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Howard Gold's No-Nonsense Investing



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## For Janet Yellen, a single mandate now Opinion: To reduce unemployment, rates will stay low

By Howard Gold



Bloomberg

### On Wednesday, the Federal Reserve let the other shoe drop.

In a statement issued after its two-day meeting, the Federal Open Market Committee declared that it would continue to wind down its extraordinary bond buying program ("quantitative easing" or QEIII) by another \$10 billion, so it will now buy \$55 billion worth of bonds a month. That was well-telegraphed.



### Fed lessens weight of jobless rate in guidance

WSJ Chief Economics Correspondent Jon Hilsenrath discusses the Federal Reserve's move to alter its guidance on the likely path of interest rates, putting less weight on the unemployment rate as a sign for when rate increases will start.

But then it dropped its 6.5% unemployment rate threshold for raising the federal funds rate, a target it had set in December 2012.

Instead it would look at some "qualitative" measures, "including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments," the FOMC's statement said.

It added that "it likely will be appropriate to maintain the current target range for the federal funds rate for a considerable time after the asset purchase program ends, especially if projected inflation continues to run below the Committee's 2% longer-run goal..."

(U.S. inflation rose 1.6% in the 12 months ended in January.)

Translation: The big problem with inflation now is that it's too low; reducing unemployment is the only game in town.

This move shouldn't have surprised anyone. The official unemployment rate was 6.7% in February and keeping that 6.5% target would have tied the Fed's hands before it's even finished tapering.

But even a cursory review of new Fed Chairwoman Janet Yellen's work as an academic at UC Berkeley and as president and Chief Executive of the

Federal Reserve Bank of San Francisco reveals an economist whose approach may be different from those of her last three predecessors—Paul Volcker, Alan Greenspan, and Ben Bernanke.

While Volcker famously tamed runaway inflation, Greenspan presided (at least initially) over the Great Moderation, and Bernanke navigated the worst financial crisis and recession since the Great Depression, Yellen must deal with an economy that's slowly recovering, but leaving a lot of people behind.

As vice chair, Yellen helped shape Bernanke's policy, and in many ways she's continuing that. But she's likely to focus even more intently on unemployment — one half of the Fed's "dual mandate" — and worry about inflation later.

"Unlike Bernanke, whose academic focus centered on policy responses to the Great Depression and inflation targeting, Yellen is a dedicated labor economist," wrote Bloomberg economist Joseph Brusuelas.

"Bernanke was well positioned to respond to the Great Recession via his credit easing policies; Yellen is equally well suited to the post-crisis policy challenge of the current labor slack in the economy."

"The Fed has this dual mandate focusing on the labor market and inflation," agreed Krista Schwarz, a professor of finance at The Wharton School of The [University of Pennsylvania](#), who has studied Yellen's writings and worked for the New York Fed. "With Yellen at the helm, it might shift...to a focus on labor market issues."

Indeed, noted Schwarz, Yellen has written or co-authored with her husband, Nobel Prize-winning economist George Akerlof, studies of the role monetary policy plays in boosting employment growth.

Yellen and Akerlof were among several prominent Berkeley Keynesians, including Christina and David Romer, Laura D'Andrea Tyson and J. Bradford DeLong. Yellen, Tyson, and Christina Romer served as chairs of the President's Council of Economic Advisors under Presidents Clinton and Obama.

Yellen's own preoccupation with employment was evident during her Senate confirmation hearings last November.



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"Unemployment is down from a peak of 10%, but at 7.3% in October, it is still too high, reflecting a labor market and economy performing far short of their potential," she said. "At the same time, inflation has been running below the Federal Reserve's goal of 2% and is expected to continue to do so for some time."

At another point, she testified:

"Around 36% of all those unemployed have been unemployed for more than six months. This is a virtually unprecedented situation, and we know that those long spells of unemployment are particularly painful for households...So, I consider it imperative that we do what we can to promote a very strong recovery. "

How high did she think unemployment really was? This exchange with Sen. Heidi Heitkamp (D-ND) was illuminating:

Sen. Heitkamp: OK. And tell me, what do you believe the real unemployment rate is today?

Janet Yellen: Well, the measured unemployment rate is 7.3% —

Sen. Heitkamp:... That was not the question.

Yellen: We have very high incidents of involuntary part-time employment. We have all too many people who appear to have dropped out of the labor force because they are discouraged —

Sen. Heitkamp: ...Would you agree that it is at least close to or probably over 10%?

Yellen: Well, certainly by broader measures, it is that high.

So, if Yellen thinks the real unemployment rate is much, much higher than the official rate, that would imply, said Schwarz, that "federal funds rate tightening is probably further away than most people think."

Investors, she said, expect the first hike in short-term [interest rates](#) to occur by mid-2015. At her press conference Wednesday, Yellen suggested the FOMC may not consider raising short-term rates until six months after it ends tapering — or at least around when the market expects.

"These days, inflation has been too low and people aren't used to thinking about too-low inflation," Schwarz told me. "Inflation now is below target, the labor market's weak, so what's the trade-off?"

"So far we haven't had that trade-off," Yellen said at her press conference Wednesday.

Her message was loud and clear: To reduce unemployment, we need to keep rates low for a long time. Dealing with inflation will have to wait until it's much higher. Welcome to the single mandate.

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