

Weekly Economic Commentary



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Hawks and Doves

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Highlights

- Housing and manufacturing data due out this week still reflect an economic "lull".
- Several Federal Reserve policy "hawks" will flap their wings this week.

Housing and manufacturing data for April and May will (for the second consecutive week) provide the economic data backdrop in the United States this week, as investors react to the latest fiscal flare-up in peripheral Europe. We examine the "hawks" and consensus at the Federal Reserve, ahead of public appearances by several inflation hawks this week.

Manufacturing and Housing Data Will Fight For Attention This Week

Economic data and events in the United States this week are again likely to take a back seat to the latest flare-up in the European fiscal situation. This week's data set in the United States includes reports on both the manufacturing (April durable goods orders and shipments and May Richmond Fed report) and the housing (April new home sales and April pending home sales) sectors. There will also be a check-in on the health of the consumer, with reports on personal income and personal spending for April, and consumer sentiment in May. In addition, the regular weekly reports on retail sales, mortgage applications and initial claims for unemployment insurance will provide the market with a more "real-time" view of the economy. As noted in the title of this week's *Weekly Market Commentary*, a flock of Fed hawks are also slated to make public appearances this week.

This week's data on manufacturing (by far the strongest area of the U.S. economy thus far in the nearly two-year old recovery) and housing are likely to continue to reflect the "lull" in the economic data we have experienced over the past month or so. Last week (May 16-20) was the worst week for economic data (relative to consensus) in more than two years, as just one of the eleven economic reports released beat expectations. In addition, just one of those reports showed improvement versus the prior period's reading, and 75% of the data released last week saw downward revisions to prior periods. All in all, it was a terrible week for data, and the bar is now quite low for economic data in the weeks ahead. In our view, the weakness of the data this past week (and over the past month or so) is more "noise" (Japan, weather, late Easter) than a "signal" on the economy, but we will continue to monitor the incoming data closely.

Economic Calendar

Tuesday, May 24	Initial Claims
New Home Sales	<i>wk 05/21</i>
<i>April</i>	Friday, May 27
Richmond Fed Index	Personal Income
<i>May</i>	<i>April</i>
Wednesday, May 25	Personal Spending
Durable Goods Orders	<i>April</i>
<i>April</i>	U of Mich Consumer
Thursday, May 26	Sentiment
GDP Price Index	<i>May</i>
<i>Q2</i>	Pending Home Sales
Real GDP	<i>April</i>
<i>Q2</i>	



The Hawks Versus the Doves

There are also a number of Federal Reserve (Fed) speakers on the docket this week. Most of this week's speakers are on the hawk-ish (favoring the low and stable inflation portion of the Fed's dual mandate of promoting low and stable inflation and full employment) side of the Fed's policymaking arm, the Federal Open Market Committee (FOMC). The hawks (who favor an early end to the Fed's stimulative monetary policy) are scheduled to make public appearances this week include Philadelphia Fed president Charles Plosser and Kansas City Fed president Thomas Hoenig. Other notable hawks include Dallas Fed president Richard Fisher and Richmond Fed president Jeffery Lacker.

Also speaking this week is Eric Rosengren, the president of the Boston Fed who is typically categorized as a "dove" (favoring the "full employment" side of the Fed's dual mandate), Narayana Kocherlakota, the president of the Minneapolis Fed, and James Bullard, president of the St. Louis Fed. Neither Bullard nor Kocherlakota (who is a relatively new member of the FOMC) is usually classified as either a strident hawk or dove, but recent comments on policy and the economy place Bullard and Kocherlakota closer to the hawks than the doves.

In our view, these hawks do not represent the consensus at the Fed and the market often overreacts to their comments given that they do not represent the consensus.

In the recent past, financial markets (especially the Treasury market) have reacted to comments from the hawks, often pushing Treasury yields higher in the process. In our view, these hawks do not represent the consensus at the Fed and the market often overreacts to their comments given that they do not represent the consensus. The true consensus on the Fed rests with the Big Three: Fed Chairman Bernanke, Fed Vice Chair Janet Yellen and New York Fed President Bill Dudley. All three favor easier policy (for longer) than the hawks, but a shift in opinion by any of these three (especially Bernanke) on their view of monetary policy would be notable, and probably signal a coming shift in Fed policy.

None of the Big Three are slated to make a public appearance this week. The next event for the Fed is the release of the Beige Book (a qualitative assessment of economic, banking and business conditions in each of the 12 regional Federal Reserve districts), which is due out on June 8. The next FOMC meeting is on June 22. The Fed will release a new economic forecast at the conclusion of that meeting and Fed Chairman Bernanke will hold a press conference that day as well. At this point, we think it is a close call as to whether or not the Fed will signal a change in policy (allowing the Fed's balance sheet to shrink) at the June 22 FOMC meeting, but the recent turmoil in Europe, the drop in commodity prices and the lull in U.S. economic activity in recent weeks suggests that the Fed might hold off on sending a signal of tighter policy until the fall of 2011.



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