2008 Fed Transcripts Show Experts Clueless, Confused

Followers of the Fed have carefully analyzed the 1,865 pages of transcripts it released in February of its eight regularly scheduled meetings and six emergency meetings in 2008 and have concluded that these experts were clueless and unaware of the opening economic abyss yawning before them. Even the *New York Times* was forced to admit, following its review of the documents, that "Federal Reserve officials are unaware in January 2008 that the economy had already entered a recession."

The first sign of trouble was missed entirely by the Fed's Open Market Committee. In March 2007, the mortgage industry ceased functioning as homeowners saddled with loans they couldn't service began to default on them in waves. In June 2007, the Dow Jones Industrial Average, which had gone vertical since the summer of 2006, hit a top of 14,000 but lost nearly 1,200 points by the fall. It then rebounded to hit what was then the Dow's all-time high of 14,164 in November. By January 9, 2008,the market had lost 1,500 points, unemployment had risen sharply for three straight months, the housing market had begun to crater, and Fed Chairman Ben Bernanke decided to call an emergency conference meeting with his board.

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As he opened the call, Bernanke remarked:

> I think there are a lot of indications that we may soon be in a recession.
>
> I think a garden-variety recession is an acceptable risk, but I am also concerned that such a downturn might morph into something more serious.

A staff report was entered into the minutes, estimating that the economy would grow nicely into the new year:

> The incoming data on spending and production have, on net, led us to revise upward our estimates of real GDP growth in [the last quarter of 2007] by about 1 ¼ percentage points….
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> In addition, the construction data for November imply a sizable upward revision to our estimate of nonresidential construction in [the fourth quarter of 2007].

Following that staff report, Bernanke asked for input from his committee. Bernanke heard lots of good news. From Richard Fisher, head of the Dallas Fed, came this:

> While there are tales of woe, none of the 30 CEOs to whom I talked, outside of housing, sees the economy trending into negative territory. They see slower growth. Some of them see much slower growth. None of them at this juncture see us going into recession.

At its regular meeting on January 29, the news about the economy, as viewed from the top floor of the Fed building in New York at least, continued to be rosy. Associate Director Reifschneider from the Fed's Division of Research and Statistics was positively giddy:

> Not all the news was bad. Nonresidential construction activity has continued to be surprisingly robust, and defense spending looks to have been higher last quarter than we anticipated.
>
> Moreover, retail sales since November [2007] came in stronger that we predicted, and the figures for September and October were revised up[ward]….
>
> We are not forecasting a recession. While estimates of the probability of a recession have moved up, they are not uniform in their assessment that a recession is at hand.
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> Another argument against forecasting recession is that, with the notable exception of housing, we see few signs of a significant inventory overhand. In addition, the recent weakness in the labor market [unemployment had begun increasing from five percent] and spending indicators are still limited….
>
> Finally, a good deal of monetary and fiscal stimulus is now in process that should help support real [economic] activity.

This was echoed by another member of the committee, a Mr. Evans:

> My … outlook for 2008 [is that] we will eke out positive growth in the first half of 2008. This expectation largely reflects the judgment that businesses have not begun to ratchet down spending plans in the nonlinear fashion that characterizes a recession.

Added Vice-Chairman Timothy Geithner:

> [The economy in 2008] is going to be a little slower … without being so slow that it's going to amplify downside risks to growth in the United States.
>
> That may be too optimistic, but the world is still looking pretty good.

By March 2008 the new numbers were frightening, as companies in the mortgage business continued to collapse, threatening the survival of major banks and Wall Street firms as well as Fannie Mae and Freddie Mac. The credit rating agencies' credibility was being called into question as they also were slow in revising downward their optimistic ratings of those institutions.

By late June the housing market was in a shambles, interest rates had been cut by several percentage points, and the Fed, well behind the curve from the beginning of the year, struggled to play catch up.

By September 2008, the full reality of the Great Recession had set in at the Fed, forcing it to make hasty and highly questionable decisions about how to respond to the unfolding crisis. Nevertheless, Chairman Bernanke remained optimistic, especially about the unemployment situation:

> It is somewhat difficult to predict the peak in the unemployment rate, given the upward momentum we are seeing.
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> Declines in energy prices, however, will improve real incomes and help consumer sentiment — so that is a potentially positive factor.

By December, unemployment — using government-generated numbers — had risen from five percent to 6.8 percent and would eventually peak out at 10 percent late in 2009.

Bernanke admitted in September 2008 that he didn't have a clue about what to do or where the economy was headed or how bad things were going to get:

> Frankly, I am decidedly confused and very muddled about this. I think it is very difficult to make strong, bright lines given that we don't have a structure that has been well communicated and well

> established for how to deal with these conditions.

By October he expressed surprise at just how bad the economy had become:

> I should say that this comes as a surprise to me. I very much expected that we could [keep interest rates] at 2 percent for a long time, and then when the economy began to recover, we could begin to normalize interest rates.
>
> Clearly, things have gone off in a direction that is quite worrisome.

At no point in any of the 1,800 pages does any single participant accept any blame for creating the crisis in the first place. No one mentions former Fed Chairman Alan Greenspan keeping interest rates lower than market rates for years in his failed attempt to stimulate the economy following the recession of 2000-2001. But that is exactly where the blame belongs, according to John Taylor, professor of economics at Stanford University:

> My research shows that government actions and interventions — not any inherent failure or instability of the private economy — caused, prolonged and dramatically worsened the crisis.
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> The classic explanation of financial crises is that they are caused by excesses — frequently monetary excesses — which lead to a boom and an inevitable bust.
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> This crisis was no different: A housing boom followed by a bust led to defaults, the implosion of mortgages and mortgage-related securities at financial institutions, and resulting financial turmoil.
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> Monetary excesses were the main cause of the boom. The Fed held its target interest rate, especially in 2003-2005, well below known monetary guidelines that say what good policy should be based on historical experience.

If the so-called experts meeting around the table and during emergency conference calls in 2008 didn't have a clue as to the depth of the crisis they had created, much less what do to about it, how much confidence should people have in their ability to predict, much less successfully manage, the next one?

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