Economics Group

Special Commentary

John E. Silvia, Chief Economist
john.silvia@wellsfargo.com • (704) 410-3275

Powell on Policy: What to Ask?

Jerome Powell has been nominated to head the Federal Reserve Board. The official changing of the guard will not occur until Chair Yellen's term expires on February 3, 2018. Not surprisingly, financial markets have not reacted strongly one way or the other on the heels of this announcement, as Governor Powell is largely expected to pick up where Chair Yellen leaves off. Powell's nomination does not change our outlook for monetary policy at this time. However, reviewing Powell's previous public comments is an interesting exercise to discern how his views may differ slightly from the current Fed Chair. How might we view his comments on policy and financial markets? What would we ask at confirmation hearings?

Powell's nomination does not change our outlook for monetary policy at this time.

Figure 1

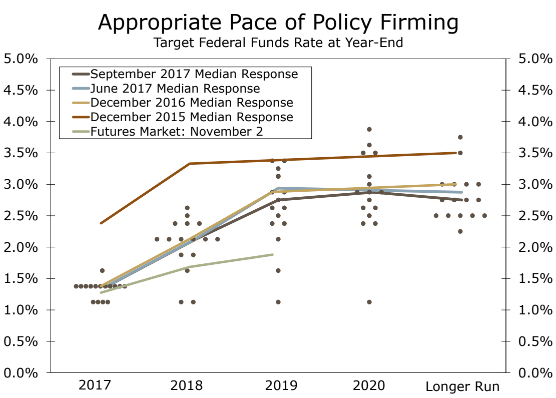
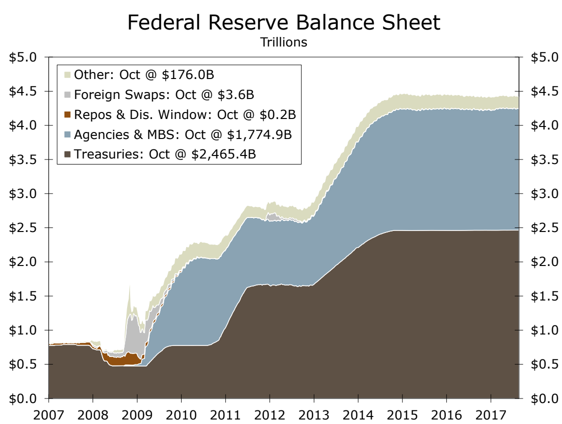


Figure 2



Source: Federal Reserve Board, Bloomberg LP and Wells Fargo Securities

Normalization of Policy

The Economic Club of New York, (June 1, 2017)[1]

"While monetary policy can contribute to growth…, it cannot reliably affect the long-run sustainable level of the economy's growth." From an economist's point of view, this is well-said. However, how will the Senators respond to the case for monetary neutrality? Question—what is your estimate of that long-run sustainable pace?

"The normalization process is projected to have several years to run…the endpoint long-run neutral rate of interest." OK, but what is your estimate of that rate—especially given that the FOMC's estimated rate has declined in recent years (Figure 1)?

"Once the process of balance sheet normalization has begun, it should continue as planned as long as there is no material deterioration in the economic outlook." Excellent, judgement matters but how will you recognize "material deterioration" given the difficulty of forecasting,

Market participants, including us, expect Powell to continue along the scheduled path of balance sheet reductions.

[1] https://www.federalreserve.gov/newsevents/speech/powell20170601a.htm

especially recessions, and given the perception of lags in the impact of monetary policy? Will this affect the planned shrinking of the Fed's balance sheet (Figure 2)?

Economic Outlook

At the Forecasters Club of New York Luncheon, New York, New York, (February 22, 2017)[2]

The lack of inflation conundrum will continue to pose a challenge to Powell.

"Two percent annual inflation…is a symmetric objective." OK, but Governor Powell, the PCE deflator has consistently run below 2 percent during the current economic cycle and has averaged below 2 percent since NAFTA was implemented in 1994 (Figure 3). Why and what could the Fed do to get back to 2 percent when, in fact, you are now talking about normalizing the funds rate and the balance sheet?

"A good way to see the range of possibilities (of policy paths) is through a generalized form of a Taylor-type rule…While these are often called "simple" rules, application of a rule requires a significant number of choices." OK Governor Powell but you cite "estimating a neutral real rate of interest… deviations of inflation and output or unemployment from their longer-run values." So, to what extent is this really a rule, since you cite many versions of rules based on research at the Cleveland Fed with seven different Taylor rules. Are these rules or guidelines and if there are seven versions then is there a rule at all?

Figure 3

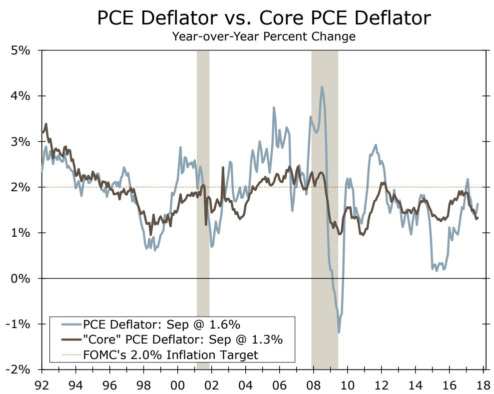
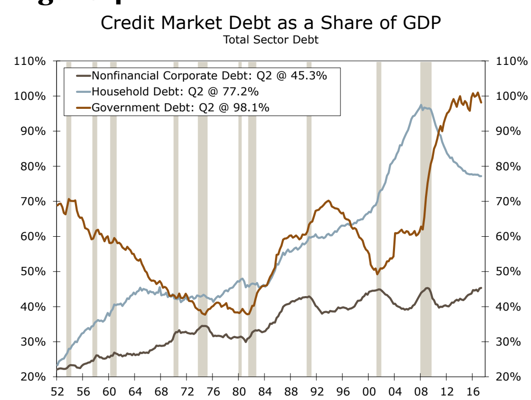


Figure 4



Source: Federal Reserve Board, U.S. Department of Commerce and Wells Fargo Securities

Low Interest Rates and the Financial System

77th Annual Meeting of the American Finance Association (Jan. 7, 2017)[3]

Powell's term as Fed chair is likely to represent a continuation of Chair Yellen's monetary policies.

"And low rates can lead to excessive leverage and broadly unsustainable asset prices—things that we watch carefully for and do not observe at this point."

OK, Governor Powell, but would you have said the same in 2005-2007 about housing, recall that the Fed issued reassurance that the housing issues were well contained. Moreover, the resiliency of any system is not revealed when the economy is doing well but when it is stressed. Finally, the government, not the private sector, appears to be the most leveraged at this time (Figure 4). Do you see a policy conflict ahead?

No Change to Our Outlook at this Time

Powell's term as Fed chair is likely to represent a continuation of Chair Yellen's monetary policies. Against the backdrop of cycle-low unemployment and modest economic growth, the new Fed chairman should be able to continue to gradually raise interest rates from historic lows. Powell's nomination does not change our outlook for monetary policy at this time.

---

[2] https://www.federalreserve.gov/newsevents/speech/powell20170222a.htm
[3] https://www.federalreserve.gov/newsevents/speech/powell20170107a.htm

Wells Fargo Securities Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloria, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Sarah House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Jamie Feik	Economist	(704) 410-3291	jamie.feik@wellsfargo.com
Erik Nelson	Currency Strategist	(212) 214-5652	erik.f.nelson@wellsfargo.com
Michael Pugliese	Economic Analyst	(704) 410-3156	michael.d.pugliese@wellsfargo.com
E. Harry Pershing	Economic Analyst	(704) 410-3034	edward.h.pershing@wellsfargo.com
Hank Carmichael	Economic Analyst	(704) 410-3059	john.h.carmichael@wellsfargo.com
Ariana Vaisey	Economic Analyst	(704) 410-1309	ariana.b.vaisey@wellsfargo.com
Abigail Kinnaman	Economic Analyst	(704) 410-1570	abigail.kinnaman@wellsfargo.com
Shannon Seery	Economic Analyst	(704)410-1681	shannon.seery@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Dawne Howes	Administrative Assistant	(704) 410-3272	dawne.howes@wellsfargo.com

WELLS FARGO SECURITIES