

# Market Update

SOUTHEAST CORPORATE

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## Economic Commentary

In his recent testimony before Congress, Fed Chairman Ben Bernanke described the current economic outlook for the U.S. as “unusually uncertain.” Growth in gross domestic product appears to be slowing, but Bernanke implied the Fed does not plan to dust off its monetary tools unless the economy slips back into recession. However, the double-dip scenario is gaining ground with market watchers and the Fed may be forced to fire up the printing presses to combat it. With interest rates already near zero, inflation dipping below the Fed’s preferred target range of 1.7% to 2.0% and a stubbornly high unemployment rate, many believe Bernanke has room to adopt the deflation fighting strategy he mentioned back in 2002 when he became a Fed governor. At the time, he suggested that the Fed could always buy long-term government bonds and corporate debt to pump more liquidity into the system to ward off the crushing effects of deflation.

Such an approach has become known as quantitative easing, as the central bank essentially prints money and buys securities, creating excess reserves in the banking system with the goal of inducing more lending which will result in output growth. Quantitative easing does not add to the national debt. The assets simply sit on the Fed’s balance sheet until they mature or are liquidated. The Fed has already used the tactic. Between early 2009 and ending in March of this year, the Fed purchased \$1.3 trillion of Treasuries, Fannie May and Freddie Mac mortgage-backed bonds and agency debt with dollars essentially created out of nothing.

At its meeting two weeks ago the FOMC surprised some by passing on the idea of a new program of quantitative easing, opting instead for a more placid plan of purchasing government securities with the cash flows being generated from the bonds it already owns. The dollars involved are miniscule and will likely have little effect on bank reserves. Nonetheless, Federal Reserve Bank of St. Louis President and FOMC member James Bullard recently prepared a research paper arguing that persistently low interest rates can have the perverse effect of fanning deflationary expectations and inhibiting economic growth. He is concerned the U.S. could fall into a deflationary trap similar to the one Japan has been plagued with for much of the past 15 years. He wants the Fed to be ready to make massive purchases of government bonds. Given the political climate, additional fiscal stimulus coming out of Washington seems remote, making room for the possibility of quantitative easing if the FOMC so chooses.

## Recent Economic Releases

Date	Release	Expected	Actual	Impact
08/17/10	Housing Starts	560K	546K	↓
08/17/10	Industrial Production	0.5%	1.0%	↑
08/17/10	Capacity Utilization	74.6%	74.8%	↑
08/19/10	Philadelphia Fed Mfg	7.0	-7.7	↓
08/19/10	Leading Indicators	0.1%	0.1%	↔
08/24/10	Existing Home Sales	4.65M	3.82M	↓
08/25/10	Durable Goods Orders	3.0%	0.3%	↓
08/25/10	New Home Sales	330K	276K	↓

↑ = positive for economy   ↓ = negative for economy   ↔ = neutral

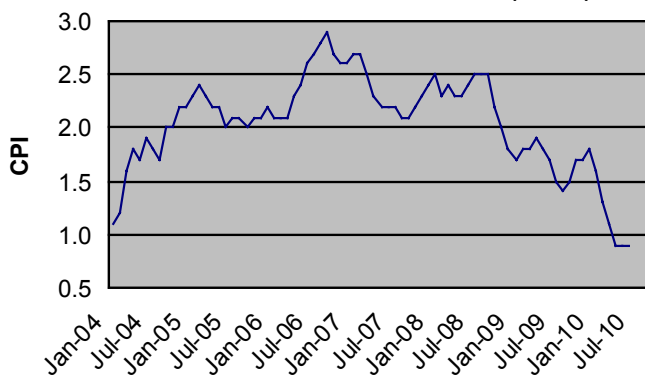
## Interest Rates as of: August 24, 2010

	Treasury	Agency	Euros/Swaps
1 Month	0.15%	0.14%	0.26%
3 Month	0.17%	0.19%	0.40%
6 Month	0.20%	0.22%	0.31%
1 Year	0.25%	0.27%	0.88%
2 Year	0.47%	0.60%	0.65%
3 Year	0.70%	0.93%	0.94%
5 Year	1.32%	1.62%	1.54%
10 Year	2.49%	2.62%	2.52%
30 Year	3.56%	4.13%	3.21%

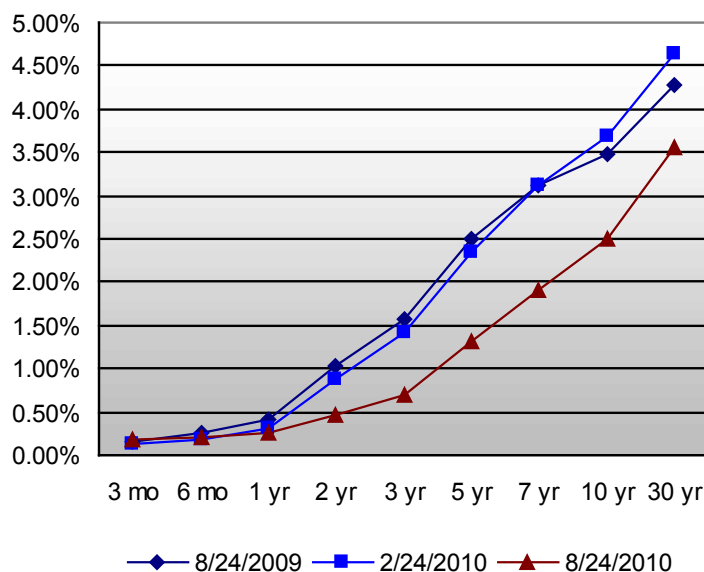
Fed Funds Target	0.00% - 0.25%
Prime Rate	3.25%
Discount Rate	0.75%

## Chart of the Day

Core Consumer Price Index (Y-O-Y)



US Treasury Yield Curve



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