



# Yellen Price Goal Shows Anti-Inflation Stance Belying Dove Image

By Craig Torres  
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Inflation expectations in the U.S. are rising in financial markets, and hedge-fund manager Mark Spindel sees Janet Yellen's candidacy to be the next Federal Reserve chairman as a catalyst.

"If it is Janet, I think you have to price in some tolerance for higher inflation," said Spindel, head of Potomac River Capital LLC, which manages \$570 million, and former manager of \$15 billion at the World Bank's private-sector lending unit, the International Finance Corp.

She might prove him and other investors wrong. Her economic framework and communications strategy show little tolerance for higher prices. She led a subcommittee of the Federal Open Market Committee that produced an explicit inflation target of 2 percent, a topic the panel debated for more than a decade. Her policy approach uses models and rules that view stable prices as a necessary condition to try to move the economy toward full employment while holding interest rates near zero.

"The market does have it wrong if they think she is going to be soft on inflation," said Stephen Oliner, a resident scholar at the American Enterprise Institute in Washington and former senior adviser at the Federal Reserve Board. "She has very little tolerance for inflation above the 2 percent target."

As the FOMC subcommittee put together a strategy document published in January 2012, Yellen stood behind a phrase that said anchoring the public's views on inflation "enhances the committee's ability to promote maximum employment in the face of significant economic disturbances."

## Dual Mandate

The panel debated in 2011 tying changes in the benchmark lending rate to thresholds for employment and inflation, with Yellen in favor of combining such a move with the publication of an explicit inflation target.

“Janet was a force -- perhaps ‘the’ force -- behind the FOMC’s decision to move to an even more accommodative policy last December, when the committee signaled its inclination to respond more aggressively to deviations from full employment,” said Laurence Meyer, a Fed governor from 1996 to 2002.

Yellen “is a devout believer in defending the medium-term inflation target, but she believes in defending it from below, as well as from above, meaning that too much slack in the labor market could eventually drive inflation too far below 2 percent,” Meyer said.

Regardless of whether her dovish reputation is overblown, doubts about Yellen’s anti-inflation commitment are likely to dog her in a confirmation hearing if President Barack Obama nominates her to succeed Chairman Ben S. Bernanke, said Mark Calabria, a former economist on the Senate Banking Committee’s Republican staff. Bernanke’s term expires Jan. 31.

## ‘Open Question’

“It is an open question,” said Calabria, director of financial regulation studies in Washington at the Cato Institute, a policy research group that espouses free markets. “Can she be Paul Volcker if she needs to be?”

Volcker, the Fed chairman from 1979 to 1987, lifted the short-term borrowing rate to 22 percent to strangle inflation, snuffing out growth. The campaign drew a backlash from builders and others upset about the loss of work.

“People don’t send you two-by-fours when you are washing the system with liquidity,” Calabria said, referring to surplus lumber sent to Volcker in protest. Under Bernanke and Yellen, asset purchases have swelled the Fed’s balance sheet to a record \$3.72 trillion.

## Inflation Defense

Yellen would do what is necessary to pre-empt an inflation outbreak, said J. Alfred Broaddus Jr., the former president of the Richmond Fed who discussed an inflation target with Yellen when she was a Fed governor in the 1990s. “I have good reason to think she would. She needs to communicate that now,” he said.

Inflation expectations have been rising ever since former Treasury Secretary Lawrence Summers removed himself Sept. 15 from contention for the chairmanship. Yellen, whom Obama mentioned in July as a possible choice, is the leading candidate, according to people familiar with White House discussions.

Annual expected inflation starting five years from now rose to as high as 2.53 percent yesterday, according to bond prices tracked by Barclays Plc, up from 2.33 percent in the trading session before Summers withdrew.

In Spindel's view, Yellen wouldn't let inflation run away. He said she would welcome a little more inflation because of the costs of too-low inflation are high.

## **Below Target**

The personal consumption expenditures price index, on which the Fed bases its 2 percent inflation target, has been at least a half percentage point below that goal on an annual basis every month since November.

Inflation expectations may also be moving higher because U.S. central bankers decided Sept. 18 to press on with their \$85 billion in monthly bond purchases at a time when investors expected stimulus to wane.

Fed officials' median estimate for the benchmark lending rate is just 2 percent at the end of 2016, a year when policy makers expect growth as fast as 3.3 percent, inflation of 1.7 percent to 2 percent, and the unemployment rate at 5.4 percent to 5.9 percent, according to their central tendency estimates released this week. That's near the level they define as full employment.

Added together, the forecasts mean the Fed expects real short-term borrowing costs to be around zero at a time when wage pressures might begin to build.

## **Long-Term Concern**

"It projects them as overly accommodative," said Bret Barker, a portfolio manager in Los Angeles with TCW Group Inc., which manages \$84.5 billion in U.S. bond investments. "It puts the employment mandate above inflation. Long term, it is definitely a concern. We are defensive and are staying defensive on long-term rates."

Part of the perception about Yellen's inflation views stems from her speeches and research on stabilization policy. In her view, monetary policy can stimulate demand and lower unemployment.

"We will employ our policy tools, as appropriate, to raise aggregate demand and employment in the context of continued price stability," Yellen said at a speech sponsored by the AFL-CIO in February. "That's good news for workers, because I believe that these steps will increase demand, and more demand means more jobs."

"People's views on her being dovish stem from her views on the cyclical softness in labor markets," said Michael Gapen, senior U.S. economist at Barclays. "She is probably more practical and even handed."

## **Solid Record**

If nominated and confirmed by the Senate, Yellen, 67, would take over a central bank that has a solid record on inflation. Over the past 20 years, the PCE index, the measure the Fed uses for its 2 percent target, has averaged 2 percent.

That heritage, won by Volcker at a high cost of a recession and unemployment of almost 11 percent in 1982, and advanced further by former Chairman Alan Greenspan, can't be easily dismissed, said Meyer, now a senior managing director at forecasting firm Macroeconomic Advisers LLC in Washington.

"You don't want to be the chairman who loses" price stability, Meyer said. "I think when you walk through that entrance to the Federal Reserve Board on C Street, you feel that burden."