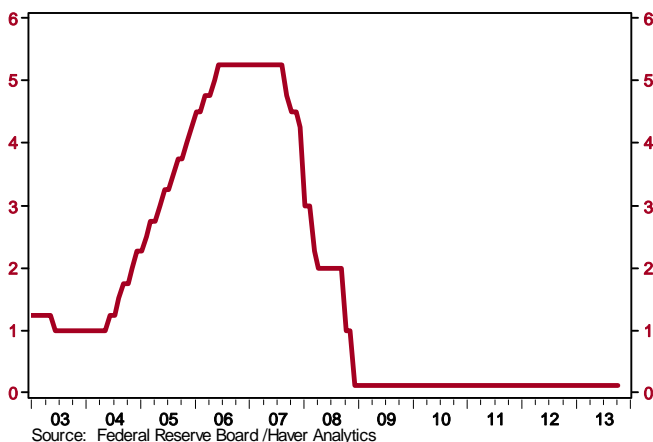


A Bit More Hawkish, All Things Considered

Today's statement from the Federal Reserve was almost a carbon copy of the last one in September. No changes to the pace of quantitative easing or interest rates, which is exactly as the consensus expected. The Fed made only minor changes to the text of the statement, making it slightly more hawkish in one spot and slightly more dovish in another.

However, given the context of the statement, coming on the heels of a multiple-week partial government shutdown and intense budget wrangling, a status quo statement is, in effect, surprisingly hawkish. In other words, we expected the Fed to use the shutdown as an excuse for slower growth and extended QE.

Fed Funds Target Rate
%



The slight hawkish tilt in the statement itself was changing the position of the word “some” in a sentence on labor market conditions. By altering the position of that word, the Fed suggested job conditions are improving. The change might have been a reaction to the recent increase in the share of unemployed who voluntarily left (“quit”) their prior job, an indicator long followed by still-Vice Chair Janet Yellen. The Fed also removed language on a tightening of financial conditions, probably because the stock market is soaring.

The slightly more dovish tilt to the statement itself was adding language on a recent slowdown in the housing sector. (Given the huge improvement in the past year, we think recent figures are statistical noise, not signs of a problem.)

The next Fed meeting is in December, the last of the year. Despite John Hilsenrath's WSJ article today, with federal budget fights looming in January and February, we doubt the Fed will change its views on tapering. Instead, we think the Fed will announce tapering in March and then fully wind down quantitative easing by late 2014.

The one dissent at today's meeting was by Kansas City Fed Bank President Esther George, who continued to say policy is overly accommodative.

As we have written many times before, QE3 is not boosting growth, but, instead, is simply adding to the already enormous excess reserves in the banking system. There is little evidence that QE has lifted growth and price-to-earnings ratios remain below their levels in early 2008, before QE ever started.

QE is not dealing with the underlying causes of economic weakness. The economy has grown slowly, not because of deleveraging, or a recovery from financial problems, but because government is too big. Spending, regulation, and tax rates have all become a bigger burden on the economy – a wet blanket on recovery that the Fed cannot possibly offset. Continuing with a loose monetary policy until inflation becomes a problem will not achieve the maximum sustainable economic growth that is supposed to be one of the Fed's goals.

Brian S. Wesbury, Chief Economist
Robert Stein, Dep. Chief Economist

Text of the Federal Reserve's Statement:

Information received since the Federal Open Market Committee met in September generally suggests that economic activity has continued to expand at a moderate pace. Indicators of labor market conditions have shown some further improvement, but the unemployment rate remains elevated. Available data suggest that household spending and business fixed investment advanced, while the recovery in the housing sector slowed somewhat in recent months. Fiscal policy is restraining economic growth. Apart from fluctuations due to changes in energy prices, inflation has been running below the Committee's longer-run objective, but longer-term inflation expectations have remained stable.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The

Committee expects that, with appropriate policy accommodation, economic growth will pick up from its recent pace and the unemployment rate will gradually decline toward levels the Committee judges consistent with its dual mandate. The Committee sees the downside risks to the outlook for the economy and the labor market as having diminished, on net, since last fall. The Committee recognizes that inflation persistently below its 2 percent objective could pose risks to economic performance, but it anticipates that inflation will move back toward its objective over the medium term.

Taking into account the extent of federal fiscal retrenchment over the past year, the Committee sees the improvement in economic activity and labor market conditions since it began its asset purchase program as consistent with growing underlying strength in the broader economy. However, the Committee decided to await more evidence that progress will be sustained before adjusting the pace of its purchases. Accordingly, the Committee decided to continue purchasing additional agency mortgage-backed securities at a pace of \$40 billion per month and longer-term Treasury securities at a pace of \$45 billion per month. The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction. Taken together, these actions should maintain downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative, which in turn should promote a stronger economic recovery and help to ensure that inflation, over time, is at the rate most consistent with the Committee's dual mandate.

The Committee will closely monitor incoming information on economic and financial developments in coming months and will continue its purchases of Treasury and agency mortgage-backed securities, and employ its other policy tools as appropriate, until the outlook for the labor market has improved substantially in a context of price stability. In judging when to moderate the pace of asset purchases,

the Committee will, at its coming meetings, assess whether incoming information continues to support the Committee's expectation of ongoing improvement in labor market conditions and inflation moving back toward its longer-run objective. Asset purchases are not on a preset course, and the Committee's decisions about their pace will remain contingent on the Committee's economic outlook as well as its assessment of the likely efficacy and costs of such purchases.

To support continued progress toward maximum employment and price stability, the Committee today reaffirmed its view that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens. In particular, the Committee decided to keep the target range for the federal funds rate at 0 to 1/4 percent and currently anticipates that this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6-1/2 percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored. In determining how long to maintain a highly accommodative stance of monetary policy, the Committee will also consider other information, including additional measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. When the Committee decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent.

Voting for the FOMC monetary policy action were: Ben S. Bernanke, Chairman; William C. Dudley, Vice Chairman; James Bullard; Charles L. Evans; Jerome H. Powell; Eric S. Rosengren; Jeremy C. Stein; Daniel K. Tarullo; and Janet L. Yellen. Voting against the action was Esther L. George, who was concerned that the continued high level of monetary accommodation increased the risks of future economic and financial imbalances and, over time, could cause an increase in long-term inflation expectations.