Dammit, Janet….again - 12/14/2017

We had three major central bank meetings during a 24-hour period this past week, and in the aftermath the global financial markets collectively yawned. I suppose after a year characterized by never-ending "Yksnim" moments, it was a fitting conclusion to 2017. However, underneath the dull surface of statements, press conferences, and projections, there was a small diamond in rough – an extremely important three and a half minutes of analysis by Janet during her last press conference as Fed chair. Below is the video link:

https://www.federalreserve.gov/monetarypolicy/fomcpresconf20171213.htm

And you should listen from the 17:00 to the 20:30 mark – there is no reason to listen to the rest. What you will find is her response to the question of whether the proposed tax package will have "supply-side" effects. Now just to be clear, I would have expected a priori that Janet, given her Yale/Berkeley biases, would be quite dismissive of the supply side. But much to my surprise, she enthusiastically embraced the core supply side drivers of corporate tax reform. It almost seemed as though she had recently started reading more papers from the *Journal of Political Economy* in lieu of those from the *Quarterly Journal of Economics.* Now I don't want to get too carried away, but this is an extremely important turn for the Federal Reserve if it is emblematic of where the Committee's thinking is headed.

So let's recap what was said. First of all, Janet noted that the tax package has "some potential to boost aggregate supply." She then went on to state that it will likely "lower the cost of capital," "stimulate investment," "increase productivity growth," and "lift potential GDP." She explicitly highlighted that "this is channel" by which the tax package could operate. And to be sure. for a die-hard Keynesian demand-sider trained by James Tobin, this line of thinking is almost heresy!! But she goes even further down the supply side rabbit hole by stating that the tax package could "boost labor supply" – meaning that labor market slack in the economy could effectively increase. She then concludes her magnum opus to the supply-side by arguing that this tax package "could support faster GDP growth at least for some period without, you know, creating a need to tighten monetary policy to offset that." BINGO JANET!!! Welcome to the wonderful world of neo-classical economics. It took a long time, but I'm glad to see you finally made it!!

Now, these surprising (but welcome) statements are also completely consistent with the Committee's projections. The December projections for growth were revised upwards in all four forecast years: 2017, +0.1; 2018, +0.4; 2019, +0.1; 2020, +0.2. This is a cumulative rise of 0.8 from the September growth projection, with NO revision whatsoever to the inflation projection or the path of the funds rate. Hmm, can anyone say "positive supply shock"??? In addition, during the press conference Janet stated that all participants now took into account the fiscal package when setting their projections. And she indicated this was not necessarily the case in prior rounds. Thus one could argue that fiscal stimulus, while causing no need to change the path of the funds rate or inflation, did cause growth projections to rise and two voting members to dissent. Could it be that a few committee members share our view that corporate tax reform may even carry with it some disinflationary risks? Maybe!!!!

In any case, the most exciting part about what we learned this week is that the utter failure of the Phillips curve this year (and of course in many years past) has even staunchest of old school Keynesians looking to the supply side for answers. Given this revelation, I must revisit an old commentary I wrote in late 2013, just before Janet took the helm at the Fed. It was entitled "Dammit Janet." And in it I expressed my excitement for her coming "dovish" stewardship (with of course loads of Jell-O shots). Here is a quick excerpt from that note:

The second scene from the 1975 cult classic "The Rocky Horror Picture Show" keeps running through my mind. The lyrics to that catchy tune, "Dammit Janet." are perfect during periods like the past two weeks, when BOTH our beloved spoos and the chartreuse have ripped higher. For those who stayed the course and held on through all the ups and downs this year, owning 100m in spoos along with 100k/01 in EDH6–EDZ6 (the chartreuse contracts) has returned well north of 20m YTD, or 20 percent on 100m of notional risk assets. That has me humming these celebratory verses from 1975:

“The river was deep but I swam it, Janet

The future is ours so let’s plan it, Janet

So please don’t tell me to can it, Janet

I’ve one thing to say and that’s

Dammit, Janet, I love you…

The road was long but I ran it, Janet

There’s a fire in my heart and you fan it, Janet

If there’s one fool for you then I am it, Janet

Now I’ve one thing to say and that’s

Dammit, Janet, I love you….”

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After listening to Janet Wednesday, I have to say it again: “Dammit, Janet, I love you….” She kept the Jell-O shots coming when needed; she got a little gangsta with Trump; and she ended her term by giving a nod to the supply side (and therefore, of course, spoos and blues). This was one of the classiest acts in central bank history. Bravo Janet, you will be missed!! Good luck trading.