Betting on Ben

Oct 27th 2005
From The Economist Global Agenda

The likely new chairman of America's Federal Reserve Board is a first-rate academic. Will he be a similarly good central banker?

Reuters

FOUR years ago, Ben Bernanke was a professor of economics at Princeton whose policymaking experience consisted of a stint on the local school board. On February 1st, barring any unforeseen hiccups in his Senate confirmation, he will become the most powerful central banker in the world, replacing Alan Greenspan as chairman of the Federal Reserve Board.

Nominating Mr Bernanke on Monday October 24th, George Bush said he was the "right man" to replace a "legend". Wall Street seems to agree. Financial pundits have heaped praise on Mr Bush's choice. Stock prices rose on the news, the dollar held steady and although bond prices fell—yields on ten-year Treasuries hit a six-month high of 4.5% on Tuesday and rose thereafter—they had seen worse. When Mr Greenspan was named as Paul Volcker's successor in 1987, stocks fell and bonds had their worst day in five years.

What explains the Bernanke bullishness? Relief, for one thing. Many on Wall Street fretted that Mr Bush might opt for a financial version of Harriet Miers, his recent Supreme Court nomination, to succeed Mr Greenspan, favouring ideological fealty more than independence and ability. (Tellingly, Ms Miers withdrew on Thursday.) Instead, he chose a man with dazzling academic credentials, a short but successful stint as a Washington policymaker and little partisan baggage.

Mr Bernanke is one of America's foremost monetary economists. He was a Fed governor between 2002 and 2005, moving from that job to become chairman of Mr Bush's Council of Economic Advisers. Whereas Mr Greenspan was regarded as a partisan figure before he became chairman of the Fed, few of Mr Bernanke's academic peers even knew he was a Republican until he moved to the White House.

More important, financial markets are calmer than when Mr Greenspan took over. Wall Street thinks the central bank's commitment to fighting inflation is so entrenched that only a wacky outsider could shake it. Mr Bernanke is no such wing nut. "My first priority will be to maintain continuity with the policies and policy strategies established during the Greenspan years," he said on Monday.

In many ways that will be easy. For all the superficial differences, the bearded academic has much in common with the owlish Washington insider he will probably succeed. Both believe in an activist Fed; both focus on the link between the pace of aggregate demand and inflation; and both prefer shifts in interest rates to be gradual and well-signalled.

Neither man believes the central bank should be in the business of puncturing asset-price bubbles. Mr Bernanke, if anything, is more committed to this view than Mr Greenspan. At the height of the stockmarket bubble in 1999, he co-authored an influential paper with Mark Gertler of New York University which argued that central banks should focus on asset prices only insofar as they are likely to influence consumer prices. Targeting asset prices directly, his paper claimed, would create more, not less, instability. This suggests that a Bernanke Fed might be even less inclined to fret about soaring house prices than Mr Greenspan, who has only recently worried aloud about them.

Mr Bernanke will be more than just a safe pair of hands. He comes to the job with a series of big ideas about monetary policy and scant fear of stating them. At the Fed, he quickly earned a reputation as its resident intellectual, attracting attention with unconventional ideas on how to beat deflation, the benefits of inflation targeting and the idea of a global saving glut.

This willingness to question conventional wisdom is also Greenspanesque. The maestro, after all, heralded America's 1990s productivity boom long before anyone else. The difference is that Mr Greenspan couched his big ideas in caveats and conspicuous vagueness, while Mr Bernanke speaks in plain English.

That has advantages. Everyone knows that Mr Bernanke, unlike Mr Greenspan, is a long-standing supporter of the idea that the Fed should set a public target for inflation against which it can be held accountable, as many central banks do. He has written a book and endless papers advocating the practice.

Mr Bernanke will doubtless nudge the Fed towards inflation-targeting. But the change is likely to be evolutionary rather than radical. The central bank has already moved in his direction. It has become more transparent, releasing minutes of Fed meetings speedily as well as publishing two-year economic forecasts. While there is no explicit inflation target, the Fed's "comfort zone"—of core inflation between 1% and 2%—comes pretty close to one. Equally, Mr Bernanke has become less dogmatic, and he is unlikely to go on an inflation-targeting crusade.

His initial task will be to prove his inflation-fighting credentials and shake off a lingering reputation for dovishness. Soon after Mr Bernanke went to the Fed in 2002, America saw a brief deflationary scare as the economy remained sluggish while core inflation kept falling. More than any other central banker, he made clear that the Fed had "non-traditional" tools to forestall deflation, such as buying long-term bonds or, metaphorically, throwing money from helicopters. The idea of "Helicopter Ben" stuck with traders, and with it the notion that he might be just a little softer on inflation than his predecessor.

Another big Bernanke idea that is widely misinterpreted is his contention that America's current-account deficit is caused by a global saving glut rather than by profligacy at home. His thesis was more subtle than the sound-bite suggests, but he is now seen by some as a bit nonchalant about the scale and cause of America's external imbalances. If the dollar were to crash on his watch, that reputation would not help to calm markets.

The truth is that big ideas and a stellar academic résumé are not always hallmarks of a good central banker. Arthur Burns, the only other academic to lead the Federal Reserve, in the 1970s, was a big thinker but a weak inflation-fighter. Good central bankers need technical competence, political smarts and sound judgment. Mr Bernanke has the technical competence and seems to have the political smarts (after all, he got the job). The big bet, therefore, is on his judgment.