Whatever It Takes

A few observations on what to look for in the language of the FOMC announcement tomorrow from a game theoretic perspective…

Ever since Mario Draghi ad-libbed the lines "whatever it takes" in his July 2012 speech in London, a speech that together with the equally fabulistic OMT program rescued Europe and the Euro from the clutches of Spanish and Italian sovereign debt woes, this has been the go-to phrase for any politician or central banker seeking to imply unlimited resolve in bringing the firepower of the State down on an unruly market. Angela Merkel and Nicolas Sarkozy immediately seized on Draghi's line once they saw what a salutary influence it had … Barack Obama now uses the phrase in the context of everything from budget fights to immigration reform to community college funding … Ben Bernanke is much more reticent to use the phrase directly (he's smart enough to see it as the psychological weapon that it is, a weapon that diminishes from overuse), but his words are constantly interpreted by the media as implying a "whatever it takes" stance. In fact, I'm hard-pressed to come up with a more prevalent — or powerful — policy language meme than "whatever it takes."

Why is it so popular? Because it works like a charm in the Common Knowledge game. Underpinning the CK game is a vast array of forward looking expected utility calculations that each and every one of us makes regarding our expectation of everyone else's expectations of everyone else's expectations. I know that's a mouthful, and for some background on the mechanics of the CK game and Fed communications you can look here and here and here in prior Epsilon Theory notes, but essentially you're playing what Keynes called the Newspaper Beauty Contest. The drivers of the CK game are public statements by famous people like Mario Draghi, and the expected utility calculations we unconsciously make in our heads are based on Who and What … Who is making the statement and how likely is it that he or she will deliver on the statement, and What is the likely impact of the policy if it comes to pass.

The power of "whatever it takes" is in the What. Expected utility calculations cannot handle an unlimited result, and there's a little piece of our brain that goes on tilt when it tries to process that phrase, particularly if it's being said by a powerful Who. That little piece of our brain returns a Does Not Compute result when it hears "whatever it takes" in a policy context, which leaves the rest of our brain floundering. Luckily for us, we have no shortage of media messengers who are only too happy to tell us what it means and repeat the message ad infinitum, because it makes those media messengers relevant and useful. And if they're more relevant they can sell more newspapers or ads or whatever. Everyone wins!

So what does this have to do with the FOMC announcement tomorrow? There's a lot of chatter out there that the Fed will hold off on a taper announcement, but will put some sort of limit on the overall size of this latest round of QE launched in September 2012. In other words, monthly purchases will continue at the current rate, but this will no longer be a QE-forever program. **From a CK game perspective, placing a limit on the QE program is a more market-negative statement than a taper.** This is what I'm going to be watching for tomorrow, along with whatever dovish (market-positive) language is inserted around forward guidance on rates. And then the battle for meaning and interpretation will be joined …

All the best,

Ben