



Discord at the Fed over Monetary Policy

Joseph E. Gagnon says that the latest minutes from the Federal Open Market Committee (FOMC) show three camps emerging: hawks, doves, and centrists, with Chairman Bernanke in the middle.

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Steve Weisman: Are the Federal Reserve Board and the Federal Open Markets Committee [FOMC] fracturing? This is Steve Weisman at the Peterson Institute for International Economics with Joseph Gagnon, senior fellow, who worked with the FOMC at the Fed before joining the institute. Joe, some recent minutes of an apparently contentious meeting of the FOMC in August have come to light. What conclusions do you draw?

Joseph Gagnon: I was surprised by the greater evidence of disagreements and multiple viewpoints. Up till now there seems to have been a dominant viewpoint, which I identify with the Chairman [Ben Bernanke] and then a few dissenters or a few people expressing their minority opinion. This time there were dissenters on both sides...

Steve Weisman: Let's back up. Frame the issue.

Joseph Gagnon: Up till now at the Federal Reserve, the dominant view that comes out of these minutes has been one of concern about the weakness of the economy, about a willingness to do aggressive actions to help, albeit tempered by some concern about inflation. They all agree on that, and I think that is why they haven't done much this year.

But there has been, for the past two or three years, a small group of members who express reluctance to do aggressive actions and even greater concern about inflation—the so-called “hawks.”

Steve Weisman: They for a time seemed outside the consensus.

Joseph Gagnon: They seemed outside the consensus. It seemed like there was a solid core of voting members who pretty much saw things the same way, and there was a small minority who saw things differently.

In this meeting it seemed that for the first time I saw evidence of dissenters on both sides. Some dissenters continued to be worried about inflation and opposed further policy views. But some members said they wanted to go even further than they went in August.

Steve Weisman: Where is Chairman Bernanke in this?

Joseph Gagnon: I'm sure he's probably in the middle. I suspect he has more sympathy with the view to doing more, but not quite enough to go into that camp yet apparently. So we will see.

Two interesting things happened. One, at the meeting, they decided that they would add an extra day to the meeting in September, to delve further into their options, which implies some desire by some people to perhaps do more, but they are not sure what.

In other words, they are not sure if they do want to either buy more assets, what assets would they want to buy. Or perhaps they won't buy more assets but they will in terms of dollars change the composition of their portfolio into longer term assets or different types of assets -- maybe mortgage assets, as opposed to Treasuries.

In other words, there are a number of options they might consider and they've added a whole day to the meeting in September to try and consider them. That seems to imply some movement towards possibly doing something.

One of the Presidents of the regional Feds [Federal Reserve Banks] who has a vote this year -- they rotate votes among themselves; they always sit in the meeting but they don't always have a vote -- one of the ones who has currently got a vote is Charley Evans of Chicago. [He] came out yesterday [August 30] saying explicitly that he would have wanted to do more already.

Steve Weisman: The Chairman of the Fed has the dual responsibility to advocate his own point of view, but also build consensus. And it sounds like you think that he is doing a little of both.

Joseph Gagnon: I don't know. He has dissenters on both sides. I don't know how that makes him feel.

Steve Weisman: He's the former chairman of an Economics Department. Maybe he's used to it.

Joseph Gagnon: Maybe he's used to it, yes, I don't know. My bottom line would be, I think that he is just waiting. The Chairman, that is, wants to see that this blip of upward inflation that happened earlier this year is over and is heading back down again. He is probably waiting for another month or two of data.

Steve Weisman: And do you think it will?

Joseph Gagnon: I think it will.

Steve Weisman: Why?

Joseph Gagnon: I just think the unemployment rate is so high and wages are so weak right now. Wage increases are so weak and unemployment is so high, that I just don't see how overall inflation can rise in a sustainable way.

And I think that blip had to do with direct energy costs that still aren't stripped out of the core measure for various reasons, and maybe some minor things in the housing rental market that won't persist.

I think he needs to see that it won't persist. And when he does I think he will be ready to act. But he's just not quite ready yet. He wants to make sure that the inflation increase wasn't permanent.

Steve Weisman: In Jackson Hole there was a lot of attention focused on his comments suggesting that the political fights in Washington this summer have contributed to uneasiness about the economy. Was that unusual?

Joseph Gagnon: Yes and no. It's actually quite normal for the chairman of the Fed to talk about fiscal policy. But I think what was a little unusual was that he was quite critical of the political process.

Steve Weisman: Right.

Joseph Gagnon: I think that was true. And he sort of indicated that he thought it unsettled markets to see Congress cut it so close on the debt ceiling.

Steve Weisman: But doesn't it unsettle markets to see that the Fed itself squabbling?

Joseph Gagnon: I think it would if there was...

Steve Weisman: If they were throwing food at each other?

Joseph Gagnon: No. Well, up until now, I've said no because I just thought the "hawks" were in the permanent minority, and there was no way they would ever get their way. So there was no real risk. But now there is. But on another hand it's a risk more towards the direction of potentially more action, so markets seem to want that.

Steve Weisman: Yes.

Joseph Gagnon: So it seems to me they should be happy.

Steve Weisman: Joe, thanks.

Joseph Gagnon: You're welcome.

