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Economic Update

THOUGHTS FROM OUR ECONOMICS TEAM

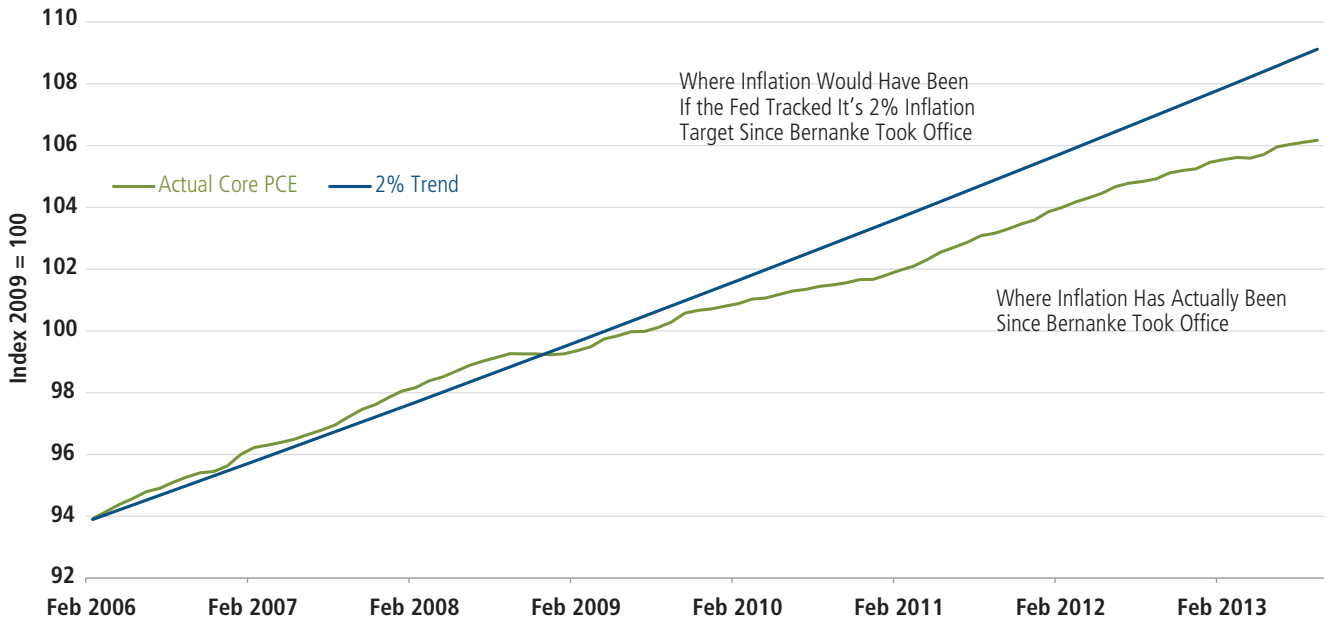
NOVEMBER 15, 2013

YELLIN' ABOUT YELLEN (AND THE ONE CHART YELLEN FEARS MOST)

On Capitol Hill today, Janet Yellen sat before the Senate Banking Committee as she began the confirmation process to become the next chair of the Federal Reserve. Scant on surprises, Yellen's prepared remarks and responses did provide financial markets with morsels to chew on. In particular, we think today's hearing brought to mind three important things: the danger of generalizations, the FOMC's preferred emphasis in 2014 and continued "dovishness" as the Fed falls short of their economic targets.

First, ex ante generalizations about new Fed policy regimes often miss the point. Anticipating Chairman Ben Bernanke's arrival in 2005, the market harkened back to a 2002 speech given at Milton Friedman's 90th birthday in which Bernake pledged to fight deflation. During the course of the speech, he referred to a "helicopter drop of money" and won the market moniker, "Helicopter Ben." But under his Chairmanship since 2006, inflation has printed below the Fed's 2% target for nearly five straight years (see Chart 1). Turns out, fears of "Helicopter Ben" plaguing the nation with consumer price inflation were wrong.

CHART 1: CORE PCE INFLATION SINCE BEN BERNANKE ASSUMED THE CHAIRMANSHIP OF THE FEDERAL RESERVE (FEB. 2006)

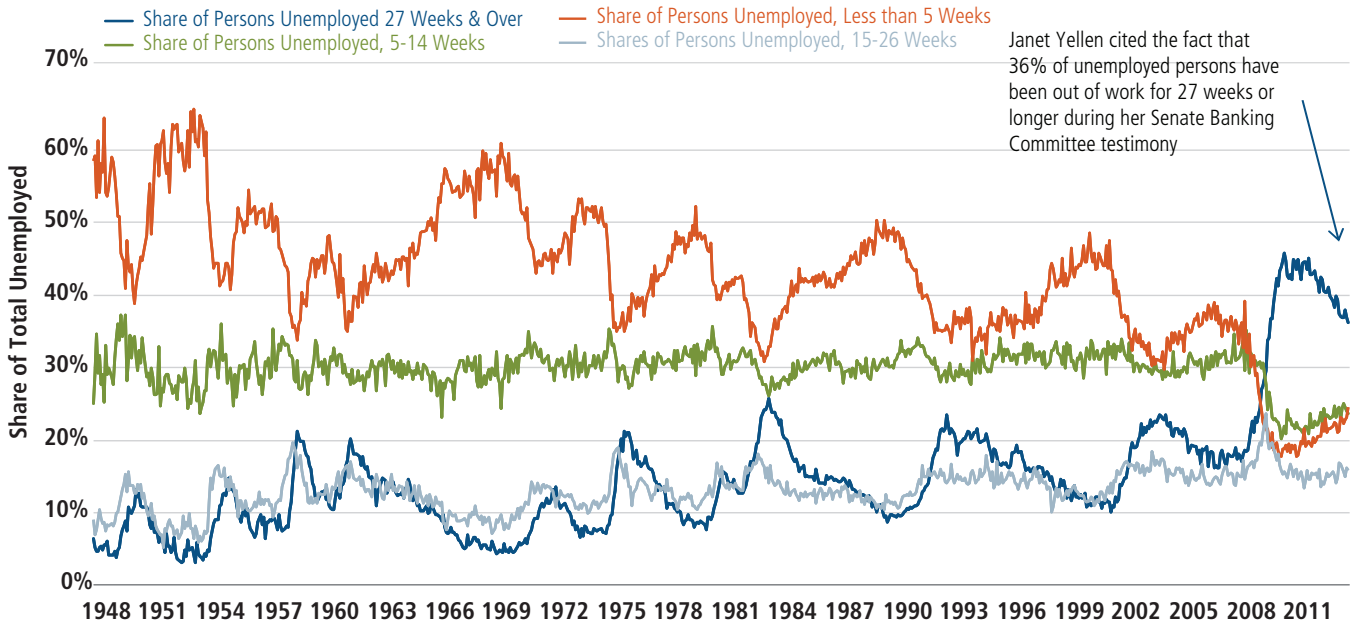


Source: Bureau of Economic Analysis

Second, Janet Yellen reiterated her commitment to strengthening and refining the FOMC's forward guidance program. She opined, "I strongly believe that monetary policy is most effective when the public understands what the Fed is trying to do and how it plans to do it." In 2014, look for forward guidance to steal the stage. With the FOMC's current thresholds for discussing a possible rate hike still far off (6.5% on unemployment so long as inflation remains under 2.5%), policymakers have expressed a desire to "clarify" and/or "strengthen" such guidance by reducing their unemployment target closer to 5.5-6% in 2014, for example. Yellen made clear today that the current 7.3% does not reflect the true health of the labor market.

Finally, into the meeting today, the market talked up the possibility of Janet Yellen appearing comparatively hawkish, heightening her concerns about inflation and the costs of QE, to appease Senators and gain confirmation. Instead, Yellen emphasized the tragedy of unemployment, concerns about longer-term unemployment, and income inequality. Yellen highlighted the fact that 36% of the unemployed have been unemployed for longer than 27 weeks (See our Chart 2 – The One Chart Yellen Fears Most). Seen from this vantage point, such a dovish tone should be expected. This is no usual recovery and the labor market is far from healed.

CHART 2: THE CHART JANET YELLEN FEARS MOST



Source: Bureau of Labor Statistics

In total, little changed today with regards to our expectations for FOMC action in 2014. We heard no mention of imminent tapering, and certainly no indication that the FOMC will move away from ZIRP (zero-interest rate policy) any time soon. Inflation is currently closer to 1% than the FOMC's 2% target and unemployment sits at 7.3%, compared to their implied 5.2% target. When Yellen assumes the role as the first female chair of the Federal Reserve and as the most powerful woman in the world, the FOMC's unconventional policies will "have farther to go to" in 2014.