FLORIDA PRIME

Weekly Commentary

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Short rates held at low levels in a week where much of the focus was on how Fed Chairman Ben Bernanke would handle a historic post-FOMC meeting press conference. The answer: he talked for nearly an hour last Wednesday afternoon but really didn't reveal much beyond what we already knew—that the recovery is continuing; that higher gas and commodities prices are showing up in headline inflation; that the Fed still believes the effects of the price increases and a related slowing in the economy will likely prove "transitory'' (Bernanke used the word extensively during his briefing); and that QE2 will run its course and be completed by the end of June.

Two revelations did emerge from Bernanke's inaugural press conference (the Fed chairman now plans to speak to the media after four of the policy-setting Federal Open Market Committee's eight meetings each year as part of his ongoing push to bring more transparency to Fed policies and actions). One was a clearer definition of what "exceptionally low levels … for an extended period'' means regarding the benchmark rate—Bernanke said "extended period'' implies at least two meetings before a target rate change. The other was the Fed's strong disinclination at further quantitative easing—Bernanke forcefully suggested that further securities purchases may only serve to reinforce inflation expectations and, ultimately, inflation itself.

As for the FOMC's official post-meeting statement, it had a slightly stronger take on the economy and a slightly more cautionary take on the inflationary pressures caused by higher energy and commodity prices. Beyond saying it would complete QE2 by quarter's end, it shifted the discussion away from securities purchases and toward the size of its balance sheet, indicating it would continue to reinvest maturing securities (and thus maintain an inflated balance sheet) for the time being but would adjust those holdings as needed to fulfill its dual mandate of fostering maximum employment and price stability. The futures markets took the statement, and Bernanke's comments, as signs that the benchmark funds rate will remain in its zero to 0.25% target range, where it's been for 29 months, until 2012 and that the first sign of tightening will come when the Fed no longer reinvests maturing securities, perhaps by summer's end.

Also last week, the government's initial estimate for first-quarter GDP came in at 1.8%, substantially lower than Q4 2010's 3.1% but roughly in line with downgraded forecasts spawned by the triple whammy of oil's spike, extreme winter weather and Japan's quake. Surprisingly, the slowdown was driven by plunging government and defense spending, both of which historically have been positive contributors to GDP. Their drop-off reflected the inability of

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Congress to pass a fiscal 2011 appropriations bill, which put spending at the previous year's level. Also surprising, consumer spending as measured by personal consumption expenditures was much stronger than expected despite higher energy prices and declining consumer confidence, rising 2.7% and contributing 1.91 percentage points to Q1 GDP.

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