Economists see Fed action as likely, but with little benefit

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For the third time in less than four years, the Federal Reserve this week will likely move to inject a sick economy with a B-12 shot.

This time, however, the Fed's medicine may be less potent and the criticism it's certain to receive will be magnified in the glare of a tight presidential campaign in its final weeks.

Many economists say last week's disappointing report on job growth in August means the Fed will likely announce Thursday that it will buy more Treasury or government-backed mortgage bonds to lower long-term interest rates and stimulate economic activity.

Yet they warn that uncertainty among businesses and consumers over looming federal government tax increases and spending cuts on Jan. 1 is likely to limit the benefits of any stimulus.

Stock prices have risen recently in anticipation this week of a third round of Fed bond buying, known as quantitative easing, dubbed QE3. Economists disagree more on the timing of Fed action than on the degree of its impact.

In a USA TODAY survey of 36 economists on Friday, 22 predicted the Fed will announce further bond buying this week. But all but four said more Fed stimulus would give only "a little" or no help to the economy by early next year. The more optimistic quartet predicted it would help "some."

"When the economy is running at less than 2% growth and there are so many domestic uncertainties and geopolitical risks we're facing, … you're not going to significantly increase hiring at this point," says **Bernard Baumohl, chief global economist at the Economic Outlook Group.**

Friday's jobs report for August seemed to underscore **Baumohl's** view. Counting last month's gains of 96,000 jobs, the economy has averaged 139,000 new jobs a month this year. That's well below the average pace of 153,000 jobs a month for all of last year.

The unemployment rate dropped, from 8.3% to 8.1%, but that owed more to a sharp reduction in the labor force rather than more jobs. The percentage of adults working or looking for work fell to 63.5%, the lowest since 1981.

The government counts 12.5 million unemployed people, 40% of them jobless for six months or more.

Fed Chairman Ben Bernanke has called the labor market's stagnation "a grave concern" that could damage the U.S. economy for many years.

The minutes of the last Fed meeting, July 31-Aug. 1, show many Fed policymakers believed then the Fed would have to take further steps "fairly soon" unless new data pointed to "substantial and sustainable strengthening in the pace of the economic recovery."

That's why many economists say Friday's jobs report points to Fed action this week.
"The Fed will act," says Mesirow Financial chief economist Diane Swonk. "The preconditions have been met."

Targeting housing

Nigel Gault, IHS Global Insight's chief U.S. economist, predicts the Fed this week will launch a bond-buying program worth $500 billion to $600 billion that will be concentrated in mortgage-backed securities. It's also likely to extend its public guidance on how long it is likely to keep interest rates low from late 2014 out to mid-2015, he says.
"We don't think these measures will be very effective in boosting growth, but for the Fed, it's a question of trying to do what it can," Gault says.

Critics of the Fed's efforts to put more money into the economy — including Republican presidential nominee Mitt Romney— say the Fed risks creating serious inflation in years to come, although inflation is low now.

They also question whether further drops in interest rates from already historically low levels will do much good. The U.S. average for a 15-year fixed-rate mortgage is 2.86%, Freddie Mac says. That's down from 5.64% in September 2008.

"Can you imagine a single consumer deciding to buy a house or a vehicle because financing costs might be even lower than they are now?" says economist James Smith of Parsec Financial.

Other economists say the Fed buying mortgage bonds could do some good for the still-weak housing market.

"The lower rates will fuel more home buying and refinancing," says Mark Zandi, chief economist of Moody's Analytics.

Just the prospect of another round of Fed stimulus is lifting stocks and therefore household wealth, Zandi says. But business uncertainty will undercut the impact of Fed action, he and others say.

Large companies are flush with cash and profits and they should be expanding and investing in new products or services to increase earnings, Zandi says.
"It's just not happening as fast," he says. "They lack the animal spirits."

While new Fed stimulus could inject $600 billion into the economy, the fiscal-cliff issues related to next year's federal budget threaten to suction that much or more out of it, says Richard Moody, chief economist at Regions Bank in Birmingham, Ala.

The fiscal cliff refers to the scheduled expiration of the Bush tax cuts and the 2010 payroll-tax cut and $1.2 trillion in automatic spending cuts over 10 years starting in 2013.
The non-partisan Congressional Budget Office says the combination could cause a recession if they all go into effect in January.

Business investment cooling

Regions Bank is already hearing from businesses that they are hiring and investing less because they don't know what Congress will do, Moody says.
There are more signs of the investment slowdown, too.

Orders for core capital goods have declined for four months in a row, Moody says. Chipmaker Intel said Friday that it would miss analysts' projections for third-quarter sales by about $1 billion because of slower growth in demand for personal computers.

Overall demand for technology is still growing but more slowly than had been expected, says Crawford Del Prete, chief research officer at industry research firm IDC. IDC will cut its forecast for technology-spending growth in 2012 to 6% on Monday, from slightly more than 7%, he says.

Even a compromise to the fiscal cliff, in which Congress lets some but not all tax increases go forward, could take as much as 2 percentage points off next year's economic growth, Moody says.

Still, there are reasons to expect economic improvement next year, and they have little to do with politics. Individuals are nearly done with a six-year process of reducing their debt loads, positioning them to spend more next year, Moody says.

Improving markets for housing should lead to more home building next year, Swonk says.

Those forces will help the economy more than further Fed stimulus, Moody says. But Swonk argues that with so many Americans still unemployed, Washington can't sit on the sidelines.

"These are real lives here," Swonk says. "This is not some fiscal game we are playing."