

EC 202.05  
**Macroeconomic Theory**  
**Supplement 15**  
Professor Sanjay Chugh

The attached *Economist* article discusses the possible pros and cons of the nomination of Janet Yellen, the current Vice-Chair of the Federal Reserve, to be the next Chairman of the Federal Reserve. Yellen is an economist that is “doveish” on inflation, which effectively means that the first hints of inflation may not necessarily cause her to want to raise nominal interest rates. (The opposite of “doveish” is “hawkish.”)

## The new head of the Federal Reserve

# Dove ascendant

**Janet Yellen will stick to her predecessor's expansionary policies**

Oct 12th 2013 | WASHINGTON, DC | From the print edition

FOR most of the past few years, monetary policy has urged the economy on while dysfunctional fiscal policy has held it back. Barack Obama's decision to nominate Janet Yellen to succeed Ben Bernanke as the Fed's chairman in February raises the odds that stimulative monetary policy will continue. But disquiet about that stance is growing.

In addition to being the first woman to run the Fed, Ms Yellen is also the first acknowledged dove.

Presidents once felt compelled to appoint monetary-policy hawks such as Paul Volcker and Alan Greenspan to reassure markets that the Fed would not succumb to the political system's inflationary bias. In appointing Ms Yellen Mr Obama has implicitly acknowledged how much the world, and the Fed's priorities, have changed. Since 2008 America, like many other countries, has struggled with slack demand and high unemployment. Meanwhile, energy prices excluded, inflation has persistently fallen short of the Fed's 2% target.

Ms Yellen is not alone in believing that unemployment is a bigger problem than inflation. So do



*EyeVine* An uphill slog awaits

most of her colleagues on the Federal Open Market Committee, through which the Fed sets interest rates. But she has felt that way longer and more strongly. She pushed publicly last year to hold interest rates near zero for longer than the Fed then planned, to hasten the fall in unemployment, even if that caused inflation to rise briefly above 2%. She was the principal author of the Fed's current statement of long-term goals and operating principles, which stresses the equal importance of its twin statutory goals of full employment and low inflation.

As vice-chairman, Ms Yellen helped Mr Bernanke nudge the FOMC towards its commitments to keep its benchmark interest rate at zero (where it has been since late 2008) at least until unemployment has dropped to 6.5% and to keep buying \$85 billion-worth of bonds a month with newly printed money ("quantitative easing", or QE) until the labour market has improved substantially. These policies have not fuelled inflation, as hawks feared they might. Indeed, Ms Yellen would probably welcome having to tighten due to inflationary pressure, because that would mean demand was buoyant. But hawks still worry that the Fed is distorting prices in financial markets, breeding excessive risk-taking and preventing investors in Treasury bonds from demanding fiscal discipline.

Such concerns are widespread among Republicans in the Senate (which must confirm her). Several voted against her nomination to be vice-chairman in 2010. "She was not particularly modest about the role of monetary policy in the economy and I don't see any evidence that that's changed," one such Republican, Bob Corker of Tennessee, said this week.

With the support of the Senate's Democratic majority, Ms Yellen is almost certain to be confirmed. But with many Republicans opposed, she will probably get fewer than the 70 votes Mr Bernanke did for his second term in 2010, at the time the lowest on record for a Fed chairman. Moreover, one of the seven seats on the Fed's board is vacant and another five may come up for grabs in the coming year, given expirations and the tug of other opportunities. The weight of opinion within the institution could change markedly as a result.

Minutes of the Fed's last meeting, in September, show that it is already divided on QE. Many officials wanted to slow its pace. But the view that the economy was not strong enough prevailed, and the Fed surprised the market by sticking to its current pace of bond-buying. Once in office, Ms Yellen is likely to pursue a gentle "taper" coupled with a firm commitment to keep interest rates at zero. If the economy falters—an all-too-real possibility given America's budget mess—she may want to increase QE, but might struggle to persuade her colleagues. The Fed's strength, she said in accepting the nomination, is its capacity to "vigorously debate diverse views, and then to unite." Maintaining that trait may be her biggest challenge.

From the print edition: Finance and economics

