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TRENDMACRO LIVE!

On Bernanke at Jackson Hole

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A Hoenig snub and a dovish speech, restoring discipline and paving the way to more ease.

We think Ben Bernanke's keynote speech this morning at Jackson Hole is a down-payment on the very necessary clarification and focusing of the FOMC's thought process, which has become dangerously opaque and dissonant over the last month (see "When PhD's Attack" August 25, 2010). Bernanke started this task last night by foregoing the chairman's usual ritual of offering welcoming remarks -- a passive-aggressive gesture to be sure, but nevertheless an aggressive one, signaling his displeasure with his host, Kansas City Fed president Thomas Hoenig and calling for party discipline.

As to the substance of Bernanke's speech, there's no doubt it's very dovish, and paves the way toward further easing (see "How to Ease, Not When to Tighten" June 23, 2010). He continues to seem to favor the sharpening of the "extended period" promise into a particular duration (see "What Should the Fed Do?" August 5, 2010). He noted that, as we have observed, a version of this strategy has already been *implicitly* implemented for some time (see "On the June FOMC" June 23, 2010). And he noted the Bank of Canada's successful experience with this approach. Most significant, he cited the difficulty of accurately communicating the parameters and conditionality framing a time-specific promise, *while completely ignoring the bizarre critique of it offered over the last two weeks by St. Louis Fed president James Bullard and Minneapolis Fed president Narayana Kocherlakota.* Subtly -- but clearly -- he concluded his discussion of this option by committing the FOMC to continue to hear him out on it, and at the same time warning Bullard and Kocherlakota that their public theorizings are confusing markets. Bernanke said,

> The Committee will continue to actively review its communication strategy with the goal of communicating its outlook and policy intentions as clearly as possible.

Bernanke was candid about the FOMC's discord, saying "At this juncture, the Committee has not agreed on specific criteria or triggers for further action…" But immediately thereafter he laid down two key points about which -- he represents, at least -- there is no disagreement:

Update to strategic view

US STOCKS, FED FUNDS, GOLD, US BONDS: Bernanke's Jackson Hole speech was very dovish, and decently assertive of intellectual leadership over the fractious FOMC. One way or the other, this makes it clear that more easing is in store unless the economy suddenly improves. This should go some way toward calming fears of an out-of-control Fed, underscoring support for stocks in their recent range and keeping the pilot light on under gold's gradual test of all-time highs. As we expected, long-term Treasuries reacted seemingly perversely to this dovish message, with yields rising thanks to upgraded growth expectations.

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> First, the FOMC will strongly resist deviations from price stability in the downward direction... It is worthwhile to note that, if deflation risks were to increase, the benefit-cost tradeoffs of some of our policy tools could become significantly more favorable.
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> Second, regardless of the risks of deflation, the FOMC will do all that it can to ensure continuation of the economic recovery... Because a further significant weakening in the economic outlook would likely be associated with further disinflation, in the current environment there is little or no potential conflict between the goals of supporting growth and employment and of maintaining price stability.

This is a very dovish speech, a "back to basics" speech calling on the FOMC to settle down and focus on what can be agreed upon -- the risks of deflation and contraction. We'll know that it was effective if Hoenig, Bullard and Kocherlakota keep their mouths closed for the next several weeks -- or even offer some words of reconciliation. It's probably already started -- even before Bernanke spoke, Bullard was conciliatory to Bernanke this morning on CNBC, saying Bernanke has "complete support" on the FOMC and was "very good at thinking way forward."

Do we really need an engraved invitation? Deflation and contraction are the risks, not inflation. In fact, when Bernanke discussed the inflation risks of further quantitative easing, he even noted that "if inflation expectations were too low, or even negative, an increase in inflation expectations could become a benefit." Setting aside the risky sociology of the FOMC, this confirms our long-standing call that the Fed will continue to find ways to ease as the economy continues its "expansionless recovery."

Bottom line

Bernanke's Jackson Hole speech was very dovish, and decently assertive of intellectual leadership over the fractious FOMC. One way or the other, this makes it clear that more easing is in store unless the economy suddenly improves. This should go some way toward calming fears of an out-of-control Fed, underscoring support for stocks in their recent range and keeping the pilot light on under gold's gradual test of all-time highs. As we expected, long-term Treasuries reacted seemingly perversely to this dovish message, with yields rising thanks to upgraded growth expectations.

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