Van Eck Hotline on Money and the Economy

Monday, May 6, 2013

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Ben Bernanke's term as Fed chairman is due to end on January 31, 2014. There have been plenty of rumors in recent months suggesting that Bernanke himself would like to step down and move on to other endeavors. With less than nine month's left in Bernanke's current term, time is growing short - both for the chairman and for the president. As spring turns to summer in America, the buzz in both political and financial circles will turn to the nomination process. The last time around, President Obama re-nominated Bernanke in August 2009. That suggests the White House will be spending the next 60 to 90 days feeling out the situation. Given his supportive policies of recent years, it is safe to say that President Obama believes Bernanke has done a good job leading the central bank. If the chairman tells the White House that he would prefer to leave the Fed next year, a suitable replacement will be sought. You can bet that such a person would lean toward a focus on unemployment and not inflation.

During the months ahead, I plan to delve into the candidates to replace Bernanke. If I had to guess today who the Fed chairman will be on February 1, 2014 (if Bernanke does not serve a third term), I would go with Janet Yellen. She has an impressive resume and currently serves as Bernanke's second in command (Vice Chair of the Board of Governors). It is not a stretch to say that Obama would enjoy being the president that nominates the first woman to serve at Fed chairman (you might have to get used to saying Fed chair for a while). Janet Yellen has a reputation of being soft on inflation. During the past few years, she has tried to push back against that label. On a number of occasions, Yellen has gone on record as saying that the Fed's asset purchases carry the risk of igniting inflationary pressures down the road. If President Obama does nominate Dr. Yellen to be the next Fed chief, the financial world would ignite in a debate about the economy's future. Some people would no doubt declare that Janet Yellen would destroy the economy - carrying through the inflationary policies set in place by Ben Bernanke during his eight years in office. I have been hearing about an imminent crash in the U.S dollar and a spike in inflation for many years. In fact, such talk has been with us since before Bernanke took over as Fed chairman in February 2006.

While the Dollar Index is down by about 30 percent from its 2002 peak (near 120), that measure of the U.S. dollar is unchanged from where it was in late 2004. Looking back to the past full decade, the Dollar Index is down by 13 percent. That shows that the long-term trend of the dollar has been lower. However, the many predictions about the national debt and Fed policies sending America into the same territory as the Weimar Republic have proven to be incorrect. Yes, the U.S. economy has faced inflationary pressures during the past decade but they have failed to escalate. Several forces have helped to keep the Washington Money Machine from fueling a spike in consumer prices. Global competition has played a role. Millions of manufacturing and service jobs have moved to other countries. The lower labor costs have translated to lower prices at Wal-

Mart and other retailers. That is the tradeoff that corporate America has made for the nation. Chronic unemployment has been partially offset by a raft of low price (and often low quality) goods and services in a variety of industries.

The relatively weak U.S. economy has also helped to keep inflation in check. U.S. real GDP expanded at an average annual rate of just 1.67% during the decade of 2003 to 2012. When population growth is taken into account (the U.S. legal population reportedly grew by about 7.1% during those ten years), the economy has struggled to improve. If the economy had spent the past decade operating under similar conditions to what we saw during the 1980s, inflation would have moved significantly higher by now. Capacity utilization continues to point at an economy that cannot sustain a prolonged surge in costs. Last month, the Fed released the March report on industrial production and capacity utilization. It showed the same kind of stagnation in manufacturing activity that has been showing up in other data of late. As for capacity utilization, it came in at 78.5%. That was up a bit year-over-year, and it was certainly far stronger than what we saw at the trough of the recession (66.9% in 2009). Looking at the big picture though, capacity utilization remains BELOW the 1990-1991 recession low of 78.8%. Ben Bernanke knows that fact and so does the next Fed chairman.

During the months ahead, there are going to be plenty of important developments regarding the economy and the markets. As I said earlier in this Hotline, the summer is likely to see lots of debates about who should replace Ben Bernanke. Assuming that a new candidate is put forth by the president, the matter will then fall to the Senate. Such a vote would follow a Senate Banking Committee hearing. At this time, the committee is led by Tim Johnson (D-SD). The Democrats outnumber the Republicans by 12 to 10 on the committee. The broad Senate has only 45 Republican members. All of that strongly suggests that President Obama would be able to push through the candidate of his choice for Fed chairman. Some Washington and Wall Street insiders are pushing Larry Summers for the job. While he has plenty of experience, Summers is known for being hardheaded. The Fed chairman is a leader, but he or she must also be diplomatic and keep most or all of the FOMC voting members on the same page.

As we have seen this year, the financial markets do not like hearing about even mild disagreements at FOMC meetings. Janet Yellen has been at Bernanke's side for a while now. The fact that she has played an active role in setting Fed monetary policy in recent years would likely create a sense of continuity with the policies of exiting Fed Chairman Bernanke. No matter what candidate President Obama sends to the Senate, the political process will fan the flames of rhetoric on both sides of the economic argument in America. During the next six months, you are going to hear a lot of talk about the long-term threats and benefits posed by Fed policies. The media will generate scary headlines, but in the end the U.S. economy is likely to churn away at subpar growth rates - keeping out of recession but failing to produce enough new jobs to trigger significant wage growth. The employment numbers have been strong enough this year to keep the skeptics at bay. According to the government, nonfarm payrolls expanded by a net

165,000 in April. The March figure was revised higher by 50,000. When combined with the recent drop in weekly jobless claims, it is hard to understand why so many people believe that the U.S. economy is already entering a new recession.

The Economic Cycle Research Institute (ECRI) is sticking with its recession call that was first issued some 20 months ago. The ECRI and other skeptics have been trying to justify their recession talk - but such scrambling is starting to look desperate. The last recession did not even last as long as the ECRI has stuck with its current incorrect recession call! A week from today, the April retail sales report will be released. The March report was a disappointment - with both the headline number and the ex-autos reading posting declines of 0.4%. Department stores were by far the weakest link in retailing during March (they were down by 7.6% year-over-year). That raised some red flags for consumer spending. However, at least some of the weakness was blamed on Easter taking place in March this year - instead of April.

The average U.S. price of gasoline fell by 3.2% during March. That helped to knock sales at gas stations down by 2.2% during the month. Given the continued weakness in gas prices last month (down 2.8%), you can expect the category to put downside pressure on the April retail sales report as well. The FOMC is not in a hurry to take away the punch bowl. After helping the nation to avert a deflationary depression, Bernanke is watching global disinflation take shape and is no doubt making plans to expand the Fed's balance sheet if such action is deemed necessary. The statement released after last week's FOMC meeting said, " The Committee is prepared to increase or reduce the pace of its purchases to maintain appropriate policy accommodation as the outlook for the labor market or inflation changes." There is no reason to believe that the $85 billion a month in asset purchases will end any time soon. When the Fed does call a halt to such purchases, you can expect the central bank to take things nice and slow. The M2 money supply fell by $49.6 billion during the latest week. If that decline takes on momentum, it would push the Fed toward still more easing. More next week.

Next hotline will be updated no later than 8:00 P.M. Eastern on Monday, May 13, 2013