

Weekly Economic Commentary



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#HumphreyHawkins

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Highlights

The Humphrey-Hawkins testimony used to be a rare window of transparency for an otherwise opaque Federal Reserve (Fed), but now it is just one of the many ways the Fed is transparent.

In this week's Humphrey-Hawkins testimony, the market is looking to Federal Reserve (Fed) Chairman Ben Bernanke to apply more of a quantitative threshold on the pace of quantitative easing (QE).

We expect the Fed to maintain its accommodative policy.

Please see the LPL Financial Research Weekly Calendar on page 3



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On Tuesday, February 26 and Wednesday, February 27, 2013, Federal Reserve (Fed) Chairman Ben Bernanke will deliver his semiannual monetary policy testimony before the Senate Banking Committee (Tuesday) and House Financial Services Committee (Wednesday). For market observers over a "certain age," this appearance is, and likely will always be known as the Humphrey-Hawkins testimony. This testimony, which is likely to be followed on social media sites like Twitter under the category [#HumphreyHawkins](#), was mandated by the Full Employment and Balanced Growth Act of 1978, which helped to set into place the Fed's current dual mandate of full employment and low inflation. The sponsors of the Act were Senator Hubert H. Humphrey of Minnesota and Augustus Hawkins of California—hence the original name for semiannual testimony that usually occurs in February and again in July/August—and is accompanied by the Fed's Semiannual Monetary Report to Congress.

#Transparency

During the 80s and 90s—first under Fed Chairman Paul Volcker (1979–1987) and then Fed Chairman Alan Greenspan (1987–2006)—the Humphrey-Hawkins testimony provided a rare window of transparency into an otherwise opaque Fed. In those years, until 1994, the Fed's policymaking arm, the Federal Open Market Committee (FOMC), didn't even issue a statement at the conclusion of its policy meeting, leaving market participants, pundits, and the financial media guessing as to what action the FOMC actually took at a particular meeting. Beginning in 1994, the FOMC released a statement each time they changed policy (at the time, the FOMC was raising rates) but didn't issue a statement if no action was taken. This regime continued until 2000, when the FOMC began issuing a statement after each of the eight FOMC meetings per year.

Since then, the Fed's transparency to the markets (and to the public) has only increased. Fed Chairman Bernanke now holds a press conference four times a year, and the FOMC publishes forecasts for key policy variables like inflation, gross domestic product, and the unemployment rate. From 1993 through 2004, the minutes of each of the eight FOMC meetings used to be published a few days after the next FOMC meeting, roughly seven weeks after the meeting. Since late 2004, the minutes of each FOMC meeting are released three weeks after each meeting. In addition, the FOMC now provides a forecast for the fed funds rate (one of its key policy tools), and



Market participants will likely call for even more transparency on Bernanke's views on QE.

is currently providing very specific guidance—unemployment rates below 6.5% and inflation above 2.5%—as to when it would begin to raise rates.

Despite the dramatic shift toward more transparency at the Fed, many pundits, politicians, and market participants are likely to clamor for even more transparency particularly regarding Bernanke's views on the Fed's quantitative easing (QE) program. The language in the minutes of the January 29–30 FOMC meeting on Wednesday, February 20, 2013, suggested a shift within the FOMC, and noted that “many” members of the FOMC are now concerned with the potential risks and costs of further QE, and “several” FOMC members noted that the FOMC “should be prepared to vary the pace of asset purchases.” On balance, the minutes suggested that if economic conditions do not deteriorate further—due to the fiscal cliff or some other event—the FOMC was prepared to at least scale back the pace of the QE3 (currently at \$85 billion per month) later in the year. In this week's Humphrey-Hawkins testimony, the market is looking to Bernanke for confirmation of the tone of the minutes, and perhaps to apply more of a quantitative threshold on the pace of quantitative easing. We expect Bernanke to comment—and be questioned by Congress—on the costs and benefits of continuing to pursue QE at the current pace.

#Fiscal Policy

On the fiscal side, Bernanke will likely gently remind his bosses in Congress, and the general public, that it is Congress' job to run fiscal policy. Bernanke almost never misses a chance to chime in on fiscal policy, even though it is outside of the Fed's mandate, as outlined in the Humphrey-Hawkins Act of 1978. Still, Bernanke is likely to be pressed by Congressmen and Senators as to the likely impact of the sequestration on the overall economy, and on various sectors as well. He is also likely to be asked directly about what approach he would favor to address the nation's long-term budget problems. Although Bernanke is now starting his eighth and maybe his last year as Chairman of the Fed, he is not yet as adept as his predecessor Alan Greenspan was in dealing with Congress at these Humphrey-Hawkins testimonies. Still, Bernanke has been fairly consistent when asked by Congress (or the public) about fiscal policy. His remarks at his post-FOMC press conference on December 13, 2012 sum up his view well: “...it will be critical that fiscal policymakers come together soon to achieve longer-term fiscal sustainability without adopting policies that could derail the ongoing recovery.” Bernanke has also made it clear that the Fed cannot offset the full impact of the fiscal cliff.

Bernanke has consistently called for policymakers to work together on a plan for long-term fiscal sustainability.

#Tone

As market participants prepare to follow #HumphreyHawkins on social media, investors may wish to focus on the tone of Bernanke's comments and his answers to questions. A barrage of hashtags (#economy #employment #Bernanke) may accompany #HumphreyHawkins, but investors will ultimately want to glean how long Bernanke and company will maintain accommodative policy. We expect the Fed will make the point that accommodation is still very much in place. ■



LPL Financial Research Weekly Calendar

	 U.S. Data	 Fed	 Global Notables
2013			
25 Feb	<ul style="list-style-type: none"> ■ Dallas Fed Manufacturing Index (Feb) 	<ul style="list-style-type: none"> 🦅 Lockhart 	<ul style="list-style-type: none"> ■ Italy: Bond Auction ■ Italy: Presidential Election Results
26 Feb	<ul style="list-style-type: none"> ■ Case-Shiller Home Price Index (Dec) ■ Consumer Confidence (Feb) ■ New Home Sales (Jan) ■ Bernanke's Humphrey Hawkins Testimony 	<ul style="list-style-type: none"> 🦅 Bernanke 	
27 Feb	<ul style="list-style-type: none"> ■ Durable Goods Orders and Shipments (Jan) ■ Pending Home Sales (Jan) 	<ul style="list-style-type: none"> 🦅 Fisher 	<ul style="list-style-type: none"> ■ Italy: Bond Auction
28 Feb	<ul style="list-style-type: none"> ■ GDP (Q4-revision) ■ Initial Claims (2/24) ■ Chicago Area Purchasing Managers' Index (Feb) 	<ul style="list-style-type: none"> 🦅 Evans* 	<ul style="list-style-type: none"> ■ Germany: Retail Sales (Jan) ■ Eurozone: CPI (Feb) ■ China: HSBC Manufacturing PMI (Feb) ■ China: Manufacturing PMI (Feb)
1 Mar	<ul style="list-style-type: none"> ■ Personal Income (Jan) ■ Personal Spending (Jan) ■ Consumer Sentiment (Feb) ■ Inflation Expectations (Feb) ■ ISM (Feb) ■ Vehicle Sales (Feb) ■ Construction Spending (Jan) 		<ul style="list-style-type: none"> ■ Eurozone: PMI (Feb) ■ China: Non-Manufacturing PMI (Feb)—Data due out on Saturday 3/2/13

🦅 Hawks: Fed officials who favor the low inflation side of the Fed's dual mandate of low inflation and full employment

🦅 Doves: Fed officials who favor the full employment side of the Fed's dual mandate

* Voting members of the Federal Open Market Committee (FOMC)

IMPORTANT DISCLOSURES

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Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Stock investing involves risk including loss of principal.

International investing involves special risks, such as currency fluctuation and political instability, and may not be suitable for all investors.

The Federal Open Market Committee (FOMC), a committee within the Federal Reserve System, is charged under the United States law with overseeing the nation's open market operations (i.e., the Fed's buying and selling of United States Treasury securities).

Quantitative easing is a government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity.

Federal Funds Rate is the interest rate at which a depository institution lends immediately available funds (balances at the Federal Reserve) to another depository institution overnight.



INDEX DESCRIPTIONS

The Chicago Purchasing Managers' Index is read on a monthly basis to gauge how manufacturing activity is performing. This index is a true snapshot of how manufacturing and corresponding businesses are performing for a given month. A reading of 50 or above is considered a positive reading. Anything below 50 is considered to indicate a decline in activity. Readings of the index have the ability to shift the day's trading session one way or another based on the results.

The Dallas Fed Manufacturing Survey is a widely followed monthly survey of state manufacturing and factory conditions.

The Eurozone Consumer Price Index (CPI) is the key monthly measure for inflation in the Eurozone.

The Eurozone Purchasing Managers' Index (PMI) measures the opinions of purchasing managers in the manufacturing and services sectors in the Eurozone.

China's monthly Manufacturing Purchasing Managers' Index (PMI) measures the opinions of purchasing managers in the manufacturing and services sectors in China.

HSBC's China Manufacturing Purchasing Managers' Index (PMI) measures monthly economic trends while attempting to remove seasonal impacts on production and demand, such as national holidays. The index includes data from purchasing executives from both state-owned and private business.

China's Non-Manufacturing Purchasing Managers' Index (PMI) measures monthly economic trends in a range of sectors, from retail trade, to environmental management, to the real estate industry.

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