First State Investments

The US Federal Reserve: She's the one

Economic research note

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– Janet Yellen, the current vice-Chair, has been nominated as the next Chair of the US Federal Reserve.

– Her confirmation process is expected to be smooth. She will take up her appointment when Ben Bernanke's term as Chairman expires in January 2014. She will be the first female Chair of the Fed in its 100-year history.

– This is a positive development and should be welcomed by financial markets.

– Janet Yellen has been a driving force behind the Fed's use of extraordinary monetary policy. But, perhaps more importantly, she has also been a key driver of the Fed's more open communications strategy.

– She was instrumental, in January 2012, in the Fed nominating a 2% longer-term inflation target and a goal for unemployment in a 5.2%-6% range.

– Known as a policy 'dove', Chair Yellen is likely to ensure that policy is driven by the data and expectations on the economy, rather than a perceived policy path.

– A Yellen led Fed could be expected to follow closely the forward-guidance on policy that has been laid out by the current Chairman.

– Given the economic and financial market risks being generated in the US by the current government shutdown and concerns over the debt ceiling, the Fed's first move to 'taper' its QE3 bond purchase program could come around the time of the transition in leadership at the Fed.

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The US Federal Reserve: She's the one

President Obama has nominated Janet Yellen, the current vice-Chair of the Board of Governors of the US Federal Reserve System (US Fed), to succeed Ben Bernanke as Chair when his term expires in January 2014.

This is a positive development that should be welcomed by financial markets.

Janet Yellen is extremely well qualified for the role. She is well known by financial markets and has been a driving force behind the US Fed's use of extraordinary monetary policy tools and, perhaps more importantly, the great advances that have been made in the US Fed's communication of its policy actions and objectives.

Her confirmation process is widely expected to be relatively smooth, with little controversy. Firstly, she will appear before the Senate Banking Committee hearing before year-end, most likely December. The Committee will then vote on her nomination where she is expected to win approval. There are 22 members of the committee, 12 Democrats and 10 Republicans.

Secondly, once the nomination is approved by the Banking Committee, it will then go to the full US Senate for debate. As the Democrats control the 100-seat Senate, Ms Yellen's appointment would only need six Republican votes to overcome potential any procedural hurdles. If successful, she will become the first female Chair of the US Fed.

Monetary policy implications

Janet Yellen is seen as being a 'dove' on monetary policy, i.e. she is more inclined to keep monetary policy easy in an attempt to encourage economic growth and job creation, over concerns about inflation.

This perceived bias has placed her in the company of the current Chair, Ben Bernanke, as well as the President of the New York Fed, William Dudley, and helped elevate her to a position where the markets follow her views very closely.

It must be noted, however, that vice-Chair Yellen was instrumental in the Fed adopting a specific 2% long-run inflation target in January 2012, as well as the goal of 5.2%-6% unemployment rate.

In the context of the current monetary policy debate in the US, Yellen is likely to have been a key driver behind the decision to delay the 'tapering' of the Fed's economic stimulus program (QE3) at the September meeting.

As Chair, she is likely to follow closely the forward-guidance on monetary policy laid out by the current Chairman and reinforce the view that any future reduction in QE3 (i.e. down from the current $US85bn per month of bond purchases) will be data-dependent.

Following the decision by the US Fed to maintain its current QE3 program in September, we now expect the start of a 'tapering' in QE3 to be announced at the 17-18 December 2013 FOMC meeting (rather than the 29-30 October 2013 meeting).

However, the negative economic implications of the current US government shutdown, the lack of data flow as a result of the shutdown and the risks around the debate over the US debt ceiling are increasing the likelihood that the Fed may wait until early 2014 before beginning to reduce the QE3 program. This is likely to be the case under either Chair Bernanke or Yellen.

Into 2014, it could be argued that a Fed Chaired by Janet Yellen may be more inclined to reduce the QE3 program only very slowly, but she will also have to bring along the Board and maintain a good consensus of opinion among its members – which from January 2014 will also include the Dallas Fed President, Richard Fisher – a noted 'hawk'.

It seems premature, therefore, to assume that Fed policy will always be easier than otherwise would have been the case under Yellen's leadership. Like Ben Bernanke, she is likely to be driven by the data and will make policy decisions as such, rather than be driven by any perceived policy path.

Who is Janet Yellen

Janet Yellen was born 13 August 1946 in Brooklyn, New York, making her 67 years old. She has been vice-Chair of the US Fed since October 2010.

Prior to this appointment she was President of the San Francisco Federal Reserve from January 2004 to October 2010. She also served as Chair of the Council of Economic Advisors to President Clinton from February 1997 to August 1999.

Janet Yellen graduated with a degree in Economics from Brown University in 1967 and received her Ph.D in Economics from Yale University in 1971. She has also served as Professor Emerita at the University of California's Berkeley Haas School of Business.

Janet Yellen is married to George Akerlof, a Nobel Prize winning economist. Their son, Robert Akerlof, is an assistant professor in economics at the University of Warwick. She is Jewish.