Powell Has Become the Fed's Dr. Feelgood

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By James Grant

If Federal Reserve Chairman Jerome Powell were selling a prescription drug instead of a monetary policy, the Food and Drug Administration would likely want a word with him. "What we're thinking about now is providing the accommodation that this economy needs for as long as it needs it. That's all we're thinking about," the central banker told the Senate Banking Committee on June 16.

To listen to Mr. Powell, the Fed's monetary medicine isn't even a drug, let alone one so freighted with side effects that you may wonder if the cure is worse than the disease. I believe he is wrong about that.

Overprescription of monetary medicine has the economy addled, addicted and searching for a fix.

Ultralow interest rates are a financial psychotropic. They induce feelings of neediness (on the parts of savers to reach for yield), grandiosity (by corporate deal-doers to reach for the moon) or fantasy (for any who would try to rationalize otherwise insupportably high stock prices with reference to the tiny cost of a loan).

Ground-scraping interest rates turn savers into speculators and quarantined millennials into day traders. They facilitate overborrowing, suppress market signals, misdirect investment dollars, and promote the dubious business of turning well-financed public companies into heavily indebted private ones.

Last week, California's Public Employees Retirement System announced it will take on debt in an attempt to generate higher returns, because low interest rates leave it no alternative. Mr. Powell, too, pleads necessity—he had to do something to lower the towering unemployment rate. Nobody doubts his humane intentions, but history will judge by results.

With opioids, the habituated patient needs ever higher doses to achieve a constant effect, and so it is with dollars. Massive credit creation (which the Fed achieves by buying bonds and mortgages with money it materializes with a tap on a computer keypad) is a kind of financial painkiller. The record of the crises of the past 20 years, beginning with the post-millennium dot-com crash, is one of lower and lower interest rates, and of greater and more aggressive bond-buying.

No such admission of potential risk fell from the lips of Mr. Powell or from the pages of the Fed's new semiannual Monetary Policy Report to Congress. The official message is rather that today's unprecedented monetary-policy offensive holds no potential for anything but a wholesome reduction in the damage of the lockdown-induced recession.

In neither medicine nor central banking is free lunch on offer. Say yes to a cortisone injection for that inflamed knee, and you risk cartilage damage, death of a nearby bone, nerve damage, etc.

The difference is that with radical monetary policy, the side effects are part of the intended cure. Low rates launch flyaway bull markets; feeling

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Fed Chairman Jerome Powell

richer, the thinking has it, people spend more. Then, again, artificial bull markets become bubbly, and bubbles burst. Do low mortgage rates advantage young families shopping for their first houses? Maybe not if the same low rates spark a rise in house prices greater than the evident savings in interest expense.

"We are deploying these lending powers to an unprecedented extent," Mr. Powell told the press on June 10, "enabled in large part by financial backing and support from Congress and from the Treasury. We will continue to use these powers forcefully, proactively and aggressively until we're confident that we are solidly on the road to recovery. When the time comes, after the crisis has passed, we will put these emergency tools back in the toolbox."

The record suggests it won't. One intervention sets up the expectation of another. In anticipation of that new monetary torrent, opportunistic people take an extra measure of risk. Fragile balance sheets deepen the next crisis, necessitating the next monetary rescue party.

It's been 10 years since former Chairman Ben Bernanke assured a "60 Minutes" audience that the central bank could raise rates "in 15 minutes," but interest-rate normalcy is seemingly as far off as ever. In March 2019, the president of the Federal Reserve Bank of Dallas, Robert Kaplan, worried that heavy corporate indebtedness made the Fed's ambition to normalize interest rates much riskier than it seemed. One year later, the lockdown slump made Mr. Kaplan a prophet.

Since the start of the year, the Fed has expanded the size of its balance sheet by a cool $3 trillion, to 33% of gross domestic product from 19%. It has acted to shore up the markets in commercial paper and municipal securities and is poised to wheel out a large-scale experiment in "Main Street" lending. The mid-June initiation of a previously announced program of corporate-bond buying jolted the stock market higher.

Inflation, as every schoolchild used to know, is too much money chasing too few goods, and whether or not today's money supply is excessive, its rate of rise is startling. According to Tim Congdon, chairman of the Institute of International Monetary Research at the University of Buckingham in the U.K., growth in the broadest measure of money has broken all modern peacetime American records, up by 25.5% in the 12 months through May.

Oddly enough, the fastest money growth is paired with the lowest interest rates. To anyone who lived through the 1970s, the juxtaposition is inexplicable. No rational investor would accept a yield of less than 1% on a 10-year Treasury note unless he had been led to believe, on the highest authority, that the rate of inflation would remain forever subdued.

At the press conference, Mr. Powell acknowledged that over the course of the just concluded 128-month business expansion, the Fed had failed to hit its targeted 2% inflation rate on a "sustained basis."

And as the Fed can't account for its inability to hit its target, it can hardly dogmatize about the risk of missing it, including a miss that might take the form of an inflation rate alarmingly in excess of 2%. Concerning the future and its side effects, Mr. Powell should admit how little he knows—he and the rest of us.

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