The Daily Dish

Policy, Politics, and the Fed

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Although hardly the biggest news story yesterday, Federal Reserve Chairman Powell made an appearance at the Cato Institute's star-studded (measured on the Eakinomics scale) 40th Annual Monetary Conference. In large part, the goal is to *not* make news. Despite the question-and-answer format, Powell managed to effectively re-deliver the key messages of his Jackson Hole speech:

- The Fed accepts responsibility for returning inflation to its 2 percent target, regardless of the roots of the inflation or shifts in other aspects of the economic environment.
- To do so will require rates to be held higher for a sustained time.
- These anti-inflation efforts will mean some pain to households and firms, but to fail to control inflation would mean even greater economic trauma.
- It is important to constrain inflation expectations (per Bloomberg): "The longer that inflation remains well above target the greater the concern that the public will start to just naturally incorporate higher inflation into its economic decision making. Our job is to make sure that doesn't happen."
- Finally, to ease prematurely would be a bigger error than moving too quickly (also per Bloomberg): "My colleagues and I are strongly committed to this project and will keep at it." (The economic literati will notice the allusion to Paul Volcker's book "Keeping At It: The Quest for Sound Money and Good Government.")

This stance does not sit well with many in the political sphere. *The Hill* noted that Senator Warren "warned in a Wall Street Journal op-ed Sunday that 'the Fed risks triggering a devastating recession' by raising interest rates too far too fast to fight inflation." It also quoted her as saying, ''There's a reason the Fed acts independently in our system but it's critical that Jerome Powell think about the implications of knocking millions of people out of work."

Others voiced similar concerns. "'Interest rates are a multi-edged sword, they have multiple impacts and [can be] very damaging on certain elements of our economy,' said Sen. Ben Cardin (D-Md.). 'We've had some discussions about affordable housing. It absolutely directly impacts affordable housing, housing stock …. When you raise interest rates it has a major negative impact, certainly on affordable housing.'"

These concerns are not wrong. Powell and the Fed are acutely aware that their actions will bring "pain" and have openly worried about the risk of recession. It is just that once the inflation has been created (in part by the actions of the very people who are complaining), there is no *good* choice: Either live with the inflation or live with the consequences of the steps necessary to get it back under control.

Finally, these harsh realities are independent of the ultimate origins of inflation. In particular, suppose that its genesis was 100 percent due to supply chain issues. That does not change the fact that the choice is between high inflation and higher interest rates. Restraining the growth of demand is the only lever that policy can exert on the scale needed in the time frame desired. Any supply side policy will be much too small and take much too long to be effective.

This back and forth on policy and politics will soon feel like Groundhog Day. Don’t lose sight of the simple realities behind it.