most sticky components*. Measured that way, again, core CPI ex-OER peaked all the way back in February. Our model points to that measure meeting the Fed's benchmark next May, and passing below 1% thirteen months from now.

We can't expect a pivot. But in the race between the tortoise (inflation moderating) and the hare (the Fed hiking to cause a recession), this speech points toward confirmation of our outlook that the hare has slowed himself down, and that the hare is willing to look at measures of inflation that make the tortoise seem to be moving a little faster. All to the good.

Update to strategic view

FEDERAL RESERVE: Powell repeated his key talking points from the November FOMC, about the need to slow down the hiking cycle due to lags, and the possibility of a higher-for-longer peak funds rate. There were two important subtleties. First, Powell posited that effects of the Fed's aggressive hiking have not been felt yet. Because all measures of inflation have peaked, he must now ask why they have done so if it's not his policy. Second, he acknowledged the distortive effects of sticky OER in inflation statistics, and noted that new-lease measures are pointing to a rollover in this key category. This positions him to do what we do – filter the noise from the signal in inflation by taking out the most volatile and the most sticky components. Core CPI ex-OER peaked all the way back in February, and our model forecasts it will hit the Fed's target next May.

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