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Fed Seen Pumping Up Assets to $4 Trillion in New Buying

By Joshua Zumbrun and Catarina Saraiva - Dec 11, 2012

The Federal Reserve will amplify record accommodation tomorrow by announcing $45 billion in monthly Treasury buying that will push its balance sheet almost to $4 trillion, according to a Bloomberg survey of economists.

Forty-eight of 49 economists predict the Federal Open Market Committee will purchase Treasuries to bolster an existing program to buy $40 billion in mortgage bonds each month. The panel pledged in October to continue that plan until the labor market improves “substantially.”

“It’s going to be massive and open-ended in size,” said Joseph LaVorgna, chief U.S. economist at Deutsche Bank Securities Inc. in New York and a former New York Fed economist.

Chairman Ben S. Bernanke and his FOMC colleagues will press on with purchases at least through the first quarter of 2014, according to the median estimate in the Dec. 7-10 survey. They are expanding the balance sheet beyond $2.86 trillion in a bid to spur growth and lower an unemployment rate of 7.7 percent.

“They view this stimulus as what’s needed to sustain the economy” and reinforce improvements in industries such as autos and housing, said John Silvia, chief economist at Wells Fargo & Co., the biggest U.S. home lender.

Stocks rose today, with the Standard & Poor’s 500 Index erasing its decline since Election Day, as investors speculated progress was being made in U.S. budget talks. The S&P 500 climbed 0.8 percent to 1,430.36, the highest since Oct. 22, at 11:02 a.m. in New York. The yield on the 10-year Treasury note climbed to 1.65 percent from 1.62 percent yesterday.

FOMC Statement

The FOMC began a two-day meeting in Washington at 11 a.m. The committee plans to release a statement on policy tomorrow at around 12:30 p.m. That will be followed by forecasts for growth, unemployment and inflation. Bernanke is scheduled to hold a press conference at 2:15 p.m., after release of the forecasts.

The central bank this month is scheduled to end Operation Twist, in which it swaps $45 billion of short-term Treasuries each month for longer-term government debt. That program kept the total size of the balance sheet unchanged, while new Treasury purchases would expand it.

The Fed's latest round of quantitative easing will total $1.1 trillion, with about $620 billion in mortgage-backed securities and $500 billion in Treasuries, according to the median estimate in the survey.

Cut Rates

By adding Treasury purchases, policy makers "would continue to lower mortgage rates and create conditions that would be favorable for a continued recovery in the housing market," said Roberto Perli, a managing director at International Strategy & Investment Group Inc. in Washington.

"It would also -- if house prices go up more -- mean more households would be able to refinance their mortgage," said Perli, a former economist for the Fed's Division of Monetary Affairs. "That's just like a tax cut or a pay increase because you have more disposable income in your pocket."

Fed purchases of mortgage bonds have helped revive the housing market by pushing down the rate on a 30-year, fixed-rate mortgage last month to a record 3.31 percent.

New-home sales rose 17 percent in October compared with the prior year, while existing-home sales increased 11 percent. Home prices gained 3 percent from a year earlier in September, according to the S&P/Case-Shiller 20-city home-price index.

"Pent-up demand, rising home prices, low interest rates and improving customer confidence motivated buyers to return to the housing market," Douglas Yearley Jr., chief executive officer of Toll Brothers Inc., the largest U.S. luxury-home builder, said in a Dec. 4 earnings call.

Six-Year Slump

Homebuilder stocks have risen after a six-year slump. The Standard & Poor's Supercomposite Homebuilding Index (S15HOME) of 11 homebuilders has surged 72 percent this year, compared with a 13 percent gain for the broader S&P 500 through yesterday.

Even with the recent improvement, home prices remain 29 percent below their July 2006 peak.

Policy makers "do not want mortgage rates to climb much higher," said John Lonski, chief economist for Moody's Capital Markets Group in New York. "They will do their utmost to keep long-term borrowing costs on the low side."

Bernanke said in a Nov. 20 speech that Fed stimulus shows no sign of fueling consumer-price increases beyond the central bank's 2 percent target. "Inflation over the next few years is likely to remain close to or a little below the committee's objective," he said in New York.

Housing Rebound

The rebound in housing hasn't shown signs of enlivening the labor market. Payroll growth averaged 153,000 in 2011 and 151,000 so far in 2012. Employment climbed by 146,000 in November, the Labor Department said last week. The jobless rate fell from 7.9 percent the month before as the labor force shrank.

Economists don't predict growth will take off in 2013. Gross domestic product expanded at a 2.7 percent annual pace in the third quarter, according to Commerce Department data. Economists in a separate Bloomberg survey forecast growth of 2 percent in 2013.

Also weighing on the economic outlook are more than $600 billion of tax increases and spending cuts scheduled to take effect next year unless Congress acts. The Congressional Budget Office has said the fiscal tightening would probably push the economy into a recession next year.

Treasury purchases would constitute "insurance that if there's a failure to agree between Congress and the president, the Fed is out there to prevent an even bigger downdraft," Silvia said.

Probably Wait

The FOMC will probably wait until its March 19-20 meeting before adopting thresholds on unemployment and inflation to indicate when it will consider raising the federal funds rate, according to the median estimate of surveyed economists.

Forty-eight of 49 economists say the Fed won't set the thresholds tomorrow. The Fed currently says it will keep its main interest rate near zero at least through mid-2015.

The Fed hasn't spelled out limits on the duration or size of its current accommodation, which was announced in September.

In the first round of quantitative easing starting in 2008, the central bank bought $1.25 trillion of mortgage-backed securities, $175 billion of federal agency debt and $300 billion of Treasuries. In the second round, announced in November 2010, the Fed bought $600 billion of Treasuries.

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