Tea Leaf

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Your guide to understanding today's economy and financial markets

July 29, 2009

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# Heaven Help Us…

Written by Jeff Thredgold, CSP, President, Thredgold Economic Associates

The President of the United States is typically viewed as the most powerful person on the planet. Surprisingly, the Chair of the Federal Reserve is typically viewed by many as the second most powerful.

Indeed, I would make the case that the Fed Chair, through his or her influence upon short-term interest rates (which leads to economic stimulus or economic restraint), current inflation pressures, and expectations of future inflation (which greatly influences the level of long-term interest rates), has perhaps more influence on our day-to-day lives than does the President.

The Fed has an ability you and I do not…the ability to create money. With this power comes enormous pressure from the bond market to do it responsibly so as to keep inflation pressures under control.

Federal Reserve Chair Ben Bernanke

The Fed enjoys a reasonable level of "independence" to make difficult choices when necessary—such as pushing short-term interest rates higher to control inflation, usually resulting in a slowing economy and rising unemployment. This independence is vital to the Fed's inflation-containment credibility.

Three major issues involve the Fed in coming months…

1) One of the most important decisions to be made by President Obama in coming weeks is whether to reappoint Federal Reserve Chair Ben Bernanke to another four-year term. Bernanke's current four-year term ends in January 2010. In my view, the President would make a wise choice in reappointing Bernanke, a view shared by more than 90% of forecasting economists in a recent survey.

What we don't need is greater uncertainty about monetary policy. Were Obama to propose someone seen as an Administration "puppet" in regard to impending monetary policy, similar to President Carter's disastrous appointment of G. William Miller as Fed Chair in 1978 (which led the U.S. dollar sharply lower and long-term interest rates sharply higher, tied to loss of credibility), the results could rival those of three decades ago.

The Fed, along with the U.S. Treasury, has taken unprecedented steps during the past two years to avoid the potential of an even greater domestic and global economic calamity than currently exits. As some suggest, the "Depression" option is no longer in the cards.

The Chairman has drawn frequent criticism for some of the steps taken, including the "bailouts" of Bear Stearns and AIG. In hindsight, some of that criticism may be warranted. However, the financial system was on the brink of collapse last fall. Aggressive steps were required and delivered

2) The second major issue is the desire of many in the Congress to bring the Fed under greater Congressional control (see title above). One effort, led by frequent Presidential candidate Rep. Ron Paul, seeks a regular audit of the Fed's conduct of monetary policy. Paul seeks the elimination of the Fed itself. Given the Congress's highly political bias, and inability to keep wasteful spending under control, one simply cringes in fear at the prospect of the Congress having a greater say in the conduct of monetary policy

3) The third major issue is how and when the Fed will implement its "exit strategy" from recent extraordinary monetary stimulus. The Fed is widely expected by forecasting economists to begin pushing its key short-term interest rate higher within 6-9 months from today's historic low. Various moves to reverse other forms of unprecedented stimulus, known as "quantitative easing," will likely begin by the end of this year

…stay tuned

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USA TODAY Money

## Quarterly economic survey

The USA TODAY economic survey of 49 top economists was conducted July 16-22. Median estimates through Q3 2010:

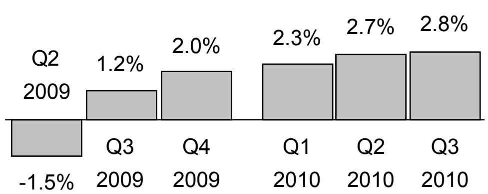
USA TODAY • MONDAY, JULY 27, 2009

## “TEA”ser

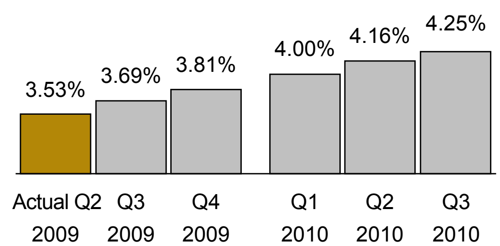
As I grow older, I pay less attention to what people say. I just watch what they do.

—Andrew Carnegie

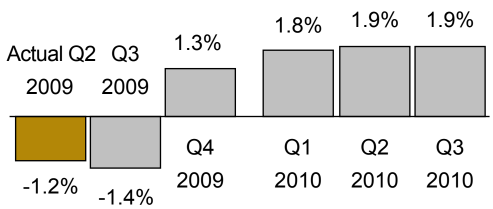
### Gross domestic product
(real annual rate)



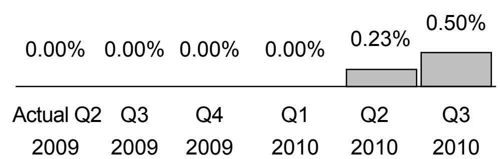

### 10-year T-note yield
(quarter end)



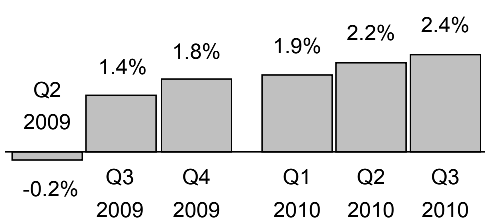

### Consumer price index
(rate of change, 12 months ended)



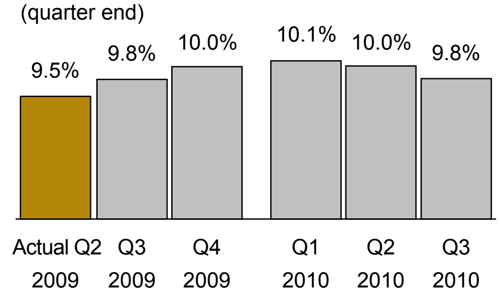

### Federal funds rate target
(quarter end)




### Consumer spending
(real annual rate)




### Unemployment rate
(quarter end)




**Survey participants:** Tucker Adams, The Adams Group; Nariman Behravesh, IHS Global Insight; Richard Berner, Morgan Stanley; David Berson, The PMI Group; Jay Brinkmann, Mortgage Bankers Association; Bill Cheney, MFC Global Investment Management; David Crowe, National Association of Home Builders; J. Dewey Daane, Vanderbilt University; Richard DeKaser, Woodley Park Research; Rajeev Dhawan, Georgia State University; William Dunkelberg, National Federation of Independent Business; Maury Harris, UBS; Stuart Hoffman, PNC Financial Services; William Hummer, Wayne Hummer Investments; Dana Johnson, Comerica Bank; Hugh Johnson, Johnson Illington Advisors; Paul Kasriel, Northern Trust; Dean Maki, Barclays Capital; Ken Mayland, ClearView Economics; Dan Meckstroth, Manufacturers Alliance/MAPI; Jim Meil, Eaton; Robert Mellman, J.P. Morgan Chase; Gregory Miller, SunTrust Banks; George Mokrzan, Huntington National Bank; Richard Moody, Forward Capital; Joel Naroff, Naroff Economic Advisors; Frank Nothaft, Freddie Mac; Donald Ratajczak, Morgan Keegan; Martin Regalia, U.S. Chamber of Commerce; David Resler, Nomura Securities International; Chris Rupkey, Bank of Tokyo-Mitsubishi UFJ; John Ryding, RDQ Economics; Joshua Shapiro, MFR; Robert Shrouds, DuPont; John Silvia, Wells Fargo; Allen Sinai, Decision Economics; James Smith, Parsec Financial Management; Sean Snaith, University of Central Florida; Sung Won Sohn, California State University; Neal Soss, Credit Suisse; Diane Swonk, Mesirow Financial; ***Jeff Thredgold, Thredgold Economic Associates***; Bart van Ark, The Conference Board; Chris Varvares, Macroeconomic Advisers; Brian Wesbury, First Trust Advisors; David Wyss, Standard & Poor's; Richard Yamarone, Argus Research; Lawrence Yun, National Association of REALTORS; Mark Zandi, Moody's Economy.com

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