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Yellen Testimony Guide From Weak Data to Interest-Rate Guidance

By Aki Ito February 27, 2014

Here's what to look for when Federal Reserve Chair Janet Yellen testifies before the Senate Banking Committee starting at 10 a.m. today. She spoke to the House Financial Services Committee on Feb. 11 in the first of two days of semi-annual testimony on the economic outlook and monetary policy.

-- Yellen's testimony to the Senate panel, originally scheduled for Feb. 13, was postponed because of a snowstorm, creating an unusual two-week gap between her appearances before the two committees that oversee the central bank. Since her House testimony, weaker-than-forecast data on retailing, manufacturing and home construction have suggested the economy is slowing, in part because of harsh winter weather.

-- Steady Helm: Yellen will probably maintain her support for predecessor Ben S. Bernanke's plan to gradually trim the monthly pace of bond purchases, even amid signs of weaker growth, said Tom Simons, an economist in New York with Jefferies LLC. "The Fed has been pretty consistent across its various members that the recent data isn't enough to derail" the reductions of about $10 billion per meeting, he said in an interview. "It would be a pretty important signal" if she deviates from that message.

-- Rate Guidance: Senators will probably also press Yellen on how she would like to alter the Fed's guidance on the labor-market conditions that would prompt it to start considering an increase in the benchmark interest rate, which has been held almost at zero since December 2008, said Carl Riccadonna, a economist at Deutsche Bank Securities Inc. in New York.

Continued Weakness

-- Policy makers said they would soon have to modify their year-old commitment to keep the rate near zero until unemployment falls to 6.5 percent, according to minutes of their Jan. 28-29 meeting released last week. The jobless rate fell to 6.6 percent last month, even as other indicators showed continued weakness in the labor market. The Federal Open Market Committee debated “the reliability of the unemployment rate as an indicator of overall labor-market conditions.”

-- Officials were divided over how to update their commitment to low rates, with some favoring keeping a quantitative link, “while others preferred a qualitative approach that would provide additional information regarding the factors that would guide the Committee’s policy decision,” according to the minutes. Yellen told the House committee that policy makers “would be looking at a broad range of data on the labor market, including unemployment, job creation and many other indicators of labor-market performance.”

Pros, Cons

-- “Now that we know about this ongoing discussion at the Fed, what does she favor?” Riccadonna said in an interview. “She could maybe hint or allude to pros and cons of the different options available” in her testimony today.

-- Partisan Gantlet: Republicans Senators Richard Shelby of Alabama and Robert Corker of Tennessee will probably press Yellen on any unintended consequences from record easing, such as long-term inflation risks and the prospect of asset-price bubbles, said Mark Calabria, director of financial regulation studies at the Cato Institute in Washington. Democrats, including Senators Elizabeth Warren of Massachusetts and Sherrod Brown of Ohio, will probably ask Yellen whether the Fed is being aggressive enough in regulating and supervising banks, Calabria said.

-- Republicans and Democrats are likely to focus on differing sides of the Fed’s dual mandate to ensure price stability and full employment, Calabria said. “The biggest distinction will be the emphasis on inflation versus the unemployment rate. You’ll hear Republicans put more emphasis on, ‘Is the Fed causing a bubble, is the Fed contributing to inflation?’” Democrats will tell Yellen “we need to focus more on creating jobs, there will be less of a concern of inflation,” he said.

Tougher Oversight

-- Out of Touch: Senators may point to transcripts released last week of the FOMC’s meetings in 2008 to criticize handling of the financial crisis, said John Canally, an economic strategist at LPL Financial Corp. in Boston. Yellen that year was San Francisco Fed president.

-- “That’s great political football during an election year,” Canally said. Lawmakers may focus on the “lack of understanding of the seriousness of the situation” in 2008.

-- Yellen in January 2008 saw the U.S. economy “at, if not beyond, the brink of recession,” differing from the less gloomy view of Fed staff, the transcripts showed. She spoke at the January FOMC meeting that year after the Fed staff reported that while the economy wasn’t in a recession, the likelihood of a downturn was increasing.