Mitchell's Musings 9-21-15: Not Fed Up – A Follow Up

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Last week's musing involved the then-upcoming decision by the Federal Reserve on whether to raise interest rates. The musing noted that there was pressure on the Fed to raise short-term rates from near zero, not because there was some evident change in economic circumstances that would warrant a hike, but because near-zero rates were abnormal. I argued that the factors that should be the determinants – the general state of the economy in real terms (including the labor market) and inflation – were not indicating a need for a shift in policy. If anything, there were some weaknesses still present on the real side and inflation (whether we are talking wages or prices) was low and not accelerating.

Ultimately, the Fed's decision – taken with only one dissent - was not to raise interest rates.[1] And the factors cited were pretty much along the lines above: the condition of the real economy and the lack of inflation:

> *"On balance, labor market indicators show that underutilization of labor resources has diminished since early this year. Inflation has continued to run below the Committee's longer-run objective, partly reflecting declines in energy prices and in prices of non-energy imports. Market-based measures of inflation compensation moved lower; survey-based measures of longer-term inflation expectations have remained stable…"*

In the run-up to the decision, there were editorials and op eds and general articles. The upcoming decision was hyped, in some cases well beyond what was warranted. In view of some observers, there were suggestions that the current low rates were an aid to Wall Street. One article suggested that financial markets were addicted – as in morphine - to low rates.[2] But another op ed after the decision complained that it was Wall Street, or at least the holders of capital, that wanted a rate hike.[3] In fact, immediately after the decision the S&P 500 index rose

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[1] http://www.federalreserve.gov/newsevents/press/monetary/20150917a.htm
[2] http://www.latimes.com/business/la-fi-fed-market-influence-20150912-story.html (See the quote at the tail end of the article.)
[3] http://www.latimes.com/opinion/op-ed/la-oe-super-fed-rate-min-wage-20150918-story.html

and then fell. For the week ending September 18 as a whole, the index ended up almost exactly where it started.

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Basically, monetary policy is a blunt instrument when it comes to such concerns as income distribution (Main Street versus Wall Street; the 1% versus the 99%). Issues of income distribution are best addressed through fiscal policy. Unfortunately, at present fiscal policy is as gridlocked as ever. Indeed, at this writing, there is looming yet another threat of a federal government shutdown. So, as has been the case for much of recent history, monetary policy is the only macro instrument we have going. We should be grateful it's in sensible hands.

Luckily for the U.S., the Fed has been chaired in the Great Recession and its aftermath by two non-ideological pragmatists who let the data talk and avoid basing decisions on outmoded theories: Ben Bernanke and Janet Yellen. Here is Yellen's policy statement after the recent interest rate decision:

> *…Our actual policy actions over time will depend on how economic conditions evolve, which is quite uncertain. If the expansion proves to be more vigorous than currently anticipated and inflation moves higher than expected, then the appropriate path would likely follow a steeper and higher trajectory; conversely,*

if conditions were to prove weaker, then the appropriate trajectory would be lower and less steep.[4]

What more do you want?

[4] http://www.federalreserve.gov/mediacenter/files/FOMCpresconf20150917.pdf