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Obama, Federal Reserve further muddy economic waters

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Federal Reserve Chairman Ben Bernanke, usually very clear and precise in his comments, muffed his recent testimony to Congress. Bernanke attempted the impossible and ended with egg on his face.

Every thinking person on the planet has known for some time that the Fed would begin raising interest rates at some time. Every thinking person has known that interest rates had been kept abnormally low by quantitative easing, which also buoyed the equity markets. Every thinking person has known that the effort to curtail QE would be very difficult to achieve and could potentially cause great upheaval in the markets.

The Federal Reserve has taken great pains to tell the markets under what circumstances it would reduce QE, and raise rates. The conditions were a reduction in unemployment to 6.5 percent, a growing economy and a lack of serious inflation. Two of these conditions are being met. Therefore, every thinking person has known that rate increases were in the cards and being contemplated.

Indeed, Federal Reserve minutes and Fed speakers indicated that there was not board unanimity, and some governors favored ending quantitative easing even now. But when Bernanke, in testimony before Congress, tried to emphasize that the Fed was considering tapering QE, the equity markets staged a tantrum.

Ending QE is admittedly a very difficult task for anyone, even normally articulate Bernanke. However, the markets appeared "shocked and appalled" that the Fed would even consider raising rates. Talk about an entitled generation. How about a whole industry? Wall Street, which has been bailed out over and over during the Great Recession, did not like having the punch bowl taken away.

It muddied the waters more when a few days later President Obama pushed the Fed chairman out the door. The president, in a surprise announcement, said that Bernanke had stayed two years longer than he wanted (Did he mean longer than Bernanke wanted or longer than the president wanted?)

Obama said that Bernanke had been a good partner (ignoring the fact that the Fed is an independent agency) and would retire at the end of the year. The president thus made Bernanke a lame duck. The president made the announcement himself; Bernanke was not with him, and indeed was in the middle of a Federal Open Market Committee meeting at the time.

Obama was apparently unconcerned the Bernanke will have to choreograph a very difficult policy change with QE coming to an end. Bernanke declined comment. It didn't look like a friendly departure to me. It was in stark contrast to the retirement of now discredited Alan Greenspan, who upon departure received high praise from President Bush.

But at last the president and the Tea Party found common ground. Both wanted Bernanke gone. Bernanke might be relieved to have the burden of running the world economy lifted from his shoulders, but it is going to be difficult to find someone who will take on this man-killing job.

So it might not be a man, but a woman who takes the job. Often in the political realm, when a job gets too tough for a man, they bring in a woman (see Margaret Thatcher and Angela Merkel).

The best and obvious choice for Bernanke's replacement is Janet Yellen, the Fed's vice chair and the Fed governor from San Francisco. However, the president muddied the waters even further by floating several names, including several unknowns and others deemed unacceptable. The markets were not impressed and dropped even further. While Yellen is not a household name, she is the best for the job.

Among the other marquee names mentioned was former Treasury Secretary Lawrence Summers, who was bounced as Harvard's president after he remarked that women have "a different availability of aptitude at the high end." Another was former Treasury Secretary Timothy Geithner, a favorite of Obama and a "Golden Slacks" alum – as if Goldman Sachs needed more influence over the economy. No, it is Yellen hands down.

The Federal Reserve was knocked on its heels by the market reaction. Of course, the Fed mandate does not include keeping the market happy. But Wall Street is a major constituency of the Fed, and keeping Wall Street happy is both practical and political. Politics may well be why the president pushed Bernanke down the plank.

It took the Fed awhile to regain its composure, but soon the Fed speakers were out in force and echoing Saturday Night Live's Gilda Radner in seemingly saying "Never mind." Federal Reserve Bank of New York President William Dudley warned the markets that they were misreading the Fed. "A rise in short-term rates is very likely to be a long way off," he stated in a speech before an event at the New York Fed.

Earlier in the week Mr. Dudley indicated an aggressively easing policy is needed right now. He said that he believes the message delivered by Mr. Bernanke was "clear," and that the path laid out by the central bank was consistent with what surveys of market participants were saying was likely.

Meanwhile, Fed President Narayana Kocherlakota held an unexpected press conference to state that the central bank had not been clear about QE and should provide greater guidance.

Dennis Lockhart, president of the Federal Reserve Bank of Atlanta, said "nothing has changed." He stated that the Fed would likely keep monetary policy very stimulative for years to come. He estimated the first move to raise rates would be sometime in 2015.

So, there you have it: muddy waters. It has been and still is clear that the effort of the Fed to change policy direction will be very difficult. Ben Bernanke only stated the obvious: "Times they are a changin.' " Stay tuned, and be calm. Expect volatility.

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