THE NEW MEANING OF 'WHATEVER IT TAKES'

At the Jackson Hole symposium, Fed chair Powell and Banque de France governor Villeroy de Galhau have insisted that their responsibility to deliver price stability is unconditional. It gives a new meaning to 'whatever it takes'. Faced with uncertainty about the persistence of elevated inflation, the Federal Reserve and the ECB will increase their policy rates to bring inflation under control, whatever the short-run cost to the economy, because not doing enough now would entail an even bigger economic cost subsequently. Equity markets declined and bond yields moved higher. Tighter financial conditions will help the monetary tightening in achieving the desired slowdown in growth. To what extent this is reflected in the inflation dynamics to a large degree will depend on what happens to the supply side, which is beyond the control of central banks.

When giving a speech, it is recommended to be succinct if you want your message to be understood easily. Since becoming chair of the Federal Reserve, the average length, until 2021, of the remarks of Jerome Powell at the annual Jackson Hole symposium has been 17 pages. This year, it was a mere 6 pages (chart 1) and the tone was set right from the start: *"Today, my remarks will be shorter, my focus narrower, and my message more direct."*[1] Concerning the message, it's difficult to be clearer: *"Our responsibility to deliver price stability is unconditional."* This implies that monetary policy will be tightened, for as much and as long as necessary.

Interestingly, similar words appeared in the speech of Banque de France governor François Villeroy de Galhau at Jackson Hole: *"But have no doubt that we at the ECB would if needed raise rates further beyond normalization: bringing inflation back to 2 % is our responsibility; our will and our capacity to deliver on our mandate are unconditional."*[2]

By insisting on the unconditional nature of monetary tightening, the Federal Reserve is signaling that price stability – bringing inflation back to target – is now more important than its other longer run goals of promoting maximum employment and moderate long-term interest rates. The rationale is that not doing enough to bring inflation back under control in the short run would in the longer run have a detrimental impact on growth and cause an increase in bond yields due to higher inflation expectations. These points were also emphasized by ECB executive board member Isabel Schnabel at Jackson Hole, adding that the "risks of a de-anchoring of inflation expectations are rising".[3]

1. Source: Monetary Policy and Price Stability, Remarks by Jerome H. Powell, Chair Board of Governors of the Federal Reserve System at "Reassessing Constraints on the Economy and Policy," an economic policy symposium sponsored by the Federal Reserve Bank of Kansas City, Jackson Hole, Wyoming, 26 August 2022.
2. Source: Monetary Policy Post-Pandemic: Balancing between Science and Art, Predictability and Reactivity, Speech by François Villeroy de Galhau, Governor of the Banque de France, Jackson Hole Economic Symposium, 27 August 2022.
3. In the euro area, consumers' medium-term inflation expectations, which were at 2% during the pandemic, have increased to 3% (median value) or almost 5% (average value). Moreover, looking at the frequency distribution of inflation forecasts of consumers and professional forecasters, one observes an increase in the right tail. Finally, inflation expectations have increased more amongst people that are financially more literate.

More rate hikes are needed, in the US as well as in the euro area, because the expected evolution of the inflation drivers won't be sufficient. This point was made in the minutes of the July FOMC meeting. Lower commodity prices would help but they might rebound, whereas "*improvements in supply would be helpful but by themselves could not be relied on to resolve the supply and demand imbalances in the economy sufficiently rapidly.*"[4] According to Isabel Schnabel, *"even if we entered a recession, it's quite unlikely that inflationary pressures will abate by themselves… The growth slowdown is then probably not sufficient to dampen inflation."*[5] An implication is that in the conduct of monetary policy, the distinction between demand and supply shocks in

4. Source: Federal Reserve, FOMC Minutes of the meeting of 26-27 July 2022.
5. Source: Interview of Isabel Schnabel, Member of the Executive Board of the ECB, with Reuters on 16 August 2022.

LENGTH OF CHAIR POWELL'S REMARKS AT THE JACKSON HOLE SYMPOSIUM

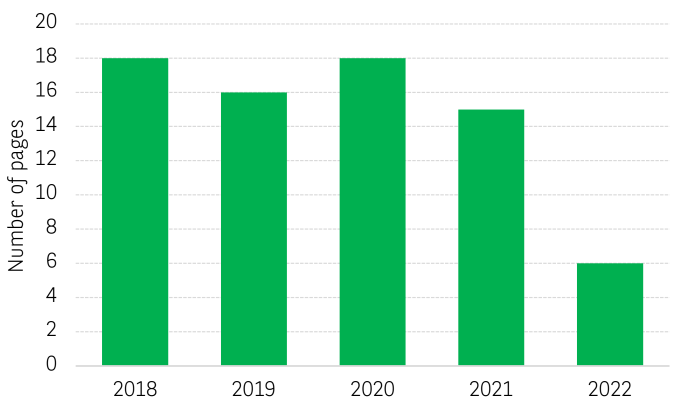


CHART 1

SOURCE: FEDERAL RESERVE

> 'Whatever it takes' has a new meaning. Official interest rates will be increased to bring inflation under control, whatever the short-run cost to the economy, because not doing enough now would entail an even bigger economic cost subsequently.

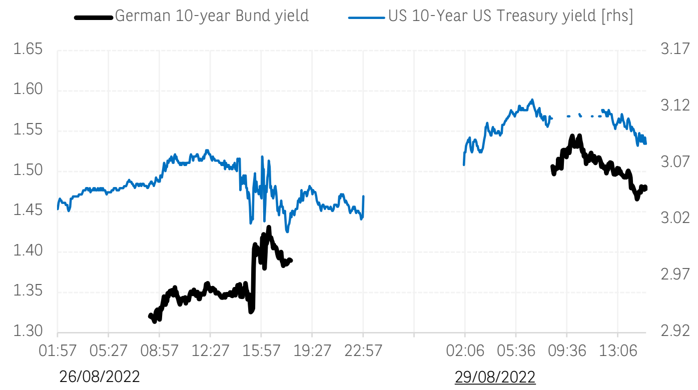
explaining the increase in inflation no longer plays a role. Previously, this distinction was made based on the view that the inflationary consequences of a negative supply shock – e.g. an increase in commodity prices – should be temporary. Powell acknowledged at Jackson Hole that high inflation reflected strong demand and constrained supply but waiting for supply to increase – reduced bottlenecks, shorter delivery times, etc. – is not an option given the current level of inflation and its expected path in the absence of a tighter monetary policy.

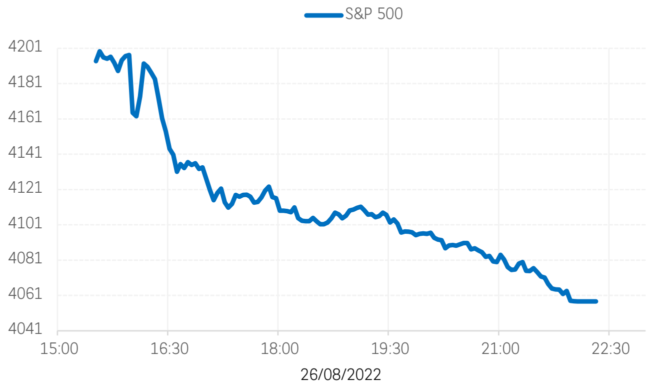
Schnabel was even more outspoken. She considers that in the current environment of uncertainty about the persistence of elevated inflation *"it is largely irrelevant whether inflation is driven by supply or demand."* The risk of high inflation becoming persistent also implies that central banks will have to be confident of having won the fight against inflation before envisaging a change in policy. According to Powell, *"the historical record cautions strongly against prematurely loosening policy."* Schnabel is aligned with this view: *"Policymakers should also not pause at the first sign of a potential turn in inflationary pressures, such as an easing of supply chain disruptions. Rather, they need to signal their strong determination to bring inflation back to target quickly."*

All this implies that 'whatever it takes' has taken on a new meaning[6]: rates will be increased to bring inflation under control, whatever the short-run cost to the economy, because not doing enough now would entail an even bigger economic cost subsequently. Unsurprisingly, markets reacted strongly to these statements (charts 2 and 3). On Friday 26th, US Treasury yields jumped and equities dropped in reaction to Powell's remarks, although later that day, yields drifted lower. Schnabel and Villeroy de Galhau made their comments on Saturday 27th, triggering a huge jump in bond yields on Monday. Central banks should welcome this. Tighter financial conditions will help the monetary tightening in achieving the desired slowdown in growth. To what extent this is reflected in the inflation dynamics to a large degree will depend on what happens to the supply side, which is beyond the control of central banks.

William De Vijlder

INTRADAY*





*J.Powell gave his speech on 26 August at 16.00 CEST.

CHARTS 2 & 3 SOURCE: BLOOMBERG, BNP PARIBAS

6. The 'old' meaning of 'whatever it takes' refers to the speech of Mario Draghi on 26 July 2012 during the euro area sovereign debt crisis: *"Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough."* Source: ECB.