

The Time For Taper Has Come

Brian S. Wesbury – Chief Economist
Robert Stein, CFA – Dep. Chief Economist
Strider Elass – Economist

It's Déjà vu all over again. Back in September, we expected Chairman Bernanke to announce that the Fed would begin to taper Quantitative Easing. Like Lucy pulling away the football just as Charlie Brown was trying to kick it, the Fed changed its mind at the last minute. No tapering.

So, here we go again. On Wednesday, at his last official press conference as Chairman of the Federal Reserve, we expect Ben Bernanke to finally announce tapering. In order to keep a lid on long-term bond yields, the Fed will also announce a lower target unemployment rate needed to trigger rate hikes.

So, why would the Fed finally start to taper now? We can think of at least five reasons.

First, the job situation is better. Back at the September meeting, nonfarm payrolls were up 148,000 per month in the prior three months. Today, the most recent three-month average is 193,000 and the jobless rate has dropped to 7.0%.

Second, Congress just forged a budget deal that takes another partial government shutdown off the table. Some at the Fed have been using “fiscal uncertainty” as an excuse not to end QE. Now that supposed concern is gone.

Third, we think Bernanke doesn't want to go down in history as “Helicopter Ben,” the guy who kept the monetary pedal to the metal right up to the end. Slowing the pace of QE is a very small step in the direction of ending easy money, but it would help protect him from future blame if inflation becomes a problem in the next few years.

Fourth, two studies suggest a shift in the Fed's thinking. [One](#) said QE wasn't effective by itself – like we've been saying

for years – it just adds idle excess reserves to the system. The study said QE just helps signal how seriously the Fed takes its commitment to keep short-term rates near zero. [The other study](#) deals with this issue by arguing that the Fed can be more effective at lowering interest rates by signaling that it needs to see a lower unemployment rate before it hikes rates.

Finally, the Fed has leaked the idea of a December tapering multiple times to key reporters, and the markets have remained relatively stable. The 10-year Treasury rose sharply in the spring, and did not return to previous levels, but has not moved in any significant fashion since then. This means that the Fed can be more comfortable with tapering now that it plans on signaling a lower future path for the federal funds rate.

As a result, when the Fed does announce tapering, we don't expect it to go in half-heartedly. Instead, it will stride in confidently, reducing purchases by \$20 billion per month starting in January and at the same time it will drop the jobless rate needed to hike rates to 6%. After that, the Fed will leak that it will certainly raise rates by the time we get to 5.5%.

We are not short-term traders, but we think stocks have a serious case of “sell on rumor, buy on fact.” Not only do we expect tapering to be a non-event for the economy, we expect stock prices to rebound once the initial negative reaction passes.

We remain stock market bulls and our early forecast for the end of 2014 is a Dow Jones Industrials Average of 18,400 and a S&P 500 at 2,075. We have never felt that QE was a driving force behind economic growth or equity values. Tapering it, or ending it, does not change our forecast.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
12-16 / 7:30 am	Empire State Mfg Index – Dec	5.0	3.9	1.0	-2.2
7:30 am	Q3 Non-Farm Productivity	+2.7%	+2.7%	+3.0%	+1.9%
7:30 am	Q3 Unit Labor Costs	-1.4%	-1.3%	-1.4%	-0.6%
8:15 am	Industrial Production – Nov	+0.6%	+0.6%	+1.1%	-0.1%
8:15 am	Capacity Utilization – Nov	78.4%	78.5%	79.0%	78.1%
12-17 / 7:30 am	CPI – Nov	+0.1%	+0.1%		-0.1%
7:30 am	“Core” CPI – Nov	+0.1%	+0.1%		+0.1%
12-18 / 7:30 am	Housing Starts – Nov	0.952 Mil	0.950 Mil		NA
12-19 / 7:30 am	Initial Claims – Dec 15	338K	329K		368K
9:00 am	Existing Home Sales – Nov	5.020 Mil	5.010 Mil		5.120 Mil
9:00 am	Leading Indicators – Nov	+0.7%	+0.7%		+0.2%
9:00 am	Philly Fed Survey – Dec	10.0	13.1		6.5
12-20 / 7:30 am	Q3 GDP Final	3.6%	3.6%		3.6%
7:30 am	Q3 GDP Chain Price Index	2.0%	2.0%		2.0%