Payden&Rygel

Economic Update

THOUGHTS FROM OUR ECONOMICS TEAM

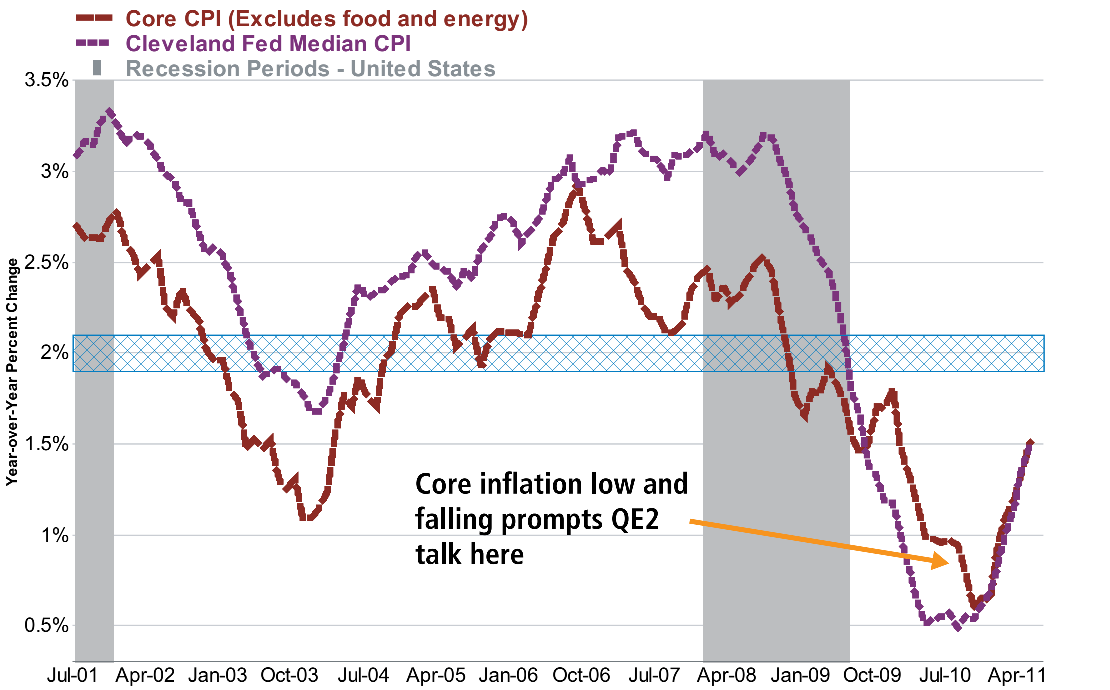
JULY 13, 2011

THE "WAIT-AND-SEE" FED

Mr. Bernanke's testimony this morning on Capitol Hill did not give us any reason to change our view: the Fed is in "wait-and-see" mode. If the economic data improves, the Fed will proceed down the exit sequence path. The Fed remains hopeful that temporary factors will fade and second half economic growth will improve. On this note, Mr. Bernanke pointed out that "private payroll gains have averaged 160,000 per month in the first half of 2011 even including the disappointing May and June readings". On the other hand, Mr. Bernanke mentioned that "the possibility remains that the recent economic weakness may prove more persistent than expected ***and that deflationary risks might reemerge,*** implying a need for additional policy support." [Emphasis mine]. What constitutes "additional policy support"? Bernanke focused on three options: 1) The Fed could tell us exactly how long the low level of the fed funds rate and the size of the Federal Reserve's balance sheet will be maintained (in Fed Speak this is called "explicit policy guidance"), 2) The Fed could buy more securities or extend the average maturity of its portfolio and 3) The Fed could reduce the interest rate paid on bank reserves, which would put "downward pressure on short-term rates more generally." In terms of "deflationary risks", the recent path of core inflation coupled with the FOMC's expected future path of inflation present a high bar for additional easing at this point. Nonetheless, the message is that the Fed is in "wait-and-see" mode and all options are available.

The market took Bernanke's remarks as more dovish than expected and ran with the "QE3" theme, with stocks up, oil up, longer term interest rates up and the dollar weaker as of this writing.

CORE INFLATION RATE LOW AND *RISING* COMPARED TO LOW AND *FALLING* A YEAR AGO



Sources: Bureau of Economic Analysis, Cleveland Fed

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