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The Central Bank Dip



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hat a difference a few decades make. In 1982, the reputation of the Federal Reserve was riding high after its leader Paul Volcker had deftly tamed the double-digit inflation that blighted the US economy during the late 1970s. A year later, when Hong Kong suffered a currency crisis, the Fed's tangential involvement played an essential part in lifting the then-

British territory out of economic and political turmoil. While the Fed's glow lasted into the early 21st century, the institution now seems to have lost some of its luster, as have other major central banks, according to some experts.

In the finance world, Fed chair Volcker and his successor Alan Greenspan were revered like A-list movie stars. “These Fed chairmen were larger than life,” says Jay Hatfield, CEO of investment company

Infrastructure Capital Advisors. “Volcker and Greenspan used judgment instead of rules,” he says. “If you believe you have someone brilliant in charge, then you have confidence.” And investors did have confidence. The stock market registered an epic bull run from 1982 through 1999, interrupted only by a brief pullback in 1987.

During the bull market, there was little transparency in how the Fed worked and how decisions got made. “Greenspan was famous for talking a lot but saying nothing during his congressional testimony,” Hatfield says. Many economists made their careers by translating the seemingly incomprehensible “Greenspan speak” into plain English.

However, after Greenspan stepped down in 2006, the Fed switched its practices. It moved from being run by brilliant autocrats to a system of committee-based decision making. At first, that was under the stewardship of Ben Bernanke, followed by Janet



Yellen, then Jerome Powell. That move to group decision-making also coincided with increased demands for transparency. Put simply, voters and politicians alike wanted to know how the Fed made its decisions. Hatfield says more transparency reduced policymakers' flexibility to make ad hoc policy changes.

Recently, the Fed, the Bank of England, and the European Central Bank have all drawn harsh criticism for their sloth-like responses to ballooning inflation following the pandemic. Some critics go further, saying the jump in inflation was caused by central bank policies of excessive money printing. “The Fed thought it could ignore the money supply,” Hatfield says. The US monetary base (cash plus deposits at the Fed) jumped by \$3 trillion between February 2020 and December 2021. Some economists correctly forecast that such a ballooning money supply would create an inflationary surge.

Another problem is that central bankers have begun weighing in on political matters, which tends to draw criticism. For decades, central bank

mandates have typically been to control inflation, promote high employment, and maintain financial stability. But now, the Fed has added achieving equity and social justice to its task list. Both are politically charged. “The Fed is the very picture of mission creep,” says Pete Earle, research faculty at the American Institute for Economic Research. “The view of the Fed as a monolithic institution with no whiff of political influence is long gone,” he says.

Others see a more benign explanation for the tarnishing of the Fed's luster. Historically, what the Fed did was far more important to investors than anything else. But that's changed. “The Fed hasn't lost its shine in what it does, but now there are other catalysts that weren't there before,” says Greg Bassuk, CEO of AXS Investments. Instead of being the top driver of financial markets, it's now one of a few engines. The other factors include geopolitical tension, such as the recent invasion of Ukraine, global supply-chain disruptions, and the pandemic. “Those catalysts will be around going forward,” Bassuk says. ▀

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