DAILY ECONOMIC COMMENTARY

Bernanke's Testimony: Shots Across the Hill

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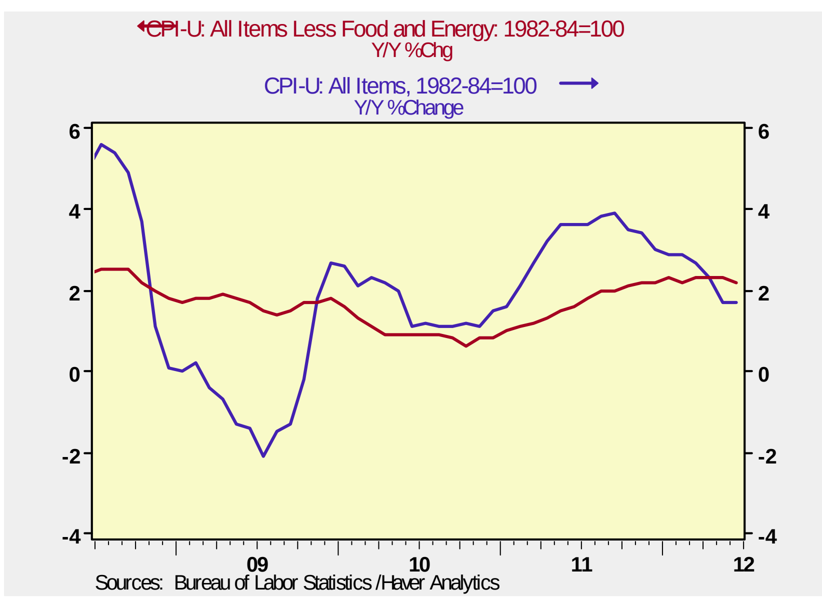
Fed Chairman Ben Bernanke completed two days of testimony in Congress this morning. Both sides revealed modest discontent with the other; this likely reflects a level of frustration with the slow recent pace of economic activity and apprehension over the policy challenges that lie ahead.

Both sides would likely agree that a stronger economic picture would be desirable, although they would certainly differ on how to get there. Some Congressmen pressed the Fed to extend its stimulus program, while others opined that our central bank has already gone too far. (The byplay between Bernanke and Ron Paul over monetary policy audits made for good theater, if not reasoned debate.)

For his money, the Fed Chairman took the opportunity to highlight the worrisome approach of the "fiscal cliff," and encouraged legislators to address it sooner, rather than later. With political gridlock only likely to harden as Election Day nears, reaching consensus in the near term seems highly unlikely. That, said Senator Schumer, leaves the Fed as "the only game in town."

That observation will only serve to up the ante for the FOMC meeting at the end of the month. The Beige Book summary released today as background for that gathering saw "modest to moderate" growth and "tepid" job creation. Some got excited over the report of a 6.9% gain in June housing starts, but that sector is just beginning its recovery from a very low base and remains challenged by a host of structural limitations.

This week's CPI report seemed reasonably benign.



Both “headline” and core inflation have come down in recent months and hover near 2%. Inflation expectations, as reflected in the market for inflation-protected Treasury securities (TIPS) are also centered around 2%. Chairman Bernanke allayed the concerns of some by reporting little appetite among the FOMC membership for raising the informal inflation target from that level.

On the surface, it might seem that a case exists for some additional steps to stimulate. Chairman Bernanke talked through the options, but did not betray a sense that any would be triggered in the short term.

We’ll have a full analysis of the upcoming FOMC meeting late next week. The outcome looks like a close call.