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Senator Calls Bernanke A 'Distraction,' Urges Abolition Of Dual Mandate

Colin Lokey | August 30, 2012

I have noted for quite some time now that the degree to which quantitative easing has come to inform the interpretation of each and every piece of economic data that comes across the wire is absurd. More often than not, articles that analyze the latest economic data reference the extent to which that data either provides the Fed with more or less "room to ease." This demonstrates the degree to which an *unconventional* measure has become not only conventional, but *expected*.

This is of course quite unfortunate for a number of reasons, not the least of which is that, as I have outlined in painstaking detail in previous articles, the benefits of these unconventional measures are diminishing and approaching zero -- and some research suggests that the long-term effects of the policies are likely to be detrimental. Nonetheless, the Fed is quite popular these days, especially on Wall Street as one thing quantitative easing has managed to do is boost equity prices.

One has to wonder however, if the Fed's new found celebrity is desirable. As Chicago Booth School of Business professor Randy Kroszner has noted in response to calls by presidential candidate Mitt Romney for the Fed to be audited, "...that information [the Fed's balance sheet] is already out there [and] Chairman Bernanke is more popular [on Capitol Hill] than Justin Beiber."

While this may indeed exonerate the Fed from (admittedly unfounded) charges of secrecy, it isn't at all clear that this kind of celebrity status is desirable for the Fed and/or its Chairman. In an op-ed in the *Financial Times* Thursday, Tennessee Senator Bob Corker suggested that the Fed's dual mandate has resulted in a situation wherein markets put far too much emphasis on what the Fed's next move will be. In short, Corker claims this undue focus on the Fed and its policies has become a "distraction."

Corker cites the fact that recent market activity has been driven by guesses as to what Bernanke will say at Jackson Hole rather than on macroeconomic factors. The *Wall Street Journal* alludes to this as well, by pointing out that the Fed's annual symposium used to be

> a pretty sleepy little conference...[until]...Bernanke in 2010 did the nose-tap about QE2 [and made] this conference...a headline event.

In discussing the Fed's dual mandate, Senator Corker notes that the Bank of England, the European Central Bank (although I'm not sure anyone wants to be taking their cues from the ECB right now), and the Bundesbank all have single mandates, and also points out that

> the maintenance of full employment in an economy as a completely separate task from price stability is much too complex for the blunt tools of monetary policy.

While some will undoubtedly accuse Corker's comments of being politically motivated (and they'd probably be right), it should be noted that Bernanke himself has expressed doubts about the Fed's ability to effectively control the unemployment rate. From a 2007 speech at the Cato Institute:

> Monetary policy determines the long-run inflation rate, whereas the factors that influence the sustainable rates of growth and employment in the long run are largely outside the central bank's control.

Given this, one wonders if Corker isn't correct in calling for the abolition of the dual mandate. One thing seems certain: The Fed is propping up the stock market by consistently hinting at more "unconventional" measures. The fact that part of the Fed's motivation for implementing these measures is the unemployment rate contributes to the view that, given the market's tendency to move up or down in response to trends in employment, eliminating this from the Fed's mandate may help to break the Fed-market link that many believe is contributing to malinvestment and volatility.

Eliminating the dual mandate might also decrease the frequency with which the Fed finds itself forced to intervene. In the long run, these measures must be scaled back and eliminated if anyone is to seriously consider them "unconventional." Of course, the whole debate may fade away sooner rather than later as it would seem that the Fed only has one more bullet in the chamber (i.e., one more shot a QE). If the economic effects of round three turn out to follow the pattern of diminishing returns (in terms of economic growth) that central bank interventions have generally produced since 2008 (this is discussed in a previous article cited above), there likely will be no more variants of these accommodative policies on the horizon.

Should that turn out to be the case, one wonders what will be left to keep the equity markets elevated in the face of a faltering economic recovery in the U.S., a deteriorating situation in Europe, and a so-called "hard landing" in China. I, for one, urge caution and recommend a 20% allocation to gold (GLD), hard assets, and short positions in major U.S. indices (SPY). There is growing pressure for the Fed to step out of the spotlight. When it does, stocks will be left to fend for themselves in an increasingly uncertain environment.

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