# U.S. Fed Flash

## FOMC Preview: September 12-13th Meeting

- **Markets are prepared for a QE3 announcement, but the latest data do not fully support this intervention just yet**
- **However, the Fed could use QE3 as a preemptive strategy in order to prepare for the fiscal cliff to hit in January 2013**
- **The FOMC is more likely to announce an extension of policy guidance into 2015**

All eyes are on the FOMC meeting announcement this Thursday. Markets are seemingly positioned for QE3, yet the latest Fedspeak and recent macroeconomic data do not provide obvious support for additional easing. The previous FOMC meeting minutes highlighted the intense internal policy debate among committee members, proving that there is still a significant divide in ideology. Since then, we have seen a relatively strong employment report for July, an upward revision to 2Q12 GDP growth, and a (deceiving) decline in the unemployment rate in August. In addition, the European sovereign debt crisis has eased somewhat due to new measures taken by the European Central Bank. However, there has also been an influx of disappointing manufacturing news, deteriorating consumer confidence, and weak employment growth in August. Ben Bernanke's speech at the Jackson Hole Economic Symposium was not a dead giveaway for what the FOMC is likely to announce in a few days. As always, he made it clear that the Fed "will provide additional policy accommodation as needed", but he hinted at no commitment to taking action in September. Options on the table include: additional quantitative easing, extension of the policy guidance, and lowering the interest rate paid on reserves, with the first two being the most likely. Just looking at the data, the probability of QE3 is lower now than it was in 2Q12, especially given how close we are to the presidential election, but there are other factors that have somewhat artificially increased the possibility of additional easing. Thus, we are not ruling out QE3 for this meeting, especially considering that the Fed may want to act preemptively before the fiscal cliff hits in 1Q13. However, it may be more likely that the Fed simply delays this announcement until the end of the year, particularly with increasing uncertainties and the dismal fiscal outlook for 2013. In general, though, the Fed will likely be more creative with QE3 compared to QE2 in order to ensure maximum impact on economic activity.

A less controversial, more probable option is an extension of policy guidance. Currently, the FOMC expects rates to be exceptionally low through "at least late 2014", but Bernanke provided reasons for possibly extending this guidance. He argued that it might be necessary to "keep rates low for a longer time than implied by policy rules developed during more normal periods", pointing to a cautious interest rate policy. Thus, we expect that the FOMC will be more likely to extend this date into 2015 at the September meeting.

Ultimately, it is unclear whether the data has been weak enough to push the FOMC to a majority decision on QE3. The August employment report and other macroeconomic indicators are not weak enough to drive FOMC members to announce QE3 just yet but could be sufficient to change the policy guidance this week.

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