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Meet Ben Bernanke, the new Fed Chair

On January 31, Alan Greenspan retired as Chair of the Board of Governors of the Federal Reserve. He had been in the post for some eighteen years. While some vocal critics argue he could have done more to prevent the bubble market of the late 1990s, economists and market participants generally feel that Mr. Greenspan served with distinction. He established a high degree of credibility, both personally and for the Fed. On February 1, Ben Bernanke, previously Chair of the President's Council of Economic Advisers, succeeded Mr. Greenspan. He has large shoes to fill.

When Mr. Greenspan started as Fed Chair, he too had large shoes to fill. He succeeded Paul Volcker, whom observers widely credited with reining in during the 1980s what had been a high level of inflation in the US economy. Journalists spoke of Mr. Volcker's having "slain the inflation dragon." During the Greenspan era, we have become accustomed to following changes in the Fed's interest rate targets. The Volcker Fed concentrated less on managing interest rates, and more on managing the money supply. The idea was that excess money supply growth is inflationary, since a larger money supply means more dollars chasing the same stock of goods and services. Under Mr. Volcker the Fed conducted its open market operations with a monetary target in mind, and would generally allow interest rates, including the Fed Funds rate, to adjust in response.

The Volcker Fed was secretive in its operations. They were careful to hide their tracks, using sophisticated techniques to mask their trading in the general flow of the market for US Treasury securities. They did not make announcements after Open Market Committee meetings, and released meeting minutes only after months had passed.

During Mr. Greenspan's tenure, the Fed changed its approach to monetary policy. The Fed now overtly manages short-term interest rates, and allows the money supply to adjust in response to interest rate policy. It has also become steadily more transparent. We now know exactly when the Fed Open Market Committee (FOMC) is meeting, and we know when to expect its statements announcing plans for open market operations. Over time Mr. Greenspan became more and more a wordsmith, both in these FOMC statements and in his public remarks. At times, traders would hang on Mr. Greenspan's words, parsing them with minute care for hints about future Fed policy.

750 Menlo Avenue – Suite 300 – Menlo Park, CA – 94025 – (650) 566-0200 Office – (650) 566-0210 Facsimile

Mr. Greenspan also substantially internationalized the Fed's analysis and policy. He has been outspoken recently on the issue of the importance of the US budget deficit, and has worried aloud about our economy's ability to sustain its current trade imbalances. For the most part, while the Greenspan Fed expressed its policy decisions in term of interest rates, Mr. Greenspan's general philosophy was one of managing risks. Many of his public statements, including the official FOMC announcements, made reference to the balance of risks, and close observers of the Greenspan Fed assert that this reflected Mr. Greenspan's thinking.

Although they have excellent reputations, Mr. Volcker and Mr. Greenspan both learned a great deal on the job. We can expect that Mr. Bernanke will need to do the same. In his brief statement at the announcement of his nomination, Mr. Bernanke emphasized the importance of continuity of policy. That's a wise statement, and a wise initial policy. But Mr. Bernanke is not quite the same as Mr. Greenspan, and neither is his philosophy. Market observers generally characterize him as more "dovish" than Mr. Greenspan; that is, he may be more tolerant of inflation. Like his predecessor, Mr. Bernanke has been a proponent of transparency in the Fed's dealings, and he is artful in crafting public statements. However, as a policy matter, Mr. Bernanke has been an advocate of a Fed policy targeting inflation, rather than interest rates or money supply. So it's reasonable to expect a shift of style, and eventually of substance, in the Bernanke Fed.

Mr. Bernanke leans toward formal inflation targets, but fighting inflation is only part of the Fed's job. The Federal Reserve has charter goals of fostering maximum employment and moderate interest rates, as well as price stability. Pursuing these three goals simultaneously has always been a balancing act. If Mr. Bernanke concentrates too heavily on targeting inflation, he may find it difficult to maintain employment or moderate interest rates.

Although the Federal Reserve has historically enjoyed a fair amount of autonomy by the standards of US Government entities, the Fed Chair's job is intensely political. While he has Washington experience, Mr. Bernanke's political skills are a bit of an unknown. However, he gave a hint of his skill, and his leanings, during his ceremonial swearing-in on February 6. 2006, which President Bush attended.

In prepared remarks,[1] with Mr. Bush standing next to him, Mr. Bernanke noted that only two previous Presidents had ever visited the Fed, Franklin Roosevelt in 1937 and Gerald Ford in 1975. These two previous Presidential visits occurred during very difficult economic times. He didn't stress that fact, but he did pointedly quote President Roosevelt to the effect that the Fed's purpose is to promote the economic well-being of all Americans. In addition, he laid special

[1] The remarks are well worth reading. See "Remarks by Chairman Ben S. Bernanke At the ceremonial swearing-in by President Bush, Federal Reserve Board of Governors, Washington, D.C." February 6, 2006, at http://www.federalreserve.gov/boarddocs/speeches/2006/20060206/default.htm

emphasis on the fact that Congress created the Fed, delegating to it the Congressional power, enumerated in the Constitution, "to coin money and regulate the value thereof."[2] In Mr. Bernanke's words, "Accordingly, it is incumbent on the Federal Reserve to report regularly to, and work closely with, the Congress. I look forward to a strong and constructive relationship with members of both the House and Senate."[3] Mr. Bernanke seemed to be staking out territory, warning the White House away from attempting excessive executive influence over the Fed. His nod to Congressional authority may also have been a response to criticism from Jim Bunning (R-KY), the only Senator to object to his confirmation. Mr. Bunning expressed doubts that Mr. Bernanke would be able to stand up to the White House.

The market's reaction to Mr. Bernanke since his nomination in October has generally been favorable. Mr. Bernanke is a distinguished academic economist with experience in high-level government service. He has served as a member of the Federal Reserve Board of Governors, and as Chair of the President's Council of Economic Advisers. The Senate confirmed him without difficulty.

Mr. Bernanke receives high marks for the quality of his thinking and the clarity with which he communicates, regardless of the audience. He displayed that skill at his swearing-in, deftly asserting the Fed's independence from the Executive Branch, even with the President at his side.

We all hope that Mr. Bernanke's tenure as Fed Chair justifies the market's optimism.

- Jonathan Tiemann
Menlo Park
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Tiemann Investment Advisors, LLC is an SEC-registered investment advisor based in Menlo Park, California. For more information, please send your request to information@tiemann.net or visit www.tiemann.net.

[2] Article I, Section 8.
[3] Bernanke remarks, *op.cit*.