# Heading the Fed

## U.S. president's nominee to lead the central bank faced with huge challenges

By Yu Lintao

When U.S. President Barack Obama deliberated on who to nominate as chair of the U.S. Federal Reserve, the gender of the nominee may not have been high on the list of criteria. However, with the nomination of Janet Yellen, a woman could soon become head of the most powerful job in central banking.

In light of the slow economic recovery and debt impasse of the United States, observers believe U.S. financial leaders prefer a relatively moderate central banker like Yellen. The majority argues that Yellen's appointment is a positive sign for the U.S. economy, as she will perhaps continue the quantitative easing (QE) policy of the incumbent Federal Reserve Chairman Ben Bernanke. However, some pessimists worry that postponing the end of the QE policy might inflate financial market bubbles and lead to hidden dangers resulting in a new round of crisis.

### Economic hot wire

Economic observers claimed that the nomination of Yellen is a strong signal of continuity at the Fed and the news will likely produce a shot in the arm for the U.S. economy.

Ding Meng, a senior foreign exchange analyst at Bank of China, said Yellen is more conservative than Bernanke. "She will certainly continue the policies of Bernanke, keeping borrowing rates low to accelerate growth and lower unemployment. It is good news at least in the short term and brings a certain amount of stability to the U.S. market," said Ding, adding "The lower level of risk associated with her policies is highly welcomed by investors. Stimulated by the good news, the dollar appears to be on the rebound."

The *Wall Street Journal* website reported on Yellen's nomination, quoting many economists who remarked that she is more qualified for the job than any of her predecessors.

In the same story, Robert Shiller from Yale University said Yellen is the kind of genuine and persuasive person who will be able to make good policies, even amid raucous debate and disagreements. Greg Mankiw, a professor of economics at Harvard University, voiced his support for President Obama's "great decision" in choosing Yellen to chair the Federal Reserve.

Yellen, a life-long economist who began her policymaking career in 1994 as a Federal Reserve governor, is known for favoring strategies that reduce unemployment even at the risk of driving up inflation. At the Fed, Yellen has built a reputation as a "dove"—someone who is typically more concerned about keeping interest rates low to reduce unemployment than about raising them to avert high inflation. She has strongly supported Bernanke's unorthodox but purportedly necessary efforts to revive the economy and bring down the unemployment rate, and to expand the Fed's thinking beyond its traditional fixation with inflation.

### Mixed global prospects

Dai Jinping, a professor on financial studies at Tianjin-based Nankai University, said the nomination of Yellen is also good news for emerging economies.

Since the U.S. Fed released the first round of QE in 2008, a large amount of capital rushed to emerging markets and fueled their economic growth. But when Bernanke announced the gradual termination of the QE policy in May, foreign capital began to withdraw from these emerging economies. As uncertainty looms behind future policies of the U.S. central bank prior to the nomination of the Fed head, the withdrawal of foreign capital has caused upheaval in emerging economies' financial markets.

Dai said that if Yellen assumes the post, the end of the QE program will likely be postponed. As a result, the financial pressure on the emerging economies will be alleviated.

"The postponement could buy some time for emerging economies to readjust their domestic economic structures," said Dai.

However, Yu Fenghui, a senior economic researcher and independent commentator on economics, said the U.S. QE monetary policy only preserves U.S. interests while doing damage to the interests of other countries in the long run.

"The ultralow interest rate and the continuance of QE could inflate financial market bubbles," Yu said.

Yu argued that the nomination of Yellen might boost the global stock market, international commodity prices as well as the futures market, but it also has dangerous implications.

**NOMINATION:** U.S. President Barack Obama and current Federal Reserve Chairman Ben Bernanke listen as Janet Yellen speaks at the White House in *Washington, D.C. on October 9*

The continuing of the U.S. QE program will form a greater threat to the exports of emerging economies and ultimately worsen growth of the entire macroeconomy, Yu added. In the meantime, the dollar assets of countries holding large foreign exchange reserves will depreciate further, causing their wealth to vanish.

Li Daokui, Director of the Center for China in the World Economy at Tsinghua University's School of Economics and Management, also claimed that a continual push of the U.S. dollar would force the appreciation of yuan, dampening China's exports. He predicted a substantial rise of the Chinese yuan against the U.S. dollar by the end of this year.

## Future challenges

After several rounds of QE, the size of the Fed's balance sheet ballooned rapidly. Abandoning the policy without causing major financial market upheaval poses a great test for the new central bank leader.

Analysts said the ending of the QE policy is unprecedented, leaving Yellen with no examples from which to take guidance. It will be a big challenge for her to reverse this prolonged and unprecedented period of monetary easing.

Moreover, a host of additional challenges are being posed by rising unemployment and inflation, a possible increase of the interest rate, as well as readjustment of fiscal and financial policies.

For other countries, professor Li of the Tsinghua University noted, the end of the U.S. QE policy would unavoidably result in capital returning to developed countries, posing potential turmoil in emerging economies. Recently, the Indian and Brazilian economies have already been affected by rumors of the removal of QE.

"The end of the QE program will likely have a limited direct influence on the Chinese economy," said Li. "Its effect on the economies of China's neighbors as well as trading partners, however, may be much more significant. As such, China must be fully prepared for any negative indirect influences." ■

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