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Sep 23, 2009

Economic Commentary

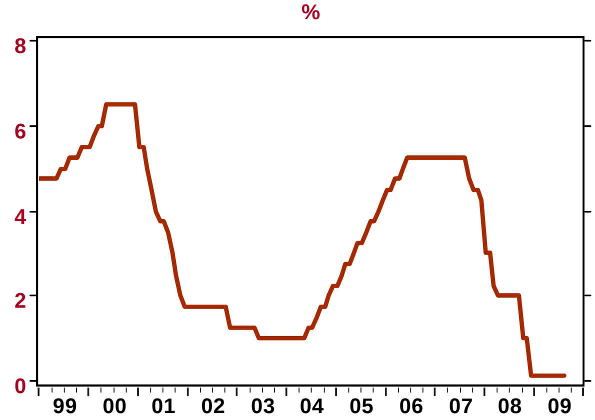
Fed Sees Better Growth

Although the Federal Reserve made no direct changes to the stance of monetary policy today, leaving the target range for the federal funds rate at 0% to 0.25%, the language was notably more optimistic about economic growth.

The Fed said "economic activity has picked up," a clear sign that it thinks the recession is over. It also said "activity in the housing sector has increased," an acknowledgement that home sales and housing starts are off the lows set early this year and unlikely to return to those levels.

Most notably, the Fed said policy measures and market forces "will support a strengthening of economic growth and a gradual return to higher levels of resource utilization." This language implies two important ideas. First, the Fed believes the economic recovery is going to accelerate. Second, it believes the economy may soon grow rapidly enough to push down the unemployment rate and generate increases in employment.

On inflation, the Fed was slightly more dovish, removing a reference to higher energy and commodity prices.



In terms of the special credit facilities to deal with the financial panic, the Fed said it wanted to "execute" its special facilities for mortgage-backed securities and mortgage agency debt by the end of March 2010.

We are pleased the Fed is showing more optimism about the growth of the economy, but are still waiting for it to be more explicit about when it intends to shift away from the loosest peacetime monetary policy in the history of the United States.

Brian S. Wesbury, *Chief Economist*
Robert Stein, *Senior Economist*

Text of the Federal Reserve's Statement:

Information received since the Federal Open Market Committee met in August suggests that economic activity has picked up following its severe downturn. Conditions in financial markets have improved further, and activity in the housing sector has increased. Household spending seems to be stabilizing, but remains constrained by ongoing job losses, sluggish income growth, lower housing wealth, and tight credit. Businesses are still cutting back on fixed investment and staffing, though at a slower pace; they continue to make progress in bringing inventory stocks into better alignment with sales. Although economic activity is likely to remain weak for a time, the Committee anticipates that policy actions to stabilize financial markets and institutions, fiscal and monetary stimulus, and market forces will support a strengthening of economic growth and a gradual return to higher levels of resource utilization in a context of price stability.

With substantial resource slack likely to continue to dampen cost pressures and with longer-term inflation expectations stable, the Committee expects that inflation will remain subdued for some time.

In these circumstances, the Federal Reserve will continue to employ a wide range of tools to promote economic recovery and to preserve price stability. The Committee will maintain the target range for the federal *funds rate at 0 to 1/4 percent and continues to anticipate that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period. To provide support to mortgage lending and housing markets and to improve overall conditions in private credit markets, the Federal Reserve will purchase a total of $1.25 trillion of agency mortgage-backed securities and up to $200 billion of agency debt. The Committee will gradually slow the pace of these purchases in order to promote a smooth transition in markets and anticipates that they will be executed by the end of the first quarter of 2010. As previously announced, the Federal Reserve's purchases of $300 billion of Treasury securities will be completed by the end of October 2009. The Committee will continue to evaluate the timing and overall amounts of its purchases of securities in light of the evolving economic outlook and conditions in financial markets. The Federal Reserve is monitoring the size and composition of its balance sheet and will make adjustments to its credit and liquidity programs as warranted.*

Voting for the FOMC monetary policy action were: Ben S. Bernanke, Chairman; William C. Dudley, Vice Chairman; Elizabeth A. Duke; Charles L. Evans; Donald L. Kohn; Jeffrey M. Lacker; Dennis P. Lockhart; Daniel K. Tarullo; Kevin M. Warsh; and Janet L. Yellen.