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# Mitch on the Markets

## Is the Fed Really "Going Crazy?"

By Mitch Zacks
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Recent remarks by President Trump make one thing clear: he is not a fan of higher interest rates. In an impromptu press conference after walking off Air Force One on October 10th, the president remarked that the "Fed has gone crazy," adding that he believed it was a mistake to tighten monetary policy, i.e., to raise interest rates.[1]

The rationale for not liking higher interest rates is obvious – higher rates can choke off lending and borrowing, thereby stifling economic growth. Since presidents are almost always judged by economic performance, tighter monetary policy can have political consequences.

In my view, however – and putting politics aside – the reality is not that the Fed is 'going crazy.' The reality is that the Fed is simply doing its job, and Fed Chairman Jerome Powell has been making data-dependent monetary policy decisions that, in our view, make sense at face value. The economy is strong, labor markets are tight, wages are growing, and inflation has firmed. Higher interest rates are justifiable.

Additionally, it is not as though the Fed has been raising interest rates without letting the marketplace know their thinking. As far as I can tell, there have been no surprise rate increases to date in this cycle, and it is also worth remembering that by historical standards, interest rates remain quite low (see chart). I don't think we're in crazy territory just yet.

**Effective Federal Funds Rate (1980 – Present)**

***Source: Federal Reserve Bank of St. Louis***

That being said, there are other realities to consider. In the Fed's September commentary, they indicated their preference for one additional rate hike in 2018, most likely in December, and at least two rate hikes in 2019. They also

dropped the term "accommodative" from their monetary policy statement, indicating they have either approached or are fast approaching the target neutral rate. There *is* such a thing as raising interest rates too much or too fast, or both. The next year or two will be important ones for this Fed.

**Jerome Powell's Delicate Task**

At the end of the day, for all the rhetoric that may rain on Federal Reserve Chairman Jerome Powell as he faces the delicate task of ending a decade of easy monetary policy, he seems to be handling his role relatively well. In his first six months in office, Mr. Powell met with or called lawmakers in Congress 48 times, compared to the 17 contacts made by his predecessor Janet Yellen in her first six months. Mr. Powell is also a lawyer by training, and is more comfortable working the halls of Washington D.C. than he is at economics seminars, which is where Ben Bernanke and Janet Yellen thrived the most.

Mr. Powell's efforts on Capitol Hill appear to be aimed at ensuring the Fed's independence, at a time when political pressure is likely to build as the economic cycle matures even further. The Fed's independence is not protected by statute as is the case with many other central banks, and there is always the risk that Congress could methodically chip away at some of the Fed's authority if they become displeased with monetary policy or the economy. Mr. Powell seems to be hyper-aware of all of these factors, particularly as he engages in tighter monetary policy.[2]

**Bottom Line for Investors**

President Trump cannot fire Mr. Powell under the law, but he could try to remove him for cause – which most agree would be very difficult to achieve, and certainly would not be possible over a simple policy disagreement. The other option available to the President would be to pack the Fed board with sympathizers to his easy money objectives, a tactic President Reagan employed (though unsuccessfully) in an effort to challenge the authority of then-chairman Paul Volcker.[3]

Whatever the outcome, it appears for now that Federal Reserve Chairman Jerome Powell has the support of lawmakers and Treasury Secretary Steve Mnuchin, two key allies. Moving forward, Mr. Powell faces the very delicate task of ending a decade of easy monetary policy without tipping the economy into a recession, and his position is far from enviable. For now, however, I think he's been managing the Fed and monetary policy well, and basing his decisions on the economic data that continues to show underlying strength in the United States. Higher interest rates may be unpopular, but they're not unwarranted.

**About Mitch Zacks**

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

[1] CNBC, October 10, 2018, https://www.cnbc.com/2018/10/10/trump-says-the-federal-reserve-has-gone-crazy.html
[2] Bloomberg Businessweek, September 21, 2018, https://www.scribd.com/article/389092231/The-Fed-S-Man-About-Town
[3] Bloomberg Businessweek, September 21, 2018, https://www.scribd.com/article/389092231/The-Fed-S-Man-About-Town

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