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Fed note: $85B QE program continued; drops time stamp adopts 6.5% un rate target to guide tightening

by Cary Leahey

DE assessment: The Fed did what the markets expected regarding QE-with a monthly program of $40B in mortgage purchases and continuing the $45 in Treasury purchases which was to expire this month. The surprise to some analysts was replacing the mid-2015 "low for long" time stamp with unemployment and inflation rate guidance. We had thought this policy switch might happen in early 2013.

- The Fed now says it will keep rates "exceptionally low' not until mid-2015 but "at least as long as the unemployment rate remains above 6 ½%" and projected inflation on more than 2 ½%. This is close to what FOMC member Evans talked about.
- But the big question is whether or not "exceptionally low" means unchanged. Would a 100 bps increase in the funds rate to 1 1/8% still be exceptionally low policy rates?
- There is a lot of wiggle room for the Fed, especially given that they are basing their inflation guideline on a forecast out as long as two years. And economists have a great record at forecasting inflation two years out. To some analysts, this is a recipe for higher inflation that a credible central bank might not like. But this is what happens to central bank inflation fighting fortitude after a once-in-every-75-years crash.

Finally, reading the description of current economic condtions gives little hint that Q4 GDp growth could drop significantly. Some forecasters are talking about an inventory correction cutting Q4 GDp growth to well below 1%, compared to the inventory-boosting 2.7% gain in Q3.

Maybe the Fed is afraid to talk about the economy slowing significantly even before we go over the cliff.

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