

AN “i” FOR AN “i”—GRADING THE FED ON THE CURVE(S)

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Recently, a fierce debate has erupted about the Federal Reserve, spreading like wildfire. At its center is a crucial “i”—the Fed’s “independence.”

Independence?! From what?

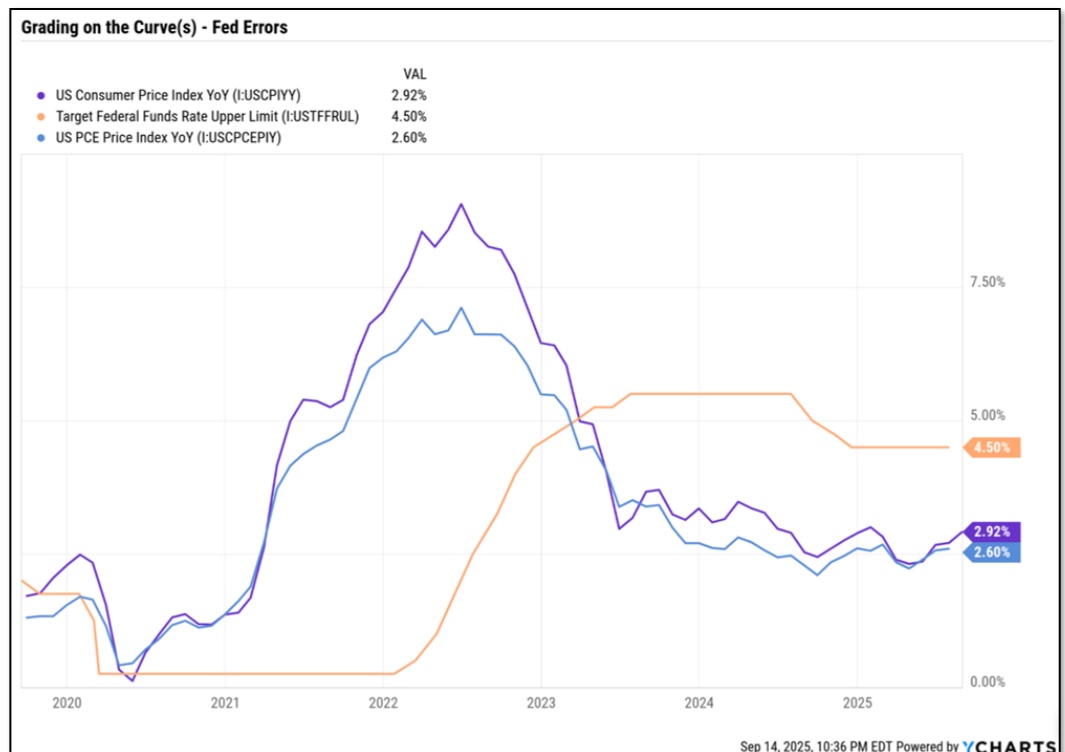
The dominant battle cry emphasizes that the Fed must be independent from external pressures—most notably the Government, with the Executive branch taking center stage, but potentially also the Legislative (and even the Judiciary, why not?). This argument can even be extended to include lobbying by industries or foreign governments and other central banks. Who would disagree?

Not so fast. We believe this conversation is adrift and profoundly misguided.

The Fed’s mission is to effectively support the economy, making the most crucial consideration another “i”: “inerrancy”—not being wrong. All other considerations are secondary and ancillary.

For example, if independence enables the Fed to fulfill its mission, that’s valuable; but if the Fed errs, whether it is independent or dependent becomes irrelevant. In any case, independence—or dependence—does not guarantee inerrancy, which should remain the paramount consideration.

But, as the chart shows, this misplaced conversation belies what the data reveal: the Fed has been in error for quite some time. Objectively, the Fed is in error whenever the two curves—the Fed Funds Rate and inflation (as measured by PCE/Personal Consumption Expenditures or CPI/Consumer Price Index)—diverge significantly. Unfortunately, it’s difficult to find any period in which the two curves have been so dramatically and persistently apart as they have been over the past six years.



As the chart shows, the Fed was on target in April 2020, when its Funds Rate and inflation (PCE or CPI) nearly overlapped.

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By December 2021, the error began widening, with the Fed lagging by a staggering 7% vs. CPI by June 2022. After that, the gap began to narrow and was fully closed around February 2023. However, from then on, the Fed has *reversed* its error, overshooting the falling inflation by nearly 2%.

This divergence highlights the Fed's fundamental problem: *erroneous policy,* even in the face of independence. While independence offers no guarantee of inerrancy—after all, any 'rates czar' would be equivalent to a Fed Chair—neither independence remedies error.

But what about the “data dependence” the Fed advertises as an instrument of sound policy?

The chart tells a different story. Rather than showing an *adaptive* use of inflation data, it reveals an almost *addictive*—even *paralyzing*—reliance: first leading it to dismiss the inflation data as “transitory” until early 2022, and then to overreact in the opposite direction starting in early 2023.

Independence may sound noble, but *inerrancy* is indispensable. Let's refocus the conversation.

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