Weekly Commentary

JUNE 27, 2011

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Rates were virtually unchanged from the prior week as overnight, one-month, three-month, six-month and 12-month London interbank offered rates (Libor) ended the week at 0.127%, 0.185%, 0.246%, 0.396% and 0.728%, respectively.

During the week, Federal Reserve officials, in both the policy-setting Federal Open Market Committee's post-meeting statement and in Chairman Ben Bernanke's press conference, expressed their belief that longer-term inflation expectations remain stable and that the recent uptick in both core and headline inflation will prove temporary. They believe that the recent statistical pick-up in inflation was caused by higher prices for commodities and imported goods, as well as supply disruptions spawned by the tragic Japanese earthquake and tsunami.

Bernanke also attributed the recent slowing in the economy to these same temporary forces, and reiterated that the Fed expects growth to resume at a higher level in the second half of 2011 and into 2012. The Fed chairman noted that inflation issues are more challenging today than when QE2 was launched last November, making it difficult to justify further asset purchases which, at the time they were undertaken, were aimed at preventing deflation—a concern no one's discussing these days.

Given the historic precedents of 1990s' Japan and 1930s' America, it is unrealistic to expect any dramatic changes in the Fed's policy or in the size of its balance sheet absent accelerating employment growth and bank lending. So the Fed's policy is unchanged. QE2 ends on schedule. Proceeds from maturing securities get reinvested. And the target federal funds rate remains at "exceptionally low levels … for an extended period." Bernanke defined the extended period language as "at least two to three meetings." In Bernanke's words, the Fed then, like all market participants, watches the "evolution of the economy."

Economic data released during the week was mixed, as gains were reported in GDP and manufacturing, while housing and employment figures remained weak.

GDP

The economy grew at a 1.9% annualized rate in the first quarter of 2011 after dropping 2.7 percent in April, according to the Commerce Department's third estimate for GDP growth. The prior estimate was 1.8%.

Manufacturing

Manufacturing improved as new factory orders for durables in May increased 1.9%, compared to April's 2.7% decline. The transportation sector produced the greatest gain at 5.8%, after April's 9.4% decline. The auto sector gained a minimal 0.6% after April's 5.3% loss.

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Housing

The housing market's problems continued as existing home sales declined 3.8% in May. The year-on-year rate fell further to -15.3%, from the previous month's 13.8% decline. Sales of single-family homes, the central component in the report, fell at a slower rate of 3.2% compared to the 8.1% decline in sales of condos. In contrast, prices of existing homes rose 3.4% for the median ($166,500) and up 2.0% for the average ($214,400). The National Association of Realtors expressed the belief that May will be the year's bottom for the housing market.

Employment

During the week of June 18, initial jobless claims rose 9,000 to reach a higher-than-expected 429,000—the 11th week in a row jobless claims surpassed the 400,000 number.