

# How Bernanke Pulled the Fed His Way

By [JON HILSEN RATH](#)

In late August, Federal Reserve Chairman Ben Bernanke argued on behalf of Fed programs to stimulate the lumbering U.S. economy and signaled that more might follow, making headlines in his highly anticipated speech at the Fed's annual retreat in Jackson Hole, Wyo.

Ben Bernanke's high-stakes plan to restart the lumbering U.S. economy took shape in an intense flurry of behind-the-scenes discussions between him and colleagues in the days before a crucial September meeting. Jon Hilsenrath explains on Lunch Break.

As markets rallied at the prospect of new measures to ease credit, a quiet drama was unfolding behind the scenes. Mr. Bernanke was negotiating a high-stakes plan in a flurry of private conversations with colleagues hesitant about aggressively re-engaging the levers of America's central bank.

For weeks, Mr. Bernanke made dozens of private calls on days, nights and weekends, trying to build broad support for an unusual bond-buying program he wanted approved during the Fed's September meeting, according to people familiar with the matter.

Fed officials in late summer were at odds over how far the central bank should go. Some wanted a bold, innovative program. Others weren't so sure; a few were opposed. Mr. Bernanke set his sights on a handful of fence-sitters who could swing a strong consensus to his side.

Interviews with more than a dozen people involved in the Fed decision, both supporters and opponents, show how Mr. Bernanke won over skeptics to advance his policy—a distinction in a Washington era marked by rancor and gridlock. These people also gave a rare view of the low-key persistence of the former economics professor.

Mr. Bernanke didn't see inflation as a threat but viewed unemployment as a deeper problem than he had realized. The central bank, in his view, needed to act. The Fed chairman listened to colleagues' concerns during the calls, people familiar with the matter said, drawing out their reservations and probing for common ground. He eventually seized on a compromise that came from a little-known Fed governor.

The result of the Fed's two-day meeting that began Sept. 12 was an 11-1 vote to undertake one of the central bank's most ambitious stimulus programs. The Fed announced it would buy \$40 billion a month of mortgage-backed securities and, for the first time, promised to keep buying until the U.S. job market substantially improved.

The commitment marked a change from the stop-and-start programs the Fed had launched since the financial crisis.

"This is a 'Main Street' policy," Mr. Bernanke said after the September meeting. "What we are about here is trying to get jobs going." The bond buying aims to drive down long-term interest rates and push up the values of homes, stocks and other financial assets. Officials hope their commitment will jolt households and businesses into spending, investing and hiring.

Drawing broad support for the plan was important to Mr. Bernanke in part because the policies he was formulating could outlast him. His term as Fed chairman ends in January 2014. Seeing a return to U.S. full employment as a distant goal, Mr. Bernanke needed the support of officials who might remain at the Fed after he left.

Roots of the Fed decision stretched to March, when Mr. Bernanke in a speech warned the U.S. economy wasn't growing fast enough. Since September 2011, the economy had produced about 200,000 jobs a month, driving down unemployment. But Mr. Bernanke warned that a slowdown would hobble hiring. Indeed, job gains by midyear fell to less than 100,000 a month.

At the central bank's June policy meeting, Fed Governor Daniel Tarullo, a lawyer appointed by President Barack Obama, said the economy felt like a vehicle "stuck in the mud," according to people there. The analogy stuck. A month later, Mr. Bernanke used the same phrase with Congress.

The meeting yielded what Mr. Bernanke considered an important step: the extension of Operation Twist, a Fed program to buy \$45 billion of long-term Treasury securities each month, paid with the sales of short-term securities. The program—intended to put downward pressure on long-term rates—was supposed to expire on June 30. The Fed agreed to keep it going through December, giving Mr. Bernanke time to make sense of the slowing job market and consider further action.

To move forward, Mr. Bernanke needed to corral several colleagues, including regional Fed bank president Dennis Lockhart from Atlanta, who had a vote on the Federal Open Market Committee, the Fed's decision making body. Under Fed rules, four of the 12 regional Fed banks vote on the committee on a rotating basis; a fifth, the New York Fed, always votes.

Mr. Lockhart, a former banker who spent much of his career working in emerging markets, said in an interview after the September meeting that he had spent his summer trying to "take stock of the recovery." He debated whether the U.S. had an economy with a 3% growth trend that was hit by bad luck—Europe's financial turmoil, for one. Or was it an economy growing at a 2% annual rate that couldn't sustain job growth and needed help? A string of weak economic data suggested it was the latter.

Like others, Mr. Lockhart had reservations about the effectiveness of Fed policies. Earlier bond buying hadn't yet produced strong growth. The banking system, still damaged by the financial crisis, wasn't delivering credit the way economists expected, given historically low interest rates. Still, Mr. Lockhart thought a program targeting the U.S. housing market might help.

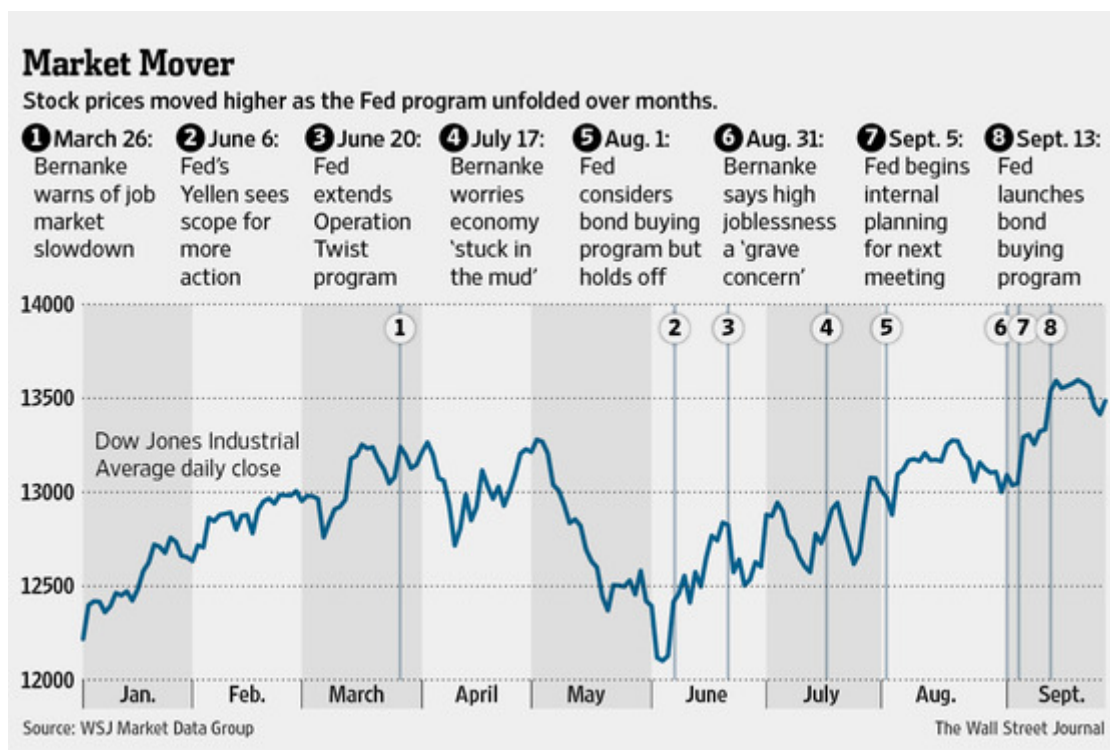
Mr. Bernanke also worked on nonvoters, including Narayana Kocherlakota, who was going through his own transformation.

Several months after becoming president of the Minneapolis Fed in 2009, Mr. Kocherlakota believed the job market had structural problems beyond the reach of monetary policy—for example, too many construction workers who couldn't easily be trained for other jobs.

Mr. Kocherlakota joined Fed skeptics, so-called hawks, who doubted the effectiveness of central bank activism. During his turn as a Fed voter last year, he voted twice against loosening credit, moves championed by Mr. Bernanke.

Though they disagreed on policy, Mr. Bernanke and Mr. Kocherlakota were kindred spirits. Mr. Kocherlakota is a scholarly Ph.D. economist who enrolled at Princeton University at age 15. Mr. Bernanke, equally wonky, was later chairman of Princeton's economics department years later.

Mr. Kocherlakota and Mr. Bernanke exchanged emails over months, debating structural unemployment—the idea that unemployment was caused by mismatches between employer needs and the skills and location of workers. In Mr. Bernanke's view, employers weren't hiring because of weak demand for their goods and services, which Fed policies might help remedy.



"I've learned a lot by talking to him," Mr. Kocherlakota said in an interview after the September meeting. Mr. Bernanke's "thinking is framed by data and models," he said. "It beats coming in there with just your gut."

By summer, Mr. Kocherlakota said, his views about structural unemployment were shifting as he found the evidence less than persuasive. This left an opening for Mr. Bernanke.

As the Fed's August meeting approached, Mr. Bernanke and his inner circle, which included Fed Vice Chairwoman Janet Yellen and New York Fed President William Dudley, were thinking that any Fed action should be a comprehensive and novel package, rather than an incremental step, according to people familiar with their views. They agreed to take time to confirm their views of the U.S. economy and develop consensus for a plan.

The August meeting turned into a policy staging ground. One proposal on an internal list of three policy options was a new bond-buying program, according to people familiar with the list. Mr. Bernanke didn't push. But it allowed a chance for officials to debate the pros and cons of a new program—in effect, a practice run for September.

Some officials argued for more bond buying. Others worried about the Fed turning into too big a player in bond markets, disrupting trading in Treasury securities or mortgage securities. Fed staff wrote a memo ahead of the meeting detailing the market's capacity to absorb central bank purchases of Treasury bonds and mortgage-backed securities. They found that the Fed could carry on a large program for a couple of years if needed without disturbing markets. The finding helped set boundaries for what the Fed could do and for how long.



The Fed's policy committee emerged from the August meeting with familiar fissures. Opponents of the Fed's easy-money policies said the measures weren't giving the economy much of a lift, while risking future inflation.

Dallas Fed president Richard Fisher said the Fed was like a doctor over-prescribing Ritalin to attention-deficient Wall Street traders. Richmond Fed president Jeffrey Lacker dissented in August for the fifth straight meeting, taking issue with a policy already in place: An assurance the Fed had given that short-term interest rates would remain near

zero through late 2014. Philadelphia Fed President Charles Plosser said in an interview that he urged Mr. Bernanke to wait until year-end before deciding on any new programs.

Despite their public disagreements, Fed officials were friendly behind the scenes. Mr. Plosser, who favors tighter credit policies, and the Chicago Fed's Charles Evans, who wants easier credit, play golf together. They joined Mr. Fisher and Mr. Lockhart for a round at the Chevy Chase Country Club after the August meeting.

By late summer, the Fed had made clear it was prepared to act if the economy continued to languish. The question was how?

Many Fed activists wanted an open-ended program of bond purchases that would continue until the economy improved. Among them, some wanted to go big—at least a few hundred billion dollars worth over several months—with a promise to keep buying as needed. Moreover, some wanted to replace Operation Twist with bigger purchases of mortgage-backed securities and Treasuries.

As the September meeting neared, Mr. Bernanke needed to assure colleagues who still had reservations about moving too aggressively. In addition to Mr. Lockhart, Cleveland Fed president Sandra Pianalto had been wavering. She was among those who worried more Fed bond buying could disrupt markets.

Another fence-sitter was Washington-based Fed Governor Elizabeth Duke, a plain-spoken Virginia banker nominated to the Fed board by President George W. Bush in 2007.

Fed officials described the Fed chairman's phone calls as low-pressure conversations. Mr. Bernanke sometimes dialed up colleagues while in his office on weekends, catching them off guard when their phones identified his private number as unknown. He gave updates on the latest staff forecasts, colleagues said. He asked their thoughts and what they could comfortably support, they said.

The calls helped Mr. Bernanke gauge how far he could push his committee. It also won him trust among some of his fiercest opponents, officials said. Nearly all of Mr. Bernanke's colleagues described him as a good listener.

"Even if you disagree with him on the programs, you know your voice has been heard," said Mr. Fisher, one of his opponents. "There is no effort to bully."

Negotiations stepped up in the week before the meeting. Fed staff circulated language for policy options. Officials debated how different approaches would be described in the policy statement, which would be released after the meeting.

Officials at Fed policy meetings typically consider three options: one representing activists who want to use monetary policy aggressively; another supporting officials seeking conservative use; and a middle-ground option that typically prevails.

The premeeting documents this time listed four options, including an aggressive approach favored by activists, and no bond buying, favored by hawks. Among two middle-ground proposals was a compromise that Ms. Duke originated.

Five days before the meeting, Mr. Bernanke took time out for the Washington Nationals—his favorite baseball team was having a dream season. He arrived at the ballpark in a worn Nationals cap and wandered the infield during batting practice.

"I wanted to ask him if I should get some gold and silver but I bit my tongue," said Nationals manager Davey Johnson. Instead, they talked about how Mr. Johnson, a math major, used statistics to manage his lineup.

At the meeting the following week, the Fed adopted the compromise that Ms. Duke helped spur. The Fed would continue Operation Twist through December but add an open-ended mortgage-bond buying program.

Activists got what they most wanted: An open-ended commitment to buy mortgage bonds until the job market improved, with the strong possibility of additional Treasury purchases later. Fence-sitters got a promise to review the plan before deciding to proceed with a bigger program in 2013. Mr. Lockhart said the chance to reassess the program based on inflation and the performance of the job market helped win him over.

With an agreement on bond buying largely in place, Fed officials at the September meeting left unanswered this question: When could they leave growth of the U.S. economy on its own? Mr. Kocherlakota and Mr. Evans failed to get agreement for inflation and unemployment thresholds to determine when to raise short-term rates, according to people familiar with the talks.

"It's an ongoing discussion," Mr. Plosser said. "We will probably continue to work on this."

**QUESTIONS:**

1. What new monetary policy action did the Federal Open Market Committee decide to launch during September's meeting? Please give specifics of the program. Is this the first such program to be attempted by the Fed?
2. Why did Ben Bernanke believe that such an action was needed at this time? What macroeconomic data supported his assertions.
3. How might the U.S. economy be affected by this monetary policy action?