Department of Economics University of Maryland

Economics 325

Intermediate Macroeconomic Analysis

Supplement 4

Professor Sanjay Chugh

Fall 2011

The following *Wall Street Journal* article, published on August 31, 2011, presents a view of historically divided Federal Reserve, which the Fed's minutes (from the early August meeting) showed. "Historically divided" should be taken with caution, since three votes of "no" against seven for "yes" seems fairly staunchly on one side. However, it was the most "no" votes since 1992, an indication that perhaps within the Fed deep divisions are arising.

Wall Street Journal – ECONOMY

AUGUST 31, 2011

Economy Deeply Divides Fed

New Records Show Central Bank Officials at Odds Over How to Revive Recovery

By **JON HILSENRATH**

Federal Reserve officials are as deeply divided as they've been in decades about how to spur the flagging economy, records released Tuesday show, as they stake out positions on what, if any, action to take at their September meeting.

Minutes of the Fed's Aug. 9 meeting, released Tuesday after the normal three-week lag, offered new evidence that some officials wanted to immediately restart a controversial bond-buying program aimed at spurring the economy. Others felt that even the smaller steps the central bank instead chose were too aggressive.

Officials considered a range of actions—which included setting numerical targets for inflation and unemployment, rejiggering their holdings of Treasury securities and trying to push already-low short-term interest rates a little closer to zero, all with the purpose of boosting markets and economic growth. They also considered doing nothing.

After the minutes were released, investors cheered the prospect of more bond-buying. The Dow Jones Industrial Average finished the day up 20.70 points, at 11559.95, after being down earlier. Gold rose and yields on U.S. government debt fell.

Various Fed policy makers have been positioning themselves for the debate at the meeting on Sept. 20 and 21. The minutes suggested that, barring a shift in coming indicators, some policy makers will keep pressing for more action to spur the economy.

In times of economic weakness, the Fed normally pushes down short-term interest rates to lower borrowing costs and encourage investment and spending. But it already has lowered short-term rates to just above zero. At the August meeting, officials ultimately decided by a 7-3 vote to make what amounts to a conditional promise: They would keep short-term interest rates near zero for at least two years, as long as inflation doesn't threaten to rise too much or unemployment doesn't fall substantially before then. It marked the first time since 1992 that three Fed officials dissented from a policy decision.

Some Fed officials favored making a bolder move Aug. 9 to try and boost a stubbornly weak U.S. economy, minutes of their last policy-setting meeting showed. Phil Izzo has details on The News Hub.

"While all felt that monetary policy could not completely address the various strains on the economy, most members thought that it could contribute importantly to better outcomes," the minutes said.

Fed chairman Ben Bernanke, in a speech Friday in Jackson Hole, Wyo., didn't tip his hand about what comes next. The Fed has a mandate to keep inflation low and employment strong but officials disagree on how to reach both objectives. Some want more action because unemployment is high and others are strongly opposed because they fear causing inflation.

In a speech Tuesday, Narayana Kocherlakota, president of the Federal Reserve Bank of Minneapolis, sought to explain why he dissented from the August decision.

He felt the economy had improved in the past year and didn't need additional help, and that inflation also had picked up, which could be fueled by more Fed actions. He said he wasn't inclined to dissent again, but if the Fed considers more actions he would consider opposing them.

There will likely be a vigorous debate at the coming meeting about whether the Fed should take the big step of new bond purchases—known by many as quantitative easing, or QE—or other actions. One possibility is that the Fed will keep taking small steps while it reads the economy and decides whether to restart bond buying.

"We need to do much more to increase the level of accommodation," Charles Evans, president of the Federal Reserve Bank of Chicago, said in an interview Tuesday.

Mr. Evans, who stirred markets with similar comments earlier in the day on CNBC, said he felt the Fed needed to make an even stronger commitment to keep interest rates low. He worries that the public has tended to be too quick to assume the Fed will raise interest rates whenever the economy perks up a little and says that view is undermining the recovery.

He doesn't think the Fed should raise rates until the unemployment rate—now 9.1%—falls to 7% or 7.5%, or unless inflation threatens to move up to 3% over the medium run, meaning over three to four years. The Fed has a 2% long-run goal for inflation, but just as it undershot that by roughly a percentage point recently, Mr. Evans thinks it's all right to temporarily overshoot it a little, too.

Without stronger commitments to keep rates low or other Fed efforts to boost growth, there is a "tangible risk" that the economy won't be any stronger two years from now than it is today, "and I think that would be a huge problem," he said.

Mr. Evans is part of a contingent of Fed "doves"—officials who tend to be less worried about inflation and favor more action to boost growth and reduce unemployment. The "hawks"—who worry more about inflation and oppose more action—have received attention because they are the ones dissenting, but the minutes showed that the doves have been very vocal internally.

"A few members felt that recent economic developments justified a more substantial move at this meeting, but they were willing to accept (the measures taken) as a step in the direction of additional accommodation," the minutes said.

Last year, the Fed launched a $600 billion bond-buying program despite some internal worry and widespread external complaints that it could fuel inflation and push the dollar lower. Inflation measures did pick up earlier this year but now show signs of retreating.

Complicating the Fed's task is the fact that the economy is hard to read right now. Apart from the 1970s, inflation and unemployment have tended to move in opposite directions—a weak job market has tended to push inflation down. In the past year, growth has been lackluster, but the unemployment rate has stalled just above 9% and inflation has risen to around 2%.

"It's unusual to see an increase in inflation and a fall in unemployment occur when GDP growth is so sluggish and when the outlook for real GDP growth has slipped so much," Mr. Kocherlakota said Tuesday, seeking to play down the Fed's internal divisions. "It is hardly surprising that there might well be some disagreement about the appropriate monetary policy response to this conflicting mix of information."

Most Fed officials expect inflation to retreat in the months ahead. But the Augustmeeting minutes showed that some officials and Fed staff are beginning to worry that one result of the financial crisis and recession is that it now might take less growth to cause an inflation spurt. If this is the case—and Fed officials aren't sure it is yet—that could limit the Fed's ability to respond to weak growth.

Beyond more securities purchases, the Fed could choose to set more formal, numerical targets for inflation and unemployment. Such a move, some argued in August, "would establish greater clarity regarding the (Fed's) intentions and its likely reaction to future economic developments," the minutes said. This might be an area where different groups can reach agreement—Mr. Bernanke has long been for inflation targets, as has inflation hawk Charles Plosser, president of the Federal Reserve Bank of Philadelphia, who cast a dissenting vote at the meeting.

And Mr. Evans, the dove, agrees that it is "really important" for the Fed to clarify the guidance it has given the public about how the economic outlook affects its interest rate plans. Still, working out the details – for instance on whether the Fed should target just inflation, or also unemployment, and at what levels – has been a huge obstacle for policy makers in the past.

Rejiggering the composition of the Fed's securities holdings could also be a half-step which wins common agreement. Economic theory suggests that the Fed can push down long-term interest rates and stimulate growth by buying more long-term securities while it sells short-term securities. The Fed could twist the portfolio in this manner without adding to it, which might pacify inflation hawks who worry that the Fed's $2.8 trillion portfolio of securities, loans and other assets already is too large.

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