Yellen: Rate policy needs to focus on jobs, not stability

By Greg Robb, MarketWatch
WASHINGTON (MarketWatch) — Federal Reserve monetary policy should continue to focus on jobs and inflation and leave stability concerns to regulation, Federal Reserve Chairwoman Janet Yellen said on Wednesday.

“I do not presently see a need for monetary policy to deviate from a primary focus on attaining price stability and maximum employment, in order to address financial stability concerns,” Yellen said in a speech at the International Monetary Fund.

Stocks barely reacted to Yellen’s remarks. Read live blog of stock market.

Yellen’s speech was a “pretty clear vote” for keeping monetary policy and financial regulation separate, said James Glassman, economist at J.P. Morgan Chase.

“It is a hornet’s nest to get into trying to understand what is a threat and what isn’t,” he added.

Many economists think the Fed should already have started to hike interest rates and failing to do so is fostering potential asset bubbles.
For example, former Fed governor Kevin Warsh, currently a fellow at Stanford University’s Hoover Institution, and billionaire investor Stanley Druckenmiller wrote an op-ed in the Wall Street Journal saying that ultra-loose Fed policy is spurring wasteful financial engineering instead of needed capital expenditures.

Another former Fed governor, Jeremy Stein, who left the Fed at the end of May, was a leader in urging the central bank to focus more attention on the “cost” of its bond-buying in terms of financial instability.

The central bank began cutting back its bond-buying program last December, and has reduced total purchases by more than half to a $35 billion-per-month pace.

Laura Rosner, an economist at BNP Paribas, said Yellen’s remarks are dovish because they lowered “the odds of the Fed tightening policy on the basis of financial stability concerns rather than their traditional dual mandate goals.”

“This was not our baseline expectation but has been a lingering risk ever since the Fed first began focusing on the ‘costs’ of accommodative policy, in addition to the benefits,” Rosner added in a note to clients.

Read recap of live blog of Yellen’s speech.

In her remarks, Yellen expanded on her existing stance that effective bank supervision must play the “primary role” in preventing future asset bubbles and crises.

“Monetary policy faces significant limitations as a tool to promote financial stability,” Yellen said.

She said the work on “building resilience” in the U.S. financial system was far from done.

Jaret Seiberg, a banking policy analyst at Guggenheim Partners, said Yellen took a “hard lined stance on capital, liquidity and leverage.” He noted that the Fed chairwoman repeated her call for reform on money market mutual funds.

Yellen pushed back on critics who argue that the financial crisis could have been avoided if the Fed had tightened rates at a faster pace in the mid-2000s.

“A tighter monetary policy would not have increased the transparency of exotic financial instruments or ameliorated deficiencies in risk measurement and risk management within the private sector,” Yellen said.

But she said she was also mindful of the potential for low rates to take on risk and reach for yield, as well as the limits of regulation.

So there “may be times” when interest rates should be raised to ameliorate emerging risks, she said.

Asked by IMF Managing Director Christine Lagarde about possible spillovers on emerging markets when the Fed exits its easy policy stance, Yellen replied: “I wouldn’t assume that this is going to go badly, and I can just say that we will do everything on our side to make sure that it goes smoothly.”
She pledged to communicate in a manner that will avoid surprising financial markets.

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