View from the Beltway

Is the Fed's Powell the New Maestro?

By Owen Ullmann

Or just a lucky guy?

Two years ago, the U.S. Federal Reserve was everybody's punching bag. Critics ranging from politicians and media columnists to academics and Wall Street investors lambasted the central bank for letting inflation get out of control and moving too late and too cautiously to rein in rising prices. Among the loudest detractors was former U.S. Treasury Secretary Lawrence Summers, who assailed the Fed for being too obsessed with wokeness. By October 2022, a few months after the consumer price index had risen to a forty-year high of 9 percent, Summers confidently predicted that a recession with 6 percent unemployment would be needed to harness inflation.

So much for that prediction. By February of 2024, the economy was growing by more than 3 percent, unemployment remained below 4 percent, and inflation was running close to the Fed's 2 percent target. Defying not just Summers but the near-unanimous prediction by top economists that a recession was inevitable, Fed Chair Jerome Powell and his colleagues appear to have pulled off a rare "soft landing," something the Fed last achieved thirty years ago under the guidance of legendary Chair Alan Greenspan. Assuming the economy doesn't unexpectedly swoon, does this accomplishment make Powell another monetary maestro? Or did good fortune and external factors play an equal or greater role? Comparing the two episodes provides many similarities as well as stark differences.

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A Brookings Institution paper on soft landings by Sam Boocker and David Wessel in September 2023 describes the Fed's rate moves in 1994–1995 as "the classic example of a soft landing." Three years after the 1990–1991 recession, unemployment was falling below 7 percent and consumer inflation was running below 3 percent, the authors noted. Still, Greenspan was worried about the potential for an inflationary surge as the expansion continued and unemployment kept dropping. He led the Fed on a path of

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preemptive tightening, beginning in February 1994, when the Fed raised its federal funds rate from 3 percent to 3.25 percent. Although Greenspan had hinted at a coming rate hike in his typically cryptic manner, the bond market was caught off-guard by the move and temporarily crashed. Over the next twelve months, the Fed doubled the fed funds rate to 6 percent with seven moves ranging from 25 basis points to a hefty 75 basis points that November. From mid-1995 through early 1996, it cut rates to 5.25 percent out of concern that the economy might be weakening more than needed to restrain inflation.

"Economic performance for the remainder of the decade was strong: Inflation was low and steady, unemployment continued to trend downwards, and real GDP growth averaged above 3 percent per year," Boocker and Wessel said. "Greenspan wrote in his memoirs that 'the soft landing of 1995 was one of the Fed's proudest accomplishments during my tenure.'"

It was deft monetary management, indeed, but not without external and internal controversy that Greenspan was forced to address from the start of the series of rate increases until they ended. Former Vice Chair Donald Kohn, who was a senior staff adviser to the Fed in the 1990s, recalled that many hawks on the Federal Open Market Committee wanted to boost rates by 50 basis points in early 1994. "Their view was that we had gotten behind the curve seriously and needed to catch up fast," Kohn said. "Greenspan and (New York Fed President William) McDonough fought like hell to keep it to 25 basis points, arguing that this is the first increase after three years of no change. Let's just take a small step here and then we'll see what we need to do."

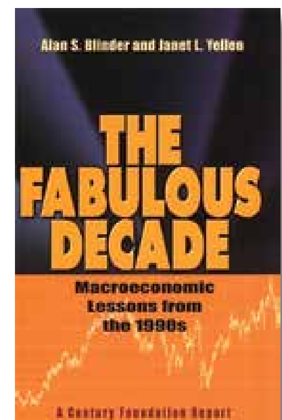
"The February meeting was important from Greenspan's perspective because he was surprised by how large the 50-basis-point wing was and how vehement their argument was," Kohn said. "He never wanted to be surprised again, so he started prowling the halls and trying to figure out before subsequent meetings where FOMC people were."

How much credit goes to the Fed and how much to the free market's self-adjustments and all the fiscal stimulus that has propelled consumer spending remains a matter of debate among economists.

By late 1994, the markets wanted the Fed to keep raising rates toward 8 percent. But the two leading doves on the FOMC, Alan Blinder, vice chair at the time, and Treasury Secretary Janet Yellen, who was then a Fed governor, worried about over-tightening. They pressed Greenspan to begin lowering rates at the first sign of economic weakness, which he did. Blinder and Yellen later co-wrote a book called *The Fabulous Decade: Macroeconomic Lessons from the 1990s* that credited Greenspan for pulling off a soft landing with great judgment and skill.

Fast forward to 2021–2023, when economic circumstances were vastly different from the 1994 rate-hike cycle. The world was coping with the Covid-19 pandemic, which left many economies in shambles because of temporary shutdowns to combat the spread of the virus. The Fed helped revive the economy by cutting the fed funds rate to zero and added further stimulus through monthly bond purchases. The Trump and Biden administrations added their own fiscal stimulus, totaling a whopping $6 trillion in 2020 and early 2021.

When inflation started accelerating from less than 2 percent in January 2021 to more than 5 percent by mid-year, Powell initially called the price burst "transitory" and predicted inflation would soon fall as supply bottlenecks caused by the pandemic eased and caught up with consumer demand that was being turbo-charged by all the federal handouts. But as inflation continued to soar, critics turned "transitory" into a modern-day scarlet letter pinned to the embattled Powell's chest and assailed the Fed for being woefully behind the curve. Beginning in March 2022, the Fed embarked on the fastest series of increases in its history,



Over twelve months beginning in February 1994, the Federal Reserve under **Alan Greenspan** *doubled the fed funds rate to 6 percent. By late 1994, the markets wanted the Fed to keep raising rates toward 8 percent. But the two leading doves on the FOMC, Vice Chair* **Alan Blinder** *and then-Governor* **Janet Yellen,** *worried about over-tightening. They pressed Greenspan to begin lowering rates at the first sign of economic weakness, which he did. Blinder and Yellen later co-wrote a book called* **The Fabulous Decade** *that credited Greenspan for pulling off a soft landing with great judgment and skill.*

boosting the fed funds rate from zero to 5.5 percent in July 2023, where it remained in early 2024. The unprecedented rate increases were accompanied by predictions from every economic corner that a recession was inevitable.

More than a year after those predictions, the economy has upended conventional wisdom by humming along in remarkably good shape, as the stock market rose to new highs. Amid widespread expectations that the Fed will begin lowering rates in the spring to prevent the economic momentum from slowing too much, Powell can rip off the "transitory"

Critics turned "transitory" into a modern-day scarlet letter pinned to the embattled Powell's chest.

sign, hold it over his head, and shout, "I was right … sorta." Yes, it appears the pandemic-prompted inflationary burst was a transitory phenomenon—just one that lasted longer than the Fed and Biden administration thought. Some supply bottlenecks that had caused huge cost increases, such as used cars and overseas shipping, came down rapidly, while others, such as food, energy, and labor, have taken longer to get back to normal. Some sectors, such as housing, remain distorted because of a depleted stock of homes on the market. Eventually, they will return to a normal supply-demand equilibrium. And

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wage growth, which shot up during a long stretch of abnormal labor scarcity due to the pandemic, also is rising at more moderate increases.

As the economy returns to its pre-pandemic self, it's fair to say that unlike the perfect soft landing engineered in 1995, this soft landing isn't all the Fed's doing. How much credit goes to the Fed and how much to the free market's self-adjustments and all the fiscal stimulus that has propelled consumer spending remains a matter of debate among economists. One camp argues that the Fed played a supporting role. "This is a totally different episode from 1994–1995," observed one senior Biden administration official who wanted to remain anonymous. "There's this line of reasoning that says, in some sense, the Fed has basically not done anything much here. They haven't in any way harmed the health of the economy, but that arguably nothing they did is responsible for inflation coming down as rapidly it has."

"This view argues that in retrospect, most of the increase in inflation that we saw was due to supply shocks and labor market disruption associated with the pandemic," the official continued. "And as these disturbances have worked their way out of the system, inflation's come down. But it's not because the Fed tightening really made some significant difference to what happened."

Former Federal Reserve Vice Chair **Donald Kohn** *counters that the Fed deserves greater credit for stanching inflation.*

"Still, you could say the Fed made two bits of difference. First, there was a lot of stimulus in the pipeline. The tightening of monetary policy may have prevented even more labor market tightening than we got. The unemployment rate came way down, at least in part because of all that stimulus. And had they not tightened as they did, you could argue that unemployment would've fallen to the point where inflation became a problem due to over-tightness of the labor market. So they avoided an outcome where you would've had inflation as a consequence of too much demand in the system," said the official.

"The other thing that arguably they did is to help control inflationary expectations to make clear they were not going to allow inflation to increase. They were committed to this program. And that helped to contain inflationary expectations and keep them from moving up. And if they had moved up, you might've gotten

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into a wage-price spiral that would've been much more difficult to unwind and resembled something similar to what happened in the late 1970s."

Kohn counters that the Fed deserves greater credit for stanching inflation. "I agree that a good portion of it was long-duration transitory factors, but a good portion of the hike in inflation was because fiscal and monetary policy both had their feet on the gas for a long time, driving up demand," he said. "We saw acute shortages in the labor market

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that were only a little covid-related. Demand was really strong. The labor market was really tight, and if monetary policy hadn't tightened, inflation wouldn't have come down the way it did. If the Fed had kept interest rates at zero, we'd have a much higher inflation rate now."

Regardless of the extent to which monetary policy contributed to lower inflation, the Fed deserves a lot

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of credit for navigating the economy through a period of turbulence unlike anything anyone has experienced before: a once-in-a-century pandemic. Whether they produced a soft landing by skill, luck, outside forces, or some of each, Powell and his colleagues deserve a big pat on the back for a job well done.

That doesn't mean it's time to unfurl a "Mission Accomplished" banner, as President George W. Bush had done regrettably during the early months of the long war in Iraq. The Fed still has to ensure that the economy remains healthy, particularly in a presidential election year, when every move and statement by the central bank will be fodder for politicians of both parties sure to question the Fed's motivations. "Whatever they do, whenever they do it, they're going to get attacked by somebody," Kohn said. "I don't see them moving those coming rate cuts around in order to stay away from particular political events or criticism. I don't think they can."

OFFICIAL WHITE HOUSE PHOTO BY ANDREA HANKS

Fed Chair Jay Powell *has nothing but contempt for former* **President Donald Trump,** *who had named him chair during Trump's presidency and then excoriated Powell repeatedly for refusing to cut interest rates as low as Trump wanted.*

The Fed is supposed to be non-partisan and act only in the best interests of the economy. Yet it isn't always immune from intense political pressure. The late Chair Arthur Burns succumbed to White House arm-twisting to keep interest rates

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low in 1972 to help Richard Nixon's re-election campaign, and in so doing planted seeds for an inflationary surge soon after.

Powell has nothing but contempt for Donald Trump, who had named him chair during Trump's presidency and then excoriated Powell repeatedly for refusing to cut interest rates as low as Trump wanted. It was a painful experience for the Fed chair, who can hurt Trump's election chances this year by doing the right thing: pursuing good monetary policy that results in continued strong economic growth with low inflation and unemployment. He knows a healthy economy always helps the party in power.

"So far, [Powell] hasn't screwed up," said the senior Administration official. "He's managed things well to date. Bad stuff can still happen and it's a little premature to declare victory for the economy. But things look very, very good. If everything continues on this path, he definitely deserves the credit."

Not to mention the gratitude of President Biden, the markets, the American public, and historians who have a new "maestro" to chronicle. ◆