Weekly commentary by Professor Jeremy J. Siegel

Bernanke Confronts Economic Slowdown and Willingness to Conduct QE

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Two important positives for the market this week. First, the sharp reduction in weekly jobless claims announced yesterday and second, today's speech by Bernanke on the economic outlook and monetary policy. Given the volatility of jobless claims, Bernanke's speech has more permanent implications for the markets.

Bernanke was considerably more positive about impact of non-traditional policy options than he was in his July Humphrey-Hawkins testimony before Congress. As readers of this commentary know, I criticized Bernanke as being too tentative during that testimony which led a number of market watchers to question his concern about the developing economic weakness.

In today's address, the current economic slowdown was front and center. He reviewed the three policy options he had noted before: Quantitative Easing (QE), lowering the interest rates of reserves, and changing the policy statement and added a fourth: a Fed-announced increase in the target range of inflation. This action has been advocated by a few economists, such as the IMF's head economist Olivier Blanchard. But Bernanke dismissed this option as undesirable since it contradicts the basic goal of price stability announced by the central bank.

Bernanke turned again to the other three options. My read is that he downplayed two of them: changing the interest rate paid on reserves and changes in the policy statement, although he didn't rule out either. He appeared to have a clear preference for Quantitative Easing, although he did admit that such a policy did have risks of igniting inflationary expectations or interfering with the Fed's exit policy once the economy picks up.

Although Bernanke did note a preference of the FOMC to conduct QE with Treasuries, he did not rule out the buying of other assets, a policy that I and former Fed Vice-Chair Alan Blinder, who wrote in a recent WSJ op-ed, prefer. Although the Fed is not ready to implement QE yet, Bernanke, without specifying targets, noted that QE would be considered if disinflationary factors became stronger or the economy stalled.

The bond market reacted more strongly to Bernanke's comments than the stock market, with the ten-year Treasury benchmark soaring 17 bps to 2.65%. The last time the bond market fell so much was last May. Stocks are up about 1% as equity investors are eagerly awaiting next week's PMI, claims, and, of course, the employment data. The market is clearly comforted by Bernanke's recognition of the need to combat further weakness.
