BBVA Research Flash
U.S.

Fed Watch: Central Bankers Ponder US Housing Market

- **Today's speeches emphasize that the Fed remains worried about the recovery**
- **Given a damaged housing sector, the economy is vulnerable to shocks**
- **The Fed will act if conditions deteriorate, but housing's infirmities set hurdles for the economy's response to further monetary accommodation**

Today's US Monetary Policy Forum in New York featured comments from a number of central bankers. The linkage between the housing market and monetary policy represented the major theme of the discussions, alongside commentary on the relationship between monetary and fiscal policy. A report sponsored by the forum argues that the housing market is irreparably damaged, causing the sensitivity of the US economy to monetary policy to be substantially less than ever before. This issue first arose in the FOMC's October 2011 minutes and persists as a central quandary for the Fed.

San Francisco Fed President John Williams asserts clearly that "…suppose monetary policy is less powerful than usual. That suggests we need to move our monetary instruments even more than usual to achieve our employment and price-stability objectives." Although different parts of the country may have exhibited varying degrees of severity in a downturn, the pace of recovery has been similar throughout the nation. According to Williams, "It's not the case that some areas are overheating and that others are languishing. Every region is facing substantial common headwinds." Williams' comments imply that he believes the broken linkage between housing and monetary policy requires a forceful response, arguing for more accommodation.

St Louis Fed President James Bullard, a nonvoting member, argues the opposite case from Williams. As he previously commented elsewhere, Bullard is of the opinion that the current calculation of the output gap is fraught with problems: the trend implied by the bubble years is throwing off our understanding of the benchmark we must return to in levels of GDP. While Bullard agrees that the housing market is a drag on the economy and also a challenge for monetary policy, he also argues that "It is neither feasible nor desirable to reinflate such a damaging bubble." According to Bullard, the state of the housing sector is now a generation-long event and a permanent shift. Bullard's comments imply that he believes the Federal Reserve cannot treat current economic conditions as a cyclical phenomenon, arguing against more accommodation.

New York Federal Reserve William Dudley's comments were typically featureless. Although an important member of the FOMC, he rarely gives a speech that is not carefully a repeat of existing Fed statements or minutes. His comments today focused on fiscal matters. He emphasized that the low burden of interest expense for the US government is temporary. The US must reform fiscal conditions in the long-run, but this will require coordination with other countries since global imbalances play a role in reversing persistent current account misalignments.

Philadelphia Fed President Charles Plosser, a nonvoting member, agreed with Dudley that long-term fiscal consolidation is important. The US needs a credible fiscal plan to provide certainty for markets. On monetary policy, he essentially said that the Fed is playing with fire with its recent actions: it is too close to a fiscal role with MBS purchases and too close to jettisoning its inflation mandate. The sum of his speech is that the Fed needs to refocus on inflation. Plosser is worried that central banks globally are toying with inflation to tweak shaky national debt issues.

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