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FOMC Forecasts, Bernanke: Malaise

The central tendency FOMC forecasts reflect what seems to be a new wave of discouragement as to what the Fed can accomplish over coming years.

These forecasts are framed in a way that equates them to what each participant thinks is the best that the Fed can do in terms of managing the economy, and they are noteworthy in that the numbers are downgraded not only to reflect the reality of the slow growth in early 2011, but also--and in significant magnitude--to reflect new thinking about 2012 and 2013.

Thus, the range for 2011 GDP growth is knocked down by a bit more than a percentage point--at each end--from what was projected in late June. That is not surprising, but the 2012 range was also pulled down by almost as much, 0.8-point at each end, and the 2013 range by a still-major 0.5 point at the low end and 0.7 point at the high end. Even the preliminary 2014 forecast, at 3.0% to 3.9%, reflects less optimism than the June-forecast range for 2013 (3.5% to 4.2%).

The basically parallel downward shifts in the forecasts indicate that the problem is not a matter of increased uncertainty about the effectiveness of Fed policy, but about the degree of effectiveness.

Bernanke's press conference included some questions that brought forth comments about "headwinds," including those that resulted in the unexpectedly poor first-half performance. His list included now-usual suspects--housing problems, consumer deleveraging, credit access, financial volatility, fiscal consolidation, and, implicitly, problems created elsewhere that might be corrected "if we could get some assistance from other parts of the government to work with us..."

In addition to those factors, Bernanke put much stress on the European crisis, "which was not anticipated to be as severe and create as much volatility as it has in financial markets."

However, the real issue is why all those negative factors are not expected to ease to any great degree over the next several years. The longer-run GDP forecast--essentially, what the participants see as the "potential" growth rate did not change significantly--so the problem is that the "headwinds" will be lingering much longer than thought back in June, and the Fed cannot do anything about it.

The downgraded GDP forecasts, of course, forced a downgrading of the unemployment rate--with a higher level predicted through the forecast period. Here, there was also a hint of new pessimism even with regard to the long-run unemployment outlook--what might be called the "natural" rate--with the upper end of the range moving up 0.4 point, to 6.0%, while the lower end was steady at 5.2%. The number of participants seeing structural deterioration in the labor market is reaching critical mass.

Oddly, even with the GDP outlook downgraded, and the level of unemployment in the economy now seen as being higher throughout the forecast period, the inflation predictions were left untouched. Participants are evidently putting great stock in the view that actual inflation is determined mainly by expectations--and that lingering extensive slack in the economy will not bend either expectations, or actual inflation, downward.

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Bernanke did highlight the extensive discussions the FOMC is having on the subject of communication strategy--essentially a way of increasing policy effectiveness. He ruled almost nothing out, including the greater use of forecasts, even interest rate forecasts, as a tool.

However, he did seem to dismiss the idea of nominal GDP targeting, indicating that the group prefers to stick with "the dual mandate approach that we've been using until this point."

There were some hints of willingness to take further policy steps. Notably, Bernanke was pushed--by a questioner noting that the central tendency forecasts for 2013 pointed to a situation still unsatisfactory with respect to the dual mandate--into emphasizing that the Fed's current low-rates promise was phrased so that it extended "at least" until mid-2013.

He also repeatedly noted that the Fed's performance, over recent years and in the forecasted outlook, was very good in relation to the price stability mandate but had "fallen short" with respect to unemployment--the signature complaint of FOMC doves. There was also his headlined description of purchases of mortgage securities as being a "viable option."

Still, Bernanke's bottom line description of the Fed's current options had a tone of fatalism: "So I think the judgment we're going to have to make is: Do the tools we have--are those tools likely to be sufficiently effective? Or do they bear costs and risks that would make them less effective--or not worth using."