Trend Macrolytics, LLC
Donald Luskin, Chief Investment Officer
Thomas Demas, Managing Director
Lorcan Roche Kelly, Chief Europe Strategist

TRENDMACRO LIVE!

On the March FOMC

Wednesday, March 20, 2013
Donald Luskin

Steady as she goes in a weak expansion -- but maybe the first hint that LSAPs could end.

The prior FOMC statement dropped for the first time since September 2011 the warning that "strains in global financial markets" pose "significant economic risk." Instead, they were said to "have eased somewhat" (see "On the January FOMC" January 30, 2013). Even that cautiously rosy evaluation is gone from today's FOMC statement -- with new risk of systemic banking contagion arising from the Cypriot depositor bail-in (see "On the Cypriot Depositor Bail-in" March 17, 2013).

Nevertheless, today's statement could be read to be offering the very earliest indication -- the first hint of a hint -- that the Large Scale Asset Purchases (LSAPs) might be reduced from their current levels and ultimately terminated. For the first time since QE3 was announced in September, its continuation was conditioned today on "the extent of progress toward its economic objectives."

Based on the moderately positive market reaction to the statement, we're probably reading too much into this phrase. Markets seem comfortable that for any relevant future the Fed will continue to be a virtual buyer of $1 billion every market day in US equities (see "Is the Fed Moving the Stock Market?" March 11, 2013). We continue to expect the end of LSAPs to

Update to strategic view

US FED, US MACRO:
Today's FOMC statement was enough steady-as-she-goes to reassure markets that the Fed will continue to be a virtual buyer of $1 billion each market day in US equities. But it's possible to read the statement as offering the first wisp of a hint that LSAPs won't last forever -- for the first time, their continuation was made conditional on progress toward the Fed's economic objectives.

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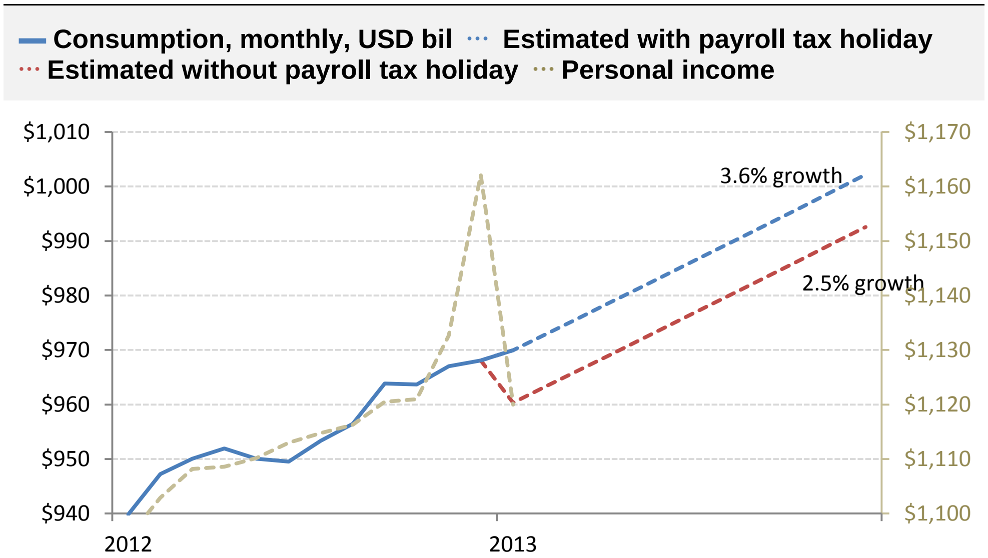

Source: BEA, TrendMacro calculations

begin this year (see "2013 Outlook: Doves Ruled Out at the Fed" January 25, 2013).

- The FOMC does not seem impressed by what seems to be a growing consensus that growth is upshifting to a new higher rate. At the last meeting the FOMC said, "growth in economic activity paused in recent months, in large part because of weather-related disruptions and other transitory factors." Today it said only that it expects "a return to moderate economic growth."
- In the economic projections of board members and regional presidents, the central tendency for 2013 real GDP growth was downgraded versus December's forecast, from 2.3%-3% down to 2.3%-2.8%. That's how we see it, too -- more of the Not So Great Expansion following the Great Recession.
- For us, there is a "transitory factor" at work in *this* quarter, beyond the bounce-back from "weather-related" weakness. There was a massive liquidity infusion in November and December last year, as about $55 billion in accelerated dividends and incentive compensation was paid out to get ahead of higher tax rates (see "On Q4 GDP" January 30, 2013). This goes a long way toward explaining the otherwise mysterious strength in personal consumption and retail sales in the face of the end of the payroll tax holiday (please see the chart on the previous page, and "Tax Hikes Have Consequences" January 2, 2013).
- Ever the master of understatement, on this subject all the FOMC said was, "fiscal policy has become somewhat more restrictive."

Bottom line

Today's FOMC statement was enough steady-as-she-goes to reassure markets that the Fed will continue to be a virtual buyer of $1 billion each market day in US equities. But it's possible to read the statement as offering the first wisp of a hint that LSAPs won't last forever -- for the first time, their continuation was made conditional on progress toward the Fed's economic objectives.

Contact TrendMacro

On the web at
trendmacro.com

Follow us on Twitter at
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Donald Luskin
Chicago IL
312 273 6766
don@trendmacro.com

Thomas Demas
Charlotte NC
704 552 3625
tdemas@trendmacro.com

Lorcan Roche Kelly
Sixmilebridge Ireland
617 600 6969
lorcan@trendmacro.com

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Recommended Reading

Growth and Opportunity Project
Republican National Committee
March 18, 2013

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