



Economics Group

John Silvia, Chief Economist

john.silvia@wellsfargo.com • (704) 374-7034

Anika R. Khan, Senior Economist

anika.khan@wellsfargo.com • (704) 715-0575

The Fed: Same Goal, Different Method

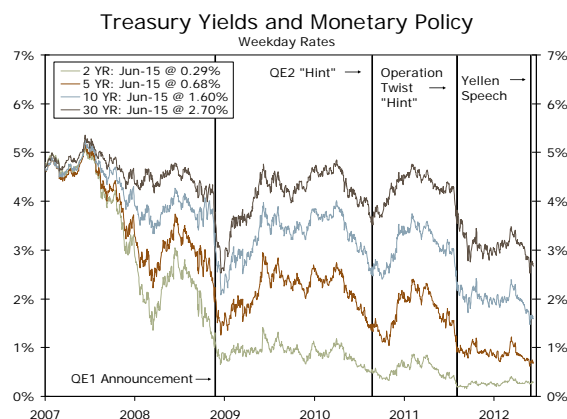
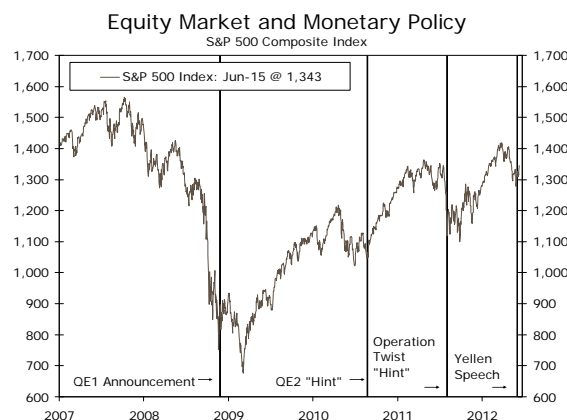
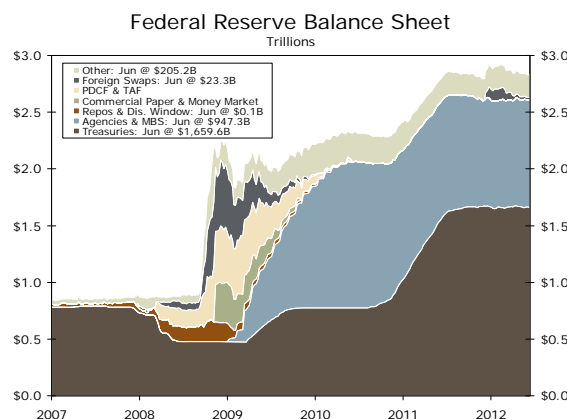
Traditionally, monetary easing has been characterized by lowering short-term rates and altering the size and duration of the Fed's balance sheet. In contrast, 2012 has been the year of speeches.

Shall We Twist Again?

We have been here before—uncertainty against the backdrop of moderate economic growth and significant downside risks. Even with the uncertainty of the Greek election behind us, the steady flow of Eurozone news will continue to cast doubt in the markets as the Eurozone attempts to create a fiscal union and insolvency issues remain center stage. Moreover, with U.S. economic data coming in weaker than expected, some are questioning whether the three-year U.S. recovery is stalling. That said, the FOMC meeting on June 20 will go a long way in making clear that the Fed will use whatever tools in its arsenal to reassure financial markets that it stands ready to provide liquidity if needed.

Up until this point, the Fed has employed two main accommodative measures outside of lowering rates to its zero-lower bound: it has extended forward guidance regarding the path of the federal funds rate and has increased the size and duration of its portfolio through large-scale asset purchases commonly known as quantitative easing and Operation Twist. With Operation Twist scheduled to expire at the end of June, the biggest question on investors' minds is whether the Fed will institute another round of easing. We suspect the FOMC will announce an extension of Operation Twist, where the size of the balance sheet is maintained by continuing to sell short-term securities and buy long-term securities. The first roll out of Operation Twist appeared to be successful, with the markets pricing in additional easing even prior to the official announcement (for additional commentary see, "Has the Fed's Unconventional Approach Been Successful?" which is available on request) Moreover, even though short- and long-term rates are at record lows, at this stage of the recovery it less about low interest rates and more about investor sentiment.

Over the past two weeks, to help boost investor sentiment and quell some of the anxiety regarding uncertainty around the Greek election and weaker-than-expected economic data releases, the Fed has used public speeches as its most recent monetary tool. To be more explicit, in one speech Fed Vice Chair Janet Yellen recently noted that, "if the Committee were to judge that the recovery is unlikely to proceed at a satisfactory pace, or that the downside risks to the outlook had become sufficiently great, or that inflation appeared to be in danger of declining notably below its 2 percent objective," she is "convinced that scope remains for the FOMC to provide further policy accommodation." While the Fed's dual mandate is limited to maximum employment and stable inflation, perceived risks could affect the Fed's twin goal in the short term. That said, headline risks will continue to cause market volatility throughout the year, but the Fed has made it clear it will use all of its tools to reach its goals.



Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research & Economics	(704) 715-8437 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 374-7034	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 383-5635	mark.vitner@wellsfargo.com
Jay Bryson, Ph.D.	Global Economist	(704) 383-3518	jay.bryson@wellsfargo.com
Scott Anderson, Ph.D.	Senior Economist	(612) 667-9281	scott.a.anderson@wellsfargo.com
Eugenio Aleman, Ph.D.	Senior Economist	(704) 715-0314	eugenio.j.aleman@wellsfargo.com
Sam Bullard	Senior Economist	(704) 383-7372	sam.bullard@wellsfargo.com
Anika Khan	Senior Economist	(704) 715-0575	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 383-6805	azhar.iqbal@wellsfargo.com
Tim Quinlan	Economist	(704) 374-4407	tim.quinlan@wellsfargo.com
Ed Kashmarek	Economist	(612) 667-0479	ed.kashmarek@wellsfargo.com
Michael A. Brown	Economist	(704) 715-0569	michael.a.brown@wellsfargo.com
Joe Seydl	Economic Analyst	(704) 715-1488	joseph.seydl@wellsfargo.com
Sarah Watt	Economic Analyst	(704) 374-7142	sarah.watt@wellsfargo.com
Kaylyn Swankoski	Economic Analyst	(704) 715-0526	kaylyn.swankoski@wellsfargo.com

Wells Fargo Securities Economics Group publications are produced by Wells Fargo Securities, LLC, a U.S. broker-dealer registered with the U.S. Securities and Exchange Commission, the Financial Industry Regulatory Authority, and the Securities Investor Protection Corp. Wells Fargo Securities, LLC, distributes these publications directly and through subsidiaries including, but not limited to, Wells Fargo & Company, Wells Fargo Bank N.A., Wells Fargo Advisors, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Asia Limited and Wells Fargo Securities (Japan) Co. Limited. The information and opinions herein are for general information use only. Wells Fargo Securities, LLC does not guarantee their accuracy or completeness, nor does Wells Fargo Securities, LLC assume any liability for any loss that may result from the reliance by any person upon any such information or opinions. Such information and opinions are subject to change without notice, are for general information only and are not intended as an offer or solicitation with respect to the purchase or sales of any security or as personalized investment advice. Wells Fargo Securities, LLC is a separate legal entity and distinct from affiliated banks and is a wholly owned subsidiary of Wells Fargo & Company © 2012 Wells Fargo Securities, LLC.

Important Information for Non-U.S. Recipients

For recipients in the EEA, this report is distributed by Wells Fargo Securities International Limited ("WFSIL"). WFSIL is a U.K. incorporated investment firm authorized and regulated by the Financial Services Authority. The content of this report has been approved by WFSIL a regulated person under the Act. WFSIL does not deal with retail clients as defined in the Markets in Financial Instruments Directive 2007. The FSA rules made under the Financial Services and Markets Act 2000 for the protection of retail clients will therefore not apply, nor will the Financial Services Compensation Scheme be available. This report is not intended for, and should not be relied upon by, retail clients. This document and any other materials accompanying this document (collectively, the "Materials") are provided for general informational purposes only.

SECURITIES: NOT FDIC-INSURED/NOT BANK-GUARANTEED/MAY LOSE VALUE