TD Economics

June 19, 2013

Data Release: Chairman Bernanke suggests that unemployment rate of 7% is "substantial" and enough to end asset purchases.

- Chairman Bernanke's press conference added important detail on the Federal Reserve's exit strategy from QE. In particular, Bernanke noted that: "If the incoming data are broadly consistent with this forecast, **the Committee currently anticipates that it would be appropriate to moderate the monthly pace of purchases later this year** (emphasis added). And if the subsequent data remain broadly aligned with our current expectations for the economy, we would continue to reduce the pace of purchases in measured steps through the first half of next year, **ending purchases around midyear**. In this scenario, **when asset purchases ultimately come to an end, the unemployment rate would likely be in the vicinity of 7%**, with solid economic growth supporting further job gains, a substantial improvement from the 8.1% unemployment rate that prevailed when the committee announced this program."

- Bernanke noted that the general path of exit strategy would likely follow the principles set out in 2011, with the exception that the majority of members see the Fed as likely to hold onto its holdings of mortgage backed securities to maturity rather than actively selling them.

- Bernanke also commented on inflation and James Bullard's decent (Bullard voted against the Fed action and wanted the Committee to do more to signal "its willingness to defend its inflation goal in light of recent low inflation readings"). Bernanke noted that the Committee does take the inflation side of its mandate seriously, but at the same time emphasized that it saw the current low inflation environment as mainly reflecting temporary factors.

Key Implications

- Chairman Bernanke's press conference delivered more detail than is typical. He effectively put a 7.0% threshold on the unemployment rate that would serve as a guidepost to when the asset purchase program would end. Similarly, he stated explicitly that as long as the current pace of economic growth continues, they will be looking to ease off their asset purchase program.

- Markets are treating the Fed statement and Bernanke's testimony as hawkish. Bond markets have sold off in the aftermath, with 10-year Treasury yields backing up 20 basis points. Interestingly, this occurred in spite of the fact that the specific detail on when the Fed will reduce asset purchases was already in alignment with the market consensus. In fact, Chairman Bernanke noted that if anything, the Fed's economic forecasts are modestly optimistic. In this regard, the sharp knee-jerk sell-off in bond markets will likely be partially unwound in the coming days.

James Marple, Senior Economist