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Monthly condensed analyses of crucial real estate and economic issues offered by the UCLA Anderson Forecast and UCLA Ziman Center for Real Estate. Here, Stephen Oliner, a senior fellow at the UCLA Ziman Center for Real Estate, gives advice on how to best predict the Fed's intentions.

How to Predict the Fed

A Guide for the Perplexed

By Stephen Oliner, senior fellow at the UCLA Ziman Center for Real Estate

The Fed continues to be a major part of the news cycle. And the news media – and the markets – continue to have trouble reading the Fed, especially when it comes to predicting when it will reduce its purchases of Treasuries and mortgage-backed securities under the ongoing Quantitative Easing (QE) program.

“To judge the Fed’s thinking, pay attention to a judiciously chosen set of the 12 Reserve Bank presidents.”

An informed reading of the Fed shows that it will likely not consider tapering down the QE purchases until the fall. But confused observers have been concerned that it will come sooner. It won't.

This confusion was readily apparent on the day of Chairman Ben Bernanke's most recent appearance on Capitol Hill to discuss the economy and monetary policy, May 22. A few hours after Bernanke left the Hill, the Fed released the Minutes for the Federal Open Market Committee (FOMC) meeting held on April 30 and May 1. The stock market initially rallied on Bernanke's prepared testimony, which was interpreted as suggesting that the Fed would not dial down its QE purchases in the near future. But his answers in the Q&A with lawmakers seemed to undercut that notion, and the Minutes went even further by noting that a number of FOMC members were willing to consider tapering as early as the June meeting. The Dow finished the day in the red, after the largest intraday price swing since February.

Press reports the next morning delivered a harsh judgment on the Fed. The headlines included: “In bid for clarity, Fed delivers opacity” (*The Wall Street Journal*), “Fed endorses stimulus, but the message is garbled” (*The New York Times*), and “Fed's mixed message takes stocks on a wild ride” (*The Washington Post*). The consensus was that the Fed had shot itself in the foot.

This consensus, however, read the Fed wrongly. The message from the Fed was a lot less complicated than the press reports would suggest.

To judge the Fed's thinking, it is better to pay attention to the speeches and interviews given by a judiciously chosen set of the 12 Reserve Bank presidents. Their comments are often more revealing than those of Chairman Bernanke and the other Board members who sit in Washington. Bernanke has to be very careful about what he says, both because his words move markets and because he doesn't want to front-run the FOMC's decision-making. The other Board members,

whose offices are just down the hall from Bernanke's, have limited latitude to express their own views. The Bank presidents, in contrast, don't work for the Chairman. They are much freer to speak their minds, and they do.

Among the Bank presidents, I would ignore the four inflation hawks (Richard Fisher of Dallas, Esther George of Kansas City, Jeffrey Lacker of Richmond, and Charles Plosser of Philadelphia). They are all thoughtful people with interesting things to say, but their views are too far outside the mainstream to affect FOMC decisions. In contrast, I would listen especially closely to what William Dudley, the president of the New York Fed, has to say. Dudley is a powerful member of the FOMC, and his views about monetary policy are close to those of Chairman Bernanke and Vice Chair Janet Yellen. And, finally, I would follow the comments of four other Bank presidents (James Bullard of St. Louis, Charles Evans of Chicago, Eric Rosengren of Boston, and John Williams of San Francisco). The first three have a vote on policy through year end, while Williams – a nonvoter this year – is an influential voice on the FOMC.

Dudley has provided important insights into his views. He has made clear that he would not support a start of tapering at the FOMC meeting this week, as he would need “the coming months” to assess the effects of the ongoing fiscal restraint on the economy. And, when asked point-blank whether tapering could begin in the fall, he responded: “I think it's possible ... if the labor market continues to improve and it's supported by economic activity.” These comments point to the FOMC's September meeting as the first likely decision point for tapering. Recent remarks by Bullard, Evans, Rosengren, and Williams echo the need for more data before making a decision. Notably, Evans said that he wanted to see whether the improvement in hiring was sustained “through the summer,” and Williams said he would be looking for the same pattern over “coming months.”

Here's my bottom line. Forget about tapering this month. That was only a theoretical possibility. If payroll gains average 200,000 or more per month over the summer, look for tapering in September. Even sustained monthly gains between 150,000 and 200,000 – which would represent a continuation of the trend so far this year – could be enough to prompt a September tapering. If the FOMC isn't ready to taper in September, it will evaluate whether to do so at every meeting from October on.

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Stephen Oliner is a resident scholar at the American Enterprise Institute and a senior fellow at the UCLA Ziman Center for Real Estate. He was formerly an associate director in the Division of Research and Statistics at the Board of Governors of the Federal Reserve System. This Letter condenses and updates an article published originally in Real Clear Markets on May 29.