# Dear dr. bernanke,

Economics, Macroeconomics

Dear Dr. Bernanke, All economic indicators point to the fact that the United States has been in a recession for at least a year now. The Gross Domestic Product (GDP), the market value of all final goods and services produced within a country in a given period of time (as defined by Gregory Mankiw in his textbook, “ Brief Principles of Macroeconomics") clearly indicates that the U. S. economy has entered a recession. Consistent with the past three recessions in the U. S. (early 80’s, early 90’s, and 2001-2003), the Real GDP’s growth rate has become increasingly volatile over the past five quarters. In fact, per the Bureau of Economic Analysis (BEA), the GDP has contracted in two of the past four quarters. According to the BEA’s Table 1. 1. 1 — Percent Change from Preceding Period in Real GDP, the only other times in the past 30 years when the real GDP decreased in two of any given four consecutive quarters was during the aforementioned recessions. This lack of growth, and in some cases, contraction of the Real GDP is a direct indicator that U. S. production is also shrinking…something that occurs during a recession. The nation’s cost of living is largely measured by the consumer prices index (CPI), the overall cost of the goods and services bought by a typical consumer. A rising CPI indicates that people are paying more for the things they are buying. Per the Bureau of Labor Statistics (BLS) website, the CPI is the most widely used measure of inflation. Inflation tends to fall during time of economic hardship due to the fact that there are fewer injections of money into a struggling economy, and less money means less inflation. According to the BLS, for the 12 month period ending December 2008, the CPI rose . 1%, the smallest calendar increase since a . 7% decrease in 1954, indicating that money is not being loaned and “ created. "

When money is not being loaned or changing hands, an economy is struggling. The unemployment rate is also an indicator of our nation's economic wellbeing, or lack thereof. Unemployment is also measured by the BLS. It is considered a lagging indicator of the economy, meaning that the unemployment rate will not reflect a recession or economic boon until such time that the event has already started (or completed, depending on the duration of the event). This is because employers do not generally layoff workers at the first sign of an economic downturn nor do they instantly hire more workers when the economy starts to recover. BLS statistics show the unemployment rate in December 2008 to be 7. 2%, a 2. 3% rise over the 4. 9% unemployment rate in December 2007. The unemployment rate had remained relatively stable during 2006 and 2007, hovering in the 4. 5%-5. 0% range. So, this rapid rise in unemployment confirms the nation is facing serious economic problems. As discussed earlier, the GDP and CPI indicate that our economy has been in a recession since December 2007. And upon closer study, the 2008 monthly unemployment rates do not start to steeply incline above the 5% threshold until May 2008, a few months after the start of the recession. This is consistent with unemployment being a lagging indicator of the economy. The Federal Reserve uses Open Market Operations, the purchase and sale of U. S. government bonds, to affect the Federal Funds Interest Rate. The current Fed Funds Rate, the rate at which banks can make short-term loans (typically overnight) to each other, has been cut to . 25%. This is the lowest since the Fed started publishing the funds target in 1990. To get the rate this low, the Fed's bond traders buy government bonds, thus increasing the money supply and the aggregate

demand of goods and services. This is supposed to encourage individuals and companies to borrow and spend. As Dr. Gregory Mankiw describes in his New York Times article, “ What Would Keynes Have Done, " low interest rates also “ bolster equity values and, by encouraging international capital to look elsewhere, reduce the value of the dollar in foreign markets. " As a result, low interest rates increase spending on consumption and investments, in addition to increasing our nation’s net exports. (It should be noted that it will be very difficult to greatly increase exports presently because the world economy is struggling, not just ours.) All of these things help strengthen the economy. If at some point in the future, it becomes prudent to raise the interest rate, the Fed’s bond traders would then have to sell the government bonds, thus decreasing the money supply in the market and lowering the aggregate demand. With the U. S. economy currently in a recession, I do not recommend raising the interest rates in the short-term future. The good news is that reducing the Fed Funds Rate to historic lows has helped prevent the U. S. from slipping into a depression by allowing banks to continue to lend money to each other and keeping the nation’s money supply somewhat liquid. However, it appears that simply lowering the interest rate will not be the only cure for our economy. We have almost reached the point where the Fed Funds rates cannot fall any lower. The Fed and the U. S. government will have to take other measures to help pull us from this economic slide. Other options that have been used and need to continue to be considered: a) Putting hundreds of billions of dollars of new reserves into the private sector — As described by Robert Lucas in his 12/23/08 article “ Bernanke is the Best Stimulus Right Now" from The Wall

Street Journal, doing this gives investors relatively safe and liquid securities to buy for those who want to flee from the non-government issued and/or insured securities. Without these safer options provided by the Fed, when investors sold their current securities, they would most likely choose to save their money as cash, thus reducing spending and furthering the recession. b) Target long term interest rates — By staying committed to keeping interest low for a substantial period of time, the Fed can make banks feel more comfortable with lending to each other, thus keeping more liquid money in the market. c) The U. S. government can help stimulate the economy by choosing to finance substantial non-wasteful improvements to the nation’s infrastructure. By pumping dollars into the economy through government funded project, Washington creates jobs and in theory will stimulate spending by companies and individuals, thus helping the economy to recover. The catches are not to be wasteful with the spending during the recession and then to be fiscally responsible and cut back on government spending once the economy has recovered. Taking the actions described above will hopefully lessen the severity and duration of this current recession.