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FED SHADOW

Yellen and Screamin' at the Fed

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Donald Luskin

Bernanke may taper in January, to defer the day when the FOMC rejects Yellen's leadership.

Taper expectations are back. Some of it might be a sense that the data are improving (see "On the October Jobs Report" November 8, 2013, and this morning's strongly upward-revised Q3 GDP report). But we think the real reason is that the politics at the Fed has changed -- and with it, the tone of its communications -- since the big surprise *not* to taper at the September FOMC (see "On the September FOMC" September 18, 2013).

- *The driver, we believe, has been the evolution of out-going chair Ben Bernanke's thinking about how to best manage the hand-off to his likely successor Janet Yellen.*
- *Specifically, Bernanke has become concerned both that the dovish Yellen will defer tapering too long -- and that her lack of leadership skills and abrasive personality will create disruptive frictions within an FOMC whose voting members in 2014 will be, on balance, significantly more hawkish.*

Nasty, brutish and short?

Update to strategic view

US FED: Markets are worried about Fed tapering again, and they're right. But it's not because the data has improved that much. It's because Bernanke is going to take his last chance to taper, raising the bar on his successor Janet Yellen to stop or reverse it. It's not just that Bernanke thinks tapering is the right policy -- more, it's a recognition that Yellen lacks the skills to lead the FOMC and the Fed staff, where she is neither liked nor respected. The voting composition of the FOMC will be much more hawkish in 2013, and facing the difficult matter of tapering, Yellen faces a rebellion the likes of which haven't been seen for a generation. By starting tapering in January, Bernanke both does the right thing and defers the day when the FOMC devolves from his benevolent despotism into a mobocracy.

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- *Thus Bernanke may wish to hand Yellen a* fait accompli *by beginning tapering at one of his last two remaining FOMC meetings -- his last one in January would be ideal, but there is a scheduled post-meeting press conference at the December meeting.*
- *A sufficiently significant failure of Yellen to lead the FOMC -- that is, to command the willing followership of its members -- will transform the FOMC from the benevolent despotism it has been since August 1979 when Paul Volcker took command, into what amounts to a mobocracy.*

We have been quite candid in our characterization of Yellen as hubristic, dogmatic, doctrinaire, rigid, bossy and angry (see "On Yellen for Fed Chair" October 9, 2013, and "So Welcome to the Yellen Years" November 15). *This view is based on our personal experiences with her. But we know that others -- including those who have worked with her at the Fed and on the FOMC -- see her just the same way.*

- *Within the FOMC, and with the Fed's massive staff of professional economists, Yellen is neither respected nor liked.*
- No one doubts that she is smart. But for all her high-flown talk of concepts like "optimal control" or her bragging about "Yale economics," her credentials just don't compare to those of Ben Bernanke. He earned the respect of Fed staff and the FOMC from the get-go based on his profound expertise and historical knowledge of monetary policy -- and a disarmingly modest demeanor.
- Neither Paul Volcker nor Alan Greenspan were monetary mavens like Bernanke -- but both had possession of commanding political and interpersonal skills. Yellen, on the other hand, rubs people the wrong way -- she offends and frightens with her intellectual certitude that comes off as snobbishness and hubris.
- Furthermore, Bernanke, Volcker and Greenspan were all battle-tested in financial crises, in which they courageously took personal responsibility for terribly difficult institutional decisions. Yellen has not been a wartime commander. But during the banking crisis of 2008, as president of the San Francisco Fed she had jurisdiction over the troubled banks Wells Fargo and Washington Mutual. We know that in that instance she largely abdicated decision-making, leaving the tough calls to Bernanke.

It's not hard to understand how an obnoxious mediocrity could rise to positions of power and authority, as Yellen has. Institutions -- especially governmental ones -- are full of such people. But when such people move from mere power and authority to leadership, they fail -- because leaders require followers, and people won't follow leaders like that.

- There are situations in which certain highly intelligent and motivated people who lack interpersonal skills can nevertheless be great leaders. One thinks of Steve Jobs. But such a person is effective only in entrepreneurial settings in which the organization is essentially an extension of himself (see *America's Obsessives* by

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[About us]

Recommended Reading

Economic Populism Is a Dead End for Democrats
Jon Cowan and Jim Kessler
Wall Street Journal
December 2, 2013

Kissinger and Shultz: What a Final Iran Deal Must Do
Henry A. Kissinger and George P. Shultz
Wall Street Journal
December 2, 2013

[Reading home]

Joshua Kendall, 2013). He could not assume leadership of a pre-established institution with strong pre-existing bureaucratic and aristocratic tradition -- such as the Fed and the FOMC.

- And it's a real reach to say that Yellen is as brilliant in her world as Jobs was in his.
- *Yellen's lack of appropriate leadership skills will be exposed, as she attempts to meet the challenge of leading the FOMC in 2014.*
- *She will want to use every tool at her disposal to keep policy as loose as possible for as long as possible. But she will be facing a voting membership that is considerably less dovish than that of 2013.*
- She'll be losing the most dovish vote on the FOMC other than her own -- that of Chicago Fed president Charles Evans. And she'll be losing the most deflation-phobic vote, that of St. Louis Fed president James Bullard.
- She'll no longer have to contend with the reliably hawkish dissents of Kansas City Fed president Esther George. But she will be replaced by two votes just as hawkish -- Dallas Fed president Richard Fisher, and Philadelphia Fed president Charles Plosser.
- She can push, she can bully, she can get angry. *At first it may work, because the FOMC will probably want to give her a good start, if for no other reason than to preserve appearances.*
- *But soon enough, we expect that the cacophony of debates carried out in public in speeches and media appearances -- and then the dissenting FOMC votes -- will start to accelerate.*

Bernanke deferred to Yellen at the September FOMC by agreeing not to taper, after assiduously conditioning markets to expect tapering (see "On the September FOMC" September 18, 2013).

We know that Bernanke didn't lend his endorsement to Yellen to succeed him. But the September FOMC was a perfect storm for him. The meeting was just three days after Larry Summers had withdrawn himself from consideration for Fed chair (see "On Larry Summers' Withdrawal" September 15, 2013). So Yellen came in as chair-presumptive, and pushed as hard as she could -- and just as data had weakened a little bit and rates had risen over the summer. So Bernanke went along to get along.

- *But now things have changed. Data have arguably improved a bit. But be that as it may, Bernanke has had the chance to see that the decision to not taper in September hasn't done much to push rates lower.* No surprise there -- we've argued all along that the back-up in rates ongoing since July 2012 had nothing do to with the Fed, and everything to do with the end of the era of financial contagion (see "US Fixed Income Strategy: The Fed Irrelevancy Hypothesis" July 2, 2013).
- *And, we think, he's had a chance to think more about the reality of Yellen as his successor, and to hear from his colleagues their reservations about being led by her.*

- So now we have Bernanke in a November speech, explaining his deferral to Yellen in September by claiming that this stark violation of his prior taper promises "appears to have strengthened the credibility of the Committee's forward rate guidance." But he went on to warn, repeatedly, of the known and unknown risks of LSAPs.
- And the next day we had the publication the minutes of the October FOMC meeting, featuring a section called "Policy Planning," 1433 words -- twice the length of a typical modern FOMC statement -- explaining that the FOMC "generally expected that the data *would …warrant trimming the pace of purchases in coming months*" [emphasis ours].
- *Put it all together, and it means tapering begins at the January FOMC -- Bernanke's last.*
- It's not just that Bernanke thinks it's time to taper -- indeed, he has though so all along, only to be delayed temporarily by Yellen's emergence as his successor just as we hit a soft-spot in the data.
- More, it's that Bernanke is thinking about the future of the Fed as an institution after this monetary Cincinnatus surrenders absolute power and returns to his farm.
- By starting tapering, he raises the bar on Yellen to try to stop it or reverse it -- and defers the day when Yellen has an ugly public break with the FOMC that she is supposed to lead.
- *The conventional wisdom is that there is a great deal of risk to markets for the Fed to taper. We don't think so* (see "Escape from Taperphobia" July 8, 2013).
- *A true risk that markets aren't appreciating is the spectacle of the FOMC devolving into a noisy and unpredictable democracy, when Yellen fails to master it as a benevolent despot in the model of Volcker, Greenspan and Bernanke.*
- In the face of that risk we can comfort ourselves, at least, by realizing that an FOMC in rebellion against Yellen is better than one that gives in to her excessively interventionist dovish tendencies.

Bottom line

Markets are worried about Fed tapering again, and they're right. But it's not because the data has improved that much. It's because Bernanke is going to take his last chance to taper, raising the bar on his successor Janet Yellen to stop or reverse it. It's not just that Bernanke thinks tapering is the right policy -- more, it's a recognition that Yellen lacks the skills to lead the FOMC and the Fed staff, where she is neither liked nor respected. The voting composition of the FOMC will be much more hawkish in 2013, and facing the difficult matter of tapering, Yellen faces a rebellion the likes of which haven't been seen for a generation. By starting tapering in January, Bernanke both does the right thing and defers the day when the FOMC devolves from his benevolent despotism into a mobocracy.