TrendMacrolytics

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On Bernanke's Testimony

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Aside from explicitly holding out the possibility of a **pause in its rate hiking program**, **Ben Bernanke** today did little to alter our basic view of the policy outlook. Although the prospect of a potential pause got much of the first blush response from markets and the media, **the Fed chairman's testimony before the Joint Economic Committee** was actually a finely balanced presentation, with hints of **dovishness** provided in the context of what still seemed an overall **hawkish** perspective. This most likely reflects the current **diversity of views among policy makers** as to the attendant risks facing policy after nearly two uninterrupted years of **rate normalization**.

No doubt, Bernanke got the response he expected to get when he stated that "even if in the Committee's judgment the risks to its objectives are not entirely balanced, at some point in the future the Committee may decide to take no action at one or more meetings in the interest of allowing more time to receive information relevant to the outlook." This assertion was immediately followed, however, by the important reminder that a "decision to take no action at a particular meeting does not preclude actions at subsequent meetings, and the Committee will not hesitate to act when it determines that doing so is needed to foster the achievement of the Federal Reserve's mandated objectives."

In Bernanke's **output gap** interpretation, the task of meeting those objectives is synonymous with ensuring that "aggregate demand for goods and services does not persistently exceed the economy's underlying productive capacity." After noting that in the past year the **unemployment rate** has fallen by half a percentage point, while the rate **of industrial capacity utilization** has risen by a point and a half, Bernanke stated: "As the utilization rates of labor and capital approach their maximum sustainable levels, continued growth in output -- if it is to be sustainable and non-inflationary -- should be at a rate consistent with the growth in the productive capacity of the economy." While he didn't specify the **growth rate consistent with "maximum sustainable levels,"** it's no secret that the **Fed's models** consider growth of more than 3% to 3.5% to be **"above potential."** Thus, unless **the economy** shows clear signs of slowing toward those levels -- which we don't expect -- it's a good bet any Fed pause will be short-lived.

That reasoning is apparent today in the response of the **futures markets** to Bernanke's testimony. While July **fed funds futures** rallied to put the odds of a move to 5.25% at the late June meeting at less than 40% from more than 60% yesterday, the September contract is still more than fully priced for 5.25%. TM

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