INVESTOR'S BUSINESS DAILY

Declining Odds Of Central Bank Stimulus Hits Markets

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April 4, 2012

Today's moderate output and job growth could be as good as it gets, based on new signals that central banks may not do more to stimulate the economy.

On Wednesday, the European Central Bank left interest rates at 1%, with no indication they will go lower. The bank also reiterated it will wait and see how the 1 trillion euros of liquidity it poured into Europe's banks will trickle through. Meantime, euro zone economies are in recession or hovering near it.

The news came a day after minutes of the Federal Reserve's latest policy meeting showed less inclination to buy more bonds in a third round of quantitative easing. Morgan Stanley analysts cut the chances of QE3 to one-third from two-thirds.

The major U.S. stock indexes sold off sharply. Gold and oil also fell, as did the yield on 10-year Treasuries. Previous rounds of QE lifted stocks and commodities.
Minutes from the Federal Open Market Committee's March 13 meeting showed "a couple of members" were open to more QE if conditions worsened vs. "a number of participants" at the January meeting.

"There's a sense there's growing dissension in the FOMC," said Jack Ablin, chief investment officer at Harris Private Bank.

The Fed may not be as aggressive in jolting the economy, but Chairman Ben Bernanke will do what he can with his public statements and may push for "sterilized" bond purchases, which are offset with equal amounts of selling, he said.

Bernanke has been skeptical of recent job gains, saying demand and production growth seem too low to sustain the improvement.

Since the financial crash, the Fed's balance sheet has nearly tripled to about $2.9 trillion through purchases of Treasuries and mortgage-backed securities.

The last major Fed action, shifting $400 billion in holdings from short-term bonds to long-term ones in order to lower mortgage rates, is expected to end in June, presenting a window for a new round of asset purchases.

But the steady growth has diminished the urgency for any more monetary stimulus, and policymakers are inclined to hold off, said **Bernard Baumohl, chief global economist at the Economic Outlook Group.**

"Even among the doves, there is a growing realization the economy may have turned a corner," he said.

Barring an outside shock like war with Iran or a sudden worsening in Europe's debt crisis, the U.S. economy will keep growing, **Baumohl** predicted.

Quantitative easing now would only have a marginal benefit while elevating inflation and asset-bubble risks, but QE in a deteriorating environment would have a bigger impact, noted Ludovic Subran, chief economist at Euler Hermes.

Investors are taking the wrong message from the Fed and instead should recognize that policymakers see a healing economy, said Phil Orlando, chief equity market strategist at Federated Investors, expressing frustration at the negative reaction to signs of reluctance for QE3.

"That's exactly what (policymakers) should be saying, based on the pattern of economic growth," he said.