Powell Press Conference Notes
Wainwright Investment Counsel, LLC

November 2022

Powell's trip to the hardware store…. Tools, tools, tools

There has been a lot of hand wringing about the Federal Open Market Committee ("FOMC") starting to tighten monetary policy too late and, now, moving too far and too fast. Monetary tightening refers to the process of increasing short-term interest rates, in the US referred to as the Federal Funds Rate, therefore increasing the cost of borrowing and reducing its attractiveness. Monetary tightening is also accomplished by selling assets on the central bank's balance sheet. CEOs, pundits and politicians from Wall Street to Main Street are concerned that the delay in starting the tightening process and the current aggressive tightening increases the likelihood that the US economy will experience a meaningful recession in 2023. Even Chair Powell does not dispute this risk, but in defending the FOMC's current path, Powell makes the case for filling his tool box.

After the FOMC raised the Federal Funds Rate by 75 basis points, Chair Jerome Powell defended the FOMC's action in a November 2, 2022 press conference[1]. Powell anticipates that ongoing rate increases will be required, giving no indication as to a target terminal rate. However, Powell did state that *'we still have some ways to go',* reiterating that underlying economic conditions, though slowing are still strong.

Powell seems focused on managing his tool box

In this recent press conference, Powell used the term 'tools' eight times. This is in contrast to two times during the September 21, 2022 press conference. To be certain, Powell has more tools now than when the short-term rate was bouncing off zero. And with further increases, this tool box becomes more useful. What seems clear from his response is that Powell believes overtightening is far better than a middling approach.

> *"And trying to make good decisions from a risk management standpoint, remembering of course that if we were to over-tighten, we could then use our tools strongly to support the economy, whereas if we don't get inflation under control because we don't tighten enough, now we're in a situation where inflation will become entrenched and the costs, the employment costs in particular, will be much higher potentially. So, from a risk management standpoint, we want to be sure that we don't make the mistake of either failing to tighten enough, or loosening policy too soon." – Powell*

Powell argues that creating a tool box that is overstocked for stimulus is less risky than inflation becoming entrenched. This case can be made by referencing the FOMC's actions during the pandemic episode. In January 2020, the target rate was near 1.50%[2]. There was not much room to tighten, but there was some.

[1] Source: https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20221102.pdf.
[2] Source: https://fred.stlouisfed.org/series/FEDFUNDS.

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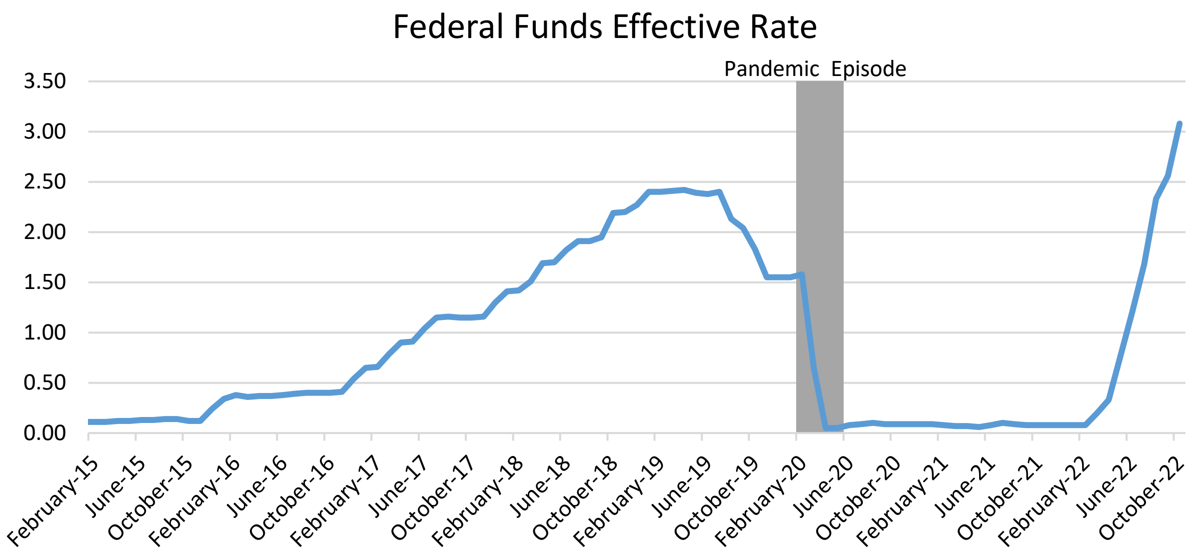
"… as we showed at the beginning of the pandemic episode, we can support economic activity strongly if that happens, if that's necessary. On the other hand, if you make the mistake in the other direction, and you let this drag on, then it's a year or two down the road and you're realizing inflation behaving the way it can, you're realizing you didn't actually get it, you have to go back in." – Powell



Reporters challenged Powell by stating that things are different now than at the onset of the pandemic, which started as a demand crunch. Now, things are reversed: supply is an issue due to outsized demand. Powell reiterated that even though many of the supply chain issues are starting to resolve, there is a ways to go. While acknowledging that raising rates has little influence on the supply side, his tools are well suited to affect the demand side.

"We've got an imbalance between demand and supply which you see in many parts of the economy. So our tools are well-suited to work on that problem, and that's what we're doing." – Powell

Powell agrees the economy's pathway to a soft landing is narrowing and acknowledges the risk of a recession. Yet, Powell and the FOMC seem to have confidence that the path they are on is more prudent from a risk management standpoint. Going forward, the short-term rate increases may not be as aggressive, but they will continue until the Fed believes it has all the tools needed to bring the inflation rate back to a range of 2 to 3 percent. The FOMC argues having too many tools is far more important that having just enough.

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