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What’s to be done?

It's always hard to please everyone. Sometimes it's hard to please anyone. You probably don't need a lot of convincing on this point, but if you desire one more case study look no further than the past week's commentary on monetary policy, starting with Wonkblog's rather negative performance review (post by Brad Plumer) of the Fed's recent policy decisions:

> "Right now, unemployment is falling more slowly than the Fed expected when it issued its forecasts back in April... When the Fed published its forecasts, it expected more jobs reports like April's, which initially showed the economy adding 115,000 jobs new jobs. But that hasn't happened… Which means the Fed's *own numbers* prove the Fed is failing to meet its dual mandate of keeping unemployment and inflation low. (Inflation is below the central bank's target right now; unemployment is not.)"

Plumer favorably references an earlier item from the Peterson Institute's Joe Gagnon, bearing the damning title "The Fed Shirks Its Duty":

> "On June 20, 2012, the Federal Reserve System's Federal Open Market Committee extinguished the last shred of doubt as to whether it intends to achieve its mandated objectives."

Carnegie Mellon's Alan Meltzer similarly wonders "What's Wrong With the Federal Reserve?" But his lament, published earlier this week in the op-ed pages of the *Wall Street Journal*, doesn't exactly mesh with the Gagnon-Plumer school of thought.

> "One of the Fed's big mistakes is excessive attention to the short term, over which it has little influence...
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> "The problem with the short term is that data reported today are subject to revision, or reflect only transitory changes. The better economic data last winter are one of many examples. Would the reported improvement in the economy persist? We didn't learn the answer until weaker data reported this spring. Is the slowdown persistent or temporary? We can only guess.
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> "Executing monetary-policy changes in response to transitory data is a mistake...
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> "Today's economic problems are serious, but the Fed can't do much about them if these problems are not monetary. Very expansive monetary policies did help during the crisis of 2008–09, but they're not what is needed now…"

I don't see a dispute here about the fact in the first half of the year the U.S. economy has grown considerably slower than most people—including those in the Fed—thought it would. As usual, the dispute comes down to how to interpret those facts and what to do about them.

Material differences of opinion about how to interpret the current economic environment was the focal point of a speech given today by Atlanta Fed President Dennis Lockhart, in Jackson, Mississippi. Acknowledging the divergent views represented by the Plumer, Gagnon, and Meltzer views, President Lockhart offers his own:

> "The question that the members of the FOMC confront is whether there is more that can be done to address the related challenges of slower GDP growth and tepid job creation. So, to wind up, let me give you my take on the key questions underlying a decision to bring on more monetary stimulus.
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> "I think the output gap—the amount of slack in the economy—is neither as sizeable as the high-end estimates, nor is it zero. If there were no slack at all, 8.2 percent unemployment would represent full employment. If this were so, the economy would have undergone profound structural change over the last five years. As I weigh the findings of research by Federal Reserve economists and others, I do not think a compelling case has yet been made that structural adjustment has played a dominant role in slowing growth and progress against unemployment.
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> "If, on the other hand, slack in the economy were close to the high estimates, we should have seen more and more persistent downward pressure on prices and wages than has, in fact, been the case. Deciding on the extent of the output gap is not straightforward. I believe the truth is in the gray middle.
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> "On the risk associated with the balance sheet: in my judgment, some further use of the balance sheet to promote continued recovery and/or financial stability brings with it manageable risks. I think reversal of the cumulative balance sheet scale and maturity structure can be accomplished in an orderly manner. But the step of additional balance sheet expansion should be undertaken very judiciously. Such a step would take us further into uncharted territory.
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> "On the likely effectiveness of further monetary stimulus—a policy that would necessarily be brought to bear at least in part through credit channels—I think we should have modest expectations about what further action can accomplish. I do not think this means monetary policy is impotent or has reached its limit. But I don't see more quantitative easing or similar policy action as a miracle cure, especially absent fixes in policy areas outside the central bank's purview."

And to the dimming forecasts:

> "So, as one policymaker, here's my situation: my support for the current stance of policy rests on a forecast that sees a step-up of output and employment growth by year-end and into 2013. If the economy continues on the track indicated by the most recent incoming data and information, that forecast will become untenable, as will the policy premises underlying it."

Plumer and Gagnon argue we are already at that point. Meltzer believes otherwise. Lockhart is weighing both possibilities. That approach pleases neither camp, but it's the right thing to do.

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