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## Soft Landing

JP Morgan's assessment that the Federal Reserve has achieved a soft-landing for the U.S. economy is incorrect.

An economic soft landing is where the Fed utilizes their policy instruments to engineer a subtle economic slowdown that brings inflation down to its two percent target from a rate that was higher than two percent for a sustained period of time. Critically, a soft landing is when the Fed accomplishes this without inducing a recession.

The BLS release on October 10th showed a Core CPI rate of inflation of 3.3 percent, which gives rise to a 6-month moving average that is also 3.3 percent. These inflation readings indicate sustained high inflation, a rate that is 65 percent more rapid than the target of 2 percent.

On a more academic note, the idea of a soft-landing conveys a connotative meaning of policy success. The Fed's monetary policy for the U.S. should not be deemed a success.

## Poor Monetary Policy

The Fed has conducted U.S. monetary policy in an economically harmful manner since 2008 when they embarked on unconventional and not-well-understood market interventions. These included an extraordinary, multi-trillion dollar expansion of the Fed's balance sheet and payments to banks to withdraw funds from the economy. These "new" policies were combined with interest rates that were too-low for too-long, a regulatory stance which heavily favors large banks, and repeated bailouts of failed financial institutions. All of these interventions have been conducted in a less methodical, or rules-based, manner.

The Fed post-2008 policies have created distortions and miss-allocations of resources in the economy. The prices of long Treasuries and mortgage bonds are heavily distorted, investor portfolios are distorted, and the Fed has incentivized excessive private risk-taking through its bailout practices.

The Fed's policies since 2008 have benefited Wall Street much more than Main Street. Larger enterprises can much more easily search for yield when interest rates are excessively low. They can more easily hedge risky positions taken to escape lower safe-yields. The U.S. Banking industry is now heavily concentrated with the 5 largest banks, whose total asset value is now approximately $9 trillion, and has relatively few small/regional banks operating following a massive consolidation. The Fed's bailout practices have incentivized excessive risk-taking by financial institution's (for the benefit of wealthy clients), where the institution (e.g. Silicon Valley Bank) knows the probability of a no-questions bailout from the Fed is very high.

The Main Street impact of the Fed's policies include chronically low economic growth since 2008 and, declining real wages since 2020, amidst taxpayer-funded bailouts of financial institutions. There is also the reverse of the impacts noted above, i.e. it is not as easy for the typical household to search for yield when passbook savings yields are excessively low, and there are relatively few regional banks in operation for a more locally appropriate suite of financial services to households and small businesses.

CERF is a Wall Street Journal Economic Forecast Survey participant. A survey question from October (published Oct. 14, 2024) requested that we give Fed chair Jerome Powell a grade for his performance. We gave him an F. With that grade we provide the following reasons for this assessment.

*Reason 1 – Policies since 2008*

An "A" grade in monetary policy requires a full normalization of the extraordinary interventions undertaken since 2008 (including interest on reserves and a bloated balance sheet). Because the Fed did not normalize policy, economic growth was substantially lower than it should have been and inflation was higher than it should have been. Earning the F grade, Chair Powell has codified the extraordinary policies embarked upon in 2008. The current GDP level is 2.5 trillion dollars lower than what it could have been based on existing trend growth starting in early 2012. Because the Fed has no plan to normalize policy and has perpetuated too big to fail, they have ensured ongoing U.S. economic fragility.

*Reason 2 – Unleashing Excessive Inflation in 2021*

Chair Powell has presided over what the Wall Street Journal referred to as the greatest monetary policy mistake since the 1970s, in unleashing historically high inflation in 2021, as of today an episode that has not yet ended as described in the Soft Landing section above.

*Reason 3 – Their Recent Policy Move*

Second quarter GDP growth was 3% and the current 3rd quarter nowcast is 2.5%, yet astonishingly, Chair Powell presided over a 50 bp cut in rates on Sept 18. As a result of this policy we expect Core PCE inflation will rise from current levels rather than subside like the Fed, markets, and most commentators are hoping for. The stock of money supply, at just under $22 trillion dollars is still 37 percent higher than it was pre-pandemic, see Figure 1. This implies that inflation still has legs, and is likely to feel welcome to stick around.

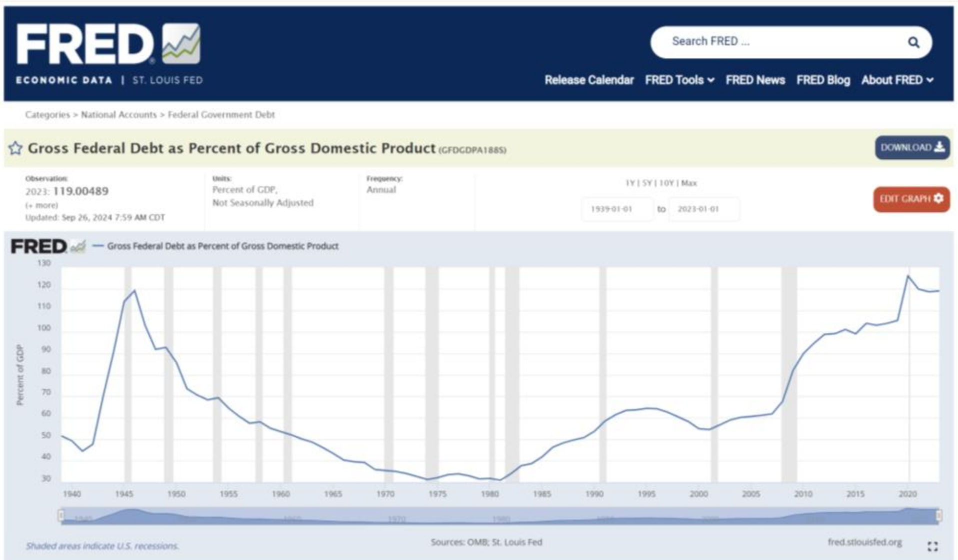
The Fed's historical mandate was for maintaining price stability (the primary mandate) with a secondary goal of promoting employment. They appear to be shifting their priorities, away from price stability. However, price stability is the explicit economic phenomena that monetary policy is *designed* to impact. CERF recommends that the Fed rediscover its historical mandate by reemphasizing price stability, and, do this with maintaining a 2 percent inflation target. They should not deemphasize the inflation target in their policy mandate.

**Figure 1: U.S. Money Supply**


## Poor Fiscal Policy

The U.S. legislative process has been engaged in a pattern of short-term expediency and long-term can-kicking (down the road) for some years now. These patterns imply larger deficits and greater debt. Deficits and debt are now at extremely high levels, levels comparable with the fight against Hitler and the Holocaust during WWII, see Figure 2. What war are we fighting now?

**Figure 2: The Debt to GDP Ratio**




Excessive government spending brings detriment to the real economy, effects that no one wants to occur. The economic problems associated with poor fiscal policy might feel counter-intuitive, as it is natural to use the national income identity to realize that US income rises when government expenditures rise. There is much more than this to the economic impact of government spending.

Excessive government spending is understood to have a short run impact of higher interest rates and lower accumulation rates of human, intellectual, and physical capital. The reduced investment rates reduce current GDP (and income) growth and future productive capacity. These are short to medium run impacts (6 months to 2 years).

Excessive government spending also brings higher future taxation, which leads to lower current and future accumulation rates of human, intellectual, and physical capital. This has the pernicious impact of reducing national medium to long-run productive capacity, which is economically harmful to households, firms, and government. One palpable reality is fewer goods and services (consumer as well as industrial) available for consumers and firms.

Another very harmful impact is reduced GDP growth which reduces federal tax receipts and therefore, reduces Washington DC's ability to borrow, pay for debt, and ultimately, to spend. These important dynamics are ones in which it is in the best interests of Congress to pay attention to … for its own sake.

**A Call for Alternate Policies**

Current United States policy trajectories are not likely to be impacted by the recent U.S. Presidential election outcome. For both Fiscal and Monetary policies, voters need to require policy changes (and accountability) from the entirety of the Washington D.C. establishment: the Democratic Party, the Republican Party, and key policy-setting agencies, including and, especially, the Federal Reserve Board.

As much as Monetary Policy has damaged our economy for decades now, I have become most concerned for the harm to the U.S. economy from the current Fiscal Policy trajectory. Voters should require that policy-makers embark on a sequence of Fiscal Policy changes that alter the trajectory to achieve long-term sustainability.

The Fed should conduct a less economically-harmful Monetary Policy. This includes a more generally rules-based and traditional approach including a dedicated focus on price stability. It also includes a reemphasis of Main Street over large financial institutions, with no bailouts of excessive private risk-taking.