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TRENDMACRO LIVE!

On Yellen for Fed Chair

Wednesday, October 9, 2013
Donald Luskin

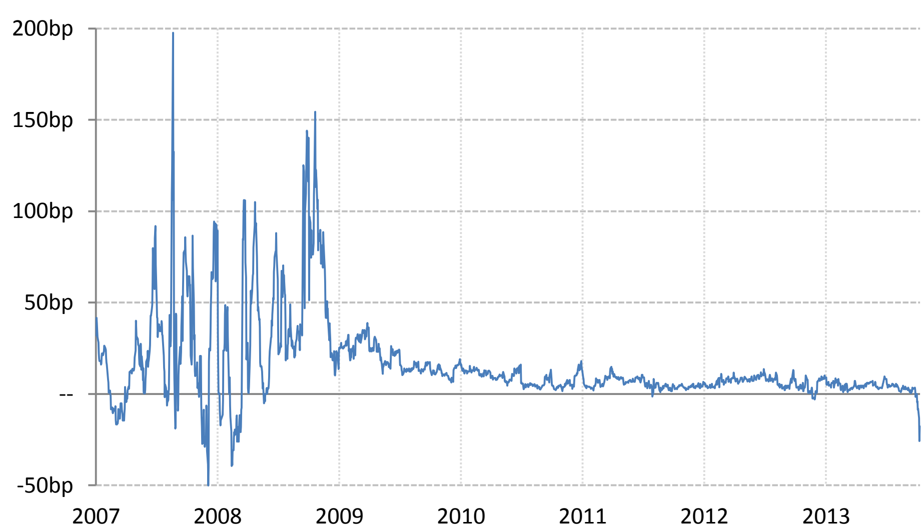
It means Obama is scared. The GOP offer to put sequesters into play will start negotiations.

We see the process of selecting the next Fed chair as having been a critical factor in triggering the present shutdown and debt limit crisis. It continues to be linked now, with the White House's announcement last night that President Obama would nominate Janet Yellen.

- *We ask: why would Obama announce the nomination of Yellen exactly now?*
- *We think it's no coincidence that the announcement would come after the US equity market's worst day since the onset of the crisis, and after a weak Treasury bill auction and a spread inversion pointing to tangible stress in a market facing the potential for technical default* (please see the chart below).
- *Things are getting a bit scary out there for the president, and the Yellen announcement is an opportunity to create a little certainty.*

But before we discuss *that*, a few words about the implications for Fed policy. Few words are all that are required. Yellen's nomination is no

US Treasury bills spread: 1-month minus 6-month



Source: Bloomberg, TrendMacro calculations

Update to strategic view

US FED, US MACRO, US STOCKS, US BONDS: Yellen's nomination is no surprise, and her policy views are well known. She is a dogmatic Phillips Curve Keynesian, and a big-government technocrat willing to apply her dogma to the maximum, with little regard for the risks. The Summers fiasco weakened Obama, and drew the GOP into provoking the shutdown and debt limit crisis. Pre-announcing Yellen's nomination yesterday, after a terrible day in US equities and a worrying bill auction, means Obama is getting scared. Combined with new overtures by the GOP, using sequester relief to get the Democrats to negotiate "peace with honor," the preconditions for a solution without default are falling into place. We continue to think this crisis will present a risk-on opportunity.

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surprise to anyone at this point, and her policy attitudes are well known.

- *Yellen is a dogmatic Keynesian who considers policy narrowly within the four corners of a graph of the Phillips Curve* -- as we have learned personally from heated discussions we've had with her.
- *She is a committed big-government technocrat who believes that her dogma should be applied to the maximum to manage the business cycle.* Unlike Ben Bernanke, who is an eclectic theoretician and a natural skeptic, Yellen will ignore the risks that attend her policy path.
- By fate, Larry Summers withdrew himself from consideration for Fed chair just three days before the FOMC was scheduled to meet and implement the first tapering of QE3 (see "On Larry Summers' Withdrawal" September 15, 2013). So Yellen went into that meeting as the anointed leader of an inherently autocratic institution, Bernanke deferred to her preferences, and tapering was put on hold (see "On the September FOMC" September 18, 2013).
- Now with her nomination assured, Bernanke's deference will only increase, and tapering will stay on hold at the October FOMC. It probably would have anyway, given what are widely advertised as systemic risks emanating from what Bernanke has called "the fiscal debate."

Now to the main event -- consideration of how Yellen's nomination plays into the shutdown and debt limit crisis.

- We had initially expected only minimal GOP interference with the continuing resolution and the debt limit. Republicans had shown little taste this year for aggressively contending with a popular president, despite several seemingly exploitable scandals. Apparently they thought it wiser to run out the clock until the 2014 mid-terms when the party not occupying the White House can be expected to make congressional gains almost automatically.
- But then Obama suffered a one-two punch from his own party -- being thwarted *first* by Democratic repudiation of his Syria strike authority request (see "A Little Distant Gunfire" August 29, 2013), and then *second* by a Democratic revolt at the prospect of the Summers Fed nomination (again, see "On Larry Summers' Withdrawal").
- *The Summers fiasco was the event at the margin that emboldened some in the GOP to launch a gamble that the Democrats were disunited, and vulnerable to schism over some wedge issue -- if pressured on it by the threat of shutdown or default.*
- Obamacare would seem now to have been a very poor GOP choice for such an issue. But at least a case could have been made that Democratic senators up for re-election next year in red states -- where Obamacare is unpopular -- could be turned.

So the Summers withdrawal got us into this. Now the Yellen nomination may signal the beginning of getting us out of it.

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Recommended Reading

Here's How We Can End This Stalemate
Paul Ryan
Wall Street Journal
October 9, 2013

Obamacare's Financial Unraveling: Predictable, and Predicted
Charles Blahous
Real Clear Politics
October 9, 2013

[Reading home]

- Again, the question is why nominate Yellen exactly *now*?
- Again, we think it's because the atmosphere in markets is finally getting a little scary -- in no small part due to panic-mongering coming from Obama himself, and his Treasury secretary (see "Let's Hope the Politicians are Lying" October 7, 2013).
- We think Obama chose this particular moment in order to calm things down a little bit, to give the markets certainty on a critical unknown, to act presidential while at the same time giving markets the nominee *they* -- not *he* -- wanted.
- Perhaps Obama remembers when, as president-elect in late November 2008, he rallied the US equity market from a panic bottom of multi-generational undervaluation by announcing he would nominate Tim Geithner to be Treasury secretary (see "Another Rescue, A New Rescue Ranger" November 24, 2008).
- *That he would go back to that playbook -- giving markets certainty, by appointing players who will generally provide policy continuity -- now means he's scared.*
- *The GOP is scared, too. For its part, it's now putting everything and anything on the table. It's not about Obamacare anymore. The idea is to start negotiations with the Democrats that will make it possible to make "peace with honor."*
- This morning's *Wall Street Journal* op-ed by House Budget Committee Chair Paul Ryan (R-WI) is a major overture -- and it puts a powerful player on the field who had been conspicuously absent until now. Ryan's arrival in the debate gives the Democrats someone to respond to other than House Speaker John Boehner (R-OH), and Ryan's impeccable conservative credentials give the GOP's right wing political cover to compromise along lines to which he gives his imprimatur.
- Ryan's op-ed contains a long list of ideas about which the Democrats and GOP might compromise. *It is significant that Ryan never mentions Obamacare in any way, as though to signal that the GOP is taking that off the table as a demand.*
- *There is one sentence in the op-ed -- one single idea from Ryan -- that we think is especially pivotal. It's something we identified on Monday as a likely key to compromise* (again, see "Let's Hope the Politicians are Lying"). *Ryan writes, referring to the sequesters, "We could provide relief from the discretionary spending levels in the Budget Control Act in exchange for structural reforms to entitlement programs."*
- If Obama is scared -- and the GOP is smart enough to use sequester relief as bait to lure Democrats to the negotiating table -- then the emotional and political preconditions for this crisis to get solved are falling into place.
- That's not to say it won't get solved at the last second of the last minute of the last hour of the last day. And who's to say when that moment even comes. There is considerable debate that the advertised deadline of October 17 would actually have to be the so-called "X day," when default truly occurs.
- But we now have new reasons to think the crisis can and will get solved. This makes us more confident that this crisis will present a risk-on opportunity.

Bottom line

Yellen's nomination is no surprise, and her policy views are well known. She is a dogmatic Phillips Curve Keynesian, and a big-government technocrat willing to apply her dogma to the maximum, with little regard for the risks. The Summers fiasco weakened Obama, and drew the GOP into provoking the shutdown and debt limit crisis. Pre-announcing Yellen's nomination yesterday, after a terrible day in US equities and a worrying bill auction, means Obama is getting scared. Combined with new overtures by the GOP, using sequester relief to get the Democrats to negotiate "peace with honor," the preconditions for a solution without default are falling into place. We continue to think this crisis will present a risk-on opportunity.