The Daily Dish

# The Fed and Inflation Dynamics

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***Eakinomics: The Fed and Inflation Dynamics***

The failure of inflation to rise to the Federal Reserve's target of roughly 2 percent (annually) has been the source of considerable comment and debate. Fed Chair Janet Yellen has called it a mystery and typically attributes the phenomenon to a series of one-time factors. Despite these downdrafts the Fed has moved steadily toward normalizing monetary policy, albeit at a moderate pace. It has announced its plan to sell off the large stock of Treasury and mortgage-backed securities accumulated during the crisis, and quantitative easing and is on track for another rate increase at the Fed's December meeting (today's strong Institute for Supply Management report seemingly sealed that deal).

So it was a bit of news when Neel Kashkari, President of the Minneapolis Federal Reserve Bank, announced that the problem is the Fed itself. As reported by Reuters, "'The FOMC's policy to remove monetary accommodation over the past few years is likely an important factor driving inflation expectations lower,' Minneapolis Fed President Neel Kashkari wrote in an essay on the bank's website, referring to the central bank's Federal Open Market Committee, which sets U.S. interest rates. 'My preference would be not to raise rates again until we actually hit 2 percent core PCE inflation on a 12-month basis, unless we have seen a large drop in the headline unemployment rate signaling that we have used up remaining labor market slack, or a surprise increase in inflation expectations.'"

In effect, Kashkari is arguing that the Fed is simply wrong. It is tightening too soon and/or too fast, that markets know and agree with this, and that lower inflation is being priced in to every contract in the economy — thereby providing a self-fulfilling lower rate of inflation. It is certainly a fear that some member of the Federal Open Market Committee (FOMC — the Fed's policymaking body) have had to contemplate. But there is also important evidence to the contrary. Services inflation has steadily met the Fed's 2 percent target throughout the recovery and has shown no weakness as the Fed began raising rates. If Kashkari were right, there would be a uniform negative impact on all types of inflation.

There is no evidence that the Fed is harming the evolution of either growth or inflation. It should maintain its course.