

FED SHADOW

So Welcome to the Yellen Years

Friday, November 15, 2013

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Rigid, dogmatic, nervous, poorly prepped -- and willing to deny the facts to defend policy.

Fed chair nominee Janet Yellen's [prepared testimony](#) and Q&A at her Senate confirmation hearing yesterday was short on surprises. The members of the Senate Banking Committee hardly lived up to the advice this week of our friend, Fed ex-governor Kevin Warsh, to ["find out where Yellen stands."](#) But if nothing else, this session was a taste of what it will be like to live with her as chair for four years.

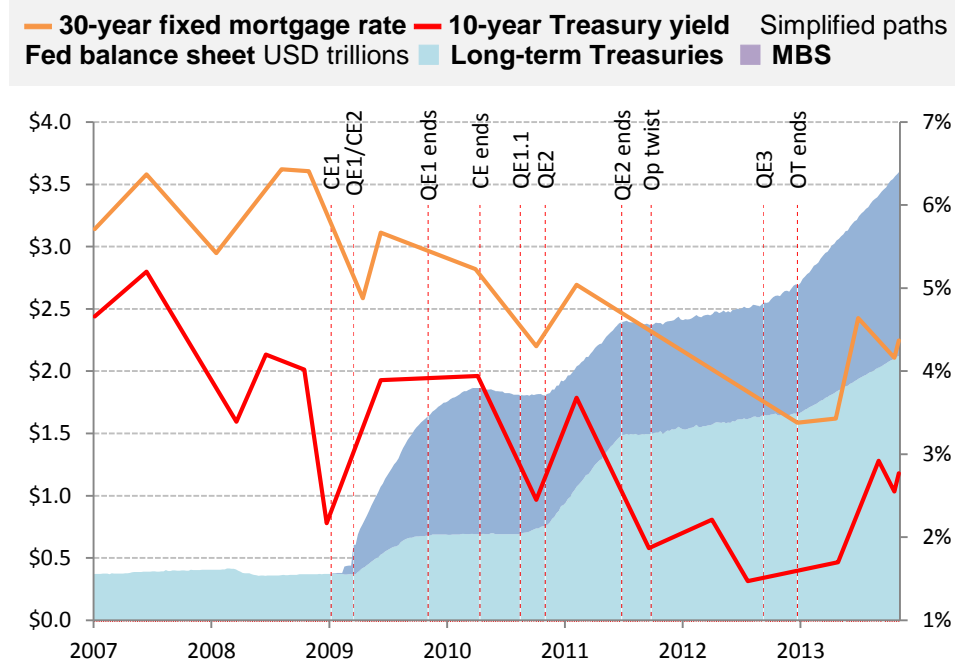
- Yellen's rigidity and dogmatism -- and her unwillingness to learn from policy failures (see ["Inflation in Fashion"](#) October 29, 2013) -- were on display yesterday. Surely she knew she'd have to defend against tough questions about the Fed's Large-Scale Asset Purchases (LSAPs) and quantitative easing, and defend she did.
- All the more so in light of a [report from the McKinsey Global Institute](#) finding that QE seems to be a non-event by any measure, but fraught with risks and unintentional wealth-transfers.
- She took a number of questions about the efficacy of the LSAPs,

Update to strategic view

US FED, US MACRO:

Yellen's confirmation hearing was a taste of what it will be like to live with her as Fed chair: dogmatic, rigid, narrow and willing to say anything -- even if it isn't true -- to defend and perpetuate her policy views. GOP members of the Banking Committee did nothing to undermine her, and indeed seemed to proactively support her. The best guess remains that Yellen's dogmatism will lead her to stay too loose for too long, and usher in inflationary risk as the global economy's appetite for liquidity subsides.

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Source: Federal Reserve, Bankrate, TrendMacro calculations

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and the risk that they would lead to asset price bubbles -- in all cases displaying her confidence that QE was working and can continue to work, and that there is no evidence of asset bubbles.

- *Several times Yellen repeated what amounts to a lie -- that "Certainly... the purpose of these purchases was to push down longer-term interest rates. We have seen interest rates fall very substantially."*
- Not only have rates not fallen "very substantially," they haven't fallen at all.
- *Indeed, the 10-year Treasury yield is about 100 bp higher now, and the 30-year mortgage rates is about 80 bp higher now, than when QE3 began. The 10-year yield is about 50 bp higher than when the first LSAPs were begun almost five years ago* (please see the chart on the previous page).
- Consistently over the last five years, from program to program, the evidence is that the Fed's LSAPs worked in reverse. Generally they made Treasury yields and mortgage rates higher while the programs were active, only to see them fall lower when the programs were paused (again, please see the chart on the previous page, and ["US Fixed Income Strategy: The Fed Irrelevancy Hypothesis"](#) July 2, 2013).
- Yet Yellen said the opposite yesterday, over and over, with an air of assurance that is difficult for mere politicians to penetrate.
- Yesterday she inserted the word "so" at very beginning of no fewer than twenty of her answers to Senators' questions. This annoying verbal tic sets up the subtle impression that what she is about to say is not just an answer to a question, but rather the definitive conclusion to some drop-dead argument she has just made.
- Yet she seemed quite unprepared, indeed downright uninformed, on banking regulation. Several times she had to disclaim that she would have to study further or be more fully briefed to give a robust answer to Senators who clearly knew more about the topic than she did.
- Even on monetary policy she came up blank on one question, when Senator Bob Corker (R-TN) asked her "how many rate increases you have voted for during your term on the Federal Reserve." She said she was on the FOMC from 1994 to 1997, a period which included a hiking cycle, and when pressed for a number came up with "twenty or more." Corker supplied the exact answer as 27, saying "I thought that was just good to get into the record."
- *The clear signal: moderate Republicans will support her nomination, and won't co-operate with Rand Paul's (R-KY) [announced intention](#) to delay it (again, see ["Inflation in Fashion"](#)).*
- *More aggressively conservative GOP members of the committee, such as David Vitter (R-LA), said nothing to suggest Yellen will face particular difficulties.*
- Perhaps it was the shadow of this possibility that made her so obviously nervous. At one point, defending LSAPs, she barely saved herself from a hilarious blooper-cum-confession: "at this point I believe the costs -- the benefits exceed the costs."

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Recommended Reading

[Why We Have Federal Deficits: The Policy Decisions That Created Them](#)

Charles P. Blahous
Mercatus Center
November 14, 2013

[QE and ultra-low interest rates: Distributional effects and risks](#)

Richard Dobbs, Susan Lund, Tim Koller, and Ari Shwayder
McKinsey Global Institute
November, 2013

[Finding Out Where Janet Yellen Stands](#)

Kevin Warsh
Wall Street Journal
November 13, 2013

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- Our favorite was when, attempting to deflect a question about whether QE is causing asset bubbles, Yellen said, "No one wants to live through another financial crisis."
- So, Ms. Yellen, if there is ever another financial crisis we would definitely prefer to live through it.

Bottom line

Yellen's confirmation hearing was a taste of what it will be like to live with her as Fed chair: dogmatic, rigid, narrow and willing to say anything -- even if it isn't true -- to defend and perpetuate her policy views. GOP members of the Banking Committee did nothing to undermine her, and indeed seemed to proactively support her. The best guess remains that Yellen's dogmatism will lead her to stay too loose for too long, and usher in inflationary risk as the global economy's appetite for liquidity subsidies. ▶