

Monetary Policy

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Econoclast Comment

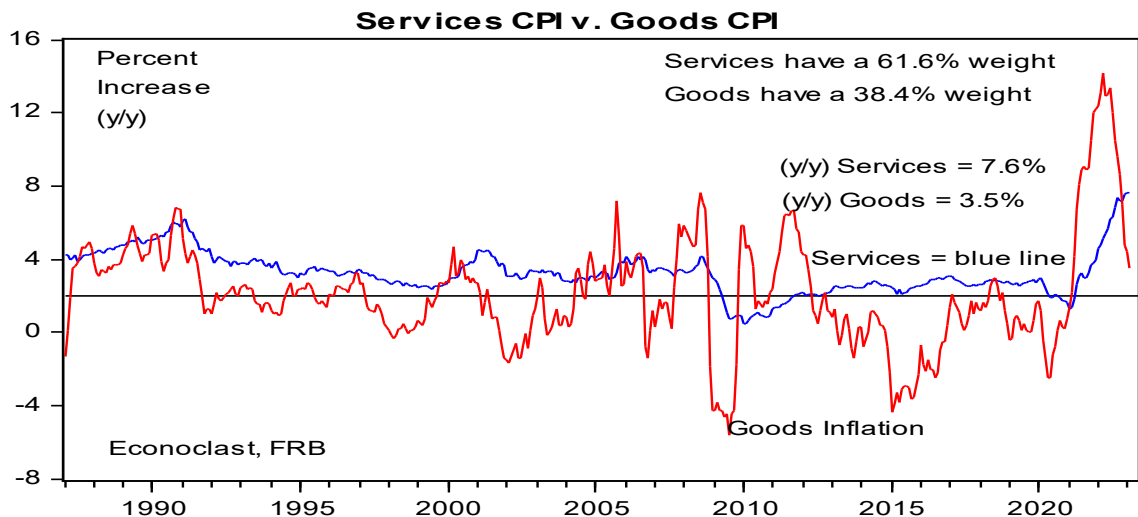
Monetary Policy

- At the upcoming March 21-22 FOMC meeting, Fed officials should announce a pause to rate hikes, but Chair Powell may want to move rates higher by 25 bps.
- Fed leaders, in their implementation of monetary policy starting in 2021, have basically done the opposite of what should have been done.
- The real economy, in 2021, was growing at nearly a 6% pace, which Fed leaders knew.
- Instead of implementing a counter-cyclical policy such as slowing the pace of QE or nudging interest rates by 25 bps a few times, Fed leaders kept running full-speed ahead with zero interest rates and a massive QE policy of injecting \$120 b/m.
- Federal Reserve leaders in 2021 implemented a pro-cyclical policy to run the economy even hotter. Monetary policy, in 2021, may go down as one of the nuttiest on record.
- Whether it was intended or not, Fed leaders fed the fires of inflation and let inflation burn until June 2022. At that point, Fed leaders knew what they had done and set out with QT and four consecutive 75 bps hikes to break the economy and inflation. Yes, Fed leaders had hikes of 25 and 50 bps before their June 2022 meeting but those should have occurred in 2021.
- Fed leaders continued to hike until the financial system broke. Breakage is the only signal Fed leaders seem to understand as a sign to stop. An office real estate bust could be the next stop sign.
- The signal to stop occurred and the Fed, Treasury and FDIC created a huge moral hazard issue by bailing out depositors above the FDIC-insured amount.

- Thousands of people at the Federal Reserve and Treasury have 30 or 35 banks and management teams to study, understand, and help assess risks.
- Their oversight of SVB and Signature Bank was a total failure. Additional regulation and more regulators won't change an incompetent regulatory system. It's a Federal bureaucracy issue. There is no fix.
- There is no point in depositors incurring costs of additional regulations and regulators.
- Point: erratic monetary policy always breaks something and because of time lags in monetary policy, it takes time for the breakage to occur.

Inflation

- Inflation continues to run warm, but the shelter component of the CPI will cool in a few months, allowing for sizeable improvement in the CPI.
- Services inflation continue to run over 7% while goods inflation has backed off and is under 4% in the below chart.



- Implication: lower inflation is ahead in the next few months.
- S&P 500 operating earnings for year-end 2023 remain elevated and need to be lowered to reflect slower growth.

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