Macro Market Insights

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Defining the Yellen Put

If the Janet Yellen testimony before the Senate Banking Committee this week illustrated anything, it is that the transition from Ben Bernanke to the incoming chair of the US Federal Reserve will be seamless. It is the typical story of the US Federal Reserve being dependent on the data driven recovery of the US economy that will affect their asset tapering decisions. Unfortunately though, it has become a distraction as to shift investor's concentrations away from the perils of unproductive fiscal policy (at any level of government) and instead focus on the financial markets, which for the sixth consecutive week saw the S&P 500 and Dow Jones trade higher.

The unfortunate realization or perhaps lack of realization is that central banks, led by the US Federal Reserve, will continue to be the only game in town, and that was the message Janet Yellen implicitly provided last Thursday. US economic growth sits at that inflection point of around 2 percent where we will still wait to see whether the economy is ready to reach former Bank of Canada and current Bank of England Governor Mark Carney's coined term "escape velocity."

But the biggest reason that the credit easing policies will continue is because of the lackluster inflation levels seen all around the world. Until inflation actually becomes a credible threat to the worlds developed economies, there is no pressure on central banks to begin tightening their policies, or even talk about it. This is especially true given the average inflation rate in the OECD developed countries has fallen from 2.2 percent in 2012 to 1.5 percent so far this year. And reports out of the European Union last week highlight that deflation was more of threat than inflation with October's inflation numbers registering at .7 percent. That creates a major threat to the nations of Europe, where the risk of seeing prices decline will create yet another impediment to their recovery from a triple dip recession.

The other issue, however, with forecasted paltry inflation levels is what countries with low inflation are associated with, and that is persisting levels of high jobless rates and mediocre growth. For this reason alone, the world's central banks continue their aggressive policies, but it does truly illustrate their positions between a rock and a hard place as any opportunity to spur or revitalize economic growth is jeopardized by an unwavering price level. As Mohammad El-Erian argues, central bankers in today's world are only destined to fail because our expectations for what they can deliver is far too inconceivable, given the "the much-sought-after trifecta of greater financial stability, faster economic growth, and more buoyant job creation."

So it is not so much that there is a responsibility among the central bankers to instill the prior mentioned trifecta of economic goals, it is rather the shortfall of elected policy makers that force us to rely on the independent institution of a central bank. And just as it was the "Greenspan Put" beginning in the early 2000's that saw the Federal Funds Rate drop every time the economy hit a speed bump to the "Bernanke Put," which commenced the greatest era of manipulation of the Federal Reserve's balance sheet in order to stimulate the economy, investors now eagerly await what will be the "Yellen Put." Whether its offered forward guidance of low interest rates into the unknown future, or perhaps quantitative easing continuing longer than anticipated, one thing is certain, and that is for this economic recovery to continue central bankers are still needed more desperately than ever.