



## MCAG MACRO: THE GREAT HESITATION

**September 22, 2010**

We have to accept the bad that goes along with the good concerning recovery. Earlier this week the National Bureau of Economic Research declared the end of the recession we are recovering from now to be June of 2009, totaling 18 months, the longest postwar recession to date. But just because the recession was “over” doesn’t mean the struggling was over. I recently heard the recovery since called the “Great Disappointment” because the economists who said recovery would be slow and painful were proven right by, among other things, recovery of output levels, or GDP. Output took only three quarters to exceed its most recent peak after both 16-month postwar recessions, 73-75 and 81-82, while after four quarters of recovery this time around output is still 1.3% below 2007 levels.

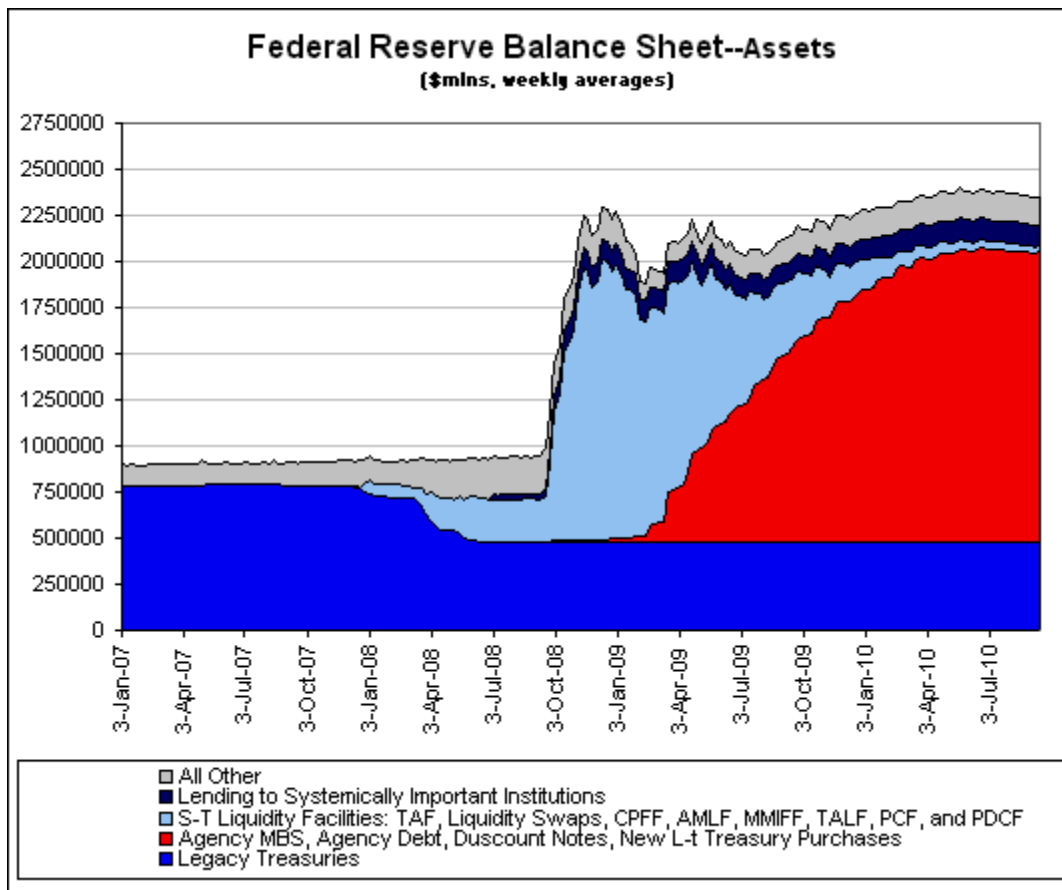
That leads me to the next point. Recovery is not happening at the rate Fed members would like, at least that’s the interpretation we are supposed to get from yesterday’s FOMC statement. I say “supposed to” because the Fed knows what reaction it will signal with its carefully worded statements. We haven’t forgotten that Bernanke and Co. admittedly sent the wrong message in the last statement with the announcement of reinvestment of maturing MBS, and then reversed the message with his Jackson Hole speech. Regardless, the widely held interpretation of the statement is that the Fed is transitioning toward a new round of QE and we can all but expect the Fed to add to its balance sheet, barring any significant signs of strength out of upcoming data. This also means the markets will be exceptionally sensitive to data leading up to the November 3<sup>rd</sup> meeting. Specifically, the language that signaled this is the change from “employ its policy tools as necessary,” to “prepared to provide additional accommodation” regarding support of economic recovery.

The Fed also changed its mention of levels of inflation in a way that anticipates easing by noting that already low inflation measures “are currently at levels somewhat below those the Committee judges most consistent” with its mandate and that “inflation is likely to remain subdued for some time.” In this regard some believe the Fed has already done too much, as illustrated by skyrocketing gold, not to mention record highs in other commodities. Cotton is at a 15 year high and Corn at a 2 year high, to name a few that feed into food-related inflation numbers. Without direct mention of inflation, the Organisation for Economic Co-Operation and Development alludes to action already taken as being a hindrance to the recovery lost in the recession with this statement; “It is likely that the financial crisis and response have raised the cost of capital for the foreseeable future and thus lowered potential output.” Even if inflation levels are not in a desirable range right now, doesn’t adding to the balance

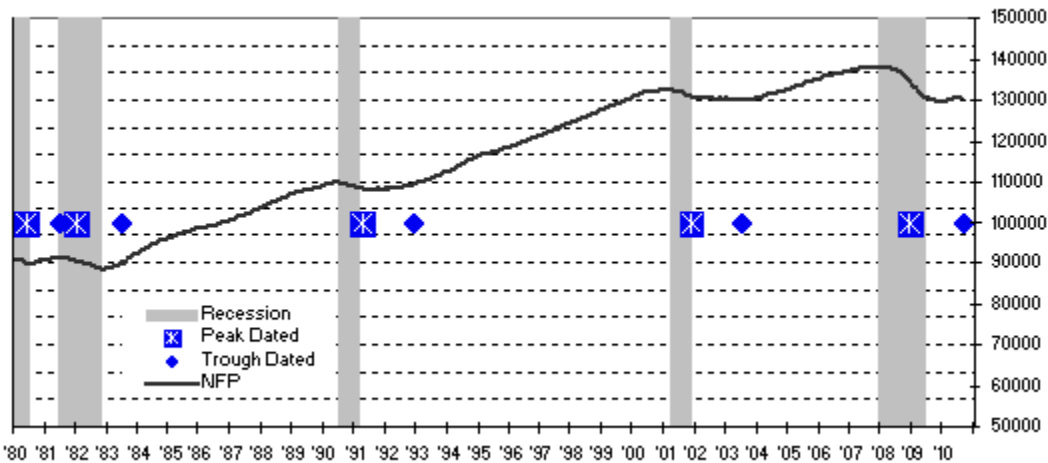
sheet and printing more money add to the imminent inflation problem we are seeing signs of already? Correct me if I'm wrong. A little inflation is good but the intention is to ignite the economy with inflation as a bi-product. Not the inverse. More easing seems a more than a little redundant.

A while back I heard some chatter about the how the Fed might not act at the November 3<sup>rd</sup> meeting because it's the day after elections and that would be too much of a shock to the markets. They don't seem to be concerning themselves with this timing factor but it might prove to be the explanation if nothing is done at the next meeting. I have my suspicions that the administration pressures this easing bias because not enough jobs have been created (has anyone pointed that out yet or is it too far out there?) but I'm drooling to see how the markets react to the elections. Having a Fed meeting the next day might put a damper on that, however. Concerning the effect of further quantitative easing on the Fed's balance sheet and consequently its ability to act versus restrained growth, it's a question of what's worse. And to that I don't have the answer.

I'll leave you with charts of the Fed's balance sheet and of Non-Farm payrolls versus NBER Recession Dating.



Recession, Nonfarm Payrolls and NBER Recession Dating



### US takes stock of the 'Great Recession'

By Robin Harding in Washington

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<http://www.ft.com/cms/s/0/e1fea3ce-c4ed-11df-9134-00144feab49a.html>

### Destroying King Dollar Is Not the Solution

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<http://www.cnbc.com/id/39313137>

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