Real test will come later, but for now Bernanke triumphs

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From Mr Alan Rohrbach.

Sir, Ben Bernanke triumphs! At least for now. The real test will be whether the economic and inflation data later this year reinforce his confidence in the Fed's forecasts. However, the sheer tone and content of his testimony, and his demeanour during the subsequent lengthy question and answer session, have restored his credibility as the new Fed chairman.

And exactly how did he reverse the previous impression that vacillation was his stock in trade? By exhibiting a much more 'Greenspan-esque' broad review of contingencies than his own previous attempts at transparency during a phase of the interest rate cycle that does not allow for such succinct niceties.

To his credit Mr Bernanke seems to have learned that as much as it clamours for clear direction, the "Street" actually wants well-informed balance from their top financial leaders. It instinctively understands that when times are unclear a certain degree of mixed expectations is reasonable and intelligent.

Back to first principles, it is neither the Fed's mandate, nor within the normal scope of its operations to guarantee bull equity markets. Yet the markets had a profoundly euphoric reaction to the notion that US economic activity might be mildly waning, and that will leave the Fed less proactive in its attempt to contain inflation. This demonstrates the degree to which the US economy and stock market remain drivers for their international brethren.

The real risks only come later if the Fed's expectations for cooling activity and inflation are not realised. In being so clear that it is still very committed to attempting the elusive soft landing, it may be sowing the seeds of stronger growth than is consistent with its forecast. As Mr Bernanke duly noted, corporate expansion has eclipsed consumer spending as an economic driver, and ". . . investment seems likely to continue to grow at a solid pace . . ."

If corporate executives are convinced the Fed tightening will actually incur nothing worse than a soft landing, they will likely maintain their spending plans. This in turn might be capable of reinvigorating the US economy to a degree not foreseen by current Fed forecasts, and keep global inflation stronger than expected.

In that case, its desire to be everybody's friend will actually make the Fed its own worst enemy. Notwithstanding the initial very positive reaction of fixed income and equity markets, quite a bit seems to rely on the accuracy of the Fed's forecasts; and those continue at risk in scenarios Mr Bernanke admits might yet come to pass. In which case, instead of just watering down the content, the Fed may still need to pull the punch bowl.

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