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Changing of the Guard:

During Ben Bernanke's tenure at the Federal Reserve, new policy tools were introduced in the wake of the worst financial crisis since the Great Depression. Despite venturing into uncharted waters, price stability, economic growth and low unemployment remained the three responsibilities of the Federal Reserve. With Janet Yellen set to replace Ben Bernanke as the Chairperson of the Federal Reserve, it is a good time to assess the success and failure of the current Chairman's unprecedented monetary policy action.

Price stability throughout the tenure of Ben Bernanke was not an issue of inflationary risk but the fear of deflation. A major consequence of the financial crisis was a massive deleveraging of households and financial institutions. The higher savings rates and the decline in borrowing created significant downward pressure for many asset classes. Through the Federal Reserve's best efforts to fight deflationary pressures, inflation has averaged a comfortable rate of 2.16% over the past five years as compared to an average annual rate of 3.5% in the preceding five years, and what may have been a decline in prices had the Chairman been less accommodative with the monetary policy action.

Economic growth has also been a story of give-and-take during the Chairman's years of oversight. There have been short periods of average growth rate followed by moments of stagnation. During Ben Bernanke's nearly eight years as Chairman, economic growth averaged 1.2% as compared to an average rate of 3.3% in the 40 years preceding the Chairman. It is unfair to place the blame for lackluster growth solely on Ben Bernanke, as many of the headwinds holding the economy back are more structural in nature and beyond the control of the Federal Reserve.

Unemployment is one of the greatest examples of structural issues facing the U.S. economy. The slow improvement in the U.S. labor force has been one of the ultimate challenges during Ben Bernanke's tenure. Faced with internet and technology related job destruction, the outsourcing of many manufacturing jobs, an aging population and a declining labor participation rate, most of the monetary policies enacted over the past eight years have had little success in creating jobs. Reviewing the Bureau of Labor Statistics' U-6 Unemployment Rate, which includes those individuals who are unemployed, marginally attached to the labor force (meaning they are neither working nor looking for a job, but indicate that they want and are available for a job), and those working a part-time job for only economic reasons (but prefer a full-time job), it is quite clear how little success the Federal Reserve has had in achieving a desirable labor market (Chart 1).

We have outlined the three broad goals of the Federal Reserve, but its policy actions had a much more specific agenda in an attempt to save the economy from the financial meltdown. By lowering interest rates and purchasing Treasury and mortgage bonds, the Federal Reserve was hoping to push savers and investors into more risky financial assets in an effort to reflate the financial markets and the housing market. If successful in creating a positive wealth effect and stabilizing the banking sector, the hope was that it would result in higher consumer confidence, resumption in normal borrowing and spending and ultimately job creation.

While there is no question the Federal Reserve has been successful in reflating the financial markets and the banking sector, its ability to deliver the subsequent goals has been stymied by the lack of money reaching the average citizen. What is clear from the data is that the Federal Reserve is losing its ability to influence the economy with every dollar it prints, as a majority of the dollars are remaining in the markets instead of being utilized for lending purposes.

The money multiplier ratio helps quantify the lending and economic benefit associated with each dollar printed and, over the past five years, the benefit has been cut in half (Chart 2). During this same time period, household income has also stagnated due to a lack of job creation that previously accompanied an expansion of the money supply and bank lending. Reviewing the five year moving average of household income, there has been little upward movement compared to the proceeding ten years. Until the Federal Reserve finds a way to entice loan demand and/or forces the banking sector to make loans, any additional money printed will remain in the financial markets. As more dollars gravitate toward the financial markets, whether it is the Treasury market, the corporate bond market or the stock market, the greater the risk of another financial bubble.

In the end, Ben Bernanke faced a 100 year storm that standard policy tools were inept at handling. In an effort to create order in an otherwise chaotic period, the Federal Reserve Chairman entered into the world of "theoretic policy making". While in the short-term, these new policy measures have been modestly successful, time will ultimately reveal whether they were successful at resolving a significant financial crisis or only delaying the day of reckoning.

Chart 1

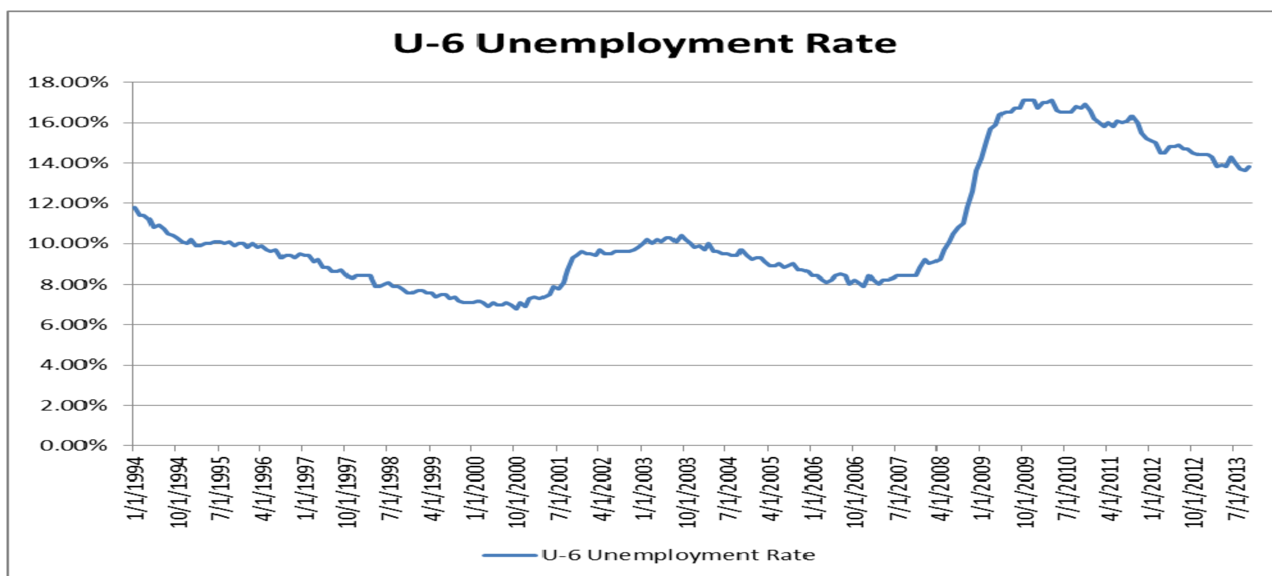
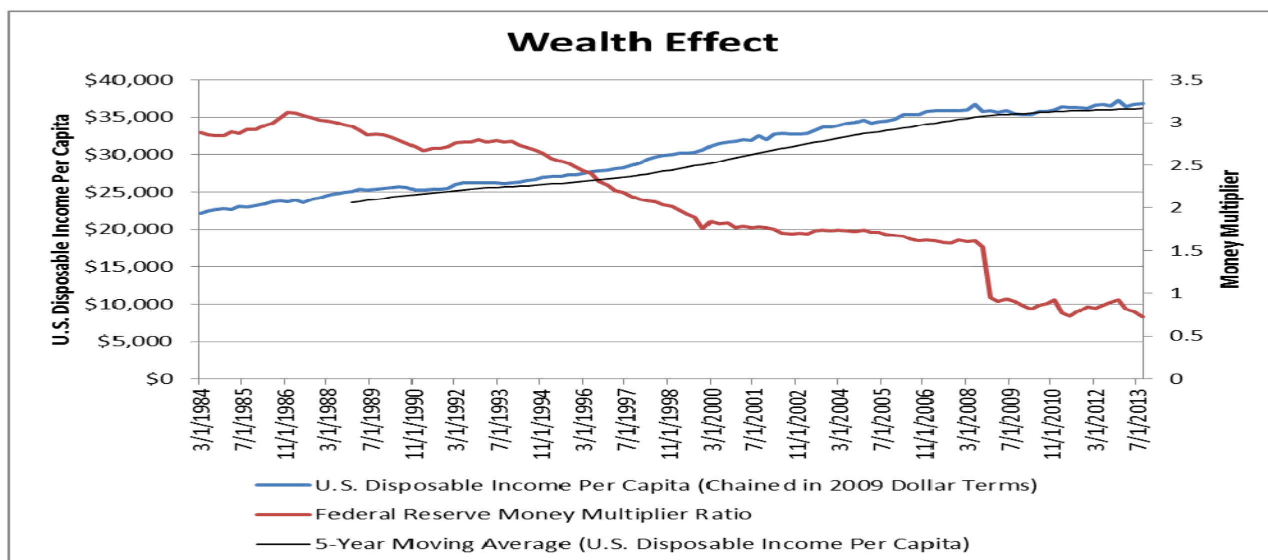


Chart 2



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