The Daily Dish

# February 25th Edition

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Late yesterday afternoon, the president vetoed the bipartisan Keystone XL legislation. In response, Speaker Boehner said, “The president’s veto of the Keystone jobs bill is a national embarrassment.” The veto came 2,349 days after the application to build Keystone XL was first filed with the State Department. On BuzzFeed, AAF has “8 Things You Could Accomplish In 2,349 Days.” What could you have accomplished in that time?

The Broadband Treasury Rate Loans program within the Department of Agriculture listed the almost unthinkable default rate of 116 percent in the back of the president’s budget. Politico found that a default rate could go above 100 percent though double counting from the government. However, the real potential default rate of 70 percent is not much better. Placing that in perspective, the average default rate for bank loans is 3 percent.

***Eakinomics: The Fed Raising Rates***

Yesterday, Federal Reserve Chair Janet Yellen delivered the Fed's semiannual economic report before the Senate Banking Committee. After keeping the target federal funds rate — the target rate for overnight borrowing by large banks — near zero for six years, the Fed is faced with normalizing interest rates. Having negotiated its exit from quantitative easing, the Fed is now trying to clearly communicate its plans for raising the policy interest rates. Yellen's comments carried three messages.

1. The first rate rise will not happen imminently. Yellen repeatedly emphasized that the Fed could be “patient” which is best interpreted as the first rate increase will not occur before June (or probably later than September). The stock market, which lives on the combination of easy access to borrowing and depressed returns to bonds, celebrated — the Dow Jones industrial average and the S&P 500 hit record highs. But perhaps the most important question is not <u>when</u> the first rate rise occurs, but <u>how fast</u> the Fed will raise rates. It is  likely that policy rates will be below 1 percent by the end of 2015. With inflation at 1.5 percent, that means that <u>real, inflation-adjusted</u> rates are still negative. The ultimate loose stance of monetary policy will likely be more important than the start of rate increases.

2. The Fed emphasizes that its decisions are data-dependent, leaving tough calls on inflation and unemployment. The Fed has a dual mandate to maintain inflation and full employment. In deciding to raise rates, Chairwoman Yellen repeatedly emphasized that its judgment of labor market tightness and inflation expectations are at the core of decisions. Unfortunately, there is no clarity regarding either. On unemployment, the major wildcard is correctly forecasting the aftermath of a dramatic and sustained decline in labor force participation. Will it reverse course? Not? On inflation, recent top-line inflation has been dominated by oil prices. Putting this aside, the key is expectations regarding the future of inflation. Given the uncertainty over the future path of unemployment and inflation, the Fed’s policy path — self-admittedly based on these basics — is comparably uncertain.

3. The Fed believes in its superiority versus policy rules. Investing, in particular, and financial markets, in general, is all about the future. The Fed is doing its best to convey the future path of policy. An alternative

approach, however, is to use a policy rule (e.g., the Taylor Rule) that dictates the link between actual performance of unemployment, GDP, or inflation and policy interest rates. Yellen, yesterday, clearly threw policy rules overboard despite the superior ability to convert data into how the Fed will respond to events.

***From the Forum***

Cutting the Future: The War on Medicare Advantage by Christopher Holt, AAF Director of Health Care Policy

8 Things You Could Accomplish In 2,349 Days by Doug Hochberg, AAF Press Secretary