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Economic Indicator Insights

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FOMC: Bare minimum $40B QE3 – not enough for the bond market

DE assessment: The Fed did the bare minimum of changes which was disappointing to the bond market which had been looking for something more aggressive. First, it lengthened the forward guidance by six months to mid-2015. Second, it augmented the $45B monthly operation twist with a $40B monthly MBS purchase program for $85B monthly total program, close to analysts' expectations of a $90B program. Third, more would be purchased if needed using stronger language "until such improvement is achieved" in the labor market. (But no numerical target was given which may have disappointed some). Lacker did a double dissent opposing both the policy guidance and the additional purchases.

A closer look at the statement:

- There was really very little change to the economic assessment paragraph. Things are slow and the only addition was a note that commodity prices had increased.

- The boilerplate description of the mandate enshrined the inflation goal with a numerical 2%.

- The third paragraph laid out the new program in which the existing operation twist of $45B in monthly Treasury purchases will be augmented by $40B in MBS purchases for a larger $85B program, close to expectations.

- The fourth paragraph strengthened the goal that now the Fed would do more "until improvement is achieved" in the labor market. Some expected a strict numerical target or maybe nominal GDP targeting which would have been perceived as more aggressive.

- The last paragraph extended the low for long language from end of 2014 to mid-2015, as most expected.

Market action: While stock improved, bonds were crushed. What was close to expected by analysts who were less convinced that action was coming was disappointing to bond traders. De had been worried about a 10 bps selloff but not a 25 bps sellout if only the low for long language had been changed.

The bottom line: The Fed did the minimum of what analysts were looking for but was disappointing to bond investors. We had been worried that bonds were going to be disappointed and they were-no nominal GDP targeting, no explicit tie to an unemployment was mentioned.