LETTER FROM

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"Janet Who?"

BY KLAUS C. ENGELEN

When the news reached Europe that Janet Yellen was in the running to succeed Ben Bernanke as Federal Reserve chairman along with Larry Summers, a frequent reaction on this side of the Atlantic was: "Janet who?"

By contrast, Summers, former U.S. Treasury Secretary and chief economic adviser to U.S. President Barack Obama in the banking crisis, had broad public recognition as a controversial American actor on the political, financial, and academic stage. Some recalled Summers' questionable role as chief economist at the World Bank. His failed Harvard University presidency was seen as a case study in American gender discrimination. As a crusader for financial deregulation, Summers lost credibility when he made millions by consulting for the deregulated financial industry.

Therefore, it came as no surprise that Summers, facing fierce opposition even from the ruling Democrats as Obama's first choice to replace Bernanke at the end of January 2014, took himself out of the race.

Janet Yellen could well endure an even more difficult tenure than Bernanke, who had to manage the aftermath of the U.S. housing bubble. Her biggest advantage may be that she does not belong to the inner circle of crusaders for financial market deregulation that brought about the worst global crisis since the Great Depression. As a highly respected economist who over many years has held top positions in the Federal Reserve system, Yellen was, of course, known to insiders in March 2010 when Obama appointed her as vice chairman of the Federal Reserve Board of Governors. In central banking and academic circles, she is highly regarded as a distinguished researcher with relevant policy experience at the Fed and at the White House. She also has an impressive track record at the helm of a large organization such as the Federal Reserve Bank of San Francisco from 2004 to 2010. Last but not least, she is the wife of Nobel laureate George Akerlof.

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And there is what one might call a "German connection" with the academic Yellen-Akerlof couple. In the aftermath of German unification, when both Yellen and Akerlof were teaching at the University of California-Berkeley, they worked on the labor market impact in East Germany after unification. Together with two other colleagues from Berkeley, they published "East Germany in from the Cold: The Economic Aftermath of Currency Union" (Brookings Papers on Economic Activity, 1-1991).

After Obama, on October 9, formally nominated Yellen as the first woman to head the Federal

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Klaus Engelen is a contributing editor for both Handelsblatt *and* TIE.

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Phone: 202-861-0791 • Fax: 202-861-0790
www.international-economy.com
editor@international-economy.com

Reserve—with good prospects for sailing through the U.S. Senate's confirmation process—some European newspapers jumped in with variations on the headline: "Janet Yellen replaces Angela Merkel as the world's most powerful woman."

It was to be expected that European reactions to the Yellen appointment would reflect the heated debates in the northern euro area member countries about the central banks as willing helpers in implementing a policy of financial repression. In this respect, the European Central Bank and other central banks such as the U.S. Federal Reserve are seen as paving the way for the next financial crisis. By continuing their policy of near-zero interest rates and implementing a broad range of unprecedented non-standard policy measures, they are heading toward the next bubble.

On the one side the news coverage was "Markets in Europe reacted positively to the nomination of Janet Yellen with higher stock market prices." On the other side were warnings: "Good news for all those who profit from cheap money. Yellen has a record of supporting printing money. Such fiat money allows a global finance elite to go on speculating on a grand scale."

Jörg Krämer, chief economist of Commerzbank AG, didn't roll out the welcome mat for Bernanke's probable successor in an interview with *Osnabrücker Zeitung*. "Like almost no one else at the U.S. central bank, Yellen stands for the policy of cheap money. This in spite of the fact that this loose monetary policy created the debt bubble under which the U.S. economy still suffers. Under Yellen, the urgent exit from the loose U.S. monetary policy will take place at a dismally slow pace. There is the risk that under Fed Chairman Yellen, asset prices in equity shares or houses will be pushed higher and the seeds for the next housing bubble will planted," argues the bank economist.

Yellen is labeled a "dove" because she is seen as supporting massive monetary expansion in order to lower unemployment levels. And those who refer to present Fed Chairman Bernanke as "Helicopter Ben" are already calling his nominated successor "Helicopter Janet." They are referring to when Bernanke quoted Milton Friedman about using a "helicopter drop" of money into the economy to fight deflation; and also to his note that "people know that inflation erodes the real value of the government debt and, therefore, that it is in the interest of the government to create some inflation."

At the same time, ECB President Mario Draghi faces a barrage of criticism for letting the euro interest rate fall close to zero (0.25 percent), and for flooding financial markets with liquidity at the disadvantage of savers, who see their retirement finances eroded. Northern savers and financial asset holders see part of their wealth melting away under the policy of "financial repression." Central banks and governments in Europe are letting returns on savings and financial holdings fall in order to ease the financing of zombie banks and higher sovereign debt issuance in the periphery. This way, governments and politicians in the eurozone are using the ECB system for transferring financial resources from Northern savers to Southern debtors, thereby causing deepening resentment against more European integration.

The European reaction to the coming changeover at the helm of the Federal Reserve is dominated by the realization of the interconnectedness of the banking systems on both sides of the Atlantic, especially with respect to the dependence on near-zero refinancing through the central banks, the remaining regulatory banking reform challenges, and also the daunting challenge of managing the exit from the present non-standard monetary measures and the return to normal interest rate policies. The Federal Reserve, the European Central Bank, and the Bank of England have been fighting the financial crisis by expanding their balance sheets through securities purchases, thereby accumulating ever-higher risk levels.

I conclude with a final word from a financial market expert from Berlin, Achim Dübel, who warns: "So far the dollar bloc has been kicking the can—China, Japan, and the Gulf have kept funding the U.S. current account deficit while shifting from the long to the short end of the dollar curve. To simplify a little bit, credit and market risk for those investors in U.S. dollars today is taken by large European banks in the global credit market and the Fed in the U.S. treasury and mortgage-backed securities market." Dübel continues: "Even that reduced dollar risk exposure could prove too much for financiers if the U.S. government continues to fail to consolidate and become attractive again for investors, which would preempt the Fed from tapering and preserving the long-term value of the dollar. Already there is a marked shift to competing arrangements in trade invoicing, including moves towards the convertibility of the Chinese renminbi, which have the potential to materially reduce short-term dollar holdings. Should the willingness of investors to hold dollar reserves decline to any material extent, Mrs. Yellen might have to manage a fully blown currency and inflation crisis." ◆

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