Fed to the Rescue? A Fanboy Account of the Central Bank's COVID Intervention: Chairman Jerome Powell's pandemic response continued a trend of increasing involvement in our economy.

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Trillion Dollar Triage: How Jay Powell and the Fed Battled a President and a Pandemic — and Prevented Economic Disaster, by the *Wall Street Journal*'s Chief Economics Correspondent Nick Timiraos, is a page-turning paean to Fed Chairman Powell and the central bank. In his account of Powell's unprecedented intervention into the economy during the COVID pandemic, Timiraos doesn't seem concerned enough about the systemic risks and the moral hazard of the Fed assuming an ever-greater role in financial markets and the economy.

President Barack Obama appointed Powell Fed governor in 2012. President Trump appointed him chair in 2018. While progressive heartthrob Sen. Elizabeth Warren, socialist Bernie Sanders, conservative Ted Cruz, and libertarian Rand Paul opposed Powell's appointment as chair, he earned broad bipartisan support from the rest of the Senate. Powell, a lawyer and former private-equity investor, checked a lot of boxes: he was smart, a gentleman, and a pragmatist. He had a good work ethic and was a registered but not partisan Republican. He fit easily within the image the Fed cultivated of being competent, technocratic, and apolitical.

Then, in March 2020, a pandemic and government-mandated lockdowns crashed the economy. The enemy, a virus, would ultimately be vanquished by vaccines, natural immunity, and treatments. But immediate-term fear and lockdowns roiled the economy and financial markets.

Congress, the Fed, and the Treasury, Timiraos reports, “applied two hard-learned lessons from the 2008 financial crisis and grinding recovery that followed: Lesson one: Go big. Lesson two: Go fast.” For Powell and the Fed, March and April were a “total blitz.”

Timiraos writes approvingly, “On the precipice of catastrophic financial meltdowns, the normally staid and predictable Fed can move faster and more powerfully than any other arm of the government.” Powell and the Fed pulled out all the stops, responding with unprecedented speed, scope, and scale, buying financial assets and committing to extend a range of credit facilities.

The *Wall Street Journal*’s chief economic correspondent criticizes political interference with the execution of monetary policy. Presidents Truman, Johnson, and Nixon bullied Fed chairmen for easy money. President George H. W. Bush chided Chairman Alan Greenspan over tight money. Timiraos lauds the “Rubin Rule” – advocated by President Clinton’s second Treasury Secretary, Robert Rubin, that presidents shouldn’t publicly demand specific Fed monetary policy. Presidents Clinton, Bush 43, and

Obama hewed to it. But President Trump, after appointing Powell chairman on the expectation of easy money, publicly hectored Chairman Powell for even lower interest rates. Trump's fusillades were striking, as Powell had been a dove's dove. On his watch, the real federal funds rate had hovered around and under zero.

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The Rubin Rule is politically sensible, as Fed chairs don't report to the president, but the central bank isn't independent. It was created and given its mandate by Congress to conduct monetary policy supporting stable prices, maximum employment, and moderate long-term interest rates.

On February 2, 2020, on the verge of the COVID crisis, the central bank's balance sheet was $4.2 trillion. The central bank bought Treasuries and mortgage-backed securities, creating dollars. It promised to, but never did buy, corporate bonds. The pledge was sufficient to unfreeze the private market. The Fed also financed a small number of businesses and governments, including Illinois and New York City's MTA. By April 1, 2020, its balance sheet ballooned to $5.8 trillion; by June 3, 2020, $7.2 trillion; and by March 30, 2022, a whopping $8.9 trillion.

Timiraos vividly recounts the deliberations and actions of the Fed "troika": Chair Powell, Vice Chair Richard Clarida, and New York Fed President John Williams. Under intense pressure, Powell worked well with Treasury Secretary Steve Mnuchin and Congress on both sides of the aisle, and he kept his cool in the face of Trump's public criticism, rants, and disengagement. Timiraos criticizes Trump heavily, judging his behavior in the crisis steadying markets and helping financial institutions and businesses survive to be erratic and counterproductive.

He characterizes the Fed's campaign as "Bagehot on steroids." Journalist Walter Bagehot, in his seminal *Lombard Street*, counseled that to avert panic, central banks should lend early and freely, to solvent firms, against good collateral, and at high rates. The Fed lent swiftly and massively, but it didn't focus on credit quality or exact rich terms. The view that businesses were imperiled through no fault of their own informed the Fed's approach. Mnuchin worried more about the creditworthiness of firms getting Treasury credit through the Fed.

The COVID recession was short. While the economy is remarkably resilient, we don't know how bad it might have been if the Fed hadn't intervened so aggressively. The reigning orthodoxy holds that the Fed must act to address every economic downturn. It was not always thus. In *The Forgotten Depression: 1921: The Crash That Cured Itself*, financial journalist and historian James Grant shows that while government and the Fed did next to nothing, the deep 1920–21 depression was short-lived, with a steep V-shaped recovery.

While Timiraos is gushing in his praise of the Fed, a powerful activist central bank trying to do much more than maintain stable prices is dangerous. The Fed's epic COVID intervention wasn't the first and won't be the last. Interventions beget more interventions.

In the 2008 financial crisis, the central bank's role and economic footprint increased dramatically. On the brink of the financial crisis, on December 26, 2007, the central bank's balance sheet was $890 billion. Timiraos says that former Fed chairman Ben Bernanke launched "arguably the easiest money policy ever." It's not arguable that since its 1913 founding the Fed had never opened a remotely comparable fire hydrant of money. By December 30, 2009, its balance sheet had mushroomed to $2.234 trillion.

The Fed's easy money and HUD's affordable housing goals for GSEs Fannie Mae and Freddie Mac gutted mortgage credit standards and fueled a tsunami of subprime and high-risk mortgages and a housing bubble, which burst, causing the financial crisis and Great Recession. In 2003 and 2004, the real federal funds rate was negative. By June 2008, 57 percent of U.S. mortgages were subprime or Alternative A-paper, including mortgages with no or negative principal amortization, no income verification, and down payments of less than 3 percent. Seventy-six percent of them were owned or guaranteed by the GSEs and government.

The Feds created moral hazard.

Congress, the executive branch, Wall Street, the commentariat, and much of the public increasingly looked to the Fed to minister to the economy, calm and buoy markets, and deal with problems best sorted by the market or fiscal and regulatory policies.

Private-sector actors expect the Fed to bail them out of their troubles. And politicians, in lieu of adopting sustainable pro-growth tax and regulatory policies, look to the Fed for easy money. Timiraos notes then-

Congressman Mike Pence's criticism that "Printing money is no substitute for pro-growth fiscal policies." Pence was correct.

By 2010 the economy was still "lackluster." This was largely because of anti-growth fiscal and regulatory policies, not insufficiently low interest rates. Nevertheless, Bernanke and the Fed undertook to "shore up" the economy by raining money on it.

From 2017 through 2019, the Fed finally started tightening, shedding assets and gently ratcheting up its benchmark interest rate. At the Federal Open Market Committee's July 30-31, 2019, meeting, however, it reversed course to "insure against downside risks" of "weak global growth and trade policy uncertainty" and to "promote a faster return of inflation" to 2 percent.

Long before COVID, the Fed had pivoted from in principle opposing to supporting inflation. In 2012, under Bernanke, the central bank lawlessly targeted 2 percent inflation. Its mandate of maintaining stable prices means zero inflation. Nobody would say an MMA fighter's weight, which increased 2 percent each year for 15 years, from 150 pounds to 202 pounds, was stable. In 2020, under Chair Powell, it went a step further, announcing it would allow higher inflation to make up for past inflation below its target.

Decades of easy money fueled asset inflation, while price inflation remained modest, albeit not zero. But with the binge of money-printing and deficit spending, COVID- and regulation-induced supply constraints, and a tight labor market, the price-inflation tiger was loosed.

In 2021, it started rising. The M2 money supply increased 9.7 percent from March 1, 2021, to February 28, 2022. In March 2022, inflation hit 8.5

percent, the highest since December 1981. While the Fed has tried to manage the economy, it has neglected its core mission of preventing inflation, something it has the tools to do.

Powell, Williams, and Vice Chair nominee Lael Brainard all have said that in May the FOMC is likely to raise rates by 50 basis points and to start reducing the balance sheet, pulling money out of the system to reduce demand. It has a long way to go. Real interest rates are negative. It will encounter political headwinds.

Chase CEO Jamie Dimon says, “If the Fed gets this right, we can have years of growth, and inflation will eventually start to recede.” If.

The Fed’s vastly expanded role is a systemic risk.

If investors believe the central bank has their backs, they take excessive risks. People take greater care when their money is at risk. Politicians find it easier to support unsustainable and reckless spending and anti-growth taxes and regulations, assuming the Fed can and will bail them out. If major improvident states like California, Illinois, and New York were unable to meet their obligations, might the Fed view that as exigent circumstances and come to the rescue?

The *Wall Street Journal*’s chief economic correspondent observes that Powell in big ways redefined the Fed. He did, but he was continuing on the trajectory from Bernanke’s massive quantitative easing.

Trillion Dollar Triage forcefully reminds how enormously consequential the Fed and who runs it have come to be — perhaps too consequential.

Timiraos should be more worried.