THE FED'S SHIFTING GOALPOST

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Public transitions at the Federal Reserve, via either the reappointment of the existing chair or the introduction of a new leader, are relatively boring, and that is on purpose. The real hand-wringing surrounding the next leg of Federal Reserve leadership tends to take place by the elected powers-that-be huddled in lonesome hallways and behind closed doors in the nation's capitol months before the opening kick-off of the nomination and confirmation process are ever turned on. This off-field decision-making isn't born of corruption or conspiracy, however, rather by the strategy of game day logic. Namely, to give an air of overall financial stability, the playbook calls for a calm, subdued public affair with respect to the Federal Reserve in the best interest of the entire team.

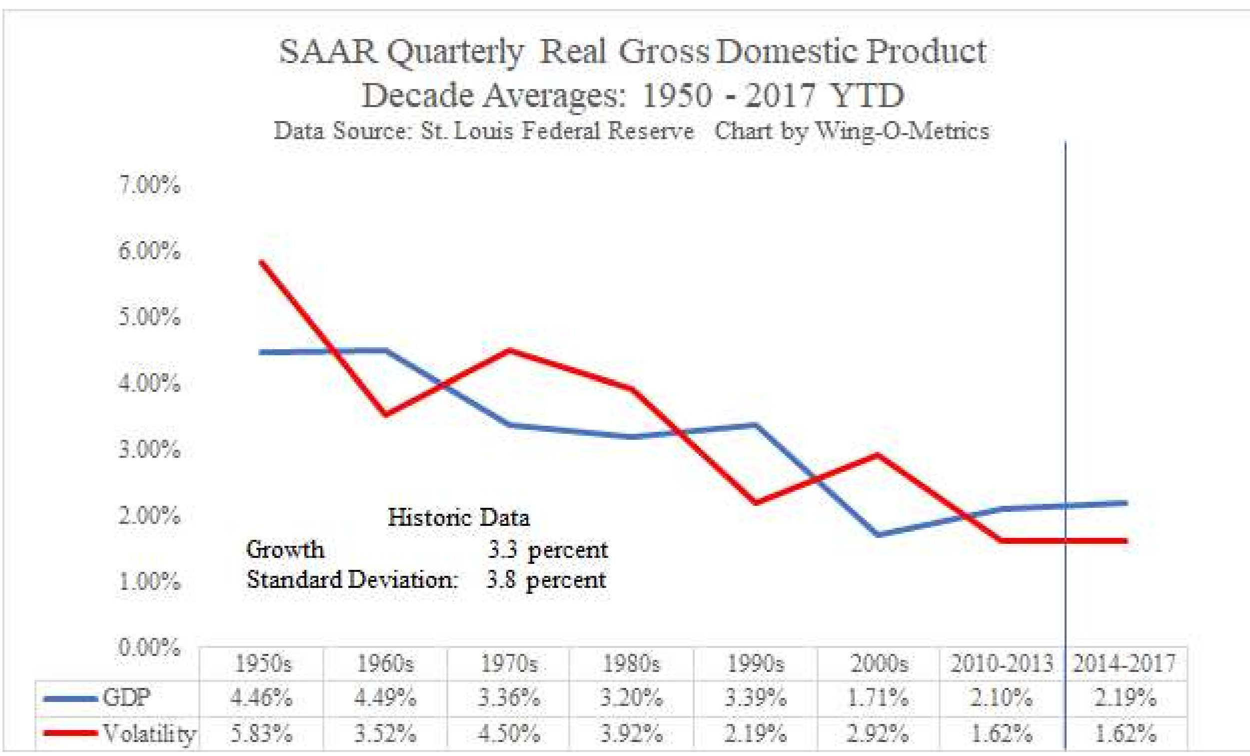
This dynamic, like those nomination games played in the past, was certainly the case when Janet Yellen was confirmed almost four years ago. All the prior months' pregame analysis, between her and Lawrence Summers, was neatly settled long before the coin was ever flipped on her tenure. And, because of this, she was able to outline an agenda of her vision as she saw the economic field ahead of her. For once on the gridiron, the actual confirmation hearing process is mostly a faux grandstand wherein the newly appointed can leverage a state of the economy address, sort of speak, and present a goal-setting speech to rally the team without fear of any arm-chair quarterbacking. That being the case, it makes sense to revisit that crowd rousing speech now as the seconds tick-off to Chair Yellen's first, and perhaps last, tenure as leader of the pack.

"We have made good progress, but we have farther to go to regain the ground lost in the crisis and the recession. Unemployment is down from a peak of 10 percent, but at 7.3 percent in October, it is still too high, reflecting a labor market and economy performing far short of their potential. At the same time, inflation has been running below the Federal Reserve's goal of 2 percent and is expected to continue to do so for some time.

For these reasons, the Federal Reserve is using its monetary policy tools to promote a more robust recovery. A strong recovery will ultimately enable the Fed to reduce its monetary accommodation and reliance on unconventional policy tools such as asset purchases. I believe that supporting the recovery today is the surest path to returning to a more normal approach to monetary policy." - [*Janet Yellen Confirmation Speech November 14th, 2013*]

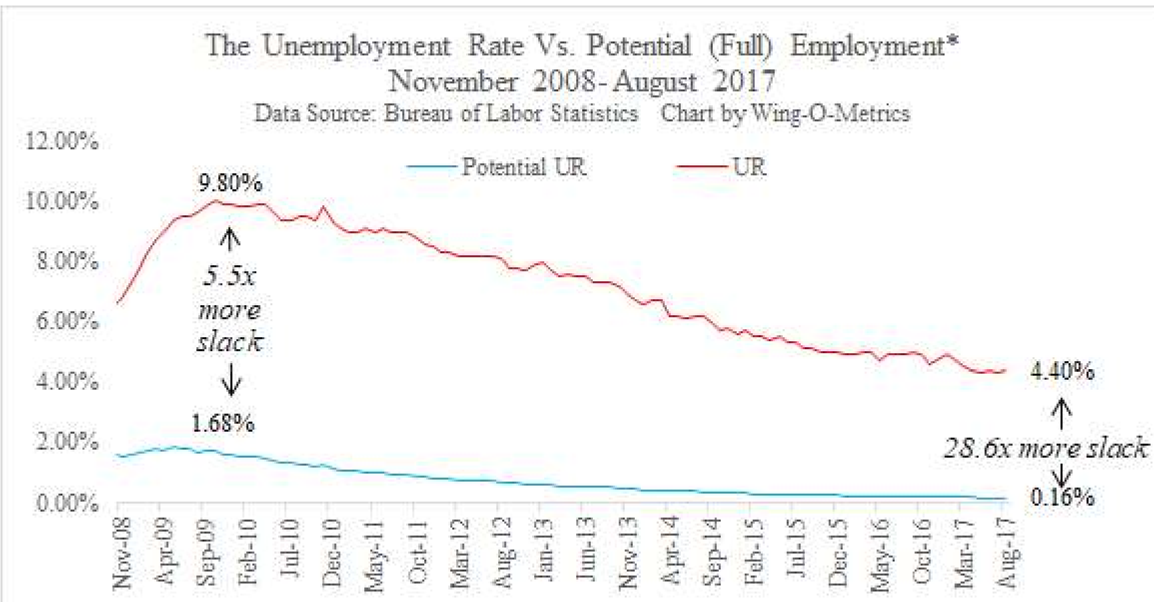
While it is easy to get hung up on the mentioned data of a 7.3 percent unemployment rate and sub-2.0 percent inflation rate, the most critical statement parsed out of that testimony was that the economy was 'performing far short of (its) potential'. As a solution to this problem, Yellen suggest that the Fed will use methods to encourage stronger growth. So the question is clear, how much stronger is growth now? That is a difficult question to answer because the goal-posts have seemingly shifted further away.

Looking at the stats of GDP, for instance, it is clear that growth is mathematically stronger over the last four years (2.19 percent SAAR) than the prior four (2.10 percent SAAR) since Yellen has been calling the plays. Marginally greater albeit, but faster nonetheless. It takes on a little more significance when that it is known that the greater growth comes in the context of no increase in volatility but again, it doesn't appear to be all that statistically significant. More so, GDP growth is still a considerable degree away from its 60 year average of 3.2 percent (although with more volatility) so it is hard to argue that growth has been 'robust', and it was 'robust' growth that Yellen perceived would allow for a return to a ' more normal approach' to policy (i.e. end of LSAP and reduction of the balance-sheet).



More important than averages reflecting what the economy is doing, to the fans in the stands though, is what the economy can be or should be doing. For it is only when the economy is consistently growing within an acceptable degree of its current long-term rate of potential output, that any central bank can truly have ac successful season. In fact, even the line markers produced by the behavior of the unemployment rate, show that more and more talent, despite desire to the contrary, is being regulated to watching from the sidelines than contributing to the team effort.

To her point, the unemployment rate has dropped considerably as she has driven the U.S. economy down the field. **But has it fallen enough?** Given the fact that the rise of surplus productivity has re-written the rules of this particular game, pushing the real goalposts much further away then when she started, t**he simple answer is no.** Due to the abnormal amount of mostly inert but ever encroaching potential GDP, the relative size of the modern U.S. economy, while numerically bigger than ever before, has never been smaller when compared to its potential. Therefore, the unemployment rate could easily be significantly lower than where it is today. How much lower? Under 1.0 percent lower before this labor force offense can even begin to exhaust itself.



*Potential full employment is a very rudimentary identfiier that is a function of the U-3 unemployment rate modified by the productivity divsior. It serves only to illustate the types of unemployment rates that might be more indicatve to real full employment based on current rates of long-term econoic potential and the corresponding shape of the eoutput gap as well as show that full employment is not static.

Ultimately, before the final whistle can be blown, Yellen's Fed has showed promise but has not pushed itself where it needs to be. The general continual under-performance of the economy is reflective not only in the data but in the overall pulse of the society that it provides for. Unable to adequately satisfy the entire team's potential, much much more hard-work has to be done to support even the slightest bit of acceptable GDP growth and labor market health or else the collective angst of the fans, and players themselves, led many to just quit on the teams altogether. This is the biggest problem facing Yellen or a new quarterback that comes out of the half-time locker-room in 2018.

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