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JVB FINANCIAL

Weekly Commentary
by Bill Sullivan, JVB Chief Economist

ABOUT
BILL SULLIVAN

William V. Sullivan, Jr. serves as Chief Economist at JVB Financial Group, working closely with the firm's trading desk, providing analysis and commentary on the U.S. economy and the financial markets. Among his duties are authoring a weekly report on credit market trends and maintaining a regular schedule of conference calls that focus on interest rate developments. He appears frequently on Bloomberg TV and is often quoted in Barron's.

Mr. Sullivan is the familiar voice that JVB features on our weekly conference call, where he discusses the economy and the events that affect the marketplace.

He was previously associated with Morgan Stanley in New York City for more than twenty years, where he was an Executive Director and a Senior Economist in the firm's Retail Fixed Income Division. Bill published a widely quoted weekly letter on the financial markets and was a frequent guest commentator on several business networks, including Bloomberg TV, CNBC, and Fox News.

Mr. Sullivan received his Bachelor of Arts Degree in Economics from Fairfield University.

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Shifting backdrop for the FOMC meeting

The Federal Open Market Committee (FOMC) will begin their first formal policy session of 2010 this Tuesday. The Committee will not only be reviewing the appropriateness of their current target for the key Federal funds rate, but the membership will also be recalibrating their economic forecast for the next three years. Although the longer term projections for growth are apt to remain fairly optimistic, there is no doubt the central bank policymakers have received some disappointing news about the economy since their last meeting in December. From that perspective, the FOMC probably has little choice but to once again pledge their resolve to maintain a highly accommodative credit stance for "an extended period."

Clearly, in the last few weeks, there have been several data series that have challenged the notion that a self-sustaining recovery process is in fact underway. The slippage in non-farm payrolls in conjunction with the huge contraction in household employment last month pointed toward a labor market setting that contained a measurable degree of weakness as 2009 came to a close, suggesting that job creation would remain anemic for the foreseeable future. In addition, personal spending lost momentum during December with retail sales registering an outright decline during the period, pointing toward a consumer that was sustaining a cautious approach amid an environment of high joblessness and subdued gains in take-home pay. As if to reinforce the fragility of the ongoing recovery process, housing-related statistics were surprisingly downbeat late last year, raising the potential for another setback for this sector during the New Year.

The Committee is also confronting an abrupt shift in the performance of the financial marketplace. Indeed, at the December FOMC meeting, the membership noted that financial market conditions had "become more supportive of economic growth." Admittedly, day-to-day trading in late January has been quite volatile and the overall situation could change dramatically before too long. Nonetheless, the 5% drop in the broad equity averages over three sessions last week could represent a long awaited correction that would lead to some reversal in the buildup of equity wealth that had taken place since last March. Obviously, any major pullback in the stock market would point towards the potential for the financial sector becoming a headwind for the economy's general performance, a situation the Fed has not really had to deal with over recent quarters. The membership will of course be rendering their policy verdict with the full recognition that lending standards remain rigid and credit is tight. This consideration is reinforced on almost a weekly basis when the Federal Reserve Board provides balance sheet data for the commercial banking system. The latest report continues to capture a shrinking loan book for these institutions, with business, consumer and real estate loans moving

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consistently lower as banks elevate their cash positions. At a minimum, the bank credit backdrop continues to be an area of the financial market setting that is not supportive of the economy's growth.

Needless to say, the Wall Street community typically insists that the Federal Reserve is immune from the politics of America. Of course, nothing is further from the truth as the Committee and Chairman Ben Bernanke now encounter a visibly different political milieu than was the case just last month. Banker bonuses, for instance, have not set well with the public, especially in an environment of near record joblessness. The Fed, rightly or wrongly, is widely perceived as having bailed out the industry and in turn provided the environment for higher paychecks. To some extent, the outrage surrounding pay practices helped a Republican to win the special election for a Massachusetts Senate seat last week. The political winds directed toward the Federal Reserve have become intense enough to raise the prospect that Mr. Bernanke would lose a Congressional vote to re-nominate him for another term as Chairman of the Federal Reserve System. For sure, Committee members must acknowledge and eventually respond to this sentiment which, in its simplest form, is that Americans want monetary policy to remain fully supportive of job creation and a self-sustaining recovery process. Adding to this political reality is the escalation in populist rhetoric from White House officials, including the President. The message to the FOMC is quite loud and can't be avoided when the membership debates policy strategies for the months ahead.

The first formal policy meeting of the calendar year does involve a shift in voting membership. The annual rotation brings four new District Branch presidents onto the panel who will have a direct vote on policy at each meeting. The new group may be a touch more dovish than the other four members who voted during 2009. In particular, FRB Richmond President Lacker will no longer have a vote. His recent statements seemed to indicate a building concern about the price outlook and from that perspective the Committee loses an acknowledged inflation hawk. For the record, there was only one dissenting ballot cast last year against the Committee's policy actions. The negative vote occurred last January when Mr. Lacker stated his preference for a larger purchase program of U.S. Treasury debt to expand the monetary base. The other seven meetings had unanimous votes in favor of the Fed's directive. ■

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