

## Chairman Bernanke's JEC Testimony Instigates Speculation

- The tone of Chairman Bernanke's testimony on economic growth and inflation before the Joint Economic Committee (JEC) yesterday was broadly similar to the contours of the March 18 post-meeting statement. Implicitly, however, Bernanke's prepared remarks appear to underscore the gap between ongoing challenges on the economy and financial markets at this juncture, and forward-looking expectations of beneficial policies (which includes monetary policy, liquidity provision programs and tax rebates) in the pipeline.
- In general, the Fed Chairman reiterates that "financial markets remain under considerable stress" and that the "near-term economic outlook has weakened". Although Bernanke mentions that "risks remain to the downside" in his prepared remarks, he did not convey the impression that the perceived risks surrounding the forecast have intensified. Instead, the Chairman highlights that the Committee anticipates "economic activity to strengthen in the second-half of the year" and "growth...to proceed at or a little above its sustainable pace in 2009", though the "uncertainty attending this forecast is quite high". Indeed, our directional growth projection in 2008 appears similar to the foregoing outlook, but I am more skeptical of the 2009 forecast.
- Taken in isolation, however, Bernanke's prepared text on the near-term economic backdrop seems more dire when he asserts that real GDP "will not grow much, if at all, over the first half of 2008 and could even contract slightly". However, the foregoing rhetoric was probably implied in the March 18 statement, which acknowledges that "recent information indicates that the outlook for economic activity has weakened further" and that several factors are "likely to weigh on economic growth over the next few quarters". Nonetheless, it is not entirely clear if the aforementioned backdrop on real GDP growth would necessarily conform to the recession definition of the National Bureau of Economic Research (NBER is the official adjudicator of US business cycles). To be sure, aside from real GDP, the NBER uses four other monthly "economy-wide measures" to determine economic cycles. And the recent readings of the composite index of these four roughly coincident indicators are still not unequivocally consistent with a typical recession. In all, I recognize that US recession risks are significant at this time but not conclusive as yet.
- While Chairman Bernanke maintains that inflation is expected to "moderate in coming quarters", he also retains the caveat that it is still important to "monitor inflation developments carefully in the months ahead". In fact, Bernanke's initial statement in the inflation discussion paragraph, which states that "inflation has also been a source of concern", seems to imply a slight increase in emphasis from the March 18 communiqué. Perhaps, Bernanke's comments on inflation and forecast-related uncertainties might be an indirect policy strategy to dissuade market participants from taking one-sided bets on interest rates.
- Although available market indicators continue to lean in favor of a 25bps reduction in the target fed funds rate at the April 29-30 meeting at this time, I am still inclined to stick to my initial forecast of a 50bps move by the Fed. Arguably, a 50bps cut simply for insurance purposes still seems a reasonable call; however, if incoming economic data on balance surprises on the upside in the coming weeks, then a 25bps move at the April meeting could become more compelling.

- Finally, the Chairman's overall comments on the Fed's unusual participation in the Bear Stearns deal--needless to say--suggest that systemic risk considerations were the primary impetus. Today's testimony before the Senate Banking Committee should shed more light on the relevant details behind the Bear Stearns situation. (The Senate press release on April 2 indicates that the first panel will consist of Fed Chairman Bernanke, NY Fed President Geithner, SEC Chairman Cox and Treasury Undersecretary Steel. The second panel will comprise of CEOs from Bear Stearns, Schwartz, and JPM Chase, Dimon.)

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