Probing Powell's Patience: Retrospect and Prospect

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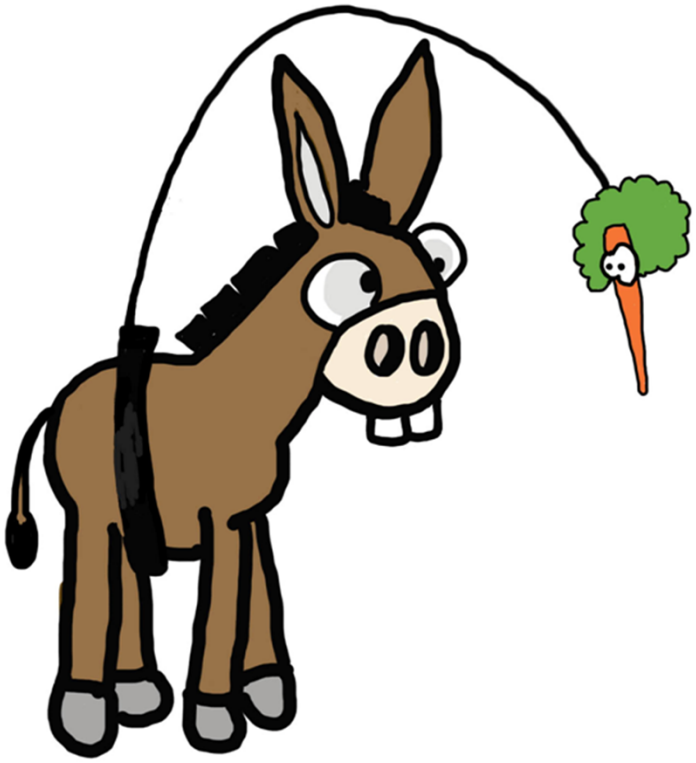

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The Risk of Mistaking Cyclical for Structural

The long-term decline in advanced economy trend growth, driven by demographics and productivity, **isn't over, despite wishful thinking to the contrary. But when that mistaken belief drives** policy – in particular the timing of **the big shift from quantitative easing to quantitative tightening** on a global scale – **monetary policy goes on a collision course with the economic cycle.** If policy doesn't change course, that raises the risk of a new recession (April 2018).

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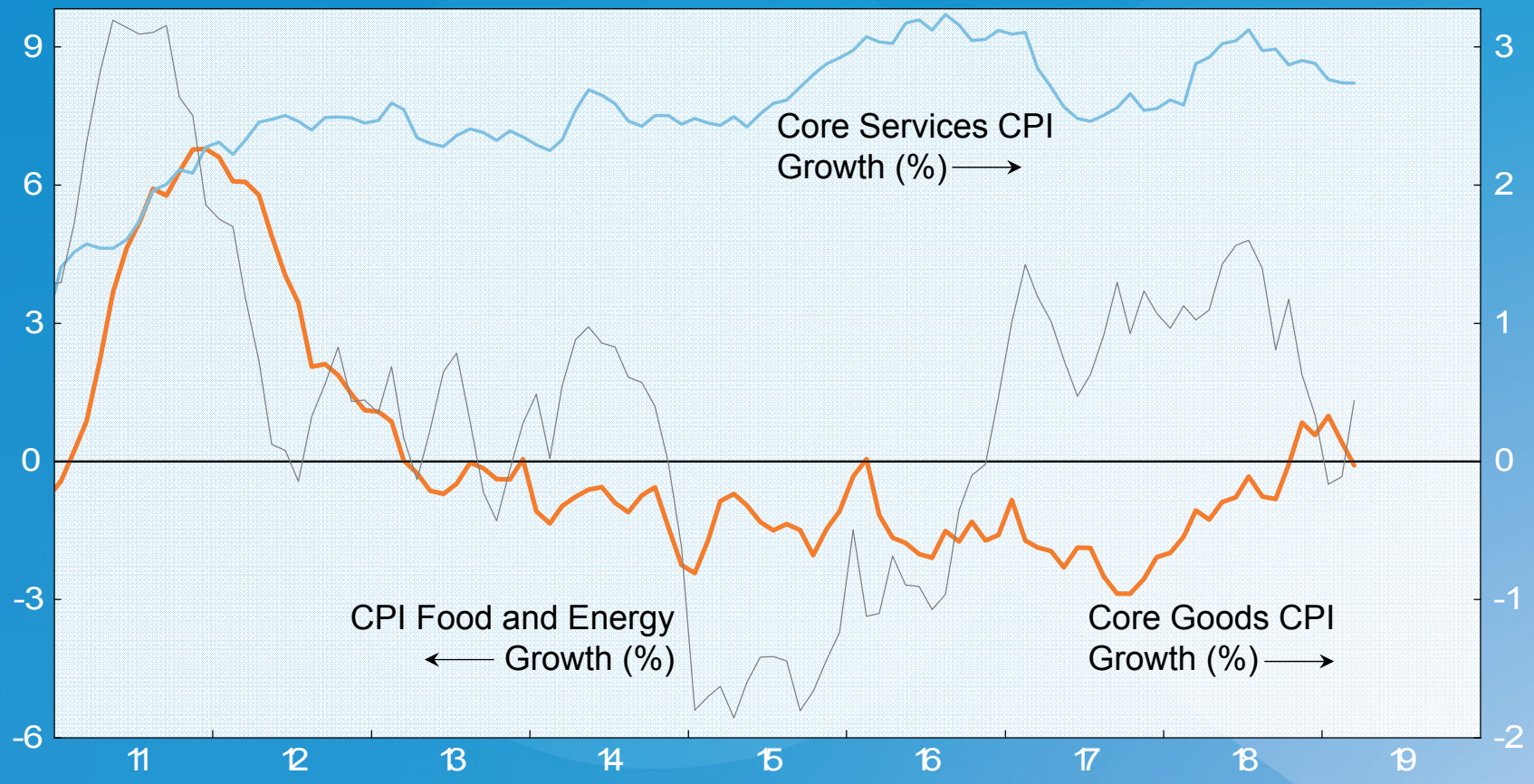
Components of U.S. CPI Inflation



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Greenspan's "Hunch"

"**In mid-1996**, the unemployment rate was below the natural rate … and many FOMC participants … were forecasting growth above the economy's potential. **Sentiment was building … to raise the federal funds rate to head off the risk of rising inflation. But Chairman Greenspan had a hunch that** the United States was experiencing the wonders of a 'new economy' in which **improved productivity growth would allow faster output growth and lower unemployment, without serious inflation risks. Greenspan argued that the FOMC should hold off on rate increases**. …"

– Jerome H. Powell, Jackson Hole, WY, August 24, 2018

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Greenspan's Fortitude

"Over the next two years, **thanks to his considerable fortitude, Greenspan prevailed**. … Starting in 1996, **the economy boomed and the unemployment rate fell, but, contrary to conventional wisdom** at the time, **inflation fell**. … Greenspan was also right that the potential growth rate had shifted up … accommodat[ing] the very strong growth that actually materialized …"

– Jerome H. Powell, Jackson Hole, WY, August 24, 2018

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Greenspan's Patience

"Under Chairman Greenspan's leadership, **the Committee converged on a risk-management strategy** that can be distilled into a simple request: **Let's wait one more meeting; if there are clearer signs of inflation, we will commence tightening. Meeting after meeting, the Committee held off** on rate increases while believing that signs of rising inflation would soon appear. **And meeting after meeting inflation gradually declined**."

– Jerome H. Powell, Jackson Hole, WY, August 24, 2018

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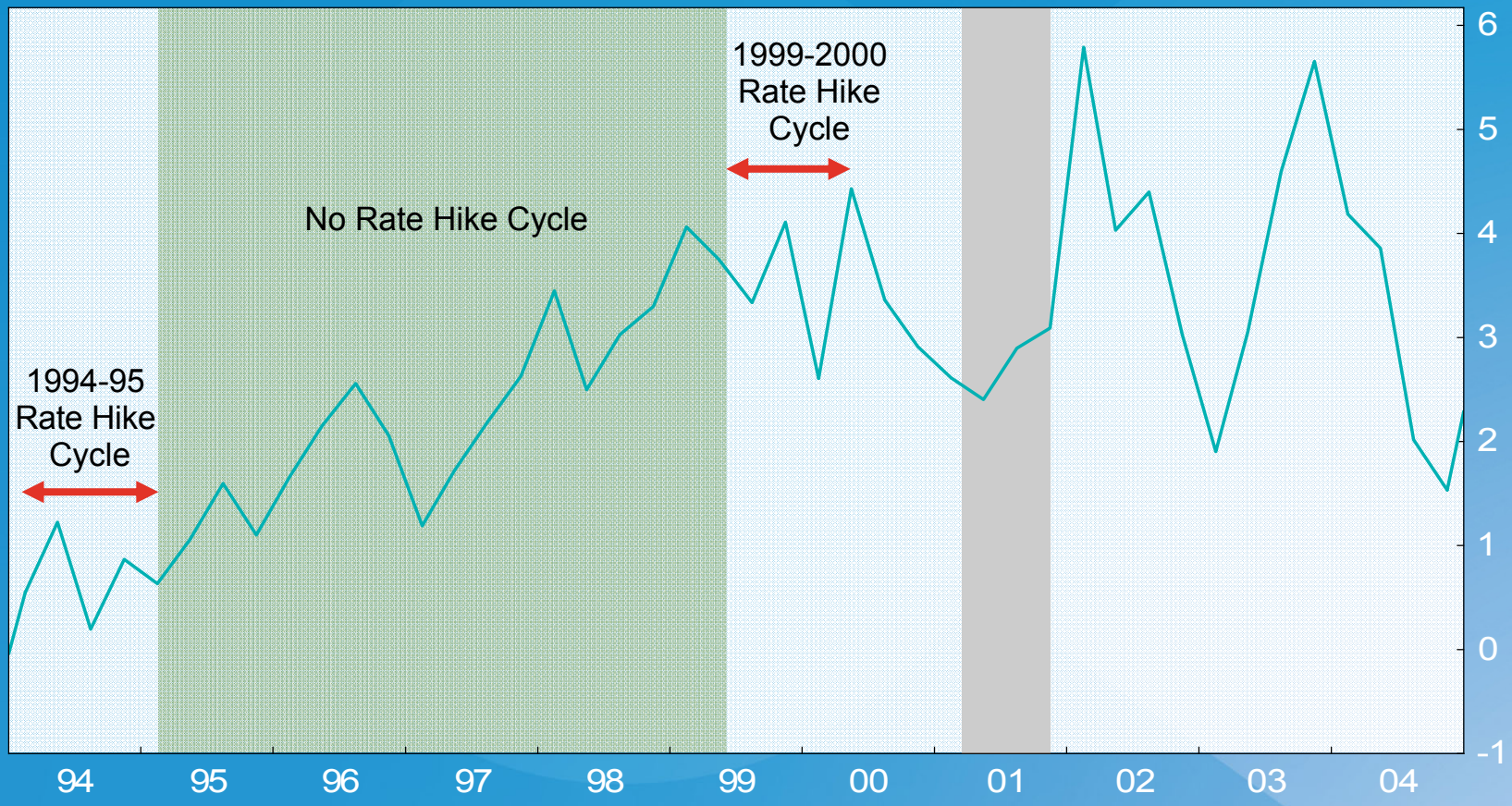
U.S. Productivity Growth (%)



Gray-shaded area represents U.S. business cycle recession.

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Greenspan's Disbelief in the Phillips Curve

"[T]he experience of the past three decades has demonstrated that what appears to be a tradeoff between unemployment and inflation is **quite ephemeral and misleading**."

– Alan Greenspan, Congressional testimony, February 22, 1994

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When to Act

On principle, I prefer **not to tighten monetary policy on the basis of strong output and employment growth or even a low unemployment rate**. I know that **we should not wait to see the "whites of inflation's eyes"** before acting, but I do think we might well **wait for some leading indicators of rising inflation before we act**.

– Robert McTeer, FOMC Meeting, July 2-3, 1996

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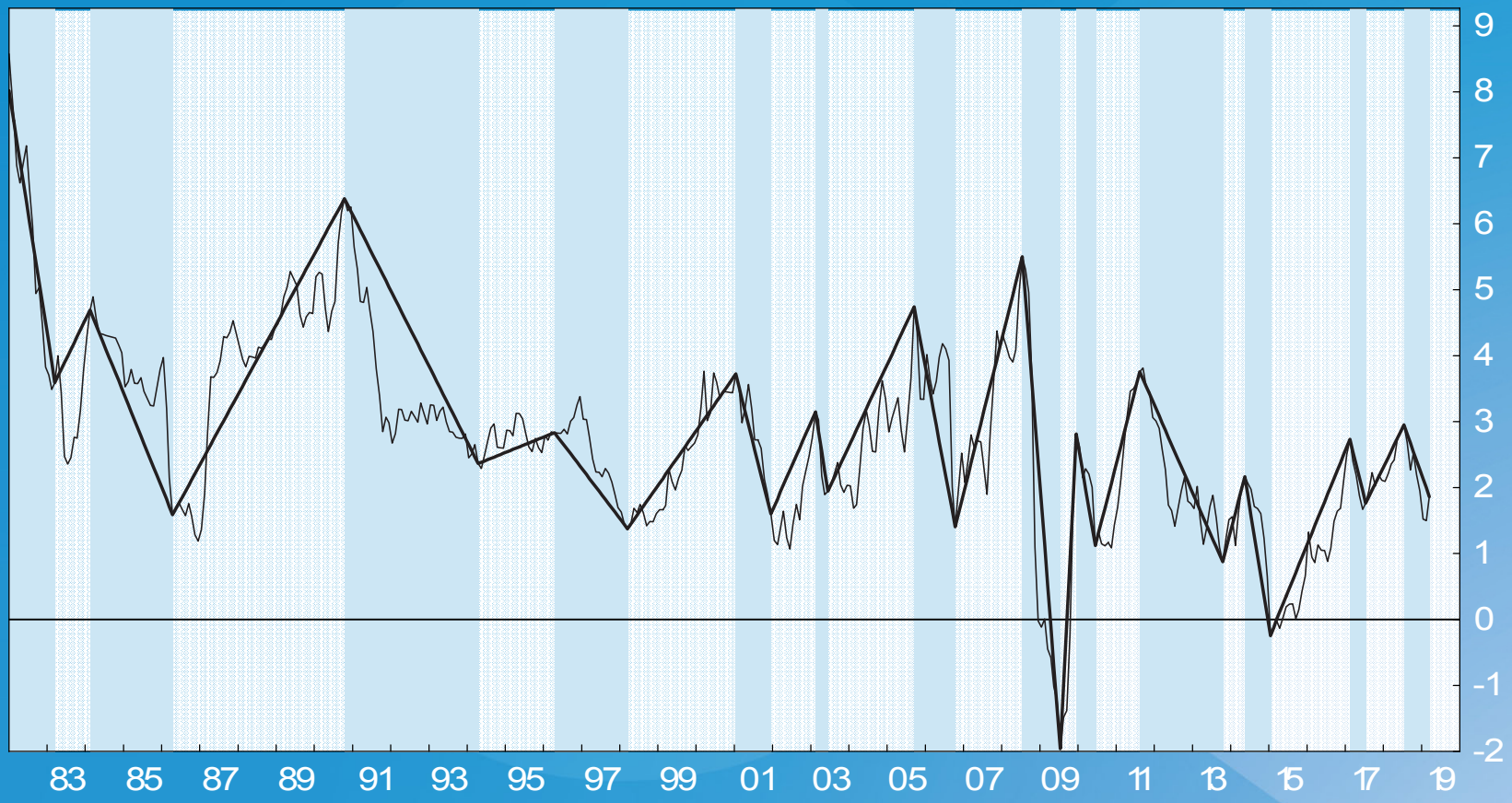
Inflation is Cyclical



Shaded areas represent U.S. inflation cycle downturns.

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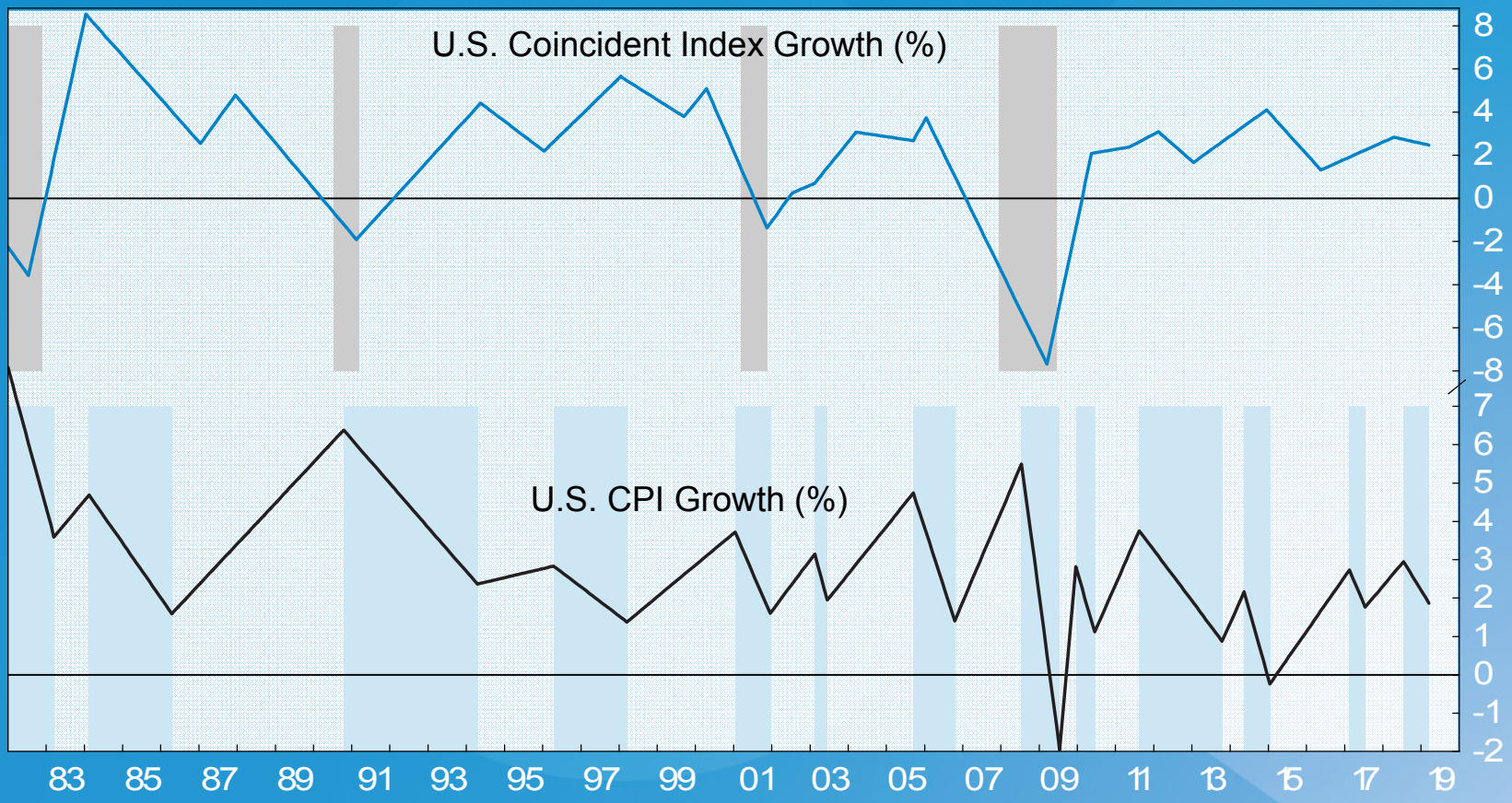
The Inflation Cycle is Not the Business Cycle



Gray-shaded areas represent U.S. business cycle recessions, and blue-shaded areas represent U.S. inflation cycle downturns.

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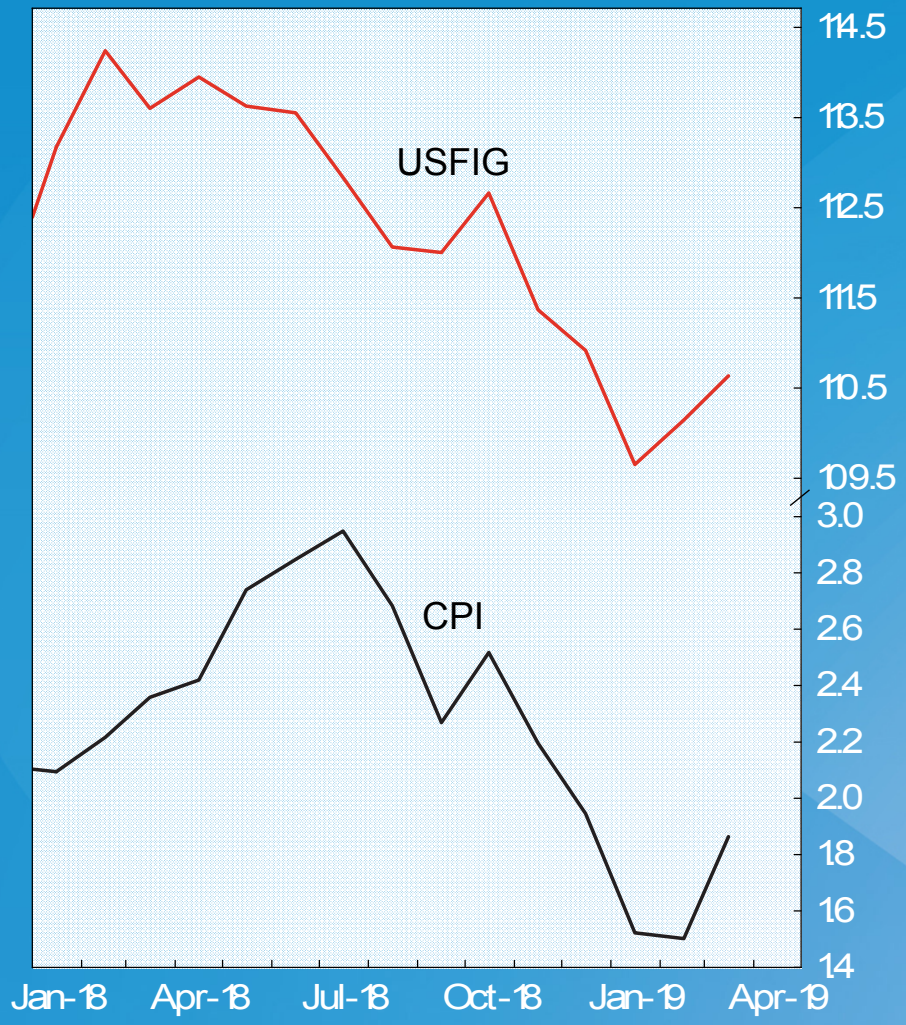
U.S. Future Inflation Gauge & CPI Growth (%)



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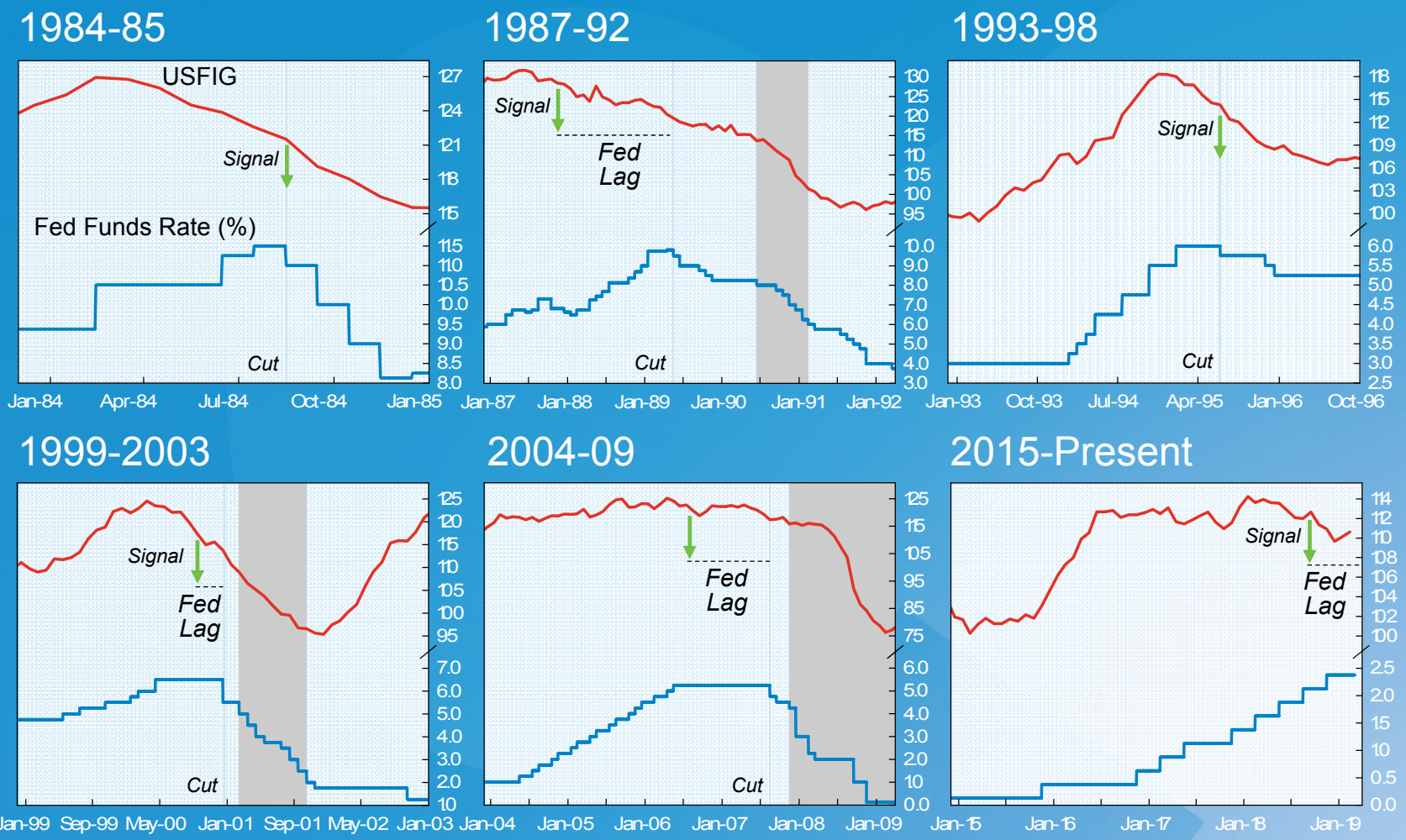
Inflation Downturn Signals and Rate Cuts



Shaded areas represent U.S. business cycle recessions.

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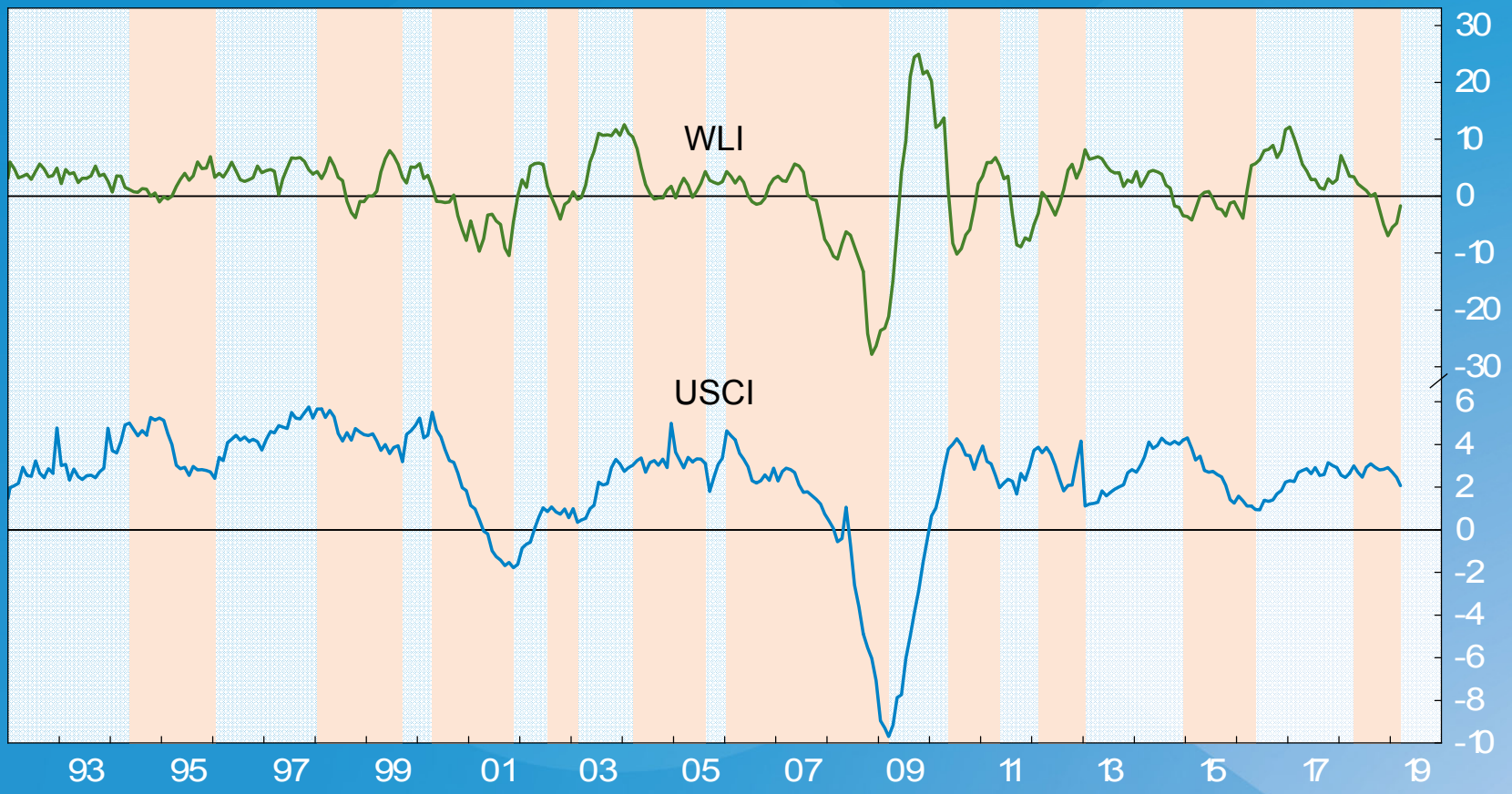
Indicators of U.S. Growth (%)



Shaded areas represent U.S. growth rate cycle downturns.

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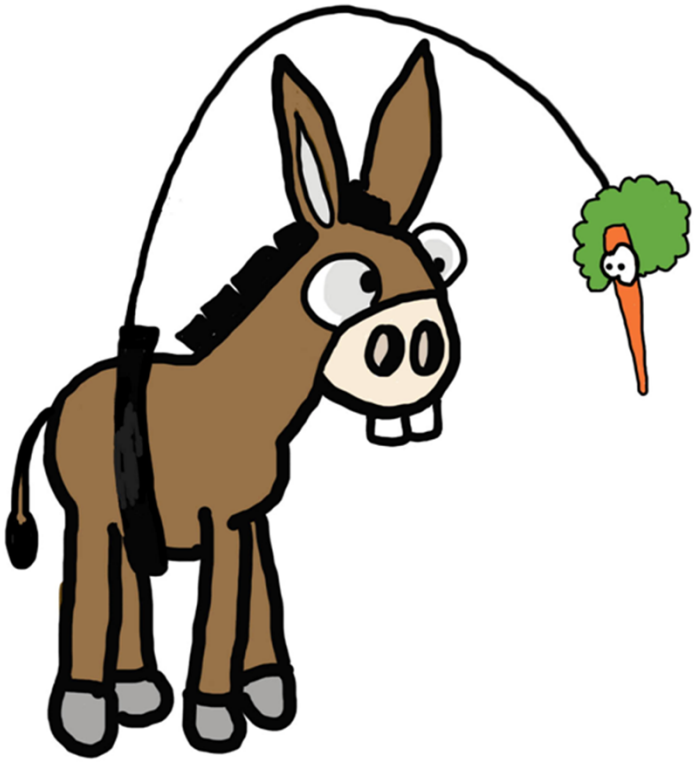

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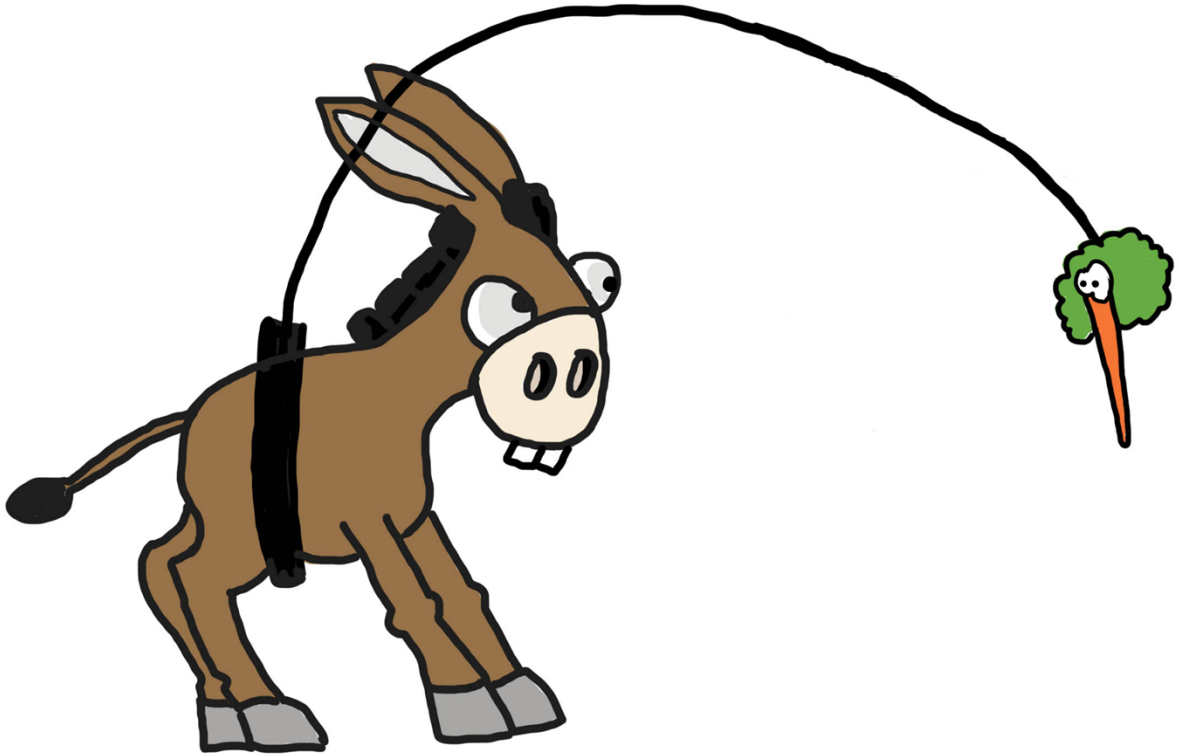

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In Conclusion

- If our leading indexes turn back down, there may be a recession later this year.
- If they enter a fresh cyclical upturn, along with the FIG, the Fed will find it hard to hold off on further rate hikes.
- In both scenarios, the inability to execute preemptive rate hike and rate cut cycles is a key danger.

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Thank you.

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