TD Economics

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Data Release: Twenty-six months and $1.8 trillion later, QE3 tapers out altogether

- As expected, the FOMC decided to end the third round of the Fed's large-scale asset purchase program.
- The long-standing qualifier of "significant underutilization" of labor resources has been revised to indicate that the FOMC believes that the "underutilization is gradually diminishing."
- The Committee indicated some concern that market-based measures of inflation-compensation "declined somewhat," but appears comforted that survey-based measures of longer-term expectations remained stable. Moreover, the Fed believes that while inflation "in the near term will likely be held down by lower energy prices and other factors," the Committee judged that the likelihood of inflation running persistently below 2 percent has not risen.
- The Fed's forward guidance that the current target range for the fed funds rate would remain in place for a "considerable time" following the end of the asset purchase program remained. However, it was qualified with additional language that makes future hikes more data-dependent. The Fed basically said that should incoming data surprise to the upside/downside, "then increases in the target range for the federal funds rate are likely to occur sooner/later than currently anticipated."
- Narayana Kocherlakota (Minneapolis) was the lone dovish dissenter, and would have preferred that the Committee continue to purchase assets at the current pace and commit to keeping the current target range at least until the inflation outlook improves.

Key Implications

- Today's decision to end QE is not surprising in the least. It was long telegraphed by the Fed and broadly anticipated – despite the bout of volatility and increased global growth worries earlier this month. Effectively, the decision to end QE is a vote of confidence on behalf of the Fed that the U.S. economic recovery is strong enough to be sustained without additional liquidity.
- What was somewhat surprising was the magnitude of the hawkish bias in the form of the dropping of the "significant underutilization" qualifier on labor markets, the relatively balanced views on inflation, and the strengthening of the data-dependent theme on forward guidance, effectively weakening the "considerable time" reference.
- This week will mark the last of 'active' bond-buying, with the New York Fed slated to purchase $1.2bn of MBS tomorrow and $675 million on Friday, bringing the Fed's balance sheet to its ultimate peak. But, while QE will end, 'passive' bond buying will continue as part of the Fed's reinvestment strategy. We believe the Fed will continue to fully reinvest its maturing Treasury and agency securities and prepaying MBS until after the first rate hike.
- We don't expect the Fed will begin to raise rates until at least mid-2015 in light of subdued domestic inflation and a muted global backdrop. Having said that, when the tightening cycle does begin, rate hikes are expected to be relatively gradual. For a thorough outline of how the Fed will go about normalizing rates and reducing its balance sheet, please see our Special Report: The Fed's (Gra)Dual Normalization.

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