

Central Banks

Mission Impossible: NAIURU Fallout & the Unobservables

Powell’s speech at Jackson Hole Symposium sets policy course for current normalization cycle

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In Powell’s first summer blockbuster (speech), stars were the theme: r^* , u^* and π^* that is. The speech titled “Monetary Policy in a Changing Economy” drew on lessons of the past, from the monetary policy mismanagement of the 1960s-1970s, to the success of Alan Greenspan’s “wait and see” strategy in a “new economy.”

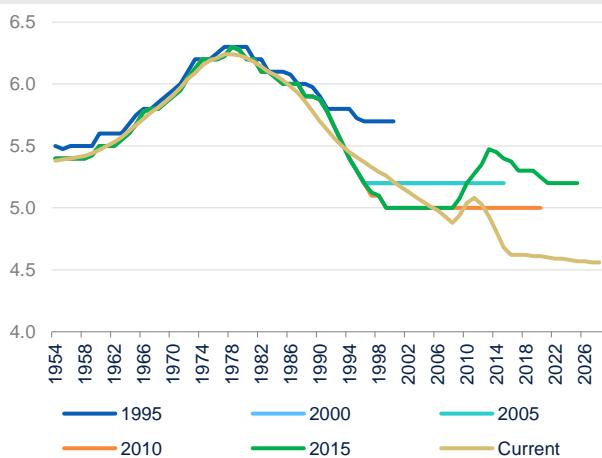
Beyond the history lesson and concerns about mismeasurement of unobservable factors (r^* and u^*), the speech was a de facto manifesto for Powell’s tenure as Chairman. His speech put to rest any concerns that Powell’s private sector background could imply a shift monetary policy, as the overarching theme was about staying true to the rules, but at the same time learning from past experiences and mistakes.

The evenhanded tone and balanced message suggest that the Chairman is comfortable with the current policy course. For instance, in an allusion to past work of William Brainard, Powell said:

...the literature on structural uncertainty ... recommends that when you are uncertain about the effects of your actions, you should move conservatively. In other words, when unsure of the potency of a medicine, start with a somewhat smaller dose

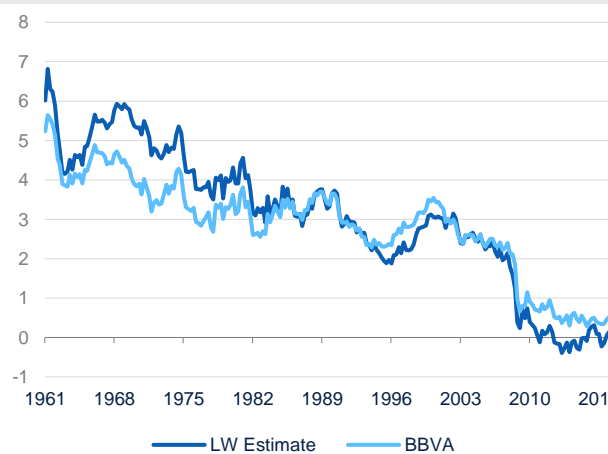
This suggests that Powell is not eager to accelerate the pace of interest rate normalization nor is he eager to change the size of the increases (to 50bp or higher). In fact, Powell referenced a well-timed report from the Federal Reserve that “no single, simple approach to monetary policy is likely to be appropriate across a broad range of plausible scenarios.”

Chart 1. CBO NAIURU Projections, %



Source: BBVA Research & CBO

Chart 2. Neutral Real Interest Rates, %



Source: BBVA Research & John Williams and Thomas Laubach

Moreover, he welcomed the “expanded scope of surveillance of the labor market tightness” and advocated for a risk management strategy when “destabilizing excesses” appear outside the traditional monetary policy framework. In attempt to soften the appearance as a revisionist historian, he said that there are two instances would require a more aggressive “whatever it takes” approach. One in which the risk of a severely adverse event is high or when there is a period that interest rates are persistently at the effective zero lower bound, or the second case, in which inflation expectations become unanchored.

While Powell covered a lot of ground in his speech, some scenes did not make it past pre-production, notably trade and political frictions. This should not come as a surprise given Powell’s political savviness.

Conclusion

Today’s speech was broadly in line with our perception of the Chairman’s leadership style: pragmatic, transparent, risk averse, but rules-based. As such, we continue to expect gradual normalization through 2019. This implies rate increases in September and December of this year, and three more increases in 2019. The major risks to the normalization strategy are a persistent rise in actual or expected inflation; or to the downside, an increase in global and financial turmoil or a perceived buildup of excesses in the domestic financial sector. Powell would not want his time in the spotlight to end in a box office flop.

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