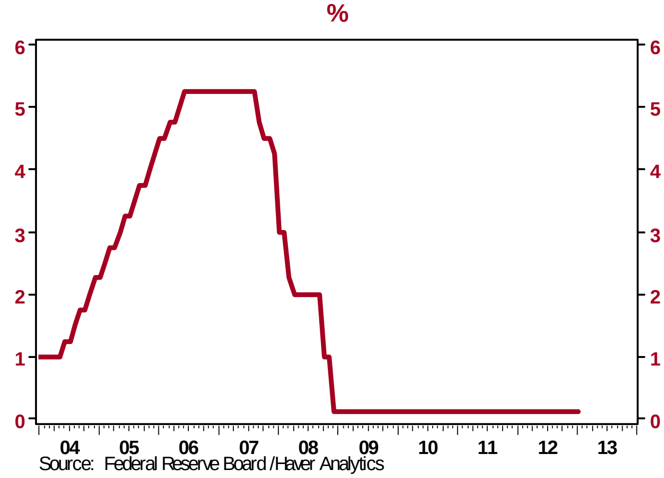
First Trust
ECONOMIC RESEARCH REPORT
Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – *Senior Economist*
Strider Elass – *Economic Analyst*

January 30, 2013 • 630.517.7756 • www.ftportfolios.com

Fed Inches Toward More Optimism

The Federal Reserve made no changes to monetary policy today and only minimal changes to the language of its statement. Despite this morning's report that real GDP shrank at a 0.1% annual rate in the fourth quarter of 2012, the Fed's comments were slightly more optimistic about the economy than they were after the last meeting in December.

The Fed acknowledged the weakness in Q4 by saying economic activity "paused," but attributed the pause to "weather-related disruptions and other transitory factors." At the same time, the Fed recognized an advance in business investment and an easing in strains in global financial markets. Notably, the Fed now says it "expects" growth will "proceed at a moderate pace and the unemployment rate will gradually decline." In December, the Fed said it was "concerned" that "growth might not be strong enough to generate sustained improvement in labor market conditions."



As everyone expected, the Fed maintained its open-ended commitment to buy additional mortgage-backed securities at a pace of $40 billion per month and more long-term Treasury securities at a pace of $45 billion per month.

Now that Richmond Fed Bank President Jeffrey Lacker has rotated off the voting membership of the FOMC, the dissenting role was taken by Kansas City Fed Bank President Esther George, who was concerned that continued loose monetary policy could create future economic and financial imbalances as well as higher long-term inflation expectations.

Like we said after the last few meetings, QE3 will simply keep adding to the already enormous excess reserves in the bank system, not deal with the underlying causes of economic weakness, including the growth in government spending (relative to several years ago), excessive regulation, and expectations of higher future tax rates. QE3 will not add anything to economic growth and, as long as banks are reluctant to lend aggressively, not cause hyper-inflation either.

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 December suggests that growth in economic activity paused in recent months, in large part because of weather-related disruptions and other transitory factors. Employment has continued to expand at a moderate pace but the unemployment rate remains elevated. Household spending and business fixed investment advanced, and the housing sector has shown further improvement. Inflation has been running somewhat below the Committee's longer-run objective, apart from temporary variations that largely reflect fluctuations in energy prices. 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 proceed at a moderate pace and the unemployment rate will gradually decline toward levels the Committee judges consistent with its dual mandate. Although strains in global financial markets have eased somewhat, the Committee continues to see downside risks to the economic outlook. The Committee also anticipates that inflation over the medium term likely will run at or below its 2 percent objective.

To support a stronger economic recovery and to help ensure that inflation, over time, is at the rate most consistent with its dual mandate, the Committee will 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.*

The Committee will closely monitor incoming information on economic and financial developments in coming months. If the outlook for the labor market does not improve substantially, the Committee will continue its purchases of Treasury and agency mortgage-backed securities, and employ its other policy tools as appropriate, until such improvement is achieved in a context of price stability. In determining the size, pace, and composition of its asset purchases, the Committee will, as always, take appropriate account of the likely efficacy and costs of such purchases.

To support continued progress toward maximum employment and price stability, the Committee expects 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; Elizabeth A. Duke; Charles L. Evans; Jerome H. Powell; Sarah Bloom Raskin; 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.