

A “Precise and Predictable” Yellen Fed?

Not surprisingly now that the nomination choice has been made, status quo opinion leaders are falling over themselves to praise Janet Yellen, describing her as “feisty” and “tough”, as well as “well-liked” and “brilliant.” I would bet that she is, in fact, all of these things, and I don’t begrudge Yellen’s media supporters for using the terminology of personality and social perception in their signals, because these will be the central issues at stake in the political theatre of a confirmation hearing. I expect her to sail through those hearings pretty much unscathed so long as she presents an **image** of feisty-tough-likable-brilliant, and that’s what the public relations campaign is all about right now. Yellen has to be portrayed as tougher than her prior image in the same way that you would be reading about how much Larry Summers loves kittens and a good romantic comedy if he were the nominee today.

What’s far more interesting to me is an article in today’s *New York Times*, by Catherine Rampell, titled [“The Yellen Fed? Precise and Predictable”](#). Ostensibly part of the pre-hearing hagiographic effort, it’s a fascinating read. Here’s a quote: “she has suggested that the Fed should be more systematic, predictable and transparent – in short, that it should lay down some rules and stick to them. It is a template that Wall Street likes, and one that underscores the Fed’s departure from the days of Alan Greenspan, its chairman from 1987 to 2006, whose Delphic pronouncements were endlessly parsed by economists and investors. Investors hope that a Yellen Fed will clearly telegraph its intentions to the financial markets, particularly as the central bank begins to taper its efforts to kindle growth.”

Really? This is “a template that Wall Street likes”? Maybe Rampell should ask Wall Street how much it liked Bernanke’s attempts to telegraph intentions clearly and provide a formula for tapering back in June.

Look ... I know it seems somehow un-American or Machiavellian to say that ambiguity can be a good thing and transparency bad, and God knows it’s even worse to be transparently ambiguous or ambiguously transparent or whatever you want to call Bernanke’s latest song and dance routine (see [“Uttin on the Itz”](#)), but precision and predictability serve neither the Fed nor the market well. The game theoretic truth is that you get a more stable world when your policy promise “leaves something to chance”, to use Tom Schelling’s phrase, not when you make a guarantee. The larger the policy stakes, the more this game theoretic insight holds true. And now that the Cold War is over, it’s hard to imagine larger stakes than US monetary policy.

Believing in the policy “if X then Y” is fine. Talking about it in private is fine. Implementing it is fine. Stating it publicly when you are one of the three or four most powerful persons in the world is NOT fine, particularly if you do not have the tools to control X directly, particularly if Y is the monetary policy equivalent of thermonuclear war.

The Fed may not have much experience with QE and how to communicate its QE policy, but the US military has more than 60 years of experience with nuclear weapons and how to communicate its strategic policy. And you know what? We won that war. We didn’t blow up the world. We outlasted the Russians economically by creating a very stable peace based on the **tacit promise** to use nuclear weapons and the **imprecise promise** to respond to threats in asymmetric ways. We learned through the hard experiences of Korea and Vietnam that open-ended commitments based on a broad guarantee were very, very costly. We learned through the terrifying experiences of Berlin in 1961 and Cuba in 1962 that extended deterrence based on the guarantee of Mutual Assured Destruction was a very unstable peace. Do we really have to learn all these lessons all over again? Really? Speaking softly and carrying a big stick works. Speaking ambiguously and carrying a giant stick works even better.

If you’re interested in reading more on this topic, see my most recent weekly note, “[A World of Guarantees](#)”.

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All the best,
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