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Upbeat data may prompt Fed to act

The improving U.S. economy may soon lead central bank to ease its bond buys.

By Jim Puzzanghera
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WASHINGTON — Improving economic data is making the prospects more likely that the Federal Reserve will start tapering its massive bond buying next month, a move that suggests the recovery is on solid ground but that would be likely to roil Wall Street.

Economic growth unexpectedly picked up in the second quarter, though it still remained relatively weak. Corporate earnings are largely stronger. Consumer confidence is back to pre-recession levels.

And revisions of decades of data now show that the Great Recession wasn't quite as bad as previously thought and the recovery since 2009 has been a tad stronger.

Fed policymakers remain focused on the high unemployment rate, and there are signs of improvement there as well.

A private report Wednesday from payroll firm Automatic Data Processing Inc. showed the private sector created 200,000 jobs in July, the most since December.

The federal government's employment report for July, to be released Friday, is expected to show a gain of 185,000 net new jobs in non-farm payrolls last month.

With the unemployment rate forecast to tick down to 7.5%, enough positive data is piling up to allow Fed officials to decide next month to begin reducing the central bank's monthly purchases of $85 billion in bonds.

"Everything now strongly signals the Fed will begin its tapering at the September meeting," said Mark Zandi, chief economist of Moody's Analytics. Zandi assists ADP with its monthly report.

But the Fed didn't tip its hand Wednesday because signs of economic difficulties remained, including a still-high unemployment rate of 7.6%.

Wrapping up a two-day meeting, Fed policymakers voted to hold steady on their stimulus efforts and offered no additional guidance on when they would start scaling back.

The Fed said economic activity had expanded at a "modest pace," interpreted by some economists as a slight downgrade from the "moderate pace" it cited in its June policy statement. But Fed officials offset that by slightly upgrading their general outlook, saying they expected the pace of growth to "pick up from its recent pace."

The lack of significant new language probably meant that Fed policymakers are still on track to begin reducing those purchases later this year, as Fed Chairman Ben S. Bernanke said in his quarterly news conference in June.

"They continue to see some improvement in the economy. The labor market continues to move along. But it wasn't overly rosy," said Joe Deaux, economist at TheStreet.com.

Still, given the recent economic data, the Fed might be ready to "test the waters" of a stimulus pullback, he said.

Stocks have gyrated and interest rates have risen as the Fed gets closer to slowing its bond purchases. Investors worry that an initial tapering of easy money would lead to even higher borrowing rates, which reduces incentives to spend.

The Commerce Department reported Wednesday that the economy expanded at a 1.7% annual rate in the second quarter, exceeding analyst expectations of about 1% growth.

Although still weak, the pace of growth from April through June showed that the economy is weathering this year's tax increases and federal spending cuts.

The 1.7% growth rate was a significant improvement over the 1.1% rate in the first quarter, which was revised down from an earlier 1.8% estimate.

"The economy is growing, but it's not growing as fast as everybody would like to see, so it's not self-sustaining yet," said Alan Whitman, managing director at Morgan Stanley Wealth Management in Pasadena. "The numbers are good, but not great."

The turnaround in the housing market continued to boost the economy, though Fed policymakers sounded an alarm about the recent rise in mortgage rates.

Construction spending was up 13.4% in the second quarter after a 12.5% increase in the first quarter, the Commerce Department said. An increase in exports also provided a boost. Exports rose 5.4% in the second quarter after dropping 1.3% in the first quarter.

Those changes helped offset a drop-off in consumer spending, the main driver in the nation's economy. Spending rose 1.8% in the second quarter, which was lower than the 2.3% increase in the first quarter, the Commerce Department said.

The drop in government spending from the automatic cuts under the so-called sequester continued to be a drag on growth, though less so than in the first quarter when federal agencies were preparing for them.

Economists are projecting growth to improve in the last six months of the year as consumers and businesses continue to adjust to the tax increases and federal spending cuts. Deaux said his forecast calls for 2% growth, on an annualized basis, for the rest of the year.

"It's not the kind of pickup where people can go out and cheer and say we're finally back to pre-crisis type of growth," he said. "But in this kind of new normal, where slow but steady has become good, 2% defines that."

The latest economic data might be enough for the Fed to begin a slow reduction in its bond purchases, said **Bernard Baumohl, chief global economist at the Economic Outlook Group.** But he said the lack of any hint of that pullback in the Fed statement means it might not come until later in the fall.

"One would think that this improvement in the job market would be a strong reason for them to consider scaling back in September," **Baumohl** said.

It's still possible, though, that Fed Chairman Ben S. Bernanke will offer those clues in public comments in the coming weeks to lay the groundwork for such a move, **Baumohl** said.

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