Federal Financial Analytics, Inc.

MEMORANDUM

TO: Federal Financial Analytics Clients

FROM: Karen Petrou

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On Thursday, the *Washington Post* included an article on all the ways in which inflation hurts middle-income families, the acute shortage of baby formula, and the cooking-oil shortage's cost impact in places ranging from a D.C. shop selling doughnuts to sub-Saharan Africa. Other articles chronicled stablecoins' instability even as stock markets wobbled precariously above going so deeply into correction that investors are not just chastened, but also cudgeled. The same day, Chairman Powell won his second term by a wide margin even as he told *Marketplace* that he couldn't promise a soft landing, didn't mean to commit the FOMC to only fifty basis-point hikes, and knows how hard inflation hits for most households while being unsure that the Fed can do much about it. What markets make of this muddle remains to be seen by those not too faint of heart to look. What I know it means is that a White House under acute political pressure will ultimately do its best to transfer blame from 1600 Pennsylvania Avenue to 20th and Constitution at considerable cost to coherent policy.

One might discount my prediction of a political reckoning for the Fed by pointing to President Biden's stout defense of his central bank last week when he tried to show the nation how much he was doing to quell inflation. But a careful read of Mr. Biden's statements shows a focus more on the Fed's independence than on its skill. So far, Secretary Yellen has persuaded White House political aides to go easy on her favorite central bank. Closer to the midterms, political aides will do what they always do – look for any way to win – and the Fed's head will be on the chopping block. Even if the White House is restrained, Congress will reach for the axe.

Under institutional and personal attack, Fed officials will go from a torrent of increasingly desperate comments about what each of them thinks to a vortex of competing statements that pushes the FOMC into an ever deeper hold, markets into still more chaos, and the public into even greater doubt about the solidity on which central banking must rest. Bewildered comments to *Marketplace* presage a sorry time in which forward guidance – or that which the market assumes to be forward guidance – is of no use in predicting what the Fed will do on a go-forward basis even though the Fed now counts forward guidance as its most powerful policy-transmission tool.

Markets may so befuddle the Fed even as the Fed befuddles the economy that the Fed goes from "whatever it takes" to "anything it can think of." Policy could thus bounce to and from over 75 bps hikes, faster QT or something else as the Fed tries ever harder to calm markets. All this will do is accelerate the market's risk-off turn as well as heighten the already steep cost of doing business, further suppressing supply well before dampening demand eases at least some inflationary pressure.

Another consequence of macroeconomic stress and the vengeful politics they spawn is an end to regular order. Here, Rohit Chopra is ahead of the curve, issuing edict after edict that sets new standards without a nod to public notice beyond nominal announcement. We have noted the

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longer-term procedural challenges this poses for the CFPB as litigation increases, but Mr. Chopra is focused on ensuring a legacy of tough new standards while he can implement them.

And, he's not the only regulator thinking along pragmatic, progressive lines. See for example the rush regulators are in to finalize their CRA proposal before Republicans get the Congressional gavel and strike it down.

Pell-mell policy is usually more than problematic policy, but the regulatory rush is founded on sound political analysis. As we noted last Thursday, Republicans are making quite clear that they'll have none of what regulators are doing if they gain control. Case in point: they have now expanded their attack against Rohit Chopra to encompass Acting Comptroller Mike Hsu. The proximate target of all of these attacks is bank-merger policy and the immediate casualty via collateral damage could be some bank mergers.

When policy becomes overtly and principally political, policy-makers go to their corners to secure a strong defense. When positions harden, bad decisions follow.