(BN) Fed Undertakes QE3 With $40 Billion MBS Purchases Per Month
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(Adds Bernanke comment in 10th paragraph.)

By Joshua Zumbrun

Sept. 13 (Bloomberg) -- The Federal Reserve said it will expand its holdings of long-term securities with open-ended purchases of $40 billion of mortgage debt a month in a third round of quantitative easing as it seeks to boost growth and reduce unemployment.

"If the outlook for the labor market does not improve substantially, the committee will continue its purchases of agency mortgage-backed securities, undertake additional asset purchases and employ its other policy tools as appropriate,"
the Federal Open Market Committee said today in a statement at the end of a two-day meeting in Washington.

The FOMC said it would probably hold the federal funds rate near zero "at least through mid-2015." Since January, the Fed had said the rate was likely to stay low at least through late 2014. The Fed said "a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the economic recovery strengthens."

Chairman Ben S. Bernanke is enlarging his supply of unconventional tools to attack unemployment stuck above 8 percent since February 2009, a situation he has called a "grave concern." The decision provoked a renewed backlash from Republicans, including Senator Bob Corker of Tennessee, who said Bernanke's policies damage the Fed's credibility while doing little to spur the economy.

Stocks soared after the Fed's statement. The Standard & Poor's 500 Index jumped 1.6 percent to 1,459.92 at 2:24 p.m. in New York. The yield on the 10-year Treasury note rose to 1.78 percent from as low as 1.71 percent.

'Aggressive Commitment'

"This is definitely a significant shift in FOMC policy,"
said Julia Coronado, chief economist for North America at BNP Paribas in New York and a former Fed economist. "This is a very aggressive commitment to success on its mandates."

The central bank released its economic forecasts for growth, inflation, unemployment and interest rates over the next three years. Twelve of the Fed's 19 policy makers said interest rates should rise for the first time in 2015.

The Fed now expects the job-market outlook to improve more swiftly by 2014, with unemployment forecast to fall to 6.7 percent to 7.3 percent, compared with 7 percent to 7.7 percent in their June projections. In 2015, unemployment will fall to 6 percent to 6.8 percent.

Growth will improve to as much as 3 percent next year and as much as 3.8 percent in 2014, up from upper estimates of 2.8 percent and 3.5 percent in their previous forecasts. The so- called central tendency forecasts exclude the three highest and three lowest of 19 estimates.

Price Stability

While the U.S. has "enjoyed broad price stability" since the mid-1990s, the employment situation remains a "grave concern," Bernanke said at a press conference after the statement. "The weak job market should concern every American."

The Fed said it will continue its program to swap $667 billion of short-term debt with longer-term securities to lengthen the average maturity of its holdings, an action dubbed Operation Twist. The central bank will also continue reinvesting its portfolio of maturing housing debt into agency mortgage- backed securities.

"The committee is concerned that, without further policy accommodation, economic growth might not be strong enough to generate sustained improvement in labor market conditions," the statement said.

Lacker Dissent

Richmond Fed President Jeffrey Lacker dissented for the sixth consecutive meeting, saying he opposed additional asset purchases. Lacker opposed the FOMC's June decision to extend Operation Twist through the end of the year and has said he expects interest rates will need to be raised in 2013.

Today's Fed meeting comes less than two weeks after Bernanke's Aug. 31 speech in Jackson Hole, Wyoming, when he lamented the state of the labor market and defended his "nontraditional policies," saying "the costs, when considered carefully, appear manageable."

Growing expectations of additional stimulus have helped propel a rally in stocks and commodities. The Standard & Poor's
500 Index rose 4.5 percent through yesterday since the Fed's last statement on Aug. 1 to near the highest level in more than four years. The S&P GSCI Spot Index of 24 commodity prices has risen 7.1 percent.

Weak employment data has increased pressure on the central bank to act. The Labor Department said Sept. 7 that the economy added 96,000 jobs in August, less than forecast by economists and down from a 141,000 increase in July. Average hourly earnings were little changed, and 368,000 Americans left the labor force.

Manufacturing Cools

Other reports have shown that manufacturing, one of the mainstays of the three-year expansion, has been weakening. The Institute for Supply Management's factory index showed a third straight month of contraction in August as it fell to the lowest level since July 2009.

"We have seen no net improvement in the unemployment rate since January," Bernanke said in his Jackson Hole speech.
"Unless the economy begins to grow more quickly than it has recently, the unemployment rate is likely to remain far above levels consistent with maximum employment for some time."

Economic growth slowed to a 1.7 percent annual pace in the second quarter from 4.1 percent in the final three months of last year. Growth will average 2.1 percent next year, according to the median forecast in a Bloomberg News survey of economists, and the jobless rate will average 7.9 percent.

Forecast Cut

Intel Corp., the world's largest semiconductor maker, on Sept. 7 slashed its third-quarter sales forecast citing declining demand for personal computers from corporate customers in a weakening economy.

FedEx Corp., operator of the world's largest cargo airline, said Sept. 4 that earnings for the quarter ended Aug. 31 will be short of its forecast after a weak global economy damped revenue.

Some companies are planning to reduce staff. Printer maker Lexmark International Inc. on Aug. 28 announced plans to eliminate 1,700 jobs globally. Hewlett-Packard Co., the world's largest personal-computer maker, said Sept. 10 that it would cut 29,000 jobs, an expansion of a reorganization plan first announced in May.

Bernanke, a scholar of the Great Depression, has deployed the most aggressive monetary policies since the Fed's founding nearly a century ago as he battled the 2007-2009 financial crisis, helped pull the nation out of the worst recession since the 1930s and then sought to keep the expansion going.

Target Rate

The Fed lowered its target interest rate to zero in December 2008 and undertook two rounds of large-scale asset purchases that swelled its balance sheet to almost $3 trillion from less than $900 billion in December 2007, when the recession began.

Republican lawmakers criticized the Fed's action, with Tennessee's Corker saying in a statement that Bernanke is "beginning to do serious damage to the Fed as an institution."

"Open-ended purchases of mortgage-backed securities will politicize the Fed and add substantially to its balance sheet risks, but it will not help our economy's long-term growth prospects," Corker said.

Alabama Representative Spencer Bachus, chairman of the House Financial Services Committee, said in a statement that the Fed's action is a "scathing indictment" of the Obama administration's economic policies, which he said had "failed to produce a sustainable recovery or put Americans back to work."

Romney View

Republican presidential candidate Mitt Romney has said he wouldn't reappoint Bernanke when his term ends in January 2014.

Glenn Hubbard, the Columbia University Business School dean and Romney adviser, has said additional bond purchases by the Fed would do little to shore up the economy.

"I don't think that another round of quantitative easing is going to have a material effect on the recovery," Hubbard said in an Aug. 31 interview on Bloomberg Television. "Lowering the 10-year yield by another handful of basis points isn't going to move the needle."

Fed district bank presidents, including Richmond's Lacker, Philadelphia's Charles Plosser and Dennis Lockhart of Atlanta, have also raised concerns about inflation or whether more Fed action would help fuel growth.

Bernanke, in his Jackson Hole speech, cited a Fed study showing that large-scale asset purchases may have raised the level of economic output by almost 3 percent and boosted private payroll employment by more than 2 million jobs.

Inflation Expectations

What's more, Bernanke said, Fed the purchases have created "few if any" disruptions to market functioning, and there are no signs the expanding balance sheet has "materially affected inflation expectations."

Still, Bernanke said monetary policy is "not a panacea" and his remarks have highlighted "two main sources of risk" facing the U.S. economy: Europe's sovereign debt crisis and the prospect of abrupt fiscal tightening in the U.S.

Europe cleared a hurdle in its debt crisis yesterday when Germany's top constitutional court rejected efforts to block the European Stability Mechanism, a 500 billion-euro ($645 billion) bailout fund.

The U.S. is also vulnerable to the so-called fiscal cliff, the $600 billion of tax increases and spending cuts that will kick in automatically at the end of the year unless Congress acts. The Congressional Budget Office said in an Aug. 22 economic report that fiscal tightening of that magnitude could cause a recession.

“We’ve got a U.S. economy where we have looming tax increases that are quite significant, we have looming spending cuts in the government which are quite significant,” Michael DeWalt, the director of investor relations for Peoria, Illinois- based Caterpillar Inc., said in a Sept. 6 presentation. A lot of customers are “unsure about what to do, highly uncertain about where it’s going to go at the end of the year.”

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