The 'New Fed' and the Outlook for 2022

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Key takeaways from Fed policy in 2022

- With unemployment below 4%, the Fed will soon agree the U.S. is at maximum employment.

- The Fed will continue *to remove its support* to demand, tapering, modest increases in the federal funds rate, and the start of a reduction in the balance sheet.

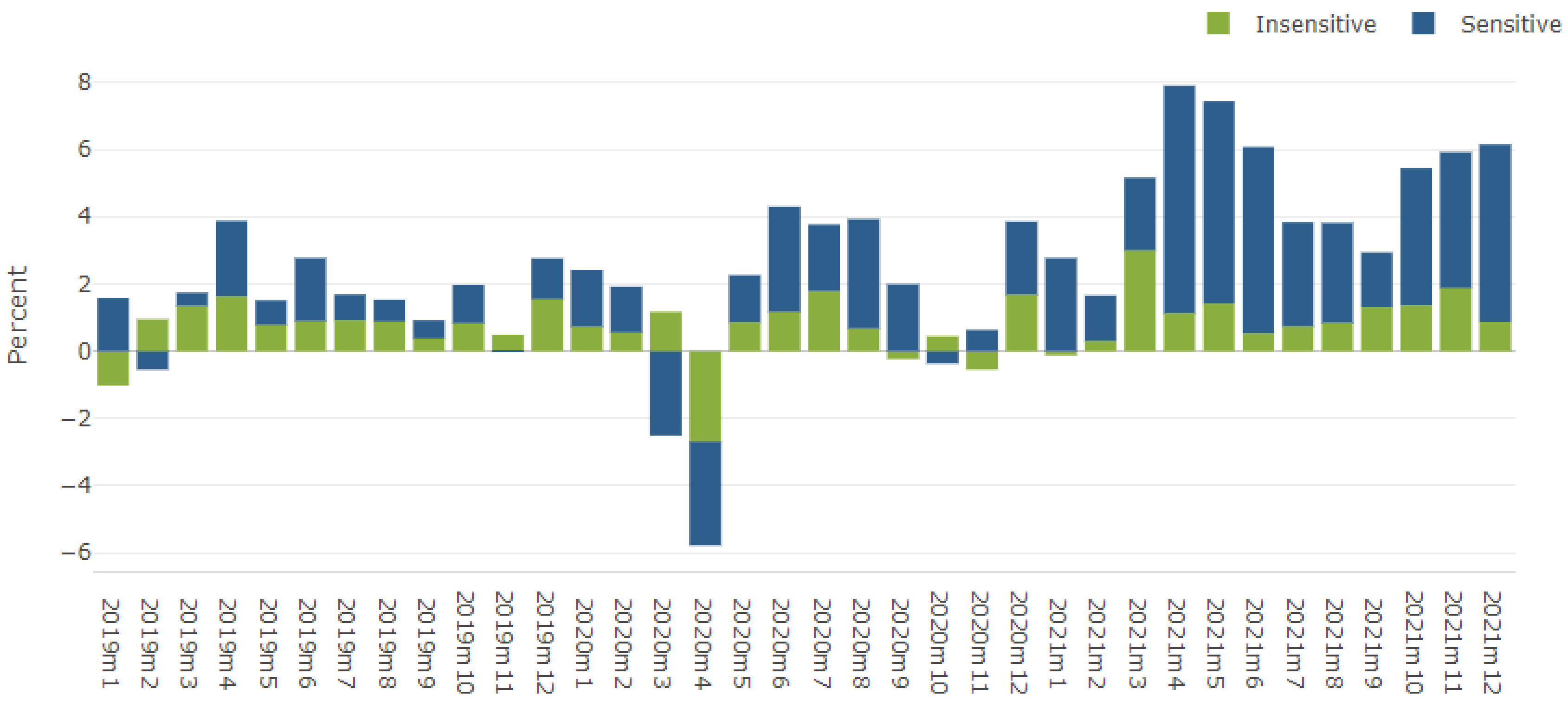
- Incoming *data*—on the pandemic and the economy--will drive the timing and degree of tightening.

THE ‘NEW FED’:

Actions consistent with the new framework

The Fed is on track, *not* 'behind the curve' on inflation.

Covid-sensitive spending driving higher month-over-month inflation, excluding food and energy



Source: Federal Reserve Bank of San Francisco.

- *Average* inflation is the goal, elevated, largely due to Covid.
- Allowing above-target inflation when shortfalls in employment.

How to fix inflation now? END THE PANDEMIC.

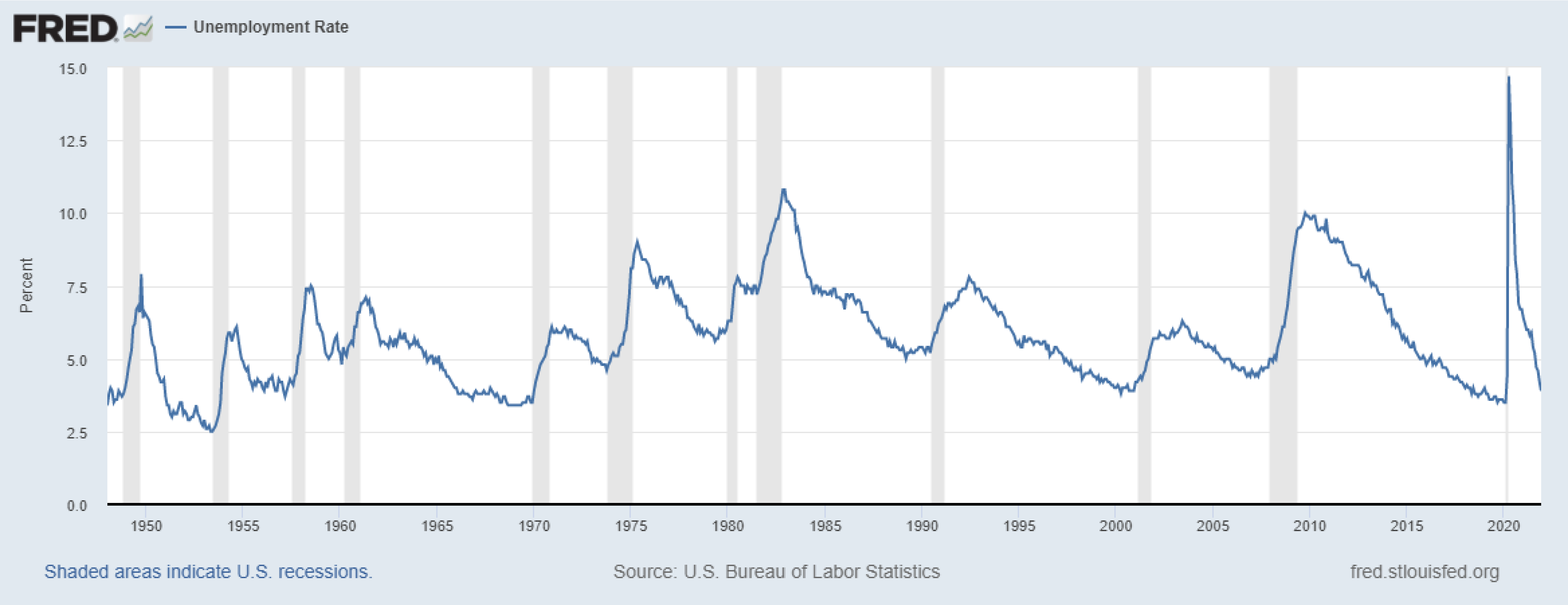
Federal Reserve Chair Jerome H. Powell agrees. Asked at his reconfirmation hearing by Sen. Catherine Cortez Masto (D-Nev.) if he believes containing the pandemic is the best way to fight inflation,

Powell said: “I do. And imagine a world in which we no longer have to deal with the pandemic. … We would quickly see the supply-side problems alleviate. We’d probably see significantly more labor supply. So, these issues are still related to the pandemic.”

Source: Claudia Sahm, *Washington Post.*

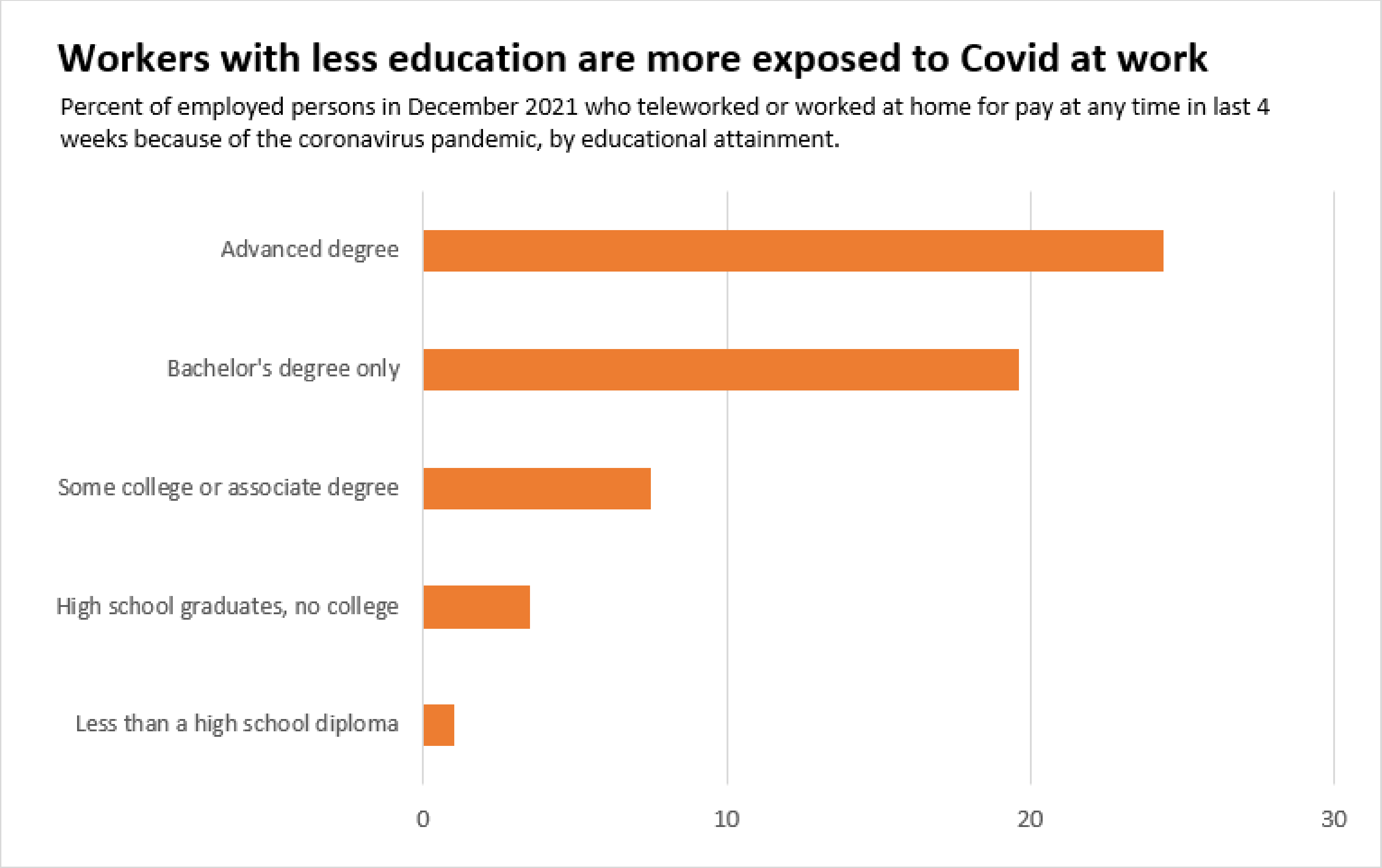
- Covid and our lacking response to it is the root of all evil.
- Eleven other ideas from experts. None are the Fed.

Monetary and fiscal policy led to huge drop in unemployment



- Largest drop in generations. Higher prices are bad, no paycheck is a disaster.
- Big question: when do mothers and older workers come back to work?

Covid remains a major headwind to the economic recovery



Source: Bureau of Labor Statistics. Chart by Claudia Sahm.

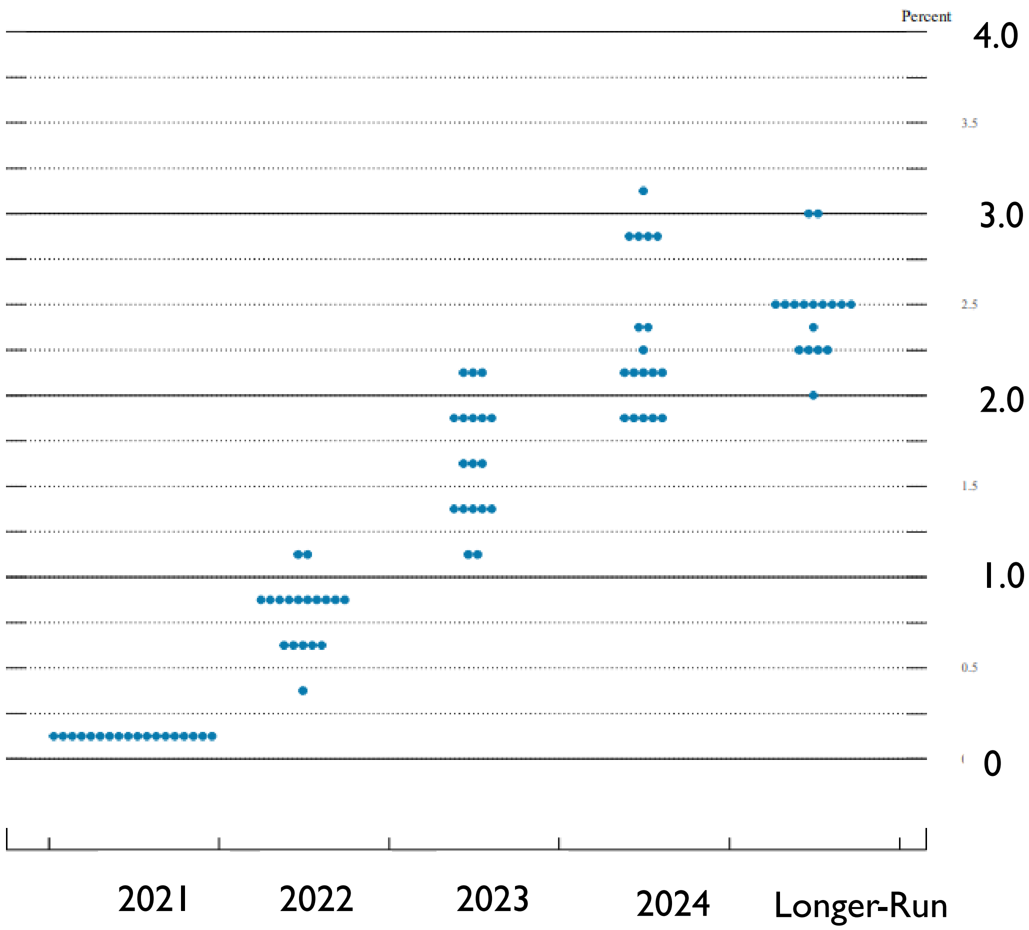
- Pandemic is not over and continues to impede an *even* recovery.
- Public health from the White House / CDC is an absolute mess.

MONETARY POLICY IN 2022:

Pushing up demand less and less

Fed officials expect a modest increase in the federal funds rate

FOMC participants' views on appropriate monetary policy in Dec. 2021



The latest data show very close to Fed's employment goal.

- Median in December was 0.75% at end of 2022.
- Unemployment below 4% likely shifted to 1%+.
- Remarks by Powell, Brainard and Daly confirm.

- Data, including since December, make a strong case for a modest increase.
- Whether lift-off in mid-March or early-May 2022 depends on Omicron.

What does “inclusive” and “broad-based” employment mean?

- Fed must define its new employment goals before lift-off.
- Question whether these race/Ethnicity gaps are in line with the mandate.

PERSONNEL IS POLICY:

Biden's nominations are historic

If confirmed, most diverse Board of Governors on race and gender

- All five nominees are highly qualified and likely to be confirmed.
- New Fed is *not* a 'woke' but it will focus more on an equitable economy.

Strong team: Powell, Brainard, Bloom-Raskin, Cook, and Jefferson

Section 2A, added to the Act in 1977, defines the dual mandate:

> The Board of Governors of the Federal Reserve System and the Federal Open Market Committee shall maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.

Section 10 of the Federal Reserve Act:

> In selecting the members of the Board, not more than one of whom shall be selected from any one Federal Reserve district, the President shall have due regard to a fair representation of the financial, agricultural, industrial, and commercial interests, and geographical divisions of the country. In selecting members of the Board, the President shall appoint at least one member with demonstrated primary experience working in or supervising community banks ...

- See my Substack posts. Part 1: Powell and Brainard, Part 2: Bloom-Raskin.
- Part 3: Cook and Jefferson (coming soon). It'll be a historic Fed.