TWO FORMER FED PRESIDENTS' OUTLOOK FOR 2020

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12/17/2019

Last week's "Behind the Markets" podcast featured two former Federal Reserve (Fed) Bank presidents: Charlie Plosser, retired president of the Federal Reserve Bank of Philadelphia, and Dennis Lockhart, retired president of the Federal Reserve Bank of Atlanta. Both were in Philadelphia for a conference hosted by the Global Interdependence Center (GIC), an organization that hosts important economic dialogue around the world.

We discussed the market outlook for 2020, and the two former Fed presidents expect little activity out of the Fed to begin the new decade.

A "Do-Nothing" Fed

Lockhart sees the bar being too high to move interest rates in either direction in the near term, and there's a strong case for the Fed to stay put instead. If the Fed does not move rates before July, Lockhart sees the Fed staying out of the political sphere by not making a move right before the election, and Plosser agrees.

Can Supply-Side Risks Be Offset by Rate Cuts?

Plosser does not think the Fed should respond to trade policy as it did in 2019. He views the trade issue as a supply-side shock to the economy and not something interest rate moves can counteract. Rather, Plosser believes the Fed's preemptive insurance cuts introduced undesirable risk-taking and added volatility.

Plosser wishes the Fed focused on declining inflation expectations when it pivoted from hiking rates to cutting them, as he saw incoherent explanations of policy.

Our two guests both are grappling with the disconnect between the economy and financial markets, and how the Fed responds to move in the markets, rather than the other way around. They both believe the Fed needs to distance itself more from responding to market moves.

Can Inflation Move Consistently Above 2%?

Fed Chairman Jay Powell continues to emphasize a 2% symmetric inflation target, allowing it to run hot for a little while without the Fed immediately hiking interest rates to curtail it.

Plosser and Lockhart are both skeptical regarding whether the Fed can so precisely control inflation with small rate cuts.

But more discussion from Fed officials centers around how long the Fed can let inflation run above 2%, with one Fed governor recently discussing the possibility of letting inflation stay above 2% for a period as long as five years!

Too Much Debt?

Professor Siegel discussed one way to stimulate inflation, which is former Fed Chairman Ben Bernanke's concept of "helicopter money," where everyone gets a tax cut and a direct deposit of cash to spend. This is an example of modern monetary theory (MMT), and it's similar to proposals made by Democratic candidate Andrew Yang to give everyone a "Freedom dividend" of $1,000 per month.

Lockhart and Plosser are skeptical of MMT and think there will be an eventual day of reckoning for our debt path, and the question is "when?" Plosser highlighted how during

World War II, our debt-to-GDP ratio was over 140% before it trended down over the next three decades. He admitted, though, that it's hard to know what level of debt-to-DGP is "optimal."

This was a great conversation with very candid views on the state of our economy and the Fed's tools. Please listen to the full conversation below.

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