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No Fed to the Rescue

September 09, 2022

With two consecutive quarters of negative GDP growth, high inflation and markets that have persistently delivered bearish returns, the hope was that the U.S. Federal Reserve was busily looking for a way to execute a 'soft landing'—meaning, basically, a return to modest economic growth, higher market returns and lower inflation. It now seems clear that that is not the Fed's plan.

In a recent speech in Jackson Hole, WY, Fed Chair Jerome Powell announced that he will do whatever it takes, pretty much to the exclusion of economic growth and better market returns, to drive inflation down to the 1.8% annual goal that has been recent Fed policy. He said, bluntly, that "reducing inflation is likely to require a sustained period of below-trend growth." Translated, that means higher short-term bond rates and an indifferent attitude toward more economic pain.

The speech even seemed to be attacking the nation's historically low 3.5% unemployment rate, the lone bright spot among a lot of otherwise grim economic statistics. Powell surprised many economists by asserting that, in his view, the labor market was "clearly out of balance" because the demand for workers exceeds supply.

Overall, the speech seemed to hint at another jumbo 75 basis point increase in the Fed Funds Rate later this month. If (when) that happens, it will grab headlines, but it might not be the most significant growth-slowing measure the Fed will be taking. The U.S. central bank is also accelerating the process of selling off the Treasury and mortgage bonds on its balance sheet, doubling the monthly sales from $47.5 billion to $95 billion. It's important to note that when the Fed was buying these bonds, the so-called QE (quantitative easing) buoyed the stock market. The opposite, called quantitative tightening (QT to some), might have the opposite effect.

Most of us know that the economy will eventually recover from its current doldrums, and the Fed's current policy will ease up as inflation declines. What we're seeing now is the inevitable 'pay the piper' moment where the bill comes due from the enormous (and, of course, unsustainable) stimulus that the Fed injected into the economy to end the Great Recession and, not so long afterwards, to pull the country out of the Covid-driven downturn. The hope now is that it won't be long before the Fed decides that the piper is paid off, and once again prioritizes growth and profitability in the economy.

Sources:

https://www.advisorperspectives.com/articles/2022/08/31/powell-abandons-soft-landing-goal-as-he-seeks-growth-recession

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