Payden&Rygel

Economic Update

THOUGHTS FROM OUR ECONOMICS TEAM

SEPTEMBER 20, 2013

Keep Your Eye on the Ball (Data)

This week's most important insight in the wake of Wednesday's FOMC meeting: stories, myths and misconceptions about QE and tapering cloud investor judgment. The Fed cast its September judgment based on the disappointing run of data versus policymakers' economic expectations. Myths include the idea that a smaller US budget deficit requires fewer monthly QE purchases from the Fed, that Mr. Bernanke's "legacy" concerns would prompt a curtailment in the rate of QE purchases, the idea that the costs of QE in terms of disrupting financial markets exceed the perceived benefits, and finally, the story that the Fed "preset" its course for QE based on a specific calendar date (e.g., September).

Instead, ignore the myths and the calendar date rumors and follow the economic data. Since Mr. Bullard, an FOMC voter from the St. Louis Fed, suggested the decision was "borderline," what data are we watching as we head into the Fall?

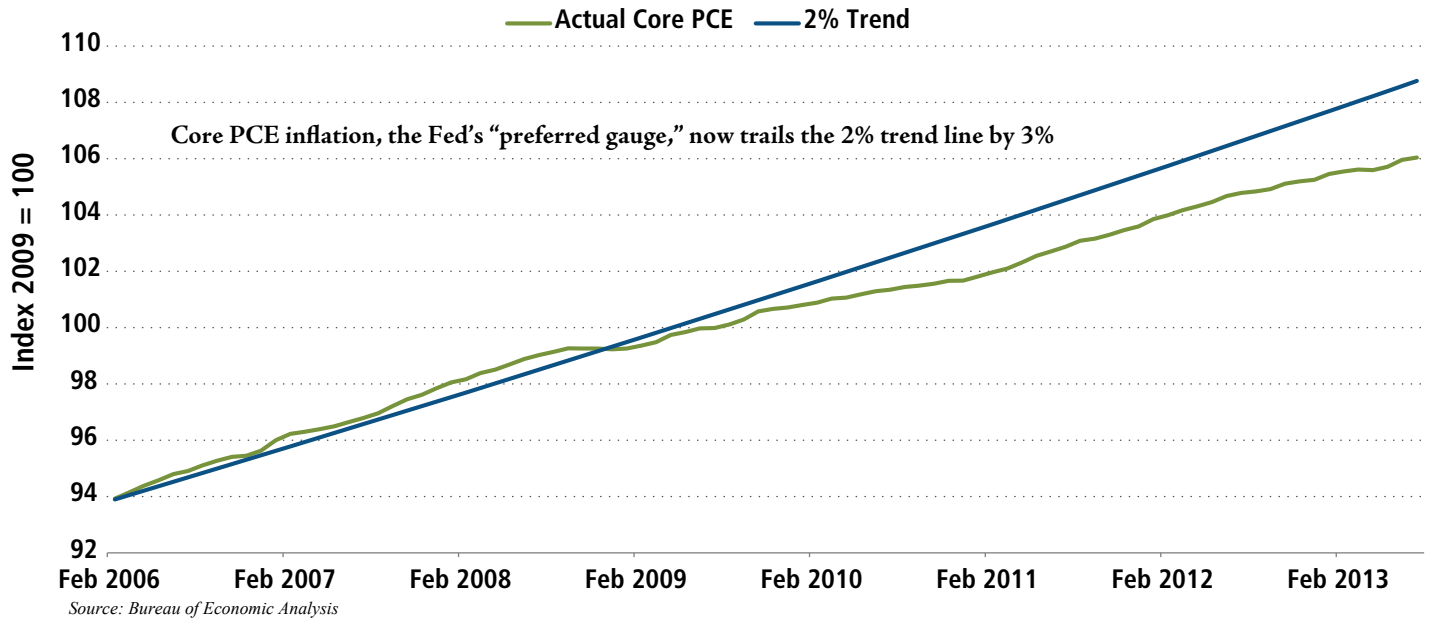
Economic Growth – The FOMC lowered its 2013 GDP forecast to 2.3-2.6%. Still, given 1.8% average GDP growth over the first half of the year, we would still need average quarterly growth of 2.7% in the second half to achieve the midpoint of that forecast. Our best estimate for Q3–based on limited data released thus far–shows the US economy growing between 1 and 2% at an annual rate. What to watch: we need to see 2.7% quarter-to-quarter annualized in Q3 and Q4. If Q3 prints below 2% (due out 10/30), this raises the hurdle rate for Q4. Also a possibility: a strong upward revision to Q2 GDP (due out 9/26) could lower the H2 hurdle rate somewhat.

Nonfarm payroll employment – Early in the year, FOMC members seemed to think that 200,000/month nonfarm payroll growth demonstrated substantial labor market progress, perhaps enough to curtail QE. But, over the last three months, average payroll growth decelerated to just 148,000. What to watch: nonfarm payroll employment needs to accelerate back toward 200,000. We also would like to see other measures of the labor market, including wages, labor force participation, quits, etc., show improvement.

Inflation – Earlier this year we called inflation the FOMC's "wild card," meaning even if employment showed improvement the disinflation trend could give the FOMC pause. The Fed's preferred gauge of inflation, the core PCE index, has spent 56 months (more than 4 years) below the Fed's 2.0% target. Even worse for an "inflation targeting" central bank, inflation is cumulatively 3% below what would be suggested by a 2% trend–see the chart below. What to watch: the year-over-year rate of change on the core PCE index needs to accelerate above 1.5% this fall and make progress back toward 2%.

If in the coming months, these economic indicators move in line with Fed expectations, the data will tip the scales toward tapering. Due to the relative dearth of data, the October FOMC meeting seems an unlikely opportunity. But again: ignore the myths and keep your eye on the ball (data).

HELICOPTER BEN GROUNDED BY PERSISTENT LOW INFLATION



Source: Bureau of Economic Analysis