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What's New at the FOMC? FOMC Minutes Aug 1 2011 and Aug 9 2011

A long set of minutes that deserve very careful parsing, but at the end of the day, what did we learn? Not much new, particularly if you read the speech Bernanke gave at the opening of the Jackson Hole conference last Friday.

The economy is recovering but more slowly than anticipated in the Fed's forecasts with the rather modest contribution of consumption expenditures being the prime culprit. Accordingly, the growth in employment has been modest and the resulting unemployment rate reductions even more modest than hoped for in earlier Fed forecasts. In addition, some of the UE rate reduction is stemming from labor force withdrawals---that is lower participation rates. If jobs are scarce and UE benefits keep being extended, we shouldn't be surprised. Clearly, nothing over the past 60-90 days has resulted in lower uncertainty or brightening prospects for business investment. Still, business investment in technology is compensating for some plant and equipment investment. Housing construction and commercial real estate construction is still depressed and housing prices are not rising. Lower interest rates on some home mortgages are increasing affordability for those who can get refinanced, but on the scale of the bloat in mortgages, it is modest. The best news was the prior quarter's export growth that made for a net positive contribution to GDP by net exports (X-M). Note X-M can be negative but if it is less negative in the quarter, it is a net positive contribution to the change in GDP.

The uncertainty created by the charade in Washington over the debt ceiling cannot have done anything good for lowering uncertainty and the most recent PMI's and other surveys of business planning indicates hesitancy. What then were the Fed's choices in the August meetings?

The newest revelation was that the Fed's statement to hold short-term rates at current levels for the next two years met with some dissent (we knew that from the Statement at the end of the August 9, meeting) but information that some Committee members wanted a more aggressive policy change was new. What exactly they wanted is not revealed (we will only know that when the full transcripts are released years from now), but we can conjecture some might have wanted a QE3 policy or an affirmation of Operation Twist (lower long rates while keeping the Fed's balance sheet constant).

Understanding the dissents got easier with the publication of Minneapolis Fed President's Kocherlakota's speech today in Bismarck, North Dakota. (http://www.minneapolisfed.org/news_events/pres/nrk08-30-11.pdf) In a tightly reasoned but quite readable speech, Kocherlakota made the argument that if one compares where we were in fall 2010 and where we are now, the core inflation rate is higher and the unemployment rate is lower (albeit marginally). To him, that suggests that if you base monetary policy on some sort of "rule," if you are moving in the right direction, the FOMC should not ease further, and arguably could tighten. The prior policy change was the commitment to keep interest rates low for an extended period together with the QE2 maneuver. That suggests to Kocherlakota that at best, you should not extend your commitments and moving from an "extended period" horizon to a two-year (conditional) commitment to keep rates low was not warranted. He offers up the possibility that when he looks at the Fed's dashboard next time the Committee meets, he may well have to change his policy recommendation. He expects better growth in Q3 and Q4 and therefore if he is right, it could suggest a stronger dissent to the current policy setting.

What moves all three dissenters is to not try to gyrate Fed policy on the basis of the "latest" dashboard but instead to focus on medium term objectives and judge whether the economy is moving toward or away from those objectives. The worry we have is that the "Aggressives" seem to want to give a bigger "Put" to the harried on Wall Street!