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Powell parries inflation questions

Fed chair dispels notion of possible rate cut

by Darrell Delamaide in Washington

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Federal Reserve Chair Jay Powell did not equivocate at the press conference that capped the two-day meeting of the Federal Open Market Committee ending 1 May as policy-makers, expectedly, left interest rates unchanged. 'Our baseline view remains that, with a strong job market and continued growth, inflation will return to 2% over time and then be roughly symmetric around our longer-term objective,' he said.

Journalists tried and tried again to get him to budge from that stubborn point of view. They noted inflation, as measured by the Fed's preferred personal consumption expenditure index, had rarely topped 2% in years. Ominously, the personal consumption expenditures index released that same week showed a dip in overall inflation to 1.5% over 12 months, and even to 1.6% for core inflation, which eliminates the impact of low energy prices.

The new dip, Powell said, was due to 'transitory factors'. Only when low inflation became 'persistent' would the Fed feel the need to act. This naturally led to questions about when low inflation should be deemed persistent. Those brought vague answers about how inflation must 'run close to and sustainably for a sustainable period of time and symmetrically around 2%' or otherwise inflation expectations would be permanently lowered and that the 2% target would lose credibility.

The frustration of the journalists was due, perhaps, to their thinking that time is here and that the 2% target has lost its credibility. Their question for Powell was that if he doesn't agree, what does he think it would take for low inflation to be called persistent. The Fed chair repeatedly said the committee is 'strongly committed' to its 2% inflation objective, as if reiterating the commitment itself would make people believe it.

At the press conference, Powell was at pains to dispel the notion gaining ground in markets that the Fed was contemplating a cut in rates. His point was that the FOMC doesn't see a need for an adjustment in either direction. Low inflation rates don't fit into that scenario – unless of course they are transient and not persistent. For Powell, it is simply a matter of faith.

Some of the Fed policy-makers expressed a more nuanced view in the run-up to the FOMC meeting. 'I definitely think that inflation running too low is justification for deciding that our setting of monetary policy is actually restrictive and we need to make an adjustment downwards in the funds rate,' Chicago Fed Chief Charles Evans said. For him, a 1.5% core inflation over a longer period would be a concern. 'I'd be very nervous about that,' he said. Core inflation in the first quarter, as measured by the PCE index, was 1.8% in January, 1.7% in February, and 1.6% in March over the year-ago month.

Fed Vice-Chair Richard Clarida suggested it would not take the prospect of recession for the panel to consider a rate cut. 'If you look back at Fed history, there have been times when the Fed in the '90s took out some insurance cuts,' he said, referring to a series of three rate cuts starting in 1995 after the Fed had raised rates to 6% but pivoted to cuts when inflation rose less than expected.

Small wonder that some market participants speculate that a rate cut is conceivable in view of sluggish inflation. The minutes of this last meeting will be closely scrutinised when they are released three weeks afterwards to see to what extent alternative scenarios were discussed.

One reporter did bring up the 1995 cuts at Powell's press conference, and the notion of insurance cuts, but only got a reiteration of the committee being comfortable with its current policy stance for his pains.

Boston Fed Chief Eric Rosengren discussed one alternative policy – namely, setting a target range for inflation rather than a 'symmetric' 2%. 'In hindsight, it appears that the 2% inflation goal has essentially acted more like a ceiling, rather than a symmetric target around which inflation fluctuates,' he said in mid-April.

While Powell pretended that inflation had consistently hovered near the 2% target, Rosengren noted that it has remained steadfastly below. 'Our below-2% average inflation rate is not an artefact of particularly bad outcomes during the Great Recession, or any other period,' he said. 'In fact, we have averaged below 2%

inflation, for both core and total PCE inflation measures, whether looking over the past five, 10, 15 or 20 years.'

His answer is to accept inflation below 2% in a recession but to allow it float above 2% when the economy recovers.

Aside from risks inherent in deflation, the main concern for policy-makers is that they will not have much room to manoeuvre when recession finally does come.

Rosengren calls this 'monetary policy space', and that is the point of his alternative. He expressed the hope that his suggestion could factor into the review the Fed is conducting this year of its monetary policy toolkit.

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