



DAILY LABOR REPORT



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Economic Outlook

Fed Official Argues Against New Round Of Monetary Stimulus to Assist Economy

DENVER—Thomas Hoenig, head of the Federal Reserve Bank of Kansas City, Oct. 12 said a proposal being considered by Federal Reserve policymakers to add more liquidity to financial markets would create long-term inflation risks while providing only a small economic benefit.

“It’s very obvious I’m in somewhat disagreement” with other members of the Federal Open Market Committee, Hoenig said in a speech to the National Association for Business Economics, referring to his six consecutive solo dissenting votes against the central bank leaders’ policy statements, issued after each of the committee’s periodic meetings.

The last time an FOMC member cast that many dissents in a row was in the 1950s, according to Richard Wobbekind, associate dean of the Leeds School of Business at the University of Colorado-Boulder who introduced Hoenig at NABE’s annual meeting in Denver. Hoenig also is the longest-serving of the Fed’s 12 district bank presidents, having headed the central states’ regional bank since 1991.

The FOMC at its next meeting Nov. 2-3 is expected to consider the proposal for the central bank to purchase federal-backed mortgage and other securities in an effort to lower interest rates further and spur the sluggish recovery and job creation. Hoenig said he favored having “a vigorous debate” because of the importance of the issue.

“These are difficult times, no doubt, and it is tempting to think that zero interest rates can spark a quick recovery,” Hoenig said. “However, we should not ignore the possible unintended consequences of such actions.”

Although the pace of recovery has slowed recently, “we’ve seen the economy come back” from an unprec-

edented crisis, he said, calling that “a very encouraging sign.” The private sector has added about 850,000 jobs since January, which is “not great, but [shows] consistent improvement over time,” he said.

“People are concerned. I’m concerned,” Hoenig said. “There is a feeling we have to do something” to bring down stubbornly high unemployment, now at 9.6 percent, he said.

However, estimates have found that purchasing \$500 billion in securities would lower mortgage interest rates by only 0.3 percentage point, which would provide little benefit, Hoenig said. “There’s no shortage of liquidity,” he said, arguing against adding to the risk of creating another “asset bubble” and heating up long-term inflationary pressures.

The main reason for the weak recovery is that banks, consumers, and some businesses still are “deleveraging” debt and restoring their own balance sheets after having overextended themselves during the period of easy money leading up to the financial crisis, he said.

A Warning Against Another ‘Bubble’. He noted that the FOMC’s low interest rate policies during much of the last decade created the housing bubble that led the recent financial crisis and severe recession from which consumers, financial companies, and other businesses are still trying to recover. “I’m not saying what the next bubble is,” but the “enormous liquidity” in the system has created imbalances that tend to lead to bubbles, he said.

“You shouldn’t create credit markets that forget risks,” he said. “Let’s not do that again.”

“As desperate as I am to see unemployment drop down,” Hoenig said, he is not willing to take that risk.

At some point, the Fed will have to start reducing its balance sheet but must do so carefully to avoid causing problems in the economy, Hoenig said. “You can’t do it overnight,” he said, adding that the proposed securities purchases would increase that challenge.

Following Hoenig’s speech, James F. Smith, an economic consultant and former NABE president, said “there’s a large subgroup” of the FOMC that is con-

cerned about the amount of liquidity the Fed has pumped into financial markets.

“So what they’re saying is, ‘Shouldn’t we wait a little longer?’ he said, referring to taking action on additional asset purchases. On the opposing side from Hoenig are those who claim “the economy is falling off the cliff,” said Smith, a former chief economist at Union Carbide and Sears Roebuck.

“He’ll probably lose but the vote might be closer than people think,” Smith told BNA.

Meanwhile, new data on the strength of the recovery will be released in late October, when the Commerce Department reports its first estimate of real gross domestic product growth in the third quarter. If real GDP posts “a good number,” substantially higher than the 1.7 percent annualized gain in the second quarter, that will “take a lot of the pressure off” the FOMC to take additional steps to boost the economy, Smith said.

No Easy Solution on Reluctance to Hire. Asked during a question period by NABE members how businesses can be encouraged to hire workers at a time when they face uncertainty over federal tax policy, Hoenig acknowledged “that’s a challenge.”

“I don’t have an easy solution,” he said.

President Obama has proposed that the 2001 income tax cuts, which expire at the end of this year, be ex-

tended for all except upper-income individuals, while Republicans want them extended for all income levels.

Policymakers should be mindful of the impact that tax policy can have on businesses in a fragile recovery, Hoenig said.

He also urged the Obama administration and Congress to make it a priority to develop a comprehensive package of revenue and budget measures to bring down the federal deficit over time as the best way to provide “clarity” to businesses.

In response to another question, Hoenig discounted the danger of experiencing a period of severe deflation, or a downward spiral in prices and wages. The Fed’s \$2.3 trillion balance sheet, along with other economic indicators, “gives me some sense we should not see deflation,” he said.

“We’re all scared of deflation. I understand that,” he said.

The rate of core inflation, excluding food and energy prices, is very low right now, at about 1.0 percent. “That’s not zero,” although it could slow further, Hoenig said. As the economy continues to grow, demand for goods and services will increase and inflation will pick up, he predicted.

“I’m not an advocate for high interest rates,” but for moving away from the Fed’s current target of nearly zero interest rates in careful steps, he said.

BY LARRY SWISHER