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Economics Group

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FOMC: QE 1.6 Sets Sail in Uncertain Seas

The Fed will re-engage in quantitative easing by launching QE 1.6—the purchasing of up to $600 billion of Treasuries on a $75 billion per month schedule through June 2011.

Vision Drives Policy: The World as Seen Through the Fed's Eyes

From the Federal Open Market Committee (FOMC)'s viewpoint, "slow" economic growth and "low" inflation suggest a monetary policy that is more concerned with the risk to the downside (deflation) in the short-run than with the risk of inflation over time. Therefore a move towards quantitative easing is consistent with the Fed's vision of the economy. Going forward, the Fed will certainly accept higher inflation, faster growth in the short-run and expect that over time, policy can reverse fast enough to avoid an inflationary spike. Our concern remains that any potential pick-up in inflation coupled with a declining dollar and rising interest rates could be adverse enough to put many investors with three percent or less fixed-income assets under water very quickly, and not everyone can get through the door at the same time.

"…the pace of recovery in output and employment continues to be slow."

According to the FOMC statement, "household spending is increasing gradually, but remains constrained by high unemployment, modest income growth, lower housing wealth, and tight credit." We agree. Business spending on equipment and software is "rising, though less rapidly than earlier in the year." Nonresidential construction spending "continues to be weak." Housing starts "continue to be depressed."

We believe this assessment is too pessimistic, but certainly the FOMC is focused on the downside. Recently we have seen a series of economic releases that have been better than expected. Jobless claims, the Institute for Supply Management surveys for both manufacturing and non-manufacturing and factory orders came in better than expectations.

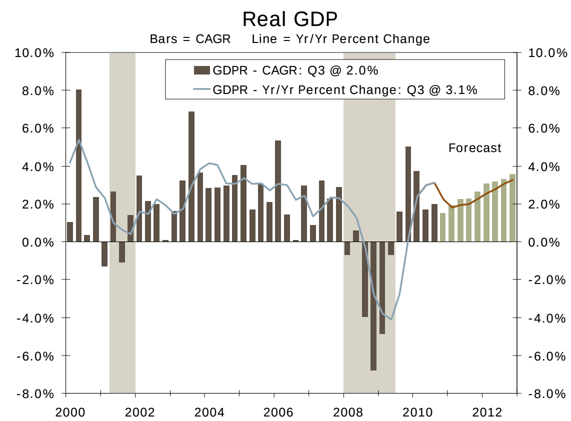
Very Conditional Quantitative Easing: Let's start with $600B Authorization and a Spend-Out Rate of $75 B/month

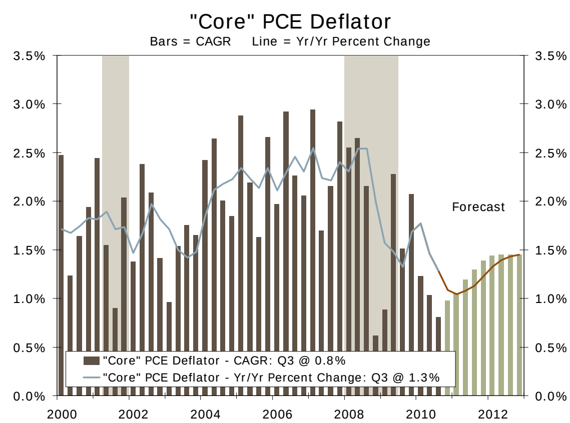
The Fed will be buying $75 billion per month of long-term Treasuries (primarily two to ten-year Treasury notes).

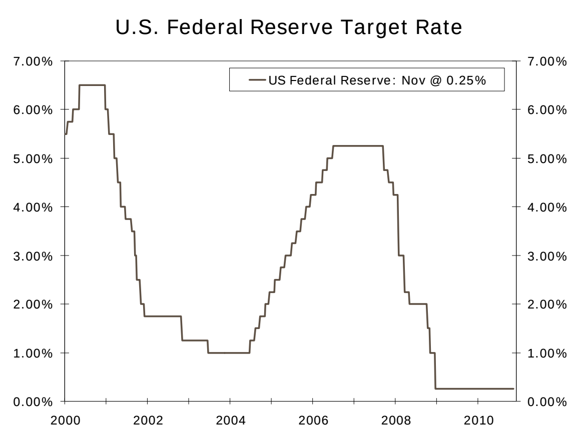
Easing in increments over the next eight months will be conditional on the economic and inflation data during this period. Our view is that the growth and inflation numbers will accommodate the Fed's full purchase of the $600 billion since inflation is not expected to rise enough over this period to cut short the Fed's efforts.

Dissent: Kansas City Fed President Hoenig

President Hoenig's dissent focuses on his view that the risks exceed the benefits of the easing. These risks include financial imbalances and could lead to unanchored long-term inflation expectations.







Source: U.S. Department of Commerce, Federal Reserve and Wells Fargo Securities, LLC.

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