Camp Kotok 2017 by Brent Donnelly

I have returned from mandatory block leave and from my annual pilgrimage to Camp Kotok. The trip is a gathering of economists, current and ex-Fed staff, traders and journalists in the bucolic backwoods of Maine. This year's gathering also included a visit from Susan Collins, one of three Republican senators voting "No" to the hastily-crafted skinny repeal health care bill. Most time was spent talking about the economy, markets and the financial industry. Here are the topics and themes I found interesting:

1. Fed relevance and credibility are making new lows. Maybe this is partly because a fair bit of discussion revolved around Danielle DiMartino-Booth's new book "Fed Up". She was at Camp Kotok and so naturally some of the topics in the book came up for discussion. I listened to the audiobook on the 9-hour drive north and have to say I found it incredibly enlightening and entertaining. The last thing I want to read (ever) is another rehash of the financial crisis so I went in with some hesitation but came away impressed. I plan on writing a review of the book for a future AM/FX but Danielle's insider status and extreme lack of filter make for some spicy reading (she worked at the Dallas Fed for 9 years, advising Richard Fisher).

In recent years, the most intense discussion at Camp Kotok has revolved around the Fed as everyone eagerly anticipated and attempted to forecast first Fed tapering and then the timing and pace of rate hikes. This year, nobody really seemed all that interested in the Fed, and many said they thought marginal ECB and BOJ policy adjustments were more important than FOMC moves going forward. This highlights the importance of Mario Draghi's Jackson Hole message. On one hand, the ECB has tried to temper expectations into the event by saying nothing new will come of it but on the other hand the ECB Minutes' reference to EUR overshoot supports the idea of a dovish Draghi as financial conditions tighten in Europe.

With regard to the Fed as an institution, there was a fair bit of criticism about their extremely academic and PhD / ivory tower viewpoint (again, echoing themes from "Fed Up"). The Fed is home to roughly 769 economists(1), making it (probably) the largest employer of economics PhDs in the world. It employs a total of 22,801 people at a cost of $3.3 billion per year or $142,011 per employee(2). The Fed employs about the same number of people in the USA as American Express(3)! This compares to 4,600 employees at the BoJ, 3,600 at the BoE, 1,800 at the ECB and 1,600 at the Bank of Canada.

Interesting side note that I ran into while researching the last paragraph: The BoJ sets a ceiling of 4,900 employees(4), perhaps in recognition of bloat risk. Jim Bianco and a few others thought that a Gary Cohn Fed Presidency might introduce a little sanity and downsizing to the organization but the room generally expected the Fed to remain risk-averse and PhD/academia-driven for many years to come.

If you want to see a cool infographic showing the changes in the Federal Reserve Board of Governors over the years and how it has evolved from a multi-faceted and diverse organization to one that is very monolithic, monotheistic and dominated by academics, check this out: http://goo.gl/eCKVrS. And one final tidbit on the PhD monoculture at the Fed: The last Fed President without a PhD was Paul Volcker5 so clearly you don't need a PhD to succeed as Fed President.

Kevin Warsh has been beating the drum on Fed groupthink for a while. His most recent comments appear here: https://www.bis.org/publ/bppdf/bispap92.pdf.

And there is another great Warsh piece from 2016 called "Challenging the Groupthink of the Guild" here. A couple of highlight paragraphs from his most recent speech:

What is the groupthink of which I speak? It’s a groupthink on monetary policy tactics, tools, governance and strategy, all. Its stated mantra of data dependence causes erratic lurches owed to noisy economic measures. Its statutory medium-term policy objectives are at odds with its myopic compulsion to keep asset prices elevated.

Its inflation objectives are far more precise than the residual measurement error. Its preferred output gap models are deeply flawed and troublingly unreliable, obfuscating uncertainty and masking policy bias. Moreover, the groupthink seeks to fix interest rates and control foreign exchange rates simultaneously. Its forward guidance begets ambiguity in the name of clarity.

It licenses a cacophony of communications in the name of transparency. It recasts poor economic results with a high-sounding slogan of secular stagnation. And it expresses grave concern about income inequality while refusing to acknowledge the effect of its policies on more consequential asset inequality

All the while, the groupthink gathers adherents as its successes become harder to find. Too many in the guild tighten their grip when they should open their minds to new data sources, new data analytics, new economic models, and a new paradigm for policy.

(1) Estimated. Source: Bob Eisenbeis, Cumberland Advisors (estimate)
(2) Source: Federal Reserve 2016 Annual Report (pages 412 and 420). If you are ever super bored, there is all sorts of fascinating stuff in the Fed’s Annual Report.
(3) Source: American Express 10-K
(4) https://www.boj.or.jp/en/about/activities/strategy/yosan/tei

in2017.htm/

Read the other points Brent Donnelly found interesting at Camp Kotok in the linked PDF: AMFX-Camp-Kotok-2017- 21AUG17